

Chapter 1: BUDGET POLICY AND POSITION

- 1.1 Budget Policy Statement**
- 1.2 Budget Position**
- 1.3 1997-98 Budget Measures**

1.1 BUDGET POLICY STATEMENT

BACKGROUND

The General Government Debt Elimination Act was passed by Parliament in late 1995. The Act provides, inter alia, for the Treasurer to prepare a Budget Policy Statement as part of each year's Budget Papers. The Statement is to include information on the following matters -

- an assessment of progress achieved against the fiscal targets and fiscal principles set out in the Act;
- projection of the ability to achieve fiscal targets in the future and to progress the achievement of fiscal principles; and
- 3-year projections of all relevant economic and financial variables.

This Section of Budget Paper No. 2 provides the Budget Policy Statement for the 1997-98 Budget.

ASSESSMENT OF PROGRESS ACHIEVED AGAINST THE FISCAL TARGETS AND FISCAL PRINCIPLES AND PROJECTED POSITION

Principle no. 1 - adherence to fiscal targets

- **Past Trends**

As far back as consistent information is readily available (and probably for at least the last few decades), New South Wales would have been running budget deficits. The only exceptions to this were in 1988-89, when a massive increase in stamp duty revenue from the Sydney property boom resulted in a surplus of around \$200 million and in 1996-97, with a surplus of \$67 million arising from the Government's commitment to expenditure restraint and debt reduction under the General Government Debt Elimination Act.

After 1988-89, the Budget result deteriorated rapidly as the economy slowed and the boom in the Sydney property market reversed. The deficit peaked in 1991-92 (refer to Table 1.8 in Section 1.2 for details).

- **Policy and Prospects**

The *short term fiscal target* set out in the is to achieve a sustainable Budget surplus for the general government sector within three years from the commencement of the Act.

The projections in last year's Budget Papers showed a Budget broadly in balance in 1996-97, with moderate surpluses in the following years. Since then, additional pressures have arisen on the Budget. These pressures include cuts in Commonwealth funding, additional costs in the provision of public health services associated with the continuing fall in private health insurance and additional costs transferred to the Budget as a result of rail reform.

The expected Budget result for 1996-97 is now an underlying surplus of \$67 million - up from the Budget-time forecast of a \$5 million surplus.

This improvement largely reflects a changed treatment of certain costs related to the sale of the State Bank. As the proceeds from the sale were treated as an extraordinary item, the costs associated with the sale were similarly excluded from the underlying Budget results in 1994-95 and 1995-96. This treatment has now been adopted for 1996-97.

Had the 1996-97 Budget been presented with these costs treated on the basis now adopted, it would have projected an underlying surplus of \$51 million.

For 1997-98 and later years, the projections continue to indicate that the short term fiscal target will be met. While the projected surpluses are lower than those previously forecast, it was not seen to be appropriate to increase taxes beyond what has been necessary in this Budget, simply to achieve those forecasts. (It is important to understand the difference between targets and projections - the former would represent a committed position to be achieved; the latter simply represent the best available estimates of the future Budget position given the continuation of current expenditure and revenue policies.)

It should also be noted that the Budget Sector results for 1996-97 to 1998-99 include the impact of large net expenditures on the Olympics and Homebush Bay development (\$430 million, \$409 million and \$448 million in the respective years). These years represent the peak years of Budget impact from these projects, confirming the prospect of continuing sustainable surpluses in following years.

It should be noted that the Budget coverage at present is not based on the general government sector. On a general government basis, the revised result for 1996-97 is for a surplus in the order of \$300 million, while the forecast result for 1997-98 is likely to be a deficit of less than \$50 million (the turnaround partly reflecting the timing of SOCOG revenues and expenditures).

Projections are not produced beyond the Budget year for the general government sector at this stage. However it is anticipated that on a general government basis, the results in 1998-99 and beyond will move from a broadly balanced position to one of modest but growing surpluses.

The *medium term fiscal target* is to reduce the level of net debt to a sustainable level. This is defined as the level of net debt at which the Budget can absorb the full adverse impact of an economic cycle without the need for significant corrective action.

At present, the annual interest bill on Budget Sector debt is around \$1.5 billion. This consumes around 6½ per cent of Budget receipts. Reducing debt and hence interest costs will decrease the exposure of the Budget to economic downturns and free resources for service provision and/or a lower tax burden. A comprehensive review is being undertaken to determine the sustainable debt level.

The *long term fiscal target* is to eliminate net debt in the general government sector by 2020.

As part of the review of the sustainable debt level, work is also being undertaken to define a range of feasible time profiles for achieving the long term target.

Principle no. 2 - maintaining or increasing general government sector net worth

- **Past Trends**

General government sector net worth is defined as *total assets* less *total liabilities*.

As at 30 June 1996, the net worth of the Budget Sector was \$19.1 billion. The Public Accounts will present data as at June 1997 in November this year.

At present the Consolidated Financial Statements do not present information on the general government sector but it is likely to be broadly in line with the net worth of the Budget Sector.

Trends in the Budget Sector net worth are set out in Table 1.1.

Table 1.1: Trends in Budget Sector Net Worth

30 June	Assets	Liabilities	Net Worth
	\$m	\$m	\$m
1991	58,195	30,718	27,447
1992	56,416 (a)	32,795	23,621
1993	57,685	35,155	22,530
1994	59,755	35,068	24,687
1995	61,742	35,985	25,757
1996	54,824 (b)	35,729	19,095

(a) The decline between 1991 and 1992 is due to changes of coverage and valuation methodology, rather than an underlying deterioration.

(b) Reduction is due to the transfer of regional roads to local councils (\$6,179m) and downward adjustments of asset values by some agencies (\$2,742m).

- **Policy and Prospects**

The principle is to at least maintain the net worth of the general government sector in real terms. While information is not yet available on Budget Sector net worth

as at June 1997 or the projected position as at June 1998, some tentative conclusions can be drawn.

In view of the projected Budget surplus for 1997-98, the \$3½ billion capital program (which adds to the asset base) and the move to full funding of accruing superannuation liabilities, it can be assumed that Budget Sector (and by inference, general government sector) net worth will increase in real terms in 1997-98.

Similarly, given the projected Budget position for the forward years, this improving trend should continue.

Principle no. 3 - funding employer superannuation contributions

- **Past Trends**

Until 1992, the policy was to fund superannuation only on a *pay as you go* basis in respect of the employer liability. In 1992, the then Government introduced a new scheme, First State Super, which is an accumulation scheme for all new employees and is operated on a fully funded basis.

Trends in the level of unfunded superannuation liability for the Budget Sector are set out below in Table 1.2.

Table 1.2: Budget Sector Unfunded Superannuation Liability

As at 30 June	Budget Sector Unfunded Superannuation Liability
	\$m
1992	11,319
1993	12,431
1994	12,250
1995	12,687
1996	13,654
1997	14,683

The increases in the Budget Sector unfunded liability as at June 1996 and June 1997 substantially reflect the assumption, by the Budget, of unfunded superannuation liabilities of various Government Trading Enterprises and State Owned Corporations as part of the corporatisation process, rather than any deterioration in the underlying position.

- **Policy and Prospects**

Debt is only a subset, although a very large subset, of total liabilities. Accordingly, it is important that the same policy of restraint that applies to debt applies to other non-debt liabilities.

Of the Budget Sector's non-debt liabilities of broadly \$19.0 billion as at 30 June 1996, the most significant component was the unfunded superannuation liabilities of \$13.6 billion.

This principle requires that -

- accruing superannuation liabilities (for both the general government and public trading enterprise sectors) should be fully funded; and
- there should be phased-in funding to eliminate the existing level of unfunded liabilities.

In the absence of initiatives taken to bring unfunded superannuation liabilities under control, superannuation payments would consume an increasing proportion of Budget outlays and restrict the flexibility to cater for emerging social needs.

In accordance with the principle, this Budget continues the practice of fully funding each year's superannuation expenses in the First State Superannuation Scheme, phasing in full funding of other accruing superannuation liabilities and moving to address past unfunded liabilities. Based on latest actuarial assessments, while the accruing liability is funded to a substantial extent, it will not be fully funded on an ongoing basis until the year 2020. Similarly, the overall scheme will not be fully funded until the year 2045.

General government sector agencies currently outside the Budget Sector are also required to fully fund each new year's superannuation expense and where they have past unfunded liabilities, they are required to address these over a period, not exceeding 30 years (as from 1992).

Principle no. 4 - asset maintenance

- **Past Trends**

It is only in recent years that there has been a proper appreciation of the need to develop a formal asset maintenance policy. In the past such a policy was not in place due to the lack of adequate information on assets. This in turn resulted in a bias towards the acquisition of further assets at the expense of proper asset maintenance.

The introduction of accrual accounting in the Budget Sector has largely rectified the information deficiency.

- **Policy and Prospects**

Under the asset management policy, agencies are required to develop asset maintenance plans which identify all assets, set out a maintenance program for each asset or grouping of assets, identify any deferred maintenance requirements and establish a funding plan.

Asset maintenance plans for most Budget Sector agencies have now been prepared. These will be submitted to the Budget Committee of Cabinet in the second half of 1997 for consideration, following review by Treasury and the Department of Public Works and Services. The result of this process will be the endorsement of an asset maintenance program and the broad commitment by Government of funding. It needs to be acknowledged that this will absorb some of the funding that may previously have gone into new capital projects. However, it is clearly inappropriate to expand the capital stock to the exclusion of adequate maintenance of existing assets.

Principle no. 5 - constrained growth in net cost of services and outlays

- **Past Trends**

Over the longer term, there has been a trend of significant real growth in Budget outlays. Over the two decades to 1994-95, New South Wales' own purpose outlays by the general government sector grew by 2.6 per cent per annum in real terms. This compares with a slightly lower growth rate of 2.3 per cent per annum for the six States combined.

- **Policy and Prospects**

The main strategy for achieving the objective of reducing debt and eliminating the Budget deficit is through restraint of Budget outlays.

The principle is to keep the growth in net cost of services and outlays below the growth in inflation and population (i.e. zero real growth in per capita terms). In respect of capital outlays, the principle is to be applied over a 3 to 5 year period to allow for the impact of large projects, such as the Olympics.

Budgets have traditionally reflected cash transactions, with outlays defined as cash payments less cash user charges.

The accrual presentation of the Budget includes non cash items such as depreciation, superannuation expenses, accounts receivable and accounts payable. This means that estimates are made up of expenses and revenues which are attributable to the current year's activities.

With the introduction of accrual accounting into the Budget Sector, the Budget is now able to measure the *net cost of services*, i.e. total expenses less user charges.

Accordingly, the commitment to restraint of the net cost of services is an important extension of the policy of fiscal restraint.

In the 1997-98 Budget, current outlays are forecast to grow by 4.2 per cent. This represents a real per capita increase of only 1.0 per cent. Net cost of services is projected to increase by 3.5 per cent in nominal terms, a real per capita increase of only 0.4 per cent.

Excluding the impact of net advances (mainly payments from Non Budget Sector agencies resulting from equity restructures and sale of surplus assets), capital outlays will grow by 14.6 per cent in 1997-98 in nominal terms (including a near 50 per cent increase in Olympics related expenditures). This represents a real per capita increase of 11.1 per cent. Capital outlays excluding both net advances and Olympics related expenditures will increase by 9.6 per cent in nominal terms in 1997-98.

Principle no. 6 - prudent risk management

- **Policy and Prospects**

There are risks that are centrally identified and managed, and others that are the direct responsibility of individual agencies. Regardless of where the risk arises, it is vital that there is a comprehensive framework in place for identifying, assessing and addressing risk.

At the level of the whole general government sector, this involves seeking to reduce debt and other liabilities and to manage them in a prudent manner. Financial risks for the Budget Sector are centralised in the main, with Treasury Corporation managing total Budget Sector debt and relatively limited powers conferred on Budget Sector agencies for the management of financial assets.

During 1995-96 Treasury Corporation was reviewed, with a view to eliminating all functions that involved undertaking a financial risk that was not essential for its core roles of funding and debt management. This has resulted in its elimination of various activities that added to the level of State risk and the elimination of broadly \$6 billion of surplus debt.

As part of the process of developing Statements of Financial Performance, each Budget Sector agency is required to identify and assess all financial and operating risks and develop strategies for dealing with these in a cost effective manner.

Principle no. 7 - tax restraint

- **Past Trends**

Over the last recession and consequent deterioration in the Budget, there was substantial recourse to tax increases to keep the Budget deficit under control.

This experience was shared by most other States and as a result, while taxes in New South Wales increased in absolute terms, the tax burden relative to other States did not.

Table 1.3: Trends in Tax Levels

Year	Policy Induced Tax Changes (a)	Index of Tax Burden in NSW relative to the National Average
	\$m	
1989-90	200	n.a.
1990-91	310	n.a.
1991-92	80	103.8
1992-93	240	103.0
1993-94	100	101.6
1994-95	(40)	104.1
1995-96	10	102.6
1996-97	180 (b)	n.a.
1997-98	420 (b)	n.a.

(a) Net effect of all tax changes impacting on the year shown, whether announced in that year or in previous years.

(b) Includes impact (\$213 million in 1996-97 and \$17 million in 1997-98) of tax increases introduced to fund the Fiscal Contribution Payments to the Commonwealth.

- **Policy and Prospects**

This principle requires that the level of taxes should be constrained to the maximum extent possible and that policies should be pursued that give a reasonable degree of predictability about the level and stability of tax rates for future years.

The existing tax system is narrowly-based, generally regressive and relatively inefficient. New South Wales will continue to seek to achieve meaningful reform of Commonwealth-State financial relations in order to provide a more appropriate revenue structure for the State.

The Government recognises the need to balance the call on taxpayers to fund Budget outlays. The 1995-96 and 1996-97 Budgets achieved the financial targets set by the Government without recourse to tax rate increases. (In fact, the 1996-97 Budget exempted refinancing of existing loans from loan security duty as from 1 July 1996.)

Subsequent to the 1996-97 New South Wales Budget being presented, it was agreed at the 1996 Premiers' Conference that the States would make Fiscal Contribution Payments over a three year period to assist the Commonwealth in meeting its deficit reduction targets. For New South Wales, the payment in 1996-97 was set at \$209.5 million.

To fund this requirement, New South Wales was obliged to introduce a range of temporary tax increases, as detailed in Chapter 3.

For the 1997-98 Budget, it has been necessary to introduce a targeted tax package to fund the cost of a number of emerging needs, particularly in the health and public transport areas. The health needs reflect both the impact on the public health system of falling private health coverage and the requirement to increase the provision of health services in under-resourced areas of the State. Overall Budget receipts are estimated to increase by only 6.4 per cent, 1.2 per cent and 3.5 per cent in the years 1997-98, 1998-99 and 1999-2000 respectively.

However, the intention is for future Budgets to maintain the position of tax restraint and, if possible and consistent with the overall fiscal targets, to achieve targeted tax relief.

It is important for taxpayers in the State to have a degree of certainty as to the level of taxes they will face in the future.

It is also intended to seek over time to improve the structure of taxes in a revenue-neutral way. At present a number of interstate reviews in the areas of payroll tax, stamp duty and financial taxes are underway or nearing completion.

ECONOMIC AND FINANCIAL VARIABLES

The General Government Debt Elimination Act also requires the Treasurer to include 3-year projections of all relevant economic and financial variables in the Budget Papers.

The following table sets out key economic and financial variables relevant to the Budget. More detailed data and discussion is contained in Section 1.2 (in relation to Budget aggregates) and in Chapter 2 (in relation to economic conditions and forecasts).

Table 1.4: Economic and Financial Variables

Variable	1996-97	1997-98	1998-99	1999-2000
NSW real GSP growth (%)	3	3½	3½	3¾
NSW employment growth (%)	1	1¾	2	2
NSW unemployment rate (%)	8	7¾	7½	7¼
Sydney CPI (%)	1½	2	2½	2½
10 Year bond rate (as at June) (%)	7½	8	8	8
Budget surplus (underlying) (\$m)	67	27	36	195
Budget Sector net debt (% of GSP)	7.5	7.1	6.7	6.2
Budget Sector debt costs (% of budget receipts)	6.3	6.4	6.1	6.1
Real growth in Budget Sector current outlays (%)	6.5	2.0	0.5	1.0
Real growth in Budget Sector capital outlays (a) (%)	(-) 4.0	14.6	(-) 11.7	(-) 0.3
Real growth in Budget Sector receipts (%)	3.9	4.1	(-) 1.0	1.7
Budget Sector employment (000)	228.8	230.9	n.a.	n.a.

(a) Excluding net advances.

