LEGISLATIVE ASSEMBLY OF THE NORTHERN TERRITORY

13th Assembly

PUBLIC ACCOUNTS COMMITTEE

Public Briefing Transcript

10.15 AM, Friday, 29 March 2019

Litchfield Room

Members: Mr Terry Mills MLA, Deputy Chair, Member for Blain
Mr Gary Higgins MLA, Member for Daly
Mr Tony Sievers MLA, Member for Brennan
Mrs Kate Worden MLA, Member for Sanderson

Witnesses: Department of Treasury and Finance

- Craig Graham, Under Treasurer
- David Braines-Mead, Deputy Under Treasurer – Policy
- Tim McManus, Assistant Under Treasurer – Finance
- Michael Butler, Assistant Under Treasurer – Revenue

Mr DEPUTY CHAIR: On behalf of the Committee, I welcome everyone to this public briefing on budget repair. The Chair of the Public Accounts Committee, Ms Sandra Nelson, is unavailable for this public meeting. As the Deputy Chair, I will be chairing this briefing.

I welcome to the table to the table to give evidence to the Committee from Department of Treasury and Finance, Mr Craig Graham, the Under Treasurer; Mr David Braines-Mead, the Deputy Under Treasurer for Policy; Mr Tim McManus, Assistant Under Treasurer of Finance; and Mr Michael Butler, Assistant Under Treasurer for Revenue. Thank you for coming before the Committee. We appreciate you taking the time to speak to the Committee and look forward to hearing from you all today.

This is a formal proceeding of the Committee and the protection of parliamentary privilege and the obligation not to mislead the Committee apply. This is a public briefing and is being webcast through the Assembly's website. A transcript will be made for use of the Committee and may be put on the Committee's website.

If, at any time during the hearing, you are concerned that what you will say should not be made public, you may ask that the Committee go into a closed session and take your evidence in private. Could each of you please state your name, title and the capacity in which you are appearing this afternoon?

Mr GRAHAM: Craig Graham, Under Treasurer for the Department of Treasury and Finance.

Mr BRAINES-MEAD: David Braines-Mead, Deputy Under Treasurer Policy for the Department of Treasury and Finance.

Mr BUTLER: Michael Butler, Assistant Under Treasurer (Revenue) for the Department of Treasury and Finance.

Mr McMANUS: Tim McManus, Assistant Under Treasurer (Finance) for the Department of Treasury and Finance.

Mr DEPUTY CHAIR: Under Treasurer, your opening statement please.

Mr GRAHAM: Thank you for inviting us to present today. I will talk briefly on the current fiscal outlook and challenges. As has been well documented, the Northern Territory is facing some significant economic and financial challenges.

We have seen a substantial deterioration in the Territory's fiscal position over the last two years. That has primarily been on the back of unprecedented reductions in our largest source of revenue, which is the GST revenue grants. They have declined from over $3bn two years ago to $2.7bn. We have also seen—due to changes in the distribution of the pool—that we have written down our forecasts of GST revenue across the forward estimates by $2.4bn.

In an annual budget of around $6.5bn, that is a significant hit on the revenue. That reduction to date has largely been due to a change in our per capita relativity. Our per capita relativity is the ratio that is calculated by the Commonwealth Grants Commission that is applied to our population share and that determines our relative share of the GST pool.

Our historical average relativity since the GST was introduced has been 5.2 and has now dropped to 4.2, the lowest it has been since the GST was introduced. On top of that we have seen changes to the distribution methodology which were legislated last year. It essentially locks us in to that lower share because the equalisation standard that the CGC calculates our revenue share around has been diminished.

That has come on top of significant pressures on the expenditure side. Government has been required to respond to the Royal Commission into Protection and Detention of Children in the Northern Territory. There are demand pressures in some of our key agencies in health, corrections and Territory Families. These fiscal developments have coincided with the completion of the construction phase of the INPEX project.

At the time it was announced it was one of the largest resource projects in the world and has been the largest project in the Territory government's history since self-government. During the construction phase it added around $5bn to private investment per annum. At its peak, there were over 10 000 workers employed on the site. That project is coming to completion.

Investment is falling from those peaks back to levels that we saw prior to INPEX. There is a large population outflow associated with that, we are seeing employment and population fall because labour follows capital. When we have capital moving out, we tend to have population move out as well. That is exacerbating our fiscal challenges because we are seeing the impact on payroll taxes. The GST is calculated on a population share basis and our share of the national population is reducing. That economic challenge is exacerbating the budgetary one.

Coming into this year's budget, there has been recognition that structural deficit requires a structural response. Government announced the establishment of a panel to undertake a wide review of our finances, to recommend a reform framework and look at fundamental changes to the way that government operates in the Northern Territory and to the way services are delivered.

That panel is chaired by John Langoulant and comprises Helen Silver—they are the two independent members—as well as myself and Jodie Ryan. Government also announced that as a part of this year's budget they would undertake a detailed program review of government expenditure to inform short term or immediate savings initiatives that can feed into this year's budget process.

That has been the response to the fiscal challenges that we face. With that opening statement, I am happy to take questions.

Mr DEPUTY CHAIR: Mr Under Treasurer, your opening statement speaks of the imbalance we have between receipts and expenditure but the core of the report that was written by Mr Langoulant speaks more prominently about the structural imbalance which is not created by the present issues of reduction of GST, and declining population, it is an underlying problem that has been in existence for some time.

You refer to an independent committee that is in place with two independent members. Is that committee in receipt of the final report?

Mr GRAHAM: The final report is currently being prepared. It will be submitted to government shortly.

Mr DEPUTY CHAIR: So it is not complete yet?

Mr GRAHAM: No.

Mr SIEVERS: When is that due?

Mr GRAHAM: It is under consideration at the moment. There will be an announcement shortly as to when it will be released.

Mr DEPUTY CHAIR: Given the bleak outlook and the three scenarios…

Mr GRAHAM: Can I just correct myself, the response to the report is under consideration. The report itself has been completed it is with government.

Mr DEPUTY CHAIR: How long has it been with government for?

Mr GRAHAM: I am just trying to think, a week or so.

Mr DEPUTY CHAIR: So it would have been at least last week? How long has the committee been working on this response?

Mr GRAHAM: The committee has been working on the report. Government is considering the response.

Mr DEPUTY CHAIR: Excuse me. On the final report, how long has the committee been working on the report?

Mr GRAHAM: Since it was received.

Mr DEPUTY CHAIR: Which was December?

Mr GRAHAM: No, that was the interim report. What is being considered now is the final report.

Mr DEPUTY CHAIR: By government?

Mr GRAHAM: Yes.

Mr DEPUTY CHAIR: But how long has the committee been working on the final report?

Mr GRAHAM: Since the interim report last December.

Mr DEPUTY CHAIR: Right.

Mrs WORDEN: I have a question on your opening statement, if that is okay. I am interested in the GST. How unexpected was the GST reduction to Treasury? Do you think there is much more that the government could have done to prepare for those reductions in GST?

Mr GRAHAM: Trying to forecast per capita relativity is fraught. There are so many variables that go into the calculation of per capita relativity. At the time of the pre-election fiscal outlook, our relativity was over five. We anticipated a reduction in our relativity over the forward estimates but the magnitude of the reduction took us by surprise.

The reduction was largely driven by factors outside of the Territory government's control. It was mainly due to changes in expenditure patterns in the larger states. Expenditure on categories where the Northern Territory is assessed as having relatively high needs. Things like remote and regional education and health. There were also changes in our share of tied Commonwealth revenue which were not anticipated by us to the extent that we have seen.

Mr DEPUTY CHAIR: Would it be correct to describe the situation as being contributed to by the GST or the unexpected lower receipt of GST, but by a number of other factors as well? That is just one factor feeding into a much deeper problem. The structural imbalance, for example. The GST receipt assists to keep our head above water but there is an underlying problem which is the structural imbalance, which is the cost of running government and compounding debt.

Mr GRAHAM: I am not quite sure I follow what you mean. If you look back over time government expenditure has grown at around 6.5% per annum. For the last 10 to 15 years government has incurred fiscal deficits. There have been periods where we have been in surplus, but primarily we have been in deficit on the fiscal balance.

A lot of that period there have been operating surpluses. During that time most of government's borrowing has been to fund infrastructure. Now we are in deficit in both the operating and the fiscal balance. Given that we are in operating deficit, we are borrowing to fund recurrent costs. That is a situation that you need to get out of. It is not sustainable.

Mr DEPUTY CHAIR: To expand that a little further, the cause of this is being characterised in some quarters has been the reduction in GST receipts. However, any fair assessment would say that it is a bigger problem than that. That is a current situation.

I need a better explanation of what you described as a structural deficit. That is, the deeper underlying problem which requires a structural fix. If we talk about the GST being the problem, then we are going to argue for more GST, but in fact, we have a different problem. That is the structural problem.

Could you explain a bit more about what that structural problem is?

Mr GRAHAM: As I said, we are now locked into a lower share of the GST pool. We cannot expect the share of the GST pool we have had historically to continue. Our expenditure base has been formulated around that level and growth in revenue historically. Now that that is no longer expected to continue, there needs to be a rebalancing and rebase of our cost base. That is the structural challenge and the issue that the fiscal strategy panel has been established to examine.

Mr DEPUTY CHAIR: That cost base, you are talking about expenditure? Which is going to have a structural implication.

Mr GRAHAM: Yes.

Mr DEPUTY CHAIR: Significant changes to expenditure.

Mr GRAHAM: That is right. The interim report that was released in December provided a set of medium-term projections which showed that if we continue on business as usual—if we factor in the shift in our revenue stream and projected our historical expenditure growth out over time—we would get into an unsustainable fiscal position over the medium-term.

It included a scenario whereby if we restrain annual growth and expenditure from 6.5% back to 3%, we get back into budget balance over the medium-term. Achieving that 3% annual growth in expenditure will require a significant change in the way government does business. It will require changes to the way we manage our finances and deliver services.

If we are going to be able to continue to meet demand and maintain government services over time, as well as get back to a balanced budget position, we are going to need to deliver services in a more efficient way.

Mr DEPUTY CHAIR: Thank you, Under Treasurer.

Mr SIEVERS: So we need to get back to 3%, is what you are saying?

Mr GRAHAM: Yes.

Mr SIEVERS: Can that be done? How do we go about that? That is the real question here. What indicators will show us that we are on track to do that?

Mr GRAHAM: It is achievable. Other governments around the country have been able to achieve similar levels of expenditure growth. Our current budget for forward estimates has flat expenditure growth. It is definitely a challenge.

It requires us to look at the structure of our agencies, workforce, business practices, the way we formulate and deliver programs, governance of our financial arrangements and the way government agencies manage finances and deliver services. We need to strengthen the accountability of government agencies, define performance standards and make agencies accountable for those.

Mrs WORDEN: I have a supplementary on that. I am not so sure of the correct terminology but at the moment we are hearing about root and branch reviews. Is that contained to departments? Let us say that review is fully conducted—I am certain that it will—how will that feed into the processes are occurring at the moment?

You have talked about reduction in expenditure. We are seeing some of that and getting back to the 3%. How will that root and branch dovetail into the other work you are doing?

Mr GRAHAM: We have had the two processes running in parallel. The root and branch is focusing more on short term and immediate measures that we need to implement in order achieve our current forward estimates. Our forward estimates are premised on a flat expenditure growth.

The fiscal strategy review is looking at medium-term structural changes that aim to get us to achieve that 3% expenditure growth over that period beyond the forward estimates.

Mr DEPUTY CHAIR: What is the current expenditure?

Mr GRAHAM: Expenditure growth or expenditure?

Mr DEPUTY CHAIR: Current expenditure.

Mr McMANUS: On the general government sector it is just under $6.6bn.

Mr DEPUTY CHAIR: What does 3% look like? I have a calculator here.

Mr GRAHAM: About $18m to $20m.

Mr DEPUTY CHAIR: Per year?

Mr GRAHAM: Yes.

Mr SIEVERS: You mentioned that it has been done somewhere, in other states, have you got an example? Was it 6% down to 3%?

Mr GRAHAM: The most recent example is Western Australia. They have been able to undertake extensive budget repair initiatives and have been able to…

Mr SIEVERS: What was their expenditure at?

Mr GRAHAM: I cannot tell you off the top of my head. A couple of years ago they had some dire looking forward estimates but they have been able to implement significant savings measures and initiatives. Their current forward estimates are much improved. They had an extensive budget repair initiative.

Mr DEPUTY CHAIR: Do you think it is a fair comparison to compare Western Australia with the Northern Territory?

Mr GRAHAM: They have similar expenditure needs as we do. They have large remote population. Their scale is larger but they have similar expenditure needs.

Mr DEPUTY CHAIR: Own source revenue is significantly higher in Western Australia.

Mr GRAHAM: It is. I am just looking at the expenditure side and that they had been to achieve significant savings from the expenditure…

Mr DEPUTY CHAIR: The observation I would make if we are going to make a comparison between Western Australia and the Northern Territory, is that we are so exposed here as a vulnerable and fragile community. These cuts are going to be felt by everybody in our community, whereas they would not be necessarily felt by everybody in Western Australia.

That is why I am assuming that this report is sitting with government because these are going to require some very significant decisions that are going to have a big impact on our community.

Mr GRAHAM: Yes, sure. That is why the focus is expenditure restraint rather than short term austerity measures. Trying to get the budget back in the balance over three to four years given our economic situation would further undermine investor and consumer confidence and exacerbate population outflow at a time when we are trying to support the economy and investor and consumer confidence.

That is why a measured and targeted approach is required to undertake budget repair and needs be done over a medium-term time frame.

Mr DEPUTY CHAIR: Could you remind us what was government's projected expenditure in the last budget?

Mr McMANUS: Not at this point in time.

Mr GRAHAM: I do not have the number off the top of my head.

Mr DEPUTY CHAIR: That is alright.

Mr BRAINES-MEAD: Can I clarify, which year?

Mr DEPUTY CHAIR: For the last budget. The current year we are in.

Mr BRAINES-MEAD: In the May 2018 budget the general government expenditure for 2018-19 was $6.2bn.

Mr DEPUTY CHAIR: How is that tracking? Are they on budget? Over or under?

Mr McMANUS: In the mid-year report there was a slight worsening of the budget projections to $6.6bn.

Mr DEPUTY CHAIR: So that is an increase or a blowout of …

Mr McMANUS: About $400m. It worsened at mid-year report.

Mr DEPUTY CHAIR: You said $400m?

Mr McMANUS: Yes.

Mr DEPUTY CHAIR: Let us go back to restraint. The government knew that we were heading into some challenging times with GST receipts diminishing and knew that there needed to be tough measures. How confident do you think the community can be that in a time such as that, that we have had a blowout of $400m? And now we are going to go into a period where we are going to make significant reductions through restraint.

Would you be concerned?

Mr GRAHAM: This is why there needs to be changes to the way we manage our finances so that there is greater accountability and transparency over how government funds are expended.

Mr DEPUTY CHAIR: We often hear about the FITA—the *Fiscal Integrity and Transparency Act*—is that being complied with? Can you unpack that for us please? The compliance measures required around that Act.

Mr GRAHAM: The FITA is the legislative framework which sets out the reporting requirements for government finances. That is the transparency part. It requires governments to publish forward looking budgets—budget papers, pre-election fiscal outlooks—and backward looking publications—the annual reports, treasurer's annual financial statements.

The integrity part establishes some high level principles around fiscal sustainability which is balanced against economic stability and prosperity objectives. Those principles are given effect in the budget through the fiscal strategy which is published in budget paper number two. That sets out targets with respect to operating expenditures, capital investment and net debt to revenue ratios. The economic forecasts are published in the budget as well.

Those high level principles have two paradigms which can be competing in terms of fiscal sustainability and economic stability. There is no guidance in the FITA as to which of those priorities or principles are to be given priority. I was not around when the FITA was designed or implemented. I gather that its intention is to give government flexibility in the way it frames its finances to respond to circumstances such as the one we are in now. Government has balanced the need to support the economy to prevent population outflow and ensure reasonable standards of government service at a time when the economy is heading into a downswing in the cycle.

Mr DEPUTY CHAIR: I need to finish one line. Going back to the projected expenditure of $6.2bn and it is now on track to be $400m more than that, what should it be if it was 3% growth? What should it have been? Going forward, what would 3% growth look like?

Mr GRAHAM: We can do that calculation but realistically the outcome for 2018-19 should be in line with the forward estimate.

Mr McMANUS: About $200m.

Mr DEPUTY CHAIR: There appears to be ground to be made up which feeds into debt.

Mr GRAHAM: Yes.

Mr DEPUTY CHAIR: Thank you.

Mr BRAINES-MEAD: Can I clarify that some of that increase between the $6.2bn and the $6.6bn is around carryover of expenditure from 2017-18 into 2018-19. If you look at the results in the Treasurer's annual financial statements for 2017-18, there was an improved fiscal position compared to what was budgeted and part of that is that at the end of financial year there is always some timing of expenditure. There might be delays in delivering programs.

Around half of that $400m increase between the budget time projection for 2018-19 of expenditure and the mid-year report relates to the carryover of Commonwealth funding around remote housing and the delivery of agency operating programs both Commonwealth and Territory funded. There is always a timing differential.

Mr GRAHAM: There are always unders and overs around timing of expenditure and receipts but the underlying result should be in line with what has been budgeted.

Mr DEPUTY CHAIR: In that commentary it is also noticeable—there is a one off injection of over $200m as a top up for the GST and is a part of that as well.

Mr BRAINES-MEAD: For the GST top up there was $260m that was provided. Although it was for 2018-19, it was actually paid to the Territory in 2017-18. That is on the revenue side and has no bearing on the level of expenditure.

Mr GRAHAM: It is factored into the budget.

Mr SIEVERS: Mr Graham you mentioned that it is a balancing act for government to keep the economy, population and job going. It is, we agree. You mentioned youth justice and the impact of those things—I am thinking you are mentioning the Royal Commission—what impact has that had on our budget? Has the federal government come to the party on any of that funding?

Mr GRAHAM: No. The federal government has not been willing to—at this stage anyway—assist in the response to the Royal Commission. The response to the Royal Commission was announced the year before last and…

Mr McMANUS: I think it was around $300m in additional funding to support the recommendations.

Mr SIEVERS: The recommendations from the Royal Commission, $300m.

Mrs WORDEN: I am interested in the infrastructure. In the budget repair report it says it is crucial that infrastructure investment is targeted towards infrastructure that provides long term economic returns to the Territory. I could not agree with that more.

Can you tell us what strategies are in place to ensure that infrastructure investment is being targeted towards a longer term economic return? What input do you have over those decisions?

Mr GRAHAM: Over the last couple of years a significant proportion of the infrastructure spend has been diverted into stimulus packages. We have had the housing repairs and maintenance package, tourism, brought forward repairs and maintenance programs and we have maintained the overall Capital Works Program at historically high levels.

The stimulus spending has been aimed at short term programs which aim to get money out of the door quickly which support construction industry and the tourism sector. In the ongoing Capital Works Program, the individual projects are required to be supported by business cases which set out the economic case for the investment. It is around access to services and supporting broader economic developments; supporting investment, pastoral industry, mining industry as well as maintaining access to social services for remote communities.

Mrs WORDEN: The ones we will see coming through will have that underpinning ideology behind them as they progress?

Mr GRAHAM: Yes.

Mrs WORDEN: Investment into the Westin Hotel comes to mind for me.

Mr GRAHAM: Yes. All those strategic investments which are aimed at economic infrastructure like the ship lift and hotel are supported by economic cost-benefit analysis.

Mrs WORDEN: Thank you.

Mr DEPUTY CHAIR: Coming back to the structural problem. The GST receipts and so on are contributors but what is the greatest expenditure burden on Territory revenue? What is the greatest cost?

Mr GRAHAM: The largest share of our budget is the health budget.

Mr DEPUTY CHAIR: But more broadly it is personnel. Is not it? It is the size of the public service.

Mr GRAHAM: You mean category costs. Yes, of recurrent costs it is personnel.

Mr DEPUTY CHAIR: How does the size of our public service compare with Western Australia, for example?

Mr GRAHAM: Our public service as a share of our economy is high primarily because of the structure and composition of our population and the requirement to deliver services over a large geographical area to a small population. A population which has a large sector which is subject to severe socioeconomic disadvantage.

The relative effect of those factors, compared to other states, means that the costs of and demand for government services in the Northern Territory is relatively high. That is why we are assessed as needing significantly above our population share of the GST pool. Compared to any other state, our public sector is relatively large.

Mrs WORDEN: Would it be fair to say that investment in changing socioeconomic outcomes for that cohort is a good investment in the longer term?

Mr GRAHAM: It requires an investment approach and it is going to take a significant period of time until we start seeing improvements.

Mr DEPUTY CHAIR: We have a 10 year frame in front of us. If we do nothing, we will be closed down because we are bankrupt. If we reduce our expenditure, practice restraint and make some savings, we might survive.

We have not seen evidence…

Mr GRAHAM: I would hope so.

Mr DEPUTY CHAIR: I would hope so as well. What has just been described there is fine. Socioeconomic investment to get us better outcomes, could we achieve that in 10 years? Spending more money to produce better results.

Mr GRAHAM: It requires better targeting and program design in order to achieve improvement in outcomes.

Mr DEPUTY CHAIR: I hear what you are saying. That is the challenge. This is the greatest area of expenditure which we would expect the greatest results from. It is going to attract the attention of anyone with a concern about reducing our expenditure but improving results and efficiencies.

One that has been suggested—Western Australia has been mentioned a couple of times. I note that in Western Australia in the 80s they had a similar problem and they reduced the wages of those in the public service by 10% across the board in order to survive. They did. Is that a recommendation that is contained with your review?

Mr GRAHAM: I cannot pre-empt the outcome of that review.

Mr DEPUTY CHAIR: That would make a big difference, would not it?

Mrs WORDEN: Is that what you are suggesting?

Mr DEPUTY CHAIR: No. I am saying that if we are talking about history and response to a real crisis, then that is what occurred in Western Australia in the 80s. It was an actual crisis and as a community—they reference in the plan for budget repair, this is not a political problem. This is a whole of Territory problem. That is why it is important we all understand how serious this is.

It is concerning that in the talk of heavy lifting and restraint, there has not been restraint in the face of this problem that has been known to government for some time. The question is out there, are we actually going to see significant changes? That is rhetorical. You do not have to respond to that.

Mr GRAHAM: The environment we are in at the moment is unprecedented. We have not had to face this particular set of circumstances since self-government. The challenge before us cannot be down spoken. It is a huge one and is why I said in my opening that it is a structural problem that requires a structural response.

Mr DEPUTY CHAIR: Correct.

Mr GRAHAM: It will require a fundamental change to the structure of the public service and the way we deliver services.

Mr SIEVERS: We have heard a number of things—our GST, no commitment around $300m into the youth justice area and the finish of INPEX made a big impact on our fiscal arrangements. The Territory is notorious for going through large peaks and troughs. Is there anything on the horizon that we are looking at to minimise those peaks and troughs and to diversify the Territory in not just one INPEX but a future Territory?

Mr GRAHAM: The economic side of this debate cannot be ignored because we need a strongly growing economy to assist us in that budget repair task. We need investment to attract population and to support employment. That supports revenue through royalties, payroll taxes and stamp duty. It supports the construction industry which supports conveyance duties—it is all interrelated.

Government has a focus on investment attraction. There is a pipeline of projects and some of them are approaching the final investment decision stage. There is active work underway through that major projects and investment attraction process.

There needs to be a focus on ensuring that we have a competitive economy so that businesses that operate here have the capacity to compete in national and international markets. The economic development framework is in place and the intent of that is to support diversification of the Territory economy so that we are less prone to the economic cycles. That has a range of initiatives in place to support investment in agriculture, international education and mining—our traditional resource based industries.

It is the economic development framework which is the policy framework to support underlying diversification of the economy.

Mr DEPUTY CHAIR: I welcome the Leader of the Opposition, Mr Gary Higgins. He has just joined us.

Going onto things on the horizon that may give us cause for hope. I would like to hear the treasury's views on the prospects of positive revenue flow into the Territory from unconventional gas. What work has been done by the treasury on that story and what does it look like from your point of view?

Mr GRAHAM: It is quite promising but we do not have any revenue factored in until the final year of our forward estimates. They are outside of the current forward estimates—we do not expect to see any royalty revenues flowing from that industry for five years. The medium-term prospects are significant given the resources we have. That is a promising source of revenue and economic activity.

Mr DEPUTY CHAIR: I assume work is being done on how that royalty flow would occur and how it would be monitored and managed. Can you describe how the royalties could or should work for the Territory?

Mr GRAHAM: I might hand over to Mr Michael Butler.

Mr BUTLER: We are working on our petroleum royalty framework at the moment. There is a petroleum royalties framework in place for conventional gas and petroleum noting however, that is has been in place for some time.

This year we are going to go through a consultation process with industry to determine what the most appropriate mechanisms for the future are. Currently it is based on a 10% ad valorem royalty, calculated at the well head. That is based on conventional petroleum production. We are looking to consult with industry as to how we can legislate and have a framework in place that will be streamlined and appropriate for the modern era of petroleum production.

Mr DEPUTY CHAIR: How would the value of gas at the well head be determined?

Mr BUTLER: Currently there are three methodologies that we can use and it depends on the nature of the production. The best case would be where petroleum is sold from the well head. We can use the actual value. This does not tend to occur given the nature of petroleum, there tends to be some need for post well head production and processing.

A second alternative is to look at comparable sales. Given the small nature of the industry at the moment, that is not there. Generally we tend to use what is called a netback methodology which is where we use the price of the petroleum at the first point of sale and then netback the costs of production, processing and transport to get to that point, which effectively values the petroleum at the well head.

Mrs WORDEN: We have gone in a specific direction. You are talking about royalty as revenue, there are other factors. Do you factor in employment? I am presuming we would not have all the skills in the Northern Territory around the gas industry. There would be some population inflow.

Does treasury look at that and model that as well in its broader figures? Or do you just look at royalty revenue?

Mr BUTLER: We are engaged in forecasting payroll tax and conveyance stamp duties. They are both population based, particularly conveyance stamp duties. Any growth in population assists with that re-transactional nature of the tax. If you have more people coming in and buying homes that means greater duties.

With payroll tax we are taking into account any expected increases in employment but you have to look at a structural nature of that given our high payroll tax threshold of $1.5m. You can see employment growth that does not necessarily correlate one to one with what payroll tax does because if the growth occurs in small business—particularly where that can be exploration companies—they might not necessarily be in the payroll tax space.

We look at those employment growth numbers and factor them in in determining payroll tax.

Mr GRAHAM: The broader exploration and production activity also feeds into our economic forecast.

Mrs WORDEN: That is the bit I was …

Mr DEPUTY CHAIR: Are you assessing how that has worked in Queensland? To get a read on how you might be able to predict results in the Territory?

Mr GRAHAM: We are looking at all jurisdictions—how they forecast, how economic people work with counterparts in other state treasuries around forecasting more generally. We look at experiences in other jurisdictions.

Given it is a green fields industry here, the extent to which we can draw on the experience of other states is limited but we look at what happens in other jurisdictions.

Mr HIGGINS: One of the big criticisms the Fraser Institute came out with is the uncertainty in policy changes. Industry was very critical of the NT in that regard. It concerns me that we are going to look at royalty regime and have not finalised that. That would have a big impact on the economics that would surround this industry.

Do you think it is a good idea to be doing that at the moment? Or should it be delayed knowing that that criticism has come?

Mr BUTLER: When I talk about reviewing the royalty framework, it is more around the manner in which it is administered. The royalty framework at the moment is reliant on a number of agreements being reached between government and the producers as to the way that we reach the value at the well head. It is more around what we can do to legislate to provide a greater certainty—particularly when we are using that netback calculation—about the nature of costs that can be deducted.

It is about providing greater certainty as opposed to looking to change the nature of the royalty that is imposed.

Mr GRAHAM: It is more around the administration of it rather than the regime itself.

Mr HIGGINS: So you would be saying to industry that you are not going to change the rates, it is just going to be how it is calculate it? Can that certainty be given to them?

Mr GRAHAM: That will be done in consultation with the industry.

Mr HIGGINS: My question is to get clarity over whether we are going to be altering the rates of royalty. The answer that was just given was that we are just going to be looking at the way it is calculated but the percentage will stay the same. The figure before was 10% at the well head. Will that stay that way or are we going to introduce another hybrid tax?

Mr GRAHAM: They are decisions for government. The work that we are doing is making sure that the regime we have in place is effective from an administration and collection perspective.

Mr DEPUTY CHAIR: I have a question around the growth of debt and the need to manage it. It is exponential growth that is frightening people. We do not have a lot of room for error here. We have to live within our means just to keep the debt under control otherwise it gets out of control.

There is a need for the community to understand that this is a very serious problem and therefore, being able to support a government when they make tough decisions which are necessary. If all of that occurs—the restraint and structural solutions are applied and supported by the community, which will be difficult—even in the better case scenario there will still be a significant debt at the end of 10 years.

What do you predict that debt to be if all goes well? If politically, government is supported sufficiently to make the tough measures and we end up in a better position than upwards of a $30bn debt, what is a reasonable level of debt and how would we be able to manage that if we get to that point?

Mr GRAHAM: As you point out, debt is the outcome of our fiscal and operating balance. To the extent that that is in deficit we have to borrow to fund that. The immediate aim is to remove those deficits so that we can get back into surplus. Then we can start paying debt.

Mr DEPUTY CHAIR: For the sake of those listening, could you say that again. People need to think about this in terms of a household budget. You need to bring in a little more than you are paying so that you can at least make the repayments.

Mr GRAHAM: Yes.

Mr DEPUTY CHAIR: That is correct, is not it?

Mr GRAHAM: Yes. To the extent that we are in deficit, that gap is funded through debt. We have to eliminate that gap.

Mr DEPUTY CHAIR: Just so that we can make the repayments on the debt.

Mr GRAHAM: Yes. To the extent that we reduce the gap over time, it reduces the amount we have to borrow, which reduces growth in the debt and the rate in which we are accumulating debt.

Mr DEPUTY CHAIR: And it increases our capacity to repay the debt. To pay the money back that we borrowed. So when we get to that point in 10 years' time, what do you think it will be if all goes well?

Mr GRAHAM: That is scenario two.

Mr McMANUS: It would peak at about just over $8bn net debt.

Mr DEPUTY CHAIR: Eight billion, okay. Are you factoring in interest rate increases in the next 10 years?

Mr GRAHAM: Yes. We have made assumptions around what the interest payments on that will be, 5% is the assumed interest rate. We are currently paying about 3%.

Mr SIEVERS: Governments around the world and Australia run in debt. There is no doubt about it. Can you tell us about positive debt and negative debt? There is a positive to having debt.

Mr GRAHAM: Yes, there is discussion around good and bad debt. Good debt is debt that is raised to fund incoming generating infrastructure, like a business. When they invest they borrow to fund a facility, initiative or research and development which will generate a return. The same applies for government.

Mr SIEVERS: Are we heading down that path?

Mr GRAHAM: In the situation we are in at the moment we are borrowing to fund recurrent costs. The aim initially is to eliminate that operating deficit so we are just borrowing to fund infrastructure.

Mr DEPUTY CHAIR: The way I see this is that I have in my electorate over 30% of households—this is over 18 months ago—in what is classified as mortgage stress. They are barely able to make the repayments. That is frightening for all those households. It appears that we have a government that is in a similar or worse position. They are not able to make the repayments but has to borrow to make the repayments.

That is pretty frightening. The money has to be paid back whether it is good or bad. Who pays that back? The future generations.

Mr GRAHAM: Yes. That, hence being the aim to return the budget to balance. That has to be the ultimate game.

Mr DEPUTY CHAIR: I am wondering whether the young people out there realise that we are passing this off onto them. They are the ones in 10 years' time that will be members of parliament, seeking employment in the Territory and wanting to live a dream in the Territory. They are the ones who will have to carry this off if we stay on track with scenario two, which is still tough and risky given that we have not shown restraint since government knew that we had problem.

Well, challenging. Any other questions?

Mr HIGGINS: The Chief Minister keeps talking about this root and branch review. Where is that going? Where is it at and when is it going to be finished? What are we going to see out of it?

Mr GRAHAM: That program review, the root and branch review, has been underway as part of the budget development process.

Mr HIGGINS: What do we mean by it? What does it mean in real terms?

Mr GRAHAM: It is essentially a review of the government's expenditure programs with the view to identify programs that are no longer priorities of government, could be delivered in more efficient ways and where there are duplications. To make sure that the government's programs are actually delivering on their priorities.

Mr HIGGINS: So that would mean when you talk about programs, whether we do them will mean in fact reducing the public sector. If you are going to get rid of a program.

Mr GRAHAM: It may or it could be merging programs or consolidating programs across areas of government. Look at delivering them at a lower cost.

Mrs WORDEN: Being smarter.

Mr HIGGINS: Effectively, if you really want to save money you need to cut the public sector back. They are hard decisions that need to be made. Do you agree? If you are doing a root and branch review, that is the sort of thing you are looking at. You are looking at individual programs and saying that a program is no longer required. I am not suggesting that the public servants are thrown out the window, we have redeployment and all these processes in place.

Basically what you are saying is that if you have 10 staff there, you are now going to have 10 less in the future.

Mr GRAHAM: That is right.

Mr HIGGINS: Do we have any idea how many of those programs have been identified up to this point? Or recommended?

Mr GRAHAM: I cannot pre-empt any government decisions. They will be announced as part of the budget.

Mrs WORDEN: Some of that was discussed earlier and will be on the record.

Mr DEPUTY CHAIR: We are drawing to a close and while we are talking about the public service, I am wondering if treasury has a definition of what a frontline public servant is? Can you share that with us?

Mr GRAHAM: A public servant that delivers services that are directly consumed by the community.

Mr DEPUTY CHAIR: It does not quite sound like it but is there an official definition of what a frontline public servant is?

Mr GRAHAM: I do not think there is an official definition but I think it is generally understood.

Mrs WORDEN: Nurses, doctors…

Mr SIEVERS: Essential services…

Mrs WORDEN: Public housing safety officers…

Mr DEPUTY CHAIR: I suggest that there probably needs to be some thinking about that so that we do not spook people about the needs to make some structural changes without compromising delivery of essential services.

In closing, thank you Committee members for your contributions. Thank you treasury for you presence here today and for those who have attended, it is good to see the level of interest. As the Public Accounts Committee, we are independent and can provide advice to government. I think we would recognise as a Committee that this is not a political problem, this is a Territory problem and it requires all of us—the community, the treasury and all agencies, the media included—the begin to understand the size of this problem so that we can understand it and ultimately support a government that is going to make the decisions that are necessary.

That is the obvious challenge before us. Thank you for the contribution you have made today. You have provided some clarification of the definition of the nature of the problem. We will all do our bit to see how we can respond to this in a constructive way so that in 10 years' time we are in a better position than we are now.

Thank you.

The committee concluded.