

CHAPTER 1: BUDGET POSITION

- ◆ A Budget surplus of \$268 million is estimated for 2008-09, with an average surplus of \$782 million per annum for the following three years.
- ◆ Budget reporting in the 2008-09 Budget is, for the first time, in accordance with Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. This standard attempts to combine both accounting and government finance statistics (GFS) principles. Previous budgets were prepared on a GFS basis.
- ◆ The Budget surplus is estimated to be \$700 million for 2007-08 (\$1 billion on a GFS basis), compared with \$40 million in the 2007-08 Budget (\$376 million on a GFS basis) and \$170 million in the 2007-08 Half-Yearly Budget Review (\$506 million on a GFS basis).
- ◆ Total revenues are expected to rise by 3.2 per cent in 2008-09 to \$47.9 billion. Revenues are expected to increase on average by 4.4 per cent per annum over the four years to 2011-12.
- ◆ Total expenses are expected to rise by 4.2 per cent in 2008-09 to \$47.6 billion. Expenses are expected to increase on average by 4.5 per cent per annum over the four years to 2011-12.
- ◆ Major taxation policies announced in this Budget – reduction in payroll tax rates, indexation of payroll tax thresholds and bringing forward the abolition of transfer duty on non-land business assets – will reduce revenues by \$148 million in 2008-09 rising to \$948 million per annum in 2011-12. This is a total reduction in revenues of \$2.2 billion over the next four years.
- ◆ Capital expenditure in the general government sector will be at record levels and is estimated to be \$5.5 billion in 2008-09. It will average \$5.3 billion per annum for the following three years.
- ◆ There will be an increase in general government net debt due to record levels of capital expenditure. Net debt will increase from \$5 billion (1.4 per cent of GSP) at 30 June 2008 to \$7.8 billion (1.7 per cent of GSP) at 30 June 2012. Net debt remains at a sustainable level and significantly lower than in 1995 when it was \$12.2 billion (7.4 per cent of GSP).
- ◆ General government net financial liabilities will increase from \$29.3 billion at June 2008 to \$36.5 billion at June 2012. This represents a decrease from 8.2 per cent of GSP at June 2008 to 8 per cent at June 2012.

1.1 INTRODUCTION

The budget papers report principally on the financial and service delivery performance of the general government sector. General government agencies typically deliver public services or are regulatory in nature.

The general government sector forms one part of the total state sector. The remainder comprises more commercially focused entities—public trading enterprises (PTE) and public financial enterprises (PFE). These agencies do not impact on the budget result, other than through payment of dividends and tax equivalents and where they receive funding to provide services on a subsidised basis.

This chapter focuses on the financial position and performance of the general government sector. An analysis of the financial position and performance of the PTE sector is provided in Chapter 7.

Financial reporting of the general government sector complies with the accrual based accounting and reporting principles of Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

AASB 1049 converges the reporting principles of Australian Accounting Standards and Government Finance Statistics (GFS) and applies, for the first time, to the 2008-09 financial year. The financial statements of prior reporting periods have been restated in these budget papers to AASB 1049 principles to ensure that performance trends can be assessed on a comparable basis.

The General Government Sector Operating Statement set out in Table 1.2 highlights the key operating statement aggregates disclosed under AASB 1049:

- ◆ The Budget result or net operating balance reports the difference between the full cost of general government service delivery in the financial year, excluding new capital expenditure but including depreciation of the existing stock of fixed assets, and the revenues earned in that year to fund those services. Accordingly, this is the principal measure of a government's financial performance and is the one that is focussed on in these budget papers.
- ◆ The operating result is the net operating balance plus other economic flows, such as net actuarial superannuation gains and losses.
- ◆ The comprehensive result is the operating result plus other movements in equity, such as revaluations of fixed assets.

- ◆ The net lending/(borrowing) result demonstrates the extent to which the current year's activities impact the general government sector's net financial liabilities.

The Government has announced its intention to lease its power stations to private operators and transfer the retail operations of Country Energy, EnergyAustralia and Integral Energy to private operators.

Following normal budget practice, the Budget assumes that the current ownership and control of electricity assets remains unchanged.

1.2 BUDGET RESULTS

The Budget results for 2004-05 to 2011-12 set out in Chart 1.1 are prepared in accordance with the accounting principles of Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. This standard attempts to combine both accounting and government finance statistics (GFS) principles. Previous budgets were prepared in accordance with GFS principles.

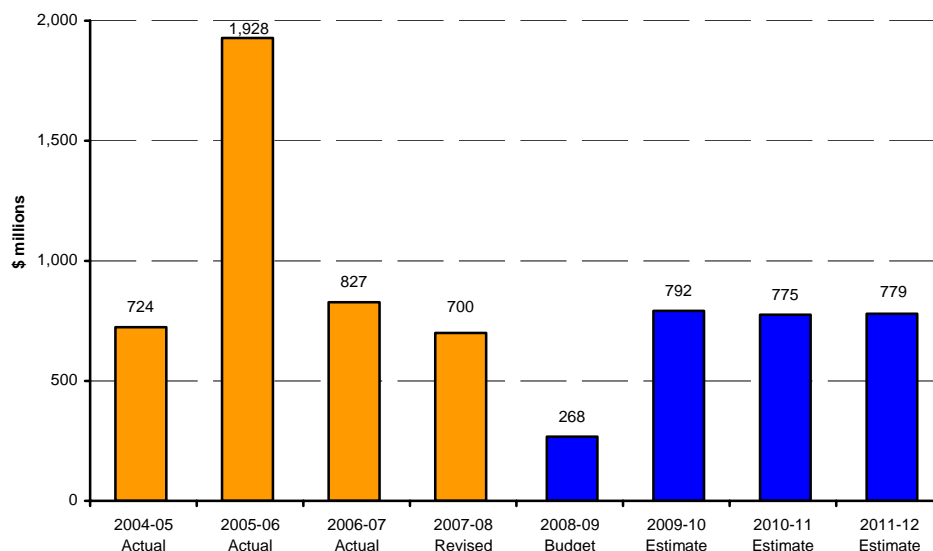
The Budget result for 2005-06 is significantly impacted by the receipt of a specific Australian road transport grant of \$960 million received from the Commonwealth government in late June 2006.

In previous budget papers, this revenue has been brought to account progressively over the financial years in which the related capital expenditure was expected to be incurred, i.e. 2006-07 to 2009-10, in accordance with GFS principles. With the adoption of AASB 1049, this revenue must be fully recognised in the financial year in which it was received, i.e. 2005-06. The introduction of AASB 1049 in the 2008-09 Budget has impacted the Budget result of a number of financial years as set out in Table 1.1 below.

Table 1.1: Budget Results – comparison on a AASB 1049 and GFS basis

	2005-06 <i>Actual</i> \$m	2006-07 <i>Actual</i> \$m	2007-08 <i>Budget</i> \$m	2007-08 <i>Revised</i> \$m	2008-09 <i>Estimate</i> \$m	2009-10 <i>Estimate</i> \$m
Budget Result - GFS basis	976	881	376	1,036	737	885
Road transport grant adjustment	952	(54)	(336)	(336)	(469)	(93)
Budget Result - AASB 1049 basis	1,928	827	40	700	268	792

Chart 1.1: Budget results 2004-05 to 2011-12



Full details of the revenues and expenses underpinning these Budget results are set out in Table 1.2.

BUDGET RESULT FOR 2008-09

The Budget result for 2008-09 is expected to be a surplus of \$268 million.

Revenue

Total revenue for 2008-09 is estimated to be \$47.9 billion. This is an increase of \$1.5 billion or 3.2 per cent over the revised estimate for 2007-08.

Taxation revenue is expected to increase by \$67 million to \$18.5 billion in 2008-09, an increase of 0.4 per cent over 2007-08. This reflects a slowing in residential and commercial property market activity (which reduces transfer duty) due to higher interest rates; and the impact of policy changes including a reduction in payroll tax rates, indexation of payroll tax thresholds; and the abolition of mortgage duty on non-owner occupied residences and unquoted marketable securities.

Commonwealth general purpose grants are estimated to be \$13 billion, an increase of 8 per cent over 2007-08. The growth results from increases in both the GST pool and New South Wales' relative share of that pool. New South Wales continues to be short changed on the GST – generating an estimated \$15 billion GST in New South Wales in 2008-09, yet getting back only \$13 billion from the Commonwealth.

Commonwealth specific purpose grants of \$7.2 billion in 2008-09 are expected to decrease by \$291 million or 3.9 per cent over 2007-08, primarily due to some SPPs such as drought assistance not carrying through to 2008-09.

Other grants and contributions are expected to fall to \$782 million from \$1.1 billion, or by 25.7 per cent, compared with 2007-08. In 2007-08, the Tugun Bypass was completed and transferred to the NSW Government. Under the relevant accounting standards, the value of the capital expenditure incurred in 2007-08 by the Queensland Government is recognised as revenue to the NSW Government.

Sale of goods and services is expected to increase to \$3.6 billion, an increase of 4.2 per cent over 2007-08. The increase relates mainly to health, education and road services. There are generally offsetting additional expenses associated with this revenue increase.

Interest income in 2008-09 is expected to be \$706 million, which reflects anticipated long run average investment returns. This follows the significant reduction in 2007-08 to \$162 million, arising from sharp falls in global financial markets.

Dividends and income tax equivalent payments are expected to decrease to \$1.8 billion, a fall of 1.3 per cent from 2007-08. Higher payments from the property, resources and water sectors will be more than offset by lower payments from the electricity sector. The recent rise in interest rates is likely to significantly increase borrowing costs and thereby reduce profits for the electricity network businesses. A significant portion of their capital expenditure is debt funded.

Fines, regulatory fees and other revenue is estimated to increase by \$354 million to \$2.2 billion in 2008-09, an increase of 19.4 per cent over 2007-08. The increase is primarily due to higher mining royalties (up \$400 million), arising from expected increases in the price for coal.

A comprehensive discussion of revenue estimates is in Chapter 4.

Expenses

Total expenses for 2008-09 are estimated to be \$47.6 billion. This is an increase of 4.2 per cent over the revised estimate for 2007-08.

Priorities in the 2008-09 Budget include:

- ◆ Health – expanding mental health services, increasing acute care capacity, integrating primary health care facilities, implementing reform initiatives agreed by the Council of Australian Governments (COAG), further reducing elective surgery waiting times, investing in oral health, renal treatment and ambulance services, and continuing to expand nurse numbers and enhance their clinical expertise.
- ◆ Education and Training – continued implementation of NSW Government election commitments including the Best Start initiative, Connected Classrooms, Support for Beginning Teachers, the Transition to Year 7 initiative, School Sport and the Training our Workforce and Learn or Earn initiatives.
- ◆ Disability Services – improving options for people with disabilities, providing increased welfare and support for carers, and expanding prevention and early intervention services.
- ◆ Aboriginal Affairs – community officers in 40 partnership communities to connect services to needs, further expansion of programs to raise awareness and prevention of child sexual assault, water and sewerage maintenance programs and the establishment of an evaluation and strategic planning unit in the Department of Aboriginal Affairs.

Employee expenses (excluding superannuation) are estimated to increase by \$828 million over the 2007-08 revised estimate, an increase of 4.1 per cent. The Government's wages policy is to limit the cost of future wage increases to 2.5 per cent per annum. The growth in expenses above this amount principally reflects additional key frontline service staffing numbers, including additional mental health professionals, nurses, ambulance operatives and acute care clinicians and the full year impact of wage increases granted in 2007-08.

Superannuation expenses are estimated to increase by \$224 million over the 2007-08 revised estimate, a rise of 9.8 per cent. This is primarily due to the decline in the value of superannuation assets following negative investment returns in 2007-08 resulting in lower projected fund investment returns and therefore higher costs to the Government.

Depreciation and amortisation expenses are estimated to increase by \$125 million or 5 per cent in line with the growth in fixed assets. Interest expenses are estimated to increase by \$143 million or 11 per cent in line with the projected increase in borrowings and interest rates.

After allowing for the inclusion of the Treasurer's Advance in 2008-09, other operating expenses are projected to increase by 6.6 per cent, reflecting the impact of a favourable movement in insurance expenses in 2007-08.

The Treasurer's Advance provision is being increased from \$215 million in 2007-08 to \$300 million in 2008-09. This is to better provide for unforeseen expenses that normally arise in any year. The new provision is only 0.6 per cent of total expenses.

Capital grants are estimated to be \$2 billion, or \$109 million below the 2007-08 revised estimate. A rail debt repayment associated with the Epping to Chatswood Rail Line of \$390 million, which was budgeted to be paid in 2008-09, will now be repaid a year earlier in 2007-08. Offsetting this are additional expenses related to land transfers associated with the South West Rail Link (\$84 million).

Further information on expense trends and budget initiatives is in Chapter 3. The details of general government agency level activity and expenses are provided in Budget Paper No. 3 *Budget Estimates*.

Table 1.2: General Government Sector Operating Statement

	2006-07	2007-08		2008-09	2009-10	2010-11	2011-12
	Actual ^(a)	Budget ^(a)	Revised	Budget	Forward estimates		
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Revenue from Transactions							
Taxation	17,697	17,553	18,466	18,533	19,194	20,034	20,923
Grant revenue							
- Commonwealth - general purpose	10,938	11,926	12,060	13,020	13,972	14,738	15,547
- Commonwealth - specific purpose	6,815	6,854	7,540	7,249	7,875	8,195	8,346
- Other grants and contributions	1,021	812	1,053	782	781	870	903
Sale of goods and services	3,303	3,423	3,474	3,620	3,739	3,852	3,953
Interest income	1,239	720	162	706	742	781	818
Dividend and income tax equivalent							
income from other sectors	1,925	1,766	1,820	1,796	1,957	2,002	2,121
Dividends from associates	29	...	...	...	58	70	81
Fines, regulatory fees and other revenue	1,760	1,591	1,821	2,176	2,347	2,681	2,494
Total Revenue	44,727	44,645	46,396	47,882	50,665	53,223	55,186
Expenses from Transactions							
Employee expenses	18,773	20,034	20,237	21,065	22,155	22,846	23,766
Superannuation expenses							
- Superannuation interest cost	749	501	420	598	601	524	513
- Other superannuation expenses	1,822	1,880	1,870	1,916	1,937	1,976	2,007
Depreciation and amortisation	2,308	2,429	2,478	2,603	2,791	2,940	3,067
Interest expenses	1,257	1,321	1,297	1,440	1,540	1,666	1,773
Other property expenses	2	...	2	3	3	3	3
Other operating expenses ^(b)	8,724	9,268	9,160	10,064	10,205	10,650	10,885
Grant expenses							
- Current grants and subsidies	7,426	7,531	8,161	7,963	8,107	8,452	8,586
- Capital grants	2,839	1,641	2,071	1,962	2,534	3,391	3,807
Total Expenses	43,900	44,605	45,696	47,614	49,873	52,448	54,407
BUDGET RESULT - SURPLUS/(DEFICIT)							
[Net Operating Balance]	827	40	700	268	792	775	779

Table 1.2: General Government Sector Operating Statement (cont)

	2006-07	2007-08		2008-09	2009-10	2010-11	2011-12
	Actual ^(a)	Budget ^(a)	Revised	Budget	Forward estimates		
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Other economic flows included in the operating result							
Other revenue (dividends from asset sale proceeds)	...	...	...	...	147	...	...
Share of net profit/(loss) from associates excluding dividends	7	97	100	114	66	50	43
Net actuarial superannuation gains/(losses) ^(c)	3,316	(169)	(2,710)	(79)	(2,418)	(121)	(126)
Other net gains/(losses)	(191)	(4)	(87)	(114)	40	125	152
Operating result (accounting basis)	3,959	(36)	(1,997)	189	(1,373)	829	848
Other economic flows - other movements in equity							
Revaluations	2,470	822	928	911	1,165	1,041	1,076
Net gain/(loss) on equity investments in other sectors	3,833	871	2,803	1,584	2,443	2,931	3,376
Net gain/(loss) on financial instruments at fair value	(590)	...	414	124	14	1	...
Other	...	...	...	...	...	...	...
Comprehensive result - total change in net worth^(d)	9,672	1,657	2,148	2,808	2,249	4,802	5,300
KEY FISCAL AGGREGATES							
Comprehensive result - total change in net worth^(d)	9,672	1,657	2,148	2,808	2,249	4,802	5,300
Less: Net other economic flows	8,845	1,617	1,448	2,540	1,457	4,027	4,521
equals: Budget Result - net operating balance	827	40	700	268	792	775	779
less Net acquisition of non-financial assets							
Purchase of non-financial assets	4,140	4,691	4,541	5,158	5,227	5,182	4,847
Sales of non-financial assets	(499)	(469)	(527)	(594)	(632)	(685)	(657)
less Depreciation	(2,308)	(2,429)	(2,478)	(2,603)	(2,791)	(2,940)	(3,067)
plus Change in inventories	36	(2)	4	(2)	12	2	(2)
plus Other movements in non-financial assets							
- assets acquired utilising finance leases	132	245	324	319	125	293	129
- other	346	16	246	15	141	(110)	140
equals Total Net acquisition of non-financial assets	1,847	2,052	2,110	2,293	2,082	1,741	1,390
equals Net Lending/(Borrowing) [Fiscal Balance]	(1,020)	(2,012)	(1,410)	(2,025)	(1,290)	(966)	(611)
OTHER AGGREGATES							
Capital Expenditure ^(e)	4,272	4,937	4,865	5,477	5,352	5,475	4,976

Notes

- (a) Australian Accounting Standard AASB 1049 has been adopted for the first time for the 2008-09 Budget. Amounts prior to 2008-09 have been classified according to the new standard, where practicable. However, where some historic dissections have not been available, the financial information has been reported on a best available basis. The 2007-08 Budget column has been restated to reflect AASB 1049 treatments. The original GFS based Budget Result of \$376million surplus is now restated to a \$40 million surplus due to the GFS accrual treatment for Australian road transport grant revenue, which is recorded under AASB 1049 on a cash basis.
- (b) Includes Treasurer's Advance of \$300 million per annum from 2008-09.
- (c) In 2007-08, the major component relates to lower investment returns compared with the long term earnings assumption. In 2009-10, the major component results from a change in the superannuation discount rate from a forecast of 6.35 per cent in 2009 to a long term parameter of 5.85 per cent in 2010.
- (d) Total change in net worth is before transactions with owners as owners and changes resulting from revisions to accounting policies. Therefore, it might not equal the movement in balance sheet net worth.
- (e) Capital expenditure comprises purchases of non-financial assets plus assets acquired utilising finance leases.

BUDGET RESULTS FOR 2009-10 TO 2011-12

The budget result is expected to remain in surplus in the forward years with surpluses of \$792 million in 2009-10, \$775 million in 2010-11 and \$779 million in 2011-12 (see Table 1.2).

Revenue

Total revenue is forecast to increase at an average 4.8 per cent per annum over the three years to 2011-12.

Taxation revenue is expected to increase by an average of 4.1 per cent per annum. This reflects moderate growth in the property market and a return to trend growth for wages and employment. These factors are offset by the impact of the tax measures announced in this Budget i.e. reductions in the payroll tax rate, indexation of payroll tax thresholds and bringing forward the abolition of transfer duty on non-land business assets.

General purpose grants from GST revenues are projected to increase by an average of 6.1 per cent per annum due to continued steady growth in the GST pool and a projected relative improvement in New South Wales' GST relativity.

Commonwealth specific purpose grants are expected to increase by an average of 4.8 per cent. This is in line with indexation and population growth estimates.

Interest income is expected to increase by an average of 5 per cent per annum, based on expectations of returning to long term investment earning rates.

Dividends and income tax equivalent revenues are projected to grow by an average of 5.7 per cent per annum, mainly within the electricity network (transmission and distribution) businesses. This is in expectation that the Australian Energy Regulator will allow a return on an increasing asset base arising from a growing capital program over that period.

Expenses

Total expenses are forecast to increase at an average 4.5 per cent per annum over the three years to 2011-12.

Employee-related expenses are estimated to increase by an average 4.1 per cent. This is based on the expectation that wages growth will be constrained within the government's policy of 2.5 per cent per annum and on expected growth in numbers of key frontline services. For example, the Government has provided for year-on-year increases in the number of hospital beds, resulting in additional doctors, nurses and allied health staff to be employed to meet this additional demand.

Superannuation expenses are expected to remain at broadly the same levels over the forward estimates period, reflecting an increase in the membership of accumulation schemes, offset by a reduction the number of members in the Defined Benefit Scheme.

Depreciation and amortisation expenses are estimated to increase by 5.6 per cent in line with the growth in fixed assets.

Interest expenses are estimated to increase by 7.2 per cent, which is in line with the growth in borrowings and changes in the effective interest rate of debt.

Capital grants will increase significantly in the forward estimates period, by an average of 24.7 per cent. This is primarily within the rail sector, representing funding for the recently announced North West Metro and South West Rail Link. Additional funding of \$530 million has been provided in 2009-10 to retire debt incurred to finance the Clearways program.

BUDGET RESULT FOR 2007-08

The Budget result for 2007-08 is estimated to be a surplus of \$700 million compared with an estimated surplus of \$170 million at the time of the Half-Yearly Budget Review, and a budgeted surplus of \$40 million (see Table 1.3). In the absence of the rail debt repayment brought forward from 2008-09, the Budget result for 2007-08 would have been a surplus of \$1.1 billion or \$1.4 billion under GFS principles.

The 2007-08 Budget Papers and Half-Yearly Budget Review were prepared in accordance with government finance statistics (GFS) principles. The 2008-09 Budget papers have been prepared in accordance with the new Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

The 2007-08 Budget estimates in these budget papers have been restated in accordance with Australian Accounting Standard AASB 1049 principles, to facilitate comparison of budget results.

The impact of this restatement is to reduce the budgeted surplus for 2007-08 in the 2007-08 budget papers from \$376 million to \$40 million and in the 2007-08 Half-Yearly Budget Review from \$506 million to \$170 million. This is because Commonwealth funds received in 2005-06 for the Hume and Pacific Highways are treated as revenue in the year of receipt (i.e. 2005-06) under AASB 1049, whereas previously, under GFS principles, these grants are treated as revenue when the related capital expenditure is incurred (budgeted to be \$336 million in 2007-08).

Revenue

Total revenue for 2007-08 is projected to be \$46.4 billion, \$1.8 billion above the budget estimate of \$44.6 billion.

Taxation revenue is estimated to be \$913 million above the 2007-08 budget estimate of \$17.6 billion. The principal reasons for this variance are:

- ◆ Transfer duty receipts are higher by \$394 million, due to a significant, albeit temporary, increase in residential property prices and volumes, primarily in the premium property market.
- ◆ Payroll tax revenue is \$190 million higher due to stronger than expected wage and employment growth.
- ◆ Land tax revenue is higher by \$218 million, due to a larger number of land tax assessments processed for the 2007 year and higher land value growth, particularly for high value properties.

GST revenue grants are estimated to be above budget by \$134 million due to an increase in the Commonwealth's estimate of the GST revenue pool.

Commonwealth specific purpose grants are estimated to exceeded budget by \$686 million primarily from new grants and increases in existing grant programs. New grants include: Groundwater Adjustments (\$79 million), various educational COAG programs (\$57 million), Equine Influenza (\$49 million) and The Living Murray program (\$35 million).

Increases in existing programs include Exceptional Circumstances Grants (\$205 million) for drought relief and the Australian Health Care Agreement (\$165 million). These revenues are generally offset by corresponding increases in expenses.

Other grants and contributions are expected to be higher than budget by \$241 million. This is mainly due to the completion and transfer of the Tugun Bypass by the Queensland Government.

Offsetting the revenue increases noted above, interest income is estimated to be \$558 million below budget, due to the significant falls in financial markets during 2007-08.

Expenses

Total expenses in 2007-08 are projected to be \$45.7 billion, which is higher than budget by \$1.1 billion.

The additional Commonwealth grants of \$686 million noted above broadly have a corresponding increase in expenses.

The stronger than expected budget position in 2007-08 allowed the government to repay debt of \$390 million associated with the Epping to Chatswood Rail Line in 2007-08, rather than as anticipated in 2008-09.

A rigorous expenditure review process ensured that agencies' expenses were largely constrained within budget, including the delivery of around \$300 million in additional efficiency dividends.

During the year, the Government sought additional appropriations for: the expansion of contracted private buses (\$6 million), higher expenditure on out-of-home care allowances (\$34.8 million), additional school teaching costs (\$26.6 million), additional hospital beds (\$10 million) and New South Wales' share of National Equine Influenza Response Plan costs (\$1.2 million).

A detailed agency by agency analysis of expected variances to the 2007-08 Budget estimates is included at Appendix D.

**Table 1.3: General Government Operating Sector Statement
2007-08 estimated results**

	2007-08		
	Budget \$m	Revised \$m	Variation \$m
Revenue from Transactions			
Taxation	17,553	18,466	913
Grant revenue			
- Commonwealth - general purpose	11,926	12,060	134
- Commonwealth - specific purpose	6,854	7,540	686
- Other grants and contributions	812	1,053	241
Sale of goods and services	3,423	3,474	51
Interest income	720	162	(558)
Dividend and income tax equivalent income from other sectors	1,766	1,820	54
Dividends from associates	...	...	...
Fines, regulatory fees and other revenue	1,591	1,821	230
Total Revenue	44,645	46,396	1,751
Expenses from Transactions			
Employee expenses	20,034	20,237	203
Superannuation expenses			
- Superannuation interest cost	501	420	(81)
- Other superannuation expenses	1,880	1,870	(10)
Depreciation and amortisation	2,429	2,478	49
Interest expenses	1,321	1,297	(24)
Other property expenses	...	2	2
Other operating expenses	9,268	9,160	(108)
Grant expenses			
- Current grants and subsidies	7,531	8,161	630
- Capital grants	1,641	2,071	430
Total Expenses	44,605	45,696	1,091
BUDGET RESULT - SURPLUS/(DEFICIT)			
[Net Operating Balance]	40	700	660

OPERATING RESULTS, COMPREHENSIVE RESULTS AND NET LENDING RESULTS FOR 2007-08 TO 2011-12

The principal focus of these budget papers in assessing the financial performance of the general government sector is the Budget result or net operating balance.

The general government sector operating statement, at Table 1.2, prepared in accordance with Australian Accounting Standard AASB 1049 discloses other aggregates.

The operating results for the period 2007-08 to 2011-12 are broadly consistent with the Budget results except for 2007-08 and 2009-10, when operating losses of \$2 billion and \$1.4 billion respectively are expected to be incurred.

In 2007-08 higher superannuation liabilities follow negative investment returns due to the global credit crisis and sub prime failures in the United States. In 2009-10, superannuation liabilities increase sharply reflecting a decrease in the discount rate used to estimate liabilities from a forecast of 6.35 per cent in 2009 to a longer term parameter estimate of 5.85 per cent.

Without these superannuation revaluations the results for 2007-08 and 2009-10 would also have been broadly similar to the Budget result.

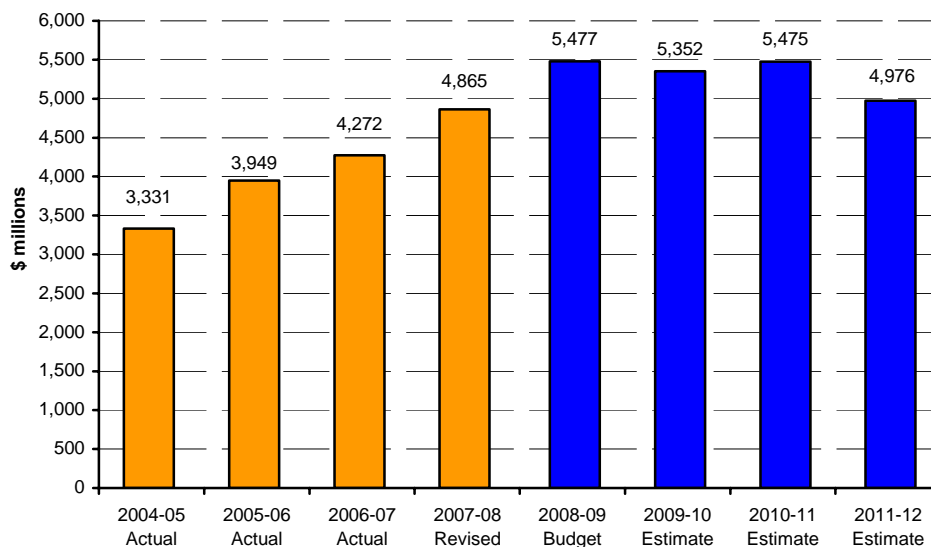
The comprehensive results are strongly in surplus for all of the years from 2007-08 to 2011-12, ranging from \$2.1 billion in 2007-08 to \$5.3 billion in 2011-12. This is a result of the Budget surpluses and the impact of anticipated revaluations of both land and other fixed assets and investments in PTEs.

The net lending result is expected to be in deficit in all the years from 2007-08 to 2011-12. In 2007-08 net lending result will be a deficit of \$1.4 billion, rising to \$2 billion in 2008-09 and averaging \$956 million per annum in the forward years.

The net lending deficits reflect the fact that the Government is partly funding its record capital expenditure program through increased borrowings.

1.3 CAPITAL EXPENDITURE

Chart 1.2: Capital Expenditure 2004-05 to 2011-12



In 2008-09, capital expenditure in the general government sector will total \$5.5 billion. This is an increase of 12.6 per cent over the 2007-08 revised estimate of \$4.9 billion. The significant increases are attributable to:

- ◆ \$732 million by the Department of Education and Training, an increase of 27.5 per cent over the 2007-08 estimate. The 2008-09 program includes five new schools, 14 major new building projects at schools and 12 new TAFE projects.
- ◆ \$2.2 billion by the Roads and Traffic Authority, an increase by 15.3 per cent over the 2007-08 estimate. The increase is mainly due to expanded programs on the Pacific, Hume and Great Western Highways, Victoria Road and the M5 East Tunnel Filtration.
- ◆ \$779 million for the Department of Health, an increase of 20.2 per cent over the 2007-08 estimate. The 2008-09 program includes a wide range of initiatives including hospital upgrades, the Ambulance Infrastructure program and the Rural Hospital and Health Service program Phase 4.

- ◆ The Minister Administering the Environmental Planning and Assessment Act will have a capital program of \$233 million in 2008-09, compared to \$130 million in 2007-08, for the Sydney Regional Development Fund, an increase of 79.2 per cent. This principally reflects the ongoing purchase of rail corridors for the North West Metro and South West Rail Link.

In the four years to June 2012, capital expenditure in the general government sector is expected to total \$21.3 billion, an increase of 29.6 per cent or \$4.9 billion over spending in the previous four year period.

The details of general government agency capital expenditure and projects are contained in Budget Paper No. 4 *Infrastructure Statement*.

1.4 BALANCE SHEET

The general government balance sheet (Table 1.4) is currently strong. Net debt and net financial liabilities will increase over the next four years to fund the Government's record capital expenditure program. However, they will remain at sustainable levels and below the levels of the early to mid-1990s.

Net debt

Net debt is estimated to be \$5 billion (1.4 per cent of gross state product) in June 2008 and to increase to \$7.8 billion (1.7 per cent of GSP) in June 2012. The increase in net debt reflects an expanded capital works program.

Discussion of the Government's fiscal strategy, including a comprehensive assessment of the Government's performance against its fiscal targets, is set out in Chapter 2.

Net financial liabilities

Net financial liabilities include the full range of the general government sector's financial obligations (including debt, unfunded superannuation liabilities, insurance liabilities and employee-related liabilities) less its financial assets (including cash and investments).

Net financial liabilities are estimated to be \$29.3 billion (8.2 per cent of GSP) in June 2008 and increase to \$36.5 billion by June 2012. However, this represents a decrease from 8.2 per cent of GSP at June 2008 to 8 per cent at June 2012.

The record levels of capital expenditure contribute to the increase in net financial liabilities.

In addition, superannuation liabilities are expected to increase between June 2007 and June 2008 due to the impact of negative investment returns in 2007-08 arising from the significant falls in financial markets. These liabilities will also increase between June 2009 and June 2010 because the discount rate used to value them decreases from 6.35 per cent in 2009 to a long term parameter estimate of 5.85 per cent.

Net worth

Net worth is estimated to be \$139 billion at June 2008, an increase of \$2.2 billion on the \$136.8 billion at June 2007.

Net worth is then estimated to increase significantly over 2008-09 and the forward estimates period so that by June 2012 it is estimated to be \$154.6 billion.

The significant increase in net worth reflects record levels of capital expenditure as well as the impact of cyclical revaluations of assets by agencies.

A comprehensive analysis of assets, liabilities and net worth is included in Chapter 6.

Table 1.4: General Government Sector Balance Sheet

	June 2007	June 2008		June 2009	June 2010	June 2011	June 2012
	Actual \$m	Budget \$m	Revised \$m	Budget \$m	Forward estimates \$m		
ASSETS							
Financial Assets							
Cash and deposits	2,421	2,933	2,451	2,681	2,985	3,371	3,818
Advances paid	795	894	861	908	912	924	922
Investments, loans and placements	7,165	7,042	6,417	7,014	7,517	8,063	8,661
Receivables	11,193	9,757	10,570	10,217	10,515	10,527	10,649
Equity investments							
in other public sector entities	68,040	67,770	70,842	72,426	74,870	77,801	81,177
accounted for using the equity method	1,519	1,662	1,619	1,733	1,799	1,849	1,892
in other entities	4	4	4	4	4	4	4
Total Financial Assets	91,137	90,062	92,764	94,983	98,602	102,539	107,123
Non-financial Assets							
Land and other fixed assets							
Inventories	173	156	177	176	187	189	188
Property, plant, equipment and infrastructure	91,599	94,161	94,247	97,306	100,215	103,095	105,724
Investment property	312	398	356	356	356	356	356
Assets held for sale	208	176	170	133	179	153	106
Biological assets	6	...	6	6	6	6	6
Intangible (produced) assets	545	556	723	960	1,145	1,193	1,167
Other non-financial assets							
Intangible (non-produced) assets	...	12	...	...	...	...	...
Other (non-financial assets)	1,587	1,467	1,734	1,884	2,040	2,183	2,337
Total Non-financial Assets	94,430	96,926	97,413	100,821	104,128	107,175	109,884
Total Assets	185,567	186,988	190,177	195,804	202,730	209,714	217,007
LIABILITIES							
Deposits held	92	39	67	77	76	76	76
Advances received	892	865	865	836	807	778	748
Borrowing	12,705	15,297	13,775	15,881	17,453	18,971	20,386
Superannuation	14,363	16,441	17,126	17,389	19,921	20,016	20,024
Other employee benefits	8,402	8,621	8,814	8,995	9,301	9,506	9,699
Payables	3,013	2,231	2,415	2,457	2,546	2,634	2,738
Other provisions	5,071	5,135	4,807	4,959	5,168	5,391	5,618
Other liabilities	4,254	1,992	3,316	3,299	3,244	3,196	3,168
Total Liabilities	48,792	50,621	51,185	53,893	58,516	60,568	62,457
NET ASSETS	136,775	136,367	138,992	141,911	144,214	149,146	154,550
NET WORTH							
Accumulated funds	100,885	100,065	102,318	104,230	105,383	109,301	113,657
Reserves	35,890	36,302	36,674	37,681	38,831	39,845	40,893
NET WORTH	136,775	136,367	138,992	141,911	144,214	149,146	154,550
OTHER KEY AGGREGATES							
Net Financial Worth	42,345	39,441	41,579	41,090	40,086	41,971	44,666
Net Financial Liabilities	25,695	28,329	29,263	31,336	34,784	35,830	36,511
Net Debt	3,308	5,332	4,978	6,191	6,922	7,467	7,809

1.5 CASH FLOW

The general government sector is expected to incur cash deficits in all four years from 2008-09 to 2011-12. The deficit is estimated to be \$811 million in 2008-09 and to average \$397 million in the three subsequent years.

The deficits principally arise from the impact of the record levels of capital expenditure and broadly mirror the growth in net debt.

It is also expected that there will be a cash deficit of \$1.4 billion in 2007-08, although this is lower than the budgeted deficit of \$1.7 billion, principally because of better than expected revenues.

The general government sector cash flow statements are set out in Table 1.5.

Table 1.5: General Government Sector Cash Flow Statement

	2006-07	2007-08		2008-09	2009-10	2010-11	2011-12
	Actual	Budget	Revised	Budget	Estimate		
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Cash Receipts from Operating Activities							
Taxes received	17,467	17,569	18,139	19,063	19,195	20,052	20,968
Receipts from sales of goods and services	3,420	3,692	3,820	3,921	4,069	4,221	4,258
Grants and subsidies received	18,158	19,249	20,060	20,716	22,304	23,396	24,359
Interest receipts	1,332	786	196	774	815	857	907
Dividends and income tax equivalents	1,697	1,497	1,870	1,710	1,872	1,997	2,005
Other Receipts	3,791	3,461	3,774	3,975	4,137	4,525	4,454
Total Cash Receipts from Operating Activities	45,865	46,254	47,859	50,159	52,392	55,048	56,951
Cash Payments from Operating Activities							
Payments for employees	(27,139)	(22,033)	(22,095)	(23,260)	(24,296)	(25,195)	(26,212)
Payments for goods and services	(10,391)	(10,857)	(11,237)	(11,657)	(11,800)	(12,235)	(12,519)
Grants and subsidies paid	(8,494)	(7,384)	(8,317)	(7,904)	(8,702)	(9,621)	(10,367)
Interest paid	(859)	(956)	(962)	(1,004)	(1,077)	(1,173)	(1,248)
Other payments	(2,730)	(2,546)	(2,635)	(2,581)	(2,581)	(2,633)	(2,635)
Total Cash Payments from Operating Activities	(49,613)	(43,776)	(45,246)	(46,406)	(48,456)	(50,857)	(52,981)
Net Cash Flows from Operating Activities	(3,748)	2,478	2,613	3,753	3,936	4,191	3,970
Cash Flows from Investments in Non-Financial Assets for Policy Purposes							
Sales of Non-Financial Assets	524	487	547	595	633	686	658
Purchases of Non-Financial Assets	(4,116)	(4,695)	(4,551)	(5,159)	(5,230)	(5,185)	(4,850)
Net Cash Flows from Investments in Non-Financial Assets	(3,592)	(4,208)	(4,004)	(4,564)	(4,597)	(4,499)	(4,192)
Cash Flows from Investments in Financial Assets for Policy Purposes							
Receipts	290	148	123	195	294	197	181
Payments	(51)	(90)	(111)	(251)	(156)	(64)	(62)
Total Cash Flows from Investments in Financial Assets for Policy Purposes	239	58	12	(56)	138	133	119
Net Flows from Investments in Financial Assets for Liquidity Purposes							
Receipts	8,431	584	802	121	146	185	162
Payments	(1,690)	(545)	(136)	(738)	(674)	(729)	(760)
Net Cash Flows from Investments in Financial Assets for Liquidity Purposes	6,741	39	666	(617)	(528)	(544)	(598)

**Table 1.5: General Government Sector Cash Flow Statement
(cont)**

	2006-07	2007-08		2008-09	2009-10	2010-11	2011-12
	Actual	Budget	Revised	Budget	Estimate		
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Cash Flows from Financing Activities							
Advances received	...	...	...	...	...	...	...
Advances repaid	(46)	(51)	(49)	(51)	(51)	(56)	(55)
Proceeds from borrowings	537	2,614	1,540	2,237	1,866	1,707	1,766
Repayments of borrowings	(153)	(207)	(798)	(482)	(457)	(544)	(562)
Deposits received (net)	16	...	(26)	9	(2)	(1)	(1)
Other financing (net)	...	...	...	...	...	...	...
Net Cash Flows from Financing Activities	354	2,356	667	1,713	1,356	1,106	1,148
Net Increase/(Decrease) in Cash held	(6)	723	(46)	229	305	387	447
Cash and Cash Equivalents at beginning of year	2,449	2,210	2,421	2,451	2,681	2,985	3,371
Reclassifications of cash and cash equivalents	(22)	...	76	1	(1)	(1)	...
Cash and Cash Equivalents at end of year	2,421	2,933	2,451	2,681	2,985	3,371	3,818
Derivation of the Cash Result							
Net cash flows from operating activities	(3,748)	2,478	2,613	3,753	3,936	4,191	3,970
Net Cash Flows from Investments in Non-Financial Assets	(3,592)	(4,208)	(4,004)	(4,564)	(4,597)	(4,499)	(4,192)
Cash Surplus/(Deficit)	(7,340)	(1,730)	(1,391)	(811)	(661)	(308)	(222)
Impact of deferred superannuation contributions							
Liability Management Fund	5,308	...	...	...	...	...	...
Adjusted Surplus/(Deficit)	(2,032)	(1,730)	(1,391)	(811)	(661)	(308)	(222)

Table 1.6: General Government Cash Results (AASB 1049), 1992-93 to 2011-12 (a)

Year	Current			Capital			Cash Flows from Operating Activities			Asset Acquisitions \$m ^(d)	Asset Sales \$m	Superannuation Adjustments \$m ^(e)	Underlying Surplus/ (Deficit) \$m
	Outlays	Receipts	Result	Outlays ^(b)	Receipts	Result	Payments ^(c)	Receipts	Result				
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m				
1992-93	16,748	16,749	1	2,892	1,776	(1,116)							(1,115)
1993-94	17,069	18,178	1,109	3,315	1,310	(2,005)							(896)
1994-95	17,819	19,122	1,303	2,941	1,048	(1,893)							(590)
1995-96	18,325	20,417	2,092	3,175	936	(2,239)							(147)
1996-97	19,717	22,100	2,383	3,316	1,086	(2,230)							153
1997-98							24,635	26,807	2,172	(2,476)	522		218
1998-99							29,231	28,596	(636)	(2,496)	784	3,266	918
1999-2000							26,440	30,459	4,018	(2,483)	626	(1,005)	1,156
2000-01							28,412	32,757	4,345	(2,609)	344	(1,058)	1,022
2001-02							29,646	34,738	5,092	(2,766)	424	(1,134)	1,616
2002-03							31,569	37,002	5,433	(3,078)	498	(1,651)	1,202
2003-04							34,360	38,779	4,419	(2,915)	407	(1,200)	711
2004-05							36,094	40,249	4,155	(3,097)	484	(1,150)	392
2005-06							38,826	44,485	5,659	(3,859)	430	(1,307)	923
2006-07							49,613	45,865	(3,748)	(4,116)	524	5,308	(2,032)
2007-08 (est)							45,246	47,859	2,613	(4,551)	547		(1,391)
2008-09 (est)							46,406	50,159	3,753	(5,159)	595		(811)
2009-10 (est)							48,456	52,392	3,936	(5,230)	633		(661)
2010-11 (est)							50,857	55,048	4,191	(5,185)	686		(308)
2011-12 (est)							52,981	56,951	3,970	(4,850)	658		(222)

(a) Aggregates in prior years may vary from those previously published because of changes in classifications and backcasting for consistency.

(b) Outlays equals capital direct expenses and capital grants. Under new reporting, capital grants are treated as expenses and therefore included in payments.

(c) Payments reflect changes in the timing of superannuation contributions. Underlying payments can be derived by deducting superannuation adjustments shown in the above table.

(d) Excludes assets controlled under finance lease arrangements.

(e) Adjustment for prepayment of superannuation contributions and establishment of General Government Liability Management Fund (see Chapter 4).

1.6 KEY BUDGET RISKS

Each year the annual budget is framed around government policy and priorities as well as economic and other parameters for the immediate and medium-term. Any change to the underlying assumptions represents a risk that may vary the anticipated budget outcomes. The risks may be economic, policy or demand driven and include unforeseen events such as natural disasters.

Wages growth

The most significant risk relates to public sector wages growth. Employee related costs are the largest component of total expenses. In 2008-09, employee related costs are budgeted at 49.5 per cent of total general government expenses. Employee-related costs rise if wages rise, numbers employed rise or the average grading of employees increases. Each 1 per cent increase in employee related costs permanently increases government expenses by around \$240 million per annum.

The large occupational groups (e.g. teachers, nurses, and police) are covered by wage agreements that have begun to expire after February 2008. Following their expiry, the Government's policy is to allow for wage increases of 2.5 per cent per annum, with increases above 2.5 per cent tied to negotiated productivity. Agencies are funded for wage increases of 2.5 per cent.

During 2007-08, wage outcomes were negotiated consistent with the wages policy. It is expected that wages outcomes negotiated in 2008-09 will be consistent with the policy. Further details of the Government's wages policy are set out in Chapter 2.

The Economy and revenue

The main State taxes—payroll tax and transfer duty—are sensitive to economic factors. Employment levels and wage rates affect payroll tax collections. Transfer revenue is sensitive to the property cycle—both the value and volume of property transactions have a significant impact. These two taxes represent around 55 per cent of total tax revenue.

The economic risks to these and other budget outcomes are discussed in detail in Chapter 9.

Efficiency dividends

Since 2005-06, the Government has required efficiency improvements from general government agencies. The aim is to develop a culture where agencies continue to revisit their operations and activities so that services are maintained but in the most efficient and cost effective way possible.

As outlined in the Government's February 2006 *Economic and Financial Statement*, an efficiency dividend of approximately \$300 million (around 1 per cent of agency controllable expenses) has been applied each year. The cumulative total of savings achieved from 2005-06 to 2007-08 will be around \$1.7 billion. Budget outcomes are predicated on agencies continuing the efficiency improvement focus.

Specific purpose payments

Specific purpose payments (SPPs) from the Commonwealth provide both revenue and expense side risks to Budget outcomes.

Typically SPPs have had matching State funding requirements and Commonwealth funding is contingent on compliance with certain conditions. Following the election of the new Federal Government in November 2007, the way these payments are allocated and reported is undergoing significant reform. SPPs will move from being input-focussed to outcomes-focussed. This refocussing on outcomes should provide greater certainty to state governments as well as improved services. The Commonwealth has guaranteed that these changes will occur "without a reduction in total Commonwealth funding for these activities". Further details on the reforms are contained in Chapter 8.

While New South Wales is fully committed to working with the Commonwealth to support the reforms, the developments in Commonwealth-State financial arrangements will need to be carefully monitored and assessed in terms of risks to Budget outcomes. In 2008-09, SPPs total \$7.2 billion or 15.1 per cent of total revenue.

Contingencies

The Treasurer's Advance provides for contingencies such as those associated with natural disasters and the costs of policy responses that may be required in the budget year. A separate Treasurer's Advance is provided for capital works. In 2008-09, the Treasurer's Advance is \$300 million for recurrent services, and \$100 million for capital works and services. To the extent that unanticipated expenditures are funded from the Treasurer's Advance, there will be no effect on budget outcomes.