

Fiscal Strategy

This chapter outlines the Territory Government's medium-term fiscal objectives and financial targets. The Fiscal Strategy which guided the 2002-03 and 2003-04 Budgets was initially set out in the 2002-03 Budget. This Budget includes an amended Fiscal Strategy for 2004-05 and the following three years.

The *Fiscal Integrity and Transparency Act* requires the Treasurer to deliver a fiscal strategy statement at the time of each Budget which specifies the Government's medium-term fiscal objectives and key fiscal indicators. Under the Act, the Fiscal Strategy Statement must be based on principles of sound fiscal management where the Government must:

- formulate and apply spending and taxation policies having regard to the effect of these policies on employment, economic prosperity and development of the Territory economy;
- formulate and apply spending and taxing policies so as to give rise to a reasonable degree of stability and predictability;
- ensure that funding for current services is provided by the current generation; and
- prudently manage financial risks faced by the Territory (having regard to economic circumstances), including the maintenance of Territory debt at prudent levels.

Economic Overview

The Northern Territory economy is relatively small and has significant exposure to the world economic cycle because of the importance of the tourism and mining and energy sectors in the economy.

In the five years to 1999, the defence force relocation to the Top End was a major contributor to strong economic growth in the Territory. As employment and population growth associated with the relocation began to weaken, the Territory recorded negative gross state product (GSP) growth in 1999-00. Onshore economic activity was weak in 2000-01 but was masked by the sharp increase in offshore oil production, which boosted GSP. Onshore economic activity strengthened a little in 2001-02, but population growth was low and tourism suffered significant external setbacks.

In 2002-03, offshore oil production fell sharply and, although consumption and business investment strengthened onshore, employment, population growth and tourism were lower than previous years.

The recovery in the onshore economy continued to gain momentum in 2003-04, although headline GSP growth was affected by declining offshore oil production. At the time of the 2003-04 Budget, GSP growth had been expected to increase by 3.4 per cent as onshore activity strengthened and Bayu-Undan stage one production commenced. Employment growth was forecast to strengthen toward 2 per cent and population growth was expected to recover to 0.9 per cent. Since then, employment has continued to be affected by external events affecting the tourism sector, and the early completion of the Alice Springs to Darwin rail link with Adelaide. Population growth has remained weaker than expected, associated with lower interstate inflows. The latest estimate is for GSP growth of 0.3 per cent in 2003-04 is primarily lower due to offshore factors, particularly the delay in commencement of Bayu-Undan production and lower production from Laminaria-Corallina.

The economic recovery is expected to broaden in 2004-05, with strengthening in the construction, mining and tourism industries, accompanied by solid employment

growth of 2.9 per cent. Population growth is expected to be positive but remain low at 0.3 per cent in 2004-05. It is forecast to strengthen in the forward years.

2004-05 Fiscal Strategy

A combination of sound financial management over the past two and a half years and improved goods and services tax (GST) revenue has resulted in the Territory making progress in achieving the fiscal targets established in the 2001 Mini Budget.

Since the formulation of the 2003-04 Budget, three key fiscal challenges have led to the Government revising the Fiscal Strategy first developed for the 2002-03 Budget. Firstly, the Territory economy, although showing clear signs of recovery in 2003-04, has not recovered as quickly as first anticipated. Therefore, the Government has departed from its previously announced strategy to provide additional support and stimulus for economic growth, both by increasing spending and by reducing taxes in the 2004-05 Budget.

Secondly, the Commonwealth Grants Commission's 2004 Major Review of State and Territory GST Relativities, released at the end of February 2004, recommended a reduction in the Territory's share of national GST revenue. This has had a significant negative impact on revenue estimates for 2004-05 and the forward years.

Finally, the decision to boost service provision, particularly in the areas of health, education and community safety, has resulted in significant recurrent expenditure beyond that anticipated in the previous Fiscal Strategy.

The Government's strategic response to the three fiscal challenges which have emerged in 2003-04 will result in a deterioration in fiscal outcomes for the forward estimate years from the targets published in the 2003-04 Budget and the Mid Year Report. Following the release on 11 May of revised GST estimates in the 2004-05 Commonwealth Budget, it is now likely that the outcome for 2004-05 will be close to the targets published in the 2003-04 Budget. However, on the basis of current estimates, the achievement of a balanced budget will be deferred for around five years, but is dependent on the volatility of GST revenue estimates.

The general government operating deficit is projected to plateau in 2005-06 and then to improve in line with the Government's commitment to achieving a net operating balance. Net lending for the general government sector will show a similar trend with negative net lending plateauing in 2005-06, following additional capital investment to support economic growth and boost service provision in 2003-04 and 2004-05.

The revised medium-term fiscal objectives and targets for 2004-05 are:

Sustainable Service Provision

Target: General Government Net Operating Balance by 2012-13

Infrastructure for Economic and Community Development

Target: Maintain Total Public Sector Infrastructure Investment at Appropriate Levels and Achieve a General Government Net Lending Balance by 2012-13

Competitive Tax Environment

Target: Ensure Territory Taxes and Charges are Competitive with the Average of the States

Prudent Management of Liabilities

Target: Net Debt plus Employee Liabilities as a Proportion of Total Revenue to Fall

Sustainable Service Provision

Since the 2003-04 Budget, and in the development of the 2004-05 Budget, the Government has approved a number of significant initiatives to improve services and to support economic growth.

Major reviews of police, fire services and adult custodial services were presented to Government during 2003-04. In response to review recommendations, Government has:

- committed additional funding over four years to strengthen policing;
- increased funding over four years for reform of adult custodial services, with the aim of reducing offender recidivism rates; and
- increased fire services funding over four years.

Education has received additional funding in the 2004-05 Budget for various initiatives including accelerated learning programs and information technology in schools.

Health and Community Services has also received additional funding, including an increase for mental health services, child protection and critical care services in hospitals.

Government support for economic growth has included:

- reduced taxes;
- additional expenditure over three years to support the tourist industry;
- commencement of a jobs strategy; and
- maintaining infrastructure spending.

Target: General Government Net Operating Balance by 2012-13

The 2002-03 Fiscal Strategy was framed in the context of the transition from cash to accrual accounting. While the target of a general government net operating balance within 10 years, that is by 2012-13, was adopted, the target was supplemented by the Mini Budget target of a balanced general government cash budget by 2004-05.

It was noted in 2002-03, when the previous fiscal strategy was first introduced, that there would be a gradual move from cash to actual targets consistent with other jurisdictions. The prime measure is now the accrual operating balance measure. However, it is noted that the general government cash outcome for 2004-05 is expected to be close to the previous cash target for a balanced budget, but returns to deficit in 2005-06. The achievement of a balanced cash budget is likely to be delayed for 5 years.

The target of achieving a general government net operating balance by 2012-13 was first established in the 2002-03 Budget and has been maintained in the revised fiscal strategy for the 2004-05 Budget. In 2001-02, the operating balance outcome was -\$116 million (-5.3 per cent of total revenue). At the time of the 2003-04 Budget, it was projected that positive net operating balances would generally be achieved in the general government sector from 2005-06. This will be delayed and affected significantly by volatility in GST revenue estimates, however, the target of balance by 2012-13 will be achieved.

As a proportion of total revenue, the net operating balance for 2003-04 is estimated to be 1.9 per cent due to increased GST revenue in 2003-04. It is expected to deteriorate to -0.5 per cent in 2004-05, plateau in 2005-06, and then improve thereafter.

Table 2.1: General Government Cash Target/Net Operating Balance

| | 2002-03 Outcome | 2003-04 Estimate | 2004-05 Budget | 2005-06 Forward Estimate | 2006-07 Forward Estimate | 2007-08 Forward Estimate |
|---|--------------------|---------------------|-------------------|-----------------------------|-----------------------------|-----------------------------|
| Cash Surplus (+)/Deficit(-) (\$M) | 9 | 34 | 0 | -16 | -9 | -6 |
| Net Operating Balance (\$M) | -1 | 49 | -12 | -31 | -18 | -5 |
| As a Proportion of Total Revenue (%) | 0.0 | 1.9 | -0.5 | -1.2 | -0.7 | -0.2 |

Source: Northern Territory Treasury

By comparison with the states, the Territory's net operating balance to revenue is consistent with the state average in 2003-04, but worsens slightly in 2004-05, associated with very low growth in GST revenue.

Table 2.2: Net Operating Balance as a Proportion of Revenue

| | 2002-03 Outcome | 2003-04 Estimate | 2004-05 Budget |
|------------------------------|--------------------|---------------------|-------------------|
| | % | % | % |
| New South Wales | 5 | 3 | 2 |
| Victoria | 6 | 2 | 2 |
| Queensland | 0 | 2 | 1 |
| Western Australia | 2 | 1 | 0 |
| South Australia | 5 | 1 | 2 |
| Tasmania | 7 | 1 | -2 |
| Australian Capital Territory | 7 | 4 | 0 |
| State Average | 4 | 2 | 1 |
| Northern Territory | 0 | 2 | 0 |

Source: Northern Territory Treasury

Infrastructure for Economic and Community Development

Target: Maintain Infrastructure Investment at Appropriate Levels and Achieve Net Lending Balance by 2012-13

Net lending provides a measure of the Territory's investment balance (that is, as a lender or a borrower). Net lending includes the effect of both capital and operating transactions after excluding the effect of depreciation.

Table 2.3: General Government Net Lending (+)/ Borrowing (-)

| | 2002-03 Outcome | 2003-04 Estimate | 2004-05 Budget | 2005-06 Forward Estimate | 2006-07 Forward Estimate | 2007-08 Forward Estimate |
|---|--------------------|---------------------|-------------------|-----------------------------|-----------------------------|-----------------------------|
| Net Lending / Borrowing (\$M) | -73 | 12 | -29 | -31 | -19 | -9 |
| As a Proportion of Total Revenue (%) | -3.1 | 0.5 | -1.1 | -1.2 | -0.7 | -0.3 |

Source: Northern Territory Treasury

In 2001-02, the net lending outcome was -\$331 million (-14.4 per cent of total revenue), with expenditure on major projects such as the Alice Springs to Darwin railway and East Arm Port significantly influencing the outcome. It is estimated that net lending will improve to a surplus of \$12 million (0.5 per cent of total revenue) for 2003-04, an improvement of \$38 million on the 2003-04 Budget forecast.

The reduced share of GST revenue and additional Government expenditure to support economic growth and improve services will result in net lending returning to deficit over the Budget and forward estimates period. The Government is committed to a balanced position for this measure by 2012-13.

Table 2.4 shows net operating balance and net lending borrowing as a proportion of revenue for each jurisdiction.

Table 2.4: General Government Net Lending (+)/ Borrowing (-) as a Proportion of Total Revenue

| | 2002-03 Outcome | 2003-04 Estimate | 2004-05 Budget |
|------------------------------|--------------------|---------------------|-------------------|
| | % | % | % |
| New South Wales | 2 | 0 | -1 |
| Victoria | 2 | -2 | -3 |
| Queensland | -1 | -3 | -2 |
| Western Australia | 2 | -1 | -1 |
| South Australia | 4 | 0 | 1 |
| Tasmania | 8 | 3 | 0 |
| Australian Capital Territory | 8 | 2 | -4 |
| State Average | 2 | -1 | -1 |
| Northern Territory | -3 | 0 | -1 |

Source: Northern Territory Treasury, State Mid Year and Outcome Reports

Table 2.5 presents the actual level of infrastructure investment for 2002-03 and estimates from 2003-04 to 2007-08. The Government's infrastructure investment comprises purchases of non financial assets (including construction and capital items) and capital grants to non government organisations. When considering capital investment in the Northern Territory, it is more appropriate to look at the non financial public sector.

Table 2.5: Capital Investment – Non Financial Public Sector

| | 2002-03 Outcome | 2003-04 Estimate | 2004-05 Budget | 2005-06 Forward Estimate | 2006-07 Forward Estimate | 2007-08 Forward Estimate |
|-----------------------------------|--------------------|---------------------|-------------------|-----------------------------|-----------------------------|-----------------------------|
| | \$M | \$M | \$M | \$M | \$M | \$M |
| Purchases of Non Financial Assets | 319 | 301 | 307 | 254 | 263 | 270 |
| Capital Grants | 52 | 50 | 43 | 44 | 45 | 46 |
| Total | 371 | 351 | 350 | 298 | 308 | 317 |

Source: Northern Territory Treasury

Higher levels of investment in 2002-03 and 2003-04 are largely associated with the railway and the development of East Arm Port. In 2003-04, this includes the completion of railway passenger terminals (\$9 million), Darwin Business Park (\$9 million), ongoing construction of East Arm Port (\$13 million) and support infrastructure for the Wickham Point Liquefied Natural Gas project.

In 2005-06 and forward years, capital expenditure is forecast to return to more historical levels which meet the social and economic needs of current and future Territorians.

Competitive Tax Environment

Target: Ensure Territory Taxes and Charges are Competitive with the Average of the States

The Government is committed to maintaining taxation at levels that are competitive with other states. Comparisons of relative tax competitiveness are complex due to inherent differences in respective economies and in taxation regimes. Taxation revenue per capita is a simple summary measure.

In the 2004-05 Budget, the Government has announced tax reduction initiatives worth \$6.7 million in 2004-05, rising to \$16.1 million in 2005-06 to further enhance the Territory's tax environment and to stimulate economic and employment growth.

Table 2.6: Taxation Revenue Per Capita – General Government

| | 2002-03 | 2003-04 | 2004-05 |
|------------------------------|---------------|---------------|---------------|
| | \$ per capita | \$ per capita | \$ per capita |
| New South Wales | 2 126 | 2 230 | 2 237 |
| Victoria | 1 894 | 2 000 | 1 969 |
| Queensland | 1 491 | 1 609 | 1 562 |
| Western Australia | 1 749 | 1 947 | 1 902 |
| South Australia | 1 597 | 1 732 | 1 746 |
| Tasmania | 1 179 | 1 254 | 1 211 |
| Australian Capital Territory | 2 122 | 2 320 | 2 318 |
| State Average | 1 844 | 1 963 | 1 943 |
| Northern Territory | 1 243 | 1 319 | 1 326 |

Source: Northern Territory Treasury, State Mid Year and Outcome Reports

In 2004-05, the Territory is expected to have the second lowest level of taxation revenue per capita after Tasmania. While taxation per capita is a useful comparative measure, it is limited in that it does not make any allowances for differences in states' capacities to raise revenue.

A more sophisticated measure of tax competitiveness is the Commonwealth Grants Commission's analysis of 'tax effort', which adjusts for the extent to which a particular state's capacity to raise revenue is above or below average. Table 2.7 details the Territory's revenue-raising capacity and effort expressed as a percentage of the Australian average in 2002-03, the latest year assessed by the Commonwealth Grants Commission.

Table 2.7: Northern Territory Revenue-Raising Capacity and Effort 2002-03
Australian Average = 100 per cent

| | Capacity ¹ | Effort ² |
|--------------------------|-----------------------|---------------------|
| | % | % |
| Total Taxation | 79 | 90 |
| Total Own-Source Revenue | 90 | 90 |

Source: Commonwealth Grants Commission 2004 Review of Relativities

¹ Northern Territory's capacity to raise revenue compared to the Australian average

² Northern Territory's revenue effort compared with the Australian average, given the capacity available

The Commonwealth Grants Commission's assessment shows that the Territory's tax effort (90 per cent) is below the Australian average (100 per cent) as the simple per capita measure implies. Further interjurisdictional comparisons of individual tax revenue measures are provided in Chapter 6.

Prudent Management of Liabilities

The effective management of liabilities gives considerable focus to targeting, monitoring and maintaining net debt at prudent levels.

For benchmarking the Territory against other jurisdictions, the broader non financial public sector scope is used, rather than the general government sector. This broader focus is appropriate because of substantial differences between the states in the allocation of assets and liabilities between general government and the non financial public sector.

Target: Net Debt and Employee Liabilities as a Proportion of Total Revenue to Fall

Net Debt as a Proportion of Revenue

The level of net debt has been a focus for all jurisdictions over the last decade. The Territory's debt level increased during the 1980s when deficits were incurred at a time of significant asset growth. Debt levels moderated in the 1990s, although not as much as other jurisdictions where reductions were largely driven by significant asset sales. In the last five years, however, the Territory's net debt has increased due to significant infrastructure initiatives such as the Alice Springs to Darwin railway and East Arm Port, as well as ongoing cash deficits.

As a result, Territory debt levels are high relative to the states, as shown in Table 2.8.

Table 2.8: Net Debt to Revenue – Non Financial Public Sector

| | 2002-03 | 2003-04 | 2004-05 |
|------------------------------|---------|---------|---------|
| | (%) | (%) | (%) |
| New South Wales | 29 | 29 | 28 |
| Victoria | 9 | 12 | 12 |
| Queensland | 1 | 0 | 1 |
| Western Australia | 32 | 38 | 42 |
| South Australia | 27 | 27 | n.a. |
| Tasmania | 53 | 47 | n.a. |
| Australian Capital Territory | -46 | -49 | -49 |
| State Average | 19 | 19 | 19 |
| Northern Territory | 64 | 57 | 58 |

Source: Northern Territory Treasury, State Mid Year, Outcome Reports and 2004-05 Budget Papers.

The Territory's commitment to gradual improvement of its fiscal performance will contribute to ongoing reductions to the burden of debt as shown in Table 2.9.

Table 2.9: Northern Territory Net Debt – Non Financial Public Sector

| | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
|-------------------------|---------|----------|---------|------------------|---------|---------|
| | Outcome | Estimate | Budget | Forward Estimate | | |
| Net Debt (\$M) | 1 723 | 1 681 | 1 717 | 1 724 | 1 722 | 1 713 |
| Revenue (\$M) | 2 679 | 2 951 | 2 953 | 3 040 | 3 122 | 3 209 |
| Net Debt to Revenue (%) | 64 | 57 | 58 | 57 | 55 | 53 |

Source: Northern Territory Treasury

Net Debt Plus Employee Liabilities as a Proportion of Revenue

Unfunded employee entitlements, consisting largely of unfunded superannuation, are a major liability for the Territory and most states.

Traditional superannuation schemes were based on defined benefits that were not paid until retirement and not funded until benefits were payable. In line with an increasing recognition that previous methods were inappropriate, most governments have reviewed their superannuation arrangements and have closed these schemes in favour of fully funded arrangements. Some states have also decided to partially fund past liabilities. In the Territory fully funded superannuation arrangements were introduced for new employees from August 1999.

A broader measure than superannuation liabilities is employee liabilities, which includes all other employee entitlements such as workers' compensation and long service leave. The sum of net debt and employee liabilities provides a comprehensive measure of the Territory's overall liability position. Table 2.10 shows

that the Territory has the highest level of net debt plus employee liabilities in 2003-04, at 118 per cent of total revenue.

Table 2.10: Net Debt Plus Employee Liabilities as a Proportion of Revenue – Non Financial Public Sector

| | 2002-03 | 2003-04 | 2004-05 |
|------------------------------|---------|---------|---------|
| | (%) | (%) | (%) |
| New South Wales | 91 | 93 | 96 |
| Victoria | 71 | 74 | 76 |
| Queensland | 64 | 61 | 66 |
| Western Australia | 76 | 82 | 84 |
| South Australia | 84 | 101 | n.a. |
| Tasmania | 124 | 115 | n.a. |
| Australian Capital Territory | 31 | 34 | 46 |
| State Average | 79 | 81 | 82 |
| Northern Territory | 131 | 118 | 120 |

Source: Northern Territory Treasury, State Mid Year, Outcome Reports and 2004-05 Budget Papers.

Table 2.11 shows the effect of the Government's commitment to prudently manage debt and employee liabilities.

Table 2.11: Northern Territory Net Debt Plus Employee Liabilities – Non Financial Public Sector

| | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
|--|---------|----------|---------|------------------|---------|---------|
| | Outcome | Estimate | Budget | Forward Estimate | | |
| Employee Liabilities (\$M) | 1 785 | 1 799 | 1 833 | 1 852 | 1 867 | 1 876 |
| Net Debt + Employee Liabilities (\$M) | 3 508 | 3 480 | 3 549 | 3 575 | 3 590 | 3 589 |
| Revenue (\$M) | 2 679 | 2 951 | 2 953 | 3 040 | 3 122 | 3 209 |
| Net Debt + Employee Liabilities to Revenue (%) | 131 | 118 | 120 | 118 | 115 | 112 |

Source: Northern Territory Treasury

Territory net debt and employee liabilities as a proportion of total revenue are expected to decline to 118 per cent in 2003-04 which represents the effect of a cash surplus caused by high GST revenue receipts offset by moderate growth in expenses. In 2004-05, the proportion is expected to increase to 120 per cent of total revenue reflecting a cash deficit caused by a reduction in the Territory's share of national GST revenue, the Government's budget initiatives and continued cost and demand pressures in health and education. Over the forward estimates period, the proportion is expected to decline to 112 per cent of total revenue by 2007-08 due to lower cash deficits, a small increase in employee liabilities and higher revenue growth.

Further information on budget aggregates and financial projections which underlie the Territory's fiscal strategy are included in Chapter 3 of this Budget Paper.