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.

<u>THE WITNESSES WITHDREW.</u>