

1.2 FISCAL STRATEGY - FINANCIAL OBJECTIVES AND KEY MEASURES

Fiscal Strategy

The Government continues its commitment to the principles of responsible financial management. The Budget delivers a net operating surplus in 2008-09, with surpluses forecast in each of the forward years.

The Government's fiscal strategy largely remains unchanged. The strategy, however, takes account of the strong budget position, the prevailing economic conditions, the potential impacts of the foreshadowed fiscal measures by the Federal Government, and the effects of the Reserve Bank of Australia's monetary policy decisions.

The strategy provides for targeted investment to respond to emerging needs, while maintaining quality of services in high priority areas, and strategic investments to grow and increase the productive capacity of the economy and reduce future costs.

Preservation of high quality services, while maintaining fiscal restraint, remain key parts of the strategy.

The budget capacity generated from prudent financial management, and from the strength of the economy, is directed at:

- responsive initiatives to meet emerging needs in high priority services areas;
- strategic and far reaching initiatives to address supply side constraints, particularly in relation to skills shortage, and to address chronic disadvantage; and
- major investments in the Territory's infrastructure to expand the productive capacity of the economy, reduce future costs, and support the growth of the city.

The 2008-09 Budget capitalises on the structural reform of the previous years, and maintains a disciplined focus to achieve the Government's financial objectives and key measures summarised below:

- to achieve a General Government Sector Net Operating Surplus;
- to maintain operating cash surpluses;
- to maintain a AAA credit rating;
- to manage debt prudently and maintain net financial liabilities within the range of all AAA rated jurisdictions;
- to fully fund the Territory's unfunded superannuation liability by 2030;
- to maintain quality services and infrastructure;
- to make targeted investments to achieve strategic objectives of economic growth, reducing future costs and addressing chronic disadvantage; and
- to maintain taxation revenues at sustainable levels.

Objective: Achieve a net operating budget surplus

An accrual operating surplus provides an indication of the sustainability of the Budget: it shows that revenues are greater than expenses, even if the associated cash flows will not occur until some time in the future. The Government's objective is to achieve an operating surplus: temporary deficits must only occur if they are offset by surpluses at other times.

The key measure of the budget operating position is the Net Operating Balance. In contrast to operating result, the net operating balance has the following exceptions:

- the Net Operating Balance excludes gains from the sale of land, as these are classified as asset sales; and
- the Net Operating Balance excludes gains and losses on the value of assets, as these are treated as "other economic flows".

The sale of land has traditionally been an important source of funding for the ACT's Budget. In the 2006-07 Budget, the Government effectively ended the reliance of the ACT's recurrent budget on land sales, by adopting the GFS accounting standard that does not include land sales as revenue.

This, however, does not mean that the Budget does not benefit from the sale of land. As with any usual asset sale, cash will be received. In this instance, the general government sector receives cash from the sale of the raw land to the Land Development Agency (LDA), which is in the public trading sector. This does not impact on the Net Operating Balance.

The general government sector also receives the benefits of dividends back from the LDA, in the same way as dividends are also received from other trading enterprises, such as ACTEW Corporation. Dividends are recorded as revenue in the general government sector.

From the 2008-09 Budget dividends attributed to market gains associated with the sale of land are no longer recognised in the Net Operating Balance. They are instead recognised as a capital distribution. Profits from LDA's development activity, however, will continue to be recognised in the Net Operating Balance.

The ACT's superannuation investments are structured in a form that makes the ACT's net operating balance appear weaker relative to other jurisdictions. This difference arises because state governments generally hold their superannuation investments in forms that allow the expected capital gains on these investments to be implicitly included in the calculation of their GFS Net Operating Balance¹.

This is a significant matter for the ACT as the long-term capital gains on superannuation investments range from \$56 million in 2007-08 to \$125 million in 2011-12.

¹ State governments have typically injected assets into their public sector superannuation schemes to partly fund those schemes. Under Australian Accounting Standard 119, *Employee Benefits*, the expected rate of return on these assets can be subtracted in determining the total superannuation expense each year. Because the expected rate of return reduces the annual superannuation expense, it has a direct impact on the general government sector Net Operating Balance. This same treatment is used by state governments in preparing their GFS financial statements. A further discussion of this accounting treatment is provided in Victoria's 2004-05 Financial Report (at page 23). This report can be accessed at www.dtf.vic.gov.au.

This treatment is not applicable to the ACT, because, unlike state governments, the ACT is precluded from holding its superannuation assets in the CSS and PSS funds. The superannuation assets are instead held in the Superannuation Provision Account, a statutory fund in the general government sector.

To ensure that the ACT's Budget is measured on a consistent basis with state governments, it is necessary to adjust the Net Operating Balance for expected capital gains on its superannuation investments.

It should be emphasised that this adjustment is not simply required to ensure consistency with the net operating balance results reported by state jurisdictions; it is also required to provide an accurate assessment of the longer term sustainability of the budget position.

This is because the operating budget each year takes into account the accruing expenses on long-term superannuation liabilities. These superannuation expenses will be paid over the next forty to sixty years. The Government's superannuation investments held in the Superannuation Provision Account (SPA) are intended to help fund these future cash payments. Clearly, long-term capital gains on investments (for example, increases in the prices of shares) provide a source of funding for the long-term superannuation liabilities. Consequently, it is necessary that these long-term average gains be taken into account when assessing the underlying budget operating position.

Therefore, the primary measure of the Budget is the Net Operating Balance adjusted for long-term expected capital gains on superannuation assets (consistent with a long-term expected rate of return of 7.5 per cent). This measure allows the ACT Budget to be compared on a "like for like" basis with the Net Operating Balances reported by state governments.

Table 1.2.1
The Budget Operating Surplus / Deficit

	2007-08	2008-09	2009-10	2010-11	2011-12
	\$m	\$m	\$m	\$m	\$m
UPF Net Operating Balance	136.6	-5.6	-34.6	-62.0	-91.4
<i>plus:</i> Expected Long-Term Capital Gains on Superannuation Investments*	55.5	90.5	105.8	115.7	125.2
Net Operating Balance	192.2	84.9	71.2	53.7	33.7

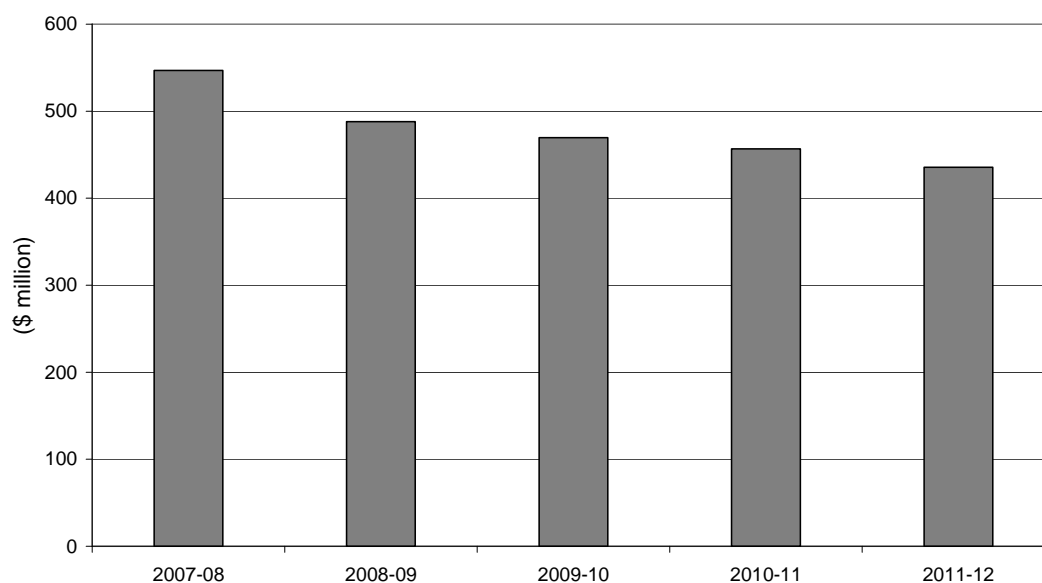
* This component of the Territory's overall returns from superannuation assets varies with assumed changes in the strategic allocation of assets held in the Superannuation Provision Account (SPA). However, in all years this adjustment, together with interest and dividend revenues, provides for expected returns on the total superannuation asset portfolio of 7.5 per cent per annum.

Objective: Maintain strong operating cash surpluses

The Government's objective is to maintain strong operating cash surpluses in the general government sector at all times. The operating cash balance is the cash counterpart to the accrual Net Operating Balance. It measures all operating cash receipts each year (for example, taxes, fees and fines, and operating grants from the Commonwealth Government) less all operating cash payments (including wages and salaries, cash superannuation payments and payments for goods and services).

Figure 1.2.1 below shows that the general government sector operating cash surplus is expected to be \$488 million in 2008-09, with similar balances across the forward estimates. A revised operating cash surplus of \$547 million is estimated for 2007-08. A strong operating cash balance ensures that there is sufficient cash generated from operations to cover the net outlay of the capital investment, to repay debt, and to put aside to address unfunded superannuation liabilities.

Figure 1.2.1
Net Cash Flows from Operating Activities: General Government Sector



Source: 2008-09 Budget Papers

Objective: Maintain a strong balance sheet

The ACT has one of the strongest balance sheets of any government in Australia. The measures announced in past budgets and continued in the 2008-09 Budget, will ensure that the balance sheet remains strong and the ACT continues to maintain the capacity to support high-priority investments into the future.

Below are the key measures of a government's balance sheet.

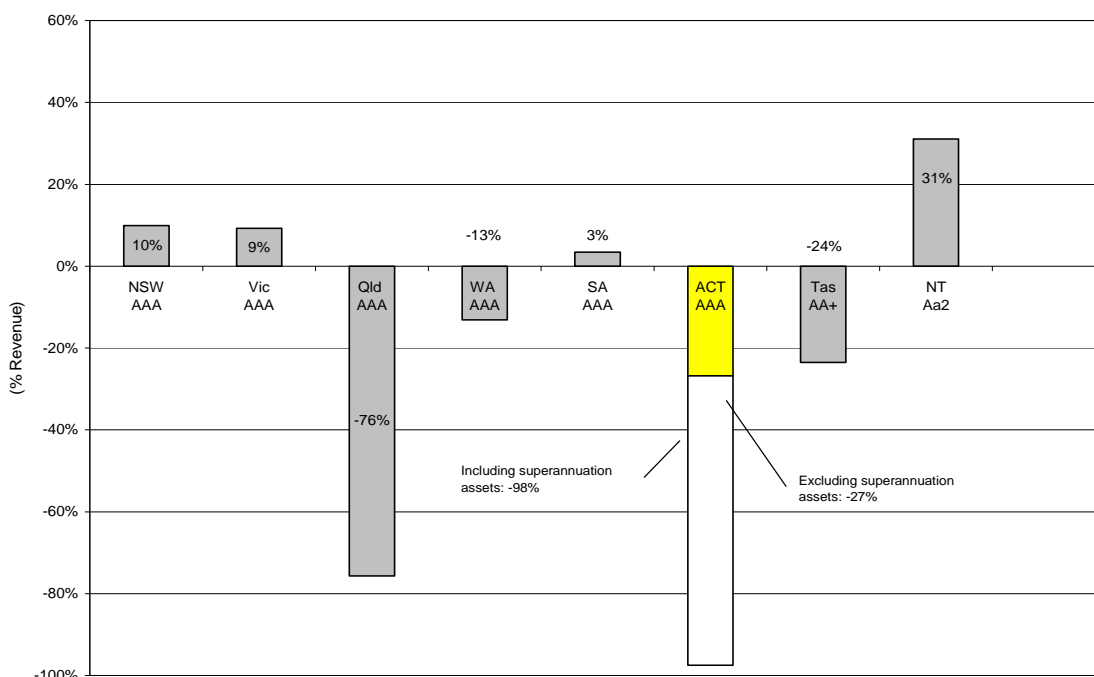
Net debt

A key balance sheet measure in the GFS framework is net debt, which takes into account gross debt liabilities as well as assets (such as cash reserves and investments). The Commonwealth Government, for example, highlights net debt as the key measure of government debt.

Figure 1.2.2 below shows that the ACT is estimated to have negative general government sector net debt in 2008-09. This indicates that the Territory's general government sector cash reserves and investments are greater than its gross debt liabilities.

As indicated in the figure, net debt for some states, including the ACT and Queensland, is reduced because of the impact of investments held to fund superannuation liabilities. However, even if these assets are excluded, the ACT has negative net debt (equivalent to around 27 per cent of revenue).

Figure 1.2.2
Net Debt Ratio
General Government Sector: 2008-09



Source: 2007-08 Budget Mid Year Review of other jurisdictions and the ACT's 2008-09 Budget Papers

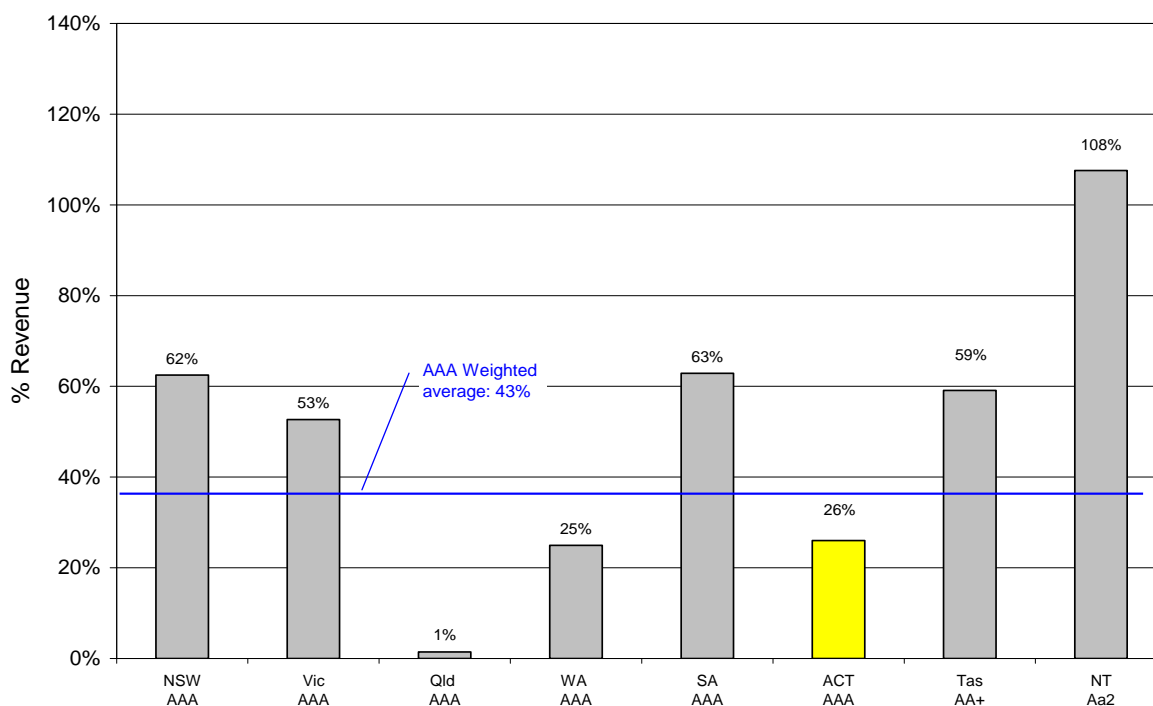
Net financial liabilities

While net debt is a widely used measure in the GFS framework, it does not take into account all financial liabilities. Most particularly, it does not take account unfunded superannuation liabilities. These unfunded superannuation liabilities are also a form of debt. As a consequence, a number of jurisdictions focus on a broader measure of debt, net financial liabilities, as a key balance sheet indicator.

Net financial liabilities is calculated as total liabilities less financial assets (such as cash reserves and investments). It takes into account all non-equity financial assets, but excludes the value of equity held by the general government sector in public corporations (for example, ACTEW Corporation).

Figure 1.2.3 below compares the ACT's net financial liabilities as a proportion of revenue with other jurisdictions. It shows that the ACT has a lower level of net financial liabilities than most jurisdictions (and below the weighted average level for all AAA rated jurisdictions).

Figure 1.2.3
Net Financial Liabilities to Revenue Ratio
General Government Sector: 2008-09



Source: 2007-08 Budget Mid Year Reviews of other jurisdictions and the ACT's 2008-09 Budget Papers

A key question for governments is whether they should borrow to invest in new capital assets.

It is widely recognised that it is appropriate for governments with strong balance sheets to incur some debt, provided that debt is used to finance high quality assets in areas of community need. This is because these assets (for example, new roads and hospital facilities) provide benefits to the community over a long period of time.

It is important, however, that the level of debt is sustainable. The ratio of net financial liabilities to revenue provides an indicator of the sustainability of a jurisdiction's debt.

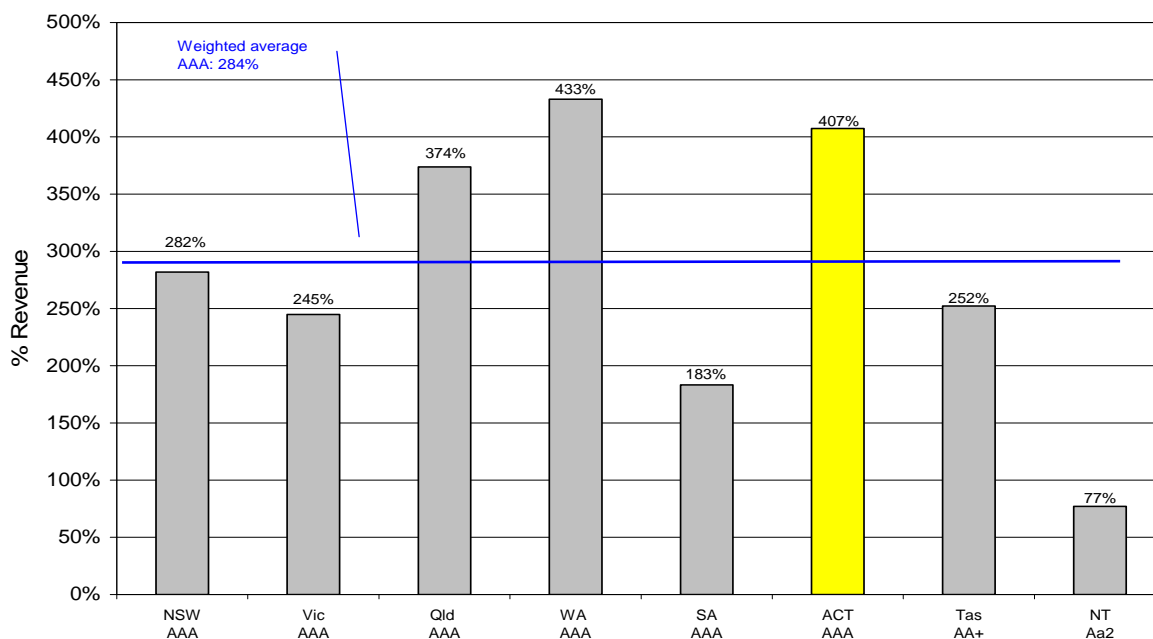
The Government's objective is to maintain this ratio within the range of all AAA rated jurisdictions in Australia. While this ratio is subject to volatility (in particular, net financial liabilities can fluctuate, sometimes substantially, from year to year depending on the condition of financial markets and actuarial valuations), it is desirable that it remains broadly stable over time.

Due to prudent fiscal management, the Territory's strong balance sheet and cash position, the Government currently has no requirement to incur borrowings to fund its \$1 billion *Building the Future* Program of infrastructure investment.

Net worth

The broadest measure of a jurisdiction's balance sheet is net worth, which measures the total value of all assets less all liabilities. The ACT has strong positive net worth, and as a proportion of revenue, one of the strongest of all Australian jurisdictions.

Figure 1.2.4
Net Worth to Revenue Ratio
General Government Sector: 2008-09



Source: 2007-08 Budget Mid Year Reviews of other jurisdictions and the ACT's 2008-09 Budget Papers

