

PART 5: FISCAL DEVELOPMENTS IN THE PUBLIC SECTOR

This part discusses trends in the fiscal balance, operating balance, cash surplus, balance sheet data (net debt, net financial worth and net worth) and net interest payments for the non-financial public sector at the Commonwealth and State/local levels of government, and together at the consolidated level. These indicators are discussed in greater detail in Budget Paper No. 1, Statement 9.

This part provides a framework in which to consider developments in the Australian Government's budget, through consideration of the fiscal positions of all Australian governments.

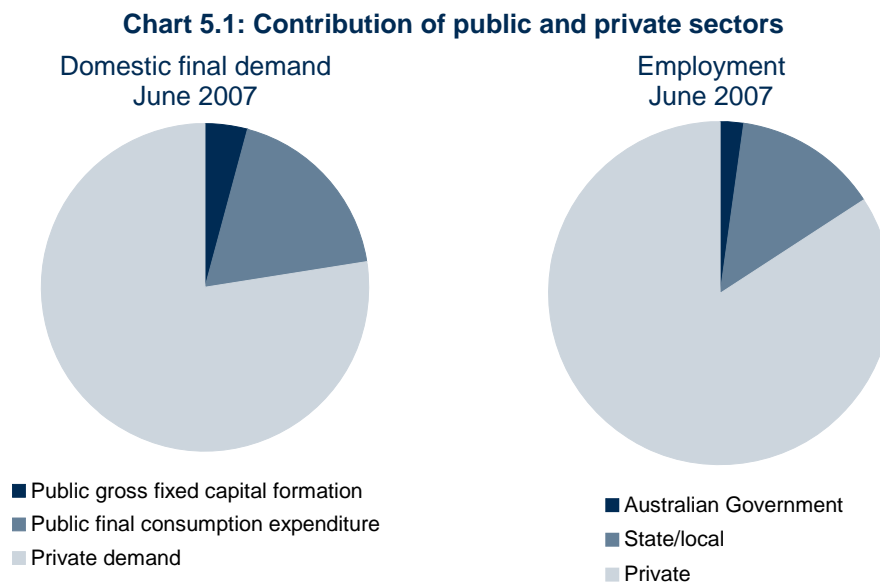
For further information on the data used in the charts and tables in this part, see Appendix A. Additional data tables can be found in Appendix C.

This Budget Paper uses the convention that references to the States include the Territories, and that the combined State and local government sector is denoted as the State/local sector and includes Territory governments unless otherwise stated. References in this paper to the Commonwealth general government sector (or non-financial public sector, or public non-financial corporations sector) relate to the public sectors of the Australian Government.

SIZE AND STRUCTURE OF THE PUBLIC SECTOR

The size and structure of Australia's public sector provides a useful context for interpreting trends in the total public sector. The total public sector constitutes a significant portion of the Australian economy (around 22 per cent of domestic final demand).

Domestic final demand (as shown in Chart 5.1) consists of public final demand (which comprises public gross fixed capital formation and public final consumption expenditure) and private demand (consisting of private gross fixed capital formation and private final consumption expenditure). The Commonwealth accounts for 35 per cent of public final demand, while the State/local level of government accounts for 65 per cent.



Sources: Australian Bureau of Statistics cat. nos. 5206.0, 6248.0.55.001 and 6202.0.

There are significant differences in the roles and responsibilities of the two main levels of government. Major components of the Commonwealth's expenses include transfer payments in relation to social security and welfare, and defence expenditure. Transfer payments, such as Commonwealth income support payments, are not included in the Commonwealth's public final demand. Rather, these payments, along with payments that the Commonwealth makes to the States and the private sector to assist in funding important services like education and health, are reflected in either State/local public final demand or private demand.

In terms of employment, the total public sector employs approximately 16 per cent of wage and salary earners (Chart 5.1). The State/local sector accounts for around 13.7 per cent of all wage and salary earners and just over 86 per cent of total public

sector wage and salary earners. The Australian Government accounts for around 2.2 per cent of all wage and salary earners and for almost 14 per cent of total public sector wage and salary earners. The State/local sector's larger share reflects that sector's major responsibilities for service delivery in the areas of education, health, transport and public order and safety.

As outlined in Figure 1 of Statement 9, the total public sector includes the non-financial public sector (comprised of the general government sector and the public non-financial corporations sector) and the public financial corporations sector. The general government sector forms the majority of the non-financial public sector (NFPS) particularly in terms of revenue and expenses. The public non-financial corporations sector (PNFC) sector tends to be more important at the State/local level, where most PNFCs are concentrated.

CASH SURPLUS

A cash surplus reflects the extent to which cash is available to a government to increase financial assets or decrease liabilities (assuming no revaluations or other changes occur). A cash deficit measures the extent to which a government requires cash, which can be sourced either by running down financial assets or by borrowing.

General government sector

The Commonwealth general government sector cash balance has recorded strong surplus outcomes over recent years and this is expected to remain the case over the forward estimates.

In aggregate, the State/local general government sector is expected to maintain small cash deficits of around 0.2 per cent of GDP from 2007-08 to 2010-11 (Panel A, Chart 5.3). In 2006-07, the sector recorded a deficit of 0.3 per cent of GDP. The 2006-07 State/local cash deficit is affected by a one-off \$7.2 billion contribution from New South Wales' General Government Liability Management Fund towards defined benefit superannuation schemes. The State/local general government sector maintained a cash surplus each year from 1994-95 to 2005-06, with the exception of 1998-99. In recent years the performance of this sector has been underpinned by strong growth in key revenue bases, in particular the GST and revenues related to the property market.

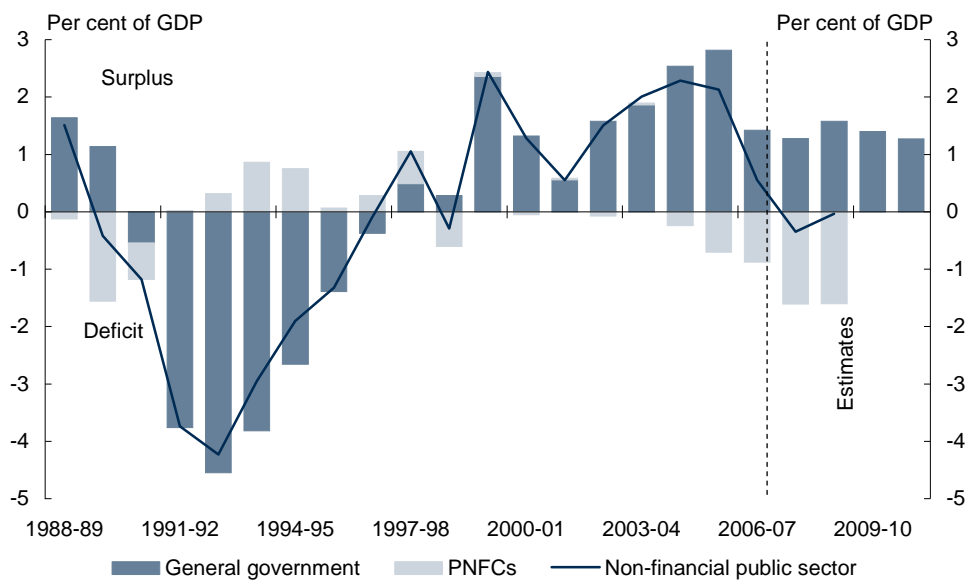
Public non-financial corporations sector

As shown in Chart 5.2, the consolidated PNFC sector maintained a cash surplus position through much of the 1990s, but has recorded deficits in recent years. A deficit of 1.6 per cent of GDP is estimated for the consolidated PNFC sector in 2007-08 and 2008-09, mainly reflecting the impact of large capital expenditure programs by State/local PNFCs.

Non-financial public sector

It is estimated that the consolidated NFPS will record a small cash deficit of 0.3 per cent of GDP in 2007-08 followed by a negligible cash deficit in 2008-09. The expected State/local NFPS deficit is predominantly a result of the large capital expenditure programs planned by State/local PNFCs. These capital expenditure programs are largely directed in the areas of electricity, gas, water, rail and port infrastructure, which will help the Australian economy to continue to grow into the future and provide essential service provision to the Australian public.

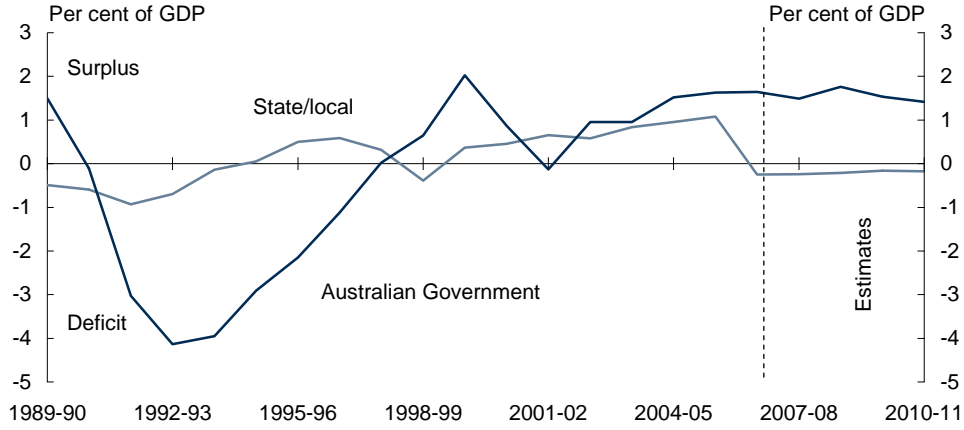
Chart 5.2: Consolidated non-financial public sector cash surplus by sector^(a)



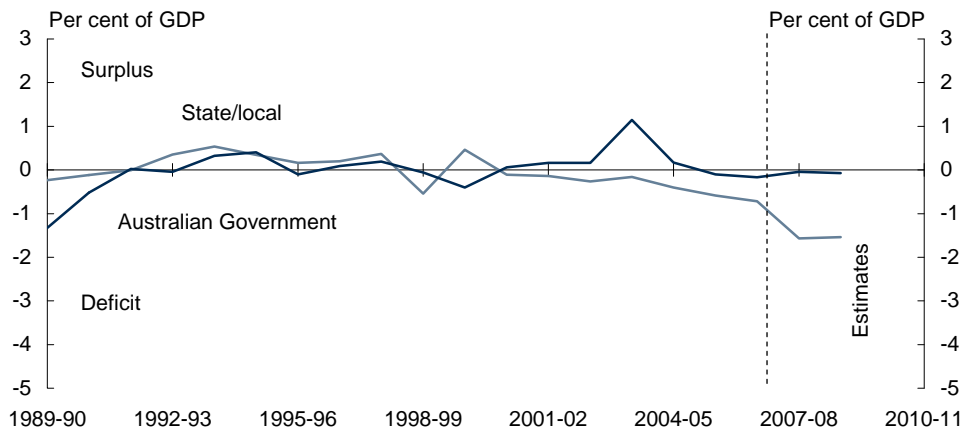
(a) Data for the consolidated PNFC and NFPS are only available to 2008-09.

Chart 5.3: Cash surplus by sector and level of government

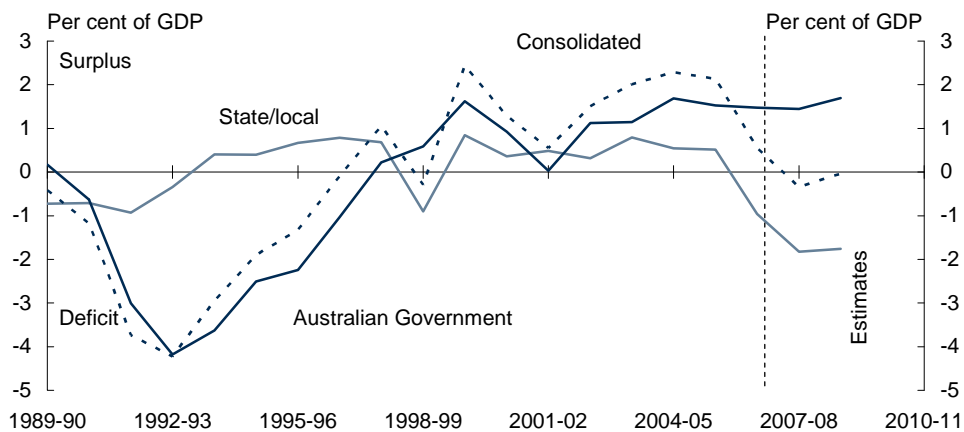
A: General government sector



B: Public non-financial corporations



C: Non-financial public sector



Receipts and payments

Chart 5.4 shows the trend in general government sector cash receipts and payments at the Commonwealth, State/local and consolidated levels, which underpin the developments in cash balances explained above. The general government sector is an appropriate focus for an assessment of public sector receipts and payments as it is the sector that collects taxes and provides non-market public services. The general government sector also accounts for the majority of NFPS receipts and payments.

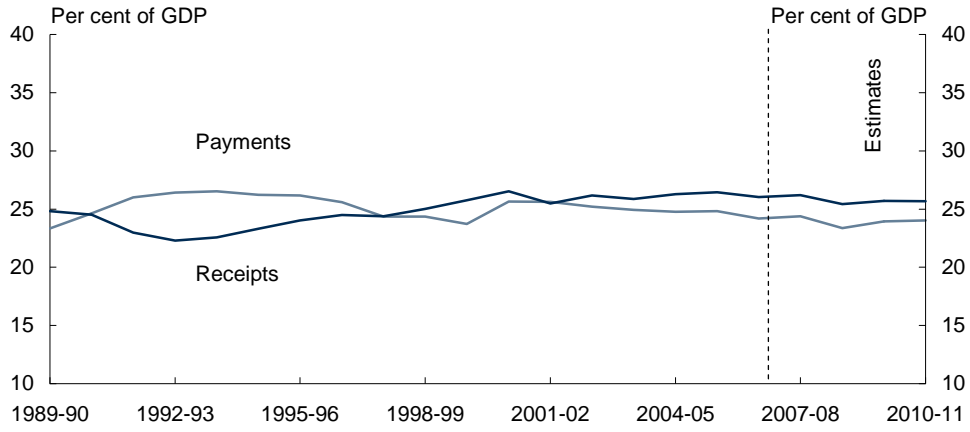
Estimates of Commonwealth receipts and payments in Panel A of Chart 5.4 are inclusive of GST receipts and the associated payments of GST revenue to the States.

The increases in receipts and payments in 1998-99 for the State/local sector and in 1999-2000 for the Commonwealth, shown in Panels B and A of Chart 5.4 respectively, were predominantly due to the move to an accrual accounting framework and the subsequent 'grossing' up of cash receipts and payments, whereas prior to this some cash receipts were netted off payments.

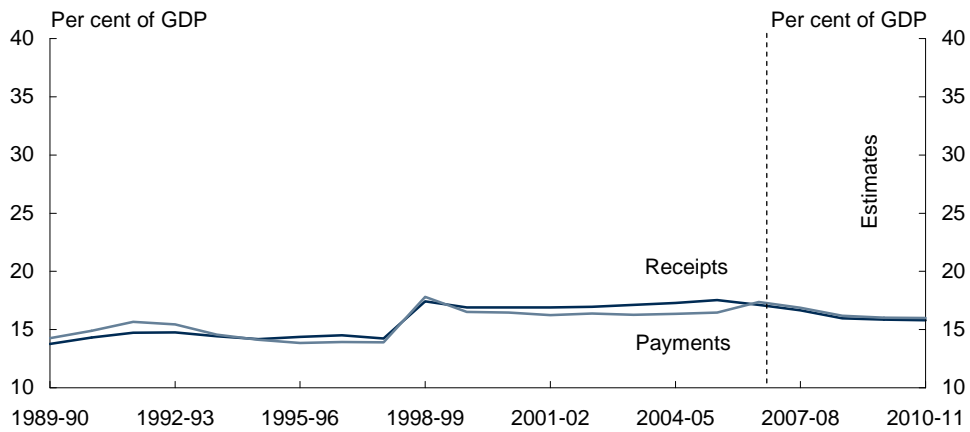
The PNFC sector is an important provider of economic infrastructure and contributes revenue to the general government sector, mainly in the form of dividends. State/local governments account for the majority of total PNFC sector receipts and payments, reflecting State responsibility for infrastructure and service provision in areas such as electricity, gas, water and transport.

Chart 5.4: General government sector receipts and payments by level of government

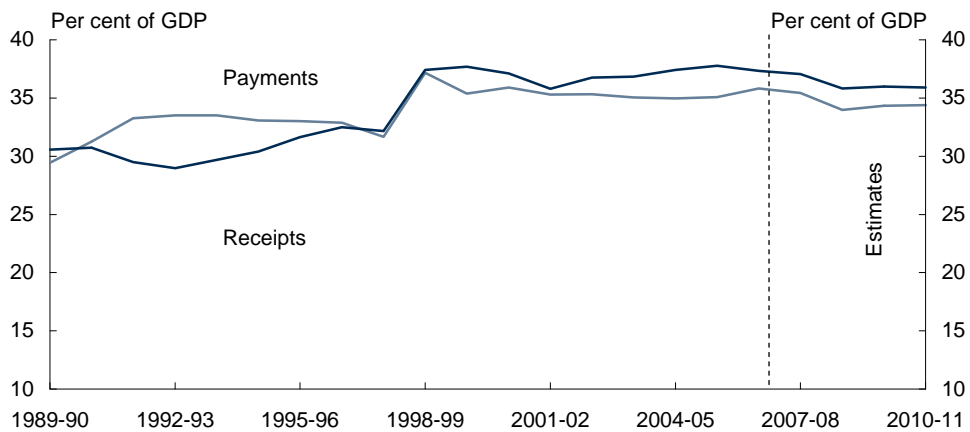
A: Commonwealth



B: State/local



C: Consolidated



FISCAL BALANCE

The fiscal balance measures, in accrual terms, a government's investment-saving balance. It is calculated as the gap between government savings plus net capital transfers, and investment in non-financial assets. A fiscal surplus indicates that a government is lending to other sectors. A fiscal deficit indicates that a government is borrowing.

The fiscal balance of the Commonwealth general government sector is expected to be in surplus by 1.8 per cent and 1.9 per cent of GDP in 2007-08 and 2008-09. The surplus is projected to remain around 1.7 per cent of GDP over the forward years.

After being in surplus in recent years, the State/local general government sector is expected to record a fiscal deficit of 0.4 per cent of GDP in 2007-08 and remain in deficit over the forward estimates. The forecast deficits reflect smaller operating surpluses and high levels of planned capital investment.

The consolidated PNFC sector fiscal balance is expected to be in deficit by 1.6 per cent of GDP in 2007-08 and 2008-09. The increase in the PNFC deficit in recent years mainly reflects increased capital expenditure by PNFCs at the State/local level.

Consolidated PNFC revenue and expenses have decreased significantly as a share of GDP since the late 1990s. This is partly attributable to the privatisation of PNFCs by both the Australian and State/local governments. For example, Telstra no longer forms part of the PNFC sector following the further sell down of the Commonwealth's interest in Telstra in 2006-07.

Fiscal deficits at the State/local level are expected to result in the consolidated NFPS being in deficit in 2007-08 and 2008-09.

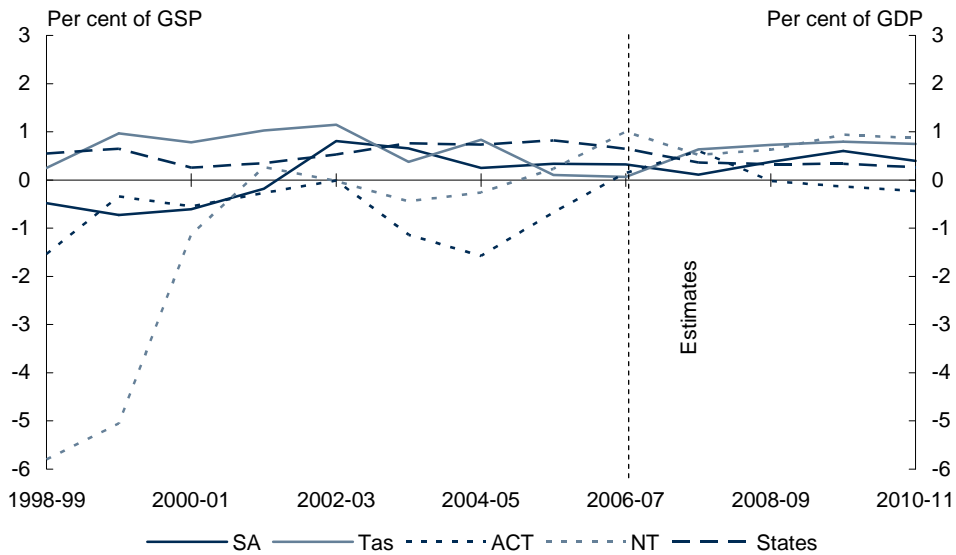
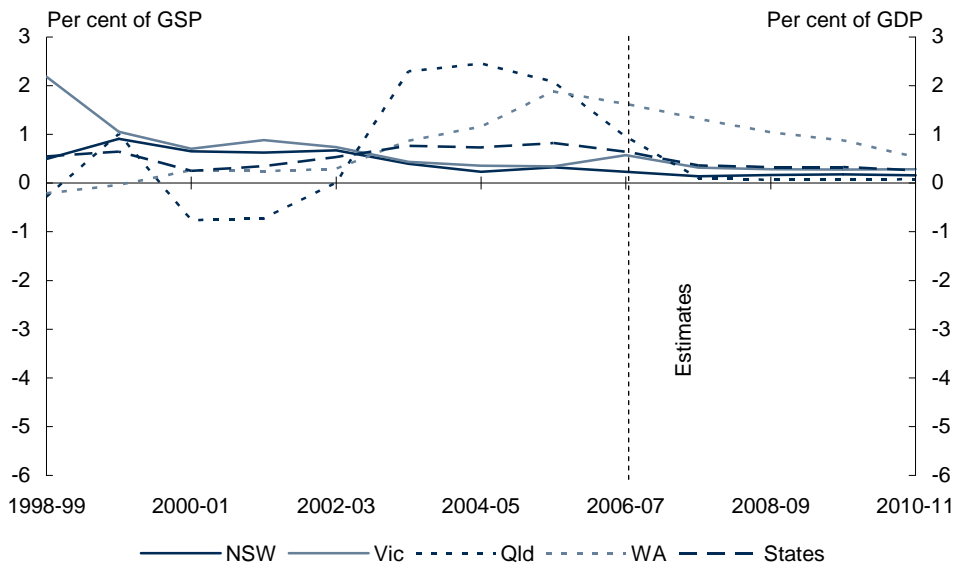
STATE GENERAL GOVERNMENT SECTOR NET OPERATING BALANCE

The net operating balance measures, in accrual terms, the gap between a government's expenses and revenue for a given period. This is the headline measure used by most States. It provides a good indication of the sustainability of the existing level of government services. An operating surplus indicates that a government can finance the services it provides in a period using revenues derived in that period. An operating deficit indicates that a government must borrow or sell assets in order to finance services provided in a period.

The aggregate state general government sector net operating position is expected to be a small surplus of \$4.1 billion in 2008-09, or 0.3 per cent of GDP. It is forecast to remain at 0.3 per cent of GDP through to 2010-11.

With one exception, all States expect to record operating surpluses between 2008-09 and 2010-11. The ACT expects to record small operating deficits over this period, at an average annual rate of 0.2 per cent of GDP.

Chart 5.5: Individual state general government sector net operating balance^(a)



(a) States' net operating balances are expressed as a percentage of Gross State Product (GSP) (left hand axis) and the States' aggregate net operating balance is expressed as a percentage of Gross Domestic Product (GDP) (right hand axis).

NET DEBT

Net debt is the sum of selected financial liabilities (deposits held, advances received, government securities, loans and other borrowing) less the sum of selected financial assets (cash and deposits, advances paid, and investments, loans and placements). Net debt does not include superannuation related liabilities.

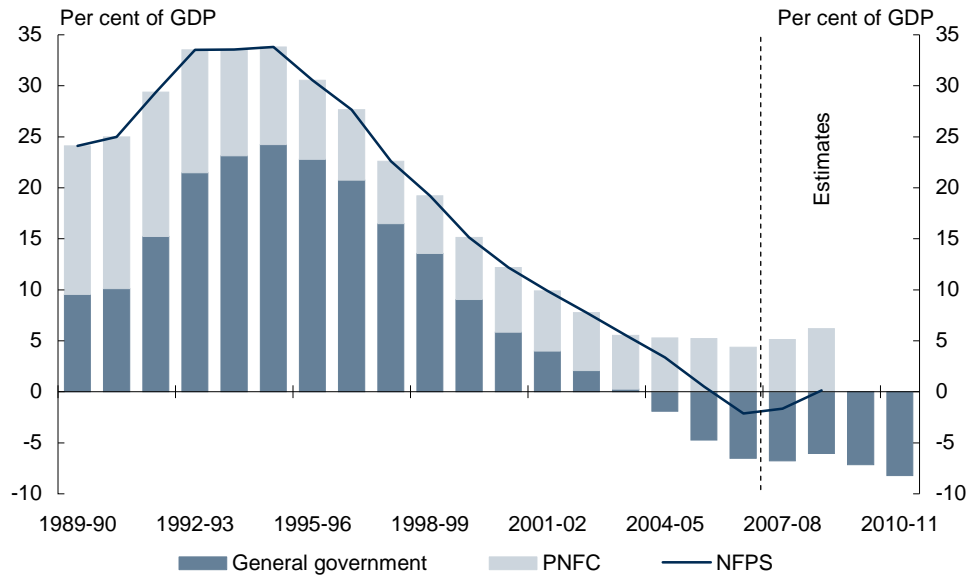
The improvement in consolidated NFPS net debt from the mid-1990s through to 2006-07 shown in Chart 5.6 primarily reflects both the Commonwealth and the State/local sector moving back into budget surpluses and the continued application of privatisation proceeds to debt retirement at both government levels. PNFC privatisations during the 1990s occurred among enterprises providing public services such as transport, communications, electricity, and some publicly owned providers of financial services.

Commonwealth general government sector net debt was eliminated in 2005-06 and Commonwealth PNFC sector net debt was eliminated in 2006-07. At the aggregate State/local level general government sector net debt was eliminated in 2001-02.

Since 2006-07, consolidated NFPS net debt is again trending upwards due to an increase in net debt at the State/local level. This primarily reflects the financing of State government infrastructure projects, particularly in the PNFC sector (as shown in Panel B of Chart 5.7). State owned corporations have the primary responsibility for the provision of infrastructure and their borrowing to fund projects can help spread the cost burden across generations.

The aggregate State/local PNFC sector now holds the entire public sector net debt.

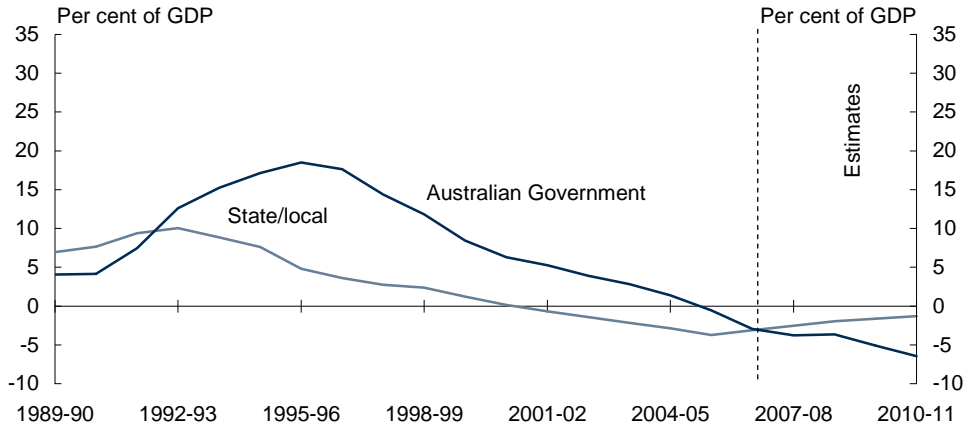
**Chart 5.6: Consolidated non-financial public sector net debt by sector
(as at end of financial year)^(a)**



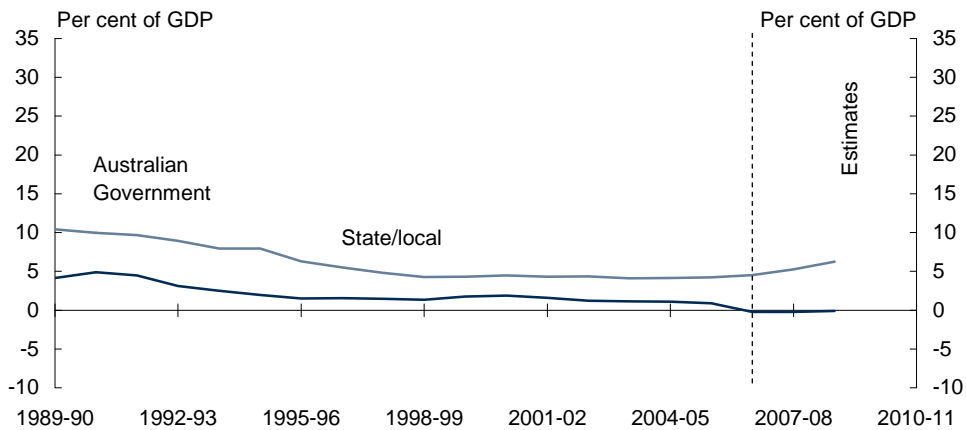
(a) Data for consolidated PNFC and NFPS are only available to 2008-09.

**Chart 5.7: Net debt by sector and level of government
(as at end of financial year)**

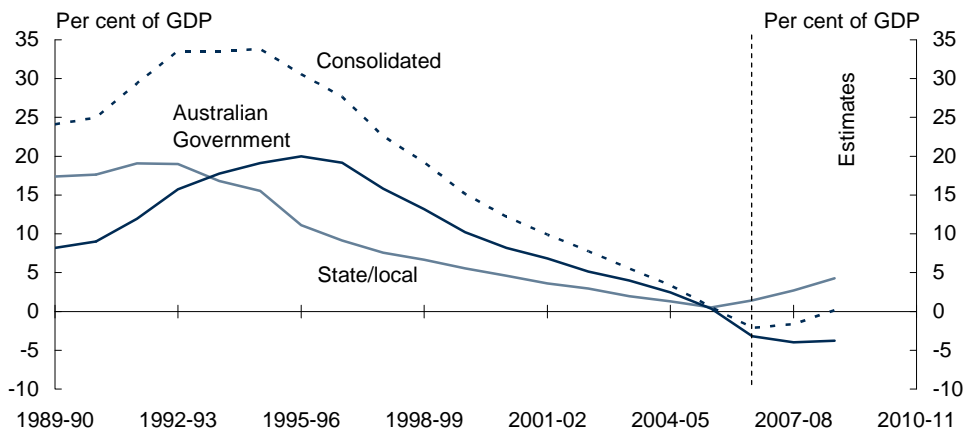
A: General government sector



B: Public non-financial corporations



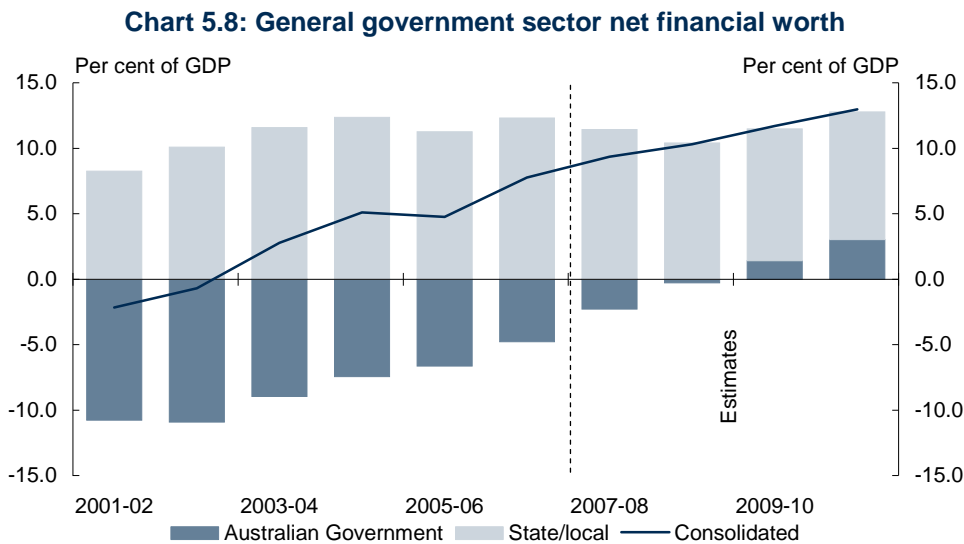
C: Non-financial public sector



NET FINANCIAL WORTH

Net financial worth measures a government's net holdings of financial assets. It is a broader measure than net debt, as it includes employee related liabilities such as superannuation, but narrower than net worth, as it excludes non-financial assets.

Following the trend in net debt, the Commonwealth general government sector's net financial worth position has improved over recent years and is forecast to become positive in 2009-10. This increase in Commonwealth general government sector net financial worth is expected to drive consolidated general government sector net worth on a continued upward path over the budget and forward years. Net financial worth in the State/local general government sector is expected to have peaked in 2006-07 and is forecast to fall slightly, as a per cent of GDP, from 2007-08 onwards.



NET WORTH

Net worth is the broadest measure of liabilities, as it includes all assets less all liabilities.

The State/local general government sector is estimated to have a positive net worth of 61.1 per cent of GDP in 2008-09. State/local net worth has increased in nominal terms each year since 1998-99, but has increased only marginally as a proportion of GDP over the same period.

The Commonwealth general government sector has historically recorded negative net worth. This difference primarily reflects the significant funding provided by the Commonwealth to the States and to local government for capital works, with the

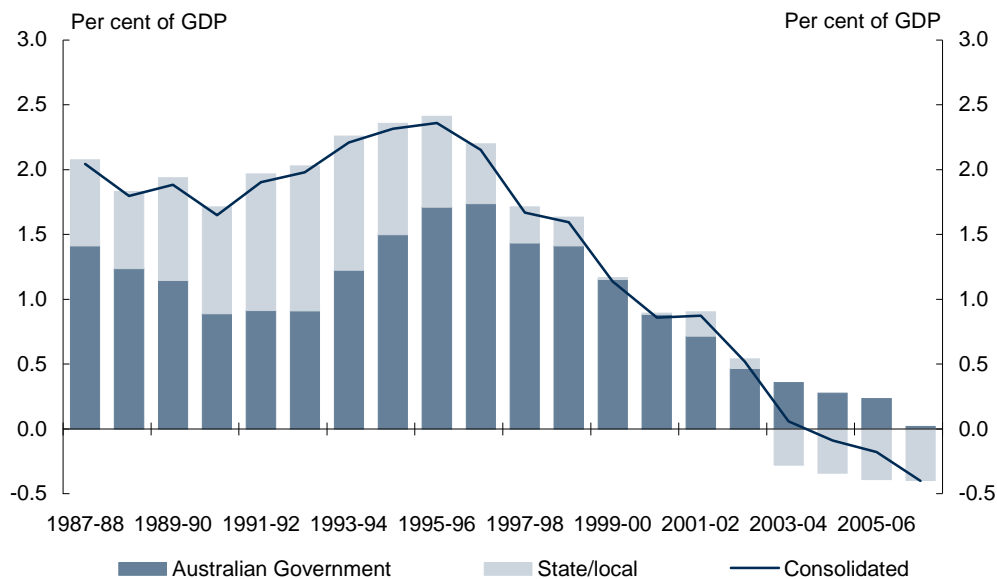
resultant assets recorded in the balance sheets of the State and local governments. There has been a consistent improvement in the net worth of the Commonwealth general government sector since 2002-03, reflecting the contribution of continued budget surpluses and the expectation of higher average investment returns through the Future Fund. Looking ahead, general government sector net worth is expected to improve across all levels of government and particularly at the Commonwealth level.

NET INTEREST PAYMENTS

Net interest payments reflect the cost of servicing debt. The higher the net debt of a government (lower net financial worth), the greater the call that will be imposed on the government's future revenue flows to service that debt.

Consolidated general government sector net interest payments peaked in 1995-96, reflecting the increased level of Commonwealth general government sector net debt. Consolidated general government sector net interest payments were -0.4 per cent of GDP in 2006-07 due to reduced Commonwealth and State/local general government sector net debt since 1995-96 and lower interest rates in recent years.

Chart 5.9: General government sector net interest payments



THE AUSTRALIAN LOAN COUNCIL

The Australian Loan Council is a Commonwealth-State ministerial council that coordinates public sector borrowing. The Loan Council consists of the Prime Minister of Australia and the Premier/Chief Minister of each State and Territory. However, in practice each member is represented by a nominee, usually the Treasurer of that jurisdiction, with the Australian Treasurer as Chairman.

Current Loan Council arrangements operate on a voluntary basis and emphasise transparency of public sector financing rather than adherence to strict borrowing limits. These arrangements are designed to enhance financial market scrutiny of public sector borrowing and facilitate informed judgments about each government's financial performance.

The Loan Council traditionally meets annually in March to consider jurisdictions' nominated borrowings for the forthcoming year. As part of the agreed arrangements, the Loan Council considers these nominations, having regard to each jurisdiction's fiscal position and the macroeconomic implications of the aggregate figure.

Outcome of the March 2008 Australian Loan Council meeting

The Loan Council met on 14 March 2008 to consider Loan Council nominations for 2008-09. The Loan Council approved each jurisdiction's nominated allocation. In aggregate, the nominations represent a deficit of \$953 million (Table 5.1). The States nominated a deficit of \$19.9 billion and the Commonwealth Government nominated a surplus of \$19.0 billion.

Table 5.1: Loan Council Allocation (LCA) nominations for 2008-09^(a)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	C'wth	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Nominated 2008-09 LCAs										
General government sector cash surplus(-)/deficit(+)	586	796	1,983	-368	392	-232	-359	0	-17,386	
PNFC sector cash surplus(-)/deficit(+)	4,495	3,732	6,061	2,290	12	77	111	134	46	
Non-financial public sector cash surplus(-)/deficit(+)(b)	5,080	4,528	8,043	1,922	404	-155	-248	134	-17,340	
<i>minus</i> Net cash flows from investments										
in financial assets for policy purposes(c)	-81	26	0	0	6	5	7	0	891	
<i>plus</i> Memorandum items(d)	130	196	506	-222	-448	26	-6	0	-743	
Loan Council Allocation	5,291	4,698	8,549	1,700	-50	-134	-261	134	-18,974	953
2008-09 tolerance limit(e)	1,287	792	867	495	270	127	75	81	6,227	

(a) LCA nominations for 2008-09 reflect current best estimates of non-financial public sector (NFPS) surpluses/deficits. Nominations have been provided on the basis of policies announced up to and included in jurisdictions' mid-year budget reports and the Australian Government's pre-election fiscal outlook. Nominations are based on preliminary estimates of general government (GG) finances provided by jurisdictions for purposes of their mid-year reports, and projected bottom lines for each jurisdiction's public non-financial corporations (PNFC) sector, where actual estimates are unavailable. Each jurisdiction will publish an updated LCA estimate as part of its budget documentation.

(b) The sum of the surpluses of the GG and PNFC sectors may not directly equal the NFPS surplus due to intersectoral transfers.

(c) This comprises net lending by governments with the aim of achieving government policy, as well as net equity sales and net lending to other sectors or jurisdictions. Such transactions involve the transfer or exchange of a financial asset and are not included within the cash deficit. However, the cash flow from investments in financial assets for policy purposes has implications for governments' calls on financial markets.

(d) Memorandum items are used to adjust the NFPS surplus/deficit to include in LCAs certain transactions — such as operating leases — that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the NFPS surplus/deficit certain transactions that Loan Council has agreed should not be included in LCAs, for example, the funding of more than employers' emerging costs under public sector superannuation schemes, or borrowings by entities such as statutory marketing authorities. Where relevant, memorandum items include an amount for gross new borrowings of government home finance schemes.

(e) Tolerance limits are designed, inter alia, to accommodate changes to the LCA resulting from changes in policy. Tolerance limits apply between jurisdictions' LCA nominations and budget estimates and again between budget estimates and outcomes. They are calculated as 2 per cent of NFPS cash receipts from operating activities in each jurisdiction.