E. PERFORMANCE AND REPORTING UNDER THE FISCAL RESPONSIBILITY ACT 2012

The *Fiscal Responsibility Act 2012* (FRA) requires the Government to report on performance against the Act's objective, targets and principles as part of the budget papers.

The FRA sets the policy objective of maintaining the State's triple-A credit rating, supported by two fiscal targets and three principles of sound financial management (see Table E.1).

Table E.1: Fiscal Responsibility Act 2012 – object, targets and principles

Object	Fiscal targets	Fiscal principles
	1) Annual expense growth kept below long-term average revenue growth	Principle No 1 is responsible and sustainable spending, taxation and infrastructure investment, including: (a) aligning general government revenue and expense growth (b) stable and predictable taxation policies (c) investment in infrastructure that has the highest benefit for the community.
Maintain the triple-A credit rating	2) The elimination of the State's unfunded superannuation liability by 2030	Principle No 2 is effective financial and asset management, including sound policies and processes for: (a) performance management and reporting (b) asset maintenance and enhancement (c) funding decisions (d) risk management practices. Principle No 3 is achieving intergenerational equity, including ensuring that: (a) policy decisions are made having regard to their financial effects on future generations (b) the current generation funds the cost of its services.

Performance

Maintaining the triple-A credit rating

New South Wales continues to meet the objective of the FRA. Both major credit rating agencies – S&P Global and Moody's – reaffirmed the State's triple-A credit rating in September 2019.

The credit rating for States and Territories is capped by the rating on the sovereign, the Commonwealth Government. Accordingly, following S&P Global's decision to place Australia on negative outlook in April 2020, New South Wales (and the other triple-A rated States and Territories) were concurrently placed on negative outlook as States cannot have a higher rating than the Commonwealth. In the event of a further downgrade to the Commonwealth rating, this would automatically flow through to New South Wales.

New South Wales is one of two Australian states and one of four comparable sub-sovereigns outside the United States to hold a triple-A credit rating from both Moody's and S&P Global (refer Table E.2).

Table E.2: New South Wales is one of four states rated triple-A by Moody's and S&P Global[(a)]

Moody's	S&P Global
New South Wales (AU)	**New South Wales (AU)**
Victoria (AU)	**Victoria (AU)**
British Columbia (CA)	Australian Capital Territory (AU)
Saskatchewan (CA)	**British Columbia (CA)**
Baden-Wuerttemberg (DE)	Vaud (CHE)
Bavaria (DE)	Zurich (CHE)
Brandenburg (DE)	**Bavaria (DE)**
	Saxony (DE)

(a) Sub-sovereigns in bold text reflect a triple-A rating issued by both rating agencies.
Note: shows sub-sovereigns comparable to the State of New South Wales, e.g. states, provinces, landers, cantons.
Abbreviations: AU (Australia), CA (Canada), CH (Switzerland) and DE (Germany)

Performance against the FRA targets and principles

The COVID-19 pandemic has resulted in a deterioration in the fiscal outlook and has placed pressure on New South Wales to maintain the triple-A credit rating.

The subdued revenue environment combined with future expense pressures presents a significant budget management challenge. In October 2020, S&P Global reaffirmed Australia's rating as triple-A with negative outlook, which automatically flows through to New South Wales. Should the Commonwealth Government be downgraded in the future, New South Wales will continue to manage the State's fiscal position consistent with a stand-alone triple-A credit rating.

The principles of the FRA remain valid and should continue to be adhered to, in particular *'responsible and sustainable spending, taxation and infrastructure investment'* and *'achieving intergenerational equity'*.

With some significant COVID-19 driven uncertainty remaining in the economic and fiscal outlook, the NSW Government will aim to update the FRA as a clearer picture of the broader outlook emerges.

Target 1 – Expense growth below long-term average revenue growth

The FRA requires annual general government expense growth to be maintained below the long-term average general government revenue growth of 5.6 per cent, as set in the *Fiscal Responsibility Regulation 2013*.

The 2019-20 expense growth rate of 9.7 per cent exceeded the long-term average revenue growth rate of 5.6 per cent, primarily due to $4.2 billion of expenditure in 2019-20 in COVID-19 response and recovery measures and $1.3 billion of support to bushfire-affected communities.

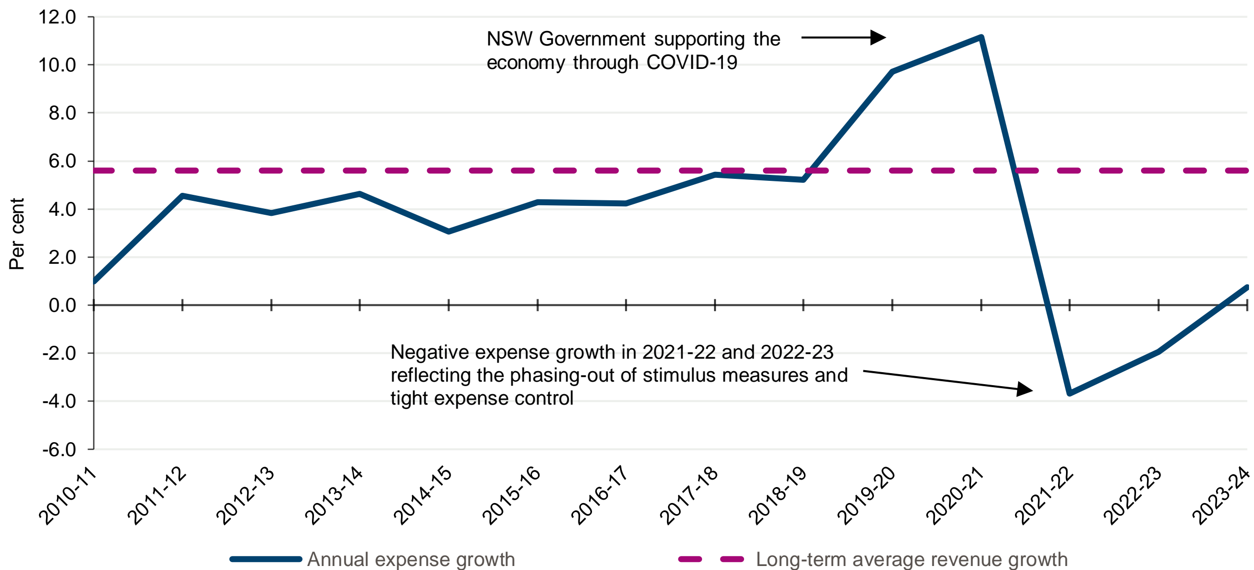
The 2020-21 Budget forecasts that 2020-21 expense growth will be 11.2 per cent, which would exceed the long-term revenue growth rate. This is primarily due to the $7.8 billion of expenditure measures in 2020-21 to support communities, businesses and the economy as part of the Government's package of response, recovery and reform measures for COVID-19.

From 2021-22 onwards, the Government is forecasting annual expense growth to remain below the long-term revenue growth rate with restraint on expenditure over the medium term (see Chart E.1). To ensure the State maintains its fiscal capacity to respond to future economic or fiscal shocks over the medium term, the Government's fiscal strategy will pivot to fiscal repair by maintaining discipline on expenses, including:

- limits wages growth through the new wages policy which will save $4.3 billion over the four years to 2023-24. Noting:
  - this wages policy incorporates:
    - the Industrial Relations Commission determination limiting wages growth to 0.3 per cent in 2020-21 for approximately 170,000 workers
    - a 12 month pause to wages growth for senior public servants and members of Parliament
    - keeping wages growth to no more than 1.5 per cent over the forward estimates to align with the average underlying inflation forecast (Sydney CPI, ex-tobacco excise)
  - this wages policy will continue to allow increases beyond this level to be considered, where employee related cost savings are achieved to fully offset the additional costs
- more efficient procurement practices delivering savings of $729.0 million over the next four years and $3.2 billion over the next decade.

Looking ahead, there is a divergence in the revenue outlook from the long-term revenue growth (which was noted in the 2018 review of the FRA). As revenue pressures emerge over the medium term, the Government will need to not only carefully manage expense growth but maintain a sustainable operating position and debt level.

Chart E.1: Revenue and Expense Growth



Target 2 – Eliminating the State's unfunded superannuation liability by 2030

The FRA currently requires the Government to eliminate the State's unfunded superannuation liability by 2030.

To achieve this target, the Government makes annual cash contributions to the State's defined benefit superannuation schemes in line with a funding plan set at each triennial review of the schemes. This funding plan takes into account any changes in both the asset (e.g. market returns) and the liability (e.g. demographic and actuarial assumptions) components of the schemes.

Following the unprecedented economic and fiscal events of 2019-20, New South Wales has re-anchored its superannuation liability target to be fully funded by 2040. Re-anchoring the target will help free up much needed fiscal capacity over the budget and forward estimates, which will support the Government's fiscal response to COVID-19. With some significant COVID-19 driven uncertainty remaining in the economic and fiscal outlook, the Government will aim to update the FRA as a clearer picture of the broader outlook emerges.

Total State net unfunded superannuation liability are estimated to be $14.6 billion at June 2021 and are projected to increase to $15.6 billion at June 2024, reaching zero by June 2040 (see Box 6.4 for further analysis).

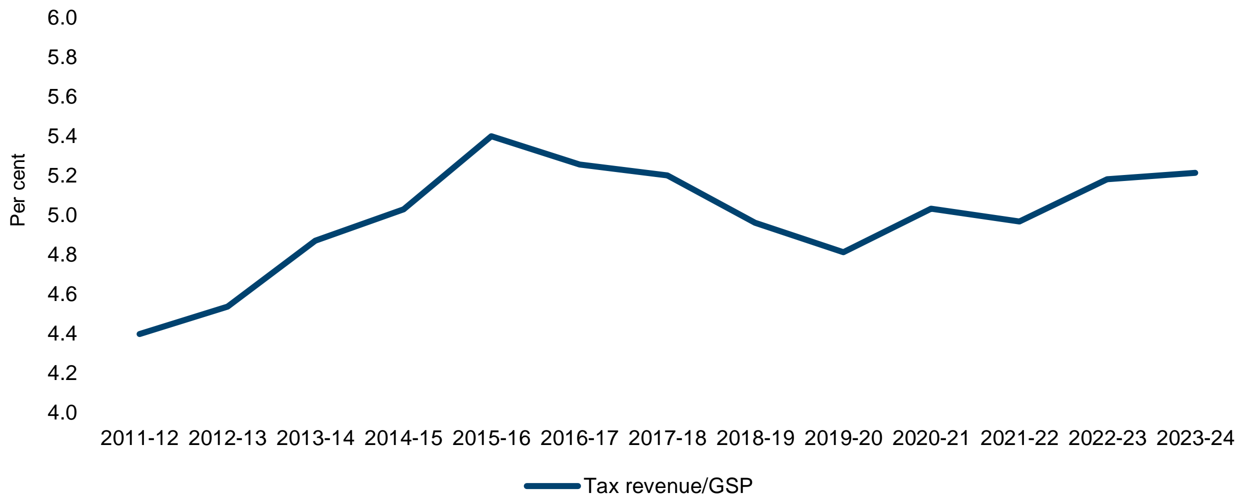
Principle 1 – Responsible and sustainable spending, taxation and infrastructure investment

The principle of responsible and sustainable spending, taxation and infrastructure investment includes aligning general government revenue and expense growth, stable and predictable taxation policies, and investment in infrastructure that has the highest benefit for the community. This involves maintaining a strong and sustainable fiscal position, by way of managing an operating position appropriate for current conditions, and debt that can be sustainably managed, while also providing recurrent services and infrastructure investment.

The FRA target to keep general government expense growth below the long-term revenue growth rate of 5.6 per cent demonstrates the commitment to responsible and sustainable spending.

State taxation has remained consistent and low, with the ratio of tax receipts to Gross State Product (GSP) declining from 5.4 per cent in 2015-16 to a projected 5.0 per cent in 2020-21, and marginally increasing over the forward estimates to 5.2 per cent in 2023-24 (as shown in Chart E.2). Tax revenue to GSP declined to 4.8 per cent in 2019-20 due to lower payroll tax and transfer duty revenue.

Chart E.2: Taxation revenue, ratio to GSP



The Government will continue to deliver its record infrastructure program with total investment in the general government sector reaching $107.1 billion over the four years to 2023-24.

The sustainability of this investment is made possible by the proceeds from the State's asset recycling program and the establishment of the State's dedicated debt retirement fund – the NSW Generations Fund (NGF).

The Government will continue its successful asset recycling program in the 2020-21 Budget and will progress the sale of the State's residual 49 per cent share in WestConnex following the successful 51 per cent of the WestConnex transaction completed in August 2018. Net proceeds from the transaction will be placed in the NGF.

Outcome Budgeting

Outcome Budgeting is a multi-year reform program that improves oversight of total expenditure, as well as providing greater evidence to support and prioritise resource allocation. Sustained over time, Outcome Budgeting improves the way that Government plans and manages resources to deliver outcomes for the people of New South Wales. The framework enables ongoing performance monitoring and assessment to ensure resources are well managed and targeted to deliver State Outcomes efficiently and effectively.

Outcome and Business Plans will be regularly updated and reviewed to inform ongoing planning and management across the suite of State Outcomes. This includes a continued focus on improving performance measurement, ensuring all Outcome Indicators have performance targets and reviewing and refining Programs and Program Performance Measures.

To support the implementation of Outcome Budgeting and the principle of sustainable spending, the Fiscal Repair Program will review Cluster State Outcomes and associated performance targets to:

- ensure New South Wales taxpayers are receiving value-for-money from the public sector
- ensure the Government is delivering its Outcomes in the most efficient and effective manner possible
- review Outcome and Program expenditures (including performance metrics) to identify reform opportunities and provide options to Government to assist in returning the budget to a sustainable operating and debt position over the medium term

- ensure financial resources are appropriately aligned across Clusters to the delivery of outcomes and government priorities
- investigate areas of government spending which may be unnecessary, inefficient, low value, do not align with State or Cluster Outcomes, and/or can be better delivered under different arrangements, and
- develop and implement frameworks to enhance financial accountability across the sector.

Principle 2 – Effective financial and asset management policies

This principle includes having sound policies and processes for performance management and reporting, asset maintenance and enhancement, funding decisions and risk management practices.

The Government has continued to focus on the State's balance sheet management, funding decisions and risk management through the Treasury Asset and Liability Committee (ALCO). This includes managing the cash centralisation strategy with further funds being brought into the State's central liquidity pool, optimisation of the State's balance sheet, and a new Asset Management Policy as a best-practice framework for managing the State's existing physical assets.

The Asset Management Policy will improve asset management planning and delivery practices across the Government by lifting agencies' asset management capability. Out of the State owned physical asset base of $368.1 billion, the largest component as at 30 June 2020 was infrastructure systems ($180.2 billion). This included roads, railways, ports, dams and pipelines. Buildings ($94.2 billion), land ($74.6 billion) and plant and equipment ($18.5 billion) comprise the remainder of the State's physical asset base. The Asset Management Policy for the NSW Public Sector (TPP 19-07) will ensure alignment of agencies' asset management approaches with industry practice and international standards (ISO 55001).

Some additional reforms and polices implemented by the Government include:

- strengthened reporting and management of contingent assets and liabilities
- the issuance of Green Bonds in November 2018 and October 2020 and Sustainability Bonds in November 2019, totalling $5.2 billion to fund projects delivering environmental and social benefits
- debt management measures including broadening the investor base by issuing into new longer-dated tenors (beyond 10 years), rate notes and sustainability bonds
- redirecting State Owned Corporation (SOC) dividends and income tax equivalents, excess Treasury Banking System (TBS) cash, proceeds of future asset sales (including the 49 per cent stake in WestConnex) and coal royalties into the NGF.

Principle 3 – Progress in achieving intergenerational equity

The FRA commits the Government to ensure that policy decisions have regard to their financial effects on future generations and that the current generation funds the cost of services delivered today.

Each budget reports the impact of its measures on the long-term fiscal gap, which is a summary indicator of the budgets financial effect on future generations.[1] The *2016 Intergenerational Report* highlighted that if current trends continue, a widening fiscal gap will emerge where expenditure would exceed revenues resulting in a fiscal gap of 3.4 per cent of GSP by 2055-56.

As a result of Government decisions, the cumulative fiscal gap has increased by 0.2 per cent (0.1 per cent since 2019-20 Budget), to be 3.6 per cent of GSP by 2055-56. The targeted nature of the Government's response and recovery measures to the drought, 2019 summer bushfires and COVID-19 means there is no structural budget deficit going forward. The extended 2040 superannuation target date, the scoping of future asset recycling measures and using the Outcomes Budgeting framework to drive efficiencies across government expenditure allow the Government to invest in new services and infrastructure without further impacting long-term fiscal sustainability. This shows that prudent budget management continues to be effective in limiting such impacts on future taxpayers.

With intergenerational challenges on the horizon, the NGF is forecast to grow to more than $70.0 billion over the next 10 years through redirecting resource revenues (e.g. mining royalties) and SOC dividends into the NGF. Future asset sales (e.g. the sale of the residual 49 per cent stake in WestConnex) will further increase the NGF balance. The Government aims at rebuilding balance sheet capacity by bringing net debt down towards 7 per cent of GSP over the medium term and make the NGF a truly inter-generational fund.

The next iteration of the intergenerational report will be published at the 2021-22 Budget.

[1] The fiscal gap is calculated for the general government sector and is the difference between the base period primary balance as a share of GSP and the primary balance as a share of GSP at the end of the projection period, on a 'no policy change' basis. The primary balance is the gap between spending and revenue (it excludes interest transactions and includes net capital expenditure). A positive gap implies that fiscal pressures will build over the projection period.