

FISCAL DEVELOPMENTS IN THE STATES

Most States are expected to record net operating surpluses in 2006-07, with improvements in their balances over the forward years. After allowing for capital investment, most States are expecting general government fiscal and cash deficits in 2006-07. The States are generally forecasting an improvement in their fiscal and cash balances by 2008-09.

Most States are expected to experience a deterioration in their net debt position in 2006-07 but their net debt levels remain low as a percentage of output. As a whole, the States eliminated net debt in 2001-02 and this strong position is expected to remain in future. This trend is primarily due to States implementing medium-term fiscal strategies.

The fiscal indicators presented below indicate that the fiscal outlook of the States is strong. However, the challenge for the States is to sustain this in the longer term in light of emerging pressures associated with the ageing population and continuing increases in demand for services such as health.

This section provides an overview of fiscal developments in the States to provide context to the discussion of the Australian Loan Council arrangements that follows.

STATE GENERAL GOVERNMENT SECTOR NET OPERATING BALANCE

The aggregate State general government sector net operating position is expected to be in balance in 2006-07, compared with a small surplus in 2005-06 (Chart 4). The 2005-06 and 2006-07 estimates are lower than in previous years, partly reflecting the impact of a softer housing market on revenue collections from property-related taxes¹ and higher expenditure, for example on health and wages.² However, the net operating balances are expected to improve in the forward years.

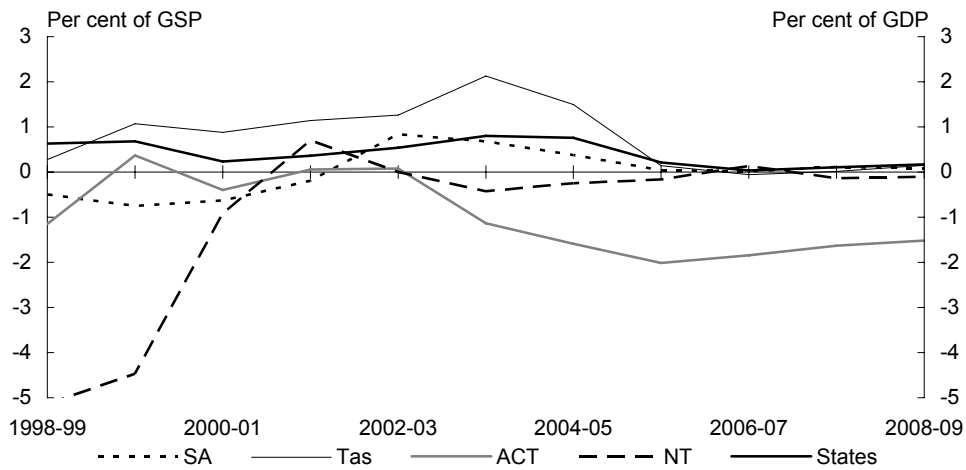
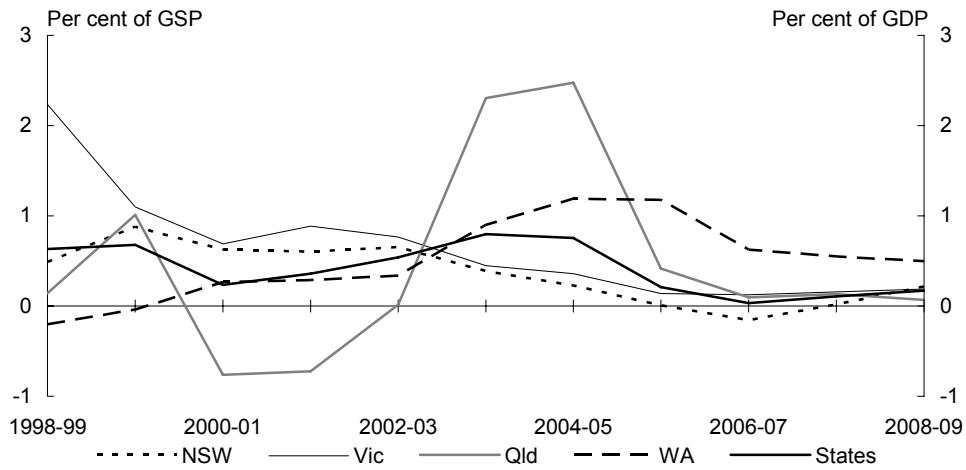
The net operating balance measures, in accrual terms, the gap between a government's expenses and revenue for a given period, and provides a good indication of the sustainability of the existing level of government services. An operating surplus indicates that a government can finance the services it provides in a period using revenues derived in that period. An operating deficit indicates that a government must borrow or sell assets in order to finance services provided in a period.

1 See, for example, New South Wales' *2005-06 Half-Yearly Budget Review*, p 1.

2 See, for example, Queensland's October 2005 *Special Economic and Fiscal Statement*, p 5, South Australia's *2005-06 Mid-Year Budget Review*, p 1, and Western Australia's *2005-06 Government Mid-Year Financial Projections Statement*, p 12.

New South Wales, Tasmania and the Australian Capital Territory are expected to record operating deficits in 2006-07. Both the Territories are expected to have operating deficits in the forward years.

Chart 4: Individual State general government sector net operating balance^(a)



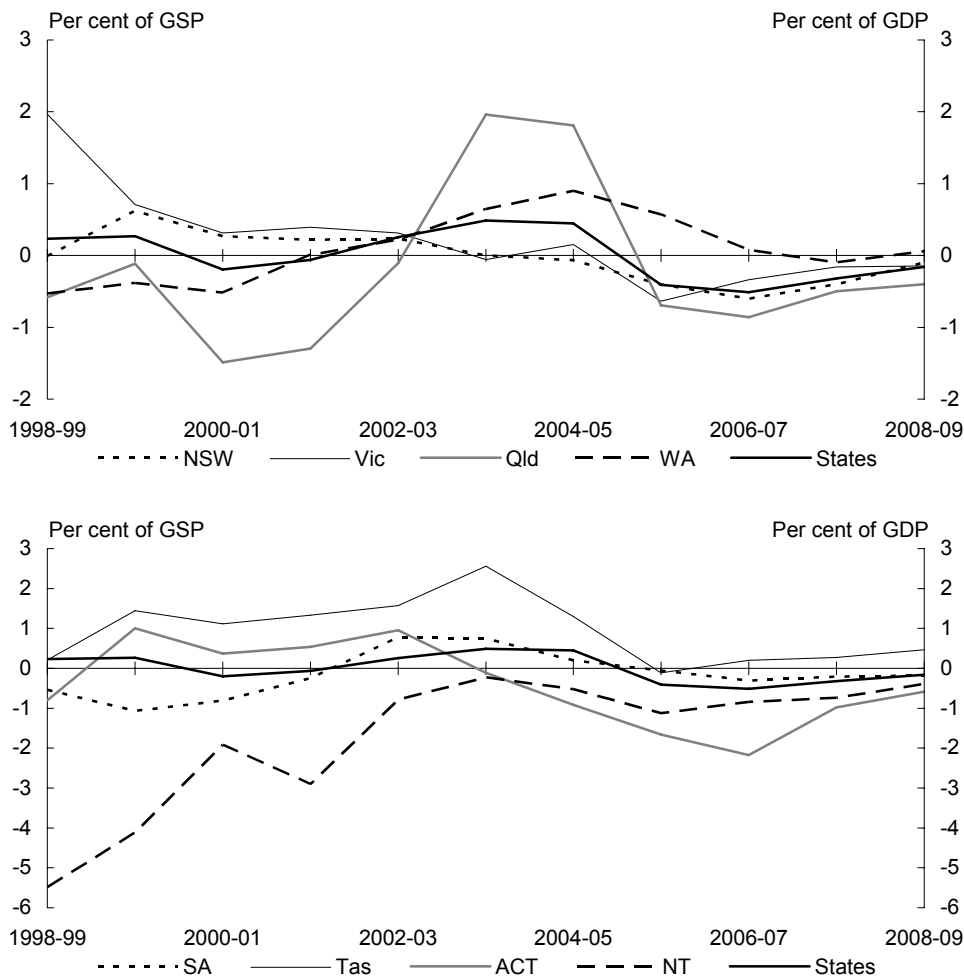
(a) States' net operating balances are expressed as a percentage of Gross State Product (GSP) (left hand axis) and the States' aggregate net operating balance is expressed as a percentage of Gross Domestic Product (GDP) (right hand axis).

Sources: ABS cat. no. 5512.0, State 2005-06 mid-year reports, Northern Territory 2006-07 Budget and Treasury estimates.

STATE GENERAL GOVERNMENT SECTOR FISCAL BALANCE

The aggregate State fiscal balance for the general government sector is estimated to be in deficit by 0.5 per cent of GDP in 2006-07 (Chart 5), a slightly larger deficit than in 2005-06 due to expected lower operating balances of the States. The aggregate balance is expected to be in smaller deficits in the forward years.

Chart 5: Individual State general government sector fiscal balance^(a)



(a) States' fiscal balances are expressed as a percentage of GSP (left hand axis) and the States' aggregate fiscal balance is expressed as a percentage of GDP (right hand axis).
Sources: ABS cat. no. 5512.0, State 2005-06 mid-year reports, Northern Territory 2006-07 Budget and Treasury estimates.

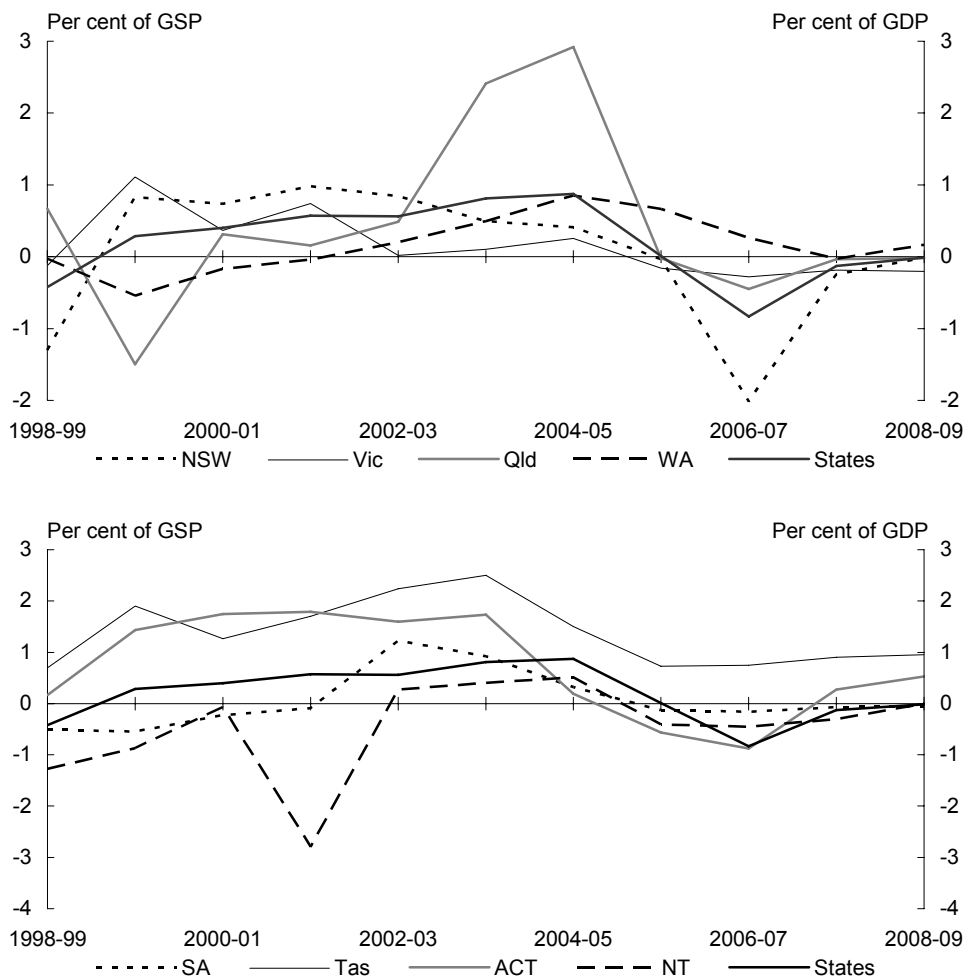
The fiscal balance measures, in accrual terms, the gap between government savings plus net capital transfers, and investment in non-financial assets. A fiscal surplus indicates that a government is lending to other sectors. A fiscal deficit indicates that a government is borrowing.

Trends in the aggregate fiscal balance for State/local general government, public non-financial corporation and the non-financial public sector are presented in Tables 1, 2 and 3, Statement 12, Budget Paper No. 1.

STATE GENERAL GOVERNMENT SECTOR CASH BALANCE

In aggregate, the general government sector cash position is expected to be a deficit of 0.8 per cent of GDP in 2006-07, compared with an overall small cash surplus in 2005-06. In 2006-07, cash deficits are expected for all States except Western Australia and Tasmania (Chart 6). The general government sector cash deficit is expected to improve in the forward years, in aggregate terms.

Chart 6: Individual State general government sector cash balance^(a)



(a) States' cash balances are expressed as a percentage of GSP (left hand axis) and the States' aggregate cash balance is expressed as a percentage of GDP (right hand axis).
Sources: ABS cat. no. 5512.0, State 2005-06 mid-year reports and Northern Territory 2006-07 Budget and Treasury estimates.

A cash surplus reflects the extent to which cash is available to a government to increase financial assets or decrease liabilities (assuming no revaluations or other changes occur). A cash deficit measures the extent to which a government requires cash, either by running down financial assets or by borrowing.

Trends in the aggregate cash surplus for State/local general government, public non-financial corporations and the non-financial public sector are presented in Chart 2, Statement 12, Budget Paper No. 1.

STATE NET DEBT

Most States are forecasting a deterioration in their levels of general government sector net debt in 2006-07 and the forward years as they borrow to finance significant capital expenditure programs (Chart 7).³ Queensland, Western Australia, Tasmania and the Australian Capital Territory are the only States to forecast a net debt position below zero in 2006-07 and the forward years.

Net debt is the sum of selected financial liabilities (deposits held, advances received, government securities, loans and other borrowing) less the sum of selected financial assets (cash and deposits, advances paid, and investments, loans and placements). Net debt does not include superannuation related liabilities.

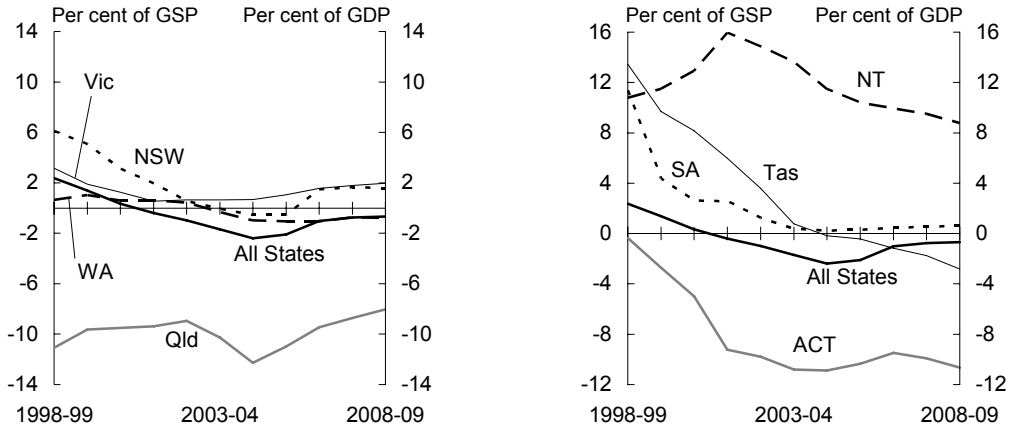
The higher the net debt of a government, the greater the call that will be imposed on the government's future revenue flows to service that debt.

In aggregate, the State general government sector continues to record net debt levels below zero. Its net debt is expected to be -1 per cent of GDP in 2006-07, falling to -0.7 per cent of GDP by 2008-09. Net debt for the aggregate State public non-financial corporations sector is estimated to be 4.5 per cent of GDP in 2005-06,⁴ up from 4.1 per cent in 2004-05. The public non-financial corporations sector owns nearly all of the stock of State non-financial public net debt.

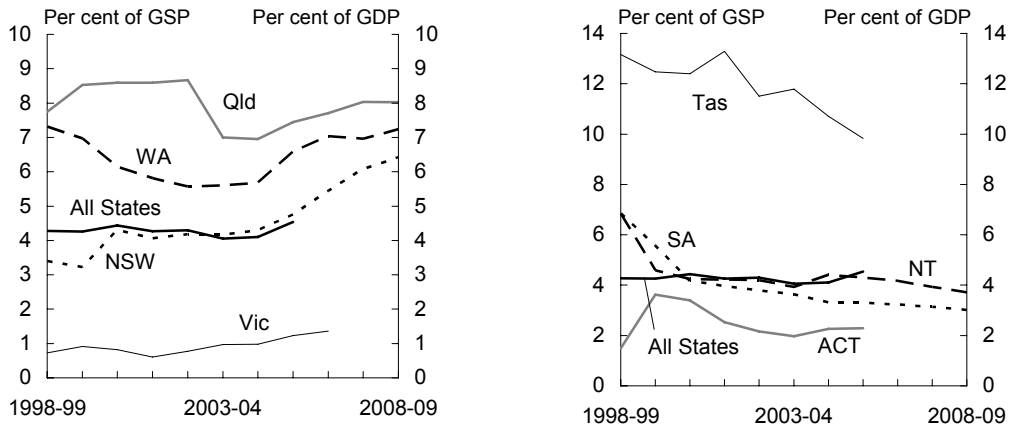
3 See, for example, New South Wales's *2005-06 Half-Yearly Budget Review*, p 5 and South Australia's *2005-06 Mid-Year Budget Review*, p 1.

4 Estimates for the public non-financial corporations sector and the non-financial public sector are unavailable after 2005-06 in some States. The public non-financial corporations sector comprises bodies that provide goods and services (such as electricity, gas and water) that are mainly market, non-regulatory and non-financial in nature, and are financed predominantly through sales to the consumers of these goods and services.

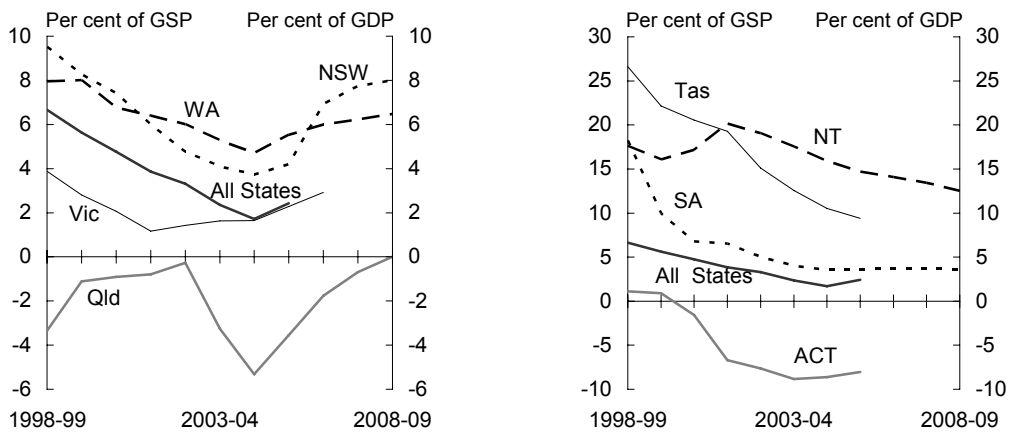
Chart 7: Individual State net debt by sector (as at end of financial year)^(a)
 General government



Public non-financial corporations



Non-financial public sector



(a) States' net debt is expressed as a percentage of GSP (left hand axis) and the States' aggregate net debt is expressed as a percentage of GDP (right hand axis).
 Sources: ABS cat. no. 5512.0, State 2005-06 mid-year reports, Northern Territory 2006-07 Budget and Treasury estimates.

AUSTRALIAN LOAN COUNCIL ARRANGEMENTS

The Australian Loan Council is a Commonwealth-State Ministerial Council that coordinates public sector borrowing. The Loan Council consists of the Prime Minister of Australia and the Premier/Chief Minister of each State and Territory. However, in practice each member is represented by a nominee, usually the Treasurer of that jurisdiction, with the Australian Treasurer as Chairman.

Current Loan Council arrangements operate on a voluntary basis and emphasise transparency of public sector financing rather than adherence to strict borrowing limits. These arrangements are designed to enhance financial market scrutiny of public sector borrowing and facilitate informed judgments about each government's financial performance.

The Loan Council traditionally meets annually in March to consider jurisdictions' Loan Council Allocation nominations for the forthcoming year. As part of the agreed arrangements, the Loan Council considers these nominations, having regard to each jurisdiction's fiscal position and the macroeconomic implications of the aggregate figure.

Outcome of March 2006 Loan Council meeting

The Loan Council met on 31 March 2006 to consider Loan Council Allocation nominations for 2006-07. The Loan Council approved each jurisdiction's nominated allocation. In aggregate, the nominations represent a surplus of \$27.4 billion (Table 20).

Table 20: Loan Council Allocation (LCA) nominations for 2006-07^(a)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	A/Gov	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Nominated 2006-07 LCAs										
General government sector cash deficit(+)/surplus(-)(e)	6,949	714	833	-311	105	-162	179	54	-11,591	
PNFC sector cash deficit(+)/surplus(-)	3,196	1,231	2,047	1,063	56	74	-16	3	924	
Non-financial public sector cash deficit(+)/surplus(-)(b)	10,145	1,942	2,882	752	161	-88	163	56	-10,667	
<i>minus</i> Net cash flows from investments										
in financial assets for policy purposes(c)	-28	1	0	0	22	-6	-2	-1	24,649	
<i>plus</i> Memorandum items(d)(e)	-7,187	2	118	-100	-234	19	-6	0	-694	
Loan Council Allocation	2,986	1,943	3,000	652	-95	-63	159	57	-36,010	-27,371
2006-07 tolerance limit	1,141	678	734	400	231	104	56	65	5,742	

(a) LCA nominations for 2006-07 reflect current best estimates of non-financial public sector deficits/surpluses. Nominations have been provided on the basis of policies announced up to and included in jurisdictions' mid-year reports. Nominations are based on preliminary estimates of general government finances provided by jurisdictions for purposes of their mid-year reports, and projected bottom lines for each jurisdiction's public non-financial corporations (PNFC) sector, where actual estimates are unavailable. Each jurisdiction will publish an updated LCA estimate as part of its budget documentation. The 2 per cent (of non-financial public sector cash receipts from operating activities in each jurisdiction) tolerance limits around each jurisdiction's 2006-07 LCA are designed, inter alia, to accommodate changes to the LCA resulting from changes in policy.

(b) The sum of the surpluses of the general government and PNFC sectors may not directly equal the non-financial public sector surplus due to intersectoral transfers.

(c) This comprises net lending by governments with the aim of achieving government policy, as well as net equity sales and net lending to other sectors or jurisdictions. Such transactions involve the transfer or exchange of a financial asset and are not included within the cash deficit. However, the cash flow from investments in financial assets for policy purposes has implications for governments' call on financial markets. The Australian Government's estimate for 2006-07 includes estimated cash flows from the possible sale of Telstra.

(d) Memorandum items are used to adjust the non-financial public sector deficit/surplus to include in LCAs certain transactions — such as operating leases — that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the non-financial public sector deficit/surplus certain transactions that the Loan Council has agreed should not be included in LCAs, for example, the funding of more than employers' emerging costs under public sector superannuation schemes, or borrowings by entities such as statutory marketing authorities. Where relevant, memorandum items include an amount for gross new borrowings of government home finance schemes.

(e) New South Wales' cash deficit and memorandum items in 2006-07 are affected by a one-off \$8 billion contribution from the General Government Liability Management Fund towards the defined benefit superannuation schemes.