Budget Statement

2006-07

New South Wales

Budget Paper No. 2

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BUDGET OVERVIEW

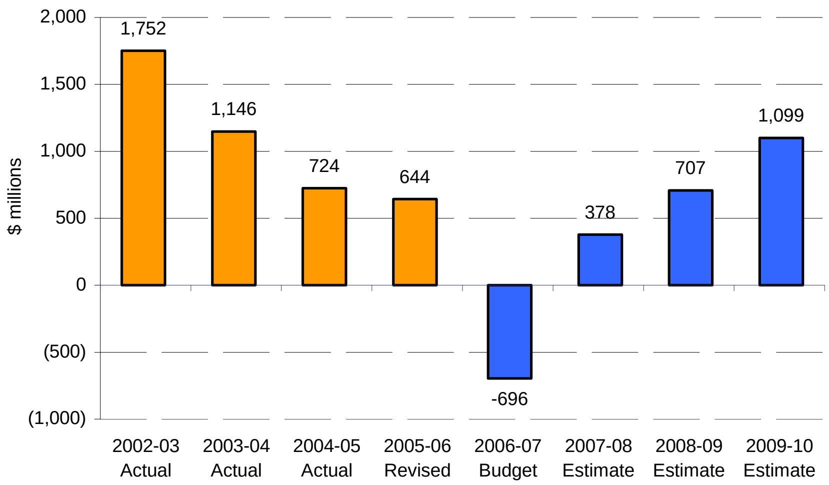
FISCAL POSITION AND OUTLOOK

The Government continues to have a strong balance sheet, and is restoring the budget to surplus while lowering taxes and redirecting expenditure to key priorities. Capital expenditure is at record levels and underlying net debt in the General Government Sector has fallen by over $10 billion since 1995.

General government sector net debt has been reduced from $12.2 billion in 1995 to an estimated $1.9 billion at 30 June 2006. This substantial improvement in the New South Wales balance sheet makes it possible to deliver key expenditure priorities despite a slowing in revenue growth.

The Budget result for 2006-07 is expected to be a deficit of $696 million. In the forward years the Budget result is expected to strengthen with a projected surplus in 2007-08. The return to surplus is based on achieving the savings outlined in the Premier's February 2006 *Economic and Financial Statement* and a slowing in annual expenses growth, to 3.8 per cent per annum over the four years ending 2009-10.

Chart 1: Budget Result, 2002-03 to 2009-10



The improvement in the Budget result will allow general government net financial liabilities to continue falling as a share of gross state product. The Government's fiscal strategy is discussed in Chapter 1.

The Budget results projected over the forward estimates mean that the increased capital expenditure will be funded from borrowings. Over the next four years total state capital expenditure is projected to be $41.3 billion, or 45.1 per cent higher than in the four years to 2005-06. Total state net debt is expected to increase by $19.6 billion (from 5.2 to 9.1 per cent of GSP) over the same period.

In 2006-07, NSW economic activity will strengthen, with a recovery in net exports and moderate growth in consumer spending. Business investment is expected to increase further to record levels. The recent rise in interest rates will delay the recovery of dwelling investment (see Chapter 6).

EXPENSES

General government expenses are estimated to increase in nominal terms by 5.7 per cent in 2006-07, but then to slow over the next three years, averaging 3.1 per cent per annum.

General government sector expenses have grown at an average of 5.9 per cent a year in the four years to 2005-06, or by 4.0 per cent excluding the growth in employee-related expenses. Total expenses have been driven by several factors:

- ♦ a significant increase in funding for priority areas;
- ♦ real wage growth, particularly for front line employees, as well as increased front line positions; and
- ♦ higher reported superannuation costs under recently introduced International Accounting Standards.

In August 2005, the Government commissioned an independent audit of Government expenditure and assets. The Government's response to this review, outlined in the *Economic and Financial Statement* in February 2006 and incorporated in this Budget, is to make structural improvements to expenditure, rather than to increase taxation.

This Budget incorporates a range of initiatives that will reduce the growth in expenses by $1.3 billion per annum by 2009-10 (and cumulatively by $4.4 billion), and will reduce the average annual growth rate in total expenses by 0.6 per cent per annum. A discussion of the Government's expenditure priorities, including saving and efficiency measures, is provided in Chapter 2.

Table 1: General Government Total Expenses*

	2002-03 Actual	2003-04 Actual	2004-05 Actual	2005-06 Revised	2006-07 Budget	2007-08 Est	2008-09 Est	2009-10 Est
In $ billions								
Employee-related	16.4	17.7	19.1	20.1	20.8	21.3	22.3	23.3
Maintenance & other operating	8.6	9.0	9.2	9.0	10.0	10.3	10.4	10.8
Grants & subsidies	6.7	7.1	7.3	8.4	8.8	8.6	8.9	9.0
Finance, Depreciation, Other	2.6	2.7	2.8	3.0	3.2	3.5	3.8	4.0
TOTAL EXPENSES	**34.3**	**36.5**	**38.5**	**40.6**	**42.9**	**43.7**	**45.4**	**47.0**
Growth Rate (%)	6.2	6.5	5.4	5.4	5.7	1.9	4.0	3.6
As % of GSP	12.4	12.6	12.6	12.6	12.7	12.2	12.0	11.7

* *Components may not sum to totals due to rounding*

Concessions and tax expenditures, while not necessarily entailing a direct budget outlay, are also a significant instrument of fiscal policy. They have budgetary and welfare effects in the same way as direct outlays. This Budget provides for concessions of $715 million and tax expenditures worth $4.1 billion in 2006-07. Tax expenditures are mainly on economic services (such as through transfer duty and payroll tax exemptions), while the bulk of concessions are for social security and welfare and housing and community amenities. Chapter 7 provides detailed estimates of tax expenditures and concessions by policy area and by type of tax.

EXPENDITURE POLICY PRIORITIES

The Government has allocated $42.9 billion in this Budget for general government services, an increase of 5.7 per cent from last year.

Key expenditure growth areas in the 2006-07 Budget include health, transport, disability services, education and public order and safety.

♦ Public access to quality health care is an ongoing priority of the NSW Government. Total expenses incurred by the Department of Health will reach $11.7 billion in 2006-07, with health services now representing 27.5 per cent of total general government expenses. The Government has provided substantial real funding increases since 2000-01, including specific enhancements for priorities such as mental health and increases in bed capacity. This commitment will continue, with additional resources in this Budget to establish new services and to ensure growing demand is managed effectively.

- Transport expenses have increased by around 10 per cent a year in recent years, and will reach $5.1 billion in 2006-07. Growth in expenses predominantly reflects a higher level of support for public transport – the major component of the increase in public transport funding is to improve the performance of rail services. The Government has significantly increased spending on rail maintenance, security (including employing 600 transit officers and closed-circuit TV monitoring) and recruiting new drivers and guards (around 350 since January 2004). The growth in funding for capital spending for rail has almost doubled from $331 million in 2000-01 to $605 million in 2005-06, reflecting major acquisitions (new Millennium and outer suburban rolling stock and the Epping Chatswood Rail link).

- The Government provides community and disability services to support those who are most disadvantaged in our community, or who are at a time of crisis. Total expenses in this area will reach $3.4 billion in 2006-07, representing 7.9 per cent of total general government expenses. Substantial additional funding is being provided in 2006-07 to meet the needs of people with a disability and their carers, Aboriginal people, frail older people, and families and children at risk or in stress. The Government will spend $1.8 billion in 2006-07 on disability services, $208 million more than the budgeted expenditure in 2005-06 as part of a 5 year $1 billion *Stronger Together* program. The roll-out of the $1.2 billion five year package for the Department of Community Services is in its fourth year, with $308.4 million being provided in 2006-07. Key programs such as the Aboriginal Communities Development Program will continue to be rolled out at a cost of $38 million in 2006-07.

- The Government is committed to a quality public education system that provides equitable opportunities for all students. Education expenses will exceed $10 billion for the first time in 2006-07, an increase of around $1.5 billion over the past four years. Additional expenditure has targeted a broad range of educational improvements including literacy and numeracy programs, teaching quality, reducing the size of classes in Kindergarten, Years 1 and 2, supporting students with special needs, and a range of technology initiatives including computers in schools and faster access to the internet.

- Over the four years to 2006-07 expenses incurred on public order and safety have increased by over 25 per cent, to $4.6 billion. In response to community concerns, police numbers have increased from 13,716 at June 2002 to 14,579 at February 2006. In 2006-07 an additional $48.2 million ($67.7 million per annum) will be spent on training and deployment of a further 750 police officers in 2007, bringing the average authorised strength to 15,206.

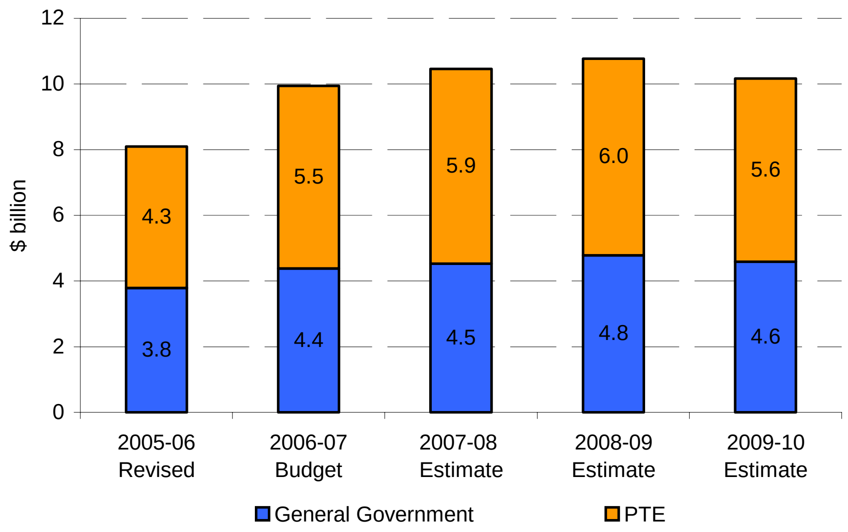
CAPITAL EXPENDITURE

Capital expenditure by the State will continue to rise substantially, reaching record levels for both the general government sector and the public trading enterprise sector in 2006-07.

Total State capital spending of $9.9 billion in 2006-07 is 22.8 per cent higher than in 2005-06. This comprises $4.4 billion in capital expenditure by the general government sector and over $5.5 billion by the PTE sector.

Over the four years to 2009-10, capital expenditure in the general government sector is estimated to be $18.3 billion, an average of $4.6 billion a year and an increase of 32.5 per cent compared to the four years to 2005-06. In the PTE sector, capital expenditure is expected to reach $23.1 billion over the next four years, an increase of 57.0 per cent on the four years to 2005-06, partly funded by an increase in net debt of $12.3 billion.

Chart 2: Total State Capital Expenditure by Sector, 2005-06 to 2009-10



In total, over the four years to 2009-10, State capital expenditure (general government sector and PTE sector) will be $41.3 billion, a 45.1 per cent increase on the $28.5 billion spent in the four years to 2005-06. This will be partly funded by an increase in total State sector net debt of $19.6 billion.

The increase in capital expenditure in the general government sector is primarily driven by additional investment in hospitals, roads, schools and police stations and prisons. These areas account for over three quarters of the general government sector's 2006-07 capital program. Major new projects commencing in 2006-07 (with the estimated total cost) include:

- Auburn and Liverpool Hospitals redevelopment ($511.9 million);
- 25 major new school projects (including two new schools at Ashtonfield and Halinda) and 11 new TAFE projects ($210 million);
- Pacific Highway – dual carriageways for: Ballina Bypass major preconstruction ($271 million), Bonville Bypass ($245 million, State/Federal funding), and Karuah to Bulahdelah Sections 2 and 3 ($114 million, State/Federal funding);
- new police stations at Burwood, Granville, Kempsey, Port Stephens, Windsor and Wyong ($80.7 million); and
- new and improved mental health facilities on the Central Coast, the Sydney metropolitan area, the Illawarra and Mid West regions ($62 million).

The increase in capital expenditure in 2006-07 in the PTE sector is primarily due to additional expenditure by the electricity agencies to meet growth in demand and to ensure continued system reliability, and by Sydney Water on sewerage and recycling programs, critical water main renewals and carryovers from 2005-06 in the property management program.

The Department of Housing will increase its expenditure on new public housing from $74.7 million in 2005-06 to $245.3 million in 2006-07 to commence implementation of a State-wide strategy for reconfiguring the Department's public housing assets to better match client needs.

The transport sector's capital program in 2006-07 totals $1.5 billion and includes:

- $830 million for continuation of the Rail Clearways Program, rollingstock acquisition (including ongoing programs to acquire 14 new carriages for services in the Hunter Valley, 122 new Outer Suburban carriages for intercity services, and around 600 new air-conditioned carriages for the suburban rail network), and further enhancements to track, signals and rollingstock to improve the safety and reliability of the system.
- $327 million for the Epping to Chatswood Rail Line; and
- $89.5 million for the State Transit Authority's capital program for 86 new buses for the Sydney and Newcastle networks, upgrading depot facilities at Leichardt, Ryde and Brookvale, and improved on-board security for passengers and drivers.

The electricity sector's capital program for 2006-07 is estimated at $2.3 billion, with over 70 per cent undertaken by the distribution businesses. As outlined earlier, the main focus of the capital program is on meeting the growth in demand across the State and continuing to ensure network reliability and security.

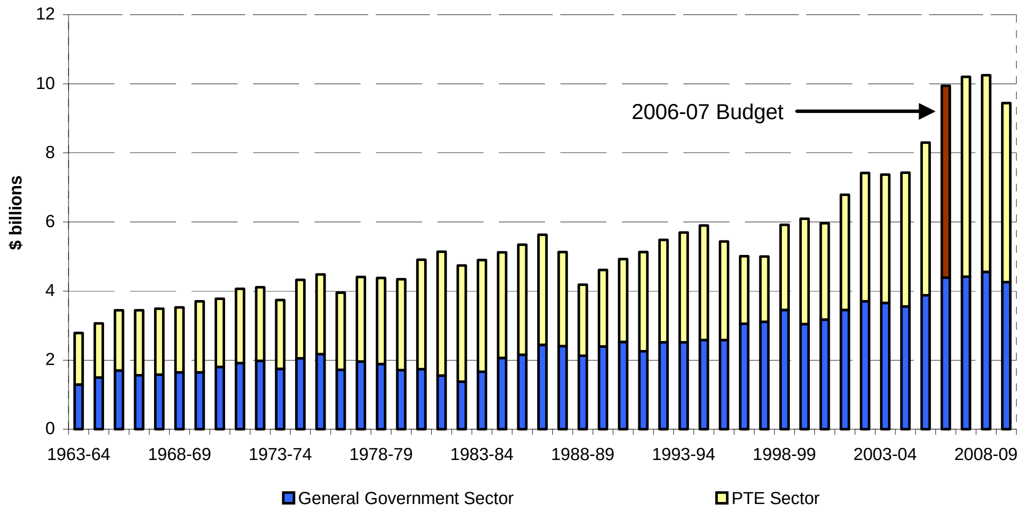
The 2006-07 capital expenditure for water businesses, excluding environment protection spending, is estimated at $431 million. This is an increase of about $55 million on last year, mainly due to increases in Sydney Water's recycling program. Expenditure associated with the *2006 Metropolitan Water Plan* includes:

- $26.1 million on water recycling projects in Sydney;
- $26.1 million on accessing deep water at Warragamba, Avon and Nepean dams, the groundwater contingency plan and investigating the transfer of more water from the Shoalhaven River (without raising the Tallowa dam wall); and
- $43.1 million on the desalination contingency plan for drought.

Chart 3 shows that the level of total state capital expenditure in New South Wales in real terms in 2006-07 will be at record levels, more than 80 per cent higher than the average of the 1990s and double the average level of the 1980s.

Budget Paper No. 4 provides further details of the State infrastructure program.

Chart 3: State Capital Expenditure Program,1963-64 to 2009-10 *(real 2006-07 dollars)*



REVENUE

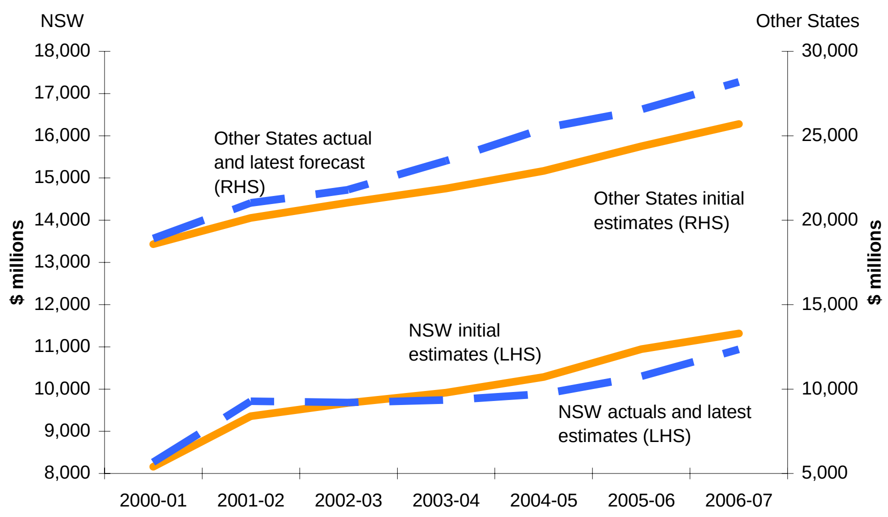
General government sector revenue is expected to grow by 2.4 per cent in 2006-07 following growth of 5.1 per cent in 2005-06. The slower growth in 2006-07 primarily reflects a decline in investment income following the extraordinary returns expected in 2005-06. There are no new tax or increases in tax rates in the Budget.

Over the four years to 2006-07, total revenue has grown by an average of 4 per cent per annum, which is below the long-run average rate of 5 per cent per annum. During this period, revenue from Commonwealth grants has grown by 3.7 per cent per annum and taxation revenue has grown by 4.3 per cent per annum. The second largest revenue source (purchaser transfer duty) declined in total by nearly 12 per cent.

- New South Wales will have received around $1.1 billion less in GST than was originally expected and just $369 million more over the seven years the GST has been in place than under the former funding arrangements. Every other State has received more in grants than was initially expected (Chart 4).

- In real per capita terms, General Purpose grants to New South Wales are estimated to be around 5 per cent lower in 2006-07 than in 2001-02, while grants to the other States in real per capita terms have risen by around 10 per cent over this period.

Chart 4: GST Revenue – Initial Estimates and Outcomes



Since August 2005 the NSW Government has:

- abolished vendor duty in August 2005, reducing revenue by $265 million in 2005-06 and $382 million in 2006-07;
- increased the tax-free threshold for land tax for the 2006 land tax year to $352,000 at a cost of $43 million in 2005-06 and $53 million in 2006-07;
- provided tax relief to clubs from 2006-07 at a cost to revenue of $233 million over the next 4 years;
- announced a timetable for the abolition of the taxes listed for review in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, beginning with the abolition of hire of goods duty in 2007-08. These taxes are estimated to raise around $680 million in 2006-07. The NSW Government has always recognised the need to abolish these inefficient taxes. However, the large shortfall in GST grants compared to original expectations made abolition of these taxes in line with the Commonwealth Government's timetable fiscally irresponsible. See Chapters 3 and 8 for further details;
- will provide a payroll tax rebate from 1 July 2006 for businesses in high-unemployment regions liable for payroll tax for the first time at a cost of $95 million over seven years; and
- other taxation measures, announced in this Budget, will reduce revenue by $57 million in 2006-07 (see Chapter 3 for details).

Table 2: General Government Sector Revenues*

	2002-03 Actual	*2003-04 Actual*	*2004-05 Actual*	*2005-06 Revised*	*2006-07 Budget*	*2007-08 Est*	*2008-09 Est*	*2009-10 Est*
In $ billions								
STATE REVENUES	31.5	33.0	34.3	35.8	37.2	39.1	40.9	42.8
- Taxation	14.2	15.0	15.3	15.8	16.7	17.5	18.4	19.4
- Commonwealth Grants								
- General Purpose	9.9	9.9	10.2	10.6	10.9	11.7	12.5	13.2
- Specific Purpose	5.3	5.6	6.0	6.4	6.7	6.8	7.0	7.0
- Financial Distributions	1.3	1.6	1.6	1.8	1.7	1.9	1.8	2.0
- Other	0.9	0.9	1.2	1.2	1.2	1.2	1.2	1.3
OPERATING REVENUES	4.5	4.6	5.0	5.4	5.0	5.0	5.2	5.3
TOTAL REVENUES	**36.0**	**37.7**	**39.2**	**41.2**	**42.2**	**44.1**	**46.1**	**48.1**
Growth Rate (%)	6.5	4.5	4.2	5.1	2.4	4.4	4.7	4.4
As % of GSP	13.1	13.0	12.8	12.8	12.5	12.3	12.2	12.0

* *Components may not sum to totals due to rounding.*

Chapter 3 provides details of general government sector revenues, including estimates for the Budget and forward years and the impact of revenue policy measures.

DEBT

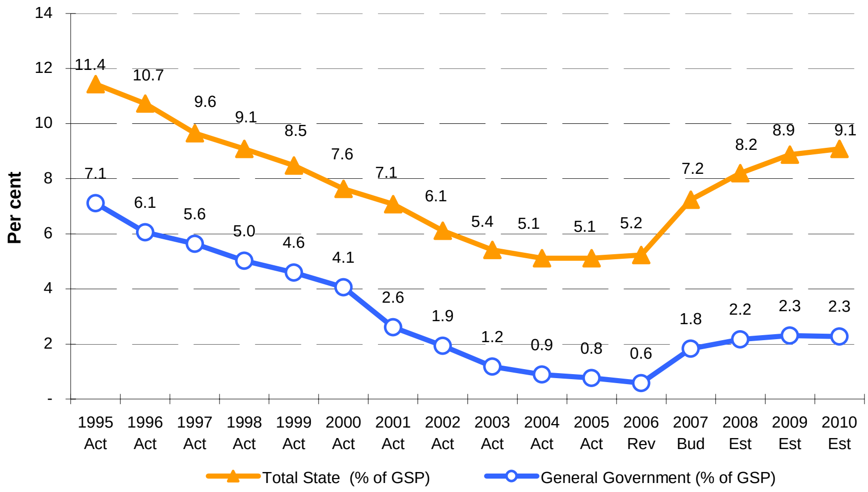
Total state sector net debt will increase over the forward years after declining substantially over the past decade, principally to fund a large PTE capital spending program. Underlying net debt of the general government sector is projected to increase somewhat over the forward years, but remains within sustainable levels.

Underlying net debt of the general government sector, having declined from over 7 per cent of GSP a decade ago, is set to increase to 2.3 per cent of GSP (or $9.1 billion) over the forward estimates period.

A portion ($2.2 billion) of the increase results from funding to reduce superannuation liabilities in 2006-07 (with no impact on overall net financial liabilities), and the balance can be attributed to the higher funding requirements associated with increased infrastructure expenditure and a smaller operating surplus.

Total state sector net debt is projected to increase to 9.1 per cent of GSP ($36.5 billion) by June 2010, largely reflecting a significant increase in PTE net debt. Since 2000, net debt in the PTE sector has increased substantially in nominal terms, from $7.5 billion (3.2 per cent of GSP) to $14.8 billion at June 2006 (4.6 per cent of GSP). The PTE sector's significant capital expenditure plans over the forward estimates period will see net debt continue to increase, by $12.3 billion to an estimated $27.1 billion (6.7 per cent of GSP) as at June 2010. Earnings in the PTE sector are projected to increase strongly over the next four years (see Chapter 5 of this Budget Paper) in line with increased capital expenditure and allow the additional debt to be supported and remain within prudent levels.

Chart 5: Underlying Net Debt as a Percentage of Gross State Product at 30 June, 1995 to 2010*



* *Excluding prepayment/deferral of superannuation contributions.*

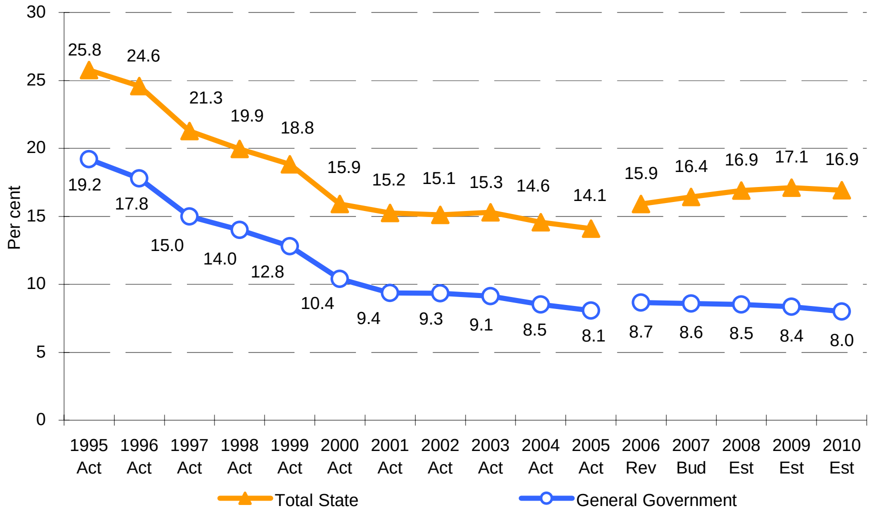
NET FINANCIAL LIABILITIES

General government sector net financial liabilities will continue their underlying trend decline as a percentage of gross state product (GSP). Total State sector net financial liabilities are projected to increase as a share of GSP over the forward years as a result of an increase in PTE sector debt.

General government net financial liabilities are projected to increase by 0.6 per cent of GSP, to 8.7 per cent of GSP at June 2006 – due to the effects of adopting Australian Equivalents to International Financial Reporting Standards (AEIFRS) - and then to decline over the forward years to 8 per cent by June 2010. General government sector net financial liabilities therefore will continue to decline as a share of GSP towards the long-term fiscal targets of the *Fiscal Responsibility Act 2005*.

Total state sector net financial liabilities are projected to increase as a share of GSP from 14.1 per cent at June 2005 to 15.9 per cent of GSP at June 2006. Adjusting for the effect of adopting AEIFRS, however, total state net financial liabilities would have declined to 13.3 per cent of GSP. Over the forward years they are projected to increase to 16.9 per cent at June 2010. The increase is driven principally by the additional debt required to fund higher PTE capital expenditure.

Chart 6: Net Financial Liabilities as a Percentage of Gross State Product at 30June, 1995 to 2010*



* *Series break in 2006 results from the adoption of Australian Equivalents to International Financial Reporting Standards. It has the effect of increasing the reported level of net financial liabilities. For example, in June 2006 general government sector net financial liabilities would have been 7.3 per cent without the change in standards.*

The reduction in general government net financial liabilities over the forward estimates period is consistent with the general objectives of the *Fiscal Responsibility Act 2005*, and is consistent with meeting the long-term fiscal target of 6.0 percent of GSP by 30 June 2015.

New South Wales' fiscal fundamentals remain strong, with international credit rating agencies again reaffirming the State's AAA rating in 2005-06.

FISCAL PRESSURES

REFORMS TO FINANCIAL ARRANGEMENTS

Chapter 8 of Budget Paper No. 2 discusses the inefficiencies of the current set of financial arrangements between the Commonwealth and the States. New South Wales commissioned an independent review by Associate Professor Neil Warren of the University of New South Wales comparing and benchmarking Australian and international arrangements for the allocation of taxation powers and expenditure responsibilities between central and subnational governments, and mechanisms for fiscal transfers between governments.

Warren found that,

> *"Australia performs comparatively poorly in international comparisons of intergovernmental fiscal arrangements. A review in the national interest is overdue and essential if Australia is to adequately meet the challenges of an ageing population. International experience shows that comprehensive reform to intergovernmental fiscal arrangements is being undertaken in many federations. Australia's system of intergovernmental fiscal arrangements is characterised by very high vertical fiscal imbalance (VFI) due to inadequate State tax powers, and complex and high level equalisation. These arrangements hinder adjustments in the economy that are essential for the economy to develop and grow, as it must if Australia is to meet future challenges."*

There has been a trend towards greater concentration of taxing powers in the hands of the Commonwealth since Federation. The range of reforms associated with the introduction of the GST increased that concentration. New South Wales believes the current Commonwealth-State financial arrangements (including the GST arrangements which see revenues raised by one level of government allocated to a different level of government) to be unstable in the longer term.

The key conclusions of Associate Professor Warren's Report are that Australia performs comparatively poorly against many of the criteria which define best practice fiscal federalism. International experience shows that:

- Australia's federal financial system is clearly in need of review in the national interest;
- comprehensive reform of intergovernmental financial arrangements has been recently undertaken in many federations; and
- if reform is necessary this should be possible without significantly disadvantaging any individual jurisdictions.

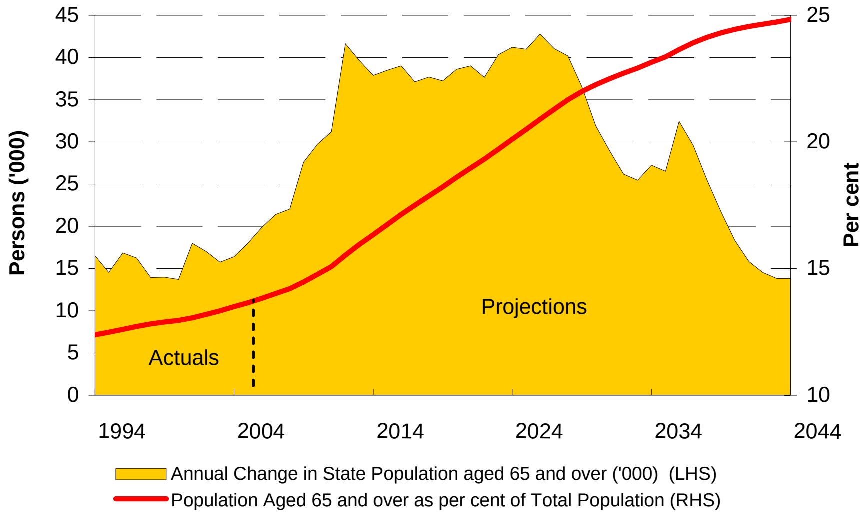
It is for this reason that the New South Wales Treasurer has called for a summit of Commonwealth and State leaders.

LONG TERM PRESSURES ON SPENDING

Ageing of the population, due to lower fertility rates in recent decades and the passing of the baby-boom cohort into the traditional retirement age, will lead to economic growth slowing in coming decades. The combination of an increasing share of the population over 64 and population growth in the 15-64 years age bracket below that of total population, will see economic growth slow to around the growth of productivity.

Budget Paper No. 6 projects that this will lead to a small decline in State revenues as a share of the economy, but a significant increase in State expenses, especially in health services. The ageing effects will be intensifying over the next decade. As the Chart below shows, the population aged 65 and over currently increases by fewer than 20,000 per annum, but in six years' time will be increasing by 40,000 per annum – and that increase will be sustained for another 20 years.

Chart 7: NSW Population aged 65 and over



It is estimated in Budget paper No. 6 that demographic factors, principally affecting health expenditures, will see a fiscal gap of 1.4 percentage points of GSP open by 2044.

Budget Paper No. 6 also concludes that there are significant longer term pressures likely to come from factors other than ageing of the population or the state of the economy. Rising health expenses associated with higher technology-related costs and greater numbers of procedures being performed are examples of such factors. These pressures are likely to lead to a further 2.0 percentage point gap opening up by 2044. In total the fiscal gap will be 3.4 per cent of GSP by 2044.

Ultimately, what is needed is a range of solutions over a sustained period to manage these fiscal pressures. A menu of policy responses will need to be consistently applied and, as the analysis in Budget Paper No. 6 makes clear, the earlier these are commenced the lower the adjustment costs. Many of the policy responses, perhaps the most important ones, will require a coordinated and hence cooperative approach from the Commonwealth and State Governments. Agreement to a National Reform Agenda is a promising start.

CHAPTER 1: FISCAL STRATEGY, POSITION AND OUTLOOK

- The Government's medium-term fiscal strategy is designed to:
  - support expenditure priorities within sustainable aggregate expenditure growth;
  - maintain a competitive tax regime that is conducive to business investment; and
  - keep net debt and other financial liabilities at sustainable levels.
- The 2005-06 Budget Surplus is estimated to be $644 million, compared with a Half Yearly Budget Review estimate of $21 million and the original Budget estimate of $303 million. The stronger outcome mainly reflects higher than projected returns on financial assets boosting State revenue by $479 million.
- Net financial liabilities of the general government sector are estimated to be 8.7 per cent of gross state product (GSP) at June 2006 ($27.9 billion) and underlying net debt is estimated to be 0.6 per cent of GSP ($1.9 billion).
- General government sector net worth declined by $4.7 billion from June 2005 to $124.2 billion at June 2006. This is due to changes in the treatment of certain liabilities, through the adoption of Australian Equivalents to International Financial Reporting Standards (AEIFRS). In the absence of adopting AEIFRS, net worth would have increased by $3.6 billion.
- The outlook is for a Budget deficit of $696 million in 2006-07, and surpluses of $378 million in 2007-08, $707 million in 2008-09 and $1,099 million in 2009-10.
- There are no new taxes or increases in tax rates in the 2006-07 Budget.
- Major taxation policies announced in this Budget and since the 2005-06 Budget will reduce revenue by $481 million in 2006-07 rising to over $1.1 billion in 2009-10.
- General government net debt will increase by $7.3 billion over the next four years, rising to 2.3 per cent of GSP (or 1.7 per cent, excluding $2.2 billion associated with a one-off payment to reduce superannuation liabilities).
- Net financial liabilities of the general government sector are expected to decline to 8 per cent of GSP by June 2010, as measured under new accounting standards.
- The 2006-07 Budget increases the long-term fiscal gap by 0.1 percentage points, with expense decisions reducing the gap by 0.3 percentage points offset by revenue decisions increasing the gap by 0.4 percentage points.

1.1 SCOPE OF THE BUDGET PAPERS AND KEY BUDGET AGGREGATES

SCOPE OF THE BUDGET PAPERS

These Budget Papers principally report on the financial and service delivery performance of the general government sector.

General government agencies typically deliver public services or are regulatory in nature. These agencies include Department of Health, Department of Education and Training, Roads and Traffic Authority and NSW Police. Budget Paper No. 3, *Budget Estimates*, provides details of the performance of each general government sector agency.

The general government sector forms one part of the total State sector. The other part of the total State sector is the more commercially focussed entities in the public trading enterprise (PTE) and public financial enterprise (PFE) sectors. These sectors do not impact on the Budget result, other than through:

- payment of dividends and tax equivalents (e.g. from energy and water corporations); and
- receipt of grants to provide services on a subsidised basis (e.g. to Rail Corporation New South Wales and the Department of Housing).

An overview of the performance of the PTE sector is included in Chapter 5.

More detail on the structure of the total state sector, together with the classification of agencies is contained in Appendix C.

KEY BUDGET AGGREGATES

Budget reporting complies with the accrual based government financial statistics (GFS) principles developed by the Australian Bureau of Statistics.

The Budget result is based on the GFS Net Operating Result. The GFS Net Operating Result reports the difference between the full cost of general government service delivery in the year (excluding new capital expenditure but including depreciation of the existing stock of fixed assets) and the revenues earned by the Government in that year to fund those services.

The Net Lending Result demonstrates the extent to which the current year's activities impact the general government sector's net financial liabilities.

Net financial liabilities show the full range of the general government sector's financial obligations (including debt, unfunded superannuation liabilities, insurance liabilities and employee related liabilities) less its financial assets (including cash and investments).

1.2 FISCAL STRATEGY STATEMENT

This section describes the Government's medium-term fiscal strategy and recent fiscal developments. It also reports against the key targets and principles in the *Fiscal Responsibility Act 2005.*

FISCAL STRATEGY

The Government's medium-term fiscal strategy has, since 1995, enabled it to meet its service delivery objectives while at the same time strengthening State finances.

The objective of the Government is to maintain services to the community over time despite the inevitable fluctuations in State revenues. With State revenues following cycles in the property market and the economy in general, the challenge is to match the growth in expenditure with a growth in revenue that is sustainable over the medium term.

During periods of above trend revenue growth the strategy has involved strengthening the State's balance sheet by reducing general government sector net debt and other financial liabilities. Once a strong balance sheet is achieved, a cyclical downturn in revenue can be absorbed through additional borrowings rather than having to reduce service delivery.

The fiscal strategy provides flexibility in how the State deals with fiscal challenges. An example of this flexibility is evident in the fiscal targets in the *Fiscal Responsibility Act 2005*, the legislation that guides the conduct of fiscal strategy. Within the constraint of the main fiscal target – i.e. reducing the level of net financial liabilities of the general government sector as a share of gross state product – the strategy allows for an increase in one component of net financial liabilities in order to reduce another. In 2006-07, a portion of the increase in net debt will be used to reduce unfunded superannuation liabilities.

This combination of factors will lead to a temporary deviation from the debt targets. However, this increase in net debt is being managed consistent with the long-term fiscal target of reducing net financial liabilities and an improvement in the State's overall balance sheet.

Although the Government's fiscal targets have most relevance to the general government sector, the fiscal strategy also takes into account the financial position of the State sector as a whole - which includes public trading enterprises (PTEs) and public financial enterprises (PFEs).

Because general government sector services are usually provided free of charge to the user, the services and any associated net debt must be paid for by taxpayers rather than the users of the services directly. In contrast, net debt in the PTE sector (which includes, for example, agencies providing electricity and water) is supported by assets that generally earn revenues to cover expenses associated with debt, although non-commercial PTEs (e.g. public transport and housing) receive support from the Budget through grants and subsidies. Therefore a complete picture of the fiscal position requires a 'Total State' focus.

The challenge for fiscal strategy is to anticipate and manage the fiscal pressures associated with both cyclical and structural change. The long-term structural issue receiving attention in recent years is the potential pressure on government agencies that will emerge from ageing of the population. More significant pressures on public finances, however, are coming from non-demographic sources, such as the increased cost of, and demand for, services. For example, medical costs unrelated to the changing population age profile are driven by new but more expensive technology and medicines and a greater volume of medical procedures. This is the subject of a special Budget report this year, '*NSW Long-Term Fiscal Pressures Report*' 2006-07 Budget Paper No. 6. The Report concludes that on current projections, and with no change in policy, spending pressures will continue to mount for the foreseeable future. The gap between government spending and revenue could increase by 3.4 percentage points of GSP over the next 40 years.

The Government's fiscal strategy is guided by a set of fiscal principles and targets, which are set out in the *Fiscal Responsibility Act (FRA) 2005*. The 2006-07 Budget is the first in which performance against the principles and targets in the *FRA* are assessed, and the results are summarised in Table 1.2. Prior to 2005-06, fiscal strategy performance was assessed against a similar set of fiscal targets and principles in the *General Government Debt Elimination Act (GGDEA) 1995*[1].

[1] *See Chapter 1.2 of 2005-06 Budget Paper No. 2 for an assessment of performance against the GGDEA fiscal targets and principles.*

To address longer-term fiscal pressures the *Fiscal Responsibility Act 2005* requires that the Budget takes into account the anticipated future fiscal gap associated with ageing and other long term fiscal trends. Beginning with the 2006-07 Budget Papers, an assessment of the long term fiscal gap is required every five years (provided in Budget Paper No. 6). In addition, each Budget must include an assessment of the impact of that year's Budget measures on the long-term fiscal gap. This is discussed later in the chapter.

Recent Fiscal Developments

Over the decade to 2002-03, the growth in revenues exceeded the growth in expenses, with State revenues boosted by high levels of activity in the NSW property market, leading to a series of budget surpluses.

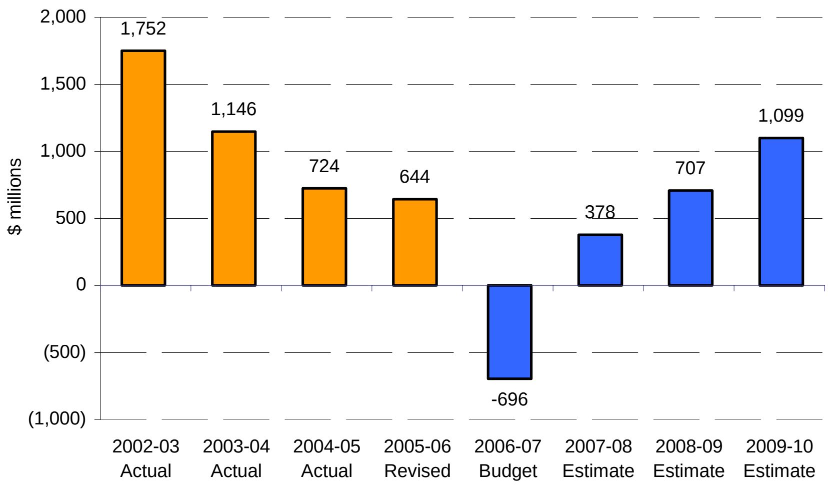
Over the past few years, however, the Budget result has weakened due to the need for higher expenditure in key service delivery areas and a cyclical and structural weakening in revenues. The Audit of Expenditure and Assets identified a gap in recent years between the growth in expenses (6 per cent) and the trend rate of growth in revenues (5 per cent). This has resulted in an operating deficit of $696 million in 2006-07 (see Chart 1.1).

The estimated net operating surplus of $644 million for 2005-06 is significantly higher than the original estimate of $303 million, and the Half-Yearly Review estimate of $21 million. With expenses expected to be close to both the original Budget and Half Yearly Review estimates, the higher Budget result reflects stronger than projected revenue in 2005-06. While State revenues (e.g. mainly taxation and Commonwealth grants) were weaker, operating revenues were $589 million higher, reflecting better than expected returns on financial assets. These returns are, however, unpredictable and cannot be relied upon when making budget plans over the forward years.

In the forward years the Budget result is expected to strengthen with a projected return to surplus in 2007-08. This is largely dependent upon achieving savings outlined in the February *Economic and Financial Statement* and a slowing in annual expenses growth, from 5.9 per cent per annum in the four years ending 2005-06 to 3.8 per cent per annum over the four years ending 2009-10.

This Budget, combined with measures announced in the *Economic and Financial Statement*, will reduce the growth in expenses by $1.3 billion per annum by 2009-10 (and cumulatively by $4.4 billion), and will reduce the average annual growth rate in total expenses by 0.6 per cent per annum. The saving of $1.3 billion comprises an efficiency dividend of $1.1 billion and specific savings measures of approximately $250 million, including savings on IT and Property.

Chart 1.1: Budget Result 2002-03 to 2009-10



Trends in Expenses and Revenue

Expenses

Over the past 4 years expenses have increased because of a number of factors, including higher wages paid to frontline employees (including teachers and nurses), as well as a more general build up in the cost, volume and quality of services provided in health, transport, social security and welfare, and public order and safety.

Table 1.1: Expenses Growth by Policy Area 2002-03 to 2006-07

Policy Area	*Total Expenses Annual average (%)*	*Non-Employee Related Expenses Annual average (%)*
Health	7.4	5.7
Education	4.2	3.4
Transport	9.3	9.5
Social Security & Welfare	6.6	5.4
Public Order & Safety	5.8	5.8
Total Expenses	5.8	5.1

- Health expenses have risen by 7.4 per cent a year on average over the four years to 2006-07, because of strong increases in both wage and non-wage costs. Non-wage costs tend to rise with advances in medical technology. This is a product of both the higher cost of many new medical interventions and the increased activity that new procedures allow. Employee-related costs have risen because of a larger health workforce and higher wages due to skills shortages in some areas, in particular nursing and certain medical specialties. Nevertheless, excluding employee-related costs, expenditure growth in health (5.7 per cent) exceeded the overall average growth in non-wage expenditure (5.1 per cent).

- Education expenses have increased by 4.2 per cent a year on average over the four years to 2006-07 – less than overall general government expenses growth – and by 3.4 per cent excluding the effect of the growth in employee costs. This reflects a steady school age population.

- Transport expenses have increased by 9.3 per cent on average over the four years to 2006-07. The main contributors to the growth in rail spending have been initiatives to improve safety and reliability, including increased maintenance of rolling stock, track signalling systems and improved security and infrastructure upgrades. Public safety and security has been enhanced by the employment of 600 transit officers and installation of closed-circuit TV monitoring. The new Millenium rail cars (141 carriages) are all now in service with further rollingstock for the intercity and Hunter rail lines due in service later in 2006. Expenditure on roads has increased by an average of 3.3 per cent a year largely because of an increase in depreciation charges and operational expenses.

- Spending on Social Security and Welfare has grown by 6.6 per cent a year on average, and by 5.4 per cent excluding the effect of employee related costs. Expenditure on ageing and disability services has grown by 8.8 per cent a year over the four years to 2006-07, and expenditure by the Department of Community Services has increased by 10 per cent per year due to a major funding boost for child protection and early intervention programs.

- Spending on Public Order and Safety has grown by 5.8 per cent a year on average, with the authorised number of police officers in New South Wales rising from 14,054 to 15,206 in the four years to 2006-07 and the number of prison inmates increasing by around 4.2 per cent per annum.

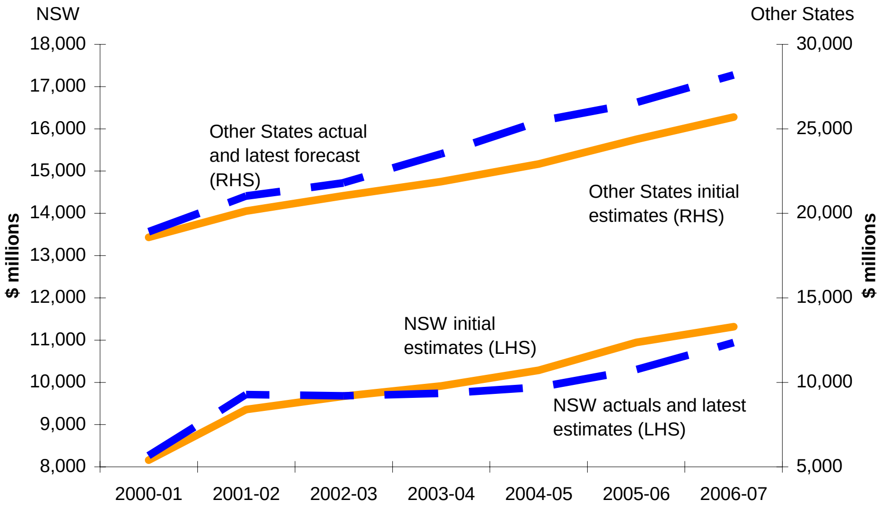
Revenue

As a result of the impact of a cyclical slowing of property markets on transfer duty and less than expected Commonwealth funding, revenue growth has slowed. In addition, Government decisions to cut taxes since the last Budget have lowered revenue growth. Over the four years to 2006-07, total revenue has grown by an average of only 4 per cent per annum, below the long-run average rate of 5 per cent per annum[2], and is expected to grow by 2.4 per cent in 2006-07.

- Revenue from Commonwealth grants has grown by an average of only 3.7 per cent per annum in the four years to 2006-07. This reflects the minimal growth of 2.5 per cent per annum in general purpose grants. GST revenue grants have delivered New South Wales less funding from the Commonwealth than was expected when the new arrangements were implemented in 2000. In real per capita terms, GST grants to New South Wales are estimated to be around 5 per cent lower in 2006-07 than in 2001-02, while grants to the other States in real per capita terms have risen by around 10 per cent over this period.

- By 2006-07 New South Wales is estimated to have received around $1.1 billion less than expected since the introduction of GST. Every other State has received more in grants than was initially expected (Chart 1.2).

Chart 1.2: GST Revenue – Initial Estimates and Outcomes



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2 *The long-run average revenue growth was calculated using ABS GFS total revenue data over a 20-year period. Average growth in real terms of 2.5 per cent over this period is equivalent to nominal growth of 5 per cent currently.*

- Taxation revenue growth averaged 4.3 per cent per annum over the four years to 2006-07, with the second largest revenue source (purchaser transfer duty) declining in total by nearly 12 per cent. Although the rate of growth in taxation revenue is expected to recover in the forward years to trend rates of growth, taxation revenue will remain below trend.

- Since August 2005, the State Government:

  - abolished vendor duty in August 2005, reducing revenue by $265 million in 2005-06 and $382 million in 2006-07;

  - increased the tax-free threshold for land tax for the 2006 land tax year to $352,000 at a cost of $43 million in 2005-06 and $53 million in 2006-07;

  - provided tax relief to clubs from 2006-07 at a cost to revenue of $233 million over the next 4 years;

  - announced a timetable for the abolition of the taxes listed for review in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, beginning with the abolition of hire of goods duty in 2007-08. These taxes are estimated to raise around $680 million in 2006-07. See Chapters 3 and 8 for further details;

  - will provide a payroll tax rebate from 1 July 2006 for businesses in high-unemployment regions liable for payroll tax for the first time at a cost of $95 million over seven years; and

  - other taxation measures, announced in this Budget, will reduce revenue by $57 million in 2006-07 (see Chapter 3 for details).

Audit of Expenditure and Assets

In August last year, the Government commissioned an independent audit of Government expenditure and assets. The Government's response to this review, outlined in the *Economic and Financial Statement* in February 2006 and incorporated in this Budget, is to make structural improvements to expenditure, rather than to increase taxation. In so doing, this Budget improves the State's finances and fosters the conditions necessary to support economic growth. Such improvements take time, and the current strength of the balance sheet allows a steady adjustment to be made.

By 2009-10, changes introduced in response to the Audit and in this Budget will reduce expenses growth by $1.3 billion per annum. That will reduce the average annual growth rate in total expenses by 0.6 per cent, helping align growth in expenses more closely with trend revenue growth.

Key initiatives include:

- extending the 1 per cent efficiency dividend on agency non-discretionary[3] expenditures to 2007-08, saving $300 million, and a further efficiency dividend of $200 million in 2008-09;

- reducing employee costs by removing up to 5,000 public sector positions over the next two years, and through a range of other measures involving wages and conditions (see section on Wages Policy below); and

- a range of reforms to promote efficiency and productivity in the way the Government delivers its services, including reducing the number of government agencies, developing a new Performance Management and Budgeting System, the creation of a new property authority and achieving greater efficiencies in recruitment and in procurement (including information and communications technology – see Chapter 2 of this Budget Paper as well as the Infrastructure Statement, Budget Paper No. 4).

The objective in making these structural reforms is to help the Government operate more efficiently so that a higher quality and quantity of frontline services can be delivered at a sustainable level of expenditure. Although the reforms include a reduction in the overall number of public sector positions, there will be no impact on frontline service delivery. In fact, there will be increases in front-line staff such as police and health employees to meet ongoing high demand in those areas. For example, there will be a permanent increase of 750 in the authorised number of police officers at an estimated cost of $48.2 million in 2006-07 ($67.7 million per annum).

Wages Policy

The Government has delivered wage increases of 60 per cent to its employees over the decade from 1996 – twice as fast as inflation and faster than private sector wage growth in New South Wales. Since the inception of the Wage Cost Index in the September quarter 1997, NSW public sector wages have grown at an annualised rate of 4.6 per cent, compared with average growth of 3.7 per cent in the private sector in New South Wales. The Government's future wages policy is to maintain those real wage improvements. While above-inflation wage increases were necessary to attract and retain staff in some front-line areas, the balance has been redressed. The objective ahead is to provide wage increases in line with inflation (when current agreements expire during 2008).

[3] *Excludes finance costs, depreciation, defined benefit superannuation and other non-discretionary expenditures*

Employee-related expenses are the most important single influence on the level and future growth of total expenses, and therefore the Budget result. They account for almost half of government expenses, and each one per cent increase in employee expenses – either from increases in rates of pay or numbers of staff – costs over $200 million per annum.

While employee numbers have risen in recent years – by about 1 per cent per annum on a full-time equivalent basis – it is growth in NSW general government wages that has been the major driver in employee-related expenses. Employee-related expenses rose at an annual rate of 6.3 per cent per annum over the four years to 2006-07. Of the 6.3 per cent increase, 5.1 per cent resulted from wage increases, 1 per cent from growth in employee numbers with the remaining 0.2 per cent resulting from other causes, including changes in workforce composition.

Wage judgements by the NSW Industrial Relations Commission and skill shortages in specific areas, such as health, have contributed to this growth. In 2006-07, growth in employee-related expenses is projected to moderate to 3.4 per cent, reflecting that most major public sector awards agreed over the past two years provide for increases of around 4 per cent per annum for four years, and do not allow for any further claims until 2008.

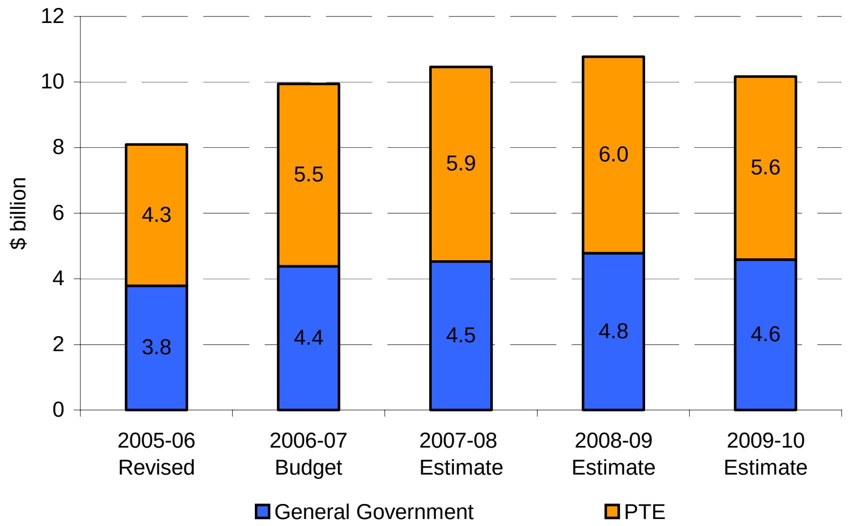
The Government continues to pursue greater flexibility in the management of its workforce, to deliver efficiencies and lower overall public sector employee costs. At times this may result in some employees being surplus to current Government service priorities and needs. The Government, in its response to the Audit, reaffirmed its commitment to make such employees redundant as a last and unavoidable resort, in circumstances where an alternative position is not found within 12 months. A four week cap for Senior Executive Service staff on the unattached list has also been imposed.

CAPITAL EXPENDITURE

In addition to recurrent expenses, the Government has in this Budget committed substantial additional funds for capital expenditure. In 2006-07, total State infrastructure spending will be $9.9 billion, an increase of 22.8 per cent on 2005-06.

This comprises $4.4 billion expenditure by the general government sector (an increase of 15.8 per cent on the previous year) and over $5.5 billion by the PTE sector (an increase of 29.0 per cent on the previous year). This is a substantial lift in the level of capital expenditure in real terms – to a level more than 80 per cent higher than the average level of the 1990s, and double the average level of the 1980s.

Chart 1.3: Total State Capital Expenditure by Sector, 2005-06 to 2009-10



The commitment to infrastructure will continue over the forward years. Over the four years to 2009-10, total State spending on infrastructure is estimated to be $41.3 billion, 45.1 per cent higher than the total of the four years ending June 2006.

In the general government sector spending on infrastructure over the next four years is estimated to be $18.3 billion, 32.5 per cent higher than the preceding four years, and the PTE sector plans to invest 57 per cent more in infrastructure, for a total of $23.1 billion. Investment in electricity, rail, water and ports infrastructure are the main contributors to the significant increase in PTE capital expenditure. More detailed information on developments in infrastructure investment over the next decade is provided in the NSW Government's *State Infrastructure Strategy*, published in May 2006, and in Budget Paper No. 4 for the four-year budget period.

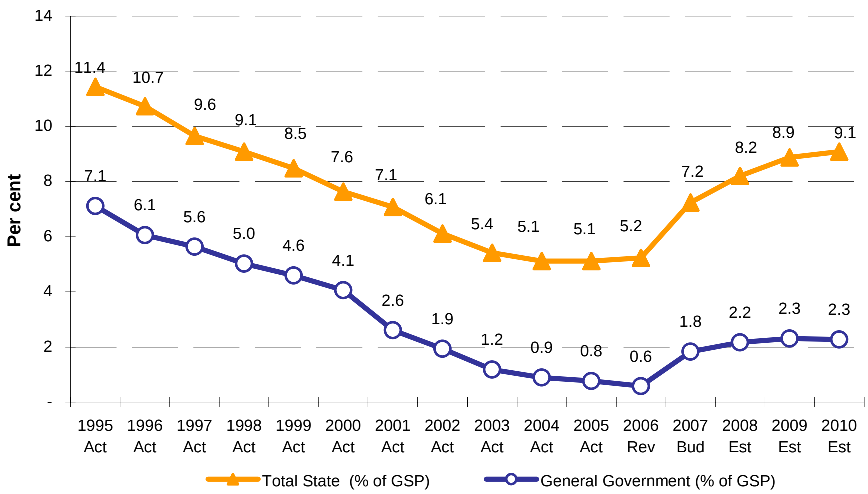
With a smaller operating surplus over the next 4 years, planned increases in general government infrastructure spending will be funded to a greater extent by borrowing than has previously been the case.

NET DEBT AND NET FINANCIAL LIABILITIES

Net Debt

The Government's fiscal strategy over the past decade has helped to strengthen the NSW balance sheet. After an almost unbroken string of cash deficits stretching back to the early 1960s the Government delivered nine consecutive cash surpluses to 2004-05. The proceeds of those surpluses were used to help reduce general government sector underlying net debt from $12.2 billion in 1995 (7.1 per cent of GSP) to $2.3 billion in June 2005 (0.8 per cent of GSP)[4].

Chart 1.4: Underlying Net Debt as a Percentage of Gross State Product at June 1995 to June 2010[(a)]



(a) Excluding prepayment/deferral of superannuation contributions.

Source: NSW Treasury for net debt; GSP from ABS (actual) and NSW Treasury for estimates from 2005-06.

The level of net debt in the general government sector is projected to fall to $1.9 billion at June 2006 (0.6 per cent of GSP), but then to increase to $9.1 billion (2.3 per cent of GSP) by June 2010. A significant part of the increase in net debt ($2.2 billion), results from funding to reduce superannuation liabilities (this comprises $1.4 billion in cash transfers and $780 million in borrowing). The balance can be attributed to the increased funding requirements associated with a smaller operating surplus and increased infrastructure expenditure.

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4 The Treasury definition of underlying general government net debt is equivalent to the ABS definition but excludes financial assets that are allocated to fund other liabilities through legislation or contract (for example, the net financial assets of the Liability Management Ministerial Corporation).

For the total State sector, net debt is also set to rise over the forward years after declining substantially over the past decade. From 11.4 per cent of GSP ($19.6 billion) in 1995, State sector net debt fell to 5.1 per cent of GSP ($15.6 billion) at June 2005. Total State sector net debt is projected to increase to 9.1 per cent of GSP ($36.5 billion) by June 2010, largely a reflection of a significant increase in PTE net debt.

Since 2000, net debt in the PTE sector has increased substantially in nominal terms, from $7.5 billion (3.2 per cent of GSP) to $14.8 billion at June 2006 (4.8 per cent of GSP). The PTE sector's significant capital expenditure plans over the forward estimates period will see net debt continue to increase, by $12.3 billion to an estimated $27.1 billion (7.1 per cent of GSP) as at June 2010. With higher capital expenditure, earnings in the PTE sector are projected to increase strongly over the next four years enabling higher debt levels to be supported (see Chapter 5 of this Budget Paper).

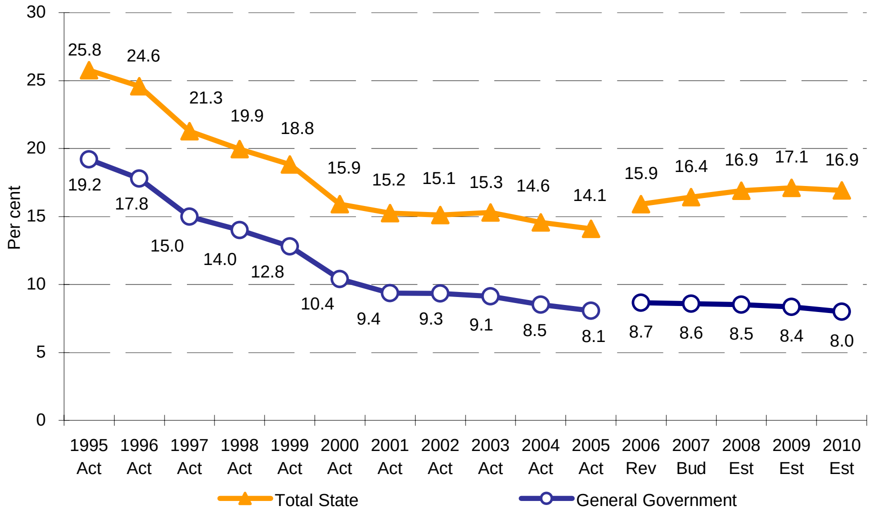
Net Financial Liabilities

The *Fiscal Responsibility Act 2005* introduced a new fiscal target - net financial liabilities in the general government sector as a percentage of gross state product – to provide a broad measure that encapsulates the full range of State financial liabilities. In addition to debt, it includes unfunded superannuation – which accounts for two-thirds of all liabilities and more than twice the level of debt – insurance, and other liabilities (such as long-service leave entitlements). General government net financial liabilities have fallen as a share of the economy over the last decade – from 19.2 per cent of GSP ($32.8 billion) at June 1995 to 8.1 per cent of GSP ($24.7 billion) at June 2005 (see Chart 1.5).

General government net financial liabilities are projected to increase by 0.6 per cent of GSP to 8.7 per cent of GSP at June 2006 – due to the effects of adopting Australian Equivalents to International Financial Reporting Standards (AEIFRS) – and then to decline over the forward years to 8.0 per cent of GSP by June 2010.

Total State sector net financial liabilities are projected to increase as a share of GSP from 14.1 per cent at June 2005 to 15.9 per cent at June 2006. Adjusting for the effect of adopting AEIFRS, however, total state net financial liabilities would have declined to 13.3 per cent of GSP. Over the forward years total State net financial liabilities are projected to increase to 16.9 per cent of GSP at June 2010. The increase is driven principally by the additional debt required to fund higher PTE capital expenditure.

Chart 1.5: Net Financial Liabilities of the General Government Sector and the Total State Sector as a Percentage of Gross State Product at June 1995 to June 2010*



Source: NSW Treasury for net financial liabilities; GSP from ABS (actual) and NSW Treasury (estimates from 2005-06).

* *Series break in 2005-06 as a result of the adoption of Australian Equivalents to International Financial Reporting Standards. It has the effect of increasing the reported level of net financial liabilities. For example, general government sector net financial liabilities in June 2006 would be 7.3 per cent without the change in standards.*

Fiscal Outlook: Risks and Uncertainties

There are a number of risks and uncertainties attached to any projections – some of which can be anticipated (e.g. ageing of the population) and others which cannot (e.g. economic recession or natural disaster). A strong balance sheet is essential to provide flexibility in dealing with both types of risk.

The impact of the ageing of the population on health expenditures is an example of a fiscal shock that can be anticipated, and one that will start to become evident in the next ten years. As discussed in detail in Budget Paper No. 6 *NSW Long-Term Fiscal Pressures Report*, the ageing effects will be intensifying over the next decade. For example, the New South Wales population aged 65 and over currently increases by fewer than 20,000 people per year. By 2012, this age group will increase by around 40,000 per year and will continue to do so through to the end of the 2020s.

Budget Paper No. 6 also concludes that there are significant longer term pressures likely to come from non-demographic sources – growth in expenditure that is not driven by ageing of the population or the state of the economy. Rising health expenses associated with higher technology-related costs and greater numbers of procedures being performed are examples of such non-demographic cost factors.

Over the forward estimates period the improvement in the Budget result is premised upon expenses growing more slowly than trend revenue growth (5 per cent). The Government has instituted a number of expense saving strategies which will deliver annual savings of $1.3 billion per annum by 2009-10.

For more detailed information on revenues, expenditure, Budget results and liabilities Tables 1.3 and 1.4 provide a comprehensive time series of key fiscal indicators for New South Wales – general government and total state sectors – from 1997-98 to 2009-10.

RECENT PERFORMANCE AND PROGRESS AGAINST FISCAL TARGETS AND PRINCIPLES

The Government reports every year in the Budget Papers on the progress achieved against the fiscal targets and principles that underlie the Government's fiscal strategy. This is the first year in which progress is reported against the fiscal targets and principles of the *Fiscal Responsibility Act 2005*.

Table 1.2 summarises the progress achieved against the fiscal targets and fiscal principles, and assesses the achievability of fiscal targets and principles in the future.

Table 1.2: Summary of Progress against Fiscal Principles in the *Fiscal Responsibility Act*, 2005

Fiscal Principle	*Progress Indicator*	*Legislative Target*	*Status*
Fiscal targets:			
- **Medium term**	General government sector net financial liabilities	At or below 7.5% GSP by June 2010	General government net financial liabilities estimated to decline from 8.7 per cent of GSP in June 2006 to 8.0 per cent of GSP at 30 June 2010.
	General government sector net debt	Maintain as share of GSP at or below level at June 2005 (0.8 per cent of GSP).	General government net debt estimated to be 2.3 per cent of GSP at 30 June 2010 (1.7 per cent excluding the increase in debt associated with the reduction in superannuation liabilities).
- Long term	General government sector net financial liabilities	At or below 6% of GSP by June 2015	Achievable on current projections
	General government sector net debt	Maintain as share of GSP at or below level at June 2005	Achievable on current projections
	Total state sector unfunded super-annuation liabilities	Eliminated by 30 June 2030	Achievable given current level and projections. Employer contributions being assessed periodically to ensure full funding by 2030. Long-term funding plan recognises that gross liabilities will continue to increase until 2010-11, and then decline subsequently due to the retirement of active members. Total state underlying net unfunded liabilities reduced by $4.3 billion between June 1996 and June 2007. Total state underlying net unfunded superannuation liabilities are estimated to be $18.3 billion in June 2006 (5.7 per cent of GSP), and $15.5 billion in June 2010 (3.9 per cent of GSP).

Table 1.2: Summary of Progress against Fiscal Principles in the *Fiscal Responsibility Act 2005* (cont)

Fiscal Principle	*Progress Indicator*	*Legislative Target*	*Actual/Status*
1. Keeping the Budget in Surplus	Net Operating Result	Net Operating Result in surplus	Operating result projected to be in deficit in 2006-07, and return to surplus in 2007-08.
2. Constrained growth in net cost of services and expenses	Growth in net cost of services (NCOS) and expenses	4-year average annual growth (1) ending with the financial year prior to the Budget year; and (2) for the Budget year and forward estimates, not to exceed long-term average revenue growth.	Average annual growth of the following variables for the 4-year periods ending 2005-06 and 2009-10 respectively are: • Total expenses 5.9 per cent and 3.8 per cent. • NCOS is 5.1 per cent and 4.3 per cent. • Long-term average revenue growth is 5 per cent per annum.
3. Managing public sector employee costs	Public sector employee costs	Government policy in negotiating rates of pay and conditions to be consistent with fiscal targets.	General government employee-related costs increased by an average of 8.0 per cent per annum over the four years to 2005-06 (including substantial increase in wages to teachers and nurses). Current wage agreements of 4 per cent per annum to 2008.
4. Evaluation of capital expenditure proposals	Stability of capital project budgets	Capital expenditure proposals to be evaluated in accordance with government procurement policy requirements.	Preliminary analysis, based on a sample of 370 major construction projects commenced before and after introduction of Gateway reviews and other procurement reforms (such as agency accreditation and enhanced Treasury assessment and monitoring), indicates a reduction in the order of 50 per cent in cost over-runs.
5. Managing State finances with a view to long-term fiscal pressures	The long-term fiscal gap	Reporting the impact of the Budget on the long-term fiscal gap	The 2006-07 Budget increases the long-term fiscal gap by 0.1 percentage points, with expense decisions reducing the gap by 0.3 percentage points offset by revenue decisions increasing the gap by 0.4 percentage points.
6. General government net worth	General government sector net worth	At least maintain in real terms	General government net worth increased by an average 4.3 per cent per annum in real terms from June 1997 to June 2006.
7. Superannuation liabilities	Unfunded super liability of GG sector and PTE sector	Manage and fund the liability to meet the long-term target, subject to periodic review	(See long-term Fiscal Targets above.)

Table 1.2: Summary of Progress against Fiscal Principles in the *Fiscal Responsibility Act*, *2005* (cont)

Fiscal Principle	*Progress Indicator*	*Legislative Target*	*Actual/Status*
8. Total asset management	Best practice asset maintenance or management policies	Progress reporting in budget papers on measures to implement this principle	In 2005 Treasury received Total Asset Management (TAM) plans from agencies responsible for 96 per cent of general government asset holdings. In October 2005, the Audit Office confirmed that TAM policy provides a best practice framework to improve asset management, and integration of TAM planning with the Budget process was starting to have a positive impact on asset management practices across the government sector.
9. Prudent risk management	Financial risk management comprising total state sector net financial liabilities; contingent liabilities; and total state debt and financial assets	Progress reporting in budget papers on measures to implement this principle	Aggregate risk is managed by Treasury, TCorp and the NSW Self Insurance Corporation. Includes ongoing review of asset allocation and risk management policies and procedures of authorities subject to the *Public Authorities (Financial Arrangements) Act 1987*. Agency and project level risk identification procedures and strategies are in place or being developed through the Financial Management Framework; the Commercial Policy Framework; and Total Asset Management guidelines. The latter incorporates *Working with Government: Policy and Guidelines for Privately Financed Projects* (Nov 2001) dealing with private sector participation in the provision of public infrastructure.
10. Tax restraint	Impact of tax policy measures	Adjustments to legislated tax rates, thresholds and bases to be made with maximum possible restraint; policies should enable predictability and stability of tax regime.	Net effect of all tax policy changes since 1999-00 is to reduce the NSW tax burden in 2006-07 by around $1 billion p.a.

IMPACT OF 2006-07 BUDGET ON THE LONG-TERM FISCAL GAP

Budget Paper No. 6 details the long-term fiscal pressures that New South Wales may face. It is estimated that demographic and other pressures could lead to a fiscal gap of around 3.4 per cent of GSP in 40 years time. One feature of the *Fiscal Responsibility Act 2005* is a requirement to report in every budget the long-term fiscal consequences of expenditure and revenue measures. Thus, in addition to the usual budget reporting on the immediate effects of policy initiatives, the Government will provide an assessment as to whether policy changes will widen or narrow the long-term fiscal gap as reported in Budget Paper No. 6. This is the first such reporting in Australia. It is a significant requirement and considerably increases fiscal transparency.

In coming years, it is anticipated that the impact on the fiscal gap for each policy change will be capable of being reported. This will require a significant investment in both the capacity to model such results as well as policies being costed by their impact on different age cohorts. While such capabilities are being developed, this year's report relies on the impact of policy changes on aggregate revenues and expenses. The methodology employed is to compare the fiscal gap projected using the current budget and forward estimates with the projected fiscal gap if there had been no policy changes to revenues or expenses since the 2005-06 Budget. The difference between these estimates is the impact of the Budget on the long-term fiscal gap.

On this basis, changes since the 2005-06 Budget, reflected in the 2006-07 Budget and forward estimates, will increase the fiscal gap by 0.1 percentage points, from 3.4 per cent of GSP to 3.5 per cent of GSP.

Policy changes impacting expenses, largely reflecting the slowing in the growth rates of expenses, reduce the fiscal gap by 0.3 percentage points.

Revenue policy changes, however, more than offset that improvement and increase the fiscal gap by 0.4 percentage points. The phased-in reductions of stamp duties listed for review in the Inter-Governmental Agreement on the Reform of Commonwealth-State Financial Relations alone account for a 0.2 percentage point increase in the fiscal gap. Without these tax reductions the impact of the 2006-07 Budget would have been to reduce the fiscal gap by 0.1 percentage points.

TEMPORARY DEPARTURE FROM THE PRINCIPLES OF THE *FISCAL RESPONSIBILITY ACT 2005*

With increases in expenditure on key services, weaker revenue growth along with the rapid growth in capital expenditure, there will be an increase in general government net debt as a share of gross state product over the forward estimates period. This will result in a temporary departure from the net debt target contained in the *Fiscal Responsibility Act 2005* (to maintain general government underlying net debt at or below its level at 30 June 2005, which was 0.8 per cent of GSP).

A 32.5 per cent increase in capital expenditure in the general government sector over the four years to 2009-10 (to a total of $18.3 billion over four years) will require an increase in net debt of $5.1 billion. In addition, there will be an increase in net debt of $2.2 billion in 2006-07 to help fund a reduction in the level of superannuation liabilities. This transfer of funds to pay down superannuation liabilities is consistent with the *Fiscal Responsibility Act 2005*, which permits an increase in one component of net financial liabilities (e.g. debt) to fund a reduction in another.

As the housing sector recovers in New South Wales, the cyclical weakening in the Budget result flowing from softer revenues will dissipate. However, improvements in the operating result will take a number of years. Thus the underlying level of net debt in the general government sector will remain above the target in the *Fiscal Responsibility Act 2005* over the forward estimates period. Adhering to the net debt target in the short term is not consistent with the Government's fiscal strategy, as it would require unnecessarily harsh cutbacks in service delivery or increases in taxation. The strength of the balance sheet permits time for a progressive structural improvement.

The Government's Budget plans will restore the operating result to surplus in 2007-08, and see underlying general government net debt heading toward the target of 0.8 per cent or less of GSP by 2015 (the long-term fiscal target). Even with higher levels of government debt, the main fiscal target in the *Fiscal Responsibility Act 2005*, reducing the State's net financial liabilities (of which net debt is one component) over time remains on track. Net financial liabilities will steadily reduce to around 8.0 per cent of GSP by 2009-10. While this is above the 2010 medium-term target of 7.5 per cent, the deviation is consistent with the Government's fiscal strategy given the fiscal challenges currently faced.

The trends in revenue and expenses underpinning the forward estimates are consistent with meeting the *Fiscal Responsibility Act's* long-term targets for net financial liabilities by June 2015.

Table 1.3: Key Fiscal Indicators NSW 1997-98 to 2009-10 (per cent)

	1997-98 Actual	*1998-99 Actual*	*1999-00 Actual*	*2000-01 Actual*	*2001-02 Actual*	*2002-03 Actual*	*2003-04 Actual*	*2004-05 Actual*	*2005-06 Revised*	*2006-07 Budget*	*2007-08 Est*	*2008-09 Est*	*2009-10 Est*
General Government Sector													
Revenue/GSP	13.2	13.3	13.2	13.0	13.0	13.1	13.0	12.8	12.8	12.5	12.3	12.2	12.0
Revenue Growth - Nominal	4.8	5.8	5.5	5.1	5.5	6.5	4.5	4.2	5.1	2.4	4.4	4.7	4.4
Revenue Growth - Real [(a)]	3.5	5.4	3.3	0.4	3.3	3.2	1.1	0.0	0.5	-0.3	1.9	2.1	1.8
Tax Revenue/GSP	6.2	6.5	6.6	5.4	5.1	5.1	5.2	5.0	4.9	4.9	4.9	4.8	4.8
Tax Revenue Growth - Nominal	10.0	9.4	7.6	-12.2	-1.0	7.1	6.2	2.0	3.1	5.7	4.5	5.3	5.3
Tax Revenue Growth - Real[(a)]	8.7	9.0	5.4	-16.0	-3.0	3.7	2.7	-2.0	-1.3	2.9	2.0	2.7	2.7
Expenses/GSP	12.6	12.8	12.3	12.4	12.4	12.4	12.6	12.6	12.6	12.7	12.2	12.0	11.7
Expenses Growth - Nominal	3.0	7.2	2.2	7.2	5.5	6.2	6.5	5.4	5.4	5.7	1.9	4.0	3.6
Expenses Growth - Real [(a)]	1.7	6.8	0.2	2.5	3.4	2.9	3.0	1.3	0.8	2.9	-0.6	1.4	1.0
Net Operating Result/GSP	0.6	0.5	0.9	0.6	0.6	0.6	0.4	0.2	0.2	-0.2	0.1	0.2	0.3
Net Operating Result /Revenue	4.8	3.6	6.6	4.6	4.6	4.9	3.0	1.8	1.6	-1.7	0.9	1.5	2.3
Gross Capital Expenditure/GSP	1.3	1.3	1.4	1.2	1.2	1.2	1.2	1.1	1.1	1.2	1.3	1.3	1.3
Net Lending/GSP	-0.2	-0.1	0.6	0.2	0.2	0.2	0.0	-0.1	-0.2	-0.7	-0.4	-0.3	-0.1
Net Lending/Revenue	-1.6	-0.5	4.3	1.6	1.7	1.3	0.1	-0.5	-1.4	-5.8	-3.2	-2.7	-1.1
Net Debt(underlying)/GSP	5.0	4.6	4.1	2.6	1.9	1.2	0.9	0.8	0.6	1.8	2.2	2.3	2.3
Net Debt (underlying)/Revenue	38.0	34.5	30.7	20.1	14.9	9.0	6.9	5.9	4.5	14.7	17.7	19.0	19.0
Interest/Revenue	5.4	4.7	4.4	3.2	2.6	2.2	2.1	2.1	2.1	2.3	2.6	2.8	2.9
Net Financial Liabilities/GSP	14.0	12.8	10.4	9.4	9.3	9.1	8.5	8.1	8.7	8.6	8.5	8.4	8.0
Net Financial Liabilities/Revenue	106.0	96.3	78.9	72.1	71.8	69.8	65.8	62.9	67.7	68.8	69.2	68.7	66.7

(a) Deflated using the gross non-farm product deflator.

Table 1.3: Key Fiscal Indicators NSW 1997-98 to 2009-10 (per cent) (cont)

	1997-98 Actual	*1998-99 Actual*	*1999-00 Actual*	*2000-01 Actual*	*2001-02 Actual*	*2002-03 Actual*	*2003-04 Actual*	*2004-05 Actual*	*2005-06 Revised*	*2006-07 Budget*	*2007-08 Est*	*2008-09 Est*	*2009-10 Est*
Total State Sector													
Net Operating Result/GSP	0.9	0.6	1.2	0.9	0.9	0.6	0.4	0.2	0.3	-0.2	0.1	0.2	0.3
Net Operating Result /Revenue	5.7	3.4	6.8	5.4	5.8	4.0	2.7	1.0	2.0	-1.2	0.4	1.4	2.0
Gross Capital Expenditure/GSP	2.1	2.4	2.4	2.2	2.3	2.4	2.3	2.3	2.5	2.9	2.9	2.8	2.5
Net Lending/GSP	0.0	-0.3	0.3	0.5	0.0	-0.2	-0.3	-0.7	-0.8	-1.6	-1.4	-1.2	-0.8
Net Lending/Revenue	0.0	-1.9	1.8	2.7	0.2	-1.5	-2.1	-4.3	-4.9	-10.8	-9.3	-7.8	-5.3
Net Debt(underlying)/GSP	9.1	8.5	7.6	7.1	6.1	5.4	5.1	5.1	5.2	7.2	8.2	8.9	9.1
Net Debt (underlying)/Revenue	54.5	51.1	45.3	41.0	37.9	33.7	32.2	32.4	33.8	47.7	54.9	59.8	61.9
Interest/Revenue	6.4	5.4	5.0	4.6	3.8	3.7	3.8	4.0	3.8	4.2	4.6	5.0	5.2
Net Financial Liabilities/GSP	19.9	18.8	15.9	15.2	15.1	15.3	14.6	14.1	15.9	16.4	16.9	17.1	16.9
Net Financial Liabilities/Revenue	119.7	113.4	94.3	88.3	93.6	95.0	91.8	89.4	102.8	108.2	113.0	115.2	115.3

Source: NSW Treasury for expenses, revenue and liabilities, GSP from ABS (actual) and NSW Treasury (estimates from 2005-06).

Table 1.4: Key Fiscal Indicators NSW 1997-98 to 2009-10 ($m)

	1997-98 Actual	*1998-99 Actual*	*1999-00 Actual*	*2000-01 Actual*	*2001-02 Actual*	*2002-03 Actual*	*2003-04 Actual*	*2004-05 Actual*	*2005-06 Revised*	*2006-07 Budget*	*2007-08 Est*	*2008-09 Est*	*2009-10 Est*
General Government Sector													
Total Revenue	27,345	28,944	30,528	32,071	33,830	36,032	37,664	39,231	41,220	42,196	44,068	46,131	48,143
Tax Revenue	12,903	14,122	15,191	13,343	13,216	14,154	15,026	15,332	15,812	16,719	17,472	18,394	19,365
Total Expenses	26,035	27,905	28,525	30,584	32,265	34,280	36,517	38,506	40,576	42,892	43,690	45,424	47,043
Net Operating Result	1,309	1,038	2,003	1,487	1,566	1,752	1,146	724	644	(696)	378	707	1,099
Gross Capital Expenditure	2,760	3,002	2,733	2,859	3,096	3,349	3,331	3,331	3,788	4,387	4,528	4,782	4,590
Net Lending/Borrowing	(426)	(135)	1,322	525	579	463	39	(178)	(591)	(2,466)	(1,395)	(1,238)	(516)
Net Debt (underlying)	10,403	9,990	9,385	6,461	5,056	3,244	2,593	2,321	1,856	6,190	7,781	8,770	9,133
Interest Expenses	1,490	1,362	1,343	1,016	868	803	788	818	883	991	1,166	1,293	1,384
Net Financial Liabilities	28,989	27,883	24,101	23,132	24,293	25,158	24,790	24,686	27,900	29,044	30,492	31,694	32,100
Total State Sector													
Total Revenue	34,495	36,130	39,032	42,651	42,014	44,305	46,163	48,196	49,866	51,341	53,550	56,306	58,921
Total Expenses	32,540	34,898	36,359	40,350	39,598	42,554	44,903	47,735	48,860	51,936	53,339	55,498	57,741
Net Operating Result	1,955	1,232	2,673	2,301	2,416	1,751	1,260	461	1,006	(595)	210	808	1,180
Gross Capital Expenditure	4,436	5,142	5,460	5,365	6,080	6,697	6,705	6,982	8,093	9,941	10,455	10,764	10,161
Net Lending/(Borrowing)	(17)	(678)	687	1,152	87	(653)	(986)	(2,055)	(2,428)	(5,544)	(4,981)	(4,375)	(3,110)
Net Debt (underlying)	18,801	18,460	17,664	17,499	15,904	14,930	14,875	15,638	16,862	24,498	29,393	33,650	36,479
Interest Expenses	2,201	1,946	1,954	1,954	1,595	1,653	1,734	1,907	1,899	2,140	2,462	2,817	3,088
Net Financial Liabilities	41,304	40,985	36,813	37,680	39,304	42,108	42,373	43,067	51,267	55,572	60,538	64,882	67,928

1.3 GENERAL GOVERNMENT SECTOR OPERATING STATEMENT

The general government sector financial statements for 2006-07 and forward years are prepared in accordance with government finance statistics (GFS) principles.

2006-07 BUDGET

For 2006-07, the Budget result is expected to be an operating deficit of $696 million. The Budget result has weakened over the past three years as a result of cyclical and structural factors, and it is anticipated that in coming years the State's finances will continue to be under pressure from relatively slow revenue growth and increased demand for services.

The NSW Budget is adversely impacted by Commonwealth funding decisions. New South Wales continues to be disadvantaged by the method of calculating the distribution of GST funds. In addition, the growth in Specific Purpose Payments from the Commonwealth Government is below the underlying growth in the cost of service delivery.

The NSW Budget result is expected to return to surplus in 2007-08, estimated at $378 million rising to $1,099 million in 2009-10. (see Table 1.5).

Revenue

Total revenues for 2006-07 are estimated to be $42,196 million, an increase of $976 million (or 2.4 per cent) over the revised estimate for 2005-06.

Taxation revenue is expected to increase by $907 million to $16,719 million in 2006-07, an increase of 5.7 per cent from the 2005-06 revised estimate. Growth in payroll tax and mild recovery in purchaser duty are the two largest contributors to revenue growth. Offsetting these are the impact of tax cuts announced since August 2005 and in this Budget on the 2006-07 Budget result of $481 million.

Commonwealth general purpose grants are estimated at $10,946 million, an increase of 3.1 per cent from the 2005-06 revised estimate. GST revenue grants have delivered New South Wales less funding from the Commonwealth than was expected when the new arrangements were implemented in 2000.

Commonwealth specific purpose grants are expected to increase to $6,679 million, a rise of $269 million, or 4.2 per cent, from the 2005-06 revised estimate. In May 2006 the Commonwealth announced an additional $960 million for upgrade of the Pacific and Hume Highways. The additional funding is being recognised as revenue over the period in which the capital expenditure is being incurred.

Dividends and income tax equivalent payments from public trading enterprises are expected to decrease by 6.6 per cent over the 2005-06 level to $1,664 million. The lower revenue is primarily due to falling Electricity and Water, Property and Resources sector payments.

Total operating revenues are expected to decrease to $5,021 million in 2006-07, a decrease of 6.9 per cent from the 2005-06 revised estimate. This reflects the expectation that the extraordinary investment returns experienced in 2005-06 will not continue and that revenues will return to more normal levels in 2006-07.

(Full details of revenue estimates are provided in Chapter 3).

Expenses

Total expenses in 2006-07 are estimated to be $42,892 million, an increase of 5.7 per cent on the 2005-06 revised estimates. The focus of the 2006-07 Budget includes the key areas of:

- *health* – continuing the commitment to increasing bed capacity, expanding mental health services, prioritising quality health care through reforming work practices and patient management, emphasising promotion, prevention and early intervention, integrating primary health care facilities, expanding the number of General Practice services co-located with hospital emergency departments and improving training and opportunities for nurses and other key health professionals;

- *education* – reducing class sizes in Kindergarten, Year 1 and Year 2 to State-wide averages of 20, 22 and 24 respectively, increasing school maintenance works, developing flexible innovative approaches to improve learning outcomes for Aboriginal students and establishing ten trade schools;

- *disability services* – improving options for people with disabilities, providing increased support for carers, and expanding prevention and early intervention services;

- *transport* – delivering on the Government's plan to revitalise bus services by extending the bus reform program to outer metropolitan bus services (Lower Hunter, Newcastle, Central Coast, the Illawarra and Blue Mountains) by the end of 2006; continuing the massive $2.5 billion rolling stock investment program, with the first of the new outer suburban and Hunter cars expected in service later in 2006, as well as other initiatives to improve safety and reliability of rail services; and

- *public order and safety* – recruiting, training and deployment of an additional 750 police officers.

Employee related expenses (excluding superannuation) in 2006-07 are estimated to increase by $818 million over the 2005-06 revised estimate, an increase of 4.7 per cent, reflecting expenditure initiatives announced in the Budget and during 2005-06, as well as the increasing employee costs in health services.

Superannuation expenses in 2006-07 are estimated to decrease by $140 million over the 2005-06 revised estimate, a fall of 5.1 per cent, reflecting the reduction in net superannuation expenses after the transfer of $8.9 billion to the SAS Trustee Corporation's fund (the State Super fund).

Further information on Budget initiatives is set out in Chapter 2 and a more comprehensive expenditure analysis on an agency basis is contained in Budget Paper No. 3.

Table 1.5: General Government Sector Operating Statement

	2004-05 Actual	2005-06 Budget	2005-06 Revised	2006-07 Budget	2007-08	2008-09 Forward Estimates	2009-10
	$m	$m	$m	$m	$m	$m	$m
State Revenues							
Taxation	15,332	16,269	15,812	16,719	17,472	18,394	19,365
Commonwealth Grants							
- General Purpose	10,181	10,675	10,617	10,946	11,733	12,519	13,239
- Specific Purpose	6,011	6,121	6,410	6,679	6,811	7,016	6,958
Financial Distributions	1,600	1,906	1,782	1,664	1,891	1,841	1,998
Fines, Regulatory Fees & Other	1,152	1,082	1,203	1,167	1,162	1,172	1,252
Total State Revenues	**34,276**	**36,053**	**35,824**	**37,175**	**39,069**	**40,942**	**42,812**
Operating Revenues							
Sale of Goods and Services	2,830	2,851	2,841	2,999	3,121	3,223	3,302
Investment Income	1,051	971	1,450	914	793	840	896
Grants and Contributions	675	638	779	789	773	788	788
Other	398	347	326	319	312	338	344
Total Operating Revenues	**4,954**	**4,807**	**5,396**	**5,021**	**4,999**	**5,189**	**5,330**
Total Revenues	**39,230**	**40,860**	**41,220**	**42,196**	**44,068**	**46,131**	**48,142**
Expenses							
Employee Related							
- Superannuation	2,443	3,044	2,740	2,600	2,343	2,375	2,384
- Other	16,527	17,150	17,384	18,202	18,936	19,969	20,871
Other Operating	9,399	9,346	8,995	9,760	10,126	10,287	10,690
Depreciation and Amortisation	1,994	2,087	2,150	2,245	2,355	2,477	2,570
Current Grants and Subsidies	5,949	6,454	6,679	7,179	7,242	7,573	7,762
Capital Grants	1,376	1,407	1,745	1,670	1,362	1,290	1,222
Finance	818	894	883	991	1,166	1,293	1,384
Recurrent Treasurer's Advance	...	175	...	245	160	160	160
Total Expenses	**38,506**	**40,557**	**40,576**	**42,892**	**43,690**	**45,424**	**47,043**
BUDGET RESULT - SURPLUS/(DEFICIT)[(a)]	**724**	**303**	**644**	**(696)**	**378**	**707**	**1,099**
Capital Expenditure [(b)]	3,331	3,825	3,788	4,387	4,528	4,782	4,590

(a) *Adopting a cash approach to the receipt of Commonwealth funds for the Hume and Pacific Highways would result in a Budget surplus of $1,604 million in 2005-06, a deficit of $796 million in 2006-07 and surpluses of $78 million, $307 million and $939 million in the following years respectively.*

(b) *Includes assets acquired under finance leases.*

The Budget results for 2006-07 and forward years reflect the impact of a significant item relating to Commonwealth road funding.

In its May 2006 budget, the Commonwealth provided New South Wales with an additional $960 million to upgrade the Hume and Pacific Highways. Prior to the Commonwealth Budget, this funding had not been expected by the NSW Government.

This funding represents revenue to the NSW Government. The revenue has been recognised in the operating statements for the Budget Year and forward years on the same basis as the related capital expenditure is incurred by the Roads and Traffic Authority. For example, in 2006-07 the RTA expects to undertake $100 million in capital expenditure, therefore $100 million of the $960 million has been brought to account as revenue in that year.

This accounting approach of deferring the revenue, and amortising it over the period in which the capital expenditure is incurred, mirrors the accounting approach adopted by the Commonwealth Government, which expenses the payment as it is expected to be spent by the NSW Government.

Capital Expenditure

In 2006-07 capital expenditure in the general government sector will total $4,387 million, an increase of 15.8 per cent over the 2005-06 revised estimate of $3,788 million. Expenditure in 2006-07 is projected to be a record in real terms and reflects the Government's commitment to, in particular, improve transport infrastructure in the State to support the efficient delivery of high quality public services.

Capital expenditure by the Department of Education and Training will total $573 million in 2006-07, an increase of 28.5 per cent over the 2005-06 revised estimate. The program includes 25 major new school projects (including two new schools) and 11 new TAFE projects.

The Department of Ageing, Disability and Home Care is projected to increase its 2006-07 capital program by 12.3 per cent to $71.1 million, with more than $50 million for improvements in accommodation for people with complex health care needs and for improvements and replacement of various accommodation facilities.

The Attorney General's Department will have a capital program totalling $123.3 million in 2006-07, compared to $89.3 million in 2005-06, an increase of over 38 per cent. The program includes continuing construction of the Parramatta Justice Precinct and continued upgrading of court facilities.

The Crown Property Portfolio has also received a significant increase in funding to support the development in Parramatta of the Justice Office Building. The capital program totals $82.4 million in 2006-07, a 50.6 per cent increase over 2005-06, with $64.3 million for Parramatta developments.

The capital program for the Roads and Traffic Authority will increase by 19.1 per cent to $1,595 million in 2006-07. The increase in expenditure includes the continuation of State funded projects (such as widening of the Great Western Highway).

Further details on capital expenditure are contained in Budget Paper No. 4, *Infrastructure Statement*.

FORWARD ESTIMATES

The GFS operating statement shows the Budget will return to a surplus of $378 million in 2007-08, increasing to $1,099 million in 2009-10.

Revenue

Total revenue is estimated to rise by an average 4.5 per cent per annum over the three years to 2009-10. This increase is well below the expected growth in nominal gross state product of 5.9 per cent per annum.

Taxation revenue is expected to increase by an average of 5 per cent per annum while financial distributions are projected to grow by an average of 6.3 per cent per annum. Commonwealth general purpose grants are also expected to increase by an average of 6.5 per cent per annum reflecting the growth in GST revenues, whilst specific purpose grants will grow by a very modest 1.4 per cent per annum.

All other revenues are expected to have minimal average growth levels, with the exception of investment income, which is expected to decrease by 13.2 per cent in 2007-08, and then increase by an average of 6.3 per cent in the following two years. This reflects the payment in 2006-07 of dedicated superannuation reserves held in the General Government Liability Management Fund, to the Superannuation Pooled Fund, thereby reducing the investment returns flowing from this source in 2006-07 and 2007-08.

Expenses

From 2007-08 through to 2009-10, growth in expenses is expected to average 3.1 per cent per annum. The increase is below the projected rate of growth in nominal GSP of 5.9 per cent per annum.

Slower spending growth will be achieved by implementing a range of efficiency savings and productivity reforms, setting spending priorities and maintaining real wages. Further details of savings initiatives are outlined in Chapter 2.

Agency initiatives impacting the forward estimates are detailed in Chapter 2 and in Budget Paper No. 3.

Expenses Growth in 2007-08

The year-to-year growth in expenses can be volatile, reflecting the timing of new initiatives, the winding down of some programs, the inflow of Commonwealth funding, lumpiness in capital grants and the timing of wage increases. For example, the growth rate of expenses forecast for 2007-08 of 1.9 per cent is reduced by a series of factors which by themselves reduce the growth rate by over 2 per cent including:

- a reduction in superannuation expenses in 2007-08 by around $260 million;
- the winding down of the Groundwater Structural Adjustment (down $100 million) and the National Action Plan for Water Quality and Salinity (down $120 million) programs in 2007-08 which are broadly funded on a 50:50 basis with the Commonwealth;
- the finalisation of significant rail capital projects and the transition to new forms of delivery for the ongoing rail improvement package will reduce Budget capital grants (down over $200 million);
- the impact on expenses in 2006-07 of the State Election increasing costs by around $40 million;
- assumed lower drought expenses in 2007-08;
- the transfer of the Uninsured Liability Indemnity Scheme to the private sector ($16 million); and
- fluctuations between years in the reported level of capital investment and maintenance expenditure undertaken by the RTA which depends upon the precise characterisation of work undertaken as part of the total roads program.

In addition to the above, agencies will be required to achieve productivity savings totalling around $300 million in 2007-08 equalling 0.7 per cent of total expenses.

Capital Expenditure

Capital expenditure in the general government sector is expected to total $18.3 billion in the four years to 30 June 2010, an increase of 32.4 per cent or $4.5 billon over the amount spent in the four year period to 30 June 2006. When added to capital expenditure in the PTE sector, the total state sector capital expenditure program for the four years to 2009-10 totals $41.3 billion. This represents an increase of $12.9 billion or 45.1 per cent compared to the previous four year period.

1.4 GENERAL GOVERNMENT SECTOR BALANCE SHEET

The general government sector balance sheets for 2006-07 and forward years are prepared in accordance with government finance statistics (GFS) principles.

Table 1.6: General Government Sector Balance Sheet, 2005 to 2010, as at 30 June (GFS Basis)

	2005 Actual $m	2006 Revised $m	2007 Budget $m	2008 Estimate $m	2009 Estimate $m	2010 Estimate $m
ASSETS						
Financial Assets						
Cash and Deposits	1,465	1,098	1,036	1,010	807	1,051
Advances Paid	1,304	1,281	1,255	1,209	1,208	1,183
Investments, Loans and Placements	12,042	14,688	8,373	8,950	9,573	10,026
Other Non-Equity Assets	6,246	9,563	9,470	9,732	9,736	10,072
PTE/PFE Equity (c)	68,105	64,353	65,134	65,739	66,594	68,120
Other Equity Assets	589	655	697	734	800	872
Total Financial Assets	**89,751**	**91,638**	**85,965**	**87,374**	**88,718**	**91,324**
Non-Financial Assets						
Land and Fixed Assets	84,210	86,226	88,619	91,234	93,923	96,326
Other Non-Financial Assets	1,260	1,492	1,600	1,733	1,877	2,031
Total Non-Financial Assets	**85,470**	**87,718**	**90,219**	**92,967**	**95,800**	**98,357**
TOTAL ASSETS	**175,221**	**179,356**	**176,184**	**180,341**	**184,518**	**189,681**
LIABILITIES						
Deposits Held	98	85	86	87	87	86
Advances Received	1,641	1,507	1,467	1,418	1,368	1,317
Borrowing	11,392	12,096	15,301	17,445	18,903	19,990
Provisions (c)	29,512	36,373	28,179	28,820	29,505	30,110
Other Non-Equity Liabilities	3,689	5,125	4,841	4,357	3,955	3,801
TOTAL LIABILITIES	**46,332**	**55,186**	**49,874**	**52,127**	**53,818**	**55,304**
NET WORTH	**128,889**	**124,170**	**126,310**	**128,214**	**130,700**	**134,377**
Underlying Net Debt/Net Debt(a)	**2,321**	**1,856**	**6,190**	**7,781**	**8,770**	**9,133**
- as a % of GSP	**0.8**	**0.6**	**1.8**	**2.2**	**2.3**	**2.3**
Net Financial Liabilities(b)	**24,686**	**27,900**	**29,044**	**30,492**	**31,694**	**32,100**
- as a % of GSP	**8.1**	**8.7**	**8.6**	**8.5**	**8.4**	**8.0**

(a) *From 1 July 2002 contributions dedicated to superannuation are made to the General Government Liability Management Fund, reducing unadjusted net debt. During 2006-07, a payment $8.7 billion will be made to the SASS Trustee Corporation to reduce superannuation liabilities. This will decrease both "Investments, Loans and Placements" and "Provisions". As from 2007, adjustments to derive underlying net debt will no longer be required. The increase in net debt in 2006-07 reflects an additional $2.2 billion transferred to State Super.*

(b) *Excluding PTE/PFE equity.*

(c) *The movement in the estimates between 2005 and 2006 was affected by the introduction of Australian Equivalent of International Financial Reporting Standards.*

Net Worth

Net worth is estimated to be $124.2 billion at 30 June 2006, a decrease of $4.7 billion from 30 June 2005. The decline is the result of the changes in the accounting treatment of certain financial liabilities, resulting from adopting Australian Equivalents to International Financial Reporting Standards (AEIFRS). In the absence of adopting AEIFRS, net worth would have increased by some $3.6 billion.

At 30 June 2007, net worth is expected to increase by $2.1 billion to $126.3 billion.

Further information regarding the financial results and projections of the PTE sector is reported in Chapter 5. A review of the PTE and general government capital expenditure programs is also contained in Budget Paper No. 4.

Net Financial Liabilities

Net financial liabilities at 30 June 2006 are expected to rise to $27.9 billion from $24.7 billion at 30 June 2005. As a share of GSP, net financial liabilities will increase to 8.7 per cent at 30 June 2006 from the 8.1 per cent level at 30 June 2005.

The increase is the result of changes in the treatment of superannuation liabilities under AEIFRS. In the absence of adopting AEIFRS, net financial liabilities would have decreased by $1.1 billion.

At 30 June 2007, net financial liabilities are expected to increase to $29.0 billion, falling from 8.7 to 8.6 per cent as a share of GSP.

Chapter 4 provides a detailed analysis of net financial liabilities.

Underlying Net Debt/Net Debt

Underlying net debt is estimated to be $1.9 billion at 30 June 2006, a decrease of $466 million from 30 June 2005, and decreasing from 0.8 per cent of GSP to 0.6 per cent.

At 30 June 2007, net debt is expected to increase to $6.2 billion, which includes the additional payment of $2.2 billion to reduce unfunded superannuation liabilities, and represents 1.8 per cent of GSP. Following the superannuation payment, net debt will no longer need to be adjusted to arrive at the underlying net debt.

Chapter 4 provides further analysis of the movements in net debt.

Forward Years

The value of land and fixed assets is projected to rise by $10.1 billion between June 2006 and June 2010. This reflects the Government's capital expenditure program totalling $18.3 billion over the period offset by depreciation of $9.6 billion and by asset sales.

Investments will steadily increase by $1.7 billion from 2007 to 2010.

Provisions will decrease in 2007 due to the payment of a lump sum contribution to reduce unfunded superannuation liabilities. Thereafter superannuation provisions are expected to increase steadily in the following years as liabilities for long service leave and superannuation accrue.

Net worth is expected to increase to $134.4 billion in 2010, an increase of $8.1 billion (or 6.4 per cent) over the 2007 level.

Net financial liabilities will increase by around $3.1 billion to $32.1 billion during the period 30 June 2007 to 30 June 2010. As a share of GSP, they are projected to fall from 8.6 per cent to 8.0 per cent.

From June 2007, the amount of net debt is expected to increase by $2.9 billion to $9.1 billion in 2010, increasing from 1.8 per cent of GSP in 2007 to 2.3 per cent of GSP in 2010.

1.5 GENERAL GOVERNMENT SECTOR CASH FLOW STATEMENT

Table 1.7 shows the net cash flow of the general government sector from operating, investing and financing activities.

The net cash flow from operating activities in 2005-06 is some $1.2 billion higher than budget mainly due to $960 million provided by the Commonwealth for road funding late in 2005-06, expenditure of which will occur in 2006-07 and future years.

For 2006-07 the net cash flow from operating activities is expected to be a deficit of $5.9 billion, a decrease of $10.7 billion from the result in 2005-06. This reflects the payment of $8.7 billion towards unfunded superannuation and the reduction in revenues from the 2005-06 levels, whilst expenses increase by 5.7 per cent.

An underlying cash deficit of $4.6 billion is forecast for 2006-07, and deficits of $1.5 billion in 2007-08, $1.3 billion in 2008-09 and $369 million in 2009-10.

Table 1.8 shows GFS cash results from 1990-91 to 2009-10.

Table 1.7: General Government Sector Cash Flow Statement (GFS Basis)

	2004-05 Actual $m	2005-06 Budget $m	2005-06 Revised $m	2006-07 Budget $m	2007-08 Estimate $m	2008-09 Estimate $m	2009-10 Estimate $m
Cash Receipts from Operating Activities							
Taxes Received	15,043	16,245	15,824	16,574	17,419	18,357	19,319
Receipts from sales of goods & services	3,245	3,097	3,305	3,259	3,359	3,492	3,604
Grants/Subsidies Received	16,376	17,121	18,445	17,976	18,677	19,567	20,438
Other Receipts	5,608	5,181	6,224	6,068	5,753	5,984	6,141
Total Cash Receipts from Operating Activities	**40,272**	**41,644**	**43,798**	**43,877**	**45,208**	**47,400**	**49,502**
Cash Payments from Operating Activities							
Payments for goods & services	(27,068)	(28,748)	(28,499)	(39,003)	(32,275)	(33,373)	(34,808)
Grants & Subsidies Paid	(5,806)	(6,188)	(6,953)	(7,285)	(6,971)	(7,181)	(7,239)
Interest Paid	(777)	(1,070)	(1,036)	(977)	(1,043)	(1,377)	(1,315)
Other Payments	(2,558)	(1,978)	(2,488)	(2,518)	(2,447)	(2,431)	(2,458)
Total Cash Payments from Operating Activities	**(36,209)**	**(37,984)**	**(38,976)**	**(49,783)**	**(42,736)**	**(44,362)**	**(45,820)**
Net Cash Flows from Operating Activities	**4,063**	**3,660**	**4,822**	**(5,906)**	**2,472**	**3,038**	**3,682**
Cash Flows from Investments in Non-Financial Assets							
Purchases of New Non-Financial Assets	(3,006)	(3,713)	(3,844)	(4,371)	(4,404)	(4,513)	(4,590)
Sale of Non-Financial Assets	485	563	545	476	515	478	539
Total Cash Flows from Investments in Non-Financial Assets	**(2,521)**	**(3,150)**	**(3,299)**	**(3,895)**	**(3,889)**	**(4,035)**	**(4,051)**
Cash Flows from Investments in Financial Assets							
Financial Assets for Policy Purposes	130	142	85	203	100	123	32
Financial Assets for Liquidity Purposes	(2,404)	(836)	(2,281)	6,258	(546)	(589)	(617)
Total Cash Flows from Investments in Financial Assets	**(2,274)**	**(694)**	**(2,196)**	**6,461**	**(446)**	**(466)**	**(585)**
Cash Flows from Financing Activities							
Advances Received (net)	(28)	(136)	(133)	(47)	(49)	(50)	(53)
Borrowing (net)	417	(141)	494	3,341	1,886	1,307	1,245
Deposits Received (net)	20	...	(14)	...	...	(1)	(2)
Other Financing (net)	(18)	...	...	...	...	...	...
Total Cash Flows from Financing Activites	**391**	**(277)**	**347**	**3,294**	**1,837**	**1,256**	**1,190**
Net Increase/(Decrease) in Cash held	**(341)**	**(461)**	**(326)**	**(46)**	**(26)**	**(207)**	**236**
Net Cash from Operating Activities and Investments in Non-Financial Assets	**1,542**	**523**	**1,523**	**(9,801)**	**(1,417)**	**(997)**	**(369)**
Assets acquired under finance leases	(187)	(95)	(47)	(15)	(125)	(269)	...
Surplus/(Deficit)	**1,355**	**428**	**1,476**	**(9,816)**	**(1,542)**	**(1,266)**	**(369)**
Impact of prepaid superannuation contributions							
Liability Management Fund	(1,150)	(1,239)	(1,234)	5,235	...	...	...
Adjusted Surplus/(Deficit)	**205**	**(811)**	**242**	**(4,581)**	**(1,542)**	**(1,266)**	**(369)**

Table 1.8: General Government Cash Results (GFS basis), 1990-91 to 2009-10 [(a)]

Year	*Current*			*Capital*			*Cash Flows from Operating Activities*			*Asset Acquisitions*	*Asset Sales*	*Superannuation Adjustments*	***Underlying Surplus/ (Deficit)***
	Outlays $m	*Receipts $m*	*Result $m*	*Outlays [(b)] $m*	*Receipts $m*	*Result $m*	*Payments $m*	*Receipts $m*	*Result $m*	*$m [(c)]*	*$m*	*$m [(d)]*	***$m***
1990-91	14,773	15,245	**472**	2,921	1,226	**(1,695)**							**(1,223)**
1991-92	16,060	16,101	**41**	2,692	1,047	**(1,645)**							**(1,604)**
1992-93	16,748	16,749	**1**	2,988	1,776	**(1,212)**							**(1,211)**
1993-94	17,069	18,178	**1,109**	3,326	1,310	**(2,016)**							**(907)**
1994-95	17,819	19,122	**1,303**	2,962	1,048	**(1,914)**							**(611)**
1995-96	18,325	20,417	**2,092**	3,290	936	**(2,354)**							**(262)**
1996-97	19,717	22,100	**2,383**	3,359	1,086	**(2,273)**							**110**
1997-98							24,576	26,820	**2,244**	(2,760)	522	...	**6**
1998-99							29,236	28,596	**(640)**	(3,002)	784	3,266	**408**
1999-2000							26,485	30,471	**3,986**	(2,734)	626	(1,005)	**874**
2000-01							28,453	32,758	**4,306**	(2,859)	344	(1,058)	**733**
2001-02							29,644	34,715	**5,071**	(3,096)	424	(1,134)	**1,265**
2002-03							31,630	37,047	**5,417**	(3,397)	497	(1,651)	**866**
2003-04							34,370	38,778	**4,408**	(3,214)	408	(1,200)	**402**
2004-05							36,209	40,272	**4,063**	(3,193)	485	(1,150)	**205**
2005-06 (est)							38,976	43,798	**4,822**	(3,891)	545	(1,234)	**242**
2006-07 (est)							49,783	43,877	**(5,906)**	(4,386)	476	5,235	**(4,581)**
2007-08 (est)							42,736	45,208	**2,472**	(4,529)	515	...	**(1,542)**
2008-09 (est)							44,362	47,400	**3,038**	(4,782)	478	...	**(1,266)**
2009-10 (est)							45,820	49,502	**3,682**	(4,590)	539	...	**(369)**

(a) Aggregates in prior years may vary from those previously published because of changes in classifications and backcasting for consistency.
(b) Outlays equals capital direct expenses and capital grants. Under new GFS reporting, capital grants are treated as expenses and therefore included in payments.
(c) Includes assets controlled under finance lease arrangements.
(d) Adjustment for prepayment of superannuation contributions and establishment of General Government Liability Management Fund. See Chapter 4.

1.6 GENERAL GOVERNMENT SECTOR OPERATING STATEMENT- 2005-06 RESULT

The Budget surplus for 2005-06 is estimated to be $644 million, compared with the estimate of $21 million at the time of the mid-year review, and the original Budget estimate of $303 million. (See Table 1.9).

Total revenue is expected to be 5.1 per cent, or $1,990 million, higher than in 2004-05, and expenses are expected to be 5.4 per cent or $2,070 million higher.

Capital expenditure of $3,788 million is projected to exceed 2004-05 by 13.7 per cent, or $457 million.

The revised Budget surplus for 2005-06 is estimated to be $341 million higher than the original Budget estimate. With expenses estimated to be close to the original Budget, the difference is mainly the result of stronger than projected financial market returns (investment income). Revenues are expected to be 0.9 per cent or $360 million above Budget. Capital expenditure is projected to be in line with budget, with a variation of only $37 million.

Further details of variations in 2005-06 are highlighted in Appendix D.

Table 1.9: General Government Sector 2005-06 Operating Statement - Estimated Result

BUDGET RESULT

	2005-06		
	Budget *$m*	*Revised* *$m*	*Variation* *$m*
State Revenues			
Taxation	16,269	15,812	(457)
Commonwealth Grants			
- General Purpose	10,675	10,617	(58)
- Specific Purpose	6,121	6,410	289
Financial Distributions	1,906	1,782	(124)
Fines, Regulatory Fees & Other	1,082	1,203	121
Total State Revenues	**36,053**	**35,824**	**(229)**
Operating Revenues			
Sale of Goods and Services	2,851	2,841	(10)
Investment Income	971	1,450	479
Grants and Contributions	638	779	141
Other	347	326	(21)
Total Operating Revenues	**4,807**	**5,396**	**589**
Total Revenues	**40,860**	**41,220**	**360**
Expenses			
Employee Related			
- Superannuation	3,044	2,740	(304)
- Other	17,150	17,384	234
Other Operating	9,346	8,995	(351)
Depreciation and Amortisation	2,087	2,150	63
Current Grants and Subsidies	6,454	6,679	225
Capital Grants	1,407	1,745	338
Finance	894	883	(11)
Recurrent Treasurer's Advance	175	...	(175)
Total Expenses	**40,557**	**40,576**	**19**
BUDGET RESULT - SURPLUS/(DEFICIT)	**303**	**644**	**341**
Capital Expenditure	3,825	3,788	(37)

CHAPTER 2: GENERAL GOVERNMENT EXPENDITURE

- The Government's key expenditure priorities are:
  - Health
  - Transport
  - Disability Services
  - Education
  - Public Order and Safety
- There is a growing demand for services, and for improved services, driven by population and economic growth, changing demographics and the potential for new or enhanced services.
- The Government's strategy, including as set out in the February 2006 *Economic and Financial Statement*, in response to the *Audit of Expenditure and Assets*, to meet its priorities while staying within prudent fiscal limits, is based on:
  - managing the frontline public sector workforce and wage outcomes;
  - managing the long life infrastructure that is intrinsic to service delivery including setting the level of maintenance necessary to preserve its functionality;
  - capitalising on new technology to deliver productivity benefits as well as meet growing community expectations of improved standards of service and outcomes;
  - delivering on the savings outcomes arising from the Government's response to the Audit including a regular efficiency dividend, reform of the information and communications technology purchasing strategy, centralised procurement and property management and agency amalgamations;
  - continuing to clearly identify priority policy areas and ensuring the ultimately limited resources of the Government are focussed on those areas; and
  - implementing a new Performance Management and Budget System focussed on setting clear priorities, driving efficiency, strengthening accountability, and, most importantly, testing value for money by measuring the results delivered.

2.1 INTRODUCTION

The NSW Government is in the business of delivering high quality public services for the benefit of the whole community.

Some services, like water, electricity, waste services and ports can be provided on a commercial basis. Consumers meet the cost of service provision, and, importantly, the cost of new infrastructure necessary to meet demand, as well as the cost of maintaining existing infrastructure.

However, many public services – health, education, policing, transport and welfare – are significantly funded through the Budget. These services have a number of common features:

- ♦ They are generally labour intensive – teachers, nurses, police officers and train crew. The total state sector in New South Wales employs some 360,000 people, equivalent to about 290,000 full time employees.

- ♦ They use long-life physical infrastructure – schools, hospitals, rail systems and roads.

- ♦ While technology has lifted service quality and improved productivity – for example, advanced medical diagnostics, new generation trains, police communications and school intranets – the fundamental delivery models, which often rely on personal service, have not changed.

- ♦ Services are generally provided on a universal basis without discrimination (other than on the basis of need). Access is often free (public education or hospitals) or at a heavily subsidised price (public transport). Demand for services therefore normally exceeds the capacity to supply services.

- ♦ Service demand is growing, and at a rate greater than general population growth. A key driver is not only changing demographics, but also changing expectations linked to increases in real disposable income.

It is against this background the Government must frame an expenditure strategy which:

- ♦ makes provision for growing demand for services and changing priorities;

- ♦ provides for and manages the growing cost of labour;

- ♦ factors in ongoing and achievable productivity savings, both in support functions and in service delivery;

- promotes the efficient maintenance and utilisation of existing infrastructure and provides for its replacement;

- allows for the acquisition of new technology to improve service delivery; and

- allocates expenditures to meet key strategic priorities.

2.2 GENERAL GOVERNMENT EXPENSES

Total general government expenses for the 2006-07 Budget are $42.9 billion. This is an increase in nominal terms of 5.7 per cent on the revised estimate for 2005-06.

Table 2.1: General Government Total Expenses, 2002-03 to 2009-10

		Actual			*Revised*	*Budget*	*Forward Estimates*		
		2002-03	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*2008-09*	*2009-10*
Total Expenses	**($m)**	34,281	36,511	38,506	40,576	42,892	43,690	45,424	47,043
Year on Year Change	**%**	6.3	6.5	5.5	5.4	5.7	1.9	4.0	3.6
4 year average growth	**%**				5.9				3.8

Year on year growth rates can be volatile reflecting the timing of new initiatives, the winding down of some programs, the inflow of Commonwealth funding, lumpiness in capital grants and the timing of wage increases. The particular factors which depress the forecast growth rate for 2007-08 are set out in Chapter 1.

Generally, the growth in expenditure over the past four years has been driven by several related factors:

- a significant increase in funding for priority areas;

- real wage growth, particularly for front line employees in areas of skill shortages, as well as increased frontline positions; and

- higher reported superannuation costs under recently introduced international accounting standards (see Table 2.2 and Chapter 4).

Health, education and transport account for a significant portion of total expenditure increases, both because of the size of these portfolios relative to the general government sector and because of the absolute rates of growth which reflect the policy priorities of the Government.

Overall, expenditure growth over the next four years will be influenced by a number of factors:

- moderation in the growth of the public sector wage bill and employment costs, including a significant forecast reduction in reported superannuation expense of $140 million in 2006-07 and $257 million in 2007-08;
- the ongoing implementation of efficiency savings and productivity reforms (with savings of approximately $1.1 billion per annum by 2009-10);
- a rigorous approach to asset maintenance and procurement which minimises the long-term real cost of infrastructure and hence service provision;
- a prudent approach to procuring new technology;
- higher financing costs associated with partly funding infrastructure spending through debt;
- a renewed focus on agency performance through further strengthening of the Budget system; and
- moderation in the rate of growth in expenditure in several areas, including grants for transport, given the significant step ups in the base level of funding in recent years and the pending completion of major projects funded by recurrent Budget grants (including the Epping to Chatswood Rail Link).

EMPLOYEE COSTS

Employee expenses grew from 48.2 per cent to 49.6 per cent of total expenses over the four year period to 2005-06. Future growth will be tempered by a combination of a reduction in the reported superannuation expense and a moderation in the rate of wages growth.

Table 2.2: General Government Employee Expense Growth, 2002-03 to 2009-10

	Actual			*Revised*	*Budget*	*Forward Estimates*		
	2002-03	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*2008-09*	*2009-10*
Employee Superannuation	2,132	2,307	2,443	2,740	2,600	2,343	2,375	2,384
Employee – other	14,384	15,509	16,527	17,384	18,202	18,936	19,969	20,871
Total Employee Expenses ($m)	16,516	17,816	18,970	20,124	20,802	21,279	22,344	23,255
Year on Year Change %	10.9	7.9	6.5	6.1	3.4	2.3	5.0	4.1

The Government, in the *Economic and Financial Statement* of 23 February 2006, in response to the *Audit of Expenditure and Assets*, confirmed a range of initiatives to manage employee costs. These include:

- maintaining wage rates in real terms following the expiry of existing agreements;
- managing displaced employees. Displaced staff may, as a last and unavoidable resort where an alternative position is not found within 12 months, be made redundant. Senior Executive staff are only able to be on the unattached list for a period of four weeks. This is estimated to save in excess of $12 million per annum after redundancy payments;
- reducing workers compensation costs by implementing WorkCover’s strategy for improving public sector occupational health and safety and injury management. Benchmark targets for savings are in the order of $66 million per annum from 2008-09;
- reducing sick leave and overtime payments. The target is reducing average sick leave taken from eight days per annum to seven days per annum, and overtime payments by 5 per cent, by 2008-09. This is estimated to save around $65 million per annum, principally from frontline agencies that are required to cover absentees; and
- better managing of leave – including considering a two week closure over the Christmas period for non-frontline services.

Most importantly, the Government announced its intention to reduce the overall size of the public sector. Up to 5,000 positions will become redundant over the next two to three years.

EFFICIENCY REFORMS

An efficiency dividend equal to 1 per cent of discretionary expenditure will be returned by agencies in 2006-07. Discretionary expenditure covers most spending excluding items an agency cannot directly control like depreciation, the pass through of Commonwealth grants and interest. Further efficiency dividends will apply in 2007-08 (of 1 per cent) and 2008-09 (of $200 million). Including the 1 per cent efficiency dividend imposed in 2005-06, which has already been achieved, the benefit to the Budget will be approximately $1.1 billion per annum by 2009-10.

The efficiency dividends have been set at a level which agencies can absorb through the iterative reform of their processes while not impacting service delivery. The 2005-06 dividend (of $270 million) was successfully implemented through the 2005-06 Budget process and involved a direct reduction in individual agency allocations.

The Government is also implementing a range of further reforms, as set out in the *Economic and Financial Statement*, to reduce costs. These include:

- reforming procurement practices to capitalise on the expertise of the State Contracts Control Board and the buying power of the State. The target is a 5 per cent reduction on total procurement costs, in excess of $250 million on Government expenditure on goods and services over the next 4 years;

- reducing rental costs through more efficiently managing space, especially in high rent precincts;

- reducing the cost, and improving the effectiveness, of information and communications technology (ICT). A State-wide ICT plan will be fully implemented within four years. The approach will yield $125 million a year in capital savings and a further $80 million in recurrent savings;

- better managing government property by the establishment of a new authority from 1 July 2006 with the task of managing the State's $80 billion property portfolio as well as around $1 billion per annum spent on new property assets. A five year target in savings in excess of $300 million per annum, including recurrent savings of $80 million per annum;

- reducing the cost of corporate services through benchmarking performance. All agencies will be required to meet benchmarks set by the Council for the Cost and Quality of Government. Those agencies performing below benchmarks will be required to produce plans for achieving the benchmarks over two years. The potential savings are in the order of $170 million per annum; and

- agency amalgamations to achieve efficiencies and better coordination. The Government has already announced a revamped Department of State and Regional Development and a new Department of the Arts, Sport and Recreation. The Government supports in principle reducing the number of Budget dependent agencies with benefits including an improvement in overall resource allocation decisions as well as operational cost savings.

ASSET MANAGEMENT & MAINTENANCE

The Government has adopted a series of reforms designed to better manage its asset portfolio, including more effective maintenance. The objective is to both minimise the whole-of-life cost of assets (including depreciation and maintenance expense) and to reduce dependency on asset intensive solutions and hence the overall cost of service delivery. These include:

- linking Total Asset Management (TAM) to the Budget process. TAM is designed to align agencies' asset planning and management with service delivery priorities;

- a reformed procurement policy which requires a far more rigorous assessment of the business case for an asset acquisition and of the procurement process;

- development of an asset maintenance strategy which is a key component of an agency's TAM plan. This requires all agencies to plan maintenance so as to minimise the whole of life costs of its assets, considering the risks of asset ownership and their impact on services; and

- a change in the reporting of asset maintenance expenditures. New Treasury guidelines require a more comprehensive reporting of the cost of asset maintenance including the cost of internal labour.

STRENGTHENING THE BUDGET PROCESS

The Government has committed to developing a new Performance Management and Budgeting System, with implementation for the 2008-09 Budget. This and other recent developments in Budget process reform are discussed in Section 2.4 of this Chapter.

2.3 MAJOR POLICY AREAS

Table 2.3 shows the relative share of the Budget and overall expenditure growth in major policy areas over the last four years. Note the Table provides program level expenses according to GFS classifications which does not necessarily align with individual agency level expenditure.

Table 2.3: General Government Expenses by Major Policy Area (GFS Classifications), 2002-03 to 2006-07

	Share of Total Expenses		*Growth in Expenses (per cent)*
	2002-03 (per cent)	*2006-07 (per cent)*	
Health	25.8	27.5	33.2
Education	24.8	23.4[(a)]	17.8[(a)]
- Government schools	*15.7*	*15.3*	*21.4*
Transport	10.5	12.0	43.4
Public Order and Safety	10.7	10.7	25.4
Social Security and Welfare	7.7	7.9	29.0
Environmental Protection	2.3	2.2	15.2
Other	18.2	16.3	12.9
TOTAL EXPENSES	100.0	100.0	25.1

(a) New bus contracts have resulted in the reclassification of funding provided to bus operators including for the School Student Transport Scheme. The result is a reduction of 2006-07 Education expenses by approximately $120 million compared to prior years. Without this factor the growth in Education expenses would have been 19.2 per cent and the share of total expenses 23.7 per cent.

Following is a more detailed commentary on the major priority areas for the Government which generally, but not precisely, match the GFS classification.

HEALTH

The NSW health system aims to keep people healthy by delivering high quality heath care and providing the health care that people need. A wide range of health services such as inpatient hospital care, emergency care, community health and mental health are delivered through eight Area Health Services and State-wide services such as the Ambulance Service of NSW.

Health outcome indicators point to a NSW health system that is world class. Life expectancy at birth in New South Wales is 78.6 years for males and 83.4 years for females. Outside Australia, only males and females born in Japan, males born in Sweden, and females born in France can expect to live longer.

Public access to quality health care is an ongoing priority of the Government. To meet this commitment, total expenditure by the Department of Health will reach $11.7 billion in 2006-07, with health expenditure representing 27.5 per cent of total general government expenditure.

Increases in wages where there were skills shortages (principally nurses and other medical professionals) account for a large portion of the additional expenditure and funding provided in recent years. Health has also been provided with substantial real funding increases for priorities such as mental health and increases in hospital bed capacity.

Funding provided in the 2005-06 Budget and service improvements introduced by NSW Health have enabled the health system to improve performance during 2005-06 despite a significant increase in demand and activity. For example, Emergency Department attendances for the nine months to March 2006 were up by 97,457 patients or 8.5 per cent compared to the same period last year. Over the same period total hospital admissions were up by 77,477 or 7.5 per cent.

Even with this increase in demand and activity, considerable improvements have been realised in health service performance and productivity. For example, the number of patients waiting longer than 12 months for elective surgery has declined in the past year from 10,364 in March 2005 to 2,525 in March 2006. Access block measured by the proportion of patients not being admitted within eight hours of attendance at emergency departments has improved and for Greater Sydney Metropolitan hospitals was 25 per cent in March 2006 compared with 30 per cent for the same period last year.

As part of its objective of *Healthier People – Now and in the Future*, the Government is providing additional resources in the 2006-07 Budget to establish new services and ensure growing demand is effectively addressed through increased funding for hospital beds, mental health services and additional health professionals.

The public health system continues to face increasing demand pressures driven by an ageing and growing population, worldwide workforce shortages, rising consumer expectations and technological change. These pressures require a government policy response that manages expenditure growth, ensures best value for money and directs resources to areas of the highest clinical need.

To address these demographic and technological challenges, NSW Health is undertaking a futures planning process and recently released an issues paper called *Fit for the Future*. NSW Health is seeking community response about future directions for the health system that include making prevention everybody's business, strengthening primary health and continuing care in the community, making smart choices about the costs and benefits of health services and redesigning and reinvigorating the health workforce.

Many elements of this agenda are already being pursued and have been reinforced by funding allocations made in the 2006-07 Budget. For example:

- Reform of traditional work practices and patient management is occurring through the Clinical Services Redesign Program. New models of care are being implemented that provide faster and safer patient flows.

- The Government will contribute to the five year, $1.1 billion reform package announced at the Council of Australian Governments' (COAG) meeting in February 2006 to achieve better health for all Australians, particularly through programs that place a greater emphasis on promotion, prevention and early intervention.

- Integrated Primary Health and Community Care Services will be established to integrate general practitioners, community health workers, allied health and other medical professionals to provide multidisciplinary care and focus on early intervention and prevention programs.

- Workforce reforms will be implemented, which include: expanding the Nurse Practitioner program to provide opportunities for experienced nurses to practice at an advanced level; enhancing recruitment and retention strategies for key health professional such as nurses and dental officers; and working through COAG to reform the training, accreditation and registration of clinicians.

- Investment in mental health services will be increased with a focus on community based care and early intervention to manage people with mental illness more effectively.

EDUCATION

The Government is committed to a quality public education system that provides equitable opportunities for all students to develop and contribute to a productive and cohesive society.

Education expenditure in 2006-07 will be over $10 billion. This is an increase of 17.8 per cent or over $1.5 billion since 2002-03. The growth has varied from year to year, predominantly due to the timing of teachers wage increases. Additional expenditure has also targeted a broad range of educational improvements including literacy and numeracy programs, teaching quality, reduced class sizes in Kindergarten, Year 1 and Year 2, supporting students with special needs, and a range of technology initiatives including computers in schools and faster access to the internet. An additional 1,500 teacher positions are being created to reduce class sizes in K-2 to State-wide averages of 20, 22 and 24 children, respectively.

NSW school students have achieved very high levels of reading, mathematical and scientific literacy, with only Finland achieving a better result in reading literacy. Retention rates in Government schools have also increased by 4.8 per cent since 2000.

The overall growth in education expenditure has been partly offset by a significant reclassification of expenditure to transport from more accurate usage information under the new bus contracts for the school student transport scheme. In addition, the growth in education expenditure has been tempered slightly by reducing student numbers in Government schools. Overall, the increase in expenditure in government schools since 2002-03 is around 21 per cent.

The 2006-07 total expenses for the Department of Education and Training will be over $9.9 billion. This is an increase of $423 million, or 4.4 per cent on the 2005-06 Budget. The main factors include a 4 per cent salary increase for teaching and administrative staff, further implementation of the class size reduction program and an additional $30 million for school maintenance works.

In the longer term a more modest outlook is anticipated for education expenditure mainly due to:

- declining student numbers over the total primary and secondary education system; and
- a moderation in the rates of wage increases following recent significant increases in salaries.

TRANSPORT

The transport policy area has two components: the management of the road system and users – undertaken by the Roads and Traffic Authority (RTA); and the provision of public transport which is funded through the Ministry of Transport.

An efficient transport system is intrinsic to a productive State economy as well as connecting individuals to the community and maintaining their well-being.

Public transport enables some 275 million annual rail journeys and 300 million bus journeys, or around 11 per cent of total journeys in the Greater Sydney Region. The rail system comprises around 1,360 kilometres of electrified track supporting around 2,400 services per week day to 304 train stations. Metropolitan buses travel over 100 million kilometres annually.

The road network supports an estimated 65 billion kilometres of motor vehicle travel annually. This includes an estimated 11 million car trips each working day in the Sydney region. Across the State the RTA is directly responsible for around 17,500 kilometres of State roads and for 3,000 kilometres of regional and local roads (in unincorporated areas). It also supports around 18,500 kilometres of local arterial routes managed by local Councils. The RTA also regulates the 4.4 million licensed motor vehicle drivers and 4.8 million registered vehicles.

The total forecast Budget expenditure on transport in 2006-07 is $5.1 billion. This is a 4.5 per cent increase on the forecast for 2005-06 and follows an average increase of 10.2 per cent per annum over the period from 2002-03 to 2005-06.

Growth in expenses over the four years up to 2006-07 predominantly reflects a series of steps up in the level of support for public transport, which comprises approximately 55 per cent of total transport expenses. The major component of the increase in public transport is additional funding to improve the performance of rail services. There has also been significant additional funding for bus reform, which will lead to improved services where they are needed.

RTA's expenses are budgeted to grow by around 4.1 per cent next year (to around $2.4 billion), after having grown by 5.8 per cent per annum over the last four years. This reflects the more stable nature of its hypothecated revenues (vehicle taxes and Federal grants) and other Budget funding (which is linked to the Consumer Price Index and vehicle registrations).

Grants for passenger rail services (including grants to RailCorp and to the Transport Infrastructure Development Corporation) have grown by an average of 15 per cent per annum over the last four years. They are budgeted to grow by 17.5 per cent next year compared to the 2005-06 Budget to around $2.2 billion. The FreightCorp sale in February 2002 and the lease in September 2004 of the interstate and Hunter Valley rail networks to the Australian Rail Track Corporation has reduced spending in freight services.

This growth in funding for passenger services reflects several related factors including:

- the growth in Budget grants for capital spending for rail, almost doubling from $331 million in 2000-01 to $605 million in 2005-06 which reflects major acquisitions (new Millennium and outer suburban rolling stock and the Epping Chatswood Rail Link).

- the steep increase in funding for City Rail maintenance commencing in 2000-01;

- the stagnation of City Rail revenue. Over the period from 2000-01, regulated fare revenue only increased by around 1 per cent per annum on average despite expenses increasing by an average of around 10.4 per cent per annum;

- major service initiatives including recruiting and training 600 transit officers and recruiting new drivers and guards (around 350 since January 2004); and

- maintaining total passenger rail workforce numbers (now around 14,000) and continued real wage increases.

The focus of the additional funding is not merely to maintain current performance, but to lay a foundation to secure the improved performance of City Rail into the next decade. Early trends suggest there is already an impact on performance. There are an additional 90,000 passengers a week this year compared to two years ago. This has coincided with improved reliability engendered by a new timetable.

Funding for Government and private bus services and other private transport, including the School Student Transport Scheme, will be up 7.6 per cent to $822 million in 2006-07. This compares to $764 million in 2005-06 which in turn was up 11.6 per cent from $684 million in 2004-05 prior to the commencement of bus reform. The new contractual funding arrangements for bus services have improved transparency, particularly for the cost of school student transport. (Note, this has resulted in the reclassification of around $120 million in expenditure from education to transport expenditure as reported on a GFS basis and shown in Table 2.3).

The future rate of growth of funding for transport will be impacted by several factors:

- the lumpy nature of rail and road capital spending which in turn may result in changed recurrent grants (in the case of rail) or a switch between recurrent and capital expenditure (in the case of the RTA);

- the completion of Budget funding for the Epping Chatswood Rail Link, including the delivery of the new Parramatta Interchange ($193 million in 2005-06, $157 million in 2006-07 and $19 million in 2007-08 including contributions from the Parking Space Levy);

- the delivery strategy for major new rail initiatives, including 600 new passenger carriages and the Clearways program, which will be financed by a Private Public Partnership and from RailCorp's borrowings respectively; and

- in the longer term, a more stable operating environment for the rail system as the major components of the rail improvement plan are rolled out including timetable changes, progressive delivery of the first of the rail clearway projects and new generation rolling stock.

The rate of expenditure growth on roads will be tempered as it is directly linked to the level of hypothecated funding (vehicle taxes and charges), with the portion of Budget funding also tied to growth in the Consumer Price Index and vehicle registrations. Additional announced grants from the Commonwealth Government totalling $960 million do not directly impact expenditure as they are allocated for capital construction projects only, and not for operating expenditure which includes maintenance.

The outcomes produced by the transport network are significantly impacted by the peak nature of travel. A level of peak congestion is unavoidable in the absence of a massive increase in capacity and alteration of the urban environment. This is particularly the case in Sydney where new projects (including the nearly complete City orbital road network and the Epping Chatswood Rail Link) must use expensive tunnel systems to cross developed urban areas.

Nevertheless, a mixture of innovation (electronic tolling), new infrastructure and traffic management has resulted in relatively stable average motor vehicle speeds during peak periods across the seven major routes to and from Sydney.

PUBLIC ORDER AND SAFETY

The public order and safety sector has broadly two areas: the criminal justice system; and emergency services. The criminal justice system is the largest area with approximately 80 per cent of sector expenditure.

The key result for the criminal justice system is fostering a safer community. A safer community is achieved by reducing crime and improving public safety, providing a responsive judicial system that protects people's rights and a correctional system that reduces the risks of re-offending.

The services and performance of criminal justice agencies are often sequential and interdependent. The key results of one agency can be influenced by the performance of other agencies as a person moves from one agency to another until their matter is finalised.

Since 2002-03, expenditure on the public order and safety sector has grown steadily. Over this period expenditure in the sector has increased by 25.4 per cent driven mainly by more police and higher numbers of inmates in the correctional system.

In response to community concerns police numbers have increased from 13,716 at 30 June 2002 to 14,579 at 28 February 2006. Additional police have been deployed to specialised operations and taskforces such as Taskforce Gain, now the Middle Eastern Organised Crime Squad, and the Counter Terrorism Coordination Command. Other policing operations include high visibility policing such as Operation Vikings. The Vikings operations deploy large numbers of police into identified crime areas with the aim of reducing crime and anti-social behaviour. In the three years to 30 June 2006 NSW Police will have conducted around 1,350 Viking Operations at a total cost of over $10.5 million.

NSW Police is approximately 40 per cent of the sector and is a major driver, both directly and indirectly, of the sector's expenditure growth with an increase of 25.3 per cent between 2002-03 and 2006-07. As well as increasing police numbers the growth in police expenditure is due to funding for the infrastructure that supports police operations, including equipment, maintenance and an extensive ongoing upgrade of information technology infrastructure.

In 2006-07 an additional $48.2 million ($67.7 million per annum) will be spent on training and deployment of an additional 750 police officers. Police numbers will increase to an average authorised number of 15,206 by 2007.

Increased policing activities and investigations have impacted on the courts system. Since 2002 the number of criminal cases finalised in the Supreme, District and Local Courts has increased by 24 per cent with the largest increase occurring in the Local Court.

The flow-on effect from legislative changes and the criminal courts is an increase in the number of inmates within correctional centres and offenders on community based programs. Between June 2002 and April 2006 the number of full time inmates has increased from 7,667 to in excess of 9,200 reflecting recent legislative amendments that impose longer prison sentences and make obtaining bail more difficult. Changes in bail laws have increased the number of people on remand from around 1,500 in June 2002 to around 2,150 in April 2006. Expenditure in the Department of Corrective Services has increased by 26 per cent from 2002-03 to 2006-07.

The outlook for expenditure growth is modest, reflecting the recent growth in police numbers. In addition, the Bureau of Crime Statistics and Research (BOCSAR) has been reporting reduced or stable crime rates in the majority of crime categories since 2002. The latest BOCSAR report shows that since December 2003 there were significant decreases in seven of the sixteen major crime categories and stability in eight of the remainder.

BOCSAR has also recently examined long term trends in property and violent crime. The analysis showed that robbery with firearm, burglary and car theft are at their lowest level in 15 years. Furthermore, compared to 1995 the rate of robbery with a firearm is 39 per cent lower, murder 37 per cent lower, motor vehicle theft 44 per cent lower, and break and enter dwelling 26 per cent lower.

COMMUNITY AND DISABILITY SERVICES

The Government provides community and disability services to support those who are most disadvantaged in our community or who are at a time of crisis. There is a wide range of responsive services including accommodation for people with a disability and people facing homelessness. Support and intervention services help families and children at risk and frail older people and also assist people with a disability to participate in community life and remain with their families.

Access to community and disability services that improve life outcomes is a priority for the Government. To meet this commitment, total expenditure in this area will reach $3.4 billion in 2006-07, representing 7.9 per cent of general government expenditure.

The key results of community and disability agencies are inter-related with many people being assisted by more than one of these agencies at different stages of their lives. The Government recognises that interventions early in a person’s life or early in the life-cycle of a problem can improve overall outcomes and reduce the severity of later problems.

Future directions in community and disability services are being informed by international research and trends in demand. For instance, early childhood interventions of high quality have been shown to have lasting effects on learning and motivation and hence life opportunities. Providing support when a family caring for a relative begins to face too many pressures can allow the family to continue to care for their relative in a home environment in the longer term.

In focussing on early intervention and prevention, key demand factors, especially for crisis-end services, need to be understood. For instance, increasing community concern and awareness of child abuse, legislative change and wider societal pressures explains increased demand for child protection services.

The Department of Community Services has seen a 555 per cent increase in child protection reports over the period 1995-96 to 2004-05. This has coincided with legislative change, the introduction of centralised reporting and greater community awareness. In December 2002, the Government responded by committing to a $1.2 billion increase in funding for the Department over five years ($308.4 million in 2006-07). A major focus has been on building case worker numbers and enhancing responses to child protection notifications. The package also supports at risk children and families before they reach notification status.

Over the next two years, $97.5 million will be provided from the funding package for early intervention and prevention. This will support the development of children and young people, improving their families' capacity to care for them. A range of services will be provided to families including supported playgroups, centre-based childcare, sustained home visiting and parental education. Despite continuing demand pressures, over time, the package is expected to help moderate demand for child protection services.

The importance of developing social and learning skills early in life is now well documented. Within this context, the Government has an objective of improving access to a quality pre-school program in the year before school. Once the existing community pre-schools sector has been stabilised, an additional $21 million per annum will be provided from 2008-09 to expand community-based services. This will provide subsidised pre-school programs for an extra 10,500 children, bringing levels of attendance at pre-school programs in New South Wales to 95 per cent, a level comparable with other States.

Spending on disability services has grown significantly over the last five years. For example, the period from 2001-02 to 2005-06 has seen an expenditure increase of over 38 per cent. This reflects demand pressures such as ageing carers and improved life expectancies for people with a disability, and wage and other service cost increases including in the non-government sector.

The Government has recently announced a new ten-year strategy *Stronger Together: A new direction for disability services*. *Stronger Together* will provide more assistance for people with disabilities to live in their own home and will also increase the range of options for people who require specialist accommodation. Expenditure by the Department of Ageing, Disability and Home Care will be $1.8 billion in 2006-07, with five year funding allocated to initiatives under *Stronger Together*. There are more places and options including for respite care, therapy programs, day programs and intensive personal care (attendant care). There will be fairer and clearer ways to access services, greater accountability and more opportunities for innovation.

Aboriginal people within the community remain disadvantaged with various economic and social indicators showing considerable disparity in outcomes. The Government's continued commitment to Aboriginal communities has been demonstrated through roll-out of the $40 million four year *Two Ways Together Package*, with $9.5 million being provided in 2006-07. Priority issues including health, education, families and youth are targeted with a strong preventative and early intervention focus.

In addition, the Aboriginal Communities Development Program continues to provide infrastructure to raise the health and living standards of 22 selected, priority Aboriginal communities. This program has a strong prevention focus. For instance, *Housing for Health* improves the condition and safety of houses making them healthier environments in which to live. Completion of the ten year, $240 million program is planned in 2007-08 with expenditure of $37.6 million in 2006-07.

ENVIRONMENT

The environment policy area contrasts with other portfolios which tend to deliver immediate services to an identifiable set of clients (for example, public transport, schools, and hospitals). Environmental and related natural resource management strategies aim to protect and sustain the natural environment – water, air, land – and its natural life for the benefit of both current and future generations.

Expenditure is not demand driven. It is influenced by the changing values of the community, the absolute condition of the environment, the need to strike a balance between environmental protection and economic growth and by the opportunities available to the Government to generate a positive change.

Direct environmental expenditures constitute around 2 per cent per annum of total budget expenditures – and have grown by an average 4 per cent per annum over the last four years. However, year-on-year changes have been volatile reflecting the opportunities presented to the Government. For example, in 2002-03 expenditure grew by 24 per cent reflecting an increase of $109 million for the remediation of the former BHP lands acquired in Newcastle.

In recent years the Government has pursued a broad range of initiatives aimed at reducing environmental degradation and pollution, conserving the State's natural and cultural heritage, fostering sustainable consumption, resource use and waste management and improving the management of the key natural resources of land and water, and of the coastal environment. Given the complexity of the environmental and natural resource issues which we face, these initiatives incorporate a number of different approaches. Much of Government activity relates to environmental and natural resource regulation, including regulation of resource access and the use of market instruments to alter individual behaviour. Other activities relate to direct intervention to halt environmental degradation and protect and restore the natural environment. In addition, substantial payments are being made to assist individuals and entities adjust to reductions in resource access aimed at protecting the resource base.

In its role of environmental regulator, the Government has sought to protect the environment from degradation by developing a sophisticated suite of regulatory mechanisms, including market instruments. It has also adopted a more integrated approach to land use development through the planning system to ensure environmental impacts are considered at the planning stage.

In line with its commitment to a comprehensive, adequate and representative reserve system, the Government has continued to expand the national park estate. Since 1995-96 some 350 parks and reserves have been created, primarily in eastern New South Wales, taking the estate to around 6.6 million hectares. Future expansion will occur predominantly in western New South Wales. This shift in focus is evident in the two most recent additions, the Brigalow and Nandewar Community Conservation Area in northern New South Wales and Yanga Station in south-western New South Wales.

In addition to a direct role in conserving the State's natural heritage, the Government is also pursuing innovative mechanisms for encouraging conservation on private land. The most recent is the Government's proposed Biodiversity Banking Scheme, which is currently under development.

A major challenge facing the State is dry-land salinity and allocation of the State's scarce water resources. In response, the Government has reformed the way in which land and water resources are allocated and managed. These reforms include the establishment of thirteen Catchment Management Authorities (CMAs) to engage communities in natural resource management and deliver projects to restore the natural resource base in their catchment, using both State and Commonwealth monies. The Government has also established the Natural Resources Commission as an independent source of advice on natural resource management issues, including providing a framework to guide the work of CMAs.

In December 2005, the Government commenced the *Native Vegetation Act 2003* as the cornerstone of the Government's commitment to end broad scale land clearing and preserve native vegetation. The Government is continuing delivery on the NSW commitment to water reform under the National Water Initiative, through continued implementation of the *Water Management Act 2000* and ongoing participation in the "Living Murray" and "Water for Rivers" programs.

Also in late 2005, the Government announced the $439 million City and County Environment Restoration Program to commence from 1 July 2006, aimed at addressing key environmental and natural resource management issues, including preserving important wetland areas, continuing the Government's program of establishing marine parks and reducing the ecological footprint of urban centres.

In 2006-07, expenditure is budgeted to increase sharply, by 21 per cent. This is driven primarily by three factors:

- increases in the Department of Environment and Conservation's Environment and Protection program, due to the commencement of the City and Country Environment Restoration Program. Components to be implemented by the Department include the Riverbank program to secure water rights and sustainable water flows for conservation areas and initiatives to improve resource recovery and control the illegal disposal of waste;

- increases in the Environmental Trust's grants program, also under the City and Country Environment Restoration Program, including urban sustainability grants to local councils and grants to farmers as part of native vegetation reform; and

- increased expenditure by the thirteen CMAs as they roll out $436 million in Commonwealth-State funding being channelled through the CMAs to meet catchment management priorities.

This step up in funding is unlikely to be matched by similar increases in future years unless offset by increases in revenue, for example, from environmental charges applied to modify environmentally damaging behaviour.

2.4 STRENGTHENING THE BUDGET SYSTEM

In the *Economic and Financial Statement* the Government committed to developing a new Performance Management and Budgeting System for implementation for the 2008-09 Budget process.

It is important that the Budget focuses on the outcomes the Government is seeking to achieve. The Government has already been working in this area through the development of agency Results and Services Plans.

The key objective of the new system will be to ensure that the Government is doing all it can to use expenditure to serve the public better.

What has been achieved so far

All budget dependent general government agencies now prepare a Results and Services Plan. These plans are being integrated with agency corporate planning and reporting processes.

The Results and Services Plans are used to inform Government decisions about the level of agency funding and any required budget enhancements or efficiencies. The Results and Services Plan is the way agencies can explain how funding proposals will impact on what they can achieve; it is also how the Government can assess the need for existing and new services.

To complement these enhancements to the Budget process, the Expenditure Review Committee of Cabinet was set up by the Premier in August 2005 to lead periodic review of agencies' allocations.

What will be done next

The new Performance Management and Budgeting System will build on the Results and Services Plan approach to establish even stronger links between planning and the funding, monitoring and reporting elements of a performance management cycle.

First, the new system will ensure that direct expenditure on services is clearly linked to Government priorities.

By end September this year the Government will publish its commitment to *Serving the Public Better*. This will be the basis for priority setting within Government. It will also provide a framework for agreeing performance expectations in Results and Services Plans in subsequent Budget years.

As a transitional measure, the 2006-07 Budget Papers have a stronger focus on the results to be achieved for the community. More information on these changes is available in Volume 1 of Budget Paper No. 3.

Second, the new system will continue the drive for efficiency and value for money, and strengthen accountability across Government for delivering high quality public services within budget allocations.

The Expenditure Review Committee of Cabinet will continue to play a critical role in reviewing the effectiveness of agencies' allocations and driving the focus on achieving value for money.

Third, the new system will promote the development of quantifiable measures of services that test and demonstrate the effectiveness of services and value for money.

The Results and Services Plan approach already encourages agencies to set measurable results and to develop a core set of performance indicators. The Government will continue to improve the quality of performance measurement by targeting further improvement in the performance information reported by the major budget dependent agencies.

CHAPTER 3: GENERAL GOVERNMENT SECTOR REVENUES

- ♦ The revenue outcomes reported in this Chapter reflect the impact of cyclical and structural pressures. Despite those pressures, Government policy is directed to encouraging business operation and investment by maximising tax restraint consistent with service delivery objectives.
- ♦ GST revenue grants provided to New South Wales continue to compare poorly with other States (see Chapter 8).
- ♦ Major taxation policies announced in this Budget and since the 2005-06 Budget will reduce revenue by $481 million in 2006-07 rising to over $1.1 billion in 2009-10.
- ♦ There are no new taxes or increases in tax rates in the 2006-07 Budget.
- ♦ Since August 2005, the NSW Government has introduced major tax policy changes to:
  - abolish vendor duty from 2 August 2005;
  - increase the land tax-free threshold for the 2006 land tax year to $352,000;
  - modify increases in club gaming machine duty announced in the 2003-04 Budget from 2006-07; and
  - provide a payroll tax rebate from 1 July 2006 for businesses in high unemployment regions becoming liable for payroll tax for the first time.

  These measures are expected to reduce revenue by $424 million in 2006-07 and $497 million in 2007-08.
- ♦ Taxation measures announced in this Budget will reduce revenue by $57 million in 2006-07 and $196 million in 2007-08.
  - To reduce volatility in land tax liabilities, from the 2007 land tax year land values for tax purposes and the tax-free threshold will be calculated on a three-year average basis.
  - The NSW Government will abolish hire of goods duty from 1 July 2007, lease duty from 1 January 2008, unquoted marketable securities duty from 1 January 2009, mortgage duty in two equal tranches from 1 January 2010 and 1 January 2011, and non-land business transfer duty from 1 July 2012. These duties are estimated to raise around $680 million in 2006-07.
- ♦ Revenue is expected to grow by 2.4 per cent in 2006-07, following 5.1 per cent growth in 2005-06. This easing in growth substantially reflects a reversion to more normal investment returns following the outstanding outcomes in 2005-06.

3.1 INTRODUCTION

Total general government sector revenue is estimated to increase by 2.4 per cent in 2006-07 following growth of 5.1 per cent in 2005-06. The slower growth in total revenue is largely due to a decline in investment income following the extraordinary returns expected in 2005-06.

Table 3.1 summarises the revenue estimates, while Chart 3.1 outlines the composition of total revenue in 2006-07.

Table 3.1: Summary of Revenues

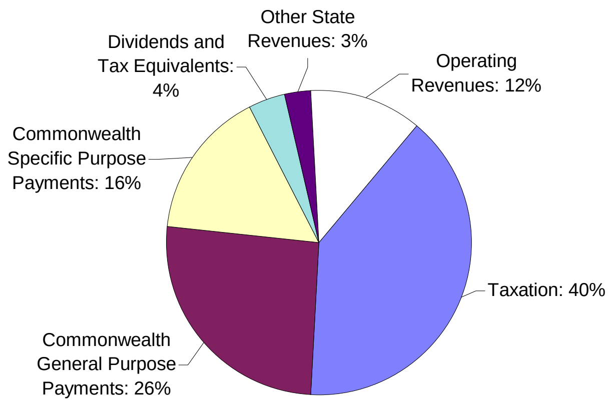
	Actual	*Budget*	*Revised*	*Budget*	*Forward Estimates*		
	2004-05	*2005-06*	*2005-06*	*2006-07*	*2007-08*	*2008-09*	*2009-10*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*
State Revenues							
Taxation	15,332	16,269	15,812	16,719	17,472	18,394	19,365
Commonwealth Grants							
General Purpose Payments	10,181	10,675	10,617	10,946	11,733	12,519	13,239
Specific Purpose Payments	6,011	6,121	6,410	6,679	6,811	7,016	6,958
Dividends and Tax Equivalents	1,600	1,906	1,782	1,664	1,891	1,841	1,998
Other	1,152	1,082	1,203	1,167	1,162	1,172	1,252
	34,276	**36,053**	**35,824**	**37,175**	**39,069**	**40,942**	**42,812**
Operating Revenues							
Sale of Goods and Services	2,830	2,851	2,841	2,999	3,121	3,223	3,302
Investment Income	1,051	971	1,450	914	793	840	896
Grants and Contributions	675	638	779	789	773	788	788
Other	398	347	326	319	312	338	344
	4,954	**4,807**	**5,396**	**5,021**	**4,999**	**5,189**	**5,330**
Total Revenues	**39,230**	**40,860**	**41,220**	**42,196**	**44,068**	**46,131**	**48,142**

State revenue – comprising revenue from State taxes, Commonwealth grants, public trading enterprise dividends and tax equivalent payments, and licences, fees, fines, levies and royalties – should increase by 3.8 per cent in 2006-07.

This outlook is underpinned by growth of 5.7 per cent in tax revenue, up from 3.1 per cent last year, reflecting payroll tax revenue growth and a gradual recovery in the property market. However, Commonwealth grants will grow more modestly (up 3.5 per cent) reflecting the cessation of national competition payments. A small decline in dividends and license fee revenue is also expected. Consequently State revenue will grow by 3.8 per cent in 2006-07 following growth of 4.5 per cent in 2005-06.

Total revenue comprises State Revenue and Operating Revenue. A significant contributor to total revenue in 2005-06 was the extraordinary return on equity investments, which were $479 million higher than expected at Budget time. Excluding this increase in investment income, revised total revenue for 2005-06 is expected to be less than the 2005-06 Budget estimate. The strength of investment returns helped offset the cyclical downturn in property market-related revenues. However, this exceptional performance is not expected to be sustained; investment returns should return to normal levels in 2006-07. This is a significant factor in the slow down in total revenue growth from 5.1 per cent in 2005-06 to 2.4 per cent in 2006-07.

Chart 3.1: Composition of Total Revenue, 2006-07



Section 3.2 details State taxation policy measures in this Budget and since the 2005-06 Budget. Section 3.3 details the estimates for State revenue in 2006-07. The outlook for operating revenue is presented in Section 3.4.

3.2 TAXATION POLICY MEASURES

MEASURES INTRODUCED IN THE 2006-07 BUDGET

Tax changes in this Budget will reduce taxation revenue by $57 million to $16.7 billion in 2006-07 and by $196 million to $17.5 billion in 2007-08. The measures are summarised in Table 3.2.

Table 3.2: Tax Measures in the 2006-07 Budget

Measure	*Revenue Impact* [(a)]			
	2006-07 $m	*2007-08 $m*	*2008-09 $m*	*2009-10 $m*
Calculate land values for land tax purposes and the tax-free threshold on an average of the last three years, from the 2007 land tax year	-57	-98	-117	-123
Abolish hire of goods duty, from 1 July 2007		-73	-81	-83
Abolish lease duty, from 1 January 2008		-25	-80	-84
Abolish unquoted marketable securities duty, from 1 January 2009			-29	-61
Halve the mortgage duty rate, from 1 January 2010 [(b)]				-106
Total	**-57**	**-196**	**-307**	**-457**

(a) *Revenue impacts are expressed in nominal dollars. These figures show the part-year effect of the revenue measures where the change commences during the year.*

(b) *Mortgage duty will be completely abolished from 1 January 2011.*

Land Tax – Introduction of Three-Year Averaging

Large annual changes in land tax liabilities resulting from volatility in annual land values are a major source of taxpayer complaint. In an October 2005 report, *Improving the Quality of Land Valuations issued by the Valuer General*, the NSW Ombudsman recommended consideration be given to basing land tax assessments on a rolling three- or five-year average land value.

To reduce volatility in land tax liabilities in future, land tax liabilities will be calculated on the basis of average land values for the past three years.

From the 2007 land tax year, land values for land tax purposes will be based on a three-year average of the most recent land valuations. Prior to the change, land tax in 2007 would have been based on land values as at 1 July 2006. Now, the value for land tax purposes in 2007 will be the average of the 1 July 2004, 1 July 2005 and 1 July 2006 valuations.

Consistent with the averaging of land values, the tax-free threshold will also be averaged. The 2007 average land tax threshold will be equivalent to the average of the 2005, 2006 and 2007 current year land tax thresholds. The 2007 current year threshold will depend on the Valuer General's determination of land values for 1 July 2006; however, to smooth the transition to the new average threshold the Government will ensure that the average 2007 threshold will be at least $352,000 – that is, no less than the 2006 current year threshold.

New South Wales is the only State that indexes the tax-free threshold each year. Consistent with current arrangements, the average land tax threshold will also be indexed.

The introduction of averaging will reduce land tax revenue, since rising land values mean that the average land value will be lower than the current land value. Revenue is estimated to be $57 million lower in 2006-07, with the revenue loss growing to $123 million in 2009-10.

As noted above, the objective of averaging is to reduce volatility in taxable land values. The impact of averaging on each taxpayer will depend on their circumstances. While averaging tends to slow the growth of taxable land values during a rising market, averaging will have the opposite effect during a slowing market. However, the general trend is for land values to rise. Over the longer term, annual falls in house prices (the best available proxy for land values) have been recorded only twice in the past 20 years (the period for which data is available).

New Tax System Changes

The NSW Government will abolish the stamp duties mentioned for review in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA) on the following timetable:

- hire of goods duty from 1 July 2007;
- lease duty from 1 January 2008;
- unquoted marketable securities duty from 1 January 2009;
- mortgage duty in two equal tranches, halving the rate from 1 January 2010 and abolishing entirely from 1 January 2011; and
- transfer duty on non-land business assets from 1 July 2012.

New South Wales has always recognised the desirability of abolishing these inefficient taxes. However, the large shortfall that New South Wales incurred in its GST grants compared to the original expectations made abolition of the taxes in line with the Commonwealth timetable fiscally irresponsible.

The abolition of these duties will still be at a significant cost to the NSW Budget. Together these duties are projected to raise around $680 million in State revenue in 2006-07. Abolition of these taxes will have a significant impact on the growth in State revenue over the next six years and as a consequence the ability to fund services. Further details on the background to these measures and their overall impact on the NSW Budget are provided in Chapter 8.

MEASURES INTRODUCED SINCE THE 2005-06 BUDGET

The Government has announced several major tax policy changes since the 2005-06 Budget. Those measures are summarised in Table 3.3.

Table 3.3: Tax Measures Since the 2005-06 Budget

Measure	*Revenue Impact* [(a)]				
	2005-06 $m	*2006-07 $m*	*2007-08 $m*	*2008-09 $m*	*2009-10 $m*
Abolish vendor duty on contracts exchanged on or after 2 August 2005 [(b)]	-265	-382	-409	-429	-450
Increase the tax-free threshold for land tax to $352,000, from $330,000, for the 2006 land tax year	-43	-53	-57	-60	-64
Modify club gaming machine duty rates announced in the 2003-04 Budget with effect from 1 September 2006		11	-25	-80	-139
Payroll tax rebates for businesses becoming liable for payroll tax for the first time in regions with above-average unemployment rates, from 1 July 2006 [(c)]			-6	-13	-21
Total	**-308**	**-424**	**-497**	**-582**	**-674**

(a) Revenue impacts are expressed in nominal dollars. These figures show the part-year effect of the revenue measures where the change commences during the year.

(b) Gross revenue cost of abolishing vendor duty. Any possible indirect impact on transfer duty revenue is not included.

(c) Rebates under the scheme will be first payable in 2007-08.

Vendor Transfer Duty – Abolished

On 2 August 2005, the Premier announced that vendor transfer duty on the sale of investment properties would be abolished on all contracts exchanged on or after that day. In doing so, the Premier noted that property market conditions had slowed markedly since the duty was introduced in the April 2004 Mini-Budget.

Abolition of vendor duty is estimated to have cost $265 million in 2005-06 and $382 million in 2006-07.

Land Tax – Tax-free Threshold Increased

On 25 January 2006, the Premier announced an increase in the tax-free threshold for land tax in the 2006 land tax year from the $330,000 announced in the 2005-06 Budget to $352,000. The increase reflected the average increase of 6.7 per cent in the value of land subject to land tax over the year to 1 July 2005, as determined by the NSW Valuer General.

The increase in the tax-free threshold to $352,000 is expected to release an additional 12,000 property investors from the need to pay land tax – on top of the 375,000 estimated to have been removed from the land tax base when the tax-free threshold was reinstated.

The measure is expected to reduce land tax revenue by $43 million in 2005-06 and $53 million in 2006-07.

Club Gaming Machine Duty – Reduced Rates

On 27 March 2006 the Government and the club industry signed a Memorandum of Understanding on new club gaming machine duty rates for the period 2006-07 to 2011-12 to replace those announced in the 2003-04 Budget. The agreed tax rates are shown in Table 3.4.

Table 3.4: Annual Club Gaming Machine Duty Rates [(a)]

	Annual Revenue Range ($)						
Marginal rates from 1 September (%):	*Up to 200,000*	*200,001 to 1,000,000*		*1,000,001 to 5,000,000*	*5,000,001 to 10,000,000*	*10,000,001 to 20,000,000*	*20,000,001 and above*
		Clubs earning up to $1,000,000	*Clubs earning $1,000,001 and over [(b)]*				
2006	0.0	10.0	10.0	21.0	25.5	27.7	27.7
2007	0.0	0.0	10.0	21.0	26.0	29.0	30.9
2008	0.0	0.0	10.0	21.0	26.0	29.0	30.9
2009	0.0	0.0	10.0	21.0	26.0	29.0	30.9
2010	0.0	0.0	10.0	21.0	26.0	29.0	30.9
2011	0.0	0.0	10.0	21.0	26.0	29.0	30.9

(a) For gaming revenue higher than $1,000,000, rates shown are before the 1.5 percentage point Community Development and Support Expenditure (CDSE) Scheme duty rate reduction. Under the CDSE Scheme, marginal duty rates on gaming revenue above $1,000,000 are reduced by 1.5 percentage points if clubs contribute 1.5 per cent of gaming revenue in excess of $1 million to eligible community projects.

(b) For clubs earning gaming revenue above $1,000,000 a year from 1 September 2007 the benefit of the tax-free threshold in the $200,000 to $1,000,000 revenue range will be withdrawn dollar for dollar as gaming revenue exceeds $1,000,000, with complete withdrawal when revenue reaches $1,800,000.

The rates shown in Table 3.4 are marginal tax rates so that, for example, a club with gaming revenue of $4 million a year from 1 September 2006 will pay no tax on the first $200,000 of revenue, 10 per cent on income in the range $200,000 to $1 million and 21 per cent on revenue above $1 million.

The main features of the revised arrangement are:

- clubs earning under $1 million a year in gaming revenue – more than half of all NSW clubs – will pay no State gaming machine duty from 1 September 2007;

- the current $200,000 tax-free threshold will apply for clubs earning more than $1 million a year in gaming revenue. However, clubs earning gaming revenue of more than $1 million a year will have the benefit of the tax-free threshold between $200,000 and $1,000,000 withdrawn dollar-for-dollar as gaming revenue exceeds $1,000,000, with complete withdrawal when revenue reaches $1,800,000 a year (see Table 3.5 for examples of how the withdrawal will work);

- the new marginal rates of club gaming machine duty taking effect from 1 September 2007, will be frozen at the new rates until 31 August 2012; and

- from 1 September 2008, marginal rates of club gaming machine duty in all revenue ranges will be lower than the rates announced in the 2003-04 Budget.

Under the new rates, the top marginal duty rate will be 30.9 per cent (before the 1.5 per cent point reduction available under the Community Development and Support Expenditure Scheme) rather than 40 per cent under the 2003-04 Budget rates. The top rate will apply on gaming revenue over $20,000,000 a year rather than $10,000,000 a year under the 2003-04 Budget rates.

The duty rate cuts will reduce club gaming duty revenue by $233 million over the Budget and forward estimates years.

Table 3.5: Tax Paid following Changes to Tax-Free Threshold for Clubs with Annual Gaming Revenue above $1,000,000 from 1 September 2007

Annual Club Gaming Revenue	*Base Tax-free Threshold*	*Second Tax-free Threshold*	*Total Tax-free Threshold*	*Tax Paid on Gaming Revenue below $1 million*	*Tax Paid on Gaming Revenue above $1 million* [(a)]	*Total Tax Paid*
$	*$*	*$*	*$*	*$*	*$*	*$*
100,000	200,000	800,000	1,000,000	0	na	0
500,000	200,000	800,000	1,000,000	0	na	0
1,000,000	200,000	800,000	1,000,000	0	na	0
1,200,000	200,000	600,000	800,000	20,000	42,000	62,000
1,400,000	200,000	400,000	600,000	40,000	84,000	124,000
1,600,000	200,000	200,000	400,000	60,000	126,000	186,000
1,800,000	200,000	0	200,000	80,000	168,000	248,000
1,900,000	200,000	0	200,000	80,000	189,000	269,000
2,000,000	200,000	0	200,000	80,000	210,000	290,000

(a) Calculated tax paid on revenue above $1 million a year is before the 1.5 percentage point duty rate reduction available under the CDSE Scheme. See Table 3.4, footnote (a).

Payroll Tax – Rebate Incentive Scheme

In the 23 February 2006 *Economic and Financial Statement*, the Government announced a payroll tax incentive to encourage business investment and job creation in New South Wales.

Small and medium sized businesses with an annual eligible payroll of up to $3,000,000 establishing or expanding in above-average unemployment regions of New South Wales will, from 1 July 2006, be eligible for a full payroll tax rebate for the first three years, a two-thirds rebate in year four and a one-third rebate in year five.

The rebate will be open to applicants for a period of three years from 1 July 2006 to 30 June 2009. To be eligible, businesses must be required to pay payroll tax in New South Wales for the first time in the year of application, either because they are start-up businesses, businesses relocating from interstate or overseas, or businesses expanding their payroll and becoming liable to payroll tax for the first time.

Regions eligible for the scheme must have had unemployment rates above the NSW State average in both of the two years to January prior to the relevant financial year. For 2006-07 the eligible statistical regions are: Richmond-Tweed, Mid-North Coast, Gosford-Wyong, Illawarra, Wollongong, Fairfield-Liverpool, Hunter, Newcastle, Outer South Western Sydney and Canterbury-Bankstown.

The rebate is estimated to cost $95 million over the seven years and around 1,400 businesses are expected to benefit.

TAX RESTRAINT

The *Fiscal Responsibility Act 2005* – Fiscal Principle No. 10 – requires that any changes to legislated tax rates, thresholds and bases be made with the maximum possible restraint having regard to the effect of these changes on the overall level of tax revenue, and that changes should be consistent with a reasonable degree of predictability and stability of tax rates, thresholds and bases for future years.

One indicator of tax restraint is the impact of policy decisions on revenue collections over time, as shown in Tables 3.2 and 3.3. Those tables show that major tax policies announced in this Budget and since the 2005-06 Budget will reduce revenue by $481 million in 2006-07 rising to over $1.1 billion in 2009-10.

Another measure of tax restraint is to examine the impact on revenue in any one year of measures that take effect for the first time in that year regardless of when the measure was announced. Under this approach, the revenue impact of measures announced to take effect part way through a financial year will be shown in two financial years with the part year revenue impact shown in the first year and the difference between the full year and part year revenue impact shown in the following financial year. Table 3.6 shows the impact of tax changes on this basis.

In the five years from 1999-2000 to 2003-04, revenues were reduced by an average of $320 million each year by tax policy changes implemented for the first time in each of those years. In 2004-05, the impact of tax policy changes increased revenue, while in 2005-06 and 2006-07 the net effect of policy changes was to slightly diminish revenue.

Table 3.6 also shows that over the three years from 2007-08, tax policy changes implemented for the first time in each those years are estimated to reduce government revenue by an average of around $170 million in that year.

Table 3.6: Impact of Revenue Policy Changes [(a)]

Year	*Annual Contribution of New Policy Changes to Revenue Collections* [(b)] *$m*
1988-89	50
1989-90	200
1990-91	310
1991-92	80
1992-93	240
1993-94	100
1994-95	(-) 40
1995-96	20
1996-97	180
1997-98	280
1998-99	(-) 110
1999-2000	(-) 390
2000-01	(-) 310
2001-02	(-) 340
2002-03	(-) 420
2003-04	(-) 140
2004-05	230
2005-06	(-) 20
2006-07	(-) 40
2007-08	(-)140
2008-09	(-)150
2009-10	(-)210

(a) This table shows the effect of new policy on revenue in any one year only. Where the revenue change commenced during the year, and therefore had only a part year effect in that year, the balance is included in the following year. For example, if a policy has a part year impact of $50 million in the year it commences and a full year impact of $70 million, the impact of the policy is measured as $50 million in the year it commences and $20 million in the following year.

(b) Expressed in nominal dollars. Notes on specific years: (1) from 1999-2000 to 2003-04, and from 2006-07, annual indexation of the land tax threshold is treated as a discrete tax change, and from 2004-05 annual indexation of the parking space levy is treated as a discrete tax change; (2) 1996-97 to 1998-99 include the tax increases to fund Fiscal Contribution Payments to the Commonwealth; (3) 1997-98 excludes the one-off loss from abolishing business franchise fees and their replacement by Commonwealth safety net taxes; (4) 2000-01 to 2005-06 excludes State taxes abolished with the introduction of the GST.

3.3 ESTIMATES OF STATE REVENUE

TAXATION

Table 3.7 provides detailed estimates of taxation revenue for the period to 2009-10.

The two largest sources of taxation are payroll tax and transfer duty (see Chart 3.2). While payroll tax collections are relatively stable, transfer duty can vary significantly from year to year as it is affected by fluctuations in the volume of property transactions.

Chart 3.2: Composition of Tax Revenue, 2006-07

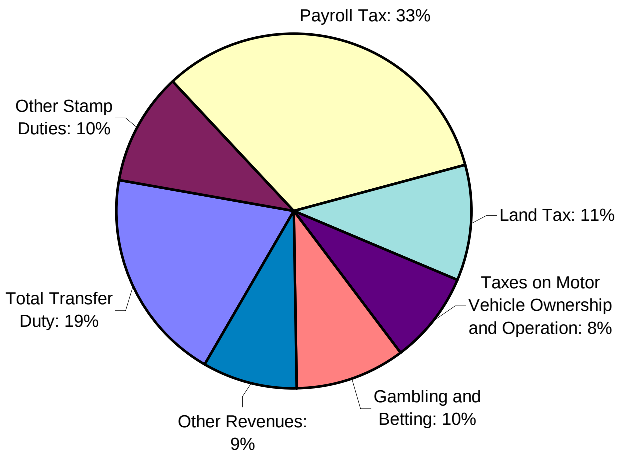


Table 3.7: Taxation Revenue

	Actual	Budget	Revised	Budget	Forward Estimates		
	2004-05 *$m*	*2005-06* *$m*	*2005-06* *$m*	*2006-07* *$m*	*2007-08* *$m*	*2008-09* *$m*	*2009-10* *$m*
Stamp Duties							
Transfer Duty							
Purchaser Transfer Duty	2,911	3,250	3,100	3,250	3,500	3,775	4,065
Vendor Transfer Duty	371	358	93	…	…	…	…
Total Transfer Duty	3,282	3,608	3,193	3,250	3,500	3,775	4,065
Other Stamp Duties							
Insurance	423	541	521	609	636	655	685
Mortgages	324	379	320	348	373	400	324
Marketable Securities	69	55	60	57	58	31	…
Motor Vehicle Registration Certificates	570	608	550	575	603	629	658
Hire of Goods	76	77	77	79	7	…	…
Leases	60	62	68	72	51	…	…
Other	2	2	2	2	3	3	3
	4,806	**5,332**	**4,791**	**4,992**	**5,231**	**5,493**	**5,735**
Payroll Tax	**4,837**	**5,114**	**5,112**	**5,438**	**5,810**	**6,176**	**6,555**
Land Tax	**1,646**	**1,633**	**1,737**	**1,793**	**1,827**	**1,923**	**2,035**
Taxes on Motor Vehicle Ownership and Operation							
Weight Tax	1,003	1,046	1,054	1,105	1,160	1,217	1,276
Vehicle Registration and Transfer Fees	244	253	254	265	276	286	302
Other Motor Vehicle Taxes	25	26	26	27	29	30	31
	1,272	**1,325**	**1,334**	**1,397**	**1,465**	**1,533**	**1,609**
Gambling and Betting							
Racing	157	160	153	160	165	170	175
Club Gaming Devices	500	562	568	655	616	637	665
Hotel Gaming Devices	395	438	418	454	443	465	507
Lotteries and Lotto	281	295	288	296	303	311	319
Casino	89	86	91	98	90	92	95
Other Gambling & Betting	9	8	8	9	9	10	10
	1,431	**1,549**	**1,526**	**1,672**	**1,626**	**1,685**	**1,771**

Table 3.7: Taxation Revenue (cont)

	Actual	Budget	Revised	Budget	Forward Estimates		
	2004-05 $m	2005-06 $m	2005-06 $m	2006-07 $m	2007-08 $m	2008-09 $m	2009-10 $m
Other Revenues							
Health Insurance Levy	102	106	106	111	114	118	122
Insurance Protection Tax	68	69	69	69	69	69	69
Parking Space Levy	46	44	44	45	46	47	48
Fire Brigades Levy	317	343	343	358	352	354	354
Bush Fire Services Levy	99	103	103	124	126	125	129
Waste and Environment Levy	104	107	118	175	220	265	309
Government Guarantee of Debt	109	129	98	100	124	130	146
Private Transport Operators Levy	10	7	12	12	12	13	13
Pollution Control Licences	44	42	44	44	44	44	48
Other Taxes	441	366	375	389	406	419	422
	1,340	**1,316**	**1,312**	**1,427**	**1,513**	**1,584**	**1,660**
Total Tax Revenue	**15,332**	**16,269**	**15,812**	**16,719**	**17,472**	**18,394**	**19,365**

In 2006-07, total taxation revenue is estimated to rise by 5.7 per cent following a 3.1 per cent increase in 2005-06. Payroll tax and purchaser transfer duty are the two largest contributors to revenue growth.

Transfer Duty (including Vendor Transfer Duty)

Transfer duty is the largest component of stamp duty revenue, accounting for nearly two-thirds of total stamp duty collections. It is also the most volatile component of stamp duties, with annual changes varying between minus 30 per cent and plus 97 per cent in the period from 1978-79 to 2005-06.

The cyclical downturn in the property market has had a significant impact on Budget revenue. Purchaser transfer duty revenue fell $1 billion, or 26 per cent, in 2004-05 from its peak of $3.9 billion in the previous year. Largely as a consequence of this downturn, tax revenue growth slowed sharply to 2 per cent in 2004-05 down from growth of 6.2 per cent in 2003-04.

As expected in the 2005-06 Budget, purchaser transfer duty recovered a little in 2005-06 reflecting a modest improvement in property market activity, while the abolition of vendor duty for all transactions entered into on or after 2 August 2005 detracted $265 million from the Budget estimate for 2005-06.

The pick up in property market activity is expected to continue in 2006-07, albeit at a slower rate following the 25 basis point increase in interest rates in May 2006.

Recovery in the property market has not been even. The downturn was milder and the recovery quicker in the non-residential sector, which has supported revenue growth in 2005-06. Within the residential market, owner-occupier activity bottomed out during the year and has started to grow again. Residential investor activity, while still above historical levels as a share of the market, has continued to fall.

Interest rates will have a significant bearing on the outlook for property market activity, as purchasers are very sensitive to financing costs. Further interest rate increases, on top of the increase in May 2006, would significantly impede the emerging recovery in activity. In addition, investors will be focused on overall returns from property (capital value and yield) which have been affected by falling house prices over the past two years.

Other Stamp Duties

Other stamp duty revenue is estimated to increase by 9 per cent in 2006-07 following a rise of 4.9 per cent in 2005-06.

The major increases are in insurance duty due to the full year impact of the increase in the general insurance duty rate from 1 September 2005, mortgage duty, reflecting a modest recovery in the property market and motor vehicle registration certificates duty as a result of higher sales of new vehicles.

Payroll Tax

Payroll tax revenue is estimated to increase by 5.7 per cent in 2005-06. Data from the Office of State Revenue suggest that the moderate growth in revenue is broadly similar across all sectors of the economy that are liable for payroll tax.

Payroll tax revenue growth for 2006-07 is estimated to accelerate slightly from 2005-06 to 6.4 per cent, in line with employment and wages growth.

Land Tax

Land tax is assessed annually. Notices of assessment are mainly issued in February, and are based on land values assessed by the NSW Valuer General as at 1 July in the preceding year. Thus, land tax revenue accrued in a financial year depends on the issue date of assessments and land values at the beginning of the financial year. From the 2007 land tax year, land values will be based on the average value of land over the previous three years which will make land tax revenue more predictable.

Land tax revenue in 2005-06 will be 5.5 per cent higher than in 2004-05. The increase reflects a 6.7 per cent increase in average taxable land values across the State (over the year to July 2005). To prevent the increase in land values leading to more land owners becoming liable for land tax, the Government increased the tax-free threshold by 6.7 per cent.

Revenue growth is estimated to slow to 3.2 per cent in 2006-07, mainly as a result of the effects of averaging land values over three years reducing the taxable value of properties.

Taxes on Motor Vehicle Ownership and Operation

Motor vehicle weight tax and vehicle registration fees are the two largest components of this category, representing around 86 per cent of revenue in 2005-06. Also included are motor vehicle registration transfer fees and miscellaneous motor vehicle taxes.

Continued growth in the motor vehicle fleet and indexation of fees will result in revenue growth of 4.7 per cent in 2006-07.

Gambling and Betting Taxes

Gambling tax revenue in 2005-06 will be 6.6 per cent higher than in 2004-05. This chiefly reflects increases in household disposable income and club and hotel gaming machine duty rates announced in the 2003-04 Budget.

Gambling revenue is expected to increase in 2006-07 by 9.6 per cent, mainly from increases in club and hotel gaming machine duty rates. In 2007-08, revenue is expected to decrease slightly due to the impact of smoking bans on club and hotel gaming machine duty and casino duty.

COMMONWEALTH GRANTS

Table 3.8 provides estimates of Commonwealth payments to New South Wales for the period to 2009-10.

The NSW Treasurer commissioned an independent review by Associate Professor Neil Warren of the University of New South Wales comparing and benchmarking Australian and international arrangements for the allocation of taxation powers and expenditure responsibilities between central and subnational governments, and mechanisms for fiscal transfers between governments.

The Report found that Australia's system of intergovernmental financial arrangements are complex and hinder adjustments that are essential for the economy to develop and grow. Further details on the Warren Report are contained in Chapter 8.

Table 3.8: Commonwealth Grants

	Actual	*Budget*	*Revised*	*Budget*	*Forward Estimates*		
	2004-05 $m	*2005-06 $m*	*2005-06 $m*	*2006-07 $m*	*2007-08 $m*	*2008-09 $m*	*2009-10 $m*
GST Revenue Grants	9,884	10,373	10,244	10,941	11,728	12,513	13,233
Budget Balancing Assistance Payments	…	…	44	…	…	…	…
Compensation for GST Deferral	64	37	37	5	5	6	6
National Competition Policy Payments	233	265	292	…	…	…	…
Total General Purpose Payments	**10,181**	**10,675**	**10,617**	**10,946**	**11,733**	**12,519**	**13,239**
Specific Purpose Payments							
Companies Regulation	53	55	54	57	59	61	61
Technical and Further Education	384	383	401	406	415	422	429
Schools	771	851	903	894	903	877	908
Highly Specialised Drugs	155	178	164	185	190	196	201
Australian Health Care Grants	2,662	2,804	2,811	2,943	3,093	3,229	3,358
Home and Community Care	248	268	266	291	314	339	362
Supported Accommodation Assistance	56	57	57	58	59	62	63
Assistance to Disabled	186	194	194	201	203	207	211
Pensioner Concessions	66	69	69	70	72	74	77
Debt Redemption Assistance	10	74	74	…	…	…	…
National Land Care	56	40	40	40	20	8	8
Public Housing	241	244	243	247	250	250	250
National Land Transport (Auslink)	532	472	494	695	779	887	620
Housing	37	38	38	38	39	39	39
Other	554	394	602	554	415	365	371
Total Specific Purpose Payments	**6,011**	**6,121**	**6,410**	**6,679**	**6,811**	**7,016**	**6,958**
Total Grants	**16,192**	**16,796**	**17,027**	**17,625**	**18,544**	**19,535**	**20,197**

In 2006-07, Commonwealth general purpose payments will grow by 3.1 per cent, following the ending of National Competition Policy payments in 2005-06.

Specific purpose payments are predicted to increase by $269 million, or 4.2 per cent, in 2006-07. Higher National Land Transport Grants (mainly to fund upgrades of the Hume and Pacific Highways) are expected to be partially offset by declines associated with an ending of assistance for the transfer of debt to the State and unwinding of the 2005-06 increase in rural assistance grants (within the Other Specific Purpose Payment category).

Further details of Commonwealth grants are contained in Chapter 8.

DIVIDENDS AND TAX EQUIVALENTS

The payment of dividends and income tax equivalents is an important commercial discipline for Government businesses. Requiring a return on the Government's equity investment in the form of dividends, and the payment of income tax equivalents, ensures competitive neutrality with the private sector and encourages public trading enterprises to make commercial investment decisions.

Dividends are based on commercial principles which include ensuring businesses retain a prudent level of cash for operational and investment needs. Determining appropriate dividends (both in forecasts and actual payments) requires a case-by-case consideration of excess cash available in each business after allowing for working capital, funding of approved capital expenditure (taking into account the appropriate capital structure of the business) and a contingency for financial flexibility.

Table 3.9 provides estimates of dividends and tax equivalents for the period to 2009-10.

Table 3.9: Dividend and Tax Equivalent Payments from Public Trading and Financial Enterprises

	Actual	*Budget*	*Revised*	*Budget*	*Forward Estimates*		
	2004-05 $m	*2005-06 $m*	*2005-06 $m*	*2006-07 $m*	*2007-08 $m*	*2008-09 $m*	*2009-10 $m*
Dividends							
Electricity	626	855	790	744	821	845	908
Water, Property and Resources	309	348	323	283	389	324	373
Financial Services	24	18	4	29	30	32	33
Ports	28	29	27	23	26	16	17
Other	37	35	34	37	37	37	38
	1,024	**1,285**	**1,178**	**1,116**	**1,303**	**1,254**	**1,369**
Income Tax Equivalents							
Electricity	392	393	405	364	367	345	363
Water, Property and Resources	125	172	137	124	160	175	204
Financial Services	11	6	10	10	11	11	11
Ports	28	34	36	35	35	39	36
Other	20	16	16	15	15	17	15
	576	**621**	**604**	**548**	**588**	**587**	**629**
Total Payments	**1,600**	**1,906**	**1,782**	**1,664**	**1,891**	**1,841**	**1,998**

Total dividend and tax equivalent payments in 2005-06 are $124 million, or 6.5 per cent, lower than the 2005-06 Budget Estimate. The major contributor is a $60 million, or 11.5 per cent reduction in payments from the water, property and resources sector, primarily due to lower revenue from developer capital contributions to Sydney Water Corporation and declining property sales revenue following a weakening in the property/development market. The electricity sector recorded a $53 million, or 4.2 per cent, fall in total dividend and tax equivalent payments, owing largely to the impact of the volatile spot market prices and volumes in late 2005 on the Electricity Tariff Equalisation Fund.

The forecast decline of 6.6 per cent in total payments in 2006-07 is also primarily due to lower dividends and tax equivalents from the electricity and water, property and resources sectors.

The $87 million fall in forecast electricity dividend and tax equivalent payments in 2006-07 is largely the result of a combination of higher capital expenditure, depreciation and interest expense. The increase in capital expenditure is to meet growth in demand for electricity and ensure continued reliability and security of electricity supply across the State.

Increased expenditures and general operating costs, and enhanced demand management measures announced in the Metropolitan Water Plan have led to a $34 million fall in forecast water, property and resources sector dividend and tax equivalent payments with a further forecast $19 million fall largely stemming from falling land sales due to the expected continued weakness in the property/development market.

OTHER STATE REVENUES

Licences

More than 85 per cent of revenue in this item comes from drivers' and riders' licences. Revenue is variable (see Table 3.10) mainly because of the renewal pattern of three and five year drivers' licences, with a significant reduction in revenue expected in 2006-07.

Fees

This category is made up of a variety of fees such as boat registrations, security industry fees, NSW Fisheries fees and motor vehicle dealers fees. The majority of fees are charged annually and therefore growth in revenue is relatively stable. The increase in revenue in 2008-09 reflects the five-yearly renewal pattern for firearm licences.

Fines

The main item – over 90 per cent – in this category relates to motor traffic fines. Total fine revenue in 2005-06 is expected to be 19.7 per cent lower than 2004-05 and 6.1 per cent lower than the 2005-06 Budget estimate. This is due to revenue from the Infringement Processing Bureau returning to normal levels in 2005-06 following processing of a backlog of fines in 2004-05, as well as reductions in the dollar amount of motor traffic fines from April 2005.

In 2006-07, total fine revenue is expected to grow by 2.3 per cent, with motor traffic fines growing by 2.9 per cent.

Table 3.10: Other State Revenues

	Actual	Budget	Revised	Budget	Forward Estimates		
	2004-05 $m	2005-06 $m	2005-06 $m	2006-07 $m	2007-08 $m	2008-09 $m	2009-10 $m
Licences	155	162	160	105	100	123	169
Fees	125	115	130	143	147	158	150
Fines	269	230	216	221	236	245	251
Royalties	396	413	485	501	480	445	480
Fire Brigades Levy on Local Government	53	57	57	60	59	59	59
Other State Revenues	154	105	155	137	140	142	143
Total Other Revenue	**1,152**	**1,082**	**1,203**	**1,167**	**1,162**	**1,172**	**1,252**

Royalties

Royalties are dependent upon commodity prices and sales volumes. Revenue in 2005-06 was higher than anticipated in last year's Budget, mainly on account of higher than expected coal prices. Coal prices are expected to remain high in 2006-07, leading to a 3.3 per cent increase in revenue. Expected price movements drive revenue growth in the forward years.

3.4 ESTIMATES OF OPERATING REVENUES

Operating revenues are earned by general government agencies in the normal course of their operations. The primary source is user charges levied to recover the costs of providing goods or services. Table 3.11 provides estimates of operating revenues for the period to 2009-10.

Table 3.11: Operating Revenues

	Actual	Budget	Revised	Budget	Forward Estimates		
	2004-05	2005-06	2005-06	2006-07	2007-08	2008-09	2009-10
	$m	$m	$m	$m	$m	$m	$m
Sales of Goods and Services							
Rents and leases	141	117	141	146	153	159	161
Fees for Service	120	113	122	140	148	160	163
Entry Fees	28	23	27	29	30	31	31
Patient Fees and Other Hospital Charges	686	666	666	698	730	759	778
Department of Veterans' Affairs	264	287	296	305	315	323	331
Court Fees	148	152	159	162	167	172	176
Road Tolls	75	74	81	84	80	81	81
Other Sales of Goods and Services	1,368	1,419	1,349	1,435	1,498	1,538	1,581
	2,830	**2,851**	**2,841**	**2,999**	**3,121**	**3,223**	**3,302**
Investment Income	1,051	971	1,450	914	793	840	896
Grants and Contributions	675	638	779	789	773	788	788
Other Operating Revenues	398	347	326	319	312	338	344
Total Operating Revenue	**4,954**	**4,807**	**5,396**	**5,021**	**4,999**	**5,189**	**5,330**

SALES OF GOODS AND SERVICES

Sales of goods and services revenue comes from the use of government assets as well as revenue generated by agencies in their normal trading activities.

During 2005-06, $31 million in revenue to NSW Businesslink – a Government owned business providing corporate services to, amongst others, the Department of Housing – was reclassified. This amount is paid as a grant from the Department of Housing to NSW Businesslink. Accordingly it is now reflected in Grants and Contributions received by NSW Businesslink and no longer recognised within the Other Sales of Goods and Services category.

Overall, however, total 2005-06 revenue from the sales of goods and services is $2,841 million, $10 million lower than the 2005-06 Budget estimate.

For 2006-07, total revenue from sales of goods and services is expected to increase by 5.6 per cent.

A major review of ambulance fees and charges conducted by the Independent Pricing and Regulatory Tribunal in 2005-06 found that the current service fee structure did not reflect the cost of services. The recommendations of the Tribunal have been generally adopted with a resulting increase in charges from 2006-07. It is estimated the changes will provide additional revenue within the Fee for Service category of $16 million in 2006-07 and $17 million in 2007-08.

INVESTMENT INCOME

Investment income includes interest on advances to public trading enterprises, income from NSW Treasury Corporation Hour-Glass facilities and bond portfolios, and interest on private sector deposits.

Investment income in 2005-06 exceeded the original Budget estimate by $479 million or 49.3 per cent mainly because of higher than expected returns from funds invested by the NSW Self Insurance Corporation. A 37 per cent decline in 2006-07 reflects a return to more normal investment yields from these funds and a decline in assets. The decline in asset balances is due to the General Government Liability Management Fund ($6.5 billion) being closed and Health Super Growth Fund ($420 million) being transferred, and another $1 billion from NSW Self Insurance Corporation being transferred to the State Super fund (see Chapter 4 for more details). Provisioning has been made within the Health Budget for ongoing payment at the investment return ($23.5 million in 2006-07).

GRANTS AND CONTRIBUTIONS

In 2005-06, revenue from grants and contributions will be $141 million higher than anticipated. The extra revenue is mainly due to:

- State water and electricity utilities contributing $73 million toward the Energy and Water Savings Funds;
- State water utilities providing $37 million to the Country Town Water Supply and Sewage program; and
- recognition of $31 million in revenue from NSW Businesslink as a grant (see Sales of Goods and Services for more details).

For 2006-07, grants and contributions revenue should be virtually unchanged.

OTHER OPERATING REVENUE

In 2005-06, Other Operating Revenue is expected to be $21 million less than initially projected. This result largely reflects $48 million lower revenue from the Crown Leaseholds Entity due to fewer leases taken out over Crown land than anticipated.

For 2006-07, Other Operating Revenues are estimated to decline slightly.

CHAPTER 4: ASSETS, LIABILITIES AND NET WORTH

- The State's balance sheet remains in a strong financial position despite the cyclical impact of a downturn in the property market on short-term budget results.
- The value of physical assets for the four-year period ending 30 June 2010 is projected to increase from $173 billion to $199 billion, reflecting the impact of the State’s record $41.3 billion capital works program – up over 45.1 per cent compared to the four-year period ending 30 June 2006.
- State sector net financial liabilities are forecast to increase from 15.9 per cent of gross state product at 30 June 2006 to 16.9 per cent in 2010. General government sector net financial liabilities for the same period are estimated to reduce from 8.7 per cent to 8 per cent.
- State sector underlying net debt will increase by $19.6 billion for the four year period ending 30 June 2010. The main increase is in the public trading enterprise sector. State underlying net debt levels will remain prudent, being forecast at 9.1 per cent of gross state product at 30 June 2010 and interest expense will be less than 5.2 per cent of total revenue over 2009-10.
- General government underlying net debt will increase to $9.1 billion by 30 June 2010, and will be 2.3 per cent of gross state product (1.7 per cent if the impact of the additional contribution to superannuation is removed). Forecast higher underlying debt levels will still result in a relatively low interest expense/revenue ratio of 2.9 per cent in 2009-10. The increase in general government underlying net debt will fund higher levels of capital expenditure compared to the previous four years, in the context of an initially smaller surplus being available from operating activities.
- Current forecasts suggest that general government superannuation obligations are on track to be fully funded by 30 June 2030.
- The State’s self insurance scheme, Treasury Managed Fund, has reduced member agencies’ overall premiums by 10.4 per cent in 2006-07. This is a direct result of reducing claims expenses following the Government’s workers compensation and tort reform legislation. Several agencies have also experienced decreased workers’ compensation claims through improved management of occupational health and safety.
- NSW Government, by 30 June 2006, will have paid about $11 million of HIH reimbursements to various local councils to enable them to meet their HIH claim debts.

4.1 INTRODUCTION

The State's balance sheet remains strong despite the impact on short-term budget results of a cyclical downturn in the property market, and structural issues discussed in the *Audit of Expenditure and Assets Report* including cuts in Commonwealth Government funding.

The estimated value of physical assets continues to increase due in part to the impact of a record $41.3 billion capital expenditure program for the four-year period ending 30 June 2010. Refer to Budget Paper No. 4, *Infrastructure Statement*, for project details[1].

The value of infrastructure system assets for the State sector will increase to $94.9 billion at 30 June 2010, up from an estimated $76.5 billion at 30 June 2006. The increased capital expenditure will be partly funded by a $19.6 billion increase in State underlying net debt for the four year period ending 30 June 2010. Forecast debt levels will remain at a prudent level representing 9.1 per cent of gross state product as at 30 June 2010, with interest expense being 5.2 per cent of total State sector revenue in 2009-10.

Net financial liabilities are primarily made up of net debt, unfunded superannuation and insurance liabilities. General government sector net financial liabilities are projected to fall, as a percentage of gross state product from 8.7 per cent in June 2006 to 8 per cent in June 2010. This reduction occurs despite an increase in underlying net debt for the same period, because the increase in net debt is more than offset by a reduction in other liabilities.

In accordance with the State's funding plan, superannuation liabilities will be fully funded by 2030. No further Crown cash employer contributions will need to be made into the State superannuation schemes after that time.

The Treasury Managed Fund (TMF) self insurance liabilities have declined significantly during 2005-06 as a direct result of the Government's workers' compensation and tort reform legislation, and improvements in occupational health and safety management within major agencies. Overall TMF agency premiums will reduce by 10.4 per cent in 2006-07 (workers' compensation down 14.6 per cent, and public liability down 4.2 per cent). This will be the second successive year that agency public liability premiums have been reduced. In 2005-06, premiums fell by 12.6 per cent, because of both strong investment returns and reduced claims. Reforms in this area have not only benefited the government but also the community generally.

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[1] *The value of physical assets shown in Budget Paper No. 4 differs from that shown in Budget Paper No. 2. The former includes the value of RTA land under State Roads.*

A motor accidents scheme will be established to provide appropriate life-time financial support for people who suffer catastrophic motor accident injuries.

4.2 NET WORTH

State sector net worth is forecast to increase by $10.2 billion between 30 June 2006 and 30 June 2010. Also, over the forward estimates period the value of physical assets is expected to increase by $26.2 billion.

Table 4.1: State Sector Net Worth

As at 30 June	*Actual*	*Revised*	*Budget*		*Estimate*	
	2005	*2006*	*2007*	*2008*	*2009*	*2010*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*
Assets						
Non-Financial Assets						
Land and Buildings[(a)]	81,706	83,143	85,545	87,853	90,004	91,848
Plant and Equipment	10,768	9,894	9,966	9,845	9,486	8,865
Infrastructure Systems	75,021	76,504	80,270	84,713	89,619	94,938
Inventories & Other	3,038	3,713	3,771	3,858	3,816	3,808
Other Non-Financial Assets	1,424	2,183	2,330	2,482	2,657	2,845
Total Non-Financial Assets	**171,958**	**175,437**	**181,882**	**188,751**	**195,582**	**202,304**
Financial Assets						
Cash and Deposits	3,217	2,601	2,512	2,403	2,258	2,595
Advances paid	293	336	335	316	342	344
Investments, Loans and Placements[(b)]	17,125	20,277	13,693	14,266	14,841	15,226
Other Non-Equity Assets	5,253	5,100	5,150	5,222	5,282	5,389
Equity Assets	619	695	765	818	899	984
Total Financial Assets	**26,507**	**29,009**	**22,455**	**23,025**	**23,622**	**24,538**
TOTAL ASSETS	**198,464**	**204,446**	**204,337**	**211,776**	**219,204**	**226,842**
Liabilities						
Deposits Held	1,618	2,072	1,888	1,831	1,738	1,672
Advances Received	1,641	1,507	1,467	1,418	1,368	1,317
Borrowing	29,012	31,262	37,683	43,129	47,985	51,656
Superannuation[(b)(c)]	16,491	23,521	14,974	15,217	15,381	15,479
Provisions	15,200	15,253	15,547	15,882	16,350	16,795
Other Non-Equity Liabilities	5,613	6,661	6,468	6,085	5,682	5,546
TOTAL LIABILITIES	**69,575**	**80,276**	**78,027**	**83,562**	**88,504**	**92,465**
NET WORTH	**128,889**	**124,170**	**126,310**	**128,214**	**130,700**	**134,377**

(a) Excludes RTA land under roads.

(b) Decrease between 2006 and 2007 is due to the transfer of $7.9 billion of investments to State Super to fund superannuation liabilities.

(c) Excludes balances held in General Government Liability Management Fund.

The reduction in State sector net worth between 30 June 2005 and 30 June 2006 is due to the introduction of Australian Equivalents to International Financial Reporting Standards (AEIFRS). This new accounting approach increases the reported estimate of the State's superannuation liabilities. The forecast increase in State sector net worth for the four year period ending 30 June 2010, as shown in Table 4.1, is primarily due to the projected increase in the value of physical assets, reflecting the State's record capital works program.

In the four years to 30 June 2010, capital expenditure is expected to total $41.3 billion compared to $28.5 billion in the four years to 30 June 2006, an increase of more than 45.1 per cent.

In 2006-07 the State will spend a record $9.9 billion on capital expenditure - a 22.8 per cent increase compared to the 2005-06 forecast expenditure of $8.1 billion.

Forty-four per cent of the 2006-07 capital expenditure program, $4.4 billion, will be invested in the general government sector whose agencies are engaged in the provision of public services such as health, education, roads and public order and safety. NSW general government sector capital expenditure will increase by 32.4 per cent to $18.3 billion over the four years to 2009-10, relative to the prior four years.

The balance of the 2006-07 capital expenditure program, over $5.5 billion, will be expended by public trading enterprises, and provide major economic infrastructure in water, electricity, ports, public housing and public transport. Capital expenditure by the public trading enterprise sector is expected to increase by 57 per cent over the four years to 2009-10, relative to the prior four years representing an increase of $8.4 billion. Public trading enterprise capital expenditure is cyclical in nature, and is currently experiencing a period of rapid growth. Current forecasts see capital expenditure in this sector increasing up to 2007-08. Trends in capital expenditure and net debt of public trading enterprises is explained further in Chapter 5.

Borrowing by the public trading enterprise sector to partially fund capital expenditure is an important part of commercial operations. The increase in public trading enterprise sector capital expenditure will result in a 73.0 per cent rise in gross debt by the sector between June 2006 to June 2010 (see Chapter 5 for a more detailed analysis).

In aggregate, underlying net debt of the total State sector will rise by $19.6 billion over the next four years, primarily reflecting the timing of high levels of infrastructure spending by public utilities.

The *Infrastructure Statement* set out in Budget Paper No. 4 provides an analysis of the State's capital expenditure program and review of the Government's physical asset management.

4.3 NET FINANCIAL LIABILITIES

State and general government sector net financial liabilities will increase in 2005-06 due primarily to the impact on superannuation of adopting the new accounting standard, AASB 119 "Employee Benefits", as shown in Table 4.2 below.

Table 4.2: Net Financial Liabilities by Sector

As at 30 June	*Actual*				*Revised*
	2002 $m	*2003 $m*	*2004 $m*	*2005 $m*	*2006 $m*
GENERAL GOVERNMENT SECTOR					
Gross Debt	12,705	12,025	12,545	13,131	13,688
Cash, Advances and Investments [(a)]	7,649	8,781	9,952	10,810	11,832
Underlying Net Debt [(b)]	5,056	3,244	2,593	2,321	1,856
Unfunded Superannuation[(b)]	11,398	13,069	12,609	12,461	18,145
Insurance Claims	5,553	5,881	6,279	6,805	6,429
Other [(c)]	2,286	2,964	3,309	3,099	1,470
Net Financial Liabilities[(d)]	**24,293**	**25,158**	**24,790**	**24,686**	**27,900**
PUBLIC TRADING ENTERPRISE SECTOR					
Gross Debt	12,133	13,264	13,812	14,883	16,563
Cash, Advances and Investments [(a)]	1,563	1,731	1,720	1,832	1,810
Net Debt	10,571	11,534	12,092	13,051	14,753
Unfunded Superannuation	325	736	391	29	141
Insurance Claims	399	386	398	433	428
Other [(c)]	3,448	3,879	4,362	4,527	7,745
Net Financial Liabilities	**14,743**	**16,535**	**17,243**	**18,040**	**23,067**
PUBLIC FINANCIAL ENTERPRISE SECTOR					
Gross Debt	32,552	36,452	27,718	30,458	32,861
Cash, Advances and Investments [(a)]	32,274	36,299	27,528	30,192	32,607
Net Debt [(e)]	278	153	190	266	254
Other [(c)]	(12)	261	150	75	50
Net Financial Liabilities	**266**	**414**	**340**	**341**	**304**

Table 4.2: Net Financial Liabilities by Sector (cont)

As at 30 June	Actual 2002 $m	Actual 2003 $m	Actual 2004 $m	Actual 2005 $m	Revised 2006 $m
TOTAL STATE SECTOR					
Underlying Net Debt	15,904	14,930	14,875	15,638	16,862
Unfunded Superannuation	11,723	13,805	12,999	12,490	18,286
Insurance Claims	6,006	6,309	6,722	7,276	6,885
Other	5,672	7,064	7,775	7,663	9,234
Net Financial Liabilities	**39,304**	**42,108**	**42,373**	**43,067**	**51,267**

(a) Gross amount of insurance assets are included in accordance with Australian Bureau of Statistics net debt calculation standards.

(b) General Government Liability Management Fund (GGLMF) is excluded from underlying net debt and offset against unfunded superannuation. Unfunded superannuation liabilities increase in 2006 due to the adoption of accounting standard AASB 119 from 2005-06 for reporting purposes.

(c) Mainly represented by employee entitlements, such as long service leave and offset by other non-equity financial assets such as receivables. "Other" in the PFE sector includes insurance claims and in both the PTE and PFE sectors includes tax payable to the general government sector.

(d) Equity investment in the PTE/PFE sectors is excluded to give a more conservative picture of the general government sector's overall financial obligations.

(e) Attribution of net debt to the PFE sector results from the valuation of debt liabilities at current capital value. At market value, the sector has a net asset position.

The adoption of Australian Accounting Standard AASB 119 "Employee Benefits" has significantly increased the reported value of unfunded superannuation liabilities. Under the new standard, employers must value their liabilities in a defined benefit superannuation scheme using a risk-free government bond discount rate rather than the rate that fund assets are expected to earn. Such a discount rate is well below the estimated long-term investment earnings rate that was previously assumed in valuing liabilities. A further consequence of the use of AASB 119 will be more volatility in the reported estimates of net unfunded superannuation liabilities because of fluctuations in the ten-year bond rate each year. Under the previous accounting standard, the discount rate did not change annually.

Table 4.3 shows the projection of net financial liabilities to 2009-10.

Table 4.3: Net Financial Liabilities Estimates

	Actual	Revised	Budget	Estimate		
As at 30 June	2005 $m	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m
General Government Sector						
Underlying Net Debt[(a)(b)]	2,321	1,856	6,190	7,781	8,770	9,133
Unfunded Superannuation[(c)]	12,461	18,145	14,883	15,190	15,430	15,617
Insurance	6,805	6,429	6,542	6,770	7,074	7,385
Other Liabilities[(d)]	3,099	1,470	1,429	751	420	(35)
Total	**24,686**	**27,900**	**29,044**	**30,492**	**31,694**	**32,100**
State Sector						
Underlying Net Debt[(a)(b)]	15,638	16,862	24,498	29,393	33,650	36,479
Unfunded Superannuation[(c)]	12,490	18,286	14,974	15,217	15,381	15,479
Insurance	7,276	6,885	6,973	7,184	7,472	7,770
Other Liabilities[(d)]	7,663	9,234	9,127	8,744	8,379	8,200
Total	**43,067**	**51,267**	**55,572**	**60,538**	**64,882**	**67,928**

(a) Excludes balances held in GGLMF.

(b) Gross amount of insurance assets are included in net debt in accordance with Australian Bureau of Statistics net debt calculation standards.

(c) GGLMF is included in unfunded superannuation. Unfunded superannuation liabilities increase in 2006 due to the adoption of accounting standard AASB 119 from 2005-06 for reporting purposes.

(d) Other employee entitlements and provisions. Adoption of AEIFRS in 2005-06 has resulted in other liabilities for the general government sector falling due to the recognition of income tax receivables from the PTE sector associated with the Tax Equivalents Regime. This does not impact on the State sector as the tax receivables are eliminated upon consolidation. Estimates prior to 2005-06 are on the old basis of measurement.

In 2006-07, around $2.2 billion of the increase in State and general government sector underlying net debt is due to the transfer of financial assets and the proceeds from additional borrowings to the State Super fund in 2006-07. Financial assets being transferred are projected to be $1.4 billion - $1 billion from the NSW Self Insurance Corporation surplus reserves and $420 million transferred from the Health Super Growth Fund - and additional borrowings are estimated at $780 million. The grants paid to the Health sector from the income generated by the Health Super Growth Fund will be preserved after the transfer, although future payments will not be sourced from the fund.

Both general government and State sector underlying net debt increase significantly over the forward estimates period to fund an expanded capital program in the context of a weaker operating result.

As shown in Chapter 1, while State sector net financial liabilities are forecast to increase over the next four years, the level of general government net financial liabilities continues to decline. The level of indebtedness remains low relative to past experience, and is sustainable on the basis of the projections in this Budget.

4.4 STATE SECTOR NET DEBT

State sector debt is used to finance both the general government sector and the public trading enterprise sector of Government. The NSW Government's fiscal strategy is different for each sector and is based on the use to which funds are put in each sector and whether they generate future income.

The general government sector provides services such as schools, hospitals and police, which are largely free of charge to recipients. These services are financed either from State taxation receipts and/or receipts from Federal taxation. Any long-term increases in net debt in this sector are limited by the capacity to finance debt within current limits to State revenue-raising powers inherent in the *Australian Constitution*. Future Budgets plan to increase net debt to a level that remains sustainable, with low debt to gross state product, and interest expense to revenue ratios, as shown in Charts 4.1 and 4.2. The current strength of the State's balance sheet allows for this limited increase in net debt.

The public trading enterprise sector provides economic services in areas such as water, electricity and ports. It is mainly funded by user charges and operates under commercial disciplines described in the Government's *Commercial Policy Framework*. Borrowing by the commercial businesses in the public trading enterprise sector to fund capital investments is an important part of imposing commercial disciplines.

Within the commercial business sector, efficient investment decisions require a return on investments to at least cover the cost of capital. Prices charged by public trading enterprises are largely set by independent pricing regulators, which take into account capital expenditure requirements. Hence capital expenditure should generate revenues to support the sector's debt levels, either through growth in volumes or increased user charges.

The underlying net debt of the State sector will increase by $19.6 billion over the next four years, largely offset by an increase in infrastructure assets totalling $26.2 billion. Major areas of public trading enterprise investment include electricity, rail, ports, housing and water infrastructure.

Spending on electricity related infrastructure will account for 23.5 per cent of all infrastructure investment in 2006-07. In 2006-07, $383 million is to be spent on maintaining and upgrading existing generation plants, $262 million will be spent on expanding and upgrading the high voltage transmission network, and $1.7 billion will be spent on maintaining and expanding the electricity distribution networks and associated works.

In total, $3.2 billion will be invested in 2006-07 across the transport network including:

- $1.2 billion on rail;
- $1.6 billion on roads;
- $112 million on ports; and
- $90 million on buses.

The State's water businesses are experiencing a period of high capital expenditure of around $1 billion in 2006-07 or 10 per cent of the State's infrastructure budget including:

- $721 million for Sydney Water for Metropolitan Water Plan initiatives including recycling and sewerage system improvements and growth;
- $134 million for Sydney Catchment Authority for Metropolitan Water Plan initiatives;
- $108 million for Hunter Water for water and sewerage system improvements and growth; and
- $28 million for State Water for maintaining the integrity of the State's regional dams.

The Department of Housing is also projected to borrow $197.5 million to implement its Maintenance Reform Program. This Program which is currently undergoing pilot trials establishes a new systematic planning approach in the delivery of maintenance to public housing, and offers a estimated 15 per cent saving on current annual spending on maintenance. The anticipated cost savings and efficiencies from the Program will fund interest costs and support loan repayments.

Chart 4.1: State Sector Underlying Net Debt as a Percentage of Gross State Product

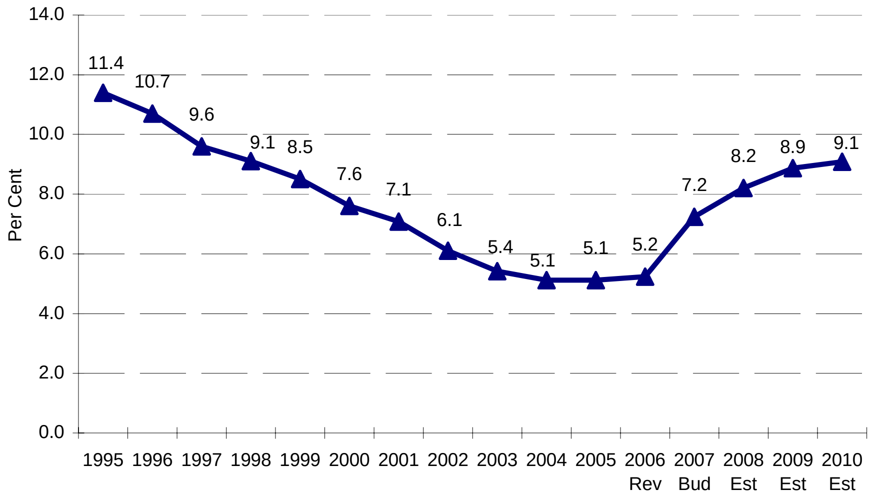
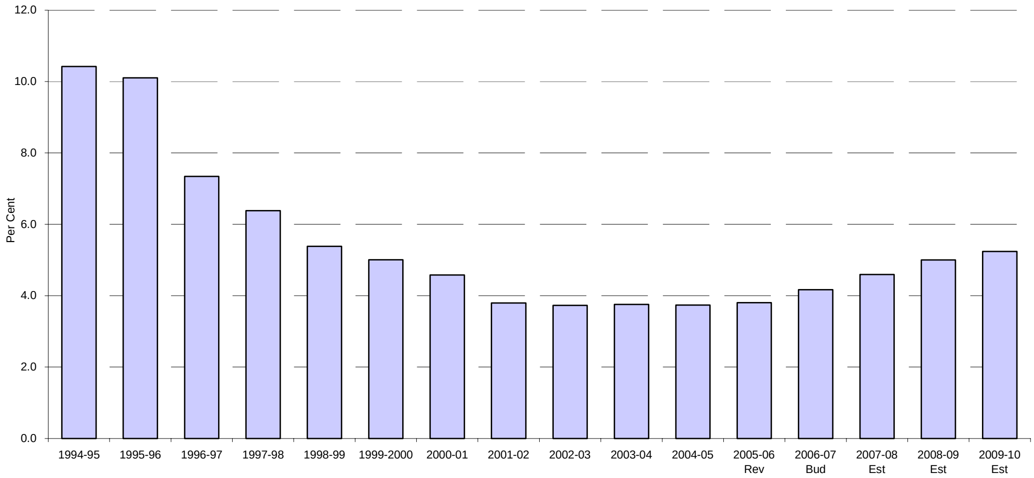


Chart 4.2: State Sector Gross Debt Interest Expense as a Percentage of Total Revenue



4.5 GENERAL GOVERNMENT SECTOR NET DEBT

The level of general government underlying net debt will increase by $7.3 billion from 30 June 2006 to 30 June 2010. Compared to the previous four years, debt will be used to fund an increase in capital expenditure. Table 4.4 shows the change in how general government capital expenditure is being funded.

Table 4.4: Estimated Funding Sources for the General Government Capital Program

Four years to 30 June	*4 years to June*	
	2006 *$m*	*2010* *$m*
Capital Expenditure	**13,800**	**18,287**
Funded by:		
Operating Surplus (net of depreciation)	12,123	11,135
Asset Sales	1,746	1,973
Increase (Decrease) in Underlying Net Debt[a]	(3,201)	5,079
Other[b]	3,132	100
Total Sources of Funding	**13,800**	**18,287**

(a) Excludes borrowings used to fund superannuation contributions in 2006-07.

(b) Includes public trading enterprise regearing, proceeds from privatisations, assumptions of debt, amortisation of discounts/premiums on loans and various accruals.

The increase in underlying net debt shown in Table 4.4 includes $2.2 billion of borrowings and the use of general government sector financial assets associated with the $8.7 billion contribution to State Super in 2006-07.

In the forward years, the Budget operating result is expected to strengthen, due to an assumed slow-down in annual expenditure growth. The underlying level of net debt in the general government sector will rise slightly above the target in the *Fiscal Responsibility Act 2005* over the forward estimates period. To force the balance sheet to adhere to the net debt targets in a short time frame would require unacceptably harsh cutbacks in service delivery or increases in taxation.

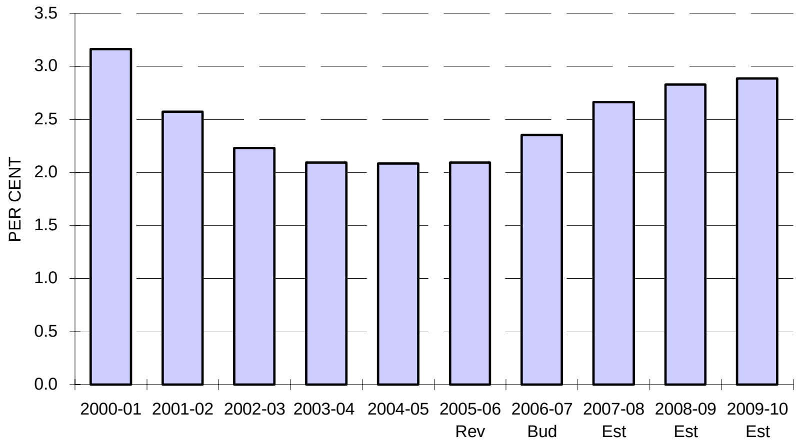
Section 6 of the *Fiscal Responsibility Act 2005* requires general government debt to be below its 30 June 2005 level as a percentage of gross state product, unless the increase in debt is used to reduce another financial liability. Underlying net debt at 30 June 2007 is 1.8 per cent, which is 1 per cent above the 30 June 2005 level of 0.8 per cent of gross state product. Of this increase, 0.7 per cent is due to additional contributions to fund superannuation liabilities.

Table 4.5: General Government Sector Underlying Net Debt

As at 30 June	Actual 2003 $m	Actual 2004 $m	Actual 2005 $m	Revised 2006 $m	Budget 2007 $m	Estimate 2008 $m	Estimate 2009 $m	Estimate 2010 $m
Gross Debt								
Borrowings	10,164	10,796	11,392	12,096	15,301	17,445	18,903	19,990
Advances Received	1,808	1,681	1,641	1,507	1,467	1,418	1,368	1,317
Deposits Held	53	68	98	85	86	87	87	86
	12,025	12,545	13,131	13,688	16,854	18,950	20,358	21,393
Financial Assets[(a)]								
Cash	1,091	1,869	1,465	1,098	1,036	1,010	807	1,051
Investments	6,289	6,724	8,041	9,453	8,373	8,950	9,573	10,026
Advances	1,401	1,359	1,304	1,281	1,255	1,209	1,208	1,183
	8,781	9,952	10,810	11,832	10,664	11,169	11,588	12,260
Underlying Net Debt	**3,244**	**2,593**	**2,321**	**1,856**	**6,190**	**7,781**	**8,770**	**9,133**

(a) Includes financial assets which have been allocated to fund insurance claims, but excludes balances held in the GGLMF.

Chart 4.3: General Government Sector Gross Debt Interest Expense as a Percentage of Budget Revenue[(a)]



(a) Includes impact of additional borrowings of $780 million in 2006-07 to fund superannuation contributions.

4.6 UNFUNDED SUPERANNUATION

Projected general government sector superannuation assets and liabilities are shown at Table 4.6. Net underlying unfunded superannuation liabilities are estimated to increase to $18.1 billion as at 30 June 2006. There will be a decrease to $14.9 billion in 2006-07 largely due to a substantial cash injection by the Crown into the SAS Trustee Corporation's fund (the State Super fund). Thereafter, unfunded superannuation will steadily increase at around 2 per cent per annum over the forward estimates period, and decline as a percentage of gross state product.

The $5.7 billion increase in 2005-06 is largely due to a change in accounting rules about the way the liabilities are reported. Prior to 2005-06, superannuation liabilities were reported on a "funding basis". With the introduction of AASB 119 "Employee Benefits" on 1 July 2005, liabilities are required to be shown on a "reporting basis". The two bases use different discount rates to calculate superannuation liabilities and are outlined below.

CALCULATION OF SUPERANNUATION LIABILITIES

Net unfunded superannuation liabilities are the difference between the present value of liabilities accrued and the market value of financial assets held in defined benefit superannuation funds.

The estimate of unfunded superannuation liabilities may vary significantly depending on the market value of financial assets (which can be volatile) and the demographic, economic and other actuarial valuation assumptions that are made to determine gross liabilities. Two of the biggest impacts are from the assumed long-term investment return on financial assets and the discount rate assumed by the actuary to calculate superannuation liabilities.

IMPACT OF AASB 119

The June 2006 net underlying unfunded liability has been calculated using a discount rate of 5.9 per cent which is based on Treasury's estimate of the Commonwealth ten-year government bond rate, plus 0.1 per cent, as at 30 June 2006. This means that the superannuation liabilities are discounted at a rate lower than in 2004-05, where a long-term investment return of 7.3 per cent was used. This difference in discount rates accounted for around 95 per cent of the $5.7 billion increase in the reported underlying unfunded superannuation liabilities in 2005-06.

An estimated long-term government bond rate of 5.9 per cent has also been used as the discount rate to calculate the unfunded liabilities for June 2007 and beyond. If the actuary used a discount rate equal to the currently assumed long-term investment return (7.6 per cent), the unfunded liabilities shown at Table 4.6 would be less by an average of $6.6 billion over the period June 2007 to June 2010.

AASB 119 requires the recalculation of superannuation liabilities each year using a discount rate equal to the actual long-term government bond rate as at 30 June. This will mean that reported superannuation liabilities are likely to change significantly from year to year even if the underlying benefit obligations to members do not change. Based on the 30 June 2006 level of liabilities, an increase of 0.25 per cent in the interest rate used to discount liabilities reduces the general government's net underlying superannuation liabilities by about $1 billion.

Table 4.6: General Government Sector Unfunded Superannuation Liabilities [(a)]

As at 30 June	*Actual*			*Revised*	*Budget*	*Estimate*		
	2003 $m	*2004 $m*	*2005 $m*	*2006 $m*	*2007 $m*	*2008 $m*	*2009 $m*	*2010 $m*
Liabilities	31,873	33,632	34,959	43,321	44,685	45,904	46,950	47,571
Less:								
Assets	17,153	18,172	18,497	19,941	29,802	30,714	31,520	31,954
Reserves held in General Government Liability Management Fund	1,651	2,851	4,001	5,235	...	...	...	...
Underlying Net Unfunded Liabilities[(a)]	**13,069**	**12,609**	**12,461**	**18,145**	**14,883**	**15,190**	**15,430**	**15,617**
Assets (including GGLMF Reserves) as proportion of Liabilities (%)	**59**	**63**	**64**	**58**	**67**	**67**	**67**	**67**

(a) Includes assets and liabilities of employers and employees. Includes STC Pooled Fund schemes, Parliamentary Contributory Superannuation Scheme and Judges' Pension Scheme.

The General Government Liability Management Fund (GGLMF) was established in 2002 to implement more flexible arrangements for the management of superannuation. Crown contributions to superannuation are paid into the GGLMF and invested in fixed interest securities. In 2006-07, the balance of the GGLMF ($6.5 billion) will be paid to the State Super fund.

SUPERANNUATION FUNDING PLAN

Despite the significant increase in reported superannuation liabilities resulting from the introduction of the AASB 119, recent actuarial advice confirms that the general government sector superannuation liabilities are expected to be fully funded by 2030 based on current planned employer cash contribution levels. In this context, "fully funded" means that by 2030 no further employer contributions will need to be made. The amount of reserves at that time, plus expected investment returns for the remainder of the life of the State Super schemes will be sufficient to fund future expected benefit payments.

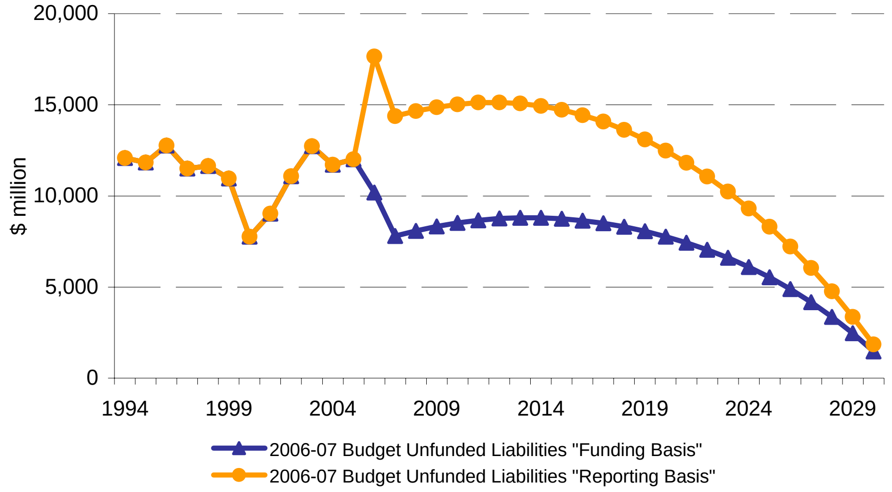
To provide greater transparency in the reporting of State finances, unfunded superannuation liabilities will now be calculated on two bases, as shown in Table 4.7, which reflect the impact on gross liabilities of the different discount rates. The first basis is for reporting purposes and follows the requirements of the new accounting standard (AASB 119). The second basis is a funding basis and is in accordance with the accounting standard AAS 25, which provides for the discount rate to be the forecast investment return for the fund assets. The funding basis is the basis on which trustees of defined benefit superannuation schemes are required to report the financial position of their schemes.

Table 4.7: Comparison of General Government Net Unfunded Superannuation Liabilities between Reporting Basis and Funding Basis

As at 30 June	*Actual*	*Revised*	*Budget*	*Estimate*		
	2005 $m	*2006 $m*	*2007 $m*	*2008 $m*	*2009 $m*	*2010 $m*
Reporting Basis - as per AASB 119	n.a.	18,145	14,883	15,190	15,430	15,617
Funding Basis - as per AAS 25	12,461	10,666	8,308	8,618	8,882	9,108
Difference	**n.a.**	**7,479**	**6,575**	**6,572**	**6,548**	**6,509**

Chart 4.4 illustrates the long-term unfunded liability position of general government sector superannuation liabilities for the State Super defined benefit superannuation schemes, both on a reported basis (using a liability discount rate based on the long-term government bond rate) and on the funding basis (using a liability discount rate based on the projected long-term investment return on State Super assets). Unfunded liabilities on a reporting basis increase significantly in 2005-06, as a result of the introduction of AASB 119. However, unfunded liabilities on a funding basis decline in the same year due to a change in the expected earnings on fund assets.

Chart 4.4: Projected General Government Pooled Fund Scheme Superannuation Net Liabilities on a Funding and a Reporting Basis, as at 30 June



For most of the period prior to the current Government's tenure, superannuation was largely funded on a "pay-as-you-go" basis. This meant that cash contributions were made to only match emerging benefit payments to beneficiaries.

Over the last ten years, contributions have been greater than benefit payments. In 2006-07 the Government will make an $8.7 billion cash injection into the State Super fund. This is not a response to the substantial increase in reported unfunded liabilities in 2005-06, it is a continuation of the disciplined approach to superannuation funding. Part of the contribution ($2.2 billion) represents an up-front payment which will enable future annual contributions to be reduced by about $200 million.

As mentioned previously, during 2006-07 the GGLMF will be closed and its balance transferred to the State Super fund. Also, a further $1.4 billion of investments ($1 billion from the NSW Self Insurance Corporation and $420 million from the Health Super Growth Fund whose income stream has been preserved), and $780 million raised through debt will be transferred to the State Super fund. The total amount transferred to the State Super fund will be $8.7 billion. The transfer of this amount will realise the Government's remaining pre-July 1988 funding credits that it is entitled to under Commonwealth income tax legislation.

Table 4.8 demonstrates the financial benefits of the government policy of moving to full funding of superannuation liabilities. From 2007-08 onwards, Crown cash contributions to the State Super fund are significantly below actual benefits paid to members. If the Government had adopted a "pay-as-you-go" approach, contributions would have had to equal benefits paid.

Table 4.8: Total State Sector Superannuation Contributions compared to Forecast Benefits Payments

	Revised	*Budget*	*Estimate*			
	2005-06 $m	*2006-07 $m*	*2007-08 $m*	*2008-09 $m*	*2009-10 $m*	*Total $m*
Benefit Payments	2,352	2,581	2,794	2,990	3,419	14,136
Contributions[a]	2,333	2,114	869	888	907	7,111
Difference	19	467	1,925	2,102	2,512	7,025

(a) Includes Crown contributions into the GGLMF which will be transferred into the Pooled Fund during 2006-07. Contributions reduce in 2007-08 because of a revised funding plan after the transfer from the GGLMF.

An important factor in fully funding superannuation liabilities is the investment return earned on State Super fund assets. The current long-term investment return assumed for the State Super fund is 7.6 per cent per annum.

4.7 INSURANCE

SELF INSURANCE

Self insurance net liabilities are comprised primarily of the net financial liabilities of the Treasury Managed Fund (TMF), the Workers' Compensation (Dust Diseases) Board, and various WorkCover Authority of New South Wales administered schemes such as the Emergency Rescue Workers' and Bush Fire Fighters' Compensation Funds. They do not include liabilities under the WorkCover scheme for private sector employees.

The TMF is a self insurance scheme owned and underwritten by the Government. It covers workers' compensation, public liability and other insurance liabilities for all general government sector budget dependent agencies. Other public sector agencies may apply to join the TMF on a voluntary basis.

In 2006-07, TMF workers' compensation premiums will reduce by $73.8 million or 14.6 per cent; public liability premiums will be reduced by $13.1 million or 4.2 per cent; and miscellaneous premiums will be reduced by $14.3 million or 53 per cent. These reductions contribute to an overall reduction in premiums of $98.1 million or 10.4 per cent from the previous year.

The fall in workers' compensation premiums was brought about through reductions in claims frequency, specific injury payments, commutations, common law and legal costs with the Government's tort reform legislation playing an important role in achieving these outcomes. A number of large agencies have also seen their workers' compensation premiums reduce through improving occupational health and safety management.

This is the second year that public liability premiums have been reduced. In 2005-06 premiums fell by 12.6 per cent

The TMF's overall purpose is to assist member agencies in reducing risk exposures and thereby maximising resources available to support their core business activities. The TMF provides incentive "hindsight adjustments" to member agencies' premiums to encourage best management practices.

Until 30 June 2005 an outsourced, single insurer (GIO) was responsible for assessing and processing claims. Since July 2005, the claims management of the insurance lines of business (workers' compensation, motor vehicle, property, liability and miscellaneous) have been distributed between three claims managers.

The new contracts appoint three workers' compensation providers, Employers Mutual Limited, Allianz Australia Limited and GIO Australia Limited. The claims management of Department of Health and other liability claims remains with GIO. There are also separate long term contracts for risk management (Suncorp), reinsurance (Benfield) and actuarial services (PricewaterhouseCoopers and Taylor Fry).

This allows for a more active in-house management model. The new model requires that a data warehouse be established to house the entire dataset. In addition, Treasury has established a new Self Insurance Branch to manage the TMF data warehouse and manage TMF claims managers performance.

The key objectives of this new structure are to improve TMF performance, generate cost savings and efficiency gains, reduce the systemic risk associated with a single provider, and enable comparison and benchmarking between providers.

It is estimated that the new management arrangements will generate savings of 1 per cent from 2006-07 onward for public liability insurance and 2.5 per cent from 2006-07 onward for workers' compensation insurance.

Table 4.9: General Government Insurance Estimates

As at 30 June	Actual 2005 $m	Revised 2006 $m	Budget 2007 $m	Estimate 2008 $m	2009 $m	2010 $m
Outstanding Claim Liabilities						
Treasury Managed Fund	4,510	4,192	4,455	4,726	5,060	5,392
Other (closed schemes)[(a)]	311	233	213	197	189	180
HIH	209	217	175	144	120	110
Dust Diseases	1,509	1,517	1,538	1,542	1,543	1,541
WorkCover Authority	261	265	156	156	157	157
Other (self funded schemes)[(b)]	5	5	5	5	5	5
	6,805	6,429	6,542	6,770	7,074	7,385
Assets[(c)]						
Treasury Managed Fund[(d)]	5,157	5,105	4,913	5,135	5,639	5,918
Other (closed schemes)	37	235	217	202	191	183
Dust Diseases	1,509	1,518	1,538	1,542	1,543	1,541
WorkCover Authority[(e)]	302	340	191	181	170	155
Other (self funded schemes)	5	5	5	5	5	5
	7,010	7,203	6,864	7,065	7,548	7,802
Assets as proportion of claim liabilities (%)	**103**	**112**	**105**	**104**	**107**	**106**

(a) *Closed schemes include the Transport Accident Compensation Fund, Government Workers Fund and the Pre Managed Fund Reserve*
(b) *Waterways Authority has a closed fund of the workers' compensation liabilities of the former Maritime Services Board incurred between 1989 and 1995*
(c) *Gross amount of insurance assets are included in financial assets for net debt reporting purposes in accordance with Australian Bureau of Statistics standards.*
(d) *TMF financial assets after forecast transfer of surplus reserves.*
(e) *Does not include liabilities under the workers' compensation scheme for private sector employees.*

HIH liabilities are expected to reduce to $217 million by 30 June 2006. During 2006-07, the Government expects to receive an initial distribution from the HIH liquidators of $35 million.

Treasury has put an Insurance Reserve Policy in place that determines appropriate level of reserves for the TMF. The Insurance Reserve Policy sets TMF's reserve at a surplus of 10 per cent of outstanding claims liabilities, plus the amount of reinsurance retention that the fund would retain for a single loss. The surplus is reviewed based on the financial results as at 31 December each year. Following the review of results as at 31 December 2005, a surplus above the Insurance Reserve requirement was identified. This allows the release of $1 billion that will be transferred to the General Government Liability Management Fund by 30 June 2006, subject to Parliament approving amended NSW Self Insurance Corporation (SICorp) legislation. Based on current net asset forecasts, further surplus amounts may appear in the following years – 2006-07 ($650 million), 2007-08 ($250 million), and 2009-10 ($250 million). These forecasts are sensitive to returns on assets, amongst other things, and may not be achieved. The forecast increases in TMF's net asset position will be actively monitored to ensure compliance with Treasury's Insurance Reserve Policy.

COMMUNITY AND OTHER INSURANCE ISSUES

HIH Liquidation

In order to maintain the community's confidence in the insurance industry, the NSW Government assumed in excess of $700 million in claims liabilities, since the collapse of the HIH/FAI Insurance Group in 2001.

To maintain the validity of HIH policies held by individuals, the Government assumed liability for the outstanding compulsory third party motor vehicle policies in force with HIH prior to 31 December 2000, and home warranty insurance policies in force with HIH prior to 15 March 2001.

The assumption of HIH liabilities by the Government ensures that persons injured in a motor vehicle accident who would have claimed against a HIH compulsory third party policy can seek recourse for compensation in respect of their injuries. Persons with home warranty claims are able to seek recourse for compensation against HIH policies because the Government has assumed HIH home warranty liabilities.

Home Building and Local Government Insurance Issues

The insurance crisis in 2001 affected individuals and insurers alike. In New South Wales the insurance companies who provided coverage to Home Building contractors were unable to obtain reinsurance protection for risks above their retention levels. To mitigate the impact of this on individuals, the Government agreed to provide reinsurance protection to insurers of builder's warranty. The Government currently has reinsurance arrangements with Vero Insurance Ltd, CGU Insurance Ltd and QBE Insurance Ltd.

Without Government intervention, insurers would have withdrawn from the builders warranty market, leaving builders unable to obtain insurance and placing consumers at risk of having no recourse for claims arising from construction faults in homes and high rise buildings.

The HIH collapse had an adverse impact on a number of local councils insured with HIH. The NSW Government negotiated with the Commonwealth to provide financial assistance to Local Governments who had judgements against them that would have been met by HIH policies.

The NSW Government has provided assistance to Evans Shire Council, Balranald Shire Council, Ballina Shire Council, Berrigan Shire Council, Copmanhurst Shire Council and Nundle Shire Council. By 30 June 2006 the NSW Government will have paid $11 million to local councils who would otherwise have suffered financial difficulty meeting HIH debts.

Public Liability Insurance Availability

Following the NSW Government's tort law reform that saw the implementation of the *Civil Liability Act 2002*, *Civil Liability Amendment (Personal Responsibility) Act 2002* and the *Civil Liability Amendment Act 2003*, the insurance industry continues to display signs of recovery with both the affordability and availability of public liability insurance continuing to improve.

Long Term Care

The *Motor Accidents (Lifetime Care and Support) Act 2006* establishes a scheme for people who suffer catastrophic injuries resulting from motor vehicle accidents. The Act extends the NSW Compulsory Third Party (CTP) scheme to provide lifetime care and support for persons who are catastrophically injured. The scheme replaces lump sum damages awards for medical and care on a 'no-fault' basis. That is, a person will not be required to prove negligence in order to be eligible for the scheme.

The scheme guarantees lifetime support and care regardless of who is at fault, and removes the financial burden on victims' families and communities. It will be managed by the Motor Accidents Authority and funded by an average $20 levy on NSW CTP premiums.

4.8 OTHER NET FINANCIAL LIABILITIES

From 2005-06, other net financial liabilities are reported under the Australian Equivalents to International Financial Reporting Standards. Figures up to 2004-05 are presented in accordance with the accounting standards that applied at that time.

Table 4.10 shows that other net financial liabilities of the general government sector are estimated to be $1.5 billion at 30 June 2006 and $1.4 billion at 30 June 2007. The main components are employee entitlements and working capital requirements, offset by other financial assets. General government long service leave liabilities are estimated to be $4.3 billion and annual leave liabilities are estimated to be $1.4 billion as at 30 June 2006.

At the State level, other net financial liabilities are projected to be $9.2 billion in June 2006, reducing to $8.2 billion at the end of the estimates period. This level is higher than in the general government sector due to the inclusion of public trading enterprise and public financial enterprise accounts payables and receivables, and the elimination of general government assets associated with tax receivables from the public trading enterprise sector under Australian Equivalents to International Financial Reporting Standards.

Table 4.10: Other Net Financial Liabilities Estimates

	Actual	Revised	Budget	Estimate		
As at 30 June	2005 $m	2006 $m	2007 $m	2008 $m	2009 $m	2010 $m
General Government Sector						
Annual Leave	1,289	1,365	1,407	1,419	1,428	1,435
Long Service Leave	4,192	4,328	4,450	4,537	4,608	4,685
Other Liabilities	4,453	5,996	5,739	5,261	4,921	4,790
	9,934	11,689	11,596	11,217	10,957	10,910
Other Financial Assets [(a)]	6,835	10,219	10,167	10,466	10,537	10,945
Total	**3,099**	**1,470**	**1,429**	**751**	**420**	**(35)**
State Sector						
Annual Leave	1,643	1,734	1,779	1,798	1,814	1,830
Long Service Leave	5,004	5,197	5,333	5,433	5,527	5,629
Other Liabilities	6,888	8,098	7,931	7,553	7,219	7,114
	13,535	15,029	15,043	14,784	14,560	14,573
Other Financial Assets [(a)]	5,872	5,795	5,916	6,040	6,181	6,373
Total	**7,663**	**9,234**	**9,127**	**8,744**	**8,379**	**8,200**

(a) Other financial assets do not include cash and deposits, advances paid, or investments, loans and placements.

4.9 FINANCIAL ASSET MANAGEMENT

THE ROLE OF ASSETS IN FINANCIAL MANAGEMENT

The Government's approach to financial management is to hold financial assets to meet liabilities as they fall due. Hence assets are held in the State Super fund and the General Government Liability Management Fund to enable the Government to meet future State Super pension and lump sum superannuation entitlements. Assets are also held in the TMF to ensure that the Government's self-insured liabilities can be met as claims are made.

Assets are accumulated to ensure that taxpayers at the time the liability is incurred meet the cost of the liability, rather than place undue burden on future generations.

The Government manages the level of its financial assets with the view to achieving the key fiscal targets in the *Fiscal Responsibility Act 2005*, namely reducing the general government sector's net financial liabilities to 6 per cent of gross state product by 2015, and to eliminate total State sector unfunded superannuation liabilities by 30 June 2030.

INVESTMENT RETURNS

The investment income from financial assets as a proportion of Budget revenue is shown in Table 4.11. Forecast investment income falls in 2006-07 partly because the General Government Liability Management Fund balance will be transferred to the State Super fund. Further, returns for forward years to 2010 are projected to be more consistent with long-term investment return trends after a number of years of high returns. Future returns are expected to be around 7 per cent.

Table 4.11: General Government Sector Investment Income as Proportion of Total Budget Revenue

	Actual			*Revised*	*Budget*	*Estimate*		
	2002-03 $m	*2003-04 $m*	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*	*2007-08 $m*	*2008-09 $m*	*2009-10 $m*
Investment Income	440	862	1,051	1,450	914	793	840	896
Budget Revenue	36,029	37,663	39,230	41,220	42,196	44,068	46,131	48,143
Income % of Revenue	1.2%	2.3%	2.7%	3.5%	2.2%	1.8%	1.8%	1.9%

The investment returns from TMF are an increasing portion of general government investment income. Details of TMF's investment returns, its past and forecast performance, are shown in Table 4.12.

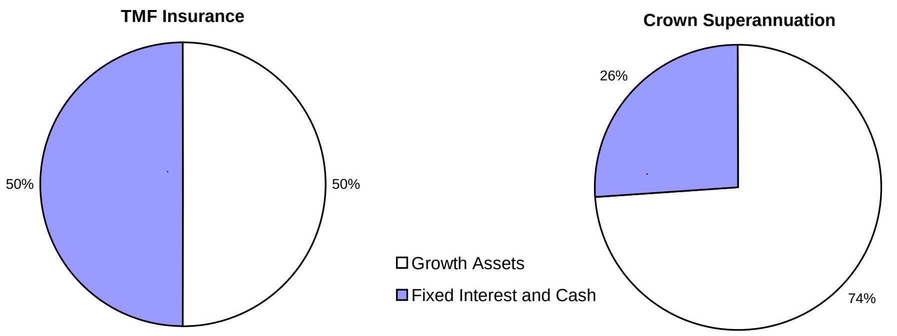
Table 4.12: TMF Investment Income

	Actual					*Revised*	*Budget*
	2000-01 $m	*2001-02 $m*	*2002-03 $m*	*2003-04 $m*	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Investment Income	167	34	129	403	481	770	391

STRATEGIC ASSET ALLOCATION

The higher the allocation to growth assets (shares and property), the greater the expected average long-term return and the wider the expected range of returns. A higher growth allocation implies greater risk. In choosing an appropriate asset allocation, the Government balances the risks and returns inherent in particular types of financial assets. The planned strategic asset allocations of the major asset portfolios held in the general government sector are shown in Chart 4.5.

Chart 4.5: Major asset portfolios' forecast strategic asset allocations as at 31 December 2007



PORTFOLIO MANAGEMENT

As a result of significant government capital contributions and strong investment returns in recent years, the TMF is now fully funded. The TMF financial asset portfolio value is expected to approximate $5.1 billion as at 30 June 2006 after allowing for the SICorp surplus above reserves, and the proposed $1 billion transfer to the State Super fund.

Bonds currently represent 60 per cent of investments in TMF on average, with the remainder in equity, listed property and a small cash allocation. The investments are held by the NSW Treasury Corporation (TCorp) in its TCorp HourGlass facilities or directly in a managed bond portfolio. A memorandum of understanding between TCorp and Treasury details investment policies and procedures and sets benchmarks for each asset class. In the 18-month period beginning in July 2006, the equity allocation for TMF will be gradually increased to 50 per cent.

Investment performance is monitored by the Crown Entity Asset Management Committee, who co-ordinate the management of large amounts of funds held centrally by the State. The Committee has representatives from both Treasury and TCorp.

4.10 FINANCIAL RISK MANAGEMENT

The major net financial liabilities of the State also represent the major financial risks, and are centrally managed.

INSURANCE MANAGEMENT

The TMF provides self insurance for all general government budget dependent agencies and those non-budget dependent agencies that have chosen to join the Fund. It is Government policy to self-insure insurance risks because of the significant cost savings compared to private sector premiums. The TMF covers a very broad range of risks. Such unlimited coverage is not available from the insurance market. All material exposures are covered by appropriate reinsurance.

The post 1 July 2005 claims management contracts contain both base fees, and incentive fees that depend on claims managers achieving specified critical service standards. These critical service standards and the move to a multi-provider claims management model will enable comparison and benchmarking between providers, and generate improved performance, costs savings and efficiency gains.

DEBT MANAGEMENT

The Crown debt portfolio is managed by TCorp to meet the objectives set by the Crown Finance Entity. Debt management has two long-term objectives; first to minimise the market value of debt within specified risk constraints, and second to minimise the cost of debt. TCorp uses an active management style that aims to add value relative to a benchmark portfolio.

During 2005-06 changes were made to the management of the debt portfolio. The benchmark modified duration was narrowed and the portfolio was split into core, strategic and tactical portfolios. This split will improve management of the debt portfolio, particularly as it will improve the transparency of TCorp's debt management activities.

The memorandum of understanding between Treasury and TCorp governs the management of the portfolios. It includes a requirement to adhere to finance expense budget allocations, which are agreed at the beginning of each financial year. The General Government Debt Management Committee, consisting of representatives of TCorp, Treasury and the Roads and Traffic Authority, meets quarterly to monitor debt strategy.

SUPERANNUATION MANAGEMENT

All new public servants join accumulation schemes which are fully funded and pose no financial risk to the Government. The SAS Trustee Corporation (STC) is the trustee for all defined benefit schemes covering the employees of general government agencies and some public trading enterprises. These schemes have been closed to new entrants for many years.

The trustee reviews State Super's strategic asset allocation annually. Currently, the amount invested in growth assets is approximately 74 per cent with the balance in bonds and cash.

The Crown employer contributions to defined benefit superannuation schemes are currently being invested through the General Government Liability Management Fund. Up to 2005-06 these funds are invested in a fixed interest portfolio managed by TCorp under a memorandum of understanding with Treasury. The balance of the General Government Liability Management Fund will be paid to the State Super fund in 2006-07 to ensure appropriate fund liquidity is maintained.

PUBLIC AUTHORITIES (FINANCIAL ARRANGEMENTS) ACT 1987

The *Public Authorities (Financial Arrangements) Act 1987* (PAFA Act) contains controls to manage risks resulting from government agencies' financial arrangements. It regulates government agencies' powers to borrow, use derivatives, invest, use funds managers and enter into joint ventures or joint financing arrangements. The PAFA Act also provides for government guarantees of financial arrangements entered into under the Act.

The PAFA Act has been updated on an incremental basis since 1987 to reflect particular changes in financial risk management. A broad review of the PAFA Act framework has commenced to refine the risk management measures contained in the Act.

Treasury and its PAFA risk management advisor, Deloitte, who was reappointed in 2005-06, review the risk management policies and procedures of randomly selected agencies based on an assessment of their risk levels.

Deloitte are responsible for the review of agencies with large borrowing/investment exposures. Treasury reviews the others, which are mostly general government sector budget dependent agencies.

The reviews focus on determining the robustness of the agencies' risk management framework. Treasury surveys are distributed to the selected agencies to examine the adequacy of agencies' staff, computer systems, risk management systems, internal reporting procedures and policy documents.

The number of PAFA risk reviews expected to be undertaken by Deloitte and Treasury, at 30 June 2006 and 30 June 2007, are shown in the table below.

Table 4.13: PAFA Risk Review Program: Number of Reviews

Reviewed by	*2005-06*	*2006-07*
Consultant:		
Mainly Public Trading Enterprises and Public Financial Corporations	27	30
Treasury:		
Mostly General Government agencies	19	20

Treasury and its external advisor aim to continuously refine the agency review methodologies to make the PAFA review process more effective and improve the financial risk management framework of the NSW Government.

CHAPTER 5: PUBLIC TRADING ENTERPRISE SECTOR

- The public trading enterprise (PTE) sector consists of a range of businesses which supply services to the NSW community. Commercial businesses, such as electricity, water, and ports, are profitable and provide a return to the Government as shareholder in the form of dividends. Tax equivalent payments are also made for competitive neutrality reasons. Non-commercial PTEs provide important services, such as public housing and public transport, to achieve Government policy objectives and are supported by the Budget through the provision of grants and subsidies.

- Dividend and tax equivalent payments from the commercial businesses will provide an estimated $1.7 billion to State revenue in 2006-07, increasing to $2 billion by 2009-10.

- The PTE sector is in a very strong capital investment phase with expenditure of about $23 billion expected over the next four years. The substantial increase in expenditure is to meet growth in demand for electricity and ensuring continued network reliability and security; for water ensuring future supply; and for public sector housing and public transport.

- As a result of the increased capital expenditure, net debt for the PTE sector is forecast to increase substantially, although still within prudent levels of risk. An appropriate mix of debt and equity imposes disciplines on PTEs to ensure they operate efficiently.

- Net cash flows from operations of the PTE sector are expected to remain strong, averaging around $3.5 billion per annum over the forecast period.

- Over the next four years, strong growth in PTE sector earnings is projected due to improved revenue growth in water and electricity sectors.

5.1 INTRODUCTION

The public trading enterprise (PTE) sector operates in a diverse range of industries. This sector includes commercial businesses (e.g. electricity, water, waste services and ports) that are profitable and provide a return to the Government, as shareholder. Other non-commercial entities in the PTE sector provide services (e.g. public transport and housing) that address important social policy objectives and receive support from the Budget through grants and subsidies. The PTE sector has considerable assets, with net assets estimated to reach $64.7 billion by June 2006.

5.2 OVERALL PERFORMANCE OF THE SECTOR

THE COMMERCIAL POLICY FRAMEWORK

Under the Government's Commercial Policy Framework, PTEs are expected to maximise the wealth of the people of New South Wales by efficiently deploying their resources and ensuring strong financial management. This framework replicates appropriate disciplines and incentives that lead private sector businesses towards efficient commercial practices. The Government continues to refine the framework and seeks efficiencies in PTE operations to improve the sector's contribution to consolidated revenue, while allowing businesses to take advantage of investment opportunities.

Since the introduction of the framework in the early 1990s, PTEs have made an important contribution to the Consolidated Fund, helping to fund services provided by the general government sector including health, education and police, through dividend, tax equivalent and government guarantee fee payments. Under the Government's Financial Distribution Policy, a commercial business is expected to make a dividend payment from their available residual cash after allowing for working capital, the funding of acceptable investments within prudent gearing and an appropriate contingency for financial flexibility. Tax equivalent and government guarantee fee payments must also be made on an annual basis and help to put the commercial businesses on a level playing field with the private sector.

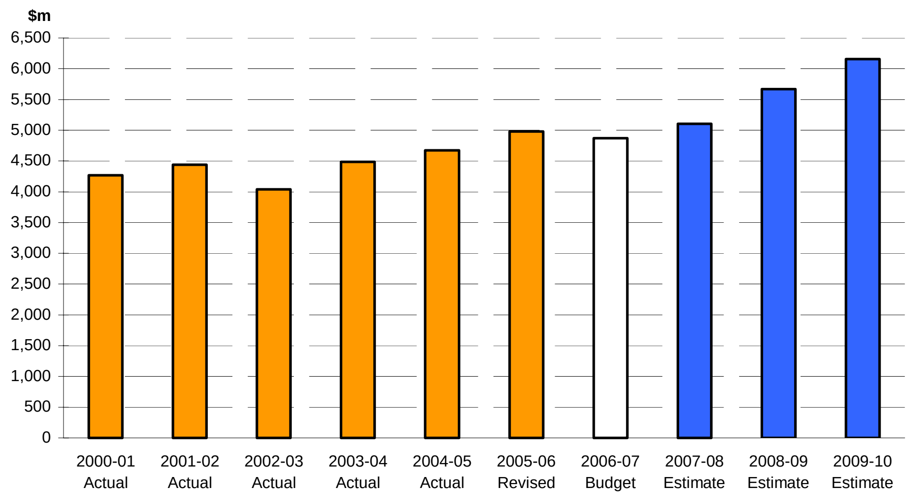
The framework and its commercialisation principles have improved the incentives for sound performance and contributed to improved financial performance in the PTE sector.

OPERATING PERFORMANCE

Under the accrual government finance statistics (GFS) framework, a good measure of the financial health of the PTE sector is the net operating surplus before interest, tax, depreciation and amortisation. This measure is equivalent to earnings before interest, tax, depreciation and amortisation (EBITDA) commonly used in the private sector. Chart 5.1 shows the net operating surplus for the PTE sector in the period 2000-01 to 2009-10.

Earnings in the PTE sector are projected to grow strongly over the next four years with the net operating surplus projected to grow at an average 5.5 per cent per annum. This growth can be attributed to significant earnings in water and electricity despite declining revenues in the non-commercial transport sector.

Chart 5.1: Net Operating Surplus before Interest, Taxes, Depreciation and Amortisation, 2000-01 to 2009-10



The net operating surplus in the water sector is expected to increase at an average 10.9 per cent per annum between 2005-06 and 2009-10. The higher water sector forecast is due to the anticipated end to drought conditions by June 2007 and higher regulated prices determined by the Independent Pricing and Regulatory Tribunal.

Earnings from the electricity sector are expected to increase by 6.6 per cent per annum over the same period. This growth can be largely attributed to forecast growth in electricity demand resulting in increased generation earnings over the forward estimates period. Steady growth in earnings from the regulated electricity distribution and transmission sectors, required to recover increased depreciation and interest charges associated with increased capital expenditure requirements, is also expected over the same period.

The net operating surplus from the transport sector is forecast to fall in 2006-07 and continue in a downward trend over the forward estimates. The declining operating surplus in the rail sector can be attributed to a higher growth in expenses relative to fare revenue. Major spending initiatives to improve safety and reliability are being undertaken, and the modest rate of growth in fare revenue falls short in offsetting the expenditure increase.

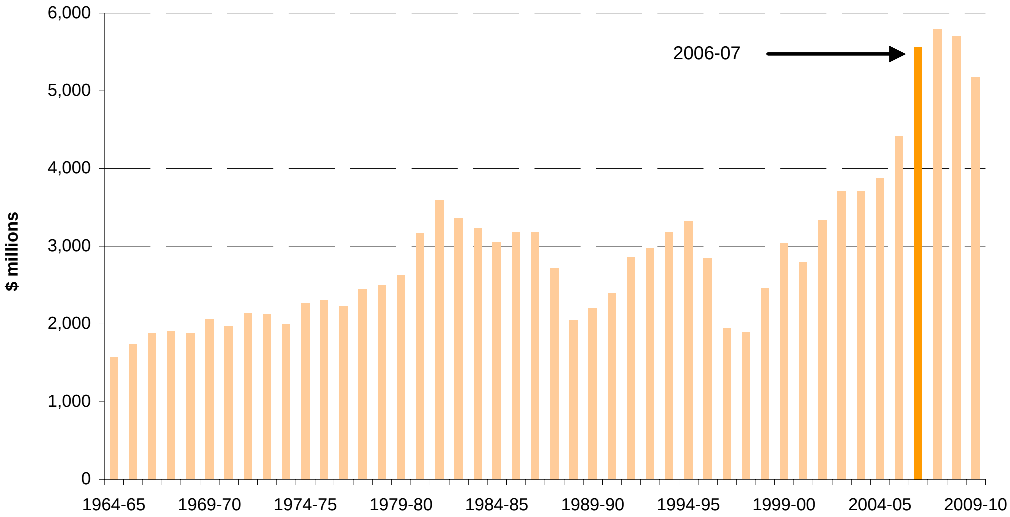
The housing sector is forecast to experience a similar decline, recording a net operating deficit from 2006-07. The housing sector should have a negligible impact on the operating balance by the end of the forecast period. This can be attributed to the Department of Housing's increased expenditure in 2006-07 on maintenance and the implementation of its Portfolio Strategy.

CAPITAL EXPENDITURE

Trends in Capital Expenditure

The PTE sector is a major contributor in the provision of the State's infrastructure, accounting for about half of the total State sector's capital spend in a typical year. Total capital expenditure in the PTE sector tends to be fairly cyclical due to the lumpy nature of infrastructure investments. The capital program grew significantly in the early 1980s reflecting growth in electricity generation, railways and ports infrastructure. It peaked again in the mid 1990s, driven by increased expenditure in transport and housing. Chart 5.2 shows the cyclical nature of the program, after removing the effect of inflation.

Chart 5.2: PTE Sector Capital Expenditure, 1964-65 to 2009-10, in real 2006-07 dollars[(a)]



(a) Figures converted to real dollars using the NSW State & Local Public Gross Fixed Capital Formation Deflator, provided by the Australian Bureau of Statistics.

The PTE sector is currently entering another period of substantial capital expenditure growth. Expenditure is anticipated to peak in 2007-08 *in real terms*, and remain at historically high levels across the forward estimates period. Investment in electricity, water, and ports infrastructure are the main contributors to the significant ramping up in PTE capital expenditure in this current high in the investment cycle.

Capital Expenditure in the Forward Estimates Period

PTE capital expenditure is expected grow by 29 per cent in 2006-07 reaching over $5.5 billion *in nominal terms*, compared with $4.3 billion in 2005-06. Expenditure is anticipated to peak in 2008-09 at $6 billion *in nominal terms*, however, 2007-08 marks the start of a decreased rate of growth, dropping to 6.7 per cent and leading to a decline of 6.9 per cent in expenditure in 2009-10.

Capital expenditure in the electricity sector is expected to mirror the overall trend, with a 30.2 per cent increase in expenditure in 2006-07 to $2.3 billion. Expenditure is expected to peak in 2008-09 at $2.9 billion, decreasing by 1.1 per cent in 2009-10. The main focus of this capital expenditure is expanding and upgrading the high voltage and distribution networks in order to meet growth in demand and ensure continued reliability and security of electricity supply across the State.

Investment in the water sector is expected to see a significant increase in expenditure in 2006-07 of 19.9 per cent to $990 million. However, after peaking at an estimated $1.2 billion in 2007-08, capital expenditure in the water sector is expected to decline in both 2008-09 and 2009-10, by 5 per cent and 15 per cent, respectively. This will see capital expenditure in 2009-10 of $953 million drop below the amount forecast for 2006-07. The main drivers behind the increase in capital spending in the period 2006 to 2010 are the Metropolitan Water Plan (including recycling) and urban growth in Sydney.

Expenditure on housing is also expected to increase significantly in the forward estimates period, with investment climbing from $375 million in 2005-06 to $536 million in 2006-07. While housing capital expenditure growth will be negative in 2007-08 and 2008-09, expenditure is again expected to increase to $569 million in 2009-10. This increase is due to a state-wide, long term plan for reconfiguration of public housing assets to better match client needs. Over a long period, larger households have been replaced by small households – many of whom are aged and/or disabled.

Capital expenditure by Sydney Ports Corporation on the Port Botany expansion is the major contributor to the substantial increase in capital expenditure in the ports sector from $79 million in 2005-06 to its peak of $312 million in 2008-09.

Major new rollingstock purchases worth more than $2.5 billion, coupled with increasing expenditures on the $1.5 billion Rail Clearways Program will substantially boost capital spending in the rail sector in the forward years.

More detail on the capital investment plans of the public trading enterprises is outlined in Budget Paper No. 4.

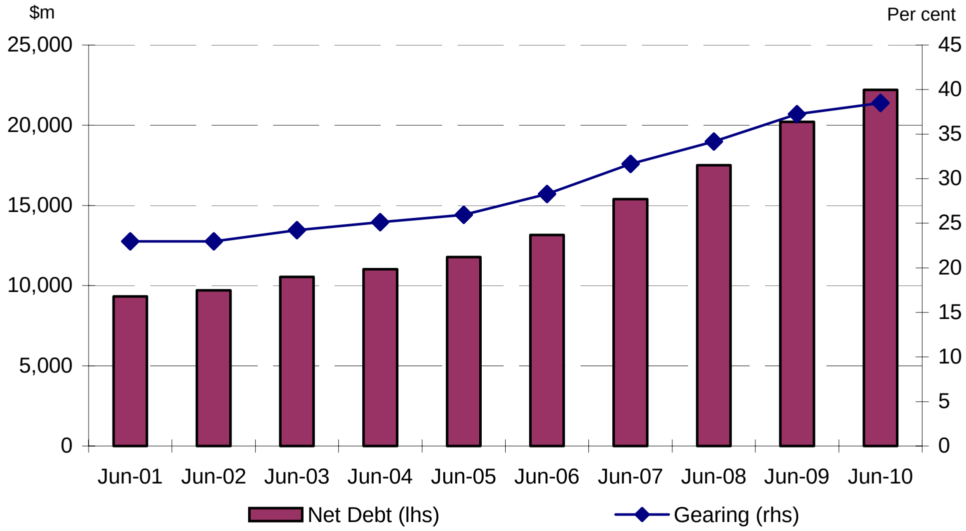
NET LENDING AND CAPITAL STRUCTURE

Commercial businesses in the PTE sector, such as electricity, water, and ports maintain a commercial capital structure and are financed by an appropriate mixture of debt and equity. The transport and housing sectors are not subject to commercial capital structures as capital expenditures in these sectors are largely budget funded.

As detailed in Tables 9.5 and 9.8 of Chapter 9, net debt in the PTE sector is forecast to grow significantly in the period to 2010 mainly due to increased capital expenditure requirements. However, projected debt gearing levels remain within target limits based on commercial benchmarks. In its 2005 Report on the State of New South Wales, rating agency Standard and Poors said of the PTE sector:

> *Although the increased investment in infrastructure will be primarily funded by debt, the capital structure of trading enterprises is forecast to remain within commercially appropriate levels.*

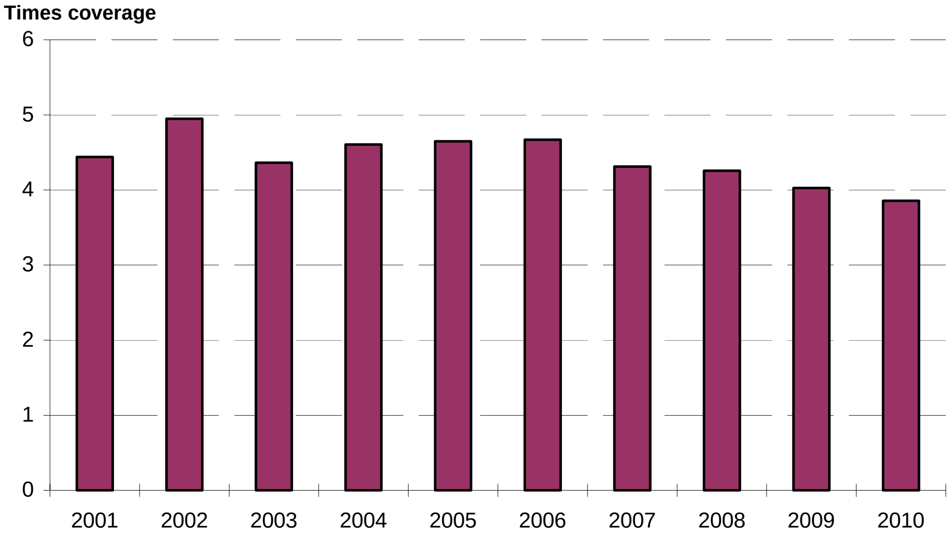
Chart 5.3: PTE Net Debt and Gearing[(a)] (excluding housing and transport), June 2001 to June 2010



(a) Gearing is defined as the ratio of Net Debt to Total Assets

Investment in the regulated electricity network and water sectors accounts for around 80 per cent of projected commercial PTE capital expenditure. Capital expenditure in these sectors earns a commercial rate of return, recovered through regulated prices. Commercial returns from these sectors help fund services provided by the general government sector such as roads, schools and hospitals. Despite significant increases in debt, EBITDA interest coverage (under GFS, net operating surplus before interest, tax, depreciation and amortisation divided by interest expense) for the commercial PTE sector is projected to only decline marginally over the forward estimates period and remain at commercially acceptable levels (see Chart 5.4).

Chart 5.4: PTE Net Operating Surplus Interest Coverage[(a)] (excluding housing and transport), June 2001 to June 2010



(a) Net Operating Surplus before Interest, Tax, Depreciation and Amortisation divided by Interest Expense

5.3 MAJOR FUNCTIONAL AREAS WITHIN THE PTE SECTOR

ELECTRICITY

The State owns the major NSW electricity utilities:

- three *generators* - Macquarie Generation, Delta Electricity and Eraring Energy;
- the high voltage *transmission* corporation - TransGrid; and
- three *distribution and retail* businesses - EnergyAustralia, Integral Energy, and Country Energy.

The State also owns a 58 per cent share in the hydro electricity generator, Snowy Hydro Limited. In total, State-owned generators have approximately 16,000 megawatts of installed capacity. These assets generate around 66,000 gigawatt hours per year. The NSW distributors have approximately 3.1 million network customers.

Investment in the Electricity Networks

Within the electricity sector, the NSW electricity network businesses (transmission and distribution) are experiencing a period of high capital expenditure. This reflects customer growth with high numbers of new connections, increasing summer peak demand from the use of air conditioners, renewal of the asset base and tightening regulatory requirements.

To ensure the continued reliability in the supply of electricity across the network, NSW network businesses have significantly increased their planned capital expenditure. Over the next four years, the electricity distribution and transmission businesses are forecasting capital expenditure of around $9.1 billion.

Investment in Generation

On 7 December 2005, the NSW Premier announced the construction of a 300 megawatt gas fired power plant by Delta Electricity at Lake Munmorah on the Central Coast. This power plant will cater for growing peak energy demand and is expected to be completed by 2009-10.

Sale of NSW Share of Snowy Hydro Limited

The New South Wales, Commonwealth and Victorian Governments have announced that they will sell Snowy Hydro Limited through an initial public offering (IPO). The sale is expected to be concluded by mid 2006. In line with normal practice, the effects of the sale are not included in this Budget.

TRANSPORT

The Transport Sector incorporates:

- *Rail services* – Rail Corporation New South Wales (RailCorp), responsible for passenger rail services (CityRail and CountryLink) and Rail Infrastructure Corporation, which manages the country regional network. The Transport Infrastructure Development Corporation (TIDC) is a construction authority managing major transport infrastructure projects, including the Clearway program and the Epping to Chatswood Rail Line. The State Rail Authority (SRA), formerly responsible for passenger services, is being wound up;

- *Bus services* - State Transit Authority (STA) provides passenger bus services in metropolitan Sydney and bus and ferry services in Newcastle;

- *Ferry services* - Sydney Ferries operates passenger services on Sydney Harbour and the Parramatta River; and

- *Port facilities* - three Port Corporations, Sydney, Newcastle and Port Kembla, manage the State's major ports, including navigation and on-shore facilities.

The Public Transport Ticketing Corporation, operative from 1 July 2006, will manage the development of a smart card ticketing system for all public transport operators in the Greater Sydney Region.

Financing the Transport Sector

Table 5.1 presents a summary of the Budget support to the PTE transport sector. Over the four year period to 2006-07, Budget grants in the sector will increase by $857 million, or 35 per cent (or an average of 7.8 per cent per annum). In 2006-07, operating expenditure (excluding depreciation and capital expenditure) by RailCorp on CityRail and CountryLink services is projected at nearly $2.3 billion. Budget grants, including subsidies for fare concessions to pensioners and students, and to finance capital expenditure, will reach $2 billion. Rail Infrastructure Corporation will receive $190 million in Budget grants, including $130 million for maintenance of the country regional network.

Table 5.1: Budget Support for the PTE Transport Sector[(a)]

	Actual 2002-03 $m	*Actual 2003-04 $m*	*Actual 2004-05 $m*	*Revised 2005-06 $m*	*Budget 2006-07 $m*
Rail Services					
Operating grants	1,290	1,369	1,504	1,683	1,692
Capital grants (plus asset sale proceeds)	477	496	581	660	697
Sub-total – Rail Services	1,767	1,865	2,085	2,343	2,389
Bus and Ferry Services					
Operating grants	239	242	287	305	312
Capital grants	3	...	5	…	…
Private Operators/Community Groups	438	463	486	556	604
Sub-total – Bus and Ferry Services	680	705	778	861	916
Total Net Budget Funding: Transport	2,447	2,570	2,863	3,204	3,304

(a) The Budget also supports borrowings by transport agencies to fund capital works. Operating grants also include fare concessions for pensioners and students.

Capital investment in 2006-07 includes a $830 million program for RailCorp and a $327 million program for TIDC, both financed by a combination of Budget grants and borrowings.

Payments for bus and ferry services are estimated at $916 million, an increase of $66 million, or 7.7 per cent on last year.

Directions in Transport

Rail services

Every day CityRail moves one million passengers between 304 stations in a fleet of more than 1,500 carriages, covering over 1,300 kilometres of track.

The rail sector has undergone a period of significant reform in the last three years. A single passenger rail entity, RailCorp, was established from 1 January 2004, combining responsibility for the safe operation, crewing and maintenance of trains and stations (formerly undertaken by SRA), with ownership and responsibility for maintenance of the metropolitan track network (formerly undertaken by the Rail Infrastructure Corporation). Integration will give an improved emphasis on network operations, safety, reliability and customer service.

New contractual arrangements with the Australian Rail Track Corporation (ARTC) from September 2004 include a 60 year lease of the interstate and Hunter Valley coal networks and a 60 year country regional network management agreement over the remaining country rail corridors. The ARTC and the Commonwealth have given major commitments to New South Wales to upgrade rail infrastructure as part of the arrangements.

These structural reforms underpin a significant increase in capital investment in both metropolitan and regional rail services. For metropolitan services, key investment strategies include:

- the $1.5 billion Rail Clearways Program, to reduce congestion and improve network capacity for more services;
- a massive rollingstock investment program worth more than $2.5 billion, including the purchase of approximately 600 new carriages for the suburban rail network under a Public Private Partnership, as well as 122 new outer suburban carriages for the intercity lines and 14 Hunter Valley carriages;
- a new rail line between Chatswood and Epping, with three new underground stations, to provide new services and connections for commuters; and
- new safety and network management systems to improve passenger safety and amenity.

New metropolitan timetables, which have substantially improved service reliability, particularly for the evening peak period, were introduced in September 2005 and May 2006. Further improvements to safety and reliability, coupled with service and financial efficiency are key objectives of the Corporation.

Rail Infrastructure Corporation is undertaking signalling and train control improvements for the country regional network to improve system safety and meet operational needs.

Bus services

State Transit Authority (STA) of New South Wales is the government owned authority responsible for the operations of Sydney buses and Newcastle buses and ferries. The Authority services more than 200 million passengers every year, with the largest fleet of buses in Australia, comprising more than 1,900 buses. The Authority also operates ferry services in Newcastle.

As part of a plan to enhance and revitalise bus services, significant reforms have now been introduced into metropolitan services arrangements. The plan stems from the recommendations of the *Review of Bus Services in New South Wales* by the Honourable Barrie Unsworth and the *Ministerial Inquiry into Sustainable Transport in New South Wales* by Professor Tom Parry.

New contracts for all metropolitan bus services, which include those provided by the STA, were finalised by November 2005. These contracts require the STA and private operators to have a consistent fares policy for the same distance, including pensioner concessions. This initiative will improve the overall viability of the bus industry and result in better services and value for money for commuters from the provision of Budget grants. Contracts for outer metropolitan services are expected to be completed by the end of 2006.

In 2006-07 the Authority is commencing the first stage of a $254 million program to replace 505 buses in the Sydney and Newcastle networks. In 2006-07, 61 standard Compressed Natural Gas and 'Euro 5' diesel buses are planned for delivery.

Ports

Port reforms are focused around the implementation of the Ports Growth Plan. The Plan includes a proposal by Sydney Ports Corporation for expansion of Port Botany to meet the rapid growth of container movements.

A $140 million redevelopment program is underway to transform Port Kembla into Australia's leading car import centre. A new cargo facility and third berth will be constructed to enable Port Kembla to handle nearly 240,000 vehicles a year, along with increased containers and general cargo. This will provide a significant economic boost to the area.

The Plan also includes nominating Newcastle as the site of a future major container terminal once Port Botany reaches its capacity and inviting the development of a smaller multi-purpose terminal in the interim. Newcastle remains the largest coal port in the world with a capacity approaching 90 million tonnes per annum. Capacity is likely to increase following a successful proposal by a coal industry consortium to develop a new terminal. The Newcastle Port Corporation is working with other parties concerned with the coal logistics chain to significantly increase capacity in the light of unprecedented coal demand.

WATER

The State owns four commercial water businesses:

- Sydney Water Corporation provides water, sewerage and some stormwater drainage services in Sydney, the Illawarra and the Blue Mountains;

- Sydney Catchment Authority is responsible for Sydney's drinking water catchment and its infrastructure, and supplies bulk water to Sydney Water and some councils in the Sydney catchment area;

- Hunter Water Corporation is a vertically integrated bulk and retail water and wastewater business in the Hunter region; and

- State Water Corporation is a bulk water business in rural New South Wales whose main customers are irrigation companies and some country towns.

Country Energy's main business is energy distribution and retailing, but it also provides water and wastewater services in Broken Hill. Urban water and wastewater services in the rest of country New South Wales and the Central Coast are the responsibility of local councils.

Metropolitan Water Plan

The Government recently released the *2006 Metropolitan Water Plan*. The Plan addresses the ongoing drought, longer-term balance between water demand and supply; and the long-term health of the Hawkesbury-Nepean and Shoalhaven River systems.

Specific measures in the Plan include:

- *Increasing recycling* through a range of measures that will provide an extra 15 billion litres of recycled water through new schemes under construction or to come on-line – increasing current recycling volumes more than fourfold, to 70 billion litres a year by 2015.

- *Increasing supply* through accessing deep water in the Nepean and Warragamba dams; contingency plans for desalination and groundwater in case of severe or extreme drought; and investigating the pumping of more water from the Shoalhaven River without raising the wall of Tallowa Dam.

- *Reducing demand* through the water efficiency labelling scheme, the $130 million Water Savings Fund, subsidised household retrofits and a range of other programs.

- *Improving river health* through an initial commitment to modest environmental flows from the Upper Nepean dams, monitoring the Hawkesbury-Nepean River with a view to setting a new environmental flow regime in 2015, a Western Sydney Recycled Water Initiative which will reduce nutrient discharges into the Hawkesbury-Nepean and developing a new environmental flow regime for the lower Shoalhaven River.

The Plan is available at www.waterforlife.nsw.gov.au

Investing in Water Infrastructure

Like the energy sector, the water businesses are experiencing a period of high capital expenditure. The water businesses are planning to invest $4.2 billion on capital works over the four years from 2006-07 to 2009-10. This is up from $2.6 billion over the previous four years.

The main drivers behind the increase in capital spending are the Metropolitan Water Plan ($525 million over the next four years) and urban growth in Sydney ($670 million).

The increase in capital expenditure is accompanied by debt levels increasing from $3.6 billion currently to $6.1 billion in 2009-10 and gearing increasing from 23 per cent to 34 per cent. Gearing at 34 per cent is still conservative compared with normal commercial practice.

Future Structure of the Water Industry

During 2005-06, the Independent Pricing and Regulatory Tribunal (IPART) finished its investigation into the industry structure for water and wastewater services in Sydney. As recommended by IPART, an access and licensing framework is being developed to allow third parties to access water and wastewater infrastructure in the Sydney, Blue Mountains, Illawarra and Hunter regions. The objective is to promote competition in the water and wastewater industries, thereby encouraging new investment and innovation in the metropolitan water industry, while continuing to protect public health, the environment and consumers. The draft access and licensing frameworks have been released for consultation and are available from www.waterforlife.nsw.gov.au.

The Metropolitan Water Plan also includes other industry reforms including:

- amendment to the *Pipelines Act 1967* to streamline the licensing process;
- streamlined application procedures, including an independent dispute mechanism, for sewer mining, (i.e. third parties "mining" effluent from the sewage systems and then recycling it);
- streamlining the development consent process to make it easier and faster to obtain approval for small-scale recycling plants; and
- new guidelines for the approval and operation of privately owned water recycling plants.

PROPERTY

A review of Landcom's scope of operations and performance has been undertaken by Treasury. This was the first such review since Landcom was corporatised in 2001. The Terms of Reference for the review included investigation of:

- the links between the Corporation's development and renewal activities;
- Landcom's ongoing capital requirements;
- future dividend and tax equivalent payments and financial risks; and
- Landcom's impact on the supply and cost of land for housing including the North West Sydney and South West Sydney sectors.

Since 2001, Landcom has grown considerably with assets at an estimated market value of over $1 billion in 2005.

The Review concluded that Landcom's substantial property holdings which are not of a strategic or complex nature should be released for sale. Landcom would then focus its operations on undertaking the more complex and strategic projects.

An implementation plan for realising the disposal of the properties has been prepared by Landcom for review and regular oversight by Treasury. Implementation is proceeding in line with market conditions. This plan includes a financial impact statement, disposal schedule and due diligence documentation prior to disposal.

SOCIAL HOUSING

The Department of Housing which will receive grants from the Budget totalling $540 million in 2006-07, is included in the PTE sector and manages the State's social housing portfolio and develops broader housing strategies. It provides tenancy and property management for just under 129,000 public housing homes. The Department sets market rents for its properties. However, around 90 per cent of current tenants cannot afford market rents and are eligible for a subsidy. These tenants pay a subsidised rent based on a percentage of the total income of the household.

The NSW Government is currently implementing reforms which are outlined in *Reshaping Public Housing*, released in 2005. The reforms will ensure a fairer public housing system that promotes responsibility and meets needs well into the future. Elements of the policy include major changes to eligibility and length of tenure for public housing to better reflect tenant circumstances; and reconfiguration of the housing portfolio to better meet the tenant profile. In 2006-07, reconfiguration of the housing portfolio will result in 1,038 new one and two bedroom dwellings to suit changing demographics and smaller sized family units. This includes 458 dwellings to suit the elderly and 160 dwellings adaptable or specifically built for people with disabilities.

Consistent with the new policy, cross-agency partnerships to provide housing and support services for tenants with complex needs will also be developed under the Human Services Accord.

Over the next five to ten years, the Government will work with Fairfield City Council, the private sector and the local community to renew the public housing estate in Bonnyrigg. This is part of the Living Communities' program to renew high-need public housing estates in New South Wales.

The Department of Housing is also trialing the Maintenance Reform Program in a number of pilot areas. The program establishes a new approach to the maintenance of public housing and potentially offers an estimated 15 per cent saving on current maintenance costs through a systematic lifecycle planning approach.

CHAPTER 6: THE ECONOMY AND RISKS TO BUDGET OUTCOMES

Economic Situation and Outlook

NSW economic activity will strengthen in 2006-07, with a larger contribution from net exports. Business investment will continue to grow and will remain at record levels. The unemployment rate will be steady. Inflation will be stable.

- ♦ The NSW economy has expanded at a more moderate rate than the national average for several years. But the growth gap between New South Wales and the rest of Australia should narrow in 2006-07.
- ♦ The cyclical extremes of 2005-06 will start to unwind in 2006-07 as the economy moves closer to longer-term trend growth rates:
  - The dwelling sector downturn of the past two years will come nearer to an end. But prospects of a near-term turnaround in the dwelling cycle were put on hold by the interest rate rise announced on 3 May 2006.
  - After several years of very strong expansion, business investment growth is predicted to moderate in 2006-07, although it will remain historically high in level terms and as a share of state final demand.

Risks to Budget Outcomes

The Budget is sensitive to variations between actual and expected outcomes for the economy. Some of the most salient risks to the economic outlook include:

- ♦ World capacity constraints, which are increasing global vulnerability to supply shocks, and adding to the risk of higher than forecast inflation and interest rates.
- ♦ Further RBA rate rises that would severely impact households and the economy.
- ♦ Growing world payments imbalances that are contributing to protectionism, and increasing the risk of global financial disruptions and economic downturn.
- ♦ Higher and more volatile oil prices, feeding inflation and disrupting activity.

Budget estimates are framed on the basis of no change in government policy and other parameters. Factors which might affect Budget outcomes include need for drought relief, public sector wage and work value claims, realisation of contingent liabilities, and change to Commonwealth policy on intergovernmental financial arrangements.

6.1 INTRODUCTION

Budget estimates rely on assumptions, forecasts and assessments made at the time of their preparation. The recent performance of the economy and economic forecasts underpinning the 2006-07 Budget estimates are presented in Section 6.2.

The sensitivity of budget outcomes to change in underlying factors is considered in Section 6.3. These factors include changing economic circumstances, unanticipated policy and regulatory decisions, changed demand for services, and the realisation of contingent liabilities.

6.2 THE ECONOMIC SITUATION AND OUTLOOK

At this time last year the general economic outlook was moderately positive with world growth expected to remain solid, and the Australian economy expected to record gains in exports and the terms of trade. The NSW economy was expected to accelerate a notch supported by further solid business investment, stronger consumption and the beginnings of a recovery in the housing sector.

While world growth met or even exceeded expectations, developments in the national and NSW economies were more subdued than expected. Reflecting earlier low levels of private sector mining investment, Australia’s exports did not keep pace with global demand. Dwelling investment declined for a second year, and private consumption growth slowed as a result of the housing downturn and escalating petrol prices.

In 2006-07, global conditions are expected to remain favourable. Economic growth in New South Wales should improve with dwelling investment bottoming out, steady growth in private consumption and improved net exports. Business investment growth is expected to slow, but both in level and as a share of gross state product (GSP), business investment will be at historical highs. Employment growth may be marginally softer but the unemployment rate should remain steady.

RECENT PERFORMANCE [1]

The NSW economy faced headwinds similar to those confronting the national economy in 2005-06, with both consumption and dwelling investment weaker than expected. In contrast to more resource-oriented states, New South Wales received little direct boost from higher commodity prices and resource sector investment, while its non-resource exporters and import-competing manufacturers bore the brunt of the commodity-driven rise in the exchange rate. Despite these challenges, NSW business investment expanded strongly in line with forecasts, rising to a record high ratio to total state final demand. NSW population growth edged higher, and NSW employment growth was a bit stronger, while the average unemployment rate was steady around three-decade lows.

Table 6.1: Revised 2005-06 Estimates

(Year average percent change, unless otherwise indicated)

	2005-06 Budget	*Half Yearly Review*	*Current Estimate*
State final demand	3½	2½	2½
Gross state product	2¾	2	1¾
Employment	1¼	1¾	1½
Unemployment rate (year average, percent)	5¼	5¼	5¼
CPI (Sydney)	3	3	2¾
Wages (wage price index, ordinary time)	3¾	4¼	4

Population growth accelerated to 0.8 per cent through the year to September 2005 from 0.6 per cent to September 2004. Lower levels of interstate migration contributed to this outcome. In September 2005 interstate migration was its lowest in four years. Population growth is expected to strengthen slightly to 0.9 per cent by June 2006, providing some underlying support for employment, consumption and housing investment.

[1] *Unless otherwise indicated, the sources for statistical information in this chapter are ABS (Australian Bureau of Statistics) data releases and NSW Treasury estimates. Economic estimates are based on data available as at mid-May 2006, which included: results to June 2005 for gross state product; to September 2005 for population; to December 2005 for state final demand; to March 2006 for consumer prices and the wage price index; and to April 2006 for employment.*

Box 6.1: Recent Challenges to NSW Economic Performance[2]

The NSW economy has faced a number of challenges in recent years. These have been cyclical, rather than structural in nature and have included:

- New South Wales was the first into the housing boom and the first to feel the after-effects of a slowdown in the property market in terms of housing construction and house price falls.
- The high level of house prices corresponded with a slowing in NSW population growth through to 2003-04, with both internal migration to other states rising and fewer overseas migrants settling in New South Wales – a similar pattern to the early 1990s, when house prices also rose sharply.
- At the same time Queensland and Western Australia have been benefiting more (in terms of employment and investment) than New South Wales from the global commodity price boom. The boost to the exchange rate from the commodity boom, moreover, negatively affects the manufacturing and services sectors of the more diversified NSW economy.
- In 2002-03 drought severely affected agriculture in New South Wales and most other States. While most other States recovered the next year, NSW farm output continued to decline in 2003-04.

The NSW Government does not control the primary policy levers that impact cycles in State economies. The levers are in the control of the Reserve Bank through monetary policy and the Commonwealth Government through taxation, expenditure and income redistribution policies. Other forces that have influenced the State's economic cycle, such as climatic conditions and international demand for NSW goods and services and the Australian dollar are clearly outside any major influence from a State Government.

Looking ahead, the impact of these shocks is waning, and the cyclical prospects for the diversified NSW economy are good.

Consumer spending growth slowed for a second year in 2005-06. This reflected falling dwelling construction (which reduced demand for household goods), declining house prices and the rising cost of petrol (which constrained budgets). These factors appeared to outweigh household gains from higher wages and employment, booming equities, lower taxes and higher real purchasing power after adjustment for the terms of trade. Retail sales trends through March 2006 suggest that the pace of consumption growth may have regained some momentum as the year progressed.

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[2] *Source: the Premier's Economic and Financial Statement, released on 23 February 2006.*

Dwelling construction continued to decline through 2005-06, gradually dissipating the remnants of the dwelling bubble that had formed in the early 2000s. While trends in first homeowner loan approvals and general housing finance to early 2006 are encouraging, dwelling approvals are trending lower (usually the most dependable short-run leading indicator). The Reserve Bank of Australia's (RBA) interest rate increase on 3 May 2006 has cast a further shadow of uncertainty over dwelling sector trends.

Business investment continued to strengthen in 2005-06 from an already solid base, buoyed by strong profits, high capacity utilisation and robust global economic conditions. Trends for components suggested a slight refocus away from plant and equipment toward construction. The share of business investment in state final demand averaged a record high 13 per cent during the four quarters to December 2005 – double the ratio a decade earlier.

Strong business investment limited the impact on 2005-06 *state final demand* growth from slower consumption growth and declining dwelling investment. State final demand is estimated to have increased by 2½ per cent in 2005-06 compared to 3½ per cent in the previous year.

As a major gateway for national imports, but a comparatively modest supplier of national exports, New South Wales usually records a net deficit on *overseas trade*. In 2005-06 NSW manufactured and service exports were weighed down by the higher exchange rate, while imports were boosted by the strength of business investment. As a result, overseas trade (plus interstate trade, inventory and other balancing items) detracted around ¾ of a percentage point from *gross state product*, which is estimated to have increased by about 1¾ per cent in 2005-06.

The *labour market* made further gains, with NSW employment growth increasing to 1½ per cent and the unemployment rate remaining steady at 5¼ per cent[3]. In year average terms, employment growth to the March quarter 2006 was strongest in communication services, finance and insurance, cultural and recreational services, and property and business services.

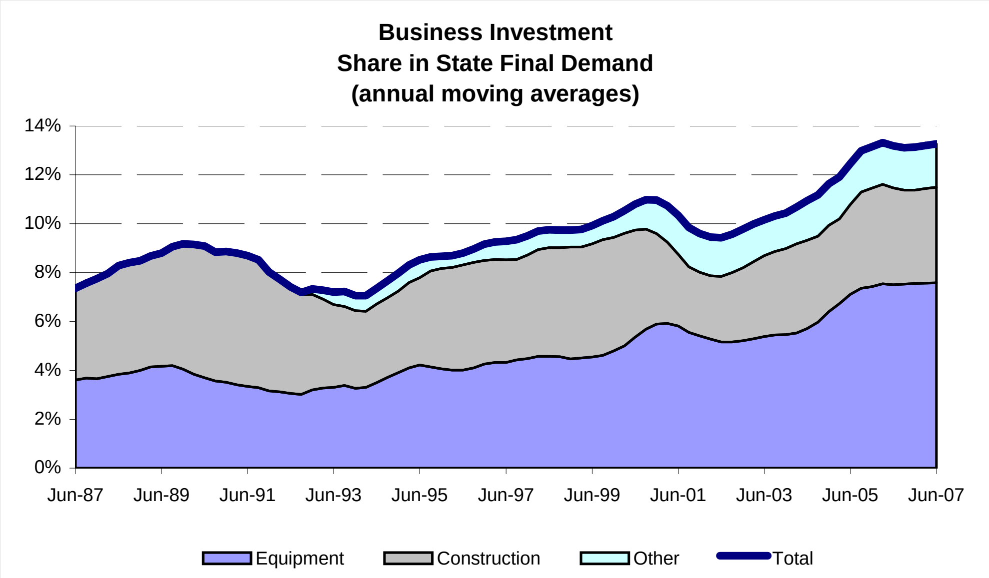
Inflationary pressures edged higher in 2005-06 in response to rising world commodity prices (particularly oil) and solid domestic economic conditions. Growth in the consumer price index moved to the top of the RBA's 2 to 3 per cent target range.

[3] *The unemployment rate was 5.6 per cent in April 2006.*

Box 6.2: Business Investment

Business investment, which responds more directly to business climate, opportunity and entrepreneurship than to population growth, has experienced a period of significant growth since the end of 2002. Business investment has been a major source of strength in the economy in recent years. After growth averaging 13 per cent in 2002-03 and 2003-04, business investment expanded by 18 per cent in 2004-05 with a solid increase (6 per cent) in non-residential construction, and exceptionally strong growth (29 per cent) in machinery and equipment. Business investment is expected to grow a further 8½ per cent in 2005-06.

While the share of business investment in state final demand has trended upwards for the past two decades, the rise has been exceptionally strong since mid-2001. In December 2005 the share of business investment in state final demand was a record 13.6 per cent (it was 13.1 per cent in year average terms).



Strong business profitability, relatively low finance costs, high capacity utilisation ratios and robust global economic conditions should see modest business investment growth in 2006-07. Quarterly business surveys from both NAB and Westpac/ACCI confirm capacity utilisation ratios are high and business profitability expectations remain healthy.

The outlook is supported by surveyed business investment intentions. Private capital expenditure expectations point to an increase of 5.3 per cent in New South Wales between 2005-06 and 2006-07 with strong growth in the manufacturing sector (19.6 per cent) and the mining sector (66.2 per cent).

Private forecasters also expect NSW business investment to remain at or near record levels in 2006-07: Access Economics, for example, expects an increase of around 3¼ per cent; while Econtech expects a small ¾ per cent decline.

Wage pressures increased somewhat during 2005-06 in response to skilled labour shortages in faster-growing sectors and to arbitrated public sector wage decisions. Annual average wage growth in New South Wales increased from 3.5 per cent in March 2005 to 4.1 per cent in March 2006. Wage growth averaged 5.2 per cent in the public sector and 3.7 per cent in the private sector in the year to March 2006[4].

Monetary policy remained on hold from 2 March 2005 until 3 May 2006 when the cash rate was increased from 5½ to 5¾ per cent. In announcing the rate increase the RBA commented that pressures from above-average world growth, solid domestic spending and a pick-up in household credit growth had added to inflationary pressures in an economy with limited capacity and low unemployment; and that inflationary risks had increased sufficiently to warrant an increase in the cash rate[5].

OUTLOOK FOR 2006-07

In line with consensus forecasts, global growth is expected to remain robust in the year ahead. Global growth is expected to slow only a touch, from 3¼ per cent in 2006 to 3 per cent in 2007, with the pace easing slightly in north Asia and North America, and remaining little changed in Europe[6].

Global interest rates are expected to edge higher, with differences among countries reflecting their positions in the cycle: policy adjustment is close to completion in the United States, but at an early stage in Europe, and as yet only being contemplated in Japan[7]. With inflation and short-term yields edging up, long bond yields have started to drift higher.

The boost from the once-in-a-generation lift in Australia's terms of trade will continue to flow through the economy in 2006-07, underwriting strong corporate profits, household income and spending.

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[4] *Growth rates in the NSW public sector wage price index do not reflect underlying trends in recent quarters. Wage settlements have generally been in the order of 4 per cent, however the wage price index measures wage increases when received rather than when they become effective. Several wage increases in the NSW public sector were backdated to July 2004, but received in the March quarter 2005 and further wage increases were received in July 2005, creating a bunching effect in the wage price index. This effect should wane from the March quarter 2006.*

[5] *Reserve Bank of Australia, media release, 3 May 2006.*

[6] *Using purchasing power parity (PPP) rather than current exchange rates to weight countries would increase these global GDP estimates. For example, the IMF's April 2006 World Economic Outlook projects global growth at 4.9 per cent in 2006 and 4.7 per cent in 2007.*

[7] *The Bank of Japan ended quantitative easing in March 2006, but left its interest rate target at zero.*

Employment growth is likely to move towards trend in 2006-07 in response to the 2005-06 dwelling sector downturn and continued high international competitive pressures in manufacturing. Wage pressures should ease and price pressures should remain steady, allowing the RBA to forego further rate increases – although monetary policy is a negative risk factor in the outlook.

The NSW economy should begin to narrow the gap against other States during 2006-07. But growth is likely to remain faster in the resource States than in New South Wales while the current commodity boom continues.

Table 6.2: Economic Performance and Outlook

(Percent change, year average, unless otherwise indicated)

	Outcomes 2004-05	*Estimates 2005-06*	*Forecasts 2006-07*
New South Wales			
State final demand	3.5	2½	2½
Gross state product	1.1	1¾	2½
Employment	1.3	1½	1¼
Unemployment rate (year average, percent)	5.3	5¼	5¼
Sydney CPI	2.5	2¾	2¾
Wage price index	3.5	4	4
Australia			
Non-farm GDP deflator	4.1	4½	2¾
Ten year bond rate (year average, percent)	5.4	5¼	5¾

NSW economic output (GSP) growth is expected to strengthen from 1¾ per cent in 2005-06 to 2½ per cent in 2006-07. State final demand growth will be steady at 2½ per cent, while the contribution from net exports will improve by ¾ of a percentage point in GSP.

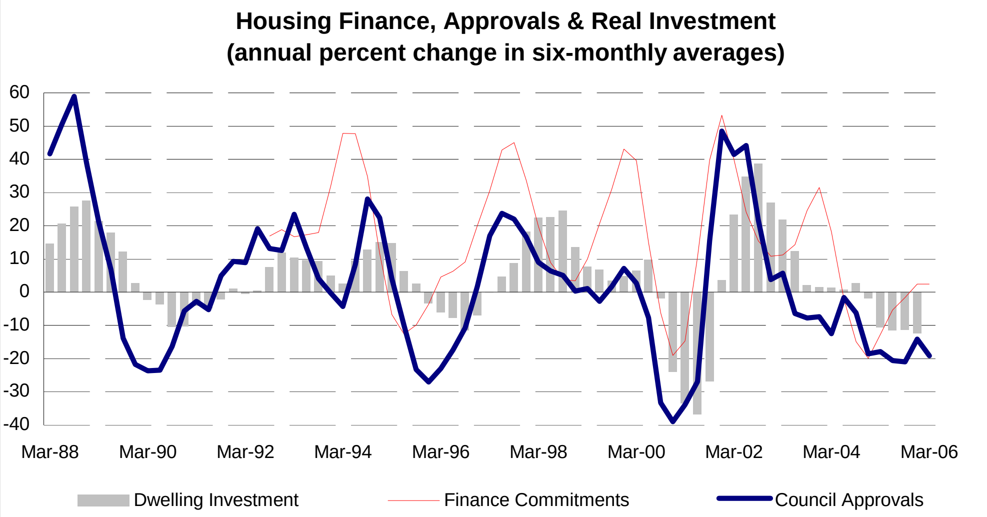
In the year ahead there is likely to be a rebalancing of activity from business investment towards net exports. The recent rise in interest rates will restrain household consumption growth and will delay the recovery of dwelling investment for another year. The structure of growth will move closer to trend after recent cyclical extremes in dwelling investment (although dwelling investment will decline a bit further both in level and in share of state final demand), and business investment (after exceptionally strong growth over the past four years).

Population growth is likely to edge higher, and the demographic growth differential to the rest of Australia should narrow somewhat[8].

Private consumption growth should remain steady after the mild slowdown experienced in 2005-06. Consumers will respond positively to continuing growth in employment and wage rates, reduced tax and the boost to non-wage income and wealth from the buoyant share market. But these positive factors will be offset by higher mortgage interest charges flowing from the May 2006 rate rise, higher petrol prices and subdued growth in home equity.

Box 6.3: Outlook for Housing Investment

Following an exceptionally long and strong cycle of growth at the start of the new century, the NSW housing sector began trending downward toward the end of 2003. The decline reflected several factors, including a normal cyclical correction to earlier excessive activity, a slowdown in population growth, tighter monetary policy, and shift in financial return relativities from property to shares.



Series shown are private dwelling investment (value, at constant prices); housing finance commitments (owner-occupier excluding refinancing plus commercial financing, at current prices); and council approvals (number of dwellings). Source: ABS.

[8] *Population growth will begin to slow later this decade as discussed in Budget Paper No. 6, "NSW Long Term Fiscal Pressures".*

Box 6.3: Outlook for Housing Investment (cont)

While conditions in the housing sector remained weak in 2005-06, several indicators suggest prospects are improving:

- Housing finance commitments are showing signs of recovery, with strong gains in lending to owner-occupiers from mid-2005 onward, and a levelling-out of the rate of decline in investor finance.
- After falling during most of 2003 and 2004, the number of properties sold at auction began to recover during 2005, and were 36 per cent above a year earlier (on a six monthly moving average basis) in April 2006.

Other indicators remain less buoyant:

- Dwelling approvals continue to trend lower through the March quarter 2006.
- Trends in Sydney house prices remain soft, with the ABS, APM and Residex series[9] all indicating some further weakness in the March quarter 2006, although the ABS series showed a small increase in the December quarter 2005.

Overall, the short-term outlook for dwelling investment toward the close of 2005-06 is fairly subdued. When assessed prior to the May 2006 rate increase, however, underlying demand forces as well as cyclical factors were expected to stabilise NSW dwelling investment in 2006-07, if monetary policy remained steady:

- Interstate migration appears to be declining, and population growth appears to be edging higher, based on data to September 2005.
- The lengthy pause in new construction has widened the gap between underlying demand and available stock of housing, and strengthened the business case for new investment. This is reflected in Sydney rental market vacancy rates, which have tightened progressively from an average 4.4 per cent in 2002 to an average 2.5 per cent in 2005, and stood at 1.9 per cent in April 2006.

This outlook was consistent with the views of private sector forecasters prior to the May 2006 interest rate increase, including Access Economics (who expected growth of 0.7 per cent) and Econtech (who expected a slight further decline of 1.9 per cent).

But their forecasts are likely to be revised lower following the RBA rate rise, which is likely to delay the NSW housing market recovery.

One of the principal factors slowing state economic growth in 2004-05 and 2005-06 was the dwelling cycle.

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[9] *The ABS House Price Index (established houses) is based on a stratified sample of prices reported at settlement. Series compiled by other organisations (such as Residex, and Australian Property Monitors) use different methodologies, and their results may differ.*

Prior to the RBA's May 2006 interest rate decision, several factors suggested the dwelling sector was close to a turning point. The cumulative reduction in new housing supply over the preceding two years, and slightly stronger demographic pressure over the course of 2005-06 suggested firmer underlying demand. Solid growth in housing finance suggested firmer market support as well, although trends in building approvals and commencements were yet to provide confirmation.

The RBA interest rate increase has cast a shadow of uncertainty over this recovery. Based on the response of the dwelling sector to previous rate increases, it is likely that prospective homeowners and investors will delay acquisitions, new construction plans will be put on hold, and house prices will be softer. While the rate of decline in dwelling investment should ease, growth will be negative for a third consecutive year.

Business investment growth is set to slow both nationally and in New South Wales in 2006-07, following several years of exceptionally strong gains. In New South Wales there will be further expansion in coal and other mineral resources[10], some increased hotel and office building and slightly less privately funded public activity[11]. The annual ABS survey of State capital expenditure expectations points to solid growth in mining and manufacturing investment. In aggregate, NSW business investment is expected to expand at a moderate pace in 2006-07, while reaching new peaks in level terms and as a per cent of state final demand.

After detracting from output growth both nationally and in New South Wales in 2005-06, net exports performance should improve in the year ahead. Faster exports growth will be supported by the substantial increase in installed capital in previous years, strong markets for export commodities such as coal[12], and normal conditions in agriculture. A flat or lower exchange rate may help performance in tourism and manufacturing. Net exports performance also will benefit from slower growth in plant and equipment investment, which has a large imported component.

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[10] *In May 2006, ABARE listed 44 major minerals and energy projects under construction or planning in New South Wales, including 23 in black coal, 10 in metal mining, and 7 in primary refining.*

[11] *Disbursements under Privately Financed Projects (PFPs) are projected to ease from the high levels reached in 2004-05 reflecting completion of several major road transport projects.*

[12] *ABARE expects thermal coal demand to remain strong, but prices to come under pressure from increased supply.*

NSW employment growth is likely to ease back toward trend in 2006-07, but it will remain in line with growth in working-age population and the labour force, keeping the unemployment rate steady at around three-decade lows of 5¼ per cent.

MEDIUM TERM OUTLOOK

Prospects for the economy in the first few years beyond 2006-07 will depend on the strength of the global economy, the business cycle, domestic policy settings and productivity trends. Because these factors cannot be predicted with reasonable confidence more than a short period ahead, the Budget estimates beyond 2006-07 are based on economic parameters determined by expectations for their average performance this decade.

The medium term parameters for output, employment and population are consistent with historical performance. Medium term parameters for prices and wages are consistent with public statements by the Reserve Bank of Australia as to their policy objectives.

Table 6.3: Economic Parameters Beyond 2006-07

(Per cent change, year average, unless otherwise indicated)

	Medium Term
Gross state product	3¼
Population	1
Employment	1¼
Sydney CPI	2½
Wage cost index	3½
Ten year bond rate (year average, per cent)	5¾

6.3 RISKS TO BUDGET OUTCOMES

Budget estimates rely on assumptions, forecasts and assessments for the economy and other factors made when the Budget was prepared[13].

This section considers the sensitivity of budget outcomes to changing economic circumstances. It also reviews other sources of uncertainty including unanticipated policy and regulatory decisions, changed demand for services, and the realisation of contingent liabilities.

[13] *Key source publications and their release dates are reported in footnote 1 to this chapter.*

These are among the more salient risks to the outlook at the time of Budget preparation. History suggests that often the critical factors for economic and fiscal outcomes are ones not foreseen or deemed too improbable when the forecasts were assembled.

ECONOMIC RISKS

Risks to the economic outlook for 2006-07 include:

Interest rates

While the forecasts assume that interest rates will rise only moderately in world capital markets and the Australian cash rate will be held steady during 2006-07, the interest rate outlook contains both global and domestic risks:

- As the world economy enters its sixth year of recovery, with a resurgent Japan adding to momentum from the United States, China and India, global activity is pressing against capacity constraints. This is reflected in sharply higher prices for industrial inputs and energy, rising inflation, and pressure on interest rates.

- Over 2006 and 2007 the International Monetary Fund expects global interest rates to rise, accompanied by higher rate volatility and risk premiums. But rate rises might be larger than anticipated and this might severely impact activity. Countries with overstretched house prices (such as the United States) would be particularly exposed.

- In Australia, consumer and producer price inflation as well as wage growth stepped up during 2005-06, in response to strong global demand, strong business investment, and skilled labour shortages. The Budget forecasts expect global demand and wage pressures to ease marginally in 2006-07, removing the need for any further monetary policy tightening beyond that announced on 3 May 2006. The new tax cuts and spending initiatives in the Commonwealth's 2006-07 Budget, however, may complicate the task for monetary policy. If inflationary pressures fail to ease and, in particular, should they start to flow through to trading margins and wage settlements, this would risk further escalation of RBA interest rate settings.

While mortgage interest rates may still appear moderate by historical standards, the cost of home ownership is high for the average mortgage holder. The decline in mortgage interest rates during the 1990s soon became capitalised into higher property prices and correspondingly larger home financing requirements, pushing household debt servicing ratios to historical highs by the early years of this decade. Given this escalation in home mortgage debt and servicing obligations any interest rate increase, such as that announced on 3 May 2006, has a far greater impact on household disposable income, consumption and the economy than in the past.

Global imbalances

The more preoccupying aspect of the global outlook, according to the International Monetary Fund (IMF), is the growth of financial imbalances between current account deficit countries (particularly the United States) and surplus countries (particularly Asia and the oil producers). One consequence has been a housing sector "bubble" in the United States, which now risks deflating. These imbalances are increasing the pressures on the financial system and are feeding the forces of protectionism.

The response must include a rebalancing of demand across countries, and a substantial realignment of their currencies, sooner rather than later. If not, warns the IMF, there is a risk of a much more abrupt and disorderly adjustment, accompanied by substantial exchange rate overshooting, a large increase in interest rates, and a sharp slowdown in growth worldwide.

World oil prices

The price per barrel of West Texas Intermediate (WTI) rose sharply from an average US$33.70 in 2003-04 to an average over US$60 in 2005-06 with spikes in excess of US$75 in the final quarter of the year.

Factors behind these increases are China's sustained rapid economic growth and the strong US recovery (both economies have high oil intensities), geopolitical uncertainties regarding supplier countries, and speculative covering in commodity markets. The risk of further oil price increases and volatility is substantial.

The world economy has the flexibility to adjust to gradual change. But there is a risk that the strong upswing since 2003, if sustained, will feed general inflation and reduce world growth. There also is the risk of further upward spikes in oil prices that might disrupt activity.

Drought

The forecasts assume normal weather conditions will prevail in 2006-07 in line with Bureau of Meteorology (BOM) climate projections in April 2006. Nonetheless the area of the State affected by drought has increased from 18 per cent in December 2005 to 62 per cent in May 2006, and dam water levels have fallen. At end-May 2006 the BOM revised its winter rainfall projection to below average for much of New South Wales. Agriculture directly accounted for less than two per cent of State output in 2004-05, but the sector's extreme volatility in response to drought events, and the flow-on to agricultural supplier and user industries, can appreciably affect aggregate State economic performance.

SENSITIVITY OF THE BUDGET TO ECONOMIC PARAMETERS

A guide to the sensitivity of budget estimates of expenses and revenues to variations in economic parameters is provided in Table 6.4.

The table gives a 'rule of thumb' indication of the direct impact on the Budget of a change in a given parameter. In each case, the analysis presents the estimated effects of a change in one economic variable only, and does not attempt to capture the linkages between economic variables that characterise changes in the economy more broadly.

Table 6.4: Sensitivity of Fiscal Aggregates to Changes in Selected Economic Parameters, 2006-07

(Effect of a one percent increase, unless otherwise indicated)

Parameter	*Effect on the 2006-07 Budget Result ($m)* [(a)]
A. Factors affecting tax revenue	
Dwelling sales (price or volume)	38
Motor vehicle sales	8
Private sector employment	54
Private sector wages	56
Household disposable income	12
B. Factors affecting grant revenue	
Household consumption [(b)]	109
C. Factors affecting expenses	
Public sector wages and salaries	-208
Prices of goods and services	-100
Interest rates [(c), (d)]	-13

Table 6.4: Sensitivity of Fiscal Aggregates to Changes in Selected Economic Parameters, 2006-07 (cont)

Parameter	*Effect on 2006-07 Net Financial Liabilities ($m)* [(e)]
D. Factors affecting Superannuation Liabilities	
Public sector wages and salaries	195
Sydney CPI	185
Investment return [(c)]	-195
Discount rate [(c)]	-4,400

(a) A positive effect (eg, from increased dwelling sales) improves the Budget Result, while a negative effect (eg, from increased public sector wages) weakens the Budget Result.

(b) Projected GST receipts are $10,946 million.

(c) Effect of a one percentage point increase in the indicated factor (discount rate, interest rate, or rate of return).

(d) Excluding the impact of actuarial adjustments to net financial liabilities (NFL).

(e) A positive effect (eg, public sector wages) increases NFL (weakens the financial position), while a negative effect (eg, improved investment returns) reduces NFL (improves the financial position).

The table excludes consideration of possible policy responses. The analysis assumes that changes are uniform across the general government sector and across the Budget year.

Both revenues and expenses may be affected by variations between actual and expected economic outcomes.

Revenues are sensitive to factors affecting revenue bases (such as the value and volume of property and motor vehicle sales, employment and earnings), profits of public enterprises, and household consumption (and its influence on GST revenue).

The main *State taxes* – payroll tax and transfer duty – are sensitive to economic factors. Both employment levels and wage rates affect payroll tax collections. Transfer revenue depends primarily on property market activity, with dwelling transactions accounting for about three-quarters of such revenue[14]. Many factors (including monetary policy, Commonwealth tax arrangements, unemployment, and trends in alternative asset markets) contribute to fluctuations in property turnover.

[14] Non-residential property transactions have far greater variation in size and timing than dwelling transactions. Due to this lumpiness in non-residential transactions, Table 6.4 provides estimates only for the dwellings component.

The arrangements for *Commonwealth general purpose and specific purpose payments* to the States are described in Chapter 8.

Expenses are less sensitive than revenues to economic variation within the Budget year. Expenses can be significantly affected by public sector wage decisions, however, and to a lesser extent by changes in the prices of goods and services purchased by government. Lower levels of general government net debt have greatly reduced the Budget's exposure to interest rate fluctuations. The maturity profile of the State's debt portfolio, moreover, limits the immediate impact of interest rate rises.

Net financial liabilities may be affected by accounting adjustments as well as operating results. With the introduction of the new Australian Equivalents to International Financial Reporting Standards (AEIFRS) accounting standard AASB119 from 2005-06, superannuation liabilities must be recalculated at the end of each year using a market-determined discount rate. This may lead to significant fluctuations in the general government sector's unfunded liability position.

OTHER RISKS TO BUDGET OUTCOMES

The Budget is framed on the basis of no change in government policy settings as well as economic and other parameters. Specific expenditure and revenue policies prevailing at budget time (including new policies announced prior to the Budget) are assumed to carry over into the forward estimates period.

In practice, financial outcomes will depend on a diverse range of factors:

- Costs of policies may vary from those assumed in the Budget estimates, for example because take-up rates differ from expectations.
- New policy initiatives and fine-tuning of existing policies are inevitable over the forward estimates period.
- New policies in one area can also have flow-on effects for other related areas. These effects are often hard to predict and may vary significantly from original budget-time estimates.
- External pressures may be exerted to either lower or abolish State taxes.
- Utility pricing decisions by independent State and Federal economic regulators affect the revenue streams of government-owned transport, electricity and water businesses.
- Outcomes may be affected by unforeseen events such as natural disasters where the Government intervenes in the public interest.

Expenditure Risks

The main factors that influence the expense side of the Budget are discussed below.

Changes in the demand for government services

Government programs and services in health, education and related social policy areas are generally provided outside market mechanisms. As such, price plays no direct role in demand. This means that high levels of demand for government services often manifest in queues (e.g. waiting for public housing accommodation).

Over time, growth in the demand for government services is largely driven by demographic and social changes and other external factors. These influences can have a substantial impact on the cost of maintaining existing policies, in particular in health, community services, criminal justice and education services. The forward estimates make allowances for such cost pressures where possible.

Unexpected events

Management of the State's finances requires anticipating the impact of new government policies as well as possible future developments which are external to the State's control. The flexibility to respond to changes in circumstances as they occur is critical to effective budget management and is integral to the NSW fiscal strategy. The impact of possible developments on budget aggregates can be favourable in some circumstances and adverse in others.

Contingency funding is provided in the Budget. The Treasurer's Advance is for contingencies such as those associated with natural disasters and the costs of unanticipated policy responses that may be required in the budget year. A separate Treasurer's Advance is provided for capital works. In 2006-07, the Treasurer's Advance is $245 million for recurrent services, and $110 million for capital works and services. To the extent that unanticipated expenditures are funded from the Treasurer's Advance or from other contingency provisions, there will be no effect on budget outcomes.

Drought relief assistance

After some easing of NSW drought conditions during summer, seasonal conditions have again deteriorated. The area of the State affected by drought has expanded from 18.5 per cent at the beginning of December 2005 to 62 per cent at the start of May 2006, while conditions for another 28 per cent of the New South Wales were described as marginal.

The Government's drought relief initiatives include transport subsidies, community support measures, interest subsidies and various rent and fee arrangements.

Technological change

New technologies have the potential to facilitate improvements in the quality of service delivery and/or reduce the cost per unit of service delivery, including in key areas such as education and health. However, new technologies can also lead to demands for new services, especially in the health sector, with the potential to increase expenses.

Employee-related costs

The Budget and forward estimates are based on assumptions regarding the rate of growth in public sector wages and employee numbers.

Employee-related costs are the largest component of total expenses. In 2006-07 employee-related costs are budgeted at 48.5 per cent of total general government expenses, up from 45.9 per cent in 1996-97. Each 1 per cent increase in employee-related costs permanently increases government expenses by around $208 million.

The large occupational groups (e.g. teachers, nurses, police) are covered by wage agreements that are set to expire from February 2008. Under these agreements, wage increases during the Budget year will average 4 per cent per annum. Following their expiry the Government's policy is that wage increases should keep the level of real wages constant.

Wage outcomes can have a permanent or structural impact on budget expenses. Public-sector pay rises in excess of the Government's wages policy therefore may require a structural response such as reduced levels of employment, lower spending elsewhere or higher taxation.

Capital Expenditure

Agencies' expectations of capital expenditure in a given period can be affected by unforeseeable circumstances such as inclement weather. While every effort is made to anticipate these factors, their impact can differ from that allowed.

The forward estimates assume that the size of the 'discretionary' component of the capital program remains constant in real terms. As such, the forward estimates contain a component for new projects yet to be identified or approved. This approach to capital budgeting gives the Government sufficient flexibility to respond to new priorities.

Contingent Liabilities

Contingent liabilities are obligations that the Government may face if a particular event occurs. Contingent liabilities include:

- claims for compensation and litigation;
- State guarantees under statute;
- other guarantees provided to facilitate the provision of services and the development of infrastructure; and
- developments where the Government intervenes in the public interest, despite there being no legal obligation for the Government to do so.

The Government's main contingent liabilities, both quantifiable and unquantifiable, are identified in the annual *Report on State Finances*. In the 2004-05 Report, Note 19 identifies total quantifiable contingent liabilities of $484 million as at 30 June 2005. The general government sector component of total quantifiable contingent liabilities is $136 million.

The *Report on State Finances* also identifies contingent liabilities that cannot be quantified, for example from pending litigation.

NON-TAX REVENUE RISKS

Commonwealth General Purpose Payments

The main component of Commonwealth general purpose payments to the States is the distribution of GST revenues. Under the current funding arrangements, the share of funding allocated to each State is recommended by the Commonwealth Grants Commission ("the Commission") but is ultimately determined by the Commonwealth Treasurer.

An estimated $13.5 billion of GST will be generated by consumer spending in New South Wales during 2006-07, while the State expects to receive about $10.9 billion in GST grants.

Other factors, such as state population shares and the size of the GST pool also affect the level of GST grants.

There is no indication of a GST windfall from higher petrol prices, on the basis that higher GST revenues from petrol are expected to be offset by lower GST revenues from other sources.

New South Wales has no ultimate control over the funding received from the Commonwealth. Given the magnitude of GST revenues to be distributed, even a minor change in the NSW share of the total can have a substantial impact on revenues, and ultimately the Budget outcome. The Commission's 2004 major review of relativities resulted in a significant loss of revenue to New South Wales (a loss of $345 million in the 2004-05 year alone). This was due to changes in the Commission's assessment methodology. The next major review on the Commission's methodology is due in 2010. However, the Commission's annual updates prior to 2009 could also lead to significant changes in States' funding.

The five-year moving average used by the Commission means that revisions to historical data (going back up to six years) can have a significant impact on the current year's grant.

Commonwealth Specific Purpose Payments

Specific purpose payments (SPPs) provide about 15 per cent of New South Wales' total budget revenues. The conditions under which the grants are paid to States are documented in agreements that are typically renegotiated every three to five years. Because these agreements each have limited duration, New South Wales does not have long-term certainty over this significant portion of total budget revenues.

The matching and maintenance of effort requirements tied to SPPs have a significant impact on the State's budget flexibility. This means that SPP arrangements can, in effect, control about 33 per cent of budget outlays.

The following SPPs are due for renegotiation over the forward estimates period:

- public housing (expires 30 June 2008);
- government schools (expires 31 December 2008);
- vocational education and training (expires 31 December 2008);
- health care (expires 30 June 2009); and
- national land transport – AustLink (expires 30 June 2009).

New National Reform Agenda

The Council of Australian Governments (COAG) recently endorsed a new National Reform Agenda (NRA) comprising a package of productivity-enhancing structural reforms. The NRA replaces the National Competition Policy (NCP) agreement.

A Communiqué outlining competition, human capital and regulation reforms was released in February 2006. In the Communiqué, COAG agreed that the Commonwealth will provide funding to the States and Territories on a case by case basis once specific implementation plans have been developed if funding is needed to ensure a fair sharing of the costs and benefits of reform. Details of future funding arrangements to the States and Territories are yet to be determined.

Public Trading Enterprise (PTE) Financial Performance

Many PTEs operate in markets where future costs and revenues are subject to significant uncertainty. Unexpected variations in PTE profits affect the Budget by changing the amount of tax equivalents and dividends they contribute to the Budget. For PTEs not profitable on a stand-alone basis, their performance variations may affect the level of capital and operating subsidies required from the Budget.

OTHER RISKS

Pricing Regulation of Government Monopoly Services

Potential impacts on the Budget, either adverse or favourable, can arise from pricing determinations made by economic regulators. Determinations may change the size of tax equivalent and dividend payments received from the businesses, or subsidies paid to them.

The Independent Pricing and Regulatory Tribunal ("the Tribunal") oversees regulation of the government-owned water, electricity (retail and distribution) and public transport businesses in New South Wales.

The Australian Energy Regulator, part of the Australian Competition and Consumer Commission, sets prices for electricity transmission networks within the State. Two NSW Government businesses, TransGrid and EnergyAustralia (to a much smaller degree), operate as regulated transmission network service providers in New South Wales (and the ACT). No budget impacts are anticipated in 2006-07 as revenue caps covering the period 2004 to 2009 are already in place (in parallel, the Tribunal set price paths for the three NSW distribution network service providers for a similar period).

Other Policy Changes

Changes in Commonwealth Government policies can affect New South Wales. These impacts can be direct such as through unilateral changes in GST arrangements. Similarly, changes in matching conditions for shared areas of service responsibility (e.g. public housing) can be significant. The impact of these changes cannot be quantified in advance, but can be sizeable.

Commonwealth Government policy can also have indirect impacts. For example, a change in migration policy, tariff policy, or commitments to international agreements could have flow-on effects to the NSW Budget.

In addition, Commonwealth policy changes can alter demand for State Government services and therefore the costs faced by States; for example, pricing and/or changes to eligibility requirements or waiting list criteria for some social services, and health insurance policy.

Policy changes in other States can flow through to the NSW Budget. For instance, different tax regimes may apply to border regions in order to minimise tax revenue leakages between States or policy changes may affect Commonwealth Grants Commission relativities. Apart from taxation, cross-border charging arrangements by other States for some services can also lead to variations in the demand for or the cost of services provided by New South Wales.

CHAPTER 7: TAX EXPENDITURE AND CONCESSIONS STATEMENT

- Tax expenditures in 2006-07 are estimated at $4,149 million (compared with $4,076 million in 2005-06) and concessions are estimated at $715 million in 2006-07 (compared with $709 million in 2005-06).
- By value, tax expenditures in 2006-07 are highest in payroll tax, general and life insurance and purchaser transfer duty which account for around 53 per cent of total measurable expenditures.

7.1 INTRODUCTION

This Chapter estimates revenue forgone from tax expenditures and concessions and discusses definition and measurement issues related to the estimates. Appendix B provides a comprehensive listing and, where possible, costing of each major tax expenditure and concession reflecting all announced policies up to and including this Budget.

Tax concessions – called *tax expenditures*, as they have a similar policy and fiscal impact as expenditures – involve granting certain taxpayers, activities or assets more favourable tax treatment than applies to taxpayers in general. One example is the transfer duty exemption provided to eligible first home buyers.

Concessional charges involve the sale by the government of goods and services to certain users at a lower charge/fee than available to the wider community. One example is lower public transport fares for pensioners and senior citizens.

Tax expenditures and concessional charges are designed to provide a benefit to a specified activity, class of taxpayer or class of consumer in accordance with government policy. These benefits, in most cases, could be provided equally by direct spending. In the examples above, first home buyer assistance could be provided by direct grants to first home buyers, while pensioners could receive cash payments to cover the cost of public transport.

Direct government spending is generally subject to annual scrutiny through the budget process, and the attention that process receives through Parliament. Tax expenditures and concessional charges have the same budgetary and welfare effects as direct outlays. However, they are less visible than direct outlays because their cost is in revenue forgone rather than dollars spent.

The purpose of this Chapter and Appendix B is to make the nature and estimated cost of tax expenditures and concessions transparent in order to permit a more comprehensive assessment of NSW Government activity.

7.2 CONCEPTS AND METHODS

DEFINITIONS

Tax expenditures can take the form of:

- exempting certain taxpayers from a tax;
- applying a lower rate of tax, a rebate or deduction, to certain taxpayers; or
- deferring the time for payment by certain taxpayers of a tax liability.

Concessions on user charges and fees can take the form of:

- exempting certain users from a charge generally applied to the community for government goods and services or exempting certain sections from a fee generally applied to the community; or
- imposing on certain sections of the community a charge lower than that applied to the general community for government goods and services, or imposing fees lower than the general fee.

There is an element of judgement in deciding what constitutes a tax expenditure or concession and what constitutes a structural feature of the underlying taxation or service delivery system.

- For example, stamp duty on property transfers is charged at different marginal rates according to the value of the property involved. This could be construed as providing a concessional rate of taxation for lower valued properties. However, those lower marginal rates are not classified here as tax expenditures. Rather, the different rates are regarded as a design feature of the duty arrangements.

- Similarly, providing a good or service at varying subsidised rates according to set eligibility criteria for clients could be seen as a concession to those charged lower rates. However, according to the definition used here, no concession is involved if the good or service is provided only to an eligible section of the community (even if at varying rates) and not to the general community at a general rate. For instance, public housing is targeted assistance provided only to some members of the community, rather than a concession in relation to a generally available service.

There is also judgement involved in deciding what concessions funded by explicit Budget payments are included in this Chapter and in Appendix B.

- Concessions are included even where the forgone agency revenue is refunded from the Budget through Social Program Policy Payments. Such concessions are included to make the cost of the concession to the total public sector apparent, regardless of whether an intra-government transfer offsets the cost of the concession for the agency concerned.

- Concessions do not include subsidies paid from the Budget to the private sector for concessions provided by the private sector to certain purchasers of goods and services. One example is payments to private sector transport operators for providing free transport for eligible students to and from school. Such subsidies are direct outlays and therefore do not represent revenue forgone.

METHODS

Both tax expenditures and concessions have been valued on the basis of public sector revenue forgone. A full discussion of alternative ways to measure tax expenditures and concessions is contained in the 1998-99 NSW Budget Papers (www.treasury.nsw.gov.au).

The revenue forgone approach involves applying the general, non-discriminatory rate of tax or charge for the class of activity or asset concerned to the current volume of exempt or lower taxed or charged activities or assets. The first step is to identify the taxation/charging arrangement that would normally apply, called the benchmark. As noted above, there is often some judgement involved in establishing the benchmark. In the second step, deviations from the benchmark are identified as tax expenditures or concessions. Information on usage of the transaction or service that enjoys the tax expenditure or concession is then used to estimate revenue forgone. Estimates for the budget year are consistent with assumptions used in budget and agency revenues.

Measurement of revenue forgone from tax expenditures and concessions in many cases is impossible to determine or highly approximate. In some cases, information is simply not available on current transactions benefiting from a service with a tax expenditure or concession. Even where information on usage is available, measurement of revenue forgone will not take into account possible behavioural changes induced by the existence of the tax expenditure or concession. Moreover, since some tax expenditures and concessions may be complementary or substitutable, the existence of one may affect usage of another.

Therefore, some caution should be exercised when using estimates of revenue forgone.

- It may not necessarily follow that abolition of a tax expenditure or concession would produce a corresponding increase in the State's revenue. Activity making use of the tax expenditure or concession may contract if the tax expenditure or concession was abolished; or there may be increased use of other concessionally-taxed or charged activities, which would reduce revenue elsewhere.

- Since some tax expenditures and concessions overlap, the elimination of one exemption may not increase a taxpayer's liability to pay tax or a client's liability to pay charges or fees. As a result, the revenue forgone under a number of tax expenditures and concessions may be considerably less than the total obtained by adding each individual item.

- Inter-jurisdictional comparisons of tax expenditures and concessions can be rendered difficult by different judgements made in defining which elements of the tax and charging system constitute tax expenditures and concessions, and which elements represent structural features.

- Removing tax expenditures provided to general government agencies would not represent a saving to the Budget since these agencies would require Budget funding to meet their tax obligations and to enable them to provide the same level of service.

7.3 TAX EXPENDITURES

The estimates of tax expenditures in this statement are for the years 2004-05, 2005-06 and 2006-07 except for the estimates for land tax, which are for the 2005, 2006 and 2007 land tax years (land tax years commence at midnight, 31 December).

Table 7.1 provides a summary of major ($1 million or greater) tax expenditures for each type of tax.

Table 7.1: Major Tax Expenditures by Type of Tax

Tax	*2004-05*		*2005-06*		*2006-07*	
	$m	*% of tax revenue*	*$m*	*% of tax revenue*	*$m*	*% of tax revenue*
Purchaser Transfer Duty	662	22.7	662	21.4	694	21.4
Vendor Transfer Duty	352	95	144	155	...	...
General and Life Insurance Duty	331	78.3	606	116.3	701	115.1
Mortgage Duty	229	70.6	405	126.6	432	124.1
Marketable Securities Duty	64	92.9	175	291.7	179	314.0
Payroll Tax	697	14.4	753	14.7	797	14.7
Land Tax	509	30.9	523	30.1	543	30.3
Taxes on Motor Vehicles	311	16.9	304	16.1	300	15.2
Parking Space Levy	18	38.9	16	36.4	16	35.6
Gambling and Betting Taxes	482	33.7	488	32.0	487	29.1
Total	**3,655**	**23.8**	**4,076**	**25.8**	**4,149**	**24.8**

Quantifiable tax expenditures (valued at more than $1 million) are estimated at $4,076 million in 2005-06, representing 26 per cent of total tax revenue. Tax expenditures are expected to increase to $4,149 million, or 25 per cent of tax revenue, in 2006-07.

The slight increase of $73 million between 2005-06 and 2006-07 is due to growth in tax expenditures associated with general and life insurance and payroll tax outweighing the removal of tax expenditures attributable to vendor duty.

The value of purchaser transfer duty tax expenditures are predicted to increase slightly by $32 million in 2006-07, despite the abolition of vendor duty from 2 August 2005. This increase is mostly driven by continued growth in first home purchases benefiting from the First Home Plus Scheme and moderate growth in corporate reconstructions.

Vendor duty tax expenditures are estimated to cost $144 million in 2005-06. This reflects contracts that were exchanged prior to the announcement of the abolition. Vendor duty tax expenditures in 2004-05 and 2005-06 exceeded revenue raised from the tax due to the many tax concessions and exemptions provided.

Tax expenditures for payroll tax are expected to increase in 2006-07 by $44 million mainly due to the higher cost of exemptions for public hospitals and Area Health Services and local councils.

The gambling and betting tax expenditures relate to the lower taxation of gaming machines in registered clubs compared to those in hotels. The relative size of this tax expenditure is falling due to the club and hotel gaming rate changes announced in the 2003-04 Budget, which took effect from 2004-05. Recent changes to the club gaming tax rates, effective from 1 September 2006, will continue to reduce the overall tax differential between clubs and hotels, but to a lesser extent.

Table 7.2 provides a functional classification of tax expenditures.

Table 7.2: Tax Expenditures by Function

Function	*2004-05*		*2005-06*		*2006-07*	
	$m	*% of Expenses*	*$m*	*% of Expenses*	*$m*	*% of Expenses*
Public Order and Safety	3	0	3	0	3	0
Education	102	1	112	1	120	1
Health	394	4	424	4	447	4
Social Security and Welfare	432	15	415	14	406	12
Housing and Associated Amenities	471	47	513	48	538	48
Environmental Protection	...	...	...	...	...	...
Recreation and Culture	489	81	495	73	495	79
Agriculture, Forestry, Fishing and Hunting	361	77	372	46	385	53
Transport	27	1	28	1	31	1
Other Economic Activities	1,188	99	1,525	140	1,523	129
Other Purposes	188	6	189	6	201	6
Total	**3,655**	**9**	**4,076**	**10**	**4,149**	**10**

In terms of revenue forgone, the largest categories of tax expenditures are Other Economic Activities (which constitutes assistance to industry generally rather than to a particular type of economic activity), Housing and Associated Amenities (including transfer duty and mortgage duty exemptions for first home buyers), Recreation and Culture (reflecting the gambling and betting tax expenditure) and Health (mostly relating to payroll tax exemptions to public hospitals).

The distribution of tax expenditures by function is broadly similar between 2005-06 and 2006-07. Despite a slight decrease in the Social Security and Welfare category, this has been compensated with expected increases in the Housing and Associated Amenities and Health categories.

7.4 CONCESSIONS

Table 7.3 classifies the major concessions provided by the NSW Government by function. The total value of major concessions in 2006-07 is expected to remain close to 2005-06 levels, at $715 million, or 2 per cent of expenses, the same proportion of expenses as in 2005-06.

Table 7.3: Concessions by Function

Function	*2004-05*		*2005-06*		*2006-07*	
	$m	*% of Expenses*	*$m*	*% of Expenses*	*$m*	*% of Expenses*
General Public Services	...	...	...	...	...	...
Public Order and Safety	...	...	...	...	...	...
Education	128	1	109	1	111	1
Health	89	1	90	1	93	1
Social Security and Welfare	260	9	223	7	218	6
Housing and Associated Amenities	260	26	276	26	281	25
Environmental Protection	...	...	...	...	...	...
Recreation and Culture	3	1	6	1	8	1
Agriculture, Forestry, Fishing and Hunting	4	1	4	0	4	1
Transport	...	...	...	...	...	...
Other Economic Activities	...	...	...	...	...	...
Other Purposes	...	...	...	...	...	...
Total	**744**	**2**	**709**	**2**	**715**	**2**

Most concessions are concentrated in the Housing and Associated Amenities and Social Security and Welfare functions, and are comprised mainly of concessional charges to pensioner concession card holders for transport, water and energy.

CHAPTER 8: FINANCIAL ARRANGEMENTS WITH THE COMMONWEALTH

- Fiscal federalism in Australia is characterised by very high vertical fiscal imbalance and overly complex horizontal fiscal equalisation according to the Warren report.
- New South Wales expects to receive $10.9 billion in GST grants in 2006-07, which is less than expected when the GST was introduced in 2000-01.
- New South Wales will abolish the taxes listed for review in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, commencing with the abolition of rental duty in 2007-08.
- New South Wales continues to cross subsidise the other States by almost $3 billion per year or almost $11 billion over four years.
- New South Wales believes that the current horizontal fiscal equalisation system needs fundamental reform, but will continue to contribute to the Grants Commission's 2010 review.

8.1 INTRODUCTION

The Australian system of Commonwealth funding has two significant aspects: Vertical Fiscal Imbalance and Horizontal Fiscal Equalisation.

The NSW Government now depends on Commonwealth grants for around 40 per cent of its revenue, compared with around 30 per cent of its revenue before the introduction of the GST. Consequently, financial relations with the Commonwealth significantly influence the financial position of the State. The high degree of vertical fiscal imbalance in Australia compared with other federations, inevitably results in conflict over fiscal matters between the levels of government and results in confused accountability among the community.

VERTICAL FISCAL IMBALANCE

Vertical fiscal imbalance refers to the mismatch between the revenue-raising capacity and spending responsibilities between the States and the Commonwealth.

State governments have access to only a small number of taxes which constrains their revenue raising capacity relative to their expenditure responsibilities. In contrast, the Commonwealth Government collects much more revenue than it needs for its own purposes. The States rely on grants from the Commonwealth to fund their expenditure responsibilities.

The introduction of the GST worsened this imbalance because States were then required to abolish a number of their own taxes. The Commonwealth collects around 80 per cent of total national taxation revenue (including the GST), but is responsible for around only 54 per cent of own-purpose expenses. The States collect around 16 per cent of taxation revenue and account for around 40 per cent of own-purpose expenses. Commonwealth grants now account for around 40 per cent of New South Wales' revenues, compared with around 30 per cent before the introduction of the GST.

HORIZONTAL FISCAL EQUALISATION

GST revenue grants are allocated among the States according to the principle of horizontal fiscal equalisation currently defined by the Commonwealth Grants Commission as:

- State governments should receive funding from the pool of goods and services tax revenue and health care grants such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.[1]

Under the current system the share of funding allocated to each State is recommended by the Commonwealth Grants Commission to the Commonwealth Treasurer. The Commonwealth Treasurer can accept or reject the Grants Commission's recommendations and therefore has the ultimate responsibility to determine the grants to the States.

[1] *Commonwealth Grants Commission Report on State Revenue Sharing Relativities 2006 Update, page 4.*

The factors that determine the distribution of the GST revenue among the States matter if Australia is to convert potential efficiency improvements into actual efficiency gains. It makes little sense for New South Wales to be subsidising Queensland and Western Australia in the current environment when those States are booming with revenue well in excess of their expenditure needs.

8.2 THE NEED FOR REFORM – THE WARREN REPORT

New South Wales commissioned an independent review by Associate Professor Neil Warren of the University of New South Wales comparing and benchmarking Australian and international arrangements for the allocation of taxation powers and expenditure responsibilities between central and subnational governments, and mechanisms for fiscal transfers between governments.[2]

Warren found that, "*Australia performs comparatively poorly in international comparisons of intergovernmental fiscal arrangements. A review in the national interest is overdue and essential if Australia is to adequately meet the challenges of an ageing population. International experience shows that comprehensive reform to intergovernmental fiscal arrangements is being undertaken in many federations.*

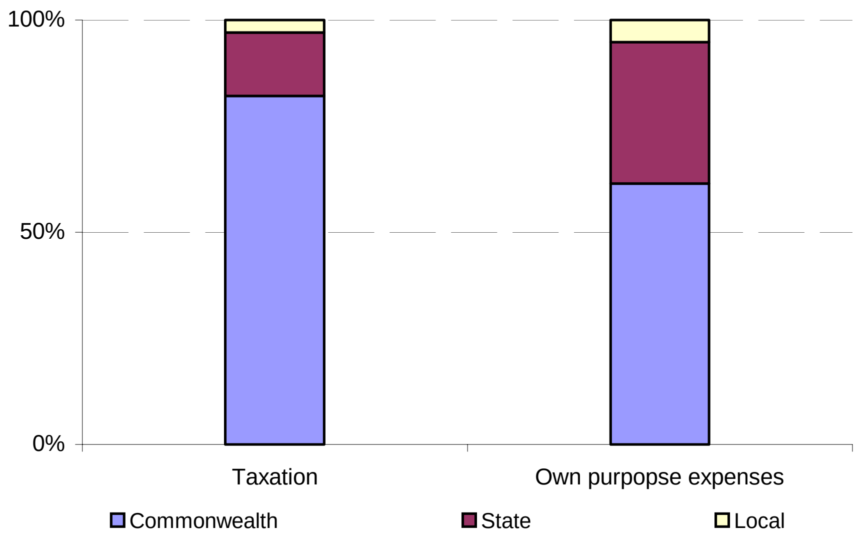
Australia's system of intergovernmental fiscal arrangements is characterised by very high vertical fiscal imbalance (VFI) due to inadequate State tax powers, and complex and high level equalisation. These arrangements hinder adjustments in the economy that are essential for the economy to develop and grow, as it must if Australia is to meet future challenges." (page xix)

The range of reforms associated with the introduction of the GST increased the degree of vertical fiscal imbalance (VFI) in Australia. There has been a trend towards greater concentration of taxing powers in the hands of the Commonwealth since Federation.

New South Wales believes the current Commonwealth-State financial arrangements (including the GST arrangements which see revenues raised by one level of government allocated to a different level of government) to be unstable in the longer term. It is for this reason that the NSW Treasurer has called for a summit of Commonwealth and State leaders.

[2] *Warren, N, "Benchmarking Australia's Intergovernmental Fiscal Arrangements", Final Report, May 2006.*

Chart 8.1: Vertical Fiscal Imbalance in Australia



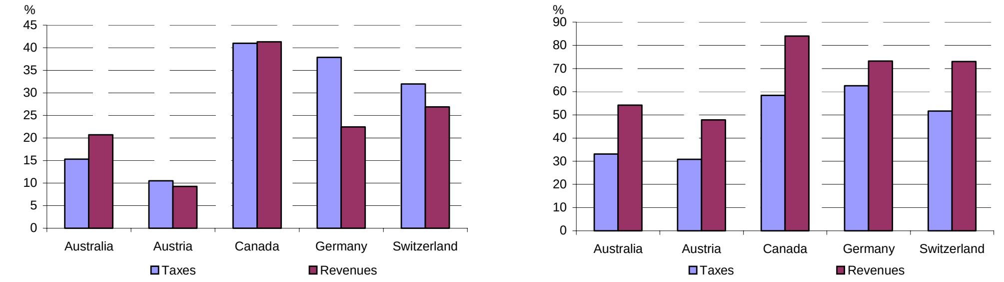
Australia has very high VFI compared to other developed federations. Australian States collect a low proportion of total taxes compared to Canadian, German and Swiss State governments. This means that State governments in Canada, Germany and Switzerland have the financial capacity to fund a much higher proportion of their expenditure from their own revenue sources than in Australia.

In Australia, States' own-source revenue accounts for around 54 per cent of their expenditures. State governments in Australia are much more dependent on fiscal transfers from the central government than most of the other federations studied in the Report (Chart 8.2).

Chart 8.2: International Indicators of Vertical Fiscal Imbalance

State Government own source taxes / revenues as a percentage of total Government taxes / revenues

State Government own source taxes and revenues as a proportion of State Government expenditures

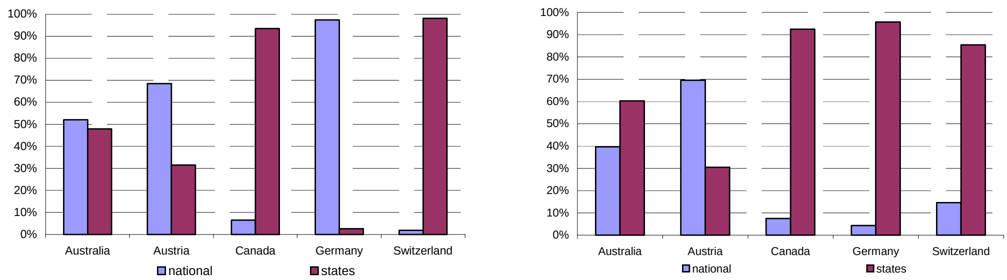


Warren found that expenditure responsibilities are generally allocated between the different levels of government in a relatively consistent fashion in the federations studied. The main points of difference between Australia and the other federations are in health and education. Health and education funding is shared almost evenly between the Commonwealth and the States. In most other federations those responsibilities are allocated almost exclusively to one level of Government. This is illustrated in Chart 8.3.

Chart 8.3: Health and Education Funding by Level of Government

Health

Education



This division of expenditure responsibilities can result in inefficiency and avoidance of accountability by blaming the involvement of the other level of government.

The high degree of VFI in Australia means that the States are very dependent on the Commonwealth for fiscal transfers. High VFI can lead to reduced public accountability and can hinder the pursuit of economic efficiency.

Warren also found that Australia's system for distributing grants among the States rated poorly when compared to other developed federations.

Warren stated that, *"In relation to domestic and international arrangements for transfers from national to subnational governments, Australia's equalisation mechanism is the most complex and comprehensive of the comparator countries, despite Australia having relatively small economic differences across the States. For example, while Australia attempts to equalise both revenues and expenditures, Canada and Germany equalise on the revenue capacity side only.*

What makes Australia's horizontal fiscal equalisation (HFE) system unique is the degree to which the equalisation objective is pursued at the expense of efficiency. In fact, the system fails to strike a balance in that it strives to achieve full horizontal equalisation without regard to the efficiency costs. Furthermore, there is no objective benchmark to assess whether Australia achieves interstate equity. It would appear that other federations acknowledge more fully than does Australia a likely trade-off between the interjurisdictional equity benchmark and achievement of other benchmarks such as efficiency, transparency and simplicity." (page xxii)

According to Warren, *"Australia arguably has the most complex transfer mechanism of any comparator federation."* There is no evidence that the complex and data intensive nature of the Grants Commission's processes lead to any more reliable outcomes than the less complex and more transparent arrangements of other developed federations.

The key conclusions of Warren's Report are that Australia performs comparatively poorly against many of the criteria which define best practice fiscal federalism. International experience shows that:

- Australia's federal financial system is clearly in need of review in the national interest;
- comprehensive reform of intergovernmental financial arrangements has been recently undertaken in many federations; and
- if reform is necessary this should be possible without significantly disadvantaging any individual jurisdictions.

8.3 COMMONWEALTH GRANTS

The *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA) sets out the current Commonwealth-State financial arrangements. The Agreement was signed in June 1999 and the arrangements took effect from July 2000. Details of the Agreement were provided in the 2003-04 Budget Paper No 2.

It is a myth that the GST based funding arrangements have brought a large funding windfall to all of the States and Territories.

New South Wales has fared poorly from the GST, worst of all the States and Territories. To 2005-06, New South Wales will have received just $209 million more in total over the six years the GST has been in place than under the former funding arrangements. That equates to just $31 per capita in six years, or $5 per capita per year. In contrast, the other States and Territories have in total received $305 per capita in additional funding from the GST over the six years, almost ten times as much as New South Wales.

Furthermore, the GST has delivered New South Wales less funding from the Commonwealth than was expected when the new arrangements were implemented in 2000. In the six years to 2005-06, New South Wales has received around $750 million less than was expected in 2000. Again New South Wales has fared worst by far, being the only State to have received less than was initially expected.

Table 8.1 provides estimates of Commonwealth payments to New South Wales for the period to 2009-10.

Table 8.1: Commonwealth Grants

	Actual	*Budget*	*Revised*	*Budget*	*Forward Estimates*		
	2004-05	*2005-06*	*2005-06*	*2006-07*	*2007-08*	*2008-09*	*2009-10*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*
GST Revenue Grants	9,884	10,373	10,244	10,941	11,728	12,513	13,233
Budget Balancing Assistance Payments	...	...	44	...	...	...	...
Compensation for GST Deferral	64	37	37	5	5	6	6
Guaranteed Minimum Amount/GST	**9,948**	**10,410**	**10,325**	**10,946**	**11,733**	**12,519**	**13,239**
National Competition Policy Payments	233	265	292	...	...	...	...
Total General Purpose Payments	**10,181**	**10,675**	**10,617**	**10,946**	**11,733**	**12,519**	**13,239**
Total Specific Purpose Payments	**6,011**	**6,121**	**6,410**	**6,679**	**6,811**	**7,016**	**6,958**
Total Grants	**16,192**	**16,796**	**17,027**	**17,625**	**18,544**	**19,535**	**20,197**

GST REVENUE GRANTS AND BUDGET BALANCING ASSISTANCE

In 2004-05, for the first time, New South Wales received GST revenue grants in excess of what would have been received under the previous set of funding arrangements, the Guaranteed Minimum Amount (GMA). New South Wales was the last State to receive top-up payments under the GMA arrangements.

However, in 2005-06 New South Wales' GST revenue grants were again less than the GMA, requiring payment of Budget Balancing Assistance (BBA). No other State required BBA in 2005-06.

New South Wales' general purpose grants (GST plus BBA where applicable) have grown much more slowly than grants to the other States. In nominal terms, GST grants to New South Wales in 2006-07 are estimated to be around 13 per cent higher than in 2001-02, compared to growth of around 34 per cent to the other States in aggregate.

In real per capita terms, grants to New South Wales are estimated to be around 5 per cent lower in 2006-07 than in 2001-02; grants to the other States in real per capita terms have risen by around 10 per cent over this period.

This significantly lower growth in grants to New South Wales reflects movements in the two components of general purpose grants i.e. the GMA, and any amount in excess of the GMA.

The Guaranteed Minimum Amount

The GMA represents what the States would have received under the previous financial arrangements. However, the GMA itself is not an unchanging baseline because it is affected by the Grants Commission's relativities.

New South Wales' GMA has been revised downwards over time as the relativities have declined.

Since 2003-04, New South Wales has been receiving significantly less in grants than was expected when the IGA was implemented in 2000. New South Wales is the only State that has received less than originally expected. Table 8.2 provides details of the differences across the States.

Table 8.2: Difference between Initial Grants Estimates and Outcomes, $m [(a)]

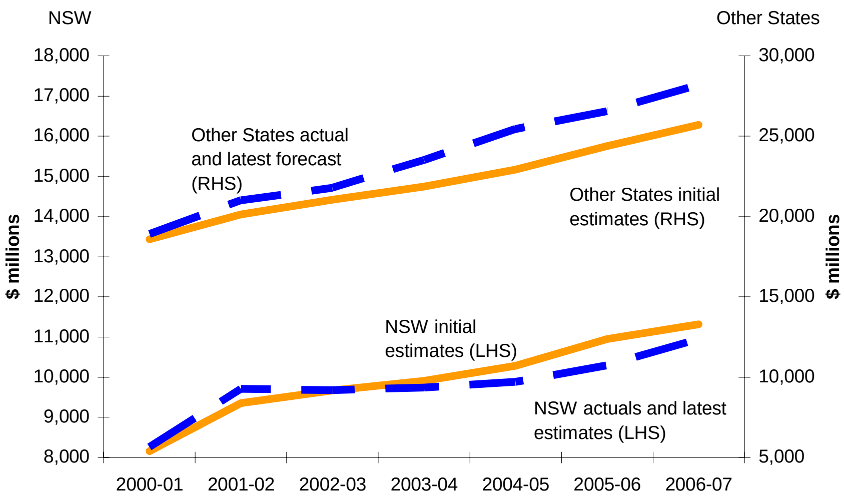
	NSW	*VIC*	*QLD*	*WA*	*SA*	*TAS*	*ACT*	*NT*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*
2000-01	103	79	148	3	63	24	6	3
2001-02	356	191	350	80	144	68	28	23
2002-03	8	12	383	75	113	98	10	60
2003-04	-174	188	647	249	219	180	29	134
2004-05	-403	422	1,050	523	261	174	11	86
2005-06	-646	383	926	470	214	149	5	26
2006-07	-380	885	823	412	190	156	3	11

(a) Defined as the difference between the initial estimates for State and Territory general purpose grants (GST and BBA) and the actual outcomes and latest estimates.

The cumulative loss to New South Wales between the introduction of the GST in 2000-01 and 2006-07 is estimated at around $1.1 billion. Every other State has received more in grants than was initially expected.

New South Wales is again expected to be the only State to receive less than originally expected in 2006-07. Based on current estimates, New South Wales should begin to receive grants that are above the original estimates in 2008-09.

Chart 8.4: GST Revenue – Initial Estimates and Outcomes



GST in excess of the Guaranteed Minimum Amount

New South Wales received GST revenue in excess of the GMA for the first time in 2004-05 (refer to Table 8.3), making it the last State to not require top-up funding. In 2005-06, New South Wales again received its GMA, that is, New South Wales received no net GST gains.

This reflects the fact that New South Wales lost significantly more revenue from abolished State taxes and abolished Commonwealth grants (in addition to facing new costs) than the GST revenue grants which replaced these revenue sources.

Table 8.3: Amount of GST above GMA, $m

	NSW $m	VIC $m	QLD $m	WA $m	SA $m	TAS $m	ACT $m	NT $m	Total $m
2000-01	nil	nil	nil	nil	nil	nil	nil	nil	nil
2001-02	nil	nil	nil	nil	nil	nil	nil	nil	nil
2002-03	nil	nil	76	nil	nil	nil	nil	10	86
2003-04	nil	112	502	150	95	70	39	110	1078
2004-05	209	296	769	250	175	106	56	141	2002
2005-06	nil	103	525	185	140	86	47	117	1203
TOTAL	209	511	1872	585	410	262	142	378	4369
Expected 2006-07	160	298	665	270	193	102	61	123	1873

National Competition Policy Payments

The Commonwealth announced its unilateral abolition of National Competition Policy (NCP) payments from 2006-07 during the 2004 federal election campaign.

The Commonwealth Government makes NCP payments to the States for implementation of agreed competition policy reforms, such as applying principles of competitive neutrality to government-owned businesses, reform of public monopolies, and assessment of legislation that restricts competition against net community benefits.

The National Competition Council (NCC) assesses each State's performance against these reform commitments and makes recommendations to the Commonwealth regarding NCP payments. These payments recognise that the States are responsible for significant elements of NCP, but most of the direct financial return accrues to the Commonwealth Government via its broader taxation powers.

In response to the NCC's recommendations for its 2004 NCP Assessment, the Commonwealth imposed a $26 million penalty on New South Wales (in the form of suspended payments) for failing to reform restrictions in rice marketing and poultry meat legislation. In addition, the Commonwealth imposed a further $26 million suspended payment penalty on New South Wales for its water sharing plan.

For the 2005 NCP assessment, responsibility for assessing jurisdictions' progress in relation to their water reform obligations under the National Water Initiative was transferred from the NCC to the National Water Commission (NWC). This represents the NCC's final assessment and final tranche of competition payments under the current NCP arrangements.

In 2005-06, New South Wales received a net total of $291.9 million in competition payments. This amount takes into account:

- ♦ the NCC's recommendation that New South Wales be fully reimbursed $26 million (in suspended payment penalties levied in the 2004 NCP Assessment) for completing reforms to rice marketing and poultry meat legislation.
- ♦ the NWC's recommendations for New South Wales:
  - reimbursement of $13 million (of the $26 million in suspended payment penalties levied in the 2004 NCP Assessment) in recognition of the progress made in the past 12 months in complying with water planning processes;
  - a continuing suspended payment of the remaining $13 million (from the 2004 NCP Assessment) on the basis that New South Wales' current water planning processes continued some of the shortcomings identified in previous NCP assessments; and
  - a new suspended payment penalty of around $13.3 million (representing 5 per cent of New South Wales' maximum available NCP payments for 2005-06) for not opening up water trading in the southern Murray Darling Basin.
- ♦ Both suspended amounts are recoverable upon demonstration of compliance to the NWC:
  - the continuing $13 million suspended payment penalty is recoverable by 1 July 2007 upon demonstrating certain improvements in current/future water planning processes; and
  - the new $13.3 million suspended payment penalty is recoverable by 1 January 2007 upon demonstrating satisfactory joint progress in opening up interstate water trading in the southern Murray Darling Basin.

At no stage was there any agreed decision between the Commonwealth and State Governments for the NWC to be able to recommend the imposition of further suspended payment penalties on jurisdictions' 2005-06 competition payments as part of the NWC's 2005 Assessment.

NEW NATIONAL REFORM AGENDA

The Council of Australian Governments (COAG) recently endorsed a new National Reform Agenda (NRA) comprising competition and regulation reforms, and human capital reforms in its 10 February 2006 Communiqué. The NRA will replace the current NCP agreement when it expires.

Competition and Regulation Reforms

These reforms are a substantial addition to the NCP reforms and are expected to further boost competition, productivity, and the efficient functioning of markets. COAG agreed to:

- recommit to the principles contained in the Competition Principles Agreement;
- continue and strengthen gate-keeping arrangements to prevent the introduction of unwarranted competition restrictions in new and amended legislation and regulations;
- complete outstanding legislation reviews from the current NCP Legislation Review Program;
- energy market reforms (e.g. strengthen electricity transmission systems);
- freight transport reforms (e.g. harmonise and reform rail and road regulation);
- infrastructure regulation reforms (e.g. ensuring more timely regulatory decisions);
- infrastructure planning reforms, including various commitments to improve nationally significant transport corridors under the AusLink program;
- adopt a new Climate Change Plan of Action and to establish a high-level interjurisdictional Climate Change Group to oversee implementation of the Plan; and
- reduce the regulatory burden.

Human Capital Reforms

COAG agreed that these reforms should be based on an overarching theme of enhancing productivity and participation, with human capital as a key component. Key elements of these reforms include:

- health reforms that increase the effectiveness of the health system in achieving health outcomes and increasing workforce participation;
- education and training reforms including improving early childhood development outcomes; and
- encouraging and supporting increased workforce participation among key groups.

Funding Arrangements

In its 10 February 2006 Communiqué, COAG agreed that the Commonwealth:

> *"will provide funding to the States and Territories on a case-by-case basis once specific implementation plans have been developed if funding is needed to ensure a fair sharing of the costs and benefits of reform. Payments to the States and Territories and, where appropriate, to local government, would be linked to achieving agreed actions or progress measures and to demonstrable economic benefits, and would take into account the relative costs and proportional financial benefits to the Commonwealth, the States and Territories and local government of specific reform proposals.*
>
> *Any funding could take the form of Commonwealth and/or shared funding for specific initiatives, and/or payments from the Commonwealth linked to results. Any funding would be in addition to other Commonwealth funding".*

The Productivity Commission has been asked to undertake some modelling of the expected economic benefits flowing from the NRA, which it expects to complete around late 2006. The outcomes of this modelling are expected to assist the Commonwealth and States/Territories to negotiate funding arrangements for the NRA.

Specific Purpose Payments

Specific purpose payments (SPPs) from the Commonwealth to the States are grants that are tied to specific types of expenditures and which usually include conditions attached to their use.

The Commonwealth offers SPPs for a variety of reasons, including:

- financial contributions to areas of State service delivery (e.g. health and education);
- implementing national priorities in areas that cross state borders (e.g. national land transport, salinity and water quality);
- complying with international obligations (e.g. world heritage properties); and
- compensating States for policies in areas of Commonwealth constitutional responsibility that adversely impact State finances (e.g. liberalising access to Commonwealth pensioner concessions).

In 2006-07, New South Wales will receive SPPs totalling $6.7 billion, for more than 50 different specific purposes. In total, SPPs are estimated to record growth of around 4.2 per cent in 2006-07. Table 3.8 in Chapter 3 includes a list of the major payments to New South Wales.

SPPs provide about 15 per cent of NSW total Budget revenues. The conditions under which the grants are paid to States are documented in agreements that are typically renegotiated every three to five years. Because these agreements each have a limited duration, New South Wales does not have long-term certainty over this significant portion of total Budget revenues.

While SPPs constitute around 15 per cent of Budget revenues, through their matching and maintenance of effort requirements, SPP arrangements can control around 30 per cent of Budget outlays. This has a significant impact on Budget flexibility.

Many SPPs are indexed, typically by reference to movements in consumer prices and the minimum wage. Such indexation falls short of the rate of increase in costs experienced in services such as health care, creating a structural problem for State Budgets as the ageing of the population increases the proportion of the population requiring such services. Budget Paper No. 6 considers the impact of ageing on the Budget in detail.

New South Wales participated in negotiations for the following SPPs during 2005-06:

- national land transport (AusLink)
- supported accommodation assistance
- vocational education and training
- disability services.

The reviews of service delivery by the Council of Australian Governments have the potential to change some SPPs.

In particular, the review of health sector SPPs being conducted by the Australian Heads of Treasuries' SPP Working Group is to identify any elements of SPPs that, if changed, could increase the effectiveness of the health system in achieving health outcomes.

The following SPP agreements are due for renegotiation over the forward estimates period:

- public housing (expires 30 June 2008)
- health care (expires 30 June 2008)
- government schools (expires 31 December 2008)
- vocational education and training (expires 31 December 2008)
- national land transport (AusLink) (expires 30 June 2009).

8.4 IGA REVIEW OF CERTAIN STATE TAXES

The original *Intergovernmental Agreement (IGA) on the Reform of Commonwealth-State Financial Relations* was signed by all the States and Territories in April 1999.

Under this IGA, the Commonwealth and States agreed to a substantial list of taxes to be abolished. However, the list of taxes to be abolished had to be amended when a number of exemptions were introduced to the GST base in order to secure its passage through the Senate, which led to a significant reduction in GST revenue.

The revised Agreement signed in June 1999, included the following provisions:

- Bed taxes to be abolished from 1 July 2000;
- Financial Institutions Duty to be abolished from 1 July 2001;
- Stamp duty on quoted marketable securities to be abolished from 1 July 2001;
- Debits tax to be abolished by 1 July 2005, subject to review by the Ministerial Council for Commonwealth-State Financial Relations (the Treasurers' Conference).

New South Wales has fulfilled all of its obligations under the IGA. New South Wales abolished debits tax on 1 January 2002, three and a half years ahead of schedule.

The IGA also stated that:

> "*The Ministerial Council will by 2005 review the need for retention of stamp duty on non-residential conveyances; leases; mortgages, debentures, bonds and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; and on cheques, bills of exchange, promissory notes; and unquoted marketable securities*."[3]

These taxes were reviewed in 2005, as required by the IGA. This review concluded that sustainable taxation reform can only be achieved where such measures are consistent with sound fiscal policy. The review also concluded that the excess of GST over GMA is not a measure of the fiscal capacity of the States to implement tax cuts, as it does not take into account the broader fiscal pressures on state budgets.

Legal advice from Mr Bret Walker SC confirms that New South Wales has fulfilled its obligations under the IGA. This advice stated,

> "*The fact that, as a result of the review, New South Wales perceived a need, for the time being, to retain the stamp duties in question cannot possibly on any legal view constitute a breach of the Agreement by New South Wales*."[4]

Notwithstanding this legal advice, the Commonwealth has continued to insist that the States must abolish the IGA listed taxes or the Commonwealth would judge the States to be in breach of the IGA.

The implementation of the Commonwealth Government's timetable would have cost New South Wales around $2 billion over the current Budget period. New South Wales cannot afford to abolish these taxes according to this schedule given it loses nearly $3 billion a year in net GST revenue.

Following discussions at the 2006 Treasurers' Conference, New South Wales has put its own counter offer to the Commonwealth. The New South Wales timetable for the abolition of these taxes acknowledges the fiscal pressures on New South Wales and that New South Wales has benefited least from the GST, and delays the abolition of the taxes until New South Wales begins to see some financial benefit from the GST.

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[3] *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, Section 5(vii).*

[4] *Legal advice prepared by Bret Walker SC for NSW, 4 May 2005, paragraph 28.*

The schedule is:

- 1 July 2007 – Abolish stamp duty on credit arrangements, instalment purchase arrangements and rental arrangements.
- 1 January 2008 - Abolish stamp duty on leases.
- 1 January 2009 – Abolish stamp duty on non-quotable marketable securities.
- 1 January 2010 – Abolish one half of stamp duty on mortgages, bonds, debentures and other loan securities.
- 1 January 2011 – Abolish remaining half of stamp duty on mortgages, bonds, debentures and other loan securities.
- 1 July 2012 – Abolish stamp duty on business conveyances other than real property.

New South Wales has always recognised the desirability of abolishing these inefficient taxes. However, the large shortfall that New South Wales incurred in its GST grants compared to the original expectations made abolition of the taxes in line with the Commonwealth timetable fiscally irresponsible.

8.5 COMMONWEALTH GRANTS COMMISSION'S 2006 UPDATE

The total GST pool size in 2006-07 is estimated to be $39.1 billion. The distribution of this revenue among the States has significant implications for the States' ability to fund services.

The Commonwealth allocates the goods and services tax revenues between the States on a per capita basis adjusted for States' relative revenue capacities and relative expense needs. The Commonwealth Grants Commission recommends the relativities to be used in the distribution of the GST among the States. Under the terms of the IGA, the Commonwealth Treasurer determines the relativity factors after he has consulted with each State and Territory.[5]

The Commonwealth Grants Commission reviews its methods of assessing State relativities every five or six years and updates these relativities with new data annually.

[5] *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, clause B2.

Table 8.4 shows for all States the impact of the 2006 annual data update on each States' GST grant. Table 8.4 isolates the impact of the 2006 data update on State relativities by assuming for the purpose of this calculation that the size of the total goods and services tax revenue pool is unchanged from 2005-06. Hence it does not measure the change in the actual goods and services tax revenue grants to States.

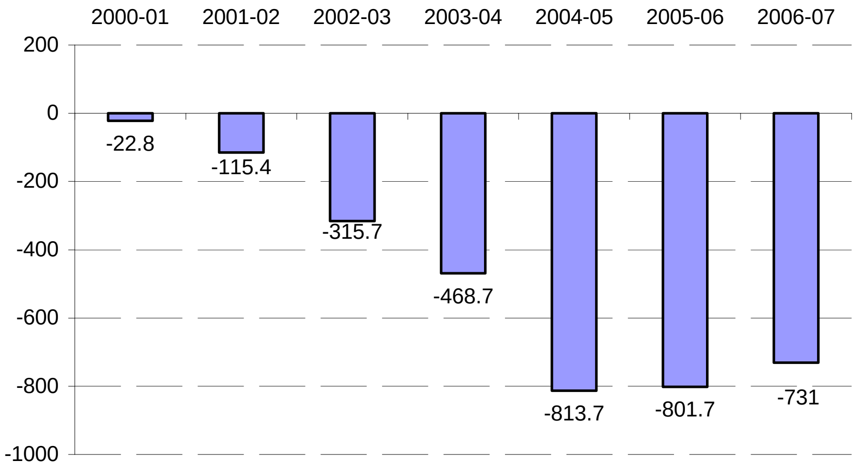
Table 8.4: Effect of 2006 data update on the States in 2006-07

	NSW	*VIC*	*QLD*	*WA*	*SA*	*TAS*	*ACT*	*NT*
$ m	71	220	- 176	- 90	- 50	- 4	2	27
% of each State's GST grants	0.7	2.6	- 2.2	- 2.3	- 1.4	- 0.3	0.3	1.4

The small increase in New South Wales' relativity in the 2006 update follows significant losses in most of the years since the introduction of the GST. In 2006-07, New South Wales again expects to receive significantly less in GST grants than was expected when the GST was introduced.

Over the six years since the introduction of the GST, New South Wales' cumulative loss from changes in relativities now exceeds $700 million annually (see Chart 8.5). Since the introduction of the GST in 2000-01, New South Wales has lost over $3 billion due to the effects of relativity changes.

Chart 8.5: NSW' cumulative annual loss from changing relativities ($m)



The Grants Commission uses a five year moving average in calculating the relativities; data from 2000-01 to 2004-05 was used in the 2006-07 update. As a result, revisions to historical data up to six years prior to the current year can affect the relativity. Revisions to historical data, particularly for compensation of employees, had a significant negative impact on New South Wales' 2006-07 relativity.

This negative impact on the relativity was offset by the inclusion of data for 2004-05 in place of data for 1999-2000 in the five year moving average calculation.

Table 8.5 lists the major changes in the Commonwealth Grants Commission's assessment for New South Wales in the 2006 update, compared to the 2005 update.

Table 8.5: Major changes in the 2006 data update

Factor	*$ million*
Payroll taxation	- 208.2
Stamp duty on conveyances	165.8
Inpatient services	30.3
Wages input costs	50.2

The large negative effect relating to **payroll tax** reflected the impact of revisions to historical data. The Australian Bureau of Statistics (ABS) revised its data on compensation of employees, which is the source for the estimates of payroll tax. In particular, the ABS revised the way in which the national figure is allocated across the States, which resulted in a large increase in New South Wales' proportion of the national figure. This significantly increased New South Wales' assessed capacity to raise revenue and led to a reduction in grant share.

The impact on New South Wales' grant share in the 2006 data update is substantial because the revised estimates of compensation of employees affect all five years of the payroll tax assessment. It is one of the perversities of the present system that future grants can be influenced by revisions to data for periods as much as six years in the past.

The Grants Commission assessed that New South Wales' capacity to raise **transfer duty (stamp duty on conveyances)** has declined because growth in property market turnover in New South Wales between 1999-2000 and 2004-05 was lower than in Queensland, Western Australia and Tasmania.

New South Wales saw an increase in the **inpatient services** assessment because the proportion of people in New South Wales likely to use inpatient services rose.

The CGC recognises that public sector **wage costs** are higher in New South Wales than the Australian average. This is due to non-policy influences such as the cost of living and location where the work is performed. An increase in the underlying wage costs led to an increase in New South Wales' relative cost of providing services.

CROSS SUBSIDIES IN THE GST DISTRIBUTION

The current system for distributing the GST revenue among the States gives rise to a large cross subsidy from New South Wales and Victoria to the other six States. This cross subsidy is apparent when the GST grants are compared to either an equal per capita distribution or to the amount of GST generated in each State.

In 2006-07, New South Wales will receive $10,941 million of the total GST pool of $39,130 million. This is significantly less in GST revenue grants than if funding were based solely on population shares (see Table 8.6).

- New South Wales' GST revenue grants in 2006-07 will be $1,594 per capita or 16 per cent less than the average of all the States;
- The average GST revenue grant in 2006-07 for New South Wales and Victoria (the donor States) will be $1,621 per capita, compared with an average of $2,260 per capita for the recipient States.

Table 8.6: GST Revenue Grants Per Capita, 2006-07

State/Territory	*GST Revenue Grants (In $ per capita)*
New South Wales	1,594
Victoria	1,657
Western Australia	1,902
Queensland	1,951
South Australia	2,279
Australian Capital Territory	2,303
Tasmania	3,182
Northern Territory	9,461
Average, 2 donor States	**1,621**
Average, 6 recipient States	**2,260**
AUSTRALIAN AVERAGE	**1,890**

In 2006-07, New South Wales and Victoria will subsidise the recipient States by $3,227 million, compared with an equal per capita distribution. New South Wales alone will transfer $2,035 million, or $296 per capita, to the recipient States.

Total cross subsidies for 2006-07 reflecting the 2006 Update relativities compared with an equal per capita distribution of GST revenue are in Table 8.7 (negative figures indicate donor States).

Table 8.7: Cross Subsidies, Equal per Capita Benchmark, 2006-07

	NSW	*VIC*	*QLD*	*WA*	*SA*	*TAS*	*ACT*	*NT*
Total, $m	(2,035)	(1,192)	250	24	605	632	136	1,580
$ per capita	(296)	(233)	61	11	389	1,292	413	7,571

The New South Wales cross subsidy is distributed to the subsidised States as shown in Table 8.8.

Table 8.8: NSW Cross Subsidy Distribution, Equal per Capita Benchmark, 2006-07

	QLD	*WA*	*SA*	*TAS*	*ACT*	*NT*	*Total*
Total, $m	158	15	381	399	86	997	2,035
$ per capita	23	2	56	58	12	145	296

Comparison with GST Generated by States

An alternative method of measuring the level of transfers from donor to recipient States is to compare GST revenue grants with the amount of GST generated by activity in each State.[6]

Economic activity in New South Wales is estimated to generate around 34 per cent of GST revenue, but New South Wales receives only around 28 per cent of GST grants. This economic activity in New South Wales is estimated to generate around $13.5 billion in GST revenue in 2006-07; significantly more than the GST grants of around $10.9 billion.

[6] *State contributions to GST revenue are estimated by NSW Treasury based on the GST generating activity in each State. Data have been sourced from ABS Cat No 5220.0, Australian National Accounts: State Accounts 2004-05. The estimates are not based on the location of the businesses remitting GST revenue. On that basis, the cross-subsidy from NSW would be much larger.*

This is a cross-subsidy to the other States (except Victoria) of around $2.6 billion, or $372 per capita. New South Wales receives around 81 cents for every $1 in GST generated in this State.

Table 8.9: GST Generated and GST Grants, 2006-07

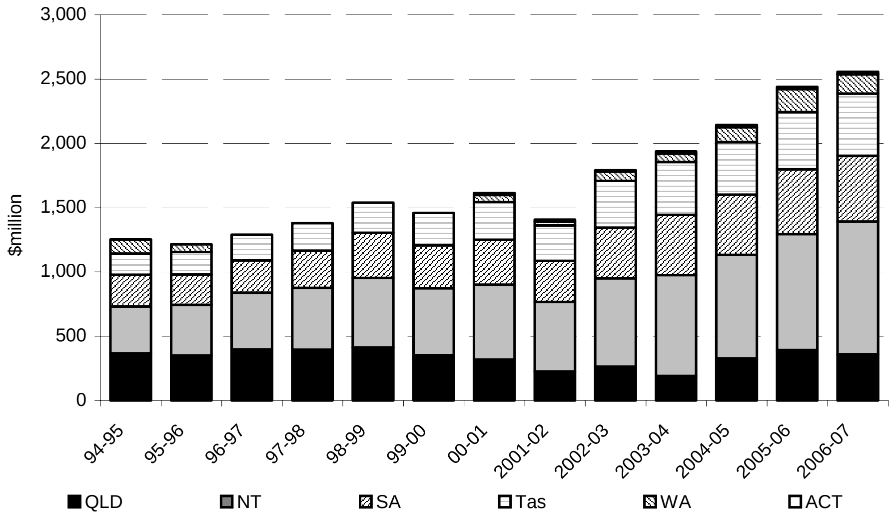
	NSW	*VIC*	*QLD*	*WA*	*SA*	*TAS*	*ACT*	*NT*
Generated $b	13.5	9.9	7.4	3.7	2.7	0.8	0.7	0.4
Grants $b	10.9	8.5	8.0	3.9	3.5	1.6	0.8	2.0
Cross Subsidy $b	(2.6)	(1.4)	0.6	0.2	0.8	0.8	...	1.6
Cross Subsidy, $pc	(372)	(283)	138	114	515	1,552	89	7,735

Table 8.10: NSW Cross Subsidy Distribution, GST Generated Benchmark, 2006-07

	QLD	*WA*	*SA*	*TAS*	*ACT*	*NT*	*Total*
Total, $m	361	150	511	485	19	1,031	2,556
$ per capita	53	22	74	71	3	150	372

This cross subsidy has been increasing over time. Chart 8.6 shows the growth in New South Wales' cross subsidy since 1994-95.

Chart 8.6: NSW Cross Subsidy to Recipient States



For the period prior to the introduction of the GST, 1994-95 to 1999-2000, the cross subsidy is based on the difference between financial assistance grants (FAGS) and a share of the combined FAG/unquarantined health care grant pool equivalent to New South Wales' share of income tax payments.[7] The cross subsidy in the GST period is based on the difference between the amount of GST generated in New South Wales and GST grants received. Clearly, the cross subsidy paid by New South Wales to the recipient States has risen dramatically over the past ten years.

New South Wales has always recognised the need for cross subsidies to be paid to the small States, with narrow economic bases, that is, South Australia, Tasmania and the Northern Territory. However, there does not appear to be any good justification for the continuation of cross subsidies to the large, prosperous States of Queensland, Western Australia and the Australian Capital Territory.

8.6 COMMONWEALTH GRANTS COMMISSION'S 2010 REVIEW

The Grants Commission's next methodology review is due to report in February 2010.

The terms of reference for this review require the Grants Commission to simplify its assessments, including by:

- aggregating existing assessment categories;
- eliminating unreliable category assessments;
- applying a materiality threshold to assessments; and
- reviewing the scope for the use of broader indicators.

The terms of reference also require the Grants Commission to report:

- to the 2006 Treasurers' Conference on its conclusions concerning the elimination of unreliable assessments and the application of a materiality threshold; and
- to the 2007 Treasurers' Conference on its conclusions concerning the aggregation of assessments and issues relating to the quality and fitness for purpose of the data that it uses.

[7] *Sourced from Commonwealth Budget Paper No. 3 for each year.*

The Grants Commission's report to the 2006 Treasurers' Conference proposed a number of measures designed to improve reliability as well as materiality thresholds for categories and disabilities.

New South Wales will continue to participate in this review despite the narrow terms of reference. However, New South Wales will also continue to argue for fundamental reform of the current system of horizontal fiscal equalisation. The need for this reform is clearly described in the Warren Report.

CHAPTER 9: GOVERNMENT FINANCE STATISTICS AND UNIFORM REPORTING FRAMEWORK

- Financial aggregates are prepared on an accrual basis in accordance with the uniform presentation framework (UPF).
- A time series is provided from 2000-01 to 2009-10 for the general government, public trading enterprise and consolidated sectors.
- There has been a break in the time series denoted on the UPF tables by a vertical dotted line. From 2005-06 transactions have been recognised in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions have been recognised and measured on a pre-AEIFRS basis.

9.1 INTRODUCTION

This chapter presents financial aggregates for the general government and public trading enterprise (PTE)[1] sectors according to international statistical standards and in accordance with a uniform reporting framework agreed by the Australian Loan Council. The format of the aggregates is based on the reporting standards of the Australian Bureau of Statistics (ABS) accrual government finance statistics (GFS) framework.

[1] *The PTE sector is also referred to by the Australian Bureau of Statistics as the public non-financial corporation or PNFC sector. Other chapters in this budget paper use the term "PTE".*

The financial aggregates presented in this chapter serve a number of purposes including:

- allowing comparisons between the financial position of Australian Governments on a consistent basis;
- facilitating time series comparisons since they are relatively unaffected by changes in public sector administrative structures; and
- permitting an assessment of the impact of NSW public sector transactions on the economy by providing data classified by economic type.

Section 9.2 outlines the format of the accrual UPF statements, comparing and contrasting them to their equivalent accrual accounting reports. It also describes the main fiscal measures in the accrual GFS reports.

The classification of public sector entities is outlined in Section 9.3.

The accrual uniform presentation framework estimates are presented in Section 9.4. They are presented in the sequence of operating statements, balance sheets and cash flow statements which are dissected by economic type. In addition to the UPF minimum disclosure requirements, these reports also include a historical and forward year time series. This is followed by tables of general government taxes by type, and expenses and purchases of non-financial assets by function. The functional reports are prepared according to the Australian Bureau of Statistics general purpose classifications.

Section 9.5 presents estimates of the State's Loan Council allocation (LCA) for 2006-07 and compares this to the original LCA bid provided to the March 2006 Treasurers' Conference. Information is also presented in Section 9.6 on new infrastructure projects involving the private sector for 2005-06 and 2006-07 in accordance with Loan Council reporting requirements.

Chapter 5 of Budget Paper No. 2 provides a brief commentary on the operations of the PTE sector.

9.2 ACCRUAL GFS REPORTING

THE ACCRUAL GFS PRESENTATION

Public sector estimates and outcomes are presented in the accrual GFS framework in three primary statements: operating statement, balance sheet and cash flow statement. These statements form the core of the accrual UPF.

GFS includes only those transactions within the operating and cash flow statements over which a government exercises control under its legislative or policy framework. This means that, unlike the accounting viewpoint, the GFS excludes from the calculation of net operating balance both revaluations (holding gains or losses) arising from a change in market prices and other changes in the volume of assets that result from discoveries, depletion and destruction of assets. This means that differences arise between the GFS and accounting frameworks, particularly within the operating statement.

Operating Statement

The operating statement presents information on GFS revenues[2] and GFS expenses[3]. This statement is designed to capture the composition of revenues and expenses and the net cost of government activities within a fiscal year. It shows the full cost of resources consumed by government in achieving its objectives and how these costs are met from various revenue sources.

Unlike a standard accounting operating statement, the GFS operating statement reports two major fiscal measures – the GFS net operating balance and GFS net lending. The *GFS net operating balance*[4] is calculated as GFS revenue minus GFS expenses. *GFS net lending*[5] is GFS revenues less GFS expenses (excluding depreciation), less net capital expenditure (i.e. after asset sales) and other selected asset movements/adjustments, thereby giving a measure of a jurisdiction's call on financial markets.

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[2] *GFS revenue differs from accounting revenues. GFS revenues include all (mutually agreed) transactions that increase net worth. Revaluations, included in accounting revenues, are not considered mutually agreed transactions and so are excluded from GFS revenues. Asset sales, which involve a transfer of a non-financial asset for a financial asset, are also excluded.*

[3] *GFS expenses differ from accounting expenses. GFS expenses encompass all transactions that decrease net worth, including dividend and tax equivalent payments. Revaluations, included in accounting expenses, are not considered mutually agreed transactions and so are excluded from GFS expenses. Included in this revaluations category are asset write-offs.*

[4] *The net operating balance is equivalent to the Budget result shown elsewhere in the budget papers.*

[5] *Commonwealth Treasury has adopted the term "fiscal balance".*

Balance Sheet

The balance sheet records the stocks of financial and non-financial assets and liabilities. This statement, also referred to as a 'statement of assets and liabilities' or a 'statement of financial position', discloses the resources over which a government exercises control. The balance sheet is a financial snapshot taken at the end of each financial year. By providing information on the type of assets and liabilities held by a government, the statement gives an indication of financial liquidity.

The balance sheet includes data on the composition of financial assets, on the holdings of fixed assets and on the extent of liabilities such as borrowing and unfunded superannuation. This allows for intertemporal and interjurisdictional comparisons of asset and liability levels.

The GFS balance sheet differs from the standard accounting presentation:

- it provides information on financial and non-financial assets, and does not distinguish between current and non-current assets and liabilities;

- receivables are presented on a gross basis (i.e. excluding all allowances for doubtful debts) resulting in GFS net worth being greater than accounting net assets; and

- the general government sector under GFS discloses an equity investment in the public financial enterprise (PFE)[6] and public trading enterprise (PTE) sectors. GFS recognises a holding company model for the general government's ownership of the PFE and PTE sectors.

Balance sheet indicators include net debt, net financial worth and net worth.

Net debt comprises borrowings and net advances received less cash and investments.

The net debt measure is limited in that it does not include employee liabilities such as superannuation or insurance claim obligations, which can be substantial and a substitute for debt obligations. In addition, net debt does not provide information on whether this debt has been incurred to finance capital expenditure or operations.

[6] *The PFE sector is also referred to by the Australian Bureau of Statistics as the public financial corporation or PFC sector. Other chapters in this budget paper use the term "PFE".*

Net financial worth measures net holdings of financial assets. It is calculated from the balance sheet as financial assets minus total liabilities (ie it includes superannuation and insurance liabilities). It is also commonly referred to as net financial assets. Net financial worth excludes physical assets such as property and infrastructure which can be subject to significant valuation movements. It is a useful indicator for examining the soundness of a government's fiscal position, particularly over the medium-to-long term.

Net worth, also known as net assets, provides a comprehensive picture of the financial position, as it is measured by total assets less total liabilities. Net worth shows the impact of asset acquisitions over time, giving an indication of the extent to which borrowings are used to finance asset purchases, rather than current expenditure. However, given that many public sector assets do not generate a financial return or are not saleable assets, net worth does not give a good indication of fiscal sustainability.

The difference between total assets and total liabilities for the PTE and PFE sector is deemed to be owner's equity (shares and other contributed capital). GFS treats owner's equity for the PTE and PFE sectors similar to a liability. Therefore the GFS net worth for the PTE and PFE sectors is always zero.

In addition to the UPF requirement to report net debt and net financial worth, *underlying net debt* is also reported after adjusting for the impact of a special prepayment of superannuation (1999-2000 to 2000-01) and the establishment of the General Government Liability Management Fund, which commenced operations in 2002-03. While the financial assets in the General Government Liability Management Fund accrue within the general government sector, they are dedicated to meet superannuation liabilities. Underlying net debt is published after adjustment to avoid the distorting impact of the superannuation transactions, which are basically temporary and reversing.

Cash Flow Statement

The cash flow statement records cash receipts and payments, revealing how a government obtains and expends cash.

This statement requires cash flows to be categorised into operating, investing and financing activities. Operating activities are those which relate to the collection of taxes, the distribution of grants, and the provision of goods and services. Investing activities are those which relate to the acquisition and disposal of financial and non-financial assets. Financing activities are those which relate to the changing size and composition of a government's financial structure.

The convention within the cash flow statement is that all inflows carry a positive sign and all outflows carry a negative sign (regardless of whether they are gross or net cash flows).

The GFS cash flow statement reports two major fiscal measures – net increase in cash held, and cash surplus. *Net increase in cash held* is the sum of net cash flows from all operating, investing and financing activities. The *cash surplus* comprises net cash received from operating activities, and from sales and purchases of non-financial assets, minus distributions paid (in the case of public trading enterprises), minus finance leases and similar arrangements.

The cash surplus measure is broadly comparable with the old cash-GFS surplus measure, allowing for comparisons between the two frameworks.

An *underlying cash surplus/deficit* has also been published. The underlying result removes the distortionary impact of both the 2000 Olympic and Paralympic Games for the PTE sector, and the discretionary timing of general government defined benefit superannuation contributions.

COMPARISON TO ACCRUAL BASED ACCOUNTING REPORTS

Information reported in the accrual UPF tables is generally consistent with that reported elsewhere in Budget Paper No. 2. However, differences in treatment and disclosure can occur because the Australian Bureau of Statistics requires that:

- selected payments that pass through the State's accounts, e.g. for non-government schools, be included in the UPF tables. Reports in other chapters of the budget papers exclude these receipts and payments as the NSW Government has no control over them;

- the general government sector balance sheet in the UPF table reports an equity investment in the public financial and non-financial corporation sectors while the accounting based statement of financial position does not record this item. A residual entity model of the Crown is considered more appropriate under the accounting framework than a holding company model; and

- allowance for doubtful debts is excluded from balance sheets presented on a GFS basis.

BREAK IN TIME SERIES – INTRODUCTION OF AEIFRS

There has been a break in the UPF time series. Prior to 2005-06 transactions have been recognised and measured in accordance with Australian Accounting Standards. From 2005-06 the underlying information has been recognised in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS).

This break in the UPF series between 2004-05 and 2005-06 is denoted by a vertical dotted line.

APPLICATION OF GFS PRINCIPLES

The standards applied to produce the uniform presentation tables in this chapter are the same as those used by the ABS in its government finance statistics publication (Catalogue No. 5512.0).

Current ABS statistical standards require a premium on a loan to be classified as a negative interest payment in the year the loan is raised. New South Wales disagrees with this approach since it results in an asymmetric treatment with discounts on loans which are treated as a balloon interest payment on the maturity of the loan.

The ABS has recognised the accounting difficulties of their approach. Given this, a compromise has been reached and all jurisdictions and the ABS have departed from GFS principles on this matter and record the premium as a negative interest payment in the final year of the loan.

9.3 CLASSIFICATION FRAMEWORK

The economic type classification adopted in this budget paper follows international conventions as outlined in the ABS information paper, *Australian System of Government Finance Statistics: Concepts, Sources and Methods*, Catalogue Number 5514.0.55.001.

CLASSIFICATION OF PUBLIC SECTOR ENTITIES

Public sector entities in New South Wales can be classified as general government entities (GGEs), public trading enterprises (PTEs) or public financial enterprises (PFEs).

GGEs consist of those public sector entities that provide, in the main, goods and services outside the market mechanism as well as providing for the transfer of income for public policy purposes. The major form of financing of these goods and services is by taxation, imposed by the State or by the Commonwealth and subsequently on-passed to the State. In New South Wales, most government departments and a number of statutory authorities, e.g. WorkCover Authority, fit into this category.

In contrast, PTEs charge for services provided and hence have a broadly commercial orientation. They do not, however, necessarily operate in competitive markets. While PTEs are not required to be fully self-funding, a substantial portion of their costs must be met by user charges. The PTE sector in New South Wales includes for example Eraring Energy, TransGrid, Sydney Water Corporation and Rail Corporation New South Wales.

PFEs are the third category of authorities in the ABS framework. NSW Treasury Corporation is the major entity in New South Wales operating in this sector. PFEs are not included in this chapter as the Uniform Presentation Agreement only requires the publication of PFE data ex-post. Further, forward estimates of financial transactions in this sector are subject to considerable uncertainty.

Appendix C lists NSW public sector entities and their sector classifications.

The non-financial public (NFP) sector is a consolidation of GGEs and PTEs.

9.4 ACCRUAL UNIFORM PRESENTATION FRAMEWORK TABLES

In accordance with the revised uniform presentation framework agreed by the Australian Loan Council in March 2000 and subsequent meetings, Tables 9.1 through to 9.12 of this Section provide estimates on a comparable basis to those which the ABS will be publishing.

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Table 9.1: NSW General Government Sector Operating Statement (ABS Basis)

		Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06 [a] $m	Budget 2006-07 [a] $m	Forward Estimates 2007-08 [a] $m	Forward Estimates 2008-09 [a] $m	Forward Estimates 2009-10 [a] $m
	GFS Revenue										
	Taxation revenue	13,343	13,216	14,153	15,026	15,332	15,812	16,719	17,472	18,394	19,365
	Current grants and subsidies	13,741	15,873	16,475	16,905	17,659	18,523	19,144	19,973	20,912	21,820
	Capital grants	866	891	914	900	1,130	1,241	1,333	1,406	1,455	1,179
	Sales of goods and services	2,659	2,699	2,914	3,006	3,148	3,155	3,259	3,380	3,515	3,632
	Interest income	471	282	440	862	1,051	1,450	914	793	840	896
	Other	2,545	2,558	2,865	2,962	3,076	3,315	3,229	3,446	3,417	3,652
	Total Revenue	**33,625**	**35,519**	**37,761**	**39,661**	**41,396**	**43,496**	**44,598**	**46,470**	**48,533**	**50,544**
less	**GFS Expenses**										
	Employee expenses	13,417	14,003	15,443	16,615	17,834	18,928	19,927	20,696	21,756	22,660
	Depreciation	1,402	1,638	1,779	1,927	1,994	2,150	2,245	2,355	2,477	2,570
	Other operating expenses	8,605	9,458	9,828	10,162	10,465	10,274	11,244	11,531	11,717	12,196
	Nominal superannuation interest expense	438	564	745	860	919	905	652	390	393	397
	Other interest expenses	1,016	868	803	788	818	883	991	1,166	1,293	1,384
	Other property expenses	...	...	...	...	...	...	...	...	...	...
	Current transfers	4,973	5,558	6,069	6,898	7,229	7,871	8,488	8,516	8,823	8,938
	Capital transfers	2,287	1,864	1,342	1,258	1,413	1,841	1,747	1,438	1,367	1,300
	Total Expenses	**32,138**	**33,953**	**36,009**	**38,508**	**40,672**	**42,852**	**45,294**	**46,092**	**47,826**	**49,445**
equals	**GFS Net Operating Balance**	**1,487**	**1,566**	**1,752**	**1,153**	**724**	**644**	**(696)**	**378**	**707**	**1,099**

Table 9.1: NSW General Government Sector Operating Statement (ABS Basis) (cont)

								Forward Estimates		
	Actual 2000-01 $m	*Actual 2001-02 $m*	*Actual 2002-03 $m*	*Actual 2003-04 $m*	*Actual 2004-05 $m*	*Revised 2005-06 [(a)] $m*	*Budget 2006-07 [(a)] $m*	*2007-08 [(a)] $m*	*2008-09 [(a)] $m*	*2009-10 [(a)] $m*
less Net Acquisition of Non-financial Assets										
Purchases of non-financial assets [(b)]	2,569	2,745	3,004	3,019	3,144	3,742	4,371	4,403	4,513	4,590
less Sales of non-financial assets	(372)	(596)	(366)	(406)	(491)	(483)	(459)	(497)	(478)	(539)
less Depreciation	(1,402)	(1,638)	(1,779)	(1,927)	(1,994)	(2,150)	(2,245)	(2,355)	(2,477)	(2,570)
plus Change in inventories	11	...	4	21	(26)	6	(3)	(6)	(4)	2
plus Other movements in non-financial assets										
- finance leases [(b)]	290	351	345	312	187	46	16	125	269	...
- other	(134)	125	83	93	82	74	90	103	122	132
equals Total Net Acquisition of Non-financial Assets	**962**	**987**	**1,291**	**1,112**	**902**	**1,235**	**1,770**	**1,773**	**1,945**	**1,615**
equals GFS Net Lending / (Borrowing)	**525**	**579**	**461**	**41**	**(178)**	**(591)**	**(2,466)**	**(1,395)**	**(1,238)**	**(516)**

Notes:

(a) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(b) Elsewhere in the Budget Papers reference is made to Capital Expenditure, which comprises purchases of non-financial assets and assets acquired under finance lease arrangements.

Table 9.2: NSW Public Non-financial Corporation Sector Operating Statement[a] (ABS Basis)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[b] $m	Budget 2006-07[b] $m	Forward Estimates 2007-08[b] $m	Forward Estimates 2008-09[b] $m	Forward Estimates 2009-10[b] $m
GFS Revenue										
Sales of goods and services	11,564	9,347	9,371	9,874	10,243	10,165	10,773	11,407	11,921	12,721
Current grants and subsidies	1,071	1,072	1,404	1,693	1,741	2,037	2,111	2,205	2,353	2,377
Capital grants	771	925	690	698	760	1,035	983	727	832	764
Interest income	142	78	85	83	72	78	61	57	59	62
Other	843	870	827	768	719	824	694	705	663	690
Total Revenue	**14,391**	**12,292**	**12,377**	**13,116**	**13,535**	**14,139**	**14,622**	**15,101**	**15,828**	**16,614**
less GFS Expenses										
Employee expenses	3,375	3,017	2,985	3,013	3,177	3,225	3,401	3,477	3,567	3,702
Depreciation	1,514	1,563	2,068	2,164	2,068	2,106	2,238	2,368	2,488	2,661
Other operating expenses	6,622	4,664	5,235	5,493	5,636	5,739	6,132	6,307	6,383	6,584
Interest expenses	825	813	823	787	904	895	1,040	1,174	1,401	1,575
Other property expenses	981	1,294	1,244	1,487	1,496	1,706	1,553	1,786	1,733	1,889
Current transfers	73	78	85	106	106	196	219	206	207	170
Capital transfers	56	92	32	18	16	...	...	7	...	...
Total Expenses	**13,446**	**11,521**	**12,472**	**13,068**	**13,403**	**13,867**	**14,583**	**15,325**	**15,779**	**16,581**
equals GFS Net Operating Balance	**945**	**771**	**(95)**	**48**	**132**	**272**	**39**	**(224)**	**49**	**33**

Table 9.2: NSW Public Non-financial Corporation Sector Operating Statement[(a)] (ABS Basis) (cont)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[(b)] $m	Budget 2006-07[(b)] $m	Forward Estimates 2007-08[(b)] $m	Forward Estimates 2008-09[(b)] $m	Forward Estimates 2009-10[(b)] $m
less Net Acquisition of Non-financial Assets										
Purchases of non-financial assets	2,510	2,989	3,352	3,378	3,655	4,309	5,559	5,933	5,987	5,576
less Sales of non-financial assets	(315)	(302)	(332)	(201)	(196)	(223)	(295)	(407)	(408)	(437)
less Depreciation	(1,514)	(1,563)	(2,068)	(2,164)	(2,068)	(2,106)	(2,238)	(2,368)	(2,488)	(2,661)
plus Change in inventories	(651)	58	47	47	95	65	15	137	24	72
plus Other movements in non-financial assets										
- finance leases	...	...	...	...	...	...	...	...	...	...
- other	159	166	119	78	130	159	143	129	129	131
equals Total Net Acquisition of Non-financial Assets	**189**	**1,348**	**1,118**	**1,138**	**1,616**	**2,204**	**3,184**	**3,424**	**3,244**	**2,681**
equals GFS Net Lending / (Borrowing)	**756**	**(577)**	**(1,213)**	**(1,090)**	**(1,484)**	**(1,932)**	**(3,145)**	**(3,648)**	**(3,195)**	**(2,648)**

Notes:

(a) The public non-financial corporation (PNFC) sector is also referred to in these budget papers as the public trading enterprise (PTE) sector.

(b) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(c) The Net Lending / (Borrowing) has been adjusted to exclude the impact of the 2000 Olympic and Paralympic Games on the results.

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
GFS Net Lending / (Borrowing)	***756***	***(577)***	***(1,213)***	***(1,090)***	***(1,484)***	***(1,932)***	***(3,145)***	***(3,648)***	***(3,195)***	***(2,648)***
adjustment to exclude SOCOG and SPOC	*(974)*	*(11)*	*...*	*...*	*...*	*...*	*...*	*...*	*...*	*...*
Underlying Net Lending/ (Borrowing)[(c)]	***(218)***	***(588)***	***(1,213)***	***(1,090)***	***(1,484)***	***(1,932)***	***(3,145)***	***(3,648)***	***(3,195)***	***(2,648)***

Table 9.3: NSW Non-financial Public Sector Operating Statement (ABS Basis)

		Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06 [(a)] $m	Budget 2006-07 [(a)] $m	Forward Estimates 2007-08 [(a)] $m	Forward Estimates 2008-09 [(a)] $m	Forward Estimates 2009-10 [(a)] $m
	GFS Revenue										
	Taxation revenue	12,656	12,597	13,437	14,218	14,756	15,149	16,014	16,733	17,625	18,553
	Current grants and subsidies	13,769	15,852	16,442	16,841	17,623	18,402	19,013	19,850	20,789	21,727
	Sales of goods and services	14,007	11,933	12,179	12,728	13,226	13,179	13,889	14,644	15,288	16,202
	Capital grants	805	886	908	900	1,130	1,237	1,333	1,405	1,454	1,179
	Interest income	549	306	473	892	1,148	1,478	926	802	852	913
	Other	2,173	2,091	2,425	2,296	2,309	2,433	2,343	2,282	2,467	2,514
	Total Revenue	**43,959**	**43,665**	**45,864**	**47,875**	**50,192**	**51,878**	**53,518**	**55,716**	**58,475**	**61,088**
less	**GFS Expenses**										
	Employee expenses	16,789	17,030	18,434	19,653	21,015	22,156	23,320	24,167	25,316	26,355
	Depreciation	2,916	3,201	3,847	4,091	4,062	4,256	4,482	4,723	4,965	5,231
	Other operating expenses	14,313	13,385	14,233	14,690	15,350	15,200	16,511	16,916	17,189	17,825
	Nominal superannuation interest expense	438	564	745	860	919	905	652	390	393	396
	Other interest expenses	1,778	1,627	1,573	1,523	1,672	1,728	1,983	2,292	2,647	2,914
	Other property expenses	...	...	...	...	...	...	...	...	...	...
	Current transfers	3,937	4,550	4,738	5,283	5,585	5,929	6,490	6,405	6,564	6,659
	Capital transfers	1,559	962	638	575	658	789	737	669	645	576
	Total Expenses	**41,730**	**41,319**	**44,208**	**46,675**	**49,261**	**50,963**	**54,175**	**55,562**	**57,719**	**59,956**
equals	**GFS Net Operating Balance**	**2,229**	**2,346**	**1,656**	**1,200**	**931**	**915**	**(657)**	**154**	**756**	**1,132**

Table 9.3: NSW Non-financial Public Sector Operating Statement (ABS Basis) (cont)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[(a)] $m	Budget 2006-07[(a)] $m	Forward Estimates 2007-08[(a)] $m	Forward Estimates 2008-09[(a)] $m	Forward Estimates 2009-10[(a)] $m
less Net Acquisition of Non-financial Assets										
Purchases of non-financial assets[(b)]	5,075	5,729	6,352	6,394	6,795	8,046	9,925	10,331	10,495	10,161
less Sales of non-financial assets	(687)	(898)	(698)	(607)	(686)	(706)	(754)	(904)	(886)	(976)
less Depreciation	(2,916)	(3,201)	(3,847)	(4,091)	(4,062)	(4,256)	(4,482)	(4,723)	(4,965)	(5,231)
plus Change in inventories	(641)	58	51	67	70	71	12	131	20	74
plus Other movements in non-financial assets										
- finance leases[(b)]	290	351	345	312	187	47	15	125	269	...
- other	27	291	202	171	210	231	233	231	251	262
equals Total Net Acquisition of Non-financial Assets	**1,148**	**2,330**	**2,405**	**2,246**	**2,514**	**3,433**	**4,949**	**5,191**	**5,184**	**4,290**
equals GFS Net Lending / (Borrowing)	**1,081**	**16**	**(749)**	**(1,046)**	**(1,583)**	**(2,518)**	**(5,606)**	**(5,037)**	**(4,428)**	**(3,158)**

Notes:

(a) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(b) Elsewhere in the Budget Papers reference is made to Capital Expenditure which comprises purchases of non-financial assets and assets acquired under finance lease arrangements.

(c) The Net Lending / (Borrowing) has been adjusted to exclude the impact of the 2000 Olympic and Paralympic Games on the results.

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
GFS Net Lending / (Borrowing)	***1,081***	***16***	***(749)***	***(1,046)***	***(1,583)***	***(2,518)***	***(5,606)***	***(5,037)***	***(4,428)***	***(3,158)***
adjustment adjustment to exclude SOCOG and SPOC	*(975)*	*(12)*	*...*	*...*	*...*	*...*	*...*	*...*	*...*	*...*
Underlying Net Lending/ (Borrowing)[(c)]	***106***	***4***	***(749)***	***(1,046)***	***(1,583)***	***(2,518)***	***(5,606)***	***(5,037)***	***(4,428)***	***(3,158)***

Table 9.4: NSW General Government Sector Balance Sheet (ABS Basis)

	Actual June 2001 $m	*Actual June 2002 $m*	*Actual June 2003 $m*	*Actual June 2004 $m*	*Actual June 2005 $m*	*Revised June 2006[(a)] $m*	*Budget June 2007[(a)] $m*	*Forward Estimates June 2008[(a)] $m*	*Forward Estimates June 2009[(a)] $m*	*Forward Estimates June 2010[(a)] $m*
Assets										
Financial assets										
Cash and deposits	1,096	1,719	1,091	1,869	1,465	1,098	1,036	1,010	807	1,051
Advances paid	1,442	1,521	1,401	1,359	1,304	1,281	1,255	1,209	1,208	1,183
Investments, loans and placements	3,950	4,409	7,940	9,575	12,042	14,688	8,373	8,950	9,573	10,026
Other non-equity assets	4,854	5,172	5,358	5,846	6,246	9,563	9,470	9,732	9,736	10,072
Equity	47,501	48,337	66,780	68,067	68,694	65,008	65,831	66,473	67,394	68,992
Total Financial Assets	**58,843**	**61,158**	**82,570**	**86,716**	**89,751**	**91,638**	**85,965**	**87,374**	**88,718**	**91,324**
Non-financial assets										
Land and fixed assets	66,306	73,916	78,936	80,402	84,210	86,226	88,619	91,234	93,923	96,326
Other non-financial assets	847	952	1,047	1,176	1,260	1,492	1,600	1,733	1,877	2,031
Total Non-financial Assets	**67,153**	**74,868**	**79,983**	**81,578**	**85,470**	**87,718**	**90,219**	**92,967**	**95,800**	**98,357**
Total Assets	**125,996**	**136,026**	**162,553**	**168,294**	**175,221**	**179,356**	**176,184**	**180,341**	**184,518**	**189,681**

Table 9.4: NSW General Government Sector Balance Sheet (ABS Basis) (cont)

	Actual June 2001 $m	Actual June 2002 $m	Actual June 2003 $m	Actual June 2004 $m	Actual June 2005 $m	Revised June 2006 [(a)] $m	Budget June 2007 [(a)] $m	Forward Estimates June 2008 [(a)] $m	Forward Estimates June 2009 [(a)] $m	Forward Estimates June 2010 [(a)] $m
Liabilities										
Deposits held	61	65	53	68	98	85	86	87	87	86
Advances received	2,041	1,826	1,808	1,681	1,641	1,507	1,467	1,418	1,368	1,317
Borrowing	12,026	10,814	10,164	10,796	11,392	12,096	15,301	17,445	18,903	19,990
Superannuation liability [(b)]	8,127	11,398	14,720	15,460	16,462	23,380	14,883	15,191	15,431	15,616
Other employee entitlements and provisions	9,185	9,982	11,155	12,127	13,050	12,993	13,296	13,629	14,074	14,494
Other non-equity liabilities	3,055	3,511	3,611	3,872	3,689	5,125	4,841	4,357	3,955	3,801
Total Liabilities	**34,495**	**37,596**	**41,511**	**44,004**	**46,332**	**55,186**	**49,874**	**52,127**	**53,818**	**55,304**
NET WORTH	**91,501**	**98,430**	**121,042**	**124,290**	**128,889**	**124,170**	**126,310**	**128,214**	**130,700**	**134,377**
Net Financial Worth [(c)]	**24,348**	**23,562**	**41,059**	**42,712**	**43,419**	**36,452**	**36,091**	**35,247**	**34,900**	**36,020**
Net Debt [(d)]	**7,640**	**5,056**	**1,593**	**(258)**	**(1,680)**	**(3,379)**	**6,190**	**7,781**	**8,770**	**9,133**

Notes:

(a) June 2006 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(b) Comprises net unfunded obligations.

(c) Net financial worth equals total financial assets minus total liabilities.

(d) Net debt equals the sum of deposits held, advances received and borrowing, minus the sum of cash and deposits, advances paid, and investments, loans and placements.

(e) Adjusted for prepaid superannuation in the year 2001, and Crown deposits to the Liability Management Fund and fund earnings in the years 2003 to 2006 inclusive.

	June 2001	June 2002	June 2003	June 2004	June 2005	June 2006	June 2007	June 2008	June 2009	June 2010
GFS Net Debt [(d)]	***7,640***	***5,056***	***1,593***	***(258)***	***(1,680)***	***(3,379)***	***6,190***	***7,781***	***8,770***	***9,133***
Impact of prepayment of superannuation	*(1,179)*	...	...	...	...	...	...	...	...	...
Impact of deposits to the Liability Management Fund	...	...	*1,651*	*2,851*	*4,001*	*5,235*	...	...	...	...
Underlying Net Debt [(e)]	***6,461***	***5,056***	***3,244***	***2,593***	***2,321***	***1,856***	***6,190***	***7,781***	***8,770***	***9,133***

Table 9.5: NSW Public Non-financial Corporation Sector Balance Sheet[(a)] (ABS Basis)

	Actual June 2001 $m	Actual June 2002 $m	Actual June 2003 $m	Actual June 2004 $m	Actual June 2005 $m	Revised June 2006[(b)] $m	Budget June 2007[(b)] $m	Forward Estimates June 2008[(b)] $m	Forward Estimates June 2009[(b)] $m	Forward Estimates June 2010[(b)] $m
Assets										
Financial assets										
Cash and deposits	960	1,289	1,163	1,202	1,435	1,320	1,071	957	979	1,068
Investments, loans and placements	920	900	568	518	397	490	417	440	482	483
Other non-equity assets	2,349	2,358	2,183	2,507	2,691	3,068	3,101	3,154	3,206	3,314
Equity	139	77	56	32	30	39	68	83	98	111
Total Financial Assets	**4,368**	**4,624**	**3,970**	**4,259**	**4,553**	**4,917**	**4,657**	**4,634**	**4,765**	**4,976**
Non-financial assets										
Land and fixed assets	61,720	62,617	82,892	84,777	86,319	87,024	90,929	95,031	98,999	103,129
Other non-financial assets	304	245	262	294	163	695	733	752	780	813
Total Non-financial Assets	**62,024**	**62,862**	**83,154**	**85,071**	**86,482**	**87,719**	**91,662**	**95,783**	**99,779**	**103,942**
Total Assets	**66,392**	**67,486**	**87,124**	**89,330**	**91,035**	**92,636**	**96,319**	**100,417**	**104,544**	**108,918**

Table 9.5: NSW Public Non-financial Corporation Sector Balance Sheet[(a)] (ABS Basis) (cont)

	Actual June 2001 $m	Actual June 2002 $m	Actual June 2003 $m	Actual June 2004 $m	Actual June 2005 $m	Revised June 2006[(b)]	Budget June 2007[(b)] $m	Forward Estimates June 2008[(b)] $m	Forward Estimates June 2009[(b)] $m	Forward Estimates June 2010[(b)] $m
Liabilities										
Deposits held	49	85	93	156	166	166	177	147	145	148
Advances received	1,155	1,153	1,116	1,088	1,041	976	949	923	896	868
Borrowing	11,309	11,522	12,056	12,568	13,676	15,421	18,436	21,702	25,058	27,630
Superannuation liability / (prepaid contributions) [(c)]	(150)	325	736	391	29	141	90	27	(49)	(138)
Other employee entitlements & provisions	3,814	4,138	4,242	4,741	5,042	8,689	8,588	8,837	8,849	9,188
Other non-equity liabilities	2,397	2,144	2,262	2,558	2,639	2,591	2,648	2,748	2,753	2,800
Total Liabilities	**18,574**	**19,367**	**20,505**	**21,502**	**22,593**	**27,984**	**30,888**	**34,384**	**37,652**	**40,496**
Shares and other contributed capital [(d)]	47,818	48,119	66,619	67,828	68,442	64,652	65,431	66,033	66,892	68,422
NET WORTH [(d)(e)]	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Net Financial Worth [(d)(f)]	**(62,024)**	**(62,862)**	**(83,154)**	**(85,071)**	**(86,482)**	**(87,719)**	**(91,662)**	**(95,783)**	**(99,779)**	**(103,942)**
Net Debt [(g)]	**10,633**	**10,571**	**11,534**	**12,092**	**13,051**	**14,753**	**18,074**	**21,375**	**24,638**	**27,095**

Notes:

(a) The public non-financial corporation (PNFC) sector is also referred to in these budget papers as the public trading enterprise (PTE) sector.

(b) June 2006 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(c) Comprises net unfunded obligations.

(d) The Australian Bureau of Statistics treats 'shares and other contributed capital' as a liability to the general government sector and deducts it to calculate a zero GFS net worth and negative net financial worth. However, these shares and other contributed capital reflect the value of the government's cumulative equity and earnings over time for the PTE sector. The PTE sector equity has grown since 2001 from $47.8 billion to a projected $68.4 billion in 2010 reflecting an increase in the value of the Government's investment. This improvement is reflected in the equity investment line in the GFS general government sector balance sheet.

(e) For entities whose equity is not traded on the market, the GFS net worth is zero as the equity (shares and other contributed capital) is recorded as an asset in the general government balance sheet.

(f) Net financial worth equals total financial assets minus total liabilities, and minus shares and other contributed capital.

(g) Net debt equals the sum of deposits held, advances received and borrowing, minus the sum of cash and deposits, advances paid, and investments, loans and placements.

Table 9.6: NSW Non-financial Public Sector Balance Sheet (ABS Basis)

	Actual June 2001 $m	Actual June 2002 $m	Actual June 2003 $m	Actual June 2004 $m	Actual June 2005 $m	Revised June 2006 (a) $m	Budget June 2007 (a) $m	Forward Estimates June 2008 (a) $m	Forward Estimates June 2009 (a) $m	Forward Estimates June 2010 (a) $m
Assets										
Financial assets										
Cash and deposits	2,056	3,008	2,254	3,070	2,900	2,418	2,107	1,966	1,787	2,119
Advances paid	286	368	285	271	263	306	305	287	312	315
Investments, loans and placements	4,870	5,309	8,506	10,092	12,439	15,178	8,790	9,390	10,054	10,509
Other non-equity assets	4,724	4,666	4,565	4,879	5,225	5,066	5,140	5,213	5,275	5,383
Equity	(179)	296	218	271	283	396	469	523	602	682
Total Financial Assets	**11,757**	**13,647**	**15,828**	**18,583**	**21,110**	**23,364**	**16,811**	**17,379**	**18,030**	**19,008**
Non-financial assets										
Land and fixed assets	128,026	136,532	161,828	165,180	170,528	173,251	179,548	186,266	192,922	199,456
Other non-financial assets	1,151	1,198	1,318	1,474	1,425	2,183	2,330	2,482	2,657	2,845
Total Non-financial Assets	**129,177**	**137,730**	**163,146**	**166,654**	**171,953**	**175,434**	**181,878**	**188,748**	**195,579**	**202,301**
Total Assets	**140,934**	**151,377**	**178,974**	**185,237**	**193,063**	**198,798**	**198,689**	**206,127**	**213,609**	**221,309**

Table 9.6: NSW Non-financial Public Sector Balance Sheet (ABS Basis) (cont)

	Actual June 2001 $m	Actual June 2002 $m	Actual June 2003 $m	Actual June 2004 $m	Actual June 2005 $m	Revised June 2006 [(a)] $m	Budget June 2007 [(a)] $m	Forward Estimates June 2008 [(a)] $m	Forward Estimates June 2009 [(a)] $m	Forward Estimates June 2010 [(a)] $m
Liabilities										
Deposits held	110	149	146	224	264	252	263	234	231	233
Advances received	2,041	1,826	1,808	1,681	1,641	1,507	1,467	1,418	1,368	1,317
Borrowing	23,334	22,337	22,218	23,362	25,068	27,517	33,737	39,147	43,962	47,621
Superannuation liability [(b)]	7,978	11,723	15,456	15,851	16,491	23,522	14,974	15,218	15,381	15,479
Other employee entitlements & provisions	11,181	12,014	13,166	14,149	15,160	15,223	15,525	15,866	16,341	16,790
Other non-equity liabilities	4,789	4,898	5,138	5,680	5,550	6,607	6,413	6,030	5,626	5,492
Total Liabilities	**49,433**	**52,947**	**57,932**	**60,947**	**64,174**	**74,628**	**72,379**	**77,913**	**82,909**	**86,932**
Shares and other contributed capital	...	...	...	...	...	...	...	...	...	...
NET WORTH	**91,501**	**98,430**	**121,042**	**124,290**	**128,889**	**124,170**	**126,310**	**128,214**	**130,700**	**134,377**
Net Financial Worth [(c)]	**(37,676)**	**(39,300)**	**(42,104)**	**(42,364)**	**(43,064)**	**(51,264)**	**(55,568)**	**(60,534)**	**(64,879)**	**(67,924)**
Net Debt [(d)]	**18,273**	**15,627**	**13,127**	**11,834**	**11,371**	**11,374**	**24,265**	**29,156**	**33,408**	**36,228**

Notes:

(a) June 2006 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(b) Comprises net unfunded obligations.

(c) Net financial worth equals total financial assets minus total liabilities.

(d) Net debt equals the sum of deposits held, advances received and borrowing, minus the sum of cash and deposits, advances paid, and investments, loans and placements.

(e) Adjusted for prepaid superannuation in the year 2001, and Crown deposits to the Liability Management Fund and fund earnings in the years ending June 2003 to 2006 inclusive.

GFS Net Debt [(d)]	***18,273***	***15,627***	***13,127***	***11,834***	***11,371***	***11,374***	***24,265***	***29,156***	***33,408***	***36,228***
Impact of prepayment of superannuation	*(1,179)*	...	...	...	...	...	...	...	...	...
Impact of deposits to the Liability Management Fund	...	...	*1,651*	*2,851*	*4,001*	*5,235*	...	...	...	...
Underlying Net Debt [(d) (e)]	***17,094***	***15,627***	***14,778***	***14,685***	***15,372***	***16,609***	***24,265***	***29,156***	***33,408***	***36,228***

Table 9.7: NSW General Government Sector Cash Flow Statement[(a)] (ABS Basis)

	Actual	Actual	Actual	Actual	Actual	Revised	Budget	*Forward Estimates*		
	2000-01	*2001-02*	*2002-03*	*2003-04*	*2004-05*	*2005-06* [(b)]	*2006-07* [(b)]	*2007-08* [(b)]	*2008-09* [(b)]	*2009-10* [(b)]
	$m	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*
Cash Receipts from Operating Activities										
Taxes received	13,170	13,341	13,952	14,979	15,043	15,824	16,574	17,419	18,357	19,319
Receipts from sales of goods and services	2,516	2,638	3,032	2,830	3,245	3,305	3,259	3,359	3,492	3,604
Grants/subsidies received	14,608	16,762	17,587	17,853	18,541	20,721	20,378	21,079	21,969	22,840
Other receipts	4,027	3,665	4,206	5,103	5,608	6,224	6,068	5,753	5,984	6,141
Total Receipts	**34,321**	**36,406**	**38,777**	**40,765**	**42,437**	**46,074**	**46,279**	**47,610**	**49,802**	**51,904**
Cash Payments for Operating Activities										
Payment for goods and services[(c)]	(21,258)	(21,784)	(23,984)	(25,660)	(27,068)	(28,499)	(39,003)	(32,275)	(33,373)	(34,808)
Grants and subsidies paid	(6,013)	(6,809)	(6,881)	(7,499)	(7,971)	(9,229)	(9,687)	(9,373)	(9,583)	(9,641)
Interest paid	(1,067)	(848)	(818)	(863)	(777)	(1,036)	(977)	(1,043)	(1,377)	(1,315)
Other payments	(1,656)	(1,852)	(1,679)	(2,338)	(2,558)	(2,488)	(2,518)	(2,447)	(2,431)	(2,458)
Total Payments	**(29,994)**	**(31,293)**	**(33,362)**	**(36,360)**	**(38,374)**	**(41,252)**	**(52,185)**	**(45,138)**	**(46,764)**	**(48,222)**
Net Cash Flows from Operating Activities	**4,327**	**5,113**	**5,415**	**4,405**	**4,063**	**4,822**	**(5,906)**	**2,472**	**3,038**	**3,682**
Net Cash Flows from Investments in Non-financial Assets										
Sales of non-financial assets	344	424	497	408	485	545	476	515	478	539
Purchases of non-financial assets	(2,590)	(2,787)	(3,052)	(2,903)	(3,006)	(3,844)	(4,371)	(4,404)	(4,513)	(4,590)
Net Cash Flows from Investments in Non-financial Assets	**(2,246)**	**(2,363)**	**(2,555)**	**(2,495)**	**(2,521)**	**(3,299)**	**(3,895)**	**(3,889)**	**(4,035)**	**(4,051)**
Net Cash Flows from Investments in Financial Assets for Policy Purposes	**3,228**	**756**	**839**	**186**	**130**	**85**	**203**	**100**	**123**	**32**

Table 9.7: NSW General Government Sector Cash Flow Statement[a] (ABS Basis) (cont)

	Actual	*Actual*	*Actual*	*Actual*	*Actual*	*Revised*	*Budget*	*Forward Estimates*		
	2000-01	*2001-02*	*2002-03*	*2003-04*	*2004-05*	*2005-06[b]*	*2006-07[b]*	*2007-08[b]*	*2008-09[b]*	*2009-10[b]*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*	*$m*
Net Cash Flows from Investments in Financial Assets for liquidity purposes[c]	**(354)**	**(575)**	**(1,115)**	**(1,542)**	**(2,404)**	**(2,281)**	**6,258**	**(546)**	**(589)**	**(617)**
Net Cash Flows from Financing Activities										
Advances received (net)	(85)	(220)	(31)	(140)	(28)	(133)	(47)	(49)	(50)	(53)
Borrowing (net)	(4,480)	(2,122)	(1,017)	367	417	494	3,341	1,886	1,307	1,245
Deposits received (net)	(25)	(5)	(8)	6	20	(14)	...	...	(1)	(2)
Other financing (net)	...	...	(2)	(1)	(18)	...	...	...	...	...
Net Cash Flows from Financing Activities	**(4,590)**	**(2,347)**	**(1,058)**	**232**	**391**	**347**	**3,294**	**1,837**	**1,256**	**1,190**
Net Increase / (Decrease) in Cash Held	**365**	**584**	**1,526**	**786**	**(341)**	**(326)**	**(46)**	**(26)**	**(207)**	**236**
SURPLUS / (DEFICIT)										
Net Cash from Operating Activities and Investments in Non-financial Assets	**2,081**	**2,750**	**2,860**	**1,910**	**1,542**	**1,523**	**(9,801)**	**(1,417)**	**(997)**	**(369)**
Finance leases and similar arrangements	(290)	(351)	(345)	(312)	(187)	(47)	(15)	(125)	(269)	...
SURPLUS / (DEFICIT)	**1,791**	**2,399**	**2,515**	**1,598**	**1,355**	**1,476**	**(9,816)**	**(1,542)**	**(1,266)**	**(369)**

Notes:

(a) A positive number denotes a cash inflow; a negative (i.e. bracketed) sign denotes a cash outflow.

(b) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(c) In 2006-07 the government will be contributing $8,700 million from the Liability Management Fund to reduce its superannuation liabilities.

(d) Deposits by the Crown to the Liability Management Fund and the fund's earnings have been set aside to meet future superannuation contributions.

GFS SURPLUS / (DEFICIT)	***1,791***	***2,399***	***2,515***	***1,598***	***1,355***	***1,476***	***(9,816)***	***(1,542)***	***(1,266)***	***(369)***
Impact of prepayment of superannuation	*(1,058)*	*(1,134)*	*...*	*...*	*...*	*...*	*...*	*...*	*...*	*...*
Impact of deposits to the Liability Management Fund[d]	*...*	*...*	*(1,651)*	*(1,200)*	*(1,150)*	*(1,234)*	*5,235*	*...*	*...*	*...*
UNDERLYING SURPLUS / (DEFICIT) (after adjusting for the timing of superannuation contributions)	***733***	***1,265***	***864***	***398***	***205***	***242***	***(4,581)***	***(1,542)***	***(1,266)***	***(369)***

Table 9.8: NSW Public Non-financial Corporation Sector Cash Flow Statement[(a) (b)] (ABS Basis)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[(c)] $m	Budget 2006-07[(c)] $m	Forward Estimates 2007-08[(c)] $m	Forward Estimates 2008-09[(c)] $m	Forward Estimates 2009-10[(c)] $m
Cash Receipts from Operating Activities										
Receipts from sales of goods and services	10,765	9,431	9,653	10,049	10,639	10,423	11,117	11,755	12,303	13,080
Grants/subsidies received	1,957	2,022	2,124	2,404	2,511	3,076	3,099	2,938	3,191	3,148
Other receipts	1,933	1,962	2,149	2,294	2,267	2,120	2,070	2,135	2,151	2,249
Total Receipts	**14,655**	**13,415**	**13,926**	**14,747**	**15,417**	**15,619**	**16,286**	**16,828**	**17,645**	**18,477**
Cash Payments for Operating Activities										
Payment for goods and services	(9,367)	(7,645)	(8,002)	(8,524)	(8,942)	(9,407)	(9,824)	(10,031)	(10,289)	(10,656)
Grants and subsidies paid	(144)	8	(99)	(120)	(103)	(195)	(219)	(205)	(206)	(170)
Interest paid	(722)	(820)	(809)	(814)	(888)	(910)	(1,044)	(1,169)	(1,391)	(1,569)
Other payments	(1,853)	(1,847)	(1,776)	(1,852)	(2,109)	(1,743)	(2,045)	(2,159)	(2,136)	(2,272)
Total Payments	**(12,086)**	**(10,304)**	**(10,686)**	**(11,310)**	**(12,042)**	**(12,255)**	**(13,132)**	**(13,564)**	**(14,022)**	**(14,667)**
Net Cash Flows from Operating Activities	**2,569**	**3,111**	**3,240**	**3,437**	**3,375**	**3,364**	**3,154**	**3,264**	**3,623**	**3,810**
Net Cash Flows from Investments in Non-financial Assets										
Sales of non-financial assets	282	358	280	207	150	255	298	412	412	439
Purchases of non-financial assets	(2,414)	(2,945)	(3,343)	(3,376)	(3,556)	(4,257)	(5,508)	(5,961)	(6,007)	(5,579)
Net Cash Flows from Investments in Non-financial Assets	**(2,132)**	**(2,587)**	**(3,063)**	**(3,169)**	**(3,406)**	**(4,002)**	**(5,210)**	**(5,549)**	**(5,595)**	**(5,140)**
Net Cash Flows from Investments in Financial Assets for Policy Purposes	**(6)**	**579**	**134**	**(1)**	**(2)**	**...**	**(18)**	**24**	**13**	**53**
Net Cash Flows from Investments in Assets for Liquidity Purposes	**(69)**	**49**	**273**	**54**	**283**	**(21)**	**43**	**(54)**	**(60)**	**(55)**

Table 9.8: NSW Public Non-financial Corporation Sector Cash Flow Statement[(a) (b)] (ABS Basis) (cont)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[(c)] $m	Budget 2006-07[(c)] $m	Forward Estimates 2007-08[(c)] $m	2008-09[(c)] $m	2009-10[(c)] $m
Net Cash Flows from Financing Activities										
Advances received (net)	(3,230)	(798)	(578)	(165)	(116)	(102)	(237)	(114)	(143)	(30)
Borrowing (net)	3,253	640	591	505	1,108	1,520	3,117	3,346	3,380	2,594
Deposits received (net)	10	42	4	16	2	8	33	(22)	3	3
Distributions paid	(758)	(671)	(738)	(666)	(925)	(919)	(1,144)	(1,013)	(1,198)	(1,146)
Other financing (net)	25	(20)	4	7	(14)	...	...	...	(1)	...
Net Cash Flows from Financing Activities	**(700)**	**(807)**	**(717)**	**(303)**	**55**	**507**	**1,769**	**2,197**	**2,041**	**1,421**
Net Increase / (Decrease) in Cash Held	**(338)**	**345**	**(133)**	**18**	**305**	**(152)**	**(262)**	**(118)**	**22**	**89**
SURPLUS / (DEFICIT)										
Net Cash from Operating Activities and Investments in Non-financial Assets	**437**	**524**	**177**	**268**	**(31)**	**(638)**	**(2,056)**	**(2,285)**	**(1,972)**	**(1,330)**
Distribution paid	(758)	(671)	(738)	(666)	(925)	(919)	(1,144)	(1,013)	(1,198)	(1,146)
Finance leases and similar arrangements	...	...	...	...	...	...	...	...	...	...
SURPLUS / (DEFICIT)	**(321)**	**(147)**	**(561)**	**(398)**	**(956)**	**(1,557)**	**(3,200)**	**(3,298)**	**(3,170)**	**(2,476)**

Notes:

(a) The public non-financial corporation (PNFC) sector is also referred to in these budget papers as the public trading enterprise (PTE) sector.

(b) A positive number denotes a cash inflow; a negative (i.e. bracketed) sign denotes a cash outflow.

(c) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(d) The underlying surplus / (deficit) has been adjusted to exclude the impact of the 2000 Olympic and Paralympic Games on the results.

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
GFS SURPLUS / (DEFICIT)	***(321)***	***(147)***	***(561)***	***(398)***	***(956)***	***(1,557)***	***(3,200)***	***(3,298)***	***(3,170)***	***(2,476)***
Reversing the impact of SOCOG and SPOC operations	*340*	*68*	*...*	*...*	*...*	*...*	*...*	*...*	*...*	*...*
UNDERLYING SURPLUS / (DEFICIT) adjusted to exclude SOCOG & SPOC[(d)]	***19***	***(79)***	***(561)***	***(398)***	***(956)***	***(1,557)***	***(3,200)***	***(3,298)***	***(3,170)***	***(2,476)***

Table 9.9: NSW Non-financial Public Sector Cash Flow Statement[(a)] (ABS Basis)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[(b)] $m	Budget 2006-07[(b)] $m	Forward Estimates 2007-08[(b)] $m	2008-09[(b)] $m	2009-10[(b)] $m
Cash Receipts from Operating Activities										
Taxes received	12,569	12,522	13,397	14,291	14,458	15,136	15,871	16,688	17,592	18,519
Receipts from sales of goods and services	13,068	12,051	12,531	12,683	13,709	13,598	14,223	14,967	15,645	16,532
Grants/subsidies received	14,602	16,738	17,557	17,777	18,502	20,600	20,246	20,955	21,844	22,746
Other receipts	4,714	4,711	5,160	6,475	6,601	6,977	6,477	6,257	6,501	6,683
Total Receipts	**44,953**	**46,022**	**48,645**	**51,226**	**53,270**	**56,311**	**56,817**	**58,867**	**61,582**	**64,480**
Cash Payments for Operating Activities										
Payment for goods and services[(c)]	(29,794)	(28,626)	(31,290)	(33,317)	(35,266)	(37,093)	(47,972)	(41,402)	(42,768)	(44,536)
Grants and subsidies paid	(4,199)	(4,897)	(4,867)	(5,223)	(5,569)	(6,216)	(6,688)	(6,477)	(6,584)	(6,614)
Interest paid	(1,723)	(1,614)	(1,575)	(1,626)	(1,615)	(1,896)	(1,971)	(2,170)	(2,731)	(2,848)
Other payments	(3,137)	(3,319)	(3,007)	(3,894)	(4,240)	(3,841)	(4,075)	(4,088)	(4,034)	(4,130)
Total Payments	**(38,853)**	**(38,456)**	**(40,739)**	**(44,060)**	**(46,690)**	**(49,046)**	**(60,706)**	**(54,137)**	**(56,117)**	**(58,128)**
Net Cash Flows from Operating Activities	**6,100**	**7,566**	**7,906**	**7,166**	**6,580**	**7,265**	**(3,889)**	**4,730**	**5,465**	**6,352**
Net Cash Flows from Investments in Non-financial Assets										
Sales of non-financial assets	626	781	778	615	635	800	773	926	890	978
Purchases of non-financial assets	(5,000)	(5,744)	(6,376)	(6,284)	(6,556)	(8,097)	(9,877)	(10,360)	(10,511)	(10,165)
Net Cash Flows from Investments in Non-financial Assets	**(4,374)**	**(4,963)**	**(5,598)**	**(5,669)**	**(5,921)**	**(7,297)**	**(9,104)**	**(9,434)**	**(9,621)**	**(9,187)**
Net Cash Flows from Investments in Financial Assets for Policy Purposes	**(7)**	**537**	**395**	**22**	**26**	**8**	**(42)**	**45**	**(11)**	**52**
Net Cash Flows from Investments in Financial Assets for liquidity purposes[(c)]	**(423)**	**(526)**	**(842)**	**(1,488)**	**(2,270)**	**(2,302)**	**6,301**	**(600)**	**(649)**	**(672)**

Table 9.9: NSW Non-financial Public Sector Cash Flow Statement[(a)] (ABS Basis) (cont)

	Actual 2000-01 $m	Actual 2001-02 $m	Actual 2002-03 $m	Actual 2003-04 $m	Actual 2004-05 $m	Revised 2005-06[(b)] $m	Budget 2006-07[(b)] $m	Forward Estimates 2007-08[(b)] $m	Forward Estimates 2008-09[(b)] $m	Forward Estimates 2009-10[(b)] $m
Net Cash Flows from Financing Activities										
Advances received (net)	(85)	(230)	(70)	(135)	(29)	(133)	(47)	(49)	(50)	(53)
Borrowing (net)	(1,227)	(1,472)	(387)	867	1,511	1,990	6,449	5,198	4,690	3,842
Deposits received (net)	(14)	38	(4)	22	23	(6)	32	(23)	1	1
Distributions paid	...	...	...	...	...	...	...	...	...	...
Other financing (net)	23	(21)	2	4	(33)	(1)	...	...	1	...
Net Cash Flows from Financing Activities	**(1,303)**	**(1,685)**	**(459)**	**758**	**1,472**	**1,850**	**6,434**	**5,126**	**4,642**	**3,790**
Net Increase / (Decrease) in Cash Held	**(7)**	**929**	**1,402**	**789**	**(113)**	**(476)**	**(300)**	**(133)**	**(174)**	**335**
SURPLUS / (DEFICIT)										
Net Cash from Operating Activities and Investments in Non-financial Assets	**1,726**	**2,603**	**2,308**	**1,497**	**659**	**(32)**	**(12,993)**	**(4,704)**	**(4,156)**	**(2,835)**
Distribution paid	...	...	...	...	...	...	...	...	...	...
Finance leases and similar arrangements	(290)	(351)	(345)	(312)	(187)	(47)	(15)	(125)	(269)	...
SURPLUS / (DEFICIT)	**1,436**	**2,252**	**1,963**	**1,185**	**472**	**(79)**	**(13,008)**	**(4,829)**	**(4,425)**	**(2,835)**

Notes:

(a) A positive number denotes a cash inflow, a negative (i.e. bracketed) sign denotes a cash outflow.

(b) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with Australian Accounting Standards.

(c) In 2006-07 the government will be contributing $8,700 million from the Liability Management Fund towards reducing its superannuation liabilities.

(d) Deposits by the Crown to the Liability Management Fund and the fund's earnings have been set aside to meet future superannuation contributions.

(e) The underlying surplus / (deficit) has been adjusted to exclude the impact of the 2000 Olympic and Paralympic Games on the results.

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
GFS SURPLUS / (DEFICIT)	***1,436***	***2,252***	***1,963***	***1,185***	***472***	***(79)***	***(13,008)***	***(4,829)***	***(4,425)***	***(2,835)***
Impact of prepayment of superannuation	*(1,058)*	*(1,134)*	...	...	...	...	...	...	...	...
Impact of deposits to the Liability Management Fund [(c) (d)]	...	...	*(1,651)*	*(1,200)*	*(1,150)*	*(1,234)*	*5,235*	...	...	...
Impact of SOCOG and SPOC operations [(e)]	*389*	*(12)*	...	...	...	...	...	...	...	...
UNDERLYING SURPLUS / (DEFICIT) (after adjusting for the timing of superannuation contributions and excluding SOCOG and SPOC operations)	***767***	***1,106***	***312***	***(15)***	***(678)***	***(1,313)***	***(7,773)***	***(4,829)***	***(4,425)***	***(2,835)***

Table 9.10: NSW General Government Sector Taxes (ABS Basis)

	Revised 2005-06 $m	*Budget 2006-07 $m*
Taxes on employers' payroll and labour force	**5,112**	**5,438**
Taxes on property		
Land taxes	1,737	1,793
Stamp duties on financial and capital transactions	3,818	3,909
Financial institutions' transaction taxes	...	...
Other	68	67
Total taxes on property	**5,623**	**5,769**
Taxes on the provision of goods and services		
Excises and levies	...	...
Taxes on gambling	1,527	1,671
Taxes on insurance	1,423	1,545
Total taxes on the provision of goods and services	**2,950**	**3,216**
Taxes on use of goods and performance of activities		
Motor vehicle taxes	1,896	1,984
Franchise taxes	8	8
Other	223	304
Total taxes on use of goods and performance of activities	**2,127**	**2,296**
Total GFS Taxation Revenue	**15,812**	**16,719**

Table 9.11: NSW General Government Sector Expenses by Function (ABS Basis)

	Revised 2005-06 $m	*Budget 2006-07 $m*
General public services	1,386	1,314
Defence	...	...
Public order and safety	4,330	4,601
Education	11,295	11,886
Health	11,048	11,782
Social security and welfare	3,035	3,388
Housing and community amenities	1,546	1,753
Recreation and culture	968	917
Fuel and energy	73	119
Agriculture, forestry, fishing and hunting	800	725
Mining, manufacturing and construction	140	149
Transport and communications	5,089	5,317
Other economic affairs	843	878
Other purposes [(a)]	2,299	2,465
Total GFS Expenses	**42,852**	**45,294**

(a) 2006-07 includes $245 million Advance to the Treasurer which will be allocated across functions as the funds are spent in the Budget Year.

Table 9.12: NSW General Government Sector Purchases of Non-Financial Assets [(a)]

	Revised 2005-06 $m	*Budget 2006-07 $m*
General public services	308	385
Defence		
Public order and safety	435	462
Education	446	558
Health	594	576
Social security and welfare	95	106
Housing and community amenities	177	116
Recreation and culture	147	165
Fuel and energy	...	...
Agriculture, forestry, fishing and hunting	40	35
Mining, manufacturing and construction	3	2
Transport and communications	1,410	1,753
Other economic affairs	32	20
Other purposes [(b)]	55	193
Total GFS Purchases of Non-Financial Assets	**3,742**	**4,371**

(a) Includes land and secondhand assets, however excludes assets acquired under finance leases.

(b) 2006-07 includes $110 million Advance to the Treasurer which will be allocated across functions as the funds are spent in the Budget Year.

9.5 LOAN COUNCIL REPORTING REQUIREMENTS

Table 9.13 presents estimates of the State's Loan Council allocation (LCA) for 2006-07.

The 2006-07 estimated NSW Loan Council allocation is a deficit of $4,838 million compared to an original deficit allocation of $2,986 million. The variance of $1,852 million exceeds the tolerance limit set by Loan Council. The tolerance limit for 2006-07 is $1,141 million and is calculated as 2 per cent of cash receipts from operating activities for the Non-Financial Public Sector. The increase in the Loan Council Allocation requirement has occurred primarily due to lower than estimated general government operating cash flows as well as higher capital investment by the general government sector.

Table 9.13: 2006-07 Loan Council Allocation Estimates, NSW

		Loan Council Allocation 2006-07 $m	Budget-time Estimate 2006-07 $m
General government sector cash deficit / (surplus) [a]		6,949	9,816
Public Non-financial Corporations sector cash deficit / (surplus)		3,196	3,200
Non-financial public sector cash deficit / (surplus) [b]		**10,145**	**13,008**
Minus	Net cash flows from investments in financial assets for policy purposes [C]	28	42
Plus	Memorandum items [a] [d]	(7,187)	(8,212)
Loan Council Allocation		**2,986**	**4,838**

Notes:

(a) Impacted in 2006-07 by a one-off contribution of $8.7 billion from the General Government Liability Management Fund towards the defined benefit superannuation schemes.

(b) Does not directly equate to the sum of the general government and PTE cash deficits due to intersectoral transfers which are netted out.

(c) This item is the negative of net advances paid under a cash accounting framework

(d) Memorandum items are used to adjust the ABS deficit 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 ABS deficit certain transactions that 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 universities.

9.6 PRIVATE SECTOR INFRASTRUCTURE PROJECTS

As confirmed at the 1997 Loan Council meeting, States are to report their full contingent exposure to infrastructure projects with private sector involvement. Exposure is to be measured by the government's termination liabilities in a case of private sector default and disclosed as a footnote to, rather than a component, of Loan Council Allocations.

CONTRACTS EXPECTED TO BE ENTERED INTO IN 2005-06

None to be reported.

CONTRACTS EXPECTED TO BE ENTERED INTO IN 2006-07

Royal Prince Alfred Hospital Car Park

Project Description:

Detailed proposals have been submitted by the private sector to finance and build a new 1,000 space car park on the Royal Prince Alfred Hospital campus. The total construction cost for the project is estimated to be $13.5 million. The successful proponent will, under a 20 or 25 year licence, operate and collect user charges from around 1,300 campus car park spaces, including the 1,000 new spaces.

The form of the arrangement is expected to be similar to that for the Randwick and St George Hospital Car Parks. At this time no government liability is anticipated based on the termination provisions of the draft contract.

Government Contingent Liability	To Be Determined

APPENDIX A: GENERAL GOVERNMENT SECTOR ACCOUNTING FINANCIAL STATEMENTS

Refer to Chapter 9 (Section 9.2) for an explanation of the differences in treatment and disclosure between the following financial statements which are prepared in accordance with Australian Accounting Standards, and the accrual uniform presentation tables reported in Chapter 9 which follow the government finance statistics convention.

Table A.1: General Government Sector Operating Statement[(a)]

	Actual	Budget	Revised	Budget	Estimate		
	2004-05	2005-06	2005-06	2006-07	2007-08	2008-09	2009-10
	$m	$m	$m	$m	$m	$m	$m
State Revenues							
Taxation	15,322	16,260	15,804	16,711	17,464	18,384	19,360
Commonwealth Grants	16,192	16,796	17,027	17,625	18,544	19,536	20,197
Financial Distributions	1,537	1,848	1,725	1,595	1,829	1,779	1,936
Fines, Regulatory Fees & Other	1,145	1,083	1,203	1,167	1,161	1,172	1,252
Total State Revenues	34,196	35,987	35,759	37,098	38,998	40,871	42,745
Operating Revenues							
Sale of Goods and Services	2,734	2,818	2,852	3,014	3,138	3,239	3,318
Investment Income	1,127	1,076	1,555	1,001	865	911	967
Grants and Contributions	753	644	784	827	794	823	817
Other	183	325	315	272	290	303	314
Total Operating Revenues	4,797	4,863	5,506	5,114	5,087	5,276	5,416
Expenses							
Employee Related							
- Superannuation	2,026	2,857	2,329	2,388	2,278	2,301	2,301
- Other	16,520	17,143	17,378	18,196	18,930	19,963	20,865
Other Operating	9,582	9,502	8,943	9,982	10,111	10,265	10,513
Depreciation and Amortisation	2,019	2,087	2,150	2,245	2,355	2,477	2,570
Current Grants and Subsidies	6,035	6,505	6,812	7,281	7,487	7,827	8,171
Capital Grants	1,372	1,400	1,736	1,661	1,353	1,281	1,217
Borrowing Costs	828	898	890	995	1,171	1,298	1,390
Total Expenses	38,382	40,392	40,238	42,748	43,685	45,412	47,027
Gains/(losses) on disposal of Physical Assets	(372)	13	14	(20)	56	63	143
Other Gains/(losses) [(b)]	...	...	3,538	947	(122)	(97)	(99)
Net Cost of Services	(33,957)	(35,516)	(31,180)	(36,707)	(38,664)	(40,170)	(41,567)
Surplus/(Deficit) for the Year	239	471	4,579	391	334	701	1,178

Notes:

(a) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with pre-AEIFRS.

(b) In applying accounting standards, the calculation of other gains/(losses) have been significantly impacted in 2005-06 due to an increase in the superannuation liability discount rate, and higher superannuation investment earnings than the average long-term earnings rate.

Table A.2: General Government Sector Statement of Changes in Equity[(a)]

	Actual 2004-05 $m	Budget 2005-06 $m	Revised 2005-06 $m	Budget 2006-07 $m	Estimate 2007-08 $m	Estimate 2008-09 $m	Estimate 2009-10 $m
STATEMENT OF CHANGES IN EQUITY							
Net Asset Valuation Increments/(Decrements)	4,044	(86)	926	827	943	850	827
Adjustments from the adoption of Australian Equivalents to International Financial Reporting Standards[(b)]	...	(1,804)	(6,397)	...	...	...	...
AASB 112 Income Tax Adjustment to Reserves	...	268	(84)	(44)	(29)	(40)	141
Other Net Adjustments	...	...	(25)	...	...	...	...
Contributions by Owners Made to Wholly Owned Public Sector Agencies (Urgent Issues Group UIG Interpretation 1038)							
- Equity Restructure Payments from Public Trading Enterprises	76	160	49	184	50	116	2
- Transfers of Net Assets on Administrative Restructure	(434)	...	35	(3)	(3)	...	...
Net income and expense recognised directly in equity	**3,686**	**(1,462)**	**(5,496)**	**964**	**961**	**926**	**970**
Operating Surplus/ (Deficit)	239	471	4,579	391	334	701	1,178
Total recognised income and expense for the period	**3,925**	**(991)**	**(917)**	**1,355**	**1,295**	**1,627**	**2,148**
Opening Balance Equity	56,601	57,525	60,526	59,609	60,964	62,259	63,886
Closing Balance Equity	**60,526**	**56,534**	**59,609**	**60,964**	**62,259**	**63,886**	**66,034**

Notes:

(a) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with pre-AEIFRS.

(b) The two main financial impacts of AEIFRS in 2005-06 include adjustment for the change in the discount rate for the Defined Benefit superannuation liability and the revaluation of the deferred income tax assets receivable.

Table A.3: General Government Sector Balance Sheet as at 30 June, 2005-2010[(a)]

	Actual 2005 $m	Budget 2006 $m	Revised 2006 $m	Budget 2007 $m	Estimate 2008 $m	Estimate 2009 $m	Estimate 2010 $m
Current Assets							
Cash Assets	1,477	953	1,098	1,036	1,010	807	1,051
Receivables	2,884	3,338	3,039	2,983	3,176	3,188	3,343
Other Financial Assets	1,002	1,018	8,021	1,418	1,538	1,654	1,498
Inventories	113	129	110	113	112	110	112
Other	94	90	94	98	98	95	95
Non Current Assets Held for Sale	...	60	184	162	147	139	122
Total Current Assets	**5,570**	**5,588**	**12,546**	**5,810**	**6,081**	**5,993**	**6,221**
Non-Current Assets							
Receivables	4,260	7,810	7,411	7,349	7,363	7,346	7,494
Other Financial Assets	11,980	12,310	7,413	7,733	8,233	8,812	9,499
Inventories	37	36	43	37	32	30	30
Investment Properties	...	643	303	304	305	440	332
Property, Plant and Equipment							
Land and Buildings	41,985	41,018	43,115	44,699	46,338	47,715	49,081
Plant and Equipment	6,569	6,033	6,075	6,116	6,013	5,783	5,318
Infrastructure Systems	35,197	34,272	35,901	36,732	37,854	39,297	40,946
Intangibles	...	205	493	454	431	405	382
Other	1,262	1,520	1,492	1,601	1,735	1,878	2,032
Total Non-Current Assets	**101,290**	**103,847**	**102,246**	**105,025**	**108,304**	**111,706**	**115,114**
Total Assets	**106,860**	**109,435**	**114,792**	**110,835**	**114,385**	**117,699**	**121,335**
Current Liabilities							
Payables	2,424	2,218	2,134	2,131	2,016	2,074	2,138
Borrowings	3,559	1,722	2,921	4,313	2,765	2,798	4,343
Employee Entitlements and Other Provisions	2,285	2,566	5,246	5,278	6,109	6,207	6,315
Other	322	196	477	646	727	467	290
Total Current Liabilities	**8,590**	**6,702**	**10,778**	**12,368**	**11,617**	**11,546**	**13,086**
Non-Current Liabilities							
Borrowings	9,470	11,531	10,681	12,455	16,098	17,473	16,964
Employee Entitlements and Other Provisions	27,255	33,313	31,178	22,897	22,711	23,298	23,792
Other	1,019	1,355	2,546	2,151	1,700	1,496	1,459
Total Non-Current Liabilities	**37,744**	**46,199**	**44,405**	**37,503**	**40,509**	**42,267**	**42,215**
Total Liabilities	**46,334**	**52,901**	**55,183**	**49,871**	**52,126**	**53,813**	**55,301**
NET ASSETS	**60,526**	**56,534**	**59,609**	**60,964**	**62,259**	**63,886**	**66,034**
Equity							
Asset Revaluation Reserves	27,512	28,233	30,760	31,540	32,449	33,254	34,218
Equity of Assets classified as Held for Sale	...	2	21	21	21	21	21
Accumulated Funds	33,014	28,299	28,828	29,403	29,789	30,611	31,795
TOTAL EQUITY	**60,526**	**56,534**	**59,609**	**60,964**	**62,259**	**63,886**	**66,034**

Note:

(a) 2005-06 and forward years are based on data that has been recognised and measured in accordance with Australian Equivalents to International Financial Reporting Standards (AEIFRS). Prior to 2005-06 transactions were recorded in accordance with pre-AEIFRS.

Table A.4: General Government Sector Cash Flow Statement[(a)]

	Actual 2004-05 $m	Budget 2005-06 $m	Revised 2005-06 $m	Budget 2006-07 $m	Estimate 2007-08 $m	2008-09 $m	2009-10 $m
Cash Flows from Operating Activities							
Receipts							
Taxation	15,025	16,235	15,821	16,557	17,412	18,349	19,314
Commonwealth Grants	16,192	16,796	17,987	17,525	18,244	19,136	20,037
Financial Distributions	1,400	1,497	1,394	1,680	1,607	1,820	1,845
Sale of Goods and Services	2,896	2,864	2,874	2,998	3,109	3,204	3,282
Investment Income	506	566	587	580	333	332	335
Other	3,696	3,208	4,196	4,015	3,962	3,970	4,051
Total Receipts	**39,715**	**41,166**	**42,859**	**43,355**	**44,667**	**46,811**	**48,864**
Payments							
Employee Related[(b)]	(17,251)	(18,002)	(18,134)	(27,908)	(20,952)	(21,993)	(22,951)
Grants and Subsidies	(7,249)	(7,742)	(8,388)	(8,777)	(8,669)	(8,924)	(9,195)
Finance	(778)	(885)	(853)	(977)	(1,183)	(1,244)	(1,339)
Other	(10,900)	(11,144)	(11,412)	(12,098)	(12,055)	(12,052)	(12,349)
Total Payments	**(36,178)**	**(37,773)**	**(38,787)**	**(49,760)**	**(42,859)**	**(44,213)**	**(45,834)**
Net Cash Flows from Operating Activities	**3,537**	**3,393**	**4,072**	**(6,405)**	**1,808**	**2,598**	**3,030**
Cash Flows from Investing Activities							
Proceeds from Sale of Property, Plant and Equipment	488	563	537	476	515	478	539
Proceeds from Sale of Investments[(b)]	395	1,230	2,024	9,019	256	246	246
Equity Restructure	76	160	49	184	50	116	2
Advance Repayments Received	66	77	77	99	87	96	98
Purchases of Property, Plant & Equipment	(3,011)	(3,702)	(3,703)	(4,267)	(4,334)	(4,451)	(4,529)
Purchase of Investments	(2,249)	(1,616)	(3,401)	(2,284)	(277)	(264)	(236)
Advances Made	(51)	(70)	(61)	(58)	(63)	(63)	(63)
Other	(45)	(8)	(140)	(119)	(71)	(59)	(59)
Net Cash Flows from Investing Activities	**(4,331)**	**(3,366)**	**(4,618)**	**3,050**	**(3,837)**	**(3,901)**	**(4,002)**
Cash Flows from Financing Activities							
Proceeds from Borrowings and Advances	1,177	1,286	1,234	3,573	2,073	1,457	1,411
Repayments of Borrowings and Advances	(764)	(1,774)	(1,013)	(280)	(71)	(359)	(201)
Net Cash Flows From Financing Activities	**413**	**(488)**	**221**	**3,293**	**2,002**	**1,098**	**1,210**
Net Increase/(Decrease) in Cash	**(381)**	**(461)**	**(325)**	**(62)**	**(27)**	**(205)**	**238**
Opening Cash and Cash Equivalents	1,779	1,378	1,398	1,073	1,011	984	779
CLOSING CASH AND CASH EQUIVALENTS BALANCE	**1,398**	**917**	**1,073**	**1,011**	**984**	**779**	**1,017**

Notes:

(a) Australian Equivalents to International Financial Reporting Standards (AEIFRS) has not resulted in any significant differences between the 2004-05 (pre-AEIFRS) and the 2005-06 and forward years (AEIFRS based) Cash Flow Statement.

(b) In 2006-07 the government will be contributing $8,700 million from the Liability Management Fund to reduce its superannuation liabilities. Refer to Section 4.6 of Chapter 4 for further details.

APPENDIX B: TAX EXPENDITURE AND CONCESSIONS STATEMENT

B.1: DETAILED ESTIMATES OF TAX EXPENDITURES

TRANSFER DUTY (INCLUDING VENDOR TRANSFER DUTY AND "LAND RICH" DUTY)

The benchmark tax rates for Purchaser Transfer Duty (other than by the Crown in right of NSW or the Commonwealth) are as follows:

- for transfers relating to the **purchase** of **non-residential** land, the benchmark tax rate is defined against marginal tax rates varying from 1.25 to 5.5 per cent (Purchaser Transfer Duty); and

- for transfers relating to the **purchase** of **residential** land, the benchmark tax rate is defined against marginal rates varying from 1.25 to 7 per cent (Purchaser Transfer Duty).

From 2 August 2005, Vendor Transfer Duty was abolished for all transactions entered into, on or after that date. Prior to that date, the benchmark tax rate was:

- agreements on the sale or transfer of land-related property or declarations of trust over land-related property, sold for a higher price than the purchase price, other than principal places of residence and land used for primary production, were taxed at the benchmark tax rate of 2.25 per cent (Vendor Transfer Duty).

From 10 November 2004, duty applied to the disposal of indirect interests in land. The same tax base as for Vendor Transfer Duty applied up to 2 August 2005.

Table B.1: Transfer Duty (Including Vendor Duty)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
PURCHASER TRANSFER DUTY			
First Home Plus			
The scheme provides all eligible first home buyers with a full exemption from transfer duty where the home is valued up to $500,000 with a phase-out of the benefit between $500,000 and $600,000. First home buyers of vacant land receive a full exemption from duty on land valued up to $300,000. The exemption phases out as land value increases to $450,000. Group self-build schemes are also eligible.	353	383	402
Transfer of residences between spouses			
An exemption is granted for property transferred between spouses or de facto partners, subject to the property being jointly held after transfer.	27	28	29
Transfers of matrimonial property consequent upon divorce			
An exemption is granted for transfers between parties under the *Family Law Act 1975* (Cth) or partnership property under the *Property (Relationships) Act 1984.*	75	77	80
Intergenerational rural transfers			
An exemption is granted for transfers of rural land used for primary production between generations, and between siblings, to facilitate young family members taking over family farms.	14	14	15
Exemption for purchases by charitable and benevolent institutions where the property is to be used for approved purposes	14	29	30
Corporate reconstructions			
An exemption is given for corporate reconstructions provided certain qualifying criteria are satisfied.	159	120	126
Transfer of property from companies and trusts to individuals			
Exemption for transfer of a principal place of residence from a corporation or a special trust to certain individuals or transfer of any land owned by a special trust from the trust to certain persons provided the land was owned by the corporation on 11 September 1990.	2	1	1

Table B.1: Transfer Duty (Including Vendor Duty) (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Purchase of property by Department of Housing and Aboriginal Housing Office tenants			
An exemption is granted for the purchase of their principal place of residence by tenants of the Department of Housing, the Community Housing Program administered by the Department of Housing and the Aboriginal Housing Office.	1	<1	<1
Other Legislation			
Exemption is granted for certain transfers of dutiable property contained in other legislation.	12	6	7
Councils and County Councils			
Duty is not chargeable on the transfer of property to a council or county council under the *Local Government Act 1993.*	5	3	3
'Off the plan' purchases			
Duty may be deferred for purchases of real estate until completion of the sale or 12 months after the contract.	n.a.	n.a.	n.a.
Nominal transfer duty is payable on the transfer of properties as a result of a change in trustees	n.a.	n.a.	n.a.
Transfer to beneficiaries of property formerly the principal place of residence of the deceased	n.a.	n.a.	n.a.
VENDOR TRANSFER DUTY			
Concession for land-related property sold for less than 115 per cent of the purchase price	54	50	…
Exemption for the sale or transfer by mortgagee or receiver under the power of sale	14	5	…
Exemption for the sale or transfer of newly constructed buildings	130	41	…
Exemption for the sale or transfer of substantially new buildings	13	7	…
Exemption for the sale or transfer of land subdivided from a principal place of residence or a farm	6	2	…
Exemption for the sale or transfer of vacant land that has been substantially improved by the vendor	34	18	…

Table B.1: Transfer Duty (Including Vendor Duty) (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Exemption for sale of business that includes land-related property subject to certain conditions	21	5	…
Exemption for the sale or transfer of compulsory acquisitions	1	<1	…
Property used by charitable or benevolent societies or institutions			
An exemption is provided for the sale of land-related property used for approved purposes by charitable or benevolent societies or institutions.	40	8	…
Corporate reconstructions			
An exemption is given for corporate reconstructions provided certain qualifying criteria are satisfied.	32	6	…
Exemption from *ad valorem* duty for certain transfers	7	1	…
Transfers of matrimonial property consequent upon divorce or break-up of de facto relationships			
Exemption for transfers of former principal places of residence to former partners or spouses on divorce or break-up of de facto relationships.	n.a.	n.a.	n.a.
Transfer to beneficiaries of property formerly the principal place of residence of the deceased	n.a.	n.a.	n.a.

Minor Tax Expenditures (< $1 million)

- A person who has sold his or her property to a local government council because the home was built on flood-prone land and has then purchased another home may pay purchaser transfer duty on the contract by instalment over a five-year period;
- certain instruments relating to superannuation are subject to nominal duty; and
- a credit of purchaser transfer duty previously paid is applied to amalgamations of certain Western Lands leases.

The following are exempt from **purchaser transfer duty**:

- transfers of poker machine permits where there is no change in beneficial ownership;
- Equity Release Scheme – an exemption from purchaser transfer duty on approved equity release schemes for aged home owners was granted from 1 October 2004;
- certain purchases of manufactured relocatable homes (caravans);
- transfers of property in a statutory trust as a result of an order under Section 66G of the *Conveyancing Act 1919*;
- no duty is chargeable on the vesting of common property in a body corporate on the registration of a strata plan or strata plan of subdivision under the *Strata Schemes (Freehold Development) Act 1973* or the *Strata Schemes (Leasehold Development) Act 1986*;
- no duty is chargeable on a call option assignment subject to certain conditions;
- transfer of incorporated legal practices;
- transfer of a liquor licence in certain circumstances under Sections 41, 42 or 61 of the *Liquor Act 1982*; and
- transfer or property related to allocating funds for water saving projects.

Prior to 2 August 2005 the following were exempt from **vendor transfer duty**:

- land subject to a conservation agreement under the *National Parks and Wildlife Act 1974*;
- transfer of land that is vested in, owned by, held on trust by, or leased by the Nature Conservation Trust of NSW constituted by the *Nature Conservation Trust Act 2001*;
- possessory application or an application to bring land under the *Real Property Act 1900*;
- transfers of gifts of land-related property to charities and others;
- transfer of principal places of residence on which there is one other residential occupancy;

- sale of former principal place of residence by vendor absent for up to 6 years prior to sale;

- sale of land used for incidental business purposes as well as principal place of residence;

- sale of former principal place of residence of a deceased person used as a principal place of residence by another person pursuant to a life estate created by the will of a deceased person;

- land used by the former spouse of the vendor as his/her principal place of residence following the break-up of the relationship;

- land used and occupied by a person under a legal disability (protected person) is taken to be the land used and occupied by the vendor where the vendor does not occupy that property as their principal place of residence. The principal place of residence exemption applies in respect of the vendor duty transaction in the same way as it would apply if the protected person were the vendor in relation to the transaction;

- duty concession for an acquisition of an interest in a land rich landholder for the purpose of securing financial accommodation; and

- concession for buy-back arrangements related to unit trust schemes that meet certain criteria.

The following are exempt from **purchaser transfer duty** and were exempt from **vendor transfer duty** prior to 2 August 2005:

- transfers back to a former bankrupt by trustee of his or her estate;

- transfers by way of mortgage or discharge of mortgage of old system titled properties;

- transfers where public hospitals are the liable party;

- instruments executed by or on behalf of a council or county council under the *Local Government Act 1993*, not connected with a trading undertaking;

- transfers executed for the purpose of amalgamation or dissolution of clubs or the formation of a new club under Section 17A of the *Registered Clubs Act 1976*;

- instruments executed by or on behalf of agencies within the meaning of the Convention on the Privileges and Immunities of the Specialised Agencies approved by the General Assembly of the United Nations in 1947;

- transfers between associations of employees or employers registered under the *Workplace Relations Act 1996* (Cth) for the purpose of amalgamation;

- transfer of property to the New South Wales Aboriginal Land Council, Regional Aboriginal Land Council, or Local Aboriginal Land Council under the *Aboriginal Land Rights Act 1983*; and

- transfers of property between licensed insurers, and between the WorkCover Authority and licensed insurers, under the *Workers Compensation Acts of 1926 and 1987* (NSW).

GENERAL INSURANCE DUTY

The benchmark is defined as all premiums for general insurance policies, except insurance covering only property of the Crown in right of New South Wales. The benchmark tax rate is 5 per cent of premium paid for contracts or renewals that take effect prior to 1 September 2005 and 9 per cent from that date forward.

Table B.2: General Insurance Duty

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Concessional rates for motor vehicle, aviation, disability income, occupational indemnity, crop and livestock			
From 1 September 2005, a concessional rate of 5 per cent applies to certain categories of insurance including motor vehicle (excluding compulsory third party (the ‘green slip’)), aviation, disability income and occupational indemnity.			
Crop and livestock insurance is taxed at 2.5 per cent.			
Until 31 January 2010, insurance under the Debtor Insurance Scheme of the Stock and Station Agents Association is also taxed at 2.5 per cent.	2	111	155
Exemption for third party motor vehicle personal injury insurance as per the *Motor Vehicle Act 1988*			
Third party motor vehicle personal injury insurance (‘green slip’) is exempt from stamp duty.	78	130	153

Table B.2: General Insurance Duty (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Marine and cargo insurance			
Exemption for marine insurance covering hulls of commercial ships and the cargo carried by land, sea or by air.	9	12	15
Exemption for WorkCover premiums	162	266	284
Exemption for medical benefits insurance	n.a.	n.a.	n.a.

Minor Tax Expenditures (< $1 million)

The following are exempt:

- insurance by non-profit charities, benevolent, philanthropic, patriotic organisations and societies or institutions whose resources are used wholly or predominantly for the relief of poverty, the promotion of education, any purpose directly or indirectly connected with defence or the amelioration of the condition of past or present members of the naval or air forces of the Commonwealth or their dependants or any other patriotic object;
- insurance by Aboriginal Land Councils and non-commercial ventures of local councils;
- insurance covering mortgages acquired for issuing mortgage backed securities;
- separate policies covering loss by fire of labourer's tools; and
- redundancy insurance in respect of a housing loan that does not exceed $124,000.

LIFE INSURANCE DUTY

The benchmark is defined as all products (or part thereof) where the sum assured offered by life insurance companies provides for a payment in the event of death or injury from natural causes of the person insured or upon survival to a specified age. The benchmark tax rate is 10 cents per $200 where the sum assured is less than $2,000 and $1 plus 20 cents per $200 or part thereof where the sum assured is greater than $2,000.

Table B.3: Life Insurance Duty

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Superannuation			
An exemption is granted to all group superannuation investment policies that are for the benefit of more than one member.	64	71	77
Annuities			
An exemption is provided to annuities.	16	16	17

MORTGAGE DUTY

The benchmark is defined as all secured loans that affect property in New South Wales, except mortgages given by the Commonwealth or NSW Government or any public statutory body constituted under a law of this State. The benchmark tax rate is $5 up to $16,000 plus $4 per $1,000 or part thereof on the excess.

Table B.4: Mortgage Duty

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Refinanced loans where the borrower and the security for the loan remain the same			
A mortgage that secures the amount of the balance outstanding under an earlier mortgage granted for the same borrower over the same or substantially the same property is exempt. Any additional amount above the previously secured amount is liable for duty.			
From 1 August 2005 the exemption for refinancing a mortgage up to the previous amount secured through a different lender was restricted to amounts not exceeding $1 million.	207	372	397
First home purchase mortgage covered by First Home Plus			
Mortgages financing a first home purchase eligible under the First Home Plus Scheme are exempt from duty up to certain loan values, phasing out as the mortgage value increases.	22	33	35
Mortgage-backed securities			
An exemption is given for financial institutions using pooled mortgages from their lending assets as security for borrowing funds.	n.a.	n.a.	n.a.

Table B.4: Mortgage Duty (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Loan-backed securities			
Securities issued backed by cash flow from loans (secured and unsecured) are exempted from duty.	n.a.	n.a.	n.a.
Fund raisings by finance companies through debenture issues			
A concession is given to companies whose sole or principal business is to provide finance to the public. Debentures issued, trust deeds and mortgages executed by "financial corporations" as defined in the legislation are not liable to duty. However, the trust deed is stamped as a Declaration of a Trust.	n.a.	n.a.	n.a.
Consumer credit contract			
Mortgages securing amounts under a consumer credit contract, where the amount financed is $35,000 or less are exempt from duty.	n.a.	n.a.	n.a.
Instruments creating mortgage-backed securities			
An instrument executed for the purpose of creating, issuing or marketing mortgage-backed securities is exempt from duty.	n.a.	n.a.	n.a.

Minor Tax Expenditures (< $1 million)

The following are exempt:

- duty is not charged on additional loans secured under a mortgage if the additional loans do not exceed $10,000 in any 12 month period, not being the 12 month period following the making of the initial loan;
- mortgages created solely for the purpose of providing security in accordance with a condition imposed on the grant of bail in criminal proceedings;
- a mortgage of any ship or vessel, or of any part, interest, share or property of or in any ship or vessel;
- the refinancing of a loan following divorce or the break up of a de facto relationship;
- any mortgage made or given to the WorkCover Authority;

- mortgages given by a council or county council under the *Local Government Act 1993*;

- mortgages given by institutions for the relief of poverty and promotion of education;

- mortgages given by institutions of charitable or benevolent nature, or for the promotion of the interest of Aborigines;

- mortgages given by NSW Aboriginal Land Council (ALC), Regional ALC and Local ALC;

- offshore banking units (as defined in *the Income Tax Assessment Act 1936* (Cth)) where a loan is executed for offshore parties;

- mortgages given by tenants of the Department of Housing, the Aboriginal Housing Office or from the Community Housing Program who, in purchasing the real property, obtain not less than 25 per cent of the beneficial ownership of land and who intend to use the land as their principal place of residence;

- mortgages granted by a non-profit organisation in conjunction with a lease not subject to duty, the purpose of which is to provide accommodation to an aged or disabled person;

- mortgages by public hospitals;

- mortgages under the *Liens on Crops and Wool and Stock Mortgage Act 1898*;

- an agricultural goods mortgage under the *Security Interests in Goods Act 2005*;

- a mortgage that secures an amount advanced by an employer or a related body corporate of an employer to an employee of the employer, to finance a purchase by the employee of shares in the employer, or a related body corporate of the employer, if the amount advanced (and the total of all advances that the mortgage secures) does not exceed $16,000;

- agencies within the meaning of the Convention on the Privileges and Immunities of the Specialised Agencies approved by the General Assembly of the United Nations in 1947;

- mortgages by clearing houses of the Sydney Futures Exchange and Australian Options Market that do not secure an advance;

- a document that becomes a mortgage if the mortgage is executed for the purposes of certain money market operations;

- a charge over land that is created under an agreement for the sale or transfer of the land if any part of the deposit or balance of the purchase price for the land is paid to the vendor (or as the vendor directs) before completion of the sale or transfer; and

- an advance to a natural person or a strata corporation for the acquisition of farm machinery or a commercial vehicle that is secured by the mortgage.

MARKETABLE SECURITIES DUTY

The benchmark is defined as the turnover (sale price *x* quantity traded) of shares that are not quoted on the Australian Stock Exchange or a recognised stock exchange. The benchmark tax rate is 60 cents per $100 or part thereof, with the purchaser paying all the duty.

Table B.5: Marketable Securities Duty

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Corporate reconstructions			
An exemption is given for corporate reconstructions provided certain qualifying criteria are satisfied.	64	175	179

Minor Tax Expenditures (< $1 million)

Duty of $10 is charged on the transfer of unquoted marketable securities between the beneficial owner and the trustee or nominee of the beneficial owner.

The following transfers are exempt:

- transfers of units in a unit trust where the purpose is to give effect to a merger or takeover of qualifying unit trusts;

- share buy-backs by NSW companies;

- mining companies whose operations relate solely to New South Wales if the consideration for the transfer or agreement is not less than the unencumbered value of the marketable securities;

- transfers to parties outside a marriage where the transfer is pursuant to an order of the Family Court of Australia; and

- certain transfers of shares by superannuation funds to and from a Pooled Superannuation Fund.

MOTOR VEHICLE REGISTRATION DUTY

The benchmark taxable activity is defined as the purchase of a new vehicle and the subsequent transfer of the vehicle. The benchmark tax rate is $3 per $100 or part thereof for vehicles valued to $45,000 and $1,350 plus $5 per $100 or part thereof for passenger vehicles valued above $45,000.

Table B.6: Motor Vehicle Registration Duty

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Local councils			
An exemption is granted for the transfer of registration into the name of a local council, not being for a trading undertaking.	14	11	12
Transfer of ownership after divorce or a breakdown of a defacto relationship			
An exemption is granted for the transfer of registration into the name of one of the parties to a divorce or separation in a de facto relationship.	2	2	2
Transfer of ownership of a deceased registered owner			
An exemption is granted for the transfer of registration to the legal personal representative of a deceased registered owner or the person beneficially entitled to the vehicle in the estate.	7	7	7
New demonstrator motor vehicle			
An exemption is granted for the registration of a motor vehicle to a licensed motor dealer or wholesaler under the *Motor Dealers Act 1974* (NSW).	39	40	42
Extreme Disablement Adjustment and other Disabled War Veterans			
An exemption is provided to war veterans in receipt of a totally and permanently incapacitated (TPI) pension, veterans in receipt of an extreme disablement adjustment pension, an intermediate service pension or 70 per cent or higher of the disability pension from the Department of Veterans Affairs.	2	2	2

Minor Tax Expenditures (< $1 million)

The following are exempt:

- all vehicles registered by non-profit charitable, benevolent, philanthropic or patriotic organisations;
- transfer of vehicles as part of a corporate reconstruction, provided certain qualifying criteria is satisfied;
- vehicles specially constructed for ambulance or mine rescue work;
- vehicles weighing less than 250 kg used for transporting invalids;
- rural lands protection boards; and
- Aboriginal Land Councils within the meaning of the *Aboriginal Land Rights Act 1983* (NSW).

HIRE OF GOODS DUTY

The benchmark is defined as all short-term consumer hiring and other non-finance rentals greater than $14,000 per month, and equipment financing arrangements, including hire purchase arrangements. The benchmark tax rate is 0.75 per cent for equipment financing arrangements, and 1.5 per cent for other hires, with a maximum of $10,000 tax payable for any single arrangement.

There are no major tax expenditures.

Minor Tax Expenditures (< $1 million)

The following are exempt:

- prosthetic items and invalid aids;
- “wet hires” (where equipment is hired with an operator);
- motor vehicles subleased by an employee to an employer;
- gas, water and electricity meters;
- arrangements between related bodies corporate;
- certain arrangements in relation to aircraft, ships and vessels;
- arrangements for the use of goods by a public hospital;

- a credit contract within the meaning of the Consumer Credit (New South Wales) Code;
- books;
- on-site caravans;
- arrangements with traders for displaying or demonstrating goods pending their sale or hire;
- hire of goods as part of a lease or franchise arrangement; and
- where the use of goods is incidental and ancillary to the provision of a service.

LEASE DUTY

The benchmark is defined as any lease of real property with a total rental cost greater than $20,000 per year in New South Wales. The benchmark tax rate is 35 cents per $100 (or part thereof) of the total cost of the lease.

Table B.7: Lease Duty

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Exemption for residential leases			
A residential lease under which a person has a right to occupy premises as a place of residence for a term not exceeding five years is exempt.	n.a.	n.a.	n.a.

Minor Tax Expenditures (< $1 million)

The following are exempt:

- leases on a movable dwelling site (mainly sites in caravan parks and relocatable home parks) used or intended to be used as a place of residence for a term of not more than five years;
- leases executed in accordance with Part 5 of the *National Health Act 1953* (Cth);
- leases executed by an Aboriginal Land Council;

- leases of premises to the Home Care Service of New South Wales; and
- leases (granted by or on behalf of a corporation, society or institution) of residential accommodation for retired and disabled persons.

PAYROLL TAX

The tax benchmark is defined as aggregate annual gross remuneration paid by a single or group taxpayer in excess of a threshold of $600,000. The benchmark tax rate is 6 per cent.

Table B.8: Payroll Tax

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Public hospitals and Area Health Services			
An exemption is granted for remuneration paid by a public hospital or an area health service to a person while engaged in work of a kind ordinarily performed in connection with the conduct of these organisations.	368	396	418
Schools and colleges			
An exemption is granted for remuneration paid by a school or college (other than a technical school or a technical college), that is not carried on by or on behalf of the State of New South Wales, is not for profit and which provides education at or below, but not above, the secondary level of education to a person while engaged in work of a kind ordinarily performed in connection with the conduct of these organisations.	98	108	116
Religious institutions			
An exemption is granted for remuneration paid by a religious institution to a person while engaged in work of a kind ordinarily performed in the conduct of these institutions.	7	8	8
Charitable institutions			
An exemption is granted for remuneration paid by a charitable, benevolent, philanthropic or patriotic institution (other than an instrumentality of the State) to a person while engaged in work of a charitable, benevolent, philanthropic or patriotic nature.	24	26	28

Table B.8: Payroll Tax (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Local councils			
An exemption is granted for remuneration paid by a council or county council, except where wages are paid in connection with a number of trading undertakings, such as supply of electricity, water, sewerage services, gas, the operation of an abattoir or public food market, parking station, cemetery, crematorium, hostel, coal mine or transport service, the supply and distribution of coal, the supply of building materials, a prescribed activity or the construction of any building or work or the installation of plant, machinery or equipment for use in or in connection with any of the activities listed.	152	164	174
Private hospitals and nursing homes			
An exemption is granted for remuneration paid by a non-profit hospital to a person in respect of time when the person is engaged in work of a kind ordinarily performed in connection with the conduct of hospitals.	11	12	13
Home Care Service			
Salaries paid to employees of the Home Care Service are exempt.	7	8	8
Apprentices			
Wages paid to apprentices are exempt from payroll tax.	16	17	18
Trainees			
Wages paid to trainees are exempt from payroll tax.	9	9	9
Redundancy payments			
Bona fide redundancy or approved early retirement scheme payments are exempt.	5	5	5

Minor Tax Expenditures (< $1 million)

The following are exempt:

- wages paid to an employee who is on leave from employment by reason of service in the Defence Forces;
- wages paid to persons employed under the Community Development Employment Project administered by the Aboriginal and Torres Strait Islander Commission;

- wages paid by the Australian-American Educational Foundation;
- wages paid by the Commonwealth War Graves Commission;
- wages paid to members of the official staff by a consular or other non-diplomatic representative of another country or by a Trade Commissioner representing in Australia any other part of Her Majesty's dominions;
- wages paid for a joint government enterprise that has the function of allocating funds for water saving projects;
- wages that would be exempt from the payment of income tax by the employee under paragraph 23(g) of the *Income Tax Assessment Act 1936* (Cth);
- wages paid by the Governor of a State; and
- wages paid to employees while the employees are providing assistance to the State Emergency Services or Rural Fire Brigades (but not in respect of wages paid or payable as recreation leave, annual leave, long service leave or sick leave).

LAND TAX

From midnight on 31 December 2004, the benchmark tax base was defined as the unimproved land value of all land owned (as defined in the *Land Tax Management Act 1956* (NSW)), with the exception of land used for owner-occupied residences, as at 31 December by a person or organisation other than the Commonwealth or NSW Governments. The benchmark tax rates were:

- 1.4 per cent of aggregate land values for non-concessional companies and special trusts; and
- marginal tax rates ranging from 0.4 per cent to 1.4 per cent of aggregate land values for all other land taxpayers.

From midnight on 31 December 2005, the benchmark tax base is defined as the unimproved land value of all land owned (as defined in the *Land Tax Management Act 1956* (NSW)), with the exception of land used for owner-occupied residences, as at 31 December by a person or organisation other than the Commonwealth or NSW Governments that has an unimproved capital value above the threshold for that year. The benchmark tax rate is 1.7 per cent.

From midnight on 31 December 2006, the benchmark tax base will be defined as the average of the last three years unimproved land value of all land owned (as defined in the *Land Tax Management Act 1956* (NSW)), with the exception of land used for owner-occupied residences, as at 31 December by a person or organisation other than the Commonwealth or NSW Governments that has an unimproved capital value above the averaged threshold for that year. The benchmark tax rate will be 1.7 per cent.

Table B9: Land Tax

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Boarding houses for low-income persons			
An exemption is granted for land used by boarding houses which meet approved guidelines, principally that the rent charged is less than the amount prescribed by the Office of State Revenue.	4	3	3
Land used for primary production			
An exemption is granted to land used for primary production purposes. In 2005 the definition was changed to restrict the exemption to situations where the land is used for primary production for the purpose of selling the produce from the land. This new definition excludes some land (such as hobby farms) previously granted the exemption.	342	352	364
Racing clubs			
An exemption is granted for land owned by or held in trust for any club for promoting or controlling horse racing, trotting or greyhound racing which is used primarily for the purposes of the meetings of the above.	7	7	8
Employer and employee organisations			
An exemption is granted for land owned by or held in trust for employer and employee organisations for that part that it is not used for a commercial activity open to members of the public.	2	2	3
Cooperatives			
An exemption is granted for land owned by a co-operative whose objectives are listed under the *Co-operatives Act 1992* (NSW) and whose objectives are listed in Section 7 of that Act.	8	8	9
Public cemeteries and crematoriums			
An exemption is granted for any land used as a public cemetery or crematorium.	12	12	13

Table B9: Land Tax (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Retirement villages			
An exemption is given for land owned and used by retirement villages, and residential parks predominantly occupied by retired persons.	91	93	97
Child care centres			
An exemption is granted for land used as a residential child care centre licensed under the *Children (Care and Protection) Act 1987* (NSW) or a school registered under the *Education Act 1900* (NSW).	4	4	4
Public and private hospitals and Area Health Services			
An exemption is granted for land used by a public hospital (including nursing homes) or Area Health Service.	15	16	16
Early Payment Discount			
A discount of 1.5 per cent on land tax payable is available where the taxpayer pays the whole amount within 30 days after issue of the notice of assessment.	13	15	15
Religious societies			
An exemption is provided for land owned by or in trust for a religious society if the society is carried on solely for religious, charitable or educational purposes.	11	11	11
Place of worship or residence			
An exemption is provided for a place of worship for a religious society, or a place of residence for any clergy or ministers or order of a religious society.	n.a.	n.a.	n.a.
Agricultural showgrounds			
An exemption is granted for land used and occupied for the purpose of holding agricultural shows, or shows of a like nature and owned by, or held in trust for, a society which is established for the purpose of holding such shows not for the pecuniary profit of its members and primarily uses its funds for the holding of such shows.	n.a.	n.a.	n.a.
Friendly societies			
An exemption is granted for any society registered under the *Friendly Societies (NSW) Code*.	n.a.	n.a.	n.a.

Table B9: Land Tax (cont)

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Non-profit societies, clubs and associations			
An exemption is provided where a building (or part thereof) is occupied by a society, club or association not carried on for pecuniary profit.	n.a.	n.a.	n.a.
Charitable and educational institutions			
An exemption is provided for land owned by or in a trust for a charitable or educational institution if the institution is carried on solely for charitable or educational purposes and not for pecuniary profit.	n.a.	n.a.	n.a.
Public gardens, recreation grounds and reserves			
An exemption is provided for land used as a public garden, public recreation ground or public reserve.	n.a.	n.a.	n.a.
Sporting clubs			
An exemption is provided for land owned by or in a trust for any club or body of persons where the land is used primarily for the purpose of a game or sport and not used for pecuniary profit of the members of that club or body.	n.a.	n.a.	n.a.
Sydney Light Rail			
An exemption is provided in respect of the land occupied by the Sydney Light Railway.	n.a.	n.a.	n.a.
Land owned and used by a local council	n.a.	n.a.	n.a.

Minor Tax Expenditures (< $1 million)

- concessions for land subject to heritage orders.

The following are exempt:

- certain public trading enterprises;
- low cost accommodation within 5 km of Sydney GPO;
- Marketing of Primary Products Boards, Rural Lands Protection Boards and Agricultural Industry Service committees;
- Aboriginal Land Councils;

- temporary absences from a home, including circumstances where a home has been destroyed due to fire, storm, earthquake, accidental or malicious damage;

- community land development;

- unoccupied flood-liable land;

- land subject to a conservation agreement under the *National Parks and Wildlife Act 1974* or a trust registered under the *Nature Conservation Trust Act 2001*, being in either case an agreement that remains in force in perpetuity;

- land owned, held in trust or leased by the Nature Conservation Trust of NSW, or land subject to a permanent conservation or trust agreement;

- land owned by a joint government enterprise that has the function of allocating funds for water saving projects;

- land used solely as a police station;

- land leased for use as a fire brigade, ambulance or mines rescue station; and

- land owned by RSL (NSW Branch), Anzac House.

VEHICLE WEIGHT TAX

The benchmark is defined as all vehicles intended for on-road use with the exception of Commonwealth Government vehicles, which for constitutional reasons cannot form part of the tax base. The benchmark tax rate is as defined in the *Motor Vehicles Taxation Act 1988 (NSW)* for private and business vehicles.

Table B10: Vehicle Weight Tax

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Selected social security recipients			
An exemption is granted in respect to any motor vehicle owned by holders of pensioner concession cards, Department of Veteran Affairs (DVA) TPI cards and DVA Gold War Widow's cards. Those pensioners must use the vehicle substantially for non-business purposes.	128	134	142
Primary producers			
Primary producer concessions include, for motor vehicles not greater than 4.5 tonnes of gross vehicle mass, private rates rather than business rates for cars and station wagons and 55 per cent of business rates for trucks, tractors and trailers.	19	20	21
General purpose plant			
Concessions are provided for machines that cannot carry any load other than tools and accessories necessary for the operation of the vehicle.	16	17	18
Roadwork equipment – owned by local government			
An exemption is granted to any motor vehicle or plough, bulldozer, mechanical scoop or shovel, road grader, road roller or similar machinery that is owned by a local council within the meaning of the *Local Government Act 1993* and which is used for the purposes of road construction, road maintenance, road repair, removal of garbage or night soil, bush fire fighting, civil defence work or to any roller, lawn mower or similar machinery used solely or principally for the rolling or maintenance of tennis courts, cricket pitches, lawns or pathways.	5	5	5
Federal government authorities			
Any motor vehicle that is leased to a Commonwealth authority and registered under Section 16, Part 3, (2) (d) of *Commonwealth Vehicles (Registration and Exemption from Taxation) Act 1997*.	2	2	2
Concessions provided under Part 16 and 17 of the *Motor Vehicle Taxation Act 1988*	1	1	1

Minor Tax Expenditures (< $1 million)

- a concessional rate of 55 per cent of business rates (or 30 per cent if outside the Sydney metropolitan area, Newcastle or Wollongong districts) is applied to any motor vehicle that is used solely or principally as a tow truck;
- a concessional rate of 88 per cent is provided for mobile cranes used for private use; and
- a concessional rate of tax is applied to any motor vehicle that is owned by Rural Land Protection Board and is used solely for carrying out the functions of the board.

The following are exempt:

- all vehicles registered by non-profit charitable, benevolent, philanthropic or patriotic organisations authorised under the *Charitable Fundraising Act 1991*;
- any motor vehicle that is used principally as an ambulance except government owned;
- motor vehicles used by the State Emergency Services except government owned;
- any motor vehicle on which a trader's plate is being used in accordance with the *Road Transport (Vehicle Registration) Act 1997* (NSW) or the regulations under that Act;
- any motor vehicle that is owned by Aboriginal Land Council; and
- motor vehicles in the name of Consular Employees and Trade Missions.

DRIVERS' LICENCES

The benchmark is considered to be the licensing of all persons to drive a vehicle in New South Wales on public roads. The benchmark tax rates in 2005-06 were $40 for a one-year licence, $98 for a three-year licence and $132 for a five-year licence.

Table B11: Drivers' Licences

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Selected social security recipients[1]			
An exemption is granted to any licence holder who also holds a pensioner concession card, Department of Veteran Affairs (DVA) TPI card, or DVA Gold War Widows Card and who can provide evidence that their income is below a certain level or can provide a DVA letter regarding their disability rate. The vehicle owned by the licence holder must be used substantially for social or domestic purposes.	45	31	13

VEHICLE TRANSFER FEES

The benchmark is considered to be all transfers of previously registered vehicles. From 1 July 2005 the benchmark rate is $24 for individuals and motor dealers.

There are no major tax expenditures.

Minor Tax Expenditures (< $1 million)

The following are exempt:

- consignees;
- beneficiaries under wills;
- executors and administrators of deceased estates;
- vehicles awarded in court decisions;
- representatives of unincorporated organisations; and
- adding/removing a trading name.

[1] *Profile of estimates is due to the renewal pattern of three and five year driver's licences.*

MOTOR VEHICLE REGISTRATION FEES

The benchmark is defined to be all vehicles intended for on-road use. The benchmark tax rate in 2005-06 was $49 for most motor vehicles, $213 for trucks with a mass of 5 tonnes or more and $377 for articulated trucks.

Table B12: Motor Vehicle Registration Fees

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Selected Social Security Recipients			
Holders of pensioner concession cards, Department of Veteran Affairs (DVA) TPI Cards, and DVA Gold War Widows Cards (based on income or based on disability pension rate) are exempt.	31	32	33

Minor Tax Expenditures (< $1 million)

- exemption for Mobile Disability Conveyance.

GAMBLING AND BETTING TAXES

The only areas where a different tax treatment is provided to essentially the same activity are in respect of gaming machines in hotels and registered clubs and the taxation of totalisators operated by racing clubs.

The benchmark for gaming machines in hotels and registered clubs is defined to be the rates of taxation applying to hotels, which vary from 5.8 per cent to 33.6 per cent (annual rates from 1 July 2004), 5.7 per cent to 36.4 per cent (annual rates from 1 July 2005) or 5.5 per cent to 39.1 per cent (annual rates from 1 July 2006) depending on the level of annual profits from gaming machines.

The benchmark for totalisators is a tax rate of 19.11 per cent of player loss.

Table B13: Gambling and Betting Taxes

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Club gaming machines			
Poker machines installed in clubs registered under the *Registered Clubs Act 1976* are taxed at lower rates than poker machines installed in hotels.	482	488	487

Minor Tax Expenditures (< $1 million)

- A full rebate of tax is provided to racing clubs operating non-TAB Ltd pools.

PARKING SPACE LEVY

The benchmark is defined as off-street parking spaces in either Category one areas (City of Sydney (as at 8 May 2003), North Sydney and Milsons Point business districts) or Category two areas (Chatswood, Parramatta, St Leonards and Bondi Junction business areas).

The benchmark levy is indexed annually to movements in the Sydney CPI over the year to the previous March quarter. For 2005-06 the benchmark levy was $880 per space in Category one areas and $440 per space in Category two areas.

Table B14: Parking Space Levy

Major Tax Expenditures	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
General exemptions and concessions in all regions			
An exemption from the levy is granted to parking spaces for bicycles or motor cycles, parking of a motor vehicle by a person resident on the same premises, parking of a motor vehicle for the purpose of loading or unloading goods or passengers, parking of a vehicle by a person who is providing services on a casual basis, parking of a vehicle while a disabled person's parking authority is displayed, parking without charge of a motor vehicle on premises owned or occupied by the council of the local government area, parking without charge of a motor vehicle on premises owned or occupied by a religious body or religious organisation, parking without charge of a motor vehicle on premises owned or occupied by a public charity or public benevolent institution, ambulance, fire brigade motor vehicle or police motor vehicle but only if used for garaging the vehicle overnight, parking without charge of a mobile crane, a forklift truck, a tractor or a front end loader, and parking without charge of a vehicle used only for carrying out deliveries or only for the provision of services, if the space is used for garaging the vehicle overnight on premises occupied by the owner of the vehicle. Concessions are also granted in all areas for certain unlet casual parking spaces and unlet tenant parking spaces.	14	14	14
Exempt parking spaces in Chatswood, Parramatta, St Leonards and Bondi Junction			
Parking spaces for customers attached to retail outlets, hotels, motels, clubs, restaurants, medical centres, car hire and sales, repair and wash establishments and funeral parlours are exempt from the levy.	4	2	2

B.2: DETAILED ESTIMATES OF CONCESSIONS

Details of concessions by function are shown below. Each concession is classified by type and a distinction is drawn between major concessions ($1 million or more) and minor concessions (less than $1 million).

Table B15: Education

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
TAFE Fee concession			
Fees are waived for students with disabilities, ATSI, students of Special Access Courses or students receiving nominated pensions or allowances while the fees for apprentices and trainees have been capped.	58	59	60
School transport subsidy scheme			
RailCorp, State Transit Authority and Sydney Ferries provide eligible students with free transport to and from school. (A similar subsidy to private transport operators is not included here, since it is an outlay from the public sector, and does not reduce public sector revenue.)	70	50	51

Minor Concessions (< $1 million)

- The Department of Primary Industries sells certain publications to schools and libraries at a lower than retail value.

Table B16: Health

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Ambulance service for pensioners			
Free transport by ambulance is provided for holders of pensioner health benefit cards.	85	85	88
Outpatient Pharmaceutical Scheme for Pensioners			
Free pharmaceuticals are provided for holders of pensioner health benefit cards.	2	2	2
Life Support Energy Rebates Scheme			
The Department of Energy, Utilities and Sustainability funds a rebate for energy costs associated with certain life support systems.	2	3	3

Table B17: Social Security and Welfare

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Public transport concessions for pensioners and welfare beneficiaries			
Pensioners, Seniors and welfare beneficiaries travel for less than full fare on RailCorp, State Transit Authority and Sydney Ferries services. (A similar subsidy to private transport operators for concession travel are not included here, since it is an outlay from the public sector, and does not reduce public sector revenue).	222	181	179
Community Transport Scheme			
The scheme subsidises transportation for individuals due to location, isolation, age, disability or factors relating to the time and/or cost of travel.	28	33	30
Spectacles Program			
Free spectacles are provided to people with visual impairment who have low income and assets.	5	4	4
Charitable Goods Transport Subsidy			
Charitable goods transport subsidy provides reimbursement to 22 charitable organisations for the cost of transporting miscellaneous goods such as donated medicines, trauma teddies, non-perishable food, physiotherapy tables and recycled clothing.	2	2	2
Community Interpreting and Translation Service			
The Community Relations Commission funds translation and interpreting services in criminal and family courts for holders of Pensioner Concession Cards.	3	3	3

Table B18: Housing and Associated Amenities

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Local council rates concession			
Local council rates are reduced for holders of Pensioner Concession Cards.	73	75	76
Pensioner Water Rate Concession			
The Department of Energy, Utilities and Sustainability grants holders of Pensioner Concession Cards with a:			
♦ 100 per cent discount on Sydney Water Corporation's (fixed) water service charge, 74 per cent discount on the sewerage charge and 50 per cent discount on the stormwater service charge.			
♦ 50 per cent discount on Hunter Water Corporation's (fixed) water, sewerage and stormwater service charges plus 50 per cent of usage up to a total of $175 per annum, and exemption from payment of the Environmental Improvement Charge.	78	83	88
Exempt Properties Water Rate Concession			
The Department of Energy, Utilities and Sustainability funds a partial discount on Sydney Water Corporation and Hunter Water Corporation charges to owners of properties used by non-profitable community services and amenities (principally local councils and charities).	9	10	10
Backlog Sewage Connection Fee Concession			
The Department of Energy, Utilities and Sustainability funds Sydney Water Corporation and Hunter Water Corporation to connect selected un-sewered areas to the sewerage network, based on public health and environmental priorities.	1	3	1

Table B18: Housing and Associated Amenities (cont)

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Large Family and Financial Hardship Water Concession			
The Department of Energy, Utilities and Sustainability funds Sydney Water Corporation to undertake a range of social programs including the Payment Assistance Scheme for customers in financial hardship and measures to offset recent price rises. The price rise offset measures include free retrofits for large families, a $40 per annum discount on their water bill for large families with a health care card, and no interest loans for efficient appliances for customers in financial hardship.	n.a.	1	1
Septic Pump-Out Fee Concession			
The Department of Energy, Utilities and Sustainability funds a discount on Sydney Water Corporation's septic pump-out fees to residences in the Blue Mountains that are residential-zoned and not connected to the sewerage network.	1	1	1
Energy Accounts Payment Assistance Scheme			
The Department of Energy, Utilities and Sustainability funds an energy rebate (including gas and electricity) for consumers in financial hardship.	8	9	9
Pensioner Energy Subsidy Scheme			
The Department of Energy, Utilities and Sustainability funds an energy rebate for holders of Pensioner Concession Cards. Under the Scheme, eligible pensioners receive a rebate of $112 per annum on their energy bills.	77	79	80
Crown Land Rent Concessions			
Registered charities and not-for profit organisations receive a discount on Crown Land rents.	13	15	15

Minor Concessions (< $1 million)

- Payment Assistance Scheme funded by Hunter Water Corporation for customers in financial hardship.

Table B19: Recreation and Culture

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Department of Environment and Conservation - Free or Discounted Entry to National Parks			
Holders of Pensioner Concession Cards, Seniors, Volunteers and Community Groups receive free or discounted entry to National Parks.	3	6	8

Minor Concessions (< $1 million)

- Maritime Authority of NSW – concessional boat licence, registration and mooring fees for pensioners;
- Royal Botanic Gardens – concessional admission charges for pensioners and Seniors Cardholders for entry to the Tropical Centre, Mount Annan and Mount Tomah Botanic Gardens;
- Historic Houses Trust – concessional admission charges for unemployed, children, pensioners, seniors and students;
- Australian Museum – concessional admission charges for entry to special exhibitions for students, the unemployed and holders of pensioner health care cards, free general admission to seniors card holders, disadvantaged school students, accompanying adults with school groups, Museum Society members and children under five years old;
- Museum of Applied Arts and Sciences – concessional admission charges for children, students, pensioners, seniors and the unemployed. Country residents are entitled to a concession on the Museum's household membership. Concessional rates for venue hire apply to community or charitable groups;
- Sydney Opera House – concessional charges on guided tours for children, pensioners, seniors, students and school group tours; and
- Art Gallery – concessional admission charges for entry to special exhibitions for the unemployed, children, pensioners, seniors, students and school groups.

Table B20: Agriculture, Forestry and Fishing

Major Concessions	*2004-05 $m*	*2005-06 $m*	*2006-07 $m*
Recreational fishing fee concession			
Pensioners and children are exempt from the recreational fishing fee.	4	4	4

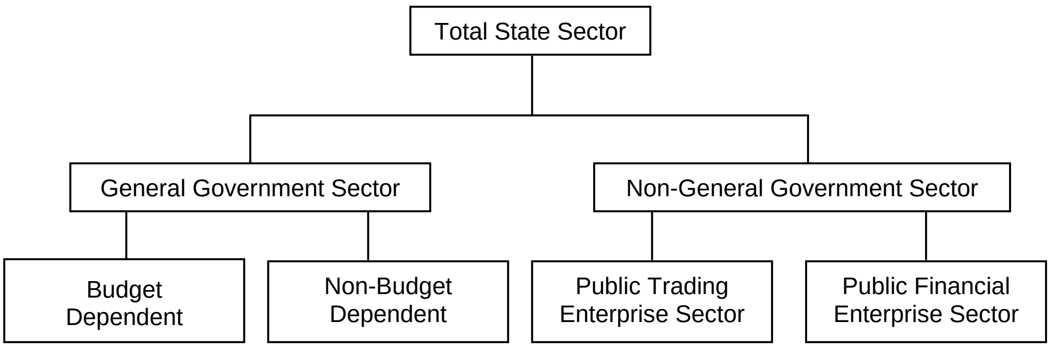
Minor Concessions (< $1 million)

- Forests NSW provides pensioner discounts on firewood permits for the collection of firewood and discounts to charitable organisations on the purchase of Christmas trees.

APPENDIX C: TOTAL STATE SECTOR AND CLASSIFICATION OF AGENCIES

In accordance with the Government Finance Statistics framework all entities controlled by the NSW Government are classified as being in either the general government sector or the non-general government sector.

Figure C.1: Structure of the Total State Sector



Budget Dependent – Includes:
- Department of Health
- Department of Education and Training
- Roads and Traffic Authority
- NSW Police

Non-Budget Dependent – Includes:
- Registry of Births, Deaths & Marriages
- Workers' Compensation (Dust Diseases) Board
- WorkCover Authority

Public Trading Enterprise Sector – Includes:
- Energy generation, transmission and distribution corporations
- Rail Corporation New South Wales
- Sydney and Hunter Water Corporations
- Department of Housing

Public Financial Enterprise Sector – Includes:
- NSW Treasury Corporation

General government agencies typically deliver public services or are regulatory in nature. There are both budget dependent and non-budget dependent general government agencies which operate under Treasury's financial management framework. Budget dependent agencies receive an appropriation from the Consolidated Fund. Non-budget dependent agencies source funds from regulatory and user charges and in some cases a grant from another budget sector agency.

Non-general government agencies are generally commercially focussed entities and include public trading enterprises (PTEs) and public financial enterprises (PFEs). They operate under the Government's Commercial Policy Framework which aims to replicate disciplines and incentives that lead private sector businesses towards efficient commercial practices. The commercial agencies in this sector generally pay dividends and tax equivalent payments to the general government sector, in accordance with normal commercial principles.

Some PTEs address important social objectives and provide services to client groups on a subsidised basis. These include Rail Corporation New South Wales and the Department of Housing, which receive substantial grants from the general government sector to provide these services.

The following table lists all material entities controlled by the NSW Government and the sector in which they are classified.

Table C.1: Classification of Agencies

Agency/Activity	*ABS[1] Category*		*Funding Category[4]*	
	General Government[2]	*Public Trading Enterprise[3]*	*Budget Dependent*	*Non Budget Dependent*
Aboriginal Affairs, Department of	•		•	
Aboriginal Housing Office	•			•
Ageing, Disability and Home Care, Department of	•		•	
Art Gallery of New South Wales	•			•
Arts, Sport and Recreation, Department of the	•		•	
Attorney General's Department	•		•	
Audit Office of New South Wales	•			•
Australian Museum	•			•
Births, Deaths and Marriages, Registry of	•			•
Board of Studies, Office of the	•		•	
Building and Construction Industry Long Service Payments Corporation	•			•
Cabinet Office	•		•	
Casino Control Authority	•		•	
Catchment Management Authorities	•			•
Centennial Park and Moore Park Trust	•			•
Children, Office for	•		•	
City West Housing Pty Ltd		•		•
Coal Compensation Board	•		•	
Commerce, Department of	•		•	
Community Relations Commission	•		•	
Community Services, Department of	•		•	
Corrective Services, Department of	•		•	
Country Energy		•		•
Crime Commission, New South Wales	•		•	
Crown Finance Entity	•		•	
Crown Land Development		•		•
Crown Land Homesites		•		•
Crown Leaseholds Entity	•			•
Crown Property Portfolio	•			•

Agency/Activity	ABS[1] Category		Funding Category[4]	
	General Government[2]	*Public Trading Enterprise[3]*	*Budget Dependent*	*Non Budget Dependent*
Delta Electricity		•		•
Education and Training, Department of	•		•	
Electricity Tariff Equalisation Ministerial Corporation	•			•
EnergyAustralia		•		•
Energy, Utilities and Sustainability, Department of	•		•	
Environment and Conservation, Department of	•		•	
Environmental Trust	•		•	
Eraring Energy		•		•
Film and Television Office, New South Wales	•			•
Fire Brigades, New South Wales	•		•	
Food Authority, NSW	•			•
Growth Centres Commission	•			•
Health Care Complaints Commission	•		•	
Health, Department of (including Area Health Services, Ambulance Service of NSW, Corrections Health Service and Westmead Children's Hospital)	•		•	
Historic Houses Trust of New South Wales	•			•
Home Care Service of New South Wales	•			•
Home Purchase Assistance Fund	•			•
Honeysuckle Development Corporation	•			•
Housing, Department of		•		•
Hunter Water Corporation		•		•
Independent Commission Against Corruption	•		•	
Independent Pricing and Regulatory Tribunal	•		•	
Independent Transport Safety and Reliability Regulator	•		•	
Integral Energy		•		•
Judicial Commission of New South Wales	•		•	
Juvenile Justice, Department of	•		•	
Land and Property Information New South Wales	•			•
Landcom		•		•
Lands, Department of	•		•	
Legal Aid Commission of New South Wales	•		•	

Agency/Activity	ABS[1] Category		Funding Category[4]	
	General Government[2]	*Public Trading Enterprise*[3]	*Budget Dependent*	*Non Budget Dependent*
Legislature, The	•		•	
Liability Management Ministerial Corporation	•			•
Local Government, Department of	•		•	
Lotteries Corporation, New South Wales		•		•
Luna Park Reserve Trust	•			•
Macquarie Generation		•		•
Maritime Authority of New South Wales	•			•
Minister administering the Environmental Planning and Assessment Act	•			•
Motor Accidents Authority	•			•
Museum of Applied Arts and Sciences	•			•
Natural Resources Commission	•		•	
Natural Resources, Department of	•		•	
Newcastle Port Corporation		•		•
NSWbusinesslink	•			•
Ombudsman's Office	•		•	
Parramatta Stadium Trust		•		•
Payments to Other Government Bodies Under the Control of the Minister	•		•	
Planning, Department of	•		•	
Police Integrity Commission	•		•	
Police, Ministry for	•		•	
Police, NSW	•		•	
Port Kembla Port Corporation		•		•
Premier's Department	•		•	
Primary Industries, Department of	•		•	
Public Prosecutions, Office of the Director of	•		•	
Public Trustee NSW	•			•
Rail Corporation New South Wales		•		•
Rail Infrastructure Corporation		•		•
Redfern-Waterloo Authority	•			•
Rental Bond Board	•			•
Residual Business Management Corporation		•		•
Roads and Traffic Authority	•		•	
Royal Botanic Gardens and Domain Trust	•		•	
Rural Assistance Authority	•		•	
Rural Fire Service, Department of	•		•	
Self Insurance Corporation, NSW	•			•

Agency/Activity	ABS[1] Category		Funding Category[4]	
	General Government[2]	Public Trading Enterprise[3]	Budget Dependent	Non Budget Dependent
State and Regional Development, Department of	•		•	
State Electoral Office	•		•	
State Emergency Service	•		•	
State Forests of New South Wales		•		•
State Library of New South Wales	•			•
State Property Authority	•			•
State Rail Authority		•		•
State Records Authority	•			•
State Sports Centre Trust	•			•
State Transit Authority		•		•
State Water Corporation		•		•
Stormwater Trust	•			•
Superannuation Administration Corporation	•			•
Sydney 2009 World Masters Games Organising Committee		•		•
Sydney Catchment Authority		•		•
Sydney Cricket and Sports Ground Trust		•		•
Sydney Ferries		•		•
Sydney Harbour Foreshore Authority		•		•
Sydney Olympic Park Authority	•		•	
Sydney Opera House		•		•
Sydney Ports Corporation		•		•
Sydney Water Corporation		•		•
Teacher Housing Authority of New South Wales		•		•
TransGrid		•		•
Transport, Ministry of	•		•	
Transport Infrastructure Development Corporation		•		•
Transport Safety Investigations, Office of	•		•	
Treasury	•		•	
Waste Recycling and Processing Corporation		•		•
Wollongong Sports Ground Trust		•		•

Agency/Activity	*ABS[1] Category*		*Funding Category[4]*	
	General Government[2]	*Public Trading Enterprise[3]*	*Budget Dependent*	*Non Budget Dependent*
WorkCover Authority	•			•
Workers' Compensation (Dust Diseases) Board	•			•
Zoological Parks Board of New South Wales		•		•

Notes:

(a) This table only includes those agencies which have had information collected directly from them for the budget papers. Other agencies not specifically listed may be incorporated within other agencies.

(b) The NSW Treasury Corporation, the Fair Trading Administration Corporation and the controlled FANMAC Trusts, all public financial enterprises, provide data that is included in these Budget Papers.

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[1] *Australian Bureau of Statistics*

[2] *Equates to the scope of the Budget in New South Wales.*

[3] *The public trading enterprise or PTE sector is also referred to by the ABS as the public non financial corporations (PNFC) Sector.*

[4] *Based on reliance on Consolidated Fund allocations.*

APPENDIX D: 2005-06 BUDGET - SUMMARY OF VARIATIONS

Category/Agency	Budget	Revised	Variation	Comment on Major Variations
	$m	$m	$m	
STATE REVENUES				
Taxation				
Stamp Duty:				
Vendor Duty	358	93	(265)	Vendor Duty abolished for transactions entered into on or after 2 August 2005.
Transfer duty	3,250	3,100	(150)	Weaker than expected property market.
Mortgage Duty	379	320	(59)	Impact of weaker than expected property market on secured lending.
Motor Vehicle Registrations	608	550	(58)	Lower than expected new vehicle registrations.
Government guarantee of debt levy	129	98	(31)	Revised methodology for calculating the payments from commercial entities.
Gaming and Racing Taxes	1,168	1,147	(21)	Lower than expected hotel gaming revenues.
Land Tax	1,633	1,737	104	Land value increases partly offset by increase in threshhold.
Other Duties and Taxes	8,744	8,767	23	Aggregated net minor variations.
Total Taxation	**16,269**	**15,812**	**(457)**	
Commonwealth Grants				
General Purpose:				
GST Revenue Grants	10,410	10,281	(129)	Downward revision to Commonwealth's estimate of GST revenues.
Budget Balancing Assistance Payments	...	44	44	GST Revenue fell below the Guaranteed Minimum Amount. Payment was required to ensure that NSW was not worse off as a result of GST-related tax reforms.
National Competition Payments	265	292	27	Restoration of previously suspended payments.
Specific Purpose:				
Rural Assistance Authority	28	180	152	Additional funding for drought relief and associated exceptional circumstances.
Education and Training	1,285	1,378	93	Mainly additional funding for vocational education programs and the Commonwealth's decision in May 2006 to bring forward $55 million in funding for its "investing in schools" program.

Category/Agency	*Budget*	*Revised*	*Variation*	*Comment on Major Variations*
	$m	*$m*	*$m*	
Roads & Traffic Authority	497	519	22	Increased funding for national highways development and related projects.
Other	4,311	4,333	22	Aggregated net minor variations.
Total Commonwealth Grants	**16,796**	**17,027**	**231**	
Dividends and Tax Equivalent Payments	**1,906**	**1,782**	**(124)**	Mainly lower revenue in the Water Sector due to drought and decrease in developer contributions with weakening property market.
Fines, Regulatory Fees & Other				
Mining Royalties and Exploration Licence Fees	416	496	80	Increased royalties as a result of higher than expected coal prices.
Other	666	707	41	Aggregated net minor variations.
Total Fines, Regulatory Fees & Other	**1,082**	**1,203**	**121**	
TOTAL STATE REVENUES	**36,053**	**35,824**	**(229)**	
OPERATING REVENUES				
Sales of Goods and Services				
Agencies did not have significant variations				
Total Sales of Goods and Services	**2,851**	**2,841**	**(10)**	
Investment Income				
NSW Self Insurance Corporation	395	775	380	Higher than projected financial market returns.
Building and Construction Industry Long Service Leave Payments Corporation	29	76	47	Higher than projected financial market returns.
Department of Health	42	60	18	Higher than projected financial market returns.
Other	505	539	34	Aggregated net minor variations.
Total Investment Income	**971**	**1,450**	**479**	

Category/Agency	Budget	Revised	Variation	Comment on Major Variations
	$m	$m	$m	
Grants and Contributions				
Department of Energy, Utilities and Sustainability	29	133	104	Increased Local Water Utilities' contributions to the Country Towns Water & Sewerage Supply Program and establishment of the Energy & Water Savings Funds (and associated expenditure against each program).
Other	609	646	37	Aggregated net minor variations.
Total Grants and Contributions	**638**	**779**	**141**	
Other Revenue				
Crown Leaseholds	42	1	(41)	The agency receives transfers of lands from Reserve Trusts for lease to other Government agencies or for private or commercial purposes. High levels of transfers in 2004-05 were not continued in 2005-06.
Other	305	325	20	Aggregated net minor variations.
Total Other Revenue	**347**	**326**	**(21)**	
TOTAL OPERATING REVENUES	**4,807**	**5,396**	**589**	
EXPENSES				
Ministry of Transport	2,968	3,277	309	Includes additional funding for concessions for community groups, extension of the Bus Reform program to outer metropolitan areas and upgrade of restricted rail lines. Also additional grants to Rail Infrastructure Corporation (debt repayment and restructure costs), Railcorp (debt repayment) and Transport Infrastructure Corporation (debt repayment).
Department of Health	10,301	10,496	195	Includes higher salary costs for Staff Specialists and Medical Radiation Scientists flowing from new award increases and conditions, capital project costs reclassified as expenses, and drug and alcohol policy and other functions transferred from other agencies. Also additional funding for elective surgery for long wait patients, mental health research and capital grants, patients treated in other states, and for Commonwealth programs, (for example immunisation).

Category/Agency	Budget	Revised	Variation	Comment on Major Variations
	$m	$m	$m	
EXPENSES (cont)				
Rural Assistance Authority	33	202	169	Reflects increased payments made to farmers for drought relief and related farming initiatives.
Department of Energy, Utilities and Sustainability	278	335	57	Increased expenditure by Local Water Utilities from higher contributions to the Country Towns Water & Sewerage Supply Program and from the newly established Energy & Water Savings Funds.
Department of Natural Resources	248	305	57	Mainly funding to support the restructure of forestry industry at Brigalow and Nandewar, and also to meet an operating shortfall.
NSW Police	1,666	1,712	46	Mainly costs associated with training of additional police recruits, saturation policing of beaches and security provisions for the 2007 APEC conference.
Department of the Arts, Sports and Recreation	211	255	44	Mainly additional funding for the Sydney Opera House Trust to facilitate essential maintenance work plus a grant to assist in the redevelopment of Kogarah Oval.
Department of Primary Industries	298	339	41	Includes additional funding for the continuation of drought assistance and increased operating expenses.
Department of Education and Training	8,471	8,501	30	Mainly reflecting additional costs associated with award increases.
Businesslink	106	129	23	Mainly accelerated depreciation expense and employee costs associated with providing additional client services.
NSW Self Insurance Corporation	1,097	747	(350)	Mainly downward revision in outstanding claims as actuaries recognise recent favourable claims experience primarily due to the effectiveness of Workers Compensation and Tort Reform legislation.
Crown Finance Entity	3,671	3,351	(320)	Includes reduction in superannuation expenses due to lower than expected interest rates and lower interest expense due to reduced borrowings.
Roads & Traffic Authority	2,236	2,155	(81)	Mainly a realignment of maintenance work to fund additional capital works undertaken due to favourable weather conditions and reclassification of expenses to capital expenditure, offset by an increase in depreciation arising from the increased capital program.

Category/Agency	Budget	Revised	Variation	Comment on Major Variations
	$m	$m	$m	
EXPENSES (cont)				
Catchment Management Authorities	188	149	(39)	Slower than expected progress in contracting and commencing a number of more complex conservation and sustainability programs.
Treasurer's Advance	175	...	(175)	Increased expenses included in agency data.
Other	8,610	8,623	13	Aggregated net minor variations.
TOTAL EXPENSES	**40,557**	**40,576**	**19**	
BUDGET RESULT - SURPLUS/(DEFICIT)	**303**	**644**	**341**	
Capital Expenditure (Including finance lease acquisitions)				
Roads and Traffic Authority	1,191	1,339	148	Includes additional works funded from increased Commonwealth grants and motor vehicle revenues, and also reclassification of expenses to capital expenditure.
Aboriginal Housing Office	7	30	23	Grant funding for Aboriginal housing reallocated to direct purchase by AHO.
Ministry of Transport	11	28	17	Development of equipment for the Integrated Ticketing Project.
Crown Property Portfolio	35	50	15	Cost increases for the Parramatta Justice Precinct due to initial underestimation by quantity surveyors.
Department of Health	646	591	(55)	Mainly capital project costs reclassified as expense.
Crown Finance Entity	95	47	(48)	Discontinuation of motor vehicle acquisition by finance lease.
Department of Corrective Services	165	120	(45)	Delays in procurement on the Long Bay Hospital Redevelopment project and other smaller projects.
Department of Education and Training	482	445	(37)	Mainly delays in major construction works at schools.
Treasurer's Advance	95	...	(95)	Increased expenditure included in agency data.
Other	1,098	1,138	40	Aggregated net minor variations.
Total Capital Expenditure	**3,825**	**3,788**	**(37)**	

Category/Agency	*Budget*	*Revised*	*Variation*	*Comment on Major Variations*
	$m	*$m*	*$m*	
Depreciation				
Crown Property Portfolio	...	15	15	Creation of restoration assets (remediated BHP sites).
Roads and Traffic Authority	718	731	13	Additional assets created through increased capital program.
Education and Training	306	315	9	The broadband assets originally intended to be depreciated over ten years are now being written off over five years.
Other	1,063	1,089	26	Aggregated net minor variations.
Total Depreciation	**2,087**	**2,150**	**63**	
Asset Sales				
Department of Education and Training	87	25	(62)	Deferral of the sale of Vaucluse High School and various other assets.
Other Asset Sales & Movements	460	458	(2)	Aggregated net minor variations.
Total Asset Sales	**547**	**483**	**(64)**	
Other Movements in Non-Financial Assets	**91**	**80**	**(11)**	
NET LENDING	**(979)**	**(591)**	**388**	

APPENDIX E: STATEMENT OF GOVERNMENT FINANCE STATISTICS AND ACCOUNTING PRINCIPLES AND POLICIES

FINANCIAL STATEMENTS

Chapter 1 of Budget Paper No. 2 presents three Budget financial statements that comply with the accrual based government financial statistics (GFS) principles developed by the Australian Bureau of Statistics:

- Operating Statement;
- Balance Sheet; and
- Cash Flow Statement.

In addition, accrual GFS statements complying with the Uniform Presentation Framework are contained in Chapter 9, and statements complying with Australian Accounting Standards (AAS) are contained in Appendix A. Australian Accounting Standards have recently been updated to include Australian Equivalents to International Financial Reporting Standards (AEIFRS), so a reference to Australian Accounting Standards includes a reference to AEIFRS.

GFS Based Reports

The Budget result is defined to be equal to the GFS net operating result. The net operating result represents the amount by which the annual operations of government increase or reduce net worth[1]. In arriving at the net operating result, depreciation (or the cost of wear and tear of agencies' assets arising from the delivery of services) is taken into account.

[1] *Other factors influence the change in net worth such as asset revaluations, equity restructure payments from PTEs, and direct adjustments to accumulated funds on adopting new or amended accounting standards.*

Under GFS reporting a further fiscal aggregate is the net lending result. It represents the balance available to reduce general government sector net financial liabilities. Consequently, the net lending result broadly approximates the movement in net financial liabilities, and links closely with the Government's focus on balance sheet management.

The principal difference between the Budget result (GFS based net operating surplus) and the net lending result is the treatment of capital. The Budget result includes a depreciation charge while the net lending result excludes depreciation but instead reflects agencies' acquisition and sale of non-financial assets.

The Balance Sheet details the financial assets, non-financial assets and liabilities that comprise the Government's balance sheet. The relevant balance sheet indicators are net debt, net financial liabilities and net worth.

The Government uses a GFS statement, rather than the accounting based version. The key difference is that the former includes an equity investment in the PTE and PFE sectors.

The Cash Flow Statement adopts a GFS format and classification approach with the key focus being the cash surplus/(deficit). The result reflects all payments and receipts on a cash basis. Any accrual transactions included in the Budget result, such as accrued dividends, are removed and replaced with the equivalent cash transactions.

Except for the time series break on the adoption of AEIFRS (from 2005-06), historical GFS data has been restated so that the results are consistent with the basis on which the forward estimates have been prepared.

Where GFS results have been impacted by one-off significant discretionary transactions, an underlying or adjusted result has been provided in these Budget Papers. This is provided to assists users compare time series on a consistent basis.

Accounting based reports

Agency statements in Budget Paper No. 3 and the consolidated statements in Appendix A of this Budget Paper, have been prepared in accordance with Australian Accounting Standards and generally accepted accounting principles.

They include all accrued expenses and revenues and reflect the operating result for general government agencies. This differs from the Budget result in Chapter 1 which is prepared on a GFS basis. GFS has an economic focus and for this reason excludes from the operating result any revenues and expenses that are related to the revaluation of assets or liabilities. These types of revenues and expenses are largely outside the control of governments. This different treatment can result in wide variances in the reported results under the GFS and the AAS approaches.

Examples of revenues or expenses included in the accounting operating result but excluded from the Budget result include:

- superannuation actuarial assessments;
- gains or losses on the sale of assets;
- valuation changes for non-financial assets; and
- gains or losses associated with debt management activities.

While the financial statements included in Appendix A and Budget Paper No. 3 have been prepared under AAS, they do not include the detailed disclosures found in annual audited accounts.

DEPARTURES FROM AUSTRALIAN ACCOUNTING STANDARDS AND GFS

Under the *Public Finance and Audit Act 1983*, the Treasurer is required to present a statement that discusses the nature of and the reasons for any departure from AAS, and from any GFS principles.

Departures from Australian Accounting Standards and Principles

The Budget preparation departs from Australian Accounting Standards as follows:

- the WorkCover Scheme Statutory Funds have not been consolidated because they are regulated, but not controlled by the NSW Government. This treatment has been confirmed in three separate legal opinions provided by the Crown Solicitor's Office since 1996, including advice given on the matter by the NSW Solicitor General. Despite these opinions the Auditor-General has qualified his recent Independent Audit Report for the 2004-05 Total State Sector Accounts, because he is of the opinion that the State has the capacity to dominate decision making in relation to the scheme's financial and operating policies;

- certain reserve trusts created under the *Crown Lands Act, 1989* have been excluded. There are approximately 37,000 Crown reserves in New South Wales. Some of these reserves are managed by the NSW Government and others by local governments and trusts. A project has commenced to identify and value Crown reserves controlled by the NSW Government. The likely value of the reserves controlled by the NSW Government cannot be estimated with any certainty. First estimates based on preliminary data are that the total value of these reserves may be between $1 billion and $7 billion. However, the total value may even be outside of this range. The NSW Government will recognise the value of Crown reserves it controls in future Total State Sector Accounts once this project is complete. The Auditor-General has also qualified his opinion on the 2004-05 Total State Sector Accounts. In his opinion, "Australian Accounting Standard AAS 31 *Financial Reporting by Governments* requires the fair value of the Reserves to be recognised because the State has the capacity to benefit from their use and can regulate the access of others to that benefit.";

- the presentation in Budget Paper No. 3, of agency Operating Statements, is more concise than required under accounting standards. The Budget Paper No. 3 presentation has been prepared to focus on agency operations and their net cost of services. Therefore Operating Statements exclude government contributions that are normally required under accounting standards.

  Further, the recent adoption of AEIFRS requires a new primary financial statement, the Statement of Changes in Equity, which reports on non-operating movements in equity such as changes in reserves and direct equity adjustments from adopting new accounting standards. There is no disclosure in Budget Paper No.3 of agency *Changes in Equity*, as most agencies have minimal equity changes, aside from their operating results; and

- AEIFRS require that comparative financial information be restated in accordance with the new standards. Throughout the 2006-07 Budget Papers, information for the 2004-05 and previous financial years has not been restated on an AEIFRS basis:

  - 2003-04 and earlier year financial information is not available on an AEIFRS basis.

  - For 2004-05, the information presented is on a pre-AEIFRS basis, which is consistent with the presentation in the 2004-05 Budget Papers and in the 2004-05 audited financial reports.

Departures from GFS Principles

The Budget as summarised in Chapter 1 of Budget Paper No. 2 has been prepared in accordance with GFS principles except as discussed below:

- the Australian Bureau of Statistics requires that selected payments that pass through the State's accounts e.g. transfer payments for non-government schools from the Commonwealth, be included in the Operating Statement and Cash Flow Statement. Reports in the Budget Papers exclude these receipts and payments as the NSW Government has no control over them;

- GFS requires the general government sector to record an investment in the equity of the PTE and PFE sectors. The equity investment has been excluded from the general government's net financial liabilities as the investment is supported largely by physical infrastructure and in practical terms is not in the true nature of a financial asset;

- GFS Operating Statements disclose a reconciliation from the Net Operating Result to Net Lending. As the Budget is prepared on a Net Operating Result basis, this additional reconciling information (on the Net Acquisition of Non-Financial Assets) has not been reported in the Chapter 1 Operating Statement. However, the relevant information is available for users in Chapter 9 of Budget Paper No.2; and

- current GFS principles as followed by the ABS statistical standards require a premium on a loan to be classified as a negative interest payment in the year the loan is raised. New South Wales disagrees with this approach since it results in an asymmetric treatment with discounts on loans that are treated as a balloon interest payment on the maturity of the loan.

  Whilst strict accordance with GFS standards requires the ABS approach to be adopted, the ABS has recognised the accounting difficulties of this approach. Given this, a compromise has been reached which involves all jurisdictions and the ABS departing from GFS principles and recording the premium as a negative interest payment in the final year of the loan.

The first three of the above four transactions have, however, been treated in accordance with GFS principles in Chapter 9, *Government Finance Statistics and Uniform Reporting Framework.*

Budget Scope

The Budget incorporates all general government sector agencies as defined by the Australian Bureau of Statistics (ABS) subject to a materiality threshold. A list of NSW public sector agencies (classified according to sector) appears in Appendix C.

The general government sector covers all agencies that receive parliamentary appropriations or are regulatory in nature.

Defining the budget sector as equal to the general government sector improves transparency and accountability by providing:

- a comprehensive picture of the non-commercial operations of the Government; and
- an independent definition of the Budget's scope.

The financial transactions of public financial enterprise (PFE) sector and public trading enterprise (PTE) sector agencies are not generally reflected in the Budget aggregates.

However, there are two exceptions to the above which the Budget aggregates do include. These are:

- explicit payments for "social programs", which are non-commercial functions required of public trading enterprises by the Government; and
- dividends, tax equivalent payments and guarantee fees payable by the public trading and financial enterprise sectors which are shown as revenues in the general government sector.

Another important measure of the Government's performance is how the Government is managing the total state sector balance sheet. Chapter 4 *Assets, Liabilities and Net Worth* includes commentary on the management of total state sector financial assets and liabilities, including net debt and superannuation liabilities.

Similarly, Chapter 9 *Government Finance Statistics and Uniform Reporting Framework* includes information presented on a GFS format for the general government sector, the public trading enterprise sector, and the non-financial public sector. This fulfils uniform presentation framework requirements agreed between the Commonwealth and state governments.

APPENDIX F: GLOSSARY

APPROPRIATION

This is the process by which monies are allocated by Parliament to Ministers for the purposes of funding agencies to provide goods and services to the public.

AVERAGE STAFFING

Represents the number of staff engaged on outputs produced by a program. It is an estimate of annual average staffing, including temporary and short term ‘casual’ staffing, expressed on an equivalent full-time basis.

AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (AEIFRS)

Australia adopted International Accounting Standards from reporting periods beginning on or after 1 January 2005, hence ‘Australian Equivalent’. In addition, the Australian Accounting Standards Board (AASB) has committed to harmonise Government Finance Statistics (GFS) reporting with Accounting Standards as a priority for the public sector.

BUDGET DEPENDENT AGENCIES

These agencies receive an appropriation from the Consolidated Fund. This is their predominant funding source (rather than user charges or other revenues).

BUDGET RESULT

Is equal to the GFS net operating result and represents the difference between the full cost of general government service delivery (excluding capital expenditure) in the year and the revenues earned by the Government in the year.

CONSOLIDATED FUND

The main banking account of the Government. In the main it records:

- taxes, fines, fees collected;
- commonwealth grants;
- dividends and tax equivalent payments from public trading and public financial enterprises; and
- recurrent and capital appropriations to agencies.

EQUIVALENT FULL-TIME (EFT)

This is a standard measure of staffing which measures an agency's labour force in terms of an equivalent number of full-time positions.

EXPENSES - EMPLOYEE RELATED

These expenses (generic to both accounting and GFS reporting) include salaries and wages and employee entitlements, such as superannuation, annual leave and long service leave accrued during the accounting period.

FISCAL RESPONSIBILITY ACT 2005

This Act commenced on 1 July 2005. It contains both medium-term and long term fiscal targets aimed at controlling the level of general government liabilities and a range of fiscal principles to address specific goals such as constraining the growth in expenditure and ensuring ongoing prudent risk management.

GENERAL GOVERNMENT DEBT ELIMINATION ACT 1995

This Act was repealed by Section 23 of the *Fiscal Responsibility Act 2005.* It was the main piece of legislation that guided budget management prior to the 2006-07 Budget. It included a number of provisions dealing with the coverage of the Budget and the standards to be used in presenting budget data, andset targets over time for the sound financial management of the State.

GENERAL GOVERNMENT SECTOR

The general government sector provides public services (such as health, education and police) that are mainly free of user charges and funded in the main by taxation (directly or indirectly). There are budget dependent and non-budget dependent agencies within this sector.

GFS CASH SURPLUS/(DEFICIT)

This measures the direct financial impact of government activity on the economy. In simple terms the cash surplus/(deficit) is equal to the net cash flows from operating activities and investing in non-financial assets less finance leases and similar arrangements.

GOVERNMENT FINANCE STATISTICS (GFS)

A system developed by the International Monetary Fund and used by the Australian Bureau of Statistics to classify the financial transactions of governments and measure their impact on the rest of the economy. Given it is based on economic impact there are some differences in the presentation and results to reports prepared under Australian Accounting Standards.

LIABILITIES

The term (generic to both accounting and GFS reporting) relates to amounts owed to other parties. They include debt obligations, unfunded superannuation, other employee entitlements, insurance claim obligations and amounts payable to suppliers.

NET COST OF SERVICES

In accounting financial statements this measures the net cost of providing government services. It equals operating expenses less operating revenues, and excludes state revenues.

NET DEBT

This is a GFS term. It is broadly equal to gross borrowings less cash and investments.

NET FINANCIAL LIABILITIES

This is a GFS term. Is broader in concept than net debt and includes all liabilities (such as debt, unfunded superannuation and insurance liabilities) less all financial assets in the general government sector.

NET LENDING/(BORROWING)

This measure adjusts the budget result by including the cost of new asset acquisitions, less asset sales, and excluding depreciation expense. It broadly represents the Government’s capacity to reduce or increase the State’s net financial liabilities.

NET WORTH

Represents total assets less total liabilities in the balance sheet (generic to both accounting and GFS reporting).

NOMINAL DOLLARS/PRICES

Shows the dollars of the relevant period. No adjustment is made each time period for inflation.

NON BUDGET DEPENDENT GENERAL GOVERNMENT AGENCIES

These are General Government agencies that do not rely on the Consolidated Fund for direct financial support. They predominately source funds from regulatory and user charge (but may be receive Budget funding from a general government agencies for certain activities or services).

OUTCOMES

This is the intended effect or impact on the community, environment or economy which the Government is trying to influence through agency activities.

OUTPUTS

These are programs, goods and services or a response capacity produced by agencies to contribute to achieving the Government’s desired outcomes.

PRIVATELY FINANCED PROJECTS (PFP)

This is a specific form of Private Public Partnerships which involves the creation of an infrastructure asset through private sector financing and private ownership for a concession period (usually long term). The Government may contribute to the project by providing land or capital works, through risk sharing, revenue diversion or purchase of the agreed services.

PRIVATE PUBLIC PARTNERSHIPS (PPP)

Any contracted relationship between the public and private sectors to produce an infrastructure asset or deliver a service.

PROGRAM STATEMENTS

Each program statement includes narrative material - program objectives and program description - as well as staffing and detailed financial information.

PUBLIC FINANCIAL ENTERPRISE (PFE)

Agencies which have one, or more, of the following functions:

- that of a central bank;
- the acceptance of demand, time or savings deposits; or
- the authority to incur liabilities and acquire financial assets in the market on their own account.

For GFS purposes these are referred to as Public Financial Corporations (PFC).

PUBLIC TRADING ENTERPRISE (PTE)

Enterprises which charge for services provided, typically by a user pays arrangement and hence have a broadly commercial orientation. For GFS purposes, the ABS refers to these as Public Non-Financial Corporations (PNFC).

RESULTS AND SERVICES PLAN (RSP)

Is a service delivery and funding plan that is agreed between the Budget Committee of Cabinet and Ministers. It uses 'cause and effect' chains to map links between an agency's services and results. This approach helps agencies set performance expectations that can be matched to funding allocations and planned service delivery.

SOCIAL PROGRAMS

These are non-commercial activities of public trading enterprises that have social objectives. Where the objectives are a high priority to the government these programs are funded from the Budget as community service obligations (CSO).

STATE OWNED CORPORATION

These include government agencies (mostly PTEs) which have been established with a governance structure mirroring as far as possible that of a publicly-listed company. NSW state owned corporations are scheduled under the *State Owned Corporations Act 1989* (Schedule 5).

SURPLUS/DEFICIT

This is the accounting result for the current financial year, which corresponds to profit or loss in private sector reports. It equals the Net Cost of Services adjusted for government contributions. This is not the same as the budget result.

TOTAL ASSET MANAGEMENT (TAM)

A plan which requires management of an agency’s physical assets (land, buildings, infrastructure, plant and equipment) so that they align with the services to be provided, and achieve required performance levels. Management of assets involves acquisition, maintenance, operations and disposals.

TOTAL EXPENSES

The total amount of expenses incurred in the provision of goods and services, regardless of whether a cash payment is made to meet the expense in the same year excluding capital expenditure (generic to both accounting and GFS reporting). It does not include expenditure on the purchase of assets.

TOTAL STATE SECTOR

Represents all agencies and corporations owned and controlled by the NSW Government. It comprises the general government sector, the public financial enterprise sector and the public trading enterprise sector (also referred to as the public non financial corporations sector).

UNDERLYING NET DEBT

This is net debt adjusted to reflect the discretionary timing of general government 'defined benefit' superannuation contributions. The contributions have been invested within the General Government Liability Management Fund and in 2006-07 will be applied to reduce the government's superannuation liabilities.

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