

Tasmanian State Budget Update

Tasmania's financial position stronger than envisaged in last year's State Budget

- The State Government's projected **cash surplus** for the 2004-05 financial year has been revised **upwards** to \$147mn from the \$96mn originally forecast in the Budget. Cash surpluses for the following two years have also been revised upwards, by \$46mn to \$197mn in 2005-06, and by \$34mn to \$180mn in 2006-07.
- The higher than previously forecast surplus is largely attributable to increased **GST revenues**, although most categories of **State taxes** are now also expected to deliver more revenue than originally forecast, reflecting the buoyancy of the State's economy and property markets.
- As a result of the higher-than-expected surpluses, Tasmania's **general government net debt** will be paid off a year earlier than predicted in the Budget. Net debt at 30 June this year is now projected to be \$77mn, as against \$230mn forecast in the Budget; while by 30 June 2006 the general government sector is projected to have net financial assets of \$107mn, instead of the \$117mn net debt forecast in the Budget. The State's general government net financial assets are now expected to build to \$482mn by 30 June 2008.
- Treasury's forecast of 3.2% growth in **State economic activity** in 2004-05 has been left unchanged. However, the **unemployment rate** is now expected to average 6.3%, rather than 6.7%, in 2004-05, largely because stronger employment growth has not attracted previously discouraged workers back into the labour force to the extent envisaged in last year's Budget.

State budget surpluses revised up

State Treasury's Mid-Year Financial Report, issued yesterday (15th February), shows that the Tasmanian Government's financial position is now expected to be stronger than envisaged in last year's State Budget.

The accrual accounting measure of the budget bottom line, the **fiscal surplus**, is now expected to be \$63mn in 2004-05, \$38mn higher than the \$15mn forecast in last year's State Budget. Projected fiscal surpluses for the out-years have also been revised upwards, by \$47mn (to \$124mn) in 2005-06; by \$28mn (to \$100mn) in 2006-07; and by \$13mn (to \$168mn) in 2007-08.

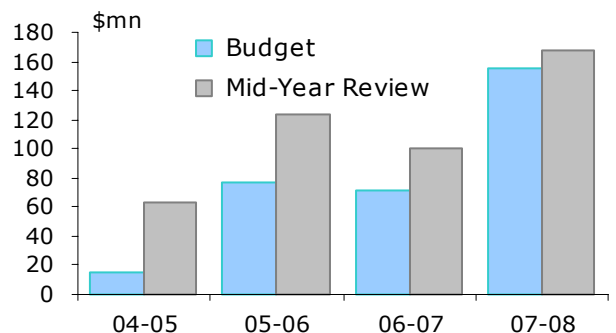
The upward revision to the fiscal surplus projected for the current financial year is largely the result of **GST revenues** now being forecast at \$1.443bn, \$64mn more than assumed in last year's Budget.

However **State taxes** are also now expected to generate more revenue than originally forecast. The buoyancy of Tasmania's property markets is reflected in a \$28mn upward revision to the forecast of collections from stamp duties on land transfers, while land tax revenues have also been revised upwards by nearly \$12mn. Upward revisions of \$12mn to payroll tax revenues, \$11mn to casino tax and licence fee revenue, and \$10mn to tax equivalent payments from Hydro Tasmania, also attest to the strength of the State's economy.

By contrast, **operating expenses** for the current financial year are expected to be only \$29mn more than estimated at Budget-time. This is more than accounted for by an actuarial review of the government's unfunded superannuation liability, (resulting in increased superannuation expenses), and additional spending under the Better Hospitals package (\$8.4mn), mental health and disability services (\$2.9mn) and the Mersey Community Hospital (\$2.3mn).

In addition, **capital expenditures** are now projected to be \$108mn more than allowed in the Budget, largely reflecting the allocation since the Budget of \$25mn to the Affordable Housing Strategy, \$10mn under the Better Hospitals package, \$4.4mn for the Mersey Community Hospital and just under \$2mn for the Mental Health Review.

General government fiscal surplus

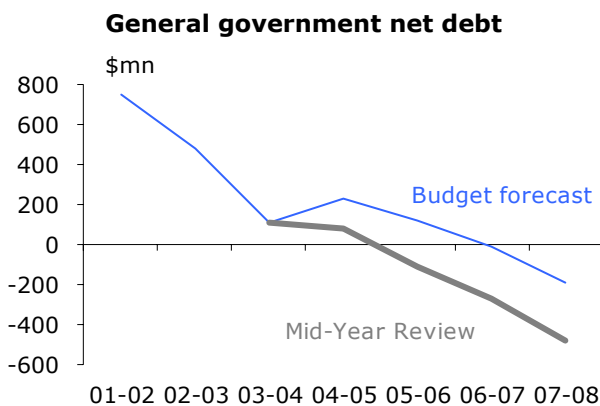


The improvement in the State government's financial position displayed in the accrual accounting measures is also reflected in the cash flow measures. The **cash surplus** for 2004-05 has been revised upwards by \$51mn to \$147mn, with slightly smaller upward revisions to the projected cash surpluses in the following two years.

State debt to be paid off one year sooner

As a result of the larger than expected cash surpluses for the current and subsequent fiscal years, Tasmania's 'general government' **net debt** will be paid off one year earlier than envisaged in the last Budget.

Instead of rising from \$114mn as at 30 June 2004 to \$230mn as at 30 June this year, general government net debt is now projected to fall to \$77mn; while by 30 June next year the Government is expected to have accumulated net financial assets of \$107mn, instead of net debt of \$117mn as forecast in the Budget. Last year's Budget projections had net debt being eliminated during the 2006-07 financial year. By 30 June 2008, the State's general government net financial assets are now expected to have built up to \$482mn, almost \$300mn more than projected in last year's Budget.



Note that even though the 'general government' sector debt is now expected to be eliminated in just over 12 months' time, the public non-financial corporations sector (of which Hydro Tasmania is the largest element) still has net debt of over \$1.6bn.

No major changes to State economic outlook

State Treasury has seen little reason to make significant changes to its forecasts for the Tasmanian economy in the current financial year. Treasury's measure of **State economic activity** (its preferred alternative to the Statistics Bureau's estimates of gross State product) is still expected to grow by 3.2% in real terms this year.

Average **employment** growth for 2004-05 has been revised up marginally from 2.4% to 2.5%, but this is now expected to result in a larger decline in the **unemployment rate**, to 6.3% (on average) in 2004-05 (instead of 6.7%), from 6.9% in 2003-04.

This reflects the fact that fewer discouraged workers than originally expected have been enticed back into the labour force by the strong employment growth of the past couple of years, with the result that the labour force participation rate hasn't risen as much as expected.

Finally, Treasury's forecast for **population growth** in 2004-05 has been revised upwards to 0.9%, from 0.7% in the Budget.

Time for new thinking on policy options

The improvement in Tasmania's financial position, highlighted by the prospect of the general government sector's net debt being paid off a year earlier than previously expected, leaves room to explore fresh policies for addressing Tasmania's longer-term problems without compromising the key elements of the Government's fiscal strategy.

As this writer has stressed in previous commentary on the Tasmanian economy¹, Tasmania's economic performance has improved significantly over the past few years, and some of the gaps between Tasmania and the mainland on key indicators such as unemployment and household income have narrowed appreciably. Nonetheless, it is still too early to be confident that these improvements will be sustainable over the longer term, especially since it is not yet clear that there has been any improvement in Tasmania's underlying productivity performance. Such improvements do, of course, take a considerable period to come to fruition. In the meantime, there remain some areas of the Tasmanian community who have derived little benefit from the improvement in the State's economic performance in recent years.

In this writer's opinion, there is little justification for State governments to accumulate piles of financial assets. Once the debt has been paid off, State budgets should seek to run, at most, only modest net operating surpluses. With the general government sector now anticipated to move into a net financial asset position during the coming financial year, the Government (and other parties) should be thinking carefully about combinations of tax reductions and expenditure initiatives (particularly capital expenditures) designed to upgrade Tasmania's physical and human capital, and enhance the prospects for improved productivity growth over the medium term.

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¹ See 'Tasmania's Economic Recovery: Is it the Real McCoy?', presentation to the Tasmanian Branch of the Economic Society, 10 December 2004, available on the ANZ website at www.anz.com/go/economics.

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