

Fiscal Strategy

Overview

The Territory's fiscal strategy provides a sound fiscal management framework for sustainable service provision, investment in infrastructure and a competitive tax environment that supports economic growth.

The 2005-06 Fiscal Strategy is consistent with that presented in the 2004-05 Budget and provides for improved services and economic stimulus. Revised budget targets in line with the revised strategy were also set in May 2004. The Territory is currently finalising contractual arrangements for the Darwin City Waterfront Redevelopment project, which includes substantial community infrastructure, and a convention and exhibition centre delivered under a public private partnership model. The projected cash outcomes for 2005-06 to 2007-08 vary from those estimated in the 2004-05 Budget, due largely to the Territory's contribution to stage 1 of the Darwin City Waterfront Redevelopment project. However, the other fiscal targets remain unchanged and are expected to be achieved.

Fiscal Principles

The *Fiscal Integrity and Transparency Act* (FITA) 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 FITA, 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 the 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.

These financial management principles underpin the Territory's fiscal strategy.

2005-06 Fiscal Strategy

The 2005-06 fiscal strategy remains unchanged from that presented in the 2004-05 Budget papers.

The broad strategic priority is for the Territory to be able to increase service provision to all Territorians, particularly in the areas of health, education and community safety, and continue to invest in infrastructure to stimulate economic growth while maintaining a sound financial position.

The Government's medium-term fiscal objectives and targets are:

- **Sustainable Service Provision:** general government net operating balance by 2012-13;
- **Infrastructure for Economic and Community Development:** maintain total public sector infrastructure investment at appropriate levels and achieve a general government net lending balance by 2012-13;
- **Competitive Tax Environment:** ensure Territory taxes and charges are competitive with the average of the states; and
- **Prudent Management of Liabilities:** net debt plus employee liabilities as a proportion of total revenue to fall.

Sustainable Service Provision

One of the Government's medium-term objectives to provide improved services to all Territorians, particularly in the areas of health, education and community safety, is reflected in the 2005-06 Budget, which includes increases for health (4 per cent), education (2 per cent) and police (3 per cent) services.

Information on specific service provision initiatives approved since the 2004-05 Budget and in the development of the 2005-06 Budget is provided in Chapter 4 of this Budget Paper.

In the 2004-05 Budget the Government set cash targets for 2004-05 and forward estimates based on a deficit of \$16 million in 2005-06, reducing steadily to a balanced budget by 2008-09, as well as a target of achieving a net operating balance by 2012-13 (that is, within 10 years of adopting an accrual framework in 2002-03).

Table 2.1 compares the 2004 cash targets with the latest estimates which incorporate all costs associated with the Darwin City Waterfront Redevelopment project. The net effect on the cash outcome of the Waterfront project over 2004-05 and 2005-06 is not significant, with the surplus in 2004-05 offsetting most of the additional net costs in 2005-06. Additional costs will be recorded in the following two years, worsening the previously reported targets, but the budget is expected to return to balance in 2008-09 as planned.

Table 2.1: General Government Cash Outcome and Net Operating Balance

	2004-05 Estimate	2005-06 Budget	2006-07	2007-08	2008-09
	Forward Estimate				
2004 cash targets (\$M)	0	-16	-9	-6	0
2005 cash targets (\$M)	46	-68	-53	-21	0
Net operating balance (\$M)	23	34	51	11	6
As a proportion of total revenue (%)	0.9	1.2	1.8	0.4	0.2

Source: Northern Territory Treasury

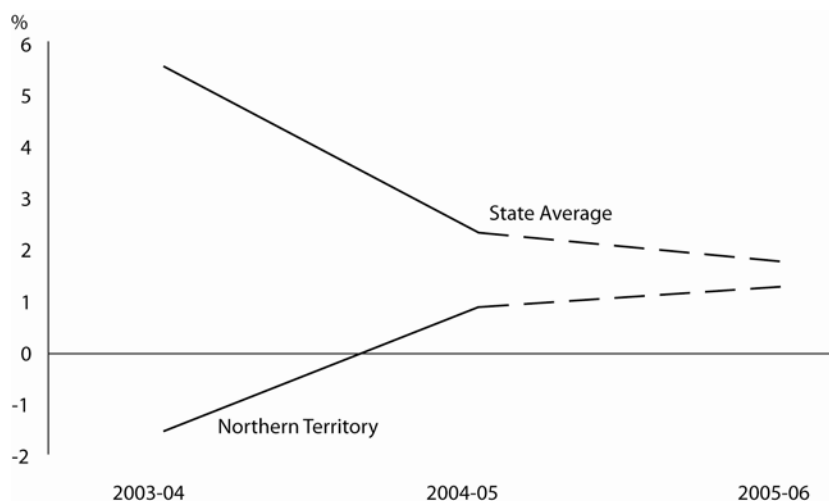
The Waterfront investment, which involves largely capital payments, has minimal effect on the operating balance. The net operating balance for 2004-05 and forward years represents an improvement in all years on those predicted at the time of the 2004-05 Budget. The improved operating result is due to increased estimates of goods and services tax (GST) revenue, following increases in estimates of total GST collections and increased population growth, together with an upward revision to own-source revenues. This has been partially offset by the taxation and spending initiatives introduced as part of the 2005-06 Budget.

The positive net operating balances in all years indicate that the target of a balance by 2012-13 will be achieved.

As a proportion of total revenue, the net operating balance is estimated to be 0.9 per cent in 2004-05 increasing to 1.8 per cent in 2006-07, before returning to a more balanced position thereafter.

By comparison with the states, Chart 2.1 shows that the ratio of the Territory's net operating balance to revenue is projected to be only marginally below that of the states by 2005-06, indicating the improved financial performance.

Chart 2.1: State and Territory Actual and Projected Net Operating Balance as a Proportion of Revenue



Infrastructure for Economic and Community Development

The provision of adequate levels of infrastructure is an ongoing challenge for the Territory largely due to both its remoteness and its stage of development, relative to the other states.

Government investment in infrastructure aims to meet both the Territory's social and economic requirements.

Net lending (fiscal balance) 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 2.2: General Government Net Lending (+)/Borrowing (-)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
	Actual	Estimate	Budget	Forward Estimate		
Net Lending (+) / Borrowing (-) (\$M)	-23	-11	-85	-71	-16	-6
As a Proportion of Total Revenue (%)	-0.9	-0.4	-3.2	-2.6	-0.6	-0.2

Source: Northern Territory Treasury

The fiscal balance deficit indicates that capital spending in each year is greater than the depreciation expense and is consistent with a developing economy such as the Territory. The effect of the Territory's substantial capital investment associated with the Darwin City Waterfront Redevelopment project in 2005-06 through 2007-08 is evident in Table 2.2.

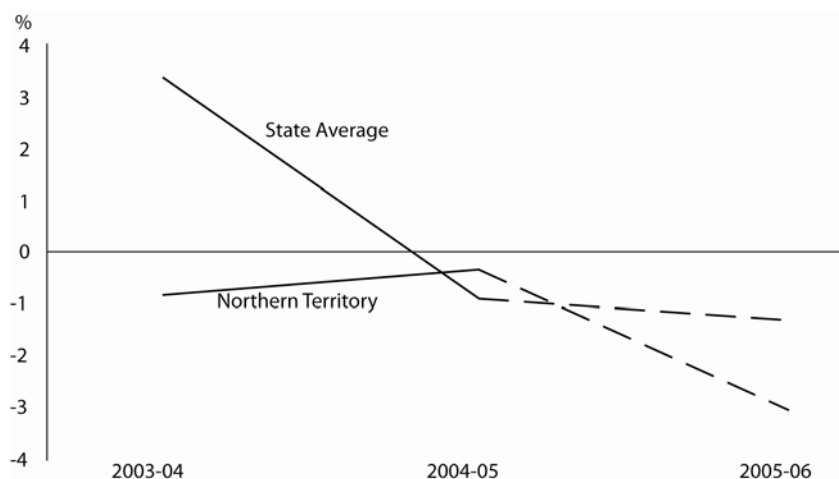
Despite this significant ongoing investment in infrastructure, the Territory is forecasting to be in a minimal net borrowing position by 2008-09, indicating that the target of balance by 2012-13 will be achieved.

As a proportion of total revenue, net lending is estimated to be -0.4 per cent in 2004-05, but is -3.2 per cent and -2.6 per cent in 2005-06 and 2006-07 respectively,

consistent with high capital investment in those years prior to returning to the more usual level of -0.2 per cent in 2008-09.

By comparison with the states, Chart 2.2 shows that the Territory's net lending to revenue is projected to be marginally above that of the states in 2004-05 but decline in 2005-06 due to the impact of the Waterfront project.

Chart 2.2: General Government Net Lending (+)/ Borrowing (-) as a Proportion of Total Revenue



When considering capital investment in the Territory, it is more appropriate to look at the non financial public sector as this better reflects the complete picture of government spending on significant infrastructure projects.

Table 2.3 presents the actual level of infrastructure investment for 2003-04 and estimates from 2004-05 to 2008-09. The Government's infrastructure investment including the Darwin City Waterfront Redevelopment project comprises purchases of non financial assets (including construction and capital items) and capital grants to non-government organisations.

Table 2.3: Capital Investment – Non Financial Public Sector

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
	Actual	Estimate	Budget	Forward Estimate		
	\$M	\$M	\$M	\$M	\$M	\$M
Purchases of Non Financial Assets	303	367	386	340	312	300
Capital Grants	56	60	47	44	44	45
Total	303	427	433	384	357	345

Source: Northern Territory Treasury

Further information on capital works projects is included in *Budget Paper No. 4*.

Competitive Tax Environment

The Government is committed to maintaining a competitive tax environment to encourage increased levels of business activity in the Northern Territory.

In the 2005-06 Budget, the Government has announced several revenue measures to stimulate economic and employment growth and to meet national tax reform agreements. A more detailed analysis of these revenue initiatives is provided in Chapter 4 of this Budget Paper.

In order to assess the competitiveness of the Territory's tax system, the following measures are utilised:

- taxation revenue per capita; and

- taxation effort as assessed by the Commonwealth Grants Commission (the Commission).

Taxation revenue per capita is a simple summary measure that affords comparability with other jurisdictions.

Table 2.4 shows that the Territory's tax collections per capita for 2005-06 are estimated at \$1474, compared with \$2031 for the average of the other states.

This also highlights that the Territory in 2005-06 is expected to collect the second lowest per capita tax revenues after Tasmania.

Table 2.4: Taxation Revenue Per Capita – General Government

	2003-04	2004-05	2005-06
	\$ per capita	\$ per capita	\$ per capita
New South Wales	2 237	2 252	2 348
Victoria	2 050	2 059	2 049
Queensland	1 737	1 690	1 645
Western Australia	2 096	1 990	1 919
South Australia	1 834	1 859	1 851
Tasmania	1 314	1 409	1 381
Australian Capital Territory	2 332	2 183	2 397
State Average	2 027	2 016	2 031
Northern Territory	1 326	1 466	1 474

Source: Northern Territory Treasury, Western Australia Pre-Election Financial Projections Statement, State Mid-Year and Outcome Reports.

Although 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 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 2.5 details the Territory's revenue-raising capacity and effort expressed as a percentage of the Australian average in 2003-04, the latest year assessed by the Commission.

Table 2.5: Northern Territory Revenue-Raising Capacity and Effort 2003-04
Australian Average = 100 per cent

	Capacity ¹	Effort ²
	%	%
Total Taxation	77	91
Total Own-Source Revenue	89	94

Source: Commonwealth Grants Commission 2005 Update

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 Commission's assessment shows that the Territory's tax effort (91 per cent) is below the Australian average (100 per cent). While being below the national average this, together with the Territory being the second lowest taxing jurisdiction after Queensland, demonstrates that the Territory continues to provide a competitive tax environment for all Territorians.

Further interjurisdictional comparisons of individual tax revenue measures and a more detailed synopsis of the methodology used by the Commission are provided in Chapter 6 of this Budget Paper.

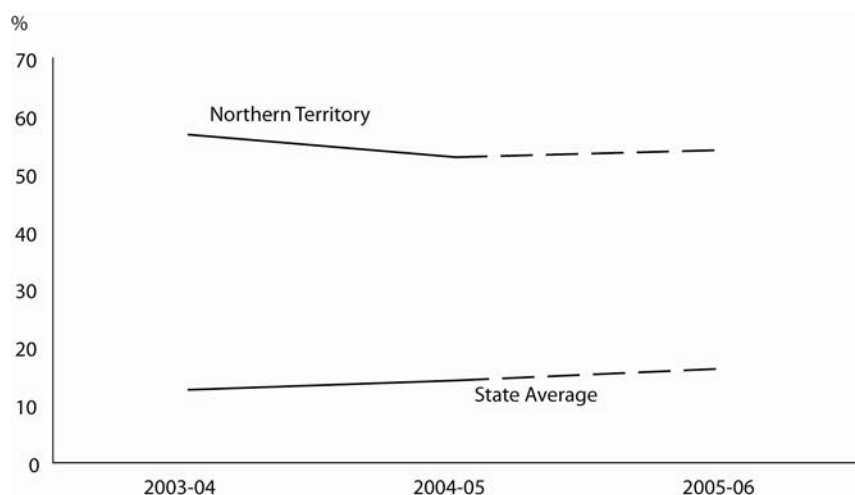
Prudent Management of Liabilities

This component of the Fiscal Strategy aims to ensure prudent management of debt, while promoting increased service delivery and continued investment in infrastructure needed to promote social wellbeing and economic growth.

The broader non financial public sector scope is used when measuring net debt, rather than the general government sector. This broader focus is appropriate as this better reflects the complete allocation of assets and liabilities across government and assists when benchmarking the Territory against other jurisdictions.

Net debt is gross borrowings less certain financial assets. Net debt is projected to increase in line with the contributions to the Darwin City Waterfront Redevelopment project. However, even after this substantial investment, the net debt level in 2007-08 will be comparable to the level recorded in 2001-02. Although the Territory's net debt to revenue ratio is higher than the states', having regard to the greater requirement for infrastructure investment, the Territory's ratio is improving gradually over time.

Chart 2.3: Net Debt to Revenue – Non Financial Public Sector



Net Debt plus employee entitlements is a broader measure than net debt in that it encompasses unfunded employee entitlements, consisting largely of unfunded superannuation, which is a major liability for the Territory and most states.

Since 2001-02 the level of net debt plus employee entitlements as a percentage of revenue has dropped from 134 per cent at 30 June 2002 to 118 per cent at 30 June 2004. This is as a direct result of the deficit reduction strategy and the cash surpluses achieved in 2002-03 and 2003-04.

Table 2.6 shows the effect of the Government's commitment to prudently manage debt and employee liabilities. This highlights that the level of net debt plus employee liabilities as a percentage of revenue will continue to drop from the 2003-04 outcome of 118 per cent to 107 per cent by 2008-09.

Table 2.6: Northern Territory Net Debt Plus Employee Liabilities – Non Financial Public Sector

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
	Actual	Estimate	Budget	Forward Estimate		
Net Debt (\$M)	1 656	1 653	1 718	1 761	1 787	1 781
Net Debt to Revenue (%)	57	54	55	55	54	52
Employee Liabilities (\$M)	1 797	1 825	1 839	1 851	1 859	1 865
Net Debt + Employee Liabilities (\$M)	3 453	3 478	3 557	3 612	3 646	3 647
Net Debt + Employee Liabilities to Revenue (%)	118	114	113	112	110	107

Source: Northern Territory Treasury

This declining trend results from increased investments in infrastructure and service provision initiatives being more than offset by a smaller increase in employee liabilities and higher revenue growth.

In addition, although the Territory and the states have now closed their unfunded defined benefit superannuation schemes, some states have also embarked on partially funding these significant unfunded superannuation arrangements. As a result, despite recent cash surpluses and the introduction of the deficit reduction strategy, Territory debt levels remain high relative to the states, as shown in Chart 2.3.

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