Department of Treasury and Finance

The Treasury Building
21 Murray Street HOBART TAS 7000
GPO Box 147 HOBART TAS 7001 Australia
Telephone (03) 6166 4444 Facsimile (03) 6173 0219
Email secretary@treasury.tas.gov.au Web www.treasury.tas.gov.au

Tasmanian Government

Hon Ruth Forrest, MLC
Chair
Legislative Council Committee Inquiry into Horizontal Fiscal Equalisation
HOBART TAS 7000

Dear Ms Forrest

Inquiry into Horizontal Fiscal Equalisation

I refer to your letter dated 15th August 2019 requesting additional information arising from the attendance of Treasury officers before the Legislative Council Committee.

Please find the requested information below.

1. ***Provide details as to all revenue sources that are included in the 'other revenue' category?***

   a. ***Are income tax equivalents and dividends included?***

   b. ***How are equity injections and transfers between state owned businesses treated?***

The other revenue category is a residual revenue category. It includes revenues for which:

- a conceptual case for a differential assessment does not exist;
- data to support a reliable assessment are not available; or
- a differential assessment would not have a material effect on State GST distributions.

Revenue included in the other revenue category is treated equal per capita (EPC). That is, there is no differential assessment by the CGC that will affect GST shares. The revenues currently include:

- gambling revenue;
- fees and fines;
- other user charges - user charges not included in a category assessment are treated EPC in the other revenue assessment. Where user charges form part of a category assessment, they are differentially assessed. For example, health, housing, post-secondary education, transport, and mining user charges are offset against relevant assessment category expenditure.
- municipal rates - because GFS data includes municipal rates with State revenue for the ACT, municipal rates are treated EPC in other revenue.
- other taxes - other taxes include revenues relocated from revenue categories to the other revenue category and treated EPC because they are not material enough to warrant a differential assessment, or can't be reliably assessed. For example stamp duty

on motor vehicle transfers is transferred from the stamp duty on conveyances category to the other revenue category.

- interest income;
- contributions by trading enterprises (income tax equivalents and dividends); and
- grants - these are grants from parties other than the Commonwealth. Only Commonwealth grants are differentially assessed.

Income tax equivalents and dividends are included in the other revenue category under contributions by trading enterprises.

Equity injections and transfers between state-owned businesses are not assessed by the CGC as they are outside of the General Government GFS operating statement that the CGC bases its assessments.

As noted, other revenue is assessed EPC so any changes in the amount of revenue received in the other revenue category do not affect GST shares.

2. Provide details regarding the differences between assessed and actual expenditure, in relation to depreciation.

The CGC currently assess net investment and depreciation separately. For the 2020 Methodology Review the CGC is proposing to assess net investment and depreciation together in an assessment of gross investment.

The current depreciation assessment provides States with the capacity to meet the depreciation expenses on their assessed infrastructure stocks, assuming they applied the average depreciation rate. The assessment, however, does not include urban transport depreciation because those expenses are part of the net expenses covered by the urban transport assessment.

The depreciation assessment has three steps.

First, the CGC estimates the stock of infrastructure each State would hold if it provided the average level of services to their population and did so using the average policies on how services are provided (called assessed infrastructure stock). The calculations allow for the effects of each State's population characteristics on the quantity of infrastructure it requires. For example, States with higher proportions of their population enrolled at school may require more schools.

Second, it adjusts that assessed stock for State-specific factors that affect its cost. For example, States with high wage structures or a higher proportion of their population in remote areas generally face higher costs to acquire a specific piece of infrastructure.

Third, it applies the national average depreciation rate (the ratio of the sum of depreciation expenses for all States and the sum of state stock of infrastructure) to the assessed infrastructure.

Tasmania's actual depreciation will therefore differ from its assessed depreciation because Tasmania's assessed depreciation expense is based on the national average rate of depreciation, multiplied by Tasmania's adjusted stock of infrastructure as described above.

Whereas, Tasmania's actual depreciation expense is based on its actual rate of depreciation and its actual stock of infrastructure.

3. *What is included in expenditure under 'investments'?*

Investment is the acquisition of additional, or upgraded, infrastructure and land. Investment is gross investment less depreciation. The CGC currently assess investment and depreciation separately.

Under the current 2015 methodology, the investment assessment includes investment in infrastructure in the following State Government activities:

- roads;
- urban transport;
- other services (all other Government services); and
- land (assessed EPC).

4. *Provide details regarding the differences between assessed and actual expenditure in relation to investment; and*

a. *Provide details regarding investment in infrastructure.*

The following is based on information contained in the CGC's 2015 Methodology Review final report.

The investment assessment estimates the amount each State would invest to acquire additional infrastructure to ensure it finishes the year with the per capita stock of infrastructure it requires to provide the average services in its circumstances.

Each State's assessed investment in roads, urban transport and other infrastructure is calculated as the difference between the infrastructure it requires at the end of the year and the infrastructure it required at the start of the year, adjusted for factors affecting the cost of acquiring infrastructure.

The calculation of assessed investment allows for the effects of:

- population growth.

  The assessment is based on the view that, if States were alike, they would need the average per capita stock of infrastructure if they were to provide the average level of services under average service delivery policies. However, because population growth is not the same in all States, the assessment recognises that States with above average population growth need to invest above average amounts. This is the main driver of the investment assessment.

- changes in other State circumstances affecting the quantity of infrastructure required to provide average services.

  States are not alike. Each State needs a State specific stock of infrastructure per capita (which reflects its specific characteristics) if it is to deliver the average level of services to its residents. For example, if a State's population uses hospitals at above average rates, it warrants more hospital beds per capita. The quantity of stock disability measures these State specific requirements. For most services, the factors for the quantity of services States provide are used to measure the stock disabilities.

- changes in the average stock of infrastructure per capita (capital deepening).

  The assessment is based on the change in the national value of the stock of infrastructure at the start of the year and end of the year. This will reflect changes in the intensity of capital used over the period.

- relative cost levels prevailing during the year.

  Cost disabilities allow for interstate differences in wage levels, the price of materials and other unavoidable factors affecting the cost of services and infrastructure.

Tasmania's assessed investment will differ from its actual investment because its assessed investment is based on the change in the national stock of infrastructure per capita adjusted for state specific quantity and cost of infrastructure disabilities.

Whereas, Tasmania's actual investment is based on its actual increase in its stock of infrastructure. Actual investment expenditure is the net acquisition of non-financial assets in the GFS operating statement, which is defined as gross fixed capital formation less depreciation plus changes in inventories plus other transactions in non-financial assets.

The CGC cautions against comparing actual and assessed net investment expenditure *because net investment is very volatile and this volatility is exaggerated by it being a net effect (that is net of depreciation). Such analysis is meaningless for assessing investment needs.* (What States Do - Investment CGC Staff Research paper CGC 2017-17-S p3).

Should you have any queries or require any further information regarding this matter, please contact Damien Febey on (03) 6166 4268 or email damien.febey@treasury.tas.gov.au.

Yours sincerely

Tony Ferrall
Secretary

3 September 2019