

Appendix E: Sensitivity of Fiscal Aggregates to Economic Developments and Statement of Risks

Sensitivity of fiscal aggregates to economic developments

Table E1 provides a guide to the sensitivity of the forward estimates of GFS expenses and GFS revenue to variations in economic parameters in 2000-01. It is important to recognise that such guides provide only a 'rule of thumb' indication of the impact on the budget of changes in economic and other parameters.

Table E1: Sensitivity of financial aggregates to changes in economic parameters

	2000-01 \$m	2001-02 \$m	2002-03 \$m	2003-04 \$m
Expenses				
Prices	90	530	640	600
Wages	0	180	340	350
Unemployment benefit recipients	130	250	250	240
Safety net adjustments	15	110	220	330
Revenue				
Prices	10	200	220	230
Wages	540	1150	1240	1330
Employment	350	750	810	870
Private final demand	130	280	290	310

EXPENSES

On the expenses side, the sensitivity analysis of the estimates provides for the following assumptions about changes to four broad groups of parameters:

- prices — all price deflators are assumed to change by one percentage point at the start of the March quarter 2001, with wage deflators left unchanged;
- wages — all wage and salary growth rates are assumed to change by one percentage point from the beginning of the March quarter 2001, with price deflators left unchanged;
- unemployment benefit recipients (includes Newstart Allowance and unemployed Youth Allowance recipients) — the total number of recipients is assumed to change by 5 per cent from the beginning of the March quarter 2001; and
- Safety Net Adjustment — the Safety Net Adjustment (SNA) determined by the Australian Industrial Relations Commission (AIRC) is assumed to increase by \$2 per week in the March quarter 2001, and each year after that. The SNA is used in the calculation of the Wage Cost Indices.

For expenses, an increase in any of the above parameters will lead to an increase in expenses, and similarly, a decrease in any of the parameters will lead to a reduction in expenses.

Projected expenses 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 Male Total Average Weekly Earnings (MTAWE) 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 MTAWE.

In addition, about \$40 billion of expenses, comprising agency departmental expenses, other Commonwealth Own Purpose Expenses and Specific Purpose Payments to the States of a departmental expense nature, are indexed to weighted averages of movements in inflation and the SNA determined by the AIRC.

The wages effect in the table above is based on the increase in Commonwealth administered expenses which are linked to wage and salary indices. It does not include changes to wage and salary payments in Commonwealth Departmental expenses.

The number of unemployment benefit recipients, and therefore the total spending on benefits, are affected by economic growth and employment growth. However, the relationship between GDP growth and unemployment benefit recipients is highly variable and difficult to quantify. For this reason, Table E1 only includes the impact of changes in the number of unemployment benefit recipients (includes Newstart Allowance and unemployed Youth Allowance recipients) on the estimates.

REVENUE

The assumptions underlying the sensitivity of the revenue estimates to changes in prices and wages are similar to those used for expenses. In each case, the analysis presents the estimated effects of a change in one economic variable only, and does not attempt to capture the linkages between economic variables that characterise changes in the economy more broadly.

The revenue effects of changes in employment and private final demand show the effect of the following assumptions:

- employment — the level of employment is assumed to change by one percentage point from the beginning of the March quarter 2001, with no change in the composition of demand; and
- private final demand (consumption plus investment) — the level of private final demand is assumed to change by one percentage point from the beginning of the March quarter 2001, with no change in the composition of demand.

For the purposes of this analysis:

- changes in prices affect revenue primarily through changes in excise revenue;
- changes in wages and employment feed through into tax revenue largely through increases in PAYG Withholding tax collections; and
- changes in private final demand affect revenue predominantly through changes in excise and customs collections.

An increase in any of the parameters considered will lead to an increase in revenue, and a decrease in any of the parameters will lead to a reduction in revenue.

Statement of risks

OVERVIEW

Full details of fiscal risks and contingent liabilities are provided in Statement 4 of *Budget Paper No. 1 Budget Strategy and Outlook 2000-01*. The Statement of Risks included in the MYEFO provides an update of that material, presenting changes since the 2000-01 Budget to fiscal risks and quantifiable and unquantifiable contingent liabilities.

The forward estimates of revenues and expenses at the 2000-01 MYEFO incorporate assumptions and judgements based on information at the time of publication. A range of factors may influence the actual budget outcome in future years. *The Charter of Budget Honesty Act 1998* requires that these be disclosed in each Economic and Fiscal Outlook report. This disclosure brings greater transparency to the fiscal projections.

Events that 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
- realisation of contingent liabilities.

Economic and other parameters

Some degree of uncertainty is attached to estimates of both revenues and expenses. While MYEFO estimates are prepared with the benefit of some revenue outcomes for the early months of the Budget year — which in general tend to reduce forecast errors — substantial uncertainties nevertheless remain. Moreover, the difficulties associated with such estimation will generally increase in accordance with extension of the forecast horizon over the forward estimates period. The sensitivity of the estimates to major economic parameters (but not other parameters) is discussed earlier in this Appendix.

Fiscal risks

Fiscal risks are general developments or specific events that 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 expenses and /or revenue and may be positive or negative.

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 exposure to contingent liabilities arises out of legislation providing guarantees over certain liabilities of Commonwealth controlled financial institutions (that is, the Reserve Bank of Australia and the 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 Telstra Superannuation Scheme.

DETAILS OF FISCAL RISKS AND CONTINGENT LIABILITIES

Fiscal risks in relation to expenses that have arisen or changed since the 2000-01 Budget are outlined below. There are no substantive changes to fiscal risks associated with revenue.

FISCAL RISKS — EXPENSES

Defence

Litigation cases in train

The Department of Defence is involved in several cases covering a wide range of litigation where either the cases have not been heard or damages and costs have not been awarded. The litigation involves Common Law liability and claims before the Human Rights and Equal Opportunity Commission. Litigation also involves asbestos litigation, and alleged defective administration by the Department. Since the 2000-01 Budget, the number of claims has decreased from 574 to 459, and in total, all of these claims are now valued at around \$59 million.

Finance and Administration

Arbitration in train — DASFLEET

Macquarie Fleet Leasing Pty Ltd, as purchaser of DASFLEET, have disputed the valuation methodology adopted by the Commonwealth in the Completion Asset and Liability Statement in relation to the vehicle fleet. The Commonwealth is also in dispute with Macquarie Fleet Leasing Pty Ltd on matters associated with the Tied Contract. These matters are subject to arbitration.

Asset sales — Telstra

The Budget and forward estimates include the effect of the sale of the Commonwealth's shareholding in Telstra, noting that the level of proceeds will depend, *inter alia*, on the prevailing levels of world equity markets at the time of the sale. The sale of the Commonwealth's remaining shareholding in Telstra is dependent on the passage of legislation through the Parliament. The Government has committed not to introduce such legislation until its plan of action in relation to the independent telecommunications service inquiry into the adequacy of service levels has been fully considered and made public.

Health and Aged Care

Australian health care agreements

The Commonwealth and all States and Territories have signed Australian Health Care Agreements for the five years to 2002-03 that incorporate a risk-sharing arrangement in case of changes in the private health insurance participation rate. Under this formula, Commonwealth grants to the States and Territories will be increased by \$82 million a year from 1999-2000 for each percentage point decrease below the December 1998 level. This is based on current estimates of movements in population, price indexation, and assuming that those leaving private health insurance have the same age/sex profile as those remaining. While the Australian Health Care Agreements provide for grants to be decreased in the event of increases in the participation rate above a certain point, the Government made a commitment that none of the States would be worse off as the result of a rise in the private health insurance participation rate. This commitment took into account public hospital revenue from both privately insured patients and veterans. The Government has decided to exclude veterans from these calculations.

Immunisation funding mechanism

Future vaccine technology will result in new vaccines substituting for ones already in use (multivalent vaccines which combine several vaccines into one, for example) and, as a consequence, could result in higher unit costs of vaccines within the routine schedule. Given the nature of current vaccine technology and the possible introduction of new vaccines, specific costs cannot be precisely quantified at this stage. The possible inclusion of new conjugate vaccines since the 2000-01 Budget, for pneumococcal and meningococcal disease, and vaccines for varicella (chicken pox) and hepatitis A within the routine schedule now has the potential to increase Commonwealth expenses by up to \$240 million over the next four years.

Immigration and Multicultural Affairs

Unauthorised boat arrivals

During 1999-2000, Australia experienced unprecedented numbers of unauthorised boat arrivals. The Budget and forward estimates include an allowance for the level of arrivals to continue at a higher rate than has been the experience in previous years.

The number of unauthorised boat arrivals early in 2000-01 has been less than anticipated at the time the 2000-01 Budget was prepared. Whilst there is as yet insufficient evidence to conclude that this trend will continue, if a reduced outcome is achieved, this will reduce expenses in the Budget and forward years.

Industry, Science and Resources

Repayment of Snowy Mountains Hydro-Electric Scheme debt

At the 2000-01 Budget, the corporatisation of the Scheme was expected to occur in 2000-01. It is now expected to occur in 2001-02 and will involve the refinancing and early repayment of debt to the Commonwealth. The estimated market value of the debt remains unchanged since the 2000-01 Budget and is in the order of \$900 million. Detailed arrangements are to be finalised between the Commonwealth, New South Wales and Victorian Governments, as shareholders in the new company. Electricity prices and the financial markets will influence the timing and amount of payments following corporatisation.

Transport and Regional Services

Maritime industry reform

On 18 August 1998 the Commonwealth provided a guarantee to cover borrowings made by the Maritime Industry Finance Company (MIFCo) to finance redundancy related payments in the stevedoring and maritime industries. MIFCo's borrowing facility, negotiated with its bankers, was \$220 million. As at 30 September 2000, approximately \$195 million has been drawn down, reflecting an increase of \$2 million since the 2000-01 Budget. The *Stevedoring Levy (Collection) Act 1998* has been amended to increase the expenditure cap in the legislation from \$250 million to \$300 million.

Treasury

International Monetary Fund (IMF) assistance to Thailand, Indonesia and the Republic of Korea

In response to instability in regional financial markets, in 1997-98 Australia offered to provide bilateral financing in support for the IMF programmes in Thailand, Indonesia and the Republic of Korea. Only the Thailand facility has been used. This took the form of a series of currency swaps between the Reserve Bank of Australia (RBA) and the

Bank of Thailand for up to \$US1 billion. Under the swap arrangement, the RBA provided US dollars to the Bank of Thailand in exchange for Thai baht. Australia has provided bilateral support of \$US862 million. The Bank of Thailand indicated in October 1999 that it did not intend to draw down any further financing. The facility expired in June 2000. Repayment of swaps drawn under the facility is to commence from March 2001, with repayment in full occurring no later than July 2004.

Transitional arrangements for reforms to Commonwealth-State financial relations

The Commonwealth has guaranteed that in each of the transitional years following the introduction of *The New Tax System*, each State's budgetary position will be no worse off than had the reforms to Commonwealth-State financial relations not been implemented. To meet this commitment, the Commonwealth has implemented transitional arrangements. As a result of these arrangements, a shortfall in estimated GST revenue over the forward estimates period may result in increased expenses to the Commonwealth.

CONTINGENT LIABILITIES — QUANTIFIABLE

Communications, Information Technology and the Arts

Australian Broadcasting Corporation (ABC)

The Commonwealth has guaranteed loans by the ABC. These loans were largely used to meet costs relating to the construction of premises for the ABC at Southbank in Melbourne and Ultimo in Sydney. The principal amount covered by the guarantee as at 30 September 2000 was \$90 million, a decrease of \$53 million since the 2000-01 Budget.

Telstra Corporation Limited — superannuation guarantee

Telstra Corporation Limited had agreed to make additional employer contributions to the Telstra Superannuation Scheme (TSS). The Commonwealth had guaranteed any outstanding additional employer contributions in the event that Telstra became insolvent. Since the 2000-01 Budget, Telstra has reached agreement with the Trustee of the TSS and the Government to release it from the obligation to make additional payments. As part of this arrangement, the Commonwealth's guarantee (and thus the risk) no longer applies.

Defence

Military Compensation

Contingent liabilities exist in relation to military compensation claims to the value of some \$27 million, which is \$1 million lower than the 2000-01 Budget estimate. The total

amount relates to outstanding claims for non-economic loss as a consequence of the Federal Court decision in *Schlenert v the Australian and Overseas Telephone Corporation* 1995.

Education, Training and Youth Affairs

Commonwealth loan guarantees – group training

The Minister for Education, Training and Youth Affairs is authorised to issue Commonwealth guarantees on a limited number of loans made to Commonwealth-endorsed Group Training companies. These loans provide access to additional working capital required to expand the number of apprentices and trainees that may be employed through Group Training companies. The maximum guarantee of each loan is \$175,000 with the total value of all guarantees capped at \$30 million. As of 30 June 2000, two Commonwealth Loan Guarantees for \$175,000 each were issued by the Commonwealth. Two applications for a Guarantee are currently under consideration.

Treasury

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 related to Notes (that is, 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. As at 30 June 2000, Notes on Issue totalled \$25,434 million. In total, the guarantee for the Reserve Bank was \$45,249 million as at 30 June 2000, reflecting an increase of around \$3 million since the 2000-01 Budget.

Uncalled Capital Subscriptions – International Financial Institutions

The liability relates to the value of the uncalled portion of the Commonwealth's shares at 30 June 2000 in the International Bank for Reconstruction and Development (\$US2,769 million — estimated value \$A4,627 million), the Asian Development Bank (\$US2,448 million — estimated value \$A4,089 million), the European Bank for Reconstruction and Development (EBRD) (\$US82 million — estimated value \$A136 million), and the Multilateral Investment Guarantee Agency (MIGA) (\$US15 million — estimated value \$A25 million). Australia will subscribe to General Capital Increases for both the EBRD and MIGA in 2000-01. When this occurs, the uncalled capital portion of the subscriptions will increase by \$US98 million for the EBRD and by \$US12 million for MIGA (with estimated values of \$A164 million and \$A19 million respectively using the 30 June 2000 exchange rate). This will not affect the fiscal balance or the underlying cash balance as the transactions involved are considered to be financing transactions.

International Monetary Fund (IMF) allocation of Special Drawing Rights (SDRs)

IMF members are currently considering a special one-time allocation of SDRs under the proposed Fourth Amendment to the IMF's Articles of Agreement. The proposed amendment will be in force for all IMF members as at the date at which the IMF certifies that three fifths of IMF members (109 members), having eighty-five per cent of the total votes, have accepted the proposed Fourth Amendment. The Joint Standing Committee on Treaties has recommended that Australia take binding treaty action to approve the proposed amendment and legislation has been introduced into Parliament to reflect this. If the proposed amendment is approved by the required majority of IMF members and Australia accepts the SDR allocation, the Commonwealth would receive approximately SDR213 million or \$A476 million, based on the \$A/SDR exchange rate on 30 June 2000. This will not affect the fiscal balance or the underlying cash balance as the transactions involved are considered to be financing transactions.

CONTINGENT LIABILITIES — UNQUANTIFIABLE

Defence

HMAS Melbourne, HMAS Voyager and HMAS Stalwart damages claims

Some former crewmembers of HMAS Melbourne have instituted legal proceedings against the Commonwealth claiming damages for injuries relating to the collision with HMAS Voyager on 10 February 1964. To date, 103 claims remain current, down from 113 at the time of the 2000-01 Budget. A number of dependency claims arising from that collision have also been made or foreshadowed by the dependants of deceased members of the crew of HMAS Voyager. To date, a number of claims from dependants have been settled and 33 additional claims have been foreshadowed. There is a possibility that further claims will be made by former crewmembers of HMAS Melbourne and the dependants of deceased members of the crew of HMAS Voyager.

There is also a claim against the Commonwealth for damages for injuries allegedly sustained as a result of the HMAS Melbourne/USS Frank E Evans collision of 3 June 1969. It is possible that further claims will be made by former crew of HMAS Melbourne arising out of that collision.

Twenty-five claims for damages for injuries allegedly arising out of an incident aboard HMAS Stalwart that occurred on 22 October 1985 have been settled. Another five claims are currently the subject of legal proceedings. It is possible that former crew of HMAS Stalwart and the dependants of deceased members of the crew will make further claims.

Environment and Heritage

Newcrest Mining (WA) Limited and BHP Minerals Limited v the Commonwealth of Australia and the Director of National Parks and Wildlife

In August 1997, the High Court of Australia found that the declarations of Stage 3 Kakadu National Park in 1987, 1989 and 1991 were technically invalid with respect to 23 small areas in the south-east of the park covered by existing mineral leases held by the Newcrest group of companies. The reason for this decision was that the declaration over these areas had, with the absolute prohibition on mining activities in Kakadu under the *National Parks and Wildlife Conservation Act 1975*, affected an acquisition of property without payment of just terms compensation, as required by the Australian Constitution.

The Minister for Environment and Heritage has indicated that the lease areas need to be re-incorporated within the Park and that the Government will address the issue of 'just terms' compensation. The Government has entered a dialogue with mining company representatives about the matter. The process was still underway as at October 2000.

Finance and Administration

Commonwealth Civilian Superannuation Liability

Every three years an actuarial review of the Commonwealth's unfunded liability in respect of the Public Sector Superannuation Scheme and the Commonwealth Superannuation Scheme is undertaken. Subsequent to the 2000-01 Budget, the review based on data at 30 June 1999 has been completed and the results have been taken into account in the current estimates of the unfunded liability. The next review will be undertaken in 2002-03 based on data at 30 June 2002.

