



State Government fiscal policy: A TasCOSS discussion paper

Tasmanian Council of Social Service
Social Policy and Research Team
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Disclaimer:

This is a discussion paper prepared by TasCOSS policy staff to encourage debate and discussion among TasCOSS members and constituent organisations about issues concerning Tasmanian State financial policies.

It does not represent current TasCOSS policy positions and should not be seen as representative of TasCOSS or its members.

Every effort has been made to accurately represent individuals and organisations referred to in this document. If you believe there has been a misrepresentation, please contact Kath McLean, Acting Manager, Social Policy and Research at TasCOSS – by e-mail kath@tascoss.org.au or by telephone (03) 6231 0755.

Contents

1. Introduction.....	4
2. A summary of Tasmania’s current fiscal position.....	8
3. Commonwealth revenue to Tasmania.....	11
4. State taxes and other revenue sources.....	14
5. Government borrowing.....	17
6. Privatisation of Government assets.....	20
7. Public-Private Partnerships.....	25
8. Conclusion – Where to now?.....	28

1. Introduction

The Tasmanian Council of Social Service (TasCOSS) is the peak industry body for the non-government community services industry in Tasmania. TasCOSS membership comprises organisations and individuals engaged in the provision of services to low income, vulnerable and disadvantaged Tasmanians. TasCOSS represents the interests of its members and their clients to government, regulators, the public, the private sector and the media.

TasCOSS has an active policy development process based on consultation with our members and other stakeholders. Through such consultation and deliberation with its policy staff, its peak policy development forum, the Tasmanian Social Policy Council (TSPC), and its Board of Management, TasCOSS develops and analyses policy and makes policy recommendations to government. We do so in the interests of both the community sector organisations which are our members and the low income and disadvantaged Tasmanians served by our members.

TasCOSS functions within a social justice framework and assesses government policy and practices in relation to the contribution, or otherwise they make to advancing social justice and equity in Tasmania. TasCOSS believes that government fiscal policy must be based on the same progressive and fair principles as social, and other government policy.

Each year, TasCOSS develops, through its consultation and policy development processes, a Budget Priorities Statement in which we identify and recommend a range of social policy initiatives, with costings, that we believe should be funded and implemented in that State Budget cycle. All involve the advancement of social justice and equity in Tasmania, and most require substantial State Government investment.

The question often put to us in response is: “How should government pay for these recommendations?”

We need to be able to answer that question, and this paper is a step in that direction.

The purpose of this paper is to analyse the Tasmanian Government’s current fiscal options in the context not only of social justice and equity, but also of practicality and responsible government. The paper examines the fiscal policy options available to the State Government and identifies a number of policy principles that TasCOSS could advocate in public debate on how the State can fund crucial community services.

The aim is for TasCOSS to produce better policy analysis and recommendations based on clear principles that are in line with our social justice framework. The outcome is intended to be better public policy – fiscal and social – with better outcomes for those most in need, that is, low income and disadvantaged Tasmanians.

Structure of the paper

The paper begins with an overview of Tasmania’s current fiscal position, revenue sources and fiscal policy. It then examines in more detail, and proposes policy principles regarding:

- Commonwealth revenue to Tasmania;
- State taxes and other revenue sources;
- Government borrowing;
- Privatisation of government assets;
- Public-Private Partnerships.

While the paper is not intended to provide a comprehensive study of all these subjects, it does aim to provide sufficient information and discussion to enable readers to make informed decisions about possible fiscal policy principles.

How you can contribute

TasCOSS is seeking feedback from members on the development of TasCOSS policy principles on each of the five fiscal policy issues above.

Your feedback will be considered by TasCOSS staff and used to develop the final agreed principles. The TSPC will then be asked to endorse the principles. Once endorsed, TasCOSS will apply the principles to its policy work, and also promote the principles and related policies to the State Government as responsible, equitable and progressive means to tackle poverty, disadvantage and exclusion in Tasmania.

We are interested in your reaction to the principles (below), and ask you to consider the following questions:

- Do you agree with the policy principles?
- Should TasCOSS adopt an alternative position in relation to any of the issues raised in this paper?
- Do the policy principles reflect TasCOSS' vision for a fair and just Tasmania?
- Do the policy principles advance the interests and encourage positive outcomes for low-income, vulnerable and disadvantaged Tasmanians, their families and communities?
- Can you suggest any further principles that you think TasCOSS should consider adopting?

Your feedback can be provided directly to Kath McLean, Acting Manager, Social Policy and Research at TasCOSS on (03) 6231 0755, or kath@tascoss.org.au.

The policy principles are:

Commonwealth revenue to Tasmania

- Support for genuine bilateral Commonwealth-State funding and policy agreements that deliver positive and equitable outcomes and services.
- The Commonwealth Grants Commission must take into account the special circumstances of Tasmania's ageing and regionalised population in allocating General Purpose Payments in the future to ensure that adequate service levels and necessary infrastructure are maintained.
- Support for the COAG process as a collaborative forum for setting a national policy agenda and for allocating related funding accordingly.

- Tasmania's unusually heavy reliance on Commonwealth grants, and the political nature of many of those grants necessitates the continuation of as many alternate revenue streams for the State as possible.

Government taxes and other revenue streams:

- The State should maintain a diverse range of revenue sources, including progressive State taxes.
- All State taxes should be progressive in nature and involve a fair re-distribution of wealth within the State.
- Flat, universal special-purpose levies or charges should be avoided where possible, and/or only be introduced with a clear mechanism for exemptions and/or concessions based on low income.
- Any proposed new State taxes, levies and/or charges should be subject to a comprehensive assessment of their likely social impact before they are introduced.
- The State Government should increase taxes on gambling industry profits and direct that revenue to policies and programs that aim to prevent problem gambling and that alleviate the harm caused by problem gambling to individuals, families and communities.

Government borrowing:

- The Tasmanian Government should be able to accommodate and service a reasonable level of debt.
- The Tasmanian Government must consider all possible options for financing significant public investment in social infrastructure and services aimed at improving capacity and life chances for low income, vulnerable and disadvantaged Tasmanians and their communities.
- Government borrowing to fund the new Royal Hobart Hospital is acceptable, as is the principle that future generations, who will continue to use the Hospital, also contribute to the costs of this significant and valuable community asset.
- Government borrowing to fund the Hospital development is the preferred option to either entering into a public-private partnership arrangement to build the Hospital, or to using existing DHHS funds and to thereby jeopardise the adequate funding of other services.

Privatisation of government assets:

- Government has a responsibility to review its portfolio of publicly owned assets and it may, at times, be appropriate for the Government to privatise certain assets.
- Any privatisation of Government-owned assets must be contingent on ongoing and effective protection of consumers, and particularly of low income, disadvantaged and vulnerable consumers.
- Any privatisation of public assets must be carried out in as transparent a manner as possible, and the full purchase price and all conditions of sale should be made public.
- A comprehensive, transparent and independent social and economic impact study must be carried out before any major Government asset is privatised. This applies in particular to Government-owned assets that provide essential services, such as government-owned companies, agencies or authorities that provide electricity supply, water, sewerage and drainage, transport, health and education services.

Public-Private Partnerships:

- The Government is responsible for financing and providing both services and infrastructure in Tasmania.
- Any PPP proposal must involve full disclosure of all contract conditions, as well as independent economic and fiscal modeling of the agreement and its impact on both public finances and Tasmanian consumers. This must include comparisons with alternative models of financing, including general government debt.

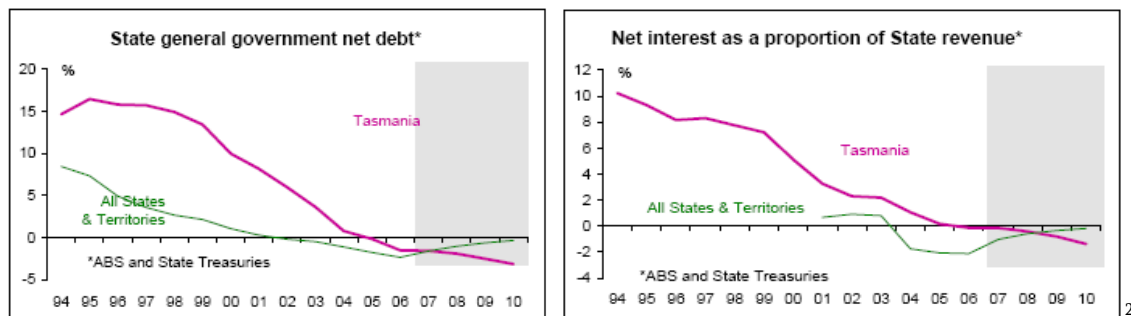
2. A summary of Tasmania's current fiscal position

Achieving a 'net debt free' Tasmania

Since it was first elected in 1998, the current Tasmanian Labor Government has maintained a fiscal strategy aimed at reducing public sector debt and freeing up state revenue to invest in new infrastructure and Government services.

The Tasmanian Government has paid off around \$1.6 billion in public sector debt since 1998¹ and, as detailed in the graph below, left, this has seen the percentage of public sector debt as a percentage of Gross State Product reduce from over 15% in 1998, to a net positive position in 2006-07.

It is important to note that a positive outcome of the Government's debt reduction strategy on its financial performance has been the dramatic change in the interest component of state finances. In 1998, the debt servicing ratio of the Tasmania Government represented 8% of state-based revenue; it has fallen consistently since then and Tasmania now earns more in interest than it spends. The outcome of this strategy is that Tasmania is one of only four states that are net recipients of interest.



It is important to note that net debt refers to the public sector's balance position; it does not mean that the Tasmanian public sector is completely debt-free, but that assets and revenue are greater than the State's debt. The Tasmanian Government continues to carry debt liabilities, including its housing debt to the Commonwealth Government. These figures also do not include the significant debts carried by State-owned Companies (SOCs) and Government Business Enterprises (GBEs), such as Hydro Tasmania and TT-Line, where the debt liability appears on the balance sheets of the individual companies.

Tasmanian Government revenue streams

The Tasmanian Government generates its revenue primarily from five major sources.

1. Commonwealth Government's General Purpose Grants:
Tasmania's share of GST revenue, as determined through the Commonwealth Grants Commission.
2. Commonwealth Government's Specific Purpose Grants:
Including grants to the State to provide specific services and programs, i.e. the CSTDA, CSHA, AHCA, SAAP, etc.

¹ PA Lennon 'Ministerial Statement to Parliament', 15 March 2007.

² Graphs developed by Economics@ANZ.com.au

3. State Tax Revenue:

Includes revenue from state taxes such as Stamp Duty, Land Tax, Payroll Tax, gaming taxes, etc.

4. Sale of Goods and Services:

Revenue derived from the sale of goods and services by State Government agencies.

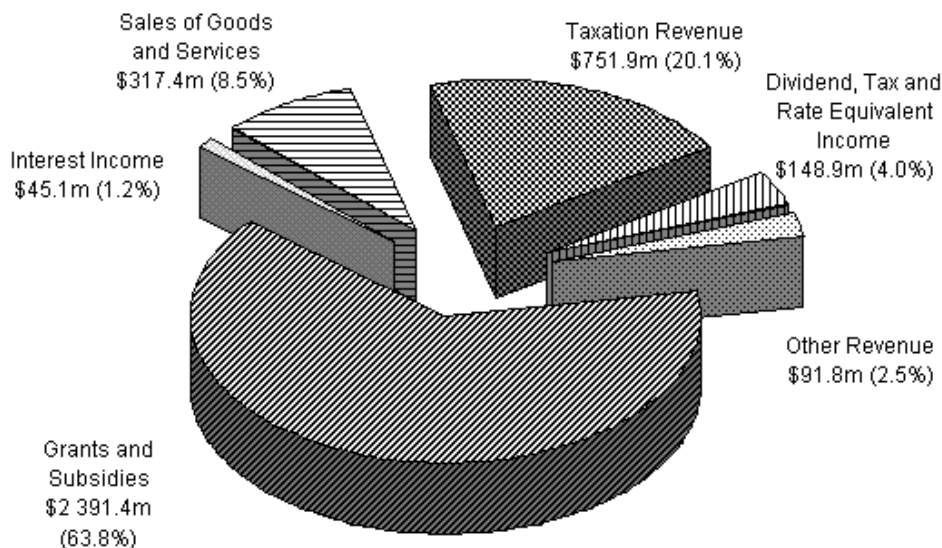
5. Dividends from State-owned Companies, GBEs and investments

Revenue from publicly owned companies such as Aurora Energy, Hydro Tasmania, Tote Tasmania, etc.

Total State income, in its various components as part of the 2006/07 Tasmanian State Budget, is detailed in the following graph. The major sources of revenue – Commonwealth grants and State taxation revenue – are discussed in detail later in this paper.

2007/08 State Budget revenue sources

(from *2007-08 Budget Paper No 1: The Budget*, Chapter 4: 'Revenue and Expense Estimates, 2007-08')



Tasmanian Government's current fiscal strategy 2006-10

Primarily in response to the considerable competing demands on its limited resources, the Tasmanian Government launched its new four-year fiscal strategy as part of 2006/07 State Budget.

The fiscal strategy is essentially the Government's plan to keep track of its spending over the medium term to ensure Tasmania's public finances remain net debt free – a key objective of the current Government's economic agenda since it was first elected in 1998.

This strategy gives the clearest indication of how much money the Government expects to have at its disposal over the period 2006-10.

The fiscal strategy shows the Tasmanian Government's operating balance is expected to return to a net deficit position in 2007-08, and for the following two years, before returning to surplus thereafter. The strategy also forecasts that Government departments will actually run an 'operating deficit' over the next four financial years; in other words, the Government is expected to spend more than it receives in revenue.

This fiscal strategy was announced prior to Premier Paul Lennon's announcement in September 2006 that the Government will proceed with the development of a replacement for the Royal Hobart Hospital.

The cost of the new hospital project – estimated at more than \$500 million – has not yet been factored into the Government's fiscal strategy. Neither the Premier, nor the Treasurer, have yet indicated how they intend to pay for what will be Tasmania's largest ever public infrastructure project. They have, however, reaffirmed their desire to keep the State net debt free.

ANZ Chief Economist Saul Eslake believes the State Government's four-year fiscal strategy was based on ambitious expectations in relation to future economic growth, and that the Government had not factored into its strategy an anticipated State and/or national economic downturn. Any significant economic downturn would have an impact on the Government's revenue streams and therefore its capacity to invest in services and/or infrastructure. The State Government's mid-year financial statement released in February, 2007 confirmed an increase in the Government's expected fiscal deficit for the 2006-07 financial year, and acknowledged that achieving its own four-year fiscal strategy 'will be a challenging task'.

3. Commonwealth revenue to Tasmania

The Commonwealth Government will provide the State's largest single source of income, amounting to 63.8% of the Tasmanian Government's total revenue in the 2007/08 State Budget.³ The Commonwealth Government provides a larger percentage of the Tasmanian Government's income than any other state or territory, apart from the Northern Territory.

As part of the 1999 Intergovernmental Agreement on Reform of Commonwealth-State Financial Relations that introduced the Goods and Service Tax (GST), the Tasmanian Government, along with other states, agreed to review several state taxes as part of a concentration, or narrowing, of its income streams.⁴

Specifically, states and territories made a commitment to review and, if possible, abolish Bank Account Debits Tax and stamp duties on:

1. non-residential conveyances;
2. non quotable marketable securities;
3. leases;
4. mortgages, bonds, debentures and other loan securities;
5. credit arrangements, installment purchase arrangements and rental arrangements;
and
6. cheques, bills of exchange and promissory notes.

With the abolition of the Debits Tax in 2006, Tasmania fulfilled its requirements under this Intergovernmental Agreement. These reforms have made Tasmania the second lowest taxing state or territory in the Commonwealth, behind only Queensland. However, it has also made Tasmania heavily dependent on Commonwealth income sources and this is the cause of some concern about Tasmania's ongoing financial management. It is a strong argument against Tasmania abolishing any more state taxes.

The Commonwealth funds the Tasmanian Government through **General Purpose Payments** and **Specific Purpose Payments**, both of which are volatile and vulnerable to both national and state economic and political pressures.

General Purpose Payments represent Tasmania's share of the national GST pool and will account for an estimated \$1.646 billion of the Tasmanian Government's income in 2007/08.

The amount of this revenue provided to the State is determined through the independent Commonwealth Grants Commission. The Commission is charged with the responsibility of ensuring that 'each state should be given the capacity to provide the average standard of State-type public services.' The Commission recognises that different states have different capacities to generate their own revenue, so it enacts a principle of fiscal equalisation, where lesser resourced states and territories receive a payment disproportionate to their contribution and population.

³ Department of Treasury (Tas) 2007-08 State Budget Paper No 1., Hobart.

⁴ Commonwealth Department of Treasury and Finance Tax Section (1998), 'Not a New Tax, a New Tax System', Canberra.

It is well known that Tasmania receives a significantly disproportionate GST payment in comparison with larger states and a much greater level of national GST revenue than Tasmanians actually contribute through the GST. Tasmania's 'slice of the GST pie' is around 4%, and is determined by the size of the GST pool, which is dependent upon the strength of the national economy. Also relevant to GST dispersal is Tasmania's population growth. If Tasmania experiences a significantly greater rate of population growth than other states in one particular year, its share of the GST increases accordingly; if Tasmania's population growth is slower than other states, its percentage of the pool will fall.

Both these points are worth bearing in mind in the context of Tasmania's ongoing financial performance. What does it mean, for instance, that the Tasmanian Government's single largest source of revenue is directly dependent on the relative performance of the national economy, through the amount of GST generated through Australians buying and selling goods and services?

The experiences of the early 1990s show that the Tasmanian economy is highly susceptible to national economic downturns. Since the GST was introduced in 1999, Australia and Tasmania have experienced a prolonged period of relative economic prosperity and therefore Tasmania has received positive financial outcomes in relation to General Purpose Grants from the Commonwealth. It is difficult to know what impact any future national economic downturn or recession, and consequent fall in GST receipts would have on Tasmania's revenue.

The other key point on Tasmania's GST payments relates to the Commonwealth Grants Commission's reliance on population size data as a mechanism to determine grant payments to individual states. Tasmania's net migration is expected to be significantly less than other Australian states. In addition to this, Tasmania is expected to experience significant demographic change, with a consequent increasing demand on Government services. The Commonwealth Grants Commission will need to recognise Tasmania's special circumstances with an ageing and regional population to ensure that the State is appropriately funded into the future to provide an adequate level of services for the Tasmanian community.

Specific Purpose Payments to the Tasmanian Government refer to the various agreements entered into by the Commonwealth and State Governments, where the State is funded by the Commonwealth to provide a particular service or program.

Examples of these arrangements include the Commonwealth-State Housing Agreement (CSHA), Supported Accommodation Assistance Program (SAAP), Home and Community Care (HACC), Australian Health Care Agreements and AusLink Road Infrastructure Funding Program.

Specific Purpose Payments are expected to account for \$679.1 million of the Tasmanian Government's total revenue in 2007/08. This is almost equivalent in value to all revenue generated in State taxes, and is therefore a significant source of revenue to the Tasmanian Government.

Coordinated Commonwealth-State policy and funding agreements have become increasingly prevalent since the Hawke Government's 'New Federalism' of the mid-1980s. They are now accepted as a sensible and cooperative method of different levels of government working together on issues of

mutual concern and responsibility, such as health care, with an agreed response. They also encourage consistency of service delivery and policy responses across the nation.

However, these agreements and their associated payments often involve service contracts between the State and Federal government, with the State being funded to take responsibility for the delivery of a service. These agreements generally provide little room for either level of Government to negotiate different funding priorities within these agreements, or to alter previously agreed evaluation and review timeframes.

For a small government like Tasmania with limited resources, it could be argued that such a significant percentage of its revenue being locked into specific grants for service delivery makes it difficult to fund infrastructure and long-term programs. An example of this is the Australian Health Care Agreement, which provided \$180 million to the Tasmanian Government in 2006/07. While this agreement is not linked to specific health services, it does include a strong emphasis on service provision by benchmarking the performance of public hospital services. The Tasmanian Government would therefore be unable to use any of this specific funding for health services, to contribute, for example, to the significant cost of new health infrastructure, including the new Royal Hobart Hospital.

In addition, these agreements are heavily dependent on the political agenda and the policy prioritisation of the Federal Government, which provides the largest funding component in Commonwealth-State funding agreements. Examples of this are the new major agreements regarding water resources, HACC and mental health services in recent years, in contrast to the apparent lack of interest in or commitment to renegotiating, in equal partnership, a new Commonwealth-State Housing Agreement, or a joint response to disability issues.

This can be frustrating for State Governments, which don't appear to have much influence in the process for initiating new bilateral funding agreements with the Commonwealth Government. However, this may change with the renewed emphasis on the Council of Australian Governments (COAG) process and the States' practice of 'caucusing' to jointly influence the COAG agenda, as well as with the formation of the new Council of Australian Federation, of which Tasmania is a full participant.

Commonwealth revenue to Tasmania: Recommended TasCOSS policy principles

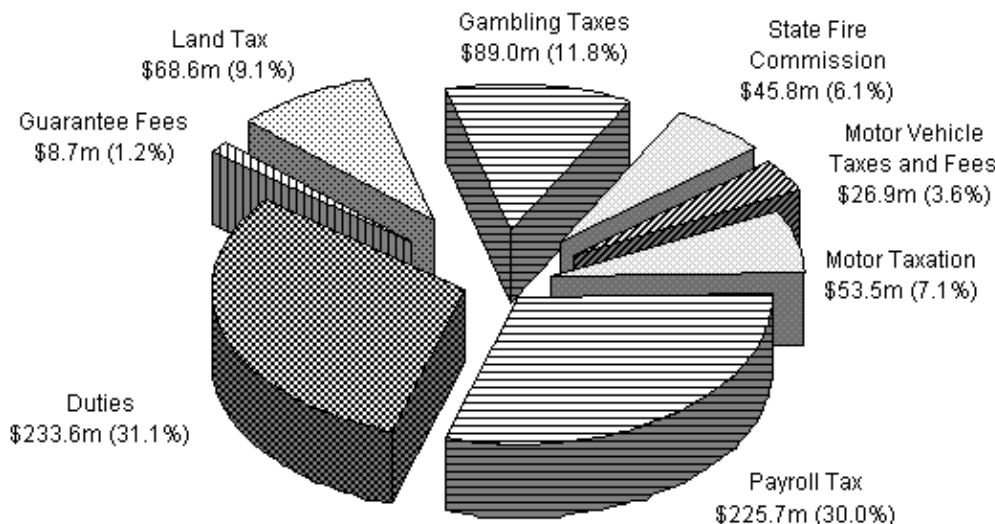
- Support for genuine bilateral Commonwealth-State funding and policy agreements that deliver positive and equitable outcomes and services.
- Support for the COAG process as a collaborative forum for setting a national policy agenda and for allocating funding accordingly.
- The Commonwealth Grants Commission must take into account the special circumstances of Tasmania's ageing and regionalised population in allocating General Purpose Payments in the future to ensure that adequate service levels and necessary infrastructure are maintained.
- Tasmania's unusually heavy reliance on Commonwealth grants, and the political nature of many of those grants necessitates the continuation of as many alternate revenue streams for the State as possible.

4. State taxes and other revenue sources

The Tasmanian Government's capacity to raise revenue through state-based taxes was significantly curtailed with the introduction of the GST in 2000. Since that time, the State's role in generating revenue through taxes remains a contentious point with the Federal Government and with some interest groups, due to the current nature and frameworks in which state taxes are levied.

Tasmanian Government taxation revenue 2007-08

(from *2007-08 Budget Paper No 1: The Budget*, Chapter 4: 'Revenue and Expense Estimates, 2007-08')



The Tasmanian business lobby and the Commonwealth Government continue to argue for the Tasmanian Government to review its revenue streams, particularly in relation to Stamp Duty on property transfers and financial transactions, and Payroll Tax.

The Tasmanian Chamber of Commerce and Industry (TCCI) argues that the existing State taxes and duties are an impediment to economic growth. Citing the current structure of the two major state revenue streams – Payroll Tax and Stamp Duty – as disincentives for the private sector to engage in economic activity and therefore achieve further growth.

The TCCI argues that the Tasmanian Government's foremost economic responsibility is to ensure Tasmania remains economically competitive. Central to this are incentives to attract investment, which include tax structures that encourage investment. Furthermore, the argument holds that the current structure of Payroll Tax (which is paid by large companies with over 100 employees) and Stamp Duty (which is tax on the trading of assets) both make little economic sense, as they disproportionately penalise companies as they grow, either through employing more staff or through buying or selling more assets. Either way, they are both seen as significant disincentives for companies seeking to invest and expand in the Tasmanian economy.

Gambling taxes are the Tasmanian Government's third largest single source of state-based revenue. Community service organisations engaged in the provision of services to Tasmanians with

unsustainable problem gambling habits have expressed concern with the Tasmanian Government's apparent growing financial reliance on gaming taxes. Notwithstanding arguments about government profiting from the gambling industry, there is an argument that calls for higher state taxation of gambling industry profits with the direct allocation of the revenue raised to policies and programs that aim to prevent problem gambling and to address the harm caused by problem gambling. South Australia, for instance, imposes very high taxes on the profits of the gambling industry.

Sustainable Revenue Streams

The Tasmanian Government is the second lowest taxing state in the nation behind Queensland, and it could be argued that any significant cut to Stamp Duty or Payroll Tax would result in a further concentration (or narrowing) of the Government's revenue streams.

As discussed above, there are widely held concerns about the growing dominance of Commonwealth grants in State revenue streams and what this could mean for the Tasmanian Government's capacity to fund services at a time of major national economic downturn or a radical policy shift of the Federal Government. This is certainly a strong argument for Tasmania to maintain significant and growing sources of State revenue. A range of revenue sources ensures a degree of fiscal independence for the Tasmanian Government, and a diverse range of income to the State is vital to maintain economic sustainability. Just as private enterprises are encouraged to diversify their revenue streams in order to ensure viability, this principle also applies to governments.

Increased State Taxes?

While there is strong pressure from parts of the business lobby for a reduction in State taxes, there is little pressure on the State Government to increase its tax revenue, either through an increase in rates of its existing taxes, or by the introduction of new taxes.

The environmental lobby has called for an increase in Government royalties and taxes on the use of the State's natural resources, but there is no evidence of this being seriously considered by Government. Rather, the Tasmanian Government's position seems to involve encouraging further investment and economic growth to increase the return on its existing tax revenue streams. This argument has been used most recently by the Tasmanian Government in relation to the proposed pulp mill development in Northern Tasmania, and the significant economic outcomes expected to flow-on to increased tax revenue to the Tasmanian Government.

However, while the Tasmanian Government has not increased State taxes, it announced, in the 2007-08 State Budget, the introduction of an ambulance service fee (insurable) and a road safety levy to be attached to all motor vehicle registrations. There has also been media speculation about possible moves toward a user-pays system for residential water supply and increases in costs for basic government services, such as drivers' licenses. TasCOSS has obvious concerns about these charges, and in particular how they will affect low income and disadvantaged Tasmanians.

TasCOSS questions any Government policy that involves the introduction of further specific universal charges for basic social and community services and infrastructure as a means to increase Government revenue streams. Our preference is for an extension of the progressive state taxation system.

The reality is that the current progressive structure of most existing State Government taxes provides

a system of wealth transfer between rich and poor. Stamp Duty is indexed to the total cost of assets transferred; Land Tax is indexed to the value of property and Payroll Tax is only paid by large, private companies.

Universal user-pays charges and flat levies, even with concessions to low income earners, cannot guarantee the same level of wealth transfer as the existing tax framework. Furthermore, experience suggests that user-pays charges for services, nearly always have an inequitable financial impact on low income earners, compared to general consumers.

Government taxes and other revenue streams: Recommended TasCOSS policy principles:

- The State should maintain a diverse range of revenue sources, including progressive State taxes.
- All State taxes should be progressive in nature and involve a fair re-distribution of wealth within the State.
- Flat, universal special-purpose levies or charges should be avoided where possible, and/or only be introduced with a clear mechanism for exemptions and/or concessions based on low income.
- Any proposed new State taxes, levies and/or charges should be subject to a comprehensive assessment of their likely social impact before they are introduced.
- The State Government should increase taxes on gambling industry profits and direct that revenue to policies and programs that aim to prevent problem gambling and that alleviate the harm caused by problem gambling to individuals, families and communities.

5. Government borrowing

Government borrowing and a deliberate debt strategy is an option the Tasmanian Government has to finance new public infrastructure and any significant immediate expansion of government services. However, it is an option that has already been rejected by the Tasmanian Government as a method of financing the new Royal Hobart Hospital development. The State Treasurer Michael Aird MLC has clearly stated that it is his preference for the Government to not enter into debt to fund the new hospital.

Tasmanian Public Sector Debt

An ongoing feature of the Tasmanian Government's economic platform has been its aggressive public sector debt reduction strategy. Since it was elected in 1998, the Labor Government has maintained stringent control of public sector finances, maintaining consistent budget surpluses and returning the State to a net debt free position in 2004, a year earlier than had been anticipated. This strategy has been the outcome of an ongoing public sector debt reduction strategy initiated by Michael Field's Labor Government of 1989-92, and continued by successive Labor and Liberal State Governments.

The impact of Tasmania's aggressive debt reduction strategy on its public sector finances has been dramatic. Having been the third most heavily indebted government in Australia in the mid-90s (behind South Australia and the Northern Territory), Tasmania has paid off over \$1.6 billion in State debt since 1998 and is now one of only four states which are net creditors, meaning that the value of general government-owned assets is greater than its liabilities.

Perhaps the most striking illustration of the general improvement in the Tasmanian Government's financial position over the past decade is the Government's debt-servicing requirements. In 1993-94, 10 cents in every dollar received by the Tasmanian Government in state-based taxation revenue was spent on interest payments. This accounted for around \$150 million of state-based revenue lost in servicing state debt each year. In this and last financial years, the Tasmanian Government will be a net recipient of interest.

Does debt reduction mean poor infrastructure?

Tasmania has not been alone in pursuing such an aggressive debt reduction strategy. Many other state and territory governments across Australia have pursued fiscal strategies aimed at reducing their own debt-servicing ratios. Most states have prioritised the repayment of public sector debt over the past two decades and all states have, to varying degrees, embarked on significant rationalisation of their government activities in order to rebalance public sector finances.

Critics of the states' robust pursuit of debt reduction strategies argue that any progress in relation to strengthening their balance sheets has come at the expense of reduced government investment in public infrastructure, and that this has had negative outcomes for the community. State governments that are actively reducing old general government debt are reluctant to then re-enter into new debt to fund new assets or services.

It is worth noting that the NSW Government, which already has one of the highest debt-servicing ratios of any state, recently entered into a further \$6 billion of public sector debt for new public

infrastructure projects, including water and transport infrastructure throughout the state. The Queensland Government has also entered into significant debt in recent years to fund similar infrastructure projects in the rapidly growing south-east corner region of Queensland. In both cases, the respective governments have defended their funding of investments through debt, on the grounds that the projects involve long-term public infrastructure that will benefit future generations and should be paid for accordingly.

The current Tasmanian Government has shown a capacity to fund significant capital investment projects, including the new Risdon Prison and the capital component of the original Affordable Housing Strategy, without sacrificing its objective to reduce public sector debt. At the same time it has managed to keep the State Budget in surplus. However, the new Royal Hobart Hospital development, at an estimated cost of over \$500 million, appears beyond the capacity of the Tasmanian Government's current fiscal strategy.

The now widely held view of government borrowing and public sector debt essentially mirrors the common view of debt in the private sector, that is, that governments should be able to accommodate a certain level of 'good debt' to fund new assets, such as one-off infrastructure projects and capital assets that will benefit current and future generations.

Borrow to fund the new hospital, but what about everything else?

A regular commentator on Tasmania's economic affairs, ANZ Chief Economist Saul Eslake has expressed his strong view that there is no economic reason why the Tasmanian Government should not consider debt as an option to finance the new Royal Hobart Hospital. Furthermore he has said that the Government would not be sacrificing its strong economic credentials by borrowing for a significant infrastructure project that will benefit future generations of Tasmanians.

This is the view that was endorsed at a forum on Government debt hosted by Anglicare Tasmania in early 2007, where the consensus of speakers, and the former Tasmanian Premier, Michael Field who was in the audience, supported debt as a viable option for funding the new hospital project. The argument was put that current Tasmanian taxpayers should not be unfairly burdened with the cost of a project that will equally benefit future generations and by funding the project through partial debt, it ensures that future generations of Tasmanians will contribute to the cost of the asset.

While this is a compelling argument for the Government to borrow funds for the new hospital, further questions arise of whether or not, and to what extent borrowing might be an appropriate funding strategy for broader social investment in Tasmania?

Investment in long-term affordable housing, in strategies to address issues related to demographic change, and in early intervention strategies in children's and family services are areas of public policy that require significant investment to achieve long-term outcomes. It is widely accepted that social policy and spending geared towards strengthening the capacity of low income and disadvantaged individuals and communities can achieve maximum long-term social and economic outcomes for the broader community, in improved economic productivity and in reduced demand for expensive social, health and justice services.

In order to justify the argument for borrowing on the grounds outlined above, comprehensive modeling would need to be carried out that could demonstrate the positive long-term social and economic outcomes that would result from such investment. It would need to demonstrate that social investment would result in better outcomes for generations of potentially vulnerable Tasmanians through the achievement of improved educational, employment and health outcomes, and would therefore result in savings in unnecessary social, health and justice system spending. Modeling would need to demonstrate a significant net benefit to all Tasmanians and to future Tasmanian Government Budgets.

Government Borrowing: Recommended TasCOSS Policy Principles

- The Tasmanian Government should be able to accommodate and service a reasonable level of debt.
- The Tasmanian Government must consider all possible options for financing significant public investment in social infrastructure and services aimed at improving capacity and life chances for low income, vulnerable and disadvantaged Tasmanians and their communities.
- Government borrowing to fund the new Royal Hobart Hospital is acceptable, as is the principle that future generations, who will continue to use the Hospital, also contribute to the costs of this significant and valuable community asset.
- Government borrowing to fund the Hospital development is the preferred option to either entering into a public-private partnership arrangement to build the Hospital, or to using existing DHHS funds and to thereby jeopardise the adequate funding of other services.

6. Privatisation of Government assets

Another option the Tasmanian Government has to generate additional funds in the short-term is through the sale of its assets, such as State-owned Companies (SOC), Government Business Enterprises (GBE) and other Government owned assets (such as land, buildings, etc). The sale of assets can not only generate one-off injections of cash as general government revenue, but can also transfer the long-term liability for the assets to the private sector. It also, of course, transfers the dividends accruing from the assets to the private sector.

Since the years of the Hawke-Keating Federal Labor Governments, Australian state and Federal governments have together sold public assets worth many billions of dollars. These have included Qantas, financial institutions (the Commonwealth Bank and several state banks), electricity assets, public transport services, airports and land and buildings. The arguments put to the public by governments in relation to assets sales often involve the notion of 'core' and 'non-core' government business. That is, in selling particular assets, governments claim to be divesting themselves of 'non-core' assets and services in order to generate significant one-off funds from the sales to invest in 'core' public services (usually including education, health, infrastructure, etc).

While such arguments carry some weight, they also raise the vexed question of what is 'core' government business? This is an ideological question, the answer to which depends on one's view of the legitimate role of government. Without entering into debate on this issue, we might examine the assets currently held by the Tasmanian Government and consider the issues involved in the potential sale of some or all of those assets.

Tasmanian Government assets

In the 2007-08 State Budget, the State Treasurer announced the Government's intention to sell three publicly owned assets: the Hobart Airport, the Southern Regional Cemetery Trust and the Printing Authority of Tasmania, and to direct proceeds from the sales to 'investment in core General Government infrastructure'. This move is expected to provide a one-off cash injection of more than \$40 million into Government coffers.

In earlier years, the Tasmanian Government has sold other assets such as the Trust Bank, land and buildings in the Hobart CBD, the Grain Elevators Board, Civil Construction Services, Stanley Cool Stores Board, and various state-owned forestry and agricultural assets. All have generated one-off injections of cash that have been used in various ways. A proportion of the proceeds from the sale of the Trust Bank, for instance, was re-invested to establish the Tasmanian Community Fund, an independently managed trust fund to provide ongoing financial support for Tasmanian 'charitable, sporting, cultural, educational, religious and other purposes'.

In addition, the Tasmanian Liberal Government (1996-1998) transferred by lease to the private sector two major public health assets, the Queen Alexandra Hospital in Hobart and the Mersey Community Hospital in Latrobe. These moves have been heavily criticised as unsuccessful, and the Mersey Hospital has since been transferred back into the public health system, while the ongoing problems of limited space at the Royal Hobart Hospital are attributed in part to removal of the Queen Alexandra Hospital from the public system.

In addition to Crown land, schools, hospitals and building assets, the Tasmanian Government currently owns the businesses listed in the chart below.

Tasmanian Government Businesses	
Government Business Enterprises	State-owned Companies
Forestry Tasmania	Aurora Energy Pty Ltd
Hydro Tasmania	Tasmanian Ports Corporation Pty Ltd
Motor Accidents Insurance Board	TOTE Tasmania Pty Ltd
Port Arthur Historic Site Management Authority	Transend Networks Pty Ltd
Printing Authority of Tasmania	TT-Line Company Pty Ltd
Rivers and Water Supply Commission	Metro Tasmania Pty Ltd
Southern Regional Cemetery Trust	
Tasmanian International Velodrome Management Authority	
Tasmanian Public Finance Corporation	
The Public Trustee	

While both State-owned companies (SOCs) and Government Business Enterprises (GBEs) operate as businesses, GBEs are subject to the State *Government Businesses Enterprises Act 1995* which imposes particular reporting requirements on the businesses, as well as making them subject to government directives in the form of 'Ministerial Charters'. SOCs, on the other hand, are governed only by the Commonwealth *Corporations Act 2001*; although SOCs may also be subject to 'Letters of Expectation' from their shareholders, that is, the relevant portfolio Minister and the State Treasurer. These 'Letters of Expectation' do not carry the same imperative as 'Ministerial Charters'. It could be said that GBEs are 'closer to government' since their activities are more subject to government direction and intervention.

When Tasmania's iconic Hydro Electric Commission was disaggregated into three electricity supply companies in 1998, Aurora Energy and Transend Networks were made SOCs and Hydro Tasmania was re-formed as a GBE. This could be said to demonstrate the relative importance of the companies to the State with Hydro Tasmania and its electricity generating capacity remaining under closest Government scrutiny. There was much debate in Tasmania throughout the 1990s about whether or not the State's electricity assets should be sold. In 2001 the Labor Government legislated to 'protect the Hydro once and for all' by amending the *HEC Corporation Act 1995* to ensure that no Hydro Tasmania generating assets (with the exception of Bell Bay Power Station) were to be sold without the approval of 'a majority of the electors voting in a referendum' [s.7 (6)]. The other two electricity supply companies are not protected from privatisation in the same way.

In the context of the recent State Budget, Saul Eslake produced estimates of the value of Tasmania's major Government owned business assets (below).

Business	Assets at 30 June 2006 \$million	Net profit after tax (2005-06) \$million	Dividend & tax equivalent payments to State Budget (2005-06) \$million	Plausible range of sale values \$million
Aurora Energy	333	22	32	291 – 358
Transend Networks*	529	31	44	397 - 488
Hydro Tasmania	907	44	67	576 – 708
MAIB [^]	173	58	82	760 – 935
Forestry Tasmania	569	10	19	134 – 165
TT Line	188	24	20	313 – 385
Rivers and Water Supply Commission	12	-1	-2	-17 - -21

* Excludes gifted assets; ^ 2004-05 results. Sources: Annual Reports and Economics@ANZ

Arguments for privatisation of Government assets

Eslake contends that there is no compelling economic argument for the Tasmanian Government not to consider privatising some of its assets to generate additional revenue, and particularly to fund specific large-scale capital projects like the new Royal Hobart Hospital.

It could be argued that the role of state and territory governments has changed significantly with the growth of a contemporary market economy and in line with National Competition Policy. The expectations for state government roles are now concentrated on facilitating the economic competitiveness of their states, and using the fruits of economic activity to deliver only the 'core' infrastructure and services to the community that cannot otherwise be provided by the market. This argument sees state government activity in areas beyond regulation and the delivery of services in education, health and infrastructure as not only an impediment to free markets, but also a distraction from government's policy and financial duties to its community.

While this can be seen as a purely economic rationalist perspective of the contemporary role of state governments, it does pose the question, in the context of unmet need in so many areas of social policy: would Tasmanians prefer that its Government divested itself of 'non-core' assets to generate revenue to spend on areas like health, education and housing?

A possible argument for selling Aurora Energy, for instance, is that it now functions as a business in a regulated and (partially) competitive market environment. Its ownership status could be argued to be largely irrelevant. The important factors are that appropriate consumer safeguards are maintained through an independent, responsible and holistic regulatory framework for the energy market that includes safety net prices and conditions for household electricity supply. The sale of Aurora Energy would, according to Saul Eslake's estimates, result in an injection of around \$300 million into Tasmanian Government coffers. This would make a handsome contribution towards the building of a new Royal Hobart Hospital.

The principle of using the fruits of Tasmania's past economic achievement, that is, successful state-owned assets, to invest in its future social and economic prosperity, is appealing to many. Also appealing to some is the notion that Government should be concentrating its assets and energies on its 'core' business rather than engaging in entrepreneurial endeavors that are outside of the legitimate role of government.

Arguments against Privatisation

Opponents of privatisation cite the experience with Telstra, which like Aurora, now functions in a competitive and regulated market, which shows that privatisation of essential services can result in negative outcomes in relation to access, quality and cost of services for consumers, and particularly for low income and disadvantaged consumers.

Critics would argue that other examples of privatisation of government assets, in Tasmania, interstate and nationally, have generally resulted in less accountability for service provision and diminished consumer protection. They also argue that regulatory frameworks are often softened by Government as a result of pressure from private companies, citing the ongoing campaign by Telstra since it was first privatised, for the Commonwealth Government to significantly deregulate its activities.

In addition to the impact on consumers, the other significant issue regarding the privatisation of Government assets is the immediate and the long-term impact on public sector finances. While the sale of any asset would provide an immediate cash injection to the Government that could be either reinvested into other areas or saved for later investments, this would come at the cost of ongoing annual dividends and financial returns generated by the company to the Government. Rather than providing a significant and sustained revenue stream to the State Government, the future profits of the asset would benefit the asset's new private owner.

In the case of Aurora Energy, which provided a dividend return to the State Government of \$22 million in 2006/07, the Government's initial financial windfall for selling this asset would eventually be off-set by the loss of this ongoing dividend payment. This is given added relevance considering that the dividends paid by Aurora Energy to the Tasmanian Government are sourced from profits earned largely by the company in providing services to Tasmanian consumers. Aurora's dividends might also be expected to grow over the long-term, as might the net value of the company, making it an increasingly valuable government asset.

The argument against the sale of assets is often illustrated with the simile – 'it's like selling the farm'. The question that arises is: how will we eat if we sell the farm that grows our food?

A related argument against the sale of government businesses has been mentioned earlier – that the State Government should maintain as many different sources of revenue as possible to avoid an over-reliance on the Commonwealth for funding. Commonwealth funding is subject to political influences and, increasingly, to conditions that may not be acceptable to all states. Dividends from government-owned businesses provide valuable independent revenue streams that are relatively reliable and sustained to the State Government each year.

Privatisation of Government assets: Recommended TasCOSS policy principles

- Government has a responsibility to review its portfolio of publicly owned assets and it may, at times, be appropriate for the Government to privatise certain assets.
- Any privatisation of Government-owned assets must be contingent on ongoing and effective protection of consumers, and particularly of low income, disadvantaged and vulnerable consumers.

- Any privatisation of public assets must be carried out in as transparent a manner as possible, and the full purchase price and all conditions of sale should be made public.
- A comprehensive, transparent and independent social and economic impact study must be carried out before any major Government asset is privatised. This applies in particular to Government-owned assets that provide essential services, such as government-owned companies, agencies or authorities that provide electricity supply, water, sewerage and drainage, transport, health and education services.

7. Public-Private Partnerships (PPPs)

While the Tasmanian Government has publicly stated that it is not considering the privatisation of major government-owned assets to finance the redevelopment of the Royal Hobart Hospital, both the Treasurer, Michael Aird and the Health Minister, Lara Giddings have said that the Government will consider opportunities for a Public-Private Partnership (PPP) to fund for the project.

The Tasmanian Government has previously shown an interest in exploring opportunities to leverage private capital in infrastructure projects, including the fibre optic cable, Basslink and the failed Macquarie Bank partnership intended to generate additional affordable housing,

What are Public-Private Partnerships ?

A Public-Private Partnership refers to any agreement between government and the private sector to co-operate in the provision of public infrastructure. Normally it involves a private company financing the development of infrastructure that is then leased or subsidised by the Government. A PPP is considered an alternative to government solely funding an asset through borrowing, selling other assets, or the redirection of resources.

Arguments in favour of PPPs

Governments across Australia have entered into PPPs as a 'debt free' method to fund new public infrastructure. Shifting the debt component for an expensive infrastructure project from a government's balance sheet to the private sector appeals to governments keen to return balanced budgets and to be seen as sound economic managers. It is a trend that has been heavily influenced by the economic policies of the Blair Government in Britain and the Kennett Government in Victoria.

PPPs are considered different to privatised services and infrastructure because governments maintain a direct interest in the asset or service owned by the private sector. A clause is usually included in the partnership agreement for the asset to be transferred to government ownership after a prescribed period, for instance, 30 years. Government is therefore effectively buying the asset through its lease payments (and possibly a final large payment). The private entity makes its profit by including a percentage profit margin (often in the vicinity of 25%) in the agreed lease payments.

The attractiveness of this funding model to governments is that the public enjoys the short-term benefits of the new asset, but not the full debt burden associated with funding the project through conventional means, and in the long-term the government still gains full ownership and control of the asset. In addition, payments for the asset are spread over time and can be factored into government budgets without appearing as debt.

Arguments against PPP financing models

While in theory the PPP model appears to offer a sensible alternative to government debt in financing new public infrastructure, the experiences of PPPs across Australia have generally shown less favorable outcomes for the public, when compared to the conventional funding model of government fully financing and owning an asset.

Many concerns centre on the reduced accountability and responsibility of private enterprise to meet the prescribed cost and timeframes for delivering projects. The government partner continues to be accountable for meeting the expectations of the public for the project, but is not actively involved in managing the project or for ensuring it remains within its budget and time parameters. The experience with PPP arrangements for major road infrastructure projects in Victoria, for instance, has shown that consumers are often provided with a frustrating 'blame game' response from both government and the private sector partners regarding extensions in the cost or time delays for delivery of a critical public infrastructure project.

Another argument against PPPs is that while the financial profits generated by the asset always benefit the private partner, the financial risks of the project generally remain with the public partner. For instance, governments are often expected to compensate the private partner for unmet earning expectations and may also be expected to eliminate competitors. The widely reported problems with the Sydney Cross City Tunnel are an example, where the NSW Government was not only required to abolish competition to the privately managed tunnel by closing public roads, but was also required to subsidise the project when revenue forecasts were not met.

It is argued that any positive fiscal outcomes for governments from adopting a PPP model to deliver new infrastructure that would otherwise be funded through government debt, is immediately lost when it agrees to retain total responsibility for the financial viability of the project over the length of the agreement.

In addition, governments are able to borrow money at lower interest rates than are available to the private sector, and since most PPPs are financed through private sector loans, governments will pay an increased interest rate component in any lease-back agreement compared to that applied to a loan made directly to government.

A PPP model to finance the new Royal Hobart Hospital

A PPP arrangement to develop the new Royal Hobart Hospital would most likely involve a major private entity, such as a managed fund or a private equity firm, funding the total development of the new hospital. The State would agree to enter into a lease for the hospital over a set period, most likely 30 or 50 years. After that period, ownership of the hospital would be transferred from the private entity to the Government at minimal, or no cost. The private entity would have factored a percentage profit margin into its leasing arrangements with the Government, to ensure it exits the arrangement with a reasonable profit, which is likely to be a 25% increase on equity.

If the total cost of the new hospital was \$500 million, the Government might agree to a lease requiring payment of about \$20.8 million per annum, indexed over the 30 year lease. When the Government eventually takes ownership of the asset, it would have paid around \$625 million in current terms for the asset, that is, 25% more than its cost.

It is unlikely that the Government would be entering into an arrangement that guaranteed the private partner any profits above those covered by the lease arrangement, however, this is uncertain. It would most likely be a simple lease arrangement with the developer, with no user-pays component, thus minimising the long-term risk for Government and the public sector finances.

The appeal of a PPP model to finance the hospital project is that it provides an element of security for the Government over the long-term in relation to its ongoing commitment to finance the project. The Government would know in advance the ongoing leasing costs for the hospital and budget accordingly within the annual state budget cycle. The community sector would also be able to take this cost as a given in every State Budget and be assured that ongoing funding of the project would not threaten to erode community sector funding every year. The Government would, at the same time, be investing in the eventual outcome of owning the asset at the conclusion of the lease.

An argument for preferring this method of finance over government debt is therefore that it is consistent with the principles of long-term investment and ensuring future generations contribute to the cost of an asset they will use, but does not commit the State to a significant debt burden or to deficit budgets. It maintains the option for government to go into debt and run deficit budgets when it is the only remaining option available to generate funds, such as at a time of significant economic downturn.

The Tasmanian Government has a relatively high credit rating which would enable it to borrow money for the hospital at a cheaper interest rate than the private sector could expect to pay. It is therefore questionable if it is financially sensible for the Government to enter into lease agreements with the private sector at a higher ongoing cost to Government. The additional cost for the hospital funded through a PPP would result in there being less in the State Budget for the funding of other government services and infrastructure.

Another argument against entering into a PPP for the Royal Hobart Hospital project is the inability of Government to control either the timeline or the project budget. Blow-outs in either could have major repercussions on other parts of the Tasmanian health system and on the Government's Budget.

The Government's current fiscal strategy, discussed above, has as key objectives a return to budget surplus by 2009 and the maintenance of Tasmania's net debt free status. It could be argued that the achievement of these objectives would leave little room for any funding method for a new hospital other than a PPP.

Public-Private Partnerships: Recommended TasCOSS policy principles

- The Government is responsible for financing and providing both services and infrastructure in Tasmania.
- Any PPP proposal must involve full disclosure of all contract conditions, as well as independent economic and fiscal modeling of the agreement and its impact on both public finances and Tasmanian consumers. This must include comparisons with alternative models of financing, including general government debt.

8. Conclusion – Where to now?

As detailed in the Introduction, the purpose of this paper is not to provide a comprehensive economic analysis of the Tasmanian Government's financial policies and fiscal strategy. Instead, this document seeks to present some of the issues likely to be debated in Tasmania over the next couple of years, as the Tasmanian Government responds to the growing list of demands on its limited financial resources.

This paper has attempted to summarise various views on the issues and to offer a social justice perspective on some of those issues. It has also considered what impact the issues have on the Tasmanian Government's capacity to continue to fund the community sector, other services and infrastructure and, above all, to support low income, vulnerable and disadvantaged Tasmanians and their communities.

It is hoped that this paper will encourage discussion and debate among TasCOSS members and constituent organisations about the positions that TasCOSS should take in future debates about the Tasmanian Government's financial policies.

Already we have heard the Government, other interest groups and independent commentators speculate about the issues discussed in this paper, particularly in relation to the Government's capacity to fund the new Royal Hobart Hospital. However, TasCOSS' interests go well beyond the short-term debate about the new hospital.

Specifically, TasCOSS needs to offer realistic views on how we expect the Tasmanian Government to not only address the significant areas of existing unmet social need in the Tasmanian community, but also to make long-term and strategic investments in fighting poverty and disadvantage in Tasmania into the future.

The well-worn argument that the Government should just be reprioritising its funding commitments still has a degree of legitimacy, but there needs to be greater understanding of the significant pressure on the capacity of the Government to respond to the legitimate and various demands of the Tasmanian community.

In order for TasCOSS to present a strong case to Government, other political parties and the broader community for the prioritisation of long-term significant investments in early intervention strategies, affordable housing solutions and a vibrant and sustainable non-government community services industry, we must also offer a considered and realistic position on how the Government can fund these investments.