

Senate Select Committee on State Government Financial Management

Submission of the Tasmanian Liberal Opposition

April 2008



Terms of Reference

Commonwealth and State and Territory fiscal relations and State and Territory Government financial management, including:

- a) Commonwealth funding to the State and Territories – historic, current and projected;
- b) The cash and fiscal budgetary positions of state and territory governments – historic, current and projected;
- c) The level of debt of state/territory government business enterprises and utilities – historic, current and projected;
- d) The level of borrowing by State/Territory Governments – historic, current and projected;
- e) An examination of State/Territory net Government debt and its projected level;
- f) The reasons for any Government debt including an analysis of the level and efficiency of revenue and spending;
- g) The level of investment in infrastructure and State-owned utilities by State and Territory Governments;
- h) The effect of dividends paid by State-owned utilities on their ability to invest
- i) Present and future ownership structures of current and former State-owned utilities and the impact of ownership on investment capacity; and
- j) The effect of investment by State-owned utilities on Australia's capacity constraints.

Summary

Tasmanian State Government revenue is dominated by Federal sources, which comprise 64% of total revenue, with 44% of total revenue being the Goods and Services Tax (GST). State taxes make up only 20% of total revenue and should be reviewed to ensure they are efficient, equitable and capable of addressing the challenges of demographic change.

The State Government has used the Superannuation Provision Account to hide \$1.17 billion of State debt and yet claims to be free of 'net debt'. Net Financial Liability is a more reliable measure than 'Net Debt' as it includes Tasmania's massive unfunded superannuation liability. Off-balance-sheet funding of the Basslink project through a lease means that this obligation is not recognised in either 'Net Debt' or 'Net Financial Liability' measures.

Improvement in operating balance and fiscal balance projections from the December Mid-Year review means that the Tasmanian State Government has the capacity to better invest in infrastructure. However, the Government has demonstrated on numerous occasions the inability to deliver vital infrastructure. The State Opposition contends that infrastructure is a joint responsibility of both the State and Federal Governments.

Capacity constraints are now a major factor in the Australian economy, placing pressure on inflation and interest rates. The key to addressing such pressures is improving efficiency and delivering infrastructure that improves productivity across the economy. Inefficient investment that simply increases aggregate demand will only aggravate capacity constraints.

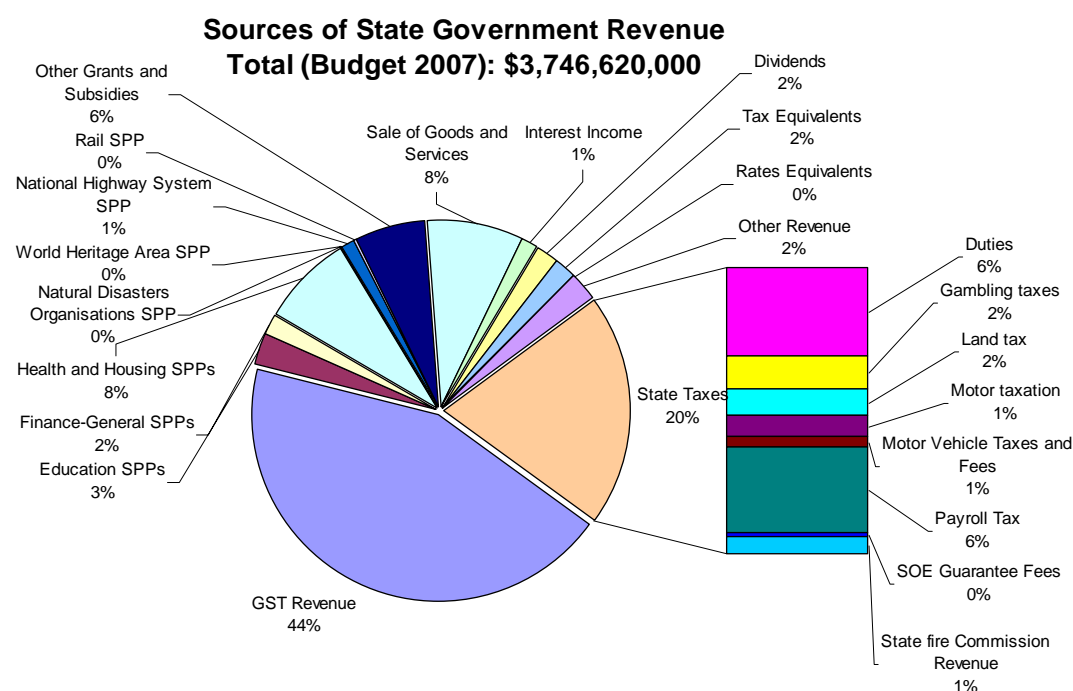
1. Revenue Sustainability

The State Government's revenue base is substantially dependent on Federal transfers, principally the GST.

The State revenue base appears to be inequitable and poorly suited to responding to the demands of demographic change. The State Opposition has proposed a Tax Summit to identify opportunities for Tax Reform that would have the effect of improving long-run economic growth and equity.

Regressive State measures for raising revenue include taxation by stealth through State-owned enterprises, ambulance fees and levies.

Chart 1.1 Sources of Tasmanian State Government Revenue, Budget 2007-08



Source: Tasmanian State Government Budget Paper No.1 2007-08 Section 4. Revenue and Expense Estimates

Chart 1.1 shows the sources of Tasmanian Government revenue for the 2007-08 budget. The State Opposition presents the information in this fashion to show how each individual component contributes to the whole.

From Chart 1.1 we can see that the most significant sources of revenue are the GST (44%), specific purpose payments for health and housing (6%), sales of goods and services (8%), payroll tax (6%) and duties (6%). Together these sources represent 70% of total State revenue. One might also include 'Other Grants and Subsidies' at 6%, but a significant portion of these funds is actually for on-payment to other organisations on behalf of the Federal Government. Federal payments represent 64% of revenue.

Issues raised by constituents and key stakeholder groups in relation to State Taxes include:

Payroll tax affects large employers, many of whom face the brunt of international competition associated with globalisation, and whose departure would result in significant negative 'multiplier' effects on the rest of the economy. While the Treasury disproportionately taxes these major employers, the Department of Economic Development spends significant time and money trying to attract or keep them in Tasmania.

Land Tax exempts owner-occupiers and farmers, hence it raises the costs for businesses and landlords and increases rents. It is a tax that is effectively paid by lower income renters, rather than owner-occupiers, which compounds the housing affordability crisis.

Duties revenue is particularly focused on conveyancing of property. It arises only when people engage in transactions – common either with bumper revenues in a boom, or a significant decline during a recession. Duty on property increases the costs for first home buyers entering the market. They also make it more expensive for families to move in response to changing employment opportunities or changes in economic or family circumstances. Duties discourage the efficient allocation of economic resources.

Gambling Taxes are paid on betting exchanges, gaming machines and lotteries. While they represent a voluntary activity, Government revenue is often being collected from gambling addicts and their families at significant social cost. As gambling taxes rise in their importance to State coffers, the Government's ability to regulate the industry for the social good is arguably compromised.

Other taxes such as motor taxation, vehicle fees and Fire Services Levy may be broadly considered efficient. This has simply allowed the State Government to increase these charges, in an example of the leviathan theory of government taxation, whereby the more efficient a source of taxation revenue, the more it will be abused by a 'tax and spend' government.

With the prospect of demographic change impacting Tasmania before the rest of the country it is important that the State's tax base is re-examined and rebalanced to improve economic efficiency and equity.

Ambulance Levy

As part of the 2007-08 State Budget, the Government flagged the introduction of ambulance service charges. Tasmania's ambulance service is currently free to users. The State Government is proposing a significant insurance fee. This is iniquitous at a number of levels.

Due to their higher use of ambulances, older Tasmanians who have already contributed to the cost of services throughout their lives will pay significantly higher insurance premiums than younger Tasmanians. Given the strain this will place on retirees in conjunction with other increased charges and prices for necessities, this is unfair. If retirees do not take out insurance, then the cost of more frequent ambulance call-outs will cause considerable financial stress.

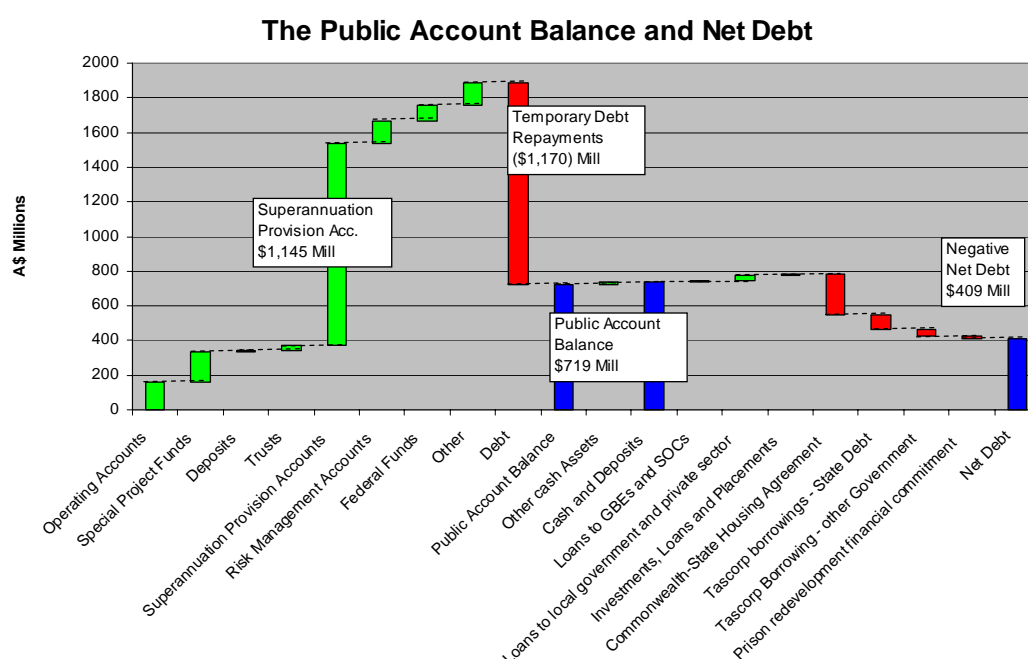
While wealthy persons are likely to take out insurance, those who cannot afford to do so will not. It is, therefore, those with limited disposable income who are more likely to face the high direct cost of ambulance charging, increasing their stress at a time of need. If the expectation is that the majority will insure, then the main impact is not an efficient use of services, but indirect taxation. The direct burden falls disproportionately on the poor who are uninsured - an iniquitous outcome. This is clearly an example of a bad user-pays system and the State Opposition is heartened that the Labor State Government is reconsidering it in the face of community opposition.

2. The Abuse of 'Net Debt'

Co-mingling of the Superannuation Provision Account

The 'Net Debt', 'Net Operating Balance' and 'Fiscal Balance' are measures developed in accordance with Uniform Government Reporting on an 'accrual basis'. The other accounting system used by the State Government is the 'Consolidated Fund' estimates and the Public Account. The Consolidated Fund is the main source of funds for Government expenditure and the fund into which State taxation revenue, and most Commonwealth payments, are paid. It is accounted for on a cash basis, similar to a bank account.

Chart 1.2 The Public Account Balance and Net Debt



Source: Tasmanian Department of Treasury and Finance, Treasurer's Annual Financial Report 2006-07

As the Consolidated Fund is accounted for on a cash basis, as are the many off-shoots accounts, it can be difficult to reconcile with measures of performance in the Uniform Government Reporting standard. When queried on various inconsistencies during the Budget Estimates, the Secretary of the Tasmanian

Treasury, Mr Don Challen made the following statement in response to a question from the Leader of the State Opposition:

Mr Challen "We have not had a chance to deal with that issue that you raised earlier. But it is going to be the same issue. The Consolidated Fund numbers are metered on a cash basis. All the other numbers in the budget papers are measured on an accrual basis. So the expenditure numbers outside that Consolidated Fund table are going to be on the basis of expenses or capital as accrued during the year and the consolidated fund ones are going to be on a cash basis. So they will rarely be directly comparable. They are not intended to be. In fact, the reason we have relegated the Consolidated Fund to an appendix this year is that we are trying to send the message that it is not terribly important anymore. It is mainly for compliance purposes that we are providing those numbers. This is the story on an accrual basis that we should be focusing on."

Source: Parliamentary Hansard Estimates Committee B (Aird) Thursday 21st June 2007

A little later in Hansard, the Secretary describes the consolidated fund accounting measure as 'archaic.'

The problems associated with the Public Account Balance can be seen clearly in Chart 1.2. The State Government claims to have a negative net debt of \$409 million, and borrowings of only \$135 million associated with Tascorp and Advances received of \$242 million (a debt associated with the State-Commonwealth Housing Agreement). This fails to recognise the \$1.17 billion of debt that is hidden in the Public Accounts.

The Public Accounts are formed by the operating balances of various departments, special project funds, deposits, trust and other accounts. The largest account by far is the Superannuation Provision Account of \$1.145 billion which has supposedly been established to cover some of the State's \$3.67 billion in unfunded superannuation liabilities. As can be seen in Chart 1.2, the \$1.145 billion supposedly put aside to cover public servants' superannuation liability does *not actually exist*. It is an accounting device that is exactly cancelled by the \$1.17 billion of debt that the government does not acknowledge. The remaining funds are in fact the necessary working capital to fund government departments operating accounts or are special trust and other funds with already allocated purposes.

In response to the obvious concern that should exist with respect to the State Labor Government's accounting for superannuation, the State Opposition has proposed the establishment of a 'Tasmanian Future Fund' so that the superannuation liability can be funded in a transparent fashion. This would also obtain a higher rate of return than that implicit in relending the money straight back to the government.

The State Government has utilised the Consolidated Fund and associated accounting to mislead the public with respect to its financial promises and performance.

During the 2006 Tasmanian State election, Labor promised to maintain the budget in surplus. However, at the following Budget it delivered a fiscal deficit of \$84 million, claiming that its promise only related to the Consolidated Fund, where it said there was a surplus of \$3.8 million. Labor also promised in this same speech that the unfunded superannuation liability would be extinguished by 2033.¹ Given the doubts as to whether these provisions actually exist as accessible financial assets, such a claim is questionable.

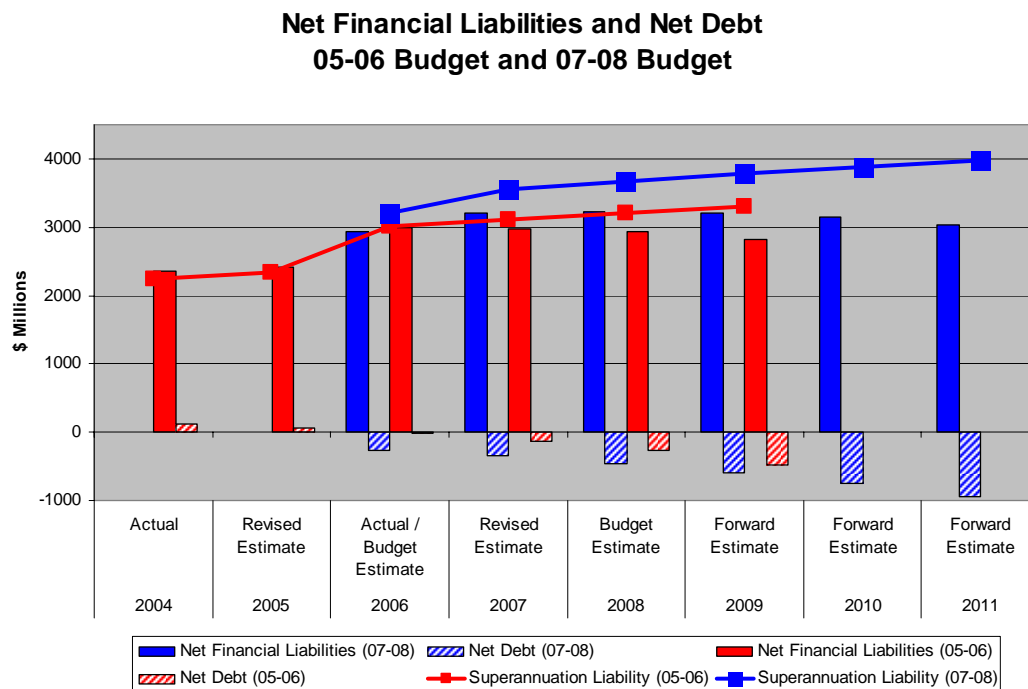
The Government continues to mislead the public on its management of the superannuation provisions. In response to a question on the State's superannuation liability by the Leader of the State Opposition, the Premier claimed that 'the State Labor Government has paid off every cent of debt' AND 'We set an aggressive target to cover off all the unfunded liability of superannuation'.ⁱⁱ What can be seen in Chart 1.2, is that either, but not both, statements can be correct.

The Special Capital Investment Funds are a part of the Public Account (noted as Special Project Funds) in Chart 1.2 and are part of Tasmanian Labor's public accounting under which funds can be transferred from the 'archaic' and 'not terribly important' Consolidated Fund accounting system to offset deficits on the UPF Fiscal Balance. An example of this accounting fraud is that while the Government ran a fiscal deficit in the 2006-07 Budget of \$84.5 million, in the same year it transferred \$33.5 million into the Economic and Social Infrastructure Fund that would then be used to 'offset' the Fiscal Deficit of \$31.4 million in the 2007-08 Budget.ⁱⁱⁱ

Net Financial Liabilities the appropriate measure

Given the extent of the Government superannuation liability and its tendency to misrepresent its position, the State's financial position can be better considered in the context of 'Net Financial Liabilities' which bring together the Net Debt and the superannuation liability.

Chart 1.3 Net Financial Liabilities and Net Debt – General Government



Source: Source: Tasmanian State Government Budget Paper No.1 2007-08, Tasmanian, Tasmanian State Government Budget Paper No.1 2005-06, Table A1.2

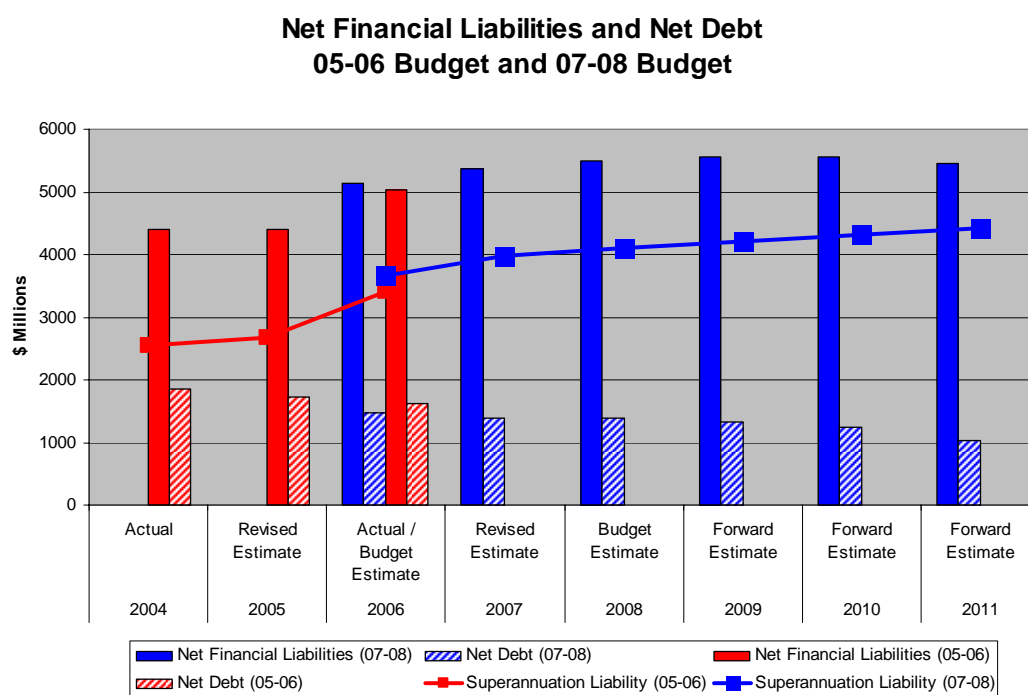
Chart 1.3 shows the evolution of the Net Financial Liabilities for the State of Tasmania, comparing the 2005-06 Budget Papers and 2007-08 Budget Papers. It can be seen that the State's unfunded

superannuation liability has grown significantly larger than first forecast, with a subsequent worsening of the State's net financial liability. The State's net debt position has improved beyond that forecast in 2005-06. Currently the outlook for Net Financial Liabilities is stable, indicating a balance between the increase in the negative net debt and the growth of the superannuation liability. The net financial liability is forecast to decline in the 2010 and 2011 forward estimates.

Prudent financial management requires a plan to bring the Net Financial Liabilities to zero.

The Government also has the capacity to distort the picture of its financial performance by requiring excessive payments from State -owned enterprises, which then borrow to fund necessary investments. A hint of this is provided by Chart 1.4 which presents the same information shown Chart 1.3, but for the total non-financial public sector, that is the general Government plus Government business enterprises and State -owned corporations.

Chart 1.4 Net Financial Liabilities and Net Debt – Total Non-Financial Public Sector



Source: Source: Tasmanian State Government Budget Paper No.1 2007-08, Tasmanian, Tasmanian State Government Budget Paper No.1 2005-06, Table A1.8

From this perspective it can be seen that the Government is definitely not 'net debt' free and its net financial liabilities stand at over \$5 billion, growing to \$5.5 billion in the 2008 to 2010 forward estimate period. 'Net Debt' is forecast to decline, with the positive 'net debt' offsetting the growth of borrowing amongst public non-financial corporations.

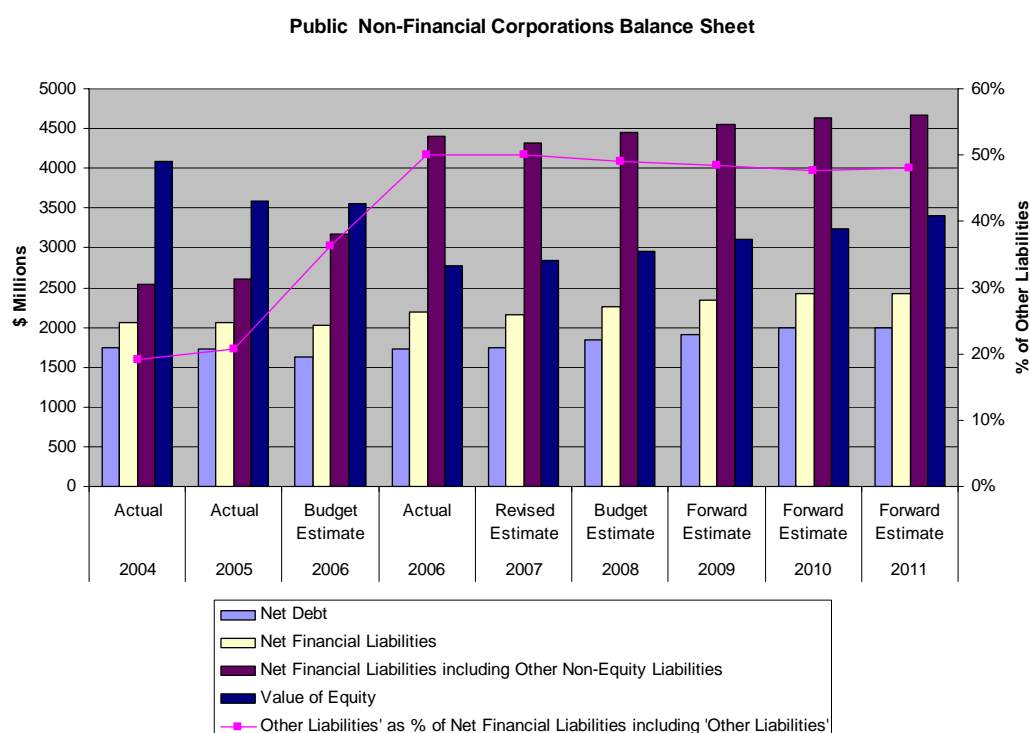
This may not be the complete picture, as the measure of 'net financial liability' does not include non-equity liabilities that State-owned enterprise may incur as a substitute for borrowing.

An incomplete picture is also presented by the identification on the State government balance sheet of liabilities associated with the Commonwealth-State Housing Agreement. Each year the Commonwealth Government provides the State Government with a specific purpose payment relating to the agreement.^{iv} The State Government then incorporates this payment as part of its housing capital allocation as 'capital expenditure' on public housing, but which is in fact repaid to the Commonwealth.^v This adds to a lack of transparency in an already woeful performance by the State Government on addressing the public housing crisis.

Off-Balance Sheet Financing of State-owned Corporations

The use of off-balance sheet financing mechanisms has been used to create a deceptive picture of the state of net debt and the net financial liabilities of the Public Non-Financial Corporation Sector. The main off-balance sheet transaction of note is the lease used to finance the Basslink electricity inter-connector.

Chart 1.5 Balance Sheet Measures for Public Non-Financial Corporations



Source: Tasmanian State Government Budget Paper No.1 2007-08, Tasmanian State Government Budget Paper No.1 2006-07, Tasmanian State Government Budget Paper No.1 2005-06, Table A1.5

In Chart 1.5 above one can see the 'standard' measures of indebtedness, Net Debt and Net Financial Liabilities (the former is borrowings less liquid financial assets, while the latter includes superannuation liabilities). These appear fairly stable over time. However viewing the value of 'Shares and Other Contributed Capital' which represents the value of the public non-financial corporations there has been a significant destruction of value (the value of assets has increased year by year). The answer lies in

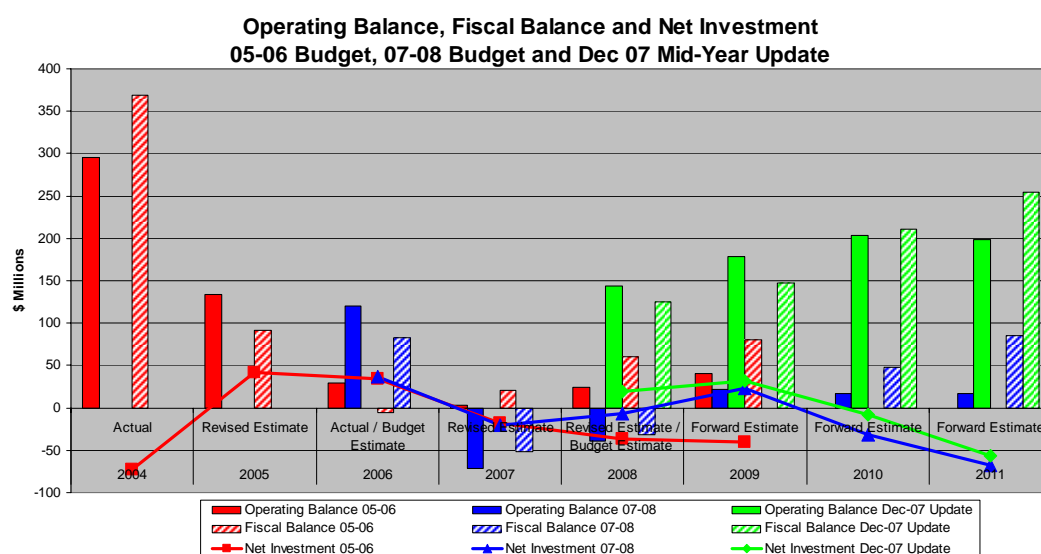
including 'Other Liabilities' in the Net Financial Liabilities measure, where the fall in the value of equity is matched by the rise in this liability measure.

3. Infrastructure Investment

There are two key operating performance measures included in the Uniform Presentation Framework (UPF). The first is the Operating Balance which reports government income and expenditure on an accrual basis and may be seen as akin to the operating profit of a company. It indicates the long-run sustainability of the governments operations. The second key measure is the Fiscal Balance which takes the operating balance and adjusts for the net-acquisition of non-financial assets, namely investment (purchase of non-financial assets) and depreciation. It indicates the long-run sustainability of government operations including a level of increased investment in infrastructure.

The difference between the two measures provides an indicator of the extent to which Government investment exceeds depreciation (Net Investment).

Chart 1.6 Operating Balance, Fiscal Balance and Net Investment for Tasmanian General Government – budget 05-06 and Budget 07-08



Source: Source: Source: Tasmanian State Government Budget Paper No. 1 2007-08, Tasmanian, Tasmanian State Government Budget Paper No. 1 2005-06, Table A1.1, Tasmanian Treasury Mid-Year Financial Report As At 31st Dec 2007.

Chart 1.6 above shows the Operating Balance, Fiscal Balance and Net Investment from the 05-06 Budget (in red), the 07-08 Budget (in blue) and the latest updated estimates in green. It can be seen that the Tasmanian Government had a 'bumper' year in 2004 on the back of the GST revenue windfall. However Net Investment in 2004 was negative, implying a decline in the State's asset and infrastructure base. Net investment improved in 2005 and 2006 but has declined since then, with a significant deficit in net investment predicted for 2010 and 2011.

The revised estimates from December 2007 show an improvement in the State's revenue of around \$245 million on average through the estimates period (based on the Policy and Parameter Statement in

the Mid-Year Update). This improvement is due to increased duties (particularly conveyancing), payroll tax, interest income, Commonwealth income (including GST and Health Grants) and Agency revenue, including user fees for the Department of Health and Human Services. This represents a gain of nearly \$1 billion in forward estimates over the previous Budget.

Part of this increase may derive from inflation. It should be noted that the economic estimates reduced expected real economic growth and increased the forecast CPI adjustment. As inflation occurs, government receipts increase thanks to GST taxation on higher prices, payroll tax on higher wages, and duties on higher property values. A substantial component of the inflation of property prices has already occurred. If inflationary, a significant part of increased revenue may be absorbed by increasing costs. From a policy perspective it is advisable for governments to run higher surpluses during periods of inflation to create a fiscal brake on continuing price increases.

The increase in expected finances has significantly improved the *capacity* of the Tasmanian State Government. The key challenge is to invest effectively to improve productivity.

The Blame Game

In Tasmania, there is a litany of examples of poorly prioritised funding despite ample resources, and plenty of crying poor on core responsibilities.

Macquarie Island – The removal of feral cats on Macquarie Island resulted in an explosion of the rabbit population with significant impacts on the environment, particularly erosion damage and further endangering threatened species. Rather than address the issue, the State Government grandstanded for Federal Government funding. Then Environment Minister Malcolm Turnbull indicated that the Federal Government would be prepared to pay for half the eradication cost, but again the State Government postured, enabling opportunities for low cost early action to pass. Eventually the State Government agreed to a joint funding proposal in June 2007, but only under pressure from organisations such as the World Wildlife Fund and creating significant delays which will result in increased damage to the environment.

Kingston Bypass – The importance of the Kingston Bypass to enable continued growth of the Kingborough Municipality was acknowledged by the Government in October 2004. As part of the 2006 State Election the Government only promised to pay half of the cost, despite it being clearly a State road. While both Federal parties have undertaken to provide funding as part of the 2007 Federal Election, the State Government had already pushed back its main commitment to spending beyond 2009-10. Delays on the Kingston Bypass increase costs to the community and aggravate capacity constraints in the economy.

Bridgewater Bridge – the Bridgewater Bridge is an important link which provides access from Hobart to the rest of the State. The State Government, while acknowledging the dilapidation of the bridge first dithered in seeking funding assistance, and when assistance of over \$100 million was made available in the May 2004 Federal Budget, the State Government continued to prevaricate. It later decided that the bridge was no longer a priority, despite the fact that by 2006, safety issues on the bridge were resulting in closures and major disruptions. In the 2007 election, the Federal Liberal Government again offered to

fund the bridge. The funding proposal is now in danger of being axed by the new Federal Labor government's cost cutting drive.

The solution to this problem is not more Federal Government intervention or over-lap in responsibilities. Instead, an option to consider might be an independent arbitrator on State-Federal fiscal responsibilities that can make firm recommendations on where fiscal responsibility lies for a particular project. This recommendation should be on the basis of improving productivity, legislative obligations, clear and consistent lines of responsibility as well as some reference to fiscal capacity. Recommendations may not be binding, but would short-circuit the politics of blame shifting.

In general, State roads should be a State responsibility and national roads should be a national responsibility. However, the continued failure by the State Government to address its core responsibilities remains a fundamental problem. It has the funds but lacks the will to act. This explains why State Roads only received a C grade in the 2005 Tasmanian Infrastructure Report Card.

Conclusion

After 10 years in office, the State Labor Government has not achieved key priorities it set for itself, including a water development plan, a commitment to 'drought proof' Tasmania in 1998 (which received a *D* in the 2005 infrastructure report card) protection of children and addressing the public housing crisis. Further, hospital waiting lists have skyrocketed and education standards have slipped.

However, the worst excess of mismanagement is a lack of transparency. The community's trust in government has been shattered during Labor's ten-year reign. To protect the integrity of Federal funding as well as the delivery of services and infrastructure to the Tasmanian community, the State Opposition will continue to call for the creation of an independent, anti-corruption authority, a Parliamentary Standards Commissioner and ensure the Ministerial Code of Conduct is both adequate and enforced.

i 2006-07 BUDGET SPEECH 'Strong Economy. Strong Communities' by the Treasurer, Hon. Michael Aird MLC delivered in the House of Assembly on 15 June 2006.

ii Hansard Wednesday 13th June 10.16 am

iii Refer 2006-07 Treasurer's Annual Financial Report Statement 8 p69 and Budget Paper 1 2007-08 Table 4.2 p 4.4.

iv Refer Tasmanian State Government Budget Papers 1 2007-08, Table 4.3 Housing.

v Refer Tasmanian State Government Budget Papers 1 2007-08, Table 7.4 CSHA Principal Repayment.