THE LEGISLATIVE COUNCIL SESSIONAL COMMITTEE GOVERNMENT ADMINISTRATION A MET IN COMMITTEE ROOM 1, PARLIAMENT HOUSE, HOBART ON WEDNESDAY, 20 MAY 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) - Thank you very much for coming. We have Kerry on the phone, and maybe on the screen if we can get that hooked up, in Launceston so be conscious of using the microphones if you would not mind to assist with *Hansard*.

I am sure you are aware this is a public hearing. It is being recorded on *Hansard* and the transcript will be published on our website at a later time. All information that you provide is public. If you do feel the need to request that some information be delivered in camera or in private then you just need to make that request and the committee can consider that.

We usually invite you to make some opening statements. It is a fairly engaging topic. I cannot imagine you thought you were going to get called into a committee inquiry about this but there you go. We have a great interest in this, particularly in recent times, and it has been quite topical.

We have received your submission. If you would like to speak to that and add any more comments then we will go to questions from the members.

Ms CALVERT - Thank you for the opportunity to present today to this inquiry. The Secretary of the Department, Tony Ferrall, has requested that I record his apologies that he is unable to attend because of the imminent release of the State Budget this week.

I am joined by Damien who heads up the project team that was formed in Treasury over two years ago to prepare the Tasmanian Government's submissions to the Commonwealth Grants Commission's 2020 Methodology Review.

Damien's team has also been responsible for preparing submissions to the Productivity Commission's recent inquiry into HFE as well as a number of other GST-related issues including this inquiry.

As you are aware, Treasury has made a detailed written submission to your inquiry that covers both elements of the terms of reference and I hope the information contained in that submission is of assistance to members of the committee.

Initially I will comment on the first area of focus which considers Tasmania's expenses and the delivery of services with particular regard to Tasmania's assessed and actual expense per capita per category, compared to the national average expense per capita per category. Welcome to HFE.

This is an issue that has received quite a bit of attention over the years and has been the subject of a great deal of confusion. Most recently, the Productivity Commission, during its public hearings in Tasmania for its inquiry into HFE, appeared to misunderstand the basic principles of HFE and the fact that HFE and the choices that Tasmania makes as to where it spends its GST allocation are two separate and distinct issues. For those who are interested, subsequent to the public hearings, Treasury prepared a supplementary submission to the Productivity Commission which responded, among other things, to these misconceptions. This submission is available on the Productivity Commission's website.

HFE is applied by the CGC, assesses the amount of GST required to give the states a fiscal capacity to provide services and infrastructure at the national average standard, if they made the same effort to raise taxes and operate at the same level of efficiency. The CGC's expenditure assessments are based on the average level of service provision using the average of what states do to determine the national average per capita cost of service provision. The national average cost is then adjusted for each state, using state-specific service delivery cost disabilities.

The CGC's assessed expenditure is therefore only a mathematical calculation made as part of the process to give effect to the principle of HFE, not a standard that must be achieved by states and territories.

In past reports, the CGC itself has cautioned against making comparisons between assessed and actual expenditure and revenue as these concepts are only intended for equalisation purposes to support the equalisation process.

As stated on page 2 of the CGC's submission to your inquiry, in developing an average standard of service, the Commission does not purport to identify an optimal or desirable level of state government spending or revenue raising. It merely uses the Australian averages to provide a simple measure of what, on average, Australian states do when they provide services and raise revenue. Nor when it assesses each state's revenue raising capacities and expense needs, does the Commission form an opinion on how much a state should spend on any particular service it provides to its population, nor on how much tax it should raise.

As noted by the Commission, it does not have a view on how a state should spend its GST revenue. Indeed, alongside the distribution of GST revenue, according to the principle of HFE, the intergovernmental agreement on federal financial relations specifies that states may spend their GST shares as they see fit. State governments are ultimately accountable to their electorates in relation to how they spend GST revenue. The specific amounts provided to the states through equalisation are untied revenue, and the CGC's assessments are not a benchmark for states' spending priorities.

The most common example where the CGC's approach is misinterpreted to argue a particular position is in relation to Tasmania's actual level of health funding relative to the CGC's theoretical assessment of health expenditure. The argument commonly used is that if actual expenditure is less than the CGC's assessed expenditure, there is a perceived funding shortfall in health. These comparisons have led to misleading conclusions by some commentators. The CGC cautions against such comparisons in its submission to the Committee and on its website where it states that:

> Our work should not be understood as identifying the desired level of spending that each state should fund for particular services.

In other words, the CGC's assessments are not intended to be a benchmark measure of the level of services that a state should provide or expenditure it should undertake in a given area.

The CGC's assessments are a mathematical construct to give effect to the principle of HFE rather than specifying an observable standard that should be achieved by all states and territories. They are a mechanism to ensure that each state has equal financial capacity to provide the average level of services in aggregate.

Some comparisons use health expenditure data from the Australian Institute of Health and Welfare that shows Tasmania's per capita expenditure at below the national average. The AIHW methodology has been developed primarily for international health expenditure comparisons rather than state comparisons.

The CGC uses comprehensive data based on ABS government finance statistics the state governments produce for budget purposes that is designed to enable comparison between states. The state budget records health expenditure based on annual financial statements of state governments, prepared in accordance with the principles of Australian Accounting Standards and, in particular, AASB1049 Whole-of-Government and General Government Sector Reporting. The AIHW data does not appear to cover the same rate of health expenditure. Tasmania's actual health expenditure, based on GFS data, is higher than the national average, which is shown in chart 2 on page 10 of our submission.

I will now return to the second term of reference, which relates to the impact of direct Commonwealth payments on Tasmania's GST receipts. Treasury's submission provides a significant amount of detail on the impact of Commonwealth payments on GST received by the states and territories. Those principles relate to Tasmania as in the same way as they do to other states and territories. The Commonwealth Treasurer's terms of reference for the commission directed to take accounts for payments for specific purposes and given direction on the treatment of specific quarantine payments. The commission treats all Commonwealth payments to the states on a case-by-case basis, guided by the HFE objective and using the following guideline; payments which support state services and for which expenditure needs are assessed will have an impact on the relativities. In effect, if a Commonwealth payment supports state services and it is an expenditure area that is assessed by the Commission, it will have an impact on state relativities. If the Commonwealth makes the state-specific payment or if a state receives a Commonwealth payment for a particular program that is above its per capita share, it will have all but its population share of that payment equalized to other states through the GST redistribution system, unless that payment is quarantined by the Commonwealth Treasurer. Where a payment is quarantined, state relativities are not affected. The mechanics of how this works in practice are detailed on pages 15 and 16 of our submission.

I will now compare two contrasting examples for Tasmania. As you are aware, the Commonwealth government transferred ownership of the Mersey Community Hospital back to

Tasmania in 2017. An associated payment of $730.4 million was paid to the Tasmanian government. This payment was quarantined by the Commonwealth Treasurer and so did not impact on Tasmania's GST share. In contrast, funding of $270 million was provided for the Royal Hobart Hospital in 2010-11 and a further $20 million in 2011-12. A final $50 million payment is still to be received. Over time, all but the state's per capita share of this funding will be redistributed to other states, meaning that Tasmania, in effect, foregoes untied GST revenue in exchange for tied Commonwealth funding.

The principle of HFE and its application by the CGC is particularly complex, as noted by the Productivity Commission during its inquiry into HFE. The complexity of the HFE system has increased over time and while this may not be a problem in itself, indeed there are many aspects of public policy that are highly complex, it can lead to misinformation and undermined accountability for decisions and public confidence in the system. The PC also said that the system is so complex that only a handful of people understand it. I am very lucky to have three of those people in this room. I hope through our submission and my comments today that we have been able to dispel some of the myths around the two aspects of HFE that have been covered by your inquiry.

It is important to remember, as noted by the CGC in its submission, that GST revenue provided to a state by the Commonwealth is general revenue assistance. That is, as agreed in IGAs by all Australian Governments, it is untied revenue the state can spend in accordance with its own spending priorities. States are accountable to their electorates, and not to the commission or Commonwealth more generally, for how GST revenue is spent. Thank you.

CHAIR - It is helpful to have this inquiry into this issue to clarify some of these issues that have not been well understood. It is quite gratifying for those of us on this side of the table that there are only three other people in the room who understand how it works entirely. It is important we understand it better as elected members and in speaking to members of the community about it.

I will begin, and other members may have questions. A lot of this is covered in your submission and opening comments but expanding them further can be of assistance. You reference point 8 of the Commonwealth Grants Commission submission to this inquiry. I assume you have a copy of their submission as well.

Ms CALVERT - I do, yes.

CHAIR - You refer to point 8, Fiona, in your comments -
[TBC]

> The Commission advises that caution is needed in interpreting its published ratios, such as the ratios of actual to assessed expenses and revenues. First, actual revenues, expenses, investment or net borrowing for each State used to derive these ratios may not be strictly comparable between States, because States sometimes classify similar revenues, expenses, investment or net lending differently under the ABS Government Finance Statistics (GFS) framework.

It goes on with an example from the ACT. Do all states and territories use the same approach, or is this saying they don't and that is part of the lack of clarity around this?

Mr FEBEY - All states provide information to the Commonwealth Grants Commission through the data submission to enable them to work out what states spend and how much revenue they raise. The ratios of actual to assess can vary because some states might record their expenditure slightly differently to others and the ratios could get slightly affected in that way.

CHAIR - Isn't it important that there is a consistent manner of reporting?

Mr FEBEY - Yes, they do try to make it as consistent as possible.

CHAIR - Are there agreements between the states to uniformly apply their reporting to the Commonwealth Grants Commission in order for the CGC to make their assessments?

Mr FEBEY - They provide the information through the GFS data collection. They gave the example of the ACT, where they do something slightly different because they have municipal operations within their territory. They have to make some adjustments for that. You have to allow for that situation. That is why those ratios may look a bit different to the other states.

CHAIR - The ACT and the Northern Territory, to an extent, are different in many ways but is there an expectation that the rests of the states will report their expenses and their revenues the same way?

Mr FEBEY - I would have thought that primarily they would but there may be some instances where there could be some variations. That is all the CGC are raising, the caution that what one state classifies as all of its health expenditure might be slightly different to another state, depending on how they run their hospitals and other services relating to health.

CHAIR - For a number of years we have heard that Victoria was often held up as the shining light in efficiency in delivering health services, for example. I am not sure on what basis that assessment was being made. Is that a demonstration that the Commonwealth Grants Commission come to an average but the bigger states, because of sheer economies of scale, can deliver services in a more efficient manner, or is it not about efficiency?

Mr FEBEY - Efficiency is not taken into consideration in their assessment. They take the average of what states do and they make an assessment based on the disabilities that each state has. What you spend and what you are assessed could reflect whether you are more or less efficient. You will only get the extra GST based on the assessment they make, not what you spend on the services. If you are an inefficient state and you are spending much more than you need to, you wear that cost. You will only get compensated by the GST up to what they assess you need, which is based on an average of what all states do, multiplied by disability factors.

CHAIR - On that front then - again I am not trying to misrepresent the assessed expenditure as opposed to the way the Commonwealth Grants Commission has determined what the money we have been allocated for health, for example - if we are spending less than what the Commonwealth Grants Commission assesses our health disadvantage - is that the word, disadvantage?

Mr FEBEY - We call it a disability factor, yes. We are talking about a cost disability.

CHAIR - If we are spending less than that, does that indicate we are perhaps being more efficient in our spending?

Mr FEBEY - That is one conclusion you could make, but there could be a whole range of reasons why it is less.

CHAIR - If we were more efficient, it would be less. We could argue perhaps we are not because there are many people who are not getting the services they need. What other reasons could there be besides an increased efficiency?

Mr FEBEY - For why we spend less?

CHAIR - Yes.

Mr FEBEY - As Fiona said, the assessments are a mathematical calculation. They don't necessarily relate to what we should be spending if we were spending an efficient amount or an amount comparable with other states. It is an assessment that takes into account whole factors based on census information on low socio-economic status - SES - population, geography, age and so on, and comes up with a mathematical value for what our assessed health expenditure should be. You are looking at that compared to our actual expenditure and asking 'Why is there that difference?'

In our submission we explained that part of the problem is that the assessments are generally, if you look at them across all expenditure areas, higher than our actual expenditure, but so, too, our actual revenue is less than what it is assessed to be. If you are assessing our expenditure categories to be at a higher level than our actual expenditure, that could be explained by the fact that we are not actually raising as much revenue as we are assessed to be able to raise. We simply don't have the additional revenue to meet that assessed expenditure level.

CHAIR - Some of that comes back to government policy positions; perhaps that is more of a question for the Treasurer. The Commonwealth Grants Commission acknowledged, through its assessment, our aging population and our health demographic, which is that we have higher rates of cardiovascular disease, obesity, our geographic spread and things like that than other regions, except for the Northern Territory. Those things are all taken into account but because they are taken into account, doesn't that then indicate it is going to be more expensive to deliver health services for us than it is for metropolitan Melbourne?

Mr FEBEY - If you look at our actual expenditure compared to the national average, it is actually higher. It is already higher than the national average. It is just not as high as it is assessed to be by the Commonwealth Grants Commission. There could be a range of reasons for that difference, one of which is that we don't raise as much revenue as we are assessed to raise.

CHAIR - And that comes back to a policy position on our taxing arrangements?

Mr FEBEY - I would argue that taxing arrangements is a policy position.

Ms CALVERT - When people do talk about this, they seem tend to focus only on the expenditure side and don't actually look at the fact that it is revenue and expenditure, that there are two sides to the equation. On page 7 of our submission, we cover the fact that, as Damien says, we don't actually raise as much in revenue as the Commonwealth Grants Commission suggests we could based on an average level. Both of those need to be taken into account.

Mr GAFFNEY - How often do you have to provide updated demographics and health statistics to the commission so that it can re-evaluate? Is that ongoing? If we were to have an influx of 1000 people over the age of 60, how would that work?

Ms CALVERT - I will get Damien to talk about the detail. There is a consistent review process. Every year there is an update report. About every five years there is a methodology review, which we are at the tail end of at the moment. As part of that methodology review, a significant amount of data has been provided to the Commonwealth Grants Commission - CGC. Damien can provide more detail around how often.

Mr FEBEY - For things like population data and so on, the CGC relies quite a bit on the census for its information, so it just depends on when the latest census information is available to it to put that information into its assessment. As Fiona says, it updates its relativities every year so it feeds whatever new information and new data comes along into its calculations. It will drop that in and it will be reflected in the next relativity update. Major reviews, such as we are going through at the moment, may involve new data sources the CGC has found which might give a better handle on what it is trying to assess.

Ms CALVERT - As part of that methodology process, apart from all the data we provide to it, the CGC also did a round of state visits in September last year which involved detailed presentations on the economic situation. The Department of Health, the police and Education presented. We had a presentation on housing and also on transport. We had presentations from agencies responsible for key areas that are major factors for us. We had a day and a half with the Commonwealth Grants Commission.

Mr VALENTINE - You have been in this area for quite some, playing in this little space. Do you see any particular aspect of modelling that needs to be improved, or is missing? Does the model miss out on certain aspects of state government operations that might need further attention? I know that is a relatively big question in a way because you basically would be saying the Commonwealth Grants Commission has it wrong. I am not really asking that, but rather whether you see any particular area that could do with a tweak to improve the relativities.

Mr FEBEY - As you say, the Commonwealth Grants Commission has been evolving its methodology over many decades. From our point of view, we have found it to be quite reflective really of our costs and we do not have too many issues with the CGC's methodology. We have had some debates with the CGC about one or two areas, and they are obviously areas where we tend not to do so well in our GST distribution. One of them is in the investment area. If you look at our submission, you will see we lose quite a bit of money from its investment assessment. That is an assessment of how much infrastructure you need to give each state to provide a similar kind of level of services. Tasmania gets a negative redistribution there because one of the major inputs into that calculation is relative population growth, which quite significantly affects our GST share.

States like Western Australia, Queensland and so on with rapidly growing populations have tended to get more GST. The argument is that because you have a rapidly growing population, you need more schools, hospitals and so on. For slower growing states like Tasmania and South Australia, the argument is you need fewer schools and hospitals and so on.

CHAIR - You still have to look after the ones that you have.

Mr FEBEY - They treat it all as though you need this stuff immediately and so each time they do their calculation each year, they are looking at the population growth that has occurred during that year. If one state has had a rapid growth in population, they get a lot more GST from infrastructure. Even though they are not going to build this new stuff for some time, because their population has grown rapidly in that year, they get more GST and we get less.

Mr VALENTINE - For instance, if you take a country school that might have had a really high population, say 15 or 20 years back, but is now experiencing a low level of attendance because of the reduced number of people living in those regional areas because they have gone to the cities, the infrastructure may have to be improved a little, but it does not mean to say that there is more infrastructure required in any major way. Do you think there is not enough flattening out of that, say, in a 10- to 20-year time span as opposed to the last three years, which is what this seems to do?

Mr FEBEY - They do not really look at what infrastructure has been built in the past, history is history, kind of thing. It is more looking forward. It was driven by concerns raised by fast growing states, that they were getting all of these people arriving with the mining boom, and so on, you have large in migration into those states and that was putting a lot of strain on their resources to build enough schools and hospitals fast enough to meet the growing population. So, the CGC thought, 'Let us compensate those states for that immediately', as the population rose, even though there are timing issues, et cetera, and the slow growing states like Tasmania, we are losing GST because of our slower growth on the infrastructure assessment. It does not take into account that you still have schools and things to maintain -

CHAIR - They have depreciation.

Mr FEBEY - They have a depreciation assessment so that picks up that aspect of it, the maintenance side of things.

Mr VALENTINE - There was only one other aspect I was wanting to ask and that was with respect to the likes of, say, grants that come through to, say, the Royal Hobart Hospital -

CHAIR - Can we leave that until after and just continue on this topic first. That is terms of reference 2, so we will stick with terms of reference 1 at this point if we can?

Ms CALVERT- Sorry, can I just follow on from what Damien was just saying. While we might have some concerns at the lower level around how particular things are treated from an HFE perspective, Treasury were strong advocates during the PC's process last year. We are strong supporters of what the model used to be. Referring to our article that was written by Ruth a few years ago, when she talks about the recent tantrum thrown by Western Australia, that is probably where we are driving that review and from a preferred outcome from our points of view, there would have been no change.

CHAIR - That could come back to bite everybody.

Mr WILLIE - I think what we are trying to do as a committee and parliamentarians is work out how we can apply scrutiny to budget and policy decisions and work out where the revenue is going and whether it is an efficient spend. I understand how complex it is with the capacity to raise revenue, the efficiencies, the inefficiencies. Where does Treasury see red flags in this process?

For example, if you look at schools and education in the table on page 7, the assessed spend is 2341.8 and the actual spend is 2394.8, so that is higher, then the national expenditure per capita is much lower. Is that a red flag for inefficiencies in the system? For example, I am thinking of your 2011-12 reforms where you have schools duplicating potential infrastructure with colleges. Does Treasury look at some of these things and then go to the department and say, 'You are getting this sort of assessment, this is your expenditure, can you explain why?' Does Treasury have that overlay?

Ms CALVERT - Ultimately these are policy decisions for government and I suppose we treat the Commonwealth Grants Commission methodology as it is meant to be treated. It is a mathematical construct that is not meant to be used for assessing efficiencies or not. If you were to look at particular issues my preference is that it is not inputs that you should be looking at, it should be outputs that are being measured in terms of deliverables.

Rather than using the Commonwealth Grants Commission's reporting the report on government services that is undertaken by the Productivity Commission is probably a better means of getting a comparison between what Tasmania does in terms of both inputs and outputs. It goes across a whole range of different services. Before I came down here I was looking at the chapter that they do, 180 pages of them, on public hospitals or something that when you look at our costs per capita in health expenditure we are once again slightly above the national average but we certainly are not way out there in terms of say the Northern Territory in terms of their costs.

Mr WILLIE - If I unpack that a little bit more, what is Treasury's role in looking at efficiencies and inefficiencies in other departments?

Ms CALVERT - We are probably not in a position to comment on that.

CHAIR - We might have to call the Treasurer around some of these questions if they are more policy questions, I think.

Ms CALVERT - Yes.

CHAIR - We are not going to get him until after budget Estimates. He is a bit busy at the moment, or I expect he is. One would hope he is.

Some information on page 7, down the middle of the page, you have talked about Tasmania's actual expenditure:

[TBC]

> is significantly below assessed expenditure because the CGC assessment is based on what states do, on average, and that is to provide electricity and water subsidies to small and geographically isolated communities where full cost recovery is most difficult because Tasmania is assessed to have small isolated communities under

> the CGC's geographic assessment is assessed to have an above EPC requirement to provide water and electricity subsidies. However, in practice Tasmania provides electricity subsidies through Hydro Tasmania for diesel generation on Bass Strait islands only and there are no water subsidies.

I understand the Bass Strait island subsidy there. Mind you they are getting off diesel. They are pretty much renewable now, so that is another area. I am interested in how the price caps that we have put onto water prices and electricity prices fit into that. It may be a policy thing and maybe we have a policy question here, but does that have an impact?

Ms CALVERT - Once again they are policy decisions of the government. It is the same thing, and I must admit I was quite surprised when I came into this area that the concessions that we pay for low income households around electricity and water and sewerage and rates and everything also do not get assessed. Under this category it is very much limited to the Bass Strait islands.

CHAIR - Have you raised that with the Commonwealth Grants Commission in your submissions to them?

Mr FEBEY - Not price capping, no. As you say, it is policy choice to impose a price cap. What they are trying to get at here is they are looking for things that are intrinsic disadvantages that a state might have. What they have observed across all the states is that there are remote communities, quite often they are very remote, indigenous kind of communities, and that states need to provide electricity and water to those communities at a much higher cost than they would for the rest of the interconnected system that they may have.

That observed higher cost is something the CGC wants to reallocate GST for. What they do is they come up with a methodology for doing that and they say, what drives these costs? It is the remoteness that seems to be the main factor. They have a geographic assessment. They use ABS geography statistics and so on to work out how relatively remote various parts of the state are and then they apply that to the costs. Higher costs as you get more remote. They just apply that as a blanket across each state, irrespective of what you actually do. If you are not providing those sorts of subsidies, that plays no part in the calculation.

CHAIR - The state gets a kicker for that, basically. We benefit.

Mr FEBEY - I can't say whether that is a kicker or not, but there are swings and roundabouts with all of these things. Some things we might do a little bit better on, maybe compared to what we actually do, and others we don't do so well at.

CHAIR - Would it make much of a difference if the concessions we provide were assessed?

Mr FEBEY - They won't assess what you actually provide. That is policy influence.

CHAIR - They assess the disadvantage?

Mr FEBEY - Yes.

CHAIR - You made comment about a couple of areas of significant difference to what was assessed, what was actual, and how it compares with the national EPC spending. That is, services to communities. Is that what we are talking about now?

Mr FEBEY - Yes, that is the one, services and communities. That does create a bit of confusion. Some commentators have thought that meant welfare-type services and so on, but it is not. It is a name the CGC has coined for specific services they want to assess because they think there is a differential cost associated with providing it. That is, water and electricity subsidies, and there are a few other things like some community development activities, the provision of certain things in remote communities to provide them with certain community facilities and so on.

CHAIR - It is looking at aspects of our community that may, by their geographical isolation or something like that, make it more difficult to provide a service to.

Mr FEBEY - Yes.

CHAIR - They are not broad services everyone might need, wherever they might live across the state.

Mr FEBEY - Remoteness does play into other assessments as well, like health, education and so on. We don't, in our budget, have a line item called services to communities. It is a construct of the CGC itself. It tries to pull out and group government activities where there is a material difference between states in costs and so on. Subsidies to remote areas would be lost in other parts of government expenditure, so they have effectively pulled it out as a separate category.

CHAIR - Our assessed expenditure in services to industry is much lower than what we spent. What we spent is much higher than the national EPC figure. One would argue we are throwing too much good money at industry. What is this being used for and how was the disadvantage assessed?

Mr FEBEY - My understanding is that it relates a lot to the regulation of industry. It does pick up business development as well but it doesn't note a disability or a redistribution based on business development-type expenses. They treat that all equal per capita because it is two-policy influence. You would not want a situation, if a state decided to spend a lot of money on economic development, that it received more GST as a result of that. It does see that there are different costs for some states. We have a naturally higher agriculture and forestry industry structure in Tasmania and we seem to require a little bit more GST as a result of that, to meet those costs. As you can see in that table, our actual spend is quite a bit more than we are assessed for. I can only put that down to, more toward, the policy choices of the state.

CHAIR - Yes. As long as we can follow up with the Treasurer at a later time.

Mr FINCH - A little bit on the history of the process, mainly because my nose was so far out of joint some years ago when Western Australia was critical of Tasmania for the GST we received. How have the circumstances changed in Western Australia and in the allocation process that may have decreased that criticism of Tasmania's allocation?

Ms CALVERT - Are you asking how Western Australia ended up where they did?

Mr FINCH - Yes, and they are not so bolshy. I know it may have been one of their premiers, a previous iteration of government, but what circumstances might have changed that decreased that criticism?

Ms CALVERT - That has decreased it now, or could have decreased it?

Mr FINCH - Then and now, because we don't seem to have the criticism now we used to.

Ms CALVERT - The issue of how they got to where they were is pretty much the mining boom. They received a huge amount of own-source revenue, mainly from mineral royalties. The issue for them was that there is a time lag between when you get your GST, so their GST was dropping off at the same time their mineral royalties were dropping off but they had committed a whole amount of ongoing funding. This is quite well-documented, if you look at the review of their finances done when their current government came in. There is a lengthy amount of detail around this. That is why they ended in that situation. That largely drove the Productivity Commission's review done 12 months ago. They have done very well out of the Productivity Commission review. They are continuing to get large amounts of funding from the Commonwealth Government. If anyone has looked at their budget this year, they have done very well on GST as well as very well on iron ore royalties. They're probably quite happy at the moment.

Mr FINCH - A point was made about the rapidly growing population in Western Australia. If you had some figures, that would be handy. It took us a long time to get to half-a-million people and I am so pleased we have gone over the 520 000. We are growing, but not growing fast enough in comparison to other areas like WA.

Ms CALVERT - Our population growth is the highest it has been for a long time. The issue is that it is not growing at the same rate as national population growth. It is all about relativities; we aren't quite growing at the same rate relative to the national population growth.

Mr FINCH - I would have thought we would have had a good case to submit in respect of that because, where we plateaued over many, many years, we are now showing that increase, steady though it may be. We would have the highest population we have ever had.

Ms CALVERT - We have, for a substantial number of years, but the issue is that a number of other states also have. The national rate is higher than our rate at the moment.

CHAIR - These may be questions relating to policy and if there are, I am happy to defer them. As to the assessed expenditure and the actual, when you look at the fiscal strategies set by the government, I am wondering how they fit in with that. Does the assessment have any impact on the fiscal strategy? Fiscal strategy number 2 is about debt servicing and the defined benefit superannuation payments; the strategy says less than 6 per cent. As the defined benefit superannuation makes up the majority of the payments, does this strategy restrict borrowings to a level where the Commonwealth Grants Commission has determined it is necessary to fund equivalent services? How are the defined benefits scheme payments actually treated by the Commonwealth Grants Commission? Are they included in the assessment, or are they not?

Mr FEBEY - They are not assessed as a disability because that is, again, a lot of policy around schemes, design and how your liabilities have grown over the years. There is no disability assessment per se, so those costs would be part of the equal per capita part of their assessment so that you would see any assessment of relative superannuation cost.

CHAIR - Even though we have quite a high -

Mr FEBEY - I appreciate that, yes. And Queensland has virtually none.

CHAIR - Yes, that is right, so that is not considered at all?

Mr FEBEY - No, that is my understanding, because it has been as a result of various states' policy choices as to how they dealt with - it is not an innate disability. They are really more concerned about innate disabilities like you have an older population, you have a poorer population, et cetera.

CHAIR - It probably is a policy question in terms of the tax environment. There are a number of comments throughout various submissions and information we have got, and through the Productivity Commission about the impact on tax policies and whether you are rewarded or penalised, I guess, on your taxation policy. So, in terms of fiscal strategy 3 which talks about maintaining a competitive tax environment, is it the fact that it has no impact on whatever we as a state, or the state decides to do as far as their taxation policies go, do we just wear the outcome of that rather than it being considered by the Commonwealth Grants Commission?

Mr FEBEY - The Commonwealth Grants Commission deals with the tax rates. Is that what you were referring to, the tax rates that states choose to levy on?

CHAIR - Payroll, mineral royalties, yes.

Mr FEBEY - Yes, that is right. They do their assessments by looking at all the tax rates across the states and they come up with an average tax rate, and then they apply that average tax rate to each state's specific tax base. If you are looking at, say, payroll tax, the average tax rate is worked out across all the states, and then they apply that to our actual payroll tax base. What you find is that because we have lower payrolls and more unemployed people and a whole range of factors, we have a weaker payroll tax base than, say, New South Wales or Victoria. That is why our ability to raise payroll tax is seen to be weaker than New South Wales or Victoria, and that is why we get GST.

If we were to change our payroll tax rates, it would not make very much difference because we are so tiny compared to the average.

CHAIR - What I am hearing, and correct me if I am wrong, is that reform of state tax policy, in Tasmania's perspective at least, would have a minimal impact on the CGC assessment?

Ms CALVERT - I think, from memory, this is covered in all of our submissions to the Productivity Commission last year. We dispute the fact that the HFE is an impediment to reform. One of my other teams looks after revenue policy and we cannot remember one situation where someone looks at a tax reform and says, 'Oh, what is the impact of this on GST?' There is a whole range of other factors that you need to take into account. Quite often it is that most tax reform has winners and losers. On a range of other issues we actually dispute the Productivity Commission's view. They were not ever able to show any examples where that was actually acting as an impediment to reform in any of the states, I don't think.

CHAIR - To take fiscal strategy number 6 about maintaining existing infrastructure and responding to economic and population growth and needs of the community, which we have touched on previously, because of our size. We did talk about some of the reasons why we may get more or less in those areas in terms of the relativity assessment, does it have no impact on that either? If Tasmania decides that as a state we are going to invest heavily in infrastructure, which we claim to do every budget, then don't, but that is another story, if we did actually do it, would that have an impact on the next lot of assessment?

Mr FEBEY - Not really. They are looking at the average of what states do. They are looking at national kind of investment. They do have specific disability factors for each state and they relate to the relative costs of providing infrastructure.

You might have higher wages or something like that which make it more costly to build infrastructure and so on, or we have a higher need for hospitals and schools, say hospitals for argument's sake, that we have an older population so you need more hospitals so you need more disability adjustment factor there.

The actual quantum of how much you build is not taken into consideration on an individual state basis. It is taken into consideration at a national basis and looks at the growth in the infrastructure nationally, otherwise you would be able to game the system and that is what they are trying to avoid. Pour a whole lot of money into infrastructure and if that was being assessed as being above our per capita share, we should not get more GST as a result of that because every state would do that.

CHAIR - We are going to run out of time before we get to the second term of reference. We might have to get you back.

Ms CALVERT - This might go to the second term of reference on infrastructure spending. It would depend who is funding it. If you are getting over your per capita amount from the Commonwealth maybe to fund some of that infrastructure, that will obviously flow through into your GST and reduce it.

CHAIR - Before we go onto that one, there is a comment on page 11, the change to the objective of the HFE, I would like you to expand on your comments around that. You made some comments in your opening statement about that. Again, it comes back to all states being no worse off. Some are obviously being a bit better off, like Western Australia at the moment. Can you expand on that a bit further as to where you see these problems and are we on the path where we can't get off now? Some legislation has been passed federally to start this process.

Ms CALVERT - You make a good point that we have now moved to a situation where not all states will be the same. At least at the moment, Western Australia will be significantly better off than most, if not all, other jurisdictions.

From our perspective, where they have gone to the equalising to the second highest is a move away from full HFE, which obviously is not a benefit to Tasmania. We do have the guarantee through until 2026-27, noting that is a guarantee across the six-year period. It is not an annual guarantee. If we do better off in the first year and then every other year up until the last year we are fine and then we are worse off in the final year, they will offset that against the first year and we will not be compensated. There will be a review is our understanding, prior to 2026-27 by the Productivity Commission.

CHAIR - When is that scheduled? How soon before the end of 2026-27?

Ms CALVERT - I am not sure it is clear. I think it is before the guarantee runs out.

CHAIR - That is going to present some real challenges for Tasmania then, isn't it? No worse off?

Mr FEBEY - When the guarantee runs out?

CHAIR - Potentially if we do better one year and then in four or five-years' time we are actually looking down the barrel at doing a bit worse.

Ms CALVERT - There are certainly cash flow issues. Over the six years we will be no worse off, and I use that extreme example from the first year to the final year because it is extreme. From year-to-year it is probably not an issue because you don't have the cash flow problem so much.

Hopefully, by the time we get to the review there will be a lot of data showing that Western Australia is significantly better off than the other states.

CHAIR - So we can all have our tantrum then? We might have to have you back to talk more thoroughly about the term of reference 2 as there is still a lot in that of importance to discuss.

Mr VALENTINE - I was interested to know the way the Government spends its dollars in terms of say, for instance, if it were to move to a very heavy preventative health program, spending less on acute health services but more on preventative health. How does that impact on the GST that it will receive? Is it possible for you to answer that? I know it is a policy decision and I am not asking -

Mr FEBEY - No, it would be treated as a policy choice by the commission. They don't assess -

Mr VALENTINE - If it reduced disadvantage in some way, because we have a healthier population, would that -

Mr FEBEY - Over time, that might happen. If you do have a healthier population because you've brought in these various measures to improve the population's health, that would ultimately be reflected in these other statistics the CGC use to measure relative need, which would be low SES, age and all the other things.

Mr VALENTINE - It doesn't give governments a lot of incentive to invest in those sorts of programs to improve the lot of the population if they're going to receive less funding.

Mr FEBEY - If your need goes down it is probably a good thing. From a CGC point of view, if you have no assessed need, why should you get more money? That is the whole idea of the HFE and fiscal equalisation. If you have a higher need then, to equalise you with other states, you should get more GST. If, over time, your economy and everything else improves, the health and welfare of your citizens improves, you will get less GST.

CHAIR - You can knock down a few hospitals.

Mr VALENTINE - We can turn them into schools. Thank you, I needed to hear about the impact.

CHAIR - On that point, Rob, if all states did that, would the relativity basically stay the same?

Mr FEBEY - It is still a relative thing.

CHAIR - It is a relativity, not an absolute.

Mr FEBEY - If everyone is improving by the same amount, we haven't changed our relative position, but if one state does improve its position relative to the others, you get -

CHAIR - We wouldn't have the expense, because we don't have people using the acute health services to the same extent. If they are healthy and staying out of them, your expenditure need drops. You would hope your actual would drop.

Ms CALVERT - That is where the Productivity Commission was heading, in saying that people are making decisions about what they do. In reality, I don't think that happens because the lag would be so long that it is going to take a number of years before you had an impact. I can't imagine governments would be making decisions based only on the impact on GST.

CHAIR - Thank you. We have run out of time. We probably needed to allocate more time. Gabrielle may will be in touch with you about coming back to talk about the second term of reference. Thank you for your time today.

<u>THE WITNESSES WITHDREW.</u>

<u>Mr MARTYN GODDARD</u> WAS CALLED, MADE THE STATUTORY DECLARATION AND WAS EXAMINED.

CHAIR - Thank you for joining us, Martyn. We have read your submission and we invite you to speak to it and will have questions flowing from that. Thank you.

Mr GODDARD - Could I start by taking up Rob's question from the last session? First of all, best of luck with trying to reduce acute hospital costs. Nobody in the history of modern medicine has been able to reduce by improving - you may slow the increase a bit but that is about as much as you could expect.

In the fantasy world you actually describe there, the activity-based funding, pretty much all health funding that you are talking about, certainly international health reform funding and activity-based funding, is included by the Grants Commission in working out our total Commonwealth payment share. If it that puts us over a national per capita average, the money is taken away from us in the end. If you treat fewer patients you will get less Commonwealth money and you will be topped up for it at the end.

It basically makes no difference as far as Commonwealth funding, the GST, is concerned. They work out your health needs basically on demographics. Unless your demographics change, that assessment is not going to change.

CHAIR - The demographics you refer to is not only age. It includes rates of illness and chronic disease, that sort of thing?

Mr GODDARD - It is the big things, age and socioeconomic status, that really drive it and they are a pretty fair indication of the relative need for health care.

Mr VALENTINE - You say it will not go down but surely it would with the baby-boomer generation bubble moving through, wouldn't that, over 20 years, significantly reduce -

CHAIR - Once we all fall off our perches, do you mean?

Mr VALENTINE - Yes, to put it kindly.

CHAIR - That is only if general health improves.

Mr GODDARD - I doubt whether that would have enough of an effect to offset the increase, which has been going up about 5 per cent a year.

CHAIR - Are you talking about expenditure?

Mr GODDARD - No, the numbers, I mean people knocking on the door. Nationally, it is about 4 per cent.

CHAIR - You are talking about demand for health services.

Mr GODDARD - That is right.

Mr VALENTINE - That is across the spectrum, not only aged -

Mr GODDARD - That is what the hospitals have to deal with. I have done some printing for you. What I have spent a lot of my time doing around this is looking at how the GST affects and interacts with the state budget, particularly with health but also across the board.

It concerned me that a few weeks ago the Treasurer seemed to be signalling that this was going to be a tough budget. He said that $560 million suddenly taken off revenue. When you actually look at what has happened to two areas he was talking about - one is GST and the other one was stamp duty, conveyance duty - you find they are both going up pretty strongly and the difference is only in estimates in forecasts. Economic forecasts are almost always wrong - well, are always wrong one way or the other -

Mr WILLIE - Like polling.

Mr GODDARD - Worse than polling, much worse than polling. The pollsters are geniuses.

In terms of the amount of money we actually get, I don't think there is any reason to have an austerity budget, but we are probably going to get one. We should not be in such a situation that we get knocked so seriously off track by a change in forecasts. It should not be like that.

What I will get to now is why that is the situation. These are printouts from the Commonwealth Grants Commission's supplementary tables as part of its 2019 update. These show you what the CGC calls the 'assessed budget'. If you look at the first one, payroll tax, it tells you what we actually got -

CHAIR - This is per capita, what we got?

Mr GODDARD - Yes, dollars per capita - what the commission thinks we would have got had we received the national average. In 2017-18, we received 2.8 per cent more from payroll tax than the commission says is the average of all states and territories. In most areas we are down. We are up a bit in land tax, but land tax isn't vast; we are down in stamp duty - and this is two years ago now; we are up in insurance tax; down in motor tax; and we are down in mining revenue, obviously. Our total tax revenue was actually quite a lot lower than it would have been with an equal taxation effort, 'taxation to verity', as they used to call it. The assessed revenue includes the amount we get for our GST assessment in that area.

Moving on to the expenses area: we spend on schools, 2.7 per cent more than the average. Post-secondary: only 63.8 per cent in that year of the average, so TAFE and university, not that the states put much into universities, but certainly TAFE and higher education generally.

For health, they say we spent 92.3 per cent of what we ought to be spending, if you like. There are limitations to these figures in that the Grants Commission really only has two columns for revenue: Commonwealth and state. It does not have non-government. When you have about 22 per cent of admitted patients in public hospitals who are private patients paying for themselves through insurance or whatever, that shows up here as state government spending. I do not think that is true. I do not think that is what the state government is doing. For my assessment of what we are spending on health, I go to the Australian Institute of Health and Welfare, which is in the submission, which breaks it down and tells you where the money is coming from.

Housing is down; welfare is down; community service is down - all the sort of social stuff is down - justice; roads and transport; services to industry is up strongly.

On the next table, investment is basically capital investment - it is infrastructure - and we spent 43.3 per cent as much as the average of the other states.

Mr VALENTINE - Does that include Commonwealth grants?

Mr GODDARD - No, that is from state revenue. That is not Commonwealth.

Our borrowing - of course, we do not borrow. Other states do, except New South Wales. Other states borrow to fund infrastructure. We do not. That money comes out of recurrent.

I think that gives you an idea of how our areas of revenue and expenditure compare with the rest of the country. The Grants Commission says that if you do not spend up to that level - it is the state's decision whether to do so or not - you are not spending enough to fund a national level of service, a national standard of service, assuming equal levels of efficiency.

Similarly with revenue. Our revenue really is down and the Grants Commission is not making us up for that because our basic taxation effort is relatively low compared with that in other states. That is a substantial hit to what any government can spend on its services.

A bigger hit is the fact that we do not borrow. We do not borrow for infrastructure. If you do not borrow for infrastructure, either it does not get built, which is the case here to a significant extent, or the money comes out of recurrent, and that is what is happening.

The money we are spending on infrastructure, although that is not enough, is about $600 million per year or thereabouts over the forward Estimates. If we are not borrowing to fund any of that, as almost every other state does and almost every government around the world does and every company does, then that money has to come from somewhere. It comes out of recurrent, out of services. Overwhelmingly it comes out of health.

Health has to put up a substantially greater proportion of its assessed budget than any other spending portfolio, not only in terms of dollars but also in terms of precaution. This has a lot to do with why our hospitals are so stretched. It is fundamental fiscal policy. We are not raising enough money but more than that, we are not borrowing to fund infrastructure.

CHAIR - A couple of points before you go on. You made a comment about what we spend on health or other things, the Commonwealth Grants Commission assumes equal levels of efficiency.

Mr GODDARD - Yes.

CHAIR - We had the Treasury officials here before you. They said, as I understand it and I will have to check *Hansard* to make sure I am not misrepresenting what they said, but that the Commonwealth Grants Commission does not look at efficiency. It looks at relative disability.

Mr GODDARD - Yes, that is right. They don't have to look at it but they assume that it is the same. If you look at any of the documentation from the Grants Commission, they say they assume equal levels of efficiency. They don't need to look at it because they assume it is equal.

CHAIR - Okay. You also said that recurrent funding or operational funding, which is probably a more accurate description of what it is, is being used to fund infrastructure which is a capital expenditure. What we see each year and we have seen it recently again, is a big supplementary appropriation bill being debated this week just when the budget is being delivered at the same time that basically tops up the Health budget. We see the way that is done by pushing out infrastructure spending. We are not actually spending ultimately, even though it is budget that we spend recurrent or operating expenditure on infrastructure, it is actually being shifted back to health.

Mr GODDARD - It is topped up a bit, Ruth.

CHAIR - Not entirely.

Mr GODDARD - What they are faced with every year is they give Health a budget that they have been told by the department is not enough to pay the bills. They are told that every year. They really try to make the system work within that. They don't give that top-up money easily or automatically, and there is a lot of shouting and screaming behind closed doors about that. In the end, the problem that the hospital has and the department has is that these patients keep showing up. What do you do? You have to treat at least some of them. In order to simply pay the bills, the government, quite reluctantly puts some top-up money in and it shows up in policy and parameters, but it is never enough.

What is happening this year, I understand, is that the $105 million that the Government put in last year, and which has been spent, is regarded as a one-off. It will not be repeated, and there is a lot of angst about that at the moment.

One more? This shows where the Grants Commission tops us up or takes money away from us in the various areas of revenue and expenditure. It is giving us $199 million in this coming financial year because our ability to raise payroll tax, for instance, is less than the average of other states. They do not bail us out for our lack of effort because they assume equal taxation effort across the states, but we get an extra $731 million because of our relatively lower capacity to raise money.

For the expenses area, again those are the numbers of millions of dollars that we will get to redress our disabilities in those various areas in this coming year. It will vary a little bit, but by the end of the year, depending on how much is actually in the GST pool, but that is usually pretty right.

CHAIR - If you apply the same logic, playing the devil's advocate here, so if you look at the table called 'Contribution to Difference Between Equalisation and Equal Per Capita Distribution of the 2019-20 GST Expense Categories million dollars'. In health, notionally, $321 million was allocated for our disadvantage in delivery of health services, but then in 'transport', we have

$208 million taken away in equalising the system back to other states. I am not sure what 'transport' actually relates to there because roads are there as well. We had $10 million taken off us and if you use the same logic, so there is $218 million that the Commonwealth Grants Commission has assessed we do not need to spend on those two areas.

Mr GODDARD - Bigger states, like Queensland, Northern Territory and Western Australia are going to get more on that. We are a small state so therefore any of the costs of getting around are going to be assessed as being less. I think it is just geography.

CHAIR - I accept that, so then if we are not saying, 'Okay, we have to take some money away from our spend on transport and roads, and not spend as much -

Mr GODDARD - This is just the amount they are topping us up.

CHAIR - I accept that, but if you are saying that they are topping us up with extra money for health and we have to spend it in health -

Mr GODDARD - I am not saying we have to. What I am saying is that in each of those expense categories, the Grants Commission is telling us what we would need to spend if we are going to deliver a national standard of service.

CHAIR - An average standard.

Mr GODDARD - An average national standard. We don't need to spend as much in transport as the average of other states to deliver a national average standard of service. In pretty much everything else we do, we need to spend more. This just tells us how much they are topping us up or redistributing. The other tables tell you, when all of this is taken into account, whether we are still spending enough in a particular category or taking enough in a particular revenue category. They are two quite separate things.

Mr VALENTINE - Can I ask a clarifying point? Is this the level we would have to spend at to deliver a national standard of service? I don't know that the Commonwealth Grants Commission is actually saying that. I think it is saying that this is the level at which it is an average of spend across all the states. It is not saying whether you are delivering a standard of services.

Mr GODDARD - What they are saying is 'assuming equal levels of efficiency' and so on.

Mr VALENTINE - If you can deliver certain services more efficiently -

Mr GODDARD - If you can deliver it more efficiently, you are ahead.

Mr VALENTINE - Yes, but you are talking about national standards of service, and I don't think that is quite accurate.

Mr GODDARD - That is the language they use.

Mr VALENTINE - Is it?

Mr GODDARD - Yes. In health, for instance, our costs are considerably greater than the average and they are climbing. The cuts began back in 2011 and continued; when you cut a hospital system, the crude cost per patient is going to go down because you are taking up the surge capacity and people are working harder. It gets to a point, and it got to the point probably about three or four years ago here, where it starts to become less efficient and costs per patient start to go up because of the simple chaos in the system.

Let's take one example of that in hospitals. As a rule of thumb, if a seriously ill mental health patient in need of admission to the psychiatric ward has to spend 24 hours in emergency, that probably means they have to spend an extra week in hospital to be detoxified. The costs of dealing with the average patient in emergency have skyrocketed. They went up by 14 per cent in a year, because people spend so long in emergency. The longer they are there, the more they cost. If there is pressure on doctors to discharge people too early, you are going to get them back in and that is another cost.

All of this is stuff we are not being compensated for by the Commonwealth because the Commonwealth gives you the national efficient price and it doesn't compensate you for being inefficient, which is what we are. We aren't going to be compensated for that by activity-based funding or any other Commonwealth funding and we aren't going to be compensated for it by the GST. The health cuts are really damaging in terms of the value for money that we are getting out of the hospital system.

The other contributor to costs is that the mix of patients in our hospitals has changed. The hospitals are full. If you can't treat everybody, and they can't, you treat the people you simply cannot ignore. More and more, that's leading us to a more acute-focused system.

The average-cost weights, as of two years ago, was already 7 per cent higher than what would be expected if you had a normal case mix. One bureaucrat was complaining to me the other day. He said, we are sucked into a vortex, was the word he used, of the most expensive acute care. We simply have to treat these people, so where is the money going to come from? It is going to come from all the other things we can put off like prevention, like diversion programs, Hospital in the Home, community care; all those things that keep people out of hospital are being cut back.

Mr VALENTINE - That feeds a downward spiral.

Mr GODDARD - It feeds a downward spiral.

Mr VALENTINE - That was why I asked if there is any detriment if a government decides to tackle that problem by reducing its need. Now, as it turns out -

Mr GODDARD - It's the reverse.

Mr VALENTINE - You are saying it's the reverse.

Mr GODDARD - It is the absolute reverse. That's what happens when you get people in charge of a budget who don't understand how that money is spent and what the effects of what they are doing are going to be. It is what happens when you get people, as in Treasury, who say all borrowing is borrowing, there is no difference between borrowing to keep the lights on, pay the groceries and build a hospital, a road or a school. If you measure the benefit to the community, which is being done now, it is called community return on investment.

The most well-placed, well-planned infrastructure in a developed country like Australia, if you look through the literature on that, is assessed at delivering between 10 and 15 per cent of its cost back every year in terms of the benefit to that community. A public hospital is never going to make a profit and a public road is never going to make a profit, so it is harder to measure that economic benefit but that is what this is. We do have a return on investment measure for that now.

Mr VALENTINE - What is the Commonwealth Grants Commission missing out in its measuring? Is it a community pain factor or something?

Mr GODDARD - There is an enormous amount. We can overestimate what the Grants Commission's remit is. It is not to solve every problem. It is not to identify every problem. It is to make sure that every state is treated fairly, that is all.

CHAIR - You talked about the case-mix funding or activity-based funding. Is the funding model wrong? This is not what you're talking about now, but what I am hearing you say is that the funding model makes it more difficult to provide a service that you would consider to be average best practice, if you like. That is what the Commonwealth Grants Commission base it on, the average of all states and territories.

Mr GODDARD - It depends whether you think that treating a patient with tonsillitis in the Royal Hobart Hospital, the Mersey, LGH, the Alfred or RPA can be done reasonably for the same cost. That is what the system assumes. There are a lot of people who think that is not the case. Stephen Duckett thinks strongly it is the case. John Deeble, for instance, who co-invented Medicare thinks it is not. Michael Pervan thinks it is not.

Apart from those very small hospitals which are block funded, it treats every hospital the same. It is one of the very few areas in which scale is not taken into account. May be a better way would be to have a differential in funding in the definition of what is a national efficient price based on hospital peer groups. Big hospitals, smaller hospitals, little hospitals. Smaller hospitals are more expensive. We have smaller hospitals than the average probably, yes, we do. How much of that is actually able to be overcome, I don't know.

The other thing with ABF and it is not part of the HFE remit that I noticed some time ago and it is absolutely chronic, is that the case mix ABF system was designed so that if a hospital was able to treat somebody adequately for less money, then they kept that. They did not get penalised, they got to keep that money. What happens in fact when they do that - and Victoria is a very good example - is that the state takes the money. The hospital doesn't get it and they are not getting any more health care in that state as a result of it, but the amount of money that the state puts in is comparatively less.

CHAIR - So, is the funding model broken?

Mr GODDARD - No, it is not broken. It needs a bit of a tweak. Changing the model to funding hospitals on the basis of their hospital peer group would be a much better model.

CHAIR - I take you back to your comments about the assessment of our expenditure in health, where the particular focus was, and you talked about using health expenditure sourced from the Australian Institute of Health and Welfare. This was mentioned by the Treasury people here earlier that they believed that the AIHW used different measures of health services.

Mr GODDARD - Yes, they do. As I said earlier, what they do is they take the same sources which comes from state Treasury and they break it down further into who put that money in originally, the source of the funding. The Grants Commission does not need to do that. What they are interested in is what the Commonwealth is putting in as that has to be equalised versus where the rest of the money comes from and they say that is the state's responsibility.

CHAIR - You have a state where they have much greater access to private hospitals for some of the services that people in Tasmania may seek the services of a public hospital. Not all of those go in as private patients. A lot of them still go in as public patients. You have Tasmania with limited access to our private hospitals for a range of services -

Mr GODDARD - That is taken into account by the Grants Commission in terms of that $321 million. They assume there is a question of substitutability and they assume that if you have fewer alternatives then the private alternatives, to at least some extent, the public system is going to have to pick that up.

CHAIR - Aren't they allowing then for less in the states where there are more options for people to go to a private hospital if they have private cover, you say that is considered. Aren't they actually considering it in a round about way?

Mr GODDARD - No. It is not that complicated. What the Grants Commission figures here talk about is, Tasmania has about 22 per cent of our admitted patients who are private. In New South Wales it is more than that, about 25 per cent to 26 per cent, but everywhere else it is much less. The national average is way less than ours. Therefore, a larger proportion of our total hospital budgets are being paid for privately.

CHAIR - With money coming from sources other than government.

Mr GODDARD - With money coming from non-government sources. The money coming from non-government sources is classed by the Grants Commission as state government money.

CHAIR - Where do we get the figure about how much comes in through non-government sources for health?

Mr GODDARD - From the AIHW and nowhere else.

CHAIR - This is a matter for health Estimates probably. You are saying the real difference here is the private money or assessed funding?

Mr GODDARD - There are two differences here. Even taking that into account we are still underspending the average.

CHAIR - Just on that point, in Treasury's submission, which I assume you have seen on the website -

Mr GODDARD - Yes.

CHAIR - they have a table on page 7 that talks about the assessed and actual expenditure per capita, an average from 2015-16 to 2017-18. It is averaged over that two-year period and Health, the assessed expenditure per capita was $3024, the actual was less, $2748 was what you have been arguing, but the national equal per capita funding was $2472.

We are actually spending on that cohort more than the national equal per capita spend. We might be spending less than what was assessed to our relative disability that the Commonwealth Grants assessed in their mathematical construct, as it has been called, and there are swings and roundabouts in that.

Mr GODDARD - We need to spend more than the average.

Mr VALENTINE - We are according to that.

CHAIR - According to this we are.

Mr GODDARD - I am sorry, it is some time ago since I read that.

CHAIR - The assessed, in round figures, was $3000, the actual was $2750, round figures, and the national equal per capita average was $2470. We are actually above the national equal per capita spending there on health.

Mr GODDARD - Yes, but we should be more than that. That is the point.

CHAIR - But didn't you say we were spending less than the national average equal per capita average?

Mr GODDARD - No.

CHAIR - What were you saying then?

Mr GODDARD - We are spending less than the assessed.

CHAIR - But in other areas of government service delivery, like services to industry we are spending a lot more.

Mr GODDARD - Yes.

CHAIR - Other expenses more -

Mr GODDARD - I'm looking at assessed as being the only measure we have, the only measure there is of what we ought to be spending if we want to deliver an equal standard of care to a population that needs much more than the national average. New South Wales and Victoria need much less than the national equal per capita -

CHAIR - I am not disputing what you're saying, Martyn. What I'm saying is that if you are taking things in isolation, aren't we missing the whole purpose of equalisation between the states?

Mr GODDARD - Precisely, but I'm not taking them in isolation. I think Treasury is taking them in isolation. I don't think I am.

CHAIR - You're focusing on health.

Mr GODDARD - Sure.

CHAIR - Not without good reason to focus on health.

Mr GODDARD - If you look across the board, you have a reasonable level - the national figure isn't the point if you're looking at what we need to spend to deliver an equal level of service. The equal per capita - the national figure - doesn't tell us what our population needs; it doesn't tell us what we're getting to top us up. It is a bit of a red herring. The question that concerns me is whether we are spending what the population needs to get the level of care that is basically available to other Australians.

CHAIR - What is the question that needs to be asked of the Treasurer, perhaps more so than Treasury, about the appropriate level of funding for health?

Mr GODDARD - I think there are two ways of answering that. One is: look at these figures. That is the only relative assessment I'm aware of - the assessment of need. It is need that is important.

CHAIR - Need or disadvantage?

Mr GODDARD - The same.

Mr VALENTINE - Page 3 of the Treasury submission says -

> The first observation that Treasury would make is that the expenditure assessments made by the CGC are not intended to be a measure of what States should spend on particular service areas. [ok]

It comes back to my earlier point that it is just an indication of the average other states are spending, not necessarily whether it is delivering the right level of service.

Mr GODDARD - Under the Intergovernmental Agreement on Federal Financial Relations, one of the two defining documents of this Federation along with the Constitution, the GST grants are regarded as general purpose grants. They replaced the old general purpose grants that came out after every premiers' conference. The agreement is that the states can use that as they wish, absolutely right. The questions I ask are: what happens if you diverge in a huge way from that? What happens to that area of service? We are allowed to do it. Should you?

I had a letter from the Secretary of the Treasury the other day, in which he said - and I sent you a copy of that correspondence - that all of this stuff the Grants Commission does was merely a mathematical construct basically of no practical guidance or relevance to anything that actually happens. I think that is worrying. It is better than that; it is more of a guide than that. Nobody is saying that we should have a law saying we have to spend exactly $321 million, et cetera. Nobody is saying that. To simply walk away from it and spend none of that money on health, minus a bit more, what does that do to the health system?

The other way of answering the question is look at the health system.

Mr VALENTINE - That is what I say - you need to measure community pain.

Mr GODDARD - That is right. Look at the health system, look at the justice system, look at the welfare system, look at Legal Aid, look at health community services right across the board.

Mr VALENTINE - I am not suggesting that the Government is or is not spending enough money; all I am saying is that this particular set of figures for horizontal fiscal legalisation does not actually takes into account what we should be spending. It is actually looking at the average level of spend. That is all I am saying; I am not casting a judgment on -

Mr GODDARD - If we are less efficient, if it costs us more per person, we should be spending more, right?

CHAIR - Or improving our efficiency.

Mr VALENTINE - Or improving the efficiency, yes.

Mr VALENTINE - I looked at your table earlier when you were talking about the taxes and the like. Fuel excise is a federal tax, is it not?

Mr GODDARD - Yes.

Mr VALENTINE - Thank you. A simple question and a simple answer.

CHAIR - We are getting close to running out of time, Martyn. Is there anything you wanted to finish off with to round it out? It is a complicated area and I think it is pretty clear there is no simple answer in terms of trying to link one to the other, but is there anything you would like to leave us with, any particular questions we should be posing to the Treasurer or Treasury?

Mr GODDARD - I think one thing is about borrowing. Before the lead-up to the last Victorian election, Daniel Andrews said on *AM* - they were coming under a lot of fire from the opposition for borrowing $20 billion to spend on infrastructure such as roads, schools, hospitals, public transport - that 'If we do not borrow, we do not build things, or we raise taxes - which we do not want to do - or it has to come out of services, but there are no alternatives.'

There is a wide view shared by people like fairly conservative economists like Saul Eslake that we ought to be borrowing something to fund infrastructure - prudently, not go into hock - but borrowing so that infrastructure can be built without taking the money out of services.

Is it true that they regard one kind of borrowing as the same as every other kind of borrowing? If they do, then that is of interest.

CHAIR - What do you mean, one kind of borrowing? What are you borrowing it for?

Mr GODDARD - The rule is you do not borrow it for recurrent, not across the cycle, but borrowing for productive capital is another matter because you are going to get more back than you put in, more back than it costs you in borrowing costs.

Mr VALENTINE - Isn't that what happens with Commonwealth grants? We end up paying it back through less GST in future.

CHAIR - Some.

Mr VALENTINE - Aren't we borrowing from the Commonwealth whenever we get a grant?

CHAIR - We are giving up GST.

Mr VALENTINE - That is borrowing, isn't it?

Mr GODDARD - Yes. If the Commonwealth comes to you, the treasurer or premier, and says, here is $50 million but you have to spend it as we want you to, and you would rather spend it in another way, you might say, no, go away, give it to somebody else. With the delay inherent in this system, you would get it back anyway. Is that what you are talking about?

Mr VALENTINE - I am thinking about, in my case and in my electorate, the Royal and the $354 million we got from the Commonwealth, we are basically losing GST in outgoing years.

Mr GODDARD - Apart from $8 million dollars, that's right.

Mr VALENTINE - It is clawed back.

Mr GODDARD - Andrew was really dudded by Gillard and Swan, who didn't let him in on the secret that this money was not going to be exempted from GST redistribution. He learned that lesson and when he went back to them after they duded him on pokies, remember, and they needed his vote again, he got $325 million out of Tanya Plibersek, who was health minister, and made that exempt. We did not lose that money.

Mr VALENTINE - Fair enough.

CHAIR - Thank you for your time, Martyn. I appreciate it is a very exciting topic and late in the day.

<u>THE WITNESS WITHDREW.</u>