STATEMENT 6: EXPENSES AND NET CAPITAL INVESTMENT

Statement 6 presents estimates of general government sector expenses and net capital investment, allocated according to the various functions of government, on a fiscal balance basis. These functions are based on an international standard classification of functions of government that is incorporated into the Government Finance Statistics (GFS) reporting framework.

The first part of this statement provides information on trends in estimated expenses while the second part presents trends in net capital investment estimates. Estimates are on an Australian Government general government sector basis.

Statement 6 focuses on short to medium term trends in estimated expenses and their underlying drivers. Consistent with this emphasis, much of Statement 6 explains year on year changes across the forward estimates period.

The main trends are:

- general government expenses as a percentage of GDP are forecast to decrease from 26.2 per cent in 2013-14 to 25.4 per cent in 2014-15, and then remain relatively stable over the forward estimates;
- in 2014-15 the social security and welfare, health, defence and education functions account for nearly two thirds of total expenses, with social security and welfare accounting for slightly more than one third of total expenses;
- in real terms, the strongest growth across the budget and forward estimates is expected to occur in the social security and welfare function; and
- net capital investment in 2014-15 largely reflects continued investment in defence capital projects.

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STATEMENT 6: EXPENSES AND NET CAPITAL INVESTMENT

OVERVIEW

Australian Government general government sector (GGS) accrual expenses are expected to decrease by 2.3 per cent in real terms in 2014-15, with the growth rate increasing to 2016-17 before decreasing in 2017-18. Total expenses are expected to decline as a percentage of GDP from 26.2 per cent in 2013-14 to 25.4 per cent in 2014-15, and then remain relatively stable over the forward estimates.

Table 1: Estimates of general government sector expenses

| | MYEFO | Revised | Estimate | | Projections | |
|----------------------|---------|---------|----------|---------|-------------|---------|
| | 2013-14 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| Total expenses (\$b) | 412.1 | 415.3 | 414.8 | 431.1 | 453.8 | 475.4 |
| Real growth on | | | | | | |
| previous year (%)(a) | 5.0 | 5.6 | -2.3 | 1.4 | 2.7 | 2.2 |
| Per cent of GDP | 26.1 | 26.2 | 25.4 | 25.2 | 25.3 | 25.3 |

(a) Real growth is calculated using the consumer price index.

As set out in Statement 3 of Budget Paper No. 1, the Government also reports spending on an underlying cash basis. When expressed in cash terms, Government spending is forecast to grow by an average of 0.8 per cent per annum in real terms over the four years to 2017-18.

Chart 1: Total spending as a percentage of GDP Per cent Per cent 30.0 30.0 28.0 28.0 26.0 26.0 24.0 24.0 22.0 22.0 20.0 20.0 18.0 18.0 16.0 16.0

Over the last seven years, total expenditure rose as a percentage of GDP from 24.8 per cent of GDP in 2007-08 to a forecast 26.2 per cent of GDP in 2013-14. Over the

forward estimates, expenses are expected to decline to 25.3 per cent of GDP in 2017-18 (see Chart 1).

Table 2 provides a reconciliation of expense estimates between the 2013-14 Budget, the *Pre-election Economic and Fiscal Outlook* 2013 (PEFO), the *Mid-Year Economic and Fiscal Outlook* 2013-14 (MYEFO) and the 2014-15 Budget showing the effect of policy decisions, and economic parameter and other variations.

Table 2: Reconciliation of expense estimates

| · · | | Estimates | | Projections | |
|--|---------|-----------|---------|-------------|-----------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | Total |
| | \$m | \$m | \$m | \$m | \$m |
| 2013-14 Budget expenses | 398,301 | 415,663 | 431,015 | 454,747 | 1,699,726 |
| Changes from 2013-14 Budget to 2013 PEFO | | | | | |
| Effect of policy decisions(a) | 1,134 | -1,628 | -1,565 | -2,303 | -4,362 |
| Effect of parameter and other variations | 2,050 | 1,950 | 1,461 | 2,092 | 7,554 |
| Total variations | 3,184 | 322 | -103 | -211 | 3,191 |
| 2013 PEFO expenses | 401,485 | 415,985 | 430,911 | 454,536 | 1,702,917 |
| Changes from 2013 PEFO to 2013-14 MYEFO | | | | | |
| Effect of policy decisions(a) | 7,710 | -1,996 | -3,014 | -6,467 | -3,767 |
| Effect of parameter and other variations | 2,864 | 3,769 | 8,121 | 9,042 | 23,796 |
| Total variations | 10,574 | 1,773 | 5,108 | 2,574 | 20,030 |
| 2013-14 MYEFO expenses | 412,060 | 417,758 | 436,019 | 457,110 | 1,722,947 |
| Changes from 2013-14 MYEFO to 2014-15 Budg | jet | | | | |
| Effect of policy decisions(a) | 51 | -1,939 | -5,498 | -7,688 | -15,075 |
| Effect of economic parameter variations | | | | | |
| Total economic parameter variations | 784 | 1,323 | 1,506 | 774 | 4,388 |
| Unemployment benefits | 4 | 17 | 295 | 32 | 348 |
| Prices and wages | 32 | 211 | -85 | -812 | -654 |
| Interest and exchange rates | 8 | 85 | 57 | 54 | 204 |
| GST payments to the States | 740 | 1,010 | 1,240 | 1,500 | 4,490 |
| Public debt interest | -15 | -247 | -608 | -872 | -1,741 |
| Programme specific parameter variations | 601 | 327 | 468 | 915 | 2,311 |
| Slippage in decisions | 0 | 0 | 0 | 0 | 0 |
| Other variations | 1,813 | -2,378 | -770 | 3,567 | 2,232 |
| Total variations | 3,235 | -2,914 | -4,901 | -3,304 | -7,884 |
| 2014-15 Budget expenses | 415,294 | 414,845 | 431,118 | 453,806 | 1,715,063 |

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

The Government has made policy decisions which reduce expenses by \$15.1 billion over the four years from 2013-14 to 2016-17 compared to the 2013-14 MYEFO, while programme specific parameter variations have increased expenses by \$2.3 billion over the same period. Economic parameter variations are expected to increase expenses by \$4.4 billion over the four years from 2013-14 to 2016-17 compared to the 2013-14 MYEFO. Public debt interest is estimated to decrease by \$1.7 billion compared to the 2013-14 MYEFO.

Estimated expenses by function

Table 3 sets out the estimates of Australian Government GGS expenses by function for the period 2013-14 to 2017-18.

Table 3: Estimates of expenses by function

| | | Estimates | Projections | | |
|--|---------|-----------|-------------|---------|---------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| General public services | 34,151 | 23,185 | 22,752 | 23,357 | 23,051 |
| Defence | 22,840 | 24,197 | 25,249 | 25,719 | 27,632 |
| Public order and safety | 4,446 | 4,389 | 4,098 | 4,054 | 4,051 |
| Education | 29,707 | 29,553 | 30,206 | 31,843 | 32,788 |
| Health | 64,511 | 66,892 | 68,203 | 71,797 | 74,856 |
| Social security and welfare | 140,569 | 145,773 | 149,269 | 158,370 | 169,585 |
| Housing and community amenities | 8,383 | 4,835 | 4,902 | 5,026 | 5,105 |
| Recreation and culture | 3,725 | 3,512 | 3,360 | 3,385 | 3,343 |
| Fuel and energy | 7,047 | 7,058 | 7,172 | 7,439 | 7,836 |
| Agriculture, forestry and fishing | 2,629 | 2,752 | 2,868 | 2,642 | 2,565 |
| Mining, manufacturing and construction | 3,139 | 2,740 | 2,580 | 2,595 | 2,504 |
| Transport and communication | 8,495 | 7,286 | 9,697 | 10,949 | 7,469 |
| Other economic affairs | 11,263 | 10,670 | 10,366 | 9,646 | 9,485 |
| Other purposes | 74,388 | 82,002 | 90,395 | 96,984 | 105,178 |
| Total expenses | 415,294 | 414,845 | 431,118 | 453,806 | 475,447 |

Major expense trends between 2013-14 and 2014-15, and from 2014-15 over the forward years include movements in the following functions:

- **general public services** the decrease in expenses between 2013-14 and 2014-15 is primarily due to a one-off grant provided to the Reserve Bank of Australia. The grant took the Reserve Bank Reserve Fund to 15 per cent of assets at risk, which ensures the bank has all of the resources available to operate in a volatile environment. In the normal course of events, the bank would be profitable, enabling the Government to receive future dividends. From 2014-15 to 2017-18 expenses in the general public services function are estimated to remain relatively stable;
- defence the increase in expenses from 2014-15 to 2017-18 reflects the Government's commitment to recapitalise Defence and put its funding back on an achievable and realistic growth path towards 2 per cent as a share of GDP by 2023-24. The increase is partially offset by the Government shifting funding within the Defence budget away from expenses in favour of capital expenditure, to improve defence capability;
- **education** the increase in expenses from 2014-15 to 2017-18 largely reflects the Government's *Students First* school education policy. Further information on *Students First* can be found in Budget Paper No. 2, *Budget Measures* and the *Mid-Year Economic and Fiscal Outlook* 2013-14;

- health the increase in expenses from 2014-15 to 2017-18 is driven by a range of programmes within the Medical Services and Benefits, Pharmaceutical Benefits and Services and Assistance to the States for public hospitals sub-functions. Higher demand for health services, and a growing and ageing population, continue to be significant drivers of increasing health costs;
- social security and welfare the increase in expenses from 2014-15 to 2017-18 are largely due to an ageing population with more people accessing age, disability and carer payments and residential and home care together with implementation of the National Disability Insurance Scheme to support people with a significant and permanent disability;
- housing and community amenities the decrease in expenses between 2013-14 and 2014-15 is primarily due to the termination of various programmes as part of the abolition of the carbon tax, including the Jobs and Competitiveness Programme, Energy Security Fund and the Biodiversity Fund;
- transport and communication the fluctuating profile of expenses from 2014-15 to 2017-18 are largely driven by infrastructure projects within the Rail Transport and Road Transport sub-functions where the value of projects funded varies year on year, and payments correspond to project timelines; and
- **other purposes** the increase in expenses from 2014-15 to 2017-18 primarily reflects growing general revenue assistance payments (largely GST) to be made to the States and Territories, increasing public debt interest costs and the conservative bias allowance component of the Contingency Reserve.

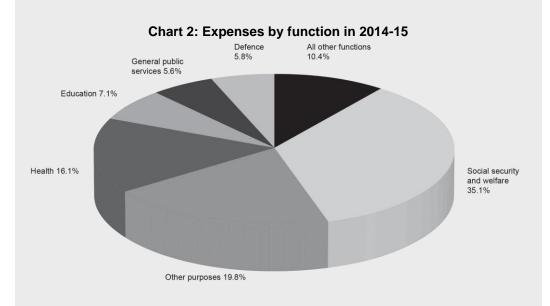
Government expenses are strongly influenced by underlying trends in spending in the social security and welfare, health and education functions (see Boxes 1 and 2). Together, these functions account for 58.4 per cent of all government expenses in 2014-15. Further details of spending trends against all functions including movements in expenses from 2013-14 to 2014-15 are set out under individual function headings.

Box 1: Where does government spending go in 2014-15?

Government spending provides a wide range of services to the community. The most significant component of government spending relates to social security and welfare, with around one third of total expenses providing support to the aged, families with children, people with disabilities, veterans, carers and unemployed people.

Another one sixth of government expenses occur in health, including Medicare Benefits Schedule (MBS) and Pharmaceutical Benefits Scheme (PBS) payments. A similar amount is also transferred to the States and Territories in general revenue assistance under the other purposes function.

The Government also provides significant investment under the education function, supporting government and non-government schools, as well as higher education and vocational education and training. The remainder is spent on defence and a range of other public services.

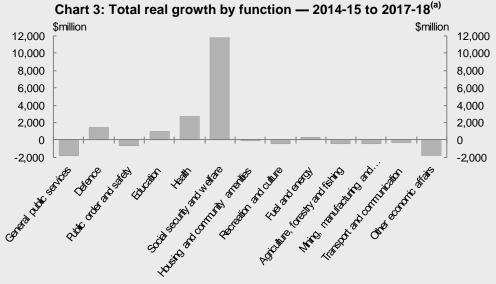


The estimates presented in the chart above are explained in greater detail under each individual function in the following pages.

Box 2: Trends in future spending

Social security and welfare expenses are projected to grow strongly over the forward estimates. Key factors driving this include age, disability and carer payments and an increase in expenses associated with home care, home support, and residential and flexible aged care programmes, with demographic factors resulting in an increase in the number of people receiving these payments. Another driver of growth is the implementation of the National Disability Insurance Scheme.

A number of major health programmes will continue to see expenditure growth, including the MBS, the Private Health Insurance Rebate, and payments to the States and Territories for public hospital services. Spending on health is influenced by population growth and to some extent by the ageing of the population together with developments in health technology and the resulting use of new products and services.



(a) The other purposes function is not included in this chart as it contains expenses for general revenue assistance to the State and Territory governments (primarily GST), public debt interest, and the conservative bias allowance.

Programme expenses

Table 3.1 reports the top 20 expense programmes in the 2014-15 financial year. These programmes represent approximately two thirds of total expenses in that year. More than half of the top 20 expense programmes provide financial assistance or services to seniors, families, people with a disability, students, carers and the unemployed.

Table 3.1: Top 20 programmes by expenses in 2014-15

| | | | Estimates | | Projecti | ions |
|----------------------------|--------------|---------|-----------|---------|----------|---------|
| | - | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| Programme | Function | \$m | \$m | \$m | \$m | \$m |
| Revenue assistance | | | | | | |
| to the States and | Other | | | | | |
| Territories | purposes | 52,056 | 54,861 | 58,165 | 61,598 | 64,909 |
| Income support for seniors | SSW | 39,501 | 42,085 | 44,658 | 47,583 | 49,665 |
| Medicare services | Health | 19,334 | 20,317 | 20,176 | 21,480 | 22,647 |
| Family tax benefit | SSW | 20,125 | 19,270 | 17,645 | 17,650 | 16,861 |
| Income Support for | | | | | | |
| People with Disability | SSW | 16,098 | 16,891 | 17,354 | 17,940 | 18,500 |
| Assistance to the States | | | | | | |
| for public hospitals(a) | Health | 13,845 | 15,116 | 16,551 | 18,095 | 18,872 |
| Job seeker income | | | | | | |
| support | SSW | 10,226 | 10,233 | 10,571 | 10,687 | 10,610 |
| Residential and flexible | | | | | | |
| care | SSW | 8,978 | 9,547 | 10,065 | 10,610 | 11,244 |
| Pharmaceuticals and | | | | | | |
| pharmaceutical services | Health | 9,455 | 9,445 | 9,607 | 10,110 | 10,467 |
| Non government | | | | | | |
| schools - national | | | | | | |
| support | Education | 8,764 | 9,260 | 9,957 | 10,685 | 11,277 |
| Income support for carers | SSW | 6,983 | 7,631 | 8,266 | 9,000 | 9,769 |
| Public sector | Other purpos | ses; | | | | |
| superannuation(b) | General p | ublic | | | | |
| | services | 8,225 | 7,549 | 7,696 | 7,847 | 8,007 |
| Commonwealth Grants | | | | | | |
| Scheme | Education | 6,222 | 6,479 | 6,566 | 6,583 | 6,709 |
| Private health insurance | Health | 5,997 | 6,302 | 6,565 | 6,873 | 7,187 |
| Fuel tax credits scheme | Fuel and | | | | | |
| | energy | 5,823 | 6,270 | 6,822 | 7,211 | 7,615 |
| Management of | | | | | | |
| Capability Acquisition | Defence | 4,268 | 6,225 | 6,781 | 6,205 | 7,373 |
| Army capabilities | Defence | 5,762 | 6,031 | 6,327 | 6,246 | 6,319 |
| Management of | | | | | | |
| capability sustainment | Defence | 5,366 | 5,939 | 6,244 | 6,531 | 6,841 |
| Parents' income support | SSW | 5,526 | 5,341 | 5,392 | 5,408 | 5,389 |
| Government Schools | | | | | | |
| National Support | Education | 2,408 | 5,114 | 5,689 | 6,348 | 6,872 |
| Sub-total | _ | 254,962 | 269,906 | 281,097 | 294,690 | 307,133 |
| Other programmes | = | 160,332 | 144,939 | 150,021 | 159,116 | 168,314 |
| Total expenses | = | 415,294 | 414,845 | 431,118 | 453,806 | 475,447 |

⁽a) Estimates for the Assistance to the States for healthcare services programme have moved to the Assistance to the States for public hospitals programme starting 2017-18.

⁽b) This programme is a combination of the public sector superannuation nominal interest and benefits programmes.

General government sector expenses

General public services

The general public services function includes expenses to support the organisation and operation of government such as those related to the Parliament, the Governor-General and conduct of elections; the collection of taxes and management of public funds and debt; assistance to developing countries to reduce poverty and achieve sustainable development, particularly countries in the Pacific region; contributions to international organisations; and the operations of the foreign service. It also includes expenses related to research in areas not otherwise connected with a specific function, and those associated with overall economic and statistical services as well as government superannuation benefits (excluding nominal interest expenses on unfunded liabilities which are included under the nominal superannuation interest sub-function in the other purposes function).

Table 4: Summary of expenses — general public services

| | | Estimates | | | Projections | | |
|------------------------------------|---------|-----------|---------|---------|-------------|--|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | | |
| | \$m | \$m | \$m | \$m | \$m | | |
| Legislative and executive affairs | 1,334 | 1,191 | 1,015 | 1,222 | 1,045 | | |
| Financial and fiscal affairs | 17,652 | 8,513 | 8,585 | 8,797 | 8,799 | | |
| Foreign affairs and economic aid | 6,060 | 6,299 | 6,125 | 6,704 | 6,733 | | |
| General research | 2,724 | 2,651 | 2,554 | 2,343 | 2,387 | | |
| General services | 714 | 821 | 757 | 773 | 797 | | |
| Government superannuation benefits | 5,667 | 3,709 | 3,715 | 3,516 | 3,290 | | |
| Total general public services | 34,151 | 23,185 | 22,752 | 23,357 | 23,051 | | |

Total general public services expenses are estimated to decrease by 33.6 per cent in real terms from 2013-14 to 2014-15, and decrease by 7.7 per cent in real terms over the period 2014-15 to 2017-18.

The uneven profile of expenses under the **legislative and executive affairs** sub-function partly reflects costs that will be incurred by the Australian Electoral Commission to support the scheduled federal election in 2016-17 and costs incurred by the Department of the Prime Minister and Cabinet due to Australia hosting the Group of 20 in 2014.

Expenses in the **financial and fiscal affairs** sub-function are expected to decrease from 2013-14 to 2014-15, primarily due to a one-off grant provided to the Reserve Bank of Australia. Over the forward estimates, bad and doubtful debts expenses are expected to increase in line with the normal growth in taxation revenue over the forward estimates.

The fall in expenses from 2013-14 to 2014-15 in the **government superannuation benefits** sub-function reflects the use of different discount rates. The superannuation expenses for 2013-14 apply a discount rate based on long-term government bonds at the commencement of the financial year (4.3 per cent) in accordance with accounting

standards. Forward years are estimated based on the discount rate applied by the superannuation scheme actuaries in preparing long term cost reports (6 per cent).

Table 4.1: Trends in the major components of foreign affairs and economic aid sub-function expenses

| | | Estimates | | Projections | |
|---|---------|-----------|---------|-------------|---------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| Official development assistance(a)(b) | 4,375 | 4,530 | 4,458 | 5,046 | 5,104 |
| Africa, South and Central Asia, Middle East | | | | | |
| and other | 881 | 1,131 | 1,081 | 1,124 | 1,440 |
| East Asia | 1,022 | 1,063 | 1,091 | 1,118 | 1,145 |
| PNG and Pacific | 882 | 967 | 1,017 | 1,045 | 1,082 |
| Emergency, humanitarian and | | | | | |
| refugee programmes | 264 | 339 | 350 | 362 | 374 |
| UN, Commonwealth and other | | | | | |
| international organisations | 369 | 344 | 343 | 421 | 425 |
| Multilateral replenishments | 265 | 118 | - | 377 | 13 |
| NGO, Volunteer and community programmes | 199 | 204 | 209 | 214 | 219 |
| Programme Support(c) | 362 | 240 | 237 | 252 | 271 |
| International agricultural research | | | | | |
| and development | 131 | 124 | 130 | 133 | 135 |
| International police assistance | 279 | 259 | 228 | 213 | 150 |
| Passport services | 239 | 253 | 263 | 256 | 258 |
| Diplomacy(d) | 759 | 854 | 766 | 745 | 760 |
| Payments to international organisations | 300 | 299 | 299 | 303 | 309 |
| Consular services | 66 | 75 | 74 | 74 | 74 |
| Finance and insurance services for Australian | | | | | |
| exporters and investors | 24 | 22 | 20 | 15 | 17 |
| Other | 18 | 7 | 17 | 52 | 61 |
| Total | 6,060 | 6,299 | 6,125 | 6,704 | 6,733 |

⁽a) The difference between these figures and the Government's ODA budget is partly due to the way replenishments are recognised in accrual terms when initial commitments are made. However, international reporting of ODA is in cash terms and reflects the timing of actual cash payments (which, in the case of multilateral replenishments, can be spread over several years).

⁽b) Some ODA delivered by other government departments is also classified to other programmes or functions.

⁽c) Programme Support includes departmental expenses of administering ODA for the Department of Foreign Affairs and Trade.

⁽d) Diplomacy includes Departmental expenditure for the Department of Foreign Affairs and Trade's Operations, Security and IT, overseas property and international climate change engagement.

Box 3: Official Development Assistance

The Government will maintain official development assistance (ODA) spending at its nominal 2013-14 level of \$5.0 billion in each of 2014-15 and 2015-16. From 2016-17 ODA will grow in line with the Consumer Price Index.

Table 4.2: Official development assistance profile

| | | Estimates | | | Projections | | |
|---------------------------------|---------|-----------|---------|---------|-------------|--|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | | |
| | \$m | \$m | \$m | \$m | \$m | | |
| Official development assistance | | | | | | | |
| - total spending estimate | 5,032 | 5,032 | 5,034 | 5,160 | 5,289 | | |

ODA spending reported internationally differs from the reporting in Table 4.1 due to some ODA eligible activities of government departments outside of the Foreign Affairs Portfolio being reported in other functions, and due to accounting differences in the treatment of investments and loans and reflects the timing of actual cash payments.

Total expenses under the **foreign affairs and economic aid** sub-function are expected to increase by 1.7 per cent in real terms from 2013-14 to 2014-15 and are forecast to decrease by 0.7 per cent in real terms across the forward years from 2014-15.

This decrease is due to the Government's decision to maintain official development assistance (ODA) expenditure at 2013-14 levels to 2015-16 with funding to grow in line with Consumer Price Index (CPI) from 2016-17 onwards. Budget Paper No. 2, *Budget Measures* 2014-15, contains further details on the Government's revision to the growth profile for ODA (see Box 3).

The **general research** sub-function incorporates expenses incurred by the Commonwealth Scientific and Industrial Research Organisation (CSIRO), the Australian Nuclear Science and Technology Organisation (ANSTO), the Australian Institute of Marine Science (AIMS) and the Australian Research Council (ARC).

Total expenses under this sub-function are expected to decrease in real terms by 4.8 per cent from 2013-14 to 2014-15 and by 16.4 per cent across the forward estimates from 2014-15. This decrease is driven by the completion of a number of one-off projects funded under the Education Investment Fund, and the measure *Science and Research Agencies – reduced funding*.

The table below sets out the major components of general research sub-function expenses.

Table 4.3: Trends in the major components of general research sub-function expenses

| expenses | | | | | |
|--|-----------|---------|---------|-------------|---------|
| | Estimates | | | Projections | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| National research flagships, science | | | | | |
| and services | 1,059 | 1,024 | 1,010 | 1,003 | 1,025 |
| Discovery - research and research training | 559 | 551 | 519 | 495 | 523 |
| Linkage - cross sector research partnerships | 330 | 327 | 278 | 266 | 273 |
| Science and technology solutions | 284 | 290 | 283 | 279 | 275 |
| National Research Infrastructure - | 111 | 143 | 150 | 164 | 164 |
| national facilities and collections | | | | | |
| Other | 382 | 316 | 315 | 135 | 128 |
| Total | 2,724 | 2,651 | 2,554 | 2,343 | 2,387 |

Defence

The defence function includes expenses incurred by the Department of Defence (Defence), the Defence Materiel Organisation (DMO) and related agencies. Defence expenses support Australian military operations overseas and the delivery of navy, army, air and intelligence capabilities and strategic policy advice in the defence of Australia and its national interests. The DMO contributes to the preparedness of the Australian defence organisation through the acquisition and through-life support of military equipment and supplies.

This function records the majority of expenses incurred by the defence portfolio but does not include the expenses incurred by the Department of Veterans' Affairs, superannuation payments to retired military personnel and housing assistance provided through Defence Housing Australia. These expenses are reported in the social security and welfare, other purposes, and housing and community amenities functions, respectively.

Table 5: Summary of expenses — defence

| | | Estimates | | | Projections | | |
|---------------|---------|-----------|---------|---------|-------------|--|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | | |
| | \$m | \$m | \$m | \$m | \$m | | |
| Defence | 22,840 | 24,197 | 25,249 | 25,719 | 27,632 | | |
| Total defence | 22,840 | 24,197 | 25,249 | 25,719 | 27,632 | | |

Total expenses for the defence function are estimated to increase by 3.7 per cent in real terms from 2013-14 to 2014-15, and increase by 6.1 per cent in real terms over the period 2014-15 to 2017-18. While the increase in expenses from 2014-15 to 2017-18 in part reflects new policy decisions which provide defence additional funding, this is partially offset by a shift in funding within the Defence budget away from expenses in favour of capital expenditure, to improve defence capability (see Box 4 showing expenses and net capital investment).

To this end, the Government will achieve savings of \$1.2 billion over four years through various initiatives to increase efficiency and reduce spending in lower priority areas. The savings will be re-invested in capital to support Defence capability.

The funding growth does not include the full cost of operations beyond 2014-15 as such funding is considered on a year-by-year basis and is subject to future Government decisions. In 2014-15, additional funding of \$194.0 million will be provided to support Defence operations in the Middle East and in protecting Australia's borders.

Box 4: Defence funding

Total Defence spending is estimated to increase by \$4.0 billion (or 6.4 per cent in real terms) between 2014-15 and 2017-18. This includes both expenses and net capital investment. Expenses for the defence function are those incurred in undertaking day-to-day activities. Net capital investment represents expenditure to acquire capital items in the form of equipment, buildings and land, less depreciation expenses.

Table 5.1: Trends in the major components of defence function expenses and net capital investment

| | | Estimates | Projections | | |
|---------------------------|---------|-----------|-------------|---------|---------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| Expenses | 22,840 | 24,197 | 25,249 | 25,719 | 27,632 |
| Net capital investment | 2,825 | 3,315 | 3,219 | 2,883 | 3,892 |
| Total defence spending | 25,665 | 27,512 | 28,468 | 28,602 | 31,524 |
| Nominal growth (per cent) | 11.7% | 7.2% | 3.5% | 0.5% | 10.2% |
| Real growth (per cent) | 0.7% | 4.9% | 1.0% | -2.0% | 7.5% |

Capital funding in the defence function is applied towards the acquisition of military equipment, enabling services and the construction of support facilities linked to capability. Fluctuations in capital spending can be due to slippage in expenditure from one year to the next year, foreign exchange rate fluctuations and additional funding decisions of Government.

Public order and safety

The public order and safety function includes expenses to support the administration of the federal legal system and the provision of legal services, including legal aid, to the community. Public order and safety expenses also include law enforcement and intelligence activities, and the protection of Australian Government property.

Table 6: Summary of expenses — public order and safety

| | | Estimates | Projections | | |
|-------------------------------|---------|-------------------------|-------------|---------|---------|
| | 2013-14 | 2013-14 2014-15 2015-16 | | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| Courts and legal services | 1,080 | 1,043 | 957 | 871 | 882 |
| Other public order and safety | 3,366 | 3,346 | 3,141 | 3,184 | 3,168 |
| Total public order and safety | 4,446 | 4,389 | 4,098 | 4,054 | 4,051 |

Total expenses for the **public order and safety function** are estimated to decrease by 3.4 per cent in real terms from 2013-14 to 2014-15, and by 14.3 per cent in real terms over the period 2014-15 to 2017-18.

Expenses within the **courts and legal services sub-function** are expected to decrease by 21.5 per cent in real terms from 2014-15 over the forward years, and by 5.5 per cent in real terms from 2013-14 to 2014-15. This is largely due to the expected completion of the three established Royal Commissions over the next three years.

Expenses within the **other public order and safety sub-function** are expected to decrease by 12.1 per cent in real terms from 2014-15 over the forward years, and by 2.7 per cent in real terms from 2013-14 to 2014-15. This is largely due to the cessation of a number of temporary measures as well as recent efficiency measures which have reduced departmental resourcing. Further information is contained in the measures Australian Federal Police officers — cessation of recruitment and Australian Federal Police — savings from efficiencies (see Budget Paper No. 2, Budget Measures 2014-15). This impact has been partially offset by additional funding provided to the Australian Customs and Border Protection Service to reform border protection services.

Education

The education function includes expenses to support the delivery of education services through higher education institutions; vocational education and training providers (including technical and further education institutions); and government (State and Territory) and non-government primary and secondary schools.

Table 7: Summary of expenses — education

| | | Estimates | | | tions |
|-------------------------------------|---------|-----------|---------|---------|---------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| Higher education | 8,970 | 9,223 | 9,274 | 9,282 | 9,465 |
| Vocational and other education | 1,766 | 1,824 | 1,837 | 2,003 | 1,515 |
| Schools | 13,567 | 14,374 | 15,646 | 17,032 | 18,149 |
| Non-government schools | 8,764 | 9,260 | 9,957 | 10,685 | 11,277 |
| Government schools | 4,803 | 5,114 | 5,689 | 6,348 | 6,872 |
| School education - specific funding | 1,151 | 734 | 282 | 194 | 163 |
| Student assistance | 3,998 | 3,338 | 3,110 | 3,264 | 3,431 |
| General administration | 255 | 61 | 56 | 67 | 65 |
| Total education | 29,707 | 29,553 | 30,206 | 31,843 | 32,788 |

Total education expenses are expected to decrease by 2.7 per cent in real terms between 2013-14 and 2014-15 and increase by 3.1 per cent in real terms from 2014-15 to 2017-18.

The major components of the higher education sub-function are set out in Table 7.1.

Table 7.1: Trends in the major components of the higher education sub-function expenses

| | | Estimates | | | Projections | | |
|---------------------------|---------|-----------|---------|---------|-------------|--|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | | |
| | \$m | \$m | \$m | \$m | \$m | | |
| Commonwealth Grant Scheme | 6,222 | 6,479 | 6,566 | 6,583 | 6,709 | | |
| Investment in Higher | | | | | | | |
| Education Research | 1,726 | 1,756 | 1,800 | 1,852 | 1,898 | | |
| Higher Education Support | 536 | 576 | 492 | 427 | 433 | | |
| University Superannuation | | | | | | | |
| Programme(a) | 289 | 324 | 332 | 340 | 349 | | |
| Other | 198 | 88 | 84 | 79 | 76 | | |
| Total | 8,970 | 9,223 | 9,274 | 9,282 | 9,465 | | |

⁽a) This does not include the 2014-15 Budget measure which is not for publication.

Expenses under the **higher education** sub-function are expected to increase by 0.6 per cent in real terms from 2013-14 to 2014-15, and decrease by 4.7 per cent in real terms from 2014-15 to 2017-18. The increase in expenses from 2013-14 to 2014-15 is due to growth in projected enrolments. The expected decrease from 2014-15 is mainly due to the implementation of the *Expanding opportunity – expansion of the demand driven* system and sharing the cost fairly measure from 2016, which allows higher education

providers to set their own course fees and a reduction in subsidies provided under the Commonwealth Grant Scheme.

Expenses under the **vocational and other education** sub-function are estimated to increase by 1.1 per cent in real terms between 2013-14 and 2014-15, and decrease by 22.9 per cent in real terms from 2014-15 to 2017-18. The forecast decline in expenses over the forward estimates is due to the conclusion of funding under the Skills Reform National Partnership Agreement in 2016-17.

Aggregate school funding expenses are expected to increase by 3.7 per cent in real terms between 2013-14 and 2014-15 and by 17.3 per cent in real terms from 2014-15 to 2017-18 reflecting the Government's *Students First* school education policy. Slower growth in 2017-18 reflects the Government's commitment to put school funding on a more sustainable footing. From 2018, school funding will be indexed by the Consumer Price Index, with an allowance for changes in enrolments, to maintain the real level of Australian Government school funding.

Expenses in the **schools** — **non-government schools** sub-function are expected to increase by 3.4 per cent in real terms between 2013-14 and 2014-15 and by 13.1 per cent in real terms from 2014-15 to 2017-18. Expenses under the **schools** — **government schools** sub-function are expected to increase by 4.2 per cent in real terms between 2013-14 and 2014-15 and by 24.8 per cent in real terms from 2014-15 to 2017-18.

Expenses under the **student assistance** sub-function are expected to decrease by 18.3 per cent in real terms from 2013-14 to 2014-15, and by 4.5 per cent in real terms from 2014-15 to 2017-18. The decrease in 2014-15 is primarily due to recent changes in tertiary student assistance including the removal of grandfathering of recipients of the Student Start-up Scholarship from 1 July 2015.

Expenses under the Higher Education Loan Program (HELP) mainly reflect the estimated cost to the Government of providing concessional loans. These expenses are recorded when loans are issued and are based on projections of future interest rates. These expenses are expected to reduce in 2014-15 and be removed from 2015-16 onwards as a result of the Government's decision to change the indexation arrangements for debts from the Consumer Price Index to a rate equivalent to the yields on 10 year Australian Government bonds from 1 June 2016. The remaining expenses relate to the write down of debts.

Health

The health function includes expenses relating to medical services funded through Medicare and the Private Health Insurance Rebate; payments to the States and Territories to deliver essential health services, including public hospitals; the Pharmaceutical Benefits and Repatriation Pharmaceutical Benefits Schemes; Aboriginal and Torres Strait Islander health programmes; Mental Health services; and health workforce initiatives.

In addition to these expenses, the Government is creating a Medical Research Future Fund (MRFF) from 1 January 2015 to provide a sustainable and growing funding stream to be invested in additional medical research in the medium to long term.

Table 8: Summary of expenses — health

| | Estimates | | | Projections | | |
|--|-----------|---------|---------|-------------|---------|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | |
| | \$m | \$m | \$m | \$m | \$m | |
| Medical services and benefits | 26,390 | 28,227 | 28,384 | 29,982 | 31,442 | |
| Pharmaceutical benefits and services | 10,519 | 10,547 | 10,693 | 11,209 | 11,589 | |
| Assistance to the States for public hospitals(a) | 13,845 | 15,116 | 16,551 | 18,095 | 18,872 | |
| Hospital services(b) | 2,844 | 1,950 | 1,777 | 1,686 | 1,705 | |
| Health services | 6,839 | 7,109 | 6,794 | 6,749 | 7,040 | |
| General administration | 3,274 | 3,214 | 3,254 | 3,257 | 3,300 | |
| Aboriginal and Torres Strait Islander health | 800 | 730 | 749 | 818 | 908 | |
| Total health | 64,511 | 66,892 | 68,203 | 71,797 | 74,856 | |

⁽a) The name of this sub-function has changed from the 'National Health Reform Payment' to the 'Assistance to the States for public hospitals'.

Total expenses for this function are estimated to increase by 1.5 per cent in real terms between 2013-14 and 2014-15. Total expenses are estimated to increase by 3.9 per cent in real terms from 2014-15 to 2017-18. This expected growth is driven by higher demand for health services, and a growing and ageing population.

The **medical services and benefits** sub-function, which primarily consists of Medicare and Private Health Insurance Rebate (PHIR) expenses, is 42.2 per cent of total estimated health expenses for 2014-15. Medicare expenses are the major driver of growth in this sub-function. Expenses for Medicare are expected to increase by 2.8 per cent in real terms between 2013-14 and 2014-15. The fall in expenses of 3.1 per cent in real terms from 2014-15 to 2015-16 largely reflects the impact of the Government's decisions to strengthen and improve the sustainability of Medicare. Expenses are still expected to grow by 3.5 per cent in real terms over the period 2014-15 to 2017-18, as a result of ongoing growth in the use of medical services and in the use of high value items on the Medicare Benefits Schedule.

⁽b) The hospital services sub-function includes payments from the Commonwealth to the States and Territories for specific hospital improvement initiatives and is in addition to the bulk of hospital funding provided under the former National Health Reform Payment sub-function (now called the 'Assistance to the States for public hospitals' sub-function).

Expenses for PHIR are expected to increase by 2.8 per cent in real terms between 2013-14 and 2014-15, and are expected to grow by 5.9 per cent in real terms over the period 2014-15 to 2017-18 due to forecast continued take up of private health insurance policies. The proportion of Australians with some form of private health insurance is now around 55 per cent, providing a high level of access to private health services and taking pressure off the public system.

Expenses for dental services are expected to grow by 3.0 per cent in real terms over the period 2014-15 to 2017-18, due to the expansion of dental services in the public dental system. Expenses for this activity had not previously been identified separately, but were included in the Medicare Services component of this sub-function.

The major components of the medical services and benefits sub-function are set out in Table 8.1.

Table 8.1: Trends in the major components of medical services and benefits sub-function expenses^(a)

| | Estimates | | | Projections | | |
|--|-----------|---------|---------|-------------|---------|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | |
| | \$m | \$m | \$m | \$m | \$m | |
| Medicare services | 19,334 | 20,317 | 20,176 | 21,480 | 22,647 | |
| Private health insurance | 5,997 | 6,302 | 6,565 | 6,873 | 7,187 | |
| General medical consultations and services | 902 | 879 | 860 | 845 | 832 | |
| Dental services(a) | 0 | 600 | 620 | 638 | 665 | |
| Other | 157 | 129 | 163 | 147 | 111 | |
| Total | 26,390 | 28,227 | 28,384 | 29,982 | 31,442 | |

 ⁽a) Dental services sub function data has previously been included as part of Medicare Services and has not been separately identified.

The **pharmaceutical benefits and services** sub-function is expected to decrease by 1.9 per cent in real terms between 2013-14 and 2014-15 due largely to the current price disclosure policy which requires manufacturers to disclose to the Government the actual price at which they sell medicines to wholesalers and pharmacies. Expenses are expected to grow by 2.1 per cent in real terms over the period 2014-15 to 2017-18. Estimates for the Pharmaceutical Benefits Scheme (PBS) do not include the potential listing of new drugs or price adjustments to existing drugs, which typically increase spending above original estimates.

The major components of the pharmaceutical benefits and services sub-function are set out in Table 8.2.

Table 8.2: Trends in the major components of pharmaceutical benefits and services sub-function expenses

| | | Estimates | | Projec | tions |
|---|---------|-----------|---------|---------|---------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| Pharmaceutical benefits (concessional)(a) | 5,641 | 5,512 | 5,564 | 5,852 | 6,040 |
| Pharmaceutical benefits (general)(b) | 1,410 | 1,378 | 1,391 | 1,463 | 1,510 |
| Pharmaceutical benefits (highly specialised | | | | | |
| and other drugs dispensed in hospitals)(c) | 2,208 | 2,358 | 2,452 | 2,595 | 2,715 |
| Pharmaceutical benefits - targeted medicine | | | | | |
| programmes(d) | 138 | 148 | 154 | 158 | 163 |
| Immunisation | 156 | 154 | 159 | 160 | 164 |
| Veterans' pharmaceutical benefits | 406 | 390 | 368 | 376 | 390 |
| Payments for wholesalers and pharmacy | | | | | |
| programmes | 368 | 406 | 402 | 401 | 401 |
| Other | 192 | 201 | 204 | 204 | 206 |
| Total | 10,519 | 10,547 | 10,693 | 11,209 | 11,589 |

- (a) Concessional benefits are those provided through community pharmacies for Pensioner Concession Card holders, Health Care Card holders and Veterans with a White, Gold or Orange card.
- (b) General benefits are those provided through community pharmacies for people without concession cards.
- (c) Highly specialised drugs are subsidised by the Australian Government through hospitals.
- (d) Targeted medicine programmes include the life saving drugs programme and Herceptin Programme.

The Australian Government's contribution to public hospital funding is reported through the **Assistance to the States for public hospitals** sub-function. Hospital services covered by this sub-function include all admitted services, programmes that deliver hospital services in the home and emergency department services. The increase in expenses of 6.8 per cent in real terms from 2013-14 to 2014-15 reflects the Commonwealth's commitment to provide additional hospital funding from 2014-15 under current agreements with the States. The increase in expenses of 14.0 per cent in real terms over the period 2014-15 to 2016-17 largely reflects growth in the volume of services and changes in the efficient price of those services. The rate of growth in the expenses slows to around 1.8 per cent in real terms between 2016-17 and 2017-18 due to the Government's decision to put hospital funding on a more sustainable footing and to index hospital funding from 1 July 2017 by a combination of population growth and the Consumer Price Index.

The **hospital services** sub-function includes payments to the States and Territories through a range of National Partnership Agreements, and support for veterans' hospital services. Expenditure growth for this sub-function is expected to fall by 32.9 per cent in real terms between 2013-14 and 2014-15, and fall by 18.8 per cent in real terms over the period 2014-15 to 2017-18. This significant fall is primarily due to the conclusion of elements of the National Partnership Agreement on Improving Public Hospital Services at the end of 2013-14, and the cessation of reward funding from 1 July 2015.

Expenses in the **health services** sub-function include Australian Government expenses associated with the delivery of population health, mental health, hearing services, blood and blood products, research and other allied health services, and health

infrastructure funding through the Health and Hospitals Fund (HHF), which will cease operation on 31 December 2014, with uncommitted funds being transferred to the Medical Research Future Fund. From 2013-14 to 2014-15 expenditure is expected to increase by 1.7 per cent in real terms, and between 2014-15 and 2017-18 expenditure is expected to decrease by 8.0 per cent in real terms. This largely reflects projects funded from the HHF nearing completion. The reduction in Health Infrastructure is partially offset by increased expenditure on the national blood agreement, reflecting both greater costs and demand for blood products, and the expenditure of earnings from the Medical Research Future Fund to support research.

The major components of the health services sub-function are set out in Table 8.3.

Table 8.3: Trends in the major components of health services sub-function expenses

| | | Estimates | | | Projections | | |
|-------------------------------------|---------|-----------|---------|---------|-------------|--|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | | |
| | \$m | \$m | \$m | \$m | \$m | | |
| National blood agreement management | 1,127 | 1,132 | 1,205 | 1,280 | 1,362 | | |
| Health infrastructure | 422 | 865 | 394 | 82 | 17 | | |
| Blood and organ donation | 732 | 737 | 783 | 833 | 884 | | |
| Mental health | 529 | 643 | 708 | 707 | 725 | | |
| Other | 4,028 | 3,731 | 3,704 | 3,847 | 4,051 | | |
| Total | 6,839 | 7,109 | 6,794 | 6,749 | 7,040 | | |

The **general administration** — **health** sub-function includes the Government's investment in health workforce measures and support for rural health initiatives. Expenditure for this sub-function is expected to fall in real terms by 3.9 per cent between 2013-14 and 2014-15, and to fall in real terms by 4.6 per cent over the period 2014-15 to 2017-18. This is a result of the recent measures the Government has undertaken to minimise the growth in programme delivery costs such as improving the efficiency of health workforce development and rebuilding general practice education and training.

Expenses in the **Aboriginal and Torres Strait Islander health** sub-function is expected to decrease by 10.7 per cent in real terms from 2013-14 to 2014-15, largely due to efficiencies in Indigenous health programme funding. Expenses are expected to increase by 15.5 per cent in real terms over the period 2014-15 to 2017-18 as Aboriginal and Torres Strait Islander people across Australia continue to access Indigenous-specific services. Substantial investments in Indigenous health also occur through other health sub-functions.

Box 5: Medical Research Future Fund

In addition to expenditure on the health function, the Government will create a Medical Research Future Fund (MRFF) from 1 January 2015 to provide a sustainable and growing funding stream to be spent on further medical research in the medium to long term. All savings from health expenditure which have been announced in the 2014-15 Budget and the current uncommitted balance of the Health and Hospitals Fund (HHF) will be reinvested in the MRFF until its balance reaches \$20 billion, which is estimated to occur in 2019-20. The capital and any ongoing capital gains of the MRFF will be preserved in perpetuity.

The net interest earnings of the fund will be drawn down in the year after they are earned and used to fund critical medical research. This additional expenditure will grow from \$20 million in 2015-16 to provide an ongoing funding stream of around \$1 billion per year from 2022-23.

Table 8.4: Medical Research Future Fund

| | Estimates | | | Projections | | |
|---|-----------|----------|---------|-------------|---------|--|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | |
| | \$m | \$m | \$m | \$m | \$m | |
| Savings invested in the MRFF | 0 | 1,039(a) | 2,680 | 2,884 | 3,938 | |
| Uncommitted balance from the HHF invested in the MRFF | | 992 | | | | |
| Total investments each year in the MRFF | 0 | 2,032 | 2,680 | 2,884 | 3,938 | |
| Net interest earnings | | 20 | 77 | 179 | 304 | |
| Capital gains | | 2 | 9 | 20 | 35 | |
| Additional funding for Medical Research(b) | | | -20 | -77 | -179 | |
| Cumulative Balance of the MRFF(c) | 0 | 2,054 | 4,800 | 7,807 | 11,905 | |

⁽a) Includes \$76 million in 2013-14 savings which will be invested in the MRFF after it is established on 1 January 2015.

Table 8.5: Expenditure and investments in health

| | | Estimates | | | tions |
|---|---------|-----------|---------|---------|---------|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| | \$m | \$m | \$m | \$m | \$m |
| Health function expenditure | 64,511 | 66,892 | 68,203 | 71,797 | 74,856 |
| Savings invested in the MRFF | 0 | 1,039 | 2,680 | 2,884 | 3,938 |
| Total expenditure and investments in health | 64,511 | 67,931 | 70,883 | 74,681 | 78,794 |

⁽b) The net interest earnings of the MRFF are paid out in the year after they are earned to fund medical research. This expenditure is included in the health function.

⁽c) The estimated cumulative balance includes capital gains in addition to savings.