STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

The cost of recent natural disasters and the weaker outlook for tax receipts have had a significant impact on the fiscal outlook for 2010-11 and 2011-12. Despite these challenges, the Government's strict adherence to the fiscal strategy means that the budget is on track to return to surplus in 2012-13, well ahead of Australia's peers.

The Government is supporting affected communities to rebuild after the recent natural disasters. While the Government has fully funded the costs of its contribution to the recovery effort over the forward estimates, the underlying cash balance will be affected as a significant share of the costs are incurred in 2010-11 and 2011-12.

Natural disasters have also affected tax receipts in the near term because production and profits have been lost. In addition the legacy effects of the global financial crisis have been greater than expected, as companies utilise capital losses. Overall, tax receipts have been revised down by $16.3 billion over 2010-11 and 2011-12 relative to the *Mid-Year Economic and Fiscal Outlook 2010-11* (MYEFO).

Notwithstanding the immediate pressures on the budget, the Government will return the budget to surplus in 2012-13. Returning the budget to surplus will ensure the Government does not draw on resources needed to support the growing investment in the resources sector and the expansion of the economy more generally. The fiscal consolidation will strengthen the long term position of the budget and support Australia's capacity to respond to unanticipated shocks, including those related to the uncertain global economic outlook.

This means that the budget is projected to return to surplus only three years after the deficit peaked during the global financial crisis, despite the challenges faced this year and next due to natural disasters and the legacy effects of the crisis. This will be the fastest fiscal consolidation in the 44 years for which data are available.

The Government is delivering the return to surplus through its ongoing commitment to the fiscal strategy. The Government has paid for its new spending, including the cost of the recent natural disasters, by making $22 billion in saving decisions. Over two thirds of savings are reductions in payments. This restraint has resulted in real growth in spending averaging 1 per cent a year over five years for the first time since the 1980s.

Net debt is expected to peak at 7.2 per cent of GDP in 2011-12, higher than previously anticipated, reflecting the impact of natural disasters and weaker tax receipts. Still, the Australian Government's balance sheet remains one of the strongest in the developed world, and its level of net debt in 2011-12 is less than one tenth the average of the major advanced economies in 2011.

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STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

OVERVIEW OF FISCAL POSITION

The 2011-12 Budget shows the Government remains on track to deliver a surplus in 2012-13. This is despite short-term challenges that have led to a deterioration of the budget bottom line this year and next and made the return to surplus more difficult.

The recent natural disasters are expected to result in additional payments of $6.6 billion over six years to assist affected communities with the costs of rebuilding.

Tax receipts have fallen by $16.3 billion over 2010-11 to 2011-12 relative to the estimates in the *Mid-Year Economic and Fiscal Outlook 2010-11* (MYEFO) reflecting a more subdued economic outlook and larger than anticipated losses accumulated during the global financial crisis.

The downward revisions to tax receipts and the rebuilding cost of recent natural disasters have increased the budget deficit in 2010-11 and in 2011-12 compared to the 2010-11 MYEFO. The underlying cash deficit is expected to be $49.4 billion (or 3.6 per cent of GDP) in 2010-11 and $22.6 billion (or 1.5 per cent of GDP) in 2011-12.

Notwithstanding these developments, the Government will deliver a surplus in 2012-13 through its continuing focus on fiscal consolidation. Returning the budget to surplus will make room for the private sector to respond to the strong demand for Australia's commodity exports and avoid compounding capacity and price pressures. The fiscal consolidation will enable the Government to strengthen the position of the budget and support Australia's capacity to respond to unanticipated shocks.

The budget projects a surplus of $3.5 billion (0.2 per cent of GDP) in 2012-13. This represents a fiscal consolidation of $52.9 billion (3.8 per cent of GDP) in the space of two years. This means that the Budget is projected to return to surplus only three years after the deficit peaked during the global financial crisis. This return to surplus will be the fastest in the 44 years for which data are available and is well ahead of any major advanced economy.

Table 1: Budget aggregates

	Actual	Estimates			Projections	
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Underlying cash balance($b)(a)	**-54.8**	**-49.4**	**-22.6**	**3.5**	**3.7**	**5.8**
Per cent of GDP	-4.3	-3.6	-1.5	0.2	0.2	0.3
Fiscal balance($b)	**-52.9**	**-45.7**	**-20.3**	**4.0**	**3.2**	**8.5**
Per cent of GDP	-4.1	-3.3	-1.4	0.3	0.2	0.5

(a) Excludes expected Future Fund earnings.

The Government's fiscal strategy

The Government's medium-term fiscal strategy is designed to ensure fiscal sustainability.

The Government's medium-term fiscal strategy is to:

- achieve budget surpluses, on average, over the medium term;
- keep taxation as a share of GDP below the level for 2007-08 (23.5 per cent of GDP), on average; and
- improve the Government's net financial worth over the medium term.

The strategy has remained unchanged since 2008-09, this Government's first budget. It has guided the Government's response to the global financial crisis and provides the basis for the Government's commitment to return the budget to surplus.

The strategy provides the necessary flexibility for the budget position to vary in line with economic conditions to support macroeconomic stability.

Consistent with the fiscal strategy, the Government took swift action through 2008 and 2009 to support the economy through the global financial crisis. The Government's delivery of a timely, targeted and temporary fiscal stimulus supported economic growth at a time that the private sector was in retreat.

In the *Updated Economic and Fiscal Outlook* (UEFO) released in February 2009 the Government also committed to take action to return the budget to surplus once the economy recovered to grow above trend. As part of this strategy, the Government will:

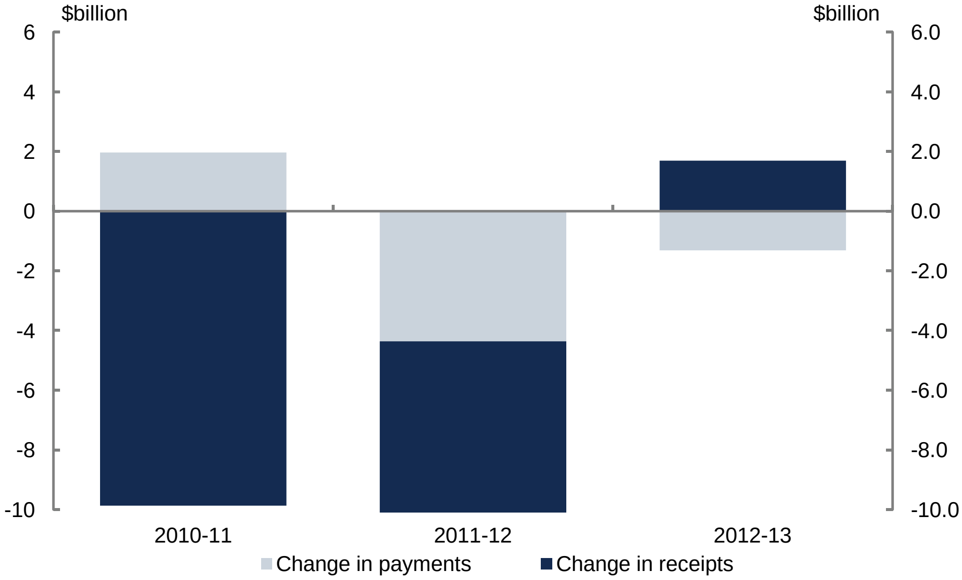
- allow the level of tax receipts to recover naturally as the economy improves, while maintaining the Government's commitment to keep taxation as a share of GDP below the 2007-08 level on average; and
- hold real growth in spending to 2 per cent a year until the budget returns to surplus.

Once the budget returns to surplus, and while the economy is growing at or above trend, the Government will maintain expenditure restraint by retaining a 2 per cent annual cap on real spending growth, on average, until surpluses are at least 1 per cent of GDP.

Short term pressures on the fiscal position

Significant pressures have emerged since MYEFO which are affecting the budget position. These pressures have increased the size of the deficits expected in 2010-11 and 2011-12.

Chart 1: Decomposition of the change to the underlying cash balance since the 2010-11 MYEFO(a)



(a) Includes GST receipts and GST payments, but excludes Future Fund earnings.

Chart 1 shows the change to the underlying cash balance since MYEFO.

Over two thirds of the change in the deficits in 2010-11 and 2011-12 is the result of the write down in tax receipts. This reflects the softer economy stemming from the impact of the recent natural disasters and the strong dollar, as well as the legacy of the global financial crisis, particularly the impact on tax receipts of unanticipated losses.

In 2010-11, all of the change in the fiscal position is driven by the downward revisions to tax receipts.

In 2011-12, around half of the change in the fiscal position is driven by the downward revisions to tax receipts. Only one quarter of the change reflects government policy decisions, and these largely reflect the Government's commitment to the military operations in Afghanistan and the bring forward of the Low Income Tax Offset.

From 2012-13, the outlook for tax receipts is expected to improve, particularly as the impact of the natural disasters diminishes and the stronger economic outlook in 2011-12 — buoyed by the higher terms of trade — flows through to tax collections. The improving outlook for tax receipts is also assisted by policy measures in this Budget to remove or adjust tax expenditures. As a result tax receipts as a share of the economy are expected to recover to 22.7 per cent of GDP in 2012-13 which is the level projected at the MYEFO.

Natural disasters

The recent natural disasters have placed considerable strain on the budget because of their unprecedented economic and fiscal costs. It is estimated that the cost to the budget from increased spending will be $6.6 billion over six years.

Recognising this significant impact, the Government has cut spending, and introduced a modest progressive temporary levy, to make room in the budget for the cost of rebuilding. Through these actions the Government has fully funded the costs of its contribution to the recovery effort over the five years of the budget estimates.

In addition, the production losses associated with the natural disasters experienced in 2010-11 are expected to reduce tax receipts by around $1¾ billion, almost entirely in the 2010-11 and 2011-12 years, compounding the impact on the budget of the increased spending on natural disasters.

Box 1 : Recovering and rebuilding from the recent natural disasters

The recent natural disasters throughout much of Australia are estimated to cost the Australian Government $6.6 billion over six years ($5.9 billion over the forward estimates) owing to increased spending to assist the States in the recovery effort through the Natural Disaster Relief and Recovery Arrangements (NDRRA) and direct Commonwealth assistance to those affected by the disasters.

The vast majority of this funding will rebuild damaged public infrastructure, mostly roads and bridges, but also other items such as schools and local council utilities and infrastructure.

The Government is also providing assistance for individuals, families, businesses, primary producers and not-for-profit organisations affected by the disasters, and assistance to help communities recover from the devastating events.

Of the total estimated expenditure, $3.9 billion will fall in 2010-11. The Budget impact in this financial year reflects immediate assistance made available to help people, business and communities affected by the disasters. The Commonwealth also agreed to provide advance payments to Queensland and Victoria (as soon as Victoria signs a national partnership agreement) to ensure that the recovery and rebuilding task could start as quickly as possible and to help fund recovery in Queensland as the work is taking place.

Rebuilding infrastructure will take time given the unprecedented scale of the natural disasters and to ensure that it is done properly. Reconstruction activities are not expected to be completed by the States until 2013-14. The Commonwealth's reimbursement of the States' costs normally occurs a year or two following reconstruction activities. Historically there have been lags in payments following significant natural disasters. For Tropical Cyclone Larry, which occurred in March 2006, the Commonwealth made payments to Queensland to fund reconstruction through to the 2009-10 financial year.

While the majority of the impact is in the early years, it is anticipated that significant expenditure as a result of the floods and cyclone will occur across the forward estimates. The Commonwealth expects to provide reimbursements of more than $1.3 billion in 2012-13 to 2014-15, with $0.7 billion anticipated to be paid outside the forward estimates. However, if reconstruction and repair work is finalised more quickly than expected then the affected States will be reimbursed sooner.

Box 1 : Recovering and rebuilding from the recent natural disasters (continued)

Table A: Budget impact of Commonwealth recent natural disasters assistance[(a)]

	Estimates			Projections		Total
	2010-11	2011-12	2012-13	2013-14	2014-15	
	$m	$m	$m	$m	$m	$m
Commonwealth natural disaster assistance						
Rebuilding infrastructure (NDRRA)	-2,550	-500	-140	-226	-982	-4,398
Assistance to individuals	-1,039	-11	-6	0	0	-1,055
Assistance to business	-49	-86	-28	-8	0	-170
Supporting local governments and communities	-214	0	0	0	0	-214
Donations to appeals	-13	0	0	0	0	-13
Natural Disasters Recovery Taskforce and Reconstruction Inspectorate	-1	-7	-3	0	0	-12
Total Commonwealth natural disaster assistance	**-3,865**	**-604**	**-177**	**-234**	**-982**	**-5,862**

(a) Underlying cash basis.

The Government has fully funded its contribution to the cost of the floods as part of the $22 billion in savings identified in the budget. These include the spending cuts, infrastructure deferrals and the temporary levy which were announced on 27 January 2011.

Weaker tax receipts

The outlook for tax receipts has been revised down significantly in the near term, with this year and next being the most significantly affected. In total, tax receipts have been revised down since MYEFO by $9.8 billion in 2010-11 and $6.6 billion in 2011-12.

The downward revisions reflect the influence of a number of important factors including:

- slower economic growth in 2010-11 and reduced production associated with the impact of natural disasters, a stronger than anticipated exchange rate and weakness in household consumption expenditure; and
- larger than anticipated losses accumulated during the global financial crisis, with the utilisation of those losses driving significant downward revisions to receipts since MYEFO, particularly to company tax and capital gains tax collections.

Tax receipts in the near term are therefore projected to remain significantly below the projections published in the 2008-09 Budget, with the shortfall being around $40 billion in 2010-11 and around $15 billion in 2011-12.

Returning the budget to surplus

Notwithstanding the challenges posed by natural disasters and the near term revenue weaknesses, the Government remains committed to return the budget to surplus as the appropriate policy response given the domestic economic outlook. Recent natural disasters will reduce Australia's economic growth in the first half of 2011, but the negative macroeconomic impacts are expected to be temporary. Australia's medium-term outlook remains strong. The economy is forecast to grow at an above-trend rate in 2011-12 and 2012-13 underpinned by an extremely strong outlook for resources investment and exports. Solid growth in jobs is forecast to reduce unemployment to 4½ per cent by the end of 2012-13.

Returning the budget to surplus will reduce the public sector's call on resources and create space for the private sector to grow, particularly in response to strong demand for Australia's commodity exports. The planned fiscal consolidation is particularly important to avoid compounding the capacity pressures expected to emerge as the result of the extremely high level of investment in the resources sector.

Australia's economic outlook remains favourable with above trend economic growth forecast over the next two years. But risks to the international outlook, if realised, would have serious negative implications for Australia. The fiscal consolidation will help ensure that the Government is well placed to respond to any eventuality.

The Government is delivering the return to surplus through its ongoing commitment to the fiscal strategy and the implementation of the most rapid fiscal consolidation in the 44 years for which data are available.

Tax receipts

The commitment to allow the natural increase in tax receipts associated with a strengthening economy to flow through to the budget is a significant part of the fiscal consolidation.

Tax receipts are expected to recover from the short term weakness that characterises 2010-11 and 2011-12, to remain broadly in line with the MYEFO projections from 2012-13 in nominal terms and as a share of the economy.

As a result, tax as a share of the economy is projected to grow from 20.3 per cent of GDP in 2010-11 to 22.7 per cent in 2012-13. This represents an increase in tax receipts of over 2 per cent of GDP which is an important part of returning the budget to surplus. Still, the projected tax-to-GDP ratio in 2012-13 remains significantly below the level specified in the Government's fiscal strategy.

The 2 per cent cap on spending

The Government has continued to meet its commitment to keep real growth in spending to 2 per cent or less in the years when the economy is expected to grow above trend. The Government has kept real growth below 2 per cent for the five years from 2010-11 to 2014-15.

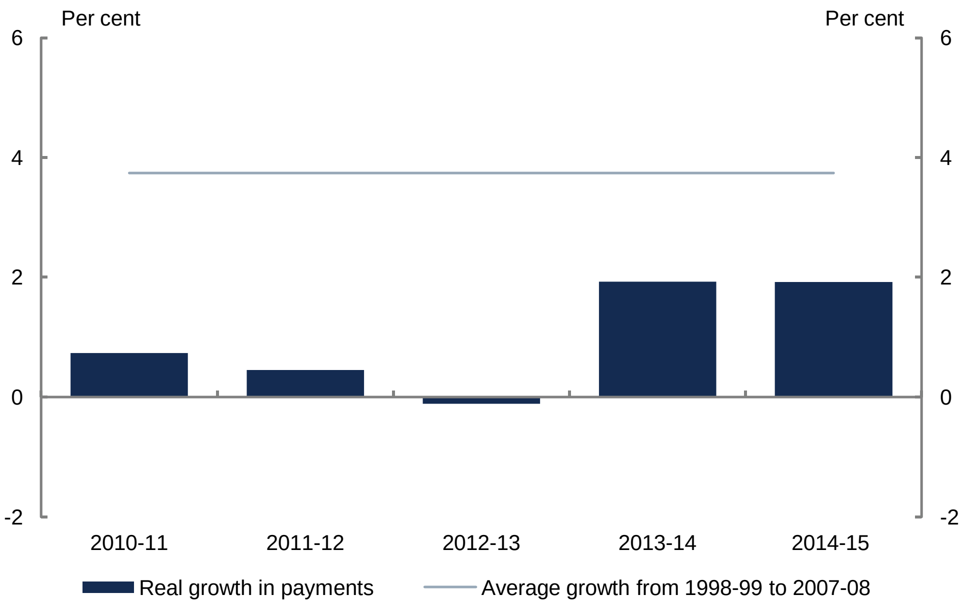
Table 2: Delivering on the 2 per cent commitment

	2010-11	2011-12	2012-13	2013-14	2014-15
Real payment growth	0.7	0.5	-0.1	1.9	1.9

The commitment to hold real growth in spending to 2 per cent has placed — and will continue to place — a significant constraint on Government spending.

- Real spending growth was above 2 per cent in 8 out of the 10 years preceding the financial crisis, with average real spending growth around 3.7 per cent.
- Real growth in spending averages around 1 per cent per year over the forward estimates, the lowest average growth rate in a five year period since the 1980s.
- Government spending, as a share of the economy, is projected to fall to 23.5 per cent of GDP by 2014-15. This is significantly below the average of the ten years preceding the financial crisis (24.0 per cent).

Chart 2: Real Growth in payments



This restraint in spending growth in the years immediately following the global financial crisis is the result, in part, of the withdrawal of the temporary fiscal stimulus. In addition, the Government has constrained spending growth by delivering its fiscal strategy.

In this Budget, the Government has built on the 2010-11 Budget by continuing to offset the cost of its new policies by making over $22 billion in savings decisions.

Fiscal discipline — savings

As part of the savings task, the Government has identified significant reductions in expenditure to help fund new priorities, with savings broadly drawn from the following areas:

- limiting growth in payments to families higher up the income scale, by maintaining the upper income thresholds for certain family payments at their current levels. This policy will improve the long-term sustainability of the family payment system;
- reforming income support payments, including Parenting Payment Single, Newstart and Youth Allowance (along with phasing out the Dependent Spouse Tax Offset), to encourage participation and enhance social and economic outcomes for individuals and the economy more broadly;
- further improving the sustainability of the health budget by capping pathology services expenditure under the Medicare Benefits Schedule;
- making the higher education loan program fairer, by reducing the upfront discount;
- requiring greater efficiency from the public sector, by temporarily increasing the efficiency dividend;
- delivering new efficiencies in defence, through ongoing reforms; and
- reducing industry assistance and spending across the budget, and better targeting the timing of programs, including infrastructure deferrals to enable re-building in flood and natural disaster affected areas.

The savings build on previously announced changes to the private health insurance arrangements, better targeting of family payments, and changes to pension eligibility, all of which are designed to improve the long-term structural position of the budget.

Box 2: Savings in the 2011-12 Budget

The 2011-12 Budget makes $22 billion worth of savings to pay for the costs of natural disasters over the recent summer and the new priorities outlined in the Budget. This fiscal discipline required difficult choices, with around two-thirds of the savings coming from reductions in expenditure.

Many of the budget savings identified deliver continuing benefits to the bottom line beyond the forward estimates, improving the sustainability of Government finances. These enduring savings build on previous saves identified by the Government in the three budgets since 2008-09, where over $80 billion of savings had been identified.

Family Payments System

This Budget continues the reform of family payments to ensure the sustainability of family payments and targeting support to those most in need. To continue limiting growth in payments to families higher up the income scale now and in the future, the Government will maintain higher income thresholds for certain family payments at their current levels.

These saves build on previous changes that are delivering enduring benefits to the budget over time such as:

- reforms in 2008-09 which better targeted Baby Bonus and Family Tax Benefit Part B payments with an income test, to ensure support was provided to families on the basis of need; and
- changes made in 2009-10 which removed the link to pension indexation for FTB-A, and maintained higher income thresholds for family payments for a three year period.

Health services

This Budget introduces reforms to pathology service items funded through the Medicare Benefits Schedule (MBS), including maximum growth rates over five years, resulting in a cap on pathology services expenditure under the MBS.

This save adds to previous changes introduced to reform the system so that it can better cope with the challenges of an ageing population and rising health care costs (the Intergenerational Reports identified these as a rapidly growing pressure in the budget), while also delivering a more responsive and better coordinated health and hospitals system.

- Reforms in the 2009-10 Budget included changes to private health insurance funding arrangements, and capping extended Medicare safety net benefits for items with excessive fees.

Box 2: Savings in the 2011-12 Budget (continued)

- Longer-term saves in the 2010-11 Budget introduced ongoing pricing reforms to the Pharmaceutical Benefits Scheme, and new arrangements for supporting community pharmacy through the Community Pharmacy Agreement with the Pharmacy Guild of Australia.

Retirement incomes

The Government has also taken additional steps in this Budget to reform aspects of our retirement incomes system. The Government has extended the freeze on the co-contribution income thresholds for another year to 2012-13. This ongoing save builds on previous reforms to the retirement income system such as:

- changes which enhanced the sustainability of the pension system by revising income test arrangements to target the pension to those who are most in need; and

- the decision, in response to the long-term cost of demographic change, and improvements in life expectancy, to increase gradually the qualifying age for the Age Pension to 67 years, at a rate of six months every two years, beginning in 2017.

Tax expenditures

The Budget also contains a number of tax measures to adjust or remove tax expenditures which improve the fairness and integrity of the tax system and provide enduring improvements to the tax system over time. These measures include:

- reform of the statutory formula for valuing FBT on car fringe benefits to remove the incentive to drive greater distances; and

- phasing out the Dependent Spouse Tax Offset for taxpayers with a dependent spouse who was born on or after 1 July 1971, strengthening the incentives for dependent spouses in couples without children to seek paid employment.

Other tax integrity measures include:

- removal of access to the Low Income Tax Offset for unearned income of minors to reduce the tax benefits available from income splitting with children; and

- improved reporting of taxable payments made to some contractors.

The overall impact of new spending and savings in the budget is a net saving of $5.2 billion over the forward estimates.

Table 3 shows the net savings achieved since the MYEFO. The net effect of policy decisions takes into account amounts that have previously been provided for in the Contingency Reserve (and as a result have no net impact on the budget position) and which principally relate to Official Development Assistance.

The savings in the budget more than cover the $4.4 billion variations in payments related to natural disasters, primarily being payments under the Natural Disaster Relief and Recovery Arrangements (NDRRA).

Table 3: Impact of policy decisions and natural disasters[(a)]

	Estimates			Projections		
	2010-11	2011-12	2012-13	2013-14	2014-15	Total
	$m	$m	$m	$m	$m	$m
Effect of policy decisions since MYEFO						
Spends	-2,368	-6,292	-3,050	-3,998	-3,248	-18,956
Saves	460	3,733	5,000	5,343	7,145	21,681
Total effect of policy decisions since MYEFO	**-1,908**	**-2,559**	**1,950**	**1,345**	**3,897**	**2,725**
Add Savings from not proceeding with the Cleaner Car Rebate(b)(c)	0	157	119	85	69	430
Add Contingency reserve offsets to policy decisions	66	142	288	601	937	2,033
Net budget impact of policy decisions	**-1,841**	**-2,260**	**2,357**	**2,031**	**4,903**	**5,189**
Add spending variations related to natural disasters	-2,550	-504	-147	-233	-988	-4,421
Net budget impact of policy decisions and natural disaster variations	**-4,391**	**-2,764**	**2,210**	**1,798**	**3,915**	**768**

(a) On an underlying cash balance basis.
(b) The Cleaner Car Rebate Save is an estimates variation, but is included in this table because it is a decision not to proceed with an election commitment.
(c) On 27 January 2011, the Government also announced reductions in spending of $244 million, which are reflected in estimates variations which improve the budget position.

FISCAL OUTLOOK

An underlying cash deficit of $22.6 billion is expected in 2011-12, compared with an estimated deficit of $12.3 billion at MYEFO. In accrual terms, a fiscal deficit of $20.3 billion is expected for 2011-12.

Table 4: Australian Government general government sector budget aggregates

	Actual	Estimates			Projections	
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Receipts($b)(a)	**284.7**	**303.7**	**342.4**	**378.5**	**395.9**	**415.5**
Per cent of GDP	22.2	21.9	23.2	24.3	24.1	24.0
Payments($b)(b)	**336.9**	**349.7**	**362.1**	**372.1**	**389.2**	**406.5**
Per cent of GDP	26.2	25.2	24.5	23.9	23.7	23.5
Future Fund earnings	2.5	3.4	2.9	2.9	3.0	3.2
Underlying cash balance($b)(c)	**-54.8**	**-49.4**	**-22.6**	**3.5**	**3.7**	**5.8**
Per cent of GDP	-4.3	-3.6	-1.5	0.2	0.2	0.3
Revenue($b)(a)	**292.8**	**310.8**	**350.0**	**383.1**	**405.2**	**425.8**
Per cent of GDP	22.8	22.4	23.7	24.6	24.7	24.6
Expenses($b)	**339.2**	**350.8**	**365.8**	**380.5**	**399.0**	**414.1**
Per cent of GDP	26.4	25.3	24.8	24.4	24.3	23.9
Net operating balance($b)	-46.5	-40.0	-15.9	2.6	6.2	11.7
Net capital investment($b)	6.4	5.7	4.4	-1.4	3.0	3.2
Fiscal balance($b)	**-52.9**	**-45.7**	**-20.3**	**4.0**	**3.2**	**8.5**
Per cent of GDP	-4.1	-3.3	-1.4	0.3	0.2	0.5
Memorandum item:						
Headline cash balance($b)	-56.5	-54.1	-31.9	0.8	0.3	3.8

(a) Includes expected Future Fund earnings.
(b) Equivalent to cash payments for operating activities, purchases of non-financial assets and net acquisition of assets under finance leases.
(c) Excludes expected Future Fund earnings.

Underlying cash balance estimates

The increase in the estimated 2011-12 underlying cash deficit since MYEFO is largely the result of changes in economic conditions reducing tax receipts and increasing a range of cash payments.

Policy decisions since MYEFO have reduced the underlying cash balance for 2011-12 by $2.6 billion. Over the forward estimates to 2014-15, Government decisions are expected to improve the underlying cash balance by $2.7 billion, consistent with the Government's fiscal strategy of returning the budget to surplus (see Table 3), before accounting for offsets to new spending previously provisioned in the Contingency Reserve.

Table 5 provides a reconciliation of the variations in the underlying cash balance since the 2010-11 Budget.

Table 5: Reconciliation of 2010-11 Budget, 2010 PEFO, 2010-11 MYEFO and 2011-12 Budget underlying cash balance estimates

	Estimates			Projections
	2010-11	2011-12	2012-13	2013-14
	$m	$m	$m	$m
2010-11 Budget underlying cash balance(a)	**-40,756**	**-13,045**	**1,016**	**5,432**
Per cent of GDP	-2.9	-0.9	0.1	0.3
Changes from 2010-11 Budget to 2010 PEFO				
Effect of policy decisions(b)	-108	135	-309	-5,381
Effect of parameter and other variations	176	2,526	2,796	4,495
Total variations	**68**	**2,661**	**2,487**	**-886**
2010 PEFO underlying cash balance(a)	**-40,689**	**-10,384**	**3,503**	**4,546**
Per cent of GDP	-2.9	-0.7	0.2	0.3
Changes from 2010 PEFO to 2010-11 MYEFO				
Effect of policy decisions(b)	-62	-540	581	-122
Effect of parameter and other variations	-718	-1,363	-964	-1,167
Total variations	**-779**	**-1,903**	**-383**	**-1,289**
2010-11 MYEFO underlying cash balance(a)	**-41,468**	**-12,288**	**3,120**	**3,257**
Per cent of GDP	-3.0	-0.8	0.2	0.2
Changes from 2010-11 MYEFO to 2011-12 Budget				
Effect of policy decisions(b)(c)				
Receipts	*82*	*-406*	*2,001*	*1,906*
Payments	*1,989*	*2,153*	*51*	*561*
Total policy decisions impact on underlying cash balance	-1,908	-2,559	1,950	1,345
Effect of parameter and other variations(c)				
Receipts(d)	*-9,957*	*-5,560*	*-312*	*1,660*
Payments	*-3,964*	*2,212*	*1,260*	*2,590*
Total parameter and other variations impact on underlying cash balance	-5,993	-7,772	-1,572	-930
2011-12 Budget underlying cash balance(a)	**-49,369**	**-22,618**	**3,498**	**3,672**
Per cent of GDP	-3.6	-1.5	0.2	0.2

(a) Excludes expected Future Fund earnings.
(b) Excludes secondary impacts on public debt interest of policy decisions and offsets from the contingency reserve for decisions taken.
(c) A positive number for receipts indicates an increase in the underlying cash balance, while a positive number for payments indicates a decrease in the underlying cash balance.
(d) Receipts will differ from the cash receipts reconciliation published in Budget Statement 5 because they exclude Future Fund earnings.

Receipt estimates

Receipts have been revised down by $9.9 billion in 2010-11 and $6.0 billion in 2011-12 since MYEFO largely reflecting the revision to economic parameters and the legacy of the global financial crisis.

New policy decisions have increased receipts by $82 million in 2010-11 and reduced receipts by $406 million in 2011-12. Parameter and other variations, including the economic impacts of natural disasters, have reduced receipts by $10.0 billion in 2010-11 and $5.6 billion 2011-12 since MYEFO.

Major policy decisions that have increased receipts over the forward estimates period from 2010-11 to 2014-15 include:

- the introduction of a temporary flood and cyclone reconstruction levy from 1 July 2011. This measure is expected to raise $1.7 billion over the forward estimates;
- the current 'statutory formula' for valuing car fringe benefits will be reformed by replacing progressive rates with a single 20 per cent statutory rate. This will be phased in over four years and apply to new contracts entered into after 7:30pm (AEST) on 10 May 2011. This measure is expected to increase the underlying cash balance by $970 million over the forward estimates period;
- phasing out the dependent spouse tax offset (DSTO) for taxpayers with a dependent spouse born on or after 1 July 1971. This measure has an ongoing gain to receipts which is estimated to be $755 million over the forward estimates period;
- removing the ability of minors (children under 18 years of age) to access the low income tax offset (LITO) to reduce tax payable on their unearned income with effect from 1 July 2011. This measure has an ongoing gain to receipts estimated to be $740 million over the forward estimates; and
- the removal of the Entrepreneurs' Tax Offset (ETO), with effect from the 2012-13 income year. This measure has an ongoing gain to receipts estimated to be $365 million over the forward estimates.

The impact of these policy decisions on receipts has been partially offset by a number of decisions that have reduced receipts, including:

- allowing low and middle income earners to receive 70 per cent of the benefits of the LITO through a reduction in tax payable on their regular pay, rather than only half as provided under existing arrangements. The remaining 30 per cent of the LITO benefit will be paid as a lump sum on assessment of income tax returns. This is estimated to reduce receipts by $1.3 billion over the forward estimates;
- the delay in the introduction, until 1 December 2011, and other arrangements for excise and excise-equivalent customs duty on alternative fuels. This is expected to reduce receipts over the forward estimates period by $641 million which is almost entirely offset by a reduction in related payments;
- allowing small businesses to claim up to $5,000 as an immediate deduction for motor vehicles, with effect for vehicles acquired from the 2012-13 income year. The remainder of the motor vehicle value will be pooled in the general small business pool. This measure is estimated to have a cost to receipts of $350 million over the forward estimates period;

- increasing the Medicare Levy low income tax thresholds to $18,839 for individuals and $31,789 for families, with effect from 1 July 2010. This has an ongoing cost to receipts estimated to be $125 million over the forward estimates; and

- an income tax exemption for certain Category C clean up and recovery grants paid to small businesses and primary producers under the Natural Disaster Relief and Recovery Arrangements. This measure is expected to cost an estimated $98 million over the forward estimates.

Payment estimates

Since MYEFO, estimated total cash payments for 2011-12 have increased by $4.4 billion, reflecting new policy decisions of $2.2 billion and parameter and other variations of $2.2 billion.

Major policy decisions since MYEFO that have increased cash payments in 2011-12 include:

- the extension of Australia's military operations in Afghanistan and the Middle East Area of Operations, East Timor and the Solomon Islands until June 2012 at a cost of $1.1 billion in 2011-12 ($1.5 billion over the five years to 2014-15);

- the Health and Hospitals Fund (HHF) Regional Priority Round, which allocates $110 million in 2011-12 ($969 million over four years) to improving regional health services, including through new hospital beds, operating theatres and patient accommodation. This is part of a total $1.8 billion investment over 6 years in new health infrastructure, which includes funding for the Royal Hobart and Port Macquarie Base Hospitals announced at MYEFO and $475 million to fund a further Regional Priority Round from the HHF; and

- enhancing mental health services by providing a more coordinated approach to mental health care and increasing access to services. The mental health initiatives are expected to increase payments by $1.5 billion over five years to 2015-16.

These increases in cash payments have been partially offset in 2011-12 by decisions that have reduced payments, including:

- achieving increased operational efficiencies in the Department of Defence that are expected to reduce payments by $227 million in 2011-12 ($1.2 billion over four years);

- deferring payments to the Victorian and NSW governments for infrastructure projects including for the Victorian Regional Rail Link, the upgrade of the Princes Highway between Traralgon and Sale and the Northern Sydney Freight Corridor, which is expected to reduce payments by $369 million in 2011-12 ($620 million over five years to 2014-15). These deferrals were previously announced as part of the Government's response to the recent natural disasters;

- increasing the rate of the efficiency dividend (to 1.5 per cent in 2011-12 and 2012-13 and 1.25 per cent in 2013-14 and 2014-15), reducing payments by $126 million in 2011-12 ($1.1 billion over four years to 2014-15);
- reducing and deferring funding for the Carbon Capture and Storage Flagships program, of $127 million in 2011-12 ($671 million over five years to 2014-15);
- reducing the discounts applying to payments under the Higher Education Contribution Scheme, saving $62 million in 2011-12 ($479 million over four years); and
- reallocating funding from the Priority Regional Infrastructure Program to support flood recovery efforts in regional Australia, reducing payments by $50 million in 2011-12 ($350 million over four years).

The Government has also decided to provide significant support to individuals, businesses and governments affected by recent natural disasters, increasing payments by $1.3 billion in 2010-11 ($1.4 billion over five years to 2014-15).

Further details of Government policy decisions are provided in Budget Paper No. 2, *Budget Measures 2011-12*. The expense estimates provided in Budget Paper No. 2 are in accrual terms and may not align exactly with the underlying cash payments figures provided in this Statement.

Major increases in expected payments in 2011-12 as a result of parameter and other variations since MYEFO include:

- offshore asylum seeker management costs largely reflecting the higher than previously expected number of irregular maritime arrivals ($585 million in 2011-12 and $825 million from 2011-12 to 2013-14);
- the re-profiling of spending under the Restoring the Balance in the Basin, National Water Security Plan for Cities and Towns, and National Urban Water and Desalination Plan as well as other Water for the Future programs (resulting in an increase in payments of $463 million in 2011-12, but an overall reduction in payments of $317 million over four years to 2013-14 including a reduction in payments of $1.2 billion in 2010-11). This re-profiling reflects lengthy negotiations to finalise funding agreements, project delays due to recent weather events, and the impact of state restrictions on trade on the settlement of water entitlement purchases;
- natural disaster relief payments to the States under the Natural Disaster Relief and Recovery Arrangements reflecting the natural disasters in 2010-11 as well as in earlier years ($887 million in 2011-12). Refer to Box 1 for further details of the recent natural disasters;

- residential aged care subsidies, owing to an increase in the estimated average subsidy for aged care residents based on recent trends in demand for residential care places ($331 million in 2011-12 and $1.1 billion over four years);

- Medicare Services payments mainly stemming from the extension of the Chronic Disease Dental Scheme (CDDS) to 31 December 2011 as a result of the Senate disallowing the determination to close the program. The closure of the CDDS remains the Government's policy. Over the forward years, Medicare Services payments are lower than forecast at MYEFO, mainly because of larger than previously expected savings from the capping of rebates for obstetrics and assisted reproductive technology services announced in the 2009-10 Budget. The expected overall change is an increase in payments of $265 million in 2011-12 but a reduction in payments of $142 million over four years to 2013-14;

- road transport payments to the States and Territories, owing to a bring forward of payments to the NSW Government to reflect the Hunter Expressway and Kempsey Bypass projects progressing faster than originally anticipated ($233 million in 2011-12 but neutral over the forward estimates). Offsetting these bring forwards, some Queensland construction that was to have been undertaken in 2010-11 has been delayed because of the floods and is now expected to be undertaken from 2011-12;

- Disability Support Pension payments, reflecting an increase in expected average payments along with higher indexation forecasts consistent with increases in forecast wage and price inflation ($214 million in 2011-12 and $1.1 billion over four years to 2013-14); and

- income support for seniors, reflecting higher than previously forecast payment indexation, consistent with updated wage and price inflation forecasts over the forward estimates ($266 million in 2011-12 and $1.3 billion over four years to 2013-14).

Major reductions in expected payments in 2011-12 as a result of parameter and other variations since MYEFO include:

- GST payments to the States and Territories consistent with a reduction in GST receipts ($1.7 billion in 2011-12 and $5.9 billion over four years to 2013-14);

- improving Australia's energy efficiency program payments reflecting lower than anticipated demand in the Renewable Energy Bonus Scheme — Solar Hot Water Rebate program, the Solar Homes and Communities Plan and the Home Insulation Safety Plan ($254 million in 2011-12 and $524 million over four years to 2013-14);

- Cleaner Fuels Scheme payments, because of a reduction in the forecast quantity of Liquid Petroleum Gas (LPG) being imported or manufactured since MYEFO ($215 million in 2011-12 and $455 million over four years to 2013-14). The

Government has announced it will amend the Scheme by replacing the payments of grants with revised taxation arrangements from 1 December 2011. This decision reduces both payments and receipts, so that its impact on the underlying cash balance is broadly neutral; and

- Superannuation Co-contribution Scheme payments, partly because of the expectation that a lower than previously anticipated number of eligible taxpayers will choose to make personal contributions to trigger the Government's co-contribution ($143 million in 2011-12 and $588 million over four years to 2013-14).

As a consequence of the weaker fiscal outlook in the near term, and higher interest rates, net interest payments have increased by $588 million in 2011-12 and $3.1 billion over four years to 2013-14.

Consistent with previous budgets, the underlying cash balance has been improved by the regular draw down of the conservative bias allowance. Details of this draw down are provided in Appendix B of Statement 6.

In 2010-11, a number of parameter and other variations have reduced expected payments, including GST payments to the States and Territories, the reprofiling of water programs and estimates adjustments for Defence. These adjustments were partly offset by higher natural disaster relief payments, increased residential aged care subsidies and costs associated with accommodating and processing irregular maritime arrivals.

Fiscal balance estimates

The fiscal deficit is estimated to be $20.3 billion in 2011-12, an increase of $9.3 billion since MYEFO.

Table 6 provides a reconciliation of the variations in the fiscal balance since the 2010-11 Budget.

Table 6: Reconciliation of 2010-11 Budget, 2010 PEFO, 2010-11 MYEFO and 2011-12 Budget fiscal balance estimates

	Estimates			Projections
	2010-11	2011-12	2012-13	2013-14
	$m	$m	$m	$m
2010-11 Budget fiscal balance	**-39,598**	**-12,093**	**1,960**	**6,325**
Per cent of GDP	-2.8	-0.8	0.1	0.4
Changes from 2010-11 Budget to 2010 PEFO				
Effect of policy decisions(b)	-106	663	-246	-5,329
Effect of parameter and other variations	282	2,692	3,387	5,092
Total variations	**176**	**3,355**	**3,141**	**-237**
2010 PEFO fiscal balance	**-39,422**	**-8,738**	**5,101**	**6,088**
Per cent of GDP	-2.8	-0.6	0.3	0.4
Changes from 2010 PEFO to 2010-11 MYEFO				
Effect of policy decisions(b)	-63	-511	584	-118
Effect of parameter and other variations	-2,434	-1,695	-1,473	-1,656
Total variations	**-2,497**	**-2,206**	**-889**	**-1,774**
2010-2011 MYEFO fiscal balance	**-41,920**	**-10,943**	**4,211**	**4,314**
Per cent of GDP	-3.0	-0.7	0.3	0.3
Changes from 2010-11 MYEFO to 2011-12 Budget				
Effect of policy decisions(a)(b)				
Revenue	102	-367	2,043	1,943
Expenses	1,971	1,722	-119	798
Net capital investment	33	379	54	-358
Total policy decisions impact on fiscal balance	-1,901	-2,467	2,107	1,504
Effect of parameter and other variations(a)				
Revenue	-9,006	-5,049	758	2,746
Expenses	-5,516	2,094	3,853	5,665
Net capital investment	-1,574	-291	-742	-267
Total parameter and other variations impact on fiscal balance	-1,916	-6,852	-2,352	-2,652
2011-12 Budget fiscal balance	**-45,737**	**-20,262**	**3,966**	**3,166**
Per cent of GDP	-3.3	-1.4	0.3	0.2

(a) A positive number for revenue indicates an increase in the fiscal balance, while a positive number for expenses and net capital investment indicates a decrease in the fiscal balance.
(b) Excludes secondary impacts on public debt interest of policy decisions and offsets from the contingency reserve for decisions taken.

Revenue estimates

Changes in revenue are generally driven by the same factors as receipts, though differences arise where revenue raised in a given year is not received in that year (see Budget Statement 5, *Appendix E: Taxation Revenue Recognition*, for further information on the difference between accrual and cash estimates).

Expense estimates

Movements in accrual expenses over the forward estimates are broadly similar to the movements in cash payments. The key exceptions include:

- changes in net capital investment, largely relating to capital reprogramming by Defence and also in relation to a range of water initiatives, which are reported as cash payments;
- superannuation benefits and the Superannuation Co-contribution Scheme, where there are differences between timing of cash payments and accruing expenses; and
- the Natural Disaster Relief and Recovery Arrangements, where expenses are being recognised at a different time to the cash payments advanced to Queensland and Victoria.

More detailed information on expenses can be found in Statement 6.

Net capital investment estimates

Forecast net capital investment for 2011-12 is largely unchanged since the MYEFO.

In 2010-11 net capital investment is forecast to be $1.5 billion lower than forecast in the MYEFO, largely reflecting the reprogramming of Defence investments and a range of water initiatives.

The higher exchange rate since MYEFO has also resulted in the forecasts of net capital investment being reduced across the forward estimates.

More detailed information on net capital investment can be found in Statement 6.

Net financial worth, net worth and net debt

The downward revisions to estimated tax receipts in this year and next, and higher than expected payments owing, in part, to the recent natural disasters, have contributed to higher estimated net debt, and lower net worth and net financial worth than was forecast in the MYEFO.

Net debt is forecast to peak in 2011-12 at $106.6 billion (or 7.2 per cent of GDP), an increase of $12.2 billion from the MYEFO. Net debt is expected to reduce to 5.8 per cent of GDP in 2014-15.

The change to the projected peak in net debt is driven primarily by an increase in the amount of Commonwealth Government Securities on issue largely reflecting the weaker fiscal outlook in 2010-11 and 2011-12, though this is partially offset by an increase in the Government's investment in Residential Mortgage-Backed Securities, an increase in Australia's quota with the International Monetary Fund, and an increase in the Future Fund's asset values in 2010-11.

The Australian Government's net debt remains extremely low by international standards. The average net debt level in the major advanced economies, measured for all levels of government, is projected to be around 80 per cent of GDP in 2011. Net debt in the major advanced economies is expected to reach an average of around 90 per cent of GDP in 2016, over 12 times higher than the expected peak in the Australian Government's net debt.

The changes to net debt described above also impact on net financial worth and net worth.

- Net financial worth is estimated to be -$200.6 billion in 2011-12, $17.2 billion lower than the MYEFO estimate.
- Net worth is estimated to be -$87.5 billion in 2011-12, $15.6 billion lower than the MYEFO estimate.

In addition to the drivers for change to the net debt position, the change in net financial worth and net worth also reflect the revaluation of the Government's superannuation liability.

Further details on the balance sheet are outlined in Statement 7, Asset and Liability Management.

Table 7 provides a summary of Australian Government general government sector net financial worth, net worth, net debt and net interest payments.

Table 7: Australian Government general government sector net financial worth, net worth, net debt and net interest payments

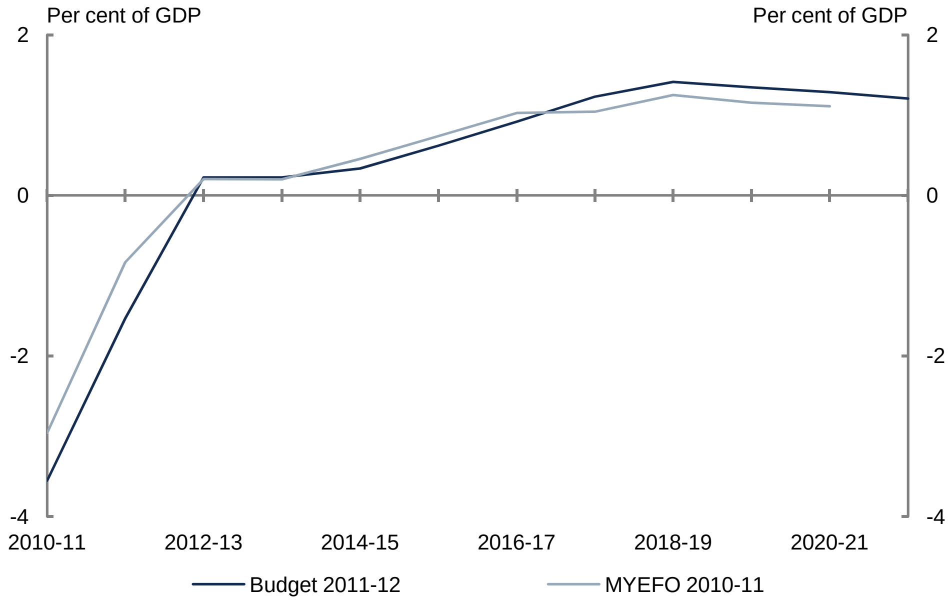
	Estimates			Projections	
	2010-11	2011-12	2012-13	2013-14	2014-15
	$b	$b	$b	$b	$b
Financial assets	214.6	232.1	241.0	252.2	263.9
Non-financial assets	108.4	113.1	115.1	115.4	117.4
Total assets	**323.0**	**345.2**	**356.1**	**367.6**	**381.3**
Total liabilities	**391.3**	**432.7**	**439.5**	**447.6**	**452.3**
Net worth	**-68.3**	**-87.5**	**-83.4**	**-80.0**	**-71.0**
Net financial worth(a)	**-176.6**	**-200.6**	**-198.5**	**-195.4**	**-188.5**
Per cent of GDP	-12.7	-13.6	-12.7	-11.9	-10.9
Net debt(b)	**82.4**	**106.6**	**104.6**	**105.3**	**100.9**
Per cent of GDP	5.9	7.2	6.7	6.4	5.8
Net interest payments	**4.6**	**5.5**	**6.7**	**6.8**	**7.5**
Per cent of GDP	0.3	0.4	0.4	0.4	0.4

(a) Net financial worth equals total financial assets minus total liabilities. That is, it excludes non-financial assets.
(b) Net debt equals the sum of deposits held, advances received, government securities, loans and other borrowing, minus the sum of cash and deposits, advances paid and investments, loans and placements.

Medium term fiscal outlook

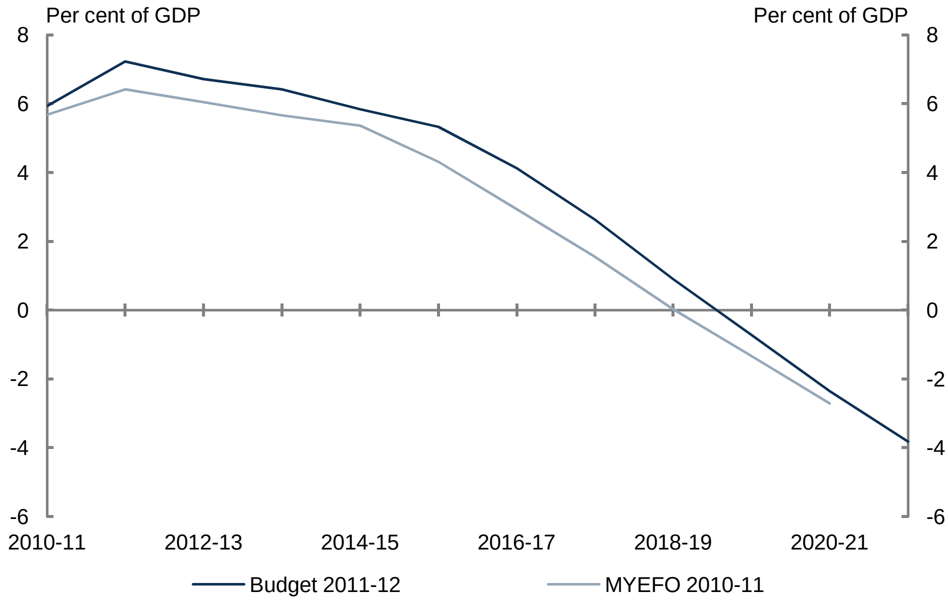
On current projections, it is expected that the budget surplus will reach 1 per cent of GDP in 2017-18. Net debt is projected to peak in 2011-12 at 7.2 per cent of GDP and fall to zero by 2019-20.

Chart 3: Underlying cash balance projected to 2021-22



Source: Treasury projections.

Chart 4: Government net debt projected to 2021-22



Source: Treasury projections.

Appendix A: Sensitivity of Budget Estimates to Economic Developments

The estimates contained in the 2011-12 Budget are based on forecasts of the economic outlook. Changes to the economic assumptions underlying the estimates will impact on receipts and payments, and hence the size of the underlying cash balance.

This section examines the effects on receipts and payments of altering some of the key economic assumptions. Tables A2 and A4 illustrate the sensitivity of key components of receipts and payments to possible variations in the economic outlook. The two scenarios considered are:

- Scenario 1: a 1 per cent reduction in nominal GDP owing to a fall in the terms of trade.
- Scenario 2: a 1 per cent increase in real GDP driven by an equal increase in labour productivity and labour force participation.

The economic scenarios provide a rule of thumb indication of the impact on receipts, payments and the underlying cash balance of changes in the economic outlook. They represent a partial economic analysis only and do not attempt to capture all the economic feedback and other policy responses related to changed economic conditions. In particular, the analysis assumes no change in the exchange rate, interest rates or discretionary policy over the forecast period. The impact of the two scenarios on the economic parameters would be different if the full feedback response on economic variables and likely policy actions were taken into account. The analysis does not aim to provide an alternative picture of the economic forecasts under these scenarios, but instead gives an indication of the sensitivity associated with different components of receipts and payments to changes in the economy. As such, the changes in the economic variables and their impact on the fiscal outlook are merely illustrative.

The impacts shown in the tables below are broadly symmetrical. That is, impacts of around the same magnitude, but in the opposite direction, would apply if the terms of trade were to increase or if real GDP were to decrease.

Scenario 1

The first scenario involves a permanent fall in world prices of non-rural commodity exports consistent with a fall in the terms of trade of around 4 per cent, which causes a 1 per cent fall in nominal GDP. The sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A1 are highly stylised and refer to per cent deviations from the baseline levels of the economic parameters.

Table A1: Illustrative impact of a permanent non-rural commodity price fall consistent with a 1 per cent fall in nominal GDP by 2012-13 (per cent deviation from the baseline level)

	2011-12 per cent	2012-13 per cent
Real GDP	0	- 1/4
Non-farm GDP deflator	- 3/4	- 3/4
Employment	- 1/4	- 1/2
Wages	0	- 1/4
CPI	0	- 1/4
Company profits	-3	-3
Consumption	- 1/4	- 1/2

Assuming no change in exchange rates or interest rates, the fall in export prices leads directly to a lower non-farm GDP deflator (from the export component of GDP) and lower domestic incomes. Lower domestic incomes cause both consumption and investment to fall, resulting in lower real GDP, employment and wages. The fall in aggregate demand puts downward pressure on domestic prices.

In reality, a fall in the terms of trade would be expected to put downward pressure on the exchange rate, although the magnitude is particularly uncertain in the short term. In the event of a depreciation in the exchange rate, the impacts on the external sector would dampen the real GDP effects, and there would be some offsetting upward pressure on domestic prices.

Given these assumptions, the overall impact of the fall in the terms of trade is a decrease in the underlying cash balance of around $2.8 billion in 2011-12 and around $6.3 billion in 2012-13 (see Table A2).

Table A2: Illustrative sensitivity of the budget balance to a 1 per cent decrease in nominal GDP due to a fall in the terms of trade

	2011-12 $b	2012-13 $b
Receipts		
Individuals and other withholding taxation	-0.7	-1.7
Superannuation taxation	-0.1	-0.1
Company tax	-1.8	-3.5
Resource rent taxes	0.0	-0.7
Goods and services tax	-0.1	-0.2
Excise and customs duty	0.0	-0.1
Other taxation	0.0	0.0
Total receipts	**-2.7**	**-6.2**
Payments		
Income support	-0.1	-0.1
Other payments	0.0	0.1
Goods and services tax	0.1	0.2
Total payments	**0.0**	**0.2**
PDI	-0.1	-0.3
Underlying cash balance impact	**-2.8**	**-6.3**

On the receipts side, a fall in the terms of trade results in a fall in nominal GDP which reduces tax collections. The largest impact falls on company tax receipts as the fall in export income decreases company profits. Lower company profits are assumed to flow through to lower Australian equity prices, therefore reducing capital gains tax from individuals, companies and superannuation funds. A fall in commodity prices is also expected to reduce resource rent tax collections.

The weaker economy results in lower aggregate demand which flows through to lower employment and wages. For this reason, individuals' income tax collections fall and the decrease in disposable incomes leads to lower consumption, which in turn results in a decrease in GST receipts (decreasing GST payments to the States by the same amount) and other indirect tax collections.

On the payments side, a significant proportion of government expenditure is partially indexed to movements in costs (as reflected in various price and wage measures). Some forms of expenditure, in particular income support payments, are also driven by the number of beneficiaries.

The overall estimated expenditure on income support payments (including pensions and allowances) increases in both years due to a higher number of unemployment benefit recipients. The increase in unemployment benefits in 2012-13 is partly offset by reduced expenditure on pensions and allowances reflecting lower growth in benefit rates resulting from lower wages growth. At the same time other payments linked to inflation fall in line with the reduced growth in prices.

The reduction in the underlying cash balance results in a higher borrowing requirement and a higher public debt interest cost.

As noted above, under a floating exchange rate, the depreciation of the exchange rate would dampen the effects of the fall in the terms of trade on real GDP, meaning the impact on the fiscal position could be substantially more subdued. Also, to the extent that the fall in the terms of trade is temporary rather than permanent, the impact on the economic and fiscal position would be more subdued.

Scenario 2

The second scenario involves a combination of an equal 0.5 per cent increase in the participation rate and in labour productivity, resulting in a 1 per cent increase in real GDP by 2012-13. Once again, the sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A3 are highly stylised and refer to per cent deviations from the baseline levels of the parameters.

The 1 per cent increase in real GDP increases nominal GDP by slightly less but the magnitude of the effects on receipts, payments and the underlying cash balance differ from the first scenario because this variation in the outlook affects different parts of the economy in different ways.

Table A3: Illustrative impact of an ongoing equal increase in both labour productivity and participation consistent with a 1 per cent increase in real GDP by 2012-13 (per cent deviation from the baseline level)

	2011-12 per cent	2012-13 per cent
Nominal GDP	3/4	3/4
Non-farm GDP deflator	- 1/4	- 1/4
Employment	1/2	1/2
Wages	1/4	1/4
CPI	- 1/4	- 1/4
Company profits	1 3/4	1 3/4
Consumption	1	1

The increase in labour force participation and labour productivity both have the same impact on output, but different impacts on the labour market. Higher productivity leads to higher real GDP and higher real wages, while an increase in the participation rate increases employment and real GDP. Imports are higher in this scenario, reflecting higher domestic incomes.

Since the supply side of the economy expands, inflation falls relative to the baseline. The fall in domestic prices makes exports more attractive to foreigners, with the resulting increase in exports offsetting higher imports, leaving the trade balance unchanged. The exchange rate is assumed to be constant.

The overall impact of the increase in labour productivity and participation is an increase in the underlying cash balance of around $2.9 billion in 2011-12 and around $4.4 billion in 2012-13 (see Table A4).

Table A4: Illustrative sensitivity of the budget balance to a 1 per cent increase in real GDP due to an equal increase in both productivity and participation

	2011-12 $b	2012-13 $b
Receipts		
Individuals and other withholding taxation	1.7	1.5
Superannuation taxation	0.0	0.1
Company tax	1.0	2.2
Goods and services tax	0.4	0.5
Excise and customs duty	0.2	0.3
Other taxation	0.0	0.0
Total receipts	**3.3**	**4.7**
Payments		
Income support	-0.1	-0.1
Other payments	0.0	0.0
Goods and services tax	-0.4	-0.5
Total payments	**-0.5**	**-0.6**
PDI	0.1	0.3
Underlying cash balance impact	**2.9**	**4.4**

On the receipts side, individuals' income tax collections increase because of the rise in number of wage earners and, additionally, higher real wages. Due to the progressivity of the tax system, wage rises may lead individuals to pay more tax than is warranted in the current year which increases individuals' refunds in the following year when tax returns are lodged. This moderates the positive impact on total individuals' income tax in 2012-13. The stronger labour market also increases superannuation fund taxes through higher contributions (including compulsory contributions) to superannuation funds. The increase in personal incomes leads to higher consumption which results in an increase in GST receipts (with the corresponding receipts passed on in higher GST payments to the States). In addition, the stronger economy results in higher levels of corporate profitability, increasing company taxes.

On the payments side, overall estimated expenditure on income support payments (including pensions and allowances) is slightly higher primarily reflecting growth in benefit rates flowing from higher wages growth. Lower inflation has a partially offsetting effect.

On balance, the rise in estimated tax collections is only partially offset by increased payments. This improves the underlying cash position, which results in a lower borrowing requirement and lower public debt interest cost.

To the extent that the increases in productivity and participation are temporary rather than permanent, the impact on the economic and fiscal position would be more subdued.