# A plan for budget repair

## Interim report overview –

an independent assessment of the Northern Territory's fiscal position and medium-term outlook

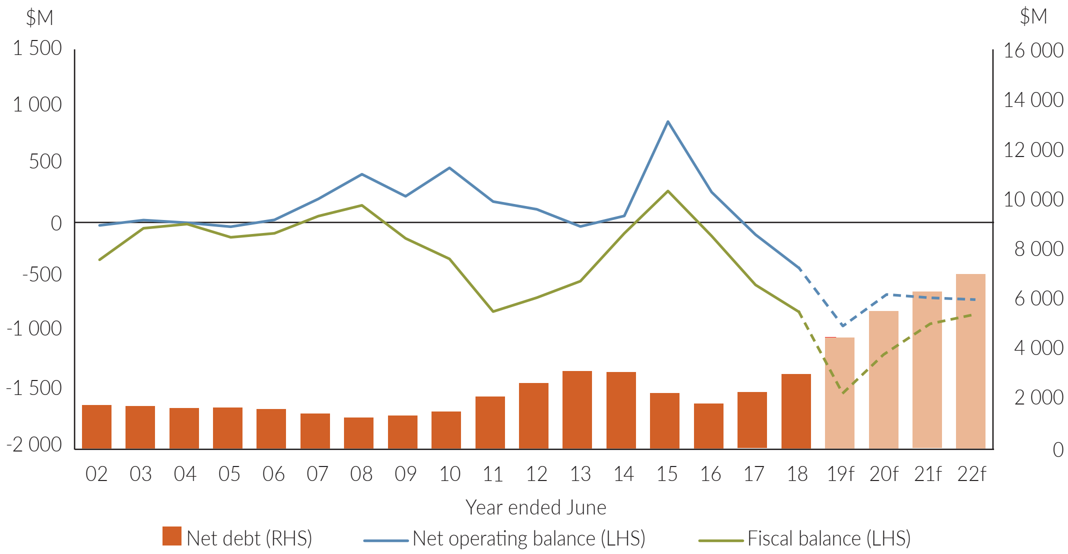
December 2018

# Interim report overview

## What's the problem?

The Territory budget is in structural deficit, meaning there is a fundamental imbalance between receipts and expenditures that is not related to one-off or short-term factors. This problem will persist in the absence of a plan for doing business differently.

Chart 1: Budget Outcomes – Non Financial Public Sector




## How has this situation arisen?

Over the past 20 years the Territory has incurred fiscal deficits not only during contractions in the economic cycle but also in times of expansion. This practice has complicated the budget and debt management task in the current economic downturn.

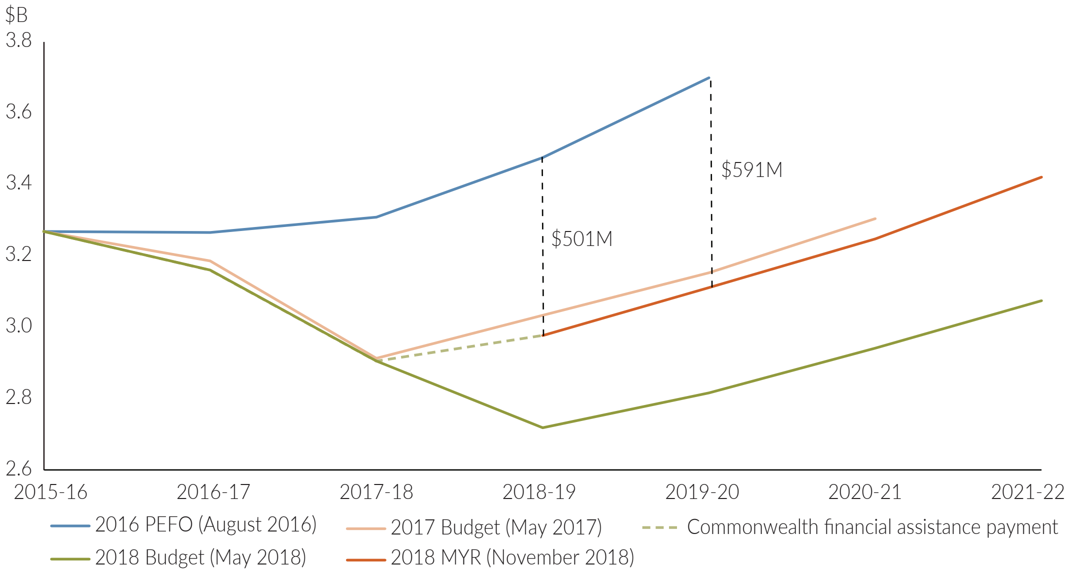
When the government came to power in August 2016, the Territory had been enjoying the highest level of untied GST revenue since the GST commenced in 2000-01. However, in the following 18 months, encompassing the 2017 and 2018 Budgets, a total of $3.4 billion was wiped off the Territory's share of GST between 2017-18 and 2021-22, without a corresponding reduction in the Territory's expenditure needs.

Chart 2: Territory GST revenue and relativities over time

At the time of the 2018 Budget, the outcome for the Territory of the Productivity Commission inquiry into horizontal fiscal equalisation was unknown. However, following the passage of Commonwealth's *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act* in November 2018, there is now greater certainty that the Territory's GST revenue share will remain below historic trends over the medium term.

Although the Commonwealth assistance and time-limited guarantees in the Act have reduced the decline to $2.4 billion from 2017-18 to 2021-22, this is still in excess of $500 million per annum, and the changes have effectively entrenched a significantly lower share of untied Commonwealth funding for the Territory for the foreseeable future.

## Chart 3: GST revenue changes since the 2016 Pre-Election Fiscal Outlook



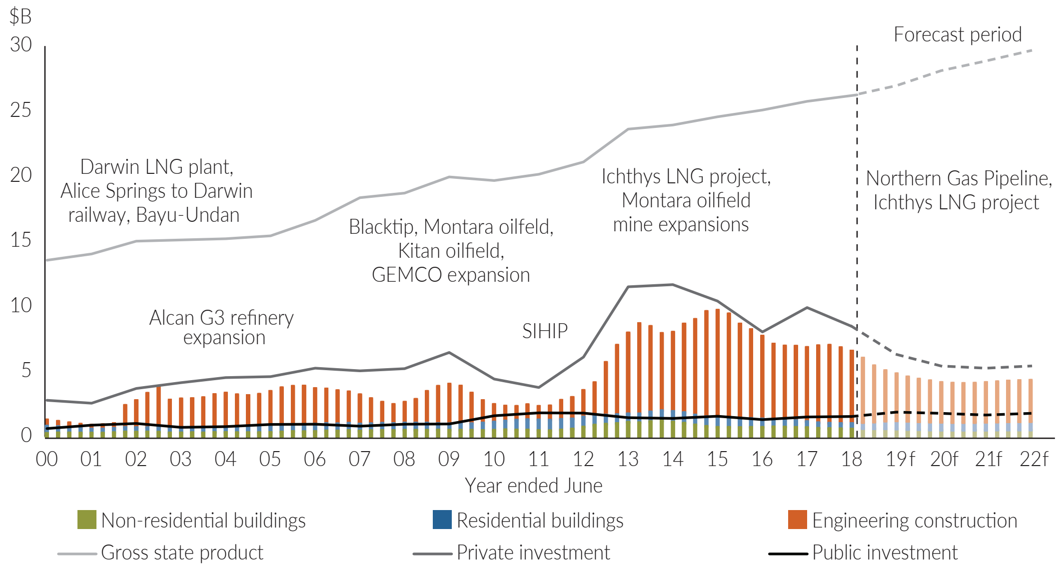

With a relatively small own-source revenue base, the Territory Government is reliant on the Commonwealth for $4 in every $5 of revenue and has little capacity to withstand fiscal shocks of this magnitude.

The reduction in GST revenue is a major burden for the Territory's finances. Unlike larger states that have more diverse and robust sources of other revenues, the magnitude of the reduction in the Territory's GST is pronounced and the impact harder to defray.

This fall in GST revenues has also coincided with a pronounced moderation in the Territory economy, reflecting the transition of one of the largest ever projects in the southern hemisphere, the Ichthys liquefied natural gas (LNG) project, from the construction phase with a peak workforce of over 10 000 to the operational phase with a workforce of around 400.

The Territory has enjoyed the economic benefits of a succession of major projects since the Adelaide to Darwin railway project in the early 2000s, culminating in the Territory's largest ever construction project (Ichthys). However, there are currently no major projects of a comparable scale to cushion the impact of the Ichthys transition on the Territory economy. While the Territory Government has sought to arrest the resultant economic and population impacts through increased infrastructure investment and economic stimulus measures, such as tourism marketing and promotion, and targeted housing industry support, it does not have the fiscal capacity to offset a decline in private investment of this magnitude.

Chart 4: Economic growth, and private and public investment over time




Historically, the growth of government operating expenses has consumed all revenues available to successive Territory governments. This has built an underlying expenditure base, which has become entrenched. Additionally, one-off revenues from asset sales have predominantly been used to fund a range of infrastructure stimulus and investment initiatives rather than retire debt.

Increasing demand for government services, notwithstanding flat population growth, and rising community expectations regarding service standards have seen the cost of public services continue to grow despite the revenue declines. This trend has further compounded the Territory's fiscal challenges. The current Territory Government has also faced unexpected expenditure demands such as the need to respond to the Royal Commission into the Protection and Detention of Children in the Northern Territory.

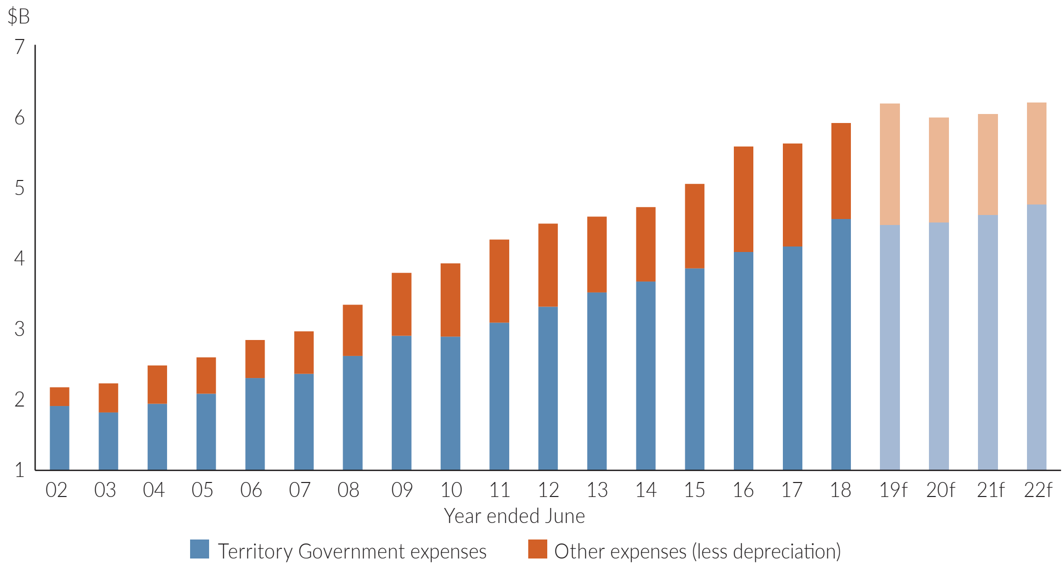
The culmination of these events has placed the Territory Budget on a debt and deficit trajectory which is unsustainable.

# Why is it such a big deal?

In 2018-19, the Territory is forecast to spend over $1.5 billion, or $4 million a day more than the revenue it collects, and is borrowing to meet the shortfall. If Territory Government spending continues to grow as it has in the past, the Territory's net debt is projected to increase tenfold from $3.0 billion in 2017-18 to $35.7 billion by 2029-30, with the net debt to revenue ratio increasing to around 320 per cent and the annual interest bill rising to almost $2 billion. Such an outcome would have severe economic consequences for Territorians.

Since the 2016 Pre-Election Fiscal Outlook, the Territory Government has made significant efforts to restrain expenditure growth through the introduction of cumulative savings and budget repair measures of around $830 million between 2017-18 and 2021-22. Despite these measures, significant budget deficits are forecast across the forward estimates as expenditure has continued to grow due to increasing demand for government services (for example, health and child protection), unexpected costs associated with the Royal Commission, and costs associated with significant economic and infrastructure stimulus.

Chart 5: Expenditure growth over time[1]




1 Excludes depreciation. Other expenses is primarily tied funding from the Commonwealth.

If left unattended, the structural deficit will result in growth in the Territory's debt that will undermine the confidence in the Territory economy and future governments' flexibility to implement its policy objectives.

A significant slowing in the rate of operating expenditure is needed urgently. While even more extreme measures to immediately halt the growth in debt could be advocated, they would be counterproductive to the Territory's economic interests. To balance the competing priorities of supporting the Territory economy while returning the budget to balance, the Territory Government will need to take a medium-term approach to fiscal reform. This will require a new fiscal strategy supported by systemic reform to the public sector and how it operates.

Successfully implementing a new fiscal strategy will require a resolute commitment by current and future governments and the broader community. The strategy will need to be supported by smarter approaches to resource allocation, a contemporised public service and greater accountability for expenditure effectiveness. Fiscal reform should focus on innovative solutions that increase the productivity of government services, making every dollar count towards better outcomes for Territorians.

The scale of this issue is beyond normal electoral cycles.

## Scenarios for the future

The interim report presents an independent assessment of the Territory Government's financial position and medium-term fiscal outlook, including scenarios for the period to 2030. It provides a plan for structural reform to return the budget to balance in a sustainable manner.

Delivering meaningful and sustainable fiscal reform will require a reduction in the Northern Territory Public Sector's operating cost growth. This can be achieved through reorganising how the public sector operates, enforcing greater discipline around meeting budget targets at the agency level, and looking at greater technological means to deliver services more efficiently. These reforms can be achieved while maintaining public sector employment levels and service delivery to remote areas.

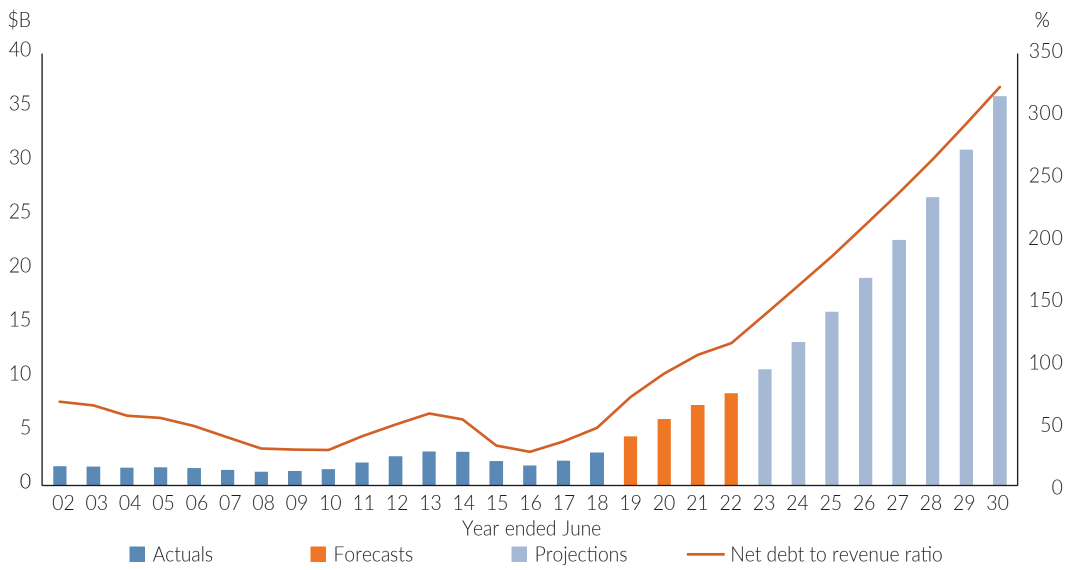
## Scenario 1

This scenario assumes business as usual expenditure growth, which differs from the figures published in the 2018 Mid-Year Report. GST projections match the figures published in the 2018 Mid-Year Report for the forecast period and continue at similar levels over the projection period. Under this scenario a surplus will not be achieved over the projection period.

| Key indicators | Historical average[1] | Forecasts[2] | Projections[3] |
|---|---|---|---|
| | % | % | % |
| Revenue growth | 5.9 | 5.2 | 5.3 |
| Expenditure growth | 6.2 | 6.9 | 7.4 |
| Average net debt to revenue ratio | 44.4 | 94.9 | 224.5 |

1 Average growth between 2002-03 and 2017-18.
2 Average growth between 2018-19 and 2021-22.
3 Average growth between 2022-23 and 2029-30.

### Chart 6: Scenario 1 – net debt




Scenario 1 assumes business carries on as usual, and no change is made to historical government spending patterns, growing community expectations, or sources of income, other than some growth in Territory revenue in five years' time when onshore gas operations commence.

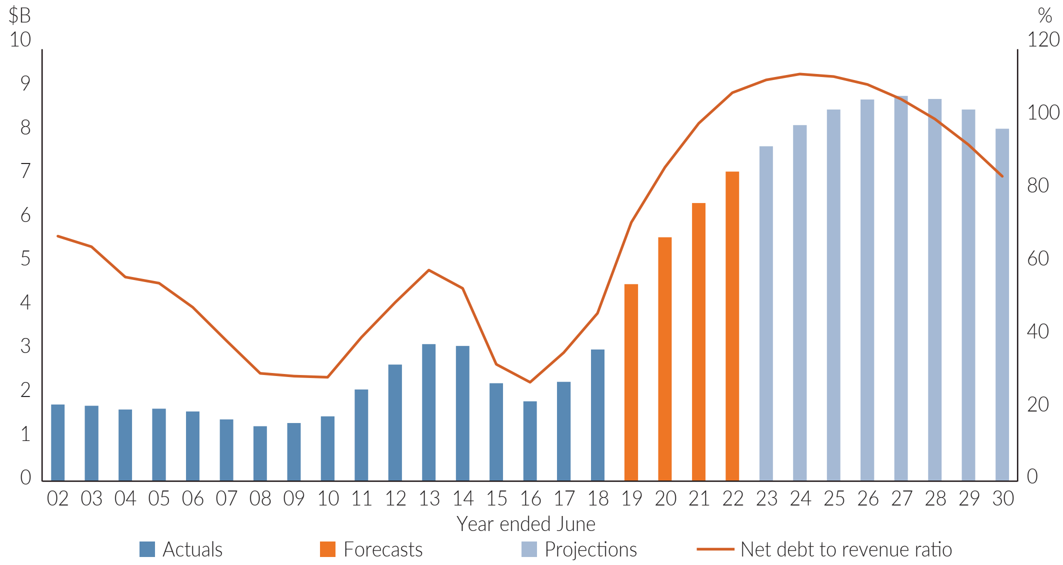
## Scenario 2

This scenario assumes the Territory implements a new fiscal strategy as part of the 2019 Budget, which keeps expenditure growth relatively flat in real terms. GST projections match the figures published in the 2018 Mid-Year Report for the forecast period and continue at similar levels over the projection period. Under this scenario a fiscal surplus would be achieved in 2028-29.

| Key indicators | Historical average[1] | Forecasts[2] | Projections[3] |
|---|---|---|---|
| | % | % | % |
| Revenue growth | 5.9 | 1.5 | 4.8 |
| Expenditure growth | 6.2 | 0.3 | 2.9 |
| Average net debt to revenue ratio | 44.4 | 90.4 | 102.8 |

1 Average growth between 2002-03 and 2017-18.
2 Average growth between 2018-19 and 2021-22.
3 Average growth between 2022-23 and 2029-30.

### Chart 7: Scenario 2 – net debt




Scenario 2 assumes a new fiscal strategy is implemented, which restrains expenditure growth over the projection period to around 3 per cent per annum (reflecting CPI plus long-term population growth less a reform dividend). As in scenario 1, growth in Territory revenue is assumed in five years' time when onshore gas operations commence[1]. The scenario recognises a quick fix is unlikely to eventuate, such as a recovery in GST revenue.

While scenario 2 is less daunting in terms of the growth in Territory debt levels, it nevertheless presents a concerning outlook for the sustainability of Territory finances. An increase in world interest rates for instance would severely compromise budget flexibility and prolong the need for austere expenditure measures. For these reasons the Territory must also address the revenue side of the budget. While Territory own-source revenues are limited in terms of their ability to generate significant revenue, the Commonwealth must see that the reduction in its support of the Territory through the GST and other measures is unsustainable.

1 The difference in revenue growth between scenarios 1 and 2 is due to tied Commonwealth revenues, which are assumed to match overall expenditure growth (excluding interest costs) in each scenario to ensure no net impact on the fiscal balance.

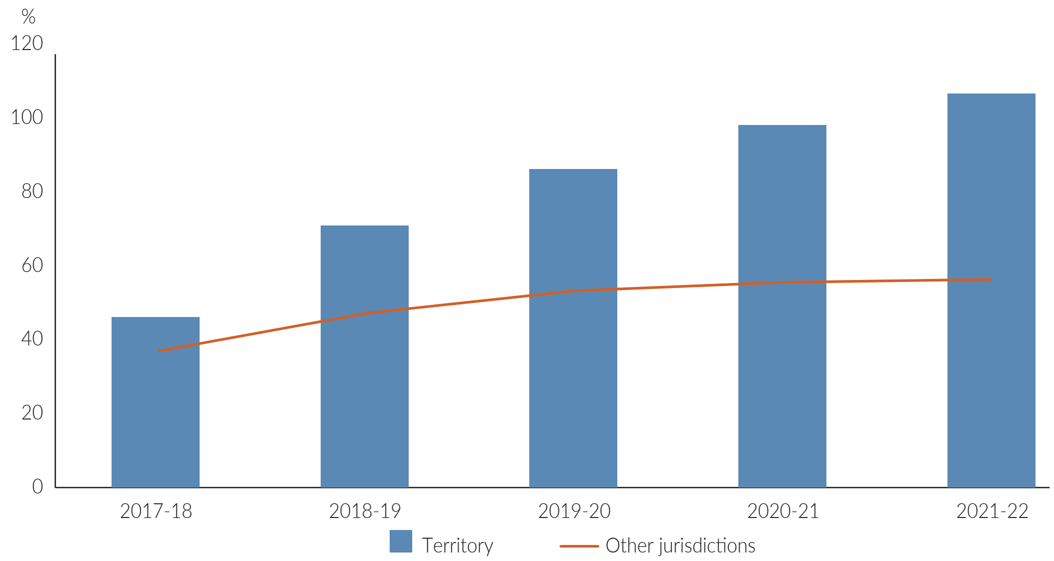
In addition, restoring the Territory's share of untied Commonwealth revenue to historical average levels, in conjunction with expenditure restraint under a new fiscal strategy, would bring forward the return to surplus to 2025-26. It will also be imperative for the Commonwealth to continue to support the Territory to close the gap in Indigenous disadvantage through ongoing funding to deliver services and address the infrastructure deficit in remote communities.

## Why our debt cannot keep rising

The scenarios demonstrate, in the absence of immediate and sustained expenditure restraint, the next generation of Territorians will bear a growing burden of current expenditure through higher interest costs and reduced capacity for service delivery with interest expenses approaching $2 billion per annum, or around 12 per cent of total expenditure by 2030. This also means a substantial proportion of borrowing over this period would be used to pay interest costs rather than deliver the services and infrastructure that future Territorians will need.

The Territory already has an above-average net debt to revenue ratio (a key indicator of capacity to service debt). Should the Territory's budget continue to deteriorate, the cost of maintaining government service levels will escalate in the form of higher interest charges associated with lower credit ratings, eroding the Territory's capacity to sustainably manage interest costs.

Chart 8: Net debt to revenue ratios




It is important industry leaders and the Territory community more broadly understand and acknowledge the limitations of government's spending capacity. Given the potential risks to all Territorians, it is essential the Territory operates in a fiscally responsible and sustainable manner.

# A plan for budget repair

The budget position is serious. A new fiscal strategy is required and government will need to take a medium to long-term approach to fiscal reform.

The government, the public service, industry and the community must adjust their expectations and be prepared to work together to achieve a balanced budget by no later than 2030. A new fiscal strategy will need to be supported by smarter approaches to spending decisions, a modern public service and improvements in the way government operates so it can live within its means. The plan for budget repair should focus on innovative ways of providing government services and lifting productivity, making every dollar count towards better outcomes for Territorians and focusing on the services Territorians need. An indicative plan for budget repair is provided on page 10.

Although the fiscal challenges facing the Territory are daunting, they also represent a once in a generation opportunity to implement systemic reform to drive better services and outcomes for all Territorians.

# Next steps

The interim report provides the basis for informed stakeholder engagement and community input to assist in the development of a framework for medium to long-term budget repair. Stakeholders will have the opportunity to contribute through a variety of channels including face to face discussions with the panel, written submissions and the Department of Treasury and Finance website.

# Appendix: A plan for budget repair

PHASE
01
IMMEDIATE

PHASE
02
SHORT TERM

PHASE
03
MEDIUM TERM

## FISCAL STRATEGY REFORM

### Fiscal Strategy Experts

- External expertise
- Establish case for change
- Review fiscal strategy and financial management policies
- Provide advice
- Avoid new taxes

### Financial Management Framework

- Review *Financial Management Act* and *Fiscal Integrity and Transparency Act*
- Refresh supporting instruments and policies
- Implement program evaluation framework

## STRUCTURAL REFORM

### Financial Management Reform

- Reform Treasury portfolio issues:
  - Refresh budget framework
  - Review tied funding arrangements
  - Review cash management policies and processes
  - Enhance forward estimates budgeting and reporting

### Machinery of Government Reform

- Identify opportunities to improve productivity through contemporary organisational models
- Harmonise policies and procedures

## ORGANISATIONAL AND PROGRAM REFORM

### Organisational Reviews

- Ongoing program of review and reform
- Focus on effective and efficient service delivery

### Public Sector Employment Reform

- With Stakeholders:
  - Review wages policy
  - Contemporise employment policies and legislation
  - Develop public sector capability and capacity

### Revenue

- Revenue policy reform:
  - Strengthen revenue compliance
  - Develop public asset management framework