

CHAPTER 2: FISCAL POSITION AND OUTLOOK

BUDGET SUMMARY

The key financial aims of the New South Wales Government are:

- ◆ To strengthen the State's Balance Sheet and maintain New South Wales' AAA credit rating.
- ◆ To continue and expand the Government's tax reduction program.
- ◆ To improve service delivery in key priority areas.

The 2001-02 Budget has been framed to deliver on each of these objectives and provides:

- ◆ A Budget Surplus of \$368 million in 2001-02.
- ◆ Budget Surpluses in each of the Forward Years.
- ◆ A reduction in Net Financial Liabilities of \$537 million in 2001-02.
- ◆ A reduction in Net Financial Liabilities over the Forward Estimates period.

KEY AGGREGATES

Introduction

In pursuing its aim to properly manage the State's financial position, the Government has expanded its focus beyond net debt to that of achieving reductions in Net Financial Liabilities. This aggregate encompasses all liabilities (including borrowings, unfunded superannuation and insurance obligations), after taking into account financial assets (including cash, investments, advances and non-equity assets). It is, therefore, a more comprehensive measure of the financial health of a government than the more narrow net debt measure. Net Financial Liabilities are affected by the Budget result and valuation changes to liabilities and financial assets.

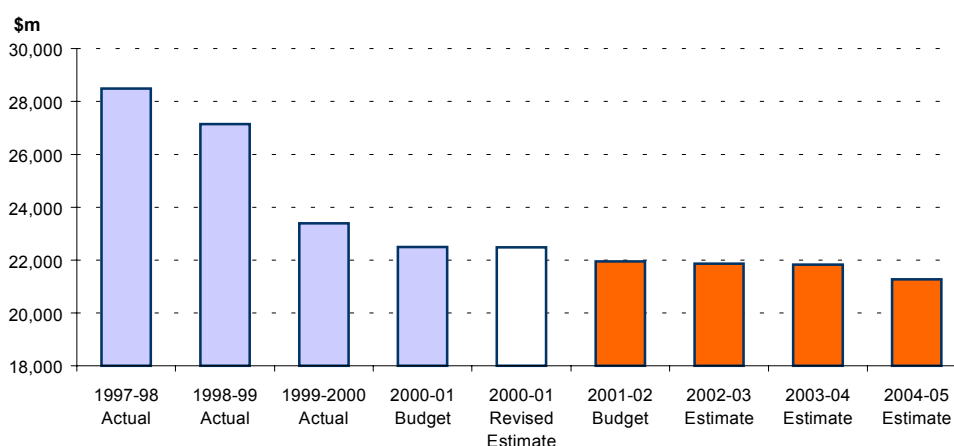
Definitions of key aggregates and terms used in this chapter can be found in the Budget Guide.

Trends

General Government Sector Net Financial Liabilities

Following the estimated decline of more than \$6,000 million in the three years to 30 June 2001, Net Financial Liabilities are projected to continue to decline over the Forward Estimate period.

Chart 2.1: General Government Sector Net Financial Liabilities



It is estimated that General Government Sector Net Financial Liabilities will fall by more than \$900 million in 2000-01. Reductions have been effected as a result of the \$2,500 million net impact of the re-gearing of the Electricity Distributors and Generators and the estimated Budget surplus of \$221 million. These gains have been partially offset by a \$1,289 million revaluation of superannuation liabilities within the Pooled Superannuation Fund following the triennial valuation of liabilities as at 30 June 2000 and other valuation losses amounting to approximately \$500 million.

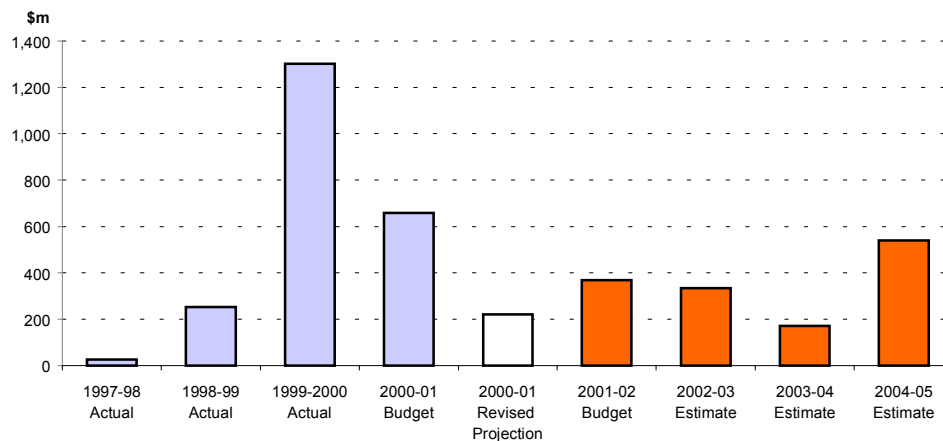
Net Financial Liabilities are expected to fall by a further \$537 million in 2001-02. This reduction is principally due to the expected Budget surplus of \$368 million.

Over the Forward Estimates period, Net Financial Liabilities are projected to fall by \$672 million, resulting in a total reduction of more than \$1,200 million on the level expected at the close of the 2000-01 financial year.

Budget Results

As shown in Chart 2.2, Budget surpluses are projected in 2001-02 and over the Forward Estimates period. These Budget Results have been made possible by the Government's fiscal strategy, which has resulted in the sizeable reductions in General Government Net Financial Liabilities achieved over recent years and projected over the Forward Estimates period.

Chart 2.2: Budget Surplus



The trend in Budget results between 2000-01 and 2003-04 encompasses the Government's taxation reduction program, the impact on revenues of projected economic conditions and additional commitments to key service delivery areas. As revenue growth returns to trend and growth in expenses moderates, the Budget result should be higher in 2004-05.

Expenses and Revenues

The Budget result is derived applying the Government Finance Statistics (GFS) principles used by the Australian Bureau of Statistics to measure the financial performance of governments⁽¹⁾. Under these principles a number of accounting expenses and revenues (primarily depreciation and valuation movements) do not have a direct impact on the Budget result. Instead the GFS Budget result captures the full impact in the year of capital expenditure and asset sales.

¹ Chapter 9 of this Budget Paper provides a detailed outline of GFS reporting and how it differs from reporting under the Australian Accounting standards

Table 2.1: Percentage Growth in Expenses and Revenues that affect the Budget Result

	<i>Projection Revised</i>	<i>Budget</i>	<i>Estimate</i>		
	2000-01 %	2001-02 %	2002-03 %	2003-04 %	2004-05 %
Revenue	4.4	0.6	2.4	3.2	4.1
Expenses	8.6	- 0.2	2.6	3.4	2.6
Gross State Product (GSP) (nominal)	6.3	5.6	5.6	5.5	5.7

The increase in expenses reflects the direction of additional spending by the Government to the priority areas of health, education, community services, transport and law and order. The reduction in 2001-02 reflects the 2000 Olympic costs met in the prior year and the additional expense incurred in assuming liabilities of \$600 million in 2000-01 as a result of the HIH collapse, which is recognised as an expense.

Employee expenses in the Budget and Forward Years are predicated on the agreed partial funding of public sector salary increases. A portion of the increase is to be met through productivity measures initiated by Agencies as agreed under the Memorandum of Understanding between Government and the relevant unions.

Revenues are expected to increase by 0.6 percent in 2001-02 following stronger than expected growth of 4.4 percent in 2000-01. The 2001-02 estimate includes a 11.1 percent increase in Commonwealth Grants offset by a 7.0 percent reduction in taxation revenue.

The increase in Commonwealth Grants in 2001-02 follows from the Intergovernmental Agreement (IGA) on the reform of Commonwealth State Relations. However, because of the New South Wales taxes that are abolished and extra spending required under that agreement, national tax reform will not benefit the New South Wales Budget until 2007-08.

In accord with the IGA, the 2001-02 Budget reflects the abolition, from 1 July 2001, of Financial Institutions Duty and stamp duty on listed marketable securities.

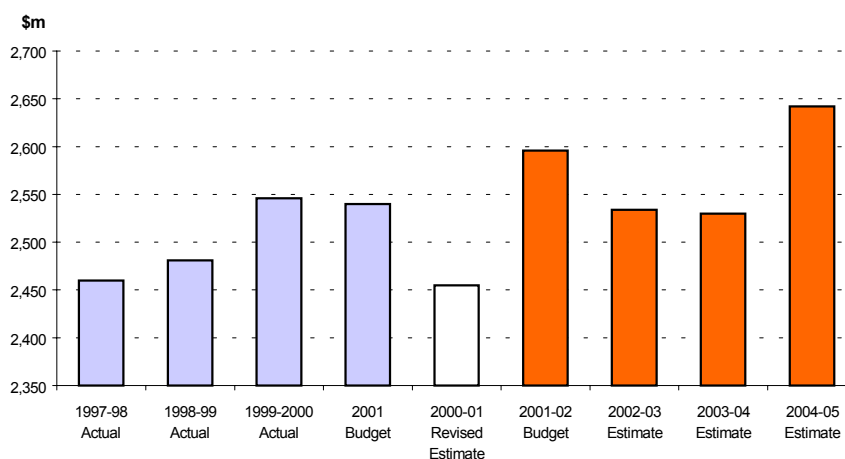
Taxation revenue will be further reduced in 2001-02 and 2002-03 through the continuation and expansion of the New South Wales taxation reduction program. Under the program the Electricity Distributors Levy will be suspended from 1 July 2001, Debits Tax will be abolished from 1 January 2002 and payroll tax will be reduced from 6.2 to 6.0 percent from 1 July 2002.

Revenue growth beyond 2002-03 is expected to strengthen under the assumed economic parameters.

Capital Expenditure

Capital expenditure and sales of capital assets by General Government agencies also affects the Budget result. Chart 2.3 illustrates the trend in asset acquisitions between 1997-98 and 2004-05.

Chart 2.3: Capital Expenditure



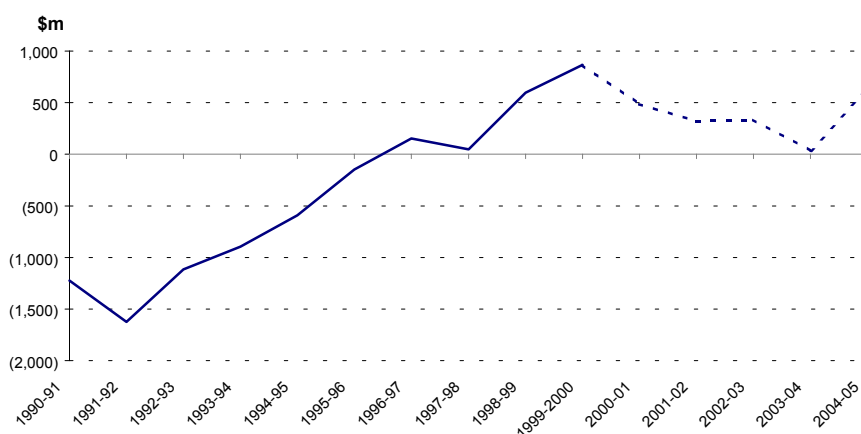
Capital expenditure is expected to increase by 5.7 percent in 2001-02 and over the four-year period to June 2005 is estimated to total \$10,302 million. Capital expenditure in the previous four-year period is expected to total \$9,942 million, including \$1,205 million for the 2000 Olympic games.

The reduction in capital expenditure in 2000-01 relative to 1999-2000 is mainly attributable to the reclassification of expenditure from capital to maintenance and other operating expenses.

GFS Cash Result

The accrual based Budget result is the key measure in determining the financial outcome for the year. However the GFS cash result, which was used as the basis for measuring financial performance prior to the 2000-01 Budget, is still a useful indicator and links closely to movements in net debt. Chart 2.4 shows GFS cash results between 1990-91 and 2004-05.

Chart 2.4: GFS Cash Result



New South Wales has recorded cash surpluses in each year since 1996-97. Table 2.5 provides details of the GFS cash results over a fifteen year timeframe.

The pattern of GFS cash results is consistent with the projected movement in the accrual Budget results over the Budget and Forward Estimates period.

THE COLLAPSE OF HIH INSURANCE

Following the collapse of HIH Insurance, the Government will introduce legislation to establish the New South Wales Policyholders Protection Fund. The Fund will pay the claims against Compulsory Third Party (CTP) policies in force with HIH prior to 31 December 2000 and claims under the Home Warranty Insurance Scheme for policies entered into prior to 15 March 2001.

For Budget purposes, the gross liabilities for these Schemes are estimated at \$600 million. At this stage, total liabilities from HIH are uncertain and could vary when the provisional liquidator makes his report. Also, the value of HIH assets available for distribution is uncertain as well as the timing of the distribution.

For CTP the Government has appointed the Motor Accident Authority as the Nominal Defendant. The Nominal Defendant is the agent and attorney of persons insured by expired policies and has the duty of discharging liabilities of those persons. Also, the Nominal Defendant is a creditor of HIH and will present a log of payments to the liquidator as proof of its claim against the HIH assets distributed after liquidation.

For Home Warranty Insurance, the Government does not have a legal responsibility as exists in the Compulsory Third Party Nominal Defendant. Consequently, an agreement has been reached with the provisional liquidator that the Government will take over the conduct of home-owner warranty claims and acquire the right to submit a log of payments to prove its claim against HIH assets.

Up to 2004-05 total claim payments are estimated at \$476 million and will be funded by:

- ◆ \$200 million from the Budget - \$50 million in 2000-01 and \$150 million over the period to 2004-05; and
- ◆ the introduction of the Insurance Protection Tax from 1 July 2001.

The Insurance Protection Tax (IPT) will raise \$69 million per annum from all general insurance companies operating in New South Wales. It will be apportioned among insurance companies on the basis of a company's share of the total premium income collected in the previous year from all classes of general insurance and Compulsory Third Party insurance in New South Wales. The IPT legislation will include provisions that allow the Government to reduce the amount of tax collected each year as greater knowledge of liabilities and assets is gained.

In the future, the Treasurer, or other responsible Minister, will have the power to extend coverage of the Fund to claims against a future insolvent insurer in home warranty or Compulsory Third Party insurance. A separate Bill establishing the New South Wales Policyholders Protection Fund will be introduced soon after the Budget.

Box 2.1 Impact of HIH on Key Budget Outcomes

	2000-01 \$m	2001-02 \$m	2002-03 \$m	2003-04 \$m	2004-05 \$m
Budget Result	221	368	334	171	639
- excluding HIH	821	299	265	102	570
Cash Result	484	321	331	35	625
- excluding HIH	534	376	390	68	628
Net Financial Liabilities	22,481	21,944	21,864	21,832	21,272
- excluding HIH	21,881	21,413	21,402	21,438	20,947
Net Debt	7,531	6,176	5,809	5,598	4,828
- excluding HIH	7,481	6,071	5,645	5,400	4,627

As shown in Box 2.1 acceptance of the gross liabilities for Compulsory Third Party and Home Warranty Schemes has reduced the 2000-01 Budget Result by \$600 million. The impact on the other accrual aggregate is an increase of \$600m in the General Government Net Financial Liabilities in 2000-01.

Between 2001-02 and 2004-05 the Budget Result improves by \$69 million per annum compared to what it otherwise would be. This increase is necessary to allow Net Financial Liabilities to be reduced by the same amount per annum, so that over the period to 2004-05, liabilities have partially recovered to the level that would have prevailed in the absence of the HIH collapse.

The cash aggregates are affected by the net flows of claims payments and revenue from the Insurance Protection Tax. The Cash Result deteriorates by \$50 million in 2000-01, \$55 million in 2001-02, \$59 million in 2002-03, \$33 million in 2003-04 and \$3 million in 2004-05. Net Debt, while still reducing, will be \$200 million higher over the period to 2004-05 than it otherwise would have been. This is equivalent to the deterioration in the Cash Result over the same period.