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STATEMENT 2 — ECONOMIC AND FISCAL OUTLOOK

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STATEMENT 2 — ECONOMIC AND FISCAL OUTLOOK

PART I: ECONOMIC OUTLOOK

OVERVIEW¹

Economic activity is expected to strengthen in 1997-98, underpinned by supportive international conditions, low inflation, the impact of the three reductions in official interest rates in the last year and the structurally sound position of both the household and corporate sectors. Employment is forecast to grow solidly and the unemployment rate should commence falling again. Inflation is expected to remain low. Despite the strengthening in activity, the current account deficit should increase only slightly as a share of GDP as higher national saving largely accommodates an increase in national investment.

The strengthening in prospect follows an easing in the pace of expansion in 1996-97, the sixth year of the current economic upswing. Such periodic easings are a characteristic of prolonged expansion periods. The slowing in the pace of growth in 1996-97 resulted in subdued employment growth and little change in the trend unemployment rate.

The expected acceleration in 1997-98 should reflect stronger private demand combined with continued modest growth in public demand and a smaller detraction from growth by net exports. Private consumption growth is forecast to accelerate in line with stronger household income. This strengthening in household income reflects stronger growth in non-wage income supported by ongoing strong growth in wages, salaries and supplements. The recovery now evident in the housing sector should strengthen as the excess supply of dwellings is further eroded and housing affordability stays high. The pace of business investment should again be strong, supported by another year of rapid non-residential construction growth.

Stronger economic growth should lead to a strengthening in employment growth and a reduction in the unemployment rate. While the unemployment rate has been little changed over the past two years, it is expected to fall to around 8 per cent by the end of 1997-98.

Underlying inflation should remain towards the bottom of the Reserve Bank's medium-term monetary policy target range during 1997-98. Labour costs should be kept in check as growth in wages and labour productivity remain little changed through 1997-98, while competitive pressures, including the lagged effects of recent increases in the exchange rate, should continue to put downward pressure on inflation.

The current account deficit is expected to increase slightly as a share of GDP in 1997-98. National saving is expected to rise to its highest level (as a share of GDP) since 1989-90, largely accommodating a rise in national investment as activity strengthens.

¹ In this Statement, unless otherwise specified, monthly and quarterly data are expressed in seasonally adjusted terms. The current price GDP (Income) measure is used as the nominal measure of GDP, while the GDP (Average) measure is the constant price GDP series used.

Table 1: Budget Forecasts^(a)

	Outcomes(b)	Estimates	Forecasts	
	1995-96 Year Average	1996-97 Year Average	1997-98 Year Average	Four quarters to June 1998
Panel A - International Outlook				
Major trading partners				
Real GDP	4.6	4 1/2	4 1/2	
Inflation	3.1	2 3/4	3	
Crude oil (\$US/barrel)	17.9	20 1/2	18 1/2	
TWI (Index points)(c)	54.8	59	60	
Panel B - Demand and Output(d)				
Private consumption	4.2	2 3/4	3 1/2	3 3/4
Private investment				
Dwellings	-12.9	-2	11	12
Total business investment	10.9	16	8	8
Non-dwelling construction	23.8	19	18	21
Equipment	6.2	15	4	2
Private final demand	3.6	4 1/4	4 3/4	5
Public final demand	0.9	2 1/4	2 1/4	-3
Total final demand	3.0	3 3/4	4 1/4	3 1/4
Increase in stocks(e)				
Private non-farm	-0.2	0	0	1/4
Farm and public authority	0.2	0	0	0
Gross national expenditure	3.1	3 3/4	4 1/4	3 1/2
Exports of goods and services	10.8	7	7	8
Imports of goods and services	5.4	9	9	7
Net exports(e)	1.1	- 1/2	- 1/4	0
Gross domestic product (Average measure)	4.1	3 1/4	3 3/4	3 3/4
Non-farm product	3.5	3	4	4
Farm product	24.0	9	-2	-3
Panel C - Other Selected Economic Measures				
Prices and wages				
Consumer Price Index	4.2	1 1/4	1	1 3/4
- Treasury 'Underlying' measure	3.2	2	2	2
Gross non-farm product deflator	2.8	2 1/4	2	1 1/2
Average earnings(f)	4.2	4 3/4	4	4
Non-farm nominal unit labour costs	3.4	2 3/4	1 3/4	2 1/4
Labour market				
Employment (Labour Force Survey basis)	2.6	1 1/4	2	2 1/4
Unemployment rate (per cent)(g)	8.5	8 3/4	8 1/4	8
Participation rate (per cent)(g)	63.7	63 1/2	63 3/4	63 3/4
Household income and saving				
Real household disposable income	4.3	3	3 3/4	4 1/2
Household saving ratio (per cent)	3.9	4 1/2	4 1/2	
External accounts				
Terms of trade	4.1	3 1/2	1 1/2	1
Current account balance				
\$billion	-20.1	-20	-21	
Percentage of GDP	-4.1	-3 3/4	-4	

(a) Percentage change on preceding year unless otherwise indicated.

(b) Calculated using annual original data.

(c) Based on the technical assumption that the TWI remains around the average level reached in recent months.

(d) Average 1989-90 prices.

(e) Percentage point contribution to growth in GDP (Average measure).

(f) Average earnings (national accounts basis). Forecast earnings growth excluding the expected impact of above average Commonwealth Government redundancies is 4½ per cent in 1996-97 and 4 per cent in 1997-98. The nominal unit labour cost estimate for 1996-97 is similarly affected.

(g) The estimate in the final column represents the forecast level in the June quarter 1998.

INTERNATIONAL ECONOMY

The world economy is experiencing a conjunction of favourable effects which should be supportive of the Australian economy in the year ahead. This reflects:

- a favourable convergence in the cyclical positions of the major economies, as increasingly strong growth in the private sector in Japan and slowly improving prospects for Europe support continuing strong growth in the United States and in the East Asian region (see below);
- the importance of the high growth Asian economies for Australia's exports;²
- the absence of inflationary pressures in most countries, reflecting the judicious use of monetary policy and greater competitive pressures more generally; and
- the adoption of budget deficit reduction plans by most major economies, which should help reduce world real long-term interest rates and sustain investment.

Overall, GDP in Australia's major trading partners (MTP)³ is expected to expand by 4½ per cent in 1997-98, while their inflation is expected to average around 3 per cent, with a subdued inflation outlook across the industrial world.⁴

Unemployment remains very high in many industrial countries and sustained growth will be fundamental to tackling that problem. On that score, analysis by the OECD and International Monetary Fund (IMF) points to the importance of not only macroeconomic stability but of pursuing structural reforms on a wide front. In a wide range of countries, it has been structural rigidities within the control of governments which have constituted the greatest impediments to improved productivity, economic growth and job creation.⁵ Many countries are now seeking to introduce reforms to reduce structural rigidities and increase longer-term growth rates.

² In 1995-96, 37 per cent of Australia's merchandise exports went to the East Asian region (excluding Japan), up from 28 per cent in 1990-91.

³ Australia's MTP in order of importance are Japan, South Korea, the United States, New Zealand, Singapore, Taiwan, China, Hong Kong, the United Kingdom, Indonesia, Malaysia, Thailand, Canada, Italy, Germany, the Philippines and France.

⁴ Because of data limitations, the forecasts contained in Table 2 are on a calendar year basis although the GDP and inflation forecasts discussed in the text have been prepared on an Australian financial year basis.

⁵ These issues are discussed in more detail in Statement 3.

Table 2: Economic Indicators for Selected Countries and Groupings^(a)

	GDP Growth			CPI Inflation(b)			General Govt. Balance(c)			Unemployment Rate(d)		
	1995	1996	1997(e)	1995	1996	1997(e)	1995	1996	1997(e)	1995	1996	1997(e)
United States	2.0	2.4	3 1/2	2.8	2.9	2 3/4	-2.0	-1.4	-1 1/2	5.6	5.4	5 1/2
Japan	1.4	3.6	2	-0.1	0.1	1 1/4	-3.7	-4.6	-3	3.1	3.3	3
Germany	1.9	1.4	2 1/4	1.8	1.5	2	-3.5	-3.8	-3 1/4	9.4	10.3	11 1/4
OECD(f)	2.0	2.4	2 1/2	4.8	4.1	3 1/2	-3.5	-3.2	-2 1/2	7.8	7.8	7 3/4
East Asian MTP(g)	8.1	7.0	6 3/4	7.0	5.1	4 1/2	2.0	1.4	1 3/4	2.7	2.8	2 3/4
Total MTP(h)	4.6	4.7	4 1/4	3.6	2.8	2 3/4	-1.1	-1.4	- 3/4	4.8	4.9	4 3/4

(a) Total and East Asian MTP GDP growth are calculated using Australian merchandise export trade weights. The other MTP series are weighted by total Australian merchandise trade weights.

(b) The GDP deflator in the case of the OECD.

(c) General government financial balance (as a per cent of nominal GDP) in the case of the OECD. Taiwan is excluded from East Asian MTP.

(d) Indonesia is excluded from East Asian MTP.

(e) Forecasts.

(f) The OECD comprises Austria, Australia, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. However, the OECD has not yet commenced publishing economic indicators which include South Korea.

(g) Australia's East Asian MTP are China, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand.

(h) In addition to Australia's East Asian MTP, Canada, France, Germany, Italy, Japan, New Zealand, the United Kingdom and the United States comprise Australia's total MTP.

Source: GDP growth and inflation data are from individual country statistical publications with Treasury estimates for 1997. The exceptions are the OECD series, which are from the OECD's *Economic Outlook 60*. General government balance and unemployment rate data and estimates are from individual country statistical publications, Treasury and the IMF's May 1997 *World Economic Outlook*.

The economic performance of the **United States** has been highly impressive over recent years. The current upswing is well into its sixth year and the economy has been operating for over 18 months at or above what most observers had considered to be full capacity. Despite this, inflation remains low. To sustain this performance, the Federal Reserve acted pre-emptively to tighten monetary policy slightly in March 1997. The major policy challenge for the United States, however, is to reduce the Federal fiscal deficit. The Administration has announced a plan to balance the budget by the year 2002, although most of the cuts in expenditure are not planned to take effect until after the year 2000.

Economic recovery is continuing in **Japan** with the private sector replacing the earlier high levels of public expenditure as the main source of growth. Fiscal policy has been tightened sharply in 1997 to improve the underlying fiscal position, but private sector activity (supported by continuing accommodative monetary policy and a weaker yen) should help maintain the recovery's momentum. Overall, growth is expected to weaken in the first half of 1997, before accelerating later in the year.

Economic growth in **Continental Western Europe** is expected to improve but remain patchy in the face of substantial regulatory structural rigidities and a concerted focus on substantial fiscal consolidation. High public sector debt levels and large fiscal imbalances prevailing across Europe through the 1990s require fiscal consolidation in most countries, with the extent and timing of the adjustment undertaken being influenced by requirements to meet the Maastricht criteria for European Monetary Union. As a result, business and consumer confidence is likely to remain subdued. The **United Kingdom** is expected to continue to outperform its continental neighbours.

Growth in **East Asia** is likely to strengthen slightly in 1997-98, reflecting a recovery from the export slowdown that affected most of the region in the latter part of 1996 and early 1997 and some easing in monetary policies. The Chinese economy is expected to remain a driving force; double-digit growth is likely to continue through stronger growth in consumption, investment and net exports. In contrast, growth is likely to moderate in South Korea as private consumption and investment growth slows further.

Strong investment is likely to support continued buoyant conditions in Malaysia and Indonesia and continued steady growth in the Philippines. Growth in Singapore has been affected by weakness in the electronics-based export sector, which is not expected to recover until around the middle of 1997. The short and medium-term outlook for Thailand will depend on the speed and effectiveness of the authorities' response to the considerable financial sector instability that occurred during the first few months of 1997.

Looking at the **world economy** as a whole, there are few signs of the tensions and imbalances that usually foreshadow significant downturns in the world economy — but there are, as always, some points that bear watching. For example:

- the possibility of significantly higher interest rates in the United States which might slow the economy more than anticipated and reduce capital flows to other countries with possible interest rate and exchange rate implications;
 - while the probability of that seems low, there is a possibility that, as the United States enters a period of monetary tightening, increasing interest rate

differentials between the United States and Japan could exacerbate movements in exchange rates between those countries and widen external imbalances, possibly leading to trade frictions;

- uncertainties about the timing and strength of the pick-up in private sector activity in Japan in the face of the need for consolidation of both government finances and financial sector balance sheets; and
- unavoidable uncertainties surrounding the European Monetary Union and, particularly, which countries will meet the requirements for membership under the Maastricht criteria. The possibility of policy shifts associated with such uncertainties could contribute to volatility in financial markets.

FORECASTING ASSUMPTIONS

The forecasts for the domestic economy depend on forecasts of economic growth and inflation in Australia's MTP and assumptions for oil prices and the exchange rate, all of which are set out in Panel A of Table 1. In line with usual practice, it is assumed that the exchange rate will remain broadly unchanged from the average level reached in recent months. The farm sector forecasts are prepared on the assumption that average seasonal conditions will prevail in 1997-98.

DOMESTIC ECONOMY

Demand and Output

Following an easing in the rate of expansion in 1996-97, GDP growth is expected to strengthen in 1997-98 in line with an acceleration in private demand growth. The easing in the pace of growth in 1996-97 reflects the combined effects of a deterioration in the net export position (as a result of stronger import growth and slower export growth) and a slowing in private consumption growth. Together, these effects more than offset stronger growth in business investment and a smaller detraction from growth from the housing sector than in 1995-96 (Chart 1).

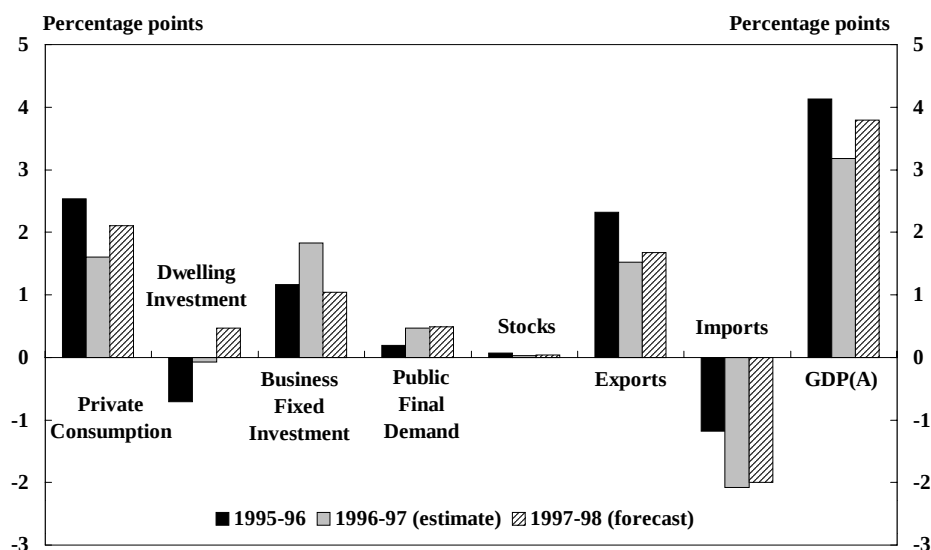
Reflecting differing developments in the components of demand in 1996-97, conditions also varied across industry sectors. The slowing in private consumption growth materialised in weak activity in retail trade. Strong growth in non-residential construction was partly offset by the housing downturn, resulting in only modest growth in the construction sector overall. Agriculture and mining both grew strongly. However, parts of manufacturing experienced poor trading conditions as a result of the housing downturn and a temporary easing in the growth of exports. Services sector output growth slowed in aggregate, although there were pronounced differences in conditions across the sector, with communications, in particular, continuing to grow very solidly.

In 1997-98, private demand growth is forecast to accelerate. Private consumption should grow more quickly as growth in real household income strengthens and the recovery in the dwelling sector becomes established. Business investment growth should remain strong, supported by ongoing private infrastructure investment, Olympics-related construction and some continuing pressures to expand capacity. Public demand growth

should continue at a modest rate. Net exports are forecast to make a modest detraction from GDP growth as import growth again outpaces that of exports.

On an industry basis, the strengthening in private consumption should help to boost retail trade while stronger demand overall, particularly the anticipated broadening of the housing recovery, should contribute to an improved outlook for manufacturing and construction. Mining and services are likely to experience further solid growth. However, activity in agriculture is expected to decline slightly after growing rapidly in each of the last two years.

Chart 1: Contributions to GDP Growth



Source: ABS Cat. No. 5206.0 and Treasury.

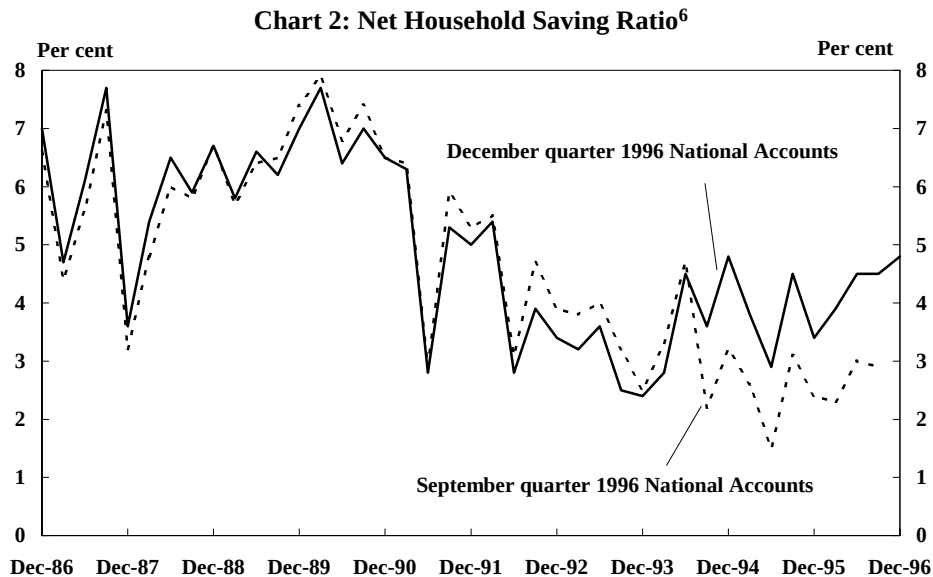
Private Consumption

Solid growth in household income, together with continued modest growth in net private sector wealth (the net financial and physical assets owned directly and indirectly by households), should underpin a pick-up in **private consumption** growth in 1997-98 to a rate comparable with average historical experience.

Growth in **real household disposable income** is forecast to accelerate in 1997-98, reflecting a pick-up in non-wage income growth and ongoing strong growth in wages, salaries and supplements. Sharp falls in interest income and farm income (a large fall in farm product prices more than offset continued growth in production) dampened household income growth in 1996-97, but these factors should wane in the coming year — farm incomes, in particular, should benefit from rising farm product prices during 1997-98.

Growth in consumption is expected to be slightly slower than growth in real household disposable income in 1997-98, although the **household saving ratio** will remain broadly unchanged, after rising in 1996-97. As always, estimates of the household saving ratio should be treated with caution, given the large and frequent revisions to estimates of

saving. For example, the December quarter 1996 National Accounts published large upward revisions to the history of household saving, removing part of the apparent downward trend in the saving ratio over recent years (Chart 2).



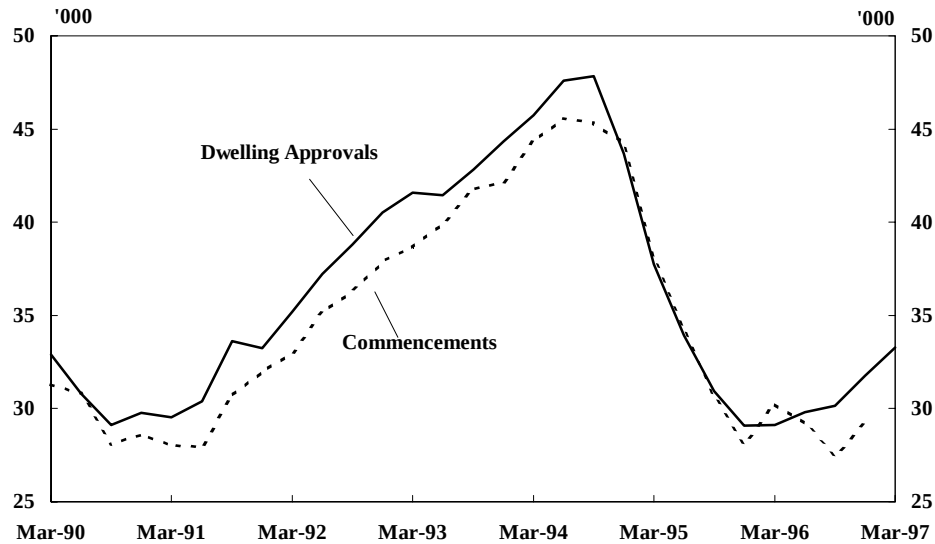
Source: ABS Cat. No. 5206.0.

Dwelling Investment

Forward indicators suggest that a recovery in the housing sector has been under way since late 1996 (Chart 3). This recovery is now becoming apparent in **dwelling investment**. The downturn in the housing sector during 1995 and 1996 reduced the excess supply of dwellings built up during the preceding upswing. Vacancy rates have fallen in some capitals to the point where the aggregate vacancy rate is now close to the levels recorded in the late 1980s. The tightness of the Sydney and Melbourne housing markets should support stronger dwelling investment, as will the current very high level of housing affordability, with bank indicator mortgage rates at their lowest level since 1973, house prices rising only modestly and household incomes increasing solidly. However, with pockets of excess supply remaining in some areas, the housing recovery is likely to be uneven across Australia.

⁶ Household income and saving are measured net of estimated economic depreciation.

Chart 3: Private Dwelling Approvals and Commencements



Source: ABS Cat. Nos. 8731.0 and 8750.0.

Business Investment

Business investment is forecast to record another year of strong growth in 1997-98, consistent with businesses' surveyed intentions (as published in the ABS *Private New Capital Expenditure (CAPEX) Survey*) and reflecting the very positive fundamental influences on investment. The realisation ratios⁷ implicit in the forecasts are comparable with average ratios from the *CAPEX* survey over the 1980s.⁸ In that context, they are conservative (given the very good fundamental influences on investment).

Business confidence is rising and surveyed aggregate capacity utilisation remains at a high level. The price of investment goods has fallen over the last year or so, reflecting declines in import prices (see Chart 6). Nominal interest rates have fallen and profitability remains high — the corporate profit share is forecast to increase for the sixth successive year in 1997-98.⁹

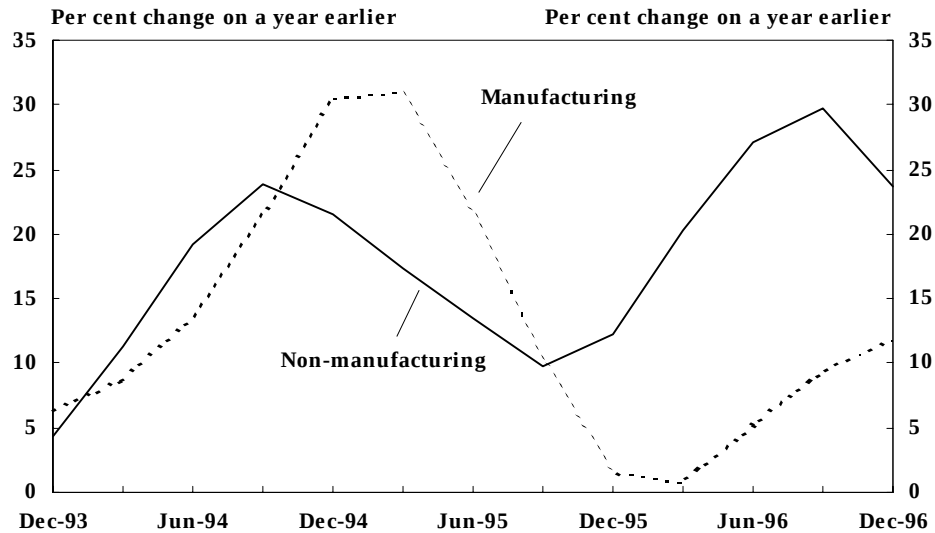
Business investment has grown strongly in aggregate over recent years, but the pattern of investment has varied in line with the different conditions in each sector. Investment in services and mining has been strong. On the other hand, manufacturing investment, while strengthening in recent quarters, has been weaker than the other sectors in line with relatively weaker trading conditions in that sector (Chart 4). Business investment intentions suggest that some variation across sectors is likely to continue, with investment growth continuing to be concentrated in mining and services.

⁷ The ratio of actual to expected investment expenditure.

⁸ The comparison is made with the 1980s in order to cover a complete economic cycle.

⁹ Other broader measures of profitability, such as the profit share for all private non-farm enterprises, are also forecast to increase in 1997-98.

Chart 4: Business Investment by Industry (Trend Series)



Source: ABS Cat. No. 5646.0.

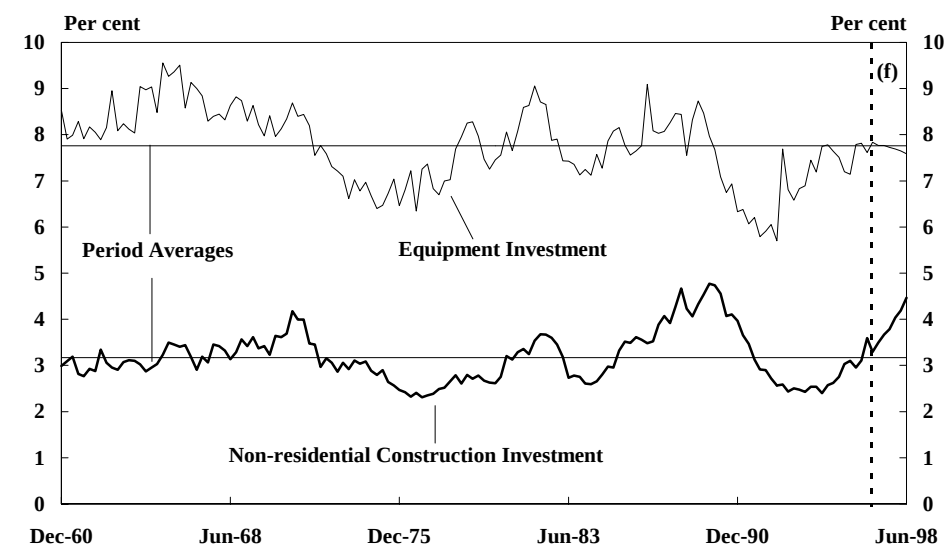
Equipment investment, while remaining strong in 1997-98, should grow more slowly than the very rapid rate estimated for 1996-97 when growth was boosted by some expenditure delayed from the previous year. Across the two years, the strength of equipment investment should see firms' capacity continue to expand in line with demand — however, investment will have grown more strongly than demand in 1996-97, with the opposite occurring in 1997-98.

Non-residential construction investment has grown at a rapid rate in recent years and is expected to continue to grow faster than equipment investment in 1997-98.

Engineering construction investment has increased rapidly over the past few years (on projects such as major roads in Sydney and Melbourne and mining-related investment). Nevertheless, strong investment in buildings, such as shops, has represented the bulk of non-residential construction investment. The momentum in this sector will be sustained by projects already under way, continued strength in the mining sector and in private infrastructure investment, new projects related to the Olympics and a gradual pick-up in office building in response to lower vacancy rates in some capitals.

Chart 5 shows that non-residential construction as a share of GDP (in nominal terms) is expected to increase to a level comparable with that of the late 1980s. There are significant differences between the two episodes, however, with the current strength in the sector more broadly-based and encompassing a number of large projects which might previously have been undertaken by the public sector.

Chart 5: Nominal Business Fixed Investment as a Share of GDP



(f) Treasury forecasts.

Source: Actual data are from ABS Cat. No. 5206.0.

Public Expenditure

Public final demand is expected to continue growing at a modest pace in 1997-98, reflecting a strengthening in public investment and slower growth in public consumption than in the previous year.

The strength of **public investment** in 1997-98 mainly reflects the significant investment programmes planned by the New South Wales and Queensland Governments and the expectation that investment by Commonwealth business enterprises will remain at a high level. Information from Commonwealth public enterprises and State governments suggests that some growth in public investment planned for 1996-97 may have slipped into next financial year. Moreover, it appears that investment in 1996-97 will be heavily weighted towards the second half of the year, resulting in slow average growth for the year as a whole.

Growth in **public consumption** is expected to slow in 1997-98, reflecting fiscal consolidation at both the State and Commonwealth government levels. Public consumption is estimated to have increased at a relatively modest rate in 1996-97.

Non-farm Stocks

Recent data indicate that movements in **non-farm stocks** have generally matched trends in sales, suggesting no contribution to GDP growth from this source in either 1996-97 or 1997-98.

Farm Sector

On the usual forecasting assumption of average seasonal conditions, **gross farm product** is expected to fall slightly in 1997-98, following strong growth in 1995-96 and 1996-97. Grain production in 1996-97 was boosted by a record wheat harvest of around 23½ million tonnes — the previous record was 22 million tonnes in 1983-84. Grain production is likely to decline in 1997-98, but the impact of that on farm production is expected to be broadly offset by increased production of livestock and of other crops.

Net Exports

Another year of strong **export** growth is anticipated in 1997-98, supported by a favourable outlook for world growth and expanding Australian capacity. While export growth in aggregate should be unchanged from that in 1996-97, the composition is likely to change. Non-rural commodity export growth is forecast to pick up in line with increases in Australia's supply capacity while rural export growth should slow as farm product declines. Growth in exports of elaborately-transformed manufactures (ETM) should return to a rate more in line with the experience of recent years in 1997-98 — slowing growth in our main ETM markets¹⁰ in 1996-97 contributed to a marked slowing in ETM growth in that year.

The flow-through of the recent rise in the exchange rate to lower import prices, and the expected pick-up in private demand growth, should result in another year of strong **import** volume growth in 1997-98. This follows a substantial acceleration in 1996-97 when: import volumes reacted to continuing strong growth in demand, especially for import-intensive equipment investment goods; lower import prices flowed from the appreciating Australian dollar (Chart 6); and 'exogenous' imports (such as ships and aircraft) were high.

Taken together, the trade forecasts imply that **net exports** are likely to detract modestly from GDP growth in 1997-98, slightly less than is estimated to have been the case in 1996-97.

Risks

Apart from the international economic environment, the key **risks** to the forecasts of demand and GDP growth centre on the uncertainties surrounding the consumption, dwelling and business investment forecasts.

The risks surrounding the consumption forecast primarily relate to uncertainties around the forecasts for wages and employment (and hence disposable income). It is also possible that the household saving ratio could resume declining (as was the case up to the early 1990s). Such an outcome would pose an upside risk to the consumption and imports forecasts. Alternatively, if households are concerned about current levels of debt (which remain moderate by world standards), they may rebuild their savings more rapidly than anticipated, leaving consumption growth and imports lower than expected.

¹⁰ Australia's main ETM markets in order of importance in 1995-96 were New Zealand, the United States, Hong Kong, Singapore, the United Kingdom, Japan, Indonesia, South Korea, Malaysia and Thailand.

The risks to the dwelling investment forecast hinge mainly upon the extent of excess supply in the market. While movements in vacancy rates suggest that excess supply is diminishing and forward indicators clearly indicate that a housing recovery is under way, the extent of excess supply in various parts of the market, and hence the speed of recovery, remains uncertain.

At this stage, only the first set of *CAPEX* data is available for 1997-98. Initial investment intentions are almost always revised up over the course of the year, although the extent of those revisions can vary significantly from year to year. While investment fundamentals are very positive, the extent to which initial intentions will be revised remains uncertain. Moreover, the timing of large investment projects is always uncertain and small variations in commencement dates can have a major impact on the amount of work undertaken in a given year. As a result, there may be some further slippage into 1997-98 of investment planned for 1996-97.¹¹ Nevertheless, it is clear that business investment will record very strong growth across the two years.

The forecast for growth in gross farm product in 1997-98 depends on the assumption of normal seasonal conditions. If seasonal conditions differ significantly from this assumption, growth in farm product would be different to that forecast, with possible flow-on effects to rural exports and GDP.

The exchange rate has appreciated significantly since last Budget to be around 25 per cent higher on a trade-weighted basis than its low point in June 1995. A further substantial appreciation or a marked depreciation of the exchange rate from its current level could have implications for a number of components of activity but net exports, in particular, would be significantly affected.

Wages

Wage pressures through the course of 1997-98 seem likely to be broadly unchanged from the previous year. This reflects the likely continuation of modest award wage growth and the moderating influences of low inflation and competitive pressures on enterprise bargaining outcomes. Abstracting from the effects of above average Commonwealth Government redundancies, average earnings are expected to grow by 4 per cent in 1997-98.

The risks surrounding the wages outlook appear evenly balanced. Enterprise bargaining outcomes remain a key uncertainty, particularly the extent to which current high wage claims in the construction, transport and metals sectors lead to more generalised wage rises in the context of a strengthening economic environment.

Influences that may moderate future wages growth include a further fall in inflation expectations on the basis of continued low inflation and increased competitive pressures. The *Workplace Relations Act 1996*, by increasing the spread of genuine bargaining, should reduce the extent to which wage increases flow on to other firms without reflecting the commercial circumstances of those firms.

¹¹ The December quarter 1996 *CAPEX* survey reported a deferral of some construction projects and delays in some projects already under way.

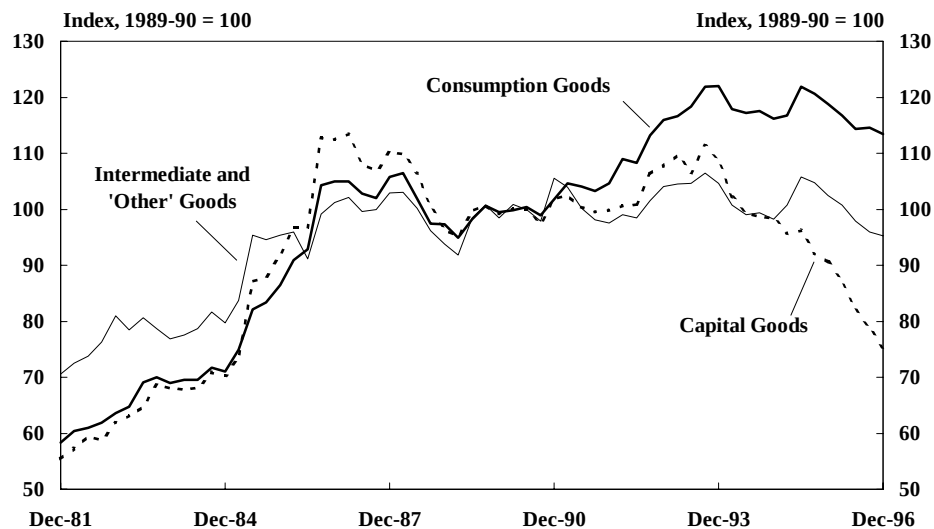
Prices

Underlying inflation is forecast to remain close to its current level in 1997-98, around the bottom of the Reserve Bank's medium-term monetary policy target range. **Headline inflation** should be lower than underlying inflation due to the lagged impact of mortgage interest rate reductions in late 1996 and early 1997.

Underlying inflation outcomes over the past few quarters have been heavily influenced by import price falls (Chart 6) stemming from the strength of the exchange rate over the last year and by sustained price competition in the retail sector. Import prices have affected underlying inflation directly, via lower prices for imported consumption goods, and indirectly, through the impact of lower prices of imported capital and intermediate goods used in the production process — and, importantly, by raising competitive pressures in the traded goods and services sectors more generally. Experience suggests that much of the impact of past exchange rate appreciation is yet to be seen, suggesting that the exchange rate will remain an important influence on underlying inflation through the remainder of 1997 and into 1998.

As import prices stabilise, ongoing growth in nominal unit labour costs should again emerge as the main influence on underlying inflation. Growth in the components of nominal unit labour costs (wages less labour productivity) is expected to remain broadly steady through the course of 1997-98.

Chart 6: Import Prices



Source: ABS Cat. No. 5302.0.

Recent reductions in official interest rates and competition between mortgage lenders have resulted in falls in mortgage interest rates and in the mortgage interest charges component of the CPI. Further falls are expected in this component of the CPI, due to the lagged impact of recent mortgage rate reductions. As a result, headline inflation will fall well below underlying inflation in 1996-97, but this gap should narrow as 1997-98 progresses.

Broader measures of inflation, such as the **gross non-farm product deflator**, are forecast to remain low in 1997-98, partly reflecting the lagged influence of recent increases in the exchange rate. The non-farm product deflator is expected to grow at a faster rate than either the domestic demand or gross national expenditure deflators reflecting a forecast improvement in the terms of trade.

The uncertainties surrounding the forecasts of growth in wages and productivity discussed earlier also pose a **risk** to the inflation forecasts. If the exchange rate moved significantly from its current level, it would also influence inflation outcomes.

The Labour Market

The emerging recovery in the labour market should broaden in 1997-98, with **employment** growth accelerating and the **unemployment** rate falling to around 8 per cent by the end of the year.

The strengthening in employment growth during the course of 1997-98, following two years of only modest growth, should be accompanied by solid **labour productivity** growth.¹²

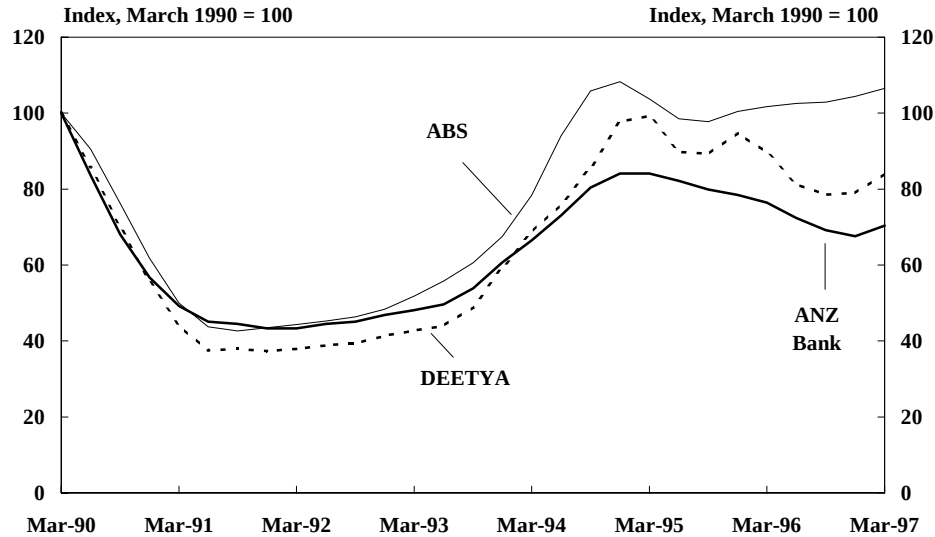
Employment growth has traditionally displayed a marked cyclical trend, moving with some delay in response to changes in growth in activity and real wages.¹³ The modest pace of employment growth in recent years may also reflect a lagged response to the surprising strength of employment growth in the first half of 1995. However, growth in employment should strengthen in 1997-98 in response to the acceleration in activity and continuing restrained growth in real labour costs. Measures of job vacancies support this outlook — all three major vacancies series have risen in trend terms recently, with the broadest measure, the ABS series, increasing for the sixth consecutive quarter (Chart 7).¹⁴ Overtime worked also appears to have reached a cyclical trough in late 1996.

¹² Employment growth is estimated to have been around 1 and 1½ per cent in the years to the June quarter 1996 and 1997, respectively, although the profile of growth in 1995 and 1996 has meant that year-average growth was strong in 1995-96 and subdued in 1996-97.

¹³ Employment trends over recent years are discussed in detail in Part I of last year's Statement 2.

¹⁴ The more subdued behaviour of the ANZ Bank series appears to reflect the fact that not all vacancies are advertised in newspapers. In addition, the propensity for public sector vacancies to be advertised in more than one newspaper may mean that fiscal consolidation at the Commonwealth and State levels may be disproportionately affecting the ANZ Bank series.

Chart 7: Job Vacancies (Trend Series)



Source: ABS Cat. No. 6354.0, the Department of Employment, Education, Training and Youth Affairs (DEETYA) and the ANZ Bank.

An acceleration in employment growth should encourage more people to seek work during 1997-98 so that not all of the increase in employment will translate into lower **unemployment**. Nevertheless, employment growth should be strong enough to reduce the unemployment rate to around 8 per cent by the end of 1997-98, following little change over 1996-97 when movements in the working-age population and the participation rate broadly offset growth in employment.

The main **risks** to the labour market forecasts centre on uncertainties surrounding the activity and real wage forecasts and the future path of the participation rate, which has been sensitive in the past to social and demographic factors. Risks surrounding the outlook for labour productivity growth also have implications for employment, as well as for activity and inflation. Although it appears likely that part of the strong growth in labour productivity from 1991-92 onwards reflects structural improvements as a result of ongoing reforms to product and labour markets, it is difficult to determine the magnitude of structural changes. This matter is discussed further in Statement 3. There is also a timing risk attached to the labour market forecasts as employment growth generally lags changes in activity. If firms have a greater than anticipated capacity to meet demand growth with current staffing levels, then the forecast pick-up in employment growth in 1997-98 could occur a little later than expected.

The Current Account Balance

The **current account deficit** is expected to be slightly higher in 1997-98, both as a share of GDP and in dollar terms. This broadly stable outlook, despite the acceleration in economic activity, reflects a forecast improvement in the balance on goods and services which partly offsets a rise in the net income deficit.

The current account deficit in 1996-97 represents a marked reduction relative to the cyclical peak of 5¼ per cent of GDP reached in 1994-95. Chart 8 illustrates that the

improvement in recent years reflects a sharp turnaround in the dollar value of the balance on goods and services. This mainly reflected the recovery in export volumes in 1995-96, but a major factor more recently has been the increase in the **terms of trade** in foreign currency terms, primarily reflecting higher commodity prices — combined with the appreciation of the dollar, this resulted in import prices falling more sharply and rapidly than export prices (Chart 9).

Chart 8: Components of the Current Account Balance

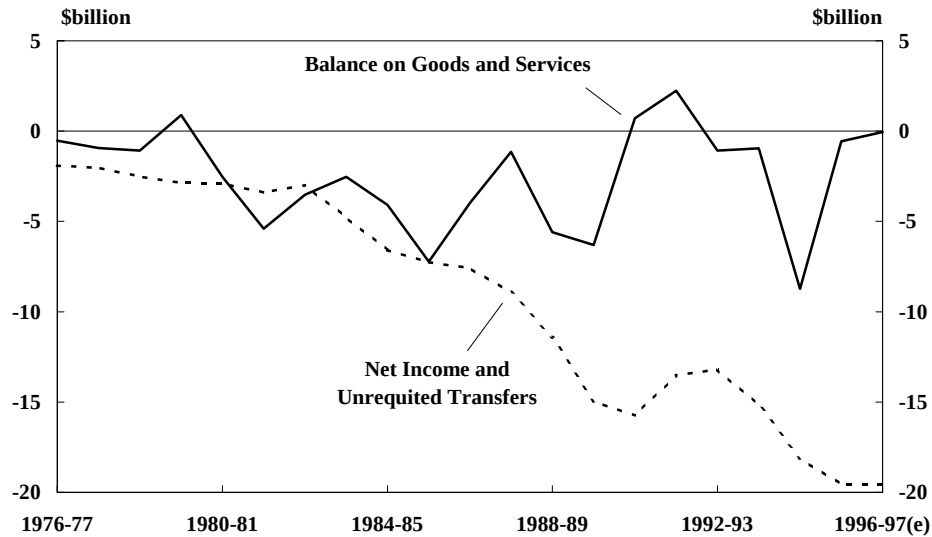
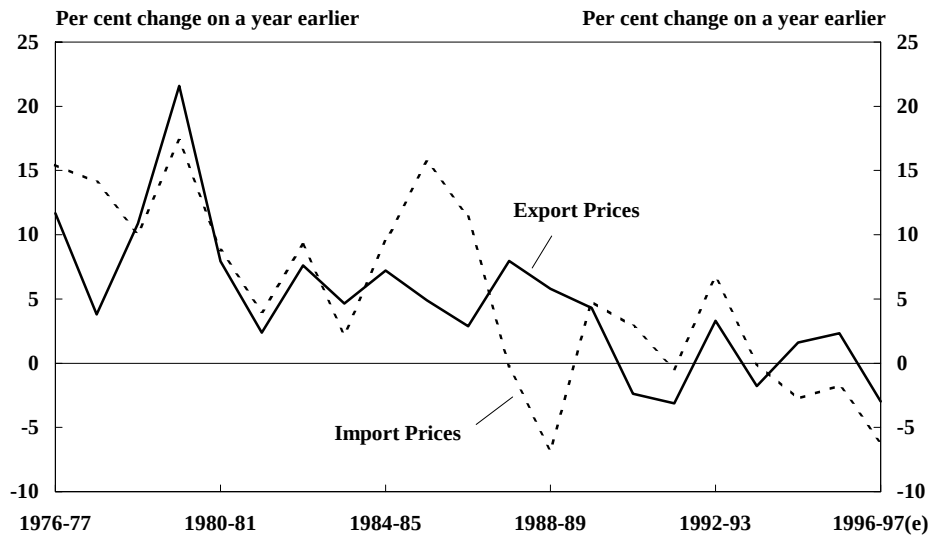


Chart 9: Export and Import Prices



(e) Treasury estimate.
Source: ABS Cat. No. 5302.0.

A further improvement in the **balance on goods and services** is in prospect for 1997-98, assisted by another rise in the terms of trade in line with stronger commodity prices. Export returns are likely to be boosted by a slight rise in export prices and ongoing export volume growth as growth in our MTP remains strong and Australia's supply capacity increases further. The value of imports should also rise due to strong import volume growth which offsets a small fall in import prices. However, the surplus on the balance on goods and services is likely to be outweighed by an increase in the **net income deficit**, which forms the bulk of the current account deficit and which has averaged around 4 per cent of GDP since the late 1980s.

In saving-investment terms, the small increase in the current account deficit in 1997-98 as a share of GDP reflects an increase in **national investment** which is largely accommodated by the anticipated rise in **national saving**. The forecast rise in national investment reflects the continued strength of business investment and the acceleration of the housing recovery. At the same time, national saving is expected to reach its highest level (as a share of GDP) since 1989-90, building on the estimated rise in 1996-97 that resulted from higher household and general government saving. This improved saving performance is helping to ease one of the traditional constraints to growth, allowing the forecast acceleration in demand growth to be accompanied by only a slight deterioration in the current account deficit.

The primary **risks** to the outlook for the current account deficit relate to the uncertainties surrounding the forecasts for domestic demand (the prime determinant of import volume growth) and world economic growth (which affects commodity prices and demand for Australia's exports).

PART II: FISCAL OUTLOOK

OVERVIEW

The fiscal outlook is expected to significantly improve in each of the four years to 2000-01. The underlying budget deficit is estimated to fall below one per cent of GDP in 1997-98 and turn to surplus in 1998-99. Increasing surpluses are projected in 1999-2000 and 2000-01. Over four years, the underlying balance will improve by around 3 per cent of GDP (see Table 3).

Sizeable asset sales in 1997-98 result in a large headline surplus despite the underlying deficit expected that year. The headline surplus improves in 1998-99 reflecting both an improvement in the underlying balance and some still significant asset sales in that year. Beyond 1998-99, movements in the headline balance reflect improvements in the underlying balance against a sharp fall in planned asset sales.

Table 3: Summary of Budget Aggregates

	1996-97		1997-98	1998-99	1999-00	2000-01
	Budget	Revised	Estimate	Projection	Projection	Projection
	\$million					
Revenue						
Tax	125028	124363	129433	138248	146191	154796
Non-tax	5132	5263	3918	4135	4139	4114
Total	130160	129625	133351	142383	150330	158911
Underlying outlays	135810	136481	137204	140786	144947	148219
Underlying balance	-5649	-6856	-3853	1597	5383	10692
<i>Memorandum items:</i>						
Net advances	-6123	-7620	-10276	-5187	-394	-405
Headline balance	474	764	6423	6784	5777	11096
	Real growth on previous year (per cent)					
Revenue						
Tax	4.5	4.5	2.0	4.2	3.3	3.3
Non-tax	-5.9	-3.0	-27.0	2.9	-2.2	-3.0
Total	4.0	4.1	0.9	4.1	3.1	3.1
Underlying outlays	0.1	1.1	-1.4	0.1	0.5	-0.2
	Per cent of GDP					
Revenue						
Tax	24.3	24.2	23.8	24.0	23.9	23.9
Non-tax	1.0	1.0	0.7	0.7	0.7	0.6
Total	25.3	25.2	24.5	24.7	24.6	24.5
Underlying outlays	26.4	26.6	25.2	24.4	23.7	22.9
Underlying balance	-1.1	-1.3	-0.7	0.3	0.9	1.6
<i>Memorandum items:</i>						
Net advances	-1.2	-1.5	-1.9	-0.9	-0.1	-0.1
Headline balance	0.1	0.1	1.2	1.2	0.9	1.7

The improvement in the underlying balance over the forward estimates period is consistent with the Government's short and medium-term fiscal objectives set out in Statement 1. The improved fiscal outlook is the product of both a favourable economic outlook and savings measures announced in the 1996-97 and 1997-98 Budgets.

Table 4 presents the major economic parameters underpinning the budget estimates presented in the Budget documents. The economic forecasts and projections are discussed in detail in Part I of this Statement.

Table 4: Major Economic Parameters (percentage change from previous year)

	Forecasts		Projections		
	1996-97	1997-98	1998-99	1999-00	2000-01
Real GDP(A)	3 1/4	3 3/4	3 1/2	3 1/2	3 1/2
Employment(a)	1 3/4	2	2 1/4	2 1/4	2 1/4
Wages(b)	4 3/4	4	3 1/2	3 1/2	3 1/2
CPI(c)	1 1/4	1	2 1/2	2 1/2	2 1/2

(a) Civilian wage and salary earners (national accounts basis). On a Labour Force Survey basis, employment growth is 1¼ per cent in 1996-97 and 2 per cent in 1997-98, as indicated in Table 1 of Statement 2.

(b) Average earnings (national accounts basis). Forecast earnings growth excluding the expected impact of above average Commonwealth Government redundancies is 4½ per cent in 1996-97 and 4 per cent in 1997-98.

(c) Headline Consumer Price Index.

The projections for the period from 1998-99 to 2000-01 are prepared solely as a basis for Budget figuring and do not represent forecasts.

A range of factors may change the budgetary outlook in future years. Appendix A sets out a Statement of Risks which details risks that may have a material effect on the fiscal outlook. One factor influencing the fiscal outlook will be variations in the economic parameters. A discussion of the estimated sensitivity of the outlays and revenue estimates to changes to the economic parameters is provided in Appendix B to this Statement.

Outlays restraint makes a significant contribution to the expected improvement in the fiscal position. In real terms, underlying outlays are expected to fall in 1997-98 and remain broadly unchanged in the outyears. With strong economic growth projected over this period, underlying outlays as a proportion of GDP are expected to fall by over 3½ percentage points between 1996-97 and 2000-01.

Outlays savings from 1998-99 stem largely from the Government's decision to introduce a new savings rebate in place of the 'LAW' tax cuts (which were later proposed as Government superannuation contributions and shown on the outlays side of the budget). As the new savings rebate scheme is to be implemented through the taxation system, there is some offset to the lower outlays in the form of lower revenues. In net terms, savings from this measure amount to \$729 million in 1998-99, rising to \$1.9 billion in 2000-01.

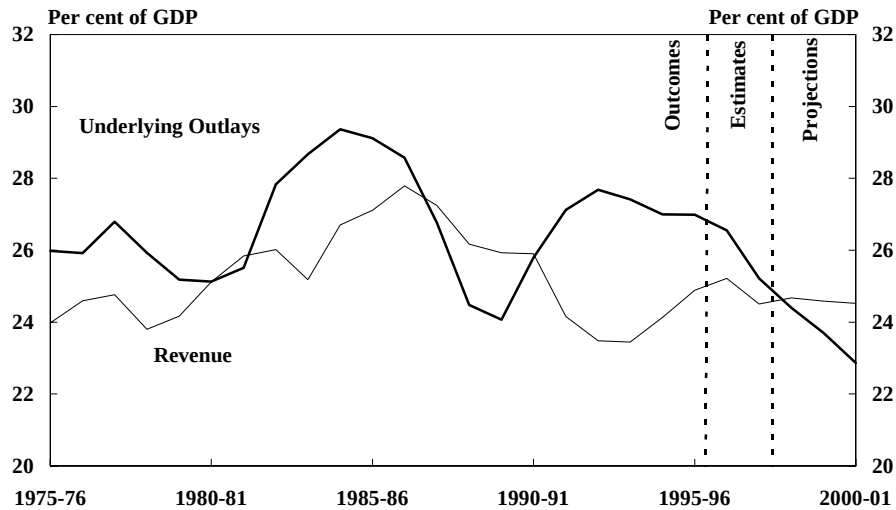
Revenue as a share of GDP is expected to fall to 24½ per cent in 1997-98 and remain broadly around that level over the forward estimates period. This reflects the effects of steady economic growth, the absence of significant fiscal drag in a low inflation environment, the impact of the savings rebate, and the effects of new base protection measures.

The fiscal outlook and projected trend for outlays and revenues compare favourably with recent history. As shown in Chart 10, fiscal consolidation in the second half of the 1990s is being achieved by the steady reduction of underlying outlays as a share of GDP and the broad maintenance of the revenue to GDP share. By the end of the forward estimates period, underlying outlays as a proportion of GDP are projected to fall to their lowest

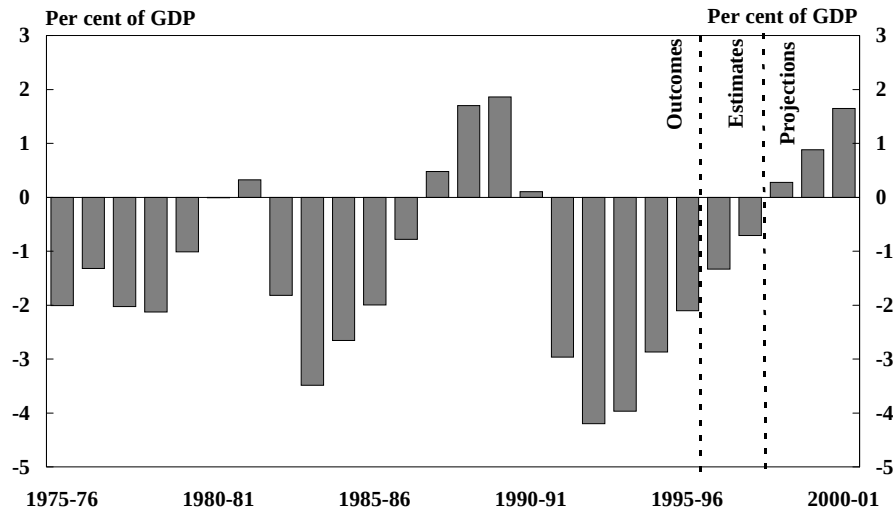
levels in more than 20 years. Fiscal consolidation in the 1980s was achieved at a significantly higher revenue to GDP share than projected in the years ahead — and therefore with the Commonwealth Government absorbing a larger share of national income through taxation and other revenue sources. The trends in outlays and revenue in prospect are indicative of the declining relative size of the Commonwealth Government in the economy.

Chart 10: Underlying Budget Aggregates

Panel A: Budget Sector Revenue and Outlays



Panel B: Underlying Budget Balances



OUTLAYS

Table 5 provides estimates of budget sector outlays for 1996-97 to 2000-01.¹⁵

Table 5: Summary of Budget Sector Outlays

	1996-97		1997-98	1998-99	1999-00	2000-01
	Budget	Revised	Estimate	Projection	Projection	Projection
Underlying outlays (\$m)	135810	136481	137204	140786	144947	148219
<i>Real growth on previous yr (%)</i>	<i>0.1</i>	<i>1.1</i>	<i>-1.4</i>	<i>0.1</i>	<i>0.5</i>	<i>-0.2</i>
<i>Per cent of GDP</i>	<i>26.4</i>	<i>26.6</i>	<i>25.2</i>	<i>24.4</i>	<i>23.7</i>	<i>22.9</i>
Net advances (\$m)	-6123	-7620	-10276	-5187	-394	-405
Outlays (\$m)	129686	128861	126928	135599	144553	147815
<i>Real growth on previous year (%)</i>	<i>-0.5</i>	<i>-0.6</i>	<i>-3.4</i>	<i>4.2</i>	<i>4.1</i>	<i>-0.2</i>
<i>Per cent of GDP</i>	<i>25.2</i>	<i>25.1</i>	<i>23.3</i>	<i>23.5</i>	<i>23.6</i>	<i>22.8</i>

Over the period 1997-98 to 2000-01, underlying outlays are expected to fall:

- in real terms, by around 1½ per cent in 1997-98, and remain broadly unchanged thereafter; and
- as a proportion of GDP, from over 26½ per cent in 1996-97 to just over 25 per cent in 1997-98, and continue to decline steadily in the outyears.

Total outlays (ie underlying outlays plus net advances) fall in real terms in 1997-98, but increase significantly in the following two years. This reflects a sharp reduction in asset sale proceeds forecast from 1998-99. A decline in real terms is forecast for 2000-01.

Net outlays measures taken since the 1996-97 Budget contribute to the fiscal consolidation task in 1997-98 and over the forward estimates period.

Table 6 reconciles the outlays estimates between the 1996-97 Budget, the MYEFO and the 1997-98 Budget in terms of policy decisions and parameter and other variations.

Between the 1996-97 Budget and the MYEFO, underlying outlays increased by \$1.5 billion in 1996-97 but decreased in 1997-98 and the outyears. This pattern largely reflected a number of policy decisions taken by the Government which impacted primarily in 1996-97 and did not have a major effect in the outyears. Revisions to economic parameters—in particular, lower expected inflation and wages growth—reduced outlays in all years, with the expected impact larger in the outyears. Lower interest rates reduced public debt interest outlays in all years. From 1997-98 these positive effects more than outweighed some increase in outlays associated with higher unemployment beneficiary numbers and higher average rates payable on pensions and other benefits.

¹⁵ Further detail on the budget outlays estimates is contained in Statement 4, while historical data on outlays excluding net advances are at Appendix E of this Statement. Details on Commonwealth general government sector outlays are at Appendix F of this Statement and in Statement 7.

Table 6: Reconciliation of Changes to Budget Sector Underlying Outlays since the 1996-97 Budget

	1996-97 \$m	1997-98 \$m	1998-99 \$m	1999-00 \$m
Underlying outlays at 1996-97 Budget	135810	138611	144365	150058
Changes from 1996-97 Budget to MYEFO				
Effect of reclassifications	-44	-44	-45	-45
Policy decisions	1020	-399	237	263
<i>of which</i> public debt interest impact of measures(a)	14	19	56	78
Revision to economic parameters				
JSA/Newstart	177	72	61	93
Prices and wages	-15	-489	-726	-1241
Interest and exchange rates	-9	-22	-18	-20
Public debt interest	-300	-455	-326	-69
Sub total: revisions to economic parameters	-147	-894	-1009	-1237
Programme specific parameters	482	280	452	593
Slippage in 1996-97 Budget decisions	32	38	3	0
Other revisions	110	-155	-153	13
Total variations	1453	-1174	-515	-413
Underlying outlays at 1996-97 MYEFO	137263	137437	143850	149645
Changes from MYEFO to 1997-98 Budget				
Effect of reclassifications	21	9	15	16
Policy decisions(b)	57	-87	-1034	-2220
<i>of which</i> public debt interest impact of measures(a)	0	-217	-310	-471
Revision to economic parameters				
JSA/Newstart	-93	-70	-118	-129
Prices and wages	-36	-414	-590	-549
Interest and exchange rates	-10	10	0	0
Public debt interest	-166	-235	-185	-608
Sub total: revisions to economic parameters	-304	-708	-893	-1286
Programme specific parameters	258	607	576	617
Slippage in 1996-97 Budget decisions	-79	90	6	7
Other revisions	-735	-143	-1734	-1833
Total variations	-781	-233	-3064	-4698
Underlying outlays at 1997-98 Budget	136481	137204	140786	144947
<i>Memorandum item:</i>				
Underlying Outlays Policy Decisions since the MYEFO excluding NHT and commitment to MTAW benchmark(c)	57	-313	-1749	-3193

(a) Includes the public debt interest savings from measures affecting either the underlying or headline balance.

(b) Includes recastings of pre-MYEFO decisions.

(c) Abstracts from Government spending decisions for which an allowance was already set aside in the Contingency Reserve in the 1996-97 Budget.

Revisions to economic parameters in the period since the MYEFO reduce outlays further across all years. Once again, favourable movements in prices and wages and lower public debt interest outlays contribute to the reductions in outlays. Lower forecasts of unemployment beneficiary recipients also reduce outlays.

Downward movements in outlays have been limited by further increases in programme specific parameters, primarily reflecting changes in client numbers and/or higher average rates payable on family payments, family tax payments and disability support pension programmes. As new data have become available, projections of client numbers and average rates payable on a number of payments have been revised. The major revisions

have been to pensions, family tax payments and disability support pension programmes. Programme specific parameters are difficult to forecast because of the need to interpret recent trends in an environment in which programmes and eligibility criteria are changing.

Outlays Measures

Policy decisions taken in the period since the MYEFO (up to and including the 1997-98 Budget) reduce underlying outlays in net terms by \$87 million in 1997-98 and by around \$1 billion in 1998-99.¹⁶

It should be noted, however, that these estimates include the effect of spending decisions for which provision had already been included in the 1996-97 Budget in the Contingency Reserve.

- While the Government's decisions to provide funding for the environment from 1997-98 (through the NHT) and to legislate the commitment to maintain pensions at 25 per cent of MTAWWE have been treated in this Budget as new spending decisions, they do not increase underlying outlays because of the allowance in the Contingency Reserve included in the 1996-97 Budget.

Excluding decisions for which an allowance was previously set aside, net outlays policy decisions since the MYEFO provide for a significant reduction in underlying outlays in 1997-98 and across the outyears.

Table 7 provides a summary of the major savings measures affecting underlying outlays, while Table 8 outlines the major spending measures.

In total, net outlays savings measures in the period since the 1996-97 Budget, after providing funding for new spending measures of \$1 billion in 1997-98 and \$1.6 billion in 1998-99, reduce underlying outlays by \$486 million in 1997-98, and \$797 million in 1998-99.

The most significant saving measure reflects the Government's decision on the 'LAW' tax cuts (shown as outlays when they were proposed as matching Government superannuation contributions) which will not be paid as outlays but part of which will be redirected to a new savings rebate implemented through the tax system. This measure reduces outlays by \$1.1 billion in 1998-99, \$2.4 billion in 1999-2000 and \$4 billion in 2000-01.

¹⁶ Includes public debt interest savings from measures affecting the headline balance.

Other key savings decisions include:

- enhancements in the delivery of public goods and services, including through outsourcing certain services;
- improved administration of social security and health payments; and
- reforms to arrangements for rent relief and funding of public housing.

The savings measures contribute significantly to the fiscal consolidation task and also enable the Government to undertake some new outlays measures including:

- an increase in the rate of Domiciliary Nursing Care Benefit and the extension of Carer Payment;
- the establishment of a Federation Fund to finance projects of national significance to mark the Centenary of Federation; and
- the establishment of the pilot 'Work for the Dole' scheme.

A full description of all 1997-98 Budget outlays measures can be found in Part I of *Budget Paper No. 2*.

Table 7: Major Savings Measures Introduced Since the 1996-97 Budget

Description of Measure	Effect on Underlying Outlays			
	1997-98 \$m	1998-99 \$m	1999-00 \$m	2000-01 \$m
SAVINGS MEASURES				
<i>Measures introduced in the 1997-98 Budget</i>				
Delivery of the 'LAW' tax cut commitment as a savings rebate	1	-1079	-2414	-3980
Therapeutic group premiums	-44	-167	-184	-199
Efficiencies in Whole of Government Information Technology Infrastructure	0	-38	-90	-104
A Planning System to influence the location and supply of new child care places with annual limit of 7000 new private places for 1998 and 1999 only	-10	-42	-72	-83
Rental Assistance to people living in public housing - remove double subsidy	-21	-58	-60	-62
Rural Adjustment Scheme	-46	-44	-50	-55
Funding arrangements under the Commonwealth State Housing Agreement	-50	-50	-50	-50
Introduce a Bonus Plan for persons deferring retirement	4	-21	-42	-42
Improvements to the Data-matching Program and increased review activity	-16	-32	-39	-40
Refocussing the General Practice Strategy on outcomes	-34	-28	-38	-40
Delisting medicine items for less serious medical conditions from the Pharmaceutical Benefits Schedule	-12	-31	-35	-40
Improve targeting of Children's Services Programme to work related care	-3	-15	-25	-34
Revised funding arrangements for repairs, maintenance and refurbishment of properties remaining in Commonwealth ownership	-47	-52	-8	-30
Increase Australian Taxation Office Employment Declaration Form matching with Department of Social Security data	-28	-27	-28	-29
Phased abolition of the Higher Education Commonwealth Industry Places Scheme	-5	-17	-23	-23
Benchmarking efficiencies in Vocational Education and Training Grants to the States	-10	-20	-21	-21
Maintain Local Government General Purpose Assistance Grants in real terms - Determination of 1997-98 Payment	-15	-15	-16	-16
Adjust Medicare Benefits for some optometrical consultations	-8	-14	-15	-16
Other(a)	-439	-590	-878	-846
Sub total	-783	-2341	-4088	-5710
<i>Measures introduced up to the 1997-98 Budget</i>				
Restructure of Australian National Railways Commission	nfp	nfp	nfp	nfp
Proceeds from sale of additional spectrum	nfp	nfp	nfp	nfp
Sale of the commercial arm of the Domestic Property Group (formerly known as the Australian Property Group)	nfp	nfp	nfp	nfp
Other	15	-13	-1	-1
Sub total	-679	-6	0	0
Total Savings Measures	-1462	-2347	-4088	-5709

(a) Includes public debt interest savings of decisions.

Table 8: Major Spending Measures Introduced Since the 1996-97 Budget

Description of Measure	Effect on Underlying Outlays			
	1997-98 \$m	1998-99 \$m	1999-00 \$m	2000-01 \$m
SPENDING MEASURES				
<i>Measures introduced in the 1997-98 Budget</i>				
Establishment of the Federation Fund	0	100	200	300
Natural Heritage Trust of Australia Reserve(a)	162	265	273	255
Sydney 2000 Games - Olympics and Paralympics	4	63	75	68
Integrated Rural Policy Package	45	46	52	55
Continuation of funding for the Australian Film Finance Corporation	0	48	48	48
Changes to entry level training employer incentives	-1	6	16	30
AQIS - Implementation of Reviews and Reports	28	31	33	28
Additional accommodation support places for people with disabilities and their families	6	12	18	18
Aboriginal and Torres Strait Islander Affairs Agencies funding arrangements - Guaranteed funding with an increased base	15	15	16	16
Additional funding for the Federal Court and the National Native Title Tribunal for workload increases and amendments to the Native Title Act 1993	16	15	15	15
Renewal of the National Mental Health Strategy	0	8	12	9
Higher education restructuring and rationalisation package	10	7	4	4
Extension of application of the Shipbuilding Bounty	8	21	1	0
Work for the Dole Initiative	17	5	0	0
Provision of funding to the Australian Electoral Commission for the cost of the election of delegates to the Constitutional Convention	24	0	0	0
National Public Health - Continuation of Public Health Programmes	12	22	0	0
Extension of funding for palliative care	15	0	0	0
Other	193	175	181	176
Sub total	553	840	944	1023
<i>Measures introduced up to the 1997-98 Budget</i>				
Maintain the single rate of pension at 25% of MTAW(a)	64	450	700	1030
Extension of real per capita guarantee on Financial Assistance Grants to the States and Territories	0	0	202	207
Application of time limits to the recovery of certain debts	24	66	69	70
Regional Telecommunications Infrastructure Fund	50	50	50	50
Enhanced assistance to the pharmaceutical industry	0	0	23	49
Amendments to migrant two-year waiting period for social security payments	114	60	43	43
Amendments to activity test penalty periods for Newstart Allowance	32	30	32	29
Additional funding for Natural Heritage Trust of Australia Reserve	25	25	25	25
Small Business Statement	7	9	5	5
Drought - extension of recovery period	33	0	0	0
Australian Leather Holdings Ltd Package	13	13	0	0
Extension of the operation of the shipbuilding bounty to 31 December 1997	10	0	0	0
Other	52	6	38	39
Sub total	422	710	1186	1547
Total Spending Measures	976	1550	2131	2570
TOTAL IMPACT OF ALL MEASURES	-486	-797	-1957	-3140

(a) An allowance was included in the Contingency Reserve for these items in the 1996-97 Budget.

REVENUE

Table 9 provides estimates of budget sector revenues for 1996-97 to 2000-01.¹⁷

Table 9: Summary of Budget Sector Revenue

	1996-97		1997-98	1998-99	1999-00	2000-01
	Budget	Revised	Estimate	Projection	Projection	Projection
Total tax (\$m)	125028	124363	129433	138248	146191	154796
<i>Real growth on previous yr (%)</i>	4.5	4.5	2.0	4.2	3.3	3.3
<i>Per cent of GDP</i>	24.3	24.2	23.8	24.0	23.9	23.9
Non-tax (\$m)	5132	5263	3918	4135	4139	4114
<i>Real growth on previous yr (%)</i>	-5.9	-3.0	-27.0	2.9	-2.2	-3.0
<i>Per cent of GDP</i>	1.0	1.0	0.7	0.7	0.7	0.6
Total revenue (\$m)	130160	129625	133351	142383	150330	158911
<i>Real growth on previous yr (%)</i>	4.0	4.1	0.9	4.1	3.1	3.1
<i>Per cent of GDP</i>	25.3	25.2	24.5	24.7	24.6	24.5

Over the period 1997-98 to 2000-01 total revenue is expected:

- in real terms, to increase slightly in 1997-98, and pick-up significantly in the outyears; and
- as a proportion of GDP, to fall to 24½ per cent in 1997-98 and remain broadly at around that level over the outyears.

Revenue measures since the 1996-97 Budget have a small net impact on revenues in 1997-98 and 1998-99, and, with the full phasing in of the savings rebate, detract strongly from revenues thereafter.

Table 10 reconciles revenue estimates at the time of the 1996-97 Budget, the MYEFO and the 1997-98 Budget in terms of policy decisions and parameter and other variations.

At the time of the MYEFO, the revenue estimates were revised downwards substantially. This primarily reflected downward revisions to company tax revenues as a result of lower than anticipated collections in 1996-97. Some large companies used stock valuation options to take advantage of the lower company tax rate applying to the 1994-95 income year. Company tax revenue in 1997-98 was expected to recover with the end of these one-off tax planning activities. In addition, lower inflation than forecast at budget time and a more favourable outlook for wages reduced revenue. Slightly lower forecast consumption also reduced expected revenue from sales tax and excise.

¹⁷ More detail on the budget revenue estimates is contained in Statement 5, while historical data on revenue are at Appendix E of this Statement. Details on Commonwealth general government sector revenues are at Appendix F of this Statement.

Table 10: Reconciliation of Budget and Forward Estimates of Revenue in Aggregate

	1996-97 \$m	1997-98 \$m	1998-99 \$m	1999-00 \$m
Revenue at 1996-97 Budget	130160	137063	145322	155729
Changes from 1996-97 Budget to MYEFO				
Policy decisions	-42	-93	-107	-116
Parameter and other revisions	-1345	-3459	-3517	-4300
Total variations	-1387	-3552	-3624	-4416
Revenue at 1996-97 MYEFO	128773	133511	141698	151313
Changes from 1996-97 MYEFO to 1997-98 Budget				
Effect of reclassifications	10	10	10	10
Policy decisions(a)	0	39	192	-1182
Parameter and other revisions	843	-209	483	189
Total variations	853	-160	685	-983
Revenue at 1997-98 Budget	129625	133351	142383	150330

(a) Includes recastings of pre-MYEFO decisions.

In the period since the MYEFO, the outlook for revenue has generally improved. This reflects stronger than expected collections for some revenue items (including other individuals tax and company tax) in 1996-97 and some favourable movements in economic parameters. Overall in 1997-98, however, parameter and other revisions have detracted slightly from revenue. This reflects a lower than expected dividend from the RBA and weaker parameter growth for certain revenue items.

Revenue Measures

In keeping with the Government's commitments, this Budget does not introduce new taxes or increase existing tax rates. The Government's policy emphasis in the 1997-98 Budget has been on protecting the tax base and addressing anomalies in the tax system. The primary purpose of many of the revenue measures is to prevent risks to the revenue estimates and therefore the fiscal outlook that would otherwise emerge.

Revenue policy decisions in the period since the 1996-97 Budget have little impact in 1997-98, increase revenue slightly in 1998-99, but reduce revenue substantially from 1999-2000 with the introduction of the savings rebate. The decision to introduce a savings rebate scheme through the taxation system is expected to decrease revenue by \$350 million in 1998-99 rising to \$1.4 billion in 1999-2000 (the first full year of implementation).

The Government has taken action in the 1997-98 Budget to remove or wind back some tax incentives, as well as replacing one with a more effective outlays measure. Appendix C discusses in more detail the revenue impacts associated with concessional taxation treatment of specific groups and/or activities.

Table 11 provides a summary of all revenue measures introduced up to and including the 1997-98 Budget. A full list of revenue measures is included in Appendix A of Statement 5 and described in full in *Budget Paper No. 2*.

The major measures include:

- The taxation rebate for savings.
- Revenue protection/tax avoidance and minimisation measures, such as:
 - changes to the system for taxing foreign source income to reduce the incentive for Australians to locate highly mobile assets and income offshore purely for taxation reasons; and
 - other tax base protection measures introduced in relation to: trust losses; taxation of distributions disguised as loans from private companies; dividend streaming; franking credit trading; passive income of life and general insurance companies; and fuel substitution minimisation.
- Changes to tax incentives, such as:
 - the introduction of a tax rebate to continue Commonwealth support of private sector infrastructure provision: this will replace the Infrastructure Borrowings (IBs) tax concession for which, as previously announced, further certificates cannot be issued (and existing certificates cannot be re-engineered) from 14 February 1997;
 - changes to the capital gains tax cost base provisions to prevent double tax deductions that can arise in respect of certain types of capital expenditure; and
 - removal of the tax exemption for payments under the Commonwealth Rebate for Apprentice Full-Time Training scheme with the revenue used to fund changes in entry level training incentives delivered through outlays.
- Changes to withholding tax arrangements, such as:
 - changes to the timing of payment of income tax amounts withheld by business under the Pay-As-You-Earn (PAYE), Prescribed Payments System and Reportable Payments System arrangements.

Table 11: Summary of Revenue Measures Introduced Since the 1996-97 Budget

Description of Measure	Estimated Change in Revenue(a)			
	1997-98 \$m	1998-99 \$m	1999-00 \$m	2000-01 \$m
MEASURES INTRODUCED IN THE 1997-98 BUDGET				
<i>Superannuation and savings</i>				
Taxation rebate for savings(b)	-	-350	-1370	-2040
Improvements to Superannuation Preservation Arrangements	-	-	-35	-105
Other superannuation and savings measures(c)	-24	-50	-26	-22
<i>Revenue protection/tax avoidance and minimisation</i>				
Trust losses	5	15	20	20
Taxation of distributions disguised as loans from private companies	2	50	30	30
National Crime Authority investigations	-	40	40	-
Taxation of foreign source income	-	150	150	150
Revenue savings through fuel substitution minimisation	13	25	25	25
Other(d)(e)	-	10	10	10
<i>Tax incentives</i>				
Infrastructure Borrowings tax rebate	-38	-75	-75	-75
Medicare levy low income thresholds — 1997-98	-3	-35	-18	-18
Conversion of the CRAFT tax expenditure to outlays	-	35	45	55
Other(f)	-5	..	-	-
<i>Other</i>				
Withholding tax arrangements	-	330	-	-
Hire purchase arrangements — balancing adjustment	5	30	20	25
Capital gains tax cost base provisions	5	80	120	125
Special dividend from Australia Post	80	80	-	-
Other	31	56	58	62
	71	391	-1006	-1758
MEASURES INTRODUCED UP TO THE 1997-98 BUDGET(g)				
<i>Small business</i>				
Capital gains tax measures(h)	-	-175	-180	-180
Fringe benefits tax measures(i)	-30	-75	-55	-55
<i>Revenue protection/tax avoidance and minimisation(j)(e)</i>				
Other	-95	-56	-57	-53
	-125	-306	-292	-288
Total Impact of all Measures	-54	85	-1298	-2046

- (a) A minus sign before an estimate indicates a reduction in revenue; no sign before an estimate indicates a gain to revenue.
- (b) This measure will reduce outlays compared with forward estimates for matching Government superannuation contributions as described in the 1995-96 Budget. The net fiscal impact of implementing the savings rebate, but not going ahead with matching Government superannuation contributions, will be positive.
- (c) Includes superannuation measures regarding: freezing the trustee tax rate for friendly societies; broadening the definition of 'complying' pensions and annuities in the Superannuation Industry (Supervision) Regulations; choice of superannuation fund; opting out of the Superannuation Guarantee system; and some preservation measures.
- (d) Includes measures regarding: taxation of trusts; trading in franking credits and dividend streaming; passive income of life and general insurance companies; and the interaction of controlled foreign company measures and capital gains tax provisions.
- (e) These measures will protect the revenue base used for the forward estimates by removing opportunities for significant future expansion of tax minimisation practices. In the absence of these measures there generally would be a significant revenue loss compared to the forward estimates. In some cases, there will also be an unquantifiable revenue gain to the extent of any existing tax minimisation.
- (f) Includes measures regarding: provisional tax exemption for pensioners and tax deductibility for Constitutional Convention election expenses.
- (g) Includes measures amended or rejected by the Senate up to the 1997-98 Budget.
- (h) Includes measures regarding: capital gains tax (CGT) rollover relief for small business — removal of like kind test and extension of rollover relief through shares; and CGT exemption on the sale of a small business for retirement.
- (i) Includes measures regarding: fringe benefits tax (FBT) car parking and record keeping exemptions; and extension of FBT taxi trips exemption.
- (j) Includes measures regarding: preventing future access to the IBs tax concession; taxation of foreign dividends paid on finance shares; life insurance companies' exempt and taxable income; and capital losses — denial of artificially created losses.

APPENDIX A: STATEMENT OF RISKS

OVERVIEW

The forward estimates of revenue and outlays in the Budget Papers incorporate assumptions and judgements based on information available at the time of publication.

A range of factors may influence the actual budget outcome in future years. The Charter of Budget Honesty Bill 1996 requires these to be disclosed in a Statement of Risks in each Economic and Fiscal Outlook Report. The purpose of this report is to increase the transparency of the fiscal projections.

Events which could affect fiscal outcomes include:

- changes in economic and other parameters;
- matters which have not been included in the fiscal forecasts because of uncertainty about their timing, magnitude, or whether they will eventuate; and
- the realisation of contingent liabilities.

Economic and Other Parameters

The major factor influencing expected outlays and revenues in any year is typically changes in forecasts of economic and non-economic parameters. Over the past decade, differences between the economic parameter forecasts and outcomes have tended to be random in their effect on the budget balance. Differences in non-economic (programme-specific) parameter forecasts and outcomes, however, have been strongly biased towards an understatement of outlays in recent years. The sensitivity of the estimates to major economic parameters (but not other parameters) is discussed in Appendix B. Part I of this Statement discusses the economic outlook and identifies risks affecting major components.

Programme-specific parameters are specific assumptions underpinning specific programme estimates, eg client numbers and/or average rates payable on family payments, family tax payments and disability support pension programmes.

The projected values for programme specific parameters are determined jointly with the relevant spending portfolio, drawing on trends in actual payments and information which the portfolio is able to provide on the impact of policy changes on the programme estimates. Forecasting of programme-specific parameters has been complicated by substantial policy changes in the past decade.

Fiscal Risks

Fiscal risks are general developments or specific events which may have an effect on the fiscal outlook. In some cases, the events will simply raise the possibility of some fiscal impact. In other cases, some fiscal impact will be reasonably certain, but it will not be included in the forward estimates because the timing or magnitude is not known. Fiscal risks may affect both outlays and revenue and may be positive or negative.

Specific sources of fiscal risk include:

- litigation currently before the courts; and
- possible Senate rejection of budget measures.

Some fiscal risks are reflected in the Outlays Contingency Reserve and are therefore included in the aggregate outlays figuring. The Contingency Reserve is an allowance included in aggregate outlays to reflect anticipated events which cannot be assigned to individual programmes at budget time. These items are not also included in the Statement of Risks. Fiscal risks in the Contingency Reserve include expected running costs carryovers from 1997-98 to 1998-99 and allowances for the established tendency for estimates of some programme expenditure to be overstated in the budget year and understated in the forward years.

Matters that are not currently under active consideration by government or pressure from interests outside the government for changes in spending levels are not treated as fiscal risks.

Details of known fiscal risks which may have an impact on fiscal forecasts but are not reflected in the forward estimates in the Economic and Fiscal Outlook are provided below.

Contingent Liabilities

Contingent liabilities differ from fiscal risks in that they are generally more readily quantifiable and clearly defined.

Contingent liabilities are defined as costs the Government will have to face if a particular event occurs. They include loan guarantees, non-loan guarantees, warranties, indemnities, uncalled capital and letters of comfort.

The Commonwealth's major exposures to contingent liabilities arise out of legislation providing guarantees over certain liabilities of Commonwealth controlled financial institutions (ie the RBA, Australian Industry Development Corporation, Housing Loans Insurance Corporation and Export Finance and Insurance Corporation) and the now fully privatised Commonwealth Bank of Australia. Other substantial non-loan guarantees include guaranteed payments from Telstra Corporation Ltd to the Telecom Superannuation Scheme.

The strategies for managing these exposures are aimed at ensuring the underlying strength and viability of the entities with respect to which guarantees have been provided so that the guarantees are not triggered. Similar strategies apply to entities not subject to explicit guarantees.

This is achieved through, for example:

- the appointment of specialist boards to manage the entities in accordance with sound business practice;

- specific oversight of the businesses by a Minister with responsibilities set down in establishing legislation (or the Memoranda and Articles of Association in the case of Corporations Law companies);
- general monitoring and oversight of all government business enterprises by the Minister for Finance and Cabinet under Government Business Enterprise (GBE) monitoring arrangements; and
- where applicable, prudential oversight by the RBA, the Insurance and Superannuation Commission and the Australian Securities Commission.

The Government has commissioned an independent review of governance and other arrangements applying to GBEs. Risk exposure is addressed as part of the terms of reference. The report has been finalised and the Government is currently preparing a response to allow any new arrangements adopted to come into effect from 1 July 1997.

Other arrangements are in place governing the entering into and monitoring of contingent liabilities such as indemnities and uncalled capital. Uncalled capital is primarily associated with international financial institutions such as the International Bank for Reconstruction and Development, the Asian Development Bank and the European Bank for Reconstruction and Development. Arrangements concerning uncalled capital are approved by Parliament and reports on the institutions are provided annually by the Government to Parliament.

Consistent with ABS standards, transactions concerned with the management of international reserves and the monetary system are classified as financing transactions (and do not impact on the deficits). Therefore, contingent liabilities (and assets) with the IMF are not shown here.

The issue of indemnities and other similar undertakings by Commonwealth agencies is primarily governed by the Finance Directions issued under the authority of the *Audit Act 1901* and related policy guidelines issued by the Department of Finance. The policy guidelines covering indemnities have been reviewed and will be re-issued. The guidelines will be prepared in consultation with the Australian National Audit Office (ANAO) and the Attorney-General's Department and will be extended to cover guarantees and letters of comfort. The guidelines will reflect recommendations contained in the ANAO Report *Commonwealth Guarantees, Indemnities and Letters of Comfort* (No. 6 of 1996-97).

DETAILS OF FISCAL RISKS AND CONTINGENT LIABILITIES

Fiscal risks and contingent liabilities with a possible impact on the forward estimates greater than \$20 million in any one year or \$40 million over the forward estimates period are listed below. Information on fiscal risks takes account of decisions of Parliament and other developments up to the close of parliamentary business on 31 March 1997. Information on contingent liabilities is based on information provided by departments and agencies and is current to 31 March 1997.

This is the second Statement of Risks for the Commonwealth General Government Sector, following that published in the MYEFO. Information on contingent liabilities is provided in annual financial statements of departments and non-budget entities.

Fiscal Risks

Outlays

Hospital Funding under Current Medicare Agreements — Two Per Cent Review

In accordance with the current Medicare Agreements, a review is currently being conducted by the Commonwealth, in consultation with the States, as a result of a decline of more than two percentage points in the private health insurance participation rate since September 1994. The cost of the resultant demand transfer to public hospitals has been estimated to be in the range of \$38 million to \$124 million per annum. The review will consider the demand transfer estimate in the context of overall changes in Commonwealth and State outlays on hospital services and other relevant factors and is expected to be finalised in 1996-97. A similar review in respect of the 2.1 per cent decline in the private health insurance participation rate from June 1993 to September 1994 did not result in an increase in Commonwealth outlays.

Renegotiation of Medicare Agreements

The current Medicare Agreements between the Commonwealth and the States for the provision of hospital funding grants expire on 30 June 1998. The basis for Commonwealth and State cost sharing beyond 1997-98 is to be renegotiated. This will involve a reassessment of the basis on which the Commonwealth and States currently share the risk of demand and cost for hospital services and may therefore result in a change to the Commonwealth funding contribution. The magnitude and direction of any such change in funding arrangements is unknown at this stage.

Pharmaceutical Benefits Scheme — Major New Listings

Cabinet approval is required when the cost of the listing of new drugs under the Pharmaceutical Benefits Scheme is over \$10 million. New drugs can only be listed after an assessment of comparative effectiveness and value for money. The listing of these high-cost new drugs between now and 2000-01 has the potential to add up to \$200 million in total over four years to Commonwealth outlays.

Industry Commission Report into Private Health Insurance

In September 1996, the Government commissioned the Industry Commission to conduct an inquiry into private health insurance and report its findings by the end of February 1997. The Commission's final report includes twenty-two recommendations which may impact on the competitiveness, productivity, efficiency and cost effectiveness of the private health insurance industry in the short to medium-term, resulting in a net increase in the proportion of the population covered by private health insurance. Although the Government has issued an interim response, the Government is still considering its final response to these recommendations. However, there is a potential impact on Commonwealth health outlays if some of the recommendations are adopted.

The magnitude and direction of any change in Commonwealth health expenditure is unknown at this stage.

National Measles Eradication Programme

On 25 February 1997, the Minister for Health and Family Services foreshadowed the development of a one-off school based catch-up programme for measles immunisation. Feasibility studies are expected to be finalised by the end of 1997. The programme could be implemented in late 1998. Detailed costings are not available at this stage. However, it is estimated that a programme of this type could cost around \$30 million.

Mortimer Review of Business Assistance

In November 1996, the Government asked Mr David Mortimer to undertake a comprehensive review of business assistance programmes with a view to ensuring that industry has available a targeted and effective suite of programmes which best meets its needs. The Mortimer Review of Business Assistance is expected to report to the Government in June 1997. The likely fiscal impacts of the Review are not known at this stage.

Native Title Cost Sharing

The Commonwealth has offered to assist States and Territories in meeting costs associated with their validation of past Acts under legislation complementary to the *Native Title Act 1993*. The extent of Commonwealth payments to the States pursuant to this offer will depend largely on the States' own liabilities to pay compensation to native title holders. Those liabilities cannot be quantified at this time. The Commonwealth has also offered to assist States and Territories with the costs of alternative arbitral bodies and regimes approved under the Act. The extent of this assistance will depend on decisions to establish such bodies and regimes, the timing of their recognition and the extent of their use.

Delay in Senate Consideration of Social Security 1996-97 Budget Measures

Loss of savings may result from delay in passage or amendment of the Minister for Social Security's revised proposals to change the Newstart Allowance activity test penalty provisions and to introduce new impairment tables for use in the assessment of Disability Support Pension.

R G Casey Building, York Park

The Commonwealth is currently in litigation with the Stage 1 contractor for the R.G. Casey Building, York Park. The contractor filed a Statement of Claim before the Federal Court in 1995 totalling \$26.1 million. It is expected the case will not be heard by the Court until late 1998.

Litigation Cases in Train — Department of Health and Family Services

The Department of Health and Family Services is involved in around 100 cases covering a wide range of litigation, in which the cases have yet to be resolved or cases have been

heard but damages and costs have yet to be awarded. The litigation involves: Creutzfeldt-Jakob disease; Acquired Immune Deficiency Syndrome; tobacco; Rehabilitation Services; benefit payments; defective products; and the Department as an employer. It is not possible to quantify the liability arising from these cases.

Litigation by Western Mining Corporation (WMC)

WMC won a Federal Court case challenging the Commonwealth for loss of property rights in relation to its loss of permit for oil exploration in the Timor Gap (following a rezoning of the area). The Commonwealth has been granted leave to appeal the decision by the High Court and the case is expected to be heard around mid 1997, with a decision by the end of 1997.

Compensation claims — Finalisation of Acquisition of Properties for the Second Sydney Airport at Badgerys Creek

Compensation claims relating to properties acquired for the proposed second Sydney Airport at Badgerys Creek which have not been finalised at 31 March 1997 give rise to a risk of \$41.1 million. The properties were acquired under the *Lands Acquisition Act 1989*.

Separation of Aboriginal Children from their Families in the Northern Territory

Earlier laws, policies and practices led to the separation of many Aboriginal and Torres Strait Islander families. Legal actions are under way against the Commonwealth concerning the separation of Aboriginal children from their families in the Northern Territory. The plaintiffs are claiming damages and if any or all of the actions are successful, the Commonwealth may be liable for payments.

Australian Nuclear Science and Technology Organisation (ANSTO) Spent Fuel Elements

There are in excess of 1600 spent nuclear fuel elements stored at Lucas Heights and storage is reaching capacity. The cost of disposition of current holdings, beyond what is already provided for in the estimates for storage relief, is in the order of \$80 million.

Diesel Fuel Rebate Scheme — Major Litigation

Legal action through the Administrative Appeals Tribunal and the Federal Court is being pursued by a range of companies involved in quarrying activities for payment under the Diesel Fuel Rebate Scheme in respect of diesel fuel used in the extraction of sand and rock undertaken prior to 1 July 1995. Possible claims on the Commonwealth from a successful legal challenge could amount to some \$90-\$100 million. The *Excise Act 1901* and the *Customs Act 1901* were amended with effect from 1 July 1995 to remove sand and rock extraction from eligibility under the Scheme.

AUSTUDY/ABSTUDY Supplement Loan

The Commonwealth currently has an agreement with the Commonwealth Bank of Australia to provide loans to tertiary students under the AUSTUDY/ABSTUDY

Supplement Loan scheme. The agreement expires on 31 December 1997. Should the agreement not be renewed, AUSTUDY/ABSTUDY outlays would increase as a result. The scheme will be reviewed in the coming months with the outcomes, including any fiscal implications, to be considered by Cabinet before December 1997.

Revenue

General Risks

The forward estimates of revenue are subject to a number of general pressures or risks. These general pressures or risks include: tax minimisation and avoidance; financial innovation; internationalisation; developments in communications technology; changes in PAYE arrangements and personal services income; the treatment of trusts; changes in community expenditure patterns; taxpayer behavioural responses; and court decisions. Tax concessions (or 'tax expenditures') are particularly susceptible to these pressures and risks. These general risks may result in a shift in the composition of revenue collected from the various tax bases and/or an erosion of the tax base.

Tax minimisation and avoidance involves the use of provisions and 'loopholes' in the tax law which were not intended by policy-makers. With evidence of greater taxpayer focus on tax avoidance and minimisation schemes, and in the absence of closing these off, the revenue base will shrink relative to that projected in the forward estimates. The Government will continue to take legislative action to close off such schemes as they are identified. In addition, the Australian Taxation Office (ATO) will continue to undertake extensive compliance enforcement work, including pursuing matters through the courts, to maintain the integrity of the tax system.

Financial innovation has increased dramatically during the past two decades and the tax system has generally not kept pace with these innovations. As a result, uncertainty has arisen over the application of existing laws to new and often complex financial arrangements and the scope for tax minimisation and avoidance through the application of financial arrangements has expanded. Ideally, the tax laws relating to financial arrangements should not create uncertainty and anomalies, should not inhibit innovation or the capacity of industry to efficiently and effectively manage risks, and should not facilitate tax minimisation and avoidance. An issues paper on the taxation of financial arrangements was released by the Treasury and the ATO in late 1996 and public discussion and submissions from interested groups on the proposals are ongoing.

The **internationalisation** of the Australian economy also introduces a general risk to the forward estimates of revenue. Income tax collections from capital are subject to increasing downward pressure due to the relatively free international flow of capital, intra-corporate transfer pricing and 'tax competition' among jurisdictions. Similarly, income tax collections from labour are coming under increasing downward pressure as labour becomes more internationally mobile and subject to tax competition. The increasing global integration of economies also means the integrity of each country's tax system will increasingly rely on international co-operation on tax matters.

Developments in **communications technology**, such as the Internet, also raise a general risk to the forward estimates of revenue. Such developments may allow the purchase or sale of an increasing number of goods and services — including the provision of labour

services — in a way which avoids the traditional tax bases (and indeed most alternative, reasonably sophisticated, tax bases). Such developments pose a major challenge in tax system design in most countries.

Changing taxpayer practices affecting **PAYE arrangements and personal services income** could also have significant consequences for the revenue estimates. Certain labour market practices involving the replacement of traditional common law employer/employee relationships with labour or result-based contracts are outside the scope of the PAYE provisions in the income tax law and must be taxed through other arrangements. In other cases, individuals may interpose an entity (eg a company) through which they provide personal services with the intention of ‘alienating’ the personal services income received. Alienation occurs where an individual performs work (personal service) but the relevant income is received by the interposed entity and either retained in the entity or distributed to other individuals (eg family members) who did not contribute to the work. In response to these trends, the Commissioner of Taxation will take the necessary steps to safeguard the intended operation of the law in these areas, including, where necessary, testing the law in the courts.

The tax treatment of **trusts** is another area of significant revenue risk, given the scope for trusts to be used to reduce tax liabilities and the reality of their modern day usage. As announced in the Budget, the Government will be reviewing the taxation of trusts.

Changes in **community expenditure patterns** are a further general risk in any tax system with differing tax rates. For example, the trend decline in expenditure on goods relative to services, moderate growth in alcohol and tobacco consumption and less intensive use of petroleum products exert downward pressure on the forward estimates of indirect tax revenue. These trends are allowed for in the estimates — it is only departures from the assumed trends that pose a risk.

Court decisions also increase the risk that revenue will be lower or higher than anticipated. Court decisions can affect the interpretation of tax legislation and, in the absence of Government action, can significantly change the level of revenue collected under that legislation.

Tax expenditures are particularly at risk of being exploited in an inappropriate manner, which can also have a significant effect on the forward estimates of revenue. The Government receives a steady stream of calls for new tax expenditures to be granted. If further tax expenditures are granted, the forward estimates of revenue will be adjusted downwards. Equally, if any existing tax expenditures are wound back, the forward estimates of revenue will be adjusted upwards. The Government has indicated that all tax expenditures will be subject to ongoing monitoring and evaluation to determine whether they remain relevant to meeting the Government’s priorities.

Apart from the above-mentioned general risks which could have a cumulative impact over time, there are general risks to the forward estimates which could have a significant effect in any one year but not necessarily a cumulative effect over time. In any one year revenue will be influenced by a number of factors, including, for example, the degree to which companies and individuals realise losses and capital gains, the valuation of stock, the utilisation of specific tax expenditures and taxpayer behavioural responses to revenue measures. Such factors can have a particularly significant effect on company tax collections and the revenue forgone through tax expenditures. Generally, such factors are not, by their nature, able to be forecast with a high degree of certainty.

Specific Risks

There are also a number of specific risks to revenue that are currently the subject of ongoing analysis and evaluation by the Treasury and the ATO. Such risks can include, for example, specific tax minimisation and avoidance schemes. Early detection and Government response to such risks is desirable. It would be inappropriate to explicitly identify such current specific risks until the Government is in a position to respond to the risks. To do so may compromise the Government's policy response and magnify the downside risks to the forward estimates of revenue.

The Government has announced a number of measures to date which have already been factored into the forward estimates of revenue but are yet to be passed by Parliament. Should the passage of legislation relating to these measures be delayed, amended or rejected, the forward estimates will need to be appropriately adjusted. Legislation relating to some of these measures is discussed below.

The Taxation Laws Amendment (Infrastructure Borrowings) Bill 1997 was introduced into Parliament on 26 March 1997. The Bill prevents, with effect from 12.00 pm, 14 February 1997: the lodging of any new **Infrastructure Borrowings** (IBs) applications; the issue of any further IB certificates (except where, prior to that time, the Development Allowance Authority had given a written undertaking to issue a certificate); and re-engineering (including amendment) in respect of existing certificates to increase tax benefits. If this legislation is rejected or substantially amended, a cost to revenue of over \$4 billion may be involved over the three years 1996-97 to 1998-99.

The Government has decided to implement its commitment to provide eligible taxpayers a choice between accelerated deductions for **Landcare works** under sections 75B and 75D of the *Income Tax Assessment Act 1936* or a tax rebate/credit set at the marginal tax rate of 34 cents in the dollar for qualifying expenditure. This will be implemented through the establishment of the Natural Heritage Trust of Australia Reserve arising from the partial privatisation of Telstra.

In the 1996-97 Budget, the Government introduced a **surcharge on superannuation contributions of high income earners**. The surcharge, of up to 15 per cent on all employer and tax deductible personal contributions made to superannuation funds or Retirement Savings Accounts, will be phased in over the income levels of \$70,000 to \$85,000. The surcharge will effectively increase by 1 percentage point for each additional \$1,000 of income from \$70,000.

As the legislation to introduce the superannuation surcharge has not yet been passed by the Parliament, there remains a risk that the measure will not progress to implementation. If this were to occur, the total cost to revenue over the next three years would be \$1,480 million. There is also the risk that the provision for advance instalment of surcharge liabilities may be opposed. If this occurred, the total cost to revenue would be \$240 million over the next three years. Some revenue may also be at risk if amendments to the legislation make it limited in application or workability.

Contingent Liabilities

Quantifiable

Commonwealth Indemnity Scheme

The Commonwealth has provided indemnities to the owners of artworks against loss of, or damage to, those artworks whilst they are on loan to galleries participating in exhibitions organised under the Scheme. The global limit on indemnities as at 31 March 1997 was \$1,000 million and the actual amount indemnified was approximately \$345.6 million.

Telstra Corporation Ltd — Loan Guarantee

The Commonwealth has guaranteed loans taken out by Telstra Corporation Ltd. The principal amount covered by the guarantee as at 31 March 1997 was \$379 million.

Australian Broadcasting Corporation

The Commonwealth has guaranteed loans totalling \$206.5 million drawn by the Corporation. These loans were largely used to meet costs relating to the construction of premises for the Corporation at Southbank (Melbourne) and Ultimo (Sydney).

Special Broadcasting Service

The Commonwealth has guaranteed loans totalling \$39 million drawn by the Corporation. These loans were used to pay for refurbishment and enhancement of the Corporation's premises at Artarmon in Sydney.

Defence Housing Authority

Private sector borrowing by the Defence Housing Authority is explicitly guaranteed by the Commonwealth under Section 38 of the *Defence Housing Authority Act 1987*. The value of loans guaranteed at 31 March 1997 was \$534 million, but after the repayment of \$189 million on 1 April 1997 this fell to \$345 million.

AUSTUDY/ABSTUDY Supplement Loan

The AUSTUDY Loans Supplement is a voluntary loan scheme which enables tertiary students to obtain additional financial assistance to enable them to meet their living expenses while studying. The loans are negotiated with the Commonwealth Bank of

Australia and guaranteed by the Commonwealth. As at 31 March 1997, the value of such loans was \$927.9 million.

Sale of Snowy Mountains Engineering Corporation (SMEC)

An indemnity has been given to SMEC in a Deed of Undertaking from the Commonwealth to Tinbury Ltd. The Deed provides an undertaking by the Commonwealth to Tinbury Ltd that if within five years of the sale of SMEC, SMEC goes into liquidation, the Commonwealth will pay \$1 million to Tinbury Ltd. This indemnity was issued on 9 November 1993 and will terminate on 8 November 1998.

Northern Territory Government Loans

Loans of the Northern Territory Government (Private Treaty Loans, Public Loan Flotations, and Private Placement of Northern Territory Stock) are covered by Commonwealth guarantee under sections 47 and 47A of the *Northern Territory Self Government Act 1978*. As at 31 March 1997 the value of these loans was \$202.8 million.

The payment of interest on the money borrowed by the Northern Territory Government is also guaranteed. At 31 March 1997 no interest payments were overdue.

Australian Industry Development Corporation (AIDC)

As at 31 March 1997, AIDC contingent liabilities totalled \$4,005 million comprising \$909 million in respect of guarantees and credit risk facilities and \$3,096 million in respect of borrowings by the Corporation which are subject to a Commonwealth guarantee. Of the AIDC's borrowings, \$168 million is invested in Commonwealth assets. These assets have been netted off the gross borrowings in determining the above liabilities.

Export Finance and Insurance Corporation (EFIC)

The Commonwealth guarantees the due payment by EFIC of money that is, or may at any time become, payable by EFIC to any person other than the Commonwealth. As at 31 March 1997 the contingent liability totals \$7,401 million comprising contracts of insurance and guarantees (\$2,978 million), loans (\$2,718 million) and national interest provisions (\$1,705 million).

Snowy Mountains Hydro-electric Authority

The *Snowy Mountains Hydro-electric Power Act 1949* provides that borrowings by the Snowy Mountains Hydro-electric Authority may be guaranteed by the Commonwealth. The Authority has issued inscribed stock at a discount to finance capital works of the Scheme. The borrowings are subject to explicit Commonwealth guarantees. At 31 March 1997 the face value of guaranteed borrowings was \$212.5 million, with the net amount guaranteed (excluding unamortised discount on the issue of inscribed stock) being \$105.8 million.

Wool International

Under Section 53(7) of the *Wool International Act 1991* the Commonwealth underwrites borrowings of Wool International for the management of the wool stockpile, contingent liabilities to Wool International total \$762 million at 31 March 1997. Sources of borrowings include domestic and overseas commercial borrowings. Wool International is reducing this debt through the sale of the stockpile. The target date for the payout of debt is 1998.

Australian Wheat Board

Under the *Wheat Marketing Act 1989* the Commonwealth underwrites borrowings by the Australian Wheat Board that fund advance and related payments from the wheat pool totalling \$3,455 million at 31 March 1997. Borrowings are repaid as the wheat pool is sold. The percentage underwritten by the Commonwealth is set at 85 per cent of the estimated aggregate net return on the wheat pool. The Commonwealth's responsibility for the underwriting of borrowings ceases in 1999.

Queensland Fish Management Authority

The Commonwealth has guaranteed a loan up to a maximum of \$40.9 million to encourage the restructuring of the Northern Prawn Fishery. The loan was taken out by the Queensland Fisheries Management Authority on behalf of the Commonwealth to buy back surplus boat units from the fishery with repayment to be made by the industry through levies.

Australian National Line (ANL) Ltd — \$100 million Promissory Note Facility

In order to enable ANL to trade in an orderly fashion, the Commonwealth has guaranteed access to a promissory note facility of up to \$100 million. Only \$45 million has been drawn down by ANL under this facility. Therefore, the maximum exposure for the Commonwealth is \$45 million, unless a further draw down/note issue is approved by the shareholder (ie the Commonwealth).

Guarantees under the Commonwealth Bank Sale Act 1995

Under the terms of the *Commonwealth Bank Sale Act 1995*, the Commonwealth has guaranteed various liabilities of the Commonwealth Bank of Australia, the Commonwealth Bank Officers' Superannuation Corporation (CBOSC) and the Commonwealth Development Bank.

The guarantee for the Commonwealth Bank of Australia relates to both on and off balance sheet liabilities. Of the existing contingent liability, 72 per cent involves off balance sheet liabilities. As at 30 June 1996, the balance of the guarantee was \$325,004.7 million. The Commonwealth's contingent liability will decline considerably by 30 June 1997 as \$280,407.5 million of the contingent liability (or 86 per cent) is due to be retired during 1996-97.

The assets of the CBOSC (\$4,934.7 million at 30 June 1996) substantially exceed existing liabilities. The stock of CBOSC liabilities subject to the Commonwealth

guarantee will decline gradually as relevant CBOSC officers retire. As at 30 June 1996, the balance of the guarantee was \$96.6 million.

As of 1 July 1996, the Commonwealth Development Bank ceased to write new business and no additional liabilities are being incurred. The existing contingent liability will gradually decline with the retirement of existing loans and exposures. The revised estimate for the balance of this guarantee was \$1,793.2 million as at June 1996.

Reserve Bank of Australia (RBA) Guarantee

This contingent liability relates to the Commonwealth's guarantee of the liabilities of the RBA. The major component of RBA liabilities relates to Notes (ie currency) on Issue. This treatment of Notes largely relates to the historical convention of the convertibility of Notes to gold — coins are not treated as a liability in the Commonwealth's accounts. At 9 April 1997, Notes on Issue totalled \$19,842 million.

The other major liability consists of deposits with the RBA by the banking sector, including the Commonwealth Bank. At 9 April 1997 these deposits amounted to \$12,008 million. The large increase from 30 June 1996 (when deposits amounted to \$3,931.6 million) is principally due to the abolition of the Authorised Money Market Dealers in July 1996 and the resulting increase in the value of exchange settlement accounts held with the RBA by the banking sector. In total, the guarantee for the RBA was \$36,011.5 million as at 9 April 1997.

Uncalled Capital Subscriptions — International Financial Institutions

The liability relates to the value of the uncalled portion of the value of the Commonwealth's shares in the International Bank for Reconstruction and Development (estimated value \$3,086 million at 30 June 1996), the Asian Development Bank (estimated value \$3,200 million), and the European Bank for Reconstruction and Development (estimated value \$103 million).

Unquantifiable

Australian Trade Commission

Under the *Australian Trade Commission Act 1985* the Commonwealth guarantees payment by the Australian Trade Commission (AUSTRADE) of money that is payable to any person other than the Commonwealth.

Telstra Corporation Ltd — Superannuation Guarantee

The Commonwealth has guaranteed payments from Telstra Corporation Ltd to the Telstra Superannuation Scheme. The Commonwealth has guaranteed that it will cover any benefits that may have to be paid from the Fund in the event that the Telstra Superannuation Scheme or Telstra is ever bankrupted and wound up.

Superannuation Act 1976 and the Public Sector Superannuation Scheme (PSS)

Under the *Superannuation Act 1976* and the PSS Trust Deed and Rules and determinations made under them, the Commonwealth guarantees payment of the amounts of members' contributions and productivity contributions with interest allocated to those amounts by respective Boards of Trustees.

The Commonwealth Superannuation Scheme and the PSS guarantee the accrued contributions and interest so there cannot be a negative rate of return on invested funds. The funds maintain a reserve which covers the possibility of negative returns and allows for 'topping up' by the Commonwealth if that should ever occur. The Commonwealth has not had to make a payment in relation to this guarantee.

Sale of Australian Airlines Ltd

The Commonwealth has given an indemnity to Australian Airlines Ltd to protect Australian Airlines Board members and officials against false or misleading information relating to the airline's operation resulting in litigation from prospective purchasers. This indemnity is open-ended and was issued on 28 May 1991.

The Commonwealth has also given an indemnity to Australian Airlines Ltd to protect employees from civil action arising out of disclosure of information. This indemnity is open-ended and was issued on 19 November 1991.

Australian Maritime Safety Authority (AMSA) — in Relation to Ship-sourced Marine Pollution.

In the normal course of operations, the Authority is responsible for the provision of funds necessary to meet the clean up costs arising from ship-sourced marine pollution. The Commonwealth has agreed that the Authority's responsibility be limited to a maximum outlay of \$10 million. The authority has a stand-by loan facility to address this contingency. In the event of costs above the \$10 million limit, funds will be provided by the Commonwealth. The Commonwealth's risk is unquantifiable. In all circumstances, the Authority is responsible for making appropriate efforts to recover the costs of any such incidents.

Australian National Line (ANL) Ltd

The Commonwealth has issued a guarantee for all ANL's major lease facilities. If the risk materialised the full termination value of the leases would be offset by the value of ANL's lessor loans and the value of assets that ANL would assume in the event of termination of the leases. The net value in the event that the leases are paid out may be around breakeven.

Australian National Line (ANL) Ltd Board

An indemnity for ANL Board members was provided to protect against civil claims relating to employment and conduct as a director of ANL Ltd and subsidiary/associated companies. This indemnity is unquantifiable and no expiry date has been set.

Sale of Aerospace Technologies of Australia (ASTA) Pty Ltd

An indemnity has been given to purchasers of ASTA to protect ASTA and the purchaser from any reasonable losses, costs (including legal expenses), liabilities and other outgoings incurred in respect of any asbestos, pollutant or other contaminant on or in the property or buildings of the Avalon property.

An indemnity has been given to purchasers of ASTA to indemnify the purchaser against any reasonable loss, cost or expense sustained or incurred as a result of breach of warranty; any work done or liabilities incurred; liabilities which may occur in the future relating to ASTA Aircraft Services Pty Ltd (ASTAAS), Pacific Aerospace Corporation Ltd (PAC) or ASTA airport (which were not purchased as a part of ASTA); and any taxes incurred or occurring in respect of the period prior to the sale.

An indemnity has been given to purchasers of ASTA to indemnify the purchaser against any payments made by ASTA in respect of indemnities given in connection with the research and development syndications which involve ASTA at or prior to the sale.

An indemnity has been given to purchasers of ASTA to indemnify the purchaser against any loss it suffers as a result of ASTA incurring any tax liability under the *Income Tax Assessment Act 1936* as a result of any action or inaction of ASTA in respect of the period prior to the sale, and in respect of any payments made by the Commonwealth to the purchaser.

These indemnities were issued on 20 June 1995 and will not extend to any claim which either accrues or is made more than four years after the closing date or is for an amount less than \$100,000.

Sale of Australian Industry Development Corporation (AIDC) Limited

An indemnity has been provided to the Directors and nominated officers of AIDC Ltd and the AIDC Corporation to indemnify them against all actions, suits, claims, demands and reasonable costs and expenses (including costs and expenses incurred as a result of a governmental or parliamentary inquiry and legal costs and expenses certified reasonable by the Attorney-General) in respect of assistance provided to the Privatisation Advisory Committee (PAC), the Commonwealth and the Corporation in respect of the PAC process and the sale of shares. This indemnity was issued on 30 May 1996 and terminates upon the sale of any of the shares. The Commonwealth may also terminate this indemnity upon reasonable notice in writing to the Chairperson of the Corporation.

An indemnity has also been provided to AIDC Ltd to indemnify them against all actions against AIDC by the minority shareholders in the same circumstances as the indemnity discussed above. This indemnity was issued on 30 May 1996 and terminates upon the buyout of the minority shareholders by the Corporation or upon the sale of any of the shares, whichever comes first.

Sale of Commonwealth Funds Management (CFM) and Total Risk Management (TRM)

An indemnity has been provided to the Directors and certain officers of CFM and TRM to indemnify them against all actions, suits, claims, demands and reasonable costs

(including legal costs and expenses certified reasonable by the Attorney-General) in relation to assistance given to the Commonwealth in the sale process in relation to provision of information to the Commonwealth or a third party. This indemnity was issued on 28 August 1996.

The Commonwealth has indemnified the purchaser of CFM, the Commonwealth Bank of Australia, from all losses and liabilities which may be suffered as a result of the exercise of powers under the *CFM Sale Act*. These powers relate to the transfer of any assets rights and obligations or liabilities of the company; employment of staff and transfer of company shares.

The Commonwealth has also indemnified the Commonwealth Bank of Australia against any stamp duty payments related to the transaction other than the basic share transfer duty.

Sale of Avalon Airport Geelong Pty Ltd (AAG)

An indemnity has been given to the purchaser of AAG to indemnify the purchaser against any loss it suffers as a result of AAG incurring any tax liability under the *Income Tax Assessment Act 1936* as a result of any action or inaction of AAG in respect of the period prior to sale.

An indemnity has been given to the purchaser of AAG to indemnify the purchaser and AAG against all liabilities, losses, costs, damages, expenses and claims arising out of: any contamination on, in or affecting Avalon Airport that existed prior to closing; any remedial action taken by the purchaser or AAG in regard to any contamination on, in or affecting Avalon Airport that existed prior to closing in compliance with any notice or order issued by a regulator; and the construction, alteration or addition prior to closing of buildings using any materials or fixtures and fittings which are a potential health hazard.

An indemnity has been given to the purchaser of AAG to indemnify the purchaser against: the holding of or disposal of shares in PAC or ASTAAS by AAG prior to closing; the exposure at Avalon Airport of any person to asbestos prior to closing; any breach of representation or warranty by the Commonwealth under the sale agreement (claims will not exceed either individually or in aggregate the amount of the purchase price); any liability of AAG arising under any lease granted to it prior to closing by the Commonwealth, or out of AAG's use or occupation, of Avalon Airport prior to closing; any breach of environmental law by AAG arising out of its use or occupation of Avalon Airport prior to closing; and any claim or liability arising out of or in relation to the Paint Shop.

CSL Ltd

CSL Ltd is indemnified against claims made by persons who contract specified infections from specified products and against employees contracting asbestos related injuries. CSL has unlimited cover for most events that occurred before the sale of CSL on 1 January 1994 but has more limited cover for a specified range of events that might occur during the period of the current contract. Given the open ended nature of some of the indemnities, damages and risk cannot be quantified.

Sale of CSL Ltd

An indemnity has been given to Potter Warburg/Price Waterhouse (PW/PW) for protection for litigation costs, limited to circumstances where PW/PW was sued as a result of the proper performance of the consultancy. This indemnity was issued on 14 October 1992. The termination date is undefined, but is limited by statutes of limitation.

An indemnity has been given to Arthur Anderson (AA) for protection of litigation costs, limited to circumstances where AA was sued as a result of the proper performance of the consultancy. This indemnity was issued on 7 June 1993 and is continuing, however it is limited by statutes of limitation.

An indemnity has been given to CSL to protect CSL from any claim made against them for breach of confidentiality as a result of CSL having provided information to the Commonwealth, and the Commonwealth subsequently failing to ensure that confidentiality. This indemnity was issued on 14 September 1992.

Provisions for this latter indemnity are continuous. However, the parties clearly anticipate that the indemnity ceased to have practical effect after conclusion of the sale of CSL. This will be formalised through an exchange of letters.

Sale of Lease of Federal Airports Corporation (FAC) Airports

A letter of comfort has been provided to assure Standard and Poor's Ratings Group that the FAC will continue to have access to adequate liquidity to enable it to continue to service its obligations and effectively conduct its operations. This assurance was issued on 27 May 1994 and effectively terminates upon the completion of the assumption of FAC debt by the Commonwealth.

An indemnity has been given to Ernst & Young to indemnify them against legal costs incurred in respect of their obligations for legal compulsion to disclose. This indemnity was issued on 15 July 1996.

An indemnity has been given to the Board of the FAC to replace the extension of Finance Direction 21 to FAC Board members. This indemnity is ongoing and was issued on 3 October 1996.

An indemnity has been given to Mallesons Stephen Jaques to indemnify the consultant in relation to all reasonable costs (including legal costs) incurred by the consultant in complying with any requests or directions by the Commonwealth given to the consultant pursuant to a confidentiality agreement dated 13 September 1996.

An indemnity has been given to BZW Australia Limited to indemnify BZW against legal costs and disbursements incurred in respect of BZW's obligations for legal compulsion to disclose. This indemnity is ongoing and was issued on 18 August 1995.

Sale of Moomba Sydney Gas Pipeline

An indemnity has been given to East-Aust Pipeline Limited in an Agreement entitled 'Asset Purchase Agreement' dated 30 June 1994 between the Commonwealth and East-Aust Pipeline Limited. East-Aust Pipeline Ltd is indemnified against losses sustained due to a claim by an employee of the Pipeline Authority for negligence or accrued salary or other entitlements arising prior to the 'Transfer Day'. By implication East-Aust Pipeline Ltd cannot bring an action more than six years after the Transfer Day.

Sale of Snowy Mountains Engineering Corporation (SMEC)

An indemnity has been given to Tinbury Limited in an agreement for the sale of shares in SMEC Ltd which indemnifies Tinbury Ltd from and against all damages, losses, liabilities, claims, costs and expenses which Tinbury Ltd may suffer from the Commonwealth's non-observance of any of the express representations, warranties, covenants or undertakings contained in the Agreement. This indemnity is ongoing and was issued on 21 October 1993.

Housing Loans Insurance Corporation (HLIC)

The Commonwealth guarantees the liabilities of the HLIC which provides mortgage insurance to lenders. Whilst it is possible to measure the total value of all insurance contracts on the HLIC's books at any given time, this does not realistically reflect the potential risk to the Commonwealth. The HLIC has never suffered a claim for the total value of any insurance contract in its thirty year history; claims amounts on policies usually amount to 10 to 20 per cent of the policy value.

Partial Sale of Telstra Corporation

An indemnity has been provided to the present and certain former Telstra directors and officers to protect against any liability incurred in connection with a civil liability; defending criminal proceedings in Australia or overseas; any application in relation to criminal proceedings; any examination, investigation, inquiry or proceeding by the Australian Securities Commission or any other authority of any Government in Australia or elsewhere arising in relation to the scoping study. This indemnity was issued on 23 September 1996 and is ongoing.

Qantas Trade Sale

An indemnity has been issued to British Airways PLC to protect against loss resulting from failure of the Commonwealth to meet its obligations in the Qantas trade sale. This indemnity is open-ended and was issued on 12 January 1993.

An indemnity has also been issued to British Airways PLC to cover a loss in economic value of shares as a result of the Qantas trade sale. This indemnity was issued on 12 January 1993 and terminates on 30 June 2003.

A Letter of Comfort has been given to Qantas Airways Ltd to provide an assurance that the Commonwealth will continue to honour a \$100 million standby facility. This letter was issued on 12 September 1991 and the termination date is unspecified.

Qantas Public Share Offer

An indemnity has been given to Qantas Airways Ltd to protect it from losses and costs resulting from Commonwealth breaches of the debt assumption agreement. This indemnity is open-ended and was issued on 12 January 1993.

An indemnity has been given to Grant Samuel and Associates Ltd to protect against losses caused in proper performance of the contract and loss of fees due to the Commonwealth triggering a conflict of interest. This indemnity is permanent and was issued on 31 March 1993.

An indemnity has been given to Joint Lead Manager on the abandoned original Qantas public share offer process of 1993 and their employees and executives to protect against loss caused by false public statements that were pre-endorsed by the Commonwealth as true. This indemnity is permanent and was issued on 10 December 1992.

The Commonwealth has indemnified Qantas Directors for all civil liabilities they may incur through their participation in the offer. The indemnity was issued in 1995.

Commonwealth Bank Public Share Offer

In 1996, the Commonwealth provided an indemnity to the Commonwealth Bank, its directors and certain officers to cover the civil liability in relation to providing assistance to the Commonwealth in the offer context.

Indemnities for Banks

The Commonwealth has indemnified a number of banks in Europe and North America and the Reserve Bank of Australia against loss and damage arising from the acceptance of certain Commonwealth cheques bearing a facsimile signature having been impressed thereon without the authority of the Commonwealth.

Civil Aviation Safety Authority (CASA) — Indemnity in Relation to the Authority's Safety Regulatory Functions

Under a Deed of Agreement, the Civil Aviation Safety Authority is indemnified against claims incurred in carrying out its responsibilities for aviation safety regulations. Under existing arrangements, this indemnity is subject to annual renewal on payment of an annual premium by CASA to the Commonwealth. The current CASA safety regulatory indemnity expires on 5 July 1997.

Civil Aviation Safety Authority — Indemnity to Officers of the Authority Administering the Carrier's Liability Insurance Requirements

An indemnity is given to those officers of the Civil Aviation Safety Authority who administer the carrier's liability insurance requirements under Part IVA of *Civil Aviation (Carrier's Liability) Act 1959* and complementary state legislation. This indemnity is unquantifiable and no expiry date has been set.

Sale of Australian National Railways Commission (AN)

The Commonwealth is funding AN's loss making operations until AN is sold. A delay in the sale of all or any parts of AN would require extending subsidisation to AN by the Commonwealth.

Sale of the Australian National Rail Commission and National Rail Corporation Ltd

An indemnity has been provided to each of the Commissioners in respect of assistance in relation to sale process. This includes the provision of information about Australian National Rail Commission or National Rail Corporation Ltd at the request of the Commonwealth or its advisers for the purposes of the sale of the Australian National Railways Commission and National Rail Corporation Ltd their business units or assets.

APPENDIX B: SENSITIVITY OF FISCAL AGGREGATES TO ECONOMIC DEVELOPMENTS

Table B1 provides a guide to the sensitivity of the forward estimates of outlays and revenue to variations in economic parameters in 1997-98. Such a guide can provide only a 'rule of thumb' indication of the impacts on the budget of changes in prices, wages and other parameters.

Table B1: Sensitivity of Fiscal Aggregates to a 1 Percentage Point Increase in Economic Parameters

	1997-98 \$m	1998-99 \$m	1999-00 \$m	2000-01 \$m
<i>Outlays</i>				
Prices	230	420	450	570
Wages	130	410	450	460
Newstart Allowance recipients	310	310	310	310
Safety Net Adjustment	90	180	270	360
<i>Revenue</i>				
Average earnings(a)	920	1000	1080	1160
Employment	600	650	700	760
Company income	20	220	190	200
Other individuals income	0	200	220	240
Consumption(b)	270	280	290	310
CPI(c)	30	140	150	160
Imports(d)	40	40	40	50

(a) National accounts basis excluding superannuation and Commonwealth government redundancies.

(b) Impact on sales tax and excise revenue, assuming uniform percentage change in all components of the tax base.

(c) Impact on excise duty revenue.

(d) Impact on sales tax and customs duty revenue.

On the outlays side, estimates are provided for the following assumptions about changes to four broad groups of parameters:

- Prices — all price deflators are assumed to increase by one percentage point at the start of the September quarter 1997, with wage deflators left unchanged.
- Wages — all wage and salary rates are assumed to increase by one percentage point from the beginning of the September quarter 1997, with price deflators left unchanged.
- Newstart Allowance recipients — the total number of recipients is assumed to increase by 5 per cent from the beginning of the September quarter 1997.
- Safety Net Adjustment — an increase in the assumed level of the Safety Net Adjustment determined by the Australian Industrial Relations Commission (AIRC) of \$2 per annum.

On the revenue side, the figures show the estimated impact of a one percentage point change in a range of economic variables in 1997-98 as a whole. The CPI is assumed to increase by one percentage point at the start of the September quarter 1997.

Differences in impact over the years reflect:

- the full-year impact on outlays of variations in parameters not occurring until the year following the variation;
- the effect on revenue collections of variations in company and other individuals income occurring largely in the year following the receipt of income; and
- for variations in most economic parameters, the flow-through effect of a higher (or lower) base in a year on revenue collections in subsequent years.

Projected outlays respond to changes in economic parameters through a variety of mechanisms. For example, the Government's decision to maintain pensions at 25 per cent of MTAWWE means that projected spending on pensions will depend not just on changes to the CPI, by which pensions have been indexed for some time, but also on expected changes in the level of MTAWWE. Payments to the States are subject to guarantees which make them sensitive to changes in the CPI.

In addition, a large component of Government spending, comprising running costs, other Commonwealth Own Purpose Outlays of a running cost nature and Specific Purpose Payments to the States of a running cost nature, is indexed to weighted averages of movements in underlying inflation and the Safety Net Adjustment determined by the AIRC. The Safety Net Adjustment is currently assumed to increase in future years in line with the recent decision handed down by the AIRC.

Economic growth, and employment growth, affect the number of Newstart Allowance recipients and therefore the total spending on benefits. However, the relationship between GDP growth and Newstart Allowance recipients is highly variable and difficult to quantify. For this reason, Table B1 only includes the impact of changes in the number of Newstart Allowance recipients on the budget.

APPENDIX C: TAX EXPENDITURES

OVERVIEW

This appendix discusses the revenue impacts associated with concessional taxation treatment of specific groups and/or activities.

Individuals and businesses derive financial benefits from various tax concessions. These concessions are usually delivered by tax exemptions, deductions, rebates or reduced rates. They can either reduce or delay the collection of tax revenue. Tax concessions will influence the allocation of resources to different activities. Direct expenditures (outlays) could equally be used to allocate resources to different activities and deliver the benefits provided by the various tax concessions. For this reason, and noting their direct impact on the underlying budget deficit, these tax concessions are generally called 'tax expenditures'.

The Government has introduced the Charter of Budget Honesty Bill 1996 to the House of Representatives and the Bill is expected to be considered by the Senate in the Budget sittings. A feature of the Charter is the requirement to publish an overview of tax expenditures as part of the budget.

AGGREGATE TAX EXPENDITURES

Table C1 shows estimates and projections for the period 1992-93 to 2000-01 of the aggregate of tax expenditures that have been identified and costed in the *1995-96 Tax Expenditures Statement* (TES), which was published in January 1997. The availability of new information on forward estimates and decisions taken since the TES was published have led to a re-estimation of forward projections for aggregate tax expenditures.

Table C1: Aggregate Tax Expenditures and Direct Outlays 1992-93 to 2000-01

Year	Superannuation (\$m)	Other Tax Expenditures (\$m)(a)	Total (\$m)	Budget Outlays (\$m)(b)	Ratio of Tax Expenditures to Outlays (per cent)
1992-93	5780	6749	12529	109590	11.4
1993-94	7765	8144	15909	114372	13.9
1994-95	5770	10451	16221	122012	13.3
1995-96	6290	9991	16281	126689	12.9
1996-97 (est)	6250	10636	16886	128861	13.1
1997-98 (est)	6450	10627	17077	126928	13.5
1998-99 (est)	6985	11607	18592	135599	13.7
1999-2000 (est)	7325	13105	20430	144553	14.1
2000-01 (est)	7670	14206	21876	147815	14.8

(a) This aggregate does not include timing measures.

(b) Outlays are reported on a headline basis.

There are a number of major considerations in analysing aggregate tax expenditures:

- Many of the tax expenditures that have been identified have not been costed due to a lack of data.
- There has been an inconsistent coverage of tax expenditures over time — some tax expenditures have been costed for only a few of the fiscal years that they have

actually been part of the tax system. Changes in aggregates over time will therefore reflect both changes in the cost of individual tax expenditures and changes in the coverage of the tax expenditures costed.

- There can be quite large revisions to tax expenditure estimates due to changes over time in methodology and available data.

The aggregate projections should therefore be treated with considerable caution and should only be used to provide a broad indication of the historical and possible future growth path of the cost of tax expenditures.

Bearing these considerations in mind, Table C1 shows that the net cost of aggregate tax expenditures, in terms of forgone revenue, has remained at around \$16.2 billion in 1994-95 and 1995-96 (excluding so called 'timing' tax expenditures which merely defer tax revenue collections to a later date). Table C1 also indicates that assistance provided through aggregate tax expenditures is about 11 per cent of total Government assistance provided (ie through tax expenditures and direct outlays).

The cost of tax expenditures (excluding 'timing' tax expenditures) is projected to rise to \$21.9 billion in 2000-01, an increase of 34 per cent from 1995-96. By comparison, direct outlays are expected to increase by 17 per cent over the same period.

TAX EXPENDITURES BY FUNCTIONAL CATEGORIES

Table C2 compares the costs of identified tax expenditures in 1995-96 with direct outlays by functional category. The functional categories are the same as for outlays in this Statement.

The figures for a number of tax expenditure categories are only approximations as some tax expenditures do not lend themselves to easy categorisation. For example, a general industry assistance measure will apply to all industries and it will not be possible to determine precisely which industry sectors have accessed the tax concession. Tax expenditures that cannot be classified as belonging to a particular functional category are aggregated in the 'Not Allocated to Function' category.

Table C2 shows that most tax expenditures are classified as being related to Social Security and Welfare (this category includes superannuation tax concessions).

- Around 19 per cent of total assistance in this category is provided through tax expenditures.

The table also highlights the significant tax relief provided to some business and industry categories through tax expenditures.

- For example, under the Mining and Mineral Resources (other than fuels), Manufacturing and Construction, and Agriculture, Forestry and Fishing categories, 33 per cent of total assistance is provided through tax expenditures.

Table C2: Aggregate Tax Expenditures and Direct Outlays by Functional Category 1995-96

	Tax Expenditures	Budget Outlays	Total
Functional Category	\$m(a)	\$m	\$m
<i>General Public Services</i>			
Legislative and Executive Affairs	<1	594	594
Financial and Fiscal Affairs	-	1696	1696
Foreign Economic Aid	128	2268	2396
General Research	10	1070	1080
General Services	5	221	226
Government Superannuation Benefits	-	944	944
Defence	60	10011	10071
Public Order and Safety	-	924	924
Education	28	10662	10690
Health	427	18616	19043
Social Security and Welfare	10961	46754	57715
Housing & Community Amenities	162	1216	1378
Recreation and Culture	20	1428	1448
Fuel and Energy	565	37	602
Agriculture, Forestry and Fishing	272	1876	2148
Mining and Mineral Resources (other than fuels), Manufacturing and Construction	1470	1651	3121
Transport and Communication	25	743	768
<i>Other Economic Affairs</i>			
Tourism and Area Promotion	60	104	164
Labour and Employment Affairs	19	3850	3869
Other Economic Affairs nec	734	336	1070
<i>Other Purposes</i>			
Public Debt Interest	-	9126	9126
General Purpose Inter-government Transactions	-	13798	13798
Natural Disaster Relief	-	-4	-4
Contingency Reserve	-	-	-
Asset Sales	-	-1230	-1230
Not Allocated to Function	1335	-	1335
Total(b)	16281	126689	142970

< 1 Denotes less than \$1 million.

(a) Aggregate cost of tax expenditures in functional categories is derived by summing the individual tax expenditure costings.

(b) Items may not sum to totals due to rounding.

APPENDIX D: 1997-98 BUDGET CLASSIFICATION CHANGES

This appendix discusses reporting classifications, and the impact of reclassifications for the 1997-98 Budget figuring.

Information in the budget papers is classified in three ways:

- the *functional* classification brings together outlays directed towards like objectives or purposes. It thus facilitates presentation of information on the basic purposes of Government activities and on the total resources devoted by the Commonwealth to those purposes;
- the *economic* type classification is designed to facilitate the study of the economic impact of Commonwealth transactions and to provide the means of grouping transactions for inclusion in ABS Government Finance Statistics and the Australian National Accounts. This classification scheme defines the concepts of outlays, revenue, financing transactions and the budget balance. Outlays are further divided into current and capital classifications; and
- the *portfolio* classification refers to the aggregation of outlays according to the Minister who has prime administrative responsibility. Because portfolio responsibilities change over time, it is not possible to provide information in an historical series.

Classification Changes for the 1997-98 Budget

Classification changes can affect historical reporting. *Comparisons between budget publications from different years can therefore be misleading.* All changes to the application of the functional and economic type classifications for the 1997-98 Budget are outlined in Table D1 and Table D2. As can be seen from these tables, historical data published in this document is broadly consistent with previous publications. A list of changes is provided in the footnotes.

Table D1: Effect of Reclassification by Function for 1997-98 Budget (\$m)

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
Legislative and Executive Affairs	2.6	3.1	3.3	4.6	4.9	5.0	4.7	4.2	0.0	0.1	0.2	0.3	0.3	0.3
Financial and Fiscal Affairs	2.5	3.1	3.0	3.6	3.9	2.6	2.3	2.1	6.0	4.2	4.3	4.4	4.5	4.6
Foreign Economic Aid	-1.5	-1.4	-1.6	-1.6	-1.7	0.0	0.0	0.0	0.0	-2.1	-2.2	-2.3	-2.3	-2.4
General Research(a)	-1.3	-2.3	-7.6	-11.3	-13.0	-12.6	-13.1	-12.6	-11.2	-6.3	-2.6	-2.7	-2.5	-2.5
General Services(b)	-0.4	-0.5	-18.2	-13.8	4.9	1.1	0.6	0.1	-1.8	12.1	16.5	11.7	12.6	13.6
Government Superannuation Benefits(c)	-22.5	-34.2	-41.4	-35.2	-38.2	-41.7	-45.3	-52.5	-46.1	-49.0	-64.7	-53.7	-53.7	-53.8
Public Order and Safety	3.7	7.1	8.9	7.4	6.0	8.8	10.7	10.7	-2.2	0.4	0.4	0.4	0.4	0.5
Education(d)	0.0	0.0	0.0	0.0	8.2	16.8	17.3	17.6	17.9	18.1	0.0	0.0	0.0	0.0
Health(d)	0.0	0.0	0.0	0.0	-8.2	-16.8	-17.3	-17.6	-17.9	-18.1	0.0	0.0	0.0	0.0
Social Security and Welfare(e)	0.0	0.0	-1.0	0.0	-0.5	-1.2	-1.2	-1.2	46.5	154.8	150.9	151.4	148.2	149.6
Housing and Community Amenities(a)	0.0	0.8	5.7	8.7	10.0	9.6	10.5	10.7	11.2	6.3	2.6	2.6	2.5	2.5
Recreation and Culture(f)	1.0	2.5	3.8	6.6	6.3	7.1	5.4	14.2	11.7	25.5	0.0	-0.1	-0.1	-0.1
Transport and Communication(f)	-2.3	-4.0	-5.2	-6.6	-6.5	-6.8	-5.0	-13.7	-11.3	0.0	0.0	0.0	0.0	0.0
Labour and Employment Affairs(e)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-46.5	-154.8	-150.9	-151.4	-148.2	-149.6
Other Economic Affairs, nec(g)	-3.1	-6.1	-6.9	-6.3	-4.8	-7.2	-6.8	8.2	27.4	10.0	10.0	10.0	10.0	9.9
General Purpose Inter-government Transactions(f)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-25.0	0.0	0.0	0.0	0.0
Revenue(g)	0.1	0.5	0.5	0.5	0.4	0.1	1.9	16.9	28.3	10.0	10.0	10.0	10.0	10.0
Finance Transactions(b)(c)	-21.5	-32.5	-57.5	-44.5	-29.2	-35.4	-39.1	-46.6	-44.5	-33.9	-45.4	-39.5	-38.5	-37.5
Published 1996-97 Headline Outlays(h)	79489	82892	87960	96187	102851	109625	114409	122042	126705					
Classification changes	-22	-32	-57	-44	-29	-35	-37	-30	-16	-24	-35	-30	-29	-28
1997-98 Headline Outlays	79467	82860	87903	96143	102822	109590	114372	122012	126689					
Components of Outlay Classification Changes:														
As at 1996-97 MYEFO									-44	-44	-44	-45	-45	
Adjustments to 1996-97 MYEFO since MYEFO									-	-2	-18	-7	-7	
Other changes post 1996-97 MYEFO									28	23	27	22	23	
Published 1996-97 Revenue	81558	88796	95994	98092	93509	95062	100745	110413	121660					
Classification changes	0	0	1	1	0	0	2	17	28	10	10	10	10	10
1997-98 Revenue	81558	88796	95995	98093	93509	95062	100747	110430	121688					

- (a) Reclassification of Greenhouse research from General Research to Housing and Community Amenities (Environment Protection).
(b) Comcare Premiums and Benefits reclassified from Financing Transactions to General Services.
(c) Payments to SA and Tasmanian Rail Pensioners and ANRC contributions to former SA Rail and Tas Rail reclassified from Government Superannuation Benefits to Financing Transactions.
(d) John Curtin School of Medical Research reclassified from Health to Education.
(e) Youth Training Allowance reclassified from Labour and Employment Affairs to Social Security and Welfare.
(f) Payment to NSW Royal Agricultural Society Site reclassified from General Purpose Inter-Government Transactions to Recreation and Culture. Also, various running costs on communication transferred from Transport and Communications to Recreation and Culture (Broadcasting).
(g) Australian Competition and Consumer Commission and Trade Practices Commission miscellaneous receipts reclassified from Other Economic Affairs to Revenue due to their regulatory nature.
(h) All the above headline outlay reclassifications also affect underlying outlays. Also, the reclassification of a \$45 million payment from grants to advances in 1994-95 is an additional effect on underlying outlays.

Table D2: Effect of Reclassification by Economic Type for 1997-98 Budget (\$m)

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
Final Consumption Expenditure(a)(d)	-21.3	-31.2	-51.5	-36.8	-20.3	-29.8	-29.9	-24.0	-10.5	-22.2	629.3	-80.7	-79.4	-77.9
Subsidies(b)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-28.3	-27.3	-17.6	-17.6	-17.6	-17.6
Current Grants Paid(a)(b)(c)	2.2	1.4	-3.2	-4.0	-6.0	1.5	0.8	2.8	26.3	-1.2	22.9	23.0	23.0	23.1
Capital Outlays on Goods, Land and Intangibles(d)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-714.8	0.8	0.4	0.0
Capital Transfer Payments(c)(e)	-2.2	-2.3	-2.5	-3.0	-2.5	-7.1	-8.0	-53.6	-3.8	26.7	44.7	45.1	45.1	45.0
Net Advances Paid(e)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	45.1	0.0	0.0	0.0	0.0	0.0	0.0
Taxation Revenue(a)	0.1	0.5	0.5	0.5	0.4	0.1	1.9	16.9	28.3	10.0	10.0	10.0	10.0	10.0
Financing Transactions(a)	-21.5	-32.5	-57.5	-44.5	-29.2	-35.4	-39.1	-46.6	-44.5	-33.9	-45.4	-39.5	-38.5	-37.5
Published 1996-97 Headline Outlays(f)	79489	82892	87960	96187	102851	109625	114409	122042	126705					
Classification changes	-22	-32	-57	-44	-29	-35	-37	-30	-16	-24	-35	-30	-29	-28
1997-98 Headline Outlays	79467	82860	87903	96143	102822	109590	114372	122012	126689					
Components of Outlay Classification Changes:														
As at 1996-97 MYEFO									-44	-44	-44	-45	-45	
Adjustments to 1996-97 MYEFO since MYEFO									-	-2	-18	-7	-7	
Other changes post 1996-97 MYEFO									28	23	27	22	23	
Published 1996-97 Revenue	81558	88796	95994	98092	93509	95062	100745	110413	121660					
Classification changes	0	0	1	1	0	0	2	17	28	10	10	10	10	10
1997-98 Revenue	81558	88796	95995	98093	93509	95062	100747	110430	121688					

- (a) - Payment to SA and Tas Rail Pensioners and ANRC contribution to former SA and Tas rail reclassified to Financing Transactions.
- Council Grants - Territories reclassified as Current Grants.
- Australian Competition and Consumer Commission receipts and Trade Practices Commission receipts reclassified as Revenue due to their regulatory nature.
- Comcare Premiums and Benefits reclassified from Financing Transactions to General Services.
- (b) Payment to Air Services Australia and Aviation Fuel Revenue reclassified to Current Grants.
- (c) Payment to New South Wales for Fox Film Studio and payment to New South Wales for Royal Agricultural Society Site reclassified as Capital Transfer Payments.
- (d) An asset sale incorrectly classified as Final Consumption Expenditure.
- (e) Equity in Multimedia Enterprise reclassified to Advances.
- (f) All the above headline outlay reclassifications also affect underlying outlays. Also, the reclassification of a \$45 million payment from grants to advances in 1994-95 as mentioned in (e) above is an additional effect on underlying outlays.

APPENDIX E: HISTORICAL DATA FOR THE COMMONWEALTH BUDGET SECTOR

Table E1 provides details of the budget aggregates for the period 1960-61 to 2000-01. The underlying budget balance is revenue minus outlays excluding net advances to other sectors. Net advances comprise net loans from the budget (new policy loans and advances less repayments) and net equity injections (injections/purchases of equity less equity sales). Classification differences and revisions, as well as changes to the structure of the budget, can impact on comparisons over such an extended period. In particular, there are some classification differences in the data relating to the period prior to 1976-77. This means that data for the earlier period may not be entirely consistent with that for 1976-77 and later years.

Table E2 provides details of tax, non-tax and total revenue for the period 1960-61 to 2000-01. These revenue data are compiled on a consistent basis from 1976-77.

Other factors which affect the comparability of budget aggregates between years are:

- adjustments in the coverage of agencies included in the accounts of the Commonwealth budget sector;
- transfers of taxing powers between the Commonwealth and the States;
- other changes in financial arrangements between the Commonwealth budget sector, Commonwealth non-budget sector agencies and the State/local government sector; and
- changes in arrangements for transfer payments where tax concessions or rebates are replaced by payments through the social security system. This has the effect of increasing both revenue and outlays as compared with earlier periods, but not changing balances. Changes in the opposite direction (tax expenditures replacing outlays) reduce both outlays and revenue.

While approximate adjustments can be made to identify trends in budget aggregates on a generally consistent basis, the further back this analysis is taken, the less manageable that task becomes.

A detailed discussion of the comparability of budget aggregates since 1960-61 is provided in Statement 5 of *Budget Paper No. 1, 1992-93*.

Further details of the coverage of the budget sector are provided in Statement 7. Detail on the changes in the classification of budget transactions are provided in Appendix D of this Statement.

Table E1: Commonwealth Budget Sector Revenue, Underlying Outlays and Underlying Balance 1960-61 to 2000-01

	Revenue			Underlying Outlays			Underlying Balance	
	Estimate \$m	% Real Growth	Per cent of GDP	Estimate \$m	% Real Growth	Per cent of GDP	Estimate \$m	Per cent of GDP
1960-61	3204	9.6	21.1	2654	5.1	17.5	551	3.6
1961-62	3262	-0.6	20.9	2941	8.2	18.9	321	2.1
1962-63	3356	1.3	19.9	3105	3.9	18.4	250	1.5
1963-64	3725	9.3	19.9	3437	9.0	18.4	289	1.5
1964-65	4349	12.4	21.1	3765	5.5	18.3	584	2.8
1965-66	4774	5.9	22.1	4220	8.1	19.5	554	2.6
1966-67	5088	2.9	21.3	4766	9.0	20.0	322	1.4
1967-68	5583	6.1	21.9	5258	6.6	20.6	324	1.3
1968-69	6228	6.6	21.7	5712	3.8	19.9	515	1.8
1969-70	7157	9.3	22.5	6188	3.1	19.5	969	3.0
1970-71	8093	6.6	23.0	7251	10.5	20.7	841	2.4
1971-72	8913	3.1	22.7	8060	4.0	20.5	853	2.2
1972-73	9471	-0.7	21.1	9189	6.6	20.5	281	0.6
1973-74	11978	10.9	22.3	10965	4.7	20.5	1012	1.9
1974-75	15431	6.0	23.8	15266	14.6	23.6	165	0.3
1975-76	18365	2.4	24.0	19904	12.2	26.0	-1539	-2.0
1976-77	21546	5.2	24.6	22701	2.3	25.9	-1156	-1.3
1977-78	23601	1.4	24.8	25534	4.1	26.8	-1933	-2.0
1978-79	25814	2.3	23.8	28119	3.0	25.9	-2305	-2.1
1979-80	29793	4.8	24.2	31039	0.2	25.2	-1245	-1.0
1980-81	35320	7.3	25.1	35335	3.0	25.1	-15	0.0
1981-82	41010	4.1	25.8	40496	2.8	25.5	514	0.3
1982-83	44879	-1.4	26.0	48013	6.8	27.8	-3133	-1.8
1983-84	49308	2.8	25.2	56141	9.4	28.7	-6832	-3.5
1984-85	57989	11.1	26.7	63754	7.3	29.4	-5764	-2.7
1985-86	65278	5.1	27.1	70090	2.7	29.1	-4812	-2.0
1986-87	73553	5.2	27.8	75622	0.7	28.6	-2069	-0.8
1987-88	81558	3.7	27.2	80132	-0.9	26.8	1426	0.5
1988-89	88796	0.5	26.2	83036	-4.3	24.5	5760	1.7
1989-90	95995	1.5	25.9	89110	0.8	24.1	6884	1.9
1990-91	98093	-2.0	25.9	97690	5.1	25.8	402	0.1
1991-92	93509	-6.4	24.2	104973	5.5	27.1	-11464	-3.0
1992-93	95062	0.4	23.5	112059	5.5	27.7	-16997	-4.2
1993-94	100747	4.8	23.4	117810	4.0	27.4	-17063	-4.0
1994-95	110430	8.2	24.1	123559	3.5	27.0	-13129	-2.9
1995-96	121688	7.2	24.9	131961	3.9	27.0	-10273	-2.1
1996-97 (estimate)	129625	4.1	25.2	136481	1.1	26.6	-6856	-1.3
1997-98 (estimate)	133351	0.9	24.5	137204	-1.4	25.2	-3853	-0.7
1998-99 (forecast)	142383	4.1	24.7	140786	0.1	24.4	1597	0.3
1999-00 (projection)	150330	3.1	24.6	144947	0.5	23.7	5383	0.9
2000-01 (projection)	158911	3.1	24.5	148219	-0.2	22.9	10692	1.6

Table E2: Commonwealth Budget Sector Taxation Revenue, Non-Taxation Revenue and Total Revenue 1960-61 to 2000-01

	Tax Revenue			Non-Tax Revenue			Total Revenue		
	Estimate \$m	% Real Growth	Per cent of GDP	Estimate \$m	% Real Growth	Per cent of GDP	Estimate \$m	% Real Growth	Per cent of GDP
1960-61	2851	10.1	18.7	353	6.4	2.3	3204	9.6	21.1
1961-62	2862	-2.0	18.4	400	10.6	2.6	3262	-0.6	20.9
1962-63	2915	0.3	17.3	441	8.5	2.6	3356	1.3	19.9
1963-64	3257	10.0	17.4	469	4.7	2.5	3725	9.3	19.9
1964-65	3835	13.4	18.6	514	5.5	2.5	4349	12.4	21.1
1965-66	4209	5.8	19.5	564	5.8	2.6	4774	5.9	22.1
1966-67	4485	2.9	18.8	603	3.2	2.5	5088	2.9	21.3
1967-68	4952	6.7	19.4	631	1.2	2.5	5583	6.1	21.9
1968-69	5533	6.8	19.3	694	5.1	2.4	6228	6.6	21.7
1969-70	6391	9.9	20.1	767	5.2	2.4	7157	9.3	22.5
1970-71	7221	6.5	20.6	872	7.2	2.5	8093	6.6	23.0
1971-72	7934	2.8	20.2	979	5.1	2.5	8913	3.1	22.7
1972-73	8468	-0.2	18.9	1003	-4.2	2.2	9471	-0.7	21.1
1973-74	10907	13.0	20.3	1071	-6.3	2.0	11978	10.9	22.3
1974-75	14211	7.2	21.9	1221	-6.2	1.9	15431	6.0	23.8
1975-76	16933	2.5	22.1	1432	0.9	1.9	18365	2.4	24.0
1976-77	19783	4.8	22.6	1763	10.4	2.0	21546	5.2	24.6
1977-78	21469	0.4	22.5	2132	11.9	2.2	23601	1.4	24.8
1978-79	23514	2.4	21.7	2300	0.9	2.1	25814	2.3	23.8
1979-80	27539	6.4	22.3	2255	-11.0	1.8	29793	4.8	24.2
1980-81	32769	7.7	23.3	2551	2.4	1.8	35320	7.3	25.1
1981-82	38058	4.2	24.0	2952	3.8	1.9	41010	4.1	25.8
1982-83	41239	-2.4	23.9	3640	11.1	2.1	44879	-1.4	26.0
1983-84	45065	2.2	23.0	4243	9.1	2.2	49308	2.8	25.2
1984-85	53208	11.6	24.5	4782	6.5	2.2	57989	11.1	26.7
1985-86	59248	4.0	24.6	6030	17.8	2.5	65278	5.1	27.1
1986-87	66881	5.4	25.3	6672	3.3	2.5	73553	5.2	27.8
1987-88	75465	5.5	25.2	6093	-14.6	2.0	81558	3.7	27.2
1988-89	83897	2.6	24.7	4899	-25.8	1.4	88796	0.5	26.2
1989-90	91343	2.2	24.7	4651	-10.8	1.3	95995	1.5	25.9
1990-91	93225	-2.1	24.6	4867	0.3	1.3	98093	-2.0	25.9
1991-92	87970	-7.3	22.7	5539	11.8	1.4	93509	-6.4	24.2
1992-93	89434	0.4	22.1	5627	0.4	1.4	95062	0.4	23.5
1993-94	94024	4.0	21.9	6722	18.1	1.6	100747	4.8	23.4
1994-95	105687	11.0	23.1	4743	-30.3	1.0	110430	8.2	24.1
1995-96	116386	7.1	23.8	5302	8.7	1.1	121688	7.2	24.9
1996-97 (estimate)	124363	4.5	24.2	5263	-3.0	1.0	129625	4.1	25.2
1997-98 (estimate)	129433	2.0	23.8	3918	-27.0	0.7	133351	0.9	24.5
1998-99 (forecast)	138248	4.2	24.0	4135	2.9	0.7	142383	4.1	24.7
1999-00 (projection)	146191	3.3	23.9	4139	-2.2	0.7	150330	3.1	24.6
2000-01 (projection)	154796	3.3	23.9	4114	-3.0	0.6	158911	3.1	24.5

APPENDIX A: COMMONWEALTH GENERAL GOVERNMENT SECTOR

This appendix presents forward estimates of the underlying balance — and the revenue and outlays components — for the Commonwealth general government sector. The Commonwealth general government sector comprises both a budget and non-budget component. The budget sector, which dominates the general government sector, consists of those departments and agencies whose transactions are recorded on the Commonwealth Public Account (CPA). The non-budget sector includes Commonwealth government authorities such as the ABC and CSIRO, which operate outside the CPA through their own bank accounts. A more detailed description of these sectors can be found in Statement 7.

The estimates provided in Table F1 are based on GFS classification principles. However, as is the case in the budget sector, in order to provide an estimate of the underlying balance broadly consistent with the ‘net lending’ concept in the national accounts, no adjustment is made for increases in provisions.¹⁸ As required by the Charter of Budget Honesty Bill 1996, general government estimates are also presented on a GFS consistent basis in Appendix D of Statement 7. A discussion of the GFS concepts and how these differ from the budget presentation is also provided in that appendix.

Table F1: Summary of General Government Aggregates (\$m)

	1996-97	1997-98	1998-99	1999-00	2000-01
	Revised	Estimate	Projection	Projection	Projection
Revenue (\$m)	130106	133861	142896	150825	159441
<i>Per cent of GDP</i>	25.3	24.6	24.8	24.7	24.6
Underlying outlays (\$m)	137233	137271	140729	145050	148189
<i>Per cent of GDP</i>	26.7	25.2	24.4	23.7	22.9
Underlying balance (\$m)	-7127	-3410	2167	5775	11252
<i>Per cent of GDP</i>	<i>-1.4</i>	<i>-0.6</i>	<i>0.4</i>	<i>0.9</i>	<i>1.7</i>
<i>Memorandum items:</i>					
Net advances (\$m)	-7404	-10146	-5089	-273	-257
Headline balance (\$m)	277	6736	7256	6048	11509
<i>Per cent of GDP</i>	<i>0.1</i>	<i>1.2</i>	<i>1.3</i>	<i>1.0</i>	<i>1.8</i>

General government aggregates in Table F1 essentially mirror equivalent budget aggregates, although components of Commonwealth outlays can vary substantially between the general government and budget sectors. This reflects the elimination of transfers to the Commonwealth non-budget sector in the general government sector, and the inclusion in other outlay categories of spending by the non-budget sector. An economic type presentation of general government outlays and revenue is presented in Statement 7. Major differences to the equivalent budget sector presentation include:

- higher final consumption expenditure in each year reflecting non-budget spending on goods and services;

¹⁸ Provisions are receipts and payments by the budget sector of PTE superannuation provisions.

- higher personal benefit payments reflecting medicare and pharmaceutical benefits paid by the Health Insurance Commission (a non-budget authority); and
- higher grants to other governments includes payments by the Australian National Training Authority (a non-budget authority).

Table F1 shows that the Commonwealth general government sector is expected to move from underlying deficit to underlying surplus from 1998-99, consistent with expected movements in the budget sector. This movement equates to a change from an underlying deficit of around $\frac{1}{2}$ per cent of GDP to an underlying surplus of around $\frac{1}{2}$ per cent of GDP. Compared with the general government estimates provided in the MYEFO, the move into underlying surplus is expected to occur one year earlier reflecting a stronger budget fiscal position.

The relative movements in the general government underlying and headline balance are dependent on changes in net advances. For instance, there is a larger increase in the headline surplus in 1997-98 compared to the fall in the underlying balance in the same year as a result of an increase in net advances in 1997-98 (mainly reflecting a higher level of equity asset sales).