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Tasmanian State Budget Update 2007-08

Budget outlook transformed by revenue windfalls – no need for ‘tough decisions’ on hospital funding

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Substantial upward revisions to forecasts of revenues in the Mid-Year Review of the 2007-08 Tasmanian Budget have dramatically improved the Government’s financial position, allowing it to fund the bulk of the projected cost of building the proposed new Royal Hobart Hospital from future budget surpluses without departing from its fiscal strategy objectives and without requiring the (politically difficult) sale of any government business enterprises.

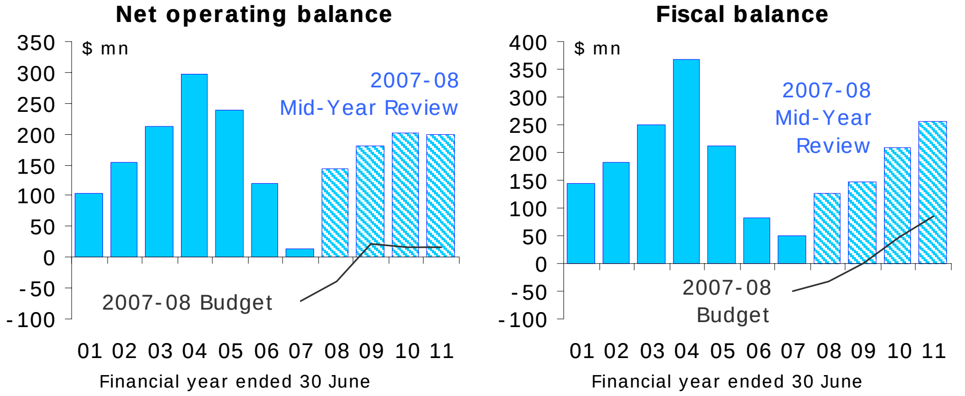
Revenue projections for 2007-08 through 2010-11 have been revised upwards by an average of $245mn per annum, or by nearly $1bn (6%) in total, while forecast operating **expenses** have been revised upwards by an average of only $69mn per annum, or just $274mn in total. The Government’s projected **net operating balance** (a measure of the extent to which on-going expenses are covered by revenues) has thus improved by a total of more than $700mn over the current financial year and the remaining three years of the forward estimates period. Instead of running an operating deficit of $38mn in 2007-08, as originally forecast in the June Budget, the Government now expects a surplus of $144mn; while the operating surpluses projected for 2008-09 through 2010-11 have been revised upwards from an average of $19mn pa to an average of $194mn pa.

And with very little change to projections of the capital side of the Budget, the projected **fiscal balance** (the accrual-accounting measure of the Government’s ‘bottom-line’) improves by a total of $641mn over the four-year forward estimates period, with the small deficits previously forecast for 2007-08 and 2008-09 turned into surpluses of over $100mn, rising to over $200mn in 2009-10 and 2010-11.

These improvements, together with the higher-than-expected proceeds from the sale of Hobart Airport just before Christmas, are mirrored in significant upward revisions to the Government’s **cash surpluses**, by over $350mn for the current financial year, and by a total of $717mn over the four-year forward estimates period.

This, in turn, has allowed Treasury to project a significant improvement in the Government’s **net debt** position: the Government’s net financial assets are now expected to exceed its net financial liabilities by almost $1.8bn by 30 June 2011, compared with the Budget-time forecast of $946mn.

The Budget’s revised ‘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.

Revenue windfalls

As noted above, the substantial improvement in the State Government's financial position is entirely due to significant upward revisions to the Budget-time forecasts of revenues. Continuing the dramatic improvements in the amount and quality of information presented by Treasury which was a noticeable feature of Michael Aird's first Budget, the Mid-Year Review indicates that these revisions stem from:

- upward revisions to **state taxation revenue** of $360mn (or more than 11%) over the four-year forward estimates period, of which more than two-thirds ($235mn) comes from higher **stamp duty** revenues, as a result of a large number of commercial property transactions in the current financial year, as well as a more buoyant outlook for property transactions over the remaining three years. **Payroll tax** revenues have also been revised up by a total of $136mn, on the back of higher forecasts for wages growth, while **land tax** revenues have been revised up by $7mn for 2007-08 and 2008-09 but downwards by a similar amount for the two following years;
- upward revisions to forecasts of **GST revenue** and other payments from the Commonwealth totalling $237mn;
- $136mn in additional **interest income** as a result of higher interest rates (since the State Budget is now a net creditor, higher interest rates actually improve the budgetary position rather than worsen it as used to be the case in the 1980s and 1990s);
- an additional $253mn (over four years) from a range of other sources, including an additional $17mn in Department of Justice fees and fines in 2007-08 alone, increased revenues from DHHS user charges, and higher tax equivalent payments from the MAIB and Transend, partly offset by lower payments from the Hydro.

These are all what are known in the language of Budget documents as 'parameter variations', that is, changes in the Budget estimates that are the result of changes in economic assumptions, patterns of service demand and delivery, or other factors outside the Government's control.

By contrast, 'policy decisions' have contributed very little to the improvement in the projected Budget position since the Budget. Over the past eight months, policy decisions have cost a total of just $80mn over the four-year forward estimates period, of which $37mn is attributable to additional pensioner concessions for Aurora energy bills.

The Government has maintained fairly tight control over expenses, which abstracting from the impact of policy decisions have been revised upwards by only 1.3%, largely reflecting additional DHHS expenditure (a good deal of which is in turn offset by increased user charges).

RHH funding now much easier

The dramatic improvement in the Government's budgetary position as a result of these revenue windfalls has greatly simplified the task of financing the construction of the **proposed new Royal Hobart Hospital**, as well as allowing it to provide for additional capital works at the Launceston General and North-West Regional Hospitals, and provide a further $60mn for public **housing,** without compromising any of the Fiscal Strategy objectives laid down by the Treasurer in his first Budget.

Previously, the only options open to the Government for meeting the cost of building a new Royal Hobart Hospital (mooted at over $1bn) had been some combination of:

- diverting the previously projected cash surpluses away from the Superannuation Provision Account (to which most of the Government's surpluses had been directed since it became 'net debt free' in 2004-05), thereby pushing out even further the timetable for fully offsetting Tasmania's unfunded superannuation liability;
- borrowing at least part of the cost, potentially imperilling the Fiscal Strategy objectives of keeping the fiscal balance in surplus on a four-year rolling average basis and of keeping the 'general government' sector net free; or
- undertaking the sale of part or all of one or more government business enterprises, such as Aurora or Transend, which would have entailed considerable political difficulty for a government which came to office in 1998 on a platform which included a pledge to maintain the State's electricity assets in public ownership.

Now, however, with Treasury revising upwards the Government's projected cash surpluses by an average of almost $180mn a year out to 2010-11, and assuming that similar upward revisions would apply to the following two years, the Government can easily divert $150mn per annum into a 'Hospital Capital Fund' which, as announced by the Premier and Treasurer last week, would provide $900mn (not including interest earnings on the fund) towards the capital cost of a new RHH and additional works at the LGH and NWRH.

And to the extent that the total cost exceeds that amount, it seems plausible that the difference could be borrowed whilst still staying within the Fiscal Strategy requirement that the fiscal balance be in surplus on a rolling four-year average basis (although it might be in deficit in the year in which any borrowings were undertaken), and that the general government sector remain 'net debt free'.

None of this is to say that (in this analyst's opinion) it would necessarily have been wrong to fund at least part of the cost of the new RHH by additional borrowings or by asset sales. But it is quite understandable that if the Government doesn't need to contemplate either of these courses of action, it can rule them out.

Little change to the economic forecast

Treasury has lowered its forecast for growth in **'State economic activity'** in 2007-08 from 3½% to 3¼%. Technically, this is attributed to 'growth in total hours worked in the first five months of 2007-08 being below the growth expected at the time of the Budget' (since this measure is constructed as the product of projections of employment, average hours worked and productivity growth), although it could equally be explained by the delay in the commencement of construction of the Gunns pulp mill. This compares with growth in Tasmania's real gross State product in 2006-07 of 2.1%, which was slightly below the Budget estimate for growth in 'State economic activity' of 2½%.

Despite the delay in the commencement of construction works at Longreach, the forecast for growth in **employment** in 2007-08 has been left unchanged at 2¼% (up from 0.8% in 2006-07), and that for the **unemployment rate** at 5½%. With employment in the first seven months of 2007-08 averaging 2.3% higher than in the corresponding period of 2006-07, and the unemployment rate averaging 5.2%, these forecasts appear eminently plausible.

Hobart's annual (headline) **inflation rate** is now forecast to average 2¾% in 2007-08, an upward revision of ¼ pc point from the Budget forecast. This is in line with Federal Treasury's forecast for the national inflation rate in last October's Mid-Year Economic & Fiscal Outlook, but around ½ pc point below the (headline) inflation forecast for 2007-08 contained in last week's Statement on Monetary Policy by the Reserve Bank.

Treasury's brief discussion of the economic outlook makes no reference to the recent turmoil in global financial markets, or to the possibility of a recession in the United States and slower growth in other major economies, and only a passing reference to the possibility of 'further interest rate rises' (which are strongly hinted at in the Reserve Bank's most recent Monetary Policy Statement).

Treasury notes that Tasmanians have lower average household debt levels than their mainland counterparts, implying that they may as a result be less affected by further increases in interest rates – although they also have lower average incomes, and their employment security may be more vulnerable to rising interest rates (given that a greater proportion of Tasmanians are employed by small businesses) or to a sharp downturn in the global economy.

Although the State Budget is not directly vulnerable to higher interest rates in the way that it was when it was a significant net debtor, to the extent that higher interest rates (or a sharp downturn in the global economy) undermined the buoyant revenue projections contained in the Mid-Year Review, the Government might again be required to contemplate other options for financing construction of the new RHH and other major projects.

A nice position to be in

In the absence of these downside risks, however, the Government can be well-pleased with the outcome of the Mid-Year Review of the 2007-08 Budget. It is now in a position to fund construction of a new hospital for Hobart, as well as a range of other initiatives, without resorting to what it would regard as politically odious methods of financing.

That's not to say that Tasmania does not still have substantial economic and social challenges ahead. It clearly does. But provided the global and national economies 'hold up' as implicitly assumed (something over which the Tasmanian Government of course has no influence), then the State is in a much better position to meet those challenges than it appeared as recently as eight months ago

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