



Centre of Full Employment and Equity

**The economic and social impact of the 2010-11 Mid-Year Financial Report in
Tasmania**

Report prepared for the CPSU & HACSU, Tasmania

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May 2011

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Executive Summary

- This report provides an overview of the Tasmanian economy and labour market and analyses the economic and social impact of the 2010-11 Mid-Year Financial Report.
- Despite significant improvements in economic performance prior to the Global Financial Crisis (GFC), the Tasmanian economy has performed below the national average on a range of indicators. It has lower Gross State Product (GSP) and employment growth, lower labour force participation rates and higher levels of labour underutilisation. Tasmania has also suffered a more significant contraction of private capital investment following the GFC and exports have been adversely affected by high exchange rates.
- The GFC caused budget outcomes to deteriorate in Tasmania as cyclically sensitive revenues such as the Goods and Services Tax (GST), stamp duties and payroll tax declined and demand for services increased. Declining revenues combined with increased expenditure to support economic activity to preclude achievement of fiscal targets.
- In 2009-10 the Tasmanian Government introduced the Interim Fiscal Strategy that was to operate during the downturn and included new targets:
 - achieving a Net Operating Surplus and an underlying Net Operating Surplus in the General Government Sector, over a rolling four-year period, by 2014-15;
 - achieving a modest Fiscal Surplus by 2014-15; and
 - remaining Net Debt free.
- In the 2010-11 Mid-Year Financial Report (MYFR) the Government introduced remedial measures so that the Interim Fiscal Strategy targets could be met within the timeframes set. Immediate measures include reductions in capital expenditures and savings equivalent to staffing reductions of up to 2300 FTEs by 2014-15.
- The Mid-Year Financial Report forecasts Net Operating Deficits over the Forward Estimates period. This contrasts with large Net Operating Surpluses in the pre-GFC period of strong economic growth. Following a protracted period of negative Net Debt Tasmania will incur Net Debt in 2012-13 and 2013-14.
- Government Budget results vary over the economic cycle as a result of economic decisions by business firms and individuals. For a state government without currency issuing capacity, budget sustainability requires that recurrent revenues are sufficient to meet recurrent expenses over the economic cycle. Capital investments provide economic and social benefits over extended periods and should be financed over similar periods.
- We estimate the impact of the recent economic downturn on the Tasmanian fiscal position using revenue and expenditure data to construct trend or predicted values that could have been expected in the absence of the GFC. While this is not an exact science, it is clear that the fiscal position of Tasmania has been significantly impacted by the GFC. This can be attributed to the operation of automatic stabilisers, primarily large reductions in cyclically sensitive revenues such as the GST, payroll tax and stamp duties. These revenues are expected to recover during the growth phase of the economic cycle.
- The tendency for growth in expenses to outstrip revenue growth in the pre-GFC period and forecast deficits in the Net Operating Balance in the Forward Estimates

period are of concern. A continuation of this trend would not be sustainable in the longer-term.

- The Government is currently undertaking a Public Sector Productivity Strategy to review programs delivered by the public sector, a review of Government businesses and a state taxation review. There needs to be careful consideration of the timing, quantum and composition of changes in fiscal policy which could occur when the findings of the taxation and expenditure reviews are completed.
- The proposed staffing cuts over the four years to 2014-15 appear to have been determined on the basis of the State's fiscal position rather than as the outcome of the review of Government services. The reduction of 2300 FTEs will reduce economic activity and employment in Tasmania compared to the levels that would have been achieved in the absence of these cuts. While we have not undertaken a detailed analysis of the effect of these reductions, we would expect that there will be total job losses of between 3200 and 4800 FTE jobs (2300 direct and between 900 and 2500 other jobs) once the flow in effects are finalised.
- Remaining staff are likely to have higher workloads and higher stress levels. Governments also contribute to economic and social development through a range of services including education, health, housing, transport and community services. The severity of the cuts announced in the 2010-11 Mid-Year Financial Report place these services at risk. The standard of service delivery is likely to decline with longer waiting times for clients and reduced client satisfaction.
- The loss of this quantum of jobs in an economy with large levels of labour underutilisation will increase the unemployment rate and have other deleterious impacts such as causing skill atrophy for those relegated to the ranks of the long-term unemployed, an increase in out-migration from Tasmania due to diminished career prospects and an increase in a range of social problems that will increase demand for social services. The Australian Government will be required to increase expenditure in the form of income support payments and will suffer reductions in income tax receipts.
- The Government's fiscal policy objectives in relation to the Net Operating Balance and remaining Net Debt free could prove to be counter-productive. The Government is attempting to improve the budget outcome with discretionary spending cuts. In these circumstances, the imposition of austerity may then cause State Product to contract and the automatic stabilisers (principally, tax revenue at the State level) to push the budget further into deficit. It also follows that a growth strategy underpinned by discretionary stimulus spending and/or tax cuts can drive reductions in the budget deficit outcome as the level of economic activity increases and tax revenues recover.
- Expenditure cuts will coincide with the withdrawal of stimulus expenditure and could threaten economic recovery. Major expenditure cuts identified through the review should be deferred to later in the economic cycle when the economy is forecast to be more robust.
- Policy decisions on revenue and expenditure adjustments require a holistic approach that takes into account a comprehensive assessment of the nature and quantum of services to be provided to the people of Tasmania and the staffing and other resources necessary to deliver these. Therefore, major decisions on future fiscal policies should be deferred pending completion of the reviews currently being undertaken.

1 Introduction

The onset of the GFC caused budget outcomes to deteriorate in Tasmania as the economic downturn reduced revenues from the GST and cyclically sensitive sources such as stamp duties and payroll taxes. The Tasmanian Government responded by deviating from the fiscal strategy with the introduction of the Interim Fiscal Strategy which was to operate until ‘normal economic conditions resume’ (Tasmanian Government, 20090a: 1.3). It was expected to operate from 2009-10 to around 2014-15.

The 2010-11 Mid-Year Financial Report noted that the impact of the GFC has been more severe than forecast in reducing revenues and increasing expenditures in relation to the 2010-11 Budget forecasts. The Government announced that:

...without remedial action the State will not meet the key fiscal measures established in the 2010-11 Budget. In addition, a number of the Interim Fiscal Strategy Measures will not be achieved within the timeframes previously set (Tasmanian Government, 2011: 1)

The MYFR announced corrective measures that included major expenditure reductions, including abandonment of election promises, reduction of some infrastructure projects, a Public Sector Productivity Strategy to review programs, and a reduction in public sector expenditure equivalent to 2300 FTE staff over the four years to 2014-15.

The Centre of Full Employment and Equity (CofFEE) was commissioned by the Community and Public Sector Union (State Public Services Federation Tasmania) and the Health and Community Services Union (Tasmanian Branch) to analyse the Tasmanian economy and assess the impact of the change in the fiscal stance and the staff cuts announced in the 2010-11 Mid-Year Financial Report on the Tasmanian economy and community. The report will:

- Present an overview of the Tasmanian economy and labour market;
- Analyse the expenditure, savings and investment initiatives in 2010-11 Mid-Year Financial Report in relation to previous fiscal outcomes; and
- Consider the impact of initiatives announced in the Mid-Year Financial Report on the Tasmanian economy and public sector service delivery.

The report is structured as follows. Section 2 provides an overview of the Tasmanian economy and labour market, including details on public sector employment. Section 3 contextualises the Mid-Year Financial Report (MYFR) by outlining previous fiscal policies and outcomes. Section 4 details the changes to fiscal policy outlined in the MYFR including proposed cuts to public sector staffing, other expenditure cuts and investment. Section 5 provides an analysis of the fiscal position that reveals the impact of cyclical influences and discusses the ongoing fiscal position which indicates that the Tasmanian Government has a considerable degree of fiscal flexibility. Section 6 examines the options available to the Tasmanian Government to address the fiscal position, paying attention to the economic and social consequences of alternative policies. Concluding comments are in Section 7.

2 The Tasmanian economy

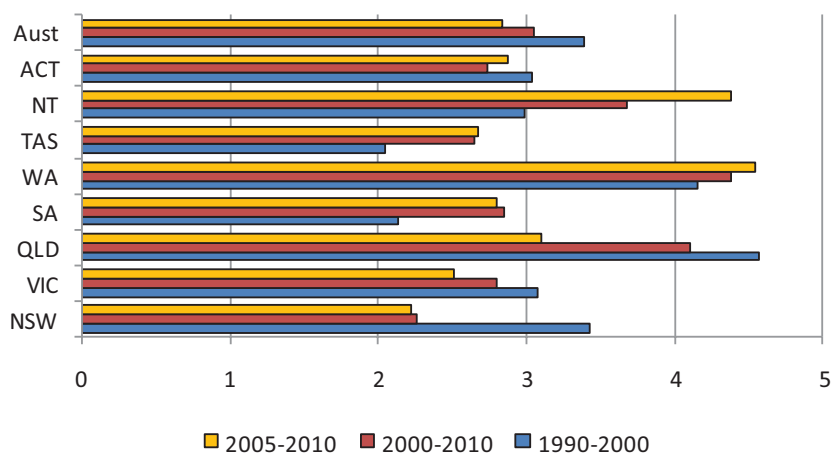
This section analyses the performance of the Tasmanian economy and labour market. The recession of the early 1990s had a severe and protracted impact on the Tasmanian economy causing a lengthy period of underperformance. During the 2000s the economy entered a period of growth, although performance has generally remained below the national average for most economic indicators.

2.1 Economic performance

Since the onset of the GFC the Australian economy has outperformed other major economies. In 2009-10 the economy grew by 1.4 per cent compared to a contraction of 3.2 per cent in advanced economies. In contrast to declining employment in other developed economies, employment increased by 225,000 in Australia (Australian Government, 2010a). Unemployment is forecast to fall to 4.75 per cent by 2011-12.

2.1.1 Gross State Product

Figure 2.1 Annual growth rate of GSP, 1990 to 2010



Source: (ABS, 2010a), Cat no. 5220.0 Australian National Accounts: State Accounts, Table 1 Gross State Product, Chain volume measures and current prices

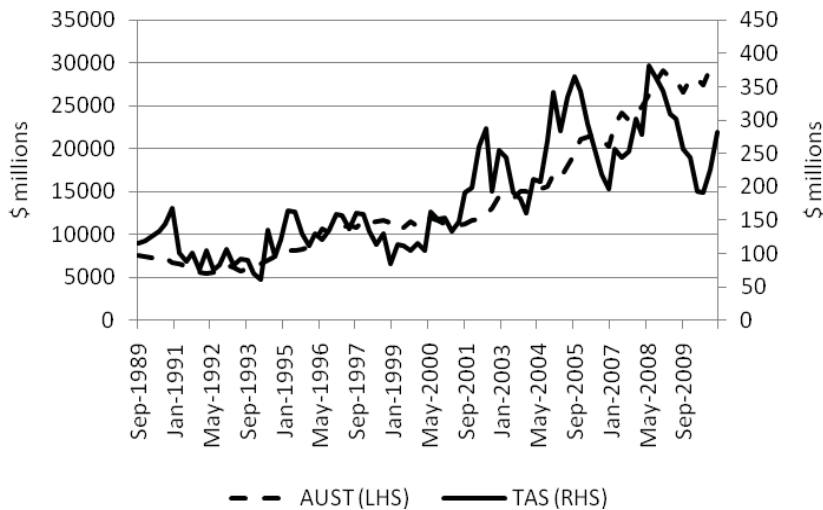
Figure 2.1 shows the average annual growth rate of GSP in real terms since 1990. We consider three separate periods to differentiate between growth rates under different economic circumstances. For the entire 20 year period from 1990 to 2010 Tasmania's GSP has grown more slowly than the average rate for all States and Territories. During the 1990s Tasmania had the lowest rate of growth in GSP of 2 per cent compared to an average growth rate of 3.4 per cent. Tasmania made gains relative to other states between 2000 and 2010 when the 2.6 per cent GSP growth rate surpassed NSW (2.3 per cent) but remained lower than the national average of 3.1 per cent. Between 2005 and 2010 Tasmania's growth rate increased marginally to 2.7 per cent and the state achieved a considerable improvement in its relative position by almost reaching the national average growth rate of 2.8 per cent and outperforming NSW (2.2 per cent) and Victoria (2.5 per cent).

2.1.2 Private Capital Investment

The contribution of private investment to GSP grew from 12 per cent of GSP in 2000-01 to 20 per cent in 2007-08 (Tasmanian Government, 2009a). Business investment of non-

dwelling construction and plant and equipment accounted for around two-thirds of private investment.

Figure 2.2 Private capital investment, 1989 to 2010



Source: (ABS, 2011a), Cat no. 5625.0 Private New Capital Expenditure and Expected Expenditure, Australia, 2010. Table 5B: Chain Volume Measures, Seasonally Adjusted

Figure 2.2 displays private new capital expenditure for Tasmania and Australia between 1989 and 2010. Private investment expenditure in Tasmania exhibits considerably more volatility than national capital expenditure and has increased more slowly. The counter cyclical nature of capital expenditure is evident in both series. There was a trough in capital expenditure in Tasmania following the recession in the early 1990s and again between 1998-99 and 1999-2000. Capital expenditure increased significantly from 2001-02 until June 2008. Investment declined after the onset of the GFC, falling from \$381 million in June 2008 to \$194 million in March 2010. It has since recovered to \$282 million in December 2010.

In 2008-09 manufacturing was the industry with the highest contribution to gross value added, contributing 12.7 per cent of the Tasmanian total (ABS, 2010b). However, the manufacturing share of gross value added has declined from 15.1 per cent in 2003-04. Finance and insurance services and health care and social assistance are the next most important industries in terms of gross value added, with contributions of 9.5 per cent and 9.0 per cent respectively.

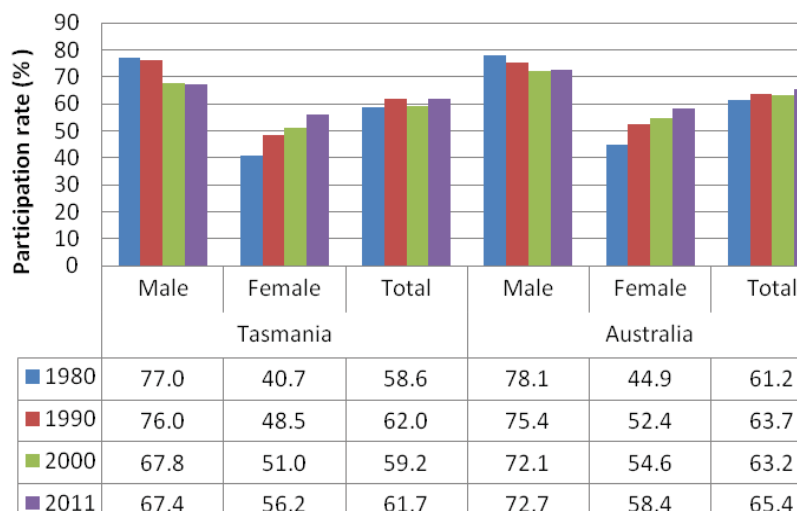
2.2 Labour Market

2.1.1 Labour force participation

Labour force participation in Australia has responded to changing economic conditions and changes in attitudes. The combination of these factors has resulted in an increase in female participation and a reduction in the male participation rate. Low skill workers have fared worse in the labour force as a result of structural changes that have reduced the proportion of low skill jobs. This phenomenon has been particularly evident in the aftermath of economic downturns as many low skill workers have been displaced from the workforce and have faced extended periods of unemployment. Some of these workers have opted to leave the labour force. This has been particularly evident with male workers whose labour force participation rates have declined significantly over the past few decades.

Figure 2.3 shows the participation rate for Tasmania and Australia between 1980 and 2011. The participation rate in Tasmania has lagged the national rate throughout this period. By January 2011 the participation rate was 61.7 per cent for Tasmania and 65.4 per cent for Australia. The male participation rate has exceeded the female rate throughout the period but the gap has closed considerably due to the fall in the male participation rate and the increase in the female participation rate, both for Tasmania and Australia as a whole. The largest fall in the male participation rate was in the 1990s when it fell from 76 to 67.8 per cent in Tasmania and from 75.4 to 72.1 per cent nationally. In addition to ongoing structural change, the significant decline in male participation during the 1990s reflects the fact that many workers displaced during the recession in the early 1990s were unable to find work and withdrew from the labour force. The greatest gains in female participation were in the 1980s with participation increasing by almost 8 per cent in Tasmania and 7.5 per cent nationally.

Figure 2.3 Labour force participation rate, 1980 to 2011



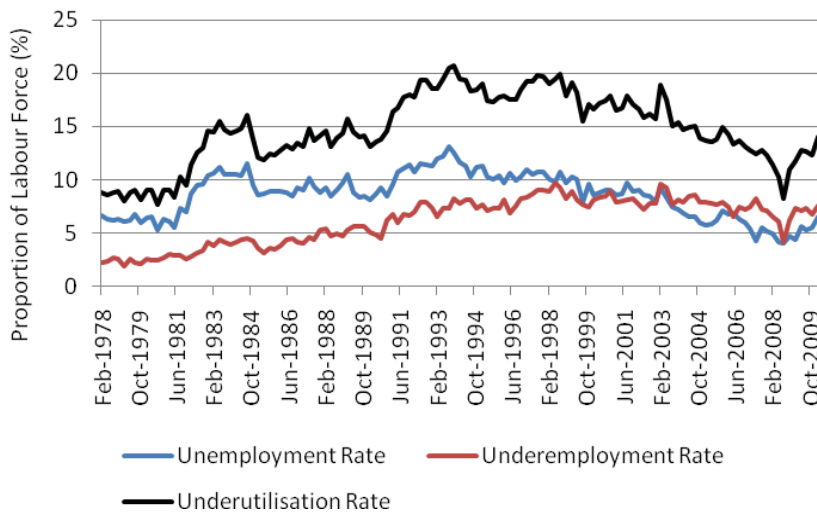
Source: (ABS, 2011b) Cat no. 6291.0.55.001 Labour Force, Australia, Detailed: Table 02 Labour force status by State, Capital City/Balance of state and Sex.

2.2.2 Underutilisation

The underutilisation rate is a measure of spare capacity in the labour force. It includes both unemployment and underemployment and peaked at 20.5 per cent or more than one person in five in 1993. Underutilisation fell to a minimum of 8.2 per cent in 2008 before increasing again to 13.8 per cent in February 2011.

Figure 2.4 shows the unemployment, underemployment and underutilisation rates for Tasmania from 1978 to 2011. The series exhibit a pro-cyclical pattern increasing as a result of economic downturns and falling during periods of increased economic activity. The unemployment rate increased to 10.6 per cent in 1984 and fell slightly over the 1980s before peaking at 13.1 per cent in 1993 after the recession. After 1993 the unemployment rate declined steadily to just 4.1 per cent prior to the impact of the GFC which saw unemployment increase to 6.5 per cent in mid 2010 and then fall to 5.7 per cent in February 2011.

Figure 2.4 Labour underutilisation in Tasmania, 1978 to 2011



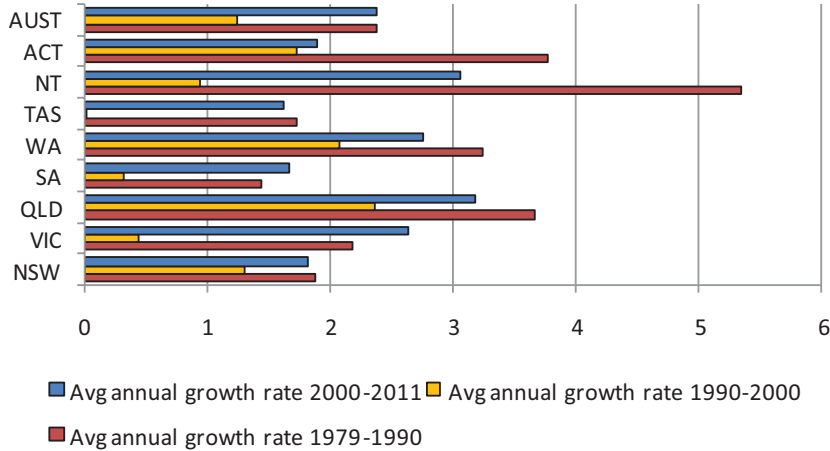
Source: (ABS, 2011c) 6202.0 Labour Force, Australia, Feb 2011, seasonally adjusted

Underemployment is the least responsive to cyclical influences. It has increased since the 1970s due to the increase in the number of part-time workers who would like to work additional hours. Underemployment stood at 2.2 per cent in 1978 and increased to a maximum of 9.6 per cent in 2003 before declining during the economic expansion in the 2000s to reach a minimum of 4.2 per cent in 2008. The rate has increased due to 8.2 per cent in February 2011 in the aftermath of the GFC.

2.2.3 Employment

Total employment in Tasmania has increased from 165,500 in 1979 to 237,900 in 2011. Figure 2.5 shows the average annual growth rate of employment between January 1979 and January 2011 broken into three time periods approximating the 1980s, 1990s and 2000s. For each time period employment growth in Tasmania is below the national average and is the lowest of all states and territories for the periods 1990-2000 and 2000-2010. Between 1979 and 1990 employment growth was lower in South Australia (1.4 per cent per annum) than in Tasmania (1.71 per cent). The 1990s were a lost decade in terms of employment growth in Tasmania with no growth recorded. Between 2000 and 2011 employment has grown more strongly at 1.6 per cent per annum which was slightly lower than South Australia (1.7 per cent) and NSW (1.8 per cent). However employment growth remains below the national average of 2.4 per cent per annum for this period.

Figure 2.5 Average annual employment growth, 1979 to 2010



Source: (ABS, 2011b) Cat no. 6291.0.55.001 Labour Force, Australia, Detailed: Table 02 Labour force status by State, Capital city/Balance of state and Sex.

Over the past 25 years the Tasmanian economy has undergone significant changes. Table 2.1 displays the industry share of employment between 1985 and 2010. In Tasmania, as in Australia as a whole, manufacturing was the industry with the highest employment share in 1985, with 13.8 per cent of total employment. The manufacturing share declined progressively due to the globalisation of production and transfer of activity from developed to developing countries so that by 2010 manufacturing accounted for less than 9 per cent of employment in the State. Health care and social assistance increased from 9.3 per cent of total employment in 1985 to 12.7 per cent in 2010 and is the industry with the largest share of employment. Retail is the second largest employing industry with its employment share increasing from 10.3 per cent in 1985 to 11.7 per cent in 2010. Other industries that increased their share of employment during the period included: education, public administration and safety, professional, scientific and technical services, and accommodation and food services. The employment share of agriculture, forestry and fishing fell from 8.6 per cent in 1985 to 6.7 per cent in 2010. The proportion of the workforce employed in electricity, gas, water and waste services halved from 3.6 per cent in 1985 to 1.7 per cent in 2010.

Table 2.1 Industry share of employment, 1985 to 2010

	1985	1990	1995	2000	2005	2010
Agriculture, Forestry and Fishing	8.6	8.7	7.9	9.2	7.7	6.7
Mining	1.8	1.6	0.7	1.1	1.0	1.4
Manufacturing	13.8	14.9	11.3	11.8	10.5	8.2
Electricity, Gas, Water and Waste Services	3.6	1.9	1.3	0.9	1.2	1.7
Construction	7.4	6.0	6.4	5.4	7.0	8.0
Wholesale Trade	4.2	4.5	4.6	3.5	3.4	3.0
Retail Trade	10.3	10.7	12.0	11.6	12.3	11.7
Accommodation and Food Services	5.6	5.3	7.0	7.0	7.0	6.9
Transport, Postal and Warehousing	4.6	4.3	4.2	5.0	4.4	4.5
Information Media and Telecommunications	2.9	2.2	1.8	1.9	2.3	1.6
Financial and Insurance Services	3.7	3.8	2.8	2.2	2.6	2.2
Rental, Hiring and Real Estate Services	0.9	1.0	1.2	1.0	1.3	1.2
Professional, Scientific and Technical Services	3.2	3.7	3.2	3.9	4.2	5.1
Administrative and Support Services	1.5	1.6	2.3	2.9	3.2	2.7
Public Administration and Safety	6.1	6.9	8.4	6.5	7.4	7.8
Education and Training	6.5	7.1	8.1	8.0	7.5	8.2
Health Care and Social Assistance	9.3	10.0	10.3	12.4	11.4	12.7
Arts and Recreation Services	1.4	1.3	1.3	1.7	2.1	2.1
Other Services	4.3	4.1	4.6	4.0	3.6	4.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: (ABS, 2010c), Cat no. 6291.0.55.003 Labour Force, Australia, Detailed, Quarterly, Table 05 Employed persons by State and industry

Table 2.2 shows the annual rate of growth for full-time, part-time and total employment for Tasmania and Australia between 1984 and 2010. Employment growth for Tasmania is below the national rate (1.2 compared to 2.1 per cent). The growth rate of part-time employment has outstripped the full-time employment growth rate.

In Tasmania full-time employment grew at an annual rate of only 0.4 per cent compared to a rate of 3.7 per cent for part-time employment. Similarly the part-time employment growth rate for Australia was higher than the full-time employment growth rate (4.1 per cent compared to 1.6 per cent). The growth rate for part-time employment exceeded the full-time employment growth rate for all industries in Tasmania between 1984 and 2010. In general, declining industries are marked by negative growth rates for full-time employment but record positive growth in part-time employment. For example, the annual rate of decline in employment in electricity, gas, water and waste services of 1.8 per cent is composed of an annual contraction of 2.2 per cent of full-time employment and a growth of part-time employment of 7.8 per cent. Similarly full-time employment fell by 1.7 per cent per annum in manufacturing while part-time employment increased by 3.6 per cent. Information, media and telecommunications was the only industry to have negative growth in both full-time and part-time employment.

Table 2.2 Employment growth by industry, November 1984 to November 2010 (per cent)

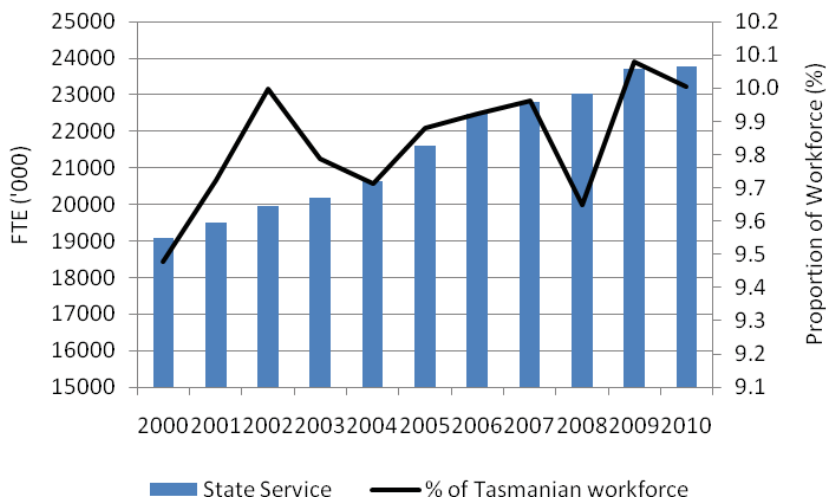
	Tasmania			Australia		
	F/T employment	P/T employment	Total employment	F/T employment	P/T employment	Total employment
Agriculture, Forestry and Fishing	0.3	2.7	0.7	-0.9	1.4	-0.4
Mining	-0.7	3.5	-0.3	2.9	3.2	3.0
Manufacturing	-1.7	3.6	-1.1	-0.7	2.2	-0.4
Electricity, Gas, Water and Waste Services	-2.2	7.8	-1.8	-0.3	7.2	-0.1
Construction	1.1	2.7	1.3	3.3	4.2	3.4
Wholesale Trade	-1.1	1.9	-0.6	0.3	2.2	0.6
Retail Trade	0.6	4.1	1.9	1.1	3.9	2.2
Accommodation and Food Services	0.8	2.6	1.7	2.1	4.6	3.3
Transport, Postal and Warehousing	1.0	4.1	1.5	1.7	6.0	2.2
Information Media and Telecommunications	-2.0	-1.3	-1.9	-0.5	2.4	0.0
Financial and Insurance Services	-2.0	3.3	-0.8	1.3	2.7	1.5
Rental, Hiring and Real Estate Services	2.0	2.7	2.2	3.2	6.4	3.9
Professional, Scientific and Technical Services	3.6	4.4	3.8	4.5	5.5	4.7
Administrative and Support Services	2.0	7.7	4.0	4.0	6.9	5.0
Public Administration and Safety	1.2	3.6	1.5	1.9	5.4	2.3
Education and Training	1.6	2.5	2.0	2.2	3.3	2.6
Health Care and Social Assistance	1.7	3.8	2.6	2.6	5.0	3.4
Arts and Recreation Services	2.3	4.3	2.8	3.6	4.3	3.9
Other Services	0.8	2.0	1.1	1.9	2.9	2.1
Total	0.4	3.4	1.2	1.6	4.1	2.1

Source: (ABS, 2010c) 6291.0.55.003 Labour Force Australia, Detailed, Quarterly, Table 05 Employed persons by State and Industry, 2010.

2.2.4 Public Sector Employment

State Service employment in Tasmania has increased from 19,092 FTEs to 23,781 FTEs over the period 2000 to 2010. Over this period the annual growth rate of FTEs in the public service was 2.2 per cent compared to a growth rate of 1.7 per cent for the Tasmanian workforce. The columns in Figure 2.6 show FTE staffing for the State Service and the line shows State Service staffing as a proportion of the Tasmanian employment over the period 2000 to 2010. Figures for State Service employment are at 30 June while the total State employment data relate to May each year. Public sector employment has been more stable than total Tasmanian employment, which has declined in some years (2001, 2002 and 2009) due to cyclical influences. This means that the line representing the public employment share of total employment has vacillated over time. Over the entire period there has been a small increase in the public sector employment share from 9.5 per cent in 2000 to 10.0 per cent in 2010.

Figure 2.6 Full-Time Equivalent employees, 2000 to 2010



Source: (ABS, 2011b; Office of the State Services Commissioner, Annual Reports, various years).

The columns in Figure 2.6 indicate that large increases in FTEs occurred in 2004-05 and 2005-06 (with increases of 969 FTE and 863 FTE respectively). The Department of Health and Human Services has been responsible for a large amount of the increase in FTE staffing during the period. Staffing in the Department of Health and Human Services increased by 135 FTEs in 2001-02. In 2003-04 there was an increase of 228.5 FTEs that consisted of:

- An additional 64.9 FTE nurses as a result of a successful campaign to attract and retain nurses;
- An increase of 20.45 FTE medical practitioners
- An increase in health professionals resulting from the transfer of the community Rehabilitation Unit from Calvary Hospital, additional positions in the Children and Family Services Division, dental therapy assistants and disability workers
- Additional clerical and support positions associated with new projects, some of which were funded by the Commonwealth.

Staffing in the Department of Health and Human Services increased by a net amount of 105 FTEs in 2005-06. The change consisted of reductions of more than 400 FTEs from the Fire Services when it was transferred to the Department of Police and Emergency Services and

staff increases of more than 500 FTEs in other parts of the Department. The increased staff provided dental assistants, ambulance officers and youth workers. Nursing, health professional and administrative staff were involved in a number of initiatives, for example, Better Hospitals, Mental Health Services (Bridging the gap), transitional care, and the nursing hours per patient day initiative.

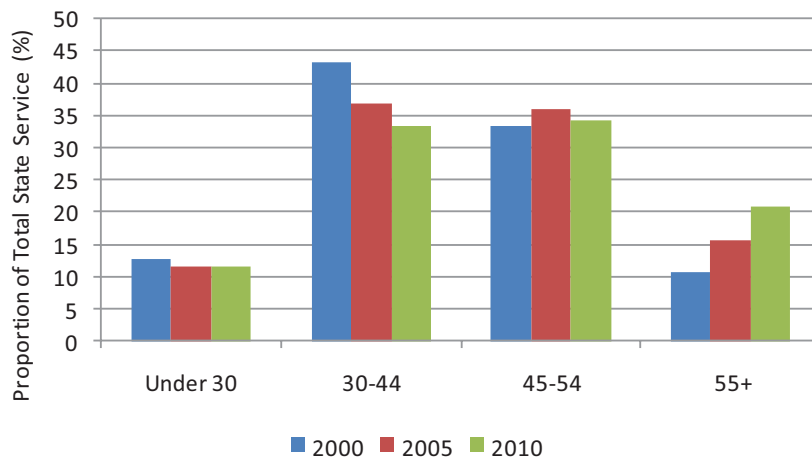
An increase of 655 FTE in 2008-09 resulted in the creation of 113 allied health professional and radiation therapist positions, 168 additional nurses, 53 additional medical practitioners as well as additional ambulance officers and clerical and administrative positions. In 2009-10 an additional 303 FTE staff included 66 allied health professionals, 4 radiologists, 135 nurses, 101 medical practitioners and 9 ambulance officers.

The Department of Education has also experienced growth in FTE staffing over the period. An addition of 316 FTE staff resulted from the transfer of Adult Education from TAFE rather than an actual increase in staffing. An additional 107 FTEs in 2007-08 delivered literacy and numeracy assistance in targeted areas and provided more school based administrative staff and teacher’s aides. In 2008-09, a reduction in staffing resulted from the combination of the transfer of 303 FTEs to Tasmanian Polytechnic and an increase of 100 FTE for literacy and numeracy programs such as *Raising the Bar* and *Closing the Gap*.

This brief review demonstrates that increases in FTE staffing over the past decade have been targeted to front-line services that have improved service delivery for the people of Tasmania. Any across the board staffing reductions will impact on access to and/or the quality of services delivered by the Tasmanian public sector.

Figure 2.7 displays the age structure of State Service employees from 2000 to 2010, including data from all Departments and Agencies. The major changes in the age structure are in the 30-44 and over 55 age groups. The proportion of employees in the 55 and over age group has increased from 10.7 per cent to 20.9 per cent and the 30-44 age group has declined from 43.2 to 33.3 per cent.

Figure 2.7 Age share of employment, 2000 to 2010

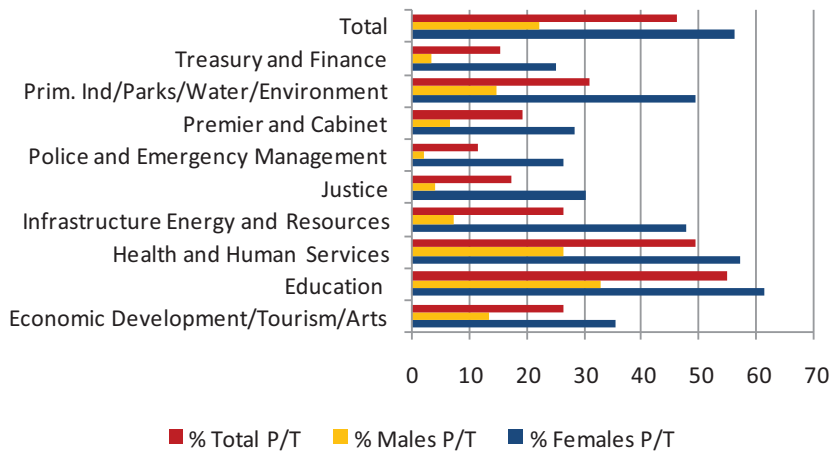


Source: Office of the State Services Commissioner, Annual Reports, various years

The analysis below is restricted to FTE staffing for the nine Government Departments: Economic Development, Tourism and the Arts; Education; Health and Human Services; Infrastructure, Energy and Resources; Justice; Police and Emergency Management; Premier and Cabinet; Primary Industry, Parks, Water and Environment; and Treasury and Finance.

Figure 2.8 shows the proportion of employees working on a part-time basis at 30 June 2010. For the State Service, 46.2 per cent of employees worked part-time (22.1 per cent of males and 56.3 per cent of females). Part-time employment was concentrated in Education (55 per cent) and Health and Human Services (49.3 per cent). 61.5 per cent of females working in Education worked part-time as did 26.3 per cent of males. In Health and Human Services 57.2 per cent of females and 26.3 per cent of males worked part-time.

Figure 2.8 Part-time employment, public sector, 2010



Source: Office of the State Service Commissioner, Annual Report, 2009-10

Table 2.3 shows the relative size of the entire public sector for each state. The first column has the number of public sector employees per state which includes all Commonwealth, State and Local Government employees. The second column shows the state population. The third column shows the number of public servants per 1000 population and the final column has the rank, with 1 indicating the largest public sector employment per capita and 8 the lowest. It is expected that states with the largest population share will have a smaller number of public servants on a per capita basis due to scale efficiencies. Tasmania is ranked second with 75.4 public servants per 1000 population which is larger than all the other states but significantly lower than the rate for the Northern Territory.

Table 2.3 State public sector employees, June 2009

	Employees	Population	Employees (per 1000 population)	Rank
NSW	429700	7191500	59.8	7
VIC	310300	5496400	56.5	8
QLD	295300	4473000	66.0	5
SA	108800	1633900	66.6	4
WA	159100	2270300	70.1	3
TAS	38100	505400	75.4	2
NT	23700	227700	104.1	1
ACT	21700	354900	61.1	6

Sources: (ABS, 2009; 2010d)

This is a crude measure of the relative size of public sector employment for the various states due to major differences in the composition of public and private sector employment for various functions. States that have undergone large privatisation programs will have less public sector employees reflecting the fact that they are delivering commensurately less services to the community. For example, Victoria has undergone extensive privatisation programs and has the lowest proportion of public sector employees (56.5 per 1,000 population). Comparisons that do not take these issues into account are misleading.

A review by the Auditor-General (2010) attempted to measure changes in public sector productivity in Tasmania over the past decade. The report noted the complexities involved in attempting to measure productivity in the public sector and the lack of appropriate indicators to capture the breadth of services and qualitative changes over time. The review adopted a conservative approach by only including quality improvements that could be measured objectively and found:

...that the quantum of services provided, based in levels of activity, increased by more than the growth in public sector employee numbers over the 1999-2000 to 2008-09 period indicating that productivity over this period improved. This finding is contrary to reports by other parties that the growth in employee numbers in Tasmania is too high without linking this to what these employees do (Auditor-General, 2010: i).

3 Fiscal Policy in Tasmania

3.1 Commonwealth – State fiscal arrangements

The Australian federal system of government exhibits vertical fiscal imbalance, a situation where there is a mismatch between the revenue raising capacity and responsibilities for service provision among different levels of government. The Commonwealth has had a greater ability to raise revenues since the transfer of income taxation powers in the 1940s. Transfers from the Commonwealth to State governments as a proportion of State's total revenue indicates the extent of vertical fiscal imbalance. In 2008-09 Australian Government funding was estimated to be around 49 per cent of total state revenue. These transfers include:

- National Specific Purpose Payments (SPPs): the National Healthcare SPP; the National Schools SPP; the National Skills and Workforce Development SPP; the National Disability Services SPP; and the National Affordable Housing SPP
- National Partnership Payments
- General revenue assistance – GST and other general revenue assistance

SPP grants are determined on a per capita basis according to population shares and are indexed annually. In the case of the National Schools SPP, payments are based on the state share of full-time equivalent students enrolled in government schools. National Partnership payments include payments for specific projects, facilitation payments and reward payments and have been the major vehicle for delivery of the economic stimulus grants to the states.

Commonwealth funding in response to the GFC provided significant additional funding. The \$4.7 billion Nation Building Package was announced in December 2008. Then in February 2009 the \$42 billion Nation Building – Economic Stimulus Plan was announced with funding over five years to support economic activity and jobs (Commonwealth Coordinator-General, 2010). The funding consisted of:

- \$16.2 billion over three years for the Building the Education Revolution program – building and rebuilding school infrastructure around Australia to support economic activity;
- \$1.12 billion for the Regional and Local Community Infrastructure program for local government to provide community infrastructure such as playgrounds, community centres, sporting fields and swimming pools;
- \$2.3 billion for road and rail infrastructure;
- \$5.2 billion for the construction of new social housing and \$400 million for repairs and maintenance. \$245.6 million for Defence Housing;
- \$12.2 billion in bonus payments to individuals;
- \$2.7 billion for business investment tax breaks; and
- \$3 billion for the Energy Efficient Homes initiative.

Tasmania's share of the package included: \$370 million for education infrastructure and capital works; \$148.9 million for new social housing and repairs and maintenance to existing social housing; and \$8.9 million for road and rail safety and roads maintenance. Local governments also received \$50 million for community infrastructure projects (Tasmanian Government, 2009a).

Australian government payments to individuals in Tasmania as part of the Economic Security Strategy in 2008 and Nation-Building – Economic Stimulus Plan in 2009 totalled around \$590 million and were equivalent to about 2.8 per cent of Tasmania's Gross State Product in 2007-08 (Tasmanian Government, 2009a). Nation Building funding was expected to increase Gross State Product by 1.25 to 1.5 per cent in 2009-10 and 2010-11.

3.2 Fiscal Strategies prior to the 2010-11 Mid-Year Financial Report

The Tasmanian Government has implemented a number of fiscal strategies in recent years that have focussed on producing surpluses and eliminating debt. The Fiscal Strategy implemented as part of the 1998-99 Budget sought to maintain budget surpluses, reduce net debt and debt servicing levels and address the State's unfunded superannuation liability (TDTF, 1999). The Fiscal Strategy that was due to run until 2003-04 included targets such as:

- The Budget was to be managed on a long-term sustainable basis by maintaining the Consolidated Fund in surplus from 1999-2000;
- Proceeds from major asset sales were to be used to repay debt;
- Costs were to be reduced by providing more efficient administration across the State Service;
- The Tax burden on industry would not be increased; and
- The Debt burden to be reduced by keeping the General Government Net Debt as a proportion of GSP below 10 per cent and keeping the net interest cost ratio 5 per cent

All targets were met two years ahead of schedule and a new Fiscal Strategy (2002-03 to 2005-06) was introduced with the objectives of: maintaining ongoing Budget surpluses; eliminating General Government Net Debt and net interest payments; making significant reductions in Total State Sector Net Debt; and eventually eliminating the Government's unfunded superannuation liability.

The next Fiscal Strategy that was to run from 2006-07 to 2010-11 included the following targets:

- Maintain a sustainable Budget Position through Net Operating Surpluses and Fiscal Surpluses (over a four-year rolling period);
- Reduce the debt and liability burden by ensuring that the General Government Sector remained debt free and eliminating the unfunded superannuation liability by 2033;
- Maintain a competitive business environment – no new taxes; and
- Maintain the General Government Sector investment in infrastructure in real terms

The impact of the GFC meant that these targets could not be met. The 2009-10 Budget (Tasmanian Government, 2009: 1.2) noted:

As a result of the GFC, the Government could not achieve its previous Fiscal Strategy targets over the 2009-10 Budget and Forward Estimates without breaching the Government's commitment to maintain frontline services, minimise the impact on public sector jobs and invest in infrastructure. Accordingly, the Government has developed an Interim Fiscal Strategy (IFS) that establishes a set of targets, the progressive achievement of which will return the Budget to a sustainable position.

The Interim Fiscal Strategy was to be in place from 2009-10 to around 2014-15, by which time normal economic conditions were expected to prevail. Specific targets include:

- By 2014-15 achieve a Net Operating Surplus, on average over a rolling four-year period in the General Government Sector;
- By 2014-15, achieve an underlying Net Operating Surplus, on average over a rolling four-year period for the General Government Sector;
- By 2014-15, achieve a modest Fiscal Surplus;
- By 2014-15, achieve a modest Consolidated Fund Surplus;
- Make the provisions necessary to extinguish the net unfunded superannuation liability by 2035;
- The ratio of Net Financial Liabilities to Revenue for the Non-Financial Public Sector will not exceed 110 per cent by 2014-15; and
- The General Government Sector will remain Net Debt free.

The Interim Fiscal Strategy was to support employment and ensure that frontline services were delivered to Tasmanians. Budget Management Strategies were also implemented with a view to reducing Government consumption by 2 per cent in real terms in 2009-10 and saving \$760 million in 2009-10 and over the Forward Estimates period. Agencies were required to reduce the size of the SES and review middle management. Other savings included efficiency dividends, wage restraint, and other cost reduction strategies.

4 The 2010-11 Mid-Year Financial Report

The 2010-11 Mid-Year Financial Report noted that the impact of the GFC in reducing revenues and increasing expenditures had been more severe than forecast in the 2010-11 Budget. According to the 2010-11 MYFR, the ongoing impact of reduced economic activity in the aftermath of the GFC meant that the targets established in the Interim Fiscal Strategy could not be achieved without remedial action. Factors that impinged on the ability to meet these targets included:

- Further reductions in GST revenues from the Australian Government totalling \$194.6 million over the Forward Estimates period due to lower than expected economic activity and increased savings by the Australian population;
- Increased infrastructure commitments that will support economic activity;
- Reduced State taxation revenues due to reduced economic activity; and
- Additional funding for the Department of Health and Human Services and Department of Education to support service delivery (around \$84 million in total).

A number of the targets set in the Interim Fiscal Strategy were not being achieved. None of the targets for the Net Operating Balance, the Fiscal Balance or the Consolidated Fund were on track to achieve surpluses by 2014-15. Similarly, the target of eliminating the Net Unfunded Superannuation Liability by 2035 was not expected to be met.

In the 2010-11 Mid-Year Financial Report the Government announced that immediate measures were required to meet the fiscal measures established in the 2010-11 Budget. Corrective measures include:

- Deferring or ceasing spending commitments attached to election pledges for the 2010 election until the impact of the GFC has dissipated;
- Ceasing non-critical infrastructure projects;
- Implementing a Public Sector Productivity Strategy to reduce expenditure to within the State's revenue capacity;
- Bring annual capital expenditure back to levels attained prior to the GFC; and
- Increased oversight and efficiency of government-owned businesses to reduce risks to taxpayers and reduce the impact on essential services.

Immediate savings amounting to \$158.6 million have been identified and will be achieved by 2013-14. The largest savings initiative is the removal of funding to Government businesses for equity purposes that will save \$97.5 million over the period to 2013-14

A Public Sector Productivity Strategy will include a major review of agency programs. The review will be completed by 2012-13 and will result in cutting programs that do not meet government priorities or are ineffective or inefficient. A 3 per cent annual productivity savings target equivalent to 2300 FTEs over the four years to 2014-15 is to be achieved by attrition, transfers and targeted separations. There is no estimate of the number of redundancies that may be required nor is there any provision in the MYFR for the cost of redundancy packages. Savings of \$30 million in 2011-12 would increase to \$200 million per annum by 2014-15. Government-owned businesses will be reviewed by Treasury prior to the 2011-12 Budget.

On 17 April 2011 the Premier announced that the Tasmanian Government would extend the Education Department's Workforce Renewal Incentive Program to all agencies but it would not be available in areas where there are skill shortages (Giddings, 2011). The packages would consist of \$1000 for each year of service up to a maximum of \$20,000, with pro-rata payments for part-time employees. This redundancy package is less generous than the Voluntary Targeted Employment Separation Arrangements Version 1.1 (Tasmanian Government, 2009b). Under these arrangements employees are entitled to 4 weeks salary in lieu of notice plus 2 weeks salary for each year of service up to a maximum of 48 weeks (minimum of 16 weeks for full-time employees). The new scheme is also much less generous than the Targeted Voluntary Separation Package available in South Australia. The South

Australian package offers 20 weeks pay plus three weeks pay for each year of service up to a maximum of 116 weeks which equates to 32 years service (Government of South Australia, 2010).

4.1 Changes between the 2010-2011 Budget and Mid-Year Financial Report

The key economic assumptions underlying the 2010-11 Budget and 2010-11 Mid-Year Financial Report are shown in Table 4.1. They point to a weakening in economic activity since the 2010-11 Budget. Tasmanian Gross State Product forecasts have been revised down in the MYFR; by 1 per cent in 2010-11, 1.5 per cent in 2011-12 and 0.5 per cent thereafter. The forecast unemployment rate has been revised up by 0.25 for 2010-11 and 0.5 per cent for subsequent years, while the forecast employment levels have been revised down slightly.

Table 4.1 Key assumptions underlying the 2010-11 Budget and Mid-Year Financial Report

2010-11 Budget	2009-10 Estimate	2010-11 Forecast	2011-12 Projection	2012-13 Projection	2013-14 Projection
Gross State Product (GSP) – real growth (%) ¹	0.25	2.25	2.75	2.75	2.75
Employment (year-average, % change)	-1.5	1.75	1	1	1
Level of Employment (year-average, '000s)	235	239	241	243	246
Participation Rate (year-average, %)	60.75	61.25	61	61	61
Unemployment Rate (year-average, %)	5.25	5.5	5.25	5.25	5.25
Consumer Price Index – Hobart (year-average, % change)	2.75	3	2.75	2.75	2.75
Population (year-average, % change)	0.9	0.8	0.8	0.8	0.8
Mid-Year Financial Report	2009-10 Actual	2010-11 Estimate	2011-12 Forecast	2012-13 Projection	2013-14 Projection
Gross State Product (GSP) – real growth (%) ¹	...	1.25	1.25	2.25	2.25
Employment (year-average, % change)	-1.6	1.25	0.5	1	1
Level of Employment (year-average, '000s)	234.5	238	239	241	244
Participation Rate (year-average, %)	60.9	61	61	61	61
Unemployment Rate (year-average, %)	5.6	5.75	5.75	5.75	5.75
Consumer Price Index – Hobart (year-average, % change)	2.7	2.75	2.75	2.75	2.75
Population (year-average, % change)	0.9	0.8	0.8	0.8	0.8

Source: (Tasmanian Government, 2010; 2011: 1.5, Table 3.1)

Note:

1. This GSP estimate is not intended to be benchmarked against the GSP estimates produced by the ABS due to ongoing concerns over the reliability of the ABS estimates of year-on-year changes in Tasmania's GSP.

4.1.1 Comparison of Net Operating Balance and Fiscal Balance

The 2010-11 Mid-Year Financial Report forecast an improvement in the General Government **Net Operating Balance** for 2010-11 of \$75.6 million (the 2010-11 Budget forecast of a deficit of \$65 million has been revised to a surplus of \$10.6 million). This is due to increased revenue (\$187.8 million) that is greater than increased expenditure (\$112.2 million). The net revenue increase arises from a \$249.5 million increase in one-off Commonwealth grants, a \$56.8 million reduction in GST revenue, and a \$15.5 million reduction in dividend, tax and rate equivalent income. The net expenditure increase (\$112.2 million) entails \$73.9 million in additional Health and Human Services expenditure expected

for salaries, consumables and grant expenses, and additional Education expenditure of \$27 million for salaries, supplies and consumables.

The government's argument for trimming expenditure over the next four years reflects concern that underlying recurrent income and expenditure are diverging. Between the original and revised budgets, the underlying net operating balance (reflecting the fiscal position once all one-off Commonwealth revenues for specific major capital projects are subtracted) falls by \$163 million for 2010-11 (from - \$332 million in the Budget to - \$495 million in the MYFR).

The **Fiscal balance** reflects the capacity of the Government to generate a surplus of revenue over operating expenses (the revised net operating balance being \$10.6 million) to fund the accumulation of non-financial assets (such as infrastructure and buildings). Net acquisition of non-financial assets of \$412.3 million comprises acquisitions of \$719.6 million (\$52.4 million less than in the original budget) less asset sales of \$58.5 million and depreciation of \$248.8 million. The revised fiscal deficit is therefore \$401.7 million, \$128 million (24.2 per cent) less than the original budget fiscal deficit of \$529.7 million.

In the Forward Estimates period State revenue is expected to fall \$58.4 million in 2011-12, increase by \$113.3 million in 2012-13, and then fall \$8.3 million in 2013-14. These variations largely reflect shifts in grant income and taxation revenues, and constitute a net revenue gain over 4 years of \$46.6 million, constituting a 1 per cent increase.

State expenditure is expected to increase by \$35.4 million in 2011-12, increase again by \$63.1 million in 2013-12 and increase again by \$42.2 million in 2013-14. Over the four year Forward Estimates period the increase is expected to be \$140.7 million, constituting a 3 per cent increase. A large increase in employee expenses (\$213.1 million over four years) and depreciation (\$30.3 million) is offset by an \$86.6 million reduction in grant and subsidy expenses and \$30.7 million reduction in supplies and consumables.

As a consequence of movements in revenues and expenses the Net Operating balance (\$10.6 million in 2010-11) will consequently fall by \$93.8 million in 2011-12 to -\$83.2 million, increase by \$50.2m in 2012-13 to -\$33 million, and decline by \$50.5 million in 2013-14 to -\$83.5 million.

Annual net acquisition of non-financial assets is envisaged to fall over the Forward Estimates period by \$333.8 million, so that given shifts in the Net Operating Balances the Fiscal Deficit (-\$401.7 million in 2010-11) will increase to -\$410.8 million in 2011-12, then fall to -\$182 million in 2012-13 and to -\$151.1 million in 2013-14.

4.1.2 Balance Sheet

In relation to the balance sheet, General Government Sector net assets are reduced by \$782.3 million between the 2010-11 Budget and the 2010-11 Mid-Year Financial Report, largely as a consequence of a \$664.2 million increase in the superannuation liability arising from an actuarial reassessment due to 'changes in assumptions used to value the defined benefit obligation' (Tasmanian Government, 2011: 27).

Net financial worth (net financial assets – liabilities) is revised down by 959.2 million (from the original \$2777.3 million to a revised amount of \$1818.1 million). Net financial liabilities (total liabilities less financial assets, excluding equity investments in the public financial and non financial sectors) are expected to be \$745.6 million higher than the original budget estimate (again, largely due to the superannuation liability increase) bringing it to \$4233.0 million by 30 June 2011, an increase of \$418.6 million from the previous year. We note that, were it not for the adoption of new actuarial assumptions for the assessment of General

Government superannuation liability, forecast net financial liabilities would have fallen during the year by \$245.6 million.

Net debt, comprising borrowings (\$39.2 million lower in the MYFR) less cash and deposits (which are \$68.7 million higher in the MYFR) and investments (which are \$10.5 million higher in the MYFR) is \$97.4 million lower in the MYFR (from -\$308.9 million to -\$406.3 million).

Over the four year period from the revised 2010-2011 budget, the state's Net Debt position appears to deteriorate by \$506.5 million, moving from a surplus of \$406.3 million in 2010-2011 to a debt of \$100.2 million in 2013-14. Borrowings decline by \$20.4 million over the period but Cash and Deposits decline by \$537.9 million. At the same time equity investments in the PNFC and PFC sectors, which are not included in Net Debt calculations, are forecast to increase by \$807 million.

While financial assets are expected to increase by \$272.8 million over the four years, non-financial assets are to grow by \$1.261 billion, comprising a \$600.7 million increase in the value of land and buildings and \$639.7 million increase in the value of infrastructure. Net Worth (Total Assets – Total Liabilities) grows by \$1000.4 million over the period. Net financial worth (financial assets – total liabilities) falls by \$260.7 million over the estimates period, because total liabilities grow by \$533.4 million, substantially comprised of a \$432.6 million increase in superannuation provision and \$83.2 million in extra employee entitlements. Net financial liabilities - calculated as total liabilities minus financial assets excluding equity investment in the PNFC and PFC sectors (which increase from 76 per cent of financial assets to 83.2 per cent) - increase by \$1067.7 million during the Forward Estimates period.

4.2 Savings not included in the Mid-Year Financial Report

The 2010-11 Mid-Year Financial Report included information on two major savings measures that will impact on fiscal outcomes in 2010-11 and over the Forward Estimates period. The first relates to immediate savings measures totalling \$158.6 million, largely new programs that will not proceed or will receive less funding. The details of these savings are shown in Table 4.2. The second major source of savings is the reduction in public sector expenditure equivalent to 2300 FTE staff. The savings will be \$30 million in 2011-12, \$60 million in 2012-13, \$150 million in 2013-14 and \$200 million in 2014-15.

The details of these savings measures are not included in the financial statements in the 2010-11 Mid-Year Financial Report. The impact on the fiscal position once these savings are included is evident in Table 4.3. In 2010-11 there is a modest improvement in the Net Operating Surplus (from \$10.6 million to \$15.6 million). The expenditure cuts in the Forward Estimates period will have a large impact on the Net Operating Balance. The deficit for 2011-12 is expected to be almost entirely eliminated and there are large surpluses forecast thereafter. Similarly, the improvement in the underlying Net Operating Balance means that there are surpluses from 2011-12 onward. There is also a dramatic improvement in the Fiscal Balance. The MYFR forecasts indicate that there will be a Fiscal Deficit for the entire Forward Estimates period. The amended figures show that the implementation of spending cuts would deliver a Fiscal Surplus by 2013-14.

Table 4.2 Immediate savings measures

	2010-11	2011-12	2012-13	2013-14	Total
	\$ m	\$ m	\$ m	\$ m	\$ m
Information Technology					
Connected Classrooms		1.0			1.0
Digital Pavilion Experience Centre	0.5				0.5
Extensions of the Wireless Waterfront Initiative	0.4				0.4
SmartGrid Trial	0.5	0.5			1.0
Virtual In-Home Health Care Demonstration Trial	1.0				1.0
Other Savings					
Cosgrove Specialist Sports School	1.0	9.0	8.0		18.0
Events Attraction Program ¹		0.8	1.5	1.5	3.8
Helicopter Emergency Medical Service	1.1	6.8	11.4	11.7	30.9
Ministerial Restructure ¹		0.5	1.0	1.0	2.5
Renewable Energy Loan Fund ²	0.5	0.5	0.5	0.5	2.0
Withdrawal of Police from Prisoner Transport and Court Security ³					
Revised equity policy for Government business		32.5	32.5	32.5	97.5
Total savings	5.0	51.6	54.9	47.2	158.6

Source: (Tasmanian Government, 2011)

Notes:

1. These initiatives were initially allocated \$1.5 million per annum from 2010-11 and thereafter.
2. This saving represents a reduction in the original Budget and Forward Estimates allocation of 50 per cent.
3. Funding for this initiative was not included in the 2010-11 Budget and Forward Estimates pending finalisation of the details of the initiative.

Table 4.3 Amended Net Operating Balance and Fiscal Balance

	2010-11	2010-11	2011-12	2012-13	2013-14	2014-15
	Budget	Revised Budget	Forward Estimate	Forward Estimate	Forward Estimate	Projection
	\$ m	\$ m	\$ m	\$ m	\$ m	\$ m
Net Operating Balance	-65.0	10.6	-83.2	-33.0	-83.5	64.0
Immediate Savings		5.0	51.6	54.9	47.2	
Reduction in staff costs			30.0	60.0	150.0	200.0
Amended Net Operating Balance	-65.0	15.6	-1.6	81.9	113.7	264.0
Underlying Net Operating Balance	-332.0	-495.0	-333.0	-107.0	-84.0	-64.0
Immediate Savings		5.0	51.6	54.9	47.2	
Reduction in staff costs			30.0	60.0	150.0	200.0
Amended Underlying Net Operating Balance	-332.0	-490.0	-251.4	7.9	113.2	136.0
Fiscal Balance	-529.7	-401.7	-410.8	-182.6	-151.1	
Immediate Savings		5.0	51.6	54.9	47.2	
Reduction in staff costs			30.0	60.0	150.0	
Amended Fiscal Balance	-529.7	-396.7	-329.2	-67.7	46.1	

Source: (Tasmanian Government, 2011; Authors' calculations)

5 Analysis of Budget outcomes

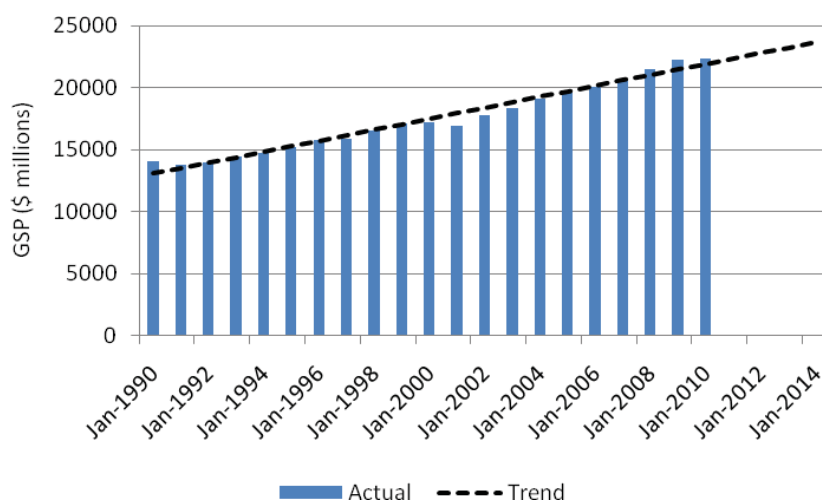
5.1 Budget outcomes in Tasmania

The global downturn resulting from the GFC impacted on government finances in a number of ways. At the Commonwealth level there was a negative impact on the budget due to the fall in revenues and additional expenditure on income support payments as the automatic stabilisers were activated. There were further large impacts on the budget bottom line due to the large expenditures to stimulate economic activity and support employment (detailed in Section 3.1).

In 2009-10, the Commonwealth fiscal balance was in deficit by \$52.9 billion or 4.1 per cent of GDP (Australian Government, 2010d). This followed a deficit in 2008-09 of \$29.7 billion or 2.5 per cent of GDP and a surplus of 1.9 per cent of GDP in 2007-08 (Australian Government, 2008). Australian Government revenue fell from 26.8 per cent of GDP in 2007-08 to 22.5 per cent in 2009-10 and expenses increased from 24.8 per cent to 26.1 per cent of GDP.

The economic downturn has also impacted on the level of economic activity and the fiscal outcomes in Tasmania since 2008. Figure 5.1 shows Gross State Product (GSP) in Tasmania to 2010. The columns in Figure 5.1 show actual GSP from 1990 to 2010. An OLS regression using data from 1990 to 2008 was used to construct a trend line for the period prior to the GFC and the estimates were then used to forecast future GSP. These values are represented by the dotted line. GSP growth has been very stable over the entire period with only minor deviations from trend growth.

Figure 5.1 GSP and predicted GSP



Source: (ABS, 2010a) Cat no. 5220.0 Australian National Accounts: State Accounts, Table 1: Gross State product, Chain volume measures and current prices.

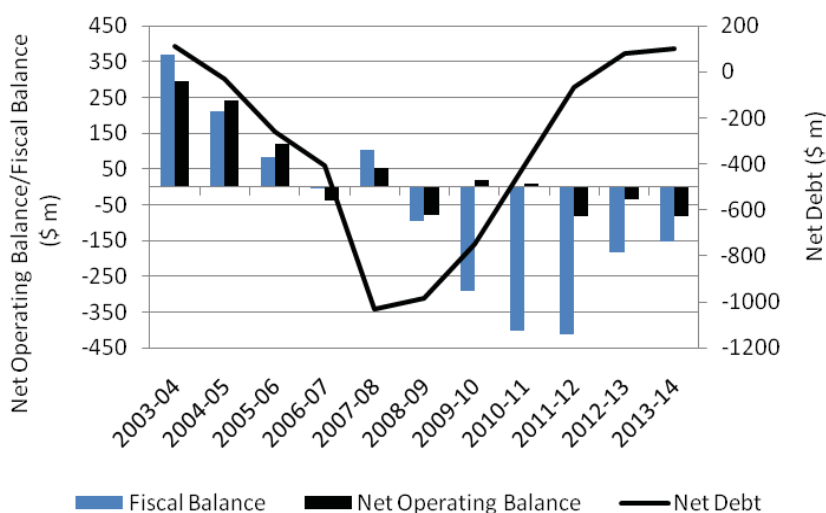
The impact of the economic cycle is evident in the decline in GSP in 1991 and 2001. GSP was below trend from 1992 to 1995 and from 2000 to 2003. GSP has remained above trend after the GFC but has fallen closer to trend in 2010. This effect may be attributable to Commonwealth expenditure on various stimulus measures designed to support economic

activity and employment. Notwithstanding the mild economic effect of the slowdown following the GFC, there may be a substantial effect on the State Government fiscal position.

Figure 5.2 shows the net operating balance, fiscal balance and net debt for Tasmania between 2003-04 and 2009-10 and budget forecasts for these parameters until 2013-14. The projections are from the 2010-11 Mid-Year Financial Report financial statements and therefore do not include the expenditure cuts introduced in the MYFR. If the expenditure cuts were included there would be a significant improvement in these outcomes as detailed in Table 4.3.

After several years of Net Operating Surpluses there were deficits of \$39 million in 2006-07 and \$78 million in 2008-09. Further net operating deficits are forecast for the Forward Estimates period. The fiscal balance was in surplus until 2007-08 (except for a deficit of \$6 million in 2006-07). Fiscal deficits occurred in 2008-09 and 2009-10 and further deficits are expected in the Forward Estimates period. During the period from 2004-05 to 2009-10 there was no net debt in the General Government Sector (GGS) in Tasmania and this is expected to continue in 2010-11 and 2011-12. Net debt is forecast to be positive in 2012-13 and 2013-14.

Figure 5.2 Fiscal outcomes for Tasmania, 2003-04 to 2013-14



Source: (Tasmanian Government, 2011; Treasurer’s Annual Financial Report, various years).

Note: 2003-04 to 2009-10 are actual outcomes; 2010-11 to 2013-14 are forecasts

5.1.1 Fiscal outcomes in Tasmania, 2006-07 to 2010-11

This section examines estimates from past Budgets and MYFRs against actual figures from the Treasurer’s Annual Financial Reports to ascertain the accuracy of Budget forecasts. Table 5.1 displays Budget and Mid-Year Financial Report forecasts and actual results (where available) for the Net Operating Balance, Fiscal Balance and Net Debt from 2006-07 to 2010-11.

Table 5.1 Forecasts and actual fiscal outcomes

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Net Operating Balance								
2006-07 Budget	-90.5	-100.9	-42.6	-28.8				
2006-07 MYBR	-111	-81	-12	-17				
2006-07 Final Outcome	15							
2007-08 Budget		-38.8	22.3	16.8	17.1			
2007-08 MYBR		144	179	203	198			
2007-08 Final Outcome		53						
2008-09 Budget			105.7	203.2	170.8	275.3		
2008-09 MYBR			-91.3					
2008-09 Final Outcome			-78					
2009-10 Budget				-117.1	-87.3	-24.1	73.6	
2009-10 MYBR				-63.4	-99.8	-83.5	5.1	
2009-10 Final Outcome				18				
2010-11 Budget					-65	-82	31.9	53.4
2010-11 MYBR					10.6	-83.2	-33	-83.5
Fiscal Balance								
2006-07 Budget	-84.5	-65.1	-44.5	11.1				
2006-07 MYBR	-109	-49	-5	12				
2006-07 Final Outcome	49							
2007-08 Budget		-31.4	-1.1	47.4	84.8			
2007-08 MYBR		126	147	211	255			
2007-08 Final Outcome		102						
2008-09 Budget			30.2	50.5	22.3	154.8		
2008-09 MYBR			-148.1					
2008-09 Final Outcome			-95					
2009-10 Budget				-569.5	-491.6	-167.6	33	
2009-10 MYBR				-310.4	-385.6	-342.4	-242.1	
2009-10 Final Outcome				-291				
2010-11 Budget					-529.7	-197.1	-65.7	1.4
2010-11 MYBR					-401.7	-410.8	-182.6	-151.1
Net Debt								
2006-07 Budget	-232.4	-298.3	-394.2	-534.8				
2006-07 MYBR	-286	-367	-505	-652				
2006-07 Final Outcome	-409							
2007-08 Budget		-456	-586	-74	-946			
2007-08 MYBR		-940	-1173	-1448	-1799			
2007-08 Final Outcome		-1031						
2008-09 Budget			-1122.8	-1262.9	-1396.9	-1665.4		
2008-09 MYBR			-948.5					
2008-09 Final Outcome			-982					
2009-10 Budget				-486.5	-112.9	-71.8	-231.4	
2009-10 MYBR				-693.2	-420.9	-185.6	-59.9	
2009-10 Final Outcome				-748				
2010-11 Budget					-308.9	-219.5	-262	-382.1
2010-11 MYBR					-406.3	-65.6	80.9	100.2
2010-11 Final Outcome								

Source: Budget, Mid-Year Financial Report and Treasurer's Annual Financial Report, various years.

Table 5.1 demonstrates the degree of difficulty involved in predicting fiscal outcomes and the large variations between forecasts and actual results. The Budget estimates underestimated the size of the Net Operating Balance and the Fiscal Balance in three of the four years between 2006-07 and 2009-10. In 2006-07 the Net Operating Balance was forecast to be in deficit to the tune of \$90.5 million but the final outcome indicated a surplus of \$15 million. There were similar transformations from predicted deficits to actual surpluses in 2007-08 (from a deficit of \$38.8 million to \$53 million) and 2009-10 (from deficit of \$117.1 million to a surplus of \$18 million). In 2010-11 the forecast deficit of \$65 million was revised to a surplus of \$10.6 million in the MYFR.

Forecast deficits in the Fiscal Balance were incorrect in 2006-07 (a forecast deficit of \$84.5 million became an actual surplus of \$49 million) and 2007-08 (forecast deficit of \$31.4 million but an actual surplus of \$102 million). In 2009-10 the actual Fiscal Deficit was much smaller than forecast (\$291 million compared to the forecast of \$569.5 million). In 2010-11 the Budget forecast of a deficit of \$529.7 million has been revised down to \$401.7 million.

The only overestimate of these balances was in 2008-09 when the economic downturn occurred. In that year the forecast of a surplus in the Net Operating Balance of \$105.7 million was transformed into a deficit of \$78 million. Similarly, the Fiscal Balance moved from a forecast surplus of \$30.2 million to a deficit of \$95 million in 2008-09.

Forecasts of Net Debt have also been subject to large forecast errors. Table 5.1 shows that the Net Debt position has been negative throughout this period and forecasts have proven to be pessimistic in all years except 2008-09 when the Net Debt position deteriorated more than was forecast (the forecast was for negative Net Debt of \$1122.8 million but the actual amount was -\$982 million). In the other years the actual outcome was much better than the forecast (by \$176.6 million in 2006-07, \$575 million in 2007-08 and \$261.5 million in 2009-10). The forecast for 2010-11 has also been revised from negative \$308.9 million in the Budget to negative \$406.3 million in the MYFR.

Economic conditions have proven difficult to anticipate, especially since the onset of the GFC. In the 2009-10 Budget, GSP was forecast to shrink by 0.75 per cent in 2009-10 but this was revised to a growth forecast of 0.25 per cent in the 2009-10 MYFR. Similarly, the forecast of 2.25 per cent GSP growth for 2010-11 was revised down to 1.25 per cent in the 2010-11 MYFR. Expectations of employment growth have also been volatile. The 2009-10 Budget forecast employment growth of negative 0.75 per cent for 2010-11. This was revised up to 1.75 per cent in the 2010-11 Budget and then down to 1.25 per cent in the 2010-11 MYFR.

This brief examination of previous fiscal outcomes suggests that past forecasts have tended to be overly conservative. Some of the variations between forecasts and actual outcomes have resulted from discretionary decisions by the Australian and Tasmanian Governments. Undertaking emergency strategies based on forecasts that have proven to underestimate fiscal balances to such an extent risks damaging economic activity in order to forestall deteriorations in the fiscal position that may not happen.

5.2 Understanding budget outcomes

The State Government's Fiscal Balance which is published in the Budget Papers each year is the difference between total state revenue and total state outlays. So if total revenue is greater than outlays, the budget is in surplus and vice versa. Many observers and politicians use the actual reported Fiscal Balance to indicate the fiscal stance of the government. So if the budget is in surplus they conclude that the fiscal impact of government is contractionary

(withdrawing net public spending) and if the budget is in deficit they conclude that the fiscal impact is expansionary (adding net public spending).

However, the complication is that we cannot then conclude that changes in the fiscal impact reflect discretionary policy changes. The reason for this uncertainty is that there are automatic stabilisers which are in-built into the budget outcome and vary with the level of economic activity independent of discretionary policy changes.

To see this, a simple model of the budget balance can be written as:

Budget Balance = Revenue – Spending.

Budget Balance = (Tax Revenue + Other Revenue) – (Welfare Payments + Other Spending)

We know that Tax Revenue and Welfare Payments move inversely with respect to each other, with the latter rising when growth in State Product falls and the former rises with growth in State Product. These components of the Budget Balance are the so-called automatic stabilisers. In other words, without any discretionary policy changes, the recorded Budget Balance will vary over the course of the business cycle.

When the economy is weak – tax revenue falls and welfare payments rise and so the Budget Balance moves towards deficit (or an increasing deficit). When the economy is stronger – tax revenue rises and welfare payments fall and the Budget Balance becomes increasingly positive. Automatic stabilisers attenuate the amplitude in the business cycle by expanding the budget in a recession and contracting it in a boom.

As a result, we cannot conclude that a rising budget deficit indicates that the State Government has suddenly become of an expansionary mind. In other words, the presence of automatic stabilisers makes it hard to discern whether the fiscal policy stance (chosen by the government) is contractionary or expansionary at any particular point in time. Any statements that suggest the budget deficit is "too large" and that program cut-backs are required to address the situation thus have to be assessed with considerable caution.

To overcome this uncertainty, economists devised what was called the Full Employment or High Employment Budget. In more recent times, this concept is now called the Structural Balance. The Structural Balance is a hypothetical budget balance that would be realised if the economy was operating at potential capacity or full employment. In other words, we would calibrate the budget position (and the underlying budget parameters) against some fixed point (full capacity) and thus eliminate the swings in the budget balance that arise from variations in the business cycle. These cyclical swings in activity around full employment or capacity would be separated out from the underlying budget position which would reflect the discretionary fiscal stance chosen by the government.

If the structural component of the budget outcome is balanced then it means, conceptually, that total outlays and total revenue would be equal if the economy was operating at total capacity. If the budget was in surplus at full capacity, then we would conclude that the discretionary structure of the budget was contractionary and vice versa if the budget was in deficit at full capacity.

An important point to understand is that the actual budget balance is to a major extent out of the control of the State government because the cyclical component reflects the variations in the spending decisions of private sector agents (household, business firms, external relations). As a result, it is often counter-productive for a government to attempt to cut back the budget outcome with discretionary spending cuts and/or taxation increases because it fears the budget balance is excessive. In these circumstances, the imposition of austerity may then cause State Product to contract and the automatic stabilisers (principally, tax revenue at the

State level) to push the budget further into deficit. It also follows that a growth strategy underpinned by discretionary stimulus spending and/or tax cuts can drive reductions in the budget deficit outcome as the level of economic activity increases and tax revenues recover.

We thus urge caution when dealing with discussions surrounding the dynamics of the State budget and efforts have to be taken to decompose the structural and cyclical components of the actual reported budget outcome before any analysis of the discretionary fiscal stance is engaged. It is impossible to make any sense of the appropriateness of the fiscal stance of the State government without undertaking this decomposition.

In the following Section, we attempt to provide some guidance on the cyclical components. It is not an exact science but aims to provide a starting point for further State government analysis. It is simply unacceptable to conduct discussions about the appropriateness of the fiscal stance by only referencing the actual reported budget position.

5.3 The cyclical budget component

As explained above, to fully appreciate the impact of variations in the business cycle on the actual budget outcome, we need to decompose the aggregate movements into those movements which indicate cyclical changes in the level of activity (the cyclical or automatic stabiliser component) and the movements that arise from discretionary changes in fiscal policy parameters.

Several techniques have been developed to estimate the structural budget deficit at the national level. Estimates are produced by the IMF and the OECD using somewhat different methodologies. In general, the process involves three main steps: estimating potential output and the output gap (the gap between potential and actual output); quantifying the cyclical component of expenditures and revenues; and subtracting the estimated cyclical components from the actual levels. Calculations of the Structural Balance are complex and sensitive to underlying assumptions so they provide indicative rather than precise estimates.

In the following discussion we provide some guidance on what the movements in the cyclical and structural components may have been in recent years. We attempt to evaluate the cyclical budget component for Tasmania by examining budget revenues and expenditures. We restrict the analysis to an examination of the net operating balance. Capital investments are excluded from the analysis because it is inappropriate to include long-term financial commitments and benefits. Investments will deliver economic and social benefits over the life of the assets and will be financed over the same period.

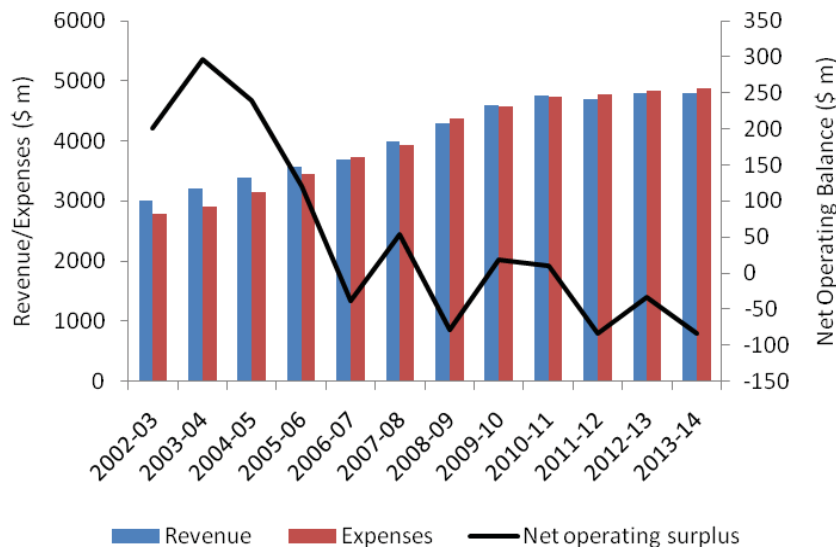
Figure 5.3 shows revenues, expenses and the net operating balance for Tasmania from 2003-04 to 2013-14. Revenues increased significantly in 2007-08 (7.9 per cent), 2008-09 (7.5 per cent) and 2009-10 (7.4 per cent) as a consequence of the stimulus expenditure. Revenue growth is forecast to slow markedly in the Forward Estimates period, attaining a 1 per cent annual growth rate between 2009-10 and 2013-14.

Growth in expenses has exhibited more variation. While growth in expenses was lower than revenue growth in 2007-08 at only 5.3 per cent it reached 11 per cent in 2008-09 and then fell to 5 per cent in 2009-10. Over the period 2003-04 to 2009-10 the average annual growth in expenses of 7.8 per cent outstripped revenue growth of 6.2 per cent per annum. The average annual growth rates are closer when the forecast period to 2013-14 is included, with expenses growing at 5.3 per cent (between 2003-04 and 2013-14) and revenue growth of 4.1 per cent per annum. Expenses are forecast to continue to grow at a faster rate than revenues over the Forward Estimates period. In contrast to the growth rate of 1 per cent per annum for revenues, expenses are forecast to increase at an annual rate of almost 1.6 per cent between

2009-10 and 2013-14. However, these figures do not include the expenditure cuts announced in the 2010-11 MYFR. When these spending cuts are included the growth rate for expenses from 2009-10 to 2013-14 falls dramatically to just 0.5 per cent.

The net operating balance has declined over the period from a situation of sustained surpluses to an expectation of deficits during the Forward Estimates period.

Figure 5.3 Revenues, expenses and net operating balance, 2003-04 to 2013-14



Sources: (Tasmanian Government, 2011; Treasurer’s Annual Financial Report, various years).

Notes. Figures for 1999-200 to 2009-10 are actual. Figures for 2010-11 are estimates from the 2010-11 Mid-Year Financial Report.

The impact of the economic downturn on the Tasmania budget position operates through both revenues and expenditures. The revenue effects are due to the effect of changes to revenues received from the Commonwealth and direct impacts on State revenues. In national estimates of cyclical effects, expenditure effects are generally limited to the impact of additional welfare payments due to higher unemployment. This is not relevant to Tasmania since welfare payments are the responsibility of the Australian Government. There may be spill-over impacts on State finances due to increased demand for social assistance as a result of deteriorating living standards of those directly affected by the GFC and economic slowdown, or other social consequences that may include increased crime or adverse impacts on health or family functioning. The major expenditure effect in Tasmania since the GFC has been due to spending generated by the Commonwealth’s economic stimulus measures.

5.3.1 Payments from the Commonwealth

This section will consider and attempt to quantify the major impacts of the cyclical downturn on Tasmania’s fiscal position due to variations in Commonwealth payments to Tasmania. The major impacts on revenues from the Australian Government are through ongoing revenue streams that are sensitive to variations in economic activity such as:

- General Revenue Assistance that is primarily GST revenue; and
- Discretionary expenditure as part of the various components of stimulus initiatives.

At the April 2010 COAG meeting there was an agreement between the Commonwealth and all the states with the exception of Western Australia that from July 2011 the National Health and Hospitals Network would be financed by a combination of a National Healthcare Specific Purpose Payment, an amount of State GST revenue and Commonwealth top-up funding (COAG, 2010). The Mid-Year Economic and Fiscal Outlook included the transfer of a portion of GST revenue payable to each state (with the exception of Western Australia) to the total amount of SPPs. At the COAG meeting in February 2011, a new Heads of Agreement – National Health Reform was signed that no longer included the transfer of GST to SPPs to finance the health sector. In the data presented below the amounts of GST revenue for Tasmania that were to be transferred to SPPs from 2011-12 have been included in the GST data to reflect this change and have been deducted from the SPP amounts presented in the Mid-Year Economic and Fiscal Outlook 2010-11 (Australian Government, 2010b).

For Australia, total GST revenues declined by \$1.8 billion or 4.6 per cent in 2008-09 and then increased by \$3.9 billion or 9.2 per cent in 2009-10. GST receipts have been weaker than expected due to lower expenditure resulting in downward revisions of Commonwealth GST collections of \$1.5 billion over the four years to 2013-14 (Australian Government, 2010b).

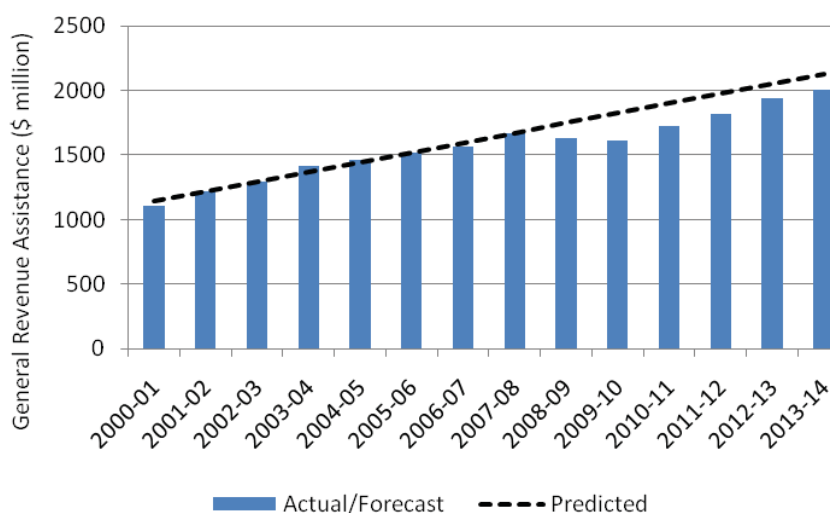
The situation in Tasmania reflects the impact of the economic crisis on GST revenues nationally. Figure 5.4 shows actual and forecast GST revenue from 2000-01. The columns represent actual GST revenue paid by the Commonwealth to Tasmania from the introduction of the GST in 2000-01 until 2009-10 and forecast GST revenue from 2010-11 to 2013-14. The data for the period 2010-11 to 2013-14 is from the Mid-Year Economic and Fiscal Outlook 2010-11. The data have been adjusted to reflect the change in policy regarding the transfer of part of the GST revenue to a SPP for health and hospitals.

The dotted line represents predicted values which are an attempt to remove the variation in GST expenditure emanating from cyclical factors. Predicted values were estimated by using an OLS regression to estimate GST revenue for the period prior to the GFC (2000-01 to 2007-08). The estimated model was then used to predict future values over the Forward Estimates period.

The cyclical impact of the economic slowdown is evident in Figure 5.4. General Purpose Payments (GST revenues) were affected by the slowdown in economic activity after the GFC as consumers adopted a more cautious attitude to discretionary expenditure. From the introduction of the GST in 2000-01 until 2007-08 GST revenues to Tasmania increased every year and achieved an average annual growth rate of almost 6 per cent. In 2008-09 receipts fell from \$1665 million to \$1627 million and declined further in the following year to \$1615 million. Compared to projected GST, represented by the dotted line in Figure 5.4, actual GST receipts for Tasmanian fell \$121.4 million short in 2008-09, were \$209.4 million below in 2009-10 and are expected to be \$177.4 million lower in 2010-11. The Tasmanian Government has indicated that the State has lost \$800 million in GST revenue in 2010-11 and the Forward Estimates period compared to growth rates experienced in the pre-GFC period (Tasmanian Government, 2011).

According to Commonwealth forecasts in the 2010-11 Mid-Year Economic and Fiscal Outlook, Tasmania's general revenue assistance will increase this financial year and over the forecast period. The gap between the forecasts indicated by the columns and the predicted values using the pre-GFC trend shows that revenue is moving toward the trend figures but will not return to the pre-GFC growth path by 2013-14.

Figure 5.4 General Revenue Assistance, 2000-01 to 2013-14



Source: (Australian Government, 2010b; Final Budget Outcomes, various years).

Note: Figures up to 2009-10 are actual, figures from 2010-11 are estimates.

There are two factors that will have a further negative impact on GST revenue in Tasmania. Firstly, national GST receipts for the six months to December 2010 were \$612 million or 2.6 per cent lower than the MYEFO estimates, suggesting that Tasmania may receive less GST revenue than expected unless collections recover in the second half of the year (ATO, 2011). Secondly, the Commonwealth Grants Commission (2011) *Update* has revised GST revenues down further for 2011-12 due to recommended changes in the GST relativities that reduce Tasmania's share of GST from 3.7 per cent to 3.6 per cent of total GST revenue. Under these estimates Tasmania's GST revenues for 2011-12 will be \$1795.2 million rather than the MYEFO estimate of \$1820.6 million and the estimate for 2012-13 will also be affected.

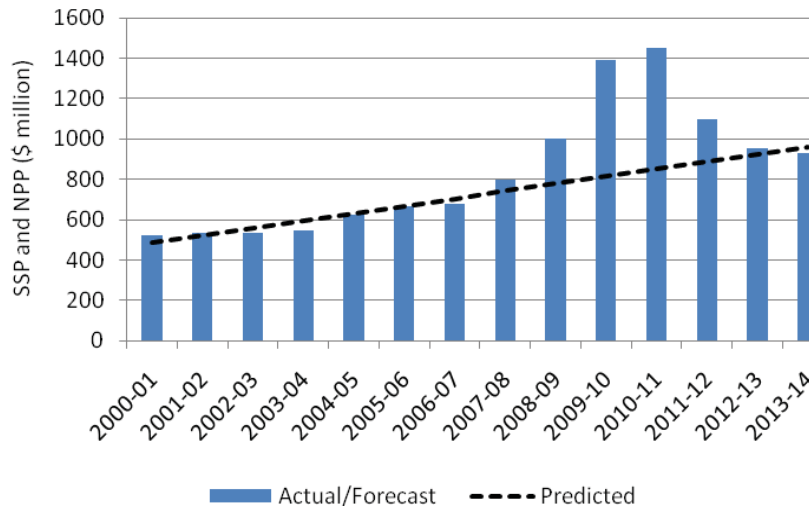
In the longer-term the State shares of GST revenues will be affected by the Review of GST Distribution that is currently in progress. The review will report by late 2012 and will be considered by COAG prior to a decision on a new formula to be used from 2013-14.

The second pathway for cyclical revenues to affect the Tasmanian Budget is through Commonwealth funding under the economic stimulus packages that comprises part of Specific Purpose Payments (SPPs) and National Partnership Payments (NPP). Specific Purpose Payments (SPP) to the States increased by 30 per cent in 2008-09 and a further 26 per cent in 2009-10 but will decline by 13.5 per cent in 2010-11 as the stimulus measures are wound back (Australian Government, 2010c). The large increases in SPPs to the States counteracted the negative impact of the GFC on GST revenues and provided a further impetus to economic activity.

The increases in SPPs as a result of the stimulus packages are evident in the Figure 5.5 that shows actual and forecast SPP and NPP grants to Tasmania from 2000-01 to 2013-14. The columns show the actual grants received by the State between 1999-2000 and 2009-10 along with Forward Estimates from the 2010-11 Mid-Year Economic and Fiscal Outlook. The dotted line is the trend of what SPP and NPP payments would have been if the past trajectory had been maintained. The impact of additional expenditure from the economic stimulus packages is evident in the large rise in grants from 2008-09. Grants increased by over 25 per cent in 2008-09 and 39 per cent in 2009-10. The graph shows that this is a temporary

injection of funds since grants fall substantially in 2011-12, return to the predicted level by 2012-13 and are marginally lower in 2013-14.

Figure 5.5 SPP and NPP payments to Tasmania



Source: (Australian Government, 2010b; Final Budget Outcomes, various years).

Table 5.2 details SPP and NPP revenues received by Tasmania as part of the economic stimulus package. The largest payments were in 2009-10 with payments totalling \$575.7 million and 2010-11(\$343.1 million).

Table 5.2 SPP and NPP grants due to economic stimulus measures

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
	\$ m	\$ m	\$ m	\$ m	\$ m	\$ m
National Building and Jobs Plan - Building the Education Revolution	30.3	264.7	138.8	11.8	0.0	0.0
Nation Building and Jobs Plan- Social Housing	7.7	92.8	29.7	4.6	0.0	0.0
National Building Program- road and rail	100.9	183.7	153.5	90.4	70.1	56.1
Regional and Local Community Infrastructure Program - Local Governments	15.7	9.3	9.9	0.0	0.0	0.0
National Building Package - TAFE facilities						
First Home Owners Boost	21.5	20.4	2.3	0.2	0.0	0.0
Jobs Fund - Infrastructure employment projects	0.0	4.7	9.0	0.0	0.0	0.0
Total	176.1	575.7	343.1	107.0	70.1	56.1

Source: (Australian Government, 2010b, 2010d, 2010e).

There is a mismatch between the timing of the receipt of grants from the Commonwealth for the Nation Building – Economic Stimulus Program and expenditure by the State. The largest

proportion of Commonwealth payments were made to the States in 2009-10 although expenditure is spread over a longer time period.

Comparing the data in Table 5.1 with the total SPP and NPP funding for the same period that is shown in Figure 5.5 demonstrates that the stimulus funding injection is responsible for the deviation from trend and indicates the importance of this funding in supporting economic activity in Tasmania during the economic downturn. The beneficial economic impact of the stimulus packages on economic activity in Tasmania was acknowledged in the 2010-11 Mid-Year Financial Report:

Tasmania's economy benefited from the fiscal stimulus measures, such as cash payments to eligible taxpayers and welfare recipients, the boost to the First Home Owner Grant and the public investment programs (Tasmanian Government, 2011: 16).

5.3.2 State Government revenues

State governments do not levy income taxes nor are they responsible for increased income support payments during periods of reduced economic activity. They are therefore less exposed to economic downturns than the Commonwealth. Grants from the Commonwealth account for around half of the revenue of State Governments and are relatively stable with the exception of GST revenues which are pro-cyclical and, in the aftermath of the GFC, Commonwealth discretionary expenditure in the form of anti-cyclical stimulus expenditure, as detailed in the previous section.

The most important State generated revenue streams relate to taxation, fees and charges for transactions and services provided by the public sector. Investments by the State and income from PNFCs also contribute to revenue. For revenues generated at the State level the major cyclical impacts are due to variations in stamp duty and payroll tax receipts.

5.3.2.1 Stamp duty

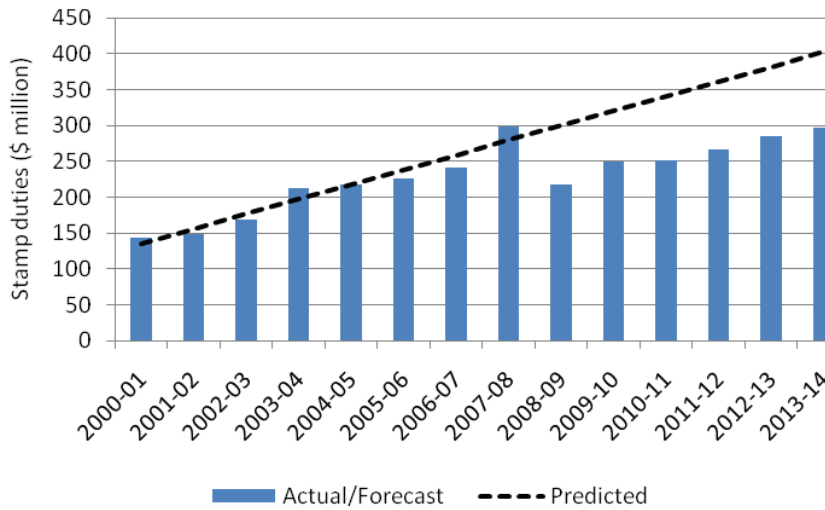
Stamp duty revenue collections fell in 2008-09 due to the impact of the GFC. The columns in Figure 5.6 show actual stamp duty receipts to 2009-10 and budget and forecast values to 2013-14. The line indicates the trend prior to the impact of the GFC. The trend was calculated using an OLS regression based the pre-GFC period 2000-01 to 2007-08 and then projected to cover the period to 2013-14. The deterioration in economic activity had a large impact on stamp duty receipts that declined in nominal terms from \$299 million in 2007-08 to \$217 million in 2008-09; a fall of more than 27 per cent. In 2009-10 stamp duty revenues increased by almost 15 per cent to reach \$249 million. The shortfall in stamp duty revenues, compared to projections using the pre-GFC data, amounted to \$82.8 million in 2008-09, \$71.4 million in 2009-10 and is expected to be \$89.5 million in 2010-11.

Stamp duty revenue is expected to remain flat in 2010-11 and then gradually recover to almost regain the pre-GFC level by 2013-14 when it is forecast to reach \$297 million. The period from 2008-09 indicates a steep cyclical fall and gradual recovery of revenues. It is unclear when or if revenues will return to the pre-GFC trend line.

The decline in stamp duties has been driven primarily by the sharp fall in conveyancing revenues on property sales. Factors affecting conveyancing revenues are shown in Figures 5.7 and 5.8. Figure 5.7 shows average monthly building approvals for houses and other residential dwellings in the columns and the line represents average monthly finance commitments for first home buyers from 2000-01 to 2010-11. The data for 2010-11 represent monthly approvals/finance commitments for July 2010 to February 2011. Building approvals

increased after the GFC, rising from a monthly average of 240 in 2007-08 to 259 in 2008-09 and 269 in 2009-10.

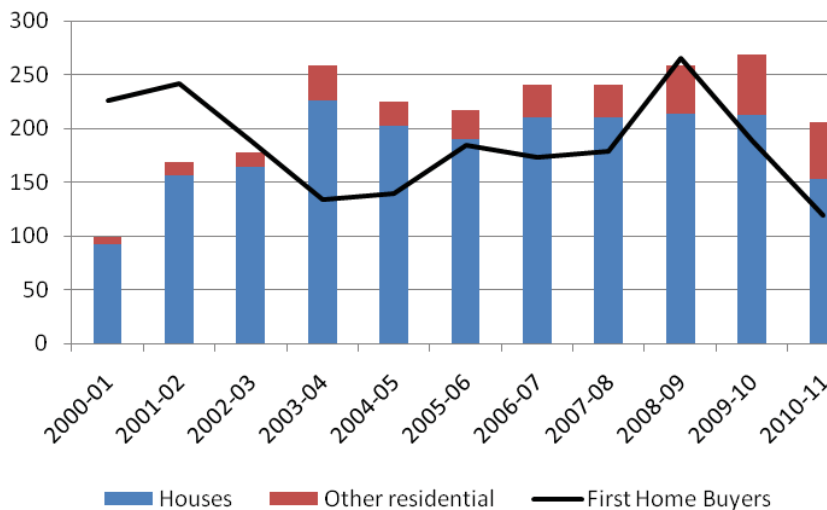
Figure 5.6 Stamp duty revenue, 2000-01 to 2013-14



Source: (Tasmanian Government, 2010; 2011a; Treasurer’s Annual Financial Report, various years).

The impact of the First Home Owners Boost Scheme in supporting the housing industry is evident in Figure 5.7. From 2000 the First Home Owners Scheme provided a grant of \$7000 to first home owners. The First Home Owners Boost Scheme was introduced as an additional grant as part of the Australian Government stimulus initiatives and provided an additional \$7000 for first home buyers of established homes purchased between 14 October 2008 and 30 September 2009, and an additional \$3500 for established home purchases between 1 October 2009 and 31 December 2009. The Scheme provided an additional payment of \$14000 for new home purchases between 14 October 2008 and 30 September 2009.

Figure 5.7 Building Approvals and First Home Buyers Finance Commitments, 2000-01 to 2010-11

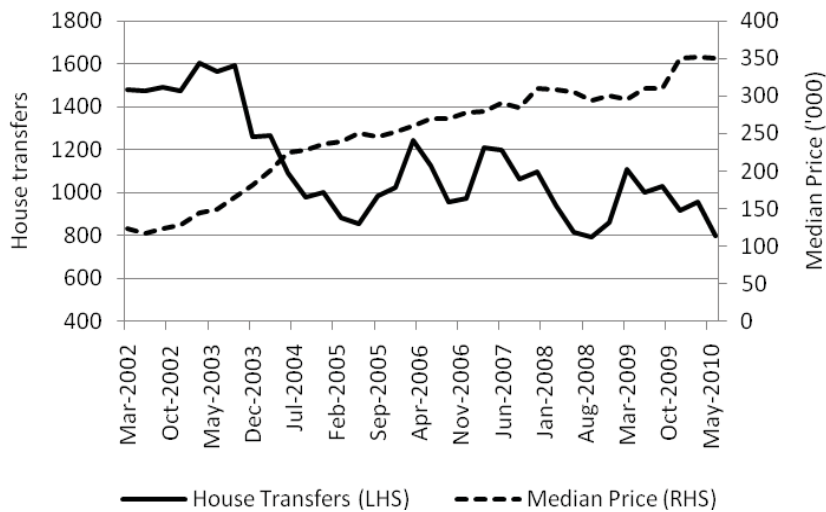


Source: (ABS, 2010f; 2011d)

Note: Figures for 2010-11 are averages for the 8 months to February 2011

Housing approvals were influenced by the steep increase in finance commitments for first home buyers. Finance commitments increased from a monthly average of 178 in 2007-08 to 265 in 2008-09 and 189 in 2009-10. During the 12 months that the additional payments for new homes operated (October 2008 to September 2009) the monthly average of finance commitments for new home owners reached 286. Many of the loans approved in 2008-09 would be reflected in increased building activity in 2009-10 which was the year that building approvals peaked. Approvals have dropped in 2010-11 to average 205 per month and finance commitments have also declined in the current financial year to a monthly average of around 120. The stimulus played an important role in stimulating the building industry and supporting stamp duty revenues for Tasmania although first home buyers were eligible for stamp duty concessions.

Figure 5.8 Median house prices and house transfers, Hobart, 2002 to 2010



Source: (ABS, 2010e) Cat no. 6416.0, 2010 House Price Indexes: Eight Capital Cities

The second factor impacting on conveyance duties relates to the slowdown in property transfers and the dampening effect on house prices. Figure 5.8 shows the median house price in Hobart and the number of house transfers between 2002 and 2010. There was a sharp fall in transfers from 1099 in December 2007 to a minimum of 790 in September 2008 before transfers increased to 1107 in March 2009. However, the recovery was short-lived and transfers declined subsequently to 798 in June 2010.

In addition to the reduction in conveyancing revenues due to the sharp fall in transfers of established homes, falling property values caused revenues to contract further. Figure 5.8 shows that the median price of established houses in Hobart was depressed during 2008 and 2009. After reaching \$310,000 in 2007 the median house price fell to \$294,000 in September 2008 and only regained the \$310,000 median price in June 2009. Consequently stamp duties were considerably lower than forecast in Budgets. In the 2008-09 Budget stamp duties were expected to return \$310 million in 2008-09 and \$328 million in 2009-10. However, actual receipts were only \$217 million in 2008-09 and \$249 million in 2009-10.

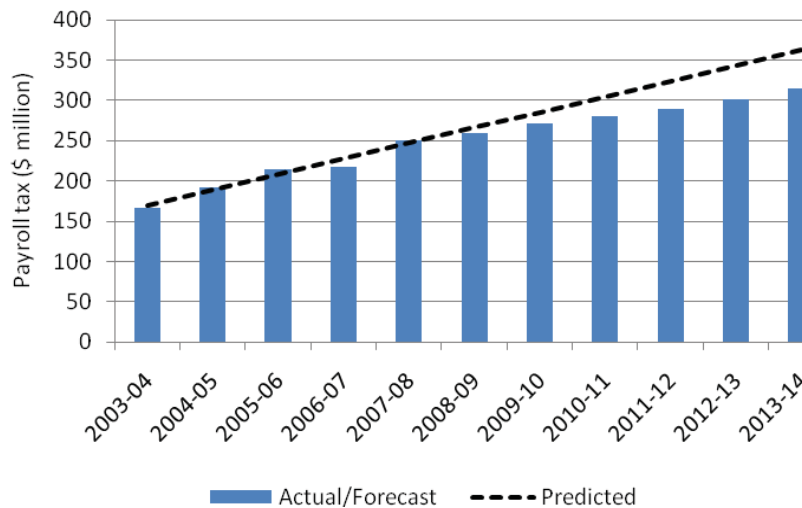
5.3.2.2 Payroll tax

The second major source of revenue that is likely to respond to cyclical factors is payroll tax. Employers with an annual wage bill to Tasmanian employees in excess of \$1.01 million per annum or averaging \$19,423 per week during a month are liable to pay payroll tax at the rate

of 6.1 per cent for wages above the threshold. Figure 5.9 shows actual payroll tax receipts between 2003-04 and 2009-10 and estimates to 2013-14 (Tasmanian Government, 2011)). The trend over the pre-GFC period has been used to forecast future trend or predicted revenues. The impact of the economic slowdown from 2008-09 is evident as the rate of growth of payroll tax revenues slowed and the actual revenues fell below the trend line.

The annual growth rate of payroll taxes was 8.5 per cent per annum in the period from 2003-04 to 2007-08. Forecast growth to 2013-14 implies a growth rate of only 3.9 per cent since 2007-08. As a consequence of the economic slowdown payroll taxes are expected to remain \$48.9 million below trend in 2013-14.

Figure 5.9 Payroll tax revenues, 2003-04 to 2013-14



Source: (Tasmanian Government, 2010; 2011a; Treasurer’s Annual Financial Report, various years).

In comparison to projections using pre-GFC growth rates, actual payroll taxes fell short by \$7.2 million in 2008-09, \$14.6 million in 2009-10 and estimates suggest a shortfall of \$24.1 million in 2010-11.

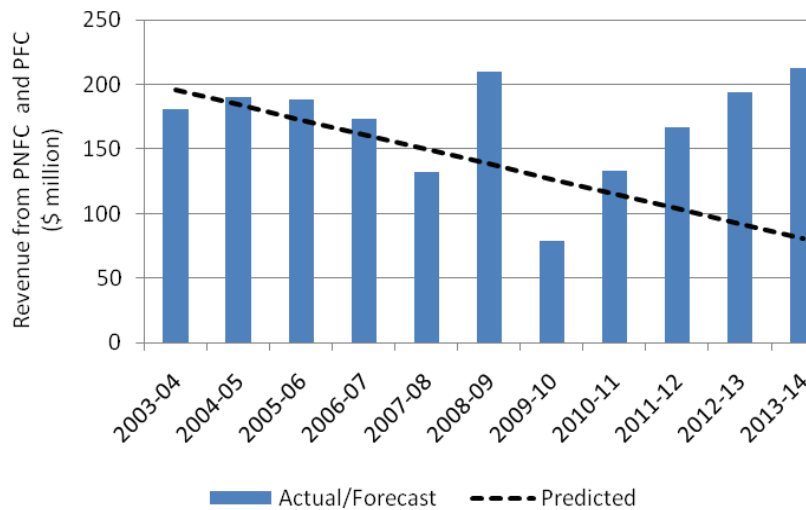
5.3.2.3 Other revenue

Transfer payments from public non-financial corporations (PNFCs) and public financial corporations (PFCs) are another source of revenue for the Tasmanian Government. These corporations make dividend payments and also contribute income tax and rate equivalent payments. Dividends are 50 per cent of the average of after tax profits and losses (calculated on a five-year rolling basis). Government corporations are required to pay tax equivalents of 30 per cent of taxable income to the State Government under the national Tax Equivalent Regime.

The actual and forecast contributions to the General Government Sector are shown in Figure 5.10. The trend was calculated using data from 2003-04 to 2007-08 and future trend values were forecast by extending the trend to show the growth path if the trend had continued. The predicted values trend downwards due to the continual decline in dividends, income tax and rate equivalent payments during the period used to calculate the trend (2003-04 to 2007-08). The actual figures show that there has been no growth in these payments with the exception of 2008-09 where revenue increased to \$210 million (from \$132 million to the previous year). This result was \$56 million above the Budget estimate and was primarily due to

additional income tax equivalent income. There was a sharp drop to only \$79 million in 2009-10 which was below the Budget forecast of \$100 million. The variation resulted from income tax equivalent payments reaching only \$23 million rather than the expected \$52 million (TDTF, 2010). The 2010-11 Mid-Year Financial Report indicates that these revenues are expected to increase continually over the Forward Estimates period to reach \$212 million by 2013-14.

Figure 5.10 Dividends and ITEs from Government Business Enterprises, State-owned Companies and State Authorities, 2003-04 to 2013-14



Source: (Tasmanian Government, 2010; 2011; Treasurer’s Annual Financial Report, various years).

Expected revenues from these sources between 2010-11 and 2013-14 are detailed in Table 5.3. There has been a considerable degree of volatility in the dividends and equivalent payments to the government. The Motor Accident Insurance Board made a dividend payment of \$43 million in 2007-08 and \$39.6 million the following year but only \$23.1 million in 2009-10 (MAIB, 2010). Similarly, the Board paid tax equivalents of \$49 million in 2007-08 and \$19.9 million 2008-09 but had no liability in 2009-10 due to accumulated tax losses.

Table 5.3 Dividend, income tax and rate equivalent payments

	2010-11	2011-12	2012-13	2013-14
	\$ m	\$ m	\$ m	\$ m
Tasmanian Ports Corporation Pty Ltd	1.5	0.7	1.2	2.0
The Public Trustee	0.2	0.4	0.5	0.5
TOTE Tasmania Pty Ltd	6.3	2.9	5.8	5.8
Aurora Energy Pty Ltd	2.8	7.0	15.7	22.2
Hydro Tasmania	47.6	70.3	89.9	89.1
Tasmanian Public Finance Corporation	7.2	6.5	5.2	5.5
Transend Networks Pty Ltd	26.5	41.5	41.8	44.7
Rivers and Water Supply Commission	6.7	2.3	2.0	0.0
Motor Accident Insurance Board	34.5	35.2	31.9	42.2
Total	133.4	166.9	194.1	212.3

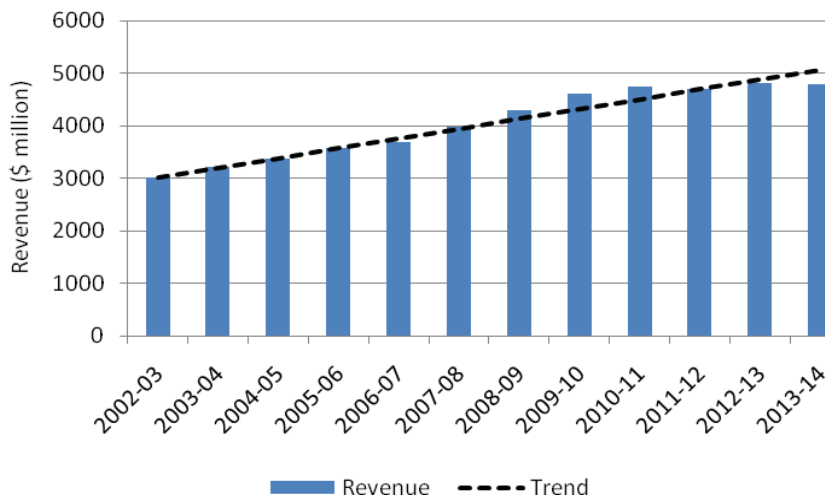
Source: (Tasmanian Government, 2011)

Hydro Tasmania expects to make income tax equivalent payments of \$43.9 million in 2011 and 64.9 million by 2015. However, there was no income equivalent payment in 2010. Dividends will also increase rapidly in the Forward Estimates period. Hydro Tasmania paid an ordinary dividend of just \$5.3 million in 2010 but this is expected to increase to \$11.8 million in 2011 and \$52.5 million in 2015. Similarly, dividends and tax equivalents from Transend Networks will increase from \$26.5 million in 2010-11 to \$44.7 million in 2013-14.

5.4.1 Revenues, Expenses and the Net Operating Balance

Figure 5.11 shows total operating revenues for Tasmania for the period 2002-03 to 2013-14. Using the methodology outlined previously for individual components of revenue, we construct a trend for revenues based on the trend prior to the GFC using an OLS regression of actual revenues for 2002-03 to 2007-08 to predict future values. When we compare the actual and forecast revenues we find that revenues in the post-GFC period exceed the predicted values. This is primarily due to the impact of the stimulus expenditure of the Australian Government that more than compensated for the reductions in cyclically sensitive revenue sources such as GST, stamp duty and payroll tax. Revenue receipts return to the predicted amount in 2011-12 but then increase at a below-trend rate as the full effect of withdrawal of the Stimulus funding is felt. This indicates that revenues are predicted to grow at a slower rate than the historical rate in the pre-GFC period.

Figure 5.11 Operating revenues, 2002-03 to 2013-14

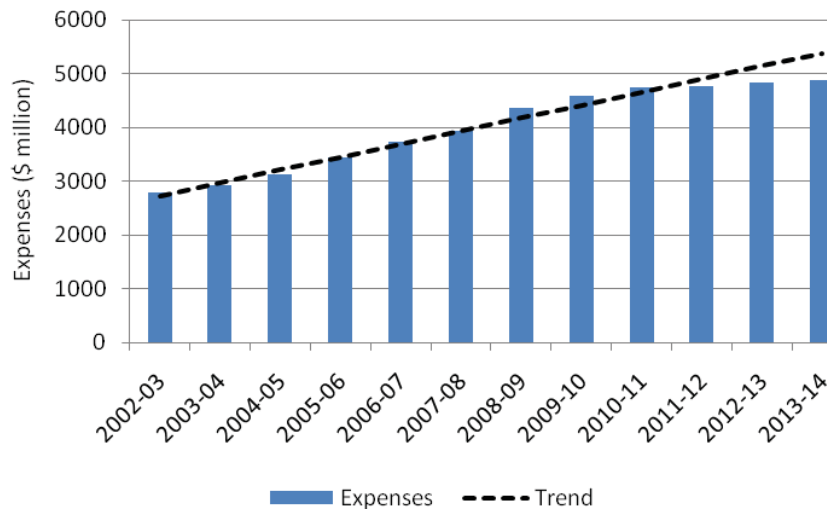


Source: (Tasmanian Government, 2010; 2011; Treasurer’s Annual Financial Report, various years).

Note: Figures up to 2009-10 are actual, figures from 2010-11 are forecasts.

A similar situation is evident for operating expenses. Expenses are slightly above trend between 2008-09 and 2010-11 as a result of the stimulus expenditure. From 2011-12 they fall below the trend line in Figure 5.12 indicating that the growth rate of expenditure has fallen in comparison to growth in the pre-GFC period. If the savings announced in the 2010-11 MYFR were included there would be a greater fall in operating expenses.

Figure 5.12 Operating expenses, 2002-03 to 2013-14



Source: (Tasmanian Government, 2010; 2011; Treasurer's Annual Financial Report, various years).

Table 5.4 displays the composition of the Net Operating Balance and the annual changes in revenues and expenses from 2002-03 to 2013-14. Revenues, expenses and the net operating balance are shown in the first three columns. Annual changes in revenues and expenses are shown in columns 4 and 5. During this period expenses have grown more quickly than revenues. This phenomenon is reflected in the figures for annual changes in columns 4 and 5. For the period 2009-10 to 2013-14 expenditure growth is expected to continue to outstrip revenue growth (1.6 per cent and 1.0 per cent per annum respectively). A net operating deficit is forecast for each year from 2011-12.

Table 5.4 Net Operating Balance, 2002-03 to 2013-14

	Revenue (1)	Expenses (2)	Net Operating Balance (3)	Change in Revenues (%) (4)	Change in Expenses (%) (5)	Underlying NOB (6)
	\$ m	\$ m	\$ m	%	%	\$ m
2002-03	3006	2794	201			
2003-04	3212	2916	296	6.9	4.4	
2004-05	3379	3139	240	5.2	7.6	
2005-06	3572	3453	120	5.7	10.0	
2006-07	3695	3734	-39	3.4	8.1	
2007-08	3986	3932	53	7.9	5.3	
2008-09	4286	4365	-78	7.5	11.0	
2009-10	4602	4584	18	7.4	5.0	
2010-11	4,750	4,740	11	3.2	3.4	-495
2011-12	4,692	4775	-83	-1.2	0.7	-333
2012-13	4,805	4838	-33	2.4	1.3	-107
2013-14	4797	4880	-84	-0.2	0.9	-84

Source: (Tasmanian Government, 2010; 2011; Treasurer's Annual Financial Report, various years).

Payments from the Australian Government for the Nation Building – Economic Stimulus Plan, Nation Building, Water for the Future and the Royal Hobart Hospital Redevelopment

are included in the Net Operating Balance but the corresponding capital expenditure is not included so that the financial position is distorted (Tasmanian Government, 2009a). The Mid-Year Financial Report indicates that the net operating deficits shown in Table 5.4 should be adjusted by calculating an underlying net operating balance that accounts for this factor. The underlying net operating balance extracts the impact of Australian Government funding for specific capital projects. A deficit is forecast for the underlying Net Operating Balance for 2010-11 and the Forward Estimates period (Column 6).

6 Government options for dealing with the fiscal situation

The GFC resulted in an economic downturn in Australia that was much more muted than in other advanced economies. The Australian Government implemented various stimulus measures to support economic activity and jobs through the period of reduced private sector activity. The Tasmanian Government embarked on a major infrastructure program by committing \$1.8 billion over 2010-11 and the Forward Estimates period (Tasmanian Government, 2010). The impact of the stimulus packages introduced after the GFC attest to the importance of the role of governments in supporting economic activity. The 2009-10 Budget stated that the Nation Building – Economic Stimulus Plan and the National Broadband Network investment was expected to increase employment by 2500 in Tasmania in 2009-10 and by a further 600 in 2010-11.

Both the Australian and Tasmanian Governments have faced reduced net operating balances and fiscal balances as a consequence of these policies and the reduction in revenues due to the decline in economic activity. This section considers the options available to the Tasmanian Government to deal with the current fiscal situation.

The Tasmanian Government has established a number of fiscal targets that were detailed previously. These include:

- achieving a Net Operating Surplus and an underlying Net Operating Surplus in the General Government Sector, over a rolling four-year period, by 2014-15;
- achieving a modest Fiscal Surplus by 2014-15; and
- remaining Net Debt free.

The Government has indicated that it intends to return to the fiscal position prior to the GFC when it ran large Net Operating Surpluses by the:

...generation of Net Operating Balance surpluses of the level necessary to ensure long-term Budget sustainability, to fund infrastructure investment and provide for future liabilities. To achieve these objectives it is estimated that operating revenues need to exceed expenditures by at least 4 per cent. In the context of the Net Operating Balance, this represents an average surplus of approximately \$240 million compared to the current underlying average Net Operating Balance of a deficit of \$228 million. (Tasmanian Government, 2011).

Budget sustainability requires that recurrent expenditures are financed by recurrent revenues over the economic cycle. The Government can support economic activity by running deficits in periods of slow economic growth when revenues are lower and the demand for services is higher. Conversely when revenues recover and the demand for Government services declines, in periods of strong economic growth, surpluses assist the Government to achieve a Net Operating Balance over the cycle.

Budget sustainability does not require a surplus in the Fiscal Balance or that the General Government Sector remains Net Debt free. In Section 5 we presented recent fiscal outcomes.

After several years of surpluses the Net Operating Balance recorded a deficit in 2008-09 and is forecast to be in deficit from 2011-12. The Fiscal Balance has been in deficit from the onset of the GFC in 2008-09 and this situation is forecast to continue over the Forward Estimates period.

The General Government Sector was debt free by 2004-05 and the Net Debt position improved every year prior to the GFC in 2008-09. The General Government Sector has remained Net Debt free in the post-GFC period. However, small positive Net Debt positions are forecast for 2012-13 (\$81 million) and 2013-14 (\$100 million).

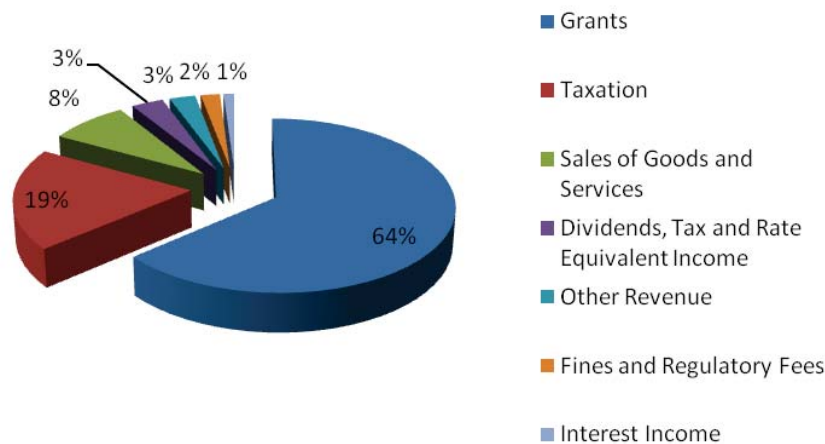
In addition to the impact of the economic slowdown, the Fiscal Balance and Net Debt have deteriorated due to the large capital investment program that includes \$1.8 billion over four years in schools, hospitals, roads, community centres and sports facilities (Tasmanian Government, 2010b). These assets will provide economic and social benefits to Tasmania over an extended period of time and it is appropriate for these assets to be financed over an extended time period.

As we saw in Table 5.4 above, expenses growth has outstripped revenue growth for the Tasmanian General Government Sector over a number of years. If this situation persists the Government has the option of cutting expenditure, increasing revenues or a combination of both to maintain a Net Operating Balance over the economic cycle. The remainder of this section examines these options.

6.1 Increasing government revenue

The first avenue for addressing declining net operating balances is through adjustments on the revenue side. Figure 6.1 shows the revenue sources for the General Government Sector in 2010-11. Almost two-thirds of total revenue is from Australian Government grants over which the Tasmanian Government has little control. The major revenue sources generated by the Tasmanian Government are taxation, which provided 19 per cent of total revenue in 2010-11 and sales of goods and services that contributed 8 per cent of revenue. Other revenues account for less than 10 per cent of total revenue.

Figure 6.1 General Government Sector revenue 2010-11



Source: (Tasmanian Government, 2010a: 1.3)

State Governments have limited ability to increase revenues in order to respond to cyclical downturns. General Purpose Payments from the Australian Government and State taxes such as duties and payroll tax are strongly pro-cyclical as we saw in Section 5.

SPP and NPP grants from the Australian Government are determined by negotiation through COAG. GST payments have been severely impacted by the economic downturn. They increase as economic activity increases but are beyond the control of the Tasmanian Government. The recently announced review of GST by the Australian Government could have an adverse impact on Tasmania's revenues if there are changes to Horizontal Fiscal Equalisation settings that deliver a higher proportion of GST funding to Tasmania than its population share indicates. GST relativities take into account differences in the States' abilities to raise revenues and seek to ensure that each State has the capacity to provide services of the same standard. The interim report from the GST review will not be available until February 2012 and the final report will be delivered later in 2012.

State government revenue sources that are also cyclically sensitive include various components of taxation such as conveyance revenue and payroll tax as well as dividends and income tax equivalent payments for PNFCs and PFCs. The Government has discretion over taxation settings such as the rate of taxation and thresholds as well as other revenues including the sale of goods and services.

The Government has a long history of delivering a competitive taxation environment and has pledged not to introduce new taxes. In the 2010-11 Budget speech it was noted that Tasmania has the lowest per capita taxation in Australia, is the second lowest taxing state in Australia and is the only state not to have introduced any new taxes for 12 years.

The 2010-11 Budget announced a comprehensive review of state taxation that will be chaired by the Treasurer and will examine all aspects of taxation. The review will consider submissions from organisations and the public as well as recommendations regarding State taxes from *Australia's Future Tax System*. The recommendations for reform to State taxes from the Henry Review, *Australia's Future Tax System*, include:

- replacing payroll tax with a wages tax or cash flow tax;
- replacing conveyance duty with consumption or land tax;
- broadening land tax;
- removal of insurance taxes;
- replacement of motor vehicle taxes with user charges; and
- replacement of resource royalties with rent taxes.

The review will consider the impact of each state tax taking into account issues such as demographic change and maintaining economic competitiveness, and will be guided by the principles of equity, efficiency, simplicity and sustainability. The review has accepted submissions and is currently conducting public forums. The final report on the review of taxation in Tasmania will be available in December 2011 and will provide the basis for decisions on the future direction for State taxes.

Discretionary cuts in taxation or charges worsen the fiscal position on an ongoing basis. The 2010-11 Budget introduced 'the biggest cuts to land tax ever in Tasmania' (Tasmanian Government, 2010b: 15). The reductions in land tax are expected to result in reduced revenues of \$28 million in 2010-11 and a total of \$117 million between 2010-11 and 2013-14. In addition to the reduction in revenue, the cost of administering the reform will total \$11 million over the Forward Estimates period. Changes to Betting Exchange Revenue will

reduce taxation revenues by \$5.3 million in 2010-11 and a total of \$24.1 million over to 2013-14.

Payroll tax rebates designed to provide incentives for job creation also reduce revenues. The Employee Incentive Scheme (Payroll Tax Rebate) was announced in the 2009-10 Budget. The rebate applied to new positions that were created between 11 June 2009 and 30 June 2010 and were maintained continuously until 30 June 2011. The Scheme was expected to reduce Payroll Tax collections by \$2 million in 2008-09, \$2.4 million in 2010-11 and \$625,000 in 2011-12 (Tasmanian Government, 2009a).

Rebates are also provided to employers of apprentices and trainees under the Tasmanian Trainee and Apprenticeship Incentive Scheme (TTAIS). TTAIS payroll tax rebates commenced on 1 July 2008 and were expected to result in reductions of payroll tax receipts of around \$4 million per annum, with a total of \$19.7 million between 2008-09 and 2012-13.

Revenues from Government businesses are also affected by asset sales. While a consideration of the merits of privatisation is beyond the scope of this report it is noted that privatisation results in a one-off payment but eliminates an ongoing source of dividend and income tax equivalent payments. Since 1998 the Government has sold Hobart International Airport, the Printing Authority of Tasmania, the Civil Construction Corporation, Stanley Cool Stores Board, Tasmanian Grain Elevators Board and Southern Regional Cemetery Trust raising around \$360 million (Tasmanian Government, 2009a).

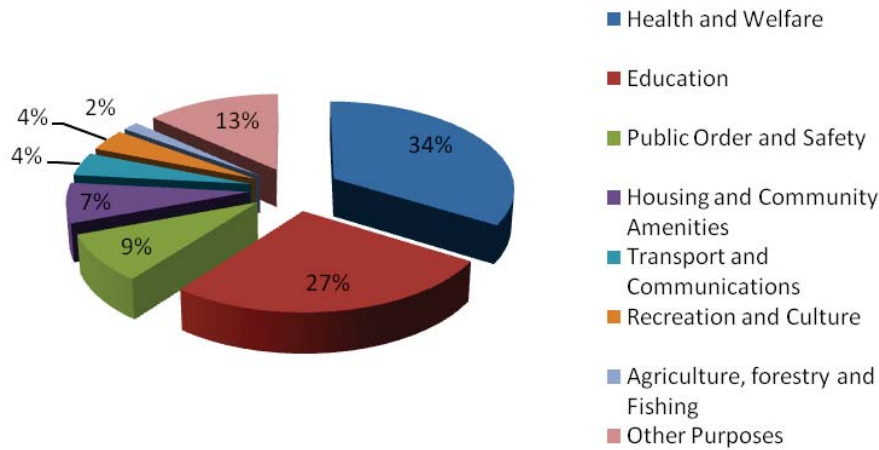
The limited ability of State Governments to increase revenues during periods of low economic activity suggests that it is necessary to adopt a counter-cyclical approach that allows for revenues to remain lower than expenses during downturns and to exceed expenses during high growth periods. The Government retains some discretionary decision-making with regard to the imposition and rates of taxes and charges as well as decisions on asset holdings.

6.2 Reducing government expenditure

The second option to reduce the net operating balance is to reduce expenditure. The Government signalled its intention to follow this path in the 2010-11 MYFR through a combination of cuts in staff expenses, not implementing Budget expenditure commitments and reviewing non-salary expenditure to identify savings.

Figure 6.2 shows the major components of expenditure in 2010-11. The four largest categories, health and welfare, education, public order and safety and housing and community amenities account for 77 per cent of total expenses. Health and welfare accounts for one-third of total expenses and education makes up another 27 per cent.

Figure 6.2 General Government Sector Expenses by Purpose, 2010-11



Source: (Tasmanian Government, 2010: 1.5).

The Tasmanian government indicated in the Mid-Year Financial Report that it will undertake an expenditure reduction strategy that will include a review of programs and staff cuts of up to 2300 FTE staff in the four years to 2014-15. The reduction in expenditure and public sector staffing has been portrayed as a necessary response to the budgetary position of Tasmanian Government that has been affected by the GFC and a situation where revenues have been rising more slowly than expenses.

Detailed information on the distribution of staff reductions is subject to the review of expenditure as part of the Public Sector Productivity Strategy that will seek to identify and cut programs that do not meet Government priorities or are inefficient. Despite the fact that the review is expected to take two Budget cycles to complete the quantum of savings from staff reductions was announced prior to the conduct of the review suggesting that funding and staff cuts are being determined by fiscal considerations rather than a considered evaluation of the need to provide quality services to the people of Tasmania.

Table 6.1 Staff cuts and annual financial savings

Year	Staff Cuts (FTEs)	New Savings	Ongoing Savings	Total Savings
		\$ m	\$ m	\$ m
2011-12	364	30		30
2012-13	353	30	30	60
2013-14	1028	90	60	150
2014-05	555	50	150	200

Source: (Tasmanian Government, 2011; CPSU Tasmania)

The government has announced the savings to be achieved and the total staff reduction of 2300 FTEs implied by the spending cuts, but has not provided a break-down in the FTE reductions for each year. Using the annual savings figures in Table 6.1 and the assumption of an annual wage increase of 3 per cent we have calculated approximate reductions in FTEs for each year. The largest reductions will occur in 2013-14.

Staff reductions are to be achieved through natural attrition or by transfers and ‘specific targeted separations will need to be used where other measures are inefficient or ineffective’ (Tasmanian Government, 2011: 9). There is no provision in the Forward Estimates for funding redundancy packages in the case of voluntary or forced redundancies.

Details of how the 2300 FTE reductions will be apportioned between agencies are not available at this time. Since around 46 per cent of public sector workers in Tasmania work on a part-time basis the reduction of 2300 FTEs is likely to result in the loss of significantly more jobs. Given that there were 23781 FTE staff and a total of 30245 staff at 30 June 2010, a reduction of 2300 FTEs could result in the reduction of around 2925 jobs (OSSC, 2010).

Table 6.2 Possible staffing reductions by 2014-15

	FTEs 30/6/2010	% of FTEs	FTE Reductions
Department of Economic Development, Tourism and the Arts	479.17	2.0	46
Department of Education	7732.39	32.5	748
Department of Health and Human Services	9292.85	39.1	899
Department of Infrastructure, energy and Resources	523.66	2.2	51
Department of Justice	1046.92	4.4	101
Department of Police and Emergency Management	868.36	3.7	84
Department of Premier and Cabinet	337.4	1.4	33
Department of Primary Industries, Parks, Water and Environment	1318.72	5.5	128
Department of Treasury and Finance	311.96	1.3	30
Tasmanian Audit Office	41.9	0.2	4
Port Arthur Historic Site Management Authority	78.86	0.3	8
Tasmanian Academy	212.72	0.9	21
Tasmanian Polytechnic	1127.43	4.7	109
Tasmanian Skills Institute	356.63	1.5	34
The Public Trustee	51.5	0.2	5
Integrity Commission of Tasmania	1	0.0	0
Total	23781.47	100.0	2300

Source: Office of State Service Commissioner Annual Report 2009-10

Table 6.2 provides indicative figures based on across-the-board cuts. The table shows the FTE staffing levels at 30 June 2010, the proportion of total staffing in each Department and the quantum of FTE reductions required to meet the target of 2300. If cuts were proportional the largest Departments would incur large job losses. The Department of Health and Human Services would lose around 900 FTEs while the Department of Education would be reduced by around 750 FTEs. If the majority of the cuts were to be targeted to administrative positions rather than front-line staff the FTE reductions in these two departments would be likely to be lower. In this case, the losses from other departments would need to be larger.

Aside from the impact of job loss on the public sector workers involved and their families the staff cuts will have other impacts. They will result in reductions in economic activity, will have repercussions for remaining employees and may result in the elimination of some services or programs and have an adverse effect on service delivery.

6.2.1 The economic impact of staff cuts

The fragility of the economic recovery in Tasmania is highlighted by the fact that the 2010-11 MYFR revised down the forecasts for GSP and employment growth and increased the unemployment forecasts. In addition:

It is now evident that the global economic downturn continues to adversely impact household expenditure and building investment, important drivers of GST revenue. (Tasmanian Government, 2011: 1)

This section will attempt to estimate the potential impact on the Tasmania economy of the reduction of 2300 FTEs using employment multipliers that have been derived using input-output analysis. It is important to emphasise that this analysis does not model the effect of the impact on the Tasmanian economy by developing state input-output tables using the latest ABS input-output data from 2006-07. This task is outside the scope of this analysis and a possible future research task. The estimates produced here therefore should be considered only as indicative of the size of the effect of changes in the level of spending.

Government expenditure stimulates other sectors of the economy through direct government purchases and through the spending power of employees. The reduction of Government expenditure due to the 2300 FTE staff cuts will reduce economic activity due to reduced consumption. In addition to the direct effect of the staff cuts there will be flow on effects to other industries as a result of the reduction in expenditure. The size of the reduction in economic activity generated by reductions in Tasmanian Government expenditures depends on leakages such as the proportion of income that is saved, taxation, and imports.

The traditional method for assessing the overall impacts of such policy changes is to use input-output analysis. This allows researchers to estimate levels of output and employment required by a particular amount of final demand and to estimate changes in output and employment resulting from changes in final demand.

Employment multipliers show the flow on effect of a change in output in one industry on other industries. In this instance the reduction in final demand is a direct result of reduced government expenditure due to the proposed staffing reduction of 2300 FTEs.

Employment multipliers represent the impact of a change of output in one industry on employment in other industries and vary by industry. The public sector is characterised by large employment multipliers so that an increase in expenditure in the public sector will induce a large amount of employment in other industries. Conversely, a reduction of public sector expenditure will result in relatively large job losses in other industries. Spoehr (2006: 10) states that employment multipliers for public services are about 50 per cent higher than for the average of all industries and therefore: 'Public investment in public services generates around 30 full-time equivalent jobs for every \$1 million'.

As can be seen from Table 6.3 below, the industries that pertain to the public sector in Tasmania have employment multipliers of between 26.5 (Government Administration and Defence) and 42 (Community Services). Spoehr (2006) used employment multipliers derived by Carman (1999) to estimate the impact of a reduction of 4000 public sector positions in South Australia. He used an employment multiplier of 29 that represents 29 jobs for each \$1 million of expenditure. These multipliers were derived from the 1993-94 input-output tables. Valadkhani (2003) used employment multipliers from 1996-97 to identify high employment generating industries in Australia. Spoehr and Burgan (2010) used Input-Output tables for South Australia for 2005-06 to estimate the impact of a reduction of 1762 FTEs in the South Australian public service. They used the reduction in household disposable income rather

than total Government savings and found that a reduction of 1762 FTEs would result in flow-on losses of around 650 jobs making a total reduction of 2400 jobs.

The wide-range in the estimates of multipliers has been the subject of criticism. It is clear that there is no definitive method available to researchers in this field of study that can provide exact multipliers. The overwhelming body of evidence, however, points to the fact that the employment multipliers associated with public spending are positive and on the balance of probabilities somewhere in the range provided in Table 6.3. The evidence does not support an argument that the impacts of public spending cuts will be positive in relation to employment.

Table 6.3 Input-output employment multipliers

Industry	Employment Multiplier			
	Carman (1999)	Valadkhani (2003)	ABS (1994)	Spoehr (2010)
Education	35	34.3		
Community Services	33		42	
Health Services	29			
Health and Community Services		30.8		
Government Administration	28			
Defence	24			
Government Administration and Defence		26.5	36	23

Source: (Carman, 1999 cited in Spoehr, 2006; Valadkhani, 2003; ABS, 1994; Spoehr and Burgan, 2010).

One of the criticisms of using Input-Output analysis relates to the assumption of highly elastic supply. It is argued that the assumption that there are idle resources available when expenditure is increased is unrealistic and that there are likely to be capacity constraints so that the forecast increases in GDP and employment are unlikely to be achieved. This is not an issue when dealing with spending cuts.

The impact of the savings will depend on the size of a number of leakages, including taxation, savings and imports from outside Tasmania. The majority of the multipliers shown in Table 6.3 relate to national input-output tables. Leakages at the national level are likely to be considerably smaller than is the case for a region such as Tasmania. In Tasmania a higher proportion of expenditure is spent on imports (to Tasmania) than is the case at the national level.

Table 6.4 Possible employment reductions due to the reduction of 2300 FTEs

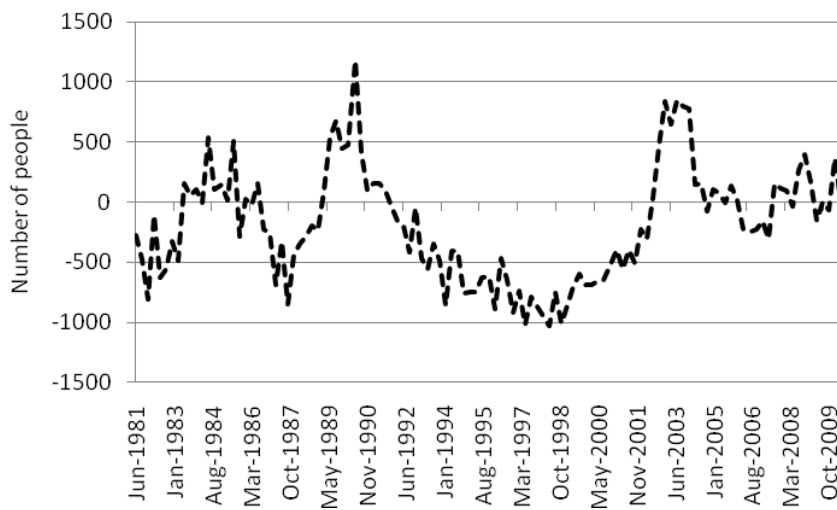
	Expenditure Reduction \$ m	Public Sector FTEs	Upper limit		Lower limit	
			Total jobs	Flow on	Total jobs	Flow on
			FTEs	FTEs	FTEs	FTEs
2011-12	30	364	720	356	480	116
2012-13	30	353	720	367	480	127
2013-14	90	1028	2160	1132	1440	412
2014-15	50	555	1200	645	800	245
Total	200	2300	4800	2500	3200	900

We provide crude estimates of the possible employment implications of the reduction of 2300 FTEs in the Tasmanian public sector using an upper limit employment multiplier of 24 jobs per \$1 million of expenditure cuts and a lower limit of 16 jobs per \$1 million reduction. The results are presented in Table 6.4. The first two columns show the reduction in government spending and FTE cuts per year.

Using the upper limit multiplier of 24 jobs per \$1 million the initial reduction of 2300 FTEs in the public sector will result in the loss of 2500 other FTE jobs and a total of 4800 FTE jobs when all flow on effects are exhausted. Similarly the lower limit multiplier of 16 jobs million dollar spending cut implies there will be 900 flow-on job losses and a total of 3200 FTE jobs destroyed.

The deterioration in the labour market as a consequence of the loss of thousands of jobs in the public and private sectors could impact on population change. Figure 6.3 shows that in the aftermath of the 1990s recession there was negative net interstate migration indicating that more people were leaving Tasmania than arriving. Between June 1997 and September 1999 the rolling annual total net outflow exceeded 3,000. The flow was stemmed by the economic recovery which resulted in positive net interstate migration from March 2003 to March 2006.

Figure 6.3 Net Interstate Migration to Tasmania, 1981 to 2010



Source: ABS, 2010, Australian Demographic Statistics, Cat no. 3101.0

The analysis of the economic and labour force implications of interstate migration is complex and is outside the scope of this study. The composition of those migrating to and from Tasmania determines the overall impact; factors such as the age profile, educational and skill levels of migrants and workforce participation. Jackson (2005) attributed the exodus from Tasmania in the 1990s to high unemployment and subsequent in-migration to the housing boom and Tasmania's relative housing affordability.

Jackson (2005) contends that population growth in the 2000s exacerbated population ageing since migration has reduced the number of young adults and increased older age groups. The 2006 Census Time Series Profile confirms that the number of young adults declined between 1996 and 2006. The 20 – 24 age group declined from 31,244 in 1996 to 29,061 in 2006. Similarly the 25-34 age group declined from 65,952 in 1996 to 54,297 in 2006. During the same period those aged 65 and over increased from 56,717 to 68,045.

In addition to the macro effects on economic activity and employment there could be long-term adverse financial impacts for individuals who are retrenched. In a study of the post retrenchment experience of Australian workers Murtough and Waite (2000) found that the probability of being retrenched increased markedly in recessions for people who had less than 5 years service with their current employer and that chances of re-employment were greater for people aged under 50 years who had been working in a high skill occupation. They also found that one in four females and one in ten males retrenched between 1994 and 1997 left the labour force. Adjustment costs include the length of time displaced workers remain unemployed as well as lower hours of work or earnings when re-employed.

As well as the direct and indirect effects for the Tasmanian economy there are other effects that warrant consideration. In the first instance reduced employment in both the public and private sectors could shift the fiscal burden from the State to the Australian Government. An increase in unemployment has a direct impact on the fiscal position of the Commonwealth because it simultaneously reduces taxation receipts and increases outlays in the form of income support payments. Both the Commonwealth and State Governments could face additional costs associated with increased need for family and community services, health and housing assistance and law and order.

In addition to the loss of production and economic costs associated with the increase in unemployment there are wider social costs. This remainder of this section examines the possible consequences of the reduction in public sector staffing on staff and the delivery of State government services.

6.2.2 Impact on remaining workers

Redundancies have a major impact on the remaining workforce as they adjust to the new environment with changes to their jobs, workplaces, working relationships and often increased workload. While the duties of the redundant positions are supposed to be eliminated, this may not be the case and some duties may be redistributed to other staff. Remaining employees may be required to accept additional duties without sufficient training and without the prospect of mentoring by the previous incumbent.

Moreover, where previous functions are not performed there could be repercussions for continuing workers due to reduced support or access to information. The removal of administrative workers may result in processing delays that impact on customers with repercussions for front-line workers who are increasingly dealing with frustrated and angry clients (Rafferty, Schutz and Yu, 2010).

Even in situations where work intensification does not occur there are likely to be major impacts on the working lives of the remaining workforce. During the period of uncertainty about whether individuals will be directly affected by staff cuts, efficiency and work output will deteriorate. The continual downsizing process is likely to increase stress levels, induce concerns for the future and reduce the level of commitment of employees. They also need to deal with the loss of former work colleagues and perhaps the stress and uncertainty associated with the possibility that they could lose their job (Amundson et al., 2004). Dunford, Bramble and Littler (1998: 399) sum up the experience of downsizing thus:

downsizing programs in the public sector have been driven by broader corporate and organizational demands, have focused on the issue of staffing (both its costs and its use) and client service, and have left behind a significant sense of aftershock among the survivors.

Therefore, work performance may decline and absenteeism may rise, resulting in additional stress on the remaining workforce.

6.2.3 Impact on service delivery

Evaluations of the impact of staffing cuts on service delivery need to consider quantitative indicators such as achievement of KPIs, the number of people assisted, the number of complaints, as well as qualitative changes such as staff morale and skills (HM Treasury, 2003).

There are several issues with downsizing that limit or negate its effectiveness as a means of improving efficiency or cutting costs. While organisations downsize to improve efficiency and productivity these outcomes are not guaranteed. UNDP (1999: 2) contextualise these issues:

Cost containment is an important aspect of civil service reform. BUT THERE ARE OTHER EQUALLY IMPORTANT ASPECTS. An efficient and motivated civil service is critical for governance, production and distribution of public goods and services, formulation and implementation of economic policy, and management of public expenditure. The broader aim of civil service reform is, therefore, the creation of a government workforce of the size and with the skills, incentives, ethos, and accountability needed to provide quality public services and carry out the functions assigned to the state. (emphasis in original)

If staff reductions are accomplished through voluntary redundancies this reduces the acrimony experienced with involuntary redundancy (Clarke, 2007) but increases the risk that the most productive and experienced workers may leave the organisation (Rama, 1999). This is because individuals assessing the benefits of redundancy weigh up the financial gains of the redundancy package against potential losses from unemployment. The most productive workers are more likely to secure employment quickly and therefore reap greater financial gains from accepting the package. The danger for the organisation is that losing the most productive workers will have a negative impact on productivity and that the less experienced workers who remain require additional training and may struggle to cope with the extra workload. The UNDP (1999) also point to the counter-productive result of skill reduction if the most productive workers accept voluntary redundancy or early retirement.

Negative consequences of downsizing include loss of institutional memory, service shortfalls, skill imbalances, increased use of overtime, increases in work backlogs, lower morale and lower productivity. A major phenomena identified in the literature is the loss of institutional memory due to downsizing so that efficiency is impaired rather than enhanced (Feldheim, 2007). A GAO (1996: 39) study of downsizing in the US public sector between 2003 and 2006 reported that half of the respondents said that ‘downsizing somewhat or greatly hindered their agency’s mission.’ Some organisations estimated that it may take several years to return to the previous skill levels and some had found it necessary to reemploy some of the downsized employees, either directly or on a contract basis. Similarly, an ANAO (1999: 34) report on the APS found that ‘there was anecdotal evidence that ex-APS staff were being reemployed, through a third party, on contract in the APS after receiving voluntary redundancy.’

The negative consequences for efficiency in downsized organisations is highlighted by Dunford, Bramble and Littler (1998) who describe the effects of work intensification when work that was previously done by specialist staff (such as administrative staff) is redistributed. In addition they contend that in a period where the role of management becomes more critical to manage the process of change, many managers are unable to handle

the increased complexity of their role and consequently suffer increased stress and psychological problems.

Annual “efficiency dividends” which reduce funding and staffing levels have been a feature of the Australian Public Service since they were imposed by the Hawke Labor government in 1986 and have more recently been a feature of state administrations.

The Joint Committee of Public Accounts and Audit (2008: xxiii) investigation of the impact of the efficiency dividend on small federal agencies questioned whether the efficiency dividend was ‘placing a higher priority on agencies’ efficiency at the expense of their effectiveness.’ The Committee found that small agencies were particularly disadvantaged by application of the dividend and there were a number of deleterious unintended consequences such as reductions in services to regional areas, pay disparities, expansion of collections for cultural agencies and impediments to innovation.

The APSC (2008) pointed to increased unscheduled absences across the APS as a warning sign that there may be insufficient resources to cope with the workload. The APSC (2008: 131) concluded:

the pressure on agency budgets from the cumulative, combined effect of the efficiency dividend and the partial supplementation for wage increases has resulted in some agencies having to reduce the quality and/or quantity of their outputs (APSC, 2008: 131)

Similarly, a study by Firms, Travaglione and O’Neill (2006) into absenteeism in a major public sector transport organisation in Australia during a period of modernisation and downsizing, found that absenteeism increased amongst employees who intended leaving the organisation.

A survey of 2785 Commonwealth public servants by the Community and Public Sector Union found that 88 per cent felt their workload was increasing, 56 per cent said there were cutbacks in their agencies and 45 per cent felt less secure about their jobs (The Age, 2009). Alam, Robinson and Pacher (2006: 743) conducted a study of middle management in the ATO in 1999 and found that ‘a substantial number of middle-managers, survivors of years of restructuring, downsizing and organizational change, were unlikely to display high-quality decision-making behaviours.’ Similar results were revealed in surveys undertaken by the CPSU and HACSU amongst their Tasmanian public sector members.

An ANAO report on downsizing in the APS during the latter half of the 1990s found that ‘there was little evidence that, during the strategic planning for and implementation of staff reductions, consideration was given to the impact of the reductions process on the ability of retained staff to fulfil operational requirements, maintain their morale, or to tailor activities to assist them to deal with the changes under way in the workplace’ (ANAO, 1999: 30).

7 Conclusion

This report has provided an overview of the Tasmanian economy and labour market and examined the 2010-11 Mid-Year Financial Report. While the Australian and Tasmanian economies have performed better than other advanced economies in the aftermath of the GFC, economic growth remains fragile. The GSP growth forecasts for Tasmania have been revised downward in the 2010-11 Mid-Year Financial Report with GSP expected to grow at only 1.25 per cent for 2010-11 and 2011-12. The unemployment rate is forecast to remain at 5.75 per cent which indicates that there is significant underutilisation, particularly when underemployment is included. In addition, the high exchange rate is impacting adversely on exports, particularly in the manufacturing sector which employs over 8 per cent of the

workforce. Other indicators of economic weakness include low household spending, retail trade and private investment (Tasmanian Government, 2011).

The withdrawal of stimulus expenditures will act to suppress economic activity at the same time that the Tasmanian Government is implementing large staffing and expenditure cuts. Experience with earlier stimulus measures points to the likelihood that the economy will be adversely affected when the stimulus measures finish.

Tasmania's economy benefited from the fiscal stimulus measures, such as cash payments to eligible taxpayers and welfare recipients, the boost to the First Home Owner Grant and the public investment programs. However, unlike the national economy, private investment and exports in Tasmania have not sustained this economic growth as the fiscal and monetary stimulus measures are withdrawn. (Tasmanian Government, 2011: 16)

Sustainable budget strategies require a net operating balance over the economic cycle. The Government has adopted a contractionary fiscal strategy that seeks to deliver a Net Operating Surplus on a four-year rolling basis by 2014-15. The Government's choice of a four-year period is a short time horizon that is not related to the length of the economic cycle. In the longer-term the fiscal stance is more contractionary, with the Government seeking to deliver Net Operating Surpluses averaging around \$240 million per annum to finance recurrent and capital expenditure and future liabilities.

Capital investment will result in economic and social benefits for the people of Tasmania over several decades. It is appropriate that these expenditures are financed over the same time period so that those who enjoy the benefits contribute to the financing of these assets. The Government objective of financing capital expenditure from the Net Operating Balance implies that the current generation should pay for investments that will provide economic and social returns to both the present and future generations. This policy will impose a disproportionate burden on the current generation and depress economic activity.

The Tasmanian fiscal position is affected by the historical experience of revenues increasing at a slower rate than expenses in the pre-GFC period and the forecast Net Operating Deficits in the Forward Estimates period. Much of the deterioration in the Net Operating Balance is a consequence of the significant reductions in revenues as a result of the GFC. If Net Operating Deficits persist after the cyclical impact of the GFC has ceased, the Government will need to address this imbalance to ensure fiscal sustainability. The Government could achieve a Net Operating Balance through cuts to expenditure or increases in revenues. In the short-term deficits could be financed by running down assets or increasing net debt.

Several factors need to be considered carefully prior to taking action. The size of the Net Operating Deficit will decline over the Forward Estimates period due to the recovery of revenues as a consequence of the operation of the automatic stabilisers. General Purpose Grants from the Australian Government and State taxes will increase in line with economic activity.

The volatility in the economic and fiscal position over the past few years makes it difficult to produce accurate fiscal forecasts. As we saw in Section 5, actual economic and budget outcomes have differed significantly from forecasts, especially since the onset of the GFC. It is therefore possible that any remedial action taken at this time to eliminate Net Operating Deficits may not be necessary.

Reduced economic activity due to expenditure cuts will have a dampening effect on revenues. This will be amplified to the extent that other States and/or the Australian Government

implement similar contractionary policies and could prove to be counter-productive. As explained previously, the actual budget balance is the outcome of spending decisions by businesses and individuals. Decisions to impose austerity through large cuts to government expenditure or increases in taxation will influence spending decisions in the private sector and can prove counter-productive by causing Gross State Product to contract and thereby reduce State revenues and worsen the budget balance. The alternative strategy of fostering growth by discretionary stimulus spending and/or tax cuts can drive reductions in the budget deficit outcome as the level of economic activity increases and tax revenues recover.

The proposed expenditure cuts, including the reduction of 2300 FTE jobs in the public service will have adverse economic and social consequences. Total job losses could be in the order of 3200 to 4800 jobs (2300 public sector FTEs and between 900 and 2500 flow-on job losses). The existing high levels of labour underutilisation strongly suggest that the displacement of public sector workers will increase unemployment and possibly result in some of the affected workers becoming long-term unemployed due to deficient labour demand in the private sector. There may be flow on effects such as increased out-migration which could impact labour productivity. There will be consequences for service delivery that may include the elimination of various programs that are not considered to meet Government priorities. There are likely to be reductions in the quality of services resulting from reduced staffing and other resources.

The Government is currently undertaking a Public Sector Productivity Strategy to review programs delivered by the public sector, a review of Government businesses and a state taxation review. The review of programs as part of the Public Sector Productivity Strategy is not expected to be completed for some time. The review may identify significant savings due to the introduction of efficiency measures that will not impact on service delivery. However, the savings targets and associated staffing cuts have been announced prior to the completion of the review on the basis of perceived financial necessity rather than a thorough consideration of the resources needed to deliver quality services to the community. The MYFR (Tasmanian Government, 2011: 8) states 'it is clearly not sustainable to continue to provide the current level of services at the current cost'.

The Government has been firmly committed to reducing taxes, boasting of Tasmania's low per capita tax take, the fact that there have been no new taxes introduced in the past 12 years and that the 2010-11 Budget delivered 'the biggest cuts to land tax ever in Tasmania' at a cost of \$120 million over four years (Tasmanian Government, 2010b: 15). The report from the state tax review will be delivered in December 2011 and will make recommendations on the future direction of State taxation.

An efficient and effective approach to policy decisions on revenue and expenditure adjustments requires a holistic approach that takes into account a comprehensive assessment of the nature and quantum of services that will be provided to the people of Tasmania and the staffing and other resources necessary to deliver these. Therefore, major decisions on future fiscal policies should be deferred pending completion of these reviews.

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