3 Fiscal strategy and outlook

Features

- The 2018-19 Budget delivers on the Government's election commitments, especially in the areas of infrastructure, jobs and skills, and services.
- A net operating surplus of $1.512 billion is expected for 2017-18. This is $1.027 billion higher than estimated at the 2017-18 Mid Year Fiscal and Economic Review (MYFER), and $1.366 billion higher than the surplus forecast at the time of the 2017-18 Budget.
- The significant 2017-18 surplus results from short-term factors, particularly higher royalty revenue from coal prices remaining higher for longer than expected, increased Australian Government grants due to a larger Goods and Services Tax (GST) pool and upwards revisions to revenue from dividends and income tax equivalent income.
- The strong 2017-18 operating surplus will see General Government Sector debt in 2017-18 around $2.4 billion lower than estimated in the 2017-18 Budget.
- The expected return of coal prices to the medium-term outlook, anticipated reductions to GST revenue and declining dividends and interest income means the fiscal environment beyond 2017-18 remains challenging.
- A General Government Sector net operating surplus of $148 million is forecast for 2018-19. Net operating surpluses are forecast across the forward estimates, though smaller than estimated at MYFER as a result of anticipated significant reductions in receipts from the Australian Government, particularly GST.
- The General Government Sector debt to revenue ratio has decreased substantially over the period to 2017-18 in each successive budget since 2014-15. The debt to revenue ratio for 2017-18 has fallen to 54%, primarily as a result of the strong 2017-18 operating surplus, and is significantly lower than the peak of 91% in 2012-13.
- Queensland's General Government Sector borrowing costs as a percentage of revenue are now largely in line with that of other states. Government borrowings are funding the investment in productive infrastructure that will grow the state's economy.
- Queensland's net worth (that is, the amount by which the State's assets exceeds its liabilities) continues to increase. At the same time, the State's long-term financial liabilities, including accruing superannuation liabilities and WorkCover, continue to be fully funded.
- Non-financial Public Sector debt will continue to increase over the forward estimates as a result of continued investment in economic infrastructure, however it is forecast to remain below $80 billion in 2020-21, and is almost $1.1 billion lower than forecast at the 2017-18 MYFER.

3.1 Context

The Queensland Government is delivering the best possible services and infrastructure to all communities.

The 2018-19 Budget focuses on implementing the 2017 election commitments, managing emerging fiscal pressures and continuing to deliver the Government's commitment to grow the economy, supporting and creating jobs, and improve health and education outcomes.

The 2017 election commitments will be funded through reprioritisations and revenue measures, consistent with *Putting Queenslanders First*. In addition, Queensland Treasury will be continuing its work with agencies to find efficiencies in expenditure and ensure effectiveness in programs and service delivery.

Since MYFER, there has been a reduction of around $749 million over the forward estimates in expected GST funding provided by the Australian Government resulting from a decrease in Queensland's share of the GST. This is despite an increase in GST funding in 2017-18, which is due to an increase in the overall size of the GST pool.

3.2 Key fiscal aggregates

The key fiscal aggregates of the General Government Sector for the 2018-19 Budget are outlined in Table 3.1 and are discussed in detail in this chapter.

Table 3.1 General Government Sector - key fiscal aggregates[1]

	2016-17 Actual[2] $ million	2017-18 MYFER $ million	2017-18 Est. Act. $ million	2018-19 Budget $ million	2019-20 Projection $ million	2020-21 Projection $ million	2021-22 Projection $ million
Revenue	56,194	56,464	58,259	57,738	58,835	59,939	62,269
Expenses	53,373	55,980	56,747	57,590	58,675	59,829	61,579
Net operating balance	**2,821**	**485**	**1,512**	**148**	**160**	**110**	**690**
PNFA[3]	4,634	4,965	4,905	5,927	7,557	7,396	7,081
Fiscal balance	536	(1,681)	(604)	(3,033)	(3,881)	(3,400)	(2,636)
Net Worth	194,936	198,268	199,686	202,636	205,775	208,101	210,515
Borrowing	**33,260**	**32,502**	**31,367**	**32,311**	**35,861**	**39,588**	**42,290**
Borrowing (NFPS)[4]	71,904	71,222	69,501	70,871	75,214	79,750	83,093

Notes:

1. Numbers may not add due to rounding. Bracketed numbers represent negative amounts.
2. Reflects published actuals.
3. PNFA: Purchases of non-financial assets.
4. NFPS: Non-financial Public Sector.

3.2.1 Net operating balance

Table 3.2 compares the General Government Sector net operating balance forecasts for the 2017-18 Budget and MYFER with 2018-19 Budget forecasts.

Table 3.2 General Government Sector - net operating balance forecasts

	2016-17 $ million	2017-18 $ million	2018-19 $ million	2019-20 $ million	2020-21 $ million	2021-22 $ million
2017-18 Budget	2,824	146	117	704	408	n.a.
2017-18 MYFER	2,821	485	165	307	531	n.a.
2018-19 Budget	**2,821**	**1,512**	**148**	**160**	**110**	**690**

The anticipated 2017-18 net operating surplus of $1.512 billion compares with a forecast surplus of $485 million expected in the 2017-18 MYFER.

Since MYFER, forecast revenue has increased by $1.795 billion in 2017-18, primarily related to:

- royalty revenues being higher than forecast, attributable largely to higher coal prices during 2017-18
- increased grants, driven by the larger GST pool
- increased dividend and income tax equivalent income, supported by increased earnings from electricity generation and network businesses.

The key drivers for a $767 million increase in expenses since MYFER include provisioning for the anticipated costs of Queensland participating in the National Redress Scheme and the Australian Government's advance payment of Financial Assistance grants to local governments in 2017-18 for the 2018-19 financial year.

In 2018-19, General Government Sector expenses are estimated to be 1.5% higher than the 2017-18 estimated actual. Factors influencing the higher expenses in 2018-19 include increased activity in Health and Education, additional job creation initiatives, community services initiatives, and advance payments to local councils for the introduction of the new Waste Disposal Levy.

Additional measures, detailed in Budget Paper 4 *Budget Measures*, support the Government's ongoing commitment to improve service delivery across the State.

Consistent with the Government's fiscal principles, net operating surpluses are forecast across the forward estimates. For 2018-19, the estimated General Government Sector operating surplus of $148 million is marginally lower than the $165 million expected at the time of the 2017-18 MYFER.

Table 3.3 provides a breakdown of the movements in the net operating balance since the 2017-18 MYFER.

Table 3.3 Reconciliation of net operating balance, 2017-18 MYFER to 2018-19 Budget[1]

	2017-18 $ million	2018-19 $ million	2019-20 $ million	2020-21 $ million
2017-18 MYFER net operating balance	**485**	**165**	**307**	**531**
Taxation revisions[2]	(20)	(160)	(304)	(407)
Royalty revisions	638	1,458	1,069	555
GST revisions	239	151	(278)	(861)
Measures[3]				
Expense[4]	*(528)*	*(832)*	*(583)*	*(561)*
Revenue	*..*	*116*	*474*	*478*
Net	(528)	(716)	(109)	(83)
Net flows from PNFC and PFC entities[5]	457	186	114	93
Australian Government funding revisions[6]	(64)	(515)	(481)	334
Other parameter adjustments[7]	303	(420)	(158)	(51)
2018-19 Budget net operating balance	**1,512**	**148**	**160**	**110**

Notes:

1. Numbers may not add due to rounding. Numbers indicate the impact on the operating balance. A number in brackets indicates a negative impact on the operating balance.
2. Represents parameter adjustments to taxation revenue excluding taxation revenue measures.
3. Reflects the operating balance impact of Government decisions since the 2017-18 MYFER.
4. Includes anticipated costs of Queensland participating in the National Redress Scheme.
5. Represents revisions to dividends and tax equivalent payments from, and community service obligations (CSOs) and Transport Service Contract (TSC) payments to, Public Non-financial Corporations and Public Financial Corporations, net of CSO and TSC expense measures.
6. Represents the net impact of funding provided by the Australian Government primarily for Specific Purpose Payments and National Partnership payments and includes funding for disaster recovery expenses.
7. Refers to adjustments largely of a non-policy nature, primarily changes in interest paid on borrowings, depreciation, swaps and deferrals.

3.3 Fiscal strategies

3.3.1 State's operating capacity

The Palaszczuk Government is committed to the sound management of the State's finances, while delivering high quality services to all Queenslanders. This includes managing within the State's means and budgeting for operating surpluses in each year of the forward estimates.

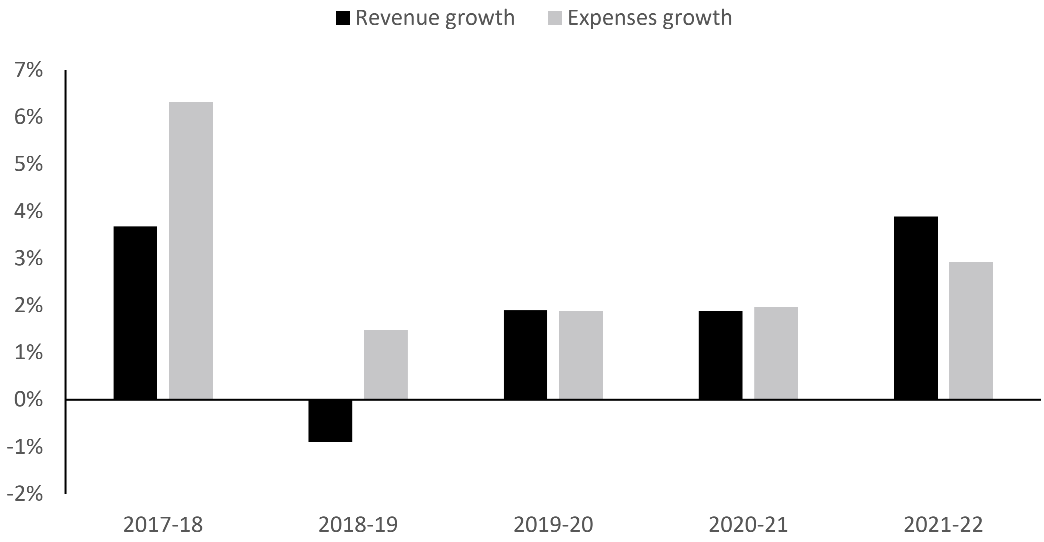
This task is made more challenging by a feature of Australia's federal system known as vertical fiscal imbalance. This imbalance occurs because the Australian Government collects the majority of the country's revenue, including GST, but States are responsible for delivering the majority of services to the public, including health and education services.

As outlined in Chapter 7, almost half of Queensland's revenue is from the Australian Government. This means that Queensland's fiscal position is largely influenced by decisions made by the

Australian Government, such as not renewing expiring funding agreements, resulting in a lack of certainty about the funding that will be received each year.

Chart 3.1 shows revenue and expenses growth over five years. Over this period, average annual growth in revenue is expected to be 2.07%, with expenses expected to grow 2.9%.

Chart 3.1 General Government Sector revenue and expenses growth



At any given time, issues exist with potentially significant fiscal impacts. However, until issues have been considered by Government or formal agreements are in place, uncertainty exists as to when and if these issues will impact on the net operating balance. Therefore, until greater certainty eventuates, the potential fiscal impacts of such issues are not included in the forward estimates.

Such issues include:

- Share of future GST revenue: The Australian Productivity Commission has completed an inquiry into horizontal fiscal equalisation – the principle underpinning the distribution of GST revenue to the states and territories. At the time of finalising the 2018-19 Budget Papers, states have not been provided with the final report. The recommendations have the potential to significantly change the amount of GST revenue that Queensland receives.
- Long-term School Funding Agreement: The Australian Government is currently in negotiation with State and Territory governments to renew a new five-year School Funding Agreement from 1 January 2019. The agreement may require Queensland to increase school funding over the coming years, based on a new funding methodology. States and Territories are negotiating the terms of the agreement, including the measurement of the funding methodology and transition period.
- Remote Housing: The National Partnership on Remote Housing focussed on addressing critical housing needs for Aboriginal and Torres Strait Islander people in remote communities

to reduce overcrowding and improve living standards. This agreement expires 30 June 2018, and no renewed funding was provided in the 2018-19 Commonwealth Budget. Significant additional investment is required to meet the growing housing needs in remote Indigenous communities. There are also significant costs to the State related to operating and maintaining existing dwellings constructed under the expiring agreement.

Revenue

An economic environment that supports business and jobs growth, and does not place undue strain on households through policy and taxation settings, is key for any jurisdiction.

To support the delivery of election commitments, the 2017-18 MYFER reflected the Government's adoption of four modest revenue measures:

- a 0.5% increase in the land tax rate for aggregated holdings above $10 million
- an increase in the Additional Foreign Acquirer Duty (AFAD) from 3% to 7%
- an increase of $2 per $100 of dutiable value for vehicles valued above $100,000
- a 15% point of consumption betting tax.

These measures are discussed in further detail in Chapter 4.

The Government will also introduce a Waste Disposal Levy of $70 per tonne from the first quarter of 2019, as part of a comprehensive waste management strategy.

More information on Queensland's revenue outlook is provided in Chapter 4.

<u>Fiscal principle supporting revenue management</u>

Taxation per capita in Queensland is significantly lower compared to the average of other Australian states and territories, as discussed in Chapter 4. In 2018-19, Queensland's taxation per capita of $2,808 will be $875 per capita less than the average of the other jurisdictions.

The Government also aims to support businesses and households by ensuring that own-source revenue in the General Government Sector, including user charges and royalties, remains at or below 8.5% of nominal gross state product (GSP), on average, across the forward estimates. Own-source revenue is derived from total State revenue less any grants received from external sources, mainly the Australian Government.

This principle is expected to be met over the forward estimates period, with revenue falling as a percentage of GSP. For 2018-19, General Government own-source revenue is forecast to be 8.2% of nominal GSP. This falls to 7.7% by 2021-22, with an average of 8.0% across the four years.

Expenses

The forward estimates include the Palaszczuk Government's election commitments, as outlined in *Putting Queenslanders First*, which total $1.383 billion. All election commitments have been fully funded through revenue measures and over $1 billion in reprioritisation measures (excluding Queensland Health) over the forward estimates. Delivery of these measures will neither be at the cost of public service jobs nor will require the sale of strategic income-earning assets.

Between 2016-17 and 2021-22, expenses are forecast to grow at an average annual rate of 2.9% per year. More information on Queensland's expenditure outlook is provided in Chapter 5.

Fiscal principle supporting expenses management

In the General Government sector, employee expenses equate to approximately 40% of total expenses. Increases in employee expenses reflect changes in the number of public sector employees as well as wages growth.

A key focus is to ensure a balance between delivery of high-quality services, and the discipline that underpins the Government's commitment to fiscal sustainability.

To manage employee expenses growth, the Palaszczuk Government has adopted a fiscal principle to maintain a sustainable public service by ensuring that overall growth in full-time equivalents (FTE) employees, on average over the forward estimates, does not exceed population growth.

FTEs are estimated to increase by around 3,833 (or 1.71%) in 2018-19, with the majority of the increase being attributable to growth in health and education.

Average FTE growth over the forward estimates period from 2017-18 to 2021-22 is 1.71%. This compares to an estimated Queensland population growth of 1¾% annually.

Further details on FTE estimates are provided in Chapter 5, with Table 5.2 providing in-scope agencies and their FTE estimates for 2017-18 and 2018-19.

3.3.2 Infrastructure investment

The Palaszczuk Government is delivering essential infrastructure and capital works to meet the State's increasing service needs and to promote increased productivity and efficiency for the State's industries. The Government also recognises that building infrastructure benefits local communities, strengthens local economies and supports local jobs.

The Palaszczuk Government's 2017 election commitments outlined $1.404 billion in new capital measures, including:

- $353 million towards Building Better Hospitals
- over $128 million towards Future Proofing the Bruce
- $308 million towards Building Future Schools
- $235 million towards Renewing Our Schools.

These capital measures will be funded primarily through allocations from the State Infrastructure Fund and through improved cash management practices.

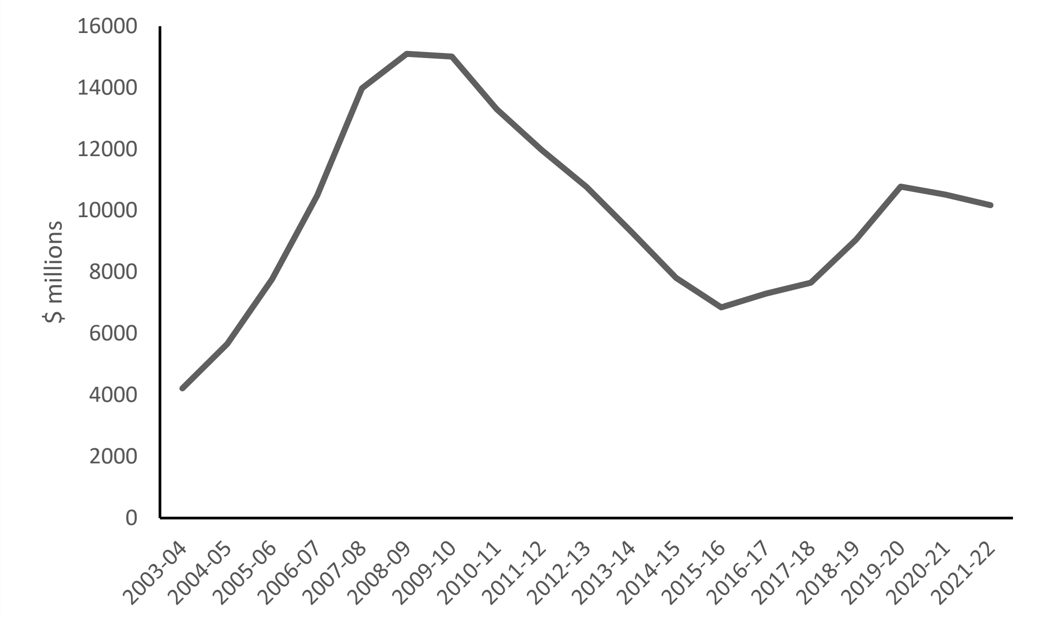
As part of the 2018-19 Budget, the Government has provided further capital funding of just over $900 million for M1 Pacific Motorway upgrades and $176 million towards the Rookwood Weir.

Further information about the Government's capital program is provided in Chapter 6 and Budget Paper 3 *Capital Statement*.

Box 3.1 History of purchases of non-financial assets in Queensland

As can be seen from Chart 3.2, purchases of non-financial assets (PNFA), across the entire Non-financial Public Sector, which includes the spending by government-owned corporations, increased significantly from 2003-04, peaking at $15.101 billion in 2008-09.

Chart 3.2 Purchases of non-financial assets, Non-financial Public Sector



The unprecedented high levels of capital spending were the culmination of many unique circumstances existing at the time. These included:

- responding to the prolonged drought in South East Queensland between 2001 and 2009, resulting in a range of measures, including the Gold Coast Desalination Plant, the Western Corridor Recycled Water Scheme and new dams and weirs, as well as the Government purchase of SEQ council-owned assets which formed the basis of the SEQ Water Grid
- several large health-related infrastructure projects from 2007-08, peaking in 2011-12, including the construction of Lady Cilento Children’s Hospital, the Sunshine Coast University Hospital, and the Gold Coast University Hospital
- ramping up of investment in electricity infrastructure from 2004-05 to meet strong growth in demand and ensuring Queenslanders could enjoy improved reliability and safety of supply
- roadway infrastructure of around $500 million per year in the four years to 2010-11, prior to the divestment of Queensland Motorways Limited
- Commonwealth stimulus in response to the Global Financial Crisis, which included programs such as Social Housing and the Building the Education Revolution program.

More recently, the State has entered into several finance lease type arrangements, mainly resulting from Public Private Partnerships (PPPs), which are included in the capital program but not fully reflected in purchase of non-financial assets.

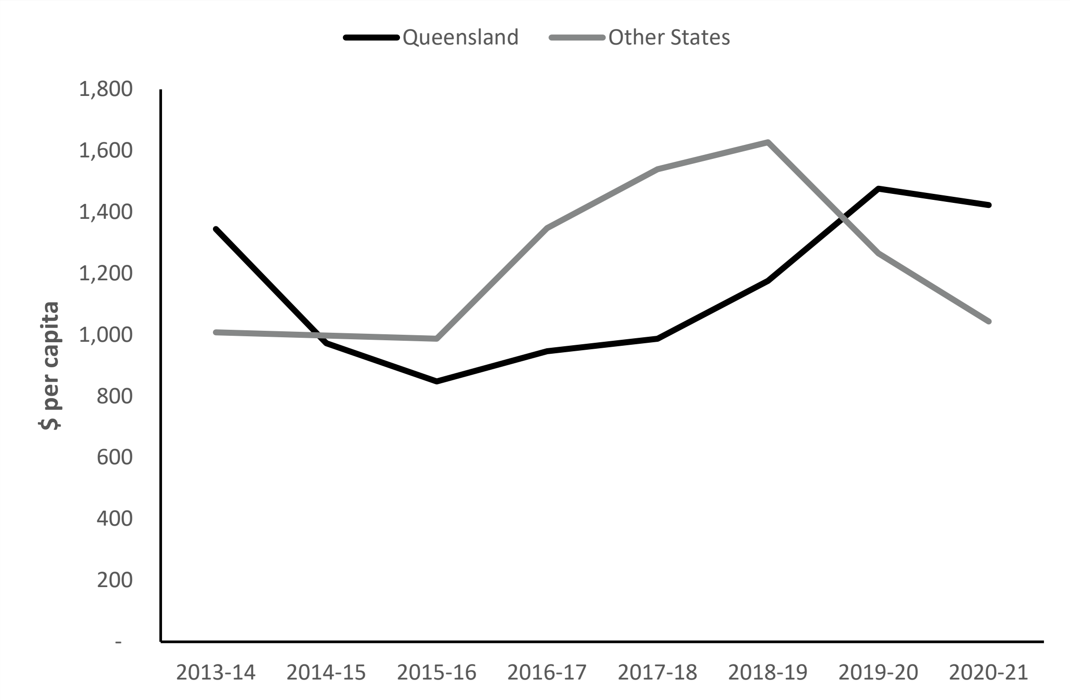
Purchases of non-financial assets going forward

Going forward, the Government is, where appropriate, funding its capital program through methods other than direct PNFA. As mentioned above, PPPs, for example, provide alternative financing approaches for the development of new infrastructure or other capital.

The magnitude of spending on PNFA that occurred from the mid-to-late 2000s was brought about by a range of unique circumstances. While the capital program is forecast to increase from its 2015-16 level, it does not return to previous highs.

Chart 3.3 provides an interjurisdictional comparison over time, showing that from 2019-20, Queensland's capital spending per capita is expected to exceed the average of other states.

Chart 3.3 Per capita purchases of non-financial assets, General Government Sector

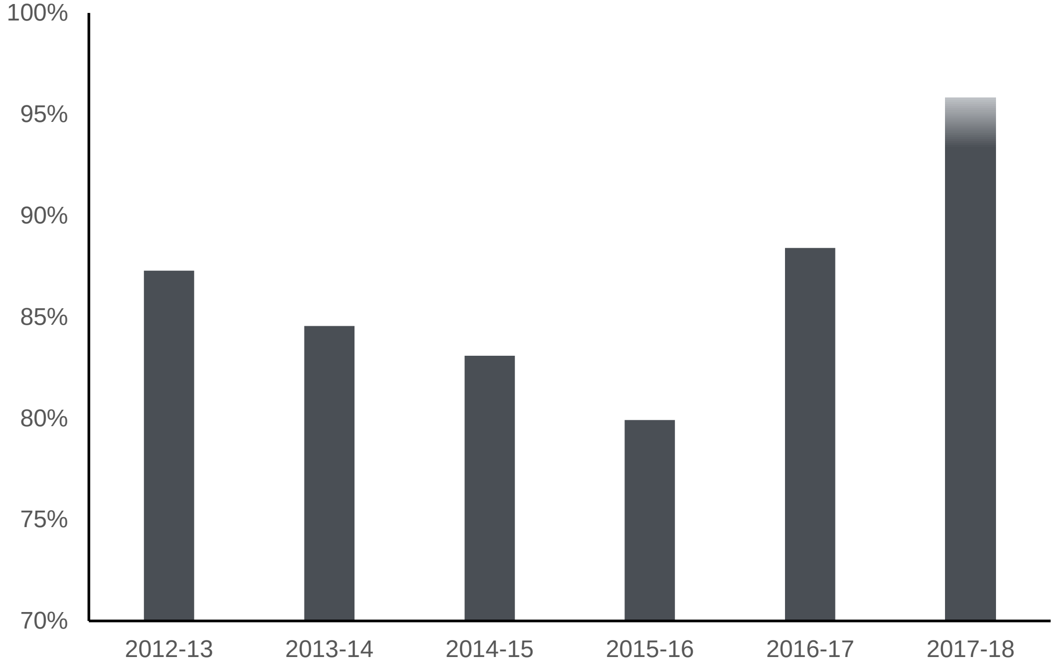


Improving delivery of the capital program

The Government has implemented a clear focus on improving the timely delivery of essential infrastructure in Queensland. This has resulted in an improvement in the amount of capital expenditure that is actually delivered, as a proportion of the Budget allocation.

This is demonstrated in Chart 3.4, which identifies that the proportion of budgeted purchases of non-financial assets actually delivered in 2016-17 was the highest in the past five years. Further improvement is anticipated in 2017-18, with more than 90% of budgeted purchases of non-financial assets expected to be delivered.

Chart 3.4 Total State purchases of non-financial assets – actual as a proportion of budget



Fiscal principles supporting capital investment management

The Government has adopted two fiscal principles to ensure that there is a consistent flow of capital works and that any new capital investment is funded primarily through recurrent revenues rather than borrowings.

While the value of the total capital program can fluctuate across financial years, the 2018-19 Budget provides for an average General Government Sector PNFA of $6.990 billion across the budget and forward estimates. Total General Government Sector PNFA over the budget and forward estimates are projected at $27.961 billion.

Infrastructure funding

The General Government Sector Cash Flow Statement (refer Table 9.7) provides details of the sources of funding for capital investment. It shows that net cash inflows from operating activities equate to 99% of the funding required for the 2017-18 net General Government Sector investments in non-financial assets.

Across 2018-19 to 2021-22, net cash inflows from operating activities are budgeted to average 49.4% of the funding required, primarily reflecting the higher level of capital spending during the period.

The Government is continuing to invest in infrastructure projects that are necessary to support Queensland's growing population and economy. Borrowings will increase to support the capital program, but are expected to remain below projections in the 2017-18 MYFER due to the stronger than expected 2017-18 operating surplus.

Gross General Government Sector borrowings of $31.367 billion at 30 June 2018 are forecast to be $1.135 billion lower than forecast in the 2017-18 MYFER and $17.054 billion less than forecast at the time of the 2014-15 Budget.

Borrowings

The history of Queensland Government debt over the past decade mirrors that of the Queensland economy. Before 2007, the economic and fiscal policies of the State reflected a transition from a low service level State, to a State with service levels comparable to other major states in Australia. This transition supported a period of sustained growth in the Queensland economy, with many significant infrastructure projects providing enhanced community facilities like schools and hospitals, along with supporting resource development as populations increased significantly across regional Queensland.

While total spending increased over this period as new major social spending programs were introduced, these costs were supported by revenues generated from the housing and mining booms, as well as increases in GST revenues arising from credit expansion. To put this into context, Queensland's GST revenue alone grew by an average rate of 7.5% per annum across the periods 2001-02 to 2007-08.

In 2007, the global financial crisis (GFC) impacted every major economy in the world, including Queensland. Consumer confidence fell, expectations of a recession rose, and the State's growing revenue base began to contract.

The Government at the time decided to maintain its economic development program and increase debt. This decision to continue the State's capital program was aimed at avoiding recession during the GFC. Combined with actions from the Australian Government and the Reserve Bank, along with strong demand from China, the Queensland and Australian economies continued to grow through the GFC.

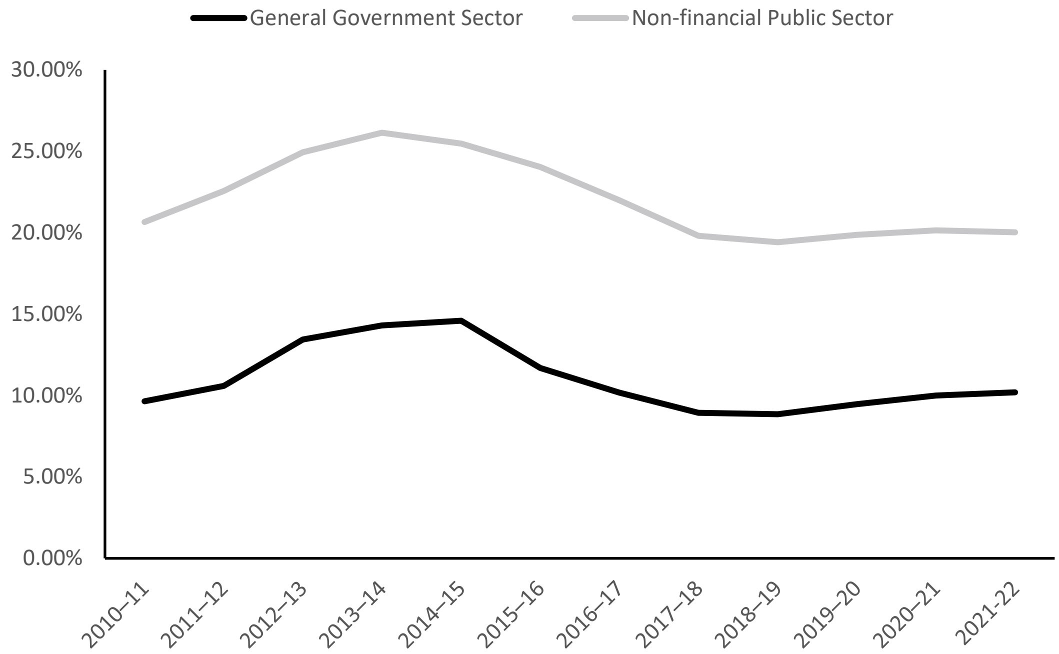
Avoiding recession also saw Queensland avoid the economic and social effects of very high and sustained unemployment, with the State's trend unemployment rate remaining below 6% through to late-2012.

Queensland is currently benefiting from the sustained levels of investment that occurred over the past decade, as discussed in Box 3.1.

The debt accumulated over this time was not wasted by governments, but was invested for the future benefit of Queensland, much of which is already being realised. This approach is consistent with fiscal sustainability principles which seek to spread the burden of public spending fairly across generations, with public consumption benefiting the current generation being paid for by that generation. This approach ensures intergenerational equity, with the debt associated with an investment repaid over the life of the asset or term of benefit received from the investment.

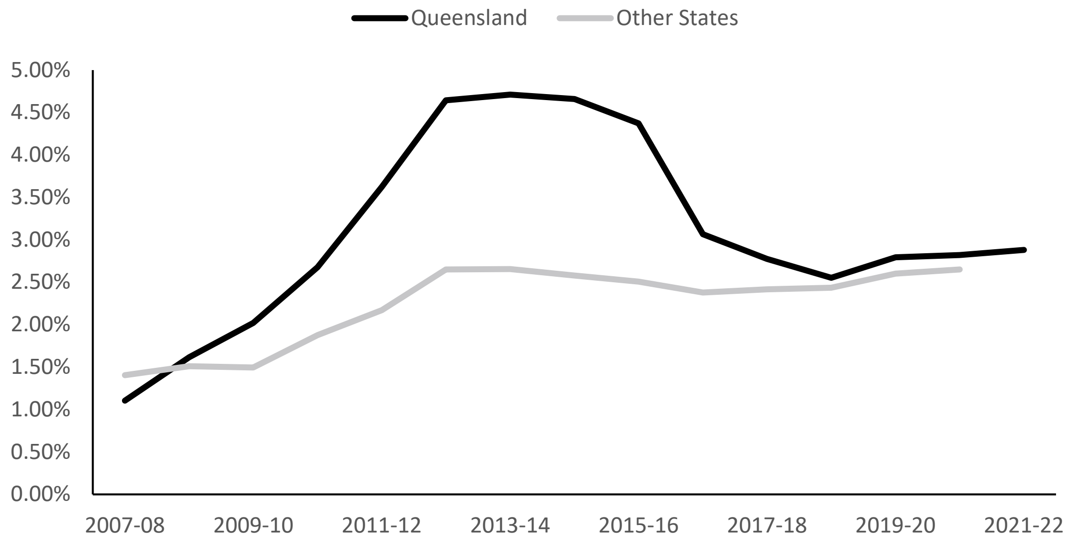
Chart 3.5 shows the ratio of borrowings to gross state product (GSP), that is, the amount of debt as compared to the state's total output.

Chart 3.5 Borrowings to gross state product ratio



An alternative way of assessing the appropriateness of debt levels is to consider the State's capacity to service its borrowing costs, that is, interest payments as a proportion of revenue (as shown in Chart 3.6). This concept can be likened to a person assessing their ability to service an interest only loan.

Chart 3.6 General Government Sector – interest expense to total revenue[1]



Note:

1. Average for other states not provided for 2021-22 as not all states have released their 2018-19 Budgets.

Queensland's ratio is projected to remain relatively flat across the forward estimates, and is only marginally higher than the average in other states.

General Government Sector net worth, which is the difference between assets and liabilities, is $200 billion, and continues to increase across the forward estimates, reflecting the State's investment in additional assets.

Fiscal principles supporting liabilities management

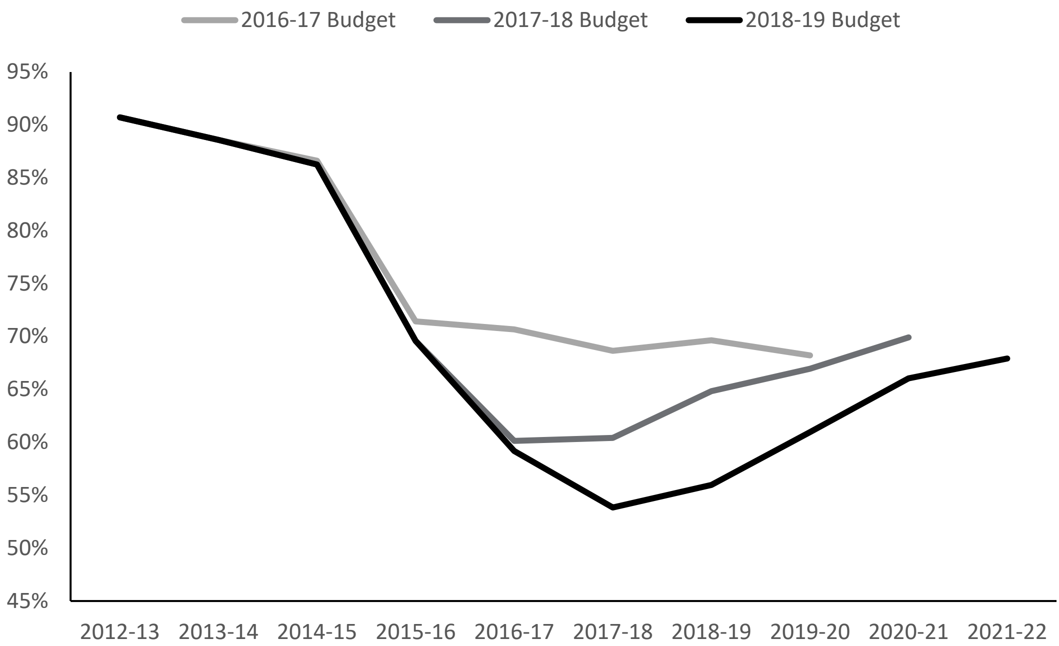
A primary fiscal principle of the Queensland Government has been to reduce General Government Sector debt, to provide the Government with the capacity to respond to market and environmental shocks.

The debt to revenue measure ratio is the key measure of the sustainability of General Government Sector debt levels. The Government aims to reduce this ratio over time to continue to improve the State's fiscal sustainability.

The General Government Sector's debt to revenue ratio has fallen substantially over the period to 2017-18 in each successive budget since 2014-15, as seen in Chart 3.7. The debt to revenue ratio for 2017-18 falls to 54%, significantly lower than the 91% in 2012-13.

Across the forward estimates, the expected moderation in revenue growth, as well as the timing of significant capital projects and associated borrowings, sees a gradual increase in the forecast debt to revenue ratio to 2020-21. On average over the budget and forward estimates, the debt to revenue ratio is 63%, well below the four years to 2019-20 forecast in the 2016-17 Budget.

Chart 3.7 General Government Sector debt to revenue ratio



The Government also remains committed to maintaining the long-standing practice of ensuring that the State sets aside assets to meet long-term liabilities such as superannuation and WorkCover, in accordance with actuarial advice.

The State Actuary's most recent valuations indicate that, as at 30 June 2017, both the defined benefit superannuation scheme and the WorkCover scheme were fully funded.

3.4 Achievement of fiscal principles

Table 3.4 provides a summary of the Government's progress in meeting its fiscal principles' targets.

Table 3.4 The fiscal principles of the Queensland Government

Principle	Indicator		
	General Government debt to revenue ratio		
		2017-18 MYFER %	**2018-19 Budget %**
Target ongoing reductions in Queensland's relative debt burden, as measured by the General Government debt to revenue ratio.	2017-18	58	54
	2018-19	60	56
	2019-20	63	61
	2020-21	66	66
	2021-22	n.a.	68
	General Government net operating cash flows as a proportion of net investments in non-financial assets		
		2017-18 MYFER %	**2018-19 Budget %**
Target net operating surpluses that ensure any new capital investment in the General Government Sector is funded primarily through recurrent revenues rather than borrowing.	2017-18	69	99
	2018-19	49	60
	2019-20	40	40
	2020-21	53	44
	2021-22	n.a	53
	General Government purchases of non-financial assets		
		2017-18 MYFER $ million	**2018-19 Budget $ million**
The capital program will be managed to ensure a consistent flow of works to support jobs and the economy and reduce the risk of backlogs emerging.	2017-18	4,965	4,905
	2018-19	6,626	5,927
	2019-20	7,486	7,557
	2020-21	6,910	7,396
	2021-22	n.a.	7,081

Principle	Indicator	
Maintain competitive taxation by ensuring that General Government Sector own-source revenue remains at or below 8.5% of nominal gross state product, on average, across the forward estimates.	**General Government own-source revenue to GSP**	
	2018-19	8.2%
	Average across the forward estimates	8.0%
Target full funding of long-term liabilities such as superannuation and WorkCover in accordance with actuarial advice.	As at the last actuarial review (as at June 2017), accruing superannuation liabilities were fully funded. The WorkCover scheme was also fully funded as at 30 June 2017.	
Maintain a sustainable public service by ensuring that overall growth in full-time equivalents (FTE) employees, on average over the forward estimates, does not exceed population growth.	*FTE growth*	
	Average across the forward estimates	1.7%
	Population growth	
	Average across the forward estimates	1¾%