1.2 FISCAL STRATEGY – FINANCIAL OBJECTIVES AND KEY MEASURES

Fiscal Strategy

The Government continues its commitment to the principles of responsible financial management.

The financial objectives, and the key measures below, outline the Government's financial policy. These measures take account of the decision to adopt the GFS framework as the basis for reporting the Territory's budget from 2006-07. Strategic priorities, as they relate to the Territory's Budget, are summarised as:

- 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; and
- to maintain taxation revenues at sustainable levels.

Objective: Achieve an 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 ACT Government has, for many years, reported the accrual operating result defined by Australian Accounting Standards as its primary fiscal target. However, all Australian governments now measure their budgets on the Government Finance Statistics (GFS) standard, or equivalent measures. The GFS standard is an internationally recognised standard promulgated by the International Monetary Fund. The Australian Bureau of Statistics (ABS) has responsibility for the application of the standard in Australia.

The key measure of the budget operating position in the GFS system is the net operating balance. There are two major areas where this measure differs from the Australian Accounting Standards operating result:

- firstly, the GFS net operating balance excludes gains from the sale of land, as these are classified as asset sales;

- secondly, the GFS standard generally treats gains and losses on the value of assets as "other economic flows" and excludes these flows from the calculation of the net operating balance.

The sale of land has traditionally been an important source of funding for the ACT's budget. However, the GFS treatment highlights the fact that land sales cannot be used to support operating expenditures indefinitely.

An important element of the Government's strategy in the 2006-07 Budget is to move the ACT away from its reliance on land sales revenue to finance the operating budget.

In the short term, land sales will continue to be important, and the Government's intermediate target is therefore to achieve an operating budget surplus after land sales receipts have been included. However, the Government's ultimate objective is to achieve an operating surplus without land sales receipts.

The measures in the 2006-07 Budget ensure that the budget will be balanced after land sales in 2007-08, and by 2008-09 the budget will be in surplus without relying on land sales receipts.

The ACT's superannuation investments are structured in a form that makes the ACT's GFS net operating balance, as presented in the *Uniform Presentation Framework* statements at Appendix E, 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 balances.[1]

This is a significant matter for the ACT as the long term capital gains on superannuation investments are around $70 million to $90 million per annum.

In order to ensure that the ACT's budget is measured on a consistent basis with state governments, it is necessary to adjust the GFS net operating balance reported in the UPF statements in Appendix E, for expected capital gains on its superannuation investments.

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

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[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 has not been applied by the ACT in its *Uniform Presentation Framework* (UPF) statements at this stage 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. The ABS is currently reviewing the GFS accounting of superannuation by state governments. The presentation of the ACT's UPF statements will be considered further once the ABS has completed its review.

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.

In light of these considerations, the primary measure of the budget balance to be adopted from the 2006-07 Budget is the GFS net operating balance incorporating 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 GFS balances reported by state governments.

The table below shows a small budget deficit after land sales in 2006-07, with growing surpluses in the forward years. The Australian Accounting Standards operating result shows a similar profile, although it is affected by accounting write-downs over the next two years (largely due to the value of surplus school buildings being written off).

However, the Government has set itself a more stringent longer-term objective in the 2006-07 Budget; that is, to achieve a net operating surplus without relying on land sales receipts. On this new measure the budget is projected to be in deficit over the next two years before moving into surplus from 2008-09.

Table 1.2.1

The Budget Operating Deficit / Surplus

	2005-06 ($m)	2006-07 ($m)	2007-08 ($m)	2008-09 ($m)	2009-10 ($m)
GFS net operating balance (UPF statements*)	**-196.0**	**-147.5**	**-123.7**	**-80.3**	**-39.7**
plus: Expected long term capital gains on superannuation investments**	33.7	67.2	83.0	98.7	107.4
Net operating balance	**-162.3**	**-80.3**	**-40.7**	**18.3**	**67.7**
Land sales receipts	79.3	72.4	73.5	75.2	83.4
Net operating balance after land sales	-83.0	-7.9	32.8	93.5	151.1
AAS Operating Result	**120.5**	**-16.4**	**-11.7**	**73.2**	**147.4**

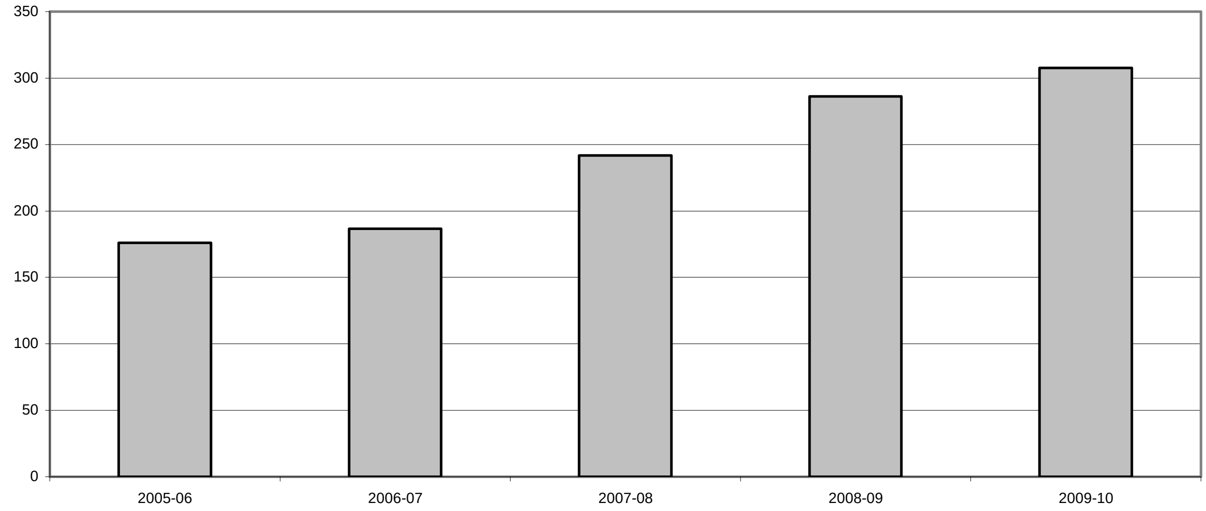
* The Uniform Presentation Framework Statements are presented in Appendix E.
**This component of the Territory's overall returns from superannuation assets varies with assumed changes in the strategic allocation of assets held in the Superannuation Provision Account (SPA). However, in all years this 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 Australian Government) less all operating cash payments (including wages and salaries, cash superannuation payments and payments for goods and services).

Figure 1.2.1 shows that the general government sector operating cash surplus is expected to be $187 million in 2006-07, rising to $308 million by 2009-10. A revised operating cash surplus of $176 million is estimated for 2005-06. It should be noted that these operating cash surpluses are calculated on a GFS basis and do not include land sale cash receipts.

Figure 1.2.1
Net Cash Flows From Operating Activities: General Government Sector
($ million)



Objective: Maintain a strong balance sheet

The ACT has one of the strongest balance sheets of any government in Australia. The measures announced in the 2006-07 Budget will ensure that the balance sheet remains strong and the ACT continues to maintain the capacity to support high priority investments in the future.

The GFS system provides several key measures of a government's balance sheet.

Net debt

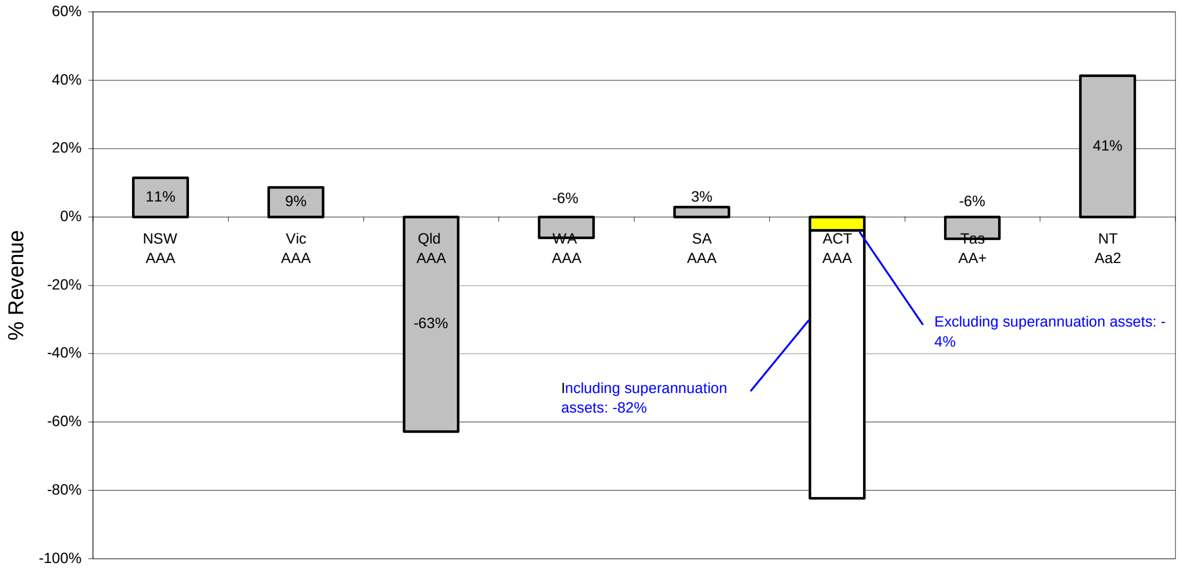
A key balance sheet measure in the GFS system is net debt, which takes into account gross debt liabilities as well as assets (such as cash reserves and investments). The Australian Government, for example, highlights net debt as the key measure government debt.[2]

[2] The ACT has previously reported its debt and assets separately (including reporting a narrow measure of general government sector cash reserves, "Territory Unencumbered Cash (TUC)", that has been used uniquely by the ACT).

Figure 1.2.2 below shows that the ACT is estimated to have negative general government sector net debt in 2006-07. 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 4 per cent of revenue).

Figure 1.2.2 - Net Debt to Revenue Ratio
General Government Sector: 2006-07



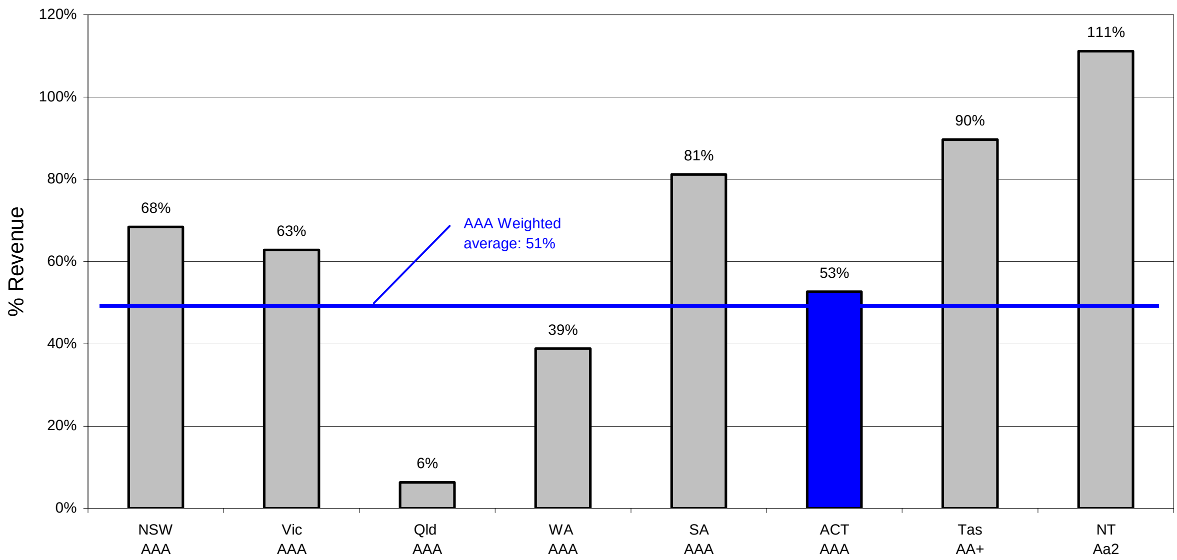
Net financial liabilities

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

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 around the weighted average level for all AAA rated jurisdictions).

Figure 1.2.3 - Net Financial Liabilities to Revenue Ratio
General Government Sector: 2006-07



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.

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, the strongest of all Australian jurisdictions.

Figure 1.2.4 - Net Worth to Revenue Ratio
General Government Sector: 2006-07