

STATEMENT 2: FISCAL OUTLOOK

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

The fiscal outlook for Australia remains sound, with the Government forecasting an underlying cash surplus of \$10.8 billion in 2006-07. Across the forward estimates the Government has maintained the budget in a surplus position after providing for substantial personal income tax cuts of \$36.7 billion over four years commencing on 1 July 2006.

The Government's sound fiscal management has seen the elimination of net debt in 2005-06 and the prospect of positive net worth in 2008-09. Such sound fiscal policy, along with the financial assets accumulating in the Future Fund, leaves the Government well placed to deal with the budget pressures of an ageing Australia.

Budget aggregates	2-3
Variations to the fiscal balance estimates	2-3
Variations in revenue estimates	2-4
Variations in expense estimates	2-5
Variations in net capital investment estimates	2-7
Cash flows	2-8
Headline cash balance	2-10
Net debt and net worth	2-10
Medium-term fiscal outlook	2-12
Fiscal policy in a medium term setting	2-12
Fiscal policy since the 2002 Intergenerational Report	2-13
Appendices	2-15
Appendix A: Reporting Standards.....	2-15
Appendix B: Budget Financial Statements.....	2-17
Appendix C: Sensitivity of Fiscal Expenses and Revenue to Economic Developments	2-23

STATEMENT 2: FISCAL OUTLOOK

The fiscal outlook for Australia remains sound, with the Government forecasting its ninth budget surplus in the last ten years. Across the forward estimates period, the Government has maintained the budget in surplus after providing personal income tax cuts of \$36.7 billion, \$993 million for increasing the income test threshold for the maximum rate of Family Tax Benefit Part A, \$905 million for funding on health and medical research and \$2.3 billion additional funding for road and rail infrastructure.

BUDGET AGGREGATES

An underlying cash surplus of \$10.8 billion is expected in 2006-07 compared with an estimated surplus of \$9.7 billion at the *Mid-Year Economic and Fiscal Outlook 2005-06* (MYEFO). In accrual terms, a fiscal surplus of \$10.3 billion is estimated for 2006-07 compared to the \$9.7 billion at MYEFO. The fiscal outlook is for continuing underlying cash and fiscal surpluses in the forward years.

Table 1: Australian Government general government sector budget aggregates^(a)

	Actual	Estimates		Projections		
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Revenue (\$b)	206.6	222.9	231.7	240.7	252.1	265.6
Per cent of GDP	23.1	23.3	23.0	22.9	23.0	23.0
Expenses (\$b)	195.7	206.0	219.7	230.6	240.9	252.6
Per cent of GDP	21.9	21.6	21.8	21.9	22.0	21.9
Net operating balance (\$b)	10.9	16.8	11.9	10.1	11.2	13.0
Net capital investment (\$b)	0.1	0.9	1.6	0.2	0.6	0.0
Fiscal balance (\$b)	10.8	16.0	10.3	9.9	10.6	13.0
Per cent of GDP	1.2	1.7	1.0	0.9	1.0	1.1
Underlying cash balance (\$b)(b)	13.6	14.8	10.8	10.6	11.2	12.0
Per cent of GDP	1.5	1.5	1.1	1.0	1.0	1.0
<i>Memorandum item:</i>						
Headline cash balance (\$b)	12.5	13.5	37.5	10.7	11.4	12.3

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

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

VARIATIONS TO THE FISCAL BALANCE ESTIMATES

The upward revision of \$0.6 billion in the 2006-07 fiscal surplus since MYEFO largely reflects higher than anticipated revenue from companies. This is partly offset by the impact of the Government's decision to provide additional tax relief and to increase the diminishing value rate of depreciation of eligible company assets acquired from 10 May 2006.

Statement 2: Fiscal Outlook

Table 2 provides a reconciliation of the fiscal balance estimates between the 2005-06 Budget, the 2005-06 MYEFO and the 2006-07 Budget.

Table 2: Reconciliation of 2005-06 Budget, 2005-06 MYEFO and 2006-07 Budget fiscal balance estimates

	Estimates		Projections	
	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m
2005-06 Budget fiscal balance	7,410	7,458	8,003	9,022
Per cent of GDP	0.8	0.8	0.8	0.9
Changes between 2005-06 Budget and MYEFO				
Effect of policy decisions(a)				
Revenue	-81	-129	-126	-141
Expenses	1,525	1,229	1,099	1,115
Net capital investment	230	59	-15	4
Total policy decisions impact on fiscal balance(b)	-1,836	-1,416	-1,210	-1,260
Effect of parameter and other variations				
Revenue	4,192	4,681	5,023	4,550
Expenses	-568	824	764	160
Net capital investment	-63	185	102	372
Total parameter and other variations impact on fiscal balance(b)	4,823	3,672	4,157	4,017
2005-06 MYEFO fiscal balance	10,398	9,714	10,950	11,779
Per cent of GDP	1.1	1.0	1.0	1.1
Changes between MYEFO and 2006-07 Budget				
Effect of policy decisions(a)				
Revenue	3	-6,952	-9,939	-10,727
Expenses	2,032	4,271	4,836	5,254
Net capital investment	57	398	191	244
Total policy decisions impact on fiscal balance(b)	-2,085	-11,621	-14,965	-16,225
Effect of parameter and other variations				
Revenue	4,239	11,181	12,309	13,071
Expenses	-3,052	-1,400	-1,542	-2,187
Net capital investment	-363	382	-104	245
Total parameter and other variations impact on fiscal balance(b)	7,654	12,198	13,955	15,012
2006-07 Budget fiscal balance	15,966	10,290	9,940	10,566
Per cent of GDP	1.7	1.0	0.9	1.0

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

(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.

Variations in revenue estimates

Total revenue for 2006-07 has been revised up by \$4.2 billion since 2005-06 MYEFO. The upward revision represents the flow-on effect of stronger growth in expected revenue from companies and individuals in 2005-06, together with a stronger outlook for corporate profits in 2006. These upward revisions have been partly offset by the impact of the Government's decision to provide personal tax cuts (including the reduction in the fringe benefits tax rate) worth \$6.6 billion in 2006-07, and \$36.7 billion

over the forward estimates and increasing the diminishing value rate for determining depreciation deductions at a cost of \$3.7 billion over the forward estimates.

Other major policy decisions affecting revenue over the four year period from 2006-07 to 2009-10 include:

- the taxation of distributions to non-resident trustee beneficiaries which is expected to increase taxation revenue by \$250 million in 2007-08 and \$800 million over the forward estimates;
- the Government providing the Australian Taxation Office with an additional \$82 million over four years to maintain tax compliance by high wealth individuals and their associated entities. This funding is expected to raise an additional \$65 million in revenue in 2006-07 and \$615 million over the forward estimates; and
- preventing some public sector superannuation schemes from improperly using pre-1 July 1988 funding credits. This is expected to increase taxation revenue by \$150 million in 2006-07 and \$600 million over the forward estimates.

Parameter and other variations are expected to increase revenue in 2006-07 by \$11.2 billion, relative to the MYEFO forecasts. The strength in taxation revenue largely stems from the improvements in corporate profitability, bolstered by the flow-on effect of stronger outcomes in 2005-06.

Looking ahead, expected growth in nominal GDP remains supportive of continued strength in revenue, particularly from the corporate sector. In underlying terms, personal income is expected to continue to grow strongly on the back of solid growth in compensation of employees and the realisation of capital gains by investors.

Further detail on how the revised outlook for the economy has affected individual revenue heads over the forward estimates is provided in Statement 5. An analysis of the sensitivity of the taxation revenue estimates to changes in the economic parameters is provided in Appendix C.

Variations in expense estimates

Since MYEFO, estimated expenses for 2006-07 have increased by \$2.9 billion reflecting the impact of new policy decisions of \$4.3 billion partially offset by parameter and other variations of \$1.4 billion.

Major policy decisions since MYEFO that have increased expenses include:

- \$792 million in 2006-07 (\$1.7 billion over four years) to acquire a new heavy airlift capability for the Australian Defence Force. The total cost amounts to \$2.2 billion over six years;

Statement 2: Fiscal Outlook

- \$242 million in 2006-07 (\$993 million over four years) to expand the eligibility for the maximum rate of Family Tax Benefit Part A so that, from 1 July 2006, a family can earn \$40,000 (up from \$33,361 in 2005-06) without having their entitlement reduced;
- \$178 million in 2006-07 (\$1.1 billion over four years) for a range of national security measures under the *National Security – Preventing Terrorism* package;
- \$137 million in 2006-07 (\$971 million over four years) to introduce the health and social services access card, to provide more convenient and efficient access to Australian Government health and social services benefits;
- \$136 million in 2006-07 to finance Australia's share of the Multilateral Debt Relief Initiative announced by G8 Finance Ministers in June 2005. The funding will enable up-front payment of Australia's contribution for the ten-year period 2006-07 to 2015-16;
- \$133 million in 2006-07 (\$1.9 billion over five years to 2010-11) for mental health reform measures including a major increase in clinical and health services available in the community; and
- \$114 million in 2006-07 (\$497 million over four years) to extend the Family Tax Benefit Part A Large Family Supplement to families with three children.

In 2006-07, parameter and other variations have decreased forecast expenses by \$1.4 billion since MYEFO largely reflecting:

- a \$287 million reduction in estimated Parenting Payment expenses largely due to a stronger labour market reducing the expected number of benefit recipients;
- a \$260 million reduction in estimated Age Pension expenses, largely due to an increase in the number of part-rate pension recipients and a decrease in the population projection for people eligible to receive Age Pension;
- a \$260 million reduction in expenses for the Pharmaceutical Benefits Scheme due to lower than expected growth in certain drug groups including anti-inflammatory, cholesterol lowering and psycho analeptic drugs;
- a \$186 million reduction in Disability Support Pension payments, largely due to increased workforce participation resulting in a revised forecast of growth in recipient numbers;
- a \$178 million reduction in Youth Allowance expenses, largely due to lower than estimated take up by new apprentices; and

- the regular draw-down of the conservative bias allowance¹ reducing estimated expenses in 2006-07 by around \$1 billion.

The above decreases in expenses are partially offset by:

- a \$200 million increase in 2006-07 due to the re-scheduling of the acquisition, maintenance and logistics support of defence weapon platforms originally planned to take place in 2005-06;
- a \$190 million increase in spending on the Investing in Our Schools programme largely due to funding being brought forward from calendar year 2008 to calendar year 2006 to meet stronger than expected demand; and
- a \$188 million increase in estimated civilian superannuation expenses, largely due to changes in demographics such as improved life expectancy of members.

In 2005-06, estimated expenses have decreased by \$1 billion since MYEFO. This largely reflects parameter and other variations, including a \$323 million reduction in civilian superannuation expenses and a \$298 million reduction in estimated expenses for the Water Smart Australia and Raising National Water Standards programmes. These decreases have been partially offset by new spending of \$2 billion, including \$444 million for the Government's response to Cyclone Larry, \$354 million for a one-off lump sum payment to eligible carers and \$270 million for the Australian Rail Track Corporation to improve rail track quality on the North-South rail corridor.

More detailed information on expenses can be found in Statement 6. A full description of all policy measures since MYEFO can be found in Budget Paper No. 2, *Budget Measures 2006-07*.

Variations in net capital investment estimates

In 2006-07, forecast net capital investment has increased by \$780 million since the 2005-06 MYEFO. This represents the combined effect of:

- new policy measures of \$398 million, including \$136 million for national security and counter-terrorism measures and \$70 million for the upgrade of information technology systems for the Department of Immigration and Multicultural Affairs as part of the Government's response to the Palmer and Comrie reports; and

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

Statement 2: Fiscal Outlook

- parameter and other variations of \$382 million, including \$100 million for the purchase of items in the national medical stockpile delayed from 2005-06 as a result of increased worldwide demand for antivirals and personal protective equipment resulting from the spread of avian influenza in Europe, Asia and Africa, and \$56 million for the re-scheduling from 2005-06 of capital works relating to the security upgrade of overseas missions.

In 2005-06, estimated net capital investment has decreased by \$306 million since MYEFO, largely reflecting \$100 million due to the above mentioned delay in the purchase of items in the national medical stockpile and \$65 million relating to the above mentioned re-scheduling of capital works for the security upgrade of overseas missions.

CASH FLOWS

In 2006-07, an underlying cash surplus of \$10.8 billion is expected, compared with the MYEFO estimate of \$9.7 billion. While the 2006-07 cash balance has increased by \$1.1 billion since MYEFO, the fiscal balance has increased by only \$0.6 billion. This difference between the change in the underlying cash balance and the fiscal balance is largely attributable to increased superannuation expenses which do not have a cash impact and increased road funding where the cash impact occurs in 2005-06 but is expensed in 2006-07 to 2009-10.

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

Table 3: Summary of Australian Government general government sector cash flows^(a)

	Estimates		Projections		
	2005-06	2006-07	2007-08	2008-09	2009-10
	\$b	\$b	\$b	\$b	\$b
Cash receipts					
Operating cash receipts	222.2	230.7	239.3	250.5	263.9
Capital cash receipts(b)	0.2	0.2	0.2	0.2	0.1
Total cash receipts	222.4	230.8	239.5	250.7	264.0
Cash payments					
Operating cash payments	204.6	214.7	224.2	234.2	247.1
Capital cash payments(c)	2.9	3.5	2.7	2.8	2.6
Total cash payments	207.5	218.2	226.9	237.0	249.7
Finance leases and similar arrangements(d)	0.0	0.0	0.0	-0.3	0.0
GFS cash surplus(+)/deficit(-)	14.9	12.6	12.6	13.3	14.3
Per cent of GDP	1.6	1.2	1.2	1.2	1.2
<i>less</i> Future Fund earnings	0.1	1.8	2.0	2.1	2.3
Underlying cash balance(e)	14.8	10.8	10.6	11.2	12.0
Per cent of GDP	1.5	1.1	1.0	1.0	1.0
<i>Memorandum items:</i>					
Net cash flows from investments in financial assets for policy purposes(f)	-1.4	24.9	-1.9	-2.0	-2.0
<i>plus</i> Future Fund earnings(g)	0.1	1.8	2.0	2.1	2.3
Headline cash balance	13.5	37.5	10.7	11.4	12.3

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

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

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

(d) The acquisition of assets under finance leases decreases the underlying cash balance. The disposal of assets previously held under finance leases increases the underlying cash balance.

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

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

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

Statement 2: Fiscal Outlook

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

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

	Estimates		Projections	
	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m
2005-06 Budget underlying cash balance	8,921	7,933	8,500	9,284
Changes from 2005-06 Budget to MYEFO				
Effect of policy decisions(a)	-1,829	-1,427	-1,202	-1,252
Effect of parameter and other variations	4,360	3,196	2,836	2,693
Total variations	2,531	1,769	1,634	1,440
2005-06 MYEFO underlying cash balance	11,452	9,702	10,134	10,725
Changes from MYEFO to 2006-07 Budget				
Effect of policy decisions(a)	-5,171	-11,411	-14,212	-15,161
Effect of parameter and other variations	8,524	12,537	14,707	15,661
Total variations	3,353	1,126	495	500
2006-07 Budget underlying cash balance(b)	14,805	10,828	10,628	11,225

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

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

Headline cash balance

A headline cash surplus of \$37.5 billion is now forecast for 2006-07 compared with a surplus of \$36.2 billion at MYEFO. The increase in the headline cash surplus estimate since MYEFO largely reflects the increase in the underlying cash balance plus the inclusion of expected Future Fund earnings.

NET DEBT AND NET WORTH

Net debt has now been eliminated and with the budget remaining in surplus in the forward years, net debt is expected to stay below zero. From its peak of 18.5 per cent of GDP in 1995-96, net debt is estimated to fall to -\$22.1 billion in 2006-07 (-2.2 per cent of GDP). Net worth is also expected to continue to strengthen and is projected to become positive in 2008-09.

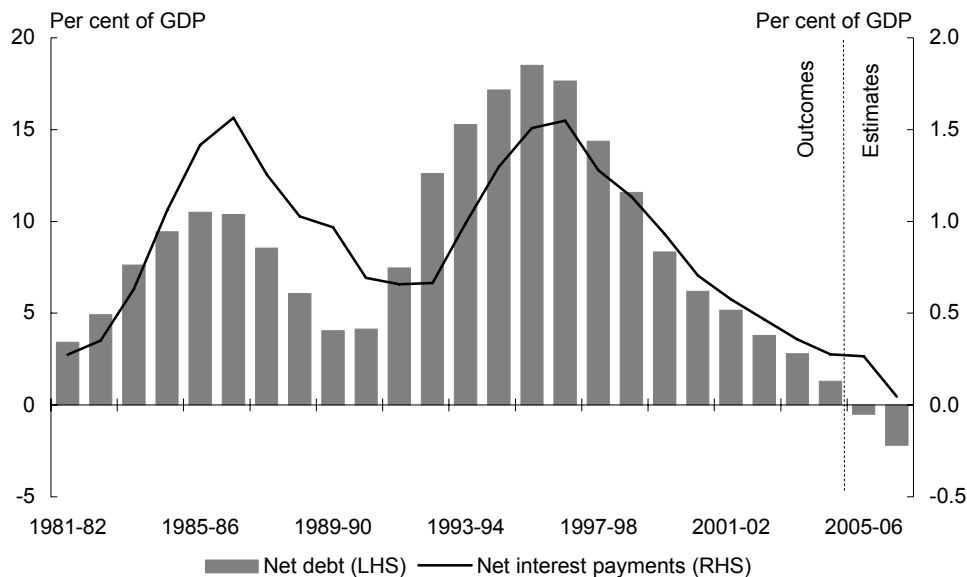
Table 5 and Chart 1 provide a summary of Australian Government general government sector net worth, net debt and net interest payments.

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

	Estimates		Projections		
	2005-06	2006-07	2007-08	2008-09	2009-10
	\$b	\$b	\$b	\$b	\$b
Financial assets	133.6	147.1	163.0	178.3	194.5
Non-financial assets	43.9	45.5	45.6	46.2	46.3
Total assets	177.5	192.6	208.6	224.5	240.8
Total liabilities	201.5	204.6	210.9	215.7	219.1
Net worth	-24.0	-12.0	-2.3	8.8	21.6
Net debt(a)(b)	-4.8	-22.1	-24.7	-37.1	-50.2
Per cent of GDP	-0.5	-2.2	-2.4	-3.4	-4.3
Net interest payments	2.5	0.5	0.3	-0.2	-0.9
Per cent of GDP	0.3	0.0	0.0	0.0	-0.1

(a) Net debt equals the sum of deposits held, advances received, Government securities, loans and other borrowing, minus the sum of cash and deposits, advances paid and investments, loans and placements.

(b) Includes the impact of the further sale of the Australian Government's shareholding in Telstra and the establishment of the Future Fund. It is assumed that the Future Fund is initially invested in term deposits but will increasingly be invested in equities until it reaches a portfolio equity allocation consistent with the benchmark return specified in the Government's investment mandate.

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

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

Over the forward years net debt is expected to fall further, primarily reflecting the assumption that the full sale of Telstra, Medibank Private and Snowy Hydro are achieved in 2006-07. Transfer of Telstra proceeds to the Future Fund has been adopted as an estimation assumption.

Statement 2: Fiscal Outlook

The net debt projections have changed since MYEFO largely reflecting assumptions regarding the financial asset composition of the Future Fund. The estimates assume the Fund is initially invested in term deposits and then gradually moves to a portfolio equity allocation consistent with the benchmark return specified in the Government's investment mandate. The assumptions are for estimates purposes only and are not intended to guide the Future Fund Board of Guardians in finalising its investment strategy for the Fund. The net debt projections are therefore sensitive to the actual asset composition of the Fund.

As a result of the lower level of net debt, net interest payments continue to fall in 2006-07 and beyond. Having peaked at \$8.4 billion in 1996-97, net interest payments are expected to fall to \$0.5 billion in 2006-07.

With the budget remaining in surplus, Australian Government general government sector net worth is expected to improve to -\$12.0 billion in 2006-07 compared with -\$16.9 billion at MYEFO. Net worth over the forward estimates is expected to continue to improve and, for the first time, is projected to be positive in 2008-09.

MEDIUM-TERM FISCAL OUTLOOK

Fiscal policy in a medium term setting

Since coming to office in 1996 the Government has adhered to a medium-term fiscal strategy that has delivered strong fiscal outcomes and supported economic growth. This strategy is based on the high level principles of fiscal management contained in the *Charter of Budget Honesty Act 1998* (the Charter). These principles require the Government to focus on financial and economic risks and the impact of fiscal decisions on future generations. For example, high debt levels reduce the ability of governments to respond to macroeconomic shocks and impose repayment burdens on future generations. With net debt now eliminated, investors and consumers have greater certainty about the stability of future government finances, thus creating an environment more conducive to investment and economic growth. The medium-term fiscal strategy provides the community with the same sound policy anchor that inflation targeting provides for monetary policy.

The Government's medium-term fiscal strategy ensures that budget commitments are affordable beyond the forward estimates period. Sound fiscal policy provides investors and consumers with confidence in the Government's fiscal intentions and ability to manage prevailing fiscal risks. The longer term fiscal risk was analysed in the Intergenerational Report 2002-03 (2002 IGR) and will be updated in future intergenerational reports that are required under the Charter.

Fiscal policy since the 2002 Intergenerational Report

The 2002 IGR raised community awareness of the demographic pressures Australia is likely to face over the long term. The 2002 IGR projected that if existing policies and demographic trends remain unchanged, a gradual fiscal adjustment of around 5 per cent of GDP would be required to meet these future commitments. The Government has subsequently introduced several policy measures designed to improve the sustainability of government finances and avoid costly burdens being placed on future generations. Moderate reforms today will reduce the need for drastic policy solutions in the future.

The Government has achieved strong fiscal outcomes over recent years which have allowed the Government to eliminate net debt and establish the Future Fund. Funding the Australian Government's superannuation liability now will reduce future pressures on the budget at a time when the budget will be facing the spending challenges associated with an ageing population.

In addition, the Government has taken steps to address the fiscal challenges posed by the 2002 IGR. These include increasing patient co-payments for the Pharmaceutical Benefits Scheme and requiring a mandatory 12.5 per cent price reduction for generic drugs. The Government has also taken steps to reduce the growth in the Disability Support Pension. While the cost of these programmes is higher today than originally projected in the 2002 IGR, these reforms have reduced their rate of growth.

Given the longer-term pressures identified in the 2002 IGR, previous budget papers have identified the importance of trends in population growth, work force participation and productivity growth in influencing economic outcomes and overall wellbeing. Policies to support economic growth through increased participation and productivity are essential to meet the demographic challenges.

Importantly for the fiscal strategy, the ageing population is expected to lead to lower labour force participation. The Government is taking steps to address this through initiatives such as the Welfare to Work package, which contained a comprehensive package of measures designed to increase incentives to enter the work force and reduce reliance on welfare. The unemployment rate is currently around the level projected in the 2002 IGR and participation rates in some groups have also been higher. The Government's workplace reforms provide the opportunity for even lower unemployment rates in the future.

Statement 2: Fiscal Outlook

Over the last four years, productivity growth has slowed to around the trend level projected in the 2002 IGR. Many of the Government's policies are aimed at improving productivity, such as a more flexible labour market flowing from the Government's Work Choices reforms and the tax reforms aimed at encouraging more efficient allocation of investment. The National Reform Agenda outlined at the February 2006 Council of Australian Governments also provides a framework for delivering further competition, regulatory and human capital reforms.

Continued strong economic and fiscal performance is essential over the medium term as the population ages. Responsible fiscal management, and the elimination of net debt, along with the introduction of several important policy measures in recent years aimed at increasing participation and productivity means that Australia is taking steps now to deal with the future challenges.

APPENDIX A: REPORTING STANDARDS

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

The major external standards used for budget reporting purposes are:

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

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

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

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

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

Statement 2: Fiscal Outlook

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

ABS GFS also requires defence weapons be treated as expenses. Defence weapons inventories are recorded as capital investment rather than expenses until such inventories can be reliably identified and measured. This treatment does not affect the underlying cash and fiscal balances. The update of the statistical standard is expected to change the treatment of defence weapons to assets and the current treatment will remain in place at least until the update is finalised.

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

APPENDIX B: BUDGET FINANCIAL STATEMENTS

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

Statement 2: Fiscal Outlook

Table B1: Australian Government general government sector operating statement

	Estimates		Projections		
	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m
Revenue					
Taxation revenue	208,085	217,157	226,076	236,741	249,452
Current grants and subsidies	0	0	0	0	0
Sales of goods and services	4,898	4,846	4,975	5,114	5,255
Interest income	2,386	3,717	3,457	4,005	4,647
Dividend income	4,321	2,701	2,866	3,058	3,228
Other	3,173	3,241	3,297	3,160	3,021
Total revenue	222,864	231,662	240,671	252,078	265,603
Expenses					
Gross operating expenses					
Depreciation	2,041	2,243	2,385	2,465	2,492
Superannuation	2,472	2,551	2,600	2,690	2,783
Salaries and wages	12,627	13,715	13,822	13,941	14,266
Payment for supply of goods and services	49,126	53,857	55,340	56,653	59,115
Other operating expenses	2,106	2,632	2,717	2,926	3,006
<i>Total gross operating expenses</i>	<i>68,372</i>	<i>74,998</i>	<i>76,864</i>	<i>78,675</i>	<i>81,663</i>
Nominal superannuation interest expense	5,583	5,784	5,870	6,077	6,289
Other interest expenses	4,084	3,900	3,833	3,678	3,634
Other property expenses	0	0	0	0	0
Current transfers					
Grant expenses	40,264	42,011	44,203	45,568	46,535
Subsidy expenses	6,343	7,268	7,523	7,953	7,870
Personal benefit payments in cash	77,332	81,108	87,303	93,684	102,261
Other current transfers	0	0	0	0	0
<i>Total current transfers</i>	<i>123,938</i>	<i>130,387</i>	<i>139,030</i>	<i>147,205</i>	<i>156,667</i>
Capital transfers	4,040	4,661	4,960	5,275	4,340
Total expenses	206,018	219,730	230,556	240,910	252,592
Net operating balance	16,847	11,933	10,115	11,168	13,010
Net acquisition of non-financial assets					
Purchases of non-financial assets	2,860	3,317	2,679	3,012	2,648
<i>less</i> Sales of non-financial assets	203	152	233	155	122
<i>less</i> Depreciation	2,041	2,243	2,385	2,465	2,492
<i>plus</i> Change in inventories	148	521	91	88	68
<i>plus</i> Other movements in non-financial assets	117	199	23	122	-63
Total net acquisition of non-financial assets	881	1,642	174	602	38
Net lending/fiscal balance(a)	15,966	10,290	9,940	10,566	12,972

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

Table B2: Australian Government general government sector balance sheet

	Estimates		Projections		
	2005-06	2006-07	2007-08	2008-09	2009-10
	\$m	\$m	\$m	\$m	\$m
Assets					
Financial assets					
Cash and deposits	1,785	1,242	1,801	2,870	3,262
Advances paid	21,471	22,941	24,626	26,410	28,259
Investments, loans and placements	47,042	62,241	64,468	74,053	83,992
Other non-equity assets	19,758	20,010	20,244	20,564	21,877
Equity(a)	43,535	40,652	51,894	54,379	57,101
Total financial assets	133,591	147,086	163,033	178,276	194,491
Non-financial assets					
Land	6,089	6,112	6,099	6,069	5,991
Buildings	13,469	13,875	13,689	14,152	14,649
Plant, equipment and infrastructure	8,595	9,063	9,091	9,056	8,874
Inventories	4,625	5,146	5,236	5,324	5,392
Heritage and cultural assets	7,723	7,753	7,767	7,777	7,795
Other non-financial assets	3,361	3,546	3,694	3,825	3,572
Total non-financial assets	43,861	45,493	45,575	46,204	46,273
Total assets	177,452	192,579	208,608	224,480	240,764
Liabilities					
Deposits held	405	405	405	405	405
Advances received	0	0	0	0	0
Government securities(a)	59,547	58,356	60,164	60,237	59,428
Loans	5,264	5,293	5,318	5,008	4,994
Other borrowing	297	296	265	542	501
Superannuation liability	95,947	99,597	103,171	106,814	110,512
Other employee entitlements and provisions	8,001	8,207	8,372	8,599	8,878
Other non-equity liabilities	32,016	32,428	33,243	34,092	34,413
Total liabilities	201,478	204,580	210,938	215,697	219,132
Net worth(b)	-24,026	-12,001	-2,330	8,783	21,632
Net debt(c)(d)	-4,784	-22,075	-24,743	-37,140	-50,184

(a) Equity includes the valuation of the Telstra shareholding in 2005-06, which is valued at the average of the daily share price over a 90-day period

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

(c) Net debt equals the sum of deposits held, advances received, government securities, loans and other borrowing, minus the sum of cash and deposits, advances paid and investments, loans and placements.

(d) Includes the impact of the further sale of the Australian Government's shareholding in Telstra and the establishment of the Future Fund. It is assumed that the Future Fund is initially invested in term deposits but will increasingly be invested in equities until it reaches a portfolio equity allocation consistent with the benchmark return specified in the Government's investment mandate.

Statement 2: Fiscal Outlook

Table B3: Australian Government general government sector cash flow statement^(a)

	Estimates		Projections		
	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m
Cash receipts from operating activities					
Taxes received	204,469	213,188	221,974	232,477	245,056
Receipts from sales of goods and services	5,189	5,008	5,137	5,297	5,427
Grants and subsidies received	0	0	0	0	0
Interest receipts	2,275	3,498	3,316	3,787	4,379
Dividends	4,341	3,000	2,866	3,058	3,228
GST input credits received by general government	2,973	3,027	2,988	2,996	3,058
Other receipts	2,928	2,944	3,003	2,893	2,723
Total operating receipts	222,176	230,665	239,284	250,508	263,872
Cash payments for operating activities					
Payments for goods and services	-51,849	-57,615	-58,477	-59,745	-62,266
Grants and subsidies paid	-51,535	-52,052	-54,327	-55,674	-56,928
Interest paid	-4,810	-3,950	-3,619	-3,544	-3,451
Personal benefit payments	-76,343	-80,168	-86,472	-93,328	-102,072
Salaries, wages and other entitlements	-17,606	-18,437	-18,695	-19,049	-19,573
GST payments by general government to taxation authority	-86	-79	-81	-82	-85
Other payments for operating activities	-2,332	-2,406	-2,533	-2,774	-2,750
Total operating payments	-204,561	-214,706	-224,204	-234,196	-247,125
Net cash flows from operating activities	17,614	15,959	15,080	16,312	16,747
Cash flows from investments in non-financial assets					
Sales of non-financial assets	224	154	233	155	122
Purchases of non-financial assets	-2,939	-3,496	-2,695	-2,808	-2,577
Net cash flows from investments in non-financial assets	-2,715	-3,342	-2,462	-2,652	-2,456
Net cash flows from investments in financial assets for policy purposes	-1,390	24,869	-1,923	-1,976	-2,028
Cash flows from investments in financial assets for liquidity purposes					
Increase in investments	-12,346	-37,424	-12,144	-10,620	-11,092
Net cash flows from investments in financial assets for liquidity purposes	-12,346	-37,424	-12,144	-10,620	-11,092
Cash flows from financing activities					
Advances received (net)	0	0	0	0	0
Borrowing (net)	-1,754	-838	2,114	29	-684
Deposits received (net)	0	0	0	0	0
Other financing (net)	577	234	-105	-24	-95
Net cash flows from financing activities	-1,177	-604	2,009	5	-779
Net increase/decrease in cash held	-15	-543	559	1,069	392

Table B3: Australian Government general government sector cash flow statement^(a) (continued)

	Estimates		Projections		
	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m
Net cash from operating activities and investments in non-financial assets	14,899	12,617	12,617	13,659	14,292
Finance leases and similar arrangements(b)	-12	-23	-6	-325	-6
GFS cash surplus(+)/deficit(-)	14,888	12,594	12,611	13,334	14,286
<i>less</i> Future Fund earnings	83	1,766	1,983	2,109	2,267
Equals underlying cash balance(c)	14,805	10,828	10,628	11,225	12,019
<i>plus</i> net cash flows from investments in financial assets for policy purposes	-1,390	24,869	-1,923	-1,976	-2,028
<i>plus</i> Future Fund earnings	83	1,766	1,983	2,109	2,267
Equals headline cash balance	13,497	37,463	10,688	11,359	12,258

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

(b) The acquisition of assets under finance leases decreases the underlying cash balance. The disposal of assets previously held under finance leases increases the underlying cash balance.

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

Statement 2: Fiscal Outlook

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

	Estimates		Projections		
	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m
Opening net worth	-31,979	-24,026	-12,001	-2,330	8,783
Opening net worth adjustments(a)	-129	0	0	0	0
Adjusted opening net worth	-32,108	-24,026	-12,001	-2,330	8,783
Change in net worth from operating transactions	16,847	11,933	10,115	11,168	13,010
Change in net worth from other economic flows					
Revaluation of equity(b)	-6,561	1,711	1,399	1,515	1,607
Net writedowns of assets (including bad and doubtful debts)	-1,858	-2,071	-2,092	-1,854	-2,039
Assets recognised for the first time	8	26	18	19	30
Liabilities recognised for the first time	0	0	0	0	0
Actuarial revaluations	-1,716	0	0	0	0
Net foreign exchange gains	85	-1	0	0	0
Net swap interest received	138	110	86	74	58
Market valuation of debt	696	333	261	166	133
Other economic revaluations(c)	443	-17	-116	25	49
Total other economic flows	-8,765	93	-445	-55	-163
Closing net worth	-24,026	-12,001	-2,330	8,783	21,632

(a) Adjustments in opening net worth arise from a change in 2004-05 outcomes for the Australian Taxation Office and the Department of Defence and the impact of moving to new international accounting standards.

(b) Revaluations of equity reflects changes in the market valuation of commercial entities, including a change in the value of the Telstra shareholding which is valued at the average of the daily share price over a 90-day period in 2005-06 only. This line also reflects any revaluations at the point of disposal or sale.

(c) Largely reflects revaluation of assets and liabilities.

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

A guide to the sensitivity of the forward estimates of expenses and revenue due to variations in economic parameters in 2006-07 is provided in Table C1. It is important to note that the sensitivity analysis gives only a 'rule of thumb' indication of the impact on the budget of changes in prices, wages and other parameters. In each case, the analysis presents the estimated effects of a change in one economic variable only, and does not attempt to capture the linkages between economic variables that characterise changes in the economy more broadly.

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

	2006-07	2007-08	2008-09	2009-10
	\$m	\$m	\$m	\$m
Expenses				
Prices(a)	710	820	820	840
Wages	110	470	490	520
Unemployment benefit recipients	260	260	280	290
Revenue				
Prices	70	150	160	170
Wages	1,120	1,180	1,250	1,340
Employment	1,440	1,520	1,610	1,730
Private final demand	260	270	270	280
Profit	350	650	700	740

(a) A change in the methodology used to estimate liabilities under the Commonwealth Superannuation Scheme and the Public Sector Superannuation Scheme means these estimates are now less sensitive to short-term changes in the CPI, compared to the estimates shown in previous budget documents.

EXPENSES

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

Prices

All price growth rates are assumed to change by one percentage point in the September quarter 2006, and to remain unchanged subsequently, with all wage and salary growth rates left unchanged through the budget and forward years.

- The effect of a change in prices is due to the indexation of Australian Government expenses (which impacts more in the forward years than the budget year) and a one-off impact on the liabilities of the military superannuation schemes in 2006-07 (which in turn impacts on the superannuation interest expense).

Wages

All wage and salary growth rates are assumed to change by one percentage point in the September quarter 2006, and to remain unchanged subsequently, with all price growth rates left unchanged through the budget and forward years.

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

Unemployment Benefit recipients (Newstart Allowance and Unemployed Youth Allowance recipients)

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

REVENUE

Prices

All price deflators are assumed to change by one percentage point at the start of the September quarter 2006, with wage deflators left unchanged.

- A change in prices affects revenue primarily through changes in other excise.

Wages

All wage and salary growth rates are assumed to change by one percentage point from the beginning of the September quarter 2006, with price deflators left unchanged.

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

Employment

The level of employment is assumed to change by one percentage point from the beginning of the September quarter 2006, with no change in the composition of employment.

- A change in employment affects revenue through changes in gross income tax withholding.

Private final demand

The level of private final demand (consumption plus investment) is assumed to change by one percentage point from the beginning of the September quarter 2006, with no change in the composition of demand.

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

Profits

The level of company profits is assumed to change by one percentage point from the beginning of the September quarter 2006.

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

