

STATEMENT 1: FISCAL STRATEGY

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STATEMENT 1: FISCAL STRATEGY

Part I: Budget Aggregates

The 1999-2000 Budget demonstrates the Government's commitment to maintain the budget in surplus while Australia's economic growth prospects remain sound. In both accrual and cash terms, the Budget provides for a substantially strengthened surplus in 1999-2000.

Table 1: Summary of Commonwealth General Government Accrual Aggregates^(a)

	Actual		Estimates		Projections	
	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
Revenue (\$b)	148.2	153.3	162.8	150.5	153.8	163.1
Per cent of GDP	26.2	25.9	26.3	22.9	22.1	22.1
Expenses (\$b)	154.7	150.2	157.1	143.8	148.4	151.4
Per cent of GDP	27.4	25.4	25.3	21.9	21.3	20.5
Operating result (\$b)(b)(c)	-6.5	3.2	5.7	6.7	5.4	11.6
Adjustment (\$b)(d)	4.5	-0.1	-0.3	0.5	-0.2	-0.3
Fiscal balance (\$b)	-2.0	3.1	5.4	7.2	5.2	11.4
Per cent of GDP	-0.3	0.5	0.9	1.1	0.7	1.5

(a) The figures in the table may not add due to rounding.

(b) Operating result before abnormal items.

(c) Accrual data for 1997-98 are taken from the annual Consolidated Financial Statements (CFS). From 1998-99, the accounting treatment of certain revenue items, in particular taxation revenue and some dividends, has changed. See Statement 4 for further information.

(d) Adjustments for capital and revaluations are required to derive fiscal balance from the operating result (revenue less expenses). See footnote 1 (page 1-5) for further information.

Table 2: Summary of Commonwealth General Government Cash Aggregates^(a)

	Actual		Estimates		Projections	
	1997-98	1998-99(b)	1999-00(b)	2000-01(b)	2001-02(b)	2002-03(b)
Underlying cash balance (\$b)	1.3	2.9	5.2	3.1	7.2	12.5
Per cent of GDP	0.2	0.5	0.8	0.5	1.0	1.7
Memorandum item:						
Headline cash balance (\$b)	16.4	8.4	23.0	2.2	24.9	29.2

(a) Estimated and projected cash balances from 1998-99 onwards are derived estimates using data from the new accrual accounting system.

(b) Following recent changes in the Australian National Accounts standards, the underlying and headline cash balance estimates in the table from 1998-99 onwards include payments by the Commonwealth in respect of accumulated public trading enterprise (PTE) superannuation liabilities. This detracts around \$1¼ billion from the surplus in 1998-99 and following years.

The 1999-2000 Budget is the first Commonwealth budget to be prepared using an accrual framework. The major accrual budget aggregates for 1997-98 to 2002-03 are shown in Table 1 above. The underlying and headline cash balances are reported in Table 2 and provide a budget result comparable to the cash basis used in previous years.

- In accrual terms, a fiscal surplus of \$5.4 billion, or 0.9 per cent of GDP, is expected in 1999-2000. This is an improvement of \$2.3 billion on the estimated outcome for 1998-99.
- In cash terms, an underlying surplus of \$5.2 billion is expected in 1999-2000. This underlying cash surplus has been achieved despite the inclusion in underlying outlays of around \$1¼ billion of Public Trading Enterprise (PTE) related superannuation provisions. The inclusion of provisions is consistent with recent revisions in national accounting standards by the Australian Bureau of Statistics. These provisions mainly involve payments to current and former employees of Telstra and Australia Post who are, or have been, members of Commonwealth superannuation schemes. Prior to 1998-99, these payments were treated as financing transactions and did not impact on the underlying cash balance.
- In 2000-01, the fiscal surplus is projected to rise to \$7.2 billion or 1.1 per cent of GDP, with substantial surpluses also projected in the years beyond. The underlying cash surplus, however, is projected to be \$3.1 billion. The principal reason for the difference is the bring-forward of company tax under the Pay-As-You-Go system. Although liability accrues in 2000-01 (and is therefore counted under an accrual system), the tax is paid in instalments over a number of years (and is therefore not counted under cash accounting until actually received).

The large falls in revenue and expenses in 2000-01 result primarily from changes in Commonwealth-State funding as a result of the implementation of the measures contained in *A New Tax System*, in particular the abolition of Financial Assistance Grants to the States and Wholesale Sales Tax. The Commonwealth will collect revenue from the Goods and Services Tax (GST) on an agency basis for the States and Territories and therefore revenue from this tax is classified as State and Territory rather than Commonwealth revenue.

Box 1: Accrual Budgeting

The adoption of accrual budgeting in the 1999-2000 Budget represents international best practice in public sector financial management and reporting. The main advantage of accrual measures (as opposed to cash) is that they provide a more comprehensive indication of the total activity of government and the long-term effects of current policy. Cash measures do, however, have some advantages for tracking expenditures in a fiscal year and helping to identify the short-term effects of fiscal policy on the economy.

Accrual budgeting builds upon the high standards of fiscal transparency and accountability already established by the Government through the *Charter of Budget Honesty Act 1998*. The accrual framework supports the principles of sustainability and sound fiscal management expressed in the Charter. One of these principles is that the Government ensures that policy decisions have regard to their financial effects on future generations.

Accrual information will allow markets, business and consumers to assess more effectively the Government's fiscal performance over time, consistent with the spirit of the Charter.

At an administrative level, accrual budgeting will require Commonwealth agencies to adopt a more 'business-like' focus and discipline. For the first time, the full cost of Commonwealth service delivery will be brought to book, and public sector managers will be accountable for the performance of their agencies in contributing to achieving government outcomes.

The Government's key fiscal indicator in the new accrual framework is the 'fiscal balance'. The fiscal balance is the accrual equivalent of the underlying cash balance. A fiscal surplus indicates that the Government is saving more than enough to finance all of its investment spending and is, therefore, not directly contributing to the current account deficit.¹

While the fiscal balance is the accrual equivalent of the underlying cash balance, there will be differences between the two measures arising mainly from timing differences in the

1 The fiscal balance can be derived from the accounting standard operating result (the difference between revenue and expenses) by making two adjustments. The first adjustment is for capital. In order to capture government investment, the fiscal balance incorporates net capital expenditure, but not capital use or depreciation. The second adjustment is for revaluations (changes to the value of assets and liabilities). Revaluations are included in the operating result, but they do not affect the fiscal balance. In addition, some further adjustments may be required to capture differences between Government Finance Statistics (GFS) standards defined by the Australian Bureau of Statistics (which are used as the basis for calculating the fiscal balance) and Australian Accounting Standards (which are used as the basis for calculating the operating result). The fiscal balance is also an aggregate in the GFS operating statement (see Statement 9).

recording of transactions under accrual and cash accounting. For example, in 2000-01 differences arise in the accrual and cash treatments of company tax changes under the proposed Pay-As-You-Go arrangements announced in *A New Tax System*.²

Coinciding with the move to accrual budgeting, the main focus of budget reporting has broadened to encompass the general government sector (previously the budget sector was the main focus). The general government sector includes non-commercial government authorities such as the CSIRO and ABC. The inclusion of these authorities has only a marginal effect on the fiscal balance, adding \$115 million in 1999-2000.

The fiscal balance and other accrual measures are discussed in further detail in Appendix A to this Statement.

2 Accrual revenue is recognised at the time an assessment for taxation occurs. New company tax payment arrangements commencing in 2000-01 will involve some companies being assessed for tax under both the existing and new payment arrangements, resulting in higher accrued revenue in that year. As announced in *A New Tax System*, companies will be allowed to defer part of this tax liability to smooth actual tax payments in 2000-01. Compared to accrual revenue, cash receipts are lower in 2000-01 and higher in later years as a result of these changes.

Part II: Economic Framework

In 1999-2000 the Australian economy will continue to benefit from sound medium-term fiscal and monetary policies implemented in the Government's first term. The recent financial crisis in Asia has demonstrated the social and economic dislocation that can occur when financial markets lose confidence in the domestic policy framework.

This year's Budget is set against continuing uncertainty in the international economy. While there are signs of recovery in some Asian economies, continuing structural problems, particularly in the financial and corporate sectors, raise questions about the sustainability of any improvement. The effects of the Asian financial crisis and the associated slowdown in the world economy in 1998 and 1999 are likely to persist into the coming year. Nevertheless, sound domestic economic fundamentals and policy settings should continue to minimise their adverse impact on Australia.

Following very strong growth in excess of 4 per cent in 1997-98 and 1998-99, the Australian economy is expected to grow by a solid 3 per cent in 1999-2000. This outlook compares very favourably with other developed economies and countries in the region.

As discussed in Statement 2, the expected moderation in growth in 1999-2000 reflects the impact of continued below-trend growth in the world economy on the domestic economy.

Some moderation in employment growth is expected over the course of 1999-2000 in line with the moderation in domestic economic growth. Nevertheless, employment growth is expected to remain solid, with the unemployment rate consolidating recent falls to remain around 7½ per cent over 1999-2000.

The inflation rate is expected to rise only modestly, from an average 1¼ per cent in 1998-99 to 2 per cent in 1999-2000. It is now clear that the impact on inflation of the depreciation in the Australian dollar since the onset of the Asian downturn will be less than that implied by past experience, reflecting enhanced competitive pressures, both domestically and internationally.

The favourable combination of a real exchange rate depreciation and continued low interest rates made possible by sound macroeconomic policy has been a major contributor to the economy's recent resilience. Financial markets have retained confidence in Australia's economic fundamentals and policy settings and long-term interest rate differentials with the United States have remained low. As the exchange rate depreciation has not been dissipated in higher domestic inflation the economy continues to enjoy the benefits of improved competitiveness, while maintaining relatively low interest rates.

The Government's main policy priorities are to maximise sustainable growth to improve living standards and create conditions to further reduce unemployment. Achieving these goals will require ongoing policy attention to ensure that inflation and current account pressures do not constrain the economy's capacity for growth. Policy must maintain discipline on inflation and public saving, consistent with the medium-term frameworks for

monetary and fiscal policy, taking account of the need to maintain adequate demand growth.

As discussed in Statement 3, improvements in the macroeconomic policy framework and structural reforms should allow the Australian economy to continue to grow strongly over the medium term. Provided the macroeconomic policy framework is sustained and continued progress is made on structural reform, average economic growth of 3½ to 4 per cent could be sustained over the early years of the next decade. Such a growth rate would see a further substantial reduction in the unemployment rate.

Continued adherence to the Government's medium-term fiscal strategy is a particularly important component in achieving sustained, strong economic growth. Restoring the Commonwealth budget to surplus has helped limit the rise in the current account deficit, and has played a very important role in retaining the confidence of financial markets and helping to maintain a low interest rates environment. The current account deficit is expected to average 5¼ per cent of GDP in 1999-2000, slightly down from an expected 5½ per cent of GDP in 1998-99.

Importantly, the increase in the current account deficit reflects private saving and investment decisions, rather than government borrowing. Private sector saving and investment decisions are now better based than they have been in past cycles as a result of microeconomic reform and low inflation. In this environment the nation's ability to service external debt should not be at issue.

Good macroeconomic policy is a necessary condition for sustaining strong growth and significantly reducing unemployment. But there are limits to what macroeconomic policy alone can achieve. As noted above, policy needs to continue to address structural barriers to raising productivity and lowering unemployment, with particular emphasis on tax reform and further labour market reform. Such reforms, combined with sound macroeconomic policy settings, are necessary for a sustained reduction in unemployment.

The 1999-2000 Budget is an integral part of the policy framework necessary for sustained high economic growth. It delivers on the Government's commitment to maintain budget surpluses while economic growth prospects remain sound. The Budget continues the Government's commitment to fiscal responsibility, while providing a comprehensive package of measures targeting priority areas of health, education and training, mutual obligation, research and development, and the social and economic infrastructure of regional and rural Australia. In addition, the introduction of accrual budgeting also represents an important step in the Government's financial management and reform programme.

Part III: Fiscal Outlook and Strategy

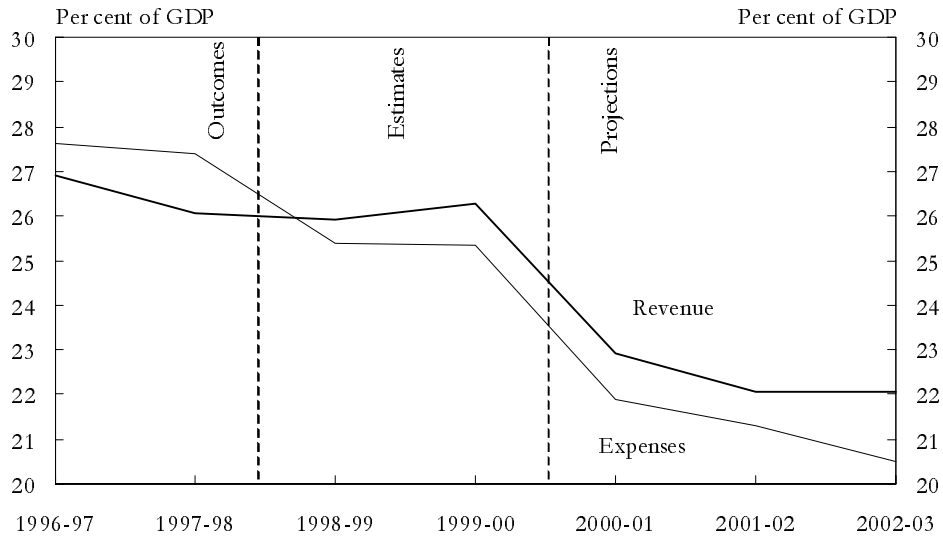
FISCAL OUTLOOK

The Budget maintains a sound fiscal outlook with surpluses in 1999-2000 and over the period of the forward projections. The fiscal balance for 1999-2000 is expected to be in surplus by **\$5.4 billion**, an increase from the **\$3.1 billion** surplus expected in 1998-99. The underlying cash surplus for 1999-2000 is expected to be **\$5.2 billion**, a substantial increase from the expected outcome of **\$2.9 billion** in 1998-99 (these estimates allow for a reduction of around **\$1¼ billion** per year from Commonwealth payments for PTE superannuation provisions).

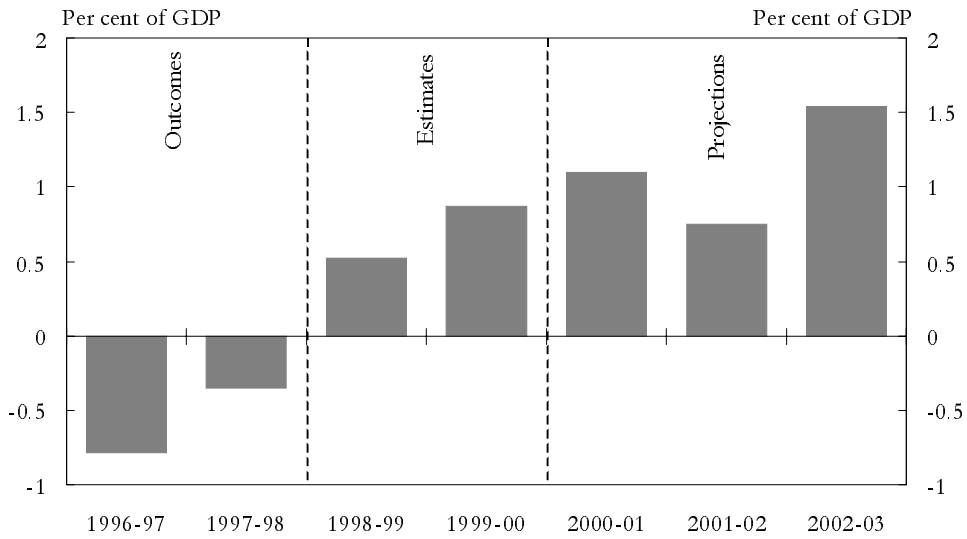
Chart 1 shows the recent outcomes, current estimates and projections for revenues, expenses and the fiscal balance for the Commonwealth general government sector. Chart 2 shows the underlying cash balance, again for the Commonwealth general government sector, over a longer period.

Chart 1: Budget Balances^(a)

Panel A: General Government Revenue and Expenses

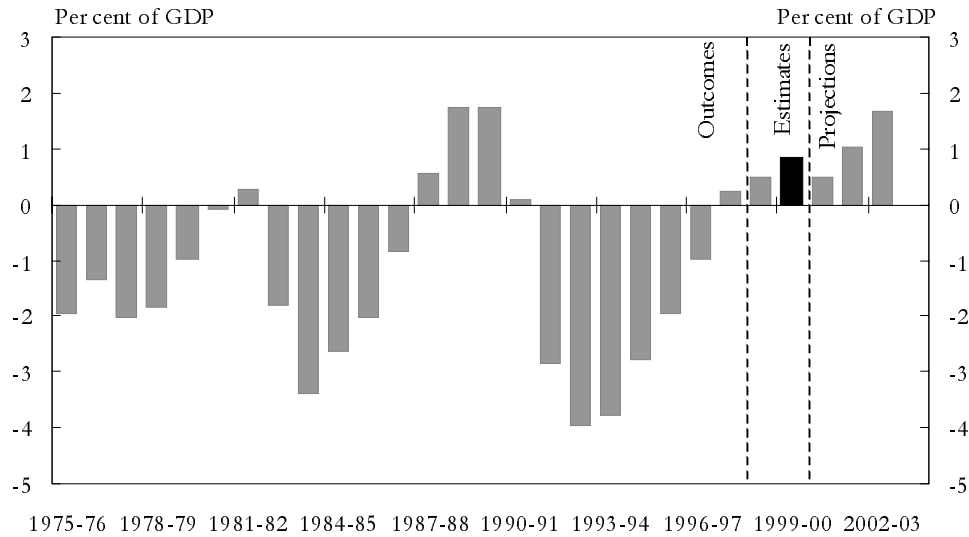


Panel B: Fiscal Balance



(a) Accrual data prior to 1998-99 are taken from the annual Consolidated Financial Statements. From 1998-99, the accounting treatment of certain revenue items, in particular taxation revenue and some dividends, has changed. See Statement 4 for further information.

Chart 2: Underlying Cash Balance^(a)



(a) From 1998-99 onwards the underlying cash balance estimates include payments by the Commonwealth in respect of accumulated PTE superannuation liabilities. This detracts around \$1¼ billion from the surplus in 1998-99 and following years.

Over the forward estimates period, both revenue and expenses as a proportion of GDP are expected to fall significantly. These reductions are largely driven by the abolition of Financial Assistance Grants to the States and Territories, the abolition of Wholesale Sales Tax and the personal income tax cuts arising from the introduction of *A New Tax System*.

The major economic parameters underpinning the budget estimates are summarised in Table 3. The economic forecasts are discussed in detail in Statement 2.

The economic parameters are based on forecasts for 1998-99 and 1999-2000 and medium-term projections for the following three financial years. The projections for economic growth in the outyears are based on an analysis of underlying trends, while the projections for inflation are consistent with the mid-point of the medium-term inflation target band. The impact on prices of the tax reforms under *A New Tax System* is not included in the projections. However, this impact has been taken into account separately in projecting the revenues and expenses affected by the tax reforms.

Table 3: Major Economic Parameters (percentage change from previous year)

	Forecasts		Projections		
	1998-99	1999-00	2000-01	2001-02	2002-03
Real GDP	4¼	3	3½	3½	3½
Employment(a)	2¼	1¾	2	2	2
Wages(b)	4¼	3¾	3½	3½	3½
CPI	1¼	2	2½	2½	2½

(a) Labour Force Survey basis.

(b) Average earnings (national accounts basis).

Table 4 provides a reconciliation between the underlying cash estimates released at the time of the 1998-99 Budget and the 1998-99 MYEFO; and fiscal balance estimates at the time of the 1998-99 MYEFO and 1999-2000 Budget.

Table 4: Reconciliation of 1998-99 Budget, MYEFO and 1999-2000 Budget General Government Estimates^(a)

	1998-99 (\$m)	1999-00 (\$m)	2000-01 (\$m)	2001-02 (\$m)
1998-99 Budget underlying cash balance	2778	4830	8613	14626
(per cent of GDP)	0.5	0.8	1.3	2.1
Changes between 1998-99 Budget and 1998-99 MYEFO				
Effect of policy decisions(b)				
Revenue	-17	700	-16611	-17512
Underlying outlays	-886	-2479	11419	12029
Total	-903	-1779	-5192	-5483
Effect of parameter and other variations				
Revenue	1816	-1448	-1373	-1451
Underlying outlays	-659	1083	1335	1746
Total	1157	-365	-38	295
1998-99 MYEFO underlying cash balance	3032	2686	3383	9438
1998-99 MYEFO fiscal balance(c)				
	3580	1624	8240	8067
Changes between 1998-99 MYEFO and 1999-2000 Budget				
Effect of policy decisions				
Revenue	-118	-124	-121	-21
Expenses	140	-965	-1295	-1472
Capital	5	0	113	55
Depreciation adjustment	5	26	12	1
Total	32	-1063	-1291	-1437
Effect of parameter and other variations				
Revenue	243	4459	-642	-546
Expenses	-833	291	659	-590
Capital(d)	-355	-330	-513	-782
Other adjustments(e)	438	445	742	478
Total	-507	4865	246	-1440
1999-2000 Budget fiscal balance	3105	5426	7195	5189
(per cent of GDP)	0.5	0.9	1.1	0.7

(a) A positive sign indicates an improvement in the fiscal balance and a negative sign indicates a deterioration in the fiscal balance.

(b) Includes total budgetary costs of *A New Tax System* (including the public debt interest effects). For all other policy decisions the public debt interest effects are included in parameter and other variations.

(c) Estimates of the fiscal balance at the 1998-99 MYEFO are based on accrual data collected for the 1999-2000 Budget.

(d) Derived from movements in physical and intangible assets in the balance sheet.

(e) Includes variations in depreciation and economic revaluations.

Parameter and other variations since the 1998-99 MYEFO reduce expenses in 1999-2000 and in 2000-01. This mainly reflects draw-downs in the conservative bias allowance³, lower unemployment forecasts, reduced pension and benefit payments due to lower CPI forecasts, and lower than expected growth in beneficiary numbers. These are partially offset by increased expenses mainly associated with higher estimates of schools funding, residential aged care and higher education operating grants.

On the revenue side, parameter and other variations since the 1998-99 MYEFO have a net positive impact on revenue in 1999-2000 driven by higher individual and other income taxes, outweighing lower indirect tax revenue. Higher than expected dividend payments also substantially increase revenue in 1999-2000. In the outyears, parameter and other variations have a negative impact on revenue. This is mainly due to lower forecasts of customs and excise duty, as well as lower public debt interest revenues.

The 1999-2000 Budget provides for targeted new policy spending largely associated with meeting the Government's election commitments. Major policy decisions taken since the 1998-99 MYEFO include:

- improved funding arrangements for non-government schools (\$338 million over four years to 2002-03; for the 2001-04 school quadrennium this will amount to \$561 million);
- improving literacy and numeracy in schools (\$131 million over four years);
- additional funding for the National Illicit Drug Strategy (over \$80 million for existing strategies and \$221 million over four years for new intervention and diversion strategies);
- increased funding for health and medical research funded through the National Health and Medical Research Council (\$274 million over four years; amounting to \$614 million over the next six years);
- a primary health care package for older Australians and those with chronic conditions (\$228 million over four years);
- funding for hearing services (\$210 million over four years);
- increased funding for national highways and roads of national importance (\$195 million over four years);

3 The forward estimates are based on decisions already made and economic projections. They also include an allowance for the established tendency for spending on existing Government policy (particularly demand driven programmes) to be higher than estimated. This allowance, known as the conservative bias allowance, is included as part of the contingency reserve in the forward estimates at the beginning of each budget year. It is then gradually reduced as the year progresses so that the budget year conservative bias allowance is zero.

- additional funding for an expansion of Work for the Dole for Year 12 school leavers (\$99 million over four years) and a further expansion of the principle of Mutual Obligation to long-term unemployed people aged between 25 and 34; and
- taxation changes to encourage philanthropy (\$189 million over four years).

A full description of all policy decisions taken since the 1998-99 MYEFO can be found in *Budget Paper No. 2*.

Appendix C in Statement 4 contains a Statement of Risks which details potential factors which could materially affect the fiscal outlook. One important factor will be variations in the economic parameters. A discussion of the estimated sensitivity of the expenses and revenue estimates to changes in economic parameters is provided in Appendix B of Statement 4.

FISCAL STRATEGY

The 1999-2000 Budget has been framed against the Government's medium-term fiscal strategy, consistent with the requirements of the *Charter of Budget Honesty Act 1998*. The Charter requires the Government to set out its medium-term strategy in each budget, along with its shorter-term objectives and targets. The Government is also required to determine its fiscal objectives with regard to the Charter's principles of sound fiscal management and report regularly on its progress in achieving them.

The primary objective of the Government's medium-term fiscal strategy is to achieve fiscal balance, on average, over the course of the economic cycle. This will ensure that, over time, the Commonwealth general government sector makes no net call on private sector saving and therefore does not directly contribute to the national saving-investment imbalance (ie the current account deficit). Sustainable fiscal settings help promote longer-term growth prospects by reducing Australia's vulnerability to external shocks and allowing greater flexibility to adjust to changing economic conditions.

This objective, which previously applied to the underlying balance in the cash budgeting framework, has not changed but has been redefined under the new accrual budget framework to apply to its accrual counterpart, the fiscal balance. The fiscal balance closely approximates the contribution of the Commonwealth to national net lending — the difference between national saving and investment. Differences between the fiscal balance and the underlying cash balance, which are discussed in more detail in Appendix A to this Statement, largely reflect the timing of bringing transactions to account.

The Government's supplementary fiscal targets will also be maintained under accruals, albeit slightly reconfigured. In addition, the move to accruals provides scope to consider an additional measure — net assets. With the move to accruals and the budget now returned to surplus, the medium-term fiscal objective has five supplementary fiscal targets:

- maintaining fiscal surpluses over the forward estimates period while economic growth prospects remain sound;

- halving the ratio of Commonwealth general government net debt to GDP from almost 20 per cent in 1995-96 to 10 per cent by 2000-01;
- directing sufficient resources to high priority areas, while significantly reducing the ratio of expenses to GDP through to the turn of the century;
- no increase in the overall tax burden; and
- improving the Commonwealth's net assets position over the medium to long term (see Box 2).

Substantial progress has already been achieved on the second and third of these targets, while tax revenue as a percentage of GDP has remained below the 1996-97 ratio.

The Government will run fiscal surpluses during periods of sound economic growth, so that deficits emerging during periods of low growth (if such occur) are manageable. Accordingly, a surplus is again forecast for 1999-2000 and current policy settings are projected to deliver fiscal surpluses over the forward estimates period (Chart 1).

The budget will remain in surplus over the forward estimates period under both the accrual fiscal balance and the cash underlying balance measures. Nevertheless, the two fiscal indicators will diverge in the short term. The fiscal balance will detect non-monetary effects, such as increases in accruing superannuation entitlements that would be ignored by the underlying cash balance. Conversely, the underlying cash balance will detect cash transactions such as superannuation payouts (outlays) on previously accrued liabilities that do not affect the fiscal balance.

The fiscal balance will generally provide a better indication of the ongoing impact of current policy on the fiscal position because transactions are recognised when economic value changes. The underlying cash balance has advantages in helping to identify the short-term impact of the budget on demand.

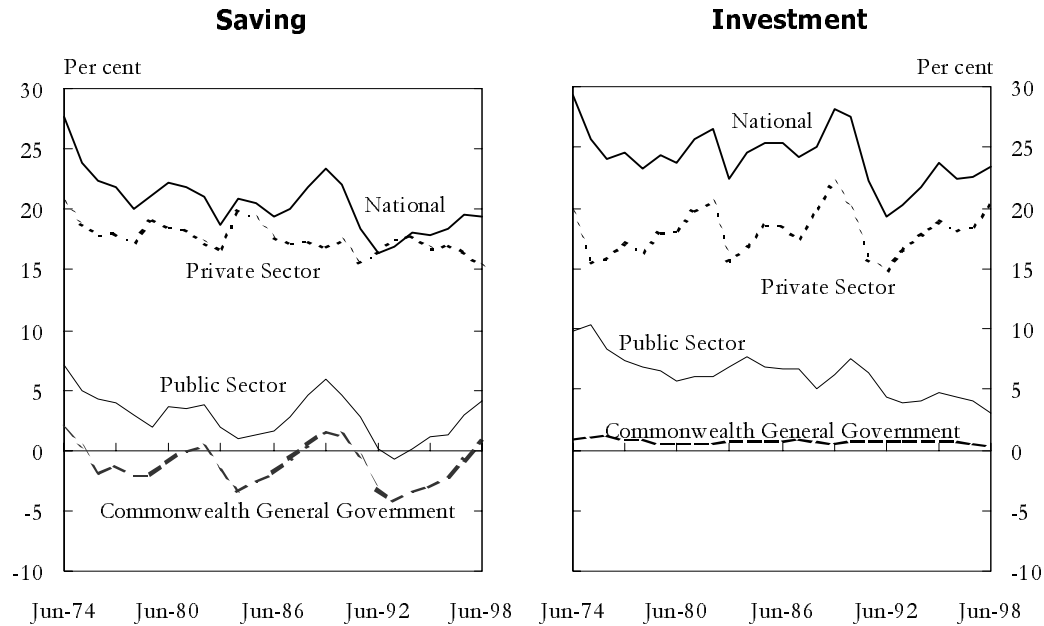
The fiscal consolidation implemented by the Government has been a key ingredient in Australia's recent strong economic performance. The Government's fiscal strategy and the outlook for continuing surpluses have been important in sustaining financial market confidence during the economic downturn in the East Asian region. These developments underscore the continuing need to operate prudent fiscal policy and maintain a strong fiscal position. This is discussed in more detail in Statement 3.

BUDGET SURPLUS, NATIONAL SAVING AND THE CURRENT ACCOUNT

Improvements in the fiscal balance as a result of the Government's programme of fiscal consolidation have been associated with increases in Commonwealth general government saving and public sector saving (Chart 3). These increases have helped maintain overall national saving during a period of declining private saving.

With the budget now in surplus, the Commonwealth is no longer drawing on the available pool of private saving; instead, it has become a net lender — adding to the pool of saving available to fund private investment. Moreover, its contribution to national net lending is expected to increase over the forward estimates period. With the State/local general government sector and the PTE sector also expected to be in surplus over the forward estimates period, both the Commonwealth and the public sector as a whole should contribute to reducing the current account deficit (CAD) over time. Projected developments in the State/local general government and PTE sectors are discussed in detail in Statement 9.

Chart 3: Ratios of Gross Saving and Investment to GDP



Source: ABS Cat. No. 5204.0 and Treasury estimates.

International evidence suggests that higher public saving tends to raise national saving. While some private saving response to fiscal consolidation might be expected, experience indicates that this only partly offsets the improvement in public saving. Chart 3 shows that national saving in Australia has normally improved when public saving has improved, and fallen when public saving has fallen. Abstracting from the long-term decline in private saving, which does not appear to be related to public saving trends, movements in national saving have clearly been strongly influenced by movements in Commonwealth general government saving.

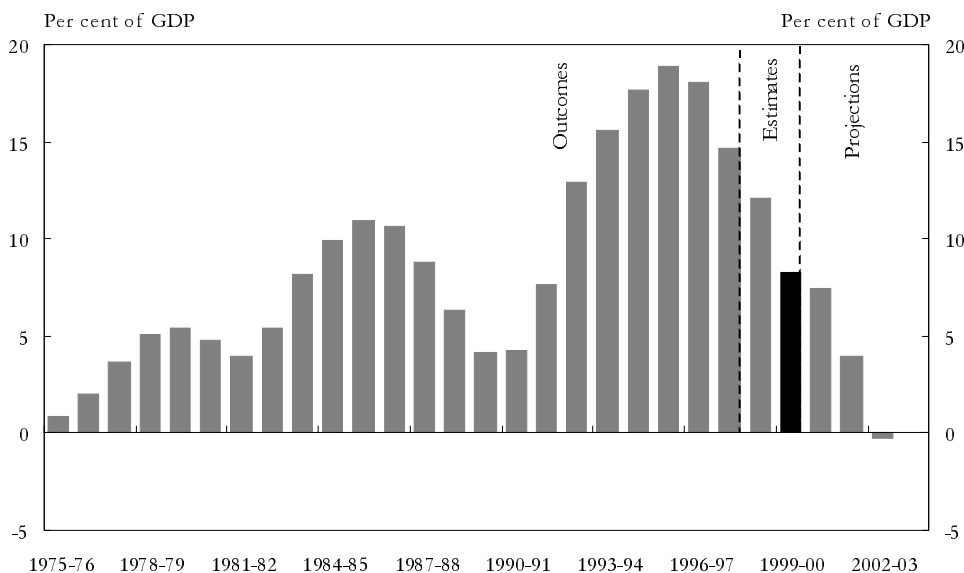
To the extent that past Commonwealth borrowing may have ‘crowded out’ private investment by raising interest rates, a sound fiscal policy may encourage private investment. Private investment should generally produce benefits in terms of higher future incomes that justify the costs of servicing external borrowing.

The fiscal strategy means that the CAD is now essentially a product of private saving and investment decisions that reflect market disciplines and incentives. Much has been done to reduce distortions to private saving and investment that have existed in the past, through the achievement of low inflation and structural and financial market reform (see Statement 3). In this environment, the fiscal strategy provides assurance to financial markets that the CAD reflects soundly based private sector decisions.

NET DEBT AND NET ASSETS

Improvements in the Commonwealth's net assets and net debt positions help to reduce Australia's vulnerability to economic shocks by reducing the risk of adverse swings in financial market confidence. Improving the Commonwealth's balance sheet will also help to ensure that the Government is better placed to cope with any emerging fiscal pressures (such as those caused by the ageing of the population) and is able to meet its future obligations without requiring sharp changes in policy settings at later — and possibly less opportune — times.

Chart 4: Commonwealth General Government Net Debt^(a)

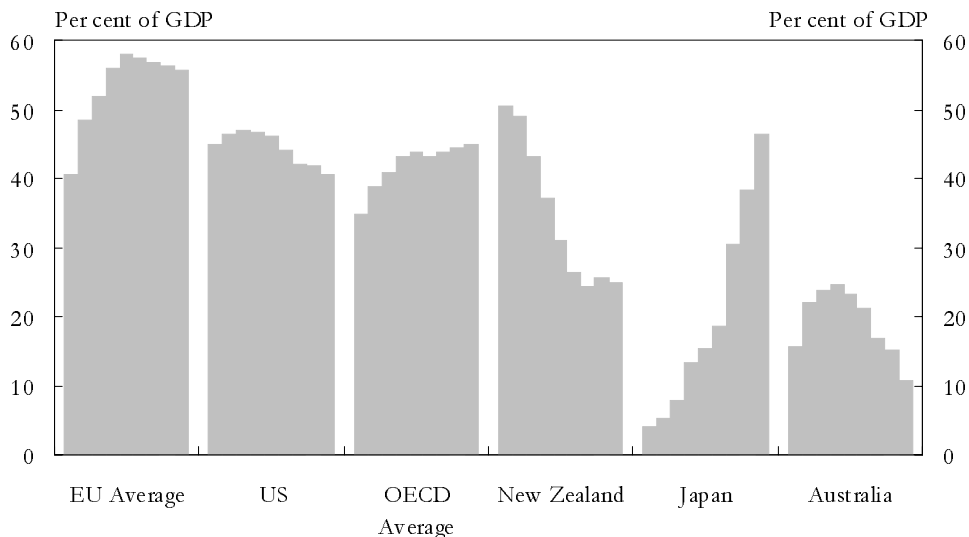


(a) Includes the impact of the sale of the Government's remaining share in Telstra.

As shown in Chart 4, the Government's fiscal strategy has been successful in reducing the level of Commonwealth general government net debt over recent years. The Government has not borrowed, in net terms since its election in 1996. From a peak of 18.8 per cent of GDP in 1995-96, net debt levels are expected to fall as a share of GDP to 8.2 per cent in 1999-2000. This compares with average net debt levels of around 43 per cent of GDP for OECD countries since the mid-1990s (see Chart 5).

The fiscal surpluses in prospect in each of the forward estimates years, along with expected proceeds from Commonwealth asset sales, provide for further substantial reductions in net debt. As shown in Chart 4, the Government's target of halving the ratio of Commonwealth general government net debt to GDP over the five years to 2000-01 is expected to be exceeded by a substantial margin. Indeed, with the further sale of Telstra, by the end of the forward estimates period in 2002-03 Commonwealth general government net debt could be completely eliminated.

Chart 5: Total General Government Net Debt Levels in Selected Countries 1992 to 2000^{(a)(b)}



- (a) All data are for the total general government sector (ie the aggregate of all levels of government, including the social security sector but excluding the PTE sector). The OECD is the Organisation for Economic Co-operation and Development. Its membership consists of the industrial countries of Europe and North America, Mexico, Japan, Korea, Australia and New Zealand. The OECD average data relate to only the 18 countries included in the *OECD Economic Outlook 64*. The EU average data relate to only the 11 member countries of the European Union included in the *OECD Economic Outlook 64*.
- (b) Data up to 1997 are outcomes, except for Japan where 1997 data is an estimate. The OECD data for the period 1998 to 2000, and the data for Australia and New Zealand for 1999 and 2000, are estimates. For Australia and New Zealand, data refer to the year ending 30 June (eg 1996 data are for the year ended 30 June 1996).

Source: *OECD Economic Outlook 64*, Reserve Bank of New Zealand *Monetary Policy Statement*, March 1999, ABS Public Sector Financial Assets and Liabilities (Cat. No. 5513.0) and Treasury estimates.

The 1999-2000 Budget incorporates, for the first time, a statement of financial position, or balance sheet, showing the Commonwealth's overall assets and liabilities. In addition to the longer-standing objective of reducing net debt, which covers selected financial assets and liabilities of the Commonwealth, the introduction of the accrual framework provides the opportunity to introduce an objective for net assets, which covers all the physical and financial assets and liabilities of the Commonwealth.

Box 2: Measuring Net Assets and Net Debt

The net assets and debt positions of the Commonwealth are reported in the balance sheet. Net assets include physical as well as financial assets less total liabilities. Net debt, on the other hand, comprises selected financial liabilities (deposits held, advances received and borrowing) less selected financial assets (cash and deposits, advances paid and investments). The net debt measure is accordingly a subset of the broader net assets measure. Net debt, however, is a measure widely used for purposes of international comparisons by international organisations and ratings agencies.

Changes in net assets result from movements in the operating result over time, as well as from asset and liability revaluations. Revaluations can cause significant, and unpredictable, movements in net asset values that governments are not able to control. The extent to which governments are able to control net asset movements in the medium to long term is achieved through the control they have over operating balances.

Due to the potential volatility of the net assets measure, particularly as the move to accrual budgeting is being consolidated, the Government has not targeted a specific net assets level, but has adopted the objective of improving the Commonwealth's net asset position over the medium to long term.

There are important reasons for governments to track their net assets positions over time, reflecting the extent to which this provides insights into their intergenerational positions. For example, while negative net asset levels do not imply insolvency for governments, as they may do for private profit making enterprises, a significant negative net assets position, particularly if it is expected to deteriorate, may be considered unsustainable and indicate an inequality between current and future generations. This inequality reflects the extent to which high past and/or current period spending by governments may limit the fiscal options open to governments in future periods. Reflecting a desire to address this issue, the Government has set as an objective an improved Commonwealth net assets position over the medium to long term. This objective is consistent with the Government's broader fiscal responsibility objectives set out in the *Charter of Budget Honesty Act 1998*.

Chart 6: Commonwealth General Government Net Assets

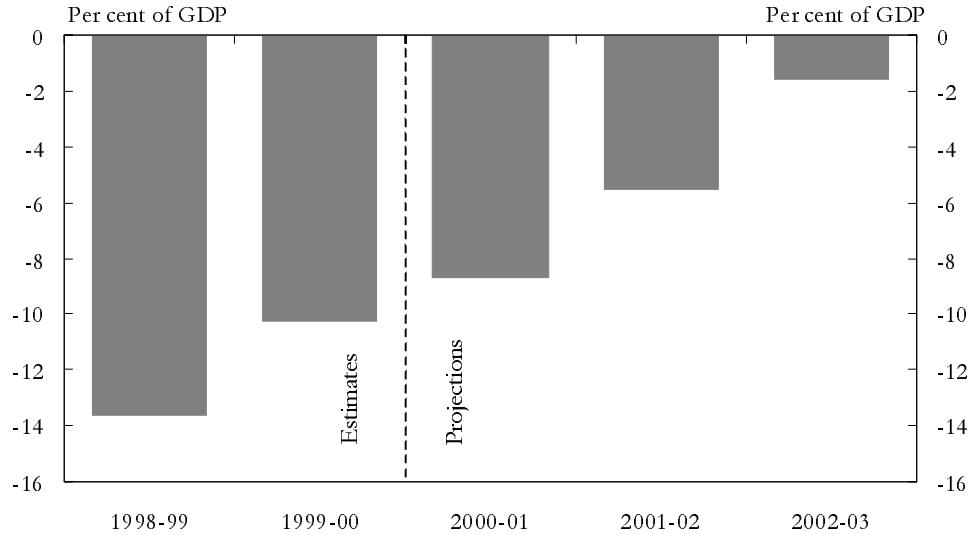


Chart 6 illustrates recent trends, current estimates and projections in Commonwealth net asset levels as a share of GDP. The level of net assets as a percentage of GDP is currently estimated at -13.6 per cent. This level is projected to improve over the forward estimates period, consistent with the Government's objective to improve its net assets position over the medium to long term. This reflects the expected operating surpluses. An additional factor contributing to this improvement is the proposed sale of the remainder of the Government's share in Telstra. In line with accounting standards, Telstra is currently recorded in the Commonwealth's balance sheet at book value⁴, which is significantly below its expected market value. That is, the estimate of the Government's current net asset position is, in fact, distorted by this valuation issue. As Telstra is sold, however, this undervaluation is undone, contributing to the significant improvement in the measure of net assets.

EXPENSES RESTRAINT AND INVESTMENT

The achievement of budget surpluses has largely relied on expenses restraint. While maintaining overall restraint on expenses, in this Budget the Government is carefully targeting high priority areas such as health, education, research and development, employment, rural and regional Australia, and families.

⁴ Consistent with accounting standards, the Commonwealth balance sheet records two thirds of Telstra's 'net assets' as a Commonwealth asset. This amount is significantly below the equivalent value of two thirds of Telstra's shares. In line with accounting standards, the Commonwealth is only able to value its Telstra investment according to its share price once the Commonwealth owns less than 50 per cent of Telstra.

The Government's budget priorities are spelt out in greater detail in Part IV of this Statement.

A feature of the move to accrual budgeting is a greater emphasis on the reporting of capital expenditure by the Commonwealth. For the first time, *Budget Paper No. 1* includes a separate capital funding statement — Statement 7.

TAXATION REFORM AND REVENUE

The tax reform package outlined in *A New Tax System* is consistent with the Government's medium-term fiscal strategy. In particular, this fiscal strategy commits the Government to maintain fiscal surpluses while growth continues and to not increase the overall tax burden.

A New Tax System will be implemented progressively from 1999–2000 and will reduce the size of the Commonwealth surplus estimated for that year and projected for subsequent years. The package will bring substantial benefits to the operation of the economy and to the sustainability of Commonwealth government and State government finances.

Reflecting the considerable improvements in the Government's fiscal position in recent years, the tax package can be accommodated while retaining budget surpluses through the forward estimates period.

Part IV: Budget Priorities

The priorities and measures in this Budget build on the priorities addressed in the Government's first term in office. Important areas that the Government consistently focused on in its first term included families, older Australians, employment, regional Australia and small business.

At the last election, the Government set out a comprehensive programme of targeted expenditures, plus a major reform of the Australian tax system, contained in *A New Tax System*. In addition to meeting these commitments, the Budget introduces new measures that aim to build on Australia's strengths and develop long-term economic prospects.

The Government's priorities for this Budget have been developed within a framework that takes account of its broader economic and social objectives. In framing the 1999-2000 Budget, the Government has given priority to:

- delivering on its election commitments;
- building a modern, fair and efficient taxation system that enhances Australia's economic prospects and provides a secure source of revenue for essential public services;
- promoting an economic climate conducive to high levels of sustainable economic and employment growth, including through contributing to greater national saving and improving the Commonwealth's net assets and net debt positions;
- fulfilling its social obligations through:
 - supplying essential public goods and services;
 - providing and maintaining a fair and effective social safety net that supports those most in need; and
- ensuring that government resources are used as effectively and efficiently as possible, including through moving to the accrual budgeting framework, which will improve public sector planning, performance assessment and reporting.

The following provides more details on the Government's key expense and revenue priorities and measures for the current Budget.

Savings in this Budget are attributable mainly to reductions in resourcing for certain agencies and rationalisation of Commonwealth property.

A New Tax System

The Government considers that reform of the tax system is essential in building an economic infrastructure that will enable Australia to compete and prosper in a competitive world economy.

A New Tax System will abolish the existing Wholesale Sales Tax and nine inefficient and distorting State and Territory government taxes and replace them with a GST, which will be locked in at a rate of 10 per cent. The Commonwealth will provide all of the GST revenue to the States and Territories. Importantly, this will ensure a stable revenue source for the States and Territories to provide essential community services such as hospitals, schools and emergency services. Financial Assistance Grants to the States and Territories will be abolished.

Implementation of *A New Tax System* will help ease the burden of raising a family through personal income tax cuts totaling \$13 billion a year from July 2000. Family benefits will be substantially increased and simplified. This will benefit over two million families at a cost of around \$2½ billion a year. Additional incentives to work and save will also be achieved by reducing family benefit withdrawal rates and increasing the income thresholds for family payments.

Some of the revenue measures announced in *A New Tax System* have been revised to improve their operation. The luxury car tax threshold on vehicles has been aligned with the car depreciation limit for income tax purposes. The Reform of Tobacco Taxation outlined in *A New Tax System* was scheduled to apply from July 1999. The new arrangements will now apply from 1 November 1999 to give the tobacco industry sufficient time to implement the required changes.

The Budget contains measures to implement *A New Tax System* and to enhance the tax reform package for families.

Reform of Commonwealth-State Financial Relations

At the 1999 Premiers' Conference, the States and Territories signed an Intergovernmental Agreement with the Commonwealth that will transform Commonwealth-State financial arrangements. Under the agreement, the States and Territories will benefit from tax reform by gaining a stable and robust source of revenue in the form of the GST and the capacity to remove a range of inefficient taxes. In the context of signing this agreement, the Commonwealth agreed to provide further assistance to the States and Territories during the transitional years of the reforms. This will ensure that the budgetary position of each State and Territory will be no worse off under the new arrangements.

Other Revenue Measures

The Government is providing a package of measures to promote corporate and individual philanthropy. The measures include a capital gains tax (CGT) exemption for testamentary

gifts of property and for gifts accepted under the Cultural Gifts Programme. These changes will apply from 1 July 1999.

To improve the overall operation and efficiency of the Superannuation Surcharge, the advance instalment requirement has been removed. The removal of the advance instalment will affect only the timing of the surcharge collections.

A Healthy Australia

A healthy Australia is a high priority of this Government. Having already delivered major funding increases to the States for public hospitals through the Australian Health Care Agreements, this Budget focuses on improving health care for the elderly, facilitating access to high quality health care in rural and regional areas and enhancing Australia's health and medical research capacity.

The Government is committed to a balanced health system, and to strengthen both the public and private sectors. In this regard the budget measure of Lifetime Health Cover will be an important complement to the 30 per cent rebate on private health insurance premiums that has been operating since 1 January 1999. Lifetime Health Cover will be implemented from 1 July 1999. This system allows registered health funds to offer lower lifetime rates of hospital cover. People taking out hospital cover early in their lives will pay lower premiums than those taking it out later in life. The new system has the potential to encourage an increase in health insurance membership numbers together with an improvement in the membership profile. Importantly, Lifetime Health Cover will not disadvantage existing fund members, maintains the principle of community rating and will allow non-members to join during a 12 month grace period without penalty. In addition, special provisions will protect people aged 65 or more on 1 July 1999 by ensuring that they can take out hospital cover at any time without penalty.

This Budget provides funding of \$228 million over four years for an Enhanced Primary Care Package, targeted to older Australians and those with chronic conditions. The package is designed to better coordinate health services, including by providing incentives for GPs to participate in better coordinated care and by providing a single point of contact for home and community care services (Carelink), and to improve people's self-reliance and capacity to manage their own conditions. Separately, \$82 million over four years has been provided to expand the provision of respite care for carers of people with dementia and other cognitive and behavioural problems. The Government will provide additional funding of \$210 million over the next four years for hearing rehabilitation services, including the provision of hearing aids for eligible persons. The funding will enable a further 67,000, mainly older, Australians to be assisted each year. A component of this funding will be directed towards the ongoing delivery of high quality hearing services to children and others with special needs.

Aboriginal and Torres Strait Islander primary health care funding is to be significantly increased. The Army/ATSIC Community Assistance Programme which provides environmental and health infrastructure to indigenous communities will also be extended.

Health and medical research plays a vital role in improving the well being of all Australians. Consequently, the Government will invest \$614 million over the next six years into health and medical research funded through the National Health and Medical Research Council. This will more than double the Council's existing research funding level by 2005 and will consolidate Australia's position in the top 10 OECD countries in terms of health and medical research investment. In addition, funding of \$20 million over the next two years will support the development of enhanced facilities for Australia's leading health and medical research institutes.

Increasing Employment Opportunities and Enhancing Education

The Government is pursuing a wide range of labour market reforms to achieve sustained reductions in the level of unemployment. As part of this, the scope of activities that satisfy the mutual obligations of unemployment beneficiary recipients will be increased and mutual obligation will be extended to those aged between 25 and 34 years who have been in receipt of unemployment payments for 12 months or more. Work for the Dole will also be broadened to include this group and Year 12 school-leavers in receipt of unemployment payments for more than three months, with a doubling of Work for the Dole places from 25,000 in 1998-99 to 50,000 by 2000-01. To combat the severe employment problems faced by Aboriginal and Torres Strait Islander people, the Government will also double the funding for indigenous employment initiatives through the introduction of the Indigenous Employment Policy, including the Indigenous Employment Programme.

Employers in rural and regional areas will be provided with an additional incentive payment of \$1000 to progress New Apprentices to higher skill levels in trades and occupations experiencing skill shortages.

The Government has already implemented its election commitment for additional funding of \$553 million over five years for Catholic systemic schools. This decision followed an independent assessment of the needs of this system conducted by the Non-Government Schools Funding Review Committee. A new allocative mechanism for distributing general recurrent funding to non-government schools will be implemented for the 2001-04 school quadrennium. The new model will be based on a measure of the socioeconomic status of the community that a school serves and will provide a fairer and more transparent model for allocating funding. Under this model, funding to the non-government school sector will increase by around \$561 million over the 2001-04 school quadrennium.

High quality education improves employment opportunities. This Budget increases school funding and provides a range of initiatives that will benefit Australian school students. Ensuring that every Australian school child is able to read and write is a key Government priority. This Budget builds on previous initiatives by allocating \$131 million over four years for literacy and numeracy programmes in schools. Funding is also being provided for studying Asian languages and a quality teacher programme that will focus on professional development in literacy, numeracy, mathematics, science, information technology and vocational education.

Investing for Stronger Growth

The Government has allocated additional funding of \$195 million over four years to upgrade the National Highway System and roads of national importance. Increased funding is also being provided for bridge upgrades to facilitate the introduction of increased mass limits for heavy vehicles. These programmes will enhance the efficiency of our road transport system, with consequential national and regional economic benefits. The Black Spot Programme is being extended for a further two years in order to make our roads safer and reduce the social and economic costs of road accidents.

Biotechnology will have a major impact on many commercial activities and has the potential to improve the lives of Australians through new medical treatments, safer and more nutritious food, reductions in the use of chemicals and more sustainable land use practices. Initiatives in this Budget will assist the biotechnology industry to maximise its contribution to the Australian economy through ensuring a consistent regulatory system, improving the management of intellectual property in biotechnology and developing measures to enhance access to genetic and biological resources.

To help ensure that Australia maintains its strength in scientific and industrial research and innovation the Government will maintain higher baseline funding for the CSIRO. Research infrastructure funding for universities will be increased and new science lectureships will be established. This complements the Strategic Partnerships-Industry Research and Training programme for which additional funding has previously been announced.

The sale of the second tranche of Telstra will provide a social bonus to enhance national communications infrastructure. Telecommunication infrastructure in remote Australia will be upgraded to give access to untimed local calls and to replace the pastoral call rate with a fairer system at a cost of up to \$150 million over three years. The Networking the Nation regional telecommunications programme will provide enhanced rural internet access, continuous mobile phone coverage on major national highways and an expansion of the Regional Telecommunications Infrastructure Fund. The Television Fund initiative will provide \$120 million over five years to eliminate between 200 and 250 television blackspots and expand the transmission of SBS television.

To enhance Australia's capacity to participate fully in the strong global growth in the financial services industry, the Government has allocated \$3.5 million in each of 1999-2000 and 2000-01 for initiatives to promote Australia as a centre for global financial services.

Rural and Regional Australia

The Government is committed to working with Australia's primary industries to secure their profitability, sustainability and competitiveness. Funding is being committed to support the Supermarket to Asia Strategy and to implement the Food and Fibre Supply Chain Programme. Resources are being provided for the Northern Australian Quarantine

Strategy, for regional flood mitigation programmes, to deter illegal fishing in Australia's subantarctic waters, and to support the sustainability of the Great Artesian Basin.

An additional 30 Regional Health Service Centres will be established over the next four years. This measure will extend to more areas an approach that draws together health, aged care and other community services to a central location; providing a mix of services to best meet local priorities. Further, in recognition of the key role of general practitioners, the Government will spend \$43 million over four years on retention payments for long serving GPs working in rural and remote areas.

To ensure that Tasmania is not disadvantaged from high transport charges, an expanded freight equalisation scheme costing more than \$20 million per year will be implemented from 1999-2000.

Two new Centrelink call centres will be established in Maryborough and Port Augusta. The new call centres will tailor services to customers in regional and rural Australia.

As part of the social bonus to be funded from the sale of the second tranche of Telstra, the Government will fund the establishment of up to 500 rural transactions centres. The programme will help small rural communities to establish centres that provide access to basic transaction services, such as banking, post, phone, fax and Medicare Easyclaim.

To enhance the access that students from rural and regional areas have to education, this Budget provides a number of initiatives including increasing boarding allowance under the Assistance for Isolated Children Scheme and extending eligibility for the student financial loan supplement.

A Safer and Fairer Community

The Budget contains measures to strengthen family relationships, reduce crime and improve accessibility to justice.

Initiatives against crime include Crimtrac and the National Crime Prevention Programme. Crimtrac will provide access to the most up to date and efficient technology to store and retrieve information to help police solve crimes. At the other end of the spectrum, the National Crime Prevention Programme is aimed at finding and promoting ways of preventing crime and violence in the community. To enhance an equitable and accessible system of federal law and justice, additional counselling and mediation dispute resolution services will be provided and access to justice for disadvantaged people in rural and regional areas will be extended. Funding will be provided to establish the Federal Magistrates Service and to construct a Commonwealth Law Courts building in Adelaide.

This Budget provides a range of specific initiatives to support families through providing increased relationship support services, assistance to resolve family disputes, developing approaches to reduce domestic violence, expansion of children's contact services, a new suicide prevention strategy and support for carers of young people with disabilities. The Government will implement a new youth homelessness early intervention programme

and provide increased funding for the Supported Accommodation Assistance Programme which provides transitional support and accommodation to help homeless people and those at risk from domestic violence.

To date the Government has committed over \$295 million to the National Illicit Drug Strategy for a range of initiatives in the fight against drugs. This includes over \$80 million in this Budget to fulfill election promises. The Budget provides an additional \$221 million over four years for early intervention and diversion of illicit drug users to counselling and treatment, and for education and prevention activities including supply control.

Environment and Sport

Funding of \$250 million has been allocated to the Natural Heritage Trust as part of the social bonus from selling the second tranche of Telstra. This will maintain support for the full range of Natural Heritage Trust programmes such as Bushcare, Rivercare, Landcare and Coastcare; Murray-Darling 2001; and support for endangered species, wetlands and World Heritage places. The Budget also contains increased funding for the Living Cities programme, oceans policy, the Bureau of Meteorology and for a range of environment protection measures.

Consistent with the Government's election commitment, a further \$148 million is to be made available to the Australian Sports Commission over the period 1999-2000 to 2002-03. This funding will maintain support for national sports infrastructure and the development of elite athletes, including the extension of the Olympic Athlete Programme.

Appendix A: Fiscal Policy under Accrual Budgeting

The Government has adopted an accrual budgeting framework for public sector budgeting and reporting. The 1999-2000 Budget is the first Commonwealth budget to use an accrual framework. This move is an important step in the Government's financial management reform programme to develop more business-like reporting in the public sector. It will ensure that agency reporting accounts for the full cost of service delivery and incorporates a 'whole-of-government' approach. The main advantage of accrual measures (as opposed to cash) is that they provide a more comprehensive indication of the total activity of Government and the longer-term effects of current policy. Cash measures do, however, have some advantages for tracking expenditures in a fiscal year and helping to identify the short-term effect of fiscal policy on the economy.

ACCRUAL ACCOUNTING STANDARDS

There are two accrual standards against which the Government has reported against in this Budget:

- The ABS's accrual Government Finance Statistics (GFS) standard (refer to Statement 9).

The ABS is moving to compile the GFS on an accrual basis. The proposed accrual presentation will consist of four statements. An operating statement will describe flows and will feature three new summary measures (net lending, the increase in net worth and the net operating result). A full balance sheet will describe the financial stocks and value of physical assets. In addition, there will be a reconciliation statement of stocks and flows, and a cash flow statement.

In the proposed GFS system, the classification of some transactions will differ from the accrual treatment under accounting standards.

- Australian Accounting Standard (AAS 31), *Financial Reporting by Government* (refer to Statement 4).

AAS 31 requires governments to prepare accrual-based general purpose financial reports, including the assets they control, any liabilities incurred, and their revenues and expenses.

Under AAS 31, governments must prepare an operating statement (also known as the statement of revenue and expense, or the profit and loss statement), a statement of financial position (or balance sheet) and a statement of cash flows.

FISCAL BALANCE

The fiscal balance (GFS net lending) is the accrual equivalent of the underlying cash balance. Like its cash equivalent, the fiscal balance measures the Government's net lending and hence direct contribution to the current account deficit.

As noted in Parts I and III, the Government's fiscal strategy will be maintained under accruals with the focus of fiscal policy moving to the fiscal balance.

Focusing on the fiscal balance (rather than the operating result) ensures consistency with the Australian National Accounts concepts of net lending.

The fiscal balance measures the extent to which the Government is adding to or drawing down on the private savings pool. The Government's fiscal strategy is to ensure that, on average, over the course of the economic cycle the government sector is not drawing on private sector saving.

Although the fiscal balance is the accrual counterpart of the underlying cash balance the two are likely to diverge in the short term due to differences between when transactions are recorded in cash and accrual terms.

Deriving the Fiscal Balance

Although fiscal balance is an aggregate in the GFS operating statement (refer to Statement 9) it can also be calculated through several adjustments to the accounting standard operating result (see Table 5). These adjustments can be broadly grouped into two categories — revaluations and capital.

Revaluations reflect changes to the value of assets and liabilities. These revaluations do not affect cash measures of budget balance, but are brought to book in the calculation of the accounting standard operating result. They are not, however, included in the measurement of fiscal balance. Revaluations do not affect the fiscal balance as they do not involve a change in the Government's resource position; instead they reflect changes in the value of assets and liabilities resulting from flows that are not transactions — such as changes in prices (eg gains from foreign exchange). For example, an actuarial driven reassessment of the Government's superannuation liability may lead to a more accurate value being recorded in the balance sheet, but this has not changed the Government's current resource position and will not affect the fiscal balance.

The other major difference between the accounting operating result and the fiscal balance is the treatment of capital expenditure. As with cash measures, fiscal balance incorporates capital expenditure (net), not capital use or depreciation, as the fiscal balance is detecting the full investment by government in a particular period. Therefore, depreciation is 'added back' to the accounting standard operating result and replaced with capital expenditure — the capital adjustment.

Table 5: Budget Estimates

	General Government Sector				
	1998-99 Total Estimate	1999-00 Total Estimate	2000-01 Total Projection	2001-02 Total Projection	2002-03 Total Projection
(1) Underlying cash balance (new treatment)	2883	5208	3114	7210	12460
<i>plus</i> net advances	5511	17828	-923	17658	16698
Headline cash balance	8394	23036	2190	24867	29159
<i>less</i> GFS/AAS31 classification differences	851	1867	750	2484	27
<i>less</i> net cash from investing activities	1020	11404	-5199	10930	11826
<i>plus</i> accrual adjustments (revenues not providing cash plus cash used (provided) by working capital items less expenses not requiring cash)	-3358	-4049	80	-6051	-5674
Operating result	3166	5717	6718	5402	11633
(2) <i>plus</i> total accrual adjustments	283	509	3604	-1808	-827
(3) Operating result (before abnormals)	3166	5717	6718	5402	11633
(4) <i>plus</i> revaluations/writedowns from superannuation	0	0	0	0	0
(5) <i>plus</i> net writedown of assets/bad and doubtful debts	1134	1066	974	1059	1073
(6) <i>plus</i> net foreign exchange losses	-500	2	2	2	2
(7) <i>plus</i> other economic revaluations	810	386	693	331	33
(8) <i>less</i> profit (loss) on the sale of assets	2	-34	-13	-22	-11
(9) <i>less</i> costs of asset sales	60	224	0	218	218
(10) GFS operating result	4548	6981	8401	6597	12533
(11) <i>less</i> purchase of property plant and equipment and intangibles	4579	4989	4838	5055	4967
(12) <i>less</i> assets acquired under finance leases	na	na	na	na	na
(13) <i>less</i> other non-financial assets	123	9	-25	1	-3
(14) <i>less</i> increase in inventories	-250	-156	-107	7	-62
(15) <i>plus</i> proceeds from sales of property, plant and equipment and intangibles	701	810	725	699	553
(16) <i>plus</i> depreciation and amortisation	2308	2477	2776	2956	3169
(17) Fiscal balance (GFS net lending)	3105	5426	7195	5189	11353

Note: Items (4) to (9) reflect revaluations. Items (11) to (16) reflect the capital adjustment.

The table below provides accrual estimates of the Government's fiscal position at the 1998-99 MYEFO. These estimates are based on accrual data collected for the 1999-2000 Budget and should therefore be treated as indicative only.

Table 6: 1998-99 MYEFO Estimates

	General Government Sector			
	1998-99 Total Estimate	1999-00 Total Projection	2000-01 Total Projection	2001-02 Total Projection
(1) Underlying cash balance (old treatment)	3032	2686	3383	9438
(2) <i>less</i> provisions	1375	1292	1176	1229
(3) Underlying cash balance (new treatment)	1656	1394	2208	8210
<i>plus</i> net advances	5378	13741	32763	8466
Headline cash balance	7035	15135	34971	16676
<i>less</i> net cash from investing activities	997	7939	28689	3958
<i>plus</i> accrual adjustments (revenues not providing cash plus cash used (provided) by working capital items less expenses not requiring cash)	-2303	-5140	1835	-4687
Operating result	3734	2056	8117	8031
(4) <i>plus</i> total accrual adjustments	2078	662	5909	-179
(5) Operating result (before abnormals)	3734	2056	8117	8031
(6) <i>plus</i> revaluations/writedowns from superannuation	0	0	0	0
(7) <i>plus</i> net writedown of assets/bad and doubtful debts	851	945	1001	1107
(8) <i>plus</i> net foreign exchange losses	-417	0	0	0
(9) <i>plus</i> other economic revaluations	352	620	931	367
(10) <i>less</i> profit (loss) on the sale of assets	29	40	30	29
(11) <i>less</i> costs of asset sales	78	215	345	5
(12) GFS operating result	4413	3366	9674	9471
(13) <i>less</i> purchase of property plant and equipment and intangibles	3379	5077	4836	4944
(14) <i>less</i> assets acquired under finance leases	na	na	na	na
(15) <i>less</i> other non-financial assets	527	0	-19	0
(16) <i>less</i> increase in inventories	-173	-168	-35	19
(17) <i>plus</i> proceeds from sales of property, plant and equipment and intangibles	648	677	595	601
(18) <i>plus</i> depreciation and amortisation	2252	2490	2753	2958
(19) Fiscal balance (GFS net lending)	3580	1624	8240	8067

Note: Items (6) to (11) reflect revaluations. Items (13) to (18) reflect the capital adjustment.

DIFFERENCES BETWEEN CASH AND ACCRUALS

Under a cash system, transactions are recorded in the reporting period in which cash changes hands. An accrual system records transactions in the period in which income is earned or expenses incurred, subject to the important caveat that the transactions are able to be reliably measured at that time. Effectively, assets, liabilities, revenues and expenses

arising from transactions or other events must be recognised in the financial statements when they have an economic impact on the government, regardless of when the associated cash flows occur.

The major differences between cash budgeting and the accrual framework are outlined below.

Superannuation

Accrual budgeting will record the accruing superannuation expense whether the liability is funded or unfunded. The superannuation expense in the operating statement, in a given year, is equal to the superannuation accruing to current employees, as well as the interest or growth of the outstanding liability. In calculating changes in the stock of unfunded superannuation liabilities, the actuary takes into account the number of salary earners and assumptions relating to wages growth, inflation and the expected rate of return on investment. While this will show the true cost of accruing superannuation liabilities, it does not change the unfunded nature of the liability.

Public Debt Interest (PDI)

Under cash accounting, PDI is recorded as the interest paid during the year. Under an accrual approach, allowance is also made for interest accrued, but not actually paid, during the period.

A further difference between cash and accrual accounting for PDI concerns the treatment of premia and discounts when debt is issued or when it is repurchased. Under the cash framework, an issue premium is recorded as an offset to PDI at the time of debt issue, and an issue discount is recorded as PDI when that debt is cancelled. In the accounting standard framework, however, both issue premia and discounts are amortised over the life of the stock, while in the accrual GFS framework premia and discounts are considered economic revaluations.

Taxation Revenue

The preparation of accrual estimates requires a conceptually consistent and reliable method of recognising when taxation revenue accrues to the Commonwealth.

The Commonwealth could record an accrual of revenue at the time that economic transactions, resulting in a taxation liability, took place. It is very difficult, however, to know when all such transactions take place. As a result, revenue will be recognised as accruing at the time the relevant tax law indicates the existence of a requirement to pay an amount in tax or when a tax liability assessment is raised by the Australian Taxation Office (ATO) or the Australian Customs Service (ACS). That is, revenue is only recognised when the taxpayer makes a self-assessment or the ATO/ACS issues an assessment.

In effect only two changes to current cash estimates are required. These are adjustments for receivables, and for bad and doubtful debts.

The adjustment for receivables recognises revenue for which an assessment has been issued but which has not yet been received and excludes cash received which has already been accounted for in receivables (because it accrued in a previous reporting period).

For example, accrual revenue is recognised at the time an assessment for taxation occurs. New company tax payment arrangements commencing in 2000-01 will involve some companies being assessed for tax under both the existing and new payment arrangements in that year. As announced in *A New Tax System*, companies will be allowed to defer part of this tax liability to later years to smooth actual tax payments in 2000-01. Companies will therefore be assessed for tax instalments in 2000-01 that will not be paid until some time in the future. Assessments on these deferred amounts are treated as a receivable in 2000-01, resulting in accrual revenue being larger than cash revenue in 2000-01 but lower than cash in the following years.

The adjustment for bad and doubtful debts allows for the fact that some accounts receivable are never paid and are eventually written off. At the end of each financial year tax receivables that are likely to become uncollectable are brought to account and expensed to the year just finishing. In this way expenses are matched to the period in which they were incurred.

Capital

Accrual accounting records capital use (depreciation) in the operating statement, whereas cash accounting records capital expenditure. However, the Government's primary fiscal target — the fiscal balance — will continue to record capital expenditure instead of depreciation. This treatment is necessary because the fiscal balance is intended to measure net lending, or the difference between saving and investment expenditure. Therefore the fiscal balance detects the cash 'investment' in a given year, not the capital used. The cash flow statement will outline most capital expenditure in the categories 'purchase of property, plant and equipment, and intangibles' and 'proceeds from sale of property, plant and equipment, and intangibles'.

Appendix B: Provisions

The Government still makes superannuation payments to current and former employees of PTEs who were once employees within the general government sector. These payments are termed 'provisions' and to date have been treated as financing transactions, and as such did not impact on the budget 'bottom line' balance. This was consistent with their treatment by the ABS in the Australian National Accounts.

The ABS has recently adopted revised international statistical standards (SNA 93) in the Australian National Accounts. As part of these new standards 'provisions' are brought 'above the line'. To maintain consistency with this revised ABS treatment, from the 1999-2000 Budget provisions will now be brought 'on budget', like other superannuation payments, and included in budget bottom lines. This classification change will have the effect of reducing the headline and underlying cash balance by around \$1¼ billion per annum.

The Government has always published budget bottom lines inclusive of provisions in GFS tables. From the 1999-2000 Budget the GFS cash balance will align with the underlying cash balance (refer to Statement 9).

Under accruals, for the calculation of fiscal balance, the relevant expense is a measure of the accruing interest or growth on the outstanding PTE superannuation liability. As a consequence of timing differences, the accrual expense is expected to be less than the cash outlays in respect of this liability.