2020 (No. 32)

PARLIAMENTARY STANDING COMMITTEE OF PUBLIC ACCOUNTS

REVIEW OF TASMANIAN GOVERNMENT FISCAL SUSTAINABILITY REPORT 2016

MEMBERS OF THE COMMITTEE

LEGISLATIVE COUNCIL

Hon Ivan Dean MLC (Chair)

Hon Ruth Forrest MLC
(Deputy Chair)

Hon Josh Willie MLC
(from 28 May 2019)

Hon Michael Gaffney MLC
(to 23 May2019)

HOUSE OF ASSEMBLY

Mr David O'Byrne MP
(from 24 September 2019)

Mrs Joan Rylah MP
(from 19 March 2019 to 27 July 2020)

Mr John Tucker MP
(from 19 March 2019)

Mr Adam Brooks MP
(to 11 February 2019)

Mr Rene Hidding MP
(to 25 February 2019)

Mr Scott Bacon MP
(to 22 August 2019)

Mr Nic Street
(from 26 August 2020)

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Charter of the Committee

The Public Accounts Committee (the Committee) is a Joint Standing Committee of the Tasmanian Parliament constituted under the *Public Accounts Committee Act 1970*.

The Committee comprises six Members of Parliament, three Members drawn from the Legislative Council and three Members from the House of Assembly.

Under section 6 of the *Public Accounts Committee Act 1970* the Committee:

- must inquire into, consider and report to the Parliament on any matter referred to the Committee by either House relating to the management, administration or use of public sector finances; or the accounts of any public authority or other organisation controlled by the State or in which the State has an interest; and

- may inquire into, consider and report to the Parliament on any matter arising in connection with public sector finances that the Committee considers appropriate; and any matter referred to the Committee by the Auditor-General.

Chair Foreword

In September 2018, the Committee commenced this Inquiry in order to review the *Tasmanian Government Fiscal Sustainability Report 2016* to assess how Tasmania was performing against the projections in the Report, whether the Report took a broad enough approach and whether the Report conveyed information effectively as required under Section 14(a) of the *Charter of Budget Responsibility Act 2007.*

As part of the Inquiry, the Committee sought information from the Treasurer and the Secretary of the Department of Treasury and Finance.

During the Inquiry, the Committee asked the Department to provide an explanation of the rationale for using the model used to measure the primary balance. The Committee also asked the Department to provide revised primary balance projections that excluded the impact of capital expenditure underspend on the primary balance for 2017-18.

In responding, the Department advised that it had examined the financial model and identified inconsistencies in the model's structure, primarily relating to public sector superannuation costs.

The Department consequently released an updated *Tasmanian Fiscal Sustainability Report 2019* and updated the Committee on the revised Report.

In 2020, the economic impact of the COVID-19 pandemic has significantly changed Tasmania's fiscal outlook to the extent that the Committee believes it is difficult to assess the State's performance against the projections, scenarios and assumptions made in the Report.

The Committee thanks the Secretary of the Department of Treasury and Finance and Department staff who provided information to the Inquiry. The Committee looks forward to receiving an update in the form of the *Tasmanian Fiscal Sustainability Report 2021.*

FINDINGS

ToR 1

1. Due to the significant changes in Tasmania's fiscal outlook due to COVID-19, it is no longer possible to accurately assess how the State is performing against projections, scenarios and assumptions made in the 2016 and 2019 Reports.

ToR 2

2. Due to the significant changes in Tasmania's fiscal outlook due to COVID-19, it is no longer possible to assess whether the 2016 and 2019 Reports consider the long-term outlook and a broad enough range of challenges and opportunities for the Government's finances over the long-term.
3. The Secretary acknowledged the Report shows that health expenditure growth is outpacing revenue growth which is putting further pressure on the State's fiscal position going forward.

ToR 3

4. Despite improvements, the Fiscal and Sustainability Report remains difficult to understand and doesn't meet the intended and desired outcome.

1 INTRODUCTION AND CONDUCT OF REVIEW

1.1 On 26 September 2018 the Committee resolved of its own motion to initiate an inquiry to review the *Tasmanian Government Fiscal Sustainability Report 2016*.

TERMS OF REFERENCE

1.2 The Committee's terms of reference are:

To inquire and report upon Tasmanian Government Fiscal Sustainability Report 2016 in particular:

1. How the State is performing against projections, scenarios and assumptions made in the report;
2. Whether the report considers the long-term outlook and a broad enough range of challenges and opportunities for the Government's finances over the long-term; and
3. Whether the report communicates its findings in an understandable, informative and useful way.

CONDUCT OF THE REVIEW

1.3 On 1 October 2018 the Committee wrote to the Treasurer and the Secretary of the Department of Treasury and Finance (the Department) to invite submissions to the Inquiry.

1.4 On 18 October 2018 the Treasurer advised the *Charter of Budget Responsibility Act 2007* places responsibility on the Secretary of the Department to determine the content and scope of the Report and Government has no role in the preparation of it.

1.5 In light of this the Treasurer did not consider it appropriate to provide a submission but did offer to attend a public hearing scheduled 19 November 2018.

1.6 Noting the Treasurer's advice regarding the responsibility of the Department, the Committee advised the Treasurer that it would limit its discussions to be with the Department and therefore his offer of attendance in November 2018 was not necessary.

1.7 The Department submission was received 31 October 2018.

1.8 The Department attended a public hearing 19 November 2018 in Hobart.

1.9 Questions on Notice were provided to the Department 20 November 2018.

1.10 The Department response was received 6 December2018.

1.11 The Department advised "*in examining the financial model to prepare responses to the Committee's questions, the Department of Treasury and Finance has identified some inconsistencies in the structure of the model. These primarily relate to the treatment of public sector superannuation costs*."

1.12 The Department determined it "*would prepare a new fiscal sustainability report following the 2019-20 State Budget, to include all economic, demographic and fiscal information available at that time and which may contain some changes to the treatment of equity contributions from the General Government Sector."*

1.13 Parliament was prorogued on 27 February 2019.

1.14 The second session of the Parliament commenced 19 March 2019 and Members of the House of Assembly and Legislative Council were appointed to the Committee.

1.15 On 8 October 2019 the Department published the *Tasmanian Government Fiscal Sustainability Report 2019*.

1.16 The Secretary of the Department, Mr Tony Ferrall, attended a public hearing 30 October 2019 in Hobart.

1.17 In October 2019, the Secretary advised that the next fiscal sustainability report is due in 2020-21.

1.18 At the time of drafting this Report in August 2020, Tasmania's economic outlook Tasmania had changed significantly due to the impact of the COVID-19 pandemic.

2. EVIDENCE

TERM OF REFERENCE 1: HOW THE STATE IS PERFORMING AGAINST PROJECTIONS, SCENARIOS AND ASSUMPTIONS MADE IN THE REPORT

2.1 The *Tasmanian Government Fiscal Sustainability Report 2016* contained the following introduction:

This report assesses the sustainability of the Tasmanian Government's finances by examining a range of possible outcomes, at the General Government Sector level, under different scenarios. This approach is designed to identify factors that may have a significant influence on the State's future financial position, and to examine the extent to which the State's finances may alter under different economic and fiscal conditions.

And

The report presents four scenarios. They are not intended to be predictions of future outcomes; rather, they examine the extent to which the State's finances are sustainable under different economic, demographic and fiscal assumptions. The scenarios are not presented as extreme cases but have been selected to provide a guide to the range of possible outcomes, in terms of underlying fiscal pressure. No scenario is presented as a base case or of more likely probability of occurrence than any other scenario.

And

It is therefore recommended that caution is exercised in drawing conclusions at this early stage on the State's performance against the projections, scenarios and assumptions in the 2016 Report.[1]

2.2 The Department submission stated:

The 2016 Report took a 15 year perspective, as it was required to examine the long term sustainability of the State's finances and the sources of fiscal pressure over an extended timeframe. It did not purport to forecast year-to-year economic, demographic or fiscal trends, including any economic cycles.

And

Some cyclical economic factors can influence General Government revenue; for example, a buoyant housing market leads to increased conveyance duty. There can also be other events that can influence fiscal outcomes, including adverse weather conditions, such as floods and droughts, unexpected infrastructure failures such as occurred with Basslink, and delays in major capital expenditure projects.

The fiscal sustainability reports are designed to look through these short term events and focus on the underlying factors that can influence the State's financial sustainability over the longer term. This is one reason why the Charter of Budget Responsibility Act requires a fiscal sustainability report to be issued every five years.[2]

2.3 In a public hearing on 30 October 2019, the Secretary of the Department provided the following explanation:

The report is intended to provide a long-term perspective on Tasmania's fiscal outlook and it outlines potential long-term fiscal imbalances which may arise under different scenarios. I point out that that is in the absence of any change in policy or direction. While there is no consensus among economists on a precise operational definition of fiscal sustainability, rather different studies use their own - but often similar - definitions –

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[1] *Tasmanian Government Fiscal Sustainability Report 2016*, April 2016, Department of Treasury and Finance, p.1-2

[2] Written submission, Department of Treasury and Finance, p.3

> *… the European Commission defines public finance sustainability as: the ability of a government to sustain its current spending, tax and other policies in the long run without threatening the government's solvency or without defaulting on some of the government's liabilities or promised expenditures.*

Therefore, there is no precise point where sustainability or unsustainability can be defined and definitely differentiated. Rather, fiscal sustainability analysis is focused on examining possible future trends and projections. As indicated previously, reports of a similar nature have been published in other Australian jurisdictions and also in countries across the world.

In preparing the report, the comments raised by the committee in relation to the measures used in the 2016 report have been considered and although there is no consensus on the measures to use for fiscal sustainability, most other jurisdictions adopt a number of measures. Net debt is the most commonly used measure and that is presented in this report. That is either used as a standalone or as a percentage of economic output.

Measures used in the 2019 report are consistent with the Treasurer's Annual Financial Report and they are consistent with those reported in the state budget. Expenditure has been categorised consistent with the Australian Bureau of Statistics classification of functions of government which is used for government reporting.

To maintain continuity with the Fiscal Sustainability Report 2016, the primary balance has also been calculated for all projection scenarios, and is included as an attachment to the report. It should be noted, though, that the results are not directly comparable between the two reports because of the difference in the methodology and calculation.

Projections have been developed over a 15-year time frame, principally because there is some level of knowledge of events likely to occur in the next 15 years, but reduced *certainty beyond that period. Projections over a longer term would likely follow the same trends as we see in the latter years of the 15-year period.*[3]

2.4 In a public hearing on 19 November 2018, the Secretary of the Department made the following comment:

It is not possible to accurately project the future trajectory of the state's finances. It is impacted by a range of external factors. A good example would be the Global Financial Crisis, which was not something anybody would have predicted before the GST and post the GFC. There is no reason another equally significant event could not occur.

The future trajectory of state finances is also affected by future government policy at both the Australian and state government levels. Again, these cannot be predicted with any level of confidence. The demand for government services is also very difficult to forecast over an extended period. Things like technology change can be a major impact on the demand and costs for government services. That is particularly true in recent years in the Health and Education areas. [4]

And

As noted by Ms Forrest in the Mercury on 16 October, the forward Estimates include the savings measures over the forward Estimates.

The inclusion of the savings measures rebases each expenditure category at the lower level implied by those savings measures, but the model doesn't include any additional budget savings beyond those forward Estimates periods so there are no incremental savings beyond the forward Estimates.

Other matters included in the model are: under the historic trend - high-expenditure and low-revenue scenarios - adjustments have been made to the projections to take account of known future events; and under the forward Estimates scenario,

[3] Hansard transcript 30 October 2019, p.2
[4] Hansard transcript, 19 November 2018, p.5

adjustments are applied outside of the immediate budget and forward Estimates period to take account of events we know are occurring outside that period.

No one scenario was put forward as being more likely or less likely than the others; they were just a range of scenarios. The projections were largely based on long-term averages of key economic and fiscal measures and they did not take into account the potential impact of future economic events or policy change. The report only covers the general government sector, therefore it excludes an assessment of fiscal pressures the state might face due to the government businesses. [5]

And

We also included the recent changes to the Australian Government funding arrangements with Housing. The Australian Government announced the Commonwealth Housing Agreement and debt totalling $157.6 million will be forgiven, so we made adjustments to that which allocated operational capital expenditure on a 50/50 basis. On that particular one, we allocated the expenditure on a 50/50 basis because we made an assumption that some of the funding would be going into built infrastructure that Housing would own and some would be paid to community groups to insure the infrastructure is built in the community groups, so we just treat it as a 50/50 basis.

Equity transfers are included in the projections and they're consistent across all scenarios. The modelling assumes the equity transfers in the 2019-20 Budget and forward Estimates will occur, including the transfer of $157.5 million for the TT-Line.

In terms of matters not included in the model, we didn't explicitly include the impact of climate change and natural disasters in the model; however, for some projections, for instance, public order and safety, they're based over a six-year prior period average and so that would, to some degree, capture events such as the recent fires so to some degree there is an implicit assumption around those changes but it's not explicitly modelled.[6]

[5] Hansard transcript, 30 October 2019, p.3
[6] Ibid, p.4

And

We also haven't modelled any changes to Australian Government funding and certainly state government policies and changes to state government policy are not modelled. The projections assume no policy response over the projection periods.[7]

2.5 The Secretary also stated:

As a note of caution: when you look at the underlying fiscal position, it is unlikely to be as positive as the chart suggests. That is really because of the delay in capital spending. Effectively the primary balance shows as being more positive and cash reserves build up simply because specified projects that might be funded by, say, the Australian Government have not advanced as they might have otherwise advanced, and that is reflected in the stronger cash position, but it will also reflect in future years with greater capital expenditure.[8]

2.6 In a letter received 6 December 2018 in response to questions on notice from the Committee, the Department advised:

In examining the financial model to prepare responses to the Committee's questions, the Department of Treasury and Finance has identified some inconsistencies in the structure of the model. These primarily relate to the treatment of public sector superannuation costs. The effect of these inconsistencies is that the Primary Balance was more positive in the years prior to 2014-15 than shown in the 2016 Report, and over the period 2015-16 to 2020-30, the Primary Balance declines more rapidly or increases more slowly, depending on the scenario, than shown in the 2016 Report. However, I am satisfied that the conclusions in the 2016 Report would not have differed materially had these inconsistencies been identified during the preparation of the Report.

[7] Hansard transcript, 30 October 2019, p.5
[8] Hansard transcript, 19 November 2018, p.4

And

The 2016 Report set out an appropriate approach to treat these superannuation expenses in order to estimate the primary balance. However, the financial model did not fully reflect this approach. As a result, the estimates in the 2016 Report of the primary balance in the years to 2014-15 were not correct and the projections of the primary balance and net debt, from 2015-16 to 2029-30, were also not correct. Some of the results that I included in my letter to the Committee of 31 October 2018 and in my presentation to the Committee at its hearing on 19 November 2018 contained these incorrect estimates.[9]

2.7 In relation to the 2016 Report, the Secretary advised:

The key measure used in the report was the primary balance, which is the difference between the state Government's revenue and expenses - that is, both recurrent and net capital - but excludes interest earnings and borrowing costs. This is not an established accounting measure per se, but it is the measure used by all jurisdictions that do similar reports. The measure really reveals the underlying fiscal pressure for each year without having the legacy effects in terms of interest costs or earnings off earlier years of net debt or surplus. As I said, other jurisdictions use similar methods in their reports.

And

As the 2016 report was issued just over two years ago, it is relatively early to assess whether the scenarios adopted were reasonable or whether the assumptions were appropriate. In particular, the short period makes it difficult to determine whether the economic and demographic trends since 2016 represent long-term trends or include cyclical factors that may change significantly in two or three years time.[10]

[9] Written correspondence received 6 December 2018, Department of Treasury and Finance, p.1
[10] Hansard transcript, 19 November 2018, p.3

2.8 In a letter dated 6 December 2018, the Secretary advised:

The methodology in the 2016 Report was to replace the accrual-based method of estimating these superannuation expenses, as presented in the State's Budgets and as reported in the Treasurer's Annual Financial Statements, with an emerging cost approach, using the level of employer contributions the Government makes each year to former General Government employees who receive pensions and lump sum payments.[11]

2.9 The Department consequently produced a revised set of primary balance and net debt estimates and drew the Committee's attention to the following key finding:

The most important finding is that the overall trends in the projections are very similar to those presented in the 2016 Report.[12]

2.10 The Member for Murchison asked the following question about the impact on the primary balance resulting from delayed capital expenditure,

Ms FORREST *- If we are looking at long-term sustainability, which is what this is about, I am really interested to see what the different models would show in terms of the impact on the primary balance, of what we know to be the case. We know forward Estimates are just that, but if that is what we are aiming at and what the Government is committed to, the question is: are we financially sustainable? The purpose of the reports and this hearing is to try to understand if we are. If the capital expenditure continues to be pushed out or has been, somewhere we have to catch up. The Royal has to be built and that is not going to be for nothing and there are also other capital works going on everywhere. It would be good to have that.*[13]

2.11 The Secretary provided the following explanation:

Mr FERRALL *- Then I think what you are asking me to do is to take the budget, Forward Estimates and the actuals we have to 2017 and make some judgments about the underspend in the capex that is in there up to 2018.*

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[11] Written correspondence, Department of Treasury and Finance, 6 December 2018, p.1
[12] Ibid, p.2
[13] Hansard transcript, 19 November 2018, p.7

… *Almost by definition, that will only go out for about two or three years because the underspend in the capex will catch up by then and it will not change the particular trend lines. What you might see is the primary balance moves below what might have been the previous trend line in that short period, but it will not change the long-term trend.*

Ms FORREST *- I could argue that in 2014-15 for the actuals, the only reason it has hovered around zero is because it has been pushing out capital expenditure and underspending. If the Government had done what it said it was going to do in terms of capital expenditure, it would be a very different picture.*

Mr FERRALL *- It would be. The primary balance would be more negative in 2014-15. In an actual sense, the easier way to do it would be to take the primary balance and adjust it in those actual years for the known under expend you can pick up from the budget.*[14]

2.12 When asked if the State is fiscally sustainable, the Secretary responded:

…the question of whether the state is fiscally sustainable - the reality is governments will always, as time passes, need to make fiscal adjustments to maintain the state in a sustainable position. We have increasing pressures, a relatively slow own-source revenue growth rate and significant changes such as things like the GST. In order to be sustainable, there will always be decisions the government of the day will have to make to ensure our revenues are relatively closely matched to our expenditures.[15]

FINDING

1. Due to the significant changes in Tasmania's fiscal outlook due to COVID-19, it is no longer possible to accurately assess how the State is performing against projections, scenarios and assumptions made in the 2016 and 2019 Reports.

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[14] Hansard transcript, 19 November 2018, p.7
[15] Ibid, p.11

TERM OF REFERENCE 2: WHETHER THE REPORT CONSIDERS THE LONG-TERM OUTLOOK AND A BROAD ENOUGH RANGE OF CHALLENGES AND OPPORTUNITIES FOR THE GOVERNMENT'S FINANCES OVER THE LONG-TERM

2.13 The Department provided the following explanation of the methodology used to prepare the 2016 Report:

The Report considers long-term fiscal sustainability under a number of different assumed scenarios.

- *Standard budgeting methods and measures were used.*
- *Projections over a 15-year timeframe.*
- *Known or expected future changes in revenue and expenditure, and major capital expenditure projects, taken into account.*
- *Projections assume no corrective policy action over the projection period.*
- *Projections are not forecasts and no scenario is considered more or less likely to occur.*

2.14 The Department submission stated:

When the 2016 Report was being prepared, Treasury sought to include relevant matters that impact on the State's fiscal sustainability. This led to four separate scenarios being included in the 2016 Report, which is more than in equivalent reports prepared in other jurisdictions. This approach was taken to enable the State's fiscal sustainability to be examined under a range of possible demographic and economic assumptions and under different fiscal policy settings. As the report makes clear, these were not presented as extreme cases, but designed to inform the reader of the possible levels of fiscal pressure, and the sources of fiscal pressure, in these different cases.

It is inevitable that, over time, new issues will emerge and some current factors will become less important. As an example, the proposed changes to the distribution of the

GST could have a major impact on the State's GST payments from the Australian Government. This could not have been predicted when the 2016 Report was being prepared. It is expected that this will be reflected in the assumptions adopted, and the scenarios developed, in subsequent reports.

And

It is conceivable that if a future report were being prepared at a time when there were significant structural fiscal deficits and a very large (positive) net debt, the Secretary may consider that recommendations are appropriate.[16]

2.15 During the Inquiry, questions were raised as to whether capital expenditure budget recorded in forward Estimates could be regarded as accurate if the Government had subsequently underspent on projects it had committed to.

Ms FORREST - *If we are looking at long-term sustainability, which is what this is about, I am really interested to see what the different models would show in terms of the impact on the primary balance, of what we know to be the case. We know forward Estimates are just that, but if that is what we are aiming at and what the Government is committed to, the question is: are we financially sustainable? The purpose of the reports and this hearing is to try to understand if we are. If the capital expenditure continues to be pushed out or has been, somewhere we have to catch up. The Royal has to be built and that is not going to be for nothing and there are also other capital works going on everywhere. It would be good to have that.*

2.16 The Secretary of the Department provided the following response:

In the long term, the reason the primary balance stays around zero is because governments make adjustments. Again, in the short term, though, if there were a capital underspend of $100 million or $200 million that goes from one year to the next or the next year, it will not make much difference at all to the long-term trend. That is the point I was trying to make. There is a debate around whether we should have capital underspends, and we should be trying not to have them, but in the long run they sort of roll through in this form of analysis.[17]

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[16] Written submission, Department of Treasury and Finance, p.9

[17] Hansard transcript, 19 November 2018, p.19

Health-related expenditure

2.17 The Secretary of the Department advised:

The underlying drivers of growth in health expenditure are likely to continue. Therefore using expenditure constraint alone to achieve fiscal sustainability will become increasingly challenging. That was the conclusion of the report.

The conclusion we included in the report is that it's really very difficult to see a sustainable position if you are trying to rely on health constraints alone. It is very difficult to achieve health expenditure restraints.

If health expenditures continue at the level they have been in the past, growing at about 5.8 per cent, and if revenues are growing at about 3.3 per cent, it is only a matter of time before those dynamics cause an unsustainable position. But it is not a matter of constraining expenditure alone, there are questions around whether there can be improvements in efficiency in health. In the medium- to long-term, as is the case in other jurisdictions, there probably needs to be a debate in the community about how willing the community is to pay for the extended health services, which leads you to a revenue debate.

And

The pressures from the health system have been well known and they are escalating. The challenge we have is that the revenue sources that states have are not growing at the same rate as the health expenditures. Another challenge is that if you look at expenditure growth of health at 5.8 per cent, as an example, it is difficult to see there would be any single revenue source that would grow at that rate, either. It is quite a complex challenge for the community in terms of looking at what is affordable long-term and making difficult choices in health expenditure. [18]

[18] Hansard transcript, 30 October 2019, p.8-9

2.18 During public hearings of the Inquiry in November 2018, questions also arose as to whether GBE dividends paid as an equity transfer and spent in the same financial year improved the overall fiscal outlook.

Ms FORREST - *I would like to clarify that. It appears that equity transfers and all those amounts you refer to as investments in financial assets for policy purposes in the cashflow statement aren't included, or are you are saying they are included in the primary balance calculation*?

2.19 The Secretary of the Department provided the following response:

I will have to go back to the modelling and pick out the modelling of those cashflows. In principle, anything that comes in or goes out is included. When you look at something like the Mersey [General Hospital]*, it nets out to zero because it came in and out. Something like the TT-Line….goes out as an equity contribution. It is not reflected in the accounting measures of the operating balance or the fiscal balance but it is in the balance sheet.*[19]

2.20 Following the appearance of the Secretary of the Department in November 2018, the Committee forwarded a number of additional questions to the Department, including a request that the Department provide:

The rationale for the use of the primary balance as a measure of fiscal pressure and its reconciliation to the General Government Summary Operating result for 2017-18.

2.21 The Department provided answers to questions on notice, together with revised primary balance estimates and projections. The Department's response included the following explanation in relation to the treatment of public sector superannuation costs:

On an accrual basis, these expenses comprise the General Government sector's liability relating to employees in the State's defined benefit schemes in any year, together with the accrual costs relating to the General Government's unfunded superannuation

[19] Hansard transcript, 19 November 2018, p.5

liability. The methodology in the 2016 Report was to replace the accrual-based method of estimating these superannuation expenses, as presented in the State's Budgets and as reported in the Treasurer's Annual Financial Statements, with an emerging cost approach, using the level of employer contributions the Government makes each year to former General Government employees who receive pensions and lump sum payments.

The 2016 Report set out an appropriate approach to treat these superannuation expenses in order to estimate the primary balance. However, the financial model did not fully reflect this approach. As a result, the estimates in the 2016 Report of the primary balance in the years to 2014-15 were not correct and the projections of the primary balance and net debt, from 2015-16 to 2029-30 were also not correct. Some of the results that I included in my letter to the Committee of 31 October 2018 and in my presentation to the Committee at its hearing on 19 November 2018 contained these incorrect estimates.

The financial model has been adjusted to correctly include superannuation costs and revised estimates have been calculated. These revised estimates do not include any actual economic, demographic or fiscal outcomes since 2014-15 and have been prepared to inform the Committee of the impact of the inconsistencies on the results, findings and conclusions in the 2016 Report.[20]

2.22 In relation to the treatment of equity contributions, the Department response noted:

The financial model for the 2016 Report did not include equity contributions from the General Government Sector as expenses, including in cases when some funding had been received from the Australian Government.[21]

2.23 In light of inconsistencies identified in the 2016 Report, the Department released an updated *Tasmanian Government Fiscal Sustainability Report 2019*. As previously noted in this Report, the Executive Summary of the 2019 Report stated:

[20] Letter received 6 December 2018, Department of Treasury and Finance, p.1
[21] Ibid, p.6

In October 2018, the Parliamentary Standing Committee of Public Accounts (the Committee) initiated a review of the 2016 Report. The Committee sought additional information from the Department of Treasury and Finance and the Secretary of Treasury appeared before the Committee to assist in the review process.

In examining the financial model, to prepare additional information for the Committee, the Department of Treasury and Finance identified inconsistencies in the structure of the model, which primarily related to the treatment of public sector superannuation costs.

While these inconsistencies did not materially alter the conclusions made within the 2016 Report, the Secretary advised the Committee that a new report would be released, in addition to the Secretary's obligations under section 14A of the Act, following the publication of the 2019-20 Tasmanian Budget (State Budget).[22]

And

The nature of the reports is such that there is not significant difference between previous conclusions and the conclusions now. In part, that is because one was 2016 and one is 2019 and you are doing 15-year projections. It goes to the point I made at the start of the hearing, which is that there is no single point where you can say we have moved from sustainable to unsustainable. I would say the two reports show the same thing over time.[23]

2.24 At a public hearing in October 2019, the Secretary of the Department advised:

In 2018 the committee asked me some questions about the capital underspend and how that was treated in the previous report. Historically there has been a fairly significant capital underspend. It's primarily a result of delays in planning design and implementation of projects. It's obviously further impacted by project submissions to things like Infrastructure Australia and timing of Australian Government funding

[22] Tasmanian Government Fiscal Sustainability Report 2019, Department of Treasury and Finance, p.1
[23] Hansard transcript, 30 October 2019, p.9

commitments. The capital underspend in each year is rolled forward generally into the next financial year.

In the modelling we have assumed a 20 per cent capital underspend and that rolls through the modelling. That is modelled in the historic trend and the low-revenue growth scenarios. In the high-expenditure and forward Estimate scenarios we don't assume any capital underspend. We have just assumed that it rolls forward, as projected under the forward Estimates.[24]

2.25 The Department advised that the next fiscal sustainability report was scheduled to be released before 30 June 2021. Its original submission stated:

When the next report is being prepared in 2020-21, if it is found that there have been structural demographic, economic, or fiscal-related changes in Tasmania, these changes will be reflected in the report.[25]

FINDINGS

2. Due to the significant changes in Tasmania's fiscal outlook due to COVID-19, it is no longer possible to assess whether the 2016 and 2019 Reports consider the long-term outlook and a broad enough range of challenges and opportunities for the Government's finances over the long-term.

3. The Secretary acknowledged the Report shows that health expenditure growth is outpacing revenue growth which is putting further pressure on the State's fiscal position going forward.

[24] Hansard transcript, 30 October 2019, p.5
[25] Written submission, Department of Treasury and Finance, p.3

Term of Reference 3: Whether the report communicates its findings in an understandable, informative and useful way

2.26 The Department of Treasury and Finance submission stated:

The 2016 Report was designed to be understandable by non-specialist readers. It included a comprehensive Executive Summary that included information on the reason for the report, the approach taken and the key results and findings. The report sought to avoid technical terms where possible and to present the results graphically, where appropriate. Technical matters, including details of the methodology and assumptions, were kept for the Attachment. However, it is inevitable that a report of this nature contains concepts and analysis that are more easily understood by persons with some understanding of public finance.

When the report was published on the Treasury website, on 27 April 2016, it was accompanied by a 'question and answer' sheet. On the day of the release, the Secretary and the Treasurer jointly briefed the media which included providing a presentation. There were articles on the 2016 Report in the Mercury and Examiner newspapers on the following day.

The Secretary also wrote to the Leaders of the Opposition parties, offering to brief them on the report; these offers were accepted and the briefings took place soon after the report's release.[26]

2.27 The Secretary advised the Committee:

It (the Report) presents information that allows other people to form views, conclusions or opinions rather than attempting to direct the readers in a particular way.[27]

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[26] Written submission, Department of Treasury and Finance, p.9
[27] Hansard transcript, 19 November 2018, p.6

2.28 In October 2019, the Secretary appeared before the Committee to provide an overview of the 2019 Report and made the following comments in relation to the 2016 Report:

The 2016 report used what was called the three 'Ps' approach to generating projections whereby economic growth was projected on assumptions relating to population, labour force participation and productivity, with revenue and expenditure calculated based on assumed relationships with economic growth. The 2019 report has not used the three Ps approach. Instead, a standard budgeting accounting practice has been used to ensure consistency with the Budget and to enable the model to take account of known future expenditure and revenue impacts. I think one of the comments the committee made to me previously was that it thought by using the approach used previously, it was maybe a little difficult to understand the report and it did not have comparability with budgets that you would have liked.[28]

2.29 The Secretary of the Department added the following comments at a public hearing in November 2019:

The report was designed to be understandable by a non-specialist reader; however, the reality is we are dealing with complex matters. The way we approached it was to include an executive summary, so a summary of findings. We used a reasonably large number of charts and tables to try to give pictorial representation of the information. We largely avoided technical terms in the report and moved technical matters like the methodology and assumptions as an attachment to the report. We included a question and answer sheet when the report was released, and certainly briefed the media - and in fact I also briefed the leaders of the opposition parties on the report.

[28] Hansard transcript, 30 October 2019, p.2

In addressing the question whether the report communicated its findings in an understandable, informative and useful way, it is my view we did our best and attempted to do that, but it is a complex matter.[29]

2.30 The Secretary also provided the following comments in relation to the definition of sustainability:

Ms FORREST - *What is … the most reliable - if you want to use that word - measure of fiscal sustainability as presented here?*

Mr FERRALL - *There is no single measure. I don't think you can pick a single measure as a measure of sustainability. I will give you an example. If you have a significant amount of debt but you have sufficient revenue to support that debt and also meet all your other recurrent costs, you are still in a sustainable position. It is only when you are in a position that you can't meet the debt servicing and meet your other recurrent costs, that debt would potentially become unsustainable. It is a question of when you start either to be unable to service any debt you've got or start to constrain or restrain your current expenditure to a point which is –*

Ms FORREST - *Or your capital expenditure, surely?*

Mr FERRALL - *Yes, capital or any of your expenditures to a point where you're reducing the capacity of the future generations to have the same level of support and services that you currently have.*

Ms FORREST - *…, wouldn't it be the case that net debt is really the better measure here?*

Mr FERRALL - *Net debt is used as a measure by many jurisdictions in terms of a fiscal sustainability measure. Some of them compare that to percentage of GST. It is quite a reasonable and appropriate measure. Debt is also a very appropriate way of getting intergenerational equity. If you have a large expensive asset that is going to provide*

[29] Hansard transcript, 19 November 2019, p.5

support to the community over a long period of time, it is not unreasonable to have debt to support that asset and share the burden of the cost of that asset over a number of generations. Debt per se can be bad, but it is not always bad.[30]

And

From my point of view, it's unlikely because the methodology used in the 2016 report, to be frank, didn't meet the expectations of the committee and was difficult for a number of readers to understand. The purpose of a report is for people to understand it. I wouldn't go back to a methodology, even though it is technically correct, that was not understandable.[31]

FINDING

4. Despite improvements, the Fiscal and Sustainability Report remains difficult to understand and doesn't meet the intended and desired outcome.

HON IVAN DEAN MLC
29 SEPTEMBER 2020

[30] Hansard transcript, 30 October 2019, p.10
[31] Ibid, p.13

Department of Treasury and Finance

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Tasmanian Government

Doc reference 18/160845

Hon Ivan Dean MLC
Chair
Parliamentary Standing Committee of Public Accounts
Parliament House
HOBART TAS 7000

Dear Mr Dean

Review of the Tasmanian Government Fiscal Sustainability Report 2016

I refer to your letter dated 1 October 2018 requesting a submission in response to the terms of reference for the review by the Parliamentary Standing Committee of Public Accounts of the *Tasmanian Government Fiscal Sustainability Report 2016* (2016 Report).

The attached document provides information to the Committee to assist in its review of the 2016 Report. The document includes data from the *Treasurer's Annual Financial Report 2017-18* which was released on Wednesday 31 October 2018.

I note that the Committee is assessing whether the 2016 Report communicated its findings in an understandable, informative and useful way, which I have addressed in the attached document.

I confirm that I have accepted the Committee's invitation to attend the hearing scheduled for 12.00 pm on 19 November 2018 and will be pleased to answer any questions from the Committee on the 2016 Report and on any matters arising from this letter.

Yours sincerely

Tony Ferrall
Secretary

31 October 2018

Review of the Tasmanian Government Fiscal Sustainability Report 2016 - Treasury submission to the Parliamentary Standing Committee of Public Accounts

Background

The *Charter of Budget Responsibility Act 2007* establishes a Charter of Budget Responsibility to ensure sound fiscal management and improve transparency and accountability in the management of the State's finances. This includes the requirement to prepare regular reports on the Government's fiscal performance.

The Act was amended in 2015 to require the Secretary of the Department of Treasury and Finance to prepare, at least every five years, a report on the long term sustainability of the State's finances. The Act requires the Secretary to have regard to the policies of the Government and the impact on the State's finances of demographic change in Tasmania. Other than these requirements, the Act places responsibility on the Secretary to determine the content and scope of the report. The Government therefore has no role in the preparation of the report.

The 2016 Report was the first report prepared under the Act. The next report is due to be prepared by 30 June 2021.

2016 Report summary

The 2016 Report examined the sustainability of the finances of the General Government Sector by presenting four scenarios over a 15 year projection period from 2015-16. The scenarios contained different economic, demographic and fiscal assumptions and were designed to allow an assessment of the sustainability of the State's finances under these different conditions. As the report made clear, the scenarios were not forecasts and no scenario was presented as being any more likely than any other scenario.

The four scenarios were:

Scenario 1 - Continuation of recent fiscal trends, to apply from 2015-16 to 2029-30, based on General Government revenue and expenditure trends over the previous 10 years. No separate demographic change projections were included; it was assumed they were reflected in the past fiscal trends.

Scenario 2 - Modelled projections under medium case population growth and economic growth assumptions. For the years to 2018-19, General Government revenue and expenditure and net debt, were assumed to reflect the estimates in the *Revised Estimates Report 2015-16*. The modelled projections applied for the years from 2019-20 to 2029-30.

Scenario 3 - Modelled projections from 2019-20 to 2029-30 under high case population growth and economic growth assumptions. Again, up to 2018-19, the fiscal estimates in the *Revised Estimates Report 2015-16* were assumed.

Scenario 4 - Extension of the Forward Estimates trends in the *Revised Estimates Report 2015-16*, with no adjustments for the impact of future demographic change.

The two key measures of fiscal sustainability were the General Government primary balance and net debt. The primary balance is not a standard accounting measure and is not therefore reported in the Budget papers, but is used widely in government reports of this nature. It includes General Government expenditure (both recurrent and net capital expenditure), except borrowing costs and the nominal superannuation interest expense, and General Government revenue, except for interest earnings. It therefore shows the underlying fiscal position for each year, without the effects of any past deficits or surpluses, or past superannuation-related liabilities, which can lead to positive or negative net debt with its associated interest costs or earnings.

The net debt that was projected was the same measure as reported in the Budget papers.

The 2016 Report found that under scenarios that reflect past trends, future governments would face increasing fiscal pressure. In particular, increased health spending was identified as a major contributor to increasing fiscal pressure. The report also identified a range of risks to the State's finances and includes, as one example, the risk that the Australian Government abandons the principle of Horizontal Fiscal Equalisation as a basis for the distribution of the goods and service tax revenue.

The 2016 Report also stated that, in practice, jurisdictions in Australia do not allow fiscal deficits to continue over time such that their finances are unsustainable. The scenarios in the report highlighted the importance of governments addressing fiscal pressure at an early stage to avoid a major disruption in the supply of government services or a loss of business and consumer confidence.

I now address the specific terms of reference for the review.

1. How is the State performing against projections, scenarios and assumptions in the report?

The 2016 Report took a 15 year perspective, as it was required to examine the long term sustainability of the State's finances and the sources of fiscal pressure over an extended timeframe. It did not purport to forecast year-to-year economic, demographic or fiscal trends, including any economic cycles.

As the 2016 Report was issued around 30 months ago, it is relatively early to assess whether the scenarios adopted were appropriate and the assumptions were reasonable. In particular, it is too short a time to determine whether the economic and demographic trends since 2016 represent long term trends or include cyclical factors that may change significantly in two or three years' time.

Some cyclical economic factors can influence General Government revenue; for example, a buoyant housing market leads to increased conveyance duty. There can also be other events that can influence fiscal outcomes, including adverse weather conditions, such as floods and droughts, unexpected infrastructure failures such as occurred with Basslink, and delays in major capital expenditure projects.

The fiscal sustainability reports are designed to look through these short term events and focus on the underlying factors that can influence the State's financial sustainability over the longer term. This is one reason why the Charter of Budget Responsibility Act requires a fiscal sustainability report to be issued every five years.

When the next report is being prepared in 2020-21, if it is found that there have been structural demographic, economic, or fiscal-related changes in Tasmania, these changes will be reflected in the report.

It is therefore recommended that caution is exercised in drawing conclusions at this early stage on the State's performance against the projections, scenarios and assumptions in the 2016 Report.

Economic and demographic estimates

Of the four scenarios, only scenarios 2 and 3 contained population growth and economic growth projections. For the years to 2018-19, these projections reflected the estimates and projections in the *Revised Estimates Report 2015-16*. The modelled projections only applied from 2019-20.

As there are only data for years up to 2016-17 and, in some cases, 2017-18, the State's actual performance must be compared against the population growth and economic growth estimates and projections in the *Revised Estimates Report 2015-16*. This is shown in Table 1 below.

Table 1: Tasmania's performance against population growth and economic growth estimates and projections in the *Revised Estimates Report 2015-16*

	2015-16	2016-17	2017-18
Population growth (% change)			
Revised Estimates Report 2015-16	0.5	0.6	0.6
Actual*	0.4	0.8	1.0**
Economic growth (% change)			
Revised Estimates Report 2015-16	2.5	2.0	2.0
Actual*	1.3	1.1	n/a***

* Australian Bureau of Statistics.
** March quarter 2017 to March quarter 2018.
*** The ABS is scheduled to release its estimate of Tasmania's economic growth for 2017-18 on 16 November 2018.

Tasmania's population growth was marginally below the estimate for 2015-16, but higher than the projected growth rate for 2016-17 due largely to net interstate in-migration being higher than anticipated.

The ABS estimate of Tasmania's population growth for the June quarter 2018, to allow the growth for 2017-18 to be calculated, is scheduled to be released on 20 December 2018. However, from the data to the March quarter 2018 it is clear that growth over 2017-18 will be significantly higher than in the *Revised Estimates Report 2015-16,* again due to strong net interstate in-migration.

According to the most recent estimates from the ABS, Tasmania's economic growth in 2015-16 and 2016-17 was significantly below the estimate and projection in the Revised Estimates Report 2015-16. The ABS State Accounts are released in November each year and contain estimates of economic growth for the previous financial year. This publication always includes revised economic growth estimates for previous years. Once the November 2018 publication is released, it is likely that the above table will no longer reflect the gap between the economic growth estimate and projection in the Revised Estimates Report 2015-16 and the revised estimates from the ABS for 2015-16 and 2016-17.

Two key economic assumptions that influence estimates of future economic growth are labour productivity growth rates and labour market participation rates. The 2016 Report assumed labour productivity growth in Tasmania would be at the long-term average of 1.6 per cent annually.

According to the ABS, labour productivity growth over 2015-16 and 2016-17 was lower, at 0.6 per cent, on average. It is too early to assess whether there is any long term trend towards lower labour productivity growth in Tasmania.

Labour market participation rates over the three year period from 2015-16 to 2017-18 were very similar to those under scenario 2, but lower than in the *Revised Estimates Report 2015-16*. As Tasmania's population ages, an increasingly important issue will be participation rates of older Tasmanians. From 2015-16 to 2017-18, the participation rates of older Tasmanians generally increased. For males aged between 60 and 64 years and for females aged between 55 and 64 years, the participation rates were higher than the rates projected under the Treasury modelling.

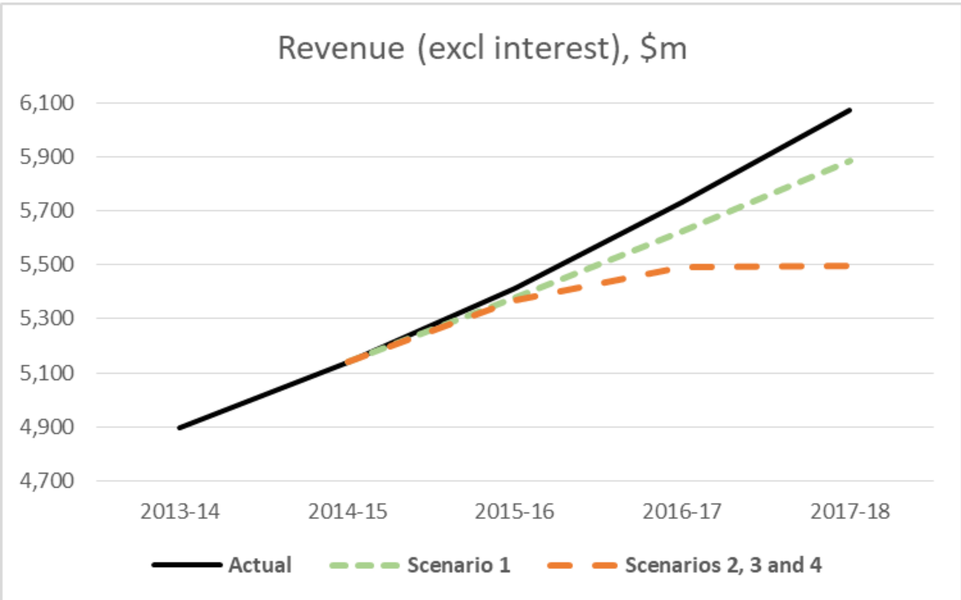
Fiscal estimates

The 2016 Report included two sets of projections for General Government revenue, recurrent expenditure and net capital expenditure up to 2018-19. These are used to calculate the primary balance and net debt. Scenario 1 contains modelled projections from 2015-16, based on the previous 10 year trend. For scenarios 2, 3 and 4, the fiscal projections were those in the *Revised Estimates Report 2015-16* from 2015-16 to 2018-19. The modelled projections were from 2019-20 under these three scenarios.

The actual fiscal outcomes can therefore be compared with the projections under scenario 1 and the estimates in the *Revised Estimates Report 2015-16*.

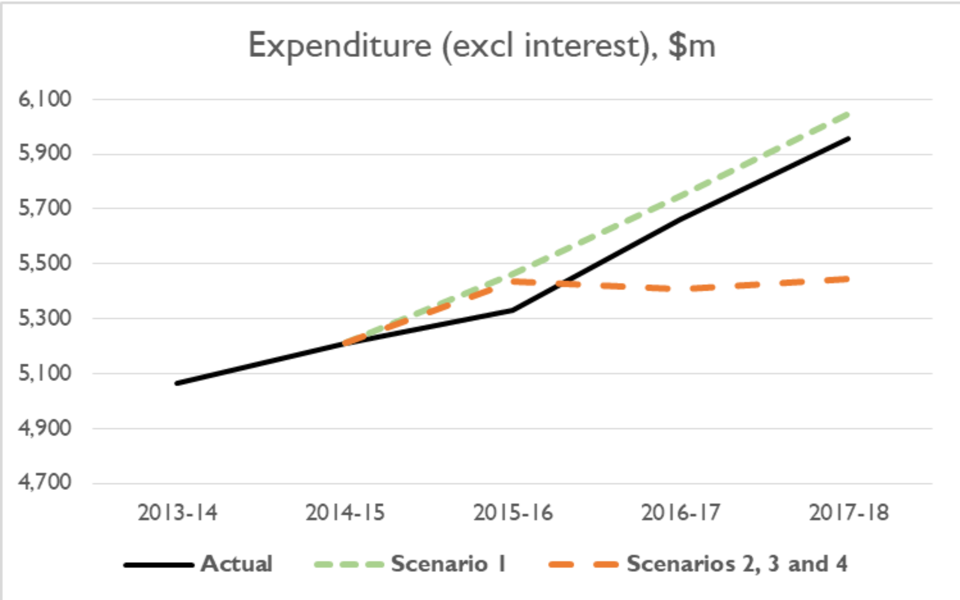
For General Government revenue, the level of actual revenue in the three years to 2017-18 was higher than projected under Scenario 1, by around $200 million in 2017-18 (Chart 1). Actual revenue was higher than under the three other scenarios, as reflected in the *Revised Estimates Report 2015-16*, by around $600 million in 2017-18. This was largely due to higher than expected revenue from the Australian Government, including transfers under National Partnerships and GST payments.

Chart 1: General Government revenue projections in the Tasmanian Government Fiscal Sustainability Report 2016 and actual outcomes



For General Government recurrent expenditure, the outcomes in the years to 2017-18 were marginally below scenario 1 but above the levels in the other three scenarios (Chart 2). Over these three years, therefore, recurrent spending followed the trend of the previous decade much more closely than the planned profile in the *Revised Estimates Report 2015-16*. The major divergence was in health expenditure, where additional expenditure was allocated every year to meet demand pressures.

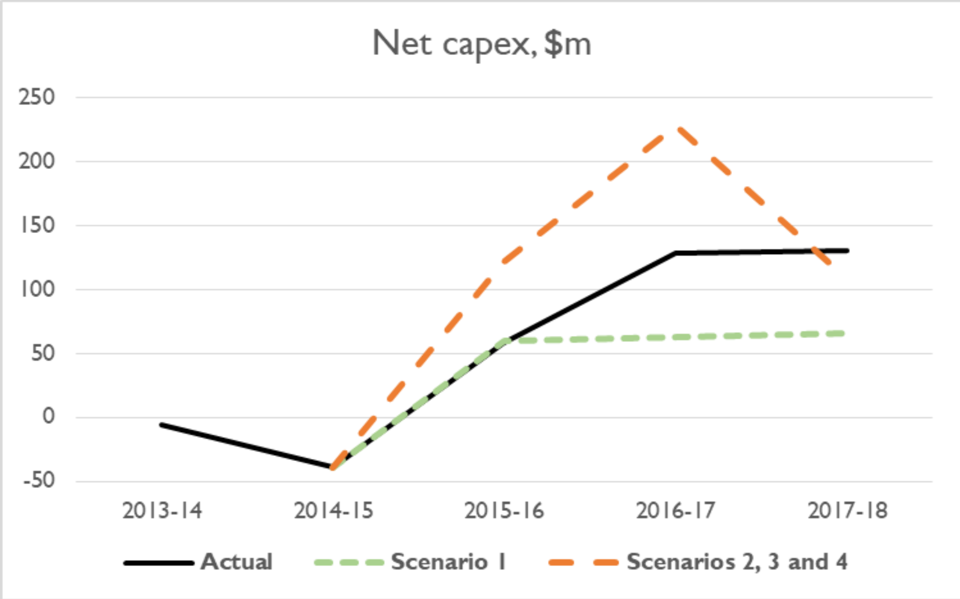
Chart 2: General Government recurrent expenditure projections in the Tasmanian Government Fiscal Sustainability Report 2016 and actual outcomes



Net capital expenditure is the purchase of capital assets by the General Government Sector less the sale of assets and depreciation and has tended to be small, relative to the level of recurrent expenditure. Under scenario 1, it was set at $60 million in 2015-16, based on the previous decade average, and then was increased by inflation and the demand for government services. For scenarios 2, 3 and 4, it was derived from the *Revised Estimates Report 2015-16* until 2018-19.

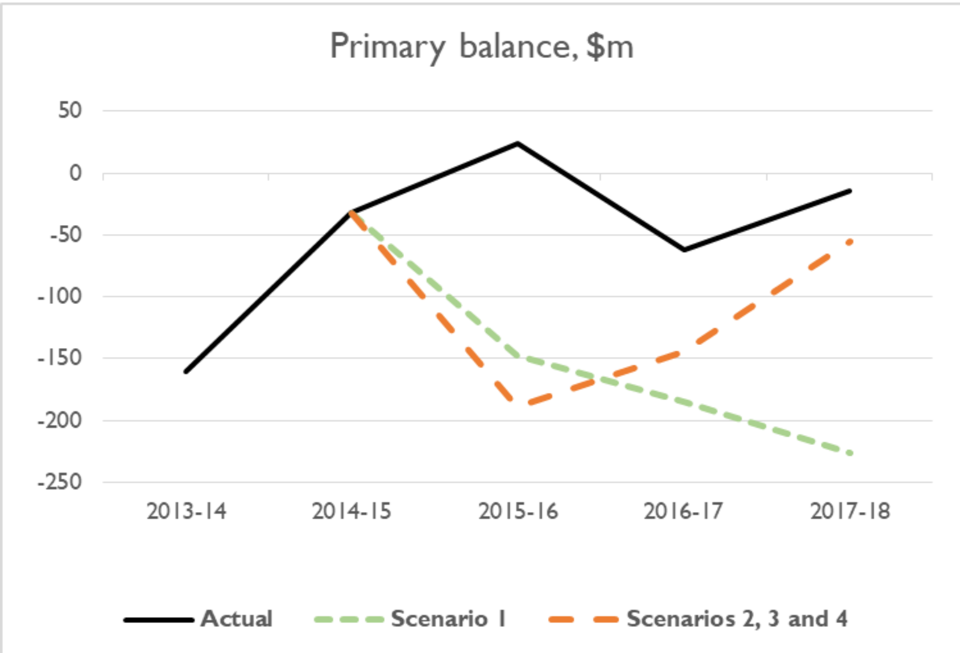
The profile of net capital expenditure since 2015-16 has been quite different from all scenarios in the 2016 report (Chart 3). It was above the longer term trend, as reflected in scenario 1, after 2015-16. It was lower, however than in the *Revised Estimates Report 2015-16* in 2015-16 and 2016-17, but marginally higher in 2017-18. Over the three years the total level of actual net capital expenditure was substantially below the total in the *Revised Estimates Report 2015-16*, due to infrastructure investment not increasing at the rate that was anticipated.

Chart 3: General Government net capital expenditure projections in the Tasmanian Government Fiscal Sustainability Report 2016 and actual outcomes



The combined impact of actual General Government revenue and expenditure, including net capital expenditure, has resulted in the profile of the primary balance being quite different from those in the four scenarios in the 2016 report (Chart 4). In 2015-16, it was marginally positive, before declining to around negative $60 million in 2016-17 and then improving to around negative $15 million in 2017-18. In this most recent year, the continued improvement in revenue outweighed the impact of higher recurrent spending and relatively unchanged net capital expenditure.

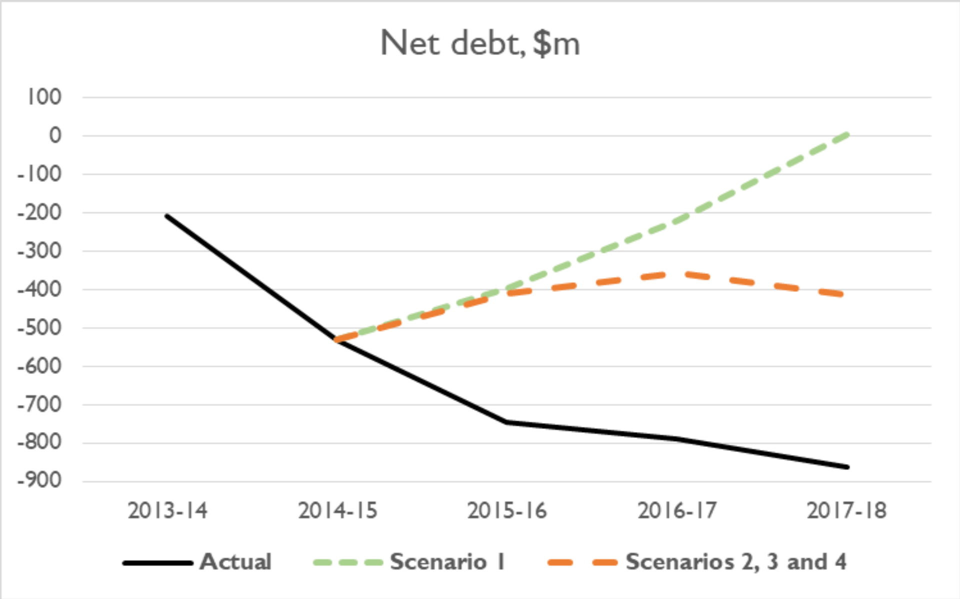
Chart 4: General Government primary balance projections in the Tasmanian Government Fiscal Sustainability Report 2016 and actual outcomes



The primary balance has therefore been much closer to zero and relatively stable over this period than under all four scenarios.

This overall more favourable outcome, relative to the projections in the 2016 report, is also reflected in the General Government net debt profile (Chart 5). Net debt has become increasingly negative, since 2014-15, indicating that the value of net financial assets has been increasing. This reflects, in part, increased cash holdings for planned future capital spending, including funds provided by the Australian Government.

Chart 5: General Government net debt projections in the Tasmanian Government Fiscal Sustainability Report 2016 and actual outcomes



Under the four scenarios, net debt is less negative, including being close to zero under scenario 1 in 2017-18.

The underlying fiscal position is unlikely to be as positive as Charts 4 and 5 suggest. The effect of delays in capital spending is that the primary balance is more positive and, as cash reserves build up, negative net debt is greater. However, much of these funds, including Australian Government funds, are for specified projects and are expected to ultimately be spent. This will be reflected in greater capital expenditure and lower cash reserves than otherwise in future years.

2. Has the report considered the long-term outlook and a broad enough range of challenges and opportunities for the Government's finances over the long-term?

In determining the matters to be included in the 2016 Report, it was considered important that the scenarios examined were plausible, but did not purport to present a definitive picture of Tasmania's future economic and fiscal position.

One decision to be made was the time period over which the report should cover. Some jurisdictions, such as the Australian Government and New South Wales, have chosen a 40 year projection period. It was determined that this was too long a period for the 2016 Report as the assumptions and the results of economic modelling become increasingly less reliable over longer time periods.

In particular, technological change can have transformative effects over the longer term, which cannot be predicted. It would have been impossible, for example, to predict in 1978 the level of technological advancement, including the digital economy, and the composition of industries in Tasmania in 2018. A range of other critical matters can also change significantly over the very long term. These can include demographic and sociological changes that may influence fertility rates, life expectancy and migration flows, but also government policies at the State and national level that can potentially have profound impacts on intergovernmental financial arrangements.

For this reason, a 15 year time horizon was chosen for the 2016 Report.

When the 2016 Report was being prepared, Treasury sought to include relevant matters that impact on the State's fiscal sustainability. This led to four separate scenarios being included in the 2016 Report, which is more than in equivalent reports prepared in other jurisdictions. This approach was taken to enable the State's fiscal sustainability to be examined under a range of possible demographic and economic assumptions and under different fiscal policy settings. As the report makes clear, these were not presented as extreme cases, but designed to inform the reader of the possible levels of fiscal pressure, and the sources of fiscal pressure, in these different cases.

It is inevitable that, over time, new issues will emerge and some current factors will become less important. As an example, the proposed changes to the distribution of the GST could have a major impact on the State's GST payments from the Australian Government. This could not have been predicted when the 2016 Report was being prepared. It is expected that this will be reflected in the assumptions adopted, and the scenarios developed, in subsequent reports.

Another decision was whether the report should make explicit policy recommendations in response to the challenges and opportunities for the State's finances in the decades ahead. It was determined that it was more appropriate for the 2016 Report to present results and make findings, without being prescriptive as to the policies future governments should adopt. This approach reflected, in part, the particular set of issues included in the report and also the State's finances at that time.

It is conceivable that if a future report were being prepared at a time when there were significant structural fiscal deficits and a very large (positive) net debt, the Secretary may consider that recommendations are appropriate.

3. Did the report communicate its findings in an understandable, informative and useful way?

The 2016 Report was designed to be understandable by non-specialist readers. It included a comprehensive Executive Summary that included information on the reason for the report, the approach taken and the key results and findings. The report sought to avoid technical terms where possible and to present the results graphically, where appropriate. Technical matters, including details of the methodology and assumptions, were kept for the Attachment. However, it is inevitable that a report of this nature contains concepts and analysis that are more easily understood by persons with some understanding of public finance.

When the report was published on the Treasury website, on 27 April 2016, it was accompanied by a 'question and answer' sheet. On the day of the release, the Secretary and the Treasurer jointly briefed the media which included providing a presentation. There were articles on the 2016 Report in the *Mercury* and *Examiner* newspapers on the following day.

The Secretary also wrote to the Leaders of the Opposition parties, offering to brief them on the report; these offers were accepted and the briefings took place soon after the report's release.

A

Tabled - 19/11/18

Appendix 2

Review of the Tasmanian Government Fiscal Sustainability Report 2016

Presentation to the Parliamentary Standing Committee of Public Accounts

Tony Ferrall
Secretary

19 November 2018

Department of Treasury and Finance

Tasmanian Government

Background on the *Tasmanian Government Fiscal Sustainability Report 2016*

- Prepared by the Department of Treasury and Finance under the *Charter of Budget Responsibility Act 2007.*

- Government's objectives:
  - increase fiscal accountability;
  - improve public reporting on the impact of current policy settings on future generations;
  - provide further information on which the Government of the day's decisions can be assessed.

Summary of approach

- The objective was to provide sufficient information to enable readers to:
  - be informed on the composition of the State's finances, both revenue and expenditure;
  - understand the potential sources and extent of future fiscal pressure on the State's finances; and
  - understand the State Government's capacity to respond to significant fiscal pressure, including the constraints.
- The results were projections and not forecasts.

Summary of approach (continued)

- Scenarios were developed to examine potential outcomes under different economic, demographic and fiscal conditions.
- Results were for the General Government Sector of the Tasmanian Government.
- It therefore did not include the Total State Sector (which includes government businesses) or local government.
- The report contained findings but not policy recommendations

The different scenarios

- Scenario 1 - extension of recent trends in General Government revenue and expenditure.
- Scenario 2 - medium population and economic growth case (reflecting recent trends)
- Scenario 3 – high population and economic growth case
- Scenario 4 – extension of trends in the *2015-16 Revised Estimates Report.*

- All scenarios covered 15 years after 2014-15.

- For the period to 2018-19, scenarios 2, 3 and 4 reflected the estimates in the *2015-16 Revised Estimates Report.*

The Primary Balance

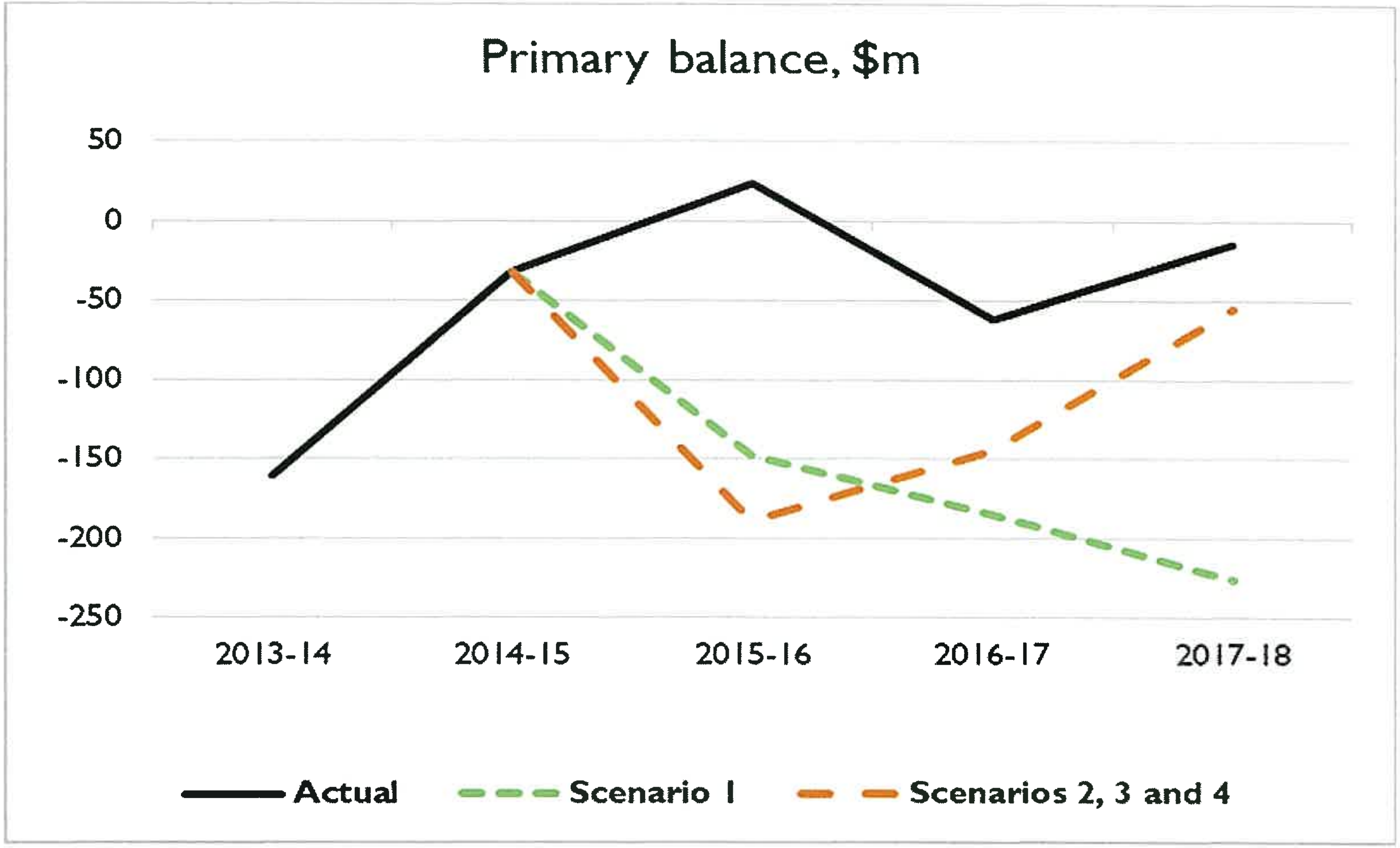
- The Primary Balance measures the State Government's underlying fiscal position for each year.
- The measure:
  - includes General Government revenue and recurrent expenditure;
  - includes net capital expenditure (capital expenditure less depreciation and asset sales); and
  - excludes interest earnings and borrowing costs.

How is the State performing against the projections, scenarios and assumptions in the 2016 report?

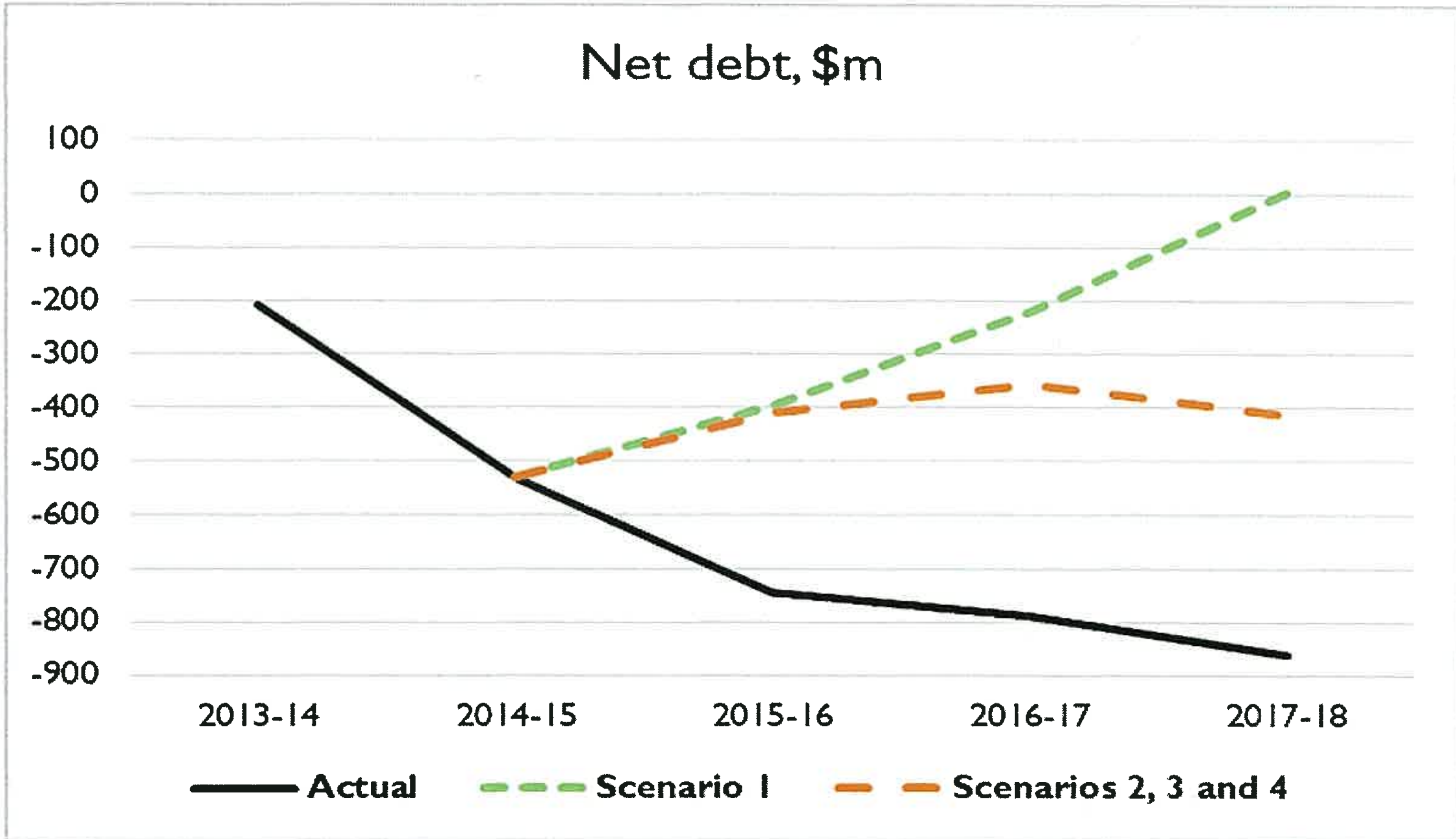
Tasmania's performance against economic growth projections

	2015-16	2016-17	2017-18
Economic growth (% change)			
Report projections (from the Revised Estimates Report 2015-16)	2.5	2.0	2.0
ABS estimates as at 17 November 2017	1.3	1.1	N/A
ABS estimate as at 16 November 2018	1.7	1.5	3.3
Labour productivity growth (% change)			
Average growth (2015-16 to 2016-17) at 17 November 2017		0.6	
Average growth (2015-16 to 2017-18) at 16 November 2018		1.2	

Primary balance projections and actual outcomes



Net debt projections and actual outcomes



MC5

Has the 2016 Report considered the long-term outlook and a broad enough range of challenges and opportunities over the long-term?

- Assumptions and results of economic modelling become increasingly less reliable over longer time periods.
- Four scenarios were included in the report which examined a range of possible economic assumptions under different fiscal policy settings.
- Over time, new issues will emerge and some current factors will become less important.

Slide 11

MC5 Careful with the reasoning for 4 scenrarios - in para 2, it says this approach enables examination of the State's fiscal sustainability.... "under different fiscal poolicy settings". However, we say in an earlier slide that changes in government policy is not considered in the assumptions. We need to make sure this doesn't confuse the committee or be seen as contradictory.
McLennan, Cameron, 13/11/2018

Did the 2016 Report communicate its findings in an understandable, informative and useful way?

Key findings:

- The State can face increasing fiscal pressure under scenarios that reflect recent trends, especially from increased expenditure on health.
- However, demographic change is not a primary driver of increased fiscal pressure.
- If these pressures are not addressed as they arise, much greater corrective action is likely to be required later.
- Tasmanian Governments have much greater control over their expenditure than over revenue.
- The State's public sector superannuation obligations add to fiscal pressure but are manageable.

PAC Tabled - 30/10/19

Handout for Parliamentary Standing Committee of Public Accounts - Fiscal Sustainability Report 2019

Appendix 3

Total GFS Net Debt by Scenario, 2018-19 to 2033-34*

	2018-19 $(m)	2019-20 $(m)	2020-21 $(m)	2021-22 $(m)	2022-23 $(m)	2023-24 $(m)	2024-25 $(m)	2025-26 $(m)	2026-27 $(m)	2027-28 $(m)	2028-29 $(m)	2029-30 $(m)	2030-31 $(m)	2031-32 $(m)	2032-33 $(m)	2033-34 $(m)
Scenario 1 Historic Trend	(535)	(234)	386	899	1 737	2 354	3 168	4 190	5 468	6 946	8 477	10 111	11 885	13 812	15 911	18 191
Scenario 2 Forward Estimates Trend	(535)	(46)	329	532	857	901	1 137	1 439	1 921	2 467	2 906	3 287	3 630	3 943	4 227	4 473
Scenario 3 High Expenditure	(535)	(81)	665	1 446	2 595	3 709	5 005	6 588	8 529	10 758	13 139	15 742	18 611	21 780	25 280	29 135
Scenario 4 Low Revenue	(535)	(219)	438	1 017	1 949	2 733	3 792	5 146	6 853	8 900	11 120	13 575	16 312	19 360	22 753	26 513

Annual changes in GFS Net Debt by Scenario, 2018-19 to 2033-34*

	2018-19 $(m)	2019-20 $(m)	2020-21 $(m)	2021-22 $(m)	2022-23 $(m)	2023-24 $(m)	2024-25 $(m)	2025-26 $(m)	2026-27 $(m)	2027-28 $(m)	2028-29 $(m)	2029-30 $(m)	2030-31 $(m)	2031-32 $(m)	2032-33 $(m)	2033-34 $(m)
Scenario 1 Historic Trend	329	301	620	513	838	617	815	1 021	1 278	1 478	1 531	1 634	1 774	1 927	2 100	2 280
Scenario 2 Forward Estimates Trend	329	489	375	203	325	43	236	302	482	546	439	381	344	312	284	247
Scenario 3 High Expenditure	329	455	746	781	1 149	1 114	1 296	1 583	1 941	2 229	2 381	2 602	2 870	3 169	3 500	3 855
Scenario 4 Low Revenue	329	316	658	578	932	784	1 060	1 354	1 707	2 047	2 220	2 454	2 737	3 048	3 393	3 760

*Differences between the above figures and cash / borrowings are minor. The difference primarily reflects that borrowings are calculated based on Finance-General cash and exclude Agency Trust account balances.

Department of Treasury and Finance

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Tasmanian Government

Doc reference 18/193895

Hon Ivan Dean MLC
Chair
Parliamentary Standing Committee of Public Accounts
Parliament House
HOBART TAS 7000

Dear Mr Dean

Review of the Tasmanian Government Fiscal Sustainability Report 2016

I refer to your letter dated 20 November 2018 confirming the questions on notice arising from the hearing on 19 November 2018 in relation to the review of the *Tasmanian Government Fiscal Sustainability Report 2016* (2016 Report).

In examining the financial model to prepare responses to the Committee's questions, the Department of Treasury and Finance has identified some inconsistencies in the structure of the model. These primarily relate to the treatment of public sector superannuation costs. The effect of these inconsistencies is that the Primary Balance was more positive in the years prior to 2014-15 than shown in the 2016 Report, and over the period 2015-16 to 2029-30, the Primary Balance declines more rapidly or increases more slowly, depending on the scenario, than shown in the 2016 Report. However, I am satisfied that the conclusions of the 2016 Report would not have differed materially had these inconsistencies been identified during the preparation of the Report.

On an accrual basis, these expenses comprise the General Government sector's liability relating to employees in the State's defined benefit schemes in any year, together with the accrual costs relating to the General Government's unfunded superannuation liability.

The methodology in the 2016 Report was to replace the accrual-based method of estimating these superannuation expenses, as presented in the State's Budgets and as reported in the Treasurer's Annual Financial Statements, with an emerging cost approach, using the level of employer contributions the Government makes each year to former General Government employees who receive pensions and lump sum payments.

The 2016 Report set out an appropriate approach to treat these superannuation expenses in order to estimate the primary balance. However, the financial model did not fully reflect this approach. As a result, the estimates in the 2016 Report of the primary balance in the years to 2014-15 were not correct and the projections of the primary balance and net debt, from 2015-16 to 2029-30, were also not correct. Some of the results that I included in my letter to the Committee of 31 October 2018 and in my presentation to the Committee at its hearing on 19 November 2018 contained these incorrect estimates.

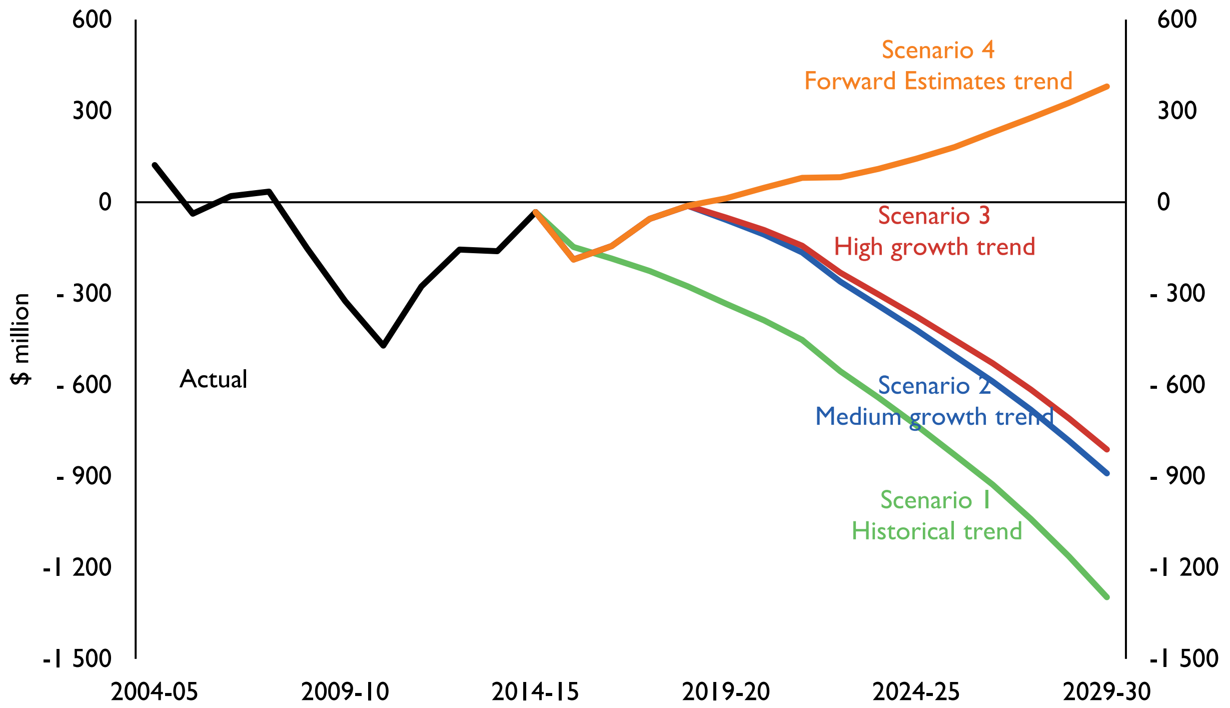
The financial model has been adjusted to correctly include superannuation costs and revised estimates have been calculated. These revised estimates do not include any actual economic, demographic or fiscal outcomes since 2014-15 and have been prepared to inform the Committee of the impact of the inconsistencies on the results, findings and conclusions in the 2016 Report.

There are no impacts on the demographic and economic growth projections in the 2016 Report. The fiscal estimates are affected because the expenses estimates have been revised. I set out below the revised estimates of the primary balance and net debt.

Revised primary balance estimates

The primary balance estimates in the 2016 Report are reproduced below. Over much of the decade to 2014-15, the primary balance was estimated as being negative. Under scenarios 1, 2 and 3, the primary balance was estimated to be increasingly negative from 2018-19. For scenario 1, in 2029-30 the deficit reached $1.3 billion or around 13 per cent of projected General Government revenue. Under scenario 4, which extended the revenue and expenses estimates in the *Revised Estimates Report 2015-16*, the primary balance was estimated to be increasingly positive, reaching $380 million or 5.3 per cent of projected General Government revenue by 2029-30.

Chart 1: Primary balance estimates and projections in the *Tasmanian Government Fiscal Sustainability Report 2016*



Revised primary balances are presented in Chart 2 below. The most important finding is that the overall trends in the projections are very similar to those presented in the 2016 Report.

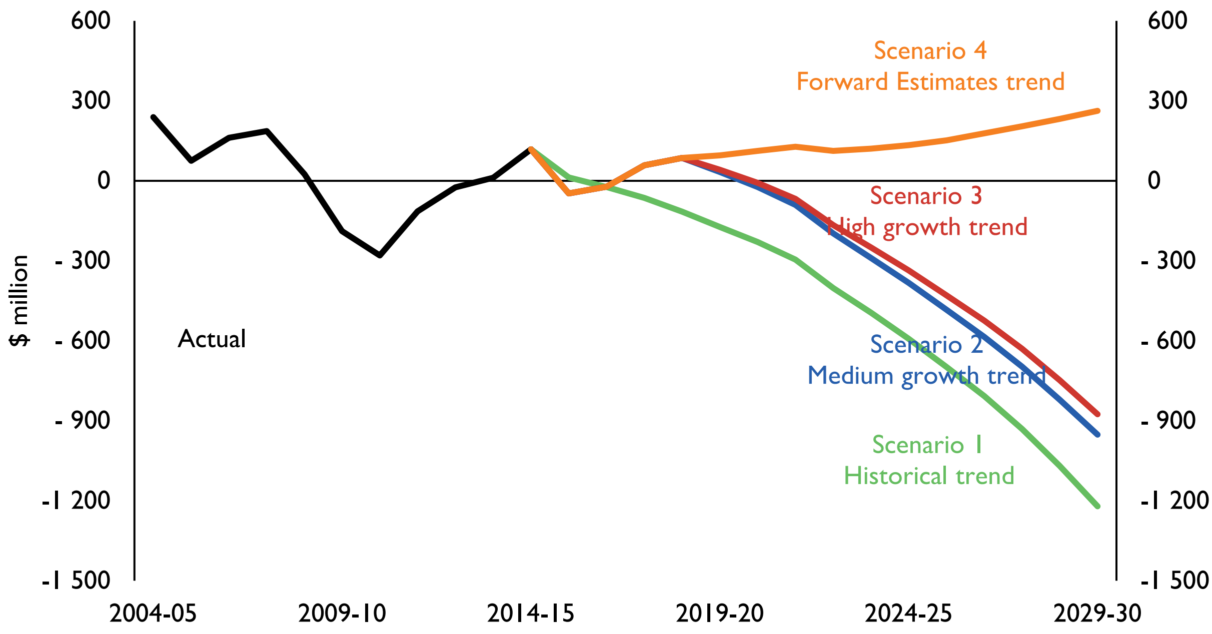
The revised profile of the primary balance for the decade to 2014-15 is very similar to the profile in the 2016 Report but the level is more positive, or less negative in each year. The effect of including actual superannuation payments for the defined benefit schemes and removing the accrual estimates of the expenses is to increase the primary balance in past years by around $150 million, on average.

For the future projections of the primary balance, the greatest deterioration in the primary balance is in scenario 1, as in the 2016 Report, where the revised estimates result in a decline to $1.2 billion by 2029-30 or almost 12 per cent of projected General Government revenue. Also, as in the 2016 report, there is a slightly greater decline in the primary balance in the medium growth case (scenario

2) than in the high growth case (scenario 3). For these two scenarios, the primary balance is positive until 2019-20 under the revised projections because the primary balance in the final year of the Forward Estimates (2018-19) is around $100 million higher than in the 2016 Report.

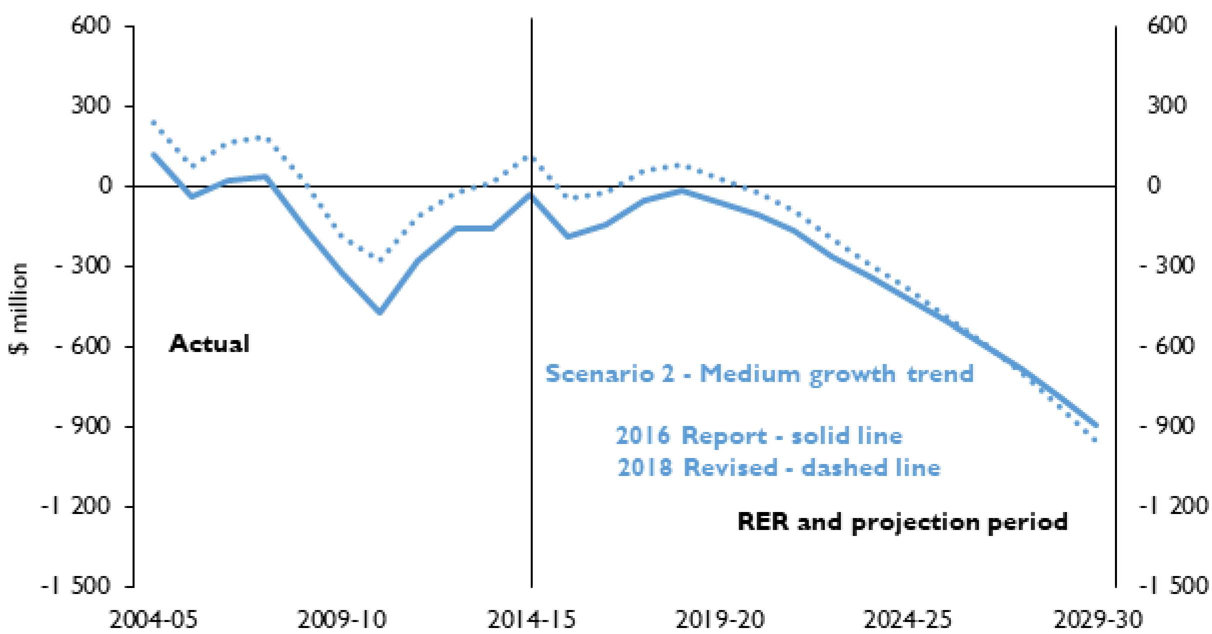
For scenario 4, which extends the Forward Estimate trends in the *Revised Estimates Report 2015-16*, the primary balance becomes increasingly positive, as in the 2016 Report, reaching $260 million or 3.6 per cent of projected General Government revenue by 2029-30.

Chart 2: Revised primary balance estimates and projections (December 2018)



The similarity of the results is shown in Chart 3 below, which presents, for scenario 2, the primary balance in the 2016 Report and the revised primary balance.

Chart 3: Primary balance estimates and projections for scenario 2 in the *Tasmanian Government Fiscal Sustainability Report 2016* and revised estimates and projections (December 2018)



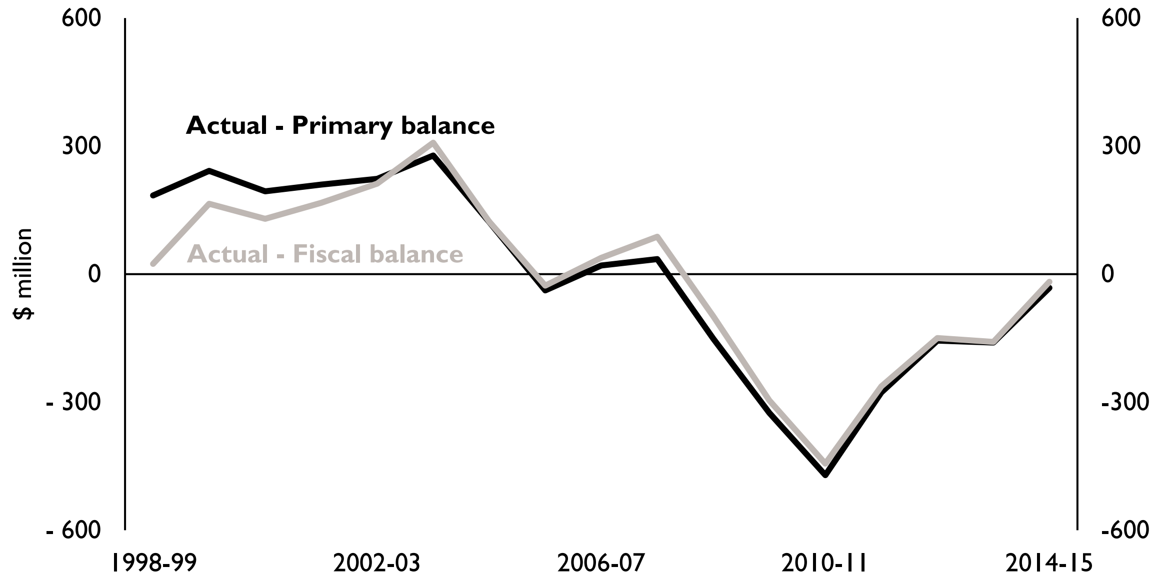
The chart shows the higher revised primary balance for the years to 2014-15 and also how the primary balance declines after the final year of the Forward Estimates period. In all four scenarios, the primary balance declines at a greater rate (or increases more slowly for scenario 4), compared to the results reported in the 2016 Report. This is because the projections capture the full cash cost of the liability that the State has been incurring for its employees in the defined benefit schemes. These costs increase significantly over the projection period.

As an example, in 2004-05, for the State's defined benefit schemes, General Government accrual superannuation costs were estimated at $241 million, while the General Government contributions, as cash costs, to lump sums and pensions were around half that amount at $124 million. By 2029-30, the accrual superannuation costs, as estimated in 2016, reach $339 million while the General Government contributions to lump sums and pensions rise to $440 million.

As in the 2016 Report, the growth in health expenditure is a key driver of the deteriorating primary balance in all the scenarios that were based on the trends of the previous decade. The revised financial modelling also confirms the 2016 Report's finding that the State Government's obligations relating to its defined benefits schemes also contribute to future fiscal pressure.

The 2016 Report included a chart (reproduced below) that showed the General Government primary balance estimates and the fiscal balance, for the years from 1998-99 to 2014-15. The commentary states that the difference between the fiscal balance and the primary balance was due to net interest costs, with borrowing costs being high in the early years due to the high level of net debt at that time.

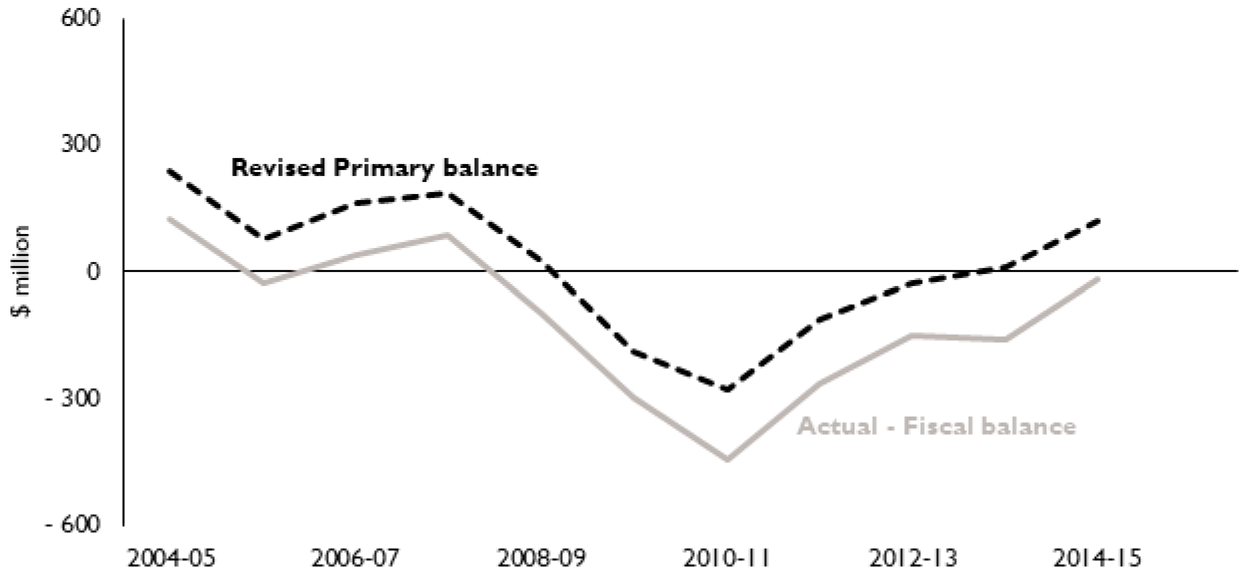
Chart 4: General Government fiscal balance and primary balance estimates in the *Tasmanian Government Fiscal Sustainability Report 2016.*



Revised estimates of the primary balance and the fiscal balance are presented in Chart 5 below. The estimates are from 2004-05 as there are no reliable data for the accrual defined benefit expenses for earlier years.

The primary balance is greater than the fiscal balance over the entire period. This is primarily because the superannuation expenses for the defined benefit schemes were much greater in these years when estimated on an accrual basis rather than on an emerging cost, or cash, basis, as discussed above.

Chart 5: General Government fiscal balance and revised primary balance estimates (December 2018)

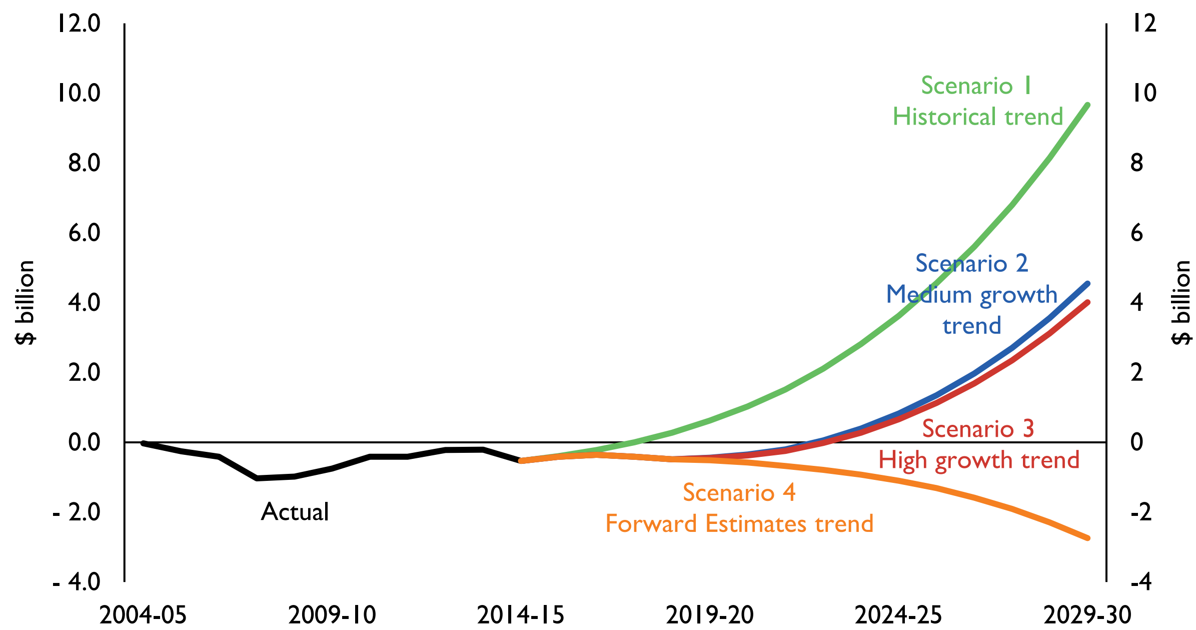


Net interest costs also explain part of the difference between the primary balance and the fiscal balance. However, for the period from 2004-05 to 2014-15, this accounted for a very small share of the difference as General Government borrowing costs were at very similar levels to interest income.

Revised net debt estimates

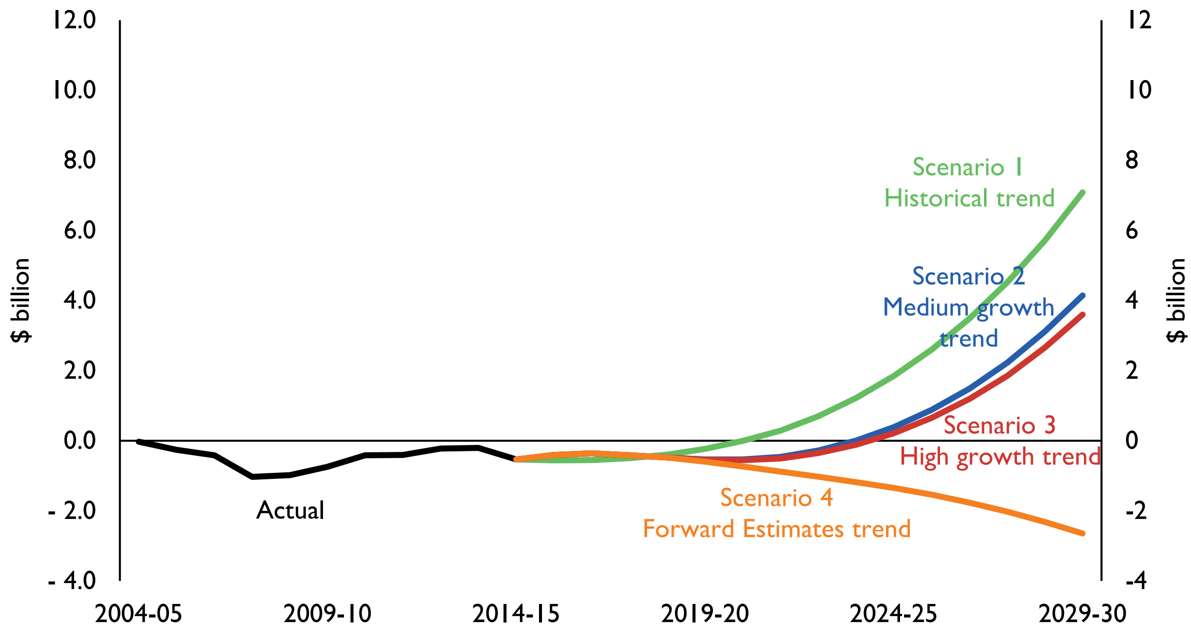
The revised net debt profiles under the four scenarios are also very similar to those in the 2016 Report. In that report, net debt was estimated to grow fastest under the scenario that reflected the trends of the decade to 2014-15 (Chart 6 below), reaching $9.7 billion by 2029-30 if no corrective action were taken. In the 2016 Report, net debt increased slightly more quickly under scenario 2 than scenario 3, while for scenario 4, net debt was increasingly negative.

Chart 6: Net debt estimates and projections in the *Tasmanian Government Fiscal Sustainability Report 2016*



For the revised net debt projections (Chart 7 below), net debt also increases most sharply under scenario 1, though at a slightly lower rate, reaching $7.1 billion by 2029-30. Again, net debt increases slightly more quickly under scenario 2 than scenario 3, while for scenario 4, net debt is increasingly negative, as in the 2016 Report.

Chart 7: Revised net debt projections (December 2018)



Treatment of equity contributions from the General Government Sector

The financial model for the 2016 Report did not include equity contributions from the General Government Sector as expenses, including in cases when some funding had been received from the Australian Government.

In years when payments were received from the Australian Government to contribute to certain infrastructure in the State, such as rail and irrigation infrastructure, these payments were included as revenue in the modelling. In some cases, the State Government transferred these funds to the relevant government businesses as State Government equity contributions.

Had the financial model treated these transactions differently, the estimates of the primary balance would have been different for the relevant years, though the change would generally not have been large, given the size of the equity contributions in most years.

More importantly, it is not expected the projections of the primary balance and net debt under the four scenarios would have been significantly affected. This is because, at the time of the 2016 Report, no future equity contributions were identified outside the then Forward Estimates period. For these reasons, the financial model used for the 2016 report has not been adjusted to include a different treatment of equity contributions.

This has become a more important issue since the 2016 Report was issued. Since then, there has been the $730 million Mersey Community Hospital Transfer and decisions of the Government to make significant equity contributions to the TT-Line and, most recently, TasWater.

Implications of the revised estimates of the primary balance and net debt

As set out above, the overall trends in the projections of the primary balance and net debt to 2029-30 under the four scenarios are very similar to those in the 2016 Report. Furthermore the drivers of the changes in the primary balance are the same as those identified in the 2016 Report.

I am satisfied, therefore, that the findings and conclusions in the 2016 Report remain valid and relevant. That is, if the financial model had not contained the inconsistencies in the treatment of public sector superannuation expenses and the results for the primary balance and net debt were as set out above, I would expect that the report would not have differed materially from the 2016 Report.

However, as a result of the issues identified in the 2016 Report, I intend to prepare a new fiscal sustainability report following the 2019-20 State Budget, to include all economic, demographic and fiscal information available at that time and which may contain some changes to the treatment of equity contributions from the General Government Sector. This would be in addition to my obligations under Section 14A of the *Charter of Budget Responsibility Act 2007*, to prepare a report no later than 30 June in the year 5 years after the date of the 2016 report (ie 2021).

In the attachment I have set out responses to the Committee's questions, which I request the Committee consider in the context of the information I have provided above.

I would be happy to meet with the Committee again to assist it in its examination of these matters.

Yours sincerely

Tony Ferrall
Secretary

6 December 2018

Responses to the questions by the Parliamentary Standing Committee of Public Accounts relating to the review of the *Tasmanian Government Fiscal Sustainability Report 2016*

1. *The rationale for the use of the primary balance as a measure of fiscal pressure and its reconciliation to the General Government Summary Operating result for 2017-18.*

There are two ways of measuring the fiscal pressure that Tasmanian Governments might be expected to face in the future. One approach is to project into the future the measures reported in the annual budgets and the annual reports of the State's accounts, of which the most recent is the Treasurer's Annual Financial Report 2017-18 (TAFR 2018). These measures would include some or all or the net operating balance, the fiscal balance, the cash surplus or deficit and net debt. These are standard accounting measures under the Australian Accounting Standard 1049 *Whole of Government and General Sector Financial Reporting*.

Under this approach, the reported level of fiscal pressure in any year is determined, in part, by the balance sheet impacts from prior years, or decades, arising from past deficits or surpluses. It does not, therefore reveal the underlying fiscal pressure in any particular year. A future State Government's finances could appear strong in any year due to a large negative net debt resulting in a high level of interest income, even though the State's total spending may exceed its revenue from all sources other than interest income. This is not sustainable year after year as the negative net debt would disappear, together with the interest income, and the State would, after that, face even larger deficits as they would incur borrowing costs. As the intention of the 2016 Report was to examine the State's fiscal pressure on a year by year basis, this approach was not adopted.

The accepted alternative approach is to estimate future fiscal pressure using a measure that removes the legacy effects of previous budget deficits or surpluses and instead reveals whether, for any year, a State Government's revenue is sufficient to meet its spending pressures. For this reason, the primary balance was chosen as interest-related costs or earnings are removed and other adjustments can be made, as necessary to remove these balance sheet effects.

This is an established approach used by the Organisation for Economic Co-operation and Development[1] and, in Australia, by the Governments of Australia and New South Wales in their reports that are equivalent to the 2016 Report.

This approach includes the superannuation payments that future State Governments must make each year to former public sector employees in the defined benefit schemes. These cash payments are not reflected in the net operating balance or the fiscal balance, because these balances reflect expenses for transactions only in cases where liabilities are created, whereas the Government's cash payments relating to the defined benefit schemes in any one year reflect the liabilities it and former governments accrued in previous years. This is important because the sustainability of the State's finances is influenced by the future level of these defined benefit schemes payments. This is why these future superannuation payments are reported in Attachment 2 of the 2016 Report.

A further advantage of the primary balance approach is that it is not necessary to forecast future interest rates. This is not so much an issue under current monetary conditions as interest rates have been relatively stable. However, in earlier decades they were highly volatile and this had very significant impacts on the borrowings costs, or interest income of governments across Australia.

In practice, any measure of the primary balance includes some revenue and expenses that are reported on an accrual approach, and other elements that reflect cash transactions. This is inevitable as the estimates for most components of Government expenditure, from which the primary balance is derived, are reported on an accrual basis, as in the Statement of Comprehensive Income in the

[1] The Organisation for Economic Co-operation and Development defines the primary balance as "Government net borrowing or net lending excluding interest payments on consolidated government liabilities". The Australian Government also excluded earnings from the Future Fund.

TAFR 2018 and the *Government Finance Statistics, Australia* issued by the Australian Bureau of Statistics. This is one reason why the primary balance is not a standard accounting measure.

The reconciliation of the primary balance estimate, as calculated in accordance with the methodology in the 2016 Report, with the fiscal balance for 2017-18 as reported in the TAFR 2018, is set out below.

Table 1: Reconciliation of the fiscal balance to the primary balance for Tasmania's General Government Sector: 2017-18 ($ million)

Revenue from transactions	
Revenue other than interest income (1)	6 073
Interest income	20
Total revenue (2)	6 093
Expenses from transactions	
Accrual expenses excluding defined benefit schemes superannuation costs and borrowing costs (3)	5 580
Nominal superannuation interest expense and defined benefit schemes service costs	377
Borrowing costs	10
Total accrual expenses (4)	5 967
Government cash payments relating to defined benefit schemes (5)	250
Net acquisition of non-financial assets (6)	130
Fiscal Balance (2 - (4 + 6))	(4)
Primary Balance (1 - (3 + 5 + 6))	113

In summary the fiscal balance is obtained from the primary balance by:

- removing the Government's cash payments relating to defined benefit schemes as an expense;
- including the Nominal Superannuation Interest Expense and the defined benefit schemes service costs as expenses; and
- including interest income as revenue and borrowing costs as an expense.

2. *A reconciliation of the net operating balance to the primary balance for the years 2013-14 to 2017-18 and for the four scenarios from 2015-16 to 2017-18*

The reconciliation of the net operating balance to the primary balance, for the years from 2013-14 *to* 2017-18 is set out in Table 2 below and the following explanation. The primary balance estimates below use the methodology as outlined above and, for 2013-14 and 2014-15 differ from those in the 2016 Report.

Table 2: Estimation of the Net Operating Balance and the primary balance for Tasmania's General Government Sector: 2013-14 to 2017-18 ($ million)

	2013-14	2014-15	2015-16	2016-17	2017-18
Revenue from transactions					
Non-interest revenue (1)	4 897	5 140	5 414	6 460*	6 073
Interest income	13	15	20	18	20
Total revenue (2)	4 910	5 155	5 434	6 478*	6 093
Expenses from transactions					
Accrual expenses excl. defined benefit schemes superannuation costs and borrowing costs (3)	4 668	4 787	4 959	5 266	5 580
Nominal superannuation interest expense and defined benefit schemes service costs	395	414	403	398	377
Borrowing costs	12	11	10	10	10
Total accrual expenses (4)	5 075	5 212	5 372	5 674	5 967
Government cash payments relating to defined benefit schemes income (5)	223	274	224	267	250
Net Operating Balance (2 - 4)	(165)	(57)	62	804	126
Net acquisition of non-financial assets (6)	(4)	(39)	58	128	130
Primary Balance (1 - (3 + 5+ 6))	10	118	173	69*	113

* Non-interest revenue in 2016-17 included the payment of $730 million from the Australian Government for the Mersey Community Hospital Transfer. This has been deducted for the estimate of the primary balance in 2016-17.

The net operating balance does not include the purchases of non-financial assets (principally public infrastructure investment) and the sale of non-financial assets.

In summary, the net operating balance is obtained from the primary balance by:

- removing the Government's cash payments relating to defined benefit schemes as an expense;
- including the Nominal Superannuation Interest Expense and the defined benefit schemes service costs as expenses;
- removing the net acquisition of non-financial assets as an expense; and
- including interest income as revenue and borrowing costs as an expense.

The first year of projected primary balances under the four scenarios is 2015-16. The table and the explanation below explain the reconciliation of the actual net operating balance to the projected primary balances under scenario 1, which extends the historical trends in revenue, recurrent expenditure and net capital expenditure (the net acquisition of non-financial assets) from 2015-16 onwards. Table 3 shows the calculation of the net operating balance and the projected primary balance under scenario 1.

Table 3: Estimation of the Net Operating Balance and the projected primary balance (Scenario 1) for Tasmania's General Government Sector: 2015-16 to 2017-18 ($ million)

	2015-16	2016-17	2017-18
Revenue from transactions			
Actual non-interest revenue	5 414	6 460	6 073
Projected non-interest revenue (1)	5 377	5 625	5 887
Actual Interest income	20	18	20
Actual total revenue (2)	5 434	6 478	6 093
Expenses from transactions			
Actual expenses excluding borrowing costs	5 362	5 664	5 957
Projected expenses excluding borrowing costs, the nominal superannuation interest expense, and defined benefit service costs and including Government cash payments relating to defined benefit schemes (3)	5 304	5 586	5 886
Actual borrowing costs	10	10	10
Actual total expenses (4)	5 372	5 674	5 967
Projected net acquisition of non-financial assets (5)	60	63	66
Net operating balance (2 - 4)	62	804*	126
Projected primary balance (1 - (3 + 5))	13	(24)	(65)

*As noted above, actual total revenue in 2016-17 included the payment of $730 million from the Australian Government for the Mersey Community Hospital Transfer, which is reflected in the reported net operating balance for that year.

For scenarios 2, 3 and 4, the projections to 2017-18 are identical as they are all derived from the *Revised Estimates Report 2015-16*. The difference between the fiscal outcomes and the projections is principally the extent to which actual General Government revenue and expenditure was different from the estimates in the *Revised Estimates Report 2015-16*. This is set out in Table 4 below.

Table 4: Estimation of the Net Operating Balance and the projected primary balance (scenarios 2, 3 and 4) for Tasmania's General Government Sector: 2015-16 to 2017-18 ($ millions)

	2015-16	2016-17	2017-18
Revenue from transactions			
Actual non-interest revenue	5 414	6 460	6 073
Projected non-interest revenue (1)	5 369	5 492	5 498
Actual interest income	20	18	20
Actual total revenue (2)	5 434	6 478	6 093
Expenses from transactions			
Actual expenses excluding borrowing costs	5 362	5 664	5 957
Projected expenses excluding borrowing costs, the nominal superannuation interest expense, and defined benefit service costs and including Government cash payments relating to defined benefit schemes (3)	5 294	5 285	5 330
Actual borrowing costs	10	10	10
Actual total expenses (4)	5 372	5 674	5 967
Projected net acquisition of non-financial assets (5)	122	228	109
Net operating balance (2 - 4)	62	804	126
Projected primary balance (1 - (3 + 5))	(47)	(21)	59

The projections in scenarios 2, 3 and 4 were derived from the *Revised Estimates Report 2015-16* and were estimated on the same basis as for the Net Operating Balance, with the Nominal Superannuation Interest Expense included and without including the Government's cash payments relating to the defined benefit schemes.

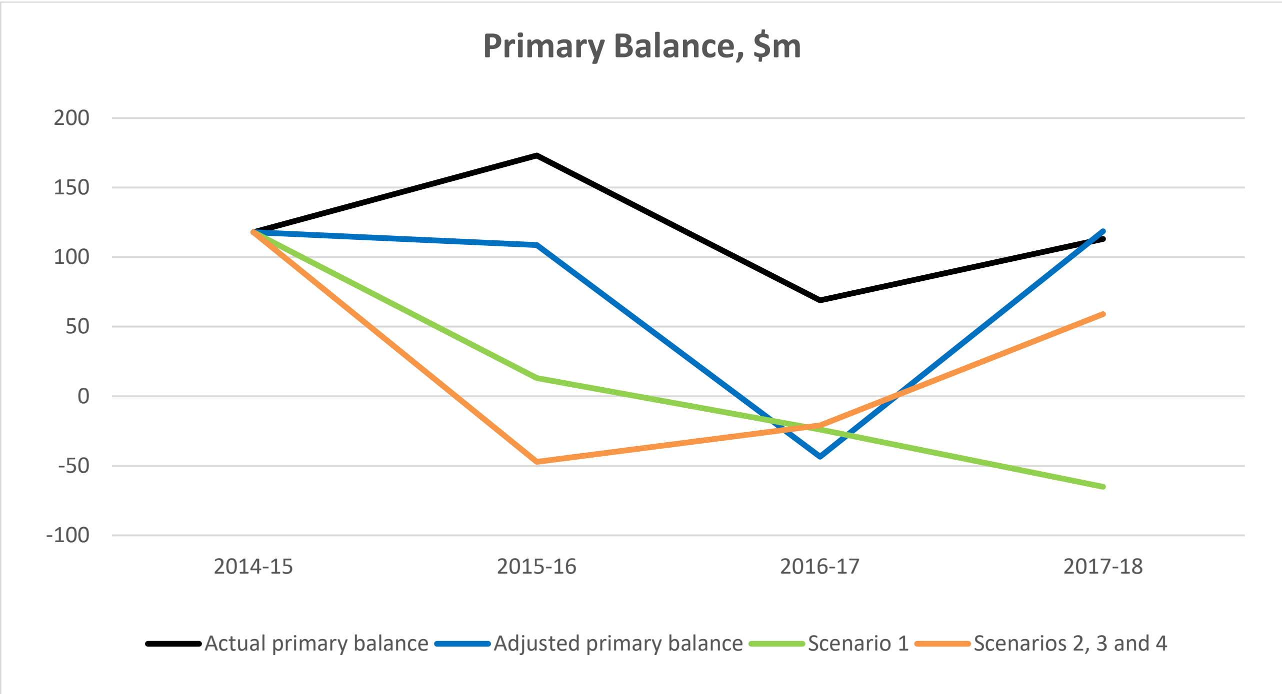
Table 4 demonstrates how actual revenues were substantially higher than estimated in the *Revised Estimates Report 2015-16*. Actual expenses were also much higher in 2016-17 and 2017-18 than in the *Revised Estimates Report 2015-16,* measured on a comparable basis, though this is not apparent from the above table.

3. *A revised chart comparing primary balance projections to actual outcomes, adjusted to exclude the impact of the capital expenditure underspend.*

Chart 1A below shows the primary balance projections and an adjusted primary balance, for the years from 2015-16 to 2017-18, that assumes that capital expenditure had been identical to the estimates in the *Revised Estimates Report 2015-16*. Again, these estimates of the primary balance include the treatment of defined benefit superannuation costs as set out above, and therefore differ, for 2014-15, from the estimate in the 2016 Report. The chart also shows the actual primary balance for these years, as presented in Table 2.

The $730 million Mersey Community Hospital Transfer was deducted from General Government revenue in the estimation of the actual and the adjusted primary balance for 2016-17.

Chart 1A: General Government primary balance projections, actual primary balances and adjusted primary balances that include the full budgeted capital expenditure,



The adjusted primary balance is lower than the actual primary balance in 2015-16 (by $64 million) and in 2016-17 (by $114 million), reflecting the difference between the budgeted capital expenditure in the *Revised Estimates Report 2015-16* and the actual capital expenditure in those years. For 2017-18, actual capital expenditure was marginally higher than estimated for that year in the *Revised Estimates Report 2015-16*.

The adjusted primary balances provide an overall indication of the budget pressure in these years if there had been no capital expenditure underspend. However, if capital expenditure levels had been higher, there would likely have been different levels of expenses in other areas. For example, the Department of State Growth may have needed additional employees to manage the additional capital expenditure if it related to more road-related works.

Also, in some cases, the additional capital expenditure may have resulted in more employees being employed in the relevant agency if the size of the workplace had been constraining employee numbers or the supply of services.

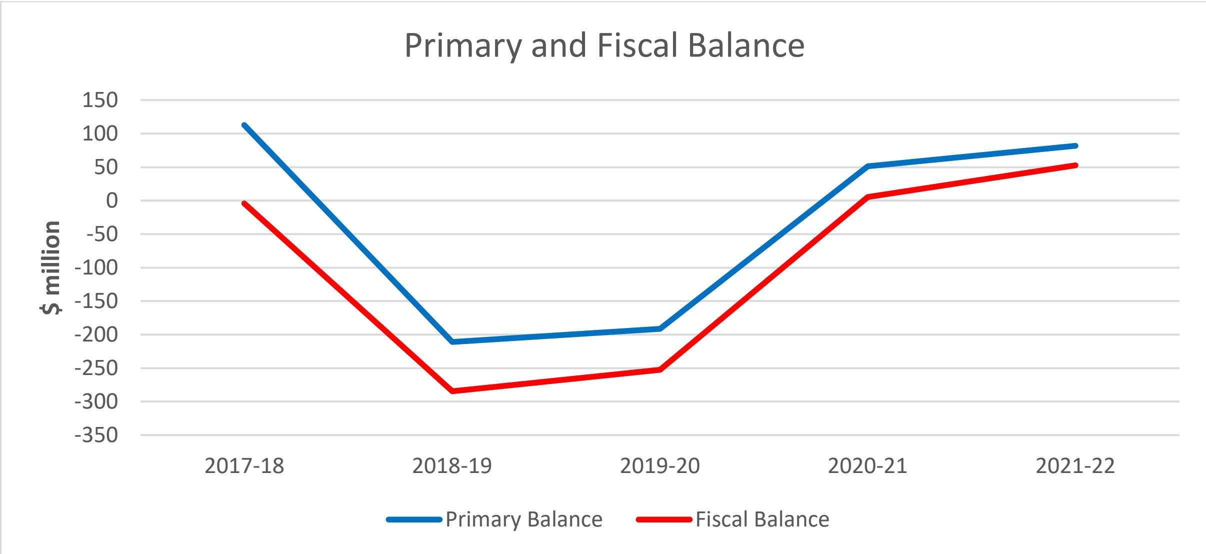
In addition, maintenance costs may have been different in these years if some infrastructure had been upgraded or replaced sooner. Therefore had all the budgeted capital expenditure been expended, the relevant TAFRs may have reported different expenses in the General Government Sector Statement of Comprehensive Income, which would have affected the primary balance.

4. *A primary balance chart for the 2018-19 Budget and Forward Estimates period, including all budgeted capital expenditure and budgeted financial impacts*

Chart 2A below shows the primary balance for the 2018-19 Budget and Forward Estimates period. For comparison, the Fiscal Balance estimates for the 2018-19 Budget and Forward Estimates period are also included.

The decline in the primary balance is due to the capital expenditure program in the 2018-19 Budget. The difference between the two measures reflects largely the inclusion in the fiscal balance of the accrual defined benefit service expenses as they relate to General Government sector employees. These expenses decline each year as a result of fewer public sector employees remaining in the defined benefit schemes. This, together with the increasing payments from the Government for pensions and lump sum cash payments under the defined benefit schemes, explains the narrowing of the gap over the Forward Estimates period.

Chart 2A: Primary balance and fiscal balance estimates for the 2018-19 Budget and Forward Estimates period



5. *Treatment of grant funding receipts distributed as equity injections within the primary balance modelling*

As discussed above, the 2016 Report and the revised estimates presented above do not include equity contributions from the General Government Sector as expenses. The next fiscal sustainability report may include some changes to the treatment of equity contributions from the General Government Sector.

Tasmanian Government Fiscal Sustainability Report 2019

The long term sustainability of the State's finances
Presentation to the Parliamentary Standing Committee of Public Accounts
30 October 2019

Department of Treasury and Finance

Tasmanian Government

Presentation objectives

- To provide a brief outline of the Report, including the
  - context;
  - purpose;
  - methodology and fiscal measures used;
  - high level results from the projections; and
  - conclusions.

Context

- Undertaking provided in 2018 that a new fiscal sustainability report would be published after the release of the 2019-20 State Budget.
- The Report has:
  - been prepared consistent with the provisions of the *Charter of Budget Responsibility Act 2007*; and
  - specific regard to the existing policies of the Government and anticipated changes to the demographics of Tasmania.
- The next report is scheduled to be released before 30 June 2021.

Purpose of the Report

- Provides a long-term perspective on Tasmania's fiscal outlook that goes beyond the reporting in the Budget and the three years of Forward Estimates.
- Outlines the potential magnitude of any long-term financial imbalances for the State that may arise in the future.
- May inform future fiscal management practices and policy.
- Similar long-term fiscal sustainability reporting is prevalent across Australia and other countries.

Fiscal sustainability measures

- Measures are consistent with those reported in the State Budget.

Measure	Definition	Used for
Net Operating Balance	The difference between General Government Sector revenue and expenditure, as defined by the Uniform Presentation Framework. This measure excludes net capital expenditure.	Shows the operating position of providing government services.
Fiscal Balance	The difference between General Government Sector revenue and expenditure, after allowing for net capital expenditure.	Shows whether a sufficient surplus is being generated by the operations of government to fund its capital expenditure needs.
Net Debt	The difference between General Government Sector borrowings and the sum of its cash, deposits and interest earning investments.	This measure is used to assess the overall strength of a government's financial position.

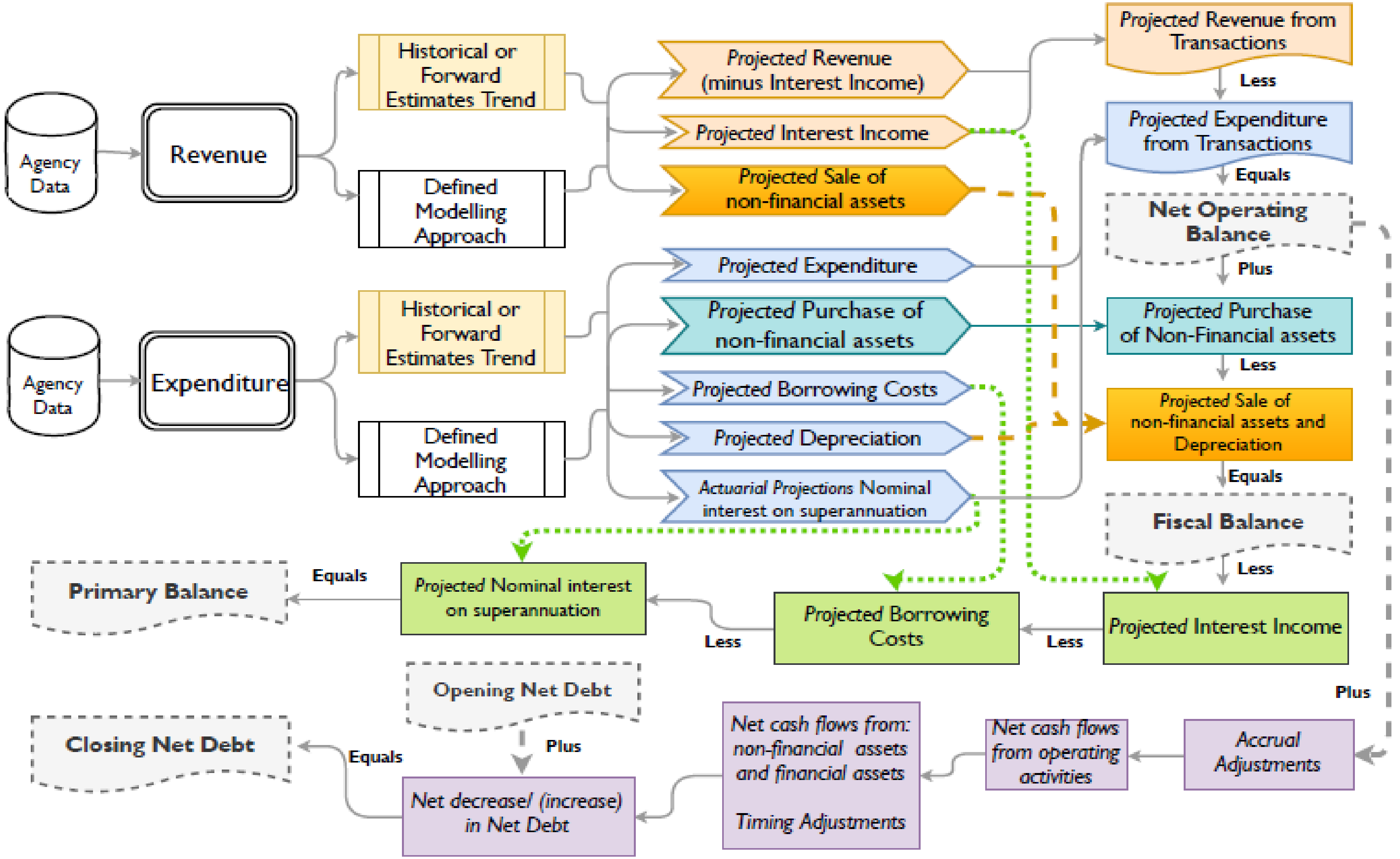
Projection methodology

- Report considers long-term fiscal sustainability under a number of different assumed scenarios.
- Standard budgeting methods and measures were used.
- Projections over a 15-year timeframe.
- Known or expected future changes in revenue and expenditure, and major capital expenditure projects, taken into account.
- Projections assume no corrective policy action over the projection period.
- Projections are not forecasts and no scenario is considered more or less likely to occur.

FSR Model

- The model was built by a specialist Project Team within Treasury.
- A complex model of the General Government Sector with an accounting framework as the basis of fiscal sustainability analysis.
- 28 variables can be altered across the four scenarios, providing capacity for an extremely large number of unique projection combinations.
- Over 20 000 formulae which work to:
  - compute projections based on inputs specified within the model; and
  - enable flow-through of changes to assumptions.
- Additional functionality supported by Excel Visual Basic for Applications (VBA) programming.

Model Schematic



Scenarios

- The Report has considered four different scenarios.

Scenario 1 Historical Trends	Scenario 2 Forward Estimates	Scenario 3 High Expenditure	Scenario 4 Low Revenue
• Uses past data to project forward expenditure and revenue on a historic trend basis. • Includes known significant future changes to both expenditure and revenue items. • Shows the potential impact of continuing historical trends in the absence of any policy response.	• Develops projections based on revenue and expenditure patterns over the 2019-20 Budget and Forward Estimates period. • Includes known significant future changes to both expenditure and revenue items. • Shows the impacts of the State Government's current policies and fiscal intent over a longer period without any policy change.	• Uses Historical Trends for most revenue items and some expenditure items. • Some expenditure items have been projected at higher levels, including health, education and capital expenditure. • Shows the potential risk of ongoing high expenditure growth in the absence of any policy response.	• Uses Historical Trends for most expenditure items and some revenue items. • Some revenue items have been projected at lower levels, including GST receipts, Australian Government payments, conveyance duty and government businesses returns. • Shows the potential impacts of lower revenue outcomes in the absence of any policy response.

Matters included in modelling

- Future events that may impact on revenue or expenditure that have been included in the modelling:
  - Royal Hobart Hospital redevelopment.
  - Northern Prison and Southern Remand Centre.
  - Bridgewater Bridge.
  - Additional road funding.
  - End of the GST Guarantee period.
  - End of the Mersey Community Hospital Fund agreement.
  - Waiver of the Commonwealth-State Housing Agreement debt.

Matters not included in modelling

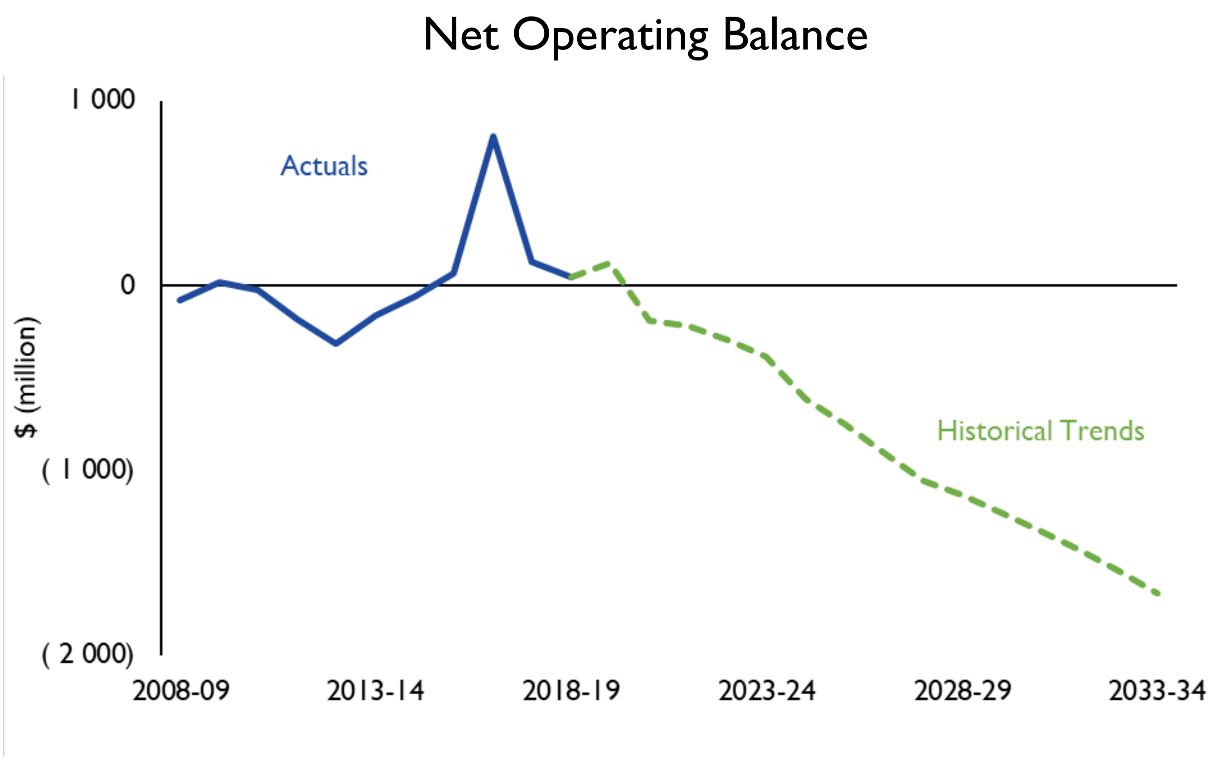
- Impacts related to the following matters have not been explicitly modelled:
  - Major electricity projects:
    - Project Marinus; and
    - Battery of the Nation.
  - Climate change and natural disasters.
  - Potential changes to the Australian Government's funding arrangements.
  - Potential changes to State Government policies.

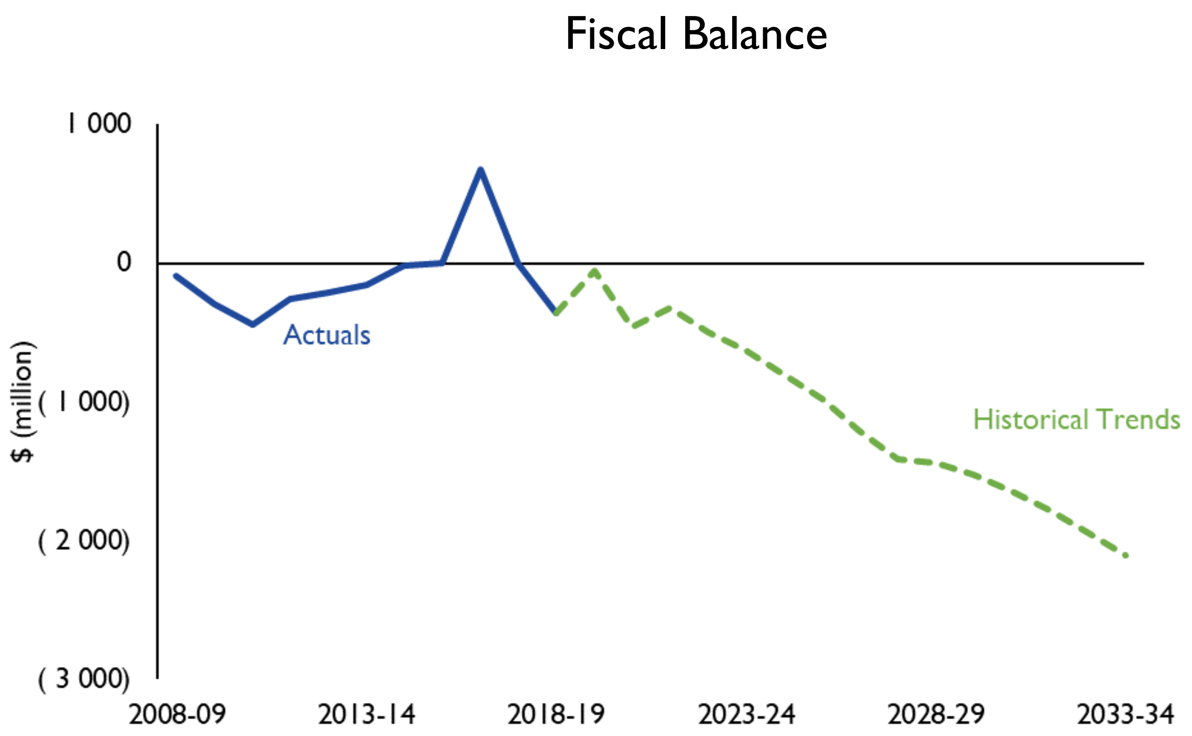
Capital Expenditure

- The projected purchase of non-financial assets is based on infrastructure commitments included in the 2019-20 Budget and Forward Estimates, and other known project commitments beyond the Forward Estimates period.
- The projections include funding for major projects including the Bridgewater Bridge, road infrastructure, the Northern Prison and the Royal Hobart Hospital redevelopment.
- The Historical Trend and Low Revenue Scenarios factor in the historical annual underspend in infrastructure expenditure.

Scenario 1: Historical Trends

Projection Results:

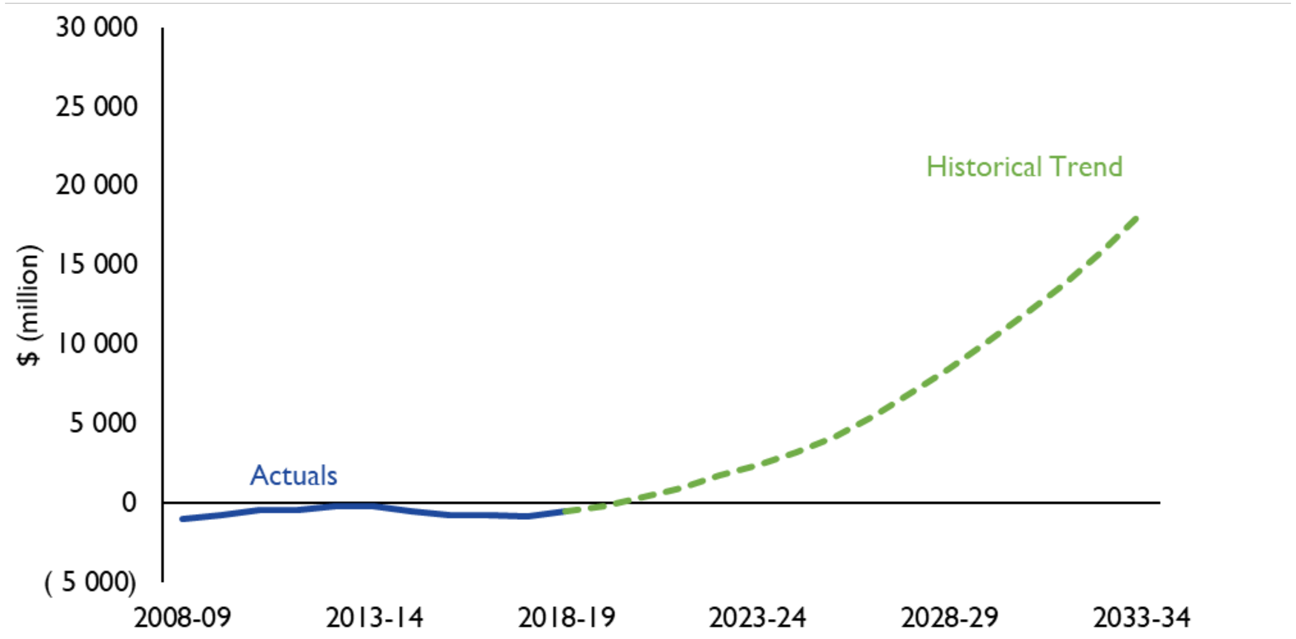




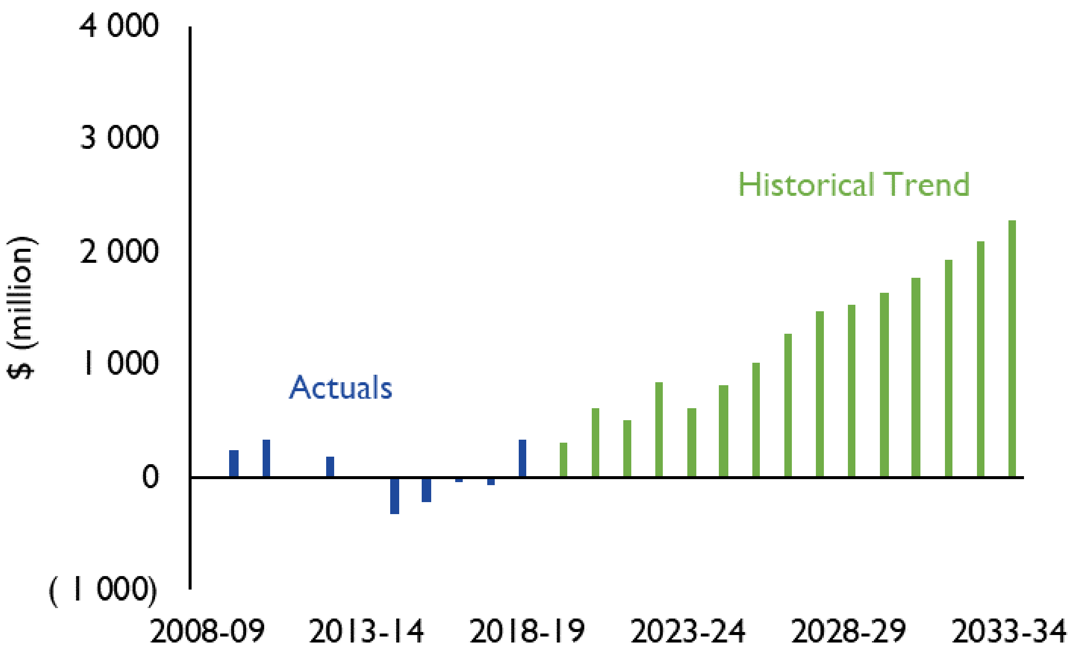
Scenario 1: Historical Trends (cont.)

Projection Results:

Net Debt



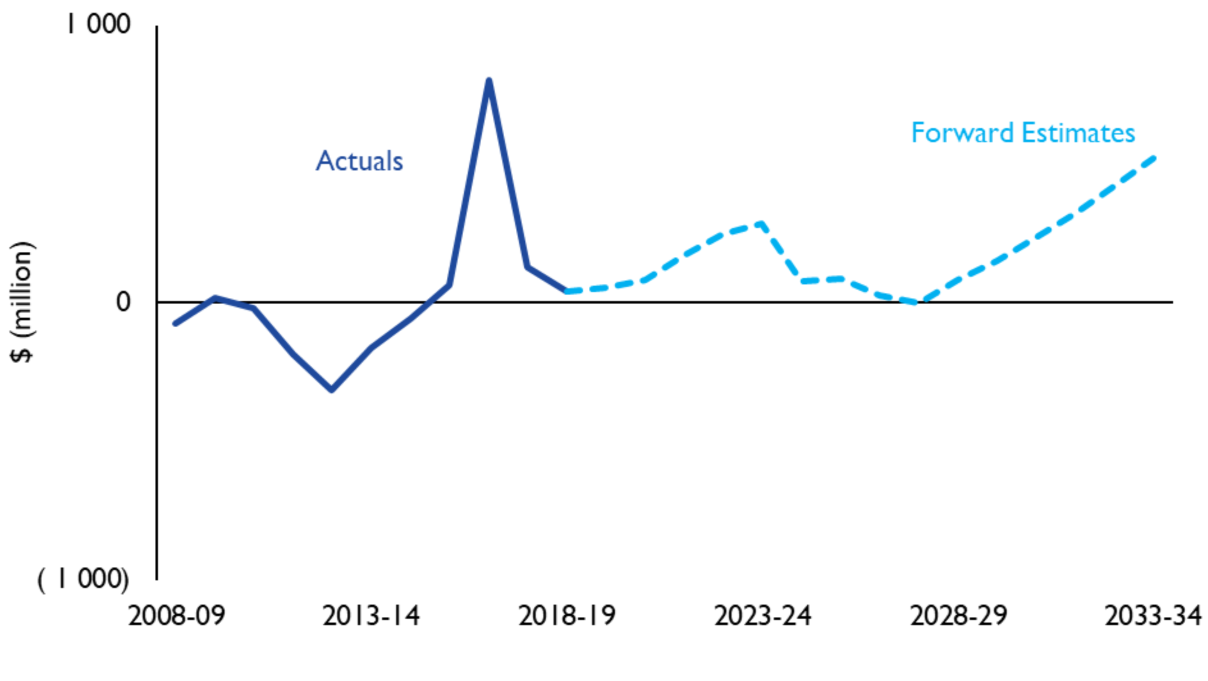
Annual Change in Net Debt



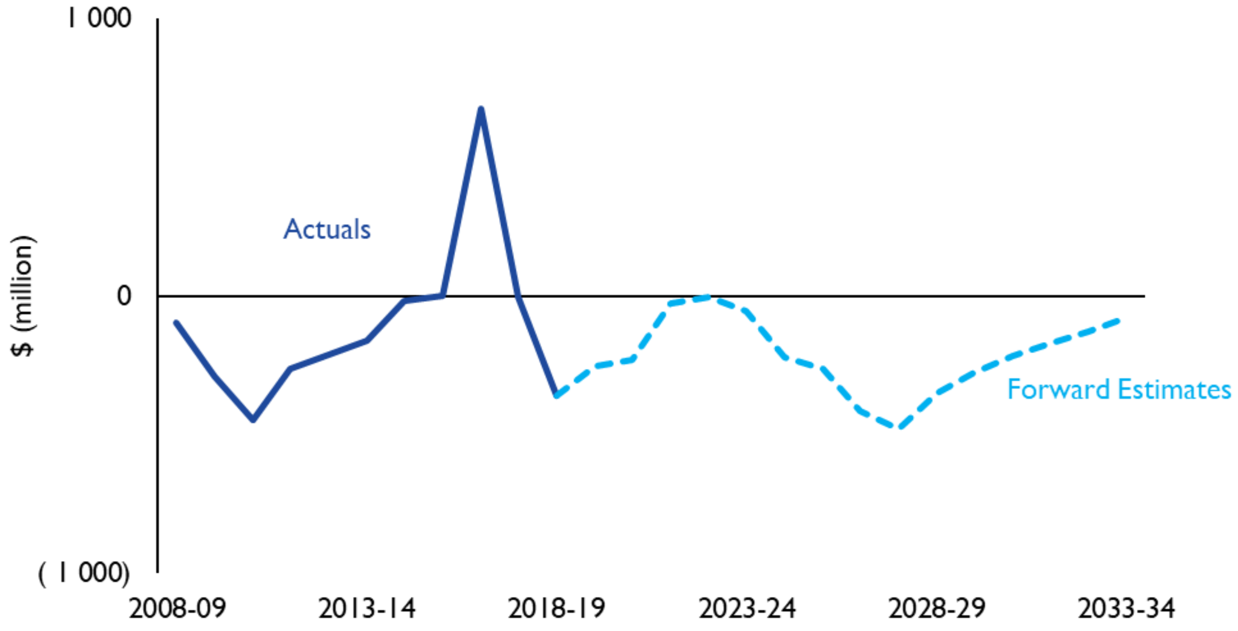
Scenario 2: Forward Estimates

Projection Results:

Net Operating Balance



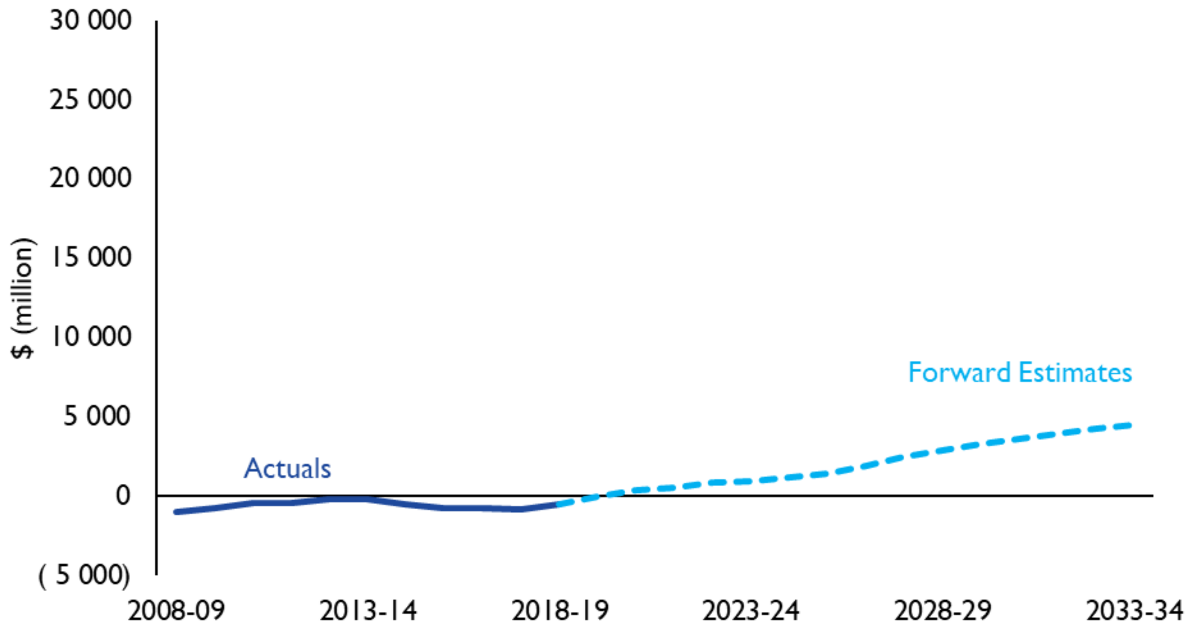
Fiscal Balance



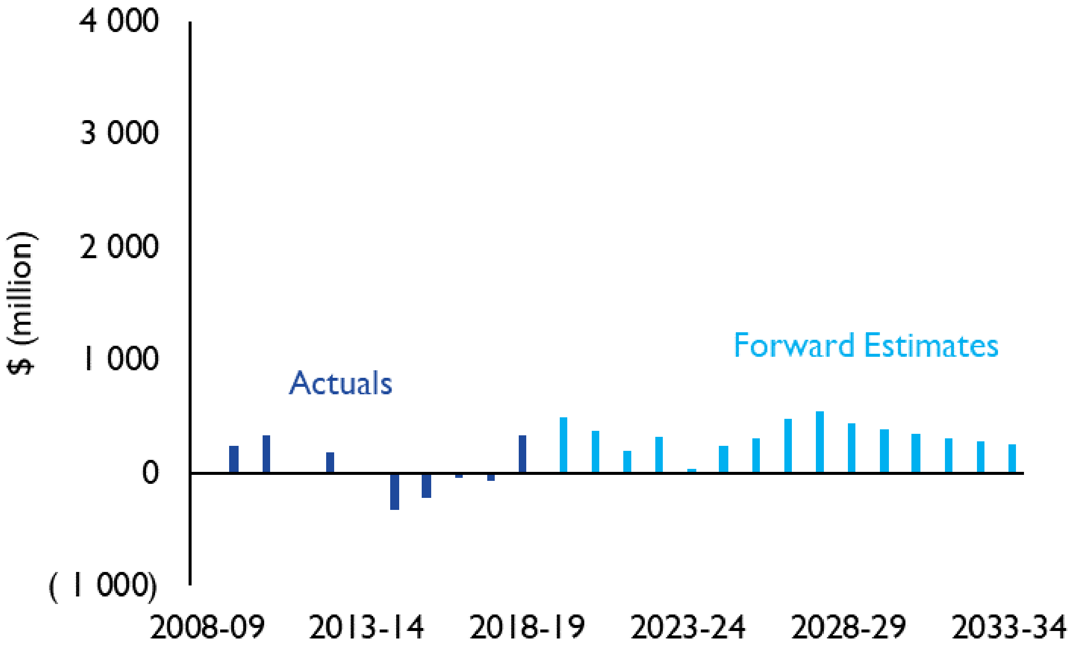
Scenario 2: Forward Estimates (cont.)

Projection Results:

Net Debt

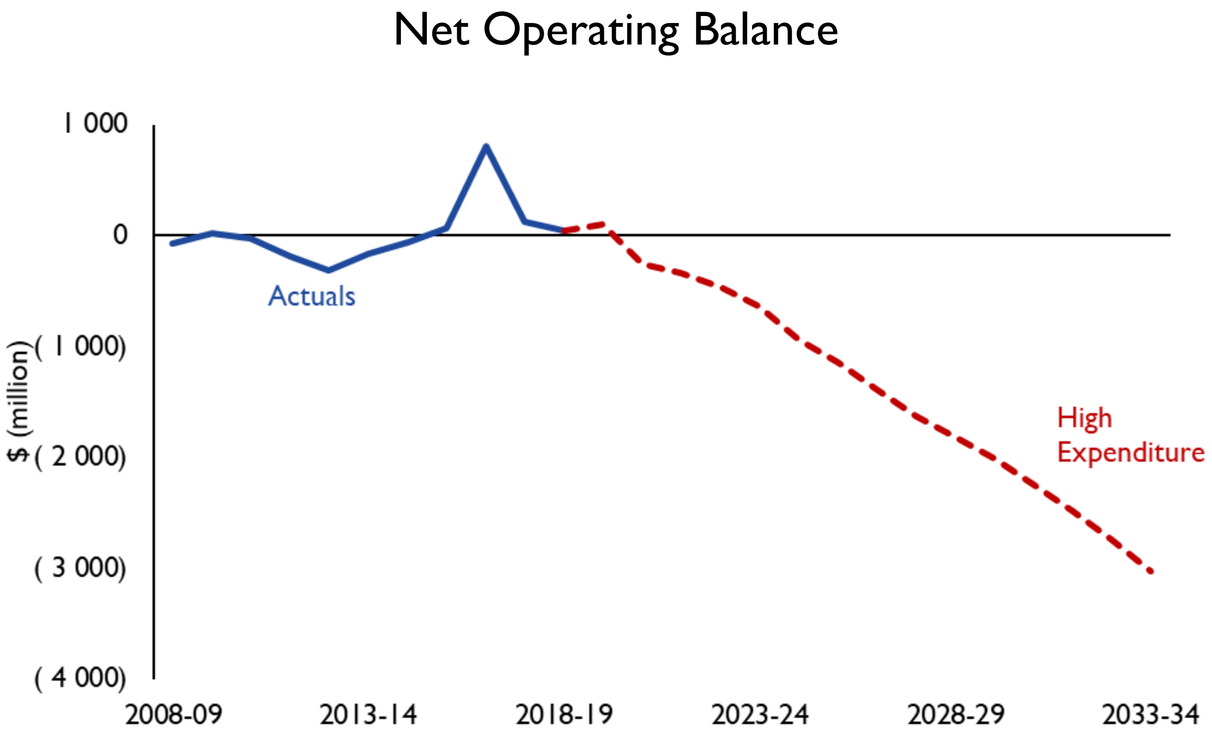


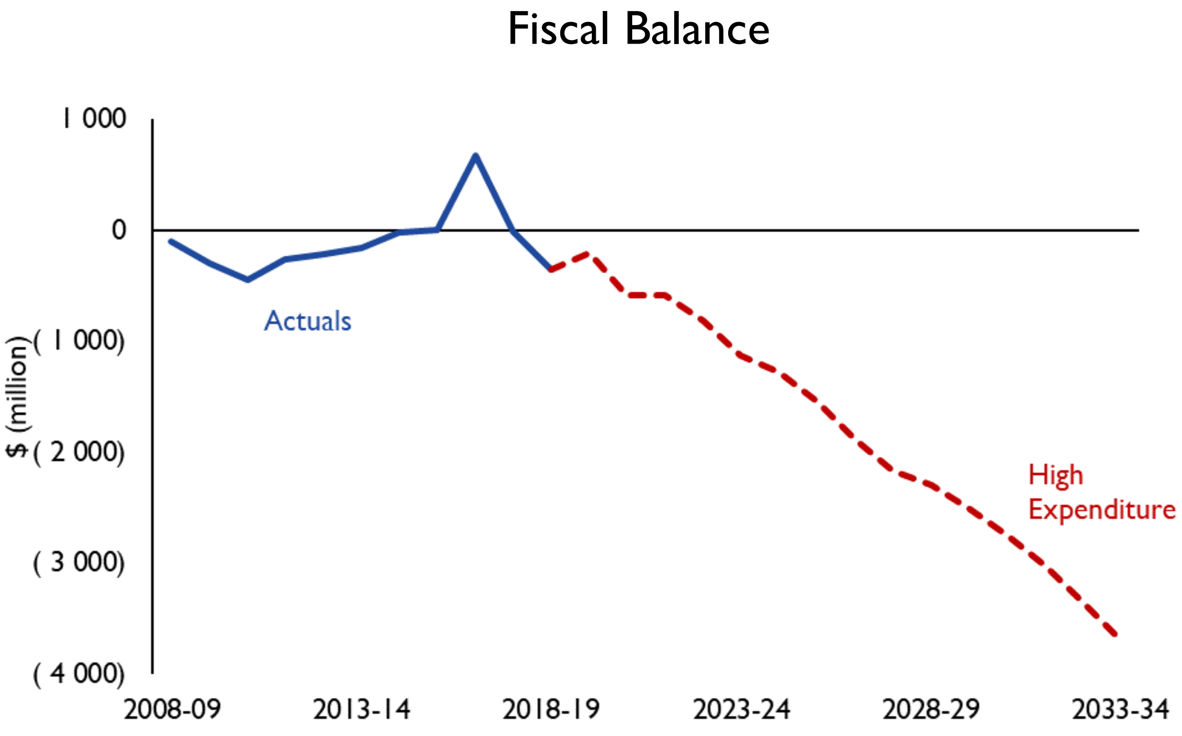
Annual Change in Net Debt



Scenario 3: High Expenditure

Projection Results:

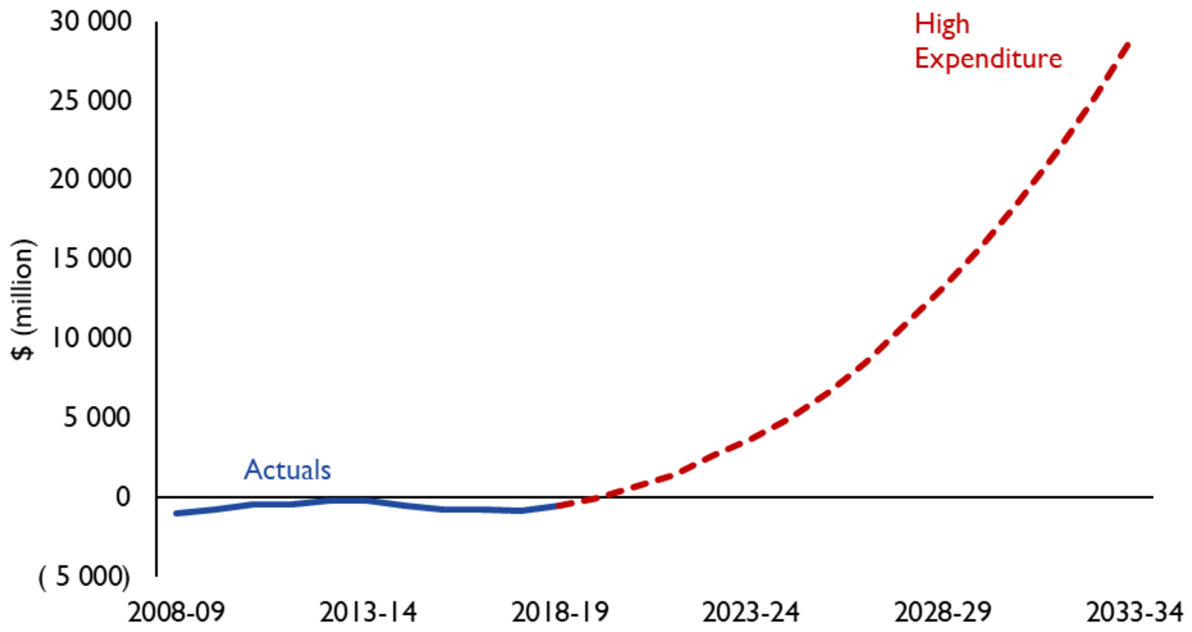




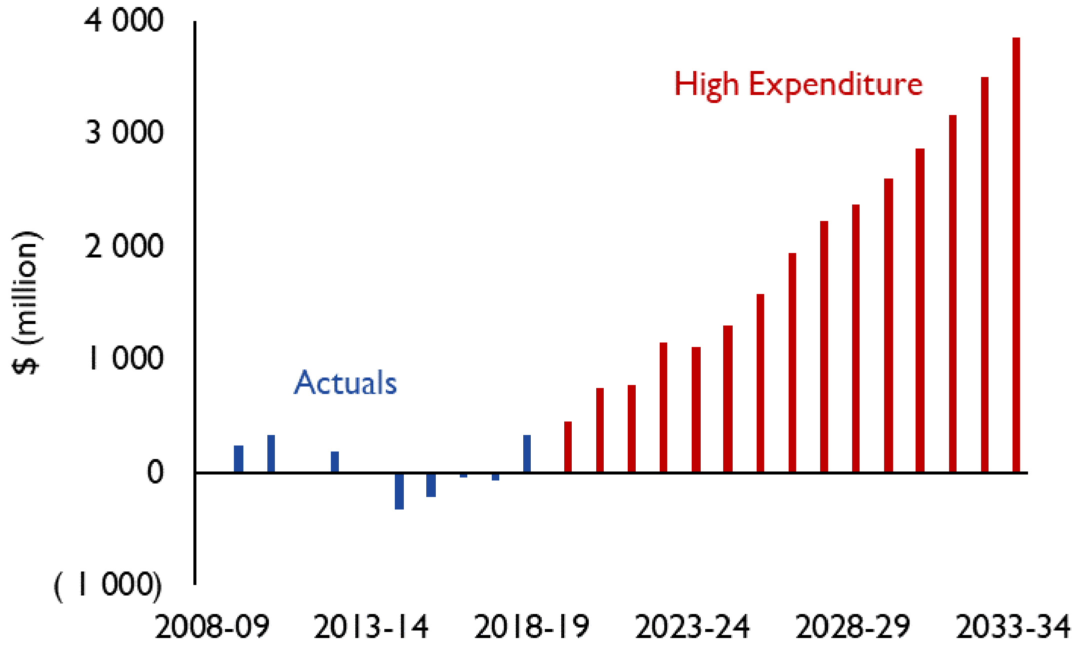
Scenario 3: High Expenditure (cont.)

Projection Results:

Net Debt



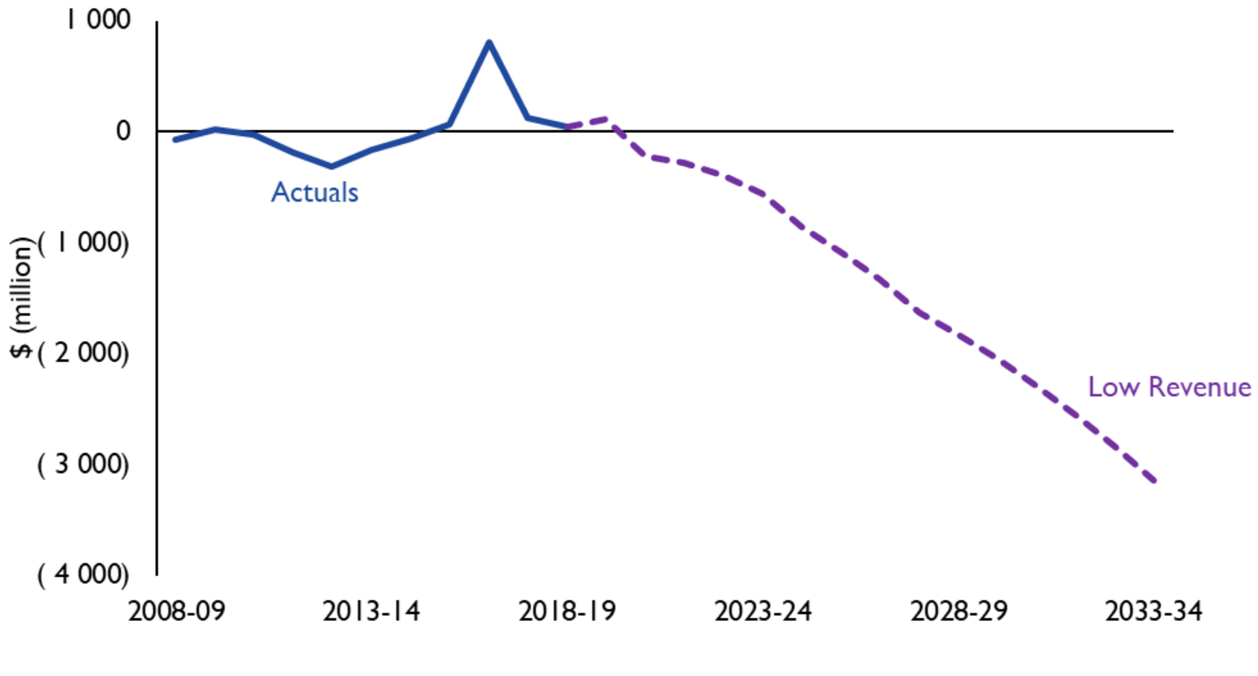
Annual Change in Net Debt



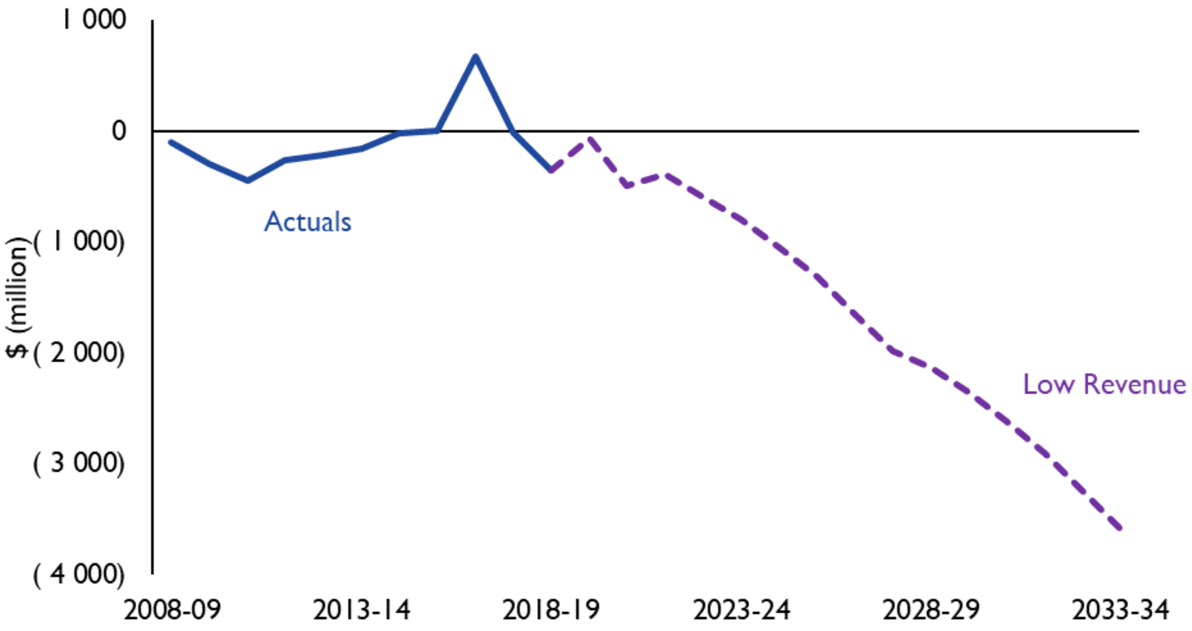
Scenario 4: Low Revenue

Projection Results:

Net Operating Balance



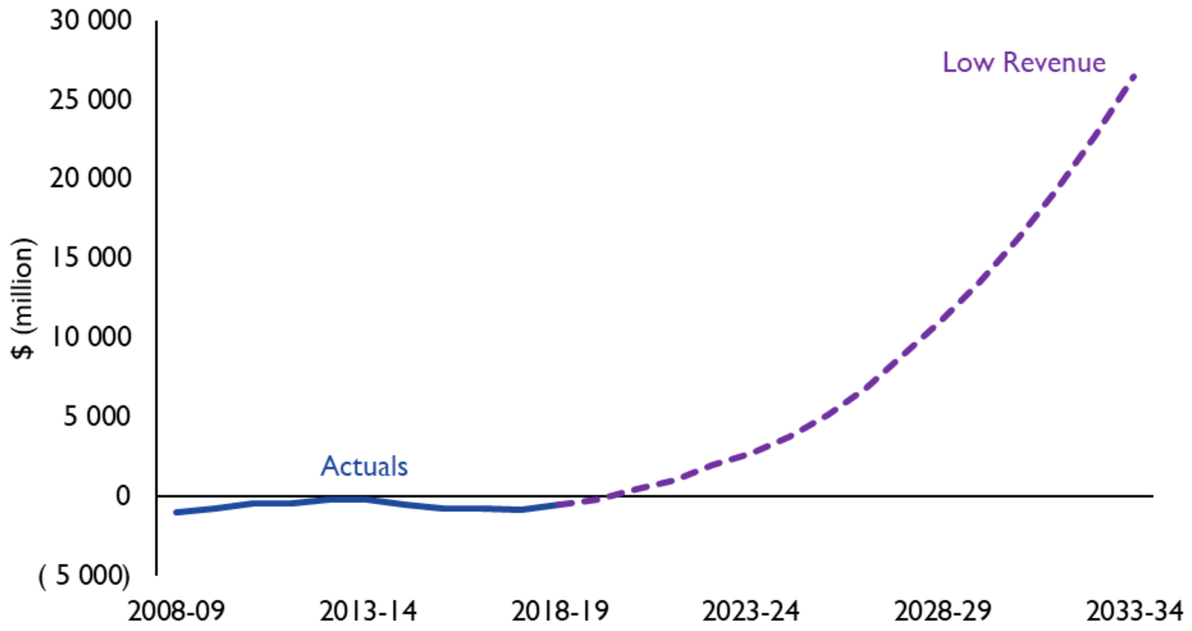
Fiscal Balance



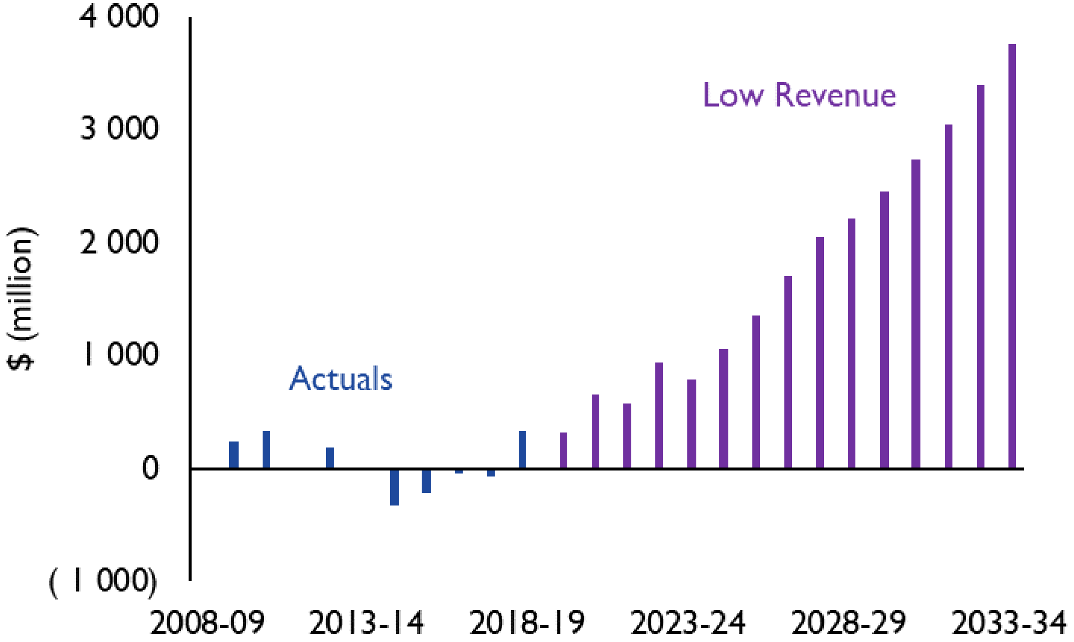
Scenario 4: Low Revenue (cont.)

Projection Results:

Net Debt



Annual Change in Net Debt



Results Summary

- Results at the end of the projection period in 2033-34 under each scenario.

	Net Operating Balance ($m)	Fiscal Balance ($m)	Net Debt ($m)
Historical Trends	(1 665)	(2 110)	18 191
Forward Estimates	520	(77)	4 473
High Expenditure	(3 030)	(3 686)	29 135
Low Revenue	(3 145)	(3 591)	26 513

Revenue and Expenditure

- The average growth over the projection period in revenue and expenses from transactions.

	Revenue from Transactions	Expenses from Transactions
Historical Trends	3.3%	4.4%
Forward Estimates	2.5%	2.2%
High Expenditure	3.3%	5.1%
Low Revenue	2.5%	4.5%

Conclusions

- Projected fiscal outcomes are manageable in the short to medium-term under all scenarios.
- Demographic change is not expected to be a significant driver of the State's fiscal outcomes over the projection period.
- Health expenditure is projected to be the single most significant driver of future fiscal outcomes for the State.
- Corrective policy actions are easier and more effective if implemented early.
- Using expenditure constraint alone to achieve fiscal sustainability will be challenging.
- Growth in expenditure needs to be matched with sources of revenue that grow at the same rate.

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Tasmanian Government

THE PARLIAMENTARY STANDING COMMITTEE ON PUBLIC ACCOUNTS MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON MONDAY, 19 NOVEMBER 2018

REVIEW OF FISCAL SUSTAINABILITY REPORT 2016

Mr TONY FERRALL SECRETARY, AND **Mr ANTON VOSS**, DEPUTY SECRETARY, ECONOMIC AND FINANCIAL POLICY, DEPARTMENT OF TREASURY AND FINANCE, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIR (Mr Dean) - Welcome, gentlemen. I will leave it open to you, Tony.

Mr FERRALL - If the committee will allow, I have some slides and a brief overview, which I might take you through if it suits the committee.

CHAIR - You can table those.

Ms FORREST - Were they meant to be incorporated into *Hansard* to make it work?

Mr FERRALL - They are tabled.

Ms FORREST - We can decide that anyway.

Mr FERRALL - You can. I will very briefly go through them. The slides are largely self-explanatory and draw on my submission. The intent of reports of this nature is to provide an important longer term perspective on fiscal policy not captured in the reporting of the Budget and the forward Estimates. The focus we took is on the demographic landscape and its potential to significantly impact the demand for future services and public infrastructure.

It is not possible to accurately project the future trajectory of the state's finances. It is impacted by a range of external factors. A good example would be the Global Financial Crisis, which was not something anybody would have predicted before the GST and post the GFC. There is no reason another equally significant event could not occur.

The future trajectory of state finances is also affected by future government policy at both the Australian and state government levels. Again, these cannot be predicted with any level of confidence. The demand for government services is also very difficult to forecast over an extended period. Things like technology change can be a major impact on the demand and costs for government services. That is particularly true in recent years in the Health and Education areas.

In developing the Fiscal Sustainability Report, we chose to develop a range of scenarios that presented projections rather than forecasts. Really, we are allowing readers to understand the potential sources and extent of future fiscal pressure under different circumstances and where risks might arise.

No one scenario was put forward as being more likely or less likely than the others; they were just a range of scenarios. The projections were largely based on long-term averages of key economic and fiscal measures and they did not take into account the potential impact of future economic events or policy change. The report only covers the general government sector, therefore it excludes an assessment of fiscal pressures the state might face due to the government businesses.

Mr BACON - Can I ask a question?

CHAIR - Are you happy to take questions on the way through? It might be easier.

Mr FERRALL - Absolutely.

Mr BACON - What is the thinking behind that?

Mr FERRALL - The impacts of the government businesses and local government are excluded because they are much more difficult to work through. When you look at the methodology used, it is projecting largely revenues and expenditures. We do not have those details at the same level for the government businesses. You also introduce a range of issues around how you necessarily consolidate those entities with the general government sector. Simplistically, if government business has expenditure, which is a receipt in the general government sector, you have to consolidate those sorts of things out, otherwise you end up double counting.

I am not aware of any other jurisdiction that has gone beyond the general government sector either. If you were to do a complete state, you would need to do the GBEs, SOCs and local government.

Mr HIDDING - But you are projecting dividends?

Mr FERRALL - As they come into the general government sector.

Mr HIDDING - Which is the net outcome generally.

Mr BACON - If you could do it, would it be a stronger report or have any more value?

Mr FERRALL - It would be a much more complex and comprehensive report. It is hard to say whether it would be more valuable or not. By way of example of challenges, if you look at some of the big things potentially happening in the government business sector at the moment, such as Project Marinus, we would not have included something like that because it wasn't even thought of. That has massive implications going forward. Whether including the GBEs would have made the report more valuable, I guess is a matter for the committee to consider.

Mr BACON - Thank you.

Ms FORREST - Is it spelt out in the charter of budget responsibility that it is only the general government sector? I understand the reason you made the decision, but I was just wondering whether it spells out whether the act would have to change to enable you to.

Mr FERRALL - I would need to check. As the committee would be aware, the report presented four scenarios. As I said earlier, no scenario was presented as a base case or with a higher probability of occurrence than others. There was no obvious set of scenarios for the exercise. You could equally make a case for doing two, four, six or any number of scenarios. The ones presented were really designed to present what we thought was a reasonable range of potential outcomes.

In the report we chose a period of 15 years. Other jurisdictions have taken longer periods of time; a number of them go for 30 years or beyond. We believed that 15 years was a sufficient time to identify the future fiscal challenges and future trends. When you actually look at the examples in other jurisdictions where they've gone for longer than 15 years, they tend to just run out projections. You get to a certain point and then you just follow the line. We didn't see any particular advantage in taking those scenarios for longer than 15 years.

The key measure used in the report was the primary balance, which is the difference between the state Government's revenue and expenses - that is, both recurrent and net capital - but excludes interest earnings and borrowing costs. This is not an established accounting measure per se, but it is the measure used by all jurisdictions that do similar reports. The measure really reveals the underlying fiscal pressure for each year without having the legacy effects in terms of interest costs or earnings off earlier years of net debt or surplus. As I said, other jurisdictions use similar methods in their reports.

It is really important not to focus on any single measure ultimately, and we note that in the context of the Budget. A range of measures are produced for budget papers: operating balance, fiscal balance, net debt and a range of balance sheet measures. You really can't put all your focus on any particular measure but you ought to be looking at a range of measures in order to draw conclusions. That is similar with the primary balance, which is one of the reasons we also included in the report some projections of net debt. It is not necessarily picked up in the primary balance.

I am on page 7, if people are following through. In terms of the committee's terms of reference, the committee has requested information on the state's performance against the projections, scenarios and assumptions. As the 2016 report was issued just over two years ago, it is relatively early to assess whether the scenarios adopted were reasonable or whether the assumptions were appropriate. In particular, the short period makes it difficult to determine whether the economic and demographic trends since 2016 represent long-term trends or include cyclical factors that may change significantly in two or three years time. The report is really designed to look beyond the short-term events, which is one of the reasons why the Charter of Budget Responsibility Act only requires the report to be issued every five years. It is quite straightforward to report the state's performance against the projections up to June 2018, which is effectively what I have presented to the committee and that is the focus of the submission.

I will start by making some comments regarding economic growth, population growth and productivity growth estimates in the report. These are only used for the scenarios 2 and 3 that are in the report. They are used to model demand for government services and for revenue growth modelling in the report. There has been no new population data since the Australian Bureau of Statistics estimates used in the report. Recent population growth has been rather stronger than in the projections in the report. Last Friday, the ABS released its economic growth estimates for 2017-18 and, as is common with the ABS, it revised earlier estimates at the same time. Those estimates are shown in the slide I just presented to the committee.

Estimates of gross state product - GSP - for 2015-16 and 2016-17 were both revised upwards by 0.4 of a percentage point for each year. Strong growth of 3.3 per cent is recorded for 2017-18. Over the three years from 2015-16, average annual economic growth was almost identical to the average from the estimate in the revised estimates report - RER - of 2015-16, which was effectively the base for the report.

Mr BACON - Do you mean the average of the three years?

Mr FERRALL - Yes. In my submission to the committee I reported that recent productivity growth at an average of 0.6 per cent was lower than the assumed growth rate of 1.6 per cent based on the long-term trend. However, the new economic growth estimates allow revised productivity growth estimates to be calculated from 2015-16. The average annual productivity growth estimate since 2015-16 is 1.2 per cent and that is shown in the slide above. It is important to note that the average productivity growth since 2015-16 has been a little lower than the 1.6 per cent that was in the report but the gap is much smaller than what I reported to the committee. Again, this is an example of the vagaries or changes you can get in the short term. With recent data on Friday, what I presented to the committee earlier has changed.

As set out in the submission for three scenarios, the actual outcomes are to be compared with the projections of the primary balance and net debt as calculated from the RER of 2015-16. For the remaining scenario trend, scenario 1, the actual outcomes are compared with an extension of the long-term revenue and expenditure trends. The results appear quite favourable against the projections with the primary balance closer to zero and relatively stable. You can see that in the black line in the chart. As the submission explains, this was principally due to revenue being substantially greater than estimated in the RER. You are seeing significantly greater revenue and significant movements in expenditure over that relatively short period.

The more favourable outcome in the primary balance projections is also reflected in the general government net debt profile, which is shown in the chart on page 10. Net debt has become increasingly negative since 2014-15. This in part reflects cash holdings for planned future capital spending. By comparison, net debt was projected to be less negative in the 2016 report, including being closer to zero under scenario 1.

As a note of caution: when you look at the underlying fiscal position, it is unlikely to be as positive as the chart suggests. That is really because of the delay in capital spending. Effectively the primary balance shows as being more positive and cash reserves build up simply because specified projects that might be funded by, say, the Australian Government have not advanced as they might have otherwise advanced, and that is reflected in the stronger cash position, but it will also reflect in future years with greater capital expenditure.

Ms FORREST - I will come back to questions on this when you have finished. It is best to get the whole story out first.

Mr FERRALL - Okay. As I said earlier, some jurisdictions chose projections longer than 15 years; we are relatively comfortable with a 15-year projection. They have tended to use extensions beyond 15 years as straight projections. We could have included more scenarios and the challenge really was the more scenarios you include, the more challenging it will be for the report to be interpreted, so we chose a limited number.

We also know new issues will emerge over time. As a current example, proposed changes in the distribution of GST could have a major impact on the state's GST payments in the future. This, again, could not have been predicted when we did the 2016 report.

From my point of view, when the next report is prepared a range of new issues will be on the table. Something like the GST then will be something we can actually build into the report. There will be other issues we will be able to directly build into a report, such as the Mersey Hospital funding where there have been changes over time, but none of those things could really be predicted at the time of doing the report.

Mr BACON - Are they the kind of things you would have factored in had you known about them?

Mr FERRALL - Yes.

Ms FORREST - You have a page in here that you probably didn't mean to include.

Mr FERRALL - Possibly, but that doesn't matter. It is not that contentious.

Ms FORREST - I want to take it out for you and put it in *Hansard* as we do. There are a few typos in it.

Mr FERRALL - The report was designed to be understandable by a non-specialist reader; however, the reality is we are dealing with complex matters. The way we approached it was to include an executive summary, so a summary of findings. We used a reasonably large number of charts and tables to try to give pictorial representation of the information. We largely avoided technical terms in the report and moved technical matters like the methodology and assumptions as an attachment to the report. We included a question and answer sheet when the report was released, and certainly briefed the media - and in fact I also briefed the leaders of the opposition parties on the report.

In addressing the question whether the report communicated its findings in an understandable, formative and useful way, it is my view we did our best and attempted to do that, but it is a complex matter. Ultimately, it is a matter for the committee to determine what its view is. I would be quite happy to consider or look at any suggestions from the committee in terms of future reports and how they might be made more understandable. I am happy to answer other questions.

Ms FORREST - This is not really related to what you've been saying, but just reading through the report - I assume you have a copy of it there?

Mr FERRALL - The original report?

Ms FORREST - On page 6, the report talks about the fiscal balance. It says -

> The difference between General Government revenue and expenditure, after allowing for net capital expenditure and nominal superannuation interest expenses.

I thought nominal super wasn't excluded.

Mr FERRALL - In the fiscal balance?

Ms FORREST - Yes. Is that a correct statement?

Mr FERRALL - It is still included in the fiscal balance because effectively the nominal superannuation interest expense is in the operating balance and so you adjust the fiscal balance effectively for net. To get to the fiscal balance you adjust for the net capital expenditure, so it is still included in there. It is in the operating balance and effectively it is still in the fiscal balance.

Ms FORREST - You are saying that in the budget papers when you report it, it's included in in the operating balance?

Mr FERRALL - Yes, nominal super is in the operating balance.

Ms FORREST - Okay, right. I just wanted to clarify that because it seemed to not quite be reflected that way in the budget papers.

I agree with your comments that it is not necessarily that easy to read and understand the report. You have tried to write it in a way that made it accessible, but I doubt there would be a lot of people out there who want to take the time to understand it, if they do.

Mr FERRALL - I suppose another comment is that we avoided forming - or I avoided forming - conclusions or opinions in the report. It presents information that allows other people to form views, conclusions or opinions rather than attempting to direct the readers in a particular way.

Mr BACON - I have a question related to that. If you had a more independent Treasury, could you then have a secretary of Treasury who did form opinions? Would that be of any use?

Mr FERRALL - From a personal point of view, I think I do form views or opinions. Ultimately, I am an employee of the Crown and I accept that, but in terms of performing my role I give an independent or personal view where it is appropriate. In relation to something of this nature or the report, really there is a range of possible outcomes of which, as the report concludes, I do not believe any have any greater reliability or likelihood, which effectively is what the report stated.

If, in preparing a future report, there were a set of events or scenarios that led me to a view that a particular scenario was more likely, I would reach that conclusion and would report it.

Ms FORREST - In the report you have Chart 1.1, which is general government primary balance, estimates and fiscal balance. I can see the benefit of using a primary balance in looking at fiscal sustainability. This may not be a question for you, it may be a question more for the Treasurer, but I am interested in why that is not considered as one of the fiscal strategies to try to keep it in a position that is at least close to zero.

Mr FERRALL - If you look at the budget papers and forward Estimates, and in fact if you look at the report, the primary balance and the fiscal balance are very close. When you start off with a position of basically balanced or not significant financial assets or not significantly in net debt, they effectively follow the same sort of line. We use the primary balance because it is giving that underlying fiscal pressure in each year, whereas when you look at the budget and forward Estimates, it is effectively looking over that period of time. It is also not a normal or accepted accounting measure or definition.

Ms FORREST - I understand that.

Mr FERRALL - Presenting a budget with operating balance, fiscal balance and net debt allows the actuals, in an audited sense, to be measured against those budgets -

Ms FORREST - We are talking about the fiscal strategy chapter. We have a lot of things in the fiscal strategy that aren't necessarily part of an accounting framework. Has consideration been given to that? It gives that better picture, taking out some of the borrowings from years ago that can have that flow-on effect, in looking at what the pressures are now.

Mr FERRALL - It gives a different picture. Which measures might be included in a fiscal strategy is ultimately a matter for the Government. At the moment, because we are sitting at a point where we don't have debt, the primary balance doesn't give you much more than the fiscal balance does in a fiscal strategy sense. It is a reasonable measure of the fiscal strategy just to use the accounting measures that are there.

Ms FORREST - You have done the update to Chart 4 on page 7 of your submission. You mentioned the pushing out of capital expenditure. It is pretty obvious from the last number of years that capital expenditure has been significantly less than what has been budgeted. Less capital expenditure will have a positive effect on your primary balance. When we look at this primary balance Chart 4 in your submission, you could argue the only reason it is sitting anywhere near zero is because the capital expenditure hasn't been made. If you look at the forward Estimates and what was projected, it was one of the Government's big 'pat ourselves on the back' moments handing down the Budget this year; if they follow through on that, won't that see a significant negative downturn in the primary balance?

Mr FERRALL - All other things being equal, the primary balance would be lower as that capital expenditure comes into it. That is correct. That was the point I was making earlier. When you look at the primary balance from the report done in 2016 to now and you are only comparing the actuals we have, it doesn't necessarily give you a true longer term picture or perspective, which, again, is challenging if you are trying to update these reports on too short a basis. You need to look at them over a long term.

Ms FORREST - Could I ask you, and hope the committee would support me, to provide an updated chart 4 that models the forward Estimates, particularly in regard to the capital expenditure and show the impact that would have on the primary balance? When you look at that in the budget papers, it is pretty significant.

Mr FERRALL - I understand, in a capital sense, recent years have been of the order of about 20 per cent to 23 per cent compared to budgeted expenditure. It does make a difference going forward. I will need to consider how we can model that. Rather than doing projections off the forward Estimates, I would be moving into the area of selectively rolling some things forward to measure them to come up with what it might be over the next couple of years.

Ms FORREST - If we are looking at long-term sustainability, which is what this is about, I am really interested to see what the different models would show in terms of the impact on the primary balance, of what we know to be the case. We know forward Estimates are just that, but if that is what we are aiming at and what the Government is committed to, the question is: are we financially sustainable? The purpose of the reports and this hearing is to try to understand if we are. If the capital expenditure continues to be pushed out or has been, somewhere we have to catch up. The Royal has to be built and that is not going to be for nothing and there are also other capital works going on everywhere. It would be good to have that.

Mr FERRALL - When you look at all jurisdictions over time, the primary balance tends towards zero. I made that comment in the report, because what happens is governments make adjustments to their fiscal settings to effectively return ultimately the budget to a balance situation. When we presented the range of scenarios, which had a sort of a fan effectively, it is very unlikely the ultimate end point after 15 years of any of those scenarios would be achieved because governments would change policy in the intervening years to bring the budget back because you cannot sustain significant surpluses or significant deficits.

Ms FORREST - I accept all that, but with forward Estimates, there is an expectation of significant capital expenditure. If it is going to end up seeing the primary balance way down in the depths, we need to know. We need to understand the impact. Are you willing to provide that?

Mr FERRALL - I am willing to have a look at how we can provide it. If you look at the very long-term trends, it will not make any real difference. What you will see is the permutations in the early years and those trend lines will still be exactly the same.

CHAIR - It is a bit like financial investments, you can't look at them short-term, you have to look at them over a long term.

Ms FORREST - I am asking for long term.

Mr FERRALL - Then I think what you are asking me to do is to take the budget, Forward Estimates and the actuals we have to 2017 and make some judgments about the underspend in the capex that is in there up to 2018.

Ms FORREST - That is right, because if you look at this -

Mr FERRALL - and then add that in to the primary balance going into the outyears.

Ms FORREST - Yes.

Mr FERRALL - Almost by definition, that will only go out for about two or three years because the underspend in the capex will catch up by then and it will not change the particular trend lines. What you might see is the primary balance moves below what might have been the previous trend line in that short period, but it will not change the long-term trend.

Ms FORREST - I could argue that in 2014-15 for the actuals, the only reason it has hovered around zero is because it has been pushing out capital expenditure and underspending. If the Government had done what it said it was going to do in terms of capital expenditure, it would be a very different picture.

Mr FERRALL - It would be. The primary balance would be more negative in 2014-15. In an actual sense, the easier way to do it would be to take the primary balance and adjust it in those actual years for the known under expend you can pick up from the budget. That is sort of a mathematical exercise that we could do which would take how much of the budget expenditure did not occur -

Ms FORREST - That is right.

Mr FERRALL - And then adjust the primary balance for that. Once you go out beyond 2017-18 year, you will see in a modelling sense it goes back to the trend line.

Mr HIDDING - Ruth, I do not want to stop your train of thought, but on the matter of underspends, how chronic are they in the system? Yes, the snapshots you are looking at now must come out, but can it be called chronic when there is generally a percentage of underspend in most jurisdictions?

Mr FERRALL - Recently we have looked at other jurisdictions; although it was a fairly light exercise, we were looking to see if any other jurisdictions were delivering their capex better and what sort of models they might have. Almost all, if not all, jurisdictions have under-expenditure against budget. There are a range of reasons for that. Our under-expenditure currently is similar in magnitude to what it has been for a long time - this is in percentage terms - but we have a larger capital expense. What you are seeing is a larger set of numbers because our capex is larger. It is similar in magnitude. There have been some years when it was bigger and some when it was smaller.

Mr HIDDING - It's just a matter of details to tidy up. We have Australian Accounting Standards and there are International Accounting Standards, a lot of which interlink and dovetail. For this kind of exercise, it doesn't appear too many standards apply. We had the benefit of a briefing by Mike Blake, former -

Ms FORREST - Auditor-General.

Mr HIDDING - Auditor-General speaking about - the organisation he is involved with is the International Public Sector Accounting Standards Board - how, around the world, nations are going with this. It appears to be somewhat patchy as to what standards people are using, whether it is out to 15 years - in fact, he mentioned some states of the USA have gone out 50 or 60 years or something like that, probably just projecting trends as you were saying. Are you aware of any work other than the IPSASB or interest around the world or around our geopolitical area that could put a set of standards for this so we don't need to argue about this stuff?

Mr FERRALL - Well, no - unless something has happened since this report, which I am not aware of. We did look, when we were preparing this report, at what is better or best practice in this space. Using the primary balance was the approach that others were using. As I said, I am personally not in favour of very long projections. If you went back 50 years and then tried, on the data we had 50 years ago, to project what there is now, it would be pretty meaningless. I don't think that is particularly useful. It is a nice exercise. It is important for components, so I think there are things you can do around long-term programs like capex where you start going out multiple years and say that on the basis of demographics and other issues that we know we need this sort of a capital infrastructure support. To try to model budgets into that very long period is an interesting, almost academic, exercise, but I don't think it is of much use when you get into that long period.

Ms FORREST - Going back to where we were - Tony, I assume your primary balance calculation for 2017 included the Mersey money that came in, the $730 million. Is that right?

Mr FERRALL - I can just check on that. I am thinking it has come in and out.

Ms FORREST - It did, it went out to TASCORP.

Mr FERRALL - I don't think it impacts because it -

Ms FORREST - If effectively excludes the money the way it was treated.

Mr FERRALL - Yes, it came in and went out, so it is netted out to zero.

Ms FORREST - The 2017 primary balance of negative $60 million on page 7 of your submission - sorry, that was the Mersey money. I am interested in the TT-Line transfers. Does the calculation you did in Chart 4 that we were looking at a minute ago for 2017-18, on page 7, contain the $40 million dividend from TT-Line each year?

Mr FERRALL - It would. I will just get Anton to check that it would. We will have to check the model underpinning it, but my view is it would.

Ms FORREST - That improved the primary balance?

Mr FERRALL - There would be no reason to exclude it, so it should include it.

Ms FORREST - Did it affect the primary balance when it was returned to TT-Line in 2018?

Mr FERRALL - It would, yes, outflow from the general government sector.

Ms FORREST - It went back below the line as an equity transfer.

Mr FERRALL - It would not matter in terms of the primary balance because it is expenditure. Even though it goes out as an equity contribution, it is treated as expenditure for the primary balance purposes.

Ms FORREST - I would like to clarify that. It appears that equity transfers and all those amounts you refer to as investments in financial assets for policy purposes in the cashflow statement aren't included, or are you are saying they are included in the primary balance calculation?

Mr FERRALL - I will have to go back to the modelling and pick out the modelling of those cashflows. In principle, anything that comes in or goes out is included. When you look at something like the Mersey, it nets out to zero because it came in and out. Something like TT-Line -

Ms FORREST - The TT-Line money goes out as -

Mr FERRALL - It goes out as an equity contribution. It is not reflected in the accounting measures of the operating balance or the fiscal balance but it is in the balance sheet -

Ms FORREST - It comes in as income for the state but it goes out as an equity below the line. All the equity transfers count in the primary balance - is that what you are saying?

Mr FERRALL - I believe they are, because of the way it is using expenditure and revenues.

Ms FORREST - Can you clarify that?

Mr FERRALL - Yes.

Mr BACON - Is the cost of running the hospital factored in when the Mersey deal runs out?

Mr FERRALL - It will be, yes.

Mr BACON - Given that is -

Ms FORREST - Will that be in the next report?

Mr FERRALL - My point was that is a significant event or change with significant magnitude. Something like that will get picked up when you look at doing a report in three years time.

Mr BACON - Was that deal done in 2017?

Mr FERRALL - Yes, it was after the report. This report was April 2016 and that was done in -

Ms FORREST - At the end of June, 30 June.

Mr FERRALL - It is definitely after the report.

Ms FORREST - In one hand and out of the other, 29 June, the usual 29 June transfers.

Mr FERRALL - We will check those inclusions to make sure.

Ms FORREST - That makes a big difference. The money coming into the government is income but when it goes out as an equity transfer, it is not.

Mr FERRALL - It goes to my earlier point that you can't look at any single measure, ultimately, over time. There are things like equity transactions, dividends et cetera that have a range of different accounting treatments that reflect differently in the measures. That, coupled with timing differences, can mean you have to look at a multitude of measures over a period to form valid or real conclusions about the state of finance.

Ms FORREST - I really need to know the answer to the modelling before I can ask other questions about that.

CHAIR - Are there any more questions in relation to this?

Ms FORREST - Going back to the infrastructure spend, which seems to be the key issue. I accept that other jurisdictions do it, too, but I'm interested in Tasmania. Are we fiscally sustainable in the decisions being made? If we had spent what we had budgeted in the last few years - if you are going to use the primary balance as a measure of fiscal sustainability - would we be fiscally sustainable?

Mr FERRALL - I think the answer to that is, broadly, yes. The primary balance as measured in Chart 4, in terms of the actuals, would be more negative than it shows in the chart. Again, when you look at the very long term, those scenarios would be largely unchanged. Again, the question of whether the state is fiscally sustainable - the reality is governments will always, as time passes, need to make fiscal adjustments to maintain the state in a sustainable position. We have increasing pressures, a relatively slow own-source revenue growth rate and significant changes such as things like the GST. In order to be sustainable, there will always be decisions the government of the day will have to make to ensure our revenues are relatively closely matched to our expenditures.

Ms FORREST - I accept that. When you have major infrastructure projects on the go, like the Royal Hobart Hospital, you really can't stop now and no-one really wants you to, so the money has to be spent and so something then is going to have to give.

Mr FERRALL - No, I think what you are doing is sort of conflating the long-term sustainable with the short term. The fact that the Royal is budgeted - and in the Budget, there was revenue from the Commonwealth to meet it and we have had GST adjustments, which we managed on receipt of that funding simply because that expenditure does not occur in a particular year - if it is a year or two later, it does not mean we are unsustainable. What it does mean - and this is the point I was trying to make earlier - is that when you look at things like the primary balance and try to see what is happened in the very short term, those sorts of impacts mean it is hard to draw conclusions from that short term, which is why the primary balance is used over a much longer time.

Ms FORREST - That is what I am interested in, seeing what it looks like over the longer time.

Mr FERRALL - We go back to trend, because that is the way the modelling is. Going back to those trend lines is where it will end up.

Ms FORREST - The question is: how do you get it back to the trend line? Do you have to keep cutting back on capital expenditure to achieve this?

Mr FERRALL - No, what I mean is that once you've taken out these short-term adjustments for the capex, you will go back to those three or four scenarios we projected. That is what you will see, I expect, from the modelling. It is big things that you need to pick up, which you can see make those changes.

CHAIR - To make that sort of projection, you obviously also have to take into account revenue projections about what might occur over that similar time. You really have to balance it then, similar to meeting I had recently with my financial adviser going through all these issues with me, on what you have to consider.

Mr FERRALL - A good example is the recent very strong population growth. You get an entirely different set of outcomes if you take that as something that will continue over 15 years or whether you say, no, we are going to use an average of the last seven or 10 years as the basis of projections, which is what those sort of fans shows. You have a broad range of possibilities.

Ms FORREST - On that point, doesn't population growth demand the need for further investment in infrastructure and capital expenditure?

Mr FERRALL - Yes, it may, absolutely.

Ms FORREST - It also requires demand to be met before the growth necessarily occurs, otherwise you find yourself having problems as some other countries are experiencing where they have had these big influxes, whether by people moving to the place or a significant increase in tourism and the infrastructure cannot cope. A population increase, whether it continues at the same rate or a lesser rate, then demand for infrastructure spend is going to be there.

Mr FERRALL - Correct, but there is also potentially revenue growth associated with population growth. It depends on the population, what the mix of the population growth is.

Ms FORREST - Exactly.

Mr FERRALL - And what the likely impact is on an expenditure sense.

Ms FORREST - In your report you say the demographic is not the key challenge in terms of health. You talked about health expenditure being a significant issue.

Mr FERRALL - Driver.

Ms FORREST - Yes, driver. I will read it to you -

> Population ageing is unlikely to exert a significant level of fiscal pressure on future Tasmanian governments. The additional costs were found to be relatively minor, even for health services, relative to the other cost pressures these governments can expect to face.

I sit on another committee where arguments have been put about the demographic causing all sorts of pressures and demands on the health budget. You are saying in this report that it is not a significant fiscal pressure and there are other cost pressures. I am interested in what other there might be.

Mr FERRALL - The analysis showed it was impacted to the tune of 10 per cent of the cost pressure on the health side. Other aspects include things like new technologies. There are more treatable diseases, which are effectively driving up costs. The actual demographic change we projected forward is a relatively small, roughly 10 per cent, component of the drivers of increasing health costs.

Ms FORREST - What are the major pressures? You said the other cost pressures that governments can expect to face: what are they?

Mr VOSS - To give you an idea, in the report on page 23 we talk about the average annual increase in health expenditure between 2004-05 and 2014-15 being 7.6 per cent. Ten years sounds like a long time, but in a demographic sense it is not a very long time. The key takeaway in the analysis was that other things are causing growth in health expenditure as demonstrated by that decade, 7.6 per cent, outside the demographic. They are the things Tony is talking about with regard to technological change and demand-driven costs.

Ms FORREST - Expensive drugs.

Mr VOSS - All those things, higher expectations.

Mr BACON - If you are saying the demographic change is 10 per cent, how does that tie in with the superannuation liability? That peaks and then falls away: is the demographic pressure increasing at that time?

Mr FERRALL - The current estimates are for the peak of the cash outlay on superannuation in the broad period of 2029-31. I do not know whether we have information that lines up in terms of the shift in demographics to line up with 2029 or 2031. We do have projections though, but I suppose the point really was it is not the big driver we are seeing in terms of cost pressures.

Mr GAFFNEY - Are you saying you have projections on population?

Mr FERRALL - Yes.

Mr GAFFNEY - Are they the Government's 'We wish for 650 000 by 2050' or are they projections from the ABS and more realistic ones?

Mr FERRALL - That is a loaded question.

Mr GAFFNEY - The Government says 650 000 by 2050, so I was just wondering -

Ms FORREST - One for the Treasurer.

CHAIR - See if you can answer it.

Mr GAFFNEY - Which projection figures do you use?

Mr FERRALL - We regularly put out population projection figures and there will be some more coming out soon. In the scenarios we developed, we made the point that the high growth scenario - I can't remember which one that is now - has a population projection towards the end that is consistent with the Government's population projections. It is slightly higher than the Government's population projections. Again, that is simply a scenario.

Mr VOSS - We updated our population projections for this part of the report. The population projections are on our website, and the same sort of thing - they are projections. For this report they are projections, not forecasts. There is a range of high/low/medium and it depends on a range of how things pan out in the future. As Tony said, we update them every four years or so. We have another set coming out in the not too distant future.

I will just add, Ruth, that we certainly didn't ignore the ageing issue. In fact, we have a chart on page 41 with the age cost index for health and how health expenditure gets much more expensive as you get older, not surprisingly. If differs for males and females, and females also have the child-rearing age. Those things were incorporated but, as I said, when we went through the history of the growth in health expenditure, demographics wasn't driving it. You get a 7.6 per cent annual increase over a decade. That was due to things outside demographics. It was all those other factors.

Ms FORREST - Did you take into consideration with that - there was a push recently, I can't remember the name of the organisation doing it now - looking at trying to reduce the rate of preterm birth? The high smoking rate in Tasmania is one factor, and they are focusing particularly on that at the moment, but the other things are living in poverty, creating nutritional challenges, poor dental health - a whole range of factors impact on the likelihood of having a preterm birth, which then adds to the cost of health services all the way through. Is that a demographic issue or is that a different issue? The north-west coast is one of the lowest socio-economic areas of the country, for example.

Mr FERRALL - I guess in terms of the report we don't, or didn't, factor in potential changes in those areas. Again, these are projections so it is based broadly on what has happened to date. Taking your point, if there were a government program or approach that reduced all those factors and led to improvements in health, that would show up over time in this sort of report. But we didn't try to predict or project effectively those sorts of changes.

Ms FORREST - I just wonder: when you talk about demographics, are you just talking about age? That chart there shows the age demographic. I am talking about the number of people living in poverty, people of low socio-economic status, of whom Tasmania has more than its fair share, particularly on the north-west coast.

Mr FERRALL - We didn't try to differentiate like that. The demographic picks up age cohorts and effectively males and females. It doesn't go into -

Ms FORREST - The other social determinants.

Mr FERRALL - No, it doesn't go into those. It would be exceedingly complex to try to do that sort of modelling or projection if you broke it down into those components.

Ms FORREST - It obviously costs a lot more to look after a preterm baby than it does a full-term baby.

Mr FERRALL - I fully understand that, but in terms of this report, it is probably a step beyond what we could try to do.

Ms FORREST - There is reasonable discussion on the GST and the impact of any change to it. This was done before Western Australia had their biggest push to see things change. In the next report, I guess that change will be picked up. Is there any indication of how that is going to impact?

Mr FERRALL - In the short term, given the guarantee there would be no real change in the modelling.

Ms FORREST - No worse off.

Mr FERRALL - What will be of particular interest is whether there is any greater indication as to what might happen beyond the no-worse off guarantee. That might not come through in the next report; it might even be in the one after that. The reality for Tasmania is that the GST is such a significant component of our revenue source that anything that negatively impacts on that is likely to put the sustainability of the budget under pressure.

Ms FORREST - It will negatively impact the primary balance as assessed?

Mr FERRALL - Yes.

Ms FORREST - You have a pretty clear indication, though, about what the next report will look like?

Mr FERRALL - No, because at the end of the guarantee period a review will be undertaken. What we will start to see by the time we do the next report is how divergent the GST revenue estimates now compared to the guarantee are, but that will only be a short period, two or three years. The big information component will come at the end of it when there is a review, which will decide whether the existing methodology, some other methodology or a guarantee continues.

Ms FORREST - When do we expect that to happen?

Mr FERRALL - It is 2026-27.

Mr VOSS - The Productivity Commission is undertaking that.

Ms FORREST - Talking about revenues, obviously we have a heavy reliance on the Commonwealth. We all know that. As the chart on page 18 of your report shows, Tasmania and the Northern Territory are the only two jurisdictions that don't have the same capacity to raise their own revenue. Is that something you think needs to be addressed to enhance our sustainability?

Mr FERRALL - If we had the same capacity to raise revenue, we would be more sustainable. We don't have the same capacity for a whole range of reasons that are not policy choices. It is the nature of the GST. It is not Tasmania's policy choice that we have less capacity to earn revenue than the average of the other jurisdictions. It is not a choice governments make. That is a reality of -

Ms FORREST - Some of it is choice, isn't it, when you erode your tax base or you do things like that? That is policy.

Mr FERRALL - Yes, but that isn't reflected in the capacity of the state to earn revenue in the way the GST methodology makes it. The way the Grants Commission does its work is effectively policy neutral. If we make poor policy choices, we live with them, but it doesn't change our capacity to earn revenue. It changes what our actual outcome is. We don't get compensated in a GST sense for making what might be considered poor policy choices.

Mr VOSS - Or penalised for a good one.

Mr FERRALL - Yes, that's correct.

Ms FORREST - You do get penalised for good ones.

Mr VOSS - No, you don't.

Mr HIDDING - I think Ruth's question is right, though; it might not be in a GST sense, but I recall reading 20-something years ago, and it is a public policy discussion these days, that Tasmania was underperforming in terms of gambling revenue and needed to lift its game. For that reason, pokies in our pubs and clubs came into being. I checked later - this was from the Grants Commission - to see whether Western Australia got the same letter and they did, but they just ignored it because they had a stream of funds from the Kimberley that didn't have the same thing. The Grants Commission at the time was saying quite openly that unless we properly explored our capacity to expand our gaming, they were going to be harsh on Tasmania in terms of grants. What you are saying is that it is not translated into GST discussions. States somehow have to have equal lifting capacity, I would have thought.

Mr FERRALL - The methodology uses effectively a constructed average. In Tasmania's case, because of a range of factors, we're deemed to have a lower revenue-raising capacity than the average and we get compensated because of that - simplifying it largely. When you go into individual components of both the revenue and the expenditure modelling, they have different ways of dealing with things like the average. There is a bit of debate around at the moment as to whether policy choices around fracking are legitimate policy choices or whether a state is making a particular approach to lower its revenue below the average. The point you made earlier about gaming was probably a similar discussion 20 years ago. I do not know and will have to get the details, but gambling is actually treated quite differently. It is not simplistic.

Mr VOSS - The Commonwealth Grants Commission treats the capacity of all states to raise gambling revenue as essentially the same. They do an equal per capita. Tony's point before around policy choices is that if WA, for example, chooses not to raise gambling revenue versus another state that does, those policy choices are not taken into account by the CGC. The state is not penalised or rewarded in that sense, because they treat every state on an equal per capita basis. Every state has the same capacity to raise gambling revenue as another, which is different, for example, as to how they treat conveyance duty. Tasmania has a capacity, which is much lower than New South Wales. They looked at gambling in past times and it was simply too challenging for them. They have a number of things they asses on a so-called equal per capita basis.

Ms FORREST - And gambling is not one of them?

Mr VOSS - Gambling is equal per capita.

Ms FORREST - Gambling is, but conveyancing is not, because we do not have the number of properties to sell.

Mr VOSS - Yes. Going back to Tony's point before, for something like that from the data and otherwise, they can tell our capacity to raise revenue in Tasmania is much less than in New South Wales and Victoria, essentially because of the value of our property prices.

Ms FORREST - Further to that, page 32 of your report down the bottom sort of flows on from what Rene was talking about -

> A further constraint is the limited capacity of the State Government to increase its own source revenue without negatively impacting on its tax competitiveness compared to other jurisdictions. This, in turn, can lead to the risk of lower overall tax revenues due to Tasmania being perceived as a less attractive State for investment and for potential interstate and overseas migrants.

We hear this all the time -

> Recent governments have also shown a limited appetite for introducing new taxes or government charges or increasing tax rates in Tasmania, even though real incomes have risen appreciably in recent decades. This approach may have been taken over concerns that a sizeable share of the Tasmanian community considers that Tasmanian governments have the capacity to improve the efficiency of providing services, and to better allocate its existing resources to meet demand, and should pursue these opportunities before they impose additional taxes and charges on the community.

This capacity to improve efficiency in providing services - the state is a service provider and I use the analogy you cannot really reduce the numbers of a string quartet and still have a string quartet. Health, education and public safety it is very labour-intensive. A nurse can only look after so many patients at once. A teacher really should only be teaching so many students at once. I do not believe we should be sending police officers out in single officer patrols. Salaries of people, particularly in these areas, are the biggest ticket items in the budget. How do we increase efficiencies if this is seen as a way to improve our own source revenue or perhaps improve our primary balance as an outcome of that?

Mr FERRALL - If you read the paragraph in context, what it is saying is that governments have limited appetite for introducing new taxes.

Ms FORREST - That is why I read the whole, rather than just picking out one line.

Mr FERRALL - I did not make in that particular paragraph any comment about the relative efficiency of our public sector or otherwise. It was an observation for lots of reasons - governments have very limited appetite to introduce new taxes or government charges. When you look at the report, the reality is governments will continue to face increasing pressure to provide new services and increase in cost of services. It was really a comment around one of the levers to manage those fiscal pressures is revenue. It is proven to be a very challenging one for governments.

Ms FORREST - It is a bit elusive, and I accept that. I was interested in the capacity to improve the efficiency for providing services. I'm not sure where we really achieve that in a meaningful way. You can cut a bit here and cut a bit there. We've seen that happen. We have seen a deterioration of services as a result of significant cuts under previous governments. That is not necessarily the answer. That is not increasing efficiencies; that is just cutting.

Mr FERRALL - No, but if you look at Tasmania, we're a relatively small jurisdiction; Treasury is a small agency and Premier and Cabinet is a small agency. There are legitimate questions whether the way we are collectively organised is the most efficient way forward. That requires some real work and some real analysis.

If there are economies of scale, as an example - and I preface that with 'if' - could there be efficiencies in Treasury and DPAC in some of our back-office functions?

Ms FORREST - This is probably a question for the Government, not for you.

Mr FERRALL - It is a question for the Government. We have improved efficiency and, broadly, government will continue to improve efficiency. We have seen technology investment, which has improved efficiency across the board. But improving efficiency does not automatically mean, and should not automatically mean, that we're reducing or changing the number of people.

Ms FORREST - That is what I am saying, in the very service-oriented functions we have as a state, as a service deliverer. Out in 'public land', you hear, 'We have too many public servants, so get rid of them'. There are so many areas where you simply can't if you are going to provide the service.

Mr FERRALL - I agree.

Ms FORREST - It's not a simple solution here.

Mr FERRALL - If it were simple, it would be done - that is the reality. Although the public sector can improve efficiency, the vast majority of public sector employees, across the board, are more than gainfully employed. I'm not saying we can't improve, because I think we always have to keep trying to improve, but there is no simplistic wholesale improvement in broad public sector efficiency.

Ms FORREST - A major capital expenditure in robots to replace the nurses would immediately damage your primary balance because of the capital expenditure required.

CHAIR - It would be interesting to have a robot attending to me.

Ms FORREST - They have them, but I think people like people dealing with them. Robotic surgery is pretty good because then you know the precision is there.

CHAIR - Any other questions at this time? Tony or Anton, anything further?

Mr FERRALL - No, just for clarity, though: going back to Ruth's earlier question about the primary balance, I think, from the discussion, what you are seeking is for us to adjust the chart for the actuals for the known underspending against the budget and present another actuals line for that 2017-18 period - is that it?

Ms FORREST - Yes, but also the projections of what it would look like with what is in the forward Estimates.

CHAIR - It is something the committee will discuss and send to you in writing so it is perfectly plain and clear as to what we require.

Ms FORREST - It might be helpful if Mr Ferrall just fleshes it out.

Mr FERRALL - I want to make sure that is doable and meaningful at the end of the day. My understanding was that if we made that adjustment of the primary balance, it would pick up the underspending in the capital for that period.

CHAIR - You raise an important point, the value of this, and that was the question I was going to ask: what is the real value of this? Particularly when you continually bring it up, quite properly, looking at this over an extended period where it is up and down, and we know that is what happens. As to what the value and the amount of work you need to do to provide the answer or position on this, I need to look at that balance.

Mr FERRALL - Fundamentally, in the short period of analysis in Chart 4 you will see the primary balance is more negative than is presented there because we would make some adjustments effectively for capex that did not occur, budgeted to occur. It will not actually change much in the long term. I would need to see how much it will change, but I do not think it will change much, because you are really going to change the starting point of a little bit of the long-term analysis. I do not see it will be massively different.

Ms FORREST - That is okay.

Mr FERRALL - We can -

Ms FORREST - The point you made, Tony, was one of the reasons this is the way it is and has been sitting around zero is because of underspending capital expenditure. We need to be honest about this.

Mr FERRALL - In the long term, the reason the primary balance stays around zero is because governments make adjustments. Again, in the short term, though, if there were a capital underspend of $100 million or $200 million that goes from one year to the next or the next year, it will not make much difference at all to the long-term trend. That is the point I was trying to make. There is a debate around whether we should have capital underspends, and we should be trying not to have them, but in the long run they sort of roll through in this form of analysis.

If you have roughly a $100 million underspend every year over a 15-year period, it will make no difference to the ultimate outcome.

Ms FORREST - That is true, Tony, but in the outyears there is a significant increase in budgeted capital expenditure.

Mr FERRALL - Ours is in the relative short term, though, in terms of this analysis, because we do not have budgeted capital expenditure beyond the forward Estimates.

Ms FORREST - I am not talking beyond the forward Estimates. I am talking about the period the Government has made commitments in. We were talking about the sustainability. I know it is the longer term, but we also need to be conscious of short term.

Mr FERRALL - Where you pick up what you are saying, it comes through in the annual budget and when we do the budget in forward Estimates. In the 2019-20 Budget, any shortfall in capex in 2018-19 will be reflected in the outyears of that rolling budget.

Ms FORREST - I accept that.

Mr FERRALL - In terms of this analysis, you are not really going to see anything new or revealing because we do not have capex beyond the forward Estimates.

Ms FORREST - This chart only goes up to 2017-18.

Mr FERRALL - You will see the primary balance move for that particular underspend. I caution that you need to be careful you do not draw any conclusions from that around sustainability based on that very short term and movements in there.

CHAIR - That is exactly my point as to probably unjustified criticism that could come from such a short-term look at this, when we know no government is going to continue to put itself in a position of where that line can continually fall away. They will always make those adjustments. My concern is unjustified criticism could come out of a short-term position. I think this is what the committee will shortly discuss.

Mr HIDDING - For the record, from my experience Treasury is not agnostic about underspends. Treasuries around the country can get quite agitated about chronic and consistent, persistent underspends. It is the job of not only infrastructure ministers, but also of every other minister who has a budget and money to get it out the door.

Ms FORREST - Community services and things.

Mr HIDDING - Yes. Obviously, there is strong management of that to the best of everyone's ability to try to avoid this underspending. I earlier called it 'chronic', only not in terms of quantum. It is harder to get money out of the door than it is to announce it.

CHAIR - I think you are probably right there.

Ms FORREST - That is an understatement if ever there was one.

Mr HIDDING - It is quite true, though, because the minute it's announced people are already banking it and away you go.

Mr FERRALL - You do draw a somewhat artificial line every 30 June. If you are a day late, it is all in next year. If you rollover from 30 June to 1 July, it is all over one -

Ms FORREST - Yes, but over the time it is there, as you said. The other question, Tony: is the modelling when a grant is spent by way of equity contributions included?

Mr FERRALL - I will confirm that.

CHAIR - Again, we will take that and give that to you by way of written correspondence. Are there any further issues or questions, members? Ruth, back to you again.

Ms FORREST - No, I am fine.

CHAIR - I thank both Tony and Anton for being here today and for the way you have answered questions. We appreciate it very much. We will follow that up with a notice to you. Thank you.

THE WITNESSES WITHDREW.

PUBLIC

THE PARLIAMENTARY STANDING COMMITTEE ON PUBLIC ACCOUNTS MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON WEDNESDAY 30 OCTOBER 2019.

Mr TONY FERRALL, SECRETARY, AND **Ms FIONA CALVERT**, DEPUTY SECRETARY, ECONOMIC AND FINANCIAL POLICY, DEPARTMENT OF TREASURY AND FINANCE WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIR (Mr Dean) - Welcome, Tony and Fiona. I think members would be known to both of you. We have our secretary Gabbie, and Ally, assistant secretary, and Hansard s also present today to record the session. It is a public session, Tony; I think I raised that with you and we discussed the fact that because it is public, if a situation arises where you would prefer to answer a question or discuss a matter in camera, we will leave that to you to advise the committee. We will then make a decision on that and move forward from there.

Thank you very much for providing us with a report on your speech or the issues you are going to touch on today; Gabbie has it up on screen as well to assist the members there.

Tony, I will leave it open to you. We can leave some time for questions or would you like to take questions on the way through?

Mr FERRALL - I am happy to do either, whichever suits the committee.

CHAIR - It might be suitable to take question on the way through, but if it looks like we are going to get close to time because we need to finish by 2.15 p.m. at the latest, we will see how we go with that. We will take questions on the way through if members are happy with that.

Tony, we will leave it up to you.

Mr FERRALL - I will go through the presentation fairly quickly. I know members have had it overnight.

Starting at page 2, the Fiscal Sustainability Report was released on 8 October. At the time I gave a briefing to the media and to the Treasurer, and also a subsequent briefing to the opposition. As members will be aware, the first FSR was published in April 2016 and in October 2018 the Public Accounts Committee initiated a review of the FSR.

When preparing additional material for the Public Accounts Committee some inconsistencies in the model were identified, and at the time I wrote to PAC and to government and opposition members. While the conclusions of the 2016 report were not altered by those inconsistencies, I indicated to PAC that I would present another report after the 2019 Budget, and that is what this report seems to do.

For context, at the PAC hearing you were also seeking to update some of the assumptions in the 2016 report and they have been updated subsequently through this report.

The 2019 report is consistent with the act but it is not a requirement of the act, so a further report will be prepared prior to June 2021.

The 2016 report used what was called the three 'Ps' approach to generating projections whereby economic growth was projected on assumptions relating to population, labour force participation and productivity, with revenue and expenditure calculated based on assumed relationships with economic growth. The 2019 report has not used the three Ps approach. Instead, a standard budgeting accounting practice has been used to ensure consistency with the Budget and to enable the model to take account of known future expenditure and revenue impacts. I think one of the comments the committee made to me previously was that it thought by using the approach used previously, it was maybe a little difficult to understand the report and it did not have comparability with budgets that you would have liked.

The report is intended to provide a long-term perspective on Tasmania's fiscal outlook and it outlines potential long-term fiscal imbalances which may arise under different scenarios. I point out that that is in the absence of any change in policy or direction. While there is no consensus among economists on a precise operational definition of fiscal sustainability, rather different studies use their own - but often similar - definitions -

> … the European Commission defines public finance sustainability as: the ability of a government to sustain its current spending, tax and other policies in the long run without threatening the government's solvency or without defaulting on some of the government's liabilities or promised expenditures.

Therefore, there is no precise point where sustainability or unsustainability can be defined and definitely differentiated. Rather, fiscal sustainability analysis is focused on examining possible future trends and projections. As indicated previously, reports of a similar nature have been published in other Australian jurisdictions and also in countries across the world.

In preparing the report, the comments raised by the committee in relation to the measures used in the 2016 report have been considered and although there is no consensus on the measures to use for fiscal sustainability, most other jurisdictions adopt a number of measures. Net debt is the most commonly used measure and that is presented in this report. That is either used as a standalone or as a percentage of economic output.

Measures used in the 2019 report are consistent with the Treasurer's Annual Financial Report and they are consistent with those reported in the state budget. Expenditure has been categorised consistent with the Australian Bureau of Statistics classification of functions of government which is used for government reporting.

To maintain continuity with the Fiscal Sustainability Report 2016, the primary balance has also been calculated for all projection scenarios, and is included as an attachment to the report. It should be noted, though, that the results are not directly comparable between the two reports because of the difference in the methodology and calculation.

Projections have been developed over a 15-year time frame, principally because there is some level of knowledge of events likely to occur in the next 15 years, but reduced certainty beyond that period. Projections over a longer term would likely follow the same trends as we see in the latter years of the 15-year period.

This is also consistent with Organisation for Economic Co-operation and Development - OECD -guidance on long-term reporting where long term is considered between 10 and 40 years. It is important to note that projections are not forecasts; they are an extrapolation of trends and they are presented in the absence of any policy change or intervention.

In preparing this report, Treasury is making no judgment regarding whether any scenario is more or less likely to occur.

The act does not actually specify whether the report is to be prepared on a general government sector or total state sector level, and projections are being prepared on a GGS level. That is consistent with the scope of the state budget and reflects the areas the state Government has direct policy control over.

In terms of the FSR model, the model has been developed over the last four months. It projects 39 inputs and of those, 28 inputs may be varied across the four scenarios. It is supported by a number of macros and programming using VBA.

The model has been subject to quite extensive quality assurance internally and effectively it uses over 20 000 unique formulas and provides capacity for over 100 000 unique projection combinations. It is a complex model even though there are only four scenarios.

In terms of the model's approach, the Treasurer's annual financial reports and the 2019-20 Budget were used as sources of data for all inputs, and the base year is 2018-19 estimated outcome.

It is not practical to project a rolling balance sheet so we did not go to the next step of projecting a full balance sheet for each of the years. Therefore, the model calculates net debt through a series of cash and accrual adjustments. The approach used has been tested against past data to ensure that it is accurate.

Going to the scenarios now, we have chosen four scenarios to cover a range of outcomes: historic trends, which could be described as business as usual; forward Estimates, which reflect the Government's current policy, as expressed in the Budget and forward Estimates; and a high expenditure and low revenue, which are the key threats to fiscal sustainability.

As noted by Ms Forrest in the *Mercury* on 16 October, the forward Estimates include the savings measures over the forward Estimates.

Ms FORREST - It's good to see you read that.

Mr FERRALL - I always read your articles.

The inclusion of the savings measures rebases each expenditure category at the lower level implied by those savings measures, but the model doesn't include any additional budget savings beyond those forward Estimates periods so there are no incremental savings beyond the forward Estimates.

Other matters included in the model are: under the historic trend - high-expenditure and low-revenue scenarios - adjustments have been made to the projections to take account of known future events; and under the forward Estimates scenario, adjustments are applied outside of the immediate budget and forward Estimates period to take account of events we know are occurring outside that period.

For example, with the Royal Hobart Hospital, under the historic trends scenario, expenditure step changes are applied from 2019-20 to 2024-25. With respect to the northern prison and the southern remand centre, in the historic trend scenario, expenditure step changes are applied from 2021-22 to 2031-32. At the end of the GST guarantee period, in all scenarios a step change of -$42 million is modelled after 2026-27, which coincides with the end of the GST guarantee period. At the end of the Mersey Community Hospital Funding Agreement, in the historic trend, forward Estimates and high-expenditure scenarios, additional SBP funding has been included from 2027-28 to reach $41 million in 2033-34, which is 45 per cent of the cost of recognised activity, so at the end of the Mersey agreement we are recognising that the activity will be partially funded by the Commonwealth as we go forward.

Ms FORREST - What year have you started that off? We're not sure how long it's going to last.

Mr FERRALL - In 2027-28.

Ms FORREST - If it doesn't make it until then, it will change, obviously?

Mr FERRALL - Obviously, it would.

Ms FORREST - With interest rates as they are it might be a bit of a challenge.

Mr FERRALL - It is still projected to make the tenth year, even with interest rate changes, but yes, it will become more challenging.

We also included the recent changes to the Australian Government funding arrangements with Housing. The Australian Government announced the Commonwealth Housing Agreement and debt totalling $157.6 million will be forgiven, so we made adjustments to that which allocated operational capital expenditure on a 50/50 basis. On that particular one, we allocated the expenditure on a 50/50 basis because we made an assumption that some of the funding would be going into built infrastructure that Housing would own and some would be paid to community groups to insure the infrastructure is built in the community groups, so we just treat it as a 50/50 basis.

Equity transfers are included in the projections and they're consistent across all scenarios. The modelling assumes the equity transfers in the 2019-20 Budget and forward Estimates will occur, including the transfer of $157.5 million for the TT-Line.

In terms of matters not included in the model, we didn't explicitly include the impact of climate change and natural disasters in the model; however, for some projections, for instance, public order and safety, they're based over a six-year prior period average and so that would, to some degree, capture events such as the recent fires so to some degree there is an implicit assumption around those changes but it's not explicitly modelled.

Mr O'BYRNE - I understand why this might have been excluded that; I think it's still a big issue for the state to confront. Did you work through those models in terms of attributing a cost to a natural disaster or a regular natural disaster every two or three years?

Mr FERRALL - No, we didn't explicitly model that at all. We would have had to make too many assumptions in respect of the costs and the periods of time they might occur. To the extent that there have been a number of significant fire events recently, the cost of those are in the previous averages that we've used, but in terms of the modelling there is no assumption that would increase as an example going forward.

Marinus and Battery of the Nation are excluded because it's not possible to identify the magnitude or timing of the potential impacts at this stage, and the impacts could be negative or positive depending on how those projects go forward.

We also haven't modelled any changes to Australian Government funding and certainly state government policies and changes to state government policy are not modelled. The projections assume no policy response over the projection periods.

In 2018 the committee asked me some questions about the capital underspend and how that was treated in the previous report. Historically there has been a fairly significant capital underspend. It's primarily a result of delays in planning design and implementation of projects. It's obviously further impacted by project submissions to things like Infrastructure Australia and timing of Australian Government funding commitments. The capital underspend in each year is rolled forward generally into the next financial year.

In the modelling we have assumed a 20 per cent capital underspend and that rolls through the modelling. That is modelled in the historic trend and the low-revenue growth scenarios. In the high-expenditure and forward Estimate scenarios we don't assume any capital underspend. We have just assumed that it rolls forward, as projected under the forward Estimates.

Ms FORREST - Very optimistic.

Mr FERRALL - In relation to scenario 1, historic trends, the average growth in revenue on historic trends is 3.3 per cent and the average growth of expenditure is 4.4 per cent. What you see at the end of the 2033-34 period is a net operating balance of negative $1.6 billion and a fiscal balance of negative $2.1 billion.

The historic trend scenario shows outcomes that are progressively worse than those experienced in the past. If you look at the past lines, they don't look like they would imply that you would see the fall-off going forward. This is primarily due to forward expenditures being adjusted to account for additional expenditure associated with major projects. In addition, it includes adjustments to some revenue lines, including GST, and returns from government businesses. When you take those into account in the projections, that is why you see that steadily worsening in historic trends.

Mrs RYLAH - But we don't see increased income from the improvement in infrastructure or the other things that will happen - is that what you're saying?

Mr FERRALL - Very little of our infrastructure generates income.

Mrs RYLAH - But there are efficiencies that the infrastructure will create?

Mr FERRALL - We haven't tried to model if there are any efficiencies coming from new infrastructure.

Mrs RYLAH - In particular from highways and all that sort of stuff.

Mr FERRALL - Even if there were efficiencies in, say, the highways, which there would be, they don't tend to have an impact on the state budget, because where our tax revenues come from doesn't tend to be driven significantly by those changes in the economy.

Mrs RYLAH - A fair point, but you get the drift.

Mr O'BYRNE - In regards to that, there is a national debate going on about road pricing and where that income is generated from. Did you, in this model, turn your mind to a change or you just worked on the basis that the net figure attributed to each state will maintain its trajectory based on the scenarios?

Mr FERRALL - We just did it based on the scenarios. We didn't try to take into account any unknown future policy changes basically.

Historic trends continuing - what the result showed is a net debt moving to about $18.2 billion, and the annual change in net debt is shown in the accompanying chart.

I have some handouts I am happy to table for the Committee which just pick up the raw numbers and the annual changes in the net debt. I think there was a question earlier about what happens under each scenario across each of the years of net debt, and what the end numbers are. The table I have presented covers that.

In scenario 2, the forward Estimates scenario, the average compound growth between the 2018-19 estimated outcome in the final projection in 2033-34 is 2.5 per cent for revenue, and 2.2 per cent for expenditure. That shows an operating balance of $520 million positive at the end of the period, and a fiscal balance of negative $77 million.

In terms of net debt, the forward Estimates scenario shows net debt of about $4.47 billion, and again the profile of the increments and changes is shown in the accompanying chart. The high expenditure scenario shows a compound annual growth in expenditure of 5.1 per cent, with revenues at 3.3 per cent.

In terms of the high expenditure scenario, we maintain the revenue growth effectively at the long-term trend. That is why we are saying they are the cases that create the extremes and the most likely pressure on fiscal sustainability. It is when you have high expenditure and normal or steady revenue growth, or you have very low revenue and normal expenditure growth. In terms of the high expenditure scenario, the net debt rises to $29 billion by the end of the period, and, again, you can see the rapidly escalating changes in net debt under that scenario.

Ms FORREST - We could have a real problem there. Look at Europe.

Mr FERRALL - The low revenue scenario shows revenue growth of 2.5 per cent, and expenditure growth of 4.5 per cent. Again, you see an operating balance towards the end of the period of $3.1 billion negative, and a fiscal balance of about $3.6 billion negative. That leads to a projected net debt of about $26 billion at the end of the period.

The summary results figures are there for each of those previous scenarios, so I do not think I need to cover those, but that gives the committee the raw figures under each of those scenarios.

The average growth over the projection period in revenue and expenditures from transactions is shown in the accompanying table as well. For the committee's interest, between 2008-09 and 2018-19 estimated outcome, revenue growth, calculated on the same basis, has been 4.1 per cent and expenditure has been 3.8 per cent. Like all these percentages you can pick different periods and you can get different outcomes.

Mrs RYLAH - So what is the historical trend based on then? It is obviously not based on that period.

Mr FERRALL - It is based on multiple periods, depending on which scenario. Primarily we have tried to take out, in some cases, abnormal changes. A good example is the GST. When GST was introduced, there was a period of the first two or three years where we had very high growth. Post that, there has been there has been much more steady growth, so in some cases we have taken those things out.

Ms FORREST - Distorting things

Mr FERRALL - Distorting things, yes.

We have tended to go for as long term as we reasonably can. There is not always data to go back to long-term trends. With things like conveyance duty we went back 18 years to come up with a long-term trend. That is a highly volatile tax and if you take a short-term period, you can get quite significant changes over the short period so we have used a very long-term trend for that.

In conclusion, the state's workforce and student population are not projected to change markedly over the projection period, meaning little impact on payroll tax or education expenses. They are largely driven by policy drivers rather than long-term trends. Under the historic trends scenario health expenditure is projected to grow at 5.8 per cent per annum, which is the average growth over the past decade. Health expenditure is a share of total general government sector expenditure, which was 25.3 per cent in 2008-09; it is 30.8 per cent in 2018-19; and it is projected to grow to 42.1 per cent by 2033-34 under the historic trend scenario.

The aging of the population along with prevalence of people with more than one health condition results in higher health costs. However, studies have shown that the primary driver of growth in health is likely to be non-demographic factors. Healthcare expenditure projections produce by the OECD to the year 2050 found that non-demographic factors were the most important drivers of increase in healthcare costs.

Mrs RYLAH - The capability, is that what you are talking about?

Mr FERRALL - No, it is things like technology. The capability of more diseases to be treated is increasing so it is not, as you might think, that it is driven by demographics. Demographics do have an impact but it is not the most significant driver.

This is consistent with previous analysis and it is also similar to the fiscal pressures we are seeing in other states and territories. By 2024-25 under the historic trend scenario a revenue increase of approximately of 10 per cent would be required to achieve a zero net operating balance and the size.

Ms FORREST - What year was that?

Mr FERRALL - By 2024-25. The size of the corrective action required after this point is projected to increase significantly. The underlying drivers of growth in health expenditure are likely to continue. Therefore using expenditure constraint alone to achieve fiscal sustainability will become increasingly challenging. That was the conclusion of the report.

Ms FORREST - In terms of those of the big picture, it is interesting talking about health expenditure; we hear it all the time - we have heard it forever. Demographics have often been cited but it is clear that there is also the ability to treat so many more things with the equipment with which they may do so.

This might be not something for you and I am happy for it to be taken to the Treasurer at a later time, but if we are not willing to have these really difficult discussions about what we do, with what you see, is there any other way of constraining this growth in a way that makes it manageable?

Mr FERRALL - I think it really is a matter of policy for government of the day so I think it is a matter for you to take up with the Treasurer. The conclusion we included in the report is that it's really very difficult to see a sustainable position if you are trying to rely on health constraints alone. It is very difficult to achieve health expenditure restraints.

Ms FORREST - We need to have a conversation around that. That is a policy question. But are there other measures within health? If we don't do something in this space, are we going to have major problems beyond 2024-25?

Mr FERRALL - If health expenditures continue at the level they have been in the past, growing at about 5.8 per cent, and if revenues are growing at about 3.3 per cent, it is only a matter of time before those dynamics cause an unsustainable position. But it is not a matter of constraining expenditure alone, there are questions around whether there can be improvements in efficiency in health. In the medium- to long-term, as is the case in other jurisdictions, there probably needs to be a debate in the community about how willing the community is to pay for the extended health services, which leads you to a revenue debate.

Ms FORREST - That is where I am going. You made it pretty clear that in the absence of any corrective action, it is all downhill or uphill, depending on whichever graph you look at. There is a bit of net debt, it is rather steep where there is no corrective action. The point was made that it becomes an even harder task if we don't act soon. Do you believe there needs to be an urgent conversation? It takes a while to make these changes. You can't start a conversation - I will use the dreadful term 'tax reform' because it frightens the pants off people - because once you start it there is a long way before anything will happen, but if we don't start that conversation pretty soon, we are going to be facing some of the scenarios we have looked at.

Mr FERRALL - That is a challenge around the country. It is not a Tasmanian challenge alone. It is almost impossible for Tasmania to go it alone in a tax debate. There have to be some more serious questions asked nationally around GST and income taxes.

Ms FORREST - Transitional arrangements, should recommendations be made, that sort of thing?

Mr FERRALL - Again, it is a policy choice for governments.

Ms FORREST - When do you think this conversation needs to start?

Mr FERRALL - A conversation is starting or has started. It has been going on for some time. If you look at reports from other jurisdictions, including New South Wales recently, if you look at reports from the Productivity Commission and the New South Wales productivity report, the conversations are starting. It is a difficult conversation for governments to have, politically.

Mrs RYLAH - This is the second sustainability report, is that right? If you compare the two reports, can you give us an overview? We are not talking the numericals, we are talking about trends and position. Are we in a better position than we were when the first report was done? How are we tracking?

Mr FERRALL - The nature of the reports is such that there is not significant difference between previous conclusions and the conclusions now. In part, that is because one was 2016 and one is 2019 and you are doing 15-year projections. It goes to the point I made at the start of the hearing, which is that there is no single point where you can say we have moved from sustainable to unsustainable. I would say the two reports show the same thing over time.

Mr O'BYRNE - Under all four scenarios it is pretty diabolical if no corrective action is taken. In answer to Ms Forrest's question about corrective action and a debate about either revenue or expenditure, you talked about Tassie not going it alone. I have noticed in recent reports you have had the New South Wales Government float some ideas, but there is a Board of Treasurers concept that has been around a while, but is that playing a role in state-federal relationships? What would be your view on that? Clearly, this report can't be seen in isolation of that conversation as well.

Mr FERRALL - That is a matter for the Treasurer and the Board of Treasurers. I don't think I can comment on the position of the collective of Treasurers in relation to Commonwealth calculations.

Mr O'BYRNE - By virtue of your report, you raised the issue; in all of the four scenarios you have painted, it is pretty grim and action needs to be taken. This report would trigger, you would think, a response from government in line with your previous answer saying that Tasmania cannot go it alone.

Mr FERRALL - It is a matter for the Commonwealth and states to decide what actions they may want to take in respect of the pressures across all jurisdictions. What is in this report is not revolutionary, in reality. The pressures from the health system have been well known and they are escalating. The challenge we have is that the revenue sources that states have are not growing at the same rate as the health expenditures. Another challenge is that if you look at expenditure growth of health at 5.8 per cent, as an example, it is difficult to see there would be any single revenue source that would grow at that rate, either. It is quite a complex challenge for the community in terms of looking at what is affordable long-term and making difficult choices in health expenditure.

Mr TUCKER - With your predictions, what would be helpful -

Mr FERRALL - Not predictions.

Mr TUCKER - the modelling, I should say. It would be interesting to see five years beforehand and see where those figures were sitting in actual figures on what has occurred.

Mr FERRALL - At any point in time you can do a set of long-term projections, which literally take a period of time and then project it without any policy intervention and you will have very positive or very negative numbers. The reality is all governments, in Tasmania and other jurisdictions, take sequential interventions against those trends. One of the points of the report is that interventions tend to be more easily taken if they are taken early than if they are taken later, and that is quite an obvious point but if you don't -

Mrs RYLAH - It is called compound interest.

Mr FERRALL - Well, it is. If governments don't take those actions early on, you see bigger swings and bigger changes, which tend to be much more disruptive for the community. Tasmania has a very solid history of acting to the economic environment it is within, and that is governments of all persuasions over a long time.

Ms FORREST - I will take you back to talk about what fiscal sustainability is. You said there is no clear definition and the OECD provides some guidance. What is, for us to look at, the most reliable - if you want to use that word - measure of fiscal sustainability as presented here?

Mr FERRALL - There is no single measure. I don't think you can pick a single measure as a measure of sustainability. I will give you an example. If you have a significant amount of debt but you have sufficient revenue to support that debt and also meet all your other recurrent costs, you are still in a sustainable position. It is only when you are in a position that you can't meet the debt servicing and meet your other recurrent costs, that debt would potentially become unsustainable. It is a question of when you start either to be unable to service any debt you've got or start to constrain or restrain your current expenditure to a point which is -

Ms FORREST - Or your capital expenditure, surely?

Mr FERRALL - Yes, capital or any of your expenditures to a point where you're reducing the capacity of the future generations to have the same level of support and services that you currently have.

Ms FORREST - On that point, wouldn't it be the case that net debt is really the better measure here? Really, when you look at the other measures, they are measuring the flows in and out, money in and out, whereas net debt actually measures the stock. When you see the stock that is left it shows you what money you have or are falling short by to meet the capital and recurrent expenditure you have committed to. This varies up and down - no government ever meets exactly what they say they are going to do with capital expenditure or recurrent. We see that every year.

Mr FERRALL - Net debt is used as a measure by many jurisdictions in terms of a fiscal sustainability measure. Some of them compare that to percentage of GST. It is quite a reasonable and appropriate measure. Debt is also a very appropriate way of getting intergenerational equity. If you have a large expensive asset that is going to provide support to the community over a long period of time, it is not unreasonable to have debt to support that asset and share the burden of the cost of that asset over a number of generations. Debt per se can be bad, but it is not always bad.

Ms FORREST - It is good to see the figures actually here in the table you have presented. To me, net debt reflects a stock measure rather than a flow measure. I wonder is it possible for you to present information with a cashflow deficit figures each year and chart them in the same way?

Mr FERRALL -The way we have presented this report the net debt is most close. Those figures you have in the increment or [inaudible] are pretty well equal to cash.

Ms FORREST - Okay. It is helpful to have that. I think that is a truer picture of what we would actually be looking at in number terms. It would perhaps make it easier for people to think 'Okay, if this is where we are going to be sitting, with a gap between what we have and what we need, which is virtually what it is, on an annual basis' -

Mr FERRALL - It is in the absence of any intervention. I do not want to labour that point, but no government would ever sit for 15 years and do nothing. There will always be policy interventions by government and changes over time.

Ms FORREST - I still feel a bit confused about the treatment of defined benefits and the differences, the normal super interest, which is part of the primary balance, which I know is removed from this situation. Just bear with me and see if there is any light you can shed on it. Normal super interest is non-interest per se, but there is rather a difference between unfunded super and the unfunded super if all members were a year older. That is what it is - it is a figure that tells you that. In some respects, you could say that is a proxy measure for what the government contributions are likely to be for that year. Is that a fair comment?

Mr FERRALL - Keep going.

Ms FORREST - If that is the case - that this is likely to be required to be paid by the government; the obligation is there - shouldn't that be included in the measure of sustainability?

Mr FERRALL - The way we have done the report, we have effectively used the actuarial assessment of the cashflows for the defined benefits super obligation. The nominal interest on super is an economic measure that goes into the financial statements. It is not the actual cash cost of the defined benefit members over time. In putting together this report, we have effectively used the actuary's assessment of the cash going out the door, which is why you end up simplistically with that direct impact on net debt, because it is the cash.

Mr O'BYRNE - What is the margin of error historically on that actuarial advice?

Mr FERRALL - I cannot tell you what it is. On the cash, it is relatively small, but you get big swings on the valuation. The valuation is done on a discount rate basis. The things that drive the cash going out the door are the assessment of how long people are likely to live and shifts between people taking pensions versus lump sums; there's a couple of other factors but they don't tend to have big movements.

Mr WILLIE - My father-in-law passed away at 96, retired at 55 on it. He got a good whack.

Ms FORREST - Just to clarify a point Tony made earlier, this additional report hasn't restarted the clock so to speak on the five-year calendar?

Mr FERRALL - No, another report must be done before June 2021; so there will be another report and that's the report required under the legislation.

Ms FORREST - Will that one contain the -

Mr WILLIE - That's a bonus report under the legislation.

Mr FERRALL - Some might call it a bonus.

Ms FORREST - Some probably don't.

Because it will have to be released by June that year, that year's budget is not going to be included?

Mr FERRALL - It wouldn't be possible.

Ms FORREST - It will only be one more budget before you are looking at producing another report?

Mr FERRALL - I haven't decided when that other report would be done. It is difficult to see it being done in the first half of the 2021 calendar year because of the budget timing so it's most likely to be done in the last half of the 2020 calendar year.

Ms FORREST - So next year?

Mr FERRALL - Yes, probably in 12 months time.

Ms FORREST - Which will factor in next year's budget?

Mr FERRALL - Yes.

Ms FORREST - It's a lot of work and it's good to see you earning the money.

It will be interesting to see because the report has made it pretty clear that there needs to be some conversations about where we go and how we deal with both the obvious issues with health expenditure, which is not new or unexpected or unique to Tasmania, and the need for that discussion more about revenue.

You ask the questions you know the answers to at times, but there are conversations going on around the country in some other jurisdictions. I know you talked about the board of treasurers but there's also the heads of Treasury secretaries, the HOT team you've told me about in the past. Does it have a role in raising these issues as the secretaries of Treasury around the nation?

Mr FERRALL -Yes, they do, and my counterparts do raise issues of a similar nature. There isn't a state budget that isn't under pressure. It's the reality of managing state budgets.

Mr O'BYRNE - The report you will do either next year or at some stage according to the act, will that be the first report where we can do a point-to-point for genuine comparison?

Mr FERRALL - You won't really be able to do a point-to-point comparison. That was my comment that for continuity we picked up the approach used in the 2016 report and did a comparison with the 2019 report, but in terms of a direct point-to-point comparison, unless we use the same methodology in the next report as we used in the 2016 report, you wouldn't get that point-to-point direct comparability.

Ms FORREST - Which is unlikely, isn't it? You haven't decided, I am sure.

Mr FERRALL - From my point of view, it's unlikely because the methodology used in the 2016 report, to be frank, didn't meet the expectations of the committee and was difficult for a number of readers to understand. The purpose of a report is for people to understand it. I wouldn't go back to a methodology, even though it is technically correct, that was not understandable.

Mr O'BYRNE - Just to clarify, the methodology you use for the next report will be different again from this report?

Mr FERRALL - No. Under the terms of the legislation the approach to the report is a matter for the secretary to determine. If I am the secretary at that point in time, it is most likely I will do a report on a similar basis to the 2019 report.

Ms FORREST - Which I must admit is more readable. It makes more sense.

Mr FERRALL - It was intended to be.

Ms FORREST - There you go. You listened to us and we appreciate that.

CHAIR - It is interesting when you look at increasing health costs and the OECD's reports about the fact that it is not going to be the aged demographic factors that are going to cause the increasing cost in health; it's going to be other issues, such as technological ones and so on. People reading these issues and looking at reports like this would find that hard to accept, wouldn't they?

I think the average person would say that the cost increases in health are going to be from people living much longer. I guess it's a growing population as well, and the demand on health services would be the driver of the expenses in that area.

Mr FERRALL - They are drivers, but not the primary drivers. That's the point: it's not that demographics doesn't have any impact, but it doesn't have as significant an impact as the other factors.

CHAIR - We are talking about the equipment and machinery and so on that's required to keep abreast of everything that's occurring. Is that the way it goes?

Mr FERRALL - Yes, and it's also the capability through changes in technology and approaches to intervene in or treat a greater number of diseases. That's growing rapidly as well.

Ms FORREST - But that has been going on for a long time. If you look at the management of micro-premature babies. Babies at 26 weeks were not even considered for resuscitation some years ago, and it's now just par for the course, at considerable expense, which you understand.

Mr FERRALL - Yes, and there is a technological component to that as well, there's a capacity to -

Ms FORREST - Absolutely there is - technological, pharmaceutical, it's all those things.

CHAIR - Are there any further questions? If there are no further questions, Mr Ferrall, is there anything you want to leave us with

Mr FERRALL - There's one thing I would like to put on the record. We had a small team within Treasury working on this report and it was quite difficult; that group worked for about three months on the project. I would like to put that on the record and thank them for all the work they did on this particular report.

Ms FORREST - As a member of the committee too, I acknowledge it was on the request of the committee that this extra work was done, in many respects. It is really gratifying to see that Treasury does take the committee seriously, and seeks to work with us to produce some information that is useful, not only to us but also to other people in the community who are interested in this.

Mr FERRALL - Thank you.

CHAIR - The committee is grateful for what has happened and the way you have gone about this. We also thank those members of your staff who were so committed during the past three months to put it all together.

We appreciate that you and Fiona came along today as well, for the report and the slides you have provided, which has made it much quicker and easier to understand. Thank you very much.

THE WITNESSES WITHDREW.