

# **Briefing Note Regarding the Claim by Mr Springborg to cut \$1 billion p.a. from Queensland Government Expenses over the Next Three Years**

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## **Statement of Qualifications**

I am an expert in government budgeting and public finance and have been engaged in research on these topics for over 20 years. I have written or edited five books on these topics starting in 1990 with *Budgetary Management and Control* (Macmillan) and the most recent *The Reality of Budget Reform in 11 OECD Nations* (Edward Elgar forthcoming) going to press. I have published a range of other refereed articles and book chapters on public finance also. I spent one year as an academic researcher in residence with the federal Department of Finance and have served on two Queensland Treasury advisory committees before I moved to the ANU. Because of my knowledge I was invited to give the annual Certified Practising Accountants research lecture in November 2007, which was used as a basis for Senator Murray's recent review of the federal budget system.

I have been asked by the ALP (Queensland Division) to provide expert comment on the proposed plan to impose a 3% 'productivity dividend' across the whole of government (raising over \$1 billion) from the Queensland budget and applying each year for the next three years. This briefing note uses the projected 2009-10 expenses figures for the Queensland Government (and from the Major Economic Statement of December 2008). Given the financial credit crisis there has been some savings measures imposed over the 2008-09 budget year but as it is now nearly over there will not be much prospect of further 'savings' from the present year's allocations.

## **General Comments on Announced Cuts to Public Spending**

### ***The Nature of Saving Initiatives***

Large savings are notoriously hard to extract from government budgets – not because governments and their public servants are selfish or interested in aggrandisement, but because governments are buffeted by rising community expectations of services and increasing cost pressures from delivery instruments. Governments are not in control of all the factors that contribute to their cost pressures – other factors intervene such as: rates of inflation, wage pressures, supply costs variations, critical shortages, events and natural disasters.

Major savings initiatives involve considerable political commitment to see through. They come at a high cost in terms of political capital. For that reason it is also hard for governments to impose major savings over multiple budget years. It would be extremely difficult, say, to extract \$1 billion per annum from the Queensland budget for three years running.

Savings initiatives are attractive and relatively easy for Oppositions to announce in election campaigns in that they provide them with an 'offset' or a nominal margin against which to balance any proposed increases in spending on other policy areas. Such cutting initiatives are usually vague or rely on generic commitments (eg, savings of 'x' millions across-the-board), rather than carefully itemised cut targets with schedules of cuts announced prior to the election. It is common, and sometimes popular, to announce cuts to 'soft targets' such as corporate services, overheads or advertising, but these items remain important to running government effectively and will not generate the magnitude of savings proposed.

Savings initiatives are usually sold on two superficial arguments (i) that greater efficiencies can be extracted or greater streamlining of administrative supports can be achieved, and (ii) that waste and duplication can be eliminated and thus free up some existing resources. But, in practice few claimed efficiencies or reductions in wasteful expenditure are ever discovered or realised. Therefore, if substantial cuts are imposed they tend to involve a reduction in service levels, greater rationing of services, governments divesting themselves from certain responsibilities (perhaps entirely or to the private or voluntary sector), or delaying intended future commitments well into the out-years.

### ***General Observations From Existing Practice***

There are a number of general observations that can be drawn from international practice over many years of experience with savings measures. These are:

1. the larger the figure claimed for budgetary cuts or savings measures, the harder they are to achieve and the more unsuccessful they will be in practice;
2. multiple year savings measures tend to taper off quickly as governments lose their commitments to make hard decisions, and new policy and spending measures gather pace;
3. the more indiscriminate the savings measures are when they are announced, the more 'political' will be the fight to impose them indiscriminately or across-the-board (all agencies will claim they are essential and should be exempted from the cuts);
4. the more focused and itemised any intended cuts are, the comparatively easier they will be to implement subsequently;
5. in terms of the principles of subsidiarity, the closer the government is to the community the harder it will be to make substantial cuts or make succeeding cuts over a number of years;
6. the political pain or cost of making cuts usually means they are imposed for one or at maximum two years after which spending increases tend to resume.

### ***Across-the-Board Cuts***

Across the board cuts are usually the easiest to announce, as one does not have to pre-specify which areas will be especially targeted for cutting. But they are also perverse in that areas a government may wish to expand or prioritise also get cut, the same as areas where cuts are desired. It is illogical to cut, say, the Police operating budget if at the same time additional Police officers are to be awarded to the agency.

There is considerable scepticism about whether across-the-board cuts can really be implemented – especially with powerful agencies that can exploit their position or generate waves of public sympathy to avoid the cuts. We have already seen some examples of this behaviour in Queensland and in other states.

A good recent example is the attempt by the Liberal Western Australian government to impose cuts of 3% on agencies which has been resisted by the WA Police Commissioner on the grounds that it would not enable him to fulfil his statutory responsibilities. The WA government has now conceded that a figure of 3% may be too optimistic and that it may have to settle for less cuts from the Police portfolio.

### **The 3% Productivity Dividend Applied Across Government – Producing Cuts to the Queensland Budget of Over \$1 Billion per annum**

Mr Springborg has announced that he intends to impose a 3% productivity dividend across government which will have the effect of cutting over \$1 billion from government expenses per annum over each of the next three years. The dollar amounts are his estimates of the impact of the 3% savings measure.

From the Budget estimates the total expenses for 2009-10 are projected to be \$36.700 billion (although the December MES revised this total up to \$37,472). To cut \$1 billion from this amount constitutes a cut of around 2.6 to 2.7% of total expenses – or 8% over three years. In real terms the proposed cuts could be much higher given that cost pressures on expenses are increasing by an average of 4.8% (or \$1.715 billion in dollars) over the past two years (7.5% in budget year 2008-09 and a projected 2.6% over 2009-10). Hence, every agency that received a cut to its operating budget of 2.7% (to achieve the \$1 billion savings) could in fact be facing a real cut of up to 7% per annum – or compounded cuts of over 20% across three years.

Over the past ten years (1998-09 to 2008-09) the expenses across many important policy sectors have increased by double figures per annum (eg, health by 16% per annum, social welfare by 16%, public order by 11%, education by 9% and transport and communication by 9%). This reflects rising costs of delivery, increased population pressures and rising expectations of the community for government services. It would be prudent to factor in some allowance for this pattern of growth when making budget commitments or announcing electoral promises. In my view it would be unrealistic to contemplate cuts of the magnitude announced by Mr Springborg given Queensland's increasing population and demands for additional services.

If Mr Springborg intends to quarantine front-line service delivery staff from his cuts, then they will fall disproportionately on other employees or on other expenses. In terms of government employees, almost 22% of government employees (or 40,642) are in corporate or administrative support roles (and 78% in direct service delivery – 144,983). If the latter are exempt from the cuts, then some 12,500 positions would have to go in the support services areas. This would represent a cut of almost 30% of support and corporate staff. If there are to be no sackings, and given an average natural attrition rate of between 6 and 6.5%, this would take over five years allowing for 2,438 voluntary separations each year. To extract \$3 billion over three years from natural attrition would take 16 years at the present rate of departures – and that assumes that in the present economic climate (and drop in foreseeable retiree incomes) that the previous rate of separation will continue – it could decline significantly over the next few years making the proposed cuts harder to achieve without initiating redundancies. It would seem that redundancies of approximately 10,000 per year would be required to meet the targeted figure in addition to natural attrition.

Looked at from the vantage point of departmental expenses, a savings measure generating \$1 billion per annum represents a cut of just over 3.4% from across all departments (or around 10% over three years). If departments were prevented from making contributions from their 'administered items', this figure would have to come entirely from their own operating expenses – which would impact on the level of services provided to Queenslanders.

#### **Options to Achieve a \$1 billion Cut per annum over Three Years**

1. **reduce the number of government employees** across the board: this would require a reduction of employees of 12,500 p.a. – a cut of 6.73% of government employees in 2009-10; and amounting to 37,500 employees over the three year timeframe.
2. **reduce the number of non-front line employees** by 12,500; this would target the cuts to backroom and support staff but such cuts would represent 30% of these essential support staff; and amount to an unfeasible 90% reduction in such staff over three years.
3. it would be unfeasible **to cut the provision for superannuation for government employees** – unless the numbers of employees were to be cut substantially. Reducing the commitment to superannuation this would merely create a larger future liability – and other governments are moving to follow Queensland's lead and fully fund their future superannuation liabilities.
4. **cut the capital budget** – this would have to come from the own funding sources of available cash the government commits to the capital budget (around \$5 billion in round figures in 2008-09). Cutting borrowings (\$10.9 billion arranged in 2008-09 but increasing over the forward estimates by a further \$10.79 billion) is irrelevant to this exercise – we would simply see less capital works undertaken on essential infrastructure (water, roads, rail, energy etc). I note that Mr Springborg has announced that he will 'retain existing infrastructure spending' which would apparently rule out this option.
5. **depreciation could be 'cut'** (theoretically) in the sense that longer asset timelines could be tolerated, lower rates of depreciation for public assets could be declared (and agreed over time with the Auditor-General), but this is likely to result in poorer asset quality, worse services, or accommodation, older plant and equipment.

6. **grants (which are also a form of expense) could be reduced** by \$1 billion, but most grants are relatively small and tightly targeted. Some grants are federal grants or governed by intergovernmental agreements and so effectively exempt from cuts (SPPs or NPPs). Other grants are regarded as sacred institutions. One such grant where the government has the discretion to reduce or eliminate the expense is the state fuel subsidy rebate, which would save \$572 million p.a. – but this option would likely result in predictable outrage from Queenslanders. Cutting out other grants, or reducing them sufficiently to generate the intended savings measure, is likely to cause widespread community outrage – such as the first home buyers’ scheme (\$214m), grants to not-for-profit bodies (1.24 billion), grants to local government (\$1.2 billion) and grants to non-government schools (\$1.7 billion). The effects over three years would be at the cost of declining social capital and trust in government.
7. **other operating expenses could be cut** – while not involving much loss of public sector employment – this option would cut down on other essential items to deliver services to the community (such as drugs and clinical supplies for hospitals (\$860m), school supplies and materials (468m), hospital repairs (\$144m), school repairs (\$143m), and even emergency vehicles and other equipment). Many of these other operating expenses allow agencies to perform their functions to a community acceptable standard. Many agencies have already had demands to tighten their other operating expenses over the years without compromising quality – but these amounts have been relatively small reductions not a major and repeated cut. For example the MES notes that operating expenses have been tightened by approximately \$190million over the present budget year.

### **The Impact of a Productivity Dividend of 3% on all Departmental Expenses**

An across-the-board productivity dividend is a largely indiscriminate and a ‘blunt device’ that would allow in theory departments to select for themselves where the cuts were to fall. It would therefore be likely that cuts to service delivery areas would result. For instance, the Education department would have to generate cuts of \$192 million p.a. from its departmental expenses of \$6.4 billion (and \$576 over three years). According to its Ministerial Portfolio Statement, its total corporate services are of the order of \$200 million per year (involving 700 corporate staff with a salary bill of \$60 m). It cannot administer schools, TAFE and arts facilities without corporate support; hence, it is impossible to extract this amount from a largely service delivery agency without compromising services. Similarly Health would lose \$249 million p.a.; Emergency Services would lose \$28.2 million; and Disability Services would lose \$37 million. In the latter agency the shadow minister has claimed disabilities will excused from the cuts implying the cuts will be larger in other areas to compensate. It is inconceivable to think that such cuts to departmental expenses can be achieved without cutting front-line services – especially staff, supplies and equipment.

A productivity dividend across government at the state level is a fundamentally different proposition for budget balancing than at the federal level. The federal government has had an efficiency dividend in place (at 1.25%) since 1987. It applies only to running costs of departments and agencies under the FMA act – a tightly defined concept relating to some expense items. The new Labor government increased the rate to 3.25% for the 2008-09 budget and will impose this same rate

again in 2009-10. However, it must be appreciated that the federal efficiency dividend applies only to around 15% of Commonwealth total expenses – it does not apply to transfers, pensions and benefits, transfers to the states and territories, or to defence. This relatively focused application comes about because the Commonwealth is not generally in the business of service delivery (and it previously cut around \$100 million and now around \$400 million at 3.25%). By comparison, a state government is largely in the business of service delivery and an across-the-board application of a high productivity dividend such as the one proposed would inevitably have to cut into service areas. The present Queensland government has announced an efficiency dividend of \$180 million in 2009-10 or a little under 0.5% of expenses and my understanding is that it is not applied across the board to all agencies but is a target of intended reductions.

### **Concluding Comments**

For a service delivery state with substantial population growth pressures, it defies credibility to claim that \$1 billion can be extracted from the across-the-board expenses of government without affecting services at the front line. Natural attrition alone is unlikely to generate the required savings – and if categories of service deliverers are exempt natural attrition would take almost two decades to approach this saving figure. In the meantime corporate services and backroom administrative support would almost grind to a halt.

It would be socially undesirable (and politically unwise) to cut grants to the community – and this would fly in the face of other worthy political or policy initiatives (cheaper petrol, assistance to home-buyers, assistance to voluntary associations delivering community services etc).

There is perhaps some scope to trim other operating expenses (delaying new vehicles, cutting back on maintenance, making assets and equipment last longer) but these are likely to have a direct impact on the quality of service delivery and potentially generate only relatively small amounts of savings – not the \$1 billion of savings claimed by Mr Springborg. It should also be noted that the present government has extracted \$60 million in savings over the 2008-09 budget and recently announced its intention to cut \$180 million in next year's budget and a further \$280 million in 2010-11 and 2011-12. As already mentioned, there has also been additional tightening in other operating expenses over the present budget year.