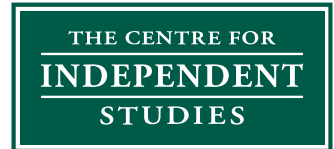




RESEARCH REPORT SNAPSHOT



TARGET30 REDUCING THE BURDEN FOR FUTURE GENERATIONS

Report Card on State Finances

Robert Carling

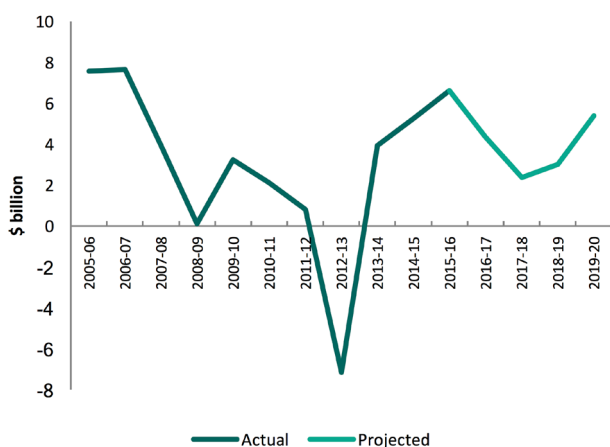
The Commonwealth's perilous financial position is widely known – with a structural deficit of \$40 billion and ballooning net debt of \$297 billion in June 2016. But the finances of the state governments also warrant our attention.

The evolution of disparity among the states and between them and the Commonwealth is highlighted in the net operating result; the states in aggregate were in operating

surplus of \$7 billion in 2015-16, having made a near full recovery from a decline into deficit after 2007.

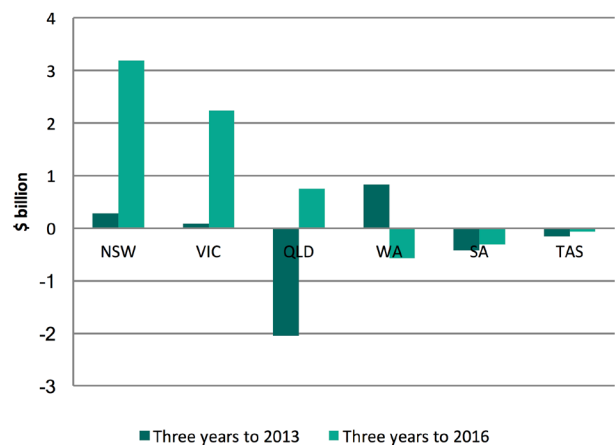
However the aggregate masks major differences: at one extreme, New South Wales boasts a surplus of \$4 billion, while at the other extreme Western Australia has deteriorated sharply from surplus to substantial deficit.

Figure 1: Net operating balance of states and territories



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

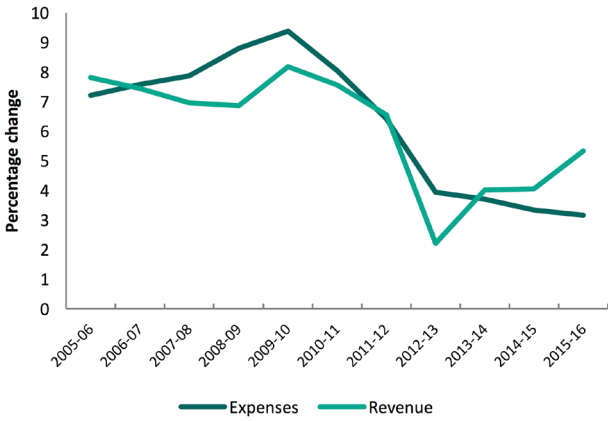
Figure 2: Average net operating result



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

Total operating revenue has recovered relative to operating expenses thanks to buoyant property tax revenue and stronger spending discipline. However, States' budget estimates for the current and subsequent years show a decline in the net operating surplus, particularly as the growth in the aforementioned property tax revenue subsides.

Figure 3: States' three-year moving average growth in operative revenue and expenses (% pa)

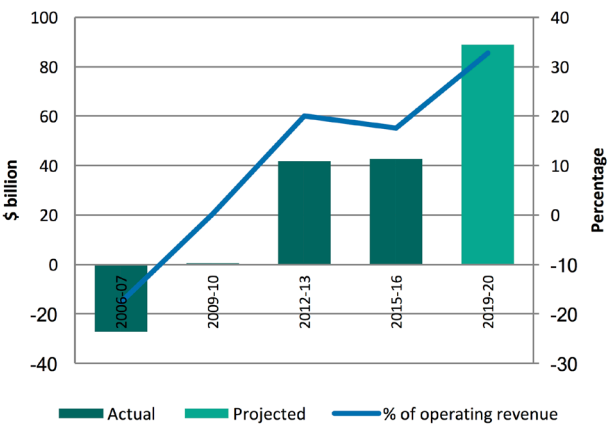


Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

The broader fiscal balance (which includes capital expenditure) has also improved in recent years, but is estimated to return to larger deficits in the next few years reflecting the large planned increase in capital expenditures.

Aggregate state general government net debt went from a negative level in June 2007 to \$43 billion in 2016. The 2016 figure would have been much higher had it not been for the proceeds of public enterprise privatisations, particularly in New South Wales. As these proceeds are reinvested in a huge infrastructure splurge over the next few years, net debt is projected to rise rapidly to almost \$90 billion by June 2020.

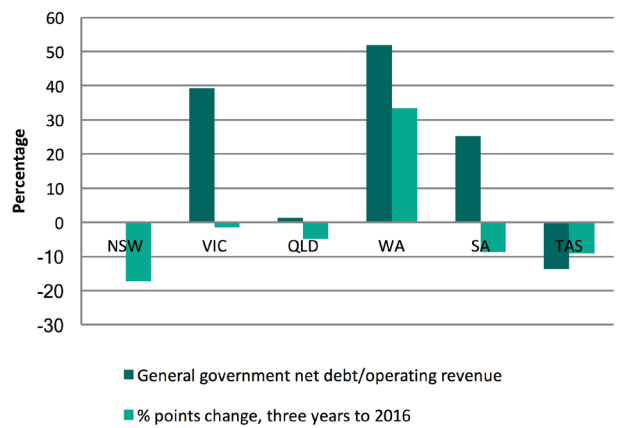
Figure 4: General government net debt of states and territories



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

Net debt expressed as a percentage of revenue is more meaningful, indicating the capacity of states to service debt. The net debt burden has fallen in all states except Western Australia, where net debt has increased markedly. NSW's elimination of net debt is only temporary, thanks to proceeds from public enterprise privatisations and long-term leases.

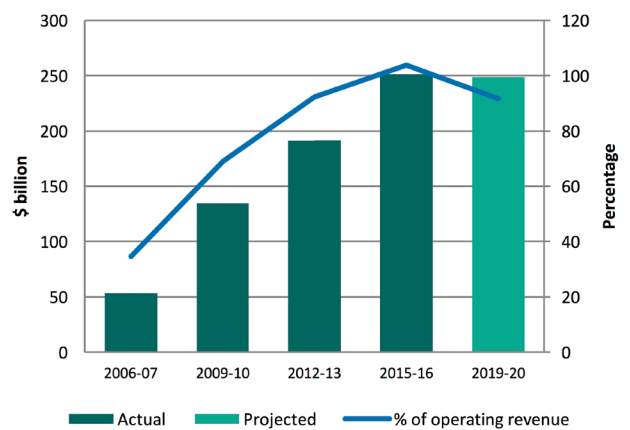
Figure 5: States' general government net debt as a percentage of operating revenue, 2016



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

Net financial liabilities are a broader measure of the stock of financial obligations. Including unfunded superannuation liabilities takes general government net financial liabilities to \$252 billion at June 2016, or 104 per cent of revenue.

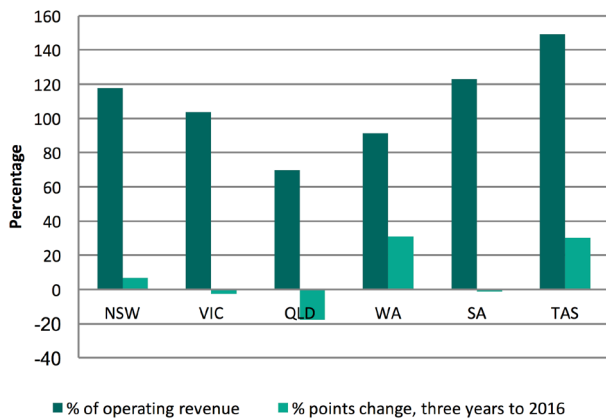
Figure 6: General government net financial liabilities of states and territories



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

Large unfunded gaps remain in NSW and Tasmania. Meanwhile, Queensland's public sector superannuation is fully funded and WA's liability is relatively low.

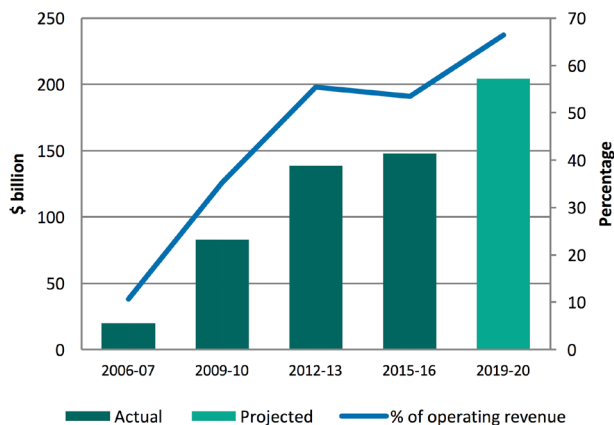
Figure 7: States' general government net financial liabilities as a percentage of operating revenue, 2016



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

All the above figures refer to the general government sector, which does not include government-owned corporations. Net debt of the non-financial public sector as a whole is much greater at \$148 billion in June 2016, rising to an estimated \$204 billion by 2020.

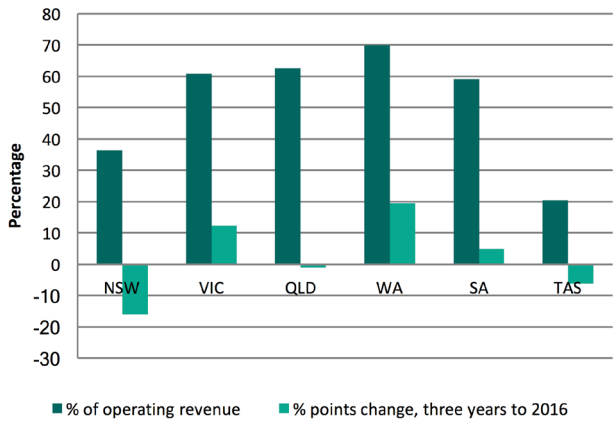
Figure 8: Non-financial public sector net debt of states and territories



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

Western Australia, Queensland, South Australia and Victoria have the highest debt burdens on this measure, and Tasmania the lowest. New South Wales had the greatest decrease in the three years to June 2016, while Western Australia had the largest increase.

Figure 9: States' non-financial public sector net debt as a percentage of operating revenue, 2016



Sources: State financial reports for 2015-16; ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2014-15*, Cat. No. 5512.0 (Canberra: ABS, 2016).

Any single summary measure of state financial strength has its drawbacks. Nonetheless, this report attempts to rank the states according to key fiscal indicators such as those outlined above. It does so within a normative framework that favours both fiscal prudence and smaller government, consistent with the CIS Target30 campaign.

The ranking of states according to their fiscal strength in 2015-16 alone is as follows:

1. New South Wales
2. Victoria & Tasmania
4. Queensland
5. Western Australia
6. South Australia

The ranking of states according to how their fiscal performance was trending in the three years to 2015-16 is as follows:

1. Queensland
2. New South Wales
3. Victoria, South Australia and Tasmania
6. Western Australia

There is nothing surprising in these rankings except the high ranking for Tasmania, which stems from that state's low net debt levels. However, as the smallest and typically slowest growing economy Tasmania has less capacity to service a given level of debt, and moreover it has the highest level of net financial liabilities due to its very high unfunded public sector superannuation liability. It is for these reasons that Tasmania is often considered to be a fiscal 'basket case'. It is also worth noting, however, that credit ratings agency Standard & Poor's now rates Tasmania more highly than Western Australia and South Australia.

There has been great diversity in fiscal performance among the states in recent years. In the long term, state governments cannot rely on booming stamp duty revenue and one-off cash injections from privatisation. They must keep a tight rein on operating expenses and be on the lookout for opportunities to bolster their budget bottom lines.

Author

Robert Carling is a Senior Fellow at the Centre for Independent Studies, where he undertakes research into a wide range of public finance issues and regularly comments in the media on taxation and other budget issues. Before joining the CIS, he was a senior official with the New South Wales Treasury and the Australian Treasury.