Independent Review of Tasmania’s State Finances

by

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Corinna Economic Advisory

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The Independent Review of Tasmania's State Finances acknowledges the ancient history of the Tasmanian Aboriginal people as the First People of lutruwita/Tasmania.

For over 2,000 generations, the health and wellbeing of Tasmanian Aboriginal peoples has been, and continues to be, based on a deep and continuous connection to family, community and the land, sea and waterways.

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Letter of transmittal

The Hon. Jeremy Rockliff MP, Premier of Tasmania
Ms Miriam Beswick MP, Member for Braddon
Mr Andrew Jenner MP, Member for Lyons
Ms Rebekah Pentland MP, Member for Bass

Dear Premier and Parliamentary Members of the Jacqui Lambie Network

I present to you, and through you to the Parliament and people of Tasmania, the Independent Review of Tasmania's State Finances, pursuant to the agreement between the four of you announced on 3rd May 2024.

I would like to thank the members of the Jacqui Lambie Network for proposing that I be asked to undertake this Review, the Premier and the Government for agreeing to that proposal, and both for agreeing to the Review's Terms of Reference.

I affirm that this Review has been conducted completely independently, and in particular that there has been no attempt by anyone in or connected to either the Government or the Jacqui Lambie Network, to influence the contents of this Report.

The Review has benefited from the assistance, advice and counsel of a number of individuals listed in Appendix 2 to this Report. However the responsibility for all the findings and recommendations contained in this Report rests with the undersigned.

Yours sincerely

Saul Eslake

(Saul Eslake)
19th August 2024

Executive summary

Since the beginning of European settlement more than two centuries ago, government has always played a major role in the Tasmanian economy and in the lives of Tasmanians. The State Government and its instrumentalities account for a larger share of economic activity and employment in Tasmania than in any other part of Australia (with the exception, in some instances, of the Northern Territory); and a larger proportion of Tasmania's population than of any other state look to the State Government for services that play a vital role in their lives.

The Tasmanian Government's capacity to meet the expectations which Tasmanians have of it is crucially dependent on its financial position. That doesn't mean that it should never resort to borrowing to meet some of its expenditure commitments, or that all of the debt which it has at any particular point in time must be repaid by some stipulated later point in time. However it does mean that its financial position should be sustainable – that is, that it should be able to maintain its spending, tax and other policy settings indefinitely without the need for major remedial policy changes.

Sustainability, in this sense, builds confidence among businesses, community groups and individuals that they won't be suddenly hit with big tax increases, or reductions in funding or services on which they depend, in turn enabling them to plan and arrange their affairs with greater surety. Fiscal sustainability also helps to promote intergenerational equity, by reducing the likelihood that one generation has to pay for the fiscal mistakes of another. Conversely, a protracted failure to ensure fiscal sustainability almost inevitably leads to a fiscal crisis – which in turn increases the risk of political and social instability, and long-term adverse economic consequences.

Fiscal sustainability is arguably more important for Tasmania, given that its long-term economic performance has been consistently poorer than that of any other state or territory – a reflection of persistently below-average participation in employment (and in particular full-time employment) and below-average productivity. One reason why so little has been done to remedy that sub-par economic performance may be that individual Tasmanians are sheltered from many of its consequences by the operation of the national taxation and social security systems. Similarly, the Tasmanian Government is partially shielded from the same consequences by the long-standing system of 'horizontal fiscal equalization', whereby Tasmania receives a much larger share of funding from the Federal Government than would be the case if that funding were distributed among the states and territories on an 'equal per capita' basis.

Tasmania's public sector finances have deteriorated significantly since the latter part of the 2010s – despite a noticeable improvement in Tasmania's economic fortunes, by many metrics, relative to the rest of Australia between about 2016-17 and 2021-22. That deterioration, best evidenced by the shift in all of the principal measures of the government's budget 'bottom line' from balance or surplus in the mid-2010s to persistent and (for the most part) growing deficits since 2018-19, and the government shift from net creditor throughout the 2010s to a net debtor from 2020-21 onwards.

These trends were partly attributable to the Covid-19 pandemic, and more recently to the need to provide for compensation payments to survivors of child sexual abuse in State institutions. But they began before the onset of the pandemic, and have continued after it.

Drawing on publicly available information, the Review finds that the deterioration in the financial position of Tasmania's 'general government sector' – that is, state government departments and agencies funded primarily by taxation revenue or grants from the Federal Government – over the past decade is entirely attributable to 'policy decisions' by government (to increase 'operating' or recurrent expenses, and spending on infrastructure projects, and to a lesser extent to reduce taxes). By contrast, 'parameter variations' – the effects of factors beyond the control or influence of any state government (such as unforeseen changes in economic activity or employment, or decisions made by the Federal Government) – have, more often than not, had a favourable impact on the government's finances.

Information publicly available prior to and during the election campaign unambiguously indicates that the financial position of Tasmania's general government sector will deteriorate further over the next three years (that is, to 2026-27), and that this will be compounded by a deterioration in the financial position of Tasmania's non-financial corporations (government business enterprises).

Indeed, based on publicly available information, by some metrics – in particular, the cash balance and net financial liabilities of the state non-financial public sector as a whole, relative to the size of the state's economy – Tasmania's financial position will become worse than that of any other state or territory (including Victoria and the Northern Territory) over the next three years.

The Review was astonished to discover that the Tasmanian Treasury does not prepare ten-year projections of the principal indicators of the State's financial position, other than as part of the five-yearly *Financial Stability Reports*, the last of which was published in 2021, and the next not due until 2026. In order to fulfil its Terms of Reference, the Review has therefore undertaken these projections itself – with more limited resources and less time than the Treasury has every five years, but with the invaluable assistance of the Australian Parliamentary Budget Office.

These projections – made using assumptions similar to those which Treasury has used in previous *Financial Stability Reviews* – indicate that, in the absence of corrective policy actions, the financial position of Tasmania's general government sector will worsen further over the next decade, with

- cash deficits averaging almost $1.3 billion per annum and totalling $12.7 billion over the ten years to 2034-35,
- net debt rising to over $16 billion (equivalent to more than 25% of gross state product) by the end of the 2034-35 financial year, and

- interest payments rising from about $250 million in 2024-25 to $730 million in 2034-35 (or from about 2¼% to 6% of total revenues) over that period.

Such an outcome would almost certainly result in Tasmania's credit rating being downgraded, probably by more than one 'notch', if it were allowed to happen.

This should not come as a surprise. Since 2016, the Department of Treasury and Finance has repeatedly warned (in its *Fiscal Sustainability Reports*) of the risks to the sustainability of Tasmania's fiscal position in the absence of corrective action (including reform of Tasmania's taxation system), of the risks associated with taking such action later rather than sooner, and of the impossibility of relying on economic growth alone to maintain fiscal sustainability. Yet these warnings have gone unheeded, not just by the government of the day, but by all of the major participants in Tasmania's political process, including during the campaign for the most recent State election.

Returning Tasmania's public finances to a sustainable position – and no less importantly, keeping them there – represents a substantial and, the Review readily acknowledges, politically challenging, task. It is one which is unlikely to be achieved during the life of the present Parliament.

It is, therefore, one which should, ideally, command in-principle support across the political spectrum. Among other things this would help to instil confidence that the return to fiscal sustainability will not be derailed by changes of government – even if there will inevitably be (as is to be expected in a democracy) differences of opinion as to how best to achieve that objective.

The Review proposes that the government, and all other political parties, commit to achieving a series of fiscal targets over the next four to ten years – including

- a return to an 'underlying' net operating surplus within four years;
- achievement and maintenance of an overall fiscal surplus over the following five-ten years;
- reducing the ratios of net debt and net financial liabilities to gross state product to below the corresponding averages for all states and territories; reducing the ratio of interest payments plus defined superannuation benefit payments to less than 7% of revenues within five years; and
- increasing the ratio of 'own-source' to total revenues to its long-term average of 37% within the next ten years, with a longer-term goal of increasing it to 40%.

Ideally, these objectives should be incorporated into the *Charter of Budget Responsibility Act.*

The Review believes that it would be both difficult and undesirable for a large proportion of the task of returning Tasmania's public finances to a sustainable condition to be undertaken through reductions in 'operating' expenses.

That's partly because, based on assessments made by the Commonwealth Grants Commission (as part of its annual determination of GST revenue shares), Tasmania has in recent years been spending about $530 million per annum less than it needs to in order to provide services similar to the average level and efficiency of all states and territories, whilst raising around $170 million less in state taxes and $42 million less in mineral royalties per annum than it would if its tax and mineral royalty regimes were similar to the average of all states and territories.

It also reflects a judgement that cutting 'operating' expenses would have a bigger adverse impact on the Tasmanian economy, and on the most needy or vulnerable Tasmanians, than raising revenues by an equivalent amount, bearing in mind that state taxes paid by businesses are deductible against federal company tax, and at least part of any increase in state taxes paid by individuals would be absorbed by lower saving.

The Government should, of course, be evaluating the efficiency and effectiveness of individual spending programs as part of its ongoing management of the budget – and there would appear to be ample opportunities for improving both the efficiency and effectiveness of current spending in areas such as health and education.

But the Review considers that 'efficiency dividends' and 'vacancy control' are very poor means of achieving meaningful and lasting expenditure savings.

By contrast, the Review considers that there are a number of options which should be considered in order to raise additional revenue, with a view to returning Tasmania's finances to a sustainable position. Specifically, the Review recommends that the Government consider some or all of the following:

- broadening the base of payroll tax by lowering the existing tax-free threshold (which is the highest of any state and which the Review considers has done little or nothing to boost employment), with a longer-term aim of lowering the rate of payroll tax (which is the highest of any state);
- over the longer term, abolishing stamp duty and replacing it with a broadly-based land tax (including owner-occupied residential property) with an appropriate tax-free threshold, provision for asset-rich but income-poor landowners to defer land tax payments as a charge against their estate, and transitional provisions to avoid 'double taxation' of recent property purchasers);
- ahead of a 'land tax for stamp duty' switch, imposing a modest surcharge on municipal rates on residential property similar to the existing fire and waste levies;
- extending the surcharges on stamp duty and land tax payable by foreign investors in residential real estate introduced in recent years to mainland-based investors in established residential real estate (with an exemption for new builds);
- increasing motor vehicle registration fees, and duty on the purchase of expensive new motor vehicles (with appropriate concessions for pensioners and other low-income earners) to levels more commensurate with other states and territories; and

- increasing mineral royalties to levels more commensurate with other states and territories.

The Review recommends that the Government explore options for moving the now relatively small number of public sector employees who are members of defined benefit superannuation schemes which were closed in the late 1990s to defined contribution schemes of which the vast majority of current public and private sector employees are members.

The Review notes that, based on currently available Forward Estimates, Tasmania will over the next three years (and probably beyond) be running the largest public sector infrastructure program, relative to the size of its economy, of any state or territory – and questions whether Tasmania can afford to do this.

The Review instead recommends that the Government should as part of the annual Budget process, determine, based on Treasury advice, how much it can afford to spend on infrastructure having regard to both the requirements of fiscal sustainability and the capacity of the Tasmanian construction industry, both over the following ten years and in each of those years. After having done so, it should then determine which projects are to be financed by ranking them according to robust estimates of their social and economic benefits relative to their costs – rather than, as appears to have been the case, arriving at an infrastructure spending program via a 'bottom-up' process.

The fact that Tasmania has found itself in an unsustainable fiscal position for the third time in less than four decades (following the previous episodes in the early 1990s and early 2010s) suggests that Tasmania needs stronger institutions and more robust rules around the management of its public sector finances.

In particular, the challenge of returning Tasmania's public finances to a sustainable condition over the next five-ten years will require Treasury to be better resourced than it has been over the past decade, and a greater willingness on the part of the Government to seek, and pay heed to, its advice than appears to have been evident over this period.

While there are some respects in which Tasmania's annual Budget Papers offer more comprehensive information than those of other states and territories (or indeed those of the Federal Government), there are others in which there is scope for improvement, which would assist in promoting greater public awareness and understanding of Tasmania's public finances and hence in restoring and maintaining fiscal sustainability. In particular, the Budget Papers and the mid-year *Revised Estimates Report* 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; and
- a more detailed and quantified Statement of Risks

The Review recommends that the *Revised Estimates Report* should be brought forward from February to December, in line with other states and territories and the Federal *Mid-Year Economic and Fiscal Outlook*.

The Review considers that the *Charter of Budget Responsibility Act* should be amended to remove the requirement that political parties present "fiscal objectives and targets for the budget year and the following three financial years" during election campaigns, and to require instead that political parties indicate how they propose to pay for their expenditure or revenue commitments, or (alternatively) to state explicitly that they will pay for those commitments by running smaller budget surpluses or larger deficits.

It also recommends that political parties be required to publish their election costing statements at least nine days before polling day, rather than on the Friday afternoon before polling day (long after a growing proportion of voters have cast their ballots) as has become the 'norm' at recent elections.

In order to enhance the capacity of the Parliament to comprehend and discuss fiscal issues, and to formulate policies which will have an impact on the Budget, the Review recommends that Tasmania follow the Federal Parliament, and the Parliaments of New South Wales and Victoria, in establishing a Parliamentary Budget Office.

Finally, the Review notes that other states and territories have in recent years implemented measures to enhance the independence of their Audit Offices, and recommends that the Parliamentary Public Accounts Committee investigate and report on how to enhance the independence of the Tasmanian Audit Office in order to bring it into line with 'best practice' in other jurisdictions.

In total, the Review has made 26 recommendations, which are set out at the end of Chapter 6 (pages 104-106) and Chapter 7 (pages 119-120).

1. Introduction

For tens of thousands of years, the ancestors of today's *palawa* people maintained their own systems of self-governance and of caring for their country, *lutruwita*.

But since the arrival of European settlers in the early 19th century, 'government' as we know it today has played an on-going large role in the Tasmanian economy and in the lives of Tasmanians.

Today the Tasmanian State Government, its departments and agencies, and the businesses which it owns, constitute a larger part of the Tasmanian economy than its counterparts in any other state or territory do in their respective jurisdictions.

In the 2022-23 financial year, state non-financial public sector operating expenses accounted for 28.3% of Tasmanian gross state product (GSP), a larger proportion than for any other state or territory, and almost 12 percentage points above the average for all states and territories. State non-financial public sector capital expenditures accounted for a further 4.6% of GSP, again a higher figure than for any other state or territory, and more than 1½ percentage points above the average for all states and territories (ABS 2024a). The total value of assets owned by the Tasmanian Government as at 30th June 2023 was equivalent to 102% of Tasmania's GSP, the highest (together with Queensland) of any state or territory, 22 percentage points above the average for all states and territories. The state public sector accounted for 18.6% of total employment in 2022-23, a higher proportion than for any other jurisdiction except the Northern Territory, and 5 percentage points above the average for all states and territories (ABS 2024c).

In other words, what the Tasmanian state public sector does, and how it is managed and financed, matters – for the Tasmanian economy, for Tasmanian individuals and families, for Tasmanian communities, and for Tasmanian businesses – to a greater extent than what the state public sector does and how it is managed and financed in other parts of Australia.

A state government can only do what citizens expect it do for them if it is adequately and sustainably financed – that is, if the financial resources available to it are consistently sufficient to pay for the services and the social and economic infrastructure that citizens, through democratic purposes, determine should be provided collectively.

Tasmania's State Government is more dependent on financial resources provided by the national government than any other state or territory government with the exception of that of the Northern Territory. If it were not for Australia's long-standing preparedness to 'equalize' the fiscal capacity of our nation's states and territories – so that the quality of education, health, policing, public transport and other services and the taxes levied in order to pay for them vary far less as between states and territories than they do in other federations – then Tasmanians would be materially poorer, and worse off in other ways besides, than other Australians by much larger margins than they presently are.

But that dependence on financial support from the national government has, arguably, made both successive Tasmanian Governments and individual Tasmanians less conscious of the importance of maintaining Tasmania's state finances in a sustainable condition, and more vulnerable to factors beyond their control (including decisions of national governments) than might otherwise be the case.

A key finding of this Review is that Tasmania's state public sector finances have for some time been on an unsustainable trajectory – and that in the absence of corrective policy actions the condition of Tasmania's state finances will inevitably and inexorably deteriorate further.

'Corrective action' inevitably implies some combination of reductions in expenditure, increases in revenue and/or sales of assets – as is also inevitable for businesses and individuals who find themselves in an unsustainable financial position.

This Review has deliberately eschewed any ideologically-grounded positions on the appropriate size of the Tasmanian public sector. The discipline of economics has nothing persuasive to say about what constitutes the 'ideal' level of government activity. In a democracy, that question is rightfully resolved by the political process.

However, the discipline of economics does have things to say about the most efficient, effective and equitable ways of delivering the services and infrastructure which a democratic society chooses to have provided collectively, and about the most efficient, effective and equitable ways of paying for them (as indeed do other disciplines). This Review does, therefore, have things to say about such matters, and makes recommendations accordingly.

Another key finding of this Review is that this is not the first time that Tasmania has found itself in this position. We have been here before, in the late 1980s and early 1990s, and again in the early 2010s. This suggests that the 'guardrails' around the decision-making processes governing the management of Tasmania's public sector finances are inadequate to the task of ensuring that Tasmania's state finances remain in a sustainable position, and require further strengthening. That is the other focus of the recommendations of this Review.

2. The economic and social context

Introduction

The condition of Tasmania's state public sector finances can't be considered independently of the state of Tasmania's economy.

That's partly because the strength, or otherwise, of Tasmania's economy has an impact on the condition of Tasmania's public sector finances – albeit not as much as economic conditions in other states affect their state public sector finances (because a larger share of the Tasmanian Government's revenue comes in the form of grants from the Federal Government, including its share of GST revenues, than for other states).

Thus when employment is growing rapidly, or residential properties are changing hands more frequently than usual and at rising prices, the State Government will typically collect more payroll tax and stamp duty revenues, respectively, than when the labour market is weak and the property market subdued. There may also be greater demand for some public services when the economy is weak than when it is buoyant.

It's also because government policy decisions, and the activities of government-owned enterprises, can and do have an effect on Tasmanian economic conditions. Decisions to raise or lower state taxes, or to cut or increase spending, may dampen or boost economic activity and employment, may adversely or positively impact business and consumer confidence, and may (over time) influence the composition of economic activity and employment (for example by giving favourable tax treatment or grants and subsidies to some industries and not to others). Likewise, the pricing, staffing, and investment decisions of government business enterprises may (indeed often will) have a positive or negative impact on economic activity and employment in Tasmania.

The state public sector constitutes a larger proportion of the Tasmanian economy than the public sectors of other states do of the economies of their respective jurisdictions. In 2022-23, for example. Tasmanian 'general government' operating expenses (that is, the recurrent spending of departments and agencies funded through the State Budget) represented 21.7% of Tasmania's gross state product, a larger proportion than for any other jurisdiction except the Northern Territory, and well above the average for all states and territories of 14.0%. The operating expenses of Tasmania's public sector non-financial corporations accounted for 8.6% of Tasmania's gross state product in 2022-23, a larger proportion than for any other jurisdiction except Western Australia, and almost 2½ times the average for all states and territories of 3.3%. Capital expenditures by Tasmania's public sector non-financial corporations represented a further 3.2% of Tasmania's gross state product in 2022-23, a substantially higher figure than for any other state or territory, and some 3½ times the all-states-and-territories average of 0.9%.

State public sector employment accounted for 18.6% of total employment in Tasmania in 2022-23, a larger proportion than for any other state or territory except the Northern Territory, and five percentage points above the average for all states and territories of 13.6%.

Of itself the relative size of Tasmania's public sector is neither a good nor a bad thing. But it does mean that whatever decisions the Tasmanian Government takes with regard to its financial position – including in response to the findings and recommendations of this Review – are likely to have a larger impact on economic activity and employment in Tasmania than proportionately equivalent actions in mainland states.

Emphatically, that should *not* be used as an excuse for avoiding decisions or actions when necessary. But it does mean that whatever actions the Government does take, in the near term or over a longer horizon, need to be calibrated with a consciousness of their impact on the economic circumstances of individuals, families and businesses.

Recent performance and near-term prospects for Tasmania's economy

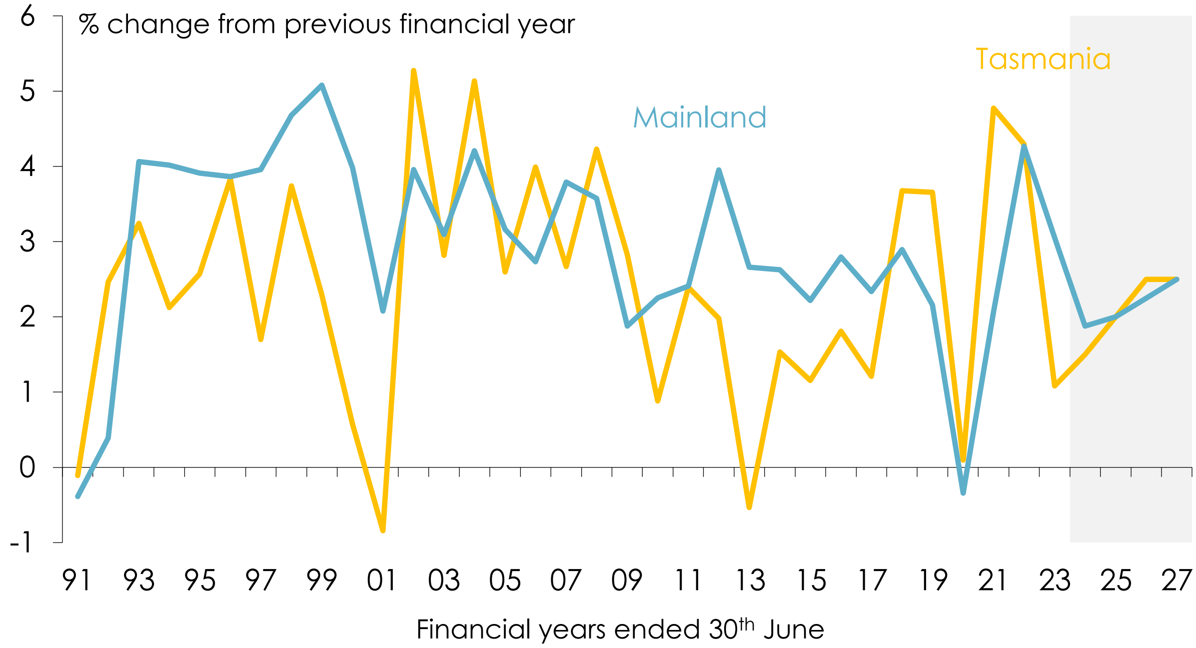
After experiencing a recession – uniquely among Australia's states and territories – in the aftermath of the global financial crisis of 2008-09, the over-valuation of the Australian dollar during the mining investment boom of the early 2010s, and the collapse of the forestry industry in 2012, Tasmania's economy performed relatively well in the years leading up to, and during, the Covid-19 pandemic. Over the five years to 2021-22, Tasmania's real gross state product grew at an average annual rate of 3.3%, faster than any other state or territory except the ACT, and more than a percentage point above the national average of 2.2% (Chart 2.1 on page 14).

Similarly, employment in Tasmania grew at an average annual rate of 2.9% over this five-year period, faster than in any other state or territory, and a percentage point above the national average annual growth rate of 1.9%. For much of 2020, Tasmania's unemployment rate was slightly lower than the national average, after having been more than 2 percentage points above the national average in 2013 (Chart 2.2).

This improvement in Tasmania's economic performance was both aided by, and contributed to, a substantial increase in the number of people living, and wanting to live, in Tasmania. Tasmania's population growth rate slowed from an average of 0.9% per annum over the five years to 2009-10, to just 0.01% in 2012-13 – a cause and a consequence of the recession which Tasmania experienced at that time. But thereafter, the growth rate of Tasmania's population began to pick up, and between 2017-18 and 2021-22 exceeded the national average (Chart 2.3 on page 15) – something which had not happened in a single year since the late 1950s, and not for five years in a row since the 1940s.

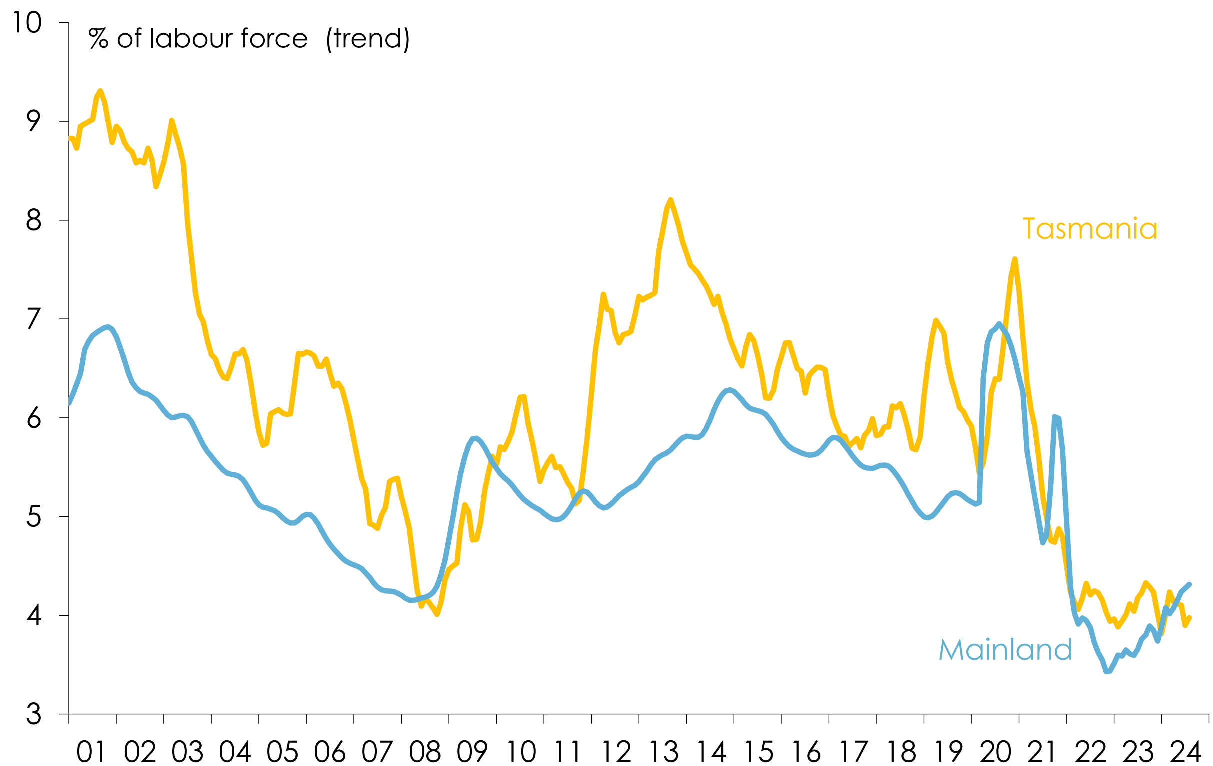
The acceleration in Tasmania's population growth rate during this period was driven by a marked pick-up in overseas migraation (largely international students), and a marked turnaround in net interstate migration to Tasmania – the full extent of which wasn't picked up until the August 2021 Census (Chart 2.4 on page 15).

Chart 2.1 – Growth in Tasmanian and mainland real gross state product



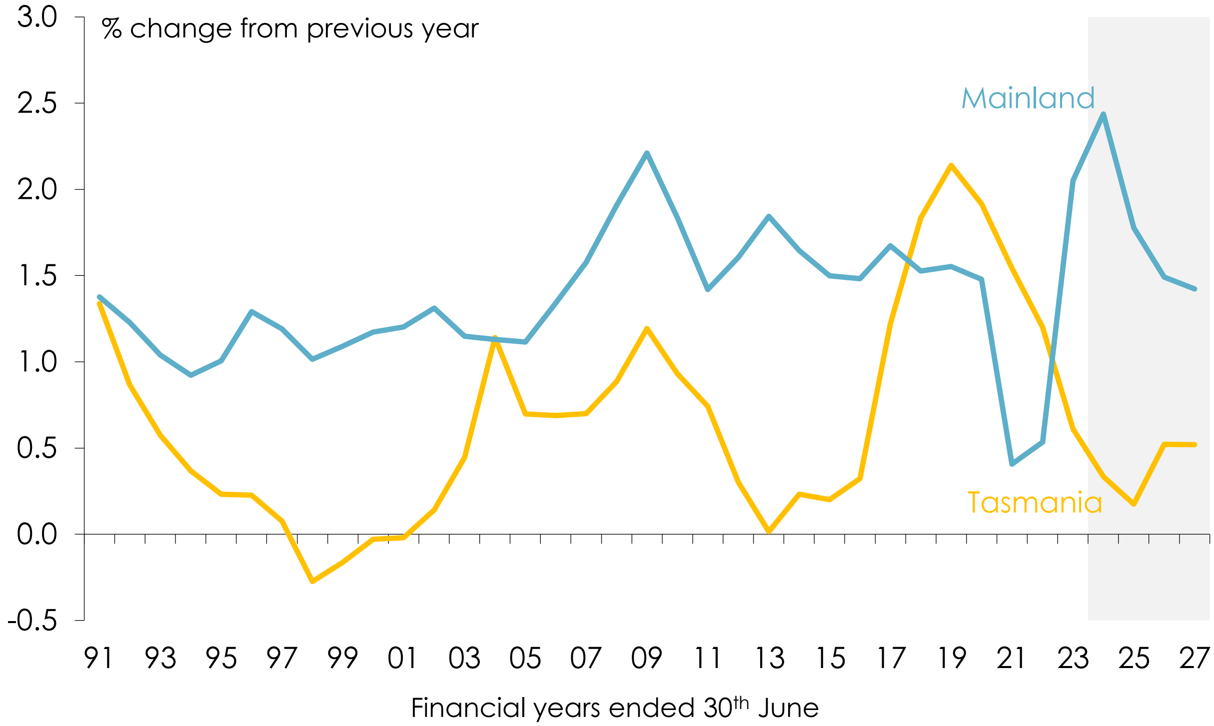
Note: Shaded areas denote Tasmanian and Australian Treasury forecasts. *Sources:* Australian Bureau of Statistics (2023a); Australian Government (2024a); Tasmanian Department of Treasury and Finance (2024a).

Chart 2.2 – Tasmanian and mainland unemployment rates



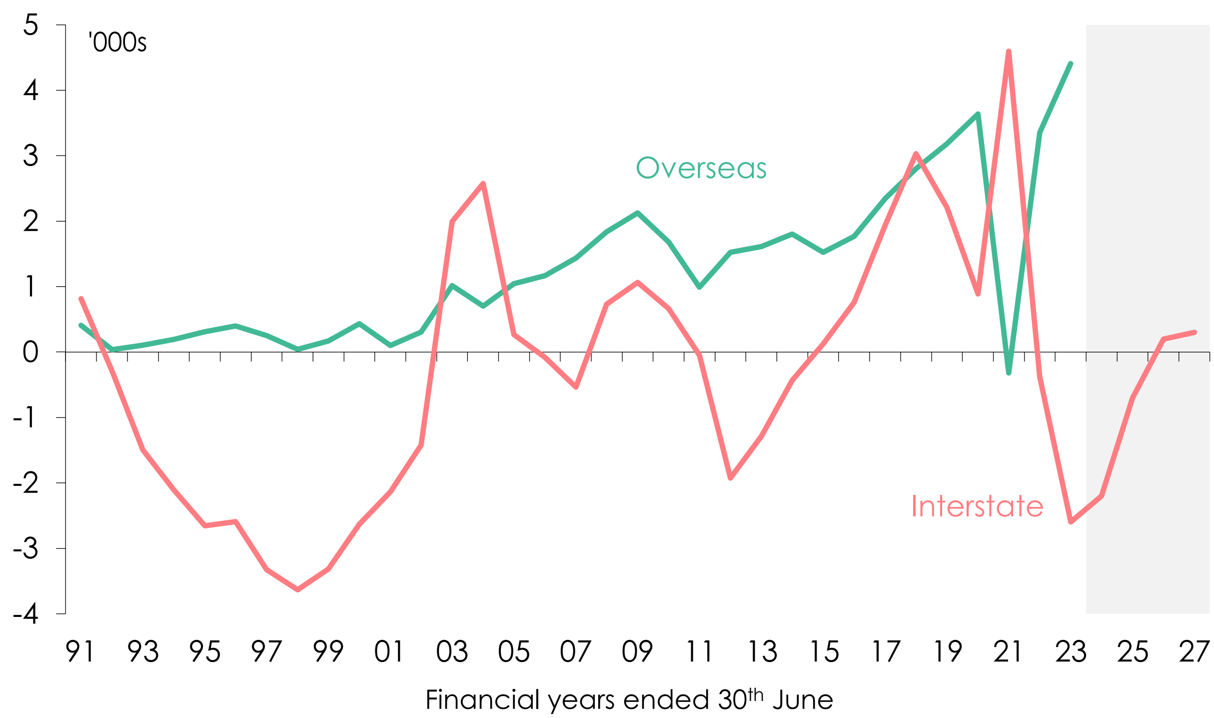
Source: Australian Bureau of Statistics (2024f).

Chart 2.3 – Growth in Tasmanian and mainland population



Note: Shaded areas denote Australian Treasury forecasts. *Sources:* Australian Bureau of Statistics (2023a); Australian Government (2024e).

Chart 2.4 – Net migration to Tasmania



Note: Shaded areas denote Australian Treasury forecasts. *Sources:* Australian Bureau of Statistics (2024a); Australian Government (2024e).

This period – when Tasmania's economy was, by most metrics, 'out-performing' the national economy and the economies of most other states and territories – would have been an ideal time for implementing reforms aimed at sustaining and prolonging this hitherto unusual conjuncture, as indeed was repeatedly urged by (for example) the annual *Tasmania Reports* produced during this period by the Tasmanian Chamber of Commerce and Industry (see eg TCCI 2015).

However, that opportunity was not taken.

And Tasmania's economy is no longer out-performing the rest of the nation. On the contrary, most of the available data since the end of 2021 suggests that Tasmania's economy may have again begun to experience, as it did for much of the 1990s and again in the early 2010s, a combination of slowing economic growth and persistent net interstate emigration which – if unchecked by decisive policy action or by strokes of 'good fortune' – risks becoming a 'vicious circle.

Thus, for example,

- Tasmania's real gross state product grew by only 1.1% in 2022-23, compared with a 3.0% increase in Australia's real gross domestic product, and was most recently (in February) estimated to have grown by 1½% in 2023-24 (Tasmanian Treasury 2024a: 19), compared with the Commonwealth Treasury's most recent (May) estimate for growth in Australia's real GDP of 1¾% (Australian Government 2024a: 6 and 53);
- Tasmania's population grew by just 0.4% over the year to 31st Decemberr 2023 (the latest available), the slowest since the year ended 31st March 2015, compared with a 2.5% increase in the total Australian population – and the Australian Treasury is projecting (in the most recent Federal Budget) that Tasmania's population will grow by only 0.4% per annum, on average, over the five years to 30th June 2028, compared with 1.6% per annum for the population of Australia as a whole (Australian Government 2024b: 129);
- 3,271 more people left Tasmania for the mainland than moved to Tasmania from the mainland in the year ended 31st December 2023, the largest net outflow since the year ended 30th June 1999 – and the Australian Treasury is projecting that net interstate emigration will continue through 2024-25 (Australian Government 2024b: 131);
- Since the Reserve Bank began lifting interest rates in May 2022, the sum of Tasmanian real state final demand and net international exports (a proxy for real GSP) has risen by 2.9%, as against a 4.7% increase in the corresponding measure for Australia as a whole;
- Over the same interval (ie, between May 2022 and July 2024), trend employment in Tasmania has risen by 0.8%, compared with a 6.3% increase in trend employment for Australia as a whole, and the proportion of the working-age population who are employed has fallen by 0.5 percentage points in trend terms in Tasmania (to 58.3%), as against a 0.2 percentage point increase (to 64.3%) for Australia as a whole.

There is no obvious single cause of this abrupt turnaround in Tasmania's economic fortunes since the end of the Covid-19 pandemic.

The series of increases in interest rates since May 2022 has dampened economic activity in Tasmania, but there is no reason why it should have had a larger impact in Tasmania than elsewhere in Australia – especially considering that interest payments account for a smaller proportion of household disposable income in Tasmania (5.3% in 2022-23) than for Australia as a whole (6.7%).

One significant factor – surprisingly unremarked in Treasury's analyses of the Tasmanian economy presented in the 2023-24 Budget Papers or the 2023-24 Revised Estimates Report – has been the effects of persistent drought conditions on Tasmania's primary production sector, which accounts for almost 10% of Tasmania's economy compared with less than 3% of Australia's. Real gross value added in agriculture, forestry and fishing declined by 6.7% in 2022-23, substracting 0.7 of a percentage point from the measured growth rate of real gross state product in that year. And drought conditions are likely to have further adversely affected this sector in 2023-24.

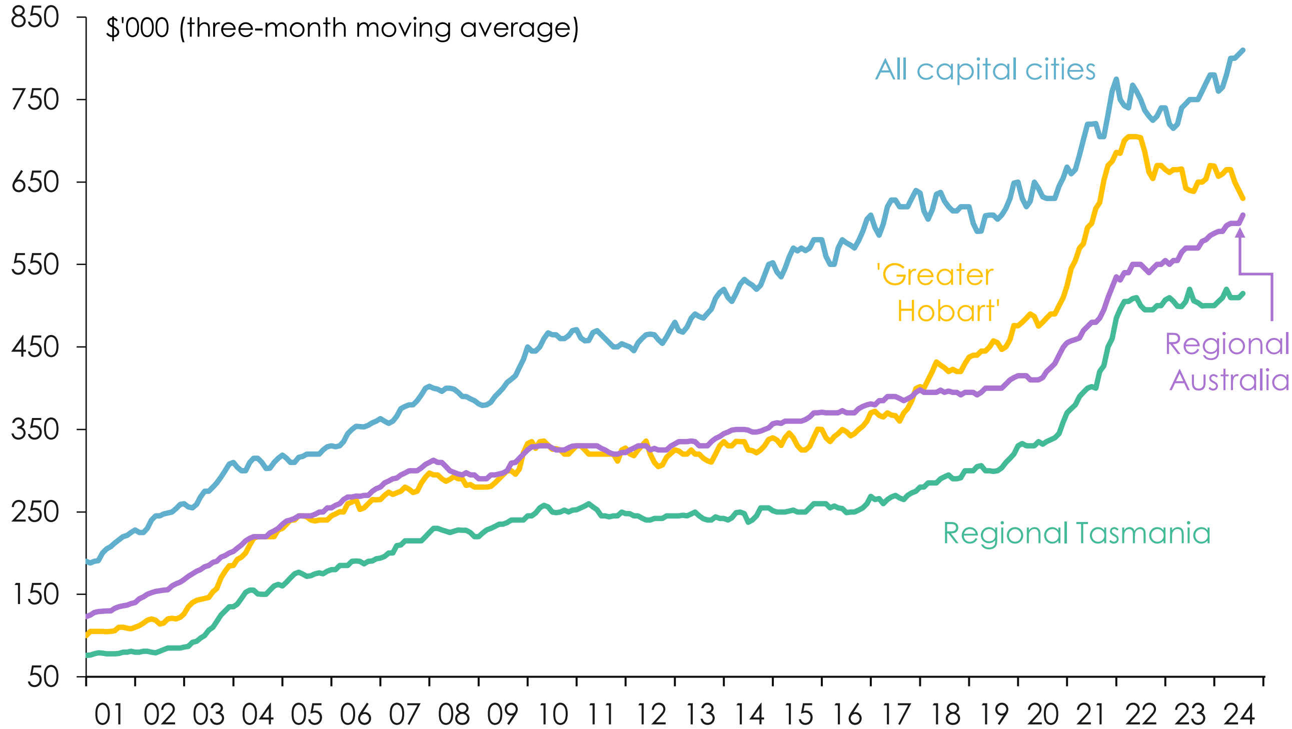
A new, but important, factor in the turn-around in population flows across Bass Strait is likely to have been the pronounced deterioration in housing affordability in Tasmania – both in absolute terms and relative to the mainland – during the period when Tasmania's economy was performing relatively better than that of the rest of Australia. Traditionally, housing costs – for both home-owners and renters – have been lower in Tasmania than in the rest of Australia, something that has partially offset the impact on material living standards of wages and salaries also tradtionally being lower in Tasmania than in the rest of Australia.

But in recent years that has no longer been the case (Chart 2.5, on page 18). Since January 2018, median residential property sale prices in Greater Hobart have averaged 81% of the average for all eight Australian capital cities, reaching a peak of 95% of the all-capitals average in March 2022, compared with an average of 66% between January 1990 and December 2017. Between May 2019 and September 2023, median sales prices in Hobart exceeded those in Adelaide; between January 2021 and April 2023 they exceeded those in Brisbane; and since Janaury 2019 they have exceeded those in Perth. Similarly, median residential property sale prices in regional Tasmania, which averaged 70% of the average for regional Australia between January 1990 and December 2017, have since then averaged 83% of the regional Australia average, exceeding 90% in 2022.

Similar trends have been evident for rents. Indeed for all but four months between March 2019 and January 2023, rents in Greater Hobart exceeded the all-capital-cities average (Chart 2.6, on page 18).

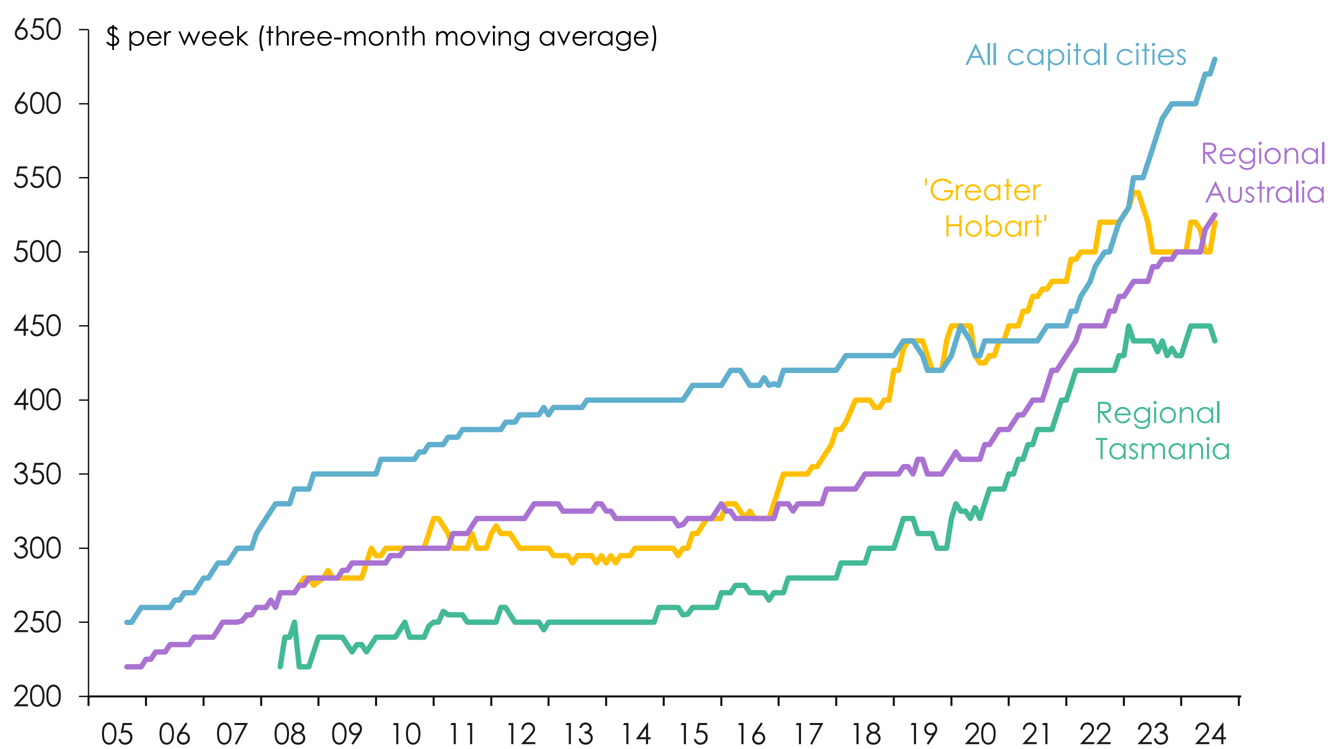
Increases in property prices are usually reported in the media as 'good news' – unlike increases in the prices of anything else. And they have been a source of wealth gains for those Tasmanians who own property (especially if they owned it before 2018). But there is another side to this story which is rarely told.

Chart 2.5 – Median dwelling sale prices, Tasmania and Australia, 2001-2024



Source: CoreLogic (2024).

Chart 2.6 – Median rents, Tasmania and Australia, 2005-2024



Source: CoreLogic (2024).

Anecdotal evidence (eg Denny 2024a) suggests that the deterioration in housing affordability has been a contributor to the decline in the number of people of working age moving from the mainland to Tasmania – because, after taking account of the lower wages or salaries typically paid in Tasmania compared to similar jobs on the mainland, higher housing costs imply a drop in material living standards for people contemplating moving to this state, detracting from whatever other 'lifestyle' factors may have been part of their decision-making process.

And it may also have been a factor in the increase in the number of older Tasmanians moving to the mainland – because they can now, to a much greater extent than traditionally, afford to purchase a property on the mainland with the proceeds of the sale of their property in Tasmania, in order (for example) to live closer to their children or grandchildren.

It's also possible that growing awareness on the mainland of the persistent (and in a relative sense growing) shortcomings of Tasmania's school education system may be a factor deterring families with children from moving to Tasmania – and, perhaps, prompting Tasmanian families to move to the mainland (Denholm 2024). Similarly, it is possible that growing awareness of the increasing shortcomings of Tasmania's health system may be deterring older mainlanders from moving to Tasmania, or encouraging both older Tasmanians and families with children to contemplate moving to the mainland (see, eg, Goddard 2020).

The history of previous episodes in the 1990s and the early 2010s warns that these trends can become mutually self-reinforcing.

The 1990s episode ended largely as a result of a combination of an ultra-low Australian dollar exchange rate (which was particularly advantageous to Tasmania's export-oriented agricultural, horticultural and manufacturing industries), a large flow of revenue from the GST in the years immediately after its introduction in 2000, a surge in interstate migration triggered by a perception that Tasmanian housing was cheap, and a sense of confidence engendered by the Bacon Labor Government.

Likewise the early 2010s episode ended largely as a result of the sharp fall in the A$ exchange rate between 2012 and 2015, the impact of China's President Xi Jinping's visit to Tasmania in November 2014 on investment and exports, a significant pick-up in Commonwealth grants to Tasmania under the Abbott Government elected in September 2013, and the sustained boost to business confidence occasioned by the election of the Hodgman Liberal Government in 2014.

It's not immediately obvious what source of 'good fortune' might result in a marked improvement in Tasmania's economic prospects, relative to the rest of Australia's, in the years immediately ahead.

Rather, it would appear that the prospects for a sustained improvement in Tasmania's economic performance will be determined by the willingness and ability (or lack thereof) of the Tasmanian Government to embrace and pursue reforms aimed at addressing the entrenched longer-term structural weaknesses in Tasmania's economy.

Tasmania's longer-term structural economic weakness

The seemingly poor prospects for Tasmania's near-term economic performance come on top of enduring structural weaknesses in Tasmania's economy, which the period of above-average economic growth between 2017-18 and 2021-22 did little if anything to remedy.

Tasmania's economy is the most poorly-performing of any state's or territory's, as measured by per capita gross state product. In 2022-23, Tasmania's per capita GSP was $26,597 (or 23.7%) below the national average (Chart 2.7).

And that 'gap' hasn't changed much over the years. Indeed, the percentage gap between Tasmania's per capita gross state product and the average for all states and territories was larger in 2022-23 than it had been in any year since the current ABS series for gross state product commenced in 1989-90 (Chart 2.8).

Indeed, even allowing for the impact of the extraordinary increase in Western Australia's per capita gross state product (in nominal terms) as a result of the stratospheric prices paid over most of the past two decades for that state's mineral and energy exports, expressed as a percentage of the per capita GSP of the "eastern states and territories", Tasmania's per capita GSP in 2022-23 was the lowest since 2004-05.

The gap between Tasmania's per capita GSP and the all-states-and-territories-average can be 'parsed' into three components using the same analytical framework as used by the Australian Treasury in the successive *Intergenerational Reports* published since 2001 (most recently Australian Treasury 2023: 25 and 27-30). This framework, adapted to the current context, can be expressed as follows:

$$\frac{\textit{gross state product}}{\textit{population}} = \frac{\textit{employment}}{\textit{population}} \times \frac{\textit{hours worked}}{\textit{employment}} \times \frac{\textit{gross state product}}{\textit{hours worked}}$$

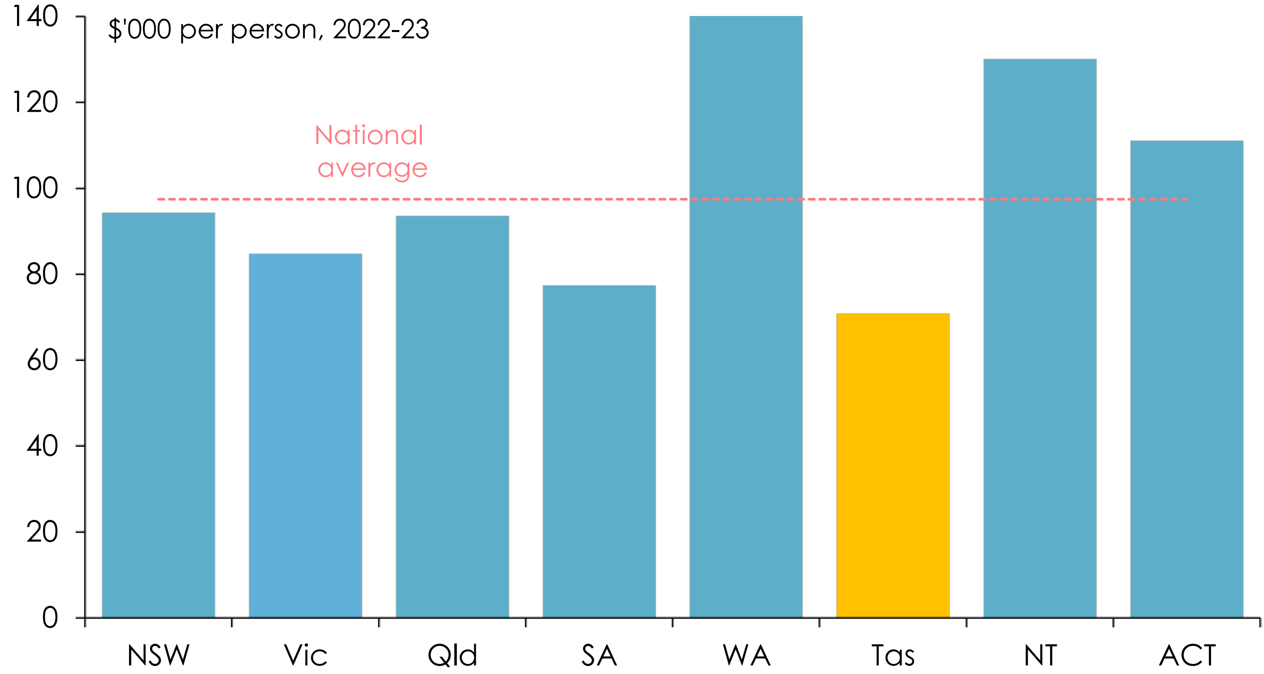
or, alternatively:

$$\textit{GSP per capita} = \textit{employment rate} \times \textit{average hours worked} \times \textit{productivity}.$$

Note that the above expressions hold true by definition, as can be seen by 'cancelling out' the employment and hours worked terms on the right-hand side of the equals sign, leaving the tautological statement that gross state product divided by population equals gross state product divided by population. Inserting the employment and hours worked terms serves simply to assist in understanding where differences in, or growth in, gross state product per capita come from.

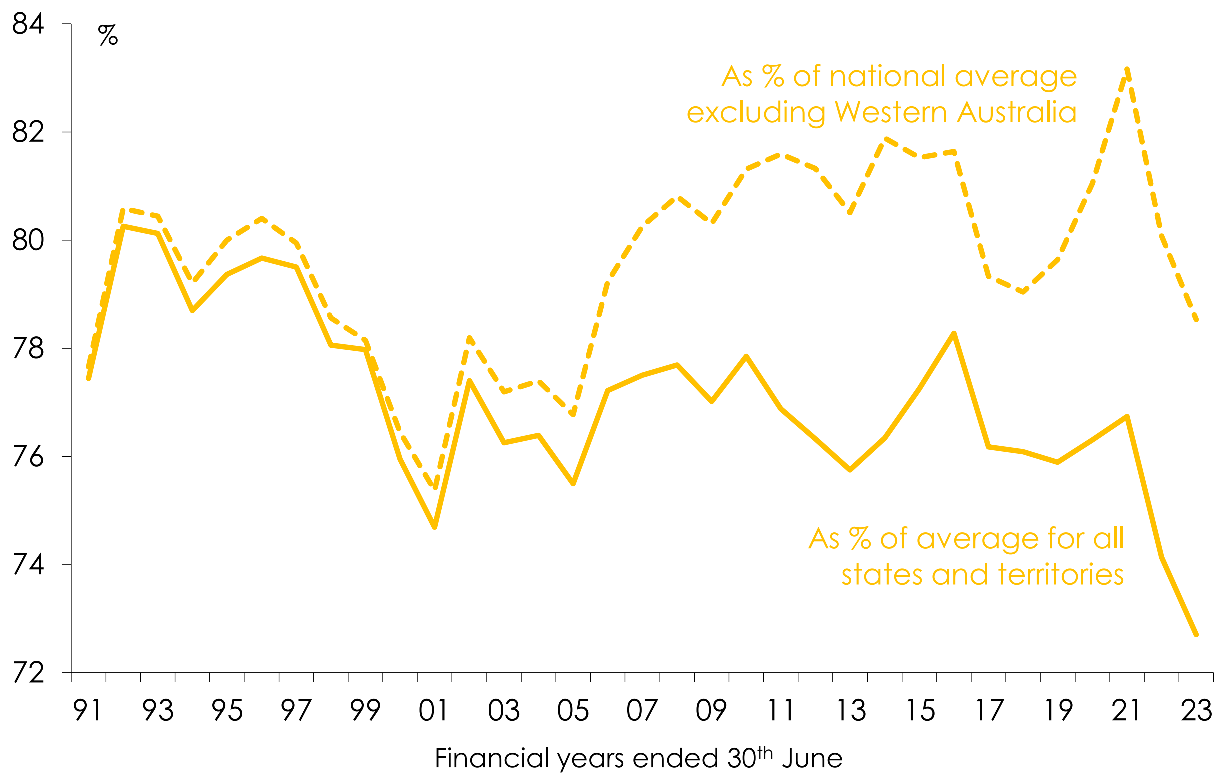
Charts 2.9 through 2.11 (on pages 22-23) show each of these components of the gap between Tasmania's per capita GSP and Australia's per capita GDP for the 2022-23 financial year.

Chart 2.7 – Gross state product per capita, states and territories, 2022-23



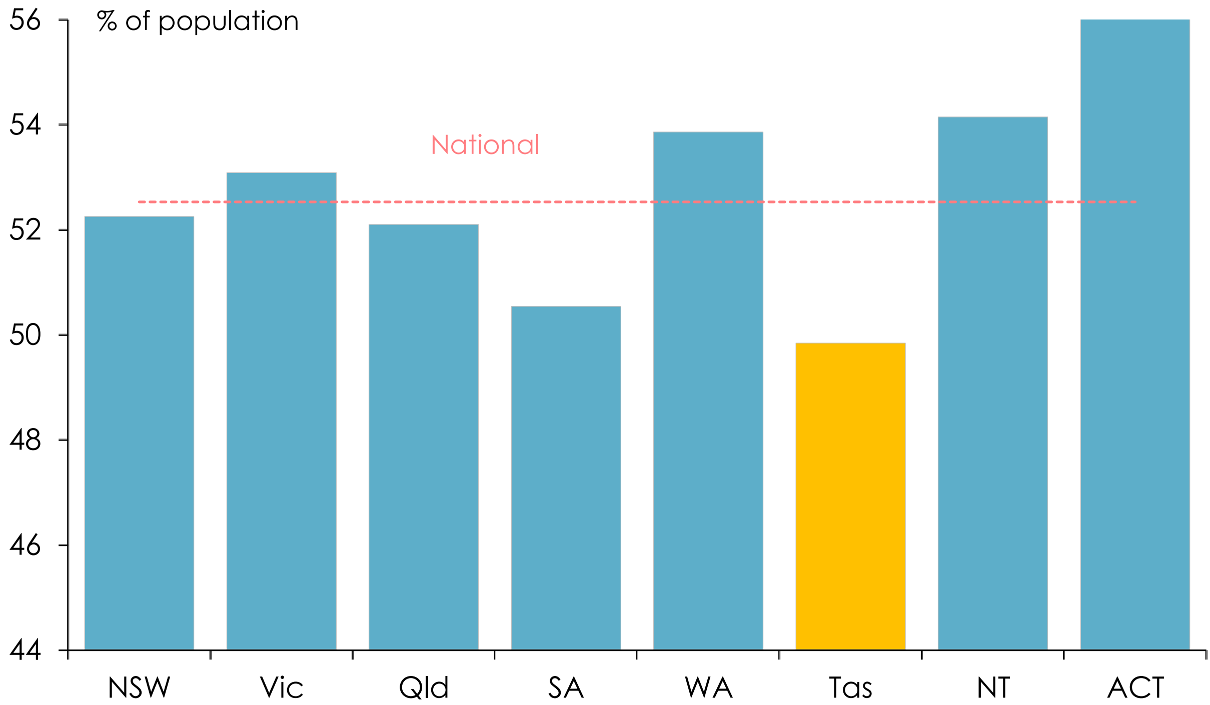
Source: Australian Bureau of Statistics (2023a).

Chart 2.8 – Tasmania's per capita gross state product as a percentage of the average for all states & territories, and all states & territories excluding WA, 1990-91 to 2022-23



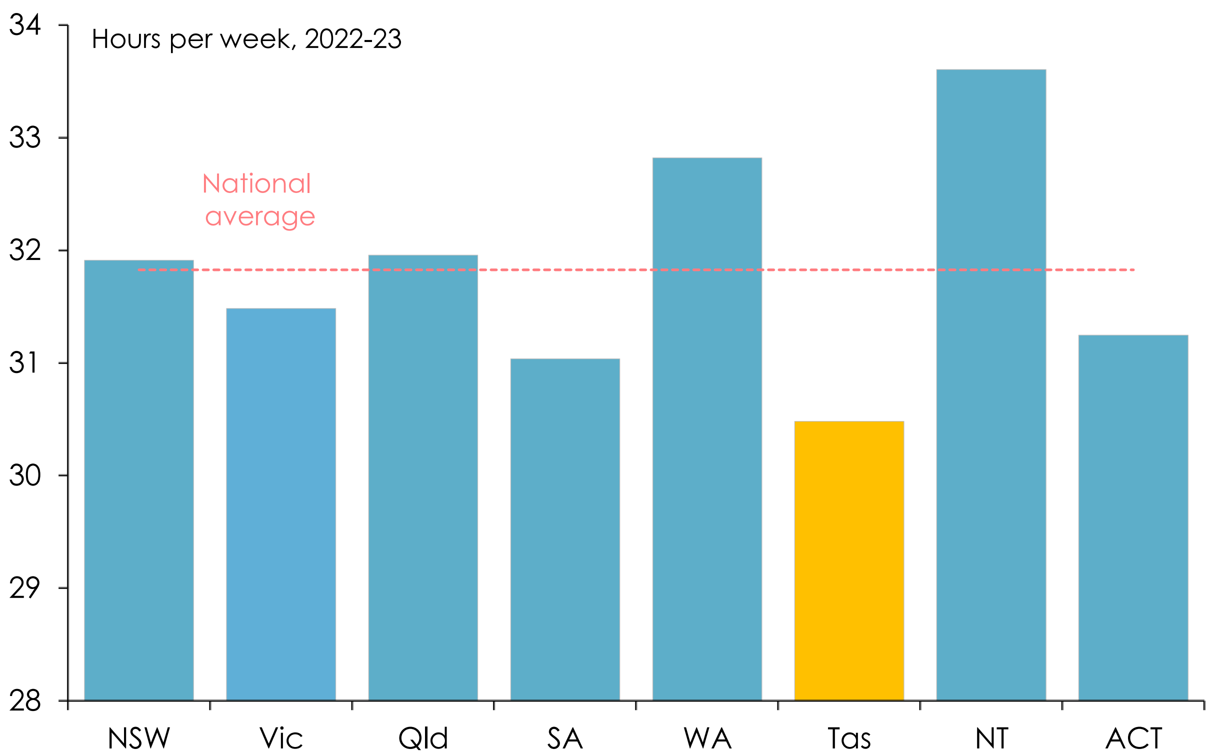
Source: Australian Bureau of Statistics (2023a).

Chart 2.9 – Employment as a percentage of population, states and territories, 2022-23



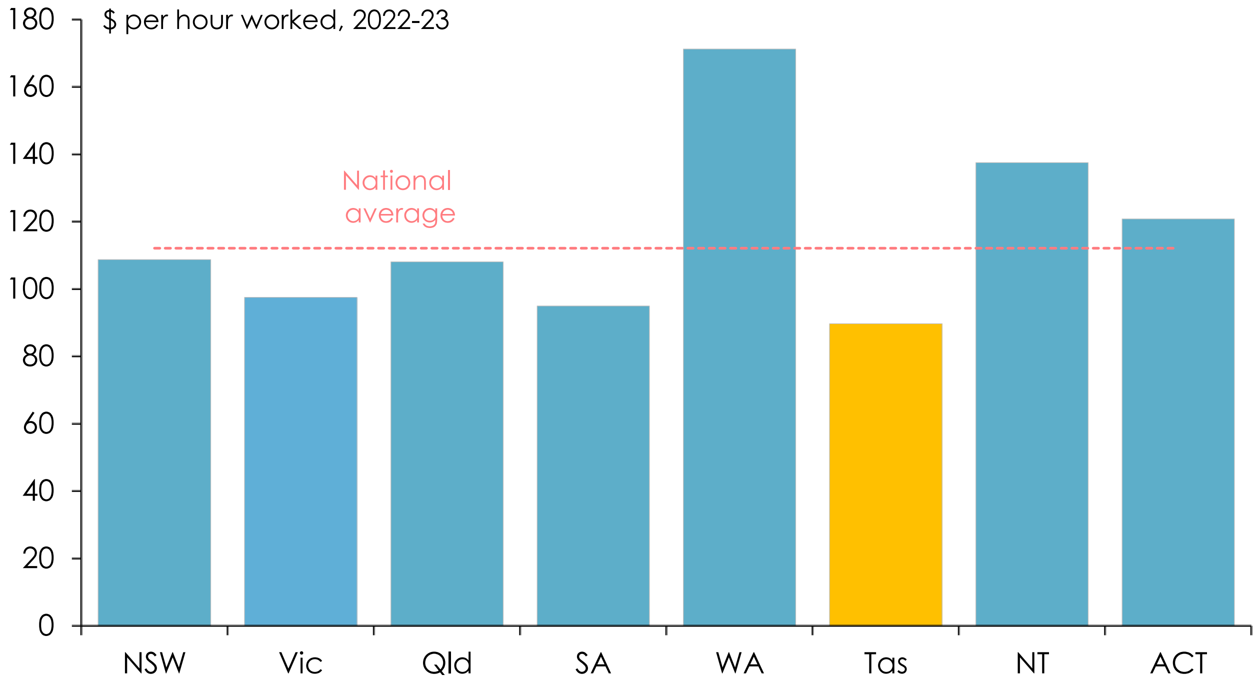
Sources: Australian Bureau of Statistics (2023a and 2024f).

Chart 2.10 – Average hours worked, states & territories, 2022-23



Source: Australian Bureau of Statistics (2024f).

Chart 2.11 – Labour productivity (gross state product per hour worked), states and territories, 2022-23



Sources: Australian Bureau of Statistics (2023a and 2024d).

Tasmania's 23.7%-below-average per capita gross state product in 2022-23 was entirely attributable to the combination of:

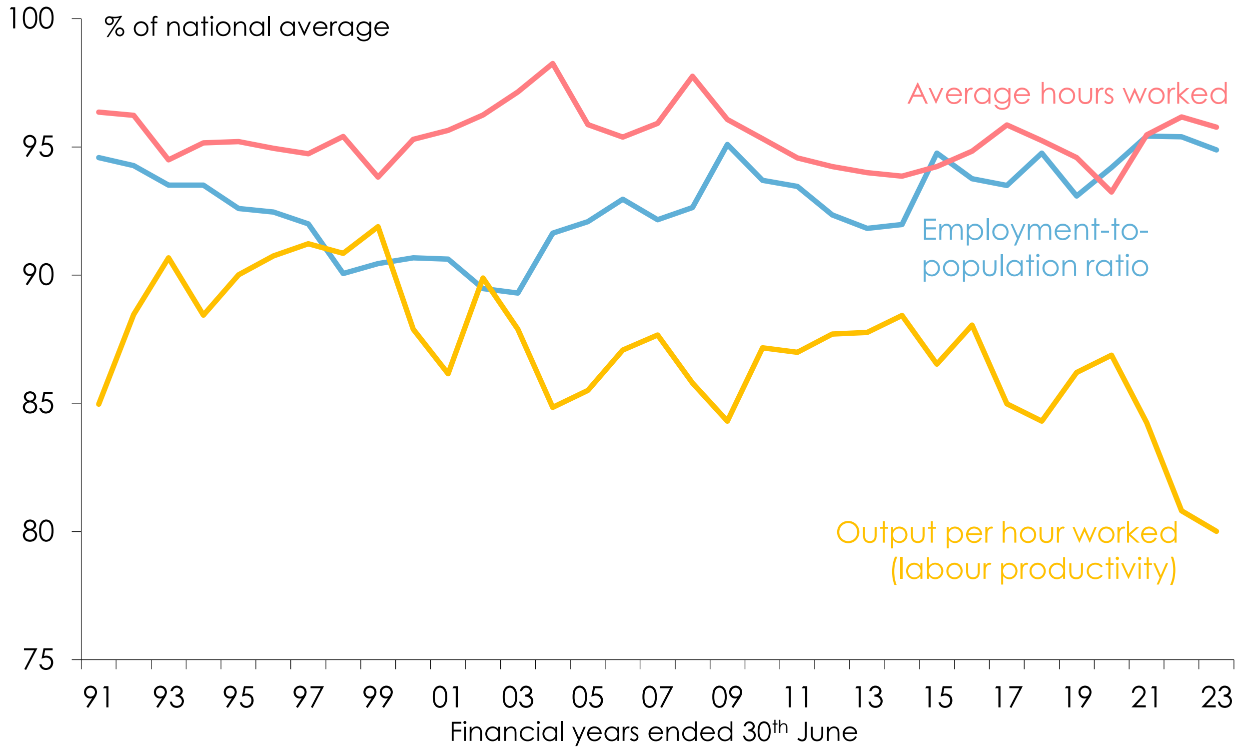
- the *proportion of Tasmania's population who were employed* being 2.7 percentage points below the national average;
- *average hours worked* by those Tasmanians who were employed being 1.4 hours per week (or 4.3%) below the national average; and
- *labour productivity* (or output per hour worked) of those Tasmanians who were employed being $20 per hour (or 18.8%) below the national average.

Chart 2.12 (on page 24) shows that while there has been some improvement in the proportion of Tasmanians in employment relative to the national average over the past two decades, that has been more than offset by a decline in average hours worked relative to the national average, and by a decline in labour productivity relative to the national average.

It wouldn't be possible to eliminate these gaps entirely – and hence to eliminate the gap between Tasmania's per capita gross state product and the national average:

- a higher proportion of Tasmania's population is aged 65 or over (and hence much less likely to be working) than that of any other state or territory (which accounts for some, though not all, of Tasmania's below-average employment-to-population ratio), and that isn't going to change in the foreseeable future; and

Chart 2.12 – Tasmania's employment-to-population ratios, average hours worked and labour productivity (output per hour worked) as percentages of national averages



Source: Australian Bureau of Statistics (2023a, 2024d and 2024f).

- a lower proportion of Tasmania's workforce is employed in intrinsically high-productivity industries (such as mining, financial and insurance services, and professional, scientific and technical services), which is also unlikely to change in the absence of new discoveries of major mineral resources, and given that Tasmania is unlikely ever to have a sufficiently large population base to support a relatively large number of jobs in financial and insurance services, or professional, scientific and technical services.

However, neither of these factors imply that the 'gap' between Tasmania's per capita gross state product and that of the rest of Australia must inevitably be as wide as it has become, or that it couldn't be substantially narrowed over time.

A common factor in all three of the 'gaps' – in employment as a percentage of the population, in average hours worked (which is almost entirely due to the fact that a higher proportion of Tasmanian jobs than in any other state or territory are part-time), and in labour productivity – is Tasmania's persistently low levels of educational attainment. There is an overwhelming body of evidence, from Australia and abroad, that the probability of a person being employed, the probability that a person who is employed will be employed full-time, and a person's earnings in employment (which are closely correlated with his or her productivity) increases with levels of educational attainment (see eg Australian Government 2023: 119; Australian Department of Education 2020; and OECD 2023: 74-107).

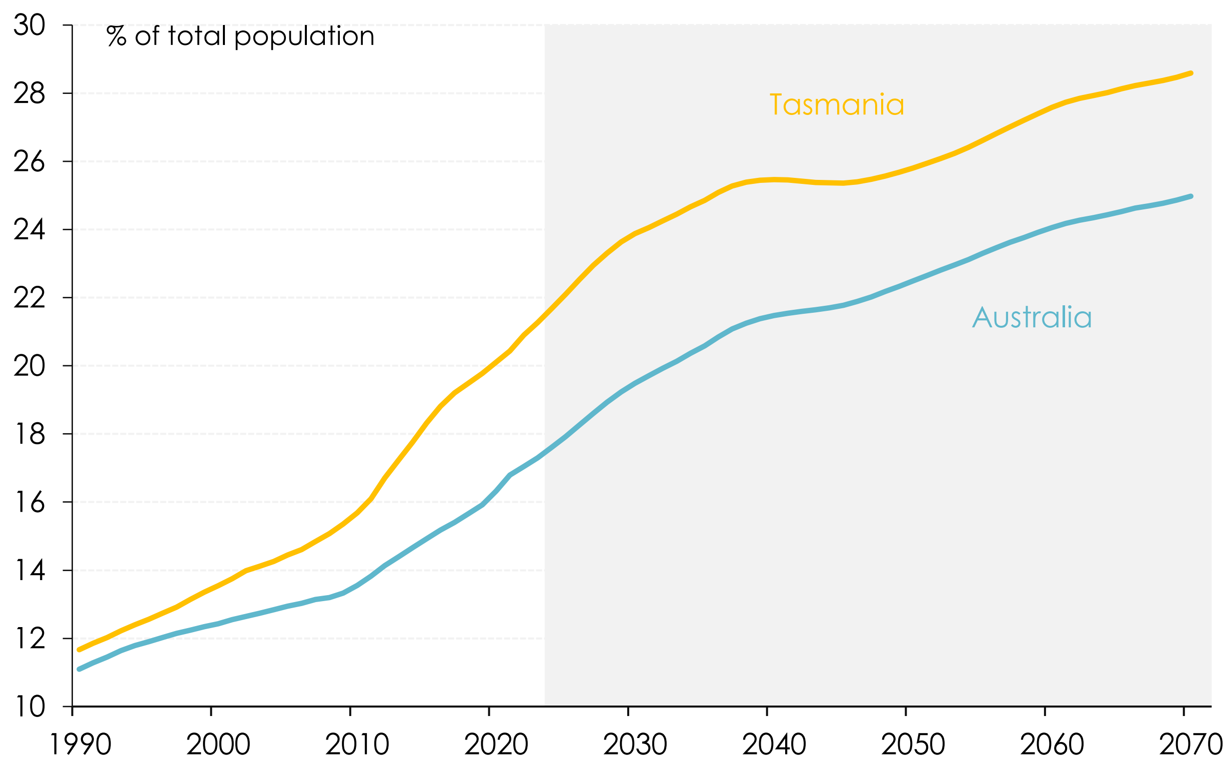
Hence, policies and strategies which succeed in lifting Tasmania's below-average levels of educational participation and attainment are highly likely also to result (over time) in increases in the proportion of Tasmania's population who are employed, an increase in the proportion of Tasmanian jobs which are full- rather than part-time, and an increase in labour productivity – and hence in a higher level of gross state product per capita, relative to other states and territories.

Medium-term prospects for Tasmania's economy

In the absence of reforms directed at increasing participation in employment and lifting both the level and rate of growth of labour productivity in Tasmania, the disparity between material living standards in Tasmania and the rest of Australia will be excerbated by the more rapid ageing of Tasmania's population over the next 15 years.

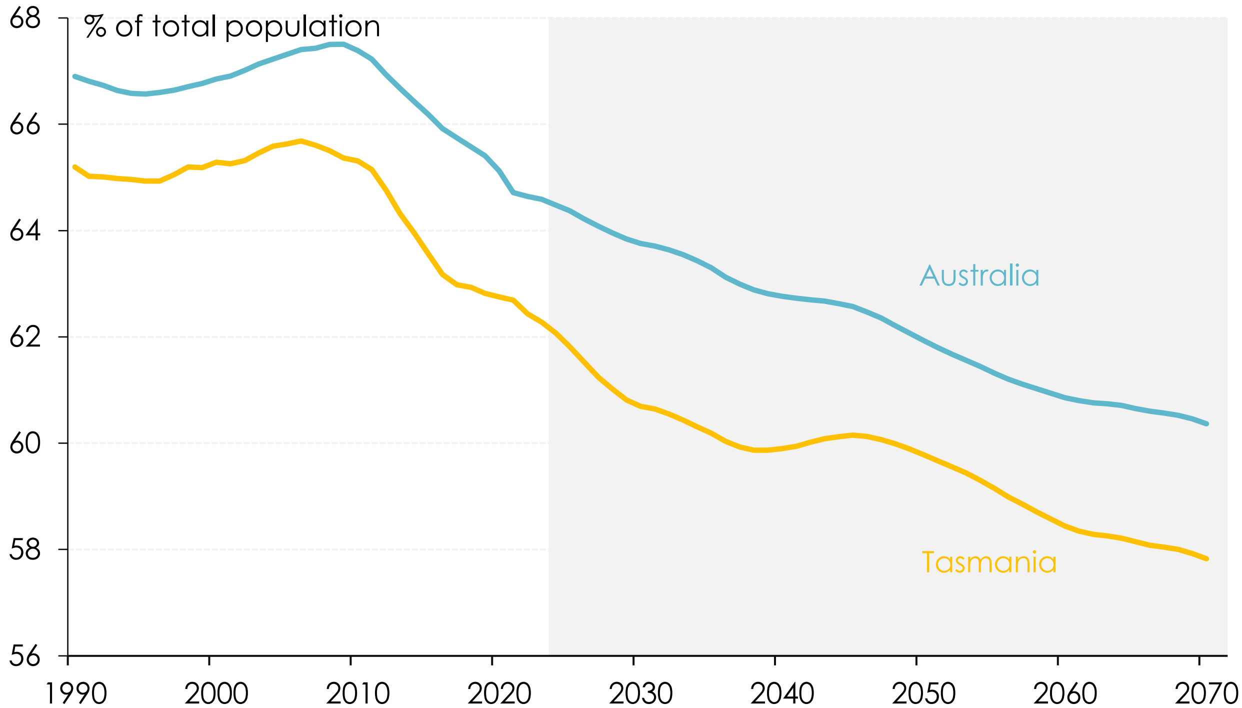
At the end of June last year, 17.3% of Tasmania's population was aged 65 or over, 2.3 percentage points above the national average. By June 2030, that percentage will have risen, according to the most recent 'medium' ABS projections (ABS 2023b) to 19.5%, 3.1 percentage points above the national average, a margin which is expected to be maintained throughout most of the 2030s before the rest of Australia begins to age more rapidly (Chart 2.13).

Chart 2.13 – Population aged 65 and over as a percentage of total



Note: Shaded areas denote ABS 'medium' projections. *Source:* Australian Bureau of Statistics (2023b).

Chart 2.14 – Population aged 15-64 as a percentage of total



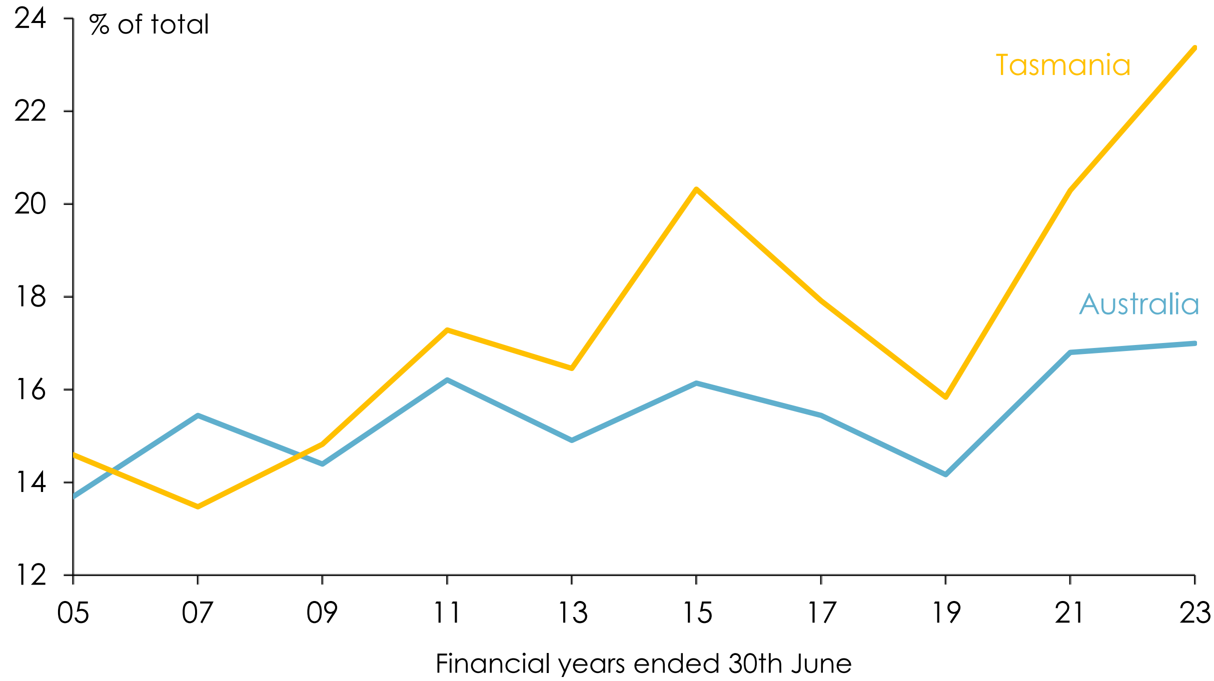
Note: Shaded areas denote ABS 'medium' projections. *Source:* Australian Bureau of Statistics (2023b).

Conversely, the proportion of Tasmania's population aged 15 to 64 – traditionally regarded as 'working age' – at the end of June 2023 of 62.3%, 2.3 percentage points below the corresponding national average, is expected to decline to 60.7% by June 2030, 3.1 percentage points below the national average, and to less than 60% in the latter part of the 2030s (Chart 2.14).

The prospective impact on Tasmania's more rapidly ageing population on Tasmania's economic performance relative to that of the rest of Australia is likely to be further compounded by the fact that Tasmanians have, over the past decade, become much more likely to retire – and to retire 'early' – than other Australians (Chart 2.15). Almost 23.4% of Tasmanians aged 45 and over in 2022-23 intend to retire within the next five years, according to a biennial ABS survey (ABS 2024b), compared with 17% of all Australians in that age range; when this survey was first taken, in 2004-05, the proportion of Tasmanians aged 45 and over planning to retire in the next five years was less than 1 percentage point above the corresponding proportion of all Australians in that age range. Almost twice as many Tasmanians aged 45 and over – 11.1% - plan to retire with in *two* years – as all Australians – 5.4%.

As demographer Lisa Denny points out, this means that "around 120,000 Tasmanian workers will likely exit the workforce over the next 20 years", which will "create further skill and labour shortages due to the demand for replacement labour [and] add to the challenges to fill new job creation opportunities as well" (Denny 2024).

Chart 2.15 – Proportion of population aged 45 and over intending to retire within the next five years



Source: Australian Bureau of Statistics (2023b).

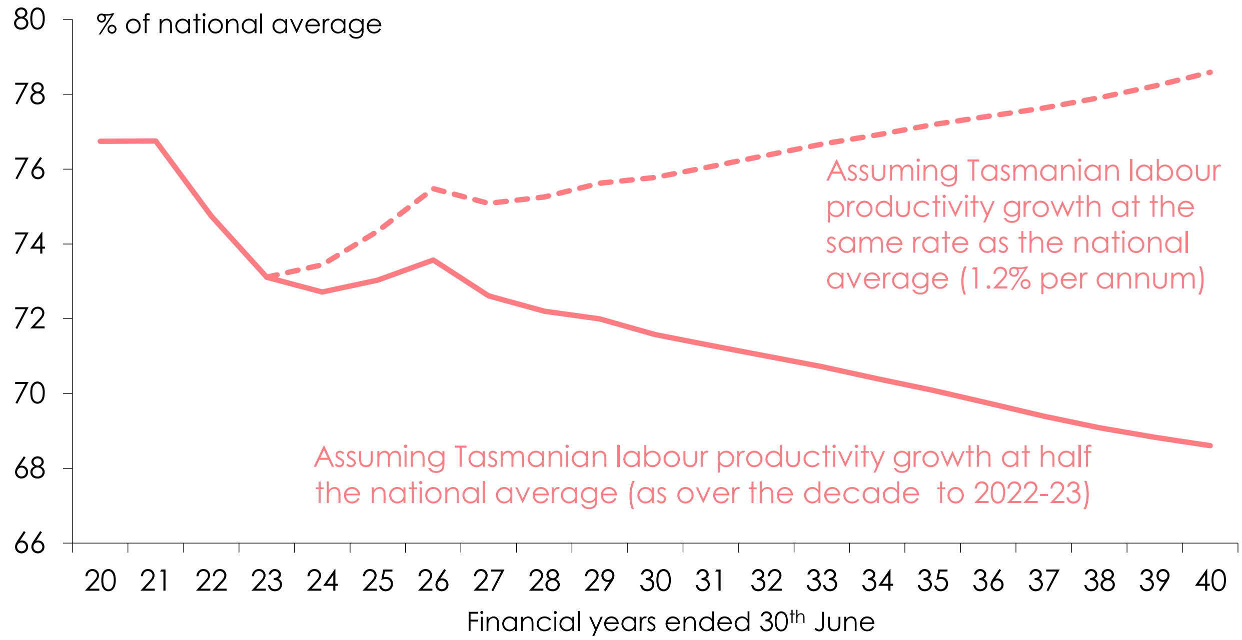
The more rapid ageing of Tasmania's population also implies that the average number of hours worked by those Tasmanians who are in employment is likely to decline more rapidly than the corresponding figure for Australia as a whole, given that older workers tend to work fewer hours (Australian Treasury 2023: 29, 61 and 72).

Hence, even if Tasmanian labour productivity were to grow, over the medium term, at the same 1.2% per annum rate which the Australian Treasury assumes in its most recent *Intergenerational Report* (2023: 21, 23 and 29), Tasmania's per capita gross product will (all else being equal) continue to decline relative to the rest of Australia – from 73% of the national average in 2022-23 to 71½% of the national average by 2029-30, 70% of the national average by 2034-35 and 68½% of the national average by 2049-40 (Chart 2.16, on page 28).

That would in turn mean that the difference in per capita gross product between Tasmania and Australia as a whole would widen from about $23,500 in 2022-23 to more than $26,750 (in 2021-22 dollars) in 2029-30, to $30,500 in 2034-35, and to almost $35,000 by 2039-40 (Chart 2.17, on page 28).

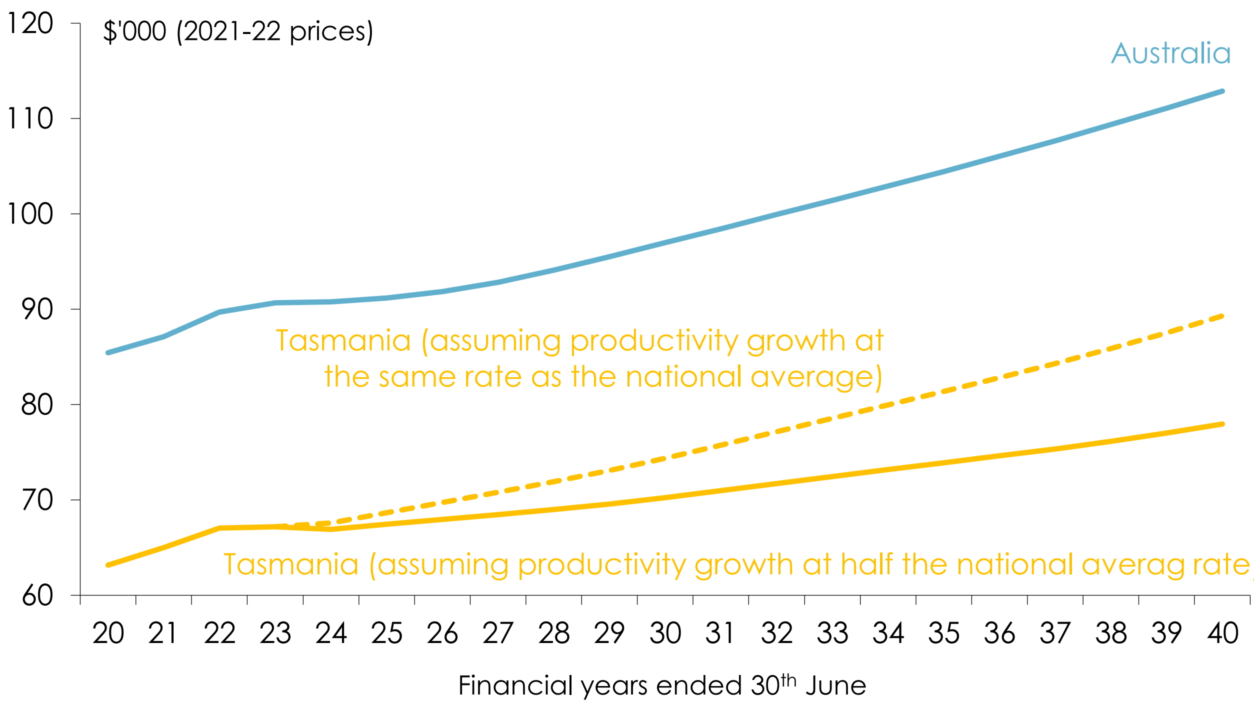
And the assumption that Tasmanian labour productivity will grow at the same rate as the national average over the next five, ten and fifteen years seems optimistic, given that over the past decade, Tasmanian labour productivity has grown at half the national average rate. If that were to continue, then Tasmania's per capita GSP would fall to just 62% of the national average by 2039-40, implying a shortfall of more than $42,000 (in 2021-22 dollars) from the Australia-wide average.

Chart 2.16 – Tasmania's per capita gross product as a percentage of the national average, 2019-20 to 2039-40



Sources: Australian Bureau of Statistics (2023a and b); Australian Treasury (2023); Australian Government (2024a); and Review calculations.

Chart 2.17 – Tasmania's and Australia's per capita gross product in constant 2021-22 prices, 2019-20 to 2039-40



Sources: Australian Bureau of Statistics (2023a and b); Australian Treasury (2023); Australian Government (2024a); and Review calculations.

Conversely, if Tasmania could lift its labour productivity growth rate to an average of 1½% per annum – that is, about ¼ percentage point per annum above the rate assumed for Australia as whole by the federal Treasury in the most recent *Intergenerational Report* – then (all else being equal) there would be no further decline in Tasmania's per capita gross product relative to the national average over the next fifteen years. That should be the minimum aspiration for Tasmanian Governments over this interval.

More optimistically, if Tasmania's labour productivity growth rate could be lifted to an average of 2% per annum, then (all else being equal) the difference between Tasmania's per capita gross product and the national average would be reduced to $32,000 (in 2021-22 dollars).

The connections between Tasmania's economic performance and the financial position of Tasmanian households and the Tasmanian Government

Improving Tasmania's productivity performance – even by enough to prevent a further deterioration in Tasmania's per capita gross product relative to the national average over the next 15 years, let alone by enough to begin narrowing that gap – will likely require comprehensive reforms to Tasmania's under-performing education system, and to a wide range of government policies which influence the decisions made by individuals and businesses (both those currently living or operating in Tasmania, and those contemplating moving to, or expanding in, Tasmania). Achieving sufficient support for those reforms will, inevitably, be politically challenging.

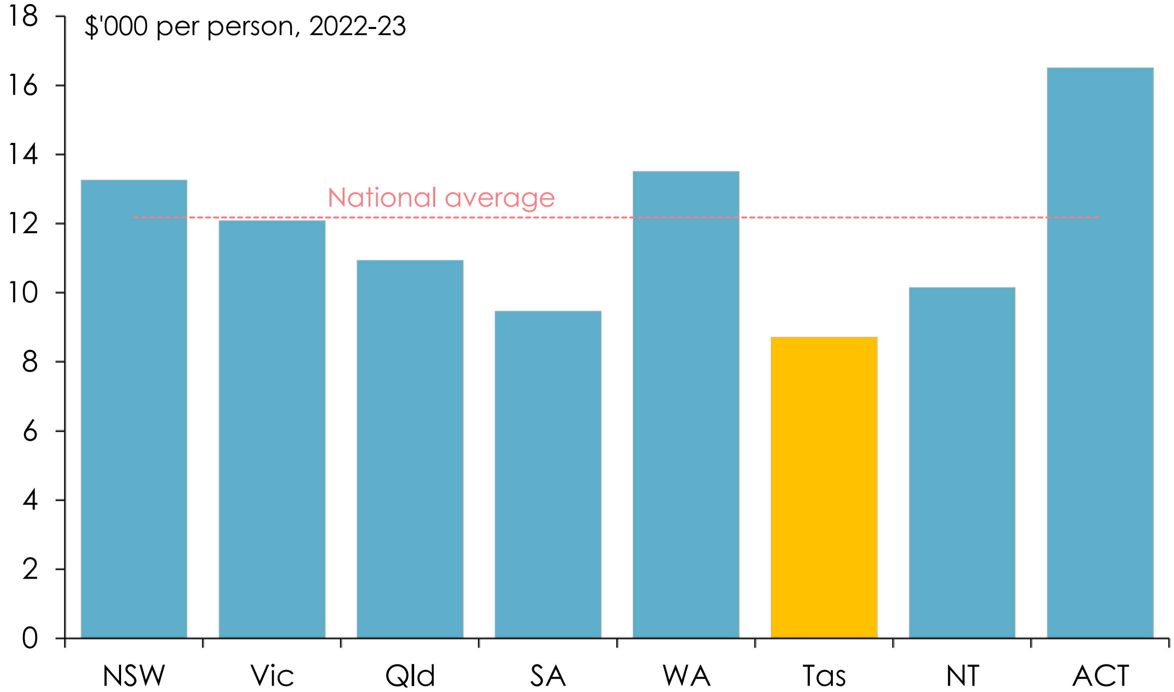
That's partly because Tasmanian households are significantly insulated from the poor performance of the Tasmanian economy by the operation of the national taxation and social security systems, which redistribute income from high-income households (of which Tasmania has a smaller proportion than any other jurisdiction) to low-income households (of which Tasmania has a larger proportion than any other jurisdiction). Thus Tasmanians paid, on average in 2022-23, $3,461 (or 28%) per head less in personal income tax (Chart 2.18 on page 30) whilst receiving $1,765 (or 32%) per head more by way of pensions, benefits and other social security transfers than the national average (Chart 2.19 on page 31).

And that in turn means that the difference between Tasmanian household disposable income per capita and the national average is much smaller ($4,764 or 8.4%) than the corresponding difference in per capita gross state product (23.7%) (Chart 2.20).

That is, of course, the way a progressive tax-transfer system is supposed to work.

But it perhaps also means that Tasmanians are less receptive than they might otherwise be to concerns about the persistently poor performance, relative to the rest of Australia, of Tasmania's economy, and less willing to support (or at least acquiesce in) reforms intended to improve Tasmania's economic performance relative to the rest of Australia. That represents a particular challenge for political leadership in Tasmania – one from which successive political leaders have repeatedly shied away.

Chart 2.18 – Personal income tax payments per capita, states and territories, 2022-23

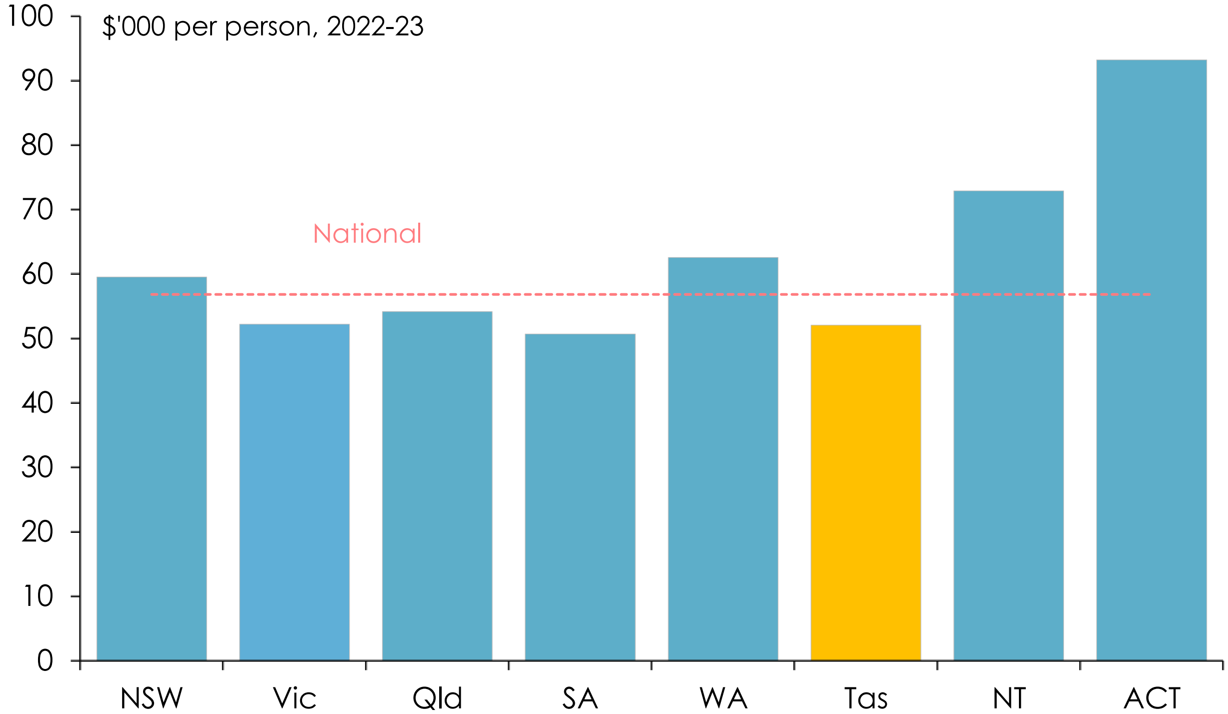


Source: Australian Bureau of Statistics (2023a).

Chart 2.19 – Social security payments per capita, states and territories, 2022-23

Source: Australian Bureau of Statistics (2023a).

Chart 2.20 – Household disposable income per capita, states and territories, 2022-23



Source: Australian Bureau of Statistics (2023a).

Indeed the Tasmanian State Government is itself insulated to some extent from the effects of the entrenched structural weaknesses in the Tasmanian economy by the long-standing system of 'horizontal fiscal equalization', under which 'general revenue' or 'untied' grants from the Commonwealth Government and, since its introduction in 2000, revenues from the goods and services tax (GST), are distributed among the states and territories with a view to equalizing their 'fiscal capacity' – that is, to enable each state and territory to provide a similar range and standard of public services to its citizens and residents whilst levying on them similar levels of state taxes and charges.

If it were not for the pursuit of 'horizontal fiscal equalization' by Federal Governments of both political persuasions for more than 90 years, the range of education, health, policing and other state public services provided to Tasmanians would have been significantly inferior to those provided to Australians living in other states and territories, and/or the state taxes paid by Tasmanians would have been significantly higher than those paid by Australians living in other states and territories[1].

[1] The principle of 'horizontal fiscal equalization, first promulgated by the Commonwealth Grants Commission in 1936, has been undermined by the changes made to the basis for determining the distribution of revenue from the GST among the states and territories by the Morrison Government (with the support of the then Opposition) in 2018, with the intention (and the result) of giving Western Australia a larger share of the revenue from the GST than it would have obtained had those changes not been made, and with the cost of insulating the other states and territories from what would otherwise have been reductions in their shares of revenue from the GST being borne by the Commonwealth: for more details see, eg, Eslake (2024b).

The Commonwealth Grants Commission, on whose recommendations the distribution of revenues from the GST among the states and territories is determined, has since its inception recognized that Tasmania's capacity to raise revenue from its own resources is lower than that of any other state or territory, while its 'expenditure needs' (how much it needs to spend, per head of population, taking into account the various economic and social factors determining the 'demand' for public services and the unit cost of providing them) are usually (though not always) greater than the average for all states and territories.

As a result, Tasmania has on average since the introduction of the GST in 2000-01 received 1.72 times as much by way of revenue from the GST as it would have had those revenues been distributed (as is often urged by the larger states) on an equal-per-capita basis (that is, in accordance with each state and territory's share of Australia's total population).

Thus for example in 2022-23, Tasmania raised $5,210 per person in revenue from its own resources, compared with the average for all states and territories of $7,689 per person; but received the equivalent of $5,934 per person in the form of revenue from the GST, compared with the average for all states and territories of $3,276 per person.

Commonwealth grants to states and territories for specific purposes (such as schools, hospitals, social housing and roads) are typically distributed on closer to an equal-per-capita basis (except to the Northern Territory), so for example in 2022-23 Tasmania received the equivalent of $3,742 per person by way of specific purpose grants, compared with the average for all states and territories of $3,145 per person.

The upshot is that the Tasmanian Government derives a higher proportion of its total revenue from grants from the Commonwealth (including its share of GST revenues) than any other state or territory government, except for the Northern Territory (Chart 2.21).

There is no evidence – from three successive inquiries between 1993 and 2018 – that any state or territory government which receives a larger share of GST revenues than it would under an equal-per-capita distribution (including Tasmania's) has been dissuaded from pursuing economic growth- or productivity-enhancing reforms for fear of losing some of that share (see Industry Commission 1993: 287; Brumby, Carter and Greiner 2012: 18, and 135-140; Productivity Commission 2018: 15 and 38).

However it is seems plausible that the insulation which the system for distributing GST revenues among the states and territories provides the Tasmanian Government from the sub-par long-term performance of the Tasmanian economy blunts the incentives to pursue growth- or productivity-enhancing reforms – since the consequences of that sub-par performance for Tasmania's own-source revenues are offset by the higher-than-average per capita share which Tasmania receives from GST revenues.

Chart 2.21 – Sources of state and territory revenues, 2022-23

Sources: Australian Government (2024b); Tasmanian Government (2023b) and other states' equivalents.

Conversely, the fact that almost 40% of the Tasmanian Government's revenue comes from its share of the GST (compared with the average for all states and territories of about 23½%) means that Tasmania is perennially vulnerable, not just to fluctuations and shifting trends in national consumer spending (and in particular to the declining share of consumer spending which is subject to the GST), but also to pressure from the larger and richer states (who regard themselves as 'donors' to what their political representatives have sometimes derided as 'mendicant states') on the Commonwealth Government to change the basis for distributing the revenue from the GST in ways that would advantage them, at the expense of Tasmania and the other fiscally weaker states and territories.

This risk will loom very large as the scheduled expiry of the so-called 'No Worse Off Gurantee' – that none of the 'eastern' states and territories would get any less from the distribution of GST revenues as a result of the changes being phased in between 2021-22 and 2026-27 at the behest of Western Australia than they would have had those changes not been made, at a cost to the Federal Budget now estimated at \$53bn over 11 years – at the end of the 2029-30 financial year draws closer.

This 'guarantee' was extended by the current Federal Government for another three years beyond its originally scheduled expiry at the end of the 2026-27 financial year, in order to cajole the states and territories into negotiations with the Commonwealth over the distribution of responsibility for funding disability services outside the NDIS.

While that sets a precedent for a further extension in the event that iron ore prices remain well above the assumptions made in the most recent Federal Budget Papers (so that the ‘eastern’ states and territories would be substantially worse off, in the absence of that guarantee, than they would have been had the basis for distributing GST revenues not been changed), there is currently no assurance that this precedent will be followed.

And of course if iron ore prices were to have fallen to (say) US$60 per tonne by the end of the decade, and metallurgical and thermal coal prices to US$140 and US$70 per tonne respectively (as the Australian Treasury assumes they will by the March quarter of next year) then Western Australia’s and Queensland’s shares of GST revenues will rise at the expense of Tasmania’s (and the other states and territories), with or without the ‘No Worse Off Guarantee’.

In sum, Tasmania’s finances would be in a stronger and more resilient position if Tasmania’s economic performance were not so far behind that of the other states and territories – that is, if its per capita gross state product was not as far below the average for all states and territories as it has for so long been – which it would be if a higher proportion of Tasmanians were employed, if a larger proportion of those who are employed were working full-time, and if the productivity of those who are employed were higher.

That’s why any comprehensive strategy for improving the sustainability of Tasmania’s public finances needs to entail more than some combination of expenditure and revenue measures, but needs to embrace more wide-ranging reforms aimed at improving Tasmania’s economic performance by lifting employment participation and raising productivity growth.

3. Recent trends in Tasmania's public sector finances

Introduction

The condition of Tasmania's state public sector finances improved during the middle years of the decade prior to the onset of the Covid-19 pandemic, but by most summary metrics began to deteriorate before the pandemic hit (notwithstanding the relatively strong performance of the Tasmanian economy during this period, as noted in Chapter 2). It deteriorated sharply during the pandemic (as to varying degrees did the fiscal condition of every other state and territory, and of the Commonwealth), and has continued to deteriorate since the end of the pandemic.

This Chapter documents the changes in Tasmania's fiscal position over the decade to 2022-23, the most recent financial year for which complete data are available (although preliminary unaudited data for the general government sector for 2023-24 were published three days before the completion of this Review), and in particular over the past six years, and seeks to shed light on the reasons for those changes.

There are a number of indicators of any government's fiscal position, and not all of them will say the same thing at the same time.

State and territory governments focus almost exclusively on *accrual accounting* measures of spending ('expenses') and revenues, and on the '*net operating balance*' (the difference between 'operating' expenses and 'operating' revenues) as 'the' measure of the 'bottom line'. Accrual accounting recognizes expenses (including expenses where no monetary payment is made, such as depreciation) when they are incurred, rather than when payments are made, and revenues when they are earned, rather than when payment is received.

The 'net operating balance', by definition, excludes 'net purchases of non-financial assets' – which used to be called 'capital expenditures' or 'capital works', and is nowadays more commonly referred to as 'infrastructure spending' (although these terms are not precisely the same thing according to public sector accounting standards). The '*fiscal balance*', which is the net operating balance plus net purchases of existing assets and changes in inventories minus depreciation, is the most comprehensive accrual accounting measure of the financial results of government operations during a given financial year.

By contrast, most commentary on or analysis of the Federal budget concentrates on the cash accounting measure of the 'bottom line', the 'underlying' cash balance, which is the difference between cash payments and cash receipts, excluding 'net cash flows from investments in financial assets for policy purposes' (which is comprised of loans or advances net of repayments, and purchases or subscriptions of equity, typically though not always in government-owned business enterprises). The 'headline' cash balance in the Federal Budget Papers is the sum of the 'underlying' balance and 'net cash flows from investments in financial assets for policy purposes'.

State and territory governments also produce cash flow statements from which the 'bottom line' measure is the *GFS* (government financial statistics) *cash surplus or deficit*, and which is analagous to the 'headline cash balance' in the Federal Budget papers. However they typically don't attract nearly as much attention in the presentation, discussion or analysis of state budgets as the accrual accounting measures.

The cash surplus or deficit is the principal driver of movements in *net debt*, which is the balance sheet item commonly of most interest in assessments of the soundness of a government's fiscal position. In Tasmania's Budget Papers, unlike those of some other states and territories, 'net debt' includes lease liabilities as well as gross interest-bearing debt minus cash and interest-bearing assets.

However net debt is an incomplete measure of a government's financial obligations, because it excludes other obligations which carry contractually binding commitments to make regular cash payments, in particular (in the Tasmanian context) the unfunded liability for pension and superannuation benefits to members of defined benefit schemes, and their surviving spouses or partners. The balance sheet measure which does include these and other obligations (such as employee entitlements) is *net financial liabilities*.

Finally, while most commentary on and analysis of a government's financial position focuses on what is referred to in Budget Papers and ABS statistics as the '*general government*' sector, which includes government departments and agencies funded wholly or largely by appropriations from the Public Account, a comprehensive assessment also needs to consider the financial position of government-owned *financial* and *non-financial corporations*, particularly in the Tasmanian context given that, as noted in Chapter 2, these represent a larger proportion of the Tasmanian economy than they do of the economies of most other states and territories[2].

Trends in Tasmania's general government finances over the past decade

The financial position of Tasmania's 'general government' sector deteriorated in the early 2010s, largely as a result of shortfalls in revenues resulting from the downturn in Tasmania's economy and from sluggish growth in the national GST pool in the aftermath of the global financial crisis (Chart 3.1). Beginning in 2009-10, the general government sector incurred cash deficits for the first time since 1996-97 (Chart 3.4), the net debt position deteriorated by $774mn over the following four years (although the general government sector remained a 'net creditor') (Chart 3.6), and total net financial liabilities (including the unfunded superannuation liability) increased by $1.7bn.

Corrective action instituted in the 2011-12 and 2012-13 Budgets – including tax increases, more stringent control over 'operating' expenses and significant reductions in infrastructure spending (Chart 3.3) – resulted in the cash balance returning to surplus in 2013-14, and net debt declining again over the following four financial years.

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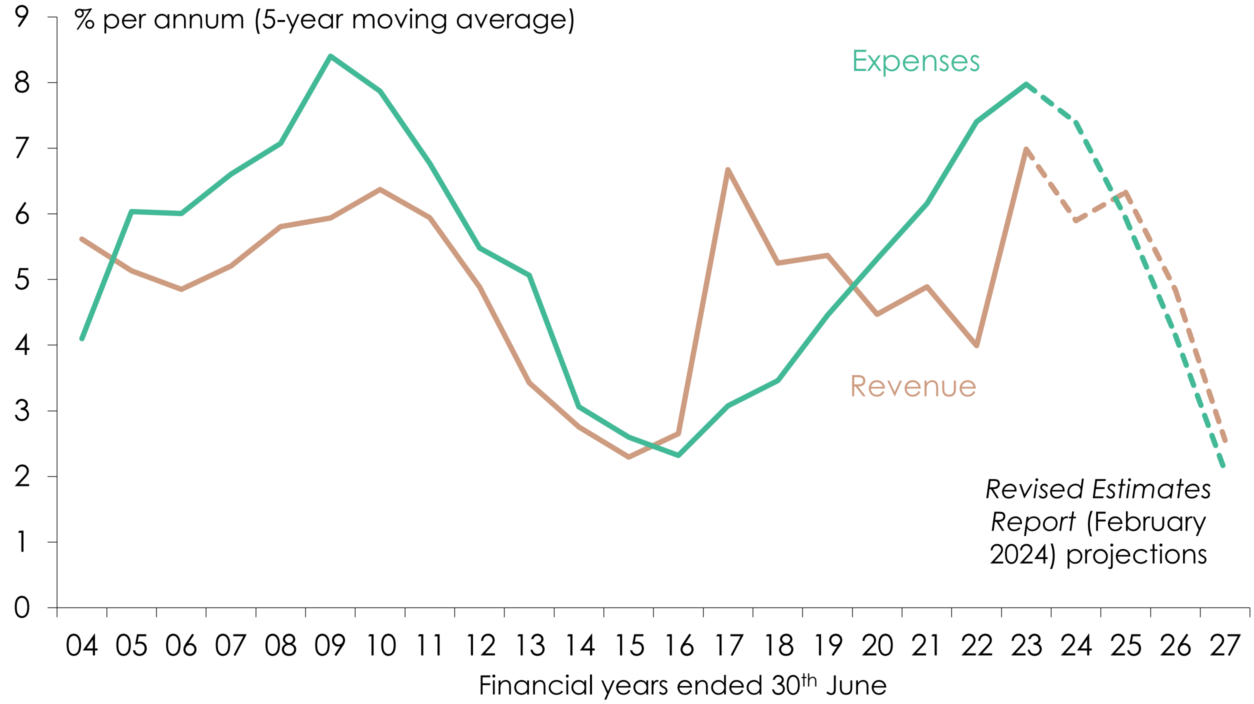
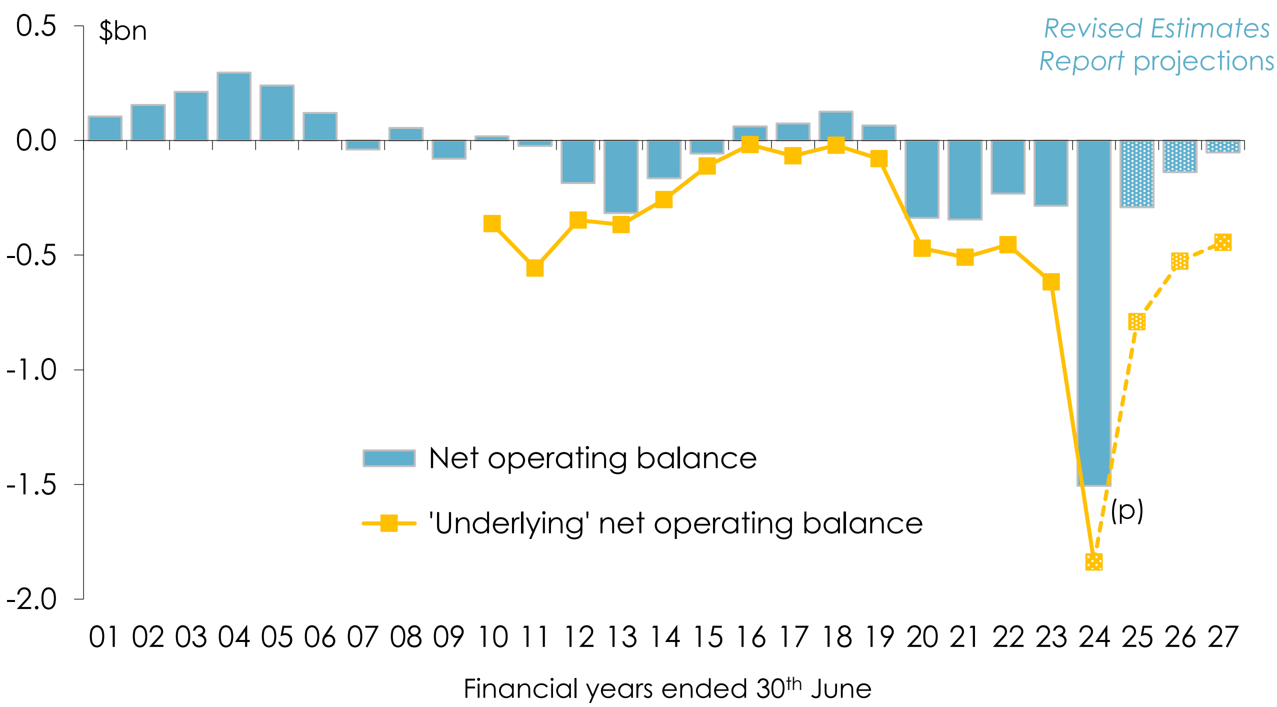
[2] For a more complete explanation of the terms and concepts used in government financial statistics and public sector accounting see ABS (2024a).

Chart 3.1 – Growth in Tasmanian general government operating revenue and expenses



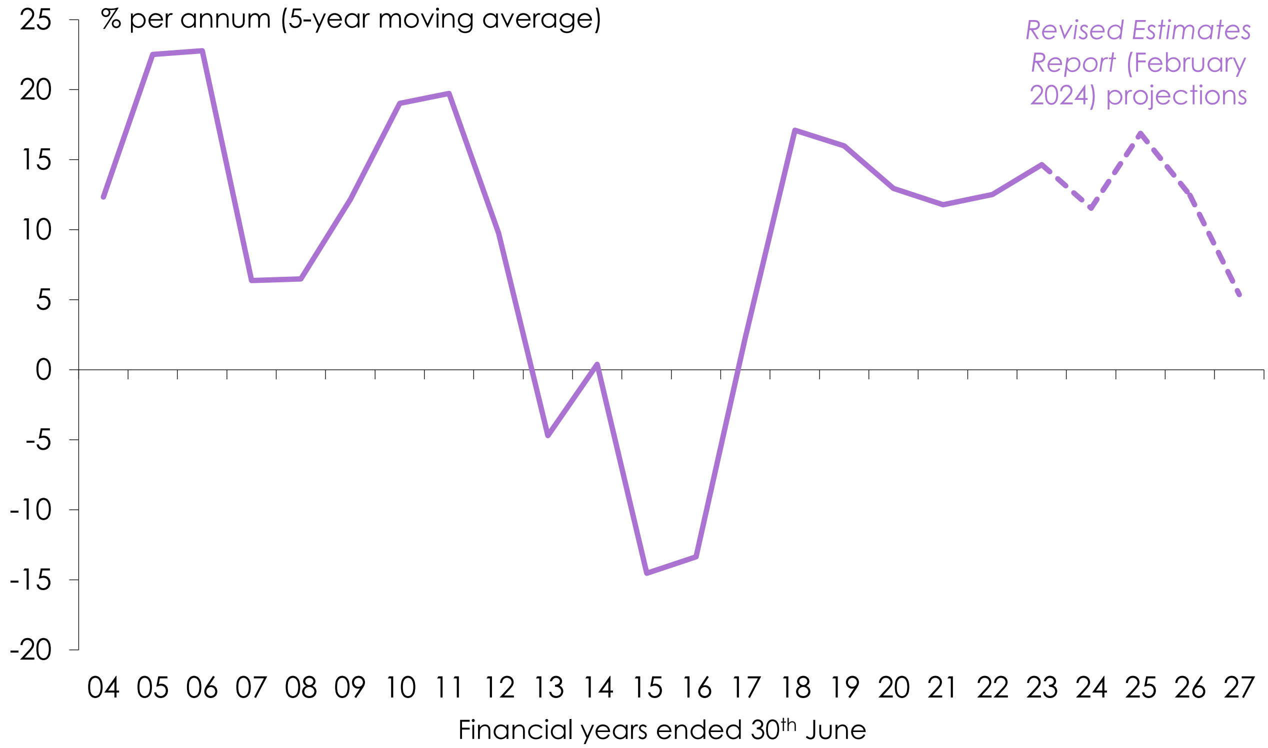
Sources: Department of Treasury and Finance (2023b and previous issues; 2024a); Review calculations.

Chart 3.2 – Tasmanian general government sector net operating balance



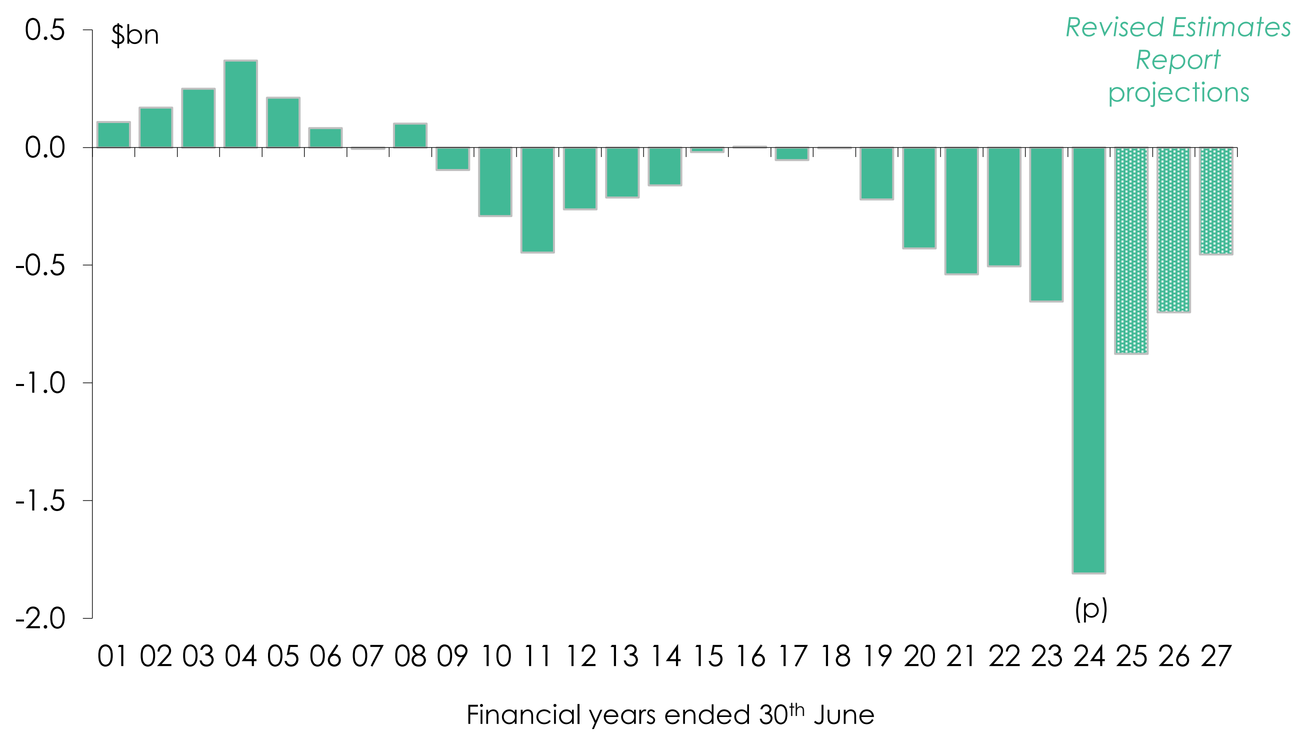
Note: The 'underlying' net operating balance excludes one-off payments from the Commonwealth for capital purposes. (p) Preliminary. *Sources:* Department of Treasury & Finance (2023b and previous issues; 2024a, 2024c).

Chart 3.3 – Growth in Tasmanian general government purchases of non-financial assets



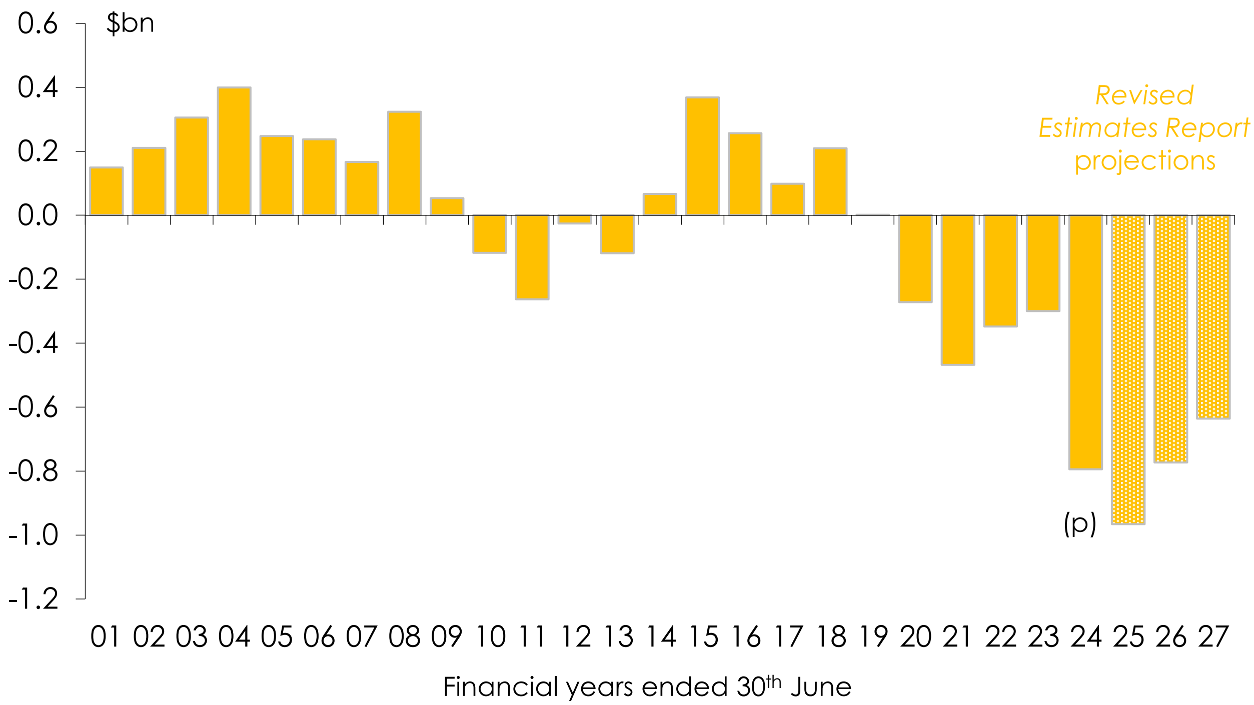
Sources: Department of Treasury and Finance (2023b and previous issues; 2024a); Review calculations.

Chart 3.3 – Tasmanian general government sector fiscal balance



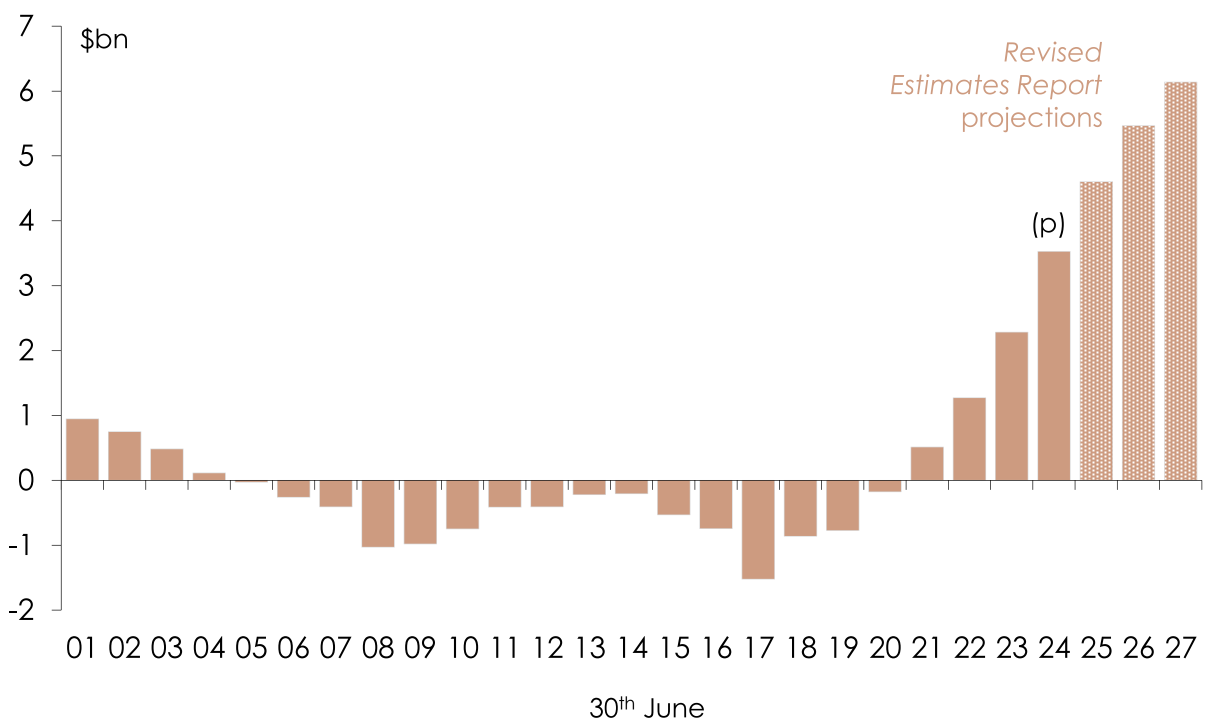
(p) Preliminary. *Sources:* Department of Treasury and Finance (2023b and previous issues, 2024a, 2024c).

Chart 3.5 – Tasmanian general government sector cash balance



(p) Preliminary. *Sources:* Department of Treasury and Finance (2023b and previous issues; 2024a, 2024c).

Chart 3.6 – Tasmanian general government sector net debt



Note: Includes lease liabilities from 30th June 2019. Negative net debt means financial assets (cash and interest-bearing investments) exceed gross debt. (p) Preliminary. *Sources:* Tasmanian Department of Treasury and Finance (2023b and previous issues; 2024a, 2024c).

The financial position of the general government sector improved in the middle years of the 2010s, largely as a result of more buoyant growth in revenues (which rose at an average annual rate of 5.3% over the five years to 2017-18, compared with 3.4% over the preceding five years), and tight control over operating expenses (which rose at an average annual rate of 3.5% over the five years to 2017-18, compared with 5.1% per annum over the preceding five years) (Chart 3.1). As a result, the net operating balance returned to surplus in 2015-16 (Chart 3.2), and despite a significant pick-up in infrastructure spending (Chart 3.3) the cash balance was also in surplus between 2013-14 and 2017-18 (Chart 3.5). This in turn allowed the net debt position to improve by \$644mn between 30th June 2013 and 30th June 2018 (Chart 3.6).

Tasmania's general government sector financial position began to deteriorate from 2018-19 onwards, and particularly during the Covid-19 pandemic which ran from (roughly) March 2020 until the re-opening of Australia's international borders in February 2022.

Of particular importance in this context, the rate of growth in operating expenses began to accelerate significantly *after* the 2018 State election, but *before* the onset of the Covid-19 pandemic in March 2020 (Chart 3.1) – as did the level of capital spending (Chart 3.3). As a result the fiscal balance had slipped into deficit (Chart 3.4) and the cash balance had all but evaporated (Chart 3.5) by 2018-19, *well before* the beginning of the pandemic.

And of course the additional spending required by the pandemic – in health and in financial support for households and businesses adversely affected by lockdowns – inevitably and unavoidably exacerbated that situation.

The 'Policy and Parameters' Statements included in the annual Budget Papers and mid-year Revised Estimates Reports (see eg Tasmanian Government 2023: 72-89 and Department of Treasury and Finance 2024a: 59-69) provide a useful way of dissecting movements in successive estimates of the net operating and fiscal balance, from one budget to the next, into those changes which are the result of conscious government decisions to increase or reduce spending or to raise or lower taxes ('policy decisions') and those which are the result of changes in economic and other assumptions underlying the forward estimates of revenues and expenses, changes in Tasmania's share of GST revenues and in other grants from the Commonwealth, changes in forecasts of revenue from government business enterprises and other factors beyond the Government's direct control ('parameter variations').

Table 3.1 shows the respective contributions of policy decisions and parameter variations to the changes in estimates of the net operating balance and the fiscal balance of the Tasmanian general government sector, for each of the financial years 2017-18 through 2022-23, from when the first estimates for each of those years were made (in the Budget four years prior to each of those years, when it was the last of the four years for which forward estimates were provided) to the final outcome for each of those years.

Table 3.1 – Sources of changes in estimates of the net operating and fiscal balances of the Tasmanian general government sector between the first estimate and the final outcome or latest estimate, 2017-18 through 2022-23

	$ million					
	2017-18	*2018-19*	*2019-20*	*2020-21*	*2021-22*	*2022-23*
Net operating balance – initial estimate	**-118**	**182**	**18**	**45**	**196**	**251**
(Plus) revenue policy decisions	0	41	258	15	4	-51
(Minus) expense policy decisions	-307	-593	-614	-1,155	-1,613	-1,455
Total policy decisions	-307	-552	-356	-1,141	-1,610	-1,506
(Plus) parameter variations	551	436	-1	751	1,182	971
Net operating balance – final outcome	**126**	**66**	**-338**	**-344**	**-232**	**-285**
Fiscal balance – initial estimate	-124	107	17	71	53	3
(Plus) change in NOB	244	-116	-356	-390	-428	-536
(Plus) non-financial assets policy decisions	-75	-228	-310	-504	-524	-161
(Plus) Parameter variations (a)	-48	17	221	284	394	40
Fiscal balance – final outcome	**-3**	**-220**	**-428**	**-539**	**-505**	**-654**

Note: Positive numbers indicate an improvement in the fiscal balance, negative numbers indicate a deterioration in the fiscal balance. (a) Includes depreciation. *Sources:* Tasmanian Government (2017, 2018, 2019. 2020, 2021, 2022 and 2023); Tasmanian Department of Treasury and Finance (2018, 2019, 2020, 2021b, 2022 and 2023b); and Review calculations.

Table 3.1 shows that:

- the general government sector incurred net operating *deficits* totalling $1,007 million over the six years 2017-18 through 2022-23;
- this figure compares with the initial estimates, made four years before each of these financial years, which envisaged net operating *surpluses* totalling $575 million over these six years;
- in other words, the net operating balance outcomes for the six years 2017-18 through 2022-23 were a total of $1,582 million *worse* than originally projected;
- this is despite the fact that 'parameter variations' – that is (in this context) economic outcomes, and outcomes for other factors affecting revenues and expenses beyond the Government's direct control which were different from those initially assumed – *improved* the net operating balance outcomes by a total of $3,891 million over this period;

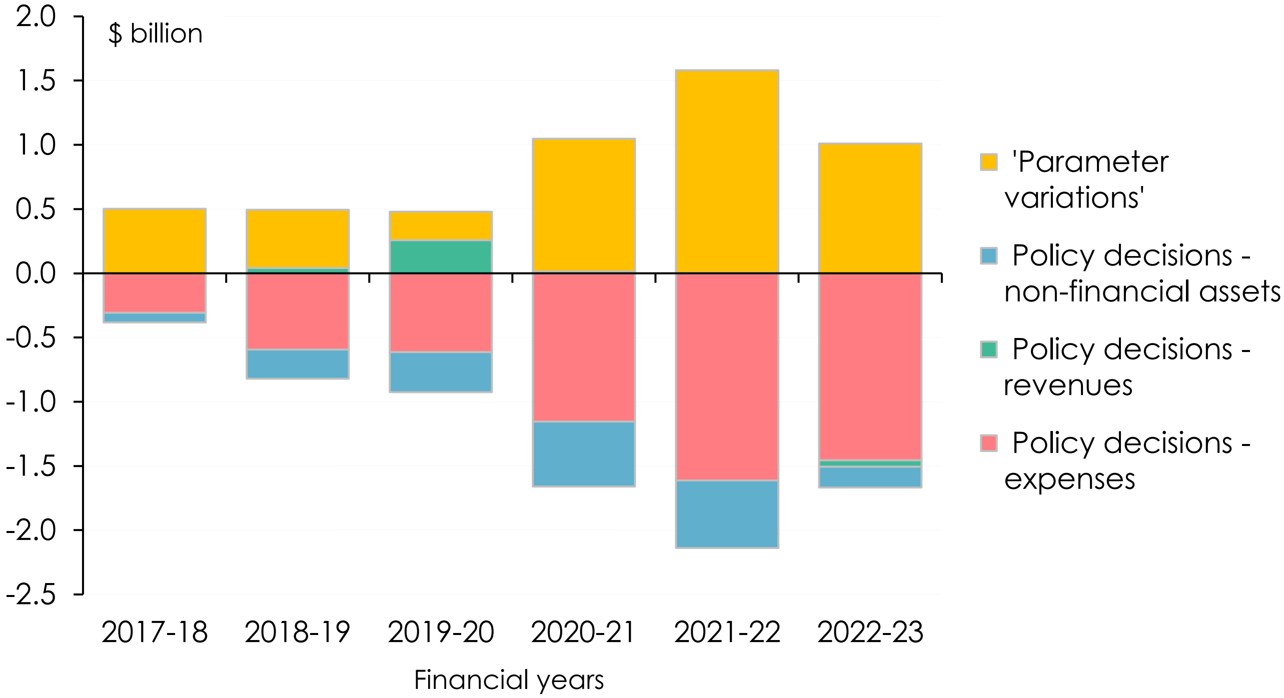
- however, ‘policy decisions’ by the Government *worsened* the net operating balance outcomes over the six years to 2022-23, compared with those originally envisaged, by a cumulative total of $5,472 million – with decisions to increase spending by a total of $5,728 million offset by decisions to increase revenue totalling just $265 million;
- in other words, if the Government had not made *any* ‘policy decisions’ during this period, all else being equal the general government sector would have recorded net operating surpluses totalling $2,309 million over the six years to 2022-23 (instead of deficits totalling $1,007 million);
- in addition to the ‘policy decisions’ regarding operating expenses and revenues during which were made between 2017-18 and 2022-23 inclusive, the Government also made ‘policy decisions’ which increased expenditure on ‘net purchases of non-financial assets’ (or, broadly speaking, ‘capital’ or ‘infrastructure’ spending) totalling $1,802 million, partly offset by ‘parameter variations’ (mostly resulting from ‘slippages’ in expenditure on infrastructure projects compared with what had initially been budgeted) totalling $908 million;
- as a result, together with the deterioration in the net operating balances compared with the initial projections mentioned above, the Government incurred fiscal *deficits* totalling $2,350 million over the six years to 2022-23, as against what had initially been projected as *surpluses* totalling $127 million.

Chart 3.7 illustrates these numbers for each of the years 2017-18 through 2022-23.

Of course, it would be unrealistic to assume that a government would not have made any ‘policy decisions’ over such a long period of time – and in particular during the Covod-19 pandemic, when governments across Australia and throughout the world committed substantial sums to the direct public health response to the pandemic and to alleviating the impact on households and businesses of the decisions governments made to contain the spread of the virus (in particular, lockdowns, quarantine requirements and international and interstate border closures). Thus, $2,769 million (or 48%) of the expense policy decisions made between 2017-18 and 2022-23 were made in 2020-21 and 2021-22, the years in which the pandemic had its greatest impact.

However not all of the expense policy decisions can be put down to unavoidable responses to the Covid-19 pandemic. As shown in Table 3.1 and Chart 3.7, policy decisions added significantly to expenses (and detracted significantly from the net operating and fiscal balances in the three years *before* the pandemic hit, and continued to do so in 2022-23, *after* the pandemic had receded. The Secretary to the Department of Treasury and Finance noted in the *Pre-Election Financial Outlook* released during the 2024 election campaign that the 2018 election campaign had “added approximately $1.4 billion to existing Budget Estimates” (over the ensuing four-year period), and that “the 2021 Election also added approximately an initial $1.4 billion” (Department of Treasury and Finance 2024b: 12).

Chart 3.7 – Contribution of 'policy decisions' and 'parameter variations' to variations in the general government sector fiscal balance between the initial estimate and final outcome, 2017-18 to 2022-23



Note: 'Initial estimates' for each financial year are the forward estimate for that year made in the Budget three years earlier. Positive numbers indicate an improvement in the fiscal balance, negative numbers indicate a deterioration in the fiscal balance. 'Parameter variations' includes the impacts of both variations in both operating and capital parameters. *Sources:* As for Table 3.1.

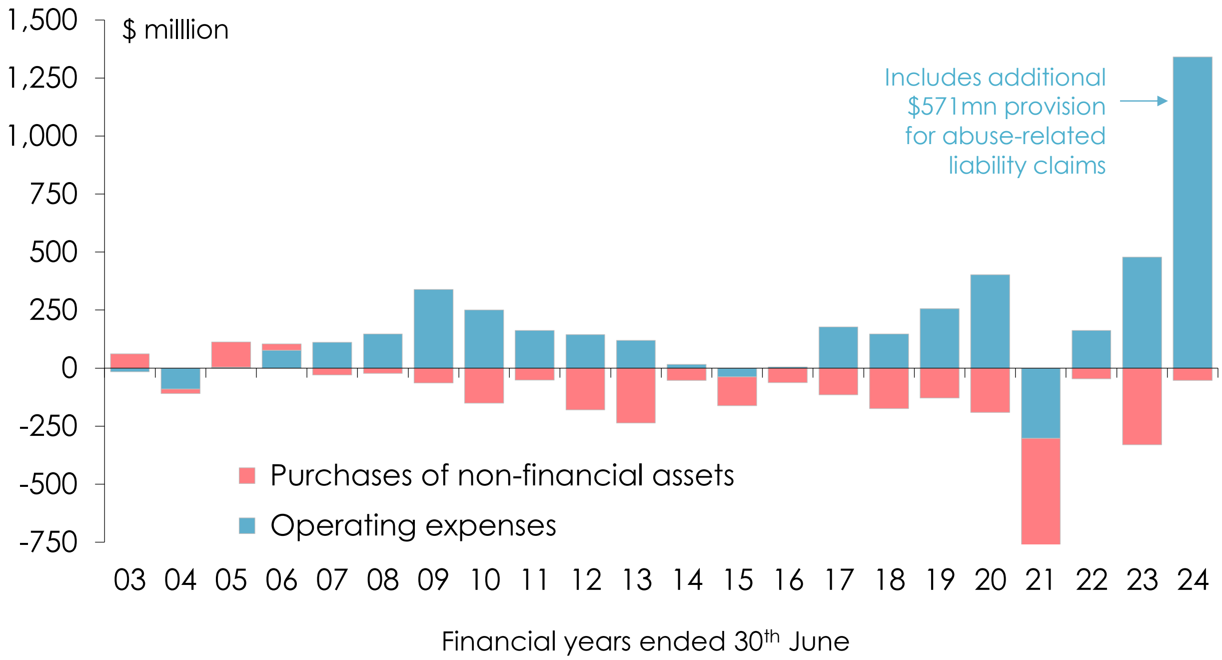
The Government chose not to offset those additional spending commitments with spending reductions in other areas, or with measures to raise additional revenues.

Additionally, to adopt the language often used in discussions of the impact of 'parameter variations' and 'policy decisions' on the Federal Budget (see eg RMIT ABC Fact Check 2024) the Tasmanian Government elected *not* to 'bank' *any* of the 'windfall gains' resulting from favourable revisions to earlier estimates of economic and other 'parameters', either before or after the pandemic.

By contrast, the Federal Government claims to have returned "82% of revenue upgrades to the budget since coming to government over the forward estimates period", as well as $28 billion in "savings and spending reprioritisations" since the 2022 federal election (Australian Government 2024a: 80).

Additionally, successive Tasmanian Governments appear to have had on-going difficulty containing operating expenses within the allocations provided in the annual Budget. As shown in Chart 3.8 (on page 44), in all but four of the past 21 financial years, operating expenses have exceeded the amount estimated in the Budgets for each of those financial years by an average of 2.3%.

Chart 3.8 – Difference between budgeted total operating expenses and purchases of non-financial assets and outcomes, 2002-03 to 2022-23



Note: Figures shown in this chart are the differences between the forward estimates for each financial year presented in the Budget for that year (typically in May or June of the preceding financial year, but occasionally later) and the outcome for that year. *Sources:* Tasmanian Government (2023 and previous issues); Tasmanian Department of Treasury and Finance (2023b and previous issues; 2024c).

In some instances, most obviously during the global financial crisis and the Covid-19 pandemic, such 'over-runs' are unavoidable and, indeed, desirable from the perspective of responding as needed to major unforeseen developments. Likewise the provision made towards the end of the 2023-24 financial year for claims by survivors of child sexual abuse in state institutions was unavoidable (in the aftermath of the abuse).

But such considerations would not have been relevant in, for example, 2016-17 through 2018-19 or in 2021-22 and 2022-23. This suggests either a persistent tendency to under-estimate expense trends in formulating the annual budget, or an inability to control spending during the year, an issue to which this Review will return in Chapter 7.

Conversely, purchases of non-financial assets (broadly speaking, 'infrastructure investment') have consistently fallen short of what has been foreshadowed in annual Budgets, by an average of 12% over the past 21 years and 23% over the past decade.

At face value this appears to point to persistent shortcomings in the planning and implementation processes surrounding infrastructure projects, or (especially in recent years) a tendency to under-estimate delays and bottlenecks in starting or continuing work on infrastructure projects.

Mirroring the deterioration in the fiscal balance (which, as noted in the introduction to this Chapter, is the most comprehensive accrual accounting measure of the budget 'bottom line') shown in Table 3.1 and Chart 3.7, the Tasmanian general government sector incurred cumulative *cash deficits* totalling $1,117 million over the six years 2017-18 through 2022-23, a turnaround of $1,833 million from the initial estimates of the cash balance for each of these six yers of cash surpluses totalling $656 million.

As a result, the *net debt* of the general government sector reached $1,875 million by 30th June 2023, $734 million (or 64%) more than the $1,141 million first projected in the 2018-19 Budget (though less than the $3,729 million projected in the 2020-21 Budget, at the height of the pandemic).

The additional $571mn provision for claims by survivors of child sexual abuse made in 2023-24 had no impact on the cash balance for 2023-24 (because payments to survivors are yet to be made). The cash deficit for 2023-24 of $794 million was actually $241 million *less* than forecast in the *Revised Estimates Report* – in part because of lower-than-projected infrastructure spending. However future cash deficits will be larger than previously forecast (all else being equal) in future years as cash payments to abuse survivors are made.

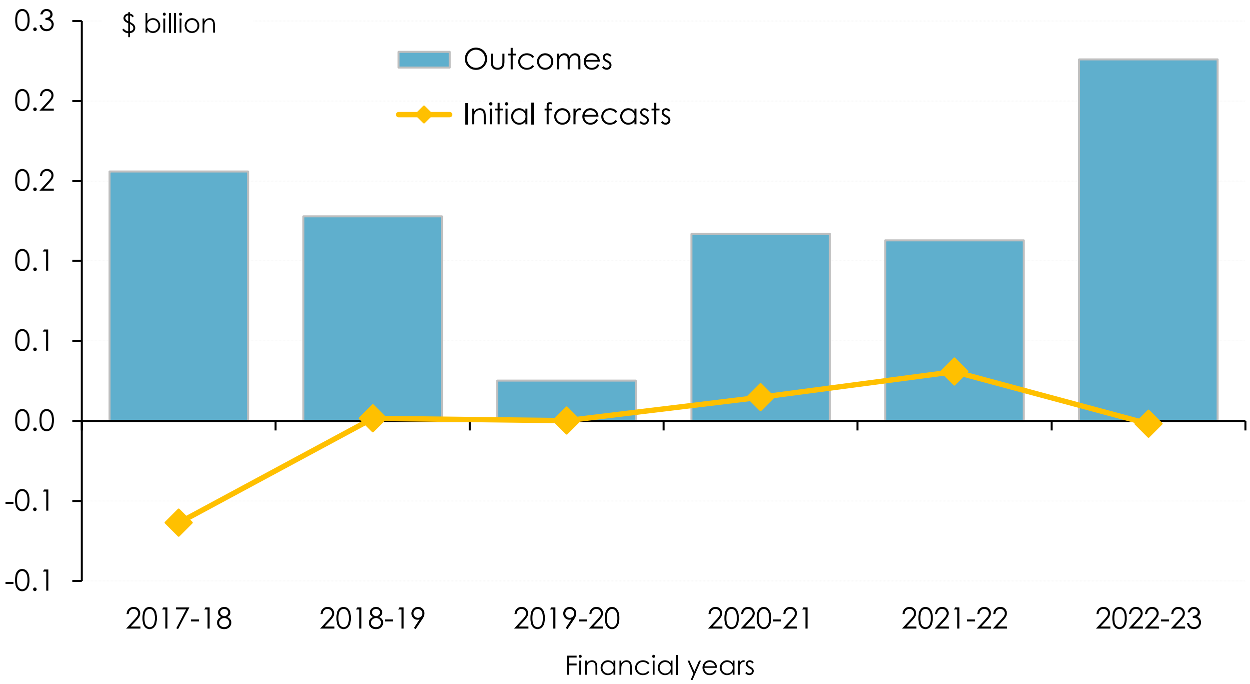
For similar reasons the increase in net debt during 2023-24, to $3,528 million, was only $142 million more than had been projected in the *Revised Estimates Report* (and only $31 million more than projected in the 2023-24 Budget) – although it is nonetheless the highest level ever recorded (and as a proportion of Tasmania's gross state product, the highest since 2001-02.

The increase in the general government sector's net debt over this period was partly offset by a decline in the (relatively large) *unfunded superannuation liability* from a peak of $10,280 million at 30th June 2020 to $7,143 million as at 30th June 2024, slightly below the $7,151 million they had been at 30th June 2015 – largely as a result of the increase in interest rates over this period, and hence in the rate at which future liabilities are discounted. Nonetheless, because of the on-going increase in the the level of net debt, *net financial liabilities* reached $12.5 billion at 30th June 2024, more than double the level of $6.2 billion ten years earlier.

Trends in Tasmania's public non-financial corporations sector finances

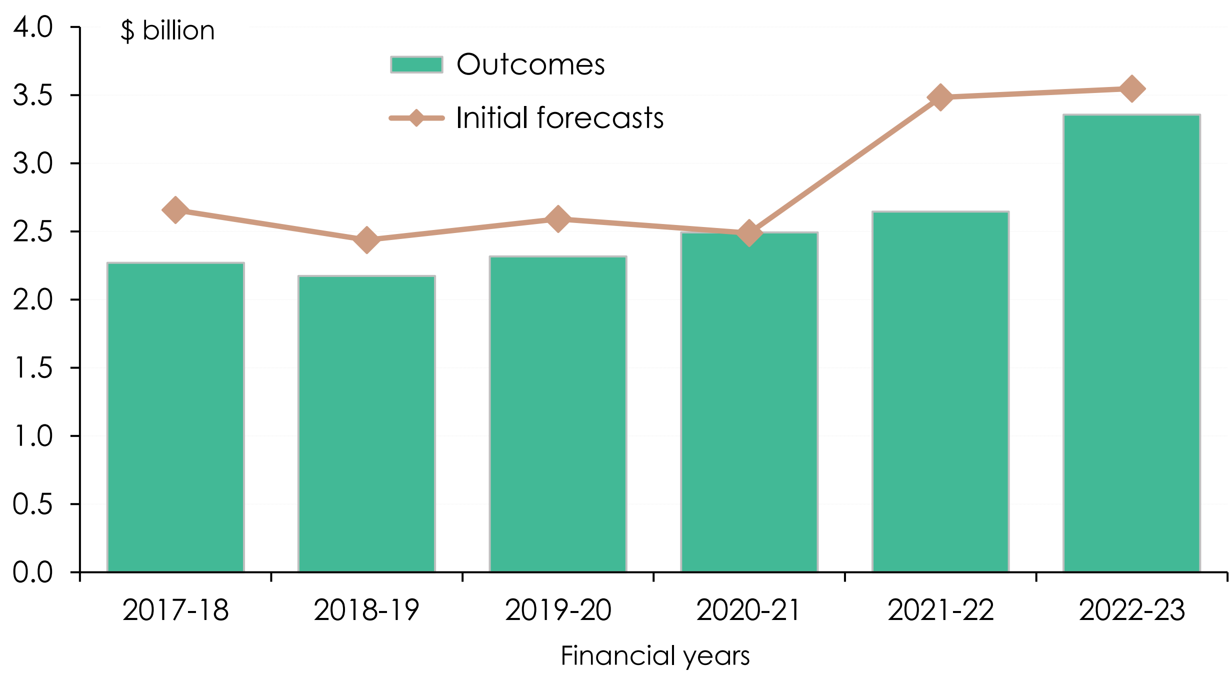
By contrast with the general government sector, financial outcomes for Tasmania's public non-financial corporations sector over the past five years have generally exceeded initial expectations. In particular, this sector's net operating balance outcomes were consistently more favourable than the first forecasts (Chart 3.9), while its net debt was consistently lower than initial forecasts – and rose by far less than that of the general government sector (Chart 3.10). However the financial position of the public non-financial corporations sector is expected to deteriorate more significantly over the next four years, as outlined in the following Chapter.

Chart 3.9 – Public non-financial corporations sector net operating balance



Note: 'Initial forecasts' for each financial year are the forward estimate for that year made in the Budget three years earlier. *Sources:* Tasmanian Government (2017, 2018, 2019. 2020, 2021, 2022 and 2023); Tasmanian Department of Treasury and Finance (2018, 2019, 2020, 2021b, 2022 and 2023b).

Chart 3.10 – Public non-financial corporations sector net debt



Note: 'Initial forecasts' for each financial year are the forward estimate for that year made in the Budget three years earlier. *Sources:* Tasmanian Government (2017, 2018, 2019. 2020, 2021, 2022 and 2023); Tasmanian Department of Treasury and Finance (2018, 2019, 2020, 2021b, 2022 and 2023b).

4. Prospective trends in Tasmania's public sector finances over the next three years

Introduction

The financial position of Tasmania's public sector appears almost certain to deteriorate further over the next three years, as a result of adverse trends in both the general government and public non-financial corporations sectors. Some of these trends were depicted in Charts 3.1- 3.6 in the previous Chapter, and will be analyzed in more detail in this Chapter.

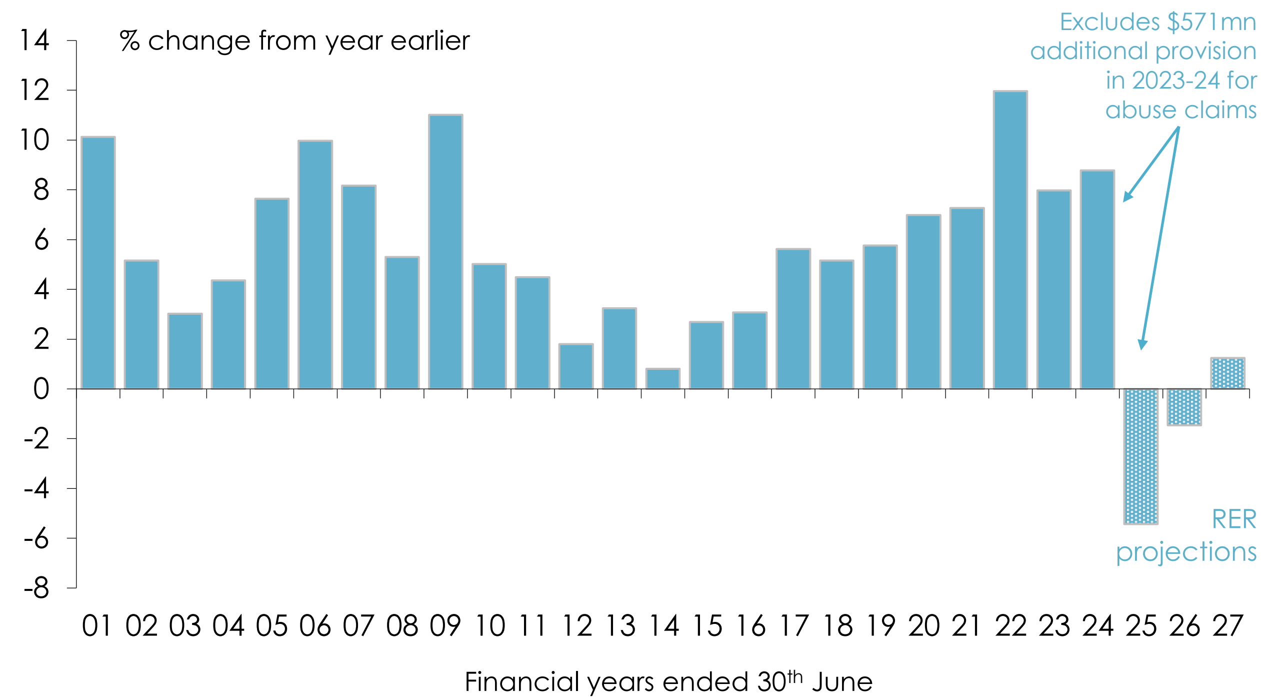
This Chapter, like Chapter 3, relies entirely on information which was publicly available up to an including the *Pre-Election Financial Outlook* published by the Department of Treasury and Finance on 28th February, together with (where noted) the *Preliminary Outcomes Report* for 2023-24 published on 15th August.

The outlook for Tasmania's general government sector to 2026-27

The forward estimates presented in the *Revised Estimates Report* published on 14th February (Department of Treasury and Finance 2024a) and repeated two weeks later in the *Pre-Election Financial Outlook* (Department of Treasury and Finance 2024b) showed that:

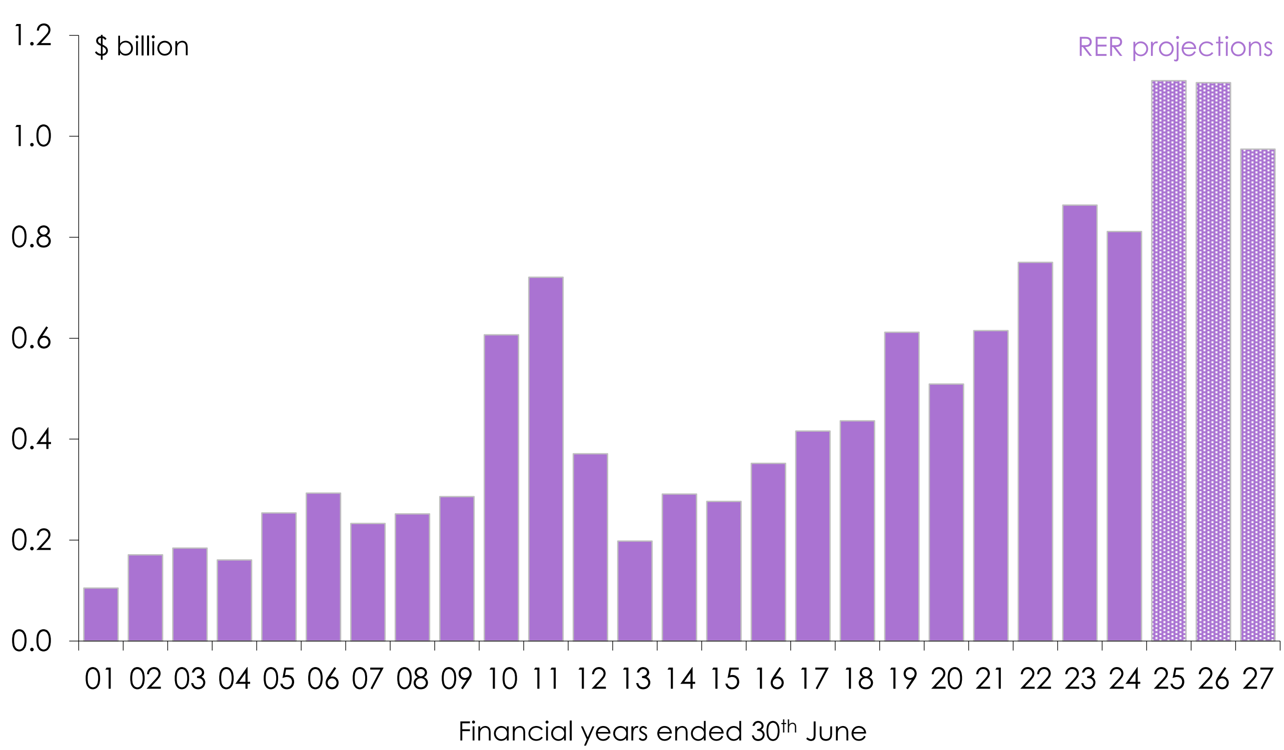
- the net operating deficit is expected to decline between 2023-24 and 2026-27, but only because of a relatively large volume of one-off Commonwealth capital funding (the 'underlying' net operating deficit will remain large by historical standards), and because it is assumed that operating expenses will decline (in nominal terms) in both 2024-25 and 2025-26 (something which has not happened in a single year this century, let alone two consecutive years) (Chart 4.1 on page 48);
- the level of infrastructure spending ("purchases of non-financial assets") is expected to remain at historically high levels throughout the current forward estimates period (Chart 4.2);
- as a result, the fiscal (accrual accounting) and cash deficits, though forecast to decline between 2023-24 and 2026-27, will both remain larger than in any year prior to 2023-24 (Charts 3.4 and 3.5 on pages 38-39);
- which in turn means that net debt will continue to increase, reaching $6.1 billion by 30th June 2027 (Chart 3.6 on page 39);
- this would represent the highest proportion of Tasmania's gross state product since 30th June 1999 (Chart 4.3 on page 49);
- with the unfunded superannuation liability projected to remain little changed at just over $7.1 billion over this period, the general government sector's total net financial liabilities are expected to increase from $10.2 billion as at 30th June 2022 to $14.1 billion by 30th June 2027.

Chart 4.1 – Annual change in general government sector operating expenses



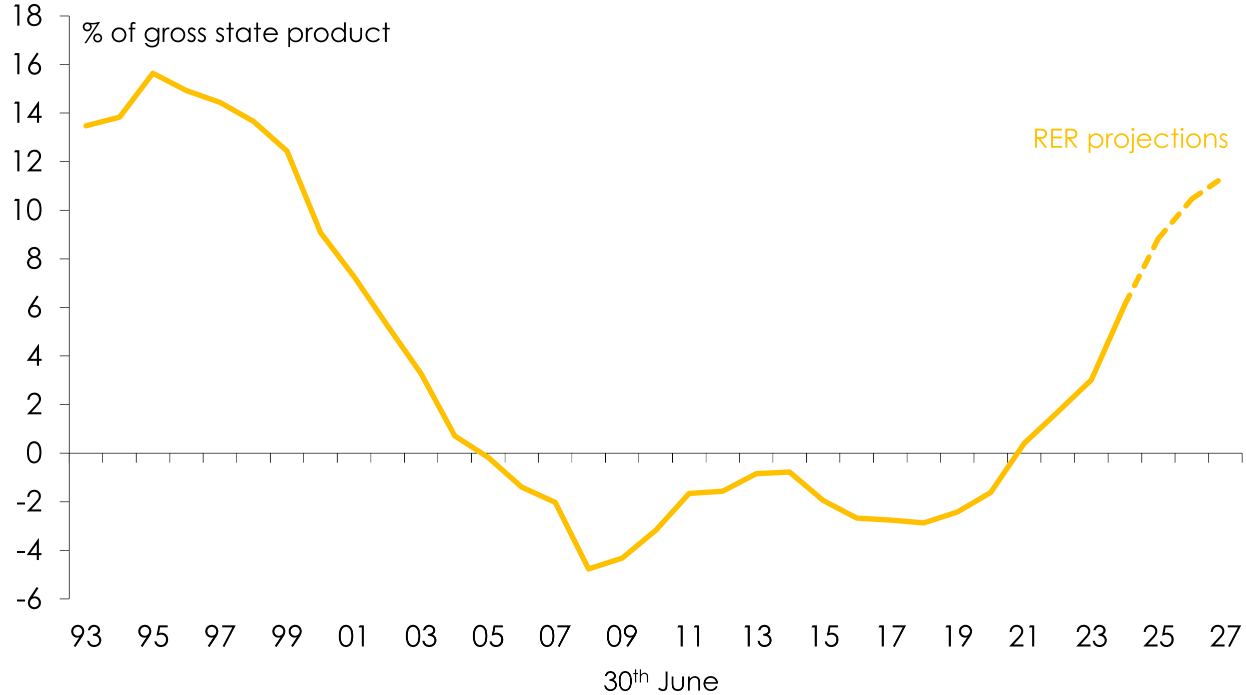
Sources: Tasmanian Department of Treasury and Finance (2023b and previous issues, 2024a and 2024c).

Chart 4.2 – General government sector purchases of non-financial assets



Sources: Tasmanian Department of Treasury and Finance (2023b and previous issues, 2024a and 2024c).

Chart 4.3 – General government sector net debt as a percentage of gross state product

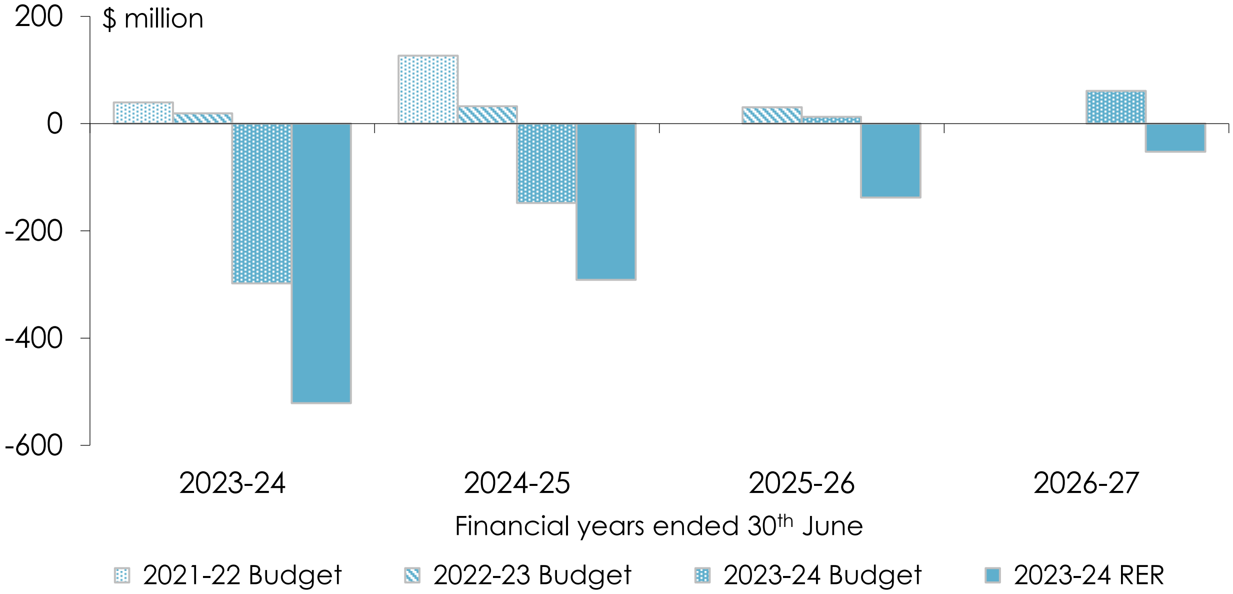


Sources: Tasmanian Department of Treasury and Finance (2023b and previous issues, 2024a and 2024c); Parliamentary Budget Office (2023).

The outlook for Tasmania's general government sector finances presented in the *Revised Estimates Report* and repeated in the *Pre-Election Financial Outlook* was significantly worse than that presented in the 2023-24 Budget in June last year, and that was in turn worse than the outlook presented in the 2022-23 Budget.

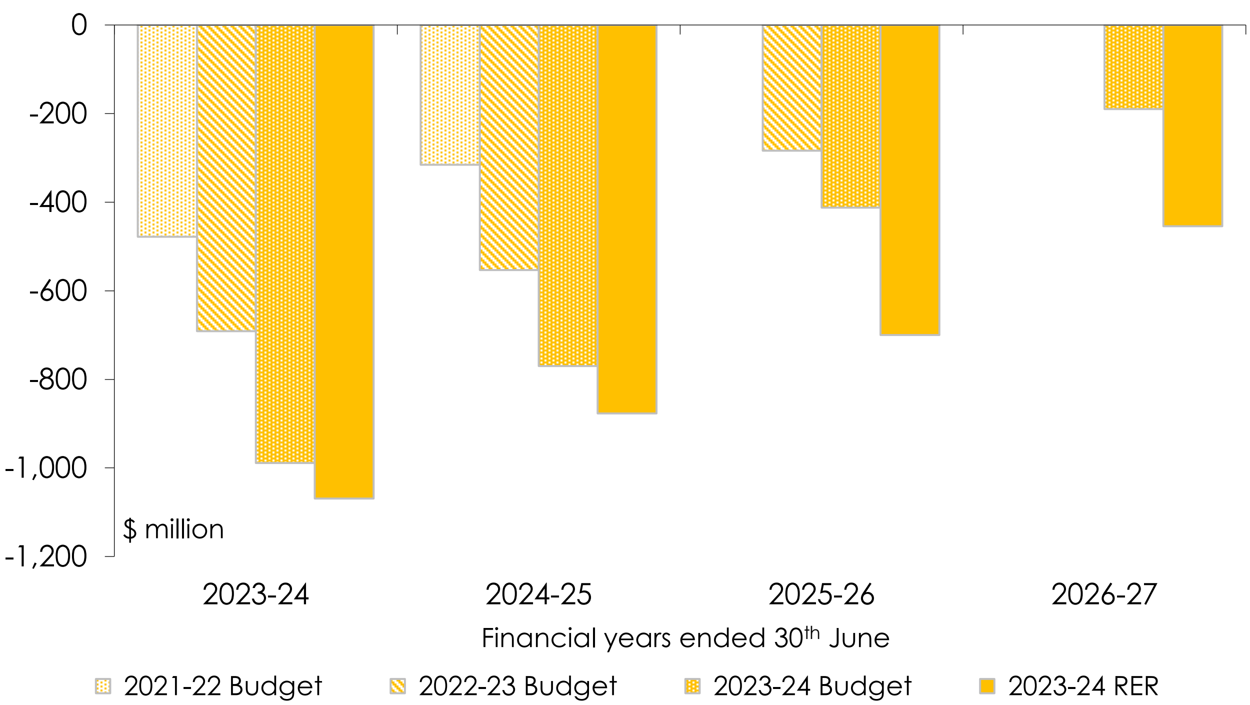
- what were forecast in the 2021-22 and 2022-23 Budgets to be net operating surpluses in each of the years 2023-24 through 2026-27 had by the 2023-24 *Revised Estimates Report* become successive deficits totalling $1,003 million, a deterioration of $631 million from what was projected in the 2023-24 Budget (Chart 4.4);
- the forward estimates of the fiscal deficit for each of the years 2023-24 through 2025-26 were revised up from a total of $1,528 million in the 2022-23 Budget to $2,172 million in the 2023-24 Budget and to $2,646 million in the 2023-24 *Revised Estimates Report*, while the forward estimates of the fiscal deficit for the four years to 2026-27 were revised up from a total of $2,361 million in the 2023-24 Budget to $3,100 million in the 2023-24 *Revised Estimates Report* (Chart 4.5 on page 50);
- the forward estimates of the cash deficit for each of the years 2023-24 through 2025-26 were revised up from a total of $1,733 million in the 2022-23 Budget to $2,300 million in the 2023-24 Budget and to $2,774 million in the 2023-24 *Revised Estimates Report*, while the forward estimates of the cash deficit for the four years to 2026-27 were revised up from a total of $2,716 million in the 2023-24 Budget to $3,410 million in the 2023-24 *Revised Estimates Report* (Chart 4.6 on page 51);

Chart 4.4 – Successive forward estimates of the general government net operating balance for the years 2023-24 through 2026-27



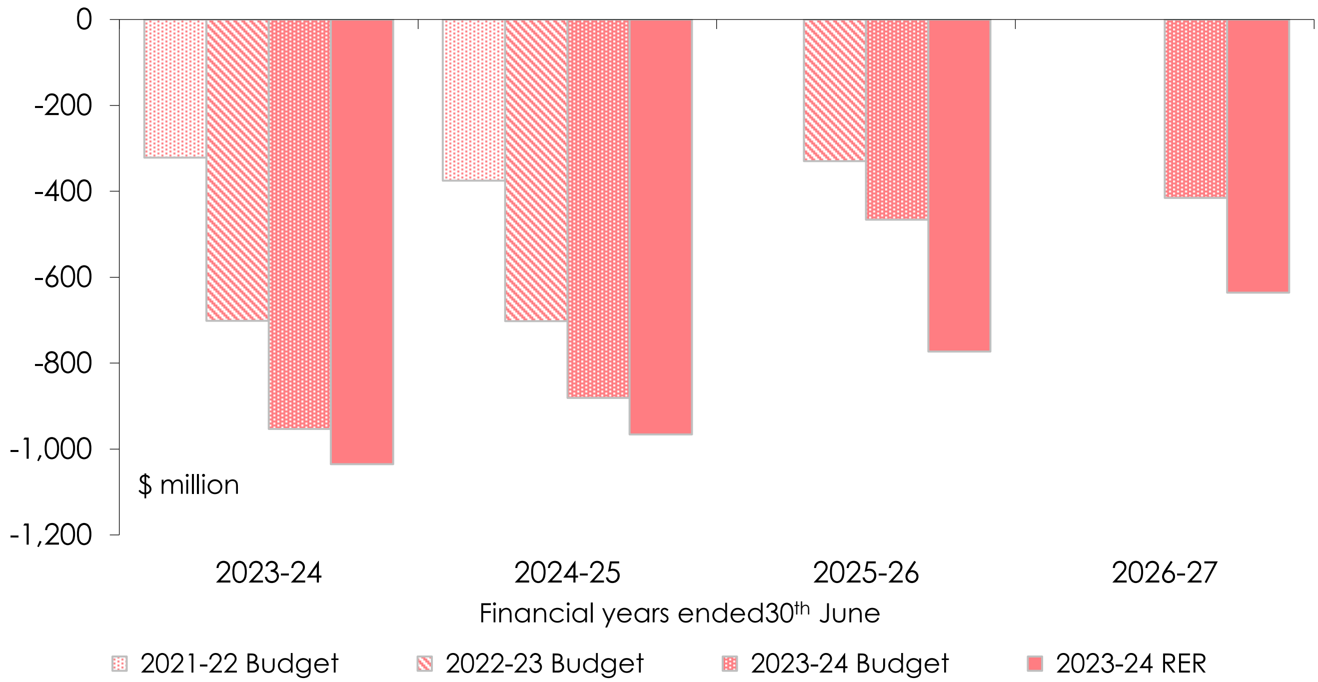
Note: The preliminary estimate of the 2023-24 outcome was $1,516 million (or $935 million excluding the additional provision for payments to survivors of child sexual abuse in State institutions). *Sources:* Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a and 2024c).

Chart 4.5 – Successive forward estimates of the general government fiscal balance for the years 2023-24 through 2026-27



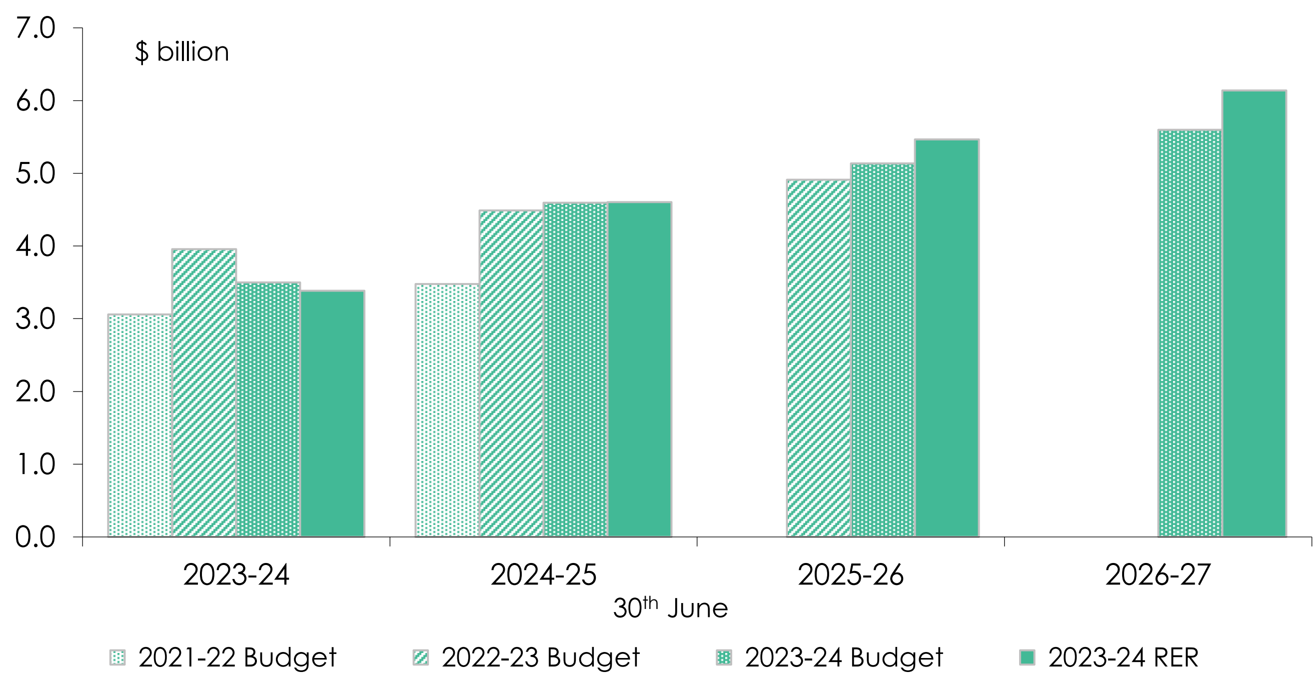
Note: The preliminary estimate of the 2023-24 outcome was $1,809 million (or $1,238 million excluding the additional provision for payments to survivors of child sexual abuse in State institutions) *Sources:* Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a and 2024c).

Chart 4.6 – Successive forward estimates of the general government cash balance for the years 2023-24 through 2026-27



Note: The preliminary estimate of the 2023-24 outcome was $794 million. *Sources:* Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a and 2024c).

Chart 4.7 – Successive forward estimates of general government net debt for the years 2023-24 through 2026-27



Note: The preliminary estimate of the outcome for 30th June 2024 was $3.53 billion. *Sources:* Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a and 2024c).

- the forward estimate of net debt as at 30th June 2026 was revised up from $3,479 million in the 2021-22 Budget to $4,912 million in the 2023-24 Budget and again to $5,136 million in the 2023-24 *Revised Estimates Report*, while the initial estimate in the 2023-24 Budget of net debt as at 30th June 2027 of $5,596 million was revised upwards to $6,139 million in the 2023-24 *Revised Estimates Report* (Chart 4.7 on page 51).

As in Chapter 3, the Policy and Parameters Statements contained in the annual Budget Papers and the *Revised Estimates Report* can be used to ascertain the reasons for the revisions to the forward estimates of the various measures of the general government sectors' deficits, and of net debt. Recall that in these statements, changes which are the result of conscious government decisions to increase or reduce spending or to raise or lower taxes are referred to as 'policy decisions'; while those which result from changes in economic and other assumptions underlying the forward estimates of revenues and expenses, changes in Tasmania's share of GST revenues and in other grants from the Commonwealth, changes in forecasts of revenue from government business enterprises and other factors beyond the Government's direct control are referred to as 'parameter variations'.

Table 4.1 shows the respective contributions of policy decisions and parameter variations to the changes in estimates of the net operating balance and the fiscal balance of the Tasmanian general government sector, for each of the financial years 2023-24 through 2026-27, from when the first estimates for each of those years were made (in the Budget four years prior to each of those years, when it was the last of the four years for which forward estimates were provided) to the final outcome for each of those years. The contributions of policy decisions and parameter variations to the changes in estimates of the fiscal balance over this period are also depicted in Chart 4.8. The data shown in Table 4.1 and Chart 4.8 intentionally do not include changes resulting from the *Preliminary Final Outcome* Report for 2023-24.

Table 4.1 and Chart 4.8 show that:

- the $1.2 billion turnaround in the cumulative net operating balances over the four years to 2026-27, from surpluses initially estimated to total $236 million to deficits most recently estimated to total $1,003 million, was more than entirely accounted for by policy decisions, which worsened the 'bottom line' by a total of $2,434 million over the four years to 2026-27 (of which $2,026 million was due to decisions to increase spending and $407 million to decisions to reduce revenues), partly offset by favourable parameter variations totalling $1,195 million over this period;

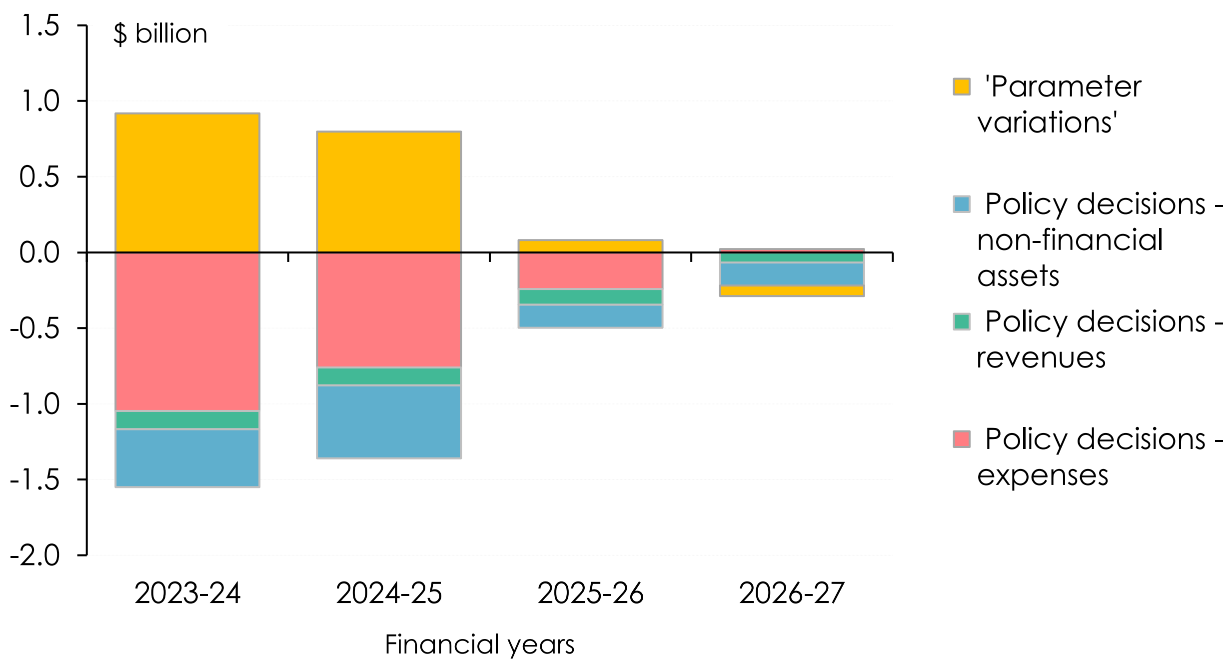
- the $1.9 billion deterioration in the cumulative fiscal deficits over the four years to 2026-27, from deficits initially forecast to sum to $1,227 million to deficits most recently (in the 2023-24 *Revised Estimates Report*) resulted from the deterioration in the net operating position noted above, together with policy decisions to increase net purchases of non-financial assets ('capital expenditures') by a total of $1,169 million, partly offset by favourable parameter variations totalling $534 million;

Table 4.1 – Sources of changes in estimates of the net operating and fiscal balances of the Tasmanian general government sector between the first estimate and 2023-24 *Revised Estimates Report* estimates, 2023-24 through 2027-28

	$ million			
	2023-24	*2024-25*	*2025-26*	*2026-27*
Net operating balance – initial estimate	**17**	**127**	**31**	**61**
(Plus) revenue policy decisions	-120	-119	-103	-66
(Minus) expense policy decisions	-1,047	-760	-242	23
Total policy decisions	-1,167	-879	-344	-44
(Plus) parameter variations	628	461	176	-70
Net operating balance – 2023-24 RER estimate	**-521**	**-291**	**-138**	**-52**
Fiscal balance – initial estimate	-438	-315	-284	-190
(Plus) change in NOB	-539	-418	-169	-114
(Plus) non-financial asset policy decisions	-383	-481	-154	-152
(Plus) Parameter variations (a)	-92	-144	-247	-150
Fiscal balance – 2023-24 RER estimate	**-1,069**	**-877**	**-700**	**-454**

Note: Positive numbers indicate an improvement in the fiscal balance, negative numbers indicate a deterioration in the fiscal balance. (a) Includes depreciation. *Sources:* Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury and Finance (2024a); and Review calculations.

Chart 4.8 – Contribution of 'policy decisions' and 'parameter variations' to variations in forward estimates the general government sector fiscal balance between the initial estimate and the 2023-24 RER estimate, 2023-24 to 2027-28



Notes and Sources: As for Table 4.1 above.

- put differently, the $1.9 billion deterioration in the fiscal deficits for the years 2023-24 through 2026-27 between the original estimates in the 2020-21, 2021-22, 2022-23 and 2023-24 Budgets and the 2023-24 *Revised Estimates Report* was more than entirely due to 'operating' and 'capital' policy decisions totalling $3,603 million over this period, partly offset by favourable parameter variations totalling $1,720 million.

A significant contributor to these policy decisions was, as noted by the Secretary to the Treasury in the *Pre-Election Financial Outlook* Report, commitments made by the Government during the 2021 election campaign which "added approximately an initial $1.4 billion" (Department of Treasury and Finance 2024b: 12). The Treasury Secretary went on to observe that "while it can … be intended that some election commitments represent fixed-term costs, it is often the case that this expenditure is subsequently changed to being permanent in nature and, thereby, has an ongoing impact".

The forward estimates presented in the *Revised Estimates Report*, and repeated two weeks later in the *Pre-Election Financial Outlook Report*, suggest that at least four of the eleven fiscal strategy targets articulated in the 2023-24 Budget (Tasmanian Government 2023: 60-61) will be breached over the next three years:

- general government sector net debt will reach 10.5% of gross state product by 30th June 2026 – above the Government's third fiscal strategy target of 10% of GSP in 2032-33 – and rise further to 11.4% of GSP by 30th June 2027 (Chart 4.3 above) (the prospects for bringing net debt down to that target by the end of 2032-33 will be considered in Chapter 5);

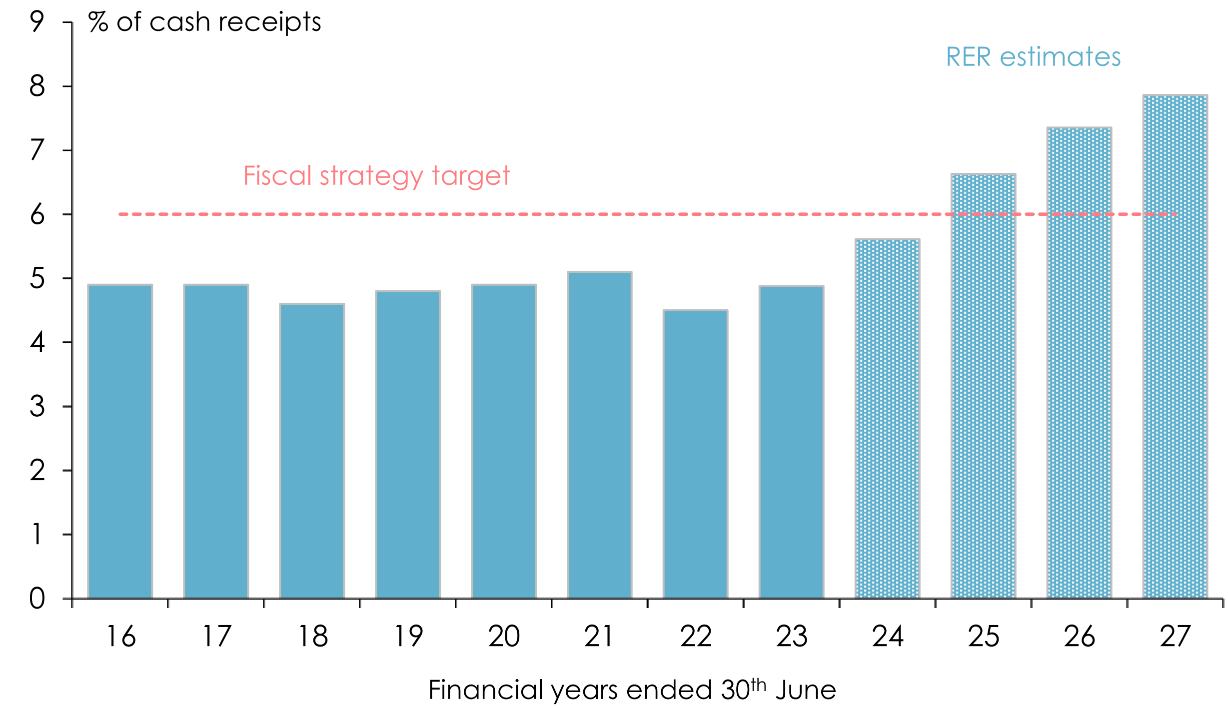
- interest payments plus net defined superannuation benefit payments will rise to 6.6% of cash receipts in the current financial year 2025-26 – above the Government's fourth fiscal strategy target of 6% - and rise further to 7.9% of cash receipts by 2026-27 (Chart 4.9);

- the fiscal balance will remain in deficit over the entire four-year forward estimates period, rather than being in a "balanced position over a rolling four-year average as required by the Government's fifth fiscal strategy target (Chart 4.5 above); and

- 'own-source' revenues (that is, revenues excluding Tasmania's share of GST revenues and other grants from the Commonwealth Government) will remain below the Government's sixth fiscal strategy target of at least 37% of total revenues throughout the four years to 2027-28 – as indeed they have been since 2020-21 (Chart 4.10).

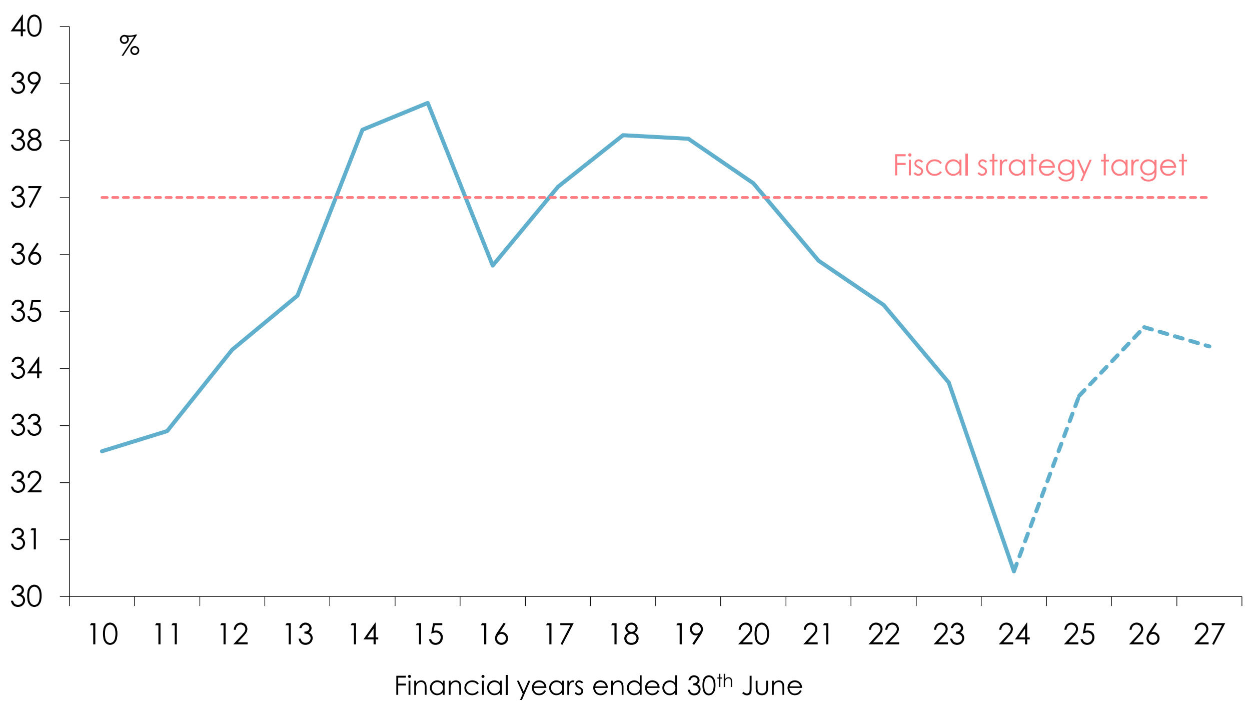
The other fiscal strategy target which can be readily calibrated numerically – the second, which requires gross debt per capita to be held below $20,000 – is unlikely to be breached during the next three years, with the forward estimates in the *Revised Estimates Report* suggesting that gross debt per capita will top $13,000 by 30th June 2027, up from just over $8,600 at 30th June 2024 (and just over $1,000 at 30th June 2019, before the onset of the pandemic). But as S&P Global (2023: 2) have noted, this is a 'relatively unambitious' target.

Chart 4.9 – Interest and defined benefit superannnuation payments as a percentage of cash receipts



Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Chart 4.10 – 'Own-source' revenue as a percentage of total general government revenue



Sources: Tasmanian Department of Treasury & Finance (2023b and previous issues; 2024a and 2024x).

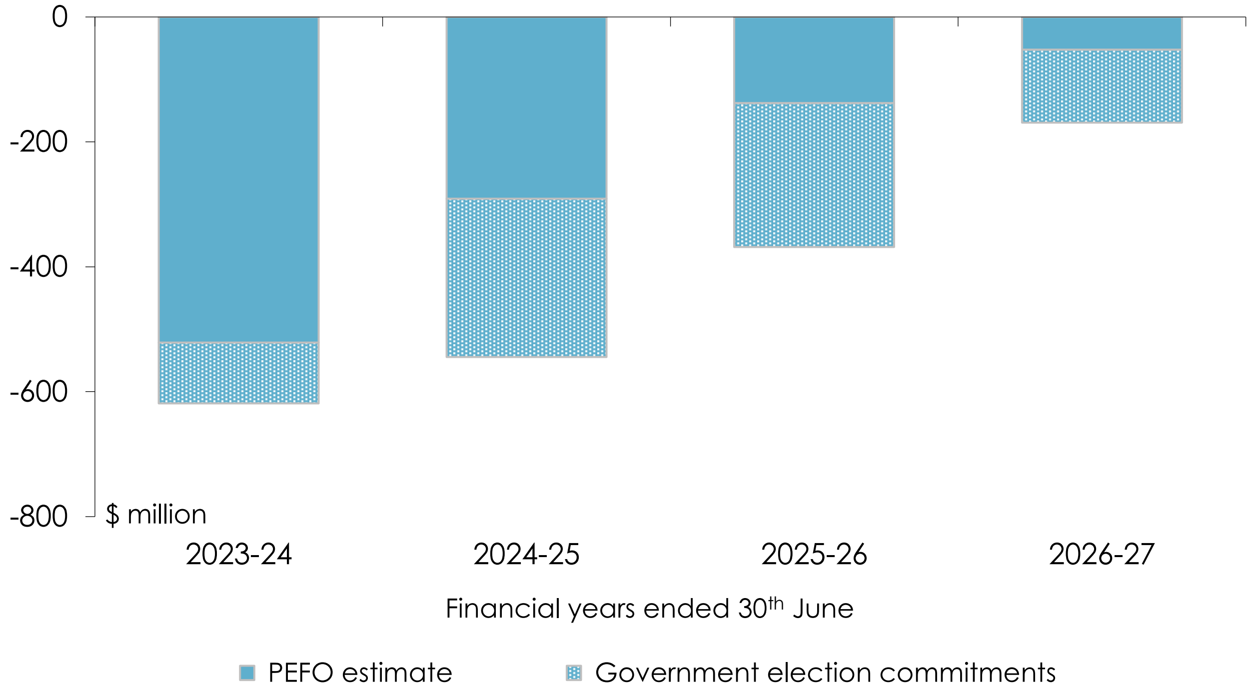
It seems probable that the estimates of the various measures of the general government budget deficit, and of net debt, presented thus far in this Chapter are under-estimates. In the *Pre-Election Financial Outlook Report* published on 28th February, the Secretary to the Department of Treasury and Finance pointed to a number of upside risks to the Forward Estimates of operating expenses, including:

- funding submissions received from departments and agencies as part of the 2024-25 Budget process, "the future acceptance of even some level of [which] would have a material negative impact on the estimates presented in the 2023-24 RER";
- the reduced likelihood that the $50 million of savings from 'budget efficiency dividends' expected to be achieved in 2024-25 would be achieved because of the "delay to the 2024-25 Budget process as a result of the calling of the State Election";
- the likely impact of the "significant policy commmitments" made during the election campaign – which the Liberal Party estimated three days before polling day would add $698 million to the net operating deficits over the four years to 2026-27 (Chart 4.11), and a total of $1,377 million to the fiscal deficits over the four years to 2026-27 (Chart 4.12) (Ferguson 2024: 4-5);
- a commitment to "make TasNetworks whole" (by way of an equity contribution) for the transfer of Marinus Link Pty Ltd to a new entity jointly owned by the Commonwealth, Victorian and Tasmanian Governments, which was "currently expected to be in the order of $80-$110 million" but for which there was "no funding allocated in the Budget and Forward Estimates";
- a likely requirement to provide additional equity funding to TasIrrigation for the Greater South East Irrigation Scheme, "currently estimated to be $75 million"; and
- the likelihood that the final budget for the relocation of the Macquarie Point Wastewater Treatment Plant (for which the Government is required, pursuant to an agreement with the Tasmanian Water and Sewerage Corporation Pty Ltd to contribute 71.4% of the cost) would "exceed original estimates" (Department of Treasury and Finance 2024b: 11-15).

Additionally, the Forward Estimates published in February assume an extraordinary and unprecedented degree of expenditure restraint between 2024-25 and 2026-27, with operating expenses projected to decline (something which hasn't occurred so far this century) by 0.1% in 2024-25 and by 1.5% in 2025-26, followed by an increase of just 1.2% in 2026-27 (see Chart 3.1 on page 37). This compares with a projected 2.4% increase in 2023-24, and with increases averaging 4.5% pa over the five years to 2018-19.

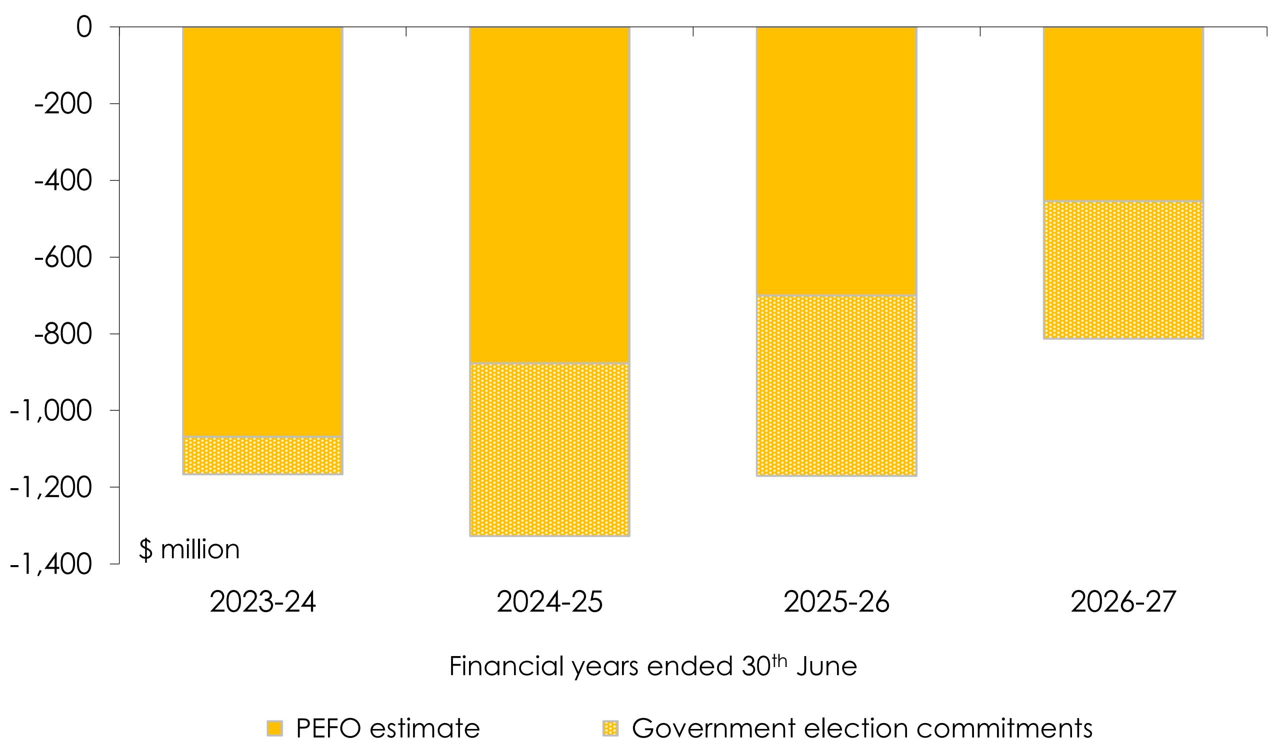
With the Government having now provided an additional $571.2 million for payments to survivors of child sexual abuse in State institutions before the end of the 2023-24 financial year (and assuming that provision is sufficient to cover all claims), those payments as they are actually made to survivors will not impact projected or reported operating expenses or the net operating and fiscal balances – although they will impact estimates and outcomes for the cash balance and net debt. The Review has not sought indepedently to estimate the profile of those payments.

Chart 4.11 – Impact of Government election promises on the net operating balance



Sources: Tasmanian Department of Treasury & Finance (2024a) and Ferguson (2024).

Chart 4.12 – Impact of Government election commitments on the fiscal balance



Sources: Tasmanian Department of Treasury & Finance (2024a) and Ferguson (2024).

The outlook for Tasmania's public non-financial corporations sector to 2026-27

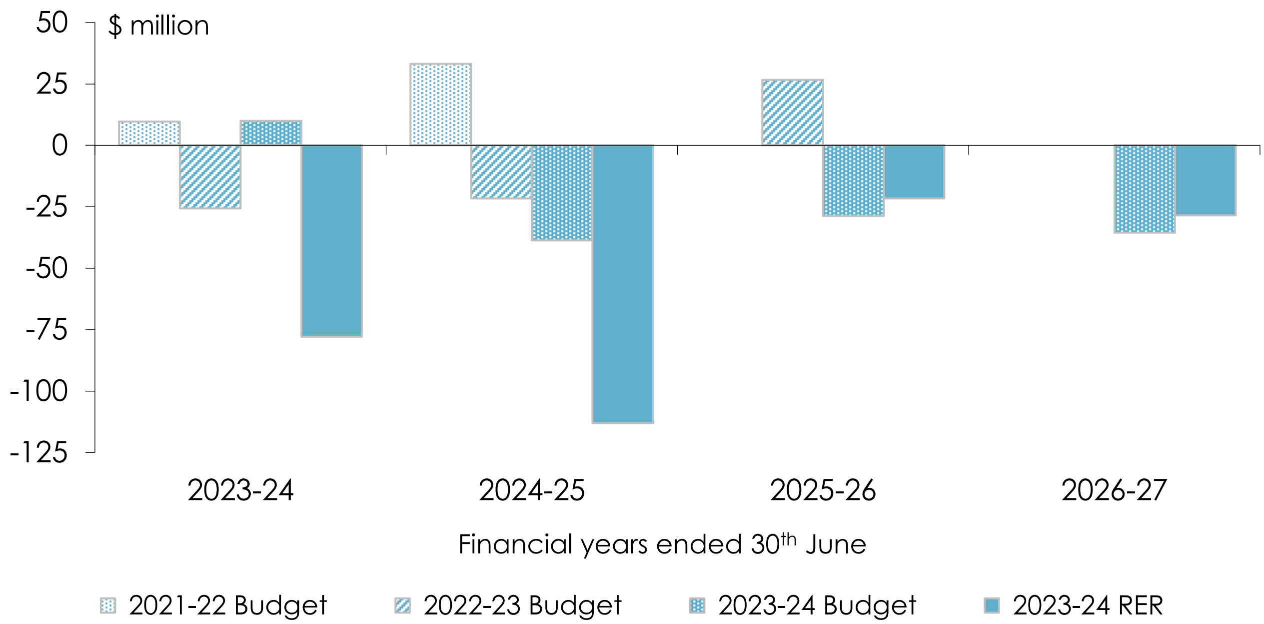
In contrast to the five years to 2022-23, during which (as outlined in Chapter 3) the financial performance and position of Tasmania's public non-financial corporations sector generally exceeded initial expectations, the outlook for this sector has deteriorated, in some respects quite markedly, over the past two years:

- the public non-financial corporations sector is expected to incur net operating deficits of $241 million over the four years to 2026-27, compared with the initial estimates (made four years prior to each of those years) of operating surpluses totalling $79 million, a turnaround of $320 million (Chart 4.13);
- purchases of non-financial assets (roughly speaking, 'infrastructure investment') by the public non-financial corporations sector are expected to total $6,716 million over the four years to 2026-27, $3 billion more than initially envisaged in the budgets four years prior to each of those years, which summed to $3,676 million, and despite downward revisions to projected spending between the 2023-24 Budget and the 2-2023-24 RER (Chart 4.14);
- largely as a result, the cash deficits of the public non-financial corporations sector are most recently forecast to total $4,357 million over the four years to 2026-27, a $2.8 billion increase over the initially envisaged total of $1,5998 million (Chart 4.15, on page 60); and
- the net debt of the public non-financial corporations sector is forecast to reach $7,212 million by 30th June 2027, an upward revision of $880 million since the 2023-24 Budget presented in June last year, and more than double the figure for 30th June 2023 (Chart 4.16, on page 60).

The four consecutive years of net operating deficits which the 2023-24 *Revised Estimates Report* projects the public non-financial corporations sector to incur between 2023-24 and 2026-27 contrasts with the fifteen consecutive years of net operating surpluses accrued by this sector between 2008-09 and 2022-23. Only once before since the turn of the century (in 2008-09) has the Tasmanian public non-financial corporations sector recorded a net operating deficit.

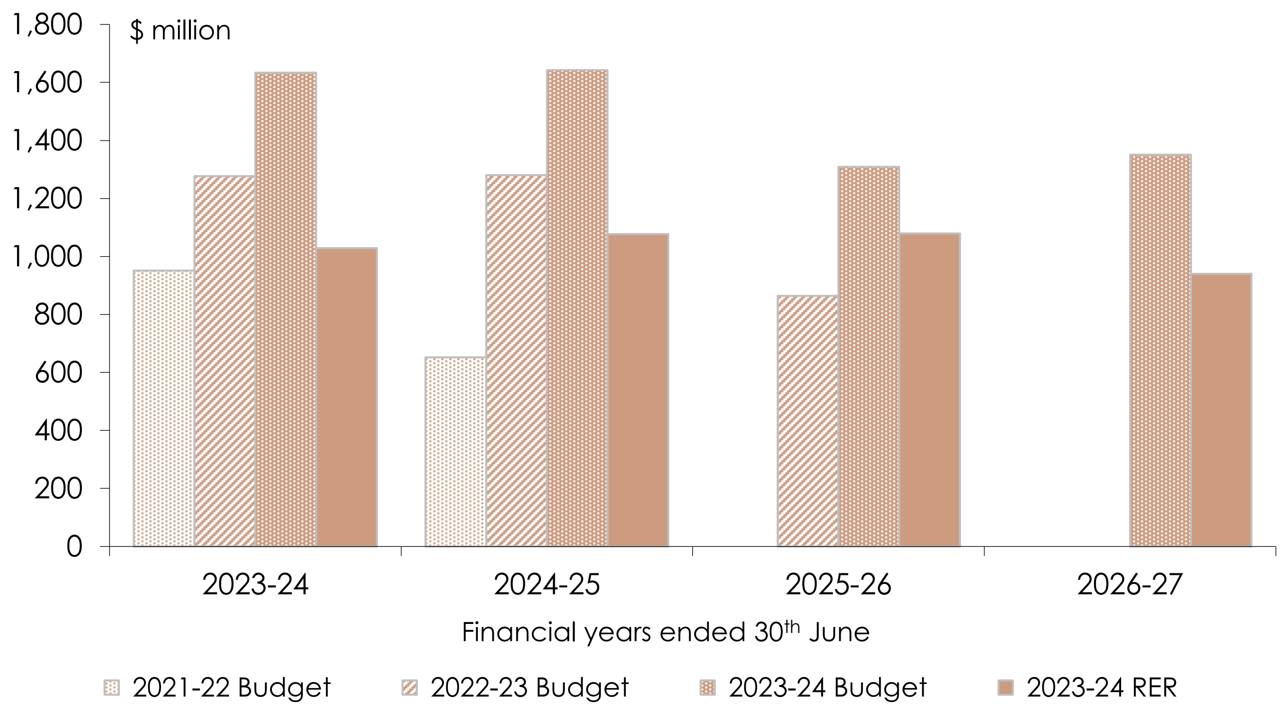
The deterioration in the financial performance and position of the public non-financial corporations sector is something that will potentially influence Tasmania's credit rating, since the borrowings of Tasmania's government business enterprises are guaranteed by the State. It will also adversely affect the financial position of the general government sector itself, via the non-financial corporation's tax-equivalent and dividend payments to the Budget. On average over the seven years to 2019-20, tax-equivalent and dividend payments represented 6.5% of the general government sector's total revenues: this figure declined to an average of 4.7% over the three years to 2022-23, and is now forecast to average just 4.0% of total revenues over the four years to 2026-27 (including a forecast of 3.0% in 2026-27 itself).

Chart 4.13 – Successive forward estimates of the public non-financial corporations sector net operating balance for the years 2023-24 through 2026-27



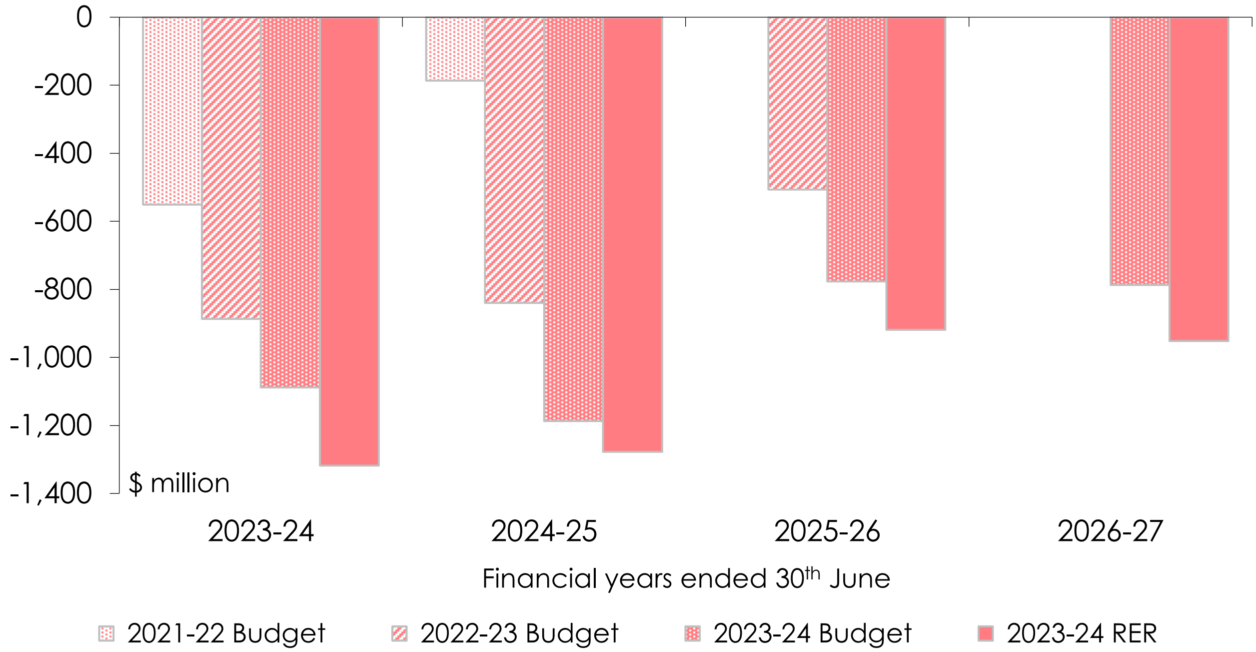
Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Chart 4.14 – Successive forward estimates of the the public non-financial corporations sector net purchases of non-financial assets for the years 2023-24 through 2026-27



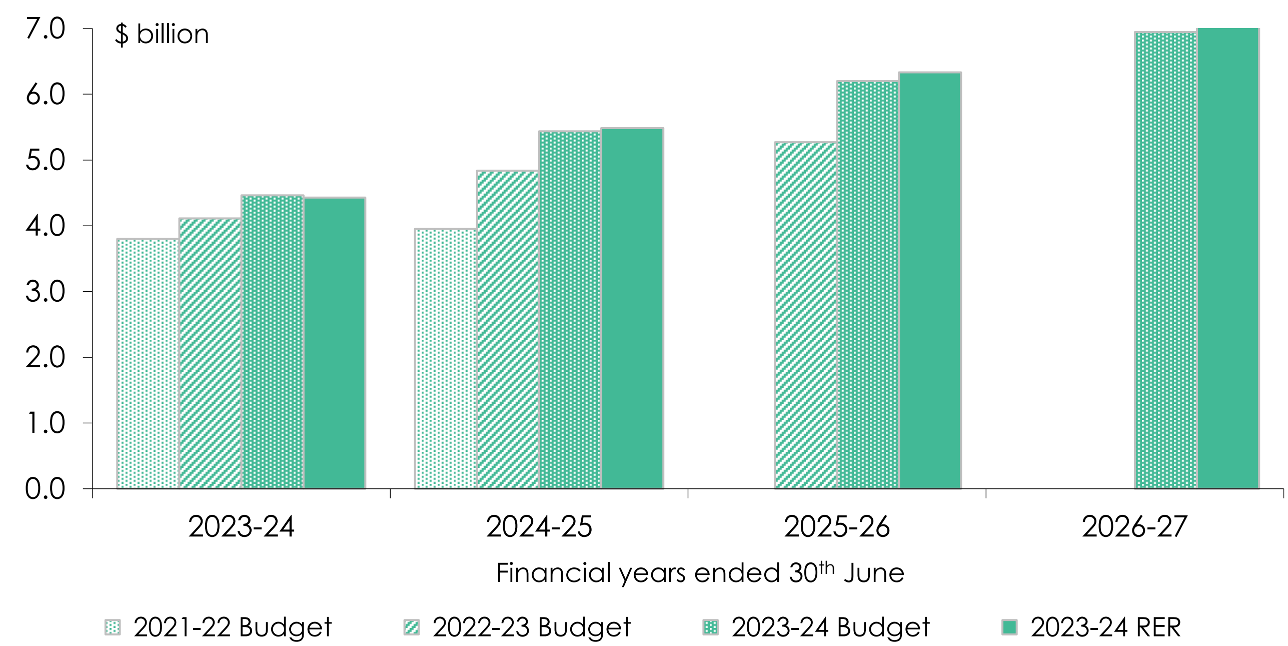
Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Chart 4.15 – Successive forward estimates of the the public non-financial corporations sector cash balance for the years 2023-24 through 2026-27



Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Chart 4.16 – Successive forward estimates of the public non-financial corporations sector net debt for the years 2023-24 through 2026-27



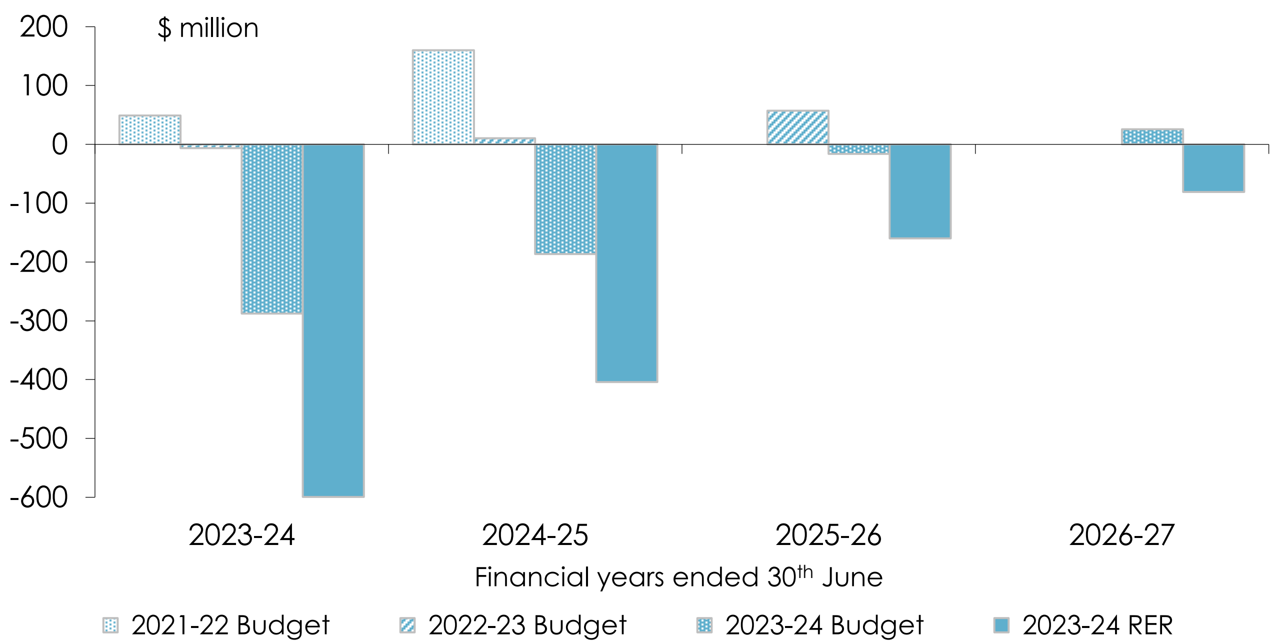
Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Tasmania's non-financial public sector as a whole

The deteriorating outlook for the financial performance and position of both the general government and public non-financial corporations sectors over the four years to 2026-27, between the 2021-22 Budget and the 2023-24 *Revised Estimates Report* has implied a significant deterioration in the corresponding financial metrics for Tasmania's non-financial public sector as a whole (note these projections do not incorporate the estimated outcomes for the general government sector in the 2023-24 *Preliminary Outcomes Report* published in 15th August):

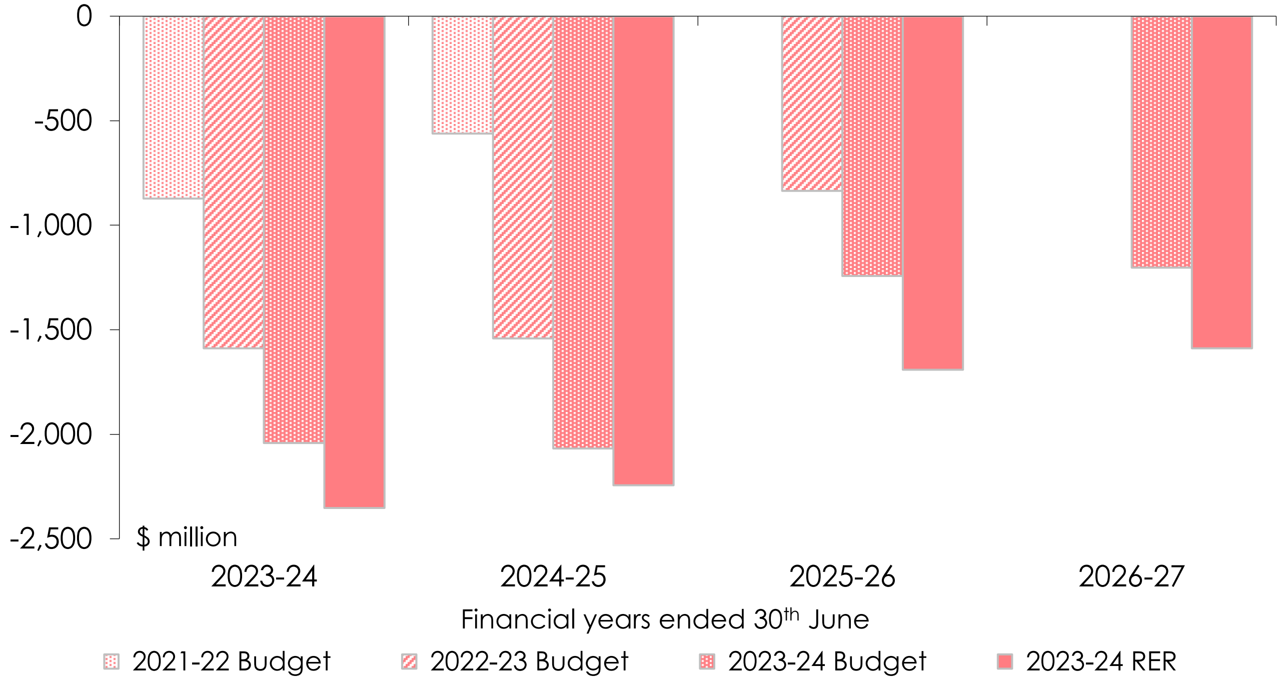
- the most recent forecasts, published in the *Revised Estimates Report* on 14th February and repeated in the *Pre-Election Financial Outlook* two weeks later, suggest that the non-financial public sector as a whole will incur *net operating deficits* totalling $1,244 million over the four years to 2026-27, a cumulative deterioration of just over $1.3 billion from the first estimates for each of those four years (Chart 4.17);
- the *fiscal* (accrual accounting) and *cash deficits* forecast for the four years to 2026-27 have each widened by over $5 billion by comparison with the initial estimates for each of those four years, from $2,398 million to $7,791 million, and from $2,718 million to $7,878 million, respectively (Chart 4.18, on page 62);
- the *net debt* of the non-financial public sector as a whole is most recently forecast to reach $13,330 million by 30th June 2027, $789 million more than predicted in the 2023-24 Budget, and $8.3 billion (or 163%) more than the last actual figure of $5,075 million as at 30th June 2024 (Chart 4.19).

Chart 4.17 – Successive forward estimates of the non-financial public sector net operating balance for the years 2023-24 through 2026-27



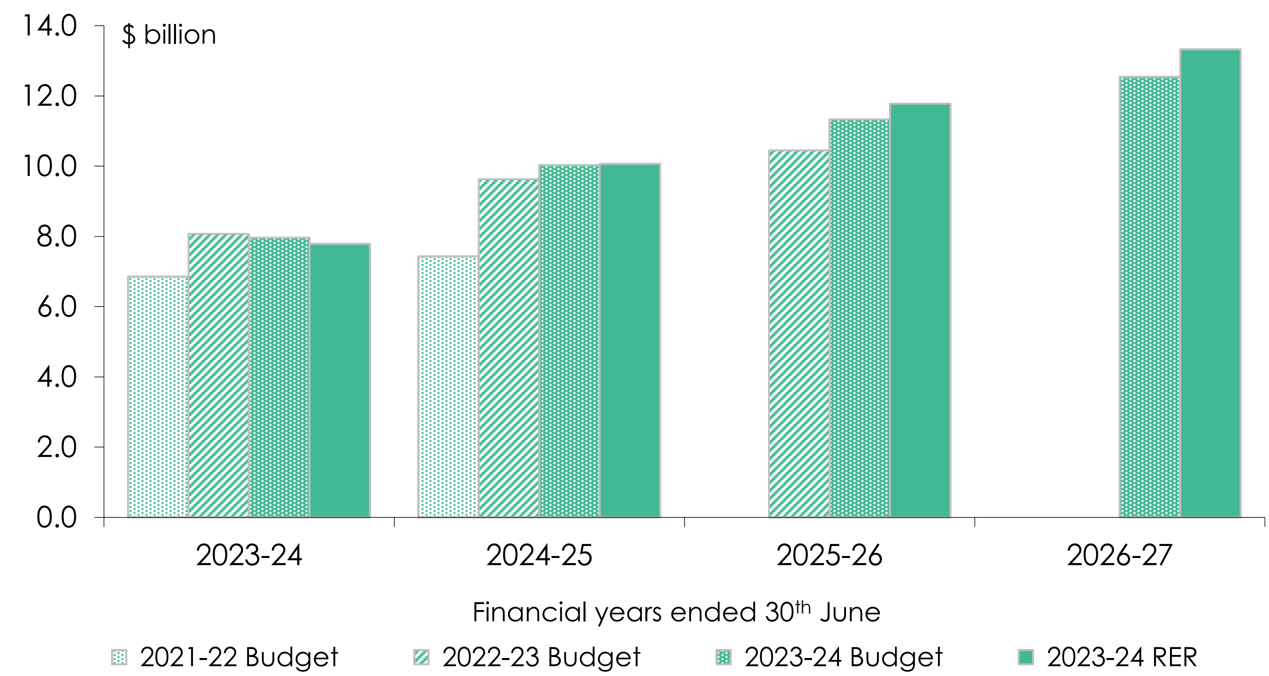
Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Chart 4.18 – Successive forward estimates of the non-financial public sector cash balance for the years 2023-24 through 2026-27



Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Chart 4.19 – Successive forward estimates of non-financial public sector net debt for the years 2023-24 through 2026-27



Sources: Tasmanian Government (2021, 2022 and 2023); Tasmanian Department of Treasury & Finance (2024a).

Tasmania's public sector finances compared with those of other states and territories

Further insights into the condition of Tasmania's public sector finances can be obtained from comparisons with the other states and territories.

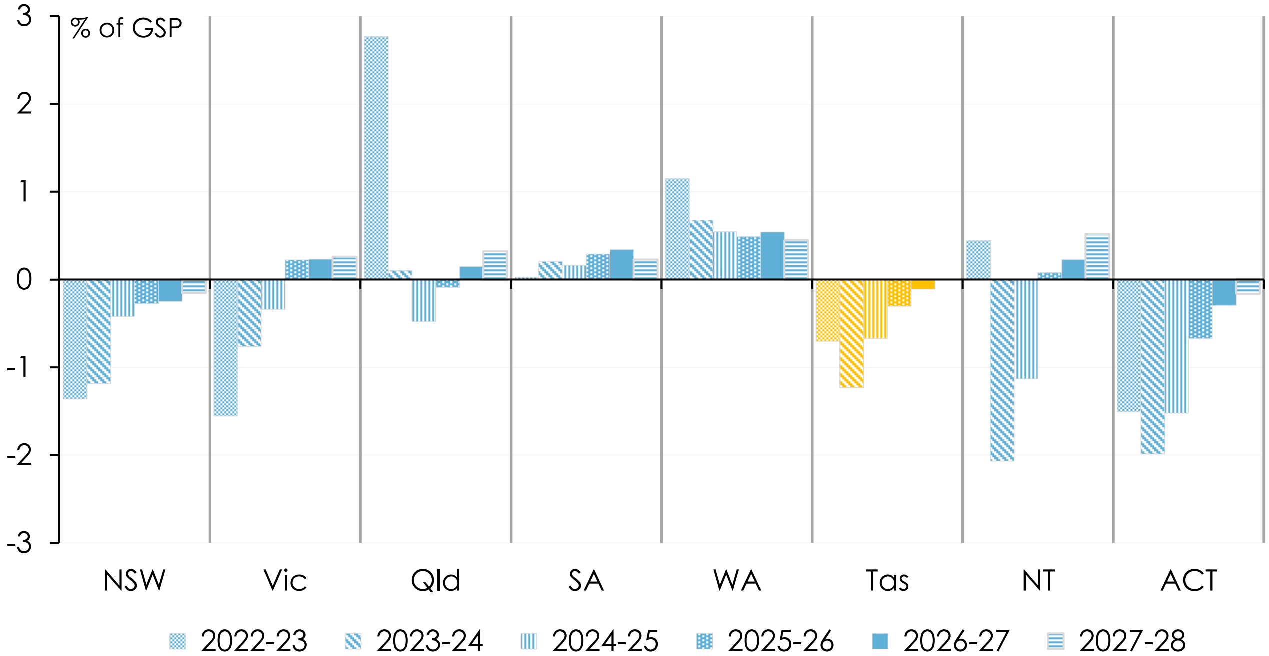
In making these comparisons four important considerations should be borne in mind:

- Tasmania's 'general government' sector is larger, relative to the size of its economy, as measured by (for example) revenues or expenses as a percentage of gross state product, or public sector employment as a percentage of total employment, than that of any other state or territory except the Northern Territory;
- State government-owned business enterprises play a relatively larger role in Tasmania's economy than in any other state or territory except, by some measures, Western Australia – largely because Tasmania (along with Western Australia) is the only jurisdiction where the State Government continues to own the entire electricity supply chain;
- Tasmania's unfunded employee superannuation liability (USL) is considerably larger, relative to the size of its economy, than any other jurisdiction except the ACT[3] - indeed, Tasmania's general government USL is larger in dollar terms than Western Australia's (whose economy is 11 times the size of Tasmania's), and about the same size as South Australia's (whose economy is 3½ times larger); additionally Tasmania's government business enterprises have USLs which, in aggregate, are larger in dollar terms than those of any other state's or territory's except New South Wales;
- measures of various fiscal aggregates (such as revenues, expenses, and net debt) as percentages of gross state product (GSP) for Western Australia have been distorted (downwards) by the enormous increase in that state's nominal GSP over the past two decades resulting from the extraordinary increase in the volume and especially the prices of its mineral and energy output – the implicit price deflator of WA's GSP rose by 136% over the twenty years to 2022-23, compared with 80% for the rest of Australia combined. Westerm Australia's, and to a lesser extent Queensland's, finances have benefited from buoyant mineral royalty revenues; and in Western Australia's case these are no longer fully taken into account in the distribution of GST revenues because of the changes made to the basis for distributing GST revenues among the states and territories by the Commonwealth in 2018 (see, eg, Eslake 2024b).

Charts 4.20 through 4.28 compare aspects of Tasmania's public finances and those of the other states and territories from 2022-23 through 2027-28. Note that the data shown in these charts do not reflect 2023-24 outcomes for Tasmania's general government sector reported in the *Preliminary Outcomes Report* published in 15th August.

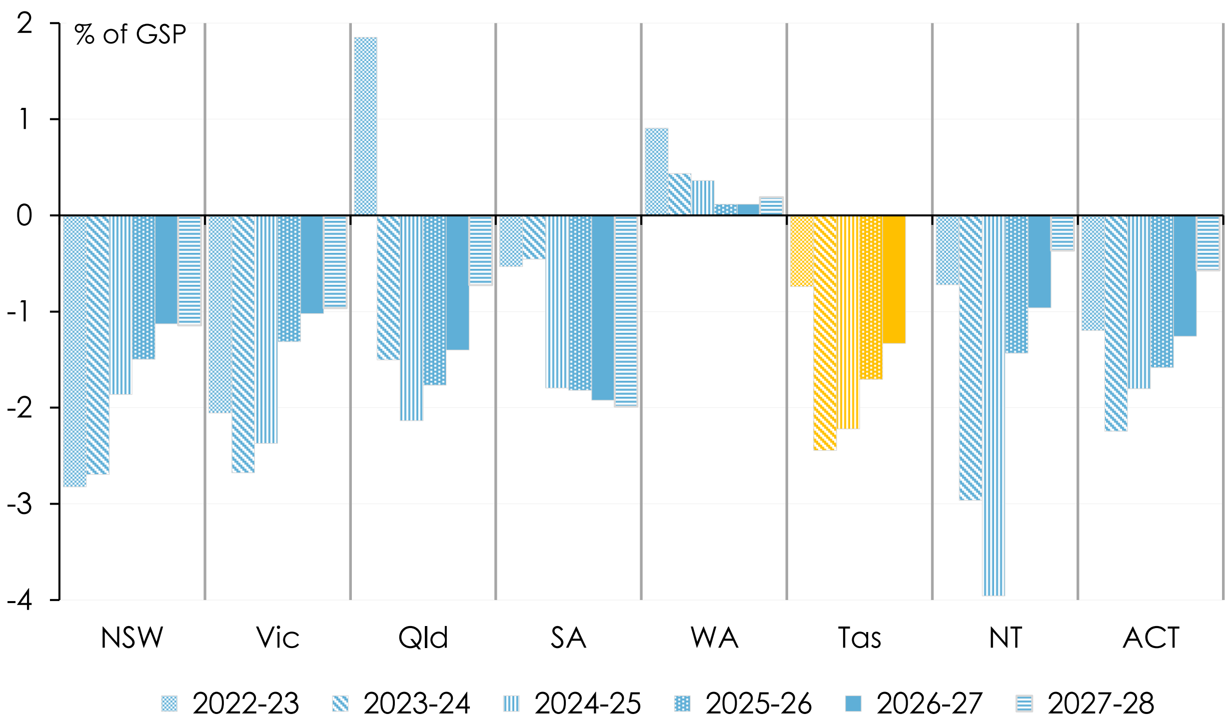
[3] The ACT's superannuation liabilities aren't as large as they appear in government finance statistics, because its employee superannuation arrangements are managed via the Commonwealth Government's superannuation fund, which precludes the ACT from including capital gains on its superannuation investments in its GFS financial statements, as the states and the Northern Territory do.

Chart 4.20 – General government net operating balances



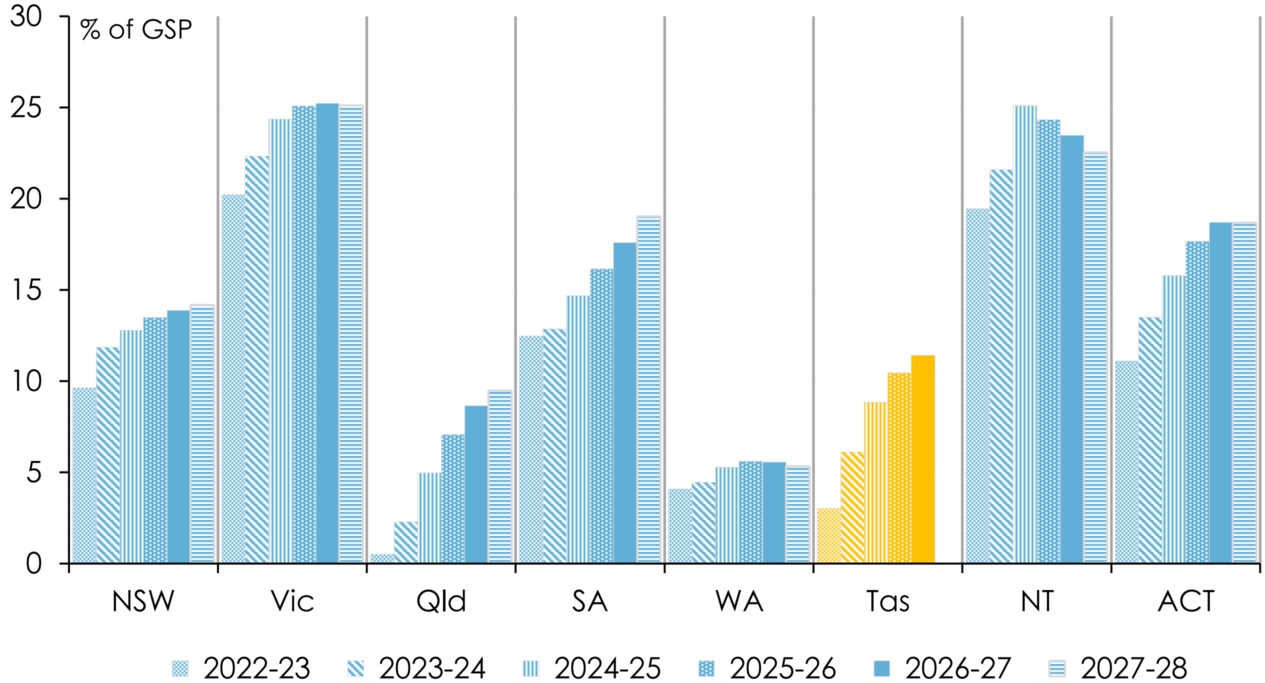
Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.21 – General government cash balances



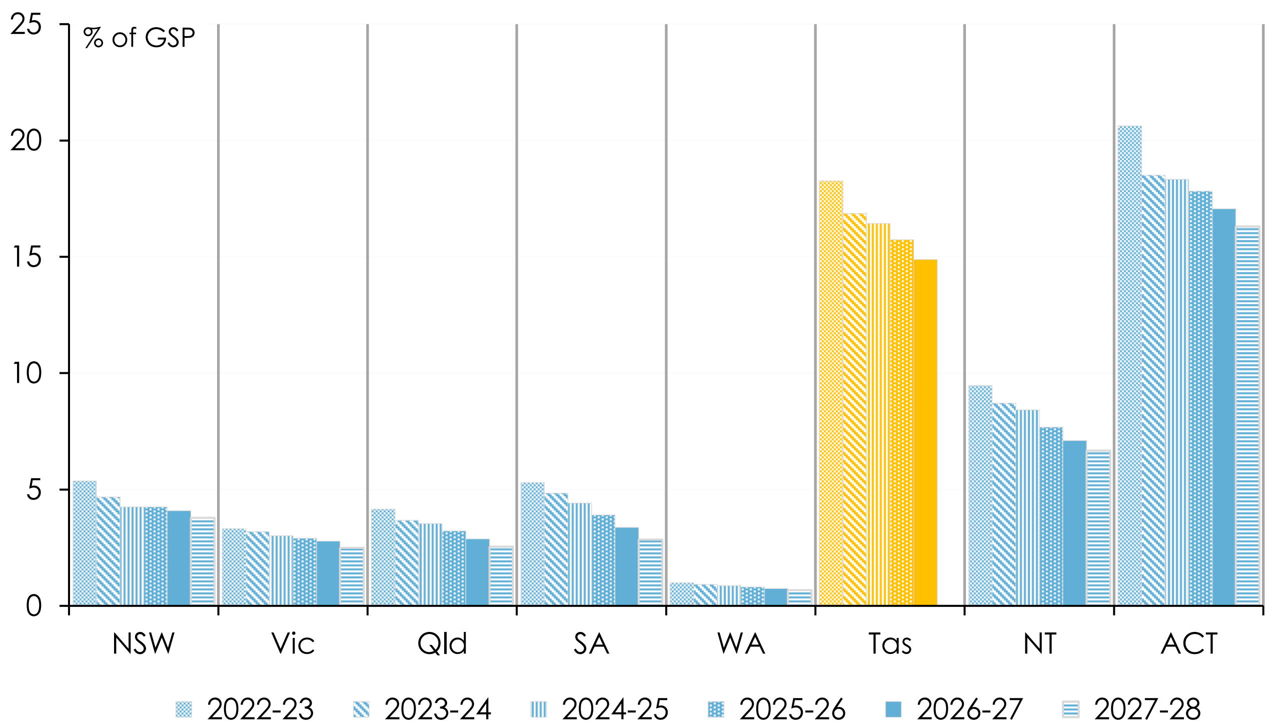
Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.22 – General government GFS net debt



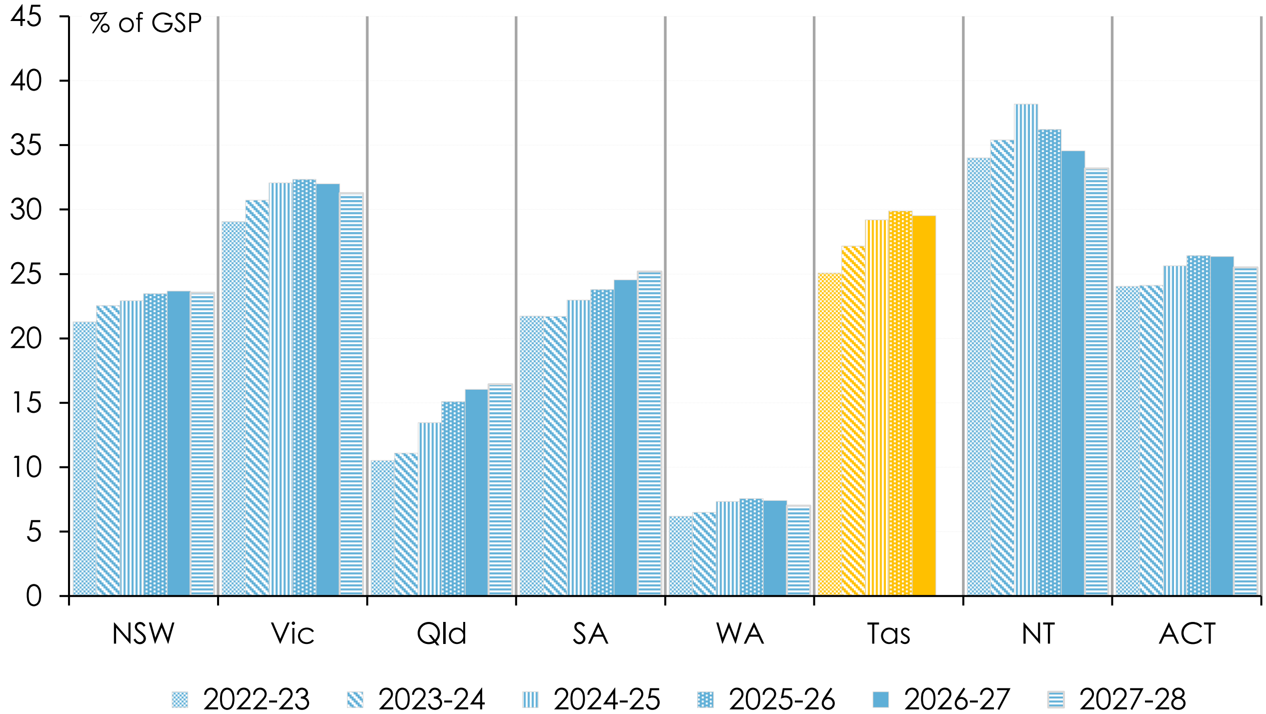
Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.23 – General government unfunded superannuation liabilities



Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.24 – General government net financial liabilities



Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Charts 4.20 through 4.24 show that:

- Tasmania is the only state or territory, other than the ACT, where the general government sector is expected to incur *net operating deficits* over the forward estimates period;
- as a percentage of GSP, Tasmania's general government *cash deficits* over the four years to 2026-27 will be larger than those of any other jurisdiction except the NT;
- Tasmania's general government sector GFS *net debt* (which excludes lease liabilities) is expected to rise by 8.4 percentage points of GSP over the four years to June 2027, a larger increase than for any other state or territory – although at 11½% of GSP by June 2027 it will be the third-lowest of all states and territories, and slightly below the average for all states and territories of 14¼% of GSP;
- Tasmania's general government *unfunded superannuation liabilities* will remain substantially higher as a proportion of GSP than those of any other jurisdiction except the ACT (and the figure for the ACT excludes the assets which the ACT Government holds within the Commonwealth Superannuation Fund); and
- Tasmania's general government *net financial liabilties* are forecast to peak at almost 30% of GSP by 30th June 2026 (before declining slightly over the following year), a higher figure than for any other jurisdiction except Victoria and the Northern Territory, and 8 percentage points above the average for all states and territories.

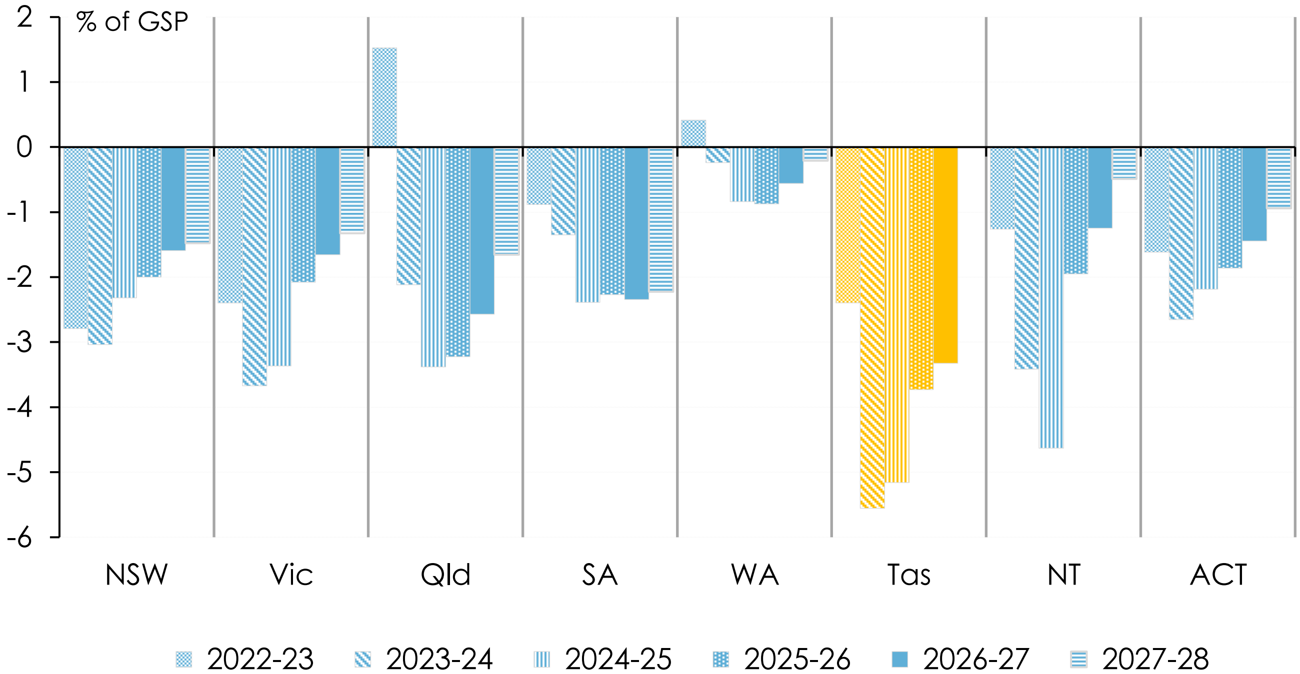
Charts 4.25 through 4.28 (on pages 68 and 69)depict fiscal metrics for the non-financial public sectors of each state and territory (ie including public non-financial corporations), and show that:

- Tasmania's non-financial public sector *cash deficits* are expected to average just under 4½% of GSP over the four years to 2027-28, larger than those for any other state or territory (including Victoria and the Northern Territory), and more than double the average for all states and territories;
- Tasmania's GFS non-financial public sector *net debt* (which excludes lease liabilities) will more than double as a proportion of GSP, from 12.5% at 30th June 2023 (lower than the all-states-and-territories average of 14.2%) to about 25¾% of GSP by 30th June 2028 (some 6 percentage points above the all-states-and-territories average of 19¾%), and will be only 3 percentage points below the Northern Territory and about 4¼ percentage points below Victoria on this score;
- Tasmania's non-financial public sector *unfunded superannuation liabilities*, though declining as a proportion of GSP over the four years to June 2027 – as they are in every other state and territory – are doing so from a much higher level than any other jurisdiction except the ACT (and as noted above, the ACT has assets in the Commonwealth Superannuation Fund which, under government accounting standards, it can't offset against its unfunded liability in its financial statements);
- Tasmania's non-financial public sector *net financial liabilities* were higher, as a proportion of GSP, at 30th June 2023 (38.1%) than those of any other jurisdiction except the Northern Territory, will rise by proportionately more (over 10 percentage points of GSP) over the four years to June 2027 than in any other state or territory (and by more than twice as much as the average for all states and territories, of just over 34 percentage points), and by 30th June 2027 is forecast to exceed 48% of GSP, highe than for any other state or territory, 10 percentage points higher than forecast for Victoria and 20 percentage points above the average for all states and territories.

In other words, when looked at holistically – in particular, by looking at net financial liabilities rather than merely net debt, and when looking at the public sector as a whole rather than simply the general government sector, Tasmania's public finances are in worse shape than most of the other states and territories, and in some respects the worst shape of all states and territories, including Victoria (whose financial difficulties have been the subject of far more public attention than Tasmania's) and the Northern Territory.

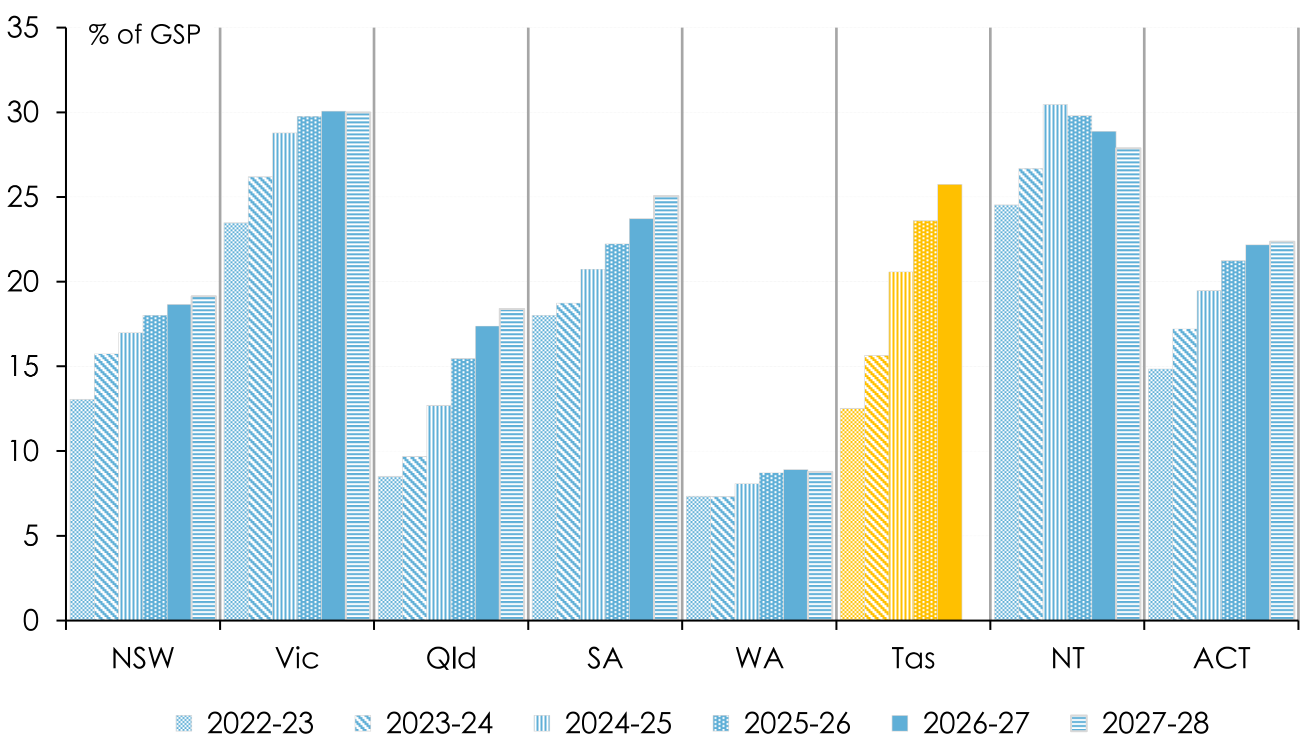
And the message of the next Chapter is that Tasmania's position is set to deteriorate further over the next decade, in the absence of concerted corrective action.

Chart 4.25 – Non-financial public sector cash balances



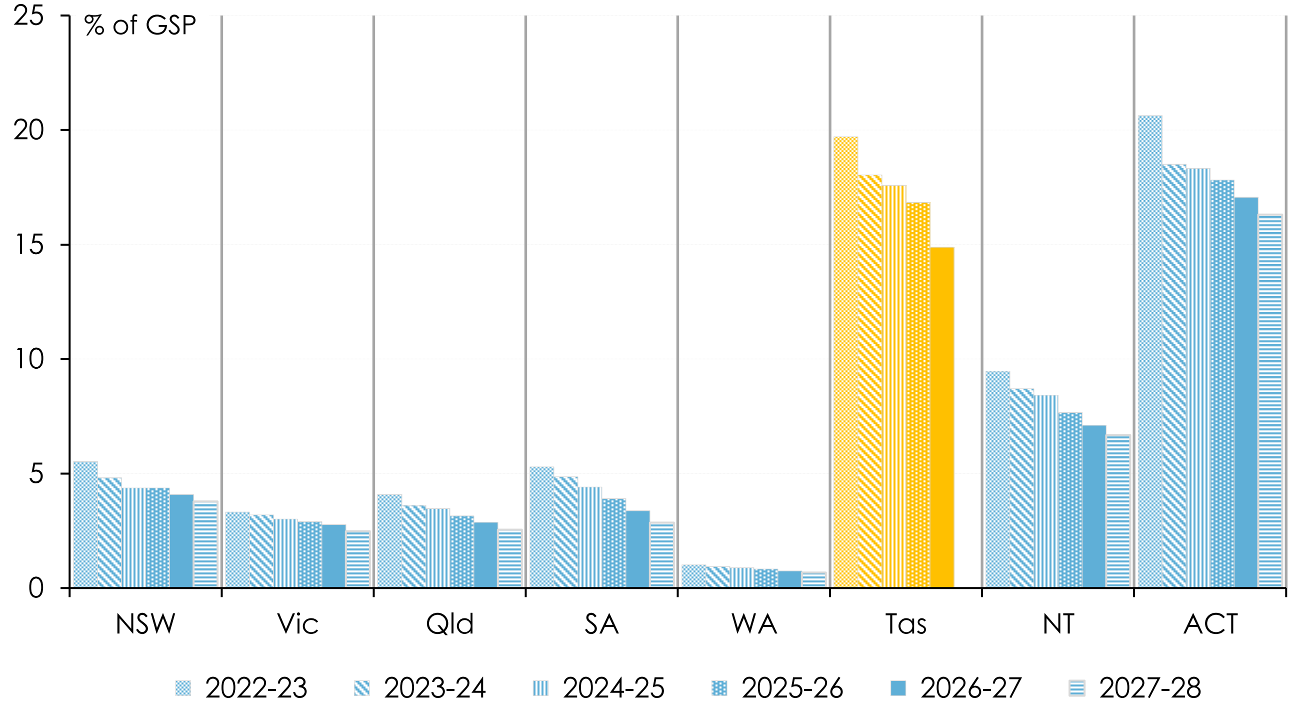
Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.26 – Non-financial public sector GFS net debt



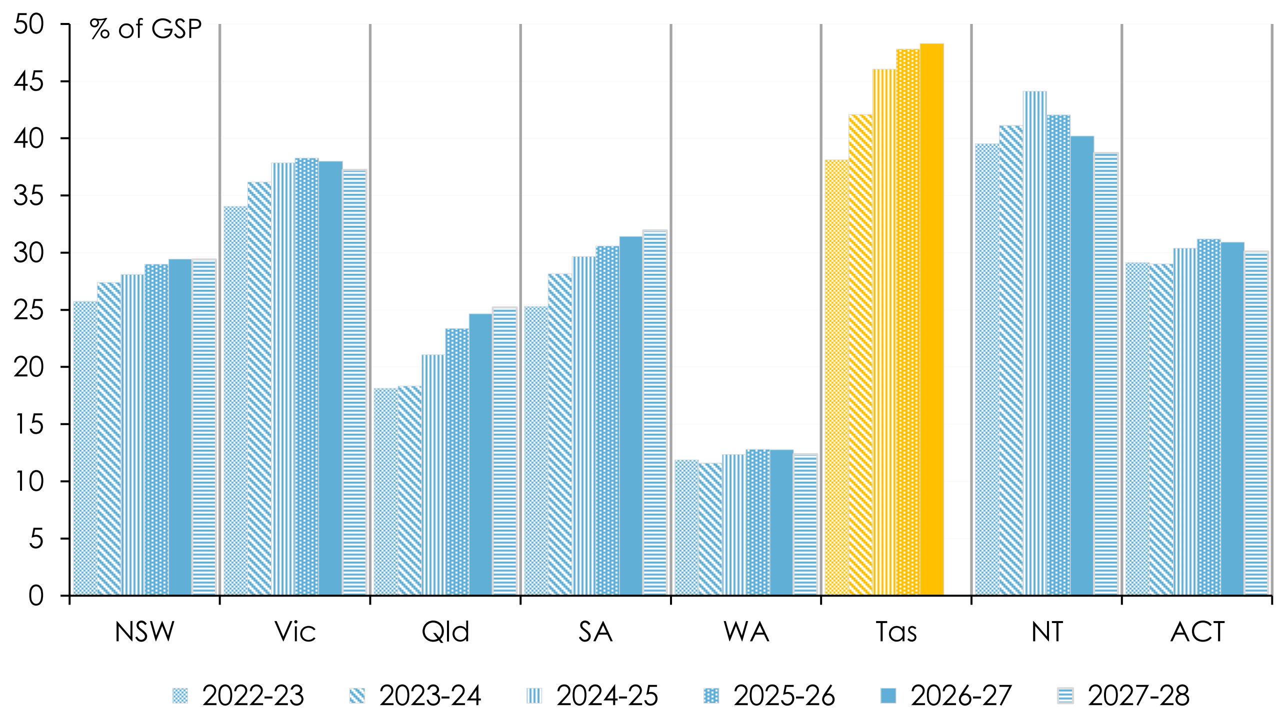
Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.27 – Non-financial public sector unfunded superannuation liabilities



Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

Chart 4.28 – Non-financial public sector net financial liabilities



Sources: New South Wales, Victoria, Queensland, South Australia, Western Australia, Northern Territory and ACT, 2024-25 Budget Papers; Tasmanian Treasury (2024a) (see References for details).

5. The medium-term outlook for Tasmania's public sector finances

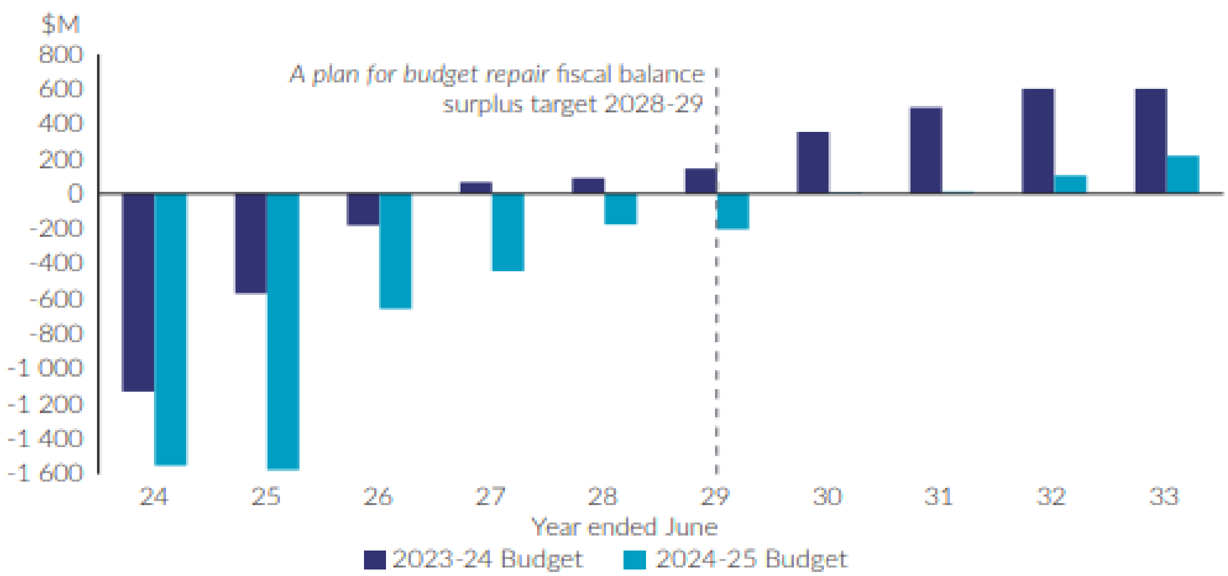
Introduction

This Chapter sets out prospective trends in broad indicators of Tasmania's general government sector finances over the decade to 2034-35. To its very considerable surprise, this Review was unable to source these projections from the Department of Treasury and Finance, which undertakes them only once every five years, as part of the five-yearly *Fiscal Sustainability Reports*, the most recent of which was published in June 2021 (Department of Treasury and Finance 2021a), and the next of which isn't due until June 2026. It is, frankly, astonishing that Ministers would be making decisions about, for example, infrastruture spending projects which may take up to, or more than, ten years to complete (see, eg, Department of State Growth 2024) without having an up-to-date assessment of the shape of the Government's budget over that interval.

Since 2006-07 the Federal Government's annual Budget Papers and Mid-Year Economic and Fiscal Outlooks have contained medium-term projections of the underlying cash balance, and since 2013-14 for net debt for ten-year periods beyond the current financial year; more recently the Federal Budget Papers have also included medium-term projections for cash payments and receipts (see, eg, Australian Government 2024a: 80 and 89-95).

And although it would be unreasonable to expect the Tasmanian Treasury to have similar resources to its Federal counterpart, it is notable that the Northern Territory Treasury (which presumably has even fewer resources than Tasmania's) does produce medium-term projections for the Territory's non-financial public sector fiscal balance out to 2032-33, which are published in its annual budget papers (Chart 5.1).

Chart 5.1 – Medium-term projections of the Northern Territory non-financial public sector fiscal balance



Source: Northern Territory Government (2024a: 13).

As a result, the medium-term projections of the financial performance and position of Tasmania's public sector have been undertaken by the Review itself – albeit without the "dedicated project team that engages broadly within Treasury and with agencies" and without the "around six months to complete" as formally advised to this Review by the Secretary to the Department regarding the *Fiscal Sustainability Report*[4].

The Australian Parliamentary Budget Office (APBO) provided technical assistance with the budget accounting frameworks underpinning the modelling presented in this Chapter. Projections for Australian aggregate GST revenues and other Commonwealth grant funding have been prepared with the assistance of the APBO's Build Your Own Budget tool. The assumptions made in constructing projections for Tasmania are entirely the responsibility of this Review and do not reflect the opinions of the APBO.

It is important to note that the projections in this Chapter have been prepared on a strict 'no policy change' basis – that is, on the assumption that, apart from the commitments which it made during the recent election campaign, the Government does not make any 'policy decisions' with regard to revenues, expenses or net purchases of non-financial assets which would alter the trajectories laid out here, either in the 2024-25 Budget to be presented on 12th September or subsequently.

That's obviously an unrealistic assumption: but the point of making it (apart from the fact that the Review has been undertaken without any knowledge of what the Government may be contemplating in its Budget deliberations) is to illustrate what Tasmania's finances would look like *in the absence* of any 'policy decisions' – in the hope that the Government (and/or future governments) will in fact make 'policy decisions' intended to produce more sustainable outcomes than those which would likely be obtained otherwise – some suggestions for which are presented in Chapter 6.

Reflecting the resourcing and time constraints noted above, this Chapter does not attempt to construct multiple alternative scenarios as the Treasury has done in the three *Financial Stability Reports* thus far. Rather, it sets out trajectories for the most important indicators of Tasmania's financial position on what are considered to be plausible and reasonable assumptions regarding economic and population growth in Tasmania, receipts from the Federal Government (GST revenue shares and other grants), Tasmania's own-source revenues, and operating and capital expenditures.

Finally, it should also be noted that the projections in this Chapter, like those in the *Financial Sustainability Reports*, relate only to the general government sector. The Secretary of the Department of Treasury and Finance has advised this Review that it is "not considered practical to attempt to assess fiscal sustainability of other sectors … as this requires a significant increase in the level of complexity resulting from the necessary detailed analysis and assessment of the projected financial position of each government business"[5]. This Review isn't questioning that judgement: but if it's "not practical" for Treasury, it's certainly "not practical" for this Review either.

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[4] Correspondence from the Secretary of the Department of Treasury and Finance, 9th May 2024.

[5] As for footnote 4.

The medium-term outlook for general government expenses

The medium-term projections for general government expenses set out in this Chapter take as their starting point the Forward Estimates presented in the *2023-24 Revised Estimates Report* (Treasury 2024a) and repeated in the *Pre-Election Financial Outlook* (Treasury 2024b), supplemented by estimates of operating expenses classified by purpose consistent with those estimates provided separately by Treasury[6].

These Forward Estimates have been adjusted to incorporate the spending commitments made by the Government during the election campaign earlier this year, as published by the Treasurer, which as noted in Chapter 4 amount to almost $1.4 billion over the four years to 2027-28 (Ferguson 2024).

They have not been adjusted to reflect the various risks noted by the Secretary to the Department of Treasury and Finance in the *Pre-Election Financial Outlook* (Treasury 2024b: 11-15) and summarized in Chapter 4, because it was not possible to allocate those risks to specific financial years. Nor do they incorporate the additional provision made in the *Preliminary Outcomes Report 2023-24* for future payments to survivors of child sexual abuse in State insitutions.

Additionally, as also noted in Chapter 4, the Forward Estimates published in February assume an unprecedented degree of expenditure restraint over the three years to 2026-27, with operating expenses projected to decline (something which hasn't occurred at least since the commencement of the accrual accounting presentation of budget estimates in 2001-02) in both 2024-25 and 2025-26.

It is thus possible that the 'starting point' for the medium-term projections of expenses (from 2027-28 through 2034-35) contained in this Chapter is too low.

For these medium-term projections the Review has used the same assumptions regarding the future growth rate of operating expenses as used by Treasury in the 'Historical Trends' scenario presented in its 2021 *Financial Stability Review*[7]. In particular:

- health expenses are assumed to grow at an average annual rate of 6.3% per annum, driven by both demographic factors (in particular, Tasmania's ageing population profile) and technological improvements resulting in increased demand for high-cost services;
- education expenses are assumed to grow at an average annual rate of 2.8% per annum, primarily reflecting slower growth in Tasmania's student population;
- spending on public order and safety is assumed to grow at an average annual rate of 4.5% per annum;
- spending on social protection is assumed to grow at an average annual rate of 4.0% per annum;

[6] Correspondence from the Secretary of the Department of Treasury & Finance, 13th June 2024.
[7] As provided in correspondence from the Secretary of the Department of Treasury & Finance, 3rd June 2024

- spending on housing and community amenities is assumed to grow at an average annual rate of 2.8% per annum but from a lower base given the creation of Homes Tasmania (outside the general government sector);
- other expenses (apart from nominal superannuation interest and borrowing expenses) are assumed to grow at an average annual rate of 1.8% per annum.

Overall, these assumptions result in total operating expenses growing (on a 'no-policy-change' basis) at an average annual rate of 4.1% over the eight years to 2034-35.

The medium-term outlook for general government revenues

As with expenses, the medium-term projections for general government revenues set out in this Chapter take as their starting point the Forward Estimates for the four years to 2026-27 presented in February.

These published estimates of taxation receipts have been adjusted for commitments made by the Government during the election campaign (principally, the introduction of a levy on short-stay accommodation, which the Government estimated would raise an additional $11 million per annum).

The published estimates of receipts from the Federal Government have been adjusted to reflect the increase in Tasmania's GST relativity as determined by the Grants Commission in April, and upward revisions to the estimates of total GST revenues and changes to forward estimates of Federal Government grants to Tasmania in the 2024-25 Federal Budget (Australian Government 2024b).

These revisions are quite significant: they imply an additional $1.1 billion in revenue from Tasmania's share of the GST, and an additional $251 million in other Commonwealth grants, over the three years to 2026-27.

Beyond 2026-27:

- projections of Tasmania's share of GST revenues are based on the APBO's projections of total GST revenues (Parliamentary Budget Office 2024a), ABS projections of Tasmania's share of the total Australian population, and an assumption that Tasmania's GST relativity remains unchanged from its 2024-25 value;
- Tasmania's share of other Commonwealth grants (as projected by the Federal PBO) is assumed to remain unchanged;
- revenue from payroll tax is assumed to grow in line with employment (in turn derived as growth in real gross state product less assumed productivity growth) plus nominal wages (in turn assumed to average 3% per annum);
- revenue from land tax and transfer (stamp) duties is assumed to grow in line with land prices, which are in turn assumed to rise at the same rate as the CPI (ie 2.5% per annum), with minimal growth in transaction volumes given slow population growth;

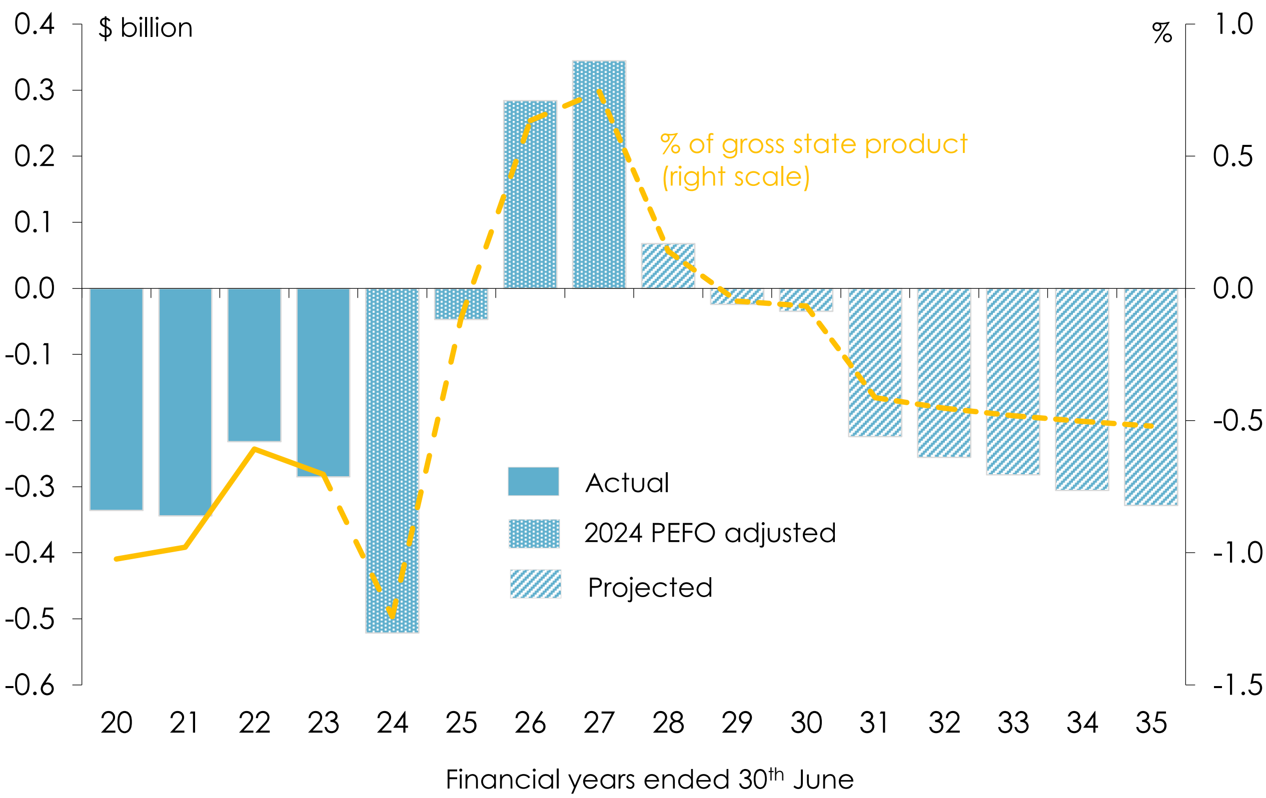
- tax-equivalent and dividend receipts from GBEs are assumed to be a constant proportion of the value of the state's equity investments in them; and
- other receipts are assumed to grow in line with gross state product.

Overall, these assumptions result in total operating revenues growing (on a 'no-policy-change' basis) at an average annual rate of 3.3% over the eight years to 2034-35.

The medium-term outlook for the net operating balance

Bringing together the foregoing projections for operating expenses and revenues, the 'no-policy-change' outlook for the net operating balance is depicted in Chart 5.2.

Chart 5.2 – Tasmanian general government net operating balance, 2020-21 to 2034-35



Note: 'PEFO adjustments' are for Government election commitments and revisions to estimates of GST revenue shares and other Commonwealth grants as described in this Chapter. The data shown do not incorporate preliminary results for 2023-24 reported in Treasury (2024c). *Source:* Review estimates.

The projections indicate that, after a greater improvement over the three years to 2026-27 than indicated by the *PEFO* Forward Estimates (due to the aforementioned upward revisions to Tasmania's share of GST revenues and of other Commonwealth grants), the net operating balance is likely – in the absence of policy changes – to swing back into deficit in 2028-29, with those deficits rising to over $300mn (or 0.5% of gross state product) in 2033-34 and 2034-35.

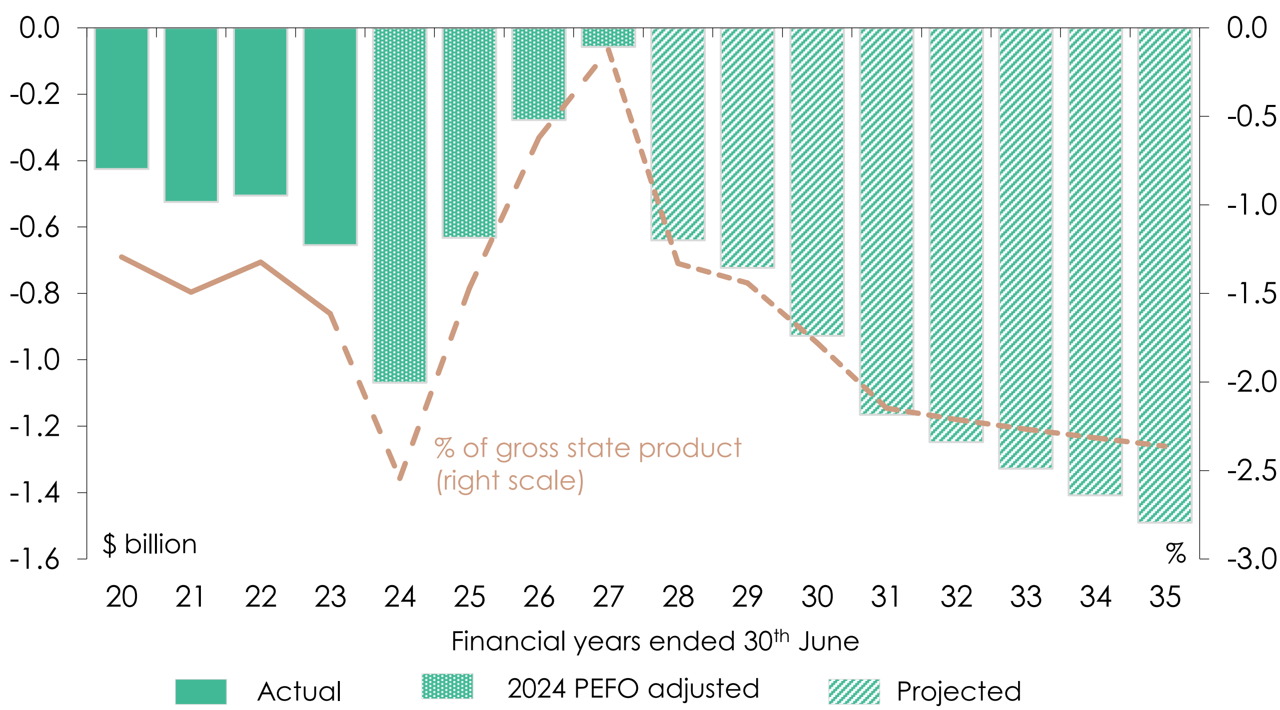
The medium-term outlook for the fiscal balance

The fiscal balance – the accrual-accounting measure of the general government sector's 'bottom line' – is equal to the net operating balance plus net purchases of non-financial assets (often referred to as 'capital expenditures') less depreciation expense.

The Review has not had access to long-term projections of the Government's infrastructure spending commitments or proposed net purchases of non-financial assets. The Forward Estimates of net purchases of non-financial assets published in February 2024 have been adjusted for the Government's election commitments (Ferguson 2024). From 2027-28 onwards, the 'no-policy change' assumption has been interpreted as implying that purchases of non-financial assets remain a constant percentage of gross state product.

The resulting outlook for the fiscal balance is set out in Chart 5.3.

Chart 5.3 – Tasmanian general government fiscal balance, 2020-21 to 2034-35



Note: 'PEFO adjustments' are for Government election commitments and revisions to estimates of GST revenue shares and other Commonwealth grants as described in this Chapter. The data shown do not incorporate preliminary results for 2023-24 reported in Treasury (2024c). *Source:* Review estimates.

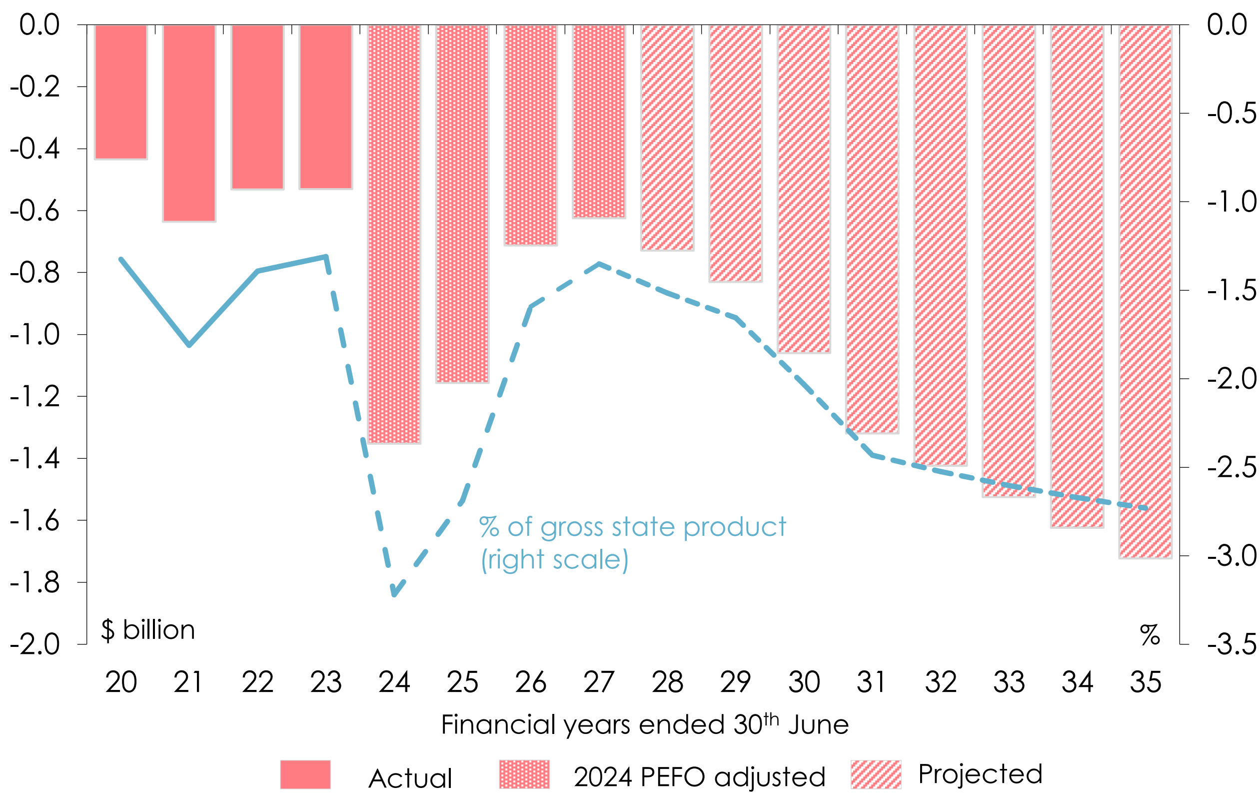
As with the net operating balance, the projections indicate that, after a greater improvement over the three years to 2026-27 than indicated by the *PEFO* Forward Estimates (due to the aforementioned upward revisions to Tasmania's share of GST revenues and of other Commonwealth grants), in the absence of policy changes the fiscal balance then deteriorates significantly, with the deficit widening to over $1 billion (2.1% of gross state product) in 2030-31 and widening to almost $1.5 billion (2.4% of gross state product) by 2034-35.

The medium-term outlook for the cash balance

The cash balance – which is simply the difference between cash receipts and cash payments – provides an alternative to the fiscal balance as a measure of the Government's 'bottom line'.

The outlook for the cash balance consistent with the foregoing projections of revenues, operating expenses and net purchases of non-financial assets is shown in Chart 5.4.

Chart 5.4 – Tasmanian general government cash balance, 2020-21 to 2034-35



Note: 'PEFO adjustments' are for Government election commitments and revisions to estimates of GST revenue shares and other Commonwealth grants as described in this Chapter. The data shown do not incorporate preliminary results for 2023-24 reported in Treasury (2024c). *Source:* Review estimates.

These projections indicate that, without policy changes, the cash balance will deteriorate steadily from 2028-29, with the deficit widening from $625 million (1.4% of gross state product) in 2026-27 to over $1 billion (2% of gross state product) in 2029-30, and to over $1.7 billion (2.7% of gross state product) in 2034-35. (Note that these projections do not incorporate any provision for cash payments to survivors of child sexual abuse in State institutions, since there is no information available as to the timing of these payments, for which provision was made in the *Preliminary Outcomes Report* for 2023-24 published on 15th August.

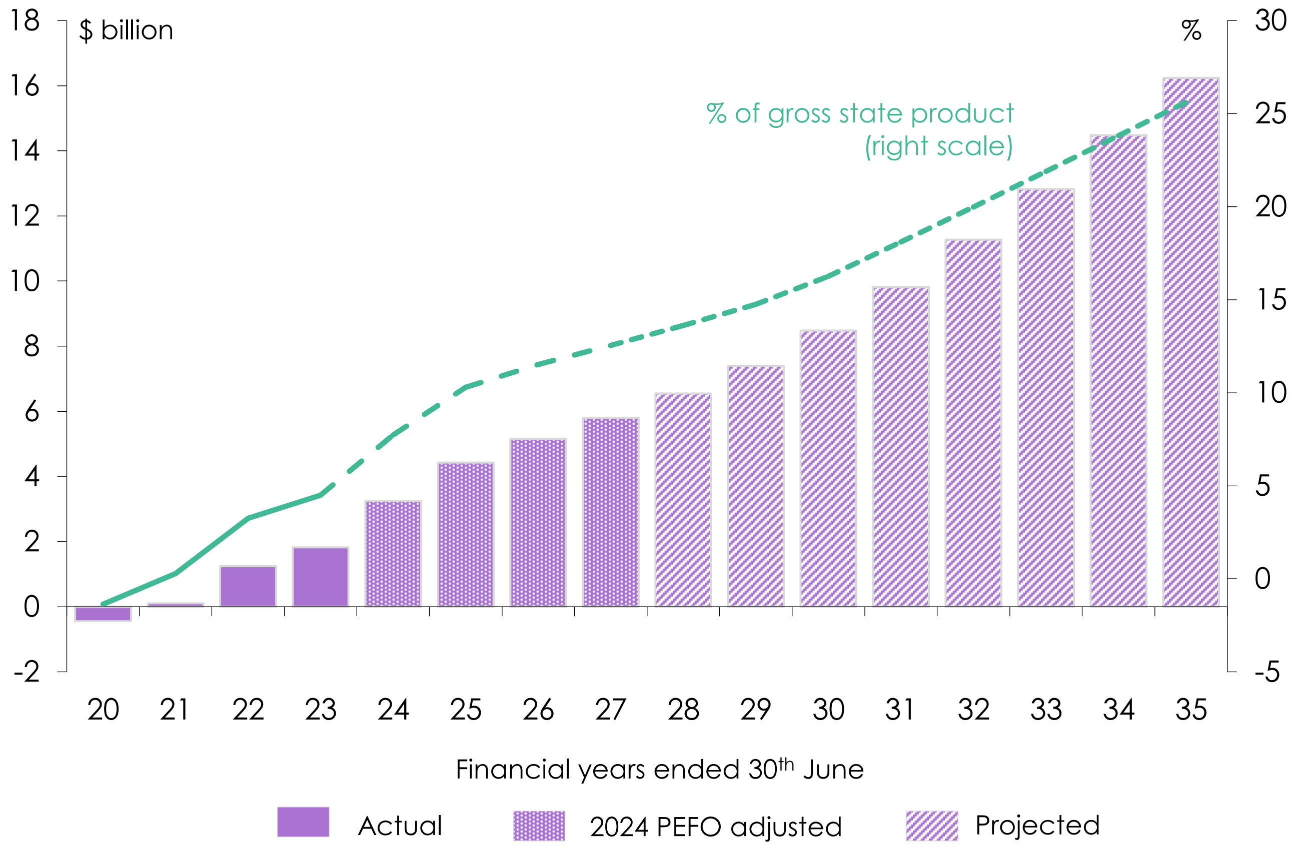
Over the period 2024-25 through 2034-35 these deficits would sum to over $12.7 billion, in the absence of corrective policy actions.

The medium-term outlook for net debt

These projected deficits will need to be financed by additional borrowing, which (assuming no change in holdings of interest-bearing financial assets) will result in net debt rising from $5.8 billion (or 12.5% of gross state product) as at the end of the 2026-27 financial year (slightly less than the $6.1 billion projected in PEFO, because of the smaller cash deficits resulting from increased revenues from the GST and other Commonwealth grants noted above) to $16.3 billion (25.7% of gross state product) at the end of the 2034-35 financial year.

The projected trajectory of net debt is shown in Chart 5.5.

Chart 5.5 – Tasmanian general government net debt, 2020-21 to 2034-35



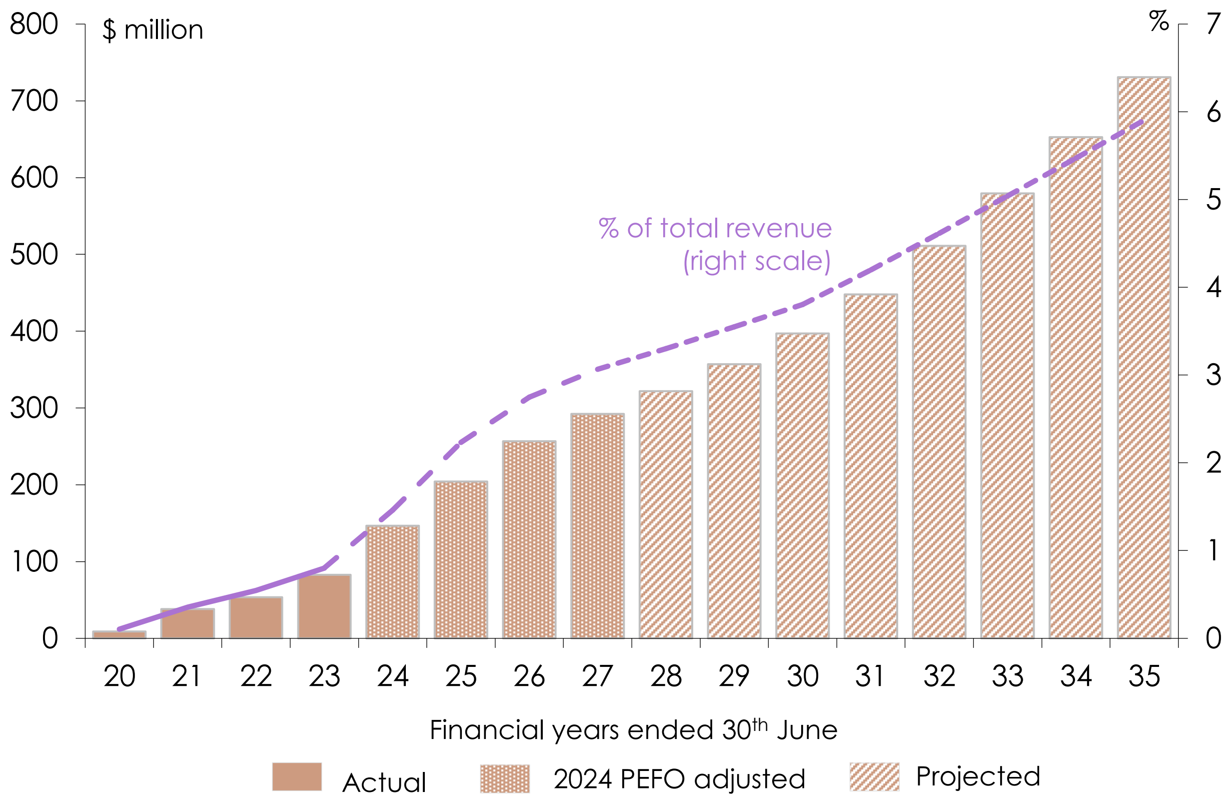
Note: 'PEFO adjustments' are for Government election commitments and revisions to estimates of GST revenue shares and other Commonwealth grants as described in this Chapter. The data shown do not incorporate preliminary results for 2023-24 reported in the *Preliminary Outcomes Report 2023-24* (Treasury 2024c). *Source:* Review estimates.

The projected level of net debt in 2034-35 lies between those presented in Treasury's 2021 *Fiscal Sustainability Report* based on its 'historical trends' and 'forward estimates' scenarios (Treasury 2021a: 26).

As a percentage of gross state product, the projected level of net debt in 2034-35 compares with the previous peak of 15.6% of GSP recorded in 1994-95.

An inevitable consequence of an increase in net debt as shown in Chart 5.5 will be a growing burden of interest payments. As shown in Chart 5.6, on a no-policy-change basis interest payments are projected to rise from just under $150 million in 2023-24 to just under $400 million in 2029-30, and to $730 million by 2034-35.

Chart 5.6 – Tasmanian general government interest payments, 2020-21 to 2034-35



Note: 'PEFO adjustments' are for Government election commitments and revisions to estimates of GST revenue shares and other Commonwealth grants as described in this Chapter. The data shown do not incorporate preliminary results for 2023-24 reported in the *Preliminary Outcomes Report 2023-24* (Treasury 2024c). *Source:* Review estimates.

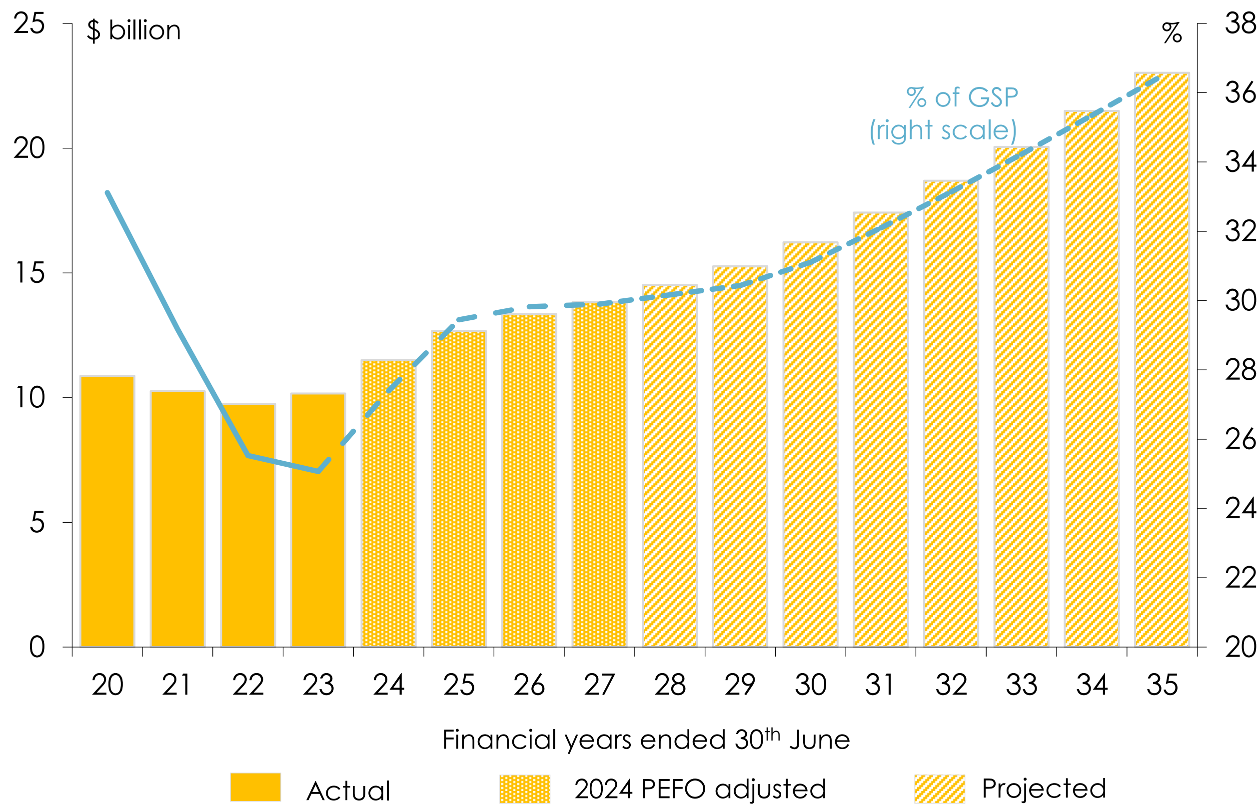
Expressed as a percentage of gross state product, Tasmania's general government net debt would, on the projections shown in Chart 5.6, be similar to those projected for Victoria and the Northern Territory towards the end of this decade (see Chart 4.22).

However that is of little comfort once account is taken of Tasmania's proportionately much higher unfunded superannnuation liability (as shown in Chart 4.23 on page 65).

Although Tasmania's unfunded superannuation liability is projected to decline by more than $1 billion (from $7.8 billion to $6.5 billion) between 30th June 2024 and 30th June 2025, according to actuarial estimates presented in the 2023-24 Budget (Tasmanian Government 2023: 157), it (and the resulting cost of making payments to members of defined benefit superannuation schemes on an 'emerging cost' basis) will remain large, relative to Tasmanian general government revenues and to the size of the Tasmanian economy, in comparison to other jurisdictions.

Tasmania's general government sector net financial liabilities, which adds to net debt the unfunded superannuation and other employee liabilities, payables and other liabilities, net of financial assets (other than equity investments in public financial and non-financial corporations), are (on a no-policy-change basis) projected to rise from \$11.5 billion (27.5% of gross state product) at 30th June 2024 to \$23.1 billion (36.5% of gross state product) by 30th June 2035, as shown in Chart 5.7. This would be, by a wide margin, the highest of any Australian state or territory (as a percentage of gross product).

Chart 5.7 – Tasmanian general government net financial liabilities, 2020-21 to 2034-35



Note: 'PEFO adjustments' are for Government election commitments and revisions to estimates of GST revenue shares and other Commonwealth grants as described in this Chapter. The data shown do not incorporate preliminary results for 2023-24 reported in the *Preliminary Outcomes Report 2023-24* (Treasury 2024c). *Source:* Review estimates.

The 'sustainability' of Tasmania's government finances

There is no universally-accepted definition of what constitutes a 'sustainable' fiscal position for a government.

The Organization for Economic Co-operation and Development (OECD) defines fiscal sustainability as "the ability of a government to maintain public finances at a credible and serviceable position over the long term" (OECD 2013: 50).

The European Commission has defined fiscal sustainability as "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 2017: 1).

Closer to home the Australian Parliamentary Budget Office defines fiscal sustainability as "a government's ability to maintain its long-term fiscal policy settings indefinitely without the need for major remedial policy interventions". The PBO goes on to say that a government's fiscal position is sustainable "if the debt-to-GDP ratio is expected to be stable or trend downwards over the long term", with the provisio that "does not mean that the debt-to-GDP ratio will not increase at times, especially in response to large unforeseen economic shocks" (Parliamentary Budget Office 2024a: 10).

This concept of 'sustainability' is likely to entail smaller debt-to-GSP ratios for state governments than would apply to the debt-to-GDP ratio for a national government, especially in the Australian federation where the revenue-raising powers of state and territory governments are much more circumscribed by the national constitution than in other federations such as the United States, Canada, Germany or Switzerland. Additionally, sub-national governments are not primarily responsible for responding to "unforeseen economic shocks". And they don't ordinarily have access to central bank financing in extreme circumstances, as national governments (with the exception of members of the euro zone, or countries which use another country's currency as a medium of exchange) in principle do.

The Review's unambiguous conclusion is that the trajectory of all of the indicators of the Tasmanian Government's financial position set out in this Chapter is unsustainable. All of the metrics considered in this Chapter are heading in 'the wrong direction', according to all of the foregoing definitions of fiscal sustainability, in the absence of substantial and sustained changes to expenditure and/or revenue policies.

If the Tasmanian Government wishes to forestall a 'fiscal crisis', in which it finds itself forced to implement drastic spending cuts and/or tax increases in a relatively short space of time – bearing in mind that it will not be up to the Tasmanian Government to determine whether or not a 'fiscal crisis' emerges – then it would be wise to embark upon a carefully considered medium-term strategy aimed at halting and then reversing the trends depicted in the charts in this Chapter, as it has repeatedly been advised by the Tasmanian Treasury over the past nine years to do.

Among other things, it appears probable that, in the absence of a credible strategy to prevent Tasmania's public finances from continuing along the trajectory spelled out in this Chapter, Tasmania's credit rating would be downgraded, possibly by more than one 'notch' – which would in turn likely result in Tasmania having to pay higher interest rates on new debt (something which hasn't been allowed for in the projections of interest expense shown in Chart 5.6) and, potentially, encountering difficulty finding investors prepared to purchase new debt issues. Indeed, market participants could well precipitate such outcomes even in the absence of a formal credit rating downgrade.

Why does 'fiscal sustainability' matter?

'Fiscal sustainability' isn't simply a concern for accountants, economists and Treasury officials. It is also important for business owners and operators, for community organizations, and for individuals in their capacities as taxpayers, recipients of government services and more generally as citizens.

Fiscal sustainability as defined in the previous section builds confidence on the part of businesses and individuals that they won't be hit by sudden large increases in taxes and charges, and on the part of community organizations and individuals that they won't be hit by sudden cuts in grants or other forms of funding, or in services on which they rely, in order to address a fiscal crisis. That in turn allows them to plan with greater surety, which among other things is likely to result in greater economic resilience.

Fiscal sustainability also enhances inter-generational equity by reducing the likelihood that one generation of taxpayers and citizens will be called upon to pay (through higher taxes and/or reduced services) for the fiscal mistakes of previous generations.

In both those senses, fiscal sustainability contributes to greater social cohesion.

Conversely, fiscal crises – which are the inevitable result of a government allowing its fiscal position to become *unsustainable* – typically result in civil unrest, may lead to political instability, and can in extreme circumstances have prolonged adverse economic consequences.

Risks to the projections set out in this Chapter

The projections set out in this Chapter have been premised on assumptions which the Review regards as plausible and reasonable, and which are not dissimilar to those which have been used by the Department of Treasury and Finance in its previously published *Financial Stability Reports*. Nonetheless, it is important to note that alternative assumptions or scenarios would produce outcomes different from those set out in this chapter (abstracting from the impact of possible policy changes).

In particular, adverse changes to the profile of Tasmania's share of GST revenues (which, as noted in Chapter 2, account for almost 40% of Tasmania's total general government sector revenues, compared with an average of 23½% for all states and territories (see Chart 2.21 on page 33), could result in a potentially significant further deterioration in the various financial metrics set out in this Chapter.

One substantial source of risk in this regard is the scheduled expiry of the so-called 'No Worse Off Guarantee' (or 'NoWO'), under which the Federal Government has guaranteed that no state or territory will receive any lesser amount from the GST than it would have done had the changes to the long-standing arrangments for determining the distribution of GST revenue among the states and territories at the behest of Western Australia (which are being phased in between 2022-23 and 2026-27) not been made (Eslake 2024b).

When these changes were originally legislated by the Morrison Federal Government in 2018, the 'NoWO guarantee' was scheduled to expire at the end of the 2026-27 financial year, but has been extended by the current Federal Government to the end of the 2029-30 financial year. This 'guarantee' is funded by the Federal Government making 'top-up payments' to the GST pool to the extent required to meet it, at a cost (to the Federal Budget) most recently estimated at $52.9 billion over the 11 years to 2029-30 (Australian Government 2024b: 3).

Without the 'NoWO guarantee', Tasmania would have been worse off by $110 million in 2023-24, and $117 million in 2024-25 (Commonwealth Grants Commission 2024: 14).

If the price of iron ore (which accounts for over 80% of Western Australia's mineral royalty revenues) remains elevated into the early 2030s, such that the changes made to the GST distribution arrangements which will have fully come into effect by 2026-27 result in Western Australia continuing to receive a larger share of GST revenues than it would otherwise have done – then Tasmania (along with all the other states and territories) stands to be worse off if the 'NoWO guarantee' is not extended beyond its currently scheduled expiry at the end of the 2029-30 financial year.

How much worse off Tasmania would be in those circumstances would depend importantly on the extent to which the iron ore price (and the volume of Western Australian iron ore and other resources exports) remained above their pre-2018 levels.

It is thus important that Tasmania continues, in company with other states and territories, to press for a further extension of the 'NoWO guarantee' beyond 2029-30 – and, as argued in Chapter 7, that Tasmania's Treasury be appropriately resourced to allow it do so.

However it is also important to note that if iron ore prices *do* decline sharply from current levels (of around US$100 per tonne), then Western Australia's share of GST revenues will rise as it would have done in the absence of the changes phased in between 2022-23 and 2026-27. And if it were to rise for that reason above the stipulated 'floor' of 75% of a notional equal per capita distribution of GST revenues, all else being equal, then the 'NoWO guarantee' would not be applicable, and Tasmania's (and the other states' and territories') share of GST revenues would decline.

Similarly, if coal prices were to decline significantly from present levels (having already fallen from the peaks attained in the aftermath of Russia's invasion of Ukraine), then (all else being equal), New South Wales' and Queensland's share of GST revenues would rise, and Tasmania's share would fall.

These risks highlight the extent to which Tasmania's public finances are vulnerable to both events (such as fluctuations in commodity prices) and decisions (by the Federal Government, at the behest of other states with greater political heft than Tasmania is ever likely to have) which are completely beyond the control of any Tasmanian Government.

And the only way to reduce that vulnerability is to reduce Tasmania's dependence on its share of GST revenues, ideally through some combination of enhancing its 'revenue-raising capacity' and reducing its 'expenditure needs' through economic reforms designed to lift Tasmania's well-below-average levels of participation in employment and labour productivity (see Charts 2.9, 2.11 and 2.12) – although that is only feasible over the longer term – or by increasing its own 'revenue-raising effort' (something which is addressed in Chapter 6).

The 'flip side' of Tasmania's above-average dependence on Commonwealth grants and GST revenues is that Tasmania's total revenues are less susceptible to fluctuations in Tasmania's own economic performance than those of other states and territories, with the exception of the Northern Territory. Nonetheless, if Tasmania were to experience a sharp drop in employment at large businesses (and hence in payroll tax revenues), or in property prices (and hence in stamp duty revenues), Tasmania's public sector financial position would deteriorate to a larger extent than suggested by the projections set out in this Chapter.

Similarly, a sharp and extended rise in unemployment, or a sustained exodus of working-age Tasmanians to the mainland, would likely result in proportionately greater demands for a range of state-funded public services, with adverse consequences for the Tasmanian Government's financial position.

6. Some options for improving the sustainability of Tasmania's public sector finances

Introduction

Chapter 3 showed that Tasmania's public sector finances deteriorated significantly between 2016-17 and 2022-23, largely as a result of conscious policy decisions to increase spending and, to a lesser extent, reduce revenues – some, but not all, of which were necessary and unavoidable responses to the Covid-19 pandemic. Chapter 4 showed, on the basis of information that was publicly available during the recent State election campaign, that Tasmania's public finances will likely deteriorate further over the four years to 2026-27, and that by many metrics (especially if applied, as they should be, to the public sector as a whole rather than merely to the general government sector) is set to resemble Victoria's, which have been the subject of far more commentary and attention. And Chapter 5 showed that, in the absence of corrective action, the condition of Tasmania's general government sector finances will deteriorate even further over the following eight years, risking a serious fiscal crisis.

This should not come as a surprise. Tasmania's Treasury has repeatedly warned of the longer-term risks to Tasmania's fiscal position in its periodical *Fiscal Sustainability Reports*:

- in its 2016 Report, Treasury warned that "the underlying demand for government services and the increasing cost of providing these services are likely to place future governments under increasing fiscal pressure", that "any emerging fiscal pressure is not likely to be eased significantly as a result of stronger economic growth" and that "under quite plausible economic and fiscal conditions, the State's financial position can deteriorate quite rapidly, and therefore the earlier these fiscal pressures are addressed, the greater the prospects that these objectives [of returning the finances to a sustainable position without loss of confidence on the part of businesses and consumers] can be achieved" (Treasury 2016: 31-33).

- in its 2019 Report, Treasury warned that although "projected fiscal outcomes … are manageable in the short to medium-term … for most scenarios, the size of the corrective action required to maintain fiscal sustainability increases significantly over the projection period", advising that " any corrective policy actions, such as expenditure or revenue measures, used to address the projected fiscal challenges that could face the State would be easier and more effective if implemented early and were focussed on the underlying causes of these fiscal pressures" (Treasury 2019b: 7 and 35).

- in this report it concluded by pointing out that "the rates of revenue growth required to maintain long-term fiscal sustainability are unlikely to be delivered through expected growth in current revenue sources or minor changes to existing taxation arrangements. While noting the challenges involved, it is likely that reform of the existing taxation system will be required, including identifying new sources of revenue" (Treasury 2019b: 37).

- in its 2021 Report, Treasury emphasized "the importance of early action to correct fiscal deterioration", warned that "it is not possible to rely entirely on economic growth to maintain fiscal sustainability", and cautioned that " it is likely that effective action to maintain fiscal sustainability will require the successful implementation of a range of measures" (Treasury 2021a: 7). It further warned that "if unchecked, the size of the corrective action required to bring net debt under control could be very large" and that "delaying action until the task is much greater is likely to place an undue burden on the community and businesses" (Treasury 2021a: 33 and 40).

All of these warnings went unheeded.

As a result, the task now confronting the Tasmanian Government of returning the State's finances to a sustainable condition is greater than it would otherwise have been.

The current and future governments will need to judge whether they are prepared to live with the consequences of inaction – which may include a downgrading of Tasmania's credit rating and, as a result, higher interest rates on the State's borrowings (diverting to interest payments money which might otherwise be available for spending on public services), and an on-going loss of confidence on the part of Tasmanian businesses and households – or whether they are willing to take actions intended to put Tasmania's public sector finances on a more sustainable footing, a course of action which inevitably entails political and (potentially) other risks.

This chapter considers a range of options that could be considered as part of any strategy to restore Tasmania's finances to a sustainable position.

However the options considered in this chapter by no means represent an exhaustive list. Nor does this Review suggest that all of the measures canvassed in this chapter amount to a *complete* solution to the fiscal challenges which Tasmania now faces. Rather, they are intended as a 'starting point' for a more wide-ranging consideration of the steps which Tasmania can and should contemplate if it wishes to return the State's finances to a sustainable condition over a reasonable period of time.

What does a 'sustainable' position look like?

As noted in Chapter 5, there is no universally-accepted definition of what constitutes a 'sustainable' fiscal position for a government. On the contrary, 'sustainability' has multiple dimensions – that is, it cannot be established by reference to a single indicator. And 'sustainability' criteria cannot be established independently of the surrounding circumstances. What is 'sustainable' for the government of a state government with limited revenue-raising powers will be different from what is 'sustainable' for a national government with access to much broader sources of revenue. What is 'sustainable' for the government of a state with a large population, or with a large and diversified economy, will be different from what is 'sustainable' for the government of a small state whose people are on average less well-off than others, and whose economy is more narrowly-based and more exposed to external economic fluctuations – as Tasmania's is.

With those considerations in mind, this Review proposes that a 'sustainable' fiscal position in the Tasmanian context requires:

- an 'underlying' operating surplus – that is, revenues (excluding one-off grants from the Federal Government for capital purposes) which are greater than operating expenses – in all circumstances other than in major economic downturns or in the event of major natural disasters, when it is likely to be appropriate for the government to incur temporary operating deficits (as it did during the Covid-19 pandemic), and an overall fiscal surplus for at least five years after that;
- a ratio of net financial liabilities to gross state product which is below the average for all states and territories (currently just under 20% for the general government sector, and a little over 25% for the non-financial public sector as a whole) – in recognition of the fact that Tasmania's economy and hence its own-source revenues are both more narrowly-based and more volatile than those of the other states and territories, on average;
- a ratio of net debt to gross state product which is *substantially* below the average for all states and territories (currently just over 11% for the general government sector, and 16% for the non-financial public sector as a whole) – an inevitably corollary of the fact that (as noted in Chapters 4 and 5), Tasmania's unfunded superanuation liability is proportionately much larger than that of other states and territories and hence Tasmania has less capacity to service debt than other states and territories;
- a 'liabilities servicing ratio' (a ratio of interest payments plus payments in respect of other liabilities, in particular superannuation, to revenues) similar to the 7% stipulated in the Government's current fiscal strategy (Tasmanian Government 2023: 52 and 60) – a requirement which allows the level of net debt to be higher when interest rates are expected to be relatively low, but conversely requires it to be lower when interest rates are expected to be relatively high; and
- an 'own-source revenues ratio' (a ratio of revenues from state taxation, fees and charges, GBE tax-equivalent payments and dividends, and other state sources, to total revenue) similar initially to the 37% stipulated in the Government's current fiscal strategy but gradually rising over time in order to achieve greater fiscal resilience.

In the opinion of this Review, a fiscal strategy based on the achievement of these five objectives over a period of five to (in some cases) ten years would likely be sufficient to ensure that Tasmania's public finances are returned to, and maintained in, a 'sustainable' condition in the sense implied by the Federal Parliamentary Budget Office's definition of that term – that is, "able to maintain its long-term fiscal policy settings indefinitely without the need for major remedial policy interventions".

In order to ensure that these objectives are clearly understood, it would be desirable (in this Review's opinion) not to have any more objectives than these five, at least until they have been attained and maintained for a number of years.

Some fundamental 'guiding principles'

It's one thing to set fiscal strategy targets: it's another, more difficult task, to decide how those targets should be achieved, and then to maintain the disciplines required to achieve them. In that context, some fundamental 'guiding principles' are likely to be helpful, especially if they are carefully communicated to, and well understood by, the public at large, and if they can command at least 'in-principle' support across the political spectrum (even if there are differences of opinion – as should be expected in a democracy – as to how they are best achieved).

First, in this Review's opinion, the task of putting Tasmania's public finances on a sustainable footing is one which should be accomplished over a period of years – probably at least five years – according to a well-defined plan which sets out a small number of key milestones to be achieved over that period, rather than something which can be accomplished in a single Budget or within a single Parliamentary term. Inevitably, there will be times when that plan needs to be adjusted in the face of unanticipated developments – but that should not be interpreted as a sign of failure.

Second, in developing a plan and selecting policy measures to put Tasmania's public finances on a sustainable footing, the Government should seek to minimize the adverse consequences of its actions on the Tasmanian economy. As Tasmania's experience with 'fiscal consolidation' during the 1990s and the early years of the 2010s indicates, decisions to cut government spending and/or raise taxes and charges can have adverse consequences for economic and employment growth, including prompting more Tasmanians to leave the state for other parts of Australia and fewer mainlanders to contemplate moving to Tasmania.

One way of minimizing those risks is to ensure that any decisions which the Government takes with a view to returning Tasmania's public finances to a sustainable condition are embedded in a clearly articulated plan, supported by sustained public advocacy, in order to build confidence that 'short-term pain' will indeed result in 'longer-term gains'.

Third, in developing that plan and in the choices it makes about how to achieve the plan's objectives, the Government should also seek to minimize the impact of those choices on Tasmania's most vulnerable citizens – in particular, people on low incomes or with few assets, people living with disability, First Nations people, and people living in remote communities.

Fourth, in developing a plan to put Tasmania's public finances on a more sustainable footing, the Government should seek where possible to improve Tasmania's resilience in the face of external shocks – in particular, to reduce the vulnerability of Tasmania's public finances to the decisions of others, notably the Federal Government.

All of these considerations point, in the Review's opinion, to the conclusion that the most important elements of any plan to return Tasmania's public finances to a sustainable condition are more likely to be found on the revenue side of the Budget, and from within the Government's infrastructure investment program, than among the Government's operating expenses.

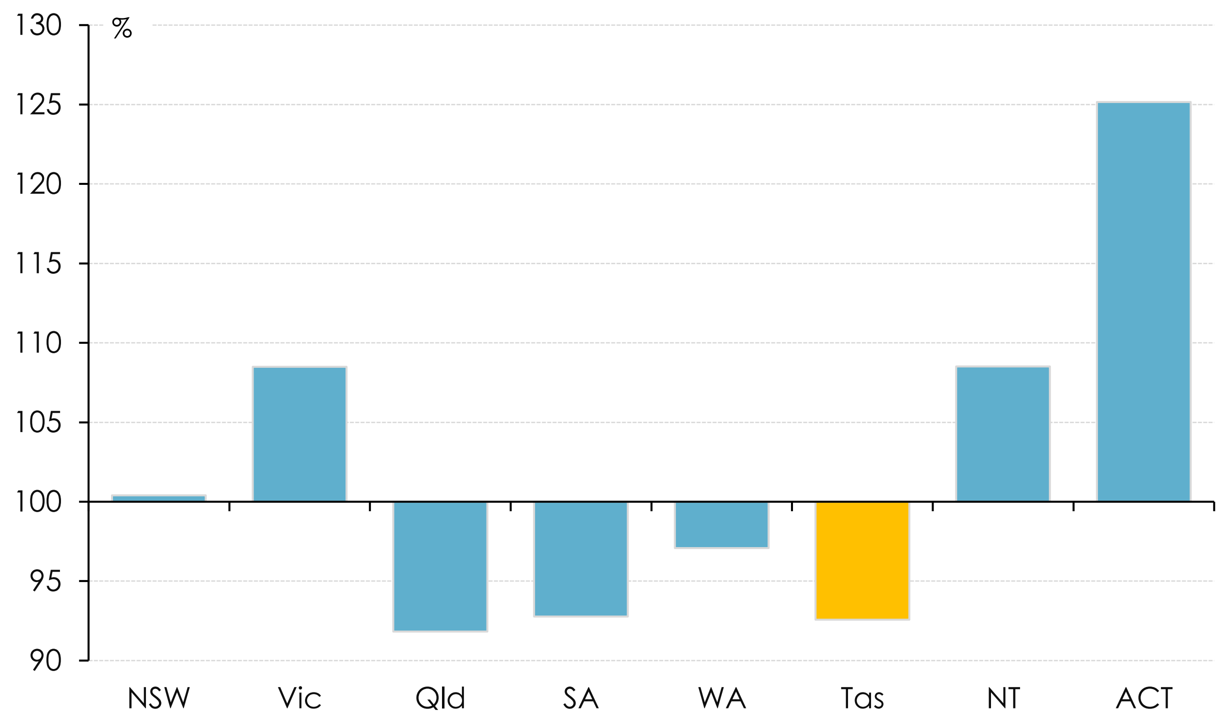
Operating expenses

It is highly unlikely, in this Review's opinion, that the task of putting Tasmania's public finances on a sustainable footing can be achieved primarily through savings in operating expenses – at least, not without imposing significant costs on Tasmania's most vulnerable citizens, and having a greater adverse impact on Tasmania's economy, than would result from raising an equivalent amount of additional revenue.

There are two reasons for this view.

First, the assessments by the Commonwealth Grants Commission, as part of their annual determination of the distribution of GST revenues among the states and territories, indicate that, on average over the four years to 2021-22, Tasmanian Government operating expenses were 92.6% (or $880 per head) <u>below</u> the level which the Commission assesses would have been consistent with providing Tasmanians with the same range and quality of services as the average of all states and territories, after taking account of differences in the assessed 'need' for those services, and the per capita cost of providing them. This is illustrated in Chart 6.1.

Chart 6.1 – Average 'level of service provision ratios', 2019-20 through 2021-22



Note: The 'level of service provision ratio' is the ratio of actual to assessed expenses per capita, where 'assessed' expenses are the Commission's estimates of the expenses a state or territory would incur if it were to follow average policies and operate at average efficiency. The figures for the ACT include municipal transactions, making its ratios not directly comparable with those of the other states and the NT.
Source: Commonwealth Grants Commission (2024), Table S6-4.

In absolute terms, this difference represents a *shortfall* in total operating expenses relative to what the Grants Commission assesses would be spent if Tasmania were providing the same services with the same level of efficiency as the average of all states and territories of $531 million per annum over the four years to 2022-23.

If Tasmania were spending *more* than the Grants Commission's assessments of how much Tasmania needs to spend in order to provide the same range and quality of public services as the average of all states and territories – as Chart 6.1 above shows that Victoria and the Northern Territory have been doing – then there would be a much stronger case for making reductions in expenses. But that is not the case in Tasmania.

Second, given the nature of the services funded by state government operating expenses (in particular, health, education, housing and social protection), it is almost inevitable that significant reductions in operating expenses would have their greatest impact on Tasmania's most economically and socially vulnerable citizens.

The Government should of course continuously be reviewing and evaluating ongoing spending programs, and improving the efficiency and effectiveness with which it provides services, in particular through better use of data and information technology.

As an obvious example of the potential for improvements in the efficiency and effectiveness of spending programs, Tasmania spends almost 25% more per full-time student on school education, yet gets poorer education outcomes than any jurisdiction except the Northern Territory (Eslake 2024a: 20), which strongly suggests that there is substantial scope for reforms to the way education services are delivered which would yield better outcomes for students.

Similarly, Tasmania spends about 26% more per capita on health than the average of all states and territories (ABS 2024a: Table 4), yet on most dimensions achieves poorer health outcomes (ABS 2023d). One reason (among many) for this appears to be the under-provision, relative to other jurisdictions, of sub-acute and convalescent care, which means that patients who no longer require acute hospital care but are not sufficiently well to go home continue to be treated in acute care beds, adding to the cost of their treatment and to delays in responding to people who do need acute care.

Housing is the only function where Grants Commission assesses that Tasmania is spending signifcantly more than 'required' to provide the average level of services with average efficiency. But that appears difficult to reconcile with other evidence, including in particular the length of waiting lists for public housing in Tasmania.

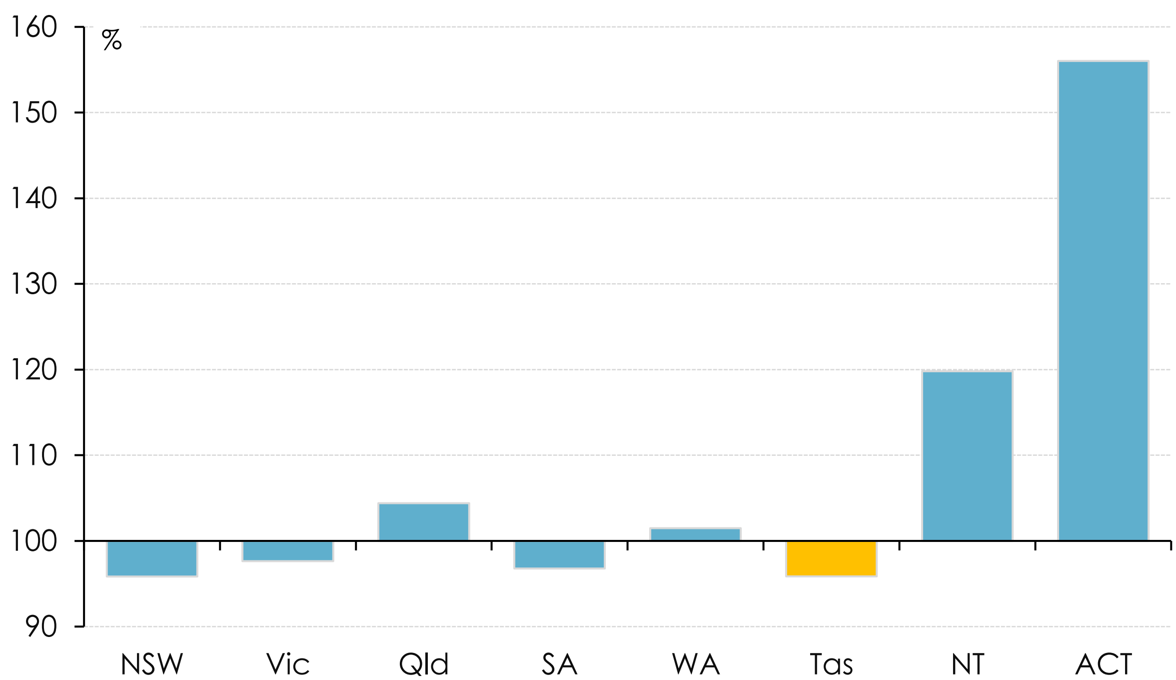
In any event, 'vacancy control' and 'efficiency dividends' are very poor strategies for achieving expenditure savings. 'Vacancy control' in practice means that 'savings' in employee expenses are achieved when employees leave (by not replacing them), rather than as a result of any conscious deliberations as to which roles should be retained and which abolished. Often the result is that the employees who leave are those most able to secure alternative employment – employees that an agency would prefer to retain if possible – while those remaining are more likely to be those less capable of securing another job somewhere else.

'Efficiency dividends' – arbitrary reductions in budgetary allocations to departments and agencies without specifying what services are to be reduced or by how much, but rather leaving it to department and agency heads and their subordinates to determine how the savings are to be realized – are a poor substitute for conscious decisions as to what services should continue to be, or no longer continue to be, provided. In government, as in the corporate world, they frequently result in services continuing to be provided with inadequate levels of staffing, leading in turn to greater *inefficiency* and lower levels of customer or client satisfaction. All too often, decisions as to which employees are terminated or which services are discontinued are taken by the lowest level of management capable of taking them – rather than as the outcome of any conscious, strategic planning and decision-making process.

Revenues

The revenue side of the budget offers more opportunities to return Tasmania's public finances to a sustainable position than the expense side. The Grants Commission's assessments indicate that, on average over the four years to 2021-22, Tasmania raised 10.9% (or $303 per head) <u>less</u> in revenue from state taxation than it would have done if Tasmania's state taxation regime had been equivalent in its incidence to the average of all states and territories, after allowing for Tasmania's below-average capacity to raise revenue from the sources available to it. This is illustrated in Chart 6.2.

Chart 6.2 – Average 'revenue-raising effort' ratios, 2019-20 through 2021-22



Note: The 'revenue-raising effort' ratio is the ratio of actual to assessed taxation revenues per capita, where 'assessed' revenues are the Commission's estimates of the revenue a state would raise if it were to apply average revenue policies to its revenue base. The figures for the ACT include municipal transactions, making its ratios not directly comparable with those of the other states and the NT. *Source:* Commonwealth Grants Commission (2024), Table S6-2.

In absolute terms, this difference represents a *shortfall* in total state taxation revenues, relative to what the Grants Commission assesses would be raised if Tasmania's state tax regime were in line with the average of all state and territories, of $171 million per annum on average over the four years to 2022-23 (or $277 million in 2022-23 alone).

Separately, the Grants Commission's assessments also indicate that Tasmania collected, on average over the four years to 2022-23, almost 40% less from mineral royalty revenues than it would have done had its royalty regime been equivalent to the average of all states and territories (an average which is dominated by the royalty regimes in Western Australia and Queensland). This represents a shortfall in revenue averaging $42 million per annum over the four years to 2022-23.

There are a number of avenues whereby the Tasmanian Government could raise additional revenues. The Review does not have the capacity to estimate the potential revenue gains from the options considered here – and Treasury was unable to assist in that task. It is worth noting here that most state taxation revenue is raised from businesses, for whom payments of state taxes are deductible against their company or personal income tax liabilities, so that at face value a part (up to 30% in the case of companies) of any increased taxation of businesses is in effect absorbed by the Federal Government. To the extent that increased state taxes fall on households, at least some part is likely to be absorbed by reductions in household saving, or in spending by households on products imported from the mainland or overseas. For both of these reasons, the impact on the Tasmanian economy of an additional dollar raised in state taxes is likely to be less than the impact of an additional dollar saved by reducing operating expenses.

Payroll tax

Payroll tax is widely regarded as a 'bad tax' because, so it is commonly supposed, it is a 'tax on jobs', and as such, is perceived as a disincentive to employment. In reality, however, payroll tax is very similar in its incidence to the GST .

The GST is, in effect, a tax on the difference between sales revenue and cost of goods sold (which is why in Europe it is called a 'value added tax' or VAT). The difference between sales revenue and cost of goods sold is, in an accounting sense, for most businesses the sum of wages and salaries, sales and marketing expenses, financing costs and gross profits. So the only difference between GST and payroll tax is that the latter doesn't tax sales and marketing expenses, financing costs and the gross profit margin, while the former grants an exemption for exports. Yet nobody regards GST as a 'tax on jobs': indeed, it's not uncommon for business groups to advocate an increase in the GST (or a broadening of its base) in order to fund reductions in (or the abolition of) payroll tax – even though that is very close to taking money out of one pocket and putting it in the other.

Tasmania's maximum rate of payroll tax of 6.1% is the highest of any state (though the ACT has a higher rate of 6.85%, and Victoria imposes a 6.85% rate on businesses with a national payroll of over $100 million per annum) (Western Australian Treasury 2023: 6).

But Tasmania also has the highest threshold (of $2 million) of any state for this maximum rate (a lower rate of 4.0% has applied to payrolls of between $1.25 million and $2 million since 1st July 2018).

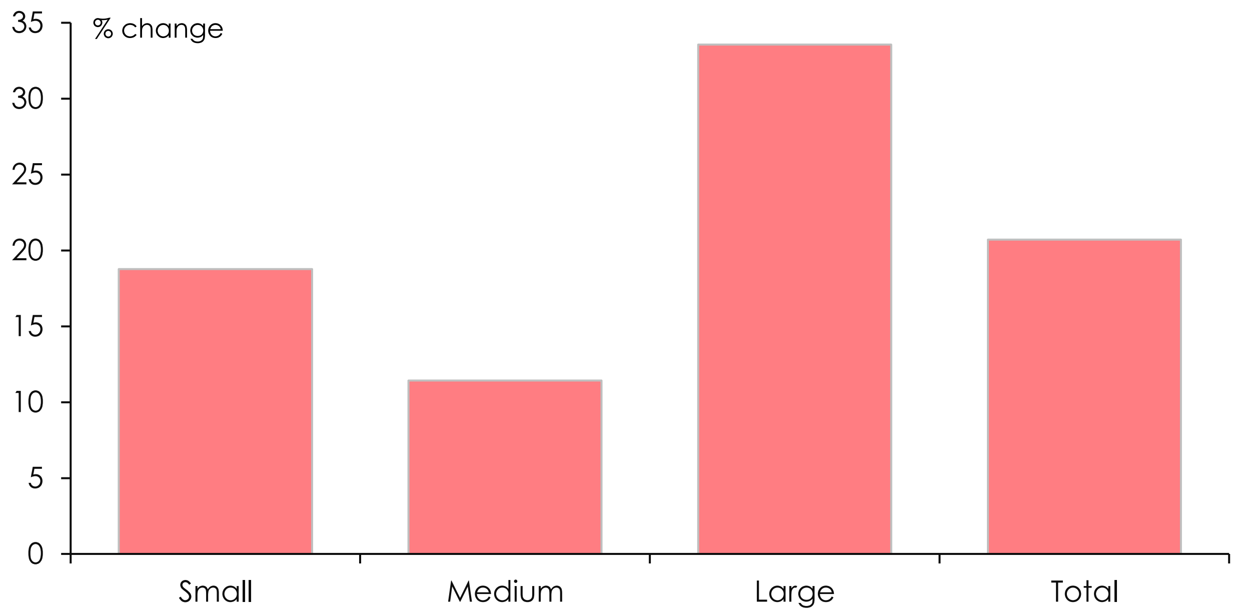
In other words, Tasmania's payroll tax regime, in comparison to other states, levies a high rate on a narrow base – the opposite of good tax design (Henry 2010a: 295-299 and 2010b: 679; OECD 2010: 14-15).

Treasury estimates that the tax-free threshold will have deprived the Government of $218.4 million revenue in 2023-24 (Tasmanian Government 2023: 112) – equivalent to 42.6% of the revenue that Treasury expected to collect from payroll tax in 2023-24 – up from $138.9 million (39.1% of forecast payroll tax revenue) in 2018-19.

Successive Tasmanian Governments have argued that the high threshold for payroll tax is a form of support for small business and helps to create jobs. But there is no evidence to support this proposition.

As shown in Chart 6.3, employment in 'large' businesses (that is, those with 200 or more employees, which are subject to payroll tax) in Tasmania grew by 33.6% between 2013-14 and 2023-24, accounting for 48% of total business employment growth in Tasmania over this period (a significantly larger proportion than large businesses' share of total business employment of 30% at the beginning of this period and 33% at the end of it). By contrast, employment in 'small' businesses (those with fewer than 20 employees, which for the most part are not subject to payroll tax) grew by 18.8% between 2013-14 and 2023-24, accounting for less than 41% of the increase in total business employment over this period (a smaller share than small businesses' share of total business employment of 45% at the beginning of this period and 44% at the end of it).

Chart 6.3 – Growth in employment in Tasmania by business size, 2013-14 to 2022-23



Note: 'Small' businesses are those with fewer than 20 employees; 'medium' businesses are those with 20-199 employees; 'large' businesses are those with 200 or more employees. *Source:* ABS (2024c).

A considerable volume of evidence supports the proposition that the payroll tax threshold acts as a *disincentive* for job creation at businesses whose annual wages bill is just below the threshold (see, eg, Henry 2010a: 298; Andrews, Buckley and Lee 2024).

The Henry Review also argued that payroll tax exemption thresholds may entice workers to move from (taxed) large businesses to (untaxed) small businesses, "moving some workers away from where they would be more productive" and "distort[ing] labour use away from its highest value use" (Henry 2010a: 297-298). Given that Tasmania's payroll tax regime imposes a higher tax rate on a narrower tax base than other states, this could be one reason (among many) why labour productivity is lower, and has grown more slowly, in Tasmania than in any other state, as noted in Chapter 2.

It would therefore seem sensible for the Government to consider lowering the payroll tax threshold as an option for raising additional revenue, as a contribution to returning Tasmania's public sector finances to a more sustainable footing, reducing Tasmania's dependence on grants from the Federal Government and (potentially) as a productivity-enhancing economic reform. And, having broadened the *base* of payroll tax, it could eventually, when Tasmania's fiscal position allows, consider reducing the *rate* of payroll tax, consistent with the principles of good tax system design.

While this might be seen as a 'politically challenging' option, it is worth noting that up to 30% of the cost to businesses of being brought within the payroll tax net would in effect be borne by the Federal Government via reductions in company tax payments.

Property taxes

A second major area of tax reform which the Tasmanian Government should consider is abolishing stamp duty on residential property transfers and replacing it with a more broadly-based land tax.

Reform of this kind has been advocated by, among others, the Henry Review (Henry 2010: 247-270), the Australian Council of Social Service (2016), the OECD (2017: 38-40 and 2023: 43 and 60), the Productivity Commission (2017: 20, 149-152), the New South Wales Review of Federal Financial Relations (Thodey 2021: 40-55), the New South Wales Productivity Commission (2021: 40, 247-253), and the Grattan Institute (Coates and Maloney 2023).

The principal economic arguments for such a reform – encouraging more efficient use of land, and enhancing labour mobility and productivity – have been set out in these publications. But the Thodey Report to the NSW Government made an important additional equity argument for this reform: that it "just doesn't seem fair" that people "who have moved to find a job, to be closer to schools, or to match housing size to their family situation" are required to contribute far more to the cost of providing schools, hospitals, policing and other state government services than those who "have remained in the same property for at least 20 years" and who " benefitted not only from the services provided by the state over that time but also from a once-in-a-generation land price windfall" but who have "contributed very little towards essential services and critical infrastructure via property taxation" (Thodey 2021: 41).

Additionally, replacement of stamp duties (the revenues from which are inherently volatile and unpredictable, being driven by the volume of property transactions and the prices at which they take place) with a broadly-based land tax would contrbute to a more stable and predictable overall revenue base for the Tasmanian Government.

As with reform of the payroll tax, reform of Tasmania's system of property taxation along these lines would be politically challenging, in particular because it would require removing the long-standing exemption of 'family homes' from the land tax base. The equity argument put by the Thodey Review should be an important part of the response to those concerns. And arguably the precedent has already been set in Tasmania by the imposition of fire service and waste management levies on all property-owners as surcharges on municipal rates.

It would of course be important to make appropriate provision for 'asset rich but income poor' property owners – such as pensioners who own their own homes, for example by providing a concessional rate of land tax for them and/or an appropriate tax-free threshold; and by allowing (as some councils do with municipal rates) the payment of land tax to be deferred until the death of the property owner (with the deferred tax becoming a claim on the estate).

It would also be sensible to make appropriate transitional provisions to prevent 'double taxation' of recent residential property purchasers – that is, to ensure that people who had purchased properties in the period immediately before a 'land tax for stamp duty' swap came into effect, and paid stamp duty on them, were not also immediately exposed to liability for land tax. The most sensible way to prevent this would be to provide those who have purchased residential property in, say, the last three or five years prior to the reform coming into effect with a credit for the amount of stamp duty paid on such purchases against the land tax liability they would otherwise have to pay.

The Review recognizes that the replacement of stamp duties with a broadly-based land tax is a long-term reform which will take time to legislate and implement. In the meantime, the Government could consider, as a means of raising additional revenue, the imposition of a levy on municipal rates similar to the $100 'household debt reduction levy' imposed by the Kennett Government in Victoria for two years in the early 1990s. As the Grattan Institute has noted, the levy "raised a relatively modest amount but sent a clear message that no-one was exempt from sacrifice" (Daley et al 2013: 14). Home-owning pensioners and social security card holders could be readily exempted from such a levy.

This would amount to a *de facto* expansion of the land tax base to owner-occupied dwellings, and thus help to 'pave the way' for more comprehensive reform of Tasmania's property tax system.

Another revenue option which the Government should consider is to extend the surcharges currently imposed on the stamp duty and land tax payable by foreign purchasers of residential property (of 8% and 2%, respectively) to *all* non-Tasmanian purchasers of established residential property (that is, to investors from mainland states and territories).

When these surcharges were first introduced, in the 2018-19 and 2021-22 Budgets, respectively, they were justified as being necessary to ensure that "foreign investors in Tasmania contribute their fair share to the Tasmanian economy" (Tasmanian Government 2022: 89). The same argument surely applies equally to mainland investors, who do not otherwise contribute any more to the Tasmanian economy than foreign investors do.

Indeed, it could legitimately be argued that the (apparently substantial) volume of mainland investment in residential property over the five years to 2022 was a major contributor to the decline in housing affordability for Tasmanians during this period (see, eg. Francis 2022), which (as noted in Chapter 2) seems likely to have been a factor in the resumption of net emigration from Tasmania to the mainland since then (see Chart 2.4 on page 15).

And if the imposition of such surcharges were to act as a 'disincentive' to investment by mainland investors in established residential properties in Tasmania, as will inevitably be asserted by those with a vested interest in rising property prices, that may be something to be welcomed, rather than feared. While it is not in Tasmania's interests to discourage investment by anyone (Tasmanians, mainlanders, or foreigners) in *new* housing, or to discourage mainlanders from purchasing residential property in Tasmania in order to move here, it is far from clear that it is in Tasmania's interests to encourage mainland investors to put additional upward pressure on the price of established housing.

It has been suggested that the Australian Constitution may pose obstacles to the imposition of surcharges on stamp duty or land tax payable by mainland investors in established residential properties in Tasmania. States are precluded by section 90 of the Constitution from levying "duties of customs and excise", a provision which has been widely interpreted by the High Court to include all taxes on trade in or the production of goods. But it is far from clear (at least to this Review) that this provision extends to services, let alone to investment flows.

Section 92 of the Constitution provides that "trade, commerce, and intercourse among the States, whether by means of internal carriage or ocean navigation, shall be absolutely free". Again, it is not clear (at least to this Review) that the reference to "intercourse among the States" being "absolutely free" precludes a state from imposing higher taxes on interstate purchases or holdings of property than on local purchases or holdings, given that purchases and holdings of property in a state by residents of another state are already not "absolutely free" but have long been subject to stamp duty and land tax.

Motor vehicle taxes and charges

The Commonwealth Grants Commission's assessments referred to previously in this Chapter indicate that, on average over the four years to 2022-23, Tasmania raised 22.4% (or $48 million per annum) less from taxes and charges on the ownership and operation of motor vehicles than it would have done had its policies in this area been equivalent to the average for all states and territories.

In particular, as shown in Table 6.1, Tasmania levies lower rates of duty on expensive motor vehicles than any other jurisdiction except South Australia and the Northern Territory; while, as shown in Table 6.2, the combined cost of registration and compulsory third party insurance for a typical top-selling motor vehicle (a Toyota Camry) is significantly lower than in any other state or territory.

While it seems appropriate – since Tasmanian disposable incomes are on average some 8½% lower than those of people living in other states (Chart 2.20), and that Tasmanians typically have fewer alternatives to driving than people living in large population centres on the mainland – that government-imposed costs of owning and operating a motor vehicle should not be *higher* than in other states and territories, it is far from clear that they should be between 15% and 50% <u>lower</u> than in other jurisdictions.

Table 6.1 – Vehicle licence duty payable on selected new passenger vehicle values, 2023-24

	Duty payable ($)							
Value ($)	*NSW*	*Vic*	*Qld*	*SA*	*WA*	*Tas*	*NT*	*ACT*
10,000	300	420	300	340	275	300	300	305
20,000	600	840	600	740	550	600	600	610
40,000	1,200	1,680	1,200	1,540	2,000	1,600	1,200	1,220
60,000	2,100	2,520	1,800	2,340	3,900	2,400	1,800	2,137
80,000	3,100	4,160	2,400	3,140	5,200	3,200	2,400	3,159
100,000	4,100	5,200	3,000	3,940	6,500	4,000	3,000	4,181
150,000	6,600	10,500	7,500	5,940	9,750	6,000	4,500	6,736
200,000	9,100	18,000	10,000	7,940	13,000	8,000	6,000	9,291

Note: Figures for Queensland are for 4-cylinder vehicles; rates of duty on 6-cylinder vehicles are 10-17% higher than for 4-cylinder vehicles. *Source:* Western Australian Department of Treasury (2023: 40).

Table 6.2 – Motor vehicle registration fees and charges – 2023 Toyota Camry SL auto

	$							
	NSW	*Vic*	*Qld*	*SA*	*WA*	*Tas*	*NT*	*ACT*
Licence fee	580.00	324.70	360.60	148.00	430.92	240.88	210.00	622.70
CTP insurance	440.00	552.20	390.60	478.82	479.40	302.00	607.25	417.90
Administration and recording fees				31.00	10.30		14.00	137.00
Other fees & levies			62.90	32.00		49.71		
Total	1,020.00	876.90	814.10	689.82	920.62	592.59	831.25	1,177.60

Note: Fees and charges shown are for private vehicles. NSW, Queensland and the ACT charge higher licence fees for business vehicles. *Source:* Western Australian Department of Treasury (2023: 44).

And there does not appear to be any compelling reason why the stamp duty on the purchase of luxury vehicles should be any less in Tasmania than in other states and territories.

There would thus appear to be a strong case for increasing the duty on the purchase of motor vehicles valued at more than, say, $100,000, and for increasing registration fees to levels closer to the average of those in other states and territories(with exemptions for pensioners and social security card holders, and posssibly smaller increases for people living outside of the four major metropolitan areas). Given Tasmania's lower CTP premiums this would still leave Tasmanians paying lower total government charges for owning and operating motor vehicles than people in other states and territories.

An increase in registration fees would also be a way of ensuring that users of electric vehicles (who don't pay fuel excise) are making a financial contribution to the costs of building and maintaining roads, a challenge which will increase over time as electric vehicles come to replace internal combustion engine propelled vehicles.

Mineral royalties

As noted earlier in this Chapter, the Commonwealth Grants Commission's assessments indicate that Tasmania collected, on average over the four years to 2022-23, almost 40% less from mineral royalty revenues than it would have done had its royalty regime been equivalent to the average of all states and territories (an average which is dominated by the royalty regimes in Western Australia and Queensland). This represents a shortfall in revenue averaging $42 million per annum over the four years to 2022-23.

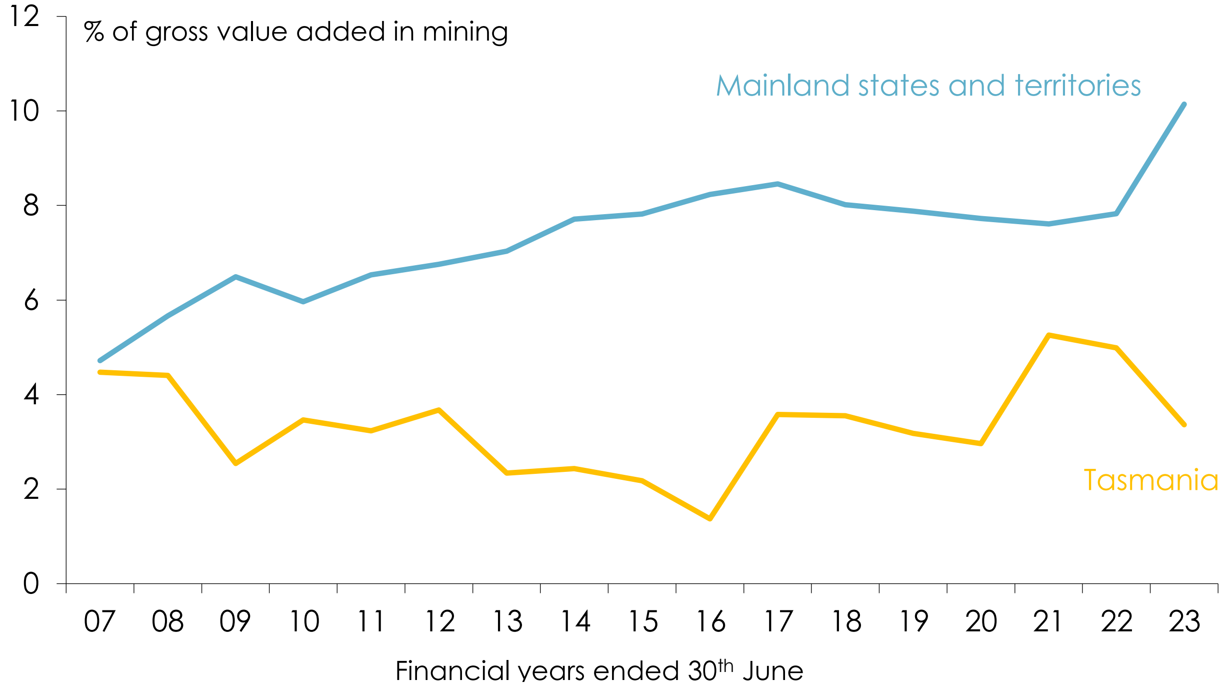
Mining accounts for only 4.2% of total industry gross value added in Tasmania, a smaller share than for any other jurisdiction except for Victoria and the ACT, less than half its peak proportion in the early 1990s, and compared with the national average of 14.2% (a key reason why the Grants Commission assesses Tasmania to have a lesser capacity to raise revenue from mining royalties than any other jurisdiction except the ACT and Victoria).

Mining operations in Tasmania are typically on a much smaller scale than in Western Australia, Queensland or New South Wales, and operating costs are typically higher given the nature of the terrain in which Tasmania's principal mining operations are located.

Nonetheless, the Tasmanian Government captures a smaller proportion of the value generated by mining operations than other state and territory governments, as shown in Chart 6.4 (on page 98).

Table 6.3 (on page 99) suggests that the royalty rates levied on mining operations in Tasmania are among the lowest in Australia.

Chart 6.4 – Mineral royalty revenues as a percentage of mining industry gross value added, Tasmania vs other states and territories, 2006-07 to 2022-23



Sources: Review calculations based on state and territory annual financial reports and ABS (2023a).

There would thus appear to be scope for the Government to capture a larger share of the wealth generated by the exploitation of Tasmania's mineral resources than it has been doing – especially whilst mineral commodity prices remain at historically elevated levels – without rendering mining operations uneconomic (noting also that mineral royalties are deductible against Federal company tax liabilities). Doing so could make a useful contribution to the task of restoring Tasmania's public finances to a sustainable condition.

Infrastructure spending

As documented in Chapter 4, a significant contributor to the deterioration in Tasmania's fiscal position over the past decade has been the large increase in purchases of non-financial assets (commonly referred to as 'infrastructure spending', the vast majority of it funded by borrowing.

Purchases of non-financial assets by the Tasmanian general government sector have risen from an average of 1.3% of gross state product between 2011-12 and 2019-20, to over 2% of GSP in 2021-22 and 2022-23, and based on the Forward Estimates presented in the *Pre-Election Financial Outlook Report* published in February will average around 2¾% of GSP over the four years to 2026-27. On top of this, purchases of non-financial assets by Tasmanian public non-financial corporations have risen from an average of 1.8% of GSP between 2011-12 and 2019-20 to an average of 2.3% of GSP in 2021-22 and 2022-23, and based on the Forward Estimates published in February will average around 3¾% of GSP over the four years to 2026-27 (Chart 6.5, on page 100).

Table 6.3 – Royalty rates on selected minerals, 2023-24

IRON ORE ROYALTY RATES

	WA	NSW	VIC	QLD	SA	TAS	ACT	NT
Royalty Rate	**Beneficiated:** 5.0% **Direct shipping:** 7.5%	4.0% of the ex-mine value (value less allowable deductions)	2.75% of net market value	$1.25 per tonne plus 2.5% of value above $100 per tonne[(a)]	5.0% of net market value	1.9% on net sales plus profit royalty up to maximum of 5.35% of net sales[(b)]	N/A	Greater of 20.0% of net value (less $10,000) or 1% to 2.5% of gross revenue[(c)]
Royalty System	Ad valorem	Ad valorem	Ad valorem	Hybrid	Ad valorem	Hybrid		Hybrid

(a) A discount of 20% is available if the mineral is processed in Queensland and the metal produced is at least 95% iron ore.

(b) A 20% rebate is available for the production of a metal in Tasmania.

(c) Royalty will only apply when a miner's annual gross production revenue exceeds $500,000. The rate applying to gross production revenue is 1% per annum in a mine's first royalty year, 2% in a mine's second royalty year, and 2.5% in subsequent years.

COPPER ROYALTY RATES

	WA	NSW	VIC	QLD	SA	TAS	ACT	NT
Royalty Rate	**Crushed and screened ore:** 7.5% **Concentrate**: 5.0% **Metallic form**: 2.5%	4.0% of the ex-mine value (value less allowable deductions)	2.75% of net market value	Variable rate (between 2.5% and 5.0%) depending on average metal prices[(a)]	3.5% of net market value if in a metal form, concentrates at 5.0%	1.9% on net sales plus profit royalty up to maximum of 5.35% of net sales[(b)]	N/A	Greater of 20.0% of net value (less $10,000) or 1% to 2.5% of gross revenue[(c)]
Royalty System	Ad valorem	Ad valorem	Ad valorem	Ad valorem	Ad valorem	Hybrid		Hybrid

(a) Producers are advised of the applicable variable rate each quarter. Prices below $3,600/tonne attract the minimum rate; prices above $9,200/tonne attract the maximum rate. A discount of 20% is available if the mineral is processed in Queensland and the metal produced is at least 95% copper. No royalty is payable on the first $100,000 of copper produced each year.

(b) A rebate of 20% is available for the production of a metal within Tasmania.

(c) Royalty will only apply when a miner's annual gross production revenue exceeds $500,000. The rate applying to gross production revenue is 1% per annum in a mine's first royalty year, 2% in a mine's second royalty year, and 2.5% in subsequent years.

GOLD ROYALTY RATES

	WA	NSW	VIC	QLD	SA	TAS	ACT	NT
Royalty Rate	2.5% of royalty value[(a)]	4.0% of the ex-mine value (value less allowable deductions)	2.75% of net market value[(b)]	Variable rate (between 2.5% and 5.0%)[(c)] depending on average metal prices	3.5% of net market value if in a metal form, concentrates at 5.0%	1.9% on net sales plus profit royalty up to maximum of 5.35% of net sales[(d)]	N/A	Greater of 20.0% of net value (less $10,000) or 1% to 2.5% of gross revenue[(e)]
Royalty System	Ad valorem	Ad valorem	Ad valorem	Ad valorem	Ad valorem	Hybrid		Hybrid

(a) First 2,500 ounces produced by each project per annum are exempt.

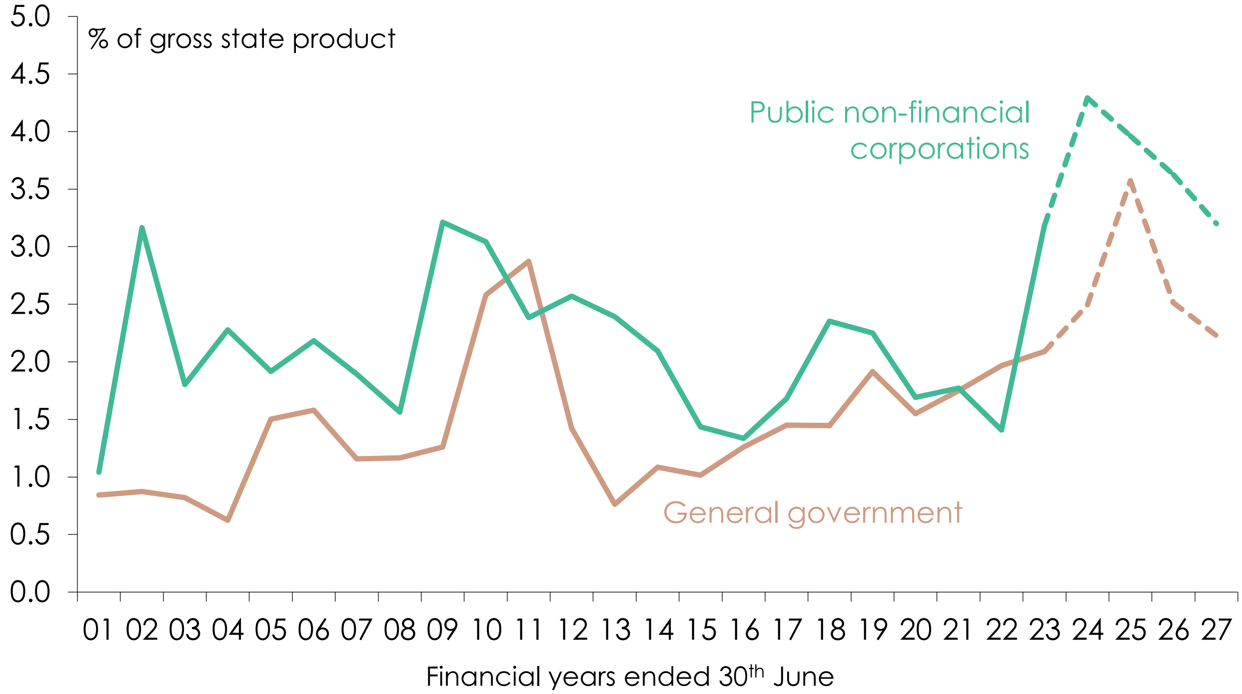
(b) Does not apply to gold produced on a prospecting licence, or to the first 2,500 ounces produced each year.

(c) Producers are advised of the applicable variable rate each quarter. No royalty is payable on the first $100,000 of gold produced per year. Prices below $600/oz attract the minimum rate; prices above $890/oz attract the maximum rate.

(d) A 20% rebate is available for the production of a metal in Tasmania.

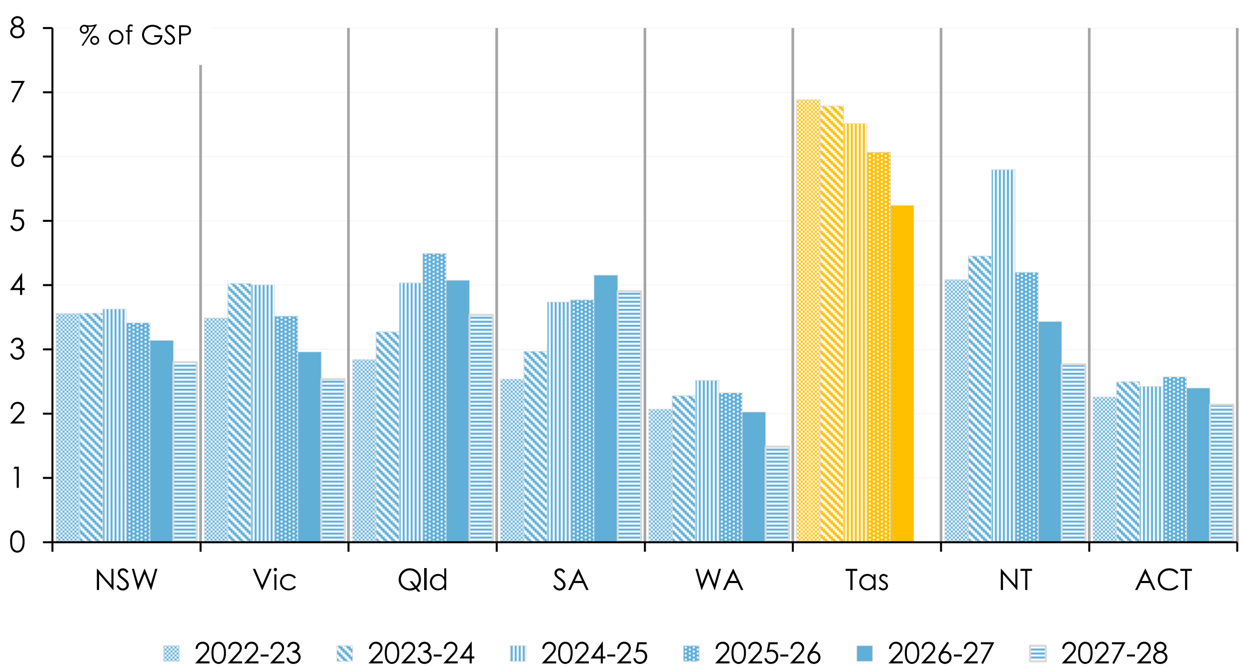
Source: Western Australian Department of Treasury (2023: 73, 76 and 84).

Chart 6.5 – State government purchases of non-financial assets, 2000-01 to 2026-27



Note: Data shown in this chart do not include infrastructure spending commitments announced during the 2024 election campaign. *Sources:* Tasmanian Treasury (2023a and previous issues, 2024b) and ABS (2023).

Chart 6.6 – Total state non-financial public sector purchases of non-financial assets, 2022-23 to 2026-27



Sources: Tasmanian Treasury (2024a and b) and 2024-25 State and Territory Budget Papers.

Chart 6.6 indicates that Tasmania's total non-financial public sector infrastructure spending program (that is, including capital expenditures by Tasmanian government business enterpries) is larger, relative to the size of Tasmania's economy, than that of any other state or territory.

Infrastructure assets, whether funded by the general government sector or through government-owned businesses, are an important part of Tasmania's economic and social capital. Since infrastructure assets are typically intended to benefit future generations of citizens as well as the present one, it's ordinarily appropriate that at least some of the cost of providing those assets be funded by debt which will then be serviced and in some circumstances repaid by those future generations, rather than falling entirely on the present generation.

But in Tasmania's present fiscal situation – and especially given the prospective trajectory of Tasmania's public finances as set out in Chapter 5 – the question is whether Tasmania can afford such an ambitious infrastructure investment program.

This Review's understanding is that the Government's present infrastructure spending program is largely the outcome of an accumulation of individual decisions to proceed with what is now a large number of projects, rather than the outcome of conscious decisions as to how much the State can afford to spend on infrastructure assets and then allocating that 'budget' with a view to ensuring that the projects which are funded are those with the highest ratio of social and economic benefits to cost.

The Review further understands that Treasury has rarely been asked to undertake any 'arms-length' review of the costs and benefits of particular projects, or of the Government's infrastructure program in its entirety – as would seem appropriate even at the best of times, let alone the circumstances in which Tasmania now finds itself.

Henceforth, the Government's approach to infrastructure investment should begin with decisions as to the amount it can afford to spend on infrastructure – both over the next decade and in each year of that decade – having regard to a clear picture of its overall financial position (including in particular its capacity to service debt), and then decide which projects should be funded on their relative merits, aided by independent assessments (by the Treasury or, alternatively, by Infrastructure Tasmania) of the 'business case' for each project under consideration.

This Review does not have the capacity to suggest which projects currently on the 'drawing board' should be deferred or cancelled (since it hasn't had access to the 'business cases' for any of them, or any analysis of their benefit-cost ratios, if indeed any such analysis has been undertaken). But as an integral part of any broader strategy to restore Tasmania's finances to a sustainable position (and keep them there) the Government should be reviewing the entire infrastructure spending program (including re-assessing the 'business case' for each project) with a view to 'weeding out' projects with low or negative benefit-cost ratios, or for which the original rationale has materially changed.

Public sector superannuation expenses

Chapters 4 and 5 have already noted that Tasmania has a larger unfunded public sector superannuation liability than any other state or territory (see Charts 4.23 on p. 65 and 4.27 on p. 68), and that the on-going cost of servicing this liability on an 'emerging cost' basis is a significant constraint on Tasmania's capacity to service ordinary debt.

Although the actuarially assessed value of the superannuation liability fluctuates, often significantly, from year to year in response to (in particular) movements in bond yields, the annual costs of meeting the Government's obligations to retiring and retired public sector employees and their surviving partners are relatively predictable. They do not move up or down in line with movements in interest rates. Unlike debt, the superannuation liability does not have to be 'refinanced', and is thus not subject to 'roll-over risk' in the way that conventional debt can be (in extreme circumstances).

Other states and territories, and the Federal Government, have sought (with varying degrees of success) to reduce their outstanding unfunded superannuation liabilities (and the on-going costs associated with them) in two principal ways:

- first, by running cash surpluses and investing some or all of those surpluses in financial or other assets with a view to generating returns which can be used to defray future liabilities to members of defined benefit superannuation funds; and/or
- selling assets (shares in Telstra, in the case of the Federal Government, and other government-owned businesses in some states and territories) and investing the proceeds so as to assist in meeting future liabilities to members of defined benefit superannuation funds.

Tasmania pursued the first of these strategies in the early 2000s, accumulating almost $1.5 billion in the Superannuation Provision Account. However this strategy was abandoned, and the Superannuation Provision Account closed, in the 2012-13 Budget (Tasmanian Government 2012: 6.11-12).

If and when the budget does return to cash surplus – something which seems unlikely in the next five years – the Government should consider again applying some or all of those surpluses to investments which can be used to defray the unfunded superannuation liability (as opposed to repaying debt). If so, it should also put in place stronger safeguards to ensure that any such funds are not subsequently withdrawn to meet short-term exigencies.

The second strategy has not been contemplated in Tasmania since the 1998 election, at which the privatization of the Hydro-Electric Commission (as it then was) was proposed by the Liberal Party, but which resulted in the election of a Labor Government which was pledged to retain the HEC in public ownership.

This Review has considered, but decided against, recommending that consideration again be given to selling government-owned businesses with a view to investing the proceeds in such a way as to reduce the ongoing budgetary cost of meeting obligations to members of defined benefit superannuation funds.

Apart from the 'political capital' which any effort to 'sell' such a proposal might entail – 'capital' which in the Review's opinion will be needed to implement other elements of what needs to be done to put Tasmania's finances on a sustainble footing – the Review has also taken into account:

- the fact that long-term interest rates are (notwithstanding the increases since 2022) considerably lower than they were in the 1990s and early 2000s when most of the 'privatisations' referred to earlier occurred, which means that the savings in terms of interest payments from paying down debt using privatisation proceeds would be smaller than in those earlier instances;
- the fact that GBEs are now making a relatively larger contribution (through tax-equivalent and dividend payments) to the Budget than they did in the 1990s and early 2000s, which together with the smaller savings from debt repayments due to lower interest rates reduces (and potentially eliminates) the purely financial benefits of privatisation;
- the risk that prospective buyers of energy businesses owned by the Tasmanian Government may under-estimate their value during and after the transition to net zero emissions;
- the considerable difficulty, in the case of Hydro Tasmania, of disaggregating it into competing businesses as occurred as (an essential) part of the privatisation of electricity generating businesses in other states;
- and, given the high probability that any acquirers of government-owned businesses being offered for sale would be based on the mainland, the potential loss of employment in Tasmania.

The Government should, however, consider the potential for closing existing defined benefit schemes which were closed to new members in 1999.

The Review understands that the continuing members of these schemes are long-serving, relatively senior and well-paid employees whose superannuation position is considerably more favourable than that of the overwhelming majority of current public sector employees.

This increasingly appears to be unfair. The Government should consider terminating these schemes for those who are still members of them, preserving their entitlements (based on their average salary over the preceding three years) up to the closure date, and then transferring them to the same defined contribution arrangements as have applied to all other public sector employees since 1999.

It has been suggested to this Review that the resulting savings, over the currently projected lifetime of these schemes could be anywhere between $2 billion and $3 billion. The Review has not been able to independently verify these 'ballpark' estimates, but they certainly indicate that the possibility should be investigated.

Revenue from government business enterprises

Given that, as noted in the previous section, government-owned businesses are now typically making (in aggregate) a larger contribution to budget revenues than they did in previous decades, the Government should avoid making policy decisions which arbitrarily reduce the capacity of those businesses to generate revenues.

As a specific example, Hydro Tasmania contributed a total of $675 million to general government revenues over the four years to 2022-23, equivalent to 96% of its net profit before fair value adjustments, impairments and tax over that period(Hydro Tasmania 2023: 102-103) and according to the Forward Estimates published in February is expected to contribute a further $565 million to government revenues over the four years to 2026-27 (Tasmanian Government 2023: 116 and Tasmanian Treasury 2024a: 60-61). These sums are larger than the amounts the Government has collected or expects to collect from (for example) taxes on gambling, or insurance premiums.

Yet during the recent election campaign both major political parties made promises which would detract from Hydro Tasmania's capacity to generate the revenues from which those payments to the budget can be made – for example by restricting its capacity to sell "Tasmanian electricity to Victorians at Victorian prices", or by requiring it to be willing to offer large blocks of electricity at discounted prices to potential large industrial users in the hope of generating jobs for workers who, if recent trends in interstate migration persist, would be hard to find, and if those trends were to reverse, would be hard to house.

In this Review's opinion, if the Government deems it appropriate or necessary to offer energy price subsidies or any other financial inducements to businesses or industries to remain in or relocate to Tasmania, it should do so transparently through the Budget – so that the costs and benefits of such decisions can be assessed – rather than by requiring government business enterprises to provide goods and services at artificially low prices masked by 'commercial-in-confidence' clauses.

Recommendations of this Chapter

The Review makes the following recommendations:

1. The Government should adopt a medium-term fiscal strategy with the explicit objective of returning Tasmania's public finances to a sustainable condition, as identified by five key targets:
   a) returning the general government operating balance to an 'underlying' surplus (that is, excluding one-off Federal grants for capital purposes) within four years, maintaining it in surplus (other than in response to significant exogenous shocks) thereafter, and achieving and maintaining an overall fiscal surplus over the following six years;

b) reducing the ratio of general government and total non-financial public sector net liabilities to gross state product (GSP) to less than 20% and 25%, respectively, over five-ten years;

c) reducing the ratio of general government and total non-financial public sector net debt to GSP to less than 8% and 12%, respectively, over five-ten years;

d) reducing the ratio 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; and

e) 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%.

It would be useful – in terms of building confidence in the durability of a fiscal strategy along these lines beyond the normal election cycle – if these targets were to be specifically legislated by the Parliament (for example, by amending the *Charter of Budget Responsibility Act 2007)* in such a way as to oblige future governments to present Budgets consistent with achieving them, unless circumstances were to change in such a way as to prompt Parliament explicitly to amend or suspend them.

2. Other political parties represented in the State Parliament should also commit to these targets (whilst reserving the right to seek to achieve them in different ways) so as to provide confidence that the prospect of returning Tasmania's public finances to a sustainable position is not imperilled by a change of government.

3. Whilst the Government should continue regularly to review the continuing need for, and the efficiency and effectiveness of individual spending programs, it should not expect significant reductions in operating expenses to make a major contribution to the task of returning Tasmania's public finances to a sustainable position, and it should avoid relying on crude artifices such as 'efficiency dividends' and 'vacancy control' to achieve expense savings targets.

4. The Government should actively consider some or all of the following options for raising additional revenues and/or improving the efficiency, equity and resilience of its revenue base:

   a) broadening the base of payroll tax by lowering the current tax-free and concessonal-rate thresholds;

   b) replacing stamp duty on land transfers with a broadly-based land tax that includes owner-occupied housing, with appropriate provisions for 'asset rich but income poor' households, and to prevent 'double-taxation' of recent property purchasers;

   c) ahead of such a reform, introducing a levy on municipal rates similar to the existing fire and waste levies as a *de facto* expansion of the land tax base;

d) extending the existing surcharges on stamp duty (for as long as stamp duty remains part of the tax system) and land tax on foreign purchases of residential property to all non-Tasmanian resident purchasers of established residential property (with an exemption for new properties, or land on which new residential buildings will be constructed within a defined period);

e) increase the duty payable on purchases of new motor vehicles, valued at more than (say) $100,000, and motor vehicle registration fees, to levels comparable to those in other states and territories; and

f) increase mineral royalties to levels closer to those levied in other states, possibly by prescribing higher royalty rates when prices for minerals are above specified levels.

5. The Government should scale back infrastructure spending to levels more commensurate, as a percentage of gross state product, with the average for other states and territories, ie about 4% of GSP.

6. The governance of general government infrastructure spending should be reconfigured by setting an overall ten-year infrastructure spending budget, including caps on the amount of spending in each year of that ten-year period, and determining the selection of individual projects within that budget by ranking them using cost-benefit criteria, with the Department of Treasury and Finance (or, alternatively, Infrastructure Tasmania) having a specified role in independently assessing and advising Ministers on the 'business case' for each project.

7. The Government should explore options for closing defined benefit public sector superannuation schemes to existing members and transferring them to the same superannuation arrangements as the majority of public sector employees.

8. The Government should avoid arbitrarily constraining the capacity of government-owned business enterprises from generating revenues for political purposes, and if it is deemed necessary or desirable to offer financial assistance to particular businesses or industries in order to influence their investment or employment decisions, that should be done transparently through the general government budget rather than requiring government-owned enterprises to sell goods or services at arbitrarily-determined prices.

7. Other observations and recommendations

Introduction

Chapters 3 and 4 showed that Tasmania's public finances have deteriorated materially since the latter part of the 2010s – the third such substantial deterioration in the past 35 years. Moreover, it also showed that this deterioration was almost entirely the result of government policy decisions, rather than being attributable to factors beyond the control or influence of the government (such as changes in the economic environment, or Commonwealth funding).

Chapter 5 demonstrated that, without significant changes in budgetary policies, Tasmania's public finances are likely to continue to deteriorate over the decade ahead, in some respects at an accelerating rate, with potentially serious adverse consequences for the capacity of the Tasmanian Government to deliver the services which the Tasmanian community rightly expect of their State Government.

And Chapter 6 set out a series of options which, if implemented, would in this Review's opinion forestall such an eventuality, and instead put Tasmania's public finances on a sustainable trajectory.

This Chapter considers the extent to which changes to institutional arrangements, including the frameworks within which the Government's budget is prepared, scrutinized and managed, and within which fiscal policy issues are considered and debated as part of the political process, can be made with a view to reducing the likelihood of this history being repeated, and to enhancing the capacity of the Government to address the fiscal challenges which now confront it.

The role and capabilities of the Department of Treasury and Finance

The Department of Treasury and Finance's role, according to its website, is to "provide the Government with objective advice on the economic and financial management of the State)", to "implement Government policies and programs", and to "perform analysis, monitoring and reporting functions on behalf of the Government".

This appears to be a somewhat more limited perspective than that of other Treasuries.

For example, the New South Wales Treasury describes its role as being to "provide advice to inform budget decision-making; manage the State's principal financial assets and liabilities; identify opportunities for economic reform, monitor and forecast the economy and state revenues, monitor the performance of its commercial agencies; and advise on performance/financial management policies" . It goes on to identify its "priorities" as "supporting economic growth, fiscal performance for the benefit of future generations, and delivering economic reform".

The Queensland Treasury states its purpose as being "to drive government priorities through [its] expert advice and services", in keeping with its vision of "a strong economy for all Queenslanders".

Western Australia's Department of Treasury describes itself as "the centre of Government decision-making", and what it does as "integral to the Government's decision-making processes about where and how to spend taxpayer's money to ensure Western Australians have access to quality services on a financially sustainable basis".

South Australia's Department of Treasury and Finance "works together to ensure South Australia is a thriving, prosperous state now and into the future", characterising itself as "the lead agency for economic, social and financial policy outcomes", playing "a vital role in providing financial services to the community and econmic and fiscal policy advice to the Government of South Australia".

Even the Northern Territory's Department of Treasury and Finance, which is a smaller organization than Tasmania's (having 112 full-time-equivalent employees compared with Tasmania's 330), has a more ambitious description of its primary role as being "to promote the long-term development of the Territory" by "providing specialist fiscal, economic and commercial policy advice to government, focusing on sustainable government finances, economic efficiency and effective risk management".

The Review has gained the impression – from its own observations and from conversations with current and former senior public servants in Tasmania, other states and the Commonwealth – that the Department of Treasury and Finance has played less of a role in shaping key aspects of economic and fiscal policy over the past decade than its counterparts in at least some other jurisdictions, or than would have been desirable in the Tasmanian context.

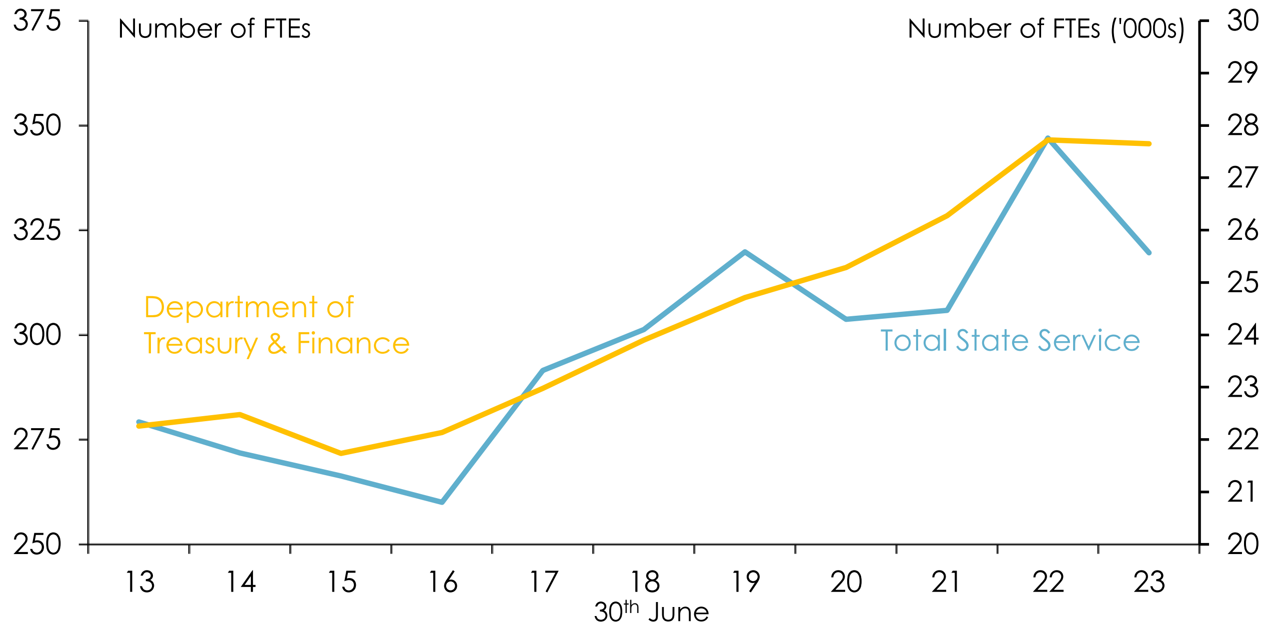
The Review emphasizes that this is *not* intended as a criticism of Treasury itself, or its officers. Indeed, one of the rating agencies characterizes Tasmania's financial management as "very strong" (S&P Global 2023: 2). Rather, there appears to have been a pattern of Treasury being sidelined – that is, for its advice to be ignored (most obviously, as noted in Chapter 6, the findings in its three successive *Fiscal Strategy* Reports between 2016 and 2021), or discounted, or not to be sought at all, or otherwise subordinated to political considerations.

The Review acknowledges that this is a subjective assessment. But there are several pieces of objective evidence which are consistent with this conclusion.

First, Treasury's resources appear to have been more tightly constrained over the past decade than those of most other agencies within the Tasmanian State Service. As shown in Chart 7.1, the number of full-time equivalent employees on the payroll of the Department of Treasury and Finance rose by 14.5% between June 2013 and June 2023, compared with a 24.5% increase in the total number of full-time equivalent employees in the Tasmanian State Service workforce.

The Review isn't questioning the appropriateness of employing more 'front line service' employees in areas such as health, in order to respond appropriately to rapidly-growing needs. But several informed observers have suggested to the Review that the Government has had a distinct preference for (to paraphrase one of them) people who 'do' rather than people who 'think'.

Chart 7.1 – Department of Treasury & Finance staffing compared with total State Service

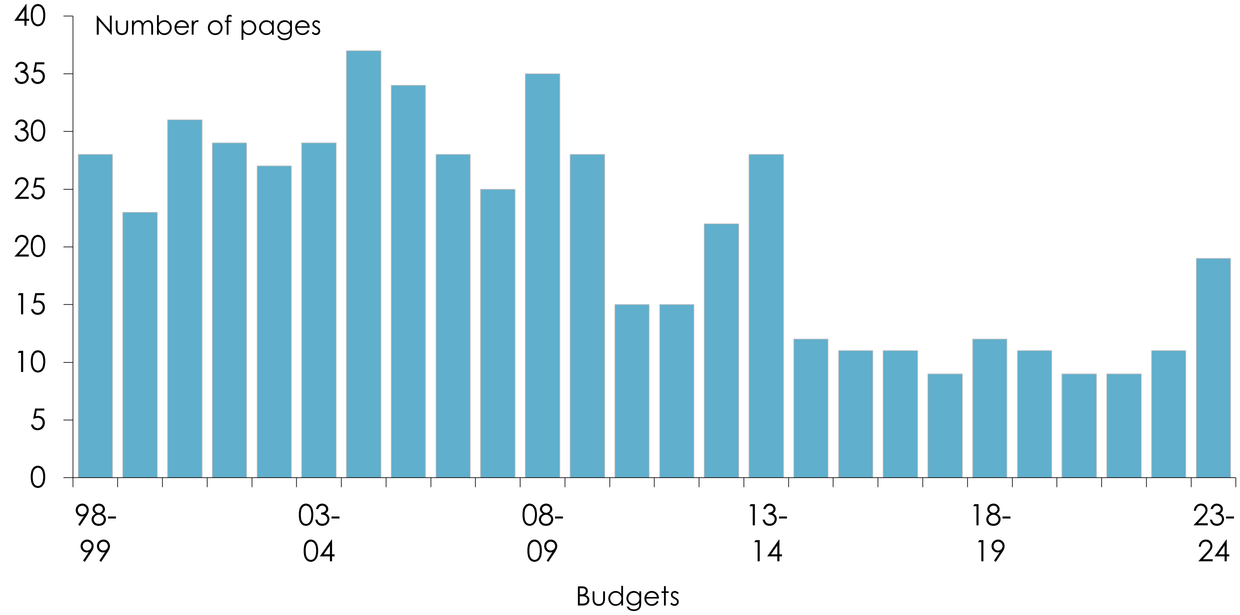


Note: The left and right scales are of identical proportion. The large increase in the number of DTF FTEs in 2021-22 and subsequent decline in 2022-23 reflects the establishment of Renewables, Climate and Future Industries Tasmania (ReCFIT) on 31st October 2021 (accompanied by the transfer of 38 employees from the Departments of Premier & Cabinet and State Growth to DTF) and its subsequent transfer on 1st October 2022 (along with 46 employees) to the Department of State Growth. *Source:* Department of Premier and Cabinet (2023, and previous issues).

While such an attitude may have some political appeal, it is not without costs. As an illustration, the Western Australian Government spent $1.6 million over three years for its Treasury Department to employ what its then Premier and Treasurer called three "GST fairness fighters" to advance its arguments for changes to the arrangements for distributing the revenue from the GST among the states and territories – changes which will result in Western Australia getting $52.9 billion more from the Federal Government over the eleven years to 2029-30 than it would have done otherwise (Spagnolo 2023). In 2023 the New South Wales Treasury beefed up its capacity to respond to the Grants Commission's five-yearly review of the GST distribution methodology (Hastie 2023). The Review was told that Victoria's Treasury has up to 20 staff working on GST-related issues. Tasmania's Treasury has three (sometimes supplemented with an external consultant). Multiple sources have advised that these staff are well-regarded: but they are also hard-pressed.

Second, Treasury appears to be allocating fewer resources to the analysis of trends in and prospects for the Tasmanian economy, if the amount of space devoted to it in the annual Budget Papers is any guide, as shown in Chart 7.2. In the first decade of the present century, Budget Paper No. 1 included an average of almost 30 pages of discussion, tables and charts on the recent performance of and outlook for the Tasmanian economy; between 2013-14 and 2021-22 that number shrank to fewer than 11, before rising to 19 in 2023-24 Budget Paper No.1.

Chart 7.2 – Number of pages devoted to discussion and analysis of the Tasmanian economy in Budget Paper No. 1, 1998-99 to 2023-24



Source: Tasmanian Government (2023 and previous issues); Tasmanian Department of Treasury and Finance, Budget Papers archive.

Of course, in this context as in others, 'quantity' is not the same thing as 'quality'. But it is not apparent to this Review that the decline in the former has been offset by an increase in the latter.

Treasury's views on the performance of and prospects for the State's economy are – or should be – an important contribution to Parliamentary and public understanding and discussion of present and future economic conditions in Tasmania.

While some other states' budget papers (in particular South Australia's) have even sketchier analysis of their states' economies than Tasmania's, it is notable that the Northern Territory Treasury (which as noted earlier has only one-third the staffing of Tasmania's) produces a 50-60 page analysis of the Northern Territory economy to accompany its annual Budget Papers (see, eg, Northern Territory Government 2024b).

Tasmania's Treasury typically produces forecasts or projections of only seven variables in Budget Paper No. 1 each year, as shown in Table 7.1 (gross state product, state final demand, employment, labour force participation, unemployment, inflation and population). In the 2020-21 Budget Papers, it omitted projections for the last two years of the four-year forward estimates period (Tasmanian Government 2020: 26) – the only state or territory to have done so (even though it must have had some internal projections of these variables in order to construct the forward estimates of revenues and expenses which were published in that year's Budget Papers).

By contrast, Western Australia's Treasury produces (and discusses) forecasts for 21 different economic variables in that state's annual Budget Papers (see Table 7.2).

Table 7.1 – 2023-24 Budget forecasts and projections for the Tasmanian economy

	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
		Budget 2023-24				
	Actuals	Forecasts			Projections[5]	
Gross state product (real, % change)[1]	4.3	1½	2	2¼	2½	2½
State final demand (real, % change)[1]	5.7	1½	2¾	2	2½	2½
Employment (year-average, % change)[2]	3.0	2½	½	1	1¼	1¼
Labour force participation rate (year-average, %)[2]	62.0	62½	62¼	62	62	62
Unemployment rate (year-average, %)[2]	4.4	4	4½	4½	4½	4½
Consumer Price Index (year-average, % change)[3]	5.0	7¼	4¼	3¼	2½	2½
Population (year-average, % change)[4]	0.7	0.7	0.9	0.9	0.7	0.7

Source: Tasmanian Government (2023: 28).

Table 7.2 – 2023-24 Budget forecasts and projections for the Western Australian economy

Western Australia, Annual Growth (%)

	2022-23 Actual	2023-24 Estimated Actual	2024-25 Budget Year	2025-26 Outyear	2026-27 Outyear	2027-28 Outyear
Demand and Output [(a)]						
Household Consumption	3.5	2.0	2.25	2.75	3.0	3.0
Dwelling Investment	-2.7	6.75	7.5	2.5	3.25	2.25
Business Investment	4.5	13.25	1.75	3.75	4.25	2.25
Government Consumption	4.8	3.25	4.0	2.5	2.25	2.5
Government Investment	10.8	10.0	15.0	1.0	1.0	-0.25
State Final Demand	3.9	5.25	3.25	3.0	3.0	2.75
Goods Exports	4.7	-0.5	1.5	1.25	1.25	1.5
Goods Imports	7.8	10.0	1.25	2.0	2.25	1.75
Net Exports [(b)]	3.8	-2.25	0.25	0.5	0.75	1.5
Gross State Product [(c)]	3.5	1.75	2.0	2.0	2.25	2.25
Labour Market						
Employment	3.1	3.75	1.75	1.5	1.5	1.5
Unemployment Rate [(d)]	3.6	3.75	4.0	4.25	4.5	4.75
Participation Rate [(d)]	68.7	68.9	68.8	68.5	68.4	68.3
Population [(e)]						
Population	3.2	2.8	1.8	1.7	1.7	1.7
Working Age Population (15+)	3.8	3.1	2.0	1.9	1.9	1.9
Prices						
Consumer Price Index [(e) (f)]	5.0	4.0	3.0	2.5	2.5	2.5
Wage Price Index [(e)]	4.2	4.25	3.75	3.5	3.0	3.0
Perth Median House Price	4.7	12.4	4.5	2.5	1.2	0.8
Other Key Parameters [(d)]						
Exchange Rate $US/$A (US cents)	67.3	65.5	65.9	67.0	68.2	69.4
Iron Ore Price ($US per tonne) Cost and Freight Inclusive (CFR)	109.6	116.1	75.0	71.0	71.0	71.0
Crude Oil Price ($US/barrel)	86.5	84.4	83.3	77.5	74.1	71.8

Source: Government of Western Australia (2023: 13).

The Watt Review of Tasmania's State Service noted that at least four other state and territory Treasuries (those of New South Wales, Queensland, Western Australia and the Northern Territory) had centralized units to conduct or oversee evaluations and reviews of government programs and activities, and that a similar capacity existed in Victoria's Department of Premier and Cabinet. It recommended that a Review and Evaluation Unit should be established in order to ensure that "TSS [Tasmanian State Service] and budget resources are used and allocated well, in particular that scarce TSS staff and staff capability are focused on programs that generate the best outcomes for Tasmanians and deliver the highest return for government expenditure" (Watt 2021: 105-106).

The Watt Review recommended that this Review and Evaluation Unit "would most suitably sit in the Department of Premier and Cabinet", but "should work closely with the Department of Treasury and Finance to provide appropriate input from a financial and budgetary perspective" (Watt 2021: 105).

This Review supports this recommendation, and indeed regards it as even more important in view of the more challenging fiscal circumstances in which Tasmania now finds itself, but considers that the proposed Review and Evaluation Unit may be more appropriately situated within Treasury.

In recommending that Treasury's analytical and management capabilities be strengthened in order to ensure that it can properly advise the Government in confronting and managing the fiscal challenges ahead, the Review is conscious of the difficulties that Treasury, like other Tasmanian Government departments and agencies, have long faced in attracting and retaining sufficient numbers of talented staff – especially given that the lower salaries which they offer compared with other jurisdictions are no longer at least partially offset, as they previously were, by cheaper housing costs.

In that context, this Review also endorses the Watt Review's recommendation for the greater use of secondments between other state and territory public services, and the Australian Public Service, and the Tasmanian State Service, and between the latter and local business and the community sector (Watt 2021: 144-147), specifically in the Treasury context. In particular, Tasmania's Treasury should seek to give promising younger staff opportunities to work in its counterparts (including the Australian Treasury), and to offer appropriately qualified mid-ranking staff in its mainland counterparts an opportunity for quicker progression to more senior roles in Tasmania.

This Review also recommends that the Department of Treasury and Finance collaborate more closely with the Tasmanian School of Business and Economics (TSBE) at the University of Tasmania to ensure that TSBE is producing graduates with knowledge and skills that will be relevant to the work and functions which the Department is expected to undertake.

Budget Papers and Financial Reports

The structure, content and timing of the various papers and reports through which the Tasmanian Government's budget is managed are governed by the provisions of the *Charter of Budget Responsibility Act 2007*, the *Financial Management Act* 2016, the *Audit Act* 2008, the Uniform Presentation Framework agreed at a Premiers' Conference in 1991, and the requirements of the Australian Accounting Standards Board (in particular, AASB 1049 *Whole of Government and General Government Sector Financial Reporting*).

These requirements are intended to ensure (among other things) accountability for the Government's management of Tasmania's public sector finances to the Parliament and people of Tasmania, and consistency in financial reporting across all Australian governments.

In three respects, Tasmania's Budget Papers represent 'best practice' among Australian (Federal, state and territory) governments:

- Tasmania is the only jurisdiction (among the states and territories) to report an 'underlying' net operating balance, that is, excluding one-off grants from the Federal Government for capital purposes (see, eg, Tasmanian Government 2023: 9-10) which are otherwise included in 'operating revenues' even though the expenditure which they are intended to fund are not included in 'operating expenses' but rather are classified (appropriately) as 'purchases of non-financial assets'. As shown in Chapter 3, during the global financial crisis and since the onset of the Covid-19 pandemic these one-off grants have been quite large, with the result that their inclusion in the net operating balance has made that balance look more favourable (or less unfavourable) than otherwise (see Chart 3.2). This Review recommends that Tasmania's Budget Papers and financial reports continue to include this measure.
- The 'Policy and Parameters Statement' included in the annual *Budget Paper No. 1* and the *Revised Estimates Report* (see, eg, Tasmanian Government 2023: 72-88 and Tasmanian Department of Treasury and Finance 2024a: 59-69) are the most detailed and comprehensive of any jurisdiction, including the Federal Government. Economist Chris Richardson refers to the version of this Statement presented in the annual Federal Budget Papers (see eg Australian Government 2024a: 87) as the "table of truth" (Read 2024). This Statement allows users to determine (in far more detail than for the Federal or any other state or territory government) the extent to which changes in the Budget 'bottom line' are attributable to conscious Government policy decisions or to factors beyond the control or influence of the Tasmanian Government (as shown, for example in Chapters 3 and 4 of this Review, and in particular Tables 3.1 and 4.1). Again, it is important that this 'best practice' be continued. Indeed, it would be helpful if the Treasurer's *Annual Financial Report* included an *ex post* dissection of the difference between the outcome for each financial year and the forward estimate presented in the preceding Budget along the same lines.

- Tasmania's Budget Papers provide details of the contributions that each of the government's public financial and non-financial corporations are expected to make to government revenue by way of tax and rate equivalent payments, government guarantee fees and dividends (see, eg, Tasmanian Government 2023: 116), which no other state or territory's budget papers, nor the Federal Government's, disclose. Again, it is important that this 'best practice' be continued.

However, there are some other respects in which the presentation of Tasmania's Budget Papers and other financial reports should be improved:

- as noted earlier in this Chapter, *Budget Paper No. 1* and the *Revised Estimates Report* should include a more detailed and thorough discussion and analysis of the recent performance of and prospects for the Tasmanian economy;
- as noted in Chapter 5, *Budget Paper No. 1* and the *Revised Estimates Report* should include 10-year projections of key budget metrics including the operating and fiscal balance, the cash balance, net debt and net financial liabilities, as do the Federal Budget Papers (see Australian Government 2024a: 93, 95 and 104-105) and, relevantly given the challenges facing Tasmania, the Northern Territory's Budget Papers (see Chart 5.1 in this Review and Northern Territory Government 2024a: 13);
- *Budget Paper No. 1* should incorporate more long-term historical data (back to at least 2000-01) on key budget metrics such as the operating, fiscal and cash balances, net debt and net financial liabilities, similar to the Federal Budget Papers (see Australian Government 2024a: 411-433), or the NSW and South Australian Budget Papers (see New South Wales Government 2024: D1-D5 and Government of South Australia 2024: 131-149), so as to facilitate comparisons with earlier periods;
- in order to facilitate external analysis and discussion of Tasmania's public finances, Treasury should publish the tables in *Budget Paper No. 1* and the *Revised Estimates Report* and the data used in charts presented in those documents on its website in excel spreadsheet format, as happens with the Federal Budget, the New South Wales Budget, the Victorian Budget and (to the greatest extent of all) the Western Australian Budget; and
- the discussion of risks (including the sensitivity of forward estimates to variations in economic and other parameter assumptions in Tasmania's *Budget Paper No. 1* (see Government of Tasmania 2023: 16-22) is fairly cursory and lacks quantification, by comparison with that in the corresponding Federal Budget Paper (see the formal Statement of Risks in Australian Government 2024: 275-348), or those in the budget papers of other state and territory governments (see eg NSW Government 2024: B1-B10, Victorian Government 2024: 87-96, Government of South Australia 2024: 77-87, Government of Western Australia 2024: 60-68, and Northern Territory Government 2024a: 77-88). In some respects the discussion of risks in the *Pre-election Financial Outlook Report* (Department of Treasury and Finance 2024b: 11-15) was more informative than that in the 2024-25 *Budget Paper No. 1*. This part of Budget Paper No. 1 should be strengthened.

The Review recognizes that Treasury would need additional resources to undertake these tasks, and recommends that they should be provided.

Additionally, there are some changes that could readily and usefully made to the requirements for the timing of some financial reports:

- Section 39 of the *Financial Management Act 2016* requires the Treasurer to issue a *Preliminary Outcomes Report* by no later than 15th August following the end of a financial year if, before 31st July, the Secretary to the Treasury determines that the "preliminary outcomes results" for that previous financial year "vary materially from the revised estimates published in the Budget Papers that relate to the previous financial year". Such a report has been published every year since at least 2003-04. The data published in this report are "unaudited and preliminary in nature", and refer only to the general government sector (Treasury 2023a: 1). No other state or territory has a similar requirement, and it is far from clear that the use of the resources required to produce it are justified by its usefulness;
- Section 36 of the *Financial Management Act 2016* requires the Treasurer to publish a *Revised Estimates Report* no later than the 15th February in the financial year to which it relates. Section 37 of that Act also requires the Treasurer to publish the *December quarterly report* (including results for the first half of the financial year) by the same date. There is no requirement that the *Revised Estimates Report* must include the *December quarterly report* and half-yearly results, but that has been the practice since at least 2004. The Federal Government and every other state and territory government publish their mid-year budget reviews during the December quarter of the relevant financial year, typically in the weeks leading up to Christmas (without needing half-yearly results in order to do so). Tasmania should do the same.

The requirement under Section 14A of the *Charter of Budget Responsibility Act* for the preparation and tabling in Parliament of a *Fiscal Sustainability Report* every five years should be retained. Consideration should be given (perhaps by the Parliamentary Public Accounts Committee, in the first instance) to requiring the Secretary to the Department of Treasury and Finance, and/or the Auditor-General, to provide annually an independent attestation to the Parliament as to the sustainability (or otherwise) of Tasmania's fiscal position.

Elections and fiscal strategies

Section 6 of the *Charter of Budget Responsibility Act 2007* requires both the Premier and the Leader of an [sic] Opposition party to "publicly announce a fiscal strategy statement " within 15 days of the dissolution of "expiry by the effluxion of time" of the House of Assembly prior to an election. Section 7 of the Act stipulates that a "fiscal strategy statement is to be based on the principles of sound fiscal management" (which are in turn set out in section 3 of the Act); while Section 8 requires a fiscal strategy statement to specify:

- the long-term objectives within which budgets will be framed;

- the key fiscal measures against which fiscal policy will be set and assessed;
- the fiscal objectives and targets for the budget year and the following three financial years; and
- how the fiscal objectives and strategic priorities relate to the principles of sound fiscal management.

For at least the past three elections these requirements have been honoured more in the breach than the observance – although in saying that, the Review also acknowledges that meeting the third of these requirements (in particular) is a much more difficult task for Opposition parties, who (unlike the incumbent Government) don't have access to the resources of the Department of Treasury and Finance (other than, during election periods, for the costing of specific policies).

As the Secretary to the Department of Treasury and Finance noted in the *Pre-Election Financial Outlook*, commitments made by the Government during the 2018 and 2021 election campaigns each added "approximately an initial $1.4 billion" to the existing Budget estimates ((Department of Treasury and Finance 2024b: 12), while by its own estimates, commitments made by the Government during this year's election campaign added a similar amount to the forward estimates for total expenses (and the resulting fiscal deficits) over the four years to 2026-27 (Ferguson 2024: 4-5).

None of the three largest political parties made any serious attempt during this year's election to indicate how they proposed to pay for the commitments they made over the course of the campaign.

This Review suggests that, instead of requiring political parties to make *de facto* forward estimates of key budget aggregates as per Section 8 (c) of the *Charter of Budget Responsibilty Act* 2007, the Act should instead require parties to stipulate how their proposed expenditure or revenue commitments will be paid for, or, alternatively, to state that their proposed commitments will be funded by running larger budget deficits financed by additional debt (or, in the event that at some future election the official Forward Estimates are projecting future budget surpluses, by running smaller ones).

To be clear, the Review is not suggesting that political parties should be precluded from offering unfunded election commitments – that would be undemocratic – but rather that they should be required to say so explicitly if that is their intention.

Additionally, having regard to the fact that an increasing proportion of voters are casting their ballots before polling day (22.2% of votes cast for this year's election were at pre-polling stations, and a further 8.3% were postal votes), political parties' practice of releasing their costing statements on the Friday afternoon before polling day makes a complete mockery of any requirement to inform voters of the budgetary implications of campaign promises. The *Charter of Budget Responsibility Act* should therefore be amended to require political parties to release their costing statements at least nine days before polling day: and consideration should be given to requiring the Secretary to the Department of Treasury and Finance to give an opinion, if practical, as to the credibility of those costings, in the final week of the election campaign.

A Tasmanian Parliamentary Budget Office

The Australian Parliamentary Budget Office (PBO) was established in 2012, pursuant to an agreement between the Gillard Government (which was returned to office as a minority government at the federal election held on 21st August 2010) and two independent MPs whose support the then Government needed on questions of confidence and supply.

The PBO now has a staff of about 45 people, and an annual budget of just over $10 million. Its principal functions are to provide costings of policy proposals and analysis of budgetary matters in response to requests from Senators and Members; publishing and presenting information to enhance public understanding of budget and fiscal policy settings; and publishing a report after every election to provide transparency around the fiscal impact of the election commitments of major parties (and minor parties and independents who choose to be included) (Parliamentary Budget Office 2024b).

The establishment of the Australian PBO followed the appointment of a New South Wales Parliamentary Budget Officer in February 2011, ahead of the state election held on 26th March of that year. The NSW Parliamentary Budget Officer is appointed for a period of about nine months, beginning "as soon as practicable after 1st September" prior to state elections which by law are held on the last Saturday in March every four years. The primary role of the NSW Parliamentary Budget Officer is to provide costings of election policies in response to requests by parliamentary leaders together with budget impact statements for all costed policies. The Officer is supported in those tasks by staff seconded from other parts of Parliamentary staff and the NSW Treasury, and "where necessary, consultants" (Parliament of New South Wales 2024).

The Victorian Parliamentary Budget Office was established in 2017 to provide "ongoing policy costing and advisory services to members of the Parliament of Victoria" and to "inform policy development and public debate in parliament and the Victorian community" (Victorian Parliamentary Budget Office 2024). The Victorian PBO provides policy costings at the request of MPs, advice to MPs on fiscal, economic and financial matters, and (during election campaigns) estimates of the cost of election platforms via a weekly 'election commitment tracker'. Within two months after an election, the Victorian PBO publishes a report estimating the financial impact of each party's stated policies on the budget. The Victorian PBO has 14 full-time staff and an annual budget of $3.3 million, supplemented during election years.

The Review considers that the establishment of a Tasmanian Parliamentary Budget Office would significantly enhance the effectiveness of Parliament's role in scrutinizing fiscal policy decisions, and in promoting more informed debate both in Parliament and within the broader Tasmanian community of budgetary and fiscal policy issues. It would assist non-government parties in fulfilling their obligations under the *Charter of Budget Responsibilty Act* (including the strengthened requirements proposed by this Review). And as a result, it would likely enhance public understanding of the requirements of returning Tasmania's finances to a sustainable position, and maintaining them there.

The Review is however also conscious of the costs potentially involved in establishing a PBO with sufficient resources to fulfil these tasks effectively. It suggests that these costs could be managed most effectively by something along the lines of the New South Wales model (at least initially), with the heightened requirements during an election year being met through staff secondments from the Department of Treasury and Finance or other agencies, and/or from the Australian or interstate PBOs.

There may even be merit in having the Tasmanian Parliamentary Budget Officer working alongside staff of the Australian PBO in Canberra, and conducting much of the required work 'virtually', in order to maximize access to the experience and expertise of Australian PBO staff.

The role of the Audit Office and the Auditor-General

The Auditor-General plays a crucial role in ensuring the accuracy and fidelity with accounting standards of the financial reports presented to Parliament, both by individual government departments, agencies and corporations, and by the Treasurer for the government and state public sector as a whole. It also investigates and reports to Parliament on the efficiency and effectiveness of public sector entities, and their compliance with legislative and regulatory requirements. In its own words, "The Tasmanian Audit Office provides independent assurance to the Parliament and community on the performance and accountability of the Tasmanian Public Sector".

Essential to the Audit Office's capacity to carry out these functions is its independence from the government of the day. In practice, the degree of independence which Audit Offices enjoy from the executive government varies across jurisdictions and over time. A study undertaken for the Australasian Council of Auditors General in 2009 ranked Tasmania's Audit Office third (out of ten, including the Australian and New Zealand Audit Offices as well as those of the other states and territories). Tasmania's Audit Office retained this ranking in the 2013 survey, but slipped to fifth in the most recent survey conducted in 2020, as a result of significant enhancements to the independence of the Audit Offices in Queensland and the ACT (Robertson 2020:11).

Disconcertingly, the Tasmanian Auditor-General formally advised the Review that "if the study was to be repeated in 2024 it is likely, that due to advances in other jurisdictions, the TAO would now be ranked 7th or 8th"[8].

The Review therefore recommends that the Parliamentary Public Accounts Committee investigate and report on how the Tasmanian Audit Office's independence can be brought into line with 'best practice' in other Australian jurisdictions.

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[8] Correspondence from Martin Thompson, Auditor-General, 12th June 2024.

Recommendations of this Chapter

The Review makes the following recommendations:

9. The Department of Treasury and Finance (with the support of the Government) should adopt a more ambitious description of its role, emphasizing its function as the principal economic and financial advisor to the Tasmanian Government and manager of the Government's assets and liabilities.

10. The Government should allocate more resources to the Department of Treasury and Finance so that it can more adequately monitor, analyse, forecast and report on developments in the Tasmanian economy, defend and advance Tasmania's interests with regard to federal-state financial relations, and assess the costs and benefits of infrastructure spending proposals.

11. The Government should establish a Review and Evaluation Unit as recommended by the Watt Review of the Tasmanian State Service, but consider locating in the Department of Treasury and Finance rather than Premier and Cabinet.

12. The Government should make greater use of secondments of staff between the Department of Treasury and Finance and its counterparts in other jurisdictions in order to strengthen its analytical and advisory capabilities.

13. The Department of Treasury and Finance should collaborate more closely with the Tasmanian School of Business and Economics to develop a greater capacity to understand and analyse developments in the Tasmanian economy and to produce graduates with knowledge and skills required by the Department of Treasury and Finance and other parts of the Tasmanian State Service.

14. The Department of Treasury and Finance should provide a more thorough and detailed analysis of, and forecasts for, the Tasmanian economy in the annual *Budget Paper No. 1*.

15. Tasmanian Budget Papers and Financial Reports should continue to show details of one-off Federal Government grants for capital purposes and the 'underlying' net operating balance.

16. The *Treasurer's Annual Financial Report* should include a breakdown of the difference between the final outcome for the net operating and fiscal balances for the financial year, and the Forward Estimates for that year presented in the preceding Budget, into 'policy decisions' and 'parameter variations'.

17. The annual *Budget Paper No. 1*, and the *Revised Estimates Report*, should include, in addition to the Forward Estimates for the budget year and the following three years, 10-year projections of the net operating balance, the fiscal balance, the cash balance, net debt and net financial liabilities for at least the general government sector and, if possible, other constituents of the state public sector.

18. The annual *Budget Paper No. 1* should include long-term historical time series on operating expenses and revenues, the net operating balance, the fiscal balance,

the cash balance, net debt and net financial liabilities for the general government sector and the other constituents of the state public sector.

19. The Department of Treasury and Finance should publish the tables presented in *Budget Paper No. 1* and in the *Revised Estimates Report*, and the data behind the charts presented in those documents, in downloadable excel spreadsheet form on its website.
20. *Budget Paper No.* 1 should include a more detailed Statement of Risks, with greater effort to quantify those risks where possible.
21. The *Preliminary Financial Outcomes Report* should be discontinued.
22. The *Revised Estimates Report* should be published in December (or earlier) each year, in line with the practice of other states and territories.
23. The *Charter of Budget Responsibility Act 2007* should be amended to remove the requirement that political parties provide "fiscal objectives and targets for the budget year and the following three financial years", and to require instead political parties to indicate how they propose to pay for their expenditure or revenue commitments, or (alternatively) to state explicitly that they will pay for those commitments by running smaller budget surpluses or larger deficits.
24. The *Charter of Budget Responsibility Act 2007* should be further amended to require political parties to issue their fiscal strategy and costings at least nine days before polling day, and that those fiscal strategies should be consistent with the objectives agreed to by the Parliament in accordance with Recommendation 1 (in Chapter 6).
25. The Parliament should establish a Parliamentary Budget Office to provide independent advice on budgetary and fiscal issues, including costings of policy options, to Members of Parliament.
26. The Parliamentary Public Accounts Committee should investigate and report on how to enhance the independence of the Tasmanian Audit Office in order to bring it into line with 'best practice' in other jurisdictions.

Chapter 8: Conclusion

This Review has sought to demonstrate the importance of the condition of Tasmania's public sector to the health of the Tasmanian economy and the well-being of Tasmanians.

It has shown that Tasmania's state public sector finances have for some time been heading in an unsustainable direction, starting before but exacerbated by the Covid-19 pandemic, and continuing in that direction after the pandemic had receded.

It has shown that this state of affairs is not, primarily, the result of factors beyond the control of any Tasmanian Government (other than the pandemic), and in particular not the result of adverse economic trends or decisions by the national government – but , rather, the result of conscious decisions by government to spend money on the provision of services and infrastructure without making commensurate decisions as to how that spending should be paid for.

It has shown that, in the absence of significant corrective actions (to arrest and reverse the trends of the past decade), Tasmania's public sector finances will become 'unsustainable', by any definition of that term, with potentially severe consequences for the capacity of the State Government to provide the services and infrastructure which the Tasmanian people expect of their state government.

It has recommended a series of actions which the Government should consider in order to restore Tasmania's state finances to a sustainable condition.

And it has recommended a series of changes to the institutions and rules for managing Tasmania's finances in order to ensure that, once restored to a sustainable condition, they are maintained in that condition.

The Review is under no illusions that this task is easy.

It will require time – more time than the conventional electoral cycle – which in turn means that it will require multi-partisan support for the objectives of returning to a sustainable fiscal position, even if there are (as is inevitable, indeed in most instances desirable, in a democracy) differences of opinion as to how those objectives should be achieved). It will require commitment and discipline on the part of those constituting the government, and a preparedness to avoid short-termism and gimmickry on the part of those aspiring to be in government. It will require the expenditure of a considerable amount of 'political capital'. It will require widespread public understanding, which will in turn require considerable effort to explain what needs to be done, and why it needs to be done.

The Review hopes that its findings and recommendations will assist in meeting those requirements.

Appendix 1: Terms of Reference

The Review shall investigate and report upon:

1) Updated forward estimates of the financial statements for the financial years ended 30th June 2024 through 2028, for the general government, public non-financial corporations, and public financial corporations sectors, and for the non-financial public sector and public sector as a whole, in the format presented in the annual Budget Papers and in the Treasurer's Annual Financial Reports, incorporating any and all information which has become available to the Department of Treasury and Finance since the publication of the Pre-Election Economic and Fiscal Outlook on 29th February 2024 and the cost of the election commitments made by the Government between the prorogation of the previous Parliament and the 23rd March 2024;

2) Longer-term projections of the principal fiscal aggregates for the general government, public non-financial corporations, and public financial corporations sectors, and for the non-financial public sector and public sector as a whole, including in particular revenue and expenses (including interest and superannuation expenses), net operating balance, purchases and sales of non-financial assets, fiscal balance, net debt, net financial liabilities, net worth, and cash flows, for each of the financial years out to at least that ending 30th June 2035;

3) Longer-term projections out to the financial year ended 30th June 2035 of each of the estimates listed in Chapter 3: Fiscal Strategy of *2023-24 Budget Paper No. 1*, as fiscal strategy targets;

4) The risks to Tasmania's financial position, and in particular to the fiscal strategy targets articulated in Chapter 3 of 2023-24 *Budget Paper No. 1*, of:

    a. the scheduled expiry of the 'No Worse Off Guarantee' of Tasmania's share of Goods and Services Tax (GST) revenues at the end of the 2029-30 financial year,

    b. a fall in commodity prices such as would result in a decline in Tasmania's share of GST revenues,

    c. Tasmania's prospective demographic profile, and

    d. alternative scenarios for population and economic growth from those used in RER and PEFO;

5) Any changes that should be made to the presentation of financial, economic or other information and analysis in the annual Budget Papers, Revised Estimates Report, and Treasurer's Annual Financial Report;

6) Options for remedying Tasmania's financial position to the extent indicated as necessary by the Review's findings in response to these Terms of Reference.

7) Any other matters which the Review considers to be relevant.

The Department of Treasury and Finance will cooperate with the Independent Reviewer in providing all available information relevant to the Terms of Reference when requested in writing to the Secretary of Treasury. This information will be provided within reasonable timeframes.

Subject to the foregoing Terms of Reference:

a. No information to be included in the 2024-25 Budget will be provided until the tabling of the 2024-25 Budget by the Treasurer in Parliament.

b. Any Cabinet information or internal working documents that relate to policy changes used to inform the preparation of the 2024-25 Budget held by Treasury will not be available at any time.

c. In addition, any information included in other financial reports prepared during the Review period will not be made available in advance of publication.

Appendix 2: Acknowledgements

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Dr Lisa Denny, Workplace Demographer
Mr Kim Evans, former Secretary, Tasmanian Department of State Growth
Mr Tony Ferrall, former Secretary, Tasmanian Department of Treasury and Finance
Mr Martin Foo, Director, Sovereign and International Public Finance, S&P Global Ratings
Mr Martyn Goddard, public policy analyst
Ms Natalie Horvat, First Assistant Secretary, Commonwealth-State and Population Division, Australian Treasury
Mr Greg Johannes, former Secretary, Tasmanian Department of Premier and Cabinet
Mr John Lawrence, economist and public policy researcher
Mr John Manning, Senior Credit Officer, Moody's
Mr Rob Nichol, former Deputy Secretary, Tasmanian Department of Treasury and Finance and former CEO, Australian Office of Financial Management
Dr Martin Parkinson AC PSM, former Secretary, Australian Treasury and Australian Department of Prime Minister and Cabinet
Mr Xavier Rimmer, Victorian Parliamentary Budget Officer
Mr Jonathan Rollings, Secretary, Commonwealth Grants Commission
Dr Mike Vertigan AC, former Secretary, Tasmanian and Victorian Departments of Treasury and Finance
Mr Anthony Walker, Director, Sovereign and International Public Finance, S&P Global Ratings
Mr Martin Wallace, former Secretary, Tasmanian Department of Treasury and Finance
Dr Ian Watt AC, former Secretary, Australian Department of Prime Minister and Cabinet
Mr Peter Woolcott AO, former Australian Public Service Commissioner, Australian Ambassador to Italy and Australian High Commissioner to New Zealand

None of the above persons has been quoted directly in this report, and none bear any responsibility for any of the contents of this report, which rests solely with the author.

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Important notice