

Report 15 of 2021

State finances and
related matters



Report of the Auditor-General

Report 15 of 2021

State finances and related matters

Tabled in the House of Assembly and ordered to be published, 26 October 2021

Second Session, Fifty-Fourth Parliament

By authority: S. Smith, Government Printer, South Australia

*The Auditor-General's Department acknowledges and respects
Aboriginal people as the State's first people and nations, and
recognises Aboriginal people as traditional owners and occupants of
South Australian land and waters.*



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25 October 2021

President
Legislative Council
Parliament House
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Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Dear President and Speaker

**Report of the Auditor-General:
Report 15 of 2021 *State finances and related matters***

Under the *Public Finance and Audit Act 1987*, I present to each of you Report 15 of 2021 *State finances and related matters*.

Content of the Report

The 2021-22 State Budget was tabled in Parliament in June 2021. This Report provides our observations on the State's public finances based on our review of the Budget. This involved:

- reviewing the Budget against the SA Government's stated fiscal strategy
- analysing new budget measures and initiatives
- examining Budget estimates and forecasts
- analysing major assets and liabilities
- analysing South Australia's key fiscal measures compared to other Australian states
- reviewing credit rating agency reports on South Australia.

Our analysis is based on data provided in the 2021-22 Budget Papers supplemented with representations and information provided by the Department of Treasury and Finance.

Acknowledgements

The audit team for this report was Salv Bianco, Ken Anderson, Stephen Gladigau and Simon Altus.

We appreciate the cooperation and assistance given by staff of the Department of Treasury and Finance during our review.

Yours sincerely

A handwritten signature in black ink, appearing to read "Richardson", with a long horizontal flourish extending to the right.

Andrew Richardson
Auditor-General

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1 Executive summary

1.1 Introduction

The 2021-22 State Budget (2021-22 Budget) was tabled in Parliament in June 2021.

In the few months since the 2021-22 Budget was released, there have been COVID-19 outbreaks across Australia, including South Australia. These outbreaks and resulting restrictions have impacted economic activity at both the national and state level. The COVID-19 vaccine rollout currently under way will be important for South Australia's economic and budget recovery.

This Report provides our observations on some key matters, trends and risks for the State's public finances based on our review of the 2021-22 Budget, including analysis of the SA Government's fiscal response to the COVID-19 pandemic. Events worldwide remain fluid. Consequently, the information in this Report, like all budget reporting in this period, is subject to unexpected events and greater than usual uncertainty about financial forecasts.

Section 2 provides further details on the objective and scope of our review.

1.2 Key observations

1.2.1 Significant ongoing economic uncertainty driven by COVID-19 may mean actual results substantially differ from 2021-22 Budget forecasts

The 2021-22 Budget aims to support the State's economic recovery from COVID-19. It notes that uncertainty remains around the timing and pace of recovery both in Australia and globally, particularly in light of new COVID-19 variants like Delta.

There are several risks arising from COVID-19 that may impact financial and economic forecasts in the 2021-22 Budget, including:

- the pace of the global vaccination rollout and the effectiveness of vaccines against new COVID-19 strains
- the ability to manage COVID-19 in the community and any further restrictions that would negatively affect confidence and weigh on private consumption and investment
- the pace at which international tourism and education can recover to pre-pandemic levels
- the delay of significant public sector infrastructure investment due to capacity constraints
- disruption to production networks and the availability of goods and labour supply.

The ongoing economic uncertainties created by COVID-19, in particular the major outbreaks in New South Wales and Victoria and new restrictions introduced in South Australia in the few months since the 2021-22 Budget was released, mean there is a higher than usual risk that actual results will differ from Budget estimates. Standard & Poor’s (S&P’s) negative outlook on South Australia’s AA+ credit rating highlights the risk that the adverse impacts of COVID-19 and the State’s proposed stimulus program could stress its fiscal indicators more than anticipated.

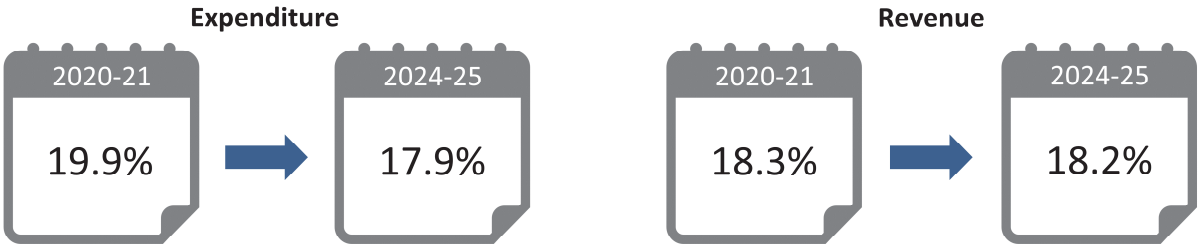
Section 3.2 provides further details on the uncertainties impacting 2021-22 Budget forecasts.

1.2.2 SA Government’s forecast return to net operating surplus from 2022-23 mainly driven by constraint in expenditure growth

The SA Government has a fiscal target of achieving a net operating surplus in the general government sector every year. It expects to meet its fiscal target from 2022-23 following significant deficits between 2019-20 and 2021-22. This return to net operating surplus is one year earlier than estimated in South Australia’s previous Budget and sooner than most other Australian states. New South Wales and Queensland are not forecasting a return to surplus until 2024-25 and Victoria is expecting operating deficits across the four years of its 2021-22 Budget.

The forecast return to net operating surplus in 2022-23 largely relies on limiting growth in SA Government expenditure. Average annual expenditure growth over the four years of the budget is 1.7% compared to 4.2% for revenue. Figure 1.1 shows that general government sector expenditure as a share of gross state product (GSP) is forecast to fall significantly more than revenue from 2020-21 to 2024-25.

Figure 1.1: General government sector expenditure and revenue as a share of GSP



The reduction in expenditure growth is expected to occur as COVID-19 stimulus expenditure, in particular business and community support grant programs, phases out after 2021-22.

Section 4.4 provide further details on net operating balance trends in the 2021-22 Budget.

1.2.3 SA Government will face several challenges in returning to net operating surpluses including achieving Health savings, enterprise agreement negotiations and volatility in GST receipts

The SA Government is forecasting a marginal surplus for the general government sector in 2022-23 (\$48 million).

There are a number of expenditure risk factors that might prevent a return to surplus by 2022-23, including:



Vaccines may have reduced effectiveness against new COVID-19 strains and impact the pace at which international tourism and education can return to pre-pandemic levels.



New expenditure measures may be required to stimulate the State economy.



The Health and Wellbeing portfolio is expected to make \$800 million of savings over the four years of the 2021-22 Budget and it has a history of not achieving its savings targets.



Growth in employee expenses may exceed that allowed for in the forward estimates due to enterprise agreement negotiation outcomes, particularly given that 66% of general government sector employees are captured by current negotiations.

GST receipts have also experienced significant volatility during the COVID-19 pandemic. GST revenue has been revised up by \$2.453 billion in the 2021-22 Budget following a \$3.638 billion write-down in the previous Budget. This largely reflects changes in national consumption expenditure and the size of the national GST pool.

The size of the national GST pool forecast at the time of the 2021-22 Budget may be reduced by the impact of ongoing COVID-19 outbreaks and restrictions in New South Wales and Victoria on consumption expenditure. This could result in lower than forecast GST revenue grants for South Australia and impact its ability to generate operating surpluses.

Sections 4.5 and 4.6 provide further details on trends and risks for forecast expenditure and revenue in the 2021-22 Budget.

1.2.4 Interest rate rises may reduce SA Government's flexibility to respond to future economic challenges

Net debt for the SA Government's non-financial public sector (NFPS) is forecast to increase from \$21.952 billion at 30 June 2021 to \$33.623 billion at 30 June 2025. This increase mainly reflects:

- the significant expected net operating deficit in 2021-22 (\$1.816 billion)
- the large scale of the SA Government's capital program over the four years of the 2021-22 Budget (\$17.909 billion).

The estimated NFPS net debt to revenue ratio is estimated to increase from 100% at 30 June 2021 to 130% by 30 June 2025. This trend is broadly in line with other Australian states.

Large infrastructure initiatives included in the 2021-22 Budget may result in further net debt increases beyond the forward estimates. Significant expenditure is expected to be incurred

for the North-South Corridor River Torrens to Darlington project (\$6.547 billion), new Women’s and Children’s Hospital (\$814 million) and Riverbank Arena (\$583 million) after 2024-25.

While credit ratings issued by S&P and Moody’s remain unchanged and the Reserve Bank of Australia (RBA) expects interest rates to remain low in the short to medium term, the increased net debt increases the SA Government’s exposure to interest rate rises. The Department of Treasury and Finance (DTF) advised us that a one percentage point increase in the average interest rate applying to NFPS net debt would result in additional interest expenses of \$336 million in 2024-25.

NFPS interest expense as a percentage of revenue is expected to increase from 3.1% in 2020-21 to 4.6% by 2024-25. As the ratio of interest expense to revenue increases there is a risk the SA Government will have less budget flexibility to respond to future economic challenges.

Section 5.4 provides further details on the State’s credit rating assessments and the risks associated with its net debt increases.

1.2.5 Capacity constraints and material shortages significantly increase risk of cost escalations for SA Government’s expanded capital program

Purchases of non-financial assets for the NFPS are projected to total \$17.909 billion over the four years of the 2021-22 Budget, an increase of \$1.197 billion on purchases over the four years of the previous Budget.

Major capital projects carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and timeliness of completion. There are several significant challenges and risks for the SA Government’s capital program, including:

- the availability of key building materials and appropriately skilled labour as governments across Australia undertake expanded capital programs
- the capacity of the South Australian building industry to cope with the significant volume of works required within short time frames and the potential for associated cost pressures on project budgets.

S&P noted that there is a risk of cost overruns, skilled labour shortages and project delays due to record levels of infrastructure construction occurring across Australia. The Australian Bureau of Statistics building construction price index increased significantly between June 2020 and June 2021, highlighting that significant upward revisions may be required to estimated capital project costs. This may further increase net lending deficits and net debt over the four years of the budget. Section 5.3 provides further details on challenges and risks associated with the SA Government’s budgeted capital program.

2 Review mandate, objective and scope

2.1 Our mandate

The Auditor-General has authority to conduct this review under section 36(1)(b) of the *Public Finance and Audit Act 1987*. This section allows the Auditor-General to report on matters that, in his opinion, should be brought to the attention of Parliament and the SA Government.

2.2 Our objective

The objective of this Report is to provide independent commentary and analysis on the 2021-22 Budget to highlight key matters, trends and risks for the State's public finances, including analysis of the SA Government's fiscal response to the COVID-19 pandemic.

2.3 What we reviewed and how

We reviewed the 2021-22 Budget to identify key matters, trends and risks for the State's public finances. This involved:

- reviewing the Budget against the SA Government's stated fiscal strategy
- analysing new budget measures and initiatives
- examining Budget estimates and forecasts
- analysing major assets and liabilities
- analysing South Australia's key fiscal measures compared to other Australian states¹
- reviewing credit rating agency reports on South Australia.

Our analysis is based on data provided in the 2021-22 Budget Papers, supplemented by representations and information provided by DTF. The 2021-22 Budget notes that while it was framed against the expectation that economic conditions will continue to improve as COVID-19 restrictions ease, some greater than usual uncertainty remains to the global, national and state economic outlook.

We expect to table a separate report on the 2020-21 Consolidated Financial Report, including the actual results for the whole of the SA Government, in 2022.

2.4 What we did not review

This Report primarily comments on Budget information. The data and assumptions underlying this information are not subject to audit and no audit opinion is provided on the accuracy of either the historical or forecast figures presented in the 2021-22 Budget. We have not performed work to provide an opinion on the effectiveness of the SA Government's budgetary control.

¹ Appendix 1 provides further details on key fiscal measures.

3 2021-22 Budget policy measures and parameter variations

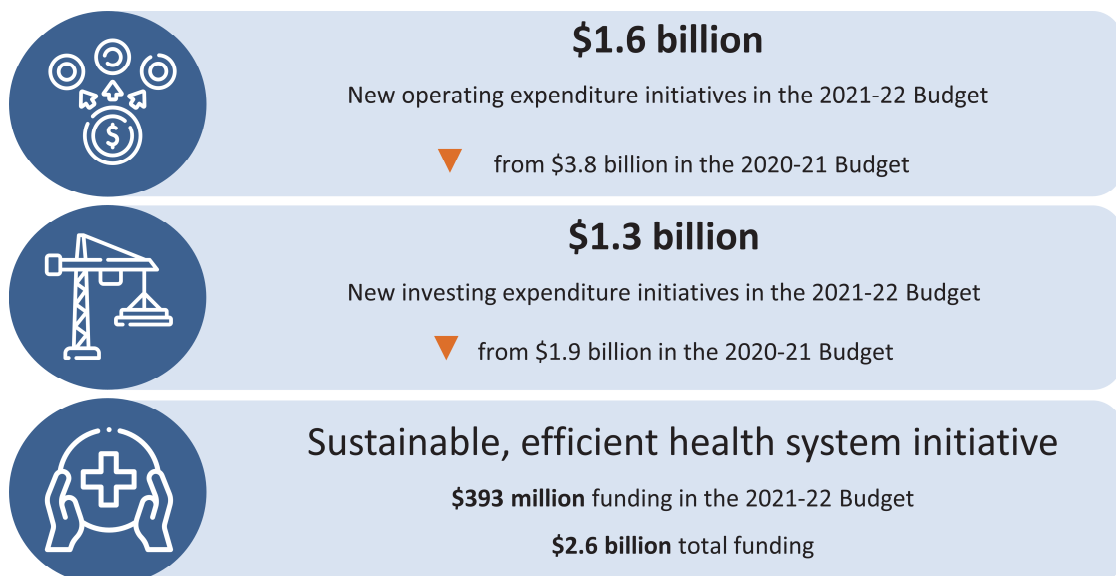
Key points

- The ongoing impact of COVID-19 outbreaks and restrictions means greater than usual uncertainty continues for economic and budget forecasts.
- Estimated GST revenue grants for the period 2020-21 to 2023-24 have been revised significantly upwards by \$2.453 billion since the previous Budget.
- 80% of new investing initiatives are for infrastructure and transport and mainly reflect road upgrades predominately funded by the Commonwealth Government.
- The budget target of achieving national average efficiency in delivering public hospital services has been delayed by another year to 2024-25. The SA Government's original time frame for meeting this objective in the 2018-19 Budget was 2021-22.
- The SA Government's \$4 billion stimulus package in the 2020-21 Budget focused on completing initiatives within a two-year time frame. DTF estimates that 78% of this package will be spent by the end of 2021-22.

3.1 Overview of key trends

Figure 3.1 highlights key trends for policy measures in the 2021-22 Budget.

Figure 3.1: Key 2021-22 Budget policy measure trends for the general government sector²



² 2021-22 Budget figures reflect the period 2020-21 to 2024-25 and 2020-21 Budget figures reflect the period 2019-20 to 2023-24.

3.2 2021-22 Budget objectives and assumptions

3.2.1 2021-22 Budget aims to support the State's economic recovery from COVID-19

Following a 3.3% contraction in the world economy in 2020, the International Monetary Fund in its April 2021 World Economic Outlook has forecast global economic growth of 6% in 2021. Advanced economies are forecast to grow by 5.1%, while emerging market and developing economies are expected to grow by 6.7%.

The 2021-22 Budget notes that Australia's economic recovery has been stronger and faster than originally expected. There have been upward revisions to economic forecasts since the 2020-21 Budget was released in November 2020. While South Australia's GSP was expected to show a 0.75% contraction in 2020-21, the expectation now is that GSP will grow by 2.25% in 2020-21, accelerating to 3.5% in 2021-22. However, sectors such as tourism and international education continue to be affected by Australia's international border restrictions.

The 2021-22 Budget aims to support the State's economic recovery from COVID-19 and grow local jobs, while investing in community infrastructure and core government services to ensure South Australia remains a great place to live and do business.

There are no changes to the SA Government's existing fiscal targets in the 2021-22 Budget. Sections 4.4.1, 4.6.2 and 5.4.4 provide further details on the SA Government's performance against its fiscal targets.

3.2.2 Ongoing and emerging impacts of COVID-19 mean greater than usual uncertainty continues for economic and budget forecasts

The 2021-22 Budget indicates that forecasting the impact of COVID-19 on SA Government revenues and expenses was particularly difficult in the initial phases of the pandemic. Forecasts and projections for South Australia from 2021-22 onwards consider the expected performance of the international, national and state economies over the short to medium term. Uncertainty about the timing and pace of economic recovery from COVID-19 remains, both in Australia and globally, particularly in light of new COVID-19 variants like Delta.

The 2021-22 Budget also notes that, with the vaccine rollout progressing in Australia, it is hoped that restrictions used to minimise the spread of the virus will reduce, thereby reducing the impact on the economy and key government budget parameters.

DTF advised us that the forecasts in the 2021-22 Budget are based on the assumptions in figure 3.2 and that these assumptions are broadly in line with those in the 2021-22 Commonwealth Government Budget.

Figure 3.2: Assumptions for forecasts made in the 2021-22 Budget

The forecasts in the 2021-22 Budget assume:



The vaccine roll-out continues, with additional funds provided to ensure access to vaccines at SA Government COVID-19 clinics and vaccination centres.



There are no further significant domestic COVID-19 outbreaks, and that those that do occur are effectively contained.



International students will start returning in early-2022 and international border restrictions will progressively ease from mid-2022.

DTF advised us that several risks that may impact financial and economic forecasts in the 2021-22 Budget are not necessarily within the SA Government's control, including:

- the pace of the global vaccination rollout and the effectiveness of vaccines against new COVID-19 strains, which can potentially impact migration numbers, the timing of a return to international travel and the ability to grow exports, including service exports
- disruption to production networks and the effect on productivity growth where international closures impact the availability of goods and labour supply
- the ability to manage COVID-19 in the community and any further restrictions that would negatively affect confidence and weigh on private consumption and investment
- the pace at which international tourism and education can recover to pre-pandemic levels
- significant public sector infrastructure investment being delayed due to capacity constraints.

The ongoing economic uncertainties created by COVID-19 mean there is a higher than usual risk that actual results will differ from Budget estimates. In the few months since the 2021-22 Budget was released, there have been further COVID-19 outbreaks across Australia, including South Australia. This contrasts with the 2021-22 Budget assumption that there would be no further significant domestic outbreaks in Australia and that those that do occur will be effectively contained. These outbreaks and resulting social restrictions have impacted economic activity at both the national and state level, and may reduce GST revenue and State taxation collections while also requiring further business support expenditure.

The South Australian Centre for Economic Studies July 2021 Economic Briefing Report highlighted the importance of the vaccine rollout to South Australia's economic recovery:

One of the most significant threats to Australia's ongoing recovery – and therefore South Australia's – revolves around the slow vaccine roll-out. Failure to improve vaccination rates, which are exceptionally low by the standards of other advanced economies, carries the threat of further outbreaks. It may also

prolong border closures which could accentuate scarring effects on those sectors that are dependent on migration, international travel or foreign workers.

DTF advised us that, given the uncertainty associated with managing COVID-19 including quarantine, trading and border restrictions, the SA Government has decided to:

- fund agencies for expected COVID-19 related costs for the first six months of 2021-22
- review resource requirements in the 2021-22 mid-year budget review (MYBR), when the requirements for the second half of the year may be clearer.

3.3 Policy and parameter variations

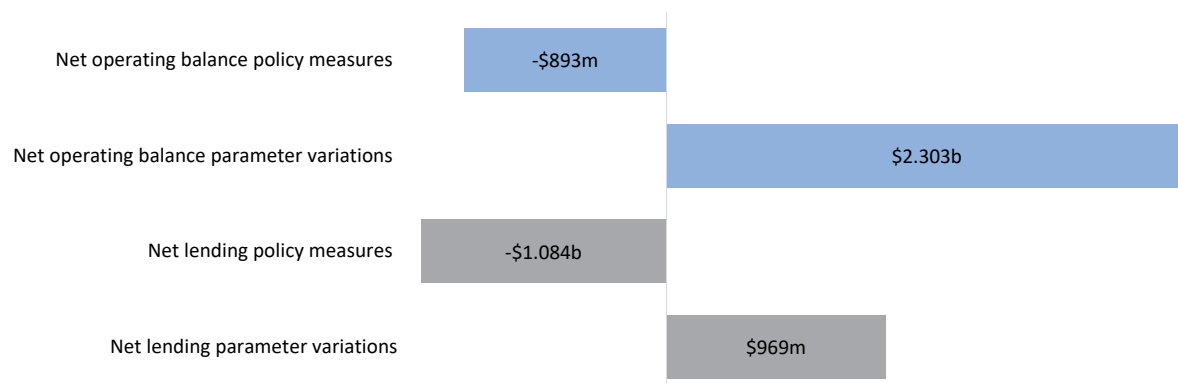
3.3.1 Significant upward revisions to estimated GST revenue have improved forecast net operating balances

The Budget Papers include a reconciliation of policy and parameter variations since the 2020-21 Budget for the net operating balance and net lending.³ This explains differences between the 2020-21 Budget and 2021-22 Budget⁴ arising from:

- policy changes – decisions made by the SA Government to increase or decrease taxation, fees and charges and spending
- parameter changes – variations that do not flow from policy choice changes, such as changes in taxation collections owing to economic conditions.

Figure 3.3 shows the total policy and parameter variations in the 2021-22 Budget for the period 2020-21 to 2023-24 and how they impact the net operating balance and net lending.

Figure 3.3: Total general government sector policy and parameter variations since the 2020-21 Budget



³ 2021-22 Budget Paper 3 *Budget Statement*, tables 1.8 and 1.9.

⁴ DTF advised us that the November 2020 release of the 2020-21 Budget enabled the inclusion in the Budget Papers of updates and transactions that would normally occur as part of the MYBR. No separate MYBR was prepared for 2020-21.

Figure 3.3 highlights that the net impact of policy and parameter variations since the 2020-21 Budget was to revise forecast net operating balances upwards by \$1.41 billion and forecast net lending balances downwards by \$115 million.

The improvement in the net operating balance forecasts is mainly due to parameter variations in the 2021-22 Budget reflecting upward revisions to estimated GST revenue (\$2.453 billion). Figure 3.3 shows that most of this additional revenue flows through to improved forecast net operating balances rather than being allocated to new policy measures. Sections 4.4 and 4.5 provide further details on net operating balance and GST revenue trends.

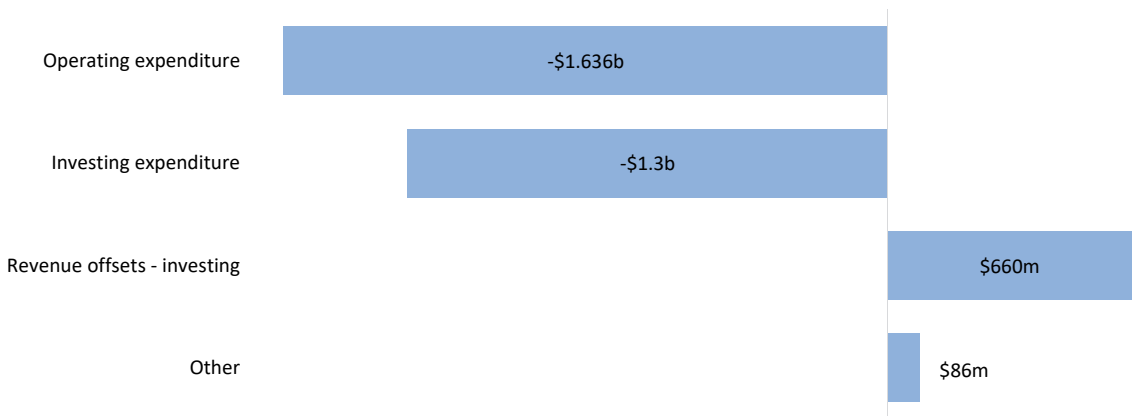
Net operating balance policy measures mainly reflect new operating expenditure initiatives (\$1.46 billion) and investing revenue offsets (\$535 million). Sections 3.4 and 3.5 provide further details on the major new operating expenditure initiatives and the Commonwealth funding for investing projects reflected through investing revenue offsets.

Net lending policy measures almost entirely comprise new investing expenditure initiatives that are further detailed in section 3.5. These are largely offset by net lending parameter variations mainly reflecting investing contingency adjustments and the changed timing of expected investing project expenditure. The investing contingency adjustments include an adjustment to reflect the SA Government’s decision not to proceed with the Brighton Road Hove Level Crossing upgrade project.

3.3.2 New operating and investing expenditure initiatives have been scaled back in the 2021-22 Budget following \$4 billion stimulus package in the 2020-21 Budget

Figure 3.4 provides a breakdown by category of new measures in the 2021-22 Budget for the period 2020-21 to 2024-25.

Figure 3.4: New general government sector measures in the 2021-22 Budget for period 2020-21 to 2024-25⁵



⁵ Figure 3.4 includes the estimated result for 2020-21 and forecast result for the four years of the 2021-22 Budget. The ‘other’ category comprises taxation revenue measures (\$2 million), operating expenditure revenue offsets (\$4 million) and asset sales (\$80 million).

The most significant new budget measures are operating expenditure initiatives and investing expenditure initiatives. Revenue offsets – investing mainly reflect Commonwealth funding for a portion of the investing expenditure initiatives.

New operating and investing expenditure initiatives in the 2021-22 Budget are less significant than in the 2020-21 Budget, with operating expenditure initiatives down by \$2.124 billion (56%) and investing expenditure initiatives down by \$555 million (30%). These significant decreases reflect the phasing out of economic stimulus measures after the \$4 billion stimulus package in the 2020-21 Budget, as the State’s economy started to recover from the impacts of COVID-19.

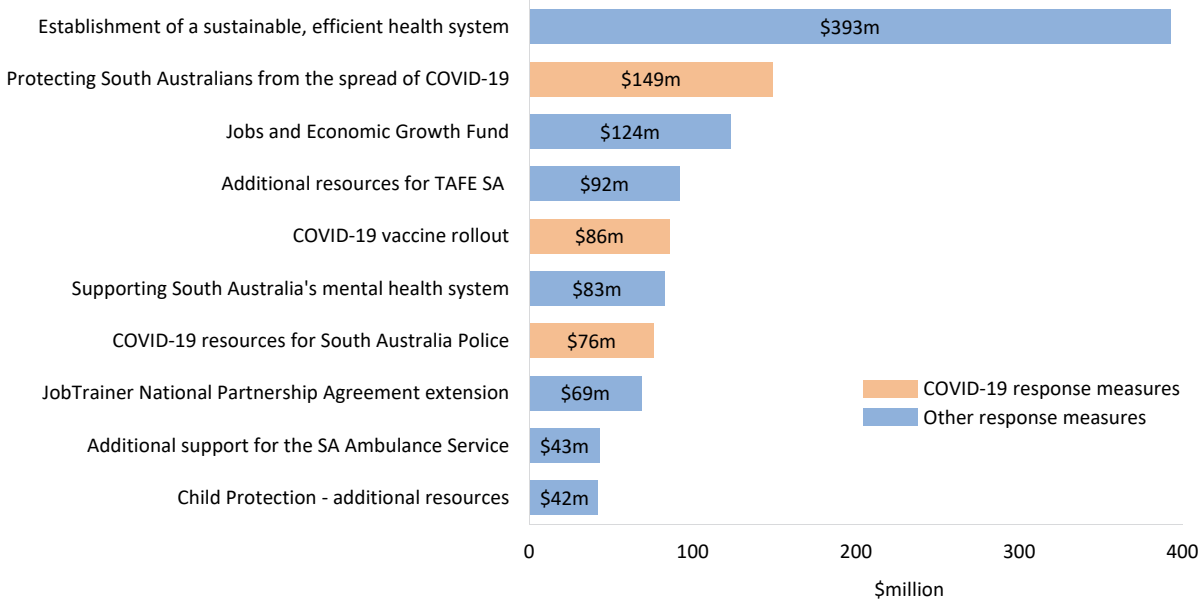
No new operating or investing savings were introduced in the 2021-22 Budget. Existing operating savings from prior year budgets range from \$136 million in 2021-22 to \$519 million in 2024-25. DTF advised us that most savings now reflect the continuation of ongoing efficiency dividends.

3.4 Operating expenditure initiatives

3.4.1 Almost half the operating expenditure initiatives in the 2021-22 Budget relate to additional funding for Health and Wellbeing

Figure 3.5 shows that the most significant operating expenditure initiative in the 2021-22 Budget is the establishment of a sustainable, efficient health system (\$393 million) in the Health and Wellbeing portfolio. This initiative commenced in 2017-18 and additional funding has been provided for it in each budget since the 2018-19 Budget. Section 3.6 provides further details on this initiative and progress against Health and Wellbeing savings targets.

Figure 3.5: Major new general government sector operating expenditure measures in the 2021-22 Budget for the period 2020-21 to 2024-25



New funding has also been provided to Health and Wellbeing for:

- the ongoing response to COVID-19 (\$149 million)
- the COVID-19 vaccine rollout in state-operated facilities (\$86 million)
- additional support for South Australia’s mental health system (\$83 million)
- additional support for the SA Ambulance Service (\$43 million).

New Health and Wellbeing operating expenditure initiatives total \$800 million and represent 49% of total new operating expenditure initiatives.

Some initiatives are expected to be partly funded by the Commonwealth Government. This includes the JobTrainer National Partnership Agreement extension (\$34 million) and a contribution to the costs of the vaccine rollout in state-operated facilities (\$16 million).

3.4.2 TAFE SA has received significant additional resources in the 2021-22 Budget in line with its revised strategic direction, savings and revenue targets

The 2021-22 Budget reports that TAFE SA is in the process of reforming its services and operations to become a contemporary training provider and to align training services with the SA Government’s direction for the delivery of vocational education and training. It also notes that additional resources have been provided to TAFE SA for the identification and achievement of efficiency measures and lower forecasts for external revenue growth. Total new operating expenditure funding for TAFE SA over the four years of the budget is \$92 million, while revenue targets were reduced by \$123 million over the same period.

3.4.2.1 Additional funding provided to TAFE SA to support its reform program

DTF advised us that prior to the 2021-22 Budget, TAFE SA’s operating expenditure budget assumed a reduction in expenditure of 8% by 2024-25. TAFE SA indicated as part of the 2021-22 Budget process that it was unable to achieve the savings targets set in previous budgets. It requested additional funding across the forward estimates based on current resourcing levels being maintained. The SA Government approved additional operating expenditure of \$92 million, net of a revised general efficiency target of \$20 million. The revised general efficiencies are broadly in line with annual efficiencies applied to other SA Government agencies.

3.4.2.2 Significant reductions in TAFE SA revenue targets owing to current course delivery profile and impact of COVID-19 on overseas student and training fee revenue

DTF advised us that TAFE SA’s external revenue targets were significantly increased in 2015-16 in response to structural budget pressures. Since then, TAFE SA has not been able to achieve the targets and successive budgets have provided partial reductions across the forward estimates. TAFE SA’s actual external revenue peaked at \$101 million in 2015-16 and has been steadily decreasing to around \$91 million in 2019-20.

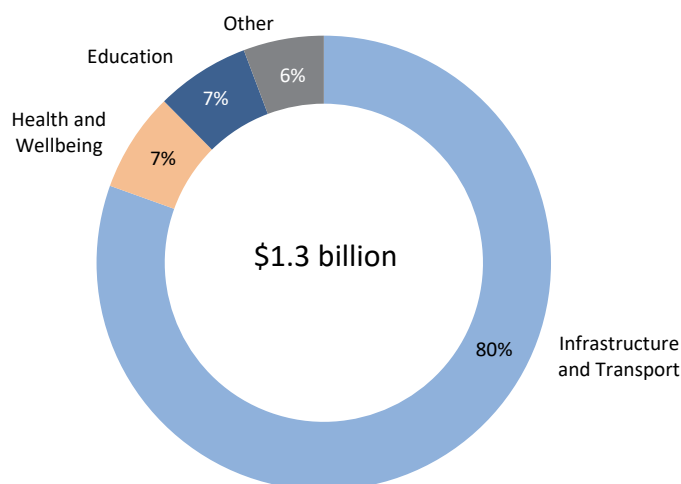
DTF also advised us that prior to the 2021-22 Budget, the forward estimates reflected external revenue targets of \$89 million in 2020-21, increasing to \$129 million by 2024-25, an increase of 45%. As part of the 2021-22 Budget, TAFE SA submitted a request to reduce external revenue targets across the forward estimates based on the current course delivery profile and the impact of COVID-19 on overseas student and training fee revenue. The SA Government approved a rebasing of the revenue targets in the 2021-22 Budget, with a growth target of 5% per annum from 2022-23 established, recognising that revenue is expected to return to previous levels and then grow as international borders reopen.

3.5 Investing expenditure initiatives

3.5.1 The significant majority of new investing expenditure initiatives are in the Department for Infrastructure and Transport

New investing initiatives in the 2021-22 Budget total \$1.3 billion between 2020-21 and 2024-25. Figure 3.6 shows the breakdown of them by agency.

Figure 3.6: New general government sector investing initiatives by agency

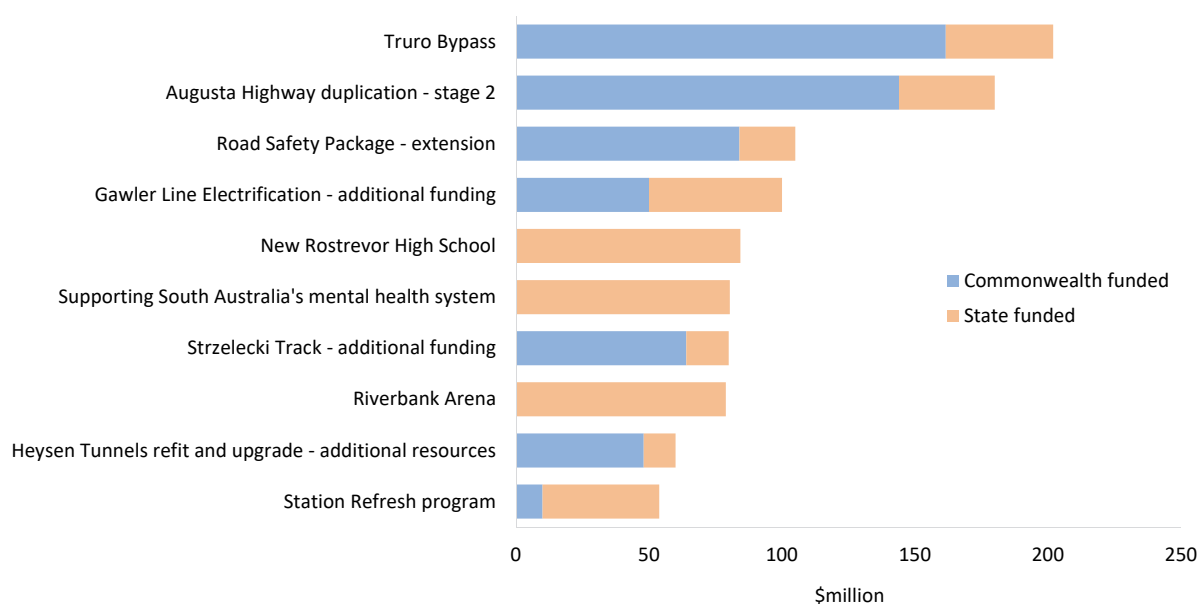


Investing expenditure initiatives in Infrastructure and Transport total \$1.047 billion.

3.5.2 The most significant new investing expenditure initiatives are road upgrades predominately funded by the Commonwealth Government

Figure 3.7 shows the most significant new investing initiatives in the 2021-22 Budget and the Commonwealth Government funding provided to them.

Figure 3.7: Major new investing initiatives in the 2021-22 Budget⁶



Most of the significant new investing initiatives focus on road and infrastructure upgrades and several are predominately funded by the Commonwealth Government. The Truro Bypass, Augusta Highway duplication, Road Safety Package, Strzelecki Track and Heysen Tunnels are all 80% funded by the Commonwealth Government. The Commonwealth Government is also providing 50% of the funding for the Gawler Line Electrification initiative and \$10 million to the Station Refresh program.

The Riverbank Arena initiative provides \$79 million between 2022-23 and 2024-25 to finalise planning and commence preparation works for the construction of a new multipurpose arena within Adelaide's Riverbank Precinct at a total cost of \$662 million. The early site works will include constructing a tunnel under Morphett Street and preparatory utilities infrastructure works, with significant construction of the new arena to commence from 2025-26.

3.6 Health savings

3.6.1 Budget target of achieving national average efficiency in delivering public hospital services further delayed to 2024-25

Figure 3.8 shows the reprofiled Health and Wellbeing savings requirement reflected in the 2021-22 Budget, as advised by DTF.

⁶ The Riverbank Arena is an investing initiative of the Adelaide Venue Management Corporation reflected on page 86 of 2021-22 Budget Paper 5 *Budget Measures Statement*. The Adelaide Venue Management Corporation is a public non-financial corporation. All other measures in figure 3.7 are in the general government sector.

Figure 3.8: Summary of Health and Wellbeing’s revised savings targets

	2020-21 \$million	2021-22 \$million	2022-23 \$million	2023-24 \$million	2024-25 \$million
2020-21 Budget savings targets	80	160	240	314	314
2021-22 Budget savings targets	-	80	160	240	320
Adjustment to savings targets	-80	-80	-80	-74	6
Additional 2020-21 overspend projected by Health and Wellbeing	-13	-15	-17	-19	-21
Total 2021-22 Budget measure	-93	-95	-97	-93	-15

Health and Wellbeing’s savings task grows by \$80 million annually and totals \$800 million over the four years of the 2021-22 Budget.

The 2021-22 Budget notes that Health and Wellbeing is not projected to achieve its 2020-21 financial targets. Health and Wellbeing faced significant operational pressures throughout the year, including the ongoing response to COVID-19. Given this and the continuing impacts of the pandemic, the establishment of a sustainable, efficient health system budget measure in the 2021-22 Budget provides \$393 million over the forward estimates to reprofile Health and Wellbeing’s financial improvement targets. The SA Government’s expectation remains that Health and Wellbeing will aim to deliver services at the national efficient price by the end of the forward estimates in 2024-25.

This represents a further one-year delay in the achievement of the national efficient price target compared to the previous Budget. The original planned timeline for achieving this target in the 2018-19 Budget was 2021-22.

The total amount allocated to the establishment of a sustainable, efficient health system budget measure since the 2018-19 Budget is now \$2.624 billion. This highlights the significant additional funding the SA Government has had to provide Health and Wellbeing compared to that initially budgeted, mainly due to Health and Wellbeing not meeting its budget target of achieving national efficient price.

DTF advised us that the cessation of time-limited COVID-19 funding contributes to budgeted reductions in Health and Wellbeing’s total expenditure in 2021-22 and 2022-23. The 2020-21 estimated result for total Health and Wellbeing expenditure is \$7.467 billion, compared to budgeted amounts of \$7.369 billion in 2021-22 and \$7.193 billion in 2022-23. This reflects a 3.7% decrease in total budgeted Health and Wellbeing expenditure between 2020-21 and 2022-23.

We expect the need for expenditure constraint to present a significant challenge for Health and Wellbeing, as it has not achieved its savings goals for several years.⁷

Further details on Health and Wellbeing’s 2020-21 budget performance, including an analysis of variations between 2020-21 Budget and actual results, are provided in the section of Part C of my 2020-21 Annual Report titled ‘Health sector overview’.

⁷ Refer to Auditor-General’s Report 8 of 2021 *State Finances and related matters*, pages 20-22.

3.7 2020-21 Budget stimulus package

3.7.1 78% of \$4 billion stimulus package expected to be spent within two-year time frame set by the 2020-21 Budget

In the 2020-21 Budget, the SA Government committed to a \$3.998 billion stimulus package intended to support South Australian businesses, community organisations and households impacted by COVID-19 pandemic restrictions and to assist the State's broader economic recovery. The stimulus package focused on projects and initiatives that could be completed or significantly completed within the next two years (ie 2020-21 and 2021-22).

This package was revised up by \$36 million to \$4.034 billion in the 2021-22 Budget to reflect additional support for the Jobs and Economic Growth Fund, which was called the Economic and Business Growth Fund until 30 June 2021.⁸

The 2021-22 Budget indicates that \$1.994 billion is expected to be spent on the stimulus package to June 2021 and a further \$1.168 billion in 2021-22. This indicates that \$3.162 billion (78%) of the current \$4.034 billion stimulus package is expected to be spent within the two-year time frame set in the 2020-21 Budget.

Part A of my 2020-21 Annual Report to Parliament provides further details on the status of the SA Government's \$4 billion stimulus package, including grants made from business and community financial assistance funds.

⁸ The Economic and Business Growth Fund was established in the 2018-19 Budget to promote economic growth in South Australia by encouraging the growth of existing industries, developing new industries, building international connections, and attracting foreign and national direct investment. From 1 July 2021, the Fund was renamed the Jobs and Economic Growth Fund and will have funding capacity of \$200 million over four years to focus on supporting initiatives that create long-term sustainable jobs and economic growth. The Jobs and Economic Growth Fund will include further funding of \$124 million in addition to unallocated funding of \$76 million from the Economic and Business Growth Fund.

4 Operating statement

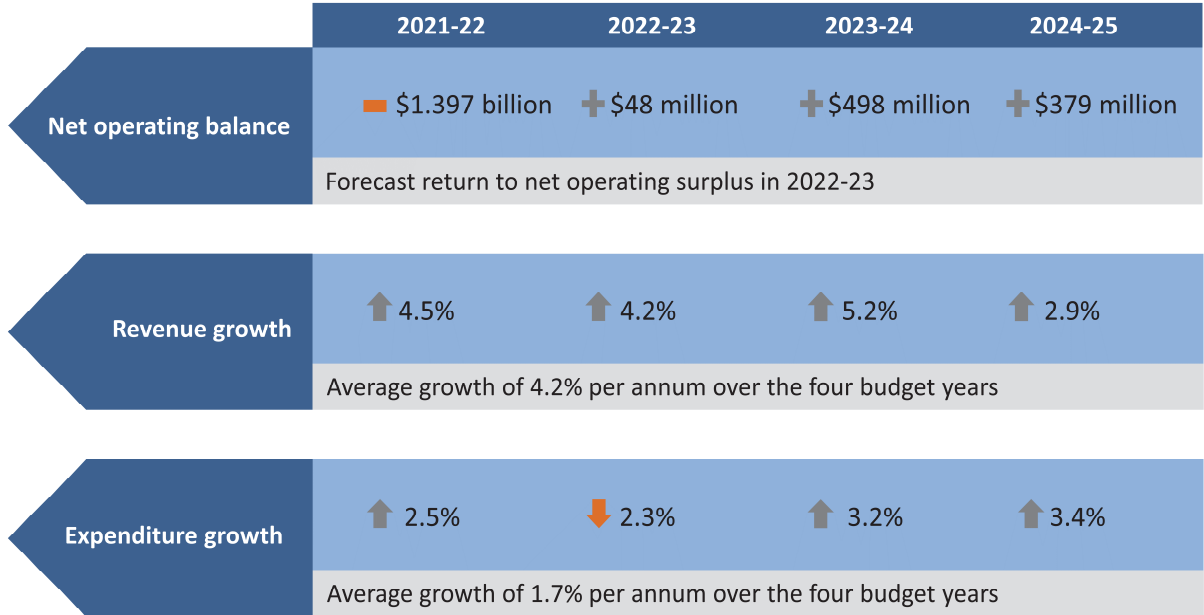
Key points

- The 2020-21 estimated net operating balance has improved by \$808 million since the 2020-21 Budget, largely due to higher GST revenue grants and conveyance duty collections.
- South Australia is expecting to return to net operating surplus from 2022-23, which is earlier than all other Australian states except Western Australia. A key driver of the forecast return to surpluses is limiting growth in expenditure.
- South Australia is more reliant on Commonwealth grant revenue than any other Australian state, except Tasmania.
- GST revenue remains below pre-COVID-19 estimates in the 2019-20 MYBR, mainly due to recent reductions in the State’s share of the national GST pool.
- Wage negotiations are planned to occur for 66% of total general government sector employees in 2021-22, which may raise challenges for the SA Government in constraining expenditure growth.

4.1 Overview of key trends

Figure 4.1 shows key operating statement trends in the 2021-22 Budget for the general government sector.

Figure 4.1: Key operating statement trends



4.2 2020-21 estimated results

4.2.1 Estimated net operating balance has improved by \$808 million since the 2020-21 Budget mainly due to higher GST revenue

Figure 4.2 shows that the 2020-21 net operating balance⁹ for the general government sector is estimated to have improved by \$808 million since the 2020-21 Budget.

Figure 4.2: 2020-21 Budget and estimated result for net operating balance

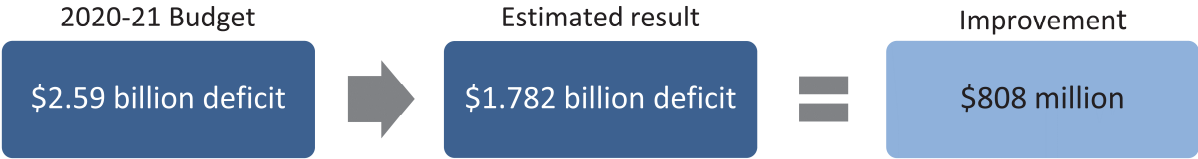
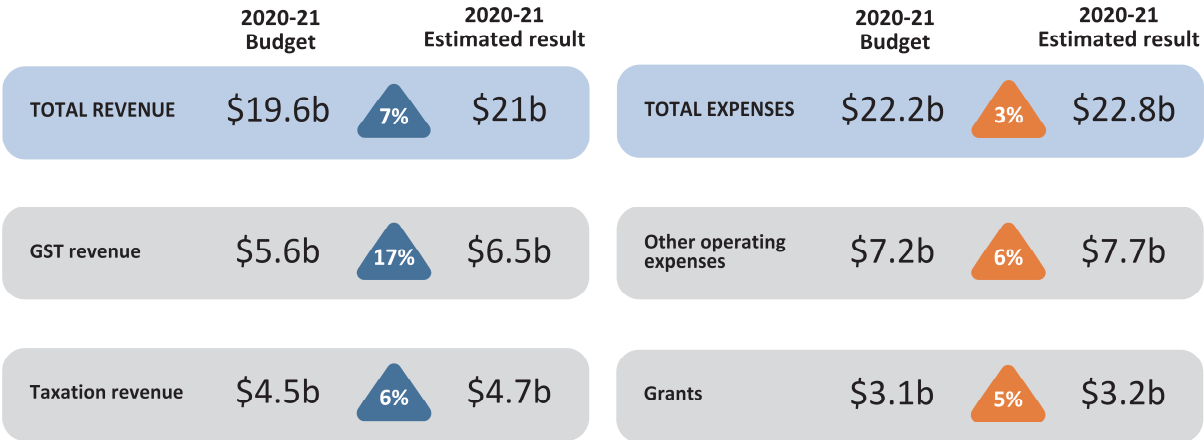


Figure 4.3 summarises the key factors contributing to the significant improvement in the 2020-21 net operating balance for the general government sector.

Figure 4.3: Key account balances contributing to the variance between the 2020-21 Budget and estimated result for net operating balance



The main driver of the improved estimated result is GST receipts, which are estimated to be \$926 million higher due mainly to the larger national GST pool resulting from recovery in national consumption expenditure. Taxation revenue is expected to be \$257 million higher due to higher estimated conveyance duty collections of \$214 million. DTF advised us that higher conveyance duties are almost entirely due to higher than expected property transaction volumes, notwithstanding recently observed increases in residential property values.

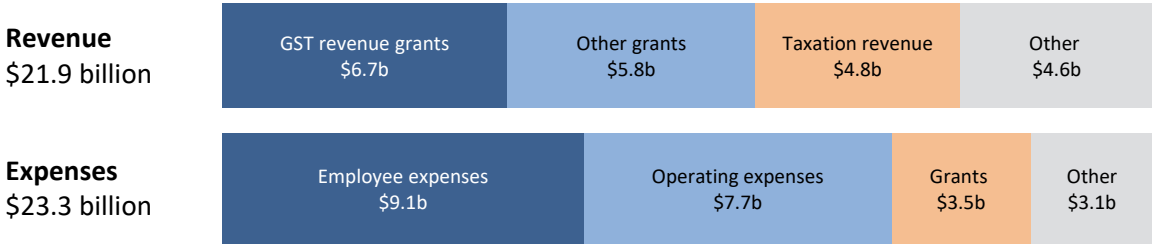
⁹ The net operating balance is the net result of revenue and expenses from transactions. It is a summary measure of the sustainability of operations that shows whether the SA Government has to borrow money to cover operating activities. If this measure is in surplus, operating revenue is sufficient to fund operating expenses.

4.3 Operating statement overview

4.3.1 Grants and taxation represent 79% of total revenue while employee expenses and operating expenses comprise 72% of total expenses

Figure 4.4 shows the main components of total general government sector revenue and expenses for the 2021-22 budget year.

Figure 4.4: Main components of total general government sector revenue and expenses in 2021-22 budget year



Note: Totals may not add due to rounding.

Budgeted revenue in 2021-22 primarily comprises grants (57%) and taxation revenue (22%). Payroll tax, property taxes, conveyance duty and motor vehicle taxes make up 80% of taxation revenue.

Employee expenses and operating expenses make up 72% of total budgeted expenses. Operating expenses include items such as supplies and services, consultancies, contractors, National Disability Insurance Scheme contributions, and repairs and maintenance expenses.

4.4 Net operating balance

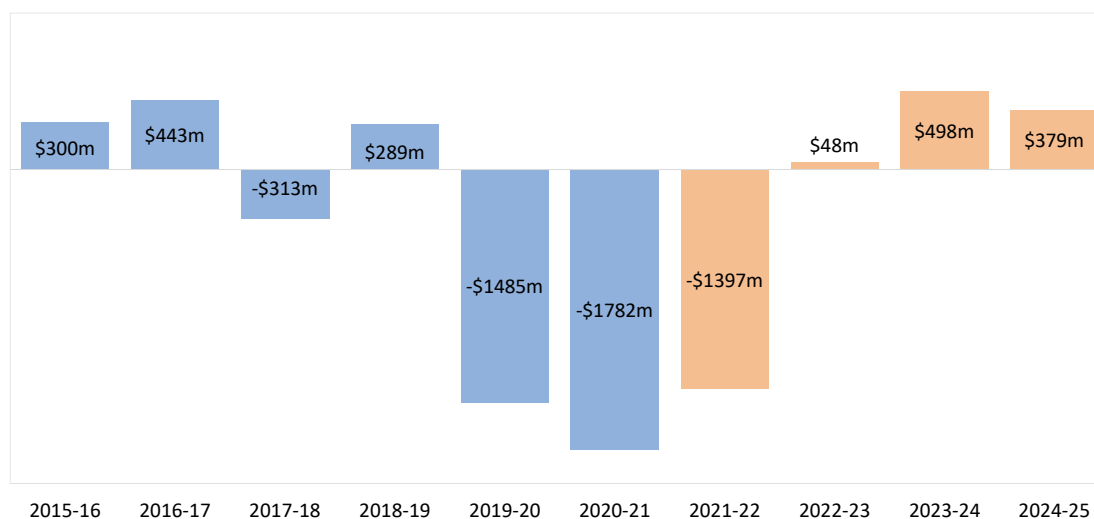
4.4.1 The fiscal target of achieving a net operating surplus every year is expected to be met from 2022-23

The SA Government has a fiscal target of achieving a net operating surplus in the general government sector every year, to enable the funding of operating expenditures from operating revenues. The Budget notes that this target is not achievable for 2021-22 as the SA Government continues to respond to the effects of COVID-19.

The SA Government maintains that this fiscal target, as well as others, remains appropriate as a medium to long-term strategy.

Figure 4.5 shows the actual outcomes for the general government sector net operating balance for the period 2015-16 to 2019-20, the estimated result for 2020-21 and the expected outcomes for the four years of the 2021-22 Budget.

Figure 4.5: General government sector net operating balance for the period 2015-16 to 2024-25



The Budget is expected to return to a marginal surplus of \$48 million in 2022-23 following significant deficits from 2019-20 to 2021-22. This is one year earlier than estimated in the previous Budget.

There remains significant uncertainty about the impacts COVID-19 will have on the community and the public health system. With the COVID-19 vaccine rollout having commenced in Australia in 2021, the 2021-22 Budget expresses the hope that restrictions to minimise the spread of the virus will reduce, in turn reducing the impact on the economy and key government budget parameters.

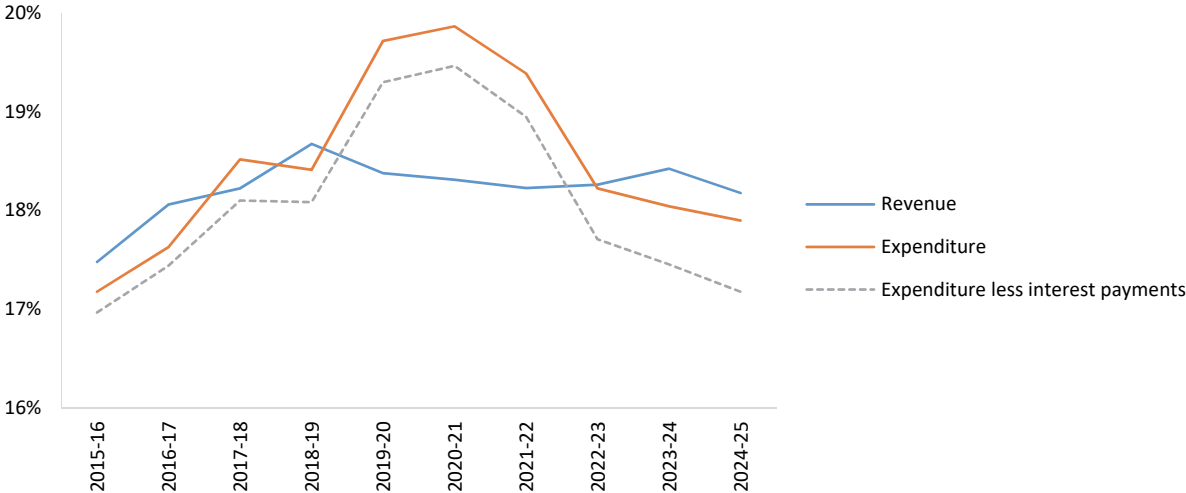
While the 2021-22 Budget has been framed against the expectation that economic conditions will continue to improve as restrictions ease, some greater than usual uncertainty remains for the global, national and state economic outlook. There are number of risk factors that might prevent a return to surplus by 2022-23, for example:

- the GST national pool may be adversely impacted by the ongoing COVID-19 outbreaks and restrictions in New South Wales and Victoria, resulting in lower GST revenue grants for South Australia
- vaccines may have reduced effectiveness against new COVID-19 strains and impact the pace at which international tourism and education can recover to pre-pandemic levels
- new expenditure measures may be required to stimulate the State economy
- the Health and Wellbeing portfolio is expected to make \$800 million of savings over the four years of the 2021-22 Budget and it has a history of not achieving its savings targets
- growth in employee expenses may exceed that allowed for in the forward estimates due to enterprise agreement negotiation outcomes.

4.4.2 Limiting growth in expenditure is a key driver of the return to net operating surpluses

Figure 4.6 shows revenue and expenditure for the general government sector as a percentage of GDP from 2015-16 to 2024-25. It also shows expenditure less interest payments as a percentage of GDP.

Figure 4.6: General government sector revenue and expenditure as a percentage of GDP



Source: Audit calculation based on the 2021-22 Budget Papers and information provided by DTF.

The forecast return to net operating surplus in 2022-23 largely relies on limiting the growth in expenditure rather than revenue growth. Expenditure as a share of GDP is forecast to fall from 19.9% in 2020-21 to 17.9% by 2024-25, while revenue as a share of GDP is expected to remain relatively stable over this period, ranging from 18.2% to 18.4%.

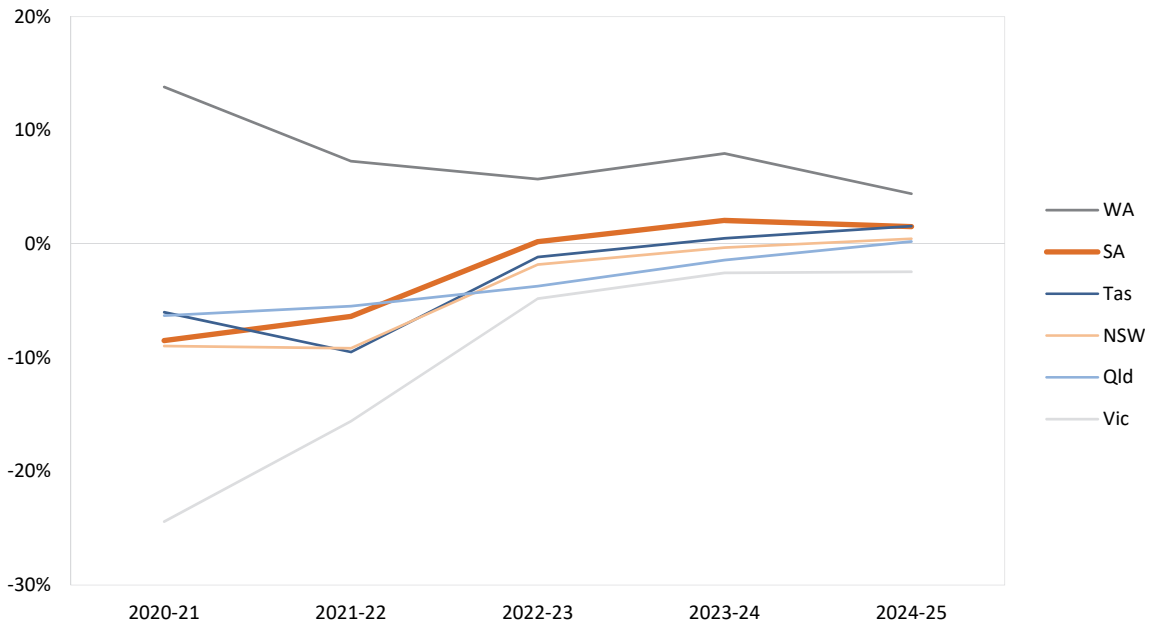
The 2021-22 Budget notes that the fall in expenditure as a share of GDP is expected to occur as measures that respond to COVID-19 and bushfires phase out and expenditures return to sustainable levels. The extent of the estimated reduction is even more evident for expenses excluding interest payments in figure 4.6. This reflects the increasing proportion of SA Government expenditure that will be spent on interest expenses from rising government borrowings over the forward estimates.

4.4.3 South Australia is forecasting a return to net operating surplus earlier than most other states

Figure 4.7 shows the expected trend in general government sector net operating balance as a percentage of total revenue¹⁰ compared to other Australian states for 2020-21 to 2024-25.

¹⁰ Due to substantial differences in the size of state budgets, net operating balance as a percentage of total revenue has been used to compare net operating balances between states on a comparable basis.

Figure 4.7: Net operating balance as a share of total revenue for Australian states between 2020-21 and 2024-25



Source: South Australian and interstate budget papers.

COVID-19 continues to have a significant impact on expenditure needs and revenue sources across all states, impacting net operating balances to varying extents.

South Australia’s net operating balance trend over the four years of the 2021-22 Budget is generally favourable compared to all states other than Western Australia. S&P noted in its August 2021 credit rating report that South Australia’s ‘successful suppression of COVID-19 to date has allowed a relatively quick economic recovery with fiscal recovery to follow’.

South Australia’s general government sector net operating balance is forecast to return to surplus in 2022-23. Tasmania is forecasting a return to surplus a year later in 2023-24, while New South Wales and Queensland are forecasting a return to surplus in 2024-25. Victoria is expecting operating deficits across the four years of its 2021-22 Budget.

Western Australia is the only state with consistent operating surpluses across the four years of the budget. Despite the significant impact of COVID-19 on state finances across the country, Western Australia expects to achieve a surplus in 2021-22 partly owing to strong iron ore royalties from its mining industry.

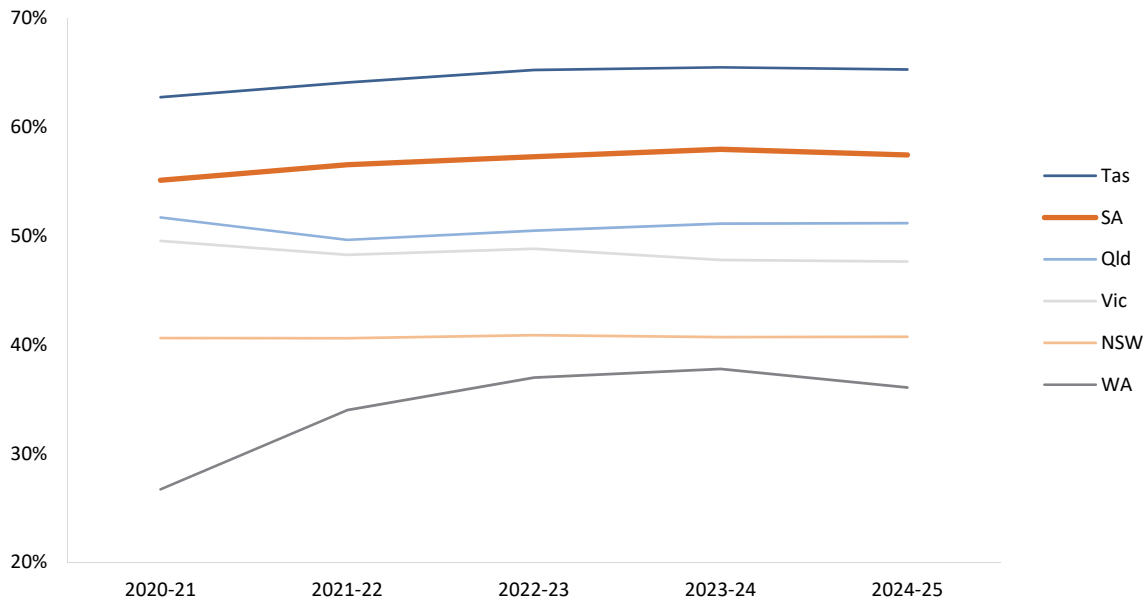
4.5 Revenue

4.5.1 South Australia is more reliant on Commonwealth grant revenue than any other state except Tasmania

South Australia’s reliance on Commonwealth grant revenue is expected to range between 57% and 58% of total revenue over the four years of the Budget. Over half of this revenue relates to GST revenue grants.

Figure 4.8 compares total Commonwealth grant revenue as a percentage of total revenue to other Australian states for the period 2020-21 to 2024-25.

Figure 4.8: General government sector Commonwealth grants revenue as a percentage of total revenue in Australian states for the period 2020-21 to 2024-25



Source: South Australian and interstate budget papers.

Figure 4.8 shows that South Australia is the second most reliant state on Commonwealth grant revenue. This mainly reflects South Australia’s more limited ability to generate its own revenue (ie weaker fiscal capacity¹¹) compared to most other states and therefore a greater need for Commonwealth revenue to provide public services.

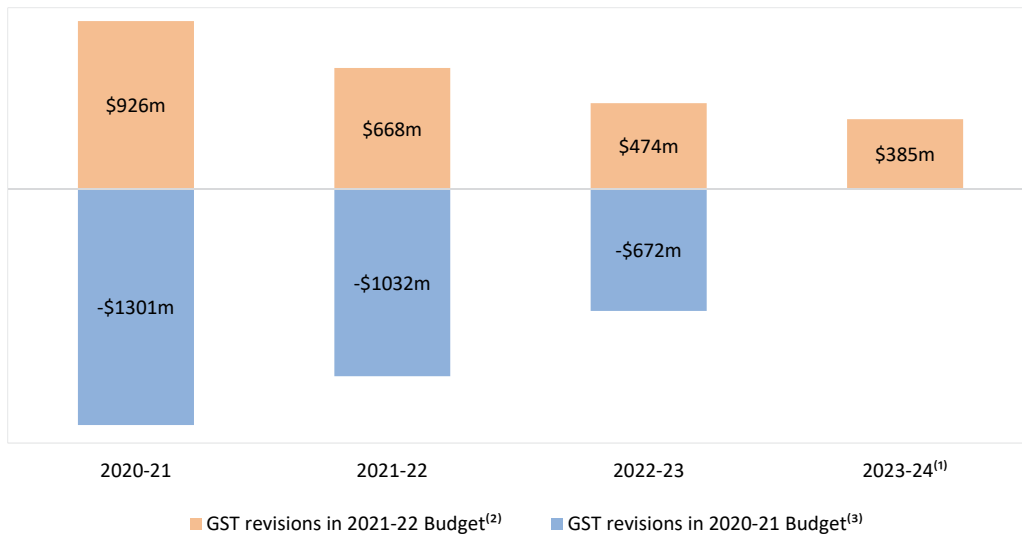
Given the significance of Commonwealth grant revenue to South Australia’s revenue base, future trends in Commonwealth grant revenue, and in particular GST revenue, will be critical to the SA Government’s ability to generate operating surpluses and pay down its significantly increased net debt.

4.5.2 Estimated total GST revenue for 2020-21 to 2022-23 is lower than pre-COVID-19 estimates despite significant upward revisions in 2021-22 Budget

Figure 4.9 shows revisions to GST grant revenue in the 2020-21 and 2021-22 Budgets. It also shows the net impact of the significant downward and upward revisions to GST revenue in those budgets since the emergence of COVID-19.

¹¹ States have different fiscal capacities due to differences in economic, social and demographic characteristics that affect their expenditure and revenues. Some of the main reasons for the differences are mining production, property sales, taxable payrolls, remoteness, Indigenous status and population growth.

Figure 4.9: GST revenue revisions in the 2020-21 Budget and the 2021-22 Budget



Total revisions made since the 2019-20 MYBR	2020-21	2021-22	2022-23	2023-24 ⁽¹⁾
	-\$375m	-\$364m	-\$198m	\$385m

⁽¹⁾ 2023-24 was not part of the forward estimates in the 2019-20 MYBR so it was not revised in the 2020-21 Budget.

⁽²⁾ Revisions from the 2020-21 Budget included in the 2021-22 Budget.

⁽³⁾ Revisions from the 2019-20 MYBR included in the 2020-21 Budget.

In the 2021-22 Budget, GST grant revenue has been revised upwards in all years between 2020-21 and 2023-24. These revisions total \$2.453 billion.

Despite significant write-ups to South Australia’s GST grant revenue in the 2021-22 Budget, total GST grant revenue from 2020-21 to 2022-23 is still projected to be \$937 million lower than pre-COVID-19 estimates in the 2019-20 MYBR. The 2021-22 Budget notes that this mainly reflects the impact of the Commonwealth Grant Commission’s 2020 review, which saw South Australia’s share of the GST pool reduce significantly from 10.1% in 2019-20 to 9.4% in 2020-21. DTF advised us that GST revisions from 2020-21 to 2022-23 made due to national GST pool changes only comprise \$13 million of the \$937 million total downwards revisions since the 2019-20 MYBR.

4.5.3 GST upward revisions in the 2021-22 Budget mainly due to increased national pool

Figure 4.10 shows that the upward GST revisions in the 2021-22 Budget mainly reflect the impact of higher forecasts for the national GST pool, rather than changes to South Australia’s GST grant share.

Figure 4.10: Factors contributing to upward GST revenue revisions in the 2021-22 Budget



Source: Data provided by DTF.

The size of the national GST pool is impacted by the amount of GST collected across Australia. DTF advised us that in forecasting GST revenues it uses the Commonwealth's estimate of the national GST pool and assumptions for the growth in the national pool.

The forecast growth in the national GST pool reflects the strong rebound in consumption expenditure subject to GST in 2020-21, following a decline in 2019-20 due to the impact of COVID-19 health restrictions.

4.5.4 The State has a significant risk exposure to GST revenue reductions

GST revenue is a large component of the State's revenue base. It is expected to represent 30.6% of total revenue in 2021-22 and increase to 32% in 2024-25.

Exposure to changes in national GST pool

The Budget Papers highlight the importance of GST revenue to the Budget projections and note that the Budget is particularly exposed to changes in growth in the national GST pool. Risk analysis in the Budget indicates that a 1% change in GST pool growth has a revenue impact for South Australia of about \$67 million per annum.

Growth rates for the pool are based on various assumptions about the timing and magnitude of the national economic recovery, which are difficult to forecast as the COVID-19 pandemic continues. Outcomes may materially differ if these assumptions do not eventuate, such as if further significant domestic COVID-19 outbreaks occur and require prolonged lockdowns to contain them, as has been the case in New South Wales since June 2021.

A number of economic forecasters have indicated that extended lockdowns in New South Wales and Victoria could have a significant impact on the national economy and lead to negative growth in Australia's GDP for the September 2021 quarter and a decline in household consumption expenditure.^{12,13} This could reduce the size of the national GST pool and, given South Australia's dependency on GST revenue, could pose a real challenge to the SA Government's ability to meet its budget forecasts.

The 2021-22 Commonwealth Government Budget highlights that COVID-19 has had profound impacts on household consumption patterns, resulting in unprecedented volatility in GST receipts.¹⁴ For area-specific lockdowns used by state and territory governments to prevent the spread of COVID-19, the Commonwealth Government Budget notes:

- that continued instances of short, sharp lockdowns pose downside risks to the outlook for consumer spending through a dampening effect on confidence

¹² Kelly A, Oster A, Spence G & Ziebell P 2021, *Australian Economic Update: GDP Q2 2021*, National Australia Bank, viewed 7 September 2021, <<https://business.nab.com.au/wp-content/uploads/2021/09/NAB-Australian-GDP-Q2-2021-Report.pdf>>.

¹³ Commonwealth Bank of Australia *Economic Insights* 2021, viewed 7 September 2021, <https://www.commbank.com.au/content/dam/caas/newsroom/docs/210728_Economic_insights.pdf>.

¹⁴ Commonwealth of Australia 2021, 2021-22 Budget Paper No. 1 *Budget Strategy and Outlook* 2021, viewed 24 August 2021, <<https://budget.gov.au/2021-22/content/bp1/index.htm>>.

- analysis of localised lockdowns suggests that while consumption typically rebounds quickly, the level of total consumption over the period is lower than in areas that did not experience a lockdown.¹⁵

Exposure to changes in South Australia’s relativity and share of GST grants

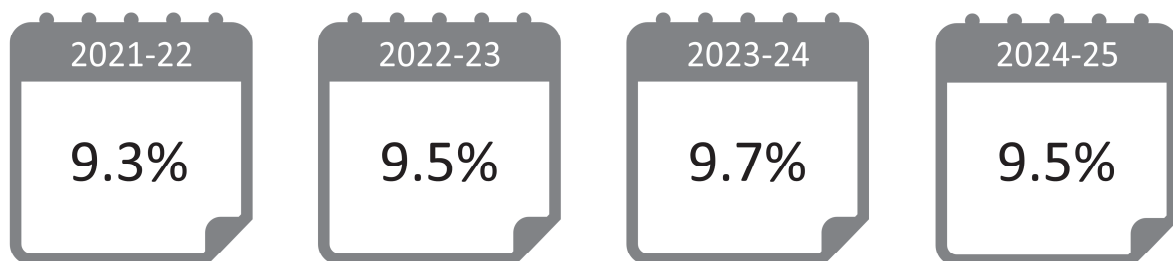
Risk analysis in the 2021-22 Budget explains that a 0.01 change in South Australia’s relativity would result in a change in GST revenue grants of about \$45 million in 2021-22.¹⁶

The Commonwealth Grants Commission (CGC) does not calculate GST relativities beyond the budget year. The 2021-22 Budget indicates that beyond 2021-22, South Australia’s GST relativity is expected to be influenced by:

- an expected moderation in royalty revenue growth in other jurisdictions
- changes in South Australia’s share of Commonwealth Government payments
- relative population growth in South Australia.

South Australia’s GST grant share fell significantly between 2019-20 (10.1%) and 2020-21 (9.4%) due to its relative fiscal capacity being stronger than previously assessed by the CGC, and changes made to some methods and data used in the CGC’s assessment.¹⁷ Figure 4.11 shows that DTF is not expecting large downward movements in South Australia’s share of the national GST pool over the forward estimates.

Figure 4.11: South Australia’s estimated GST grants share from 2021-22 to 2024-25



Source: Information provided by DTF.

The estimated grant share for 2021-22 is based on the CGC’s relativity determination and the grant shares for the remaining three years are based on DTF’s relativity forecasts. While DTF is forecasting that South Australia’s grant share is expected to be relatively stable over the forward estimates, actual outcomes may vary. This is because calculating a state’s grant share is influenced by many factors.

¹⁵ *ibid.*

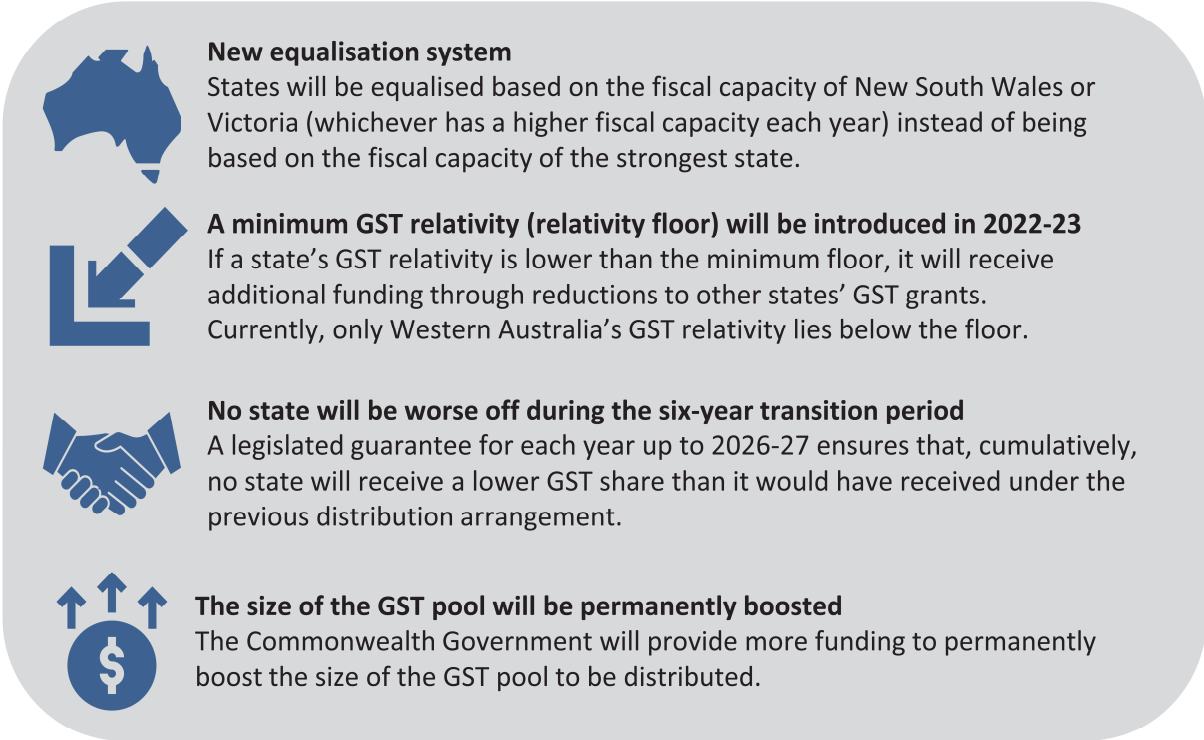
¹⁶ The CGC provides its recommendations in the form of GST distribution relativities, which reflect the relationship between a state’s GST entitlement under horizontal fiscal equalisation and its population share of total GST grants. For example, a relativity above 1.0 indicates that a state requires more than its population share of GST grants, due to a lower capacity to raise revenue compared to other states and/or higher costs of providing services and infrastructure to the same standard as other states.

¹⁷ Commonwealth Grants Commission 2020, *2020 Review – South Australia Summary*, fact sheet, viewed 7 September 2021, <<https://www.cgc.gov.au/inquiries/2020-review>>.

4.5.5 Transition to new GST distribution arrangements starts in 2021-22

New arrangements for distributing the national GST revenue pool to the states are being introduced over a six-year transitional period that starts in 2021-22 and ends in 2026-27. Figure 4.12 shows key features of the new arrangements and the transition.

Figure 4.12: Key features of new GST distribution arrangements starting in 2021-22



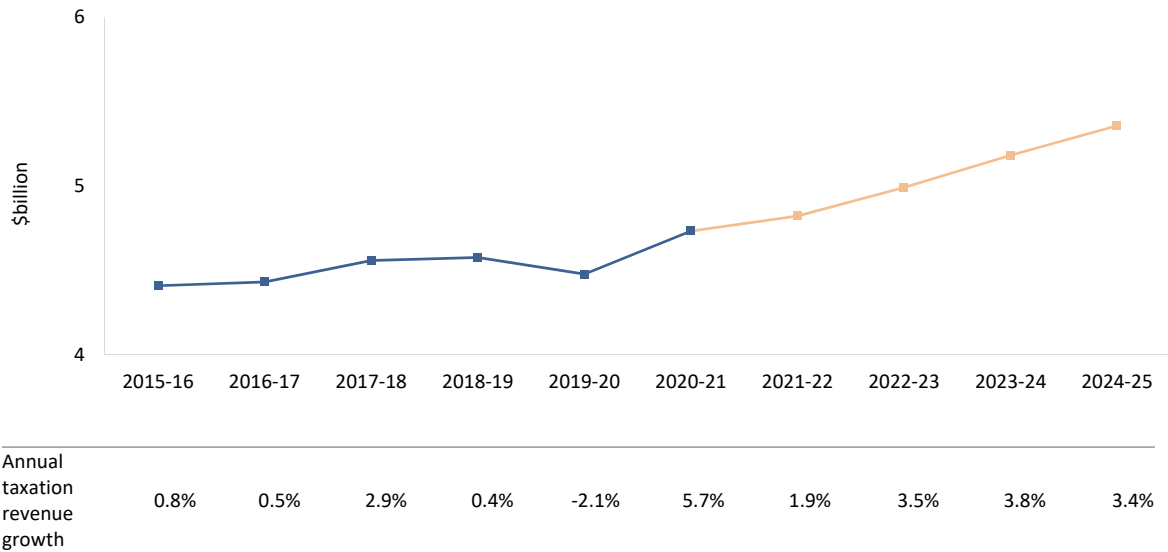
Over the four years of the 2021-22 Budget the risk of South Australia’s GST revenue share reducing because of the new arrangements is mitigated by the ‘no worse off’ guarantee. Instead, the main risks in this period remain consistent with those under the previous arrangements, including changes to estimated national GST pool growth and the State’s relativity as determined by the CGC each year.

When the transition period ends in 2026-27, all States including South Australia will be exposed to a higher risk of their share of GST revenues reducing. This is because the ‘no worse off’ guarantee will end. DTF advised us that it will continue to monitor the impact of the revised GST distribution arrangements on South Australia’s GST revenue, including the impact of the CGC’s relativity determinations and the Commonwealth’s national GST pool and population forecasts.

4.5.6 Annual growth in taxation revenue expected to be higher across the forward estimates than in the years leading up to the COVID-19 pandemic

Figure 4.13 shows the trend in taxation revenue between 2015-16 and 2024-25 including annual taxation revenue growth.

Figure 4.13: Taxation revenue from 2015-16 to 2024-25



Taxation revenue is expected to steadily increase by an average of 3.6% each year between 2021-22 and 2024-25. This is largely due to the forecast growth in payroll tax and conveyance duty as shown in figure 4.14.

Figure 4.14: Average annual growth in taxation revenues from 2021-22 to 2024-25

Taxation revenue	2021-22	2024-25	Average annual percentage change
Payroll tax	\$1.396b	\$1.597b	4.6%
Conveyance duty	\$876m	\$1.012b	4.9%
Property taxes	\$819m	\$870m	2.0%
Motor vehicle taxes	\$755m	\$810m	2.4%
Insurance taxes	\$527m	\$592m	3.9%
Gambling taxes	\$450m	\$476m	1.9%

The 2021-22 Budget Papers note:

- growth in payroll tax is expected to return to longer-term trend levels with forecast annual average growth of 4.6% over the three years to 2024-25, largely consistent with the estimated underlying growth in total hours worked and earnings
- conveyance duty collections are forecast to return to more normal levels from 2022-23 with annual average growth of 4.9% over the three years to 2024-25, reflecting moderate growth in transaction volumes and property prices.

Figure 4.13 highlights that the expected annual growth in taxation revenue between 2021-22 and 2024-25 is higher than that experienced in the years before the COVID-19 pandemic, which was generally less than 1% between 2015-16 and 2018-19.

We have previously commented that conveyance duty estimates have historically been optimistic and often revised downwards.¹⁸ This highlights difficulties in predicting trends in property market values and transaction levels that drive conveyance duties, which have only been exacerbated by COVID-19.

4.5.7 Changes to the timing of National Partnership funding for infrastructure projects could impact net operating balance outcomes

In 2020-21 South Australia is estimated to have received \$1.253 billion in National Partnership payments (NPP) funding from the Commonwealth Government. This funding is budgeted to increase to \$1.487 billion in 2021-22, with further increases expected over the forward estimates. The 2021-22 Budget Papers indicate that these NPPs largely reflect the timing of funding for major infrastructure projects.

The proportion of total NPP funding for infrastructure projects is expected to rise from 62% in 2021-22 to 84% in 2024-25. This change in profile reflects the expiry or winding down of several existing programs in future years.¹⁹

Most of this capital grant funding does not have a corresponding operating expenditure in the operating statement. Rather, the expenditure from this funding is reflected in the 'purchases of non-financial assets' line item, which impacts directly on the net lending balance as it is spent. The operating result is impacted once assets are complete and in use through the annual charging of depreciation expense over their useful life.

Given the sizeable amount of NPP funding expected, actual net operating balance outcomes could differ significantly to budget forecasts if the timing of this funding changes.

4.6 Expenditure

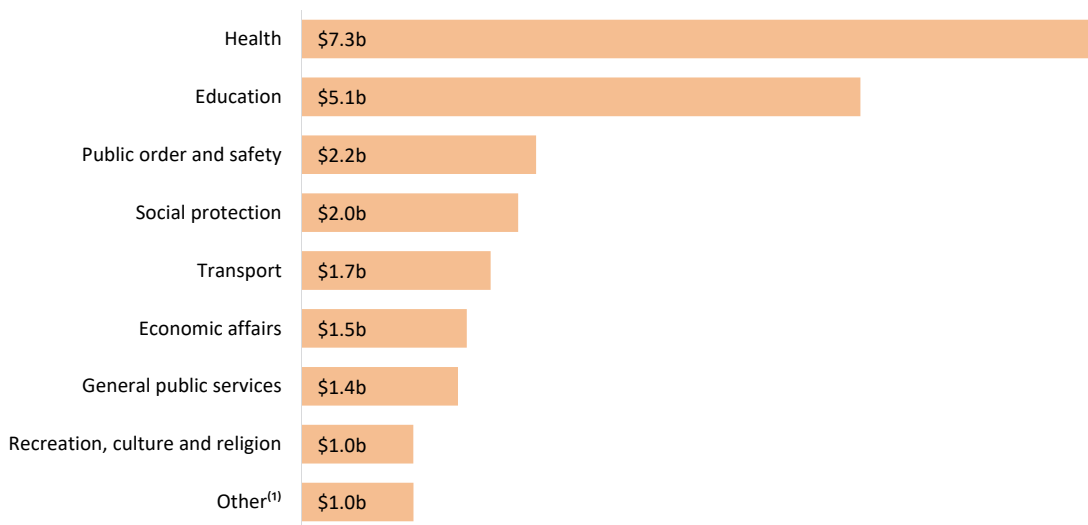
4.6.1 Health and education sectors comprise just over half of total expenses in the 2021-22 Budget

Figure 4.15 shows the split of 2021-22 Budget expenses by sector and highlights the significance of the health and education sectors for total SA Government expenditure.

¹⁸ Auditor-General's Report 8 of 2019 *State finance and related matters*, October 2019, page 31.

¹⁹ The expiry or winding down of existing programs in future years includes the Job Trainer Fund program, the HomeBuilder grant scheme, proton-beam funding, current Disability Care Australia Fund arrangements and National Disaster Relief and Recovery Arrangements funding.

Figure 4.15: General government sector expenses by function²⁰



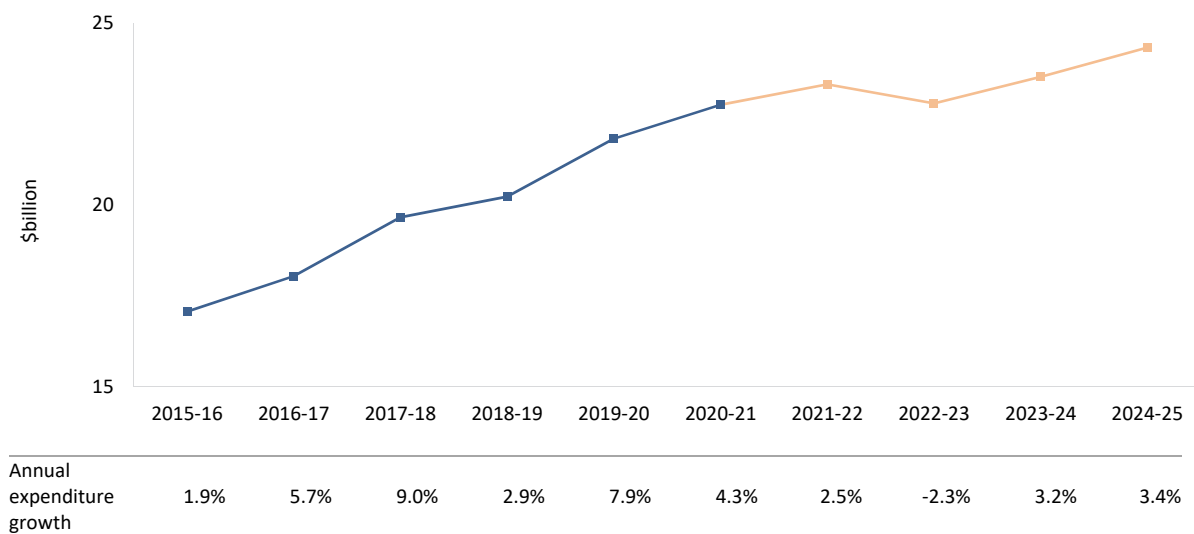
⁽¹⁾ Includes environmental protection and housing and community amenities.

Health and education sector combined expenses are \$12.418 billion in the 2021-22 Budget, which makes up 53% of total general government sector expenditure (\$23.312 billion).

4.6.2 Total expenses expected to decrease in 2022-23 as COVID-19 stimulus expenditure scales back then steadily grow each year over the remainder of the forward estimates

Figure 4.16 shows trends in total expenses and annual expenditure growth in the 2021-22 Budget against the experience of the previous six years.

Figure 4.16: General government sector total expenses from 2015-16 to 2024-25



²⁰ Sourced from 2021-22 Budget Paper 3 *Budget Statement*, table A.13.

The SA Government has a fiscal target of limiting the average growth in operating expenditure to trend growth in household income (4% per annum).

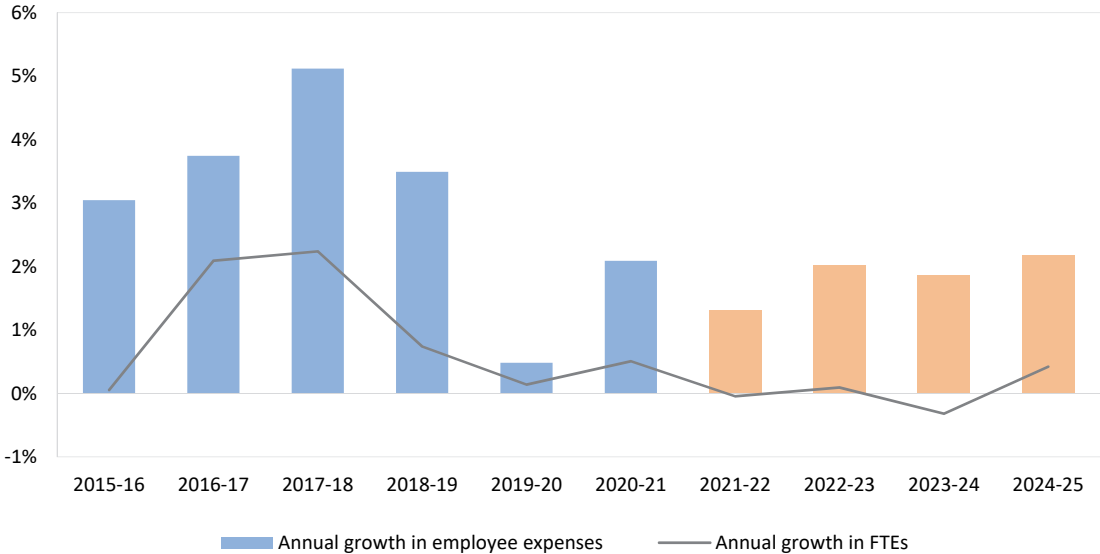
The 2021-22 Budget shows average annual expenditure growth of 1.7% over the four years of the Budget. Growth rates are expected to remain below trend growth in household income over the forward estimates, consistent with the SA Government’s fiscal target.

Expenses are expected to decline in 2022-23 as time-limited COVID-19 stimulus expenditure is completed. The increased growth rates from 2023-24 reflect higher interest expenses as net debt levels and longer-term interest rates increase and higher depreciation expenses as projects are completed under the SA Government’s infrastructure program.

4.6.3 Limited change in total public sector workforce numbers expected between 2021-22 and 2024-25

Figure 4.17 shows the relationship between general government sector employee expenses and FTEs for the period 2015-16 to 2024-25.

Figure 4.17: Annual movement between years for employee expenses and FTEs from 2015-16 to 2024-25



Annual growth in FTEs over the four years of the 2021-22 Budget is limited to less than 1% each year, with minor falls expected in 2021-22 and 2023-24. This contrasts with growth of more than 2% per annum in 2016-17 and 2017-18. This trend is consistent with the SA Government’s aim in recent years to reduce employment levels and contain wage growth.

The 2021-22 Budget indicates that falls in FTEs in 2021-22 and 2023-24 are mainly due to FTE reductions in Health and Wellbeing.²¹

²¹ 2021-22 Budget Paper 3 *Budget Statement*, table 2.8.

DTF advised us that approximately 450 FTEs provided for the COVID-19 pandemic response are budgeted to cease before the end of 2021-22 and are therefore not included in the 2021-22 FTE cap.

Further, DTF advised us that FTE reductions also reflect Health and Wellbeing’s target of moving towards national efficient price. These FTE reductions are a notional budget assumption only and it is ultimately up to the local health networks to develop plans and deliver efficiency improvements to achieve the national efficient price. This does not necessarily require FTE reductions.

Figure 4.17 shows that growth in employee expenses is generally 2% to 3% more than annual growth in FTEs, which is mainly due to enterprise agreement salary increases. Growth in 2019-20 did not follow this trend, with DTF advising us that this resulted from the changed presentation of the 2019-20 Budget to achieve compliance with the Uniform Presentation Framework (UPF).²²

The FTE impact of new policy measures in the 2021-22 Budget over the four years of the Budget is shown in figure 4.18.

Figure 4.18: Estimated FTE impacts of 2021-22 Budget measures

	2021-22 FTE impact	2022-23 FTE impact	2023-24 FTE impact	2024-25 FTE impact
Total FTE impact of new policy measures	1 113	898	852	296
Health and Wellbeing	679	664	672	242
TAFE SA	91	87	55	(59)
Other	343	147	125	113

The increase in FTEs from 2021-22 Budget policy measures is estimated to significantly reduce in 2024-25 due to:

- lower additional resources for Health and Wellbeing in 2024-25 as it is expected to achieve the national efficient price for delivery of public hospital services
- TAFE SA delivering a program of system and process improvements that is expected to result in a reduction in FTEs.

The SA Government may face challenges in meeting its 2024-25 FTE targets, as in recent years Health and Wellbeing has not been able to achieve the national efficient price for delivery of public hospital services (see section 3.6.1) and TAFE SA has not met its savings targets (see section 3.4.2).

4.6.4 Wage negotiations may raise challenges for the SA Government in constraining expenditure growth

Salaries and wages are a major public sector operating cost and represent \$9.057 billion (39%) of total general government sector expenses in the 2021-22 Budget.

²² Auditor-General’s Report 8 of 2021 *State finances and related matters*, March 2021, page 42.

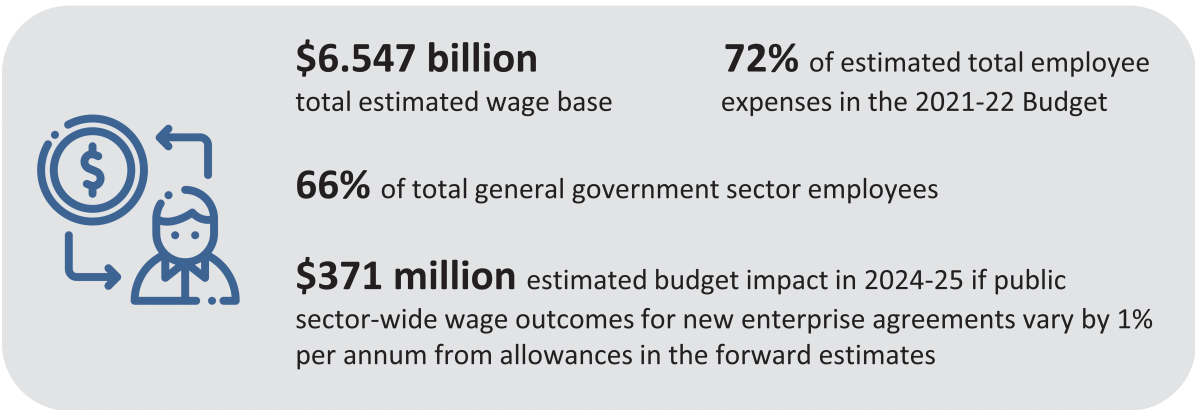
The 2021-22 Budget notes that wage negotiations are continuing or will start in 2021-22 for major employee groups in the general government sector, as shown in figure 4.19.

Figure 4.19: Employee groups subject to enterprise agreement negotiations in 2021-22



The 2021-22 Budget indicates that the outcomes of future wage negotiations will be crucial in determining whether expenditure forward estimates in this Budget can be achieved and the planned level of government services can be delivered. Figure 4.20 highlights the significance of the wage negotiations.

Figure 4.20: Wage negotiations that are continuing or starting in 2021-22



Source: 2021-22 Budget Papers and information provided by DTF.

The 2021-22 Budget provides for anticipated wage increases from enterprise agreement outcomes over the forward estimates, both in individual agency budgets and in the total of the contingency items in DTF’s administered items. DTF advised us that it is not possible to provide time frames for when the SA Government expects to finalise the wage negotiations. It noted that some negotiations take considerably more time than others and there are always a number of factors that influence this.

4.6.5 New employee separation scheme established in 2021-22 Budget

The 2021-22 Budget established a new scheme for agencies to rejuvenate their workforce by providing incentives to employees to separate from government employment. DTF advised us that each chief executive has discretion as to whether they will use the scheme and any decision to accept an offer of a termination payment by an employee will be voluntary.

The Budget explains that this scheme will work alongside the existing targeted voluntary separation package scheme, operate until 31 December 2021 and provide a gross termination payment of \$50 000 to an employee with 10 years or more service or \$25 000 to an employee with less than 10 years of service.

DTF advised us that no separate funding was set aside in the 2021-22 Budget for the scheme, with agencies required to self-fund²³ any termination payments, and that the SA Government has no expectations or targets as to how many employees will separate under the scheme.

4.6.6 Other operating expenses and grant expenses are expected to fall in 2022-23 as COVID-19 response measures phase out

Other operating expenses and grant expenses are the second and third most significant items of expenditure and together make up 48% of total budgeted expenses for 2021-22.

Other operating expenses are projected to decrease in real terms over the forward estimates, including an expected \$205 million reduction between 2021-22 (\$7.7 billion) and 2022-23 (\$7.495 billion). DTF advised us that this mainly reflects lower expenditure following the expected completion of measures to respond to COVID-19, including the protecting South Australians from the spread of COVID-19 and COVID-19 vaccine rollout measures in Health and Wellbeing and the SA Local Economic Recovery Package.

Grant expenses are also expected to decline between 2021-22 and 2022-23, decreasing by \$696 million from \$3.477 billion to \$2.781 billion. DTF advised us that this is mainly due to expected falls in First Home Owner Grants, the phasing out of grants from the COVID-19 Support Fund and Local Government Infrastructure Partnership Program and the bringing forward of SA Government payments to non-government schools for the 2022 school year from 2022-23 to 2021-22. The payments to non-government schools were brought forward to help them as they recover from COVID-19 and transition to new SA Government funding arrangements.

²³ DTF advised us that the Treasurer has approved that agencies self-fund any termination payments. If an agency requires any budget assistance in 2021-22 to support the payments it will be required to repay that assistance by way of a budget reduction over the current forward estimates (ie by the end of 2024-25).

5 Balance sheet

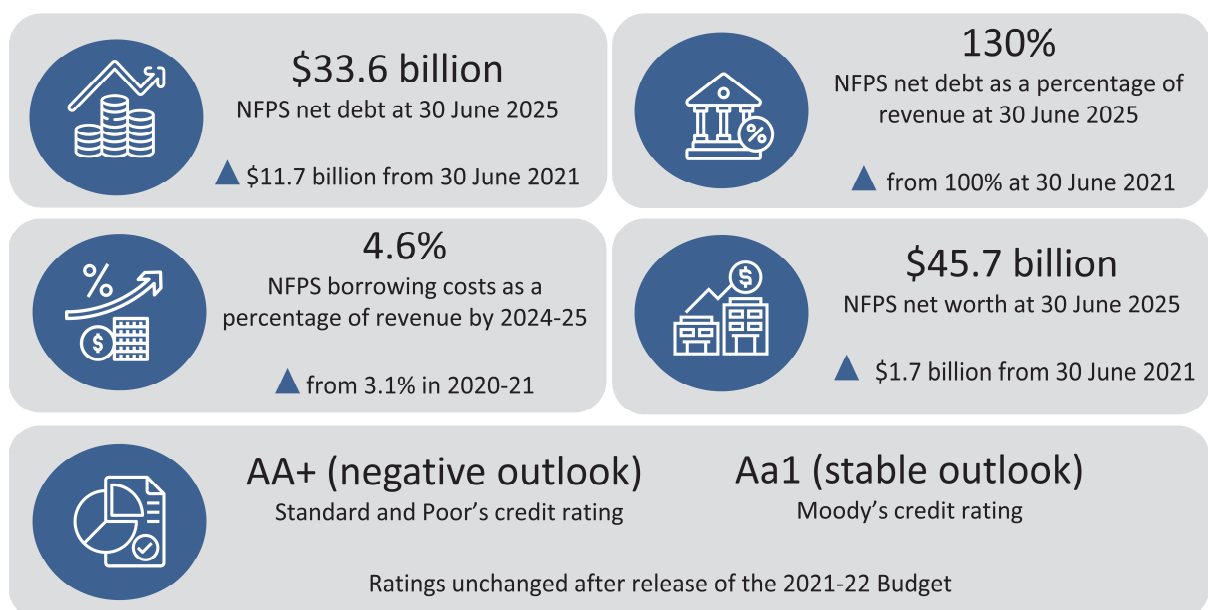
Key points

- The NFPS capital program is \$17.9 billion over the four years of the 2021-22 Budget, an increase of \$1.2 billion on the four years of the 2020-21 Budget. The expanded capital program will see land and fixed assets increase by \$11.3 billion between 2021-22 and 2024-25.
- The SA Government will face significant challenges in ensuring its capital program is completed on time and on budget given capacity constraints and shortages of key building materials.
- Forecast net debt levels have improved compared to the previous Budget, mainly due to improved GST revenue grants.
- South Australia's increases in net debt and ability to fund budgeted expenditure after meeting borrowing costs are generally comparable to other Australian states.
- There is a high likelihood that net debt levels will rise further due to substantial infrastructure project expenditure planned beyond the forward estimates and other budget risk factors.
- South Australia's risk exposure to interest rate rises is significantly increased by higher net debt levels.

5.1 Overview of key trends

Figure 5.1 shows key balance sheet trends in the 2021-22 Budget for the NFPS.

Figure 5.1: Key balance sheet trends in 2021-22 Budget

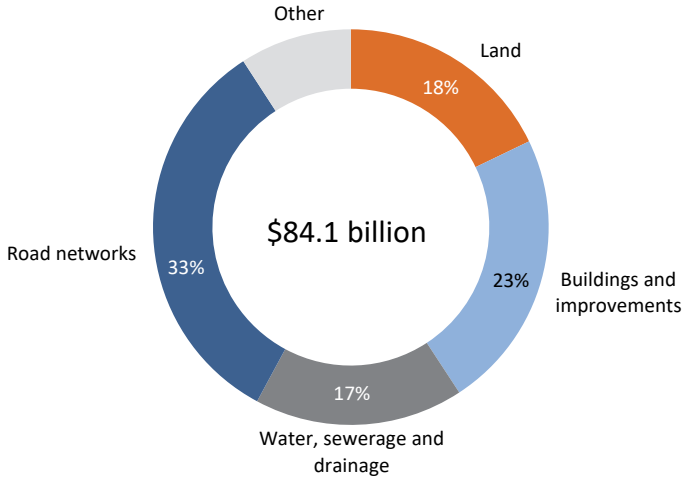


5.2 Balance sheet overview

5.2.1 Land and other fixed assets represent the vast majority of total assets

The vast majority of estimated total NFPS assets at 30 June 2021 are land and other fixed assets (87%).²⁴ Figure 5.2 shows the composition of land and other fixed assets.

Figure 5.2: Composition of NFPS land and other fixed assets estimated at 30 June 2021

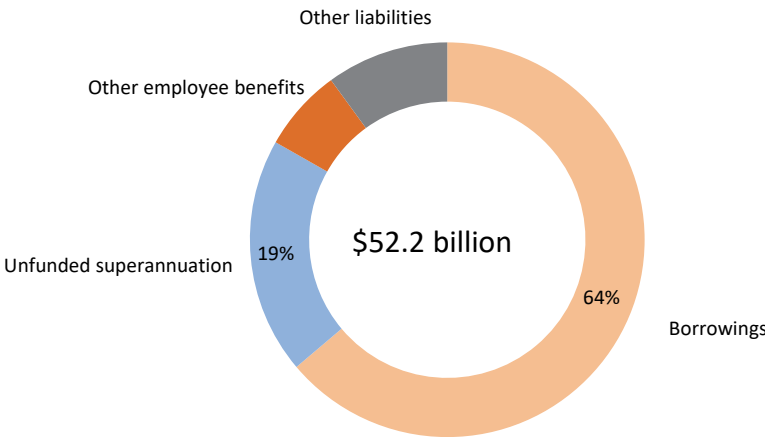


Road networks represent the largest component (\$27.75 billion), with the other major components including buildings and improvements (\$19.266 billion), land (\$15.011 billion) and water, sewerage and drainage assets (\$14.365 billion).

5.2.2 Liabilities primarily comprise borrowings and the unfunded superannuation liability

Figure 5.3 shows the estimated composition of total NFPS liabilities at 30 June 2021.

Figure 5.3: Composition of total NFPS liabilities estimated at 30 June 2021



²⁴ Balance sheet data in this section is for the NFPS unless otherwise stated. The NFPS consolidates the general government and public non-financial corporations (PNFC) sectors.

The major components of total liabilities are borrowings (\$33.31 billion) and the unfunded superannuation liability (\$10.103 billion).

NFPS borrowings increased from 57% of total NFPS liabilities at 30 June 2020 to an estimated 64% of total NFPS liabilities at 30 June 2021. The increase was principally to fund the estimated operating cash deficit (\$1.355 billion) and significant purchases of non-financial assets (\$2.916 billion) in 2020-21.

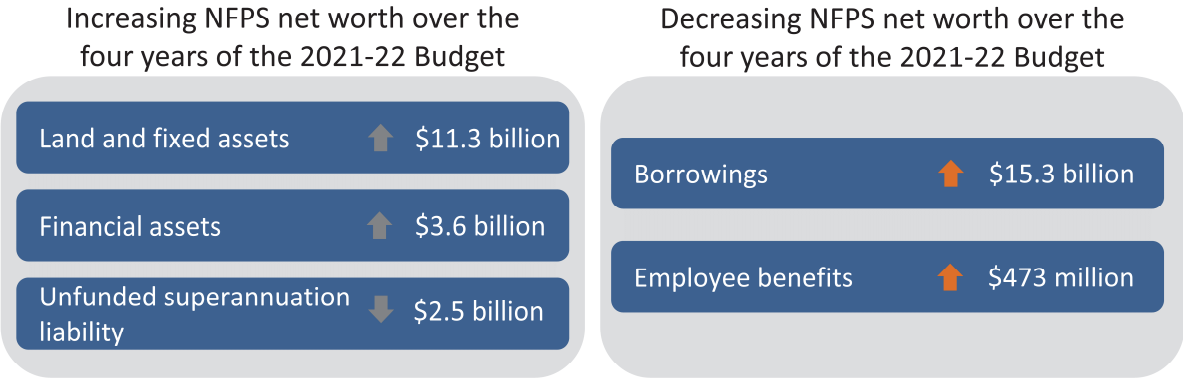
The unfunded superannuation liability is a long-term liability to current and past members of the closed defined benefits superannuation schemes.²⁵ The liability decreased from 25% of total NFPS liabilities at 30 June 2020 to an estimated 19% of total NFPS liabilities at 30 June 2021.

The 2021-22 Budget reports that the SA Government has a long-term funding strategy in place and is on target to fully fund the State’s defined benefit liability by 2034. By then, superannuation assets are projected to be \$10.3 billion, fully offsetting projected superannuation liabilities.

5.2.3 Net worth forecast to increase by \$1.7 billion over the four years of the 2021-22 Budget

NFPS net worth is expected to increase by \$1.717 billion, from \$44.027 billion at 30 June 2021 to \$45.744 billion at 30 June 2025. Figure 5.4 shows the major drivers of this increase.

Figure 5.4: Major drivers of the increase in NFPS net worth



While NFPS borrowings are projected to increase significantly, the increased borrowings will principally be used to fund the SA Government’s capital program, which is reflected in the increase in the value of NFPS land and fixed assets. Commonwealth Government funding for specific capital projects over the forward estimates will also partly fund the SA Government’s capital program. Sections 3.5.2 and 4.5.7 provide further details.

²⁵ The unfunded superannuation liability is calculated in line with Australian Accounting Standards as the net difference between the estimated value of the accrued defined benefits superannuation obligations and the value of the asset set aside to meet these obligations.

5.3 Purchases of non-financial assets

5.3.1 NFPS capital program over the four years of the 2021-22 Budget is \$17.9 billion

Purchases of non-financial assets for the NFPS are projected to total \$17.909 billion over the four years of the 2021-22 Budget, compared to \$16.712 billion over the four years of the 2020-21 Budget.

The 2021-22 Budget indicates that the SA Government’s investing program is focused on building key economic and social infrastructure, improving existing facilities and supporting job creation. It includes:

- \$1.3 billion in new general government sector investing initiatives (see section 3.5.2 for details of these initiatives)
- investing expenditure increases for the North-South Corridor River Torrens to Darlington project (\$1.376 billion) and the new Women’s and Children’s Hospital (\$427 million).

Figure 5.5 shows the purchases of non-financial assets for the NFPS over the 10 years to 2024-25 compared to the asset replacement ratio.²⁶

Figure 5.5: NFPS purchases of non-financial assets from 2015-16 to 2024-25

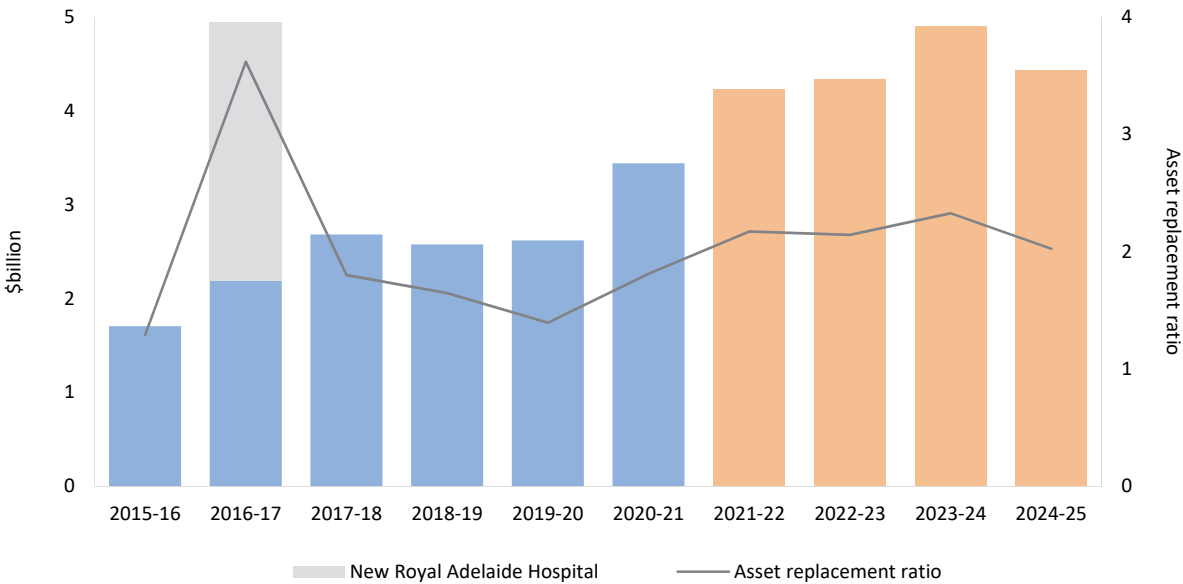


Figure 5.5 shows that purchases of non-financial assets for the NFPS over the four years of the 2021-22 Budget are substantially larger than prior years. The one-off large increase in 2016-17 was mainly due to the recognition of the new Royal Adelaide Hospital finance lease asset (\$2.758 billion), which represented 56% of total NFPS purchases of non-financial assets in that year.

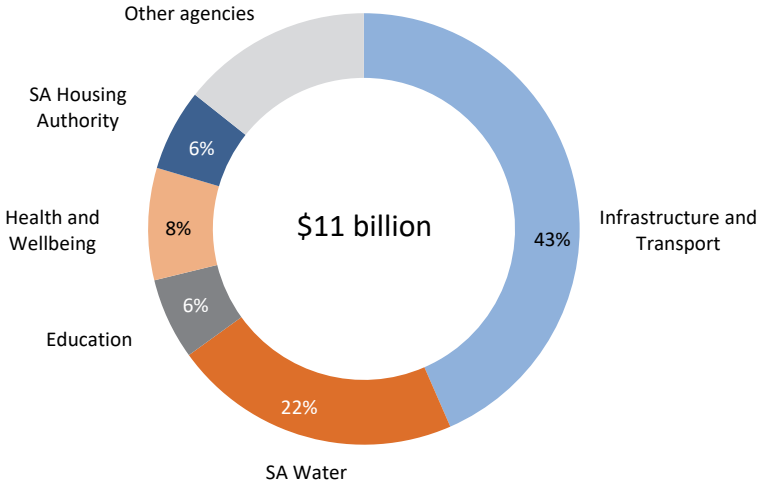
²⁶ The asset replacement ratio compares capital expenditure to depreciation to assess whether assets are being consumed at a rate consistent with their replacement. Ratios higher than 1:1 indicate that assets are being replaced faster than they are consumed.

Figure 5.5 also highlights that the asset replacement ratio has generally been trending higher. It mostly ranged between 1 and 2 for the period 2015-16 to 2020-21 and rises to 2 or higher between 2021-22 and 2024-25. This indicates that the SA Government has spent or expects to spend more on replacing and renewing assets each year than the consumption of assets through depreciation.

5.3.2 Department for Infrastructure and Transport and South Australian Water Corporation have the largest capital programs

Figure 5.6 provides a breakdown of the capital program by agency over the four years of the Budget.

Figure 5.6: Breakdown of NFPS capital program by agency²⁷



A large proportion of the capital program over the four Budget years is attributable to Infrastructure and Transport (\$4.77 billion) and SA Water (\$2.374 billion). Health and Wellbeing (\$922 million), the SA Housing Authority (\$673 million) and Education (\$670 million) also have significant capital programs.

The capital program also includes \$6.972 billion allocated to contingencies and other over the four years of the Budget (39% of the total NFPS capital budget).²⁸ The general government sector budget holds a contingency provision over the forward estimates to maintain the overall size of the SA Government’s investing budget. While agency capital budgets typically decline over the forward estimates as projects are scheduled to finish, the contingency provision rises as the unallocated component of the overall general government sector budget increases.

²⁷ \$11 billion total reflects the portion of the NFPS capital program that has been allocated to agencies.

²⁸ Table 2.16 in 2021-22 Budget Paper 3 *Budget Statement* notes that ‘other’ includes a capital slippage provision to reflect the tendency, on a whole-of-government basis, for underspending due to some projects slipping from their current budgeted expenditure profile. ‘Other’ also includes consolidation adjustments to eliminate inter-agency transactions and recognise contributed assets.

The contingency provision includes amounts allocated to specific investing projects and general contingencies. The portion allocated to general contingencies provides the SA Government with some flexibility over the nature and timing of its investing program.

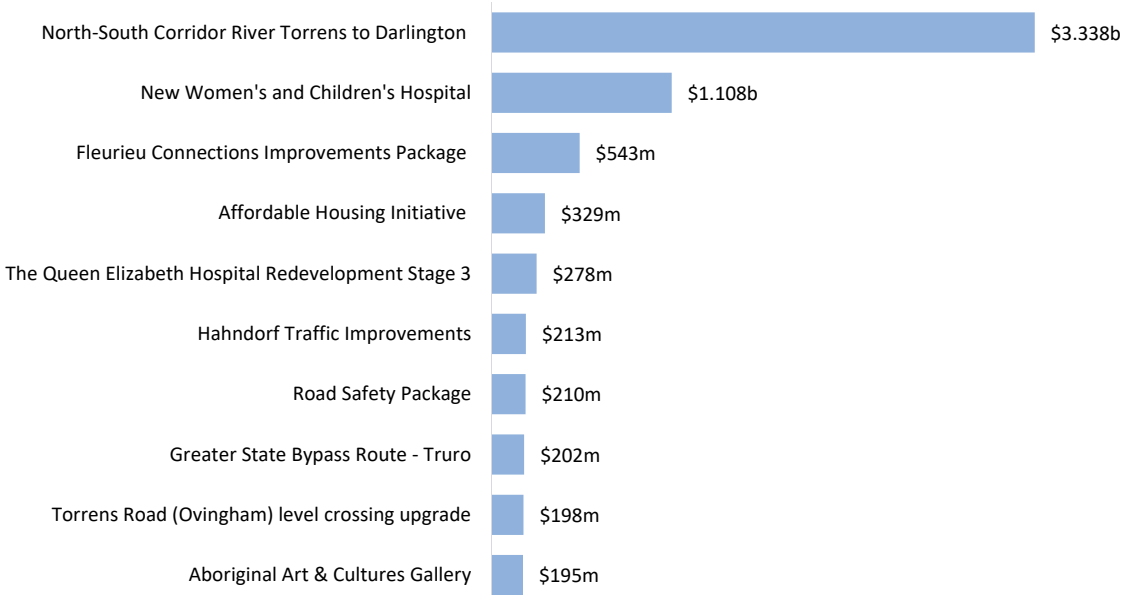
Investing contingencies over the four years of the 2021-22 Budget include amounts allocated to the North-South Corridor River Torrens to Darlington project and the new Women’s and Children’s Hospital.

DTF advised us that a transfer from contingency to agency budgets for investing projects will generally occur after a Cabinet approval for final costs and project scope. A transfer may also occur after DTF receives a signed agreement with another party (eg a Commonwealth National Partnership agreement) or when the agency enters into the contract to deliver the works. In these circumstances the Treasurer’s approval to transfer contingency is sought, either specifically or through the budget process.

5.3.3 North-South Corridor River Torrens to Darlington project and new Women’s and Children’s Hospital expected to incur the most expenditure over the four years of the Budget

Figure 5.7 details the most significant capital projects over the four years of the 2021-22 Budget.

Figure 5.7: Major capital projects over the four years of the 2021-22 Budget²⁹



The North-South Corridor River Torrens to Darlington project and new Women’s and Children’s Hospital are expected to incur the most investing expenditure over the four years

²⁹ Includes amounts held in contingencies for these projects.

of the 2021-22 Budget. Other projects with significant capital expenditure include the Fleurieu Connections Improvements Package³⁰ and the Affordable Housing initiative.

The 2021-22 Budget notes that significant work has occurred on the design of the tunnels and road project to inform the final costings for the North-South Corridor River Torrens to Darlington project. The total project cost is now expected to be \$9.938 billion. The increase in the estimated project cost from that in the 2020-21 Budget (\$8.9 billion) reflects an updated road layout that includes wider tunnels to allow for three lanes. The 2021-22 Budget also noted that the final project cost estimate will be settled when finalising the business case.

The 2021-22 Budget notes that the full business case for the new Women's and Children's Hospital project will be considered shortly by Infrastructure South Australia and the final project cost is expected to be around \$1.95 billion.

5.3.4 The SA Government will face challenges in ensuring its capital program is delivered on time and on budget

The 2021-22 Budget outlines a large capital program with significant capital projects, such as the North-South Corridor River Torrens to Darlington project and new Women's and Children's Hospital, to be delivered over several years. Major capital projects carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and timeliness of completion. Proper planning, management and control of them is critical to achieving budgeted outcomes.

There is an increased risk that significant revisions may be required to project costs for larger and more complex capital projects.³¹ For example, the estimated cost to deliver the North-South Corridor River Torrens to Darlington project has increased by \$1 billion from the previous Budget.

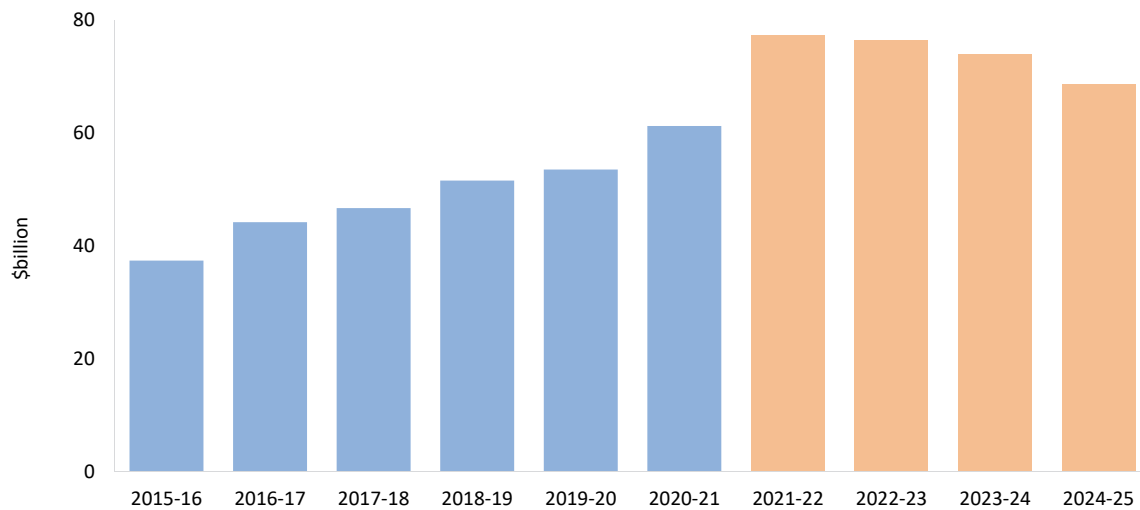
5.3.4.1 Budgeted capital spending across all Australian states is expected to be significantly higher than historical trends

The SA Government's capital program in the 2021-22 Budget is 88% larger than the four-year capital program in the 2017-18 Budget and other states are also currently implementing significant capital programs. Figure 5.8 shows the combined value of capital programs of all Australian states over the period 2015-16 to 2024-25.

³⁰ The Fleurieu Connections Improvements Package includes the Main South Road duplication from Seaford to Aldinga and Victor Harbor Road duplication projects.

³¹ The Grattan Institute analysed all public road and rail projects costing more than \$20 million completed between quarter 1 2001 and quarter 1 2020. It found 45% of projects with an initial estimated cost above \$1 billion had a cost overrun. The average cost overrun for these projects was \$1.05 billion. Terrill M, Emslie O and Moran G, 2020, *The rise of mega projects: counting the costs*, Grattan Institute, 8 November 2020, page 17.

Figure 5.8: Australian states' NFPS purchases of non-financial assets from 2015-16 to 2024-25³²



Source: South Australian and interstate budget papers and financial reports.

5.3.4.2 Capacity constraints may drive significant cost escalations for South Australia's capital program

Large capital programs across Australia have led to capacity constraints within the construction industry. Infrastructure Australia has noted:

The volume and scale of infrastructure construction, particularly in New South Wales and Victoria, has grown considerably, consuming and in some cases exceeding industry capacity. This has led to reduced competition and ability of governments to achieve value for money outcomes.³³

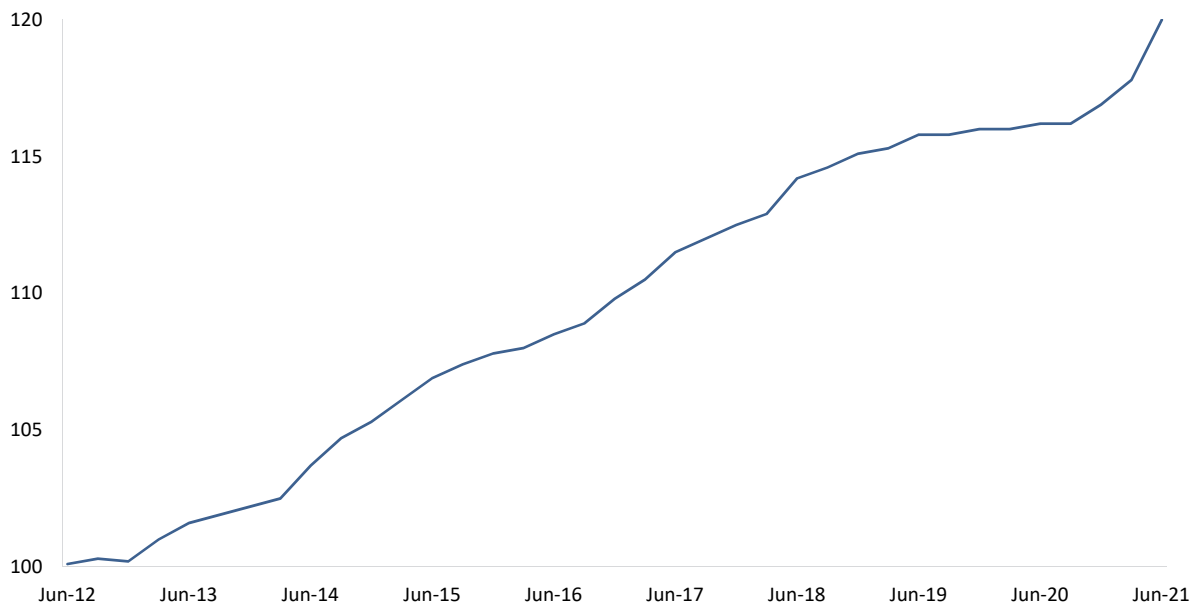
The 2021-22 Budget identifies the risk that significant public sector infrastructure investment could be delayed due to capacity constraints. It also notes that project estimates include prudent allowances for cost escalations. DTF advised us that the total project cost is developed by each agency on a project-by-project basis. As such the size of the allowance for cost escalations is dependent on the nature of the project and any project specific risk factors identified at the time of developing the budget.

Capacity constraints are placing pressure on the cost of construction inputs including workers, materials and equipment. Figure 5.9 highlights the increase in construction costs currently being experienced.

³² NFPS purchases of non-financial assets for Victoria included in figure 5.8 include changes in inventories. NFPS purchases of non-financial assets for Tasmania included in figure 5.8 between 2015-16 and 2019-20 reflect the estimated outcome as published in its budget papers.

³³ Infrastructure Australia 2019, *An Assessment of Australia's Future Infrastructure Needs: Australian Infrastructure Audit 2019*, June, page 213.

Figure 5.9: Building construction price index June 2012 to June 2021



Source: Australian Bureau of Statistics (June 2021), 6427.0 Producer Price Indexes, Australia, Table 17. Output of the construction industries, subdivision and class index numbers, Index No 30: Building Construction Australia, Series ID: A2333649T, accessed 7 September 2021.

As figure 5.9 shows, building construction costs increased by 3.3% in the 12 months to June 2021. The Australian Bureau of Statistics noted the following on this increase:

Federal and state (Western Australia and Tasmania) based Homebuilder grants coupled with government investment in infrastructure has resulted in increased activity, driving demand for labour and putting upward pressure on material prices.³⁴

Significant increases in construction costs above the allowances provided for in the project estimates pose a risk to the State's finances.

5.3.4.3 SA Government will need to implement robust controls and ensure it has appropriate skills and expertise to deliver its capital program on time and on budget

Appropriate procurement, contract and project management expertise, as well as sound information systems and financial controls, are required to effectively manage risks associated with the capital program and meet budget targets.

Infrastructure Australia has noted that inadequate public sector procurement expertise, including oversight of projects during delivery, can result in the taxpayer being exposed to inappropriate risks or costs and compromise the capability of projects to achieve user outcomes.³⁵

³⁴ Australian Bureau of Statistics (June 2021), Producer Price Indexes, Australia, Output prices of the construction industries, viewed 1 September 2021, <<https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/producer-price-indexes-australia/latest-release>>.

³⁵ Infrastructure Australia 2019, *An Assessment of Australia's Future Infrastructure Needs: Australian Infrastructure Audit 2019*, June, page 236.

My previous Reports have highlighted significant scope to improve the planning, procurement, project management and contract management of major capital projects.³⁶ It is important that due consideration is given to the findings and recommendations in these Reports when planning and managing the State’s capital program.

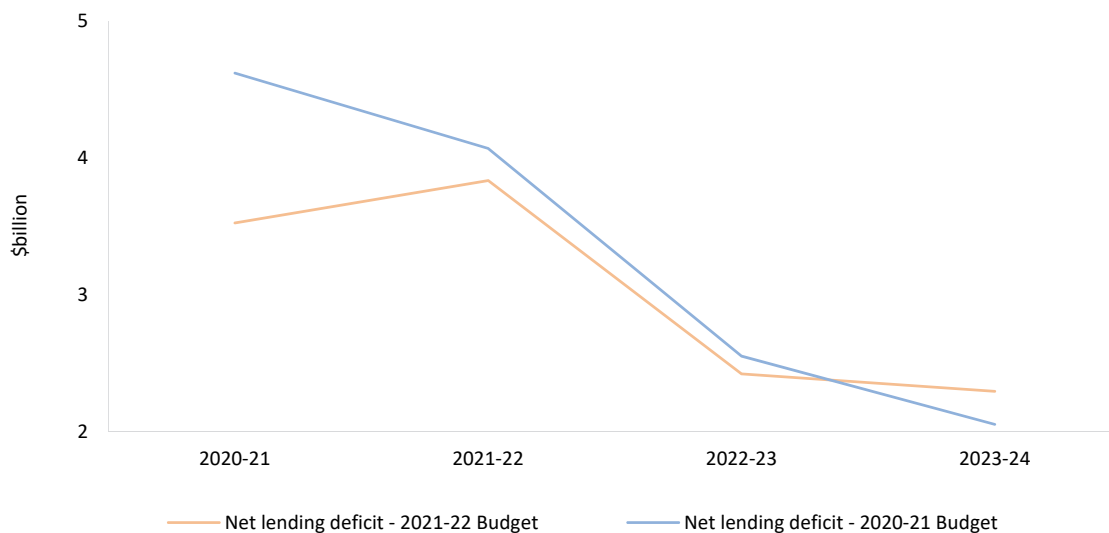
Infrastructure South Australia was established in 2018 to provide independent advice to the SA Government to enable informed and integrated decisions on infrastructure planning, investment, delivery and optimisation. It maintains oversight of the delivery and performance of the SA Government’s major infrastructure projects. The SA Government has also established an Infrastructure Cabinet Committee to monitor the status of major public sector projects and ensure the delivery of the agreed infrastructure work program.

5.4 Borrowings and net debt

5.4.1 Forecast net lending balances have improved slightly since the previous Budget but significant increases in net debt are still expected by 2024-25

NFPS net lending deficits for the three years from 2020-21 to 2022-23 are now projected to be lower than that forecast in the 2020-21 Budget, as shown in figure 5.10.

Figure 5.10: Comparison of NFPS net lending deficits in 2020-21 and 2021-22 Budgets



The improved net lending deficits for 2020-21 to 2022-23 are mainly due to:

- improved net operating balance forecasts for 2020-21 and 2022-23 compared to the 2020-21 Budget

³⁶ Refer to Auditor-General’s Report 7 of 2020 *Flinders Link Project* and Auditor-General’s Report 11 of 2019 *Darlington Upgrade Project* for examples of projects where significant scope for improvement in planning, procurement, project management and contract management of major capital projects was identified.

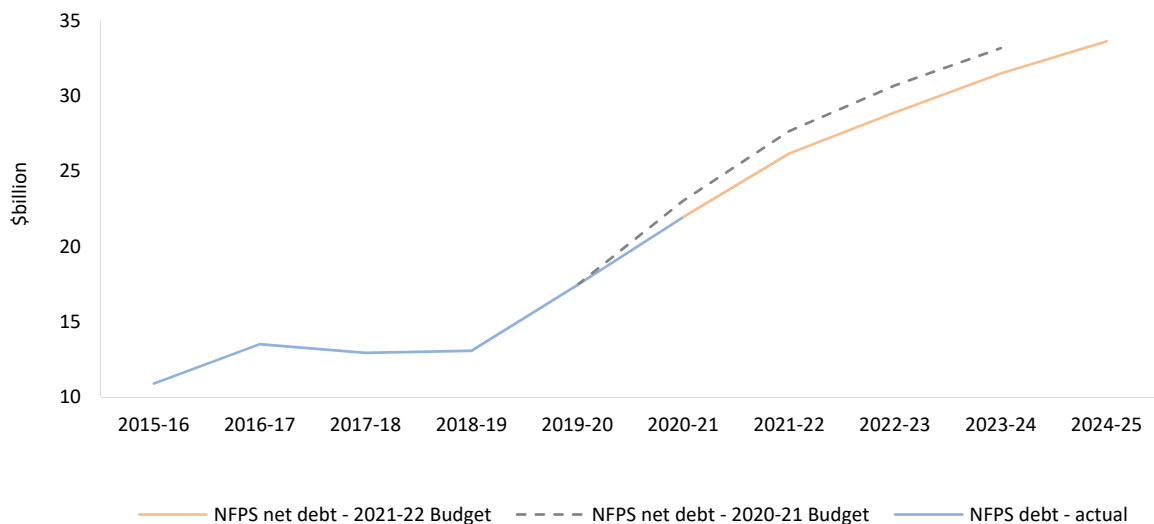
- a decrease in expected purchases of non-financial assets for 2021-22 compared to the 2020-21 Budget.

The NFPS net lending deficit for 2023-24 (\$2.294 billion) is forecast to be higher than the previous Budget (\$2.052 billion). This is primarily due to an increase in expected purchases of non-financial assets for 2023-24 in the 2021-22 Budget (\$4.902 billion) compared to the previous Budget (\$4.615 billion).

The net lending deficits result in significant expected increases in net debt. NFPS net debt is projected to increase by \$11.671 billion, from \$21.952 billion at 30 June 2021 to \$33.623 billion at 30 June 2025. Most of the increase in NFPS net debt relates to the general government sector (\$10.552 billion).

Figure 5.11 shows NFPS net debt for the period 2015-16 to 2024-25, including a comparison between the NFPS net debt forecasts in the 2020-21 and 2021-22 budgets.

Figure 5.11: NFPS net debt from 2015-16 to 2024-25

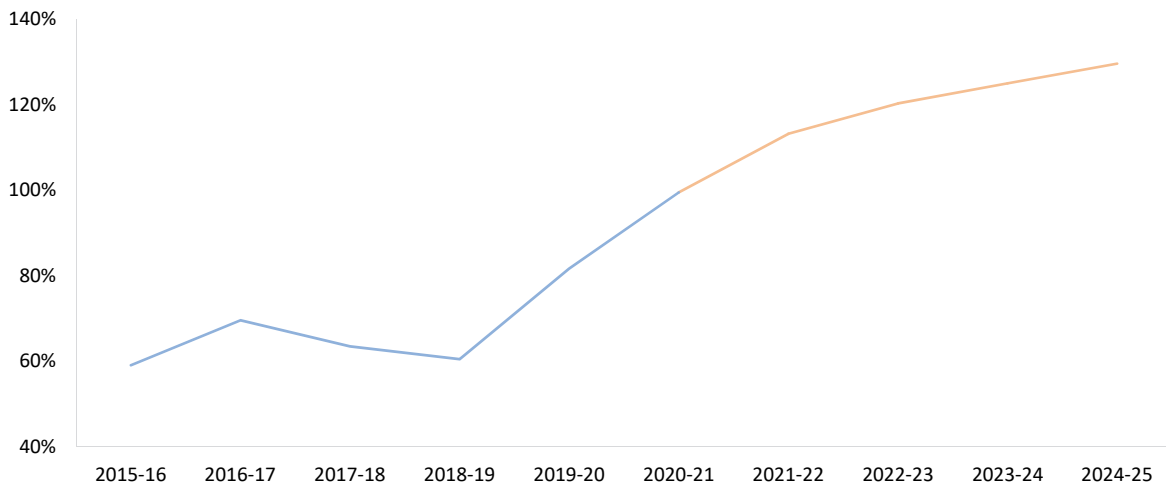


NFPS net debt is now expected to be \$1.677 billion lower at 30 June 2024 than estimated in the 2020-21 Budget. Despite the improved forecasts, NFPS net debt at 30 June 2025 (\$33.623 billion) is still projected to be more than triple that at 30 June 2016 (\$10.912 billion).

5.4.2 NFPS net debt projected to rise to 130% of revenue by 30 June 2025

Comparing net debt to the State’s revenue provides one measure of the sustainability of the State’s debt levels. Figure 5.12 shows the NFPS net debt to revenue ratio over the period 2015-16 to 2024-25.

Figure 5.12: NFPS net debt to revenue ratio from 2015-16 to 2024-25



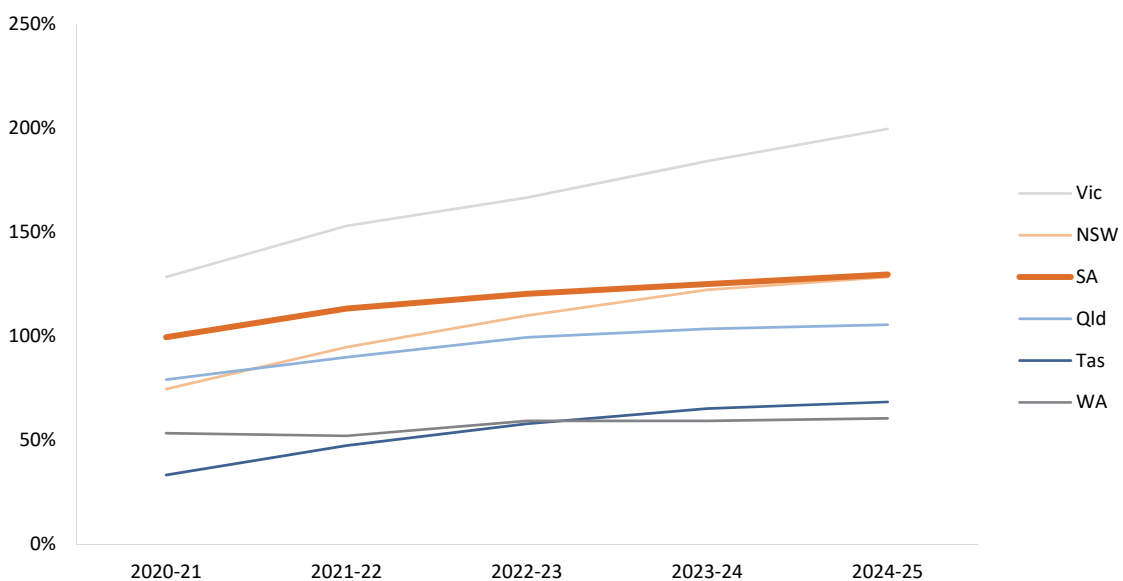
The NFPS net debt to revenue ratio has increased significantly from 59% in 2015-16 to a forecast 130% in 2024-25. This mainly reflects higher borrowings to fund:

- the significant operating deficits between 2019-20 and 2021-22 resulting from the economic impacts of COVID-19 and the SA Government’s economic stimulus response
- the SA Government’s large capital program since 2020-21.

5.4.3 Increases in net debt generally similar to other Australian states

Figure 5.13 compares South Australia’s NFPS net debt to revenue ratio to other Australian states for the period 2020-21 to 2024-25.

Figure 5.13: South Australia’s NFPS net debt to revenue ratio compared to other Australian states from 2020-21 to 2024-25



Source: South Australian and interstate budget papers.

Figure 5.13 highlights that the NFPS net debt to revenue ratio for all Australian states is expected to trend upwards from 2020-21 to 2024-25.

Coming into the COVID-19 pandemic in 2019-20, South Australia's NFPS net debt to revenue ratio was comparable to Victoria but higher than the other states.³⁷ By 30 June 2025, South Australia's net debt to revenue ratio (130%) is expected to be similar to that of New South Wales (128%) and substantially lower than Victoria (200%).

The increase in the NFPS net debt to revenue ratio across Australian states reflects increased borrowings by each State to implement significant capital investment programs to support job creation and economic growth.

Figure 5.13 reflects net debt and revenue projections for New South Wales and Victoria as published in their 2021-22 budgets. These budgets were handed down prior to the current COVID-19 outbreaks and resulting public health restrictions in these states.³⁸ The economic downturn from these restrictions, combined with the fiscal response of the New South Wales and Victorian governments, may result in significant variations to the net debt and revenue forecasts in their 2021-22 budgets. This could adversely impact the NFPS net debt to revenue ratios for these states.

5.4.4 No specific quantifiable measure established to monitor performance against the fiscal target of achieving a sustainable level of net debt

The SA Government's Fiscal Target 3 aims to achieve a level of net debt that is sustainable over the forward estimates. The 2021-22 Budget notes that this target requires the maintenance of sustainable debt levels that allows for sustainable borrowings for investment in key infrastructure without placing undue burden on future generations.

The SA Government has not set a clear and quantifiable measure to assess its performance against Fiscal Target 3. Without this, it may be difficult to assess what is a sustainable level of debt over the forward estimates and whether it has been satisfactorily achieved.

DTF advised us that rather than having a quantitative measure for Fiscal Target 3, the SA Government considers the views of the credit rating agencies, benchmarking against interstate peers and the level of interest cost burden in assessing the sustainability of its debt levels.

DTF also advised us that:

- Fiscal Target 3 acknowledges that there can be variability in debt levels over time as decisions are made to invest in infrastructure or the budget responds to challenging short and medium-term fiscal circumstances
- the SA Government assesses the sustainability of its net debt levels annually through the budget process and credit rating agencies assess the SA Government's position and budget annually

³⁷ Auditor-General's Report 8 of 2021 *State finances and related matters*, pages 53-54.

³⁸ The New South Wales 2021-22 Budget was handed down on 22 June 2021 and Victoria's 2021-22 Budget was handed down on 20 May 2021.

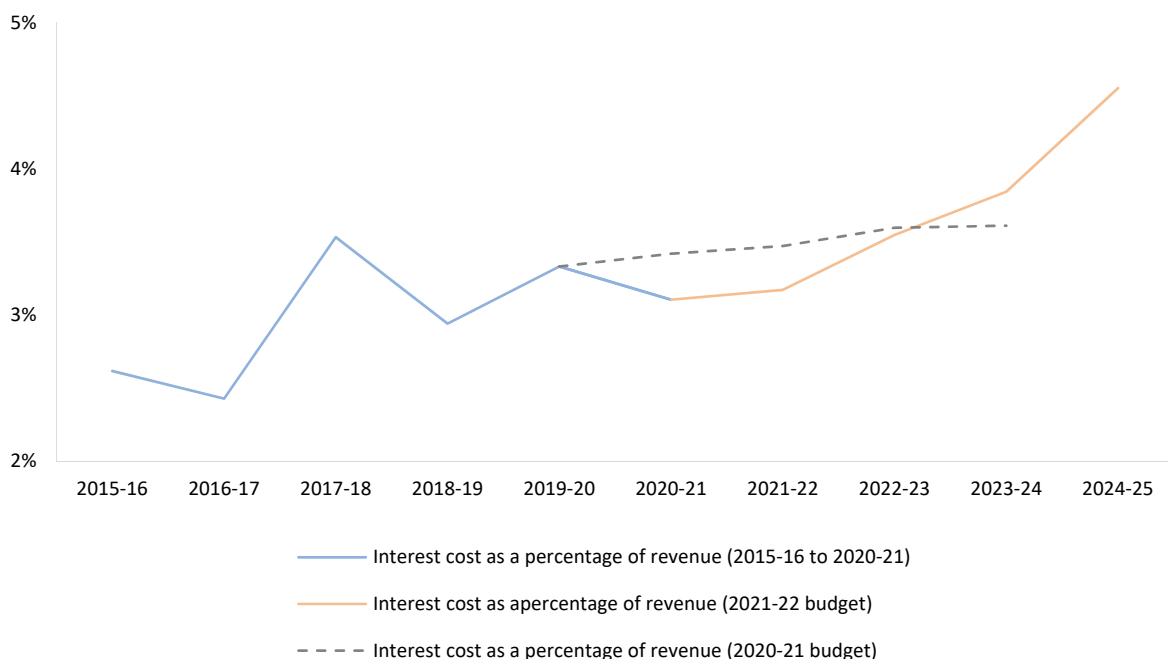
- Moody’s, in its latest release, maintained South Australia’s existing credit rating (Aa1, stable outlook) and indicated that South Australia’s debt levels, while rising over the next few years, will remain moderate and sustainable (section 5.4.8 provides further details)
- while increases in interest rates and large investing programs will, in isolation, have implications for debt, the level of net debt beyond the forward estimates will be determined in the 2022-23 budget process, as the SA Government can tailor its expenditure decisions over time to manage its financial position.

The SA Government’s Fiscal Target 3 only considers the sustainability of net debt over the forward estimates. The SA Government has committed to several significant investing expenditures beyond the forward estimates, which may lead to further increases in net debt (see section 5.4.9). Given the increased likelihood that net debt will rise further beyond the forward estimates, it is prudent for the SA Government to consider significant investing expenditure commitments beyond the forward estimates when assessing the sustainability of its net debt.

5.4.5 Estimated borrowing costs as a percentage of revenue projected to increase significantly in 2024-25 as interest rates are expected to rise

Interest expense as a percentage of total revenue (interest expense to total revenue ratio) is an indicator of the State’s capacity to fund its borrowing costs from operating revenues. Figure 5.14 shows the NFPS interest expense to total revenue ratio over the period 2015-16 to 2024-25.

Figure 5.14: NFPS interest expense to total revenue ratio from 2015-16 to 2024-25



The NFPS interest expense to total revenue ratio is forecast to increase significantly from 2.6% in 2015-16 to 4.6% by 2024-25. The increase principally reflects the increase in NFPS borrowings.

Figure 5.14 highlights that borrowing costs as a percentage of revenue in 2023-24 are forecast to be above that estimated in the 2020-21 Budget (3.8% compared to 3.6%). This reflects an increase in expected interest rates. DTF advised us that the interest rate used to forecast interest expense in 2023-24 for the Treasurer’s:

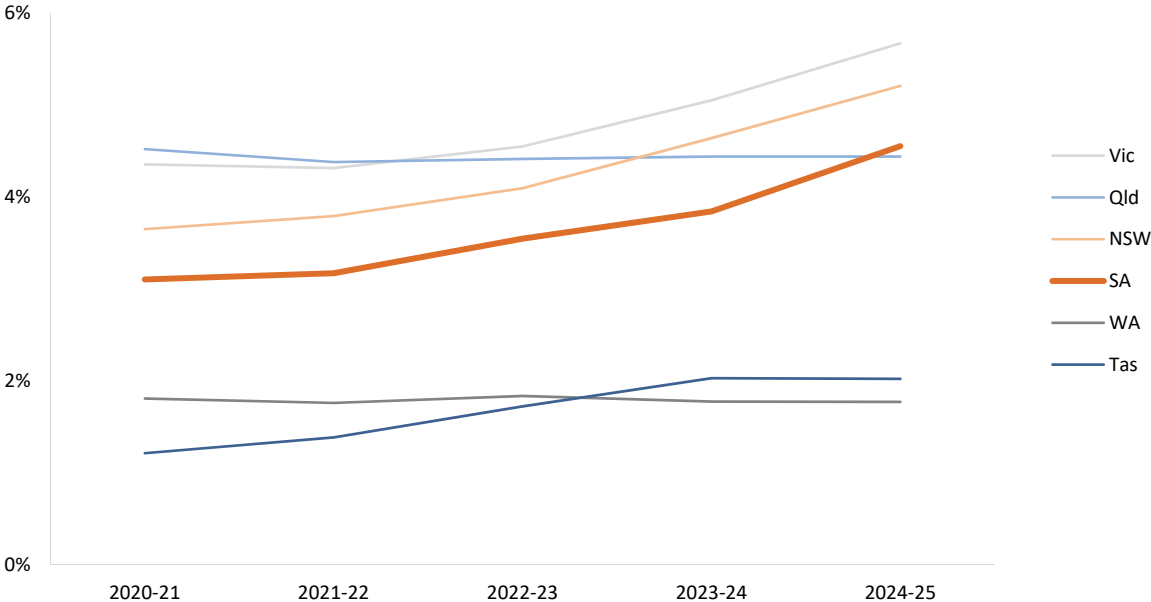
- cost of fund loan³⁹ is 0.47% higher than the interest rate used in the 2020-21 Budget
- cash loan⁴⁰ is 0.3% higher than the interest rate used in the 2020-21 Budget.

As the ratio of interest expense to revenue increases there is a risk the SA Government will have less budget flexibility to fund service delivery needs and respond to future economic challenges.

5.4.6 South Australia’s ability to fund borrowing costs from operating revenues is generally comparable to other states

Figure 5.15 compares South Australia’s NFPS interest expense to total revenue ratio to other Australian states for the period 2020-21 to 2024-25.

Figure 5.15: South Australia’s NFPS interest expense to total revenue ratio compared to other states from 2020-21 to 2024-25



Source: South Australian and interstate budget papers.

³⁹ Cost of loan funds portfolio comprising liquid nominal rate liabilities and hedge instruments and certain non-liquid nominal long-term borrowings.

⁴⁰ Loan from the South Australian Government Financing Authority (SAFA) to the Treasurer to meet the working capital needs of general government agencies.

Figure 5.15 highlights that by 30 June 2025 South Australia's interest expense to total revenue ratio is expected to be very similar to Queensland and less than New South Wales and Victoria.

5.4.7 South Australia's risk exposure to interest rate rises significantly increased by the higher level of net debt

The Reserve Bank of Australia has indicated that it will not raise the cash rate target⁴¹ until inflation is sustainably in the 2% to 3% range. It does not expect this condition to be met before 2024.⁴²

While interest rates are currently low and expected to remain low in the short to medium term, the increased net debt significantly increases the SA Government's exposure to interest rate rises. DTF advised us that the borrowing cost impact of a one percentage point increase in the average interest rate applying to NFPS net debt ranges from additional interest expenses of \$262 million in 2021-22 to \$336 million in 2024-25.

The 2021-22 Budget notes that the SA Government's debt management objective is to minimise long-term average interest costs subject to acceptable levels of interest rate risk. DTF advised us that SAFA continues to focus on lengthening the maturity profile⁴³ of the State's debt. This has the effect of locking in current low long-term interest rates and spreading the refinancing risk.

The 2021-22 Budget also notes that a review of the SA Government's debt management strategy has seen debt now managed within a duration⁴⁴ range of four to eight years compared to the one to five-year duration range adopted previously.

DTF advised us that the duration of general government sector debt increased from 4.46 years to 5.44 years in 2020-21. DTF also advised us that, based on the forward estimates, SAFA will need to consider issuing debt with maturities out to 30 years.

5.4.8 No change made by Moody's or Standard & Poor's to South Australia's credit ratings after the 2021-22 Budget

5.4.8.1 Moody's maintained South Australia's credit rating at its second highest level

Following the release of the 2021-22 Budget, Moody's maintained South Australia's credit rating at Aa1 with a stable outlook. Figure 5.16 shows Moody's credit rating for each Australian state at 31 August 2021.

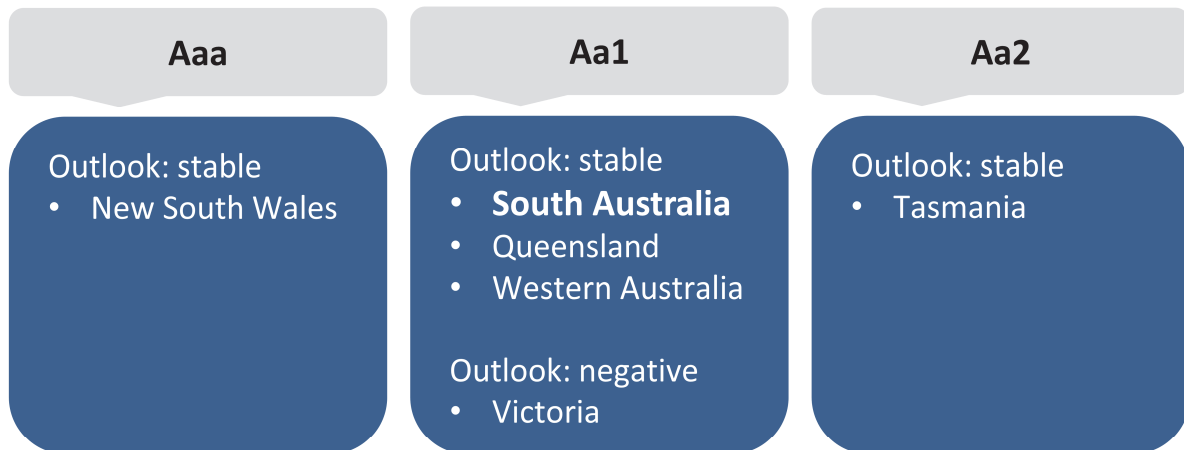
⁴¹ The cash rate forms the base on which the structure of interest rates in the economy is built. Movements in the cash rate are passed through to other capital market interest rates, including bond yields. The Reserve Bank of Australia implements conventional monetary policy by setting a target for the cash rate.

⁴² Lowe, P, 6 August 2021, Opening Statement to the House of Representatives Standing Committee on Economics.

⁴³ A bond's term to maturity is the length of time during which the owner will receive interest payments. When the bond reaches maturity the principal is repaid.

⁴⁴ Duration means how long it takes, in years, for an investor to be repaid the bond's price by the bond's total cash flows.

Figure 5.16: Moody's credit ratings for Australian states (August 2021)



Source: Information provided by DTF

South Australia has the same Moody's credit rating as all other states except New South Wales and Tasmania.

Moody's indicated that the stable outlook for South Australia's credit rating reflects its expectation that, while COVID-19 will markedly affect the SA Government's revenue and debt metrics, the increase in the State's debt burden will be contained by its fiscal resolve and close ties with the Commonwealth.

On the increase in the SA Government's net debt, Moody's noted:

- South Australia's debt burden benchmarks favourably with its domestic peers
- debt affordability at the budgeted levels remains strong and the State's debt position is expected to remain sustainable in the context of sustained low global interest rates, the likelihood of fiscal repair in the wake of the impact on the economy of COVID-19 and comparisons with similarly rated peers.

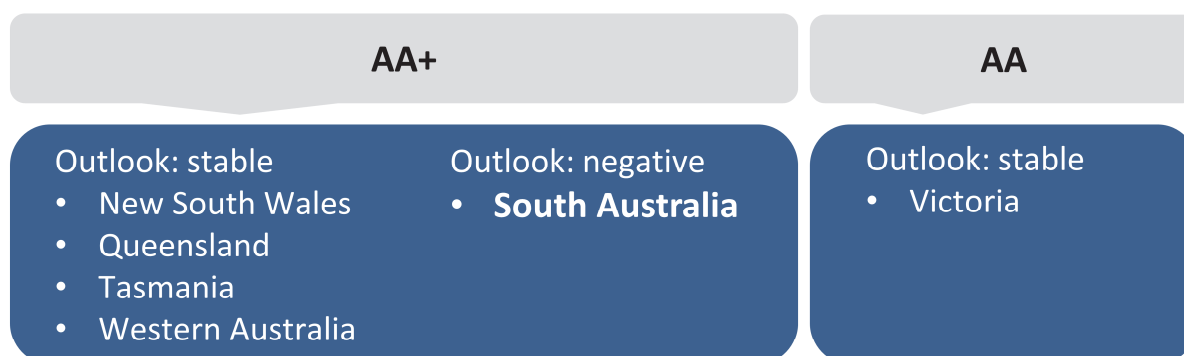
Moody's also indicated that South Australia's credit rating could be:

- upgraded if revenue growth recovers with strong control over spending, resulting in a prolonged period of budget surpluses and material and sustained reductions in debt
- downgraded if the economic and fiscal impact of COVID-19 pandemic shock is larger than it expects and/or the SA Government's policy response is less effective than it assumes, resulting in larger and longer increases in debt.

5.4.8.2 Standard & Poor's maintained South Australia's credit rating at its second highest level with a negative outlook

In August 2021 S&P affirmed South Australia's credit rating at AA+ with a negative outlook. Figure 5.17 shows S&P's credit ratings for each Australian state at 31 August 2021.

Figure 5.17: S&P's credit ratings for Australian states (August 2021)



Source: Standard & Poor's website, <<https://www.spglobal.com/ratings/en/>>.

South Australia has the same S&P credit rating as all other Australian states except Victoria, which has a lower S&P credit rating.

S&P indicated that its negative outlook for South Australia's credit rating reflects the risk that fallout from COVID-19 and the State's proposed stimulus program could stress the State's fiscal indicators more than it anticipates. S&P also indicated that it could:

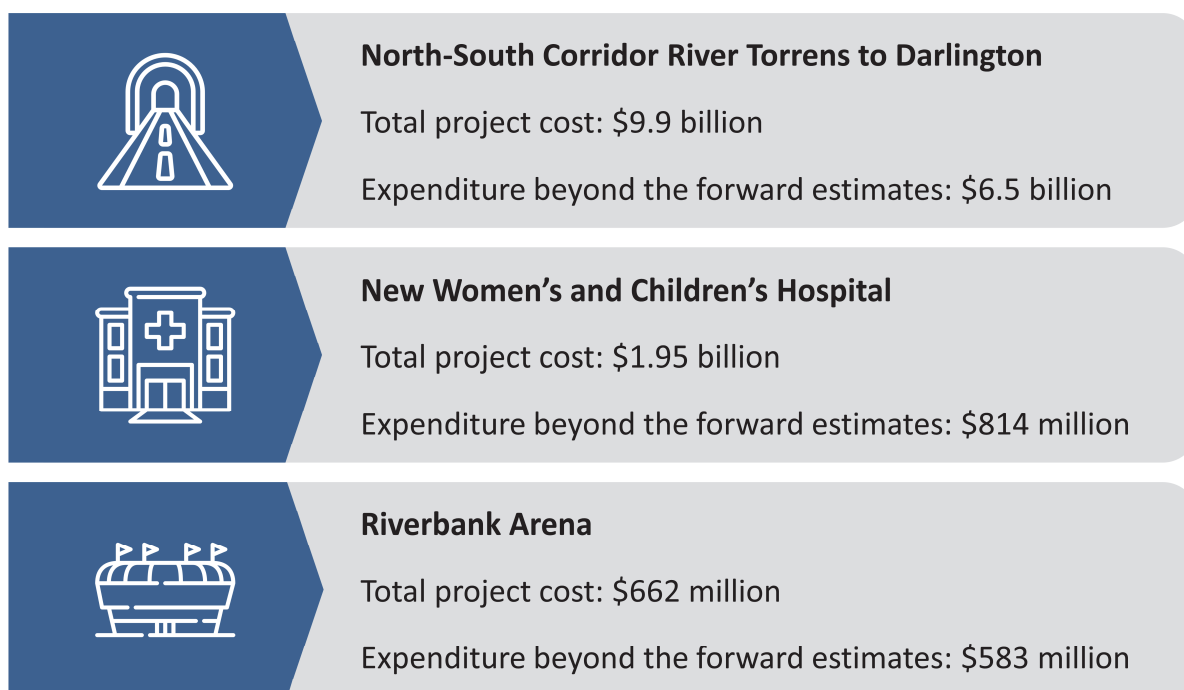
- lower South Australia's credit rating over the next 24 months if its fiscal metrics do not recover to the degree it forecasts. This could occur if operating deficits persist while the SA Government rolls out large infrastructure spending, resulting in wider after capital account deficits
- revise its outlook for South Australia's credit rating to stable in the next two years if financial management strengthens. This could occur if the SA Government successfully implements its policies and manages its deficits and debt level in line with S&P's forecasts.

On the SA Government's large capital program, S&P noted that there is some risk of cost overruns, skilled labour shortages and project delays due to the record levels of infrastructure construction occurring across Australia. Section 5.3.4 discusses these risks and other challenges the SA Government will face in ensuring its capital program is delivered on time and on budget.

5.4.9 Net debt levels will likely rise further as a result of substantial infrastructure project expenditure planned beyond the forward estimates and other budget risk factors

The 2021-22 Budget outlines some major investing expenditure commitments that exist beyond the forward estimates period. These are summarised in figure 5.18.

Figure 5.18: Major investing expenditure commitments beyond the forward estimates



These large infrastructure initiatives may result in further net debt increases as they will be primarily funded by the SA Government. DTF advised us that the Commonwealth Government has currently committed total funding of \$2.711 billion to the North-South Corridor River Torrens to Darlington project, with the State matching funding on a 50:50 basis (\$5.422 billion total expenditure). The State continues to work collaboratively with the Commonwealth Government to secure the additional funding required for the total project cost, currently estimated at \$9.9 billion, with final funding required to be informed by the final business case. The further commitment from the Commonwealth Government on this project is expected to be on a 50:50 basis. No Commonwealth Government contributions are budgeted for the new Women's and Children's Hospital or the Riverbank Arena.

Debt levels may also increase if:

- the national GST pool declines due to weaker consumer spending resulting from extended COVID-19 health restrictions
- significant budget overruns occur in major investing program projects
- additional expenditure measures are required by the SA Government to respond to COVID-19 outbreaks or to stimulate economic recovery from the pandemic
- Health and Wellbeing savings targets are not achieved
- growth in employee expenses exceeds that allowed for in the forward estimates due to enterprise agreement negotiation outcomes.

Given these risk factors and the substantial infrastructure expenditure planned beyond the forward estimates, it is important the SA Government closely monitors its net debt fiscal target and budget risk exposures to ensure its net debt remains sustainable.

5.4.10 SAFA manages most of the State's debt

SAFA is the State's central borrowing authority and is responsible for managing most of the State's debt. It lends funds raised from financial markets to various South Australian public sector clients, including the Treasurer (who borrows on behalf of public sector agencies to support their operational requirements) and SA Water.

At 30 June 2021, SAFA's liabilities were \$39.87 billion. It had loans to the Treasurer (\$21.656 billion), loans to PNFC (\$8.323 billion) and loans to public financial corporations (PFC) (\$1.993 billion).

DTF advised us that:

- based on the forward estimates in the 2021-22 Budget, SAFA forecasts that its term debt outstanding will increase from \$23.8 billion at 30 June 2021 to \$35.8 billion by the end of 2024-25
- SAFA targets \$2.5 billion outstanding in short-term debt to manage the State's liquidity requirement. With the forecast increase in net debt, SAFA estimates that it will gradually increase its short-term debt outstanding to \$3 billion by the end of the forward estimates.

Further details on SAFA and its debt management approach are included in the section of Part C of my 2020-21 Annual Report titled 'South Australian Government Financing Authority'.

Appendix – Reporting framework

Uniform Presentation Framework

By agreement between the Commonwealth, States and Territories, each jurisdiction presents its Budget Papers and mid-year budget update on a UPF basis.

The primary objective of the UPF is to ensure that Commonwealth, State and Territory Governments provide a common core of financial information in Budget Papers to enable direct comparisons across jurisdictions.

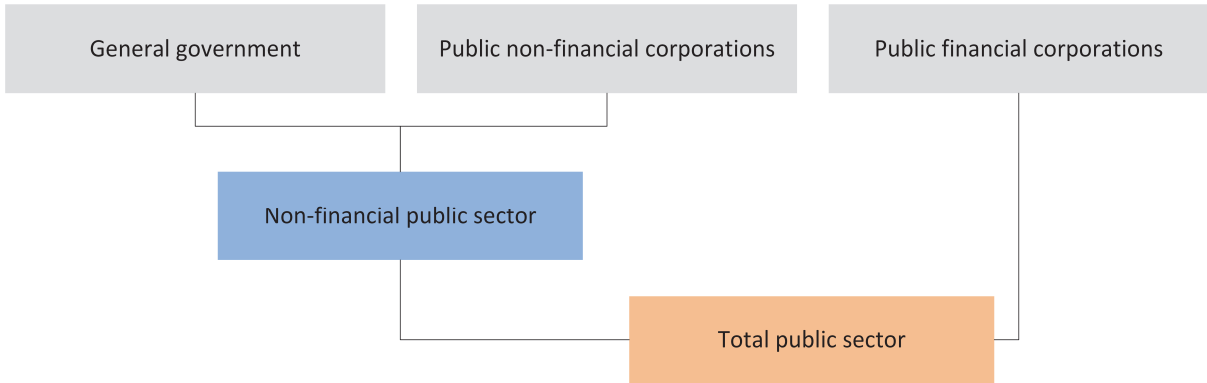
Institutional sectors

Budget reporting is prepared for the following institutional sectors:

- **General government sector** – agencies providing services free of charge or at prices below their cost of production or service cost. These are the services that tend to be primarily financed through taxes and other charges, and for this reason this sector tends to be the focus of fiscal targets.
- **PNFC sector** – trading enterprises mainly engaged in producing goods and services for sale in the marketplace at prices that aim to recover most or all of the costs involved. In South Australia this sector includes SA Water and the SA Housing Authority.
- **PFC sector** – bodies primarily engaged in providing financial services. This includes financial institutions such as SAFA, HomeStart Finance and the Superannuation Funds Management Corporation of South Australia.
- **NFPS** – the consolidation of the general government and PNFC sectors.

Figure A1 shows the structure of the sectors, which when consolidated form the total public sector (whole of government).

Figure A1: Sectors of government activity



Budget reporting

Budget estimates are presented on an accrual basis. Three primary statements are prepared for the general government sector, PNFC sector and NFPS:

- operating statement including other economic flows
- balance sheet
- cash flow statement.

PFC sector data is not published in the Budget Papers.

Fiscal measures

The UPF prescribes various fiscal measures as a basis for evaluating the soundness of the government's fiscal position and the effect of fiscal policy. Figure A2 sets out the key fiscal measures in the UPF referred to in this Report.

Figure A2: UPF – key fiscal measures

Fiscal measure	Description
Net operating balance	Revenue from transactions less expenses from transactions. The net operating balance excludes expenditure on the acquisition of capital assets, but includes non-cash costs such as accruing superannuation entitlements and the consumption of capital (depreciation). This provides a measure of the sustainability of the government's fiscal position over time and provides an indication of the sustainability of the existing level of government services.
Net lending/borrowing (fiscal balance)	Net operating balance less the net acquisition of non-financial assets. This measures a government's investment-saving balance. A net lending balance (fiscal surplus) indicates that a government is saving more than is required to finance all of its investment spending. A net borrowing (fiscal deficit) position indicates that the public sector's level of investment exceeds its level of savings.
Net debt	Sum of deposits held, advances received and borrowings, less the sum of cash and deposits, advances paid, investments, loans and placements.
Net worth	Total assets (both financial and non-financial) less total liabilities, shares and other contributed capital. Net worth incorporates a government's non-financial assets, such as land and other fixed assets, which may be sold and used to repay debt, as well as financial assets and liabilities not captured by the net debt measure, most notably accrued employee superannuation liabilities, debtors and creditors.

The glossary in Budget Paper 3 provides further detail on the terms used in the Budget Statement and definitions.

Abbreviations used in this Report

Abbreviation	Description
CGC	Commonwealth Grants Commission
DTF	Department of Treasury and Finance
Education	Department for Education
FTE	Full-time equivalent
GSP	Gross State Product
GST	Goods and services tax
Health and Wellbeing	Department for Health and Wellbeing
Infrastructure and Transport	Department for Infrastructure and Transport
MYBR	Mid-year budget review
NFPS	Non-financial public sector
NPP	National Partnership Payment
PFC	Public financial corporations
PNFC	Public non-financial corporation
S&P	Standard & Poor's
SAFA	South Australian Government Financing Authority
SA Water	South Australian Water Corporation
UPF	Uniform Presentation Framework

