



Tasmanian State Budget

2008-09

Much improved financial position allows for higher spending on health, education and infrastructure

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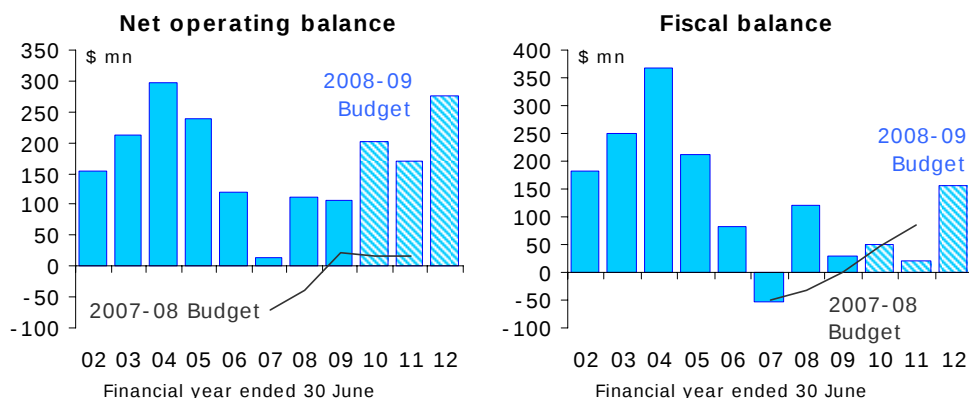
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The first Budget of the new Bartlett administration (the Tasmanian one, not the fictional one depicted in the TV series *The West Wing*, of which Tasmania's new Premier was by his own admission an ardent devotee) has deployed a **dramatic improvement in the State's revenues** to fund a range of **new spending** initiatives, especially in **health** and **education**, and a substantial increase in **infrastructure investment**, whilst adhering to a very **conservative fiscal strategy** (especially by comparison with that of other States) and leaving Tasmania's general government sector in a **strong financial position**.

The Budget is predicated on a **confident** (but realistic) **outlook for the Tasmanian economy**, noting that 'Tasmania's economic performance is likely to remain strong even if some major projects do not proceed as currently expected'.

There have been further improvements in the **quality of the State's Budget Papers**, such that Tasmania is now only marginally behind Western Australia (and significantly ahead of the Commonwealth and Victoria) in terms of the comprehensiveness and transparency of the information provided about the government's financial position and prospects.

The Budget's 'bottom lines'



Note: the 'net operating balance' is the excess of revenue (excluding asset sales) over expenses (including depreciation but excluding capital expenditures). The 'fiscal balance' is the net operating balance plus net additions to the capital stock.

A dramatic improvement in the State's revenue position ...

As foreshadowed in the Mid-Year Review of the 2007-08 Budget which was released in February, the Tasmanian Government's revenue position has improved significantly since last year's Budget. Total revenue for the 2008-09 financial year is now estimated at \$4.1bn, \$40mn (or 1.0%) more than forecast in the Mid-Year Review, \$258mn (6.7%) more than forecast (for 2008-09) in last year's Budget, and \$579mn (or 16.3%) more than the initial projection for 2008-09 made back in the 2005-06 Budget. Over the next three years (2008-09 through 2010-11), the Government will collect almost \$900mn (or 7.6%) more in revenue than it envisaged at the time of last year's Budget.

Of this latter amount, \$388mn comes from upward revisions to estimates of State tax revenues (mostly stamp duties and payroll tax), \$287mn from upward revisions to projections of GST revenue and other grants from the Commonwealth Government, and \$315mn from other sources, including what appears to be a massive increase in revenue from fines (which are forecast to raise \$27.4mn in 2008-09 compared with \$13.6mn in 2007-08).

... used to fund new spending measures

In contrast to last year's Budget, which directed most of the uplift in revenues over the preceding 12 months to the 'bottom line' (in order to achieve the Fiscal Strategy targets which had been established but not met in the first Budget after the 2006 election), this year's Budget directs most of the further improvement in revenues to a range of **new spending initiatives** totalling **more than \$1bn** over the next four years.

New 'operating' or **recurrent expenditure initiatives** total \$388mn over the four-year forward estimates period (2008-09 to 2011-12), and include:

- \$80mn over four years for a range of 'reviews and reforms' in **health and human services**, including out-of-home care, disability services and children at risk, and \$21mn for the employment of **additional nurses**;
- \$56mn over four years for **education** including \$35mn for literacy and numeracy initiatives and \$15mn for the employment of additional teacher aides;
- \$50mn over four years to extend pensioner electricity and local government rate **concessions** to all Health Care Card holders (with a further \$9mn over four years to similarly extend concessions for motor vehicle registration, compulsory third party insurance and drivers' licence fees on the revenue side of the budget);
- \$12mn for **water and sewerage reform** and regulation;
- \$11mn for the Government's **social inclusion strategy**; and
- \$12mn for efforts to save the **Tasmanian devil**.

Overall 'operating expenses' are estimated to grow at an average annual rate of 2.5% over the forward estimates period.

The Budget also provides an additional \$622mn over four years for **capital expenditures**, including:

- \$232mn for design and construction work on the proposed new **Royal Hobart Hospital** (most of this to be spent in 2010-11 and 2011-12);
- \$72mn for a range of **other hospital and health care centre** upgrades and projects;
- \$116mn for **road projects**, including the Brighton and Kingston by-passes (\$33mn and \$23mn respectively), the Brighton transport hub (\$23mn) and a new tourist road in the north-west (\$23mn);
- \$60mn for the new **Housing Fund** (most of which will not be spent until the second half of the forward estimates period)
- \$54mn for **schools**, of which \$30mn is for the Bridgewater and Southern Midlands renewal program;
- \$45mn for **water infrastructure** projects;

- \$19mn for the redevelopment of the Glenorchy, Bellerive and Devonport **police stations**; and
- \$17mn for Stage D of the **Risdon prison** redevelopment.

These new initiatives lift total infrastructure spending funded from the Budget by some 60%, to more than \$1.6bn over the four years to 2011-12.

No new taxation measures

Despite the significant improvement in the Government's revenue position, there were no new taxation reforms or measures announced in the Budget, other than the extension to other Health Care Card holders of the motor vehicle related concessions presently available to pensioners mentioned above.

Total State taxation revenue is projected to rise at an average annual rate of 3.6% over the four years to 2008-09, while reflecting the slower (2.1% pa) expected growth rate of GST revenue, overall revenues are forecast to rise at a 2.1% average annual rate over the forward estimates period.

The Treasurer's Budget Speech announced the establishment of a Business Tax and Regulation Reference Group to advise the Government on 'efficient and equitable' changes to taxes and regulations, and to assist the Tasmanian Government's participation in the national review of taxation chaired by Commonwealth Treasury Secretary Ken Henry.

Overall financial position is very strong

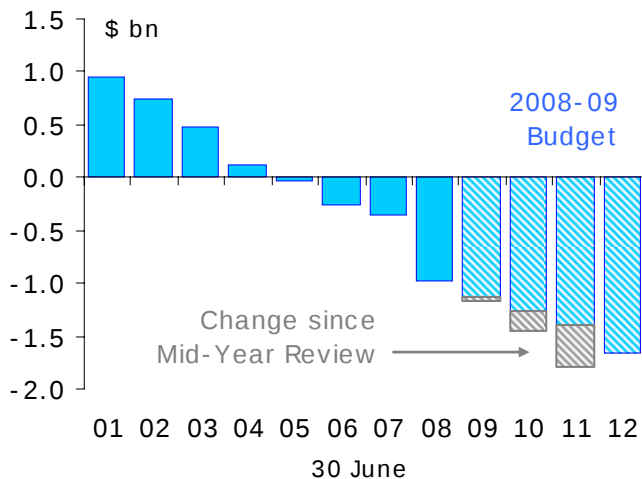
As noted above, the substantial improvement in the revenue outlook since last year's Budget has allowed the Government to commit to new spending initiatives totalling more than \$1bn over the next four years while adhering to all of the requirements of its Fiscal Strategy and leaving the budget in a very strong financial position.

In particular:

- the **net operating surplus** will exceed \$100mn in each year of the forward estimates period, reaching \$275mn in 2011-12;
- the **fiscal balance** will be in surplus each year and by an average of \$65mn per annum over the next four years;
- the overall **cash surplus** will exceed \$100mn in each of the next four years; and
- **net financial assets** (ie, the excess of financial assets over debt) will rise from \$969mn at the end of the current financial year to an expected \$1.66bn by 30 June 2012.

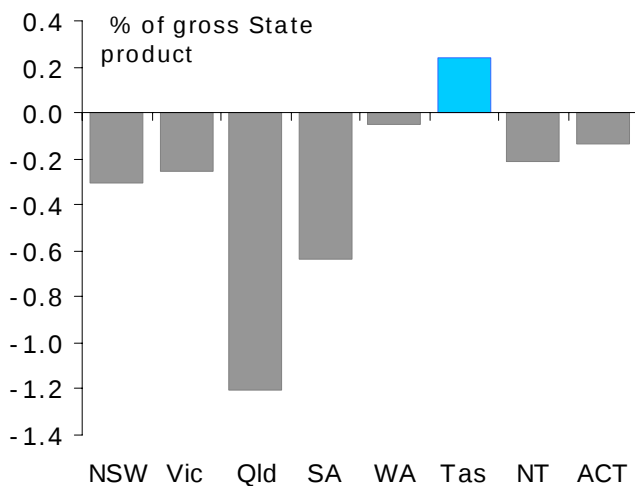
These surpluses are smaller, and the level of net financial assets will be somewhat lower, than projected in February's Mid-Year Review. This reflects the impact of the policy decisions outlined above which have been taken in the period between the Mid-Year Review and the Budget.

Tasmania's general government net debt



Tasmania will be the *only* jurisdiction (other than the Commonwealth) running fiscal surpluses over the next four years. Indeed every other State with the exception of Western Australia expects to incur a fiscal deficit in each of the next four years. Tasmania and the two Territories are alone in projecting cash surpluses in each of the next four years; NSW, Victoria, Queensland and South Australia are all expected to incur cash deficits in each of the years 2008-09 through 2011-12.

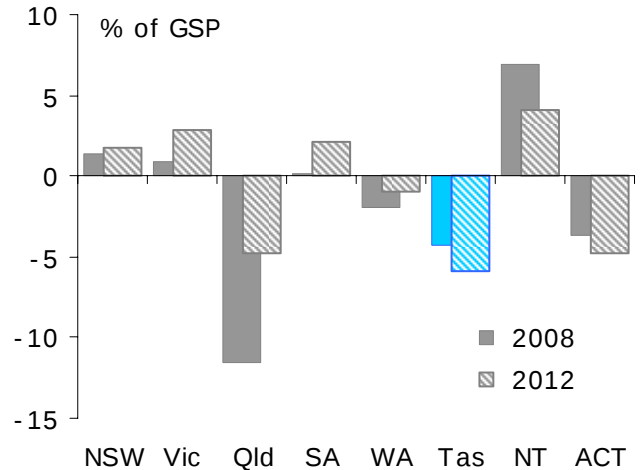
General government 'fiscal balance' - average 2008-09 through 2011-12



As a result, in a rather amazing turnaround from the position of a decade ago, by 30 June 2012 Tasmania will have the strongest 'general government' net debt position of any State or Territory.

This results partly from the relatively much larger infrastructure investment programs which some States – notably Queensland and the Northern Territory, and to a lesser extent South Australia – will be funding, although as a proportion of gross State product, Tasmania's budget sector capital expenditures will be larger than those of NSW, Victoria and (somewhat surprisingly) Western Australia. However it is also a reflection of the genuinely stronger fiscal position in which Tasmania now finds itself.

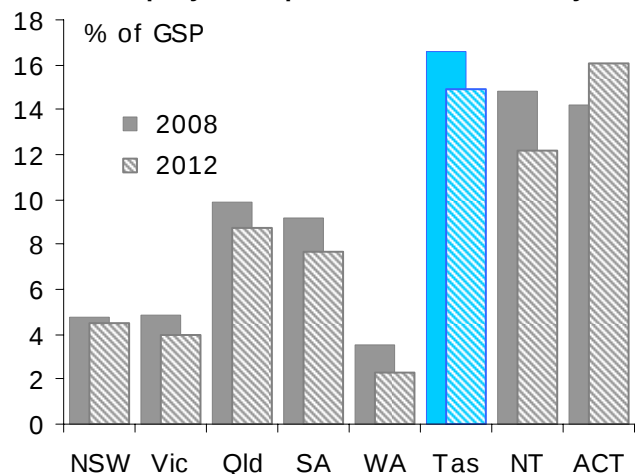
General government net debt



However there are two important respects in which Tasmania's financial position remains weaker than that of other States and Territories:

- Tasmania's **unfunded superannuation liability** is significantly greater (relative to the State's economy) than that of other States (though it is similar to that of the two Territories); and
- the net debt of Tasmania's **public enterprise** sector is relatively larger than that of most other States and Territories (with the exception, now, of Queensland where government business enterprise sector net debt is projected to increase by nearly \$30bn, or 4% of GSP, over the next four years).

Employee superannuation liability



Of the \$434mn in cash surpluses which are projected over the four years to 2011-12, \$415mn will be allocated to the Superannuation Provision Account, reducing the *net* unfunded liability from an estimated \$2.5bn at the end of this month to under \$2.4bn by June 2012, after providing for the payment of \$626mn in pensions and lump sums during this period. The Fiscal Strategy still envisages that the net liability will be fully extinguished (ie, funds in the SPA will match the gross liability) by 2033.

Confident outlook for Tasmania's economy

Notwithstanding that Tasmania's external environment is now 'more mixed', with the outlook for the global economy having 'weakened' and 'prospects for the Australian economy [being] weaker than in recent years', Treasury paints a reasonably up-beat assessment of the outlook for the Tasmanian economy in the Budget documents.

Treasury's measure of '**State economic activity**' – its proxy for the Statistics Bureau's measure of gross State product (about which Treasury continues to harbour doubts despite substantial changes to the way in which the ABS calculates it) and which is derived from the forecast for employment growth and average hours worked, plus an assumption about productivity growth – is forecast to increase by 3¼% in 2008-09, the same as expected for the current financial year. Significantly, this is above the Commonwealth Treasury's forecast of 2¾% growth in the national economy in 2008-09.

Treasury expects **employment** in Tasmania to grow by 2% in 2008-09, down slightly from the 2¼% likely for 2007-08 but again, significantly, above the 1¼% forecast for Australia as a whole. Assuming a labour force **participation rate** of 60¾% (unchanged from 2007-08), this is sufficient to keep the **unemployment rate** for 2008-09 as a whole steady at 5% (although in the last four months, the participation rate has been higher and the unemployment rate lower than these estimates). Some of the projected increase in employment is assumed to be taken up by immigrants from the mainland, pushing the State's **population** growth rate up temporarily to 0.8% in 2008-09 from 0.7% in 2006-07 and 2007-08.

Treasury's confidence that Tasmania's economy can achieve faster growth than the national average in the year ahead reflects:

- a (reasonable) belief that Tasmanian households are less vulnerable to **higher interest rates** than their counterparts in other States, given that the average level of household debt is some 44% below the national average;
- for the same reason, a stronger outlook for **housing activity** in Tasmania than on the mainland;
- continued strong growth in **business investment**, including the (assumed) commencement of major construction activity on the Gunns Ltd pulp mill 'early in 2008-09', as well as the Musselroe Bay eco-tourism project, the DFO at Hobart Airport and continuing work on the gas-fired Tamar Valley Power Station;
- a large increase in **public sector capital spending**, including initiatives funded in this Budget and GBE projects such as Transend's transmission line from Waddamana to Lindisfarne and Roaring Forties' Musselroe Bay wind farm project; and

- increased **mineral exports** from the Avebury nickel mine on the West Coast and the expected resumption of tin mining at Renison, and the re-developed scheelite mine on King Island.

Treasury identifies the principal **risk** to this outlook as being the possibility that **inflation** continues to increase, leading to further increases in **interest rates**, in turn adversely affecting Tasmania's export sales to the mainland (which accounts for about 30% of Tasmania's total output of goods and services) as well as potentially dampening local consumer sentiment and property prices.

A further risk noted by Treasury is that 'some **major investment projects** scheduled to commence in Tasmania are **delayed or cancelled**'. Although it is not mentioned specifically in this context, the Gunns pulp mill could come into this category. Last year's Budget assumed that the commencement of construction work at Longreach in the first half of 2007-08 would boost employment growth by ¼%. That assumption turned out to be invalid, yet the employment forecast appears to have been achieved and unemployment actually fell by more than forecast.

Treasury's perspective on this risk is worth quoting in full: "A decade ago, a delay in a major project, or the closure of a major employer, would have had a measurable impact on consumer and business confidence, and in some cases would have affected some major economic indicators. By contrast, economic activity and employment growth in Tasmania have remained strong in Tasmania over the past year, despite closures such as the Telstra call centre in Launceston and the Blundstone boot factory in Moonah, which altogether have shed 500 jobs. This reflects the high demand for labour, and for skilled workers in particular, and provides evidence that *Tasmania's economic performance is likely to remain strong, even if some major projects do not proceed as currently expected*' (emphasis added).

Elsewhere Treasury notes that the **skilled labour shortages** in the context of greater labour mobility between different parts of Australia and Tasmania's relatively unfavourable demographic profile (compared with other States) may be a constraint on future investment growth in Tasmania.

The third major risk identified by Treasury is that **global economic conditions** may deteriorate sharply over the next year. In particular, Treasury notes that a reduction in China's growth rate would adversely affect Tasmania's exports of ores and concentrates, processed metals and metal products, and (via the negative effects on Australia's terms of trade on other States), Tasmania's export sales.

Notwithstanding these risks, Treasury's assessment of the outlook for the Tasmanian economy in 2008-09 seems soundly-based, and we have no significant quarrel with it. We also commend the extended discussion of structural change in the Tasmanian economy over recent years to interested readers.

Further improvement in the Budget Papers

Last year we commended Treasurer Michael Aird and the Treasury for a significant improvement in the quality of Tasmania's Budget Papers, in particular for picking up suggestions we had made previously:

- to include a **'Policy and Parameter Statement'** showing separately the impact on the Budget of 'policy decisions' taken by the Government and of changes in economic and other assumptions since the previous Budget (so-called 'parameter variations');
- to provide financial statements for the **public non-financial corporations sector** and for the **non-financial public sector as a whole** for the **full four-year forward estimates period**, instead of (as previously) just for the forthcoming financial year (as the Commonwealth and Victorian Budget Papers still do); and
- to provide **projections of key economic and demographic indicators** for the **full four-year forward estimates period** rather than just for forthcoming financial year.

This year's Budget Papers incorporate further enhancements which we again warmly commend:

- the Policy and Parameters statement includes details for individual revenue items and categories of expenditure over the full four-year forward estimates period;
- the Budget Papers now include an indication of the sensitivity of key components of the Budget (such as taxation revenue or expenses) to changes in economic parameters such as employment growth or inflation – showing, for example, that a 1% pt decline in employment would reduce payroll tax revenues by \$4mn, or that a 1% increase in property market turnover or in the average value of property sales would boost stamp duty revenues by \$2.9mn; and
- (as in other States and Territories) a single accounting framework has been used for the presentation of all of the financial information in the Budget Papers, instead of two as in previous years.

These enhancements in last year's Budget and this one have propelled Tasmania to the forefront of Australian governments with regard to the quality, transparency and comprehensiveness of the financial information provided to the Parliament, public and analysts. The only material respect in which Tasmania falls short of Western Australia (which we regard as representing 'best practice' in this regard) is the absence of information on the public financial enterprises sector (which in WA is presented in the same detail as for the public non-financial enterprises sector).

There has also been a significant improvement in the breadth, depth and sophistication of the analysis of the Tasmanian economy over the past two years.

Tasmania's Budget Papers still have some way to go to match New South Wales, Western Australia and especially Queensland (which puts a considerable amount of resources into the compilation and analysis of State economic data) in this respect, but they now compare more than favourably with other States.

Scope for more initiatives before 2010

Assuming the Tasmanian economy performs in line with Treasury's forecast, the 2008-09 Budget puts the new Bartlett administration in a strong position looking forward to the next State election due in the first half of 2010.

Presumably with an eye to the electoral cycle, the new spending initiatives funded in this year's Budget build are 'back-loaded' into the 2009-10 fiscal years and beyond, while leaving some scope for further measures in next year's (pre-election) Budget without putting at risk the key elements of the Fiscal Strategy laid down after the 2006 election.

As it has been since the last election, health was again a big 'winner' in this year's Budget. This year's Budget was also notable for the significant uplift in infrastructure spending – something for which there is considerable justification and capacity. Although David Bartlett assumed the Premiership only a couple of weeks ago, there are some hints of his priorities in the new education and IT initiatives funded in the Budget, and (perhaps also) in the absence of any explicit mention of the Tamar Valley pulp mill in the Budget Speech or of any funding for infrastructure associated with it.

From a different perspective the 2008-09 Budget highlights the broadly-based benefits which accrue from achieving sustained economic growth and a sound financial position.

Tasmania's improving economic performance is now throwing off positive revenue 'surprises', which are in turn allowing the Government to address both previously unmet and newly emerging social and economic needs, which can in turn lead to improved economic performance and greater social well-being, without having to increase State taxes or incur excessive financial risks. This is almost literally a world away from the treadmill on which Tasmania found itself in the 1990s, and is a tribute to the efforts of previous Premiers and Treasurers during that period and since.

The challenge for David Bartlett, and for other aspirants to the position which he now holds, is to sustain this new-found prosperity, and to use it as a platform for comprehensively narrowing the gaps between Tasmanians and other Australians in terms of educational attainments, employment opportunities, productivity, social inclusion and general well-being. In all of these areas, there is much which remains to be done.

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