Tasmanian State Budget 2005-06

Priority shifts to addressing social needs and longer-term economic development

- Since the Labor Party returned to office in 1998, the focus of successive State budgets has been largely (though not exclusively) on restoring Tasmania's public finances to a sustainable position after the havoc wreaked by the Gray Government's deficit spending in the 1980s. This focus was reflected in the objectives of maintaining the budget in surplus and eliminating the 'general government' (budget) sector's net debt.
- Thanks to a combination of prudent economic and fiscal management and better-than-expected revenue streams, these objectives have been achieved ahead of their original schedule – in the case of the debt elimination target, by two years. This has freed the State Government to turn its attention to social and economic development issues which have, of necessity, given lower priority over the past seven years.
- On a 'no-policy-change' basis, the **cash surplus** for 2005-06 would, on our reckoning, have been a little under \$260mn – \$63mn more than forecast in February's Mid-Year Review, \$109 mn more than projected (for 2005-06) in last year's Budget, and \$143mn more than foreseen in the 2003-04 Budget.
- However, **tax cuts** (of \$44mn in 2005-06) and **spending increases** (by our count, \$46mn of increased operating expenses and \$74mn of new capital investments), amounting to \$164mn (equivalent to about 1% of gross State product) have cut this prospective surplus to a (still respectable) \$106mn. Cash surpluses are forecast to climb again to \$196mn by 2008-09.
- The initiatives announced in the Budget will push the **fiscal balance** (the accruals measure of the bottom line) into a deficit of \$5mn in 2005-06, as against the \$124mn surplus projected in the Mid-Year Review and the \$92mn surplus now forecast for 2004-05. Nonetheless, the fiscal balance returns to surplus in 2006-07, and the surplus climbs to \$80mn by 2008-09.
- The Tasmanian general government sector is still set to become a **net creditor** by 30 June next year, albeit by 'only' \$13mn rather than the \$107mn forecast in February. Even so, net financial assets are still projected to reach \$470 mn by June 2009.

A shift in focus

The 2005-06 State Budget represents a significant shift in the focus of the Labor Government's economic policy, away from strengthening the State's financial position and towards addressing long-standing social and economic development issues which, until now, have of necessity taken second place.

This emphatically does *not* mean that the Government has taken an imprudent turn. Rather, it reflects the fact that the Government's financial position has improved to the point where it can now *afford* to give greater attention to these issues.

The government's improved financial position reflects the prudent fiscal management of former Treasurer David Crean combined with stronger-than-expected revenues generated by a better-performing Tasmanian economy.

Unlike the Commonwealth and some other States, the Tasmanian Government does not provide a reconciliation between the Budget estimates and those published previously (they should, in our opinion). On our (necessarily rough) figuring, the Government would have been looking at revenues for 2005-06 of around \$3,570mn on a 'no policy change' basis, some \$113mn more than projected in the Mid-Year Review (published in February) and \$220mn more than estimated for 2005-06 in last year's Budget. Grants and subsidies from the Commonwealth (including GST revenues) in 2005-06 have been revised upwards by \$129mn since this time last year, while (on a no-policy-change basis) collections from State taxes would have been \$120mn more than forecast in the 2004-05 Budget. On the other side of the ledger, 'no-policy-change' operating expenses for 2005-06 would have been only \$115mn higher than projected at this time last year.

On a 'no-policy-change' basis, the Government would probably have been looking at a cash surplus for 2005-06 of around \$260mn, compared with the \$197mn envisaged in the Mid-Year Review, \$151mn in last year's Budget and with a revised forecast for the current (2004-05) fiscal year of \$160mn.

However, as this analyst noted in commenting on the Mid-Year Review, it is not the function of State governments to run surpluses (or deficits) for reasons of macro-economic policy; nor is there any justification for them to accumulate piles of cash in their bank accounts.

Now that the State's general government net debt is set to be eliminated before 30 June next year, two years ahead of the schedule originally laid down by David Crean – so that, instead of devoting some $150mn, or over 7% of the State's revenues, to net interest payments as it did in Labor's first budget, from 2005-06 onwards the Government will be a net recipient of interest - the shift in the Government's emphasis towards providing tax relief and increased spending on areas of social and economic need is entirely appropriate.

To that end, the 2005-06 Budget contains revenue and expenditure initiatives that appear to tally (there is no total given in the Budget Papers, although again there should be) at $111mn in 2005-06. This is equivalent to about 0.7% of Tasmania's gross State product, made up as follows:

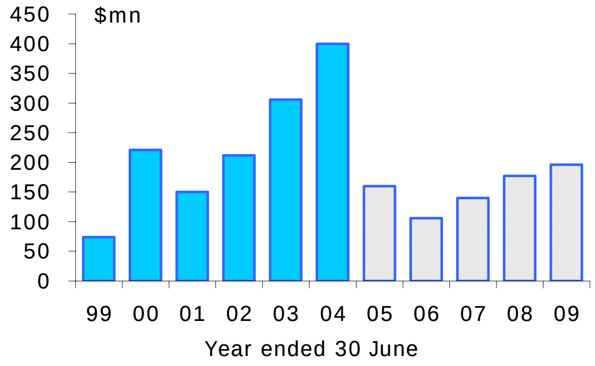
- **tax cuts** worth $44mn, including a simplified and (for land worth less than $750,000) less progressive land tax scale at a cost to revenue of $13mn in 2005-06, the abolition of duty on bank account debits, and the phasing out of stamp duty on mortgages and non-real-property business conveyances;

- increased **operating expenses** totalling $46mn, including $25mn for increased expenses in health and human services (in addition to previously announced increases in spending totalling $54mn in 2005-06 for the *Better Hospitals* package, Mersey Hospital and mental health services), $2.5mn to address skills shortages, and $4.2mn for initiatives in the Tourism, Parks Heritage and the Arts portfolio; and

- additional **capital investments** totalling $74m, including a $25mn equity contribution to TT-Line to keep *Spirit III* in service, $10mn in additional capital funding for hospitals, $8mn for school redevelopment, and $11mn from the Royal Hobart Hospital Redevelopment Fund and Better Roads program.

As a result of these initiatives, the **cash surplus** for the 2005-06 financial year is projected to be 'only' $106mn, down from an estimated $160mn in the current financial year. This will be the smallest cash surplus since 1998-99, although the surplus is then expected to increase again to $196mn by 2008-09. Similarly, the accrual-accounting measure of the Budget's bottom line, the **fiscal balance**, will slip into deficit by $5mn in 2005-06, as against a $124mn surplus projected in the February Mid-Year Review, and a $92mn surplus forecast for the current financial year.

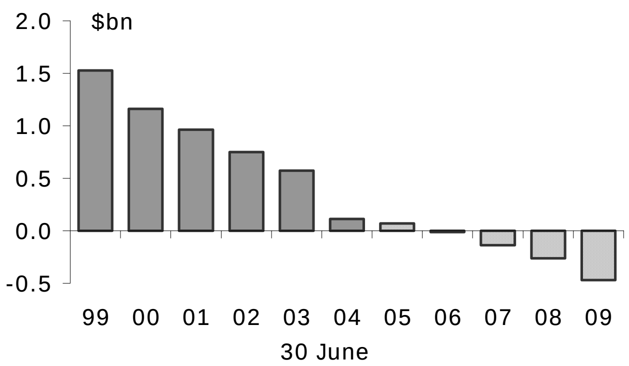
General government cash surplus



This is the first such deficit since accrual accounting measures commenced in 1998-99.

Even so, Tasmania's general government **net debt** is expected to be eliminated during the current financial year, with the government having a positive net financial asset position of $13mn (down from the $107mn projected in February) by 30 June next year, which will rise to $470mn by 30 June 2009. (State-owned enterprises will still have net debt totalling $1.6bn by 30 June next year).

General government net debt

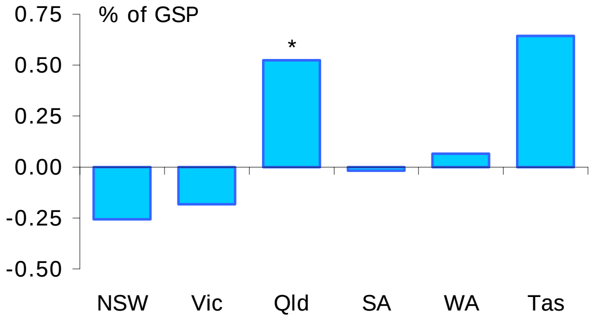


The growing cash surpluses projected for the years 2006-07 through 2008-09, and the return to surplus on the accrual accounting measure, assume very tight control of recurrent expenses after increases of 7.8% in the current financial year and 7.6% in 2005-06 (including a whopping 12.5% increase in employee expenses). Over the following three years, recurrent expenses are forecast to grow by an average of just 1.3% per annum – implying a decline in real terms (with employee expenses projected to increase by an average of 3¾% pa, which would appear to imply no growth in public sector employment). Although there are some 'one-off' items in the estimates of recurrent outlays for 2005-06 (most notably, the $15.4mn for compensation payments arising from the Ombudsman's inquiry into child abuse), it is difficult to believe such low growth in expenses can actually be achieved.

Tasmania compares well with other States

Of the five States which have so far brought down their 2005-06 Budgets, Tasmania is one of only two to project a cash surplus for the coming financial year, and Tasmania's surplus is nearly double that projected in the Western Australian budget. Indeed, unless the Queensland Budget (due on 7th June) projects an increase in that State's surplus, Tasmania will have the healthiest cash 'bottom line' of any State, as a proportion of gross State product, in 2005-06, notwithstanding the measures contained in this Budget.

Cash balances as a p.c. of gross State product, 2005-06



* Mid-Year Review estimate

Tasmania's fiscal deficit for 2005-06 will also be smaller, as a proportion of GSP, than those projected in the NSW and Victorian Budgets (and in the Queensland Mid-Year Review); while the fiscal surpluses projected in the WA and SA Budgets represent just 0.02% and 0.01% of GSP, respectively.

Tasmania will also be the only State other than Queensland where the general government sector is a net creditor.

Plenty of scope for further initiatives

In short, the measures contained in this year's Budget are readily affordable, and still leave the State in a stronger financial position than it has been in for decades.

Unlike the Commonwealth Government, which should be running large budget surpluses for economic management reasons at this stage of the business cycle, there is no compelling reason why Tasmania needs to run surpluses rising to the equivalent of 2½% of GSP by 2008-09.

Tasmania should thus be able to afford additional tax relief, spending on unmet social needs, and infrastructure in subsequent budgets. From that perspective, it probably doesn't matter very much that the spending forecasts for 2006-07 and beyond look unrealistically low.

A buoyant outlook for Tasmania's economy

The other notable feature of this year's Budget papers is the bright outlook painted by Treasury for Tasmania's economy in 2005-06. Indeed, so enthused were Treasury's forecasters by the economy's performance in 2004-05 and outlook for 2005-06 that they used the word 'strong' (or its derivatives) no fewer than 55 times in the 44 pages (also a record) which they devoted to the discussion of the economy in this year's Budget Paper No. 1.

Treasury forecasts growth in **State economic activity** of 3¼% in 2005-06, roughly the same as estimated for 2004-05. This compares with the forecast in the recent Commonwealth Budget of 3% growth in the Australian economy in 2005-06; and is faster than the forecasts of growth in gross State product in any of the other 2005-06 State Budgets brought down so far except for Western Australia (whose Treasury expects growth of 5¼% in the coming financial year; Queensland Treasury will probably forecast growth in that State's economy of over 4% in next month's budget).

Treasury expects another year of strong economic growth to result in the creation of another 6,000 new jobs, lifting **employment** by an average of 2½% (following on from the 2.8% growth in employment expected for 2004-05), and cutting Tasmania's **unemployment rate** to an average of 5½% (compared with the most recent figure of 6.1% for April). Treasury expects some of the new jobs to be taken up by new entrants to the labour force, lifting Tasmania's **participation rate** to an average of 59¾% from 59.3% in 2004-05 (though this would still be well below the mainland average of 61.2%).

Treasury expects growth in Tasmania's economy to derive more support from exports in the coming financial year, partly stemming from an assumed decline in the A$ (this is unusual: Treasuries, including the one in Canberra, conventionally assume that the exchange rate remains unchanged when constructing budget forecasts), and partly from continued strong growth in east Asia. This is expected to be sufficient to offset slower growth in dwelling construction (although the *level* of housing activity is forecast to remain high).

Consumer spending in Tasmania is expected to be less affected by higher interest rates than in other States, reflecting the smaller mortgages of Tasmanian home-buyers; while stronger population and employment growth combined with 'the tax relief included in this Budget' and steady or slightly firmer spending by tourists are expected to lend additional support to consumer spending.

Business and public investment are also expected to continue to contribute to buoyant overall economic growth, with tourism-related projects, the further rolling out of natural gas reticulation, Basslink, and State-funded capital works including the new Risdon Prison and public housing all boosting construction activity in 2005-06. Gunn's pulp mill proposal at Longreach is not scheduled to commence until the following financial year.

Treasury's forecasts are somewhat higher than ours – Economics@ANZ has been forecasting growth in Tasmania's real gross State product of 2½%. As Treasury points out every year, its measure of State economic activity 'not designed to be consistent with the experimental GSP series produced by the Australian Bureau of Statistics'; but since Treasury doesn't provide any detail of its measure, nor any history of it (the actual figure for 2003-04 is simply 'unavailable'), GSP is all that private sector analysts have to work with. That said, Treasury's forecast is by no means implausible, and indeed I rather hope they're right.

Tasmania's Budget Papers could be improved

One area of the Budget where there is room for improvement – in this writer's humble opinion – is in the presentation of the Budget papers themselves. Although Tasmania's Budget Papers now provide more detail than they used to in previous decades, they still fall well short of best practice in other States in several important respects:

- the Budget Papers do not provide estimates of the total of discretionary spending or revenue measures to enable a quick assessment of the overall size of policy measures – nor is it easy to arrive at such totals by thumbing through the Budget papers with a calculator.

- there is no reconciliation between successive estimates of key budget aggregates, such as expenses and revenues, made in Mid-Year Reviews and Budgets, showing the extent to which changes are due to policy decisions or to 'parameter variations' (changes in economic assumptions, etc.). The Commonwealth Budget Papers provide this essential detail, as does WA (see p. 17 of Budget Paper No. 3).

- Treasury provides economic projections only for the financial year immediately ahead, and not for the 'forward estimates period' (the following three financial years). Every other State Budget provides 4-year projections for at least real GSP, employment, inflation and (in most cases) population growth. The Commonwealth, WA and Victoria also provide an indication of the sensitivity of the major budget aggregates to changes in key economic assumptions.

- As noted earlier, Treasury provides no detail and no historical information on its measure of 'State economic activity'. By contrast, Queensland's Treasury publishes detailed quarterly estimates of that State's GSP (see http://www.oesr.qld.gov.au/publications/regular_publications/economic_performance/state_accounts.shtml)

- Tasmania provides forward estimates for the public non-financial corporations sector only for the Budget year (in this case 2005-06). Apart from Victoria, every other State provides the same detail for the public non-financial corporations sector (operating statement, balance sheet and cash flow statement) as it does for the general government sector for the full four-year forward estimates period. Given the relatively large size of this sector in Tasmania, this additional information is important for understanding the full impact of the public sector's activities on the economy.

- Tasmania's Budget Papers provide very little information on the financial performance (and contribution to the Budget) of individual public enterprises. By contrast, WA's Budget papers show the contribution of 16 individual public enterprises to that State's budget by way of income tax and local government rate equivalents, and dividends, as well as their dividend payout ratios (see Appendix 7 to WA Budget Paper No. 3, pp. 223-225).

- Tasmania's Budget Papers do not include much historical information for use in comparison with the forward estimates. The only longer-term time series shown in this year's Budget Papers are for net financial liabilities and net debt as a percentage of GSP, and then only in chart form. By contrast, SA and NSW provide historical data on key budget aggregates going back as far as 1979-80 and 1989-90, respectively (for cash measures), which enable useful longer-term assessments of fiscal performance to be made.

There's no suggestion (by this analyst) that Treasury (or the Government) are seeking to hide anything; simply that analysis of Tasmania's financial performance could be greatly enhanced by the provisions of information which, in most of the cases noted above, is available in every other State.

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