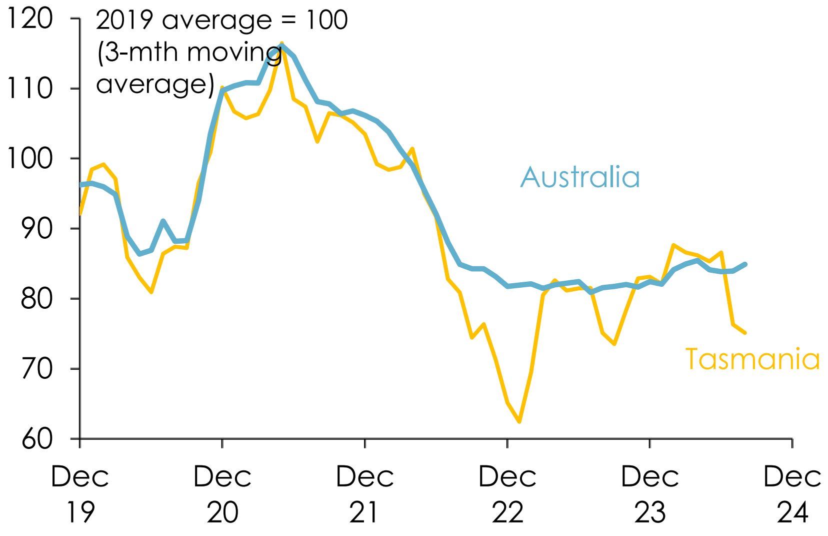
TASMANIA’S STATE FINANCES

REPORT OF THE INDEPENDENT REVIEW OF TASMANIA’S STATE FINANCES

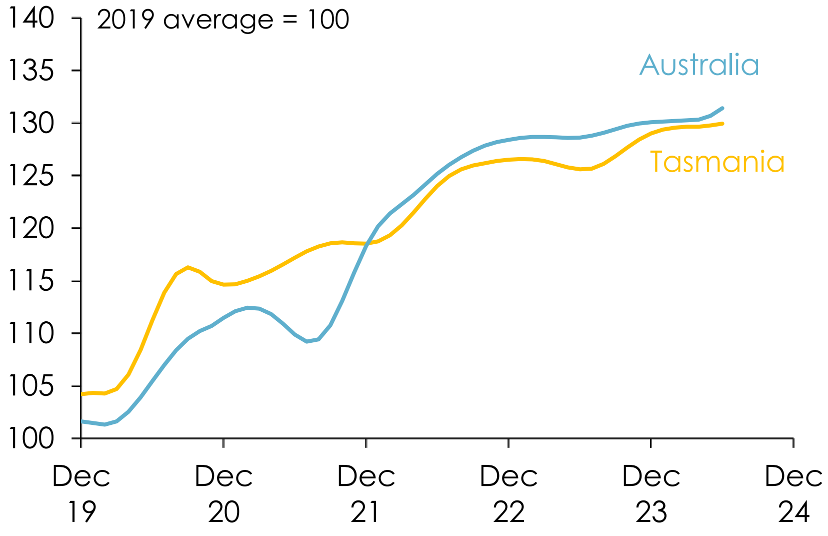
AUGUST 2024

On a wide range of metrics, Tasmania is no longer ‘leading the nation’

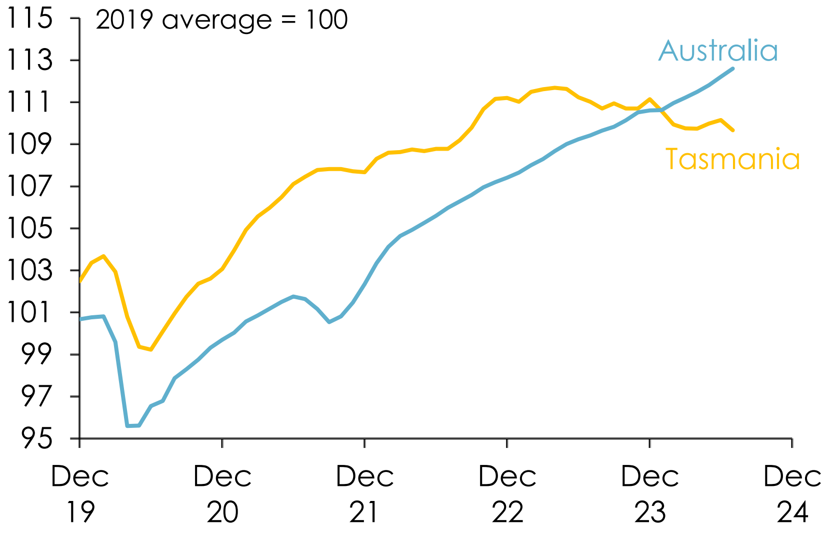
Consumer confidence



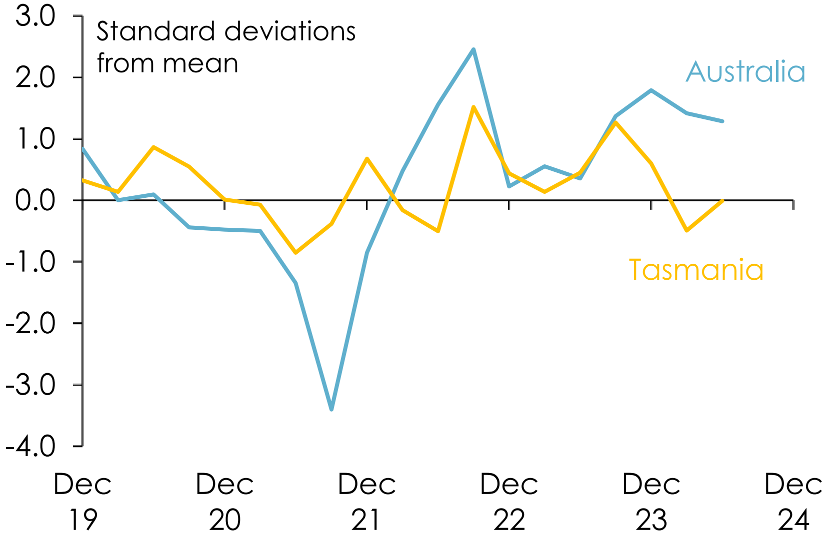
Retail sales



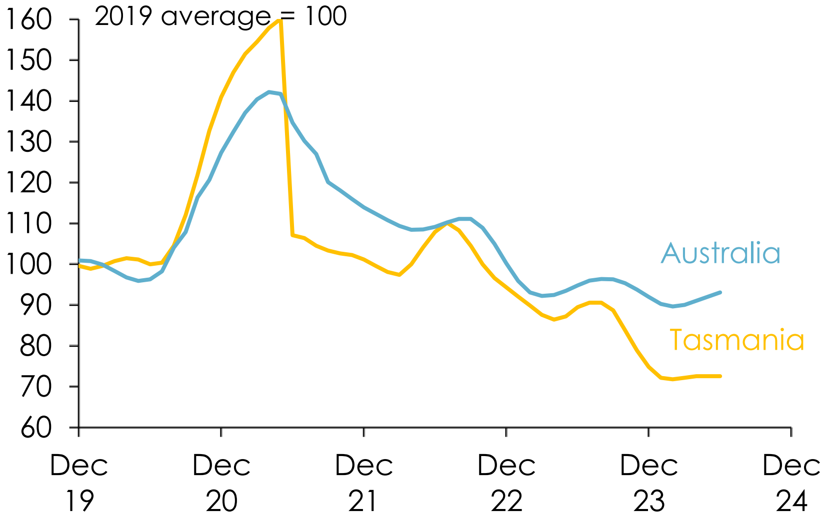
Employment



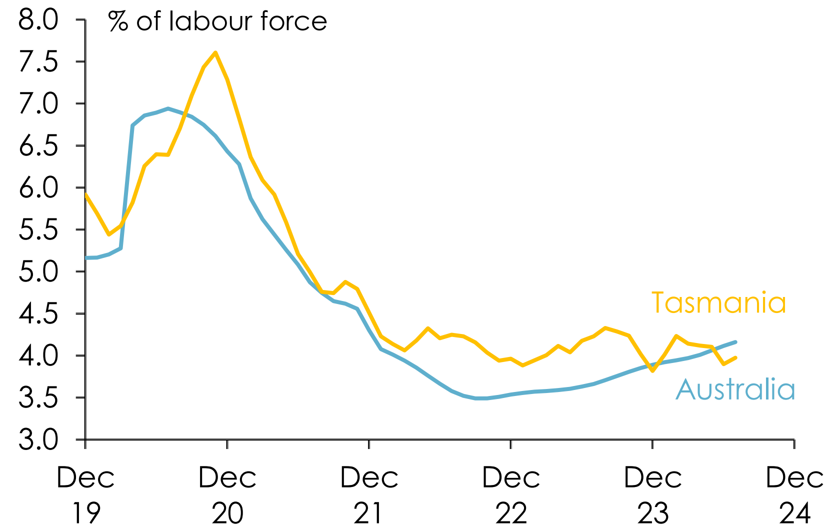
Business confidence



Residential building approvals



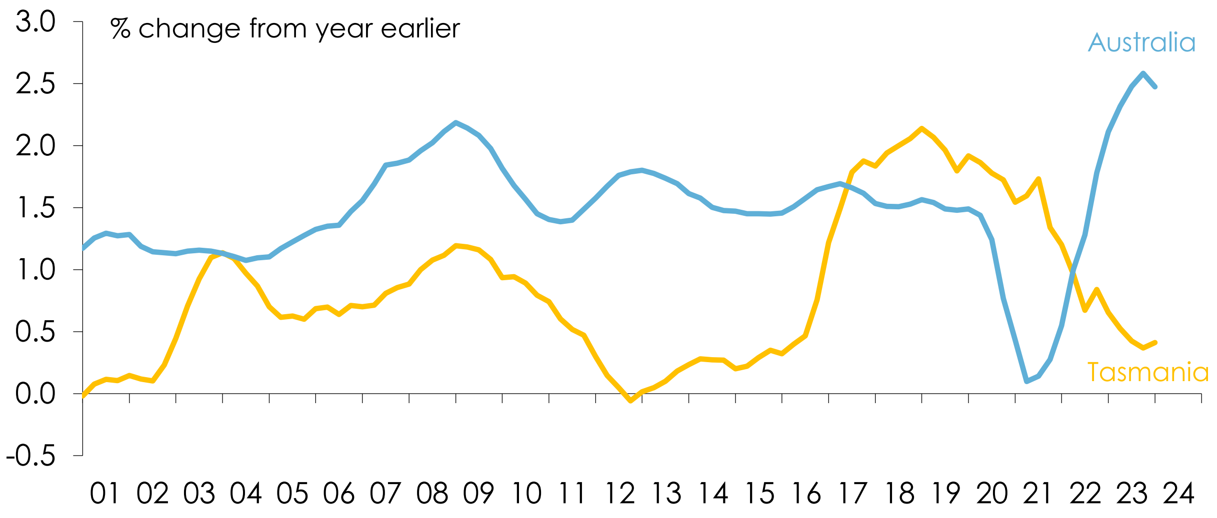
Unemployment



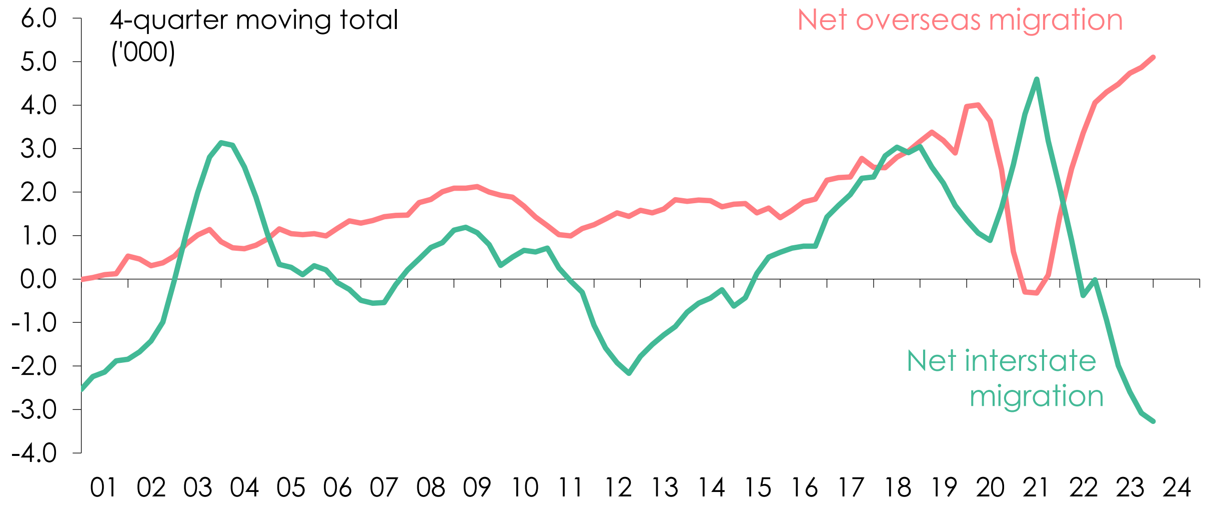
Note: all data except for consumer and business confidence are derived from trend estimates. *Sources:* National Australia Bank, *Quarterly Business Survey*, June quarter 2024; Westpac-Melbourne Institute, *Westpac-MI Consumer Sentiment*, August 2024; ABS, *Retail trade*, June 2024; *Building Approvals*, June 2024; and *Labour Force*, July 2024;

A major difference between Tasmania and the rest of Australia over the past two years has been population growth

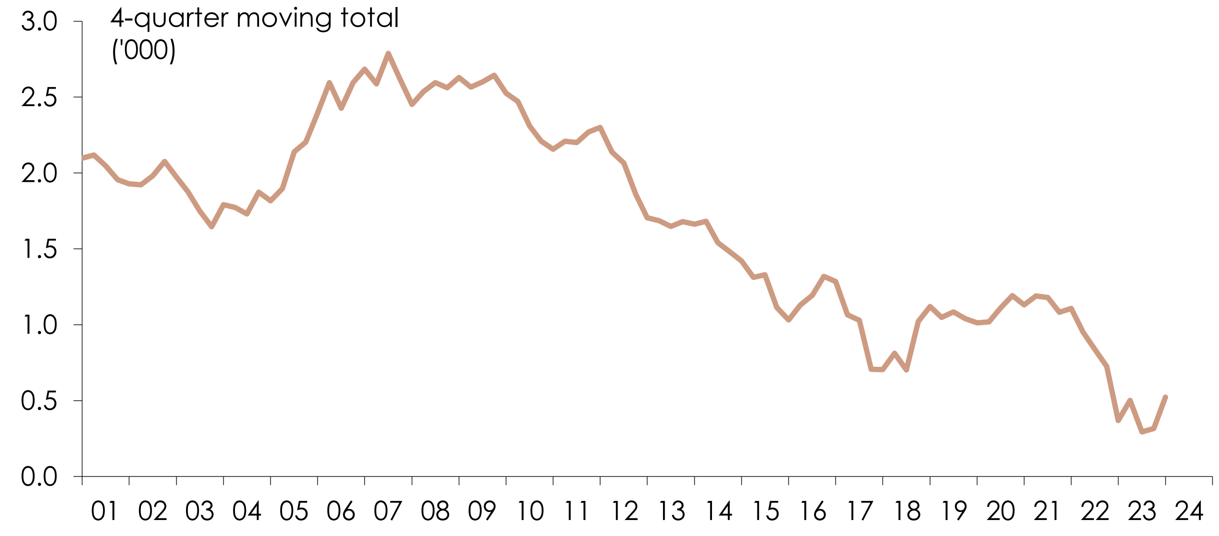
Population growth



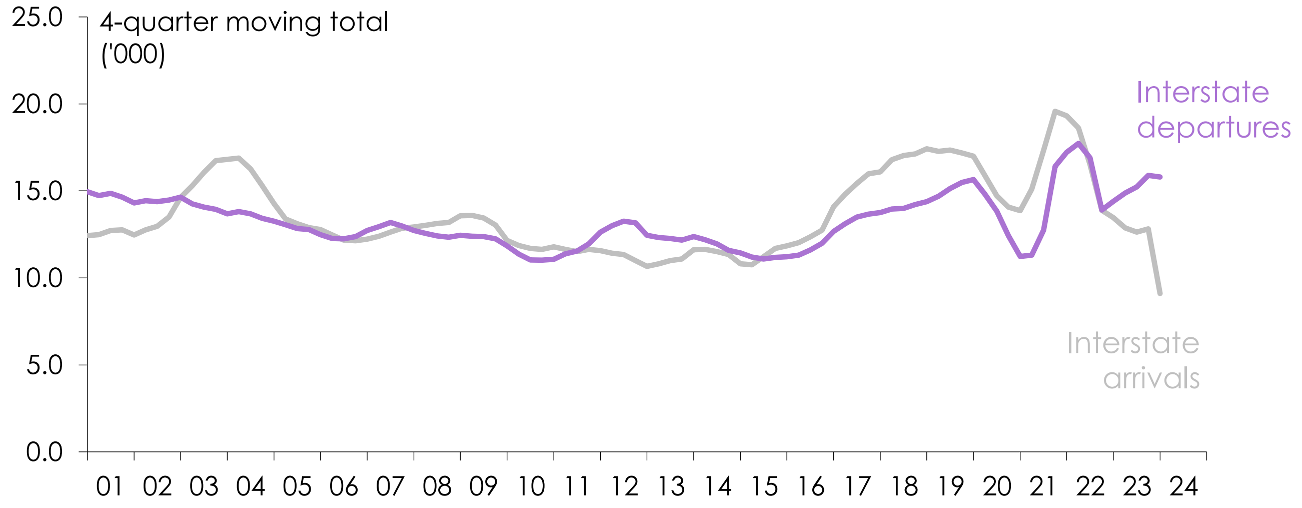
Net migration to Tasmania



Natural increase (births minus deaths)



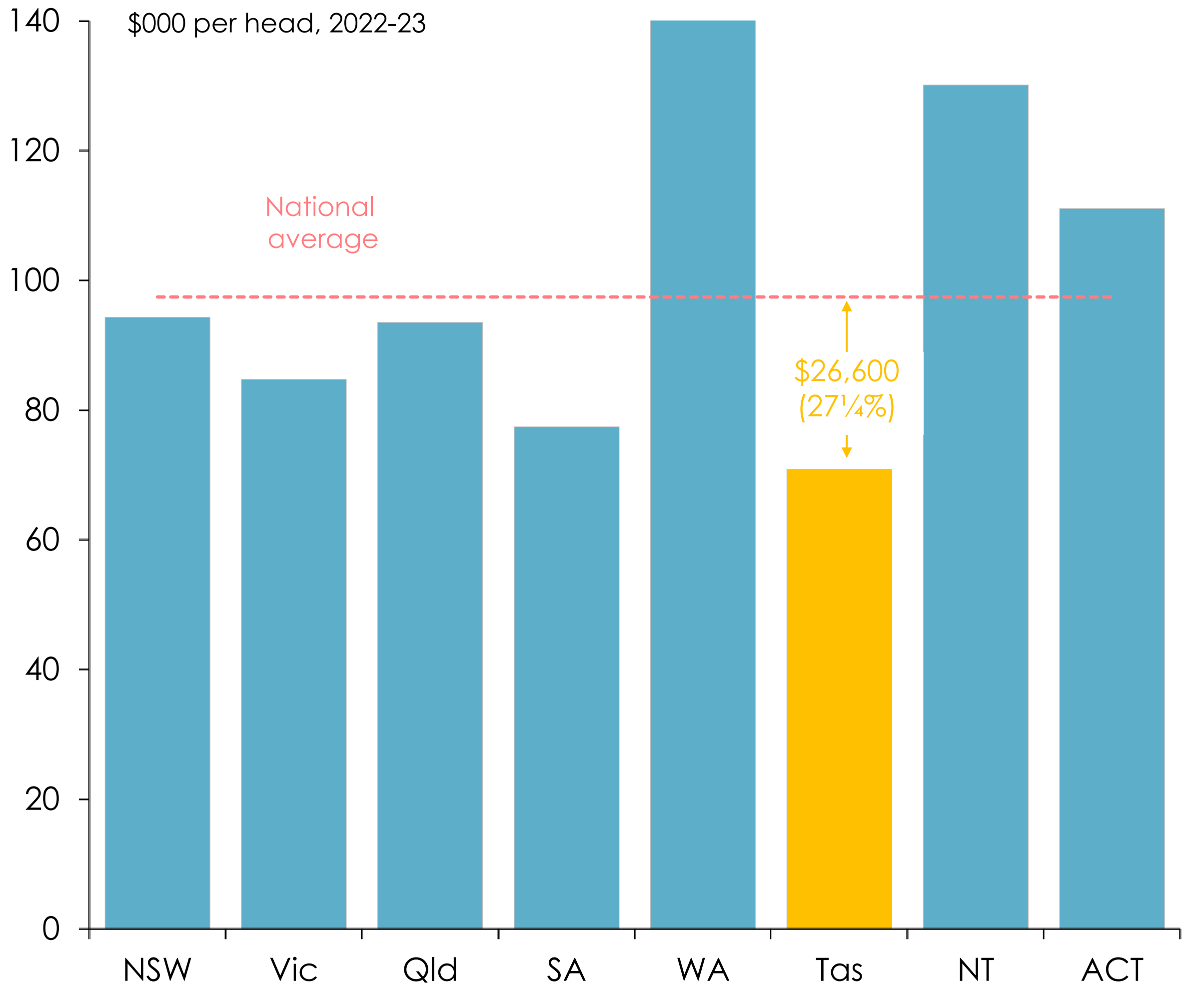
Interstate arrivals and departures



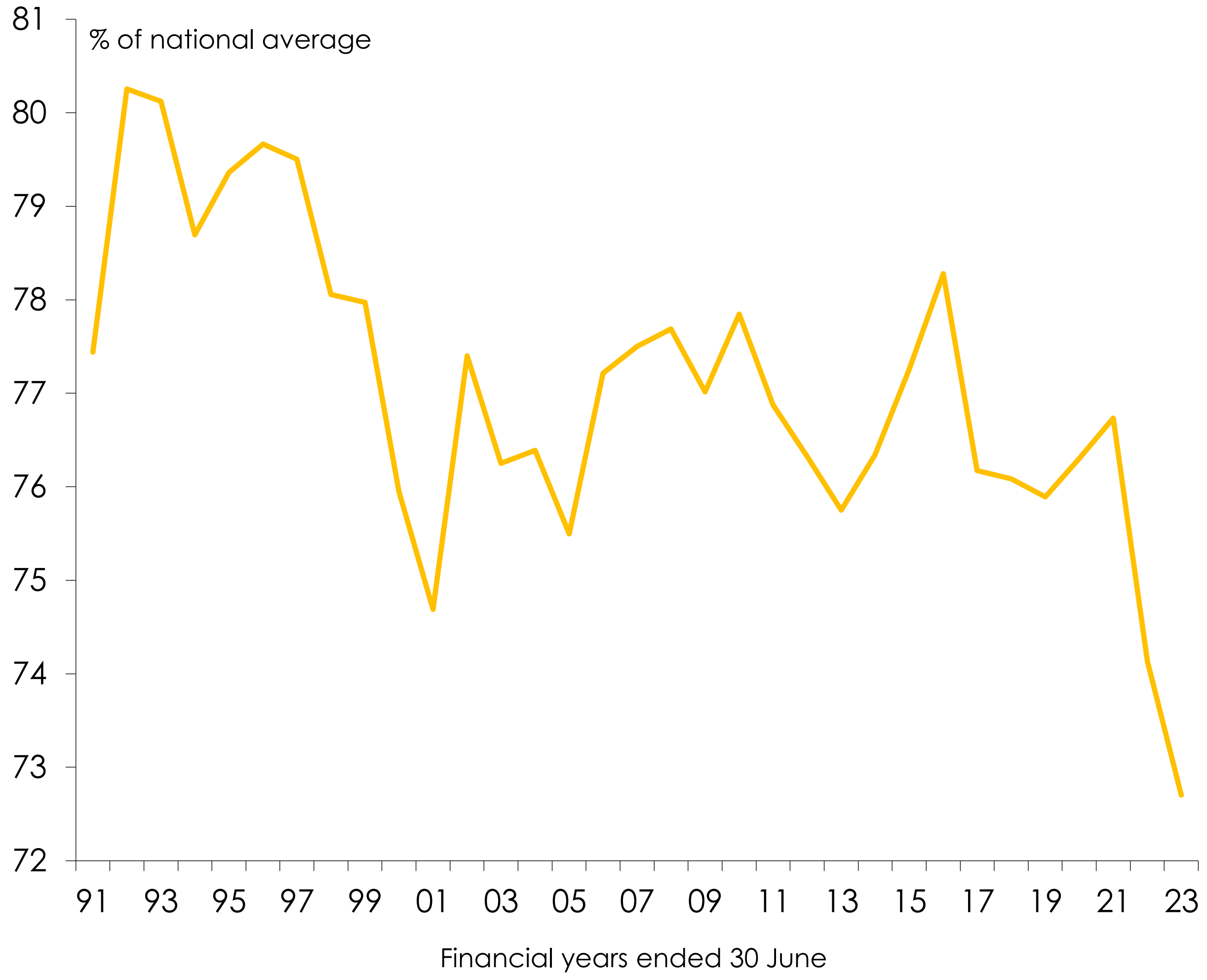
Sources: ABS, *National, state and territory population*, December 2023.

Tasmania remains Australia's poorest state, measured by per capita gross product – and in 2022-23 by the biggest margin in 32 years

Gross state product per head of population, states and territories, 2022-23



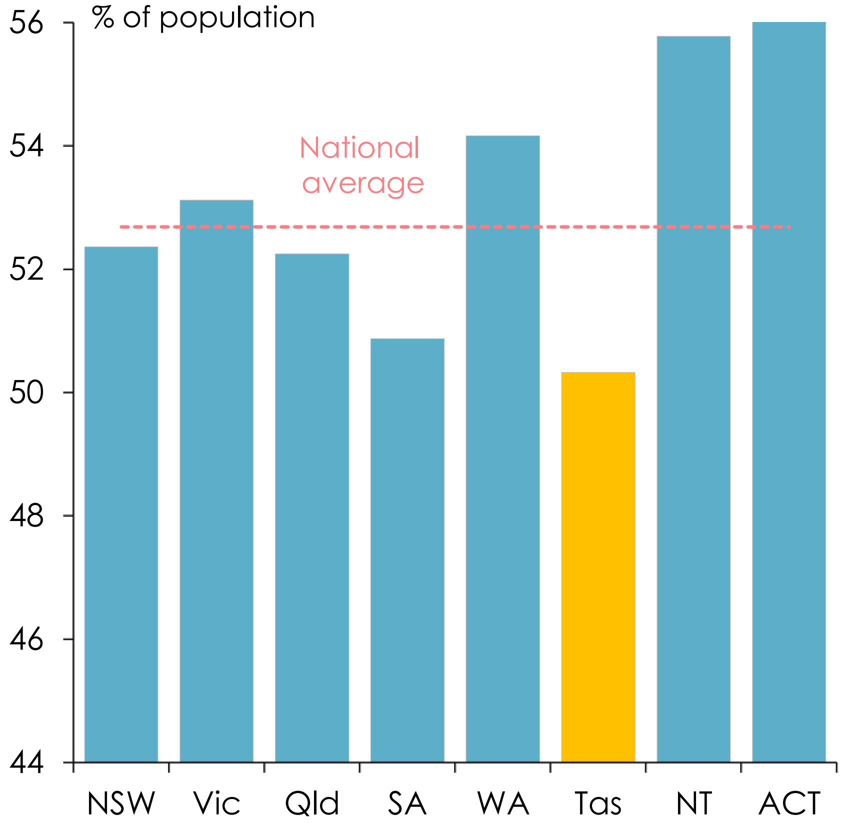
Tasmania's per capita gross state product as a proportion of the national average



Source: ABS, *Australian National Accounts: State Accounts*, 2022-23.

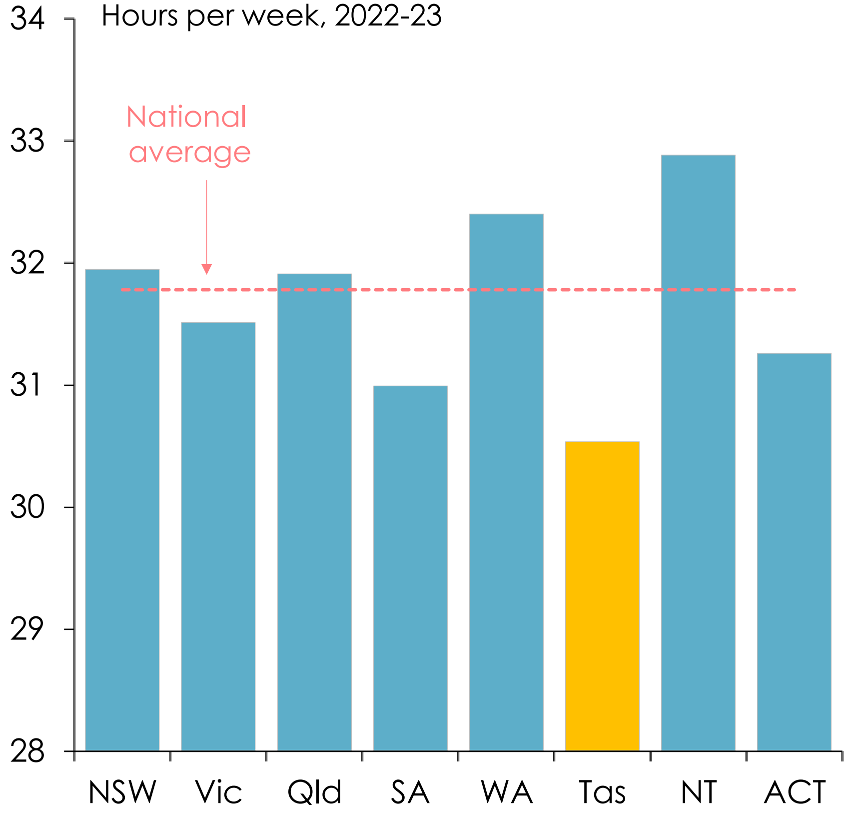
We're the poorest state in the nation because fewer of us have jobs, we work fewer hours, and for each hour that we work we produce less

People with jobs as a proportion of the population, 2022-23



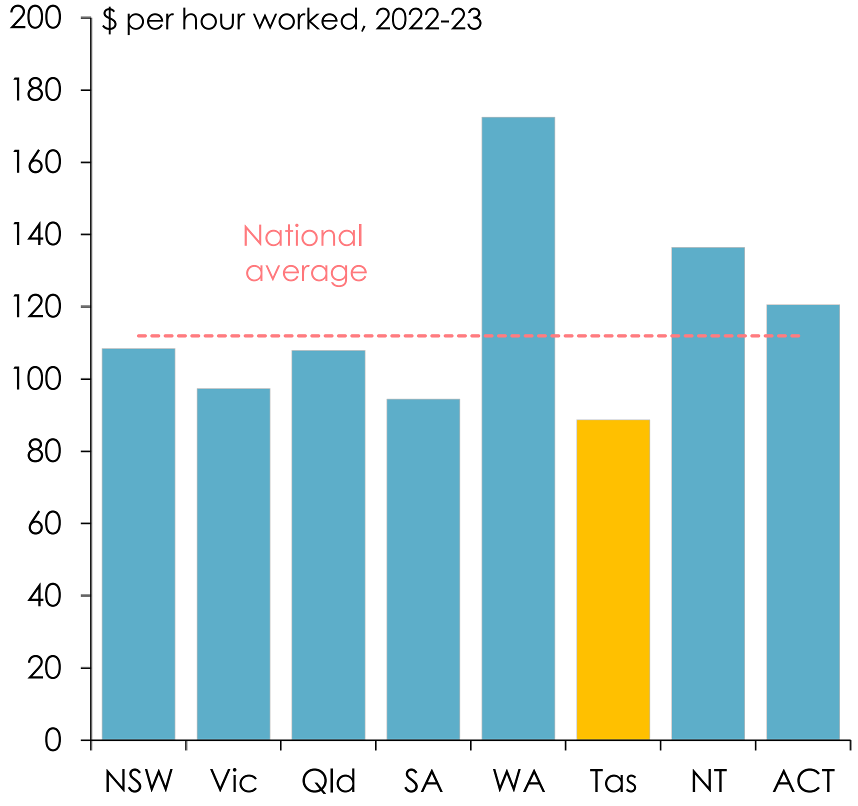
Only 50.3% of Tasmanians work – 2.4 pc pts less than the corresponding proportion of mainlanders

Average hours worked by people with jobs, 2022-23



Tasmanians work 1¼ fewer hours per week than mainlanders – equivalent to an additional 7 days off a year

Output per hour worked by people with jobs, 2022-23

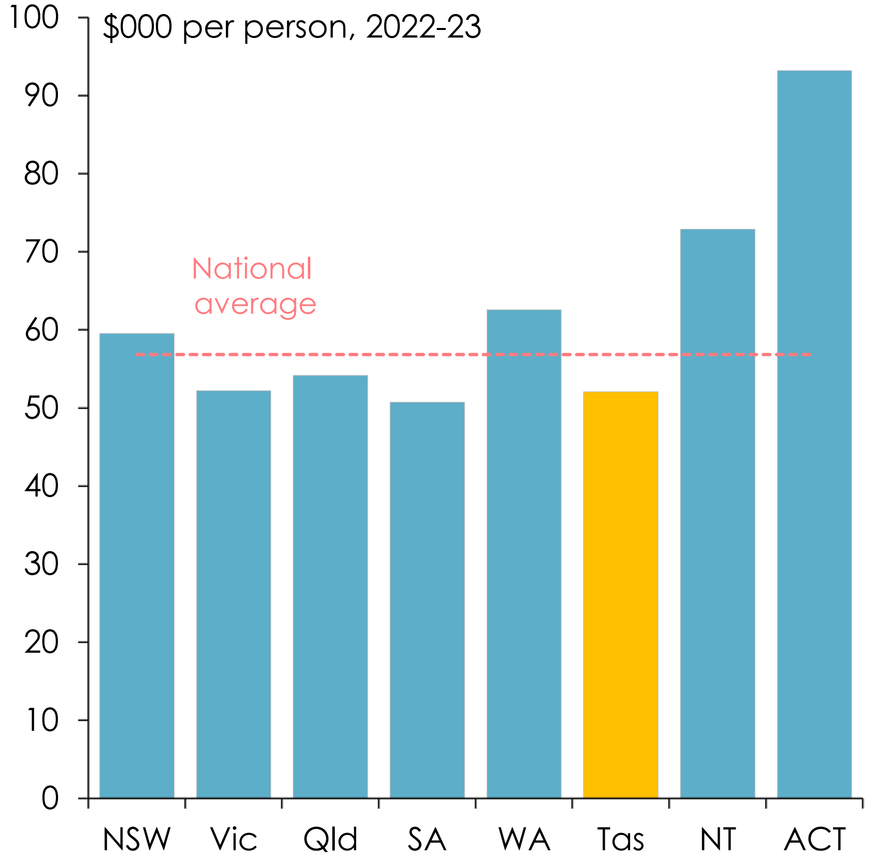


Tasmanian labour productivity is $21.60 (20¾%) less than the mainland average

Sources: ABS, Australian National Accounts: State Accounts, 2022-23; Labour Force, Australia, July 2024.

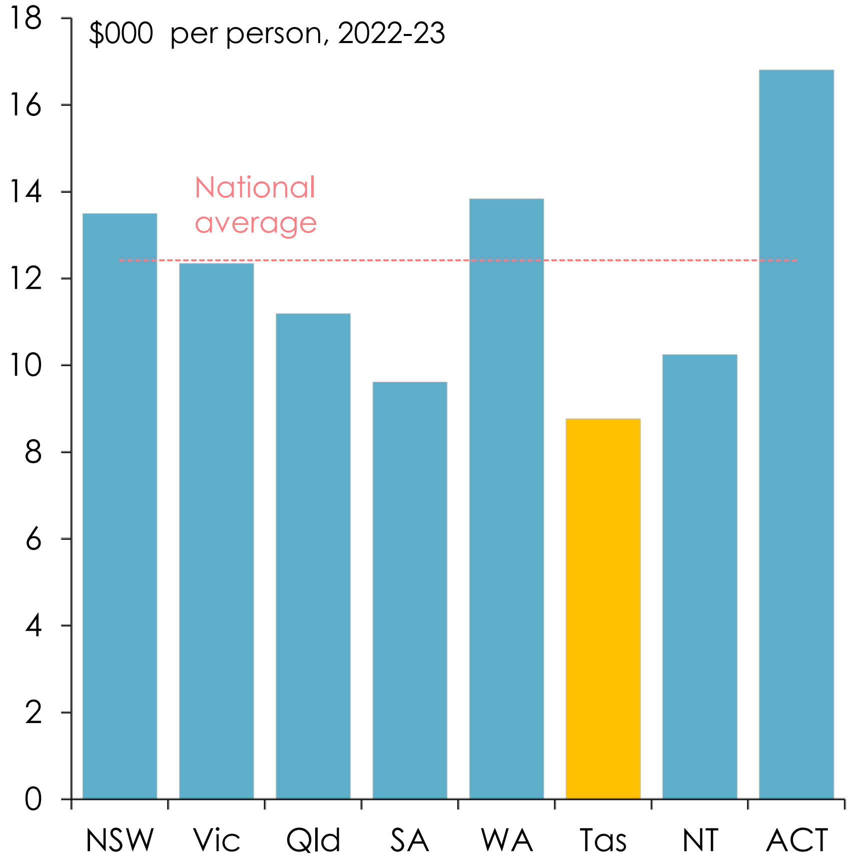
The national tax and social security systems shield Tasmanian household incomes from the effects of Tasmania's poor economic performance

Household disposable income per head, 2022-23



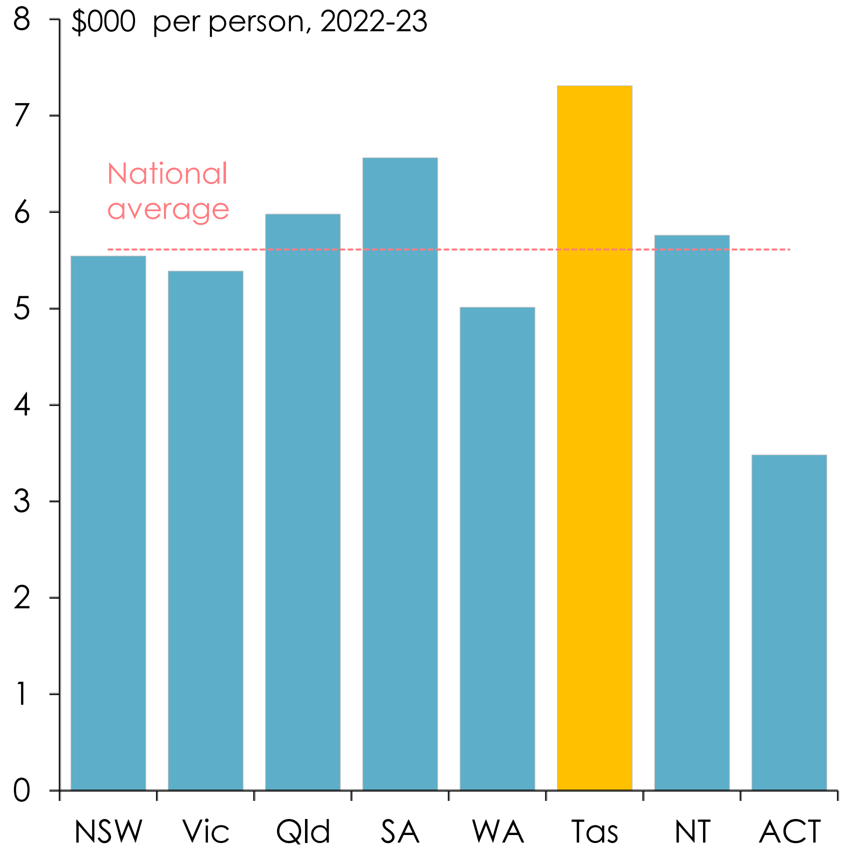
Tasmanian per capita household disposable income is 'only' 8½% below the national average (cf. per capita GSP 27¼% below average)

Personal income tax payments per head, 2022-23



Tasmanians pay $3,654 per head (21½%) less in personal income tax than the national average

Social security benefit payments per head, 2022-23

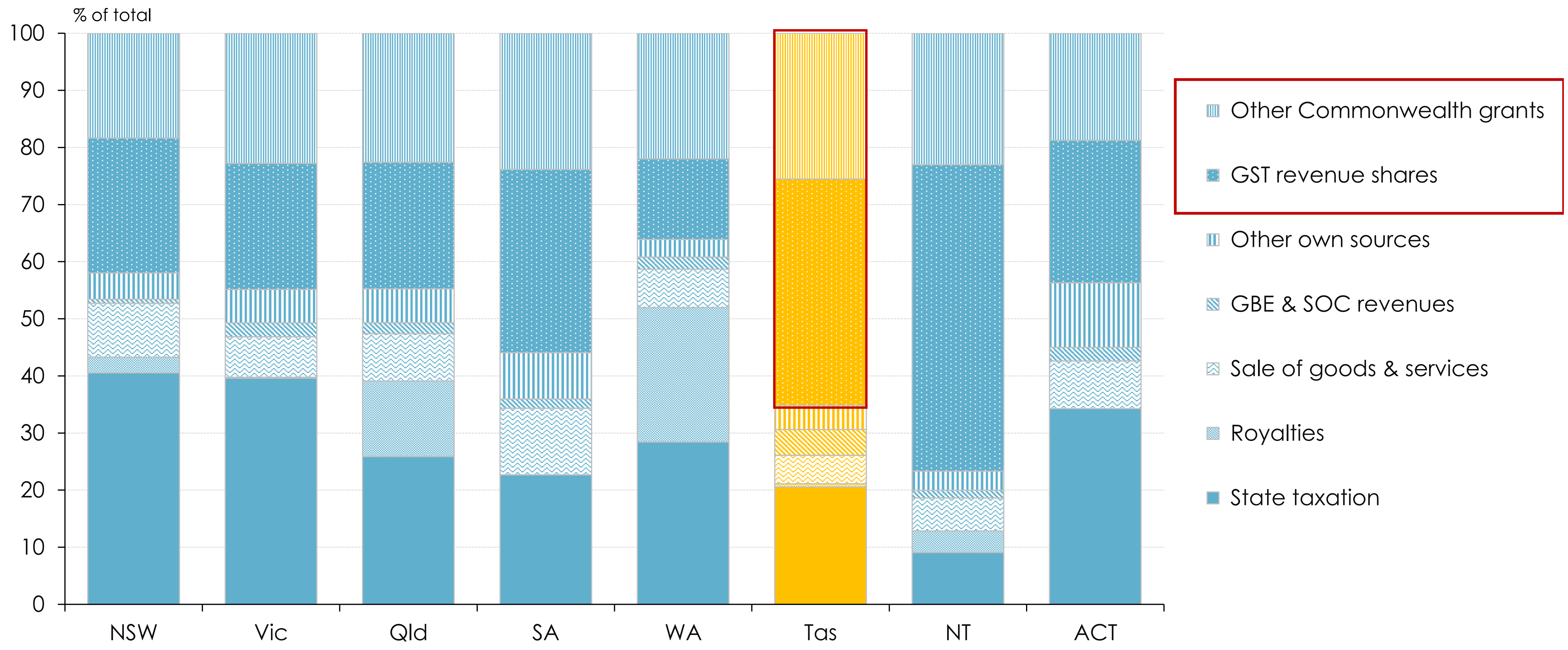


Tasmanians receive $1,318 per head (20¾%) more in benefits than the national average

Sources: ABS, *Australian National Accounts: State Accounts*, 2022-23.

And the distribution of GST revenue shields the Tasmanian Government from some of the consequences of our poor economic performance

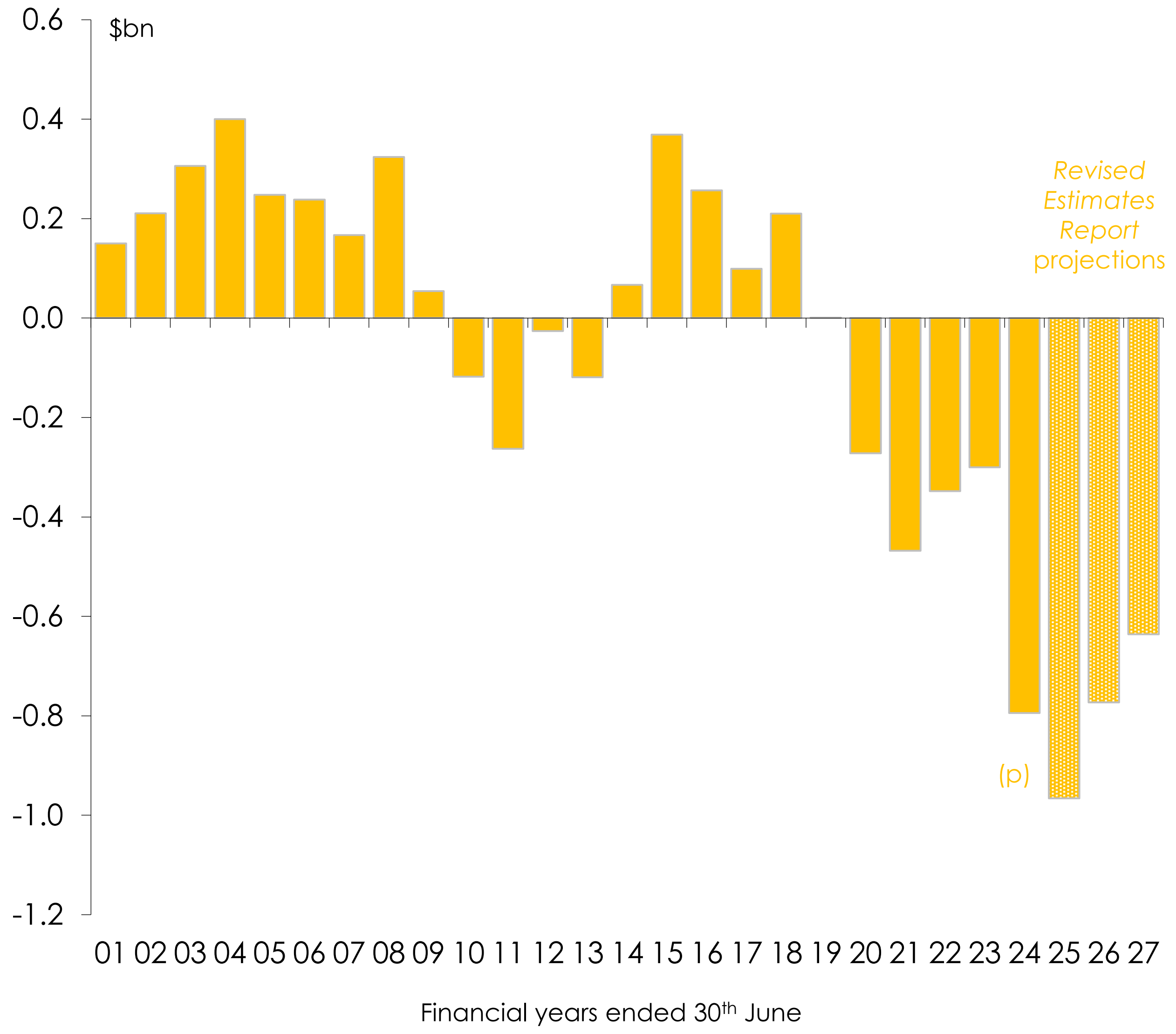
'General government' revenue by source, States and Territories, 2023-24



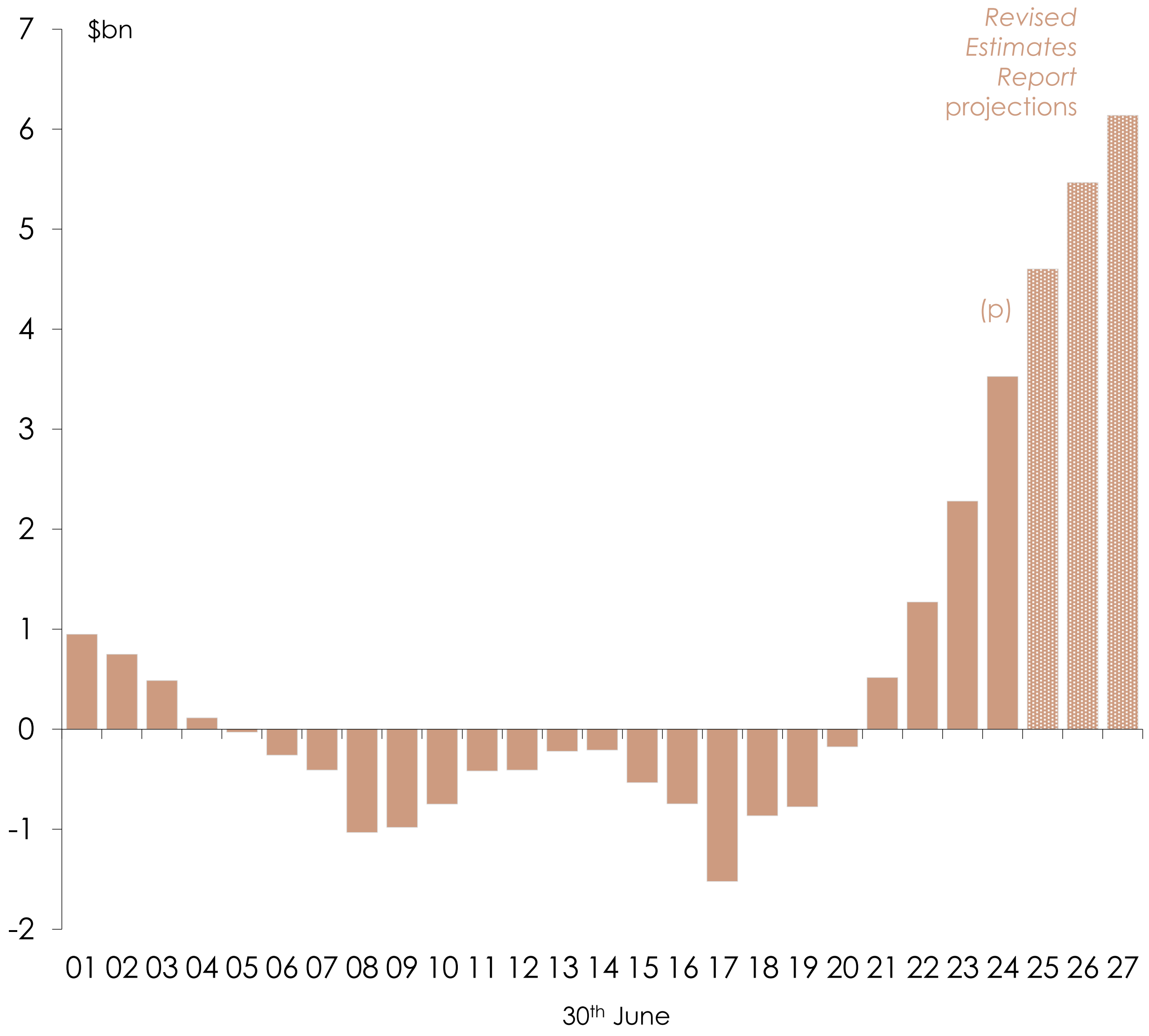
Sources: State and Territory Government Budget Papers. Note that the Western Australian Government gave most of its public sector non-financial corporations a 'dividend holiday' for the 2023-24 financial year.

Tasmania's 'general government' finances have deteriorated sharply over the past six years, and will do so further over the next three years

'General government' sector cash balance



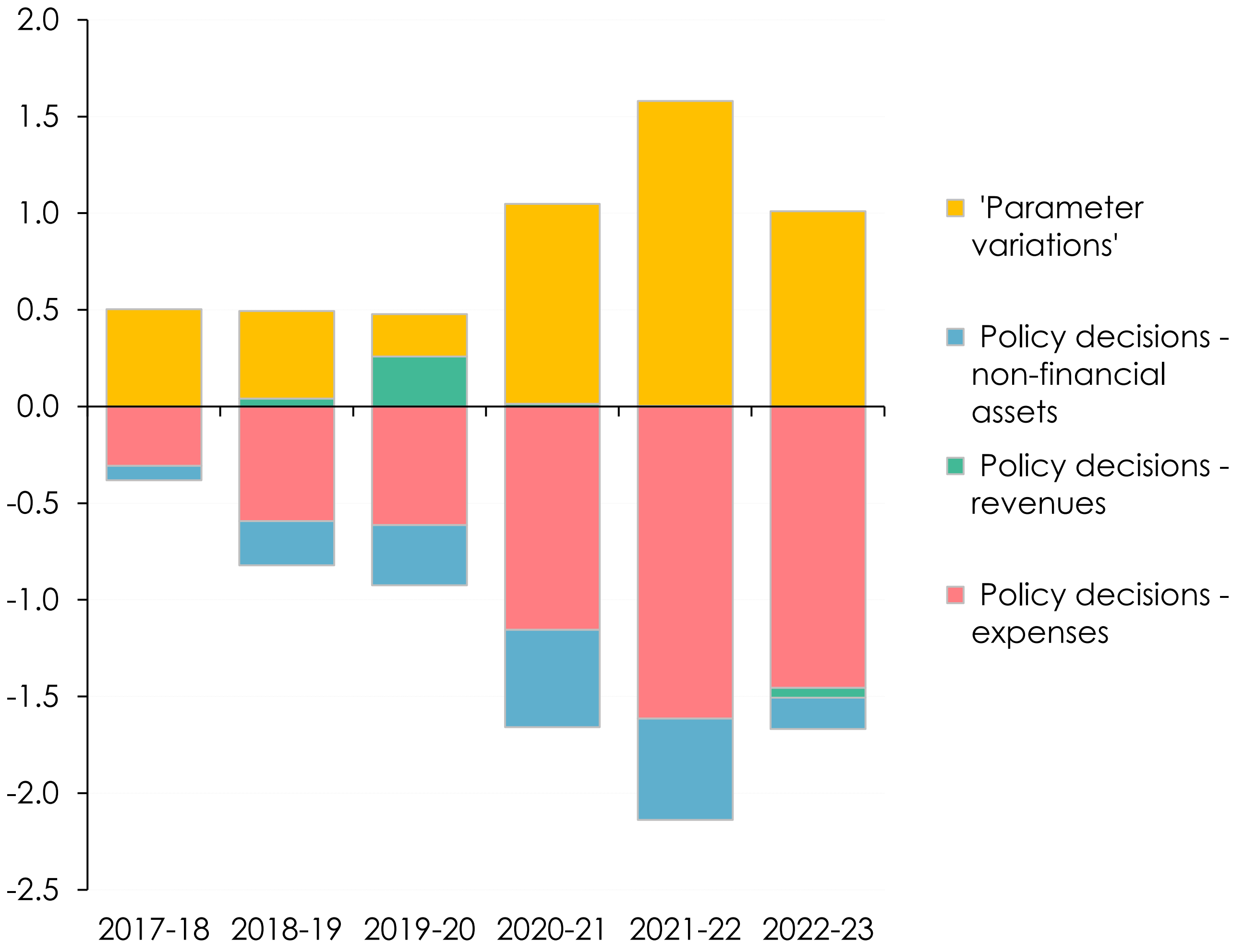
'General government' sector net debt



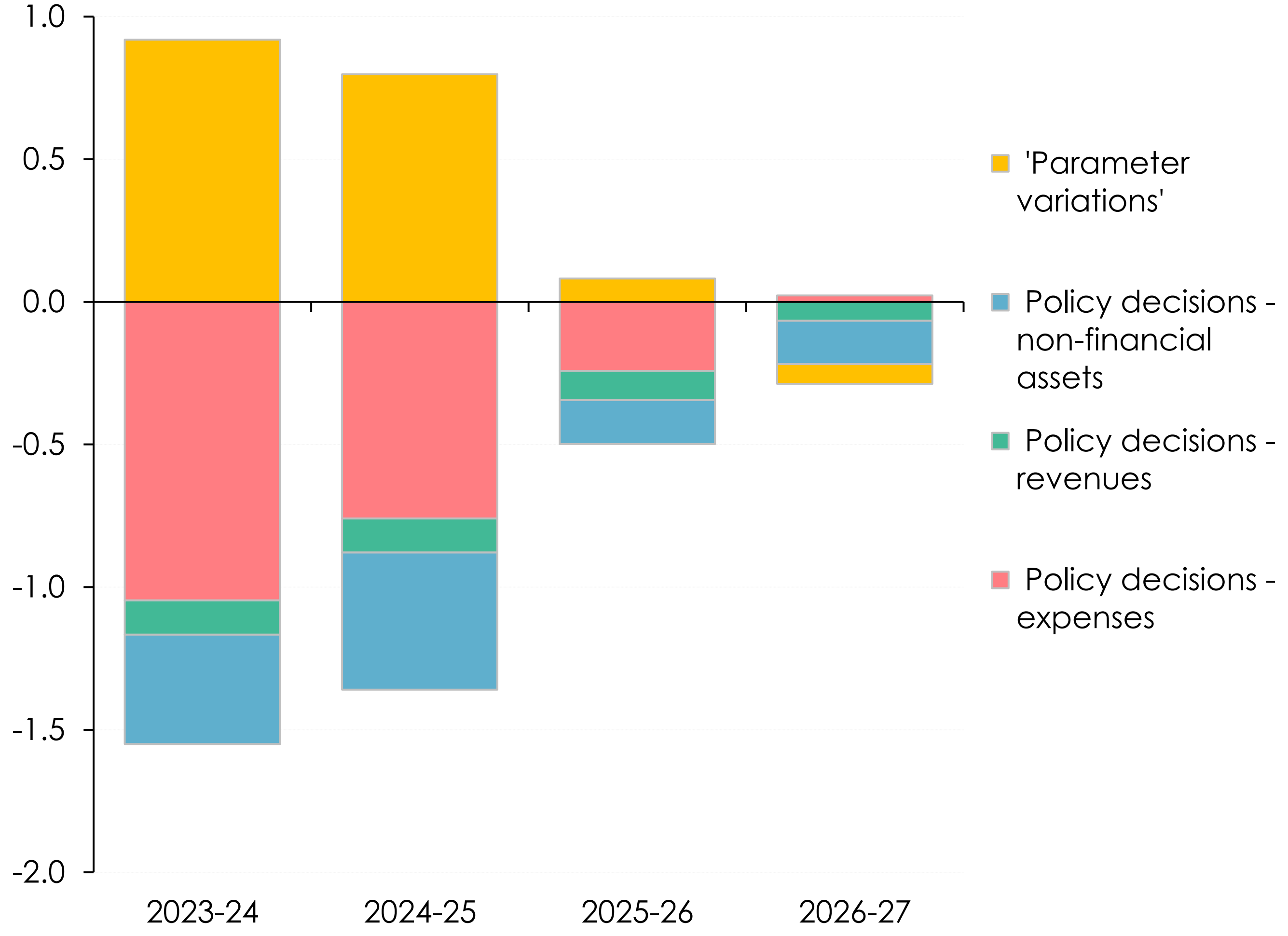
(p) Preliminary. *Sources:* Tasmanian Treasury, *Treasurer's Annual Financial Report 2022-23* and previous issues; *2023-24 Revised Estimates Report* and *Preliminary Outcomes Report 2023-24*.

The deterioration in Tasmania's public sector finances is <u>entirely</u> the result of conscious decisions to increase spending and cut taxes

Sources of changes in the fiscal balance from initial estimates, 2017-18 to 2022-23



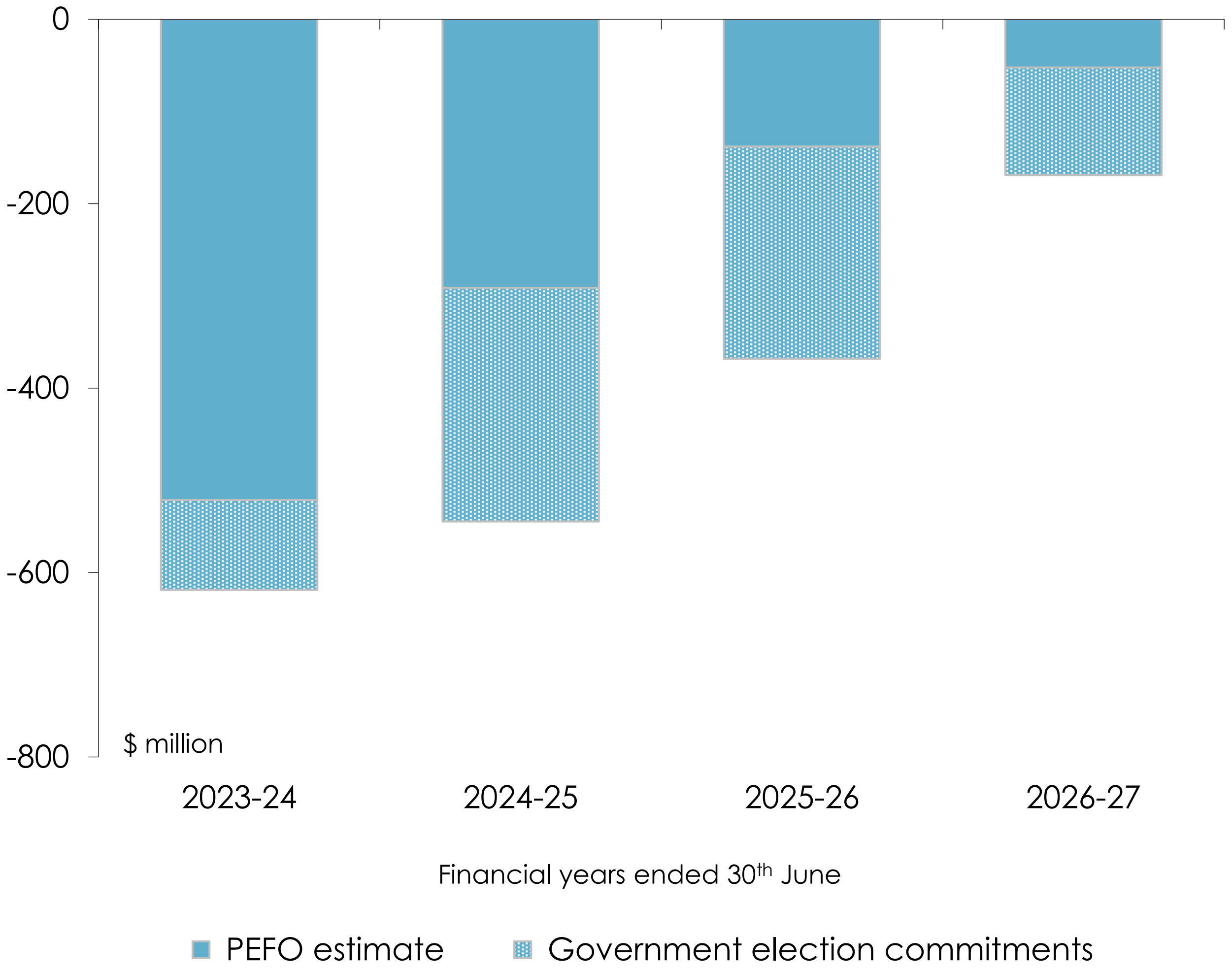
Sources of changes in forward estimates of the fiscal balance from initial estimates, 2023-24 to 2026-27



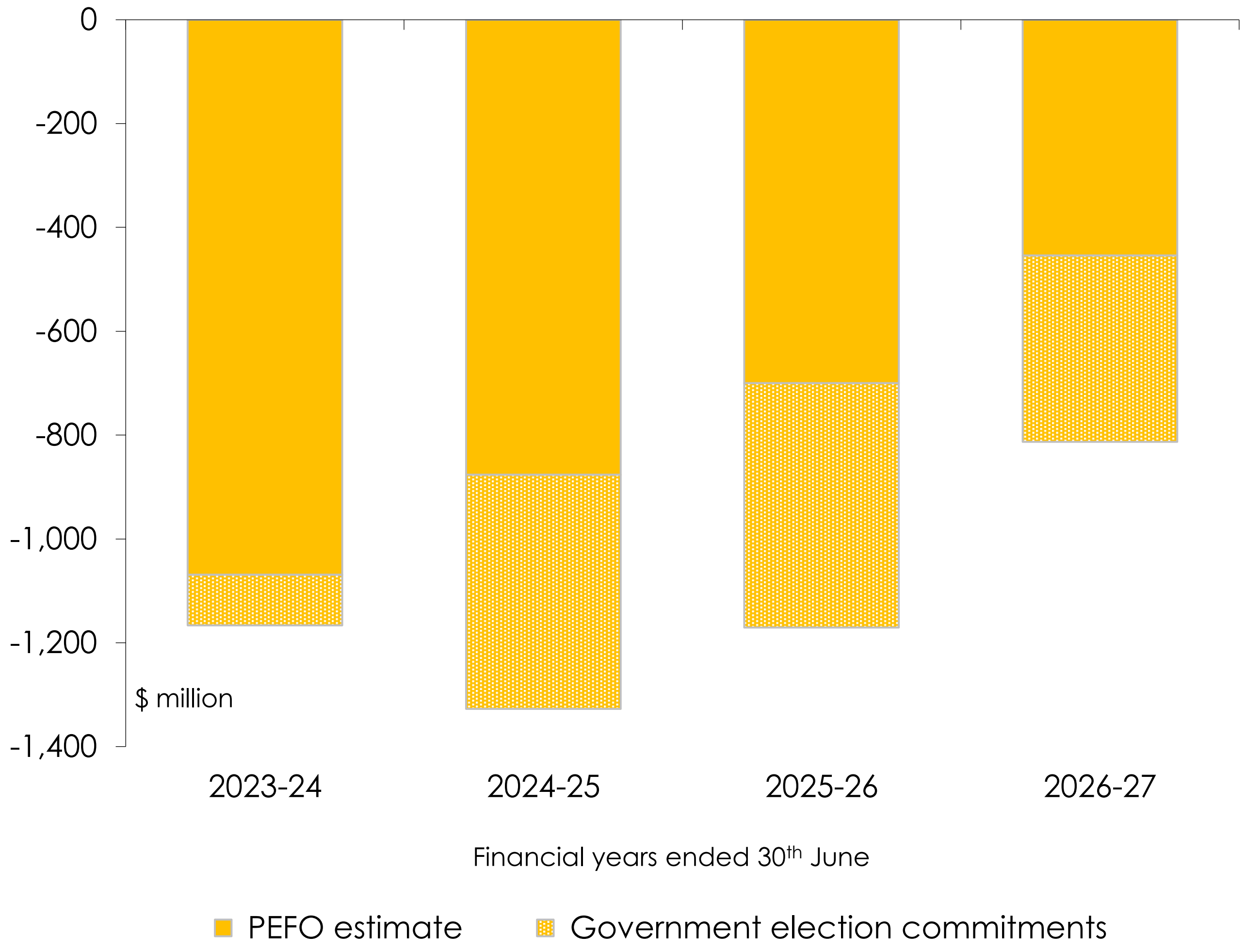
Note: 'Parameter variations' are changes in economic and other assumptions used in constructing forward estimates of expenses and revenues (including changes in GST revenues and other Commonwealth grants). 'Policy decisions' are conscious government decisions to increase or reduce operating expenses, 'purchases of non-financial assets' (ie, capital expenditures) and revenues. *Source:* Independent Review of Tasmania's State Finances, August 2024.

Unfunded election commitments have been a significant contributor to the deterioration in Tasmania's fiscal position since 2018

Impact of Government 2024 election commitments on the 'general government' net operating balance



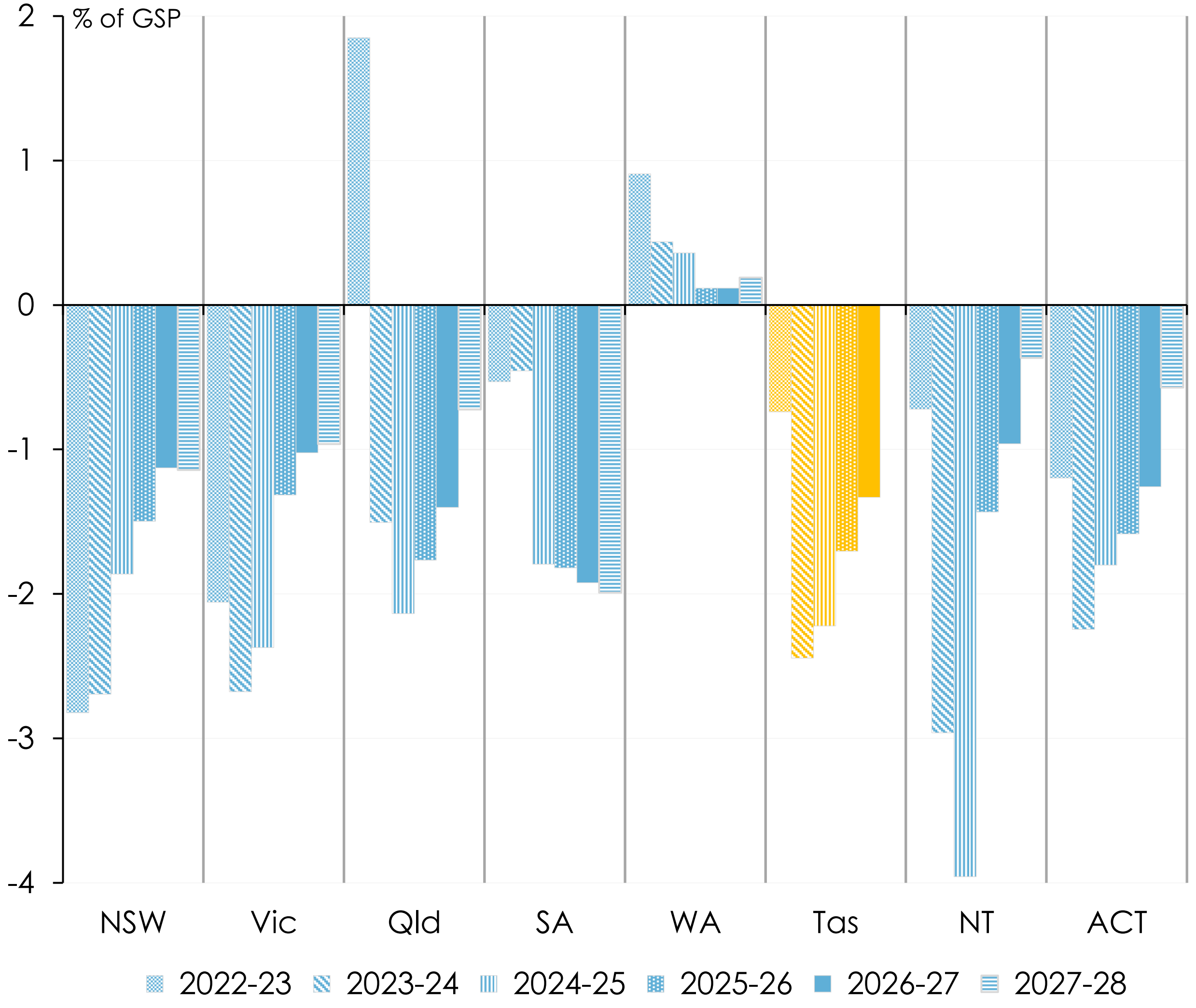
Impact of Government 2024 election commitments on the 'general government' fiscal balance



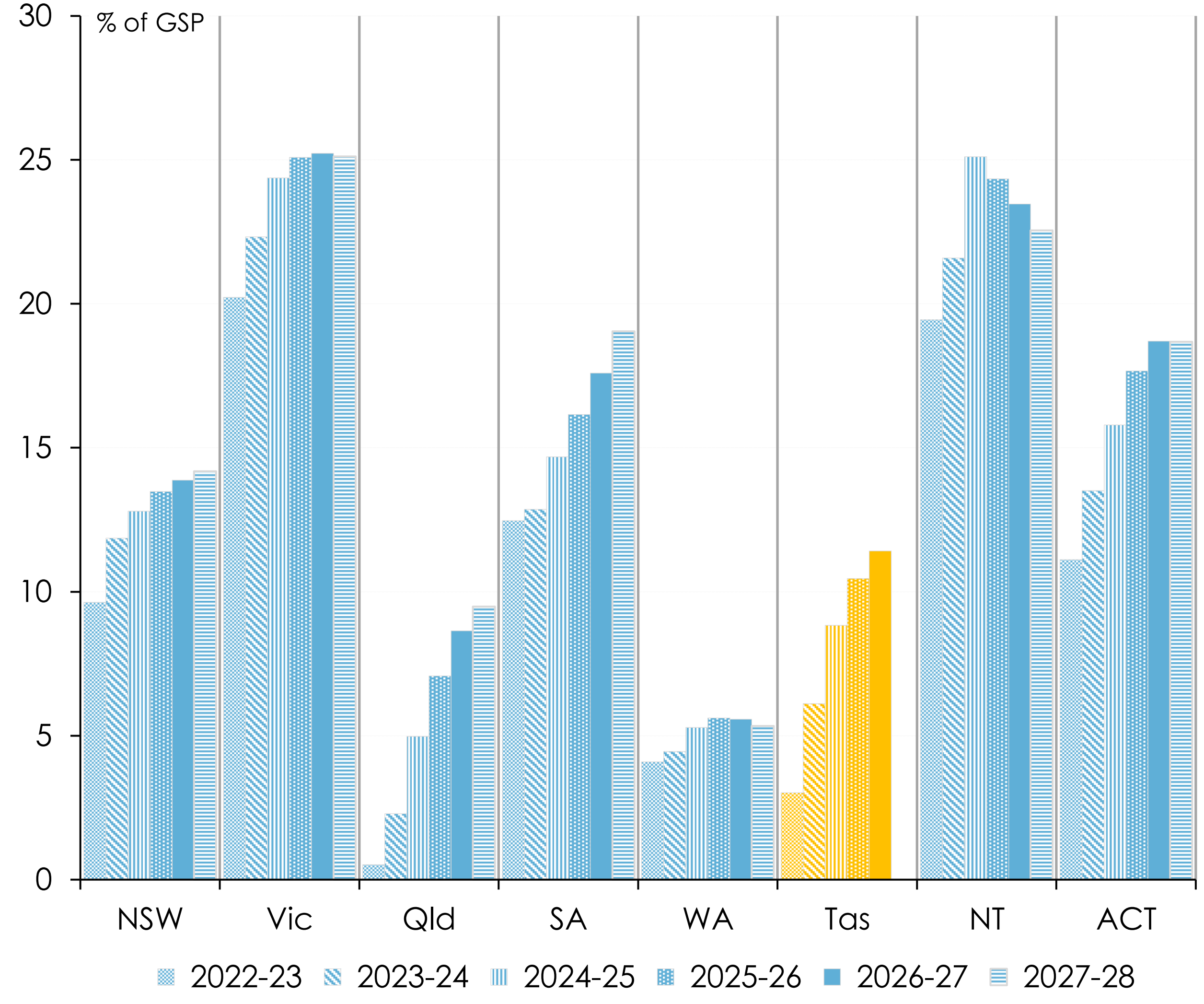
Sources: Tasmanian Treasury, *Pre-Election Financial Outlook Report - February 2024*; Hon. Michael Ferguson MP, Treasurer, *Liberals Election Costings Confirm 2030 Strong Plan Can Be Delivered Without Increasing Taxes*, March 2024.

Tasmania's general government sector cash balance and net debt positions aren't the worst in Australia, but they're no longer the best, either

'General government' cash balances, Tasmania and other states and territories, 2022-23 to 2027-28



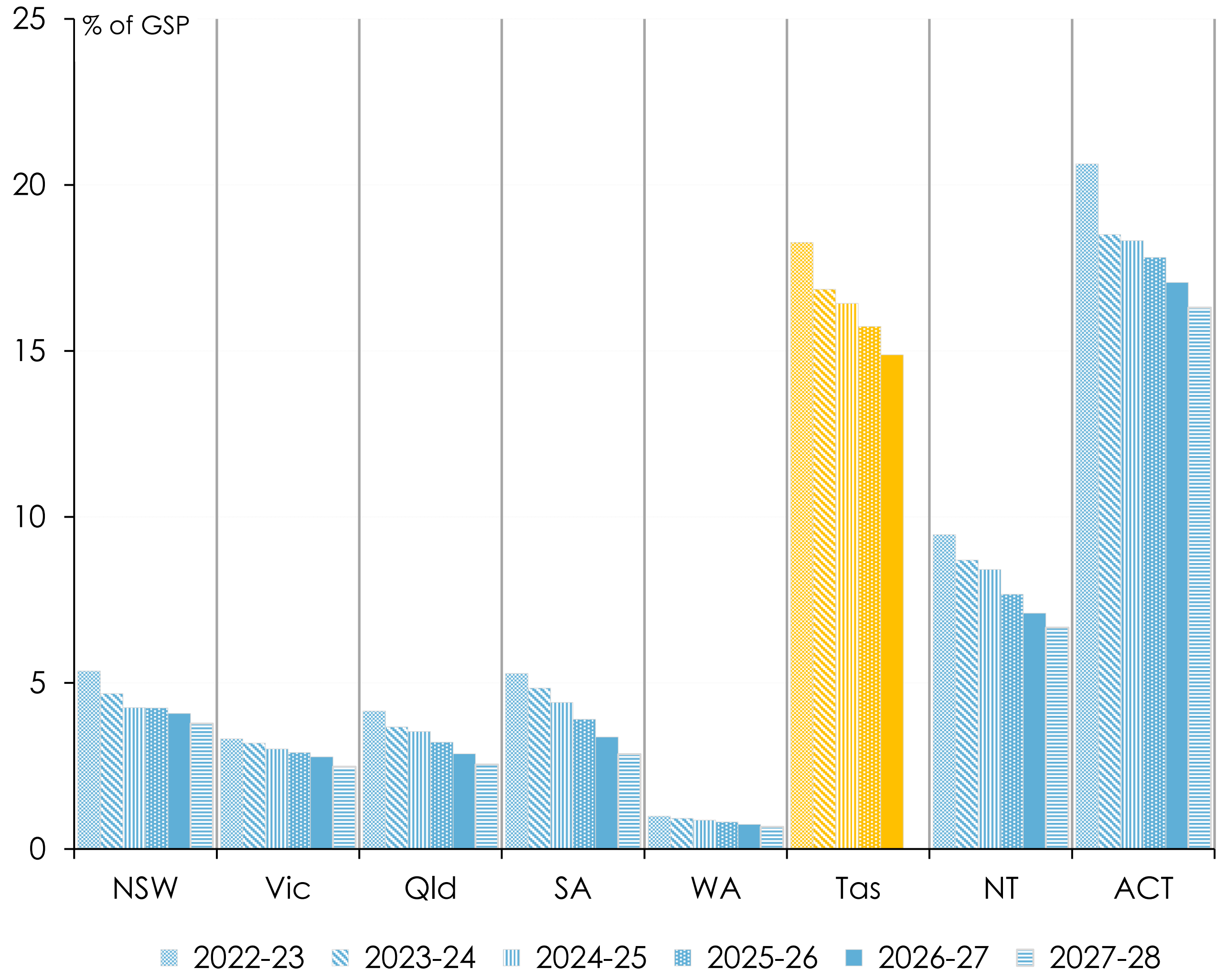
'General government' net debt, Tasmania and other states and territories, 2022-23 to 2027-28



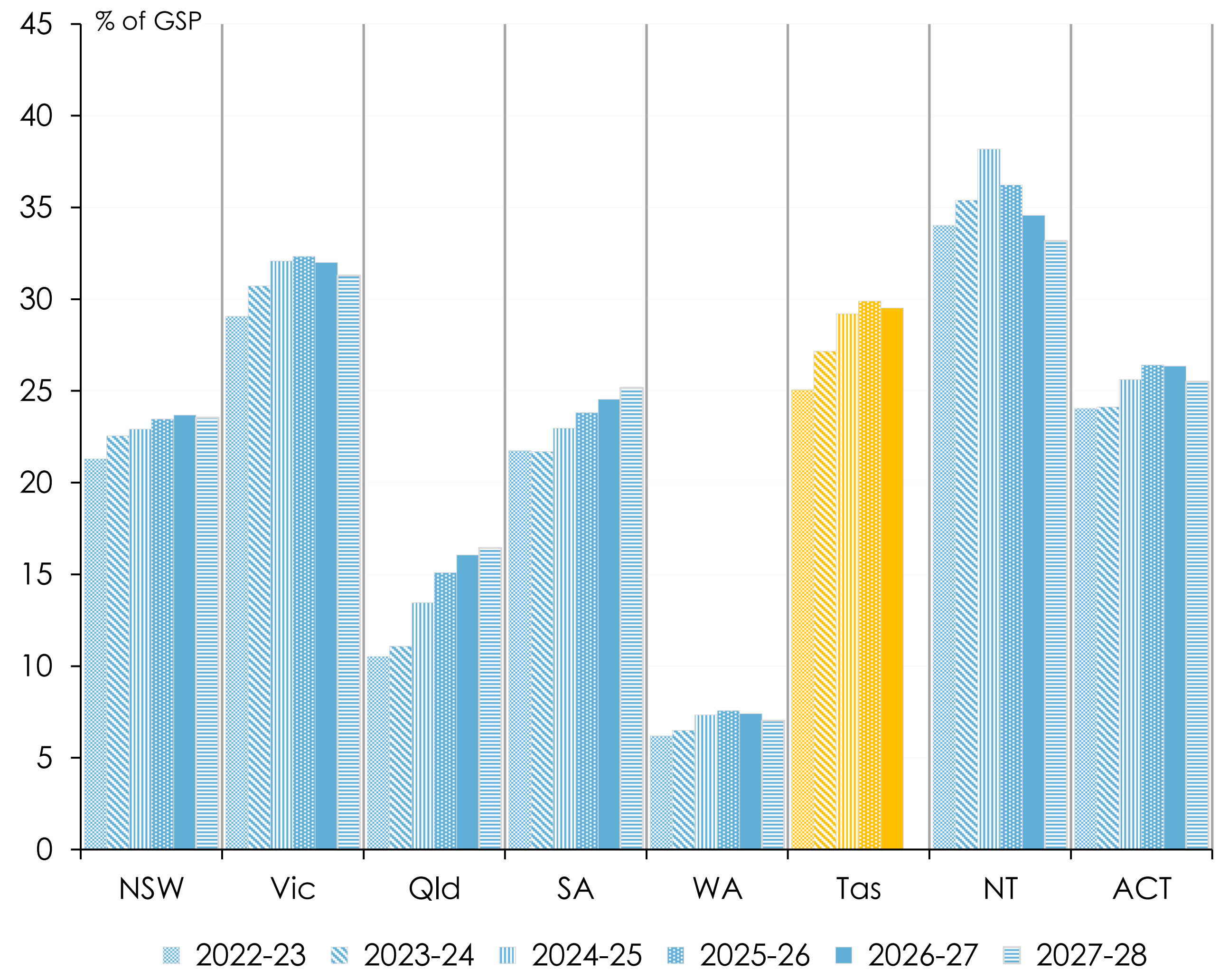
Sources: Tasmanian Treasury, *2023-24 Revised Estimates Report*; other state and territory 2024-25 Budget Papers.

Including Tasmania's outsized unfunded superannuation liability, 'general government' net financial liabilities are exceeded only by Victoria & the NT

'General government' unfunded superannuation liabilities, 2022-23 to 2027-28



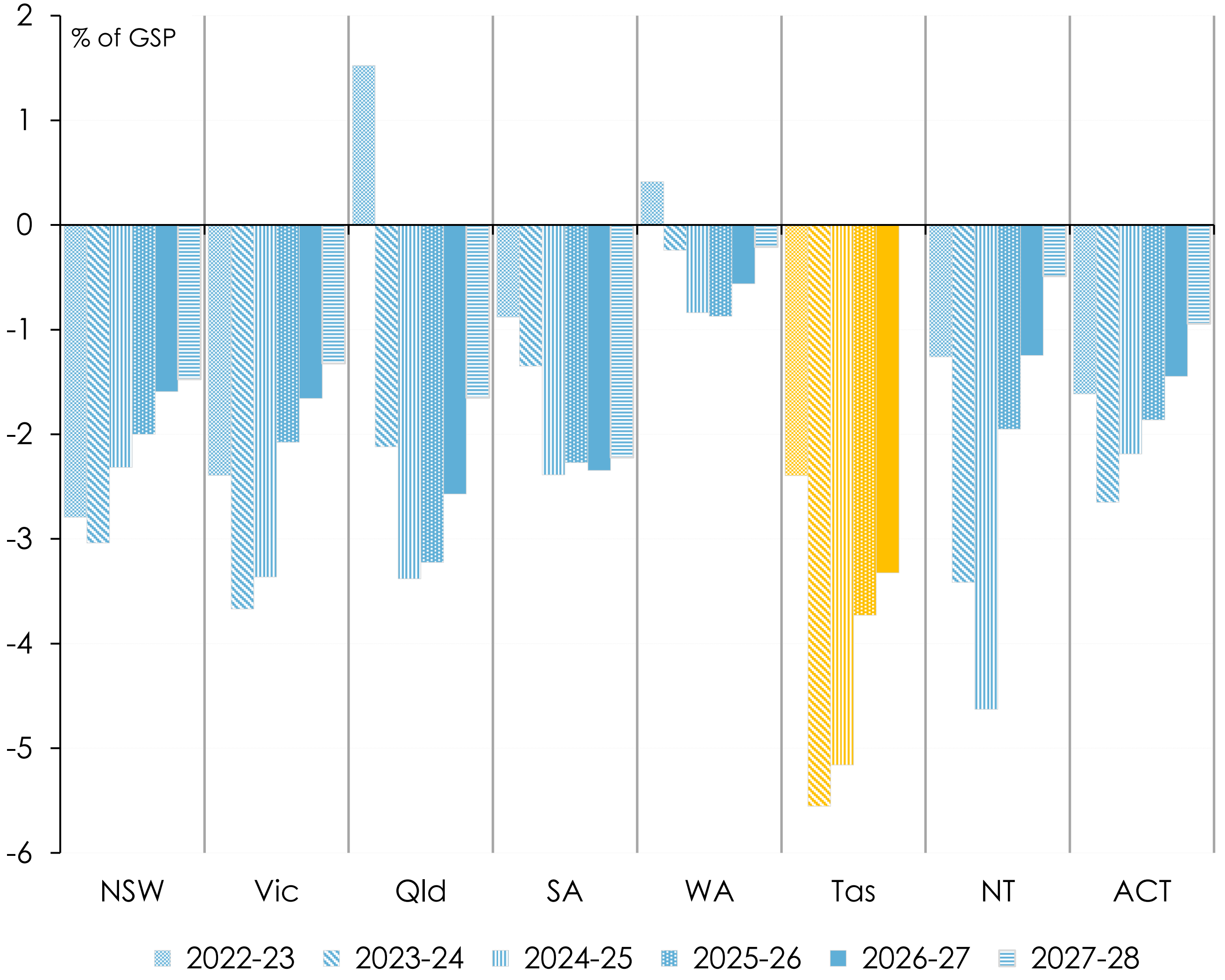
'General government' net financial liabilities, Tasmania and other states and territories, 2022-23 to 2027-28



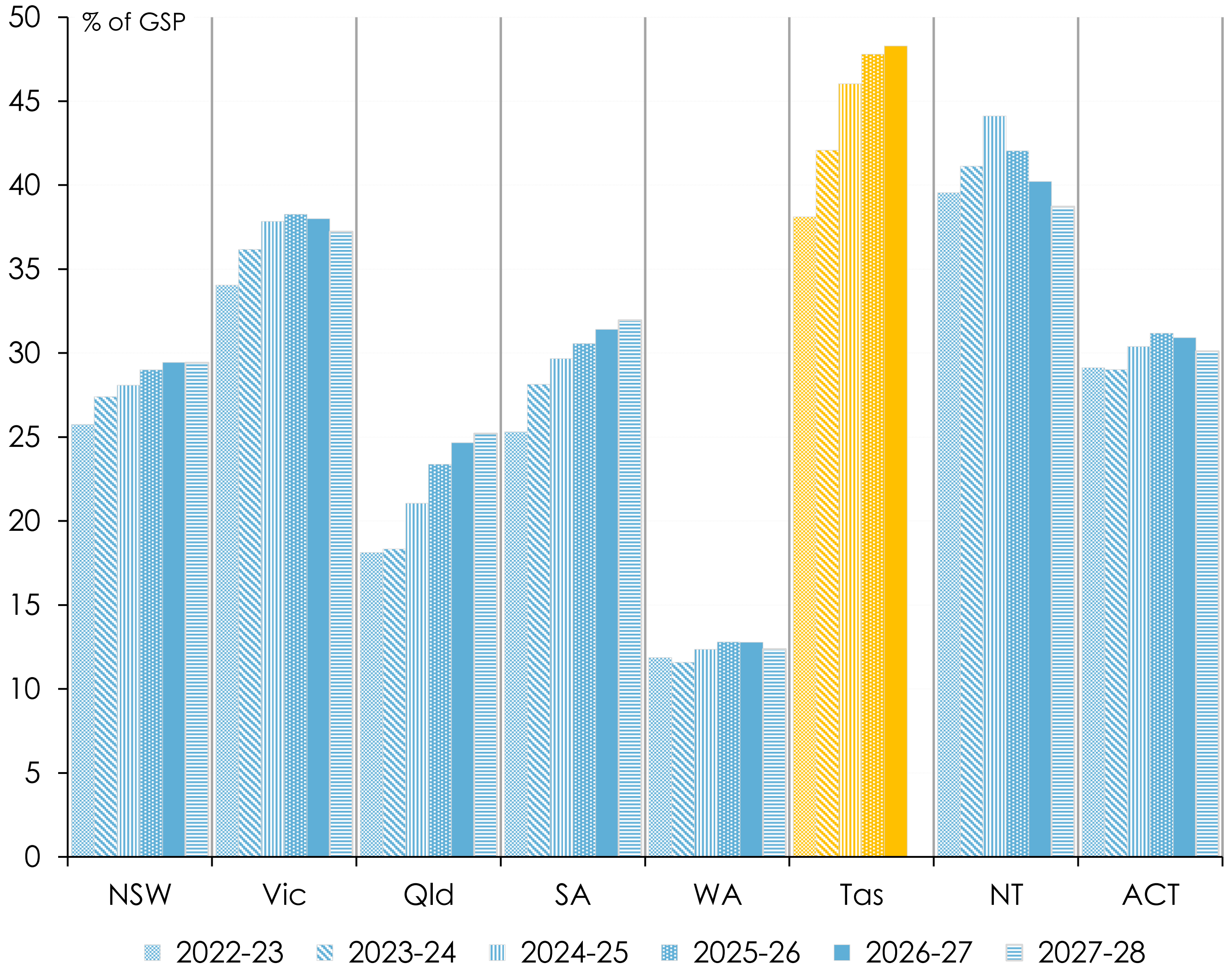
Note: The ACT's superannuation liabilities aren't as large as they appear in government finance statistics, because its employee superannuation arrangements are managed via the Commonwealth Government's superannuation fund, which precludes the ACT from including capital gains on its superannuation investments in its GFS financial statements, as the states and the Northern Territory do.
Sources: Tasmanian Treasury, *2023-24 Revised Estimates Report*; other state and territory 2024-25 Budget Papers.

When government-owned businesses are included, Tasmania's fiscal position looks worse than even Victoria's and the Northern Territory's

Total non-financial public sector cash balances, 2022-23 to 2027-28



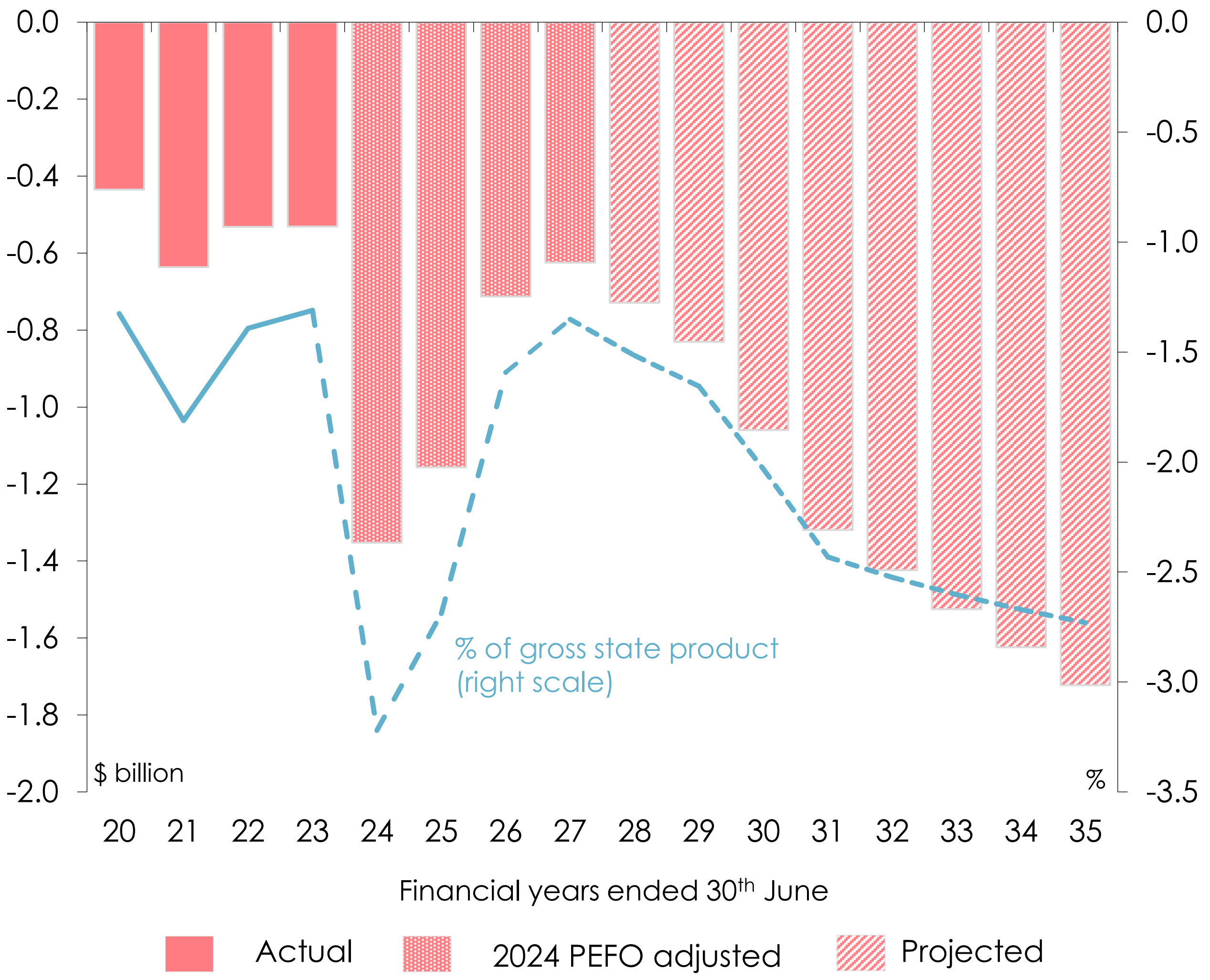
Total non-financial public sector net financial liabilities, 2022-23 to 2027-28



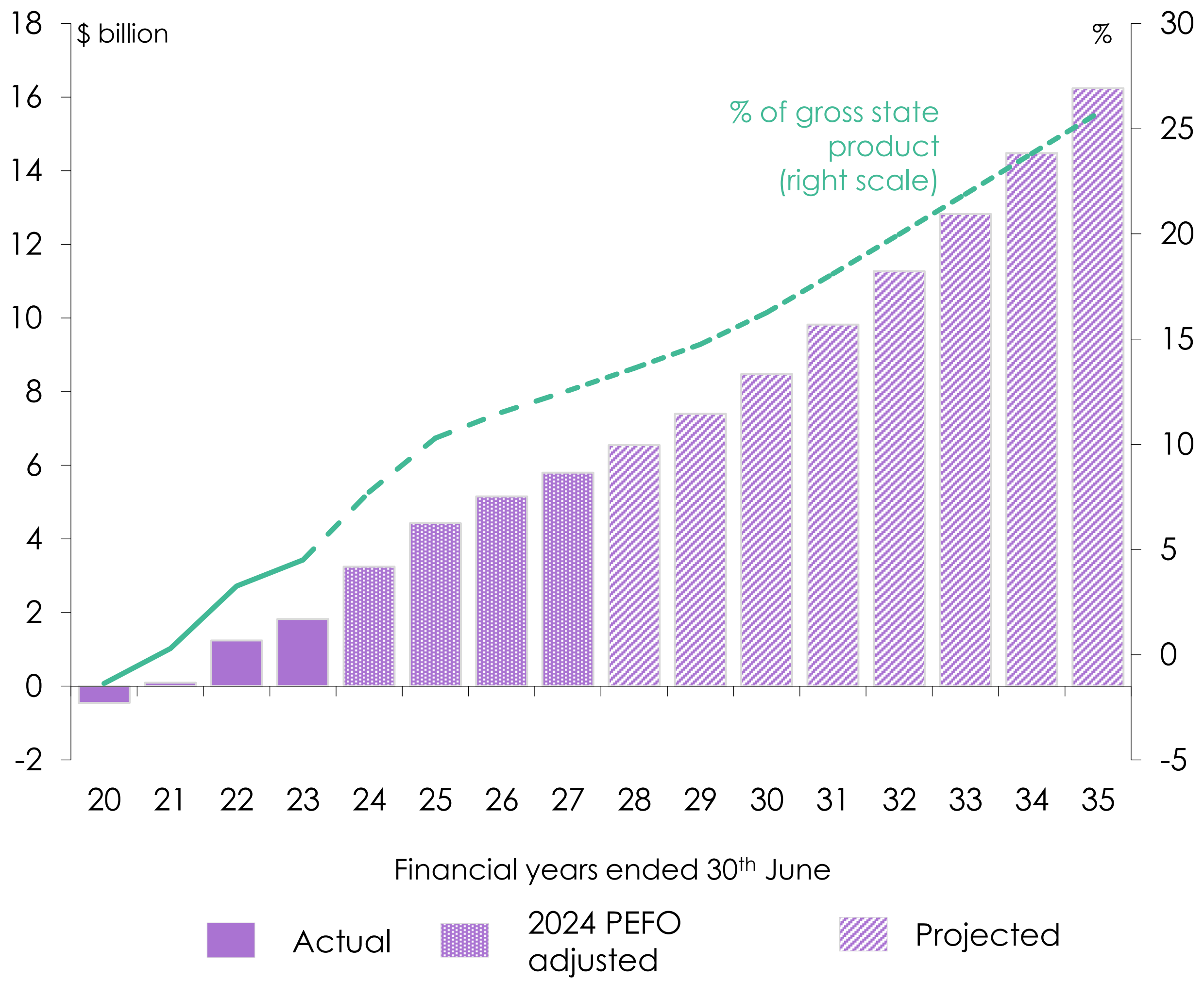
Sources: Tasmanian Treasury, *2023-24 Revised Estimates Report*; other state and territory 2024-25 Budget Papers.

And Tasmania’s public sector finances will get a lot worse over the next ten years if nothing is done

Cash balance



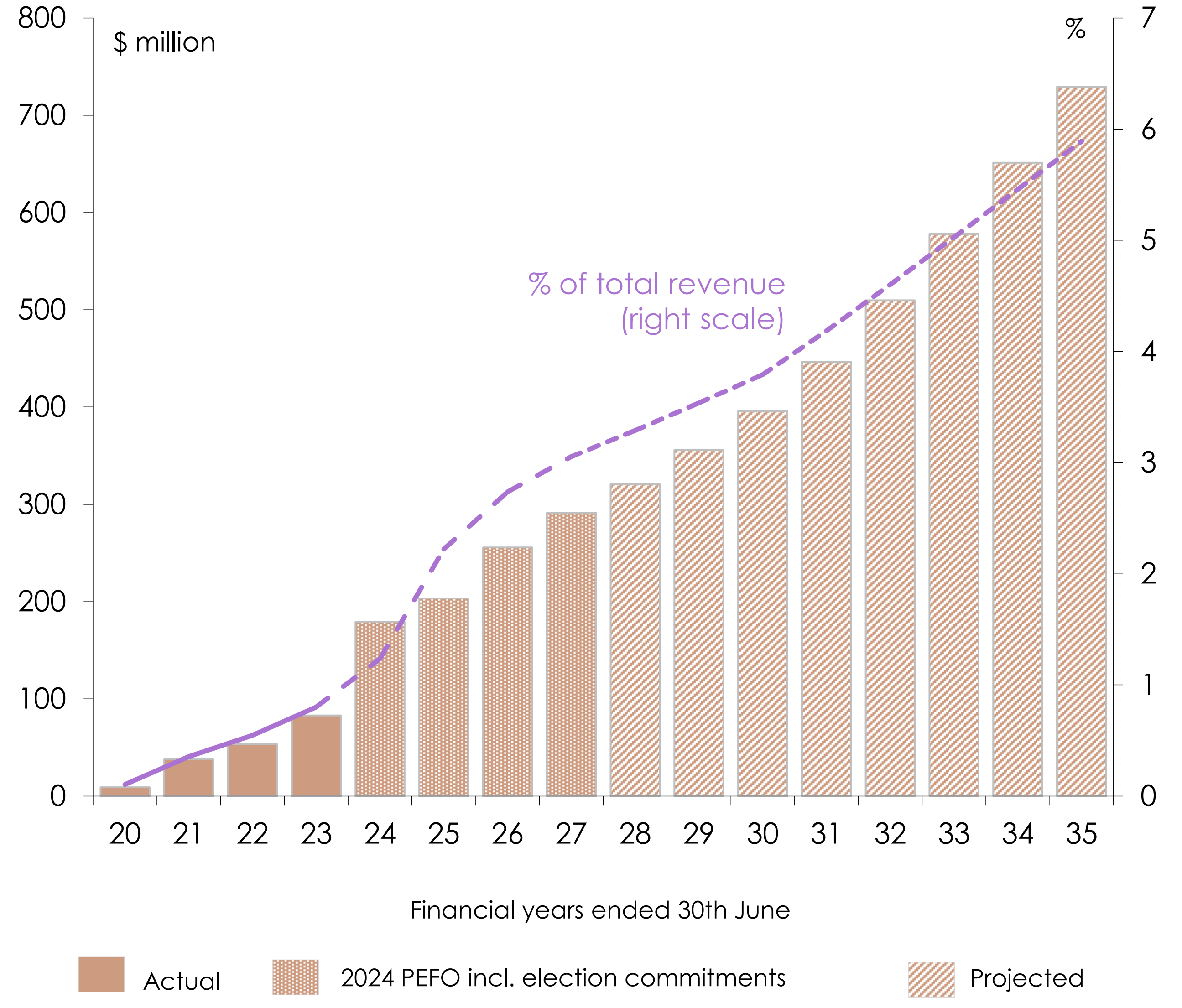
Net debt



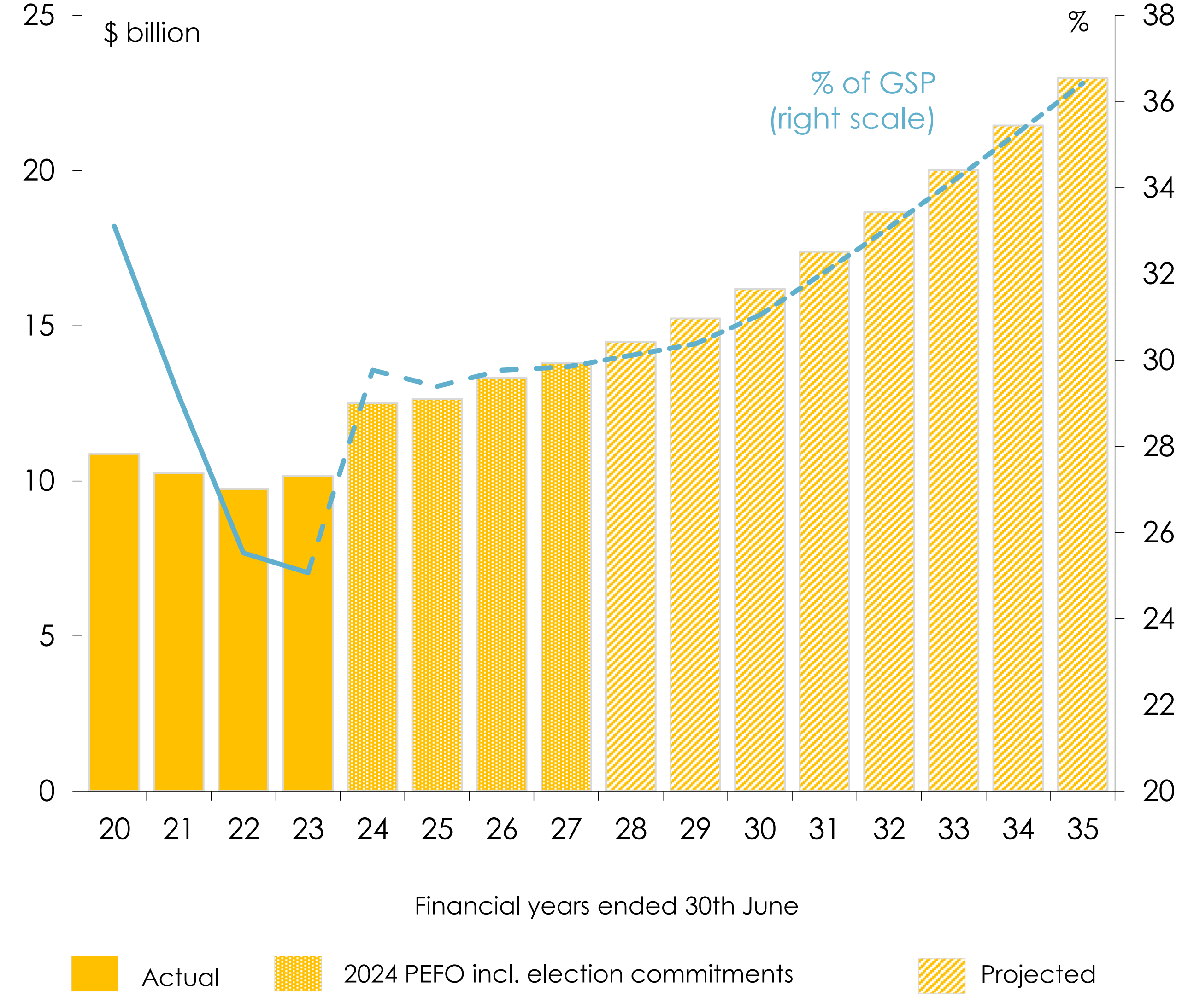
Note: figures shown are for the general government sector. Data shown in these charts do not incorporate the results for 2023-24 reported in the *Preliminary Outcomes Report 2023-24*.
Source: Independent Review of Tasmania’s State Finances, August 2024

Tasmania's public sector finances will get a lot worse over the next ten years if nothing is done

Interest payments



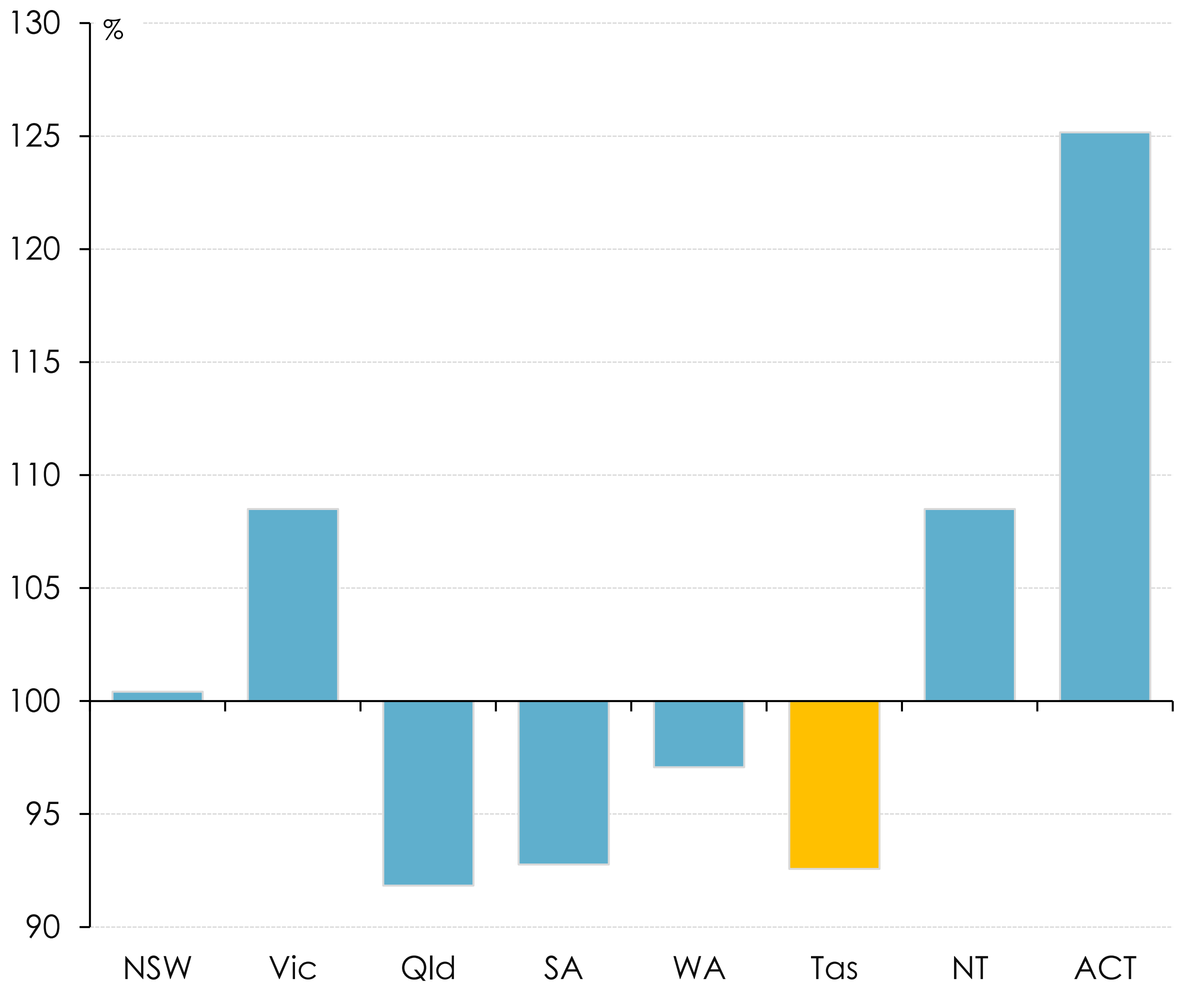
Net financial liabilities



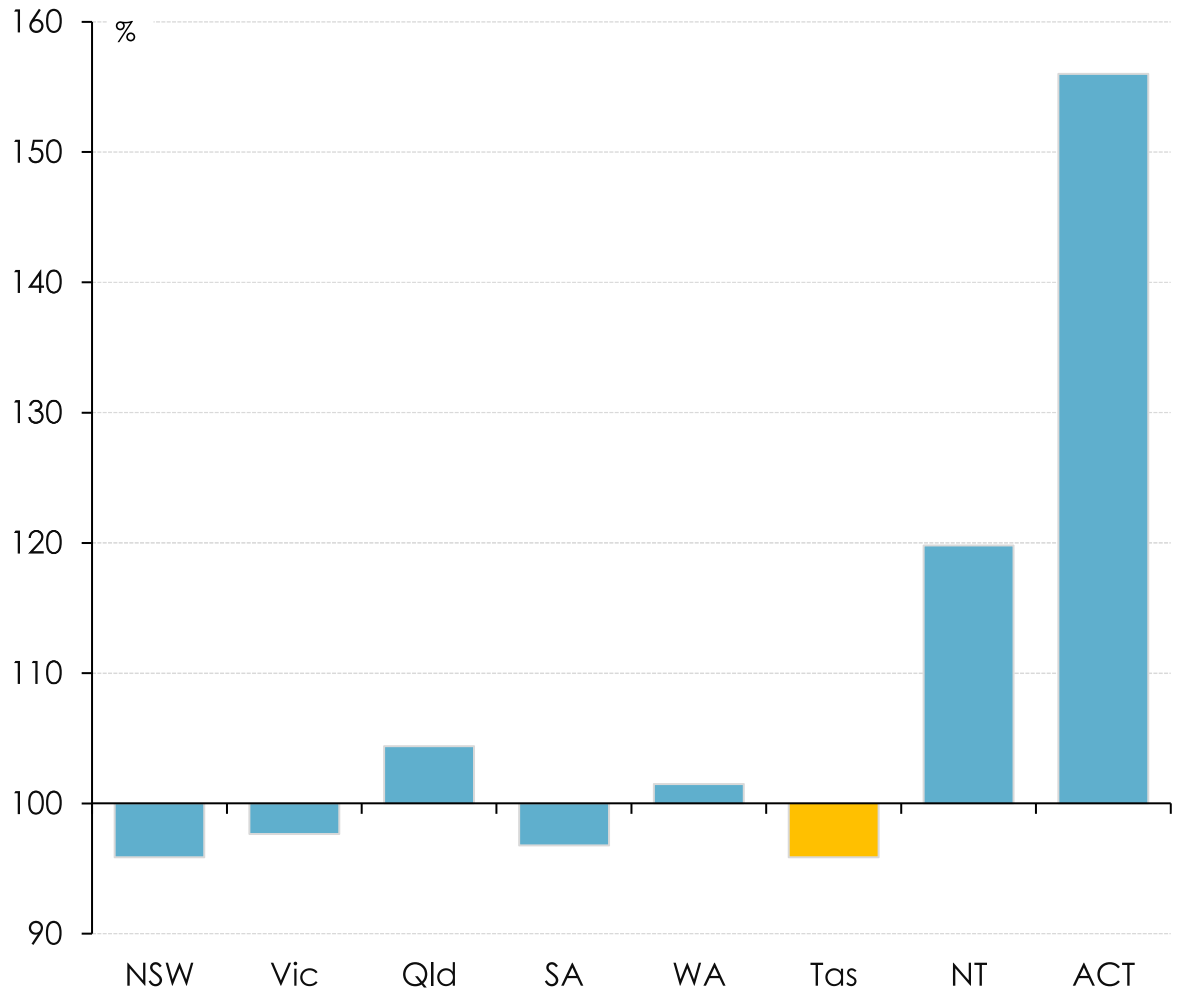
Note: figures shown are for the general government sector. Data shown in these charts do not incorporate the results for 2023-24 reported in the *Preliminary Outcomes Report 2023-24*.
Source: Independent Review of Tasmania's State Finances, August 2024

Tasmania's finances can't be restored to a sustainable position solely by cutting recurrent spending – state taxes will have to rise

Average 'level of service provision' ratios, 2019-20 to 2021-22



Average 'revenue-raising effort' ratios, 2019-20 to 2021-22

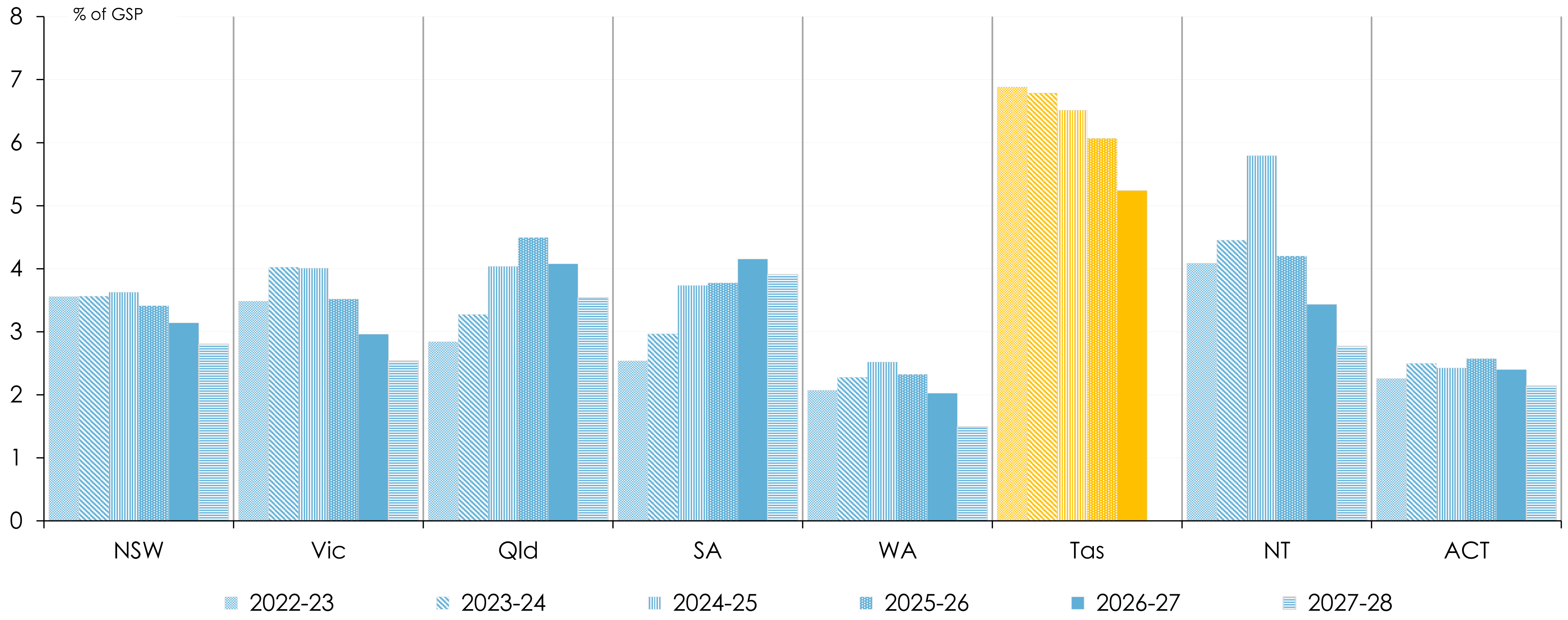


Note: The 'level of service provision' ratio is the ratio of total actual operating expenses by each state and territory to the Grants Commission's assessment of what it would need to spend in order to deliver the same level of services with the same 'efficiency' as the average of all states and territories. Similarly, the 'revenue-raising effort' ratio is the ratio of total taxation revenue actually raised by each state and territory to the Grants Commission's assessment of what it could raise if its tax regime were the same as the average of all states and territories.

Sources: Commonwealth Grants Commission, *2024 Update of GST relativities*; Independent Review of Tasmania's State Finances, August 2024

And Tasmania can't afford to run the nation's largest infrastructure spending program (relative to the size of our economy)

Total state non-financial public sector 'purchases of non-financial assets', 2023-24 to 2026-27



Note: 'Total state non-financial public sector' includes GBEs.
Sources: State and territory 2024-25 Budget Papers; Independent Review of Tasmania's State Finances, August 2024

What is ‘fiscal sustainability’?

- **There are many definitions of fiscal sustainability – although they have common features**
  - “the ability of a government to maintain public finances at a credible and serviceable position over the long term” (OECD)
  - “the ability of a government to sustain its current spending, tax and other-related policies in the long run without threatening its solvency or defaulting on some of its liabilities or promised expenditures” (European Commission)
  - “a government’s ability to maintain its long-term fiscal policy settings indefinitely without the need for major remedial policy interventions … if the debt-to-GDP ratio is expected to be stable or trend downwards over the long term [although] does not mean that the debt-to-GDP ratio will not increase at times, especially in response to large unforeseen economic shocks” (Australian Parliamentary Budget Office)
- **Fiscal sustainability is important because**
  - it builds confidence – among households, businesses and community groups that they are unlikely to be suddenly hit with large tax increases, or abrupt curtailment of funding or services that are important to them
  - it enhances inter-generational equity by reducing the likelihood that one generation of taxpayers and citizens will have to pay (through higher taxes and/or reduced services) for the fiscal mistakes of previous generations
  - for both those reasons, maintaining fiscal sustainability can enhance social cohesion and economic growth
  - whereas by contrast, fiscal crises usually result in large, long-term adverse consequences

What should be the objectives of a strategy to return Tasmania's finances to a sustainable position?

- **Returning to an 'underlying' net operating surplus within four years**
  - that is, revenues (excluding one-off grants from the Commonwealth for capital purposes) which are greater than operating expenses – in all circumstances other than in response to major economic downturns or major natural disasters
- **Achieving and maintaining an overall fiscal surplus over a five-to-ten-year period**
  - that is, fully funding both operating and capital expenditures from revenues, until the objectives for net debt and net financial liabilities have been attained
- **Reducing the ratios of net financial liabilities to gross state product to less than the average for all states and territories**
  - which in practice would imply ratios for the general government and total non-financial public sector of around 20% and 25%, respectively
- **Reducing the ratios of net debt to gross state product to substantially less than the average for all states and territories (reflecting the difficulty of reducing Tasmania's unfunded superannuation liabilities quickly)**
  - which in practice would imply ratios for the general government and total non-financial public sector of around 8% and 12%, respectively
- **Reducing the of general government interest and defined benefit superannuation payments to less than 7% of general government total receipts within five years, and maintaining it below that level thereafter**
- **Increasing the ratio of 'own-source' to total general government receipts to the long-term historical average of 37% over the next five-ten years, with a longer-term aim of lifting it further to 40%**

Ideally, these objectives should be supported by all political parties (while allowing for differences as to how to achieve them) and entrenched in legislation (eg by amending the *Charter of Budget Responsibility Act 2007*)

How can these fiscal strategy objectives best be achieved?

- There's not a lot of scope on the 'operating' (or recurrent) expenditure side
  - on-going review of the continuing justification for, and efficiency and effectiveness of, existing spending programs
  - look for ways of moving remaining defined benefit superannuation members to SGC arrangements
  - 'efficiency dividends' and 'vacancy control' are a very poor way of achieving expenditure savings
  - big spending cuts will have a larger adverse impact (dollar-for-dollar) on economic activity and on the most vulnerable Tasmanians than equivalent revenue measures
- Most of the 'heavy lifting' will have to be on the revenue side
  - at least some of the impact of any increases in state taxes will be absorbed by reductions in company tax payments or reductions in household saving (hence less impact on economic activity)
- Revenue-raising options
  - reduce the tax-free threshold for payroll tax (which is the highest of any state, and which has done nothing to create jobs)
  - over the longer-term, replace stamp duties with a broadly based land tax (including owner-occupied homes)
  - in the near term, consider imposing a surcharge on council rates as a *de facto* extension of land tax
  - extend the stamp duty and land tax surcharges imposed on foreign investors to mainland investors in established residential real estate
  - increase motor vehicle registration fees and motor vehicle duty for more expensive motor vehicles
  - increase mineral royalties
- Defer or reduce planned infrastructure spending and reform infrastructure budgeting processes
  - first determine how much Tasmania can afford to spend on capex over 10 years and in each year of those ten
  - then select projects based on ranking of projects according to economic & social cost-benefit ratios

This is the third time Tasmania has found itself in this position in 35 years – how can we prevent it from happening again?

- **Treasury's role should be strengthened, the resources available to it enhanced, and greater use made by the Government of its capabilities and advice**
  - including greater use of staff secondments between Treasury and its federal and interstate counterparts
  - and greater collaboration with the Tasmanian School of Business and Economics at UTas
- **The annual Budget Papers should include**
  - more comprehensive and detailed analysis of recent developments in and the outlook for the Tasmanian economy
  - ten-year projections of key fiscal aggregates
  - more long-term historical fiscal data
  - tables and data underpinning charts in excel spreadsheet form
  - a more detailed and quantified Statement of Risks
- **The mid-year Revised Estimates Report should be brought forward from February to December**
  - in line with every other jurisdiction
- **The Preliminary Outcomes Report can be discontinued (no other jurisdiction has one)**
- **The *Charter of Budget Responsibility Act 2007* should be amended**
  - to require political parties to indicate how their expenditure and revenue commitments will be funded, or to state explicitly that they won't be funded, and to issue their fiscal strategy statements at least nine days before polling day
- **A Tasmanian Parliamentary Budget Office should be established**
  - to provide independent advice on budgetary and fiscal issues, including costings of policy options, to MPs
- **The Parliamentary Public Accounts Committee should investigate and report on how to enhance the independence of the Audit Office to bring it into line with 'best practice' in other jurisdictions**