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THE LEGISLATIVE COUNCIL SESSIONAL COMMITTEE GOVERNMENT ADMINISTRATION A MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON MONDAY 12 AUGUST 2019.

INQUIRY INTO COMMONWEALTH HORIZONTAL FISCAL EQUALISATION SYSTEM

Ms FIONA CALVERT, DEPUTY SECRETARY, ECONOMIC AND FINANCIAL POLICY DIVISION, AND **Mr DAMIEN FEBEY**, ASSISTANT DIRECTOR, INTERGOVERNMENT AND FINANCIAL POLICY BRANCH, DEPARTMENT OF TREASURY AND FINANCE, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIR (Ms Forrest) - Welcome. I probably do not need to go through the whole spiel but I just remind you that your evidence will be public. We are broadcasting today and it will be published on the website once the transcript is made available to us. Everything you say is covered by parliamentary privilege while you are in this setting.

We thank you for coming in a little earlier to fill the position that the Treasurer left vacant by retiring hurt. We will reschedule with him at a later time. Members have had a chance to go back through the *Hansard* of our last hearing. We didn't get to cover much on term of reference 2 particularly, and there may be a few other questions on term of reference 1 as well. Do you want to make any opening comments from where we left off last time?

Ms CALVERT - No, I think I made opening comments on both terms of reference last time.

CHAIR - Okay. To open the questioning on term of reference 1, I assume that you were provided with a copy of a recent supplementary submission by Martyn Goddard talking about gaming tax revenue of Tasmania? We sent it to the Treasurer.

Mr FEBEY - We received it indirectly; it did not come to us directly but we did get a copy of it.

CHAIR - Some of the points I was going to raise he raises in his submission around the other revenue. In terms of the other revenue that forms part of our own source revenue, I would like to explore this a little further. As I understand it, it does not include taxation in terms of the assessment by the Commonwealth Grants Commission. It does not include income tax equivalents and dividends and guarantee fees and it also does not include gambling tax, or does it?

Mr FEBEY - It includes it but it's not accessed. All other state taxes are covered in the other revenue component but they are not accessed; they are all treated equal per capita.

CHAIR - So if we raise less - or more, potentially - that is a situation we have to deal with because it is equal per capita share.

Mr FEBEY - It has no effect on our GST outcomes, so if we raise more or less we either get to keep more or retain less. In the other revenue categories - like gambling, for argument's sake -

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if you raise more taxes it doesn't affect our GST outcome because it's not assessed; it is treated equally per capita across the nation.

CHAIR - The Commonwealth Grants Commission talks about the difficulty it has had of not being able to find a way to -

Mr FEBEY - A driver of need - why one state would have greater difficulty in raising revenue than another state.

CHAIR - Around policy decisions?

Mr FEBEY - There are certainly a lot of different policies in gambling across the state. Some have banned gaming machines in venues, such as Western Australia, and others have arrangements with casinos and so on. That is one of the problems; there is not a very uniform approach to gambling and what is taxed and what is allowed and not allowed, and how they are regulated and so on. That is the policy side of things.

In terms of the driver of need and why one state would have more revenue than another or be able to raise more revenue than another, it looked at various things in the past. Household disposable income was one that was used in the past as a driver in that if you have high levels of household disposable income then potentially you have more capacity for the public to gamble. Therefore, you would raise more revenue from gambling taxes. We have not followed that line of exploration because it hasn't been able to prove that there is a strong relationship there. They have looked at other drivers as well and haven't found anything that is material or robust or reinforced by the evidence.

CHAIR - If you can't answer this because it is more one for the Treasurer I am fine for you to turf it to him at a later time. If we make policy decisions around the new gaming licence arrangements, basically giving them away cheaply and not getting a decent amount for the fee or the taxing arrangements that are proposed, don't raise significant revenue, or raise less than they might if you are applying another measure or another policy position, there is no impact at all on the assessment of our GST on that basis? The same with the income tax equivalents and dividends from our government-owned businesses?

Mr FEBEY - I can't answer the income tax equivalence question but with the gambling one, because it is not assessed, if we were to change our tax rates for gambling, it wouldn't affect the GST outcome. The amount that we raised would just be whatever we get to keep, whatever that is. If we increase the amount of tax, we get that increased amount. If we reduce our tax rates, we lose that amount.

CHAIR - What is in the other category then?

Mr FEBEY - Of other revenue?

CHAIR - Yes, the revenue.

Mr FEBEY - I did touch on some of them. It's fees and charges; it is basically every other kind of revenue that the government raises that is not captured by the other ones. That is probably

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the easiest way of explaining it. I am not a tax expert so I don't know all the sources of revenue, but there's lots of fees and charges and legislating contacts equivalents, and other things.

CHAIR - So income tax equivalents and dividends are included?

Mr FEBEY - I can't answer that -

CHAIR - It would be interesting to know whether you could follow that up?

Mr FEBEY - Yes.

CHAIR - Again, it has come back to policy decisions around the dividend policy and, maybe the profitability of your GBE. If you do a big equity transfer from, say, one of the energy entities to another, then that would reduce the profitability of that one, thus the income tax equivalents would be less. I am interested in the whole bucket that makes it up.

Mr FEBEY - First of all, the income tax equivalents, are they in there? How are they treated and what's the effect of changing your policy on that?

CHAIR - Yes. I assume it would be similar to the gaming levies and taxes. What else is in there? It is not an insignificant category obviously.

Mr FEBEY - No, it's not. It's all the fees and charges that are raised by government. I guess it would be sales of goods and services, and all the other forms of non-state revenue.

Ms CALVERT - If you look in chapter 5 of the budget papers, it shows all of the revenue. There is some quite substantial revenue outside those key tax lines that is already included, so your statement is correct: it would be things like fees and charges, and sales of goods and services, those types of things.

CHAIR - Looking at the budget papers, page 51, budget paper 1, there is a chart, 3.3, that shows the ratio of actual to assessed revenue and that shows we only raised about 90 per cent of what other states do after allowing for our disabilities it seems.

Ms CALVERT - Sorry, what page was it?

CHAIR - Page 51.

Mr FEBEY - That is overall revenue, I take it.

CHAIR - This is after allowing for the disability. So the assessment of the other areas, the Commonwealth Grants Commission does make an adjustment on -

Mr FEBEY - That's right, for payroll tax and all the other tax lines.

CHAIR - Going back to the other original question, if tax policy is such that we don't earn as much as we could, as perhaps other jurisdictions might, then this will be reflected in this ratio because it's the overall ratio? Is that what you're saying?

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Mr FEBEY - Yes, that is saying that overall total revenue for the CGC assessments that our actual is less than what our assessed is.

CHAIR - Yes. Can you explore that a bit further? Provide a bit more context around that?

Mr FEBEY - Some of the tax lines we do - we raise more than we are assessed. Others are less. One of the issues is a lot of it is in the 'other revenue' category. That is because it is assessed equal per capita, there is no assessment made. So, we may have a disability in some of those areas which has not been captured. Our actual 'other revenue' is going to be less than an equal per capita share.

CHAIR - So does that drive some of the policy decisions, do you think?

Mr FEBEY - I cannot say why that is the case. We are a state which generally has a lower revenue-raising capacity because of our lower incomes, and so on. In the 'other revenue' category, they are assuming we can raise revenue at an equal per capita level because they have not got any other way of assessing it. But we may have a disadvantage in there because of our lower incomes. That means we cannot raise as much in the 'other revenue' category as other states.

CHAIR - Through payroll tax and things like that?

Mr FEBEY - Yes, with the other ones they can assess those but they cannot assess the 'other revenue', so there are no disability factors for Tasmania or any other state in the 'other revenue' area. It could be missing a disability that we have.

CHAIR - That is why it would be interesting to know exactly what is in the 'other revenue' category.

Mr FEBEY - We could certainly give you a list of what is in it, but if it was assessable whether we would do better or worse in each one of those we do not know.

Mr VALENTINE - Is that the \$842 million you are talking about?

Mr FEBEY - Yes.

Mr VALENTINE - The \$842.2 million?

Mr FEBEY - That is our actual revenue compared to \$1062.8 million as our assessed -

Mr VALENTINE - So we are \$220.6 million behind under the assessed?

Mr FEBEY - That is right, yes. So, if we were able to raise revenue at an equal per capita rate in 'other revenue', we would have \$1062 million in 'other revenue'.

Mr VALENTINE - Gambling revenue is another revenue?

Mr FEBEY - That is right, that is one of them.

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Mr VALENTINE - And you are not sure what others are in there?

Mr FEBEY - As I say, it is a lot of miscellaneous stuff.

CHAIR - We have always known we have had a greater challenge for a range of reasons in raising our own revenue, and we are particularly reliant on the Commonwealth. So, there are some aspects that are obviously policy driven. But you are suggesting there are some that are not policy driven.

Mr FEBEY - Well, there could be a needs-driven thing, because they are not being assessed because they cannot do an assessment because it is not material. They look at various components of that assessment like gambling and think, can we come up with an assessment that shows that there is a material difference between the state's ability to raise revenue. If they can do that they will pull it out and assess it. They look at gambling each time to try to see if they can do that, but they have not had any success with it to date.

CHAIR - Do you know if they are still continuing to look at that?

Mr FEBEY - It was part of the 2020 review.

CHAIR - And we end up with the same outcome - that it is no easy way. There is nothing easy about this.

Mr FEBEY - Well they have not publicly released their report yet.

CHAIR - Having come to Mr Goddard's paper indirectly, is there anything you want to comment on in particular in relation to his assertions in this? He focuses particularly on gaming revenues, on tax revenues from gaming, suggesting that Tasmania would be a lot better off if it was assessed. But again, you have to have a method to assess, and I accept that. Did you want to make any comments about this submission?

Mr FEBEY - We have not really focused on the revenue side of the HFE argument. The terms of reference are really about expenditure. I know it has come out as a side issue because our expenditure is being assessed. You have to look at the complete picture, I suppose, when you are looking at the GST outcome. We certainly have not given much thought to gambling revenue as an area of assessment that we should be looking at in terms of this committee.

Ms CALVERT - As part of this process.

CHAIR - When is the next Commonwealth Grants Commission report out? It must be due soon.

Ms CALVERT - It's due soon.

Mr VALENTINE - There is a draft up, because I've printed part of it out.

CHAIR - Is it, of their review?

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Mr VALENTINE - Yes. It worries me as to where we might be going next, to be quite honest. I think that is the findings and recommendations from that.

CHAIR - Do we have the draft report?

Ms CALVERT - Not on the website no. Is that the 2020?

Mr VALENTINE - I think so.

Ms CALVERT - Is that the initial report that we provided comment on 12 months ago?

Mr VALENTINE - Sorry, what is the date on it? I haven't printed that page out, so I will go to it.

Ms CALVERT - That was from the CGC website?

Mr VALENTINE - Yes.

CHAIR - They would have notified you if they published a report?

Mr VALENTINE - It's a draft.

Ms CALVERT - Is it the original draft report, or -?

CHAIR - I will give him a moment to look for that, Fiona, but I think you would have been notified if there had been a formal report released.

Mr FEBEY - The states usually get it under embargo.

CHAIR - And that hasn't happened as yet.

Ms CALVERT - There is a 'terms of reference' on the website, there's a transmittal, but I can't see it there. There was a whole range of staff assessment papers that we commented on last year.

CHAIR - We might move on. If you find something there, Rob, we might come back to it. While we are tabling your submission, regarding the Commonwealth Grants Commission's assessed and actual expenditure and revenue estimates, page 9 of your submission: the Commonwealth Grants Commission figures also show we are depreciating our assets at less than average. Why is that? You would have thought assets were pretty consistent across jurisdictions. Is there an explanation as to why it is less?

Mr FEBEY - Our assessed investment is fairly low compared to the national average, so that may have something to do with it. It's probably something that bounces around a bit too, so we will have to look at it and get back to you on why that's the case.

CHAIR - I guess the question is, what is the cause of that? Is it that we use a different rate of depreciation, or do we adjust it, perhaps, for other political reasons?

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Mr FEBEY - The CGC don't have differential depreciation rates for each state. It would be a national rate applied to Tasmania's share of the national assets.

CHAIR - Which begs the question: why is ours less than what was assessed?

Ms CALVERT - I think we should look into it and come back to you.

CHAIR - Okay, I will make a note of that. Looking under assessed expense, under investment, the Commonwealth Grants Commission defines this as the acquisition of new infrastructure equivalent to the purchase of non-financial assets in the general government accounts. After the assessed difference, it seems that we are still spending at a low rate, so maybe this is part of looking at the rate of depreciation, as well as the investment. We have pushed our infrastructure spend over a number of years, past and current government; it is one of those things that is done to balance budgets.

Do you have any comment about the investment aspect of that?

Mr FEBEY - Why there is a variance between actual and assessed is something we cannot answer right now.

Ms CALVERT - It is probably better not to guess, and to actually look at the facts and come back to you.

CHAIR - Yes. There is quite a difference.

Ms CALVERT - It is a significant one.

CHAIR - It is significant. The actual amount is \$6.2 million, and the assessed amount is \$144.4 million. It would be good to have further detail around the differences in this. I know it is a complicated area, but people ask us, and then we get criticisms about all the suggestions that we are not spending as much on health as we are assessed to spend, and which we talked about last time, so I will not revisit all of the arguments.

Mr VALENTINE - I think that is 2018; it is not recent.

CHAIR - Okay. In the last hearing, you talked about how the payments to meet the defined benefits of superannuation are not included by the Commonwealth Grants Commission. We have dealt with our general government debt, to basically zero, but have kept that large superannuation liability, which everyone gets a bit focused on around Budget time, but other states have done different things and they have bigger borrowings. Just confirming that the Commonwealth Grants Commission - I will use the word 'ignores' - the superannuation liability. Does it also ignore principal payments on loans as well? Do you know?

Mr FEBEY - No. I cannot tell you offhand how they treat that. We have a net debt assessment there, which basically deals with the difference between your revenue and your income. That is how they treat borrowings in their assessments of GST.

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CHAIR - So they do - or they do not - assess the principal repayments on loans?

Mr FEBEY - I cannot say the actual repayments themselves are assessed.

Ms CALVERT - I think we should go back and confirm, and provide you with advice.

CHAIR - Also, with regard to the interest, will you comment on interest and the principle payments?

Ms CALVERT - Yes, interest and principal.

CHAIR - Are there any other questions on term of reference 1: assessed and actual expenditure per capita? I am going to go the second one: the Commonwealth payments.

Mr VALENTINE - I am interested in public sector wages and some of the assertions that Mr Goddard makes.

CHAIR - In his most recent one? Or that was the earlier one.

Mr VALENTINE - March 2019. Are you aware of Mr Goddard's statements on public sector wages? He says here:

It is of note that the gap between Tasmania and national rates increased sharply in 2014-15 in line with the Hodgman Government's policy of restricting wages. That widened gap has persisted. In addition, the numbers of state employees were reduced, which does not show up in this graph, and which is not taken into account by the Grants Commission, but which also affects the Government's overall wages bill.

The calculations are based on average ordinary-time earnings, so the amount of overtime being worked by some employees such as nurses is not counted as part of the wages bill and, therefore, does not affect GST redistribution.

I am interested in - where is the sense in the model that we use at the moment? If, indeed, staff are working overtime and that isn't actually brought into the calculation by the Grants Commission, aren't we at a disadvantage in that sense? I appreciate they link it with the private sector.

Mr FEBEY - That is right, so there is no reference to what we actually pay our public servants. The reason they do that is they do not want their assessments to be influenced by policy decisions. You would not want a situation where you simply pay your public servants more and then you are compensated by extra GST because you have higher wages than other states. So they want to come up with a measure of wages cost as a disability. They are of the view that the cost of wages is a cost disability that needs to be assessed and it cuts across a lot of the service categories such as health and education and so on. They need a measure of the relative cost of wages in each state that is unbiased and not policy driven, so they use private sector wages as a proxy and link the movements in private sector wages to the outcome for public sector wages.

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Mr VALENTINE - And because we have such a high level of public sector employment in Tasmania that quite often drives the private sector, doesn't it? I guess Mr Goddard's thesis - and I hope I am not verballing him - is that by keeping wages low we are actually at a disadvantage. He says that in 2019-20 Tasmania would therefore receive \$166 million less than it would if it had paid national average wages to state government employees and had averaged associated employment costs. I know these are policy issues and you cannot go to the policy side of it, but is there any comment on why that is not the case?

Mr FEBEY - The state Government's policy towards wages does not affect the GST outcome because the CGC is careful not to allow those sorts of policy choices about whether you have higher or lower wages affect the GST outcome.

CHAIR - The assessment of the private sector wages is a national assessment, like an average.

Mr FEBEY - It uses each state's private sector wages as a cost.

Ms CALVERT - That is Tasmanian private sector wages.

Mr FEBEY - They model private sector wages such that they are a reasonable proxy of public sector wages, so they include the wages of relevant occupation and skills and so on.

CHAIR - Like nurses who work in private hospitals as opposed to public?

Mr FEBEY - That's right. So you are not including people in the retail sector, for argument's sake, who do not have any nexus with any kind of public sector work. So it is those kinds of jobs and occupations you would find in the public sector.

CHAIR - You say wages growth in the public sector will drive wages growth in the private sector and, as Rob was alluding to, we have quite a small private sector here in comparison because of the large number engaged in the public sector in employment. So does that put us at a disadvantage? If it does, is that considered by the Commonwealth Grants Commission because of our size and the relative reliance on public sector employment?

Mr FEBEY - We have a high public sector in the state but it is really just looking at what the private sector does and then getting the data from the Australian Bureau of Statistics on what the salaries are for nurses, teachers and clerical people and so on in the private sector and mirroring those movements to the public sector.

CHAIR - So it is only the Tasmanian private sector that relates to Tasmanian public sector in wages?

Mr FEBEY - Yes, that's right.

Ms CALVERT - If you look at the 2016 census data, the private sector is in most of those professions being paid less than the public sector.

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Mr VALENTINE - I think Mr Goddard's thesis is that is if the Government paid more to their employees that would force the private sector to do the same and we would therefore get, as he says here -

Mr FEBEY - That's probably a long bow.

Ms CALVERT - The census is not showing that because the private sector is generally paid below already.

Mr VALENTINE - Maybe we need to ask Mr Goddard what he is getting at there.

CHAIR - In your submission on page 11, just before you go into the impact of the Commonwealth grants and the GST, you talked about the change to the objective of HFE, saying:

The Commonwealth Government has, in response to the Productivity Commission inquiry into HFE, changed the objective of HFE to be equalised in the states with the strongest to be New South Wales and Victoria.

Then you talk about the legislative changes:

While the GST will no longer have a direct relationship to the Commonwealth Grants Commission's initial assessment of fiscal capacity, the 'no worse off' provisions of the legislation mean that Tasmania's overall budget result will not be affected and will receive additional untied funding on top of the GST if required.

Then you go on to say:

This further questions the relevance of making any comparison in the Commonwealth Grants Commission's assessed and actual expenditure. [TBC quotes]

Could you expand on that last statement a little? I know it is about the new model which is probably still a bit of a work in progress, but I am interested in where we go from here.

Mr FEBEY - At the moment we have full equalisation. It is equalised to the strongest states so all the assessments are developed on that basis. The CGC will continue to do that, but then there will be a further step in the process where they re-equalise to the second strongest. Having gone through the process of equalising to the strongest and coming up with assessments based on that objective, they then have to bring it down to a lower objective, so the assessments won't be on the basis of full equalisation but on partial equalisation, if you like. We're looking at more of a partial HFE world, I guess, and that means the assessments are not reflective of the full disabilities we face.

CHAIR - Does that fundamentally undermine horizontal fiscal equalisation and what it is intended to do as part of the federation?

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Mr FEBEY - We have argued that in our submissions to the Productivity Commission on numerous occasions but it fell on deaf ears, unfortunately.

Ms CALVERT - What we have been trying to say last time and in our submission is that this is a mathematical construct. This makes it even more of a mathematical construct because it is even less linked to reality than it has been in the past.

CHAIR - Again, future-gazing is a bit difficult and I appreciate you haven't got a crystal ball any more than the rest of us, but because of that disconnect and this talk about a mathematical construct and that being difficult to apply directly to fit numbers on a page effectively, is there going to be any way of the average person understanding, or even people in Treasury potentially understanding, how Tasmania can see itself in a 'no worse off' situation? It seems to me that it is putting all sorts of barriers in our way.

Ms CALVERT - One of the things the PC review was meant to deliver is more simplicity, but I think it has actually complicated it more. The benefit in the guarantee period is that the CGC will have to do both calculations so we at least will be able to see what is happening under what is at the moment near enough to full HFE and then the new model. Yes, it is the big unknown, which is another thing we included in our submissions in that it is unclear where this will go.

CHAIR - I guess it will be interesting to see what is in their next report.

Ms CALVERT - The review will be very interesting.

CHAIR - We hope not to have to call you back after that.

As to the impact of the Commonwealth payments on Tasmania's GST, you made some comments in your opening comments last time, Fiona, on this particularly, but just to reiterate and perhaps to go to further explain, on page 11 at the bottom you talk about the Commonwealth Grants Commission using a set of guidelines to assist when making decisions on the treatment of a payment - that is, impact or no impact - and they also give direction on the treatment of specific payments, that is quarantined payments.

Can you talk me through a bit more about how that actually works? If you quarantine lots of payments you basically undermine this whole system too, but that doesn't stop them with the other one. Where are we headed with this?

Ms CALVERT - That is correct, and that is certainly why Treasury doesn't support quarantining payments, unless its exceptional circumstances, like the Mersey. The really useful document to look at is on the CGC's website. This is part of the 2019 update where they actually give an explanation. We provide some comments around Tasmania, but for all the payments, Australia-wide and their justification for why things are quarantined, and why things aren't.

CHAIR - There is a good list in there. Is the decision entirely for the Commonwealth Treasurer?

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Ms CALVERT - When you are negotiating a payment you effectively need to negotiate with the Commonwealth Treasurer, for him to recommend to the CGC that it be included in the terms of reference, which is what we did with the Mersey.

Mr VALENTINE - In terms of how that actually operates, let's take the Royal, for instance, and I think it was Mr Wilkie who negotiated with the Commonwealth Government about that particular project. Does the state government have to agree with that payment?

Ms CALVERT - That predates me but my understanding is that the state government wasn't involved in the negotiation. If we were, we probably would have recommended strongly that it be quarantined.

Mr VALENTINE - Okay.

CHAIR - Because we have effectively paid all that back through reduced GST. Is that a fair statement?

Ms CALVERT - Except for 2.1 per cent

Mr VALENTINE - The state government may not get an opportunity to have a say. That is what I am wondering.

Ms CALVERT - My understanding is they didn't, but as I said, I wasn't around then.

CHAIR - In the normal way of things, and obviously you have a chance to have a say about the Mersey money, that is the money to operate the Mersey, and it is designed to last 10 years, or thereabouts. What was the process around the discussions there? If that was discussed with the state, and there was an agreement around having that fully quarantined, how is it that a significant - not quite as much - but a significant amount of money for the Royal Hobart Hospital rebuild was not subject to similar consultation? Before your time, maybe it is not a question you can answer.

Ms CALVERT - And it wasn't negotiated by the government with the people who understand how the GST system works.

CHAIR - So it was an agreement made at a Commonwealth level that the state had no input into. Is that what you are saying?

Ms CALVERT - I don't know.

Ms WEBB - It is extraordinary to think that that could be the case, that a substantial amount of money, non-quarantined, could be brought in and negotiated without the state government that would then go on to affect our GST.

Mr VALENTINE - That is why I was interested in the process. I'm not necessarily saying they were bad decisions. I am just saying the fact that the state government ends up wearing the reduced GST is a concern.

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CHAIR - This may be a question for the Treasurer, and feel free to say if it is. We have talked about the housing debt being forgiven. There are big projects like the Bridgewater bridge and other big projects that are on the radar, and I am sure there are many others we could mention. In terms of, say the federal government want to get something through the federal parliament, and one of our senators who holds the key, then negotiations go on. I have spoken to her about how this works, too. Is there not a process where the state is involved in that? It could just happen like the Royal, that there is no discussion with the state, and suddenly you are given this money -

Mr VALENTINE - Well, if there wasn't any discussion, I presume, we don't know?

CHAIR - You are asking about the process. What is the process when a significant grant is coming the state's way, for whatever purpose. Is there a process?

Ms CALVERT - It is probably better that you asked the Treasurer on that one. In terms of Commonwealth payments that the government is involved in, there are processes and DPAC has guidelines, which are on their website, which effectively require all agencies to take into account the GST impact of any Commonwealth payment. That is where you end up with some payments being quarantined; obviously some aren't. As I said, Treasury's preference is that unless there are exceptional circumstances, they are not quarantined because that undermines HFE and we benefit significantly from HFE, so we prefer that didn't happen. And then end up with a situation where all states are pushing to have all their payments quarantined.

CHAIR - You do mention on page 4 of your submission that in response to the Productivity Commission inquiry, recommendations of the Commonwealth Government in consultation with the states intends to develop clear guidelines detailing the basis on which Commonwealth payments are to be quarantined by the Commonwealth Treasurer. Is that the document that you referred to?

Ms CALVERT - No. This is a state government document.

CHAIR - No. The one from the Commonwealth Grants Commission.

Ms CALVERT - No. This is the CGC's - effectively how they treat particular payments.

CHAIR - Have these guidelines been developed then?

Ms CALVERT - No. We did not necessarily support it. The issue is this is always complicated. Where they are effectively wanting to go is like a tax ruling where in advance you get an opinion on whether or not it would be quarantined. The problem is that these things move quite a bit during the negotiation process. You do not necessarily know whether they will end up the same as they started out so flexibility is always good.

The Commonwealth Grants Commission is very good if you call and run examples of payments past them in terms of how they might treat them. We have a good relationship with them. We have found in the past they have been useful in terms of getting advice. It does come back to that materiality threshold and whether you want to argue for something to be quarantined.

CHAIR - Are you saying that the guidelines could be more problems to develop because of the need for flexibility?

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Ms CALVERT - Yes, they might lock things in that we don't necessarily want locked in.

Mr FEBEY - I don't think the Australian Government is pursuing this recommendation anyway.

Ms CALVERT - I am not sure where it has got to.

Mr FEBEY - We haven't heard any more since the legislation.

CHAIR - So it will be dealt with on an individual basis, a grant by grant basis, rather than having black and white guidelines?

Mr FEBEY - Yes.

CHAIR - And you think that is preferable?

Ms CALVERT - It seems to be working well at the moment.

CHAIR - A question I had in relation to page 15, the GST treatment of Commonwealth payments for specific purposes, it follows on from what we have been talking about. Unless the CGC is directed by the Commonwealth Treasurer in its terms of reference, in assessment you are to quarantine the Commonwealth payment, the benefits of state specific Commonwealth payments are largely equalised away by the CGC's methodology. If not quarantined, approximately 98 per cent, all of Tasmania's population share, the payment will be offset in the form of reduced GST payments to Tasmania over time.

Can you explain the process around that and how long it takes? There is a bit of confusion. We talk about getting the GST clawed back, then it happens right away. Could you explain that process?

Mr FEBEY - We have provided an example in our submission which I will talk through. There is a hypothetical example there in table 4 on page 16 where we receive a payment of \$100 million in year one. This is an example of a one-off payment. In year one we receive \$100 million. That goes straight to the state government in that year, that is the cumulative budget impact of plus \$100 million.

In year two, because the CGC's assessments are lagged by one year, in the second year you will not see any impact there. It will still retain the \$100 million. But year three is when the application years and the one-year lag is past, and now what they are doing is averaging over three years. So, it will take three years for that to wash out.

In year three, roughly one-third of it is redistributed. In the following year another third, and the last year the remainder, with only our per capita share left plus \$2.1 million out of the \$100 million. That is a simplistic example but that is more or less how it works. Some payments you don't get in one year. It is spread over time so it will drag out for quite a number of years before it is eventually redistributed away. The Royal Hobart Hospital is a classic example. We are still receiving payments for that and it is still to be redistributed away.

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CHAIR - Further down that page it talks about payments and says:

The Commonwealth Grants Commission does not make a differential expense assessment to payments where the CGC has not been able to develop a differential assessment. In each case the assessment is treated equally per capita and any Commonwealth payments do not affect relativities; for example, payments for the purpose of protecting environment, municipal and essential services and remote areas. [TBC]

There is a range of other payments for the benefit of local government, payments to other third parties and payments to the states for Commonwealth purchases, or COPEs as it is called, and I could go on. It's in the submission there. We often see these sorts of payments, or it seems to be that some of these are used around election time. Again, it is a slightly political question and you don't have to answer it except to talk about the process, but we see money thrown around at election time to try to encourage people to consider how they might vote. Does that sort of action undermine the way this is supposed to work?

Ms CALVERT - It will impact.

CHAIR - Can you expand a bit further on that, Fiona?

Ms CALVERT - Effectively, unless they are quarantined they will be treated in the same way as Commonwealth payments for GST purposes and will be equalised away.

CHAIR - Do you think there is a need for greater transparency around that when election commitments are being made and it is made clear that these will affect - depending on the process used - our GST further down the track, or is it just a political game and we have to deal with it?

Ms CALVERT - The issue is that the methodology, as we all know, is extremely complex and getting that broader understanding is quite often difficult.

CHAIR - Is it reasonable, then, for me or a constituent to ask when someone is in their electorate promising to fund this, that and the other whether it will be quarantined, or isn't it evident at the outset?

Mr VALENTINE - 'Have you thought about the impact on our GST?' - it's a simple question.

CHAIR - That's what I mean.

Ms CALVERT - As I said, Treasury is not a big fan of the whole quarantine concept except in exceptional circumstances because it undermines HFE. Tasmania needs to be very careful about any more undermining of HFE, so we wouldn't necessarily recommend increasing the level of quarantine, especially for smaller payments.

CHAIR - The question was, though, do you think these sorts of things would be better if they were made clear at the time of the announcements? Is it known at the time of the announcements?

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Ms CALVERT - I suppose it depends on the audience.

CHAIR - So someone knows?

Ms CALVERT - Yes.

Mr FEBEY - I guess your average person in the street wouldn't know the GST implications of a Commonwealth payment.

Ms WEBB - But if a question was put in the public domain about that, an answer should be able to be provided accurately as to whether it would or wouldn't affect GST going forward.

Ms CALVERT - Yes. If we use Health as an example again and an election commitment for a particular health facility, for instance, the general person sees that as a positive anyway and they are not necessarily concerned by the lack of flexibility the Government gets in that change from untied to tied funding.

Ms WEBB - I was not really asking about the perception of, say, a person in the street. I was asking whether the ability to have it accurately identified if the question is put at the time would affect GST assessment? You should be able to know that at the time in relation to that promise.

Ms CALVERT - Yes, although it is not always that simple. As I said, things necessarily change in the negotiation process and while you think it might be treated one way, at some point it might vary.

CHAIR - I think in terms of the public and newly elected members of parliament understanding it, it might help to avoid deals being done for funding that can undermine the system.

Ms CALVERT - We have a significant number of documents on our website and through the Productivity Commission process we did a simple HFE GST document to try to get a greater understanding. I am not sure how many hits that has had, probably a lot more from people in Treasury than anywhere else, but it isn't necessarily something that is easy to get people to understand, but we are always willing to have more simple communication around GST and the impacts of some actions out there.

CHAIR - I guess that is complicated by the current review of the way the whole system is working anyway.

Ms CALVERT - From our perspective, and this was the case in the Productivity Commission review, and we are seeing a little bit of it locally at the moment, there is also a lot of misinformation out there, which Western Australia seems to do very well.

CHAIR - Yes, but doing very well at the moment generally.

Ms CALVERT - Yes.

Mr VALENTINE - With respect to the tied and untied, I am wondering whether untied grants, which are paid from the Commonwealth to a state, at some point in time in the future get factored

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into the assets of the state or the value of assets the state has. Is that at any time taken into account in the calculation of GST?

Ms CALVERT - Untied funding is GST.

Mr VALENTINE - Sorry, the tied funding. When it's untied it doesn't affect GST, does it?

Ms CALVERT - Well, it is GST. Untied funding is funding that we can do with what we like, whereas tied funding is -

Mr VALENTINE - Sorry, I'm talking about grants, projects - specific purpose payments. It's all in the terminology. When specific purpose payments are made they are generally tied and affect GST.

Ms CALVERT - Yes.

Mr VALENTINE - But in the case where they are not tied -

CHAIR - Specific purpose payments are not part of GST. They are grants that are tied for a purpose.

Ms CALVERT - They will always be tied.

Mr VALENTINE - Therefore they will always be taken into account with GST.

Ms CALVERT - Yes, unless they are quarantined.

Mr VALENTINE - Okay; I am getting this clear in my mind. A quarantined grant is what I suppose I am pointing at now. This is going to look funny in the *Hansard*. A quarantined grant, if that's of significant value - say it's a bridge or -

CHAIR - The Mersey money.

Mr VALENTINE - Yes, the Mersey money. Even though that is not supposed to affect GST, in other words, it doesn't reduce the payments, does that at any point into the future actually get taken into the broader picture by the Commonwealth Grants Commission in terms of the level of assets the state has? I am asking whether there is a point where it actually gets taken into the broader picture rather than specifically for that particular quarantined grant?

Mr FEBEY - No, I wouldn't have thought so. The asset's still there.

Mr VALENTINE - There is obviously a maintenance cost to any quarantined grant, if you could call it that, to uphold that. I am presuming that is a detriment to the state at the end of the day because they have to maintain something they didn't pay for but someone else has -

Ms CALVERT - The only requirement was taking back the hospital, so obviously there's the cost of the hospital. It probably goes back to other revenue sources, because the Mersey money is creating revenue through a Mersey community fund dividend.

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CHAIR - Which is interest in the TASCORP account but also the dividend when paid to fund the Mersey. Is that what you are talking about there, Ms Calvert?

Ms CALVERT - No. When you look in the revenue chapter under government business returns, you will see the Mersey dividend, which is \$73 plus million. Every year that comes in as revenue, which I assume will be picked up in that other revenue category. It should not impact; it should be treated EPC, if what we think is correct.

CHAIR - What about the interest on the money that is still sitting in TASCORP, and other money that TASCORP holds?

Mr VALENTINE - That would be accounted as revenue to the state, wouldn't it?

Ms CALVERT - No, because it's in TASCORP. It is included in the principal amount. The interest on the Mersey money goes back into the principal, so that it lasts for the -

Mr VALENTINE - It doesn't go into consolidated revenue. It is quarantined.

Ms CALVERT - Well, it does annually, through the dividend payment.

Mr VALENTINE - Okay.

CHAIR - If you can clarify the interest and principal payments on borrowings, as well as on that money, because that is designed to make it last, but the interest rates are not helping.

Mr VALENTINE - You can see where I am coming from, in terms of a liability to the state, if there is a quarantined grant that is made.

Do you know whether the states are responsible into the future for maintenance and upkeep of whatever that grant might be producing - the hospital in one case? We are. You do not get continuing funds from the federal government; it is a 10-year agreement and it includes maintenance as well.

CHAIR - To maintain or operate the hospital? Is that what the question is?

Mr VALENTINE - To maintain it. The fabric.

Ms CALVERT - There are no conditions linked to the payment, apart from taking back the hospital. We operate the hospital, and obviously we need to operate the hospital to maintain it at a particular level.

Mr VALENTINE - That is at our cost - but then we have the money that is part of the grant to help with that?

Ms CALVERT - Into the tenth year. Yes.

Mr GAFFNEY - All the funds have to be spent at that hospital. They did not.

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Ms CALVERT - No. That was a government policy decision. The conditions that were provided by the Commonwealth were that we took back the hospital. It was not that we continue to operate the hospital. The Government has decided to continue to operate the hospital and to use the returns from that funding towards that.

Mr VALENTINE - In 10 years time, or whatever it is now - eight?

Ms CALVERT - It was two years ago.

CHAIR - It could be less if the interest is not enough to -

Mr VALENTINE - The government could choose not to operate that hospital because of the costs involved. That would be a policy decision at the time.

CHAIR - Are there any other questions?

Ms WEBB - Presumably, they can make that policy decision at any stage, given that it was not a requirement?

Mr VALENTINE - They could, and they probably will.

Mr GAFFNEY - This becomes a policy thing. When it first came out, it was said the Government had bought - we have the hospital back for 10 years for \$730 million; \$73 million a year to run the Mersey Community Hospital. However, the contract does not say the money has to be spent on the Mersey Community Hospital.

Ms CALVERT - That was not a commitment to the Commonwealth; it was effectively a commitment the Government made to the committee.

Mr GAFFNEY - Okay. At the end of each year, do we know exactly how much is spent on the Mersey Community Hospital?

Ms CALVERT - It is whatever the amount was in the legislation, escalated at 3.5 per cent per annum. It is around \$77-78 million.

CHAIR - Thank you very much for coming back, and particularly for going through those latter points we did not get to last time. We will write to you about those other questions, and we will have the Treasurer in at some stage when he is fit.

Ms CALVERT - Recovered.

CHAIR - Yes, that is right. There are some other questions that were asked that were more about policy rather than political aspects, so we will direct those to him.

Thank you very much.

Ms CALVERT - Thank you. We will come back to you with those questions.

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Mr FEBEY - Will you write to us formally?

CHAIR - We will.

Mr FEBEY - Do you have the correct questions required to be answered?

CHAIR - Yes. It is really about the other category and the information within that, and the other question regarding assessed and actual expenditure - regarding depreciation and investment particularly.

THE WITNESSES WITHDREW.