

Senedd Cymru / Welsh Parliament

Y Pwyllgor Cyllid / Finance Committee Ymchwiliad i  
weithredu Deddf Cymru 2014 a'r Fframwaith Cyllidol /  
Inquiry into the implementation of the Wales Act 2014  
and operation of the Fiscal Framework

FFWA 04

Swyddfa Cyllidebol Seneddol Fictoraidd / Victorian  
Parliamentary Budget Office

4 September 2020

Llyr Gruffydd MS / AS  
Cadeirydd / Chair  
Finance Committee  
Welsh Parliament  
Cardiff Bay  
Cardiff  
CF99 1SN

**RE: Inquiry into the implementation of the Wales Act 2014 and operation of the  
Fiscal Framework—Consultation**

Dear Mr Gruffydd

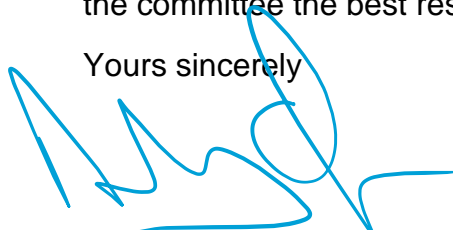
Thank you for the opportunity to contribute to your inquiry, in relation to the committee's desire to compare Wales and other international fiscal frameworks.

I am the Parliamentary Budget Officer for the state of Victoria, a subnational independent fiscal institution in Australia. I lead an office that provides members of our parliament and the public with independent policy costings of their policy proposals and advice on economic, fiscal and financial matters. At each election, I independently cost and publish parliamentary leaders' publicly released policies. To perform my functions, I have powers to request information and documents from the public sector.

As requested, I provide the following input to your inquiry from specific questions made of me, using Victoria's approach and experience as my basis.

I am happy to provide further input or clarification if you require and I wish you and the committee the best result in your deliberations.

Yours sincerely



Anthony Close  
Parliamentary Budget Officer

## **What are the strengths and weaknesses of subnational fiscal frameworks and how could they be designed to maximise their effectiveness?**

### **Context**

In Victoria, grants represent almost half of total state revenues, mainly through Australian Government goods and service tax distributions and payments for specific purposes, such as funding agreements for the state to deliver major projects or national reform. The Victorian Government collects the remaining revenue—mainly state taxes and from the sale of goods and services.

Victoria's state tax revenue relies heavily on property taxes through land transfer duties on transactions and land tax on eligible properties. Combined with payroll tax, these make up over two thirds of state taxation. Most of the remainder of Victoria's state tax revenue applies to a relatively narrow scope of household consumption and business expenditure—gambling, insurance and motor vehicles.

Land transfer duty is sensitive to changes in the property market as it reflects both the number of transactions and property prices. Land tax is sensitive to the number and value of land holdings. It is less sensitive to fluctuations in economic conditions than land transfer duty. However due to exemptions and concessions—particularly through exemptions on principal place of residence and land used for agricultural purposes—the Victorian Government forgoes more land tax revenues than it collects. Payroll tax is sensitive to employment growth, wage growth and the tax-free threshold that aims to exempt smaller businesses.

### **Design options**

In designing a fiscal framework, governments make decisions about what taxes to levy, how much and on whom the tax burden lies. When setting tax policy, governments generally consider:

- the efficiency of a tax—the impact a tax has on economy activity
- the equity of a tax—how the impact is distributed across individuals
- compliance—how burdensome the tax is to administer by governments and for liable individuals.

Maintaining a broad range or a few broad-based taxes are ways for governments to stabilise their revenues—as different parts of the economy expand and contract, increases in some revenue sources may offset decreases in others.

Minimising tax exemptions, which narrow the tax base, could also be considered.

Please refer to [Victorian taxes and revenue—Volatility, trends and stability](#) at [pbo.vic.gov.au](http://pbo.vic.gov.au) for further analysis.

## **How should fiscal rules be implemented to enable subnational frameworks to react to economic downturns and national emergencies such as the COVID-19 pandemic?**

### **Fiscal rules in Victoria and their evolution**

The Victorian Government's long-term financial management objectives, medium-term financial targets and objectives and fiscal sustainability objectives are in Victorian Budget 19/20 Paper No. 2 and No. 5 and the budget update (Appendix A).

A trend toward greater use of qualitative fiscal targets and objectives has taken place since 2011-12 (Appendix B), despite an independent Review of State Finances in 2011-12 concluding that a:

‘fresh approach to financial management is required  
if the State's finances are to be sustainable into the future.’

The government of the day implemented a range of the review's recommendations, but many were dropped by successive governments.

### **Issues**

Unlike the past 3 decades of positive growth, Victoria is in the midst of a profound shock to its economic and fiscal landscape. This is reflected in sharply falling economic growth and revenues and rising borrowings associated with expanded asset investment and COVID-19 related expenditures. Even prior to this, a large public infrastructure program with intergenerational debt implications was progress.

We assessed Victoria's fiscal targets and objectives and found:

- Some feature fixed numerical floors or ceilings on fiscal measures—known as first generation targets—which can be rigid and complicated, or so flexible that they form non-binding constraints.
- They focus on a limited area of public finances—net debt, superannuation liabilities and net operating surpluses—which does not fully align to revenue and expenditure that the Victorian Government can control.
- The government has also set progressively fewer targets and objectives and they have become increasingly less specific and measurable in recent years.
- When it cannot meet them, the government has changed or discontinued them.

We also found that the scope and quality of budget paper performance indicators make public scrutiny of whether these targets have been achieved difficult. General government fiscal targets and objectives are spread across the budget papers, different terms have the same meaning and less information is published to monitor performance than was provided around 2011-12.

But the single largest issue we found was that budget paper planning horizons for fiscal policy can work against medium and longer-term fiscal sustainability objectives and targets. The Victorian budget covers the budget year and 3 years of forward estimates and can accommodate near term fiscal challenges, such as the COVID-19 pandemic. Yet some fiscal challenges faced by the state, such as population ageing which the budget papers describe, unfold over decades.

### Implement flexible fiscal rules

We undertook a global scan of fiscal rules and found an emerging trend where some subnational governments are using more flexible, effective and transparent fiscal targets and objectives—known as second generation targets— which feature:

- measurable target ranges for net operating balances, revenue, expenditure and debt levels
- clear escape clauses to give policymakers discretion to support citizens during periods of economic weakness without recasting targets
- greater focus on expenditure targets that are not linked to revenues to avoid overspending during periods of strong revenue growth
- regular fiscal statements that assess fiscal sustainability over the longer-term
- independent oversight to assess performance against targets and objectives.

Flexibility provides opportunity for policy adjustments to be made instead of changing or discarding targets and objectives if they become unachievable in the short term.

Most importantly, fiscal rules could be enshrined in legislation and focused on the medium to long term to avoid successive governments reducing their effectiveness or transparency. The state of New South Wales in Australia has enshrined its targets and objectives in legislation—the *Fiscal Responsibility Act 2012* (NSW). This Act also requires the NSW Government to:

- report annually on its performance against fiscal targets and objectives
- outline the reasons for a departure from the fiscal targets and objectives
- planned actions to achieve the fiscal objectives over the budget forecast years.

Please refer to [Fiscal sustainability—Victoria's performance and options to strengthen](#) at [pbo.vic.gov.au](http://pbo.vic.gov.au) for further analysis (available late September 2020).

## Appendix A – Victoria’s fiscal objectives and targets

**Figure 1 – Long-term financial management objectives**

Priority	Objective
Sound financial management	Victoria’s finances will be managed in a responsible manner to provide capacity to fund services and infrastructure at levels consistent with maintaining a triple-A credit rating
Improved services	Public services will improve over time
Building infrastructure	Public infrastructure will grow steadily over time to meet the needs of a growing population
Efficient use of public resources	Public sector resources will be invested in services and infrastructure to maximise the economic, social and environmental benefits

Source: Department of Treasury and Finance, Victorian Government.

**Figure 2 – Medium-term financial measures and targets**

Financial measure	Target
Net debt	General government net debt as a percentage of GSP to be maintained at a sustainable level over the medium term
Superannuation liabilities	Fully fund the unfunded superannuation liability by 2035
Operating surplus	A net operating surplus consistent with maintaining general government net debt at a sustainable level over the medium term

Source: Department of Treasury and Finance, Victorian Government.

**Figure 3 – Financial sustainability objectives**

Fiscal sustainability objective
Net operating surpluses in each year over the next 4 years
Operating expenditure growth will be no greater than revenue growth, on average, over the next 4 years
Net debt to gross state product will be no greater than 12 per cent over the medium term

Source: Department of Treasury and Finance, Victorian Government.

## Appendix B – Evolution of Victoria’s fiscal framework

Financial measure	2011-12	2012-13 to 2014-15	2015-16	2016-17 to 2018-19	2019-20
Net debt and net financial liabilities	Ensuring that debt as a percentage of GSP will stabilise, with net financial liabilities falling as a percentage of GSP by 2014-15 and remaining consistent with retaining Victoria’s AAA credit rating	General government net debt reduced as a percentage of GSP over the decade to 2022	General government net debt as a percentage of GSP to be maintained at a sustainable level over the medium term		
Superannuation liabilities	Fully fund unfunded government superannuation liability by 2035				
Operating balance	Operating surplus of at least \$100 million in each year	A net operating surplus consistent with maintaining general government net debt at a sustainable level over the medium term			
Expenses	Constraining expenses growth to average 3.2 per cent a year over the forward estimates	No target	No target	Expenditure growth no greater than revenue growth, on average, over the budget and forward estimates	
Infrastructure	Over rolling five-year periods, net infrastructure investment is at least equal to 0.5 per cent of the historical five-year average of GSP	Infrastructure investment of 1.3 per cent of GSP (calculated as a rolling five-year average)	No target	No target	No target
Taxation	When revenue growth exceeds the rolling five-year average, the Government preserves the excess in the form of cash reserves or equivalent financial assets	No target	No target	No target	No target
Efficiency	Efficiency savings totalling \$2.2 billion over five years	No target	No target	No target	No target
Wages	Constraining public sector wage outcomes to 2.5 per cent a year plus productivity gains	No target	No target	No target	No target

Source: Parliamentary Budget Office, Victoria.