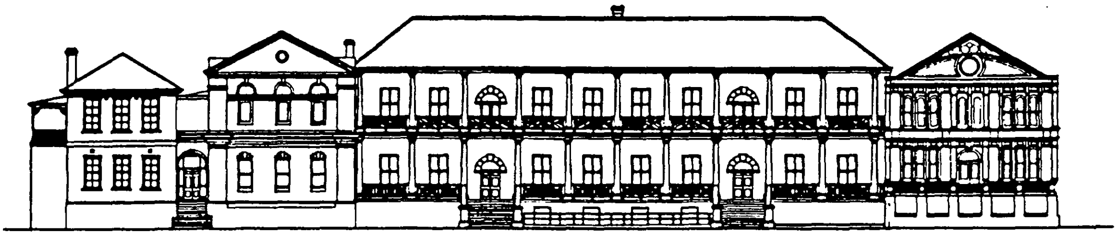
PUBLIC ACCOUNTS COMMITTEE

Inquiry into State Debt Control (Balanced Budget) Bill 1994



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MEMBERS OF THE PUBLIC ACCOUNTS COMMITTEE

Mr Ian Glachan, MP Chairman

The Liberal Member for Albury since 1988, Ian Glachan has had a varied background. He served five years at sea as a marine engineer, was a farmer for ten years, and operated a newsagency in Albury for 18 years. Mr Glachan is also a past president of the Albury-Hume Rotary Club and a Paul Harris Fellow, an active member of the Anglican Church, and the Legislative Assembly member on the Board of Governors of Charles Sturt University. Other parliamentary responsibilities include Chairmanship of the Minister's Advisory Committee on Health, and vice-chairmanship of the Minister's Advisory Committee on Roads and Transport. Mr Glachan was elected Chairman of the Committee on 15 September, 1994.

Mr Peter Cochran, MP, Vice-Chairman

Following a background in farming, the Army, the Commonwealth Police, ASIO, and the Cooma-Monaro Shire Council, Peter Cochran won the seat of Monaro for the National Party in 1988. His other parliamentary responsibilities include the chairmanship of the Minister's Advisory Committee on Land and Water Conservation, deputy chairmanship of the Committee for Police and Emergency Services, and membership of the committee for the Environment and the Select Committee on Public Sector Superannuation. He is also the Premier's representative on the Anzac House Trust and the Anzac Memorial Trust.

Mr Geoff Irwin, MBA, ProdEngCert, DipTech, DipEd, MP

Geoff Irwin was elected to Parliament in March, 1984 as the Labor Member for Merrylands, and he has been the Member for Fairfield since March 1988. Before entering Parliament he worked in industry as a planning and supply manager and taught business studies at TAFE. He served as a member of the Select Committee upon Small Business and as Opposition Spokesperson on Business and Consumer Affairs.

Mr Terry Rumble, FCPA, MP

Terry Rumble was elected Labor Member for Illawarra in March 1988. Before entering Parliament he qualified as an accountant and was employed in public practice and in the coal mining industry. He has served as a member of the Regulation Review Committee and is the Chairman of the Leader of the Opposition's Backbench Committee which involves Treasury, arts and ethnic affairs.

Mr Andrew Humpherson, MP

The Liberal member for Davidson since May 1992 Andrew Humpherson was Deputy Shire President of Warringah Shire Council having served several terms on the Council. Mr Humpherson was an Area Manager for Shell. He has also worked as an Engineer for Repco and Shell. He holds a degree in Chemical Engineering from the University of New South Wales. His other parliamentary responsibilities have included the Chairmanship of the Select Committee on Motor Vehicle Emissions and Legislation Committee upon the Endangered Species Bill. He has served as a Member of Select Committee into Water Board, State Owned Coal Mines, Bushfires and the Joint Committee on the Office of the Ombudsman.

The Public Accounts Committee

From left: Terry Rumble, Andrew Humpherson, Ian Glachan **(Chairman)**, Geoff Irwin Peter Cochran (Vice-Chairman)

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CHAIRMAN'S FOREWORD

This report is the result of a highly unusual exercise for the Committee.

In the first place, the short period of forty-one hours — the time between receipt of the reference at 4 p.m. on Tuesday 29 November 1994 and the reporting deadline of 9 a.m. on Thursday 1 December 1994 — made the Committee's task somewhat difficult. In the space of forty-one hours, the Committee had to organise and hold hearings, make its deliberations and prepare its report, all during the course of an ordinary Parliamentary sitting day. I pay tribute to my fellow members for their co-operation and contribution, despite the demands on their time arising from their Parliamentary commitments.

Second, this issue had already been the subject of debate in the House. Indeed, one PAC member had already spoken on the question and the major parties had already adopted fixed and clear positions.

All members of the Committee have requested me to record our strong concern about the fact that members were required to reach a conclusion on a matter of policy on which the major parties had already taken clear public positions. The last factor regrettably made consensus impossible in a committee which has a strong tradition of bipartisanship.

The only course left open to the Committee was therefore to obtain evidence from a wide and balanced range of expert witnesses (as wide and balanced as time would allow), and then to set out the arguments for and against the Bill in summarised form.

The Committee greatly appreciates the extraordinary readiness of witnesses to give evidence on a few hours' notice. It is particularly grateful to Professor Marc Robinson, who travelled to Sydney from Brisbane on three hours' notice, and to Don Nicholls, who set out from Coffs Harbour only two hours after being requested to attend.

The Committee was grateful to Professor Emeritus Lane, formerly Challis Professor of Law at the University of Sydney, for his learned and thorough exposition of the intricacies of the State and Federal constitutions and their interlocking relationships.

We would like to express our appreciation to Michael Lambert, Secretary of the Treasury, and to Mr Ian Neale, Assistant Secretary, for presenting the Treasury's position.

Our special thanks go to Paddy McGuinness, the distinguished columnist and economic commentator, for his clear distillation of the issues.

The appointed members of the Committee have specially asked me to note their gratitude to the staff for their dedication and commitment, and for the personal sacrifices they made to meet the deadline. In particular, we recognise the contribution made by our Director, Patricia Azarias, by our Clerk, Jozef Imrich and by Assistant Committee Officer, Caterina Sciara.

Ian Glachan MP
Chairman

MAIN FEATURES OF THE BILL

1. It provides that a state budget must not contain a fiscal forecast of a budget sector deficit. (S. 59(1)).

2. It therefore by implication provides that the government must balance the total budget in the budget sector, that is, the capital and the current accounts combined.

3. It covers only the budget sector, not the non-budget sector, but does not provide a complete definition of what the budget sector includes and excludes[1].

4. It seeks to amend the Constitution. This can only be done through a referendum of the people, not just by a vote of the Parliament. The Treasurer has pointed out[2] that once the Act is approved at a referendum, it will not be able to be changed without the approval of voters at a further referendum.

5. It provides that if the government cannot balance its budget in a particular year, it must eliminate the impact of this failure "over a period not exceeding the next 3 years or any other period provided by law" (S. 60(2)).

6. It allows for flexibility. That is, a future Budget may contain a fiscal deficit if this is due to exceptional circumstances (S. 59 (2)). It does not provide a definition of "exceptional circumstances", but it does give examples.

7. It includes a requirement for the Secretary of Treasury to certify that the Government's Budget projections are reasonable in his or her professional judgement.

8. The Budget must be presented on the basis of internationally accepted

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1 Although current Treasury documents do define a budget sector agency as one which receives more than 50% of its revenue from the Consolidated Fund.

2 Media Release, 17 November 1994

standards. However, the Bill does not specify which one.

9. The Treasurer must provide a half-yearly Budget update to Parliament by February each year. However, Section 62(6) allows the Government to circumvent this by providing that "any of the requirements of this section (Section 62 provides that the Treasurer must table half-yearly state budget updates) may be altered or excluded by another law".

SUMMARY OF SELECTED ARGUMENTS FOR AND AGAINST THE BILL

Arguments for

The arguments presented to the Committee for introducing the bill may be divided into economic arguments, on the one hand, and political arguments, on the other.

1. The State's Budget Sector Debt must be reduced.

That the strategy of debt reduction is of prime importance has been recognised by leading authorities. In tabling a letter from Mr Vince Fitzgerald, author of *National Saving, A Report to the Treasurer* (1993), Mr Lambert said:

> I table a letter which we have received from Vince Fitzgerald which indicates general support with our [deficit reduction] approach.

Mr Paddy McGuinness actually maintained that the State's budget sector debt should always be zero. He said:

> I should say that to the general principle of balanced budgets for State governments or State parliaments as distinct from Federal Parliament, I am very sympathetic. I really think there is absolutely no need for State governments ever to run a budget deficit or when there is no nett indebtedness, budget surpluses.

The main reasons the state's budget sector debt must be reduced include the following:

- **High debt has an adverse effect on a state's Triple-A rating**

Mr Lambert, Secretary of the NSW Treasury, suggested in his evidence that:

> It is unsustainable for NSW to maintain a Triple A and have a substantial gap with Queensland's international performance position. It is not sustainable ... if we were to lose one notch on the Triple A, go from Triple A to Double A plus, it would have a present value impact of about half a billion dollars.

> If we were to go to the level of the lower rated States, South Australia and Tasmania, we are talking about a present value impact of $1.2-billion. So these are not trivial numbers. More importantly the loss of such a rating would have a very significant impact on consumer and business confidence. We would cite the impact that occurred in South Australia and Victoria where the loss of the Triple "A" did produce a significant impact on business confidence.

- **Interest Charges put too high a burden on future generations.**

High debt incurs high interest charges, which have to paid by the children and grandchildren of the present generation. In his evidence, Mr Paddy McGuinness maintained that the financial burdens that will need to be borne by future generations will be high enough without the present generation entering into debt on their behalf.

- **Debt service charges divert government resources from more productive use.**

- **Public savings need to be increased.**

The Fitzgerald Report on the level of national savings[3] identified that the level of national savings is not high enough and that there has been a trend downwards both in the private sector and in the pubic sector level of savings. The Bill, by reducing debt levels, will have a significant effect on public savings.

- **Reliance on foreign creditors needs to be reduced.**

A number of witnesses made the point that Australia depends too much on overseas borrowings. The discipline which this Bill will impose will have the effect of reducing foreign borrowings.

- **It should not be a State's responsibility to run a "counter-cyclical" policy and thereby run into debt in recessions.**

Mr McGuinness made this point very strongly, asserting that it was the Commonwealth's responsibility to spend the country's way out of a deficit. Associate Professor Robinson agreed:

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[3] Fitzgerald, V.W. *National Saving. A Report to the Treasurer and Executive Overview,* Treasury Department Australia, 1993.

> The White Paper argues . . . that macro economic policy, counter cyclical policy is a Commonwealth responsibility . . . I completely agree . . . In my view it is quite right that State Governments should not be trying to run active counter cyclical policies.

- **Non-budget sector debt has been declining and this must be mirrored in the debt of the budget sector.**

It has been suggested that it would be easy for governments to circumvent the requirements of the Balanced Budget Bill by allowing non-budget sector entities to run up debt. However, Mr Lambert said in this context:

> We were very mindful in advising the government on this approach of Victorian experience where there was a push to force the government trading enterprises to increase their level of debt inappropriately and pay large dividends to the budget and that, effectively, meant that the GTE's were borrowing to pay dividends and creating unsustainable financial structures. That seemed to us to be quite inappropriate and the policy we have in place now certainly avoids that, and the government has actually referred to, and endorsed that policy. It is referred to in the actual legislation and in the second reading speech.

In relation to the controls applying to the non-budget sector, Mr Lambert said:

> The key issue is whether, in fact, there is in place a mechanism to control the level of debt and obligations of the non budget sector - that is the key issue. The answer to that is "Yes, there is." There is a very rigorous system of financial policy framework which cover dividend policy, monitoring policy, capital structure policy, taxation policy, community service obligations policy and that is in place for each of our GTE's. We monitor them on a regular basis. There is an established government policy on capital structure which has to find the optimal debt equity ratio for each of our GTE's. A number of them are not quite at that level of optimal debt equity and there are adjustments occurring in 1995, 1996 as part of our established financial strategy to get to that optimal position and we believe that will occur, and thereafter the requirement will be to maintain the optimal level of debt to equity.

This Bill will now provide a more effective level of control in the budget sector to match the controls in the non-budget sector.

- **in any future recession, the State would be freed from the need to adopt draconian measures to reduce debt.**

Mr Lambert pointed out that at present, debt levels were too high for the state to weather, or absorb the effects of, the recession comfortably and said:

> The basic assessment is that the current level of debt for the budget in the general government sector is too high; that the level is too high in a sense that the financial structure is not robust enough to absorb the fiscal shocks such as the economic cycle.

The Bill, he said, would prevent this situation arising again in the future:

> It has the very important benefit that over time it will reduce the level of debt belonging to gross State product and thus, very importantly, increase the fiscal robustness of the State sector and means that in going forward into future recessions - inevitably you have recessions and cycles - the State would not be in a position of having to adopt fairly draconian actions in the future and would not have to either cut expenditure severely, or increase taxes severely in going into cycles. I think that is a fairly objective to be achieved.

2. The Bill is the most powerful way of reducing debt.

Given the over-riding need to restrain state debt, if possible to zero, what is the most powerful way of achieving this end?

By actually seeking to change the Constitution itself, the Bill makes the clearest and most forceful statement possible about the Government's commitment to reducing debt. In doing so, it seeks to change the mindset of the Parliament, the Government, the public servants and especially the general public about incurring deficits at a state level.

This is one of its major aims. Mr Lambert said:

> the legislation, I think, does have a useful role to play in changing mind-set and putting disciplines on the governments, Parliaments and the community to look at the level of resources absorbed.

So the Bill seeks to enlist the community in its effort to reduce debt.

3. The Bill puts into effect the established fact that the general public want governments to run balanced budgets.

Opinion polls indicate that debt reduction is a strong public preference, and the Government has adopted the most effective way possible of allowing this public will to be expressed, that is, through a referendum.

4. The Bill allows for flexibility in cases of exceptional circumstances.

Examples given in the Bill are natural disasters and serious recessions. In these cases, the Treasurer will be able to incur a deficit, provided that he redresses the balance within the prescribed period.

5. The Bill would help governments resist pressure from interest groups for unnecessary expenditure.

6. Similar measures have been introduced elsewhere.

All but one of the States of America have introduced balanced budget requirements. In addition, New Zealand has introduced similar budgetary discipline in their *Fiscal Responsibility Act* 1994.

The Arguments Against

The arguments against can also be divided into economic, political and legal.

1. Sledgehammer to crack nut: less drastic alternative available to amending the Constitution.

There is no need to enshrine this measure in the Constitution. This is too drastic and final a step. A more moderate and less radical solution would be to amend the *Public Finance and Audit Act* 1983 to provide for balanced budgets. The aim of reducing debt would be achieved without the extreme step of altering the Constitution itself.

Major Government agencies hold a large proportion of debt, yet are only subject to Government policy on debt to equity ratios. They would thus not be subject to the provisions of the Bill.

It is illogical to take the important step of changing the constitution and yet to leave a significant part of the Government's activities untouched.

2. Two key provisions of the Bill either are hollow and easily circumvented by the Government or may precipitate a constitutional crisis.

(a) S 60(2)

This subsection provides that if the government cannot balance its budget in a particular year, it must eliminate the impact of this failure "over a period not exceeding the next 3 years *or any other period provided by law*". (emphasis added)

Thus a Government with a majority in the Parliament may extend indefinitely the period over which the impact of a budget deficit is to be eliminated.

The Bill therefore effectively allows Governments with a clear majority in both Houses of Parliament to run budget deficits indefinitely if they wish.

It should be noted that unless a Government can achieve *surpluses* in one or more of the years following a deficit year, it will be unable to eliminate the impact of previous deficit(s). This could lead to an extraordinary situation. For instance, one Government may run three years of deficits, and should there then be an election resulting in a Government without a clear majority, the new Government could be obliged by these provisions to achieve surpluses.

(b) S. 62(6)

This subsection provides that "any of the requirements of this section (Section 62 provides that the Treasurer must table half-yearly state budget updates) may be altered or excluded by another law".

Similarly, this requirement — which is a crucial element of the New Zealand legislation — may be circumvented by a Government with a majority in the Parliament.

* * *

While both of these provisions would allow the legislation to be subsequently amended by an Act of Parliament, without the need for a further referendum, this is dependent on the Government having a clear majority in both Houses of Parliament.

However, a Government without such a clear majority may face a constitutional crisis. This could happen if the Legislative Council failed to pass an amendment to Section 60(2).

Therefore, it is possible to conclude that two equally unsatisfactory outcomes may result from this Bill:

- the Government may easily circumvent the provisions of the Bill, *or*
- a constitutional crisis may be precipitated.

3. Failure to define "exceptional circumstances" could lead to legal challenge and dismissal of Government.

While Section 59(1) requires that a State budget must not contain a fiscal forecast of a budget sector deficit, section 59(2) allows for a fiscal forecast of a budget sector deficit if the deficit is due to exceptional circumstances.

The Bill does not clearly define what constitutes exceptional circumstances, other than to give some examples, namely a natural disaster or a major economic recession. Indeed, it is very difficult to establish such a definition.

As a result, these provisions could subject to legal challenge a deficit budget which a Government claims is due to exceptional circumstances.

A successful legal challenge to a deficit Budget would result in the Budget being declared invalid. This in turn could result in the dismissal of the Government.

4. Balanced Budgets require spending cuts when revenues fall.

In a recession, State Government revenues typically fall.

This Bill could require the Government to match falls in revenue with falls in spending. It could therefore force Governments into reducing spending in a recession, which is exactly when some members of the public need the government to spend. This reduction in spending could create even more suffering, social upheaval and demand for government services, thus creating a vicious downward spiral.

While it may not be the responsibility of the States to stimulate spending in a recession, it is nevertheless true that for a State to cut spending in a recession is undesirable.

5. Bill may encourage "fiscal deceit" on the part of Government.

The Bill may lead to Governments adopting practices which understate the Government's true level of expenditure or overstate revenue, such as:

- Requiring public enterprises to pay larger dividends;
- Shifting of capital expenditure off-budget (e.g. into the private sector);
- asset sales;
- sales of future revenue streams
- leaseback arrangements
- require the private sector to undertake certain expenditures such as parking levies.

6. Bill precludes the use of an intergenerational equity approach.

While presently high debt levels make borrowing a greater burden for future generations, these provisions, if adhered to, would prevent borrowing flexibility at a future time when debt levels might be lower.

7. Cash accounting relating to capital expenditure distorts spending decisions and the budget result

The Treasury now present the budget on a cash basis and will do so in terms of this legislation. Cash accounting, however, particularly for capital items, results in misleading spending decisions and runs counter to the principles of accrual accounting.

8. Rating agencies provide enough discipline anyway.

9. It is easy for Government to redefine "Budget Sector" and "non-Budget Sector"as and when it wishes.

The Bill's definition of the Budget sector is meaningless. The Budget Sector is defined as "the recurrent and capital programmes, specified in the State budget estimates of expenditure". The Government of the day may redefine this to suit its own purposes.

10. There are numerous possible definitions of "deficit".[4] Government might adopt whichever suits it at the time.

[4] Don Nicholls, *Managing State Finance*, NSW Treasury, Sydney, 1991 pp. 134 -6.

THE COMMITTEE'S VIEWS

In the short time available to it, the Committee carefully considered the evidence and the documents presented.

During its deliberations, there were some serious reservations expressed about various aspects of the Bill by a number of members of the Committee.

The motion was put:

That the State Debt Control (Balanced Budgets) Bill 1994 will achieve the desired objective of requiring the Government of the day to balance the State Budget.

When a vote was taken that the motion be agreed to, the result was:

Mr I. Glachan	yes
Mr A. Humpherson	yes
Mr P. Cochran	yes
Mr G. Irwin	no
Mr T. Rumble	no

The Committee specifically wishes it to be noted that the decision was not unanimous.

This outcome is unusual for the PAC, which operates in a harmonious and bi-partisan manner.

The Committee recommended that the Report be noted.

APPENDICES

APPENDIX I

TERMS OF REFERENCE

Treasurer of New South Wales
Australia

29 NOV 1994

Mr Ian Glachan MP
Chairman
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000

Dear Mr Glachan

Pursuant to Section 57(1)(f) of the Public Finance and Audit Act 1983, I hereby refer the State Debt Control (Balanced Budgets) Bill 1994 for consideration by the Public Accounts Committee.

In terms of this reference, the Committee in connection with the presentation of the Public Accounts, is asked to inquire into whether the Bill currently before the Legislative Assembly, will achieve the desired objective of requiring the Government of the day to balance the State Budget.

The Committee is required to report to the Legislative Assembly on this reference as soon as possible, but at any event by no later than 9:00am on Thursday, 1 December 1994.

Yours faithfully,

Peter Collins QC MP
Treasurer

28th floor, State Office Block, Phillip Street, Sydney 2000
Telephone: (02) 228 3535 Facsimile: (02) 228 3475

APPENDIX II

STATE DEBT CONTROL
(BALANCED BUDGETS) BILL 1994

Hansard, Legislative Assembly:
See speech by Hon. P. Collins, MP—17 November 1994.
See speech by Mr B. Carr, MP. —23 November 1994.

(For further parliamentary debates see Hansard, Legislative Assembly
23 November1994:
Mr P. Zammit MP, Mr J. H. Murray MP, Mr J. Kinross MP, Mr P. Nagle MP, Hon. J. Longley MP, Mr J. Hatton MP, Mr P. Debnam, Mr. B. Harrison, Mr B. Rixon, Mr M. Iemma MP, Mr A. Tink MP, Mr P. Crittenden MP.
24 November 1994:
Mr. A. Cruickshank MP, Dr A. Refshauge MP, Mr. T. Rumble MP, Mr I. Petch MP, Hon. J. Fahey MP, Mr W. Davoren MP, Mr P. Whelan MP, Mr S. O'Doherty MP.)

STATE DEBT CONTROL (BALANCED BUDGETS) BILL 1994

FIRST PRINT

STATE DEBT CONTROL (BALANCED BUDGETS) BILL 1994

NEW SOUTH WALES

EXPLANATORY NOTE

(This Explanatory Note relates to this Bill as introduced into Parliament)

The object of this Bill is to require the Government to balance the State budget. The Bill amends the Constitution Act 1902 as outlined below.

Referendum

Under the Constitution Act 1902, the proposed Act is required to be submitted for the approval of the voters of the State at a referendum. This is because the proposed Act amends section 7B of the Constitution Act 1902 for the purpose of its entrenchment as referred to below. It is proposed to hold the referendum in conjunction with the next general election (which is due to be held on 25 March 1995). The question to be put to the voters at that referendum is whether they approve of the Bill entitled "A Bill for an Act to require the Government to balance the State budget". The proposed Act will only become law if a majority of the voters approve of it at that referendum.

Entrenchment—changes to proposed Act must be approved by electors

The proposed Act (if approved by the electors at the referendum) cannot be changed without the approval of the electors at a further referendum. (Schedule 1 (1)—proposed amendments to section 7B)

State budget and certificate of its compliance required for budget Bill

The proposed Act prevents the introduction of a budget Bill into Parliament (or any increase in the amount appropriated) without a State budget for the budget sector and without a certificate by the Treasurer that the State budget complies with the requirements of the proposed Act. The head of the Treasury must also certify that the forecasts in the State budget are reasonable in his or her professional opinion. (Schedule 1 (2)—proposed section 58)

State budget—requirement for balanced budget

The proposed Act provides that a State budget must not contain a budget sector deficit for the current financial year or for either of the following 2 years. The requirement covers both recurrent and capital services and works. A temporary deficit is permitted in the case of exceptional circumstances, such as a natural disaster or a major economic recession. (Schedule 1 (2)—proposed section 59)

State budget—requirement to eliminate deficits

If a budget sector deficit is forecast or an actual deficit occurred in a previous financial year, the State budget must indicate the measures that will be taken by the Government to eliminate the impact of the deficit on State debt over a period not exceeding 3 years or any other period provided by Parliament. The fiscal forecasts in that State budget must be based on those measures. (Schedule 1 (2)—proposed section 60)

State budget—accounting principles for fiscal forecasts

The proposed Act requires fiscal forecasts in the State budget to be made in accordance with the principles for the classification of Government financial transactions adopted by the Australian Statistician or with any other nationally recognised principles. (Schedule 1 (2)—proposed section 61)

Half-yearly State budget updates

The Treasurer will be required to provide a half-yearly State budget update to Parliament each financial year. The update is to be tabled in the Legislative Assembly in February each year (or, if the Assembly does not sit in February, in the first 3 sitting days thereafter). The Treasurer will be required to update the economic and fiscal forecasts in the last State budget for the remainder of the financial year and for the following 2 years. The fiscal forecasts are to be updated having regard to the actual result in the first 6 months and other available information. If a State budget update discloses a deterioration in the budget forecasts so that the State budget no longer complies with the proposed Act, the Treasurer is required to indicate the measures that will be taken to ensure that future State budgets will comply with the proposed Act. The head of the Treasury must also certify that the forecasts in the State budget update are reasonable in his or her professional opinion. These provisions may be altered by Parliament without a further referendum. (Schedule 1 (2)—proposed section 62)

Proposed Act applies from 1997–98 financial year

The proposed Act will not apply until the State budget for the 1997–98 financial year. (Schedule 1 (2)—proposed section 63)

Review of operation of proposed Act

The Treasurer will be required to conduct a review of the operation of the proposed Act every 5 years and obtain a report from a Parliamentary committee for that purpose. (Schedule 1 (2)—proposed section 64)

Meaning of key terms used in proposed Act

The proposed Act uses the following key terms:

"budget Bill". This expression refers to the annual Appropriation Bill that is introduced to appropriate sums of money for the ordinary annual services of the Government in accordance with the State budget for that year. The definition excludes the supply Bill (which normally secures supply for the months of October and November pending the passage of the annual Appropriation Act, following the lapsing of the automatic carry over appropriation of 3 months from the end of the financial year under section 25 of the Public Finance and Audit Act 1983). The definition also does not include standing appropriations (e.g. for the repayment of Government guarantees) or an appropriation during a financial year for a special purpose.

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State Debt Control (Balanced Budgets) 1994

"**budget sector**". This expression is defined in accordance with the current program-budgeting arrangements, namely, the recurrent and capital programs specified in the budget estimates relating to the Legislature, to Government agencies funded mainly from the Consolidated Fund and to Crown transactions. Government trading enterprises and certain other Government agencies not so funded are not part of the State budget sector. A list of the current agencies in the budget sector is set out in Appendix D of Budget Paper No. 2 1994–95.

"**Consolidated Fund**". This expression, referred to in the above definitions, refers to the principal account of the Government for budget sector transactions. It comprises taxes, fines, some regulatory fees, Commonwealth grants and income from Crown assets.

"**State budget**". For the purposes of the proposed Act, the State budget for a budget Bill is the budget (containing budget estimates and fiscal forecasts for the budget sector) in the budget papers prepared by the Treasurer and tabled in the Legislative Assembly.

(Schedule 1 (2)—proposed section 57)

Clause 1 specifies the short title of the proposed Act.

Clause 2 provides that the proposed Act commences on its assent by the Governor.

Clause 3 is a formal provision giving effect to the Schedule of amendments to the Constitution Act 1902.

Schedule 1 contains the amendments to the Constitution Act 1902 described above.

FIRST PRINT

STATE DEBT CONTROL (BALANCED BUDGETS) BILL 1994

NEW SOUTH WALES

TABLE OF PROVISIONS

STATE DEBT CONTROL (BALANCED BUDGETS) BILL 1994

NEW SOUTH WALES

No. , 1994

A BILL FOR

An Act to require the Government to balance the State budget.

BE it enacted by the Queen's Most Excellent Majesty, by and with the advice and consent of the Legislative Council and Legislative Assembly of New South Wales in Parliament assembled, with the approval of the electors as required by the Constitution Act 1902, and by the authority of the same, as follows:

Short title

1. This Act may be cited as the State Debt Control (Balanced Budgets) Act 1994.

Commencement

2. This Act commences on the date of assent.

Amendment of Constitution Act 1902 No. 32

3. The Constitution Act 1902 is amended as set out in Schedule 1.

SCHEDULE 1—AMENDMENT OF CONSTITUTION ACT 1902

(Sec. 3)

(1) Section 7B (**Referendum for Bills with respect to Legislative Assembly and certain other matters**):

(a) In section 7B (1) (a), before "the Seventh Schedule", insert "Part 10,".

(b) In section 7B (7), after "section 29 (2)", insert ", 60 (2) or 62 (6)".

(2) Part 10:

After Part 9, insert:

PART 10—STATE DEBT CONTROL (BALANCED BUDGETS)

Definitions

57. In this Part:

"budget Bill" means a Bill that appropriates sums of money from the Consolidated Fund for the ordinary

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State Debt Control (Balanced Budgets) 1994

SCHEDULE 1—AMENDMENT OF CONSTITUTION ACT 1902—*continued*

annual services of the Government (whether or not it deals with any other matter), but does not include a Bill that secures supply for those services (for a period not exceeding 3 months after the authority of the Treasurer to pay for those services would otherwise lapse);

"**budget sector**" means the recurrent and capital programs, specified in the State budget estimates of expenditure, relating to the Legislature, to Government agencies funded mainly from the Consolidated Fund and to Crown transactions;

"**Consolidated Fund**" means the fund referred to in section 39 or any fund that replaces that fund;

"**financial year**" means the period for which a budget Bill appropriates the Consolidated Fund (whether or not it is a period of 12 months);

"**State budget**", in relation to a budget Bill, means papers prepared by the Treasurer and containing budget estimates of expenditure and fiscal forecasts for the budget sector (including fiscal forecasts for the financial year for which the Bill appropriates the Consolidated Fund and for at least the next 2 years);

"**Treasurer**" means the Minister responsible for budget Bills;

"**Treasury**" means the Government agency responsible to the Treasurer for budget Bills.

State budget and certificate of its compliance required for budget Bill

58. (1) A budget Bill may not be introduced into the Legislative Assembly unless:

(a) there is a State budget relating to the Bill; and

(b) the Treasurer certifies that the State budget complies with this Part,

and the State budget and certificate are tabled in the Legislative Assembly with the Bill.

(2) The Legislative Assembly may not pass any vote or resolution for an alteration to a budget Bill that would

SCHEDULE 1—AMENDMENT OF CONSTITUTION ACT 1902—*continued*

increase the total amount appropriated from the Consolidated Fund under the Bill as introduced into the Legislative Assembly unless:

(a) the Treasurer certifies that the State budget relating to the Bill (as revised to take into account the proposed alteration to the Bill) complies with this Part; and

(b) the certificate is tabled in the Legislative Assembly before the vote or resolution is passed.

(3) A Treasurer's certificate must contain a statement of responsibility signed by the head of the Treasury certifying that the fiscal forecasts for the budget sector contained in the State budget are reasonable in the professional judgment of the head of the Treasury.

State budget—requirement for balanced budget

59. (1) A State budget must not contain a fiscal forecast of a budget sector deficit.

(2) However, a State budget may contain a fiscal forecast of a budget sector deficit if the deficit is due to exceptional circumstances (for example, a natural disaster or a major economic recession).

(3) This section applies to fiscal forecasts for the financial year for which the budget Bill appropriates the Consolidated Fund and for the following 2 years.

State budget—requirement to eliminate deficits

60. (1) A State budget must indicate the measures that the Government proposes to take to eliminate the impact on State debt of any budget sector deficit that is forecast in that State budget or of any actual budget sector deficit that occurred in a previous financial year.

(2) Those proposed measures are to provide for the elimination of that impact over a period not exceeding the next 3 years or any other period provided by law.

(3) The fiscal forecasts for the budget sector contained in that State budget must take those proposed measures into account.

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State Debt Control (Balanced Budgets) 1994

SCHEDULE 1—AMENDMENT OF CONSTITUTION ACT 1902—*continued*

(4) The actual budget sector deficit for a financial year is the estimated deficit if actual results for the year are not available when the State budget is prepared.

State budget—accounting principles for fiscal forecasts

61. The fiscal forecasts for the budget sector in a State budget must be made in accordance with the principles for the classification of Government financial transactions adopted by the Australian Statistician or in accordance with any other nationally recognised principles.

Half-yearly State budget updates

62. (1) A State budget update must be tabled in the Legislative Assembly by the Treasurer each year.

(2) The State budget update must be tabled in the month that follows the first 7 months of the current financial year or, if the Legislative Assembly does not sit in that month, in the first 3 sitting days after that month.

(3) The State budget update must provide the following information for the current financial year and for the next 2 years:

(a) an update on the economic forecasts contained in the latest State budget;

(b) an update on the fiscal forecasts for the budget sector having regard to the actual results in the first 6 months of the current financial year and other available information.

(4) If a State budget update indicates that the latest State budget may no longer comply with this Part, the update must indicate the measures that the Government proposes to take to ensure that future State budgets will comply with this Part.

(5) A State budget update must contain a statement of responsibility signed by the head of the Treasury certifying that the forecasts contained in the State budget update are reasonable in the professional judgment of the head of the Treasury.

(6) Any of the requirements of this section may be altered or excluded by another law.

SCHEDULE 1—AMENDMENT OF CONSTITUTION ACT 1902—*continued*

This Part applies from 1997–98 financial year

63. (1) This Part applies to budget Bills and State budget updates for the financial year commencing in 1997 and subsequent financial years.

(2) This Part does not apply to an actual budget sector deficit in a financial year commencing before 1997.

Review of operation of this Part

64. (1) The Treasurer is to review the operation of this Part in the year 2002 and every 5 years thereafter.

(2) For the purposes of that review, the Treasurer is to seek a report on the operation of this Part from an appropriate Parliamentary committee.

(3) A report of the outcome of each review is to be tabled in each House of Parliament after the completion of the review.

APPENDIX III

MINUTES OF EVIDENCE: 30 November 1994

Date	Name	Organisation	Page nos
30. 11. 94	M. Lambert Secretary	NSW Treasury	39
	I. Neale (Deputy Secretary)	NSW Treasury	39
	M. Robinson (Associate Professor in Economics and Public Policy)	Queensland University of Technology	60
	D. Nicholls (Former Deputy Secretary, NSW Treasury)		74
	P. Lane (Professor Emeritus)	Sydney University Law School	92
	P. McGuinness (Financial Commentator)		102

MINUTES OF EVIDENCE

TAKEN BEFORE THE

PUBLIC ACCOUNTS COMMITTEE

STATE DEBT CONTROL (BALANCED BUDGET)

At Sydney on Wednesday, 30 November 1994

The Committee met at 8.30 a.m.

PRESENT

MR GLACHAN MP (Chairman)
MR COCHRAN MP
MR HUMPHERSON MP
MR GEOFF IRWIN MP
MR RUMBLE MP

MICHAEL GEORGE LAMBERT, Secretary, N.S.W. Treasury, [redacted], and

IAN WILLIAM NEALE, Assistant Secretary, N.S.W. Treasury, [redacted] both sworn and examined:

CHAIRMAN: Would either of you like to make an opening statement?

MR LAMBERT: Yes, I would like to make an opening statement which I think will cover some of the issues that have been identified for discussion today. I just want to elaborate a little bit on the rationale for the legislation. Because there are some well founded concerns being raised I think it is useful to just discuss the rationale in a little bit more detail.

The first and fundamental rationale is one of actually controlling the level of debt and getting debt to an appropriate level. The basic assessment is that the current level of debt for the budget in the general government sector is too high; that the level is too high in a sense that the financial structure is not robust enough to absorb the fiscal shocks such as the economic cycle.

The actual appropriate level of debt - and it is a very interesting question, what is the appropriate level of debt? It is an issue which we have looked at for some years now, IMF and New Zealand have looked at, and indeed all three of us are actually working almost conjointly on this issue. But it is a function of a range of factors such as the volatility of revenue (the State's revenue is quite volatile); the flexibility of expenditure (the State's expenditure is relatively inflexible because a high proportion is fairly high priority social expenditure); and the ability to match expenditure and revenue. There is very little ability to match expenditure and revenue. The capacity for user charges in the budget sector is quite limited.

Those factors, in principle, mean that you can either have a very low level limit or, in terms of the corporate finance sector, a very low level of gearing. At the present moment we have quite a high level of debt and it was demonstrated by the significant fiscal adjustments that were required during the last recession. I will not elaborate here but there were very substantial expenditure adjustments, taxation adjustments and a major structural change in terms of the dividends take from our GTEs which added up to over $2-billion adjustment factor. It is not sustainable or possible to every cycle have a $2-billion adjustment occurring. That indicates quite clearly to us that the current level of debt is too high.

We do not reject the intergenerational or equity arguments that say that there is a case for borrowings. Of course, there is a case for borrowings for financing long term lumpy capital expenditure. What must be stressed though is that any such argument needs to be conditional on the appropriate level of debt to start with. You need to have the appropriate balance sheet or starting point. You can not just look at the flow which, I think, a lot of people who argue for financing capital expenditure in the budget, focus on the flow and do not consider the stock.

The current situation with the debt level excessive means in the current structure that we are putting too higher a burden on future generations already, irrespective of what we do with respect to the flow. Secondly, one has to be very careful when one talks about capital expenditure for the budget sector or general government sector. The capital expenditure, a high proportion of it is maintenance expenditure. It is not providing an on-going service but is maintaining the existing stock of capital.

In addition, a very high proportion of the budget sector capital expenditure is non lumpy. What we are talking about here is more schools, more hospitals, more police stations - those sorts of things. They are really maintaining effectively the current stock or capacity of the current stock and, in the case of health, reallocating the stock between geographic areas, allowing for some moderate growth in population. They are not lumpy.

There is sufficient argument, and I would quote the Nobel Laurette, James Buchanan on this, who argues that in respect of social expenditure, that is basically what the budget sector is involved in, the only argument for a borrowing is when there is a very substantial expenditure. I quote James Buchanan *Public Principles of Public Debt, A Defence and Restatement 1986* where he makes a very clear argument that the public sector should only borrow for lumpy projects or where there are extraordinary demands on revenue. My assessment is that very little of the budget sector capital expenditure fits in that category at all.

You can actually, on that basis, lead on to an argument for virtually zero debt in the budget sector. In fact, I note that is actually the Queensland government's policy to have zero debt. I am not certain that that is valid but I would certainly be of the view that the current level debt is far too excessive.

The second issue is more an issue of improving the overall economic performance. The Fitzgerald Report on *Level of National Savings* did identify that the current level of national savings is not high enough and that there has been a trend downwards both in the private sector and in the public sector level of savings. Of course, with the current economic upturn we have significant growth in business investment. That means effectively that there is upward pressure on interest rates - interest rates are higher than they would otherwise be - and there is a greater reliance on overseas savings through foreign debt. The issue is if you run with a lower level of public savings, a higher deficit, the corollary is, of course, that you put more pressure on the private sector for interest rates and you lead to a higher level of overseas or foreign debt.

I table a letter which we have received from Vince Fitzgerald which indicates general support with our approach. He does raise the intergenerational equity issue, but notes that this would be overridden by any concern about the overall level of the balance sheet.

(LETTER FROM MR V FITZGERALD TABLED)

I table that for the information of the Committee which is a letter in support of the general approach of the legislation.

It can be argued that States should be able to run a counter cyclical fiscal policy and that this legislation does not allow for that. I think generally we have accepted that States - you can even argue governments generally - should not run a counter cyclical policy. They do not have the capacity. There is a very high leakages that occur with a regional government. Any regional government which runs a counter cyclical policy would have very high leakages to other regions.

Secondly, the State does not have the fiscal capability or capacity to undertake a counter cyclical policy. Thirdly, to the degree to which there is an argument for a counter cyclical policy it clearly is the ultimate responsibility and prerogative of the Commonwealth Government to undertake such counter cyclical policy. We do not see that you could argue counter to the proposal that this reduces the capacity of the States to undertake counter cyclical policy.

The third rationale is the maintenance of the State's Triple "A" rating. Currently the N.S.W. is Triple "A" but it certainly is significantly less robust in that position than Queensland. Queensland does not borrow - in fact, it is running high surpluses on its budget and it is running high surpluses on its general government sector over $1-billion a year and it has virtually, not quite, zero general government debt. It has a modest level of debt, about $4-billion is our assessment.

It is unsustainable for N.S.W. to maintain a Triple "A" and have a substantial gap with Queensland's performance position. It is not sustainable. The position at the moment is that Queensland is moving further ahead and N.S.W., to retain its Triple "A" has to actually bridge that gap, certainly not to increase that gap. It has a fiscal impact. If we were to lose one notch on the Triple "A", go from Triple "A" to Double "A" plus, it would have a present value impact of about half a billion dollars.

If we were to go to the level of the lower rated States, South Australia and Tasmania, we are talking about a present value impact of $1.2-billion. So these are not trivial numbers. More importantly the loss of such a rating would have a very significant impact on consumer and business confidence. We would cite the impact that occurred in South Australia and Victoria where the loss of the Triple "A" did produce a significant impact on business confidence.

In terms of context it is important to be aware that this legislation is not produced in isolation and that there is a comprehensive strategy in respect of the non budget sector. We have in place now a capital structure policy which is endorsed by government which is referred to in the legislation which establishes prudent and appropriate capital structure levels, that is, debt levels, for each of our government trading enterprises. That provides a very effective mechanism to ensure that there is not an inappropriately low, or inappropriately high level of debt for our non budget sector.

In addition, of course, there has been a very substantial reduction occurred over the last five years in the non budget sector debt levels. They have been declining by $7-billion in real terms.

We also have in place a policy on non debt liabilities and we have in place policies to phase in full funding of superannuation both for budget sector and for the non budget sector. We meet the f ull accruing costs through the budget of the accuring costs of our superannuation as a current outlay, and we are phasing in the full funding for the tail of non funded liabilities. So that there is, in addition to the debt strategy, an established and a legislated non debt strategy.

Finally, of course, we have a strategy which is in respect of financial risk for financial institutions and that has resulted in the privatisation first, of the G.I.O. and more recently the State Bank which has eliminated, will phase out over time, over $20-billion of contingent liabilities.

I could briefly mention overseas experience which is relevant here. We have looked at the U.S. experience and the New Zealand experience. I am not aware of other countries that have an approach in this area. In the U.S. experience we looked at the States. We felt the States are more appropriate, just regional governments rather than the Federal government. We looked at the Federal government legislation and we drew certain lessons from that which have been incorporated in this legislation. The major ones being that you need to have budget standards defined, otherwise you lead to creative budget presentations. Secondly, you do need to have accountability and responsibility for the fiscal forecasts.

The U.S. legislation did not have accountability for revenue forecasts which resulted in quite inappropriately optimistic revenue projections. We have looked at New Zealand legislation and we have incorporated in this legislation and features of the New Zealand legislation such as the Statement of Fiscal Responsibility by the Secretary of Treasury,, the commitment to a fairly transparent approach with statements during the year and the adoption of budget standards.

It also should be borne in mind that though New Zealand does not have what is called legislatively enacted balance budget requirements, it effectively does that anyway. The legislation in New Zealand has standards of transparency and information and it also has fiscal standards. The New Zealand government in its legislation is committed to running budget surpluses until such time as it gets to a sustainable position and thereafter running a balanced budget so that the legislation in New Zealand is quite clear - the New Zealand government is committed to running budget surpluses.

Overall, in summary, it has got to be said that legislation of itself is not the issue, it is really the mind-set that is created by legislation and the impact on governments and the community. The objective of the legislation is, in fact, to create a benchmark of a balanced budget and a sustainable fiscal position and to require a convincing argument to the contrary. The basic status quo would be to maintain a balanced budget, it allows flexibility to deviate but the onus of proof must be on the advocates of deviating from the balanced budget position. So very much the objective is to rechange a mind-set and to create a greater discipline on fiscal performance. That is all I wish to say.

CHAIRMAN: You say it is to create a mind-set?

MR LAMBERT: Yes.

CHAIRMAN: Is that all you are aiming to do with this legislation to actually create a mind-set or is it really aiming go have a balanced budget?

MR LAMBERT: It is requiring a balanced budget by legislation but it does enable a government, if it believes there are extraordinary circumstances, or circumstances warranting a deviation, to articulate those reasons but then to indicate how it would, over time, correct that situation. It is really saying, look, the benchmark is running balanced budgets, any deviation requires a justification. It changes the onus of proof, effectively.

CHAIRMAN: You did mention the United States of America and, I think, in all of those States they have the capacity to levy their own system of taxation?

MR LAMBERT: Yes.

CHAIRMAN: Do you think that makes their case different to N.S.W.?

MR LAMBERT: It is certainly true that probably the level of fiscal risk in N.S.W. and Australian States would be higher because of the greater degree of what we call, vertical fiscal imbalance, the higher dependence of States on the

Commonwealth. Though we have now in place a multi year agreement with the Commonwealth which is based on maintenance in real per capita terms of our financial grants. The Commonwealth has indicated a general commitment to extend that beyond the three year period as a longer term arrangements. So that the general view is that there is trend towards a potentially a longer term fiscal compact between the Commonwealth and the States. It is not ideal from the point of view of the States. The States would like a more formalised either revenue sharing or more formalised tax powers policy but it is certainly an improvement on the situation in the late 1980's, early 1990's.

CHAIRMAN: Can you give us some more details about the budget and off budget sector and whether the off budget sector could have an effect on this effort to balance the budget?

MR LAMBERT: There have been advocates at various times of bringing the whole of government on to budget. Professor Walker at various times has advocated such a position. I think there is a confusion as to what the purpose of a budget is. A budget is, effectively, a method of appropriating the taxation dollars of the community which have been obtained by force, effectively, to public uses. The budget is not the consolidated financial statements of the whole State.

We produce the budget on a basis of international standards in terms of the way we present comprehensively all transactions but there are not international standards on coverage. Our coverage is that the budget covers all agencies that are substantially funded from the budget from the public purse, plus the payments to non budget agencies that are funded from tax dollars, community service obligations, for example, which are mainly in the transport area.

It seems to us it would not be appropriate to include non government agencies that are self-funding in the budget, such as Pacific Power. There is not an appropriation relationship to that body. However, the budget papers do present comprehensive information, in Budget Paper No. 6, on the full State sector: general government sector, public trading enterprises; and total State sectors. So it is very transparent in the budget papers what is the overall position for the whole State sector.

The key issue is whether, in fact, there is in place a mechanism to control the level of debt and obligations of the non budget sector - that is the key issue. The answer to that is "Yes, there is." There is a very rigorous system of financial policy framework which cover dividend policy, monitoring policy, capital structure policy, taxation policy, community service obligations policy and that is in place for each of our GTE's. We monitor them on a regular basis. There is an established government policy on capital structure which has to find the optimal debt equity ratio for each of our GTE's. A number of them are not quite at that level of optimal debt equity and there are adjustments occurring in 1995, 1996 as part of our established financial strategy to get to that optimal position and we believe that will occur, and thereafter the requirement will be to maintain the optimal level of debt to equity.

We were very mindful in advising the government on this approach of Victorian experience where there was a push to force the government trading enterprises to increase their level of debt inappropriately and pay large dividends to the budget and that, effectively, meant that the GTE's were borrowing to pay dividends and creating unsustainable financial structures. That seemed to us to be quite inappropriate and the policy we have in place now certainly avoids that, and the government has actually referred to, and endorsed that policy. It is referred to in the actual legislation and in the second reading speech.

CHAIRMAN: At some time in the future could a government redefine what was on budget and what was off budget?

MR LAMBERT: Yes.

CHAIRMAN: Could a government do what you have just spoken of - force these trading enterprises to borrow money to pay dividends to government?

MR LAMBERT: In the end unless you constrain it by legislation I suppose the answer is, yes, they could though this government has committed itself and I think there probably would be bipartisan support to this proposition. The reforms of GTE's has gone back over many years and it could be said to have begun with the previous government. I think there is general bipartisan support to a commercial approach to GTE's and I have read the Opposition's statements on commercialisation and corporatisation and I would think their general policies would be consistent with the government's policy.

In terms of can you redefine the budget? We have got a formal definition of the budget which is that it includes all agencies that are funded by more than 50 per cent of their revenue from the Consolidated Fund, plus the community service obligations. We have in Budget Paper No. 2 a list of all budget agencies. They are all listed there and any variation in that list is quite transparent and subject to Parliamentary scrutiny as to the rationale for any changes.

There have been some changes in the last few years with some budget agencies being created and some going off budget. We have looked at it and it has made no impact at all on the actual budget result at all. If an agency is making a loss, and goes off budget, the loss still has to be funded and the budget will continue thus making a payment to an off budget agencies. In principle, our view is that there is sufficient transparency in terms of the way the budget is defined to make a government very accountable for any changes. Secondly, in principle, it should not make a difference if agencies are taken off budget.

Our general view would be to support an extension of the budget sector to include certainly, probably, a greater coverage of the general government sector though the current coverage of the general government sector is actually very high. I think it has grown from about 65-70 per cent to about over 80 per cent now. It is a very high proportion. The budget sector now tracks very closely the broader concept of general government very closely - the difference is very marginal. It was very significant going back a decade or two.

CHAIRMAN: Could this measure force governments to turn more and more to the private sector?

MR LAMBERT: Private sector infrastructure is the argument there. Let us take it in two parts: contracting. The government has got a policy on contracting. The degree to which a government agency contracts out, it is actually entering into a contract for the provision of services so it is actually entering into a contract to actually expend money to obtain services. That does not impact on the budget in terms of taking things off budget, expenditure is still occurring through the budget.

If there is a savings that is affected by the contracting, typically the savings are up to about 20 per cent, then that results in lower operating cost. You are not taking expenditure off budget by contracting. The more pertinent example is private sector infrastructure which is cited in this area as a potential area for creative accounting or creative approach to public finance. The general policy in respect of private sector infrastructure is that it is restricted to economic infrastructure and there are two classes that occur of private sector infrastructure.

The first class is where the end user makes the payment and the typical examples here are the actual toll roads. In those cases the community is paying directly via their own pocket for the user charge. That means it is self-funding except to the degree that there is a government contribution. If there is a government contribution it is made through the budget. So in that particular case there is not an impact or any reduction or impact on the budget. It is the impact on the community that is occurring. It does not effectively artificially affect the budget.

Secondly, the situation is where we have government trading enterprises who enter into private sector infrastructure contracts. A typical example there was the Port Macquarie Hospital or the Water Treatment Plants of the Water Board. In those cases those agencies are entering into contracts and they have contractual payments that are occurring which are reflected in our public finances. In the cases of the Department of Health it reflects in the outlays of that Department which reflects in the budget. In the case of the Water Board it reflects in its operating expenditure and thus reflects in its financial performance, and thus reflects in its published financial statements and in the overall State financial statements that are published, a consolidated statement.

There is no leakages that occur and generally speaking the incentives and approach with the private sector infrastructure is not to take activities off budget, but to actually have a more appropriate distribution of risk between the public and private sectors and to actually hopefully harness competition to improve the design and operation of the facility.

It is an area where governments and Opposition of the Parliament would have to continue to have close scrutiny and that is the case, of course, with the Auditor-General looking at the issue recently and to produce quite a helpful report. There is need for on-going scrutiny. We, Treasury, would support that. There is a need to ensure that the current policy is maintained in its integrity and that it is not driven as an objective to try and take activities off budget.

CHAIRMAN: Could you see governments being forced into selling assets to balance their budget?

MR LAMBERT: There are two classes of asset sales - there is the on-going minor asset sales that occur on an on-going basis, and then there is large strategic asset sales. Under GFS standards, of course, asset sales are treated as a negative outlay and, therefore, they impact on the budget result. There are arguments both ways which are quite technical as to whether that is appropriate or not. I will not go into them here but the current government certainly has argued that in terms of large scale privatisation or sale of business assets that it is not budget driven and it has presented these sales as abnormal items. It is argued that it is not seeking to undertaking these sales to impact on the budget result. We would certainly advocate that in general practice we should continue to treat such substantial sales as abnormal items to avoid any implication that these sales are budget driven.

CHAIRMAN: In your view do you think this Bill will achieve its objective of requiring the government of the day to balance the State budget?

MR LAMBERT: That is the objective, it requires the government of the day to follow a policy of fiscal restraint and to enter into the spirit of legislation. The legislation does have an ability for some deviation. It does have the ability in the legislation for the government to declare exceptional circumstance and to have a deficit for a period.

In theory, I suppose, that could be an on-going process so that the integrity of the legislation is dependent upon governments of all political persuasions seeing the benchmark as being a balanced budget and not seeing the exceptional circumstance becoming the norm. Subject to the qualification the legislation, I think, does have a useful role to play in changing mind-set and putting disciplines on the governments, Parliaments and the community to look at the level of resources absorbed.

It has the very important benefit that over time it will reduce the level of debt belonging to gross State product and thus, very importantly, increase the fiscal robustness of the State sector and means that in going forward into future recessions - inevitably you have recessions and cycles - the State would not be in a position of having to adopt fair draconian actions in the future and would not have to either cut expenditure severely, or increase taxes severely in going into cycles. I think that is a fair objective to be achieved.

MR COCHRAN: You spoke of the appropriate level of debt. Do you consider this a variable factor according to international economies and the effect of general revenue grants and other factors which might be impacted on the State economic management by the Federal government?

MR LAMBERT: It is not a constant number. First of all it is a range, not a single number. Secondly, it is a function of a number of variables. I have mentioned it is a function of the volatility of revenue. If we were to get a broader tax base, a more efficient tax base in N.S.W. and/or if the Commonwealth were to transfer tax powers to us, for example, and thus reduce our level of dependency on the Commonwealth revenue, then that would impact upon the optimum level of debt. You could actually sustain a higher level of debt because your fiscal risk is lower. Therefore, you could, in principle, sustain a higher level of debt.

Similarly if we were to introduce a greater proportion of user charges as a funding mechanism, that means there is a greater matching between revenue and expenditure and that reduces your fiscal risk and, in principle, yes, it means you could sustain a higher level of debt.

The level of debt is a function of a number of variables that you would have to monitor over time. The legislation here does propose, in fact, every five years that there is a substantial review of the legislation and of the level of debt and its target level. Certainly, Treasury will be producing some research in the near term to try and address this issue of optimum level of debt and provide some guidance to Parliaments and PAC's in the future as to what is the appropriate level of debt and whether we are converging towards that level of optimum debt.

MR COCHRAN: You stated that the current level of debt is excessive?

MR LAMBERT: Yes.

MR COCHRAN: Given the fact that we have 10-11 per cent unemployment and there is considerable social upheaval and difficulty with people coping with the recession, don't you think in an attempt to run a balanced budget that you are going to exacerbate that situation and create greater demands on government services through unemployment and social upheaval?

MR LAMBERT: That is probably a better question for government. I did say at the beginning I think it is generally accepted in probably all States now that it is not a role for State government to run counter cyclical policy.

MR COCHRAN: You say it is a role for governments.

MR LAMBERT: It is not a role for State governments, it is a role for National government. You see there are very high leakages --

MR COCHRAN: But there is a consequence of seeking the balanced budget in somewhere having to reduce expenditure by the various means we could describe - we could raise taxes, cut goods and services, cut spending on goods and services, all sorts of mechanisms. But somewhere there is going to have to be reduction in expenditure and this would, no doubt, impact on various social services and services provided by the government?

MR LAMBERT: This is another issue from the issue of counter cyclical policy. First of all, of course, the legislation says 1997/1998 and on fiscal projections that will be a budget which is, on current projections, in balance. So that to get to that situation, based on current projections, there is no need for fiscal adjustment. It is beyond that period that one has to stay in that position.

MR COCHRAN: If there is a significant downturn in the Australian economy between now and that object date, do you think then we could describe our current level of debt as being excessive?

MR LAMBERT: It does not impact upon the level of debt. If the level of debt is excessive now it will be excessive when it goes into a downturn, that will not change its circumstance. If our level of debt is now excessive when we go into a downturn it will mean that we will have to take fairly drastic corrective actions. There is a capacity in the legislation if, in fact, there is a downturn which impacts upon revenue severely for that to trigger exceptional circumstance and, in those circumstances, a short term measure for the budget to go into deficit, subject to there being corrective action over an appropriate year, "three years or such longer term as the Parliament approves." There is a capacity and flexibility in the legislation to handle that circumstances.

MR COCHRAN: Do you think the taxpayers of N.S.W. will have to accept a lower standard of living in order to achieve a balanced budget?

MR LAMBERT: I do not see why or how?

MR COCHRAN: You mentioned that New Zealand runs a surplus budget. Can you explain to us how they achieve that given their past levels of debt?

MR LAMBERT: I am saying the New Zealander have got very high levels of debt. In fact, they have got a negative net worth for the State sector. It is negative. They are trying to rebalance their balance sheet. They have only now, recently in the last year, committed themselves to the Fiscal Responsibility Act which has, in it the commitment to surpluses. They have to run long terms surpluses to repair their balance sheets.

MR IRWIN: In the Treasury's Information Paper on this you state that the legislation itself is not the solution but a means to a solution - the solution is to change the mind-set of government, Parliament and the community.

MR LAMBERT: Yes.

MR IRWIN: Bearing in mind that this is intended to be enshrined in the Constitution and, consequently, is very difficulty, if not impossible, to change at some future date, why is it what we are looking at here is a means to a solution? Indeed, what do you mean by the sort of mind-set that governments must adopt?

MR LAMBERT: Generally speaking I think that is true of all State governments that there has been a capacity, or a tendency, to not focus on the overall balance sheet position and to target that, but to run fiscal positions each year focussing on the flow, that is the revenue and expenditure, and to not see the long term costs of running consistent budget deficits.

Fitzgerald has documented the impact and the costs of long term dis-savings to the public sector and they are higher interest rates, low economic activity and higher dependence on foreign savings. These are long term impacts. They are not apparent initially or only apparent over a longer period of time.

This legislation is trying to, in a way, make a contribution to that and at the same time repair the balance sheet, if you like, so that in future cycles the State can move through economic cycles without a need for drastic corrective actions. Those corrective actions were apparent in other States in the last cycle and it is obviously desirable from all points of view of avoiding social dislocation to avoid in future having to make drastic corrective actions.

MR IRWIN: In terms of what that means to government and the actual figure for a deficit, I note that in his speech the Treasurer refers to the projected deficit as

> "$353 million yet in the legislation it requires government financial transactions adopted by the Australian statistician"

and in that case the GFS deficit for the general government estimates is $523 million. Can you explain to the Committee that it is not possible to fiddle figures if, in this year's budget, the Treasurer says the deficit is $353 million by one set of figures and in Budget Paper No. 6 it comes out at $523 million?

MR LAMBERT: Yes, it is quite simple. The legislation and the budget as presented on government finance statistics basis which is international IMF standards. They relate to comprehensive coverage of all transactions of a sector and to the way information is presented. They cover such things as you must separate financing and show them below the line and not above the line, standards of that nature.

The second issue is the issue of coverage. In coverage terms the IMF do not prescribe a budget sector standard. That is a standard for each government. So the budget is presented for the budget sector, but it adopts IMF standards. The figures that you are referring to there in Budget Paper No. 6 relate to a particular coverage called the general government coverage which is a coverage which is consistent across States. It does not relate to any State's budget sector but it is a way of showing a standardised approach for States.

The legislation clearly relates to the budget sector and applying GFS standards to the budget sector. At the same time though there is useful information there which provides you with a supplementary broader concept and public trading enterprises and also provides you with information on the total State sector as well.

Yes, as I said before, the budget is about appropriation and, therefore, it is quite appropriate to present a budget that relates to the budget sector, not to some constructions of a broader coverage.

MR IRWIN: When I look at the Bill it really does not specify any of that. In fact, it actually concludes:

"..or in accordance with any other nationally recognised principle."

To me that appears to be incredibly vague and, as you have just said, there are all kinds of definitions that you can apply here as to exactly what a budget deficit is.

Can you explain to the Committee how that is spelt out in this Bill, that it exactly proscribes what you have suggested?

MR LAMBERT: It prescribes the adoption of the government finance statistic standards which are IMF standards. It could be in the future the IMF ceases to produce standards and, therefore, there is a general statement in there "or such other standards" to enable some continuity, bearing in mind that this legislation is going to be, if passed, put to a referendum, and only may be varied by referendum in the future. So there is a need for some ability in the event that, say, the IMF were to change or to abolish its standards, to have some on-going standards.

But the standards are very clear. They are documented. They are basically available to any citizen and they are the basis on which the budget is presented. These standards have been in place for the budget presentation since 1991/1992. Indeed, in the Public Finance and Audit Act the legislation currently prescribes the budget standards. Finally, the budget is audited. The Auditor-General audits the budget result these days and, therefore, he will audit the budget to ensure that we are adhering to standards.

MR IRWIN: In the way in which those figures are treated there, and I would refer to - Don Nicholls is here, in fact, - *Managing State Finance* under 7.7 The
"Best" Budget Measure he states:

> "At the beginning of the budget speech the Treasurer should say that the net requirement, as measured by the net PSBR for the inner budget sector (ie the general government sector), is $x million."

If this figure is so important, if this measure is so important to be enshrined in the Constitution, why is it that it appears in the last few paragraphs of the Treasurer's speech, and not as Mr Nicholls would suggest in the opening paragraph?

MR LAMBERT: That is the budgetary result and that is the key aggregate we are talking about and that is the bottom line budget result about which this legislation is based.

MR IRWIN: But it was not important enough to include it in the early stages of the Treasurer's speech in the 1994/1995 budget?

MR LAMBERT: I do not see the import of that. The bottom line is, in fact, the result of expenditure and revenues and that was the focus of the budget and this legislation is proscribing that bottom line and it is defined in terms of international standards.

MR IRWIN: You mentioned a moment ago that the New Zealand legislation has much the same effect although it does not include the Constitutional requirement for a balanced budget. Can you briefly explain why it has that same affect and if that is the case why it is necessary to have added requirement of balanced budget?

MR LAMBERT: The New Zealand legislation has a number of features and one of them is, in fact,, a set of principles which proscribe what they state as being appropriate fiscal strategy. There are five principles:

. "Reducing total Crown debt to prudent levels by achieving operating surpluses every year until a prudent level of debt has been maintained;
. Maintaining total Crown debt at a prudent level by ensuring that on-going operating expenses of the Crown do not exceed operating revenue;
. Achieving and maintaining levels of Crown net worth to provide a buffer against adverse future changes;
. Prudent management of fiscal risk facing the Crown; and
. Pursuit of policies consistent with the degree of predicability of upper levels of stability of tax rates for the future."

There is a set of principles and one of the principles, in fact, is committed to running surpluses on their operating position. They produce a full accrual position for a period going forward until such time as they have reached a sustainable debt level for the overall State sector.

They have not mandated that in legislation since every year the budget must conform to that but they are saying these are the principles on which this Parliament has conformed. Any Parliament which deviates from those principles is deviating from principles of prudent fiscal management. There are two ways they can go on that. Future governments can say "we are going to deviate from the principles of prudent fiscal management" or else they can redefine what they mean by "prudent fiscal management." Until they do the latter, I would have thought that they will continue to run fiscal budget surpluses.

MR IRWIN: In terms of the overall debt of the State, according to one set of figures the budget sector debt is actually less than one third of the total of State debt, yet the measure proposed here simply leaves guidelines to cover two thirds of the debt but a Constitutional change to cover the other one third?

MR LAMBERT: That is not correct. The gross level of debt of the State of June 1994 was $30 billion. The gross level of budget sector debt would have been over $20 billion. So at least two thirds of the debt of the State is, in fact, budget sector. The trend has been that the budget sector has been increasing relative to the total State sector. The debt for the non budget sector has been declining in real terms and in nominal terms, whereas the budget sector debt has been increasing.

It is clear the problem lies in the actual budget sector. Secondly, of course, as I have said, the government has got a policy which sets optimal debt equity ratios for government trading enterprises. I do not believe it is prudent or appropriate to set a macro across the board debt cap for government trading enterprises. You really have to set debt levels for each of them individually because it depends on the operating position they are in, the market they are in, the financial risk they are in. You have got to really set appropriate debt equity ratios for each individual government trading enterprise.

For the budget sector as a group you can set an overall sector target. It is appropriate to do such. Now the policy is clear. We have a strategy in place for the non budget sector in terms of debt and the debt levels are coming down and we also have a policy in place for non debt liability, such as superannuation, where that will, over time, eliminate the unfunded separation liability. As I said before we have reduced financial risk by privatisation of financial institutions.

The only area where there is continuing difficulty in the overall debt side is, in fact, the budget sector.

MR IRWIN: If I can turn to the issue of half yearly State budget updates and your predecessor, Mr Allen, in 1988 he gave evidence to the Committee:

> "Our revenues are becoming increasingly difficult to predict. Stamp duties is an extremely volatile revenue, our ability to project revenues had diminished.
>
> In these circumstances I believe it is important to have a mechanism such as revenue equalisation account to enable the government to smooth out its revenues over a long period."

Of course, since then we have had a revenue equalisation account. In terms of those half yearly State budgets how do you see the effect of a revenue equalisation account? What would you see as the future of s 22 payments in the light of that.

MR LAMBERT: Revenue equalisation accounts are not consistent with and can not be used in a GFS environment. They are no longer operative or appropriate. They are simply running down a reserve and that has no benefit at all. The key issue there, of course, is, in fact, every year to ensure that you have got a prudent budget result.

Section 22, I do not see that this would have an impact upon that issues.

MR IRWIN: Given the size of those s 22 payments over the years there is as much as $400 million in any one year --

MR LAMBERT: Usually on debt costs which are non controllable type items.

MR NEALE: I think s 22 is just a mechanism in the Public Finance and Audit Act that allows the government to incur expenditure where there are exigent circumstances so that you do not fetter the government because it has not foreseen something and has allocated the money for it. But basically at the end of the day the public accounts will disclose whether in managing the overall budget the government through s 22 payments has exceeded the budget target and resulted in a deficit.

The legislation provides that if you end up with an actual deficit you have got to come out with a strategy to explain what measures you are going to take to address that situation.

MR RUMBLE: Going back to the New Zealand experience, the White Paper reference is made to the New Zealand Fiscal Responsibility Act which became law this year. The Committee understands that the New Zealand Parliament considered and rejected the option of including a mandatory balanced budget requirement in that Bill. Why was that according to your information?

MR LAMBERT: I have spoken with Ruth Richardson about this who actually initiated the legislation. They looked at that issue. It was partly concern that a national government should not so constrain themselves. New Zealand is, of course, a National government that does potentially have a responsibility for fiscal policy. The general view there was that National governments should, at least, even if they exclude use of fiscal policy not unduly constrain themselves.

That does not apply to a regional government such as a State government where there is not mandated stabilisation of fiscal policy type role. Beyond that, to be fair with them, they also felt that the general statement of principles would be sufficient in their view to maintain a prudent level of fiscal position going forward.

MR RUMBLE: I will just touch on the subject of accrual accounting, this is a new concept for governments, how would a requirement to balance the budget affect the adoption of accrual accounting?

MR LAMBERT: Accrual accounting, it will not affect it, that is the short answer. The budget will continue to be presented in terms of this legislation and focussed on in terms of its cash position. But we have presented information on an accrual basis, the public accounts, which have been tabled recently for the budget sector and provide accrual information on the budget sector. They show an operating statement on the accrual concept and also a balance sheet on an accrual concept. So that information is available but the budget itself will continue to be presented on a cash basis in terms of this legislation.

I would envisage also in the future though that the budget papers themselves should and could have projected accrual positions of an operating statement and balance sheet. That would be by way of additional information, but the focus would continue to be equally on the accrual position and on the cash position.

MR RUMBLE: It is my understanding that when the calculation is being made to balance the budget capital expenditure is also included with current expenditure?

MR LAMBERT: In a GFS approach?

MR RUMBLE: Yes, and I would imagine that that would run counter to the accrual accounting concept?

MR LAMBERT: Yes but there are two sets of standards. The standards that apply to present a presentation of a budget which is a cash statement and that is the government Finance Statistics standards. Then there are the generally accepted accounting standards that apply to presentation of accrual information.

With the accrual information, of course, they do not show capital expenditure as an expenditure. They show the use of the capital but not the capital expenditure whereas with the GFS approach you show capital expenditure as an outlay and not the cost of the use of capital.

MR RUMBLE: What do you think of the proposition that has been propagated recently that if a budget is going to be balanced current expenditure should be matched against current income and the amounts to do with capital expenditure should be excluded from that calculation?

MR LAMBERT: I have already discussed that in my opening remarks. That is a proposition which is put and it can be sustained only if two very important conditions are met. The first condition is that you have already got an appropriate fiscal position, that is, that you have got sustainable balance sheet position. If you have already got excessive level of debt, then clearly you can not and should not add to that debt by financing recurrent or capital expenditure from additional borrowings. That is the first issue, you need to look at the stock. Our view is that the current level of debt is too high and that means already we have got too high a level of burden on future generations.

The second condition is that the borrowings would only really be justifiable, even if you had a sustainable balance sheet, if it was related to true capital which was truly lumpy. We have said that a substantial amount of our capital expenditure is maintenance expenditure and very little of the capital expenditure for the budget sector is lumpy in any sense.

It is really about maintaining a system, be it a system of schools, of hospitals. There is very little that would fit into the category of a quantum leap in terms of being lumpy capital expenditure. Therefore, in our view, even if you had an optimal debt ratio the actual case for borrowings, for financing capital expenditure would be very limited for the budget sector unlike the government trading enterprises where there is a valid case where you have lumpy expenditure such as new power stations. There is a case there for use of debt to appropriate level.

MR RUMBLE: You mention that lot of the capital expenditure the major item is maintenance expenditure. Over what period of time would that be expended?

MR LAMBERT: Over the life of the asset.

MR RUMBLE: That could be numerous?

MR LAMBERT: It depends on the asset life. If you are talking about Harbour Bridge or you are talking about roads and that sort of thing you are talking about relatively long periods of time.

MR RUMBLE: I would have thought from an accounting point of view maintenance expenditure is like a revenue expenditure as distinct from capital expenditure?

MR LAMBERT: That should be the position. We are wishing to certainly implement a redefined approach to separate maintenance, identify maintenance separately. The reality is in this budget and and for other Australian Governments there is not a rigorous distinction between capital expenditure and maintenance expenditure. It is important that that be done.

MR RUMBLE: Once again we get back to accrual accounting, it doesn't comply really to the accrual accounting either, does it?

MR LAMBERT: No, you can apply the same standard into your government budget result too and that is what we aim to do. It is not a question of only for accrual accounting but the revised definition for capital maintenance would apply also to the budget presentation on a cash basis and would result in a significant reduction in the apparent level of capital expenditure.

MR RUMBLE: Bearing in mind that this legislation or this Bill has to go to a referendum and there is an immediate escape clause there if say, the revenue is run down. In other words in the collapse of the State revenues. Now this has been mentioned in Parliament for many years, do you see there is a good purpose taking something off to a referendum when it is full of loop holes like that?

MR LAMBERT: I think it is a question for Government.

MR RUMBLE: You mentioned to do with this proposed Bill mind-set discipline, would you agree that most probably one of the most important disciplines these days for governments are the rating agencies?

MR LAMBERT: Yes.

MR RUMBLE: Why should we take something to a referendum when governments have got Poors and Moodies looking over their shoulder?

MR LAMBERT: I did say at the beginning that while we are Triple "A" rated entity we are on the cusp, if you like, or certainly a long way from Queensland which is the other Triple "A" rated entity. I did say that it is not sustainable to have such a large gap between N.S.W. and Queensland. I did indicate that Queensland has a policy not only of not borrowing to fund capital expenditure for the budget sector, but has a policy of zero debt.

Now that establishes a benchmark for a Triple "A". If you want to be a Triple "A" that is the basic benchmark, the entry price, if you like. If we were to forego that and accept that we can not sustain that fiscal position then, as I said before, if we were to say, our rating was reduced to a level of the lesser rated States, we are talking about a cost of about $1.2 billion in present value terms.

MR RUMBLE: I just get back to my original point - you know that, the Treasurer knows that - do you think that would be enough discipline for the taking of a Bill like this to the public?

MR LAMBERT: The history has been in the whole fiscal history of this State there has been only one year in which there has been even a modest surplus. So the history of this State has been one of continuous deficits and that is continuing to exacerbate an overall debt position.

MR RUMBLE: I have said that in the context of deregulation of the financial markets and governments of all persuasions these days take more recognition of the attitude of the rating agencies.

A question to do with Queensland and their good financial position is that because their revenues are booming or because they have got their expenditure under control or a combination of both?

MR LAMBERT: It is a long history attached to Queensland. You can not replicate Queensland overnight. They run a policy of low expenditure and low taxes. They have much lower taxes than any other State and they have decided that sort of mix is appropriate for their strategy. If you look at their expenditure they tend to spend less on a per capita basis than other States across a wide range of areas. There has been some reduction in that gap in the last few years but, nevertheless, there is still a significant gap. Whether that is because of higher efficiency or lower standards or simply that they decided to take a higher dependence on private sector provision, that is an open question. Certainly there is a very large difference in expenditure and also their tax levels are lower than this State.

MR RUMBLE: Getting back to the question that was raised by the Chairman to do with the United States experience where the States that do have the balanced budget legislation, in the main, they have also got other separate legislation like A GST tax or a State income tax as well. That is the position, as I understand it?

MR LAMBERT: The U.S. States, yes, do tend to have broader tax powers and the level of dependence on their Federal government is less. I should note though in terms of States that the overall position is that the States as a group have actually run surpluses on a GFS basis since 1967. So that on what we see to be a fairly comprehensive measure of fiscal position, the U.S. States as a group, have a run fiscal surpluses - some States have been in deficit, New York is one - but overall the position has been one of consistent surpluses since 1967.

(The witnesses withdrew)

MARC LAURENCE ROBINSON, Associate Professor in Economics and Public Policy, Queensland University of Technology in Brisbane, of [redacted] affirmed and examined:

CHAIRMAN: Did you receive a summons issued under my hand to attend before this Committee today?

Mr ROBINSON: Yes I have.

CHAIRMAN: Have you given us a written submission?

Mr ROBINSON: No Mr Chairman.

CHAIRMAN: Would you like to make an opening statement?

Mr ROBINSON: Yes, I will make a brief opening statement if I may. This, I think, is an extremely important issue. It is one with potentially I think the most serious ramifications both financially and socially and I think it deserves to be treated with the utmost seriousness for that reason. My view in summary of this proposal is that it is frankly profoundly misguided and I say that for a number of reasons. The first is that in my view the deficit which is targeted for elimination under this proposal is in fact the wrong deficit in the sense it is the overall deficit, capital and current deficit which is targeted rather than the current deficit. I believe that that potentially can have serious implications in terms of volatility of tax levels; volatility of service levels; and also in terms of volatility in the level of provision of infrastructure.

I think in addition while there is absolutely no doubt that Australian States certainly have some serious debt problems that have emerged over recent years, I believe that this type of proposal is not the right answer to a debt problem. Firstly, because it is not necessary for debt reduction and secondly because it goes beyond what is necessary. If you wish to reduce debt then that requires you clearly to run an overall budget balance or a surplus for a period of time; for a period of time. What this proposal is saying though is not just that the New South Wales Government should run an overall budget balance for a period of time or a surplus. It is saying effectively - if it were to work it would be saying - that for all time an overall budget balance would be necessary. In my view there is no economic rationale for that, it is not necessary from the point of view of the debt reduction policy.

I believe that insofar as the policy can be made to stick, that it will in fact aggravate recessions. In other words, I am arguing, contrary to the belief of the Government, that it has not solved the problem of the tendency of these sorts of provisions to aggravate recessions. And I think that, in addition, the problem with these types of proposals and concretely with the specific legislation for the New South Wales Parliament is that not only can they be evaded, but frankly you can drive a bus right through them. I am obviously happy to amplify on that point. In fact I believe that the New South Wales Government itself has already in a whole range of ways which we are well aware including providing infrastructure provision already demonstrated how this in fact can be done.

I would say in summary on this point of evasion that, rather than being a legislative requirement or mandate for fiscal responsibility, what a legislative piece of constitutional change of this sort would in fact be, is something which would make fiscal deceit mandatory frankly. And I believe I suppose in summary that all of these points are ones which even a fairly cursory look at what happened overseas bears out very strongly. I want to emphasise that in my view this is not in any way even an ideological issue. I see it actually as a question I suppose of economic rationality, commonsense if you like, versus what really frankly is a form of crude populism which panders to the knee-jerk views in the electorate that simply regards, for understandable reasons, debt as a bad thing and which tends to react to these sorts of propositions on that sort of crude level.

But if I can indicate in support of my contention, this is not just an ideological or political issue, two things. The first is that you have only got to look at the most recent issue of the Economist to see in that very respectable of magazines an editorial criticising the U.S. Republicans on grounds of economic logic for the proposal that they have brought forward to introduce a balanced budget proposal again into the U.S. Congress. Secondly I have with me here a copy of a submission that was presented to the New Zealand Parliament earlier this year by the New Zealand Business Round Table - this was sent to me just a week or two ago. The New Zealand Business Round Table is effectively the equivalent of the Business Council of Australia. It is the, if you like, intellectual driving force in the New Zealand business community. They made a submission to the New Zealand Parliament in the context of the work towards developing the Fiscal Responsibility Act and they came out very categorically against any mandatory balanced budget requirement.

I have this submission here and I am happy to provide it or a copy of it to the Committee. Can I just quote their summary, referring to the balanced budget mandatory balanced budget proposal. It says, "The institution of such a constraint in New Zealand would induce excessive substitution into policies that do not require expenditures, undesirable counter cyclical macro economic policies and the reclassification of spending into off budget categories." Evidence from the United States and from the Gramm-Hollings Act indicates that all of these fears have been borne out by experience. I think this submission represents - I suppose I cannot commend it highly enough because it embodies a highly rational and considered economic approach to this issue. I think the comments that have been made there about the New Zealand policy apply unambiguously also to the approach that is before the New South Wales Parliament at this stage.

CHAIRMAN: You mentioned the effect on recessions of legislation such as this; it has been argued by many people that the Federal Government actually is the body that controls, has the overall control of the economy and the States play a very minor role in that area. What is your view on that?

Mr ROBINSON: I think if I can go back a step in terms of this question of recessions. I think there are at least three crucial points. One is that the Bill that is before Parliament is one which would allow deficits in, and I quote the words, "exception circumstances" such as a major economic recession. I think the first point about that is that that wording suggests to me that it does not apply to ordinary run of the mill recessions, if you like. The fact is, as I pointed out in the article in the Sydney Morning Herald, recessions are not exceptional circumstances in the Australian economic life and the wording of that suggests to me that an escape clause will only apply in the most serious and unusual economic recessions. That is point number one.

The second point I would like to add is that it will, if this constitutional change goes through be, the judges, it will be the judiciary, the legal system which decides what constitutes "exceptional circumstances" and what constitutes "major economic recessions". There are obviously a whole host of issues that arise there. One, of course, is that judges are unelected - you might see that as a strength I suppose but what is unambiguously the case is that for all of the qualities of the judiciary by and large judges are not economically trained and not economically knowledgeable and we have seen the adverse consequences of that in a whole range of areas - such as company law which we can go into. I think it is most undesirable to put something like this into the hands of the judiciary.

Thirdly, if I can come to the very important point you have raised about counter cyclical policy; I think there is a fundamental, with respect, confusion in the Treasury White Paper on this point. The White Paper argues, firstly, that macro economic policy, counter cyclical policy is a Commonwealth responsibility and it also expresses doubts about the effectiveness of counter cyclical policy. I completely agree with the first of those points. In my view it is quite right that State Governments should not be trying to run active counter cyclical policies.

I happen to disagree with the second point. However, I think all of that is really essentially beside the point, because there is a crucial distinction between so-called counter cyclical policy and the danger of so-called pro cyclical behaviour. The distinction is something like this; when you get an economic recession, that automatically blows out deficits because of course revenue suffers, some forms of expenditure will blow out, although that is more a problem at the Commonwealth level than the State level. Pro cyclical behaviour is when a Government reacts to a situation like that by actually trying to stop that recession-induced deficit by raising taxes or cutting spending. And that is behaviour which aggravates a recession and the difference between that problem of pro cyclical behaviour and the counter cyclical issue that has been raised by the Treasury is that counter cyclical policy does not just say that you let the recession induced part of the deficit go, that you do not worry about that, it will fix itself when the economy recovers. If you are trying to have a counter cyclical policy then you go further and you actually boost the deficit beyond the level that is just a consequence of the recession in order to stimulate the economy. I agree with the Treasury's point about that counter cyclical element.

But the point I am trying to make is that this proposal is likely to force pro cyclical behaviour. It is likely to force the government to kick the economy when it is already down at least unless it is a very serious or one of these major economic recessions or exceptional circumstances.

CHAIRMAN: Can I ask you then, what is your view with respect to the triple A rating of the States and the points that Mr Lambert made in respect of Queensland's rating

Mr ROBINSON: Mr Lambert asserted that - I think I jotted his words down here - the policies being pursued by the Queensland government set a "benchmark" was the term he used; he also referred to an entry price for triple A rating. In other words, he seems to be suggesting that one had to match the Queensland debt policy in order to maintain the triple A credit rating. I have no idea frankly what the basis of that assertion was and I think it is, bluntly, wrong. And I would add to that, that there is I think, and I have recently completed some research into Queensland budget policy; there are certain misconceptions about the nature of Queensland policy, and while I unfortunately have not got the full details here, can I simply quote from the 1994 Budget Speech of the Queensland Treasurer, where he says, "I need to stress as I did last year that the Goss government is not pursuing a debt reduction strategy." I am sure you do not want to be bored with a long recitation of the details of Queensland policy. But I am saying essentially firstly that I think there is some misunderstanding of Queensland policy and secondly that in any event it is not necessary to reach Queensland's standards in order to maintain a triple A credit rating.

Mr IRWIN: You mentioned that this legislation would make fiscal deceit mandatory; can you outline to the Committee some of the areas where you would see budget fiddling or ways in which that might be evaded and what effect that would have on the overall accountability and transparency of government finance?

Mr ROBINSON: Yes, sure. As I said before it seems to me that not only can you drive a bus through the terms of this legislation, but I did advisedly go further and say that I thought it would make fiscal deceit mandatory - I would like to explain that. But firstly in terms of the techniques for evading the Bill. Really, some of this gets quite technical and of course one could potentially provide a very very long list. But there are at least five techniques that I think are very obvious ones and the first of course is one of the devices that was referred to in the questioning of Mr Lambert beforehand and that is the technique of requiring public enterprises to pay larger dividends in order to make the budget sector balance look better. And I understood Mr Lambert to have essentially acknowledged that was perfectly possible under this legislation and that frankly he was placing reliance upon the goodwill of the members of Parliament to avoid that. I think that speaks for itself quite frankly.

In terms of other problems, the second technique I would identify is the device of shifting capital expenditure off budget. Now, the point here is that if you can transfer capital expenditure which is carried out by an agency which is defined as being in the public trading enterprise sector rather than being in the budget sector then automatically that capital expenditure will not be part of the overall budget balance which is targeted by this Bill. Mr Lambert appeared to be arguing that this was not possible because the transfer of agencies to the budget sector would not make a difference to the budget balance. The argument gets technical but I think he was in fact mistakenly referring to the impact on the current balance rather than the overall budget balance. That is, I believe, true. What he said is in fact true in relation to the current balance budget but is not in my view true in relation to the overall budget balance.

There are a whole range of other means. Let me just whip through them quickly because I do not want to spend 20 minutes over this. I believe the general technique; I mean the work that has been done in New South Wales by the New South Wales Auditor General on the question of private provision of infrastructure, lease backs, asset sales, is admirable. It is streets ahead of work of Auditors General in other States. I think as a result of that work one really does not need to labour the point that what these sorts of devices can often involve or frequently involve is the substitution of private debt for public debt. And in many cases the fact that it has become private debt does not make - that it ends up being tantamount to the same thing from the point of view of the public sector because very frequently it involves commitments for the budget sector; commitments about contract servicing; charges or commitments in the form of a loss of a revenue stream which are, in many cases, not too far difference from an interest commitment in terms of their effect in terms of their effect upon flexibility. That is the second point.

The other two points I would like to mention are firstly that another standard technique which would be available under this NSW proposal would be that instead of undertaking a public expenditure, government could pass a law requiring the private sector, particularly the private business sector, to undertake certain expenditures. I mean, the United States health insurance system is an example of that. Governments would have an incentive to do that type of thing under this proposal because expenditure of that sort would not appear in the budget. In other words, this is what the New Zealand Business Round Table was referring to as policy substitution.

Rather than going into any more of these technical details, let me just summarise by saying that I think there is no shortage of mechanisms for evasion of this type of legislation and that the sort of evasion that is likely to be resorted to will not only defeat the purpose of the legislation but it will undermine public accountability and in many cases may actually raise the cost of government doing business. I think, as I have said before, that experience overseas amply demonstrates this point. Can I just add though, I think governments do not just resort to these sorts of manipulations and fiddles because they are naughty and deceitful; they do so often because they are under pressure to do so. In the NSW case, all of the creative accounting that has been so much in evidence over recent years, has a lot to do with the pressure placed on this State by the Commonwealth global limits approach which has had a lot of problems over recent years.

The problem with this proposal is that it will actually provide an additional source of pressure to engage in these sorts of practices and when you have got something which is as fundamentally misconceived in terms of its impact on capital expenditure and its impact during business cycles, it is that which leads me to say that I think this legislation is better regarded as a Bill to make fiscal deceit mandatory rather than a step forward in terms of fiscal responsibility.

Mr COCHRAN: You mentioned several times the term making fiscal deceit mandatory; how would you see this as being achieved?

Mr ROBINSON: I suppose what I am saying is basically this; that if this constitutional amendment goes through, then governments will be faced with a couple of very serious problems. One is the problem I have referred to during recessions which might not fall into this category of the exceptional circumstances, and the way that the judiciary ends up interpreting it. My argument is, I think, that this Bill will probably put a lot of pressure on governments to behave in a pro cyclical fashion; in other words to undertake tax increases or expenditure cuts which will aggravate recessions under those circumstances. My point is that if governments are faced with that sort of position as a result of a clause in the constitution, then for very understandable reasons they will seek means of avoiding the horror scenarios that might involve and under those circumstances I believe that you can expect that in ordinary recessions there is likely to be an upsurge in creative accounting of this sort in order to avoid this situation.

The other point is that this goes back I think to some of the other points that have been raised in Mr Lambert's evidence beforehand when he quoted James Buchanan; Capital expenditure is highly irregular by nature. It is irregular for a number of reasons. One is that replacement needs tend to bunch up as a result of - for example in Australia there was a big surge of capital expenditure after the Second World War, that means replacement needs tend to come together to some extent. That is one point. The other point is that if population growth rates surge, then an economic mechanism known as the accelerator simply means you have suddenly got to increase capital expenditure quite a lot under those circumstances. Mr Lambert appeared to be suggesting that when James Buchanan said that lumpiness in capital expenditure was the only qualification to his principle of funding is only reason for justification for using debt for capital expenditure. Mr Lambert seemed to be suggesting this is a minor qualification but it is not a minor qualification. It is, however, an enormously important one and the point I am making whenever in future if this is passed and it sticks, whenever in future the NSW government is faced with one of these surges in capital expenditure needs because of the bunching of replacement or because population growth rates increased, it will be in a hell of a pickle. It will either have to just let the standards of capital services erode, or it will have to jack taxes up substantially or it will have to cut current services. Once again under those circumstances I think any government will be looking for the creative accounting ways out. Once again that is why I am lead to suggest that this really will be a step in the direction of greater pressure for fiscal irresponsibility rather than responsibility.

CHAIRMAN: Can I ask you how Queensland achieves lower debt levels, is it by providing a reduced standard of services by comparison to New South Wales or is it through some creative accounting?

Mr ROBINSON: I think the answer is frankly through both, to be blunt. This is one of the problems I might say that this particular proposal with the - economically speaking, it goes back to Mr Rumble's question beforehand, economically speaking you should be dealing with accrual budget balance concept rather than cash accounting concepts. The GFS, the Government Finance Statistics, basis which is what is used in this legislation, is a cash accounting mechanism essentially and a whole lot of things it leaves out, for example, superannuation liabilities. You know all about that. In Queensland's case it happens that when you add in the growth in superannuation liabilities the position in relation to net liabilities as opposed to nett debt is nowhere as favourable as has generally been represented or understood around the country. That is the first point.

The second point is that I regret to say that Queensland right now is a good example of some of the problems you can encounter in the sense that Queensland's population, as you all know, is surging ahead very rapidly and there are frankly huge problems given current policy in Queensland with providing necessary infrastructure levels, both in terms of social and economic infrastructure.

Mr COCHRAN: How would you describe excessive debt?

Mr ROBINSON: Debt essentially has to be defined firstly in relation to affordability. In other words, there is the question of can you service that debt given your tax base in a reasonable fashion. Secondly, debt appropriateness has to be defined in relation to the uses of that debt. In other words, if you are acquiring debt in order to fund capital assets and so on, that is a lot more acceptable than the completely unacceptable strategy of using debt to fund current deficits and in addition there is the question of so-called gearing risk which has been referred to by the Secretary to the Treasury before. There is no doubt - I come from Victoria a couple of years back and that is a bloody good example of debt; huge debt problem given the tax position of the State. So I am not denying for one minute the points that have been made about the debt problems of Australian States and the need for policies to deal with those, but I am saying you do not use a sledge hammer to crack a nut, you do not ban borrowing for all time in order to deal with the current debt situation.

CHAIRMAN: What would you do then?

Mr ROBINSON: Let us go back to this question of debt reduction. If you regard debt as excessively high there are a couple of things you can do about it. One is of course to reduce the actual dollar levels of debt. In addition to that there are other devices. One can also freeze the dollar amounts of debt and then allow the debt burden to erode through population growth. In other words, if you maintain a constant dollar level of debt in the face of population growth, obviously that will effectively amount to a reduction of the debt burden over time. Or you can combine both of those two. I think there is an argument essentially for a combination of those two. The point I am essentially making is that you would do that for a period of time until you got your debt down to what you thought was an acceptable level. This proposal requires you to do something like that for all time.

CHAIRMAN: Allowing though for exceptional circumstances?

Mr ROBINSON: I think the comments I made before, stand on that.

CHAIRMAN: So what you are saying is debt is a good thing for governments, you should be in debt?

Mr ROBINSON: Other things being equal.

CHAIRMAN: Should they or shouldn't they?

Mr ROBINSON: I believe that debt is a necessary and appropriate mechanism for capital funding for a State government. I do not believe that all capital expenditure should be debt financed by no stretch of the imagination. Essentially application of something like the inter-generational equity approach leads you to argue that capital expenditure ought to be financed partly through current surpluses which are the result of proper depreciation policies, and partly through borrowing. What it sort of adds up to - and I am over simplifying here - what it adds up to is that if you are increasing the size of your capital stock that is an argument for increasing debt, if your capital stock is running down as it will do at times quite legitimately, then you should be reducing debt. And all of that of course is subject to the qualifications that have been made about circumstances where you regard debt as being too high and you might need to override that with policies to reduce debt.

CHAIRMAN: Considering that Mr Lambert said that in the history of this State that has only ever in one year been a modest surplus and that State governments of NSW had always run at a deficit, do you think it might be a good idea to have some sort of guidance in some way or another for State governments, some aim, some benchmark, some restriction to some extent anyway on the amount of level of debt that they can incur?

Mr ROBINSON: If you can define an economically rational set of rules for fiscal policy of this sort which you could rely on enforcing, then I would support it. But I believe that firstly translating into law the economic principles is exceedingly difficult and secondly that it is impossible to make it stick in practice. So for those reasons my support goes to something more like the New Zealand Fiscal Responsibility Act which relies on visibility, on reporting standards, and which should be accompanied with explicit government statements of its policy objectives. I believe that is a preferable approach.

CHAIRMAN: Do you think governments should aim to retain a good credit rating?

Mr ROBINSON: Absolutely.

Mr COCHRAN: Do you think that nil debt and surplus funds reserves is an optimum of economic management?

Mr ROBINSON: Certainly not, certainly not.

Mr HUMPHERSON: Mr Robinson, can I come back to the question the Chairman was asking; you pointed out all the shortcomings of the Bill. It would seem to me there surely must be some benefits and disciplines imposed on Treasury and governments by having a legislation of this form, particularly bearing in mind some of the debts that have been run up by previous governments in this State, even more particularly some of the southern States in Australia.

Mr ROBINSON: I think if one takes the stated objectives of this legislation at face value then one has to applaud them. I think what I am saying is the means do not really suit the end and I suppose I have given some concrete reasons for my assertion that there are not only a whole range of means of avoiding a balanced budget requirement of this sort, but also for arguing governments will find themselves under strong pressure to do so. The point I make to you is under those sorts of circumstances what you are doing by going beyond the New Zealand style approach to this sort of mandatory requirement is actually, if you like, debasing the currency of fiscal responsibility because every time governments do one of these fiddles it actually erodes standards rather than building them up.

Mr HUMPHERSON: Are you saying there would be no disciplines would be imposed or would arise from this Bill?

Mr ROBINSON: No, I think there would be some constraints on governments particularly in the short term which would be imposed as a consequence of this and it is for that reason I think it is likely to be a problem in recessions.

Mr HUMPHERSON: You went on from that and you talked about the resulting of creative accounting or fiscal deceit or similar expression. Drawing an analogy with a domestic budge which most people would relate to, balancing your own home budget; if you have to buy a new car and you do not have the ability to purchase it outright, one of your options is to lease it. And that is no different from the analogy you referred to before or the analogy you referred to in your article.

Mr ROBINSON: Sure, I absolutely agree. But the point I am making is the lease option is indistinguishable from the option of borrowing from the bank in buying that car. In fact, I mean in the government context - I saw last night the Herald report of the Auditor-General's report and he has once again drawn attention to the widespread use by the NSW government of sale and lease back operations which are essentially precisely that. They are saying instead of upfront borrowing from the banks if you like to fund these capital expenditures, instead we will engage in the sale and lease back operations which have the accounting effect of taking the debt out of the government's accounts and putting it in the private sector. But from the point of view of the taxpayer and the New South Wales budget, what is the difference? Except that it is probably more costly.

Mr HUMPHERSON: That probably a debatable point.

Mr ROBINSON: Certainly it was the Auditor-General's view.

CHAIRMAN: Almost everything you have said today has been based on the fact that in your belief governments are devious, dishonest and always looking for ways to fiddle the books. If there was a government that genuinely wanted to run the economy in a sensible and responsible way, could this Bill assist that government to do that and put some sort of discipline and given some guidance to them and Treasury to help them to achieve that aim of running the economy sensibly and efficiently?

Mr ROBINSON: Can I firstly say that I am perhaps not being quite that unkind.

CHAIRMAN: You were actually.

Mr ROBINSON: I suppose I partly was.

CHAIRMAN: Let me stop and say, most of what you said was very emotional, very theatrical and you used some very emotional and flamboyant terms about making deceit mandatory and those sort of things; those are very hard things to say about governments. I wonder if there is any justification for adopting that sort of attitude. But putting that aside, if that is your view, couldn't you agree that a government wishing to act responsibly may be assisted to act responsibly with legislation of this kind?

Mr ROBINSON: I think that a government that was committed to acting responsibly could achieve its desired effect by explicitly stating in its budget the policy targes and goals it was pursuing and by supporting those with clear accounting and reporting in order to give an indication of its compliance with its stated policy targets and objectives.

CHAIRMAN: From the point of view of the taxpayer, wouldn't it be useful for the taxpayer to have this sort of legislation in place so that governments would have at least a guideline, an indication of the way in which they should act as far as the economy of the State was concerned?

Mr ROBINSON: I think the problem is that, firstly, the principles that are stated in this legislation are the wrong ones. Even if they were fixed up to become the right ones, the legislation does not simply provide guidelines in your terms. It goes further. The whole essence of it is to seek to provide, to implement mandatory standards and it is precisely on that basis that I am objecting to it and supporting the New Zealand type strategy of having policy guidelines and strong reporting standards to support that. The logic of the sort of objectives, laudable objectives you are referring to is better achieved by the New Zealand type strategy.

CHAIRMAN: Except of course for the fact that to circumvent the aims of this legislation, governments would have to fiddle. But in New Zealand they have an option. They can either uphold the guidelines or decide openly that they do not want to and ignore them totally. Whereas with this legislation they have the alternative of either following the guidelines or else deliberately, deliberately setting out to circumvent them and deliberately finding ways of doing that and surely that can then be discovered; it can be exposed publicly and people then are able to make a judgment on the economic performance of that government and the way it has gone about implementing the laws of the State in relation to the management of the economy. So surely then if the sanction that the taxpayers have then is in the ballot box then the government, if it deliberately sets out to circumvent this legislation, then it exposes itself to judgment by the electorate at the next general election.

Mr ROBINSON: I think the problem is that we are working our way back from a position where, on the one hand, we are saying that a constitutional requirement gives an ironclad guarantee, legal guarantee that the government won't engage in certain practices and so on. We are now moving away from that to an acknowledgment that the means of evasion for government are such that the only real discipline is the discipline that exists right now, namely one of public exposure and attention being drawn to it in Parliament. Frankly, if the belief is that the current situation whereby the Auditor-General and the Parliament scrutinise government budgetary practices and draw attention to practices which are regarded as improper; if that is felt to be inadequate then I am not sure one would argue for a proposal of this sort which will, on this argument, end up relying on the same sort of sanction or discipline.

Mr COCHRAN: With regards to the level of accountability and the method of exposing incompetent management or managing the economy for a deficit. We saw examples in Victoria, South Australia, Western Australia in recent times of obvious incompetence which was exposed publicly but after an extended period of time; do you think ;that is adequate?

Mr ROBINSON: The answer is no, it is not adequate. It has not been adequate in the past so that said. As a second point I would simply say is that policy ...No, I think I would confine my comments to that. I suppose I am essentially arguing that I do not believe this will improve the situation and it will have a range of undesirable policy consequences.

Mr COCHRAN: Does the Auditor-General in Queensland audit budget and publicly expose government management practices in the same way as it does in New South Wales, that sort of transparency, the public management of the economy?

Mr ROBINSON: I think the answer to that is no. The Auditor-General neither has a legislative mandate in Queensland that is as wide as the mandate of the New South Wales Auditor-General. Nor is the practice of the Auditor-General up there to take such, if you like, an aggressive approach to his responsibility.

Mr COCHRAN: Why not?

Mr ROBINSON: That is a very good question I do not think I am in a very good position to answer.

Mr RUMBLE: With the calculation of expenditure, the proposition is that you combine current expenditure with capital expenditure instead of just lumping all the capital expenditure in willy nilly with current expenditure, what would you say to the proposition that current expenditure either amortised or depreciated should be the figure which would then reflect the capital expenditure for that particular year allocated towards that particular financial year and succeeding years. Do you have a view on that?

Mr ROBINSON: Yes I wholly support the approach you are advocating. I believe that in essence the appropriate budget balance principle is that a conceptually sound accrual current balance should be achieved over the business cycle and if I might just say this; this business of adding capital expenditure in and targeting the overall deficit rather than the current deficit which is I think one of the worse features of the New South Wales proposal; is one which firstly does not relate in any way to private sector accounting practices because it is sort of analogous to the notion of including investment expenditure or expenditure on plant and equipment is a current expenditure as part of a profit and loss statement for a private company which would have bizarre consequences. I might also say I think the overwhelming preponderance of economic opinion focuses on the current account balance rather than the overall budget balance is the appropriate policy variable. I might just indicate here I have got a quote from an article of a very well known American economist, Michael Boskin, who was in fact very high ranking economic official under the Reagan administration for a period of time as well as being a very distinguished research economist and he said, "If we maintained separate and conceptually correct current and capital account system, the deficit on the current account would be the true deficit." It goes on to provide reasons for that.

In America they have a particular problem because their government accounting is so inadequate that they do not distinguish between current and capital accounts to a large degree. In Australia we are a great deal better off because the government financed the national accounting format which is of course the format specified in this legislation, does distinguish between current and capital accounts although of course it is clearly deficient in that it is based on cash accounting rather than accrual accounting as I indicated before. In summary I think I wholly agree with the approach that you are asking me to comment on.

Mr RUMBLE: To what extent would you say that with the rating agencies checking and investigating State finances; to what extent would that be admissible as distinct from the proposition that this Bill would become a - would go as a referendum. What are your views on that?

Mr ROBINSON: It is only relatively few years now since the Commonwealth has essentially devolved to the States responsibility for their own borrowing and with that its discipline of credit rating has come into effect. My feeling is that already the evidence is that it is a very substantial discipline on governments because if only that - I think Don Nicholls put this very well in one of his audit report where he pointed out that the political sensitivities of having that public report card, if you like, were very great indeed. I think that is a very substantial discipline.

Mr RUMBLE: You mentioned before and the Chairman alluded to it, about the matter of fiscal deceit; would a government have to indulge in fiscal deceit bearing in mind that they can forget about this proposition, say if the revenue collapsed or whatever; all you have to do is have a bit of a downturn on the property market and then this proposition that we have got before us now, that can be put to one side for some time. So really you have got that many loopholes in it, you would not have to indulge in any deceit would you?

Mr ROBINSON: The problem is we are dealing with are legal unknowns here to some degree. Section 59, sub-section 2 does not provide a way out simply in major economic recessions, it provides a way out in exceptional circumstances and then it gives as an example of that major economic recessions. The point I think I was raising before, there is a big question in my mind as to whether in fact this Bill will allow the balanced budget requirements to be put aside under the circumstances of any normal recession, that sort of revenue collapsed you are talking about. There is a real possibility that something far more dramatic and unusual will be required. I stress once again that in a way, this is ultimately something which would be put in the hands of judges to determine.

DONALD FREDERICK NICHOLLS, Private Citizen, of [redacted]. sworn and examined:

CHAIRMAN: Did you receive a summons issued under my hand to attend before this Committee?

MR NICHOLLS: Yes, I did.

CHAIRMAN: Formerly your occupation was?

MR NICHOLLS: Well, I have done financial management consulting for four governments. I was head of the Victorian Treasury putting in place a couple of their early budgets a few years ago. Prior to that I was Deputy Secretary of N.S.W. Treasury. I should say, not that it is relevant, I am presently a trustee of the State Superannuation Board.

CHAIRMAN: Would you like to make any comments initially about this legislation that is proposed?

MR NICHOLLS: Yes. Perhaps I may ramble a little bit, if you will forgive me, because when you live in the Bellingen Valley you do not concentrate your mind on these issues and I only became aware of this at 3.30/3.45 yesterday afternoon in which case, perhaps my reading has been concentrated on the material that was given to me.

I should open my remarks, in case I might be interpreted of being critical of the Bill, I want to open my remarks by saying that I am in favour of low debt levels for the budget sector. I just want to make that clear. My experiences in reviewing finances of other States and N.S.W. are that some of those debt levels were much too high and they got governments into considerable difficulty.

As you are aware in Victoria there has been a major effort by the present government to get the finances back into shape and that has required drastic action which just had to be taken regardless of which government got in power. It was mainly as a result of the interest levels, superannuation payments and other contractual payments, such as off budget lease arrangements, which altogether were getting up towards 28 per cent of their budget. At the same time they were running education and health expenditure levels much beyond other States.

It is demonstrated, I think, in the Victorian case; and it is demonstrated in the Tasmanian case which is probably even worse, that debt levels in the budget sector need to be very closely controlled and kept under close surveillance by Parliament because governments do not always - I do not like to use the word "truthful" - display the information in a form that Parliament can always understand.

In the case of South Australia, of course, there is a different situation where their problems mainly arose from a collapse of a financial institution. I notice in N.S.W. those particular problems, the high risk of having financial institutions, has now virtually been overcome by - I think the sale of the bank has gone through, has it? And the G.I.O. has been sold so N.S.W. is in a better position than it would have been if they had not have been sold.

Secondly, I agree with the Secretary of the Treasury that generally I do not think States should run their budgets in a counter cyclical manner. I think that is for National Government. I suppose the only experience we have in Australia where there was a Keynsian approach by a State Government - I think, I can use that word because it was used by the people at the time - was in Victoria and I think they did not appreciate they did not have the revenue flexibility to offset the higher expenditure levels.

I would mention there was a quote from my book by Mr Irwin. That book was written in 1991 and you may well be aware that it was probably around the time and in the context that there was an argument between the Premier at the time and Professor Bob Walker as to what the actual deficit was. I thought there was an actual deficit but the government said that there was a balance but they were talking about the consolidated fund which certainly was balanced so both parties were right. I think there was an actual deficit at the time.

CHAIRMAN: This is one of the really confusing things for people like me who have no training in economics, and no training in accountancy at all, to hear all these figures passed around and really not knowing what any of it means. On the one hand there is a deficit here and a deficit there, and they are all different amounts - it is very, very confusing.

MR NICHOLLS: Could I refer you to my book, sir? There is, in fact, a couple of pages there, it may be a bit out of date, in which I mention about eight different deficit figures and ways of calculating it.

CHAIRMAN: Would it help me if I read the book?

MR NICHOLLS: No, just read those two pages.

CHAIRMAN: Ignore the rest?

MR NICHOLLS: If you went back to, say, the 18th or the 19th Century it would be much simpler because all the accounts of government, authorities and everything else all went through the consolidated fund. Towards the end of the 19th Century and into the 20th Century - in N.S.W. for example, in the 1920's they took a lot of those authorities out of the budget sector and run them as businesses. Once they started to do that you then start to get financial statements not quite as clear as to what was meant.

I just mention in the South Australian Commission of Audit expressed some views as to what governments and the Treasurer should say in his speeches. I did give a speech to the meeting of public accounts committees in about 1992 in which I made comments about that.

I might add and it probably sounds a bit contrary to what others have said, the biggest problem is government is not the spending in depression when revenues are down and things are bad in the economy, that is not such a problem. The big problem in government in my experience over many years was in the good times and, a number of Treasurers that I have been involved with, what they were most anxious to ensure was that when the revenues were very good that you achieved a small deficit, or a very small surplus.

Their concern was that if there was a surplus they would get into trouble from some of their Ministers where he had been restraining them during the year, and then at the end of the year the Ministers would see a surplus. A big problem in Treasuries was in the good times. I am not sure how that relates to this particular Bill.

For that reason that revenue equalisation account was introduced back in a period when there was a different accounting approach. It was to try to overcome that particular problem. It is probably irrelevant now because, I believe, Parliament, is much more educated in understanding the totality of public accounts than it was at that stage.

The particular Bill - and I will come on to that later - has a particular concept of deficits. As I mentioned there are about eight different concepts of deficit. This particular deficit, as I read it, is the one based on the ABS definitions. It is a cash deficit as, I think, one of the members of the Committee, Mr Rumble, queried. He queried whether it was a cash or accrual and it is certainly a cash, but it is cash on a particular definition. It is not necessarily the cash fund type statement as incorporated in the standards of the accounting standards body. It is not necessarily exactly the same as a cash flow statement produced by a private company.

Anything I say in this area, someone would have to check because there could have been developments in the last couple of years with which I am not familiar. As I understand it, the ABS definition is not exactly the same as a cash flow definition is under the accounting standards.

As I say I am rambling here but I will get down to some particulars later. There was some comment about Triple "A". Triple "A" standard, the budget result is not solely the determining factor for the standard. It is not solely the determining factor and I think this is very important.

One of the reasons why N.S.W. has a Triple "A" standard is because it is such a large State and it has a large economic base. Rating agencies look at the size of the economy, the base of the economy, so N.S.W. in theory could run a higher debt level than say Tasmania and get away with it. Tasmania would probably never achieve a Triple "A" standard because it's economy is not diversified enough. South Australia is now going to find it very difficult to get to a Triple "A" standard because of the nature of the economy.

N.S.W. and Victoria - and this is somewhat contrary to what Mr Lambert said but I think it is consistent looked at from a different view - because of Commonwealth/State financial relations where the State's revenue, 40 per cent or something, whatever the percentage of the revenue N.S.W. gets from the Commonwealth, it might be lower than that - because that revenue is certain, it means that all the States in Australia get much higher ratings than States in the United States of America.

In other words because there is more certainty, in a sense there is less possibility of volatility - I will go back to that. That is one of the reasons why we get Triple "A". If you looked at the ratings in America you will find, you know, some States have got Triple "B", they are not all Triple "A" States. But that is one of the reasons. It is not just budget sector results or the level of the budget sector debt it is a range of issues.

On the private provision of infrastructure - this is a personal view but I think there is some logic to it - you judge the provision of private infrastructure on its effectiveness and efficiency, not on whether you are getting it off budget, it should be judged on if it is an efficient and effective way to have a hospital, provide the infrastructure because it may be able to make different arrangements with its unions, more flexible. I am not saying that the public sector could not but if there is some way of making it more cost effective that is how you judge it.

But the consequence of it is that you do move, as the previous witness said, the debt which may be required to, say, build a new hospital, in fact, move that off budget. You do not have to borrow. But it does in a sense become what you might call a contingent liability. Because once that private hospital is built and it is sitting there and, say, they go bankrupt, it is going to be very difficult for the government to say "Hey". The government might have to run it for a while before it gets another private concern. There is some contingent liability.

But I do not believe you should judge it, whether it is a good or bad thing, it should be judged on its performance. Is it an effective and efficient way to provide it. But, as I say, it has got that impact, it would then become a contingent liability.

I agree with the previous witness too that if you had introduced this legislation into Victoria it may not have made very much difference to their performance because of the number of borrowings, in a sense, that were off budget and would not have been captured by that ABS definition of cash at that particular time. It has changed.

The other comment I would make on the appropriate level of debt. There is no single figure. It is a range. I do not think anyone will ever come up with the answer. Obviously to become a Triple "A" State in Australia your debt ratio can not be beyond a certain level. If you look at the Standard and Poor reports you can get a fairly good indication as to what those ratios should be. The last Commission of Audit I was involved with in South Australia has a - I should not say this but I think it is a fairly good section on comparative debt figures in Australian states and you can pick up ratios there.

The biggest the most important ratio in relation to the appropriate level of debt that, as I understand, the agencies use is the budget sector, the narrow one, budget sector interest to revenue. That is the interest paid over revenue.

Now I was involved in the Commission of Audit Report in N.S.W. in 1988 and there was a concern there within Treasury, I think, and also with the change of government, that the actual level in budget sector, the level of debut was rising. I retired shortly after so I am not sure whether that percentage has come down or not, but I think the percentage -

CHAIRMAN: Mr Lambert said that the level within the budget sector is increasing. It is the off budget sector where it is reducing?

MR NICHOLLS: I am never too concerned about the off budget sector, particularly in N.S.W. where the financial reforms and management changes starting back in Ken Booth's day, right through have been quite dramatic and when you look at other States - I have not looked at Queensland so I can not comment - we are so far ahead of other States, you know? The amount of information you receive is just way beyond what other States were getting.

In looking at your States accounts and looking at debt levels and those sorts of issues it is this interest ratio to debt that is the key one. That is one that the rating agencies are particularly concerned about.

If I could go and look at the Act and make a few particular comments about that. I can give these notes to anyone if they are useful at all but I will speak to them.

Firstly, definitional problems, I referred to that earlier. I was not sure originally whether it meant cash or accrual but because it is the ABS it will be cash. My concern about that is because there is no depreciation involved in that concept you can have a situation where the government could say "Hey, we have got to balance the budget, we will keep our capital expenditures down" and you could have deteriorating infrastructure. That was certainly the case of Victoria, I can assure you that capital expenditure there virtually ceased for three or four years. Also, as Mr Lambert and other witnesses have said, in the States they have not adopted the proper accounting standards. Certainly in the other States anything up to 20, 30, 40 per cent of their capital expenditure was really under accounting standards maintenance expenditure and should have been shown in the current account.

I can not comment on N.S.W. because I have not looked at that but certainly back in 1990 that would have been the case in N.S.W. I understand that there have been movements to improve that but it makes a considerable difference to your current account. You end up with a significant deficit on your current account if you move all of it. It does not affect the overall balance, but the current account if you move all your maintenance expenditure which is in capital across.

Therefore, in effect, you could have a deficit building up outside; you could still have your balanced budget on a cash basis but you could have a deficit building up of infrastructure that is deteriorating. If you adopted this I think you would need a separate report - and I am not sure whether you get it at all - at regular intervals about how is the infrastructure being maintained?

I mentioned that ABS definition. The ABS definition of cash used to include financial leases but it did not include operational leases. The accounting standards also do not, as yet, I do not think, include operational lease payments. They are coming in in a couple of years' time. Therefore, if that is still the case, legitimately government could continue not to include the total borrowing on an operational lease basis, would not include that in the budget. That would need to be checked but that was certainly the situation a few years ago.

There were better rules that the Australian Loan Council laid down. If it was intended to follow the Australian Loan Council rules about definition of debt, I would be a little bit more comfortable.

There is another problem too, as I mentioned there are different ways of calculating the budget deficit. There was mention, I think someone said there was $500 million deficit on an ABS basis and a $300 million by the Treasury. I have not looked at the two figures but I would think that the Treasury figure was a better figure than the ABS figure. Because the ABS has to go across a lot of jurisdictions there are particularities in every State that they would not include because it is an international definition but which, in reality, should be included if you are looking at a deficit.

In any of the reports I have done in government I have never said they should not do the two of them. I have said what they should do is have a reconciliation statement and very clearly state what they mean and what they are.

I think it may be that the non ABS one is more legitimate in a sense. For example, the ABS one used not to include - here again, as I say, it is a few years since I have looked at this and when you are up in Bellingen you do not do a lot of that sort of reading. They used to exclude T Corp - Treasury Corporation transactions. That did have quite an impact on the resulting deficit.

Now liabilities generally - there does not seem to be any accepted definition of liabilities apart from the Australian Loan Council ones. There is an issue in this debt area, and I am not sure how this is treated by ABS, if you have a deep discount loan, that means say, you want to borrow $80. So you borrow $100, you get $80 in cash and then, in five years' time, you have to pay out $100. If the accounts - and I am not sure what happens in N.S.W. but certainly in some of the other States this did not happen - do not reflect the accrual of that interest, when you get to the fifth year, you have actually increased your debt by the non payment of the interest.

I am not saying that N.S.W. does that, some other States were doing that, so that debt was increasing right off the balance sheet altogether. There are other ways, if you had higher or lower interest rates, if you have been borrowing when it was 10 per cent and you can refinance and do all sorts of things when it is lower debt levels - all those sorts of transactions can occur that will not, as I have said, probably get caught by this deficit and yet they do affect your liability.

There has been a move to transfer the concept of debt to what they called a mark to market concept - I think T Corp might actually produce some figures that show this - that is you actually assess the value of the debt as to what it would be if it was bought back from the market. I think the T Corp in Victoria, whatever it is called, Vic Fin, I think, certainly were going to show, or did show, those particular figures. I am not too sure whether the Australia Loan Council rules handle some of this change in debt profiles.

I only mention that to indicate that there could be events going on off budget that are not deliberately actioned by the government but which, if you are thinking normally, you might think should be included in the budget before you strike your balance.

The second matter I would like to turn your attention to - I did not fully come to grips with this concept of rolling forward the deficit over a three year period. It seemed to me that it is fairly open ended. At the end of each year, it appeared to me, if you had a deficit - I mean "exceptional circumstances" to me could be put to any circumstance a bit exceptional to the normal.

CHAIRMAN: You would not agree in that case with what Mr Robinson said that it would only be what he termed an ordinary recession would not count? You would be of the view that it could be almost any circumstance?

MR NICHOLLS: It could be anything. If the revenues dropped suddenly. I mean even the situation where you say, well look, we have come to the last two months of the year, in order to achieve the budget deficit we are going to have to sack 2000 teachers. Now that might be called an "exceptional circumstance." That is the will of the government.

CHAIRMAN: So that then would allow you to go into deficit?

MR NICHOLLS: Yes, and then you could spread that over, the next three years and the next year comes along and you say "Ah". You know, in order to finance this deficit, we are going to have to knock off another 3000 teachers.

CHAIRMAN: So what you are saying is there would be ample opportunity for governments to run into deficit if they wished to under this legislation?

MR NICHOLLS: The way I am reading it, I am only a bush lawyer, but there is no particular definition shown as to what, or no guide as to what "exceptional" means. We are talking here about something being written into a Constitution that is going to go on forever, as I think one of the members said, once you get it into the Constitution, even though there is this five years' review, it is going to be very hard to change it, isn't it? Someone would need to look at that more carefully.

MR HUMPHERSON: Isn't there a guide there though? It does say "natural disaster or major economic recession" surely that is a guide?

MR NICHOLLS: For example - putting off 2000 teachers is pretty exceptional, isn't it? It could be. You might have to close down half the schools.

MR HUMPHERSON: You said there was no guide - I am saying there are two examples there?

MR HUMPHERSON: Yes, two examples, right, but there is nothing that exactly states what it means. They are guidelines, I accept that, yes.

CHAIRMAN: Who would determine what those exceptional circumstances were? The government of the day?

MR NICHOLLS: The government of the day. I would not think that the courts would get involved.

CHAIRMAN: I would not think so either.

MR NICHOLLS: I think it would be a constitutional matter. The courts would say it is a matter for Parliament to determine, I am pretty sure that is the case so within Parliament the Opposition have the numbers, it would roll the government and say it is not an exceptional circumstance.

CHAIRMAN: Yes.

MR HUMPHERSON: Surely - my interpretation would be - we are talking about the last month of a financial year where expenditure may have exceeded forecast. We are going back to the beginning of the financial year, in effect, I mean, what has been budgeted for? It may ultimately be that the budget was actually well crafted or, alternatively, not have been well crafted?

MR NICHOLLS: I suppose what I mean is that - and this has happened in N.S.W. by the way - between March and June in a couple of years revenue collapsed. Although it was marginal, we are talking about stamp duty revenue collapsed on the estimate by, about a figure of $1.5 billion but when it come to March the estimate was $1.2 billion. Now only $300 million does not sound much in a total budget of $14 billion or something, but $300 million, in order to achieve that saving, in two or three months, requires a tremendous effort by government. It means an annual saving of about four or five times that figure because you have got to achieve it in a short period.

CHAIRMAN: Those are exceptional circumstances.

MR NICHOLLS: Yes, that's what I say.

MR HUMPHERSON: May be I have not picked this up in my reading of the Bill but where does it require, if you like, in the last quarter of a financial year --

MR NICHOLLS: No, I am saying if it happens in the last quarter.

MR NICHOLLS: Preceding a budget or in the last quarter of a financial year following the budget?

MR NICHOLLS: Following the budget.

MR NICHOLLS: It requires a half yearly budget update?

MR NICHOLLS: Yes.

MR HUMPHERSON: I may have missed it, as I said, but where in the Bill does it require a government if, unforeseen circumstances arise, three quarters of the way through the financial year, to jettison teachers?

MR NICHOLLS: No, it does not. I am saying you can interpret "exceptional circumstances" in such a way that you would have an exceptional circumstance. Therefore, you did not have to take any action in that last three months, therefore, you carry it forward and spread it over three years, isn't it? Or five years, the deficit for that year, you could then spread forward.

MR HUMPHERSON: I am not clear, carry on but we may be at cross purposes.

MR NICHOLLS: I may be reading it differently. I am thinking in a bureaucratic way if the situation came to you and you had this particular problem presented to you, how do you solve it as a bureaucrat?

Penalties - I am not exactly sure what the penalty is if the budget is not achieved. Does the government resign? That is a question I am not sure about. What is the penalty?

MR COCHRAN: Presumably they don't bring the budget down unless it is passed - there is legislative direction there.

CHAIRMAN: They do not have the opportunity to put themselves in a position where they have to resign. They just have to balance the budget.

MR NICHOLLS: What happens if they do not achieve that balance at the end of the year and there is no exceptional circumstance?

MR HUMPHERSON: This is the point I was getting at. I think the exceptional circumstances apply to forecasting the budget. Once the budget is established for the financial year, obviously elements can change within the budget, and the outcome, I suppose, on my reading may or may not meet the budget. There may be a marginal surplus, there may be a marginal deficit but that is an outcome. This is talking about balancing the budget.

MR NICHOLLS: I think the normal person in the community would imagine it meant that the result would be the balanced budget. Perhaps that would need to be made much clearer to the community that it does not mean that the result has to balance.

MR HUMPHERSON: Surely that is something that has to be taken into account in the following year's budget?

CHAIRMAN: That is what Mr Nicholls is saying. You would declare exceptional circumstances and that would allow you then, over the years to come, to go into debt to cover whatever the need was and you just spread it over the three years, what the time period.

MR NICHOLLS: I think it needs to be very clear. I have done a little bit of reading in public finance and the previous witness too, is probably under the misapprehension also, that we would assume that this meant that the budget for the year, the actual result, would be balanced. If it does not mean that, what is the point of the legislation at all? At any rate, that is a question. I am not hear quizzing people, it is just a question I raised in my mind and I followed that through and said "Well, you know, what is the penalty?" I don't know. If it is only a matter of producing a budget that appears to be balanced -

MR HUMPHERSON: Suffice to say a question has been raised and that is something we are to take advice on.

CHAIRMAN: It seems to me that what it means is this if, at the end of the year, a deficit is achieved, then the government has to then explain why that happened firstly. Secondly, how it proposes to correct that position within the next three years.

MR NICHOLLS: This legislation will not impose the final discipline on?

CHAIRMAN: The discipline it imposes is that the government, first of all, produces estimates that are in balance, that show a balance for its budget. As the year progresses and when the year finishes, if that has not been achieved, and the government has to explain firstly why it has not been achieved? Secondly, it must take steps in the next budget and the two following that to correct that problem and it has to explain how it is going to do that.

MR NICHOLLS: If that is the case, it does not have to actually achieve a balance, that probably answers some of my problems here. I will just mention that I did have the opportunity - and this is some years ago also - to visit some of the states in the United States and Canada. I did take a note of some of the experiences I came across there.

If I could mention one of the worst States, of course, Hawaii. I was forced to visit Hawaii. They had a system - and I am going back some years - where actually the budget at the end of the year if it was in surplus they actually drew cheques, even if it was only for $1, and paid taxpayers. In some other States, and there are articles in the Public Budgeting and Finance magazine - I can not recall which month or year. I may have the wrong State, it was one of the corn growing States; they got towards the end of the budget year in April, May and June and found that they were not going to balance their budget, and this was a requirement. So they introduced what they called "free work days." All public servants worked for five days and got four days' pay. Then in the last pay period of the year they were also in trouble so they, in effect, were given an IOU that the State would pay them the next year and they could go to the bank and, I believe, cash those.

It is very similar to the Whitlam proposal, remember when he run into trouble with supply? There was a proposal floated that they would provide public servants like that until supply was passed. I must admit when I was reading the Bill I thought this could have been a problem because Federal and State law would prevent this government from taking that sort of action against its public servants.

CHAIRMAN: In the Bill, schedule one, s 60(1) indicates what a Government must obviously do as far as a deficit is achieved?

MR NICHOLLS: Yes, I mentioned the U.S.A. one as being a red balance but I didn't think we had that flexibility if we were required to balance; the actual result had to be the same as the budget result.

MR IRWIN: Bearing in mind what we are looking at a cash flow deficit here, it is quite logical for a government, for instance, to withhold payment to creditors, say, through June into the New Year and that would be one way op avoiding it?

CHAIRMAN: We have Premier's requirement that departments pay according to normal business practices in the time?

MR NICHOLLS: There was in my time, and I don't know if it still continues, a requirement to pay within a certain period. If you did not pay the Minister could, in fact, pay interest to the contractor whoever it was who was not paid. There was quite a procedure. I do not know whether that is still in or not but I will come back to that point because there are other ways.

There is a problem with the treatment of fortuitous revenue such as asset sales. Regardless of what Mr Lambert said, in the ABS definition they would be included. So you would, in fact, run a surplus in the year which you say, sold the bank. You would show a particular surplus. If a government decided it did have a budget problem in that year and sold the bank and got the proceeds, it would, in fact, under ABS definition, meet the deficit balance budget situation.

We are talking about expenditure deferrals, you can do that legitimately other than just not paying creditors. For example, in Victoria the schools subsidies which are significant sums in this State $300 million payments to private schools. They entered into arrangements where the schools were due for their subsidy say, in February, the government gave them a letter which was not a contract but a letter of comfort to the bank that the state would pay the subsidy in the following July. So the whole of that subsidy was deferred for three months. It never had to be caught up because the next year they borrowed from the bank again.

There are actions that you can take but as somebody said, those sorts of procedures would be brought to the attention of Parliament, I imagine, by the government itself or, if not the government - I have got great faith in governments. Certainly in Victoria they did include that in their papers if you read the fine print - the Auditor-General would, no doubt, mention it. There are other ways other than just deferring.

For example, this has happened in N.S.W. you can sell your forward income streams. In Victoria they have sold off the TAB. To some extent that is a forward sale of an income stream. I am not saying completely. You could forward sell the TAB here, the forward income from the TAB. I am not suggesting you do it here but there are different ways of doing it. I think the Housing Commission some years ago sold forward its income streams from rents.

CHAIRMAN: There are all sorts of ways that governments could get around this legislation. There is no denying that but do you think that they are likely to try to do that? Is it possible that governments might attempt to stay within the letter of the legislation for the benefits that it would bring, such as not having to play interest on debt and maintaining a good credit rating anyway?

MR NICHOLLS: I have only got the experience of some of the governments I have been involved with and certainly they did do the things I am talking about. Certainly they produced budgets and gave speeches as if they were being financially responsible. That is all I can say. Now we are talking here about writing something into a Constitution that is going to go for hundreds of years. Now I can not tell you whether some future government might --

CHAIRMAN: Do you think it is desirable to make some attempt to try and get away from those problems that you say have been experienced in the past of governments doing those things?

MR NICHOLLS: My preference is for Parliament to accept responsibility to compare government's performance against benchmarks; for Parliament to know what those benchmarks are and they do not at the moment do it sufficiently effectively. I have very rarely seen any use of the Commonwealth Grants Commission figures which show comparability with other States. They have been used occasionally but not in a way in which brings out particular financial problems.

There is a series of benchmarks about liability changes that could be available. If you were going to proceed with this sort of legislation I probably would have preferred it to be in a normal Act to start with, to try it out - it is such a major change - or amend the Audit Act. Include in the Audit Act to say this is what governments must do.

It is still a problem if another government comes in and wants to dramatically change it. At least when it is in that Act you could sort out some of these problems about definitional changes. I suppose that would be my preference. Again I am saying I am supporting low debt levels in the budget sector.

Just on the expenditure side, I would mention also that the legislation puts considerable pressure on the Secretary to the Treasurer - I am quite happy that he is prepared to accept that responsibility - to declare that the revenue estimates have been prepared professionally. I might add that some other States - I am not saying what might have happened in N.S.W. - they were not always prepared in a professional manner.

It does not say anything about the expenditure side. If I could mention that. I became aware of a budget produced in another State where, in effect, they wanted to bring the deficit under $1 billion. So the revenue estimates might not have been too bad but when it come to the expenditure estimates all that happened was, in fact, they added up. There was $500 million more, we have got two days to knock $500 million off, so just go back and knocked it off everywhere - I am sorry, more than that, it was a bit over $1 billion. They did not put in place or indicate that in order to achieve this they would have to have huge reductions in public service levels which required pay outs in redundancies which were going to be significant sums.

On the expenditure side the system did not provide a means of achieving those expenditure estimates. In fact, nothing was done for four or five months which meant that they were never ever going to be achieved.

I am not suggesting that a government in N.S.W. would do that, but sometimes if elections are around about budget time professionalism does not always, I believe from a distance, apply. We are looking here at something that is set in stone, isn't it, for hundreds of years?

My situation is I am very much in sympathy with the concept of keeping debt levels in budget sector fairly reasonable and low. N.S.W. may have a problem there and it is worried about its Triple "A" ratings and I am supportive of that. If this sort of legislation is to go ahead, I would prefer it to be first tried out in legislation that wasn't written in stone, for a couple of years, see how its gets on, and then if you want to take the next step.

Certainly before you proceeded with it I would suggest that some of the issues I have raised about definitional problems about ABS you could clarify. I may be talking off the top of my head because it is a few years since I have really gone into those figures. Using this ABS, you are the Public Accounts Committee reporting back to the Parliament, you really want to know what is included and what is not included in the ABS definitions compared with accounting standards of cash flow, and compared with the Loan Council definition of liabilities and debts.

MR COCHRAN: As an optimum goal for government do you think they should seek to achieve a balanced budget and surplus funds?

MR NICHOLLS: Are we talking about the capital and revenue combined balance?

MR COCHRAN: Yes.

MR NICHOLLS: I think I have expressed views elsewhere that I think it is legitimate in the budget sector for governments to borrow for new capital works, an intergenerational argument, that is, if Coffs Harbour where I live expands and it needs a new school because the population has moved there, I think that is legitimate. If it was purely a school district and it was not being funded by the State, that school district would actually borrow the funds and pay for it. I think that is legitimate.

If there is a school that is, sort of, clapped out in the western suburbs or wherever,that has been up for ages and you want to replace it with another new school, now I think there should have been funds provided, if you are on the accrual basis, that should be charged in an accrual sense against the revenue.

In a perfect world with your business undertakings - now you look at gearing ratios don't you? You do not have absolute levels of debt or anything else, you look at gearing ratios. If the gearing ratios are consistent with the risks of similar businesses in the private sector, you say, "yes, that borrowing is probably all right." In the budget sector it is very hard to think of what a gearing ratio is. That is the problem. If there was a gearing ratio you could say "Hey, that ratio is getting a bit high." You may be able to get something more if there is a better use by Parliament of the consolidated financial statements in N.S.W. There may be some problems but those are exceptionally well done, I think. There could be more use of those.

I would like to see those actually get incorporated into the budget. In other words I would like to see forward estimates and balance sheets. Then when you look at your capital works program you can see whether you are actually increasing your assets or just replacing or maintenance. In other words, does your capital budget increase your assets or is it really only maintenance?

MR RUMBLE: What is your views of capital expenditure being added into current expenditure and also abnormal items, say, for the sale of the State Bank which in accounting terms would be an abnormal item as far as a balance sheet goes, but conceivable could be added in as income?

MR NICHOLLS: Under this ABS definition it would be just treated as income. But from my experience with N.S.W. - you are very well served here - they do show all those abnormal items separately as I understand it. The ABS statistics, it was very difficult to get it from the ABS statistic because they net them off. I think now they do show gross and net in the ABS statistics. The answer is, yes, it would be included under ABS either as revenue or negative capital expenditure. Yes, they would be included.

Whether that would be regarded in the private sector under accounting standards (they have changed the rules, there are very few abnormals now in the private sector by the way). In fact, you might happen to find that would be included actually as a non abnormal. I am not saying it would. I think there should be a much clearer - I thought the State had actually adopted accounting standards for current capital expenditure. I thought N.S.W., because it has led the pack in everything, I thought by now they would have actually had that definition in place and were actually preparing the budget on that basis. I was a bit surprised there was a suggestion that they were not.

MR RUMBLE: The purpose of the Balanced Budget Bill here, capital expenditure is just added in?

MR NICHOLLS: That's all yes, it is an economic concept, rather than an accounting concept, yes, GFS based, yes.

MR IRWIN: In your 1991 book *Managing State Finance* you mention in terms of the net financing requirement:

> "...the "deficit" of New South Wales has been declining as a percentage of GSP since 1981-82 at a rate faster than the other states. This trend has accelerated since 1987-88."

Obviously with the date of your book it has not taken it beyond that. The Treasury points out in relation to this legislation it is not the solution but a means to a solution and the solution is to change the mind-set of government, Parliament and the community to achieve a consensus on the desirability of achieving and maintaining a sustainable prudent fiscal structure.

Given that, as you have stated there, the net financing requirement has, in fact, declined as a percentage of GSP and given your experience in two different State Governments and N.S.W., would you say that there has, in fact, been a deficit reduction strategy of sorts in operation since 1981-1982? How consistent has that been? How effective has it been?

MR NICHOLLS: Probably 1981-1982 may be a good year to start because I think that was the year that the government had a financial problem. It only had six weeks cash left and it had to sell off the Railways system overnight and the merchant bankers raised $350 million overnight. That was a period in which they were actually short of cash in the bank. I think that because of that it really stirred the then government into getting involved in financial management reform and tightening up in the whole budget area.

I think under - if I can mention names - Ken Booth who was the Treasurer then, there was some work done. it was difficult in the budget area sector to achieve that. I think they certainly would have done better than Victoria. They will never match Queensland. To match Queensland, if you look at the health, education and debt figures in Queensland, you have got to spend something like - I can not quote the figure now but in something like Health you have got to spend $100 a head less, and something the same in Education.

In other words you would have to spend - Treasury could tell you this, in should be in the Budget Paper - something like $2 billion less just in those two areas in N.S.W. N.S.W. spends about the average in health and education. As I say Queensland runs such a good budget result because it spends very low in those two areas. Because they spend low in those two areas they have not got a debt problem.

I am not saying what the level or the quality or effectiveness of the services are. I do not know whether they are better or worse in Queensland than they are in N.S.W. I have got no idea.

MR IRWIN: Could you say that there has been at least informally a strategy of reducing budget deficits since the early 1980s?

MR NICHOLLS: It is a bit hard to say since the 1980s because governments did not really come to grips with this concept of net PSBR until the mid 1980s. People like Paddy McGuinness and other commentators were very critical of governments for not adopting these concepts. So you did not actually have these concepts. The concentration was on the consolidated fund.

In fact, in those years, up to the change of government, there had been whether it was strategy - I think it was a strategy. They have, in fact, kept expenditure below budget estimates and there have been surpluses each year. What was happening was that funds were being transferred into trust accounts. You would look at N.S.W. and find the trust account balances really increased. That would have affected the PSBR concepts. Just what the results of that was, I do not know. There was, I think, a policy of keeping expenditure under control after that shock that the government got around about 1981 or 1982.

Also the government was prepared to do some tax changes as against, say, in Victoria where they increased expenditure but they then introduced what they called the Cain family pledge which said "No tax increases." Now that destroyed their budget for a couple of years and they could not catch up on it.

The most that happened in N.S.W. in that area, I think, was say, in the Electricity Commission area where there was a decision during a period of fairly high inflation not to increase electricity tariffs. But there was not a decision to improve the efficiency of the electricity to offset that loss. The Electricity

Commission got into significant problems for a couple of years until decisions were made "We have got to increase the price of electricity."

It is very legitimate, going back to what one of the witnesses said, that in Victoria they had what they called a rate of return concept applied to their business undertakings. That is, every business had to make a certain rate of return on their assets. It started off it was just a common rate of return for everyone. What happened was that in some of the years, the later years when they were really under strife and these authorities were not achieving their actual rate of return, the Government said "This is the rate of return you have got to achieve." "You give us a dividend." The authorities actually had to borrow. It was not a deliberate, I don't think, action by the government to circumvent borrowings by the budget sector, it was just a decision of the government they had to make those payments regardless of how their finances were.

In fact, many of them were paying more than 100 per cent of their profit in dividends. There is an argument that if accounts are kept on a proper valuation method that, in effect, they do not need to keep any surpluses. There is an argument about that. It has even been argued in the private sector as well if you keep your accounts in a proper manner and base your depreciation on current values, that any surplus should actually go back to the shareholders. Then if that imposes a discipline on both the private sector and the public sector to justify more borrowings or more raisings from the shareholders to finance further development.

(The witness withdrew)

PATRICK HARDING LANE, Emeritus Challis, Professor at Law, University of Sydney, of [redacted], before the Committee:

CHAIRMAN: Have you received a summons issued under my hand to appear before this Committee today?

PROFESSOR LANE: I think so. I do not know whether it is under your hand.

CHAIRMAN: Would you like to give us any views about this legislation and what it might mean.

PROFESSOR LANE: I would only speak about the constitutionality or the legality or the proper way of going about the exercise because I appreciate that fiscally or from the point of view of Auditor-General or Treasury I have no expertise there. If you want to know whether the kind of material you have here is going to stick, from those perspectives, I cannot answer about that.

As for the constitutional aspects of the legislation, I can make four points pretty quickly then you can ask me to elaborate. Firstly, the Parliament can, under Section 5 of the constitution enact this kind of provision which has a manner and form provision implicating the referendum. Secondly, you might wonder whether the Balanced Budgets Bill requires a manner and form provision and that will depend on what the Balance Budgets Bill is doing. It is doing one of two things; either it is altering the constitution in Section 7B by the two insertions or arguably it is altering the powers of the Legislative Council under Section 7A. Thirdly, if the Bill is doing either of those; achieving either of those effects, then either because of the Commonwealth Constitution Section 106 the Bill has to go through the way in which it is going because there is a manner and form provision in the State Constitution. S. 7B or S 7A restricts Parliament enacting this kind of legislation; because this proposed Bill alters the powers of Legislative Council, as it seems to me, the backing in this case or the fundamental law in this case or the requirements in this case flows from the Australia Acts 1986. That takes care of the Balanced Budget Bill itself. In time you will Budget Bill under the Balanced Budgets Bill itself and that budget bill with then be locked into the requirements of either Section 7B or Section 7A. And that would equally be backed by either the Commonwealth Constitution Section 106 or the Australia Acts Section 6.

I can see you are a bit mystified. I am giving you the general highlights. I do not mean to bamboozle you with science and you can take me back more slowly. I will just take it more simply. The Parliament of New South Wales can of course make laws under Section 5. It can make a law which introduces a manner and form provision. The Parliament can even make a law under Section 5 which requires a referendum before the Bill becomes an Act. That was done under Section 7A. And the High Court said Section 5 can be used for that purpose. You are now using Section 5 to bring a manner and form provision into the Balanced Budgets Bill and I say the authority for that is under Section 5. It would be a law making power. You then say the manner and form provision in the Balanced Budgets Bill affects the existing Constitution. I say yes it will affect the existing Constitution. Immediately you can see the Balanced Budgets Bill makes two insertions into Section 7B thereby altering the constitution.

Just stopping at that point, you can say now the Commonwealth Constitution Section 106 comes into operation and this is probably a novel law to you because you never thought that the constitution of New South Wales would be somehow governed by the Commonwealth Constitution in this respect. Commonwealth Constitution Section 106 states that, coming Federation January 1st 1901, the Constitutions of the States shall continue until altered in accordance with the Constitution existing at that time in the State. Section 106 can be seen as a fundamental law, giving authority or a source of the New South Wales Constitution Act. That Section 106 is the provision which ensures that when you put a manner and form provision into the Balanced Budgets Bill by virtue of Section 5, when you put that manner and form provision in your proposed Bill, I say Section 106 of the Commonwealth Constitution ensures that that manner and form provision will stick. It also meets the argument that whether a change of government or change of heart in the present government, in either of those two circumstances the new Parliament cannot say that the earlier Parliament is binding the successor. It is rather Section 106 which is requiring a later Parliament to follow an earlier Parliament.

That gets over the argument about sovereignty of Parliament. That line of argument was based upon the proposition that the Balanced Budgets Bill alters the Constitution and such alteration under Section 106 of the Commonwealth Constitution must comply with the existing provisions in the State Constitution as they alter from time to time. And that argument flows over into a Budget Bill and its peculiar conditions laid down in the Balanced Budgets Bill itself. The other line of argument is arguable; the other line of argument turns not to Section 7B which it is clearly altering the State Constitution so affecting Section 106 of the Commonwealth Constitution; that line of argument looks to Section 7A which says you cannot abolish the Upper House, you cannot alter it powers. People in the Upper House may say that we in the Upper House can make rules under Section 5 of the New South Wales Constitution Act and under Section 8A(1)(a), the inference is that Parliament makes the law or passes a Bill to become a law merely by assenting to a Bill. Whereas the Balanced Budgets Bill intrudes another factor, another element a referendum; its power under Section 5 together with Section 8A(1)(a) may say its power has been altered although you did not comply with the provisions in Section 7A.

If the Balanced Budgets Bill is seen as altering the powers of the Legislative Council then the Legislative Council may say or take the point that Section 6 of the Australia Acts of 1986 requires any law of the State of New South Wales "respecting" - a pretty broad term - any law "respecting" the powers of the

Legislative Council must comply with any manner and form provision. In this instance that provision in Section 7A. Does that answer you ---?

CHAIRMAN: I think it must have.

PROFESSOR LANE: I do not think you can repeat it after me, but the material is there if you want to feed into some other constitutionalist and see what they think about it.

CHAIRMAN: I must say I totally understand it but I have to say I do not think some of my colleagues do.

PROFESSOR LANE: One of the difficulties your colleagues will have will be this; they assume that they have a State Constitution under which they operate. They now discover perhaps for the first time that because of the Commonwealth Constitution Section 106 the State Constitution gets its authority or is sourced by Section 106 which is a novel idea to your colleagues and to many people. The High Court repeated that in may an abiter. That means that the State Constitution, if it is sourced or gets its authority from Section 106 of the Commonwealth Constitution, the State Constitution must comply with the Commonwealth Constitution which says that the constitution in New South Wales continues after Federation until it is altered in accordance with the State Constitution. It is as simple as that.

You go to the Constitution to see what the requirements are in State Constitution. And the requirements under Section 7B or 7A. Put it a different way from a different perspective, the point of political science; political scientists may say this Parliament cannot bind a later Parliament which is commonly said. That is true enough. Unless you find that a Parliament operates under a Constitution as indeed it does, and at the back of that Constitution is a fundamental law, the fundamental law here is the Commonwealth Constitution Section 106 or Section 6 of the Australia Acts.

CHAIRMAN: Does the State Constitution get its legitimacy from the Federal Constitution or does the Federal Constitution simply guarantee the legitimacy of the State Constitution?

PROFESSOR LANE: If there is a difference. All you get in the High Court from time to time about Section 106, is that after the Federation 1st January 1901 the State Constitution shall continue until altered in accordance with the Constitution of the State. Now that is the way it has been read by the High Court several times in many an obiter, and not always by Murphy J, who was not enamoured of the States; Barwick J. too has read section 106 in the High Court, maybe two or three times, as something which is the "authority" for a State Constitution, whatever is meant by the authority. Or - that is right, that is the ambivalent word - or it is the source of the State Constitution. But that cannot be taken too far. That is to say, every time you alter your Constitution, our State Constitution, because of 128 the State Constitution was locked into the Commonwealth Constitution and every time you alter the State Constitution you would require referendum under Section 128 of the Commonwealth Constitution.

I think, in other words, the High Court has not thought through what it means by the term "authority" for the State Constitution founded in the Commonwealth Constitution. It is true that Quick and Garran back in 1901 suggested that the State Constitution ought to be read as if it is incorporated into the Commonwealth Constitution which is pretty drastic. I would not let them get away with that. Just because if that was the case and each time you amended the State Constitution you would have an amendment to the Commonwealth Constitution which would attract Section 128 which would require a Federal referendum. Nevertheless you pick up the ambiguous word, namely that the Commonwealth Constitution Section 106 is the source or the authority of a State Constitution.

But that is rather an aside because what you ought to know is that if you introduce a manner and form provision as has been introduced in Section 7A or as has been introduced by Mr Walker in Section 7B in 1979, if you introduce those manner and form provisions a later Parliament may say that they do not stick. Then under Section 5 of the State Constitution the later Parliament can override the previous Parliament and then I say we have overlooked Section 106 which gives the backing to what is done by State Parliament or Section 6 of the Australia Acts.

CHAIRMAN: Just to put it simply, if this Bill is enacted can a future government do away with it?

PROFESSOR LANE: Not unless it follows the requirements laid down in the Balanced Budgets Bill itself which requirements will be locked into Section 7B with a string of sections and in Section 7B there is a manner and form provision about referendum.

CHAIRMAN: So there has to be another referendum?

PROFESSOR LANE: That is right. Supposing Parliament inadvertently brought down a Budget Bill under the Balanced Budgets Bill itself, so later Parliament brings in a Budget Bill which does not comply with the Balanced Budgets Bill, that Budget Bill I would say is inconsistent with the provisions now interwoven in Section 7B so that later "Budget Bill"---

CHAIRMAN: Would contravene the Constitution?

PROFESSOR LANE: Would contravene Section 7B and would be invalid. But the later Parliament cannot bring down its budget bill and override

State Parliament and I say it can't because the Balanced Budgets Bill has been woven into Section 7B and that has a certain procedure and Section 7B is backed by the Commonwealth Constitution Section 106. Or you say that - a different argument - that the Balanced Budgets Bill alters the powers of the Legislative Council and those powers are not to be altered other than by the provision in Section 7A, again a manner and form provision.

CHAIRMAN: Does this Balanced Budgets Bill alter the powers of the Legislative Council?

PROFESSOR LANE: The argument is that the Legislative Council is a law making body in Section 5 of the Constitution. It makes the law by inference in Section 8A(1)(a), makes a law merely by passing a Bill, assenting to a Bill. Section 8A(1)(a) says nothing about a referendum so the normal way in which the Upper House exercises its law making power is simply by passing and assenting. I am saying that the Balanced Budgets Bill makes that power at best an incomplete power. Some may take exception to that, may say that the Balanced Budgets Bill does not affect the powers of the Legislative Council. If that is the case one cannot implead the Australia Acts as a backing. Somehow to get behind the Constitution of New South Wales, behind to some fundamental law which says that provisions in the Constitution of New South Wales such as these provisions will be that those provisions must be complied with. It cannot be a bootstrap operation whereby the State of New South Wales somehow binds itself. And the higher law or the fundamental law is in the Commonwealth Constitution Section 106 according to the case in 1981. If I could get it into Section 7A it would be better because with Section 7A you have no difficulty there. If you alter the powers of the Legislative Council then you are stuck with the Australia Acts.

To spell it out clearly, the 1986 Australia Acts Section 6 speak about a law respecting the powers of Parliament and such a law respecting the powers of Parliament must comply with the existing manner and form provision. You do not have that elaborate phraseology in Section 106. I was about to say another High Court may be State orientated - the High Court might say that 106 has nothing to do with State Parliament, that 106 merely says that in a twinkling of an eye you have a colonial constitution and then you have a State constitution. And that colonial constitution proceeds to a State constitution, that is all 106 does. But the High Court has talked about 106 being the authority or the source which was novel to me. But nevertheless not just me but Barwick J. and State judges have taken it up too.

Mr IRWIN: A couple of questions to deal with the Bill itself. I might put this to you; in relation to half yearly State budget updates; that is Section 52, any of the requirements of this Section may be altered or excluded by another law. Can we assume from that, that would not require ---

PROFESSOR LANE: Where?

Mr IRWIN: Section 62(6).

PROFESSOR LANE: That has been taken out of Section 7B.

Mr IRWIN: So the effect of that would be that it would not require a referendum to alter that section?

PROFESSOR LANE: That is right. Section 60(6) has been expressly taken out of Section 7B. Have got Page 2 of the proposed Bill?

Mr IRWIN: Not in the same format. Yes.

PROFESSOR LANE: If you look at Schedule 1, sub section 1 (b) you will see that you insert in Section 7B (7) of the State Constitution Section 60(2) and Section 62(6).

Mr IRWIN: And my other question related to Section 62.

PROFESSOR LANE: The basic manner and form provision is in Section 7B. You begin with the manner and form provision of Section 7B, it has got a series of sections on the Legislative Assembly. You now want to put into Section 7B the Balanced Budgets Bill and its requirements. However, Section 7B(7) says that the provisions in Section 7B do not apply to Section 29(2) which does not refer to you and does not apply to Section 60(2) or Section 62(6) of the Balanced Budgets Bill.

Mr IRWIN: We then referred to 62(6). In relation to Section 62(2) which states those proposed measures are to provide for the elimination of that impact over a period not exceeding the next three years or any other period provided by law. That sub section again can be amended.

PROFESSOR LANE: No, because of Section 62(6), which Section 62(6) ---.

Mr IRWIN: No, I am referring to Section 60(2).

PROFESSOR LANE: I have said that has been taken out of Section 7B.

Mr IRWIN: Can you just - without necessarily saying yes or no but in simple terms that can be amended without a referendum?

PROFESSOR LANE: Yes.

Mr IRWIN: So the period over which measures to provide for the elimination of that impact can be increased or decreased from three years.

PROFESSOR LANE: Yes, because Section 60(2) is an ordinary Act. Section 60(2) is not qualified with the manner and form provision because Section 60(2) is to be read with the first page here which says that Section 60(2) is to go into Section 7B(7) of the State Constitution and Section 7B of the State Constitution sub section 7 takes out Section 60(2) from the manner and form requirement.

Mr IRWIN: That is fine, that will cover that question there. If I can refer to Section 59(2) where it states, however a state budget may contain a fiscal forecast of a budget sector deficit if the deficit is due to exceptional circumstances. How broadly would you expect that sub-section to be interpreted? It does say there for example a natural disaster or a major economic recession. Would that be interpreted in a fairly narrow fashion that it would require an actual natural disaster or what may - however it is defined, major economic recession or could there be other exceptional circumstances?

PROFESSOR LANE: The answer is yes on your last point. The draughtsman has deliberately put in "for example", he does not say "that is". It is merely by way of giving some instances.

CHAIRMAN: It could be a very broad interpretation?

PROFESSOR LANE: Yes.

CHAIRMAN: Who would give that interpretation?

PROFESSOR LANE: When you say broad interpretation, "exceptional circumstances" are required.

CHAIRMAN: Who would define "exceptional" then?

PROFESSOR LANE: You people will, to begin. But it would go before the court to consider what is meant by exceptional. All I can say is that the court defers to the legislative act generously these days. I suppose you have to put something like exceptional - it is rather a severe term - natural disaster or major economic recession; perhaps you bind yourself too much in saying major economic recession. Natural disaster I suppose that is exceptional circumstance, almost acknowledged insurance in law. Major economic recession - I do not know that I would put "major" in.

CHAIRMAN: So just economic recession?

PROFESSOR LANE: I think so. It is true enough you have a genus, an over arching concept, "exceptional circumstances". Now that is qualified to begin with. You do not say other circumstances, you say "exceptional circumstances" and then you go to give some examples. For example, nature disaster or an economic recession. I think these are what I do say. It is true they are merely examples as I said to my friend here but I would not bind myself too much. That also, by the way, Section 59(2) will quieten those people who are concerned about Parliamentary sovereignty. A later Parliament can say because of Section 59(2), people scrutinise this Parliament, this parliament can say, we have a let out for a later Parliament or this Parliament itself in exceptional circumstances.

CHAIRMAN: So would you see that as a significant escape hatch for future parliament?

PROFESSOR LANE: You say significant, I can only say only for "exceptional circumstances". I do not think you can water it down any more.

CHAIRMAN: If the Parliament for instance were to discuss the circumstances and said these are exceptional, would that be generally accepted?

PROFESSOR LANE: Yes, by the court, yes, true.

Mr IRWIN: The question arose earlier, what are the consequences for a government if it does not meet the requirements of Section 59, could you outline ---.

PROFESSOR LANE: Section 59(1) the substantive section in the Bill?

Mr IRWIN: Yes.

PROFESSOR LANE: The answer was that Section 59 is interlocked with the other provisions in the budget bill and the budget bill as a whole is interlocked into Section 7B, so that the Balanced Budgets Bill, its provisions are corralled within Section 7B and its requirements of a referendum. You then have in your proposition a Budget Bill seemingly which does not follow these requirements and that purported Budget Bill is affecting to alter the provisions in the Balanced Budgets Bill and by that very fact purporting to alter the provisions in Section 7B and that it cannot do because Section 7B, because the backing behind it, either the Commonwealth Constitution or the Australia Acts, requires the purported Budget Bill should meet those manner and form provisions.

Mr IRWIN: And the consequences of that for a government would be?

PROFESSOR LANE: The purported budget bill would be invalid.

CHAIRMAN: Could I interrupt there to say that in Section 60(1), which is on page 4, schedule 1, the State budget must indicate the measures; that is if there is a deficit the budget then must indicate the measures the government proposes to take to eliminate the impact. Would that cover the circumstances within the Bill?

PROFESSOR LANE: I attempted to disarm you at the beginning by saying I am not an auditor or a treasury official. I do not know much about fiscal matters. I do not mean to evade you, I can only say that if these provisions interlock, what treasury does what government does, because of the way this is drafted or interlocked so that it becomes a part of the legislative activity these are pre-conditions of the legislative activity, then I say that legislative activity is governed by Section 7B and in that way I suppose I have to say in that indirect way or that way in effect the government is bound. Because when it comes into the legislature, the legislature will ensure that the government or the treasury will ensure that the budget does not run over, however it is put, and the condition for this kind of budget bill within the Balanced Budgets Bill, the conditions will not have been met. Those conditions may be treasury, fiscal, government and legislative but I am coalescing them into a legislative exercise. I do not think you can divorce what the government or the treasury or auditor does under this from the legislative act and I keep protesting that I can only answer you on the plateau of the law and the Constitution.

CHAIRMAN: Does the Bill not say if the budget does not meet these requirements these are the steps the government has to take?

PROFESSOR LANE: Yes.

CHAIRMAN: This is in schedule 1, Section 61.

PROFESSOR LANE: Yes I have that. What was your question?

CHAIRMAN: What I am suggesting is doesn't this section say if the government does not achieve a balanced budget then it must automatically take these steps that are set out here?

PROFESSOR LANE: I have not read the Bill as closely as that. Which entity has to take the steps you refer to? The government takes certain steps?

CHAIRMAN: The government. It says here, State budget requirements will eliminate deficits. State budget must indicate the measures the government proposes to take to eliminate the impact on State debt. Doesn't that set out the steps the government has to take if the budget does not meet the requirements of the Bill?

PROFESSOR LANE: If you have a budget bill under the Balanced Budgets Bill that budget bill must comply with certain pre-requisites. Those pre-requisites flow into what treasury does, what government does, what measures and if they were not complied with, if those pre-requisites are not complied with I would say the resulting budget bill will not comply with this Balanced Budgets Bill.

CHAIRMAN: So therefore governments would have to take these steps set out here?

PROFESSOR LANE: Yes, not because you are binding the government directly, it is rather because they are pre-requisites that have to be satisfied before you can have a Budget Bill that satisfies the Balanced Budgets Bill. Just as Mr Whitlam brought down a - purported to pass the PMA Act, Petroleum Minerals Authority Act, and Mr Whitlam in time had a joint sitting on that. The High Court threw that out. The High Court said that Section 57 of the Commonwealth Constitution laid down certain pre-requisites governing the Governor-General, or governing the Senate, that had to be followed. The point I am making is that it may be a legislative act but it may implicate other entities, other arms of government.

PADRAIC PEARSE McGUINNESS, Journalist, of [redacted],

affirmed and examined:

CHAIRMAN: Did you receive a summons issued under my hand to attend before this Committee today?

Mr McGUINNESS: Yes.

CHAIRMAN: Would you like to make an opening statement about this matter?

Mr McGUINNESS: Sure, I will be pretty brief. I should say that to the general principle of balanced budgets for State governments or State parliaments as distinct from Federal Parliament, I am very sympathetic. I really think there is absolutely no need for State governments ever to run a budget deficit or when there is no nett indebtedness, budget surpluses. They have their own taxing authorities. Whatever the problems of those are problems of the Federal Constitution and they are perfectly able to raise the revenues to finance any expenditures that they undertake for State purposes. If there is a problem of recession, if there is a problem of natural disaster, or economic fluctuations that requires any kind of deficit financing that is the function of the Federal government and if the State is in problems as a result of revenue fluctuations it is the duty of the Federal Government to compensate for that to the extent that it creates problems of unemployment or whatever. So that for example if the exceptional circumstances that Don Nicholls referred to, for example, if there was such a shortfall in revenue that the requirement was to sack State employees the appropriate thing for the Federal Government to do is to provide the finance to prevent that taking place if it feels that for economic reasons that is desirable.

In other words there is no case for State Keynesian financing, Keynesian deficit policies. Of course we have the disasters for example of Victoria under the Cain and Kirner government. What happens if States pretend that they are independent nations? I think it is important we have very few examples that most Australians are familiar with of Federal systems except that of the United States to compare ourselves with. There are balanced budget amendments in 48 of the 50 States I believe of the United States. They operate with varying degrees of efficacy and honesty. I think we ought to look at - if we were to consider the desirability of balanced budget amendments in New South Wales - at the immense amount fo work that has been done in Europe on what is essentially the preparation for a Federation like that of the Australian Federation, and that is the move towards a monetary union and eventually full economic union, between the members of what is already called the European Union, the former European Economic Community. Every economist has analysed this. As I said you cannot have a monetary union such as we have in Australia of course, the States are in a monetary union without any barriers to trade or to monetary and financial flows unless you have fiscal policies that are co-ordinated. And the reason why all the moves towards European monetary union co-ordination have so far failed is simply because fiscal policies have not been co-ordinated. This implies of course that you cannot have an economic union without a common fiscal policy operating from a common fiscal authority. In other words, even the pretence of State Government to operate independent fiscal policies is ill advised unworkable and probably illegal.

If I could refer to Professor Lane, one of the really interesting things that Professor Lane reminded us all of, was that of course anything in a State Constitution is justifiable that is, can be taken to the Supreme Court and then to the High Court and the High Court is the ultimate constitutional court in this country. So anything said in this if it is enacted by referendum can land a government and a parliament in the High Court. I think perhaps Professor Lane did not make clear the answer to the question that arose several times. What sanctions are there if in fact a government or a parliament breaches the provisions of a clause of this State Constitution? The simple answer is the court orders it - that is it declares the particular Bill invalid as passed, if that is not remedied then that government is liable to dismissal under the reserve powers of the Crown. In other words, the governor would then be virtually obliged to dismiss the government and call a general election.

CHAIRMAN: That would be on the basis of the court order?

Mr McGUINNESS: If the Supreme Court or the High Court ordered the State Government to remedy what it says was an illegal act and the government did not do that; then reserve powers of the Crown would come into play. Which I think is a pretty considerable ultimate sanction. Many aspects of this proposed referendum bill worried me. First of all most of it does not mean anything at all since all the vital provisions can be changed by a simple act of parliament. Just as we have already seen reference to Section 60(2) proposed measures are to provide for the elimination of that impact on State debt, etc., not exceeding the next three years or any other period provided by law. In other words, its totally meaningless, that there is no limit; effectively the parliament of the day could say we will implement this over the next 10, 15 or 20 years and could amend that the next year anyway. So effectively it could - what I am saying it is no restriction at all except in that it requires the formal passing of a law by the State Parliament. The importance of that is the same end could be achieved by a simple act of parliament now.

But the attempt to entrench this in the constitution, as I say, changes nothing since it can be revised practically every year anyway. It has one or other disturbing features. Again, what happens if the thing actually does get into the court; for a start you have made the Secretary to the Treasury a statutory officer effectively by the Bill because to entrench the title and the duty of the Treasurer in the State Constitution, makes the Treasurer in fact answerable not just to the government but to parliament. And that is going to change the function of the Treasurer and the significance of the Treasurer. Effectively you are putting him at least for one purpose pretty well on the status of the Auditor-General. Whether you want to do that or not is another question. I suspect the government has not thought about that.

The other thing of course, again referring to courts; as with any act of parliament there are a number of definitions but the essential items of the act are not defined. Professor Lane again referred to exceptional - what exceptional circumstances might be. First of all what is an economic recession, there is no such thing as a legal definition of an economic recession. In fact, there is not any good agreed economists' definition of an economic recession. Then what is the difference, again raised a couple of times, between any old economic recession and a major economic recession; how to cope with what are called growth recessions, that is, decline in the growth rate. Many economists would call that a recession but would a court call it that. We do not know.

So in that sense I am very worried about the idea of changing the constitution to introduce something which nobody can define to a system which operates on definitions which are very complex anyway; none of which are included in the Act. The matter has been raised of whether it applies to current consumption, spending, by the State government or current spending and current revenue; whether capital items would be included or excluded, how they should be dealt with, the accrual accounting effect of this, and so on. The simple answer to that is there is no logical way of defining what is the difference between a capital and a current transaction for a government. Even for an individual it is often very confusing. There is a lot of debate in economics about the very definition of income. What does it mean? And although it sounds a very simple complex, in fact you can write books about it and get more confused at the end.

Effectively here again Don Nicholls made a very valuable contribution by just emphasising the diversity of concepts and to use Professor Robinson's terms, the different ways of fiddling the concepts. Any government can fiddle anything that it wants to. You can call it fiddling if you want to just criticise it or you can call it - making fine legal distinctions - classificatory distinctions, reclassification, whatever. Effectively there is nothing in this Act as stated which makes it impossible to change the definitions. Unless it goes to court and then you find a court which will give you - again Don Nicholls emphasised - for the next hundred years or so a definition which you might not be able to live with. So you have to redefine your budget by referendum. So again really that comes back to the - I very strongly agree with the idea of a general approach of budget balance for the State, capital transactions are difficult to deal with by general rule and in some cases capital expenditure should be financed from current revenue, but clearly in some cases it does make sense to borrow. Once again the classic case of infrastructure.

The question of intergenerational equity has been brought up from time to time. This again is not directly related to the contents of the Bill. I think the biggest issue of intergenerational equity in the next few years is going to be the way in which we have already burdened future generations, our children and our children's children with a huge debt of superannuation, health bills, an aging population, falling working population relative to the dependents, which they are going to be paying for by increased taxes in any case. The case for borrowing on behalf of those future generations when you have effectively borrowed from them in the first place is going to be a very difficult political issue. In that sense I would be inclined to agree with the proposition that really capital and current expenditures ought to be locked together and no further debt incurred since there is a huge debt already to be dealt with in one form or another.

If that is what you want to do and I think it is very defensible position, it should be done by simple legislation. The very fact of having to change that legislation if you want to abandon it will attract sufficient public attention and sufficient debate in parliament to achieve just as much as entrenching it with the variation clauses already included in this Bill.

CHAIRMAN: What you are saying is that you believe that States should not get heavily into debt, there is no justification for that; that the aims of the Bill might be good but the way it is going about it you would question? There are other ways it could be achieved?

Mr McGUINNESS: Yes. I think the Bill is unnecessary and possibly harmful. The idea of entrenching it in the constitution, the State Constitution.

CHAIRMAN: But not the aims of the Bill?

Mr McGUINNESS: No, the aim of the Bill in terms of fiscal responsibility and general budget balances is extremely desirable and that is really the way that the New South Wales government under both political parties has been going for some time. Again Don Nicholls pointed out that much of this process started when Ken Booth was Treasurer and I think that the New South Wales Treasury clearly in that sense is a remarkable and useful organisation. Its performance is extremely good. That has helped keep the government honest as much as anything else because the answer to so called fiddling or deceit is simply publicity, transparency.

CHAIRMAN: Would you agree that it is a big advantage not having debt, that there is an advantage in that you do not have to pay interest on that money and that the money you would normally be using for interest you can use for other purposes. Do you see that as an advantage?

Mr McGUINNESS: I mean, that is always the case but obviously that does not apply to an individual when they want to buy a house on a mortgage. So there is always a case for some kind of borrowing. Again, the economists case is not at all clear. Certainly not as clear as Professor Robinson seemed to think. There is a - without going into the details - there is a concept known as Ricardian equivalence which means that you can never in fact borrow from the future. That is effectively defer the cost of borrowing since it always falls on the community in terms of demands on current resources, in terms of the effects on tax rates and interest rates. So the only people you can really borrow from effectively as a nation, is other nations. In that sense what the State governments were doing in the 1920s made some sensed that they were borrowing from Britain mainly and increasing the available resources available to States of Australia. But of course they borrowed too much and got into terrible trouble as we all know. Because it seemed so easy, it was conducive to irresponsibility; people did not know what was happening.

CHAIRMAN: Would you agree a good aim would be to increase national savings so that we have got a pool of funds here in Australia that we can use for special purposes?

Mr McGUINNESS: Yes, I absolutely agree with Vince Fitzgerald's analysis on that and it is going to be a very painful process to get our savings ratio up. That is the biggest problem facing us nationally. But it is a problem to which State governments can contribute only to the extent that they run surpluses or reduce debts.

CHAIRMAN: Would you like to make a comment on the New Zealand model where they have a stated aim but no compulsion to comply with it.

Mr McGUINNESS: It is a good model except first of all new Zealand is a national government. Should never be forgotten. There is occasionally a case for some counter cyclical financing, that is running deficits in time of recession; but that is the role of a national government, not the role of a state government. So New Zealand has a case for not having a balanced budget amendment. Secondly, to the extent I am not sure how fully the good intentions of the New Zealand government are embodied in the law. I think they are to some extent insofar as parliament would have to explicitly depart from those intentions and that is I think as far as you can go and should go. Ultimately it has to be the decision of parliament as the supreme authority.

CHAIRMAN: It was suggested that there could be an amendment made to the PS&A Act; would you feel though that having a referendum and having the community express a definite view on the matter, would that bring greater discipline into a government than simply having requirements in the PS&A Act?

Mr McGUINNESS: No. Forgive my using language like this but much as I favour the ultimate objective I think the referendum is political stunt.

Mr RUMBLE: To what extent would a government have financial discipline by virtue of the rating agencies operating and looking over their shoulder?

Mr McGUINNESS: Again, since the federal government effectively put the state government on their own again, that is the major form of external discipline and a very effective one. Because it gets so much publicity. If Standard and Poors turned around and reduced the triple A rating of New South Wales tomorrow, that would be extremely bad publicity for the government. It would also as well as impacting on the future servicing cost of the debt. So effectively we do have a very useful and disciplinary mechanism in the market.

Mr RUMBLE: Do you think it is more effective than this proposition?

Mr McGUINNESS: Yes, because as I say, anything of significance in this can be changed by an act of parliament anyway.

Mr IRWIN: Going back to what I see as fairly central to this and that was the proposal put forward by the treasury, that the legislation itself is not the solution but the means to the solution and the solution is to change the mind set of government, parliament and the community. Given that by most indications the sorts of definitions or ways in which a deficit would be defined, relatively simplistic, do you see any danger in the government, parliament and the community focusing on what is at the end of the day a relatively minor aspects of fiscal responsibility?

Mr McGUINNESS: I do not see any danger in focusing on it. I think it is very useful - this is a personal judgement - but I do not believe in legislation as a form of education, I think teaching is better. To simply sat that this will alter - any piece of legislation will alter say the mind set of the community is I think just rhetoric. The important thing is to convinced the community of the importance of the issues and this has been an achievement which is I think something that has come about in recent years in New South Wales as a result of the professionalism of the Treasury people, the fact that governments have realised how important the issues are, all governments have acted on them and increasingly the fact that the newspapers rather than television or radio which do not analyse the issues are taking an interest in the issues. So there has been a feedback process. So the mind set has been altered.

Mr IRWIN: Perhaps I should stress there that in terms of focusing on that whether it becomes too simplistic and whether many of the other areas of financial accountability such as the results from accrual accounting, many of the other measures, reforms in public sector management which would be concentrated on as well. Do you see this as being one of those things, like the balance of payment figure where everybody concentrates on one magic figure rather than looking at the big picture.

Mr McGUINNESS: You can say that the balance of payment figure is the big picture as far as the balance of payment is concerned. Of course it is necessary to analyse the details. No, given the centrality of fiscal deficits in the history of all governments in the post war world you cannot say that it is misleading to concentrate on the deficit figure. What a lot of effort has been devoted to is to getting an accurate deficit figure which is of economic significance. That is why the concept of the old consolidated fund stuff was quite misleading for many purposes. The importance of accrual accounting of course is that it is moving away from the Keynesian concept of the government's immediate drawing on the community's resources and its contributions to community resources by way of deficits and the overall macro economic effects on that and is looking rather more at the managerial competence of the government in looking after the assets and liabilities of the State or the Commonwealth. In the long run accrual accounting is a much more important concept but you still have to look after the pennies.

Mr IRWIN: Would that make treating the issue of the government's liabilities rather than its debt more important?

Mr McGUINNESS: Yes, but of course it runs up its liabilities by incurring debts.

Mr IRWIN: Is that in the relatively simple framework that you are looking at there in defining deficits or do you see that in a broader context?

Mr McGUINNESS: Again as Don Nicholls said there are lots of concepts of deficits. The accrual account concept of deficit is when you allow the assets of the State to be run down through inadequate depreciation so your nett position is worsening. The Keynesian concept is you really look at the resources of the community, current production, how much the government takes and how much it puts back. Whether the government actually puts anything back by running a deficit is itself a question for debate. There is the crude Keynesian concept of deficit as what you run when you have unemployment because it will increase output and employment. There is a lot of evidence that that does not work. The most prosperous period of Australia in the last 10 years was when the Federal Government was running surplus. The German government has argued that for years and Germany has always grown faster when the government has been in surplus. So that although the economists and the economists will tell you all about the deficit, many other economists will argue to the contrary.

Mr COCHRAN: At the risk of duplicating a question I suppose; do you think it is a public expectation of government to have a balanced budget?

Mr McGUINNESS: On the latest opinion poll, yes and I think it is a educated concept that people have been convinced that governments have been irresponsible in past years, not the New South Wales government in recent times, certainly the Victorian government, certainly Tasmania for years; so yes it is public expectation that governments should run balanced budgets.

Mr COCHRAN: You have head me ask the question of the previous witness; a balanced budget is an optimum expectation of governments, that should be the optimum aim?

Mr McGUINNESS: I think everybody in the community who thought about it and most people think more sensibly about these things than they are often given credit for; is that in normal circumstances the budget should be balanced, if something exceptional happens; exceptional circumstances; quite clearly you might have a problem which might take more than one year to solve.

CHAIRMAN: In light of what happened in some other States, South Australia and Victoria in particular; do you think that the concept of having some sort of restriction on governments and some sort of ability to make them at least consider balanced budgets or work towards balanced budgets; do you think that is a good concept, some sort of accountability?

Mr McGUINNESS: Yes I do think it is a good concept but I do not know how to make it work and I do not think anybody has ever really made it stick.

CHAIRMAN: But you would agree if a way could be found that it would be useful and to the community's advantage?

Mr McGUINNESS: If a way could be found, possibly yes but again we come back into this whole problem of definitions.

CHAIRMAN: Could I ask you this then; under our terms of reference we have to inquire about whether the Bill can achieve its desired objectives of requiring the government of the day to balance the state budget. Do you think this Bill could do that?

Mr McGUINNESS: No, because the Bill itself provides for let outs. The fundamental section of the Bill is really section 60(2), " any other period provided by law". In other words it says this is what we want to do but you are not going to be able to make us do it unless we want to do it that way. If in fact you threw that clause out you could create a straitjacket with quite unpredictable circumstances, quite unpredictable effects in the future.

CHAIRMAN: So what you are saying is if you went ahead without that clause, it would be counter productive. It could be counter productive?

Mr McGUINNESS: If we had a recession say of the scale that we had a couple of years ago, undoubtedly you would then have a political movement campaigning for a referendum to change the Act.

APPENDIX IV

NSW TREASURY BACKGROUND DOCUMENTS

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Mr Michael Lambert
Secretary
The Treasury
GPO Box 5285
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Dear Michael

18 November 1994

NSW Balanced Budget and Debt Control Proposal

Thank you very much for sending me a copy of the document outlining the Balanced Budget and Debt Control Proposal, including the text of the State Debt Control (Balanced Budgets) Bill 1994. You invited my comments on the proposal.

Over the past two decades, Australian governments collectively have allowed their underlying fiscal positions to deteriorate and have accumulated debt levels which are clearly excessive—in the sense that, to a large extent, the debt was incurred to finance recurrent spending rather than being the counterpart of acquiring of long-lived assets contributing to economic and fiscal capacity in a lasting way.

The consequences, made very clear in the recent downturn, have included:

- reduced flexibility to respond to changed economic circumstances;
- reduced ability to advance broader economic and social goals;
- a bias in government expenditures away from provision of economic and social infrastructure and towards spending on current consumption; and
- a persistent drain on the national savings pool, affecting both the availability and cost of finance for private sector business investment, and increasing our dependence on foreign savings; and hence reducing our ability to sustain strong economic growth over the medium and longer term.

It is also fundamentally unfair to borrow to meet the present generation's needs while leaving the cost, in the form of debt servicing obligations, to fall on future generations without any compensating benefit to them.

Against that background, it was a basic recommendation of my *National Saving* report last year that at each level of government, Budgets should be set so as to achieve, on a persistent basis, significant surpluses on recurrent transactions in the general government sector—corresponding broadly to the Budget sector. That would mean that at least a substantial part of government's investment in the Budget sector was financed internally by these recurrent surpluses (rather than being debt financed).

The NSW Balanced Budget and Debt Control Proposal goes somewhat further than this: it requires that, for the time being, *all* NSW Budget sector investment be financed internally in the above sense.

I myself would not prescribe that as a *permanent* rule, but I agree that it makes sense after a period in which debt levels became excessive and there was significant loss of Budget flexibility.

Moreover, experience elsewhere has demonstrated that where a government does accept the discipline necessary to restore a sound ongoing financial position and viable debt levels, it will also restore the ability to finance by borrowing, on favourable terms, some of the investment it undertakes—where the investment adds more to economic capacity in the community than its cost in debt service.

In this regard, I note that the Bill provides for a review in 2002, then every five years; and that there is provision for deficits in "exceptional circumstances", albeit with the impact of any deficit to be eliminated over 3 years, or some other period provided by law.

I note that while it is not yet general practice in Australia to present government Budgets on a full accrual accounting basis, NSW has a policy for funding fully the annual accruing cost of superannuation liabilities, and indeed for directing some funding towards reducing the past unfunded liability. This is the major item omitted from traditional cash Budgets, helping explain why around $100 billion of formerly "hidden" debt in the form of these liabilities was allowed to accumulate with (until recently) little accountability to the community.

The overall approach described in the document you sent also includes assurance that non Budget sector finances are being managed appropriately under the Capital Structure policy.

In short, together with those other policies, the Balanced Budget and Debt Control Proposal represents a comprehensive and transparent approach to fiscal consolidation.

With the one proviso that, in my view, such a proposal should allow, in the future, some Budget sector investment offering high returns to be part financed by borrowings, consistent with achieving and maintaining viable overall debt levels, I welcome the proposal as a constructive and comprehensive approach to a key issue for the community. It stands to make a valuable contribution to the restoration of Australian public finances and national saving.

Best wishes

Yours sincerely

Vince FitzGerald

Vince FitzGerald

State Debt Control (Balanced Budgets) Bill 1994

Legislation Summary

- **Objective**

To control Budget Sector net debt and require sensible fiscal discipline through the maintenance of a sustainable balanced Budget starting in 1997-98. The Budget must be in balance or surplus for the current year and the following two years from that time, subject to short term variation due to exceptional circumstances.

- **Next Step in Financial Reform**

Over the past six years, the Government has initiated a package of financial reforms which has focussed on responsible financial management, to control Government debt and provide important community services, and improving the Budget process and presentation. The proposed Balanced Budget Legislation will continue this process of reform by placing a discipline on the State Government to simply live within its means. This Bill will ensure that future Governments do not revert to the poor practices of the past.

- **Preserves Past Achievements**

The NSW Government has been steadily reforming the public sector since 1988. As a result of the Government's determination to improve efficiencies, contain debt and reduce the deficit, a sustainable balanced budget is achievable by 1997-98 for the first time in living memory. This legislation locks in the benefits of the Budget improvement, and initiates the mindset by the Government, Parliament and the community that debt control is an integral part of prudent fiscal policy.

- **Three Principles**

The legislation is based upon three principles which are consistent with the Government's financial reform agenda:

> **Accountability**: the Executive has responsibility for Government debt control and the strategies to achieve it, but Parliament is being asked to endorse the underlying strategies to maintain sustainable balanced Budgets.
>
> **Credibility**: the Budget must be presented using internationally accepted financial standards to create consistent and transparent reporting, and to prevent manipulation of the Budget result through presentation changes.
>
> **Flexibility**: Managing the economy is primarily the responsibility of the Commonwealth Government but States may need some flexibility over a business cycle to respond to fiscal shocks without resorting to excessive taxation or expenditure initiatives.

- **Coverage**

The requirement covers the Budget Sector, both recurrent and capital. It does not apply beyond the Budget Sector because the Government has in place policies covering Non Budget Sector Government Trading Enterprises and is committed to full-funding of non-debt liabilities, such as superannuation.

- **Exceptions to Balanced Budget Requirement**

In exceptional circumstances, a temporary deficit is permitted. In such cases, the Treasurer must outline strategies to Parliament and provide supporting projections to eliminate the impact of the deficit and achieve a sustainable balanced Budget within a three year period or such longer period as approved by Parliament.

- **Standards**

The Budget is to be presented on the basis of Government Finance Statistics (GFS) standards which are internationally accepted standards consistent with the presentation of public finance.

- **Certification**

The Treasurer is to provide Parliament with a certificate for each Budget that it complies with the requirements of the Act. The Secretary of Treasury must also certify that the projections in the Budget are reasonable in his or her professional opinion.

- **Half Yearly Budget Updates**

The Treasurer must provide Parliament with an update in February each year to include revised forecasts in the Budget for the remainder of the year and the following two years. This update report is also to be certified by and the Secretary of Treasury.

- **Review of Operation of Act**

The Treasurer will conduct a review of the Act every five years and obtain a report from a Parliamentary Committee for that purpose. The purpose of the review is to assess the level of Budget Sector net debt relative to a range of appropriate criteria.

- **Variation to Act**

Once the Act is approved at a referendum, it will not be able to be changed without the approval of electors at a further referendum.

State Debt Control (Balanced Budgets) Bill 1994

ANSWERS TO KEY QUESTIONS

What is Balanced Budget Legislation and what are its benefits?

Balanced Budget Legislation simply advocates debt control. It is a sensible discipline to avoid spiralling debt in the future by keeping total spending in line with total income, just like family budgeting. The State Government will be disciplined to live within its means.

By controlling debt, the Government reduces debt servicing costs as a proportion of Budget outlays. This reduces the burden passed on to future generations of taxpayers; allows for a greater proportion of Budget receipts to be allocated to core services such as hospitals, schools and roads; and provides Budget flexibility to withstand fiscal shocks such as natural disaster or a collapse in State revenue. Another benefit of the legislation is to assist the Commonwealth Government in improving the nation's economic performance by reducing the public sector's overall call on savings. This frees savings for productive investment and reduces reliance on overseas capital.

Will the legislation prevent the State from stimulating the economy in a recession (anti-cyclical fiscal policy)?

Fundamentally, it is the responsibility of the Commonwealth Government to manage the economy. State Governments have neither the fiscal capacity nor the assigned role for such macroeconomic policy. So it is entirely appropriate, and even responsible, for States to aim for balanced Budgets - it is one of the most effective contributions that State Governments can make to the national economy.

However, the legislation does allow the Government to have a Budget deficit in exceptional circumstances.

Won't balanced Budgets give the State Government an excuse to raise taxes or cut essential community services?

The Bill will provide a more flexible Budget to withstand fiscal shocks by reducing and controlling debt in a phased, sensible manner. Therefore, drastic corrective action such as tax increases or expenditure cuts should not be necessary. Budget projections indicate that a balanced Budget can be achieved by 1997-98 without recourse to tax increases or service cuts.

Debt service on loans currently costs NSW over $1.6 billion a year, the equivalent of:
- one-third of its annual hospitals and health budget, or
- the entire Social and Community services budget, or
- one-third of expenditure on schools and education, or
- the entire roads budget for a year.

By reducing interest payments, more income will be available for community services rather than repayments to lenders.

What can the Government do in exceptional circumstances such as a national disaster or a drastic decline in revenue?

The Bill allows the Government to propose a deficit Budget if there are exceptional circumstances. However, where a deficit is warranted, the Budget must be supported by strategies to bring it back into balance within three years or such longer period as approved by Parliament.

How does this legislation fit with the past six years of New South Wales' financial reform? Are we just starting a whole new strategy?

The proposed Balanced Budgets Legislation is the next step in the Coalition Government's financial reform of the past six years, which have focussed on improving efficiency, debt containment, provision of core services and improving the accountability and transparency of Budget process and presentation. Since 1988, the New South Wales Coalition Government has dramatically improved the State's financial situation and long-term outlook through a package of reforms including:
- introduction of 3 year forward estimates of both revenue and outlays
- adoption of international finance standards
- control of unfunded superannuation liabilities
- the establishment of a comprehensive financial framework via the Capital Infrastructure Policy for Government Trading Enterprises
- privatisation of non-core financial institutions, namely the GIO and State Bank

This Bill will build upon these reforms already in place, locking in the benefits of the Budget improvement and achieving sustainable balanced Budgets. We have come a long way from the old ways of Government that were still in practice as late as 1987. This Bill is to ensure that future Governments do not go back to the poor practices of the past.

Are there examples of other States who have successfully enacted such legislation?

New South Wales is the first State in Australia to propose balanced Budget legislation. However, similar legislation is in place in 48 out of 50 States in the United States. New Zealand has also introduced fiscal discipline legislation aimed at improving the standard of financial reporting. The proposed legislation draws upon the best features from each of these countries, and is founded on principles of accountability, credibility and adequate flexibility.

Is it true that similar legislation has not worked in the USA and hence, why should it work in Australia?

Balanced Budgets Legislation at the State level in the US tends, on average, to achieve better fiscal performance. The US Federal Government's balanced budget legislation, on the other hand, has not worked, but its failure reflects a number of problems which do not exist in the New South Wales proposal:

- lack of standards for Budget presentation
- lack of accountability between the Executive and Congress, and
- lack of integrity of the Budget forecasts.

Furthermore, it is Federal Government's responsibility to manage the economy with macroeconomic policy, while States can only assist in this role.

Can the Government avoid the intent of the legislation by fiddling the Budget result or by adopting of Budget measures?

The legislation contains safeguards to avoid fiddling the Budget presentation. As part of financial reform of the past six years, the Budget is required to be presented on a Government Finance Statistics (GFS) basis, with any changes in coverage quite transparent to Parliamentary scrutiny.

As for the possibility of taking activities off Budget, such as private sector provided infrastructure, the Coalition Government has already put in place a policy framework which requires a vigorous financial, economic and risk assessment. Where there is some requirement for a level of Government underpinning, this is reported in the Consolidated Financial Statements. If such transactions are self financing (for example toll roads) then there is no Budget impact.

Why does the legislation only cover the Budget Sector net debt?

The balanced Budget requirement has not been applied beyond the Budget Sector because the Coalition Government's reform policies of the past six years already address these areas.

Policies to control Non Budget Sector net debt ensure appropriate levels of debt for Government Trading Enterprises. In addition, the Government is committed to phasing in full funding for superannuation liabilities and eliminating the Government guaranteed liabilities of non core government financial institutions.

Will this legislation ensure a sound fiscal environment for New South Wales?

The legislation is not in itself a solution or a panacea for all fiscal ills, but rather a discipline. The solution is to change the mindset of Government, Parliament and the community to achieve a consensus on and commitment to prudent fiscal policy and structure, year in and year out. It will no longer be acceptable for governments to produce deficits year after year.

This initiative cannot be assessed separately from the Government's overall financial strategy. These complementary policies include the Capital Structure Policy, which ensures optimal debt to equity structures for each Government Trading Enterprise, the full funding of superannuation liabilities, and privatisation of non core Government financial institutions such as the GIO and State Bank.

What if the legislation is ineffective or needs to be changed?

A Parliamentary Committee and the Treasurer will review the Act every 5 years to assess the level of Budget Sector net debt and to determine the contribution that Balanced Budget Legislation is making. The Act could be changed if found to be necessary, but the changes would require approval at a referendum. This requirement will act as a safeguard against changes aimed at reducing the discipline imposed by the Bill.

BALANCED BUDGET AND

DEBT CONTROL PROPOSAL

NSW Treasury
November 1994

CONTENTS

1. INTRODUCTION

Budget reform over the last five years has focussed on:

- **improvement in the accountability and transparency of the Budget process and presentation.**

  Prior to the reforms, which are detailed in Appendix II, the Budget was based on a Consolidated Fund approach. This approach had a number of major deficiencies:

  - lack of any standards which meant it was not possible to draw conclusions either about the Budget position over time or between Governments;
  - no distinction between financing transactions and normal operating transactions and hence treated drawdown of cash balances and borrowings as revenue items;
  - varying coverage of agencies and transactions.

  Now, the Budget:

  - is presented within a medium term financial strategy and with the publication of forward estimates of both revenue and outlays over a three year period;
  - is presented according to internationally accepted public finance standards, called Government Finance Statistics (GFS); and
  - contains supplementary information on a GFS basis for categories of public sector agencies that enables comparison across Governments.

- **the process of fiscal consolidation**

  By containing the impact on the Budget of the severe economic recession and cuts in Commonwealth payments, New South Wales has been able to improve the trend in the Budget deficit.

  The Budget deficit was capped at $1,255 million in 1991-92 and brought back sharply to a projected deficit of $353 million in 1994-95 and $144 million by 1996-97. This has been achieved through restraint on outlays, with the actual severity of taxes declining over the period relative to other States.

Complementary to these Budget reforms, the Government has undertaken a series of other financial reforms directed at improving the fiscal and economic performance of the State. They include:

- **phasing in full funding of superannuation for both the Budget and Non Budget Sectors**

  Over time, this will eliminate the major non debt liability of the State - the under funding of superannuation liabilities;

- **establishing a comprehensive financial framework for Government Trading Enterprises**

  This includes rate of return requirements on assets and equity, shareholder monitoring arrangements, a tax equivalent regime, government guarantee fees, the Government Pricing Tribunal to avoid exploitation of monopoly pricing powers, a Social Program policy to separate social from commercial programs and the Capital Structure policy. The latter policy establishes optimal debt to equity structures for each Government Trading Enterprise. This guards against the possibility of either excess debt for Government Trading Enterprises and, hence, excess dividend payments to the Budget, or inadequate levels of debt and, hence, lack of commercial pressure on agencies to perform; and

- **the privatisation of non core financial institutions, namely the GIO and State Bank**

  This has the potential to eliminate over time well over $20 billion of contingent liabilities applicable to government guaranteed obligations.

The proposed legislation to control Budget Sector net debt by requiring the maintenance of balanced Budgets aims to build on the financial reforms already in place. It will lock in the benefits of the Budget improvement and build on the process of fiscal consolidation for the future. This will arise from the change of mindset expected because the legislation recognises that a desirable feature of a State Budget is to achieve a balance between revenue and expenditure in order to further control the level of debt.

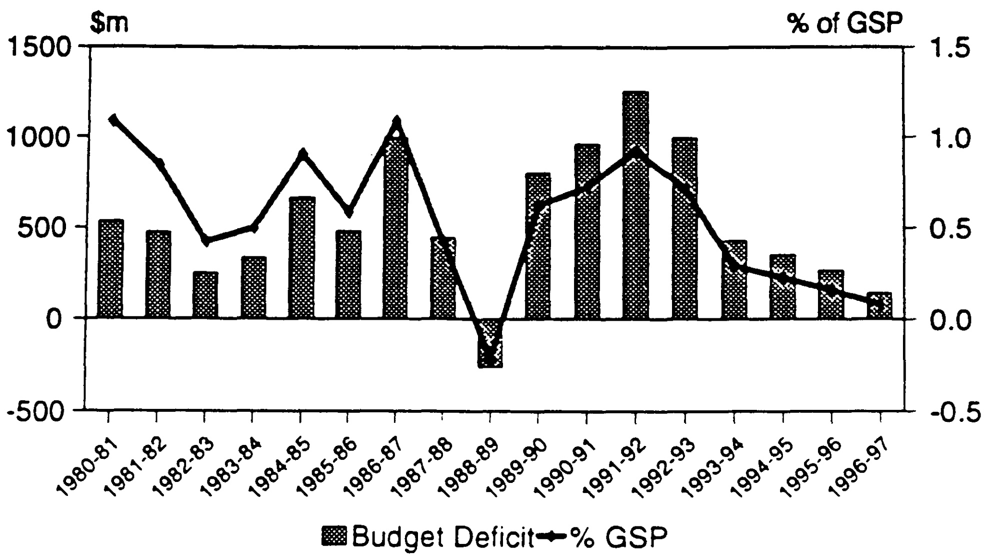
2. TRENDS IN BUDGET DEFICIT, DEBT AND LIABILITIES

LONGER TERM TRENDS

It is clearly useful to examine debt and Budget trends over a longer term perspective. However, there are significant data difficulties in achieving longer term consistent information given the major reforms and improvements that have occurred in recent years in the presentation of Budget information.

Due to these data difficulties, four aggregates have been focused on, the Budget result, Total State Gross Debt, Gross Budget Sector Debt and Total State Debt Servicing Costs.

Figure 1
Budget Deficit Result
$million and % of GSP



In recent history, the NSW Budget has been in deficit, with a surplus on current operations (ie current outlays less current receipts) more than offset by a deficit on capital operations (capital outlays less capital receipts). The deficit has generally fluctuated between 0.5 per cent and 1.0 per cent of Gross State Product. The only time the Budget achieved a surplus was in 1988-89, the last year of the previous property boom. Subsequently, the deficit rose sharply due to the impact of the severe economic recession, which adversely affected all revenue sources, the cuts in

Commonwealth general purpose payments to the States and the decline in the NSW share of general purpose payments through the process of fiscal equalisation.

The Budget deficit reached a peak of $1,255 million in 1991-92. Since that time, it has been wound back by a combination of tax increases, expenditure restraint and the impact of the improving economy on State revenue.

The Budget strategy in recent years has been to reduce the Budget deficit to a level at which it does not add further to the level of Budget Sector net debt in real terms. Based on Budget Sector net debt in real terms of broadly $15 billion and a medium term inflation rate of broadly 4 per cent per annum, this required the deficit to be reduced to not greater than $600 million. The target was to achieve this level by 1995-96. However, the improving economy and its flow through effect into State revenue reduced the deficit to $430 million in 1993-94, well below the Budget time projected deficit of $890 million.

The latest projections indicate an improvement of broadly $400 million per annum relative to projections in last year's Budget, with the deficit trending down to just $144 million by 1996-97.

Debt, in contrast to the deficit, is a stock concept that measures the total level of interest bearing financial obligations of the public sector. Net debt is gross debt less financial assets. Debt can be divided into Budget, Non Budget Sector and Government Financial Institutions debt [1].

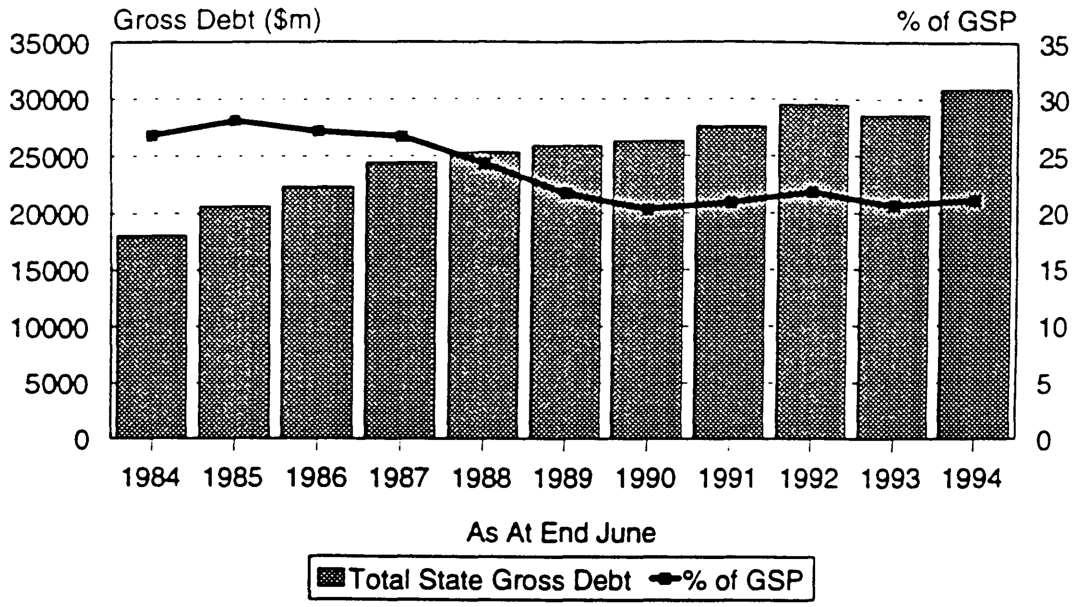
Total State Gross Debt increased steadily over the 1980s in real terms and was relatively steady as a proportion of Gross State Product (GSP) up to 1987-88 when it declined due to the impact of the property market boom. This continued into 1988-89 when the property market boom peaked. Thereafter, Total Gross State Debt has remained relatively steady as a proportion of GSP with increasing Budget Sector debt offsetting the decline in Non Budget Sector debt.

1 Another possible division is between General Government Sector, Public Trading Enterprises and Public Financial Institutions.

Figure 2

Total State Gross Debt

$million and % of GSP

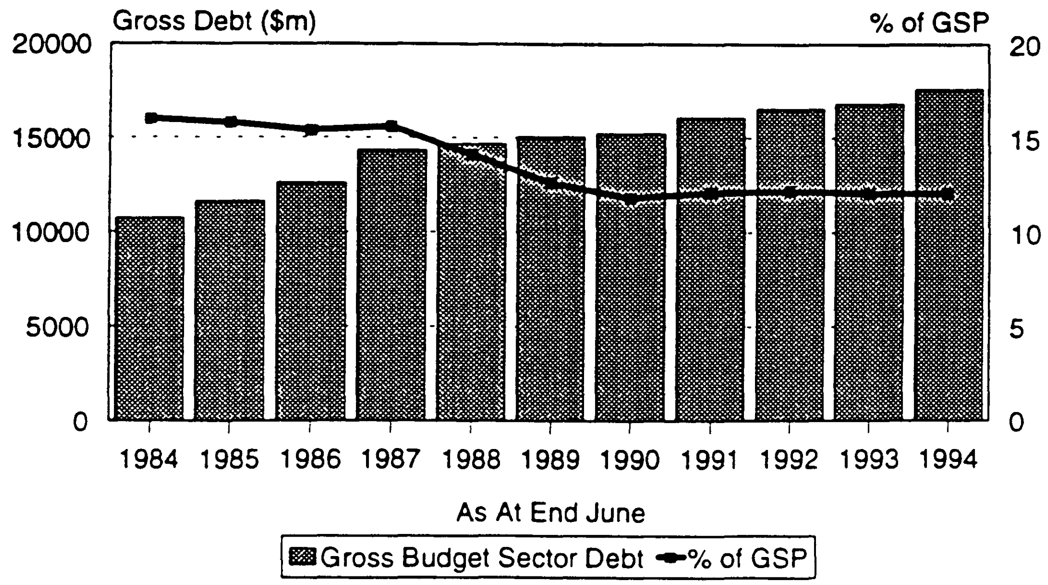


A similar trend is apparent with Gross Budget Sector Debt (see figure 3 below).

Figure 3

Gross Budget Sector Debt

$million and % of GSP

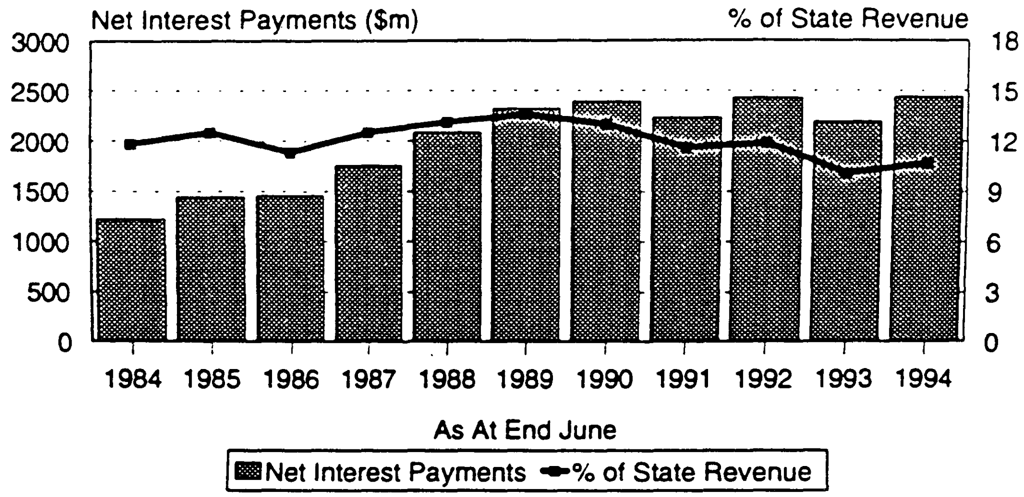


Debt impacts on State finances through debt servicing costs. This information is presented in figure 4 for the total State sector. There was rapid growth in debt servicing costs during the 1980s with the cost doubling between 1984 and 1989, increasing from $1.2 billion to $2.4 billion. Expressed as a proportion of Total State revenue, debt servicing cost rose from 11.8 per cent to 13.6 per cent. Since then, the cost has been capped and the ratio reduced to 10.7 per cent by June 1994.

Figure 4

Total State Debt Servicing Costs

$million and % of Total State Revenue



Notes: Debt servicing costs equal interest paid less interest received.
Total State revenue is net of interest received.

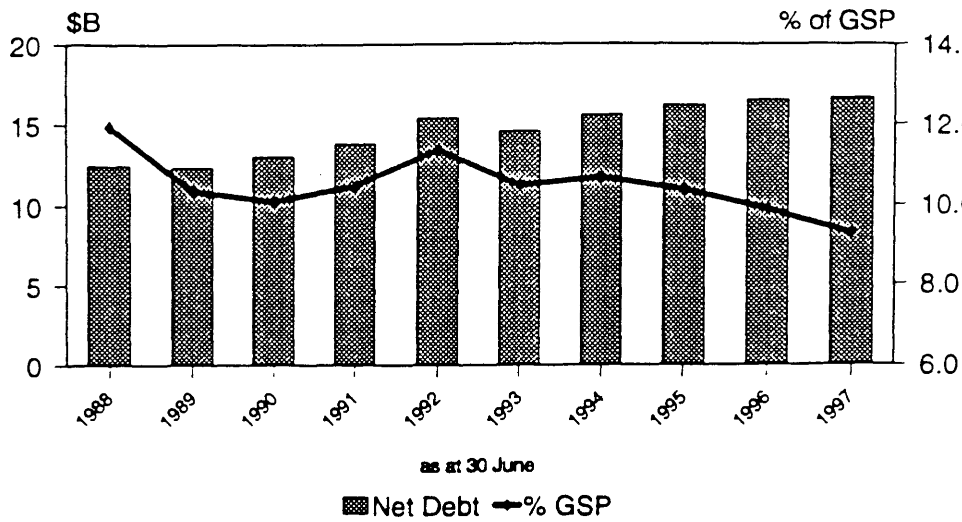
RECENT TRENDS IN DEBT, DEBT COSTS AND LIABILITIES

The trends in **Budget Sector net debt**, both in absolute terms and as a proportion of Gross State Product, is presented in Figure 5. Budget Sector net debt is gross debt less financial assets.

Figure 5

Budget Sector Net Debt

$Billion and % of GSP



Budget Sector net debt declined sharply from 12.0 per cent of Gross State Product to 10.4 per cent between June 1988 and June 1989. Since then, over the last five years, it has increased in absolute terms as well as relative to Gross State Product (GSP), reflecting the blow out in the Budget deficit. As at June 1994 Budget Sector net debt was $15.6 billion or 10.7 per cent of GSP. It is projected to gradually decline, as a percentage of GSP, in the out years to reach 9.3 per cent by June 1997. Broadly speaking, movements in Budget Sector net debt reflect movements in the Budget result. The other major factor impacting on Budget Sector net debt is variation in the valuation of the stock of debt.

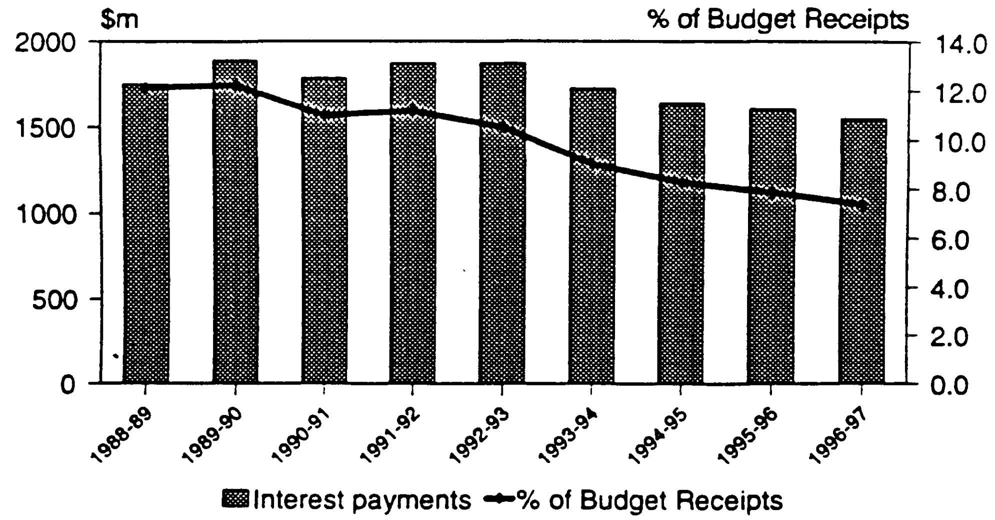
Both the level of Budget Sector net debt and movement in interest rates impact on **debt servicing costs**. The objective of active debt management is to minimise the impact of variation in market interest rates by adjusting the maturity structure of debt. For example, when there is an expectation that interest rates will increase, debt management strategy should lengthen the maturity structure of debt to lock in current interest rates. Similarly, when there is an expectation that interest rates will decline, debt management strategy should seek to shorten the maturity profile. Of course, given the level of outstanding debt and the uncertainty of interest rate movements, it is not possible to undertake a strategy that is 100 per cent based on a specific interest rate view. The trend in Budget Sector debt servicing costs is shown in Figure 6.

Debt servicing cost has declined over the period since it peaked at $1.9 billion in 1989-90 and is estimated at $1.6 billion for 1994-95. Expressed as a percentage of Budget receipts, debt servicing costs have declined from 12.1 per cent in 1988-89 to 8.3 per cent in 1994-95 and are projected to further decline to 7.4 per cent in 1996-97. The decline reflects, to a substantial degree, the impact of the decline in interest rates and the successful debt management policy pursued over that period. However, in view of the continuing high level of Budget Sector net debt, the Budget continues to be vulnerable to upward movements in interest rates.

Figure 6

Budget Sector Debt Servicing Costs

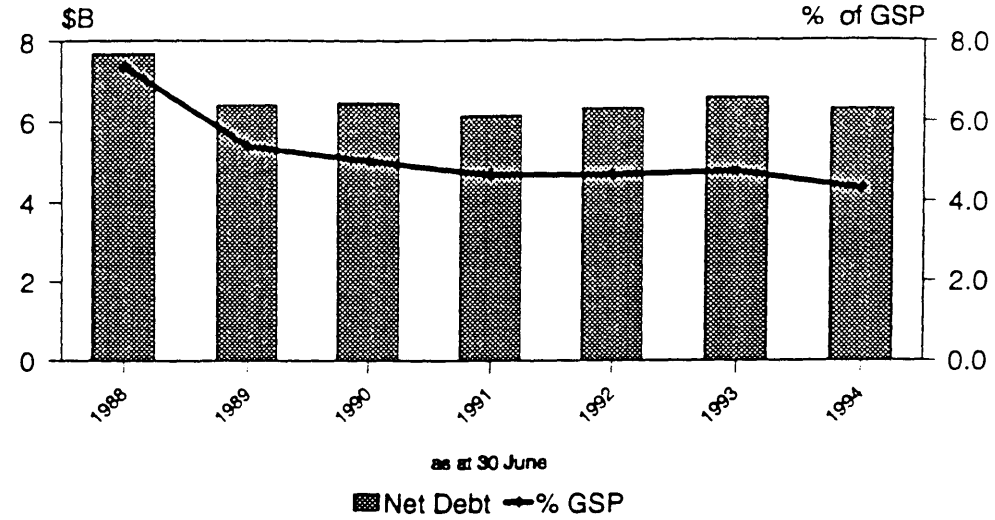
$million and % of Budget Receipts



In contrast to Budget Sector net debt, **Non Budget Sector net debt** has declined over the last five years in real terms and relative to Gross State Product. This decline reflects the impact of the Government's commercialisation policy which sought, as a first priority, to establish sustainable appropriate levels of debt for Government Trading Enterprises. More recently, the Capital Structure Policy has been endorsed which will establish optimal debt-equity ratios for each Government Trading Enterprise based on a range of criteria. Figure 7 shows the trend in Non Budget Sector net debt.

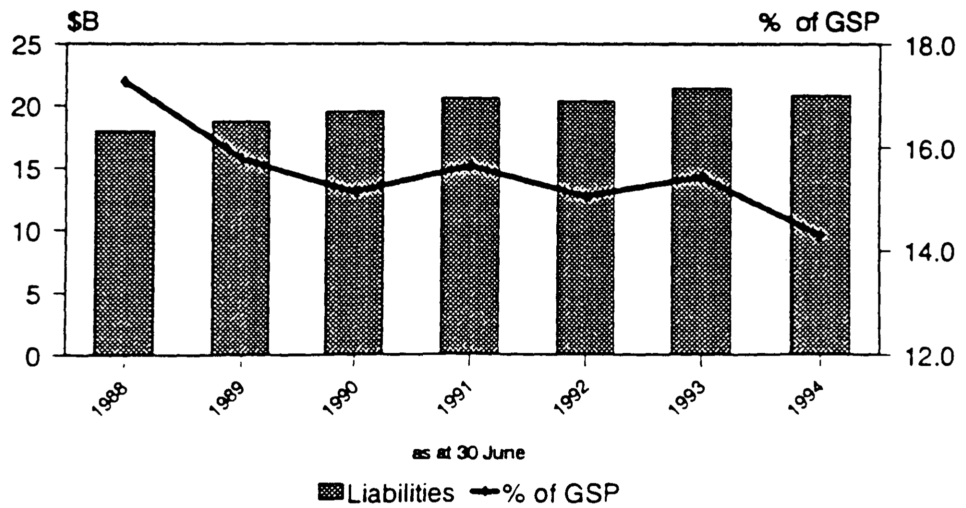
Non Budget Sector net debt has declined from $7.7 billion in June 1988 to $6.3 billion in June 1994 or, expressed as a percentage of GSP, it has declined from 7.4 per cent to 4.3 per cent of GSP. This decline reflects both the improved financial performance and hence financial structure of Government Trading Enteprises and in certain cases the transfer of excess debt to the Crown (notably the case of SRA).

Figure 7
Non Budget Sector Net Debt
$Billion and % of GSP



Finally, there are **non debt liabilities** which are dominated by unfunded superannuation liabilities. Over the last five years these liabilities have declined in real terms and relates to GSP, reflecting the reduction in staff numbers in the public sector, reform of various superannuation schemes and more recently the Government's policy of phasing in full funding of superannuation. The trend in non debt liabilities is shown in Figure 8. Non debt liabilities have declined from 17.3 per cent of GSP in June 1988 to 14.3 per cent in June 1994.

Figure 8
Non Debt Liabilities
$Billion and % of GSP



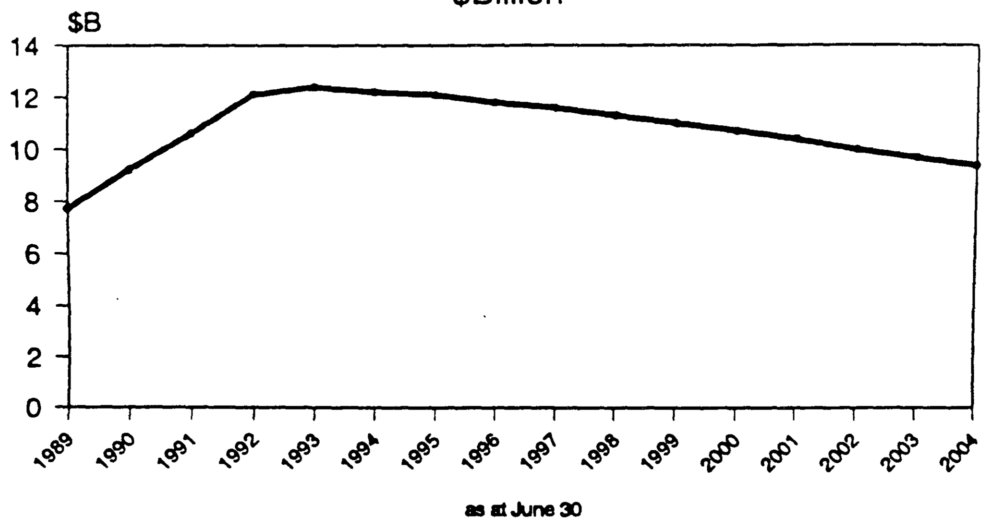
The falling trend will continue as full funding is applied to meet the annual accruing cost of superannuation liabilities and as additional funding is provided both in the Budget and by Non Budget Sector agencies to address the past unfunded liability.

Figure 9 shows the trend in Budget Sector net unfunded superannuation liabilities for the period 1988-89 to 1993-94 and the projected movement to 2003-2004.

Figure 9

Budget Sector Unfunded Superannuation Liabilities

$Billion



Current estimates indicate that by June 2004 unfunded liabilities for the Budget Sector will be about $9.4 billion, expressed in 1993-94 dollars, representing a real decline of $2.8 billion from the level as at June 1994. This estimated fall reflects the phasing in of full funding of employee superannuation entitlements.

In summary, control is being established over both net debt and non debt liabilities. In addition, actions to date and underway are aimed at reducing and, over time, eliminating government guarantees of Government financial institution liabilities. A key remaining challenge is to lock in the gains to date and maintain the improving trend for Budget Sector net debt.

3. WHY HAVE DEBT CONTROL?

Control of Budget Sector net debt is crucial because it:

- **controls and over time, reduces the relative level of debt servicing costs.** This in turn increases Budget flexibility to withstand fiscal shocks and reduces the burden passed on to future generations of taxpayers.

  A fundamental issue is what is the appropriate level of debt for the Budget Sector. This issue has exercised the attention of a wide range of public finance practitioners and theorists, including the International Monetary Fund and New Zealand Treasury.

  There are two broad ways of tackling this issue. The first is a public finance approach based on intergenerational equity. It involves matching the time profile of the services provided by the capital stock with the debt servicing cost. Questions arise as to how to quantify the level and time profile of the services provided by social capital. To date any tangible results from this approach have been elusive.

  The second is a corporate finance approach and seeks to define the optimal debt-equity ratio for the Budget Sector. This is done by seeking to achieve a sustainable, robust financial structure. It relates the optimal debt-equity ratio to the level of volatility of revenue, the degree to which revenue can be matched to expenditure and the extent of flexibility in the level and pattern of expenditure.

  In view of the high volatility of State revenues, the relatively low level of user charges and the relative inflexibility of expenditure, the optimal level of debt for the Budget Sector is quite low. In the light of the experiences of the last business cycle, when the Budget was placed under extreme pressure, it is clear that the current level of debt is excessive and should be substantially reduced. Research will be undertaken to further clarify what is the optimal level or range of debt for the Budget Sector;

- **assists in improving economic performance.** The Fitzgerald report on national savings concluded that the national level of savings and, hence, investment was too low. This has resulted in an excessive reliance on overseas savings through the balance of payments deficit. A vital strategy to address this deficiency is a reduction in the public sector's call on savings by cutting the public sector borrowing requirement. While prime responsibility for this strategy rests with the Commonwealth Government, the States can play a useful role.

In addition, a more stable fiscal environment assists financial markets and reduces the pressure on interest rates which in turn assists capital investment; and

- **enhances the State's credit standing.** The State currently has a AAA credit rating which enables the State to borrow on the finest possible terms. A downgrading of the credit rating would increase the cost of the State's debt servicing costs. More importantly, a downgrade would adversely impact on business and consumer confidence and hence on economic activity.

4. PRINCIPLES OF DEBT CONTROL

In order to ensure adherence to the concept of debt control, the NSW Government has decided to develop legislation which seeks to control Budget Sector net debt by requiring the maintenance of a balanced Budget. The legislation is based on a number of principles which are consistent with the Government's financial reform agenda. Account has also been taken of the difficulties experienced in other jurisdictions with a legislated approach to balanced budgets and debt control.

The key principles follow.

- **Accountability**

In order to achieve proper control of debt it is essential that there is a clear assignment of accountability. In the US Federal sphere responsibility for debt control has been divided between the Executive and Congress and as a consequence no single party can be said to be accountable.

The proposed legislation identifies the responsibility for debt control and the strategies to achieve it with the Executive, but commits Parliament to endorsing the underlying strategy of maintaining sustainable balanced budgets.

- **Credibility**

Commitment to debt control through balancing the budget can only be achieved if it is a credible target.

The US Federal Government's balanced Budget legislation established fiscal targets which were quite unrealistic and, hence, achieved no commitment. In contrast, the State Budget deficit has been brought under control and a balanced Budget by 1997-98 is achievable without the need for drastic corrective actions.

A related aspect of credibility is the need to present the Budget on the basis of consistent, appropriate standards. Without such standards it is possible to manipulate the Budget result by changing presentation and coverage.

- **Flexibility**

While States do not have a macroeconomic stabilisation role, there is a need to have some degree of flexibility over a business cycle and to absorb possible fiscal shocks without excessive adjustment through expenditure and taxation initiatives.

At the same time, there need to be certain constraints imposed to avoid sustained deviation from the principles of fiscal balance.

Furthermore, Governments have to take responsibility for the means by which Budget balance and hence debt control is achieved. It is not considered appropriate to build into the legislation automatic adjustment mechanisms on either the revenue or expenditure side to achieve balance.

The proposed legislation is based on these principles of clear accountability, credibility and reasonable fiscal flexibility.

5. OUTLINE OF PROPOSED LEGISLATION

Legislation has been developed to address the issue of controlling Budget Sector net debt by requiring the maintenance of sustainable balanced Budgets. The legislation is based on the three principles set out in the previous section. While the legislation requires each Budget presented to Parliament from 1997-98 onwards to be balanced or in surplus, it does incorporate flexibility to allow for exceptions. The crucial point to note is that the key purpose of the legislation is to alter the mindset of Governments, the Parliament, the public sector and the community about Budgets and to establish as the norm the benchmark of a balanced Budget. While deviations are allowed for, such deviations need to be explained and justified.

The key features of the proposed legislation are as follows:

- **Objective**

The objective is to control Budget Sector net debt through the maintenance of a sustainable balanced Budget.

- **Coverage**

The focus of the legislation is on the Budget Sector, with the balanced Budget requirement covering the full Budget Sector and all transactions of Budget Sector agencies, both recurrent and capital.

The principle of a balanced Budget has not been applied beyond the Budget Sector for a number of reasons:

- Non Budget Sector net debt is under control and there is an established Government policy, the Capital Structure policy, which is in the process of implementation for achieving an optimal capital structure for each Government Trading Enterprise;

- government guaranteed obligations of Government Financial Institutions is being addressed through the sale first of GIO and the current sale of the State Bank which in aggregate will, over time, remove well over $20 billion of government guaranteed obligations; and

- non debt liabilities are similarly being addressed , through the Government's commitment to full funding of superannuation.

- **Exceptions to Balanced Budget Requirement**

All Budgets from 1997-98 onwards presented to Parliament for approval are to be balanced or in surplus except where, in the view of the Treasurer, there are exceptional circumstance which justify a deficit. Where such circumstances exist, the Treasurer is to outline strategies and provide supporting projections to demonstrate the achievement of a sustained balanced Budget as well as eliminating the impact of any deficit within a three year period or such longer period set by an Act of Parliament.

Where a projected balanced Budget actually results in a deficit due to variations from assumptions employed, the Treasurer is similarly to outline strategies and provide supporting projections to achieve a balanced Budget and eliminate the impact of the deficit.

- **Standards**

The Budget is to be presented on the basis of GFS standards which are internationally accepted standards for the presentation of public finance.

- **Certification**

The introduction of a Budget Bill into Parliament is to be accompanied by a certificate by the Treasurer to the effect that the Budget complies with the requirements of the Act.

The Secretary of Treasury must also certify that the projections in the Budget are reasonable in his or her professional judgement.

- **Half Yearly Budget Updates**

The Treasurer is to provide a half yearly Budget update to Parliament each financial year by February. The update is to provide revised economic and fiscal forecasts for the Budget year and the two forward years. These reports to Parliament are to be certified by both the Treasurer and the Secretary of Treasury.

- **Review of Operation of Act**

The Treasurer will conduct a review of the operation of the Act every five years and obtain a report from a Parliamentary Committee for that purpose. The purpose of the review is to assess the level of Budget Sector net debt relative to a range of appropriate criteria.

Studies of the USA State requirements have concluded that the most important factor contributing to balanced Budgets is not an enforcement mechanism or a provision specifying how a shortfall will be made up. Rather, the tradition of balancing Budgets, the "mindset" this tradition creates, and the importance placed on balanced Budgets, both perceived and real, results in States complying with their requirements.

The model adopted in the proposed legislation, while placing a balanced budget discipline on future governments, allows flexibility to deal with exceptional circumstances (e.g. an emergency, a disaster or an economic recession). It also allows discretion in developing Budget policy to offset any resulting deficit.

At the USA Federal level, there has not been the same history of fiscal discipline legislation. The Balanced Budget and Emerging Deficit Control Act of 1985 (called the Gramm-Rudman-Hollings Act, after its sponsors) has not proved effective. Contributing to this lack of success have been the large size of the deficit and the imposition by the Legislature of a restraint on the Government's ability to cut a wide range of sensitive programs. It is also questionable whether balanced budget requirements are appropriate for a national government which has macroeconomic responsibilities.

The main features taken from the New Zealand legislation are the requirements for:

- a Statement of Responsibility to be presented with Budget Bills and Budget updates. The Statement is to be executed by the Secretary of Treasury who will certify that the Budget estimates are reasonable in his or her professional judgement while the Treasurer will certify that the Bills comply with the requirements of the Act;

- a half-yearly Budget update is to be tabled in the Legislative Assembly in February of each financial year. The Budget update will provide an update of economic forecasts adopted in the preceding Budget and an update of forecasts of Budget receipts and outlays, in the light of actual results in the first 6 months of the financial year, fiscal decisions made by the Government since the beginning of the financial year and any other relevant developments; and

- a prime focus on debt control, on reducing the level of debt to sustainable levels by not running consistent Budget deficits.

The legislative requirement for a balanced Budget to reduce debt has been modelled on legislative requirements existing in 48 of the 50 states in the USA. Of these, 44 require the Government to submit a balanced Budget and 37 out of these States also require the legislature to run a balanced Budget. Additionally 35 States are prohibited from carrying a deficit into the next budgetary period. While the US States operate a range of funds, the balanced Budget requirement tends to cover most of the Budget. For 36 of the States, the balanced Budget requirement covers between 75% and 100% of the Budget. While nearly all States have balanced Budget requirements, their end of year Budget result can be a deficit. However, 39 of the States have had balanced Budgets or surplus Budgets at the end of each Budget period since 1990.

The requirements and coverage of the USA State legislation are diverse and can be technically complex. All States apart from Vermont and Wyoming have balanced Budget requirements. Other discipline devices include:

- enforcement provisions;

- provision for spending cuts and tax increases;

- powers for the Governor to reduce the Budget without legislature's approval; and

- veto powers by the Governor on line item appropriations.

6. LESSONS FROM OVERSEAS

The proposed legislation draws upon the best features of:

- the New Zealand Fiscal Responsibility Act which adopts a "Truth in Budgeting" approach, without legislatively imposed fiscal restraint; and
- the United States approach of legislatively imposed fiscal constraints but with little or no delineation of the fiscal rules of presentation.

The Fiscal Responsibility Act was passed by the New Zealand Parliament in June 1994 and sets out a framework for medium term fiscal policy objectives.

The Act has four main purposes:

- a requirement for regular and explicit fiscal reporting;
- a set of benchmarks against which fiscal policies can be assessed;
- a more open, transparent budgetary process; and
- a requirement for Parliamentary review of fiscal reports.

The Act was a reaction to the history of large New Zealand Budget deficits and to criticisms about the inadequacy of fiscal reporting.

While the Act does not have a legislated balanced Budget requirement, it does set out five principles of responsible financial management, these being:

- reducing total Crown debt to prudent levels by achieving operating surpluses every year until a prudent level of debt has been attained;
- maintaining total Crown debt at a prudent level thereafter by ensuring that on average operating expenses of the Crown do not exceed operating revenue;
- achieving and maintaining levels of Crown net worth (assets less liabilities) that provide a buffer against adverse future events;
- prudent management of the fiscal risks facing the Crown; and
- the pursuit of policies consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

- **Variation to Act**

Once the Act is approved at a referendum, it will not be able to be changed without the approval of electors at a further referenda.

The actual Bill is provided at Appendix I.

7. SOME QUESTIONS AND ANSWERS

Since the Government announced its in-principle commitment to legislating to achieve debt control through sustained balanced budgets, a range of concerns have been expressed.

These concerns were expressed before the proposed legislation was completed. It is useful to assess these concerns in the context of the proposed legislation.

Question:

Will not the legislation constrain the Government from undertaking anti-cyclical fiscal policy, that is, increasing expenditure and/or reducing taxes in economic downturns and reducing expenditure and/or increasing taxes in economic upturns ?

Answer:

Fundamentally, macroeconomic policy is the responsibility of the Commonwealth, with the States having neither the fiscal capacity nor the assigned role for undertaking this responsibility.

Moreover, there are severe doubts about the effectiveness of actual counter cyclical policy with increasing emphasis now placed on Governments establishing a stable medium term fiscal framework and a commitment to price stability.

However, to the degree that the economic cycle impacts significantly on the Budget or, in the view of the Government of the day, justifies a counter cyclical policy response, the provisions of the Bill provide adequate flexibility.

Question:

Does not a commitment to control debt and to maintain a sustained balanced Budget ignore the issue of intergenerational equity whereby borrowings are undertaken to finance capital expenditure whose services are enjoyed by future generations ?

Answer:

It is accepted that intergenerational equity considerations justify some level of Budget Sector debt to reflect the time profile of services generated by the capital stock.

However, that consideration needs to be balanced by the need to maintain a prudent, robust financial structure which can withstand fiscal shocks.

It is clear from the experience of the last economic cycle that the level of debt is excessive. In order to achieve a more prudent fiscal structure, the structure of the Budget needs to be altered by increasing expenditure flexibility or reducing revenue volatility or, alternatively or complementary, the level of debt needs to be reduced.

Question:

Does not the legislation reduce the flexibility of Government to respond to exceptional circumstances such as a national disaster or a drastic decline in revenue ?

Answer:

The legislation allows the Government to propose a deficit Budget if there are exceptional circumstances which justify such an approach. However, adequate discipline is provided in the legislation to ensure corrective measures are undertaken by the requirement that the Budget must be brought back into balance and the impact of the deficit eliminated within a three year period or such longer period as approved by an Act of Parliament.

In effect, the legislation is stating that the benchmark or target is a balanced Budget and justification has to be provided for a variation from that.

Question:

Will not balanced Budgets mean cuts in services or increased taxes ?

Answer:

The legislation is directed at reducing the level of debt in a phased, sensible manner and to reducing the level of debt servicing cost of the Budget.

This in turn increases the flexibility of the Budget to withstand fiscal shock without the need for drastic corrective action such as expenditure cuts or tax increases.

Budget projections indicate that a balanced Budget can be achieved by 1997-98 without significant corrective actions. Thereafter, it is a matter of sustaining that position and, over time, achieving a decline in debt servicing costs. Debt servicing costs in the 1994-95 Budget total $1,641 million.

Question:

> *Why does the legislation not address total debt or total liabilities rather than simply Budget Sector net debt ?*

Answer:

The legislation has to be assessed in the context of the Government's overall financial strategy and policy. The Government has in place policies to achieve an appropriate level of debt for each Government Trading Enterprise; to phase in full funding for superannuation liabilities; and to eliminate the government guaranteed liabilities of non core government financial institutions.

The proposals in the legislation are complementary to these other policies and in total represent a comprehensive financial strategy to reduce financial liabilities.

Question:

> *Is it not true that similar legislation has not worked in the USA and hence why should it work in Australia ?*

Answer:

While balanced budget legislation has not worked for the US Federal Government, such legislation is in place in 48 out of 50 US States. Furthermore, the US Advisory Commission on Intergovernmental Relations has found evidence that at the State level such legislation does work. States with more restrictive fiscal discipline legislation tend, on average, to achieve better fiscal performance.

In addition the failure of the US Federal Government balanced budget legislation is instructive. That failure reflected a number of problems:

- lack of standards for Budget presentation;
- lack of clear accountability between Executive and Congress; and
- lack of integrity of the Budget forecasts.

None of these problems exist in the New South Wales proposal.

Question:

Can the Government avoid the intent of the legislation by fiddling the Budget result or by adopting off Budget measures ?

Answer:

The legislation itself is not the solution but the means to a solution. The solution is to change the mindset of Government, Parliament and the community to achieve a consensus on the desirability of achieving and maintaining a sustainable, prudent fiscal structure.

However, the legislation does incorporate safeguards to avoid fiddling the Budget presentation. The Budget is required to be presented in accord with GFS standards and a definition of the Budget Sector is provided, with any changes in coverage of agencies quite transparent to Parliamentary scrutiny.

In regard to the issue of taking activities off Budget, such as through private sector infrastructure, it needs to be noted that there is an established policy framework for such initiatives which requires a vigorous financial, economic and risk assessment. Where there is some requirement for a level of Government underpinning, this is reported in the Consolidated Financial Statements. If such transactions are self financing (for example toll roads and commercial contracts with Government Trading Enterprises) then there is no Budget impact. Where there is a need for Budget support, this by definition is reflected in the Budget result.

8. CONCLUSIONS

The State Debt Control Bill cannot be viewed as a panacea for all fiscal ills. Rather, it is an initiative directed at changing the mindset of Government, Parliament and the community and achieving a broad consensus on and commitment to prudent fiscal policy and structure.

The initiative cannot be assessed in isolation from the range of complementary policies that form the Government's overall financial strategy. These policies include the Capital Structure Policy which implements optimal debt levels for Government Trading Enterprises, the phasing in of full funding for superannuation and the privatisation of Government financial institutions such as the GIO and the State Bank.

The proposed legislation is founded on principles of clear accountability, credibility and adequate flexibility. The legislation is based on what are assessed to be the best features of both US State legislation and the New Zealand Fiscal Responsibility Act.

THE BUDGET

AND

HOW IT WORKS

NSW TREASURY

INDEX

1. TREASURER'S FOREWORD

The annual State Budget is the core strategy for striking the right balance between the needs of the community and the Government's ability to provide for those needs.

Our task, while certainly more complex than the budgeting that virtually every family must do in order to live within its means, is still in many ways the same. The State is also limited to the income earned and its ability to borrow to pay for the things the community needs and wants.

Like everyone else, the State must seek value for money in its expenditure.

One thing is certain: in State budgeting, the demands of the community will always exceed the State's ability to pay.

This means a continual process of establishing priorities and making choices across all areas of government services which affect the lives of everyone in the community.

Too often the Budget process is misunderstood; the commonsense reasoning behind funding decisions is lost in the labyrinth of analyses, political commentary and vested interest group arguments about preferred alternatives.

Adding to this haze is the complexity and jargon of bureaucratese, and financial and economic language.

Because taxpayers are becoming increasingly interested in Government finances, we have prepared this manual in an effort to improve understanding in the community of the Budget process, its language and – most importantly – the constraints on government to meet all the needs and wants of the community.

Hopefully this guide will help people to better understand the financial limitations and the complex process which government faces in determining priorities for income and expenditure each year.

It is our sincere hope that an improved understanding will lead to a better quality of discussion in the community about the Budget and State finances.

I trust you will find this manual a useful plain-English reference guide.

Please feel free to use the forms of words we have provided here in any descriptions you make of the Budget.

Peter Collins, QC MP
Treasurer of NSW

2. A PLAIN ENGLISH GUIDE TO BUDGET SPEAK

THE NEED FOR PLAIN ENGLISH EXPLANATIONS

The New South Wales Treasury and budget system dates back to 1824 with the appointment of the first Treasurer who was responsible for the Colonial Fund.

It is probably not surprising to anyone that, with 170 years of evolution, our Budget and Treasury language has become littered with a vast number of jargonistic and interchangeable terms and acronyms.

This brief plain English guide attempts to clarify the key terms you will find in today's Budget papers. A further, more detailed glossary is also provided at chapter 10. It defines financial and economic terms which defy plain English explanation!

In understanding the Budget and terminology used, it is helpful to remember these basic points:

- The State Budget mostly deals with the comings and goings of money in the 'Consolidated Fund', the Government's central bank account – this is where State taxes, Commonwealth grants, fines, licence fees and the like end up. It deals with the way in which we spend that money on behalf of the community, and what they get for it.

- The Budget doesn't deal with what is happening in the businesses it owns like Pacific Power, the Water Board or the TAB. That is because they get to keep most of their earnings. But, dividends from these businesses go into the Consolidated Fund to help pay for such services as Health, Education and Police.

- Because Government businesses borrow money to finance expansion, replace old assets, and put in new technology, as part of the Budget we include an estimate of the total State borrowings for the coming year – our charge card account if you like.

- The Budget also deals with the Deficit – the amount we spend which exceeds the amount we received. It also deals with the net public financing requirement – the amount we need to borrow to finance the Deficit.

The key Budget terms are as follows:

1a) **Budget Sector:** This covers all Government departments and activities funded from the Budget and excludes self-funding enterprises and authorities such as the State Bank, TAB, Commercial Services Group, etc.

1b) **Non Budget Sector:** As you would expect from 1a above, the Non Budget Sector is made up of the self-funding organisations of Government. Further examples include Pacific Power and the Water Board.

2) **Consolidated Fund:** The Government's main "bank account." All State taxes, levies, fines, penalties and dividends from Government Enterprises are deposited or paid in to the Consolidated Fund; also most Budget Sector outlays are paid out of this fund.

3) **Capital Program, Capital Revenue:** Capital payments are the amount of money spent each year on one-off permanent facilities like school buildings, hospital buildings and major equipment, roads, computer equipment, etc.

Capital revenue comes from two sources. One is the Commonwealth Government in the form of special purpose grants for specific projects. The other source is the proceeds from the sale of State-owned assets such as buildings and land.

4) **Current Revenue and Payments:** These are the ongoing income and expenditure of the State. Current payments are for the regular costs of running the State, such as wages and salaries of nurses, doctors, teachers, policemen and other public servants; general stores; rent; electricity bills; tourism promotion; welfare programs; corrective services; the arts, sports and recreation.

5a) **Deficit:** Generally, when the Government spends more in a year than it receives from all sources, the gap between the amount spent and the amount received is called the deficit. It's what is left on the States "bankcard" statement after we've made all the payments we can afford each year.

5b) **Total State Debt:** This is the combination of the balance owing on our "bankcard" along with all other borrowings the State has taken on over the years.

6) **Enhancement:** A decision to increase the level or number of services provided by a department beyond the maintenance level.

7) **FAGs**: Not cigarettes! Financial Assistance Grants (or payments) are the State's share of the Commonwealth tax pie.

FAGs are paid into the State's Consolidated Fund and are used to help pay for the general running costs of the State each year.

8) **Fiscal Equalisation:** This is the process that the Commonwealth uses to determine the proportion of FAGs paid to each State. It is a complex formula that gives greater per head of population assistance to the smaller, less populated States (see figure 2 in chapter 4).

9) **Global Budgeting:** This system was introduced to NSW in 1989. It simply means that once the overall Budget is set, departments have the freedom to manage their spending flexibly provided they live within the funds provided as well as the overall Budget. It allows for far more sensible management flexibility than previous, more rigid systems which encouraged end-of-year spend-ups and the like in order to secure the same order of funds in the next Budget.

10) **GSP:** Gross State Product is the estimated total value of all the goods and services produced within New South Wales in a twelve month period. Percentage growth in GSP is a good measure of the strength of the State's economy from year to year.

11) **Maintenance:** What it costs to continue to provide the same level and quality of services and products.

12) **NPSFR:** (Net Public Sector Funding Requirement): The NPSFR is the gap between public sector outlays and government revenue in a given year, that has to be financed by either borrowing or drawing on the cash savings of Government authorities and businesses. Ultimately, the NPSFR is a measure of the extent to which the public sector calls on the savings of the private sector, including individuals. Therefore, NPSFR must be considered against GSP. NPSFR as a percentage of GSP indicates the Government's "cash flow" deficit, i.e., whether the deficit is widening or shrinking over time. Like everyone else, government can't indulge in unrestricted borrowings.

13) **Productive Efficiency:** Achieving maximum output for a given level of inputs.

14) **Productivity Saving Requirements:** The reduction in funding each year for Budget Sector agencies to reflect cost containment, efficiency improvement and rationalisation. Normally set at 1.5 per cent of funding each year.

15) **Program Budgeting:** This is the presentation of expenditure information according to the output produced.

16) **Program Performance Evaluation:** Is the review of programs to see if they are delivering best possible value for money spent.

17) **Protected Items:** Expenditure which is driven by factors outside the control of a department, e.g. the number of pensioners eligible for a particular service.

18) **Rate of Return:** Just as private enterprise companies have to deliver an acceptable investment return to their shareholders, so should government owned businesses and authorities. Rate of Return is determined by looking at the amount of profit made by a government business as a percentage of the amount of money the community has invested in that organisation.

19) **Real Terms:** Adjustment of money value so as to reflect the real value or a constant purchasing price. Real terms, takes into account the fact that the purchasing power of the same amount of money each year is devalued by the rate of inflation. For example, the $200 a week you spent on groceries in 1989 buys less groceries now, so in real terms that $200 is worth less than its face value.

20) **Specific Purpose Payments:** In addition to the General Purpose Payments to the States such as FAGs, the Commonwealth also allocates specific amounts of

money to finance special projects. These special projects may be for recurrent programs or capital projects.

21) **Supplementation:** The provision of extra money to a department after the Budget has been presented to Parliament to meet unanticipated demand.

22) **Tied Grants:** The same as Specific Purpose Payments (see 20 above).

23) **Vertical Fiscal Imbalance:** Nothing to do with vertigo, acrobatics or physics. This term is the polite way of saying that the tax system in Australia is pretty well upside down to the way it should be. On one hand the Commonwealth raises about 80 per cent of the taxes and is directly responsible for about 50 per cent of all Government expenditure in the country. On the other hand the States and Local Government have responsibility for 50 per cent of all Government expenditure but only have the power to raise about 20 per cent of what they need.

FAGs, Special Purpose Payments and the like are the Commonwealth's way of redressing Vertical Fiscal Imbalance.

3. THE PURPOSE OF A BUDGET: BALANCING NEEDS AND MEANS

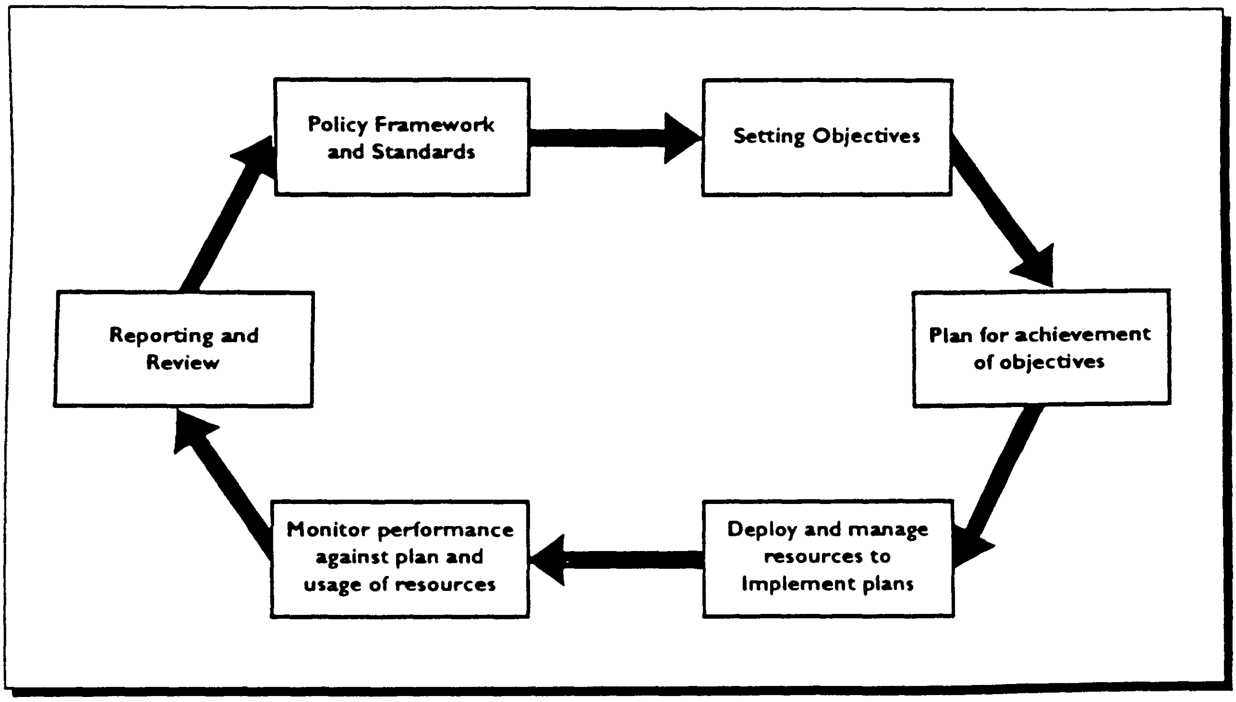
BUDGETING IN CONTEXT

Budgeting is part of the overall planning framework of organisations, be they public or private sector, including the family unit. Simply put, a budget is an estimate of income and expenditure for a future period of time.

The State Budget sets out estimates of the NSW Government's expenditure and revenue for the financial year ahead. Given the increasing importance of governmental financial management to the economy, the Budget is an important instrument of economic policy and a key factor in judging the performance of the Government.

Budgeting is best understood as one component of the planning cycle as set out in Figure 1 below:

Figure 1: The Management Process.



A crucial function of the Government is to monitor and review performance against the Budget and, if necessary, to make changes to the plan. It may be necessary, under certain conditions, to introduce a mini-Budget.

DEMANDS ON THE BUDGET PROCESS

While everyone is understandably most interested in the final allocation of funds, the most important purpose of the State Budget is not the individual funding decisions announced in it. What must be understood before one can evaluate decisions about particular portfolio funding decisions is that they have to be taken in light of the financial reality facing the State as a whole, and the nation as a whole.

One of the considerable pressures faced by Western democratic systems today is the fact that the level of the demands made by constituents on their governments always exceeds the means of governments to meet those demands.

Governments in pluralist democracies have to balance the demands of various interest groups against the pressures of having to act in a financially responsible manner.

Therefore, governments face three choices in dealing with the conflicting demands placed on them in a pluralist democratic system:

1) Spend only as much as is raised in revenue – a balanced budget

2) Ensure expenditure is lower than income – a surplus budget

3) Allow expenditure to exceed revenue in order to meet community demands – a budget deficit.

So what's wrong with a deficit anyway?

A Budget deficit means that the government is drawing upon the community's savings. This, in turn, means that there is less savings available to fund private investment. In turn, this can either mean lower investment or else greater use of overseas savings to finance the investment, so reducing our economic independence.

It is possible to make a case, in times of economic downturn, for the national Government, to provide a short term stimulus to the economy through increased expenditure, although that would produce a deficit. State Governments do not have either the fiscal capacity or the responsibility to undertake such action.

Is a balanced budget a good budget?

Until recently a balanced budget was considered a sign of good financial management by government. However, a balanced budget in itself is not necessarily a sign of good financial management nor of good government. The means used to balance a budget can have disastrous effects on an economy. For example, if a government were to raise taxes on the wealthy and business to pay for excessive government programs, business and investor confidence would suffer and economic activity would decline. The net result could be the opposite to that intended.

Then a surplus budget must be desirable?

Likewise, a surplus budget can have considerable negative impact on a nation or state's economy if it is achieved by such means. While it is highly desirable to achieve, over time, a balanced or surplus budget, careful consideration needs to be given to ensure this is achieved in a responsible way.

So, what makes a good budget?

The Budget is not only the plan for raising revenue and allocating expenditure. It is also a statement on the whole of our affairs as a State. It is not possible to effectively assess the decisions taken in the Budget without understanding the reasoning behind them.

The Budget is a core statement of the State's economic governance – it is our financial and economic credentials and is of keen interest to:

- Ratings agencies and lenders to the State
- National and international investors
- Special interest groups such as business, unions, the welfare lobby and environmental groups

There are some simple principles which can be of assistance in determining whether a budget is good or not.

Because there is a broad range of people interested in the Budget, the Budget document must be structured to demonstrate financial integrity, accountability, responsibility and equity.

Core Principles

1) **financial integrity:**
Financial integrity is the need to prepare a Budget that conforms with established rules and standards. In the case of the NSW State Budget, it is prepared in accord with international public finance standards. These standards are set out in legislation.

2) **financial accountability and transparency:**
Not only must the Budget be based on generally accepted standards, but it should present the State's financial position in a clear and unambiguous way so as to foster full accountability.

3) **financial responsibility and equity:**
In funding Budget outlays, there is a need to draw an appropriate balance between the use of revenue and the use of borrowings.

Financial responsibility is concerned with striking the right balance between the use of revenue and borrowings in order to achieve a sustainable financial position.

4. WHERE THE MONEY COMES FROM AND WHERE IT GOES - COMMONWEALTH, STATE AND LOCAL GOVERNMENT

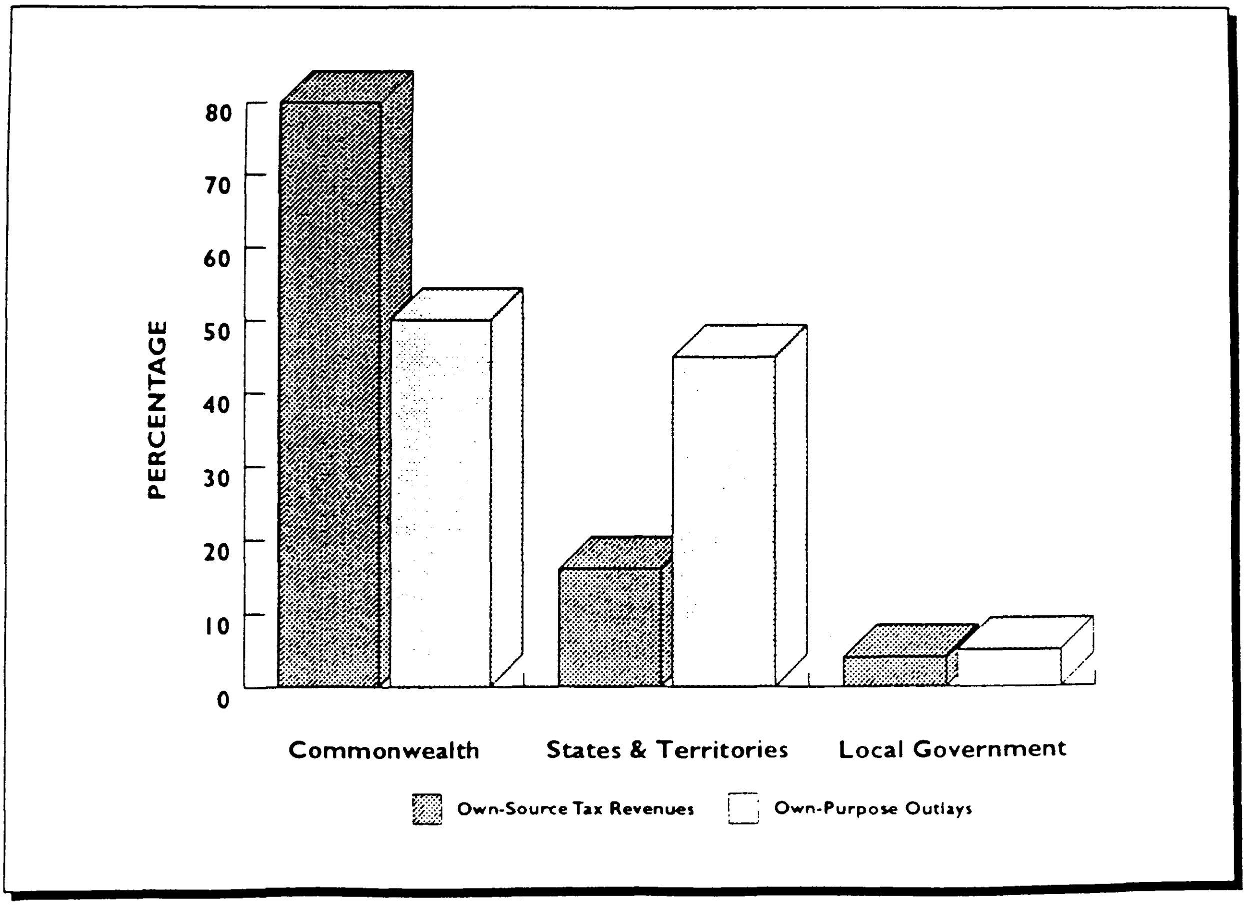
• WHO RAISES AND SPENDS MONEY?

One of the keys to understanding the State Budget is an appreciation of the significant imbalance that exists between the State and Federal levels of Government in their revenue and expenditure. This imbalance creates many restrictions on the State Government's ability to fund expenditure programs. Overall, the Commonwealth broadly receives 80 per cent of public sector revenue but is only responsible for about 50 per cent of public sector outlays. In contrast the States raise about 16 per cent of public sector revenue but account for 45 per cent of public sector outlays.

Local Government has a less severe imbalance, being responsible for 5 per cent of public sector outlays and raising 4 per cent of revenue.

The imbalance between expenditure responsibilities and revenue power is called vertical fiscal imbalance. Figure 2 demonstrates the funding shortfall faced by State and Local Governments.

Figure 2: Expenditure and Revenue by Level of Government.
Percentage of Total Public Sector Expenditure and Revenue.



- **WHO DOES WHAT?**

The States have a broader service provision and funding role than the Commonwealth with responsibilities for the provision of school and technical education, health service, public safety, public transport, community services and a host of other services.

States also have constitutional responsibility for local government which in turn has responsibility for local road systems, services to properties, local recreation and cultural activities delegated to it.

In contrast to their expenditure responsibilities the States have relatively narrow revenue powers and hence rely substantially on Commonwealth payments. These are set out in Figure 3 below:

Figure 3: Summary of Responsibilities by Levels of Government.

COMMONWEALTH GOVERNMENT	DIRECT SERVICES
Constitution: Specific Powers	Social Services, Defence, Foreign Affairs, International Trade, Postal and Telecommunications, Industrial Relations (across States), Business Regulation
STATE GOVERNMENT Balance of Powers	Education, Health, Police, Prisons, Transport, Housing, Agriculture, Basic Services (e.g. Electricity, Water, Roads, Sewerage, etc.), Industrial Relations (within States), Business Regulation
LOCAL GOVERNMENT Under State Legislation	Local Roads, Street Lighting, Libraries, Planning

Vertical fiscal imbalance requires the Commonwealth Government to make transfer payments to the State and Local Governments as a means of carving up the tax revenue pie. In other words, State and Local Governments are dependent on financial assistance from the Federal Government for much of their funding requirements.

• HOW THE PIE IS CARVED UP

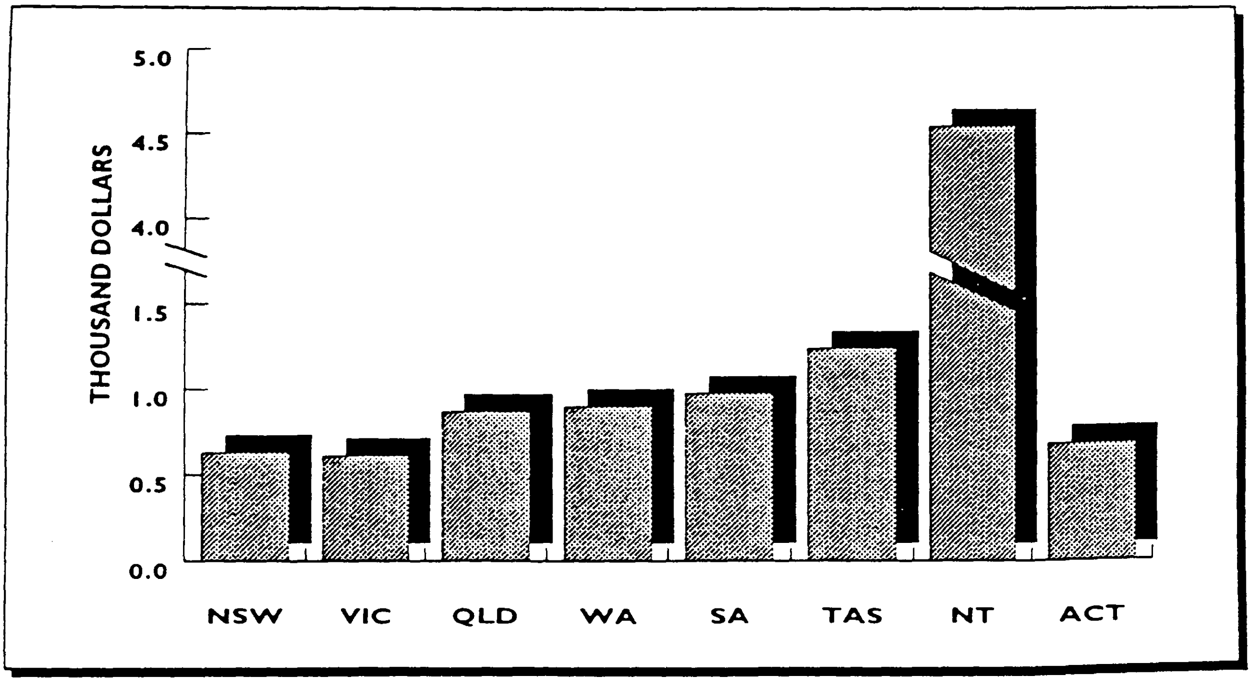
Financial arrangements between the Federal, State and Territory Governments centre on three key issues: slicing up the Commonwealth tax pie, borrowings, and shifts in the levels and types of payments by the Commonwealth.

1) Key issues in slicing up the pie

i) Determining the level of **General Purpose Payments.** These are untied financial grants given to the State and Territory Governments by the Commonwealth for the purposes of funding ongoing governmental activities, including capital programs. The Commonwealth each year sets the level of such payments. In the past three years the major part of the payment has been increased in line with inflation.

ii) The allocation of the **General Purpose Payments** between States and Territories. Once the level of general purpose payments is set, it is necessary to allocate them across States and Territories. The great bulk of those payments are Financial Assistance Grants whose allocation is based on the principle of fiscal equalisation, which means the funds are distributed in such a way that consistently standard services can be supplied by all States, without their having to impose tax levels which are greatly different from each other. In other words, States with relatively higher costs, but lower capacity to raise revenue, are compensated by other States.

Figure 4: Share of Financial Assistance Grants per head of population between the States and Territories 1993-94.



The application of the principle means New South Wales and Victoria receive a disproportionately smaller share of Commonwealth Financial Assistance Grants.

New South Wales subsidises the smaller States and Territories to the extent of $1,200 million per year. The other States and Territories receive relatively greater shares than would be indicated by their respective populations. In other words, the larger States subsidise the smaller States (see Figure 4).

The Commonwealth Grants Commission advises the Premiers' Conference on the allocation of Financial Assistance Grants to achieve fiscal equalisation between States and Territories.

The remaining component of General Purpose Payments is General Capital Payments which is relatively small and allocated between the States on the basis of historical share.

iii) **Specific Purpose Payments.** These are payments by the Commonwealth to the States for particular, tied purposes. The agreement for these payments sets out the basis of funding, the objectives to be achieved, reporting requirements and any particular conditions on the use of monies for a specific purpose. Each Specific Purpose Payment is subject to individual negotiation and agreement between the Commonwealth and State Governments. These agreements may extend over a number of years.

2) How Borrowings are determined

In addition to the States' share of Commonwealth tax revenue, they borrow from the financial market.

The level of borrowings and other external financings undertaken by the Australian public sector is centrally determined by the Australian Loan Council.

Loan Council Allocations are the annual limit on financing by State authorities other than State financial and marketing authorities. The Australian Loan Council establishes the annual limits on each State's financing.

Under new agreements approved at the July 1993 Loan Council meeting, each Government submits to Loan Council its assessed financing needs. These include funding of the Budget deficit and the borrowing requirements for the capital program of Government Trading Enterprises. Also various other miscellaneous matters that impact on the financing requirements of the State are taken into account.

These are assessed at the annual Loan Council meeting and decisions taken on the level of the Loan Council Allocation and its distribution between Governments, having regard to the overall macroeconomic situation and the specific financial positioning of each State Government.

3) Trends in Commonwealth-State Financial Arrangements

The key trends in the area of inter-governmental financial relations between the Commonwealth and the States in recent years have been:

- a real decline in general purpose payments;
- a real increase in specific purpose payments; and
- a real decline in borrowing allocations.

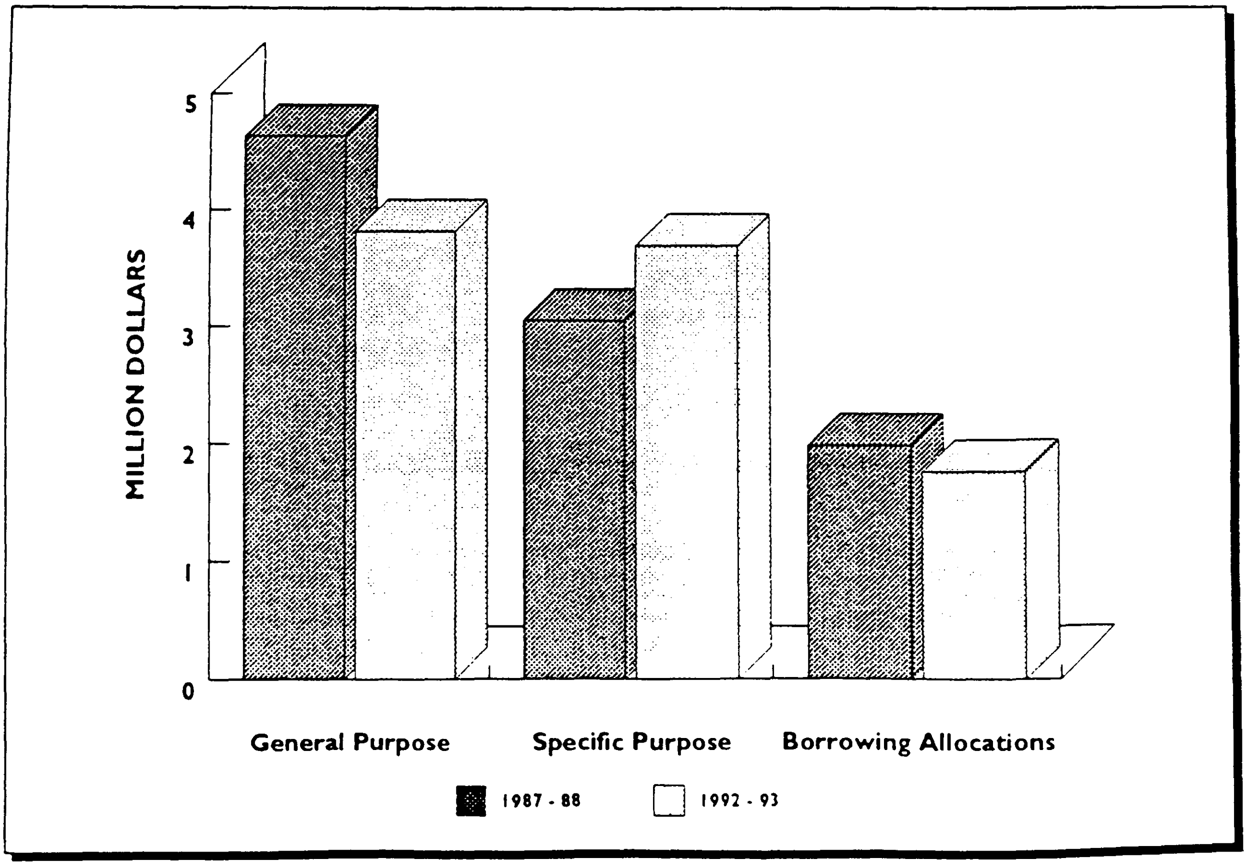
Over the past five years, 1987-88 to 1992-93, Commonwealth general purpose payments to the States and Territories have declined by broadly $2 billion in real terms. At the same time, Commonwealth specific purpose payments have increased by just over $2 billion in real terms.

However, this does not mean the decline in general purpose payments is being made up for by the increase in specific purpose payments.

Cuts in General Purpose Payments reduce a State's ability to make decisions about funding expenditure in areas where the State has needs. Specific purpose payments, on the other hand, relate to funding for priorities determined by the Commonwealth. This means that at best the additional payment by the Commonwealth results in a corresponding increase in State payments, with no benefits to our Budget. However, the situation can be worse than this.

The increases in specific purpose payments often are linked to requirements that the States match Commonwealth payments, thereby exacerbating the difficult financial position of State Governments.

Figure 5: Real Change in General Purpose Payments, Specific Purpose Payments and Borrowing Allocations.



5. HOW THE BUDGET IS LAID OUT

OVERVIEW

*The **Budget** is a statement of the payments and revenue of the Budget Sector of the Government for the coming year. It shows all cash revenue and all cash payments, both of a current and capital nature.*

The key to understanding the process is to understand the distinction between Budget and Non-Budget Sectors.

*The **Budget Sector** consists of all revenues and payments of agencies that are predominantly funded from the public purse, that is by funds approved by Parliament. Accordingly, the Budget covers tax-funded functions such as public hospitals, health, education, law and order and public safety.*

*The **Non Budget Sector** consists of agencies that are predominantly self-funded from user charges for the services they provide. Examples include Pacific Power, the Water Board, the Maritime Services Board, etc.*

The Budget Sector, in contrast to the Non Budget Sector, is thus funded from the public purse and not from **user charges**.

In the main, Budget Sector services are provided free of charge or at a charge well below the cost of provision.

Figure 6: Overview of Budget and Non Budget Sector Funding.

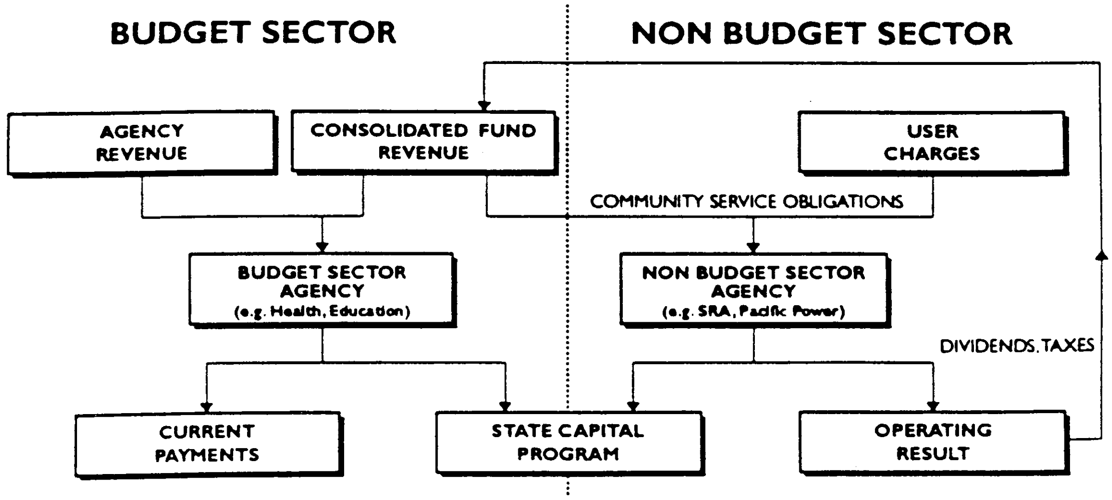


Figure 6 shows two main funding sources for the Budget, the Consolidated Fund and agency revenue. The Consolidated Fund receives all taxes, fines and regulatory fees, payments from the Federal Government, and contributions from the Non Budget Sector. Agency revenue is revenue raised by government agencies from user charges and donations.

The Budget Sector capital program is funded from the Budget and is subject to the strategic direction and control set by the Government in the Budget. The capital program of individual Non Budget Sector agencies, while broadly overseen by the Government, is largely driven by commercial objectives and in particular the need to achieve an appropriate return on investment.

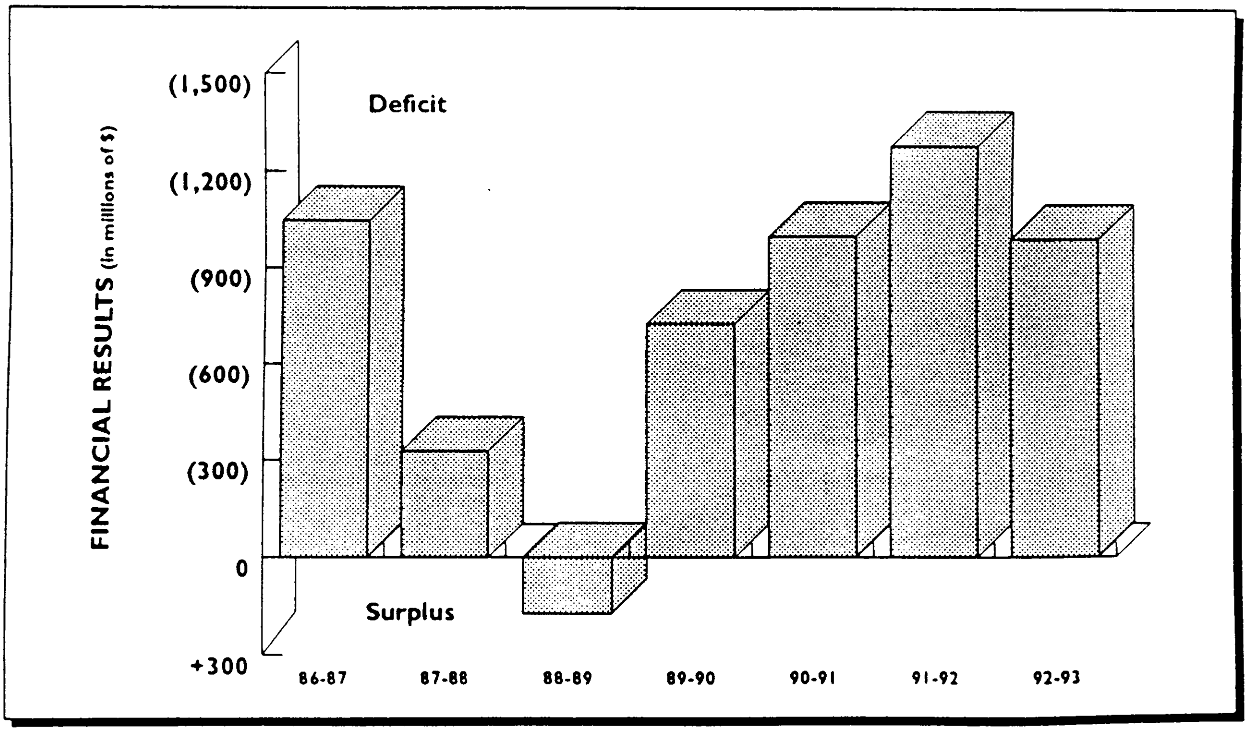
STRUCTURE OF THE BUDGET

The Budget presents information on revenue and outlays (outlays are simply payments less agency revenue). The Budget is segmented into two parts:

- **current financial position**: current revenue less current outlays;
- **capital financial position**: revenue for capital projects less capital outlays.

The overall Budget position is simply the sum of the current and capital financial position.

Figure 7: Budget Position.



Traditionally the State runs a modest surplus on the current financial position, a large deficit on the capital financial position and an overall moderate deficit.

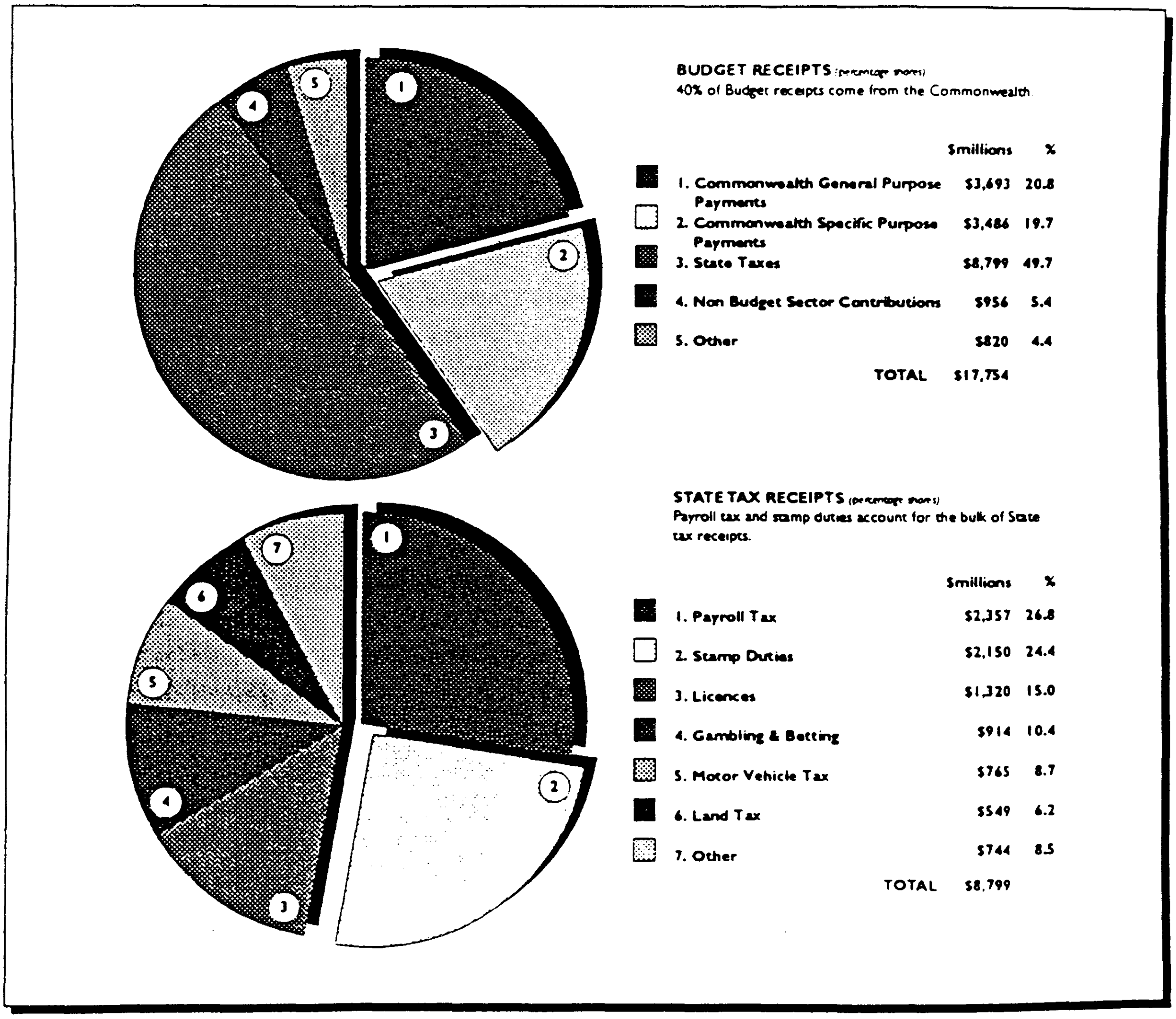
In 1988-89, the peak year of the property market boom, an overall Budget surplus was achieved but then increasing deficits occurred in the following three years to 1991-92, peaking at $1,280 million in that year. This deterioration reflects, in the main, substantial real cuts in Commonwealth general purpose payments and the collapse of State revenue due to the property market downturn and the recession. However, in 1992-93 the New South Wales Government was able to turn the deficit trend around and delivered a deficit for last year of under $1 billion. This result was over $200m better than projected at the beginning of the year.

BUDGET REVENUE

Taxes, fines and regulatory fees make up 50 per cent of Budget revenue. These receipts are obtained by compulsion from the community and are provided in the main without any direct relationship to the services provided.

Commonwealth payments make up 40 per cent of Budget revenue and these can be divided into two categories: General Purpose Payments (capital and recurrent) which in 1992-93 total $3,693 million or 21 per cent of Budget revenue, and Specific Purpose Payments (capital and recurrent) which in 1992-93 total $3,486 million or 19.4 per cent of Budget revenue.

Figure 8: Budget and State Tax Receipts 1992-93.



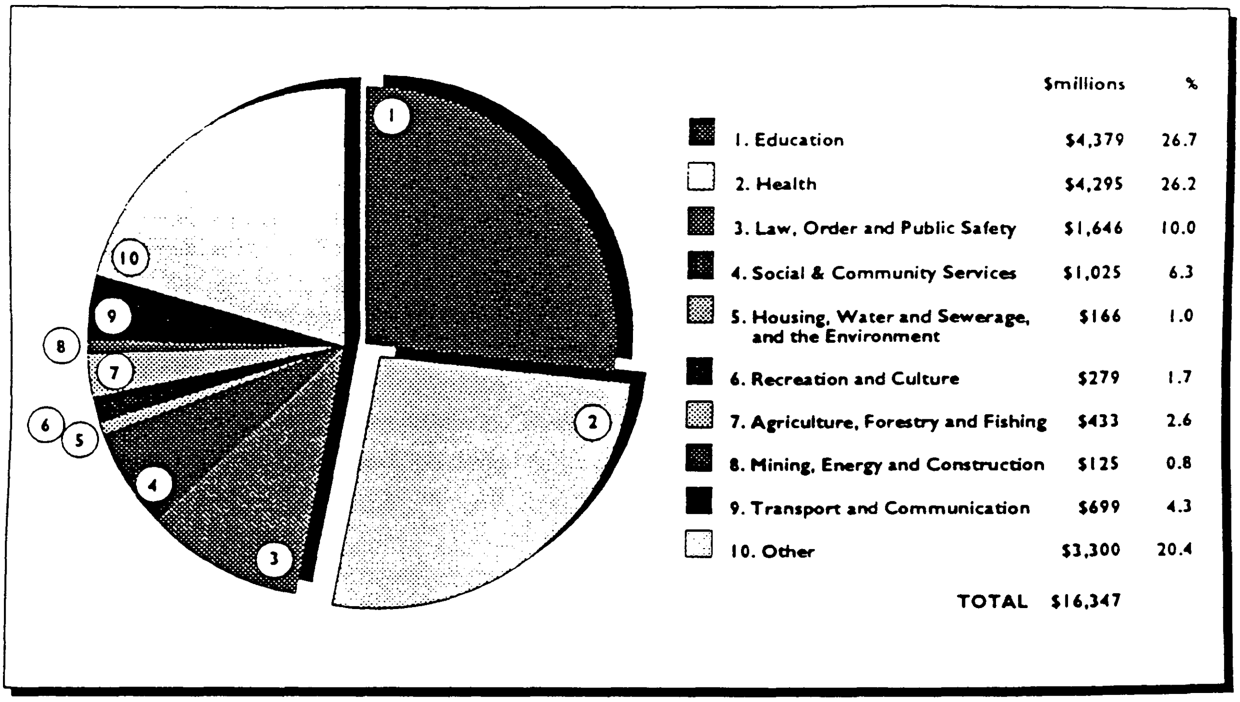
The third major category of Budget receipts is Non Budget Sector contributions which in 1992-93 total $956 million or 5.4 per cent of Budget receipts. The State owns a number of Government Trading Enterprises which have a commercial charter to provide services on a fee-for-service basis. Examples of these bodies include Pacific Power, the Water Board, the Maritime Services Board and the State Bank. The financial objectives of these Enterprises are to achieve a commercially realistic profit or rate of return on their assets.

The achievement of a reasonable return on assets provides a financial incentive for the agency to use its assets effectively as well as delivering a return to the Budget to finance high priority social needs.

OUTLAYS

Budget outlays can be divided into two categories: current and capital.

Figure 9: Current Payments, 1992-93.

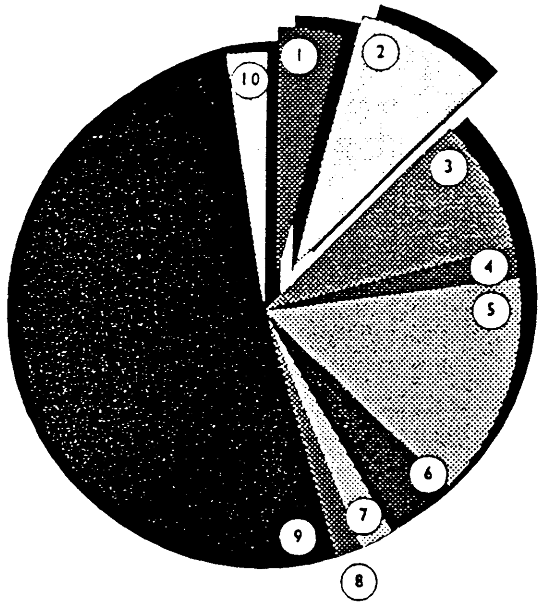


Current outlays in 1992-93 totalled $16.3 billion. Overall, 75 per cent of current outlays are absorbed in just four areas: education, health, law and order and debt costs (this increases to over 80 per cent when superannuation costs are added).

The key point is that the main area of responsibility for States is the provision of core public services. In contrast, the Federal Government is responsible largely for making transfer payments, either to other levels of government or to the community (social welfare payments and unemployment benefits, for example).

Capital outlays, on the other hand, are dominated by road funding and public transport which account for 52 per cent of all capital payments.

Figure 10: Budget Sector Capital Payments.



	$millions	%
1. Law, Order and Public Safety	$166	4.2
2. Education	$343	8.7
3. Health	$324	8.2
4. Social and Community Services	$81	2.1
5. Housing, Water and Sewerage, and the Environment	$543	13.8
6. Recreation and Culture	$175	4.4
7. Agriculture, Forestry and Fishing	$90	2.3
8. Mining, Energy and Construction	$64	1.6
9. Transport and Communication	$2,061	52.3
10. Other	$91	2.4
TOTAL	$3,938	

CAPITAL PAYMENTS 1992-93 *(expenditure by function)*
Roads, water and sewerage, housing / homesites, public transport and health dominate the capital program.

STATE CAPITAL PROGRAM

In addition to the presentation of the Budget, the Budget Papers also present information on the State Capital Program. The State Capital Program is the sum of the capital payments included in the Budget plus the capital payments of the Non Budget Sector.

The State Capital Program thus provides an overview of the total level of capital expenditure planned to be undertaken by State agencies in the Budget year.

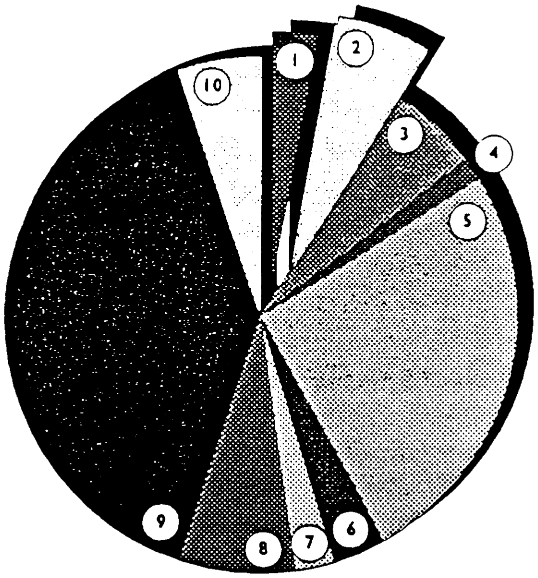
There are two important differences between the Budget Capital Program and the Non Budget Capital Program.

First, the Budget Capital Program is funded from the Budget. The Non Budget Sector Capital Program is funded by individual agencies, largely from revenue and reserves, with only a relatively small level of borrowings. In 1992-93, the Non Budget Sector Capital Program was $2,622 million ($1,646 million if you exclude grants from the Budget), of which only $232 million or 9 per cent was funded by borrowings.

Secondly, the Non Budget Sector Capital Program is largely commercially driven, as agencies seek to achieve an appropriate return on assets. This can mean that there are significant variations in the program within the year from that planned as projects are reassessed for commercial and service benefits.

The State Capital Program in 1992-93 totalled $5,584 million, with the distribution by functions set out in Figure 11.

Figure 11: State Capital Payments.



	$millions	%
1. Law, Order and Public Safety	$166	3.0
2. Education	$343	6.1
3. Health	$324	5.8
4. Social and Community Services	$81	1.5
5. Housing, Water and Sewerage, and the Environment	$1,443	25.8
6. Recreation and Culture	$178	3.2
7. Agriculture, Forestry and Fishing	$136	2.4
8. Mining, Energy and Construction	$409	7.3
9. Transport and Communication	$2,215	39.6
10. Other	$289	5.3
TOTAL	$5,584	

CAPITAL PAYMENTS 1992-93 *(expenditure by function)*
Roads, water and sewerage, housing / homesites, public transport and health dominate the capital program.

6. THE THREE YEAR OUTLOOK

WHAT IS THE TIME PERIOD FOR THE BUDGET?

The Budget submitted to Parliament each year has a three year time horizon. The first year is the Budget year and this is the period for which Parliamentary approval of the level of funds to be allocated is sought. In addition, information is presented in full detail on projections of revenue and expenditure for the two years beyond.

The presentation of information on a rolling three year horizon achieves a number of important objectives including disciplined long-term financial planning with clear goals, and enhances central control and accountability.

Discipline of longer term planning

Without a three year plan, it is easy to make decisions that do not have regard to the longer term costs and financial impacts involved. The danger is that, without a longer term perspective, decisions can be made which have a larger than expected financial impact in years to come.

By using a three year planning period the full cost and benefits of budget strategies and initiatives can be assessed. The three year discipline also creates awareness of the need for commitment to forward planning throughout Government departments and agencies.

Goal setting

Long-term planning establishes precise goals for the Government and its agencies to work towards.

Central control and accountability

Long term planning gives the Government better control of the expenditure decisions of its agencies and ensures that the principle of full accountability can be upheld. The alternative to a forward estimates system is for agencies each year to bid for funding. The difficulty with this approach is that it leads to "expenditure creep" where agencies pad their bids in anticipation of possible cutbacks and Treasury tries to identify the padding by cutbacks. The process consumes substantial effort and resources and tends to lead, over time, to increased expenditure.

WHAT THIS MEANS FOR NSW

The broad financial strategy of the NSW Government is to contain debt in order to avoid increasing the real burden of debt for future generations. The present level of net debt for the Budget Sector is $15 billion. To avoid this level of debt increasing at a rate greater than inflation and therefore keep it manageable, it will be necessary to achieve a sustainable Budget deficit of broadly $600 million per annum.

Such a financial target cannot be achieved immediately but needs to be phased in over a reasonable period. In the meantime, targeted, responsible privatisation that makes financial sense, such as the sale of the GIO, will provide significant, once-up reductions in the level of debt.

In addition to the net debt referred to above, there is the guaranteed debt of State owned financial institutions such as the State Bank. Under Australian Bureau of Statistics convention such debt is not included. However, the credit rating agencies include it when assessing the overall financial exposure of the State.

The liabilities of the Government extend beyond debt to include obligations such as to fund superannuation payments. The Government is also committed to reducing its non debt liabilities (such as public sector superannuation). In 1992-93 the Government introduced a new superannuation scheme, modelled on the Commonwealth's Superannuation Guarantee, which is fully funded. This scheme, First State Super, applies to all new employees. Over time, as the new scheme increases its coverage of public servants, there will be a phase-in of full funding of superannuation. Similarly, Non Budget Sector agencies are phasing in full funding of superannuation for their employees.

7. HOW IS FLEXIBILITY MAINTAINED?

As set out in the previous section, the Budget operates on the basis of a rolling three year system of forward estimates of expenditure. This raises the issue of how flexibility is maintained to address unexpected needs and developments.

NO END-OF-YEAR SPEND-UPS

The important point to note is that the level of funding for each year is the Budget allocation, not the actual level of expenditure. In addition, agencies are able to transfer funding between years, that is to either carry forward unspent monies or borrow in the current year against future allocations. Hence there is not an incentive to spend up to the Budget for fear the following year's Budget will be reduced. Similarly, any over-expenditure does not automatically result in an increase in the following year's Budget.

MAINTENANCE REVIEWS

Each year Treasury advises agencies of the revised forward estimates which are based on a review of inflation rates and the overall progress of the Budget strategy.

Ministers are able, in their Budget submissions, to raise any issues of concern about the adequacy of funding to maintain their operations or any special, unforeseen circumstances.

INTERNAL AND EXTERNAL REVIEWS

In addition, all agencies undertake regular planned reviews of their programs to assess their efficiency, effectiveness and appropriateness. This provides the means to assess whether programs should be maintained at current levels or resources re-allocated to higher priorities.

Also, there are external reviews undertaken both by the Office of Public Management and by the Auditor-General which seek to provide an independent assessment of programs.

ENHANCEMENT FUNDING

While the Budget is subject to substantial constraints due to the State's difficult revenue position, there is a limited capacity to provide additional funding for high priority initiatives of the Government. Ministers are able in the Budget cycle to submit proposals for **enhancement funding**. These are assessed by the **Expenditure Review Committee** in terms of overall priorities of the Government.

OWN AGENCY REVENUE

Agencies are able to retain for their own use all revenue they have raised, including user charges and donations.

This allows agencies to increase their funding without a need for Parliamentary appropriation.

In addition, agencies are able to retain, depending on individual circumstances, between 50 per cent and 100 per cent of all asset sale proceeds.

8. HOW TO FIND YOUR WAY AROUND THE BUDGET PAPERS

The Budget Papers consist of six core Budget papers, together with a number of supporting papers. As such, they provide a comprehensive guide to the position of State finances.

In addition to the various Budget Papers, the Government issues other information during the course of the year.

CORE BUDGET PAPERS

Budget Paper No. 1: The Speech

This paper sets out the Government's financial strategy and key Budget initiatives.

Budget Paper No. 2: Budget Information

This Budget paper is the key Budget document which sets out the Budget in broad detail. Key items of information contained in this paper are:

- summary of the Budget, the strategy and Budget initiatives — *Chapter 1*
- overview of the economic environment within which the Budget is framed — *Chapter 2*
- detailed information on the Budget receipts for the Budget year and the two forward years by category of revenue — *Chapter 3*
- information on **current payments** by each functional area for the Budget year, together with forward estimates of Consolidated Fund support for recurrent purposes for the two forward years, total payments and the net cost of services — *Chapter 4*
- information on **capital payment** by functional area for the Budget year for the Budget Sector and Non Budget Sector — *Chapter 5*
- information on actual results for both the Budget and capital program for the past year and an explanation for variations from the projected figures — *Chapter 6*

- information on financial arrangements between the Commonwealth and New South Wales and a complete listing of all Commonwealth payments contained in the Budget — *Chapter 7*

- general background information on the State's finances, financial policy initiatives and financial performance — *Chapters 8 to 11 inclusive*

- tables providing detailed information on total payments both current and capital by program — *Attachment to the Budget Paper*

Budget Paper No. 3

This Budget paper provides information in detail on each minister's portfolio, each organisation and each program. Information is provided on an accrual basis for expense, revenue and the net cost of services. Adjustments are then made to derive the level of Consolidated Fund recurrent allocation. In addition, information is provided on:

- current and capital payments
- revenue raised by the agency and paid to Consolidated Fund.

A full explanation on the concepts is provided in the Introduction to this Budget paper.

Budget Paper No. 4

This Budget paper provides a listing of all capital projects in the State Capital Program, divided up by minister and agency.

Budget Paper No. 5

This Budget paper is the Appropriations Bill for both the Government and the legislature which sets out the level of Consolidated Fund support allocated to each Minister and agency for the coming year for current and capital purposes separately.

Budget Paper No. 6

This Budget paper presents a more comprehensive position on the State's expenditure, revenue and financing requirement, covering all State agencies, not just those in the Budget Sector.

SUPPORTING BUDGET PAPERS

Budget Summary

This booklet provides a useful summary of the Budget, the key initiatives and the strategy in a readily assessable form.

Community Benefits

These are a series of papers that provide information on the Government's broad strategy for addressing the need for particular groups and particular key areas of the Budget, such as in health or for the aged.

9. WHAT IS THE PROCESS FOR PREPARING AND IMPLEMENTING THE BUDGET AND CAPITAL PROGRAM?

STAGES IN THE BUDGET CYCLE

There are five key stages in the overall Budget and Capital cycle:

- *preparation of Budget and Capital Program plans;*
- *authorisation of the expenditure and commitments to be made;*
- *implementation of the approved Budget and Capital Programs;*
- *reporting on the results achieved against the approvals;*
- *performance reviews, both internal and external.*

The key features of the Budget cycle are:-

top down control through a system of three year rolling forward estimates of recurrent payments -

The forward estimate system was introduced in 1989-90 and replaced the previous approach whereby agencies bid for funding which was in turn reviewed by Treasury.

Under the forward estimate system agencies are provided with a rolling three year forward estimate of funding from Consolidated Fund for recurrent payments. This approach provides agencies with greater certainty about the level of funding, hence facilitating forward planning, while at the same time achieving greater control of funding.

requirement to submit and review enhancement bids at a single point in the year -

Enhancements are new programs or increased activity levels for existing programs. Agencies are able each year to submit bids for enhancement funding which are evaluated by the Expenditure Review Committee, assessing all proposals in terms of Government priorities and community needs.

Enhancement bids outside this period need to demonstrate that they are urgent (cannot be deferred for consideration until the next Budget) and were unforeseen at the time of the last Budget.

regular within-year monitoring and reporting -

Monthly reports are prepared on the Budget and staff numbers, indicating position both for year to date and projected full year position.

CAPITAL PROGRAM CYCLE

The key features of the Capital Program cycle are:

authorisation limits -

The Capital Program combines the features of a bid and review process and a forward estimates system.

Agencies are provided with an authorisation limit which is in effect a commitment for funds for works in progress and approved new works as well as minor works.

annual approval of new works -

New work proposals for each new year are subject to prior approval of the Capital Works Committee.

requirement for new works proposals to be assessed, based on economic cost benefit and value management principles -

Guidelines have been developed on economic cost benefit and value management analysis which must be applied before any proposal is considered by the Capital Works Committee.

tight macro control of Budget Sector capital payments -

Given the dependence on the Budget for funding, combined with a lack of commercial discipline and pressure on Budget Sector agencies, the overall Budget Sector capital program is set at a macro level based on the overall Budget position.

greater flexibility for Non Budget Sector agencies -

Consistent with the approach to the classification and control of agencies, Non Budget Sector agencies should not, in general, be subject to input controls. It is entirely appropriate to assess the proposed capital program of Non Budget Sector agencies on the basis of consistency with the Business Plan and impact on the rate of return, rather than on the basis of a detailed project by project appraisal.

10. KEY FINANCIAL AND ECONOMIC TERMS

Accrual Accounting: Accrual accounting is the recognition of income and expenditure items as they are earned or incurred respectively (and not as money is received or paid) and included in the financial statements in the year to which they relate. The New South Wales Budget, as with those of the other States and the Commonwealth, however, has traditionally been presented on a cash basis. See cash accounting below.

Advance to the Treasurer: The sum appropriated to the Treasurer under the Appropriation Act as an advance to allow for supplementary payments of an unforeseen nature for the ordinary annual services of government. Actual expenditures charged against this item are recorded against appropriate departmental items and are accounted for to Parliament in the following year's Appropriation Act.

Allocative Efficiency: A term that refers to the allocation of the nation's scarce resources across competing needs to achieve the highest benefit for the consumer. This is achieved by ensuring that prices closely reflect the costs of producing goods and services in cases where the benefits of market competition are absent (i.e., that prices reflect minimum cost where monopoly situations exist), and by nurturing competition to achieve appropriate pricing structures.

Appropriateness: A term used in program performance evaluation to denote whether a program's stated objectives adequately address real community needs and the Government's policy priorities.

Appropriation Act: The Act passed by Parliament each year authorising the payments out of the Consolidated Fund for recurrent and capital purposes.

Appropriations – Annual: Amounts which may be spent from the Consolidated Fund under the authority of an annual Appropriation Act during the period 1 July to 30 June.

Assets: General term covering financial resources (cash, securities, etc.), physical items (property, plant and equipment, etc.) or intangibles (patents, trademarks, etc.) capable of providing a future benefit to the organisation either by use or sale.

Auditor-General: A statutory office established under the Public Finance and Audit Act 1983 to oversight and report to Parliament on the Public Accounts and the accounts of departments and authorities.

Average Staffing: An estimate of average monthly staff employed over the course of the whole financial year, expressed in terms of average full-time equivalent numbers (see Effective Full-Time Staff).

Borrowings: Refers to any form of debt incurred where there is an obligation to repay over a fixed term.

Borrowings guaranteed by the State: Loans guaranteed by the State in accordance with specific Acts.

Borrowing/Lending facility: Procedures whereby (i) organisations which overspend their allocation for a particular year are required to fund that excess by a reduction in future years' allocations or (ii) organisations which underspend in a year may carry those savings forward to a future year.

Budget: The several Budget papers including Estimates of revenue and payments of the Consolidated Fund and the Appropriation Bill.

Budget Estimate: Summarised and detailed dissections of estimated revenue and amounts which may be expended by departments and statutory bodies, in the Budget Sector, on recurrent services and capital works and services from the Consolidated Fund (under authority of the annual Appropriation Act or specially appropriated under other Acts), or from sources other than the Consolidated Fund.

Budget Sector: Departments and certain statutory bodies which are predominantly funded from the Consolidated Fund rather than from user charges. For example, the Department of Health, Department of Schools Education.

Capital revenue and payments: Revenue or payments for works of a permanent character such as schools and other public buildings. Revenue includes Commonwealth payments for specific capital purposes, proceeds of the sale of assets and repayments by authorities.

Cash accounting: In contrast to accrual accounting, only takes into account cash payments to be made and cash receipts to be received during the year. It does not take into account liabilities and debts arising during the year, but not settled at the end of the year.

Consolidated Fund: A central fund through which the main activities of Government are funded.

Current Payments: Cost payments made for operating or ongoing purposes as distinct from capital payments.

Deficit: General term used to describe an excess of government expenditure over revenue. Its definition varies between different States. In New South Wales, usage of the term in describing the Budget result is based on international conventions for presenting public finance statistics (e.g., in the case of borrowings, these are not included as revenue, but as a "below the line" financing transaction).

Dividend: A share of profits payable to the Consolidated Fund by Government Commercial Services, Businesses and Enterprises.

Economy: When used in the context of program performance evaluation, this means keeping inputs (i.e., resources) to the minimum necessary to provide an adequate program service.

Effective Full-Time Staff (EFT): Staff numbers derived by adding to full-time staff the full-time equivalent of any part-time staff.

Effectiveness: A term used in program performance evaluation to denote whether a program's stated objectives are being achieved.

Efficiency: Efficiency is a term frequently used in the context of program performance evaluation and relates to its production of a set of goods and services by using the least possible amount of resources (see Allocative Efficiency above).

Employee Related Payments: A classification of expenditure for dissection of program costs relating to the costs of employing staff including allowances, overtime payments for leave on retirement and resignation, worker's compensation, employer superannuation contributions, meal allowances, payroll tax and fringe benefits tax.

Enhancement: Expenditure above maintenance level that provides a real increase in the level of existing services or the addition of new services (see Maintenance below).

Equity: The value of the interest held by the owners in the assets of an organisation as represented by the value of the assets of the organisation less external liabilities (e.g., borrowings from outside bodies).

Estimates: See Budget Estimates.

Expenses: The level of operating expenditure, including the use of capital, expressed in accrual terms.

Expenditure Review Committee (ERC): A committee of Cabinet consisting of the Premier, the Treasurer and other Senior Ministers which oversees Budget strategy and implementation.

Expenditure: See payments and total payments.

Financial Agreement: An agreement between the Commonwealth and State Governments controlling the borrowing arrangements of those Governments.

Financial Assistance Payment/Grant: The general revenue grant payable to the State by the Commonwealth – originally based on reimbursement to the State for withdrawing from the income tax field.

Fiscal Equalisation: The principle whereby Financial Assistance Grants revenue funds are distributed so that each State can provide consistent standard services without having to impose tax levels which are greatly different from those of other States. The principle means that the larger States of New South Wales and Victoria subsidise the smaller States and Territories.

Fiscal policy: The name given to all measures and policies announced in the Budget. The name also applies to any other measures whose impact is felt through any increase or decrease in government spending or revenue raising (i.e., taxation).

Forward Estimates: The forward estimates are for Consolidated Fund recurrent expenditure and cover a rolling period of three years. They exclude capital expenditure and expenditure from funding sources other than those passing through the Consolidated Fund. The reason for the latter exclusion is that the focus is on expenditure financed from taxes, fines and levies excluding, in the main, user charges.

General Purpose Payments/Grants: Financial grants given to the State and Territory Governments by the Commonwealth for the purposes of funding ongoing governmental activities, including for capital funding purposes.

Global budgeting: System allowing departments much greater freedom to alter spending patterns between expenditure categories and line items (salaries, maintenance, etc.) and programs, provided they live within their total budgets and staff ceilings. Moreover, greater flexibility in expenditure patterns will be allowed within the limits applying at the service delivery level such as schools and health services. Ministers may seek to "borrow" from following years' allocations or "lend" forward to following years up to 2 per cent of their allocations.

Government Business Enterprise: See Government Trading Enterprise.

Government Finance Statistics: The international standard for the presentation of general Government or Budget Sector finances as a cash basis.

Government Trading Enterprise: A unit within the public sector that produces goods or services which are, or could be, sold or tendered in the marketplace without compromising the Government's economic or social objectives. GTEs include not only organisations engaged in trading activities, but also organisations which provide subsidised community services on a contractual basis.

Grants and subsidies: A classification of expenditure for dissection of program costs; generally applying to payments to assist voluntary bodies and firms in the business sector.

Gross State Product (GSP): The total level of goods and services produced by the public and private sectors in the State.

Liabilities: Claims against the Government by those from whom it has borrowed or otherwise owes money.

Line items: Individual allocations specified under the "Grants and subsidies" and "Other Services" expenditure categories of departmental budgets. Departments are also required to keep separate accounting records for individual line items under the "Employee related payments" and "Maintenance and working expenses" categories (e.g., for overtime, rent, fees for services rendered).

Loan Council: Consists of representatives of the Commonwealth and the States established for the purpose of the orderly management of Commonwealth and State debt and borrowings (see also Premiers' Conference).

Loan Council Allocation: The level of external finances approved by the Loan Council for each Government to enable the financing of the Budget and of borrowings by Government Trading Enterprises.

Loan Liability to the Commonwealth: The indebtedness to the Commonwealth for the State's share of loan raisings in terms of the Financial Agreement.

Maintenance: Level of expenditure necessary to provide the existing level of real resources used by a Budget organisation. Expenditure above this level is referred to as enhancement(s).

Ministerial Head: The highest level at which funds are appropriated under the Appropriation Act.

National accounts: A systematic summary and analysis of the economic transactions taking place within Australia.

Net appropriation budgeting: A method of budgeting whereby the Consolidated Fund is sourced from only State taxes, Commonwealth payments, regulatory fees, fines and GTE contributions. Under this form of budgeting, user charges are retained by agencies and not paid into the Consolidated Fund. Hence appropriations from the Consolidated Fund represent the gross payments of agencies less proceeds from user charges. In other words, appropriations are "net" of user charges.

NPSFR (Net Public Sector Funding Requirement): The NPSFR is the gap between public sector outlays and government revenue in a given year that has to be financed by either borrowing or drawing on the cash savings of Government Authorities and businesses. Ultimately, the NPSFR is a measure of the extent to which the public sector calls on the savings of the private sector, including individuals. Therefore, NPSFR must be considered against GSP. NPSFR as a percentage of GSP indicates the Government's "cash flow" deficit, i.e., whether the deficit is widening or shrinking over time. Like everyone else government can't indulge in unrestricted borrowings.

Net Cost of Services: Total expenses less ongoing revenue, both measured on an accrual basis.

Nominal Terms: Only expresses the face value of money and not its market value, that is to say nominal values do not indicate the purchasing power of money. See Real Terms Recurrent Expenditure.

Non Budget Sector: Government entities which are predominantly funded from user charges. For example, Pacific Power and the Water Board.

Organisational unit: Generally, an administrative unit (department) or declared authority (certain statutory bodies) within the terms of the Public Sector Management Act and within the Budget Sector. Also includes the Legislature. It is the lowest level at which funds are specifically allocated under the Appropriation Act.

Outlays: Current payments less user charges and capital payments less asset sales.

Payments: See Total Payments.

Payments under Section 22: Public Finance and Audit Act 1983: Consolidated Fund payments determined by the Treasurer, with the approval of the Governor, to provide for unforeseen expenditures considered to be in the public interest. Payments under this authority are approved retrospectively by Parliament in the following year's Appropriation Act.

Performance Agreement: The formal undertaking between the Department Head and the responsible Minister that particular special projects and initiatives will be undertaken over a one-year period within financial and staffing budgets. Whenever possible, quantifiable performance targets to be achieved during the period are also included in the Agreement.

The Performance Agreement facilitates measurement of short-term performance. The items included within it should be consistent with the Department's mission, objectives and strategies and generally they represent a subset of the Corporate Plan's implementation tasks.

Policy Area: A broad aggregation of policy sectors representing the main areas of government endeavour.

Policy Sector: A grouping of related programs representing a particular function of government.

Portfolio Savings: Reduction in expenditure achieved through the elimination or reduction of specific activities or programs.

Premiers' Conference: Annual meeting of all State Premiers with the Prime Minister to discuss issues of inter-governmental concern and set financial arrangements between levels of government.

Productive Efficiency: See Efficiency.

Productivity Dividends: Reduction in expenditure achieved through increased efficiency and economy while maintaining service levels.

Program: A grouping of activities to achieve a particular goal.

Program Area: A grouping of programs with related goals within the same organisational unit.

Program Budgeting: A budgetary system in which spending is classified according to the purposes (objectives) to be accomplished.

Program Performance Evaluation: Assessment of appropriateness, effectiveness, efficiency and economy of a Budget program or activity. Program performance evaluations are undertaken by Government organisations in accordance with a methodology and guidelines adopted by the Office of Public Management. External evaluations (called Efficiency Audits) may be undertaken by that office.

Program Revenue: Revenues of an ancillary nature generated by a program and paid into the Consolidated Fund.

Protected Items: Items in the Budget, expenditure on which is determined largely by factors external to the department (e.g., numbers of eligible pensioners), needed without requiring "borrowing" from future years' allocations.

Public Accounts: The annual financial statements prepared by the Treasurer in terms of Section 6, Public Finance and Audit Act 1983.

Public Accounts Committee: A Committee of five members of the Legislative Assembly appointed under the provisions of the Public Finance and Audit Act 1983, which is empowered to examine the financial administration of departments and bodies within the State Public Sector. The Committee reports to the Legislative Assembly.

Public Authorities (Financial Arrangements) Act 1987: The principal legislation governing the borrowing and investment powers of public authorities (as defined by the Act) and the provision of guarantees in respect of such borrowings.

Public Finance and Audit Act 1983: The principal legislation dealing with the State's financial administrative machinery, including provision for independent audit by the Auditor-General and review by the Public Accounts Committee.

Rate of Return: A measure of the financial performance of an organisation derived by expressing income (after all expenses but before interest and taxes) as a proportion of the asset base (or a component of the asset base) of the organisation.

Real Terms Recurrent Expenditure: Expresses the value of recurrent expenditure which has been adjusted for changes in the purchasing power of money, for example it has factored in the effects of inflation.

Recurrent Revenue and Payments (services): The on-going revenue and payments of government departments and authorities contained within the Budget sector including payments to the State by the Commonwealth under financial assistance grant arrangements.

Section 26, Public Finance and Audit Act 1983: Authorises the Treasurer to amend the revenue and expenditure estimates after the Budget is passed, to reflect changes in the level of Commonwealth specific purpose payments provided to the State.

Specific Purpose Payments: In addition to general purpose revenue payments to the States, the Commonwealth Budget also makes provision for payments to the States which must be used for specific purposes. The authority for such payments is Section 96 of the Australian Constitution.

Statutory Body (or Authority): An agency representing the Crown and set up under its own Statute.

State Owned Corporations: Public sector authorities that have been corporatised and established as companies under the State Owned Corporations Act.

Supplementation: The provision of additional Consolidated Fund money to an organisation after the Budget is presented. This provision may be from the Treasurer's Advance or under Section 22 of the Public Finance and Audit Act – in either case, Parliamentary approval is required in the following year's Appropriation Act.

Except for protected items, organisations exceeding their budget allocation are now supplemented on the basis that they will "borrow" from following years' allocations to cover the over-expenditure.

Supply: An Act that permits payments out of the Consolidated Fund pending passing of the annual Appropriation Act.

Tax: A compulsory payment to a government or government-sponsored entity not resulting in a direct benefit to the payer. Taxes include regulatory fees and fines.

Tied Grants: See specific purpose payments.

Total Payments: Estimated cash amounts that will be expended by Budget Sector organisations from all funding sources, including the Consolidated Fund, and Special Deposit Accounts. They can be either recurrent or capital payments.

Treasurer's Directions: Directions issued by the Treasurer, under Section 9 of the Public Finance and Audit Act 1983, covering accounting practices and procedures of departments and those statutory bodies not specifically exempted from the Directions.

User Charges: A user charge is a payment to a producer for the voluntary acquisition of a particular good or service of direct benefit to the user.

Vertical Fiscal Imbalance: Refers to the imbalance between the expenditure responsibilities and the revenue powers of the Commonwealth, the States and Local Government. On one hand the Commonwealth raises about 80 per cent of the taxes and is directly responsible for about 50 per cent of all Government expenditure in the country . On the other hand the States and Local Government have responsibility for 50 per cent of all Government expenditure but only have the power to raise about 20 per cent of what they need.

For further information on the Budget and How it Works
Contact the Treasurer's Office - Peter Sertori on 228 4363

APPENDIX V

BRIEFING NOTE BY PARLIAMENTARY LIBRARY:

COMMENTARY ON THE PROPOSAL TO PROVIDE FOR A BALANCED BUDGET IN THE NEW SOUTH WALES CONSTITUTION BY GARETH GRIFFITH

Briefing Note

Commentary on the Proposal to Provide for a Balanced Budget in the New South Wales Constitution

by

Gareth Griffith

No 022/94

COMMENTARY ON THE PROPOSAL TO PROVIDE FOR A BALANCED BUDGET IN THE NEW SOUTH WALES CONSTITUTION

by

Gareth Griffith

1. INTRODUCTION

On 13 September 1994 the Premier, the Hon J Fahey MP, and the Treasurer, the Hon P Collins MP, announced that NSW is to become the first Australian State to introduce legislation to guarantee a balanced budget. It was said that the legislation would be "enshrined in a referendum" to coincide with the March 1995 election. It is reported that voters will be asked to support a change to the NSW Constitution to ensure a debt-free annual balance sheet by 1997. It seems that not only would the Budget have to be balanced under the proposed scheme, but forward estimates contained in it would also have to show balanced Budgets into the future. According to the Premier, this would be based on certificates given by the Treasurer and the Secretary of the Treasury indicating it is within proper accounting procedures, otherwise the Budget appropriation bill "will not be valid or passed".[1] Budget deficits would be permitted but only in exceptional circumstances, such as natural disasters and other "emergencies".[2] The Treasurer elaborated, "Obviously in balanced-Budget legislation, you have to have provision for unforeseen consequences; natural disasters for example, major cyclical changes and as American States mostly provide, a stipulation in balanced legislation that should there be an overrun, that there will be a recovery in a specified period of time".[3] In support of the proposal it was also pointed out that every State but two in the US has balanced budget legislation.[4]

This briefing note looks first at certain constitutional considerations arising from the proposal and secondly at some of its economic implications.

2. CONSTITUTIONAL CONSIDERATIONS

(i) An entrenched provision?

Specific details of the proposal are not known at this stage. However, one possibility is that any proposed amendment to the *Constitution Act 1902* would take the form of an "entrenched" provision involving a restrictive procedure

[1] "People may get vote on balanced Budgets", *The Sydney Morning Herald*, 14 September 1994.

[2] "Balanced budgets to be law", *Telegraph-Mirror*, 14 September 1994.

[3] "Collins back-pedals over balanced Budget move", *The Sydney Morning Herald*, 15 September 1994.

[4] The Treasurer, Mr Collins, speaking on the 7.30 Report, ABC, 14 September 1994.

for its repeal or amendment, outside the normal legislative process. A number of mechanisms can be used for this purpose, including requirements for special majorities. More likely in this context is a manner and form provision similar to sections 7A and 7B of the Constitution Act. Under section 7A a referendum is required for bills abolishing the Legislative Council or altering its powers (and for certain other matters). Similarly, section 7B requires a referendum for bills affecting the Legislative Assembly in certain respects, specifically: compulsory voting; the requirement of single member electoral districts; redistribution; the number of voters in electoral districts; the conduct of Legislative Assembly elections; and the duration of the house beyond four years. Further provision for a referendum procedure is found in section 5B which refers to disagreements between the two houses. Any "Bill appropriating revenue or moneys for the ordinary annual services of the Government" is excluded from the operation of section 5B.

What may be proposed therefore is an entrenched provision mandating a balanced budget which could not be repealed without a referendum.

At one level the matter goes to the issue of parliamentary sovereignty, in particular to the question as to whether the NSW Parliament is disabled from fettering its own legislative action. Can it deprive itself and its successors of the power to legislate on any particular topic or to repeal any statute it may enact?[5] Put another way, what is the basis for requiring restrictive procedures for the repeal or amendment of any statute?

Peter Hanks explains[6] that the power to legislate so as to require restrictive procedures for legislation is derived from two sources: the general legislative power of each State Parliament; and from the *Australia Act 1986* (Cth). The general legislative power of the NSW Parliament "to make laws for the peace, welfare and good government of New South Wales in all cases whatsoever" is found in section 5 of the Constitution Act. In *Clayton v Heffron* (1960) 105 CLR 214 the High Court held that section 5 of the Constitution Act confers a full constituent power on the NSW Legislature and that the enactment of section 5B of the Act is a valid exercise of that power.

Section 6 of the *Australia Act 1986* (Cth), on the other hand, makes effective a restrictive procedure which prescribes a "manner and form" for the enactment of certain categories of legislation. It provides that where a State Parliament legislates respecting the constitution, powers or procedure of the Parliament of the State, its legislation will be of no force or effect unless it is made in such manner and form as may be required by a law made by that Parliament. Its

5 P Hanks, *Australian Constitutional Law: Materials and Commentary*, 5th ed, Butterworths 1994, p 126.

6 *Halsbury's Laws of Australia*, Vol 5, Butterworths 1993, at 164,394.

effect is substantially the same as section 5 of the *Colonial Laws Validity Act 1865* (UK). In the *Trethowan case* (1931) 44 CLR 394 it was held that section 7A of the Constitution Act was within the power conferred by section 5 of the Colonial Laws Validity Act. At issue was the validity of legislation to repeal section 7A and to abolish the Legislative Council. The High Court held that legislation to repeal the provision was a law respecting the powers of the legislature; the legislation to abolish the Legislative Council was a law respecting the constitution of the legislature; and the requirement that such laws be approved by the voters at a referendum was "properly described as requiring a manner in which the law shall be passed".[7]

It is clear, therefore, that the law-making power of the NSW Parliament can be constrained by means of a self-imposed requirement that a special legislative procedure be followed by the legislature.[8] Section 5 of the Constitution Act may provide a more general power in this respect, whereas reliance on section 6 of the Australia Act is explicitly restricted to laws on the subject of the constitution, powers or procedure of the Parliament. A referendum requirement is consistent with that provision. As King CJ said in *West Lakes v South Australia* (1980) 25 SASR 389

> a requirement that an important constitutional alteration be approved by the electors at a referendum....although extra-parliamentary in character, is easily seen to be a manner and form provision because it is confined to obtaining the direct approval of the people whom the 'representative legislature' represents (at 397).

A further question is whether (a) a mandatory balanced budget provision would be a law on the subject of the "constitution, powers or procedure of the Parliament" according to section 6 of the Australia Act, or (b) failing that, whether State Parliaments may impose manner and form requirements in relation to issues not within the meaning of that phrase, pursuant to the general legislative power under section 5 of the Constitution Act?

As to question (a) above, at issue is whether the mandatory budget provision could be characterised as a law with respect to the powers of the legislature to enact legislation. RD Lumb discusses the limits of section 6 of the Australia Act in this regard, noting

> It may be pointed out that a Bill of Rights which gives protection to civil rights (such as life, liberty, and property) and

7 *Attorney-General (NSW) v Trethowan* (1931) 44 CLR 394, at 432 (Dixon J).

8 *McCawley v R* [1920] AC 691; *Attorney-General (NSW) v Trethowan* (1931) 44 CLR 394.

which imposes a manner and form requirement (such as a referendum) for the passage of inconsistent legislation could not operate under s. 6 of the Australia Acts to affect or control legislation inconsistent with the Bill of Rights, for the reason that the later legislation would have been characterised as legislation on specific matters and not as legislation relating to the constitution, powers or procedure of the legislature.[9]

It seems that on this analysis an entrenched Bill of Rights would have to rely on the plenary law-making power under section 5 of the Constitution Act. Lumb goes on to say in this respect that the changes made in recent years to State constitutions (e.g. relating to the position of the Governor, the Supreme Court and electoral matters) have not depended on section 6 of the Australia Act. The key point is that the power to make manner and form provisions under section 5 of the Constitution Act appears to be much broader, qualified only by considerations of a procedural kind. Thus, Lumb concludes that the State Parliament "cannot make legislation unrepealable or impose a manner and form provision which is in effect a limitation of substance designed to inhibit the power of a State legislature to repeal the legislation. Viewed in another light, it would amount to an abdication of the power of the representative legislature to legislate in a particular area".[10] The example is given of a provision requiring that the repealing Bill be approved by ninety per cent of electors voting at referendum.

In any event, whether reliance is placed on section 5 of the Constitution Act or section 6 of the Australia Act, it is clear that an entrenched balanced budget provision, modelled on section 7A and others in the Constitution Act, would be legally valid. Thus, entrenchment of parts of the State's Constitution does not derogate from the sovereignty of the NSW Parliament, so long as the form of entrenchment is not too rigid in nature.[11]

The same conclusion would apply a fortiori if the proposed provision were not in an entrenched form. The provision could be repealed through the normal parliamentary procedures and so the legislature would not have bound itself or its successors in any way.

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[9] RD Lumb, *The Constitutions of the Australian States*, 5th ed, University of Queensland Press 1991, p 119.

[10] ibid, p 131.

[11] That view finds support in *Bribery Commissioner v Ranasinghe* [1965] AC 172.

(ii) An issue of constitutional practice and principle?

Having crossed the threshold of legal validity, the next step is to consider how the proposal sits within the framework of constitutional practice and principle informing the operation of the Westminster system of responsible government.

One general point is that, as a matter of constitutional principle, it is said that one Parliament should not stay the hand of its successors by entrenchment for the reason that circumstances change, as do community needs and values, and Parliament must be as free as possible to change with them. As the Legal and Constitutional Committee of the Victorian Parliament said in its report on the *Constitution Act 1975* (Vic), "A past Parliament is in no position to confidently predict the future, and so it should not seek to confine the liberty of action of its successors in attempting to cope with that future. Thus, as a general principle, entrenchment is to be avoided as comprising an intrusion of the dead hand of the past into the present".[12] However, one exception was noted, with the Committee stating, "It is widely accepted that the entrenchment of truly fundamental constitutional precepts and values may be appropriate, provided that the degree of entrenchment is not so great as to in practical terms completely incapacitate a future parliament from action".[13] Thus, the first matter the Committee considered was whether or not the constitutional entrenchment of the Supreme Court under section 85 of the Victorian Constitution Act was justified as "fundamental to the constitutional well-being of Victoria". If not, then, the practical difficulties of procedural and legal uncertainty created by that entrenchment would be unwarranted as a matter of constitutional principle. The Committee went on to approve the entrenchment on the grounds that it protected the fundamental principle of the Rule of Law. The argument has not met with universal acceptance, with Carol Foley contending that the Committee read "the concept of Rule of Law too narrowly and that it is not at all clear that s 85(1) does encapsulate the rule of law".[14]

Looked at in this context, the issue is whether the balanced budget proposal

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12 Legal and Constitutional Committee of the Victorian Parliament, *Report Upon the Constitution Act 1975*, 39th Report, p 10.

13 Ibid

14 CA Foley, "Section 85 Victorian Constitution Act 1975: Constitutionally Entrenched Right...or Wrong?" [1994] 20 *Monash University Law Review* 110-150. Foley comments: "It has been said that the Rule of Law is 'a set of concepts encompassing legal rules, institutions [and] processes of reasoning' and as such 'encompasses a great deal more than Courts' which merely provide a 'physical and institutional site' for the Rule of Law to be exercised. If this is so, then protecting the jurisdiction of the Supreme Court has little to do with protecting the Rule of Law; it is simply protecting the jurisdiction of the Supreme Court" (p 128).

constitutes a fundamental constitutional precept or value of sufficient weight and significance to require entrenchment. The issue, then, is not one of legal validity per se but of conformity with constitutional principle and established practice.

(iii) *Responsible government and representative democracy*

Further to this line of reasoning, it can be asked how the proposal would sit with the doctrine of responsible government, in particular as this relates to the making and passing of appropriation Bills. Under the doctrine of responsible government ministers are individually and collectively answerable to the Parliament and can retain office only while they have the "confidence" of the lower House, that is, the House of Representatives in the case of the Commonwealth and the Legislative Assembly or the House of Assembly in the case of the States. This is not the place to deal with this matter in any detail. It is enough to note the critical role played by the debate concerning the "power of the purse" in the historical development of responsible government and representative democracy. The crucial point is that responsible government has been linked, conceptually and practically, to the ability to obtain supply in the lower House of the legislature. In this way a link was forged between popular government and popular control. Thus, David Mayer refers to

> the constitutionalist interpretation of responsible government which links the convention that the prime minister should resign when denied supply, to the position of the government in the popular house. The ability to obtain supply indicates that the government has a majority in the lower house. The convention is not simply that denial of supply requires resignation. 'It is rather that *failure to retain majority support in the lower house, of which ability to obtain supply is the crucial test, requires resignation*'.[15]

That account of responsible government finds very clear expression in section 5A of the NSW Constitution Act, which accords legislative supremacy to the Legislative Assembly in relation to "any Bill appropriating revenue or moneys for the ordinary annual services of the Government". The section was inserted in the Constitution Act in 1933.

The compatibility of an entrenched balanced budget provision with the theory and practice of responsible government is open to various interpretations,

[15] DY Mayer, "Sir John Kerr and Responsible Government" in *Responsible Government in Australia*, ed by P Weller and D Jaensch, Drummond Publishing 1980, p 53.

which in turn depend on the different meanings attached to the term "responsibility". AH Birch set out three possible meanings of responsibility.[16] The one of least interest in this context is the idea of collective and individual ministerial responsibility. A second meaning is that of responsiveness to public opinion; thus, responsible government refers to the exercise of democratic authority in a liberal democratic state. It could be argued that a referendum requirement would enhance that aspect of responsible government. In *Trethowan's case*, Rich J described a referendum as a mode of manner and form legislation which "includes the electorate as an element in the legislative authority in which the power of constitutional alteration resides" (at 421). An entrenched balanced budget proposal would extend the operation of that popular involvement in Parliament's legislative authority, taking it into an area which constitutes one of the core testing grounds of popular control. However, neither the nature nor extent of this popular involvement should be overstated: it would be basically procedural in kind, limited to the passing (or rejecting) of the original Bill at referendum and to any subsequent referendum for amending the provision. On both occasions the decision to hold a referendum would be made by Parliament itself.

Alternatively, it could be argued that a balanced budget proposal would constitute an unnecessary appendage to the legislative authority of the lower House, one which may even be seen as compromising its pre-eminent position in relation to appropriation Bills, at the same time putting a question mark over the Legislative Assembly's claim to be the people's House. Arguably, it would introduce an uncomfortable tautology into the Constitution, whereby the defining legislative authority of the people's House would itself be subject to popular constraint. On this basis, it could be argued that the balanced budget proposal would fetter Parliament as a popular or representative body.

This leads into the third meaning of "responsibility", with AH Birch referring to prudent and consistent government in which unpopular decisions may be taken in the "national interest" (the terminology used by Birch was that appropriate to a unitary state). With the necessary modifications required for a federation, this third meaning suggests that good government may not always coincide with popular government and, further, that parliamentary representatives are not mere delegates or agents of their constituents, since they are expected to exercise their judgment and discretion in enacting legislation. Further to this, the comment can be made that a mandatory balanced budget proposal would inevitably fetter judgment and discretion. It could also be said that budgetary matters are quintessentially of this kind: discretionary in nature, varying according to circumstance, requiring popular and sometimes unpopular judgment and decision on the part of government. Of

[16] Birch's view are summarised in JR Archer, "The Theory of Responsible Government in Britain and Australia" from Weller and Jaensch, op cit, p 23.

course there is always another side to these conceptual debates, which on this occasion may lead to an alternative argument based, for example, on considerations of fiscal responsibility. One advantage which could be cited by proponents of the balanced budget proposal is that it would effectively de-couple the business cycle from the electoral cycle. Further to this, the comment can be made that a balanced budget proposal seeks to create the fiscal underpinning needed for the economic and social stability upon which responsible, stable government depends.

The above discussion suggests the extent to which the balanced budget proposal impacts on the matrix of conventions and practices basic to our system of government.

What is clear is that any proposal would have to be considered in the light of its potential effect on the operation of section 5A of the NSW Constitution Act.

(iv) Procedural and definitional uncertainty

Without in any way attempting to pre-empt the form any proposal will take, it is worth at least noting the obvious concern about procedural and definitional uncertainty which can arise in relation to any constitutional provision. Mention was made in passing to the difficulties of this kind which have arisen in regard to section 85 of the Victorian Constitution Act, but the point is not limited to that example. The wider issue relates to the level of generality of language which tends to be used in constitutions and the uncertainties which flow from this. Also, as Pilita Clark explained in *The Sydney Morning Herald* of 16 September 1994 in regard to the US debate on the balanced budget rule, "judges, rather than politicians, would become the ultimate umpires in any dispute about whether the terms of the balanced budget laws have been met".

The difficulty in this context is that a term such as "budget deficit" has no agreed legal meaning. Indeed it may even be the case that professional economists do not agree as to its meaning. If that is true, then statements of the following kind need to be read with caution: "A budget deficit is simply the amount by which government's expenditures exceed its revenues during a particular year".[17] A NSW Treasury guide to *The Budget & How It Works* defines "deficit" thus: "General term used to describe an excess of government expenditure over revenue. *Its definition varies between different States*" (emphasis added).[18]

[17] J Jackson, R McIver and C McConnell, *Economics*, 4th ed, Mcgraw-Hill Book Co 1994, p 277.

[18] NSW Treasury, *The Budget & How It Works*, p 32.

A key issue, then, relates to what constitutes government expenditure for budgetary purposes, along with the method of calculation. Naomi Caiden made the point in an American context, adding that whatever categories are excluded from the definition of expenditure will automatically attract spending: "Everything depends on the wording of the limitation and how it is interpreted".[19] One obvious question is whether both the capital budget and current revenue outlays would have to be in balance, or would the provision be limited in its application to the latter, as seems to happen in some of the US States.[20] Beyond this, some indication of the complexities that may arise is gained from a NSW Treasury publication of 1991, which states: "Most budgets provide for discretionary expenditure by the executive, the budgets do not incorporate the financial operations of all public sector agencies and most governments have trust funds which receive dedicated revenues".[21] Bob Walker makes the point that the NSW budget "relates to a part of government activities, mainly government departments" and that it excludes some of the public sector's most important agencies and activities.[22]

Writing in *The Australian* of 12 June 1992 Paddy McGuinness commented on the potential difficulties involved in these terms

> The prospect of having lawyers debating and deciding fundamental issues of economics and accountancy like the definition and significance of Budget deficits is hardly attractive to the serious analysts of fiscal policy, even those who believe that Budgets in some sense should be balanced.

McGuinness proceeds to say of the Gramm-Rudman Bill, which requires a balanced Federal budget in the US, that "it has led to a great deal of creative accounting by Congress, and the invention of numerous different concepts of

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19 N Caiden, "Problems in Implementing Government Expenditure Limitations", from *How To Limit Government Spending* by A Wildavsky, University of California Press 1980, p 150. Caiden adds, "It is probably impossible to frame an amendment which cannot be avoided".

20 JR Cranford, "State Budgets: Deceptive Models", *Congressional Quarterly Weekly Report*, 13 June 1992.

21 D Nicholls, *Managing State Finance: The New South Wales Experience*, NSW Treasury 1991, p 156.

22 B Walker, "Budget's lost balance", *The Sydney Morning Herald*, 15 September 1994. Cited as examples are the Department of Public Works and government trading enterprises. Walker adds: "the government of the day might decide what it will include and what it will exclude from its 'budget sector'".

what a Budget deficit is".[23] The same fate has been predicted for the NSW proposal.[24]

It may be that a provision could be drafted which makes no direct reference to the term "budget deficit", except perhaps in the section heading. This is the case with some of the comparable provisions found in the constitutions of the US States. For example, Article III, section 52 (5a) of the Maryland Constitution provides

> The Budget and the Budget Bill as submitted by the Governor to the General Assembly shall have a figure for the total of all proposed appropriations and a figure for the total of all estimated revenues available to pay the appropriations, and the figure for total proposed appropriations shall not exceed the figure for total estimated revenues. Neither the Governor in submitting an amendment or supplement to the Budget shall thereby cause the figure for total proposed appropriations to exceed the figure for total estimated revenues, including any revisions, and in the Budget Bill as enacted the figure for total estimated revenues always shall be equal to or exceed the figure for total appropriations.

It has been indicated that exceptions would be made to the balanced budget provision in NSW to accommodate "emergencies" of various kinds and, according to the Treasurer, in the event of "major cyclical changes". The provision would therefore have to provide both for a balanced budget and a sufficient measure of flexibility required to deal with a range of contingencies. Taken with the comments made already about the scope for potential uncertainty, this further complication adds to the perception of difficulty involved in the transformation of a mandatory balanced budget proposal into a constitutional provision. Procedural matters would have to be spelt out with great care to include, presumably, appropriate mechanisms for revising the expenditure limit. To offer an American example again, the Louisiana Constitution provides that "The expenditure limit may be changed in any fiscal year by a favorable vote of two-thirds of the elected members of each house. Any such change in the expenditure limit shall be approved by passage of a specific legislative instrument which clearly states the intent to change the limit".[25] An alternative approach may be to draft a provision which could be

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[23] A detailed account of the Bill and its history is found in J White and A Wildavsky, *The Deficit and the Public Interest*, University of California Press 1989.

[24] "Mr Collins's Budget Stunt", *The Sydney Morning Herald*, 15 September 1994.

[25] Article VII, section 10 (2)

Any such change in the expenditure limit shall be approved by passage of a specific legislative instrument which clearly states the intent to change the limit".[25] An alternative approach may be to draft a provision which could be set aside or modified relatively easily. Indeed, the initial suggestion seems to have been that if "a government wanted to run a deficit, the Treasurer would be required to present a valid reason to the Parliament".[26]

3. ECONOMIC CONSIDERATIONS

(i) Annually or cyclically balanced budgets?

The debate about balanced budgets is part of the wider discussion among economists of the relative merits and de-merits of the Keynesian and neo-classical approaches to fiscal policy. Within this discussion it is asked whether it is desirable to incur deficits and thereby realise a growing public debt, or should the budget be balanced annually? A corollary to this is whether the budget should be balanced annually or across the business cycle?

Following Jackson et al it can be said that until the 1930s the annually balanced budget was generally accepted as a desirable goal of public finance: "Upon examination, however, it becomes evident that an annually balanced budget largely rules out government fiscal activity as a counter-cyclical, stabilising force. Worse yet, an annually balanced budget actually intensifies the business cycle". The example is offered of a situation of high unemployment, falling incomes and declining tax receipts. To balance its budget the government must increase tax rates and/or reduce government expenditures, both of which are contractionary in nature, resulting in a further dampening of aggregate expenditures. The conclusion, according to Jackson et al, is that an annually balanced budget is not economically neutral: "the pursuit of such a policy is pro-cyclical, not counter-cyclical".

Jackson et al pose the alternative of a cyclically balanced budget which sees government exerting a counter-cyclical influence and at the same time balancing its budget. The budget would not be balanced annually but over the course of the business cycle. It is remarked that "there is nothing sacred about 12 months as an accounting period". The authors comment

> The basic problem with this budget philosophy is that the upswings and downswings may not be of equal magnitude and

[25] Article VII, section 10 (2)

[26] "Fahey to make Budgets balance", *The Sydney Morning Herald*, 14 September 1994.

> duration and hence the goal of stabilisation comes into conflict with balancing the budget over the cycle. For example, a long and severe slump, followed by a modest and short period of prosperity, would mean a large deficit during the slump, little or no surplus during prosperity and therefore a cyclical deficit in the budget.[27]

At least two issues are raised here. One concerns the general desirability of an annually balanced budget. A second refers to the conditions under which a deficit would be permitted. As noted, the Treasurer cited the example of those American States which provide a "stipulation in balanced legislation that should there be an overrun, that there will be a recovery in a specific period of time". For example, the Louisiana Constitution provides, "If a deficit exists in any fund at the end of a fiscal year, that deficit shall be eliminated no later than the end of the next fiscal year".[28] Further to Jackson et al, the difficulty is that business cycles are irregular in length and that, on their analysis, it may not always be prudent to seek to balance the budget within a fixed time period. Alternatively, a constitutional provision which made reference to "the business cycle" (or some equivalent term) may only intensify the potential problems of legal interpretation alluded to earlier in this briefing note. Again, one option could be to adopt a relatively flexible provision, perhaps avoiding definitional disputes by allowing Parliament itself to determine the time-period over which the budget is to be balanced, with that time-period being defined in terms of "the business cycle" or otherwise.

It should be emphasised that the comments referred to here do not of themselves deny the benefits that might flow from some kind of balanced budget provision. Such a provision could well facilitate good economic management practices, resulting perhaps in budget surpluses during economic upturns, or at least in the avoidance of debt. The absence of debt would then place the government in a better position to deal with any downturn in the economy. Looking to the extremes among the Australian States by way of illustration, the difference alluded to here is between the way Queensland, on one side, and Victoria, on the other, has been equipped in a fiscal sense to respond to recessionary pressures over recent years. A further argument is that a balanced budget policy would assist with the foreign debt problem which, arguably, is an important contributing factor to the boom-bust cycle experienced by the Australian economy. Perhaps the more general point to make is that there probably is no such thing as an economically neutral approach to public finance; rather, the choice is between competing alternatives, all of which are infused with the value judgments of the opposing

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[27] J Jackson, R McIver and C McConnell, op cit, pp 277-278.

[28] Article VII, section 10 (4) (G)

schools of economic thought. It is in this context that the debate about mandatory balanced budget legislation takes place.

(ii) Other economic issues

The following questions have been posed:

- would the proposal restrict unduly the State government's ability to finance capital projects?[29]

- would the proposal compromise the principle of intergenerational equity in the financing of capital projects? The argument is that the costs of building and maintaining the State's infrastructure of roads, schools, hospitals etc should be shared between generations of taxpayers and the concern is that balanced budget legislation may impede the application of that principle of social justice. Ian McDonald states: "Under a balanced government budget, the current population is forced to sacrifice income to pay for government investment. The benefits from that investment will be enjoyed by people in the future. Is it fair that one group of people bears the costs and another group gets the benefits? Surely fairness would require that taxes and charges to pay for the investment are levied on the people who enjoy the benefits from the investment. Those who use the roads, hospitals, universities, etc. should be the ones who pay for the construction, not the people unlucky enough to be around at the time of construction".[30]

  As with all economic arguments and propositions, the above needs to be handled with some care. For example, it seems that the argument of fairness only really works if the savings level of the current generation is not for some reason disproportionately low. If the savings level is distorted in some way, then it may indeed be fair to ask the present generation to pay for capital projects.

- would the constitutional provision refer to cash accounting or accrual accounting for its standard of measurement?[31] Bob Walker has

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[29] RL Heilbroner and JK Galbraith, *Understanding Macroeconomics*, 9th ed, Prentice-Hall 1990, p 302. The comment is made in relation to the US Federal budget but the point it makes is of wider interest and relevance.

[30] IM McDonald, *Macroeconomics*, John Wiley & Sons 1992, p 455.

[31] "Balanced Budget proposal raises political stakes", *The Sydney Morning Herald*, 14 September 1994.

commented that "cash-based budgets and budget results don't cover unpaid financial commitments which are included in measures of State liabilities....Hence governments could readily evade any such legislation by running up liabilities through GTEs or other agencies outside the scope of their self-defined 'budget sector'".[32]

- would the proposal engender forms of creative accounting, leading to a loss of faith on the public's part in budget estimates?[33]

- does the proposal rely for its popular appeal on a "household analogy" of budgeting, the validity of which can be questioned in its application to economic-wide management? The Premier is reported to have said, "it's the household analogy: you can't spend what you haven't got".[34] The validity of that analogy was questioned by John Veale in these terms: "If a household is spending more than it is earning, it can lower its expenditure, and for every dollar expenditure is lowered, the excess of expenditure over income will be similarly lowered. This occurs because the household's income is independent of its expenditure. This is not the case at the macro-economic level. The level of government income, that is, tax revenue, depends upon the level of government expenditure. If the government lowers the level of expenditure this leads to a multiplied decrease in the level of income and a fall in tax

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32 B Walker, "Budget's lost balance", *The Sydney Morning Herald*, 15 September 1994. The issue of cash-based versus accrual accounting was discussed in *The Economist* of 15 August 1994 in an article headed "New Zealand Inc". The article commented: "Under the crude cash-based method of accounting which governments have traditionally used to measure their budget deficits, revenue and expenditure are recorded when the cash is received or paid out. Accrual accounting, by contrast, records spending and taxes when they are incurred, regardless of when the money actually changes hands. Cash-based accounting gives a false sense of security about the sustainablity of government policies. It does not distinguish between current and capital expenditure....Accrual accounting should provide a more accurate picture of a government's financial position because it keeps track of the changing value of assets and liabilities....it would also expose all the financial tricks in conventional budget accounts, such as using asset sales to reduce a budget deficit". It has been said that the NSW Government has been a leader in introducing accrual accounting - the form of accounting used by public companies ("Balanced Budget proposal raises political stakes", *The Sydney Morning Herald*, 14 September 1994).

33 "Mr Collins's Budget stunt", *The Sydney Morning Herald*, 15 September 1994.

34 "Fahey to make Budgets balance", *The Sydney Morning Herald*, 14 September 1994.

revenue".[35]

- would the proposal compromise the principle of "reasonable management flexibility" discussed in the NSW Treasury's publication of July 1991?[36]

- would the proposal impose significant pressure on tax rates in NSW at a time when all States are using tax concessions to attract new businesses?[37]

(iii) A comment on the United States

As noted, the existence of balanced budget legislation in the US is used to support its proposed introduction in NSW. The US experience has also been used in opposition to the proposal. This raises an empirical question as to the success or otherwise of the US States in the implementation of balanced budget legislation. Also, it raises the issue of comparative analysis in an acute form. Basically, the question is "are we comparing like with like?".

Meaningful and reliable answers to either question would require substantial research work; anything that follows by way of comment needs to be read in that light, as no more than tentative and partial observations.

Central to the issue of comparability is the way fiscal arrangements differ between federations. Much has been written in recent years about the extent of vertical fiscal imbalance in Australia, both in absolute terms and relative to other federations. The contrast has been made with the US States, for example, many of which have their own income taxing powers. The contrast with the US position is particularly striking. Unlike Australia, there are few constitutional or legal limitations on the taxing powers of the US States, which thus enjoy considerable fiscal sovereignty.[38] In any event, the general point is

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35 J Veale, "Fiscal Policy - Fiscal and Monetary Impacts" in *Australian Macroeconomics: Problems and Policy*, 2nd ed, edited by J Veale, G Walker, T Murphy and L Perry, Prentice-Hall 1983, p 86.

36 D Nicholls, op cit, p 156.

37 "Rethink on the balanced budget", *The Sydney Morning Herald*, 19 September 1994.

38 CE McLure, "A North American View of Vertical Imbalance and the assignment of Taxing Powers" from *Vertical Fiscal Imbalance and the Allocation of Taxing Powers*, ed by DJ Collins, Australian Tax Research Foundation 1993, p 253. Another comparative account is found in TA Rounds, *Tax Harmonization and Tax Competition*, Federalism Research Centre 1992. Rounds comments: "The

that budgetary matters in a federation must be understood in the context of inter-governmental fiscal and other arrangements, which obviously vary from one federation to another. True comparisons are difficult to make therefore.

It is also the case that budgetary considerations vary within as well as between federations. The argument is put that significant variations exist among US States in revenue-raising capacity and service needs, considerations which further complicate any commentary on the merits and de-merits of balanced budget legislation.

As always with economists, different accounts can be found of the success or otherwise of such legislation in the various States. A common observation is that, in aggregate, US State governments experienced considerable fiscal stress during the recent economic downturn, with many States having to deal with record-level projected budget deficits in an effort to conform to their constitutional or statutory requirements to balance their budgets.[39] The blow-out in Medicaid financing is often cited as a source of continuing fiscal stress, as are court orders to reform school finances and relieve prison overcrowding, plus decreases in the real value of discretionary Federal grants-in-aid.[40] However, this gloomy picture has been revised in last year or so. A survey conducted by the National Governors' Association and National Association of State Budget Officers calls the outlook for State budgets "the most favourable since the start of the national recession in 1990".[41]

The one thing that can be said with confidence is that balanced budget legislation is certainly prevalent among the US States. One 1992 account said that every State but one - Vermont - has either a constitutional or statutory requirement for a balanced budget. The article went on to say that the following methods were used to control deficit spending:

United States Constitution provides relatively little direction in the division of tax bases vertically between levels of government and consequently except for customs duties, all tax bases are shared between two or more levels of government" (p 17).

39 HA Coleman, "External Limits on State Taxation of Business Activities", from *Economic Union in Federal Systems*, ed by A Mullins and C Saunders, The Federation Press 1994, pp 194-214.

40 MA Howard, "State Finances in a Changing Economy", *The Book of the States 1992-1993*, The Council of State Governments, pp 346-350.

41 J Connor, "Budget outlook may lead States to ease taxes", *The Wall Street Journal* 28 April 1994. For a brief overview of the current situation see HS Wulf, "State Government Finances, 1992", *The Book of the States*, 1994-1995, The Council of State Governments, pp 323-331.

- in all but six States, the Governor must submit a balanced budget to the legislature;
- in all but twelve, the legislature has to pass a balanced budget;
- in all but nineteen, the Governor must sign a balanced budget; and
- in all but nine, the Government cannot carry a deficit over to the following year.[42]

Mandatory balanced budget provisions are undoubtedly popular in the US and, to that extent at least, they deserve serious scrutiny and analysis.

4. CONCLUSION

The proposal to include a mandatory balanced budget provision in the NSW Constitution Act presents us with interesting and novel issues of constitutional analysis. Economically, its implications are both highly complex and contentious, going as it does to the very heart of the matters which divide the different schools of economic thought on the vexed question of public finance. Constitutionally however things are more clear cut.

[42] JR Cranford, op cit.

APPENDIX VI

FISCAL RESPONSIBILITY ACT 1994, NO.17 (NEW ZEALAND)

1994 *Fiscal Responsibility* No. 17

ANALYSIS

1994, No. 17

An Act to improve the conduct of fiscal policy by specifying principles of responsible fiscal management and by strengthening the reporting requirements of the Crown and, in particular,—

(a) By requiring the Minister of Finance to report regularly to the House of Representatives on the extent to which the Government's fiscal policy is consistent with the specified principles of responsible fiscal management and to justify in his or her report any departures made by the Government from those principles; and

(b) By requiring all the Crown's financial reporting to be in accordance with generally accepted accounting practice; and

(c) By requiring the Minister of Finance—

(i) To publish, at least 3 months before the start of each financial year, a budget policy statement containing the Government's long-term objectives for fiscal policy, its broad strategic priorities for the Budget for that financial year, and its fiscal intentions for that and the next 2 financial years; and

(ii) To lay before the House of Representatives, on the day on which the first Appropriation Bill relating to a financial year is introduced, a fiscal strategy report assessing the consistency of the Budget with the budget policy statement and providing progress outlooks for the next 10 years, and an economic and fiscal update prepared by the Treasury for the next 3 years; and

(iii) To publish, in December of each financial year, an economic and fiscal update prepared by the Treasury for the next 3 years; and

(iv) To publish, before each general election, an economic and fiscal update prepared by the Treasury for the next 3 years; and

(v) To lay before the House of Representatives, towards the end of each financial year, a fiscal update prepared by the Treasury for that year, including forecast estimated actual financial statements for the Crown

[*27 June 1994*

BE IT ENACTED by the Parliament of New Zealand as follows:

1. Short Title and commencement—(1) This Act may be cited as the Fiscal Responsibility Act 1994.

(2) This Act shall come into force on the 1st day of July 1994.

2. Interpretation—(1) In this Act, unless the context otherwise requires, "Budget", in relation to a financial year, includes—

(a) The statement delivered by the Minister when moving the second reading of the first Appropriation Bill relating to that financial year; and

(b) The fiscal strategy report laid before the House of Representatives under section 7 (1) of this Act for that financial year; and

(c) The report containing an economic and fiscal update laid before the House of Representatives under section 8 (1) of this Act for that financial year; and

(d) The Estimates laid before the House of Representatives under section 9 (1) of the Public Finance Act 1989 for that financial year.

(2) In this Act, unless the context otherwise requires, the terms "commitment", "contingent liability", "Crown", "department", "expenses", "financial year", "generally accepted accounting practice", "Government", "Minister", "Secretary", and "Treasury" have the meanings given to them by section 2 (1) of the Public Finance Act 1989.

3. Act to bind the Crown—This Act shall bind the Crown.

4. Principles of responsible fiscal management—(1) Subject to subsection (3) of this section, the Government shall pursue its policy objectives in accordance with the principles of responsible fiscal management specified in subsection (2) of this section.

(2) The principles of responsible fiscal management are—

(a) Reducing total Crown debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total Crown debt in the future, by ensuring that, until such levels have been achieved, the total operating expenses of the Crown in each financial year are less than its total operating revenues in the same financial year; and

(b) Once prudent levels of total Crown debt have been achieved, maintaining these levels by ensuring that, on average, over a reasonable period of time, the total operating expenses of the Crown do not exceed its total operating revenues; and

(c) Achieving and maintaining levels of Crown net worth that provide a buffer against factors that may impact adversely on the Crown's net worth in the future; and

(d) Managing prudently the fiscal risks facing the Crown; and

(e) Pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

(3) The Government may depart from the principles of responsible fiscal management specified in subsection (2) of this section, but when the Government does so—

(a) Any such departure shall be temporary; and

(b) The Minister of Finance shall, in accordance with this Act, specify—

(i) The reasons for the Government's departure from those principles; and

(ii) The approach the Government intends to take to return to those principles; and

(iii) The period of time that the Government expects to take to return to those principles.

5. Generally accepted accounting practice—All financial statements included in reports required under this Act shall be prepared in accordance with generally accepted accounting practice.

6. Budget policy statement—(1) The Minister shall, not later than the 31st day of March in each year, cause to be published a budget policy statement.

(2) The budget policy statement shall specify the Government's long-term objectives for fiscal policy and, in particular, for the following variables:

(a) The Crown's total operating expenses; and

(b) The Crown's total operating revenues; and

(c) The balance between the Crown's total operating expenses and the Crown's total operating revenues; and

(d) The level of the Crown's total debt; and

(e) The level of the Crown's net worth,—

and shall explain how these long-term objectives accord with the principles of responsible fiscal management specified in section 4 (2) of this Act.

(3) The budget policy statement shall, for the financial year commencing on the 1st day of July after it is published and the 2 financial years following that financial year,—

(a) Specify the broad strategic priorities by which the Government will be guided in preparing the Budget for that financial year; and

(b) Indicate explicitly, by the use of ranges, ratios, or other means, the Government's intentions regarding each of the variables specified in subsection (2) of this section.

(4) The budget policy statement shall—

(a) Assess the extent to which the intentions indicated under subsection (3) (b) of this section are consistent with the principles of responsible fiscal management specified in section 4 (2) of this Act and with the objectives specified under subsection (2) of this section; and

(b) Where the intentions indicated under subsection (3) (b) of this section are not consistent with the principles of responsible fiscal management specified in section 4 (2) of this Act or with the objectives specified under subsection (2) of this section or with both, specify—

(i) The reasons for the departure of those intentions from those principles or from those objectives or from both; and

(ii) The approach the Government intends to take to ensure that its intentions regarding each of the variables specified in subsection (2) of this section become consistent with those principles and those objectives; and

(iii) The period of time that is expected to elapse before the Government's intentions regarding each of the variables specified in subsection (2) of this section become consistent with those principles and those objectives.

(5) The budget policy statement shall—

(a) Assess the consistency of the objectives specified under subsection (2) of this section with the objectives specified in—

(i) The immediately preceding budget policy statement; or

(ii) Where the objectives specified in the immediately preceding budget policy statement were amended in the report most recently prepared under section 7 of this Act, the objectives specified in that report; and

(b) Where the objectives specified under subsection (2) of this section are not consistent with those in the immediately preceding budget policy statement or in the report most recently prepared under section 7 of this Act, justify the departure of the objectives specified under subsection (2) of this section from those in that immediately preceding budget policy statement or in that report.

(6) The budget policy statement shall—

(a) Assess the consistency of the intentions indicated under subsection (3) (b) of this section with the intentions indicated in—

(i) The immediately preceding budget policy statement; or

(ii) Where the intentions indicated in the immediately preceding budget policy statement were amended in the report most recently prepared under section 7 of this Act, the intentions indicated in that report; and

(b) Where the intentions indicated under subsection (3) (b) of this section are not consistent with those in the immediately preceding budget policy statement or in the report most recently prepared under section 7 of this Act, justify the departure of the intentions indicated under subsection (3) (b) of this section from those in that immediately preceding budget policy statement or in that report.

(7) The Minister shall not later than 3 sitting days after the date of the publication of a budget policy statement under subsection (1) of this section, lay a copy of the statement before the House of Representatives.

7. Fiscal strategy report—(1) The Minister shall, for each financial year, after the introduction of the first Appropriation Bill relating to that financial year, but on the day of the introduction of that Bill, lay before the House of Representatives a report on the Government's fiscal strategy.

(2) The fiscal strategy report shall include—

(a) An assessment of the extent to which the report containing an economic and fiscal update being laid before the House of Representatives under section 8 (1) of this Act is consistent with the intentions indicated under section 6 (3) (b) of this Act in the budget policy statement most recently published under section 6 (1) of this Act; and

(b) Where the economic and fiscal update departs from the intentions indicated under section 6 (3) (b) of this Act in that budget policy statement, an explanation of the reasons for the departure; and

(c) Where the Government's intentions under section 6 (3) (b) of this Act have changed from those indicated in that budget policy statement, an amended version of the intentions required by section 6 (3) (b) of this Act.

(3) The fiscal strategy report shall also include—

(a) Progress outlooks that—

(i) Include projections of trends in the variables specified in section 6 (2) of this Act, which projections shall illustrate, for stated significant assumptions, likely future progress towards achieving the longer-term fiscal strategy and objectives specified in the budget policy statement most recently published under section 6 (1) of this Act; and

(ii) Explain the reasons for any significant differences from previous progress outlooks; and

(b) An assessment of the consistency of the progress outlooks with the objectives specified under section 6 (2) of this Act in the budget policy statement most recently published under section 6 (1) of this Act; and

(c) Where the progress outlooks depart from the objectives specified under section 6 (2) of this Act in that budget policy statement, an explanation of the reasons for the departure; and

(d) Where the Government's objectives under section 6 (2) of this Act have changed from those specified in that budget policy statement, an amended version of the objectives required by section 6 (2) of this Act (which version shall accord with the principles of responsible fiscal management specified in section 4 (2) of this Act).

(4) The projections required by subsection (3) (a) (i) of this section shall relate to a period of 10 or more consecutive financial years commencing with the financial year to which the Appropriation Bill relates.

8. Economic and fiscal update—(1) The Minister shall for each financial year, after the introduction of the first Appropriation Bill relating to that financial year, but on the day of the introduction of that Bill, lay before the House of Representatives a report containing an economic and fiscal update prepared by the Treasury.

(2) The update shall contain economic and fiscal forecasts relating to the financial year to which the Appropriation Bill relates and to each of the following 2 financial years.

(3) The update shall contain a statement specifying the day on which the contents of the update were finalised, or the days on which the contents of different specified aspects of the update were finalised.

9. Economic forecasts—(1) The economic forecasts contained in the update shall, for each of the 3 financial years to which they relate, include forecasts of movements in New Zealand's—

(a) Gross domestic product, including the major components of gross domestic product:

(b) Consumer prices:

(c) Unemployment and employment:

(d) Current account position of the balance of payments.

(2) The economic forecasts shall also include a statement of all significant assumptions underlying them.

10. Fiscal forecasts—(1) The fiscal forecasts contained in the update shall, for each of the 3 financial years to which they relate, include forecast financial statements for the Crown.

(2) The forecast financial statements for the Crown shall include—

(a) A statement of the forecast financial position of the Crown at the balance date for each of those financial years:

(b) An operating statement reflecting the forecast revenue and expenses of the Crown for each of those financial years:

(c) A statement of cash flows reflecting forecast cash flows of the Crown for each of those financial years:

(d) A statement of borrowings reflecting the forecast borrowing activities of the Crown for each of those financial years:

(e) Such other statements as are necessary to fairly reflect the forecast financial operations of the Crown for each of those financial years and its forecast financial position at the end of each of those financial years.

(3) The forecast financial statements for the Crown shall also include—

(a) A statement of commitments of the Crown as at the day on which the forecast financial statements are finalised (other than the commitments included in the statements prepared under subsection (2) of this section):

(b) A statement of specific fiscal risks of the Crown as at the day on which the forecast financial statements are finalised, being the fiscal risks in relation to—

(i) The Government decisions and other circumstances required by section 11 of this Act to be incorporated in the economic and fiscal update; and

(ii) Any other contingent liabilities of the Crown, including any guarantees or indemnities given under any Act:

(c) A statement of all significant accounting policies, including any changes from the accounting policies contained in the annual financial statements of the Crown most recently laid before the House of Representatives or published under section 31 of the Public Finance Act 1989:

(d) In relation to each statement required by paragraphs (a) to (d) of subsection (2) of this section and, where appropriate, in relation to any statement required by paragraph (e) of that subsection,—

(i) Comparative budgeted and estimated actual figures for the financial year immediately before the first of the financial years to which the fiscal forecasts relate; and

(ii) Comparative actual figures for the financial year 2 years before the first of the financial years to which the fiscal forecasts relate.

(4) The forecast financial statements for the Crown shall be for the same reporting entity as the annual financial statements for the Crown to be prepared under section 27 of the Public Finance Act 1989 for the first of the financial years to which the fiscal forecasts relate.

(5) The fiscal forecasts shall also include a statement of all significant assumptions underlying them.

11. Disclosure of policy decisions and other matters that may influence future fiscal situation—(1) Every economic and fiscal update prepared under section 8 (1) or section 13 (1) or section 14 (1) of this Act shall incorporate to the fullest extent possible consistent with subsection (4) of this section all Government decisions and all other circumstances that may have a material effect on the fiscal and economic outlook.

(2) Where the fiscal implications of Government decisions and other circumstances referred to in subsection (1) of this section can be quantified for particular years with reasonable certainty by the day on which the forecast financial statements for the Crown are finalised, the quantified fiscal implications of those Government decisions and other circumstances shall be included in the forecast financial statements for the Crown.

(3) Where the fiscal implications of Government decisions and other circumstances referred to in subsection (1) of this section cannot be quantified for or assigned to particular years with reasonable certainty by the day on which the forecast financial statements for the Crown are finalised, those Government decisions and other circumstances shall be disclosed in the statement of specific fiscal risks of the Crown required by section 10 (3) (b) of this Act.

(4) Subsection (1) of this section and section 10 (2) (e) of this Act shall not apply to a decision, circumstance, or statement where the Minister determines that—

(a) To incorporate that decision, circumstance, or statement in an economic and fiscal update is likely—

(i) To prejudice the substantial economic interests of New Zealand; or

(ii) To prejudice the security or defence of New Zealand or the international relations of the Government; or

(iii) To compromise the Crown in a material way in negotiation, litigation, or commercial activity; or

(iv) To result in material loss of value to the Crown; and

(b) There is no reasonable or prudent way the Government can avoid this prejudice, compromise, or material loss—

(i) In the case of a circumstance, by making a decision before the day on which the forecast financial statements for the Crown are finalised; or

(ii) In the case of a decision or circumstance, by incorporating in the update the fiscal implications of that decision or circumstance, or the nature of that decision or circumstance but without reference to its fiscal implications; or

(iii) In the case of a statement, by incorporating that statement in the update.

12. Statement of responsibility—Every economic and fiscal update prepared under section 8 (1) or section 13 (1) or section 14 (1) of this Act shall be accompanied by a statement of responsibility signed by the Minister and the Secretary and comprising—

(a) A statement by the Minister that all policy decisions with material economic or fiscal implications that the Government has made before the day on which the contents of the update or of the relevant aspect of the update were finalised, and all other circumstances with material economic or fiscal implications of which the Minister was aware before that day have been communicated to the Secretary; and

(b) A statement by the Secretary that the Treasury has supplied to the Minister, using its best professional judgment on the basis of economic and fiscal information available to it before the day on which the contents of the update or of the relevant aspect of the update were finalised, an economic and fiscal update incorporating the fiscal and economic implications of those decisions and circumstances, but not incorporating any decisions, circumstances, or statements that the Minister has determined under section 11 (4) of this Act should not be incorporated in that update; and

(c) A statement of the Minister's responsibility—

(i) For the integrity of the disclosures contained in the update; and

(ii) For the consistency with the requirements of this Act of the information contained in the update; and

(iii) For the omission from the update under section 11 (4) of this Act of any decision, circumstance, or statement.

13. Half-year economic and fiscal update—(1) Subject to subsection (3) of this section, the Minister shall, not earlier than the 1st day of December nor later than the 31st day of December in each financial year, cause to be published a report containing an economic and fiscal update prepared by the Treasury.

(2) The economic and fiscal update shall—

(a) Include the information required by sections 8 (2), 8 (3), 9, 10, and 11 of this Act to be included in the economic and fiscal update prepared under section 8 (1) of this Act, except that the reference to estimated actual figures in section 10 (3) (d) (i) of this Act shall be read as if it were a reference to actual figures, and the actual figures required by section 10 (3) (d) (ii) of this Act shall not be required; and

(b) Be accompanied by the statement of responsibility required under section 12 of this Act.

(3) The Minister shall not be required to cause a report to be published under subsection (1) of this section in any financial year if, in that part of that financial year beginning on the 1st day of October and ending with the 31st day of December, an economic and fiscal update—

(a) Has been published under section 14 of this Act; or

(b) Is required to be published under section 14 of this Act.

(4) The Minister shall, not later than 3 sitting days after the publication of a report under subsection (1) of this section, lay a copy of the report before the House of Representatives.

14. Pre-election economic and fiscal update—(1) The Minister shall, except as provided in subsection (4) of this section, cause to be published, not earlier than 42 days, nor later than 28 days, before the day appointed as polling day in relation to any general election of members of Parliament, a report containing an economic and fiscal update prepared by the Treasury.

(2) The economic and fiscal update shall,—

(a) Except as provided in subsection (3) of this section, include the information required by sections 8 (2), 8 (3), 9, 10, and 11 of this Act to be included in the economic and fiscal update prepared under section 8 (1) of this Act; and

(b) Be accompanied by the statement of responsibility required by section 12 of this Act.

(3) Where, before the day on which an economic and fiscal update is required to be published under this section, the annual financial statements of the Crown for the financial year immediately before the first of the financial years to which the fiscal forecasts relate have been laid before the House of Representatives or published under section 31 of the Public Finance Act 1989, the reference to estimated actual figures in section 10 (3) (d) (i) of this Act shall be read as if it were a reference to actual figures, and the actual figures required by section 10 (3) (d) (ii) of this Act shall not be required.

(4) Where the day of the dissolution of Parliament is less than 35 days before the day appointed as polling day in relation to the general election of members of the House of Representatives, the Minister shall cause the economic and fiscal update required to be published under this section to be published not later than 14 days after the day of the dissolution of Parliament.

(5) The Minister shall, not later than 3 sitting days after the first meeting of the new Parliament, lay before the House of Representatives a copy of the report published under this section.

15. Current-year fiscal update—(1) The Minister shall, on the introduction of the first Appropriation Bill after the last day of March in each financial year, not being an Appropriation Bill that deals solely with matters relating to a previous financial year, lay before the House of Representatives a report containing a fiscal update for that financial year prepared by the Treasury.

(2) The update shall contain fiscal forecasts for that financial year and a statement of all significant assumptions underlying them.

(3) The fiscal forecasts shall include forecast estimated actual financial statements for the Crown for that financial year including—

(a) A statement of the forecast estimated actual position of the Crown at the balance date:

(b) An operating statement reflecting the forecast estimated actual revenue and expenses of the Crown for that financial year:

(c) A statement of cash flows reflecting forecast estimated actual cash flows of the Crown for that financial year:

(d) A statement of borrowings reflecting the forecast borrowing activities of the Crown for that financial year:

(e) A statement of all significant accounting policies, including any changes from those contained in the annual financial statements of the Crown most recently laid before the House of Representatives or published under section 31 of the Public Finance Act 1989:

(f) Such other statements as are necessary to fairly reflect the forecast estimated actual financial operations of the Crown for that year and its forecast estimated actual financial position at the end of that financial year:

(g) In relation to each statement required by paragraphs (a) to (d) of this subsection and, where appropriate, by paragraph (f) of this subsection, comparative budgeted and actual figures for the previous financial year.

(4) The forecast financial statements for the Crown to be prepared under subsection (3) of this section shall be for the same reporting entity as the annual financial statements for the Crown to be prepared under section 27 of the Public Finance Act 1989 for the financial year to which the fiscal forecasts relate.

16. Referral to select committee—There shall stand referred to any committee of the House of Representatives responsible for the overall review of financial management in government departments and other public bodies—

(a) Every budget policy statement published under section 6 (1) of this Act:

(b) Every fiscal strategy report laid before the House of Representatives under section 7 (1) of this Act:

(c) Every report laid before the House of Representatives under section 8 (1) of this Act:

(d) Every report published under section 13 (1) or section 14 of this Act:

(e) Every report laid before the House of Representatives under section 15 (1) of this Act.

17. Publication, inspection, and purchase of statements and reports—(1) The Minister shall, in respect of every statement or report referred to in section 16 of this Act, arrange for publication in the *Gazette* of a notice—

(a) Indicating, where the statement or report is published in advance of being laid before the House of Representatives, that the statement or report has been published; and

(b) Showing a place at which copies of the statement or report are available for inspection free of charge; and

(c) Showing a place at which copies of the statement or report are available for purchase.

(2) The Secretary shall, for at least 6 months after the date of the publication of the notice required by subsection (1) of this section, cause copies of the statement or report referred to in that notice to be available—

(a) For inspection by members of the public free of charge; and

(b) For purchase by members of the public.

18. Power of Secretary to obtain information—(1) The Secretary may from time to time request any department or any entity mentioned in section 27 (3) of the Public Finance Act 1989, or any entity that manages an asset or liability of the Crown, to supply to the Secretary such information as is necessary to enable the preparation of any of the fiscal forecasts referred to in sections 8, 10, 11, 13, 14, and 15 of this Act.

(2) Any request under subsection (1) of this section may specify the date by which and the manner in which the information requested is to be provided.

(3) Where a date is specified under subsection (2) of this section, that date shall be reasonable having regard to the time limits prescribed by this Act for the laying before the House of Representatives, or the publishing, of the report for which the information is being requested.

(4) Where any request under subsection (1) of this section is made to a department or entity, that request shall be in writing and that department or entity shall comply with that request.

19. Transitional provision—(1) The fiscal strategy report required to be laid before the House of Representatives under section 7 (1) of this Act for the financial year commencing on the 1st day of July 1994 shall include—

(a) The long-term objectives required by section 6 (2) of this Act and an explanation of how those long-term objectives accord with the principles of responsible fiscal management specified in section 4 (2) of this Act; and

(b) The intentions required by section 6 (3) (b) of this Act; and

(c) Progress outlooks that include projections of trends in the variables specified in section 6 (2) of this Act, which projections shall illustrate, for stated significant assumptions, likely future progress towards achieving the long-term objectives included under paragraph (a) of this subsection.

(2) Subsections (2) and (3) of section 7 of this Act shall not apply to the fiscal strategy report to which subsection (1) of this section applies.

(3) Subsection (4) of section 7 of this Act shall apply to the fiscal strategy report to which subsection (1) of this section applies as if the reference in section 7 (4) of this Act to subsection (3) (a) (i) of section 7 of this Act were a reference to subsection (1) (c) of this section.

This Act is administered in the Treasury.

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APPENDIX VII

MEDIA ARTICLES

Ian Rogers	*Australian Fianacial Review*, ' Collins Promises a New Era of NSW Balanced Budgets': 25 August 1994, p 12.
Marc Robinson	*Australian Financial Review*, 'Those Artificially Balanced Budgets Can't Change Reality': 19 October 1994, p 18.
	Sydney Morning Herald, 'Deficit Bill is Political at Heart': 28 November 1994, p 9.
The Economist	*'California's Budget: The Missing $3 billion'*, 19 November 1994, p 38.
Paddy McGuinness	*Australian* 'Fiscal Policy in the Balance'.
	Sydney Morning Herald (early edition), ' Budget poll is a stunt', 1 December 1994, p 9.
David Rosenbaum	*International Herald Tribune*, 'The Americas / a Daunting Project. Balancing the Budget: Possible Theoretically but "Painful as Hell" Politically', 29 November 1994, p 3.

AFR 25 August 1994 p12

Collins promises a new era of NSW balanced Budgets

By IAN ROGERS

THE NSW Treasurer, Mr Collins, has pledged to return the State's Budget to balance in his Government's next four-year term, and to permanently balance the books thereafter.

"We want to enshrine a balanced Budget in this State's political lexicon," Mr Collins said yesterday.

He released new estimates showing the State recorded a deficit of $440 million for 1994-94.

In June, Mr Collins estimated the deficit at $490 million. Last year's Budget estimated the deficit at $1.2 billion.

The improvement was primarily because of windfall gains from increased stamp duty, a result of increased stockmarket activity in the financial year, and increased property turnover.

CONSERVATIVE APPROACH: Mr Collins opposes 'wildly optimistic figures'.

Mr Collins said it would be "wrong to base our 1994-95 Budget predictions on wildly optimistic figures", and insisted this year's deficit forecast would be "conservatively based".

He would not reveal the State's funding requirement for 1994-95. However, NSW Treasury Corp has estimated the net funding requirement at $1.5 billion, pending the Budget.

According to recent estimates by NatWest Capital Markets, this implies a new money requirement for this year of $900 million (taking into account refinancing of $600 million of Commonwealth debt), up from the 1993-94 requirement of $770 million.

However, this figure could be reduced if the Government concluded the sale of State Bank of NSW to Colonial Mutual Life. The Opposition finance spokesman, Mr Michael Egan, offered only lukewarm endorsement for the Government's Budget pledge. "You really ought to balance the Budget in boom times," he said. "You need the surplus to tide you over the necessary deficits."

He questioned the State Budget's outcome. "Taken over the cycle, you have to wonder what the underlying deficit really is."

Those artificially 'balanced' Budgets can't change reality

Enshrined balanced Budgets may create fiscal inflexibility and will be easily circumvented, reports MARC ROBINSON.

THE Victorian Government has now joined the NSW Government in announcing that it will move to enshrine balanced Budgets. NSW proposes constitutional changes, while the Victorians will rely upon legislation. The intent is the same – to ensure financial responsibility into the future.

There is, however, a fundamental difference between the two proposals.

The Victorian version proposes to guarantee that the State Budget is balanced on the budgetary current account – the difference between taxes and current expenditure. Broadly speaking, the principle of a balanced budgetary current account is a correct one. It reflects the doctrine of intergenerational equity, which simply asserts that it is inappropriate for the costs of current consumption to be deferred to the future via borrowing.

The NSW version aims at overall Budget balance. This means, in principle, that all expenditure – capital as well as current – must be financed out of tax revenue, without recourse to borrowing.

There is no evident rationale for such an arbitrary rule. Unlike current expenditure, capital expenditure gives rise to flows of benefits into the future. From an intergenerational equity perspective, debt finance has a legitimate role in spreading the costs of capital expenditure over time to reflect that flow of benefits.

At the same time intergenerational equity implies that the current "generation" should pay for its consumption of pre-existing capital. What this adds up to is a rule that it is justifiable to increase debt when the public sector capital stock is being increased.

Departures from the intergenerational equity principle may be appropriate at times, particularly if debt levels are too high relative to the tax base. Even acknowledging that point does not, however, leave us with a justification for anything like the proposed NSW rule.

Historically, Australian States have gone through periods when they have substantially increased their capital stocks, and periods when the capital stock has declined. Insofar as this has been a reflection of the "bunching" of capital replacement needs, and of demographic patterns, there is nothing wrong with this.

But the corollary of such a pattern is that debt has at times increased, and at other times reduced. The NSW referendum proposal would seek to bar such a perfectly reasonable policy.

Setting these issues aside, would a correctly formulated constitutional change or legislative guarantee be a good idea?

The answer is no, for a number of reasons.

The first is that such rules may produce damaging fiscal inflexibility. Even though State Budget deficits are not as heavily affected by the business cycle as is the Federal Budget, there remains a significant cyclical element. To force year-by-year overall Budget balance would not only prohibit active Keynesian counter-cyclical policy, but would force State financial policy to become "pro-cyclical". In other words, it would compel unnecessary and damaging expenditure cuts or tax rises during recessions.

This point is also relevant to the Victorian proposal. When we take into account economic fluctuations, the appropriate intergenerational equity policy rule is that the current account should be balanced over the business cycle, rather than on a year-by-year basis. In other words, it is the "structural" current account which should be balanced in any given year, not necessarily the actual current account. Yet formulating the rule so as to require a "structural" current account balance is no easy matter.

Paradoxically, the one factor which would mitigate somewhat this "pro-cyclical" difficulty is that it is well-nigh impossible to formulate these types of constitutional rules tightly enough to prevent fiscal responsibility. I am prepared to wager that, no matter what form the Victorian and NSW rules take, there will be no shortage of techniques for circumventing the rule.

If the rule were directed to the current account along Victorian lines, three techniques immediately spring to mind. First, borrowings can be "smuggled" into the Budget from the Government's public enterprises, and dressed up as revenues in order to artificially improve the Budget sector current account. The most obvious way of doing this is to compel public trading enterprises to pay increased "dividends" which are unrelated to increases in their profitability. The present Victorian Government indulged in this practice in its 1993-94 Budget. A second and even more obvious technique involves the systematic reclassification as capital expenditure of all items of expenditure in the grey zone between capital and current spending.

A third technique involves depreciation. Intergenerational equity requires that depreciation be treated as a current cost in the calculation of the current account balance. In other words, the current account which should be balanced is a conceptually sound accrual accounting current balance. But this in turn raises a whole host of problems. At the technical level, there is the important difference between "economic" depreciation and accounting depreciation. A far more mundane problem is the wealth of opportunities which will arise for budgetary window-dressing by fiddling the calculation of depreciation.

As for the proposed NSW rule of overall Budget balance, the best examples of techniques for circumventing such a rule come from the recent budgetary practice of the NSW Government itself. There is no superior practitioner in the whole of Australia of the art of taking public debt "off balance sheet". A myriad of artificial transactions have been entered into which make the debt nominally private but which do not change the exposure of the public sector. It was only about a year ago, for example, that the NSW Auditor-General exposed the way in which the Government had artificially reduced the 1992-93 deficit by about $100 million through a sale and lease-back deal on the government car fleet. More generally, however, much of the currently fashionable private provision of public infrastructure, in which NSW "leads" the way, falls into the same boat.

The overall message is simple. To define a balanced Budget rule in a manner which is both watertight and intellectually credible is virtually impossible. One needs, in fact, to look no further than US experience – both at the State level, and federally in the context of the "Gramm-Rudman" legislation – to find support for this point.

Marc Robinson is Associate Professor in Economics and Public Policy, Queensland University of Technology.

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[illegible] - Deficit Bill 's

State Debt Control (Balanced Budget) Bill

By MARC ROBINSON

THE State Government has introduced into the NSW Parliament legislation for a referendum to change the State Constitution to ban budget deficits. The Government claims that such a constitutional change will prevent State debt growing and thus ensure fiscal responsibility.

A deficit means, of course, that expenditure exceeds income. The standard way of financing deficits is through borrowing, with the result that debt increases. Hence if you can ban deficits, you can prevent debt increasing.

It is therefore hardly surprising that, when polled, a majority of NSW voters think a balanced budget requirement is a good idea. After all, who likes debt?

A moment's thought tells us, however, that this is a proposal with huge problems.

To start with, not all borrowing is irresponsible. Think of it in individual terms. If we make a habit of borrowing to pay our daily living costs, we will end up in trouble. By contrast, however, there is nothing wrong with borrowing to buy a house, as long as the amount borrowed is affordable, and the house is a good buy. The difference is that a house is an investment which will yield long-term benefits into the future. This makes it acceptable to take a mortgage which is paid off over time.

In the public sector, this distinction leads us to differentiate between two types of budget balance. The first is the current account balance. The current account balance represents the difference between current expenditure and income. If the current account is in deficit, this is broadly like an individual borrowing to meet daily living expenses.

The other type of budget balance is the overall budget balance. This represents the difference between total expenditure (current expenditure plus capital expenditure) and income. It is possible to run an overall budget deficit while having a balanced current account. This would be the result if government was following a policy of borrowing strictly for capital expenditure.

It is overall budget deficits which the State Government's constitutional change seeks to ban. The Government is, in other words, trying to impose a ban on borrowing not just to fund the "living expenses" of government, but also upon borrowing for capital expenditure.

The Government argues that this is necessary to control debt. Now there is no doubt that debt levels have become a problem for a number of Australian States. But this is not the way to deal with a debt problem.

There are at least three reasons why not.

First, governments face periods when they are obliged to undertake heavy capital expenditure, and periods when capital expenditure can be allowed to ease off. For example, intensified population growth or major infrastructure replacement requirements are good reasons for substantially accelerating capital expenditure. A perfectly responsible strategy for coping with the cost of this is to increase debt when there is a surge in capital expenditure, and then reduce debt levels when the demand for new capital expenditure eases off.

> "Recessions are, regrettably, not "exceptional" circumstances in Australian economic life. They are a regular and indeed normal part of economic experience."

The proposed constitutional change seeks, however, to rule out such an approach. It seeks to create a position where, for all time, debt levels would only be able to move one way.

It is highly significant that not even the present arch-conservative Victorian Government is prepared to go that far. The Victorian Premier, Mr Kennett, announced last month that his State would pass a law requiring balanced budgets.

What he foreshadowed, however, was a requirement of balanced current accounts In other words, the Victorians do not propose to ban borrowing for capital expenditure.

Second, this proposal does not appear to have found a way around the well-known tendency of balanced budget requirements to force governments to behave in ways which aggravate recessions. Recessions tend automatically to produce budget deficits, particularly because tax revenues drop off when company profits and individual incomes and spending are depressed. A government may, of course, cut expenditure or raise taxes to eliminate such a recession-induced deficit. To do so would, however, be to kick the economy in the guts when it was down.

The State Government seems to think it has solved this problem by providing in its proposal that deficits will be allowed in "exceptional circumstances" such as "a major economic recession". This, however, is full of problems.

Recessions are, regrettably, not "exceptional" circumstances in Australian economic life. They are a regular and indeed normal part of economic experience. However, a fair interpretation of the bill is that only in extra-specially severe recessions — say like the Great Depression — would deficits be permitted.

Third, there will remain great scope for governments to avoid and evade the balanced budget requirement in ways which are not in the public interest. Many of the techniques which may be used are not easy to explain. Some are, however, straightforward. The private provision of infrastructure, so extensively employed already by the NSW Government, is one such.

What this does is to keep public sector borrowing down by replacing it with nominally private borrowing. As shown in the recent NSW Auditor-General's Report on road infrastructure, the result can be a substantial increase in the cost to the public of providing infrastructure.

All these problems are well known to economists. I would imagine that the Government's Treasury advisers are well aware of them.

The likelihood, therefore, is that the origins of this referendum proposal are to be found in the Government's political strategy, rather than in any considered economic advice which it has received.

Marc Robinson is Associate Professor in Economics and Public Policy, Queensland University of Technology.

John Button is unwell.

THE ECONOMIST NOVEMBER 19TH 1994 pp 38-39

California's budget

The missing $3 billion

LOS ANGELES

WHY did Pete Wilson back Proposition 187? To win votes, of course. But there was another, less obvious, purpose: to bludgeon the White House into helping him balance California's budget.

On Mr Wilson's desk is an outline of the 1995-96 budget, which has to be presented to the legislature on January 10th. But even before he can attend to that, the Republican governor of California has to find $3 billion to fill a gaping hole in the current budget. Mr Wilson papered over the deficit last summer by claiming $3 billion from the federal government for having to provide public education, welfare and other services to illegal immigrants. The year before, he had asked for $1.5 billion; he wound up getting only $324m. His backing for Proposition 187 would, he hoped, increase the pressure. President Clinton has resisted it.

Even before Mr Wilson struck a deal with the Democrat-controlled legislature in Sacramento to "erase" the $14 billion shortfall in the budget in 1991, California was living way beyond its means. Between 1987 and 1991, tax revenues in California were growing at a 4% annual rate, but spending was soaring by 6% a year.

Mr Wilson's deal with the Democrats failed to tackle California's basic problem of runaway welfare costs. The proposed spending cuts, tax increases and one-time book-keeping adjustments used to fudge the budget in 1991 allowed some $2 billion of debt to be rolled forward into subsequent years. With tax revenues down as a result of defence cuts and the recession, California's deficit has crept up to $3 billion this year.

What can the governor do? During his re-election campaign, he swore never again to raise taxes. On the other hand, his scope for cutting spending is severely limited. Some $12 billion of California's $54 billion budget is a "special fund", earmarked for such things as highway construction, which cannot be tampered with. Of the remaining $42 billion in the general fund, a further $30 billion is untouchable—it is mostly contributions from the federal government for education, health and welfare. The best that the governor can do is tinker at the margin.

During his campaign, Mr Wilson proposed eliminating certain Medi-Cal services, such as dental care, which the state provides in addition to the federal government's basic requirements. He has also suggested cutting welfare payments for families of three with an able-bodied adult who has been receiving payments for six months or more. Such savings, however, come nowhere near closing the budgetary gap. His Democratic challenger, Kathleen Brown, the state treasurer, at least proposed rolling up all California's short-term debt into a single bond that would be repaid over a five-year period at $600m a year. Mr Wilson would be wise to borrow that proposal.

But such measures are only temporary at best. A recent study of California's budget crisis by Rand Corporation in Santa Monica points out that health care, prison services, public schools and higher education account for more than 90% of the budget's general fund. Spending on prisons, which absorbs 9% of the budget, is about to leap to 14-20%. The recent "three-strikes-you're-out" legislation is expected to increase prison costs by $4.5 billion to $6.5 billion.

Worse, the bill for public schooling in California is about to go through the roof. Enrolment in the state's schools is set to grow by 30% over the rest of the decade. As a consequence, the cost of providing primary and secondary education will soar from 35% of the general fund to 47%.

Even if Mr Wilson can hold the line on the state's health and welfare costs, they are unlikely to account for less than their present 34% of the general budget: California's population is ageing fast. That leaves Californians with one inescapable (and traditional) conclusion: there is going to be nothing in the pot for higher education. The state's much-praised university system is just going to have to fend for itself. What a rotten time to be governor of California.

Fiscal Policy in the Balance The Australian

State Debt Control (Balanced Budget) Bill

LOS ANGELES: Americans, unlike Australians, talk about their Constitution all the time. Usually they mean the Bill of Rights and the structure of the American system of politics. But right now the United States Congress is debating a proposed amendment which would change the government financial system dramatically.

The House of Representatives will vote today (Australian time) on an amendment which would impose a balanced Budget on the US Government, thus making it mandatory to eliminate the huge US Budget deficit – either by drastically cutting the social services and military budgets, along with many other federal programs, or by raising taxes.

The surprising thing is that this proposal, which was a favourite notion of President Ronald Reagan, seems to have a good chance of being approved. That, of course, would be only the beginning – the process of amending the US Constitution is long drawn out, the amendment needing, after Senate consent, the approval of three quarters of the State legislatures. So there is little likelihood of it becoming part of the Constitution before the end of the century.

Even that would be lightning speed compared with the amendment, proposed by James Madison the best part of 200 years ago, preventing Congress raising its own salaries before contesting an election with the proposal on the table. Only a matter of weeks ago, the three-quarters support of legislatures was obtained – and there is now a difficult legal and constitutional issue to be determined as to whether the amendment could properly be revived after pending so long.

However, the strong support for the Balanced Budget Amendment (BBA) is a reflection of the huge accumulated deficit of the US Government of \$US4 trillion, twice what it was six years ago and showing no signs of coming under control. It is believed by many in the US that there is no way of persuading the politicians to bring the deficit under control unless the authority of the Supreme Court is invoked as well as that of the two other arms of government.

The prospect of having lawyers debating and deciding fundamental issues of economics and accountancy like the definition and significance of Budget deficits is hardly attractive to the serious analysts of fiscal policy, even those who believe that Budgets in some sense should be balanced.

The big problem for the US Supreme Court would be to define just what a Budget deficit is. So far, the supporters of the BBA have treated this as a simple matter, just a case of the excess of spending over revenues of the government.

There is already legislation on the books which requires the Budget to be balanced. This is the Gramm-Rudman Bill, which has been in force totally unsuccessfully for some years. It has led to a great deal of creative accounting by Congress, and the invention of numerous different concepts of what a Budget deficit is.

But the law has been totally unsuccessful in bringing the deficit problem under control. There is little disagreement that it should be. Even those who blame Japan for America's international trade deficit accept that the domestic Budget deficit is far too large, and out of control, even if they do not understand the link between the domestic and foreign trade deficits – with Japan in effect financing the US Budget deficit.

But neither the executive nor the Congress can summon the political will to take the initiative in reducing the deficit, let alone balancing the Budget. The longer it is delayed, of course, the greater the pain involved when the problem is eventually faced up to. The President blames Congress, and Congress blames the President – as the opponents of the BBA say, there is nothing to prevent him presenting a balanced Budget at any time.

There is also nothing to prevent the Congress amending the Budget, as it frequently does. So what the argument really is about is who will take the blame for the combination of expenditure cuts and tax increases which any serious effort to move the Budget towards balance would involve.

McGUINNESS

The public debate in the US about taxation is hardly sophisticated – the pre-election "read my lips" reassurance by George Bush that there would be no tax increases is an example of this.

The problem is aggravated by the political schizophrenia which now is commonplace in the US: the electorate votes for a Republican president and a Democratic Congress. Whichever arm of government advocates practical action to overcome the deficit will be assailed by the other, regardless of their mutual recognition that reform is necessary. What to do about this?

Listening to the political debate in this country, it is depressing to hear the answer being offered by the opponents of the BBA: leadership. That means that they haven't got a clue what to do and want someone else to do all the hard policy work and persuasion of the electorate which political reform requires. (It is a familiar refrain in Australia, too.)

So, with all its faults the BBA does seem to offer some way to resolve the impasse, by invoking the third arm of government in the US, the Supreme Court and the federal courts. To an outsider it might seem that this is a problem which could only arise in the US system, with its strict separation of powers. Senator Peter Walsh in Australia argues that it is only in a Westminster system that the degree of fiscal responsibility displayed by the Hawke government (a responsibility since abandoned by the weaker Keating Government) would be possible.

However, there is a respectable intellectual heritage behind the BBA, which is best expressed in the proposals for a "fiscal constitution" put forward by Nobel Prize-winning economist James Buchanan and others. This heritage goes back to the great Swedish socialist economist

'Reflection of the huge deficit'

Knut Wicksell, who nearly 100 years ago suggested that each spending proposal of a parliament should be linked to a corresponding financing proposal.

If the budgetary period be defined as the length of the business cycle (from peak to peak, even John Maynard Keynes was strongly in favour of Budget balance – his idea of deficit financing was simply a temporary deficit to be recouped in the upswing. Keynes's concept of deficit financing was, however, debauched by the Keynesian economists who turned it into an excuse for never running a surplus or balanced Budget. It thereby became the justification for endless expansion of welfare schemes, the education industry and the public sector bureaucracy.

The theory of Keynesian deficit financing has long since been exploded, even though there remains occasional justification for allowing Budgets to go into deficit when unemployment is rising. However, the argument in the US – at least at the congressional and media level – is not being conducted in terms of economics.

Rather, it is an argument about the American system of government and whether the time has come for not just a simple amendment of no great significance (like the Madison amendment, which might just be allowed through without challenge, despite its great antiquity) but a grand reshaping of the constitutional framework, as has taken place on several occasions in US history, most recently the New Deal of the Roosevelt administration.

To have Congress and the president held responsible under the Constitution for their fiscal policy would be extraordinary – but if not today, it will happen eventually.

– Padraic P. McGuinness

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McGUINNESS

Budget poll is a stunt

WITH both the Victorian and the NSW governments now embracing the idea of some kind of constitutional prohibition of State Budget deficits, or what is in the US known as a Balanced Budget Amendment (BBA), the notion of imposing compulsory fiscal discipline on State governments has achieved a prominence which it has never had since the '20s.

It is attractive in Victoria, for very similar reasons to those of the '20s — the record of a profligate and irresponsible State Government has shown just how much damage a government run by economic-creation scientists with a total ignorance of how the world works can do, especially if it lies to the electorate about its own finances. No wonder Jeff Kennett, for all his eccentricities, is so popular — the Victorian electorate knows only too well what Cain and Kirner did to them. But even if a BBA made sense, there is no way in which the Victorian Government could entrench it as a constitutional discipline on future parliaments unless it were to amend the Victorian Constitution so as to be subject to future amendment only by referendum, instead of, as at present, by absolute majority of both Houses of Parliament.

But in NSW a BBA is also being proposed by the State Government, even though for the last 10 years fiscal management under both sides of politics has been improving greatly. The Fahey Government has actually produced a bill which it proposes to put to a referendum at the next State election, due on March 25, which would entrench in the State Constitution the requirement that the Budget (including both current and capital transactions — the Kennett Government proposes to balance only the current programs budget) should be balanced every year, save in exceptional circumstances.

Now, first of all, it ought to be stated that in principle a requirement on State governments to balance their budgets is a good idea. Since 1901 Australia has been an economic and monetary, as well as a political, union — there are no permitted barriers to trade between the States, financial and labour flows between the States are absolutely free, and there is a fixed exchange rate (a single currency) between the States. As the countries of the European Union are discovering, as they move towards a monetary union, the prerequisite for such a union to work is that the members of it must have [illegible]ially identical fiscal policies or, ultimately, that [illegible] policy should be in the hands of a central [illegible]rnment. Not only is it undesirable for the Australian States to have independent fiscal policies, it is impossible for long. The "Keynesianism in one State" approach of the Cain-Kirner Government was as unworkable as Stalin's "socialism in one country".

It is strange that the Labor Party, which is so passionately devoted to centralism and the abolition of State governments (except when it is in power in a State), should find it hard to accept the idea of fiscal discipline imposed on the States by the Federal Government. If in the event of "exceptional circumstances" there should be an unexpected shortfall of State revenues, the appropriate thing for a central government committed to fiscal stabilisation and boosting employment to do is to increase payments to the States rather than have them sack their employees.

Still, there is a host of academic economists who argue that it is possible to run different State fiscal policies, and a host of Labor centralists who want States to be able to run deficits in defiance of central government macroeconomic policy also.

IN PRINCIPLE, as long as we have State governments, and regardless of the vertical fiscal imbalance whereby the Commonwealth grabs the lion's share of revenue, it would be desirable for each State to be subject to the constitutional requirement of a balanced Budget. Whether such a thing would be desirable at the Federal level is another question — simple-minded Keynesianism is not of much use at the national level, either.

But this does not make the BBA which is being proposed by the NSW Government terribly sensible. This is for two main reasons.

The first is that the proposed law is badly and sloppily drafted, with too many loopholes, and the second is that nobody knows exactly what should be balanced anyway.

The NSW proposition is that the "Budget sector" should be either in balance or in surplus, the "Budget sector" including both recurrent and capital programs. It is silent about commitments entered into "off Budget", with the private sector, which as the Auditor-General has pointed out is the most worrying aspect of NSW State finances at present. (This was one of the many shonky practices of the Victorian Labor Government, like flogging off the Melbourne trams to Swiss corporations and leasing them back at high rates.)

As the former Victorian Treasury secretary, and former deputy secretary of the NSW Treasury, Don Nicholls, pointed out yesterday, there are many subterfuges available to a determinedly dishonest government to disguise financial commitments. In short, if a government is honest and conscientious you don't need a BBA and, if it is not, a BBA will not stop it.

But a constitutional amendment soon might have the NSW Government in the High Court, entangled in definitions. And there is one thing of which the High Court cannot be accused, and that is the slightest knowledge of economics. Since some of the most important terms of the proposal are not even defined (one shudders to think of what would happen when the courts started to define "exceptional circumstances", or even a recession) the possibilities are endless. But the whole thing is really pointless, anyway, since there is a let-out clause which allows Parliament to provide for the elimination of the debt incurred by a deficit "over a period not exceeding the next three years or any other period provided by the law". In other words, the Parliament could run deficits anytime it liked simply by legislation — and since a budget is legislation, why bother about the charade of a constitutional amendment? The truth is, of course, that the NSW Government's proposed referendum on the BBA is a straightforward political stunt.

There is nothing that could be achieved by a BBA which is impossible now, and nothing of importance which would be prohibited by the proposal as drafted which could not be flouted by a government prepared to hide the truth, or a Parliament willing to over-rule it by ordinary legislation. Victoria gave us an awful warning of what can happen when a State government goes crazy about deficit financing, and effectively debauches the State tribunals and bureaucracy while buying off the unions. NSW, in the event of the adoption of the BBA, will give us a lesson in how to make a mess the opposite way. Neither is a good pattern for government and nothing beats simple fiscal responsibility.

THE AMERICAS /

A DAUNTING PROJECT

Balancing the Budget: Possible Theoretically but 'Painful as Hell' Politically

By David E. Rosenbaum
New York Times Service

WASHINGTON — In mid-January, the House of Representatives will vote on a constitutional amendment to require a balanced federal budget. It will be "our first smashing victory," said Representative Newt Gingrich of Georgia — a safe political forecast.

But then what? If the Senate also passes it, and it is ratified by 38 states and becomes part of the constitution, can the budget actually be balanced early in the next century, as the Republicans promise?

And can they do it, as they claim, without raising taxes or touching Social Security retirement beneefits and with cuts in the military budget much smaller than those President Bill Clinton has proposed?

Theoretically, yes. Politically, the prospects are daunting.

In March, Representative Gerald B.H. Solomon, a senior Republican from upstate New York, proposed such a budget in the House Only 73 representatives voted for it; 342, including Mr. Gingrich, who will presumably be the next speaker of the House, voted against it.

The Solomon budget is important because it is the only existing program-by-program, line-by-line accounting of how the budget can be balanced and meet the Republican specifications of no additional taxes, no reduction in Social Security and military cuts only half as deep as the administration's.

An examination of the fine print shows what the cuts would entail. Beginning in the 1995 fiscal year, they would total about $700 billion over five years and well over $1 trillion over seven. Even more cuts would be needed if Republicans followed through on another promise — to reduce taxes.

"It's painful as hell," Mr. Solomon, who is expected to be the new chairman of the Rules Committee, said in an interview. "But eventually you have to stop talking about it in the abstract and begin dealing with the details."

Under his plan, federal spending on environment would be cut by 44 percent, on agriculture by 72 percent, on foreign aid by 32 percent, on transportation by 29 percent, on community and regional development by 40 percent and on energy by 65 percent.

Medicare and Medicaid spending would be cut by much more than $100 billion over five years, with upper-income retirees having to pay much more for their health insurance than they do now and poor people restricted to certain doctors and hospitals.

Spending on income security, a budget category that includes welfare and almost all other programs for the poor, would be reduced by $150 billion over five years, or about 12 percent.

At the same time, spending on job-training would be cut in half. And states would have to pick up part of the cost of food stamps and a larger share of foster-care expenses.

Dozens of federal activities would be abolished altogether, including economic aid to Russia, almost all agriculture price supports, construction of a space station, grants for new sewer systems, subsidies for Amtrak operations and air service to isolated communities, economic development grants to local governments, the national service corps and the legal services corporation.

"This is a radical restructuring of government, cutting or eliminating wholesale huge swaths of the government as we know it," said Martha Phillips, executive director of the Concord Coalition, a bipartisan group devoted to eliminating the federal budget deficit.

The Concord Coalition has its plan to balance the budget. But it would require wealthy Americans to pay more in taxes and forgo some of their Social Security benefits, provisions opposed by the Republicans.

Gene Sperling, a White House economic adviser, said the spending cuts in the Solomon plan would be "Draconian for poor children and go far beyond what many Americans think would be reasonable."

But Mr. Sperling said Mr. Solomon deserved credit for "putting forth a line-by-line, item-by-item plan like this."

Mr. Solomon made a few concessions to practical politics For example, dairy price supports would be retained, while all other agriculture subsidies would be abolished. Why? Perhaps because Mr. Solomon's constituents in the Hudson River Valley produce more than a billion pounds of milk a year

Many other proposed cuts would surely run into roadblocks. For example, Mr. Solomon would turn over the government's air traffic operation to a private corporation, a shift Mr. Clinton supports, saving the government more than $30 billion over five years.

The main opponent of such a step is the private plane industry, and as long as Bob Dole of Kansas is the Senate's majority leader, the measure is bound to face trouble.

Beechcraft, Cessna and Learjet aircraft are manufactured in Kansas, a state the spokeswoman for the General Aviation Manufacturers Association calls "the capital of our industry."

When the Solomon budget was debated on the House floor in March, a supporter, Representative Dick Zimmer, Republican of New Jersey, declared, "Those of us who advocate a balanced budget have a moral responsibility to get specific and show how it can be done."

But even Republicans voted against the measure by a 2-to-1 margin. Mr. Gingrich said at the time that he opposed it because he did not want to draw attention from a Republican alternative budget that would have reduced the deficit by only a fifth as much as the Solomon plan.

The Republican alternative was rejected more or less along party lines.

Mr Solomon said last week that many more lawmakers would have supported him if his proposal had stood any chance of being approved. Since it was sure to be defeated, he said, many colleagues saw little point in casting a vote that could be used against them by groups of constituents

But he said that even next year, with Republicans in control of the House, he was not sure he would get more than about 150 votes on his side

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