



The New South Wales 2005-06 Budget

Overview

The New South Wales Budget delivered on 24 May 2005 confirmed that the State is pursuing a tight fiscal strategy with pressures on its own tax base; from the Commonwealth Grants Commission allocation of GST revenue and the battle to contain costs while absorbing greater-than-anticipated wage increases in key public sector areas.

The Budget anticipates a small (\$303 million) operating surplus and commits to an increase in capital works funded partly with new borrowing.

Unlike in the other States and Territories (most notably in Queensland and in Victoria), the NSW government does not use the opportunity of the budget to display its commitment to developing and encouraging the business sector. NSW tends to adopt a hand-off approach in this regard. How much of the current period of relative sluggishness (including lower population growth) in NSW can be attributed to this stance is open to debate.

That said, NSW does make major expenditures in the more general drivers of the economy such as education, transport and energy. Business shares in the benefits of these investments and recurrent expenditures.

The 2005-06 Budget heralds the beginning of a new Fiscal Strategy. This strategy is embodied in a Fiscal Responsibility Bill 2005 that will replace the General Government Debt Elimination Act 1995 that provided the guidelines for fiscal policy for the past decade.

The Government reasons that the emphasis on debt reduction is no longer as central as it was 10 years ago. In that time general government debt has fallen from \$12.2 billion (1995) to \$2.6 billion (2004). It is important to note that in that time the debt levels of the public trading and financial enterprises has risen from \$7.4 billion to \$12.3 billion. The emphasis now is on maintaining the level of general government debt at sustainable levels.

With the change in emphasis from debt elimination to sustainable levels of debt, over the next five years the level of borrowing by the general government sector is set to

rise slightly (to \$3.4 billion) while that of public trading and financial enterprises is set to rise to \$22.3 billion. Expressed as percentages of Gross State Product, total State debt is set to rise from around 5% to about 6.5% (in 1995 it was over 12%).

The 2005-06 Budget represents a modest relaxation of budget strategy and in that sense the first Refshaughe budget is a departure from the very strong focus on debt reduction pursued under the guidance of the former Treasurer. The slight relaxation of budgetary policy, with greater accommodation of the need for investment, is in line with an approach that has been argued by Ai Group for several years.

Expenditure

Total general government (recurrent) expenditure in 2005-06 is expected to be \$40.6 billion. The majority of this spending is directed to the traditional areas of State responsibility such as health, education, transport and law and order.

Major Areas of Spending 2005-06

	\$ million	% of expenditure
Health	10,900	24.5
Education	9,700	23.7
Transport	4,600	15.5
Public Order and Safety	4,400	9.5
Children and Families	3,100	6.9
Protecting the Environment	800	2.0

In recent years the leading pressure on the budget, and part of the reason for NSW's inability to sustain a program of tax reform, has come from higher than expected wage increases. This year's budget appears to suggest that the period of rapid wages growth is fading. At the same time, however, public sector wages outcomes are identified as one of the leading risks facing current Budget estimates and projections. This is an area that will be keenly watched.

Without fanfare, the government has improved its position on public sector efficiency by qualifying its policy of "no forced redundancies." This policy no longer appears to be as a big a constraint on reducing areas of overstaffing as it has been in the past.

Infrastructure Investment

The Budget was promoted as big on borrowing to fund a significant expansion in infrastructure investment. This was somewhat of an overstatement as borrowing remains under a tight reign and investment is increasing only modestly.

Much has been made of the fact that investment in public infrastructure is set to total \$34.7 billion over the next four years compared with \$26.6 billion over the four years to 2004-05. These figures would be consistent with an average annual rate of increase in nominal investment by the State of slightly less than 7% pa over the eight-year period involved in this comparison.

Investment by the State is largely in the form of off-budget investment by NSW's public trading enterprises. In 2005-06, total capital expenditure is expected to be

\$8,238 million. Transport (\$2,488 million); electricity (\$1,762 million); housing and water (\$841 million) and health (\$649 million) are the largest categories.

Taxation

New South Wales own source tax revenue is expected to be \$16,269 million in 2005-06. This compares with a revised estimate for the 2004-05 year of \$15,306 million. This revised amount is about \$200 million less than anticipated when the 2004-05 Budget was framed. In round figures, a \$500 million shortfall in transfer duties was partly offset with higher than expected collections of \$200 million on payroll tax and \$100 million on land tax.

Major NSW Tax Revenues (\$million)

	2004-05 (revised)	2005-06 Budget	Percentage increase
Transfer Duties	3,370	3,608	7.1%
Other Stamp Duties	1,533	1,724	12.5%
Payroll Tax	4,852	5,114	5.4%
Land Tax	1,591	1,633	2.6%
Taxes on Motor Vehicles	1,264	1,325	4.8%
Gambling and Betting	1,437	1,550	7.9%
Other levies	1,258	1,315	4.5%
Total Tax Revenue	15,306	16,269	6.3%

The Budget reversed a number of positive initiatives by the current government on taxation and persisted with a number of recent negative initiatives.

The Government has reversed its **Land Tax** reforms announced in 2004. The Land Tax system will revert to a 1.7% rate above a threshold of \$330,000. The threshold will be increased annually in line with an index of property values. The change will apply for the 2006 tax year.

The now-abandoned reforms introduced last year followed classic tax policy principles of financing reductions in rates with base broadening (by removing the threshold). The Government reacted to the response of small investors and holiday house owners who were brought into the Land Tax net for the first time. The change means that most businesses will now pay more in land tax either directly or in the form of rental readjustments.

The rate of duty levied on many **general insurance** premiums is to be increased from 5% to 9% from 1 September 2005. This also reverses an earlier reform direction. The new standard rate of 9% will apply to public liability insurance, mortgage insurance and some other commercial insurance categories. Some insurance categories (including professional indemnity, motor vehicle and consumer credit insurance) will attract what will now be called a "concessional" rate of 5%. Workers compensation and CTP insurance will remain exempt.

The exemption from **Mortgage Duty** for the refinancing of loans has been wound back and will only apply to refinanced loans of less \$1 million after 1 August 2005. This reverses another tax reform introduced in Michael Egan's period as Treasurer.

Notwithstanding the significant cry from some sectors, the **Vendors Duty Tax** introduced in April 2004 will remain in force. No other tax changes were announced either to rates or thresholds. NSW will continue to be the highest taxing of the States and Territories.

Commonwealth Grants

The deadlock between the States, Territories and the Commonwealth over the GST reform of State and Territory taxes is still unresolved. In the Budget NSW claims to have met its obligations under the 1999 Intergovernmental Agreement on Commonwealth State Financial Relations.

NSW claims to be disadvantaged by the Intergovernmental Agreement even though GST revenues are higher than anticipated. Working through the various arguments of the Commonwealth and NSW is very difficult – illustrating the general lack of transparency in Commonwealth/State finances. Part of the difficulty is that the Commonwealth unilaterally changed the allocation of funding when it decided to reduce taxes on fuel in the lead-up to the 2001 election. Part of this reduction was passed on to the States and, while the Commonwealth uses the adjusted measure, NSW appears to use the original measure as a basis of comparison.

General Purpose Grants from the Commonwealth to NSW are anticipated to be \$10,675 million in 2005-06 (compared with a revised figure for 2004-05 of \$10,153 million – itself up from the original 2004-05 Budget estimate of \$10,004 million).

Specific Purpose Grants from the Commonwealth to NSW are expected to reach \$6,121 million in 2005-06 (compared with a revised figure of \$5,849 for 2004-05 – this was also up by about \$90 million on the original 2004-05 Budget estimates.)

Total Grants in 2005-06 are expected to be \$16,796 million compared with the \$15,760 million budgeted for in 2004-05. This increase of \$1,036 million or 6.6% between budgets appears to take some of the steam out of the NSW Government's arguments about the shortfall in Commonwealth funding – at least in absolute terms.

NSW also puts forward another argument against the current funding arrangements based on the operation of horizontal fiscal equalization whereby, in crude terms, the taxpayers in the “richer” states subsidise the “poorer” states. This raises major questions for the Australian federation and again underlines the need for much greater clarity of principles and transparency of processes in intergovernmental financial relations.

Other Revenue Sources

The major other sources of revenue of the NSW budget sector are dividends and tax equivalents from Public Sector Trading enterprises (\$1,906 million in 2005-06 compared with a \$1,644 million revised figure for 2004-05); operating revenues (\$4,806 million in 2005-06) and “other revenues” (\$1,082 million in 2005-06).