

# Chapter 8

## Conclusions and recommendations

8.1 This chapter aims to draw together the following four main threads that have interwoven with one another throughout this report:

- Financial reporting
- Fiscal management
- Government Business Enterprises
- Infrastructure investment

8.2 The evidence before the committee, which has been discussed in the preceding chapters, highlights significant failings in each of these four areas. In the committee's view, state and territory governments need to introduce much more rigorous discipline in all of these areas.

8.3 The committee is persuaded by the evidence of Associate Professor Graeme Wines who told the committee that the states and territories need a fiscal discipline mechanism like the Commonwealth's *Charter of Budget Honesty*. According to the *Charter of Budget Honesty Act 1998*:

The Charter of Budget Honesty provides a framework for the conduct of Government fiscal policy. The purpose of the Charter is to improve fiscal policy outcomes. The Charter provides for this by requiring fiscal strategy to be based on principles of sound fiscal management and by facilitating public scrutiny of fiscal policy and performance.<sup>1</sup>

8.4 The committee agrees that this underpinning framework is required in state jurisdictions to improve state budgetary discipline. It has adopted Associate Professor Wines' suggestion and applied it to the four key areas of state government financial management identified during the inquiry.

### Recommendation 1

**8.5 The committee recommends that each state and territory government enact a Charter of Budget Honesty.**

### Financial reporting principles

8.6 In chapter 3 of this report the committee found that despite the existence of the Uniform Performance Framework and the harmonised accounting standard, AASB 1049, states are still able to publish budgetary information in a non-uniform

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1 *Charter of Budget Honesty Act 1998*, s. 1.

way, to suit their own political purposes. States are free to report on whichever of the three main 'bottom line' balances they wish to.<sup>2</sup>

8.7 The committee was concerned to note that the harmonised accounting standard could be undermined by allowing departure from prescribed accounting rules, as long as those departures are disclosed.<sup>3</sup>

8.8 Not only do consistent reporting standards across jurisdictions make good common sense, they also reduce the ability of governments to successfully pick, choose and publicise different headline data year-to-year to suit their political purposes.

8.9 The committee is of the view that, as is the case in the corporate sector,<sup>4</sup> governments should be required to comply completely with the accounting standards. Accordingly, the committee makes the following recommendation.

## **Recommendation 2**

**8.10 The committee recommends that each state and territory government adopt principles to govern financial reporting in its Charter of Budget Honesty, including requirements that financial reporting:**

- **be fully consistent with all relevant financial reporting standards;**
- **enable improved transparency and parliamentary and external scrutiny, of a state's progress towards achieving its fiscal objectives;**
- **forecast, as accurately as possible, future levels of government revenue and expenditure; and**
- **include provision that specifically prevents the state government from using misleading accounting practices.**

## **Fiscal policy formulation**

8.11 Chapter 4 of this report considered certain aspects of state government financial management such as public sector wages, unfunded superannuation liabilities and interest payments.

8.12 Sound fiscal policy formulation doesn't happen by chance. It certainly doesn't happen by governments taking short-term, politically expedient decisions at budget time or in election years. It must occur with the aim of maintaining the on-going

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2 The Uniform Presentation Framework provides, at page 27, that 'Jurisdictions should provide full explanations for any departures from the UPF in the presentation of their data'. See [www.treasury.gov.au/documents/1371/PDF/2008\\_UPF.pdf](http://www.treasury.gov.au/documents/1371/PDF/2008_UPF.pdf) (accessed 21 August 2008).

3 Associate Professor Graeme Wines, personal capacity, *Submission 17*, p. 13.

4 Associate Professor Graeme Wines, personal capacity, *Submission 17*, p. 12.

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economic prosperity and welfare of the people of Australia and must be part of a sustainable medium-term framework.

8.13 Drawing on the principles of sound fiscal management laid down in the Commonwealth's Charter of Budget Honesty<sup>5</sup> the committee makes the following recommendation.

### **Recommendation 3**

**8.14 The committee recommends that each state and territory government adopt principles to govern fiscal policy formulation in its Charter of Budget Honesty including requirements that fiscal policies:**

- **prudently manage financial risks including levels of government debt;**
- **contribute to dampening cyclical fluctuations in economic activity;**
- **contribute to the achievement of adequate state-wide saving;**
- **pursue spending and taxing arrangements that are consistent with a reasonable degree of stability and predictability;**
- **maintain the integrity of the tax system; and**
- **ensure that policy decisions have regard to their financial effects on future generations.**

### **Government Business Enterprises**

8.15 Throughout this inquiry the committee heard that state and territory governments take advantage of Government Business Enterprises (GBEs) in order to improve the governments' financial position to the detriment of the long-term performance and service delivery of GBEs. Chapter 5 discussed the impact that the payment of high levels of dividends to government has on the ability of GBEs to re-invest in essential infrastructure.

8.16 In particular the committee focussed on the Productivity Commission's latest research paper on the financial performance of GBEs from 2004–05 to 2006–07. That report highlights the imperative that GBEs, as significant providers of infrastructure services, operate efficiently. The Commission found that many GBEs continue to be commercially unsustainable with the majority failing to achieve even the risk-free rate of return in 2006–07. Furthermore the Commission found that poor profitability can lead to inadequate investment and asset maintenance, which can in turn reduce the future profitability of GBEs. Without a return to commercially sustainable operations, this cycle can persist.

8.17 Disconcertingly for the committee, the Commission emphasised specific examples of what can only be described as GBEs being 'milked' for short-term gain at

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5 *Charter of Budget Honesty Act 1998*, s. 5,  
[www.scaleplus.law.gov.au/html/pasteact/2/3115/0/PA000140.htm](http://www.scaleplus.law.gov.au/html/pasteact/2/3115/0/PA000140.htm) (accessed 21 August 2008).

the expense of their medium- to long-term viability. The Commission found that more than 10 per cent of GBEs examined paid dividends that exceeded their operating profit in 2006–07. Furthermore, around 7 per cent of GBEs were found to have made dividend payments after reporting after-tax losses, resulting in negative dividend payout ratios. This is a result of state and territory governments requiring GBEs to pay pre-determined special dividends regardless of after-tax profits.

8.18 This situation is of grave concern to the committee which is of the view that state and territory governments must fully consider the impact of their decisions on GBE viability. The committee acknowledges that there needs to be an appropriate and carefully determined return from GBEs to the community through the government. State and territory governments must allow GBEs to operate on a commercially sustainable basis and to make ongoing infrastructure investments. Dividend payout ratios must be justified. In order to improve transparency and to allow GBEs to develop medium-term management strategies, governments must publicise forward estimates of the dividend payout ratio of each GBEs. These principles are the basis of the following recommendation regarding GBEs.

#### **Recommendation 4**

**8.19 The committee recommends that each state and territory government adopt principles governing its relationship with Government Business Enterprises (GBEs) in its Charter of Budget Honesty including requirements that:**

##### **Dividend payments:**

- **be an appropriate return on the community's investment;**
- **allow GBEs to operate on a commercially sustainable basis; and**
- **allow GBEs the ability to make ongoing investment in infrastructure.**

##### **Governments:**

- **justify the dividend payout ratios they require from individual GBEs;**
- **publicise in advance a dividend payout ratio range for each GBE for the Budget year and forward estimates period and explain any actual deviations; and**
- **must fully cost, and fully fund out of General Government Sector revenue, Community Service Obligations and publicise these funding commitments.**

#### **Infrastructure**

8.20 Throughout this inquiry the committee heard evidence of mismanagement, cost blow-outs, backlogs and delays in much-needed state-level infrastructure projects. From the committee's viewpoint, these management failings by state and territory governments are particularly problematic given the importance of infrastructure to the national economy.

8.21 The committee heard evidence of the outdated and ailing state of some of Australia's existing infrastructure. Chapter 6 highlights the fact that the average age of Australia's public sector infrastructure has been rising since the 1970s, with an average age of approximately 20 years. Australia's infrastructure lags behind the average of leading advanced economies on its ability to support economic activity.

8.22 Time and again the committee heard of the deficient strategic management of infrastructure development. Issues included ill-considered timing of projects, the poor quality of infrastructure investments, and inefficient and ineffective management practices. Such mismanagement at the state government level results in infrastructure bottlenecks which are likely to impose severe constraints on economic growth.

8.23 The committee is also concerned with state government management of Public-Private Partnerships. While the committee recognises the potential value of public-private sector collaborations, when the process is mismanaged or the project poorly designed, the results can be a disastrous waste of taxpayer funding. The committee therefore recommends that state and territory governments clearly enunciate guiding principles aimed at improving infrastructure investment.

### **Recommendation 5**

**8.24 The committee recommends that each state and territory government adopt principles governing its infrastructure investment policies in its Charter of Budget Honesty, including requirements that infrastructure investment policies:**

- **Enunciate a strategic management framework for infrastructure projects including criteria for project timing, quality and management; and**
- **Enunciate conditions for the use of Public-Private Partnerships.**

### **Other recommendations**

8.25 The committee makes a number of other recommendations on specific issues that have been discussed elsewhere in this report.

#### ***Abolition of inefficient state taxes***

8.26 In chapter 2 the committee noted a range of inefficient indirect state taxes that were impeding and continue to stymie economic activity. The states had identified these taxes under the GST Intergovernmental Agreement and the presumption was that these taxes would be abolished at the earliest opportunity. The taxes to be abolished included accommodation tax, financial institutions duty, quoted marketable securities duty and debits tax stamp duties on mortgages and leases and stamp duty on conveyances of real non-residential property.

8.27 The committee noted the agreed abolition timetable for most of these taxes, with some stretching out until as late as 2012–13. Importantly, the committee also noted that the states have not made a commitment to abolish stamp duty on conveyances of real non-residential property.

## **Recommendation 6**

**8.28 The Committee recommends that the Commonwealth Government should require all states to abolish inefficient state taxes covered by the Intergovernmental Agreement on the reform of Commonwealth-State Financial Relations. Furthermore the states should agree to, and abide by, a timetable to abolish stamp duty on conveyances of real non-residential property.**

### *State income tax*

8.29 At various stages during the inquiry the prospect of states levying their own income tax was raised. The committee noted the obvious appeal such a move would have as it has the potential to significantly reduce or bring an end to the funding 'blame game' between states and the Commonwealth.

## **Recommendation 7**

**8.30 The Committee recommends that the Commonwealth Government appoint a special taskforce, to examine the feasibility of options to reduce Commonwealth income taxation, and introduce state and territory income taxes, so that the states and territories are less reliant upon the Commonwealth Government for funding.**

**8.31 The Committee recommends that in developing detailed options for a system of state and territory income taxes, the taskforce should be required to have regard to how the following objectives can be maintained, or obtained:**

- **reducing Commonwealth payments to the states and territories, which could be offset through each state/territory's income taxation system;**
- **ensuring that a system of state income taxation is simple to administer, preferably as part of the collection of income tax by the Commonwealth;**
- **ensuring that states and territories are accountable to their constituents for their own spending and management of services;**
- **promoting real competition between the states and territories to be the lowest taxing jurisdiction; and**
- **ensuring that the tax burden in the initial years does not increase.**

**8.32 The Committee recommends that the taskforce be required to provide its report to COAG, for detailed consideration.**

### *Specific Purpose Payments*

8.33 In chapter 2 of this report, the committee flagged two recommendations related to Specific Purpose Payments (SPP). The first related to whether it is preferable to use input or output controls for SPP conditionality requirements. The committee is of the view that COAG needs to undertake further analysis in this area in order to achieve the most preferable and efficient outcome.

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## **Recommendation 8**

**8.34 The Committee recommends that the Council of Australian Governments carefully consider the costs and benefits of input controls compared to output controls in the development of Specific Purpose Payments.**

8.35 The committee noted (in chapter 2) the major overhaul of the SPP framework currently being undertaken by COAG. The Australian National Audit Office has identified this topic as possibly warranting a future performance audit, a view which is supported by the committee.

## **Recommendation 9**

**8.36 The Committee recommends that the Australian National Audit Office undertake a performance audit in 2008–09 into the development and implementation of the new federal financial framework.**

### *Strengthening the Australian Loan Council*

8.37 Chapter 6 discussed the possibility of strengthening the powers of the Australian Loan Council as a mechanism to stringently scrutinise and control unreasonable growth in state debt. The committee considers that it may be appropriate to re-energise the Australian Loan Council.

## **Recommendation 10**

**8.38 The committee recommends that the Commonwealth Government consider mechanisms to enhance and strengthen the powers of the Australian Loan Council to scrutinise excessive growth in state debt.**

### *Funding local government*

8.39 The committee noted various concerns regarding the relationship between state and local levels of government (see chapter 4). The committee heard evidence of a lack of transparency on the part of state governments in the provision of funding to local councils. This was of particular interest to the committee, because much of the funding in question originates from the Commonwealth.

## **Recommendation 11**

**8.40 The committee recommends that the Australian Government impose more stringent requirements on state governments having regard to the identification of Commonwealth funds flowing through states to local government.**

### *Norfolk Island*

8.41 The committee also examined the financial situation of Norfolk Island, with particular focus on its longer term sustainability (see chapter 7). The main conclusions drawn were that improvements are required in relation to education, healthcare, social security and governance arrangements, but also to the regulation of corruption,

corporate, financial and trade activity, and the inclusion of all Norfolk Islanders on the Australian electoral roll. The committee notes that these problems have been extensively documented in other places, and reflects this in its recommendations.

### **Recommendation 12**

**8.42 The committee recommends that the Commonwealth Government reform Australia's relationship with Norfolk Island with a view to assisting improved governance, health, aged care, education and other issues reported to exist on the Island, drawing on information from the 2006 Cabinet submission process and the recent work of the Parliamentary Joint Standing Committee on the National Capital and External Territories.**

### **Recommendation 13**

**8.43 The committee, whilst acknowledging government evidence of some improvements, recommends that the Government of Norfolk Island implement measures to improve the level of financial and management transparency of Government Business Enterprises.**

**Senator the Hon Ian Macdonald**

**Chair**