# STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

The Government is returning the budget to surplus in 2012-13, with surpluses growing across the forward estimates.

This delivers on the Government's fiscal strategy, first set out in 2009, to return the budget to surplus as the economy recovers. The fiscal consolidation will strengthen the long-term position of the budget and provide a buffer against an uncertain global economic outlook.

Returning the budget to surplus in 2012-13 is appropriate given domestic economic conditions and provides ongoing scope for monetary policy to respond to economic developments, if needed. A return to surplus, ahead of any major advanced economy, sends a strong message to international investors on the Government's commitment to fiscal discipline.

The economy is forecast to grow around trend, with low unemployment, contained inflation, record levels of mining investment and very low levels of government debt.

Government revenues continue to be affected by structural changes in the economy and the lingering effects of the global financial crisis. This has led to weaker-than-expected tax receipts compared to those anticipated at the *Mid-Year Economic and Fiscal Outlook 2011-12* (MYEFO). Write-downs in total tax receipts since the global financial crisis are now around $150 billion over the five years to 2012-13.

In response, the Government has made $33.6 billion in targeted savings to: return the budget to surplus; spread the benefits of the resources boom to help low and middle-income families and help businesses struggling with the economy in transition; and improve the long-term position of the budget.

Following a revised underlying cash deficit of $44.4 billion (3.0 per cent of GDP) in 2011-12, a surplus of $1.5 billion (0.1 per cent of GDP) is expected in 2012-13, growing to $7.5 billion (0.4 per cent of GDP) in 2015-16.

The Government's ongoing commitment to fiscal discipline will ensure Australia's balance sheet remains one of the strongest in the developed world. Net debt is expected to peak at 9.6 per cent of GDP in 2011-12, reducing to 7.3 per cent of GDP by 2015-16.

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# STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

## OVERVIEW OF FISCAL POSITION

The Government is returning the budget to surplus in 2012-13, with surpluses growing across the forward estimates. This delivers on the Government's fiscal strategy, first set out in the *Updated Economic and Fiscal Outlook* in 2009, to return the budget to surplus as the economy recovers.

The return to surplus in 2012-13 reflects a fiscal consolidation of 4.3 per cent of GDP since 2009-10. This is appropriate in the context of an economy where the fundamentals remain strong and the outlook remains positive.

The challenge in returning to surplus has increased since MYEFO with the recovery in tax receipts weaker than anticipated. Tax receipts (excluding GST) in 2012-13 have been revised down by $4.6 billion since MYEFO. The return to surplus in 2012-13 is being achieved by the Government making net savings of $3.0 billion and lower payments than expected at MYEFO.

The fiscal consolidation across the forward estimates is being supported by the post-global financial crisis recovery in tax receipts. Notwithstanding this rebound, tax receipts as a share of GDP are expected to reach around 1 percentage point below the unsustainable levels reached in the mid-2000s. This means that tax as a proportion of GDP in 2011-12 and the previous two years is the lowest it has been since 1993-94.

In response, the Government has made $33.6 billion in savings in this Budget to make room for priority spending and to improve fiscal sustainability. The net budget impact of policy decisions is a $17.0 billion improvement to the underlying cash balance over the forward estimates.

The Government is funding initiatives to spread the benefits of the resources boom to families and businesses struggling with the economy in transition, and to assist families with the costs of educating their children. The Government also has been able to support key social reforms such as the first stage of a National Disability Insurance Scheme and reforms to aged care.

### Table 1: Budget aggregates

| | Actual | Estimates | | | Projections | |
|---|---|---|---|---|---|---|
| | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 |
| **Underlying cash balance ($b)(a)** | **-47.7** | **-44.4** | **1.5** | **2.0** | **5.3** | **7.5** |
| Per cent of GDP | -3.4 | -3.0 | 0.1 | 0.1 | 0.3 | 0.4 |
| **Fiscal balance ($b)** | **-51.5** | **-42.0** | **2.5** | **2.6** | **7.0** | **9.5** |
| Per cent of GDP | -3.7 | -2.8 | 0.2 | 0.2 | 0.4 | 0.5 |

(a) Excludes expected Future Fund earnings.

In 2012-13 and each subsequent year across the forward estimates, payments as a percentage of GDP, are expected to be at their lowest level since the onset of the global financial crisis. This Budget is also delivering payments below 24 per cent of GDP across the forward estimates from 2012-13, the longest period since the early 1980s.

Following a revised underlying cash deficit of $44.4 billion (3.0 per cent of GDP) in 2011-12, a surplus of $1.5 billion (0.1 per cent of GDP) is expected in 2012-13, growing to $7.5 billion (0.4 per cent of GDP) in 2015-16.

Net debt is expected to peak at 9.6 per cent of GDP in 2011-12, reducing to 7.3 per cent of GDP by 2015-16. Although the peak is higher than previously expected, the Australian Government's net debt position remains low by international standards. The Government's commitment to fiscal discipline will ensure Australia's balance sheet remains one of the strongest in the developed world.

## The Government's fiscal strategy

The Government's fiscal strategy is designed to ensure fiscal sustainability while providing the necessary flexibility for the budget to vary in line with economic conditions to support macroeconomic stability.

The medium-term fiscal strategy has remained unchanged since 2008-09, the Government's first budget.

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 (23.7 per cent of GDP), on average; and
- improve the Government's net financial worth over the medium term.

Following its response to the global financial crisis, the Government committed to ensuring a timely return to surplus as the economy recovered to grow above trend by:

- allowing 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
- holding real growth in spending to 2 per cent a year until the budget returns to surplus.

With the budget returning to surplus, the Government remains committed to allowing tax receipts to recover naturally as the economy improves, and to maintaining a 2 per cent annual cap on real spending growth, on average, until surpluses are at least 1 per cent of GDP and while the economy is growing at or above trend.

## A strong rationale for returning to surplus in 2012-13

The Government's medium-term fiscal strategy guided the Government's successful response to the global financial crisis and provides the basis for the Government's determination to return the budget to surplus.

Consistent with this strategy, the Government delivered its fiscal stimulus at the height of the global financial crisis and, at the time, committed to return to surplus as the economy recovered.

At MYEFO it was recognised that there were some challenges to the domestic economic outlook arising from a deterioration in global economic conditions, but that it was important for the Government to remain committed to returning the budget to surplus.

Returning the budget to surplus in 2012-13 remains appropriate given domestic economic conditions. The economy is forecast to grow around trend over the next two years, the unemployment rate is expected to remain low and commodity prices are still close to historical highs.

Importantly, the forecasts for Australia's overall economic growth remain around trend in 2012-13 even after this consolidation.

A significant portion of the consolidation is occurring through taxation receipts rebuilding, albeit from the very low levels of the global financial crisis. This is to be expected as the economy recovers, and is consistent with the experience in previous cycles. For instance, while tax receipts are growing, total tax receipts are weaker than expected at MYEFO. However, this rebound in receipts notwithstanding, receipts as a share of GDP remain at relatively low levels.

Fiscal consolidation is also being driven by carefully considered saving decisions, adding to the savings made at MYEFO and earlier budgets.

Returning to surplus provides ongoing scope for monetary policy to respond to economic developments. It allows monetary policy to play the primary role in managing demand to keep the economy growing at close to capacity consistent with achieving the medium-term inflation target.

A strong fiscal position sustains confidence in the strength of Australia's public finances. The European sovereign debt crisis has underscored the importance of maintaining strong fiscal discipline and credibility. That is now more important than ever, with financial markets punishing those economies without it. Growing surpluses provide a fiscal buffer in uncertain global economic times.

Together with Australia's very low level of public debt, the Government's strategy to return the budget to surplus reinforces fiscal credibility and demonstrates the strength and sustainability of Australia's public finances. This is a key support for the AAA credit rating which it has received from all three major ratings agencies for the first time in Australia's history.

## Weaker tax receipts have made returning to surplus harder

The global financial crisis affected all aspects of the economy — production, consumption, profits and employment. As a result, all revenue heads were hit, and the tax-to-GDP ratio fell 3.6 percentage points from its pre-crisis level in 2007-08 to 20.1 per cent in 2010-11. This was the biggest decline in the ratio since the 1950s. Relative to the forecasts made at the 2008-09 Budget, total tax receipts have been written down by around $150 billion over the five years to 2012-13.

Combined with the write down in revenues across the forward estimates, tax receipts, as a percentage of GDP, are expected to be significantly lower than their 2007-08 level across the forward estimates.

In 2012-13, the tax-to-GDP ratio is expected to be 1.6 percentage points lower than the 2007-08 level, which equates to around $24.1 billion of tax in that year. Tax receipts are projected to reach 22.9 per cent of GDP in 2015-16, around 1 percentage point below the unsustainable levels reached in the mid-2000s. This means that tax as a proportion of GDP in 2011-12 and the previous two years is the lowest it has been since 1993-94.

Since the post-crisis trough, receipts have begun to recover, but at a slower pace than expected at MYEFO. Tax receipts are expected to be around $18.4 billion lower over the four years to 2014-15 than projected at MYEFO. The downward revisions since MYEFO principally reflect sluggish asset prices, consumer caution, weak profitability outside the resources and resources-related sectors, and high levels of investment-related tax deductions within the mining sector.

In the mid-2000s, strong growth in asset prices combined with a maturing capital gains tax system resulted in strong capital gains tax receipts. With asset markets currently sluggish, capital gains tax receipts are expected to remain much lower than their pre-crisis levels. Also affecting capital gains tax is the larger-than-anticipated stock of losses generated during the global financial crisis, which will take a number of years to be fully utilised against future gains.

Consumers remain cautious which is damping GST and other indirect tax collections.

This ongoing consumer caution and the sustained high dollar continue to put pressure on the profitability of industries outside the resources and resources-related sectors, such as manufacturing, retail and tourism, affecting company tax receipts from these sectors. Tax receipts from the mining sector are being affected by the substantial pipeline of investment which means depreciation deductions will remain high.

## Achieving surpluses through targeted savings and disciplined spending

The downward revision in tax receipts since MYEFO has meant that to deliver on the Government's commitment to return to surplus and build surpluses across the forward estimates it has had to make further targeted savings.

Table 2 shows the effect of spending and savings decisions since MYEFO. The net budget impact of policy decisions takes into account amounts that previously have been provisioned for in the Contingency Reserve (and as a result have no net impact on the budget position) and which principally relate to the Nation Building 2 Program and Official Development Assistance.

### Table 2: Effect of spending and savings decisions in the 2012-13 Budget[a]

| | Estimates | | | Projections | | |
|---|---|---|---|---|---|---|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | Total |
| | $m | $m | $m | $m | $m | $m |
| **Effect of policy decisions since MYEFO** | | | | | | |
| **Spends** | **-2,917** | **-1,744** | **-4,278** | **-6,695** | **-6,801** | **-22,435** |
| **Saves** | **216** | **4,668** | **8,212** | **9,187** | **11,323** | **33,605** |
| *Payments* | *140* | *2,606* | *4,531* | *4,144* | *4,949* | *16,370* |
| *Non-tax Receipts* | *6* | *466* | *194* | *312* | *316* | *1,294* |
| *Tax Receipts* | *70* | *1,596* | *3,487* | *4,730* | *6,058* | *15,941* |
| **Total effect of policy decisions since MYEFO** | **-2,701** | **2,924** | **3,934** | **2,491** | **4,522** | **11,170** |
| *Add* Contingency Reserve offsets to policy decisions | 27 | 126 | 191 | 2,425 | 3,080 | 5,849 |
| **Net budget impact of policy decisions** | **-2,674** | **3,050** | **4,125** | **4,916** | **7,603** | **17,019** |

(a) On an underlying cash basis.

The net budget impact of policy decisions is a $17.0 billion improvement to the underlying cash balance over the forward estimates.

The Government has made $33.6 billion in savings in the budget to return to surplus and pay for new spending of $22.4 billion (of which $5.8 billion had been provisioned for in the Contingency Reserve). The savings in this Budget build on the $11.5 billion of savings in MYEFO and more than $100 billion of savings identified in the four budgets since 2008-09. Less than half of the savings in this Budget are from changes in tax receipts.

The budget contains decisions not to proceed with (or defer) some previously announced measures that otherwise would have reduced tax receipts. The decisions in this Budget not to proceed with some measures will maintain tax liabilities at present levels.

The tax reforms in this Budget build on past measures to improve the integrity and fairness of the tax system, such as the reforms to car fringe benefits and the Dependent Spouse Tax Offset announced in the 2011-12 Budget.

## Payments

A continuing focus on restraining growth in payments remains an important element of the Government's fiscal strategy. Given the range of factors that can affect payments in any one year, looking at payments over a number of years is a better indicator of spending restraint.

The discipline imposed on real spending growth has reduced payments as a proportion of GDP to 23.5 per cent in 2012-13, a fall of 1.6 percentage points from 2011-12. Payments as a share of GDP then remain broadly constant over the forward estimates. This is the longest period that payments have remained below 24 per cent of GDP since the early 1980s.

The budget also sees a fall in nominal payments in 2012-13 compared to 2011-12, the first fall in the 42 years for which data are available. The fall in payments in 2012-13 highlights the key role disciplined spending is playing in the fiscal consolidation.

Assessing payments over a number of years to judge spending restraint is reflected in the fiscal strategy that commits to maintaining a 2 per cent annual cap on real spending growth, on average, until surpluses are at least 1 per cent of GDP and while the economy is growing at or above trend.

Average real growth in payments across the forward estimates is 1.8 per cent (Table 3).

**Table 3: Real growth in payments**

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 |
|---|---|---|---|---|---|
| Real payment growth | 4.8 | -4.3 | 3.7 | 2.0 | 2.9 |
| Average real growth in payments | | | 1.8 | | |

Real growth in payments is estimated to be 4.8 per cent in 2011-12 and -4.3 per cent in 2012-13, averaging 0.3 per cent over these two years. There are a number of common factors which have contributed to the real growth rates in payments in 2011-12 and 2012-13.

MYEFO outlined a number of one-off factors affecting real growth in payments in 2011-12, including the significant assistance to households and businesses in delivering the *Clean Energy Future* package and addressing the effects of the most expensive natural disasters in Australia's history. These factors reduce real growth in payments in 2012-13. Since MYEFO, increased payments have further contributed to the increase in real growth in payments in 2011-12 and will detract from real growth in 2012-13. These increased payments include: the Schoolkids Bonus; the bring forward of payments for local government services; and earlier-than-expected payment for the Ipswich Motorway upgrade (Dinmore to Goodna), which is expected to be completed ahead of schedule.

The commitment to restrain real growth in spending to 2 per cent, on average, until surpluses are at least 1 per cent of GDP and while the economy is growing at or above trend will continue to restrain government expenditure.

The sustainability of Government finances has also been improved as many of the budget savings identified deliver continuing benefits to the bottom line beyond the forward estimates.

## FISCAL OUTLOOK

An underlying cash surplus of $1.5 billion (0.1 per cent of GDP) is expected in 2012-13, largely unchanged from the estimate at MYEFO. In accrual terms, a fiscal surplus of $2.5 billion (0.2 per cent of GDP) is expected for 2012-13.

**Table 4: Australian Government general government sector budget aggregates**

| | Actual | Estimates | | | Projections | |
|---|---|---|---|---|---|---|
| | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 |
| | $b | $b | $b | $b | $b | $b |
| **Receipts(a)** | **302.0** | **330.0** | **368.8** | **392.5** | **413.6** | **438.4** |
| Per cent of GDP | 21.6 | 22.3 | 23.8 | 24.0 | 24.0 | 24.2 |
| **Payments(b)** | **346.1** | **371.3** | **364.2** | **387.3** | **404.9** | **427.3** |
| Per cent of GDP | 24.7 | 25.1 | 23.5 | 23.7 | 23.5 | 23.6 |
| Future Fund earnings | 3.7 | 3.0 | 3.0 | 3.2 | 3.4 | 3.7 |
| **Underlying cash balance(c)** | **-47.7** | **-44.4** | **1.5** | **2.0** | **5.3** | **7.5** |
| Per cent of GDP | -3.4 | -3.0 | 0.1 | 0.1 | 0.3 | 0.4 |
| **Revenue(a)** | **309.9** | **336.4** | **376.1** | **402.2** | **424.8** | **449.6** |
| Per cent of GDP | 22.1 | 22.8 | 24.2 | 24.6 | 24.7 | 24.8 |
| **Expenses** | **356.1** | **373.7** | **376.3** | **398.5** | **416.4** | **439.0** |
| Per cent of GDP | 25.4 | 25.3 | 24.3 | 24.4 | 24.2 | 24.2 |
| Net operating balance | -46.2 | -37.3 | -0.2 | 3.7 | 8.4 | 10.5 |
| Net capital investment | 5.3 | 4.7 | -2.7 | 1.0 | 1.4 | 1.1 |
| **Fiscal balance** | **-51.5** | **-42.0** | **2.5** | **2.6** | **7.0** | **9.5** |
| Per cent of GDP | -3.7 | -2.8 | 0.2 | 0.2 | 0.4 | 0.5 |
| *Memorandum item:* | | | | | | |
| Headline cash balance | -51.1 | -48.4 | -8.7 | -6.8 | -0.1 | 2.0 |

(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 a result of changes in economic circumstances reducing tax receipts, as well as new policy decisions that have increased payments including the Schoolkids Bonus and the bring forward of payments for local government services.

A small underlying cash surplus of $1.5 billion is expected in 2012-13. The downward revision to total parameter and other variations of just under $2.9 billion since MYEFO has been offset by policy decisions of just over $2.9 billion.

Table 5 provides a reconciliation of the variations in the underlying cash balance since the 2011-12 Budget.

### Table 5: Reconciliation of underlying cash balance estimates

| | Estimates | | | Projections |
|---|---|---|---|---|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| | $m | $m | $m | $m |
| **2011-12 Budget underlying cash balance(a)** | **-22,618** | **3,498** | **3,672** | **5,795** |
| Per cent of GDP | -1.5 | 0.2 | 0.2 | 0.3 |
| **Changes from 2011-12 Budget to 2011-12 MYEFO** | | | | |
| Effect of policy decisions(b) | -4,860 | 2,857 | 3,701 | 4,676 |
| Effect of parameter and other variations | -9,634 | -4,876 | -5,509 | -7,363 |
| **Total variations** | **-14,495** | **-2,019** | **-1,808** | **-2,687** |
| **2011-12 MYEFO underlying cash balance(a)** | **-37,113** | **1,479** | **1,864** | **3,108** |
| Per cent of GDP | -2.5 | 0.1 | 0.1 | 0.2 |
| **Changes from 2011-12 MYEFO to 2012-13 Budget** | | | | |
| Effect of policy decisions(b)(c) | | | | |
| *Receipts* | *76* | *2,021* | *3,680* | *4,915* |
| *Payments* | *2,777* | *-903* | *-253* | *2,424* |
| Total policy decisions impact on underlying cash balance | -2,701 | 2,924 | 3,934 | 2,491 |
| Effect of parameter and other variations(c) | | | | |
| *Receipts(d)* | *-6,117* | *-7,825* | *-7,797* | *-7,288* |
| *Payments* | *-1,529* | *-4,958* | *-4,043* | *-7,007* |
| Total parameter and other variations impact on underlying cash balance | -4,588 | -2,867 | -3,754 | -281 |
| **2012-13 Budget underlying cash balance(a)** | **-44,402** | **1,536** | **2,044** | **5,318** |
| Per cent of GDP | -3.0 | 0.1 | 0.1 | 0.3 |

(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

Since MYEFO, receipts have been revised down by $6.1 billion in 2011-12 and $7.8 billion in 2012-13, largely reflecting changes in economic circumstances.

This largely reflects a downward revision to tax receipts. Tax receipts (excluding GST) have declined by $3.8 billion in 2011-12 and $4.6 billion in 2012-13. The main downward revisions have been to company and superannuation taxes, principally reflecting high levels of investment-related tax deductions with the mining sector, weak profitability outside the resources and resources-related sectors, and sluggish asset prices.

New policy decisions have increased receipts by $76 million in 2011-12 and $2.0 billion in 2012-13. Around a third of these savings in 2012-13 relate to decisions taken not to proceed with (or defer) some previously announced tax measures that would otherwise have reduced tax receipts. The decisions in this Budget not to proceed with some measures will maintain tax liabilities at present levels.

Major policy decisions that have increased receipts from 2011-12 to 2015-16 include:

- not proceeding with lowering the company tax rate, which was due to commence from the 2013-14 income year, nor the early start to lowering the company tax rate for small businesses, which was due to commence from 2012-13. The Government was not able to secure the necessary Parliamentary support and for this reason the decision not to proceed with the company tax cut will now help fund initiatives to spread the benefits of the resources boom to help families on low and middle incomes and support business investment. This measure is expected to increase cash receipts by $4.6 billion over the five years to 2015-16, which includes a reduction in receipts from the unwinding of the associated growth dividend;

- not proceeding with the standard deduction for work-related expenses and the cost of managing tax affairs, which was scheduled to commence on 1 July 2013, as the Government is pursuing other simplification measures, such as trebling the tax free threshold. This will increase cash receipts by $1.6 billion over the four years to 2015-16;

- deferring the higher concessional contribution caps for individuals over 50 with superannuation balances below $500,000 to 1 July 2014, which was due to start on 1 July 2012, increasing cash receipts by $1.4 billion over the four years to 2015-16;

- increasing cash receipts by $1.1 billion over the four years to 2015-16 by providing $106 million over four years to the Australian Taxation Office (ATO) to increase the ATO's collections of outstanding taxation debts and superannuation guarantee charges. This has no impact in fiscal balance terms;

- further reform to the fringe benefits tax concessions for living-away-from-home allowances and benefits by limiting access to the concessions. This measure increases cash receipts by $1.0 billion over the four years to 2015-16;

- reducing the higher tax concession for superannuation contributions of very high income earners, increasing cash receipts by $1.0 billion over the four years to 2015-16;

- extending the 2010-11 Budget measure to fund additional GST compliance activities to promote voluntary compliance by a further two years, increasing cash receipts by $1.1 billion over the four years to 2015-16; and

- not proceeding with the 50 per cent tax discount for interest income which was due to commence on 1 July 2013, saving $795 million over the four years to 2015-16.

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

- allowing companies to carry back tax losses so they receive a refund against tax previously paid, decreasing receipts by $700 million over the four years to 2015-16; and
- increasing the Medicare levy low-income thresholds to $19,404 for individuals and $32,743 for families for the 2011-12 income year, with effect from 1 July 2011, with a cost to the budget of $85 million over the four years to 2015-16.

The effect of the carbon price on the budget is outlined in Box 1.

**Box 1: Effect of the carbon price on the budget**

The Carbon Pricing Mechanism will commence from 1 July 2012, with a fixed price period of three years (commencing at $23 in 2012-13). The 2012-13 Budget includes for the first time carbon price estimates for the 2015-16 projection year, when the scheme will transition to a flexible price and be linked to the international market. In the flexible price period, international carbon prices are expected to set the domestic carbon price.

The Carbon Pricing Mechanism is expected to raise $24.7 billion in receipts over the forward estimates. The receipt estimates incorporate a carbon price for 2015-16 of $29, based on Treasury modelling in *Strong Growth, Low Pollution.* Budget projection year parameters generally rely on longer-term factors such as those captured in the *Strong Growth, Low Pollution* modelling.

Over the four years to July 2011, daily international carbon prices traded in the range of $14 to $50. Trading in the futures markets, however, is thin and sporadic for contracts as far out as 2015. More recently, traded international prices have fallen, in part due to the downturn in Europe. The unsettled global economic outlook is contributing to uncertainty around the future path of carbon prices.

Potential policy and regulatory change, particularly in the European Union Emissions Trading Scheme (EU ETS), has added to uncertainty around future carbon prices at this time. The EU recently brought forward a scheduled report on their scheme to 2012, which is now expected in coming months. Following this, the EU may consider policy options to increase the current low prices in the EU ETS, with implications for international carbon prices.

These circumstances indicate that the most suitable long-run carbon price projection remains the Treasury projections in *Strong Growth, Low Pollution*.

Any change in international carbon prices would have an impact on the estimates of the *Clean Energy Future* package included in the Budget. As well as affecting carbon price receipts, a different carbon price would also affect the cost of assistance provided under the *Clean Energy Future* package. Assistance under the Jobs and Competitiveness Program and permit-based assistance under the Energy Security Fund will move in line with the carbon price. Household assistance is permanent and will not be reduced.

To the extent that the carbon price is different than that modelled, it will have a different impact on consumer prices. For example, a lower carbon price would lead to a lower impact on consumer prices which would benefit households given the Government's household assistance package remains fixed.

**Box 1: Effect of the carbon price on the budget (continued)**

While forward auctions of carbon permits will be conducted in 2013-14 and 2014-15, changes in the international carbon price parameter would have only a small impact on total budget revenues in those years. In 2015-16, the budget would be firmly in surplus even if the price floor of $15 were to bind.

## Payment estimates

Since MYEFO, total cash payments for 2012-13 have decreased by $5.9 billion, comprised of new policy decisions which have reduced payments by a net $903 million and parameter and other variations which have reduced payments by $5.0 billion.

Major policy decisions since MYEFO that have increased cash payments in 2012-13 and over the four years to 2015-16 include:

- spreading the benefits of the resources boom by: increasing the maximum rate of Family Tax Benefit Part A (FTB-A) by $300 per annum for families with one child and $600 per annum for families with two or more children from 1 July 2013. For families receiving the base rate of FTB-A, the increase will be $100 for families with one child and $200 for families with two or more children; and introducing a new supplement for eligible income support recipients to assist with cost of living pressures. These measures are expected to increase cash payments by $153 million in 2012-13 ($2.9 billion over the four years to 2015-16);
- continuing Australia's military contribution to international stabilisation in East Timor, in Afghanistan and the wider Middle East Area of Operations, and Solomon Islands. These measures are expected to increase payments by $1.0 billion in 2012-13 ($1.4 billion over the four years to 2015-16);
- replacing the Education Tax Refund with a new Schoolkids Bonus provided through the transfer system at a cost of $2.4 billion over five years to 2015-16. This measure increases payments by $1.3 billion in 2011-12 and reduces costs by $105 million in 2012-13 because of differences in the timing of payments under the new arrangements;
- the first stage of a National Disability Insurance Scheme which will provide support to people with a significant and permanent disability in up to four launch locations around Australia from 2013-14. This measure is expected to increase payments by $84 million in 2012-13 ($1.0 billion over the four years to 2015-16);
- funding for the Government's Aged Care Reform package, which includes initiatives to increase the number of home care services, funding to attract and retain staff and improve the quality of care for older Australians, and increase support to people with dementia. These measures are expected to increase payments by $55 million in 2012-13 ($284 million over the four years to 2015-16);

- support for a range of Dental Health measures including funding to alleviate pressure on public dental waiting lists, increasing the size and capacity of the dental workforce, and funding for national oral health promotion activities. These measures are expected to increase payments by $85 million in 2012-13 ($515 million over four years to 2015-16). This funding is partially offset by the decision not to proceed with the Commonwealth Dental Health Program (saving $94 million in 2012-13 and $290 million over three years to 2014-15); and

- funding to construct a new Commonwealth-operated Post-Entry Quarantine facility, commencing operations in 2015-16, to replace existing facilities as leases expire. The funding will also cover maintenance of core biosecurity operations and continue progress on reforming Australia's biosecurity system. These measures are expected to increase payments by $67 million in 2012-13 ($365 million over the four years to 2015-16).

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

- changing the eligibility for Parenting Payment from 1 January 2013 for all recipients who were receiving the payment prior to 1 July 2006 to align eligibility for all parents receiving parenting payments. This measure is expected to decrease payments by $97 million in 2012-13 ($687 million over four years to 2015-16);

- limiting eligibility for FTB-A to young people under 18 years of age, or where a young person remains in secondary school, the end of the calendar year in which they turn 19. This change will focus payments in the family assistance system on families with children who are at school, while Youth Allowance will become the primary form of assistance to eligible young adults. This measure is expected to decrease cash payments by $25 million in 2012-13 ($312 million over the four years to 2015-16);

- restructuring apprenticeship incentive payments for existing workers in occupations not on the National Skills Needs List, by removing the $1,500 commencement payment and increasing the completion payment by $500, which is expected to save $60 million in 2012-13 ($354 million over the four years to 2015-16);

- improving the targeting of the Extended Medicare Safety Net to help manage Medicare expenditure whilst continuing to provide support for people with high out-of-pocket costs. This measure is expected to decrease cash payments by $8 million in 2012-13 ($95 million over the four years to 2015-16);

- deferring the commitment to spend 0.5 per cent of Gross National Income on Official Development Assistance by one year to 2016-17 which is expected to decrease payments by $447 million in 2012-13 ($2.9 billion over the four years to 2015-16);

- deferring some Defence acquisitions, adjusting the Defence capital equipment program and delivering further operating efficiencies, while delivering priority 2009 White Paper capabilities. This is expected to reduce payments by $971 million in 2012-13 ($5.5 billion over the four years to 2015-16); and

- accelerating funding for Local Government Financial Assistance Grants to assist in the response to challenges arising from natural disasters in 2010-11 and 2011-12. This measure is expected to reduce payments by $1.1 billion in 2012-13 and increase cash payments by the same amount in 2011-12.

Further details of Government policy decisions are provided in Budget Paper No. 2, *Budget Measures 2012-13*. 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 2012-13, as a result of parameter and other variations since MYEFO, include:

- natural disaster relief payments to the States under the Natural Disaster Relief and Recovery Arrangements, which are expected to be $324 million higher in 2012-13 largely reflecting increased costs and changed timing for the submission of State claims;

- Disability Support Pension (DSP) payments which are expected to be $353 million higher in 2012-13 ($1.5 billion over the four years to 2015-16) due to an increase in the estimated number of DSP recipients, partly offset by slightly lower than anticipated average pension rates;

- offshore asylum seeker management costs, which are expected to be $378 million higher in 2012-13 ($1.3 billion over the four years to 2015-16) due to increased estimates of expected costs for holding irregular maritime arrivals in detention;

- Medicare Services payments which are expected to be $232 million higher in 2012-13 mainly reflecting the extension of the Chronic Disease Dental Scheme (CDDS) to 30 September 2012 as a result of the Senate disallowing the determination to close the program. The closure of the CDDS remains government policy;

- employee assistance payments which are expected to be $115 million higher in 2012-13 ($469 million over four years to 2015-16) mainly due to an increase in demand for the General Employee Entitlements and Redundancy Scheme. This scheme provides assistance to employees of bankrupt businesses who are owed certain employee entitlements; and

- Commonwealth Grants Scheme payments to universities which are expected to be $103 million higher in 2012-13 ($993 million over the four years to 2015-16) due to faster-than-expected growth in university enrolments following the Government's decision in 2009 to uncap enrolment numbers from 2012. The uncapping of enrolment numbers also affects tertiary student assistance payments which are expected to be $278 million higher in 2012-13 ($1.2 billion over the four years to 2015-16).

Major reductions in expected payments in 2012-13 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 ($2.9 billion in 2012-13 and $13.8 billion over the four years to 2015-16);
- reprofiling infrastructure spending ($927 million in 2012-13 and $957 million over four years to 2015-16). This reflects the earlier-than-expected completion of some projects, reprofiling rail payments to the States and Territories to better align funding with the delivery of projects, and the slippage in the Regional Infrastructure Fund payments due to the need for comprehensive project evaluations;
- Income Support for Seniors payments which are expected to be $229 million lower in 2012-13 ($1.2 billion over the four years to 2015-16) because of lower than previously forecast growth in payment rates as a result of lower forecasts for indexation parameters than those expected at MYEFO;
- defence force superannuation benefits which are expected to be $130 million lower in 2012-13 ($457 million over the four years to 2015-16) due to lower exit rates and a higher proportion of benefits taken as a pension in place of a lump sum payment. These factors will lead to higher superannuation costs beyond the forward estimates for defence force personnel; and
- Income Support for Carers payments which are expected to be $56 million lower in 2012-13 ($348 million over the four years to 2015-16) due to a lower-than-projected number of recipients partially offset by an increase in average payment rates.

As a consequence of the weaker fiscal outlook in the near term, and lower interest rates, net interest payments have increased by $158 million in 2012-13 but decreased by $1.1 billion over the four years to 2015-16.

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, *Expenses and Net Capital Investment*.

## Fiscal balance estimates

The fiscal surplus is expected to be $2.5 billion (0.2 per cent of GDP) in 2012-13, a decrease of $2.2 billion since MYEFO.

Table 6 provides a reconciliation of the variations in the fiscal balance since the 2011-12 Budget.

### Table 6: Reconciliation of fiscal balance estimates

| | Estimates | | | Projections |
|---|---|---|---|---|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| | $m | $m | $m | $m |
| **2011-12 Budget fiscal balance** | **-20,262** | **3,966** | **3,166** | **8,539** |
| Per cent of GDP | -1.4 | 0.3 | 0.2 | 0.5 |
| **Changes from 2011-12 Budget to 2011-12 MYEFO** | | | | |
| Effect of policy decisions(a) | -5,589 | 4,958 | 2,820 | 3,555 |
| Effect of parameter and other variations | -6,599 | -4,210 | -1,828 | -5,700 |
| **Total variations** | **-12,188** | **748** | **993** | **-2,144** |
| **2011-2012 MYEFO fiscal balance** | **-32,450** | **4,714** | **4,159** | **6,395** |
| Per cent of GDP | -2.2 | 0.3 | 0.3 | 0.4 |
| **Changes from 2011-12 MYEFO to 2012-13 Budget** | | | | |
| Effect of policy decisions(a)(b) | | | | |
| Revenue | 76 | 1,722 | 3,362 | 4,763 |
| Expenses | 1,951 | 201 | 773 | 3,095 |
| Net capital investment | 46 | -532 | -930 | -648 |
| Total policy decisions impact on fiscal balance | -1,921 | 2,053 | 3,519 | 2,316 |
| Effect of parameter and other variations(b) | | | | |
| Revenue | -7,768 | -8,415 | -8,707 | -8,084 |
| Expenses | -27 | -3,864 | -2,893 | -5,509 |
| Net capital investment | -110 | -285 | -781 | -884 |
| Total parameter and other variations impact on fiscal balance | -7,631 | -4,267 | -5,032 | -1,691 |
| **2012-13 Budget fiscal balance** | **-42,002** | **2,500** | **2,646** | **7,020** |
| Per cent of GDP | -2.8 | 0.2 | 0.2 | 0.4 |

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

## 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 Appendix E of Statement 5, *Revenue*, 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:

- superannuation benefits where there are differences between timing of cash payments and accrued expenses; and
- the Natural Disaster Relief and Recovery Arrangements, where expenses are being recognised at a different time to cash payments.

More detailed information on expenses can be found in Statement 6, *Expenses and Net Capital Investment*.

### Net capital investment estimates

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

In 2012-13 net capital investment is forecast to be $816 million lower than forecast in MYEFO, largely reflecting adjustments in the Defence capital equipment program, including deferring some Defence acquisitions, and water purchases under the Restoring the Balance in the Murray-Darling Basin program.

Fluctuations in the exchange rate since MYEFO have 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 debt, net financial worth and net worth

The further write down to tax receipts has contributed to higher estimated net debt, and lower net worth and net financial worth than was expected at MYEFO.

The Australian Government's net debt continues to remain very low by international standards. While the average net debt for major advanced economies is expected to peak at around 93 per cent of GDP in 2016 and 2017, Australia's net debt will peak at 9.6 per cent of GDP in 2011-12. It is expected to reduce to 7.3 per cent of GDP by 2015-16.

Net debt for the Australian Government general government sector is forecast to be $143.3 billion (9.2 per cent of GDP) in 2012-13, $10.1 billion higher than forecast at MYEFO.

The change in the projected level of net debt in 2012-13 since MYEFO is driven primarily by an increase in the value of the existing stock of Commonwealth Government Securities (CGS) on issue owing to lower interest rates. It also reflects an increase in issuance owing to the weaker fiscal outlook in 2011-12, partially offset by an increase in the value of certain investments held by the Future Fund.

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

- Net financial worth is estimated to be –$248.6 billion in 2012-13, compared to the MYEFO estimate of -$228.3 billion.
- Net worth is forecast to be –$137.8 billion in 2012-13, compared to the MYEFO estimate of -$115.9 billion.

In addition to factors driving the change in the net debt position, the change in net financial worth and net worth also reflect the upward revaluation of the Australian 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 | |
|---|---|---|---|---|---|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 |
| | $b | $b | $b | $b | $b |
| Financial assets | 216.3 | 238.5 | 255.4 | 269.6 | 283.4 |
| Non-financial assets | 109.5 | 110.9 | 111.5 | 112.2 | 114.0 |
| **Total assets** | **325.8** | **349.4** | **366.8** | **381.9** | **397.4** |
| **Total liabilities** | **467.6** | **487.2** | **499.6** | **505.5** | **509.1** |
| **Net worth** | **-141.8** | **-137.8** | **-132.8** | **-123.6** | **-111.8** |
| **Net financial worth(a)** | **-251.3** | **-248.6** | **-244.3** | **-235.9** | **-225.8** |
| Per cent of GDP | -17.0 | -16.0 | -15.0 | -13.7 | -12.4 |
| **Net debt(b)** | **142.5** | **143.3** | **144.9** | **140.1** | **131.6** |
| Per cent of GDP | 9.6 | 9.2 | 8.9 | 8.1 | 7.3 |
| **Net interest payments** | **6.5** | **7.0** | **6.8** | **7.0** | **8.2** |
| Per cent of GDP | 0.4 | 0.5 | 0.4 | 0.4 | 0.4 |

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

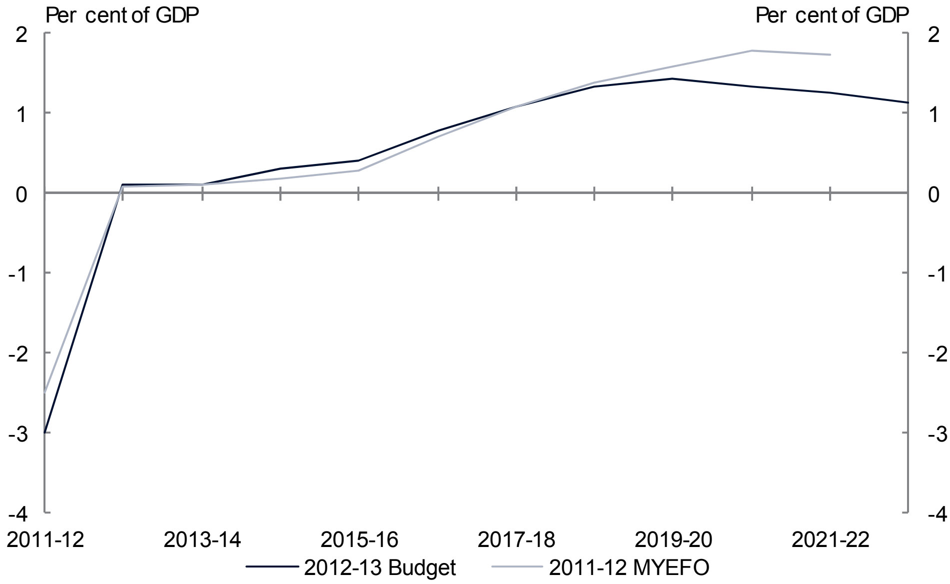
CGS on issue subject to the current legislative limit is projected to be below $250 billion at the end of each financial year across the forward estimates. The volume of CGS on issue at various times throughout the year is projected to exceed this level due to within-year fluctuations of CGS on issue. To manage most efficiently this normal within-year financing task, and to ensure flexibility in meeting the Government's objective of maintaining a deep and liquid CGS market, an amendment will be sought to the *Commonwealth Inscribed Stock Act 1911* to increase the legislative limit on CGS to $300 billion.

## Medium-term fiscal outlook

On current projections, the underlying cash surplus is expected to reach 1 per cent of GDP in 2017-18, the same year as projected in MYEFO (Chart 1). Net debt is projected to return to zero in 2020-21, also unchanged from MYEFO (Chart 2).

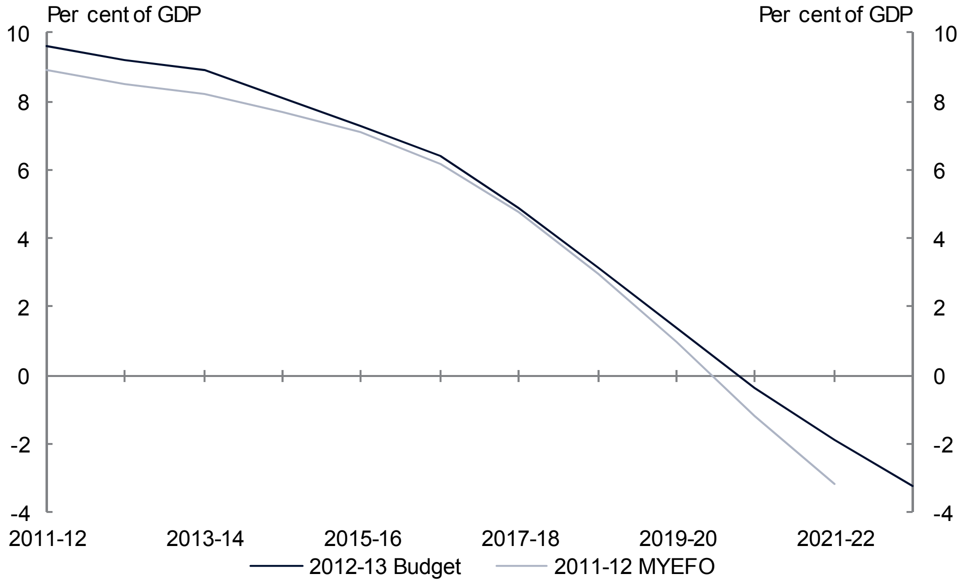
Towards the end of the medium term the projected surplus is slightly lower than expected at MYEFO. This reflects a downward revision to the projected participation rate which has flowed through to projections for GDP, tax receipts, and the surplus.

**Chart 1: Underlying cash balance projected to 2022-23**




Source: Treasury projections.

**Chart 2: Government net debt projected to 2022-23**




Source: Treasury projections.

# APPENDIX A: SENSITIVITY OF BUDGET ESTIMATES TO ECONOMIC DEVELOPMENTS

The estimates contained in the 2012-13 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 increase in labour productivity and labour force participation, with each contributing equally.

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 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 in 2012-13 consistent with a fall in the terms of trade of around 4 per cent, which causes a 1 per cent fall in nominal GDP by 2013-14. The sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A1 are 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 2013-14 (per cent deviation from the baseline level)**

| | 2012-13 | 2013-14 |
|---|---|---|
| | per cent | 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 lead to a fall in the exchange rate, although the magnitude is particularly uncertain in the short term. In the event of a fall 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 $3.4 billion in 2012-13 and around $7.1 billion in 2013-14 (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**

| | 2012-13 | 2013-14 |
|---|---|---|
| | $b | $b |
| **Receipts** | | |
| Individuals and other withholding taxation | -0.6 | -2.0 |
| Superannuation taxation | 0.0 | -0.2 |
| Company tax | -2.1 | -3.9 |
| Resource rent taxes | -0.5 | -0.6 |
| Goods and services tax | -0.1 | -0.2 |
| Excise and customs duty | 0.0 | -0.1 |
| Other taxation | 0.0 | 0.0 |
| **Total receipts** | **-3.3** | **-7.0** |
| **Payments** | | |
| Income support | -0.1 | -0.2 |
| Other payments | 0.0 | 0.1 |
| Goods and services tax | 0.1 | 0.2 |
| **Total payments** | **0.0** | **0.1** |
| PDI | -0.1 | -0.2 |
| **Underlying cash balance impact** | **-3.4** | **-7.1** |

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 is on company tax receipts as the fall in export income decreases company profits. Owing to lags in the tax system, the effect on company tax is larger in 2013-14. Lower company profits are assumed to flow through to lower Australian equity prices, therefore reducing capital gains tax from individuals, companies and superannuation funds.

The weaker economy results in lower aggregate demand, which flows through to lower employment and wages, reducing individuals' income tax receipts. 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 taxes.

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 because of a higher number of unemployment benefit recipients. The increase in unemployment benefits in 2013-14 is partly offset by reduced expenditure on pensions and allowances reflecting lower growth in benefit rates resulting from lower wages growth and lower inflation. 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 fall in the exchange rate would damp 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 permanent 0.5 per cent increase in both the participation rate and labour productivity, resulting in a 1 per cent increase in real GDP in 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 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 different parts of the economy are affected 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 in 2012-13 (per cent deviation from the baseline level)**

| | 2012-13<br>per cent | 2013-14<br>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 increases in labour force participation and labour productivity 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 lower domestic prices make 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 unchanged.

The overall impact of the increase in labour productivity and participation is an increase in the underlying cash balance of around $3.3 billion in 2012-13 and around $4.4 billion in 2013-14 (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**

| | 2012-13<br>$b | 2013-14<br>$b |
|---|---|---|
| **Receipts** | | |
| Individuals and other withholding taxation | 1.7 | 1.3 |
| Superannuation taxation | 0.1 | 0.2 |
| Company tax | 1.2 | 2.5 |
| Goods and services tax | 0.5 | 0.4 |
| Excise and customs duty | 0.2 | 0.2 |
| Other taxation | 0.1 | 0.1 |
| **Total receipts** | **3.8** | **4.7** |
| **Payments** | | |
| Income support | -0.1 | -0.1 |
| Other payments | 0.0 | 0.0 |
| Goods and services tax | -0.5 | -0.4 |
| **Total payments** | **-0.6** | **-0.5** |
| PDI | 0.1 | 0.2 |
| **Underlying cash balance impact** | **3.3** | **4.4** |

On the receipts side, individuals' income tax collections increase because of the rise in the number of wage earners and, additionally, higher real wages. The stronger labour market also increases tax collections from superannuation funds because contributions (including compulsory contributions) are higher. 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 through their indexation to wages. 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.