

Attachment C

SENSITIVITY OF THE FISCAL BALANCE TO ECONOMIC DEVELOPMENTS

A guide to the sensitivity of the forward estimates of expenses and revenue (in terms of their impact on the fiscal balance) due to variations in economic parameters in 2004-05 is provided in Table 10. It is important to note that the sensitivity analysis gives only a 'rule of thumb' indication of the impact on the budget of changes in prices, wages and other parameters. In each case, the analysis presents the estimated effects of a change in one economic variable only, and does not attempt to capture the linkages between economic variables that characterise changes in the economy more broadly.

Table 10: Sensitivity of the fiscal balance to changes in economic parameters

	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m
Expenses				
Prices	930	560	870	900
Wages	0	310	410	420
Unemployment benefit recipients	130	270	270	280
Safety net adjustments	0	90	180	270
Revenue				
Prices	10	100	110	110
Wages	720	1,550	1,660	1,780
Employment	480	1,040	1,120	1,200
Private final demand	140	280	280	290
Profit	100	340	360	390

EXPENSES

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

Prices

All price deflator growth rates are assumed to change by one percentage point in the March quarter 2005 and to remain unchanged subsequently, with all wage and salary growth rates left unchanged through the Budget and forward years.

- The effect of a change in prices is due to the indexation of Australian Government expenses and a large one-off impact on superannuation liabilities in 2004-05 (which in turn impacts on the superannuation interest expense).

Wages

All wage and salary growth rates are assumed to change by one percentage point in the March quarter 2005 and to remain unchanged subsequently, with all price deflator growth rates left unchanged through the Budget and forward years.

- The effect of a change in wage and salary growth rates is largely due to the Government's commitment to maintain selected pensions at a minimum of 25 per cent of Male Total Average Weekly Earnings. The wages effect in Table 10 above does not include changes to wage and salary payments in Australian Government departmental expenses.

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

The total number of recipients is assumed to change by 2.5 per cent in the Budget year and by 5 per cent in all the forward years.

Safety Net Adjustment

The Safety Net Adjustment determined by the Australian Industrial Relations Commission is assumed to change by \$2 per week in 2005-06 and the following years.

- About \$47 billion of expenses in 2004-05, comprising agency departmental expenses, other Australian Government Own Purpose Expenses and Specific Purpose Payments to the States of a departmental expense nature, are indexed to weighted averages of movements in the Consumer Price Index and the Safety Net Adjustment.

REVENUE

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

Prices

All price deflators are assumed to change by one percentage point at the start of the March 2005 quarter, with wage deflators left unchanged.

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

Wages

All wage and salary growth rates are assumed to change by one percentage point from the beginning of the March 2005 quarter, with price deflators left unchanged.

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

Employment

The level of employment is assumed to change by one percentage point from the beginning of the March 2005 quarter, with no change in the composition of employment.

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

Private final demand

The level of private final demand (consumption plus investment) is assumed to change by one percentage point from the beginning of the March 2005 quarter, with no change in the composition of demand.

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

Profits

The level of company profits is assumed to change by one percentage point from the beginning of the March 2005 quarter.

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