



PREMIER OF TASMANIA

16 OCT 2021

Hon Ruth Forrest MLC
Chair
Legislative Council Sessional Committee Government Administration A
Inquiry into the Horizontal Fiscal Equalisation system
HOBART TAS 7000

Dear Ms Forrest

Inquiry into the Horizontal Fiscal Equalisation system

Thank you for providing a copy of the Final Report on the *Inquiry into the Impact of the Commonwealth Horizontal Fiscal Equalisation System as assessed by the Commonwealth Grants Commission as it applies to Tasmania's expenses and the delivery of services* prepared by the Legislative Council Sessional Committee Government Administration A.

I welcome the opportunity to provide comments on the findings of the report, as detailed below.

Terms of Reference 1

The Tasmanian Government welcomes the findings of the Committee and in particular, the finding that the Commonwealth Grants Commission (CGC) assessments are mathematical constructs that include assessments for each category and are not observable amounts that can be identified by examining government accounts. The Government also welcomes the finding that, in developing its revenue and expense assessments, the CGC does not purport to identify an optimal or desirable level of State government spending or revenue raising. As highlighted in the Committee's report, the CGC does not form an assessment on how much a State should spend on any particular service it provides to its population, nor on how much tax a State should raise under the available revenue streams.

As also noted in the Committee's report, GST is provided to the States in accordance with the *Intergovernmental Agreement on Federal Financial Relations* on the basis that it is untied, general purpose revenue. The report also acknowledges that State governments are ultimately accountable to their communities in relation to how they spend untied GST revenue.

This is consistent with the recent Occasional Paper published by the Department of Treasury and Finance, entitled *GST and the Commonwealth Grants Commission's assessment of health expenditure needs*, which is available at www.treasury.tas.gov.au/gst-distribution-to-tasmania/publications.

As highlighted in the Occasional Paper, the primary objective of the CGC is to produce relativities for each State which provide an indication of whether a State needs more or less than its per capita share of the GST pool. The CGC's calculation of each State's relativity is based on a one year lag and three-year average of each State's overall assessment of fiscal capacity. For example, Tasmania's actual GST received in 2019-20 is based on the average of the 2015-16, 2016-17 and 2017-18 assessment years. As well as being driven by relativities, a State's population share and the size of the GST pool will also impact the amount of GST distributed to a State in any year.

Also, as indicated in the Committee's findings, the primary source of data used by the CGC is Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS) data. However, the CGC makes some adjustments to the ABS GFS data to simplify its assessments and remove components to other categories to more closely align with its classifications. As the Committee will appreciate, the expenditure and revenue categories utilised by the CGC also do not necessarily align with the categories included in State financial reports.

There are therefore a number of technical reasons arising from the CGC's methodology that explain why comparisons between actual and assessed expenditure can vary. For these reasons, it is generally not appropriate to make comparisons between the CGC's assessments in a particular area or use them as a benchmark for government spending priorities. Drawing any conclusions, without proper consideration, can misrepresent the CGC's assessments.

Treasury's Occasional Paper provides a comparison between what Tasmania actually spends on health and what the CGC has assessed it needs to spend to provide the same standard of health services as any other State in order to address a number of misconceptions put forward by some commentators. However, for the reasons identified by the Committee in its report, and in the Treasury Occasional Paper, it is generally not appropriate to undertake these comparisons.

As the Committee is no doubt aware, the Productivity Commission, in its 2018 Report on Horizontal Fiscal Equalisation recommended that the CGC should provide a strong neutral voice to facilitate a better informed public discourse on the HFE system. The CGC has recently released a number of papers that provide an overview of topical and background issues with the aim of improving public understanding of the system of HFE.

As part of the 2021 Update, the CGC also published state-specific summaries to provide an overview of the major causes of changes in relativities and the distribution of the GST pool since the 2020 Review. The summaries illustrate the financial impact of the CGC's recommended GST revenue sharing relativity, and outline any changes in data or circumstances which have driven a change in assessed expense requirements or revenue raising capacity.

The Government understands that the CGC will continue to publish these summaries for each Update, which are available on its website at www.cgc.gov.au/inquiries. It is hoped that these summaries, along with the range of background information on Treasury's website, will provide user-friendly information to enable informed discussion on any changes in Tasmania's GST allocation from year-to-year.

Terms of Reference 2

The Government also welcomes the findings of the Committee in relation to the judicious use of quarantined Commonwealth payments.

As indicated in the Committee's report, any Commonwealth payments which support State services, and for which expenditure needs are assessed, will impact on States' relativities. This means that any Commonwealth payments to a State that are not quarantined will be equalised away by the CGC's methodology, in the form of reduced GST payments over time. This is particularly problematic with

larger payments and has occurred in the past with the Royal Hobart Hospital funding. In effect, the State forgoes untied GST revenue in exchange for tied Commonwealth funding.

However, the Government does not generally support the quarantining of Commonwealth payments, except in exceptional circumstances, as it undermines the principle of HFE. A recent example of an exceptional circumstance where Tasmania has benefited from the quarantining of a Commonwealth payment is when the Commonwealth Government transferred ownership of the Mersey Community Hospital back to Tasmania, with an associated one-off payment of \$730.4 million.

Treasury will continue to work closely with Government agencies, including consulting informally with the CGC where necessary, to ensure that the Government understands the potential GST implications of any new Commonwealth payments. Given the complexities of the CGC's methodology, it is generally not possible to definitively determine the exact financial impact of any specific payment in advance. However, Treasury will investigate options to provide more user-friendly information to assist agencies in understanding the relationship between Commonwealth and State Government grant funding.

As the Committee is no doubt aware, as part of the PC's Report on Horizontal Fiscal Equalisation, it also recommended that the Commonwealth Government, in consultation with the States, develop clear guidelines detailing the basis on which Commonwealth payments are to be quarantined from the GST distribution by the Commonwealth Treasurer (so that they do not unnecessarily erode the efficacy of the CGC's relativities and compromise the objective of HFE). The Report also indicated that the guidelines should strike a balance between enhancing accountability and transparency, while not unduly affecting the Commonwealth Treasurer's ability to quarantine payments in exceptional circumstances that are in the national interest. My understanding is that the development of these guidelines is being progressed between the Commonwealth and the States through relevant officer-level intergovernmental forums. It is expected that these guidelines will be considered by the Council on Federal Financial Relations prior to being published.

Once again, thank you for providing a copy of the Committee's final report the *Inquiry into the Impact of the Commonwealth Horizontal Fiscal Equalisation System as assessed by the Commonwealth Grants Commission as it applies to Tasmania's Expenses and the Delivery of Services*. I appreciate the Committee's interest and engagement in these important issues to the State, and welcome further engagement from members in ensuring that Tasmania continues to receive its fair share of GST revenue. On this note, the Committee may also be interested in the further Occasional Paper prepared by Treasury and published in September 2021, entitled *New GST distribution arrangements*, which is available at www.treasury.tas.gov.au/gst-distribution-to-tasmania/publications.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Peter Gutwein', with a long horizontal flourish extending to the right.

Peter Gutwein MP
Premier
Treasurer

cc: Clerk of Legislative Council