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The Queensland Commission of Audit Final Report: A Critical Review

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The Queensland Commission of Audit Final Report: A Critical Review

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Summary

1. The Final Report adds nothing to the discussion of the Queensland government's balance sheet presented in the Interim Report. The projections are not updated in the light of new data, or policies implemented since the Interim Report. Further, despite the demonstration of numerous analytical errors in the original report (Quiggin 2012), the Commissioners have declined to respond in any way. This mirrors the conduct of the previous Labor government, which similarly ignored criticism by economists of the unsound case it presented for privatisation.

2. Whereas the Interim Report blamed Queensland's fiscal difficulties on the alleged mismanagement of the previous government, the Final Report correctly focuses on the structural problems arising from the growing demand for health, education and similar services. These problems are not unique to Queensland, but are faced by all governments in the developed world.

3. The Commission's proposed solution is to raise the rate of productivity growth in the services sector by 1 per cent per year. This is little more than wishful thinking. The relatively low rate of productivity growth in the services sector is inherent in the technology of service delivery. It has persisted despite strenuous attempts by governments throughout the world, including past Queensland governments, to constrain the growth of costs

4. The measures proposed by the Commission are a continuation of the microeconomic reform agenda that has been pursued in Australia for the past thirty years, with only limited success. Measures such as privatisation, corporatisation and contestability have been adopted on a large scale, and have been applied systematically since the adoption of National Competition Policy in the early 1990s. There is no reason to suppose that extension of these policies to areas where they have previously been considered in applicable will yield significant savings.

5. The Commission proposes a range of expenditure reductions in health and education, based on inadequate and spurious measures of the productivity, that would have the effect of reversing recent gains in service quality.

6. The Commission's proposals are a distraction from the central fiscal policy issue facing the Australian people, namely the extent to which we are prepared to pay higher taxes in return for improved services.

The Queensland Commission of Audit Final Report: A Critical Review

The establishment of a Commission of Audit has been a routine measure for newly elected conservative governments since the election of the Kennett government in Victoria in 1992. Most notably, Peter Costello, Treasurer in the incoming Howard government, appointed a commission headed by Professor Robert Officer, a leading free-market economist.

The primary stated task of these Commissions, as implied by the name, is to review the current and forecast condition of public finances and to make recommendations for improvement. In reality, however, the primary function has been to justify cuts in public expenditure and other policy changes. In most cases, these policy changes have not formed part of the platform on which the newly elected government campaigned and, in many cases, they represent a direct repudiation of election promises.

1. The Interim Report

The Commission of Audit issued its interim report in June 2012. The report presented an alarming picture of Queensland's financial position. It was presented by the Premier, Campbell Newman, as supporting his claim that Queensland was on the way to becoming 'the Spain of Australian states', and as justifying his dismissal of more than 10 000 public employees, in direct violation of his electoral commitments.

The Interim Report was the subject of vigorous criticism from Walker and Walker (2012) and Quiggin (2012). In response, the Commission issued a brief statement disputing some of the claims of Walker and Walker (2012), but declining to offer any rebuttal to the criticisms presented in Quiggin (2012). Although the Final Report runs to over 1000 pages, the Commission has again failed to make any response to these criticisms, summarised as follows

(a) The report of the Audit Commission has been presented as an independent assessment of the state's finances. In reality, the appointment of an Audit Commission is a routine political manoeuvre undertaken by incoming governments seeking to abandon electoral commitments.

(b) The Commission has not discovered any 'black holes' or substantial mis-statements in the budget estimates of the outgoing Labor government. These estimates have been confirmed, with modest changes, in the May 2012 forward estimates prepared by Treasury for the LNP government.

(c) The Commission's claims that projections of revenue and expenditure (made under the previous government and reaffirmed in the May 2012 forward estimates) are over-optimistic does not stand up to scrutiny in most respects. The Commission's extrapolation of recent experience implicitly assumes a repetition of the financial crisis and natural disasters that generated recent large deficits.

(d) The Commission's focus on gross public sector debt is misplaced. The most relevant measure of the balance sheet as a whole, public sector net worth, remains strong. Focusing purely on financial assets, Queensland's net financial debt remains comparable to, or slightly below, the average level of other states when expressed as a proportion of government revenue.

(e) Like all state governments, Queensland faces the problem of meeting growing demands for services such as health and education, while having access to only a limited range of revenue sources. State governments have further exacerbated the problem by offering distorting concessions and exemptions that have eroded the efficiency and revenue effectiveness of the taxes that are available to them, most notably land tax and payroll tax. Queensland has gone further than any other state in this respect, and its finances have therefore proved particularly vulnerable to shocks such as the global financial crisis and the natural disasters of 2011.

(f) Simply by matching the thresholds and rates applicable to land and payroll tax applicable in NSW, Queensland could raise up to $1 billion a year in additional revenue. The shortfall in tax revenue caused by these unjustified concessions is the primary reason for Queensland's budget difficulties. The Commission recognises the distortions and inefficiency associated with these concessions but proposes no concrete measures to address them

Some of these points requiring updating in the light of events since the publication of the Interim Report.

On point (a), it is now known that the chairmanship of the Commission was offered to Mr Costello some months before the state election and in a context where he was actively involved in the LNP campaign. While not surprising, this evidence further undermines any claim of independence.

While not responding to early criticisms, the Final Report largely accepts point (e). Both the general analysis presented at the beginning of Volume 2 and the detailed analysis presented in Volumes 2 and 3 support the conclusion that Queensland's problems are shared, to a greater or lesser degree by all modern governments, and reflect the combined of effects of constrained revenues and increasing demand for services, such as health and education, that are typically funded by governments.

The challenge facing Queensland

The primary claim made in the Interim Report was that Queensland faced a debt crisis arising from mismanagement by the previous Labor government. In Volume 2 of the Final Report, this claim is effectively abandoned in favour of a more realistic assessment of the challenges facing Queensland. Unfortunately, the recommendations put forward by the Commission still reflect the mistaken analysis of the Interim Report.

Even in the Interim report there was some acknowledgement of the fundamental problem. Queensland was formerly a low-tax, low-service state. Queenslanders are no longer willing to accept a lower quality of service provision than is provided in other states, but there is a bipartisan commitment to maintaining our low-tax status. This position is inherently contradictory, and is bound to lead to structural deficits in the long term.

As is pointed out in Volume 2, this problem will be exacerbated over time by the growth in demand for services that are normally funded by the public sector, such as health and education. Because these services are delivered by skilled workers, with limited opportunities for substitution of capital or information technology, the cost of these services, relative to that of goods and services in general, has risen over time.

This is not a new observation, nor is it unique to Queensland. The problem was first observed by Baumol (1967) in the United States.

Wishful thinking

As the Commission notes, growth in demand Unfortunately, the solution proposed by the Commission is little more than wishful thinking. The Commission observes that, if the rate of productivity growth in human services could be raised by one percentage point a year, the problem would disappear. This is not a solution but a restatement of the problem - despite extensive efforts all around the world over many decades, it has proved impossible to increase productivity growth in the human services sector at a rate sufficient to prevent rising costs.

No new ideas

A survey of the measures proposed by the Commission shows that they fall into two main categories

* Continuation of efforts to improve cost efficiency, reduce duplication, clarify responsibilities and so on. These efforts have been under way, in Queensland and elsewhere, for many years. These efforts should be continued, but are unlikely to be advanced by a top-down assessment such as that of the Commission

* Spurious 'magic bullet' solutions that have been tried unsuccessfully in the past. Most notably, proposals for a comprehensive approach to outsourcing, as opposed to leaving agencies and departments to manage the balance between internal provision and outsourcing formed the basis of the Office of Asset Sales and IT Outsourcing (OASITO) established under the Howard Commonwealth government by then Treasurer Peter Costello and Finance Minister John Fahey. OASITO was a disaster and was abolished after only a few years of operation.

Going backward

In the early 2000s, Queenslanders received substandard services in a number of key areas. In education, whereas students in other students received thirteen years of schooling, including six secondary years, Queensland students received twelve years, with only five secondary. This was the result of an ‘emergency’ cost reduction introduced in response to the postwar baby boom. The Labor government addressed this problem by introducing a prep year, as in other states and announcing plans to shift Year 7 from primary to secondary.

In health, the Forster review identified a wide range of deficiencies. In response, the government greatly increased health funding with the aim of increasing both the volume of services delivered and the quality of service.

The Commission of Audit, while acknowledging that its analysis took no account of service quality, used volume based measures to support the conclusion that these measures had reduced productivity. It endorsed cuts in staff numbers already adopted by the Newman government and proposed further reductions in quality, such as an increase in school class sizes.

These measures are backward steps that, as in the past, will ultimately require costly reversals.

No easy choices

For the last fifty years, governments around the world have grappled with the problem of funding health and education services by seeking efficiency improvements and cost reductions, increasing tax revenue, reducing spending in other areas, and increasing user charges and contributions. Some combination of these measures

Governments have also adopted a range of short-term expedients such as sale-and-leaseback of assets, public-private partnerships and pressure to hold down wages and conditions of staff, or to reduce staff numbers without identifying productivity improvements. Such measures can produce apparent savings in the short run, but lead to higher costs in the long run. As an example, pressure to restrict growth in the number of doctors over the 1980s and 1990s, in the hope of cutting costs, led to severe shortages by the early 2000s. Responses included a relaxation of entry standards for overseas doctors, with tragic results in the case of Bundaberg hospital, and a high-cost expansion of medical schools.

There is no way of escaping the fundamental problem here. If the community wants continued improvement in publicly provided services, it must pay for those improvements one way or another. In particular, the objective of being a low-tax state is incompatible with the provision of a level of services comparable to the general Australian standard.

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