Appendix D: Risks to the Budget

Statement of Risks

OVERVIEW

Full details of fiscal risks and contingent liabilities are provided in *Budget Strategy and Outlook 2002-03 — Budget Paper No. 1*. The following statement updates (where necessary) those fiscal risks and contingent liabilities that have changed since the 2002-03 Budget and includes any new risks or contingencies that have arisen since the 2002-03 Budget.

The forward estimates of revenue and expenses in the 2002-03 MYEFO 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 Act 1998* requires these factors be disclosed in a Statement of Risks in each Economic and Fiscal Outlook Report.

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 and/or likelihood; and
- the realisation of contingent liabilities.

Fiscal risks

Fiscal risks are general developments or specific events that may have an effect on the fiscal outlook. In some cases, the events simply raise the possibility of some fiscal impact. In other cases, some fiscal impact may 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 on expenses, revenue and/or the budget balance.

Contingent liabilities

Contingent liabilities are defined by the accounting standard AASB 1044, which came into effect from 1 July 2002. Broadly, they represent possible costs to the Commonwealth arising from past events that will be confirmed by the outcome of uncertain future events. Contingent liabilities include loan guarantees, non-loan guarantees, warranties, indemnities, uncalled capital and letters of comfort. These possible costs are in addition to those recognised as liabilities in the consolidated financial statements of the General Government Sector of the Commonwealth.

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 — that have arisen or changed since the 2002-03 Budget are outlined below.

Information on contingent liabilities is also provided in the annual financial statements of departments, agencies and non-budget entities.

FISCAL RISKS — EXPENSES

Agriculture, Fisheries and Forestry

Exceptional Circumstances Assistance for drought-affected farmers

Exceptional Circumstances Assistance is available, subject to eligibility criteria, to drought-affected farmers by way of interest rate subsidies and/or the Exceptional Circumstances Relief Payment. Continuation of dry climatic conditions could result in increases in expenses. It is not possible to quantify the cost arising from such potential development as this depends on the intensity, duration and scale of the drought.

Health and Ageing

Medical Indemnity Insurance — Incurred-But-Not-Reported Scheme

In announcements on the medical indemnity package in May and October 2002, the Prime Minister indicated that the Commonwealth would assume the liability for the unfunded Incurred-But-Not-Reported (IBNR) liabilities of Medical Defence Organisations (MDOs), with this liability to be funded by doctors who were members of the organisations as at 30 June 2000, subject to a number of conditions.

Legislation has been introduced to give effect to the IBNR scheme. An estimate of the liability for United Medical Protection/Australasian Medical Insurance Limited was reported as an expense in the 2001-02 Final Budget Outcome, however further data for other MDOs is, as yet, unavailable.

Industry, Tourism and Resources

Corporatisation of the Snowy Mountains Hydro-electric Scheme — sharing of company tax collected from Snowy Hydro Limited with New South Wales and Victoria

The Commonwealth, New South Wales and Victorian Governments have entered into a Tax Compensation Deed in respect of company tax collected by the Commonwealth and land tax collected by New South Wales from Snowy Hydro Limited. The Department of Industry, Tourism and Resources will make the Commonwealth's tax compensation payments for company tax to New South Wales and Victoria in proportion to the Governments' shareholdings in Snowy Hydro Limited.

Treasury

International Monetary Fund (IMF) assistance to Thailand

Australia's offer to provide bilateral financing of up to $US1 billion in support of the IMF programme in Thailand was taken up in the form of a series of currency swaps between the Reserve Bank of Australia (RBA) and the Bank of Thailand. Under the swap arrangements, the RBA provided $US862 million to the Bank of Thailand in exchange for Thai baht. From March 2001, the Bank of Thailand began repaying the swaps as scheduled. Currently, $US204.3 million of the facility remains outstanding. Repayment in full is scheduled to occur no later than July 2004. Changes to the schedule of repayments outstanding may result in the RBA dividend stream in the forward estimates being affected.

CONTINGENT LIABILITIES — QUANTIFIABLE

Communications, Information Technology and the Arts

Art Indemnity Australia

The Government indemnifies cultural objects loaned to exhibitions held in museums and galleries. The estimated indemnified amount of exhibitions in 2002-03 is $610 million. However, the exact amounts involved would vary with the exchange rate applying at the time any claim for loss or damage to an artwork or heritage object loaned from overseas is paid and the extent of the loss or damage. Most of the Commonwealth risk in indemnifying exhibitions is insured through Comcover. Uninsurable risk continues to be borne solely by the Commonwealth.

Education, Science and Training

Commonwealth loan guarantees — Group Training

The Minister for Education, Science and Training has authorised 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. The Commonwealth issued three guarantees to Group Training companies over the period July 1999 to June 2001. Two of these guarantees, for $175,000 each, were still active as of 1 October 2002.

Employment and Workplace Relations

Special Employee Entitlement Scheme for Ansett group employees

A contingent liability of $104 million exists in relation to the Special Employee Entitlements Scheme for Ansett group employees (SEESA). This scheme was established by the Federal Government on 9 October 2001 under section 22 of the *Air Passenger Ticket Levy (Collection) Act 2001* to provide a safety net arrangement for staff of the Ansett Group of companies who were terminated after 12 September 2001 due to their employer's insolvency. Contingent revenue also exists in relation to the SEESA.

Foreign Affairs and Trade

Export Finance and Insurance Corporation (EFIC)

The Commonwealth guarantees the due payments by EFIC of money that is, or may at any time become, payable by EFIC to any body other than the Commonwealth. The Commonwealth also has in place a $200 million callable capital facility available to EFIC on request to cover liabilities, losses and claims. As at 30 September 2002, the Commonwealth's total contingent liability was $7.1 billion, comprising EFIC's liabilities to third parties ($3.4 billion) and EFIC's contracts of insurance and guarantees ($3.7 billion). The National Interest Account accounted for $2.8 billion of these liabilities.

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 to finance redundancy-related payments in the stevedoring and maritime industries. Outstanding borrowings covered by the guarantee as at 30 September 2002 were $136 million.

Aviation War Risk Insurance — indemnities for Australian carriers, airports and service providers

Following terrorist attacks in the United States on 11 September 2001, regular insurance cover for claims arising out of war and terrorism was withdrawn or significantly limited, placing global aviation operations at risk. In common with other aviation countries, the Commonwealth has been providing temporary third party war risk indemnity cover to air operators, airports and other aviation service providers, initially rolled over on a monthly basis.

On 30 August 2002, the Government entered into three-monthly indemnity deeds with 22 operators — 6 carriers (4 airlines and 2 cargo carriers), 11 airports and 5 other service providers. Indemnity deeds are being entered into on the basis of the recipient paying a charge and taking out commercial insurance when available.

The notional upper limit of the Government's contingent liability for these indemnities is approximately $20.6 billion, based on the difference between the amount of commercial insurance currently held by an entity and the level of cover held prior to cancellation. Individual contingent liabilities range from $100 million to $2 billion. It is extremely unlikely that the total liability would be called upon as facilities are spread across Australia. Nonetheless, a terrorist incident could involve claims from several indemnified parties.

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 relates 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 2 October 2002, Notes on Issue totalled $31.5 billion. In total, the guarantee for the RBA was $49.4 billion as at 2 October 2002.

Terrorism insurance — commercial cover

On 25 October 2002, the Government announced the detailed plans for a scheme for replacement terrorism insurance, to operate until the market recovers. The Scheme will cover commercial property and infrastructure facilities, and include associated business interruption and public liability. It will commence on 1 July 2003.

The Scheme will provide for a pool of funds (initially planned to accumulate to about $300 million) funded by premiums. The pool will be supplemented by a back-up bank line of credit of $1 billion, underwritten by the Commonwealth, as well as a Commonwealth Government indemnity of $9 billion, giving aggregate cover of up to $10.3 billion when the pool is fully funded.

The notional upper limit of Government contingent liabilities under the Scheme is $10.3 billion (which assumes a full utilisation of all Scheme resources). However, as the Commonwealth may recoup payouts made under the Scheme, any liability is likely to be considerably less than this amount. Such repayments to the Commonwealth may take some years.

Uncalled capital subscriptions — international financial institutions

The liability relates to the value of the uncalled portion of the Commonwealth's shares at 30 June 2002 in the International Bank for Reconstruction and Development ($US2.8 billion — estimated value $A4.9 billion), the Asian Development Bank ($US2.4 billion — estimated value $A4.3 billion), the European Bank for Reconstruction and Development ($US81.7 million plus EUR77.5 million — estimated value $A280 million), and the Multilateral Investment Guarantee Agency ($US26.5 million — estimated value $A46.9 million).

CONTINGENT LIABILITIES — UNQUANTIFIABLE

Defence

Australian Submarine Corporation (ASC) — indemnity provided to Electric Boat Corporation (EBC) under the Services Agreement

In October 2002, the Department of Defence and ASC entered into a Services Agreement with EBC of the United States and its subsidiary, Electric Boat Australia, to provide commercial advice to ASC as a Capability Partner to the company. For the purpose of this agreement, EBC and its subsidiaries were granted a warranty that the Department of Defence and ASC had a right to disclose certain information provided to EBC under the Services Agreement; and an indemnity to EBC against any claims brought by third parties arising out of EBC's use of information provided by the Department of Defence and ASC for the purposes of the Services Agreement.

HMAS MELBOURNE and HMAS VOYAGER damages claims

Former crew members of HMAS MELBOURNE have instituted legal proceedings against the Commonwealth, claiming damages for injuries allegedly caused by the HMAS VOYAGER/HMAS MELBOURNE collision on 10 February 1964. About 200 claims have been made of which some 60 claims have so far been settled. A number of dependency claims arising from that collision have also been foreshadowed by the dependants of deceased former members of the crew of HMAS VOYAGER. Further claims are likely to be made in connection with the collision. There are also claims outstanding in relation to other naval incidents.

Litigation cases

The Department of Defence is involved in a wide range of litigation and other claims for compensation and/or damages that may result in litigation where the matters have yet to be finalised by negotiation or, where required, litigation. Various claims, the subject of cases that have yet to be heard or are part heard, await a decision on what (if any) damages and/or costs should be paid to the claimant. The litigated and non-litigated claims include common law liability claims and claims before the Human Rights and Equal Opportunity Commission. The litigation also includes asbestos claims and claims from injury resulting from the F111 Deseal/Reseal programmes. In total there are about 350 claims at present, with a value in excess of $120 million. There is identified potential for additional claims from known incidents of non-military asbestos exposure and the F111 Deseal/Reseal project of some 130 claims with a value of some $30 million.

Finance and Administration

Australian Submarine Corporation (ASC) — directors' indemnities

The Commonwealth has indemnified the members of the Board of ASC for any claim associated with the provision of information to the Electric Boat Corporation (EBC) of the United States. Certain information is to be provided to EBC under a Process Agreement between it, the Commonwealth and ASC. This indemnification has been separately extended to include any claim associated with the provision of information to EBC and its subsidiary, Electric Boat Australia under the Services Agreement between ASC, the Department of Defence, EBC and Electric Boat Australia.

Health and Ageing

United Medical Protection (UMP)/Australasian Medical Insurance Ltd (AMIL) Guarantee

In the 2002-03 Budget the Government announced that the Commonwealth would guarantee to the provisional liquidator, or to any other subsequently appointed liquidator, the obligations of UMP/AMIL to pay any amount properly payable in the period 29 April 2002 to 30 June 2002 in respect of claims made under a current or past policy to provide coverage for claims incurred during that period.

On 31 May 2002, the Prime Minister announced an offer to extend the Commonwealth Guarantee provided to UMP/AMIL and the companies' provisional liquidator to 31 December 2002 on a claims made basis. In his 23 October 2002 press release on the medical indemnity package, the Prime Minister announced a further extension to 31 December 2003.

The guarantee will provide Commonwealth financial support to allow UMP/AMIL to meet the following payments under the cover provided to its members:

- amounts payable in respect of claims incurred in the period 29 April 2002 to 30 June 2002;
- amounts payable in the period 29 April 2002 to 31 December 2003 in respect of claims notified or finalised prior to 29 April 2002; and
- amounts payable in respect of claims notified in the period 29 April 2002 to 31 December 2003, whenever the claim is finalised (including after 31 December 2003).

The guarantee will apply to the extent that the provisional liquidator is unable to meet UMP/AMIL's obligations under these policies from UMP/AMIL's assets. The liabilities cannot be quantified, as a reliable estimate cannot be produced at this time.

Both extensions of the guarantee will be funded, if necessary, via a levy on doctors. At present, the Provisional Liquidator has not called on the Commonwealth guarantee.

Industry, Tourism and Resources

Snowy Hydro Limited — directors' indemnities

The Commonwealth has, together with the co-shareholder Governments of New South Wales and Victoria, indemnified the members of the Board of Snowy Hydro Limited for liabilities arising from entering into agreements to implement corporatisation of the Snowy Mountains Hydro-electric Scheme, and from liabilities transferred to Snowy Hydro Limited at corporatisation. The indemnity will apply to liabilities arising within five years of corporatisation, and for which a claim is notified to the Governments within eleven years of the corporatisation date of 28 June 2002.

Snowy Hydro Limited — water releases

The Commonwealth, New South Wales and Victorian Governments have indemnified Snowy Hydro Limited for liabilities arising from water releases in the Snowy River below Jindabyne Dam, where these releases are in accordance with the water licence and related regulatory arrangements agreed between the three Governments. The indemnity will apply to liabilities for which a claim is notified within twenty years from 28 June 2002.

The Commonwealth, New South Wales and Victorian Governments will provide financial support to the company if this is necessary to avoid the company breaching its loan covenants to fund the cost of civil works required to address a cold water pollution offence. The undertaking applies for seven years from 28 June 2002.

Transport and Regional Services

Australian Maritime Safety Authority (AMSA) — incident costs

In the normal course of operations, AMSA is initially responsible for the provision of funds necessary to meet the clean-up costs arising from ship-sourced marine pollution and in all circumstances the Authority is responsible for making appropriate efforts to recover the costs of any such incidents. The Government meets costs that cannot be recovered from such incidents through contingency provisions specifically made for this purpose.

Treasury

HIH litigation

The HIH Liquidator filed a claim on 11 November 2002 in the ACT Supreme Court against the Commonwealth of Australia and the Australian Prudential Regulation Authority (APRA) for damages, interest and costs. The claim is based on an alleged duty of care owed by the Insurance and Superannuation Commission (ISC) and APRA to the HIH companies, which it allegedly breached in its regulation of the FAI companies. The liquidator proposes to serve the documents after the HIH Royal Commission has reported in February 2003. The Commonwealth is being sued as the successor to the liabilities of the ISC.

Sensitivity of fiscal aggregates to economic developments

Table D1 provides a guide to the sensitivity of the forward estimates of expenses and revenue to variations in economic parameters in 2002–03. It is important to recognise that such guides provide only a 'rule of thumb' indication of the impact on the budget of changes in prices, wages and other parameters. In each case, the analysis presents the estimated effects of a change in one economic variable only, and does not attempt to capture the linkages between economic variables that characterise changes in the economy more broadly.

Table D1: Sensitivity of financial aggregates to changes in economic parameters

	2002-03	2003-04	2004-05	2005-06
	$m	$m	$m	$m
Expenses				
Prices	860	520	810	830
Wages	0	270	360	380
Unemployment benefit recipients	140	280	300	300
Safety net adjustments	0	50	100	180
Revenue				
Prices	10	90	100	100
Wages	730	1570	1680	1810
Employment	480	1040	1110	1200
Private final demand	130	260	260	270
Profits	60	210	220	230

Expenses

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

Prices

All price deflators are assumed to change by one percentage point at the start of the March quarter 2003, with wage deflators left unchanged.

- The effect of a change in prices is due to the indexation of Commonwealth expenses and a change in the nominal superannuation interest expense.

Wages

All wage and salary growth rates are assumed to change by one percentage point from the beginning of the March quarter 2003, with price deflators left unchanged.

- The effect of a change in wage and salary growth rates is largely determined by the effect of the Government's commitment to maintain selected pensions at 25 per cent of Male Total Average Weekly Earnings. The wages effect in Table D1 above does not include changes to wage and salary payments in Commonwealth departmental expenses.

Unemployment Benefit Recipients (includes Newstart Allowance and unemployed Youth Allowance recipients)

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

Safety Net Adjustment

The Safety Net Adjustment (SNA) determined by the Australian Industrial Relations Commission is assumed to change by $2 per week, taking effect from the beginning of the March quarter 2003, and each year after that.

- About $45 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.

Revenue

On the revenue side, the sensitivity analysis of the estimates provides for the following assumptions about changes to five broad groups of parameters. 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.

Prices

All price deflators are assumed to change by one percentage point at the start of the March quarter 2003, with wage deflators left unchanged.

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

Wages

All wage and salary growth rates are assumed to change by one percentage point from the beginning of the March quarter 2003, with price deflators left unchanged.

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

Employment

The level of employment is assumed to change by one percentage point from the beginning of the March quarter 2003, with no change in the composition of employment.

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

Private final demand

The level of private final demand (consumption plus investment) is assumed to change by one percentage point from the beginning of the March quarter 2003, with no change in the composition of demand.

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

Profits

The level of company profits is assumed to change by one percentage point from the beginning of the March quarter 2003.

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