

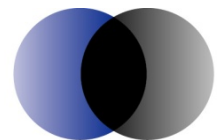
Confidential

Reforming Federal Finances

Why a review of Australia's fiscal sustainability is urgently needed, and how it could be conducted

Prepared for the Business Council of Australia

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Executive summary

Australian government finances have compared favourably with those of most developed countries over the past decade. While overseas demand for resources has been a major driver, successive governments' economic and fiscal management has both contributed to and benefited from high growth.

Today and in the foreseeable future, however, government finances face significant threats to their sustainability. Tax concessions and welfare increases put in place at the height of the mining boom are no longer sustainable in the face of decreasing revenue. The aging of the baby boomer generation will put increasing pressure on the budget due to health spending and tax concessions for retirees. The ratio of retired Australians to taxpayers will continue to grow until the demographic wave passes by around 2050.

For the States, a structural shift in consumer spending has caused the GST - in its early years the "growth tax" it was claimed to be - to level off as domestic savings rates have risen. Australians have become more cautious in the face of global economic uncertainty. This uncertainty will continue in the western world until the overhang of bad debt from 2000s excessive lending is worked through in the major economies of Europe and North America.

Due to global economic conditions it will also be some time, if ever, before company tax revenues rebound (in real terms) to levels seen immediately prior to the global financial crisis.

This report outlines the case for a comprehensive review of government finances to address these problems. It should be an independent, external review in order to have an unfettered ability to raise difficult issues and suggest fundamental structural changes. A 'business as usual' approach with marginal changes will not be sufficient to deal with the fiscal problems.

There have been some useful initiatives in recent budgets as government has realised the scale of the task it faces. However, it is becoming ever more apparent that in the face of Australian governments' fiscal unsustainability, small or piecemeal expenditure savings or tax changes are not an answer.

Further public service efficiency dividends or increases in the frequency of company tax collections will never bridge the gap. Asset sales offer short term cash benefits rather than long term sustainable gains; they might be pursued for other reasons but are not a long term fiscal answer.

Fundamental structural solutions are needed. The most important reform that could be made to solve the sustainability problem would be to clarify and rationalise the division of roles and responsibilities between the



Commonwealth and States. Federal systems work well in many countries and in principle should work well in Australia. In practice our system is plagued by overlap, duplication and excessive administration. If these could be addressed, the fiscal sustainability of both Federal and State/Territory governments would improve markedly.

The areas of spending overlap, including health, education and transport, include those where the pressures due to demographic change are largest. While confusion in roles persists it will be difficult to deal effectively with these fiscal pressures and the sustainability problem will worsen.

The Commonwealth also needs to address fundamental reform in its own taxing and spending programs.

Possible options on the revenue side include: broadening the GST base (notably, removing exemptions in areas of spending growth such as health and education), and restructuring income taxes along the lines suggested in the Henry review.

On the spending side the areas with both rapid growth and future pressures – especially, health, social security and welfare - have to be addressed. The demographic driver is an aging population; the key policy question is how best to address the costs of aging while maintaining fiscal sustainability.

In addition to areas where growth has been due to demographic change, there also would be merit in examining the proliferation of small discretionary spending programs. While in isolation each has an insignificant impact on the budget balance, their combined effect has been large.

Allied to this, the unchecked growth in government regulation has not only put costs on the economy as a whole but has made the fiscal sustainability problem worse. Each new regulation requires resources to monitor, administer, enforce and evaluate, imposing a large but so far unquantified burden on government spending.

Equally important, any national inquiry will need to learn from past experience with similar exercises. Fundamental structural reforms of the sort required to bring the budget to a sustainable footing are not easy. A plan to recast Commonwealth finances and address roles and responsibilities should contain a realistic implementation plan and a staged approach.



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1 Introduction

Fiscal sustainability is important

The 2012-13 Budget papers observe that

Maintaining fiscal sustainability is particularly important at this time of ongoing global economic uncertainty...fiscal sustainability is essential in maintaining macroeconomic stability, reducing economic vulnerabilities and achieving sustained growth in living standards...is also important because of the longer-term challenges arising from population ageing and climate change¹

But the budget is fragile

Ageing of the population will put increasing pressure on both Commonwealth and State budgets due primarily to the costs of health and aged care. As successive Treasury intergenerational reports have shown, the long term state of Australia's public sector finances is fragile:

Ageing – pressures on fiscal sustainability

Between now and 2050 the number of:

- older people (65 to 84 years) is expected to more than double;
- very old people (85 and over) is expected to more than quadruple, from 0.4 million people today to 1.8 million in 2050.

The number of traditional working age people to support each retiree is expected to fall from 5 people today, to 2.7 people in 2049-50.

Rising health costs are by far the biggest contributor to fiscal pressures...

Rapid growth in real spending during the 2000s economic expansion has locked in permanent increases in spending, compounding the challenges...

Together, these forces – ageing pressures, rising health costs and a structurally high spending base – are expected to result in spending exceeding revenue by around 2¾ per cent of GDP in 2049-50.

Source: Treasury, Intergenerational Report, 2010

In both the long term, due to ageing and various other factors including climate change and weather

The latest intergenerational report also notes the costs of climate change.

Questions about the effects of climate change and an appropriate government policy response remain contested between the major political parties.

Different responses will involve different degrees of pressure on the budget.

It is notable however that Australia's extreme weather events have increased in number and severity in recent years. Such events inherently involve large and unpredictable imposts on Commonwealth, State and local government budgets. Policy responses have included new tax measures. In announcing² a temporary flood levy in January 2011 the Prime Minister noted prospective costs of \$5.6b due to flooding in Queensland and unspecified but "significant" costs arising from flooding in other states.

¹ Statement 4, Budget Paper1, pp. 4-16 to 4-17.

² <http://www.pm.gov.au/press-office/rebuilding-after-floods> viewed 12 December 2012



And in the short term due to the international economic outlook

In the more immediate term, the fragility of the budget is shown by the government's difficulty meeting its target of returning the budget balance to a surplus by 2013-14. The fiscal strategy target of "holding real growth in spending to 2 per cent a year until the budget returns to surplus" is also proving difficult and in public statements³ is increasingly accompanied by the qualifier "while the economy is growing at or above trend"⁴.

A surplus is not in itself a marker of good fiscal policy and the government's announced change of direction in late 2012 was largely welcomed by economists. Indeed, in a slowing economy measures to cut government spending could – without central bank intervention to reduce interest rates – potentially induce a recession.

Nevertheless the size of the revenue turnaround (reported at around \$4b) highlights the vulnerability of the budget to changes in international conditions and the fragility of the forward estimates.

Finding savings is hard

The Treasurer has commented on the difficulties the government has faced in meeting this target in today's economy:

we are absolutely committed to getting the budget back into the black this year, even though that task has got considerably tougher in recent times⁵

The decisions taken in this MYEFO were difficult but critical at a time of falling revenues and ongoing global headwinds. ⁶ [underlines added]

And will get even harder in future

Treasury Secretary Dr. Martin Parkinson has drawn attention⁷ to the sustainability problem

"...there are growing pressures on fiscal sustainability at all levels of government.

As a community, we need to make choices about what governments can and should provide, and how these will be funded....

...while we are getting richer, our expectations for more goods and services delivered by governments are also growing.

³ See eg <http://www.afr.com/p/national/economy/>

"surplus_will_depend_on_growth_gillard"_A7ejnrBHE6OB5cV6bDTFiM

⁴ Both the target and the qualification from Budget Paper 1, Statement 3 2012-13 p.3-4

⁵ Opinion Piece *We Run a Strict Budget So That You Can Balance Yours* 23 October 2012 at www.treasurer.gov.au

⁶ Mid-Year Economic and Fiscal Outlook 2012-13, 23 October 2012

⁷ *Challenges and opportunities for the Australian economy* Speech to the John Curtin Institute of Public Policy, Breakfast Forum Perth 5 October 2012 at www.treasury.gov.au



...in the next ten years we will be facing significant spending pressures, particularly in the areas of health and aged care, as our population ages and the average cost of services increases.

...at the same time that we face these increased pressures on public spending, significant structural change in the economy and global economic weakness mean that the relationship between the size of the economy and the amount of tax we collect from it is changing, too...revenues will simply not be returning to the unsustainable levels of the previous decade.

The choices will be difficult

We then need to consider how governments should fund the goods and services they are to deliver... any increases in spending need to be funded either via higher taxes, introducing more user-pays options, and/or reducing spending on other services.”

Superannuation concessions are less affordable

On a separate occasion recently he noted⁸ the “very significant” costs to revenue of superannuation concessions and that “with the Commonwealth budget coming under increasing pressure...the fiscal sustainability of all policies, including superannuation, will demand greater public scrutiny”.

Adding to the problem of growing costs and a declining revenue base is the apparent fundamental shift in consumer behaviour to higher savings.

Fiscal sustainability is as much a problem for the States as the Commonwealth

Lower consumer spending means revenue collections from the goods and services tax (GST) have been levelling off. In its early years the GST was described as “growth tax” and provided States and Territories with real increases in revenue annually. This is no longer the case.

In addition, as indicated in the 2012-13 budget papers⁹, “households have been allocating a larger share of consumption towards goods and services not subject to the GST, such as education, rent, health and food...”

There is a growing gap between funding capacity and demands for services

This means that the capacity of State governments to meet increasing health and other costs due to ageing is diminishing at the same time as demand for services is growing. This mismatch between capacity and demand will continue to grow between now and 2050.

Expectations can no longer be met

The problem of community expectations was highlighted particularly effectively in Laura Tingle’s *Great Expectations*¹⁰, which charts the rise under successive governments in the 1990s and 2000s of a public expectation of ever increased government intervention and spending, an expectation that can no

⁸ *Future Challenges: Australia's Superannuation System* ASFA 2012 28 November 2012 at www.treasury.gov.au

⁹ Statement 5, Budget Paper 1, 2012-13, p5-8.

¹⁰ Laura Tingle (2012) *Quarterly Essay 46* ‘Great Expectations: Government, Entitlement and an Angry Nation’ June 2012



longer be met. The expectation problem has also been noted by the public service:

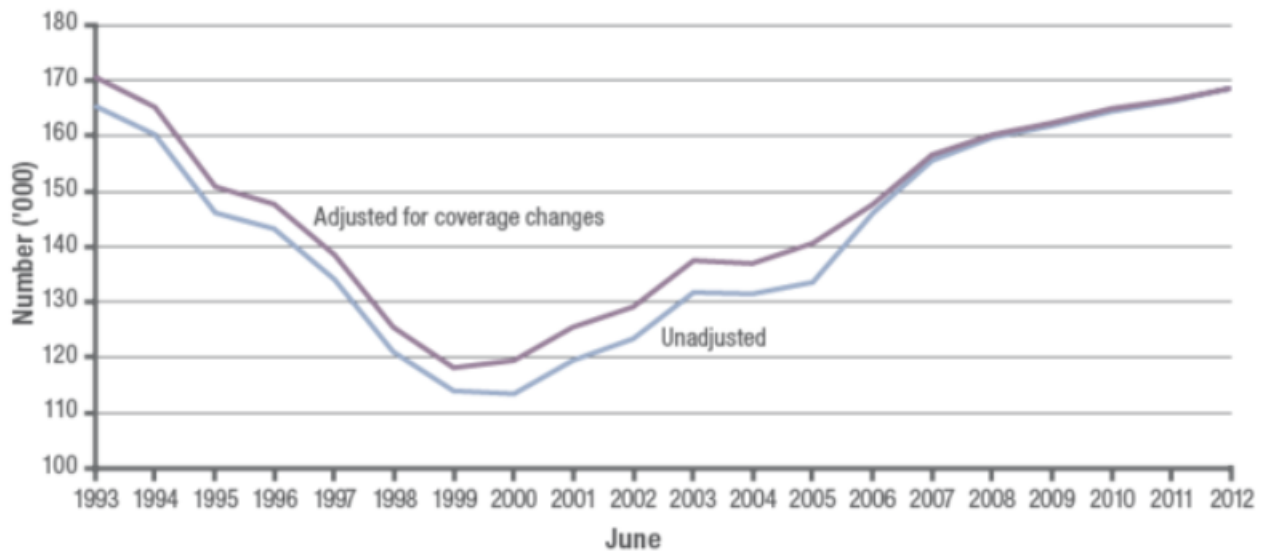
Public expectations of government service delivery are increasing...largely being driven by private sector service improvements, but also by comparative improvements in public services nationally and internationally¹¹.

The public service continues to grow.

The public sector response to the expectations problem has to date been increased numbers of public servants. Despite the high profile of expenditure control mechanisms such as the efficiency dividend the Australian public service (APS), continues to grow. The *State of the Service* report for 2011-12, tabled in the Federal Parliament on 29 November 2012, indicated that “there were 168,580 APS employees at June 2012, compared with 166,252 at June 2011. The total number of employees rose by 2,328 or 1.4%”.

As the graph below shows, APS numbers (adjusted for changes in coverage as agencies come under or move out of the *Public Service Act*) have risen every year since 1999.

Figure A1 APS Employees 1993 to 2012



Data source: Australian Public Service Commission, *State of the Service* report, November 2012.

Decisions in the 2012-13 Budget are however expected to result in a drop in public service numbers by June 2013, the first fall in numbers for 14 years. The fiscal pressures now faced by government mean the growth trend simply cannot be sustained.

¹¹ *Empowering Change. Fostering Innovation in the Australian Public Service.* Management Advisory Committee, Canberra, 2010.



Public service is important

The public service delivers vital functions in any country – but the nature of these functions varies widely between countries depending on their constitutions and history. There is no simple formula for determining the desirable size of the public sector.

Optimal size cannot be established a priori

Internationally, there is no obvious correlation between the size of a country's public sector and its overall economic prosperity or social wellbeing. The international literature shows there is no consensus on whether there is an optimal size of government, and a range of opinions on whether there is a threshold at which public sector size begins to reduce national wellbeing.

Depends on the activities we want it to undertake

A key question is how well a public service carries out whatever functions it is allocated. As noted by the Public Service Commissioner in the overview to the State of the Service report,

the optimal size of the APS is difficult to establish a priori. It is best derived from the nature and scale of the activities the Australian Government undertakes and its preferred delivery model in pursuing them.

But efficiency gains can be found

There is however a strong case that more can be done in pursuit of greater efficiency in the public sector. The government's 2010 *Ahead of the Game* blueprint for public service reform noted that while measuring public sector productivity and efficiency was difficult,

Improving efficiency and effectiveness is a basic business discipline that needs particular attention in a tight fiscal climate...incentives need to be right to ensure agencies continually refine their structures, systems and management arrangements to deliver efficient, high quality outcomes for citizens.

Questions of how well the public service is performing cannot be resolved by the public service itself – it has an obvious conflict of interest.

An independent external inquiry can play a valuable role in helping identify possible public service efficiency gains by comparison with practices elsewhere whether in the private or not for profit sectors or other governments.

Where an independent inquiry can help is in promoting a high profile debate about what services we can afford and where efficiency can be improved, without any ties to existing programs. Any internal public service inquiry would face perceived conflicts of interest in examining its own operations.

Ultimately though, the success of measures to improve public sector efficiency depends on implementation. It needs political will from Ministers and implementation skills on the part of public servants.



2 How can the sustainability problem be addressed?

We need a fundamental review of finances

When faced with fiscal problems of this magnitude in the past, governments at both the Commonwealth and State level have commissioned far-reaching reviews of revenue and spending. Often, but not always, these reviews have been called a Commission of Audit and followed a change of government. They have been commissioned by governments of all political persuasions. Appendix A provides a listing of Commissions of Audit and reviews of this nature, together with their terms of reference.

It has been 16 years since the National Commission of Audit

The size of the fiscal gap facing Australia's governments at present suggests that the Commonwealth should undertake a fundamental review of this kind.

The last comprehensive review of the Commonwealth government's finances was the National Commission of Audit in 1996.

In the 16 years since, the shape of the public sector has changed dramatically: the GST and a carbon tax have been introduced; the number of Australians claiming some form of social security and welfare benefits has grown to more than half the population; regulation and the associated employment of regulators has increased many times over; a mining boom began, peaked and has started to decline.

Things have changed since 1996. An independent and rigorous examination of financial sustainability would be timely

Consultations for this report were undertaken with a number of stakeholders in senior positions both inside and outside the public sector. Their names have been kept confidential. All agreed on the desirability of a fundamental review that could be properly resourced, independent of the public service (but well supported and informed by it), rigorous and innovative in its thinking. They provided many valuable suggestions on the issues such a review should consider, how it should be organised, and the kinds of people who might be commissioned to undertake it.

There was a strong consensus that an external review was required, rather than an internal process within government. The annual budget deliberations by the Expenditure Review Committee of Cabinet already involve a searching examination of all portfolios and are informed by advice from all of the central agencies (Treasury, Finance and the Department of the Prime Minister and Cabinet). An external review would not cover the same ground.

An independent review has greater scope to suggest structural change than does an internal government review

The advantages of an external, independent review include:

- Raising awareness of the extent of the fiscal problem facing government, and so helping to moderate public expectations of ever increasing government handouts



- An ability on the part of independent, external review members/commissioners to engage with other levels of government - especially the States – without being weighed down by a history of entrenched inter-governmental rivalries
- A capacity to raise difficult questions about areas of tax and spending that have been off the table politically and thus unlikely to be considered by government without an external catalyst.

But still needs support from key players in the bureaucracy

To be effective, an independent review still needs strong support from the public service. In the letter transmitting the 1996 National Commission of Audit report to the Treasurer the commissioners noted the “first class work” and “skill and professionalism” of its secretariat. All of the reviews and commissions listed in the Appendix received similar support, particularly from Treasury or Finance departments in their respective jurisdictions

2.1 Drivers of fiscal fragility

Our consultations, a literature search and a survey of recent commentary and media reporting revealed a number of other underlying drivers of the growing pressure on government finance, in addition to the issues documented in the Intergenerational Reports. They included:

2.1.1 The structure of Australia’s federation

Spending in health, education, transport, infrastructure cannot be addressed by one level of government alone

It will be difficult, if not impossible, to address some of the large and complex areas of expenditure growth such as health while roles and responsibilities between the Commonwealth and the States/Territories remain unclear.

The current system has entrenched structural incentives for different jurisdictions to pursue their own interests at the expenses of overall national welfare. Boundaries in roles and responsibilities are fuzzy and able to be interpreted in very different ways. This in turn leads to problems of cost shifting, blame shifting, unnecessary duplication and overlap.

Around the world, for all but the smallest states, federal systems are a preferred governance model.

Federations work well

Federations combine the advantages of national coordination with service delivery responsive to local needs. A principle of good governance is subsidiarity – that is, service delivery works best when those who deliver the services are close to the recipients¹². It encourages higher quality service delivery that is adaptive to local needs and also improves accountability.

¹² See eg Paquet, G (2001), Ch 7 “The new Governance, Subsidiarity and the Strategic State” *Governance in the 21st Century* OECD Paris



But fiscal imbalance is greater in Australia than in any other large industrialised country

Budgeting is problematic if governments are not publicly responsible for the tax consequences of spending

Australia is an extreme case

However, some federations operate more effectively than others. Australia's is characterised by a marked imbalance between national and state financial capacity (known as vertical fiscal imbalance). That is, the States have higher spending needs than their revenue can cover, and rely on the revenue collection capacity of the Commonwealth.

This Henry tax review report¹³ suggested a principle that:

The assignment of tax responsibility in a federation should take into account the revenue needs of each level of government. Each level of government should have access to tax revenue it can use to finance significant marginal expenditure decisions.

In coming to this view it noted a paper by Bird and Smart¹⁴ that

a government will face a hard budget constraint if... it is publicly responsible for the consequences of its actions. In other words, if a government chooses to spend extra money on a particular program, that government must raise the revenue required to fund that program rather than burden another level of government and it needs to be clear to people they are paying tax to fund the extra spending.

According to stakeholders outside the Commonwealth who were consulted in the course of this review, the Federal level of government is simply unaware of the extent of the pressures facing State/Territory governments, especially in those less exposed to mining revenues. The capacity of States to deliver services has been eroded and is likely to come under even more pressure in future.

The problem of vertical fiscal imbalance was addressed in the report of the Senate Select Committee on the Reform of the Australian Federation, which noted, quoting Twomey and Withers¹⁵ "that 'some VFI is not unusual in a federation' but... 'its extent in Australia is the most extreme of any federation in the industrial world.'" The point was illustrated graphically in the Senate committee's report:

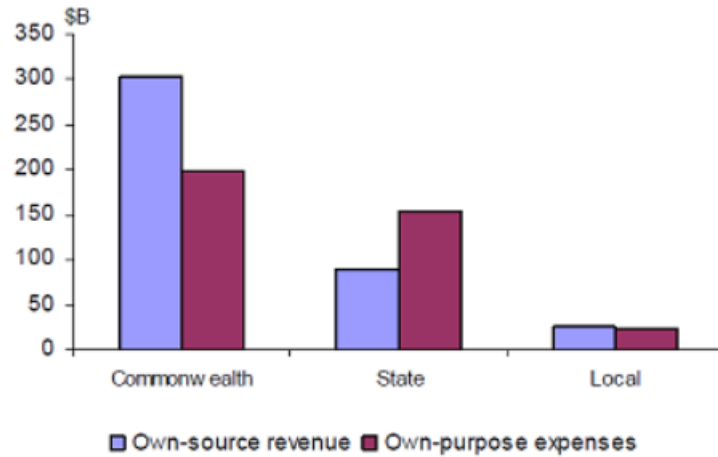
¹³ *Australia's Future Tax System* Report to the Treasurer, December 2009

¹⁴ *Assigning state taxes in a federal country: The case of Australia*, paper prepared for Australia's Future Tax System Review, Tax and Transfer Policy Conference, Melbourne, July 2009

¹⁵ Dr Anne Twomey & Dr Glenn Withers, *Federalist Paper 1: Australia's federal future. Delivering growth and prosperity. A Report for the Council of the Australian Federation*, April, 2007, pp 37–38.



Figure 2 Commonwealth, state and local government revenue and expenses



Source: Senate Select Committee on the Reform of the Australian Federation *Australia's Federation: an agenda for reform* 30 June 2011

Symptoms of the problem include:

- a questionably large bureaucracy at Federal level with supervisory and oversight rather than service delivery functions.
- institutionalised distrust between levels of government that has seen a long and complex reform agenda for the Council of Australian Governments (COAG) moving at a tortuously slow pace, and
- a concern¹⁶ on the part of bodies such as the COAG Reform Council about the problems inherent in driving national performance and the lost opportunities in not developing better arrangements.

Areas of particular concern for fiscal sustainability include health, education and disability.

Health

Health administration costs are very high, but hard to estimate precisely

It is difficult to obtain an accurate estimate of the costs in administration of federal agreements on healthcare. Each new health initiative by successive governments has added millions to administrative costs. The budget papers¹⁷ for example indicate direct supervisory and administrative costs arising from the 2011 COAG health reform agreement of \$38m for establishment of an 'Administrator of the National Health Funding Pool' and the 'National Health Funding Body'. Such costs are the tip of an iceberg.

¹⁶ See eg Paul McClintock AO, *Harnessing Federalism: the missing key to successful reform* 19 November 2012, *Performance Federalism, the cutting edge* August 2012, and many others at www.coagreformcouncil.gov.au/media.

¹⁷ Budget Paper 2, 2012-13, p196



At the Commonwealth level, the jurisdiction not involved in health services delivery, there is an estimated staff of 4,600 in the central department, part of a total of 6189 staff in the portfolio including in other administrative and regulatory agencies. The costs of “general administration” in the health function are \$3.2 billion¹⁸ or 5.2 per cent of total expenses.

An important role for an independent fiscal review would be to identify, quantify and report on the costs of duplicate health administration, allowing a better informed public debate on how to address the problem.

Education

Funding Gonski reforms is a challenge

The education function has a lower proportion of total funding classified as ‘general administration’ (\$258m or 0.8 per cent of the total of \$29.6b in 2012-13¹⁹). The area of greatest concern for sustainability is the cost of funding reforms arising from the Review of Funding for Schooling (the Gonski review), estimated at some \$6 billion. Debate is still ongoing on which level of government will fund the reforms, and what if any administrative overheads will be incurred by the Commonwealth.

Disability

National Disability Insurance is an expensive and complex reform

The Productivity Commission estimated the additional costs of the proposed new national disability insurance scheme at \$6.5b annually, revised in recent estimates to some \$7.5b. (on top of a current spend of some \$8b per annum²⁰). The Commonwealth government to date has only committed to funding a “share”²¹ of the scheme. As noted by the Parliamentary Library²²

if the NDIS was to be fully funded by the Commonwealth, this would require a renegotiation of national disability funding arrangements. Renegotiations of Commonwealth, state and territory financial arrangements tend to be complex and problematic.

In December 2012, the Commonwealth agreed to funding for NSW in 2018-19 (at the end of the NDIS trials) of \$3.32b, roughly half of total estimated costs with the NSW government to contribute \$3.18b.

¹⁸ Budget 2012-13, Paper 1, Statement 6, p 6-21

¹⁹ Budget 2012-13, Paper 1, Statement 6, p 6-17

²⁰ These estimates will be subject to considerable revision as the scheme is developed, and some commentators consider they significantly understate the likely total costs.

²¹ J Gillard, National Disability Insurance Scheme to launch in 2013, media release, 30 April 2012

²² Budget Review 2012-13, National Disability Insurance Scheme



While there is a bipartisan commitment to national disability insurance, the funding details are still being developed, and many of the States and Territories are concerned about the implications for their own fiscal position. At present the forward estimates provide for only \$1b over four years (\$139m in 2013-14) for the first stage of the NDIS.

A large wedge into future spending estimates

The full costs fall outside the budget horizon of 2015-16: it is a classic case of a “wedge-shaped” program where the early costs are far less than costs beyond the forward estimates. It is however highly unlikely that they could be met without significant re-shaping of priorities.

If in implementing the scheme the Commonwealth adopts a model similar to health of a parallel bureaucracy to administer and supervise spending, it could involve some \$1b per annum of additional administration costs.

2.1.2 Volatility in revenue.

Income taxes as a proportion of total revenue have fallen in the period since 1996, and the remaining sources of revenue (primarily company tax, GST) are more sensitive to changes in economic parameters than income tax, fluctuating markedly as conditions change.

Taxes are now more volatile and forecasts less reliable than in the past

Some commentators have queried²³ the reliability of Treasury revenue forecasts, and a review is underway (Review of Treasury's Forecasting Methodology and Performance). This review “will assess the quality of Treasury's forecasts of the macroeconomy and revenue by examining the appropriateness of forecasting methodologies and comparing forecast accuracy with other forecasters both in Australia and overseas”²⁴. It will be an internal review conducted in Treasury but overseen by an independent external reference group. This review is potentially a useful contribution to a more fundamental examination not only of the forecasting methodologies but also of whether the structure of the tax system has made revenue forecasts inherently more difficult.

2.1.3 Proliferation of small programs

Small programs fly under the radar of proper scrutiny

Although the major items of expenditure by the Commonwealth fall into large programs in the health, social security and welfare, defence and education functions, there has been pressure placed on the budget by the proliferation of numerous small programs. These are rarely given prominence in debate on fiscal reform because in isolation each is too small to make any significant

²³ Eg ‘Treasury wide of the mark on tax revenue’, David Uren, *The Australian* June 25, 2012

²⁴ From www.treasury.gov.au viewed 8 December 2012



but in aggregate they represent a large spending commitment

difference to the budget bottom line. However, their cumulative impact is large.

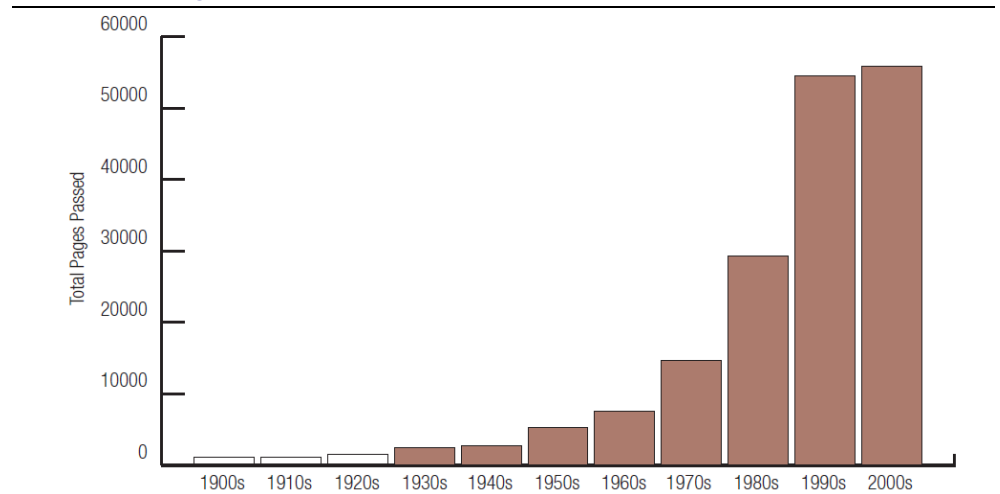
Each year the Budget provides a list of new measures (that is, “government decisions that involve changes to its revenue, expenses or investing”²⁵) since the last update. These are voluminous – the 2012-13 measures document at 309 pages was relatively modest compared with others (for example the 2008-09 measures document ran to 439 pages).

By far the majority of measures in any one Budget over the past 16 years have been new spending decisions. The overall cost from the accumulation of small programs has never been collated and released publicly, but is likely to total many billions of dollars. An independent review could be tasked with identifying this cost and recommending ways to deal with the problem.

2.1.4 Regulation

The Taskforce on Reducing Regulatory Burdens on Business chaired by then Productivity Commission chairman Dr. Gary Banks, documented the costs to Australia of the ever increasing amount of regulation. It graphed pages of legislation (a proxy measure for the amount of regulation):

Figure A1 **Estimated growth in pages of Australian Government primary legislation**



Data source: *Rethinking Regulation*, January 2006.

Regulation continues to grow

The quantity and complexity of government regulation however has not diminished, and government institutions continue to struggle to control the growth in regulation (see the Independent Review of the Australian

²⁵ Budget Paper no 2 2012-13, *Budget Measures*, page iii



Government's Regulatory Impact Analysis Process (RIA review)²⁶, and the Productivity Commission Research Report 'Identifying and Evaluating Regulation Reforms'). The RIA review found that

data indicates the critical nature of effective review of proposed future regulations (future stock) as well as sustained steps to reduce the existing stock

and suggested²⁷ that if trends continued regulation was projected to reach 18,000 pages of legislation passed each year by 2030.

Regulatory costs add to the fiscal burden

Regulation is essential for the functioning of society and the economy, but involves costs. Each piece of regulation requires staff to administer, monitor and enforce, and the growth in regulation is one of the drivers of growth in the numbers of the Australian public servants identified in the previous section of this report.

A "better regulation" approach is more likely to succeed

There is no simple solution to the growth in regulation. Fundamental changes in the structures for regulation are needed, including:

- Effective regulatory governance and
- the adoption of the principle of better regulation (including first principles consideration of whether regulation is needed, and where it is determined to be the best option, application of a "responsive regulation"²⁸ approach).

2.1.5 Loss of budget coherence

Australia was once a leader

Australia was at one time a world leader in public sector financial management. Reforms such as the running costs system and the financial management improvement program in the 1980s, the Charter of Budget Honesty and accrual budgeting in the 1990s, made the Australian experience an international model of good practice.

But has fallen behind

Since then, other countries have also reformed public sector fiscal management. Far from being a leader, Australia is now lagging others in areas such as management of programs that cross portfolio boundaries, intergovernmental financial relationships, evaluation, benchmarking to improve performance.

Loss of transparency

In some ways Commonwealth transparency in budgeting has declined since the 1990s. Application of accounting standards is inconsistent, with the

²⁶ The review and the government response are available at www.finance.gov.au/dewregulation/raireview; the government response to the Productivity Commission research report is also available at www.finance.gov.au .

²⁷ See graph at page 22, RIA review.

²⁸ Ian Ayres and John Braithwaite, (1992) *Responsive Regulation Transcending the Deregulation Debate*. Oxford University Press



government adopting both Australian Bureau of Statistics Government Finance Statistics and Australian Accounting Standards with a range of departures based on the government's own judgment of whether "it provides a better conceptual basis for presenting information"²⁹

The Commonwealth, according to one of the experts consulted for this review, has over time accumulated the most significant departures from accounting standards of all jurisdictions. This has made consistent reporting across Australia difficult.

Funds distort priorities and reduce flexibility

The Commonwealth has created a series of separate funds outside normal budget processes. In addition to the Future Fund, the *Nation-building Funds Act 2008* created a Health and Hospitals, Building Australia and Education Investment fund. Other funds include the Caring for Our Country fund, an earmarked \$2b for environmental and related spending. The problem with funds (or any allocations of monies that are fenced off in some way) is that spending from them is not subject to the same budget process as other programs. This distorts priority setting and reduces government budget flexibility. Proponents of funds see this as positive because it shields these programs from cuts: but they may not be appropriate in tight fiscal times.

Some of the financial management problems have been under review

The Australian Government has addressed some of the internal financial management issues in its Commonwealth Financial Accountability Review. That review has been conducted internally by the Department of Finance and Deregulation, and so far issued a discussion paper and position paper³⁰ that put forward a series of questions and options. It has however gained little attention outside the Commonwealth government and virtually no media coverage.

How the public sector manages its finances is important to the overall fiscal position

Many of the problems it raises are significant contributors to Australian fiscal fragility. They include the quality and reliability of performance information, the tendency of many agencies to spend up monies unwisely as the end of their financial year approaches, and the reluctance of the public sector to engage with risk (at present the tendency is to try to avoid risk, regardless of cost to the taxpayer). The position paper however lacks a clear direction on how best to solve these problems. An external review is likely to gain more traction and give impetus to the necessary reforms.

²⁹ Budget Paper One 2012-13, Statement 9, Appendix A, page 9-28. A particularly impenetrable section of the budget papers replete with acronyms (eg financial statements "comply with ABS GFS and AAS...AASB 1049 and the UPF also provide a basis for reporting of the PNFC and PFC sectors and the total NFPS" – whatever that means).

³⁰ Finance Minister Sen. the Hon Penny Wong media release *Next Step in Reforming the Commonwealth's Financial Framework* 22 November 2012



2.2 Putting it in perspective – why urgent and fundamental reform is needed

In the face of the growing sustainability problems, minor savings or bring forwards of revenue here and there cannot provide an answer. The longer Australia delays addressing the problem, the more likely it is to face a point at which financial markets lose confidence in governments' capacity to deal with the long term: which would lead to a dramatic deterioration in investment, employment and national wellbeing.

There have been some steps taken recently to improve finances

The government has made numerous savings and revenue decisions in the last two budgets and the 2012-13 MYEFO in pursuit of its fiscal goal of a surplus in 2013-14. Some have made a long term structural difference, but others have been short term or temporary in nature. Instance of the latter include an announcement in the 2011-12 Budget of “an additional one-off efficiency dividend of 2.5 per cent in 2012-13 to departmental appropriations” saving some \$500m. There was also an announcement in the 2012-13 Mid-Year Economic and Fiscal Outlook that large companies would pay tax instalments monthly rather than quarterly, raising \$5.5b in 2012-13, \$1.6b in 2013-14 and \$1.2b in 2014-15.

As the published estimates show, the impact of measures such as this is higher in the short term, and tails off into the future.

Limits have been reached

There are limits to how often a government can apply such measures. The efficiency dividend is sustainable only if it corresponds to equal or greater productivity improvements. Beyond that it will affect service delivery. Changes in timing of collection bring revenues forward but do not create long term gains.

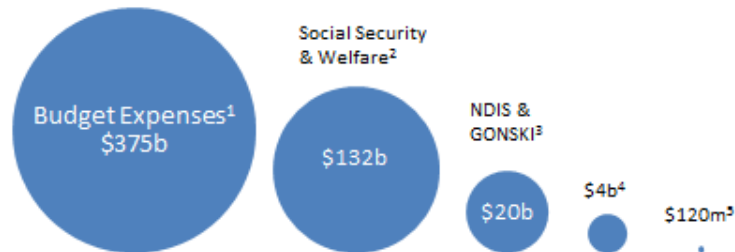
Over the longer term, sustainable savings can only be found by reducing or removing whole areas of government activity.

New spending on disability or education cannot be funded from small savings

The government is also facing demands for greatly increased spending in numerous areas, including aged care, schooling (as a result of the Gonski review), a national disability insurance scheme, the level of the Newstart allowance, investment in higher education, and many others. They are pressures likely to be faced in the coming decades regardless of which political party is in office. These are orders of magnitude larger than the savings delivered in recent budgets.



Figure 2 The scale of the fiscal sustainability challenge



1. MYEFO, 2012-13
2. Budget Paper 1, Statement 5, 2012-13
3. Likely Annual Costs across all governments. Funding arrangements are yet to be negotiated, so the distribution of the costs to different jurisdictions is as yet unknown.
4. Reported shift in revenue between MYEFO and year end 2012 that led to dropping of surplus commitment.
5. Savings from increased efficiency dividend announced in 2011-12 Budget, year 1 (noting that savings are cumulative, still a tiny proportion of total budget).

Any government in the future that seeks to meet Australia’s new priorities will need to find fiscal headway somewhere. The range of services we expect from governments have changed dramatically over the course of history. The Australian Constitution for example lists “lighthouses, lightships, beacons and buoys” as a key Commonwealth government responsibility (s.51 vii) but makes no mention of health or education.

While the budget benefited from the increasing revenue of the mining boom, new priorities could be funded relatively easily. This is no longer the case.



3 How should a fundamental fiscal review be undertaken?

3.1 Principle-based review

Principles provide a foundation for action

The most successful reviews of this nature in Australia have taken as a starting point establishing a set of principles against which to assess government intervention. For example the 1996 National Commission of Audit suggested a decision sequence:

- Assess whether or not there is a role for government
- Where there is, decide which level of government, and assess whether or not government objectives are clearly specified and effectively promoted
- Assess whether or not effective activities are being conducted on a 'best practice' basis.

Is there a compelling rationale?

In other words, for any government spending or tax concession is there a compelling underlying rationale, what is it, and can the results be measured?

A framework of this sort enables the review to develop clear criteria for its recommendations. Without criteria any recommendations and subsequent government decisions run the risk of seeming capricious and unjustified.

Develop criteria:

The sorts of criteria that a review today could consider might include the basic questions common to most such reviews such as:

Public benefit

- Does the activity have a rationale in terms of public benefit (social, economic or environmental)
- Is it being done at the right level of government (noting the subsidiarity principle, that services are best delivered as close as possible to the people they affect)
- Are outcomes from the activity measurable? (if not, there is a likelihood that the program or activity is not achieving anything)

Right level (Commonwealth, State or local?)

Measurable results

but could also include:

Adding capacity

- Does this activity add to the capacity of the Australian economy, or is it reducing capacity by drawing resources away from other sectors?

Affordability

- Is it affordable? (even if a program meets cost-benefit criteria it may still not be desirable due to overall constraints in the current fiscal climate)

Best type of intervention possible

- If government intervention is necessary, have alternative modes (spending, taxing, regulation) been considered and a conscious choice made as to which is most effective and efficient for the problem being addressed?



3.2 Better service delivery

Much of government activity is services

Having established principles, a fundamental review will be able to think more constructively about how public sector services can be delivered better. There is scope for broader examination of whether or not the public sector has kept pace with developments in other service delivery organisations throughout the rest of the economy (such as transport, communications, retail, finance, banking, hospitality).

The service sector has improved dramatically

Many of these have shown huge gains in service quality, at lower prices, due to application of new technology, better processes and better customer interfaces. This has been particularly notable for previously protected businesses exposed to greater competition³¹.

What drives quality in public services?

The factors that drive better quality in service delivery, policy or regulation in the public sector are harder to pin down. Most public sector activity is not exposed to market competition. However, learning from leading service delivery organisations is possible. Key issues for the public sector in this light to be examined by a review might include how best to:

- gain employee engagement and commitment
- encourage innovation
- recognise and manage risk (rather than, as present, seek to avoid it through excessive regulation).

User charging where practical can reduce costs and improve quality

User charging for services can be both a source of revenue, reducing the fiscal sustainability problem, and also a driver of better quality. Where users have a degree of discretion in the quantity and type of services they receive from government, charges that reflect the cost of delivery of those services can drive efficiency and help ensure the services better meet users' needs. In cases where a government service is a monopoly however, efficiency gains are less likely to arise and a user charge is akin to an additional tax.

The Henry tax review noted the importance of user charging, citing examples such as the co-payment for pharmaceuticals, ABS charges for information not provided on the internet, and had an extensive discussion on road taxes and investment. It concluded that

Australian governments do not employ user charging as much as they should, particularly for natural resources

While many of the obvious areas for expansion of user charging principles rest with States and Territories, the independent review could consider its applicability in relation to Commonwealth services and where responsibilities

³¹ See for example Telstra customer service reforms “we’re changing to provide better service”



overlap, the degree to which user charging (for example in health) could fund emerging pressures.

3.3 Raise awareness of the fiscal problem

We have a strong economy

Australia's economy is one of the strongest in the developed world. In a 2010 speech³² marking some twenty years of uninterrupted economic growth Reserve Bank deputy governor Ric Battelino noted that

While Australia will, most likely, continue to do well over the next few years, it would be a mistake to assume that the economic cycle has been eliminated.

...with the economy now operating close to its capacity, it will take further improvement in productivity and disciplined policies for this growth to be sustained.

Positive signs for the future

So far Australia has escaped the negative consequences of the high exchange rate (driven by commodities exports), and unemployment and inflation remain low. The forward projections in the budget reflected this generally optimistic outlook, but warned of "substantial downside risks".

But more of the fiscal risks are coming to pass

One of the risks identified in the May budget – lower tax receipts – was seen to have eventuated in October's Mid-year Economic and Fiscal Outlook. Other risks remain in the short term

New initiatives are not affordable...

Of even greater concern is long term fiscal sustainability in light of growing demands on government. High profile, high priority initiatives such as education reform and a national disability insurance scheme have to compete for funds with existing programs that are themselves facing pressures due to demographic, social and environmental change.

...unless we reset priorities and change policies.

One of the important roles for an independent inquiry is to set out these issues clearly, backed by evidence. The problems can be overcome, but only if the government is willing to make policy changes to reduce or eliminate current programs in order to make way for new ones. There is not enough fiscal headroom to maintain all current programs and fulfil new demands. Reducing funding for existing programs will however require political will to tackle vested interests that have benefited from those programs.

Lack of State fiscal capacity is a problem for the nation

Many of the stakeholders consulted took the view that the Commonwealth had little awareness of the severity of the financial pressures faced by governments in those States without large mining revenues. One of the key pressures is infrastructure: ageing existing stock and demands for new infrastructure including hospitals, transport links, port capacity, and water security.

³² *Twenty Years of Economic Growth* Address to Moreton Bay Regional Council Queensland - 20 August 2010



Some States are experiencing extreme difficulty funding the necessary capital expenditure while maintaining fiscal stability. Given that much of the infrastructure concerned forms part of a national network (transport) or system (health, education), shortfalls in investment will reduce national economic performance.

3.4 Better asset management

How well a government manages its assets is an important contributor to fiscal sustainability. The current and former government have measured government net worth (which includes physical and financial assets) and a current budget objective is an improvement in net worth over time.

Good management does not necessarily mean government should dispose of its assets. Sales of government assets produces a short term cash injection, but over the longer term can result in loss of dividends (for trading enterprises) or loss of other benefits delivered by the asset. That will be the case where the assets in government hands are demonstrably well run and delivering benefits.

On the other hand, asset sales can lead to an overall improvement in national welfare in some cases:

- a non-government body is better placed to deliver higher quality services through that asset
- the risks to government of keeping an asset that is unable to be managed effectively through government structures are too high, or
- a private owner can make better use of the asset due to constraints inherent in government ownership.

A former state premier has noted³³ that decisions about what assets it is appropriate for government to own change over time:

At times in Queensland's history the government has owned pubs, commercial timber plantations, we've retailed fish and at one point owned 90 State run butcher shops... While they made sense in the last century they make no sense in this century.

There is a role for an independent review to conduct a stocktake of major government assets, ask whether or not government ownership of the asset is still appropriate, and what viable alternatives might be available.

The Commonwealth has \$111 billion of non-financial assets, including land and buildings

Selling assets for short term cash is not necessarily good fiscal management

But some asset sales are justified

It depends on the needs of the time – something an independent review is well placed to assess

³³ Anna Bligh, Spann Oration, IPAA NSW, 2012.



4 Who should be asked to conduct the review and how should it be run?

Rather than nominating individuals, or prescribing a particular methodology, this section identifies the type of person who would be best placed to undertake a fundamental fiscal review and some general principles for its conduct.

4.1 Need for a mix of skills and expertise

Too big for one individual

The size and scope of the Commonwealth means that no one person would be able to conduct a credible review. The exercise requires a mix of different backgrounds and experience.

Needs a balanced team

A well balanced team for conducting such an exercise would include people with:

- Senior level public sector experience in both the Commonwealth and the States/Territories
- Experience leading a high performing and innovative private sector or not for profit organisation
- Work experience in an overseas country, whether in the public or private sector, to bring a fresh perspective to the questions
- Change management experience, given that the recommendations will involve reform of organisations and institutions
- Accounting expertise to work through the complexity of accounting and financial reporting issues.

Cannot be dominated by a jurisdictional interest

One of the key issues to be examined is the division of roles and responsibilities between the Commonwealth and State/Territory governments. It will be difficult for the inquiry to obtain cooperation from States if it is dominated by people with strong Commonwealth public sector experience, and conversely will make little headway if it is dominated by State public servants. This argues for a majority of the team to come from an independent, perspective.

Keep it small and effective

The size of any review body is ideally small enough to allow it to come to decisions quickly, but large enough to provide for a range of perspectives to be brought to bear. It is though possible to find suitable candidates who have more than one set of skills and experience they can bring to the task. It will be a matter for judgment for the government, but somewhere around 2-4 commissioners would seem suitable.



A broader advisory body can be very useful

A mechanism used effectively in the recent NSW Commission of Audit, which had three commissioners, was an Advisory Board of nine commissioners. They were drawn from a wide variety of backgrounds in the public, private and not for profit sectors. The Advisory Board acted both as a source of expertise and as a knowledgeable sounding board for the commission in developing its recommendations.

4.2 Timing, making use of pre-existing materials

Three months is too short

One of the weaknesses of the 1996 National Commission of Audit, apparent in the letter from the Commissioners to the Treasurer, was that it had only three months for its task. This meant the Commission was not able to undertake a comprehensive evaluation of areas where improvements might be made.

Need time to consider principles

The consensus among those consulted was that any review like this is most useful if it spends time to consider, deeply, the underlying principles and structures of government. It adds more value in this than in very specific and detailed recommendations for change around the edges of government.

However, a very protracted review process would have the disadvantage of raising levels of fear and apprehension among public servants and interest groups. It would also run the risk that by the time its recommendations were released any momentum generated initially would be lost.

Review could take 6-9 months

It would be possible for a review of this nature to conduct its work in less than a year provided it was well supported by a skilled secretariat. It would also have the advantage of being able to take account of past reviews of particular aspects of the financial framework (in particular, the *Australia's future tax system* report, Productivity Commission reports on regulation, and numerous other review reports conducted over recent years). It should not be asked to duplicate the work of those previous exercises.

4.3 Implementation focus

Although the 1996 Commission of Audit was wide ranging it lacked any detail on how it might be implemented (not surprising given its brief timetable). As a result many of its recommendations were never carried through.

Government has to be able to implement the vision

Although it is important for an independent external review to provide government with a vision of fiscal sustainability, good public administration also requires a plan for how that vision could be achieved.

Opposition to change should never be underestimated

Especially where significant structural change is proposed, a government will always face strong opposition. As Niccolo Machiavelli noted in around 1514:



ACIL Tasman

Economics Policy Strategy

Reforming Federal Finances

there is nothing more difficult to arrange, more doubtful of success, and more dangerous to carry through, than initiating changes ... the innovator makes enemies of all those who prospered under the old order and only lukewarm support is given from those who may prosper under the new.

But can be overcome with intelligent implementation planning

There are though some mechanisms for implementing structural changes to government that have a track record of success:

- Small steps, involving interim stages that allow failing initiatives to be evaluated and abandoned gracefully if they are failing to meet objectives
- pilot projects for new approaches (for example, one region or one State at a time)
- Rewards and incentives for early adopters, to build a library of success stories
- If there are to be savings, making sure they are shared widely so government is not seen as favouring some sectional interests over others.



5 Proposed scope and objectives for a review

A commission³⁴ could be established to report on the state of Commonwealth finances, with a particular focus on their long term sustainability.

A government commissioning such a review would be expected to develop detailed terms of reference, and desirably should also use the opportunity provided by such a review to engage the community and raise levels of awareness of the scale of the problem.

5.1 What would a review examine?

Any such commission ought to have scope to examine and report on a wide range of the key issues of concern. They could include:

5.1.1 The financial state of the Commonwealth:

- Sustainability of current levels of spending and revenue
- The effect of government fiscal policy settings and financial performance on Australia's international competitiveness and overall national wellbeing
- Pressures on the budget as a result of demographic and other changes over the longer term future
- The current state and future trends of the balance sheet: assets, liabilities, net and gross debt, debt servicing.
- Trends in net worth and ways to improve net worth over time
- Revenue projections, trends in sources of revenue, whether the current tax mix (including personal income tax, company tax, mining tax, GST carbon tax and other taxes and charges) remains sustainable over time
- Trends affecting the goods and services tax (GST), possible scenarios for how consumer spending might affect future GST collections, and how these might affect Commonwealth payments to the States/Territories.
- Risks to Commonwealth finances, including international and domestic economic developments and contingent liabilities, and strategies for managing these risks.
- The rationale for the current level of tax expenditures, and whether changes to tax concessions are required.
- Small spending programs, and how to manage their proliferation.

³⁴ The review body need not be a Commission of Audit, it could be called a commission, expert panel, functional review or any other suitable title. For convenience this section uses the term commission.



5.1.2 Financial Relations between the Commonwealth and the States/Territories

This should be a priority for independent review given its criticality to solving the sustainability problem. The kinds of questions that could be examined include:

- What steps can be taken to improve the distribution of roles and responsibilities between different levels of government
- Pressures on service delivery in areas such as (but not limited to) health, education and transport
- Ways in which service delivery can be improved through reduction in duplication and overlap
- How best to address shortfalls in States' capacity to deal with emerging capital expenditure needs

5.1.3 Improving public sector performance

- What lessons can be learned from public sector reform in other jurisdictions in Australia and internationally
- What lessons are applicable from other sectors of the economy about improving productivity and the quality of service delivery through innovation, people management, use of technology and other means
- Ways to improve Commonwealth public sector financial management, transparency, performance measurement and accountability, including application of accounting standards and improving budget reporting
- The management of Commonwealth assets, including whether the current mix of assets meets contemporary needs.
- The scope for efficiency gains in program administration.
Institutional mechanisms for improving budget transparency and accountability.

5.2 The broader context of reform

The review ought to be informed by analysis on the trends in government spending over time, and the drivers of changing priorities. As noted earlier in this report, expectations on government scope and services have changed and will continue to change over time. Given that one of the aims of such a review would be to promote public debate, a discussion on expectations would be one way not only of garnering information but also helping address the present mismatch between expectations and government fiscal capacity.

Various other sources of information on fiscal sustainability are readily available: the review would not need to go over old ground, but in developing its thinking could take advantage of the wealth of previous studies and reviews



already in the public domain. Ideally, it would also obtain extensive support and advice from the Commonwealth Treasury and Finance departments and the equivalent central agencies in the States and Territories.

5.3 Implementation plan

The commission's report would provide the government with a comprehensive strategy for future fiscal sustainability. This could ideally include not only recommendations for government consideration, but also an implementation plan for those recommendations. As noted earlier in this report, the lack of a defined implementation pathway was a weakness of the 1996 Commission of Audit. Implementation issues to be covered could include timing, staging, whether suggested measures could be piloted or tested, and how best to overcome any barriers to achieving the recommendations' objectives.

A staged implementation plan could encompass:

- Early initiatives that could be identified for immediate action and some demonstrable “quick wins
- A longer term program of revision of roles and responsibilities involving both Commonwealth and the States in areas such as health and education
- Enlisting wider public support for fundamental tax reform (likely to be a longer term project, but with large gains in prospect).



Appendix A Commissions of Audit since 1988

Commonwealth – National Commission of Audit established March 1996

Terms of reference:

The Commission of Audit will investigate and report on the financial position of the Commonwealth Government with a view to advising the Government on the future management of its finances consistent with a medium to long term goal of improving the Government's fiscal position.

The Commission of Audit will report on:

- (i) The finances of the Commonwealth.
 - The Commission shall report on the actual state of those finances including identification of assets and liabilities, contingent liabilities and any other liabilities of a non-debt nature. The contingent liabilities examined should include, but not be limited to, those that may relate to guarantees by the Commonwealth, foreign exchange exposures, unfunded liabilities in superannuation and other employee benefits, insurance and financial arrangements such as leases. The Commission should consider the appropriateness of current arrangements in these areas and provide options for reform as necessary.
- (ii) The compilation and publication of a comprehensive (ie. 'whole of government') balance sheet for the Commonwealth Government.
 - This should include consideration of the conceptual, technical and interpretive issues relating to preparation of government financial statements on an accrual basis. The Commission should provide advice on the system requirements for preparing a balance sheet and the information that should be presented in the balance sheet.
- (iii) The impact of demographic change on Commonwealth finances, with the intention of making recommendations as to how emerging pressures could be provisioned.
- (iv) The extent, condition and adequacy of Commonwealth sector infrastructure and, if found to be deficient, factors that may have contributed to the current situation and possible remedies.
 - The Commission should clearly delineate areas of responsibility between the private, Commonwealth and State/Territory sectors.



- (v) Establishing a methodology for developing and implementing financial performance targets for Commonwealth departments and agencies.
- The Commission should look at international experience and best Australian practice (including by government business enterprises) in this area with a view to identifying potential efficiency gains in the operations of Commonwealth departments and agencies. The Commission should investigate and analyse methods for setting financial performance targets with a view to recommending the form of financial performance targets that should be adopted.
- (vi) Current service delivery arrangements between the States/Territories and the Commonwealth and their effectiveness and efficiency.
- The Commission should focus on identifying duplication, overlap and cost shifting between the Commonwealth and the State/Territory tiers of government in delivering services and recommend measures needed to promote more efficient service delivery, having regard to the need to improve outcomes for clients and value for money for taxpayers. This should include examination of the appropriate roles of the Commonwealth and the States/Territories, the relationship between service funder and service provider and the scope for contestability in service provision.
3. The Commission, in undertaking its investigations and reporting on the above issues, will have regard to areas of expenditure which warrant closer examination with the objective of restraining the growth of total outlays and improving the quality of public expenditure. These could include (but not necessarily be limited to) expenditure reductions resulting from recommendations with respect to the elimination of duplication, identification of efficiency savings by setting performance benchmarks, or examining the cost implications of demographic changes.
4. The Commission should also advise on additional matters which should be included in the Charter of Budget Honesty.
5. In carrying out its investigations, the Commission may invite submissions and seek information from any persons or bodies.
6. The Commission will provide a report to the Treasurer and the Minister for Finance by 19 June 1996. In addition to recommendations appropriate for consideration by the Government in the context of the 1996-97 Budget preparations, that report should seek to identify any areas contained in the terms of reference which may require further investigation.

Additional terms of reference

The terms of reference were later expanded by the Government. On 22 March 1996, Senator Gibson advised the Commission that Cabinet had confirmed its

election commitment to a 2 per cent reduction in agency running costs from 1996-97 and that it had agreed that the Commission should establish any additional running cost efficiencies achievable by agencies in later years. On 16 April 1996, the Treasury informed the Commission that Ministers had requested that it consider the current policy of benchmarking the level of the aged pension against 25 per cent of average weekly earnings (AWE). In particular, Ministers had requested that the Commission determine the most appropriate measure of AWE, having regard to the fact that the current benchmark is expressed in terms of AWE for males rather than the total workforce. (See appendix A.)

Queensland Commission of Audit (2012)

The Queensland government following its election in 2012 appointed a Commission “to review the Queensland Government’s current and forecast financial position, and to make recommendations on:

- strengthening the Queensland economy
- improving the State’s financial position including regaining a AAA credit rating
- ensuring value for money in the delivery of frontline services.”

It appointed three independent Commissioners: the Honourable Peter Costello AC (Chairman), Dr Doug McTaggart and Professor Sandra Harding.

Source: <http://www.commissionofaudit.qld.gov.au/index.php>

Terms of reference

The Independent Commission of Audit is asked to review and report on:

1. Financial position:
 - a) the State’s balance sheet, including net debt position and associated debt servicing charges
 - b) the forecast trend in the balance sheet position over the forward estimates period
 - c) the trends and long-term projections in growth of own-state revenue, including the various state taxes and charges as well as resources royalties
 - d) the trends and long-term projections of GST Revenue under current arrangements as well as potential future arrangements as a result of the Greiner-Brumby-Carter report, which will be released before the Commission of Audit is due to report
 - e) the trends and long-term projections of growth in expenditure across the various classes



- f) whether there are any events, such as the 2018 Commonwealth Games funding obligation and the Carbon Tax, not adequately provided for in the Mid-Year Fiscal and Economic Review or forward estimates
 - g) any contingent liabilities that should be brought to the Government's attention.
2. Improving the State's financial position
- a) policy settings and strategies to address any structural factors affecting the State's finances, and to restore its AAA credit rating
 - b) strategies to improve the State's balance sheet management
 - c) strategies to improve the sustainability of the State's capital program beyond the forward estimates period to 2030.
3. Service delivery
- a) benchmarking public sector management and service delivery issues, including procurement, corporate services, and asset management, against other states
 - b) identify any potential improvements to productivity, service quality, and value for money in service delivery across the public sector
 - c) effectiveness of existing performance metrics and options for greater transparency and accountability through improved public reporting
 - d) the adequacy, affordability and deliverability of the capital program over the forward estimates period
 - e) strategies to encourage greater private sector involvement in the funding and/or direct provision of public infrastructure and services
 - f) the efficiency of current pricing arrangements for regulated infrastructure, including electricity, water rail and ports.
4. Government commercial enterprises
- a) the financial performance of Government owned corporations (GOCs) and commercial agencies
 - b) the level of indebtedness of GOCs and commercial agencies, how such indebtedness compares with private sector peers and whether it is a prudent level
 - c) measures to improve the operational performance and financial returns to the State from GOCs and commercial agencies
5. The economy
- a) whether any government policies, taxes, regulatory arrangements, ownership structures or actions or inactions represent a constraint on Queensland's economic growth
 - b) recommendations to generate long-term systemic reform to grow and strengthen the Queensland economy.

NSW Commission of Audit (2012)

<http://www.nsw.gov.au/news/nsw-commission-audit-final-report>

Terms of reference

The Commission of Audit delivers a long standing commitment by the Government to review the current fiscal situation of the State of NSW and to establish a framework for future reform. The Audit is to be delivered in two stages:

1. Financial Audit (the Lambert Review), comprising:
 - a) Review of State Finances
 - b) State Financial Strategy
2. Expenditure and Management Audit.

The Commission of Audit reports to the Treasurer. The Financial Audit (Lambert Review) was completed before the 2011-12 Budget and informed that budget and the second stage Expenditure and Management Audit. An interim report of the Expenditure and Management Audit was issued in February 2012. This covered Management and this Final Report addresses expenditure.

Dr Kerry Schott is the CEO of the Commission of Audit, and is an ex officio member of the Advisory Board. Chris Eccles and Phil Gaetjens are also ex officio members of the Advisory Board and are Director General of the Department of Premier and Cabinet and the Secretary of the Treasury respectively.

An Advisory Board of Commissioners, directed by a Chairman, has provided advice to the CEO of the Commission of Audit on both the Stage 2 Interim Report (Management) and the Final Report Expenditure Audit.

The Commissioners on the Advisory Board were chosen on the basis of their management and professional background with expertise in areas including public service delivery, community services, regional issues, performance management and auditing. The CEO is responsible for the stage 2 Expenditure and Management Audit, the Interim Report in February 2012 and the Final Report due in April 2012.

The Advisory Board is:

- David Gonski AC Chairman
- Chris Eccles (ex officio)
- Phil Gaetjens (ex officio)
- Belinda Hutchinson AM

- Sue Page AM
- Kerry Schott (ex officio)
- Peter Shergold AC
- Richard Spencer
- Gerard Sutton AO.

NSW Commission of Audit, The Curran Report (1998)

[http://www.parliament.nsw.gov.au/prod/parlament/committee.nsf/53090fd8806f7be5ca257344001a4c8e/57d7984d1130064f4a2563ae000dc63b/\\$FILE/100-%20Pioneers%20-%20Progress%20but%20at%20a%20Price-Implementation%20of%20Accrual%20Accounting%20in%20the%20NSW%20Pub.Sector.pdf](http://www.parliament.nsw.gov.au/prod/parlament/committee.nsf/53090fd8806f7be5ca257344001a4c8e/57d7984d1130064f4a2563ae000dc63b/$FILE/100-%20Pioneers%20-%20Progress%20but%20at%20a%20Price-Implementation%20of%20Accrual%20Accounting%20in%20the%20NSW%20Pub.Sector.pdf)

This Commission was a major catalyst for the introduction of accrual accounting in the NSW public sector, particularly for the budget sector. On 4 April 1988, the then Premier of NSW, the Hon. Nick Greiner, announced the establishment of an independent Commission of Audit to review the State's balance sheet and financial commitments. The Commission was chaired by Mr Charles Curran AO, and the report of the Commission is referred to as the Curran Report. One of the

Terms of Reference:

“To advise on the impact of, and procedures involved in, applying full accrual accounting to all public sector bodies.” (Focus on Reform - Report on the State's Finances, Executive Summary report, July 1988, Preface.)

Summary of report

The Curran Report details how the Commission found that the State had been living beyond its means, and that the high level of State debt and the decline in Australia's competitiveness required that both the private and public sectors operate at maximum efficiency and cost effectiveness. The overspending of previous decades was to give way to future fiscal restraint. The Commission advocated a fundamental change in Government attitudes, and included among its suggestions for change was the adoption of a system of comprehensive disclosure to the community of the financial affairs of the State, and an increased emphasis on balance sheet management. In Part II of the Report, “What do We do in the Future?”, the Commission lists a number of imperatives for action. In relation to the Budget Sector, the Commission believed the State's financial position would be vastly improved by:

- the preparation of an annual balance sheet and income and expenditure statement for the State budget sector and the Statutory Authorities for presentation to Parliament
- the identification of the State deficit and the Consolidated Fund deficit on an accrual basis in accordance with commercial practices
- the identification of the Public Sector Borrowing Requirement (PSBR) in all budget statements
- the presentation of the Consolidated Fund Statement in a form that clearly distinguishes capital expenditure from recurrent expenditure.

Victorian Independent Review of State Finance (2011)

<http://www.dtf.vic.gov.au/CA25713E0002EF43/pages/publications>

The Independent Review of State Finances was announced by the Victorian Government on 25 January 2011.

- The Review is being conducted by a panel comprising:
 - Dr Michael Vertigan AC (Chair)
 - Mr Don Challen; and
 - Professor Ian Harper.

The Panel is supported by a full-time Secretariat comprising staff selected from departments and agencies of the Victorian Government.

In announcing the Review, the Victorian Government stated that two reports would be produced—an Interim Report in April 2011 and a Final Report in February 2012.

Terms of Reference

Victoria's finances

- The development of a comprehensive financial management plan for the State's finances which will be periodically reviewed and which should include:
 - clear short and long-term financial objectives and strategies; and
 - potential expenditure reforms informed by trends over the last decade.
- The outlook for the Victorian budget beyond the forward estimates period including:
 - the potential impact of future demographic change on Victorian public finances and options to address emerging pressures; and
 - stress testing the Victorian budget to examine the potential impacts of a range of economic and fiscal shocks.

Debt management

- The creation of a State debt management plan, including potential strategies to repay debt and provide a buffer for future economic shocks.

Service delivery and infrastructure

- The efficiency and effectiveness of agency approaches to service delivery.
- The use of benchmarking and performance information to drive results.
- The use of/potential for private sector involvement in service delivery (where appropriate/relevant) including through the use of market-based instruments or other service delivery reforms.
- Infrastructure funding, management and delivery of previous infrastructure projects, and, if these are to be found to be deficient, factors that may have contributed to the current situation and possible remedies, including:
 - an assessment of possible actions to maximise competition for tenders, reduce costs for the projects and increase transparency.
- Possible cost savings through the identification of existing waste in expenditure and potential for efficiency gains.

Public sector governance

- Improved governance of Victorian public sector departments and public bodies:
 - reforms or improvements to the efficiency, effectiveness, financial, operational and other performance and accountability of government departments and public bodies.

South Australia – Sustainable Budget Commission (2010)

Terms of reference:

“The functions of the Commission will be to report to the Government on proposals to reform the budget determination process and to identify budget improvement measures to return the State Budget to a sustainable net operating surplus.

Initial Task

The initial task of the Commission will be to report to the Government on an appropriate process including timelines for the development, consideration, agreement and delivery of the 2010-11 State Budget. The Commission may also recommend changes to Budget and Cabinet processes to better support the full critical analysis of financial decisions of the Government.

The Commission will also advise the Government on the appropriate date for the presentation of the 2010-11 Budget.

Budget Improvement Measures

Building on already identified savings, the Commission will recommend measures to the Government to achieve the savings targets contained in the budget forward estimates.

The Commission will have the capacity to review all Government expenditures and revenues.

To assist in that task the Commission may:

- Review the efficiency and effectiveness of Government service delivery and seek to identify any opportunities to save costs through removal of duplication of resources to achieve policy outcomes.
- Identify expenditures in areas of diminishing priority against the priorities outlined in South Australia's Strategic Plan and outcomes and objectives agreed under funding arrangements with the Commonwealth Government".

Structure and reporting

The Sustainable Budget Commission (the Commission) was announced by the South Australian Government on 4 June 2009. The Commission Members were:

- Mr Geoff Carmody (Chair)
- Mr Bruce Carter
- Monsignor David Cappo AO
- Professor Jennifer Westacott
- Mr Chris Eccles; and
- Mr Jim Wright.

The Commission was supported by a secretariat from the Department of Treasury and Finance and the Department of the Premier and Cabinet.

It reported in two phases: the first with "findings and recommendations concerning the initial task set out in its Terms of Reference and recommended changes to the budget and Cabinet processes to better support the full critical analysis of financial decisions of the government", and the second a report that "outlined a menu of specific budget improvement proposals for consideration by the government" (www.treasury.sa.gov.au). The government's response was published in September 2010.

Northern Territory Review of Territory's Finances (2012)

<http://state.governmentcareer.com.au/news/board-appointed-to-review-nt-finances>

Chief Minister, Terry Mills, has released details of the Government's planned review of the Territory's finances.

Mr Mills said the Renewal Management Board will have six months to examine the state of the Territory's finances and provide options for Government on how to return to a balanced budget during the first term.

The make-up of the Board is:

- Neil Conn (Chair)
- Ken Clarke (Deputy Chair)
- John Gardner (Deputy Chair)
- Alan Tregilgas (Under Treasurer)

NSW Commission of Audit (1988)

On 4 April 1988, the Premier of New South Wales, the Hon N F Greiner MP, announced the establishment of an independent Commission of Audit to review the State's balance sheet and financial commitments.

Structure of the Commission

Chairman:

Mr Charles Curran A.O, Deputy Chairman Kleinwort Benson Australia Limited

Members:

Mr Jim Dominquez A.M, Chairman Dominguez Barry Samuel Montagu Limited

Mr James Yonge, Deputy Chairman and Managing Director Wadley Australia Limited

Mr Don Nicholls (Executive Director), Deputy Secretary New South Wales Treasury

Terms of Reference

1. Preparation of State Macro Financial Study
 - 1.1 Prepare a macro view of New South Wales financial accounts combining inner and outer budget sectors in terms of revenues, recurrent and capital expenditure, so as to determine the true deficit of the total New South Wales public sector. Such data should be prepared for 1986-87, with historical data over the last five years. The data should highlight the impact of debt charges, revenue sources (including State taxes) and employment.
 - 1.2 Advise on the overall cost impact facing Government funded programmes arising from demographic and other economic trends.
 - 1.3 Determine the full extent of New South Wales public sector actual and contingent liabilities, including but not limited to, unprovided for superannuation and other employment benefits, and foreign exchange exposures. Examine this against estimates in New South Wales budget papers.
 - 1.4 Using the above data and other sources of information prepare a Balance Sheet for the State as at 30 June, 1987.
 - 1.5 The New South Wales accounts as reconstructed should be reconciled with the Australian Statistician's estimates of the New South Wales position in the publication "Government Financial Estimates Australia 1986-87, and similarly reconciled with statistics in Grants Commission reports.
 - 1.6 Review progress for the establishment of a proposed set of financial performance targets for New South Wales public sector trading enterprises. Examine different methods of financial performance targeting by the Victorian and New Zealand Governments. Prepare recommendation on action to be followed in New South Wales together with recommendations on public authority dividend policy as a commitment to improving financial performance targets.
 - 1.7 To advise on total assets of State Departments and the major Authorities and the liabilities to be faced in providing for their replacement and maintenance, including major overhauls and renovation.
 - 1.8 To advise on the impact of, and procedures involved in, applying full accrual accounting to all public sector bodies.
 - 1.9 To advise on the State's revenue sources and their likely long term prospects.



2 Specific Reviews of Public Sector Bodies

To report on:-

- 2.1 The financial structure of selected authorities to determine the total liabilities, assets, revenues and expenditures if commercial principles were fully applied
- 2.2 The property holdings of Government Departments and Authorities, their valuation, purpose and management
- 2.3 The use of, and stewardship of, any public funds paid to community bodies directly or through the Community Welfare Fund
- 2.4 Any other matter relevant to State finances and management.

QLD Commission of Audit (1996)

Members:

- VW FitzGerald (Chairman)
- J Carmichael (Commissioner)
- DD McDonough (Commissioner)
- B Thornton (Commissioner)

Terms of Reference

1. The Commission is asked:
 - a) to review and report on the current and prospective state of Queensland's public finances, taking account of the service delivery performance of Queensland's public agencies and government-owned corporations, and the adequacy of the State's public infrastructure; and
 - b) to report on and recommend strategic priorities, policies and measures to enable existing and emerging service delivery requirements and infrastructure needs to be met, and services to be enhanced, to best-practice standards while safeguarding Queensland's financial position, low tax status and AAA credit rating
 - c) making appropriate comparisons with other States and/or Australia as a whole, and to present its report to the Treasurer by no later than 30 June 1996.
2. In carrying out its review, the Commission is asked in particular to present and report on:
 - a) recent trends in State Budget Sector recurrent outlays and revenues and their implications for the State's future budgetary position



- b) a comprehensive statement of the assets and liabilities (including any unfunded liabilities), contingent liabilities and other future obligations of public agencies (classified into the general government sector, public trading enterprises and public financial enterprises) as at 30 June 1995 using best estimates where necessary
- c) forward projects of the main transactions and balances impacting on the Budget for the next five and ten years (assuming policies unchanged from the May 1995 Budget except as varied subsequently up to and including May 1996)
- d) significant risk and other factors which might affect these projected outcomes and might also affect future commitments and contingent liabilities
- e) to the extent feasible, an assessment of the condition of Queensland's public social and economic infrastructure in relation to:
 - i its adequacy to support efficient and effective delivery of public services to best-practice standards, and world-competitive performance of the business sectors that depend on it
 - ii deficiencies that need early attention; and
 - iii medium and longer-term public capital investment needs

and provide directions on areas requiring further work

- f) measures to improve the efficiency, financial and competitive performance, and accountability of Queensland's major government-owned corporations and other major asset-owning entities and/or the industries in which they operate
- g) identification of opportunities for contracting-out, commercialisation, corporatisation, privatisation and other actions where these would be in the public benefit; and
- h) any other matter which the Commission considers relevant to the sound management of Queensland's public sector resources, including consideration of best-practice budgetary and accounting practices.

The Commission is also asked to address in its review:

- a) the adequacy or otherwise of the identification of capital expenditures (and capital revenues) and the measurement of the Budget surplus (or deficit); and
- b) the inclusion of otherwise in Queensland Budget balances of the State's funded superannuation liabilities and their counterpart financial and other assets.

VIC Commission of Audit (1993)

Commission Charter and Terms of Reference

Charter

The Charter of the Commission is to investigate and report upon the condition of Victorian State public finances; to comment generally upon the causes of the present condition; to recommend policies, management reforms and other measures to improve efficiency, effectiveness and the State's financial position; and to recommend measures to safeguard against the future recurrent of policies and practices likely to have adverse effects on the State.

Terms of Reference

The Commission shall review and report upon Victorian State public finances generally and make recommendations on the future management of the State's finances with particular reference to significant financial performance indicators. The review and report should cover the budget sector and Victorian public agencies outside the Budget sector (with particular reference to the major statutory authorities and major asset-owning agencies).

The Commission shall review and report on the following:

1. Preparation of a broad and comprehensive statement of the assets and liabilities of the Victorian public sector as at 30 June 1992 with comment upon the previously published balance sheet.
2. A statement of the full extent of the debt and liabilities including unfunded liabilities, contingent liabilities and other future obligations of the Victorian public sector.
3. The State public sector's budgetary and financial trends for each of the three years ended June 1992 in relation to:
 - a) the revenue and expenditure of both the Budget and non-Budget sectors
 - b) the Budget deficit and the total public sector deficit
 - c) public debt and other liabilities (use may be made of the concept of "State indebtedness" applied by the Victorian Auditor-General)
 - d) interest commitment, identifying accrued and unpaid interest and interest deferred to future years; and
 - e) the extent to which published figures accurately reflect the true underlying position.
4. Forward projections of the expenditure, revenues and the financial position (assuming unchanged policies from the Budget published on 12 August 1992) for

- a) The Victorian Budget; and
- b) The Victorian public sector.

For the years ended 30 June 1993 through 1997. Forward projections may include measures drawn from the significant performance indicators listed in Schedule A.

5. Any significant changes or movements which seem likely to occur (assuming unchanged policies from the Budget published on 12 August 1992) in Victoria's public sector debt and other liabilities including unfunded liabilities, future commitments and contingent liabilities.
6. A review in broad terms of the financial position of other Australian States (with special reference to New South Wales and Queensland), where appropriate, contracting Victoria's position with those of other States, and/or Australia as a whole.
7. Recommendations in relation to major strategic priorities in the future management of Victorian public finances and the Victorian public sector generally, including the most effective service-delivery to the Victorian community.
8. Recommendations as to a course of action to reduce Victorian public indebtedness, to improve the management of borrowings, debt, risk and financial flows and to secure restoration of Victoria's AAA credit rating.
9. Recommendations to improve the efficiency, financial and other performance and accountability of Victoria's major statutory corporations and other major asset-owning entities and/or the industries in which they operate. The Commission may identify opportunities for contracting out, corporatisation, privatisation and other actions to secure the public benefit.
10. Any other matter which the Commission considers relevant to the management of Victorian public sector finances.

The Commission may issue one or more interim reports and the Premier may request advice from the Commission at any time.

Commission Staff and Consultants

Staff

Executive Officer

- Saul Eslake (National Mutual Funds Management Ltd) (October 1992 – April 1993)

Research

- Geoff Carroll (Department of Finance) (November 1992 – April 1993)

- Sue Dahn (Department of Premier and Cabinet) (November 1992 – March 1993)
- Helen Dineen (Department of Premier and Cabinet) (November 1992 – April 1993)
- Eric Dyrenfurth (Commonwealth Department of Social Security) (November 1992 – April 1993)
- Laura Fett (Department of the Treasury) (November 1992 – April 1993)
- Una Gold (Department of the Treasury) (November 1992 – February 1993)
- Colin Hay (Department of the Treasury) (November 1992 – April 1993)
- Zena Helman (Department of Conservation and Natural Resources) (October 1992 – April 1993)
- Louisa Jordan (Department of Business and Employment) (November 1992 – April 1993)
- John Manolakos (Department of the Treasury) (October 1992 – April 1993)
- Stephen Paterson (Department of the Treasury) (February 1993 – April 1993)

Financial statements preparation

- Paul Abbott (Melbourne Water Corporation) (January 1993 – March 1993)
- Paul Brunner (Coopers & Lybrand) (November 1992 – March 1993)
- Nick Daicos (Victorian Auditor-General's Office) (November 1992 – January 1993)
- Damian Ivers (Arthur Andersen Ltd) (January 1993 – March 1993)
- David Smith (SECV) (January 1993 – March 1993)
- Peter Moloney (Coopers & KLybrand) (January 1993 – March 1993)

Editor

- Susan McKerihan (Coopers & Lybrand) (March 1993 – April 1993)

ACT – Strategic and Functional Review 2006

The report of the review has not been released; the ACT Chief Minister did however issue a statement around the time of the budget in 2006 (*For the Future: Economic and Financial Outlook for the ACT*) that in effect canvassed many of the background issues and recommendations of the review. According to an ACT Treasury Fact Sheet at the time of the ACT 2006-07 Budget:

The Chief Minister commissioned the Strategic and Functional Review of ACT Public Sector and Services (the Functional Review) to review the outlook for the ACT Budget, to benchmark government expenditure against other jurisdictions and to



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identify options to improve efficiency through more effective government structures. The Review was also tasked with making recommendations for reducing expenditure or increasing non-taxation revenues.

The review was led by Michael Costello AO, former Secretary of the Commonwealth Department of Foreign Affairs and Trade. It also included former senior Treasury official Greg Smith³⁵. It took public submissions from a wide range of business and community groups.

³⁵ Mr Stanhope: "...the ACT government has sought a functional and strategic review of ACT government and service provision. We have specifically sought the functional review, which is chaired by Mr Michael Costello and comprises Mr Greg Smith, supported by Treasury and other officers." Legislative Assembly for the ACT: 2006 Week 1 Hansard (14 February) .p 29..