

Part 2:

Report on performance

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INTRODUCTION

The report on performance covers Treasury's administered items and departmental outputs for 2005-06.

The administered items are revenues, expenses, assets or liabilities managed by agencies on behalf of the Australian Government. Administered expenses include subsidies, grants and benefits. Departmental outputs are the goods and services the department provides for, and on behalf of, the Government.

Treasury reorganised its outcomes from three to four in 2005-06, to align its outcome reporting structure with the organisational structure. Changes to outcomes and outputs are detailed in the Outcome Overview sections of this report. Treasury's new outcome and output structure is reflected in Figure 1: Treasury's portfolio outcome chart, and Figure 2: Treasury's outcome and output structure chart in Part 1 of this report.

Performance outcomes are reported against the performance information published in the Treasury section of the *2005-06 Portfolio Budget Statements*.

OUTCOME 1: SOUND MACROECONOMIC ENVIRONMENT

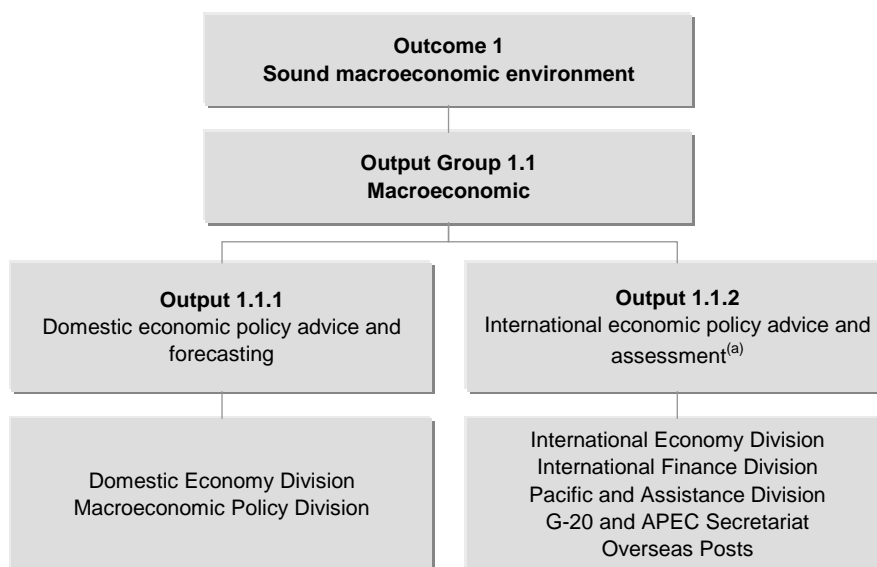
Treasury aims to contribute to a sound macroeconomic environment by monitoring and assessing economic conditions and prospects, both in Australia and overseas, and by providing advice on the formulation and implementation of effective macroeconomic policy, including monetary and fiscal policy.

Treasury also provides advice on advancing Australia's interests at international forums and institutions such as the Group of Twenty (G-20), the International Monetary Fund (IMF), the World Bank and the Asian Development Bank (ADB), and the Asia-Pacific Economic Cooperation (APEC) process. Australia is contributing significantly to international efforts to sustain international economic stability and growth through these forums.

During 2005-06, Treasury provided strategic advice and assessments on a range of macroeconomic issues, supported by in-depth analysis of domestic and international economic developments. Its forecasts helped shape budget estimates and policy formulation. Treasury provided strategic advice on international economic policy issues, underpinning sustained growth, openness and sound governance in the global economy. Treasury also played a key role in advancing Australia's interests through international financial institutions and forums and bilaterally with a range of countries, particularly within the Pacific region.

Feedback from Treasury portfolio ministers indicated these outputs effectively contributed to their needs in influencing and formulating policy aimed at achieving a sound macroeconomic environment.

Figure 4: Outputs contributing to Outcome 1



(a) Treasury's overseas posts are a whole-of-department resource but are allocated to this output for reporting purposes.

KEY PRIORITIES IN 2005-06

Treasury's *2005-06 Portfolio Budget Statements* and internal planning processes identified the following key priorities for Outcome 1:

- examining domestic and international developments affecting the Australian economy and forecasting the direction of the Australian and international economies;
- assisting in identifying policies likely to improve Australia's economic growth potential and wellbeing, including improved understanding of the impact of changes in workforce participation and productivity on future growth and fiscal pressures;
- influencing international policy outcomes in favour of growth enhancement and poverty reduction, open trade and investment regimes, and market-oriented public policy based on rule of law and strong institutions through:
 - strengthening, effectively using and directly participating in international forums (including the IMF, World Bank, Organisation for Economic Co-operation and Development (OECD), ADB, G-20, APEC, Pacific Islands Forum Economic Ministers' Meeting and the East Asia Summit);
 - playing a lead role in the Government's initiatives to improve economic governance in the Pacific, particularly in Papua New Guinea (PNG), Solomon Islands and Nauru;

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- engaging directly with key counterparts in East Asia to strengthen relationships, build capacity and participate in policy dialogue; and
- providing technical assistance in the Asia-Pacific region.

KEY OUTCOMES IN 2005-06

- The G-20 and APEC Secretariat continued preparations for Australia to host the G-20 meetings in November 2006 and the APEC meetings in March 2007.
 - For the G-20, this included further development of the policy agenda and logistics arrangements, as well as the organisation of policy analysis workshops that support the discussions of the deputies, ministers and governors of the G-20.
 - Treasury commenced preparations to host APEC in 2007.
- In the Asia-Pacific region, Treasury continued to advance its engagement with key Asian economies through policy dialogue, cooperation and institution building.
 - Under the auspices of the Government Partnerships Fund, a partnership programme of capacity-building activities was developed with the Indonesian Ministry of Finance. As part of the programme, a senior Treasury official will be deployed to Indonesia on a long-term basis.
 - Treasury officials attended and participated in a range of conferences addressing economic and policy issues, received delegations for policy discussions and made regular visits to the region in 2005-06.
- Economic forecasts assisted the Government with policy formulation.
- Briefings were prepared for the Treasurer on economic statistics released by the Australian Bureau of Statistics (ABS) and the private sector, including advice on their implications for the economic outlook.
- The Treasurer regularly received advice from Treasury on global economic developments and emerging international risks.
- Published material included economic forecasts and analysis in budget papers, four issues of the *Economic Roundup* and working papers and speeches to better inform the public about economic developments and issues.
 - The *Economic Roundup* examined the external sector, including mineral commodity exports, Australia's current account deficit and the terms of trade, as well as Australia's productivity trends and fiscal sustainability.

Outcome 1: Sound macroeconomic environment

- For the 2006-07 Budget, Statement 4 of Budget Paper No. 1, *Australia in the World Economy*, focused on the increasing economic importance of China and India and the resulting implications for Australia.
- Treasury continued to help the Government take an active role in international forums and institutions to influence outcomes supportive of sustained international economic stability, growth and development.
 - Australia helped to lead the debate around reforming the governance of the IMF.
 - Australia continued to engage with the IMF, World Bank, European Bank for Reconstruction and Development and ADB on strategic, governance and effectiveness issues.
- Treasury provided policy advice and skilled staff to assist countries experiencing economic challenges, including PNG, Solomon Islands and Nauru.

Table 2: Financial and staffing resources summary for Outcome 1

	Budget 2006 \$'000	Actual 2006 \$'000	Budget 2007 \$'000
Administered expenses			
Appropriation Acts No. 1 and 3	-	-	-
Appropriation Acts No. 2 and 4	-	-	-
Special Appropriations	24,867	28,498	31,647
Other expenses	-	-	-
Total administered expenses	24,867	28,498	31,647
Revenue from government			
Output Group 1.1 Macroeconomic			
Output 1.1.1 Domestic economic policy advice and forecasting	8,473	8,473	8,397
Output 1.1.2 International economic policy advice and assessment	24,012	24,012	27,695
Total revenue from government contributing to the price of departmental outputs	32,485	32,485	36,092
Revenue from other sources			
Output Group 1.1 Macroeconomic			
Output 1.1.1 Domestic economic policy advice and forecasting	158	197	135
Output 1.1.2 International economic policy advice and assessment	4,652	3,580	4,392
Total revenue from other sources	4,810	3,777	4,527
Total revenue for departmental outputs (Total revenues from government and other sources)	37,295	36,262	40,619
Price of departmental outputs			
Output Group 1.1 Macroeconomic			
Output 1.1.1 Domestic economic policy advice and forecasting	8,631	8,141	8,532
Output 1.1.2 International economic policy advice and assessment	28,664	23,427	32,087
Total price of departmental outputs	37,295	31,568	40,619
Total estimated resourcing for Outcome 1 (Total price of outputs and administered expenses)	62,162	60,066	72,266
Average staff levels (number)	201	183	213

Notes: This resource table is presented in the four outcome structure effective from the 2006-07 Budget in May 2006. The Budget for administered expenses for 2006 is as per the *2005-06 Portfolio Additional Estimates Statements*. Actuals from 2005-06 have been realigned for comparative purposes to the 2006-07 Budget. The Budget for departmental price of outputs for 2006 and administered expenses and departmental price of outputs for 2007 is as per the *2006-07 Portfolio Budget Statements*.

OUTPUT 1.1.1: DOMESTIC ECONOMIC POLICY ADVICE AND FORECASTING

Domestic Economy Division and Macroeconomic Policy Division in Macroeconomic Group are responsible for the delivery of Output 1.1.1, domestic economic policy advice and forecasting.

Treasury contributes to Outcome 1 by monitoring and assessing economic conditions and prospects, and by providing advice on formulating and implementing effective macroeconomic policy, including monetary and fiscal policy.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice on economic policy and the economic outlook meets Treasury portfolio ministers' needs in administering their responsibilities and implementing government decisions that contribute to a sound domestic economy; and
- effective presentation of budget documents and other publications adequately informs public debate.

ANALYSIS OF PERFORMANCE

Policy advice and inputs into policy processes

During 2005-06, Treasury advised the Treasurer and other members of the Government on a range of macroeconomic issues.

- Treasury analysed and provided briefings on economic statistics released by the ABS and the private sector. This included advice on implications for the economic outlook and analysis to assist the Treasurer in responding to the releases.
- As part of the Business Liaison Programme, Treasury officers discussed issues relating to business activity with organisations in major business centres and regional Australia. Summaries of the liaison findings appeared in the *Economic Roundup*.
- Treasury held discussions with visiting delegations from bodies such as the OECD and IMF, and briefed the Treasurer on the outcomes.

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- The Treasurer was provided with advice on fiscal policy and strategies as part of developing the 2006-07 Budget.
- In preparing advice to the Secretary as a Reserve Bank of Australia (RBA) Board member, Treasury monitored economic, financial and policy developments to assess their implications for policy settings.
- Treasury also provided advice on administrative arrangements for the RBA.
- Treasury made a submission to the House of Representatives Standing Committee conducting a public inquiry into current and future directions of Australia's service industries.
- Similarly, Treasury made a submission to the House of Representatives Standing Committee inquiring into the outlook for Australia's manufactured exports.
- Treasury advised the Treasurer on the evolution and drivers of the Australian economy and factors likely to influence medium-term performance.

Economic forecasts

Economic forecasts inform policy settings and underpin the calculation of budget estimates of expenditure and revenue. For policy formulation purposes, macroeconomic forecasts provide an understanding of the broad developments within the economy and the balance of risks surrounding the economic outlook.

Forecasting activity focused on 2005-06 and 2006-07, with forecasts published in the *Mid-Year Economic and Fiscal Outlook 2005-06* and the 2006-07 Budget. These forecasts helped develop policy that contributed to the solid performance of the Australian economy. In 2005-06, particular attention was paid to analysing movements in commodity prices, including oil prices, and their implications for economic growth.

Treasury's forecast for economic growth in 2005-06 was revised down from 3 per cent in the 2005-06 Budget to 2½ per cent in the 2006-07 Budget. This reflected slower export growth, a moderation in household consumption in response to higher than expected petrol prices and a more pronounced slowing in dwelling investment. These factors were partially offset by stronger business investment.

Treasury prepared forecasts with contributions from the Joint Economic Forecasting Group, which comprises Treasury (chair), the RBA, the Department of the Prime Minister and Cabinet, the Department of Finance and Administration and the ABS. These contributions, together with information gained from liaison with the private sector and other departments, helped improve the quality of the forecasts. Forecasts from Treasury's macroeconomic model of the Australian economy contributed to the forecasting process, and sensitivity analyses using the model were used to improve policy advice.

Contributions to public awareness and debate

Important contributions to public awareness and debate were delivered to a wide audience including international forums, foreign government agencies, state government agencies, tertiary institutions and the Australian public. Treasury economic publications and selected presentations are available from www.treasury.gov.au.

Published economic forecasts, such as those contained in the *Mid-Year Economic and Fiscal Outlook 2005-06*, were accompanied by an update on the economic outlook to help inform the public of key developments in the domestic and international economies and the likely effects on economic growth in the short term. A comprehensive report on the domestic and international outlook, focused on 2006-07, was provided in Statement 3 of Budget Paper No. 1, *Economic Outlook*.

Statement 1 of Budget Paper No. 1, *Fiscal Strategy and Budget Priorities*, discussed the medium-term approach to fiscal policy, establishment of the Future Fund and the public debt position.

Statement 4 of Budget Paper No. 1, *Australia in the World Economy*, focused on the increasing economic importance of China and India and the resulting implications for Australia. In particular, the increased demand for resources by China and other economies has contributed to a huge rise in Australia's terms of trade. Compared with previous episodes, the Australian economy has adjusted well to the current terms of trade boom. The smoother adjustment partly reflects the benefits of a floating exchange rate, an independent monetary policy regime and competitive labour and product markets. Statement 4 also examined the continuing process of globalisation, population ageing and Australia's possible exposure to adverse external shocks, such as terrorism, pandemics and threats to energy security.

In addition, the non-technical discussion in the *Budget Overview* made major policy developments and forecasts widely accessible.

Media and market commentary enhanced public awareness about the Australian economy's current performance, outlook and risks to the outlook.

Treasury's *Economic Roundup* analysed key issues underpinning Australia's recent economic performance. Reflecting current interest in the external sector, articles covered mineral commodity exports, Australia's current account deficit and the terms of trade. In addressing another current theme, the Summer 2006 *Economic Roundup* contained articles on Australia's productivity trends, fiscal sustainability and pre-funding strategies in OECD countries, health promotion, innovation across OECD countries, recent developments in Australian bond yields and issues around the measurement of happiness and wellbeing in OECD countries. *Economic Roundup* includes contributions from all groups within Treasury. For example, the Winter *Economic Roundup* included articles analysing Australia's tax system.

Treasury's working paper series covered issues such as the evolution of fiscal policy in Australia, macroeconomic effects of an influenza pandemic, competitiveness of Australia's

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economy and importance of geographic isolation in explaining the difference between productivity levels in Australia and the United States.

Treasury also distributed quarterly updates of its macroeconomic model of the Australian economy and associated database. The model has evolved to reflect structural changes in the economy.

Bilateral meetings with a range of external delegations were held and advice was provided on forecasting methodology and economic policy development.

Treasury provided training to the economic forecasting sections of the Bank of Thailand and the Indonesian Ministry of Finance.

The Secretary and other senior Treasury officials spoke on the short-term macroeconomic outlook, fiscal and monetary policy, the medium-term fiscal strategy and longer-term challenges. Particular issues addressed included Australia's terms of trade and current account deficit. The speeches were to organisations such as the Australian Business Economists, the Australian Industry Group's Economy 2006 Forum, the Leading Australia's Future in the Asia-Pacific programme, and the Cape York Institute. These speeches are available on the Treasury website.

Reviews of economic data

Treasury liaised extensively with the ABS, both informally through regular discussion at all levels and formally through ongoing representation on the Australian Statistics Advisory Council and the Economic Statistics User Group.

OUTPUT 1.1.2: INTERNATIONAL ECONOMIC POLICY ADVICE AND ASSESSMENT

International Economy Division, International Finance Division, Pacific and Assistance Division and the G-20 and APEC Secretariat in Macroeconomic Group are responsible for delivery of Output 1.1.2: International economic policy advice and assessment.

Macroeconomic Group contributes to Outcome 1 by providing strategic advice to government ministers on the global and regional economic outlook, Australia's economic engagement with East Asia, the global economic architecture including the international financial institutions, and development prospects and governance challenges facing Pacific economies. The group participates directly in various international forums, and provides policy advice and support to ministers and senior Australian representatives at the international financial institutions. It also administers Australia's subscriptions to the international financial institutions.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing government decisions relating to international economic and financial issues;
- participation in international forums is effective and bilateral dialogue facilitates achievement of government objectives;
- effective hosting of G-20 meetings and associated workshops in 2006;
- preparations are made for the effective hosting of APEC meetings and associated workshops in 2007;
- advice on and direct support for improving economic governance and policies and building capacity in PNG, Solomon Islands and Nauru is effective;
- achievement of government objectives is facilitated in international forums, including strengthening the international financial system, progressing multilateral debt relief and achieving institutional reform in the multilateral development banks; and
- timely and accurate financial transactions with international financial institutions are made with due regard to minimising cost and risk for Australia.

ANALYSIS OF PERFORMANCE

Facilitation of government objectives in international forums

International Monetary Fund

In 2005-06, the IMF continued to work to promote macroeconomic and financial stability at the global and national levels. Australia continued to be actively engaged in this work, attending regular meetings of the International Monetary and Financial Committee Deputies and other forums, including the G-20. An important component of Australia's work as chair of the G-20 was to help lead the debate on reforming IMF governance.

The Managing Director released his report on the IMF's Medium-Term Strategy in September 2005, proposing a wide ranging reform agenda to help focus the work of the IMF and improve operational effectiveness. Australia has previously called for improved focus and effectiveness, and welcomed the report that proposes many reforms that Australia has advocated.

In June 2006, the Managing Director of the IMF visited Australia to meet with the Prime Minister, the Treasurer, the Minister for Foreign Affairs, the Shadow Treasurer, the Deputy Governor of the RBA, and other senior officials and representatives of the

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academic and business community. Treasury coordinated the visit, and also organised the IMF's annual Article IV consultations in June.

European Bank for Reconstruction and Development

In 2005-06, the European Bank for Reconstruction and Development (EBRD) completed its third Capital Resources Review, outlining priorities and direction over the forthcoming five years. The review confirmed a further shift in the EBRD's activities to the east and south, with members who recently joined the European Union graduating within five years, and closure of some resident offices in central Europe.

The Capital Resources Review was endorsed by the Board of Governors at the 2006 Annual Meeting, held in May in London. A statement on behalf of Australia and New Zealand was delivered at the Annual Meeting by the New Zealand High Commissioner. The statement focused on Australia and New Zealand's key priorities for the EBRD, largely the implementation of the Capital Resources Review and ensuring good governance.

World Bank

Australia continues to support the World Bank's objective of reducing global poverty. Australia worked to strengthen the World Bank's engagement in the Asia-Pacific region, emphasising the importance of a strong operational approach to address the development challenges confronted in small and fragile states. Australia also supported the World Bank's focus on anti-corruption and governance issues and improving the development effectiveness of aid flows.

In March 2006, the IMF and World Bank announced a review of collaboration between the institutions. The Executive Director of Revenue Group, Mike Callaghan, is a member of the External Review Committee which is scheduled to provide recommendations to IMF and World Bank management by the end of 2006.

Asian Development Bank

Australia contributed to the ADB's decision-making through representation on its Board of Directors and ministerial representation at the 2006 Annual Meeting in Hyderabad, India. At the meeting, the Minister for Revenue and Assistant Treasurer, the Hon Peter Dutton MP, welcomed President Kuroda's announcement that the ADB will review its long-term strategic framework, highlighted the need for greater assistance to fragile states and encouraged the focus on internal governance to strengthen development effectiveness. More generally, Australia continued to engage the bank on its long-term strategic direction. Australia supported the Medium-Term Strategy II and enhanced regional cooperation and integration strategy, as well as the focus on catalysing investment, improving governance and preventing corruption to help reduce poverty in the region.

Debt relief

Throughout 2005-06, Australia continued to support the provision of debt relief through the Heavily Indebted Poor Countries Initiative. This provides multilateral debt relief to the world's poorest and most heavily indebted countries, which have demonstrated commitment to reform. In 2005-06, Australia provided the World Bank with \$14.7 million for this initiative.

The Australian Government continued to provide a moratorium on scheduled debt repayments until the end of 2005 for governments of tsunami-affected countries. The moratorium was agreed by all Paris Club creditors in March 2005.

In May, the Australian Government signed the bilateral agreement with Iraq that put in place the legal arrangements to fulfill Australia's commitment, as a member of the Paris Club, to provide 80 per cent bilateral debt relief to Iraq.

In the 2006-07 Budget, the Treasurer announced that Australia had committed \$136 million to the World Bank for the Multilateral Debt Relief Initiative. Australia is one of only a handful of countries to have committed to an up-front payment to cover the first ten years of the World Bank's costs under this initiative.

Timely and accurate financial transactions

Management of international financial commitments

As part of its membership of the international financial institutions, Australia makes a significant financial commitment to support their operations.

Treasury manages most of Australia's financial relations with the IMF, along with its capital contributions to the World Bank Group (IBRD, MIGA and IFC), ADB and EBRD.

Australia did not enter into any new commitments on general capital increases for the institutions during 2005-06. During the year, Treasury did conduct routine financial transactions to manage existing obligations. These transactions were conducted in a timely and efficient manner and are summarised in Table 3.

Table 3: Financial transactions with the international financial institutions in 2005-06^(a)

	Nature of transaction	Number of transactions	Total \$'000
Receipts			
IMF Net Remuneration	Revenue	4	25,676
IMF Burden Sharing Refunds	Revenue	3	320
IMF Maintenance of value	Financing transaction	1	152,523
Payments			
IMF Special Drawing Rights allocation charges	Expense	4	26,629
IMF Poverty Reduction and Growth Facility	Financing transaction	1	2,500
EBRD Promissory note drawdown	Financing transaction	1	2,299

(a) Transactions are reported on a cash basis. There were no transactions relating to the IBRD, IFC, MIGA or ADB. Australia is a participant in the IMF's Financial Transactions Plan. Further information on these transfers is reported in Australia and the International Financial Institutions Annual Report to Parliament.

Organisation for Economic Co-operation and Development

Treasury officials participated in the work of OECD committees on macroeconomic and microeconomic policies, structural reform, forecasting, taxation, statistics, budget policy, consumer policy, competition policy, corporate governance, insurance and private pensions, financial markets, sustainable development and investment, and capital markets. Treasury was involved in developing Australia's position on the selection of a new OECD Secretary-General as well as on new governance arrangements.

David Pearl, General Manager, International Economy Division, attended the OECD's Ministerial Council Meeting in May 2006 and participated in discussions on the OECD's Economic Outlook and country experiences with structural reform.

Treasury convened the OECD-sponsored Global Forum on Harmful Taxation Melbourne in November 2005. The forum was opened by the Treasurer, and attracted representatives from over 50 OECD and non-OECD jurisdictions.

Treasury organised the OECD's mission to Australia in March 2006 to review the Australian economy. Treasury also participated actively in the review of member and non-member economies, contributing to best practice policy development and influencing other member countries on matters of significance to Australia.

Aid and development policy

Treasury contributed to policy formulation on key elements of Australia's aid programme and development policies. Treasury provided advice in the context of the Prime Minister's announcement on 13 September 2005 of the Government's goal to double overseas aid to about \$4 billion by 2010, conditional on strengthened governance and reduced corruption in recipient countries. Treasury also contributed significantly to the development of the Government's Aid White Paper, released by the Minister for Foreign

Affairs on 26 April 2006, which provides the strategic framework to guide the direction and delivery of Australia's overseas aid programme over the next ten years. Treasury is represented on the recently established Development Effectiveness Steering Committee which provides high level advice to the Government on aid effectiveness and priorities.

Relations with East Asia

Treasury has continued to advance its engagement with key Asian economies, particularly with Indonesia, Japan and China.

Treasury continued its engagement with Indonesia under the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD). In September 2005, the Treasurer visited Indonesia where he met with senior Indonesian Government officials and visited areas of Aceh devastated by the 2004 Boxing Day tsunami. The Treasurer sits on the AIPRD Joint Commission and Treasury's Secretary is one of the five agency heads on the AIPRD Secretaries' Committee. Treasury provides advice to the Secretaries' Committee on all aspects of the programme.

An important component of the AIPRD is the \$50 million Government Partnerships Fund (GPF), which seeks to promote government-to-government cooperation, focusing on exchanging skills, knowledge and expertise with key public sector institutions in Indonesia. Under the GPF, Treasury has established a programme of capacity-building activities with our Indonesian counterparts. As part of this programme, Treasury expects to deploy a senior official to Indonesia to provide direct policy development assistance.

During the year senior Treasury officials gave addresses on issues of importance to Australia and East Asia, including financial challenges and opportunities in the Asia-Pacific region for the 21st century, and Asian economic growth prospects and the impact on Australia. The Treasurer also delivered a number of speeches on similar topics, including international demographic and economic change, and what it means for Australia, and energy security in the Asia-Pacific region. The Treasurer also featured Asia in his speech to the Australian-American Leadership Dialogue Forum.

As part of the Government's commitment in the 2004-05 Budget to promote economic security in East Asia, Treasury officials participated in a number of regional conferences dealing with economic and policy issues of importance to the region.

Gordon de Brouwer, General Manager, G-20 and APEC Secretariat, visited Tokyo in October 2005 and participated in the Asian Development Bank Institute's Seventh Tokyo Round Table on Capital Market Reform in Asia. Roy Nixon, Manager, International Investment and Compliance Unit, visited South Korea in November 2005 to participate in the APEC Investment Opportunities Conference. Treasury provided financial support and sent participants to the Asia Economic Panel Meeting held in September 2005 in Sydney. Treasury also provided funding to support Professor Allan Fels' OECD Secretary-General campaign, which helped raise Asia's profile and promoted greater OECD engagement with the region.

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More generally, Treasury continued to receive delegations from the region for discussions of policy issues. Treasury hosted senior officials from the Japanese Ministry of Finance in August 2005, including the Vice Minister for International Affairs, Hiroshi Watanabe, for discussions on regional and global economic developments. Treasury facilitated the secondment of a Chinese Ministry of Finance official to the Victorian Department of Treasury and Finance under the auspices of the United Nations Development Programme. In November-December 2005, Treasury hosted three interns from the Indonesian Ministry of Finance under a World Bank programme. Treasury also helped establish the first AusAID-funded Joint Fiscal Policy Course for Chinese and Indonesian Government officials, held in March 2006. As part of the course, senior Treasury officials presented lectures on issues such as demographics and fiscal policy.

Canberra-based Treasury officials regularly visited the region in 2005-06. In addition, three Treasury officials remained posted to Beijing, Jakarta and Tokyo, to assist Treasury's understanding of conditions in regional economies. They continued to build closer contact with Treasury's counterparts in Japan, South Korea, China, Hong Kong, Chinese Taipei, Indonesia, Singapore, Malaysia, Thailand and the Philippines, and, as part of the team at the relevant embassies, helped enhance Australia's relations with the region.

Relations with Pacific economies

Treasury provides policy advice to Australian Government ministers and departments on economic and fiscal issues relating to the Pacific, particularly Solomon Islands, PNG and Nauru where Treasury officers have been deployed as part of whole-of-government approaches.

Pacific Islands Forum Economic Ministers' Meeting

The Treasurer attended the tenth annual Pacific Islands Forum Economic Ministers' Meeting in Honiara, Solomon Islands in July 2006. The meeting focused on the necessity to improve the environment for economic growth in the Pacific and the importance of stronger governance to deliver stability and improved living standards.

Policy advice

Economic reconstruction issues

Solomon Islands

The Financial Management Strengthening Program is part of the Regional Assistance Mission to the Solomon Islands to assist the Solomon Islands Government in developing fiscal policy by improving fiscal and financial management systems, strengthening tax administration, managing public debt and building the capacity of Solomon Islanders to perform these functions. Three Treasury officers were deployed to the programme, including one as the Under-Secretary of the Department of Finance and Treasury. Treasury officers assisted the Solomon Islands Government to use the budget process as a mechanism to articulate its priorities through accountable and transparent spending decisions. Treasury officers also supported the Solomon Islands Government's processes for renegotiating government debt.

In addition, three Treasury officers, deployed to the Economic Reform Unit within Solomon Islands Department of Finance and Treasury, continued to engage with government, donors and other stakeholders to identify opportunities for economic reform and facilitate its implementation. For example, Treasury officers in the Economic Reform Unit worked with the Solomon Islands Department of Commerce, Industries and Employment to coordinate technical assistance, public consultations and legislative drafting for the new Foreign Investment Act which came into effect on 26 June 2006; contributed to a discussion paper, *A Better Tax System for Solomon Islands*, launched on 13 December 2005; and provided advice on the Goods Tax and Import Duty Exemption Guidelines to help reduce corruption in the Solomon Islands tax system by establishing a more transparent, fair and accountable exemptions process.

Papua New Guinea

The Papua New Guinea-Australia Treasury Twinning Scheme provides for short-term reciprocal placements. In 2005-06, two Treasury officers were deployed to the PNG Treasury, one PNG Treasury officer was deployed to work in the Australian Treasury and two PNG Treasury officers were deployed to the Australian Department of Finance and Administration. One PNG Treasury officer is also studying at the Australian National University.

Treasury works closely with other agencies involved in the economic and public sector reform component of the Enhanced Cooperation Program. Treasury officers deployed to the PNG Treasury under the programme worked closely with the PNG Treasury Secretary and senior officers.

Deployed Treasury officers assisted their PNG counterparts to establish the framework for the 2006 and 2007 Budgets within the context of a sustainable medium-term fiscal strategy. They also provided significant assistance to the Public Sector Rightsizing Working Group, tasked to advise the PNG Government on realigning expenditures against priorities under the Medium-Term Development Strategy (such as primary

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education and health), and the Public Expenditure Review and Rationalisation Implementation Committee. Treasury officers also assisted the PNG Treasury on taxation policy, financing issues arising from the proposed PNG-Australia gas pipeline, and financial market regulation.

Nauru

As part of the Economic Advice and Governance Assistance Program, two Treasury officers are deployed to the Nauru Ministry of Finance, one as the Secretary of Finance. During 2005-06, these officers assisted with development of Nauru's 2006-07 Budget and provided advice on state-owned enterprise reform and financial sector reform. With the assistance of Treasury officers, in October 2005, Nauru was removed from the OECD's Financial Action Task Force Non-cooperative Countries or Territories list.

The Group of Twenty

The G-20 Finance Ministers' and Central Bank Governors' forum¹ brings together policymakers with the capacity and authority to shape the international economic and financial environment. The G-20's comparative advantage lies in its relatively small but diverse membership, representing a balance of advanced and developing country views.

Australia is host of the G-20 in 2006 and the Treasurer will chair its annual meeting in November in Melbourne. Throughout 2005-06, Treasury has been preparing for this meeting to deliver both policy and operational objectives.

The key agenda themes are reform of Bretton Woods institutions, global energy and minerals markets, demographic change, domestic economic policies and principles, and aid effectiveness.

The G-20 has had a mandate to review the Bretton Woods institutions from its inception in 1999. In 2006, the G-20 provided further focus to the reform agenda and helped sustain the momentum for reform, playing a key role in securing an agreement on IMF quota and governance reform at the IMF/World Bank Annual Meetings in Singapore in September 2006.

Australia introduced the theme of global energy and minerals markets for its 2006 host year. Discussion has focused on the broader effects of changing resource markets and the implications for economic growth and development. The G-20 is an ideal forum for such a discussion as it enjoys representation among the key resource producers and consumers.

G-20 dialogue on demographic change is focusing on the impact on economic growth, encompassing the capital market implications of ageing societies, alongside a continuing focus on labour mobility issues.

¹ G-20 members are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States. The European Union is represented by the Council presidency and the President of the European Central Bank. The Managing Director of the IMF and the President of the World Bank, plus the chairpersons of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate as ex officio members.

In its Accord for Sustained Growth (2004), the G-20 agreed on a set of domestic policy principles, including the importance of robust domestic institutions, good governance, sound structural policies and stable macroeconomic frameworks. In 2006, discussion has focused on the implementation of these principles.

Following donors' commitments in 2005 to significant increases in aid volumes, the G-20 has considered the effective use of aid.

Australia remains a member of the G-20 management, comprising the previous, current, and future chairs (China, Australia and South Africa). Treasury officials participated in deputies' meetings by video-conference in November and February, and attended meetings in March in Adelaide and in June in Alberta.

In 2005-06, Treasury established a Consultation Group with the Victorian Government to coordinate support for the delivery of the G-20 Finance Ministers' and Central Bank Governors' meeting across Federal and State jurisdictions. Treasury is also represented on a Security Working Group and sub-committees that address the national and state security issues associated with hosting a high-profile international meeting.

Treasury briefed the Treasurer throughout 2005-06 on the G-20 themes and logistics, as well as briefing delegations to two G-20 deputies' meetings, four G-20 workshops, and the 2005 G-20 Finance Ministers' and Central Bank Governors' meeting.

Treasury provided a background paper on Demographic Challenges and Migration for the G-20 deputies' meeting in September 2005 and a paper on Reform of Bretton Woods Institutions for both the G-20 deputies' meeting and the G-20 Ministers and Governors' meeting in 2005. In early 2006, Treasury papers on IMF quota reform and broader IMF and World Bank governance reform were provided to other G-20 members as background for the March G-20 deputies' meeting in Adelaide, before being released publicly.

G-20 members participate in specially convened workshops that provide analytic support to the policy discussions of the deputies and ministers and governors. Treasury officials represented Australia at the following G-20 workshops in 2005-06: Economic Growth, in August 2005 in Pretoria; Demographic Challenges and Migration, in August 2005 in Sydney; Reform of Bretton Woods institutions, in February 2006 in Tokyo; and Energy and Resources, in June 2006 in Alberta.

As part of Australia's host year responsibilities for the G-20, Treasury organised several G-20 meetings, involving venue management, contract negotiations, delegate liaison and event management. Treasury successfully delivered the Demographic Challenges and Migration Workshop, in August 2005 in Sydney; Roundtable on Global Savings and Investments Patterns and the Changing Structure of the World Economy, in March 2006 in Adelaide; and the G-20 Finance and Central Bank Deputies' meeting, also in March 2006 in Adelaide.

Part 2: Report on performance

Treasury prepared and began implementing an outreach strategy publicising Australia's chairing of the G-20 in 2006, Australia's role in the forum and the G-20's place in global economic governance. The Treasurer promoted the G-20 2006 agenda through a speech in Beijing after attending the G-20 2005 Ministers' and Governors' meeting and a piece published in the *China Daily* in October 2005.

Asia-Pacific Economic Cooperation

The Treasurer received policy advice and briefings for the twelfth APEC Finance Ministers' Meeting, in September 2005 in Jeju Island, Korea. The meeting focused on the progress by APEC economies towards freer and more stable capital flows and the challenges facing ageing economies.

Treasury conducted policy and capacity building initiatives within the APEC Finance Ministers' process. Treasury co-sponsored workshops in February 2006 (Fiscal Management I), April 2006 (Insolvency Reform), and June 2006 (APEC Future Economic Leaders' Think Tank). Treasury officials also participated in key discussions at the Finance Ministers' Technical Working Group in December 2005 and June 2006.

Treasury provided assistance to Vietnam's Ministry of Finance in hosting the APEC Finance Ministers' Meeting in 2006 and commenced preparations to host the APEC Finance Ministers' Meeting in 2007.

Treasury sought to re-engage with the Economic Committee given its new policy focus on structural reform mandated by the APEC Leaders' Agenda to Implement Structural Reform. Treasury officers attended meetings in September 2005 and February 2006.

The Investment Experts Group chaired by Treasury is pursuing a substantial work programme (in conjunction with OECD, United Nations Conference on Trade and Development and other international organisations) on investment liberalisation and facilitation in the region. Treasury officers attended five meetings in Japan, Korea and Vietnam during the year.

OUTCOME 2: EFFECTIVE GOVERNMENT SPENDING ARRANGEMENTS

Effective government spending arrangements are crucial to achieving the Government's economic objectives and improving the wellbeing of Australians. Ongoing advice provided by Treasury to the portfolio ministers assists in formulating, implementing and explaining government spending decisions.

Fiscal Group focuses on the core government activities of producing the Australian Government Budget and related updates; advising on debt management policy; reviewing the funding of other levels of government; and advising on core government services, such as social policy, health policy, labour market participation, industry and environment policy, and defence and national security policy. Policy advice includes attending to the need to address pressures from an ageing population by improving participation, productivity and fiscal sustainability.

During 2005-06, Treasury devoted significant resources to delivering services related to key budget products, administered payments to the States and Territories and to the development of the Council of Australian Government's (COAG) National Reform Agenda announced in February 2006.

By providing advice on welfare to work, education and training, immigration, health, water reform, climate change, defence and national security, and industrial relations reform, Treasury contributed significantly to policy development. Major contributions related to Government funding packages and/or measures announced in the 2006-07 Budget in relation to family assistance, child care, support for older Australians and carers, water infrastructure, illegal foreign fishing, venture capital industry initiatives, health and aged care, mental health care, education, strengthening indigenous communities, abolition of state taxes as agreed under the Intergovernmental Agreement, defence and national security.

ORGANISATIONAL CHANGES

To better align reporting against the organisation's current structure, Outcome 2: Effective Government Spending and Taxation Arrangements, which incorporated both Fiscal and Revenue Groups, was split in 2005-06 into:

- Outcome 2: Effective government spending arrangements (Fiscal Group), and
- Outcome 3: Effective taxation and retirement income arrangements (Revenue Group).

Part 2: Report on performance

Within Outcome 2, Output 2.1.3: Industry, environment and social policy advice was split into:

- Output 2.1.3: Industry, environment and defence policy advice which covers the Industry, Environment and Defence Division, and
- Output 2.1.4: Social and income support policy advice which covers the Social Policy Division.

Figure 5: Outputs contributing to Outcome 2



KEY PRIORITIES IN 2005-06

Policy advice from Fiscal Group covers a broad spectrum. Strategies to further enhance the Group's capabilities in policy advising include developing specialist expertise in policy design, further developing key partnerships with other participants in the policy process and focusing on the strategic assessment of emerging core issues. Key priorities in 2005-06 included:

- developing and advising on budget policies and government expenditure programmes, with a focus on programmes with significant economic or budgetary implications;
- providing advice on financial relations between the Australian Government and the States and Territories;
- developing policies relating to the Australian Government's debt portfolio and managing the portfolio;
- implementing the framework to support the establishment of the Future Fund;
- promoting policies to use resources efficiently and sustainably and improve the competitiveness and productivity of Australian industries, thereby promoting higher levels of sustainable economic growth;
- producing the *Final Budget Outcome 2004-05*, *Mid-Year Economic and Fiscal Outlook 2005-06* and, 2006-07 Budget;
- providing advice on issues such as defence and national security, infrastructure, energy, science and innovation, the environment and rural and regional policy;
- involvement in the development of the human capital elements of the National Reform Agenda;
- assisting with implementation of Welfare to Work; and
- assisting in developing policies in relation to mental health, the health workforce and the Australian Better Health Initiative.

KEY OUTCOMES IN 2005-06

Key achievements for Treasury during 2005-06 were:

- advising on the fiscal outlook and budget priorities consistent with the medium term fiscal strategy;
- initiating the review of the Commonwealth Grants Commission's methodology for distributing goods and services tax (GST) revenue, obtaining agreement from all States and Territories to abolish taxes under the Intergovernmental Agreement and making timely and accurate payments of GST revenue and other administered funds to the States;
- contributing to the harmonisation of Australian accounting standards with the Government Finance Statistics (GFS) framework;
- developing the governance framework and legislation for the Future Fund;
- advising the Government on venture capital, innovation, and industry policy issues, including venture capital initiatives announced in the 2006-07 Budget;
- continuing to be active in the areas of greenhouse, water infrastructure issues, including measures to enhance the infrastructure along the River Murray announced in the 2006-07 Budget, agricultural and natural resource management, and other environmental issues;
- with the Department of Finance and Administration, delivering the *Final Budget Outcome 2004-05* (September), the *Mid-Year Economic and Fiscal Outlook 2005-06* (December), and the 2006-07 Budget (May);
- advising on implementation of the Welfare to Work reform package which commenced on 1 July 2006;
- continuing to contribute to the development of immigration policy, especially skilled migration;
- contributing significantly to the development of education policy, particularly through the COAG initiatives to increase training and skills recognition and improve the quality of education;
- advising on measures to support Australian families announced in the 2006-07 Budget, including childcare places and child support arrangements;
- contributing to indigenous policy, including working with the Cape York Institute on developing a welfare reform trial;

Outcome 2: Effective government spending arrangements

- continuing work on the development of policy on a wide range of health issues, including with a longer term sustainability focus, in areas such as Medicare, the Pharmaceutical Benefits Scheme, Pharmacy Agreement, preventative health and mental health;
- advising on measures to build the capacity of the health workforce as part of the COAG reform agenda;
- advising on financial support arrangements for older Australians and carers;
- continuing to advise on industrial relation reforms;
- advising on defence expenditure, including the Defence Capability Plan; and
- continuing to provide advice on national security capabilities and on measures to manage the risks of illegal fishing.

Table 4: Financial and staffing resources summary for Outcome 2

	Budget 2006 \$'000	Actual 2006 \$'000	Budget 2007 \$'000
Administered expenses			
Appropriation Acts No. 1 and 3	-	-	-
Appropriation Acts No. 2 and 4	350,459	347,717	19,504
Special Appropriations	37,623,225	38,093,267	39,130,000
Other expenses	-	-	-
Total administered expenses	37,973,684	38,440,984	39,149,504
Revenue from government			
Output Group 2.1 Fiscal			
Output 2.1.1 Budget policy advice and coordination	4,484	4,484	3,789
Output 2.1.2 Commonwealth-State financial policy advice	2,752	2,752	2,874
Output 2.1.3 Industry, environment and social policy advice	3,954	3,954	4,134
Output 2.1.4 Social and income support policy advice	3,628	3,628	4,978
Total revenue from government contributing to the price of departmental outputs	14,818	14,818	15,775
Revenue from other sources			
Output Group 2.1 Fiscal			
Output 2.1.1 Budget policy advice and coordination	71	52	63
Output 2.1.2 Commonwealth-State financial policy advice	56	46	50
Output 2.1.3 Industry, environment and social policy advice	83	66	74
Output 2.1.4 Social and income support policy advice	74	62	83
Total revenue from other sources	284	226	270
Total revenue for departmental outputs (Total revenues from government and other sources)	15,102	15,044	16,045
Price of departmental outputs			
Output Group 2.1 Fiscal			
Output 2.1.1 Budget policy advice and coordination	4,555	3,372	3,852
Output 2.1.2 Commonwealth-State financial policy advice	2,808	3,103	2,924
Output 2.1.3 Industry, environment and social policy advice	4,037	4,092	4,208
Output 2.1.4 Social and income support policy advice	3,702	3,933	5,061
Total price of departmental outputs	15,102	14,500	16,045
Total estimated resourcing for Outcome 2 (Total price of outputs and administered expenses)	37,988,786	38,455,484	39,165,549
Average staff levels (number)	111	109	121

Notes: This resource table is presented in the four outcome structure effective from the 2006-07 Budget in May 2006. The Budget for administered expenses for 2006 is as per the *2005-06 Portfolio Additional Estimates Statements*. Actuals from 2005-06 have been realigned for comparative purposes to the 2006-07 Budget. The Budget for departmental price of outputs for 2006 and administered expenses and departmental price of outputs for 2007 is as per the *2006-07 Portfolio Budget Statements*.

OUTPUT 2.1.1: BUDGET POLICY ADVICE AND COORDINATION

Budget Policy Division in Fiscal Group and Tax Analysis Division in Revenue Group are responsible for the delivery of Output 2.1.1: Budget policy advice and coordination. Fiscal Group and Revenue Group contribute to Outcome 2 by providing advice to Treasury portfolio ministers on budget policy issues, current and prospective trends in Australian Government revenue and major fiscal aggregates, the fiscal framework and debt policy. In addition, Fiscal Group, with the Department of Finance and Administration, coordinates preparation of the Budget and related documents.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing government decisions as they relate to assessments of the budget position and outlook, and budget strategy and debt policy; and
- effective presentation of budget documents for which Treasury has responsibility and other publications to adequately inform public debate.

ANALYSIS OF PERFORMANCE

Advice on the budget outlook

During 2005-06, Treasury provided advice to the Treasurer and other portfolio ministers on the Australian Government's budget position to inform overall policy settings and provide the context for the Government's decision making. The fiscal outlook was updated in the Mid-Year Economic and Fiscal Outlook and the 2006-07 Budget.

As budget estimates are a joint responsibility, preparation of this advice required extensive liaison with the Department of Finance and Administration, the Australian Taxation Office (ATO) and other Australian Government departments and agencies. Assessments of the budget position incorporated changes to the economic outlook, so advice was based on the most reliable and up-to-date information available.

Final budget outcome for 2004-05

The *Final Budget Outcome 2004-05* was published in September 2005. In 2004-05, the Australian Government general government sector recorded an underlying cash surplus of \$13.6 billion, some \$4.4 billion higher than estimated at budget time, mainly due to lower than expected cash payments.

An accrual fiscal surplus of \$10.8 billion was recorded for 2004-05. This was \$3.8 billion higher than estimated at the time of the 2005-06 Budget, primarily reflecting higher than expected revenue in accrual terms.

Budget forecasts

The 2005-06 Budget, published in May 2005, contained forecasts of the fiscal outlook for 2005-06 and the following three years. The Mid-Year Economic and Fiscal Outlook (MYEFO), released by the Treasurer and Minister for Finance and Administration in December 2005, forecast an underlying cash surplus of \$11.5 billion for 2005-06, some \$2.5 billion more than at budget time. This largely reflected an increase of \$4.0 billion in receipts, partly offset by an increase of \$1.7 billion in expected payments.

The increase in estimated cash receipts followed higher than expected tax collections from individuals and companies, reflecting the continued strength in employment and company profits. The increase in expected payments was principally due to policy decisions taken following the 2005-06 Budget. In accrual terms, the 2005-06 fiscal balance was revised up \$3.0 billion to \$10.4 billion since the 2005-06 Budget.

The 2006-07 Budget, published in May 2006, revised up the estimated underlying cash surplus for 2005-06 by \$3.4 billion since the MYEFO to \$14.8 billion, largely reflecting the ongoing strength of company taxes. In accrual terms, the estimated fiscal surplus for 2005-06 was revised up by \$5.6 billion to \$16.0 billion.

Budget and financial frameworks policy advice

Treasury assisted the Government in implementing its fiscal strategy by managing budget processes and advising Treasury ministers on the overall budget strategy and priorities. Good budget processes help governments make decisions based on accurate information, allowing proposals to be prioritised according to the overall budget objectives.

Debt management policy

While the Australian Office of Financial Management (AOFM) is responsible for operational aspects of the management of the Australian Government debt portfolio, Treasury provides advice to the Treasurer on strategic debt policy issues and relevant wider public policy issues. This includes providing advice to the Treasurer on matters

where debt management issues carry implications for other arms of government policy or for the effective functioning of the real economy. Treasury also provides advice where broader macroeconomic developments or public policy considerations may affect debt management, and Treasury plays an important role in the governance structures for the management of the Australian Government debt portfolio.

During 2005-06, Treasury worked closely with the AOFM on implementing the debt issuance strategy, consistent with the outcomes of the 2003 review of the Australian Government Securities market. These issues are discussed further in the AOFM's Annual Report.

Future Fund

During 2005-06, Treasury took a lead role in developing the policy framework and governance arrangements for the Future Fund, and drafting the legislation. The Future Fund Management Agency was established on 3 April 2006, and the Future Fund Board was subsequently appointed.

An investment mandate was issued by the Government to give guidance on how the Board should invest the funds provided. An initial transfer of \$18 billion was made on 5 May 2006, with further contributions expected from future realised surpluses.

CONTRIBUTION TO PUBLIC DEBATE AND AWARENESS

Budget publications

The Government's budget publications are available free at www.budget.gov.au. Widespread access to these documents helps the public keep informed of budget decisions and the fiscal outlook.

Treasury and the Department of Finance and Administration jointly prepare the Government's budget documentation. Treasury also prepares accessible summaries for non-specialist readers. These were the general budget overview, an overview of *A Plan to Simplify and Streamline Superannuation*, a budget-at-a-glance and a budget highlights.

Generally, Treasury is primarily responsible for preparing budget documentation on:

- the principal budget aggregates and the Government's fiscal strategy and objectives;
- economic assumptions underpinning the budget estimates;
- taxation revenue estimates;
- taxation expenditure estimates; and
- the conduct of Commonwealth-State financial relations.

Part 2: Report on performance

The 2006-07 Budget documents also included a ministerial statement prepared by Treasury, *Continuing Tax Reform*, outlining reforms undertaken over the past 10 years and major tax reforms included in the Budget.

Reporting requirements are set out in the *Charter of Budget Honesty Act 1998* and are consistent with leading international practice. To help achieve better fiscal outcomes, the charter promotes:

- disciplined budget management, with fiscal policy based on principles of sound fiscal management;
- transparency, with regular reports stating fiscal objectives and expected outcomes;
- accountability, with information allowing an informed assessment of the conduct of fiscal policy; and
- reporting against external accounting standards.

Under the charter, budget reporting follows an annual cycle comprising the budget in May, a mid-year update around December and a final budget outcome in the following September. The charter also stipulates that an intergenerational report be produced on a five-yearly cycle.

The budget website at www.budget.gov.au was redesigned for the 2006-07 Budget. The new website presents information in a format that is more accessible to readers.

In 2005-06, Treasury met with representatives from countries including Korea, China, Cambodia and the Philippines, interested in learning about Australia's budgeting and reporting framework.

Tax Expenditures Statement

Treasury prepares the annual Tax Expenditures Statement to estimate the value of concessions, benefits and incentives delivered to taxpayers through the tax system. The *2005 Tax Expenditures Statement*, published in December 2005, reported on the cost of tax expenditures with estimates and projections to 2008-09. Production of this statement assists transparency and encourages public scrutiny of government programmes delivered through the tax system.

OUTPUT 2.1.2: COMMONWEALTH-STATE FINANCIAL POLICY ADVICE

Commonwealth-State Relations Division in Fiscal Group is responsible for the delivery of Output 2.1.2: Commonwealth-State financial policy advice.

Fiscal Group contributes to Outcome 2 by providing high quality advice on Commonwealth-State financial policy, including on the implementation of the *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations*, and on related State and Territory fiscal and taxation issues.

Fiscal Group also manages the efficient administration of payments to the States and Territories (the States), including GST revenue, Budget Balancing Assistance, compensation for GST revenue deferred, National Competition Policy Payments and Special Revenue Assistance.

PERFORMANCE INFORMATION

The key performance indicators are:

- payments to State and Territory governments are calculated accurately according to agreed formulae and paid according to agreed schedules;
- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing government decisions as they relate to Commonwealth-State financial relations; and
- effective presentation of relevant information, including in the budget documentation and other publications, adequately informs public debate.

ANALYSIS OF PERFORMANCE

Advice on reform of Commonwealth-State financial relations

This was the sixth full year of operation of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*. Treasury provided advice to the Treasurer on various aspects of the agreement, particularly issues such as calculation of the Guaranteed Minimum Amount and the abolition of state taxes listed in the Intergovernmental Agreement.

Ministerial Council for Commonwealth-State Financial Relations

The Ministerial Council, comprising the Australian Treasurer and all State and Territory Treasurers, oversees the implementation and operation of the Intergovernmental Agreement. Treasury coordinates the agenda for the Ministerial Council. At the seventh Annual Meeting of the Ministerial Council in March 2006, Treasurers discussed the Australian Government's proposal for the elimination of inefficient state taxes and progress on the review of horizontal fiscal equalisation methodology. Other matters discussed included expected payments to the States, GST administration issues and other policy and administrative matters, including specific purpose payments. Treasury advised the Treasurer on the key issues.

The Australian Loan Council traditionally meets in March to consider each jurisdiction's expected borrowing for the next financial year. Treasury advised the Treasurer on the key issues and coordinated arrangements for this meeting, which was held in conjunction with the Ministerial Council meeting.

Heads of Treasuries

The Heads of Treasuries meetings are a forum to share information on issues common to the Treasuries of the Australian, State and Territory governments. The Treasury Secretary and his State and Territory counterparts met three times to focus on issues arising under the Intergovernmental Agreement, economic conditions, demographics and longer-term fiscal issues, taxation and financial issues and specific purpose payments.

GST Administration Sub-committee

The GST Administration Sub-committee assists the Ministerial Council in monitoring the operation and administration of the GST. Treasury chairs the sub-committee, which comprises officials from the Australian Treasury, the ATO and State and Territory Treasuries. The sub-committee met three times and advised on proposals to modify the GST base and the ATO's administration of the GST. The sub-committee monitored the operation of the GST Administration Performance Agreement between the States and the ATO. The sub-committee discussed GST revenue receipts and payments, GST implementation and administrative issues.

Review of state taxes

Treasury provided policy advice to the Treasurer on issues relating to the Ministerial Council's review of the need to retain the State and Territory stamp duties listed under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*. In 2006, the Australian Government agreed with the States on a schedule to abolish all but one of these taxes listed for review.

Information for the public

Treasury contributed to the Australian Government's provision of information, in particular, by facilitating the preparation of television and newspaper announcements to the public on Australian Government payments to the States.

International relations

In 2005-06, Treasury continued to participate in the Organisation for Economic Co-operation and Development's (OECD) Network on Fiscal Relations across Levels of Government, and presented to visiting overseas delegations on funding arrangements between the Australian Government and the States.

Payments to the States

Treasury administers a number of payments to the States, including payments under the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*. A total of \$38.1 billion was paid to the States under the Act in 2005-06 comprising GST revenue and National Competition Policy Payments. In addition, compensation payments of \$127 million for GST revenue deferred were made in 2005-06.

Goods and Services Tax Revenue

Under a key element of *The New Tax System*, introduced on 1 July 2000, the States receive all GST revenue. GST revenue is the largest payment made by the Australian Government to the States. The Australian Government provides all GST revenue in monthly payments, consistent with relativities determined by the Treasurer following recommendations by the Commonwealth Grants Commission and discussion at the Ministerial Council meeting. In 2005-06, the States received around \$37.2 billion in GST revenue. All payments were calculated correctly and paid on the scheduled dates.

The ATO collects GST revenue on behalf of the States, and the States compensate the Australian Government for the costs the ATO and the Australian Customs Service incur in administering and collecting GST. Estimated costs incurred in 2005-06 amounted to around \$604 million. Treasury monitored the payments made by the States to ensure all were accurately administered.

Small business annual payment and lodgment of GST — compensating the States and Territories for GST deferred

In the 2004-05 Budget, the Government committed to compensate fully the States for the revenue impact of annual reporting and payment by taxpayers who voluntarily register for GST. Consistent with this commitment, Treasury paid around \$127 million to the States as compensation in 2005-06.

Budget Balancing Assistance

The Australian Government guaranteed that, in the transitional years of tax reform, each State and Territory's budgetary position would be no worse than had the reforms to Commonwealth-State financial relations not been implemented. Treasury provides advice to the Treasurer on how much funding each State and Territory would have received under the previous system to enable the Treasurer to determine the Guaranteed Minimum Amount.

To meet its guarantee, the Australian Government pays Budget Balancing Assistance to cover any shortfall of GST revenue compared with each State and Territory's Guaranteed Minimum Amount. In 2005-06, each State and Territory's GST revenue entitlement exceeded its determined Guaranteed Minimum Amount, so no State required this assistance.

Consistent with the terms of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, the Australian Government advanced Budget Balancing Assistance of \$74.6 million to New South Wales during 2005-06. These advances were based on the Budget Balancing Assistance entitlement of New South Wales estimated at the time of each advance. However, the subsequent upward revision to GST estimates resulted in no Budget Balancing Assistance entitlement for New South Wales.

Consistent with provisions of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*, Treasury will deduct the amount of excess Budget Balancing Assistance of \$74.6 million paid to New South Wales in 2005-06 from payments made in 2006-07.

Residual adjustments

The Australian Government introduced residual adjustments in 2004 to ensure that all States receive their appropriate payments under the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* as they move off or onto Budget Balancing Assistance. The Act stipulates the Australian Government and the States must agree on the methodology for calculation of the adjustments before payments can be made. This was agreed; consequently Treasury gave effect to residual adjustments totaling \$95.2 million to the States in 2005-06.

National Competition Policy Payments

Each State and Territory's receipt of National Competition Policy Payments is subject to its satisfactorily meeting conditions specified in the *Agreement to Implement the National Competition Policy and Related Reforms*. The National Competition Council (NCC) assesses whether each State and Territory has met the conditions and recommends associated penalties, and the States have the opportunity to comment. In 2005-06, for the first time,

the Australian Government also considered recommendations from the National Water Commission in relation to each State's and Territory's progress on water reform.

The Government, after considering recommendations from both the NCC and the National Water Commission, decided that out of a maximum level of payments in 2005-06 of \$799.9 million, it would apply permanent deductions of \$40.7 million and suspensions of \$43.2 million to the States. The Government also decided to reimburse \$100.5 million of amounts suspended from the States in 2004-05. Consistent with this decision, National Competition Policy Payments of \$816.5 million were made to the States in 2005-06. In relation to the 2005-06 suspensions for water reform, the National Water Commission has indicated it will, in 2007, assess jurisdictions progress relevant to the suspensions.

Budget publications

Information on the Government's financial relations with State, Territory and local governments is documented in Budget Paper No. 3, *Federal Financial Relations 2006-07*. This document is the main public source of information on Australian Government payments to the States and local governments. It also informs the States of their expected payments in the upcoming financial year, including GST revenue and specific purpose payments.

This paper also includes information on fiscal developments in the States, as well as any policy changes affecting the relationship between the Australian and State and Territory governments.

OUTPUT 2.1.3: INDUSTRY, ENVIRONMENT AND DEFENCE POLICY ADVICE

Industry, Environment and Defence Division (IEDD) in Fiscal Group is responsible for the delivery of Output 2.1.3: Industry, environment and defence policy advice.

IEDD contributes to Outcome 2 by working with other departments and agencies to develop and provide policy advice to Treasury ministers and the Government in the areas of industry, regional assistance, agriculture, environment, defence and national security. While other departments have major responsibility for policy and programmes in these areas, IEDD focuses on improving productivity, competitiveness, and sustainable economic growth, taking account of fiscal policy objectives and broader issues relating to wellbeing.

During 2005-06, Treasury participated in a wide range of policy development processes, worked with other agencies to develop policy, provided coordination comments on policy for the consideration of Cabinet ministers, and briefed the Treasurer for his participation in Cabinet and the budget processes.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing government decisions as they relate to industry, environment and defence policy; and
- effective presentation of relevant information to adequately inform public debate.

ANALYSIS OF PERFORMANCE

Environment and agriculture policy

Treasury provided advice to the Treasurer on environmental and agricultural issues including water reform, climate change, fisheries, alternative fuels, low emission technologies, quarantine and drought policy.

Particular examples of the provision of Treasury advice include assistance for the Great Barrier Reef Marine Park and for the Murray-Darling Basin Commission. In addition, Treasury provided advice on Australia's *Securing our Fishing Future* package which was announced in the *Mid-Year Economic and Fiscal Outlook 2005-06* and the *Securing borders against illegal foreign fishing* package in the 2006-07 Budget.

Treasury contributed to a number of inter-departmental committees during 2005-06. This included membership of the Biofuels Taskforce and providing advice on the report and its implementation process. Treasury was also involved in the development work associated with the COAG Climate Change Group and the National Water Initiative, as well as providing advice to inform debate in the Secretaries' Group on Greenhouse.

Treasury contributed to public awareness and debate to gain wider support for ideas on water policy through the Summer 2006 *Economic Roundup* article *Water and Australia's future economic growth*. In addition, Treasury's submission to the Agriculture and Food Policy Reference Group was also printed in the Spring 2005 *Economic Roundup*.

Industry policy

Treasury provided advice on industry assistance, including export assistance, tariffs, customs operations, and innovation as well as advice on regional assistance.

In particular, Treasury provided advice on the venture capital review and measures to stimulate Australia's venture capital industry, including the introduction of the early stage venture capital limited partnership investment vehicle, improving the venture capital limited partnership regime, and continuation of the Innovation Investment Fund.

Treasury also provided advice on export assistance, participating in committees which reviewed the Export Finance and Insurance Corporation and the Export Market Development Grants scheme.

Additionally, Treasury provided advice on regional policy including the regional partnerships programme and participated in an inter-departmental committee on the revised support arrangements for natural disaster relief and recovery.

Treasury participated in a number of other inter-departmental committee meetings, bringing a broad whole of economy perspective. This included committees considering Australia's energy security position, innovation and Australian Government support for films.

National security policy

Treasury provided advice on a range of defence and national security issues, including on long-term funding guidance for Defence, a revised Defence Capability Plan and a Defence strategic update. Ensuring that defence related expenditures remained fiscally sustainable in the long run was the focus of that advice.

Treasury also provided advice on domestic security arrangements, including the Wheeler report into airport security and policing, other aviation and maritime security issues, and additional resources for the Australian Security Intelligence Organisation. Advice was also provided on some non-security related aspects of the Attorney-General's portfolio.

Treasury has continued to participate in the Secretaries' Committee on National Security that examines and advises on proposals going to the National Security Committee of Cabinet. It is also a member of the Defence Procurement Advisory Board, as well as participating in inter-departmental committee processes concerning Defence Capability Plan projects, Defence funding, Defence estate and various aspects of domestic security arrangements.

OUTPUT 2.1.4: SOCIAL AND INCOME SUPPORT POLICY ADVICE

Social Policy Division in Fiscal Group is responsible for the delivery of Output 2.1.4: Social and income support policy advice.

Fiscal Group contributes to Outcome 2 by working with other departments and agencies to develop and provide policy advice to Treasury ministers and the Government in the areas of social, labour market, and health policy. While other departments have major responsibility for policy and programmes in these areas, Fiscal Group focuses on improving participation, productivity and economic sustainability and competitiveness, taking account of fiscal policy objectives and broader issues relating to wellbeing.

Part 2: Report on performance

During 2005-06, Treasury participated in a wide range of policy development processes, worked with other agencies to develop policy, provided coordination comments on policy for the consideration of Cabinet ministers, and briefed the Treasurer for his participation in Cabinet and the budget processes.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and assisting in implementing government decisions as they relate to social policy, labour market and health policy issues; and
- effective presentation of relevant information adequately informs public debate.

ANALYSIS OF PERFORMANCE

Advice on labour market policy

During 2005-06, Treasury provided advice on the development of workplace relations reforms, with the Government's WorkChoices measures taking effect in March 2006 and an Independent Contractors Bill introduced to the Parliament in June 2006. Treasury also contributed to implementation of the WorkChoices reforms, particularly through involvement in developing the Australian Government's submission to the first minimum wage review by the Australian Fair Pay Commission and arrangements to promote further award rationalisation.

Treasury continued its focus on policies designed to remove barriers to participation in the workforce. This included assisting in the implementation of the Welfare to Work reforms announced in the 2005-06 Budget, providing advice on improving Indigenous wellbeing through economic development and reforms to the Community Development Employment Projects Programme, and advising on developing more effective systems of delivery for social and health-related services.

Treasury also contributed to a number of conferences on comparative labour market performance and policies, including the OECD's reassessment of its Jobs Strategy.

Development of labour market data is ongoing and Treasury is a member of the steering committees for the Melbourne Institute Poverty and Disadvantage project, the Household, Income and Labour Dynamics in Australia survey, Labour Statistics Advisory Group of the Australian Bureau of Statistics (ABS) and the National Ageing Statistics Unit of the ABS.

Advice on health policy

Policy development processes spanned a range of health and aged care issues. Treasury advised the Treasurer on Medicare, the Pharmaceutical Benefits Scheme, private health insurance, community care and residential aged care. Engagement in these areas assisted the Treasurer's involvement in several significant Government initiatives during the year.

Treasury participated in interdepartmental committees that provided advice to Government, including influenza pandemic, consideration of electronic claiming of Medicare benefits, and the effectiveness of the Pharmaceutical Benefits Scheme. Treasury was also involved in the development of a number of COAG initiatives, including the Australian Better Health Initiative, mental health reforms and strengthening the health workforce.

Advice on social policy

Treasury made a substantial contribution to the development of the COAG National Reform Agenda. With respect to the human capital aspects of that Agenda, Treasury provided advice on potential participation and productivity gains, with a focus on the four areas identified as priorities: early childhood development, child care, literacy and numeracy, and diabetes.

During 2005-06 Treasury significantly increased its involvement in indigenous policy issues. Treasury worked with other agencies to identify priorities and address disadvantage and contributed to the development of the Cape York Welfare Reform Pilot.

In the context of the 2006-07 Budget, Treasury provided advice to the Treasurer on a range of measures with respect to families and child care, including uncapping outside school hours care and family day care places to increase the supply of child care places.

Treasury contributed to a number of processes focused on organisational and cultural change within the Department of Immigration and Multicultural Affairs following the report by Mr Mick Palmer AO APM. Treasury provided advice on both the scope and costs of the substantial reforms announced by the Government in response to the Palmer Report.

Treasury provided policy advice on a number of education measures to underpin a national approach to supporting skills being progressed through the COAG. This included programmes to encourage skills development, flexible pathways into skilled occupations and movement of trade qualified people throughout Australia.

OUTCOME 3: EFFECTIVE TAXATION AND RETIREMENT INCOME ARRANGEMENTS

Effective taxation and retirement income arrangements are crucial to achieving the Government's economic objectives and improving the wellbeing of Australians.

Revenue Group has the primary responsibility within the Australian Public Service for providing high-quality advice to the Treasury ministers on taxation and retirement income policies and legislation. Advice is formulated through an integrated process, beginning with design and costing, and including consultation with business and community interests and close cooperation with the Australian Taxation Office (ATO) and relevant Commonwealth departments. The contribution to better tax policy and better tax law are key elements of Treasury's role as a central policy agency.

During 2005-06, Treasury devoted significant resources to tax and retirement income reform, including establishing the Participation Modelling Project, reporting on the International Comparison of Australia's Taxes, hosting the Organisation for Economic Co-operation and Development (OECD) Global Forum on Taxation, identifying inoperative provisions which will cut tax legislation by more than 4,000 pages, and implementing fuel tax reform measures.

A longer term focus to develop a sustainable and effective superannuation system by simplifying superannuation was announced in the 2006-07 Budget. The proposals in *A Plan to Simplify and Streamline Superannuation* will simplify superannuation for retirees making it easier to understand, and improve incentives to work and save. Major personal tax changes and family tax benefit changes as well as business tax changes were also announced in the budget.

Revenue Group has primary responsibility for advising on, designing and bringing to Parliament all taxation and retirement income legislation. In all, 20 taxation and superannuation bills, containing 73 measures, were introduced into Parliament.

Treasury continued to consult extensively with industry and other stakeholders on taxation and superannuation measures. Consultation processes were evaluated and Treasury made available on the Treasury website three reports on consultation on announced tax measures. These reports were also provided to the Board of Taxation to assist in its role of monitoring consultation processes.

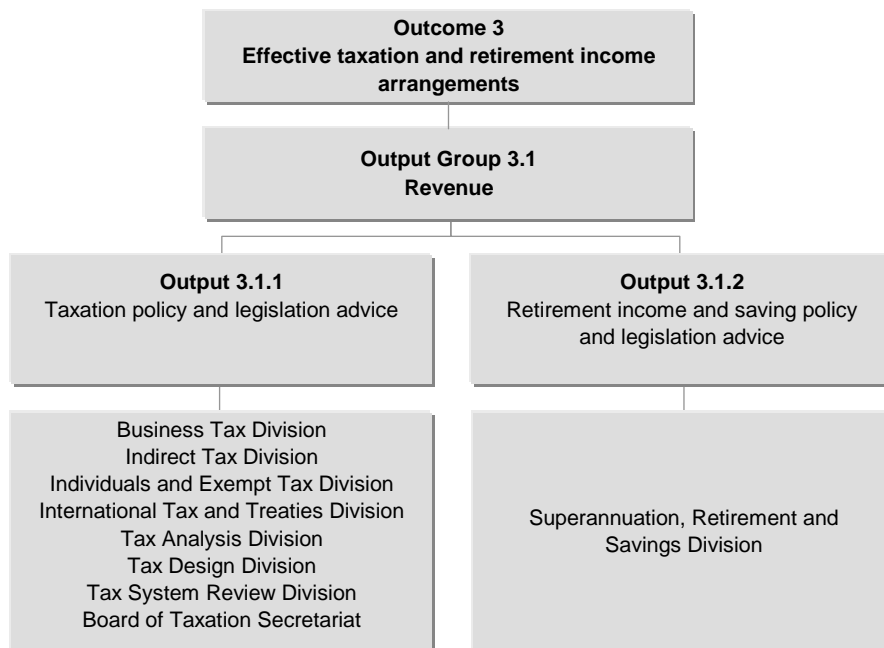
ORGANISATIONAL CHANGES

To better align reporting against the current organisational structure of the department in 2005-06, Outcome 2 was split into:

- Outcome 2: Effective government spending arrangements (Fiscal Group); and
- Outcome 3: Effective taxation and retirement income arrangements (Revenue Group).

The new Outcome 3 has two new output groups, Output 3.1.1: Taxation policy and legislation advice, and Output 3.1.2: Retirement income and saving policy and legislation advice.

Figure 6: Outputs contributing to Outcome 3



KEY PRIORITIES IN 2005-06

Treasury contributes to Outcome 3 by providing high quality advice on taxation and retirement income policies and legislation. Advice is formulated through an integrated process, including consultation with business and community interests.

Part 2: Report on performance

Treasury's 2005-06 *Portfolio Budget Statements* and internal planning processes identified the following key priorities for 2005-06:

- commencing development of quantitative modeling to identify the labour force participation effects of government policy proposals, including tax and income support changes;
- implementing decisions arising from the Australian Government's Review of the System of Self Assessment for Income Tax Returns;
- improving processes and outputs in developing advice on taxation and superannuation policies (including consultation processes and design of legislation);
- implementing the business fuel tax credits and the first phase of the fuel excise reforms as announced in the white paper, *Securing Australia's Energy Future*;
- advancing measures relating to the taxation of financial arrangements, the definition of charities, penalties for tax scheme promoters, taxation treatment of business 'blackhole' expenditures, foreign resident withholding tax and a substantial programme of other tax legislation;
- developing the child care tax rebate and introducing five new deductible gift recipient categories;
- improving preparation of costings and quantitative analysis of taxation, income support and retirement incomes policy proposals, as well as revenue forecasting;
- implementing additional measures arising from the review of international taxation arrangements;
- hosting the OECD Global Forum on Taxation and continuing with the negotiation of international tax treaties;
- implementing a range of superannuation measures, as well as monitoring the implementation of the choice of fund initiative; and
- identifying inoperative provisions in tax legislation.

Other key priorities identified through the year were:

- launching by the Treasurer of a major study to examine how Australia's tax system compares with other developed economies. The study was led by Mr Richard Warburton AO and Mr Peter Hendy and supported by a small secretariat within Treasury; and
- commencing development of superannuation reform proposals.

KEY OUTCOMES IN 2005-06

- Provision of the secretariat to report on the *International Comparison of Australia's Taxes*.
- Advice to the Government on *A Plan to Simplify and Streamline Superannuation*, which was announced in the 2006-07 Budget. Treasury coordinated extensive public and industry consultation on the proposals and continues to develop legislation to implement these proposals.
- Commencement of development of quantitative modeling to identify the labour force participation effects of government policy proposals, including getting the Melbourne Institute Tax and Transfer Simulator behavioural microsimulation model operational in Treasury.
- Advice to the Government on a range of business tax policy issues included the consolidation regime, imputation system reforms, taxation of financial arrangements, taxation treatment of business 'blackhole' expenditures, moving depreciation allowances closer to economic rates of depreciation, enhancements to the simplified tax system and changes to both venture capital arrangements, and company loss recoupment rules.
- Advice to the Government and implementation of a range of indirect tax policy initiatives including fuel tax credits, goods and services tax (GST) amendments, excise and budget announcements relating to petroleum resource rent tax.
- Advice to the Government on the design and implementation of a number of personal tax measures including personal income tax cuts, family tax benefit reform, employee share schemes, capital gains tax (CGT) marriage roll-over, small business CGT concessions and deductible gift recipients.
- Advice to the Government led to the enactment of an Act implementing the second stage of the Government's decisions arising from the *Report on Aspects of Income Tax Self-Assessment*.
- Advice to the Government led to the enactment of an Act to create a regime to deter the promotion of tax avoidance schemes.
- Participation in the Review of the Taxation Treatment of Plantation Forestry.
- The project of identifying inoperative provisions which will cut tax legislation by more than 4,000 pages.
- Treasury continued to assess developments in the tax system as well as advancing a strategic approach to tax policy issues, including efforts to reduce complexity and compliance costs.

Part 2: Report on performance

- Treasury implemented further changes to Australia's international tax arrangements announced in the 2003-04 and 2005-06 Budgets. These changes ensure the continued modernisation and competitiveness of Australia's international tax system.

Table 5: Financial and staffing resources summary for Outcome 3

	Budget 2006 \$'000	Actual 2006 \$'000	Budget 2007 \$'000
Administered expenses			
Appropriation Acts No. 1 and 3	-	-	-
Appropriation Acts No. 2 and 4	-	-	-
Special Appropriations	-	-	-
Other expenses	-	-	-
Total administered expenses	-	-	-
Revenue from government			
Output Group 3.1 Revenue			
Output 3.1.1 Taxation policy and legislation advice	35,038	35,038	35,899
Output 3.1.2 Retirement income and saving policy and legislation advice	6,445	6,445	6,427
Total revenue from government contributing to the price of departmental outputs	41,483	41,483	42,326
Revenue from other sources			
Output Group 3.1 Revenue			
Output 3.1.1 Taxation policy and legislation advice	647	605	571
Output 3.1.2 Retirement income and saving policy and legislation advice	122	107	105
Total revenue from other sources	769	712	676
Total revenue for departmental outputs (Total revenues from government and other sources)	42,252	42,195	43,002
Price of departmental outputs			
Output Group 3.1 Revenue			
Output 3.1.1 Taxation policy and legislation advice	35,685	33,624	36,470
Output 3.1.2 Retirement income and saving policy and legislation advice	6,567	6,824	6,532
Total price of departmental outputs	42,252	40,448	43,002
Total estimated resourcing for Outcome 3 (Total price of outputs and administered expenses)	42,252	40,448	43,002
Average staff levels (number)	302	292	304

Notes: This resource table is presented in the four outcome structure effective from the 2006-07 Budget in May 2006. The Budget for administered expenses for 2006 is as per the *2005-06 Portfolio Additional Estimates Statements*. Actuals from 2005-06 have been realigned for comparative purposes to the 2006-07 Budget. The Budget for departmental price of outputs for 2006 and administered expenses and departmental price of outputs for 2007 is as per the *2006-07 Portfolio Budget Statements*.

OUTPUT 3.1.1: TAXATION POLICY AND LEGISLATION ADVICE

Revenue Group provides a wide range of services to Treasury ministers to support their role in delivering effective taxation arrangements. Specific group outputs include overall strategic advice, policy and legislation advice, revenue forecasting, policy costing and provision of information services.

Seven divisions contribute to Output 3.1.1. The Business Tax Division, the Indirect Tax Division, the Individuals and Exempt Tax Division, the International Tax and Treaties Division and the Tax System Review Division are responsible for the delivery of taxation and income support policy advice. The Tax Analysis Division prepares revenue forecasts, costings and quantitative analysis of taxation policy proposals, provides strategic analysis of key developments in the tax system and current policy issues, and develops and maintains models for labour force participation and tax-related analysis. The Tax Design Division assists Revenue Group by formulating a strategic direction on organisational issues for the group, improving the tax design process, providing a range of services such as managing the legislation programme, budgeting and administration, assisting in governance issues, and developing and leading key relationships.

During 2005-06, Revenue Group provided secretariat services to the Board of Taxation. The Board of Taxation publishes its own annual report on its website.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing decisions relating to taxation policy and legislation;
- effective presentation of relevant information, including budget documentation and other publications to adequately inform public debate;
- tax law is developed in accordance with the principles for good law design; and
- legislation is delivered according to government programmes.

ANALYSIS OF PERFORMANCE

Business taxation

Policy advice on business taxation issues covered the consolidation regime, imputation system reforms, taxation of financial arrangements, company loss recoupment rules, plantation forestry and a range of small business tax issues.

Consolidation

Treasury consulted with the business sector and provided policy advice on the consolidation regime to make refinements to overcome practical concerns and to clarify interactions with other parts of the income tax law. The Minister for Revenue and Assistant Treasurer announced changes to improve the treatment of pre-CGT membership interests and to clarify the operation of the tax cost setting rules. The Minister also announced changes to improve interactions with the life insurance provisions and the demerger rules.

Amendments to improve the operation of the consolidation regime were included in the *Tax Laws Amendment (2005 Measures No. 5) Act 2005*, which received Royal Assent on 19 December 2005, the *Tax Laws Amendment (2005 Measures No. 6) Act 2006*, which received Royal Assent on 29 March 2006, and the *Tax Laws Amendment (2006 Measures No. 4) Bill 2006*, which was introduced into the House of Representatives on 22 June 2006.

Imputation system

Treasury consulted with the business sector and provided policy advice on the share capital tainting rules. The new share capital tainting rules were included in the *Tax Laws Amendment (2006 Measures No. 3) Act 2006*, which received Royal Assent on 30 June 2006 and the *New Business Tax System (Untainting Tax) Act 2006*, which received Royal Assent on 30 June 2006. Amendments to modify the operation of the franking deficit tax rules contained in the *Tax Laws Amendment (2006 Measures No. 2) Act 2006*, which received Royal Assent on 22 June 2006, were made in response to industry concerns and will remove uncertainties and practical difficulties.

Treasury continues to consult with the business sector and to provide policy advice on the dividend tainting rules, the trans-Tasman imputation rules and the holding period and related payment rules.

Taxation of financial arrangements

Treasury continued to advance a major tax law reform project to improve tax accounting for financial arrangements. Exposure draft legislation and explanatory material were released in December 2005. Treasury is continuing to consult with key industry and professional bodies.

Treasury continued to develop legislation to restore fairness and neutrality to the taxation of capital protected borrowing arrangements. Confidential consultation was undertaken on this issue with both financial institutions and other taxpayers.

The Office of Parliamentary Counsel and Treasury prepared legislation and explanatory memorandum relating to the taxation of 'at call' loans of small business which was included in the *Tax Laws Amendment (2005 Measures No. 5) Act 2005*. This Act received Royal Assent on 19 December 2005.

Lower Tier 2 subordinated debt

Treasury consulted with the business sector and provided policy advice on the effect of a clause (under the debt/equity rules in the income tax law), which allows an issuer to defer payment if the payment would cause insolvency. The Minister for Revenue and Assistant Treasurer announced that an income tax regulation would be made to clarify that the existence of such a clause in certain term subordinated notes would not preclude the notes from being debt for tax purposes.

Improved depreciation arrangements

The 2006-07 Budget announced a major improvement to the depreciation arrangements in the uniform capital allowance regime by increasing the diminishing value rate for the purposes of determining depreciation deductions. The measure was included in the *Tax Laws Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Act 2006*, which received Royal Assent on 19 June 2006.

Company loss recoupment reforms

Treasury consulted with the business sector and provided policy advice on the company loss recoupment rules to improve the operation of the continuity of ownership test and to remove the same business test for large companies. These amendments were included in the *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*, which received Royal Assent on 14 December 2005. Further consultation with stakeholders took place in 2006, in relation to the operation of the same business test, following a request from the former Minister for Revenue and Assistant Treasurer for submissions on this issue.

Simplified tax system and aligning business thresholds

Treasury provided advice on simplifying and improving alignment of various small business tax thresholds in the tax laws, including the simplified tax system (STS). In particular, the package of measures will increase the STS annual turnover threshold from \$1 million to \$2 million; remove the \$3 million depreciating assets test from the STS eligibility requirements; increase the net assets threshold for the CGT small business concessions from \$5 million to \$6 million; and allow STS taxpayers to be eligible for the CGT small business concessions (without having to satisfy the net assets threshold) and to pay quarterly pay-as-you-go instalments on the basis of gross domestic product (GDP)-adjusted notional tax.

Part 2: Report on performance

Treasury also provided advice on extending optional depreciating asset roll-over relief to taxpayers in the STS. Providing roll-over relief in these situations will provide more flexibility for STS taxpayers wishing to restructure their business and ensure that roll-over relief available under the uniform capital allowances regime is also available in relation to STS depreciating asset pools. The Government announced these measures in the 2006-07 Budget.

Venture capital

Treasury provided advice on measures aimed at increasing activity and investment in the venture capital sector. The measures will introduce an early stage venture capital limited partnership investment vehicle providing flow-through tax treatment and a complete tax exemption for income, both revenue and capital, received by its domestic and foreign partners. As the income will be exempt from tax, investors will not be able to deduct investment losses. As a consequence of the introduction of the new vehicle, the existing pooled development funds arrangements will be closed to new registrations. The Government announced these measures in the 2006-07 Budget.

Family trust elections

Treasury provided advice on increasing flexibility for family trust elections and interposed entity elections. This measure will allow family trust elections and interposed entity elections to be revoked or varied in certain limited circumstances. The definition of a family group will be broadened to include lineal descendants of family group members. In addition, trust distributions to former spouses, and to widows or widowers of family group members with new spouses, will be exempted from family trust distribution tax. The Government announced this measure in the 2006-07 Budget.

Taxation of trusts

Treasury provided advice on simplifying the reporting requirements under the ultimate beneficiary rules for closely held trusts. The measure will require that trustees of closely held trusts report and identify (with a tax file number) only the first-tier of trustee beneficiary instead of the trustee having to trace the distribution through to the final recipient of the distribution. The measure will reduce compliance costs for taxpayers while maintaining the integrity of the taxation of trust income. The Government announced this measure in the 2006-07 Budget.

Taxation treatment of business 'blackhole' expenditures

The 2005-06 Budget announced a proposed treatment in the income tax law to recognise business 'blackhole' expenditures from 1 July 2005. Treasury undertook confidential targeted stakeholder consultations on the policy and draft legislation. The measure was included in the *Tax Laws Amendment (2006 Measures No. 1) Act 2006*, which received Royal Assent on 6 April 2006.

Review of plantation forestry

Treasury, together with the Department of Agriculture, Fisheries and Forestry and the Department of Prime Minister and Cabinet, undertook a comprehensive review of the taxation arrangements for plantation forestry. There was extensive consultation with stakeholders, who also provided a significant number of submissions to the review. On 9 May 2006, the Minister for Revenue and Assistant Treasurer announced that there would be further consultation on the basis of proposed new taxation arrangements for plantation forestry.

Inclusion of film copyright in the effective life regime

Treasury provided advice on amendments to the uniform capital allowance rules to allow the cost of copyright, and certain licenses relating to copyright, in a film, to be written-off over their effective life. Legislation to give effect to this measure was included in the *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*, which received Royal Assent on 14 December 2005.

Indirect taxation

Treasury provided advice on fuel tax reform, cleaner fuels, GST, tourist shopping, excise and petroleum resource rent tax issues.

Fuel tax reforms

On 1 July 2006, the new fuel tax credit system took effect, implementing Government policy as announced in the energy white paper *Securing Australia's Energy Future*. The *Fuel Tax Act 2006* and the *Fuel Tax (Consequential and Transitional Provisions) Act 2006* were given Royal Assent on 27 June 2006.

The fuel tax credit system will lower compliance costs and reduce the burden of taxation for thousands of businesses and households. The new system is being introduced over a number of years. It will extend fuel tax relief to business activities and fuels not previously eligible. Treasury worked closely with the ATO and relevant industry groups to implement these policies.

Cleaner fuels

As part of the cleaner fuels measure announced by the Government in the 2003-04 Budget, a grant is being provided to suppliers of premium unleaded petrol with 50 parts per million or less of sulphur over the period 1 January 2006 to 31 December 2007. This will encourage the supply of this fuel into the domestic market before it becomes mandatory under the fuel standard on 1 January 2008. This measure was implemented via the *Energy Grants (Cleaner Fuels) Scheme Amendment Regulations 2005 (No. 1)*.

Goods and services tax

In partnership with the States and Territories, Treasury has fine-tuned the GST law in several areas, including property and telecommunications vouchers. These enhancements will ensure that the GST continues to operate as intended.

Review of the administrative arrangements for tourist shopping

Treasury led a review of the administrative arrangements for tourist shopping in Australia. This review examined options to improve the delivery and administration of the tourist refund function and inwards and outwards duty free shops. Targeted public consultation with industry occurred as part of this process.

Excise

Legislation was enacted to replace the current Schedule to the *Excise Tariff Act 1921*, which specifies the excise duty applicable to goods, and to amend related excise and customs laws as a consequence of an extensive review undertaken by Treasury. Targeted public and confidential consultation with industry occurred as part of this review.

The legislation, which received Royal Assent on 27 June 2006, implemented certain elements of the Government's fuel tax reforms and clarified and simplified excise arrangements with a view to reducing compliance costs for excise manufacturers, importers and administering authorities.

Petroleum resource rent tax

Treasury implemented a number of measures relating to the petroleum resource rent tax which were announced in the 2005-06 Budget. These measures are directed at lowering compliance costs, improving administration and removing inconsistencies. These measures are contained in the *Petroleum Resource Rent Tax Assessment Amendment Act 2006* and the *Petroleum Resource Rent Tax (Instalment Transfer Interest Charge Imposition) Act 2006*, which both received Royal Assent on 30 June 2006.

Personal taxation

Advice to the Government on the design and implementation of a number of personal tax measures sought to promote economic growth, participation in the workforce and good governance.

Reductions in personal income tax

The 2006-07 Budget included tax cuts worth \$36.7 billion over four years. The tax cuts were included in the *Tax Laws Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Act 2006*, which received Royal Assent on 19 June 2006.

The key changes taking effect from 1 July 2006 were:

- increasing the 30 per cent tax threshold from \$21,601 to \$25,001;
- increasing the low income tax offset from \$235 to \$600. In addition, the point at which the low income tax offset starts to phase out was increased from \$21,600 to \$25,000;
- cutting the top marginal tax rate from 47 per cent to 45 per cent and increasing the top tax threshold from \$95,001 to \$150,001; and
- reducing the second-highest marginal tax rate from 42 per cent to 40 per cent and increasing the threshold at which it cuts in from \$63,001 to \$75,001.

In addition, with effect from 1 April 2006, the fringe benefit tax rate was reduced from 48.5 per cent to 46.5 per cent.

Fringe benefits reporting exclusion for security concerns

Treasury advised the Government and helped develop legislation that excludes, from reporting, fringe benefits provided to address certain security concerns relating to the personal safety of an employee, or an associate of the employee, arising from the employee's employment. As a result of this reporting exclusion, the payment summaries of employees who receive such fringe benefits will not include these amounts. This measure was included in the *Tax Laws Amendment (2006 Measures No. 3) Act 2006*, which received Royal Assent on 30 June 2006.

Employee share schemes

Treasury advised the Government and helped develop legislation that amended the employee share scheme provisions to ensure that a taxing point does not arise for taxpayers participating in an employee share scheme in the event of a corporate restructure or 100 per cent takeover. In the event of such, taxpayers are now able to treat the new shares or rights they are issued as a continuation of their old shares or rights.

This measure was included in the *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*, which received Royal Assent on 14 December 2005.

Treasury hosted several consultation meetings attended by industry representatives to discuss employee share scheme issues and to identify inhibitors to employee participation in employee share schemes.

Amendments to the capital gains tax marriage roll-over

Treasury advised the Government and developed legislation to extend the CGT marriage breakdown roll-over relief to assets transferred to a spouse or a former spouse under certain binding financial agreements, arbitral awards and written agreements. This measure was introduced into Parliament on 22 June 2006 in the *Tax Laws Amendment (2006 Measures No. 4) Bill 2006*.

Amendments to the small business capital gains tax concessions

Treasury advised the Government on its response to the Board of Taxation's review of the small business CGT concessions. Following this advice:

- the Government will reduce the compliance costs for small business by making changes to the maximum net asset value test, the active asset test, the 15-year exemption, the retirement exemption, the small business roll-over, and how the concessions apply to partnerships; and
- the Government will increase the availability of the concessions by replacing the 50 per cent controlling individual test with a new significant individual 20 per cent test that can be satisfied either directly or indirectly.

These amendments were announced in the 2006-07 Budget and will take effect from 1 July 2006.

Five new deductible gift recipient categories

Treasury advised the Government and helped develop legislation to introduce five new deductible gift recipient general categories, with effect from 1 July 2006, to cover war memorials, disaster relief, animal welfare, charitable services and educational scholarships. This legislation will allow taxpayers to claim an income tax deduction for certain gifts of money or property to organisations that are endorsed as deductible gift recipients under these categories.

This measure was included in *Tax Laws Amendment (2006 Measures No. 3) Act 2006*, which received Royal Assent on 30 June 2006.

International taxation

A range of reforms to international tax arrangements were implemented during 2005-06 including further measures as part of the Government's ongoing response to the 2003 Review of International Taxation Arrangements:

- The *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*, which received Royal Assent on 14 December 2005, included legislation extending the exemption from Australian tax of dividends paid to foreign shareholders in Australian companies out of foreign profits, through the broadening of the categories of income subject to conduit taxation relief.
- Reforms to the Australian CGT treatment of non-residents were included in the *Tax Laws Amendment (2006 Measures No. 4) Bill 2006*, which was introduced into Parliament on 22 June 2006. These reforms narrow the range of assets subject to Australian CGT and strengthen the integrity of CGT regime. The reforms more closely align Australia's domestic CGT law with international practice and the approach adopted in Australia's tax treaties.

These measures continue efforts to make investment in Australian multinational companies more attractive to foreign investors and encourage foreign businesses to establish regional holding companies in Australia.

The *Tax Laws Amendment (2005 Measures No. 5) Act 2005*, which received Royal Assent on 19 December 2005, contained amendments simplifying the operation of the foreign employment income exemption by allowing different service periods to be aggregated. The amendments also extended the exemption to situations where an individual dies before completing the required period of foreign service, and reinstated the exemption for Australians employed in Iraq. This Act also introduced amendments providing a three-year transitional period under the thin capitalisation rules, during which entities may choose to defer the impact of the adoption in Australia of international financial reporting standards and continue to use the former accounting standards for thin capitalisation purposes.

The *Tax Laws Amendment (2006 Measures No. 1) Act 2006*, which received Royal Assent on 6 April 2006, contained amendments to introduce a foreign source income tax exemption for certain temporary residents. This measure was first introduced into Parliament in 2002, but did not pass the Senate. The Government announced its reintroduction in the 2005-06 Budget. The exemption will assist Australian business in attracting mobile skilled labour and improve the international competitiveness of Australian business through the skills and knowledge such employees transfer to Australia.

OECD global forum

Treasury convened the OECD Global Forum on Taxation, which Australia hosted in Melbourne in November 2005. The Forum brought together OECD countries and other jurisdictions with significant offshore financial centres — around 60 countries in all. The Forum is committed to implementing higher standards of transparency and information exchange in relation to tax matters, and removing limitations such as bank secrecy.

Australia also concluded its first tax information exchange agreement with Bermuda on 10 November 2005. The agreement provides for full exchange of information on criminal and civil tax matters between Australia and Bermuda. These agreements are an essential tool in Australia's efforts to reduce offshore tax evasion.

Tax treaties

The Government's tax treaty programme of 20 countries promotes closer economic cooperation between Australia and other countries by eliminating possible barriers to trade and investment caused by overlapping taxing jurisdictions. Tax treaties offer protection for Australian businesses investing offshore, and reduce or eliminate double taxation of income flows between treaty partner countries. They also create a framework through which tax administrations can combat international fiscal evasion. During the year, negotiations were held with five countries and resulted in tax treaties being signed by the Government with France and New Zealand.

Part 2: Report on performance

Tax policy advice was provided on various international agreements, including free trade proposals and privileges and immunities requests being negotiated by the Government.

Tax system review

Treasury provided advice on, and developed legislation on systemic issues in tax system administration, including the assessment process, ATO rulings and advice, compliance and enforcement, tax offences and penalties, tax collection and recovery systems, tax relief, tax identity, disclosure of taxpayer information, record keeping obligations, and tax agent matters. Tax administration systems must contribute to the tax policy outcomes Parliament intends and avoid the pitfalls of unnecessary risk, complexity and high transaction costs.

The Government announced reviews on the following issues:

- specific provisions that expose taxpayers to open-ended review periods to identify those that could have a set period before a taxpayer's liability is considered to be final;
- Commissioner of Taxation (Commissioner) discretions that determine a taxpayer's liability to increase certainty by recommending replacement tests that a taxpayer can apply at the time of lodgment;
- taxpayer elections to establish guidelines for framing those elections in the law;
- possible application of the Review of Self Assessment recommendations to all federally administered taxes; and
- the possibility of reducing the volume of law that individuals and small businesses with very simple affairs need to access.

The *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005* received Royal Assent on 19 December 2005. It amends the income tax laws to reduce the periods in which the Commissioner may amend many income tax assessments to increase a taxpayer's liability, and also enhances the framework for the provision of ATO advice, including through the rulings system in the *Taxation Administration Act 1953*.

The *Tax Laws Amendment (2006 Measures No. 1) Act 2006* received Royal Assent on 6 April 2006. It amends the *Taxation Administration Act 1953* to impose civil penalties on promoters of tax exploitation schemes. Prior to this amendment, the Commissioner could not take legal action to stop the promotion of tax exploitation schemes.

Treasury has also been involved in the Joint Committee on Public Accounts and Audit inquiry into 'Certain Taxation Matters'. The inquiry, announced on 7 December 2005, is examining the administration of tax laws by the ATO and the FBT regime, particularly its interaction with the family tax benefit programme. In a submission made to the inquiry, Treasury outlined:

- key policy measures that have been implemented or are under development to improve the framework within which the ATO must operate; and
- the purpose of FBT and an explanation of the important role that reporting of fringe benefits plays in enhancing the overall fairness of the taxation and welfare systems.

Policy evaluation frameworks

Treasury has developed enhanced frameworks for the evaluation of taxation policy to ensure appropriate consideration of taxation proposals within the broad policy context of Treasury's mission of improving the wellbeing of Australians. The new frameworks are designed to improve the quality of advice provided to ministers and are a response to the increasing community and government concern to achieve an appropriate balance between the benefits of tax regulation and the efficiency, compliance and administration costs associated with its implementation.

Treasury has commenced the development of quantitative modelling to identify the labour force participation effects of government policy proposals, including tax and income support changes. This included getting the Melbourne Institute Tax and Transfer Simulator behavioural microsimulation model, developed by the Melbourne Institute, operational in Treasury.

Community consultation

Treasury consults to gather information about the practical operation of the taxation system and improve the quality and effectiveness of proposed changes to the system. The emphasis on enhanced community consultation continued, including liaising with peak bodies on tax system issues and extensive consultation on individual measures. Evaluation of consultations is continuing. Generally, feedback from consultation participants was positive. Some concerns were raised about insufficient feedback to participants. Treasury is working to improve this. Treasury prepares a report three times a year which provides details of the consultation strategy for announced tax measures, the progress of the measures and a contact officer for each consultation. These reports are published on the Treasury website and are provided to the Board of Taxation to assist in its role of monitoring consultation processes.

Repeal of inoperative provisions from the tax laws

Treasury provided advice on, and developed with the Office of Parliamentary Counsel and the ATO, draft legislation to repeal inoperative provisions from tax laws.

The *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* which received Royal Assent on 14 September 2006 repeals more than 4,000 pages of inoperative provisions and inoperative Acts from Australia's tax legislation. Inoperative provisions and Acts are

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those that no longer apply to taxpayers, either because they have no effect after a date in the past or because all the transactions or events they did affect have now concluded.

Public consultation on a draft of the legislation was undertaken in April and May 2006 to ensure that the provisions identified were inoperative. In announcing the release of the draft legislation, the Treasurer described it as a major step to reducing the complexity of tax laws. It reduces the income tax law by almost one-third and the *Income Tax Assessment Act 1936* to half its current size.

In addition to repealing inoperative provisions and Acts, this Act also makes a number of minor improvements to the usability and readability of tax law. For example, it makes a number of amendments to ensure that certain expressions are defined in only one way across the tax laws.

Publications

International comparison of Australia's taxes

In April 2006 the Treasurer released the *International Comparison of Australia's Taxes*, a report prepared for the Treasurer by Mr Richard Warburton and Mr Peter Hendy. Treasury provided secretariat support for the analysis of Australia's tax settings and the preparation of the report. The report delivered some significant insights into the taxation arrangements both within Australia and in other countries around the world. The study attracted wide public interest and provided an important opportunity to inform the public discussion about Australia's taxation arrangements.

OUTPUT 3.1.2: RETIREMENT INCOME AND SAVING POLICY AND LEGISLATION ADVICE

Treasury provided advice to the Government on the revenue aspects of superannuation, retirement income and saving policy in particular, and advised on development of effective retirement income and saving policy in the context of demographic change.

Superannuation, Retirement and Savings Division contributes to Output 3.1.2. The division has an ongoing programme to improve retirement incomes for Australians. In its role, the division consults widely across the private and public sectors. It has close relationships with the Tax Analysis Division which prepares revenue forecasts, costings of policy proposals and other quantitative studies, and provides strategic analysis of tax-related issues, and with the Tax Design Division which formulates a strategic direction on organisational issues and provides key services, such as managing the legislation programme, budgeting and administration.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing decisions relating to retirement income and saving policy and legislation;
- effective presentation of relevant information, including in the budget documentation and other publications informs public debate;
- law relating to retirement income and saving policy is developed in accordance with the principles of good law design; and
- legislation is delivered according to government programmes.

ANALYSIS OF PERFORMANCE

Superannuation, retirement income and saving

A Plan to Simplify and Streamline Superannuation

On 9 May 2006, the Government announced *A Plan to Simplify and Streamline Superannuation* to simplify superannuation for retirees, provide greater flexibility in drawing on superannuation saving and improve incentives to work and save.

Treasury provided policy advice and assisted the Government in developing the plan.

Treasury also coordinated consultation on the plan. Submissions on the proposals were invited for three months, until 9 August 2006. Around 1,500 submissions were received from the superannuation industry, professional associations and the general public.

During this period Treasury analysed the submissions and extensively discussed particular aspects of the proposals with the superannuation industry, employer and other interested groups. Treasury also consulted a number of other Government departments and agencies. Fact sheets outlining various aspects of the plan were posted on Treasury's website and made available to the general public.

Implementation of the Government's proposed reforms to simplify and streamline superannuation remains a Treasury priority for 2006-07.

Other superannuation measures

Treasury also consulted with the superannuation sector, provided policy advice, developed legislation and implemented policy on other superannuation issues, including:

- prevention of the inappropriate use of pre-1 July 1988 funding credits by certain superannuation schemes;
- a submission to the inquiry by the House of Representatives Standing Committee on Economics, Finance and Public Administration into improving the superannuation savings of people under 40;
- the extension of choice of superannuation fund to employees working for a corporation who were previously employed under a state award;
- implementation of superannuation contribution splitting from 1 January 2006;
- extension of the law on family law and superannuation to cover superannuation annuity products;
- provision for 'interdependency' relationships in determining if someone is a dependant under certain provisions of superannuation law;
- development of new rules for the recovery of superannuation contributions in the event of bankruptcy; and
- negotiation and implementation of social security treaties to provide exemptions from the need to make compulsory superannuation or social security contributions for employees working temporarily in treaty countries. Treaties with Belgium and Ireland commenced during the year and a treaty was signed with Norway. Negotiations continued with a number of other countries, including Germany, Japan, South Korea and Greece.

OUTCOME 4: WELL FUNCTIONING MARKETS

A well functioning market economy and financial system is integral to the continued economic development of Australia and the wellbeing of the Australian people. Improving the operation of markets is intended to underpin stronger sustainable economic growth and enhanced living standards for all Australians.

The efficient operation of Australia's product and services markets is supported by a combination of laws, institutions, policies and administrative practices. Treasury provides advice to the Government on forming and implementing policies to support well functioning markets. Treasury's advice and other outputs help maintain and improve markets so investors and consumers can have confidence and certainty in making decisions that are well informed and free from market distortions and impediments. Treasury also provides the executive for the Takeovers Panel, and is represented on the advisory board of the Australian Government Actuary. The Royal Australian Mint became a prescribed agency with effect from 1 July 2005.

Markets Group is responsible for providing advice on policy processes and reforms that promote a secure financial system and sound corporate practices; remove impediments to competition in product and services markets; and safeguard the public interest in matters such as consumer protection and foreign investment.

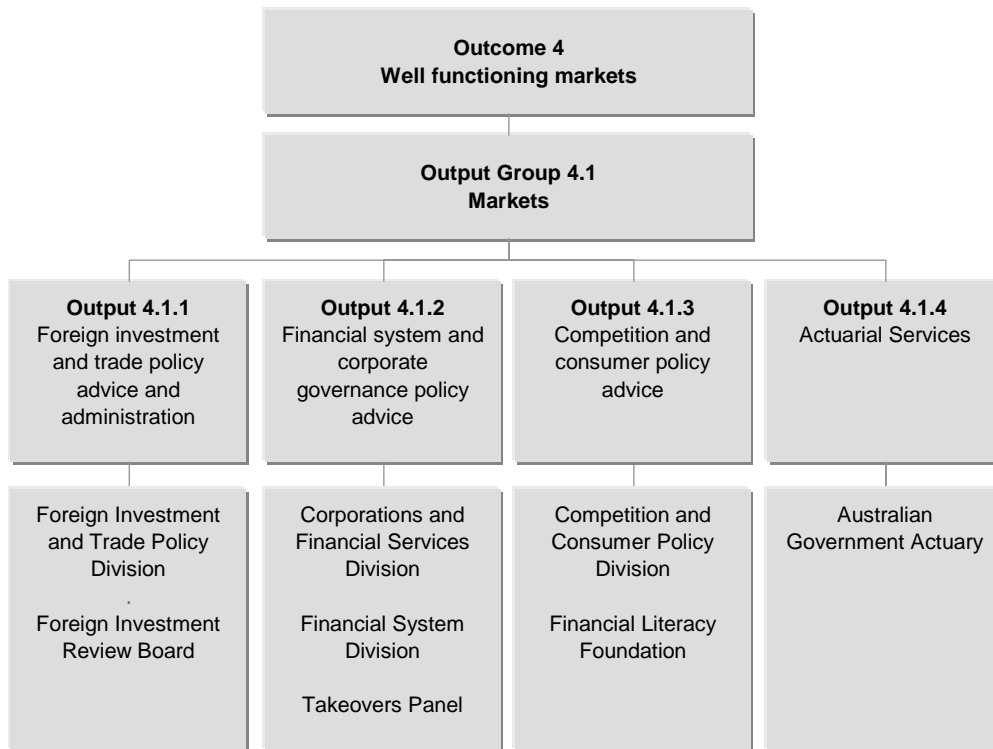
Markets Group is involved in consultations, particularly where reforms or new Government measures are proposed, with other Australian Government agencies, State and Territory governments, industry, the general public and other stakeholders.

In 2005-06, Markets Group provided advice on a range of issues affecting the operation of markets. For financial markets, that included advice on the prudential framework, market access and pricing, market integrity and investor protection, company law and corporate governance issues, corporate insolvency and corporate financial reporting. For markets more generally, that included advice on structural reforms of key sectors and the operation of competition and consumer policy, including issues of financial literacy. Markets Group also provided professional actuarial services, and advice on foreign investment and trade policy.

Markets Group also commenced negotiations with New Zealand for an investment protocol under the Closer Economic Relations Agreement, and continued to contribute to the Free Trade Agreement negotiations with China, Malaysia and, in partnership with New Zealand, the Association of South East Asian Nations (ASEAN).

Feedback from Treasury portfolio ministers indicated these outputs effectively contributed to their needs in formulating and implementing policies in support of well functioning markets.

Figure 7: Outputs contributing to Outcome 4



KEY PRIORITIES IN 2005-06

Treasury's 2005-06 *Portfolio Budget Statements* and internal planning processes identified the following key priorities for Markets Group in 2005-06:

- providing advice on foreign investment and trade policy, and screening foreign investment proposals;
- representing Australia's interest in international negotiations on investment issues, currently with China, Malaysia, and, in partnership with New Zealand, ASEAN;
- progressing a range of international investment cooperation issues, particularly with the United States under the Australia-United States Free Trade Agreement, and with New Zealand under the Australia-New Zealand Closer Economic Relations Trade Agreement;
- contributing to trade and investment issues in international groupings such as the Asia-Pacific Economic Cooperation (APEC), G-20, OECD and World Trade Organization (WTO);
- providing advice on a range of initiatives to integrate more closely the Australian and New Zealand markets, including in prudential supervision of banking, in competition and consumer law and administration, in fundraising and accounting standards, including harmonising financial reporting frameworks, and through forums such as the Trans-Tasman Council on Banking Supervision;
- providing advice on implementing reforms covering auditor independence, legislative backing of auditing standards and oversight arrangements for the Financial Reporting Council (FRC);
- progressing reforms relating to corporate insolvency;
- consulting on and implementing refinements to financial services regulation;
- coordinating implementation of the recommendations of the Review of Corporate Governance of Statutory Authorities and Office Holders for Treasury portfolio agencies falling within this outcome, such as the Australian Prudential Regulation Authority (APRA), the Australian Competition and Consumer Commission (ACCC), and the Australian Securities and Investments Commission (ASIC);
- monitoring and liaising with APRA and stakeholders on the transition to the superannuation trustee licensing reforms introduced under the *Superannuation Safety Amendment Act 2004*;

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- providing advice on a sound and efficient prudential framework, including through work on the International Monetary Fund (IMF) Financial Sector Assessment Program, the Council of Financial Regulator's proposed financial claims compensation arrangements, the recommendations of the HIH Royal Commission, the HIH Claims Support Scheme and the General Insurance Stage 2 Reforms proposed by APRA;
- facilitating well functioning and competitive financial markets, particularly by addressing insurance market issues including public liability, professional indemnity and medical indemnity;
- providing amendments to the Commonwealth legislation to support state and territories insurance liability law reform;
- contributing to the development of the Commonwealth Government Action Plan for a possible influenza pandemic;
- implementing reforms relating to the Dawson Review, the Senate small business report, criminal sanctions for cartels and the National Access Regime;
- contributing to the Council of Australian Governments (COAG) review of National Competition Policy and the development of the COAG National Reform Agenda;
- advancing reforms in key infrastructure markets including energy, transport and communications;
- reviewing the Australian consumer policy framework, including the product safety framework and penalties available for consumer protection;
- implementing a national financial literacy strategy to deliver the Government's commitment to give all Australians the opportunity to better manage their money;
- raising awareness of financial literacy and its benefits and building the capacity of Australians to take advantage of significant reforms to the finance sector that have improved competition and consumer choice;
- providing services, through the Australian Government Actuary, related to financial matters including benefits depending on contingencies such as injury, death or retirement. The Australian Government Actuary also assists departments and agencies with policy development in areas where it has specialist expertise;
- continuing to provide advice relating to the currency system; and
- maintaining successful operations of the Australian Government Actuary and the Takeovers Panel.

KEY OUTCOMES IN 2005-06

In 2005-06, Markets Group advice covered a broad agenda including issues such as corporate governance, market integrity, financial system safety, financial product safety, financial literacy, competition and consumer policy, and protecting the national interest under Australia's foreign investment policy.

Key Group outcomes included:

- working on a range of international investment cooperation issues, particularly the Trade and Investment Framework with Indonesia, a Trade and Economic Framework with India, and an Investment Protection and Promotion Agreement with Mexico. Markets Group also contributed to Free Trade Agreement negotiations with China, Malaysia and — in partnership with New Zealand — ASEAN;
- assisting the Council of Financial Regulators in formulating recommendations for the Government to consider in dealing with distressed financial institutions, including a Financial Claims Compensation Scheme (FCCS) to enhance current arrangements. Markets Group also contributed to the IMF's Financial Sector Assessment of Australia, to be released later in 2006;
- contributing to the Taskforce on *Reducing Regulatory Burdens on Business*, and the Government's interim response to the recommendations relating to Financial and Corporate Regulation in the *Report of the Taskforce on Reducing Regulatory Burdens on Business — Rethinking Regulation*;
- progressing the new superannuation trustee licensing reforms introduced by the *Superannuation Safety Amendment Act 2004*. The transition period for these reforms concluded on 30 June 2006;
- finalising amendments to the Commonwealth legislation to support State and Territory insurance liability law reform. The *Trade Practices Amendment (Personal Injuries and Death) Act 2006* received Royal Assent on 23 March 2006;
- working with the Department of Finance and Administration to implement the recommendations arising from the Review of Corporate Governance of Statutory Office Holders (Uhrig Review);
- working with the National Competition Policy Review Secretariat, within the Department of Prime Minister and Cabinet, to develop the National Reform Agenda announced by COAG on 10 February 2006;

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- continuing to progress reforms relating to the *Trade Practices Act 1974* on competition provisions and national access regimes. These reforms were integrated into the Trade Practices Amendment (2006 Measures No. 2) Bill 2006, the Trade Practices Legislation Amendment Bill (No. 1) 2005, and the Trade Practices Amendment (National Access Regime) Bill 2006;
- developing a draft Bill on component pricing reforms, releasing a discussion paper on pecuniary penalties, and through the Commonwealth Consumer Affairs Advisory Council, releasing a booklet, *The Australian Guidelines for Electronic Commerce*;
- continuing to develop the *Understanding Money* media campaign, website and handbook, and progressing the education, training and research initiatives which underpin the advancement of financial literacy in the longer term;
- executing necessary arrangements in the lead up to the establishment of the Financial Reporting Panel. The Parliamentary Secretary to the Treasurer announced the appointment of Mr Paul Shannon as the inaugural Chairman on 23 May 2006;
- implementing a package of refinements to the Financial Services Reform Act in December 2005 after extensive consultation;
- developing a revised Memorandum of Understanding on the coordination of business law and a treaty regarding mutual recognition of securities offerings which were both signed by Australian and New Zealand Ministers on 22 February 2006;
- conducting, through the Trans-Tasman Accounting Standards Advisory Group, a regional policy forum in October 2005 in Sydney which promoted cooperation and communication in adopting International Financial Regulatory Standards in the Asia-Oceania region; and
- continuing to provide advice relating to the currency system and maintaining successful operations of the Australian Government Actuary and the Takeovers Panel.

Table 6: Financial and staffing resources summary for Outcome 4

	Budget 2006 \$'000	Actual 2006 \$'000	Budget 2007 \$'000
Administered expenses			
Appropriation Acts No. 1 and 3	6,000	576	5,000
Appropriation Acts No. 2 and 4	164,701	163,742	168,492
Special Appropriations	1,158	173	-
Other expenses	-	5,732	-
Total administered expenses	171,859	170,223	173,492
Revenue from government			
Output Group 4.1 Markets			
Output 4.1.1 Foreign investment policy advice and administration	3,990	3,990	3,962
Output 4.1.2 Financial system and corporate governance policy advice	21,972	21,972	21,797
Output 4.1.3 Competition and consumer policy advice	19,292	19,292	13,041
Output 4.1.4 Actuarial Services	-	-	-
Total revenue from government contributing to the price of departmental outputs	45,254	45,254	38,800
Revenue from other sources			
Output Group 4.1 Markets			
Output 4.1.1 Foreign investment policy advice and administration	92	83	80
Output 4.1.2 Financial system and corporate governance policy advice	307	557	267
Output 4.1.3 Competition and consumer policy advice	235	343	235
Output 4.1.4 Actuarial Services	1,629	1,164	1,629
Total revenue from other sources	2,263	2,147	2,211
Total revenue for departmental outputs (Total revenues from government and other sources)	47,517	47,401	41,011
Price of departmental outputs			
Output Group 4.1 Markets			
Output 4.1.1 Foreign investment policy advice and administration	4,082	4,918	4,042
Output 4.1.2 Financial system and corporate governance policy advice	22,279	19,463	22,064
Output 4.1.3 Competition and consumer policy advice	19,527	11,818	13,276
Output 4.1.4 Actuarial Services	1,629	895	1,629
Total price of departmental outputs	47,517	37,094	41,011
Total estimated resourcing for Outcome 4 (Total price of outputs and administered expenses)	219,376	207,317	214,503
Average staff levels (number)	223	221	231

Notes: This resource table is presented in the four outcome structure effective from the 2006-07 Budget in May 2006. The Budget for administered expenses for 2006 is as per the *2005-06 Portfolio Additional Estimates Statements*. Actuals from 2005-06 have been realigned for comparative purposes to the 2006-07 Budget. The Budget for departmental price of outputs for 2006 and administered expenses and departmental price of outputs for 2007 is as per the *2006-07 Portfolio Budget Statements*.

OUTPUT 4.1.1: FOREIGN INVESTMENT AND TRADE POLICY ADVICE AND ADMINISTRATION

During 2005-06, Foreign Investment and Trade Policy Division in Markets Group was responsible for the delivery of Output 4.1.1: Foreign investment and trade policy advice and administration.

Markets Group provided advice on foreign investment proposals, providing executive support to the Foreign Investment Review Board and making decisions under the *Foreign Acquisitions and Takeovers Act 1975* (FATA) and Australia's foreign investment policy (the Policy) under authorisations provided by the Treasurer, consistent with the policy. It also advises the Government on foreign investment and trade policy as it relates to Australia's participation in multilateral and bilateral agreements on investment. Further, it also provides the Australian National Contact Point for OECD Guidelines for Multinational Enterprises (the OECD Guidelines).

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in fulfilling their responsibilities;
- foreign investment proposals are processed efficiently to meet the needs of ministers, the Foreign Investment Review Board, foreign investors and their agents;
- Government policy is appropriately represented and Australia's negotiating position is pursued effectively in international forums; and
- the OECD Guidelines are promoted effectively and Australian National Contact Point responsibilities are fulfilled.

Performance is currently regarded as satisfactory if:

- Treasury effectively disseminates and explains Australia's foreign investment policy to improve the standard of applications and compliance to minimise the proportion of foreign investment proposals requiring Interim or Final Orders;
- Treasury undertakes a programme of compliance checks on previous proposals subject to conditions — possibly leading to prosecutions, but overall aimed at reducing non-compliance; and
- ministerial correspondence is handled satisfactorily.

Advice on and processing of individual foreign investment proposals

Most proposals require notification to the Treasurer. Proposals must conform with the general and particular requirements of Australia's foreign investment policy. If a proposal is determined to be contrary to the national interest, it can be prohibited.

Where a foreign person enters into an agreement to acquire an interest in Australian urban land, they must notify the Treasurer under section 26A of the FATA. In most real estate cases, applicants are required to comply with specified conditions. Where a foreign person proposes to acquire a substantial interest² in an Australian corporation valued above \$50 million (or from 1 January 2006, \$831 million for a United States investor, except in prescribed sensitive sectors), they must notify the Treasurer under section 26 of the FATA. Proposals to establish a new business must be notified if the value of that business exceeds \$10 million. Direct investments, regardless of size, by foreign governments and their agencies must be notified.

Under authorisation from the Treasurer, senior Treasury staff make decisions on less complex proposals that do not involve issues of high sensitivity. The bulk of proposals (around 95 per cent) are decided under such authorisation.

Treasury considered 5,721 proposals in 2005-06, which represented 808 (or 16.4 per cent) more than in 2004-05. Around 91 per cent of proposals received were decided within 30 days. Treasury also received around 32,000 telephone calls and 4,580 items of written and email correspondence during the year. In examining large or otherwise significant proposals, State and Australian government departments and authorities, with responsibilities relevant to the proposed activity, are consulted to provide advice and comment to assist in assessing the implications of proposals.

During 2005-06, the Foreign Investment Review Board provided advice to the Treasurer on a number of major proposals. The Foreign Investment Review Board oversaw the investment screening functions of the division on a weekly basis. The General Manager of Foreign Investment and Trade Policy Division is also the ex officio executive member of the Foreign Investment Review Board.

Additional information on Australia's foreign investment screening arrangements, including statistics on foreign investment, is contained in the Foreign Investment Review Board's Annual Report. A copy and other information is at www.firb.gov.au.

2 A substantial interest is defined as an interest of 15 per cent or more for a foreign person, or a interest of 40 per cent or more for two or more foreign persons and their associates.

Compliance standards

Treasury's efforts through 2005-06 to strengthen compliance focused on three broad elements:

- introducing a new case management system and integrated online application facility to improve application accuracy and reduce processing times;
- enhancing communication about foreign investment policy to foreign investors, their agents, industry associations and other government agencies involving a continuing programme of targeted public speeches, ongoing improvements to the Foreign Investment Review Board website and development of easy-to-follow written materials; and
- monitoring compliance with foreign investment policy through a rolling programme. Treasury examined around 3,000 decided proposals in 2005-06 to ensure fulfilment of conditions, and monitored all major conditional business sector approvals. Targeted follow-up in the real estate sector ranged from routine checking of compliance with conditions to more complex investigations based on information from the public and from interagency sources. In some instances, this resulted in action against foreign parties, including prosecution.

Representation in international forums

Treasury provides policy input on international investment issues in multilateral forums, such as the WTO and the OECD, in regional forums such as APEC, and bilaterally through free trade agreements, Investment Protection and Promotion Agreements and other bilateral partnerships.

Free trade agreements/closer economic cooperation

New negotiations

In February 2006, Australia and New Zealand agreed to commence negotiations on an Investment Protocol to form part of the Australia New Zealand Closer Economic Relations Trade Agreement.

The Investment Protocol aims to facilitate stronger trans-Tasman investment flows and further strengthen the economic relationship between Australia and New Zealand. It will benefit investors by reducing compliance costs and providing improved legal certainty. Inclusion of an Investment Protocol would bring this agreement into line with Australia's more recent free trade agreements with Singapore, Thailand and the United States. Although the 1988 Australia New Zealand Closer Economic Relations Agreement in Services Protocol covers investment in establishment of a commercial presence by a trans-Tasman service provider, the broad carve-out for each country's foreign investment

policies means neither nation needs to make liberalising commitments for their respective foreign investment screening regimes.

Negotiation of a trans-Tasman Investment Protocol is an important step towards the goal of creating a single economic market between Australia and New Zealand.

Continuing negotiations

During 2005-06, Australia continued free trade agreement negotiations with China, Malaysia and ASEAN. The ASEAN Free Trade Agreement is being negotiated by Australia in partnership with New Zealand.

Australia's free trade agreement negotiations with the United Arab Emirates were suspended in June 2006 following the decision to expand the negotiations include all members of the Gulf Cooperation Council. Australia is currently analysing the economic and trade implications of this.

Other agreements

In September 2005, Australia signed a Trade and Investment Framework with Indonesia. This aims to strengthen commercial ties by enhancing business opportunities and improving facilitation of trade in goods, services and investment.

During 2005-06, work commenced on the Australia-Japan Free Trade Agreement feasibility study. The feasibility study group met three times and aims to finalise the study towards the end of 2006.

During 2005-06, Australia signed an Investment Protection and Promotion Agreement with Mexico, although it has not yet entered into force. Australia also commenced negotiations with Iran and Lebanon.

In March 2006, Australia signed a Trade and Economic Framework with India to support the further expansion of economic and commercial ties.

Under a side letter to the Australia-United States Free Trade Agreement, Australia had to review certain aspects of its investment screening arrangements by 30 June 2006. Treasury undertook that review in consultation with United States authorities and other relevant stakeholders.

Organisation for Economic Co-operation and Development

Australia is represented at the OECD's Investment Committee meetings by the General Manager of the Foreign Investment and Trade Policy Division. The committee promotes investment for growth and economic development, and represents the investment community from developed countries which are the source of 90 per cent of world investment flows.

The Investment Committee oversees the operation of the OECD Guidelines, a voluntary code providing recommendations for responsible business conduct in labour relations, human rights, the environment, bribery, taxation and consumer welfare. As a signatory,

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the Australian Government has undertaken a commitment to promote and implement the guidelines. This responsibility rests with the Treasury and is performed by the Australian National Contact Point, the General Manager of the Foreign Investment and Trade Policy Division.

In 2005-06, the Australian National Contact Point reviewed a submission lodged in June 2005 by five Australian and overseas non-government organisations. The submission alleged that, through its provision of immigration detention services to the Australian Government, GSL (Australia) Pty Ltd (a UK-controlled multinational enterprise) had breached the OECD Guideline's human rights and consumer interest provisions. The review process culminated in a mediation session involving conciliation on many issues. The Australian National Contact Point successfully concluded the proceedings and released a final statement on 6 April 2006. The Australian National Contact Point also worked to maintain stakeholder awareness of the guidelines by conducting targeted business and community consultation. This consultation focused on the Australian Textiles, Clothing and Footwear Industry and was well attended by representatives from businesses, trade unions and non-government organisations.

Asia-Pacific Economic Cooperation

Since taking over convenorship of the Investment Experts Group in early 2005, Treasury has undertaken a more active and strategic role in APEC's investment liberalisation agenda. Our leading role continues to form a significant part of Treasury's contribution to the development of key policy themes and priorities in the lead up to 2007, the year Australia hosts APEC.

Liaison with Department of Foreign Affairs and Trade

Treasury provided specialised advice to the Department of Foreign Affairs and Trade on Australia's involvement in the WTO Working Group on Trade and Investment and the WTO Doha round of negotiations on the General Agreement on Trade and Services. Treasury also provides advice to the Department of Foreign Affairs and Trade on Australia's negotiation of bilateral and regional free trade agreements and bilateral investment treaties.

OUTPUT 4.1.2: FINANCIAL SYSTEM AND CORPORATE GOVERNANCE POLICY ADVICE

During 2005-06, the Financial System Division and Corporations and Financial Services Division in Markets Group, with the Takeovers Panel, were responsible for the delivery of Output 4.1.2: Financial system and corporate governance policy advice.

Markets Group provided advice on the prudential framework, market access and pricing, market integrity and investor protection, company law and corporate governance issues, corporate insolvency, corporate financial reporting, the responsible portfolio agencies, and currency.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in administering their responsibilities and implementing government decisions as they relate to financial system and markets issues;
- effective presentation of relevant information informs public debate;
- statutory and other procedural requirements are met;
- secretariat services provided to advisory bodies are effective;
- representation and/or liaison by Treasury officers with other agencies, private sector organisations and international bodies, are assessed by participants as effective;
- Takeovers Panel achieves intended results; and
- ministerial correspondence is handled satisfactorily.

ANALYSIS OF PERFORMANCE

Treasury provided advice and programme support to Treasury portfolio ministers, and engaged with other agencies on issues relating to financial institutions, financial markets and issues concerning corporate disclosure, governance and insolvency. Treasury also processed related ministerial correspondence, published relevant information and met other procedural requirements. It provided effective support services to advisory bodies, liaised and consulted with stakeholders and represented the Australian Government at various meetings.

Financial system reform

Financial Claims Compensation Scheme

Treasury contributed to the work of the Council of Financial Regulators examining crisis management arrangements in Australia. The council endorsed many of the arrangements currently in place for dealing with distressed financial institutions. It also recommended that the Government consider introducing a financial claims compensation scheme to enhance current arrangements. The council consulted with industry on the proposed

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scheme and its design before reporting back to the Treasurer. Treasury participated in this process.

Reducing Regulatory Burdens on Business

Treasury provided assistance to the Taskforce on Reducing Regulatory Burdens on Business, including providing resources for the secretariat. Treasury provided advice and assisted the Government in developing its interim response to the recommendations by analysing areas of prudential regulation where the regulatory burden could be reduced.

Superannuation

The *Superannuation Safety Amendment Act 2004* introduced a universal licensing regime for trustees of superannuation funds regulated by APRA. The transition period for these reforms concluded on 30 June 2006. Treasury liaised with APRA and industry stakeholders to ensure a smooth transition to the new licensing regime.

General Insurance Stage 2 Reforms

Treasury liaised with APRA and industry stakeholders and provided advice to the Government on APRA's proposed further reforms to the general insurance prudential framework, collectively known as the General Insurance Stage 2 Reforms.

These reforms primarily include prudential standards concerning corporate governance arrangements, 'fit and proper' requirements, risk and financial management, outsourcing arrangements and prudential supervision of corporate groups involving an authorised general insurer.

Final prudential standards concerning 'fit and proper' requirements, risk and financial management and corporate governance arrangements will be implemented from 1 October 2006. Generally, the insurance industry has received these standards well.

Money laundering

Treasury continued to assist the Attorney-General's Department in developing a risk based legislative proposal to implement the recommendations of the *Financial Action Task Force on Money Laundering*. Treasury consulted with financial sector representatives on the legislative proposals and the potential implications of the anti-money laundering and counter-terrorism financing standards, and remains in close contact with other government departments and regulators.

Professional indemnity and public liability insurance

The *Trade Practices Amendment (Personal Injuries and Death) Act 2006* received Royal Assent on 23 March 2006. It implements recommendations 19 and 20 of the Review of the Law of Negligence, chaired by the Hon Justice David Ipp of the NSW Court of Appeal, and applies to personal injuries or death claims made in relation to unfair practices such as misleading and deceptive conduct.

In May 2006, the Australian Government prescribed the New South Wales Bar Association's professional standards scheme. This scheme limits an eligible member's civil liability to \$1,000,000, in return for risk management practices and compulsory insurance cover.

Commonwealth prescription ensures State and Territory professional standards legislation is not undermined through the use of Commonwealth legislation as an alternative avenue for legal action.

Discretionary mutual funds and direct offshore foreign insurers

Treasury released a discussion paper in December 2005 examining how to implement the findings of the Review of Discretionary Mutual Funds and Direct Offshore Foreign Insurers. It continues to progress the implementation of the review's recommendations.

Natural disaster insurance

Treasury is working with the Insurance Council of Australia to progress the insurance recommendations contained in several reports to the Government on natural disasters. The reports include the COAG report, *Natural Disasters in Australia: Reforming mitigation, relief and recovery arrangements* and the COAG National Inquiry on Bushfire Mitigation and Management.

Assessment of APRA and ASIC against Uhrig Review recommendations

Treasury is working with the Department of Finance and Administration to implement the recommendations arising from the Uhrig Review. APRA, ASIC and the Corporations and Markets Advisory Committee probably will each transfer to a new governance and financial framework by 1 July 2007.

Financial services refinements

Treasury assisted the Government to prepare proposed refinements to the regulatory regime and consulted widely on their implementation.

International liaison

IMF Financial Sector Assessment Program

The IMF conducted a Financial Sector Assessment of Australia, assessing the codes and standards relating to banking, insurance, securities and the payments system. A macroeconomic stress test assessed the strengths and vulnerabilities of major banks to an economic downturn.

The IMF's Executive Board will consider the outcome and release it as the IMF's Financial Sector Stability Assessment for Australia later in 2006.

Organisation for Economic Co-operation and Development

With the support of the Australian Agency for International Development, Treasury collaborated with partners including the OECD and APEC to hold a forum on Asian Insolvency Reform, held in April 2006 in Beijing.

Trans-Tasman Council on Banking Supervision

The Trans-Tasman Council on Banking Supervision reports to the Treasurer and New Zealand Minister of Finance on promoting a joint approach to trans-Tasman banking supervision to deliver a seamless regulatory environment for banking services. The council is chaired jointly by the Secretaries to the Treasuries of Australia and New Zealand, and its membership also comprises senior officials from APRA, and the Reserve Banks of New Zealand and Australia.

In February 2005, Ministers endorsed a forward work programme that includes looking at improved cooperation on crisis management, promoting seamless services provision for customers and sharing experiences on improving the quality of insurance regulation.

In August 2005, the Trans-Tasman Council on Banking Supervision reported to ministers on legislative changes that would require APRA and the Reserve Bank of New Zealand to support each other in the performance of their statutory objectives and, wherever reasonably practicable, avoid actions that would have a detrimental effect on the other country. Both Governments agreed to implement the changes, which Treasury is progressing in Australia.

Financial Markets Meeting

Australia hosted the first meeting of the Financial Markets Group in October 2005, in Sydney. Australia, China, Japan, Hong Kong (PRC), South Korea and Singapore share their perspectives on macroeconomic, financial market and regulatory developments in the region.

This forum has grown out of the Four Markets Group, of Australia, Hong Kong (PRC), Japan, and Singapore, which in 2004, agreed to expand in view of the importance to the Asian region's financial markets of China and Korea.

The topics discussed were domestic and regional macroeconomic developments, key developments in domestic financial markets and regulation in the region, prospects for regional financial integration and international standards. Australia led a discussion on the role international standards play in domestic policy development, the policy challenges that countries have experienced in dealing with international standards and membership of standards-setting bodies.

Member countries rotate the hosting of meetings and Hong Kong has agreed to host the 2006 meeting.

Coordination of business law with New Zealand

A revised Memorandum of Understanding on coordination of business law was signed by Australian and New Zealand Ministers on 22 February 2006. The work programme includes issues relating to competition, regulation of financial intermediaries and accounting standards and frameworks.

On the same day, they signed a treaty regarding mutual recognition of securities offerings. Australia will need to amend its corporations legislation to implement this treaty.

Treasury also participated in a Trans-Tasman Accounting Standards Advisory Group with representatives from the FRC, Australian Accounting Standards Board (AASB), Financial Reporting Standards Board (New Zealand), Accounting Standards Review Board (New Zealand), officials from the New Zealand Ministry of economic development and members of professional accounting bodies of both countries. Treasury is working towards consistency in financial reporting frameworks and implementation of International Financial Reporting Standards in both countries.

International Financial Reporting Standards Regional Policy Forum

In October 2005, the Australian and New Zealand Governments hosted a regional policy forum to promote cooperation and communication in adopting International Financial Reporting Standards in the Asia-Oceania region. Representatives from relevant policy and standard setting institutions in eleven countries attended. A second forum is planned for early 2007.

Takeovers Panel

The Takeovers Panel contributed to well functioning securities markets in Australia by resolving 31 applications, based on the Takeovers Chapter of the *Corporations (Repeals, Consequential and Transitional) Act 2001*, ensuring the acquisition of control over voting shares in listed and widely held companies takes place in an efficient, competitive and informed market; security holders and directors are appropriately informed; security holders have a reasonable and equal opportunity to participate in the benefits from a proposal; and appropriate procedures are followed.

The panel also fosters the confidence and efficiency of the market by publishing Guidance Notes. In 2005-06, the Panel released three new Guidance Notes, revised others and published two issues papers for public comment.

A panel decision was challenged for the first time in court. Glencore International AG applied to the Court for review of the panel's decisions. The application was upheld, but the constitutional validity of the legislation was maintained.

Financial Reporting Panel

On 23 May 2006, the Parliamentary Secretary to the Treasurer announced the appointment of Mr Paul Shannon as the inaugural Chairman of the Financial Reporting Panel and eight other members. The new alternative dispute resolution body was established under the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* to determine contested issues between ASIC and companies on the application of accounting standards and the true and fair view requirement in companies' financial reports.

The panel is located in Melbourne and formally commenced operation on 3 July 2006.

Currency

Treasury chaired and served on the Royal Australian Mint Advisory Board. Treasury also prepared currency determinations for the Perth Mint's numismatic coin programmes.

Company law and corporate governance

Corporate governance

Treasury provided advice to Government on a range of corporate governance issues, including development of draft amendments to the *Corporations Act 2001* on shareholder participation. Treasury officials made submissions to an inquiry into corporate social responsibility by the Parliamentary Joint Committee on Corporations and Securities, which reported in June 2006.

Corporate insolvency

Treasury provided advice to the Government on reform proposals for Australia's corporate insolvency framework. An Insolvency Law Advisory Group comprising private sector experts was established to assist Treasury develop a package of draft legislation, which is expected to be introduced in 2006-07.

Corporate Law Economic Reform Program 9 (CLERP 9)

Treasury continues to monitor the implementation of CLERP 9, particularly auditor independence and audit standards. Treasury consulted with the Auditing and Assurance Standards Board (AuASB), ASIC, the FRC, professional accounting bodies and industry stakeholders on implementation issues.

International Financial Reporting Standards

Treasury provided advice to the Government on implementing the International Financial Reporting Standards. Treasury also consulted with the FRC, the AASB, professional accounting bodies, ASIC, industry groups and individual companies on this issue.

Statutory and other procedural requirements

Financial sector levies

Treasury consulted with industry and provided advice to the Government in relation to the determination of financial sector levies which primarily support APRA's operations.

Ministerial decisions under statutes

In 2005-06, Treasury officers made delegated decisions regarding the availability of body corporate names and related matters.

Treasury also advised on, and prepared associated instruments on, nine applications under the *Financial Sector (Shareholdings) Act 1998*; two applications under section 63 of the *Banking Act 1959*; two applications under the *Insurance Acquisitions and Takeovers Act 1991*; and one application under the *Financial Sector (Transfers of Business) Act 1999*.

Appointments

Treasury processed appointments to the AuASB, the AASB, APRA, the Australian Reinsurance Pool Corporation Board, ASIC, the Companies Auditors and Liquidators Disciplinary Board, the Corporations and Markets Advisory Committee and its legal subcommittee, the FRC, the Financial Reporting Panel, the Financial Sector Advisory Council, the Life Insurance Actuarial Standards Board, the Payments System Board, the Superannuation Complaints Tribunal, and the Takeovers Panel.

Secretariat services

Treasury provided secretariat services to the Ministerial Council for Corporations, which met three times during 2005-06. Treasury also assisted the Parliamentary Secretary to fulfil the Government's obligations under the Corporations Agreement 2002.

Treasury provided secretariat support for the FRC, a stakeholder body that provides strategic oversight of the accounting and audit standard setting processes, including the AuASB, and the AASB.

Treasury provided secretariat support to the Financial Sector Advisory Council, which brings together a range of senior financial market participants to provide advice to the Government on policies to facilitate the growth of a strong and competitive financial sector.

OUTPUT 4.1.3: COMPETITION AND CONSUMER POLICY ADVICE

During 2005-06, Competition and Consumer Policy Division and the Financial Literacy Foundation were responsible for the delivery of Output 4.1.3: Competition and consumer policy advice.

Markets Group provided advice on policy issues and the legislative framework for the development and operation of competition and consumer policy, and markets more broadly, including the competition and consumer provisions of the *Trade Practices Act 1974*, and structural reform of key sectors, including those providing essential infrastructure.

Through the work of the Financial Literacy Foundation, Markets Group provided policy advice on initiatives which will lead, over time, to the advancement of consumer financial literacy, and a greater capacity for consumers to function effectively in financial markets and better understand and manage financial risk. The foundation provides a national focus for financial literacy issues and works in partnership with government, industry and community organisations to advance financial literacy in Australia.

PERFORMANCE INFORMATION

The key performance indicators are:

- advice meets Treasury portfolio ministers' needs in discharging their responsibilities under legislation and in implementing government decisions in relation to competition and consumer policy and national financial literacy issues;
- statutory and other procedural, administrative and reporting requirements are met;
- effective representation and/or liaison with other agencies, private sector organisations and international bodies promotes competitive, efficient and well informed markets;
- effective presentation of relevant information informs consumers and businesses;
- implementation of the Government's financial literacy initiative;
- secretariat services provided to advisory bodies are effective;
- ministerial correspondence is handled satisfactorily;

- clearinghouse and website services with information on financial and education services, superannuation and superannuation choice are established and maintained effectively; and
- establishment of educational benchmarks and standards in schools is promoted.

ANALYSIS OF PERFORMANCE

Competition policy

Treasury has been developing legislation to implement the Australian Government's response to a June 2004 report of the Senate Economics References Committee on *The effectiveness of the Trade Practices Act 1974 in protecting small business*. In accordance with the intergovernmental Conduct Code Agreement, the Australian Government has consulted with the States and Territories on the draft Bill. The voting requirements of the agreement have been met.

Treasury is developing the Trade Practices Amendment (2006 Measures No. 2) Bill 2006 which will introduce criminal penalties for serious cartel conduct. The Bill, along with the Trade Practices Legislation Amendment Bill (No. 1) 2005, implements the Government's response to the independent review of the competition provisions (Part IV) of the *Trade Practices Act 1974* (the Dawson Review).

At their annual bilateral meeting on 22 February 2006, the Treasurer and the New Zealand Finance Minister announced they agreed to amend the Trade Practices Act and NZ Commerce Act to allow the ACCC and the New Zealand Competition Commission to exchange information gathered in the course of investigating competition and consumer protection matters under the agencies' respective powers. Treasury is developing legislation to implement this decision.

Treasury has also been involved in negotiations for the inclusion of competition chapters in free trade agreements with several countries. Treasury led the Australian Government's involvement in the Australia-United States Free Trade Agreement Working Group on Competition Law and Anti-competitive Business Practices. The working group was established to further advance cooperation between Australia and the United States for the effective enforcement of each other's competition laws and policies.

Treasury coordinates and advises the Government on preparation of terms of reference for Productivity Commission research and inquiries. In 2005-06, this involved four public inquiries and three commissioned research references.

Treasury has an advisory, reporting and coordination role for the Government's implementation of National Competition Policy. During 2005-06, Treasury provided advice to ministers on the last round of payments to the State and Territory governments. Treasury also provided advice on sector-specific reforms and inter-jurisdictional issues.

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Treasury worked closely with, and provided staff to, the National Competition Policy Review Secretariat within the Department of the Prime Minister and Cabinet to develop the new reform agenda that was announced in 2005-06 by COAG as part of the National Reform Agenda.

Treasury prepared amendments to the Trade Practices Amendment (National Access Regime) Bill 2006, which implements the Government's final response to the Productivity Commission's review of the National Access Regime for infrastructure facilities of national significance. The amendments were made by the Government in response to a report on the Bill by the Senate Economics Legislation Committee on 8 September 2005. Overall, the reforms aim to improve the operation of the National Access Regime and promote more efficient investment in, and use of, essential infrastructure. The House of Representatives passed the Bill and its amendments on 9 February 2006. A consolidated Bill was introduced in the Senate on 28 February 2006.

Treasury prepared advice on a range of issues concerning energy market reform. Treasury has worked with the Department of Industry, Tourism and Resources, and State and Territory governments towards amending COAG's Australian Energy Market Agreement 2004, and commencing implementation of the amendments. This agreement provides for the transfer of energy regulation functions from multiple state regulators to the new national regulator, the Australian Energy Regulator.

Treasury provided policy advice on a range of transport issues, including implementation of the Government's national land transport plan, *AusLink*; the Government's review of international aviation policy; and development of the Government's response to the Productivity Commission's review of Part X of the *Trade Practices Act 1974*.

Treasury engaged with other central and relevant line agencies (including the ACCC) on implementing measures contained in the Telstra sale legislation, including arrangements for the operational separation of Telstra, and regulatory and targeted funding measures to ensure the ongoing adequacy of telecommunications services for all Australians.

Treasury has also been involved in addressing key regulatory issues in telecommunications, including wholesale access pricing arrangements for Telstra's Unconditioned Local Loop Service, and the application of Part XIC of the Trade Practices Act to Telstra's proposed fibre-to-the-node broadband network.

Treasury is working closely with other agencies to progress key reforms in Australia's media sector. Central to the reform agenda is ensuring that Australians are able to access exciting new broadcasting services delivered, via new and emerging technological platforms, as well as liberalising media ownership regulations.

Consumer policy

In 2005-06, Treasury provided advice to the Government regarding the consumer policy framework which facilitates the effective and positive engagement of consumers in the economy.

Treasury continued to provide advice regarding the review of the Australian consumer product safety system, following release in February 2006 of the Productivity Commission's research study. Treasury examined the recommendations, and provided advice on the implications of adopting them.

Following the Treasurer's announcement in 2005 that the Australian Government would be amending the *Trade Practices Act 1974* to respond to the increased use of component pricing in a number of industries, Treasury progressed the proposed changes. A draft Bill and the draft Explanatory Memorandum were prepared and released in March 2006. Treasury has consulted with various stakeholders about the impact of the amendment.

Treasury also progressed the Ministerial Council on Consumer Affairs consumer policy research agenda. The two projects are research into scams in Australia and form a baseline study for product safety.

Financial Literacy Foundation

The Financial Literacy Foundation was established in June 2005 to give all Australians the opportunity to better manage their money.

The foundation aims to build the capacity of Australians to better understand and manage financial risk, deal effectively with market complexity and take advantage of increased competition and choice in Australia's finance sector. The foundation is addressing the structural, attitudinal and behavioural barriers to meeting these objectives through:

- developing partnerships with relevant government, industry and community organisations to deliver quality financial literacy programmes and resources;
- creating opportunities for Australians of all ages to learn more about money — at school, through vocational and higher education, in the workplace and in the community;
- playing a leadership role in obtaining the national endorsement of the National Consumer and Financial Literacy Framework, under which all Australian school children would receive financial literacy education in their compulsory years at school from the beginning of 2008;
- facilitating and supporting the introduction of financial literacy to workplace training, such as through the pilot programme implemented in partnership with the Master Builders Association (ACT);
- researching financial literacy issues, including establishing benchmark levels of financial literacy awareness, engagement and competence across the Australian community, and investigating the most effective ways to deliver financial literacy information to consumers; and

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- raising community awareness of financial literacy and its benefits through delivery of the *Understanding Money* media campaign, which will run from 30 July 2006 to mid-December 2006, and be supported by the *Understanding Money* website and handbook, and a programme of community seminars.

The Foundation's Advisory Board, chaired by Mr Paul Clitheroe, provides independent and strategic guidance on financial literacy issues. Advisory Board members are appointed by the Minister for Revenue and Assistant Treasurer, with the Prime Minister's approval.

Secretariat services

Treasury continued to provide secretariat support to the Ministerial Council on Consumer Affairs. A discussion paper was published in September 2005 on *Civil Penalties for Australian Consumer Protection Provisions*. Treasury analysed the submissions in preparation for drafting a position paper.

Treasury also continued to provide secretariat support to the Commonwealth Consumer Affairs Advisory Council, including publication of the booklet, *The Australian Guidelines for Electronic Commerce*, and an accompanying Fact Sheet, launched in March 2006 at the National Consumer Congress.

OUTPUT 4.1.4: ACTUARIAL SERVICES

During 2005-06, the Australian Government Actuary was responsible for the delivery of Output 4.1.4: Actuarial services.

The Australian Government Actuary provides, on a fee-for-service basis, accurate and timely actuarial and related advice to the Government, its departments and agencies.

PERFORMANCE INFORMATION

The key performance indicator is efficient provision of high quality professional services, with income from consultancy fees relative to total costs meeting specified quantitative criteria.

ANALYSIS OF PERFORMANCE

The Australian Government Actuary operates in a competitive and contestable market for actuarial services. Income from consultancy services relative to total costs is, therefore, a primary indicator of performance. The Australian Government Actuary operates a special

account to ensure its financial operations are managed properly and transparently. At 30 June 2006, the account was in a sound financial position.

Feedback from clients has generally been positive, consistent with an ongoing demand for services.

Consultancy services

Australian Government Actuary consultancy services typically involve analysing uncertain future financial flows using financial modeling techniques, documenting the analysis and presenting the results to clients.

Departments which sought advice included Defence; Attorney-General's; Education, Science and Training; Family, Community Services and Indigenous Affairs; Health and Ageing; Veterans' Affairs; and Finance and Administration. Centrelink, Medicare Australia and the Australian Taxation Office also sought advice.

Feedback from these agencies indicates that they were generally very satisfied with the advice received, and its value as an input in achieving their objectives.

Services to Treasury

The Australian Government Actuary contributed its technical expertise on a range of policy issues, including long-term care, medical indemnity arrangements, the superannuation system and insurance matters.

Treasury funded this work which accounted for around 15 per cent of the office's total revenue for the year.

Operational outcomes

The office operates under the direction of an internal advisory board comprising three senior Treasury officers, including the Australian Government Actuary. This board reviews financial performance and oversees the strategic direction of the office.

STRATEGIC COMMUNICATIONS DIVISION

Strategic Communications Division assists in the achievement of Treasury's outcomes by providing services in relation to Cabinet liaison; parliamentary liaison; ministerial correspondence; ministerial briefing coordination; coordination of freedom of information requests; advice and general secretariat services to the Secretary, Executive Board and Audit Committee; issues monitoring and management; proofreading services and evaluation of policy development and implementation.

It also undertakes Treasury-wide projects directed at enhancing the services provided to ministers, including on risk management and quality assurance.

KEY PRIORITIES IN 2005-06

The key priorities were to:

- ensure the delivery of appropriate services to Treasury ministers; and
- monitor and manage issues, in partnership with relevant policy areas in groups.

KEY OUTCOMES IN 2005-06

The key outcomes achieved were:

- provision of issues management services and support across Treasury;
- liaison, briefing and correspondence coordination for Treasury and its stakeholders;
- continued enhancement of Treasury's risk management and quality assurance capabilities;
- further improvement of reporting, support services and systems for advice sent to ministers; and
- implementation of the Executive Board decision to establish a policy evaluation function within the division.

CORPORATE SERVICES DIVISION

Corporate Services Division assists in achieving Treasury's outcomes through providing accurate, cost effective and timely management of information, corporate services and advice to the department and Treasury ministers. Corporate Services Division also seeks to provide a quality working environment for Treasury staff.

In 2005-06, Corporate Services Division restructured from six units to four units by merging four units into two new units. The key objectives of the amalgamation were to strengthen synergies between teams, eliminate overlap and duplication of services, and streamline reporting. The restructure was also aimed at providing staff in Corporate Services Division with improved career opportunities in the larger units and an opportunity to use resources more effectively and flexibly during peak periods. The newly formed units are:

- the Information Services Unit which is responsible for the delivery of information technology (IT) training, publishing, internet, intranet, library and records management services.
- the Financial and Facilities Management Unit which is responsible for the delivery of financial, accounting, facilities management, procurement, security and governance services.

Two Senior Executive Service (SES) positions, one in the Human Resources Unit and one in the Financial and Facilities Management Unit, were created to strengthen the strategic capacity of the division.

Other corporate structural changes made in 2005-06, included:

- transferring risk management and audit functions to the Strategic Communications Division; and
- transferring information and knowledge management responsibilities to the newly created Information Services Unit.

KEY PRIORITIES IN 2005-06

Corporate Services Division priorities identified in the 2004-05 Corporate Plan were to:

- continue to progress knowledge management initiatives, including continuing to implement electronic records management, enhancing the departmental intranet and continuing to develop departmental internet sites;
- promote a risk management framework across Treasury;

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- contribute to the negotiation and implementation of Treasury's remuneration and conditions framework;
- enhance further human resource and financial information management systems;
- further develop internal financial management processes, including implementing a long-term capital management plan;
- analyse and align the staff survey outcomes with organisational strategies;
- maintain and expand IT applications to support departmental operations;
- continue to ensure the security of the IT network and systems, including a re-accreditation of the Internet gateway; and
- enhance professional development programmes for staff at all levels.

KEY OUTCOMES IN 2005-06

Key outcomes in 2005-06 were:

- Consultation for the development of Treasury's Information and Knowledge Management Strategic Plan commenced in May 2006. The plan will set out the overall direction and general framework in which Treasury's knowledge management initiatives can be assessed and prioritised, so corporate objectives can be achieved. The plan is due to be released in October 2006.
- Other information and knowledge management initiatives progressed in 2005-06, included:
 - Treasury's Legal Opinion Register which will provide a central repository for all legal advice provided to Treasury; and
 - Recordkeeping and TRIM Electronic Records Management which included recordkeeping field visits to each division in Treasury. The field visits evaluated the progress of records management, assisted staff in using the TRIM recordkeeping system more effectively and provided advice on records management policies and procedures. In 2006, the focus was on addressing issues relating to staff awareness of recordkeeping obligations and staff concerns regarding accessibility of documents. Emphasis was placed on continuing user training on the TRIM system and improving the stability and usability of the system.
- Treasury's Corporate Policy and Framework for Managing Risk was finalised in April 2006. The statement integrates existing risk management initiatives under one framework and establishes a risk communication strategy and training framework for stakeholders.

- Treasury's Mature Age Employment Strategy which provides mature age workers with more flexible options for continuing to work. The strategy was released in May 2006.
- The Treasury Certified Agreement 2004–2006 is due to expire in September 2006. Processes to replace the Certified Agreement with a new collective agreement, incorporating the government's recent WorkChoices changes, are under way.
- Treasury consulted with staff and the representative staff body, the Workplace Relations Committee, on Treasury's remuneration framework, which includes the Collective Agreement and Australian Workplace Awards (AWAs). AWAs are offered to all APS6, Executive Level 1 and Executive Level 2 employees. AWAs offer performance based pay points above those available under the Collective Agreement. Both types of agreement offer conditions of service that are designed to make Treasury an attractive employer of choice. SES employees are exclusively covered by AWAs.
- Treasury continued to enhance its Human Resource Management Information System in areas which support business functions, including reporting and employee access to personnel information. In 2005-06, a query tool and single sign-on for Employee Self Service were introduced. Use of Treasury's web-based recruitment system, JobOffice, was expanded to include job seekers, managers and selection panels for advertised vacancies.
- A new contracts' module in Treasury's Financial Management and Information System will link financial management and contracts information, ensuring better reporting and control in the procurement of goods and services.
- The Capital Management Plan is being updated to enable Treasury to evaluate its requirements for infrastructure and information management initiatives and set priorities. The plan will address the capital needs for the full range of infrastructure, including Information Communications and Technology (ICT) infrastructure, which will contribute to a well functioning organisation. Components of the Capital Management Plan will be aligned to the Information Knowledge Management Strategy, currently under development. This strategy is designed to better integrate the systems and ICT resources across the whole of Treasury.
- The results of the Staff Opinion Survey conducted in 2005 indicated, overall, that staff satisfaction had improved. Areas of particular strength include people values, commitment to the department, satisfaction with the nature of the work and the quality of staff. The results indicated staff are highly satisfied that Treasury provides a safe, healthy and supportive work environment including support for learning and development. Staff were especially satisfied with work/life balance and the value placed on diversity. The results of the

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survey did suggest, however, that staff would value more career guidance, especially from their Manager-One-Removed.

- Key outcomes in information management and IT security in 2005-06 were developing and implementing the new Foreign Investment Management System, implementing Treasury's email classification system, re-accrediting Treasury's Internet gateway and certifying Treasury's network to the protected level.
- Treasury received a favourable outcome following the internal audit of IT Governance and Benchmarking against industry standards and other government agencies. There were no reported hackings, unauthorised intrusions or IT virus infections of Treasury's IT Network in 2005-06.
- Treasury's Professional Development Framework continued to place a high priority on skill development. Executive coaching was introduced in 2005 for senior executive staff members, with a gradual take-up of the opportunity. Changes to the studies assistance guidelines and postgraduate study awards were implemented in 2005 with almost 14 per cent of staff accessing the financial and leave provisions. Other key learning and development priorities for 2005-06, included:
 - selection of a new provider for Treasury's Executive Level Leadership Programme;
 - a panel arrangement for skills development workshops;
 - launch of an extended Business Services Programme for administrative staff;
 - semester-long courses in law and economics; and
 - delivery of technical seminars and workshops relating to the core business areas of Treasury.