SAUL ESLAKE

CORINNA ECONOMIC ADVISORY



## The 2021-22 Tasmanian State Budget

The 2021-22 State Budget is a big-spending affair – the biggest, in fact, of the eight which Peter Gutwein has presented since becoming Treasurer in 2014, if you discount the Covid-related in last year's budget.

It applies 'windfall gains' of more than $2 billion accruing from upward revisions to forecasts of Tasmania's share of revenue from the GST and of state taxation revenue, together with 'savings' from slippages in previously forecast infrastructure spending, and adds over $500bn to the forecast 'fiscal deficits' over the next four years, in order to fund some $2½ billion in new spending over the next four years (of which a little over $1½ billion is to fulfil the Government's election commitments) and around $85 million in tax relief (most of it reductions in land tax).

As a result, although the Government's 'operating' deficit (the difference between revenue and 'operating' expenses) in the 2020-21 financial year turned out to be some $707 million less than had been forecast in the 20201-21 Budget, the 'operating' deficits for the three years between 2021-22 and 2023-24 are now forecast to be, in total, almost $500 million more than had been forecast in last year's Budget (and, for that matter, over $930 million more than projected in the Pre-Election Financial Outlook Report released in late April).

Likewise, though the 'fiscal balance' (which includes infrastructure spending) turned out to be almost $1.2 billion less in 2020-21 than had been foreshadowed in last year's Budget, the 'fiscal deficits' for the next three years will be around $600 million more than projected in last year's Budget (and almost $730 million more than projected in the PEFO Report).

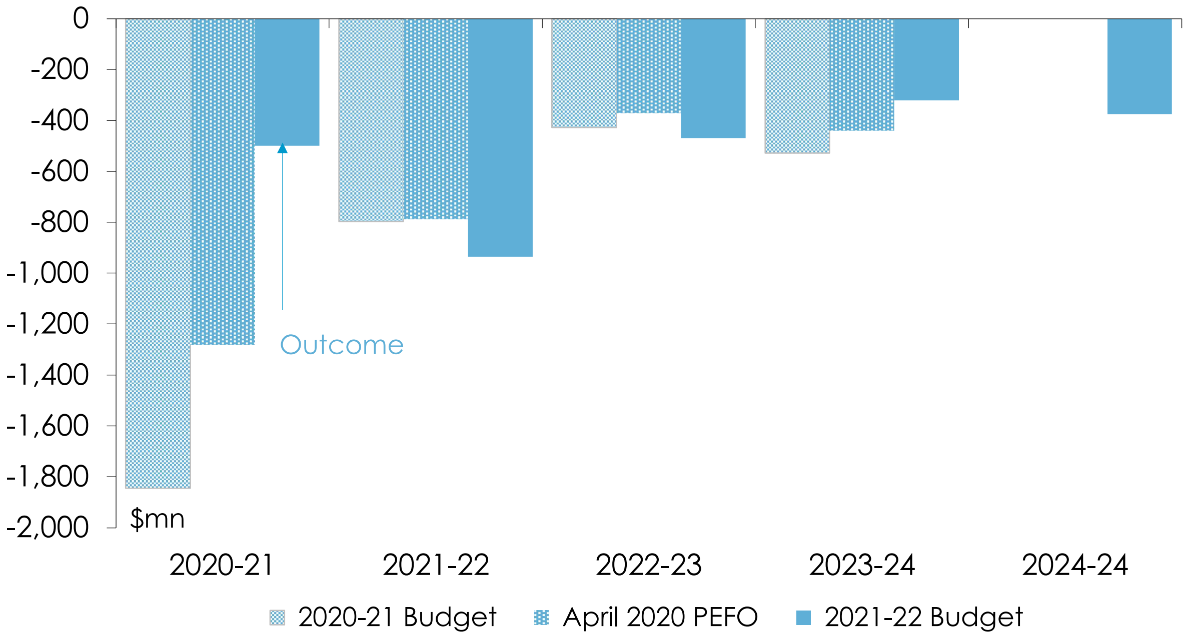
And the overall cash deficit (which is what drives net debt) turned out to be $1.3bn less in 2020-21 than had been projected in last year's Budget – but the cash deficits for 2021-22 and 2022-23 will be larger than those forecast in last year's Budget, or in April's PEFO (though the 2023-24 deficit will be smaller) (Chart 1).

Does this matter? Well, perhaps not.

Largely because last financial year's deficit was so much smaller than forecast in last year's Budget, the Government can afford to run bigger deficits than it had previously envisaged, and still end up with less debt than it had previously forecast – just over $3 billion in June 2024, compared with a forecast of $4.4 billion for the same point in time in last year's Budget (and $3.7 billion in PEFO), and just under $3½ billion as at June 2025 (Chart 2).

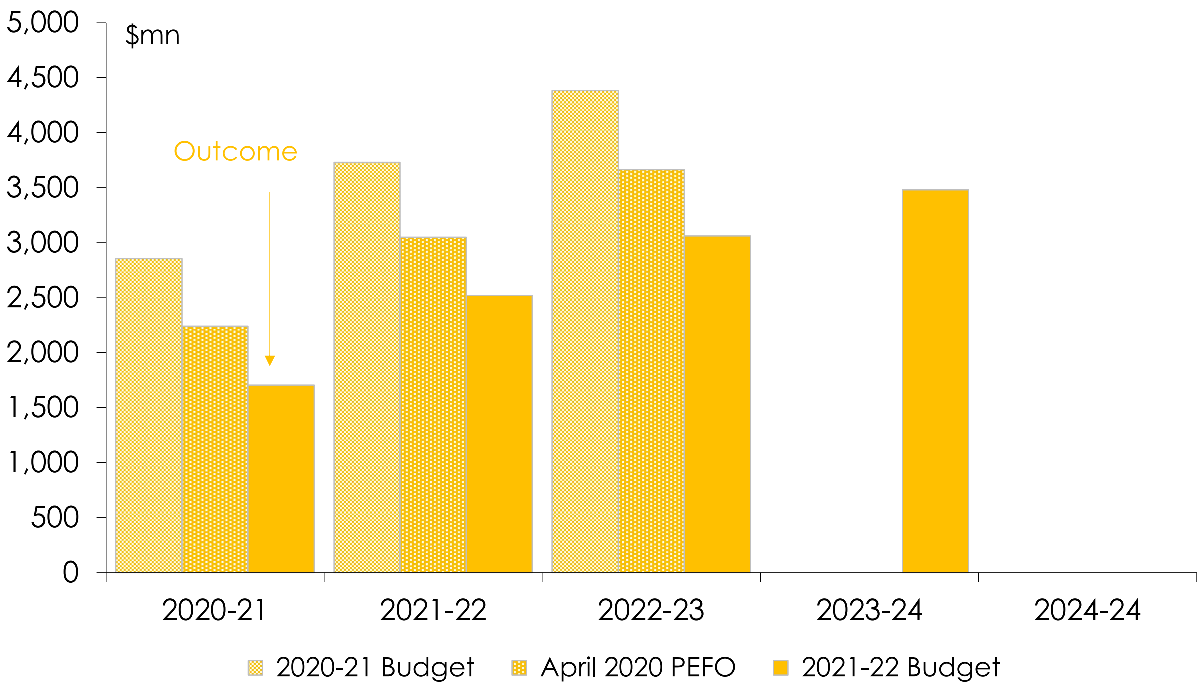
Relative to the size of Tasmania's economy, that's smaller than for any other state or territory except Western Australia (which is yet to present its 2021-22 Budget) – although if you add in the debt of Tasmania's GBEs, the total is larger as a percentage of gross state product than for not only WA but also (by a small margin) New South Wales and Queensland (Chart 3).

**Chart 1: Successive projections of Tasmanian general government sector cash balance**



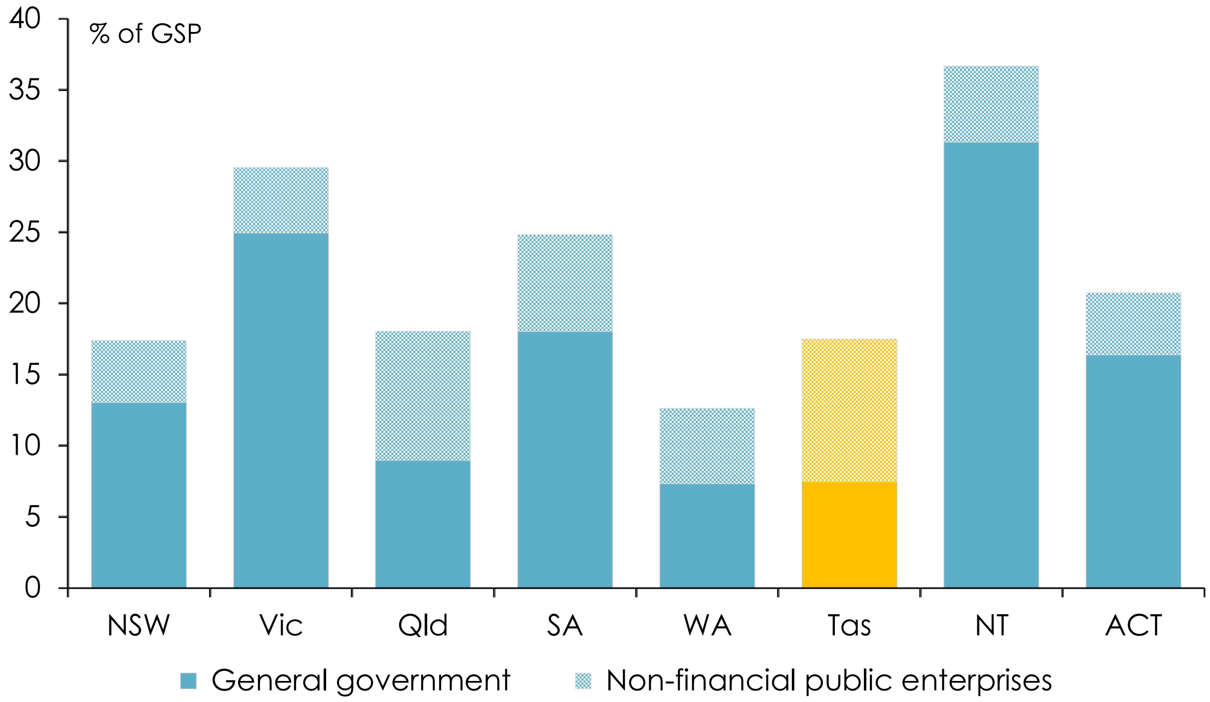

*Sources:* Tasmanian Government Budget Paper No. 1, *The Budget*, 2020-21 and 2021-22, and *Pre-Election Financial Outlook*, Table AI.3

**Chart 2: Successive projections of Tasmanian general government sector net debt**




*Sources:* Tasmanian Government Budget Paper No. 1, *The Budget*, 2020-21 and 2021-22, and *Pre-Election Financial Outlook*, Table AI.2.

**Chart 3: Projected net debt, states and territories, as at 30th June 2024**




*Sources:* State and Territory 2021-22 Budget Papers, except for Western Australia, March 2021 *Pre-Election Financial Projections Statement*, and ACT, 2020-21 Budget Papers (published in February 2021); Corinna Economic Advisory.

And if you also add Tasmania's unfunded public sector superannuation liability (which is far and away the largest of any state or territory, relative to the size of its economy) then Tasmania's total net financial liabilities are larger than those of any except the Northern Territory.

But at today's interest rates, and those likely to be prevailing over the next three or four years, those liabilities can be reasonably comfortably serviced. Tasmania will be devoting a much smaller proportion of its revenue to interest payments than it did as recently as five years ago, let alone in the 1990s (when at one point more than 10 cents in every dollar of revenue was being absorbed by interest payments).

Ultimately, a more important question is whether the money that's proposed to be spent is money that's *well* spent: and presumably, based on the results of the recent State elections, the Tasmanian public thinks it is.

Another important question is whether the picture would look quite so comfortable if things don't turn out as the Treasury has assumed. On that question, more anon – after a more detailed look at the Budget.

**The Budget in more detail**

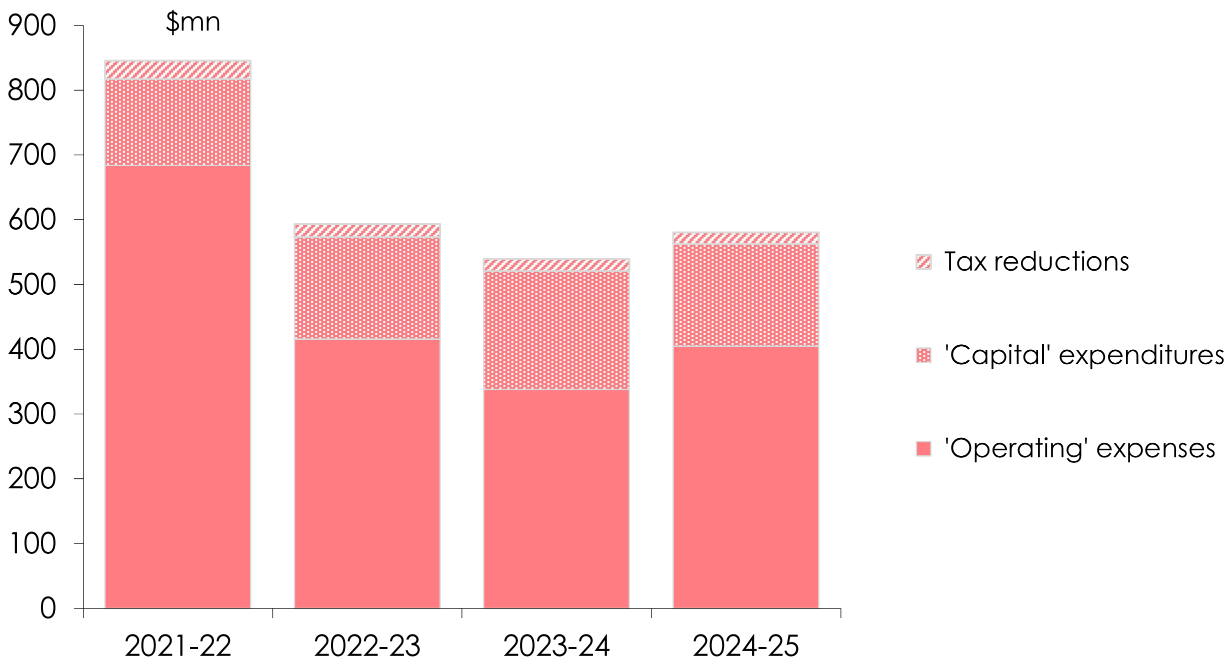
The 2021-22 State Budget funds new '*operating*' (roughly speaking, 'recurrent') expenses totalling $1,842 million over the four years 2021-22 through 2024-25 (see Chart 4).

This comes on top of the decisions taken in last year's Budget which added almost $2,100 million to 'operaating' expenses over the four years to 2023-24 (of which $620 million were directly related to Covid-19 response and recovery measures).

Of the new 'operating' expenses funded in this year's Budget, $980 million is to fulfil the Government's spending commitments from the last election (of which the largest slice, $315 million, is in health, and the next-largest individual slice is $54 million for TAFE); and $863 million is in other spending (of which $365 million is directed towards initiatives in health).

In addition, the Budget provides for reductions in state taxation revenue totalling $83 million over the four years to 2024-25, of which $56 million is for adjustments to land tax thresholds, and $14 million is to allow for motor vehicle registration payments to be made quarterly (both of which were election commitments).

**Chart 4: Contribution of 'policy decisions' to changes in projections of the 'fiscal balance' between the 2020-21 and 2021-22 Budgets**



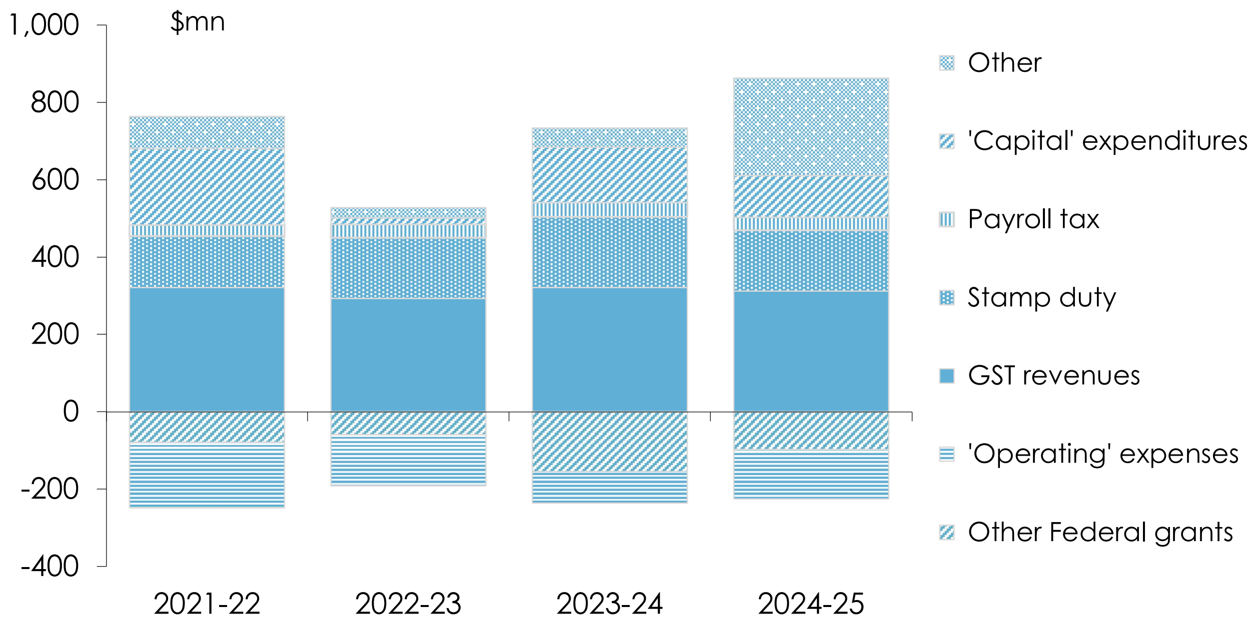

*Note:* In this chart positive numbers detract from the 'fiscal balance'. 'Capital' expenditures are purchases of non-financial assets. *Source:* Tasmanian Government Budget Paper No. 1, *The Budget*, 2021-22, Tables 4.4 and 4.5; Corinna Economic Advisory calculations.

These measures have been funded largely from 'windfall gains' totalling some $2,100 million over the four years to 2024-25 arising from, in particular:

- upward revisions to the projections of revenue from Tasmania's share of revenue from the GST totalling around $1,250 million over the four years to 2024-25 (assuming that the upward revision to 2024-25, which isn't published, is similar to the average for the three previous years), which in turn result from upward revisions made by the Commonwealth Government to its previous forecasts of total GST collections, and from the increase in Tasmania's share of GST revenues as recommended in the most recent review of GST relativities by the Commonwealth Grants Commission; and
- upward revisions to previous forecasts of state taxation revenue totalling around $850 million over the four years to 2024-25 (of which around $630 million is from stamp duty on land transfers, and $135 million from payroll tax.

These 'windfall gains' were partly offset by downward revisions to forecasts of 'specific purpose' payments from the Commonwealth totalling around $400 million over the four years to 2024-25, and to forecasts of revenue from GBEs (mainly Hydro Tasmania) totalling a little over $100 million); and 'over-runs' on 'operating expenses' totalling about $500 million over the forward estimates period (Chart 5).

**Chart 5: Contribution of 'parameter variations' to changes in projections of the 'fiscal balance' between the 2020-21 and 2021-22 Budgets**




*Note:* 'Parameter variations' are changes in the fiscal balance which result from changes in economic and other assumptions or influences, as distinct from 'policy decisions' by the Government. In this chart positive numbers improve the 'fiscal balance' and negative numbers detract from it. 'Capital' expenditures are purchases of non-financial assets. *Source:* Tasmanian Government Budget Paper No. 1, *The Budget*, 2021-22, Tables 4.4 and 4.5; Corinna Economic Advisory calculations.

Because the new spending and revenue decisions exceeded the net total of these 'windfall gains' (what are called 'parameter variations' in the Budget Papers), the 'net operating balance' will be in total some $360 million worse than had been foreseen at the time of last year's Budget.

In particular the 'operating deficit' for 2021-22 is now expected to be $690 million – compared with the $282 million forecast in last year's Budget, and $225 million in April's PEFO Report.

The 'net operating balance' is however still forecast to return to a surplus of $39 million in 2023-24 (though that's less than the $230 million projected in the April PEFO) and to increase to $127 million in 2024-25.

Note, however, that these 'operating surpluses' include one-off capital grants from the Commonwealth, which are included in 'operating revenue' even though they are intended for spending on capital programs. Excluding these, the 'underlying' operating balance is projected to remain in deficit throughout the Forward Estimates period, declining from $1,041 million this financial year to a deficit of $315 million in 2024-25.

In addition to the 'operating' expense commitments mentioned above, the Budget also funds increases in 'purchases of non-financial assets' (roughly speaking, infrastructure and other capital spending) totalling $679 million over the four years to 2024-25, of which $589 million is to meet the Government's election commitments.

This additional 'capital' spending is funded in part by favourable 'parameter variations' to the forecasts for 'purchases of non-financial assets' in last year's Budget totalling around $465 million over the four years to 2024-25 – which appear (although it's hard to be sure) to represent (conscious or otherwise) shortfalls in spending on infrastructure programs comapred with what had been envisaged in last year's Budget – with the rest being funded by a larger 'fiscal' deficit than previously projected.

Bringing these two parts together, the Budget is funding additional (recurrent and capital) spending totalling around $2.5 billion over the four years to 2024-25, of which around $1.65 billion (or two-thirds) is in fulfilment of election commitments, and the remainder is for another initiatives announced either before the election (for example in the Premier's 'State of the State' address) or after it.

Had the Government not made any of the 'policy decisions' funded in this Budget – in other words, had it allowed *all* of the 'windfall gains' noted above to have 'gone through' to the 'bottom line', its net debt would likely have risen from $459 million at 30th June this year (which was a lot less than the $1,855 million projected in last year's Budget, or even the $1,261 million projected four months ago in PEFO) to a little under $900 million by 30th June 2025.

Of course, *that* was *never* going to happen. No government, state or federal, Liberal or Labor, would let the equivalent of almost one-third of a year's revenue drop into their lap and not spend most of it, or give it away in tax cuts, or some combination of the two.

And this is a Government which since coming to office has set great store by keeping its promises (understandably enough, given what typically happens to governments which don't keep their promises, or do things which they've promised *not* to do). So, having made a lot of promises during the recent election campaign, the Government was never not going to deliver on them.

Instead, net debt will rise to a projected $3,479 million by 30th June 2025 – although that's still less than the $4,381 milllion which last year's Budget projected for 30th June 2024.

**The view on the economy**

The Budget Papers present an optimistic, but not unrealistic, view on the Tasmanian economy. And at least this year State Treasury have presented a picture of the Tasmanian economy for the full four years of the Forward Estimates period – unlike last year when, alone among Commonwealth and State Treasuries, they declined to do so.

Treasury expects Tasmania's economy to grow by 4% in 2021-22 – which would represent the fastest growth since 2007-08 (the year before the onset of the global financial crisis).

That's not an unreasonable forecast, given that the Commonwealth Treasury expects the Australian economy to grow by 4¼% this financial year (or at least, it did at the time of May's Federal Budget – it might have revised that down a bit because of the lockdowns on the mainland, but Tasmania hasn't had any more lockdowns as yet, and fingers crossed).

Growth is then expected to fall back to 2% in 2022-23, and then (by assumption) to continue at 2¼% per annum in 2023-24 and 2024-25.

The forecast assumes that "there are no extended or sustained State border restrictions that materially impact the Tasmanian economy over the forecast period" (they could hardly do otherwise). It expects that growth in 2020-21 will be driven largely by household consumption, dwelling investment and government spending – with business investment, perhaps surprisingly, expected to decline in both 2021-22 and 2022-23.

Services exports are expected to remain weak in the current financial year, but to pick up in 2022-23 "reflecting the expected return of international tourists and increased international students" following the assumed re-opening of Australia's international borders from mid-2022. (Treasury appears not to have given much thought to the possibility that Chinese tourists and students might *not* return to Australia after our borders re-open, given the deterioration in the bilateral political relationship between Australia and China since the borders were closed in March last year).

Reflecting the stronger economic growth forecast for this financial year, Treasury expects employment to increase by 2%, on average, in 2021-22, which again seems quite plausible.

However Treasury appears to expect virtually all of the new jobs to go to new entrants into the labour force (whether from within Tasmania, or from interstate or overseas), with the participation rate forecast to rise marginally to 61½% (¼ pc point above the 2020-21 average), and the unemployment rate to stay at 5¼% - that's ¾ of a percentage point above the June and July figures - throughout the Forward Estimates period. We could, perhaps, do better than that.

While no-one could accuse the State Treasury of excessive optimism in any of these numbers, it's worth noting that if their forecasts turn out to be correct, and the corresponding Federal Treasury forecasts for the national economy likewise turn out to be correct, then Tasmania's material living standards (as proxied, however imperfectly, by per capita gross state product) will not have changed relative to those relative to the rest of Australia., They will still be just over 20% below the national average – a little bit better than at the trough of the recession which Tasmania had a decade ago, when they were more than 23% below the national average, but worse than they were (by this metric) during the 1980s and 1990s.

Again, we should – in my opinion, anyway – be aiming for better than that. But we won't get there without a more ambitious reform agenda than this Government took to the last election (or, to be fair, than the Opposition did either).

**A brief comparison with other states**

With every other jurisdiction except Western Australia and the ACT having now brought down their 2021-22 budgets, it's possible to make some meaningful comparisons with other states and territories. And in most respects, Tasmania compares reasonably favourably.

- Tasmania's 'general government' (that is, excluding GBEs) *'net operating deficit'* will be larger, at 1.9% of gross state product (GSP) than that of any other jurisdiction except Victoria (2.3%) in 2021-22 (and it will be the only state or territory, apart from NSW, to be running a larger 'operating' deficit in 2021-22 than in 2020-21) – but, on average over the four years to 2024-25, Tasmania's 'operating deficit' will be slightly smaller (as a percentage of GSP) than the national average;
- Tasmania's general government *cash deficit* is expected to average just under 1½% of GSP over the four years to 2024-25, which is in line with Queensland but less than that envisaged for any of the other states which have thus far presented their 2021-22 Budgets, or the Northern Territory (Western Australia is the only jurisdiction projecting cash surpluses over the next four years, based on projections published before its state election in March, notwithstanding their continuous whining about their share of GST revenues);
- Although Tasmania's general government *net debt* is projected to increase (in dollar terms) by more than 550% over the next four years, it will nonetheless remain smaller as a proportion of GSP than that of any other state or territory except (based on earlier estimates) Western Australia (see Chart 3 on page 3 above);

- As a result, and despite a significant increase in prospect over the next four years, *net interest expense* will absorb an average of less than 1% of Tasmania's 'general government' revenues over the next four years, a smaller proportion than for any other state or territory except Queensland (which is a net recipient of interest income because of its high level of financial assets as a result of having long fully-funded its public sector superannuation schemes);
- When Tasmania's unfunded superannuation liabilty is factored in – and despite a significant reduction in that liabilty in this year's Budget as a result of assuming a higher 'discount rate' applied to future pension obligations than last year, those liabilities are still equivalent to well over 25% of GSP, more than four times the average for all states and territories – Tasmania's balance sheet position doesn't look quite so good, with *net financial liabilties* exceeding 170% of revenues, a higher figure than for any other jurisdiction except Victoria and the Northern Territory;
- Likewise when Tasmania's (relatively large) GBEs are included in the picture, Tasmania's total *non-financial public sector net debt* seems likely to top 18% of GSP by 2024-25, which would be higher than WA, NSW or Queensland; and if unfunded superannuation is included as well, then net financial liabilities of the Tasmanian non-financial public sector as a whole are likely to be higher relative to GSP (and to total revenues, which is an important metric for rating agencies) than for any other jurisdiction except the NT.

**Some risks**

A recurring theme in my commentaries about Tasmania's public finances in recent years has been our larger-than-average exposure to factors completely beyond our control – in particular, to fluctuations in the revenue we get from our share of the GST.

More often than not since the present Government came to office in 2014 – and especially in the current financial year – those fluctuations have worked to Tasmania's advantage.

That is, the GST 'pie' has turned out to be larger than initially expected; and/or our 'slice' of that pie has turned out to be bigger than originally anticipated.

But we can't assume it will always turn out that way.

In particular, there must be a non-trivial prospect that the national GST 'pie' will turn out to be smaller in the current financial year than predicted in the May Federal Budget, and hence in this week's State Budget, as a result of the recurring lockdowns in mainland states, especially New South Wales.

And it could also turn out that, whenever Australians are eventually "allowed out" of the country, they will be in something of a hurry to spend the more than $50 billlion per annum which they had been spending overseas before March last year, which they have since last March been spending at home, on things which are mostly subject to GST. That would also result in a downward revision to forecasts of GST revenues.

SAUL ESLAKE

CORINNA ECONOMIC ADVISORY



The Federal Parliamentary Budget Office warned last September that GST revenue is likely to continue to decline as a share of GDP over the long term, something which would affect Tasmania more adversely than any other state or territory except the Northern Territory.

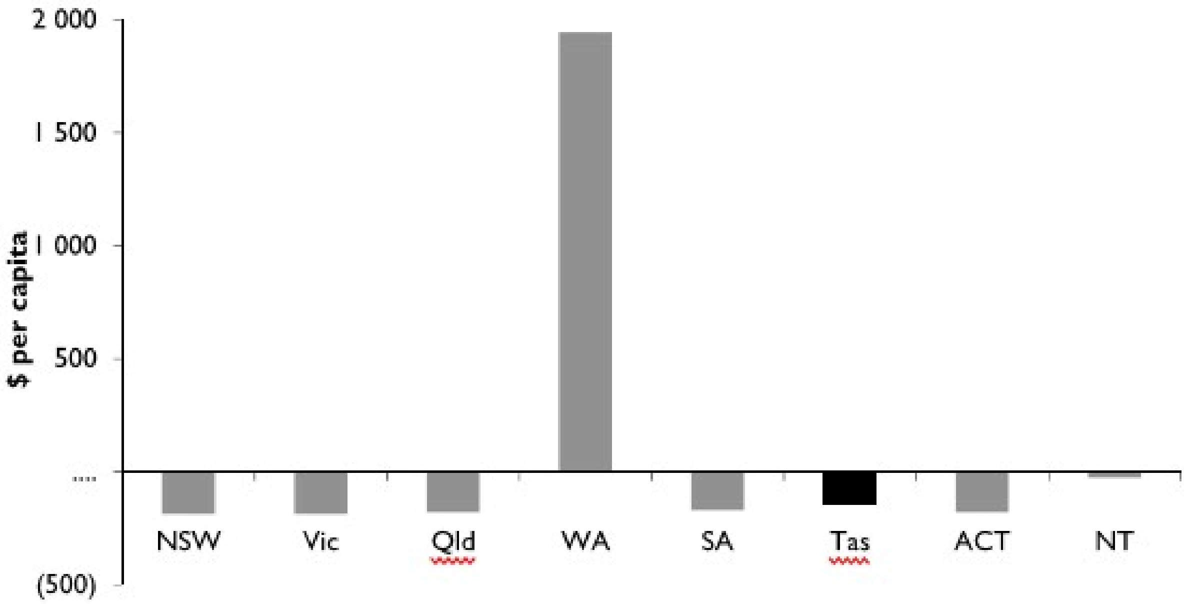
On top of that, Tasmania potentially faces a huge hit when the 'transitional guarantee' that the Commonwealth Government is providing as part of its 'corrupt bargain' with Western Australia (which it imposed on the other states and territories three years ago) expires after 2026-27.

From then on, Tasmania, and the other states and territories, will wear the costs of appeasing Western Australia's insistence on keeping the bulkof the windfall gains it reaps from the good fortune of having so much iron ore under part of its surface, and China's willingness to pay so much for so much of it.

The Budget Papers note that this 'transitional guarantee' (under which the Commonwealth bears the cost of giving WA a larger share of the GST than it would otherwise have received, but for this 'corrupt bargain') is worth $112 million to Tasmania in 2023-24 and 2024-25. It also notes that Tasmania stands to lose $83 million, or $147 per head, in 2027-28, as part of the process by which Western Australia stands to gain $5.6 billion, or $1,945 per head (Chart 6).

And it rightly notes that this loss of GST revenue "could signficantly impact Tasmania's ability to provide essential services, such as health, education and emergency services".

**Chart 6: Estimated change in GST revenue per capita in 2027-28 after the Federal Government's 'no-worse-off' transitional guarantee expires**




*Source:* Tasmanian Government Budget Paper No. 1, *The Budget*, 2021-22, page 74.

But Tasmania has very little 'purchase' with the Federal Government, especially by comparison with Western Australia, when it comes to challenging the 'corrupt bargain': and it has less capacity to absorb these prospective losses than other states and territories, with the exception of the Northern Territory.

That's why Tasmania should be actively considering reforms to its own state taxation system, which I've previously argued is one of the most inefficient and least equitable of any in Australia.

More broadly, reform of Tasmania's state taxation system ought to be an integral part of ensuring the sustainability of Tasmania's overall fiscal position, which State Treasury argued in its Fiscal Sustainability Report published in June required "corrective action" in order to be "sustainable", and that fiscal sustainability could *not* be attained solely by relying on economic growth, or by any other "single solution" (such as constraining health expenditure".

Unfortunately, the present Government – unlike its Liberal counterpart in New South Wales – appears to have no appetite for anything that could be meaningfully described as 'tax reform. And nor does the Opposition.

Which is such a pity.

If governments can't bring themselves to contemplate reform when, as the Premier said in his Budget Speech, "our economy is strong … and our businesses and our people are confident"; and when, as he went on, "we are the state of the extraordinary, where our unique is our advantage", when on earth are we going to do it?

Saul Eslake
27th August 2021
Corinna Economic Advisory