Report of the Auditor-General

Audit Office of South Australia

Report 11 of 2024

State finances

Insights for the 2024-25 State Budget

Government of South Australia

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State finances – insights on the 2024-25 Budget

Tabled in the House of Assembly and ordered to be published, 29 October 2024

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The Audit Office of South Australia 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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28 October 2024

President
Legislative Council
Parliament House
ADELAIDE SA 5000

Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Dear President and Speaker

Report of the Auditor-General:
Report 11 of 2024 *State finances – insights on the 2024-25 Budget*

Under the *Public Finance and Audit Act 1987,* I present this report to each of you.

Content of the report

The 2024-25 State Budget was tabled in Parliament in June 2024. This report provides our observations on key trends and risks for 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 2024-25 Budget Papers, supplemented by information provided to us by the Department of Treasury and Finance.

Acknowledgements

The review team for this Report was Salv Bianco, Ken Anderson and Simon Altus.

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

Yours sincerely

Andrew Blaskett
Auditor-General

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Audit snapshot

What we reviewed and why

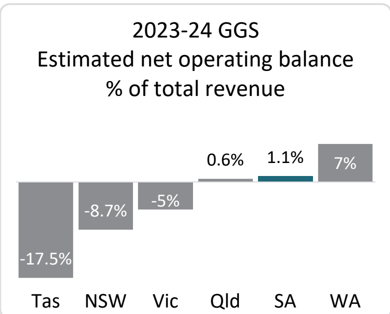
The State Budget sets out the SA Government's fiscal strategy, actual and forecast financial position and new policy initiatives. It is also a key tool to manage and monitor government programs and performance. This report gives our insights into key trends and risks for the State's public finances based on our review of the 2024-25 State Budget.

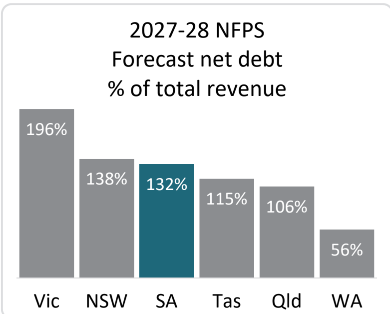
Our key insights

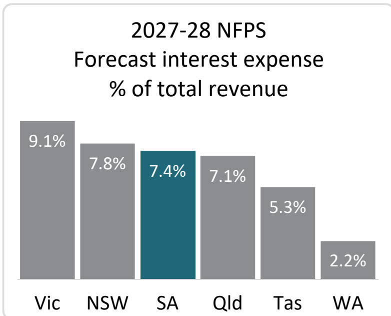
- The current challenging economic environment could put forecast net operating surpluses at risk. Cost of living pressures on household budgets and the possibility of lower employment rates increase the **risk of downward revisions to budget forecasts** for GST revenue and payroll tax. Wage negotiations for most of the general government sector workforce are also occurring in a period of high inflation.
- **SA Health will face challenges achieving its savings targets** and expenditure forecasts in the 2024-25 State Budget given public hospital activity growth and difficulties it has had in improving the efficiency of its service delivery. If its savings targets are not met, other areas of the Budget may need to be managed to deliver forecast net operating surpluses.
- There are **several risks attached to the SA Government's very large capital program**. This includes delivering projects on time and on budget given construction industry capacity and skills constraints. Relatively small percentage budget overruns on the capital program could also significantly impact the State's overall financial position.
- Rising debt and interest costs owing to the scale of the State's capital program may **constrain the State's fiscal capacity** and its ability to deliver the same level of services in the future.

Key budget indicators

South Australia generally compares favourably to Victoria and to some extent New South Wales and Tasmania on key budget sustainability indicators. It is in a similar or less favourable position compared to Queensland and Western Australia.







S&P/Moody's credit rating

Vic AA/Aa2 **Tas** AA+/Aa2 **SA AA+/Aa1** **Qld** AA+/Aa1 **NSW** AA+/Aaa **WA** AAA/Aaa

Note: GGS refers to the general government sector and NFPS to the non-financial public sector.

1 Executive summary

1.1 Introduction

The State Budget sets out the SA Government's fiscal strategy, actual and forecast financial position and new policy initiatives. It is also a key tool to manage and monitor government programs and performance.

This report provides our observations on key trends and risks for the State's public finances based on our review of the 2024-25 State Budget (2024-25 Budget).

Our analysis is based on data provided in the 2024-25 Budget Papers, supplemented by information provided to us by the Department of Treasury and Finance (DTF). The data and assumptions underlying this information were not subject to audit and no audit opinion is provided on the accuracy of historical or forecast figures in the 2024-25 Budget.

1.2 Our key insights

1.2.1 Challenging economic environment could put forecast operating surpluses at risk

There is ongoing volatility in GST receipts due to changes in South Australia's share of the national GST pool, and challenging national economic conditions impacting consumer spending and the size of the pool. This could put GST budget forecasts at risk.

The South Australian Centre for Economic Studies' June 2024 Economic Briefing Report indicates that the South Australian economy has recently shown a significant slowdown with key economic indicators showing weaker trends, including declining employment levels. This increases the risk of downward revisions to budget forecasts for state taxation revenue, in particular payroll tax.

The SA Government will also face challenges in negotiating wages agreements that meet employee expense forecasts in the 2024-25 Budget. The negotiations planned for 2024-25 cover a significant proportion (73%) of general government sector employees and are occurring in a period of high inflation. The Adelaide Consumer Price Index increased by 7.9% in 2022-23 and was estimated to rise by 4.8% in 2023-24. This is likely to influence wage increases sought through enterprise bargaining negotiations.

1.2.2 Ongoing funding pressures in Health and Child Protection

SA Health will face challenges in achieving its savings targets and expenditure forecasts in the 2024-25 Budget, given recent growth in activity for public hospitals and difficulties it has had in improving the efficiency of its service delivery. The planned time frame for achieving the national efficient price (NEP) in delivering public hospital services has been repeatedly delayed over several consecutive Budgets and is now not planned to occur until 2027-28.

If SA Health continues to not meet its savings targets, the SA Government may need to manage the Budget in other areas to deliver its forecast net operating surpluses. This could impact funding to other government programs and the efficiency demands made on other agencies.

The 2024-25 Budget indicates that total Department for Child Protection expenditure was expected to increase by 38% from 2020-21 to 2023-24. This trend is not expected to continue, with total expenditure forecast to decrease between 2023-24 and 2024-25 and only grow by 6% from 2024-25 to 2027-28.

If growth in the number of children and young people in care and the placement mix between family and non-family-based care are more in line with recent trends than 2024-25 Budget assumptions, there is a risk that considerable additional funding to the Department for Child Protection may be needed.

1.2.3 Assessments of sustainability of net operating surpluses should consider variability in Commonwealth capital grant revenue

Commonwealth Government national partnership grants for infrastructure are an important driver of the forecast operating surpluses in the 2024-25 Budget. These grants are expected to increase significantly over the four years of the Budget, mainly due to the North-South Corridor Torrens to Darlington (T2D) project. Excluding this funding, which is for the specific purpose of purchasing assets rather than for operational purposes, forecast net operating balances in each year would be in deficit.

Where capital grant revenue is expected to be significant, it should be considered in making any assessments about the Budget's sustainability, particularly any relating to fiscal target 1 in the 2024-25 Budget[1] and ensuring operating expenditures can be fully funded from operating revenues.

1.2.4 Challenges in delivering very large capital program on time and on budget

The non-financial public sector (NFPS) capital program over the four years of the 2024-25 Budget is $25.6 billion and is significantly higher ($4.5 billion more) than the previous Budget. From 2026-27, South Australia's capital program as a proportion of its asset base will be larger than every other state except Tasmania.

Given the very large size of the capital program, even small percentage budget overruns could have a significant impact on the State's overall financial position, including increased net lending deficits and net debt. As an example, a relatively small budget overrun (based on past experience with transport infrastructure projects in South Australia) of 10% would amount to $1.54 billion for the T2D project.

The risk of significant cost overruns and project delays for the capital program is high given:

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[1] Fiscal target 1: Achieve a net operating surplus in the general government sector every year.

- the inherent challenges in managing very large-scale infrastructure projects in which the State has limited experience (for example, the extensive tunnelling works in the T2D project)
- construction industry capacity constraints and skilled labour shortages in South Australia.

Proper project planning, management and control will be essential to achieving the budgeted outcomes for capital projects in the 2024-25 Budget, including ensuring project budgets contain realistic allowances for unexpected cost increases.

1.2.5 Rising interest expenses may constrain the State's fiscal capacity

Total NFPS interest expenses as a proportion of total revenue are expected to reach 7.4% in 2027-28, up from 5% in 2023-24.

Rising debt and interest costs, mainly due to the scale of the State's capital program, may limit the State's fiscal capacity to respond to economic challenges and its ability to deliver the same level of services in the future. Total general government sector expenditure as a proportion of the State's economy, excluding interest payments, is expected to trend downwards from a high of 19.3% in 2019-20 to 16.5% in 2027-28. This is occurring at the same time as critical service delivery areas are experiencing increasing demand and the State has below national average levels of spending on services.

Significant capital expenditure is also committed beyond the forward estimates, which could increase net debt and interest expenses further. This includes an estimated $8.3 billion for the T2D project and the new Women's and Children's Hospital after 2027-28.

1.2.6 SA Government is 'middle of the pack' compared to other states on budget sustainability indicators

South Australia generally compares favourably to Victoria, and to some extent New South Wales and Tasmania, on key budget sustainability indicators. It is in a similar or less favourable position compared to Queensland and Western Australia.

There have been no changes to the SA Government's credit rating and outlook in the most recent Standard and Poor's (S&P) and Moody's credit opinion reports (AA+ stable and Aa1 stable, respectively). South Australia is 'middle of the pack' compared to other states on credit ratings, with Western Australia having the highest credit rating (AAA and Aaa) and Victoria the lowest (AA and Aa2).

South Australia generally performs less well on sustainability indicators that measure net debt and interest expenses as a proportion of the State's economy (gross state product (GSP)). As an example, South Australia's NFPS interest expense as a percentage of GSP ratio is estimated to be the same as Victoria's in 2027-28 (1.39%). This is the equal highest of all Australian states and reflects South Australia and Victoria having more limited ability to service their debt than other states based on the size of their economies.

2 Net operating balance

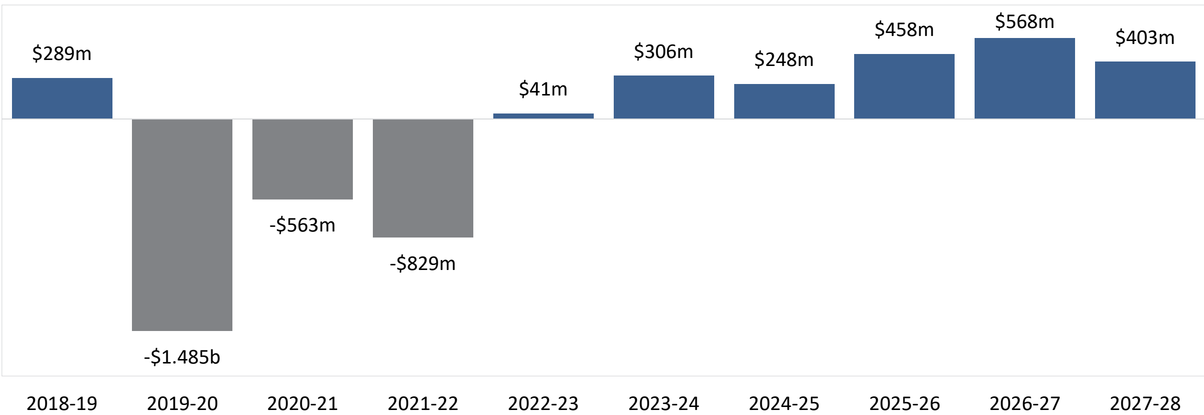
2.1 Net operating balance fiscal target

2.1.1 The fiscal target of achieving a net operating surplus every year is expected to be met in the 2024-25 Budget

The SA Government has a fiscal target of achieving a net operating surplus in the general government sector every year, so that operating expenditures can be funded from operating revenues.

Figure 2.1 shows the actual outcomes for the general government sector net operating balance from 2018-19 to 2022-23, the estimated result for 2023-24 and the expected outcomes for the four years of the 2024-25 Budget.

Figure 2.1: General government sector net operating balance from 2018-19 to 2027-28



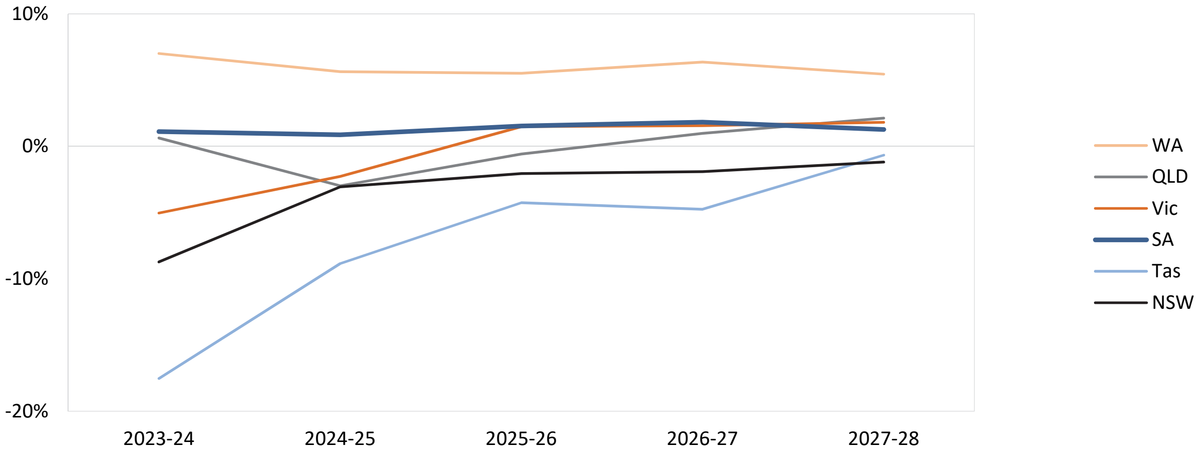
Following significant deficits during the COVID-19 pandemic period between 2019-20 and 2021-22, the Budget returned to surplus in 2022-23. Moderate surpluses are expected in 2023-24 and over the four years of the Budget.

2.1.2 South Australia's forecast net operating balances over the four years of the Budget generally compare favourably to other states

Figure 2.2 shows the expected trend in general government sector net operating balances as a percentage of total revenue[2] compared to other Australian states.

[2] Due to substantial differences in the revenue base of each state, net operating balance as a percentage of total revenue has been used as the basis for comparison.

Figure 2.2: Net operating balance as a share of total revenue for Australian states between 2023-24 and 2027-28



Source: 2023-24 South Australian and interstate budget papers.

There is significant variability in the estimated 2023-24 net operating results of the states:

- Western Australia's estimated 2023-24 operating surplus is significant
- South Australia and Queensland have estimated relatively small operating surpluses
- Tasmania, New South Wales and Victoria are expecting large operating deficits.

South Australia's forecast net operating balance as a proportion of total revenue is either more favourable, or similar, when compared to all other states except Western Australia between 2024-25 and 2027-28.

2.2 Policy and parameter variations

2.2.1 Expenditure on new policy measures exceeds upward revisions to estimated revenues

Policy measures are decisions made by the SA Government to increase or reduce spending or to raise or lower taxes.

Parameter changes are variations that do not flow from policy choice changes and are generally outside the SA Government's control, such as changes in GST receipts from the Commonwealth Government owing to national economic conditions and revisions to distribution methodologies.

Figure 2.3 shows how policy and parameter variations since the 2023-24 Budget cumulatively impact net operating balances from 2023-24 to 2026-27.

Figure 2.3: Total general government sector net operating balance policy and parameter variations since the 2023-24 Budget

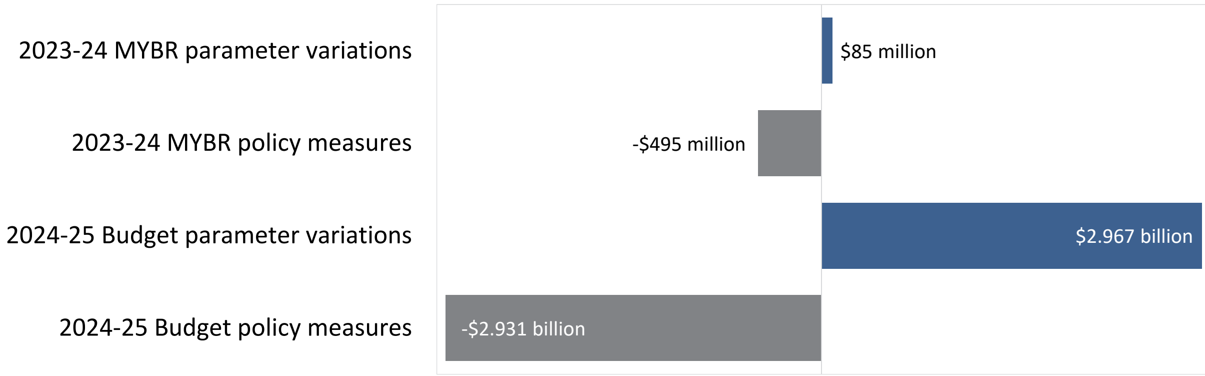


Figure 2.3 shows that total expenditure from new policy measures in the 2023-24 mid-year budget review (MYBR) and 2024-25 Budget ($3.426 billion) is $374 million higher than improvements in net operating balance forecasts due to parameter variations ($3.052 billion). This has led to a reduction in net operating balance surplus forecasts between the 2023-24 Budget and the 2024-25 Budget, for the years 2024-25 to 2026-27.

Expenditure on new policy measures in the 2024-25 Budget mainly relates to SA Health,[3] the National Skills Agreement, and the Early Childhood Education and Care Reform initiative. Section 3.1.1 provides further details on these new policy measures.

Parameter variations are mainly due to improved forecasts for State taxation revenue ($2.591 billion), GST revenue ($762 million) and Commonwealth Government specific purpose grants ($783 million), offset partly by downward revisions to Commonwealth national partnership grant revenue ($707 million) and increased interest expense estimates ($389 million). These variations mainly reflect:

- higher payroll tax collections due to current strong labour market conditions
- higher conveyance duty revenue owing to stronger than expected growth in residential property prices and transactions
- higher Commonwealth specific purpose funding for the Quality Schools program and increased hospital service delivery costs and activity levels
- revised construction profiles and anticipated timing of Commonwealth national partnership grant revenue for a range of transport infrastructure projects
- higher interest rates and borrowings.

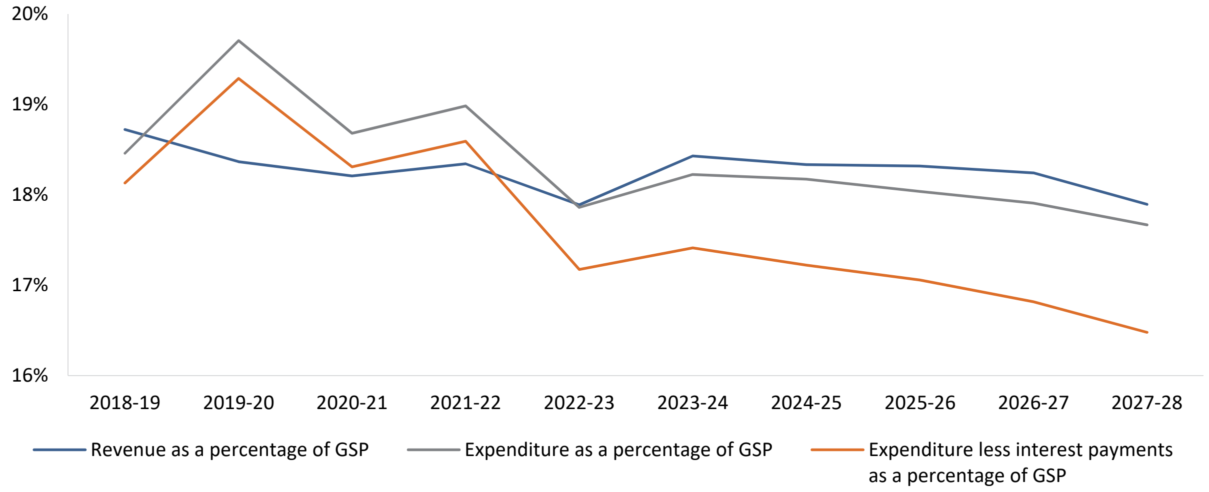
[3] SA Health comprises the Department for Health and Wellbeing, local health networks and the SA Ambulance Service Inc.

2.3 2024-25 Budget in context of the State's economy

2.3.1 SA Government's expenditure on service delivery as a proportion of the State's economy is trending downwards

Figure 2.4 shows revenue and expenditure for the general government sector as a percentage of GSP from 2018-19 to 2027-28. It also shows expenditure less interest payments as a percentage of GSP.

Figure 2.4: General government sector revenue and expenditure as a percentage of GSP



Source: Audit calculation based on 2024-25 Budget Paper 3 *Budget Statement* and information provided by the Department of Treasury and Finance (DTF).

Figure 2.4 shows that general government sector:

- expenditure as a percentage of GSP is forecast to drop by 2% from a high of 19.7% in 2019-20 to 17.7% by 2027-28
- expenditure as a percentage of GSP less interest payments is expected to decrease by 2.8% from 19.3% in 2019-20 to 16.5% in 2027-28
- revenue as a percentage of GSP is forecast to drop by 0.8% from a high of 18.7% in 2018-19 to 17.9% in 2027-28.

The Commonwealth Grants Commission analyses each state's ratio of actual to assessed expenses. Assessed expenses reflect the Commission's estimate of the expenses a state would incur if it were to follow average policies and operate at average efficiency.[4] A ratio below 100 suggests a state has below national average levels of spending, given its characteristics.

[4] Commonwealth Grants Commission, *Glossary*, viewed 1 October 2024, <https://www.cgc.gov.au/publications/glossary>.

The actual to assessed expenses ratio for South Australia was 94.4% in 2022-23, which is the second lowest of all Australian states and territories.[5] As this ratio is less than 100%, it indicates a shortfall in expenditure relative to what the Commonwealth Grants Commission assesses would be spent if South Australia was providing the same services with the same level of efficiency as the average of all states and territories, taking account of differences in assessed need for those services.

Risk insight

General government sector expenditure as a proportion of the State's economy is trending downwards. An increasing proportion of that expenditure is expected to be for interest expenses rather than service delivery over the four years of the 2024-25 Budget. This increasing interest burden may limit the State's fiscal capacity and its ability to deliver the same level of services in the future, at the same time as critical service delivery areas are experiencing increasing demand[6] and the State has below national average levels of spending on services.

2.4 National partnership grants for infrastructure

2.4.1 Assessments of sustainability of net operating surpluses should consider variability in capital grant revenue

National partnership grant revenue from the Commonwealth Government for infrastructure is expected to increase in each year of the 2024-25 Budget, rising by 149% between 2023-24 and 2027-28, from $710 million to $1.767 billion. This mainly reflects the T2D project, which accounts for 62% of this grant revenue between 2023-24 and 2027-28.[7]

The capital expenditure related to this grant 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 net operating balance is only impacted once assets are complete and in use through the annual charging of depreciation expense over their useful lives. This depreciation expense is spread over several years in later reporting periods.

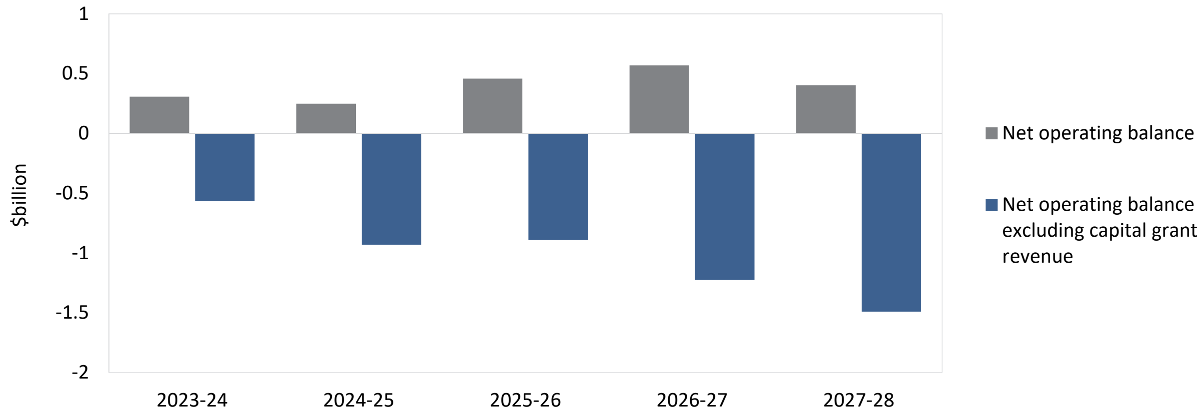
Figure 2.5 shows capital grant revenue is important driver of forecast operating surpluses over the four years of the 2024-25 Budget.

5 Commonwealth Grants Commission 2024, *U2024 Revenues and expenses*, S6-3 to S6-4 expenses, Summary tables, Total expenses, viewed 1 October 2024, <https://www.cgc.gov.au/reports-for-government/2024-update/tables-charts-and-supporting-data>.

6 Section 3.2 provides further details on Health demand trends.

7 DTF advised us that revenue from capital funded Commonwealth national partnership agreements is budgeted to be recognised progressively in proportion with the budgeted capital expenditure of the associated project, up until the revenue limit of the project is reached, at which point no more revenue can be recognised as there is no guarantee of additional Commonwealth funding. If there is no anticipated difference between the expenditure profile for the investing expenditure and the receipt of cash funding, the revenue is recognised on receipt of cash funding.

Figure 2.5: General government sector net operating balance excluding capital grant revenue for the period 2018-19 to 2027-28



Excluding this funding, which is for the specific purpose of purchasing assets rather than for operational purposes, forecast net operating balances in each year would be in deficit. The net operating balance deficit excluding capital grant revenue progressively increases in most years between 2023-24 and 2027-28, rising to $1.491 billion in 2027-28.

Where capital grant revenue is expected to be significant, it should be considered in making any assessments about the Budget's sustainability, particularly any relating to fiscal target 1 and ensuring operating expenditures can be fully funded from operating revenues.

3 Expenses

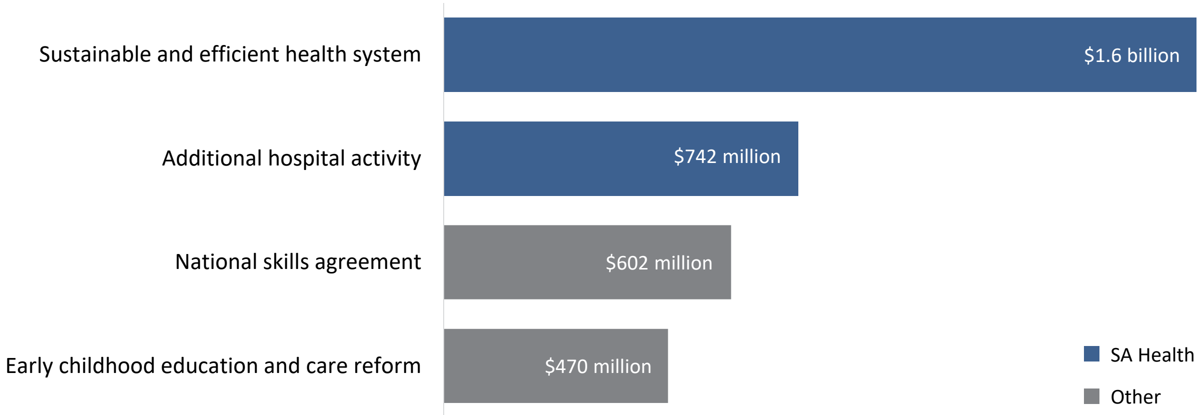
3.1 New operating expenditure initiatives

3.1.1 Over half of new operating expenditure policy initiatives in the 2024-25 Budget are for SA Health

New operating expenditure initiatives for the general government sector are considerably higher in the 2024-25 Budget ($4.231 billion) than in recent years ($3.622 billion in the 2023-24 Budget and $2.865 billion in the 2022-23 Budget).

The four largest new initiatives in the 2024-25 Budget represent 80% of total new operating expenditure initiatives.

Figure 3.1: Major new general government sector operating expenditure measures in the 2024-25 Budget for the period 2023-24 to 2027-28



The 2024-25 Budget includes $2.354 billion in new operating expenditure initiatives for SA Health, reflecting more than half of the total (56%). The sustainable and efficient health system and additional hospital activity initiatives account for almost all new initiatives in SA Health and mainly reflect:

- additional funding for increases in the NEP set by the Commonwealth Government's Independent Health and Aged Care Pricing Authority (IHACPA) for each type of hospital service
- higher than expected growth in public hospital weighted activity than was forecast at the time of the 2023-24 Budget.[8]

The National Skills Agreement is being delivered in partnership with the Commonwealth Government. Funding will support TAFE SA, not-for-profits and other non-government training providers and includes:

- $276 million for more than 160,000 training places over the life of the agreement across TAFE SA and non-government training providers, prioritising the State's future skills needs in areas including defence, health, building and construction, early childhood education, clean energy transition and ICT

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8 Section 3.2 provides further details on the sustainable and efficient health system and additional hospital activity initiatives.

- $63 million for quality training, including additional audits and investigations to ensure training providers and employers are meeting quality standards.

The Early Childhood Education and Care Reform initiative provides funding to implement the recommendations from the Royal Commission into Early Childhood Education and Care, including the rollout of universal pre-school for three-year-olds and funding to build the workforce and infrastructure needed to expand the sector for these reforms.

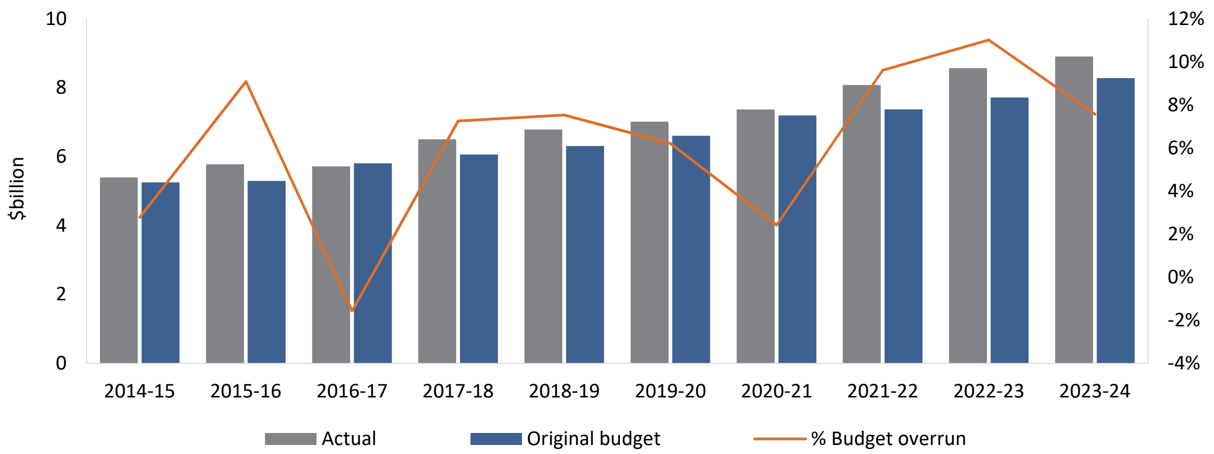
The 2024-25 Budget puts the total cost of this reform package at around $1.9 billion over the life of the reforms, which spans until 2032.

3.2 SA Health expenditure

3.2.1 SA Health's total actual expenditure is consistently higher than its original budget

Figure 3.2 shows that SA Health's actual total expenditure was above its original budget over the last 10 years, except in 2016-17. Since 2021-22, the overrun has trended above 7.5%.

Figure 3.2: Comparison of SA Health's original budget and actual total expenditure from 2014-15 to 2023-24[9]



Actual SA Health expenditure increased by $1.539 billion (21%) between 2020-21 and 2023-24.[10] The 2024-25 Budget estimates that it will only grow by $613 million (7%) between 2024-25 and 2027-28. SA Health expenditure as a proportion of total general government sector expenses is expected to decrease from 33% in 2023-24 to 31% in 2027-28.

[9] The amounts in figure 3.2 reflect total actual expenses for the Department for Health and Wellbeing in the Agency Statements (Budget Paper 4, Volume 3), excluding payments to the SA Government. The estimated result from the Agency Statements is shown for 2023-24, as the final actual budget outcome for that year was not available at the time of this report.

[10] Further details on SA Health's 2023-24 budget performance and activity are provided in the section of Part C of Auditor-General's Report 9 of 2024 *Annual report for the year ended 30 June 2024* titled 'SA Health overview'. This report notes that SA Health's actual total 2023-24 expenses in its annual financial statements were $955 million (11.5%) above its original budget.

3.2.2 Growth in activity has continued above historical trend in 2023-24

The 2024-25 Budget includes an additional hospital activity initiative ($742 million) that provides funding to meet activity demand pressures in the public health system. This reflects higher than expected growth in public hospital weighted activity than was forecast at the time of the 2023-24 Budget.

Demand for public health services, based on national weighted activity units,[11] is expected to have grown by more than 4.3% in 2023-24. This follows growth above 4% in 2022-23 and is well above the historical trend growth of 2% per annum assumed in 2023-24 Budget forecasts.

DTF advised us that:

- the drivers behind additional activity in 2023-24 are likely multi-faceted and involve an increase in separations (episodes of care) and acuity/complexity of patients
- most of the growth has been in outpatient activity, sub-acute maintenance care and acute inpatient activity
- the 2024-25 Budget recognised the estimated financial impact of this projected additional activity in 2023-24 and used the estimated total activity for the year as the opening baseline for future year activity projections
- from 2024-25, activity growth is budgeted to revert back to the historical trend of 2% per annum on the basis that there is insufficient evidence at this point that activity will continue to grow at the accelerated rate experienced in 2022-23 and 2023-24.

Risk insight

Forecasts of weighted activity need to be mindful of relevant new emerging trends, particularly where there is evidence that activity is growing at higher rates than experienced historically.

For example, the 2024-25 Budget notes that in the year to September 2023, South Australia's estimated resident population grew by 30,700 (1.7%) to 1.9 million people. This was substantially higher than the State's long run average rate of growth (about 0.8% per annum). Emerging trends in population growth could potentially impact public hospital weighted activity growth.

3.2.3 Additional funding provided to meet increases in national efficient price for delivering public health services

The IHACPA sets a price for each type of hospital service at a national level based on data collected from all states and territories, known as the NEP.[12] This price is a measure of the

[11] Demand for health services is based on a weighted activity measure that considers both volume and complexity of patient treatment, called the national weighted activity unit.

[12] The IHACPA determines the national efficient price for public hospital services by analysing data on actual activity and costs in public hospitals. Costing information used to determine the national efficient price is drawn from the National Hospital Cost Data Collection. This data is submitted to the IHACPA by states and territories.

national average efficiency for delivering public health services. The NEP is the price paid per unit of service (based on national weighted activity units) and is determined annually.

Under the current 2020-25 National Health Reform Agreement, the Commonwealth Government funds 45% of efficient growth of state public hospital activity-based services. Annual funding growth is capped at 6.5%, with the jurisdiction responsible for funding growth beyond the cap.

The 2024-25 Budget notes that:

- the sustainable and efficient health system initiative in the 2024-25 Budget ($1.577 billion) recognises the recent increase in the NEP,[13] and the higher cost of service delivery across local health networks
- the NEP has significantly increased as it responded to the considerable cost increases experienced in previous years in hospital service delivery across the nation.

3.2.4 Revised SA Health savings targets are similar in size to forecast net operating balance surpluses

Figure 3.3 shows SA Health's savings targets in the 2024-25 Budget, as advised to us by DTF.

Figure 3.3: Summary of SA Health's savings targets

	2023-24 $million	2024-25 $million	2025-26 $million	2026-27 $million	2027-28 $million
Savings targets in 2023-24 Budget	220	360	460	480	480
Re-profile of savings targets	-220	-255	-262	-164	-20
Revised savings targets in 2024-25 Budget	-	105	198	316	460

SA Health's savings targets total $1.079 billion over the four years of the 2024-25 Budget, which is 65% of total general government savings of $1.657 billion. This compares to SA Health savings totalling $1.52 billion over the four years of the 2023-24 Budget.

DTF advised us that:

- SA Health did not achieve its 2023-24 savings target of $220 million, primarily due to increased demand for public health services and the higher cost of service delivery experienced across all local health networks
- the revised savings targets for SA Health relate to achieving the NEP
- the significant uplift in the 2024-25 NEP has contributed to a reduction in SA Health's overall savings task.

[13] DTF advised us that there was a 7.2% increase in the NEP per national weighted activity unit between the 2024-25 and 2023-24 NEP determinations made by the IHACPA.

The NEP has increased significantly compared to forecasts at the time of the 2023-24 Budget. If it increases between budgets, the price at which SA Health is expected to deliver units of service also increases. This increase in the price per unit at which SA Health is expected to operate to achieve NEP in effect reduces its savings target. This adjustment is shown as re-profiling in figure 3.3.

There is a significant time lag in the data used by the IHACPA to calculate the NEP, as it dates back to 2020-21. This makes it challenging for DTF to accurately forecast NEP movements and savings targets for health funding purposes.

Risk insight

SA Health's savings targets progressively increase over the four years of the 2024-25 Budget. By 2027-28, the savings target ($460 million) will exceed the estimated net operating balance for the general government sector ($403 million). This highlights the importance of SA Health meeting its savings targets to ensure forecast net operating surpluses are achieved, particularly in the later years of the forward estimates.

If SA Health continues to not meet its savings targets, the SA Government may need to manage the Budget in other areas to deliver its forecast net operating surpluses. This could impact funding to other government programs and the efficiency demands made on other agencies.

3.2.5 The target time frame for achieving national efficient price has been repeatedly delayed over several budgets

The 2024-25 Budget notes the SA Government's intention for the health system to work towards achieving the NEP in 2027-28, the end of the current forward estimates period.

DTF advised us that South Australia's performance against the NEP has improved slightly in recent years, performing at 115% relative to the NEP in 2020-21, compared to 118% in 2018-19 and 2019-20. South Australia performed closer to the NEP than all other states in 2020-21, except New South Wales (106%) and Queensland (107%).

The planned time frame for achieving the NEP has been delayed by one year from that set out in the 2023-24 Budget. In our previous State finances reports, we have noted that the planned time frame for achieving the NEP has been repeatedly delayed over several consecutive Budgets.

Risk insight

Achieving savings targets and expenditure forecasts in the 2024-25 Budget will present a significant challenge for SA Health, given weighted activity growth and difficulties it has had in improving efficiency.

Robust monitoring and evaluation frameworks are needed to inform assessments of whether SA Health initiatives and programs are demonstrating improvements in the efficiency and effectiveness of the South Australian health system. This includes understanding the root causes for the system operating in excess of the NEP.

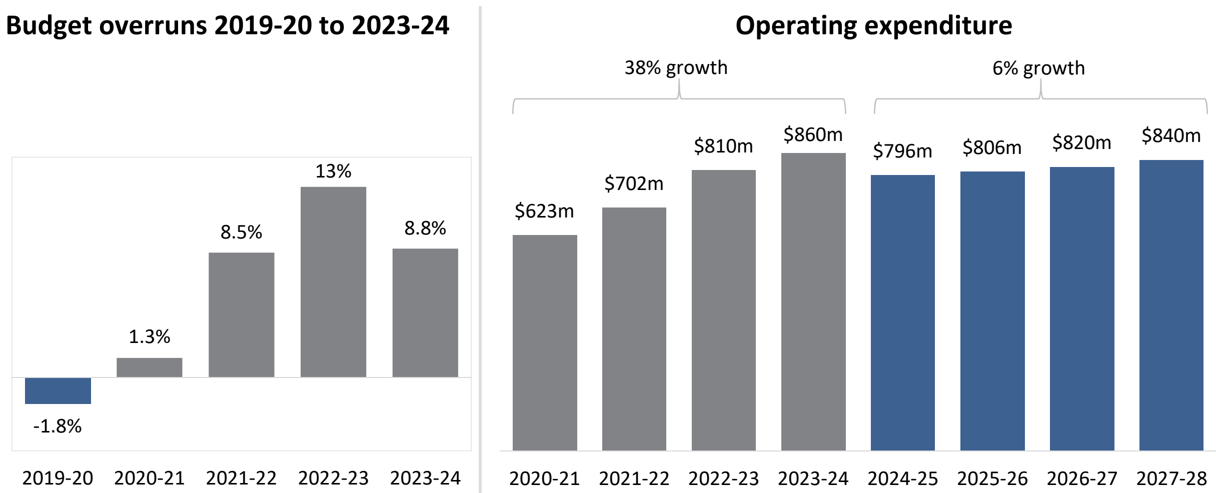
DTF advised us that it is working closely with SA Health on overseeing budget improvement plans. Plans to achieve budget improvement targets in 2024-25 have been created and DTF will continue to monitor the implementation of these plans through joint governance processes with SA Health, in addition to regular financial reporting processes.

3.3 Department for Child Protection expenditure

3.3.1 Department for Child Protection continues to face challenges meeting its budget

Figure 3.4 shows recent significant unfavourable variations between the Department for Child Protection's budget and actual total expenditure, trending at or above 8.5% since 2021-22.[14]

Figure 3.4: Overview of Child Protection's operating expenditure in the 2024-25 Budget



Department for Child Protection expenditure increased by $237 million (38%) between 2020-21 and 2023-24. This includes an extra $70 million in funding provided in the 2024-25 Budget for 2023-24, to support the number of children and young people in non-family-based care placements.[15] However, the 2024-25 Budget does not forecast that this trend will continue.

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14 The amounts presented in figure 3.4 reflect total actual expenses for the Department for Child Protection in the Agency Statements (Budget Paper 4, Volume 1), excluding payments to the SA Government. The estimated result from the Agency Statements is shown for 2023-24, as the final actual budget outcome was not available at the time of this report.

15 Further details on the Department for Child Protection's 2023-24 budget performance are provided in the section of Part C of Auditor-General's Report 9 of 2024 *Annual report for the year ended 30 June 2024* titled 'Department for Child Protection'. This report notes that the Department for Child Protection's actual total expenses in its 2023-24 annual financial statements were $116 million (15%) above the original budget.

It estimates that total Department for Child Protection expenditure will decrease from $860 million in 2023-24 to $796 million in 2024-25, and then grow by only $44 million (6%) from 2024-25 to 2027-28.

DTF advised us that the main assumptions adopted for the 2024-25 Budget include:

- maintaining relatively low levels of growth in the number of children and young people in care, reflecting the recent slowing of growth after a number of years of significant growth
- improvements (increases) in the percentage of the number of placements in family-based care as a proportion of the total number of placements in care, reflecting the Department for Child Protection's focus on growing family-based care[16]
- the continuation of specialist residential care services, such as Supported Independent Living Services, to help young people transition to independent living and the funding of specialist disability placements for high-needs children and young people.

Risk insight

If growth in the number of children and young people in care and the placement mix between family and non-family-based care are more in line with recent trends than these assumptions, there is a risk that considerably more funding to the Department for Child Protection than is reflected in the 2024-25 Budget will be needed.

3.3.2 Financial and service optimisation in the Department for Child Protection

The 2024-25 Budget states that the 'Department for Child Protection is currently undertaking financial and service optimisation to ensure that services are being delivered effectively and efficiently. This work will inform future investment in child protection and family support'.[17] DTF advised us that this financial and service optimisation includes:

- examining supports and programs that aim to increase the number of family-based care placements
- workforce strategies to position the Department for Child Protection as an employer of choice
- a review of non-government organisation residential care contracts to ensure that service provision is appropriate.

[16] The average cost per child is significantly higher for non-family-based care than for family-based care, which makes placement mix an important cost driver for child protection services. The section of Part C of Auditor-General's Report 9 of 2024 *Annual report for the year ended 30 June 2024* titled 'Department for Child Protection' provides further details on child protection services expenditure.

[17] 2024-25 Budget Paper 5 *Budget Measures Statement*, p. 12.

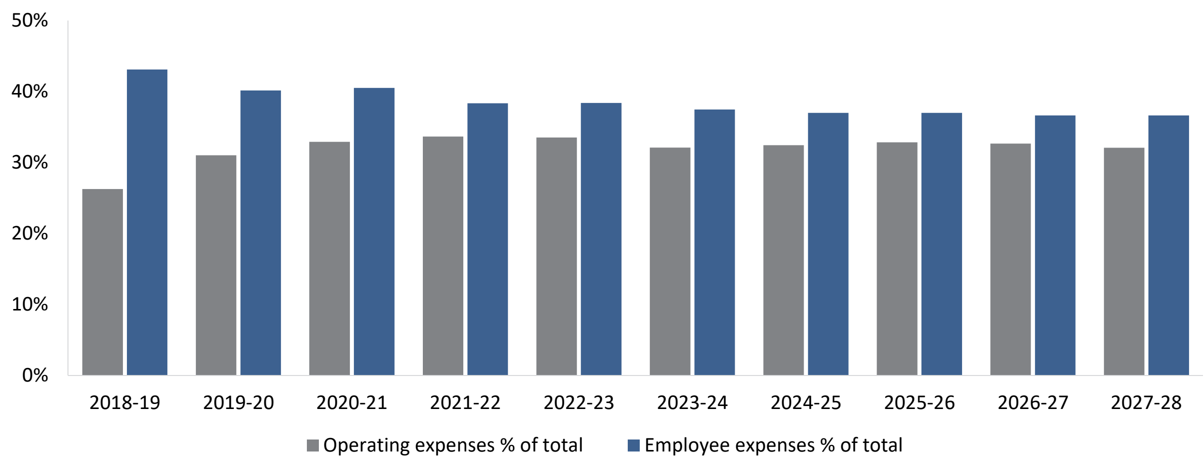
DTF also advised us that it is working with the Department for Child Protection to establish metrics to monitor the progress of these strategies.

3.4 Employee expenses

3.4.1 Employee expenses trending downwards as a proportion of total expenses in contrast to other Australian states

Employee expenses are the SA Government's largest expenditure item, representing 37% of estimated total general government sector expenses in 2024-25. However, as figure 3.5 shows, employee expenses as a proportion of total expenses are trending downwards.

Figure 3.5: Employee and operating expenses as a proportion of total expenses in the 2024-25 Budget from 2018-19 to 2027-28

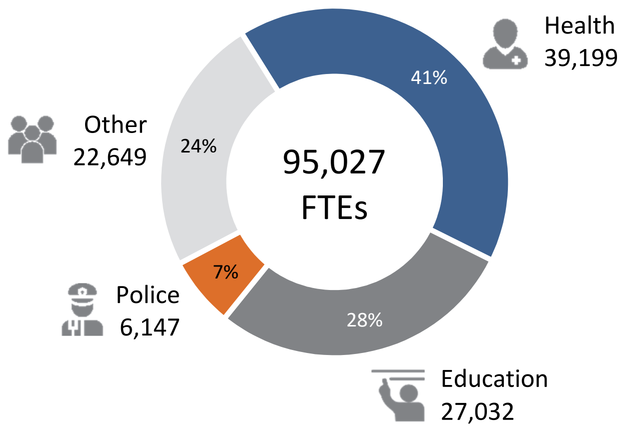


Actual employee expenses were 43% of total expenses in 2018-19, while operating expenses were 26%. The 2024-25 Budget forecasts that employee expenses will represent only 37% of total expenses in 2027-28, compared to 32% for operating expenses. This contrasts with the trend in all other Australian states, where employee expenses as a proportion of total expenses are higher and increasing over the four years of the 2024-25 Budget. As an example, in Western Australia employee expenses are estimated to increase from 40% in 2024-25 to 44% in 2027-28, while operating expenses remain steady at about 24%.

3.4.2 Meeting SA Health and Education FTE targets is important to achieving forecasts for employee expenses

The number of employees (FTEs) in general government sector agencies is a key driver of employee expenses. Figure 3.6 shows the estimated breakdown of general government sector employees by agency in 2024-25.

Figure 3.6: Estimated general government sector FTEs by agency in 2024-25



Source: 2024-25 Budget Paper 3 *Budget Statement*.

Nearly 70% of general government sector FTEs are employed by SA Health and the Department for Education. This highlights the importance of meeting SA Health and Education FTE targets in achieving the total budget for employee expenses.

3.4.3 Actual FTEs have been higher than estimated in recent budgets

General government sector employment levels are expected to gradually rise over the four years of the 2024-25 Budget, increasing by 3,514 from 95,027 in 2024-25 to 98,541 in 2027-28. This reflects an average increase in FTEs of 1.2% each year.

SA Health FTEs are estimated to rise by 2,528 (6%) in total over the four years of the Budget, while marginal or no increases are expected for Education (0.6%) and Police (no change).

Total estimated FTEs for 2023-24 in the 2024-25 Budget (93,505) are 2,939 FTEs (3.2%) higher than those originally estimated in the 2023-24 Budget. This follows higher actual than estimated FTEs in both 2022-23 (3.3%) and 2021-22 (4.1%).

Risk insight

FTE projections are fundamental to employee expense budget forecasts. If they are not realistic and accurate, the risk of employee expense budget overruns increases.

3.4.4 Increases in FTEs from new policy measures are mainly in SA Health

The FTE impacts of new policy measures in the 2024-25 Budget is shown in figure 3.7.

Figure 3.7: Estimated FTE impacts of 2024-25 Budget measures[18]

	2024-25 FTE impact	2025-26 FTE impact	2026-27 FTE impact	2027-28 FTE impact
Total FTE impact of new policy measures	**2,003**	**2,149**	**2,244**	**2,272**
SA Health	1,490	1,516	1,538	1,526
Education	96	157	221	270
Other agencies	417	476	485	476

Source: 2024-25 Budget Paper 3 *Budget Statement*, table 2.9 and audit calculation using data from 2024-25 Budget Paper 5 *Budget Measures Statement*.

The increase in FTEs from 2024-25 Budget policy measures is mostly due to new initiatives in SA Health, in particular:

- the sustainable and efficient health system initiative (785 additional FTEs in each of the four years of the Budget)
- the additional hospital activity initiative (655 additional FTEs in 2024-25 rising to 713 in 2027-28).

The Early Childhood Education and Care Reform initiative provides 93 additional FTEs for Education in 2024-25, increasing to 265 in 2027-28.

The increase in FTEs for other agencies from new initiatives is mainly attributable to the National Skills Agreement, with 233 additional FTEs in 2024-25 rising to 342 in 2027-28.

3.4.5 Wage negotiations in high inflation environment create challenges for achieving employee expense forecasts

The 2024-25 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. It also notes that wage negotiations will continue or start in 2024-25 for a range of employee groups.

Figure 3.8: Largest general government sector employee groups[19] subject to enterprise agreement negotiations in 2024-25

Negotiations continuing	Negotiations to start in 2024-25
South Australia Police	SA public sector salaried and weekly paid employees Nursing/Midwifery employees Salaried medical officers

[18] The FTE impact in figure 3.7 reflects the number of additional FTEs funded in each year by the new policy measures and is not cumulative across the four years of the Budget.

[19] Negotiations are also starting for other employee groups in the general government sector in 2024-25, specifically SA Ambulance Service Inc, South Australian Metropolitan Fire Service, SA Health Clinical Academics, SA Health Visiting Medical Specialists, SA Health Visiting Dental Specialists and SA public sector weekly paid employees.

Figure 3.9 highlights the significance of the wage negotiations.

Figure 3.9: Wage negotiations that are continuing or starting in 2024-25 for general government sector employees

$7.916 billion
total estimated wage base

78%
of estimated total employee expenses in the 2023-24 Budget

73%
of total general government sector employees

$304 million
estimated budget impact in 2027-28 if public sector-wide wage outcomes for new enterprise agreements vary by 1% p.a. from allowances in the forward estimates

Source: 2024-25 Budget Paper 3 *Budget Statement* and information provided by DTF.

DTF advised us that as a proportion of the total general government sector workforce, SA public sector salaried employees (35%), nursing/midwifery employees (18%) and SA public sector weekly paid employees (7%) are the most significant employee groups subject to wage negotiations in 2024-25. Salaried medical officers represent 3% of the total workforce, but over 10% of total estimated employee expenses.

The 2024-25 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.

Risk insight

The current high inflation environment and cost of living pressures will create challenges for the SA Government in negotiating wage agreements to meet its employee expense forecasts in the 2024-25 Budget. The Adelaide Consumer Price Index increased by 7.9% in 2022-23 and was estimated to rise by 4.8% in 2023-24.[20] This is likely to influence wage increases sought through enterprise bargaining negotiations.

3.5 Monitoring budget programs and initiatives

3.5.1 Robust ongoing performance monitoring required for existing programs as well as new budget initiatives

New operating expenditure initiatives represent only 3% of total expenses in each of the four years of the 2024-25 Budget, while existing programs and initiatives account for 97% of the total. The agency statements in the 2024-25 Budget (Budget Paper 4) present performance and activity indicators with targets for existing programs.

[20] Sourced from table 7.1 in 2024-25 Budget Paper 3 *Budget Statement*.

DTF advised us that:

- agency statements and their content (including performance and activity indicators) are prepared by agencies and then used by Ministers to inform Parliament about the agency's activities (programs) and how funding has been and will be spent
- the estimates hearings use the agency statements, and the information in them, as tools to hold agencies and Ministers accountable by Parliament for their budgets and service delivery
- changes to existing performance indicators are at an agency's discretion, in consultation with the Minister.

Some of our previous reports have highlighted significant scope to improve the performance monitoring and evaluation of SA Government programs to effectively inform decisions on future program investments, including using relevant and reliable data and sound performance measures to assess whether programs are achieving intended objectives.[21]

In monitoring budget performance, useful activities include:

- reviewing performance and activity indicators in agency statements regularly to ensure they remain relevant, align with policy objectives, cover intended outputs and outcomes, and are supported by appropriate and reliable data
- actively monitoring performance targets and activity indicators in agency statements to ensure they are being met and using this to inform the budget preparation process, including decisions on program investments and whether they should be continued, expanded or ceased[22]
- evaluating the efficiency and effectiveness of individual spending programs as part of ongoing management of the Budget.[23]

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21 Auditor-General's Report 8 of 2024 *Managing Homelessness Services*, Auditor-General's Report 3 of 2023 *Gambling Harm Minimisation* and Auditor-General's Report 6 of 2022 *Access to Mental Health Services*.

22 Organisation for Economic Cooperation and Development, *OECD Performance Budgeting Framework* 2024, viewed 1 October 2024, <https://one.oecd.org/document/GOV/SBO(2023)1/REV1/en/pdf>.

23 Eslake, S 2024, *Independent Review of Tasmania's State Finances*, p.7, viewed 1 October 2024, <https://www.sauleslake.info/independent-review-of-tasmanias-state-finances/>.

4 Revenue

4.1 Grant revenue

4.1.1 South Australia continues to be more reliant on Commonwealth grant revenue than any other state except Tasmania

South Australia is expected to rely on Commonwealth grant revenue for about 56% of its total revenue over the four years of the 2024-25 Budget. Over half of this Commonwealth revenue relates to GST revenue grants.

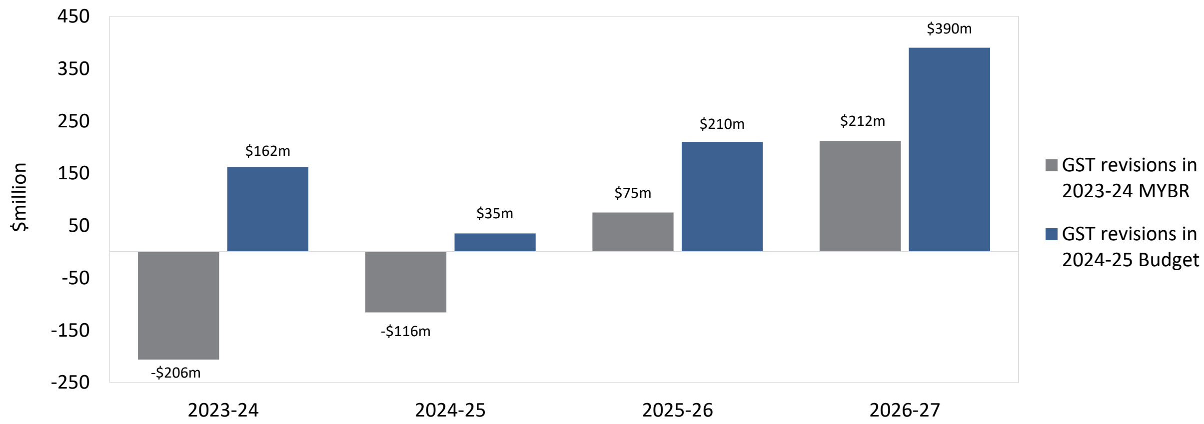
South Australia continues to be the second most reliant state on Commonwealth grant revenue. This mainly reflects its lesser ability to generate its own revenue (that is, weaker fiscal capacity[24]) compared to most other states, and therefore its greater need for Commonwealth revenue to provide public 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.

4.1.2 Volatility in GST receipts owing to changing economic conditions

GST revenue is the largest component of South Australia's revenue base and is expected to represent between 30% and 32% of total revenue between 2024-25 and 2027-28. It has been revised up by a net total of $762 million in the 2023-24 MYBR and 2024-25 Budget.

Figure 4.1: GST revenue revisions in the 2023-24 MYBR and 2024-25 Budget

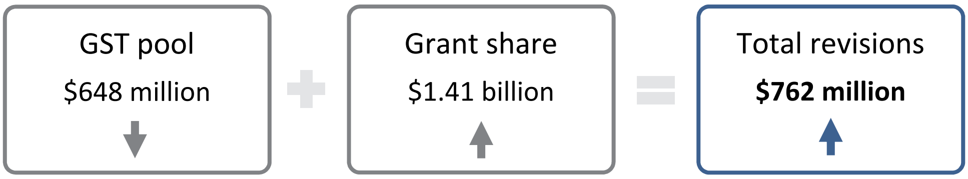


Total revisions made since the 2023-24 Budget	-$44 million	-$81 million	$285 million	$602 million

[24] 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.

This is due to changes in the size of the national GST pool and South Australia's share of the pool since the 2023-24 Budget, as shown in figure 4.2.

Figure 4.2: Factors contributing to GST revenue revisions in the 2023-24 MYBR and 2024-25 Budget



Source: Information provided by DTF.

The national GST pool has been revised down from estimates in the 2023-24 Budget. This reflects a relatively soft outlook for discretionary household consumption and that the pool is expected to grow more in line with longer term historical growth rates.[25]

Risk insight

The size of the national GST pool is impacted by the amount of GST collected across Australia and is directly influenced by national trends in consumer spending and housing construction.

The current economic environment, including the impact of higher interest rates and cost of living pressures, may limit growth in household consumption spending across the country and put forecast growth in the national GST pool at risk.

The RBA Board noted at its meeting in late September 2024 that household consumption in the June 2024 quarter was weaker than expected. Financial pressures from persistent inflation and restrictive monetary policy have meant that many households are having to make difficult adjustments to their spending and financial arrangements.[25]

South Australia's share of the national GST pool between 2024-25 and 2026-27 is higher than that estimated in the 2023-24 Budget. This is due to the Commonwealth Grants Commission's *2024 Update* increasing South Australia's GST relativity owing to the following main factors:

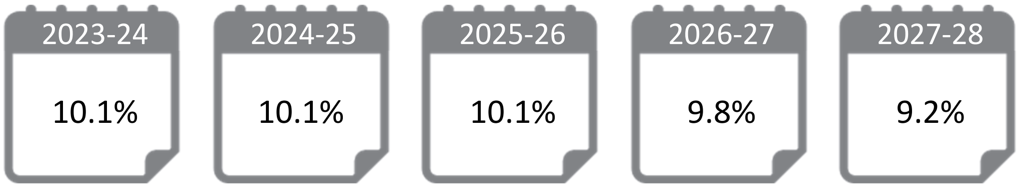
- strong growth in the value of coal mining production in Queensland and New South Wales reducing South Australia's relative mining royalty revenue capacity
- below average growth in taxable payrolls relative to the national average given strong employment across the nation
- revisions to national urban transport investment spending resulting in increased GST needs for South Australia.[26]

[25] Reserve Bank of Australia 2024, *Minutes of the Monetary Policy Meeting of the Reserve Bank Board – Hybrid 23 and 24 September 2024*, Reserve Bank of Australia, viewed 8 October 2024, <https://www.rba.gov.au/monetary-policy/rba-board-minutes/2024/2024-09-24.html>.

[26] 2024-25 Budget Paper 3 *Budget Statement*, pp. 42-43, provides further details on the calculation of South Australia's GST relativity and how it impacts the State's share of the national GST pool.

South Australia’s total share of the national GST pool is expected to trend downwards from 2026-27.

Figure 4.3: South Australia’s estimated GST grants share from 2023-24 to 2027-28



Source: Information provided by DTF. Includes estimated ‘no worse off’ guarantee payments from the Commonwealth Government.

The 2024-25 Budget notes that negative growth in GST revenue grants is expected in 2027-28, reflecting expected moderation in mining royalty revenue growth in other jurisdictions, which reduces South Australia’s expected GST requirements. Changes in South Australia’s share of Commonwealth Government payments and relative population growth are also expected to reduce South Australia’s estimated share of GST grants.

Risk insight

There are multiple factors impacting the size of the national GST pool and South Australia’s share of that pool. This creates challenges for DTF in making accurate forecasts and can lead to significant upward and downward revisions in annual budget and MYBR cycles.

4.1.3 The ‘no worse off’ guarantee under GST distribution transitional arrangements extended to 2029-30

New arrangements for distributing the national GST pool to the states started in 2021-22 and are being introduced over a six-year transitional period that ends in 2026-27. States are to be equalised based on the fiscal capacity of New South Wales or Victoria, depending on which has a higher fiscal capacity in each year. A legislated ‘no worse off’ guarantee ensures that, cumulatively, no state will receive a lower GST share than it would have received under the previous distribution arrangement. Without the ‘no worse off’ guarantee, South Australia’s GST revenue would be $390 million lower in 2024-25.[27]

National Cabinet agreed at its December 2023 meeting to extend the no worse off guarantee under the new distribution system transitional arrangements from 2026-27 until 2029-30.

The 2024-25 Budget notes the SA Government’s view that:

- *while the extension will provide funding certainty for the rest of the decade, a permanent extension is required for the long-term fiscal sustainability of states and territories*
- *it still strongly supports the previous system of full equalisation, under which all jurisdictions were equalised to the same fiscal capacity*

[27] Sourced from table 3.15 in 2024-25 Budget Paper 3 *Budget Statement*.

- *any proposal to distribute GST on a purely per capita basis would represent an even greater assault on the equity principles that underpin the aims of horizontal fiscal equalisation and the operation of the Australian federation.*

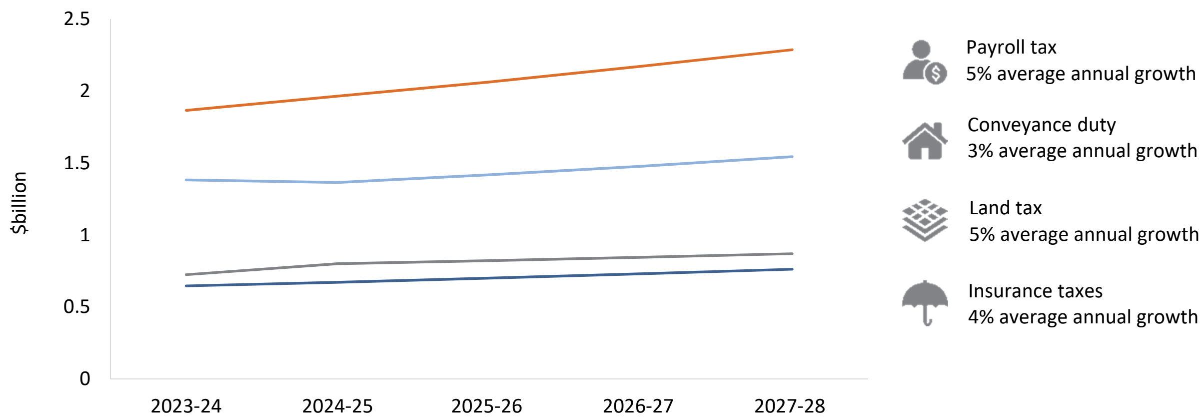
4.2 Taxation revenue

4.2.1 Forecast increases in taxation revenue mainly due to payroll tax and conveyance duty

Taxation revenue as a proportion of total revenue is expected to remain steady at 23% over the four years of the 2024-25 Budget. It is forecast to grow by an average of 3.8% between 2023-24 and 2027-28, increasing by $1.04 billion from an estimated $6.412 billion in 2023-24 to $7.452 billion in 2027-28.

Forecast increases in taxation revenue are mainly due to payroll tax ($422 million), conveyance duty ($161 million), land tax ($146 million) and insurance taxes ($116 million).

Figure 4.4: Key taxation revenue trends from 2023-24 to 2027-28



The forecast rate of growth shown in figure 4.4 is much lower than that experienced between 2019-20 and 2023-24, when average annual growth for total taxation revenue was 9.4%. This was mainly due to growth in payroll tax (50%), conveyance duty (69%) and gambling taxes (91%) during this period.

4.2.2 Payroll tax forecasts may not be achieved due to challenging economic environment

A key driver of growth in taxation revenue is payroll tax. Payroll tax is expected to grow consistently by about 5% each year in the four years to 2027-28, rising from an estimated $1.866 billion in 2023-24 to $2.288 billion in 2027-28.

Forecast payroll tax revenue estimates are based on estimated underlying growth in employment and earnings in South Australia. Employment is forecast to grow by 0.5% in

2024-25 and 0.75% in 2025-26, before rising to 1% in 2026-27 and 2027-28,[28] with assumed average wages growth of around 3.5% per annum.

The South Australian economy has recently lost momentum, with key economic indicators showing weaker trends. Weak household incomes and consumer spending, a drop in business investment and declining employment levels are the central causes of the slowdown.[29]

Annual real growth in State Final Demand, a measure of aggregate spending across the State's economy, slowed to 1.8% in the March 2024 quarter, which is below its long-term average. Trends over the summer were particularly weak, with State Final Demand contracting in the December 2023 quarter before expanding by just 0.2% in the March 2024 quarter. This latest result equates to an annualised growth rate of only 0.8%, roughly half the current rate of population growth, indicating a decline in per capita spending over recent quarters.[30]

Employment levels have also fallen in South Australia since October 2023 and total employment in May 2024 was down 0.7% from a year earlier.[31]

Risk insight

The current challenging economic environment poses a risk to expected growth in employment and earnings in South Australia and the achievement of payroll tax forecasts.

4.2.3 Growth in conveyance duty expected to return to longer term trends after small decline 2024-25

Conveyance duty is expected to decrease by $18 million (1%) between 2023-24 and 2024-25. It is then estimated to grow by an average of 4% per annum over the forward estimates, rising from $1.365 billion in 2024-25 to $1.544 billion in 2027-28.

The 2024-25 Budget notes that this reflects an expected slight decline in residential transactions in 2024-25 based on the assumption that some new home building activity was brought forward into previous years. Residential transaction volumes are then forecast to gradually return to long-term trend levels by the end of the forward estimates.

The 2024-25 Budget also indicates that based on conveyance duty collections, the average residential property price grew by around 18% in 2021-22 and 9% in 2022-23, and is projected to increase by a further 9% in 2023-24. Given the strong growth experienced in recent years, it is assumed that residential property price growth will return to its long-term average of 3% per annum from 2024-25.

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28 Sourced from table 7.1 in 2024-25 Budget Paper 3 *Budget Statement*.

29 South Australian Centre for Economic Studies 2024, *Significant slowdown in economy amidst weak spending,* The University of Adelaide, viewed 1 October 2024, <https://www.adelaide.edu.au/saces/news/list/2024/07/02/significant-slowdown-in-economy-amidst-weak-spending>.

30 South Australian Centre for Economic Studies, *Economic Briefing Report – June 2024*, Vol. 42 No.1, p. vi.

31 ibid.

Risk insight

Conveyance duty revenue is affected by variations in the local property market. Trends in property market values and activity levels can be difficult to predict, particularly transaction numbers which can change significantly from year to year. For example, the 2024-25 Budget notes that residential transactions in 2021-22 were 47% above 2019-20 transaction levels, but fell by around 19% in 2022-23. This contributes to significant volatility in conveyance duty collections.

4.2.4 No new revenue raising measures limits budget flexibility

The impact of new revenue measures in the 2024-25 Budget is negligible, reducing the net operating balance by a total of $18 million between 2024-25 and 2027-28.

Risk insight

No new policy measures for raising revenue in the 2024-25 Budget removes one potential avenue for achieving net operating surpluses if prevailing economic conditions do not drive forecast revenue increases or expenditure growth is greater than expected.

As interest costs are increasing significantly, no new policy measures for raising revenue also means less funding may be available for service delivery.

5 Capital program

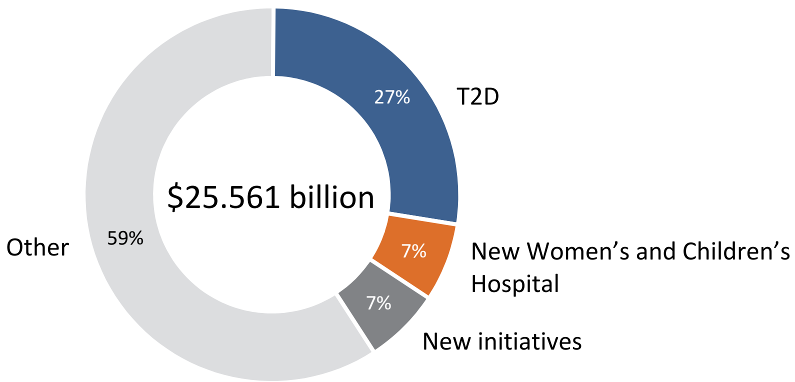
5.1 Non-financial public sector capital program

5.1.1 The scale of the NFPS capital program continues to increase in the 2024-25 Budget

The NFPS capital program[32] is $25.561 billion over the four years of the 2024-25 Budget, an increase of $4.521 billion compared to the four years of the 2023-24 Budget. This increase is largely due to:

- higher expenditure expected to be incurred in 2027-28 compared to 2023-24 for the T2D project and the new Women's and Children's Hospital
- the 2024-25 Budget including additional expenditure for South Australian Water Corporation (SA Water) infrastructure projects that was not in the 2023-24 Budget.

Figure 5.1: NFPS purchases of non-financial assets in the 2024-25 Budget from 2024-25 to 2027-28



The expanded capital program will see land and fixed assets increase by $18.063 billion between 30 June 2024 and 30 June 2028.

Figure 5.2 shows the purchases of non-financial assets for the NFPS over the 10 years to 2027-28 compared to the asset replacement ratio.[33]

[32] The capital program is referred to as investing expenditure in the Budget papers and comprises the State's current and planned infrastructure projects.

[33] 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 5.2: NFPS purchases of non-financial assets from 2018-19 to 2027-28

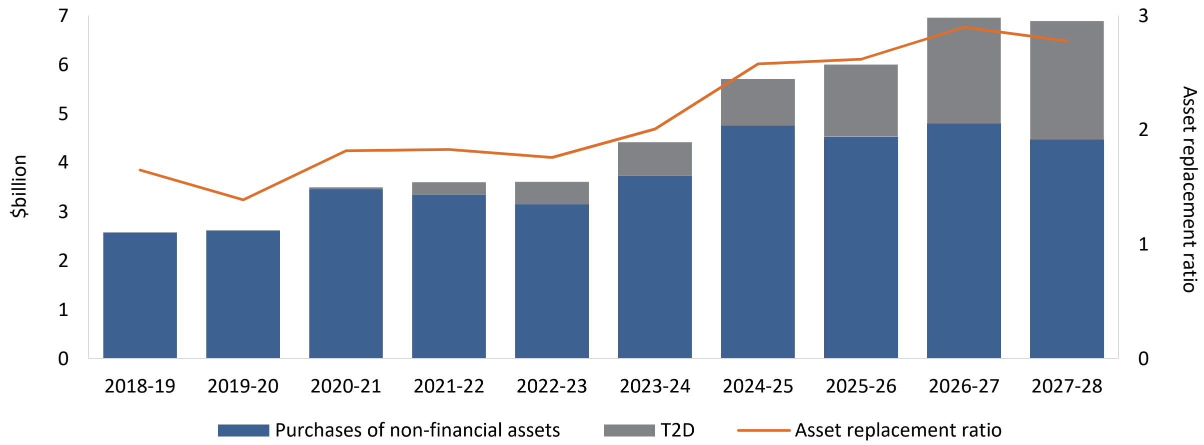


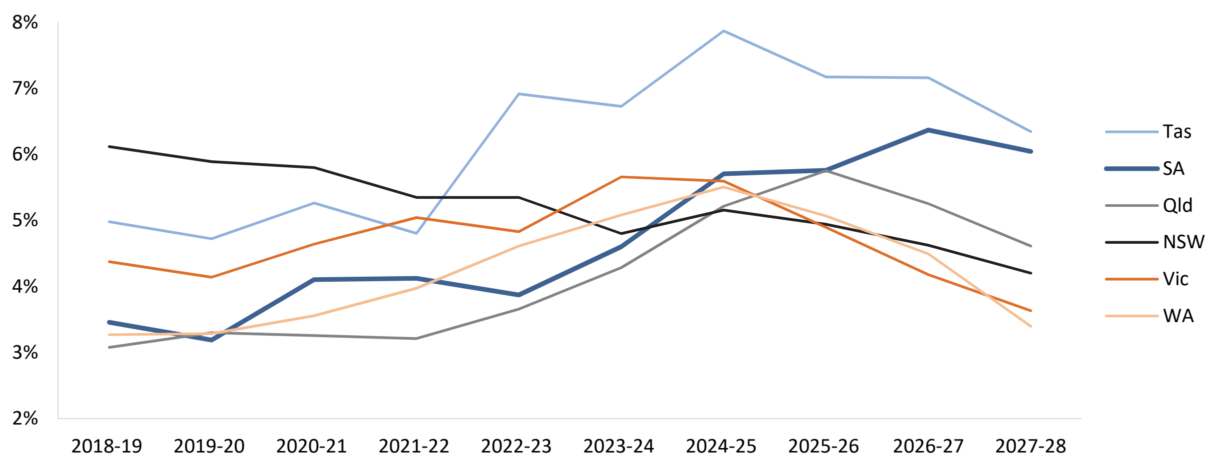
Figure 5.2 shows that purchases of non-financial assets for the NFPS over the four years of the 2024-25 Budget are substantially higher than prior years, mainly due to the T2D project which forms an increasingly significant component over the forward estimates period.

Figure 5.2 also highlights that since 2019-20 the asset replacement ratio has generally been trending higher, rising to 2 or above from 2023-24 onwards. 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.

5.1.2 South Australia's planned capital program as a percentage of its asset base is larger than all other states

Figure 5.3 shows that except for Victoria, each state's NFPS capital program as a percentage of its land and fixed assets base increases between 2023-24 and 2024-25.

Figure 5.3: NFPS purchases of non-financial assets as a percentage of land and fixed assets from 2018-19 to 2027-28



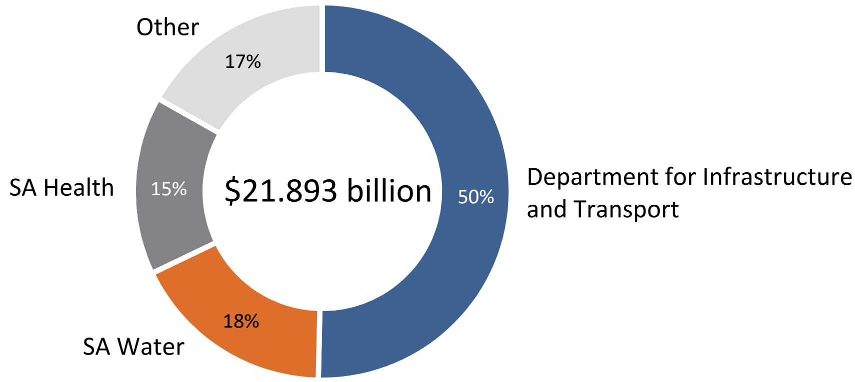
Source: South Australian and interstate budget papers and financial reports.

South Australia's annual NFPS capital program as a percentage of its land and fixed assets base over the four years of the 2024-25 Budget is larger than all other states except Tasmania, averaging 6%. It is also projected to increase over the forward estimates, in contrast to the declines projected in most other states.

5.1.3 Infrastructure and Transport, SA Water and SA Health have the largest capital programs

Figure 5.4 provides a breakdown of the capital program by agency over the four years of the 2024-25 Budget.

Figure 5.4: Breakdown of NFPS capital program by agency[34]



The NFPS capital program also includes $3.668 billion over the four years of the Budget that has not been allocated to agencies (14% of the total NFPS capital budget). This includes contingency provisions that are allocated to specific capital projects and general contingencies.[35] The portion allocated to general contingencies provides the SA Government with some flexibility over the nature and timing of its capital program. There is also a provision for capital slippage to reflect the tendency, on a whole-of-government basis, for underspending due to some projects slipping from their budgeted expenditure profile. On average over the past five years, actual capital expenditure has been 11% less than what was budgeted. S&P notes that market capacity constraints will make it difficult for the State to spend the full amount budgeted and any underspending would result in slower growth in debt.[36]

[34] The $21.893 billion total reflects the portion of the NFPS capital program that has been allocated to agencies. The total NFPS capital budget over the four years of the Budget is $25.561 billion.

[35] This amount also includes agency administered items, and consolidation adjustments to eliminate inter-agency transactions and recognise contributed assets.

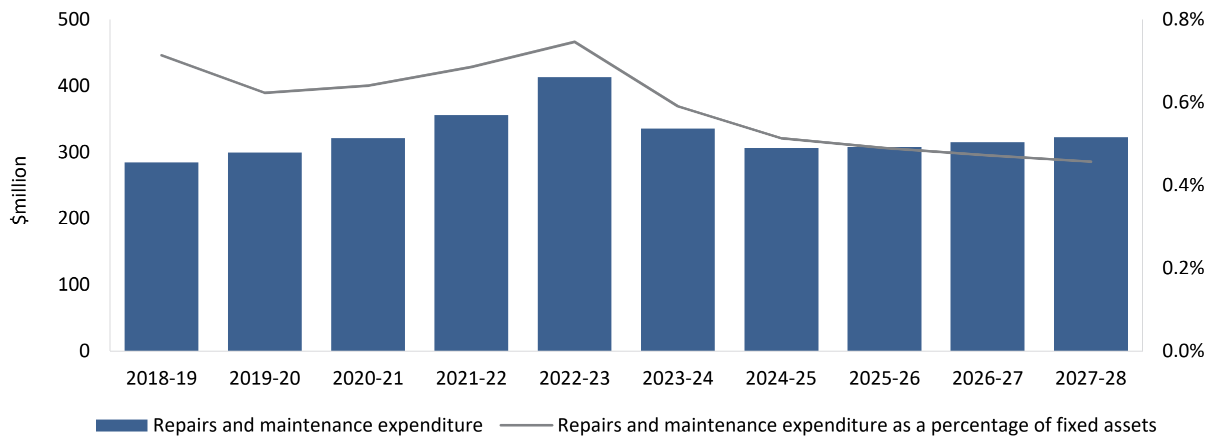
[36] S&P Global Ratings 2024, Bulletin: *South Australia Can Handle Higher Infrastructure Spending*, S&P Global, viewed 24 September 2024, <https://www.spglobal.com/ratings/en/research/articles/240606-bulletin-south-australia-can-handle-higher-infrastructure-spending-101599005>.

5.1.4 Repairs and maintenance expenditure is projected to decrease as a proportion of the asset base

Infrastructure Australia says that there is evidence of a growing imbalance between capital expenditure and asset maintenance and renewals across jurisdictions, with capital expenditure becoming more prominent. It notes this as a significant concern for the long-term ability of governments to manage their existing asset bases and the continued ability of infrastructure assets to serve community needs.[37]

Figure 5.5 shows that while general government sector repairs and maintenance expenditure increased from 2018-19 to 2022-23, the 2024-25 Budget forecasts a decline in 2023-24 and again in 2024-25. It is projected to only marginally increase across the remaining three years of the 2024-25 Budget, with the value of fixed assets expected to grow at a higher rate.

Figure 5.5: General government sector repairs and maintenance expenditure for 2018-19 to 2027-28 as a percentage of fixed assets



Source: Information provided by DTF.

The 2024-25 Budget notes that the capital program includes annual program expenditure that is generally provided to agencies to complete minor works or upgrade existing assets. NFPS annual program expenditure is projected to decrease by an average of 2.7% per annum from 2023-24 to 2027-28.

[37] Infrastructure Australia, *Annual Budget Statement* 2024, p. 15, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-budget-statement-2024>.

[38] Infrastructure SA 2023, *South Australia's 20-Year State Infrastructure Strategy: Discussion Paper*, p. 5, viewed 24 September 2024, <https://www.infrastructure.sa.gov.au/our-work/20-year-strategy>.

[39] Infrastructure Australia 2024, *Annual Budget Statement*, p. 15, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-budget-statement-2024>.

Risk insight

Infrastructure SA says that due to fiscal constraints from increasing net debt, it is more important than ever for the SA Government to maximise the value of its existing infrastructure and strategically prioritise new investments where necessary.[38]

The increase in capital expenditure for new infrastructure projects in recent Budgets is likely to have a longer-term impact on the expenditure required to maintain and optimise the SA Government's growing asset base. Infrastructure Australia has recommended that governments ensure a more sustainable investment mix by focusing on better use, maintenance and renewal of existing infrastructure alongside potential new investments.[39]

5.2 New capital expenditure initiatives

5.2.1 New capital expenditure initiatives in the 2024-25 Budget are generally consistent with recent budgets

New capital expenditure initiatives in the 2024-25 Budget total $1.682 billion[40] and mainly relate to the Department for Infrastructure and Transport and the Department for Education.

Figure 5.6: New NFPS capital expenditure initiatives in the 2024-25 Budget from 2023-24 to 2027-28

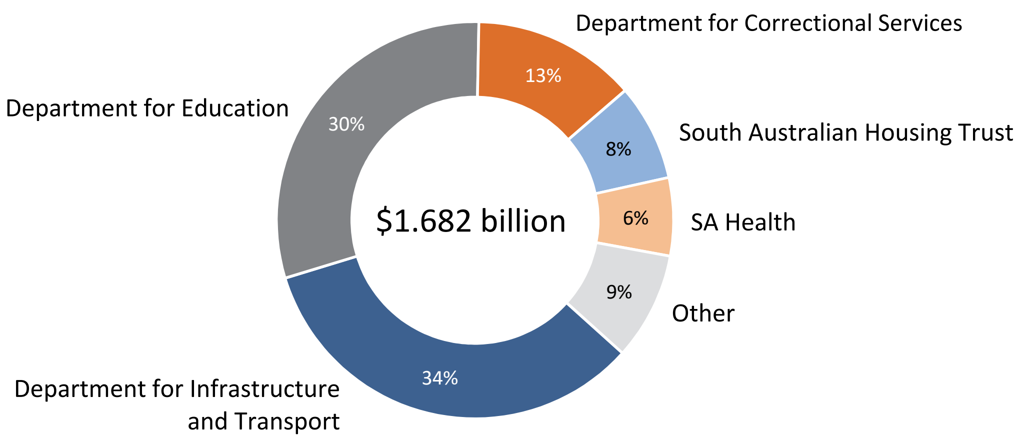
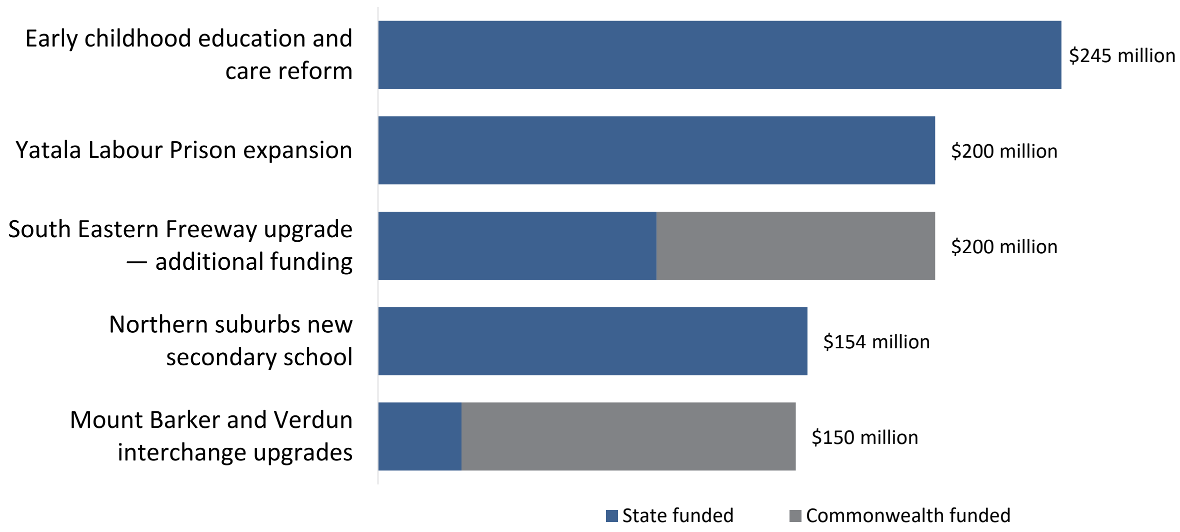


Figure 5.7 shows the largest new capital expenditure initiatives in the 2024-25 Budget.

[40] New capital expenditure initiatives of $1.682 billion excludes expenditure for new initiatives allocated to the Urban Renewal Authority to redevelop land at Seaton ($121 million) and Noarlunga Downs ($99 million), as this expenditure is classified as inventories and is not included in capital investment.

Figure 5.7: Major new capital expenditure initiatives in the 2024-25 Budget from 2023-24 to 2027-28



While new NFPS capital expenditure initiatives of $1.682 billion in the 2024-25 Budget are significantly higher than in the 2023-24 Budget ($867 million), they are generally consistent with the average of new capital expenditure initiatives over other recent Budgets.

Infrastructure SA says that it is important for new initiatives and investments to be strongly justified based on critical need and robust, evidence-based assessment that clearly demonstrates the case for change within a tightly constrained environment.[41]

5.3 Major capital projects

5.3.1 T2D project and new Women's and Children's Hospital make up a third of total capital expenditure over the four years of the Budget

Figure 5.8 details the capital projects with the most investing expenditure over the four years of the 2024-25 Budget.

[41] Infrastructure SA, *Capital Intentions Statement* 2023, p. 4, viewed 24 September 2024, <https://www.infrastructure.sa.gov.au/our-work/capital-intentions>.

Figure 5.8: Major capital projects over the four years of the 2024-25 Budget[42]

$7.006 billion
North-South Corridor T2D project

$1.72 billion
New Women's and Children's Hospital

$467 million
Hydrogen Jobs Plan

$408 million
Flinders Medical Centre upgrade and expansion

$350 million
Marion Rd – Anzac Highway to Cross Rd

$346 million
South Australian Forensic Centre

$314 million
New Mount Barker Hospital

$306 million
Fleurieu Connections

The SA Government has also completed a business case for the Northern Water project, which proposes to build:

- a desalination plant in the Spencer Gulf region in two stages
- a pipeline network of about 600km to connect the desalination plant and transfer water to northern South Australia.

The business case for the Northern Water project notes that preliminary capital costs are likely to be more than $5 billion and completion of stage 1 is targeted for 2028.[43] Capital expenditure estimates for this project are not included in the four years of the 2024-25 Budget. A final decision on whether the project will proceed is expected to be made in the first half of 2026.[44]

The T2D project and new Women's and Children's Hospital account for 34% of the total NFPS capital program in the 2024-25 Budget.

Both projects also have significant capital expenditure allocated beyond the forward estimates. DTF advised us that the estimated expenditure for the T2D project beyond the forward estimates is $6.932 billion and for the new Women's and Children's Hospital there is currently $1.344 billion allocated beyond the forward estimates.

42 Includes amounts held in contingencies for these projects.

43 Infrastructure SA, *Northern Water Business Case Summary* 2024, p. 23, viewed 24 September 2024, <https://www.northernwater.sa.gov.au/reports>.

44 South Australian Government 2024, *Northern Water Business Case Summary Released*, *yourSAy*, viewed 24 September 2024, <https://yoursay.sa.gov.au/northern-water/news_feed/northern-water-business-case-summary-released>.

For the T2D project, DTF advised us that:

- the project remains on budget and there has been no change to the total project cost of $15.4 billion and estimated completion date of December 2031 since the 2023-24 Budget
- the SA Government announced the preferred alliance partner selected to deliver the main construction works in August 2024
- the timing of expenditure for the main construction works will be updated and reflected in the 2024-25 MYBR.

In November 2023 the Commonwealth Government committed to a 50% ($7.7 billion) contribution to the T2D project.[45]

5.4 Key capital program risks

5.4.1 There continues to be a large pipeline of infrastructure projects across Australia and constraints on construction capacity

There is a large pipeline of infrastructure projects across Australia, which Infrastructure SA expects to remain strong in the medium to long term. It says that this is placing significant pressure on the construction industry's ability to respond and deliver, and that opportunities to address skill shortages will need to be created. Workforce capacity constraints are also impacting infrastructure delivery by creating cost pressures and delays.[46]

Infrastructure Australia notes that:

- labour scarcity continues to be the single biggest issue facing the construction industry, driven by heightened activity in public and private investments
- Australia will continue to see prolonged pressure on construction capacity because of sustained demand across different sectors
- labour capacity is expected to increase steadily from 2024, but this increase in supply is not projected to close the construction sector's labour gap.[47]

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45 Department of Infrastructure, Transport, Regional Development, Communication and the Arts 2023, *Independent Strategic Review of the IIP – Project changes summary*, p. 10, viewed 1 October 2024, <https://www.infrastructure.gov.au/department/media/publications/independent-strategic-review-iip-project-changes-summary>.

46 Infrastructure SA 2023, *South Australia's 20-Year State Infrastructure Strategy: Discussion Paper*, p. 47, viewed 24 September 2024, <https://www.infrastructure.sa.gov.au/our-work/20-year-strategy>.

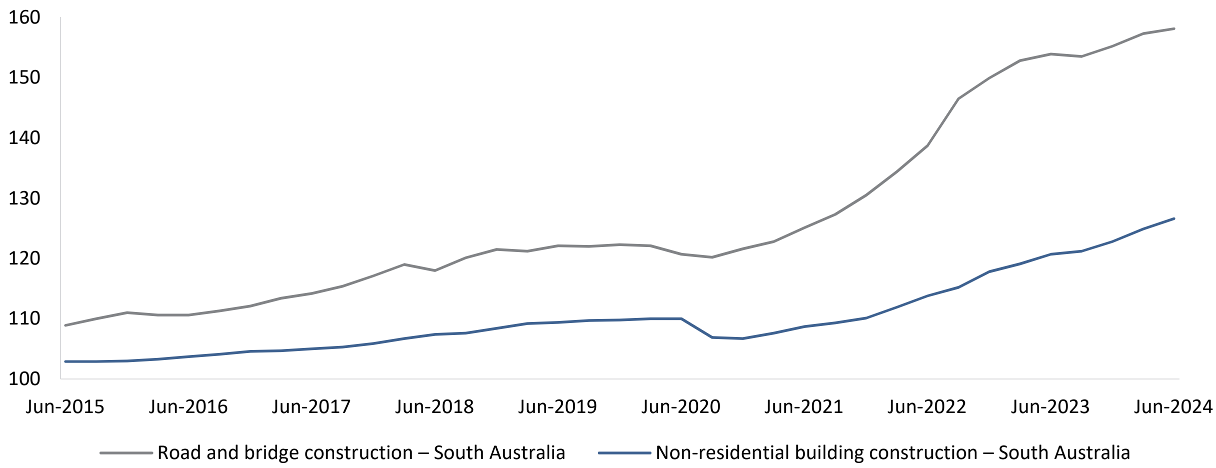
47 Infrastructure Australia 2024, *Annual Budget Statement*, pp. 8-9, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-budget-statement-2024>.

Infrastructure Australia's analysis of infrastructure workforce capacity and the demand for workers from projects across Australia indicates that South Australia's labour shortages are projected to progressively increase from October 2024 and peak in March 2027. This contrasts with national labour shortages, which are projected to decline in this period.[48]

5.4.2 Capacity constraints and inflationary pressures may drive significant cost escalations for South Australia's capital program

Supply chain disruptions, skilled labour shortages and increased activity driving demand for trades and materials have seen a substantial increase in construction costs over the last three years. Figure 5.9 highlights the increase in non-residential building and road and bridge construction costs currently being experienced in South Australia.

Figure 5.9: Construction price indexes – South Australia – June 2015 to June 2024



Source: Australian Bureau of Statistics 2024, *Producer Price Indexes*, June, cat. no. 6427.0, table 17. Output of the construction industries, subdivision and class index numbers, Index No 3020: Non-residential building construction South Australia, Series ID: A2333742K, Index No 3101: Road and bridge construction South Australia, Series ID: A2333748X, accessed 24 September 2024.

Figure 5.9 shows that in the 12 months to June 2024, non-residential building construction costs increased by 4.9% and road and bridge construction costs increased by 2.7%. The growth in road and bridge construction costs has slowed compared to the sharp increases in the previous two years, while growth in non-residential building costs has moderated but remains at elevated levels.

48 Infrastructure Australia 2023, *Public Infrastructure Workforce Supply Dashboard,* Infrastructure Australia, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/public-infrastructure-workforce-supply-dashboard>.

49 Infrastructure Australia 2024, *Annual Budget Statement*, p. 8, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-performance-statement-2024>.

50 Infrastructure SA 2023, *Capital Intentions Statement*, p. 4, viewed 24 September 2024, <https://www.infrastructure.sa.gov.au/our-work/capital-intentions>.

Risk insight

Infrastructure Australia notes that factors such as rising costs of labour and materials, labour and skill shortages and disruptions or under-supply of materials have been identified by multiple Australian states as a major cause of cost increases and delays to delivering infrastructure projects, and are an ongoing challenge.[49]

The 2024-25 Budget recognises that the current high demand for infrastructure-related labour and materials increases the risks of cost escalations for the capital program. It also notes that agency capital project estimates include prudent allowances for cost escalations.

Significant increases in construction costs above the allowances provided in agency capital project estimates pose the risk of project costs exceeding budget forecasts. Infrastructure SA notes that these factors require South Australia to manage infrastructure project delivery risks and rigorously apply best practice across all project lifecycle stages.[50]

5.4.3 The T2D project and new Women's and Children's Hospital have greater risk exposure due to their scale and complexity

Infrastructure Australia describes projects that cost over $1 billion as megaprojects. It has observed that projects across Australia are growing in scope, scale, complexity and cost, and that the number of megaprojects as a proportion of state infrastructure pipelines is also increasing.[51]

This trend is also seen in South Australia, with the T2D project ($15.4 billion) and the new Women's and Children's Hospital ($3.201 billion) being megaprojects that make up a significant proportion of the State's capital program in the 2024-25 Budget.

These major and complex infrastructure projects lead to increased risk for the SA Government's capital program. Infrastructure Australia has noted across jurisdictions that high-value projects are more at risk of failing to achieve cost and time estimates than lower value projects.[52]

Given the very large size of these projects, even small percentage budget overruns could have a significant impact on the State's overall financial position, including increased net lending deficits and net debt. As an example, a relatively small budget overrun (based on past experience with major transport infrastructure projects in South Australia) of 10% would amount to $1.54 billion for the T2D project.[53]

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51 Infrastructure Australia 2024, *Annual Performance Statement*, p. 13, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-budget-statement-2024>.

52 ibid.

53 Auditor-General's Report 11 of 2019 *Darlington Upgrade Project* provides an example of a South Australian major transport infrastructure project that exceeded its original project budget.

Risk insight

Infrastructure Australia notes that:

- megaprojects are inherently more complex and riskier
- there is clear evidence that megaprojects often experience cost increases and delivery delays and do so to a greater degree than lower value projects that experience overruns
- increasing project scopes also drives cost in an overheated market and increases project complexity and delivery risk.[54,55]

These risks are already evident in the T2D project and the new Women's and Children's Hospital, with significant cost and timing revisions made to both projects in the 2022-23 MYBR.[56]

The SA Government has limited experience in managing and delivering projects of the scale and complexity of the T2D project and new Women's and Children's Hospital. These projects are more likely to face increased risks due to their size, higher complexity, longer time frames and unique characteristics.

Infrastructure Australia notes that inadequate public sector procurement expertise, including oversight of projects during delivery, can result in taxpayers being exposed to inappropriate risks or costs and compromise the achievement of intended user outcomes.[57] Proper planning, management and control of these and other large capital projects, including engaging appropriate expertise, will be critical to achieving budgeted outcomes.

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54 Infrastructure Australia 2024, *Annual Performance Statement*, pp. 12-13, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-budget-statement-2024>.

55 Infrastructure Australia 2024, *Annual Performance Statement*, pp. 11-12, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/reports/annual-budget-statement-2024>.

56 Auditor-General's Report 10 of 2023 *State finances and related matters, pp. 46-47,* provides further details of cost and timing revisions made to the T2D project and the new Women's and Children's Hospital.

57 Infrastructure Australia 2019, *An Assessment of Australia's Future Infrastructure Needs: The Australian Infrastructure Audit 2019*, p. 236, viewed 24 September 2024, <https://www.infrastructureaustralia.gov.au/publications/australian-infrastructure-audit-2019>.

6 Net debt and interest expenses

6.1 Net debt

6.1.1 Net debt continues to rise and is forecast to reach $44.2 billion by 2028

NFPS net debt is projected to continue to trend upwards and increase by $16.319 billion over the four years of the 2024-25 Budget to $44.206 billion by 30 June 2028. This is largely due to increased borrowing to fund the SA Government's significant capital program, which includes the T2D project and new Women's and Children's Hospital.

6.1.2 SA Government aims to achieve sustainable net debt levels over the forward estimates

It is important that governments can access debt to fund key initiatives over the longer term that cannot be immediately funded through current revenue streams. However, if debt is not managed at a sustainable level it can pose a risk to future economic stability and prosperity.

The SA Government has set a fiscal target in the 2024-25 Budget to achieve a level of net debt that is sustainable over the forward estimates, but it has not set a quantifiable measure to assess its performance against this target. It has also not specified a time frame within which it aims to stabilise and reduce net debt, which some other states have done.[58]

The Commonwealth Parliamentary Budget Office notes that there is no single agreed measure of fiscal sustainability. Judgements about fiscal sustainability relate to the longer term and are dependent on past, current and future government activity. The Office views fiscal sustainability as the government's ability to maintain its long-term fiscal policy arrangements indefinitely, without the need for major remedial policy changes. This includes:

- borrowing and repaying debt while keeping taxation and spending within reasonable and expected bounds
- providing key goods and services without the need for rapid cuts to spending
- having sufficient capacity to meet investment priorities and to provide support when an economic downturn occurs.[59,60]

[58] Victoria has a target to stabilise and reduce its general government net debt to GSP ratio in the medium term. Queensland has a target of stabilising its general government sector net debt to revenue ratio in the medium term and reducing the ratio in the long term. Tasmania has established a strategic target for its net debt to GSP ratio to be less than 10% in 2032-33.

[59] Parliamentary Budget Office 2021, *Fiscal sustainability: Long-term budget scenarios*, p. 4, viewed 24 September 2024, <https://www.pbo.gov.au/publications-and-data/publications/fiscal-projections-and-sustainability/fiscal-sustainability>.

[60] Parliamentary Budget Office 2023, *Online Budget Glossary,* p. 34, viewed 24 September 2024, <https://www.pbo.gov.au/about-budgets/online-budget-glossary>.

Having a clear strategy for how and when projected rising levels of net debt are to be stabilised and then reduced can help governments to:

- ensure the ongoing delivery of essential services over the longer term
- prevent the need for sudden adjustments to the level of government spending
- reduce the risk of interest costs crowding out higher priorities
- ensure there is capacity to provide economic support during economic downturns and crises.

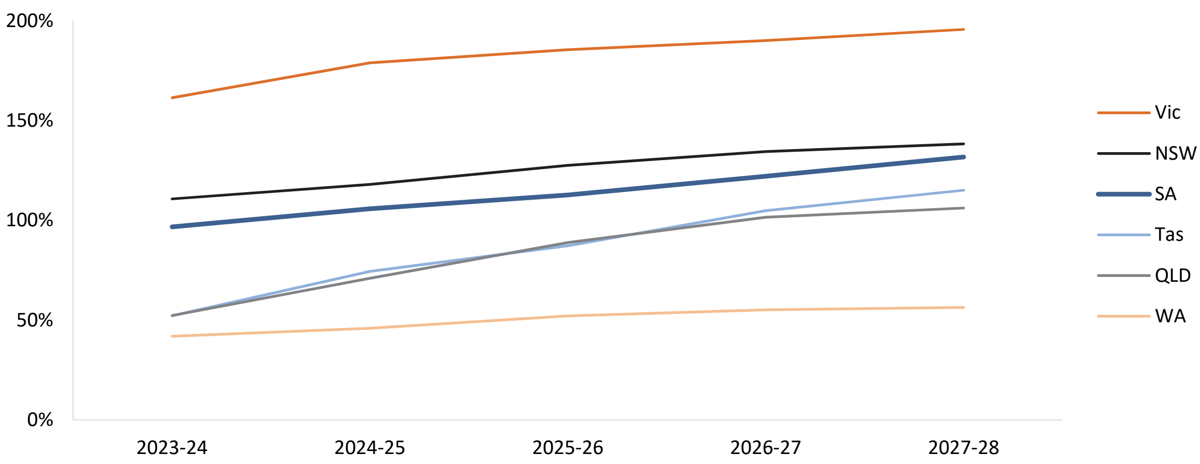
DTF advised us that:

- comparing net debt to revenue is the SA Government's key debt affordability metric and the SA Government has not publicly specified an upper limit for this measure where net debt is no longer considered sustainable
- the SA Government assesses the sustainability of its net debt levels annually through the Budget process considering the views of credit rating agencies, benchmarking against interstate peers and the level of interest cost burden
- it performed medium-term modelling of net debt to 2035-36 as part of the 2024-25 Budget preparation process.[61]

6.1.3 Net debt is projected to rise from 97% of revenue in 2023-24 to 132% of revenue in 2027-28

Comparing net debt to revenue provides one measure of the sustainability of a state's debt levels. Figure 6.1 shows that the NFPS net debt to revenue ratio for all Australian states is expected to trend upwards from 2023-24 to 2027-28.

Figure 6.1: Jurisdiction comparison of NFPS net debt to revenue ratio from 2023-24 to 2027-28



Source: South Australian and interstate budget papers.

[61] This modelling was based on broad assumptions of a policy-neutral setting, economic indicators returning to long-term average growth rates and the capital program returning to lower levels once commitments to the T2D and new Women's and Children's Hospital projects are completed.

South Australia's net debt to revenue ratio is expected to be higher than all other states except Victoria and New South Wales across the four years of the 2024-25 Budget, and to progressively increase. The increasing ratio is due to net debt growing faster than the increase in total revenue in each of the four years of the Budget.

The increase in the NFPS net debt to revenue ratio across Australian states mainly reflects increased borrowings by each state to implement significant capital investment programs. The net debt to revenue ratio can be influenced by the significant variability in Commonwealth Government grant revenue for capital projects, which is often one-off for specific capital projects and is not for operational purposes. Section 2.4.1 provides further details.

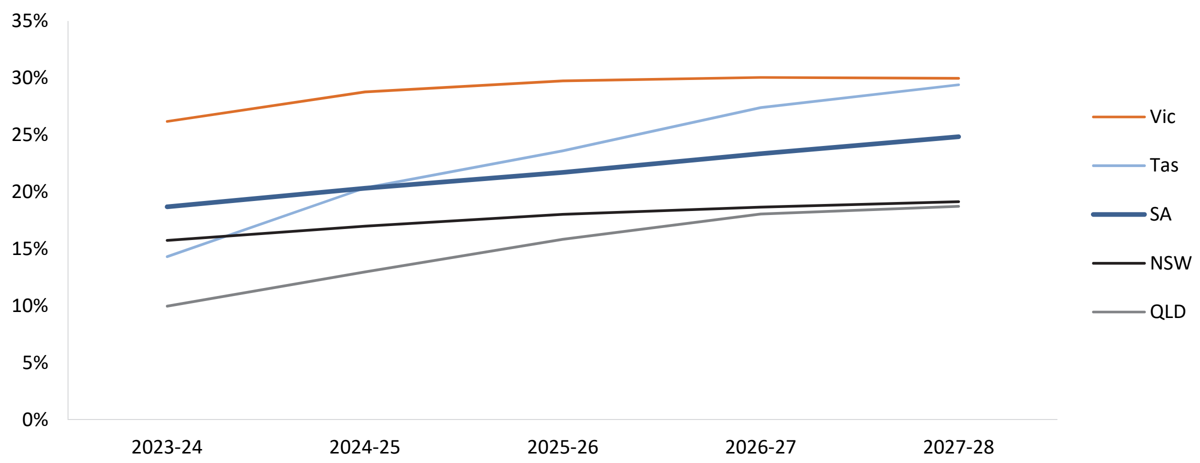
6.1.4 Net debt is projected to rise to 25% of gross state product by 2028

Net debt as a proportion of GSP is another common measure used by state governments to assess fiscal sustainability. It measures the size of the state's net debt in relation to the size of its economy and is an indicator of the government's ability to service its debt.

The Commonwealth Parliamentary Budget Office considers a sustainable fiscal position to be where net debt as a proportion of GSP is expected to be stable or trend downwards over the long term. It notes that this provides governments with the fiscal space to pursue their long-term policy objectives and flexibility to respond to changes in economic conditions, including large, unforeseen economic shocks.[62]

Figure 6.2 shows that the NFPS net debt to GSP ratios for South Australia and other Australian states[63] are expected to trend upwards from 2023-24 to 2027-28.

Figure 6.2: Jurisdiction comparison of NFPS net debt to GSP ratio from 2023-24 to 2027-28



Source: South Australian and interstate budget papers and our own analysis.

[62] Parliamentary Budget Office 2024, *Beyond the Budget 2024-25: Fiscal Outlook and Sustainability*, p. 10, viewed 24 September 2024, <https://www.pbo.gov.au/publications-and-data/publications/fiscal-projections-and-sustainability/beyond-budget-2024-25>.

[63] Western Australia is not included in figure 6.2 as data for its projected GSP is not publicly available.

South Australia generally compares less favourably to other states on the NFPS net debt to GSP ratio than it does on the NFPS net debt to revenue ratio. It has a higher ratio than New South Wales and is closer to Victoria.

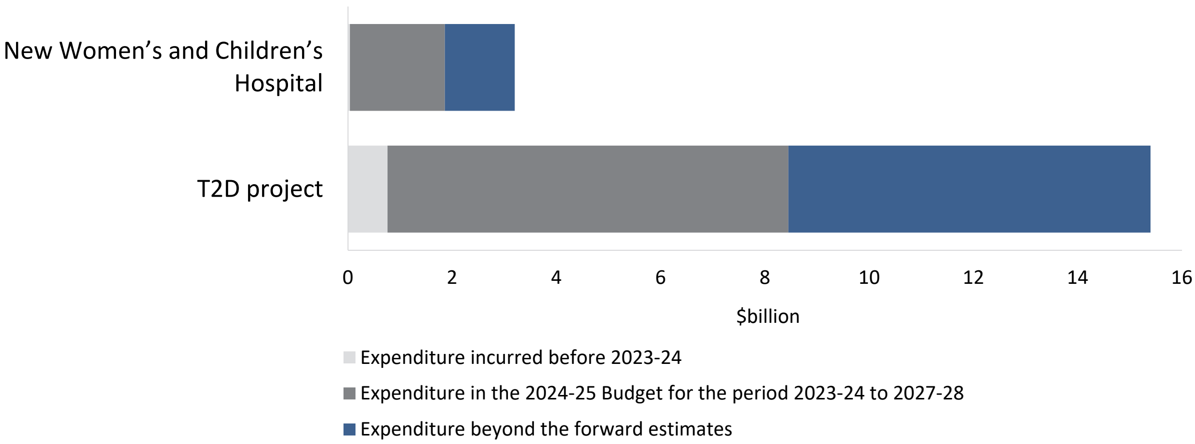
The higher the net debt to GSP ratio the more difficult it is for governments to repay their debt. An increasing ratio means South Australia's net debt is growing faster than its economy.

6.1.5 Net debt is expected to rise further beyond the forward estimates due to planned expenditure on major infrastructure projects

Major capital expenditure commitments exist beyond the forward estimates.

Figure 6.3 shows that 45% of expenditure for the T2D project ($6.932 billion) and 42% of expenditure for the new Women's and Children's Hospital ($1.344 billion) is expected to be incurred after the forward estimates.

Figure 6.3: Major capital expenditure commitments beyond the forward estimates



DTF advised us that its modelling shows that net debt is expected to continue to rise immediately after the forward estimates, primarily due to the T2D project. Net debt levels are then expected to moderate over time as the T2D project is completed and the SA Government's capital program reduces.

The SA Government has not entered into the alternative funding arrangements for major transport infrastructure projects that are commonly used in other states.

In preparing the next 20-Year State Infrastructure Strategy, Infrastructure SA has noted that it may be relevant for the SA Government to consider broader funding and financing models in future. This is to ensure that its capital programs remain affordable and sustainable given the pressure on future budgets and the need to meet fiscal targets, including sustainable levels of net debt.[64]

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[64] Infrastructure SA 2023, *South Australia's 20-Year State Infrastructure Strategy: Discussion Paper*, p. 49, viewed 24 September 2024, <https://www.infrastructure.sa.gov.au/our-work/20-year-strategy>.

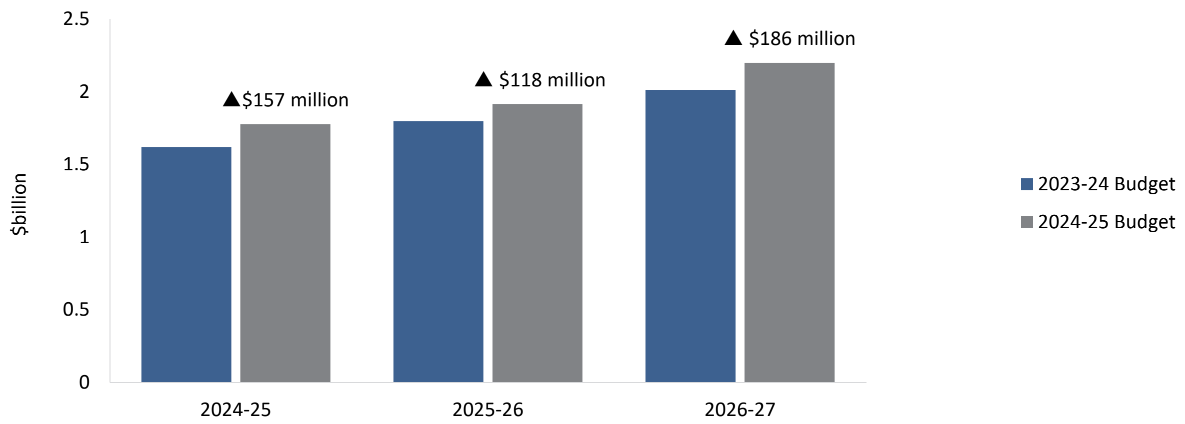
6.2 Interest expenses

6.2.1 Interest expenses projected to increase significantly due to rising net debt and interest rates

NFPS interest expenses are estimated to increase by $1.027 billion between 2023-24 and 2027-28, to $2.472 billion. Interest payments are the fastest growing operating expenditure category, increasing by an average of 14.5% per annum in this period. The 2024-25 Budget notes that the increase is the result of higher government borrowing to fund the significant capital program and increasing interest rates.

Figure 6.4 shows that interest expense projections in the 2024-25 Budget have increased by $461 million from those in the 2023-24 Budget.

Figure 6.4: NFPS interest expense in the 2023-24 and 2024-25 Budgets



DTF advised us that between preparing the 2023-24 Budget and the 2024-25 Budget, the South Australian Government Financing Authority's (SAFA's) borrowing rates increased, influenced by the Reserve Bank of Australia (RBA) increasing its cash rate from 3.6% in April 2023 to 4.35% in November 2023. The rate remains at the November 2023 level at the time of this report.

DTF also advised us that a further influence on the increase in interest expense projections is a larger portion of debt being refinanced from the ultra-low rates of the COVID-19 pandemic.

6.2.2 Interest expenses as a percentage of total revenue are higher than 2023-24 Budget estimates and will rise to 7.4% by 2027-28

Interest expenses as a percentage of total revenue (interest expense to total revenue ratio) is an indicator of a state's capacity to fund its borrowing costs from operating revenues. A lower percentage indicates the state's greater ability to repay debt.

South Australia's NFPS interest expense to total revenue ratio is forecast to increase significantly from 2.9% in 2018-19 to 7.4% by 2027-28. This mainly reflects the increase in NFPS borrowings and interest rates.

The NFPS interest expense to total revenue ratio is forecast to average 6.5% over the four years of the 2024-25 Budget, compared to 5.9% over the four years of the 2023-24 Budget.

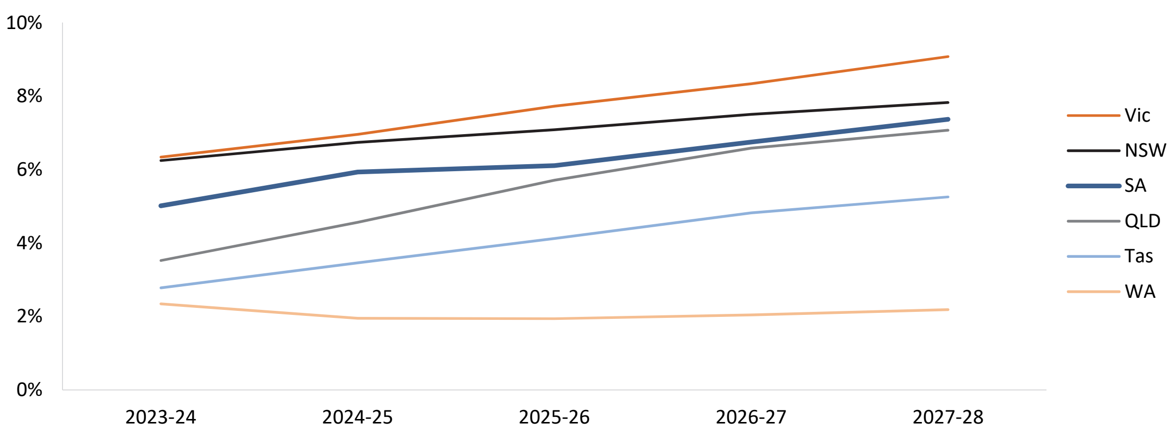
Risk insight

As the ratio of interest expenses to total revenue increases and interest expenses place more pressure on the SA Government's operating position, there is a risk that the SA Government will have less budget flexibility to fund service delivery needs and respond to future economic challenges.

6.2.3 South Australia's interest expense as a percentage of revenue is the third highest of all states

Figure 6.5 compares South Australia's NFPS interest expense to total revenue ratio to other Australian states from 2023-24 to 2027-28.

Figure 6.5: Jurisdiction comparison of NFPS interest expense to total revenue ratio from 2023-24 to 2027-28



Source: South Australian and interstate budget papers.

South Australia's interest expense to total revenue ratio is projected to remain higher than all states except Victoria and New South Wales over this period.

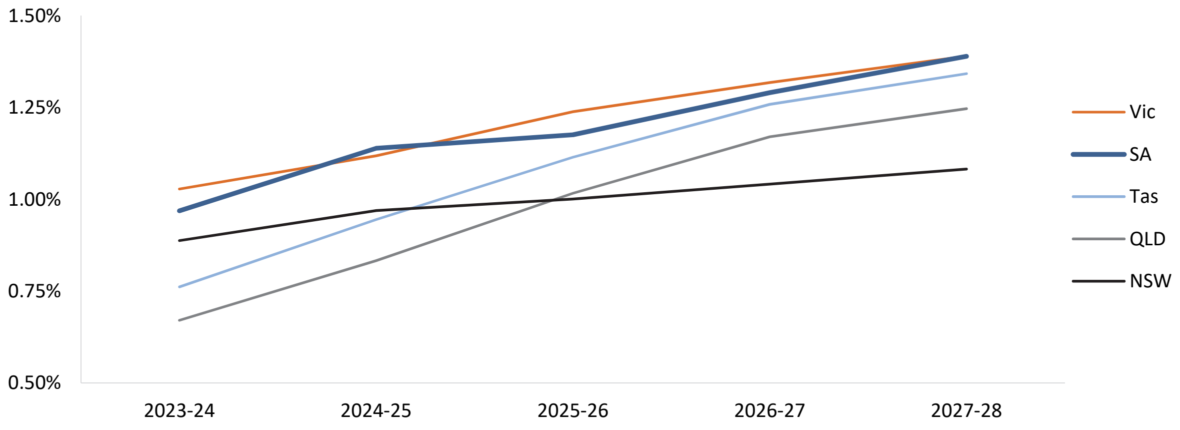
6.2.4 South Australia's interest expense as a percentage of GSP is similar to Victoria and higher than other states

Interest expenses as a percentage of GSP (interest expense to GSP ratio) is another indicator of a state's capacity to service its debt.

Figure 6.6 compares South Australia's NFPS interest expense to GSP ratio to other Australian states[65] from 2023-24 to 2027-28.

65 Western Australia is not included in figure 6.6 as data for its projected GSP is not publicly available.

Figure 6.6: Jurisdiction comparison of NFPS interest expense to GSP ratio from 2023-24 to 2027-28



Source: South Australian and interstate budget papers and our own analysis.

South Australia's interest expense to GSP ratio is forecast to increase from 0.97% in 2023-24 to 1.39% in 2027-28. This is very similar to Victoria and higher than Tasmania, Queensland and New South Wales. South Australia generally compares less favourably to these states on this ratio than it does on the interest expense to total revenue ratio, reflecting differences in the size of each state's economy and revenue base.

6.2.5 South Australia's risk exposure to interest rate rises is significantly increased by its higher level of net debt

The RBA has indicated that inflation is still too high and is proving persistent. In late September 2024 the RBA Board noted that the economic outlook remains highly uncertain and it remains vigilant to the risk that inflation may increase. It also discussed several scenarios in which interest rates might need to remain at current levels for a prolonged period or rise.[66,67]

Risk insight

The SA Government's projected rising level of net debt significantly increases its exposure to increases in interest rates. There is a risk that if inflation stays high the RBA may need to keep its cash rate target at the current level for longer or further increase it.

DTF advised us that a one percentage point increase in the average interest rate applying to NFPS net debt in the 2024-25 Budget would increase NFPS interest expenses by a total of $1.5 billion (18%) over the four years of the Budget. A two percentage point increase would lift them by $3 billion (36%).

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66 Reserve Bank of Australia 2024, *Statement by the Reserve Bank Board: Monetary Policy Decision - 2024-18,* viewed 24 September 2024, <https://www.rba.gov.au/media-releases/2024/mr-24-18.html>.

67 Reserve Bank of Australia 2024, *Minutes of the Monetary Policy Meeting of the Reserve Bank Board – Hybrid 23 and 24 September 2024*, viewed 8 October 2024, <https://www.rba.gov.au/monetary-policy/rba-board-minutes/2024/2024-09-24.html>.

6.2.6 Interest expense is likely to be impacted if existing debt needs to be refinanced at higher rates

The 2024-25 Budget notes that the SA Government's debt management objective is to minimise the long-term average interest expense to acceptable levels of refinancing and interest rate risk.

SAFA is the State's central borrowing authority and is responsible for managing most of the State's debt.[68] A significant amount of the debt borrowed by SAFA (83% at 30 June 2024) is long-term debt that is held under a fixed interest rate.

DTF advised us that SAFA manages its borrowings by targeting the spread of its long-term debt maturities over time. This includes targeting less than 10% of total debt being refinanced each year to reduce refinancing risk to a manageable level.

Risk insight

Long-term fixed rate debt of $19.501 billion was issued prior to 2022, before market rates started to significantly increase. This is 63% of the $31.205 billion total long-term fixed rate debt as at 30 June 2024. The State needs to refinance a significant proportion ($12.458 billion) of this debt by 30 June 2028. This includes $3.458 billion issued in 2020 and 2021 in a very low interest rate environment.

As fixed rate debt begins to mature it is likely that refinancing will be at a significantly higher interest rate, which will increase interest payments and the State's cost to service the debt.

Further details on SAFA and its debt and interest rate risk management approach are provided in the section of Part C of Auditor-General's Report 9 of 2024 *Annual report for the year ended 30 June 2024* titled 'South Australian Government Financing Authority'.

6.3 Credit ratings

6.3.1 S&P and Moody's have maintained South Australia's credit rating following the 2024-25 Budget

In September 2024, S&P and Moody's confirmed that they have maintained South Australia's credit rating with a stable outlook.

[68] SAFA 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.

Figure 6.7: S&P and Moody's credit ratings for Australian states (September 2024)

S&P credit ratings		
AAA	**AA+**	**AA**
Stable outlook:	**Stable outlook:**	**Stable outlook:**
Western Australia	New South Wales	Victoria
	Queensland	
	South Australia	
	Tasmania	

Moody's credit ratings		
Aaa	**Aa1**	**Aa2**
Stable outlook:	**Stable outlook:**	**Stable outlook:**
New South Wales	Queensland	Tasmania
Western Australia	**South Australia**	Victoria

Source: Reports and information published by S&P and Moody's and information provided by DTF.

Credit ratings can impact the SA Government's cost of borrowing and help it to access financial markets. A higher credit rating may lower the cost of borrowing, while a lower credit rating may increase borrowing costs and result in higher interest expenses.

Appendix 1 – Review mandate, objective and scope

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 their opinion, should be brought to the attention of Parliament and the SA Government.

Our objective

The objective of this report is to provide independent commentary and analysis on the 2024-25 Budget to highlight key trends and risks for the State's public finances.

What we reviewed and how

We reviewed the 2024-25 Budget Papers to identify key 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 states
- reviewing credit rating agency reports on South Australia.

Our analysis is based on data provided in the 2024-25 Budget Papers, supplemented by information provided to us by DTF.

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 historical or forecast figures presented in the 2024-25 Budget. We also have not performed work to provide an opinion on the effectiveness of the SA Government's budgetary control.

Appendix 2 – Budget presentation framework

By agreement between the Commonwealth, states and territories, each jurisdiction presents its Budget Papers and mid-year budget update on a Uniform Presentation Framework (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.

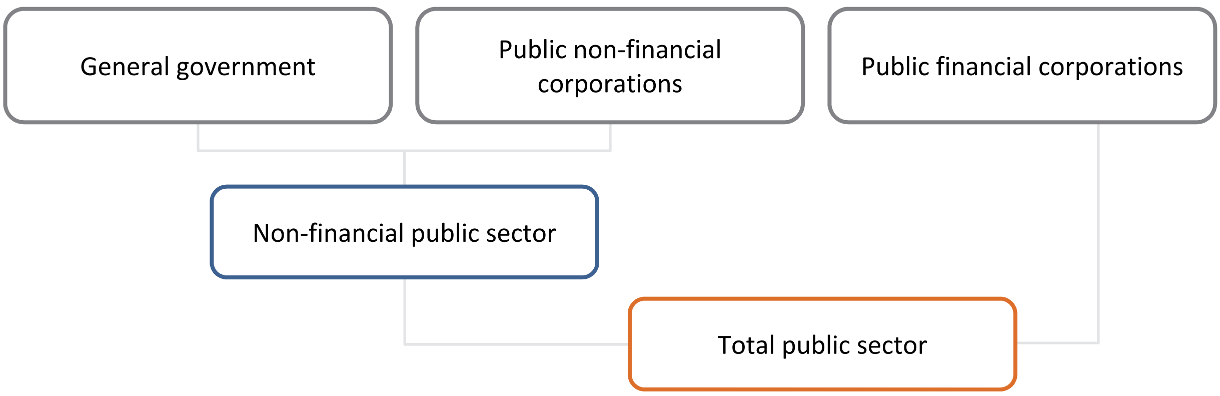
Institutional sectors

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.
- **Public non-financial corporations (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 South Australian Housing Trust.
- **Public financial corporations (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.
- **Non-financial public sector (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



PFC sector data is not published in the Budget Papers.

Appendix 3 – Abbreviations used in this report

Abbreviation	Description
DTF	Department of Treasury and Finance
FTE	Full-time equivalent
GSP	Gross State Product
GST	Goods and services tax
IHACPA	Independent Health and Aged Care Pricing Authority
MYBR	Mid-year budget review
NEP	National efficient price
NFPS	Non-financial public sector
PFC	Public financial corporations
PNFC	Public non-financial corporations
RBA	Reserve Bank of Australia
S&P	Standard & Poor's
SAFA	South Australian Government Financing Authority
SA Water	South Australian Water Corporation
T2D	North-South Corridor – Torrens to Darlington
UPF	Uniform Presentation Framework