Part Four

FINANCING THE PUBLIC SECTOR

Introduction

Part Four develops recommendations for financing public sector renewal. It puts forward options for a more equitable, efficient and administratively coherent system of financing the Australian State public sector which complements the macro and micro-economic goals of economic restructuring and the principles of a socially just society.

To provide public services, governments at all levels must have the means to purchase the necessary resources and/or products. Revenue is also required to finance transfer payments between the public and the private sector.

Funds have traditionally been raised in three main ways:

- taxation;
- borrowing; and
- charges

Chapters Six, Seven & Eight provide an analysis of these areas of State finance and put forward recommendations for State revenue-raising. Chapter Nine outlines a range of new fund-raising mechanisms which have recently been developed (such as equity trusts).

In order to understand the current position of the States two important features of the Australian Federal System need to be reiterated. First, the dependence of the States on the Federal Government for finance. Second, the currently problematical financial position of the States in relation to their economic, social and administrative functions and responsibilities. Any program of public sector renewal must consider the consequences of this environment for public social and economic activities. Accordingly, these two issues are key targets for the following analysis.

Chapter 6

STATE TAXATION

6.1 The State Tax Base

One of the key reasons why there is a significant imbalance between the expenditure responsibilities held by the States and their revenue-raising capacities is the fact that taxing powers are dominated by the Federal Government. R.L. Mathews (1988, p. 261) explains that after World War II, the States':

> 'expenditure needs burgeoned as demographic, social and economic pressures made it necessary for them to *commit more and more resources to education, health, housing, transport, urban and manufacturing industries*. On the other hand, they were subjected to a three-pronged attack on their fiscal autonomy, as a result of their loss of access to income tax under the uniform taxation arrangements which the Commonwealth introduced during World War II, the Commonwealth's domination of the Loan Council (achieved through its supremacy in taxation and monetary policy) and its consequent control over State borrowing programs, and the High Court's refusal to permit the States to impose the more important taxes on the sales of goods which are available to States in other federations' (emphasis added).

Of the four main tax bases used in Australia (income, employers' payrolls, wealth [or property] and goods and services), the income tax base was given exclusively to the Federal Government in 1942, and has become increasingly more significant in relative terms over the last 25 years (around 35% of total Federal Government tax revenue in 1960, climbing to over 56% in 1985-86). Payroll Taxes were also an exclusive Federal Government tax, but were transferred to the States in 1971, and have become their most important source of own-revenue.

Current constitutional interpretation prevents the States from imposing taxes on the production or sale of goods and services in their own right. The States tax gambling, insurance, motor vehicles and also charge for business franchises. The latter source of revenue have become a way around the inability to impose excises. The States enact legislation which requires a licence to be obtained to sell a product from a particular outlet. The charge for the licence (the franchise) is scaled according to the turnover at the outlet in the last accounting period. This 'back-dating' of taxable revenue has been the basis upon which State franchises have been deemed legally separate from sales taxes which levy current revenue (cf. Dennis Hotels Pty. Ltd. v. Victoria, [1960], 104, CLR).

While legally distinct, business franchise taxes are similar in incidence and impact to a retail sales tax. Certainly, if the State Governments broadened the range of products that required licences, the franchise taxes would effectively become a broad-based retail sales tax.

In terms of the four bases identified above, the Commonwealth gains about 60% of its revenue from the income base, and about 30% from goods and services; whereas the States collected around 55% of their revenue from property and payroll taxes, and the rest from goods and services.

The sharing of tax responsibilities between the units of government that define the federal structure is an important aspect of the financing problem facing the State Governments. Table 6.1 provides a broad description of tax responsibilities among the levels of government and indicates some of the recent changes. It shows a real growth in Federal Government

tax revenue of 18.4% between 1981/2 and 1986/7; a growth in State tax revenue by 22.6%; growth in Local Government tax revenue of 12.5% and an increase in total tax revenue of 18.7%.

These figures indicate a number of key political and economic developments. First, corporate tax has declined in real terms by 9.8% through both cuts in the company tax rates and persistent tax minimisation and avoidance (cf. Martin, 1989, pp. 72-77). Second, the growth in indirect taxation at both Federal and State levels amounts to the introduction of a consumption tax by stealth. Federal wholesale sales tax increased by 51% between 1981/2 and 1986/7. This increase represents a de facto movement from direct to indirect taxation since the overall contribution of the wholesale sales tax to total revenue rose from 7.5% to 9.6%. At the State level between 1980/81 and 86/87 the revenue raised through business franchise taxes (which ultimately fall on the consumer) have increased by 93.9%, and furthermore, entirely new indirect taxes like the Financial Institutions Duty were introduced.

Table 6.1

Real Tax Revenue by Governmental Units
1981-82 to 1986-87
$m at 1981-82 prices

	1981-82				*1986-87*			
	Federal	*State*	*Local*	*Total*	*Federal*	*State*	*Local*	*Total*
Income Tax								
Individual	21205.0			1205.0	25842.6			25842.6
Company	4903.1			4903.1	4420.9			4420.9
Other	*354.6*			*354.6*	*552.1*			*552.1*
*Excise Tax**	6226.4	138.4		6364.8	6638.5	222.6		6861.1
Sales Tax	2854.			2854.2	4310.2			4310.2
Customs	2059.7			2059.7	2197.7			2197.7
Payroll Tax	15.5	2434.0		2449.5	23.0	2500.5		2523.5
Stamp Duties	8.6	1123.7		1132.3	26.9	1502.9		1529.8
FIT1					179.7	240.6		420.3
Motor Taxes	10.6	996.8		1007.4	17.2	1154		1171.4
Property Tax	20.9	369.9	1720.9	2111.7	25.1	540.4	1932.5	2498.0
FBT					363.4			363.4
*Other***	283.7	2165.9	96.0	2545.6	308.3	2088.9	112.4	2509.6
Total	*37942.3*	*7228.7*	*1816.9*	*46987.9*	*44905.6*	*8250.1*	*2044.9*	*55200.6*

Notes: * For the States this comprises levies in statutory corporations.
** For the States this includes *Taxes on Gambling* (1981/82 $718.8m 1986/87 $845.5m, an increase of 17.6%); *Taxes on Insurance* (1981/82 $435.5m 1986/87 $482.7m, an increase of 10.8%); and *Franchise Taxes* (1981/82 $499.8m, 1986/87 $969.6m, an increase of 93.9%).

State revenue from stamp duties increased by 33.7% and from property taxes by 46%. However, these increases were largely obtained by the States from the property boom. The essentially windfall nature of these recent revenue benefits is not a sound foundation on which to base the future of public sector activity, as the Victorian and Western Australian Premiers have recently made clear (cf *AFR*, 8th June, 1989).

Unfortunately one of the few progressive and broad based taxes available to the States has become a casualty of tax competition and administrative difficulties. In the 1970s, most

Australian States imposed death duties which were variously imperfect and subject to inestimable evasion by the wealthy. Small estates were heavily taxed, and fluctuations in the amount and timing of real tax burdens (as inflation rose) created uncertainty. The Queensland Government, sensitive to the liquidity burdens of the tax on small farmers and businesses, abolished the tax in 1977. The abolition proceeded despite the more obvious solution of indexing brackets and varying thresholds. The other States, principally New South Wales and Victoria, feared that their tax bases would be eroded through migration to Queensland, and accordingly began to abolish their own death duties, with Victoria finally abandoning the tax in 1983.

6.1.1 The Current Tax Position of the States

In this section the relative contributions of the various taxes and charges imposed by State Governments in Australia to their respective total taxation revenue is further developed and the differences between the States in terms of the distribution of tax revenue across the various taxes are analysed.

The States reacted to the developments in federalism in the latter half of the 1970s in two contradictory ways:

- they appeared to rely increasingly on Federal grants; and
- they sought ways of increasing the contribution of taxes under their control, particularly business taxes, gambling taxes and motor vehicle taxes (see Mathews, 1988, p. 264).

They did not embrace the income tax opportunities restored by the 'new federalism', preferring to pressure the Federal Government to improve the grants system, which had become the exemplar of Federal domination (or the anathema of fiscal independence).

To facilitate comparative analysis, all the data presented in this section is drawn from the ABS Taxation Revenue in Australia 1985/86 Cat. No. 5506.0, although similar but less uniform information can be found in the individual Budget Papers of each State.

While the States are excluded from imposing any substantial broad-based tax, in sum, they employ a large number of narrowly-based taxes (29 in all, according to the ABS classification, although each individual State only imposes a subset of the total range of taxes). In this section a more aggregated classification (9 categories) is used to simplify analysis and presentation (New South Wales Tax Task Force, 1988, Review of the State Tax System, p. 19; hereafter referred to as the Collins Report).

Tables 6.2 and 6.3 present the relative contribution of the nine categories of taxes to the total revenue raised in each State. It should be noted that similar tables appear in the Collins Report (1988, pp. 20-21). However, the figures presented in this chapter are different to those in the Collins Report due to classification errors in the latter. The authors of that Report fail to consistently decompose the State and the Local Government sectors, and therefore, overstate certain categories of State tax revenue.

From Table 6.2, it is clear that payroll taxes are the largest source of taxation revenue for all the States (ranging from 24.6 to 28.4%). The Federal Government agreed to transfer payroll taxation to the States in return for a reduction in financial assistance grants in 1971. While this trade-off was based on the previous Federal payroll rate of 2.5%, the States progressively increased the payroll tax rate to 5.0% and more. Payroll taxation is a strong growth tax, but is inferior to more broad-based taxes on the use of goods and services because it directly discriminates against labour.

The payroll tax contributions vary across States due to variations in rates of taxation and to differences in thresholds. Both South Australia and Western Australia receive a lower contribution from their respective payroll taxes. South Australia has no surcharge over the basic rate of 5%, whereas Western Australia introduces its tax at the lower rate of 3.75% (although it does impose a progressive tax rate).

Queensland has a similar structure to South Australia but receives a larger contribution from its payroll tax because its total taxation receipts are relatively lower than the other States. The per capita figures (See Table 6.3) confirm the lower tax impact in Queensland ($569.57 per person compared to the average

for all States of $753.93 per person), and also show the per capita similarity between South Australia and Tasmania.

Taxes on property are divided between Taxes on immovable property (ABS Categories 311-319) which are shared between State (land taxes, metropolitan improvement rates, contributions to fire brigades, and other taxes) and Local Government (municipal rates); and Taxes on financial and capital transactions like stamp duties and Financial Institutions Tax (FID). In the past, States also raised revenue by imposing the Estate Inheritance and Gift Duties and any revenue from this category reflected past liabilities only (the question of death duties is dealt with in a later section of this chapter).

Table 6.2

Relative Contribution of Individual Taxes to States' Tax Revenue
1986-87

	NSW $m	*Vic.* $m	*Qld* $m	*SA* $m	*WA* $m	*Tas.* $m
Payroll Taxes	*1489.2*	*1108.4*	*423.0*	*223.6*	*310.5*	*81.2*
%	28.4	28.8	28.0	24.6	26.7	27.7
Taxes on Property						
Imov. Property	*349.3*	*227.4*	*96.3*	*46.2*	*67.9*	*12.6*
%	6.6	5.9	6.4	5.1	5.8	4.3
Fin. & Capital	*1024.4*	*819.1*	*292.9*	*154.8*	*219.9*	*40*
%	9.6	21.3	19.4	17	18.9	13.
Taxes on Provision of Goods and Services						
Stat. Corp. Levies	*32.5*	*217.9*	*7.1*	*31.1*	*31*	*8.4*
%	0.6	5.7	0.5	3.4	2.7	2.9
Gambling	*571.9*	*353.2*	*150.3*	*80*	*65.8*	*22.6*
%	10.9	9.2	9.9	8.8	5.7	7.7
Insurance	*286.2*	*208.2*	*63.7*	*81.3*	*60*	*11.6*
%	5.5	5.5	4.2	8.9	5.2	3.9
Taxes on Use of Goods and Services						
Motor Vehicles	*683.1*	*394.4*	*280.4*	*133.4*	*160.6*	*39.3*
%	13	10.3	18.6	14.7	13.8	13.4
Franchises	*539.8*	*430.7*	*69.8*	*127.7*	*203.2*	*65.8*
%	10.3	11.2	4.6	14.1	17.5	22.4
Fees and Fines		*260.5*	*86.0*	*126.1 11.9*	*30.1*	*42.9*
	4.9	2.2	8.4	3.3	3.7	4.1
Total	*5236.9*	*3845.3*	*1509.6*	*908.2*	*1161.8*	*293.4*

Source: ABS Taxation Revenue Australia 1986/87, Cat. No. 5506.0, p. 17.

Land taxes are the most important contributor in this general category. Interstate variations in this contribution (varying between 6.6% in New South Wales to 4.3% in Queensland) can be attributed to the rates imposed, the growth in the relative land values, and the amount of taxable land. Tasmania has lower land values and a small amount of land, whereas New South Wales with a lower relative tax rate (to other States) has experienced rapid growth in land value.

The other major contributor to total revenue (with Tasmania being an exception) is the financial and capital transactions taxes, with stamp duties being the most significant in this category. There is a plethora of stamp duties imposed across the States which makes a comparative analysis difficult. New South Wales

has experienced rapid growth in stamp duties reflecting the land value escalation and its progressive rate structure. The other States have received a fairly stable contribution from stamp duties.

The revenue capacity derived from the FID clearly depends upon the strength of the financial sector in the State concerned. Again, States like Victoria and New South Wales, which account for a significant proportion of the financial transactions in Australia, gain more from this tax (from lower rate scales), than the smaller States like Tasmania (despite the higher rate in Tasmania). The per capita figures confirm this relative advantage. Queensland does not impose a FID, but capital revenue still accounts for a large proportion of total tax revenue due to the burgeoning Gold Coast property market and the stamp duties derived from this.

The States are prevented by constitutional fiat (and later High Court interpretations) from imposing broader-based retail sales taxes, more excises or customs duties. The States do receive revenue from Taxes on the provision of goods and services by imposing:

– excises in the form of levies on statutory corporations (ABS category 42);
– taxes on gambling (ABS categories 441-449); and
– taxes on insurance (ABS categories 451-459).

Victoria gains an appreciable amount from its statutory corporations levy (5.7% of total tax receipts) because it bases its rate on the accumulated public equity held in the public authorities. The other States receive much more modest contributions because their coverage is more narrow than in Victoria, and they levy on revenue rather than accumulated equity. This levy is a recent source of revenue for the States.

Gambling taxes are imposed on government agencies (TABs and State lotteries) and on private activities (bookmakers, clubs, casinos, lotteries etc). They are tantamount to a consumption tax. However, these taxes have a socially useful purpose and there is widespread community support for taxes on windfalls. Revenue potential is high because gambling tends to increase as per capita incomes grow.

Table 6.3

Per Capita Contribution of Individual Taxes to Total States' Tax Revenue
1986-87
$s per person

	NSW	*Vic.*	*Qld*	*SA*	*WA*	*Tas.*
Payroll Taxes	267.29	264.90	159.60	161.06	209.83	181.49
Taxes on Property						
Immovable Property	62.70	54.35	36.33	33.88	45.88	28.16
Financial and Capital	183.87	195.76	110.51	111.50	148.60	89.41
Taxes on the Provision of Goods and Services						
Levies on Stat Corps	5.83	52.08	2.68	22.40	20.95	18.78
Gambling	102.65	84.41	56.71	57.62	44.47	50.51
Insurance	51.37	49.76	24.03	58.56	40.55	25.93
Taxes on the Use of Goods and Services						
Motor vehicles	122.61	94.26	105.80	96.09	108.53	87.84
Franchises	96.89	102.93	26.34	91.98	137.32	147.07
Fees and Fines	46.76	20.55	47.58	21.68	28.99	26.57
Total	939.96	919.00	569.57	654.18	785.11	655.20

Source: ABS Taxation Revenue Australia 1986/87, (Cat. No. 5506.0). Population figures are the estimated mean resident population for the financial year as published by the ABS Australian Demographic Statistics (Cat. No. 3101.0).

The relatively large contribution of gambling taxes to total revenue in New South Wales arises because it is the only State which levies a poker machine tax. Western Australia languishes behind the other States in gambling tax receipts because its lottery is poorly subscribed and the range of gambling taxed is relatively narrow.

Insurance tax receipts vary as a consequence of the relative rate structures on third-party insurance, the size of the tax base (Tasmania has fewer motor vehicles), and the size of the contribution of the private insurance companies (low in Tasmania and high in Victoria). South Australia relies most heavily on insurance tax (raising $58.56 per person compared to the average for all States of $41.70 per person). A large stamp duty on insurance component (based on annual premiums rather than the sum insured as in other States), contributes significantly to the total South Australian insurance tax receipts.

Taxes on the use of goods and the performance of activities (ABS category 5) are divided between Motor Vehicle taxes (ABS categories 511-514), Franchise taxes (ABS categories 521-524), and other taxes (ABS category 53). *Queensland places considerable reliance on motor vehicle taxes (18.6% of total receipts compared to around 11-15% elsewhere).*

Franchise taxes include taxes on gas, petroleum products, tobacco and liquor franchises. Their contribution in real terms to total State revenue (all States) has nearly doubled since 1981-2, and in 1986-87 accounted for around 43% of taxes raised under this category (taxes on the use of goods and the performance of activities), whereas in 1981-82 this share was only 30%.

Queensland gains a very small amount of revenue from this source because it has not levied gas, petrol, or tobacco franchises until recently. Although three States levy gas franchise taxes (New South Wales, Victoria and South Australia) their contribution is small. Tasmania offsets its size disadvantage by imposing significantly higher tobacco and petrol levies and as a result it raises in per capita terms the highest franchise revenue.

The final category is Fees and Fines (ABS category 91-93, and 94). Both State and Local Governments gain revenue from taxes and charges in these tax categories. Table 6.4 shows the share of each tier of government.

Table 6.4

Share of State and Local Government in Fees and Fines
1986-87
%

	NSW	*Vic.*	*Qld*	*SA*	*WA*	*Tas.*
Fees from Regulatory Services						
State	170.2	36.2	88.9	16.5	22.9	9.4
Local	41.1	33.8	31.1	6.2	2.8	2.0
Fines						
State	90.3	49.8	37.2	13.6	20.0	2.5
Local	2.6	27.9	5.0	5.8	4.9	1.6
Total Fees and Fines	304.2	147.7	162.2	42.1	50.6	15.5

Source: ABS Taxation Revenue Australia 1986/87 (Cat. No. 5506.0).

The notable feature is the relative emphasis that the Queensland State Government places on Fees and Fines as a source of revenue. While this category contributed less than 5% of total revenue in all the other States (New South Wales receiving 4.9% and Victoria 2.2%),

Queensland received 8.4% of its total tax revenue from this source. It has been noted that Queensland's total tax burden is lower than other States, but the per capita contribution of fees and fines shows that its relatively large percentage contribution is not a consequence of the small total revenue raised.

6.1.2 The Changing Pattern of State Taxation
Table 6.2 shows the share of taxation at the various levels of government in real terms between 1981-82 and 1986-87. While the static picture (as at 1986-87) of the distribution of the total State revenue across the various States according to the range of taxes imposed is useful, it is also important to discuss how the picture changes over time.

Three aspects of this changing picture can be considered:

- the changing percentage contributions of the individual taxes across the States;
- the changing percentage distribution in real terms; and
- the changing concentration of the tax base measured by the changing contribution of the largest three categories in each State.

Table 6.5 augments the earlier information adding data for 1977-78. This allows for a comparison over the decade in terms of the changes in percentage contribution of the individual taxes. Note that a similar Table appears in the Collin's Report (Table 2.5, p. 27) comparing 1976-77 to 1986-87. The data for both periods in that Table appears to be subject to arithmetic errors, arising in part from the previous failure of that Report to decompose the Local and State sectors correctly. Table 6.5 in this section compares the 1977-78 figures with the most recent available (1986-87) because the 1976-77 data was not published in the same format, using the ABS categories currently employed. In addition, Table 6.5 separates the estate inheritance and gift duties component of property taxes from the taxes on immovable property.

Table 6.5

Percentage Contribution of Taxes to Total State's Tax Revenue
1976-77 to 1986-87
%

	NSW	*Vic.*	*Qld*	*SA*	*WA*	*Tas*
			Financial Year Ending			
	1978/1987	*1978/1987*	*1978/1987*	*1978/1987*	*1978/1987*	*1978/1987*
Payroll Taxes	35.9/28.4	30.8/31.7	39.5/28.8	38.5/24.6	38.9/26.7	37.0/27.3
Taxes on Provision of Goods and Services						
Property	6.8/6.6	5.6/5.9	2.8/6.4	5.4/5.1	4.8/5.8	4.0/4.3
Estate/gifts*	5.4/0.0	6.8/0.0	3.1/0.0	4.9/0.0	4.1/0.0	14.3/0.0
Capital	13.2/19.6	17.9/21.3	18.6/19.4	16.0/17.0	15.1/18.9	14.3/13.6
Taxes on Provision of Goods and Services						
Levies	0.0/0.6	1.8/5.7	0.8/0.5	0.0/3.4	1.9/2.7	0.0/2.9
Gambling	12.0/10.9	10.7/9.21	5.9/9.9	5.3/8.8	5.5/5.7	7.2/7.7
Insurance	1.8/5.5	2.2/5.4	4.3/4.2	2.7/8.9	4.3/5.21	4.0/3.9
Taxes on Use of Goods and Services						
Vehicles	14.4/13.0	16.3/10.3	15.6/18.6	17.7/14.7	17.0/13.8	19.9/13.4
Franchises	5.1/10.3	4.5/11.2	4.5/4.6	5.3/14.1	5.8/17.5	3.9/22.4
Fees and Fines	5.4/4.9	2.3/2.2	3.4/8.4	2.2/3.3	2.7/3.7	3.8/4.1

Note: * Outstanding Estate inheritance and gift duties in 1986-88 for New South Wales were $1.9m which represented 0.03% of total revenue in that year; in Victoria $1.8m and 0.04%.
Source: ABS Taxation Revenue Australia 1982/83 and 1986/87 (Cat. No. 5506.0).

Table 6.5 indicates that significant changes in the relative contributions to the total tax revenue for each State have occurred, despite the contributions of some taxes remaining roughly constant. So, as some taxes have declined, old taxes have been made more potent and/or new taxes have been introduced.

Reading from the top, all the States (except Victoria) have experienced significant declines in the revenue derived from their most important tax, employers' payroll taxes. Victoria has experienced a modest increase in its relative receipts from payroll taxes.

In all cases (except Queensland), taxes on immovable property have remained relatively constant. The decline in contribution (as a result of abolition) in estate inheritance and gift duties is striking. It is ironic that Queensland, which led the way in the abolition of estate duties, has always received the lowest contribution from this source, but is the only State to have bolstered the relative contribution of immovable property taxes. This relative growth probably reflects the boom in Gold Coast real estate and low tax levels in Queensland.

Tasmania has lost a significant amount from the abolition of estate duties, and has not replaced the revenue with growth in the relative contribution of the other property taxes. Victoria, South Australia and Western Australia have developed the revenue contribution of the financial and capital taxes, partially compensating for the loss of estate duties. New South Wales has expanded the revenue capacity from this source by almost 50%.

The growth in the relative importance of levies on statutory corporations has been uniformally modest, with the exception of Victoria for reasons noted previously. Gambling taxes have been a modest growth area for the States which have opened casinos (South Australia, Western Australia and Tasmania), with small relative declines in New South Wales and Victoria. The contribution of insurance has been static in Queensland and Tasmania but has been a growing source of revenue for New South Wales (threefold growth), Victoria (250% growth), South Australia (330% growth) and Western Australia (23% growth).

For all States except Queensland, franchise taxes have significantly increased in their relative contribution to total revenue. New South Wales has doubled the contribution of franchise taxes, while the increase in the other States is even more striking: Victoria (11.2% from 4.5%), South Australia (14.1% from 5.3%), Western Australia (17.5% from 5.8%) and Tasmania (22.4% from 3.9%). It is clear from these large changes that the franchise taxes represent the largest relative source of revenue growth in the States mentioned.

Vehicle taxes have generally declined in relative importance, although Oueensland is the notable exception, choosing to expand the contribution of these taxes while engaging in inter-State competitive actions on other taxes. Fees and fines have been approximately constant in their contribution for all States.

Table 6.6 reports the percentage changes on the real tax revenue received by each State for the period 1977-78 to 1986-87. In terms of total real revenue growth, Western Australia experienced the largest real increase (39.8%) over the period, followed by Tasmania (31.8%), New South Wales and Victoria (around 28%), Queensland (23.4%), with South Australia an emphatic last on 4.7%. The trends in the mix of the States' taxes are clearly shown.

There has been growth in business taxes like franchises, capital taxes and insurance. However, the pattern is not uniform across all States. Queensland is the notable exception, where the growth taxes have been property (179.2% compared to the average of the other States of 33.5%); gambling (108.1% compared to the average 37.8%); and fees and fines (205.5% compared to an average of 46.9%). Payroll taxes grew in Victoria (19.8%) and New South Wales (1.5%), but declined in all other States. Motor Vehicle taxation also declined in Victoria, South Australia and Tasmania.

Table 6.6 shows the general trends over the past decade. These developments reflect the development of new taxes in the early 1980s.

Another dimension of the trends in taxes is the per capita level and growth in real taxation. Table 6.7 displays these figures in terms of total real taxation for each State for the period 1977-78, and the two sub-periods 1977-78 to 1981-82, and 1981-82 to 1986-87. The per capita measure corrects for population growth, and allows the distinction to be made between the growth in total taxation revenue (shown in Table 6.1) and the growth in the burden of taxation (per capita real taxes).

Table 6.6

Percentage Changes in Real Taxes
(1980-81 prices)
1977-78 to 1986-87
%

	NSW	*Vic.*	*Qld*	*SA*	*WA*	*Tas.*
Payroll Taxes	1.5	19.8	-12.5	-33.	-4.	-1.8
Taxes on Property						
Property	24.1	33.4	179.2	-1.7	70.6	40.0
Capital	90.0	52.0	28.7	11.7	75.2	5.5
Taxes on Provision of Goods and Services						
Levies	–	304.0	-31.3	–	101.1	–
Gambling	16.9	10.1	108.1	75.7	44.6	41.8
Insurance	297.0	111.2	21.0	252.1	70.0	29.1
Taxes on Use of Goods and Services						
Vehicles	15.3	-20.0	34.8	-22.3	14.8	-13.6
Franchises	159.3	214.2	25.4	180.4	320.5	664.2
Fees and Fines	18.9	23.3	205.5	59.5	92.7	40.3
Total	28.1	27.8	23.4	4.7	39.8	31.9

Source: ABS Taxation Revenue Australia 1986/87 (Cat. No. 5506.0).

Table 6.7

Real Per Capita Taxation
(1980-81 prices)

	$			% Changes		
	77-78	*81-82*	*86-87*	*77-78/81-82*	*81-82/86-87*	*77-78/86-87*
NSW	499.9	495.2	578.1	-0.9	16.7	15.6
Vic.	480.2	490.4	565.2	2.1	15.3	17.7
Qld	349.8	363.8	350.3	4.0	-3.7	0.1
SA	412.8	333.8	402.3	-19.1	20.5	2.5
WA	419.8	462.2	482.8	10.1	4.5	14.9
Tas.	328.7	342.5	403.2	4.2	17.7	22.7

From Table 6.7, real per capita tax obligations have risen in all States except South Australia over the period 1977-78 to 1986-87. Queensland has marginally increased its receipts, although the level of taxes per person in Queensland is much lower than the rest of the States. New South Wales and Victoria tax their respective populations at much higher levels (per person) than the other States.

It is also evident that all the States bar Western Australia faced financial stringency in the first period (1977-78 to 1981-82), and the improved per capita revenue-raising in the second period (1981-82 to 1986-87) reflected a change in attitude. *Specifically, the States sought and developed new tax bases like franchises and financial taxes.*

Table 6.8 disaggregates the information in Table 6.7 and displays for the period 1977-78 to 1986-87 the percentage growth in the individual taxes imposed. The changing tax mix in real terms is once again evident.

Table 6.8

Changes in Per Capita Real Taxes (1980-81 Prices)
1977-78 to 1986-87
%

	NSW	*Vic.*	*Qld*	*SA*	*WA*	*Tas.*
Payroll Taxes	-8.4	10.3	-28.9	-37.7	-31.1	-8.6
Taxes on Property						
Property	12.0	22.8	126.7	-8.6	40.3	30.3
Capital	71.5	39.9	4.5	4.0	44.0	16.8
Taxes on Provision of Goods and Services						
Levies	–	271.6	-44.2	–	65.4	–
Gambling	5.6	1.4	68.9	63.5	19.0	32.0
Insurance	258.6	94.5	-1.8	227.6	39.9	20.2
Taxes on Use of Goods and Services						
Vehicles	4.1	-26.0	9.4	-27.8	-6.5	-19.5
Franchises	134.1	189.3	1.8	160.9	245.9	611.4
Fees and Fines	7.3	13.5	147.9	48.4	58.5	30.7
Total	15.7	17.7	0.1	-2.6	14.9	22.7

Source: ABS Taxation Revenue Australia 1986/87 (Cat. No. 5506.0).

6.1.3 Measuring the Narrowness of the States' Tax Bases

It has been emphasised that a significant imbalance exists in the Australian Federal system which is, in part, due to the extreme narrowness of the States' tax bases. A narrowly based tax structure means that tax revenue is raised from a small number of taxes. The preceding analysis shows that in all States, a large percentage of the tax revenue is raised from payroll, motor vehicle, and financial and capital taxes. It is also apparent that in recent years, the franchise taxes have become a significant contributor in all the States except for Queensland.

The Committee of Inquiry into Revenue Raising in Victoria Report (1983) proposed a measure of the narrowness of the tax base which draws on the concept of concentration in the literature on industry economics. Two measures of concentration are shown in Table 6.9. The first calculates the cumulative percentage share in total tax revenue raised by the three most important contributors for 1977-78 and 1986-87. To account for the increased emphasis on franchise taxes, the second measure of concentration uses the top four contributors to total taxation. The addition of the franchise taxes is important because without it the top three measure is somewhat misleading.

Based on the top three measure, all the States experienced decreased concentration over the period shown, which means that new sources of revenue were found and/or an increased contribution from previously imposed taxes occurred. In 1977-78, New South Wales and Victoria had the least concentrated tax bases, whereas the remaining States had noticeably higher levels of concentration.

Over the period shown, both New South Wales and Victoria experienced modest declines in their respective degrees of tax-base concentration. The striking changes occurred in South Australia, Western Australia and Tasmania which experienced large reductions in their tax base concentration. These changes placed these States below New South Wales and Victoria. While Queensland also experienced a large reduction it remained the most concentrated of all the States.

Table 6.9

Measures of Concentration in States' Tax Bases
1977-78 and 1986-87
% of Total Tax Revenue

	*Top Three Taxes**		*Top Four Taxes***	
	1977-78	*1986-87*	*1977-78*	*1986-87*
NSW	63.5	61.0	68.6	71.3
Vic.	65.0	63.3	9.5	74.5
Qld	73.7	66.8	77.2	71.4
SA	72.2	56.3	77.5	60.4
WA	71.0	59.4	76.8	76.9
Tas.	71.2	54.3	75.1	76.7

Notes: * Top three taxes are Payroll, Financial and Capital, and Motor Vehicles.
Notes: ** Top four taxes add franchise taxes to the top three.

These relative changes are partly a consequence of the significant increase in the contribution from the franchise taxes in all States, bar Queensland. In Victoria, Western Australia and Tasmania the top three taxes in 1986-87 would include franchises taxes, and exclude motor vehicles. South Australia receives an almost equal contribution from franchise taxes (5.3% in 1977-78 and 14.1% in 1986-87) and motor vehicle charges (17.7% in 1977-78 and 14.7% in 1986-87).

The top four measure of concentration incorporates these important trends in States' taxation. The rankings are the same for 1977-78 using both measures (except that South Australia and Queensland swap positions at the top). This reflects the uniform insignificance of franchise taxes in this earlier period. Comparing this ranking with that in 1986-87 for the top four measure, significant differences are noted relative to the same comparison for the top three measure.

On the top four measure, all States except for South Australia and Queensland have increased their concentration. This is partly explained by the rising prominence of the franchise taxes, and a less-than-proportionate decline in the other three taxes included in the measure. More relevant is the fact that the States (Tasmania excepted) have tried to broaden their tax bases by introducing the Financial Institutions Duty (FID). The introduction of the FID does not reduce either concentration measure because it is included in the capital tax category. This aggregation problem demonstrates the care that should be taken in interpreting concentration measures. In other words, as the aggregated categories include more than one specific tax, the tax base could be broadening, while the concentration measure, which is insensitive to these disaggregated changes, will indicate the opposite.

The declining contribution of the payroll tax, and the rising importance of franchise taxes, have changed South Australia from the most concentrated to the least concentrated. Queensland's concentration decline can be attributed almost exclusively to the fall off in the payroll tax contribution.

Although the tax mix of each State differs to some degree the more general difficulties of State revenue raising are clearly apparent. The State tax base is extremely narrow and, even though attempts have been made in recent years to introduce new forms of taxation, these have been largely regressive. Taxes such as FID and business franchises are new and piecemeal additions to the State tax base and the overall regime of indirect taxation in Australia, while more progressive taxes like death duties have fallen victim to tax competition among the States. Other increases in State revenue have been obtained in areas like stamp duties, but these windfall gains over the last few years are not a sound basis for stable budgetary planning, much less a program of public sector renewal.

6.2 Federal-State Tax Arrangements: Collection and Distribution of Revenue

The development of a stable fiscal base for

public services is an urgent priority. Resolving the imbalance in Federal-State financial arrangements requires systematic reforms to the revenue base of the States, which must include considerations of equity and efficiency so far lacking in the haphazard attempts of the States to overcome their fiscal constraints. In order to adequately evaluate the possibilities it is important to develop appropriate benchmarks of analysis and comparison.

6.2.1 What is a Good Tax Structure?
The three requirements for a good tax system are usually summarised in terms of equity, efficiency and simplicity (the latter embracing administrative considerations). In other words:

> – The distribution of the tax burden should be equitable with everyone paying their fair share (equity objective);
> – Taxes should introduce minimum distortion to the allocation of productive resources, and if possible correct for market failures (neutrality objective);
> – The tax system should be administratively simple and easily understood, with the costs of administration and compliance being as low as possible (simplicity objective) (Musgrave & Musgrave, 1976, p. 210-211).

On the evidence presented so far it is clear that the system of tax collection and revenue distribution in Australia is in need of serious reform. The States rely on a range of narrowly-based taxes like stamp duties, payroll taxes and (increasingly) franchise taxes. It is self evident that this regime of taxes does not satisfy the principles of simplicity or neutrality. However, the principle of equity is also an important benchmark for analysing State taxes and charges. Some principles of efficiency and equity, which provide a framework for considering the various taxation options available to the States, are outlined below.

Equity
There have, in fact, been few attempts at assessing the success or otherwise of the States' taxes in meeting the equity objective. This is, in part, due to both the paucity, and poor quality, of the available data. However, the Collins Report does provide an assessment of the New South Wales tax regime. Some of the Report's conclusions can be generalised to the other States.

As noted previously, payroll tax is the largest contributor to the States' tax revenue. Such a tax can be passed on in prices to consumers or users; it can result in lower wages being paid; or it can result in lower profits. *If passed on to consumers, the tax operates as a consumption tax; if passed on in the form of lower wages, it operates as a flat rate income tax; and if passed on in so that profits fall, it is a tax on profits levied on the value of wages paid*. Collins concluded that:

> 'the incidence of the payroll tax will most likely be a composite mix of a tax on sales, a tax on wage income and a tax on company profit but in every case levied on firms according to their payroll and not as a proportion of their sales or profits' (p. 197).

On the basis of this analysis, payroll taxes cannot be used to achieve desirable equity goals.

Generally, Collins concluded that '. . . State Governments have precious little influence open to them on . . . aspects of equity' (p. 197). It is clear, however, that a considerable amount of research needs to be undertaken on the issue of equity in the States' tax regimes. This would be an important task for a reformed Premiers' Conference as discussed in Chapter 4, Section 4.4.1.

It is important to realise also that the principle of equity need not always be adhered to. The use of inequitable consumption taxes on specific products may, in fact, be socially desirable. For example, taxes on tobacco or alcohol are designed to reduce their use and, in Victoria, the revenue raised from tobacco is diverted back into health funding.

The Distribution of the Tax Burden
The distribution of the tax burden across taxpayers is also important for equity in taxation. Determining who bears the burden of taxes or tax incidence must take into account two things:

- the effects of the individual taxes; and
- the effects of the system in general.

Taxes are legal obligations. Some individuals or corporate entities who are legally obligated try to avoid or pass on the burdens to others. To determine who pays, one must go beyond the meagre legal obligations. Two points are important here:

- the entire tax burden is always borne by individuals (or evaded), even if corporate entities are at the outset legally obliged to pay some taxes; and
- the final distribution of burdens is not likely to coincide with the distribution of initial legal obligations.

Economists distinguish between legal or statutory incidence (which relates to the legal obligation to pay tax) and effective or economic incidence (which considers who ultimately bears the burden of the tax). The difference between these two concepts arises because the legal obligation must always be paid to the Tax Department by the person or corporate entity concerned, who can then shift the burden onto other individuals through their pricing (and employment) behaviour. *In assessing the equity impact of a particular tax or taxes in general, it is the effective incidence which is relevant.*

Taxes are usually imposed on some aspect of economic behaviour. Economic transactions involve more than one person (or entity), and if taxes are imposed on the transactions, the legally obligated party may seek ways to reduce the economic activity in question, or alter the terms which define the conduct of the transaction. Either way, the behavioural changes impact on the other transactors.

Companies can forward shift taxes by increasing prices. The tax is therefore passed on in a sales tax form, which is regressive in impact. In summary, any forward shifted business tax is regressive. Companies can also backward shift taxes by reducing the prices offered for inputs. *A payroll tax, for example, which taxes labour costs, creates an incentive for the employer to offer lower wages (reduced wages growth) and/or less employment. It is claimed that this type of shifting would have a proportional impact across the workforce. However, to the extent that the firm has more discretion over the wages paid and employment variations for lower wage groups (less protected jobs) relative to salaried employees, the backward shifting would also be regressive.*

Legal and effective incidence may coincide if no shifting occurs. In this case, profits, dividends and/or capital gains will be reduced, and it is possible that the incidence would be progressive, as a result of the type of individual income profiles which would be equity participants.

If the firm produces an intermediate good or service (that is, produces inputs for another firm(s) closer to the final product stage), then a forward shifted tax would spread throughout the economy (as burden impacts first on all the firms using the input) ultimately as a broad-based consumption tax.

The concept of tax burden must be outlined. Fiscal or budgetary policy, may or may not involve a transfer of resources to the public sector. If the government imposes a tax to finance its expenditure on goods and services, a resource transfer occurs because the private sector has less to spend. The resources utilised by the public sector represent the opportunity cost of the tax or the fiscal burden. Tax incidence considers how the burden is distributed across all the individual households in the private sector. The net burden considers, in addition to the tax burden, the benefits derived from the public expenditure.

Alternatively, if the tax finances transfers back to the private sector, no resource transfer to the public sector occurs. Tax incidence in this case seeks to determine the private households who gain from the transfers and those who lose as a result of the tax.

Progressive, Proportional and Regressive Tax Burdens

The distinction between progressive, proportional and regressive taxation can be made as follows:

- A tax is progressive if the ratio of tax to income rises with income. That is, the average tax rate increases with income;
- A tax is proportional if this ratio remains constant as income rises; and
- A tax is regressive if the ratio falls as income rises.

Empirical Estimation of Tax Incidence
In assessing the incidence of State taxes it must be acknowledged that considerable shifting of the incidence is exported to other States and/or to the Federal tax base (via Federal deductability of State charges). Conclusions made regarding the incidence of a tax system are extremely sensitive to the choice of incidence assumptions. A recent Australian study by N.A. Warren appears in Volume 2 of the Collins Report.

Warren estimated:

'the incidence of selected New South Wales taxes on New South Wales taxpayers on certain assumption as to the shifting behaviour adopted in response to these taxes' (Task Force Report, 1988, Vol. 1, p. 77).

The essential findings of Warren's Study into the incidence of some selected New South Wales taxes are worth reporting here.

Table 6.10

Incidence of New South Wales Taxes

Tax	*Incidence*	*Proportion Exported**
Payrolls	proportional	high
Franchise Taxes	mildly regressive	significant
Motor Vehicles	regressive	small
Stamp Duties:		
motor vehicles	regressive	small
property/contracts	mildly regressive	small
other	regressive	significant
Gambling	uncertain	small
Land Tax	mildly regressive	small

Note: * Indicates degree to which the tax burden is shifted interstate.
Source: Table 6.10 is based on Table 4.1 on p. 86 of the Collins Report.

Warren concluded that almost all the taxes imposed by the States are regressive in their incidence, with the exception of the payroll tax. The States have no current progressive tax instruments, although they could introduce progressivity into their tax structures by imposing (as is their constitutional right) either:

– a surcharge on the personal income tax imposed at the Federal level; and/or
– imposing a tax on the transfer of wealth in the form of death duties.

Tax Competition and its Implications for More Equitable State Taxes
The financing problem facing the States is significantly related to the constitutional constraints which prevent them from exploiting some desirable broad-based tax bases. However, even where valid tax bases (some with desirable efficiency and equity features) exist, tax competition between the States has negated (or reduced) the revenue potential of these bases. A major goal of tax reform should be the increased harmonisation of the States' tax systems.

Tax competition can occur if a tax base is mobile, in the sense that the taxable activity can be transferred at a relatively low cost to another State, which imposes a lower tax burden on that particular base. Business activities and property are the two most mobile tax bases. Where a tax base is immobile (motor vehicles being a classic example), wide disparities in the tax burdens imposed on that base between the States can persist.

Tax competition (or the threat thereof) can lead to the abolition of taxation imposed on a particular base. *The States not only lose a potentially significant revenue source, but they are forced to rely more heavily on a narrower overall tax base.* The classic case of this destructive behaviour in

recent history is the abolition in all States of the estate, inheritance and gift duties. This tax base represented a substantial revenue source, was progressive and allowed the States to redress severe inequities.

However, despite the case of death and inheritance duties, the competitive abolition of a tax base is rare and tax competition more often increases the administrative costs of enforcing compliance to the existing taxes imposed. In either case, the States lose revenue and are further forced to impose narrowly-based, discriminatory taxes.

The Collins Report (1988, pp. 379-380) concluded that it would:

> '. . . *be very much in the interests of effective New South Wales tax policy to initiate a process designed to increase the degree of tax harmonisation and to reduce the degree of tax competition.*
>
> The distinction should be stressed between *tax harmonisation* and *tax standardisation*. There is no suggestion that States should be required to implement the same tax bases and apply to these bases the same tax rates . . . States should have the right to determine whether they wish to adopt high tax/high expenditure policies or low tax/low expenditure policies and to determine which tax mix is appropriate to their objectives . . .' (emphasis added).

The first recommendation regarding tax harmony within the Federal system is fully supported here. A Federal structure is appropriate where several separate jurisdictions share common interests in terms of national and international affairs, but who desire to preserve their individualism and where benefit-areas are smaller than the nation as a whole. It is difficult to conceive of tax competition as being a valid example of individualism. It is destructive to all the States.

The distinction between tax harmonisation and tax standardisation referred to in the quote from the Collins Report is not easy to make in practice. Standardisation does not necessarily mean equality of tax revenue. The different size of individual States would lead to unequal outcomes even where tax bases and rates were totally uniform. In the interests of harmony a large degree of standardisation is necessary and desirable.

6.2.2 Fiscal Equalisation

The previous discussion outlined the principles of equity and efficiency in tax collection. Such principles apply equally to the subsequent distribution of revenue back to the States.

As this book has repeatedly indicated, there is a marked imbalance between the Federal and State Governments in terms of revenue-raising capacity and expenditure responsibilities. Another imbalance occurs when the States are considered as a group (horizontal imbalance). Some States because of their size, location and/or economic structure suffer deficiencies in their revenue-raising capacity relative to their per capita expenditure responsibilities. The Commonwealth Grants Commission (CGC) is the principle administrative institution which attempts to redress the horizontal fiscal imbalance between States through the principle of fiscal equalisation.

The CGC allocates general revenue grants in order to redress the horizontal imbalances between the States. An important consideration is the extent to which horizontal fairness is achieved. Certain States (like New South Wales) have argued that in fact the process of fiscal equalisation discriminates excessively against the larger States. The consequence of the lower revenue grants is that more reliance must be placed on the States' own taxation revenue. The higher taxation burdens inhibits growth and prosperity in those States.

The Collins Report (1988, pp. 381-407) discusses this issue in detail. The 1976 Grants Commission Report indicates that the Commission redistributes resources:

> 'To enable a claimant State to function at a standard not below that of other States without having to levy taxation and other charges of greater severity than those in other States, its revenue needs to be supplemented because of:
> (a) its lower capacity to raise taxes and other revenues; and
> (b) its needs to incur higher costs in order to provide comparable government services.'

Of course, no State is forced to spend and/or tax in line with the average levels.

The Grants Commission adopts a tax-by-tax (or partial) approach when it assesses the revenue-raising capacity of each State, and aggregates these into an estimate of total State taxable capacity. An alternative method, the so-called global approach, has been suggested in recent years by New South Wales and Victoria, although the remaining States prefer the partial approach.

The global approach is based upon the view that a State's revenue-raising capacity is best measured by some overall indicator of State income and/or wealth. Collins (1988, p. 6) presents evidence, based upon the assumption that the State Gross State Product (GSP) per capita is the best indicator of ability to pay, that the Grants Commission's application of fiscal equalisation has not led to equity between the States. The Collins Report argues that:

> 'The fundamental issue here is the nature of the objectives of fiscal equalisation, an issue which appears not to have been squarely faced by the Grants Commission. The objective of fiscal equalisation should clearly be one of horizontal (that is, inter-State) equity . . . The Commission, in its fiscal equalisation process, has shown little interest in the achievement of horizontal equity in the sense of equal tax treatment of individuals (or families) in different States but having comparable capacity to pay . . . the equalisation process should put the States in the position of being able to arrange for the equal treatment of taxpayers in different States with comparable abilities to pay . . .
> This approach to fiscal equalisation based on the similar tax treatment of individuals in different States having similar capacities to pay is at odds with the mechanistic approach taken by the Commission . . . the Commission assigns priority to achieving the capacity to levy the same rates of tax, rather than the same burdens of tax measured against some appropriate indicator of ability to pay' (Collins Report, 1988, pp. 386-387).

The Collins Report argues that fiscal equalisation should give the States the capacity to provide public services to individuals in the same family circumstances and having the same incomes at similar standards to those provided in other States, and with similar levels of taxes and charges.

The report recommends (Collins Report, 1988, p. 398) the global approach which reflects the true, calculable, and stable taxable capacity, and overcomes the problem arising from the States changing their assessed taxable capacity by manipulating their policy mix. The best measure of taxable capacity is Disposable State household income which is calculated from ABS State Accounts Data as total household income less direct personal taxes raised at Federal and Local levels, plus the State taxes, and then adjusted for company income undistributed or remitted overseas.

Table 6.11

Commonwealth Grants Commission Outcomes and Outcomes Under the Global Approach 1987-88

	CGC Recommendation		*Global Outcome*		*Difference*	
	$m	*$ per capita*	*$m*	*$ per capita*	*$m*	*%*
NSW	3356.7	630	3689.8	654	133.1	+3.7
Vic.	2645.2	625	2639.5	624	-5.7	-0.2
Qld	2398.9	888	2454.4	908	55.5	+2.4
SA	1294.8	925	1151.4	823	-143.4	-11.1
WA	1383.5	913	1395.5	921	12.1	+0.9
Tas.	477.1	1059	425.5	945	-51.6	-10.8

Source: Collins Report (1986) p. 406.

Calculations by the New South Wales Treasury comparing the CGC grants in 1987-88 based upon the tax-by-tax partial approach, and the grants which would be forthcoming under a global approach using the measure of taxable capacity defined above, are presented in Table 6.11. The implications of the figures in Table 6.11 are clear. Where a State is provided with higher grants under the global approach (New South Wales, Queensland and Western Australia), it would be able to reduce its taxes and charges and still provide the same level of public services. Alternatively, it could provide more public services at the current level of taxes and charges.

The change to the Global Approach, while not without problems (see Collins Report, 1988, pp. 402-406), would appear to have merit and, at the very least, clearly warrants more thorough analysis and assessment.

6.3 Some Options for Tax Reform

Taking into account the equity and efficiency principles outlined above, we are now in a position to evaluate the various tax options available to broaden the revenue base of the States. In addition to correcting the inadequacies in their tax regimes, the financing problems faced by the States must be overcome if they are to remain capable of meeting their economic, social and administrative goals as outlined in Part Three.

There are two available courses of action. First, the States could generate more revenue by innovations in the tax bases currently available to them. Several possible options can be identified, which include:

- taxes on business;
- personal income tax surcharge on Federal income tax liabilities;
- taxes on wealth; and
- resource taxes.

Secondly, the States could develop revenue-raising capacity in areas previously not available to them. In this regard an obvious answer is either to change the constitutional interpretation, or otherwise provide the States with some broad-based taxing power.

Options in each of these categories are outlined below. However, the current constitutional environment dictates the relative worth of each of these options and we begin with a summary of some recent High Court Decisions.

6.3.1 The Current Constitutional Environment

As *State of Siege* has already outlined, Section 92 (s92) of the Australian Constitution is a major constraint on the revenue-raising powers of the States, although it has recently been reinterpreted by the High Court in the Cole v. Whitfield (CvW) decision ([1988], 62 ALJR p. 303). The decision appears, at first glance, to increase the States' taxation discretion.

The focus in this case was 'on the notion of freedom from burdens of a discriminatory kind to which, in our view, the history and text of s92 point' (CvW [1982], 62 ALJR p. 303). S92 was plainly aiming to create free trade throughout the Federation, and to deny any governmental unit within the Federation the powers to inhibit this trade.

CvW is important because it reviewed the previously accepted interpretation of s92 (the so-called *fons et origo* doctrine espoused in Gilpin v. Commissioner for Road Transport and Tramways (New South Wales), (1935) 52 CLR 189, pp. 205-206).

In one case relating to motor vehicle charges (Finemores Transport P/L v. New South Wales [1938] 139 CLR, p. 338), while the charges were not intended to be discriminatory (being imposed on vehicles irrespective of their use), the High Court considered that such charges on vehicles registered exclusively to undertake interstate trade were invalid under s92. This was in effect discrimination in reverse (against local traders) because it provided protection for interstate traders.

CvW sought to remedy this 'protectionism' by focusing on the intention of the State law in question. CvW (p. 303) prohibits 'the discriminatory burdening of interstate trade.' Three points were made in the decision (CvW [p. 319]):

- a law which 'in effect, if not in form, discriminates in favour of inter-State trade' will

offend against s92 'if the discrimination is of a protectionist character';
– a 'law which has as its real object the prescription of a standard for a product or service or a norm of commercial conduct will not ordinarily be grounded in protectionism and will not be prohibited by s92'; and
– 'if a law, is not protectionist in object, but discriminates against inter-State trade or commerce; it will offend s92'.

Discrimination must be of a protectionist nature to offend s92. CvW found that a State regulation (Tasmania) did burden interstate trade, but was not intended to be protectionist. The problem that is left by CvW is in deciding what constitutes discrimination upon protectionist grounds. A recent case, the first to apply the CvW principle of narrowing of s92 and increasing States' powers, is evidence that the decision is far from clear (Bath v. Alston Holdings P/L [1988]).

Accordingly, the legal straight-jacket that has constrained State taxation may be looser now than it has been in the past. The consideration of this factor is important because depending on High Court interpretations and decisions, some of the following proposals to rationalise and improve State taxes may become real alternatives, which no State will be able to ignore, in the near future.

6.3.2 Business Tax Initiatives

Groenewegen (1988) recently studied possible developments in the area of business taxation. He suggested four initiatives in business taxation:

– a State Corporate Income Tax;
– a State Retail Sales Tax;
– a State Business Tax; and
– a tax on Commonwealth Public Sector Business Enterprises.

After reviewing the overseas experience in the area of business taxation Groenewegen concludes (Collins Report, 1988, pp. 350-51):

'(i) business taxes internationally are an important component of sub-national taxation revenue, particularly with respect to corporate business income.
(ii) Corporate business income internationally is most efficiently taxed if sub-national access is given to the federal base (Canada, West Germany) either through constitutionally guaranteed revenue-sharing or through *centralised piggy-backing*.
(iii) The other potentially significant forms of business taxes are the retail sales tax used efficiently in Canada and the US and the business *property* tax at the French, Canadian and German local and provincial level.
(iv) Canadian, German and US experience likewise suggests that there is a role for motor use taxes at the State level at least in part geared to motor fuel taxes' (emphasis in original).

A State Corporate Income Tax

A State Corporate income tax could be administered in an analogous fashion to the personal income tax surcharge allowed for in the 1978 Act (previously mentioned), which would be a low cost, proportional in incidence source of revenue. As long as the surcharges were similar, distortions in company location would be avoided. Certain problems might arise concerning the preparation of taxable income for companies that earn income across State borders, although the US experience shows that this problem can be solved.

The possibility of such a tax is, however, dismissed on the grounds that it is directly opposed to the current agenda of the Federal Government, which would be required to enact legislation along the lines of the personal income surcharge law. Certain other problems relating to dividend imputation, deductability of State taxes against Federal liabilities, reinforce the essentially political rejection of this attractive (and buoyant) potential source of State revenue.

Franchise Tax Growth

It has been shown that all the States (except Queensland), have vigorously expanded the contribution of franchise taxes by increasing tax rates; by reducing the period for which a licence remains valid; and by expanding the

range of businesses subject to licensing and charges.

The range of products taxed by the States in this manner remains narrow, being confined (largely) to tobacco, alcohol and petroleum products, with small amounts gained from gas in New South Wales, Victoria, and South Australia. Franchise taxes bear similarities to retail sales or consumption taxes. An expansion of the contribution could involve more products and activities being subjected to the tax. A wider range of retail goods and services could be included by issuing licences and imposing the accompanying charges to retail establishments. Further, the States could introduce licensing (and charges) to providers of professional services such as tradespersons, medical practitioners, entertainment businesses, etc.

This is clearly a constitutionally valid area for the States to increase their revenue-raising capacity, and could be exploited in an administratively efficient and simple way. The degree of small business discrimination could be ameliorated by varying the licence period according to gross turnover.

The incidence of the franchise taxes are similar to a retail sales tax. The equity problems (lower income groups face a higher average tax rate than the higher income earners) may be reduced if forward shifting is not uniform, and is concentrated on luxury goods with higher margins. Warren's (1988) study confirms the regressive incidence of franchise taxes.

The expansion of the franchise tax by broadening the tax base reduces the possibility of distorting differentials, thus increasing the efficiency of the tax. Interstate distortions may occur (particularly at border locations) if the move to increase taxation is not uniform, although there would have to be substantial differences for capital to migrate. Evidence from the US indicates large variations in business franchise taxes between the States but only minor locational distortions arising (see Fox, 1986; Papke & Papke, 1986).

Efficiency is therefore most likely to be enhanced if:

- competitive incentives arising from differences in rates or coverage in franchise charges are minimised; and
- harmonisation of franchise taxes is a high priority of the States.

6.3.3 A State Surcharge on the Federal Income Tax

The Income Tax (arrangements with the States) Act 1978, introduced as an integral component of the Fraser Government's New Federalism strategy, gave the States powers to impose a surcharge on Federal personal income tax liabilities. Under current law, the tax would take the form of a percentage increment on the overall assessed income tax liabilities, rather than an increment on the marginal tax rates or a separate State income tax. All administration responsibilities would be retained by the Commonwealth.

Alternative State income taxation arrangements (which would require a further law change) could lead to percentage increments on each marginal tax rate, or an administratively separate State income tax structure. The latter would be administratively difficult and costly, and would increase the disharmony between the States.

What are the advantages of this option? First, the surcharge would have a similar incidence to the Federal income tax, and would give the States access to a progressive revenue source. This would overcome a major problem arising from the overriding regressivity of States' taxes.

Two qualifying points should be noted:

- it is usually accepted that State Governments should not try to redistribute income; and
- the progressivity of the present Federal income tax structure is questionable.

Second, harmonisation would be stimulated because all States would face the same tax-base and marginal tax rates, with the only State choice variable being the size of the surcharge.

Third, access to the Federal income tax base would expand the revenue-raising capacity of the States by a significantly greater degree than that arising from the feasible reforms to the existing States' tax bases.

Fourth, related to the advantage of increasing tax harmony between the States, the surcharge

also satisfies the desirable objective of increasing the simplicity of the tax system. Other feasible reforms to existing State taxes would require more complex variations and subsequent learning difficulties by the taxpayers. A simple percentage surcharge is readily understood, easily calculated, and administratively tractable.

On the negative side three major shortcomings can be identified. First, a lack of flexibility is inherent in the current option because the only choice variable available to the States is the magnitude of the surcharge. The Federal Government would continue to determine the extent of the income base and the structure of the marginal tax rates. It has been suggested that 'the States would face a major problem of unpredictability of surcharge revenue' (Collins Report, 1988, p. 325), as a result of Federal Government changes to the income tax base and/or structure.

Of course, the fact that only one policy variable is available to the States under the current legislation, which the Federal Government intends to revoke (the surcharge), is an advantage because the States would only need a simple, low cost variation to the surcharge to protect their revenue.

Second, the surcharge imposed by the States increases the effective marginal tax rates, *ceteris paribus*. The Federal Government aims to further reduce the marginal income tax rates, and to introduce a greater degree of proportionality (reduce progressivity) into the direct taxation system. With the corporate tax rate currently set at 39%, it is inevitable that the top personal income tax rate will fall from 49% (having already been reduced from 60% in July 1987), to achieve a closer parity with the company tax rate.

The push for lower marginal tax rates and increased proportionality is based on the assertion that high marginal tax rates erode work incentives, encourage an increased reliance on the welfare system, and stimulate tax avoidance and evasion strategies. *It should be clearly stated, that none of these arguments has received any unambiguous empirical support*. The argument relating to welfare abuse (if such welfare abuse occurs in any significant proportion) is not a problem of the tax system. It would arise because of an inadequate or poorly enforced work test for example (assuming that employment opportunities are available).

The fact that the Federal Government is intent on reducing income tax rates is not, in itself, an argument against the States imposing their own surcharge. Indeed, decreasing Federal taxation provides the States with more room to impose a surcharge, without a net increase in the overall direct tax burden (compared to the present). Some argue that the Federal Government would feel thwarted and retaliate by reducing Federal payments to the States. This is tantamount to saying that there is some level of State revenue which the Federal Government has targeted. As a basis for federalism, such a view would be untenable.

Third, unless all the States imposed a more or less equal surcharge, the so-called double taxation might provide incentives for labour and capital to migrate to the States without a surcharge (or with a lower surcharge). This argument was used in the successful campaign to abolish death duties. In fact, little evidence is available to support the hypothesis that significant resource migration occurs between States as a result of tax changes.

It has already been argued that there is considerable disharmony among the respective State tax structures at present. The change in the degree of distortion between States would depend upon how the surcharge was introduced (for example, whether it was revenue-neutral or not; uniform or not). A revenue-neutral or a uniform surcharge would be an unlikely source of interstate migration.

Double-taxation already occurs in the States' taxation structures. What evidence is there to suggest that it is easier to evade direct taxation (through migration), than it is to evade indirect taxes?

6.3.4 Death Duties and Wealth Taxes

Wealth taxes can be imposed on an annual (or periodic) basis, or at the time of transfer by bequest or gift. Taxation of bequests (death duties) may take the form of estate taxes, or inheritance taxes which are imposed on the heirs. State Death Duties are no longer used by the States but are valid under the constitution. These taxes would enhance equity goals and

would not promote major distortions in resource use.

States could impose a tax on the estate (prior to transfer) or on the heir (following transfer). Various objectives for death duties have been identified in the literature, and the specific form of the tax will depend on the objective chosen. First, society may choose to restrict wealth transfers following death. Thus a person relinquishes his/her right to use their property upon death. An estate tax with varying thresholds and rates of tax would be appropriate. Second, society may also wish to restrict wealth attainment independent of one's own labour. An inheritance tax would be the appropriate form of the death duty in this case. Third, inheritance contributes to the concentration of wealth, which suggests that a progressive tax on the heir is applicable if a more equal distribution of wealth is desired.

Most US States impose death taxes of an inheritance type with progressive rate structures. Progressivity is based on two considerations:

- the size of the individual shares in the estate; and
- the basis of the relationship between the deceased and the heir (the rate reducing as the closeness increases).

Death duties have both efficiency and equity effects. The main allocative effects include an increase in business mergers and property management distortions; distortions to labour supply; and effects on consumption decisions. The introduction of death duties may stimulate business mergers and distort the management of property. The uncertainty of the amount of tax and the problems of liquidity necessary to pay the tax may promote small business mergers with large corporations to avoid dissipating wealth in the form of cash. Liquidity worries affect the composition of asset holdings, with a bias towards marketable assets being introduced. These effects are sensitive to the administration of the tax, and where arrangements like the one-year instalment payment scheme are used (in the US) these distortions are small.

A death tax might change a person's decision to work or retire, in a similar way to an income tax. Economic theory is ambiguous here. The evidence is that the measured effect on work effort of income taxes does not appear to be large.

There are offsetting forces operating on consumption (savings). First, if a person desires to pass on wealth, they will save more rather than less to accommodate the tax. Alternatively, the anticipation of the tax may lead to a person avoiding accumulation and passing on the excess as consumption (for example, by increasing educational expenditure on children). However, as the tax is imposed at the end of life, severe behavioural changes are unlikely.

The distributional effects are likely to be progressive because the inequality of wealth is generally greater than for income, the size of estate transfers usually increases with income, and high exemptions are common. US evidence indicates that the burden of taxation is not shared evenly at the high income levels because of the different efforts undertaken to explore loopholes.

The design of the tax should attempt to achieve four main objectives:

- as an explicit device for breaking-up large fortunes, the tax structure should be progressive;
- the proximity of the heir to the descendant should be considered. Less taxable capacity is transferred to an immediate relative (for example, a spouse) than a more-distant heir;
- the tax rate should not discriminate according to the time of giving or the form in which the wealth is transferred. The death duty should minimise the effects on choice of methods of transferring wealth;
- the tax should minimise business effects, like those pertaining to liquidity problems of closely-held business assets.

If all these considerations are included in the design of the tax, the efficiency effects are likely to be small, while the equity effects are likely to be significant.

Death duties are a valid State tax and possess very desirable equity features. The problem is that they are highly susceptible to destructive tax base competition between the States,

which led to the abolition of the tax across all States. They are also unpopular and subject to considerable evasion. For practical reasons alone it is hard to recommend them as a panacea for the States' financing problem. However, if a death duty was levied at the Federal level, and the proceeds returned to the States, the problems of tax competition could be minimised, while the effects on low-income earners could be avoided through the use of an indexed threshold. As the Collins Report concludes, even at the low rate of 2%, a wealth tax with a generous exemption level of $500,000 could raise $400m in the State of New South Wales alone (Collins, 1988, p 361).

6.3.5 Indirect Taxation

The Federal Government levies four taxes on goods and services: Customs Duties; Excise Duties; the Crude Oil Levy; and a Wholesale Sales Tax. These taxes contribute around 32% of total Federal taxation revenue. It is important to realise that the imposition of a particular tax can be motivated by a variety of non-revenue reasons. For example, Customs Duties are an integral component of Industry policy; excise duties are levied to inhibit the consumption of tobacco; and the Crude Oil Levy is aimed at assisting local oil exploration.

The existing Wholesale Sales Tax (WST) is a narrowly-based tax on commodities alone. *In 1987-88, the collections increased by a massive 18.9%, and the current Budget estimate for 1988-89 is for a 14.4% increase. Both these rises are well in excess of the inflation rate. The WST is beset with problems. Its narrow base requires higher tax rates to yield a given revenue level; consumption and production distortions arise from the differential rate structure; different tax burdens arise because individuals with equivalent incomes have different consumption patterns; and it is costly to administer the array of exemptions and tax rates.*

The States already impose an assortment of narrow-based indirect taxes, although not all of them are explicit. For example, the State franchise taxes (imposed on turnover generated in the previous financial year) are not legally considered to be sales taxes but are in fact quasi-sales taxes.

Warren (1987, pp. 87-88) concludes that:

> 'there is a strong case for a rationalisation of the Australian indirect tax system. Studies of tax incidence such as those by Warren (1987) highlight the potential to replace the current array of indirect taxes by a single broad based goods and services levy with only minimal effects on tax incidence.'

Australia's problem is it collects the same ratio of indirect to total taxes as the OECD, generally from a base of four commodity groups (tobacco, alcohol, petroleum and motor vehicles). There would be large gains from rationalising the maze of State indirect taxes; a broad-based State Goods and Services Levy (SGSL) would also provide a basis for further revenue neutral indirect tax rationalisations (See Warren, 1987, pp. 89-90).

Warren's conclusions together with the analysis above indicate the States' reliance on a narrow and regressive band of indirect taxes. Coupled with the Federal Government's increasing reliance on a somewhat ramshackle indirect tax regime, there is substantial potential for the reform of indirect taxation as a whole, in a program of rationalising and improving the revenue base of the States.

6.3.6 Resource Revenue and its Distribution

A significant source of tax revenue growth for the States could come from natural resource developments. Currently, all the States gain some revenue from this source.

Mineral wealth is unevenly distributed throughout Australia. There is a stark geographic separation between the mining and manufacturing industries, as a result of mineral discoveries well away from the populated areas.

The Constitution does not specifically discuss mineral resources. The States traditionally did not gain significant revenue from their natural resource deposits directly (by State royalties), preferring to use them to entice other industry. Rising international resource prices during the 1970s prompted the Federal Government to introduce mineral export controls (to inflate prices further), market sharing among the States, and used its foreign trade powers to control such things as foreign ownership. A landmark 1975 High Court decision

gave the Commonwealth the power to own and control offshore oil and other resources. This was modified in 1979 and rights were shared with the States.

A resource rent tax (RRT) would begin at some threshold profit rate, which ideally would represent the opportunity cost of capital in projects of similar risk. It is not the same as a straight royalty because it allows for the recovery of capital costs before payments are required, thereby allowing for projects of differing scale and costliness.

A RRT could distribute net revenues (among the Federal and State Governments), with cash-bidding for rights to develop projects considered desirable. This system overcomes the major problem with a fixed front-end payment of ignoring different set-up and extraction costs.

A major difficulty in designing a RRT (or any taxing instrument) is the lack of clarity between Commonwealth and State taxing powers in this area. Resource developers, especially those from overseas, are likely to approach investment with a great degree of uncertainty, given the lack of clear agreements on taxation between the two levels of government.

The question arises, given the likely sharing of tax powers between the Commonwealth and the States, as to the most appropriate allocation of these powers between the two. For onshore resources which are owned unambiguously by the States, the auction system and subsequent revenue flow should be left to the States. This should be seen as a growth in revenue capacity for the States, rather than a revenue-neutral change achieved by reducing equalisation payments.

For efficiency reasons, the RRT should be harmonised across all States. Because of the uneven distribution of the mineral resources, the Commonwealth should collect the RRT (thereby ensuring tax harmony across all States), and adjust the equalisation accordingly.

6.4 The Tax Reform Package

6.4.1 Rationalising the Federal System of Indirect Taxation

'We accept that there is potential to rationalise the existing wholesale sales tax and extend into selected areas (sic) indirect taxation provided there is adequate compensation and that concerns about inflation and employment can be met.'
ACTU Policies & Strategies Statement, 1985, pp. 39-40

Of all the options available to overcome fiscal 'siege' of the States, the one offering the best mix of efficiency and equity is a reform of the Federal system of indirect taxation. This has the potential to achieve three major benefits. It could:

- rationalise economically irrational and distortionary taxes;
- provide a more stable and accountable fiscal base for the States; and
- ensure that a clear compensation package for regressive taxes is developed for low income and needy groups.

A State Goods and Services Levy (SGSL)

The best vehicle for reforming the Federal system of indirect taxation is through the introduction of a State Goods and Services Levy (SGSL), which would replace the Federal Wholesale Sales Tax and a range of State indirect taxes. The SGSL would be levied on forms of private final consumption expenditure (excluding residential accommodation, gambling, financial services, education, public administration and defence) with the Federal Government assuming responsibility for its collection and distribution back to the States. The SGSL would also involve a comprehensive compensation package in order to offset any inequities of the levy for low income groups.

In designing an SGSL to replace existing State tax bases, which are narrow and highly discriminatory, *the current proposal is clearly not equivalent in any form to Option C, which was correctly rejected at the Tax Summit in 1985. Option C sought to alter the tax mix at the Federal level away from direct taxation towards indirect taxation. The problems of regressivity that this move raised were sufficient to reject the proposal.*

Two of the most important aspects underlying the introduction of a SGSL are the maintenance of the progressivity of the overall

tax/transfer system, and the imperative that a shift to indirect taxation does not give rise to an increase in Australia's underlying rate of inflation.

It is assumed, therefore, that the Federal Government would continue to pursue progressivity in the net budgetary incidence. Clearly, this was a vital concern at the 1985 Tax Summit because the question was one of changing the Federal Tax Mix from direct (progressive) to indirect (regressive) taxes. (As is argued below there are a number of initiatives which should continue to be undertaken in this regard and need to be investigated through a Wealth Inquiry.) In terms of our analysis, the suggestion is to alter the mix of indirect taxes per se, from more regressive (and discriminatory) to less regressive (less discriminatory) sources of taxes.

The SGSL would not increase the overall degree of regression. The crucial consideration is, of course, the degree of progression which applies in the taxation/welfare system overall. An SGSL would allow the States to rationalise the ragbag collection of indirect taxes that they currently rely upon for own-tax revenue, but which clearly are regressive and distortional. The extent to which the SGSL would allow a rationalisation of the existing State indirect taxes depends on the coverage, rate and other design features of the tax.

To generate some reasonable estimates of the proposal, the following assumptions are made:

- the SGSL is collected at the retail level;
- the current Federal Wholesale Sales Tax (WST) is abolished and the Commonwealth revenue loss neutralised; and
- the SGSL covers all Private Final Consumption Expenditure (PFCE) except those listed in 1985 (Draft White Paper [DWP], 1985, p. 118).

A single-rate SGSL is considered here. However, there are trade-offs in the design and implementation of any tax reform which would have to be considered. Bearing in mind the fact that the present taxes involve considerable administrative costs, the simplicity gains alone of a broad-based retail sales levy on goods and services are worthwhile.

What should be included in the Base? This is a contentious matter which requires careful evaluation and discussion. In general, this comes down to the question as to whether essentials (food, clothing, heating, power and housing costs) should be included. On simplicity grounds and in order to reduce the discriminatory impact of the reform, the tax would be as broad as possible.

Table 6.12 shows some estimates of the revenue potential for various rates. The base is the PFCE for 1987-88. It should be noted that the available data for 1987-88 is not sufficiently disaggregated to decompose the expenditure according to the categories exempted. As an approximation, the base excludes dwelling rent; gas, electricity and fuel; post and telephone; and financial services.

The base includes food; cigarettes; alcohol; clothing, footwear, and drapery; household appliances; other durables; health, fares, motor vehicle purchases and operating expenses; entertainment and recreation; and other expenditure on goods and services. The total base subject to the State goods and services levy is $126, 277m, and it is assumed that the WST revenue ($7, 561.5m) is netted out.

Table 6.12

Sensitivity of State Goods and Services Levy Revenue to Different Tax Rates

1987-88

$m

	6%	*8%*	*9%*	*10%*	*12%*
Gross Revenue from SGSL	7576.6	10102.2	11364.9	12628.0	15153.2
Less WST Revenue Lost	7561.5	7561.5	7561.5	7561.5	7561.5
Net Revenue	15.1	2540.7	3803.4	5066.2	7591.7

There are important qualifications that must be made with respect to the estimates in Table 6.12. There is no attempt to estimate the price elasticity of the items in the base. It is likely that if the incidence of the SGSL is fully shifted to final consumers, various substitution and income effects will occur. The abolition of the WST would result in relative price changes and variations in the size of the base. Further, no attempt has been made to adjust beer excises to maintain a CPI neutral result in terms of beer (see DWP 1985, p. 124).

A major criticism of the Option C proposal which has some relevance to the current proposal relates to the CPI effects of the SGSL. For any good subject to the SGSL, but not currently subject to the WST, the retail price would rise in proportion with the tax rate. The price change for a good currently under the WST would equal the difference between the WST rate and the SGSL rate, with rises and falls occurring as appropriate.

While these effects would also occur under the current plan, several offsetting factors (which would reduce the pressure on the CPI) can be identified. These effects were absent in the Option C proposal. The current plan involves the substitution of SGSL revenue for revenue raised by the existing narrow-based taxes at the State level. The existing taxes vary in terms of their distortional impact. Distortions increase costs and reduce efficiency. The greater the revenue contribution from more efficient taxes (like the SGSL) the lower the pressure on the price level. So in the period following the transition, the CPI effects should be moderated as resources are reallocated and efficiency gains are made.

A broad view of the amount of revenue-substitution which can be achieved through the introduction of the SGSL can be gauged from Table 6.13, which shows in some detail the revenue contributions from the existing taxes imposed by the States in total. An SGSL levied at a rate of 9%, for example, would raise around 21% of total State taxation revenue after the WST revenue is given back to the Federal Government. A 10% SGSL raises around 27% of total revenue.

In specific terms, a 9% SGSL could, for example, completely replace all Stamp duties and Other Property tax revenue. Similarly, a 10% SGSL could replace all Payroll tax revenue and, say, a third of stamp duty revenue.

If the States were seeking to provide significant stamp duty concessions to first-home buyers to alleviate some of the burden of high interest rates, then this type of substitution would prove attractive. Employment would be stimulated if payroll taxes were abolished.

Table 6.13

Total State Taxation 1987-88

	$m
Payroll Taxes	4033.1
Taxes on Property	
Immovable	4052.2
Stamp Duties	3507.3
Other	452.5
Taxes on Provision of Goods and Services	2482.8
Taxes on Use of Goods and Services	
Motor Vehicles	1884.8
Franchises	1567.2
Other	35.6
Fees and Fines	932.8
Total	18948.2

Source: ABS Government Financial Estimates, Australia 1987-88, Cat. No. 5501.0.

The question of which taxes would be abolished at a State level would have to be determined through the consultative mechanism provided by the new Premiers' Conference Secretariat. This consultative process would have to take into account:

– the relative contribution that each State tax makes to each individual State's revenue;
– the rate at which the SGSL is set; and
– the amount of revenue collected and distributed back to each State from the SGSL.

However, the following options are canvassed here for further debate. The introduction of the SGSL could result in a number of offsetting tax reductions. The analysis in this chapter has assumed the SGSL would replace the Federal WST and after compensating the poor for real income losses, the net revenue could then be used to replace (or reduce) a number of taxes currently levied by the States.

Option 1:
Assume that the SGSL is 10% and the WST is replaced.

The $5066.2m net revenue for 1987-88 (excluding a base figure of 20% of net revenue for compensation measures) could replace a package of taxes at the State level. If this option was taken up each State would determine its own basket of taxes to abolish in consultation with community representatives, the other States and the Federal government. Possible packages could include: the abolition of all State payroll taxation; or the abolition of all stamp duties with some cuts to payroll tax; or the abolition of selected regressive State taxes (such as FID and/or stamp duties for first home buyers); or the abolition of State taxes which most impact on families whose income is from $0 to average weekly earnings; or the abolition of State taxes which have the most dramatic impact on inflation and standards of living or finally, tax cuts of over $4 billion across all State taxes, fees and fines could be delivered. Studies of the desirable socio-economic effects of each package would need to be put forward and evaluated as part of the tax reform process.

Option 2:
The Federal Government could reduce the equity impact of the SGSL by abandoning the WST but increasing its excises on luxury items. The States would then have more net revenue from the SGSL which means that the compensation packages could be more attractive; and/or the taxes replaced could be more wide ranging.

The increased excises would place a higher cost on luxury items so that equity would be achieved, not by reducing the taxes to lower-income groups, but by increasing them for higher-income groups. If the increased excises were targeted towards imported goods, disincentives to spend on imports would result. At a macro-economic level, such disincentives could help improve the current account problems without endangering equity.

Equity Effects
Two particular issues should be taken into account when considering the question of equity and the SGSL. First, as Neil Warren has recently argued, public finance analysts typically examine the reform of one tax in isolation from another, that is, they present arguments 'which might have substance if no other taxes were being considered'. However, he goes on to point out that '. . . if the tax change is part of a package of tax reforms, then it might be possible for the inequities of one reform to be offset by the equity improvement resulting from another' (Warren, 1987, p. 32). This point is particularly relevant to the option of the State Goods and Services Levy being used to replace regressive State taxes. The proposal for an SGSL acknowledges the need to fully compensate low income and needy groups who currently are not compensated for the regressive effects of indirect taxes.

Second, the SGSL is a vehicle of reform to the Federal system of indirect taxation. The evidence presented above indicates that there is already a move from direct to indirect taxation. Between 1981/82 and 1987/88, revenue from the Federally-levied Wholesale Sales Tax rose by 51% and the revenue obtained from business franchises at the State level rose by 93.9% and, while there is a need for further study of these rises, the possibility that *a consumption tax is being imposed by stealth* is of considerable concern. It is only by analysing the drift in differ-

ent taxes across the levels of government that this event can be confirmed. However, there has been no debate or concern about this development and there is a clear need for public scrutiny of it. The inequity of the current regime of indirect taxes is also of considerable concern. There is currently no compensation accorded to low income and needy groups who carry the greater burden of paying levies such as the Federal Wholesale Sales Tax and other regressive State taxes and charges.

One of the purposes of an SGSL, as defined above, would be to eliminate the problems of a consumption tax by stealth and the temptation to increasingly rely upon a narrow and *ad hoc* range of taxes. It would make make any growth in the collection of indirect taxation explicit and ensure that there is no move away from the overall reliance on direct personal and corporate taxation.

Some Tentative Analysis of the Distributional Impact of the SGSL

The question of equity impact of an SGSL is not as straightforward as is often presumed. Certainly, the impact of the SGSL will be felt directly in the form of price rises of all goods and services which are included in the base. Lower income groups are disadvantaged disproportionately in relation to higher income groups because the expenditure on staples as a proportion of their income is higher. The CPI effects of the SGSL could be reduced by imposing price neutral conditions on goods currently subject to excise duties. This would have to be determined in the context of the previous discussion concerning the taxing of bads.

However, these equity-price effects are offset to some extent by the fact that the SGSL would replace (or reduce the impact of) a number of other regressive taxes. Currently, a person may have to pay small amounts to the States for a variety of reasons. For example, a person pays taxes or charges to obtain a licence to drive, to register a vehicle, to trade a vehicle, to buy a first or subsequent home, to obtain copies of birth and death certificates and the like.

Over time, these small regressive amounts add to considerable sums. It is therefore likely that the price effects of the SGSL would be substantially offset by a reduction in these imposts, if we analysed trade-offs over an extended period of time. Ensuring that price movements reflect the balance between the reduction of existing taxes and the introduction of the SGSL could be a role undertaken by State prices authorities (see Part Three).

In designing a State tax reform package centred around the SGSL, we must ensure that the taxes that we replace (reduce):

- are not serving to reduce the production and/or consumption of bads;
- are relatively distortionary with respect to resource allocation
- are relatively regressive.

In this regard, a detailed study should be made to determine the relative allocative and equity aspects of the range of taxes currently levied by the States.

We have some information (Warren, 1988) which allows us to make some educated guesses about the likely gains from the introduction of the SGSL. However, the exact nature of the trade-off between the SGSL and the current taxes needs to be calculated after a detailed analysis is made of the complex effects that would result.

The 1984 Household Expenditure Survey, Australia (HES) is the most recent source of data measuring levels and patterns of expenditure on goods and services by private households in Australia. It allows us to analyse the distribution of household expenditure and income.

The HES provides data on household expenditure by household income decile group at the time of the survey. Some summary results are shown in the Table 6.14 below which relates the percentage of total expenditure for selected Gross Weekly Income (GWI) Groups for broad commodity or service groups.

The poorest (in terms of GWI) spend much more on current housing, fuel and power, food and non-alcoholic beverages, tobacco, household equipment, and medical and health than the average household. The top 10% GWI household spends more on alcoholic beverages, clothing and footwear, medical care and health, transport, recreation and miscellaneous, than the average household.

Table 6.14

Household Expenditure by Household Income Decile

	Lowest 10% ($0-113)	*Third 10% ($172-235)*	*Six 10% ($388-472)*	*Top 10% ($861+)*	*All HH*
			% of Total Expenditure		
Current Housing Costs	17.18	12.27	14.20	10.21	12.84
Fuel & Power	4.56	3.91	2.95	2.26	2.92
Food and Non-Alcoholic Beverages	23.40	22.94	19.83	17.87	19.68
Alcoholic Beverages	2.44	2.82	3.53	3.83	3.40
Tobacco	1.83	2.09	1.80	1.07	1.58
Clothing & Footwear	4.99	5.93	5.70	7.79	6.48
Household Equipment etc.	12.30	12.93	12.20	11.35	11.99
Medical & Health	4.13	3.59	4.05	3.55	3.89
Transport	10.11	15.83	15.88	17.17	16.31
Recreation	10.73	10.90	12.23	14.09	11.92
Personal	1.83	1.78	1.74	1.86	1.83
Miscellaneous	6.50	5.03	5.89	8.96	7.17

Source: (ABS, Cat. No. 6530.0).

A rough guide to the dollar loss as a result of different rates of the SGSL can be calculated. It should be noted that the expenditure categories used by the HES are not entirely congruent with the categories used in the Draft White Paper (DWP) produced for the 1985 Tax Summit or those used to assemble the estimates in Table 6.15. The estimates discussed in this Section are very broad and are intended to provide some ball-park numbers to help focus the debate.

The following figures are very much an overestimate of the real income loss because first, there has been no deduction for the savings to each household resulting from the abolition (reduction) of the WST, nor second, any deduction for savings resulting from the reduction or abolition of existing taxes. The calculations displayed in Table 6.15 assume that the SGSL is passed on fully to consumers in the form of higher prices. The average household GWI was $453.60 which would be placed in the sixth decile.

These estimates are based on 1984 prices and incomes. Two adjustments can be made to provide a rough guide to the net impact on real expenditure of the introduction of the SGSL and the abolition of the WST (measured as at 1987-88 which is the latest year that tax and national accounts expenditure data is available). First, the figures can be scaled up to reflect inflation. Second, the benefits of abolishing the WST can be estimated if certain assumptions are made concerning the distributional impact of the tax.

Table 6.15

State Goods and Services Levy — Estimated Real Income Loss

			Gross Weekly Income			
Rate of SGSL (%)	*0-113 Lowest Decile*	*172-235 Third Decile*	*315-387 Fifth Decile*	*473-564 Seventh Decile*	*861+ Highest Decile*	*All Households*
			Weekly Dollar Loss			
6	6.61	12.05	16.10	20.81	36.02	18.28
8	8.81	16.10	21.42	27.75	48.03	24.38
10	11.02	20.10	26.78	34.70	60.00	30.48
12	13.22	24.10	32.14	41.63	72.00	36.57

To get some idea of the WST savings, we assume that the total WST revenue for 1987-88 ($7, 561.5m) is spread across the households in the respective GWI groups in proportion to the HES expenditure distribution in 1984. This is an imperfect method of assessing the savings, but in the absence of actual data any method will be *ad hoc*.

The estimated annual savings from the abolition of the WST for each household in each GWI group are reported in the Table 6.16 below.

Table 6.16

Estimated Annual Savings — Abolition of Wholesale Sales Tax

Household Gross Weekly Income				
0-113 Lowest Decile	*172-235 Third Decile*	*315-387 Fifth Decile*	*473-564 Seventh Decile*	*861+ Highest Decile*
Per Annum Dollar Saving Per Household				
587.69	*987.94*	*1,363.25*	*1,724.33*	*2,954.20*

Combining these savings with the dollar loss figures (inflated and annualised), a very rough guide to the extent of the distribution of the net loss arising from the introduction of the SGSL (based on 1987-88 data) can be calculated. The gross figures (ignoring any savings from the abolition of the WST) are reported in the Table 6.17 below.

Table 6.17

Total Gross Loss — State Goods and Services Levy

	Gross Weekly Income				
Rate of SGSL (%)	*0-113 Lowest Decile*	*172-235 Third Decile*	*315-387 Fifth Decile*	*473-564 Seventh Decile*	*861+ Highest Decile*
	Inflation Adjusted Gross Dollar Loss — 1987-88				
6	409.02	745.65	996.27	1287.72	2228.90
8	545.16	996.26	1325.47	1717.17	2972.10
10	681.91	1243.79	1657.15	2147.24	3712.80
12	818.05	1491.30	1988.82	2576.06	4455.36

The inflation-adjusted per annum net loss (taking into account the WST estimated savings) are shown in Table 6.18. While some questionable assumptions were employed in their derivation, the magnitudes involved indicate that poorer households would be worst-off once the SGSL reached 8%, whereas households on higher GWI would only suffer a disadvantage at SGSL rates over 10%.

Table 6.18

Real Loss — State Goods and Services Levy

	Gross Weekly Income				
Rate of SGSL (%)	*0-113 Lowest Decile*	*172-235 Third Decile*	*315-387 Fifth Decile*	*473-564 Seventh Decile*	*861+ Highest Decile*
	Inflation Adjusted Net Dollar Loss (Gain) — 1987-88				
6	+178.7	+242.30	+366.98	+436.61	+725.30
8	-42.6	-8.32	+37.78	+7.16	+17.90
10	-94.2	-255.85	-293.90	-422.91	-758.60
12	-230.4	-503.36	-625.57	-851.73	-1501.16

The annual cash grants which would make an average household in the lower deciles neutral to the change are indicated in these figures. For example, the total annual cost of compensation for a 10% SGSL to every household in the lowest decile would be around $47.1m (using the HES estimate of the number of households in each decile). It is reiterated, however, that the price effects of reducing or abolishing certain existing State taxes have not been calculated, and the compensation required may, in fact, be less than that calculated above.

Compensation Options

As we have already seen, a State goods and services levy is tantamount to a flat rate tax on retail expenditure. If the index used to measure equality is income, then such a tax is inequitable (horizontal equity) because households with the same income have varying savings propensities and therefore pay different amounts of tax. Conversely, the tax is equitable if the index is expressed in terms of consumption. In terms of *vertical equity,* a SGSL would be proportional with respect to consumption and regressive in terms of income. Consumption as a percentage of income declines as income increases.

Regressivity can be moderated in a number of ways. The introduction of exemptions of necessities (like food and clothing) or, alternatively, multiple rates (higher rates on luxuries) are obvious methods. These complications may, however, add administrative difficulties and distort consumption and production choices. It is also difficult to assess the distributional impact of these variations. On this point it has been argued that:

> 'the tax revenue foregone by such a blanket concession . . . [exempting food and clothing] . . . would greatly exceed that required to compensate the low income earners for any regressive effects of the indirect tax on food and clothing prices' (DWP, 1985, p. 120).

In this regard, an alternative method of reducing regressivity is to provide certain income groups with credits against income tax (equivalent to tax-free expenditure). Various credit schedules could be used (flat-rate, sliding-scale etc.). For zero income tax payers a direct refund is given (assessed at the tax-rate capitalised value of the per person credit).

Although a credit scheme can eliminate the regressive features of the SGSL, two problems arise:

- there might be difficulties in the direct payment provision for low income groups; and
- the regressivity at high incomes is unavoidable. Other taxes have to be relied upon to introduce the progressivity at this level.

The best alternative is for the States to use Federal support schemes like the Family Allowance Supplement as means of compensating for the SGSL because the costs of implementing compensation would be lower and easier to understand. In the same way the SGSL would have to offset the Federal loss of the Wholesale Tax revenue, the States could also offset the revenue required to implement the compensation package through the Federal transfer system.

The introduction of the SGSL would amount to a reduction in the purchasing power of disposable income. Two possible approaches to compensation include:

- compensation for the additional consumption required, or
- compensation for the reduction in real disposable income.

It is also important that low income groups dependent entirely on income support payments should be compensated fully through that system (that is, by increases in entitlements). Other low income groups not dependent on the income support system should be compensated either through a cash transfer or through an entitlements system which generates relief from the SGSL.

How it Could Be Implemented

A Constitutional amendment to facilitate the proposed introduction of an SGSL is unlikely, although the discussion above in relation to the recent Coles v. Whitfield decision in the High

Court certainly makes the situation more fluid. The s92 constraint in certain respects is not necessarily bad because separate State retail sales levies introduce the potential for disharmony. Different rates and exemptions across States could lead to locational distortions, particularly along border areas, although the US evidence suggests that the extent of such inefficiencies is minimal.

The most desirable arrangement, given the Constitutional rigidities, would be *a piggybacking agreement* between the Federal and State Governments. In this case the Federal Government would impose the tax, and give the States access to revenue from a uniform base and rate structure. Minimal efficiency losses would occur, although some equity problems would persist. The problems could be redressed within the structure of the tax by exemption and/or credits (with some general efficiency losses at the national level); or could be solved by progression in, say, the income tax structure.

In the limit, the States could receive all the revenue (distributed as if the tax was imposed at the individual State level). Thus, the Federal Government would merely be acting as an agent of the States in order to bypass the Constitutional constraint.

The States would in turn abolish or downgrade some of the other more discriminatory taxes (like payroll taxes). The net gain in efficiency (with essentially neutral equity outcomes) would stimulate growth and stabilise revenue capacity. At a national level, there would be a once-off price level effect, reflecting the shifting of the tax onto the consumer, although the increased efficiency resulting from a replacement of more discriminatory taxes by less discriminatory taxes would help contain any adverse price rise.

The proposal certainly implies a substantial degree of uniformity between the States. This uniformity is in fact highly desirable. Importantly, the proposal would accomplish three desirable goals of tax reform:

- it would provide the States with a more reliable, buoyant, and neutral (less discriminatory) revenue source;
- it would negate any incentives for the States to compete away the revenue capacity from mobile tax bases; and
- it would maintain the individuality of the States in terms of their respective budgetary discretion.

In other words, standardisation of a significant portion of the States' overall tax base does not inevitably reduce their individual freedom to choose a particular budgetary stance. It is important to harmonise – with a high degree of standardisation – the mobile tax bases. While some divergences between the rates imposed by individual States are tolerable (given the costs of mobility), the States should accept that a substantial degree of tax base (and rate) consistency is preferred.

However, the States could still achieve fiscal discretion by imposing varying rates on the immobile tax bases. If a State desired to achieve a low tax/low expenditure outcome it could adjust its taxation on its immobile tax bases. A high tax/high expenditure State could overcome the uniformity arising from the broad-based (consistent) SGSL by levying higher relative charges on its immobile tax bases. Where size considerations interfered with such discretion, adjustments could be made via the process of fiscal equalisation.

However this sharing/choice trade-off is achieved, the implication of tax reform in each State is that all States and the Federal Government will have to increase the degree to which they cooperate on tax matters. *As Part Three recommends, the Federal and State Governments should establish some formal institutional framework through the Premiers' Conference to enhance the degree of cooperative federalism, through close consultation, aimed at developing shared tax bases, and non-competitive, individual tax initiatives at the State level.*

6.4.2 Other Tax Measures

Although the SGSL forms the major recommendation of this book, other tax initiatives should be investigated by the Premiers' Conference Secretariat. These include:

Wealth Tax

In the interests of social equity and public revenue generation it is vital that a national

inquiry into the distribution of wealth be established. The terms of reference for this inquiry should include consideration of: the adequacy or otherwise of the existing Federal capital gains tax as a wealth tax; and the scope for further wealth taxes, such as annual net wealth taxes and death duties. If this inquiry supported the introduction of additional wealth taxes, a proportion of the revenue so-gained should be returned to the States, as compensation for the loss of death duties.

Land Tax

State Governments should seek higher land tax payments from Australian non-residents and endeavour to plug the loopholes allowing transfer of ownership to other parties without the knowledge of State tax authorities.

Stamp Duties

Along with the possible abolition of stamp duties for homebuyers made possible through the introduction of the SGSL, the States should investigate the possibility of applying stamp duties to vendors rather than buyers. The abolition of stamp duties on cheques is also recommended as part of the SGSL package. Each State should also agree to significantly rationalise the multiplicity of minor duties applicable on documents such as Letter of Power of Attorney, Letter of Allotment and Letter of Renumeration etc which are not cost effective to collect.

Franchises on Petroleum Products

The equity impact of abolishing franchise taxes on petroleum products would be positive. As indicated in Table 6.14, lower income groups spend more on fuel and power than the average household. However, environmental factors should be taken into account when considering the rationalisation of petroleum franchises.

Motor Taxes

A distinction should be made between taxes specifically designed to finance expenditures relating to motorists and roads and other general revenue taxes on motor vehicles.

The costs of roads, road use, road damage and administration of motoring and roads should be met from various road user charges and taxes designed specifically to finance expenditures relating to motorists and roads, and their revenue, together with specific allocations from the Commonwealth, should cover the costs of road construction expenditure, maintenance and the administration of roads and motoring. Motoring taxes on heavy vehicles should be increased to the point where the costs of road damage inflicted by these vehicles are fully recovered.

Longer licence fees and reduced registration fees in all States should be considered as part of the package offered up to supplement the SGSL.

Alcohol & Tobacco Franchises

A greater percentage of the revenue from tobacco and alcohol franchises should be earmarked for health expenditure following the Cain Government's initiative in this area.

Financial Institutions Duty

As part of the SGSL package all States should immediately index and adjust the FID single receipt threshold to a new limit of $1.5m (see Collins Report, p. 266).

Interstate Tax Competition and Harmonization

The Premiers Conference Secretariat should pursue all avenues to promote harmonization of State and Federal taxes. In particular it should examine the merits of establishing an Interstate Tax Commission for promoting interstate tax harmonization.

Chapter 7

NON TAX REVENUE: STATE PRICING AND CHARGES POLICY

7.1 Introduction

State Governments also generate revenue through non-tax charges or payments to government bodies for the provision of a particular good or service. This revenue includes public transport fares, gas and electricity charges and rates for services such as water provision.

There is another reason, too, for considering government bodies' pricing policies. That is, some public undertakings provide inputs to downstream, private sector, industries. In this regard, electricity and telecommunications rank most highly (IAC, 1989, pp. C-5 to C-6). However, it is important that the impact of their costs on downstream industries is not exaggerated. In this regard, the Elcom discussion in Chapter Ten is particularly illuminating. Such undertakings are also significant in governments' capital spending programs and, as such, pricing policies are an important consideration for debt-servicing by government.

There have been some attempts to establish general principles for pricing and charges at a State level in recent times. The 1989 IAC Draft Report on Government Non-Tax Charges (IAC, 1989) advocated that charges should not be too high '. . . otherwise industry costs are necessarily increased and competitiveness is impaired', nor too low because '. . . charges which are below efficient costs of supply advantage user industries. However, the resulting implicit subsidies have to be compensated for by charging other users more, or through higher taxes or by reduced government spending'. According to the IAC, exposing public agencies to competition is the best means of ensuring that prices and charges were 'just right' (IAC, 1989, pp. 79-80).

While the IAC cursorily summarises some of the administrative reforms which have been articulated in Part Three of this book, in the end it favours exposing public organisations to competition with the private sector and the privatisation option (IAC, 1989, p. 80). There are two fundamental problems with such a strategy. First, public trading enterprises are often used to cross-subsidise social functions which is only possible where the profits on the commercial operations are protected; and second (as noted in Chapter Five) there exist a class of public undertakings which meet the conditions necessary to justify a 'natural' monopoly (eg. large reticulation infrastructures like electricity, water and gas). Furthermore, as we have already established in Chapter Five, there are many contexts in which competition would not ensue through either privatisation or the breaking up of public enterprise markets. The text book world of competitive pricing rarely prevails in areas of public provision.

The fact is that there is no single principle for determining the prices and charges of government enterprises. State Government organisations vary in terms of the type of service that they provide: regulatory; public goods; private goods; mixed goods. The three broad methods of financing – governmental (taxes etc), market (user-charges), and mixed – follow logically from this distinction. For example, some organisations like public transport agencies offer services such as passenger transport which are financed partly by user-charges but which also attract a subsidy for public-good reasons, and other services like freight transport are essentially private goods and hence

should so far as is possible be financed through user-charges. Table 7.1, based on the findings of the *New South Wales Task Force on the Classification of State Organisations*, provides a useful guide to the different types of government organisation and the role which prices and charges have in their operations.

Table 7.1

Classification of State Organisations

A.	**Public Service:**	Fully or almost-fully subsidised monopolistic bodies such as the Department of Mineral Resources, Business and Consumer Affairs, or central agencies such as Treasury and the Premier's Department.
B.	**Community Service:**	Partly subsidised monopolistic bodies such as Registries of Births, Deaths and Marriages.
C.	**Community Business:**	Partly subsidised semi-competitive bodies such as transport services.
D.	**Commercial Service:**	Self-sufficient monopolistic bodies such as the Sydney Water Board and Electricity Commissions.
E.	**Commercial Business:**	Self-sufficient semi-competitive bodies such as the New South Wales' County Councils or the TAB.
F.	**Commercial Enterprise:**	Self-sufficient fully competitive bodies such as Insurance Offices and Banks.

Of all the tiers of government the States collect the greatest amount of revenue from government charges in Australia. Nearly 50% of such charges are collected by the States compared to 40% by the Federal Government and 10% by Local Government (IAC, 1989, p. 8). This breakdown indicates the relative importance of charges as a source of revenue for the States. Categories C, D, E and F are examined in the following section, and Categories A and B in Section 7.3.

7.2 State Public Enterprise Pricing and Charges

State public enterprises (ie. those organisations which generally fall into the categories of C, D, E and F in Table 7.1) contribute significantly to State revenue. However, it is difficult to calculate exactly how much revenue is raised from non-tax charges because revenue obtained though charges is netted-out in the net operating surplus of public trading enterprises. As a guide, the surpluses of public trading enterprises contributed around 7.1% of total States' revenue in 1979-80, 7.4% in 1985-86 and 10% in 1986-87, and the contribution of surpluses for public trading enterprises in each State is depicted in Table 7.2.[1]

It is clear from these figures that public trading enterprises represent a growing source of revenue for the States, but this development counsels caution for the equity element in the pricing policies of these bodies.

7.2.1 Principles and Practicalities

It has already been established in Chapter Four that public trading enterprises should be evaluated according to the principles of economy, economic efficiency, equity and effectiveness. Within this framework, financial performance and appropriate pricing strategies are crucial.

The public enterprise pricing literature suggests three main pricing guidelines:

– Prices should not fall below marginal (opportunity) cost levels and as far as possible should equal those cost levels (unless a divergence is warranted by the second or third guidelines);

– If there is a shortage of capacity (ie at times of peak demands) prices should be raised to higher levels (which reflect the

higher value users) to clear markets; when there is excess capacity, prices should be lowered to reflect the lower real opportunity costs of supply and to stimulate demand; and

– If prices determined by the first two guidelines do not generate the desired revenue, additional revenue may be raised by higher charges on less price-sensitive market segments. Thus, where additional revenue is required the optimal departure from marginal cost pricing requires higher additional charges on those users who are less sensitive to higher prices (so that distortions to marginal decisions are minimized). This policy is consistent with the better known commercial practice of price discrimination or charging what the market will bear.

Table 7.2

Contribution of Public Trading Enterprises to State Revenue
(81/82 Prices)

	81/82		*82/83*		*83/84*		*84/85*		*85/86*		*86/87*	
	$	%	*$*	%	*$*	%	*$*	%	*$*	%	*$*	%
NSW	483.5	(4.7)	760.5	(7.5)	702.6	(6.7)	860.6	(7.8)	822.0	(7.2)	768.0	(6.5)
Vic.	631.4	(7.9)	687.4	(8.2)	615.3	(7.1)	603.2	(6.7)	726.1	(7.8)	929.3	(10.4)
Qld	156.5	(3.5)	229.9	(4.4)	322.9	(6.2)	472.8	(8.8)	546.3	(9.5)	535.9	(9.3)
SA	190.5	(7.8)	209.1	(7.9)	227.8	(8.3)	205.8	(7.2)	235.2	(7.7)	216.8	(7.3)
WA	154.7	(5.8)	176.1	(5.5)	232.9	(6.7)	246.7	(7.2)	304.5	(8.6)	357.6	(9.9)
Tas.	97.7	(6.6)	102.8	(9.9)	122.7	(10.8)	138.3	(11.2)	143.2	(11.8)	154.8	(13.4)

Source: ABS 5504.0 'State and Local Government Finance, Australia', deflator CPI for each State capital.

The second guideline is relevant when peak/off-peak demand occurs. Thus, for a public enterprise subject to peak load demand, it is now well established that higher prices should be levied:

– to reflect the higher costs of meeting such demand (as in a multi-plant firm which caters for peak demand by using least efficient plants);
– for a single plant firm, to reflect the higher opportunity cost of satisfying the marginal consumer; and/or
– simply as a means of reducing peak (excess) demand towards a target level on the grounds that price rationing is more economically efficient than non-price rationing measures such as interrupting supply.

Where peak and off-peak demand are responsive to price, better load management and reduced pressure for capacity expansion (which is substantially occasioned by peak demand), including the accompanying effects of energy and environment conservation, would be amongst the more tangible benefits.

In practice, the concept of marginal cost can be used to justify any one of a number of pricing structures. The estimation of future costs, for instance, may be subject to large errors and historical costs, although more easily measured than future costs, do not necessarily provide a useful guide to the costs that will have to be incurred in the future. The diverse social and economic responsibilities of public sector activity mean that the application of marginal cost pricing in this sector is even more difficult than the complexities of a textbook model. The fact that many activities undertaken by public trading enterprises are more amenable to average cost pricing (eg electricity production) makes marginal cost pricing, as outlined above, still more problematic (IAC, 1989, pp. 33-34).

7.2.2 A Required Rate-of-return

From a practical viewpoint, it is useful to examine one approach to the problem of

pricing by the public sector, given that the textbook prescriptions are difficult to replicate. Since 1983, the Victorian Government has required its public enterprises to price their goods and services so as to meet a Required Rate-of-return (RRR). The principle performance criteria was a target rate-of-return on assets of 4%. This meant that public authorities were required to manage their internal costs and set prices to achieve a 4% real rate-of-return on the written- down current replacement cost of assets in service.

The Cain Government argued that:

> 'If lower rates of return are achieved . . . the result would be a misallocation of resources. Public authorities are required to recover all operating costs and capital costs and the real rate-of-return is a component of the capital costs of the public authority's operations. This means that public authorities performing commercial-type functions should achieve the same level of efficiency expected of private sector organisations.'

It was also maintained that a rate-of-return policy contributed to long-term price stability and provided flexibility to the utilities by lowering the cost of finance, consistent with the borrowing limits of State and Commonwealth Governments. Such an approach also avoided the problem of prices setting to achieve a fixed level of internal funding for capital expenditure and prevented significant price changes due to investment needs (Information Paper on Energy Pricing, 1985-86, p. 11).

How was the rate of 4% arrived at? The 4% RRR was derived from estimates of the long-term costs of debt and equity to the public sector, weighted by the extent to which these forms of finance (ie. debt and equity) are utilised by public enterprises (the debt:equity ratio).

To determine the long-term cost of debt to Victoria's public enterprises –

> '. . . research was undertaken as part of studies conducted with the SECV and the Melbourne and Metropolitan Board of Works. These studies involved time-series analyses spanning more than 100 years to derive data on interest rates and inflation so as to determine the real interest rates on the debt of these authorities. The long-term average of these real rates, whilst subject to short-term fluctuations, was found to be around 3%. While acknowledging that at any particular point in time it is likely that the real interest rate would differ from this 3%, it was considered that this rate reflects the long-term average of the cost of debt which investors in these authorities would impute into their investment decisions as expectations of the long-term return' (Department of Management and Budget 1984, p. 42).

Is the 4% RRR defensible? On a positive note, the 4% RRR directly focuses attention on the opportunity cost of capital utilized, even if the actual amount may only approximate the true RRR required.

Australian studies have indicated that previously estimated average real rates-of-return in the private sector are substantially inflated. For instance, the Institute of Applied Economic and Social Research (1982) estimated that over the 9 years to 1977-78, private corporate trading enterprises in Australia achieved a real rate-of-return on all assets employed, before interest, of about 12% p.a. However, Ball and Davis (1984, pp 40-43) report recent estimates which show that in the 1970s the average real return was considerably less than 4%.

Even though a specific RRR may be questionable (if, for example, it does not take account of the community service obligation which the Public Trading Enterprise (PTE) may be required to meet) the use of a RRR as one of several financial and non-financial indicators is sound because it places an emphasis on the opportunity cost of capital used by a public enterprise.

Requiring a PTE to achieve a required rate-of-return can encourage increased efforts to lower costs of production. However, in the case of a monopoly supplier facing highly inelastic demand curves, alternative opportunities are available through price increases and/or quality of service deterioration. Thus constraints to limit these activities are required if

pressures for cost reduction are to be sustained.

Price increases can be constrained by a CPI – X type system which is used in the UK to regulate British Telecom and British Gas (and which will be introduced in July 1989 to regulate Telecom Australia's price increases). Under this price-regulation system, if the X factor (the expected level of real price reduction per annum) is 2% and the increase in the Consumer Price Index is 7%, the level of price increase on average would be restricted to no more than 5% p.a. Incentives for cost reductions in excess of 2% are present since these better-than-expected cost savings are retainable (in the absence of other government decisions) by the PTE. Although difficult to develop and monitor, quality-standards performance indicators can be introduced to guard against cost savings achieved through lower quality.

Further, an appropriate RRR target, combined with a test rate of discount for investment projects helps to ensure that public enterprises do not absorb resources in unwarranted capacity expansion which might be more productively employed elsewhere. This enhanced cost-consciousness can serve to facilitate 'dynamic' efficiency.

7.2.3 Dividend Requirements

Since 1983 the Victorian Government has required its major public enterprises to make dividend payments (New South Wales introduced them in 1986). The Commonwealth and the other State Governments have announced their intention to pursue a similar policy. This development has clear implications for the pricing and financing of public enterprises.

The Victorian Public Authorities (Dividends) Act of 1983, requires that 'commercial statutory authorities' (public enterprises) pay to the State's Consolidated Fund each year a return on equity, in the form of a Public Authority Dividend (PAD) of up to 5% of the value of the public equity held in that authority.

PAD payments have important implications for State revenue. The Victorian Consolidated Fund receipts from PADs have increased from a total of $372.5m in 1983-84 to an estimated $589.3m in 1988-89 comprising about 5% of total Consolidated Fund receipts.

Since the community ultimately owns all public enterprises the PAD offers a means by which a return on that equity can be realised. This return should be paid to the Consolidated Fund and thereby made available for use in pursuit of the Government's overall programs and objectives, or to reduce State charges and/or taxes elsewhere, thus distributing the benefits according to the priorities of the community as a whole.

The PAD payable by individual public enterprises could depend on a number of factors, including:

- the return on equity disclosed by RRR financial statements;
- historical cost profits (measured in accordance with conventional accounting principles);
- the availability of cash flow;
- the nature of the enterprise's capital program;
- conditions in money markets and the ability of the public enterprise to borrow;
- trends in the enterprise's debt to equity ratio; and
- community service or other obligations to be met by the enterprise.

Pricing and the PAD

The PAD requirement and the RRR guideline should be distinct aspects of public enterprise policy. The level of prices are affected by the target RRR but not the PAD because the RRR determines the enterprise's surplus out of which the return to equity remains after the cost of debt is met. The equity return is then available to meet PAD payments.

Many public enterprises are currently short of new capital. It might be argued that PAD payments, by depleting internal funding capacity (that is, by limiting the use of 'retained earnings' per capital expansion) promote a demand for increased borrowing, which in turn increases debt repayments and servicing charges and leads to price increases. It is therefore arguable that at least in the medium or longer term, (unless offset by sustained cost reductions) PAD payments will affect the level of public enterprise prices (and/or result in

reductions in the range and quality of services).

As a matter of fact, real tariffs charged by Victoria's public enterprises have decreased in each year since 1983-84 and are expected to continue decreasing in the foreseeable future.

What Level of PAD is Appropriate?
One possible method of assessing the appropriateness of a given PAD level would involve a comparison with those prevailing in private enterprise. Table 7.3 indicates that private sector dividends paid as a percentage of average shareholder's funds have varied from year to year and for 1984 ranged from 3%, for resource-based manufacturing, to 8.3% for the services industry, averaging 4.8% for all non-financial industries. Thus, depending on which sector a public enterprise is considered comparable to, a PAD requirement of 5%, for instance, may be argued to be either excessive, appropriate or too low.

Table 7.3

Dividends as a Percentage of Average Shareholders' Funds

Industry Type	1979/80	1980/81	1981/82	1982/83	1983/84
Resource Based Manufacturing	4.3	3.6	2.8	2.8	3.0
Other Manufacturing	5.6	5.9	5.9	5.5	5.8
Total Manufacturing	5.1	5.0	4.6	4.4	4.7
Wholesale trade	5.1	4.7	5.2	4.8	4.5
Retail trade	5.2	5.4	5.8	4.8	6.8
Services	6.7	5.9	5.4	5.5	8.3
All industrials	5.2	5.1	4.8	4.5	5.2
Mining	7.3	4.0	2.1	2.5	3.0
Total Non-Financial	5.6	4.9	4.3	4.1	4.8

Source: Reserve Bank of Australia (1986), Bulletin Supplement: Company Finance (August) p. 6.

While other charts could be listed, such comparisons are problematic. Ergas (1986), writing of the telecommunications industry, warned that some of the factors underlying dividend policy in a private company (like the differential tax treatment of interest payments, retained earnings and dividends, and the disclosure element of company dividend announcements) are not applicable to the government and its commercial undertakings.

He suggested (p. 61) some factors which might be considered in setting PAD payments:

> 'It is reasonable, however, to suggest that the dividend policy of a public enterprise should perform two functions:
> – reflect a capital structure, in terms of debt-equity ratios, which does not impose an excessive burden of fixed interest obligations on the enterprise, since (particularly in capital intensive industries) this will lead to unjustifiable price rises during cyclical downturns;
> – take account of the growth prospects of the industry, of the need to provide for growth through adequate injections of equity, and of the fact that commercial equity capital would generally be available on favourable terms to rapidly growing private companies.'

In short, governments should decide which level of dividend payment is appropriate for the enterprise, taking into account the PTE's overall financial strategy and planning process rather than set a blanket, predetermined rate.

7.2.4 Equity Considerations
Efficiency concerns are important for any enterprise, but trading enterprises which are publicly owned have a particular obligation towards community equity and social justice considerations. The concept of universal

service provision has evolved because of these obligations.

It has already been noted that the difficulties inherent in the marginal cost pricing system can lead to the conclusion that universal, subsidised provision of a particular service is the most rational decision to make. In reality, governments have a variety of criteria by which they make decisions regarding the way in which a service will be delivered, including the objective of income redistribution. For instance, should it be decided that neither full user-pays (for equity reasons) nor universal service (for efficiency reasons) is appropriate, then the use of cross-subsidisation is available. In Australia, for example, the provision of electricity facilities to non-metropolitan areas at prices which do not fully recover costs is commonplace. Reducing cross-subsidies between metropolitan and non-metropolitan customers by setting all prices to more accurately reflect costs would increase the electricity bills of currently subsidised customers. Such a decision may also militate against other policies (eg. decentralisation).

As Chapter Four has already argued, the specific community goals need to be clearly developed for each State trading enterprise. It is also important to note that, where the extent of cross-subsidisation does not meet the cost of Community Service Obligations (CSOs), the rate-of-return requirement will need to be adjusted. And while this is a controversial area for some economists, the work of public enterprise economists does provide some evidence that a more exact specification of community costs and subsidies is possible (De Ridder, 1989).

7.3 Charges for Other Government Services

In recent years there has been a marked increase in the application of policies of charging consumers of non-public enterprise services. There are clearly public services for which user charges can legitimately be levied. The arguments supporting this principle instead of financing free distribution from general revenue or borrowings are:

- the non-user is not penalised by having to support the service through taxation;
- the added funds reduce the revenue-gap, enabling more services to be provided for a given level of taxation (and borrowings);
- the costs of service provision will be partially offset by consumers who cross jurisdictional boundaries;
- where comparisons exist, charges could help to correct distorted prices in the private market; and
- since the buyer's response provides valuable information about demand, the allocation of resources within the government sector can be improved.

7.3.1 Industry Cost Recovery

Perhaps the most justifiable area for public service cost recovery lies in the provision of economic infrastructure and administrative services for industry. The increasing development and complexity of private economic activity has meant that new functions have been taken up by governments. In other cases functions which were undertaken privately have been increasingly taken over by governments. Examples of the former include such things as the provision of economic infrastructure for the aviation industry by government. Shifting responsibility for craft training to government is an example of the latter. *In these cases more pressure is placed on governments to expand their functions and put burdens on taxpayers which should properly be borne by industry* (cf. O'Connor, 1979).

At the Federal level the government has redressed these tendencies to some extent. Services for the aviation industry are fully funded by, in particular, landing fees and an excise surcharge on avgas. Agricultural services, quarantine, research and marketing, and other areas are funded by various levies and charges providing 100% cost recovery in some instances. Press reports suggest AUSTEL, the new Telecommunications regulatory authority, will be fully funded by some sort of industry levy. Meteorological services for specialised areas, particularly transport, are in part funded by industry charges. TV and radio operator licences contribute to the regulation of the broadcasting industry. The list could be greatly enlarged.

Many of the Federal initiatives seem to have

developed through Cabinet's Expenditure Review Committee (ERC). While the ERC may not have begun with a specific model in mind, the recovery proceeds from industries which require government infrastructure and activity. As far as regulatory activity is concerned, there are two main alternatives to the Federal model. First, taxpayers generally could fund the activity, which completely fails to address the historic problem of private activities generating the need for more government functions. Second, there is the option of relying on self-regulation, as for example occurs in some of the professions. For obvious reasons, self-regulation is unlikely to be a feasible option in most circumstances, the incentive of an industry body to turn a blind eye to the activities of a member being too strong.

An examination of the functions of State Governments in Part Three indicates many areas where some sort of industry cost recovery mechanism could and perhaps should be implemented. The examples include industry training, professional education, lands and legal records, agricultural services and regulation, conservation, regulation of industry and commerce, regulation of labour standards, health and safety functions, and infrastructure provided in mining towns, to name a few. In each example a strong case can be made for government activity but not necessarily taxpayer funding.

7.3.2 Social and Community Services

For some government provided services, charges are not practicable because it is not possible (or possible only at prohibitively high cost) to exclude those who are unwilling to pay the charge from benefitting from the service. In the case of the classical example of a 'Public Good', that of National Defence, everyone benefits, the externality is pervasive, and the 'non-excludability' characteristic prohibits the application of user charges.

For many other goods and services produced by the government which are designed to benefit the 'public purpose' but which are recognized also to yield significant individually appropriated benefits, the extent of cost-recovery through charges needs to be determined judiciously.

To summarise, charges are least justifiable when:

- they cannot be successfully employed at a relatively low cost (compared with the benefits);
- the benefits are not direct, so that charges, which reduce demand, will cause significant loss of externalities;
- demand (for the particular good or service) is highly inelastic, so that the application of charges does not aid resource allocation and does not help to eliminate excessive utilisation;
- charges result in inequities to lower income (or other groups) deemed by the government (or on the basis of accepted standards) to be in need of special consideration in the sense of not being required to pay for benefits received from the public services;
- a government service is deemed to be part of the social wage, and therefore should not be priced; and
- the government service is considered to be a merit good which consumers will demand too little of if user-charges are payable.

Under this model the approach of the Curran Commission (New South Wales) is simply untenable. This report contended that cost recovery should apply wherever possible to all public activities, including community services. For example, the Curran Commission recommends that performance indicators and target ratios of 'grant money to self raised ratios or paid hours to voluntary hours should be developed to evaluate recipients' qualification for grants' (Curran, 1989, p. 116).

7.4 Conclusion and Recommendations

7.4.1 Monitoring State Prices and Charges

Despite the importance of non-tax revenue for the States, the other tiers of government and for the economy as a whole, there is a dearth of information on the range of prices and charges provided levied by all the tiers of government. This lack of information and data should be addressed by the Premiers' Conference Secretariat proposed earlier in this book, for unless

the ABS or an alternative information agency is charged with collecting and analysing the relevant data in this area, then policy makers will have no firm basis upon which to develop the micro-economic policies which are appropriate for public trading enterprises. The 1989 IAC Draft Report is also correct to point out that the quality of inter-governmental relationships is also a factor which retards the performance of State trading enterprises and other organisations. This is also an important task which needs to be addressed by a central intergovernmental forum commissioned by the Premiers' Conference Secretariat.

7.4.2 User Charges

The States should continue to provide free and subsidised goods and services to users where they:

- generate systematic externalities,
- advance social equity

This principle applies to a large range of services within health, education, social welfare and public transport.

7.4.3 Industry Cost Recovery

In the areas where a user charge can legitimately be applied, we recommend strategies for increased self-financing and commercial performance of public services by extending the application of full and partial user charges and competitive pricing consistent with principles of social justice.

It should be stressed that unless the principle of industry cost recovery is endorsed, State Governments will find themselves unable, in the present fiscal climate, to respond to obvious new or increased needs thrown up by economic developments. However, it must be conceded that the exact mechanism which should be used in specific instances is not always obvious. It is therefore important that State Governments establish similar mechanisms to determine the appropriate means and level of industry cost recovery tailor-made to the specific circumstances involved. Not only must the incentive structure of the cost recovery mechanism be considered, but also the actual payment arrangements must be such that they do not in any way compromise the body being funded.

Without the appropriate funding mechanisms there is a serious danger that necessary government functions will be provided at sub-optimal levels or not at all. Of course, critics of government activity argue that Australian industry is already over-regulated. Generalities in this area are hard to establish. However, much of this regulation upholds the community's right to determine appropriate health, safety, product and other standards. It is axiomatic that industry bear the costs of both meeting and policing these standards.

It should be pointed out that genuine self-regulation, if it were adequate, could be expected to impose much the same costs on industry in meeting the same standards. In the absence of the obvious moral hazard problems, self-regulation funded by industry would have much to recommend it. In practice, that function should be a government responsibility – but there seems no logical reason why industry should benefit financially from the fact that self-regulation would not work.

7.4.4 Public Enterprises

Rate-of-Return Requirement

In principle, the imposition of a Rate-of-Return Requirement (RRR) for public trading enterprises is justifiable on economic and financial grounds. In the interest of an efficient allocation of resources, it is desirable that investments and resources utilized by public enterprises be required to earn a return comparable to their opportunity cost (what they would be able to earn in their best alternative use). At very least, an RRR would increase the capital-cost consciousness of management and staff, and provide an observable, monitorable focus for performance monitoring and evaluation.

An RRR also goes some way towards providing a surrogate for the discipline of a profit requirement in containing costs. It is true that many public enterprises face price inelastic demand schedules – at least for some services – so that cost increases might be easily passed on by way of higher prices. Nonetheless, where there are constraints on the ability of public enterprises to increase their prices, such

as consumer resistance or the Victorian Government's policy guideline that price increases not exceed the rate of inflation, this restraint should preferably be formalised by a 'CPI – X' formula, where the level of X is the productivity improvement that might reasonably be expected of that enterprise. Such an arrangement would provide pressures to contain costs.

However, there are several questionable aspects concerning the use of a prescribed RRR:

- the RRR should not be regarded as a 'principal performance criterion' since this would be to claim or expect far too much of it. Other potential sources and incentives of improved performance for public enterprises need to be identified, developed, implemented and monitored;
- a uniform RRR applied to all public enterprises is not prescribed by economic theory, nor by the observation that rates of return vary widely between and among private and public sector enterprises. One must guard against the danger, though, that the prospect of rationalising a lower RRR for a particular public enterprise could provide a cloak behind which inefficiencies of various types might readily proliferate; and
- although in principle an appropriate RRR need not conflict with economic objectives, in practice it is difficult to identify the appropriate RRR for public enterprises. The RRR of 4% prescribed by the Victorian Government, which was determined by the 'weighted average cost of capital approach', cannot be demonstrated to be correct or superior on uncontentious theoretical grounds (see Chapter Five and Xavier & Graham, 1987).

Profit Measurement

The conventional historical cost accounting system is inadequate for facilitating measurement of a public enterprise's economic performance, for example, its RRR. A Current Cost Accounting (CCA) system, which takes into account the effects of inflation is more appropriate, particularly when the concern is to estimate real RRR. Hence the Victorian Government's requirement that public enterprises publish supplementary current Cost Accounting (CCA) information in their Annual Reports is to be commended. But the use of CCA is complicated by the fact that the choice of the appropriate CCA approach continues to be a controversial issue. Thus, Historical Cost Accounting information should continue to be published in Annual Reports. In particular, although it may be convenient to use the more objective and monitorable CPI index to calculate inflation-generated gains on debt, as done under the Victorian Government's Rate-of-return Reporting version of CCA, such a procedure can significantly understate or overstate the measure of profit and the dividend-paying capacity of the enterprise.

The Compatibility Between Economic and Commercial Objectives

A threat to the compatibility between commercial and economic objectives could arise if governments require unreasonably large dividend payments by public enterprises in the sense that the level of payments are insensitive to the need for these enterprises to pursue prudent financial and performance improving policies. In this context it is notable that some forms of Current Cost Accounting, including the Victorian Government's Rate-of-return Reporting approach, can estimate conceptual returns to equity which are far in excess of actual distributable profits (backed up with cash resources). Where such conceptual returns to equity are used to justify dividend payouts which, in the longer term, threaten the financial and economic performance of a public enterprise, the incompatibility between commercial and economic objectives can become quite stark. The Victorian Government's dividend requirement policy, which has at times required payments by an enterprise in excess of its conventionally calculated historical cost profit, should be reviewed in this light.

7.4.5 Revenue Issues

A further comment is required on the issue of public sector pricing. There are those who would prefer to see the public sector undertaking only those activites which cannot be commercially provided by the private sector

(see, for instance, Curran, 1988, p. 66). There is no rational justification for such a view.

It is the prerogative, and responsibility, of State (Federal and Local) Governments to use those of their enterprises for which commercial pricing policies are applicable (ie. where equity objectives will not be prejudiced) as revenue-raising instruments in order to ensure that other, non-commercial activites can be maintained. In Chapter Six we showed that levies on statutory corporations are becoming increasingly important in State revenues, and in Section 7.2 we showed that the Gross Operating Surplus of State Public Trading Enterprises represent a growing source of States' own-revenue. In this context, it would be extremely myopic for any State Government to relinquish ownership of these revenue sources, a fact that even the New South Wales Government seems to have realised in its decisions to pull-back from the privatisation of the State Bank and the Government Insurance Office.

This point is also applicable to those (few, if any) public enterprises that are *exactly* identical to private sector enterprises, ie. where no social equity issue pertains at all. The onus is on the would-be-privatisers to justify ethically, economically and politically the alienation of such enterprises for the public sector. As we have shown in Chapter Five, such justifications do not exist.

Notes

1 Direct charges may also comprise part of Other Revenue. In 1979-80, Other Revenue was around 6.7% of Total State revenue and in 1986-87 this contribution had risen to 9.0%.

Chapter 8

FINANCING CAPITAL EXPENDITURE AND STATES' INDEBTEDNESS

8.1 An Introduction to State Debt

State Governments are responsible for the majority of public sector capital formation and the provision of capital infrastructure, which is partly financed by borrowings. Any analysis of public sector finance must therefore consider their borrowing and investment policies.

A number of misconceptions are commonly made concerning the role of debt finance in public expenditure by opponents of the public sector. For instance, the Executive Summary of the Curran Report (1988, p. 42) argues that 'public sector debt has grown significantly and represents one of the most serious issues for the New South Wales financial position.' They recommend debt reduction as a matter of high priority and 'strongly oppose the funding of capital infrastructure for social services through borrowings . . . [which should] . . . not be used to fund non-income generating activities such as schools' (p. 43). These issues are addressed following the presentation of some factual detail.

Capital outlays by State Governments as a proportion of total Commonwealth, State and local capital outlays have declined from 69% in 1980-81 to 64% in 1986-87. Over the same period, the Federal Government capital outlays to total Commonwealth outlays have declined from 11.6% to 10.9%, while the States' capital outlays to total State Outlays have declined from 27.7% to 25.4% (see ABS, Government Financial Estimates, Australia, 1986-87, Cat. No. 5501.0). Borrowing either in the form of Net Advances received from the Commonwealth Government, or Other Borrowing (domestic or overseas) provided about 17.5% of total funds received by the States in 1986-87 (rising from 15.9% in 1980-81).

The problem of debt management for State and Local Governments is somewhat different to that faced by the Commonwealth due to the Commonwealth's power over the level of State and Local Government borrowing. As an important aspect of stabilisation policy, aggregate debt management is an issue in which the the States are still expected to play a role.

Nevertheless, the States, even though constrained by the Commonwealth's overall macroeconomic policy, must still be cognisant of prudential limits and economic principles. The conservative approach is to ensure that public debt is in the form of long-term maturities, which protects the government from creditors imposing short-term calls on the loans. In modern times, however, it is assumed that maturing issues can always be refunded through new issues. The shorter the average outstanding debt, the larger is the refunding operation.

State Governments borrow primarily to finance capital works. Prudence suggests that loan finance is preferred to tax finance because capital formation yields benefits to successive generations. In some cases, capital formation generates income flows which can be used to service the debt, while otherwise, it provides enduring services to the community (like education) which do not directly generate revenue. In both cases, it is appropriate for the beneficiaries (the community in general) to contribute to the debt-servicing through general budget revenue (taxes and charges).

The notion of intergenerational equity justifies the use of debt-financing. Large-scale public works which yield services over a

lengthy period tend to require large lumpy expenditures. If once-and-for-all capital expenditures were tax-financed a sharp tax increase would be necessary. Apart from the problem of fluctuating tax rates, this financing method also places an unfair burden on the current taxpayers. It is only fair to spread the burden across the generations which will enjoy the services. Thus, the initial cost would be covered by issuing debt, and tax revenue each successive year is used to service the debt.

The accumulation of debt therefore represents the cost to the future users of the services provided by the stock of public sector assets. In assessing the appropriateness or otherwise of any given level of debt it is necessary to have regard to the level of assets in place and their service potential; and the ratio of the debt to GDP.

From the Federal Government's perspective considerations of intergenerational burden transfer may be less important than the objectives of macro-economic stabilisation. The chosen mix between loan and tax-finance to satisfy these macro-economic goals may not be consistent with an ideal intergenerational burden distribution. However, the financing decisions of the States should consider the issues of intergenerational equity more carefully.

8.2 State Government Debt and Intergenerational Equity

To achieve an equitable transfer of the burden of financing the substantial capital expenditures between generations, the States should use debt rather than tax-finance. Of course, this proposition can be used to justify both positive and negative attitudes to borrowing:

- borrowing to provide services predominantly for the present generation might be excessive because the burden is transferred to the future generation; and
- borrowing is desirable in order to achieve intergenerational equity by spreading the costs of providing benefits among all the generations which enjoy them.

Musgrave & Musgrave, (1976, p. 606) note that the issue of 'intergenerational equity arises most acutely at the State and Local levels where the bulk of public investment expenditures are made and financed.' A typical State expenditure might be the construction of a school building involving a substantial immediate (once-off) outlay for a resource which will provide services for twenty or more years. Tax financing would imply a sudden and large increase in taxes for a short period. Such a financing approach would place the burden of the provision of the school on the current taxpayers.

So debt-finance covers the initial cost of the school, and tax revenue (to service the debt) is raised in each future period according to the intertemporal distribution of benefits flowing from the school building. Musgrave & Musgrave (1976, p. 607) conclude that:

> 'A township which finances its school building by borrowing and amortizing the debt over the length of the asset life thus provides for an equitable pattern of burden distribution not only between age groups but also between changing groups of residents as the population of the jurisdiction changes in response to in-migration and out-migration.'

While debt-finance clearly facilitates a more equitable distribution of the burden of providing public goods over subsequent generations, it is clearly not an issue of financing exclusively. The expenditure side of the budget must always be analysed. Each generation should pay for the benefits they receive in accordance with the ability-to-pay of individuals within each generation.

8.2.1 Debt as Future Taxation

Economists antagonistic to debt-finance argue that the burden of all public expenditure must eventually be carried by taxation. It is argued that borrowings merely delay the inevitable tax raisings. Musgrave & Musgrave (1976, p. 603) summarise this view in the following way:

> 'The burden is thus postponed and future generations are born with a chain around their necks, ie., with the obligation to pay off the national debt.'

The fallacy in this argument is that the national debt need never be paid-off, and it is only the interest payments which generate future tax liabilities.

The opposing view argues that interest payments do not impose a burden on future generations because the future generation contains both taxpayers and interest-receivers (debt holders), and therefore, interest payments transfer resources from one group to another within the same generation. While valid, this view ignores, first, the costs of any inefficiencies arising from the tax distortions which could still lead to losses to the future generations; and, second, the issue of overseas debt which is particularly important in periods of exchange rate volatility. As a guide, economists believe that as long as the debt does not grow faster than GDP there is no cause for alarm.

8.2.2 The Effects of Debt-Financing on Savings, Capital Formation, and Growth

The debt burden may be shifted to future generations by reducing the growth of capital endowments passed on in time. Taxation tends to affect private consumption, whereas debt finance tends to affect the rate of saving and hence investment. If the present generation reduces its rate of saving as a result of debt-creating behaviour the growth in capital and future income will be reduced, other things equal.

Present saving is likely to be reduced if debt rather than tax financing is used because tax obligations are unambiguous to the present generation, whereas debt obligations involves a future commitment which is less clear. The declining savings rate would represent an indirect transfer of the burden from the present to the future generation, in the form of reduced growth potential (less productive capacity). But importantly, public capital formation provides vital infrastructure which may accelerate the growth potential of the economy.

8.3 Understanding and Defining State Debt

In examining trends in indebtedness of the States we must differentiate between gross indebtedness (the value of securities or other forms of debt outstanding) from net indebtedness (the gross figure less the value of the financial investments held by the public sector). Further, the trend in real debt is more important than the nominal trend. In South Australia, for example, there has been a very large decline in the real value of indebtedness of the public sector. The composition of the debt is also of interest. Typically, there has been a decline in reliance on Commonwealth grants, and a commensurate rise in direct fund-raising from the capital markets.

For the purpose of this analysis, the public sector in each State is defined as the sum of the State Government itself (the Crown in right of the State) and the various corporate entities (semi-government authorities) created by Statute.

Certain financial intermediaries (for example, the State Bank of South Australia) are excluded. The framework follows the ABS national accounting definitions, which categorises government-owned banks, government-owned insurance companies, and public sector superannuation funds as being located in the finance sector rather than the public sector. In the South Australian data, the South Australian Financing Authority (SAFA) is included in the public sector, despite the fact that it is a financial institution (for a justification of this see South Australian Treasury [1985b], The Indebtedness of the South Australian Public Sector 1950 to 1985).

What is indebtedness? Public debt was traditionally defined in terms of the 1927 Financial Agreement, although this concept does not embrace the total stock of debt held by the entire State public sector. The latter includes the debt of the State Government and the borrowings of the semi-government authorities (whose debt activities come under the so-called Gentlemen's Agreement of 1936).

In the past, the debt raised under the Financial Agreement was for specific purposes, like housing, water supply, and urban development, and was subject to conditions stipulated by the Commonwealth. While still the most important source of debt, State Governments have increasingly accessed new capital sources independent of the Commonwealth. Following these trends, the concept of debt used in this section covers all financing arrangements 'which confer substantially the same rights and

obligations as conventional borrowings' (South Australian Treasury, 1985, p. 7).

What is the relevance of the net indebtedness concept? First, consolidated relations are presented to avoid double-counting of transactions within the public sector. Second, the total stock of debt should not be viewed in isolation to the assets that it has financed. Not all of the public sector asset holdings are in the form of capital items. Some assets are held in the form of financial claims against third parties (cash or interest-bearing investment) and they directly offset a portion of the public sector's financial obligations. These offsets can be large and therefore the measure of indebtedness should be expressed in net terms.

8.4 Trends in Debt Management

In the period following the 1927 Financial Agreement, the States' borrowings and semi-government authorities' loan raisings, in both volume and form, were closely controlled by Commonwealth-dominated Loan Council arrangements.

Major changes followed the harsh cuts in Loan Council borrowings in the late 1970s, which provided incentives to the States to find alternative financing arrangements. The innovations which resulted included lease-back arrangements, security deposits, and trade credits. The cost of these funds was cheaper and their volume unrestricted by the Commonwealth, but they represented a transfer of funds from Federal to State in the form of Federal tax losses.

The Commonwealth recognising both its diminishing (though still substantial) control:

- varied tax legislation to eliminate the room for gains from lease arrangements; and
- developed the Global approach to public sector borrowing which essentially widened the public sector institutions who came under direct borrowing limits.

A summary of debt management since 1927 is as follows:

'(1) a long period between 1927 and the mid 1970s where debt management was seen as a joint (although largely Commonwealth) responsibility of members of the Loan Council;

(2) a period of about a decade when Loan Council controls became more stringent on the face of it but less effective and the States were able to take on financial liabilities on other forms; and

(3) the current period where greater flexibility is allowed with respect to forms of taking on liabilities, but where the volume controls are potentially more effective' (South Australian Treasury, 1988b).

8.5 Interstate Comparisons

In the past, comparisons between the States in terms of indebtedness have adopted the narrow concept of debt defined in terms of the Financial Agreement. In this section the more pervasive concept of debt is used.

Although the Curran Commission of Audit makes much of the indebtedness of New South Wales – without let it be noted, adequate reference to sources – the most meaningful indicator of the debt burden is ratio of debt to Gross State Product (GSP). This is because debt is usually incurred to finance a growth in productive capacity. Economists have long argued that rising debt levels should not cause alarm as long as it is associated with a proportional growth in output. Indeed, constructive use of debt finance is the principle source of growth. Table 8.1 expresses public sector net debt as a percentage of GSP in New South Wales, Victoria, and South Australia. The significant conclusion which can be drawn from Table 8.1 is that in New South Wales and Victoria the ratio grew in the mid 1980s, and is now declining. This is consistent with the suggestion that the debt has not been used to finance non-productive expenditure.

Another dimension of indebtedness is the trend in real debt holdings. Inflation reduces the value of nominal debt, and to gain an appreciation of the resource cost of the debt, price changes must be accounted for. Table 8.2 displays trends in various debt concepts in nominal terms and Table 8.3 indicates the real equivalents of these concepts.

The effects of price rises on the value of nominal debt are clearly shown. The rise in per

capita debt since 1981 in South Australia and New South Wales has been modest in real terms, while Victoria's more substantial rise in real debt reflects its more aggressive economic development strategy.

Table 8.1

Public Sector Debt as a Percentage of GSP

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
NSW	n/a	n/a	20.2	22.5	24.4	23.0	23.8	17.9
Vic.	26.7	27.2	29.3	28.9	26.4	27.2	29.7	27.6
SA	22.4	22.4	23.0	21.1	19.6	19.3	19.3	17.2

Source: New South Wales Budget Papers, Victorian Treasury and South Australia Budget Papers.

Table 8.2

Total Debt Outstanding of State Public Sector
(Government and Semi-Government)
$m (Current Prices)

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
*NSW**								
Gross Debt	10943.8	12867.7	15296.0	18389.0	21104.1	22641.9	24714.1	26097.5
Net Debt	8575.8	9967.7	12185.1	14965.7	17791.4	18777.6	21341.9	18116.6
Per Capita	1638.2	1879.4	2276.3	2769.9	3255.8	3394.7	3802.8	3178.7
Victoria								
Gross Debt	10538.0	11846.0	13957.0	15738.0	17688.0	19857.0	21687.0	22962.0
Net Debt	10132.0	11428.0	13478.0	15034.0	17012.0	19319.0	21145.0	21951.0
Per Capita	2567.1	2867.1	3339.7	3687.9	4129.0	4642.9	5023.9	5152.5
South Australia								
Gross Debt	3379.7	3575.7	3969.8	4641.9	5533.9	6271.6	6990.8	9098.9
Net Debt	2367.0	2571.0	2917.0	3242.0	3387.0	3662.0	3958.0	3908.0
Per Capita	1794.8	1931.5	2167.5	2383.8	2470.1	2648.6	2838.9	2775.6

Note: * Includes debt of semi-government sector not directly and explicitly guaranteed by the New South Wales State Government.

Source: New South Wales Budget Papers; South Australian Treasury (1988), The Finances of South Australia; and Financial Paper No. 1 1989-89; Victorian Department of Management and Budget (1988), 'Victorian Public Sector Debt', Information Paper No. 2; Australian Bureau of Statistics.

The figures certainly do not indicate a massive blow-out in debt of the States. The Debt/GSP ratios are nowhere near critical and the trends summarised by Table 8.4 are also consistent with a controlled situation.

8.6 The Global Approach to Loan Council Borrowings

The borrowings by Commonwealth and State authorities are not subject to the Financial Agreement. The Gentlemen's Agreement in 1936 corrected this, and provided the framework until 1984 for Loan Council approval of annual debt-raising for semi-government and local authorities. A major change occurred in June 1984 with the introduction of the Global Approach whereby these authorities are subject to global borrowing limits agreed annually by the Loan Council.

The Global Approach was introduced because the Federal Government realised that the Loan Council was progressively exerting less influence over the totality of authority borrowings. It aimed to broaden the ambit of Loan Council control over the totality of authority borrowings, by including all forms of borrow-

ings by Commonwealth and State semi-government and local authorities, government-owned companies and trusts.The States all sought more creative sources of debt for their authorities, and such techniques as financial lease-back arrangements were relied upon increasingly.

Table 8.3

Total Debt Outstanding of State Public Sector
(Government and Semi-Government)
(Excluding Financial Institutions)
Real Terms (1988 dollars)

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
*NSW**								
Gross Debt	18718.0	19502.0	21364.0	23938.0	26050.0	25994.0	26451.0	26097.5
Net Debt	14668.0	15107.0	17019.0	19482.0	21961.0	21558.0	22842.0	18116.6
Per Capita	2802.0	2848.0	3179.0	3606.0	4019.0	3897.0	4070.0	3179.0
Victoria								
Gross Debt	18024.0	17954.0	19494.0	20487.0	21834.0	22797.0	23211.0	22962.0
Net Debt	17330.0	17320.0	18825.0	19750.0	20999.0	22179.0	22631.0	21951.0
Per Capita	4391.0	4338.0	4665.0	4801.0	5097.0	5330.0	5377.0	5152.5
South Australia								
Gross Debt	5781.0	5419.0	5545.0	6043.0	6831.0	7200.0	7482.0	9099.0
Net Debt	4048.0	3897.0	4073.0	4220.0	4181.0	4204.0	4237.0	3908.0
Per Capita	1319.0	1331.0	1346.0	1360.0	1371.0	1383.0	1394.0	1408.0

Note: * Includes debt of semi-government sector not directly and explicitly guaranteed by the New South Wales State Government.

Source: New South Wales Budget Papers; South Australian Treasury (1988), The Finances of South Australia; and Financial Paper No. 1 1989-89; Victorian Department of Management and Budget (1988), 'Victorian Public Sector Debt', Information Paper No. 2; Australian Bureau of Statistics.

The main features of the Global Approach are summarised in the 1988-89 Budget Paper No. 4, *Commonwealth Financial Relations with other Levels of Government 1988-89*, pp. 50-51. The major thrust of the Approach is to impose aggregate global limits on borrowings by Commonwealth and State authorities. In addition, there is a constraint imposed upon the ratio of overseas to total borrowings by State authorities.

Individual Governments have discretion to determine how global limit approvals are allocated among their respective authorities. The limits cover borrowings by semi-government and local authorities, government-owned companies and trusts. Excluded from the limits are borrowings by government-owned financial institutions and statutory marketing authorities except where their borrowings are on-lent to bodies subject to the limits.

Borrowings by other exempt institutions are also covered when on-lent to Government except where they are associated with temporary or unexpected fluctuations in outlays and receipts. New money borrowings are defined widely to include conventional domestic and overseas loan raisings; domestic deferred payment arrangements; overseas trade credits; financial leases including leveraged leasing, sale and leaseback, and similar arrangements; net changes in temporary purposes borrowings over the financial year and 'any other means of financing capital expenditures'. It excludes operating leases and temporary borrowings within the financial year.

Under the Global Approach, approval of the timing, terms and conditions and the form of all domestic borrowings undertaken by authorities is effectively delegated to the individual Loan Council members subject to the Council

being kept appropriately informed. A ceiling on new money overseas borrowings by State authorities is set (currently at 22% of the total global limit with the distribution among the States to be determined by Loan Council and advised to the Commonwealth and the States to determine the allocation among their own authorities), and some controls operate over the access to public issues markets. Loan Council approval of terms and conditions of borrowings now only applies with respect to the sterling private placement market, although members are required to keep the Council informed of terms and conditions applying to borrowings in all other overseas markets.

Table 8.4

Percentage Growth in Real Gross, Net, and Per Capita Debt
Outstanding of State Public Sector
Annual (June on June)

State	*1981/82*	*1982/83*	*1983/84*	*1984/85*	*1985/86*	*1986/87*	*1987/88*
NSW							
Gross Debt	4.10	9.55	12.04	8.82	9.98	1.75	-1.30
Net Debt	2.99	12.65	14.47	12.72	9.82	9.82	-20.68
Per Capita	1.64	1.62	13.43	11.45	-3.70	4.40-	21.89
Victoria							
Gross Debt	-0.38	8.58	5.09	6.57	4.41	1.82	-1.07
Net Debt	-0.06	8.69	3.96	7.30	5.62	2.04	-3.00
Per Capita	-1.20	7.54	2.92	6.17	4.57	0.90	-4.18
South Australia							
Gross Debt	-6.76	2.33	8.98	13.04	5.40	3.92	21.61
Net Debt	-3.73	4.52	3.61	-0.01	0.55	0.78	-7.76
Per Capita	0.90	1.13	1.04	0.81	0.87	0.79	1.00

Source: New South Wales Budget Papers; South Australian Treasury (1988), The Finances of South Australia; and Financial Paper No. 1 1989-89; Victorian Department of Management and Budget (1988), 'Victorian Public Sector Debt', Information Paper No. 2; Australian Bureau of Statistics. 2 includes debt of semi-government sector not directly and explicitly guaranteed by the New South Wales State Government.

Significant discretion also lies with the States in operating domestic conversion and refinancing programs during the term of the debt, provided that there is no addition to the total level of outstanding debt. Debt conversion and refinancing programs are permitted as an addition to the new money overseas ceiling provided that there is no addition to the total overseas debt outstanding and that appropriate advice is given to the Loan Council.

Table 8.5 provides details of the annual borrowing limits set by the Loan Council since 1983-84, initially under the Gentleman's Agreement and from 1984-85 under the Global Approach. The significant increase which occurred in 1984-85, reflects, in part, the incorporation within the Global Approach of 'unconventional' borrowings previously outside the Gentleman's Agreement. Some have argued that the limits under the Global Approach were initially set at generously high levels so enabling the States in following years to convert surplus borrowing capacity into financial assets, the so-called hollow logs. It is evident, however, that since 1984-85, the global limits have in total and for each State and the Commonwealth been cut significantly in real terms.

8.7 Borrowing Reforms: Commercial Authorities and Loan Council Controls

Should Commercial Authorities be exempted from Loan Council control? This question has stimulated considerable debate over the past

decade. Those who advocate the relaxation of Loan Council controls point to the detrimental effects that the restricted access to capital funds has had on the performance of these authorities. *Limited access to borrowings may force greater reliance on internal funding of capital works and this may have to be achieved by excessive price rises* (Campbell Report, 1981).

Table 8.5

Australian Loan Council Limits for Annual Borrowings by Commonwealth, State and Northern Territory Public Bodies

$m

	83-84	%	*84-85*	%	*85-86*	%	*86-87*	%	*87-88*	%
NSW	1883.9	29	1940.6	28	2059.1	29	1845.0	29	1539.7	29
Vic.	1580.3	24	1984.8	28	2006.6	29	1858.9	30	1526.4	29
Qld	1652.0	25	1552.0	22	1538.9	22	1387.0	22	1160.5	22
WA	758.8	12	818.1	12	741.3	11	635.0	10	584.0	11
SA	481.0	7	493.0	7	400.0	6	350.0	6	300.8	6
Tas.	180.2	3	229.0	3	230.0	3	217.0	3	181.6	3
States	6586.2		7017.4		6976.0		6292.9		5293.0	
NT	16.6		50.0		65.0		86.3		65.0	
C'wealth	758.0		1200.2		1189.0		1459.0		1187.9	
Total	7360.8		8267.6		8230.1		7838.1		6545.9	

Source: Australia, Commonwealth Financial Relations with Other Levels of Government, 1987-88, Budget Paper No. 4, Table 99, p. 144.

Similarly, there is little to distinguish commercial authority investment from investment in the private sector. Therefore, it is discriminatory to control one and not the other. In most cases, commercial authorities could operable viably in the private sector and their investments are often complementary to the investment of private sector firms.

It is arguable that strict competitive neutrality between public and private sector enterprises requires not only that firms have equal access to capital markets, but that in other respects, firms do not have particular advantages or disadvantages arising from their ownership status (public or private), that would affect the cost of borrowing or the returns that could be obtained with borrowed funds. Whilst it would be relatively easy to free commercial authorities from Loan Council controls it may be considerably more difficult to achieve competitive neutrality in the wider sense.

Further, there are difficulties in using public capital works expenditures as an instrument of short-term counter cyclical policy. First, due to the long lead times between planning and actual expenditure, and constraints with continuing contracts, it is generally difficult to significantly reduce these expenditures in the very short-run. By the time changes become effective, the reductions may in fact be inappropriate. Second, in the rush to expand or contract expenditure, little regard may be had for project viability and the wider social costs and benefits. This may mean that projects with relatively low rates of return get higher priority, with consequential detrimental effects for long-term GDP growth.

Those who oppose the relaxation of Loan Council controls over the volume of borrowings by commercial authorities fear the loss of control and co-ordination of public sector borrowings in general (see disussion of Martin Committee below). While commercial authorities are only a subset of those authorities subject to global limits, they account for a very significant share of approved borrowings in total. It is argued that when controls were relaxed in the past there was a very large increase in borrowings (for example, in 1982, major electricity authorities were exempted from Loan Council controls and their borrowing increased rapidly).

Debate over the necessity for controlling the

level of public sector borrowings is influenced by the possibility that public sector investment and borrowings may crowd out private sector expenditures. There are various ways in which crowding out can occur in theory (see H.V. Evatt, 1988; Neville 1987). However, as Chapter Two shows the short to medium term crowding out effects are likely to be minimal.

In what way can commercial and non-commercial authorities be distinguished? The Campbell Committee (1981) failed to make this distinction clear, although it saw commercial authorities as being subjected to market disciplines, whereas non-commercial authorities would tend to be those with a strong social element. Suggested tests for commerciality included whether an authority had an adequate capital base; clear current and future cash flow to service debt; competitive pricing discipline, etc. The Campbell Committee considered that the small number of commercial authorities should be freed from Loan Council controls, and be subject to similar market disciplines experienced by private sector firms. In particular, there would no longer be a Government guarantee for their borrowings. Underlying these recommendations was the Committee's view that:

> '. . . the benefits to be derived from a market allocation of funds are sufficient to warrant at least, for those who clearly operate on a commercial basis, a limited move in the direction of borrowing freedom . . .' (p. 199).

The Campbell Committee considered that non-commercial authorities should remain subject to Loan Council controls over the volume of borrowings, but not the terms and conditions, and should continue to borrow under Government guarantee. It saw advantages in centralising the borrowings of non-commercial authorities under Commonwealth control, but, in light of the practical difficulties, recommended that State Based Central Borrowing Authorities be established to consolidate the borrowings of these authorities. The States, with Loan Council approval, subsequently moved to establish such organisations.

The Campbell Committee did note some practical difficulties with its recommendation to free commercial authorities from Loan Council control and subject them to normal market conditions. First, there was the problem that even when no explicit Government guarantee was given, the market might still impute such a guarantee. It would indeed be difficult for a Government not to become involved if one of its authorities could meet its debts.

Second, commercial authorities frequently do not have a totally free hand in their pricing policies, but must accommodate decisions taken at the political level. Third, the capital structure and profit requirements of the public commercial authorities could not be regarded as being strictly commercial in the private sector sense.

These difficulties were clearly seen as reducing the force of its recommendations notwithstanding the fact that the Campbell Committee also made other recommendations aimed at obtaining competitive neutrality with the private sector. These would involve the levying of fees to offset the borrowing advantages gained through Government ownership; a movement to full capitalisation to the standard of private sector competitors; recognition of any differences in taxation treatment between public authorities and private companies; the maintenance of operating efficiency; return on capital and dividend payments at comparable private sector levels; and appropriate disclosure of authority performance in commercial and non-commercial areas.

8.7.1 Other Developments Concerning the Relaxation of Loan Council Controls

In its 1982 report, the Advisory Council for Inter-Government Relations considered that there were potential advantages in freeing commercial authorities from these controls.

The Martin Committee (1983) supported the Loan Council's decision to eliminate its controls over the terms and conditions of domestic borrowings by local and semi-government authorities as previously recommended by the Campbell Committee. However, it rejected the Campbell Committee's recommendation to

remove volume controls over commercial authority borrowings. It considered that direct control over the volume of public sector borrowing was necessary largely for macro-economic policy reasons (influencing aggregate demand via interest rates and private sector investment).

In 1987, the Commonwealth Minister for Finance issued a policy information paper which detailed broad guidelines within which Commonwealth statutory authorities and business enterprises were to operate in the future. Attention was given to the capital and financial structure of the enterprises. The paper specifically mentioned that consideration would be given to removing enterprise loan raisings from the requirement to obtain Loan Council approval. Clearly, if Commonwealth enterprises were to be exempt from Loan Council controls, State enterprises would also be affected. The issue has become somewhat controversial in light of broader discussion of the merits or otherwise of privatisation. It is probable that, even with the substantial management and accounting changes proposed for public enterprises, that the commercial aims and performance of the same will be impaired by the restriction in the access to funds for capital expansion by the limits set by the Loan Council. This loss of efficiency in turn has given rise to greater pressure for privatisation despite the erroneous logic of the latter strategy.

A major concern of the the House of Representatives Standing Committee on Transport, Communications and Infrastructure which reported to Parliament in November 1987 was a perceived shortage of public investment in Australia. It specifically recommended that the borrowings of commercial public authorities by excluded from the PSBR.

8.8 State Borrowings — A More Logical Approach

The arguments for exempting commercial authorities from Loan Council controls are stronger where those authorities have been established to compete with private sector organisations. Such authorities require this freedom if they are to provide a competitive stimulus in highly concentrated industries where firms have market power, either through dominance, or potentially, through cartel type behaviour. The case for exempting natural monopolies — in the main the large public utilities — is not as strong in this respect.

However, where such authorities are subject to rigorous guidelines concerning investment appraisal, borrowing practices, and pricing controls which require them to act as if they were operating in competitive markets, the case for exclusion from Loan Council controls is greatly enhanced.

On both efficiency and equity grounds, it would seem appropriate that commercial authorities (either operating in close competition with the private sector or subject to rigorous guidelines mentioned above) should be able to operate on the basis of competitive neutrality. This means that they receive no benefits or suffer disadvantages (like Loan Council controls) as a consequence of their public sector status, which are not similarly experienced by the private sector firms.

It is difficult to see why such public sector firms should be more restricted in their capital raising and investment policies than their private sector counterparts. Accordingly, commercial authorities in close competition with private sector firms, or subject to rigorous guidelines aimed at promoting effective market performance be no longer subject to Loan Council controls over the volume of their annual borrowings. This is especially relevant if investment is assessed according to the project's ability to generate a competitive rate-of-return.

8.9 State Financing Authorities

In the past, it was common for State bodies to arrange their own finance and develop expertise in-house or hire consultants externally. This lead to a number of diverse securities for a State's agencies being traded in the market. Thus, each agency may have become unfamiliar with the latest corporate finance techniques because it arranged and developed its own finance and financial expertise.

A centralised fund raising body for each State has the following advantages:

- greater flexibility in structuring approaches to the capital market;

- ability to develop expertise in-house;
- opportunity to exploit modern structured financing techniques to obtain finance at lower rates than traditional sources;
- management of the State's financing and investment plans to achieve lower borrowing costs through planning;
- improved liquidity management, ensuring that the whole State's financing needs are met, without foregoing short term investment opportunities; and
- provide a mechanism to centrally fund economic development, infrastructure and provide venture capital.

All States have now established such centralised fund-raising bodies in recognition of the advantages they provide. Chapter Twelve provides a case study of a State central borrowing agency, the South Australian Financing Authority.

8.10 Conclusion

If the commercial trading authorities of the States are subject to market derived interest rates in the absence of guarantees, crowding out arguments diminish in strength. A public enterprise, paying corporate tax, when exposed to the capital market will face a cost of capital that ensures a socially optimum level of investment. That is, debt finance will be allocated between private and public sector enterprises at market derived rates. These rates will then be used in calculating the marginal cost of capital for use in investment evaluation. For all bodies the capital budget will then be determined by accepting all investment up to the point where the marginal efficiency of investment equals this marginal cost of the capital.

To work in practice, the debt:equity ratios (or leverage) of the statutory authorities need to be reviewed. In the absence of government guarantees, high leverage levels, with the associated high risk of liquidity difficulties (financial risk) will lead to the authorities being granted relatively poor credit ratings and hence high interest costs. So for the recommendations outlined here to work it may be necessary to accompany borrowing freedoms with an equity injection into some authorities.

The level of overseas borrowings is another important consideration. Australia, like any borrower, has a credit rating that is determined in part by the perceptions of the likelihood of default. As the level of overseas debt rises, the credit rating may fall, increasing interest costs. Increased overseas borrowings by authorities, while not necessarily crowding out private investment, may lead to a lower credit rating for the country. Accordingly, the new Premiers' Conference Secretariat should monitor, and publicise, the borrowing activities of commercial authorities freed from Loan Council controls, and the purposes for which funds are raised. Such 'transparency' will provide a means by which macro-economic stability can be safeguarded from excessive borrowing. Overseas borrowing also requires the acquisition of exchange rate risk management skills to avoid significant capital losses that may result from fluctuations in the Australian dollar.

Chapter 10

NEW SOUTH WALES

10.1 Introduction

New South Wales is in the habit of characterising itself as the 'premier' State. In a number of respects – in addition to the obvious one (colonial history) – it actually is; New South Wales has the largest population, the highest Gross State Product, and also the largest State public sector (in absolute size). The predominant economic position of New South Wales, when combined with other pressing facts, greatly strengthens the importance which attaches to an analysis of the role of the New South Wales State public sector: the crisis of persistent external imbalance with which policy makers have struggled over recent years, and the imperative for economic restructuring consequent upon that crisis; and the election of a conservative State Government in March 1988 resulting in the prospect that New South Wales would serve as a 'laboratory' for an experiment in applying the political economy of the so-called New Right.

The role of the public sector is subject to scrutiny, question and controversy. This is not necessarily a bad thing – because a healthy political culture will ensure that nothing is beyond appraisal and criticism. However, it is unfortunate that public debate has been dominated by a resurgence of conservative (or economic liberal) doctrine concerning the State and public enterprise. As usual this recent intellectual fashion in Australia has uncritically imitated, with a lag, some overseas developments. The purpose of this study is both to expose the New South Wales application of this doctrine to critical appraisal and to project the essential and positive role which the State public sector does play – and, can increasingly play – in the economic and social life of New South Wales.

10.2 Demography and Economy

10.2.1 Demography

New South Wales' population in September 1988 was 5.7 million, over one third of the total Australian population of 16.6 million (ABS, 3101.0). At that time, no other State had a population over 4.3 million.

In fact, New South Wales' population has been over 5.0 million since 1981 (ABS, 3102.0). New South Wales has retained its position as Australia's most populous State despite net estimated migration to other States in every year since at least, 1971, and a rate of natural increase less than the Australian average. The net gain in population is accounted for by overseas migration to New South Wales, with nearly one half of all migrants settling in New South Wales. Table 10.1 illustrates this trend in more detail.

In 1986, about 60% of New South Wales' population lived in Sydney, and a further 15% lived in the cities of Newcastle and Wollongong. However Wollongong and the southern areas of Newcastle are both within commuting distance of Sydney.

The predominance of the State capital in New South Wales (in terms of population), is not as marked as Melbourne (70.6% of Victoria's population), Adelaide (72.3% of South Australia's population) or Perth (71.2% of Western Australia's population) (New South Wales Yearbook, 1988). However, the degree of urbanisation in New South Wales is still high, due to the larger number of urban centres in New South Wales compared to other States (ABS, 3102.0).

In common with the rest of Australia, the New South Wales' population is ageing. Graph 10.1 shows the change in the age of New South Wales' population between 1966 and 1988, and

indicates that the New South Wales population is older than the Australian average.

These demographic trends place severe pressure on the New South Wales public sector. The urban sprawl associated with the growth of Sydney demands considerable infrastructure investment, together with a relocation of community services from the inner-city to the western suburbs. An active and well-funded public sector is required in these circumstances, if the quality of life in under-resourced regions in Sydney (and the State in general) is to be improved.

Table 10.1

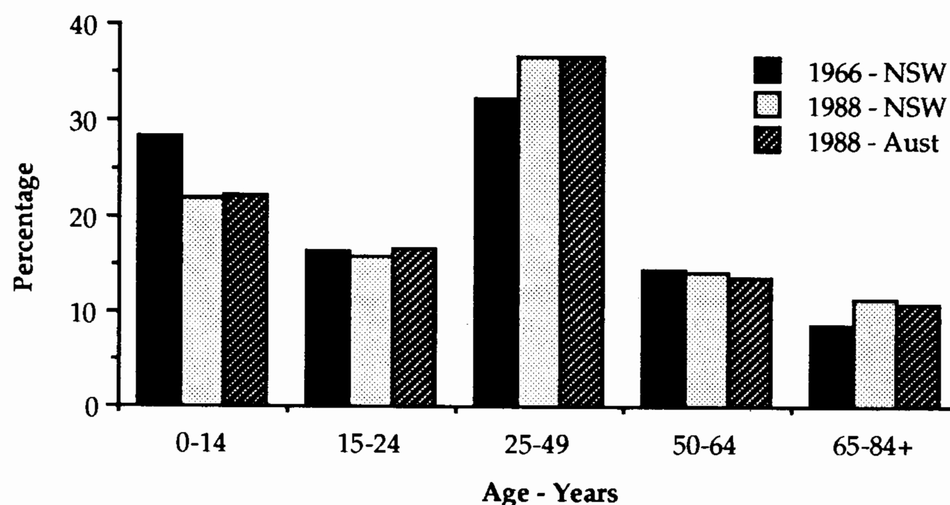
New South Wales Population Trends: 1983-1988
% Increase

Year Ended 30 June	*Natural Increase*		*Net Overseas Migration*		*Total Pop. Growth*	
	NSW	Aust.	NSW	Aust.	NSW	Aust.
1984	0.77	0.84	0.39	0.32	0.93	1.21
1985	0.78	0.82	0.58	0.47	1.14	1.34
1986	0.72	0.78	0.75	0.64	1.23	1.46
1987	0.75	0.79	0.90	0.74	1.46	1.53
1988 p	0.75	0.77	*p* 1.05	0.88	*p* 1.55	1.65

Note: p – Preliminary data.
Source: ABS Catalogue 3101.0.

Graph 10.1

NSW Population by Age



ABS Catalogue No. 3101.0, NSW Yearbook

10.2.2 Economy

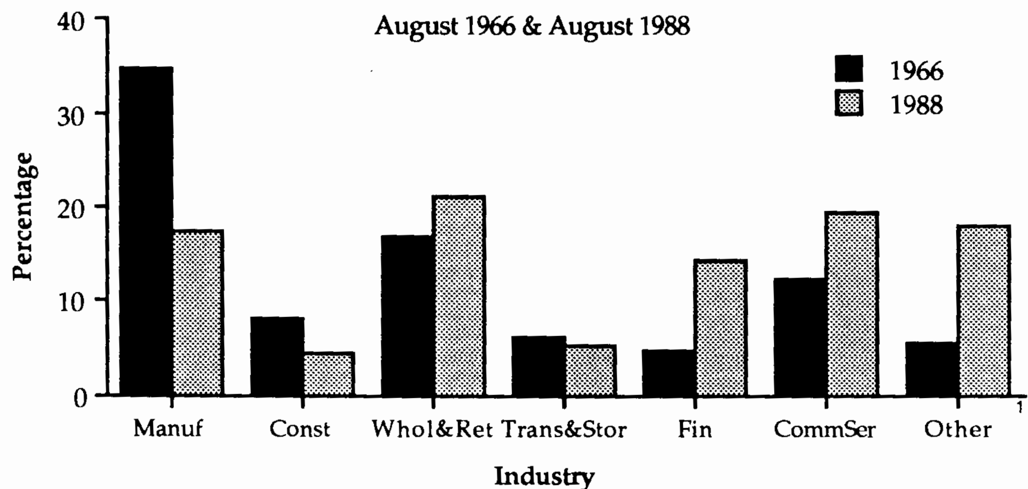
Graph 10.2 shows the proportion of New South Wales' employment accounted for by each industry sector in 1966 and 1988.

The change in employment patterns illustrated in this graph is basically consistent with the structural changes which have occurred in the Australian economy as a whole, resulting

in a decline in manufacturing's importance as an employer. About 40% of Australia's manufacturing production is undertaken in New South Wales. Metal and metal manufactures account for approximately 25% of New South Wales' exports, compared with about 10% of Australia's exports, reflecting the scale of the New South Wales manufacturing base (New South Wales Treasury, Budget Paper No. 2, 1988-89, pp. 4-7).

Graph 10.2

NSW Employment by Industry Division



1. 1988 includes Defence Personnel

ABS Catalogue No. 1305.1 & NSW Monthly Summary of Business Statistics, No. 396

Unlike the resource rich States of Queensland and Western Australia, mining contributes far less to employment in New South Wales (1.4%), and to New South Wales' export performance. Indeed, the mining industry is dominated by just one product, black coal. With the uncertainty of the world market (including changes in rates of energy requirements in manufacturing and the opening of internationally competitive mines elsewhere) the future performance of the industry is somewhat uncertain, despite recent signs of some improvement.

Overall, the New South Wales economy has lagged behind the performance of the national economy , as Table 10.2 shows. Despite relatively strong economic and employment growth in New South Wales in recent years, the State's 'misery index' (ie the sum of the unemployment and inflation rates) is still notably worse than the national figure, a point made in Table 10.3

10.2.3 Labour Market

The total number of full time employees in New South Wales in March 1989 was 1.67 million, comprising of 903,200 males and 469,000 females. Clearly, the participation rate for males (74.2%) is far higher than for females (51.4%), reflecting the discrimination which women experience in the workforce, and the institutional factors which still operate to exclude women from employment (including inadequate childcare).

The unemployment rates also provide evidence of this stratification of the workforce: in March 1989 the unemployment rate for men was 5.5%, and for women 6.8% (again it is worth noting that this higher unemployment rate occurs despite the markedly lower participation rate for women).

Table 10.2

Some Comparative Economic Trends

	*Real Rate of Economic Growth**		*Real Rate of Growth in Private Consumption Expenditure*		*Employment Growth*	
	NSW (GSP)	*National (GDP)*	*NSW*	*National*	*NSW*	*National*
	%	%	%	%	%	%
1978/79	5.4	4.7	4.2	3.6	0.6	1.1
1979/80	2.8	2.7	3.0	2.5	4.4	2.9
1980/81	3.2	4.1	4.2	3.8	1.8	2.3
1981/82	3.9	1.7	3.0	3.2	-0.5	–
1982/83	-4.8	-2.2	-0.6	0.9	-3.3	-2.3
1983/84	4.0	5.0	1.8	2.7	3.6	3.7
1984/85	5.3	6.4	5.2	5.2	5.9	2.0
1985/86	3.5	3.1	2.7	2.6	-0.2	5.1
1986/87	0.9	0.8	-0.2	-0.2	1.7	2.0
1987/88	4.4+	4.4	3.6	2.9	4.3	3.4
10 Year Avg. Growth Rates	*2.9*	*3.1*	*2.7*	*2.7*	*1.8*	*2.0*

Notes: * For purposes of comparison these growth rates are calculated using the relevant CPI as a deflator.

+ Based on New South Wales State Treasury estimates in Budget Paper No. 2.

Source: ABS 'Labour Force' Cat. No. 62030, 6204.0, ABS 'State National Accounts' Cat. No. 5220, ABS 'National Accounts – Income and Expenditure, 1987-88' and ABS 'Consumer Price Index', Cat. No. 640/0.

Table 10.3

The 'Misery Index'*: Unemployment Plus Inflation

	NSW	*National*
	%	%
1978/79	14.9	–
1979/80	16.3	16.3
1980/81	15.1	15.3
1981/82	15.9	16.6
1982/83	21.4	20.5
1983/84	16.4	16.5
1984/85	12.9	12.9
1985/86	17.0	16.3
1986/87	18.2	17.6
1987/88	15.7	15.1

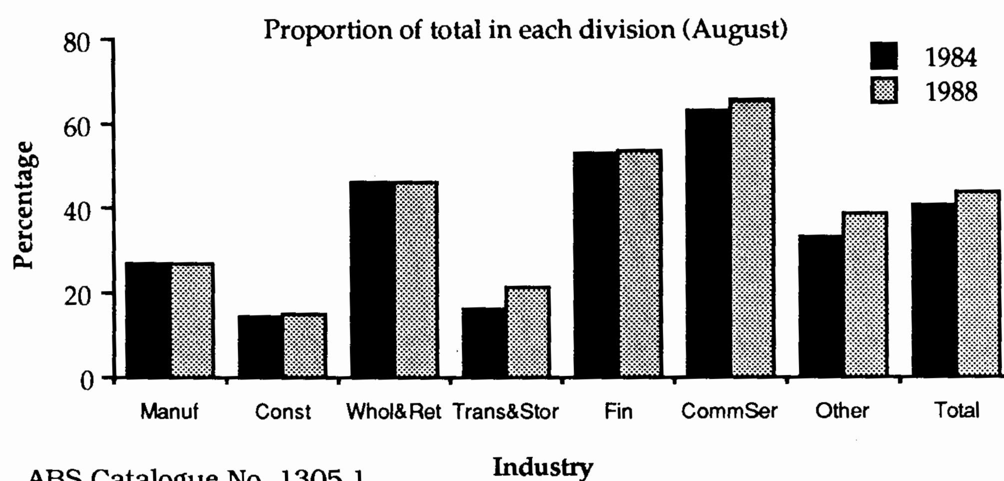
Note: * Calculated by adding the average annual unemployment rate to the corresponding average annual inflation rate.

Source: ABS 'Labour Force, Australia', Cat. No. 6203.0 and ABS 'Consumer Price Index', Cat. No. 6401.0.

Women are also stratified in the workplace by industry. The following graph shows the proportion of total female employment by industry in New South Wales, in 1984 and 1988.

Graph 10.3

Female Employment by Industry Division



ABS Catalogue No. 1305.1

10.2.4 Some Implications for the Public Sector. This brief outline of New South Wales' economy and society indicates that the New South Wales Government is confronted with a range of existing and emerging demands which will have to be met if living standards and basic human rights are to be maintained. To those special infrastructure needs outlined above can be added those needs readily identifiable from the discussion of the features of New South Wales' demography and labour market.

They include:

– the maintenance and extension of ethnic services;

– the provision of adequate services for an ageing population;

– the need to resource what positive reforms there have been in health and social welfare, and

– the need to provide the conditions whereby women would be able to fully participate in the State's economic and social life through, for example, the provision of child care.

The current status of the New South Wales public sector and the revenue-induced limitations it faces are examined in the following sections.

10.3 The Functions and Structure of the New South Wales Public Sector

10.3.1 The Size of the Public Sector.

By various measures the New South Wales State Public sector is comparable in size to those of other large mainland States, in relation to the size of their economies (see New South Wales Budget Information Paper No. 2, p. 550). It is the State's largest employer, and its expenditures contribute importantly to capital formation in the New South Wales economy. Its considerable command over resources in the New South Wales economy is indicated by the magnitude of public sector outlays and revenue as a proportion of Gross State Product (GSP) at market prices which stood at approximately 19% and 15.8% respectively in 1986-87. Trends in revenues and outlays suggest that the size of the State sector has remained relatively stable over the past five years, during which economic growth and employment in the State have been in line with national performance. As illustrated in Table 10.4 the share of both outlays and revenue in GSP rose only marginally between 1981/82 and 1986/87, with

slightly faster growth in revenue (12.5%) over outlays (11.0%) leading to a steady decline in the annual net public sector borrowing requirement over this period.

Table 10.4

Trends in New South Wales Government Revenues and Outlays

	Outlays		*Revenues Grants Received*		*Net Public Sector Borrowing Requirement **	
	$m	*% of GSP*	*$m*	*% of GSP*	*$m*	*% of GSP*
1981/82	10,222	18.1	7,939	14.0	1,880	3.3
1982/83	11,253	18.7	9,406	15.6	1,349	2.2
1983/84	12,462	18.7	10,600	15.9	1,802	2.7
1984/85	13,625	18.7	11,753	16.2	1,094	1.5
1985/86	15,210	18.6	13,118	16.1	1,644	2.0
1986/87	17,185	19.0	14,293	15.8	1,354	1.5

Note: * Excludes funding provision from internal financial sources.
Source: ABS 'State and Local Government Finance, Australia 1986/87', Cat. No. 5504.0.

An important indication of the size of the public sector also emerges from its role as the largest employer in the New South Wales economy, employing nearly 374,000 persons, representing some 18.2% of total New South Wales employment. Since 1983/84 however, this ratio has fallen by about 1.5 percentage points reflecting the discernible slowdown in New South Wales State public sector employment growth over recent years.

Table 10.5

New South Wales State Public Sector Employment

	*State Public Sector * Employment * (1) ('000)*	*Total NSW Employment (2) ('000)*	*(1) as % of (2)*
1983/84	353.3	1,795.2	19.7
1984/85	358.1	1,845.7	19.4
1985/86	363.1	1,903.5	19.1
1986/87	369.7	1,959.4	18.9
1987/88	373.8	2,056.2	18.2

Note: * Average yearly figures.
Source: ABS 'Employed Wage and Salary Earners, Australia', Cat. No. 6248.0.

A broad picture of the structure of the New South Wales State public sector is provided in Table 10.6 showing a breakdown of employment by major departments and authorities as of 31 March 1986 (the most recent data available).

The relative contraction of the New South Wales public sector is confirmed by the declining contribution of the public sector to capital formation. This decline is revealed in Tables 10.7 which charts New South Wales General Government Investment for 1986/87 to 1987/88, comparing it to Australian General Government Investment and total Australian investment.

It is interesting to note that from these tables that, while New South Wales public sector investment has been rising as a proportion of Australia's public sector investment, it has been falling as a proportion of total Australian investment.

10.3.2 Economic Services and Strategy

As the largest manufacturing state in Australia, the economic services provided through the New South Wales public sector are of special

importance. Table 10.8 indicates the range of departments and agencies which come under this classification.

The Greiner Government strategy for deploying its economic services and infrastructure is exemplified by its industry policy. While it is true to say that no New South Wales Government has developed an economic strategy as comprehensive as that in Victoria, the previous State Labor Government had formulated an Economic Development Strategy. This included a number of elements somewhat similar to elements in the Victorian Strategy, including the extension of the New South Wales Industrial Supplies Office's operations; the establishment of a Defence Industry Task Force to maximise New South Wales' industry involvement in defence projects; and the use of the Research and Consultancy Bureau to assist local industry take advantage of State public sector R&D facilities (EPAC, 1988, p. 19).

It should be noted, however, that the New South Wales Strategy also bore some resemblance to the types of national economic policies in vogue in the 1950s and 1960s. That is, it was designed to create the conditions in which economic development could take place, rather than a coherent set of policies and programs designed to stimulate and support those industries judged to have greater value-added and export potential.

The Greiner Government appears to have lapsed even further into the myopia of a bygone era. While it has maintained the Department of State Development (now in the Deputy-Premier's portfolio), its responsibilities have little more substance than facilitating proposals brought to it by the private sector

Table 10.6

Composition of New South Wales State Public Sector Employment

As at 31 March 1986	*Employment No.*	*Percentage of total Public Sector Employment*
Departments		
Education	69,762	28.0
Health	14,763	5.9
Public Works	5,693	2.3
Social Welfare and Community Services	22,471	9.0
Economic and Industrial Services	12,764	5.1
Administrative Services	20,606	8.3
Total	*146,059*	*58.6*
Authorities		
Electricity Commission (Elcom)	10,876	4.4
Department of Main Roads (DMR)	9,105	3.6
State Rail Authority (SRA)	41,269	16.5
Urban Transit Authority (UTA)	6,561	2.6
Other Economic and Industrial Services +	35,306	14.1
Total	*103,117*	*41.2*
Other	379	0.2
Total	*249,555**	*100.0*

Notes: * The figure significantly underestimates the total number of New South Wales State Public Sector employment. It only includes employment identified by the Public Service Board of New South Wales in its personnel reports.

+ Includes an estimate of employees in the State Bank and Government Insurance Office.

Source: Public Service Board of New South Wales 'Personnel Management Data of Departments and Declared Authorities', 1985, 1986.

(Department of State Development, 1988), and the disposal of 'strategic government assets' (Department of State Development, 1989). Tripartite industry bodies, for instance, have been abolished. In addition, the failure of the Greiner Government to recognise the importance of coherence in, and co-ordination of, the public sector's role in industry policy or economic development is evident in the duplication of activities between the Department of State Development and other portfolio areas, particularly those remaining in Business and Consumer Affairs (the old Department of Industrial Development and Decentralisation).

Table 10.7

Gross Fixed Capital Expenditure (GFKE) 1976/77 — 1987/88:

	NSW State & Local Govt $m (1)	*Aust. Govt $m* (2)	*Total Aust. $m* (3)	(1 as % of 2)	(2 as % of 3)	(1 as % of 3)
1976/77	841	3,316	21,055	25.4	15.7	4.0
1977/78	951	3,463	22,566	27.5	15.3	4.2
1978/79	1,005	3,482	25,933	28.9	23.4	3.9
1979/80	1,039	3,607	28,783	28.8	12.5	3.6
1980/81	1,162	3,725	35,176	31.2	10.6	3.3
1981/82	1,165	4,080	41,437	28.6	9.8	2.8
1982/83	1,185	4,562	41,035	25.9	11.1	2.9
1983/84	1,436	5,230	44,225	27.5	11.8	3.2
1984/85	1,713	6,128	50,859	27.9	12.0	3.4
1985/86	1,967	7,125	58,837	27.6	12.1	3.3
1986/87	2,328	7,807	63,161	29.8	12.4	3.7
1987/88	2,529	7,516	70,887	33.6	10.6	3.6

Sources: ABS 5206.0 Australian National Accounts, National Income and Expenditure & ABS 5220.0 State Accounts.

A feature of the new industry policy of the New South Wales Government is the extent of spending on decentralisation. Of a total $48m of recurrent funding allocated to Business Services by Business and Consumer Affairs in the 1988/89 Budget, $17m was allocated to 'payroll tax rebates and other assistance associated with the decentralisation of secondary industry in country areas' (New South Wales Treasury, 1988b, p. 226). Some of the components of the agency's decentralisation policies are laudable (for instance, the extension of the National Industry Extension Service's operations to regional centres to promote value-added production). However, much of the activity appears to have little or no focus; the range of products 'adopted' provide little opportunity for integration into a coherent industry plan. Such projects include promotion of Broken Hill airport for export of primary products and bulk wool handling facilities at Eden, neither of which reflect any commitment to vertically integrated development (BACA, 1988, pp. 35-45). Such lack of coherence illustrates a lack of vision and appreciation of the changing patterns of resource utilisation and industrial production.

One of the key challenges for New South Wales public economic services, attested to by Sydney beach-goers, are the difficulties currently facing Sydney's water supply and sewerage system. There, market-based solutions to a pressing social and economic problem are conspicuous by their absence, leaving the public sector to undertake vital social and economic services. This challenge is magnified by the current inadequacy of the system which has failed to keep pace with expansion of Sydney.

Table 10.8

Economic Services

Departments	**Functions, Services and Financing**
Agriculture (and Fisheries)	Promotion of agricultural, livestock and fisheries resource development; Pastures Protection Boards; agricultural information services; quarantine services; research laboratories. *Large deficit.*
Business and Consumer Affairs	Regulation of corporations and capital markets; 'fair trading'; consumer information Affairs services; registration of businesses and agents; Corporate Affairs Commission; Consumer Claims Tribunal; Office of Small Business; Fair Rents Board. *Medium deficit.*
Industrial Relations & Employment	Industrial conciliation and arbitration; occupational health and safety; training and apprenticeship schemes; employment programs. *Large deficit.*
Lands	Public land management; land information systems; mapping and surveying services. *Small deficit.*
Mineral Resources	Promotion of mineral resource development. *Large surplus.*
Planning	Environmental planning; coastal protection; heritage agencies. *Large deficit.*
Public Works	Building and civil engineering works. *Medium deficit.*
State Development	Co-ordination and promotion of major private investment and employment programs.
Technical and Further Education	Post-school education. *Large deficit.*
Water Resources	Management of water and related resources. *Medium deficit.*
Authorities	
Electricity Commission (Elcom)	Electricity generation and bulk transmission. *Small deficit.*
Govt. Insurance Office (GIO)	Commercial insurer; third party vehicle insurer. *Small surplus.*
Grain Handling Authority	Bulk grain handling. *Small (operating) surplus.*
Maritime Services Board (MSB)	Port facilities; shipping; cargo movement; marine environmental protection. *Small (operating) surplus (before abnormal items).*
Marketing Authorities & Produce Corporations	Marketing of primary produce.
Metropolitan Waste Disposal Authority	Management of waste. *Medium surplus.*
Nat. Industry Extension Service	Promotion of Industry efficiency and international competitiveness (joint Commonwealth/State initiative).
Roads and Traffic	State road system; traffic management; driver *Authority* licensing, motor vehicle registration (amalgamation of DMR, DMT, and Traffic Authority).
State Bank	Retail banking *Small surplus.*
State Rail Authority (SRA)	Passenger and freight rail services. *Medium (operating) deficit (approximately 7% of Consolidated Fund receipts).*
State Transit Authority (STA)	Bus and ferry services; co-ordination of inter-*(STA)* urban passenger services; taxis for disabled scheme. Previously UTA. *Large (operating) deficit.*
Water Board(s)	Water supply; dams; sewerage; drainage systems. *Small surplus.*

Notes: The terms 'small', 'medium' and 'large' deficit/surplus refers to the agency's outlays, net of its own revenues, as a proportion of outlays (less than 20%, between 20% and 50%, more than 50%, respectively). Where deficits/surpluses are a significant proportion of total State revenues to Consolidated Fund (this percentage is indicated in parenthesis). The economic significance of these ratios needs to be treated with care because the agencies' revenues (particularly departments) commonly include charges and fees which are taxes or quasi-taxes (in so far as they are compulsory and bear no relation to the costs of any service provided), as well as asset sales.

This need was made clear by the Water Board in 1986, as was the fact that considerable expenditure would be required. The following quotes are from the *Interim Corporate Plan* of that year:

> Water, sewerage and drainage infrastructure to cater for future urban expansion will increasingly become more expensive. The current Urban Development Program projects the need for an average of about 10,000 new lots each year over the next 5 years in the Sydney region (p. 18).
>
> The backlog of urban properties supplied with water but without connection to the sewerage system is an ongoing priority and an important aspect of meeting community needs in a cost effective manner. The current backlog consists of about 16,000 properties which require extension of existing systems (p. 19).
>
> Improved pollution control and environmental protection is increasingly becoming a major aspect of the Water Board's operation. However, qualitative programs to protect the environment are expensive particularly as they entail large capital outlays and generally do not contribute additional revenue (p. 23).

The recent moves made by the New South Wales Government to increase water and sewerage rates for industry in New South Wales are welcome as a means of raising revenue to combat the real pollution problems in New South Wales (*SMH*, 1/5/89). This positive move, however, needs to be contrasted with the capital amount allocated for water and sewerage in the 1988-89 budget, which amounted to a nominal cut of 2.7%; environmental protection fared even worse, with a cut in nominal terms by 24.0% (New South Wales Treasury, Budget Paper No. 2, p. 228). These spending cuts are a consequence of the Greiner Government's desire to cut the absolute size of the public sector, based on a belief that economic and social functions can be unproblematically shifted to the private sector. In many areas like water and sewerage, such a transfer of responsibility clearly will not take place, and yet the Government persists in denying the public sector adequate funds with which to meet its responsibilities.

10.3.3 Social Services

Chapter Three has identified a number of significant social problems which come under the direct jurisdiction of State social services. However, according to the New South Wales Council of Social Services, social welfare is one of the Greiner government's lowest priorities. In their analysis of the 1988/89 Budget NCOSS showed that welfare services in New South Wales received a decrease in recurrent funding of $98m or 17% on the previous years' appropriations (NCOSS News, Oct 88, pp. 2-3). Table 10.9 shows the major social service departments and agencies in New South Wales.

Despite some increases in capital spending on social services and welfare which are shown in Section 10.5, serious shortfalls in the social services area still exist, and under the current Government, are likely to deepen.The issue of housing is dealt with in some detail in a later case study, but shortages in this area are a source of widening social inequality in New South Wales. This inequality is not meeting with an appropriate policy response from the New South Wales Government which prefers to support home owners or to subsidise private developers rather than develop the public housing stock (New South Wales Treasury, Budget Paper No. 2, 1988-89, p. 229).

The deinstitutionalisation of psychiatric health care which has occurred in recent years also added to the demand for suitable housing while, at the same time, privately-owned boarding houses (which appear to be popular with people with disabilities) are closing due to higher rates of return available on other forms of property development (Benson, 1989, p. 28). Simultaneously, there has been a general rise in demand for public housing in New South Wales '. . . because of the rise in the number of people living below the poverty line' (Benson, 1989, p. 25). While the New South Wales Department of Housing appears to have made commendable efforts to meet demand for this specialised public housing, the fact is that '[The department] has funded this extra demand for public housing from mainstream public housing funds. As public housing funds are being

extended at both the Commonwealth and State levels of Government there is major concern about people with disabilities gaining access to these depleted funds' (Benson, 1989, p. 27).

It is obviously not desirable for deinstitutionalisation to be reversed. But without adequate levels of support to complement these moves, the result can be both a personal, and social, disaster as volunteer agencies and families are again forced to undertake a role more adequately handled by the public sector.

Table 10.9

Social Services

Departments	**Functions, Services and Financing**
Arts (Ministry)	State Library; museums; archives; Opera House; historic houses; Art Gallery; cultural grants.
Attorney-General	Courts and other legal tribunals; law reform; Anti-Discrimination Board; registry of births, deaths and marriages. *Medium deficit.*
Education	Public primary and secondary schooling; registration and public funding of private schools; Ministry includes Adult Migrant Education Service. *Large deficit (approximately 15% of Consolidated Fund receipts).*
Family and Community Services	Community welfare programs – pre-school and day care; refuges; Home Services Care Service; child protection; youth projects; status of women. *Large deficit.*
Housing	Public housing; home finance; residential development; information and advisory services; Residential Tenancies Tribunal. *Small surplus.*
Health	Public hospital services; community and mental health services; dental and disability services; immunisation; ambulance service; pure foods and sanitation; regulation of medical practice. *Large deficit (more than 20% of Consolidated Fund receipts).*
Housing	As above.
Sport, Recreation & Racing	Development of sport, recreation and racing; State Sports Centre; sport and recreation centres. *Large surplus.*
Authorities	
Ethnic Affairs Commission	Cultural, educational and welfare assistance to ethnic communities.
Home Care Service	Home care for the elderly and disabled.
Nat. Parks & Wildlife Service	National parks; nature reserves; State recreation areas; historic sites; Aboriginal areas. *Large deficit.*
State Rail Authority (SRA)	Concessional fares and community service obligations.
State Transit Authority (STA)	Concessional fares and community service obligations.

Notes: See Table 10.8.

10.3.4 Administrative Services

One of the major areas of change between the current Greiner Liberal government and its Labor predecessor lies in its philosophy with regard to administrative services and particularly the sphere of law and order and social control. The 1988/89 Budget saw large capital expenditure devoted to police stations, juvenile courts, prisons, detention centres and other institutions on top of a rise over the previous years' appropriations of $288m. This represented an increase of 28% to law, order and public safety over the previous year. Table 10.10 shows the key administrative agencies and departments.

Reflecting another dimension of the New South Wales Government's philosophy of administrative services is the rationalisation of emergency services between fire, police and ambulance departments. While good coordination and efficiency are essential in such important public services this clearly cannot be achieved by cutbacks or by playing off one department against each other as if they were 'market competitors' (cf. 'Rescuers Row at Crash Site Alleged', *SMH*, June 28, '89, p. 2).

And yet another indication of the government philosophy of administration is exemplified by the June 27 Cabinet decision to shut down the Government Printing Office with the loss of some 700 jobs. Announcing the decision, the Minister of Administrative Services, Mr. Webster is reported to have said 'the closure was the only rational decision and that the majority of the employees would be able to get new jobs'. While this example cannot warrant a full scale case study in this book for reasons of timing, it appears the decision has been motivated by the views on privatisation and competitive tendering which have been criticised in Chapter Five. Apart from the publication of Hansard, the government is reported to be 'contracting out' all the work of the Printing office (Media Release: The Hon. Robert Webster, MP, 27/6/89). The opposition challenged the financial merit of the sell off because it is clear that strategies of commercialisation and renewal can considerably reduce the current subsidy of the Printing Office (Carr, AFR, 28.6.89). It is unfortunate that this final option did not receive any attention since the printing industry with its changing technology has proven to be a fertile ground for strategies of renewal and development (Botsman & Rawlinson, 1986).

Table 10.10

Administrative Services

Departments	**Functions, Services and Financing**
Administrative Services	Administrative services to the public service; Government Information Service; Government Supply Office, Govt Printing Office. *Large deficit.*
Local Government	Administration of Local Government. *Small deficit.*
'Premier'	Two departments – Cabinet Office (monitoring of government policy); Premier's Office (administration, Aboriginal affairs). *Large deficit.*
Police	Enforcement of law and order. *Large deficit.*
Corrective Services	Custody of prisoners; community-based programs; post-custodial services (probation and parole). *Large deficit.*
Treasury	Economic policy advice to government; economic management of State public sector; revenue collection (Office of State Revenue). *Large surplus (more than 25% of Consolidated Fund receipts).*
Valuer-General	Valuation for rating and taxation. *Medium deficit.*
Agriculture (and Fisheries)	As above.
Business and Consumer Affairs	As above.
Authorities	
State Lotteries	Draw and instant lotteries. *Medium surplus.*
State Pollution Control	Air, water and noise pollution control; overseeing of waste disposal; environmental Commission protection. *Large deficit.*
Treasury Corporation	Loan raising for Budget sector, authorities and electricity county councils. *Zero deficit.*

Notes: See Table 10.8.

10.4.4 The Trend to Privatisation

Naturally, an outline of the range of public sector functions does not, in any manner justify the status quo, for it may be that those functions are not being adequately fulfilled; or that their benefit-cost ratios do not warrant them being carried out at all. Indeed the critique of public sector activity by conservatives and economic liberals (as well as others) inevitably is a variation on one or more of these themes.

There is, in fact, great scope for reform, but any such change must recognise the role of the State sector, since this establishes the rationale or objective for reform. The position taken in

this study is that the role of the New South Wales State public sector is to advance the material and social conditions of the citizens of the State, subject to constitutional limitations and the constraints of national policy. This objective points to the need for effective and efficient provision of State services, sound management of State assets (and liabilities), and a progressive system of State expenditures, taxes and charges, consistent with maintenance and advancement of real (social) wages and decent working conditions. This provides the basis for a program of progressive State sector reform and renewal.

Against this, the conservative government is instituting a program which is ultimately pernicious in its consequences for working people, and the community's disadvantaged. On the one hand, the government has moved to sell assets (enterprises and physical assets) which are profitable or capable of being made so, thereby reducing the asset base of the sector to the extent that the resulting funds are used for purposes other than asset purchases (or debt retirement). This deprives the State sector, and thereby the community of New South Wales, of a non-tax income stream (or potential income stream) which could be used to finance other (non-profitable) services (taken to the limit it would deprive the sector of any profitable activities). On the other hand, non-profitable services are being run down and public provision narrowed via contracting out, State public sector abrogation and voluntarism. To the extent that this asset management and expenditure policy is part of a strategy to deliver tax reductions in the future (to whose benefit is unclear at this point in time), it involves running down the sector in order to finance consumption (public or private). In this respect the policy stance of the government involves a twofold abrogation of managerial responsibility: an unwillingness to manage the State sector capital stock so as to maximize pecuniary returns to the community, where appropriate (subject to socio-economic objectives); and an unwillingness to manage the sector so as to maximize non-pecuniary economic and social returns. The following is a (by no means complete) list of policies which the conservative government has initiated along these lines during the first year of its administration:

– sale of State Investment Corporation; 99 Macquarie Street (UTA, now STA), an Australian record auction price for a building ($69m); space above and land adjacent to St. Leonard's Railway Station (SRA), the former on a 99 year lease; industrial land, Homebush Bay (MSB);

– proposed sale of GHA; four power station sites at Balmain, Bunnerong, Pyrmont, White Bay (Elcom); harbourside properties (eg., Woolloomooloo Bay Finger Wharf) and coal loaders in Sydney, Newcastle, Wollongong (MSB); Transport House, Wynyard (SRA); New South Wales House, London; land vacated by closure of Homebush Abattoirs and State Brickworks (Homebush, Blacktown) – the Blacktown property has been sold already; 178-80 Phillip Street (Public Works); Sydney Showground; Prince Henry Hospital, Camperdown Children's Hospital, parts of Rydalmere and Parramatta Hospitals, Strickland House in Vaucluse (Health); Pyrmont Point, Mort Bay (Housing); 15 homes previously used for teenage State wards (FACS);

– inauguration of a number of private tollways; partial privatisation of electricity production (proposed); private sector 'Darling Harbour style' commercial/tourist/residential redevelopment of Pyrmont-White Bay area, using land now owned largely by Elcom, GHA and MSB (proposed); lease of navy base at South Head, for a private university; substantial staff cuts and expanded use of contract labour in Elcom (especially for maintenance), Public Works, and elsewhere; expanded private involvement in the Local Employment Initiatives program ('Business in the Community Ltd.', a subsidiary of Rotary) – grant from Department of Industrial Relations and Employment; increased use of community groups in provision of welfare services (eg., grants to the Volunteer Centre of New South Wales);

– abolition of 2,000 teaching positions; closure of approximately 15 inner city and North Shore schools; closure and cutback of country hospitals, rail services and court

houses; closure of one quarter of the State's community welfare offices and abolition of 350-400 positions (FACS); abolition of ethnic policy adviser position (FACS) and Ethnic Consumers Unit (BACA); abolition and reduction of a variety of employment assistance schemes (eg., Youth Employment Scheme); asset sales, equipment cutbacks and station closures (Police); abolition of independent tenancy advice services; imposition of fees for legal aid.

– commercialisation of SRA freight division; recommended shift towards commercial pricing in MSB; abolition of TransCover, with substantial increases in third party motor vehicle insurance premiums; removal of union representatives from Boards of statutory authorities.

Table 10.11

Trends in New South Wales Budget Revenue by Source

	81/82	*82/83*	*83/84*	*84/85*	*85/86*	*86/87*	*Growth 81-87*
Taxes, Fees & Fines							
%	28.2	29.6	29.7	29.8	30.2	30.5	
$m*	2,880.1	2,976.8	3,117.5	3,292.9	3,424.6	3,574.1	4.4
*NOS** of PTE's*							
%	4.7	7.5	6.7	7.8	7.2	6.5	
$m*	483.5	760.5	702.6	860.6	822.0	768.0	12.3
C'wealth Grants							
%	40.1	42.1	43.9	44.1	43.0	40.7	
$m*	4,095.9	4,226.0	4,602.4	4,867.7	4,889.8	4,769.9	4.1
*GG*** Net Borrowings*							
%	1.0	0.7	1.0	3.2	3.3	3.2	
$m*	100.0	66.4	101.7	354.6	371.8	375.0	75.0
PTE Borrowings							
%	17.4	11.3	13.5	4.8	7.5	4.7	
$m*	1,780.8	1,137.7	1,415.2	532.3	856.0	549.5	-9.8
Other Provisions							
%	8.6	8.8	5.3	10.3	8.8	14.4	
$m*	881.6	880.2	550.8	1,133.2	994.8	1,693.8	45.2
Total Revenue							
%	100.0	100.0	100.0	100.0	100.0	100.0	
$m*	10,221.9	10,047.6	10,490.2	11,041.3	11,359.0	11,729.8	2.8

Notes: * Average 1981/82 Prices.
** Net Operating Surplus.
*** General Government.

Source: ABS 'State and Local Government Finance, Australia 1986/87', Cat. No. 5504.0 and ABS 'Sydney CPI', Cat. No. 6401.0.

It may be noted that not all of these policies are necessarily undesirable. In some exceptional cases the asset-selling department may gain all (this is the case with Health Department asset sales) or part of funds realized – the usual procedure now seems to be divert approximately 50% of returns to Consolidated Revenue, and retained funds can be used for debt retirement or acquisition of new assets. However, as will be made clear the Government's program is not based upon the principles of sound asset management, but an ideological determination simply to wind back the public sector, regardless of the social or economic costs.

Table 10.12

Trends in New South Wales Tax Revenues

Average 1981/82 Prices

	1982/83	*1983/84*	*1984/85*	*1985/86*	*1986/87*	*1987/88*	*Avg. Ann. Real Growth*	*1987/88 % of Total*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*	%	%
Payroll	983.3	949.4	1006.0	1019.0	1016.5	1010.1	0.5	25.1
Property	559.0	624.6	704.3	797.7	948.5	1335.8	19.5	33.2
Land Taxes	166.2	159.0	182.8	221.0	235.9	261.9	9.9	6.5
Stamp Duties	322.1	363.2	418.9	470.6	586.4	927.5	24.6	23.1
FID	49.6	94.1	99.1	102.5	112.4	117.1	22.5	2.9
Other	21.1	8.3	3.5	3.6	13.9	29.3	94.9*	0.7
Provision of Goods and Services	589.6	618.0	607.3	603.7	592.4	615.2	–	15.3
Levies of Stat Corps	9.7	10.4	11.9	12.0	10.8	17.8	15.1	0.4
Gambling	378.6	380.7	388.7	393.3	372.7	381.9	0.2	9.5
Insurance	201.3	226.9	206.7	198.4	208.9	215.5	1.7	5.4
Use of Goods and Services	689.7	759.7	809.9	838.2	834.7	842.1	4.1	20.9
Motor Vehicles	400.2	438.5	468.7	472.6	466.3	473.2	3.6	11.8
Business Franchise	282.7	316.2	336.3	361.0	364.3	364.6	5.3	9.0
Other	6.8	5.0	4.9	4.6	4.1	4.3	-7.7	0.1
Fees and Fines	163.4	172.5	178.8	177.6	198.7	220.2	7.2	5.5
Total	2985.0	3124.2	3306.3	3436.2	3590.9	4023.4	6.2	100.0

Note: * This growth is due to the introduction of the Statutory Authorities' Loan Guarantee Fee in 1986/87.

Source: ABS 'Taxation Revenue, Australia, 1987/88', Cat. No. 5504.0 and ABS 'Sydney CPI', Cat. No. 6401.0.

10.4. The Finances of the New South Wales Public Sector

10.4.1 Revenue

The main sources of revenue to the New South Wales State Government are Commonwealth Grants, which in 1986-87 accounted for 41% of total revenues, and State taxation which accounted for nearly 30%. Other sources of revenue include net operating surpluses of trading enterprises (6.5%) and other internal financial provisions (14.4%). The remaining source of finance to the State budget comes from net borrowing (both trading enterprises and general government) which accounts for nearly 8% of total revenues (see Table 10.11 below). There has been a marked reduction in the contribution of net borrowing to the budget over the past five years – particularly net borrowing by trading enterprises. The rapid growth in other provisions as a source of funding suggests greater use by the government of sinking fund facilities in meeting debt commitments. Although its contribution to revenue remains relatively small, nevertheless, the income generated by trading enterprises has been an increasing source of State funding despite the fact that government charges for public services have risen at a rate lower than the consumer price index over recent years (see New South Wales Budget Information Paper No. 2, p. 365). Perhaps the most important trend has been the strong growth in State taxes as a source of New South Wales budget revenue.

Table 10.13

New South Wales Consolidated Fund Recurrent Receipts

	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*	*1988/89*[a]
State Sourced: Taxation	40.5	40.4	40.6	42.0	44.6	46.3
Mining, Lands & Forestry	1.9	1.9	1.7	1.7	1.4	1.5
Receipts for Services Rendered	5.0	5.1	4.7	4.7	4.6	4.7
DMT[b]					1.7	1.8
Health					0.7	0.7
Other					2.2	2.2
Other	6.6	6.9	6.8	6.0	6.5	6.7
State Instrumentalities Contributions					1.0	1.6
State Lotteries					0.7	0.7
Other Recurrent Receipts					4.8	4.4
Total, State Sourced	54.0	54.3	53.7	54.4	57.2	59.2
Commonwealth Recurrent Payments	46.0	45.7	46.3	45.6	42.8	40.8
Total Recurrent Receipts	100	100	100	100	100	100

Notes: [a] Estimates.
[b] Now the RTA.
Due to rounding, in some cases percentages do not add to 100.
Source: New South Wales Budget Paper No.2, 1988/89, Tables 4.2,4.3.

As illustrated in Table 10.12 below the major sources of tax revenue are payroll tax (25.1%), stamp duties (23.1%), motor vehicle taxes (11.8%), taxation on business franchises (9%), gambling taxes (9.5%) and land taxes (6.5%). The reasonably strong growth in tax revenues over the past five years is attributable to a number of factors, primarily the rapid growth in stamp duty and tax collections arising from the buoyant activity in the stock exchange market in Sydney (Australia's major financial centre) and the escalation in Sydney housing and land prices. Resilient employment growth has ensured that payroll tax, the major source of tax revenue, also has remained a solid contributor.

Table 10.13 below shows that the declining share of Commonwealth payments since 1986-87 has been offset by a rising share of State tax revenues. State non-tax revenues are a small though significant component; but actually have shown some tendency to decline as a percentage of recurrent receipts. Commercialisation is about increasing this contribution (as well as reducing Budget outlays to a range of trading, or potential trading activities).

10.4.2 Expenditure

As Table 10.14 reveals, of total New South Wales Government expenditure in 1986-87, capital spending represented around 25%, consumption nearly 48%, interest payments 12.6% and other unrequited transfer payments 14.4%. Accompanying the compositional change in outlays has been a discernible increase in the allocation of own purpose expenditures towards interest payments and associated debt retirement. Since the early 1980s there has been a more subdued approach by government to public capital formation. This partly reflects an increased priority to wind back long-term government debt – particularly that of trading enterprises, which are the State agencies primarily responsible for the provision of economic and industrial infrastructure – so as to retard the growing allocation of expenditure to debt servicing costs. Although this development has been seized upon by policy makers sympathetic to privatisation, Chapter Eight has already demonstrated that the debt burden of New South Wales is entirely bearable, and cannot be used to justify the goal of a smaller public sector.

Table 10.14

Trends in New South Wales Government Expenditure

	81/82	*82/83*	*83/84*	*84/85*	*85/86*	*86/87*	*Avge 81-87****
Capital Expend %	27.0	25.0	25.4	24.2	24.3	25.3	
$m *	2,762.4	2,513.3	2,663.7	2,667.8	2,761.7	2,971.6	1.6
Consmp. Expend %	49.6	48.6	47.8	48.8	48.3	47.7	
$m *	5,066.8	4,877.8	5,012.5	5,387.4	5,483.3	5,590.5	2.1
Interest %	9.9	11.3	11.4	11.9	12.8	12.6	
$m *	1,012.3	1,138.8	1,200.2	1,317.7	1,451.8	1,475.6	8.0
Other **%	13.5	15.1	15.4	15.1	14.6	14.4	
$m *	1,380.5	1,517.8	1,613.7	1,668.4	1,662.1	1,692.6	4.2
Total %	100.0	100.0	100.0	100.0	100.0	100.0	
$m *	10,221.9	10,047.7	10,490.1	11,041.3	11,358.9	11,730.3	2.8

Notes: * (average 1981/82 prices).
** Unrequited Transfer Payments.
*** Average Annual Real Growth.
Source: ABS 'State and Local Government Finance, Australia, 1986/87', Cat. No. 5504.0 and ABS 'Sydney CPI', Cat. No. 6401.0.

10.4.3 Functional Priorities

Table 10.15 shows that economic and industrial services (inclusive of transport and communication), which for the most part are carried out by statutory authorities, account for nearly 25% of total outlays in 1986/87, a figure which had steadily fallen over the preceding 5 years. In contrast, the social services area increased its share of total expenditure. Education (24%), health (17%) and social welfare and community services (22%) together accounted for nearly 65% of total expenditure outlays.

While total public sector outlays have grown at about the same rate as New South Wales GSP during the 1980s, there has therefore been a significant compositional change, reflecting the changing priorities of government in response to social and economic needs. The considerable slowdown in expenditure on economic and industry services evident from 1982/83, follows a period of large scale investment related to the installation of increased energy, transport and communication capacity. This slowdown can, in part, be explained by the reluctance (until recently) of government to raise charges in line with inflation. Governments were also responding to the demand to minimise the rate at which long-term accumulated debt grew, particularly as interest rates were generally higher than historic levels. However, the main reason was the need to redirect expenditures towards social welfare and community and recreational facilities, arising from the growing demands in these areas, in turn due to lower real incomes, housing rental shortages and demographic factors related to the marked aging of the population. The average annual real growth in State public sector spending over the past five years has been particularly strong in social security and welfare (9.9%), public housing and community amenities (8.8%), health (5.9%), as well as recreation and culture.

These changes in spending priorities are mirrored by the pattern of capital expenditure. Although approximately 52% of total capital spending is directed toward economic and industry services (including transport and communication), the growth in capital expenditure in these areas has been slow or negative, whereas there has been strong growth in capital spending in the areas of health (20.9%) and social security and welfare services (14.2%). This pattern is revealed in Table 10.16.

Table 10.15

Trends in New South Wales Government Outlays by Purpose

	1981/82	*1982/83*	*1983/84*	*1984/85*	*1985/86*	*1986/87*	*Avge Real Growth 1981-87*
Education							
%	27.4	27.2	26.7	26.5	25.8	24.3	
(avg 1981/82 prices) $m	2,793.0	2,735.6	2,804.0	2,922.0	2,932.2	2,855.6	0.5
Health							
%	14.6	13.1	14.0	15.3	15.8	16.6	
(avg 1981/82 prices) $m	1,483.6	1,320.2	1,466.3	1,691.2	1,789.5	1,939.7	5.9
Soc. Welfare & Community Services							
%	18.6	17.2	18.1	19.5	19.8	22.3	
(avg 1981/82 prices) $m	1,890.8	1,727.4	1,894.7	2,160.5	2,252.9	2,615.5	7.1
Transport & Communications							
%	15.4	14.6	16.0	15.6	15.5	13.6	
(avg 1981/82 prices) $m	1,571.2	1,471.3	1,680.3	1,718.4	1,758.3	1,594.1	0.6
Economic & Industrial Services							
%		12.8	14.5	12.2	9.8	9.1	9.4
(avg 1981/82 prices) $m	1,314.4	1,453.8	1,282.5	1,084.4	1,034.1	1,101.7	-2.9
*Other **							
%	11.2	13.3	13.0	13.3	14.0	13.8	
(avg 1981/82 prices) $m	1,137.1	1,339.0	1,362.3	1,464,9	1,591.9	1,621.4	7.5
Total Outlays							
%	100.0	100.0	100.0	100.0	100.0	100.0	
(avg 1981/82 prices)	10,190.1	10,047.3	10,490.1	11,041.4	11,358.9	11,728.0	2.9

Note: * Includes Public Debt Transactions.

Source: ABS 'State and Local Government Finance, Australia 1986/87', Cat. No. 5504.0 and ABS 'Sydney CPI', Cat. No. 6401.0.

Indebtedness

The level of outstanding (net) State sector debt as a proportion of GSP is also worthy of attention here. In New South Wales, this ratio is about 18%, somewhat down on its recent peak of over 24% in mid-1985 (see Table 10.17 below). According to figures compiled by State Treasury this is well below the ratio prevailing in other States (New South Wales Budget Information Paper, No. 2, p. 359). Although net debt has been reduced over recent years, debt servicing costs as a proportion of State Government receipts (including Commonwealth Grants) have gradually increased, reflecting the increased budget expenditure allocation to interest payments and provisions for the retirement of debt, as well as the relative decline in Commonwealth grants.

Table 10.16

Trends in New South Wales Government Capital Outlays by Purpose

	81/82	*82/83*	*83/84*	*84/85*	*85/86*	*86/87*	*Avge 81-87* **
Education							
%	8.9	7.9	8.0	8.6	8.3	7.8	
$m *	247.2	199.4	213.4	228.8	229.1	233.0	-0.6
Health							
%	1.8	1.7	1.7	2.6	3.3	3.9	
$m *	49.5	43.6	44.2	69.8	89.8	115.3	20.9
Social Welfare & Community Services							
%	22.4	18.6	24.6	30.2	30.8	36.3	
$m *	618.5	467.9	655.0	806.7	849.5	1,078.8	14.2
Transport & Communications							
%	29.8	26.7	33.9	34.9	35.3	28.4	
$m *	822.8	671.8	904.2	932.5	975.7	842.6	2.1
Economic & Industrial Services							
%	36.9	45.0	31.7	23.5	22.9	23.9	
$m *	1,018.0	1,129.4	844.8	625.9	633.2	710.8	-5.2
Other							
%	0.2	0.1	0.1	0.2	-0.6	-0.3	
$m*	6.6	1.1	2.1	4.1	-15.7	-8.9	–
Total							
%	100.0	100.0	100.0	100.0	100.0	100.0	
$m *	2,762.6	2,513.2	2,663.7	2,667.8	2,761.6	2,971.6	1.7
General Government							
%	32.8	33.3	40.0	45.5	43.1	42.3	
$m *	906.2	836.3	1,065.9	1,214.3	1,190.6	1,256.0	7.4
Public Trading Enterprises							
%	67.2	67.7	60.0	54.5	56.9	57.7	
$m *	1,856.4	1,676.9	1,597.8	1,453.5	1,571.0	1,715.6	-1.2

Notes: * Average 1981-82 prices.
** Average Annual Growth Rate.
Source: ABS 'State and Local Government Finance, Australia 1986/87', Cat. No. 5504.0 and ABS 'Sydney CPI', Cat. No. 6401.0.

By way of summary the following points may be emphasized:

– the size of the sector has increased only marginally over the course of the 1980s with revenues growing slightly faster than expenditures as a percentage of GSP – though State sector employment has grown more slowly than total State employment;

– on the expenditure side, there has been an increased allocation of State own purpose expenditure to meeting debt servicing commitments over the past few years, though the present trend in (net) debt reduction suggests that the burden on the State budget of debt servicing costs in future years will fall; and,

– on the revenue side, the government has

over recent years reduced its reliance on external borrowings by increasing its 'internal' sources of revenue from tax receipts and charges on public services.

Finally it should be kept in mind that these trends in the State sector have occurred against a background of economic and employment growth in the New South Wales economy which is slightly below national performance, as Section 10.2.2 demonstrated.

Table 10.17

Trends in New South Wales State Public Sector Debt

	Outstanding State Public Sector Debt *	*Debt Serv. Costs to the State Budget* +	*Gross State Product at Market Prices*	*Debt as a Proportion of GSP*	*Debt Servicing as a Proportion of State Govt. Receipts*
	$m	*$m*	*$m*	%	%
As at 30 June					
1983	12,185.1	n.a	60,298	20.2	n.a
1984	14,965.7	732.3	66,531	22.5	17.7
1985	17,710.3	852.9	72,750	24.3	18.5
1986	18,862.6	1,081.2	81,726	23.1	21.0
1987	21,492.3	1,269.7	90,242†	23.8	21.9
1988	18,116.6	1,483.4	101,369†	17.9	21.4

Notes: * Debt is at its capital value, calculated as 'the amount of the loan proceeds, amortised over the life of the loan to face value' (Budget Paper No. 2, 1988-89, p. 319).
+ Refers to Debt Servicing Costs for the 'Inner Budget Sector Plus Transport Authorities' (Budget Paper No. 2, 1988-89, p. 322).
† Based on New South Wales State Treasury estimates of GSP growth.
n.a. Not available.
Source: Budget Paper No. 2, 1988-89, ABS 'State Accounts, 1986-87', Cat. No. 5220.0 and ABS 'Australian National Accounts — National Income and Expenditure, 1987-88', Cat. No. 5201.0.

10.5 Budgetary Policy — Revenues, Outlays and Debt

The purpose of this section is to provide an analysis of budgetary policy and its implications for the management and direction of the New South Wales State public sector, though at a number of points budgetary policy becomes inseparable from 'micro-economic' policy. For example, the scale of State sector outlays (expenditures) is inter-dependent with the amount of State revenues (receipts); but the latter is in part a function of the pricing policies applied to State trading enterprises, since these policies influence the size of non-tax revenues of the sector and hence the size of any net subsidy to (or from) trading enterprises, financed from other, essentially tax, revenues (or contributing to other, essentially non-traded, State sector activities). (The micro-economic dimensions are taken up in detail in Section Five below). By way of preliminary, the logic of budgetary policy — as it particularly pertains to New South Wales under conservative government — may be indicated by considering two stylised cases.

1. A deficit between total outlays and recurrent revenues entails new borrowings and/or asset sales. From the standpoint of maintaining and enhancing the State sector this might appear at first glance an undesirable situation, since it increases liabilities and/or reduces assets. However, there are two sides to these capital transactions and in themselves new borrowings or asset sales are not undesirable. Suppose that the 'outlay/recurrent-income deficit' is due to a capital outlay (asset purchase) to be financed by asset sales. In this case the composition of public assets is merely being changed; and if the priorities dictating the compositional change are appropriate, this

would be desirable (taking as given the total scale of assets). If this reshuffling of assets involved a switch towards better utilized assets (eg., surplus or under-utilized land sales to finance increased public housing), then this restructuring would yield higher social and/or pecuniary returns to the State sector capital stock – in the latter case, subsequently adding to recurrent revenues. The same logic applies to new borrowings used to finance capital outlays – the addition to liabilities is matched by an addition to assets. If these capital outlays generate pecuniary returns which at least cover debt servicing costs, then the debt will be self-financing, generating recurrent revenue which at least covers the cost of capital. There is no compelling reason why use of borrowings should be limited to public sector projects which are (or are expected to be) self-financing in this sense: if the social returns from the use of borrowings are regarded as more than compensating for debt costs, then borrowings can also be justified. However, it should be evident in the latter case that if borrowings are used to finance capital outlays which do not generate a (sufficient) pecuniary return (eg. new schools), or consumption outlays (eg. more teachers), then debt servicing will have to be financed out of recurrent revenues (or asset sales). This involves a cross subsidy from those who provide the recurrent revenues (or benefited from the previously owned assets), most notably tax payers, to those who benefit from the outlay – which, of course, may be perfectly justifiable from the social standpoint.

II. Consider now a second case where a State Government pursues a budgetary policy aimed at reducing both taxes and State debt. To retire debt with a view to reducing total debt levels requires an excess of revenues net of new borrowings over outlays net of debt servicing costs, so that the resulting surplus can be used to service debt principle. If at the same time tax revenues are to be reduced, then this budgetary policy points to some combination of three options: reduce outlays net of debt servicing costs, so as to more than offset tax reductions; increase non-tax revenues; and/or sell assets. The first would include reduced public goods and services, running down the State sector capital stock, getting the same services at lower outlays by altering wages and conditions of State sector workers, contracting for lower input prices for the sector, or improving technical efficiency. The second would include increasing the prices of State traded goods and services by extending the application of 'user pays' with a view to non-tax financed cost recovery. The third would include sale of assets which generate, or are potentially capable of generating, pecuniary returns to private wealth-holders (commercial or potentially commercial assets or enterprises), including public land. This case II budgetary policy is in essence the strategy of the Greiner State Government.

A number of subsidiary points may be added:

– *at first glance it might appear to the lay person that debt retirement is always a good thing – the old-fashioned maxim, 'neither a borrower or lender be' – but this is not so.* If the stream of (pecuniary and/or non-pecuniary) returns from debt-financed outlays exceeds debt costs then acquiring debt is desirable, subject to the viability of servicing debt costs. Asset sales to finance debt retirement may be desirable if the reduction in debt servicing costs frees up recurrent revenues for other purposes (eg., health, education and welfare); on the other hand, if the interest rate on a debt is less than the rate which can be earned on public funds invested, debt retirement will generate pecuniary losses. The retirement of Sydney Harbour Bridge debt by the Greiner Government was just such an error, probably designed to serve as a political stunt. Retiring debt may or may not be desirable – what is required in general to determine this is an analysis of the relation between outlay returns and debt costs, and debt costs and recurrent revenues (income);

(ii) case II above is a strategy which inevitably involves reducing the State sector capital stock and/or consumption expenditures, to the benefit of increased private consumption or capital accumulation – with all the macroeconomic and redistributional consequences likely to flow from this (Certainly tax reductions financed by public asset sales

will increase consumption at the expense of total (public and private) capital accumulation);

– treating the New South Wales State sector as a corporation in the generic sense is quite harmless in itself; but there is a fundamental difference between a 'social corporation' like New South Wales and a private corporation. A private corporation has no other function or obligation than to maximize the private rate of return to private capital, within the law, the pecuniary rate of return being private wealth-holders' only interest in investment. *The function and obligation of government is to maximize social returns to social capital, of which, in a representative democracy, government is the mere custodian on behalf of the people.* Consider a case where government reduces outlays on home care. From the narrow standpoint of the State sector considered in isolation and purely in pecuniary terms, this 'improves' the balance sheet since (all other things being equal) consumption outlays have fallen. However this change increases costs to the individuals and families that previously benefited from this service – a new cost is added to their 'budgets' and so impacts adversely on their (notional) balance sheets. From the social standpoint – and this is the only legitimate standpoint for economic analysis as well as public administration – costs have simply been shifted from one balance sheet to others. From the social standpoint this exercise thus appears as a kind of fraud. For economic analysis what is required is a social calculus, not merely a pecuniary calculus. It is the 'budget' and 'balance sheet' of New South Wales society as a whole – where revenues (costs) and outlays (benefits), assets and liabilities, are conceived in the most comprehensive social and economic terms – which is the proper object of both economic analysis and socio-economically responsible government.

10.5.1 The Budgetary Strategy of the Liberal-National Government

Though the conservative government has been in power only since March 1988, there is little mystery about its medium term (3-4 year) strategy for the State sector. After coming to power the government established a 'Commission of Audit' (Curran *et al.*, 1988) with a view to establishing a 'true' balance sheet for the sector, so that the new 'sound (conservative) managers' could proceed with their task of placing 'NSW Inc.' on a proper financial footing. It may be said at the outset that this exercise has had a primarily political motivation, though the program has wide-reaching economic consequences (In particular, Curran's exaggeration of the State sector's exposure to liabilities set a tone of crisis – a kind of $1.5m public relations stunt, for justifying radical action (compare with the Auditor-General's comments in A-G II ([1988], pp. 111-13).

The government is aiming to reduce debt and taxes; and it is evident that this points, almost inexorably, to asset sales and expenditure reduction. Likewise it points to a strategy of generating more services for the same budget expenditures, or the same services for less expenditures. This aspect points to pervasive micro-economic consequences of the strategy: attempting to extract more work out of State sector workers by worsening conditions; contracting out to private sector agencies whose workers are denied similar wages and conditions to State sector workers; shifting social and welfare services on to private charitable agencies, including family units; wide-reaching structural changes to the pricing policies and operations of trading (or potential trading) enterprises, particularly the major deficit agencies which draw heavily on State revenues which the government would prefer to release for tax cuts (See Section 10.4.4 for examples). In the latter case the transport utilities are particularly under scrutiny (the UTA's deficit was much larger as a proportion of outlays than the SRA's; but the SRA's much larger outlays give it a greater budgetary significance). Nevertheless all trading enterprises are under examination as to asset (and debt) management, technical efficiency, pricing policy, and wages and conditions. It must be stressed that all this structural ('micro-economic') change, or projected change, is driven by a budgetary strategy; and behind this is a political strategy of seeking to ensure that the State sector after 3-4 years will

have delivered up net revenues for the provision of tax cuts, with a view to the re-election of the conservative government

The strictly ideological character of much of Curran *et al.*, (1988) can be evidenced by the following statements – further examples of which could be multiplied many times over – with regard to the related issues of tax reduction, contraction of State expenditures and activities, and the abolition of State trading enterprise. It must be stressed again that no attempt is made to justify these propositions or the desirability of these policies, other than mere assertion:

> – '. . . a more secure future for New South Wales . . . [is] a future offering a smaller, more responsible Government meeting genuine community needs, a lowered taxation impost on its citizens, all within a framework of productive effort and financial responsibility' (p. viii);.
>
> – 'The . . . general presumption . . . should be that the private sector has a number of advantages over the public sector . . .' (p. 69).
>
> 'In the future, the State . . . sector would be much smaller with only those services being performed which cannot be provided commercially by the private sector' (p. 66);
>
> – '. . . the Government should retain only that property necessary for its operations which cannot be economically provided by the private sector in a competitive environment. . . . Property which is not currently required, or by rationalisation [ie., sale] of activities can be made available, or is considered surplus, should be disposed [sic]' (p. 97); and
>
> – 'The government should, as a matter of urgency, act to reduce significantly the size of Government based upon a review of services and activities in which it should properly be engaged. Possible areas for early rationalisation [ie., sale] of Government activities include:
>
> Building maintenance
> Bus services . . .
> Elcom coal mines
> Engineering Workshops
> Ferries . . .
> Government Insurance Office
> Grain Handling Authority
> Hydrofoil services
> Land Development – other than genuine welfare housing
> Maritime Services Board Coal Loaders
> State Bank
> State Lotteries Sales Offices . . .' (p. 109).

How far down this track the government will try to go, in part remains to be seen; but the Curran 'vision' certainly replicates the thrust of the government's program. What lies behind these views is a conviction that, as compared to the private sector, State service provision is invariably and inevitably inferior, if not an outright failure – and illegitimate if it occupies any ground which private capital could profit from. This is a view not arrived at by any empirical analysis of performance, but rather, an *a priori* belief from the catechism of the politico-economic theology of certain conservatives and economic liberals. It follows from this view that the government, rather than seeking to reform and revitalize the State sector in cooperation with the workforce, will be inclined, on the one hand to dismantle as much of the sector's trading enterprises as is politically and economically feasible, on the other hand to restrict those residual services which have no such commercial potential. The mere size of government becomes an irrational obsession, whereas the real issue of effective public administration is what is worth doing and how can it be done well, in the public interest and subject to budgetary and political constraints. Instead we witness a massive actual and prospective sell off of public capital assets which the government only controls on behalf of the public – a scale of sell offs for which the government sought no mandate at the 1988 election – to finance politically motivated tax cuts.

As mentioned above, in large part the Commission of Audit was an exercise in seeking to project a State debt crisis in order to 'soften up' community opinion for a sell off public assets and a reduction of State sector services. Our comments are not intended to convey the impression that State public debt should be

treated as trivial to State sector management and reform; but the significance of debt must be grasped in the framework of a reasoned economic analysis.

It is in the nature of much State sector capital accumulation that it does not, or should not – and in many cases, could not conceivably – yield pecuniary returns in any way commensurate with costs (eg., capital assets such as schools, hospitals and police stations). In these cases borrowings cannot be self-financing but this does not mean that they are unjustified. From the social standpoint, which is the proper standpoint for economic analysis, a stream of non-pecuniary economic and social returns can warrant debt-financing of such investments.[1] The contrary Curran doctrine has no economic or ethical justification (it should be stressed that these non-pecuniary returns are not merely intangible, but include quite tangible economic returns – eg., from education – which are either not appropriated or non-appropriable by government). On the other hand, in general there is no warrant for borrowing for current public consumption (which by definition yields no future returns, pecuniary or otherwise) since this imposes the costs on 'future generations' who receive no benefits from the consumption. There seems no justification in general for such 'inter-generational' redistribution of net benefits.

In the case of State sector borrowings which are not self-financing the question of debt management becomes particularly important. The growth of debt increases debt servicing costs which must ultimately be financed out of recurrent revenues, thereby reducing revenues available for other budgetary purposes. It follows that continuous growth of debt may lead to a continuous rise in the proportion of State revenues devoted to debt servicing – a situation which would be unsustainable since it would eventually lead to debt charges consuming all of recurrent revenues. However, New South Wales is far from a position wherein the growth of debt, or debt service costs, would be alarming; notwithstanding the efforts of Curran *et al*. (1988) to project such a crisis. Their use of nominal and absolute debt magnitudes, gross rather than net debt, assisted in this misrepresentation. Nor is there any recognition in their analysis of the fact that increase in debt service burdens primarily has been due to interest rate rises. As Groenewegen (1988, p. 8) has summed it up:

> '. . . the Commission's debt story is designed to drum up public support for higher public utility charges and social expenditure restraint by instilling fears of the near bankruptcy of the New South Wales State Government. This overt political purpose was exploited so ably by the Premier that it caused problems for State security values in overseas financial markets. The Commission has also tended to ignore the State's low relative debt levels (with respect to GSP) as compared to the other Australian States . . .'.

Social responsibility finds no place in a framework of mere financial accounting, which seems to provide a model of good government for the conservative administration. This is not to indict accounting – it simply cannot be asked to perform a task for which it is not designed. This important point can be illustrated in the language of accounting itself. The government has moved to shift a number of welfare services 'off budget' by placing these functions under the responsibility of private agencies, including families (eg., child care and refuges). From the accounting standpoint this increases State receipts net of outlays (all other things being equal) and hence allows an improvement in the sector's balance sheet (net assets); but from the social standpoint this shifts new costs on to other social units (charitable organisations, families, etc.) thereby reducing their 'revenues' (including non-pecuniary benefits) net of 'outlays' (including non-pecuniary costs) all other things being equal, thereby impacting negatively on their (in many cases, purely notional) 'balance sheets'. If there are diseconomies of scale in decentralised private provision of any welfare services (as seems likely), relative to the public provision, total net social benefits actually will decline. The same kind of illustration could be given in other areas, for example the deterioration of teachers' working conditions in order to cut costs, the resulting deterioration in

public education, and the impact of this on the 'balance sheets' of school children, and others (including in the future their employers and the Australian economy in general!). This kind of 'social audit' is essential to both economic analysis and responsible government. The 'corporate' model which apparently mesmerizes the Liberal Premier's administration is an abrogation of normal methods of economic assessment and normal social responsibilities of government.

Having said all this it should be added that there are aspects of the Commission of Audit's proposals and the government's program which deserve more serious consideration. These include: improvement of financial disclosure and accounting procedures, with a view to increasing the accountability of State sector agencies; related to this, reform of management practices, particularly with respect to asset management; and commercialisation of trading enterprises and explicit accounting and budgeting for cross-subsidisation. These will be discussed below.

10.5.2 Expenditure and Revenue Policies

With regard to the scale of State expenditure there are three basic accounting variables making up the budget identity: aggregate expenditure, recurrent revenues and net budget financing (consisting of net borrowings and asset sales). It is apparent, at least in the first instance, that for the purposes of budgetary policy only two of these three variables can be regarded as independent, with the remaining one treated as dependent on the prior policy setting of the other two. Of these three budget variables it seems more appropriate to treat the aggregate level of expenditures as largely dependent on prior determination of the amount of revenue raised and the size of net budget financing. The largest source of State revenues is Commonwealth Grants which depend in large part on the independent fiscal stance of the Federal Government, as well as how the Grants are allocated between the States, while Loan Council funds for capital works programs are subject to agreement under global borrowing limits. There is also at least a long term constraint on the State Government in raising loans because of the debt charges it implies, which ultimately impact on the size of expenditures net of debt servicing costs. Given these parameters, the State Government can only alter the scale of expenditures by adjusting revenue contributions from State taxation and charges on public goods and services. In the current macroeconomic environment governments at both the Federal level and in New South Wales have given priority to controlling debt financing and revenue raising, and then adjusting the scale of aggregate expenditures accordingly.

As indicated above, the budgetary strategy of the conservative government is to reduce State sector debt and deliver tax cuts by 1991/92, implying a decline in budget expenditure as a proportion of GSP. In order to meet its aim of 'containing the size of the State Budget Sector and indeed to reduce it relative to the size of the economy' it intends to allow the level of expenditure to grow at only a zero real rate (New South Wales Budget Information Paper No. 2, p. 3). Part of its strategy is to procure productivity gains in the sector through administrative restructuring as well as altering the wages and employment conditions of employees so as to maintain services at lower dollar expenditures. However, as suggested in the above quotation, the main thrust of the government's medium to long term expenditure policy implies a decline in the quantity, range and quality of services provided by the public sector. *To justify this position, the government has enlisted the simplistic economic argument asserted by Curran (1988, ch. 1), that restraining State sector expenditure in real terms will decrease State sector demands on productive resources and so release a greater volume of community savings which will increase private sector investment, and in areas traditionally serviced by the State sector. This spurious argument neglects the fact that State public expenditures provide an important source of demand which stimulates production in the private sector.* In contrast to the conservative argument, there is every reason to believe that a real reduction in State public sector expenditures, particularly capital spending, will lead to a slowdown not an acceleration in capital formation and economic growth and employment in the New South Wales economy. There are no formidable economic grounds why the role of the State

sector should be downgraded, nor why the scale of State public expenditures should be reduced in relation to the GSP.

The second aspect of expenditure policy is the composition of outlays, over which the State Government has fairly wide discretion, though subject to Federal constraints (Specific Purpose Payments in particular). The allocation of available funds for expenditure (net of debt servicing) cannot be regarded as based solely on objective criteria, it depends also on the political interests of the incumbent government. However, the government cannot easily ignore clearly recognized social and economic demands in the State; on the contrary, its political interests may well be best served, on many occasions, by giving priority to those areas of public demand. The conservative government's expenditure policy consists of giving priority to the areas of law, order, public safety, health, and roads in particular. These and other areas of social expenditures have been receiving increasing priority in budgetary funding over recent years, reflecting the acute need for such facilities and services in New South Wales. Demographic changes in the community, largely with respect to the aging of the population and the considerable shift in the distribution of population toward the Western and South-Western metropolitan regions of Sydney, has required both an expansion and relocation of public services, particularly in health, law, order and public safety, and education. In addition, the shortage of low cost rental housing in metropolitan Sydney and the general cuts in real incomes within the community over recent years has created a considerable need for public housing/community facilities including rental assistance programs as well as other welfare services to low income groups. The long-term trend in these demographic factors suggest that the provision of social welfare and community services will need to be a priority for some years into the future.

Given the government's commitment to reduce the overall level of expenditure and tax revenue, the increased allocation of expenditures to those priority areas mentioned above will be heavily dependent on obtaining expenditure savings in other areas of the New South Wales State public sector. Two main budgetary measures are to be adopted in order to obtain the necessary expenditure savings:

- an outright reduction in capital works programs undertaken by the sector in relation to the provision of economic and community services; and
- greater commercialisation of State trading enterprises, designed to increase their capacity to generate sufficient income to internally finance their operations and thereby remove or reduce reliance on the budget as a source of funds – if not provide a contribution to consolidated revenue. Some critical evaluation of these budgetary measures is warranted.

The reduction in State public works can to some extent be justified in the current circumstances, at least in the short-term, following the large-scale capital works program undertaken by the previous Labor Governments. The changing composition of Budget outlays since the early 1980s is outlined in Section 10.5 above, especially Tables 10.15, 10.16 and 10.17. The capital works program under Labor consisted of a marked expansion in infrastructure related to energy capacity (resulting in excess capacity) and public transport facilities, as well as the upgrading and the development of new recreational and cultural facilities (eg. the Entertainment Centre and Darling Harbour). These earlier capital works programs have provided scope for redirecting investment to other areas, in particular, the construction of public hospitals and other health facilities, public housing and community amenities, courts, prisons and police stations. While the conservative government has taken the opportunity to redirect capital spending in this way, its budget strategy clearly portends a long-term rundown in the capital stock of the State sector, particularly with respect to the public utilities.

The government's adoption of measures designed to 'encourage the private sector to play a greater part in infrastructure projects including transport links, energy and water systems, schools and hospitals' (New South Wales Budget Information Paper No. 2, p. 193) represents a serious attack on the capital spending

function of the New South Wales State public sector. There is no economic reasoning which suggests that the community will benefit by transferring these investment functions from the State sector to the private sector.

The government's expenditure strategy is also motivated by a desire to reduce budget subsidies to trading enterprises through the expansion of non-tax revenue-raising via commercialisation and corporatisation of enterprises. The objective of commercialisation and corporatisation is to improve trading enterprises' commercial performance. There can be little objection to the adoption of budgetary measures which improve the cost-effectiveness of public trading enterprises, via improved management practices and investment decision-making, providing it does not entail an abrogation of legitimate social responsibilities of government. In this sense, there is no contradiction between economic performance and the pursuit of social objectives.

Turning to the revenue side of the Budget, it has already been indicated as a general principle that borrowings should be used only to finance capital outlays – though not necessarily revenue-generating capital outlays – or debt retirement. Borrowing for investment with non-pecuniary returns is legitimate because there are future returns and so a debt burden may reasonably be placed upon 'future generations'. There is of course no completely compelling reason why capital outlays should not be financed by recurrent revenues – this would be 'State sector saving' – or indeed by asset sales. It may be added that strictly symmetrical reasoning leads to the recommendation that asset sales also in general should be used only to finance capital outlays or debt retirement: to do otherwise involves incurring liabilities or shedding assets – ie., reducing net State sector assets – to finance consumption or outlays. This would be State sector 'dissaving'. The use of asset sales to finance capital outlays (or debt retirement) simply involves a change in the composition of State sector assets (or assets and liabilities). There is no reason why this should not be desirable as effective public administration seeks to adjust the composition of assets to more accurately reflect the sector's socio-economic objectives in changing circumstances.

Formally speaking, an asset sale for purchase of another asset (or debt retirement) will be desirable if the stream of pecuniary and/or non-pecuniary returns from the existing asset – actual returns, or potential returns from better utilisation of the existing assets – is less than the stream of returns from the prospective asset (or the stream of debt costs of some existing State debt). It is evident from Curran *et al.* (1988, Ch. 5) and other sources that a part of the property holdings of State agencies have at least actual returns which have been near zero. This is related to the poor management and accounting practices in parts of the sector.[2] Since some agencies have not even had a clear idea of what properties they hold, they could not possibly have been managing those assets effectively, so as to generate some social return or other. These assets should be put to full and effective use so as to generate adequate pecuniary and/or non-pecuniary returns to the community. If they generate pecuniary returns these can be used to service debt or finance recurrent outlays. If they cannot be put to any such use they should be realized with a view to debt retirement. Quite symmetric principles apply to the use of borrowings to finance capital outlays: debt should be used to finance only capital outlays, or purchase of other assets which yield at least a commensurate stream of pecuniary and/or non-pecuniary returns; where debt is used to finance investments which do not yield sufficient pecuniary returns to be self-financing, this must be subject to an overall (long-term) debt management policy which ensures that debt servicing does not impose an undesirable drain on recurrent revenues. A high ratio of debt service costs to recurrent revenues which reduced revenues available for other recurrent outlays, is not in the interest of the community or of State sector workers.

Given a prudent debt policy, and a responsible policy towards selling truly 'surplus assets', recurrent revenues will determine the level of consumption expenditures plus any additional capital expenditures. Of course, instead of determining expenditures in this 'residual' manner one could independently determine expenditures and then ensure that

sufficient revenues are raised. Subject to broad economic constraints, the extent to which this can be done is essentially a political question.

New South Wales recurrent revenues divide into three fundamental categories:

- Commonwealth (general revenue and general capital purposes) grants and Commonwealth payments for specific recurrent and specific capital purposes;
- revenues arising from New South Wales non-tax charges, including fees for services rendered, revenue contributions by State trading enterprises (STEs) and the State Lotteries, minerals royalties, leases, interest receipts and rents; and
- New South Wales tax revenues, including receipts from stamp duties, pay-roll tax, land and racing taxes, licences.

Commonwealth grants do not lie within the power of State Government policy. It is also worth noting that via specific purpose payments, as well as the mix between general revenue and capital grants, the Commonwealth is able to exert a considerable influence on the composition of State expenditures. With regard to non-tax charges, these revenues arise primarily from pricing, profitability and sales of traded goods and services. The ability to generate revenues from these sources depends upon micro-economic policies pertaining to the extent of application of full or partial user pays, pricing policies of STEs, technical and cost conditions, management and so on. These issues will be dealt with below. It need only be pointed out here that to the extent that STEs and other user pays services generate net revenues they provide non-tax funds which can be used to finance other non-profitable or non-commercial State sector activities, reducing reliance upon tax and Commonwealth revenues.

Hence if we take borrowings and asset sales as determined by a prudent and progressive policy of debt/asset management, treat receipts from the Commonwealth as an external parameter, and take non-tax revenues as a given for the time being, then total outlays will depend upon State tax revenues.

As indicated above, tax reduction is part of the political program of the conservative government, serving as an axiomatic assumption for the Commission of Audit, not a conclusion of any economic or other argument. The proportion of tax revenues to Gross State Product (GSP) – and given GSP, the level of tax revenues – may rise or fall as a matter of policy decision. This is a political as much as an economic question. What we consider here is the tax mix, ie., the composition of any given level of tax receipts. The ratio of taxes to GSP can then be specified in accordance with politico-economic objectives and constraints, taken in conjunction with the possibilities offered by other sources of financing.

As it turns out, the issue of New South Wales tax mix has been capably and quite comprehensively examined by a Task Force established by the previous government (Collins *et al.*, 1988). The changing structure and scale of New South Wales tax revenues over the decade 1976/77 to 1986/87 are indicated in Table 10.18 below).

Although New South Wales imposes a wide variety of taxes (in 24 of the 29 categories of State taxation identified by the Australian Bureau of Statistics) many of these are 'nuisance' taxes which make only minor contributions to revenue and offer little prospect of providing a much greater contribution, as well as imposing high compliance costs. The great bulk of tax receipts derive from three sources: payroll tax, stamp duties and motor vehicle taxes. New South Wales (apart from Queensland) has the most highly concentrated State tax base, with the 'big three' tax sources together accounting for 61% of tax revenues. The narrowness of the tax base is a long-term problem facing all States, in so far as it prejudices a steady growth of tax receipts per capita in line with GSP, as well as making revenue raising prone to cyclical disturbances. Furthermore, virtually all New South Wales taxes are regressive, or at least non-progressive, in their incidence. Since the abolition of death duties no progressive taxes have been in place in New South Wales, with the partial exception of land tax (a form of wealth taxation), and there are severe constraints upon bringing more progressivity to the structure (Collins *et al.*, 1988, p. 86). But the most striking feature of the New South Wales

tax system (shared with all other States) is that it amounts to an arbitrary and discriminatory regime of indirect taxes – a piecemeal ramshackle product of history – with no economic or ethical rationale. Its only possible rationale is a political one: the Constitutional limitation upon State imposition of a broad-based indirect tax; and even supposing this to be an insurmountable obstacle does not justify the current degree of narrowness. A major conclusion of Collins et. al., (1988) is that a mere change in the mix of current taxes can change little with regard to either incidence or base narrowness.

Table 10.18

Trends in New South Wales Tax Revenues, 1976/77 to 1986/87

	% of Total 1976/77	*% of Total 1986/87*	*% increase in real tax revenues 1976/77 1981/82 **	*% increase in real tax revenues 1981/82 1986/87 **	*% increase in real tax revenues 1976/77 1986/87 **	*Tax Revenue per capita 1986/87 ($)*
Payroll	32.65	28.20	25.43	2.08	28.04	267.29
Property	13.73	6.61	-36.37	12.27	-28.56	62.70
Capital	10.65	19.40	60.66	68.00	169.91	183.87
Goods	0.00	0.62	**	108.07	**	5.83
Gambling	12.43	10.83	37.23	-5.85	29.20	102.65
Insurance	5.04	5.42	72.65	7.67	59.42	51.37
Vehicles	14.80	12.94	21.86	6.33	29.57	122.61
Franchises	5.56	10.22	134.51	16.19	172.47	96.89
Fees/Fines	5.15	5.76	66.39	-0.29	65.90	54.60
Total	100.00	100.00	32.63	11.76	48.23	947.80

Notes: * 1979/80 prices.
** No taxes imposed in this category until 1981/82.
Source: Collins *et al.* (1988), Tables 2.4, 2.5, 2.7, 2.8 (pp. 21, 27, 30, 31). Columns may not sum to Totals due to rounding.

10.6 'NSW Inc.' and Issues in the Reform and Development of State Public Services in New South Wales

The purpose of this section is to examine Premier Greiners' 'NSW Inc' in the light of micro-economic policy issues and the effective and equitable provision of State public services. By micro-economic policy in this context we mean policies pertaining to the structure, performance and methods of service provision of the sector. This involves a critical consideration of structural changes being pursued by the current government, as well as positive proposals for reform in light of the social objectives of the sector.

Section 10.6.1 provides an overview of the critical issues in micro-economic policy in New South Wales with regard to the State sector, since the election of the conservative government. This is followed by more detailed examination of three particular State instrumentalities: the Department of Health, Elcom, the GIO and housing. These case studies are followed by an analysis of the human services industry in NSW.

10.6.1 Issues in Micro-economic Reform

The link between budgetary policy and micro-economic policy was briefly indicated above. Restating the central point, a budgetary policy aimed at reducing State taxes and debt necessarily requires some combination of:

- reduced budget expenditures; and
- increased non-tax recurrent revenues and/or asset sales.

An additional point should be stressed here. Even in the absence of the conservative budgetary strategy State public administration in New

South Wales, as in other States, would be facing a difficult period of fiscal restraint. This is so because along with the impact of State Government policy, the State sector is coming under fiscal pressure from the Federal Government's strategy of fiscal restraint with respect to Commonwealth grants to the States (as well as pressure from restrictive monetary policy). The latter (Federal policy) is about as likely to go away as the former (State policy). Financing constraints, with all their attendant micro-economic implications, are likely to persist at least in the medium term (2-3 years).

Privatisation and Corporatisation

On the one hand, the doctrine of privatisation enunciated by Curran *et al.* (1988) and the government involves asserting that any profitable (or potentially profitable) activities should be the preserve of private capital, so that in the extremity, public capital and expenditures would be left merely to service 'residual' welfare activities and social services. On the other hand, profitable assets which return revenues to the government – and these are the privatisable assets of most interest to private capital – are difficult for a government to give up, since it thereby gives up a stream of income (albeit in return for a capital sum). The private consultants who examined privatisation of the State Bank for the government recommended against it – which amounts to concluding that the (discounted) stream of revenues from the Bank is worth more to the government than its marketable value (*SMH*, 30/11/88, p. 45), quite apart from any non-pecuniary returns. The GIO is likely to go the same way. The salutary lesson in this for the government is that it should get on with its proper business of managing its assets effectively, on behalf of the people and in pursuit of progressive social and economic objectives, rather than seeking to deprive the State sector of profitable and potentially profitable assets and enterprises. Obviously, this is conceptually distinct from that sale of truly surplus assets in order to purchase other more appropriate assets, or to retire debt, which is a legitimate and more or less continually necessary activity. *What privatisation is really about is a reduction in the net asset position of the sector as a whole.* Corporatisation of State sector agencies, which is now proceeding in Elcom, the GHA, the GIO, the MSB, the SRA, the State Bank and the UTA, will create enormous pressure for ultimate privatisation, not least from the managements themselves, and should be as vigorously rejected as privatisation. Corporatisation is only properly applicable to State trading enterprises which are exposed to systematic and substantial competitive forces; and which do not carry any social responsibilities which cannot be unambiguously reduced to financial flows.

The major agencies which have these characteristics – the State Bank and GIO – are indeed already corporatised. On the other hand, the Water Board for example – which is a self-financing commercial agency – is not subject to significant competition and is being asked to pursue complex social objectives (of an environmental nature) which cannot be expressed in transparent financial terms. Corporatisation would be inappropriate in this case. The dangers of corporatisation are well-illustrated by the experience of the GHA.

The Curran Commission's recommendation on corporatisation formed the starting point for the Steering Committee on Government Trading Enterprises to explore the major issues which would be addressed in a corporatisation process. The Committee released its report ('A Policy Framework for Improving the Performance of Government Trading Enterprises') in September 1988. The recommendations made by the Steering Committee included that:

- Boards of Directors of the corporatised authorities should be appointed on the basis of commercial expertise;
- the objective of the boards should be to maximise the return on assets; and
- private sector analysts should assist in monitoring and assessing the corporatised authorities' commercial performance.

Consequently, Ernst and Whinney Services were appointed as consultants to undertake a review of systems and organisation structure for corporatisation of the Grain Handling Authority. The Report was released in March 1989. In fact, some of the recommendations made in the Report are desirable (for example,

the establishment of an up-to-date asset register and that proper training be provided to staff). Somewhat paradoxically, the Report criticised the over-use of consultants in the GHA, but then goes on to recommend that consultants be used for implementing aspects of the corporatisation process many of which could be undertaken in-house.

Having received the recommendations as to what would be necessary for corporatisation, it is understood that the GHA has prepared a draft corporate plan for a corporatised body. As part of this corporate plan, it is understood that the GHA will be converted to a company – that is, become incorporated under the Companies Code. It is nowhere mentioned that, having done this, the government may lose control over the total operations of the GHA should it establish subsidiaries outside the Parliamentary discipline imposed currently. The Western Australian experience with aspects of WA Inc. should have offered a salutary lesson in this regard.

More specifically, Curran argued that corporatisation would form the basis of better service and greater customer satisfaction because 'exposing authorities to competition . . . is the best way to ensure that goods and services desired by the customer are provided at the lowest economic cost' (p. 70). In the case of the GHA its customers are primarily grain growers. Does corporatisation mean an improvement in the quality and efficiency of services provided to them? The simple answer is no.

The simplistic view adopted by Curran has, in fact, been refuted in a recent study of privatisation and corporatisation options for the Grain Elevators Board (GEB) in Victoria undertaken by Price Waterhouse Urwick which explicitly rejected corporatisation as offering no benefits to grain growers (*The Land*, 8/6/89, p. 5).

Economic services have not been the only area to undergo 'corporate review' in 1989, the State Minister for Education and Youth Affairs appointed a team of consultants (headed by Dr. Brain Scott) to review all aspects of his portfolio. The first 'briefing' from that review was released in June 1989 ('Schools Renewal: A Strategy to Revitalise Schools Within the New South Wales Education System'). A number of aspects of this Report indicate that corporatisation (and privatisation) for the Greiner Government is not limited to PTEs.

In respect of the roles of senior educational administrators, for example, the Report draws an analogy between the Assistant Director-General in each Region and the Chief Executive Officer of a subsidiary company of a large commercial enterprise with each having responsibility for the Region;s operations and performance (p. 17). In isolation, there may be no real objection to such an analogy, but when put in the context of other recommendations made in the Report, it takes on a more negative connotation. For instance, Regional plans would be developed, including Regional budgets, which would cover '. . . among other things, schools budgets, special grants, education programs, professional development programs, student welfare, minor and major capital works . . ., cyclical maintenance, and major plant and equipment purchases' (Scott, 1989, p. 17). This proposal seems to conflate two separate functions. The important function for any education system is the provision of quality education to students; a quite separate function is that of funds and resource management. It may well be that the quality of such management needs to be improved, but there is no justification provided in the Report for combining two roles. The distinction drawn here is, in fact, tacitly accepted by Scott when he urges the appointment of bursars for larger schools (p. 14).

There are a number of recommendations for privatisation in the New South Wales education system. The following are some examples:

- use of contracted externally-supplied curriculum support materials and services (p. 23);
- the establishment of Education Resource Centres to act as 'shop-fronts' for the sale and contracting of educational resources (p. 23);
- individual schools contracting cleaners and maintenance services (p. 31);
- tendering outside the Department of Public Works for construction (p. 31); and

– tendering for printing needs (p. 31).

The Report explicitly canvasses the option of privatising the Wetherill Park Furniture Complex, one of the largest furniture producers in the Southern Hemisphere (p. 32) In short, it gives a clear indication of the direction in which the Greiner Government is moving in its stewardship of the State's social infrastructure. That direction is consistent with its policies and programs outlined elsewhere in this Chapter, and is likely to have just as deleterious effect.

Contracting out and Tendering Processes
The expanding use of private contractors in the provision of public services – directly, or indirectly, through provision of inputs and services to the State sector – is a less visible but much more pervasive form of privatisation in New South Wales than enterprise and asset sales, with a multitude of instances throughout the sector; eg., in Public Works (*SMH*, 6/10/88, p. 1; see also Hogan, 1988a, pp. 35-37). While there is scope for sensible use of contracting out – in consolidating State sector activities and using outside contractors for peripheral or highly specialist activities which do not warrant a permanent State sector agency – in general contracting out has been motivated by an imperative for cost reductions as such, rather than any desire to increase efficiency. If however, the government believes that wages and conditions in the State sector are inappropriate it should negotiate that case with the unions which represent State sector workers, and before the relevant industrial tribunals (though it showed itself to be noticeably reluctant to do this in 1988, with regard to teachers), not circumvent these employment conditions by substituting private employees. The shift towards greater reliance upon private charitable organisations (and households themselves) for provision of welfare services (voluntarism) can only contribute to a declining quality and quantity of welfare services at a time when declining real incomes and increasing real housing costs are threatening the most basic needs of many. It obviously has the effect of simply shifting costs of welfare services 'off budget' and onto families, households and voluntary welfare agencies.

Commercialisation
It seems clear from the available evidence on tax incidence and the final beneficiaries of subsidies that the distributional impact of free-to-user services and subsidy-to-user services is by no means invariably to the benefit of 'widows and orphans', to use the old cliche; that is to say, there are extensive benefits to people who fall outside the objectives of a policy designed to benefit working people and the poor. In many cases it is desirable that the community in general derives the benefits from public services which are subsidised through the tax system. Nevertheless, as has been argued in Chapter Seven there is a strong micro-economic rationale for extending the scope of commercial practices in the State sector i.e. extending the application of cost recovery (including a rate of net profit) in the pricing of services, as well as reducing the rate of budget subsidy per unit of some services. Such commercialisation has a micro-rationale in terms of ensuring that the redistribution of income resulting from the State sector fiscal regime is not indiscriminate or ill-targeted. It also has a financial rationale since it will increase net non-tax revenues (fees for service) – or equivalently, reduce budget expenditures/subsidies – thereby generating funds for other more worthy purposes. Examples of areas where aspects of commercialisation usefully could proceed include the Water Board, Elcom and, to some extent, the SRA.

Pricing Policy and Cross-Subsidisation
Commercialisation has implications for the pricing policy employed in the State sector, the structure of cross subsidies, and the allocation of resources both within the sector and in the broader economy. Pricing services to ensure full cost recovery is synonymous with 'user pays' (ignoring externalities); and therefore, if universally applied to the sector, would be equivalent to abolition of all cross subsidisation. Attempts to widely or universally implement such a policy therefore would tend to abolish what has been described above as a fundamental (though not exclusive) objective of having the State sector at all: cross subsidisation is the mechanism for the redistribution of income which the sector brings

about. *A generalised move towards full user pays should be firmly repudiated*. Certainly application of full user pays is inappropriate if applied to public services which are intended to overcome social inequities and ensure equality of access to essential goods and services, according to need; eg., health, education, welfare, legal aid, housing and public transport.

There are also resource allocation issues involved in pricing policy. It would appear to be desirable in general, for example, for households to face the full cost of electricity and water supply in deciding what quantity to use. This would encourage a more considered use of services and hence derivatively, also of State sector resources. The Water Board and Elcom are indeed (slowly) moving in this direction. Movement towards greater cost recovery in such areas should be combined with rebates and concessions which more accurately target specific groups deserving of subsidisation. Explicit cross-subsidisation through the Budget, as suggested by Curran et. al. (1988) would assist in accurately gauging the performance of enterprises by disentangling the financial impact of Community Service Obligations etc but is probably impracticable in many areas

Efficiency Costs and Performance

In discussing contracting out above, a distinction was drawn between cost reduction and efficiency improvement, in relation to the 'fiscal imperative' behind the conservative Government's micro-restructuring of the State sector. The point to be emphasised is that improved efficiency requires an unambiguously improved technical relation between inputs and outputs, such that the same outputs can be produced with an unambiguously smaller quantity of inputs; or the same inputs can produce an unambiguously larger quantity of outputs. As Chapter Four has shown, reduced costs on the other hand, can be a purely pecuniary phenomenon, not reflecting any technical improvement at all. The sad fact is that the fiscal imperative means that the government is concerned merely with cost reduction, not technical efficiency as such: a government can move a cost or an activity off its budget and simply enforce it upon someone else's budget! This reallocates costs; it does not necessarily reallocate resources more efficiently. The litmus test for this issue is that the New South Wales Government will not be interested in any measures for increasing efficiency which do not contribute to cost reduction. However, in the current period of economic restructuring, the achievement of real efficiency gains in the public sector is essential if it wishes to maintain its economic and social relevance into the future. The present government's policies are not aimed at achieving such a result.

Management and Unions

Management of State sector agencies in general is a complex task, more difficult than the parallel management tasks in private sector corporations, as at least one advocate of privatisation recently has acknowledged (Hogan, 1988b). This is so because private sector management is required only to pursue a singular and relatively transparent objective – maximisation of the pecuniary rate of return on private capital invested – whereas State sector management often requires the pursuit of multidimensional objectives insusceptible of reduction to pure quantities. This necessary complexity is not something to evade by misspecifying objectives along private sector lines; but nor is it something to glory in. However, wherever possible management objectives should be clarified as much as possible, both to assist management and to better enable assessment of its performance.

State sector workers and their Unions have an important role to play in the process of reform and restructuring of public services provision; and a decent (and realistic) government and management will draw them into the process. Indeed it would be foolish and counter-productive to proceed without the support and cooperation of the workforce and their industrial representatives, the State sector unions. Government and management can either deny the legitimacy of the unions and seek to work around them; or accept their legitimacy as representatives of workers' objective interests and work with them. The conservative Government is naturally drawn to the former view, which is in nobody's interests, not

least due to alienation of the workforce and destruction of worker morale. Whatever policies are pursued by government (at least, short of privatisation), it is the public sector workers 'on the ground' who will, in the end, be delivering the services.

10.6.2 Department of Health

Introduction

The recently released study by the Australian Institute of Health (April, 1989) estimates that the cost of public health care in Australia has declined by 1% per treatment since 1980. There has also been a 10% decline in public inpatients and a 45% increase in out patients. While these simple calculations cannot be a comprehensive measure of efficiency, it is clear that the public health system has become more cost effective and flexible over time. In national terms, it is also clear that the State hospital and community health system is the logical and cheapest place to develop comprehensive health services. Yet irrationally in NSW, the public hospital and community health system is being rationalised and is being forced to share its expertise and responsibilities with often 'immature', untried and ill prepared private hospitals and practitioners. These 'privateers' invariably provide only for the cheaper end of the health care system, they don't work in the unprofitable areas of health care and have benefited from public sector education and research paid for by taxpayers. One of the key questions to be posed of the NSW health system is: Is the course set by the Greiner Government destined to lead us towards the American model of profit oriented health care with its massive costs and inefficiencies?

The vital statistics of the Department of Health in NSW are as follows: under the Health Administration Act (1982) and the Area Health Services Act (1986) the Department of Health is responsible to the Minister of Health for the administration and delivery of a vast array of health care services to the people of New South Wales. These include the activities of public hospitals, mental health and development disability services, community health services, dental services, regulation of all hospitals (including private hospitals), forensic medicine, drug and alcohol programs, immunisation services, diagnostic and analytical laboratories and ambulance services. The Department is also responsible for the administration of Acts of Parliament relating to pure foods, the sale of therapeutic goods and medicines, sanitation etc. and through ten Professional Boards constituted under the various Acts for the licensing and control of practitioners of medicine, nursing, dentistry, optical services, pharmacy, chiropody, chiropractics and physiotherapy. In addition, the Department's administrative responsibilities encompass ancillary services such as hospital catering, laundry and other cleaning services etc. which are necessary to the provision of public health care.

Employment

As of 30 June 1988, public hospitals and other health care centres employ 74,949 persons of which 32,244 are nursing staff; while ambulance services employ 2,490 people, scientific services employ 283, and 991 are employed in departmental/regional administration.

Administrative Structure

Under the present structure, the administration of New South Wales public health is conducted by the Department through six country regional offices and ten Area Health Services in the metropolitan, Hunter and Illawarra regions where the mass of New South Wales population lives (This precludes some of the major metropolitan public hospitals which are managed by their own boards and have a direct administrative link to the Department). Each Area Health Service has a ministerially appointed board which is responsible for the day-to-day management of health care services in its designated region. Eighty per cent of departmental expenditures are through Area Health Services. With regard to funding allocation, based on annual returns furnished by the Area Health Services and hospitals indicating their financial needs the Department determines their level of subsidies after taking account of the population sizes, service requirements and objectives within a global budgetary framework.

Public Health Care Capacity
In New South Wales the provision of health care services is dominated by the public sector with the only major exception being nursing home care which largely operates on a commercial basis in the private sector. With respect to health care facilities (as at 30 June 1988), there are 232 public hospitals including the largest State hospitals providing general services, compared with 93 general private hospitals (New South Wales Department of Health, Annual Report, 1988). Interestingly, of the private hospitals only 21 are established in country regions compared to 170 public hospital establishments, reflecting the fact that general hospital services are less commercially viable in more sparsely populated areas. Of the twenty mental health and development disability hospitals in New South Wales fifteen are public; while of the 509 nursing homes 489 are private institutions. A more accurate picture of public health care capacity, especially as compared with the private sector, is the number of authorised beds in hospitals and other health related institutions. Table 10.19 below confirms the crucial importance of public health care capacity in the delivery of services other than those related to the accommodation and care of the aged in New South Wales (especially in country regions).

Table 10.19

Number of Authorised Beds in Public and Private Hospitals in New South Wales at 30 June, 1988

	Public No.	%	*Private* No.	%	*Total* No.
General Hospitals					
Metropolitan	13,141	74.4	4,512	25.6	17,653
Regional	9,901	88.3	1,308	11.7	11,209
Total	23,042	79.8	5,820	20.2	28,862
Mental Health and Development Disability Hospitals					
Metropolitan	3,265	91.6	299	8.4	3,564
Regional	2,326	100.0	0	0.0	2,326
Total	*5,591*	*95.0*	*299*	*5.0*	*5,890*
Nursing Homes					
Metropolitan	1,919	8.8	20,007	91.2	21,926
Regional	2,227	24.4	6,914	75.6	9,141
Total	4,146	12.3	26,921	86.7	31,067

*Note:** This total does not include two public hospitals which do not submit financial returns to the New South Wales Department of Health because they do not receive any State Government subsidy and two hospitals which are supervised by the Department of Veterans' Affairs – constituting 1,028 hospital beds.
Source: New South Wales Department of Health Annual Report, 1988, Appendix B2, p. 98.

Due to an increase in the construction of hospital facilities over the past few years there has been moderate growth in public hospital beds. Nevertheless it has not kept pace with the growth and changing distribution of the New South Wales population. Table 10.20 shows the decline in the overall number of authorised public hospital beds per 1,000 persons over the past four years as well as the low ratio persisting in the Western metropolitan region of Sydney where there has been a large shift in the distribution of the urban population.

These figures reflect the shortage of overall public hospital capacity in New South Wales to meet the rapidly growing demand for public health care (particularly since they tend to over-estimate actual hospital bed capacity). A major factor in this respect has been the large

preferential shift from private to public hospital care following the introduction of Medicare which caused a significant reduction in the number of people electing to be privately insured. The Department of Health reported that between June 1983, prior to the introduction of Medicare, and March 1985, the proportion of the New South Wales population privately insured for hospital care had declined from 68% to 49% (New South Wales Department of Health, Annual Report, 1985, p. 1). Partially reflecting the shift from private to public hospital care, the proportion of non-chargeable patients to public hospital bed days occupancy increased from 47.3% in June 1983 to 67.6% in June 1985. The increasing access to public health provided by universal health insurance (Medicare) together with the significant ageing of the population has considerably increased the demand for public health care. These pressures on capacity have been moderated to some extent by the implementation of joint Commonwealth-State funded programs to reduce the average period of inpatient occupancy and so reduce outstanding hospital waiting lists. However, despite these measures the severe pressures on public hospital capacity have persisted due in no small part to the shortage of nursing and other medical staff which also has contributed to a marked reduction in many kinds of services. In addition, the shortage of hospital facilities in many regions has reduced the effective delivery of health care services. This has been most severe in the Western and South-Western metropolitan regions of Sydney where the range and standard of health care services is well below the State average. *Indeed, a State parliamentary appointed taskforce (consisting of five Liberal-National parliamentarians) reported that hospital facilities in the Western metropolitan region were in a dilapidated State – a consequence of years of neglect. They estimated that $750m additional expenditures would be necessary to adequately upgrade health services in this region.* Given that some regions (eg., Eastern suburbs of Sydney) are relatively over-serviced there is a clear need for restructuring of hospital facilities in New South Wales to more appropriately (and equally) deliver health services to areas of need, in particular in Western Sydney where the mass of urban population is gravitating.

Table 10.20

Number of Authorised Beds per 1,000 Persons in General Hospitals in New South Wales *

	As at 30 June 1984	*As at 30 June 1988*
Northern Metropolitan	3.32 (1.83)	2.96 (1.73)
Southern Metropolitan	5.50 (1.57)	5.66 (1.57)
Western Metropolitan	3.25 (0.77)	2.83 (0.63)
Hunter Region	4.38 (0.91)	4.16 (0.78)
Illawarra Region	3.27 (0.85)	3.7 (0.85)
All other country regions	5.22 (0.58)	4.63 (0.61)
Total	4.48 (1.04)	4.04 (1.02)

Note: * Private hospital beds per 1,000 persons are in brackets.
Source: New South Wales Department of Health, Annual Reports 1984, 1988.

Financing

The considerable prominence given to the provision of health care services is reflected in the fact that the Department of Health now receives the largest allocation of funds in the New South Wales budget. This allocation consists of three main sources of finance: Commonwealth financial assistance, Department of Health receipts and State budgetary revenue consisting of consolidated general revenue, Treasury receipts related to health care insurance and Treasury corporation approved borrowings. Table 10.21 provides a breakdown of the various sources of finance for the 1987-88 New South Wales health budget.

Table 10.21

Sources of Finance — 1987/88

	$m	$m	%
Commonwealth Contributions			
Medicare Compensation	444.3		
Hospital Grants	674.0		
Special Purpose Grants	75.2	1,193.5	32.8
Department of Health Receipts:			
Public Hospital Revenue	405.9		
Other	165.4	571.3	15.7
Treasury Receipts:			
Health Levies and Ambulance Insurance Plan Contributions	39.6		
Road Transport and Traffic Fund Ambulance Contribution	0.8		
Consolidated Fund General Revenue	1,691.2		
Treasury Corporation Approved Borrowings	138.2	1,869.8	51.4
Total Cost of Health Services		3,634.6	100.0

Source: Auditor-General of New South Wales (1988), Annual Report, Vol. 2, p. 250.

Commonwealth financial assistance represents a major source of revenue to the New South Wales Department of Health. Under a four year Commonwealth-State funding agreement associated with the introduction of Medicare, this assistance has consisted of an Identified Health Grant (under the States Tax Sharing and Health Grants Act 1981), Medicare compensation (for the loss to State hospitals of private insurance collections) and specific purpose grants encompassing a variety of health service programs. The introduction of this financing arrangement saw Commonwealth financial contributions increase significantly in 1984/85 such that it represented about 41% of the Department of Health expenditures, but has since gradually declined to 33% in 1987/88. At the May 1988 Premiers' Conference these funding arrangements were altered resulting in the discontinuation of the Indentified Health Grant and Medicare payment and the introduction of a specific purpose payment for hospitals. In 1988/89 under this new arrangement Commonwealth contributions are estimated to decline by 3.5% in 1987/88 so that as a proportion of the total New South Wales health budget they are anticipated to fall below 30%. This gradual decline in Commonwealth assistance over recent years, which is one consequence of the Federal Government's fiscal austerity policy, has placed a greater burden on internal State financing out of consolidated revenues to finance New South Wales health services. *In 1987/88 State contributions to health funding rose by some 40%, including a substantial increase in Department of Health revenues arising from an increase in charges on the provision of services by public hospitals.* Continued fiscal contraction by the Commonwealth means that the expansion of public health care services in New South Wales will be increasingly dependent on New South Wales Government financing.

Key Policy Issues

The socio-economic benefits conferred on the community by public health services are often overlooked possibly because they are for the most part less transparent. The provision of health services by the State public sectors in Australia plays an essential role in Australian

social and economic well being, not only by directly raising the quality of people's active lives but also by improving the health of the mass of the working population, thereby reducing days lost at work from sickness etc. and generally improving the physical and mental performance of workers and so contributing indirectly to labour productivity in the economy. Although difficult to quantify the external benefits to the economy of public health services is nevertheless obviously very significant.

In most OECD countries, especially Western European countries, there is a well established universal health care system with the delivery of services predominantly the province of the public sector, the notable exception being the US where health insurance and services are mainly provided by the private sector. In Australia the prominence of the public health system (as administered by State Governments) has been traditionally important in providing affordable health care services to the wider population. The introduction of the Medicare universal health insurance scheme by the Commonwealth Government in 1983 represented an important step in further widening the access to basic health services which, along with education, law and order etc. should be regarded as fundamental goods to which all citizens should have right of access. However, as already indicated, this initiative in conjunction with the implementation of a fiscal austerity program which has seen Commonwealth financial assistance to the States decline markedly over the past few years has placed considerable pressures on public health care capacity. In New South Wales these pressures have been exacerbated by long-term structural inadequacies within its public health system. These key problems afflicting the New South Wales public health system can now be dealt with in terms of the policy strategy of the present conservative Government.

Notwithstanding its overall contractionary strategy the New South Wales Government has given expenditure priority to health. However, much of its budgetary policy in health consists of financing an upgrading not an expansion of hospital facilities and an accompanying range of health care services through the attainment of substantial cost savings. In accordance with the government's budgetary strategy, the Department of Health, along with the rest of the sector, is aiming to obtain productivity savings of 1.5% in 1988/89 and again in 1989/90. To obtain cost reductions supposedly through more efficient service delivery the New South Wales Department of Health, broadly following the recommendations of Curran et al., has introduced a corporate management approach to administration. It was indicated in Section 10.5.1 that there are considerable limitations to applying corporate management techniques to non-commercial socially oriented areas of the State sector, such as health, where performance can not be simply gauged by balance sheet results and performance criteria must take into account a myriad of qualitative factors. This is not to say that financial monitoring techniques such as program budgeting now used in the Department of Health is not relevant in the decision-making process. The point is that financial performance indicators are not sufficient on their own in making appropriate management decisions where qualitative social objectives are involved. The excessive reliance which the conservative Government places upon corporate management techniques in health administration indicates a greater concern with attaining cost savings per se rather than obtaining improvements in the quality and efficiency of health care service delivery.

The imperative to procure expenditure savings underlies the conservative Government's whole approach in solving the many problems in the New South Wales public health system. The over-riding problem is inadequate size and structure of health care service capacity in New South Wales of which there are a number of aspects. With respect to hospital facilities, the conservative Government's strategy is to fund an upgrading of facilities in areas of need (such as Western Sydney) by the closure of some public hospitals and the sale of surplus property sites. In 1989/90 the Department had earmarked six hospital property sites for sale which were estimated to raise $170m. The sale of unutilised assets is justified within a restructuring strategy, providing the funds raised are used to build facilities in areas in greater need of additional health care services and the

process is associated with a net expansion in the capital stock of the whole public hospital system. *The New South Wales Government, however, has indicated that 'emphasis will be placed in future years on replacement and upgrading the existing capital stock, rather than increasing bed capacity' and that 'this policy is based on projections that the number of beds are adequate for future years, taking into account changing patterns of bed usage, a decline in the length of stay for inpatients and a greater role by private hospitals'* (New South Wales Budget Information Paper No. 2, 1988/89, p. 223, emphasis added).

The clear intention of this policy is to meet acute (regional) demands for hospital services largely through an expansion of private hospital coverage rather than through an expansion of the public hospital system. To this end the New South Wales Department of Health approved the construction of fourteen new private hospitals and the expansion of eleven existing ones in 1988/89; some on the sites of existing as well as closed public hospitals. This policy has been justified by arguing that it would assist in overcoming waiting lists at public hospitals as if there was no net loss to the public health system. As Professor S. Leeder has countered: '. . . it is not true that private hospitals "won't cost us anything"' because the 'Medicare money spent in private hospitals . . . comes off the Medicare allocation [by the Commonwealth] to New South Wales for public hospitals' (*SMH*, 4/10/88, p. 19). The policy therefore represents an insidious form of privatisation with the growth in private hospital institutions occurring at the expense to the public health system. *No efficiency gains will be made from such a privatisation policy as it will simply lead to an increase in private health costs (and eventually contribute to a rise in the Medicare tax levy) that in all likelihood will exceed the savings made in the New South Wales public health system. This policy portends a long-term reduction in public hospital capacity in relation to demand and hence represents a downgrading in the role of the public health system in New South Wales.*

Another major problem has been the shortage of medical personnel in the New South Wales public hospital system. The most notorious example is the long waiting lists for elective surgery following the withdrawal of orthopaedic and opthalmic surgeons from public hospitals in 1984 over a change in fees for service under Medicare. This long running saga revealed the severe shortage of permanently employed specialist surgeons in the public system and the corresponding over-reliance on Visiting Medical Officers (VMOs) who in many cases have a substantial competing interest in private hospital institutions. The agreement by which the New South Wales Minister for Health induced these VMOs back to public hospitals in 1989 cannot be regarded as a permanent solution. In the interests of a stronger public health system the number of permanently staffed medical officers and in particular specialist surgeons needs to be increased so as to minimise the reliance on VMOs who should only be used to overcome short-term demand pressures for services. In view of the prospective increase in demand for elective surgery which will accompany the ageing of the population this would be a sensible policy move.

Nursing staff shortages are also a major problem. These shortages have led to the under utilisation of public hospital capacity over recent years with many hospitals forced to close whole wards at various times because of the lack of nursing staff. The very high staff turnover which is no doubt associated with pay and work conditions (and been the subject of industrial disputation) is significant in this regard. Measures have been adopted in recent years to increase the supply of nurses. These measures are ineffective however if, as reported as recently as early 1989, many public hospitals with acute staff shortages cannot employ the additional nurses required to attain full hospital service capacity because of inadequate funding.

Conclusion

This study has focussed on the key problems in the New South Wales public health system as well as the conservative Government's privatisation oriented strategy to overcome them. *The government's strategy portends a long-term transference of health service provision from the public to private sector and will ultimately lead to higher health costs being borne by the community. It represents a fundamental attack on the public health*

system which is the vanguard of universal health care in New South Wales and for which the community has already demonstrated its strong support. A more responsible strategy which makes better use of its resources rather than divesting them is warranted. The renewal of New South Wales' public health system will require three essential ingredients:

- an overall expansion of public hospital capacity and community health(ie. facilities, better staffing levels and technology) and an accompanying increase in the range of health services to meet the strongly growing demand of the community;
- a restructuring of health care coverage, particularly in the metropolitan region, so as to more adequately distribute services to regions of greatest need (ie. Western Sydney); and
- a substantial increase in the levels of permanently employed medical and nursing staff to ensure fuller utilisation of hospital and other health care facilities.

10.6.3 Electricity Commission (Elcom)

The Electricity Commission of New South Wales (Elcom) was established in 1950 as a result of organisational restructuring which separated generation (production) and distribution functions with regard to electricity supply in New South Wales. Elcom is a statutory authority responsible for the production and supply of bulk electricity to 25 distribution agencies (23 county councils, 1 city council, 1 shire council) and 8 large industrial users (including the SRA); and is also empowered to engage in mining operations (The system of county councils was first established in 1919 and the Sydney County Council in 1935). This structure is unusual in Australia (Queensland has a similar system), in so far as generation is a State responsibility (and in minor part a Commonwealth responsibility, through the joint Commonwealth/New South Wales/Victorian Snowy Mountains Hydro-Electric Authority), and distribution is primarily a Local Government function. Elcom is responsible to the Minister for Minerals and Energy, the Department of Energy being the department of government primarily responsible for electricity supply policy. The following are some key statistics indicating the scope and significance of Elcom's operations (quantities are approximate).

Production Capacity

Total capacity is 12,100 MW (30/6/88). This is one third of total Australian generating capacity, involving seven major power stations. Coal fired power stations represent 95% of capacity. Additional capacity is available from the Snowy Mountains Scheme (2,500 MW of peak generating capacity) and through interchange with Victoria (typically 500 GWhr p.a.).

Output and Demand

Elcom is the largest electricity producer in Australia (approx. 40% of national output) and generates more than 90% of New South Wales requirements. In 1986-87 annual sales were 40,000 GWhr (1987-88: 43,000 GWhr), maximum New South Wales demand (winter evening peak) was approximately 9,000 MW (1987-88), and highest daily demand was 16783 GWhr. Almost 80% of total electricity output is sold into the Sydney, Newcastle and Wollongong markets.

Employment

Generation and transmission employs 10,350 people and a further 3,000 are employed in Elcom's coal mines. The distribution system (essentially the County Councils) employs 17,470 people.

Coal Supply

Elcom owns three coal mining companies which provide 55% of coal supplied to its power stations (1986-87). A further 21% of coal is supplied under contract by private companies from leases owned by Elcom, and the remainder from privately owned and operated mines.

Income and Expenditure

Income for 1987-88 was $2,376m, deriving from electricity sales ($2,278m), interest ($72m) and miscellaneous items ($26m). Expenditure was $2,355m, giving an operating surplus of $21m. The operating result after contributions, sub-

sidies, loan guarantee fee and dividend was minus $165m.

Distribution

Sales by the 25 distribution agencies (1986-87) were approximately $2,700m p.a., to an estimated 2.3m consumers. Business sales (excluding rural) are 59% of the total. Most of the distribution agencies are relatively small: the four agencies servicing Sydney, Newcastle and Wollongong account for almost 80% of State sales. Business sales into this urban/industrial market are more than 60% of total sales by the four agencies and more than 80% of total State business sales.

Throughout Australia electricity production and transmission is an important publicly owned industry, servicing both final ('domestic') consumers and providing a fundamental energy input to other production sectors ('business' consumers, commercial and industrial) (The electricity industry is publicly owned, or majority publicly owned in most OECD countries, Japan and Spain being notable exceptions and the US industry being 75% privately owned). As such the electricity industry exemplifies an important fact about State public sectors in the Australian Federal system: State sectors contribute to the economy fundamental economic and infrastructural services, particularly in the areas of energy (including gas), transportation, water supply and waste disposal. *To this extent the State public sectors have a fundamental and quite direct role to play in the restructuring of the Australian economy, which has been consequent upon the problems of external imbalance of the 1980s, and is intended to revitalise Australian industrial and trading performance.*[3] In this regard public sector renewal is a necessary complement to industrial restructuring and revitalisation. With regard to electricity in particular, it accounts for approximately 18% of all public sector inputs to industry (based on 1980-81 input-output data) and is the first, second or third largest public sector input to 57, 22 and 12 industries respectively, of the 108 industries classified in the input-output tables. Electricity is the most significant public sector input to Australian industry – in terms of its total cost, its percentage of total public sector inputs, and the pervasiveness of its role in production (Industries Assistance Commission, 1988, pp. 3-7).

On the other hand, in terms of electricity's proportion of total costs of Australian industry a much less significant role emerges. Of the 57 industries for which electricity is the largest public sector input only two have electricity contributing more than 5% of total costs and only the top eleven have electricity costs in excess of 3% (IAC, 1988, pp. 18-19):

		$m Elect. Input Costs	*%Total*
1.	Cement	22.2	6.1
2.	Cotton Ginning, etc.	27.0	5.4
3.	Ferrous Metal Ores	49.5	4.8
4.	Basic Iron and Steel	164.4	4.3
5.	Other Basic Chemicals	66.0	3.9
6.	Water, Sewers and Drainage	67.9	3.8
7.	Restaurants, Hotels	128.9	3.6
8.	Non-Ferrous Metal Ores	78.3	3.4
9.	Clay Products, Refract's	21.6	3.4
10.	Veneers and Boards	10.3	3.4
11.	Worsted and Woollen Yarn	6.3	3.4

More recent data for New South Wales (New South Wales Government, 1988, pp. 135-38) indicate that for broad industrial sectors (agriculture, mining, manufacture, etc.), only mining has electricity costs in excess of 2% of the value of sectoral output, at 3.15%. Coal mining uses approximately two thirds of the New South Wales mining industry's electricity input; but estimates suggest an average electricity input cost for coal of little more than $1.00 per tonne.

A breakdown of electricity costs to manufacturing industries in New South Wales (1984-85) indicates only two sectors with electricity costs as a proportion of turnover greater than 2%: basic metal products (4.33%) and non-metallic mineral products (2.49%) (These two sectors include industries 4 and 1,9 above, respectively). The moral to be drawn from this is that while public sector inputs as a whole are significant components of unit costs in some industries (vide IAC, 1988b, pp. 12-17), it would be a mistake to suppose that any possible restructuring of electricity production, costs and pricing by itself could offer any substantial contribution to the competitiveness of Australian industry. However it should be added that these data do not capture the indirect element of electricity costs (and public sector input costs in general) which are 'embodied' in other inputs to industry.

This is a cautionary tale, indicating that while public industrial inputs as a whole are significant for national economic performance, no satisfactory solutions can be found for Australian external problems by making public sector restructuring the cure-all – however ideologically seductive that may be to some. It almost goes without saying that this does not in any way diminish the importance of technical efficiency and minimising production costs for electricity generation in general and Elcom in particular. In this regard, movements in unit costs and productivity measures do not suggest a poor performance by Elcom or the distribution system in recent years. In the five years to 1987-88 Elcom's 'controllable costs' per unit of output (costs net of depreciation, government charges and contributions, finance charges) were reduced by 22% in real terms, resulting from a real reduction of 5.1% in fuel costs and 33.6% in other costs (Coal accounts for approximately 25% of Elcom's total costs). Total employment also fell, notwithstanding expansion of capacity during the same period. Elcom is of course also going through the same award restructuring process which is occurring throughout the Australian economy (vide Electricity Commission of New South Wales, 1989). With regard to the distribution sector, controllable costs per unit of output (costs net of electricity purchases, depreciation and finance charges) have decreased by 5.6% p.a. since 1985 and employment per unit of output has declined by 4.3% over the same period (New South Wales Government, 1988, pp. 144-48).

It is worth noting that when Curran *et al.* (1988, App. A.1, esp. pp. 6, 9, 21) consider Elcom's costs and productivity, using (unsourced) comparative data, they choose to compare Elcom's performance with the Queensland Electricity Commission (QEC). Indeed, when a favourable productivity comparison between Elcom and the State Electricity Commission of Victoria (SECV) is presented all that Curran et al. can find to say is that Elcom and the SECV have both shown little improvement compared to the QEC. No attempt is made to determine the quantity of private contractor labour employed in the Queensland system, which is certainly relatively much higher than in New South Wales and Victoria. A Federated Engine Drivers' and Firemen's Association response to the Commission of Audit's analysis of Elcom offers a pithy response to this strange oversight with regard to contract labour:

> 'On this basis of accounting if [Elcom] had a total contractor labour force the Curran Report would no doubt conclude that nobody was responsible for the generation of all power in New South Wales' (FEDFA, 1988, p. 7).

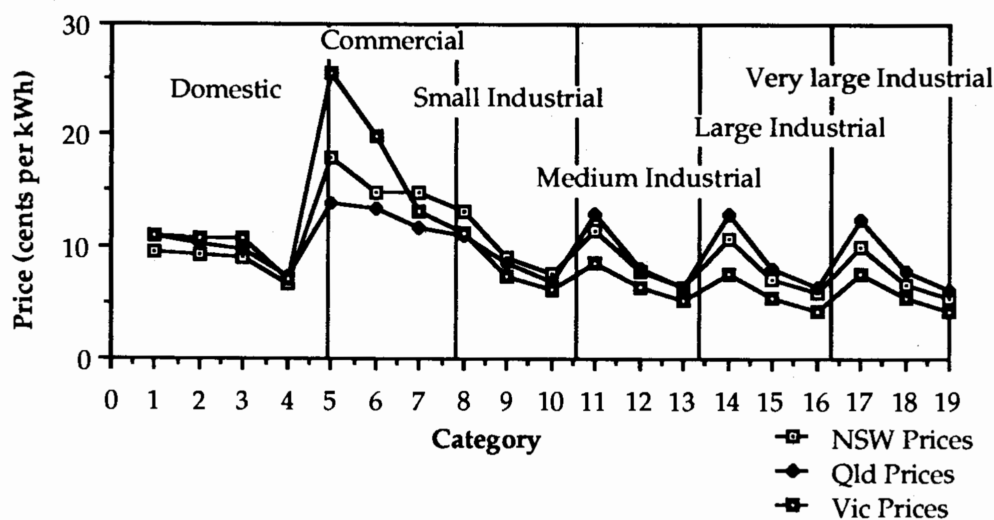
Curran *et al.* are also silent about the fact that this difference might have something to do with the vicious and successful attack on Queensland power workers' wages and working conditions in the infamous SEQEB dispute; but a little further on (p. 23) there is an extraordinary if somewhat coy statement on industrial relations, virtually inviting the New South Wales Government to proceed on similar lines: 'The Queensland experience suggests that long term benefits can justify short term dislocations' (!).

The accompanying Graphs indicate the level and broad structure of electricity prices in New South Wales, as well as Queensland and Victoria – the systems with which New South Wales is most closely comparable. Graph 10.4 maps average prices/kWh for 19 categories of electricity consumers. With regard to domestic

consumers (1-4), New South Wales prices compare favourably with the other two States. For industrial consumers (8-19), New South Wales compares favourably with Queensland (except for small industrial consumers), but Victoria betters them both in all industrial categories (except 8). Queensland offers the best prices to commercial consumers (5-7), with Victoria setting extraordinarily high tariffs for low and medium usage. Put briefly, relative to New South Wales the Queensland tariff favours commercial and small industrial relative to large industrial, whereas the Victorian tariff relatively favours industrial as a whole. Relative to both Queensland and Victoria, the New South Wales tariff favours domestic as against business consumers.

Graph 10.4

Average Electricity Prices – NSW, QLD, VIC

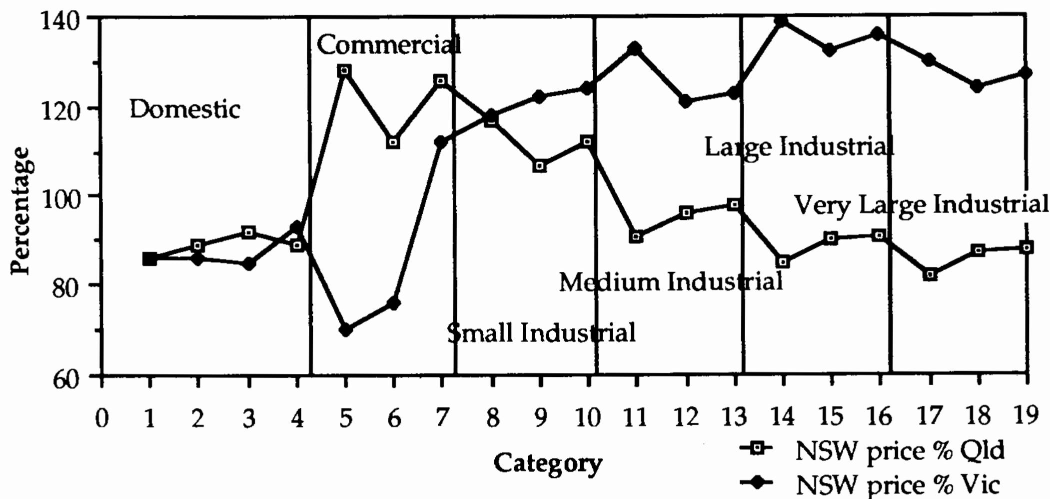


Graph 10.5 renders the scale and structure of the New South Wales tariff, compared with the other two States, somewhat more transparent. If tariff structures were identical overall, or in particular consumer categories, Graph 10.5 would map horizontal lines: the narrower the band of variation, the more similar the tariff structure. Hence comparing New South Wales and Queensland industrial prices, the levels of the former are lower except for small industrial; the structure of the two systems of industrial prices are similar (again, other than for small industrial). The rising curves indicate that the price advantage in moving from low to high usage in each category is less in New South Wales than Queensland. In the small industrial category the v-shaped curve indicates that New South Wales prices are more advantageous in the shift from low to medium usage but this is reversed in the shift from medium to high usage. Comparing New South Wales and Victoria, industrial prices are something of a mirror image of New South Wales versus Queensland. The levels of all Victorian industrial prices are lower than New South Wales. In the case of each industrial category except small industrial, the New South Wales tariff structure is more favourable in the shift from low to medium usage and less favourable in the shift from medium to high usage. In the small industrial category the New South Wales tariff is less advantageous throughout the transition from low to high usage. Tariff levels and structures are most markedly different in the

commercial category, with Victoria in particular, heavily penalising low and medium usage. For domestic consumers the New South Wales and Victorian tariff structure are almost identical except that the Victorian off-peak tariff is relatively more favourable. The Queensland domestic tariff is more favourable to higher domestic usage, but this is reversed for off-peak use.

Graph 10.5

Average NSW Electricity Prices — % of Vic and Qld Average Prices



Source: Derived from NSW Government (1988), App. 20

The structure of the New South Wales tariff in relation to other States points to a feature which has received comment for some time: the cross-subsidisation of domestic consumers by business consumers, worth approximately $170m in 1987-89. There is no obvious justification for this practice – and indeed, the extent of cross-subsidy has been and is being reduced. To the extent that business consumers subsidise households, these costs will enter into business costs of production and hence will be forward shifted into business prices. The subsidy is thus akin to an indirect tax on production inputs: while formally it is paid by business, finally it is paid by consumers of all goods and services, in proportion to the electricity intensity of the various business outputs. There is no economic or ethical rationale for such a regime. It is of course necessary to the abolition of such cross-subsidies that Elcom and the distribution agencies have in place adequate accounting structures to enable a correct identification of unit costs to various consumer categories.[4] Furthermore, reform of accounting structures is required for the implementation of any sensible system of rate-of-return (ROR) pricing in Elcom and the distribution agencies (Improvements to the accounting system have been taking place – see Elcom, Annual Report, pp. 36, 64-66). This is so because a rate of return can only be factored into the price system if depreciation and the replacement cost of capital can be accurately identified. New South Wales electricity prices do not look so favourable once differentials in ROR on capital are taken into account (cf. Industries Assistance Commission, 1989, pp. 7-9). Elcom is supposed to be moving towards a system of ROR pricing and appropriate dividend payments on equity, in consultation with State Treasury. (A dividend has been levied since 1986-87. It was $1.5m that year and

$10m in 1987-88. By comparison the very much smaller South Australian electricity authority – with about one fifth of Elcom's production capacity – generated a dividend payment of more than $50m in 1987-88. The SECV, with little more than half the assets of Elcom, paid a $103m dividend in 1987-88).

However, it must be stressed that given the considerable degree of monopoly enjoyed by Elcom, mere ROR pricing with accurate identification of costs will not be satisfactory: within some limits, costs due to inefficiencies etc. easily can be passed on to consumers (Elcom of course does face some competition – in particular, from alternative energy sources and for some 'mobile' business customers from other States). An independent external monitoring of technical and cost performance is essential. The distribution agencies are in the process (begun in July 1987) of adopting fully commercial accounting practices and Australian Accounting Standards, recognized as a necessary prerequisite for effective application of cost performance indicators to the distribution system. In the case of Elcom, monopoly power is the major reason why corporatisation should be avoided.

That the management of Elcom has been less than satisfactory is most strikingly evident from Elcom's extraordinary excess capacity – quoted variously at anything from 25% to 73%, though closer to the former on peak demand – which does not speak well for its investment decision-making and asset management. Related to this, much has been made of Elcom's debt burden by Curran *et al.*, (1988) and others. Elcom itself blames the ill fated resources boom of the early 1980s for this excessive investment but even if this argument is accepted, this begs the question of whether Elcom has been adequate to the task of forecasting demand and planning (new capacity) as well as managing existing capacity).[5] Certainly its reserve capacity is much higher than for any other State (Industries Assistance Commission, 1989, pp. 10-18). Elcom apparently only recently has adopted formal investment appraisal procedures and one can only wonder how capital expenditure decisions were previously made. Its capital expenditure budgets are reviewed by Treasury, which hardly amounts to a vote of confidence in management (and is, incidentally inconsistent with the government's corporatisation model). Elcom is also seeking to achieve the ongoing objective of funding 50% of capital works from internal funds, on a cumulative basis, by 1990. What these difficulties point to is that if Elcom is to be organized on an essentially commercial basis, as is entirely proper, then the reform of its management systems will be essential (cf. Industries Assistance Commission, 1989, pp. 29-31). This will require a management with the expertise to make investment decisions as economic decisions, not merely technical or engineering decisions, so that the cost of carrying excess capacity is fully taken into account; it will require a management with the economic expertise also adequately to manage assets and debt, including foreign currency exposure, so as to generate an acceptable rate of return on capital, and dividend on (government) equity; and it will require accounting systems which give decision-makers an accurate and pertinent information base for making these decisions (Elcom has been earning a negative real rate of return on capital). Finally, it may be doubted whether such a course can successfully be pursued unless senior management can be effectively made accountable for performance, by way of the 'ultimate' price: dismissal for failure. This is more viable now, in the New South Wales State public sector, than it has been in the past.

The Implications of Privatisation

The consequences of privatisation were thrown into stark relief by proposals put forward in 'Strategy Options for the Future: Overview of the Electricity Development and Fuel Sourcing Plan' (June 1989) which foreshadows further private sector involvement in the power generation industry. Key features of the proposed strategy include:

– incorporating polices to encourage private investment in power generating plant bases on waste coal and other fuels; and
– provides for the continued investigation of alternative options for future coal-fired power stations which 'may involve significant private sector participation'

The strategy is supposed to 'provide a sound basis for ensuring that the future needs of the State's electricity users are met reliably and in the most cost efficient way over the next 30 years' (Elcom, 1989, p. 5-6). The inability of this strategy to achieve this goal is evident in a confidential report prepared by a private team of consultants. The press reports of the report are as follows: 'Elcom would be subsidising the private companies, buying electricity from them at much higher prices than it costs the Commission to produce it' (*SMH*, 17 June 1989) It is in this context that the closure of the Tallawarra power station in June 1989 should be viewed; that is existing public sector capacity (which could be modernised) is being closed at the same time as the way is being made clear for private power stations to evolve. The destruction of the public sector's asset base as a consequence of such a strategy can only have negative effects for both economic efficiency and equity in NSW.

The implications of any privatisation of Elcom's functions which does occur (and the Greiner Government is certainly predisposed to such action) are evident from the international experience. The 3,000 electricity supply utilities in the US are predominantly owned by private investors. However, about three hundred of these account for approximately 75% of the electricity produced, and many of these are either subsidiaries of others or linked together in corporate groupings. There is a small publicly or co-operatively owned electricity generation capacity which sits alongside the private utilities (Electrical Power Engineers' Association [EPEA], 1986, pp. 13,15).

In consideration of the market dominance achieved by a relatively few electricity generation corporations, there is an extensive regulatory system (encompassing both State and Federal Governments) designed to ensure that they do not abuse what is, in effect, monopoly power in the their markets. The power of the regulatory bodies (of which the State Public Utility Commissions (PUC) are the most powerful) is immense:

> '. . . the PUC regulates (ie. controls) the price charged for electricity, the capital available to the utility and the cost of that capital (by regulating the issue of stacks and bonds), the return it may earn on its capital and the agreements it may have with other companies. The utilities also have to obtain a Certificate of Need and Convenience prior to any major construction of generating plant or transmission facility, and prior to including the cost of any new plant in their rate-base they must have it declared "used and useful" by their PUC.
>
> In some States there is an additional obligation on the utilities to submit regular advance plans (for up to 20 years ahead) to the PUC, which then rules whether or not the the proposed investments are in the "public interest" ' (EPEA, 1986, pp. 22-23).

One of the major rationales given for privatisation is that it will encourage competition thus leading to greater efficiencies and reduced costs. These efficiencies and cost savings, it is argued, will become evident in the pricing structures of the privatised bodies. *However, it is clear from the US example that private ownership is not necessarily accompanied by competition. This reality is borne out by the British experience of privatisation of the electricity generating capacity: there is nothing in the British Electricity Bill to provide for competition at the point of consumption* (Trade Union Congress, 1989, p. 11).

In addition it should be noted that, while those who advocate privatisation laud the qualities of private sector management, in the privately dominated US example, the fact is that:

> 'In many States, in spite of their best endeavours, the regulatory Commissions were effectively shadow managing the utilities. In a number of instances, the public interest requirements at the State level has led to the management prerogative passing in a number of key areas from utility to Commission' (EPEA, 1986, p. 27).

This is a clear example of the public sector undertaking those tasks associated with the generation of private sector returns, but which do not themselves generate returns to the public sector. The agenda for reform that we have

put forward both in this Chapter and in Part Three provides a significantly more realistic means of resolving the problems that (undeniably) do exist in the New South Wales electricity generating industry than could be achieved by any process of privatisation.

10.6.4 Government Insurance Office (GIO)

The GIO owes its foundation to the Workers Compensation Act 1926, which provided for the first time in New South Wales labour history that employers undertake compulsory insurance for their employees against liability for injury sustained in the workplace. On its enactment many private insurance companies indicated a refusal to cater for the business of workers compensation insurance so the government was under an obligation to provide a vehicle via which employers could obtain such insurance so as to comply with the Act. The objective of the newly created Office was to offer workers' compensation insurance in competition with private insurers and through its operations exert competitive pressures on premium rates charged by private insurance companies. Prior to this initiative the New South Wales State sector had not been involved in commercial insurance activities, though it had conducted inhouse insurance business with respect to its own contingent liabilities since as early as 1891. The activities of the GIO were given legislative authority under the Government Insurance Act, 1927, though its commercial operations were to be restricted to workers compensation insurance and as a legal entity it remained a branch of Treasury. It is worth noting in view of the current discussion about privatisation that in 1933 the then conservative Government of New South Wales sought to effectively privatise the operations of the Office by requesting policy-holders to transfer their insurance business to private insurance companies. While this policy was never given legislative expression it did nevertheless result in a significant loss of business and materially reduced the capacity of the Office to universally maintain low cost workers compensation insurance to policy holders.

It was not until 1942, following a period in which the Office rapidly expanded its activities that amendments were made to the 1927 Act establishing the GIO as a body corporate with power to carry on the general business of insurance, encompassing any class of commercial insurance activities and any other business activity whether the business of insurance or otherwise.

The Government Insurance (Amendment) Act 1985 conferred upon the GIO full corporate status with authority to have 'a subscribed capital and to pay dividends as provided for in Sections 7B and 7C'. Under Section 7B the GIO has a subscribed capital of $25m: the life insurance business division – $8m; insurance funds administration business division – $1m; and the general insurance business division, $16m. Pursuant to Section 7C,c the GIO pays dividends from these divisions 'as are determined by the Treasurer, after consultation with the Board, and after ensuring that sufficient profits are retained by the Office to maintain adequate solvency margins and to make such other provisions as may be considered necessary or desirable'. As a statutory body the GIO is not subject to Federal Income Tax and is exempted from government charges including Sales Tax and Stamp Duty. In lieu of these exemptions the GIO is required in addition to dividend payments to make a contribution equivalent to income tax payable and such other government charges payable to the New South Wales Treasurer. This source of income to the New South Wales sector is not discretionary (like dividends) though it clearly depends in large part on the profitability of the organisation.

Under its charter (as set out in the 1927 Act) the GIO is essentially regarded as a commercial profit-earning enterprise which should also fulfil a social purpose. The main ongoing social responsibility of the GIO – as directed variously by the New South Wales Government of the day – is to use its market share to exert a stabilising influence on the insurance industry particularly with respect to premium rates and to support State development through its investment activities (GIO Annual Report, 1987/88, p. 4). GIO management nevertheless has considerable independence in the conduct of its commercial activities and the pursuit of commercial objectives, though it remains ultimately responsible to, and subject to direction from, the Treasurer.

Structure and Performance
Insurance business conducted by the GIO is divided into three divisions – the Life Division which manages life insurance and related superannuation funds, the Funds Administration Division which manages insurance funds on behalf of the New South Wales Government and any body so directed by government, and the General Insurance Division encompassing the administration of funds for all other classes of commercial insurance operated by the Office. The operation of GIO's insurance funds depends heavily on services provided by other administrative related divisions for which the costs of operation are imputed to these three major insurance divisions. The Investment and Financial Services Division which incorporates retail and corporate funding as well as lending essentially acts as the inhouse banker for GIO's operations. Distribution (ie. retailing) which is an important aspect of GIO's commercial insurance business as well as accounting, personnel, information services and general administrative services come under the auspices of the Corporate Services Division. Overall GIO employs 2,483 people (30/6/88) mostly in the areas of insurance, legal, investment and financial, sales and information systems (GIO Annual Report, 1987/88, p. 64).

The GIO is a valuable income generating asset to the New South Wales sector. It has total assets under management of $116,178m (30/6/88) and in 1987/88 for example it earned total premium income of $1,268m – representing nearly a three-fold increase since 1983/84. In the past five years the GIO has contributed over $270m to New South Wales Consolidated Revenue in the form of dividend and income tax payments. Reflecting the growing profitability of the GIO these yearly contributions have escalated markedly over this period. Table 10.22 provides some important financial statistics relevant to GIO's performance.

General Insurance
General Insurance is the most profitable GIO Division. It conducts virtually all variants of commercial insurance with the main areas of coverage being motor vehicle, household property, small business insurance as well as specialist forms of high risk liability insurance for industry such as the insurance of museums and satellite insurance. The GIO has also a growing presence in the international reinsurance market. In 1987/88 this Division earned profits before tax of $103.6m, paid $14m in dividends and was liable to make income tax contributions of $45.5m.

Life Insurance
This division is also a fully commercial operation providing a range of life insurance and investment linked products. Despite the fact that its operations are confined to New South Wales, the GIO is the fourth largest life insurer in Australia thereby giving it a significant presence in the market. Policies in force as at 30 June 1988 numbered 105,597 with a total insurance value of $4,213m. The Life Division has experienced strong growth over recent years due to GIO's participation in a rapidly expanding life insurance market. Total assets were $2,479m as at 30 June 1988 representing a six-fold increase since 30 June 1984. In 1987/88 it earned net profits of $19.6m, paid dividends of $1m and taxable contributions of $30.6m.

Funds Administration
Although this division earns positive profits and pays dividends (in 1986/87 they were $6.6m and $1m respectively) its operations are not fully dependent on the pursuit of commercial objectives. The main insurance funds for which the division is responsible are the Transport Accident Compensation Fund covering compulsory third-party motor accident insurance, the State Compensation Board's Workcover Fund that services GIO's private sector clients, and the Government Workers Compensation Account that services New South Wales sector employees and various other statutory funds. Pursuant to the 1985 (Amendment) Act the GIO charges the New South Wales Government a management fee for administering these insurance funds on its behalf. In this regard the Funds Administration Division represents the key social function of GIO's operations. Illustrating this social role, in 1986/87 for instance when many private insurers temporarily withdrew from the market because of uncertainty surrounding an alteration in workers compensation liability follow-

ing the introduction of Workcover, the GIO's strong presence in the market effectively stabilised premium rates. *This role is no more clearly demonstrated than by GIO's management of statutory funds (as required by government legislation) to meet outstanding workers compensation claims of failed private insurance companies.* The four workers compensation funds in Table 10.23 (named in each case after the failed insurance companies) have been established by Act for this purpose.

Table 10.22

New South Wales Government Insurance Office Financial Statistics
(As at 30th June)

	1988 $m	*1987 $m*	*1986 $m*	*1985 $m*	*1984 $m*
Life Division					
Premiums & Unit Trust Subscriptions	725.0	533.6	290.7	168.7	87.8
Life Cover in Force	4,287.3	3,235.0	2,564.4	2,158.4	1,821.9
Life Insurance Fund	2,114.5	1,460.1	871.3	490.7	325.6
Shareholders Capital & Reserves	93.9	75.2	53.7	–	–
Total Assets	2,479.0	1,768.8	1,037.7	650.3	434.9
General Insurance Division					
Premiums & Non Investment Income	497.4	611.4	422.5	384.4	368.8
Profit Before Tax	103.6	107.2	73.4	77.4	62.6
Net Profit	76.8	80.7	70.0	53.1	40.6
Shareholders Capital & Reserves	490.7	428.2	361.7	305.7	252.6
Total Assets	1,829.7	1,691.7	1,258.8	1,009.9	851.5
Funds Administration Division					
Management Fee	45.5	34.5	24.9	–	–
Profit Before Tax	6.6	4.5	3.0	–	–
Net Profit	3.1	2.8	1.8	–	–
Shareholders Capital & Reserves	8.1	5.2	2.6	–	–
Funds Under Management	1,869.3	1,416.7	1,409.9	1.474.5*	1,560.5*
Summary					
Tax Payable to State Treasury	85.2	36.8	13.9	44.0	32.7
Dividends	15.2	14.2	32.2	–	–
Assets Under Management	6,178.0	4,877.2	3,706.4	3,134.7	3,807.9
Total Premium Income	1,267.9	1,179.5	738.1	553.1	456.6

Note: * Assets of Transport Accident Compensation Fund and other Statutory Funds.
The assets of these Statutory Funds came under management of Funds Administration Division as from 1st July, 1985.
Source: GIO Annual Report, 1987/88.

GIO and Privatisation

The GIO is a highly successful Australian commercial public enterprise whose operations are certainly not handicapped by any capital funding difficulties. It is therefore an asset which private insurance companies would be desirous of acquiring, especially offshore insurers wishing to obtain a substantial foothold in the domestic insurance market. As one of the participants in the Commission of Audit was reported to have said with respect to the privatisation of State sector assets, 'some of them such as the State Bank, the Government Insurance Office, the Maritime Services Board Coal Loader and the Lotteries Office are packaged with ribbons around them' (*SMH*, 3/8/88, p. 4). Among the recommendations made by Curran *et al.*, (1988, p. 109) was the privatisation of the GIO along with similarly profitable assets. While the notion of privatising the GIO

strongly appeals to the ideological instincts of the conservative Government, the substantial stream of income which could be foregone by its divestment, especially in light of the considerable budgetary pressures now operating, persuaded it on practical grounds to act otherwise. In this regard the privatisation of GIO (or any other profitable Statutory Authority for that matter) would mean foregoing not only dividend payments but also substantial income in lieu of Federal taxes, which would (in private hands) largely flow to the Commonwealth.

Table 10.23

New South Wales Government Insurance Office Compensation Funds

Statutory Funds	*Cumulative Claims Paid* $
Riverina Insurance Company Ltd. and Other Insurance Company Act (Country Traders Mutual Insurance Company Ltd), 1971	712,625
Northumberland Insurance Company Ltd. Act, 1975	788,499
Associated General Contractors, Insurance Company Act, 1980	7,805,957*
Bishopgate Insurance Australia Ltd. Act, 1983	29,295

Note: * Loans advanced to liquidator, Associated General Contractors Insurance Co. Ltd.
Source: GIO Annual Report, 1987/88, pp. 156-163.

This exercise should serve notice to the government of the economic superiority of retaining a valuable income generating asset as against the attainment of a one-off capital windfall. Corporatisation of GIO that is now proceeding suggests that the government has not completely rejected the possibility of future privatisation. GIO management have already indicated their preference for eventual privatisation (*SMH*, 30/1/88, p. 45). This pressure for privatisation should be rejected, both on the basis of financial considerations and also social grounds. It is perhaps not readily appreciated that apart from being a significant source of revenue to the New South Wales sector, the GIO plays an important ongoing social role in the community. We have already seen that the GIO has historically played a crucial role in the establishment of universal workers compensation insurance and the development of third party motor accident insurance. It continued to be a medium by which to discipline private insurance companies from charging excessive premiums in socially oriented areas of insurance and by which the New South Wales Government can introduce insurance schemes which have an important social objective. As a public enterprise the GIO therefore confers upon the people of New South Wales who are in fact its ultimate shareholders considerable socio-economic benefits.

10.6.6 Privatisation of Human Services in New South Wales: Housing

Introduction

Since 1988 the new philosophy articulated in the Curran Report has been felt not only in NSW commercial enterprises or in the general search for staff cuts and productivity gains, but also in the human services. Three areas which have been noticeably affected are housing, Family and Community Services and non-government organisations.

The latter are important, both because they are flexible and responsive deliverers of human services and because they are very likely to carry the ultimate burden of privatisation in the human services area. Such non-government organisation are funded by annual grants or specific project funding, often with a

mixture of Commonwealth and State funds or jointly funded programs. This funding amounted to around $115m in 1987/88. The Curran Report noted that 19 State departments provide this funding. However, the largest funding source is the Community Welfare Fund administered by the Department of Family and Community Services.

Human services in New South Wales have been and continue to be the subject of a wide range of reviews intended to produce changes which fit under the general rubric of 'privatisation'. In particular there have been a number of instances of significant deregulation, a significant increase in user pays in services whose primary function is improvement of equity, the reduction (and in some important cases the elimination) of services in the belief that they are better provided in the private sector, contracting out, asset sales, lease back, shared equity and joint venturing. There has also been a stated policy of transferring funding to services with a higher use of volunteer labour. It should be noted, too, that the trends towards corporatisation and commercialisation in public enterprises have direct parallels in the non-government welfare sector. There are, however, important differences related to the different requirements of effectiveness and accountability in both management and services delivery in the welfare area. A recently released NCOSS discussion paper, 'Shifting the Balance – Public Responsibility and Privatisation in the Community Services Industry', takes up these issues in detail.

Transfer to the Private Sector

On 25 May 1989 the Minister for Housing announced that National Australia Limited had been awarded a mandate to establish a private partnership to construct housing for public tenants. The Partnership will effectively privatise a large part of public housing provision in New South Wales by moving the financing of $2m of rental accommodation for rebatable tenants to the privately run structure over the next five years. Unlike the existing New South Wales Rental Property Trust which depends on tax benefits to investors largely based on depreciation allowances, the new Partnership will be financed by a structure based on borrowings and a range of new financial instruments offering lenders a AAA return on funds at a guaranteed real rate of interest. However, the return to investors comes from the capital gain realised by the sale of the stock. Because of the average length of public tenancies, all stock will have been sold by the end of twenty years. If the scheme is approved by the Commonwealth, the lower income generated by lower public housing rents will be subsidised by rebates made available through the Commonwealth State Housing Agreement.

A pilot program of 1,000 new units in 1989/90 at a cost of $120m will be undertaken (*AFR*, 25/5/89). New starts by the partnership are planned to rise to 3,000 per year by 1991/92, with a total of about 16,500 new starts over five years. To put this in some perspective, in 1987/88 the New South Wales Department of Housing achieved 3,611 commencements of new units in public housing. The same level of starts was announced for 1988/89. However, nine months into the financial year less than 1,000 units had actually been commenced. Against this should be set the planned sale in 1988/89 of the sites of around 760 planned units in the Sydney metropolitan area and the planned sale to tenants of 400 existing units throughout the State. Compared to this virtual standstill in public housing construction and coupled to the erosion of public stock through sales to tenants, the proposed Partnership clearly constitutes a dramatic privatisation of social housing provision.

The Minister's announcement of the agreement with National Australia Limited, preempts the report of the Client Services Review still being conducted by the Department. That review is primarily intended to restructure the direct management of public housing. It is, however, the platform from which the shift to privately financed, constructed and managed social housing has been planned. The pilot construction of 1,000 units was then, in effect, to be stage two of the Client Services Review. The announcement of a five year plan, however, is a dramatic step forward in the process.

In principle there is very little concern over the use of private funds to increase the stock of social housing. Already a substantial amount

of public housing construction is financed by State borrowings (forced in part on the States by escalation of the rebate bill for public tenants as a result of reduced cross subsidisation from non-rebated tenants as the proportion of low income tenants has increased – from 56% in 1980-81 to 74% in 1986-87). Proposals also exist to gear public housing to provide much greater access to borrowings. Important innovations in social housing programs such as Community Tenancy Schemes (CTS) and housing co-operatives also use private rental market stock or private funds to provide subsidised local community based housing.

The crucial difference between the three models – public housing financed through borrowings, community housing financed at least partly on the private market, and a privately owned and financed scheme like the National Australia model – lies in the forms of management, pricing structures and decisions about resource allocation.

Public Housing is managed publicly. It also has a degree of tenant participation. It has provided security of tenure, using rents from those tenants whose income increases to cross subsidise rents from low income earners. It has also attempted to develop innovative programs to provide access to target groups such as women, single young people, Aborigines, people from non-English backgrounds and people with disabilities. In New South Wales the Department has also begun to develop a world reputation for design and urban renewal. All of this is about to change. The pricing structure of public housing has, until recently, been based on a cost rent formula (a formula which nonetheless can include interest repayments on borrowings, management and maintenance, and the market cost of the land in different locations). It does not include a component for profit.

Community housing provides far greater tenant participation in management, and hence far greater responsiveness to tenant needs such as maintenance. It is also able to target local populations and create the smallest possible housing dislocation. It, too, is intended to provide security of tenure. It's pricing structure is more vulnerable to market pressures since it often leases from the private market. But by head leasing a substantial number of properties and providing its own management, it is able to substantially reduce the costs over the private market.

Rental property trusts or other commercial schemes, on the other hand, are managed purely to provide a return to investors. In the case of Trusts, they contract management to private real estate agents, excluding any tenant participation. They guarantee no security of tenure and are not able to target provision to meet low rental or special needs.

The National Australia scheme is presently different in an important respect. Rather than managing privately it will contract management and construction to the Housing Department (a somewhat ironical reversal of contracting out). This concession was only secured in order to gain access to Commonwealth subsidies. Security of tenure is also guaranteed, although the public utility of the stock is only secured for one, rather than sequential, tenancies. This raises the question of the cost effectiveness of the public subsidy (part of which goes to subsidise returns to lenders). In terms of tenant years of occupancy, it appears that the use of subsidy for direct construction would have produced greater public benefit.

The more difficult task of targeting specific areas of need will be left with the public housing sector. Even with the addition of public subsidies, the Partnership's pricing structure will be determined entirely by the private rental market. One effect of this is that, unless the public housing sector makes savings by reducing management and maintenance costs and by excluding the more expensive target groups such as people with disabilities, the cost of the rental rebate bill borne by the State and Commonwealth will increase to subsidise private profits.

Public Housing Sales Policy

The New South Wales Government has embarked on a program of sales, both of housing stock and of land, which it hopes will change the emphasis of the Department from construction to sales. This approach is underpinned by a policy often stated by both the Premier and the Minister to place the greatest

emphasis on self reliance through home ownership.

In the 1987-88 Budget asset sales of public housing sites or of existing dwellings was estimated to raise $80m, with the possibility of increasing this figure as more potential asset sales are identified. One major effect of this policy has been to reduce the availability of housing stock in the inner city where infrastructure already exists, with the intention of replacing it in currently unserviced areas. Given the renewed emphasis on urban consolidation this policy is, at the least, contradictory.

The economic effectiveness of some sales must also be questioned with some tendering arrangements apparently ignoring higher bids, and with proposed asset sales including sites with facilities such as shopping centres which produce a very good income stream. In terms of overall government policy some housing department profits realised through asset sales must be seriously questioned. In particular, the site of the old Crown Street Women's hospital was sold to the Housing Department by the Health Department at well below market rates because of its intended use for public housing. The windfall profit of its current sale has therefore at least partly been at the expense of another government department.

Sales to Tenants

The New South Wales Housing Department has launched a major publicity campaign to induce public tenants to either buy their existing dwellings or to purchase other accommodation at substantially discounted rates. A number of financing options have been made available. As well as Affordable Home Loans and Premier Low Start Loans, the Ready to Buy program offers public tenants simplified contracts, and discounted mortgage interest rates (12.9% rather than 13.5%) which are exempted from stamp duty. Under a generalised Homefront program other options such as the purchase of part equity in public housing are being offered to tenants. The expected level of sales in 1988-89 is around 400. However the 1988-89 budget increased funding from $100m to $440m, $65m of which was to be allocated to the Ready to Buy program with the aim of enabling 1,000 public tenants to purchase their homes.

Commercialisation

Under the new government an explicit change in the emphasis has taken place. Construction has been reduced – with the elimination of a significant number of jobs in the production department – while land sales and joint ventures have substantially increased.

Joint ventures, of course, may provide a cost effective way of increasing both public and private rental accommodation. A typical model would be for the Department to provide the land while the joint venturer would construct the dwellings, with 50% being allocated to the Department for public housing. What is lost under this arrangement is the considerable expertise developed by the New South Wales Housing Department in the area of urban renewal and consolidation and innovative urban housing construction. It is probably no exaggeration to suggest that over recent years, the New South Wales Department has become a world leader in this field. Certainly no such expertise exists in the private sector.

In April 1989, the Department eliminated 102 positions (34 currently filled) from its production staff in a departmental restructure. The restructure has reduced the number of production teams from seven to five, a number of which already work exclusively on the preparation of land sales. Twenty of the positions lost filled by professional and technical officers (planners, architects and officers responsible for designs, overseeing planning submissions and supervision of contractors) will not be redeployed within the Department. It has been suggested that some technical staff may be redeployed as consultants.

The new emphasis on land sales is on line with a shift to more commercial areas of activity and to providing services mainly directed towards home purchase. The land acquisition and development program received a 68% boost in the 1988-89 budget with an increase from $49.5m to $83m.

Contracting Out and Client Services

The Housing Department has always made considerable use of contractors, both in construction and maintenance. However, it has maintained direct management of such areas and of basic client services such as rent

collection. The current Client Services Review is set to change all that.

Although it has not yet reported, its initial recommendation is believed to be a transfer of all rent collection from Department offices to automatic collections through the banking system. The effects of such a change are not expected to be felt solely in rent collection. Since rent payment is the main point of contact between tenants and the Department, it is also the point at which maintenance requests are made. It is anticipated that the change to rent collection will also significantly reduce the extent of maintenance.

Combined with the initial impact of the Public Housing Rental Trust, the reduction of client services is expected to cut positions within the Department and is expected to accelerate once the Trust is beyond the pilot stage.

The Client Services Review was initiated, not simply to save costs, but to change the balance of the Department's functions. It is believed that the balance between services to existing tenants and to new applicants is inappropriately weighed in favour of existing tenants. Beyond this, it is argued that the Department should place more emphasis on the administration of programs such as the Mortgage and Rent Relief Scheme which is designed to keep people in home ownership or the private market, than in servicing public tenants. Perhaps the clearest indication of this is the new official requirement to describe public housing as 'welfare housing'.

Increased User Pays

Pricing policy for public housing rents has never been straightforward. The Commonwealth State Housing Agreement (CSHA) has established a fairly comprehensive cost rent formula which includes management and maintenance costs as well as the cost of the property. In fact the States' discretion about how the components of the formula are calculated means that it is possible for cost rents and average market rents to be similar. Nonetheless, the cost rent model does provide a basis for State Governments to charge rents which are both more affordable to tenants, are not market driven (particularly in a period of volatile rent increases) and can act as a brake on the private market.

However, the CSHA simply requires that *at least* the cost rent formula be charged. Some States, including New South Wales, have moved to a policy of charging market rents. The crucial point about market rents is that the notion is hard to measure in a practical sense. First, since there is no market in public housing accommodation, it is impossible to say what the market would determine. Comparisons are also impossible since the public housing estates are unique forms of housing and often the major development in a given region.

More importantly, the market rents policy means that rents are based on a periodical review of market rents. Since the only available data are the Real Estate Institute Rent Survey and Rental Bond Board data these become the benchmark for rent increases. However, they only measure rents for new tenancies. These are always considerably higher than actual rents for sitting tenants. Consequently, they do not represent the actual rents being charged. Instead of public being a brake on private rents, a market rents policy makes them market leaders.

New South Wales has just completed a market rent review with resulting rent increases of 30% or more. At least part of the explicit intention of this review is to encourage non-rebated tenants to move back into the private market or to take up home purchase assistance under the Ready to Buy program.

However, a second, and as yet uncompleted part of the government's review of public housing rents is equally significant. New South Wales public housing tenants receive a rebate which ensures that the amount of rent paid does not exceed 20% of income (and 18% in the case of pensioners). The current review is investigating a new scale which will increase these levels – possibly with a sliding scale from 20% to 27% of income. This alone would represent a rent increase of 35%, but the review is also examining which household members should be included in the calculation of the rent. Previously the household rent was increased by a flat $5 a head for each additional household member other than the lessee. Under the previous government this was changed so that all other adults paid 20% of income (like

the lessee) and children aged 18 to 25 paid 10% of income. The Commonwealth also included 15% of the Family Allowance Supplement. The current review is considering increasing the contributions from other members by including income from those under 18 and including the full family income in the determination of whether the rent is calculated at the top of the sliding scale or lower down.

It is important to note that this arrangement treats public tenants quite differently from private tenants. Two very important considerations are whether it is appropriate to include the income of young people in the calculation of rents and the extent to which expanding the income base will mean that households are drawn closer to the full 'market' rent for the dwelling.

Deregulation

The Greiner Government has not only placed greater emphasis on the private market, it has also moved to deregulate that market. Five recent changes to legislation have had this effect or are currently being considered – the amendments to the Residential Tenancies Act 1987 (enactment of which was delayed by the new government); the amendments to the State Environmental Planning Policy No. 10 (SEPP 10) of the Environment Planning and Assessment Act 1979; an inquiry is being conducted in to Section 94 of the same Act; a similar inquiry is due to report on 'anomalies' in the Landlord and Tenant (Amendment) Act 1948 which concerns protected tenancies; and finally, changes to planning regulations which have reduced Local Government controls over a range of developments.

The amendments to the Residential Tenancies Act 1987 had the effect of increasing landlords' powers to enter properties and evict tenants while further reducing tenants' protections already watered down by the previous Labor Government. The inquiry into protected tenancies follows recommendations by the Government's Inquiry Inner City Homelessness, chaired by Max Raine of Raine & Horne Real Estate, that such protection be immediately removed. Changes to SEPP 10 and Section 94 weaken measures designed to slow the loss of boarding house stock or other low income rental accommodation.

Community Tenants Advice

Just as deregulation has removed protection for private renters, particularly at the bottom of the market, so too has the removal of funding for the State's non-government Tenant's Advice and Housing Referral Services (TAHRS). In 1989 these services responded to 50,000 requests. They provided not only independent advice, but also representation and advocacy on behalf of tenants in dealings with landlords or agents.

As the services were funded from interest money from New South Wales Rental Bond Board, the cuts did not represent any saving to the Housing Department budget. However, it did represent considerable gains to the profitable operation of the private rental market. It has also meant an increase in cost in other areas as Local Government and neighbourhood centres as well as some church organisations (such as the Uniting Church Board of Social Responsibility) have attempted to replace some of the services. The 70 retrenched TAHRS workers have been replaced by four new department positions and one existing officer in each regional centre who will be trained to take on the purely informational aspects of this work as well as an additional duty.

Community Housing

Community Tenancy Schemes (CTS) were designed to proved a 'fourth tenure' which could increase the stock of low cost rental accommodation without putting extra strains on the public housing system, but offering comparable security and enhanced tenant access and control.

This year the 62 CTS in New South Wales (housing 7,000 tenants) were given a March 31 deadline to accept a radical restructure of the program or loose funding. The restructure made four important changes. It increased rents from 20% of income to 25%. CTS tenants have lower average income than other housing department tenants. It made the scheme a medium term accommodation program. Tenants will be annually reviewed for eligibility to remain. The intention is to encourage a return

to the private market as soon as they are financially able. Existing Housing Department capital stock will be handed back to the Department (it is unclear what will happen to the current tenants) leaving almost all stock to be leased from the private rental market. Finally, the management load is to greatly increase, but with a dramatic reduction in tenant participation and facilities such as interpreter services. With no increase in management hours (in fact with a cut in 18 of the largest schemes, the number of households managed will increase from 2,257 to 3,148. Management workloads will increase from 2,257 to 3,248. Management workloads will increase between 43% and 82%.

Not only does this change the nature of the scheme to a temporary respite from the private market, rather than an innovative use of mixed public and private resources to provide a secure alternative to the private market, but it also is a particularly blatant example of the increased exploitation which governments can enforce when they devolve service to the community sector. Of course this is not necessary. The motivation for such devolution can be the provision of more responsive and effective services. In this case that objective has given way to cost cutting and exploitation.

10.7 Conclusion

This chapter has covered a considerable range of economic and social issues pertaining to the New South Wales State public sector under the management of a conservative government. Indeed the complexity of these issues has been increased by the frightening pace with which the Greiner Government is pursuing privatisation. In the process, the coherence and quality of the public sector is being broken down, as the principles of social justice are abandoned and economic services are being reduced. This is a model of public sector activity of a bygone era, not one capable of undertaking socially equitable, structural adjustment in an industrialised economy.

This chapter has often had cause to comment on the ideological intent of the conservative government, together with the broader national economic problems of external imbalance and economic restructuring. In consequence, the role of the public sector has never been more subject to question. From this point of view the role of the New South Wales State public sector is at a crossroad. On the one hand it may head down the conservative path, whereby activities capable of profitability are removed into the hands of private capital; and even the remaining tax funded and unprofitable social and welfare services are straitened in the name of low taxes – or shifted as much as possible onto a user pays basis, thereby eliminating redistributive mechanisms. On the other hand the State public sector may take the path indicated by the renewal model: a rationalised tax system providing a secure basis for appropriately funded services; and the great majority of trading enterprises, and some other appropriately user-charge financed activities, organised on commercial lines, providing effective services, and generating net non-tax revenues for application in a progressive manner to free or subsidised services.

This model offers the best prospect for a New South Wales State public sector which will serve the interests of ordinary wage and salary earners, as well as the poor and welfare dependent, and at the same time enhance the life of the community in a multitude of ways which would be impossible in the absence of a vigorous and expanding public sector.

Notes

1 Analogies between societies and households, however beguiling, are notoriously misleading in economics. Nevertheless the state debt issue here may be compared with a common household debt issue: the fact that debt-financed purchase of a house for owner-occupation does not in general generate pecuniary returns which cover debt costs does *not* mean that it is in general economically irrational for a household to undertake such transactions. The same applies to the New South Wales Government.

2 Consultants to the State Government, Booz Allen Hamilton Inc., reported that 'the SRA's accounting system was the worst [railway accounting system] they had seen, including that of mainland China' (*Sydney Morning Herald*, 5-3-89, p. 2; hereafter cited as *SMH*).

3 As indicated above, other parts of the State sector – eg., education and health – also provide an 'investment in New South Wale's economic future, albeit less direct, less obvious, and in some cases less tangible'.

4 The abolition of the winter surcharge by the Conservative Government also amounts to an unwarranted subsidisation of peak domestic demand. (There are also regional cross-subsidies between urban and rural areas (favouring the latter) and within rural areas. These may well have an equity justification. There are also a range of (now) rather minor Community Service Obligations in electricity supply (New South Wales Government, 1988, pp. 105, 116). See also Industries Assistance Commission (1989, Apps. G and H), for a more detailed discussion of pricing policy.

5 The extension of interconnection between the state systems also has potential to reduce the margin of excess capacity required to satisfy seasonal and daily demand variations (*vide* Industries Assistance Commission, 1989, pp. 13, 31-32, App. E). Interconnection currently exists between New South Wales and Victoria, and will be extended to South Australia in 1990. It should be said that excess capacity is a particular problem for electricity producers, because the product cannot be stored.