

1.2 FISCAL STRATEGY - FINANCIAL OBJECTIVES AND KEY MEASURES

Fiscal Strategy

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

The circumstances in which the 2009-10 Budget has been developed are entirely different from previous years. The Budget has been formulated in an environment of financial market turmoil, and the forecasts of world growth being revised down several times. The depth of the global as well as the likely Australian recession is unknown. The time of the recovery is also uncertain.

While the ACT economy performs relatively better than the economies of other Australian jurisdictions during a recession, its budget has the same exposures. The 2009-10 Budget has therefore been developed in an environment of falling revenues leading to significant deficits, and further exposures.

The Government's fiscal strategy from previous years nonetheless remains sound, and has been successful in cushioning the effects of global events, and ensuring sustainability of services.

The Government has adopted a longer term approach to dealing with the effects of global events on the budget. Services in priority areas have not only been maintained, but supplemented where necessary to meet the needs of the community and to respond to growth in demand.

The Government has maintained fiscal discipline while implementing new policy initiatives, which are largely being offset through reprioritisation, wage restraint and efficiency dividends.

The Government's financial objectives and key measures are 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.

The objective of achieving a General Government Sector Net Operating Surplus is not being met in this Budget and across the forward estimates. A longer term approach to meeting this objective has been taken, in view of the prevailing circumstances, and other service delivery objectives under its fiscal strategy. The Budget Plan targets to restore the budget to surplus by 2015-16. Section 1.3 provides further information on the Plan.

While the Budget Plan adopts a longer term perspective, implementation of the Plan has commenced in this Budget, with a significant proportion of the required savings incorporated in the 2009-10 Budget and Forward Estimates.

Based on the current projections, the objective of fully funding the Territory's unfunded superannuation liability by 2030 will not be met without further cash injections. Nonetheless, funding the Territory's superannuation liability remains a key objective.

A review will be undertaken during 2009-10 to assess the magnitude and timing of further cash injections to achieve the objective of fully funding the liability.

Objective: Achieve a General Government Sector Net Operating Surplus

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 General Government Sector is in deficit for the Budget and Forward Estimates, however, it will return to surplus over the longer term. The 2009-10 Budget provides a longer term plan to restore the Budget to surplus by 2015-16.

The 2009-10 Budget and Forward Estimates has moved into temporary deficit, largely through external factors impacting on the GGS revenue base. The factors that have moved the budget into deficit are:

- a significant loss of GST revenue due to the drop in the national GST pool as a result of the decline in consumer confidence and business activity nationally;
- lower returns on investments due to the declines in financial markets;
- lower interest earnings due to lower interest rates and cash balances; and
- a softening in the property market.

Table 1.2.1
The Budget Operating Surplus/Deficit

	2008-09	2009-10	2010-11	2011-12	2012-13
	\$'m	\$'m	\$'m	\$'m	\$'m
UPF Net Operating Balance	-95.3	-171.0	-212.5	-272.5	-267.1
<i>plus:</i> Expected Long-Term Capital Gains on Superannuation Investments*	53.9	88.9	100.0	107.6	114.9
Net Operating Balance	-41.3	-82.2	-112.4	-164.9	-152.2

Note: Tables may not add due to rounding.

* 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.

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 other jurisdictions.

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 Balance.

This is a significant matter for the ACT as the long-term capital gains on superannuation investments range from \$54 million in 2009-10 to \$115 million in 2012-13.

To ensure that the ACT's Budget is measured on a consistent basis with other jurisdictions, it is necessary to adjust the Net Operating Balance for expected capital gains on 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 value of investments held) 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 budget operating position.

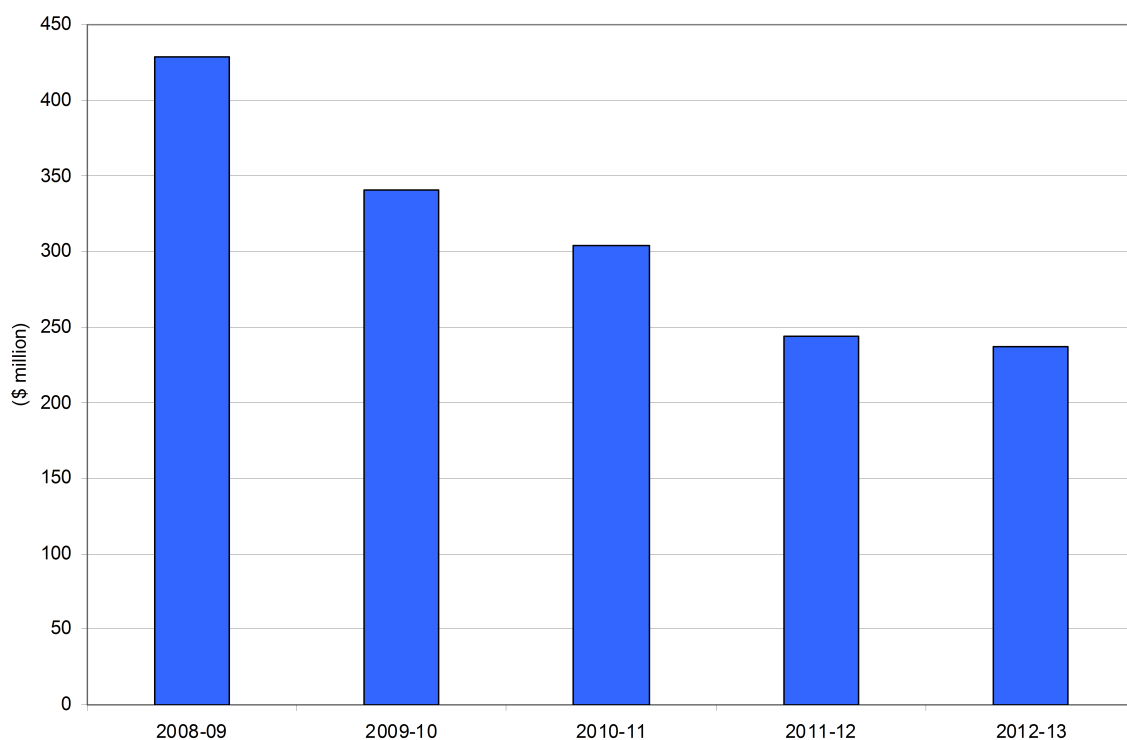
Objective: Maintain operating cash surpluses

The Government's objective is to maintain operating cash surpluses in the General

Government Sector at all times. The operating cash balance 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 \$340 million in 2009-10, with surplus balances across the forward estimates. A revised operating cash surplus of \$428 million is estimated for 2008-09. 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



Objective: Maintain a strong balance sheet

The ACT has one of the strongest balance sheets of any Australian government. The measures announced in past budgets and continued in the 2009-10 Budget, despite the downturn in the Australian economy over the past year, will ensure the balance sheet remains strong and the ACT continues to maintain capacity to support high-priority investments into the future, enabling it to provide high quality services expected by the ACT community. Below are the key measures of the General Government Sector's balance sheet.

Net debt

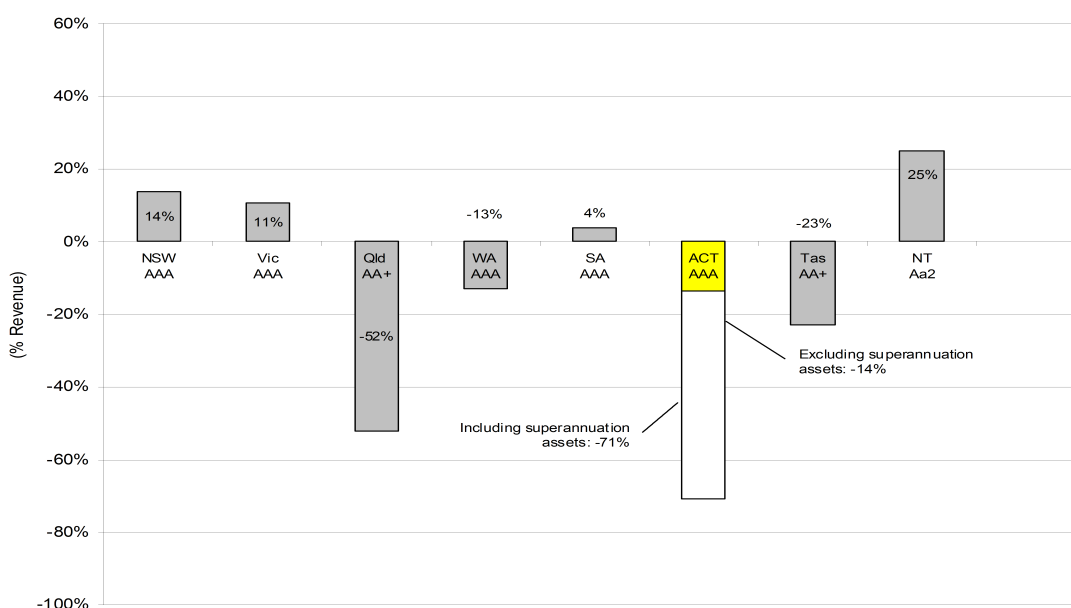
A key balance sheet measure in the GFS framework is net debt to revenue ratio, which takes into account gross debt liabilities as well as financial assets (such as cash reserves and investments). The Commonwealth Government, for example, highlights net debt as the key measure of government debt.

Figure 1.2.2 below shows that the ACT is estimated to have negative General Government Sector net debt in 2009-10. This indicates that the Territory's General Government Sector cash reserves and investments are greater than its gross debt liabilities.

As indicated, net debt for some states, including the ACT and Queensland, is reduced due to the impact of investments held to fund superannuation liabilities. However, if these assets are excluded, the ACT has negative net debt equivalent to around 14 per cent of revenue.

The figures below have been sourced from other jurisdictions' Mid Year Review releases. It is most likely that the net debt to revenue ratio for most jurisdictions would have deteriorated due to GST revenue shortfalls and decreases in financial assets due to the poor performance of the financial markets.

Figure 1.2.2
Net Debt to Revenue Ratio
General Government Sector: 2009-10



Source: 2008-09 Budget Mid Year Review of other jurisdictions and the ACT's 2009-10 Budget Papers.

Net Financial Liabilities

Net financial liabilities are a broad measure of General Government Sector liabilities, including net debt and superannuation liabilities. Despite a deterioration in the net financial liabilities to revenue ratio from 26 per cent (2008-09 Budget) to 62 per cent (2009-10 Budget), the ACT continues to have a strong balance sheet, and remains below the weighted average level for all AAA rated jurisdictions.

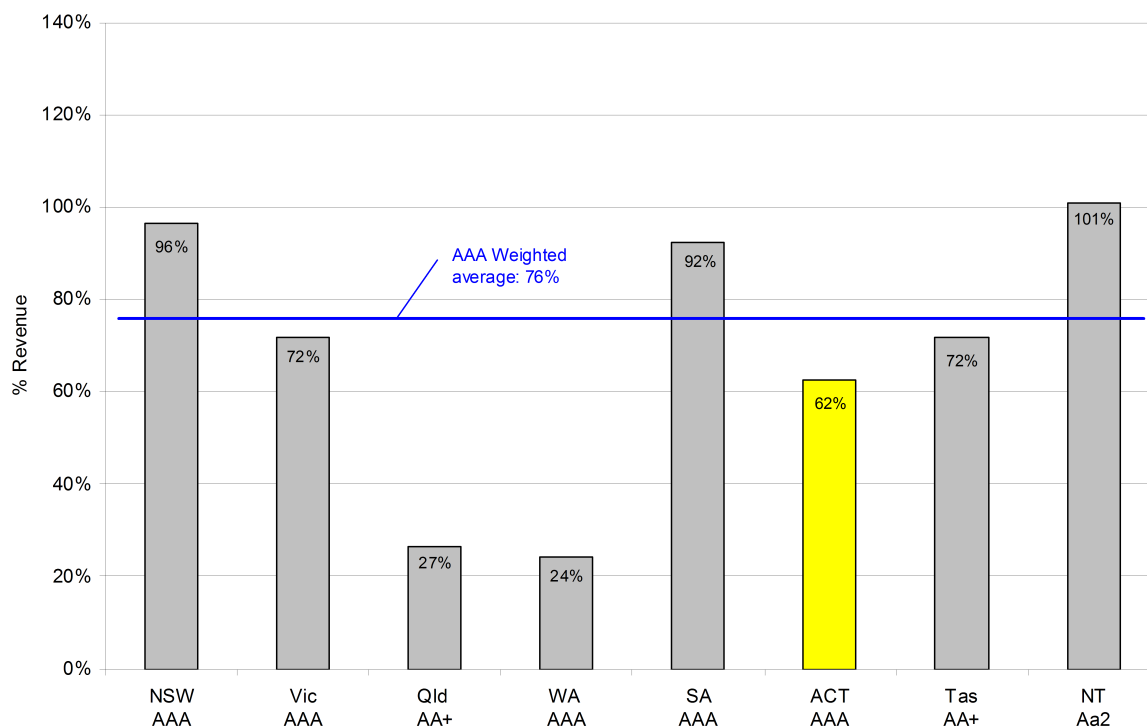
Net financial liabilities are calculated as total liabilities less financial assets (such as cash reserves and investments). It takes into account all non-equity financial assets, but excludes the value of equity held by the General Government Sector in public corporations (for example, ACTEW Corporation).

The deterioration of this ratio from the 2008-09 Budget is due to the significant reductions in the General Government Sector financial assets (cash and super related investments).

The ratios appearing in the below table for all other jurisdictions are based on their Mid Year Reviews. The position of other jurisdictions will most likely have also deteriorated (resulting in an increase in their ratios) since the time of these publications.

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: 2009-10



Source: 2008-09 Budget Mid Year Reviews of other jurisdictions and the ACT's 2009-10 Budget Papers.

A key question for governments is whether to 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.

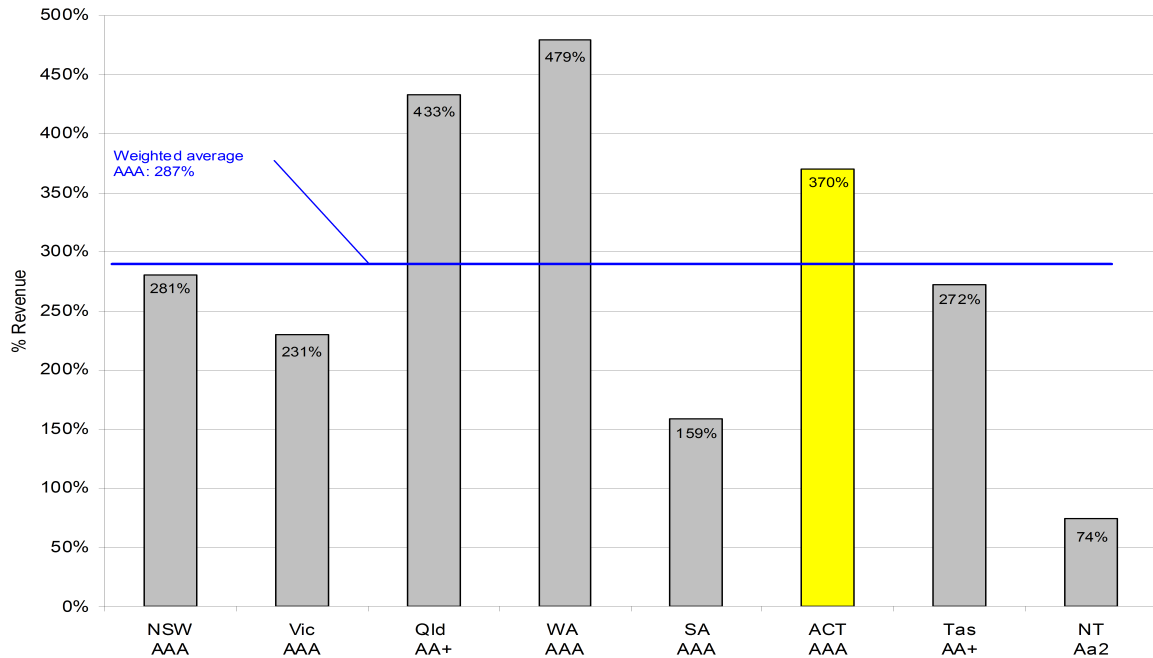
The Government's objective is to maintain this ratio within the range of all AAA rated jurisdictions in Australia. While this ratio is subject to volatility (in particular, net financial liabilities can fluctuate, sometimes substantially, depending on the condition of financial markets as was the experience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

The 2009-10 Budget anticipates new general government sector borrowing for capital purposes of up to \$400 million in June 2011. This infrastructure investment will assist the ACT economy, consumer confidence, and the most importantly, service delivery for ACT residents. Even with those borrowings, and the reductions in financial assets, the Territory's net financial liabilities to revenue ratio is estimated to be within reasonable levels.

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: 2009-10



Source: 2008-09 Budget Mid Year Reviews of other jurisdictions and the ACT's 2009-10 Budget Papers.

