

PRE-ELECTION ECONOMIC AND FISCAL OUTLOOK

REPORT BY
THE SECRETARY TO THE DEPARTMENT OF THE TREASURY AND
THE SECRETARY TO THE DEPARTMENT OF FINANCE
AND ADMINISTRATION

SEPTEMBER 1998

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PRE-ELECTION ECONOMIC AND FISCAL OUTLOOK

FOREWORD

The *Charter of Budget Honesty Act 1998* (the Charter) requires the Secretaries to the Departments of the Treasury and of Finance and Administration (the Secretaries) to publicly release a pre-election economic and fiscal outlook report (PEFO) within ten days of the issue of the writ for a general election. Such a writ was issued on 31 August 1998.

The 1998 PEFO updates the estimates contained in the 1998-99 Budget. The information in the report takes into account, to the fullest extent possible, all Government decisions made before the issue of the writ and all other circumstances that may have a material effect on the fiscal and economic outlook.

In recognition of the limited time available to prepare the PEFO, the Charter provides that information which is unchanged from that provided in an earlier economic and fiscal outlook report may be summarised in the PEFO.

The reporting standards used in the PEFO are those used for the 1998-99 Budget and are outlined in Appendix E to Statement 2 in *1998-99 Budget Paper No. 1*. Similarly, the definitions, drafting conventions and notations used in the PEFO are those used in the 1998-99 Budget.

Consistent with the Charter's requirements, the PEFO:

- provides an updated fiscal outlook;
- presents the updated economic forecasts which underpin the revised outlays and revenue estimates;
- provides detail on the changes in the outlays and revenue estimates;
- lists in **Appendix A** all the policy decisions taken by the Government since the 1998-99 Budget;
- updates in **Appendix B** the general and specific risks to the forward estimates for changes since the 1998-99 Budget;
- discusses in **Appendix C** the sensitivity of the forward estimates to changes in economic and other parameters; and
- provides in **Appendix D** updated estimates for the Commonwealth general government sector.

STATEMENT BY THE TREASURER AND THE MINISTER FOR
FINANCE AND ADMINISTRATION

Consistent with the *Charter of Budget Honesty Act 1998*, we declare that we have disclosed to the Secretary to the Treasury and the Secretary to the Department of Finance and Administration all details of any Government decision, or any other circumstance, that we know about:

- (i) that has, or could have, material fiscal or economic implications; and
- (ii) that neither of the responsible Secretaries could reasonably be expected to know about.

Peter Costello
Treasurer
2 September 1998

John Fahey
Minister for Finance & Administration
2 September 1998

STATEMENT BY THE SECRETARY TO THE TREASURY AND
THE SECRETARY TO THE DEPARTMENT OF FINANCE AND
ADMINISTRATION

Consistent with the *Charter of Budget Honesty Act 1998*, we declare that, to the fullest extent possible, the information in the Pre-election Economic and Fiscal Outlook 1998 for which we are responsible:

- (i) reflects the best professional judgement of the officers of the Treasury and the Department of Finance and Administration;
- (ii) takes into account all economic and fiscal information available; and
- (iii) incorporates the fiscal implications of Government decisions and circumstances disclosed by the responsible Ministers.

E.A. Evans
Secretary
to the Treasury

7 September 1998

Peter J. Boxall
Secretary
to the Department of Finance and
Administration
7 September 1998

PRE-ELECTION ECONOMIC AND FISCAL OUTLOOK

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PRE-ELECTION ECONOMIC AND FISCAL OUTLOOK

OVERVIEW

The Australian economy is expected to continue to record solid economic growth and low inflation in 1998-99, despite the sharp slowdown in the Asian region and a highly uncertain international environment.

The underlying budget balance is estimated to be in surplus in 1998-99. Based on long-term trend growth projections, the fiscal outlook is for further underlying budget surpluses in 1999-2000 and the remaining outyears. Revised budget aggregates for 1998-99 to 2001-02 are shown in Table 1.

Table 1: Summary of Budget Aggregates

	1998-99	1999-00	2000-01	2001-02
	Estimate	Projection	Projection	Projection
Revenue (\$m)	145243	152119	143385	153378
<i>Per cent of GDP</i>	25.3	25.0	22.2	22.4
Underlying Outlays (\$m)	142698	148684	139419	143004
<i>Per cent of GDP</i>	24.9	24.4	21.6	20.9
Underlying Balance (\$m)	2545	3435	3967	10374
<i>Per cent of GDP</i>	0.4	0.6	0.6	1.5
<i>Memorandum items:</i>				
Net Advances (\$m)	-5377	-12922	-30138	-7182
Headline Balance (\$m)	7922	16357	34104	17557
<i>Per cent of GDP</i>	1.4	2.7	5.3	2.6

ECONOMIC OUTLOOK

The Australian economy is expected to record further solid growth of 2¾ per cent in 1998-99, down slightly from the Budget forecast of 3 per cent growth. The downward revision reflects the apparent impact of weaker than expected international economic developments on business and consumer confidence in Australia.

Japan is in recession and demand and output have fallen in a number of other countries in Asia. While financial instability in Russia and South America has added recently to the general uncertainty surrounding the international outlook, strong growth in the United States and Europe continues to temper these weaknesses and underpin aggregate world economic growth of the order of two per cent or so.

Notwithstanding weaker international conditions, Australian exporters have successfully diverted sales from the troubled Asian economies and total export outcomes to date have been consistent with the Budget forecast. Domestic demand has also continued to grow in line with the Budget forecast. International and financial market upheavals have, nevertheless, adversely impacted on some measures of domestic business and consumer confidence. While the relationship between confidence and economic activity has traditionally been loose, the fall in confidence and uncertainty associated with international developments suggest that business investment and consumption growth

in 1998-99 is likely to be a little lower than the Budget forecast. This should be partially offset by stronger than expected growth in public final demand.

The forecast for year-average employment growth in 1998-99 is unchanged, but slightly slower growth in non-farm activity is expected to result in an easing in the pace of employment growth through the year to 1½ per cent compared with the Budget forecast of 1¾ per cent. With workforce participation higher, the unemployment rate is expected to be around 8 per cent by the June quarter 1999 compared with the Budget forecast of 7¾ per cent. The forecasts for inflation and the current account deficit are unchanged from Budget.

Table 2 presents the major economic parameters underpinning the PEFO budget figuring. The projections for the period from 1999-2000 to 2001-02 do not represent forecasts and are unchanged from those prepared for the 1998-99 Budget. The projections were prepared by Treasury in accordance with the convention that outyear projections are based on long term growth rates. Accordingly, the economic projections do not incorporate the potential impact on the economy of the Government's tax reform package.

Table 2: Major Economic Parameters (percentage change on previous year)

	1998-99 Forecasts		Projections		
	Budget	Revised	1999-00	2000-01	2001-02
Real GDP(A)	3	2 3/4	3 1/2	3 1/2	3 1/2
Employment (a)	1 3/4	1 3/4	2 1/4	2 1/4	2 1/4
Wages (b)	4 1/4	4	3 1/2	3 1/2	3 1/2
Headline CPI	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2
Underlying CPI	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2

(a) Labour Force Survey basis.

(b) Average earnings (national accounts basis).

FISCAL OUTLOOK

In 1998-99, the underlying budget balance is estimated to be in surplus by \$2.5 billion or 0.4 per cent of GDP. This compares with the \$2.7 billion surplus estimated at the time of the 1998-99 Budget.

Based on the medium term growth projections set out in Table 2, surpluses are projected for the outyears. These surpluses are lower than those projected at the time of the 1998-99 Budget.

Large headline budget surpluses are expected in 1998-99 and over the forward estimates period, reflecting both underlying surpluses in prospect and asset sale proceeds (most notably those from Telstra). The estimates assume that the Commonwealth Government sells its remaining equity in Telstra but allow for some changes in the proposed method and timing of the sale as well as more recent estimates of its market value.

Table 3 provides a reconciliation of budget estimates between those contained in the 1998-99 Budget and the 1998 PEFO in terms of policy decisions and parameter and other variations.

Table 3: Reconciliation of Underlying Budget Balance Estimates^(a)

	1998-99	1999-00	2000-01	2001-02
	\$m	\$m	\$m	\$m
1998-99 Budget underlying balance estimate	2688	4733	8614	14588
(per cent of GDP)	0.5	0.8	1.3	2.1
Changes between 1998-99 Budget and PEFO				
Effect of parameter and other variations				
Revenue	982	87	-257	-282
Underlying outlays				
Unemployment benefits	396	324	246	186
Prices and wages	-107	-147	-73	-11
Interest and exchange rates	100	399	203	203
Public debt interest	-412	-228	-405	-690
<i>Subtotal: revisions to economic parameters</i>	<i>-23</i>	<i>348</i>	<i>-29</i>	<i>-312</i>
Programme specific parameters	101	-125	-173	-235
Slippage in 1998-99 Budget decisions	5	-	-	-
Other revisions	444	-420	-355	-498
<i>Subtotal: programme specific parameters and other variations</i>	<i>549</i>	<i>-545</i>	<i>-528</i>	<i>-733</i>
Total underlying outlays revisions	526	-197	-557	-1045
Total	-455	-284	-300	-763
Effect of policy decisions (b)				
Revenue	3	734	-16558	-17435
Underlying outlays	601	2315	-11611	-12459
Total	598	1581	4947	4976
PEFO underlying balance estimate	2545	3435	3967	10374
(per cent of GDP)	0.4	0.6	0.6	1.5

- (a) A negative figure for revenue indicates a deterioration in the budget balance. For all other items, a negative figure indicates an improvement in the budget balance.
- (b) Includes total budgetary cost of the tax reform package (including PDI effects of the tax reform policy). For all other policy decisions, PDI effects are included in parameter and other variations.

The underlying budget surplus in 1998-99 reflects revisions to both the revenues and outlays estimates. Revenues in 1998-99 are now estimated to be higher than expected at budget time, principally as a result of the flow through of the better than expected revenue outcome in 1997-98. There is also a contribution from higher than expected capital gains tax revenue associated with the disposal of shares following the recent AMP demutualisation.

While both of these factors continue to exert a positive impact on revenues into 1999-2000 and the outyears, they are offset by the effects of weaker economic parameters in 1998-99 as well as downward revisions to expected interest revenues. The lower interest revenues in the outyears are associated with the delay in the receipt of Telstra sale proceeds.

The higher outlays estimate in 1998-99 reflects both policy decisions and parameter revisions. New policy decisions add \$0.6 billion to outlays in 1998-99. 'Carryovers' from underspends in 1997-98 and an increase in the number of unemployment beneficiary recipients also contribute to higher outlays in that year. Revised

unemployment beneficiary recipient numbers and a weaker exchange rate contribute to higher outlays across all outyears.

Downward revisions to projected surpluses in the outyears relative to the 1998-99 Budget principally reflect the impact of the Government's tax reform package. This results in both lower revenues and outlays. In net terms, the tax reform package reduces underlying budget surpluses by \$1.2 billion in 1999-2000 and by \$4.8 billion in 2000-01 and 2001-02.

The tax reform package accounts for the bulk of new policy decisions since the 1998-99 Budget. Other decisions reduce the budget surplus by around a further \$0.4 billion in 1999-2000 and \$0.2 billion in 2000-01 and 2001-02. Appendix A provides a list of policy decisions taken since the 1998-99 Budget.

A range of factors may change the budgetary outlook in future years. Appendix B contains a Statement of Risks which details risks that may have a material effect on the fiscal outlook. A discussion of the estimated sensitivity of the fiscal aggregates to changes to the economic parameters is provided in Appendix C to this report.

APPENDIX A: SUMMARY OF POLICY DECISIONS

Table A1: Policy Decisions Taken Since the 1998-99 Budget

Description of Measure	1998-99 \$m	1999-00 \$m	2000-01 \$m	2001-02 \$m
Underlying Outlays Measures				
Child Support - Pilot services to assist parents when contact orders are made	0.4	0.6	0.6	-
Australian Federal Police - Resourcing needs and reform programme	24.7	24.6	16.0	-
Sale of Telstra - Social Bonus - Upgrade of the telecommunications infrastructure in remote Australia to facilitate the abolition of pastoral call rate	-	50.0	50.0	50.0
Sale of Telstra - Social Bonus - Increased funding for Networking the Nation	20.0	20.0	20.0	-
National Gallery of Australia - Building repairs	0.6	-	-	-
Enhancement to Job Network Services	38.9	16.6	-	-
Employment Services Market - Reprioritisation of funding	-25.4	-10.1	-	-
Joint Standing Committee on Electoral Matters Report on the 1996 Election - Funding of Government Response	-	5.1	4.2	4.2
Restoration of Harrick's Cottage - Grant to Brimbank Council	0.1	-	-	-
Natural Disaster Mitigation Studies	3.0	3.0	3.0	3.0
Natural Disaster Mitigation Studies - Funded from within Natural Disaster Relief Assistance	-3.0	-3.0	-3.0	-3.0
Administrative savings in management of non-commercial estate - Harrick's Cottage and St Peter's Church	-0.5	-	-	-
Grant to St Peter's Church East Melbourne	0.4	-	-	-
Child Care Communication Strategy - Enhancement of information activities	2.0	-	-	-
Australian Health Care Agreements - Additional funding to States	182.0	192.7	169.2	180.1
Establish an Institute of Clinical Studies	-	5.0	5.1	-
Additional aged care places in rural and regional communities	-	1.8	1.8	1.8
Transfer of aged care places to rural and regional communities	-	-1.8	-1.8	-1.9
Student Visa Programme	3.5	3.7	4.2	4.8
Assistance to Textile, Clothing and Footwear (TCF) and Leather industries	-	-	10.2	144.8
The Commonwealth Games Association - Grant to assist its preparation for and involvement in the 1998 Commonwealth Games	0.4	-	-	-
Sugar Industry Assistance Package	3.6	3.5	3.5	3.6
Pork Industry Assistance Package	2.7	2.7	2.7	-
Loxton Irrigation Area Water System - Refurbishment	0.8	-	-	-
East Gippsland floods - Grant to Victorian Farmers Federation for fodder transport	0.1	-	-	-
Drought Exceptional Circumstances Assistance - Duaringa, Monaro C and Cobar/Wilcannia	3.6	3.5	0.1	-

Table A1: Policy Decisions Taken Since the 1998-99 Budget (continued)

Description of Measure	1998-99 \$m	1999-00 \$m	2000-01 \$m	2001-02 \$m
Underlying Outlays Measures (continued)				
Flood Relief - Wollongong	0.1	-	-	-
Federation Fund - Revised funding profile	-	100.0	-	-100.0
Federation Fund - Additional funding	-	6.8	-	-
Apply full rate of rent assistance to people lodging in marginal accommodation - Bring forward implementation to 1 January 1999	3.5	-0.4
Exempt Farm Family Restart Scheme re-establishment grants from income test lump sum provisions	2.9	1.7	-	-
Sydney-Canberra Very High Speed Train Project - Proving up phase	1.0	-	-	-
Community education and information programme on the tax system	3.0	-	-	-
Community education and information programme on the tax system - PHI rebate	2.0	-	-	-
Community education and information programme on the tax system - Tax Reform Call centres	2.0	-	-	-
Extend rent assistance eligibility for the Veterans' Children Education Scheme	0.6	0.6	0.6	0.6
Extension of Electronic Travel Authority to Hong Kong and Taiwan - Offsetting savings	-	-9.5	-10.3	-11.1
Tax Reform Package (includes PDI)	327.0	1897.0	-11888.0	-12737.0
Decisions taken before caretaker period but not yet announced	1.3	1.0	1.0	1.0
<i>Total Outlays Measures</i>	<i>601.0</i>	<i>2315.0</i>	<i>-11610.9</i>	<i>-12459.0</i>
Revenue Measures				
Defer start date for opting out of Superannuation Guarantee System	-0.7	-	-	-
Student Visa Programme - Additional revenue from visa processing	3.9	4.1	4.6	5.2
Extension of Electronic Travel Authority to Hong Kong and Taiwan from 1 July 1999	-	-9.5	-10.5	-11.6
Cessation of TCF Import Credit Scheme	-	-	107.0	120.0
Extend TCF Overseas Assembly Programme	-	-	-8.0	-8.0
Tax Reform Package	-	739.0	-16651.0	-17541.0
<i>Total Revenue Measures</i>	<i>3.2</i>	<i>733.6</i>	<i>-16557.9</i>	<i>-17435.5</i>
Total Impact of all Measures	597.8	1581.4	4947.0	4976.4

APPENDIX B: STATEMENT OF RISKS

The forward estimates of revenues and outlays in the PEFO incorporate assumptions and judgements based on information available at the time of publication. A range of factors may influence the actual budget outcome in future years. The Charter requires these to be disclosed in a Statement of Risks in each Economic and Fiscal Outlook Report.

This appendix updates the information on fiscal risks and contingent liabilities detailed in the Statement of Risks in Appendix A to Statement 2 of *1998-99 Budget Paper No. 1*. It includes fiscal risks and contingent liabilities, with a possible impact on the forward estimates of greater than \$20 million in any one year or \$40 million over the forward estimates period, that were new or had changed at the time of the issue of writs for the election on 31 August 1998.

Some degree of uncertainty attaches to the budget and forward estimates for both revenues and outlays. The major factors influencing estimated revenues and outlays in any year are typically policy decisions and changes in economic and non-economic parameters. The sensitivity of the estimates to major economic parameters (but not other parameters) is discussed in Appendix C.

The outlays estimates include a conservative bias allowance in the contingency reserve which accounts for the established tendency for underestimation of programme expenditures in future years.

A fiscal risk relates to the revenues and outlays estimates for measures which require the enactment of legislation. These include measures where legislation has not yet been introduced into Parliament as well as where legislation lapsed with the announcement of the election.

FISCAL RISKS — REVENUE

Tax Reform

The tax reform revenue projections are subject to the usual risks surrounding the economic parameters and revenue estimation techniques.

Several of the measures included in the Government's tax reform package are subject to post election consultation. As a consequence, the budgetary implications of those measures could change. Key areas of post election consultation are the Commonwealth's offer to the States, the design and implementation of the business tax measures and outstanding issues surrounding the design of the Goods and Services Tax.

FISCAL RISKS — OUTLAYS

Communications and the Arts

Sale of radiofrequency spectrum licenses

The Commonwealth has announced the release of spectrum licenses for sale. The estimates of the proceeds from spectrum license sales are based on current market

information. However, the actual amount realised will depend on the market conditions at the time of sale.

The precise timing of the sales will also depend on market conditions. Those sales, which are expected to occur in 1998-99 and 1999-2000, will be deferred if market conditions prove unfavourable.

Defence

Litigation cases in train — Department of Defence

The Department of Defence is involved in several cases covering a wide range of litigation where either the cases have not been heard, or damages and costs have yet to be awarded. The litigation involves claims before the Human Rights and Equal Opportunity Commission, and claims relating to HMAS Stalwart, HMAS Voyager, asbestos litigation, compensation for termination of sand mining leases at Shoalwater Bay, and alleged defective administration by the Department. The value of these claims now stands at some \$100 million.

Employment, Education, Training and Youth Affairs

Catholic schools systems — application for a review of their level of general recurrent funding

All State and Territory Catholic education systems, with the exception of the Western Australian and Australian Capital Territory Catholic education systems, have applied for a review of their level of general recurrent funding. It is estimated that, if agreed to, the re-categorisation would require additional funding of approximately \$85 million a year, effective from 1 January 1998.

Finance and Administration

Asset sales

The major asset sale provided for in the 1998-99 Budget figuring was the sale of the Commonwealth's remaining equity in Telstra Corporation.

The revised estimates include the effect of the sale of the remainder of Telstra, noting that the level of proceeds will depend, inter alia, on the prevailing levels of world equity markets at the time of the sale. The first stage of the sale will leave majority control in Government hands.

Constitutional referendum

At the close of the Constitutional Convention in February 1998, the Prime Minister confirmed that, if re-elected, the Government would put the Convention's preferred bipartisan appointment of the president model to a referendum in 1999. No provision for the referendum has currently been made in the estimates. Both the timing and the cost of the referendum are subject to uncertainty. However, a referendum held on its own in 1998-99 or 1999-2000 could cost around \$55 million.

Member choice and Commonwealth Superannuation Arrangements

New superannuation arrangements for Commonwealth employees have been provided for in the budget and forward estimates. These new arrangements involve the closure of the Public Sector Superannuation Scheme (PSS) from 1 July 1999 and the choice for employees of either a complying superannuation fund or a Retirement Savings Account. The impact of incorporation of the new superannuation arrangements in the estimates has been to bring forward future superannuation liabilities for employees in the amounts of \$12 million in 1999-2000, \$265 million in 2000-01, and \$295 million in 2001-02 without increasing the superannuation costs to employers. It therefore represents no net cost to the Budget on an accruals basis.

The bringing forward of these outlays is subject to the passage of legislation by Parliament. As a result of the dissolution of Parliament, this legislation has now lapsed and would require reintroduction and passage by the new Parliament for these arrangements to apply and the consequent outlays to be made.

Health and Family Services

Capital assistance to aged care facilities

The status of some commitments to provide capital assistance grants to aged care facilities is currently under review. Should increased funding prove necessary, the maximum amount would be approximately \$61 million over four years.

Australian Health Care Agreements

This fiscal risk was identified in the 1998-99 Budget. The Commonwealth and all States and Territories except Western Australia and Tasmania have since signed new five-year Australian Health Care Agreements (AHCA), commencing 1 July 1998. Western Australia accepted the AHCA proposal in-principle on 3 August 1998. The Agreements incorporate revised risk sharing arrangements for changes in the private health insurance participation rate. Under the new formula, a nationally consistent rise of one percentage point in the participation rate above a point midway between the March 1998 and June 1995 levels will reduce Commonwealth grants to the States and Territories by approximately \$82 million a year from 1999-2000. Commonwealth grants will be increased by a similar amount from 1999-2000 if the participation rate falls by one percentage point below the December 1998 level.

Previously, the AHCA funding formula provided for the adjustment of a large proportion of the funding grants to reflect changes in measured hospital output costs. The hospital output cost index is now applied to total funding. Every one percentage point change in hospital output costs (relative to the budget assumption of a 0.5 per cent increase) will change grants by approximately \$57 million a year from 1999-2000.

Hearing services

Demand for the Hearing Services Programme has increased dramatically following the Government's 1997 announcement and subsequent publicity regarding these reforms. Possible further changes in the level of demand for, and utilisation of, vouchers for

hearing services, along with contract variations to provider organisations, may increase outlays by up to \$47 million in 1998-99.

Litigation cases in train — Department of Health and Family Services

The number of cases the Department of Health and Family Services is involved in has decreased from 93 to 81. These cases cover a wide range of litigation, where either the cases have not been heard or damages and costs have yet to be awarded. The litigation now involves Creutzfeldt-Jacob disease, Acquired Immune Deficiency Syndrome, Hepatitis C, defective products, personal injuries, the Department as an employer, and a variety of other claims against the Commonwealth. It is not possible to quantify the liability arising from these cases.

Industry, Science and Tourism

Diesel Fuel Rebate Scheme — major litigation

This fiscal risk appeared in the Statement of Risks in *1998-99 Budget Paper No. 1*. The litigation has been resolved with the Court finding in favour of the Commonwealth.

Textiles, Clothing and Footwear assistance package

This fiscal risk was identified in the 1998-99 Budget. A formal decision has since been taken and the timing and costs have been incorporated in the forward estimates of underlying outlays.

Primary Industries and Energy

Repayment of Snowy Mountains Hydro-electric Scheme debt

The expected corporatisation of the Scheme in 1999 will involve the refinancing and early repayment of debt to the Commonwealth. The estimated market value of the debt is in the order of \$900 million. The 1999-2000 headline estimates provide for repayment. Detailed arrangements will be agreed between the Commonwealth, NSW and Victoria as shareholders in the new company. The timing and level of repayment are subject to agreement between the Commonwealth, NSW and Victoria as shareholders in the new company, and may be influenced by the electricity and financial markets.

Social Security

Abolition of Employment Entry Payment and Education Entry Payment

The measures that abolished the Employment Entry Payment and Education Entry Payment were rejected by the Senate in December 1996. A new bill to re-present these measures was introduced into the Senate in June 1997. If equivalent legislation is not passed, the forward estimates will need to be increased to exclude the estimated savings from these measures.

Repeal of data-matching sunset clause

A Bill to repeal the sunset clause applying to data-matching was introduced into the Senate in May 1998. If equivalent legislation is not passed before 22 January 1999, there could be a potential increase to outlays of \$560 million over the forward estimates period.

Youth Allowance and related measures

This fiscal risk identified in the 1998-99 Budget has been removed from the Statement of Risks as the legislation for the Youth Allowance and related measures was passed by the Senate in June 1998.

Transport and Regional Development

Compensation claims — finalisation of acquisition of properties for the Second Sydney Airport at Badgerys Creek

Compensation claims relating to disputes arising from the compulsory acquisition of properties for the proposed Second Sydney Airport at Badgerys Creek which had not been finalised at 30 June 1998 give rise to an estimated risk of \$44 million.

Northern Territory Government Loans

Loans of the Northern Territory Government (Private Treaty Loans, Public Loans Flotations, and Private Placement of Northern Territory Stock) are covered by Commonwealth guarantee under sections 47 and 47A of the *Northern Territory (Self Government) Act 1978*. As at 30 June 1998, the value of these loans was \$162.1 million.

Treasury

Australia's involvement in the International Monetary Fund (IMF) assistance to Thailand, Indonesia and the Republic of Korea

In response to instability in regional financial markets and economies, Australia has offered to provide bilateral financing in support of IMF programmes in Thailand, Indonesia and the Republic of Korea. In the case of Thailand, this has taken the form of a currency swap between the Reserve Bank of Australia (RBA) and the Bank of Thailand for \$US1 billion which is being drawn down over a three-year period. In the event of default, the ability of the RBA to maintain the dividend stream projected in the forward estimates may be affected.

In the case of Indonesia and the Republic of Korea, Australia has agreed to provide supplementary financing or 'second tier' financing of up to \$US1 billion each. This financing would be provided via a loan on a non-concessional basis that would be repaid to the Commonwealth. Whilst as yet no funds have been drawn down by these two countries, Australia has supported the early draw down of \$US300 million for Indonesia and \$US330 million for the Republic of Korea as required.

Contingent Liabilities — Quantifiable

Communications and the Arts

Telstra Corporation Ltd — Superannuation Guarantee

An unquantifiable contingent liability was identified in the 1998-99 Budget in respect of additional employer contributions to the Telstra Superannuation Scheme. This contingent liability has now been quantified. The net present value of the contingent liability in respect of the guaranteed stream of payments for the Telstra Superannuation Scheme as at 30 June 1998 was \$1.1 billion. (See also the possible offsetting contingent liability for the 'Telstra Corporation Limited — notional fund surplus' under Finance and Administration.)

Telstra Corporation Ltd — loan guarantee

The Commonwealth has guaranteed loans taken out by Telstra Corporation Ltd. The principal amount covered by the guarantee as at 31 August 1998 was \$216.9 million.

Australian Broadcasting Corporation

The Commonwealth has guaranteed loans by the Australian Broadcasting Corporation. The principal amount covered by the guarantee as at 31 August 1998 was \$153 million. These loans were largely used to meet costs relating to the construction of premises for the Corporation at Southbank (Melbourne) and Ultimo (Sydney).

Special Broadcasting Service

The Commonwealth has guaranteed loans taken out by the Special Broadcasting Service. The principal amount covered by the guarantee as at 30 June 1998 was \$39 million. These loans were used to pay for the refurbishment and enhancement of the Service's premises at Artarmon in Sydney.

Commonwealth Indemnity Scheme

The actual amount indemnified for artworks on loan to galleries participating in exhibitions under the Scheme has increased to \$495.6 million as at 30 June 1998. This reflects three new exhibitions being covered by the Scheme.

Defence

Defence Housing Authority

Private sector borrowing by the Defence Housing Authority is explicitly guaranteed by the Commonwealth under section 38 of the *Defence Housing Authority Act 1987*. The value of loans guaranteed at 30 June 1998 is \$80 million.

Military Compensation

Contingent liabilities exist in relation to military compensation claims to the value of some \$188 million. These outstanding claims include long term incapacity payments,

permanent impairment payments, medical, rehabilitation and death payments and also includes long term Incurred But Not Reported (IBNR) payments. These long term IBNR payments are considered a contingent liability because payment is contingent upon the fact that an officer has to place a claim, and the Department of Defence does not necessarily have a present obligation to pay that claim.

Employment, Education, Training and Youth Affairs

Commonwealth Loan Guarantees — Student Financial Supplement Scheme

Contingent liabilities reported under this item in the 1998-99 Budget were \$1,188 million, which included some \$146 million relating to the ABSTUDY element of this scheme.

The remaining liabilities were associated with the Youth Allowance which has been administered by the Department of Social Security since 1 July 1998 (see separate entry under Social Security).

As at 1 July 1998, the value of loan guarantees outstanding for ABSTUDY recipients (Indigenous tertiary students) was in the order of \$150 million.

Finance and Administration

Telstra Corporation Ltd — notional fund surplus

Past employer contributions by Telstra to the Commonwealth Superannuation Scheme (CSS) have resulted in Telstra's CSS notional fund being in surplus. The Commonwealth has indicated that repatriation of part of that surplus to the Telstra Superannuation Scheme (TSS) will be permitted where the surplus is greater than 15 per cent of the employer financed benefits (past and future) for Telstra's CSS members and the outstanding deferred transfer value payments for ex-CSS members who transferred to the TSS. The Australian Government Actuary and Telstra's actuary are currently examining the extent of that surplus, but it is expected to be around \$1.1 billion.

If this payment is made to the TSS in the form of a lump sum, the contingent liability for the 'Telstra Corporation Ltd — Superannuation Guarantee' identified under the Communications and Arts portfolio may be offset.

Immigration and Multicultural Affairs

Adult Migrant English Program — teacher redundancy costs

This liability has been removed from the Statement of Risks as the Commonwealth has since extinguished its liability with the States covering claims for teacher redundancy costs. There are no outstanding claims against the Commonwealth.

Industry, Science and Tourism

Australian Industry Development Corporation (AIDC)

As at 1 August 1998, AIDC contingent liabilities have decreased to \$206.5 million in respect of guarantees and credit risk facilities. The Corporation's other guaranteed borrowings, which totalled \$2,234 million as at 24 September 1997, have been offset by holdings in Commonwealth Government securities and certain hedging instruments guaranteed by UBS Australia.

Export Finance and Insurance Corporation (EFIC)

The Commonwealth guarantees the due payment by EFIC of money that is, or may at any time become, payable by EFIC to any person other than the Commonwealth. As at 31 July 1998, the contingent liability totalled \$7,480 million, comprising contracts of insurance and guarantees (\$3,728 million), balance sheet liabilities (\$891 million), and national interest provisions (\$2,861 million).

Primary Industries and Energy

Snowy Mountains Hydro-electric Authority (SMHEA)

The *Snowy Mountains Hydro-electric Power Act 1949* provides that borrowings by SMHEA may be guaranteed by the Commonwealth. The Authority has issued inscribed stock at a discount to finance capital works of the Scheme. The borrowings are subject to explicit Commonwealth guarantees. Following a scheduled repayment of \$22 million on 15 September 1998, the face value of guaranteed borrowings will be \$190.5 million with the net amount guaranteed (excluding the unamortised discount on the issue of inscribed stock) becoming \$101.4 million.

Wool International

Under section 53(7) of the *Wool International Act 1993*, the Commonwealth underwrites borrowings of Wool International for the management of the wool stockpile. The contingent liability for borrowings by Wool International totalled \$272 million as at 30 June 1998. Sources of borrowings include domestic and overseas commercial lenders.

Australian Wheat Board (AWB)

Under the *Wheat Marketing Act 1989*, the Commonwealth underwrites borrowings by the AWB that fund advance and related payments from the wheat pool up to a maximum of \$2,731 million as at 1 June 1998. Borrowings are repaid as the wheat pool is sold. The percentage underwritten by the Commonwealth is set at 85 per cent of the estimated aggregate net return on the wheat pool. The Commonwealth's responsibility for the underwriting of borrowings ceases after the 1998-99 season's pools are finalised.

There is also an additional borrowing guarantee for a total principal of \$20 million for the AWB, which allowed for the payout of equity in the 1990-91 pools to assist growers who were in financial difficulties at the time following a fall in international wheat prices.

Queensland Fish Management Authority

The Commonwealth guaranteed a loan up to a maximum of \$40.9 million to encourage the restructuring of the Northern Prawn Fishery. As at 1 September 1998, the amount outstanding on the loan is \$5.1 million, which is to be paid off within three years. The loan was taken out by the Queensland Fisheries Management Authority on behalf of the Commonwealth to buy back surplus boat units from the fishery with repayment to be made by the industry through levies.

Social Security

Commonwealth Loan Guarantees — Student Financial Supplement Scheme

Contingent liabilities of \$1,188 million were reported under this item in the 1998-99 Budget against the Employment, Education, Training and Youth Affairs portfolio. This amount included some \$1,042 million relating to the Youth Allowance and Austudy Payment elements of the Scheme, for which responsibility was transferred to the Department of Social Security on 1 July 1998.

The other liabilities concern the ABSTUDY element of the scheme, which remains the responsibility of the Department of Employment, Education, Training and Youth Affairs (see separate entry under Employment, Education, Training and Youth Affairs).

As at 1 July 1998, the value of outstanding loan guarantees related to Youth Allowance and Austudy had increased to \$1.1 billion.

Treasury

Reserve Bank of Australia (RBA) guarantee

This contingent liability relates to the Commonwealth's guarantee of the liabilities of the RBA. The major component of RBA liabilities relates to Notes (ie currency) on Issue. This treatment of Notes largely relates to the historical convention of the convertibility of Notes to gold — coins are not treated as a liability in the Commonwealth's accounts. At 26 August 1998, Notes on Issue totalled \$22,088 million.

The other major liability consists of deposits with the RBA by the banking sector. At 26 August 1998, these deposits amounted to \$6,688 million. In total, the guarantee for the RBA was \$32,196 million as at 26 August 1998.

Uncalled Capital Subscriptions — international financial institutions

The liability relates to the value of the uncalled portion of the Commonwealth's shares in the International Bank for Reconstruction and Development (\$US2,769.5 million — estimated value \$A4,875.9 million at 31 August 1998), the Asian Development Bank (\$US2,477.5 million — estimated value \$A4,361.8 million), and the European Bank for Reconstruction and Development (\$US81.7 million — estimated value \$A143.8 million).

Tasmanian Debt Retirement

The Commonwealth has made an offer of a \$150 million financial assistance package to Tasmania for the retirement of debt. The Commonwealth's offer was conditional on the privatisation of the State's Hydro-electric Corporation. This offer has yet to be accepted.

Contingent Liabilities — Unquantifiable

Defence

HMAS Melbourne compensation

The recent decision in the Mewett case which went against the Commonwealth may be used by up to 900 crewmen of HMAS Melbourne, in relation to the Voyager incident, to lodge claims against the Commonwealth. There is no basis for quantifying potential claims (95 have been lodged to date).

Defence indemnities

The Commonwealth has created indemnities, for loss and damage, for a number of:

- port authorities in Australia caused by Royal Australian Navy vessels whilst in, or entering, port;
- individuals and entities in Australia caused by Defence forces whilst on work experience, training exercises or recruitment drives;
- entities in Australia caused by various displays undertaken by Defence forces; and
- companies in Australia and overseas caused by disputes over, or termination of contracts.

These indemnities have a range of expiry dates and are unquantifiable.

Finance and Administration

Macquarie Bank — valuation of DASFLEET

Macquarie Fleet Leasing Pty Ltd, as purchaser of DASFLEET, have disputed the valuation methodology adopted by the Commonwealth in the Completion Asset and Liability Statement in relation to the Non-CPA vehicle fleet. This matter is subject to arbitration.

Sale of ADI Limited

An indemnity was provided to ADI Limited on 20 August 1998 dealing with the payment of any insurance excess under a Directors' and Officers' insurance policy. The Commonwealth has agreed to be responsible for the payment of the amount of any excess in respect of any claim under the policy where ADI Limited is unable to pay the excess post-sale. The indemnity is ongoing.

Robina/Australian Law Reform Commission (ALRC) employees

Notice of potential claims under the Commonwealth Funds Management (CFM) share sale agreement has been received from the Commonwealth Bank in relation to an action brought against CFM (among others) as successor to the former Superannuation Fund Investment Trust by certain employees of the Australian Law Reform Commission in respect of their superannuation entitlements. The Commonwealth has exercised its right to take over the defence of the action. The financial effect of this claim cannot be quantified at this stage.

ANL Limited

ANL Limited has executed contracts to sell ANL's liner shipping business to Compagnie Generale Maritime, and the bulk shipping business to AUSCAN Self-Unloaders Pty Ltd. On completion of the sale there will be contingent liabilities covering warranties, indemnities and employment matters. The total estimated value of these is not able to be determined until completion. The time period and value of the contingency is limited by the terms of the contract.

Certain guarantees of ANL's financing will continue post-sale.

The ANL board has been provided with a letter of comfort covering the liabilities under the sale contracts.

Transport and Regional Development

Civil Aviation Safety Authority (CASA) — indemnity in relation to the Authority's safety regulatory functions

Under a Deed of Agreement, CASA was indemnified against the claims incurred in carrying out its responsibilities for aviation safety regulation. This indemnity was subject to an annual renewal on payment of an annual premium by CASA to the Commonwealth. This indemnity expired on 5 July 1998 and CASA has replaced this arrangement with commercial insurance. The Commonwealth is obliged to continue to

indemnify CASA in relation to liabilities associated with acts or omissions which occurred before the date of expiry of the Deed of Agreement.

Civil Aviation Safety Authority (CASA) — indemnity to officers of the Authority administering the carrier's liability insurance requirements

An indemnity has been given to those officers of CASA who administer the carrier's liability insurance requirements under Part IVA of the *Civil Aviation (Carrier's Liability) Act 1959* and complementary State legislation. This indemnity is to be revoked shortly as CASA has obtained commercial insurance covering the risks specified in the indemnity. The indemnity will still apply in relation to liabilities associated with acts or omissions that occurred before the date of revocation.

Tripartite Deed relating to the sale of Core Regulated Airports

Previously the Tripartite Deed related to the sale of Phase 1 Airports. As from 30 June 1998 Phase 1 Airports are referred to as Core Regulated Airports.

The Tripartite Deeds between the Commonwealth of Australia, airport lessees and lessees' financiers provide for the Commonwealth to 'step-in' as airport operator in defined circumstances. The potential liability of the Commonwealth in the event varies considerably with the specific factors leading to such an action.

If the Commonwealth entered into possession of an airport site it could seek to recover its costs from a number of sources, including airport revenues.

Wind-up of Federal Airports Corporation

An indemnity was provided on 30 June 1998 to directors of the Federal Airports Corporation whereby the Commonwealth has agreed to inject equity into the Corporation in the event that the Corporation has inadequate cash reserves to meet debts as they become due and payable. The indemnity is ongoing.

Transfer of former Federal Airports Corporation contingent liabilities to the Commonwealth

As part of the wind-up of the Federal Airports Corporation (FAC), the Commonwealth assumed responsibility on 1 July 1998 for a contingent liability of the Corporation which relates to debtors of the FAC who are challenging the validity of network charges made under the *Federal Airports Corporation Act 1986*. If the network charging approach is found to be invalid, this raises the prospect of further claims from other airport users who have previously paid network based charges to the Corporation. There is no basis for quantifying potential claims.

Workplace Relations and Small Business

Maritime Industry Finance Company Ltd (MIFCo) — board members' indemnity

Indemnities for MIFCo board members have been provided to protect against civil claims relating to employment and conduct as directors of MIFCo. These indemnities are unquantifiable and no expiry date has been set.

Litigation by Maritime Union of Australia

Litigation has been instituted by the Maritime Union of Australia claiming unspecified damages against Patrick Stevedores and others, including the Commonwealth. The Commonwealth has denied liability for the claim. A deed for the settlement of that litigation, subject to fulfilment of certain conditions, has been executed. The proposed settlement does not involve payment of any damages or costs by the Commonwealth. At the date of preparation of this entry, the process to complete the settlement is well advanced. The risk faced by the Commonwealth, if the litigation were to proceed and be successful, is not quantifiable at this stage.

Maritime Industry Finance Company Ltd (MIFCo) — loan guarantee

The Commonwealth has guaranteed repayments of a loan taken out by MIFCo for the purpose of making redundancy related payments arising from the reform of the stevedoring industry.

The *Stevedoring Levy (Collection) Act 1998* provides for payments to be made by the Commonwealth to MIFCo to enable it to meet its loan repayment obligations.

ANL Limited

The Commonwealth has undertaken to continue its guarantee of ANL's major lease facilities following the sale of the Liner Shipping and Bulk Trades businesses of the company. Steps are being taken to put in place a back-to-back guarantee arrangement with a financial institution that would shift the risk of any claim against the guarantee from the Commonwealth to that institution.

Possible increased workers' compensation costs to the Commonwealth

In December 1997, the NSW Court of Appeal found that Commonwealth employees, who were previously considered to be covered solely by the provisions of the *Safety, Rehabilitation and Compensation Act 1988*, could choose to claim compensation under State workers' compensation legislation (the case is *Telstra Corporation v Worthing & Anor*).

On 19 May 1998 the High Court granted special leave for the Commonwealth to appeal. A hearing date has not yet been set. If the Court of Appeal's decision is not overturned, there is some risk of Commonwealth exposure to financial liability under State workers' compensation legislation.

APPENDIX C: SENSITIVITY OF FISCAL AGGREGATES TO ECONOMIC DEVELOPMENTS

Table C1 provides a guide to the sensitivity of the forward estimates of outlays and revenue to variations in economic parameters in 1998-99. It is important to recognise that such guides provide only a 'rule of thumb' indication of the impact on the budget of changes in prices, wages and other parameters.

Table C1: Sensitivity of Fiscal Aggregates to Changes in Economic Parameters

	1998-99 \$m	1999-00 \$m	2000-01 \$m	2001-02 \$m
<i>Outlays</i>				
Prices	220	520	580*	640*
Wages	70	300	340*	350*
Unemployment benefit recipients	210	280	280	280
Safety Net Adjustment	0	80	160	240
<i>Revenue</i>				
Average earnings	980	1060	1140*	1230*
Employment	650	700	750*	810*
Company income	20	240	200*	210*
Other individuals income	0	140	110*	110*
Consumption	260	280	290*	300*
CPI	10	130	140*	140*
Imports	40	50	50*	50*

* Estimates can be expected to be affected by — but do not allow for — the impact of the tax reform package. See text below.

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

- prices — all price deflators are assumed to increase by one percentage point at the start of the December quarter 1998, with wage deflators left unchanged;
- wages — wage and salary levels are assumed to increase by one percentage point from the beginning of the December quarter 1998, with price deflators left unchanged;
- unemployment benefit recipients (includes Newstart Allowance and unemployed Youth Allowance recipients) — the total number of recipients is assumed to increase by five per cent from the beginning of the December quarter 1998; and
- Safety Net Adjustment (SNA) — the SNA determined by the Australian Industrial Relations Commission (AIRC) is assumed to be \$2 per week higher than estimated in each year from the commencement of the 1998-99 financial year.

Projected outlays respond to changes in economic parameters through a variety of mechanisms. For example, the decision to maintain pensions at 25 per cent of Male Total Average Weekly Earnings (MTAWE) means that projected spending on pensions will depend on changes to the CPI and the level of the MTAWE and the interaction between these two parameters. This interaction will also be affected by measures in the

Government's tax reform package to increase pensions by 4 per cent and ensure they are 1.5 per cent higher than if automatic indexation arrangements applied. In addition, about \$26 billion per annum of underlying outlays are indexed to weighted averages of movements in underlying inflation and the SNA determined by the AIRC.

The number of unemployment benefit recipients, and therefore the total spending on benefits, are affected by economic growth and employment growth. However, the relationship between GDP growth and unemployment benefit recipients is highly variable and difficult to quantify. For this reason, Table C1 only includes the impact of changes in the number of unemployment benefit recipients (ie Newstart Allowance and unemployed Youth Allowance recipients) on the estimates.

On the revenue side, the figures show the estimated impact of a one percentage point change in a range of economic variables in 1998-99 as a whole. The CPI is assumed to increase by one third of one percentage point at the start of each of the last three quarters of 1998-99.

Differences in impact over the years reflect:

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

The impact of the tax reform package on the sensitivity analysis has not been presented. However, the overall impact is not expected to be significant because of the offsetting nature of changes in many of the individual components of the tax reform package.

APPENDIX D: COMMONWEALTH GENERAL GOVERNMENT SECTOR

This appendix provides budget and forward estimates for the Commonwealth general government underlying balance and its major components. A description of the Commonwealth general government sector and its relationship to the budget sector can be found in Appendix E to Statement 2 of 1998-99 Budget Paper No. 1.

The Commonwealth general government sector comprises Commonwealth government units whose principal role is to provide non-market services. This includes the Commonwealth budget sector and those Commonwealth non-budget agencies that provide mainly non-market services, such as the ABC and CSIRO.

Table D1 presents the estimates of the underlying balance (and its revenue and outlays components) for the Commonwealth general government sector on the same basis as the budget sector estimates provided elsewhere in the PEFO.

Table D1: Summary of General Government Aggregates

	1998-99	1999-00	2000-01	2001-02
	Estimate	Projection	Projection	Projection
Revenue (\$m)	145308	152192	143470	153464
<i>Per cent of GDP</i>	25.3	25.0	22.2	22.4
Underlying Outlays (\$m)	142835	148639	139482	143037
<i>Per cent of GDP</i>	24.9	24.4	21.6	20.9
Underlying Balance (\$m)	2473	3553	3988	10427
<i>Per cent of GDP</i>	0.4	0.6	0.6	1.5
<i>Memorandum items:</i>				
Net Advances (\$m)	-5293	-12811	-30075	-7119
Headline Balance (\$m)	7766	16364	34063	17546
<i>Per cent of GDP</i>	1.4	2.7	5.3	2.6

The Commonwealth general government sector underlying balance is expected to be in surplus throughout the period 1998-99 to 2001-02. Developments in the budget sector are the major factor behind movements in the general government sector.