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A happy new year is unlikely...

By John Lawrence – downloaded from Tasfintalk

One lesson from the recent Federal election is that the successful campaign relied more on dissatisfaction with the incumbents than the alternative policies offered.

The State election campaign seems to be following a similar pattern.

When it comes to describing the State government's position and prescribing alternative solutions we are yet to proceed beyond a few slogans.

The final State accounts for 2012/13 were issued at the end of October to an underwhelming response from the media and the alternative government. Talking about the State government's financial position for a few days once a year at budget time in May is scarcely enough to run an informed discussion, a necessary prerequisite if ever we are to reverse our lemming like progress over the precipice.

Tasmania will survive despite what governments may decide in the future. Survival will be easier if the government gets its own house in order and that necessarily requires a much better understanding of our situation and a more enlightened exchange by Giddings Gutwein and Hodgman.

As the government is essentially a cash operation the best understanding of a government's financial health is to look at the cash flow statement.

The following is an abridged version of the actual figures for 2012/13.

General Government cash flow 2012/13 actual

Operating

Cash in

General purpose grants(GST)	1,729		
Specific purpose grants (operating)	1,111		
Taxation revenue	919		
Sales goods and services	345		
Government business dividends etc	207		
Other revenue	268	4,579	100%

Cash out

Employee costs incl super	2,238		
Supplies & consumables	1,008		
Borrowing costs	14		
Grants to government businesses	251		
Other grants and subsidies	873		
Other payments	55	4,439	97%

Net operating cash

140 3%

Investing

Specific purpose grants (capital)	101
Sale existing assets	56
Capex	198
Investment government businesses	66

Net investing cash

107 2%

Financing

Loan repayments	20
Unfunded super payments	218

Net financing cash

238 5%

Cash deficit

205 4%

Inflows and outflows are split between operating, investing and financing.

- Operating flows, as the label suggest, relates to operating revenue and expenses
- Investing flows relate to capital items, capital grants and sales of assets as inflows, and capex and investments in government businesses as outflows
- Financing relates to payment of loans. There are no inflows (new loans)

It is essentially the same as the official figures, with minor adjustments.

- Specific purpose grants are split between operating and investing to give a more realistic picture, an approach followed by the Auditor General. The government includes all grants as operating revenue.

- Unfunded superannuation amounts on behalf of retired employees are excluded from operating expenses and included instead as financing, the payment of an old debt.
- Certain amounts that merely flow thru' government coffers, and don't appear in the P&L statement are netted off against one another and ignored.
- Temporary overnight borrowings of \$900 million on 30th June 2013 to restore the missing funds from deposits and trust fund accounts are ignored as they disappear again the next day. It's a mirage for accounts preparation purposes.

The cash deficit for 2012/13 was \$205 million. Don't worry about trying to understand net operating balances, underlying fiscal balances and all the other labels politicians hide behind but rarely understand, just look at the cash deficit and its components.

Operating expenses represent 97% of operating revenue. For a State that can't print money and can't borrow because it can't repay this is not sustainable. It needs to be less than 90% preferably 85%.

Only 3% of operating revenue remained after payment of operating expenses. The net amount spent on new capex and investments in government businesses was only 2%. This is disastrous. Only \$198 million was spent on capex. The fiscal strategy was to spend a bare minimum of \$246 million. The budgeted amount was \$434 million. Whenever there's a cash flow problem, capex, the Royal Hobart Hospital for instance, is either abandoned or deferred. Only 45% of budgeted capex was spent for the year.

We should be spending at least 5% on investing activities not 2%.

Finally the amount spent on financing activities was 5% of operating revenue. This won't change a lot, possibly creep up to 7% to 8% of operating revenues in the next 10 years as the unfunded superannuation liability peaks.

The overall actual result for 2012/13 was therefore a deficit of \$205 million equal to 4% of operating revenues.

The following table gives the 2012/13 actuals and compares it to the 2013/14 budget for the current year.

General Government cash flow

Operating	2014 budget		2013 actual	
Cash in				
General purpose grants(GST)	1,800		1,729	
Specific purpose grants (operating)	964		1,111	
Taxation revenue	941		919	
Sales goods and services	354		345	
Government business dividends etc	352		207	
Other revenue	316	4,727	268	4,579
Cash out				
Employee costs incl super	2,230		2,238	
Supplies & consumables	1,096		1,008	
Borrowing costs	12		14	
Grants & subsidies	1,026		1,074	
Other payments	33	4,397	55	4,389
Net operating cash		331		190
Investing				
Specific purpose grants (capital)	87		101	
Sale existing assets	26		56	
Capex	345		198	
Investment government businesses	66		66	
Net investing cash		298		107
Financing				
Loan repayments	20		20	
Unfunded super payments	236		218	
Net financing cash		256		238
Cash deficit		223		155

To make the years comparable an amount of \$50 million re Macquarie Point redevelopment has been excluded from grant expenses in 2012/13. This was received in 2011/12 but transferred to the new statutory authority in 2012/13, therefore overstating grant expenses for comparison purposes.

The cash deficit for 2013/14 is budgeted to be \$223 million, worse than the comparable figure of \$155 million for last year.

The major differences are an extra \$145 million of revenue from government businesses and extra \$147 million in capex.

The following year, 2014/15, revenue from government businesses is budgeted to rise by another \$69 million before crashing back to 2012/13 levels by the end of the forward estimates in 2016/17.

The one chance Tasmania had of repairing its fiscal situation via increased revenues from government businesses involved with renewable energy will be lost with the abolition of carbon pricing. The

alternative government has cheered the demise of carbon pricing but as yet hasn't addressed the problem of the resultant hole in the State's finances.

The alternative government produced a plan in May 2013 which it claimed would improve the net operating balance (the operating loss) by \$28 million. As all proposed budget adjustments were cash items it's reasonable to conclude the Lib's planned for a cash deficit of \$177 million instead of \$205 million, negligible given the size of the problem. It was just part of a silly game of my-bottom-line-is-better-than-yours, rather than a responsible attempt to chart a sustainable way forward. Both plans lead to an unsustainable government.

A closer look at the savings suggests most are not achievable anyway. For example:

- Withholding \$25 million from Forestry Tasmania would have meant FT was irretrievably insolvent necessitating payouts including unfunded superannuation amounts for 300+ employees.
- Savings from tearing up the TFA of \$17 million implies the Feds would continue to pay agreed TFA amounts and allow the government to spend the amounts elsewhere. An unlikely occurrence.
- Savings from reducing the Treasurer's Reserve by \$10 million is a mirage, because it's a contingent appropriation only, it does not appear in the budgeted outlays.

Thus far Tasmania has been funding cash deficits by spending amounts set aside for other purposes.

At 30th June 2013 there was supposed to be \$1,351 million in government deposit and trust fund accounts. Ignoring the temporary overnight borrowing designed to restore the rightful balances for accounting purposes, there was only \$451 million, the rest had been internally borrowed and spent on other things.

The three largest accounts are:

- Australian Government Funding Management Account \$501 million. This comprises specific purpose grants paid in advance, the \$270 million Royal Hobart Hospital funds for instance, the so called Wilkie money, plus other specific purpose grants. The total of \$501 million is more than 50% of what Tassie can expect to receive as specific purpose grants in a year. The government's specific purpose grants are 150 days in advance. The advance grants provide working capital. One obvious downside is the cash will have to be found from somewhere when the time comes to spend the grants as intended. Another downside will be if the Feds start winding back paying grants so far in advance. In that event the government will have to find working capital from somewhere else. It is not clear from the cash flow projections over the forward estimates as to what assumptions have been made about the extent of advance payments in the future.
- Risk Management Account \$190 million. The government is a self insurer and puts away funds to meet liabilities. Unfortunately it has all been internally borrowed and spent.
- TFA funds of \$49 million received as at 30th June but unspent as intended at that stage.

The three largest accounts total \$740 million.

There are many smaller accounts held by Finance-General (part of Treasury) adding up to a total of \$922 million.

All but \$22 million has been borrowed and spent as at 30th June 2013.

Another \$205 million has to be found to fund this year's deficit.

Where from?

We haven't been told yet? The only bank accounts left are those used by departments and agencies for ordinary operations.

One would have expected Hodgman and Gutwein to raise questions as to how the government proposes to:

1. Fund the extra deficit this year? Will the temporary overnight borrowings become permanent?, and
2. Repay amounts owing to special deposit and trust fund accounts which by 30th June 2014 will exceed \$1.1 billion.

As is well known the government has few borrowings. Most debt is held by government businesses who borrow from Tascorp the government's finance company. What is not well known is that in order to minimise future refinance risk of its portfolio of wholesale loans of varying size and maturity, Tascorp has borrowed roughly \$5 billion and only on-lent \$3 billion to government businesses, mainly the electricity companies. It still has \$2 billion sitting in the bank.

So there's plenty of money there. Except as presently structured repayments to Tascorp are impossible because the government is still running cash deficits.

We can probably only afford one more year, the current year, of cash deficits. We in no way resemble the Australian government where debt financing is easily accommodated. We don't have many lives left.

But as yet no Plan B. Instead just an unrealistic hope that forward estimates may be correct for once. It's a 10 to 1 outsider.

A cursory look at the components of government revenue suggest all risks are on the downside. The sensitivity of revenue upside to parameter changes, to use the macro accounting jargon, is slight. GST revenue is linked to a national pool, specific purpose grants often locked in for five years at a time, State taxes and charges will lag rather than lead, which all implies that increasing State revenue by parameter changes will be slow.

Policy changes are required.

Everyone avoids addressing revenue shortfalls. The broken down tax system is ignored. The alternative government's only extra revenue raising policy change is to raise another \$3 million in fines (currently about \$20 million pa), although when faced with another cash deficit approaching \$200 million the Libs flagged raising an extra \$750,000 from the proceeds of crime.

Fair dinkum, that was their response to the budget emergency. It's hardly likely to cover the increased incarceration costs as more forest protesters are locked up.

Assuming Messrs Hodgman and Gutwein understand the problem, although this is by no means certain from their public pronouncements, the reason for the avoidance of budgetary issues may

simply be tacit acknowledgment that their entire plan for the future is built on the same shaky foundations as the government's budget.

Why don't the media ask a few more probing questions?

Or will it be similar to the way Tony Abbott was treated with kid gloves before the election?

The losers in all of this are the voters of Tasmania, who will have to decide between two parties, who either don't understand and/or are quite willing to conspire to withhold the true state of the State's finances and the absolute ineffectiveness of the current proposed solutions.

Mr Hodgman seems determined to outperform Jaymes Diaz with his mindless repetition of his six? point plan to save the State....we're open for business.....no Will that's a slogan, what's your plan.... we'll get rid of red and green tape.....no Will we can read your placards. Just tell us about your plan..... and so it will go.....for another 3 months at least?

A recent Mercury poll of journos, movers and shakers recently awarded Peter Gutwein the accolade of the State's best politician, ahead of his leader, one remarking he had a good grasp of economics. The last few months heading towards an election will be an opportune time to demonstrate this well disguised trait, how his alternative plan will succeed in achieving sustainability and how realistically Tasmania will be able to repay \$1.1 billion missing from government deposit and trust accounts needed to fund capex such as the Hobart hospital project.

Ms Giddings was described by those polled as doing her best with the cards as dealt, but she's leading us off a cliff while still babbling about a pulp mill when she knows or at least should know, at least half the current inadequate resource won't ever be replanted. Maybe she's saving up the bad news for the Mid Year economic report due before 15th Feb 2014 or even the pre-election update required under the Charter of Budget Responsibility Act.

It may be a merry Xmas but the chances of a happy new year are remote.