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Hey presto, enjoy these state budget conjuring tricks

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State budget season has wrapped up, with the last two delivered last week. The first cab off the rank was the Victorian budget, handed down on May 5. The last two, the NSW and Queensland budgets, were delivered on June 21.

State budgets don't command the same attention as the federal budget. There are no multi-page newspaper wraparounds or interminable television programs. But these budgets do matter from an economic point of view.

The cumulative budget position of the states shows up on the macro-economic dial. In 2020-21, the total budget deficits recorded by the states amounted to 2.5 per cent of gross domestic product. A decade ago, the amount of general government debt held by state governments was trivial; it now adds significantly to the total indebtedness of the public sector.

In Victoria, government net debt is expected to reach $167.5bn or 26.5 per cent of gross state product by mid-decade. Not far behind is expected NSW government debt of $115bn in 2025-26.

State governments have many opportunities to hide debt in their government-owned corporations – think Queensland – as well as in off-budget funds. A case in point is the dubious Transport Asset Holding Entity created by the NSW government.

State budgets distinguish between recurrent and capital spending, a difference not made at the federal level. While there are some arguments in favour of the state approach, it leads to a degree of obfuscation because of the rubbery definition of what is and what is not capital spending.

(Labor politicians, in particular, are fond of calling all sorts of recurrent spending "investment", which can lead to its classification as capital spending.)

The result is the states can record ostensible budget surpluses (on their recurrent accounts) while being deeply in deficit were the federal accounting standard to apply. To be sure, capital spending generally pays dividends only after several years. But there is plenty of scope for wasteful capital spending – wrong projects, expense overruns, misclassification. It's why it's important to watch what is happening to net government debt at the state level.

These days, the budget papers released by state governments resemble the ones put out by the federal government. There seems to be a view that if a government can look professional then perhaps all that wasteful and pork-barrelling spending will be excused. No doubt it keeps lots of graduates busy in the respective state treasuries, but many of papers have as much credibility as the plot line of a superhero movie.

Take the NSW budget. Even as the economic clouds gather internationally, nationally and at the state level, it is expected that real state demand will grow by 5.5 per cent in 2022-23, with the unemployment rate at 3.75 per cent.

Conveniently, the growth assumptions have been altered – to be higher – compared with the 2021-22 half yearly review. Even so, the NSW budget is not expected to be back in surplus until 2024-25, a worse result than most of the other states.

Of course, there are differences between state and federal budget papers. Hilariously, the term budget cash balance, let alone the dreaded deficit, is studiously avoided in Victoria. According to that budget, it is the "net result from transactions". The inclusion of "government infrastructure investment" in the key summary table of fiscal aggregates should be interpreted along the lines: we know the budget is in bad shape but we are investing for the future; just look at the large number ($21.4bn in 2022-23).

From the point of view of financial stability and macro-economic management, it's not possible to ignore what the states are up to. Their self-importance has grown since the pandemic, notwithstanding the fact the federal government would be on the hook were a state to really get itself into financial hot water.

All state budgets contain the same fundamental flaw: they confuse government spending on particular programs for solutions with the problem at hand. Domestic violence is a societal blight; spend a few hundred million dollars. Poor educational outcomes; spend billions more on schools and preschools. The scourge of mental health; spend millions as well as create special mental health levies, even on companies.

The pre-election NSW budget took this to new heights, particularly with its Women's Opportunity Statement. By spending close to $5bn (and just under $2bn on childcare), the payback is an additional 13,000 women in work in NSW by 2032-33. (Female employment in NSW is 2.03 million.)

To say this is statistically insignificant is to state the obvious. This didn't stop NSW Treasurer Matt Kean waxing lyrically about using taxpayer money for this end. "It is an economic imperative that we respect, hear and empower women in the workplace because their brilliance, contribution and creativity are things that we should be backing. This is an economic opportunity we cannot ignore."

Here's another feature of state budgets: they use taxpayer money to attempt to rectify problems to which they have contributed. The clearest case of this is in affordable housing where supply restrictions at the state (and local government) level are the main driver of rapidly rising house prices. But instead of fixing the supply side of the market, state governments implement schemes designed to assist first-home buyers, in particular. By driving up demand, they contribute to the problem they are seeking to address.

Another example is the juxtaposition of states negotiating bad deals with road toll companies, then using taxpayer funds to subsidise some toll road users.

A final important point is the reliance of budgets in some states on coal and other commodities; high prices and booming exports have improved the bottom lines markedly. This is in the face of these same state governments introducing policies that are hostile to these activities while also heavily subsidising renewable energy. Western Australia, Queensland and NSW have all had higher than expected revenue because of high commodity prices.

With elections pending in the two most populous states, it will be interesting to see whether the "buying votes" approach to governing works. It certainly has become the standard modus operandi of state governments in recent times, with little thought given to any budget constraints. Voters may turn out to be smarter than we think, particularly if oppositions get their acts together.

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