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More Flexible Public Expenditure Management

REPORT

This study has sought to assess the management of public expenditure in Australia and measures that might be taken to meet Australia's needs. We conclude that both the absolute level of public expenditure and the inability of government to vary major programmes because of their rigidity, are serious concerns. Further, we question whether the measures now being applied by government - or contemplated by the opposition - will be adequate to meet the situation. We believe governments need to consider a number of measures to strengthen their capacity for both tactical (i.e. annual) and strategic (i.e. medium term) management of public expenditure.

The overriding requirement for successfully meeting present needs is strategic, consistent and clear political leadership. All political parties tend to succumb to electoral expediency, despite national needs. A four or five year term for governments could bring national needs into sharper focus. Without an uncompromising effort to communicate to Australians the realities of our position as a trading nation, national sentiment cannot be mobilised. The proposals advanced later are designed to aid leadership. Without leadership - without a consistent effort to improve understanding of economic exigencies - none of these measures will be successful. In conjunction with determined leadership we believe these measures will help the executive overcome the prevailing immobilism.

In the paragraphs that follow we first set forth some of the reasons for our concern. Then we review the current approach of the government

and the opposition. Third, we weigh the requirements for achieving a significant absolute reduction in public expenditure. Lastly we suggest some actions that might be taken to strengthen government in dealing with expenditure management on both a tactical and strategic basis.

1. The 'Problem' of Public Expenditure

We have reviewed the various grounds that have been advanced for concern at public expenditure. Some argue the absolute size of government in Australia retards economic growth. We accept recent economic evidence (e.g. O.E.C.D. and E.P.A.C. studies) that suggests no clear grounds for criticising the absolute size of government in Australia relative to other countries. This is not our decisive concern. We share the anxiety of all political parties that the magnitude and inflexibility of public expenditure constrains excessively the governments capacity to 'manage' the macro-economy. Big government has been associated with chronic deficits. The link between deficits and interest rates is clearly established. Indirectly big deficits have had a major impact on the balance of payments. Perhaps most importantly, the government inability to offer significant tax relief is linked to its inability to vary expenditure other than marginally. In years past budget deficits have been used to stimulate the economy. Now they usually act to inhibit economic activity.

Our associated Discussion Paper refers to studies of the expansionary momentum implicit in the present scope of government and to the leverage the present political and administrative process affords to sectional interest groups. This is exacerbated by the still widely prevalent public assumption, nourished in the past by all political parties, that

government can create resources. Samuel Brittan describes this as the 'Wenceslas myth'. This is reflected in the number of new programmes created by the present government, despite its overall commitment to restraint. Mr. John Howard's recent statement of intent also foreshadows a number of new commitments that would add to costs. The following table indicates the extent to which new policies have added to expenditure in recent years:

CHANGE FROM FORWARD ESTIMATE TO BUDGET ESTIMATE*

	New Policies	Savings	Net Change*	Per cent of Forward Estimate
	\$m			
1976-77			-1490	-5.8
1977-78			-1880	-6.6
1978-79			-1092	-3.6
1979-80			-680	-2.1
1980-81			-105	-0.3
1981-82	308	-783	-475	-1.1
1982-83	1153	-656	+497	+1.1
1983-84	2485	-1214	+1271	+2.3
1984-85	1138	-556	+582	+0.9
1985-86	716	-1480	-764	-1.1

* From 1981-82 onwards, the net change shows only the change due to new policy and savings decisions; i.e. it excludes revisions to estimates due to changes in economic forecasts, numbers of beneficiaries etc.

Sources: Report on the forward Estimates of budget Outlays 1984-85, 1985-86
1986-87, Department of Finance, March 1984.

Budget Paper No. 1 1983-84, 1984-85, 1985-86.

Looking to the annual budget, the evidence suggests that the best reduction Australian governments have been able to achieve over the past 7 years amounts to no more than just over 2% of forward estimates. This has been in a generally positive economic climate. In earlier years reductions of up to nearly 7% of forward estimates were obtained. We see no reason why such performance should not be replicable.

Yet the increase of public expenditure in the U.K. during Mrs. Thatcher's term is salutary for those envisaging significant reductions in Australia. In fact public expenditure increased from 49% of GNP at factor cost in 1979 to 54% in 1984.

Today in Australia, education, health and welfare expenditure absorb 44% of the federal budget. Outlays in these areas have grown by 66% in real terms in the past 10 years. Comparable improvements in outcomes are perhaps harder to discern. Significant change will require strategic reorientation of some current programmes. Yet the present system seems to have scant capacity to achieve major, strategic change of programmes and only limited capacity for tactical change.

2. Current Approaches to Public Expenditure Management

Australian governments in recent years have taken steps to strengthen their capacity to manage public expenditure. The current federal government has taken a number of initiatives. Its most important strategic commitment involves the 'Trilogy'. Under this doctrine, current federal government expenditure will not grow to more than approximately 31% of GDP. As a strategic decision, this commitment maintains the absolute size of the federal government. It has only indirect impact on

the activities of state governments. As a tactical measure, it does presumably help Treasury ministers in their annual efforts to impose restraint on colleagues responsible for spending programmes. An Expenditure Review Committee of Cabinet has been established. This committee examines all expenditure proposals throughout the year in the light of the government's budget strategy. The government now establishes total outlay and staffing targets for each portfolio at the outset of the budget process. New policy should be accommodated within these target figures. The Department of Finance has sought to consolidate appropriations to give departments more flexibility in managing resources. There have been moves to present appropriations on a programme basis. The volume of information in the public domain and the clarity of that information has been improved. For example Forward Estimates are now published covering a three year period. At the level of individual departments the Financial Management Improvement Programme aims to increase the responsibility of individual programme managers for the efficiency and effectiveness of the resources for which they are responsible.

These steps all represent significant change. We applaud them all. We doubt whether they will be adequate to the task. We look particularly to the experience of the United Kingdom where a similar battery of measures has not succeeded in containing public expenditure growth. And that is in a unitary political system. Australia's federal system compounds the difficulties of public expenditure management. We also note that this battery of measures is primarily designed to improve action at the bureaucratic and administrative levels. They fail to address what we conceive to be the central problem in expenditure management - that is strengthening the government's capacity to manage effectively and lead a

society that is now largely a collection of interest groups. We endorse Samuel Brittan's observation.

Interest groups have acquired a stranglehold over the political process - whether these are the unions, the professions, the farm lobby, the pensions industry, the home owners' lobby, the heavy exporters' lobby (usually known as overseas aid), council employees and all the rest. The fact that most of us belong to one or more of these lobbies does not reduce their perverse effect. But the commitment to defend, keep and protect goes into areas which make no economic sense, from any point of view.

We will return to these issues in the final section.

3. The Opposition alternative

In a recent speech to the National Press Club the Leader of the Opposition, Mr. John Howard, outlined the approach he would propose to take to economic management. He said:

"On our election to office, the Coalition Government will set expenditure and taxation limits that are significantly more rigorous than those of the present Government's Trilogy..

In Government the Coalition will go even further. We will invite the private sector to establish a body not unlike President Reagan's Grace Commission."

We are not persuaded that either of these proposals suggests the Opposition has adequately come to grips with the magnitude of the task. It is possible that a tougher set of expenditure targets might be implemented. But this would involve variation within the existing broad array of programmes. It would not enhance the capacity of governments to achieve significant strategic change. If more than deferral of capital expenditure or *ad hoc* temporary cuts is to occur, a capacity for strategic change is essential.

It is in this context that the proposal to establish a Grace-style Commission should be weighed. This is unlikely to yield major saving unless the Opposition is willing to allow such a body to review programme philosophy as well as administrative costs and unless the Commission carries continuing responsibility for oversight of implementation of its recommendations. Administrative costs currently amount to only approximately 8% of total federal public expenditure. If however, a Grace style commission were allowed to review programme philosophy, this would involve conceding more to a private group than is currently conceded to parliament and its committees. We would be concerned that an ambitious programme of expenditure reduction that took no account of political feasibility, might simply be so much rhetoric, raise expectations but not result in action. This said, providing a Grace-style Commission was associated with other measures likely to strengthen the political capacity of government to take action, such an enquiry could help to build momentum.

4. An absolute reduction in public expenditure

A number of study participants believe the current situation requires an absolute reduction in the level of public expenditure. We have reviewed two mechanisms for achieving such an outcome. The first involves tax led pressures for expenditure reduction. The second involves a referendum to impose a constitutional limit on spending. These approaches are not mutually exclusive.

Some members favour an early reduction in taxation as a way of galvanising public support for subsequent reduction in programmes. This would arise because the resultant deficit would be seen to be intolerable.

Tax reduction it is suggested would meanwhile mobilise constituencies on behalf of further expenditure restraint. This approach does not carry unanimous endorsement from participants mainly because of the risks to fiscal responsibility which it would entail. It also overlooks the fact that a significant part of the electorate does not fully understand the implications of large public sector deficits.

The proposal for a constitutional limit on spending attracted more support. Members however recognised the very great political difficulties that such an approach would entail. If the economy were to severely deteriorate we could see a climate emerging more favourable to such a step. This would have the great merit of locking federal and state expenditures together. We note that this is the approach recommended by analysts who have considered the alternatives to Mrs Thatcher's current array of measures. We can see merit in a referendum campaign, even if it fails, as a way of alerting the community to the need for action at the level of individual programmes.

Most members of the group however remain sceptical about the capacity of any government in the foreseeable economic circumstances to mobilise sufficient support to achieve significant absolute contraction in the level of public expenditure. By this we understand a permanent contraction of the order of more than 6 to 8 percentage points on current outlays. This suggests the problem of expenditure management needs a variety of remedies aimed at reinforcing government capacity to manage strategic programme developments. It requires measures which build awareness of the strategic limits on government and of the negative consequences of overly large and inflexible government.

5. The Expenditure Management Task

We do not believe that any one measure by itself holds the key to strengthening government's capacity to manage public expenditure. At the level of programmes a variety of steps might be taken, for example:

- . mandatory use of sunset clauses of, say, three years in legislation setting up programmes. Some moves have already been made in this direction but more could be done. Many programmes designed to address temporary problems become permanent;
- . formation of institutions to take the responsibility for essentially commercial programmes out of the hands of politicians. For example, the National Airports Authority, being relatively independent of the Minister, would make provision of airports for pork-barrelling more difficult (privatisation is the ultimate example of this approach);

As a general comment we also believe serious consideration should be given to a wider application of the user pays and/or cost sharing systems that put at least some of the financial burden on those who are pressuring Governments for provision of services, regulations, etc. Introduction of university fees and trainees contributing part of the cost of training schemes are potential examples.

But the issue of strengthening the capacity of government to manage public expenditure also breaks into a series of questions concerning the role of government in the modern state and the relations between government, bureaucrats, opposition parties and external interest groups. These are political not technical questions. Yet if the issue of public

expenditure is to be settled in a way that reflects the real nature of the problem and that is to involve more than political rhetoric, these are the issues that need to be addressed.

We believe the government will need to look for remedies that strengthen both its capacity for tactical (i.e. annual) management of the budget and for strategic (i.e. medium term) expenditure management. We review below a series of measures that might be taken in these two contexts.

6. Public Expenditure Limits

We believe the government should aim to restore public expenditure to a level that would, in conjunction with other measures, be sufficient to permit significant tax cuts. That would probably involve a figure of around 29% of GDP. Associating tax cuts with public expenditure reduction could help to provide a political constituency for change.

We would not oppose a referendum campaign to establish expenditure limits if for no other reason than to dramatise the magnitude of the problem.

7. Revenue and Expenditure White Paper

Each term, we believe, every government should introduce a detailed public revenue and expenditure white paper indicating its perception of the strategic issues and options in public revenue and expenditure management, their longer term significance and the broad areas where programme change needs to be achieved. This White Paper could canvas

positive changes (e.g. potential tax cuts) as well as expenditure reduction. This White Paper might review the precise options being contemplated for programme reduction. In effect, the White Paper would provide the strategic context within which political consideration of changes to individual programmes might occur. It is essential that this document be designed for consumption by intelligent laymen and not only by those familiar with public expenditure or with the Byzantine workings of government. The primary constituency for this document should be regarded as individuals and groups beyond government not people within the apparatus of government. Its primary purpose would be to begin the process of creating the political coalitions that the Government will need to sustain its proposals against 'losers' who will inevitably mobilise to defend their interests.

8. Improve Presentation of Budget Documents and Forward Estimates

Current budget statements and the Forward Estimate documents statements are too esoteric. They are designed for consumers within government not for interests in the wider community who need to understand public expenditure issues. The summaries of documents available in press releases are also inadequate for this purpose. We commend the report of the House of Commons Treasury Committee on Budget Documents in the U.K. for consideration as a framework (this is cited in our Discussion Papers, Expenditure Management, Strategic Issues Forum, Committee for Economic Development of Australia, February 1986). Public understanding of budgetary exigencies needs to be expanded if expectations are to be better managed not only at the national level but also amongst particular interest groups.

An essential step is improved presentation of information and deliberate steps by the government to project its case to particular interest groups (positively and negatively affected) in terms tailored to their interest and concerns.

9. Strengthen Parliamentary Accountability

Parliamentary scrutiny can contribute both to the strategic and tactical review of programmes. So far as strategic programme review is concerned, significant change will usually need to require some degree of bi-partisanship. Both the Assets Test and the Tax Summit (by contrast with financial deregulation) reveal the difficulties in achieving major programme change when not associated with some degree of bi-partisanship. Parliamentary Committees represent one way of exploring the possibilities. Further, if strategic change is to be obtained, this involves review of programme objectives. A political forum offers the best context in which this process can be adequately carried forward. We are persuaded by the evidence about the work of the House of Commons Select Committees in this area. We would like to see a significant strengthening of the Senate Committee system to require review of major new proposed spending programmes before entry to the budget not after as is the current arrangement. The Expenditure Committee could be empowered to review programme philosophy, not simply the effectiveness and efficiency of spending. Furthermore, we would like to see the Senate Estimates Committees retrospectively reviewing significant areas of public expenditure each year.

At a tactical level we can see great benefit in extending the role of parliamentary committees. Members have the capacity to call spending

ministers and bureaucrats to account in public. They have the capacity to take evidence from interest groups in the process of reviewing particular areas of activity. Members of Parliament are 'streetwise' in the ways of departments. They can augment the capacity of ministers to review current programmes. Currently Senate Estimates Committees review estimates on a relatively perfunctory basis after they have been tabled by the government. We believe their role could be significantly extended. Proposed estimates could, and in our view should, be reviewed before final decisions are taken by the government.

We believe that this form of accountability is more desirable and more likely to be successful than independent reviews (e.g. Grace Commission style reviews). Such reviews could perhaps be used initially to define an agenda. But parliamentary committees would provide a permanent source of scrutiny. They would be sensitive to political cross-currents when programme reductions are being considered. There is, of course, no guarantee of successful outcomes. But a scrutiny structure that builds out from parliament is most closely attuned to the political character of the problem and the political requirements for achieving change.

10. Transfer EPAC to Parliament

We believe EPAC should be reconstructed. Its consultative function could remain with the Prime Minister or Treasurer. But its professional research and review capacity could be established as an agency of the Parliament along the lines of the Congressional Budget Office. This would ensure that independent information would be publicly available on strategic economic issues. It would provide high quality professional

staff for parliamentary Enquiries. It would help sensitize politicians, the media, interest groups and the public to major issues in public expenditure control and the options for handling these problems.

11. Extend Role of Auditor General

The Auditor General in the United Kingdom is an independent officer responsible to the Parliamentary Commission and appointed independently of the government in consultation with the Chairman of the Public Accounts Committee. This practice could be followed in Australia. We would also like to see the staff and funds of the Auditor General transferred to the Parliament vote and authorised independently of the government. This could permit an expanded programme of effectiveness audits particularly in the health, welfare and education area to be undertaken.

12. Privatisation

Many participants endorse a strategy of widespread privatisation as a way of reducing the scale of public expenditure. This would also be a source of revenue for tax relief. Considerably more work needs to be done to identify the potential scope and likely successful political strategies. Clearly however, public sector utilities such as TAA and Qantas vie for consideration. There are positive suggestions in our companion report on Telecommunications. Similarly there is enormous scope for contracting out as the statistics in our companion paper on Individual Responsibility and the Role of the State reviewing the U.S. experience suggest. Privatisation can play a major role in bringing efficiency to government operations. As the Economist recently observed:

"Though voters expect the state to go on doing most of the things they are used to, they also want to pay lower taxes ... Those politicians who respond to it best will prove the most successful governors of the next few generations..."

That title used to belong to the governments that presided over the most efficient private sectors. In future, the efficiency of the public sector will matter at least as much... that means, to begin with, passing chunks of what is now public into private hands: airlines, coal, steel, shipyards, telecoms -- in short, many of the businesses that are nationalised in Europe but never have been in America. What began in Britain as Margaret Thatcher's doctrinaire privatisation will come to seem pragmatic and routine throughout Western Europe, and many other countries as well. It will be done not to "destroy the state", but to give the bulk of it that remains a chance to serve the people ...

The next stage will be to introduce competition and productivity standards into all state activities. Standards need to be measured, and rewarded: so the successful economies of the next century will be those where nurses and teachers and bureaucrats have their output assessed as surely as any factory worker or salesman does now. "

13. Other Measures

Some of our members favour a four year term for government. It is not clear that Mrs. Thatcher with a five year term has been better able to handle expenditure management than our own government. Such a measure presumes elections cloth the victorious party with effective political authority. The evidence of policy failure belies that presumption. This was canvassed in our earlier paper, Business-Government-Trade Union relations in Australia (Strategic Issues Forum, Committee for Economic Development of Australia, July 1985). However if support for a four year term could be developed that would be a worthwhile measure in conjunction with other steps enumerated earlier in this report: