The 2020-21 Tasmanian Budget: an assessment

This year's State Budget is a radically different piece of work from the previous six which Peter Gutwein has presented since becoming Treasurer in 2014. Whether it is "the most important budget in Tasmania's history", or "since at least World War II", or some other piece of hyperbole, I'll leave for historians and others to judge. But it's certainly very different from any of the 25 or so that I've examined closely – as it should be, because it has been presented in circumstances which are radically difficult from those which have confronted any Tasmanian government in living memory. And that also means that it should be judged by different criteria from those which I and other economists and commentators have used in assessing previous budgets.

The advice to governments from the International Monetary Fund – traditionally a bastion of economic orthodoxy and fiscal conservatism – is clear:

> "As lockdowns ease and become more selective, governments should ensure that lifelines are not withdrawn too rapidly. Improvements in the ability of social protection systems to reach, target, and deliver benefits to vulnerable people should be preserved. When health risks diminish and a durable recovery is foreseeable, support should shift from protecting employee-firm relationships to helping workers find new jobs, helping viable but still-vulnerable firms reopen, and supporting structural transformation towards the post-pandemic economy.
>
> When the pandemic is under control through effective vaccines or treatments, governments will need to foster the recovery while addressing the legacies of the crisis—including elevated private and public debt levels, high unemployment, and rising inequality and poverty" (IMF, *Fiscal Monitor*, October 2020, p xii).

And although, in Australia's federal system, some of the policy priorities recommended by the IMF fall within the purview of the national government, the underlying message also applies to state governments.

The advice to governments from international agencies like the IMF has been re-inforced in the Australian context by the Reserve Bank, which has also historically been an upholder of orthodox economic policy prescriptions. RBA Governor Dr Phillip Lowe last month said:

> "Economic policy also has a critical role to play in reducing uncertainty about the future … In previous downturns, it was monetary policy that played the leading role, but this time it has been fiscal policy that has taken the lead. This switch is entirely appropriate given the pandemic and the low interest rate world that we are living in … This fiscal support necessarily involves increased borrowing. For a country that became used to low budget deficits and low levels of public debt, this is quite a change. But it is a change that is entirely manageable and affordable and it is the right thing to do in the national interest … States and territories can also borrow at record low rates and have an important role to play in the national fiscal response" (Phillip Lowe, "The Recovery from a Very Uneven Recession", 15th October 2020).

So my assessment of this year's State Budget isn't based on judgements about 'fiscal sustainability', the size of the 'bottom line' surplus or deficit, or the level of net debt. Rather, it is based, predominantly, on whether the Government is doing all that it should and can to support a sustainable recovery from the current recession, in the face of the unprecedented uncertainty created by the Covid-19 pandemic here and around the world; and on whether the particular policy measures which the Government has chosen are the best that it could have chosen.

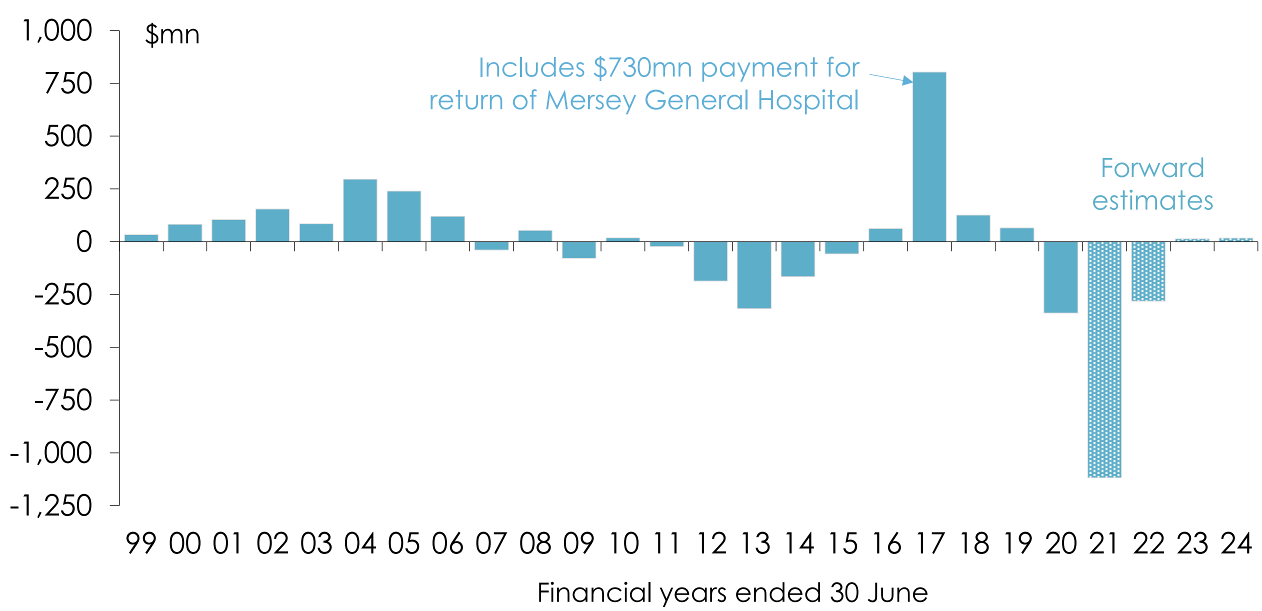
And my immediate judgement is that the Budget has done pretty well, against both of those criteria. That doesn't mean that it's perfect – no budget ever is, and I do have some criticisms to offer, which are set out below. But the overall conclusion is that this Budget *is* an appropriate response to the circumstances which the Government is confronting.

The budget numbers

The 2020-21 Budget envisages a '*net operating deficit*' (the difference between revenues, from all sources, and *recurrent* spending) for the 'general government sector' of $1.18 billion (equivalent to about 3½% of gross state product) this financial year – a dramatic turnaround from the $49mn surplus envisaged for 2020-21 in last year's Budget, and $111mn more than projected in the Government's May 'Update', when the outlook seemed at its darkest.

If realized (or indeed even if only half-realized) this would be the largest 'operating deficit' Tasmania has run since the introduction of accrual accounting in the late 1990s: the current record is last year's $338mn; and, prior to that, a $317mn deficit in 2012-13 (when the Tasmanian economy was last in recession).

Chart 1: 'General government' net operating balance



This large deficit is however expected to be temporary: the operating deficit is projected to shrink to $282mn in 2021-22, and to be followed by very small surpluses of $14mn and $17mn in 2022-23 and 2023-24, respectively.

Tasmania's projected net operating deficit for 2020-21 is larger, as a proportion of gross state product (3½%) than that envisaged in Tuesday's South Australian state budget (about 2½% of GSP), or the ACT's (2% of GSP); but considerably smaller than the Northern Territory's, also announced on Tuesday (5¾% of GSP). But, as will be noted shortly, Tasmania's government balance sheet is stronger than South Australia's, so it can 'afford' to run a larger deficit this year; while the Northern Territory's is much weaker, so it has been able to do less by way of providing economic stimulus, but still finds itself running such a large deficit that it may need to ask for another 'bailout' from the Federal Government. The only other state to have presented its 2020-21 Budget, Western Australia, did so two days after last month's Federal Budget, perhaps because it didn't want people in the eastern states to notice that, thanks to iron ore royalty revenues almost literally coming out of their ears, they're planning to run a surplus of almost ½% of GSP in 2020-21.

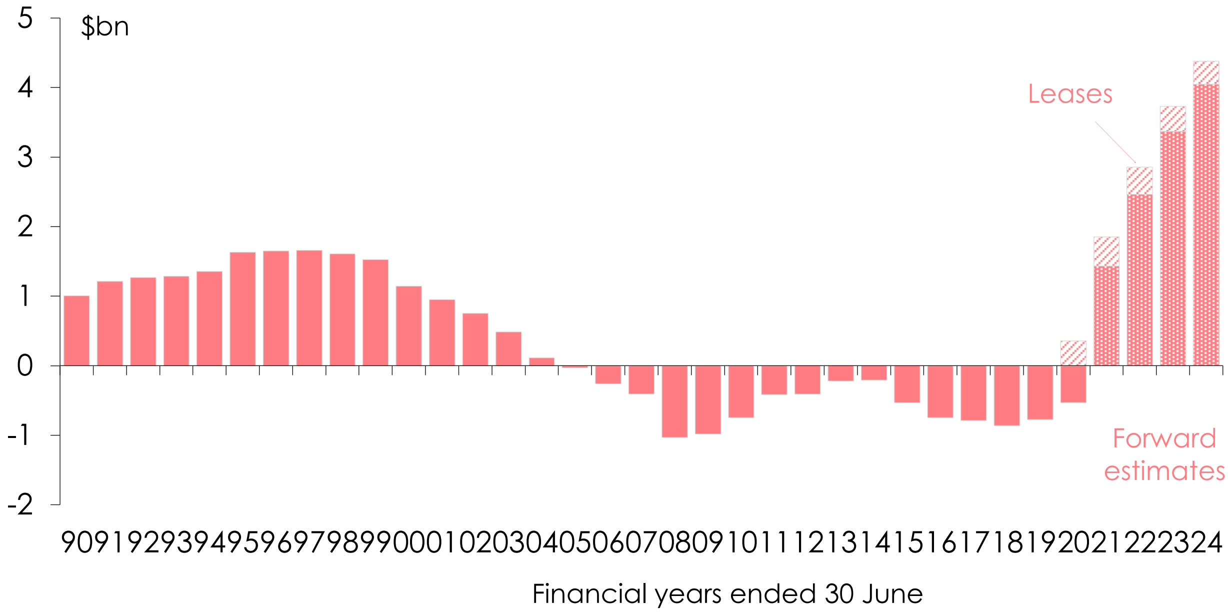
Tasmania is the only state which is honest enough to acknowledge the extent to which its 'operating result' is propped up by grants from the Federal Government that are used for 'capital' (rather than 'recurrent' purposes), which are included in 'revenues'. Excluding those, the *'underlying'* operating deficit for 2020-21 is projected to be $1.4 billion this financial year, and to improve much less rapidly over the remainder of the forward estimates period than the 'headline' balance: to a deficit of $597mn in 2021-22, followed by (still large) 'underlying' deficits of $441mn in 2022-23 and $503mn in 2023-24. That's something that may require greater attention in a year or two's time.

Including the Government's proposed infrastructure spending, the *'fiscal balance'* is forecast to be in deficit by $1.78bn in 2020-21, and to remain in deficit over the following three years, by $746mn in 2021-22, $228mn in 2022-23 and $438mn in 2023-24. The fiscal deficit is equivalent to about 5½% of forecast GSP in 2020-21.

In *cash* terms – that is, similarly to the way in which the Federal Government reports its 'bottom line', Tasmania's general government sector is forecast to run a deficit of $1.85 billion in 2020-21, again far and away the largest such deficit since at least 1994-95 (in all but five of the past 21 years the cash balance has been in surplus). The cash deficit is forecast to shrink to $798mn in 2021-22, but after that decline only a little further to $428mn in 2022-23, before widening again to $528mn in 2023-24.

It is these cash deficits which drive the forecast increase in *net debt* from -$178mn (that is, more cash in the bank than debt outstanding) as at 30th June last, to $1.6 billion as at 30th June next year, and eventually to $4.4bn by 30th June 2024. The forecast for net debt as at 30th June 2021 is $276mn more than the Government had forecast in August, but almost $500mn less than it had forecast in May when (as noted earlier) the outlook seemed bleakest.

Chart 2: 'General government' net debt



Excluding leases (which under the accounting standards the Government adopted last year are included in net debt), the debt forecast for 30th June next year will be the highest in dollar terms since 30th June 1998: although as a proportion of forecast gross state product it will be considerably lower, at about 4½ of GSP, than the peak of 15.3% of GSP at the end of the 1994-95 financial year, and indeed lower than at any time up to 2001-02. Even by th end of the 2023-24 financial year, as a proportion of GSP the net debt will, at around 11% of GSP (my estimate), be less than at any time during the 1990s.

More importantly, the cost of servicing this debt will be very low, thanks to the record low interest rates on government debt created by the Reserve Bank's "quantitative easing operations", and the generally low level of government bond yields globally as a result of similar undertakings by other central banks around the world, persistently low inflation, and the deepest global recession since the 1930s. The government's (gross) interest expense will average just over $50mn per annum over the next four years, less than one-third as much as it was spending on interest during the 1990s.

Tasmania's general government net debt will also be considerably lower, relative to the size of our economy, than that of the other states and territories which have so far presented their budgets. The 4½% of gross product to which Tasmania's forecast general government net debt will be equivalent as at 30th June next, compares with 8½% for WA, 11% for the ACT, 14% for SA and a whopping 23% for the NT. Queensland's pre-election fiscal update forecast general government net debt equivalent to 6½% of GSP as at 30th June 2021, while Victoria's most recent budget update forecast net debt of 10% of that state's GSP at the end of the current financial year. NSW has not published any budget estimates since last December's Mid-Year Review (when it was projecting net debt of 3¼$ of GSP for 30th June 2021): its 2020-21 Budget is next Tuesday.

On these metrics, Tasmania's general government sector is in a relatively strong position, compared with every other state or territory except (perhaps) New South Wales: which is why Tasmania has been able to be more generous in the support it has thus far provided to households and businesses through the pandemic than any other state or territory, and why it can 'afford' to contemplate running a relatively larger budget deficit this year and next than most other states or territories.

The one large blot on Tasmania's current financial position remains its outsized unfunded superannuation liability – which according to today's Budget Papers is expected to rise from $10.3bn as at 30th June last, to $11.5bn next June, and to remain around that level over the following three years. As a proportion of GSP this is equivalent to over 30% - considerably higher than in any other state or territory, and almost four times the average for all states and territories of about 8½% of GSP. Tasmania thus has to divert to paying lump sums and pensions to retiring or retired public servants (and their dependents) a much larger proportion of its revenue than any other state or territory, and thus in practice can't contemplate paying as much in interest (by incurring higher levels of debt) as other states or territories can.

But the only ways in which this problem can be 'solved' is by running large cash surpluses and setting them aside to defray the liability (which David Crean did during his time as Treasurer in the early 2000s), or by selling assets and using the proceeds to defray the liability. The former is neither practicable nor sensible in current economic conditions: and while the latter is certainly feasible, neither side of Tasmanian politics has any appetite for it.

Tasmania has, by comparison with other states and territories, a fairly large GBE sector: and it in turn carries a relatively high level of debt. Including GBEs, Tasmania's *non-financial public sector debt* is projected to increase from $1.8bn as at 30th June last, to $4.2bn at 30th June 2021, and to $7.5bn by 30th June 2024. As a percentage of GSP this is equivalent to rising from 5½% of GSP as at 30th June 2020, to about 12¾% of GSP by June next year, and to about 21% of GSP (my estimate) by 30th June 2024.

Although the projection for June next year is below the corresponding forecasts for the four other states and territories to have presented their budgets for this year, by 2023-24 Tasmania's total non-financial public sector net debt will be larger as a proportion of GSP than WA's, and about the same as the ACT's, though still smaller than SA's or (especially) the NT's (which on current projections will be close to 40% of its GSP).

The measures in the Budget

Arguably of more importance, especially in the current context, than the foregoing numbers, are the means by which they were reached: in other words, what about the quality of the policy decisions that the Budget incorporates?

Tasmania's Budget Papers are more transparent about the respective roles of 'policy decisions' (that is, conscious government decisions to change levels of spending or taxation) and 'parameter variations' (changes in economic assumptions and other factors beyond the control of the government) than those of any other state or territory, or for that matter the Federal Government.

The 'Policy and Parameters Statement' in this year's Budget Papers show that, of the $1.2bn turnaround between the $49mn net operating surplus for 2020-21 envisaged in last year's Budget, and the $1.1bn now forecast, some $814mn was the result of conscious 'policy decisions', and $390mn the result of 'parameter variations'. One of the larger contributors to the latter was a $347mn shortfall in Tasmania's share of the revenue from the GST (because of the impact of sharply lower consumer spending nationally on the total GST 'take'): although that was largely offset by higher than expected receipts from other Commonwealth grants. Indeed, in 2021-22 and 2022-23, higher specific purpose grants from Canberra outweigh shortfalls in GST revenues by margins of more than $200mn per annum.

New recurrent spending decisions have increased total recurrent spending by $775mn this financial year, and by a total of $2bn over the four years to 2023-24. Ordinarily, assessments such as this one would be questioning the merits of such an apparently large spend-up. But in current circumstances, given the spending required to deal with the pandemic, and the importance of supporting households and businesses through the recession and into the hoped-for recovery, these spending decisions look quite reasonable, in the aggregate.

In particular, the Government does appear in this Budget to have responded to concerns that its previously-announced stimulus measures, which have focussed on infrastructure and new private dwelling construction, have been too narrowly based. Thus, for example there are specific measures which attempt to create jobs for women (who account for less than 12% of all employment in construction), and additional support for Tasmania's arts and cultural sector. People will quibble about the adequacy or otherwise of the sums involved in these areas – and I'd argue the budget could have stepped up more in spending on social housing – but they do appear at least to have recognized some of these concerns.

The *additional* infrastructure spend in the Budget – over and above what had already been announced – is actually quite modest. Although 'general government' infrastructure spending will approach almost $4bn over the four years to 2023-24 (including over $1bn this year alone, and GBEs another $3bn (including the projected $800mn or so for the replacement of the two *Spirits of Tasmania*, although where and when that will be done is now in the realms of the unknown), only $300mn of the additional general government infrastructure spending has been added since last year's Budget.

That's not necessarily a Bad Thing, given that there are constraints on the construction sector's capacity to undertake these kind of projects, and the importance of proper project selection and planning.

Also notable is that the Budget for the most part eschews tax cuts as part of its stimulus strategy. The only revenue policy decisions that have added significantly to the deficit in 2020-21 are the previously announced land tax waiver for commercial land owners adversely affected by pandemic-related restrictions, and the payroll tax waiver for employers accessing the JobKeeper program: and the impact of those is largely offset by the revenue from the introduction of the Point of Consumption Wagering Tax (although much of that revenue is being handed over to the racing 'industry').

The Government has extended its payroll tax rebate scheme for apprentices and trainees, and youth employees, to 30th June 2022, which is a well-targeted measure: but, to its credit, it has resisted pressure to extend payroll tax 'relief' more broadly, as (for example) South Australia did in its 2020-21 Budget last Tuesday. As I argued in my September paper on *Options for reform of Tasmania's state tax system*, payroll tax isn't as "bad" a tax as it's usually portrayed: it is actually much more like the GST in its incidence, and no-one calls the GST a 'tax on jobs' or says that small businesses should be exempt from it. And as I also showed there (quite convincingly, if I say so myself!), Tasmania's very generous payroll tax exemptions for small business have done next to nothing to create jobs: almost all the private sector employment growth in Tasmania over the past five years (and more than all of it over the past decade) has been at businesses which actually have to pay payroll tax. So kudos to the Government for not falling for that one.

The outlook for Tasmania's economy

The Premier has a number of times argued that because Tasmania's economy was doing better than the national average heading into the current recession (which is undoubtedly true), it will therefore do better coming out of it too (which I don't think is necessarily the case, and which certainly isn't supported by my reading of the history of the last three recessions over the past four decades).

What's interesting is that Tasmania's Treasury also seems to have its doubts about its Minister's assertion. In this year's Budget Papers, Treasury forecasts that Tasmania's economy (as measured by real gross state product) will contract by a further 1½% this financial year, after an estimated ½% decline this year (we get the ABS estimates next Friday, 20th November), but then grow by 3¾% in 2021-22.

They're probably reasonable numbers, especially if we continue successfully to keep the virus at bay until a vaccine arrives; we continue to attract immigrants from interstate at the rate we had been doing in the years immediately before the onset of the pandemic (which we should be able to do given the damage Victoria has done to itself as a destination for interstate migration); and assuming overseas migration resumes in 2022-23 (and that we get a similar share of it as we were getting in the years leading up to the onset of the pandemic).

But State Treasury's forecast for Tasmania's real GSP growth rate in 2021-22 is a full percentage point below the Commonwealth Treasury's Federal Budget forecast of 4¾% growth in the national economy that year.

Tasmania's Treasury is also more pessimistic on the outlook for unemployment here than its federal counterpart is for the national labour market. In today's Budget Papers State Treasury says Tasmania's unemployment rate will average 8½% in 2020-21, and 8¼% in 2021-22, falling to 7¾% in June 2022 (cf. 7.6% in September, the latest available figure). By contrast, Federal Treasury expects the national unemployment rate to be down to 6½% by June 2022.

I don't have any serious quibble with any of these forecasts. But that's in part because they *don't* suggest that Tasmania's economy will recover faster than that of the rest of Australia.

One thing I would give State Treasury a 'serve' for is for not providing economics forecasts for the 2022-23 and 2023-24 financial years, supposedly because of all the 'uncertainty' that there is around at the moment.

As a number of people, including the scientist Neils Bohr and the New York Yankees' coach Yogi Berra are supposed to have said, "forecasting is difficult: especially when it's about the future".

And yes, there is a lot of uncertainty around at the moment. But (and I say this as someone who has done a fair bit of forecasting, some of which have turned out to be wide of the mark, myself), that's not an excuse for not forecasting!

Treasury obviously *do* have economic forecasts for 2022-23 and 2023-24: otherwise they wouldn't have been able to make projections for all of the other numbers that permeate the Budget Papers. So why not share them with the rest of us?

There is, surely, no more uncertainty around Tasmania's economic outlook than there is about South Australia's or the Northern Territory's: yet both of their Budget Papers, published on Tuesday, have a full set of economic forecasts out to 2023-24 – see for example page 99 of South Australia's Budget Paper No 3 or page 3 of the Northern Territory's Budget Paper on the NT economy (and bear in mind the NT Treasury probably has fewer resources than Tasmania's). No State or Territory matches Western Australia for the forecast detail which it provides (see page 11 of their most recent Budget Paper No 3 presented two days after the Federal Budget) – nor does the Commonwealth.

But especially given that no jurisdiction provided more detail about the state of its budget during the pandemic than Tasmania (for which the Government gives itself a little pat on the back on page 2 of Budget Paper No 1), keeping their economic forecasts for the last two years of the Forward Estimates period a 'state secret' is a bit of a 'cop-out', to say the least.

A couple of risks

There are more than the usual number of risks around the numbers in this Budget, not least because of the uncertainties referred to in the previous section – which in the context of this section is not intended as a criticism.

But there are two in particular that are worth highlighting.

One is that the prospective return to 'operating surplus' in 2022-23 and 2023-24 depends not only on the (secret) forecasts for the Tasmanian economy being borne out, and the other assumptions (regarding the virus, the availability of a vaccine, the opening of borders etc) turning out to be broadly correct – but also on very tight control of the spending side of the Budget from next year onwards.

A lot of the 'bump' in spending in 2019-20 and 2020-21 is inherently temporary, and provided we don't get another outbreak of the virus will fall away as temporary support programs expire.

But today's Forward Estimates imply that government spending will fall by 0.2% in nominal terms in 2022-23, and rise by 'only' 3.4% in 2023-24. The Government has something of a 'track record' of over-promising and under-delivering when it comes to longer-range spending projections, so one is entitled to regard these forecasts with a quizzical eye. Of course, if there is another serious outbreak, or if the economy doesn't recover, then the goal of returning to surplus would need to be put aside anyway.

(It also bears repeating that, even assuming that all the forward estimates turn out to be correct, the small surpluses projected for 2022-23 and 2023-24 are entirely propped up by receipts of capital grants from the Commonwealth, without which the 'operating balance' would be in deficit by close to $500mn in each of those years.

The second risk worth highlighting is the one mentioned in passing on page 17 of Budget Paper No 1, namely that the 'deal' under which Tasmania's share of the revenue from the GST as the distribution methodology shifts from "equalization to the fiscally strongest state" to "equalization to the stronger of NSW or Victoria" is guaranteed to be no less than it would have been under the previous arrangements (which were overturned in order to appease Western Australia) expires at the end of the 2026-27 financial year.

After that, Tasmania's share of revenue from the GST is subject to (potentially significant) downside risk, as a result of factors over which we have no influence or control (including things like the price of iron ore, which is universally expected to be significantly lower in the second half of this decade than it is now – and which would then result in WA's share of GST revenues rising significantly, and thus that of other states, including Tasmania, falling).

That's why, as I argued in my tax reform options paper in September, we ought to be talking about possible reforms to our system of state taxation between now and the state election due in March 2022.

We are more exposed to shortfalls in revenue from the GST than any other jurisdiction except the Northern Territory.

I had no expectation that there would be any serious effort at reform of Tasmania's tax system in this Budget, not least because the Government doesn't have an electoral mandate for tax reform, not having sought one at the last election: and I totally 'get' that tax reform is something that not only can't, but shouldn't, be done without having told the electorate what you plan to do, and persuaded them that it should be done. I was however disappointed, but not surprised, that the reaction to my paper, particularly from the Government, was exactly where, on the spectrum between patronizing and contemptuous, that experience had taught me to anticipate it would be. It would be nice to think we could expect something better, from every political party, over the next 16 months.

A concluding note of thanks

I do want to thank the Premier and Treasurer, and his Chief of Staff, for making the Budget Papers available to me – under the same conditions as apply to those who get into the Budget 'lock-up' (and which I have of course scrupulously observed) – ahead of the presentation of the Budget Speech. Had they not been willing to do so, you'd be reading this no earlier than (say) 9pm this evening, rather than (at the earliest), 5:30pm.

In the grand scheme of things, it's no "biggie", but I do nonetheless appreciate it.

Saul Eslake
12th November 2020