Submission No: 25-1

Australian Government

Department of Finance and Deregulation

Dr Ian Watt AO
Secretary

Our Ref: SEC0000092

Mr Russell Chafer
Committee Secretary
Joint Committee of Public Accounts and Audit
Department of the House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

Dear Mr Chafer

Further to my appearance before the Joint Committee of Public Accounts and Audit's hearing of 19 September 2008, I undertook to provide further information relating to the Budget Rules. Please find attached an extract of the Budget Process Operational Rules, which contains the rules relating to genuine savings and offsets and the definition of new policy proposals, including minor new policy proposals.

The Government provides guidance to agencies annually relating to the provision of offsets for their spending proposals. Final decisions as to whether agencies must provide offsets for particular spending proposals are ultimately made by the Cabinet.

If requested by the Government, offsetting proposals brought forward by Ministers can be drawn from anywhere within their portfolios. The Budget Rules do not require such offsets to be brought forward from the agency proposing the new policy proposal.

Yours sincerely

I J Watt
8 October 2008

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CONSIDERATION AND DEVELOPMENT OF NEW POLICY PROPOSALS

All NPPs must be considered by the Expenditure Review Committee Prior to Consideration of the Cabinet unless the Prime Minister agrees otherwise

- In the Budget process, the Finance Minister, in consultation with relevant Ministers, will consider expense, capital and non-tax revenue minor NPPs. The Finance Minister's decisions will be put to ERC for endorsement.

Definition of NPPs

- NPPs are classified as major or minor NPPs. Minor NPPs are proposals with a financial impact of $10 million or less in each of the Budget and forward years. Major NPPs are those with a financial impact of more than $10 million in one or more of the Budget and forward years.

- NPPs are any proposals that require a Government decision and that:

    - have certain or potential financial impact (including on the fiscal balance, underlying cash balance, operating balance, headline cash balance, net debt or net worth) on existing estimates within the forward estimates period or beyond; or

    - have changes in expenses offset by changes in other expenses or user charges (revenue); or

    - create a legal, financial, contingent or other commitment for the Commonwealth; or

    - change the intent of a previous new policy decision or position, including proposals that are fully offset, and proposals involving movements between or within outcomes.

- Individual Internally Funded Investments are NPPs if:

    - they are greater than $10 million in one or more of the Budget and forward years (regardless of whether they are replacement assets); or

    - they are a change to an approved internally funded investment where that change is greater than $10 million in one or more of the Budget and forward years; or

    - they are proposals to purchase new (rather than replacement) assets.

        - A new asset, for this purpose, is one that creates new, or changes existing, policy, for example by expanding existing service capacity.

- Examples of NPPs include expense and revenue proposals; capital expenditure proposals financed via equity injections, loans or that are internally funded;

reallocation of funds within and between outcomes which change the intent of previous Government decisions; extensions of lapsing and terminating measures other than those considered under the Movement of Funds between years provision.

NPPs can also include guarantees, loans, indemnities or other forms of assurance; entering treaties or agreements, on behalf of the Commonwealth, that are not within the powers normally exercised by an agency Board or Chief Executive or not previously approved by Ministers or Cabinet.

- For expenditure and non-tax revenue related issues, Finance will form a judgment as to what constitutes a NPP. For taxation revenue related issues, the Treasury will form a judgment as to what constitutes a NPP.

<u>NPPs outside the Budget process must be Offset by Genuine Savings</u>

- All NPPs (including new tax expenditures) submitted outside the Budget process must be offset by Genuine Savings, unless otherwise agreed by the Prime Minister or the Cabinet, and the Treasurer in the case of tax revenue proposals.

- If Genuine Savings are not provided the Minister must explain, in writing to the Prime Minister, why savings have not been provided. If Cabinet or the Prime Minister has requested that the proposal be brought forward and savings offsets are not provided, the Minister must explain in the Cabinet Submission why savings have not been provided.

<u>Definition of Genuine Savings</u>

- Genuine Savings require either:
    - a Cabinet decision to alter existing policy; or
    - a discretionary reordering of priorities by a Minister; and

- reduce expenses from any source or net capital investment below what they would otherwise have been.

- Examples of Savings which are **not** genuine are at Appendix 1.

- Savings from the discontinuation of a lapsing measure are considered genuine offsets, unless indicated otherwise in the decision taken to discontinue the measure.

- Proceeds from the sale of real property will not automatically be available to offset NPPs.

- Genuine Savings proposals that have been previously rejected by the Expenditure Review Committee (ERC), the Cabinet or by the Prime Minister as being unsuitable cannot be brought forward again to be used to offset the cost of any NPPs, except with the prior approval of the Prime Minister.

APPENDIX 1

NON-GENUINE SAVINGS

The following specific types of reductions are not considered Genuine Savings.

1. *General revenue increases:* Tying general revenue increases (from specified revenue streams) to additional expenses is undesirable as it reduces budgetary flexibility and distorts resource allocation between competing outcomes. Nevertheless, Cabinet may be prepared to accept revenue measures involving specific portfolio fees and regulatory charges as genuine offsets.

2. *Fortuitous underspends:* A fortuitous underspend is one that will occur, or has already occurred, regardless of any consideration by Cabinet or a decision/action taken by the Minister or portfolio.

3. *Deferral of existing expenses:* Resourcing proposals that simply defer existing expenses to later in the forward estimates period (with no advantage to the Budget) make no contribution to medium term fiscal targets. Accordingly, these are not considered genuine savings.

4. *Senate consideration:* Reductions requiring changes in legislation, which have previously been rejected by the Senate and are unlikely to be agreed if reintroduced, or savings proposals that are unlikely to be agreed, are not considered genuine.

5. *Second round effects*: Individual costings will not incorporate second round economic effects because of the difficulties inherent in quantifying such effects. The focus of costings will be on first round effects (which may include direct behavioural responses) and the direct budgetary consequences of policies. Where second round effects are identifiable, these should be detailed in the Cabinet submission.

6. *Public Debt Interest:* Public Debt Interest savings resulting from changes in Budget outcomes are beyond the control of portfolio ministers and are not, therefore, considered genuine.

   6.1 However, there are two circumstances where costings should include estimates of these effects. Firstly, where a proposal has the explicit policy objective of affecting the level of interest payments and secondly where the proposal involves transactions of financial assets (such as loan schemes). Public Debt Interest costings should assume no change to the debt management strategy.

7. *Administrative reductions arising from improvements in program management:* Ministers and portfolios have an ongoing responsibility to use existing resources to achieve the best outcomes and deliver outputs effectively without seeking supplementation from the Budget for activities already within their charter.

8. *Return or use of excess cash reserves:* The return or use of excess cash reserves by agencies cannot be used to offset NPPs. In particular, the use of cash reserves still impacts on the cash and fiscal balances.

9. *Savings beyond the forward estimates period:* Any savings beyond the forward estimates period are not considered genuine savings to offset new policy from within the forward estimates period.