5 Budget Sector Spending

Introduction

The success of the government will depend crucially on its ability to improve the appropriateness, efficiency and effectiveness of government services. Most of the goals that the government should pursue—including reducing State debt, limiting or reducing taxes, reducing the regulatory burden on businesses, cutting back the nanny state, empowering people rather than institutions—hinge on finding ways in which government spending can be reduced without reducing the quality of services available to the community. Even in the best of times this is an extremely difficult task, with no easy or painless solutions. The easy options have already been taken up: departments have been merged and remerged so often that staff are demoralised; administrative staff have been reduced in number; and public servants are already travelling in economy class. As the recession recedes, and given the last couple of years of restraint, the government should expect new and old demands for spending to burgeon. But as the following sections show, there exist both the need and scope for additional spending restraint, and the ways and means available to achieve this restraint in an efficient, effective and equitable manner.

Level and Trends in Spending

Spending: Growth With a Degree of Restraint

Contrary to the claims of successive Western Australian governments and lobby groups, the Western Australian public sector has not been starved of funds or experienced a reduction in spending over the 1982–92 period. In 1992, spending by the total public sector and the general government subsector consumed the same proportions of the State's Gross Product (GSP) as in 1982 (Table 5.1). Since most other States over this period (even the fiscally delinquent State of Victoria), experienced a reduction in public sector spending as a share of GSP, the Western Australian public sector has, relative to other States, and to the private sector, not been subject to any restraint over the period as a whole. In fact, adjusted for inflation and population growth, spending by the State government has actually increased strongly over the 1982–92 period, with outlays of the total public sector and the general government subsector growing in real per capita terms by 16 per cent and 17 per cent respectively between 1982 and 1992:

Table 5.1. Western Australian Government: Total Outlays

Sector:	Total Public		General Government	
	1982	1992	1982	1992
As % of GSP	19.0	19.1	16.4	16.3
Real Per Capita ($)	2526	2940	2147	2511

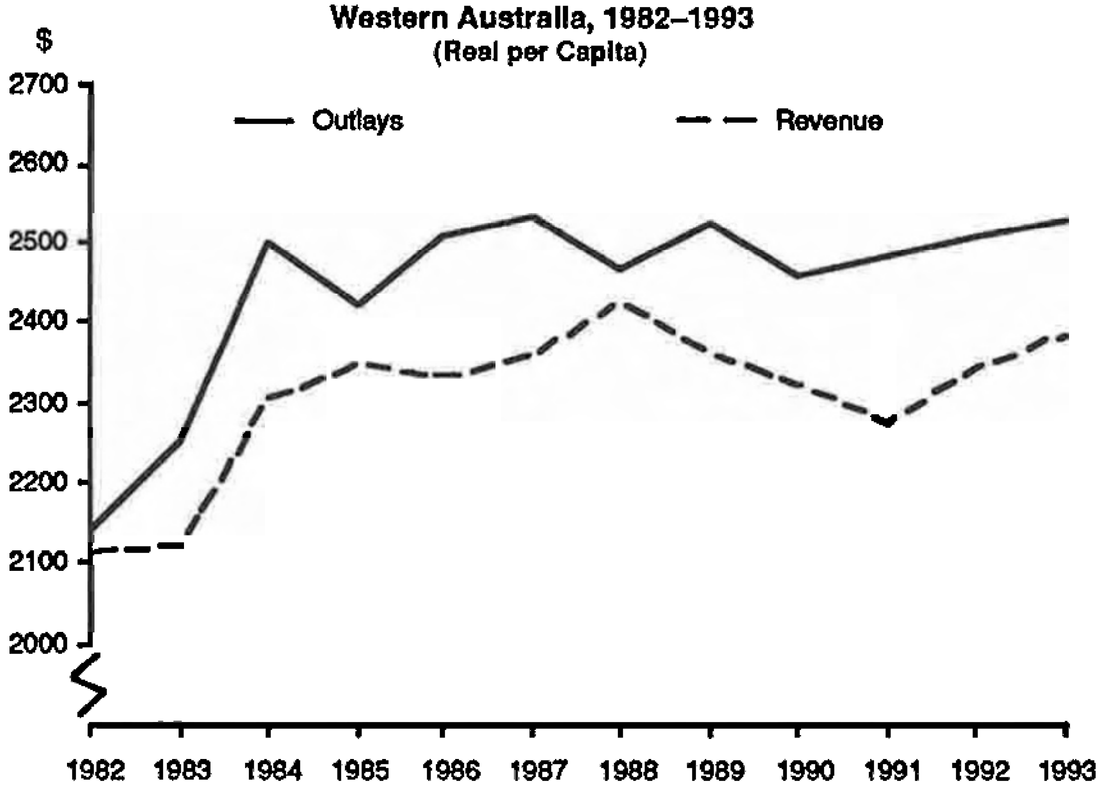
Source: ABS Cat. Nos 5501.0, 3106.0 and 5220.0.

As in other States, the increase in spending did slow during the latter half of the 1982–92 period. This was, however, only after very rapid growth during the first half of the period. As shown in Figure 5.1, real per capita spending in the general government sector grew very sharply between 1982 and 1984, and reached a historic high level in 1987. Between 1987 and 1993 (est.), spending in this sector showed no overall increase (although there has been a steady growth in real per capita terms since 1990).

Spending Beyond Our Means

While it could be argued that there has been a measure of spending restraint in recent years, over the decade as a whole it is clear that Western Australian governments simply allowed their spending to expand as revenues grew; that is, no serious attempt was made to look at the alternative of tax reductions—on the contrary, taxes were increased. Moreover, in the latter part of the period the slowing in revenue growth was not accompanied by an equivalent slowing in expenditure growth, resulting in increased resort to debt financing. That spending expanded excessively through short-sighted financial management and pre-election pork-barrelling. As Figure 5.1 shows, between 1982 and 1988, the Western Australian general government subsector experienced a large increase in revenue. This, as discussed

Figure 5.1: General Government Outlays and Revenue, Western Australia, 1982–1993
(Real per Capita)



Source: ABS Cat. Nos 5501.0, 3106.0

in Chapter 4, resulted primarily from a sharp increase in tax revenue flowing from both the asset boom and higher tax rates and, until 1986, substantial increases in Commonwealth grants. Rather than use these windfall revenues to reduce the deficit or to save in other ways for the inevitable day when revenue would be curtailed, the government not only spent the lot on recurrent outlays, but increased its level of deficit spending. When, in 1988, the revenue windfall began to fall away, the government found itself with a much higher spending base than at the start of the 1980s and a declining revenue base, leading to higher deficits. The State's financial problem was made worse during the late 1980s by the need to bail out financial enterprises. It is evident, therefore, that there has not been sufficient restraint in spending since 1988 to adjust to the changed circumstances, and as a result deficit spending and debt have grown markedly. The fiscal problem was further exacerbated by the pre-election budget of 1989, which, despite falling revenue, increased spending in the general government sector by 16.5 per cent and committed the subsequent government to large additional spending increases. The large budget deficits in 1986 and 1987 were also driven by election-related spending. It must be stated, however, that during the years of the Lawrence government, spending overall was more restrained than in any other State except Tasmania. Moreover, except for the large growth in capital spending associated with pre-election, pump-priming policies of both the Commonwealth and State governments, spending growth is, as shown in Table 5.2 expected to be restrained in 1993.

Table 5.2: Average Annual Growth in General Government Outlays, WA (Real per Capita)

	1982–1992	1987–1992	1992–1993
Expenditure	%	%	%
Current	1.3	0.8	0
Final Consumption	1.0	0.4	0
Interest	2.7	4.4	-8
Capital	0.8	-3.4	7
New Fixed Capital	0.2	-5.0	16
Total	**1.2**	**0.0**	**1**

Source: ABS Cat. Nos 5501.0, 3106.0

Recurrent Outlays Dominate Spending Growth

Over the period 1982–92, recurrent outlays exhibited a significant rate of growth, averaging 1.3 per cent per year in real per capita terms, or 18 per cent over the 10-year period (see Table 5.2). The rate of growth in recurrent outlays did slow somewhat after 1987, but growth continued nevertheless, expanding by 0.8 per cent per year in real per capita terms between 1987 and 1992. This growth was driven by two types of outlays: final consumption expenditure and interest payments. (Grants to non-profit organisations, which represented less than 10 per cent of recurrent spending, also grew rapidly.) Final consumption expenditure, which is the single largest type of expenditure (65 per cent of general government outlays) grew, on average, by 1.0 per cent per year in real per capita terms over the 1982–92 period and continued to grow at a slower pace after 1987. This category is primarily made up of labour costs (about 60 per cent); the key to restraining its growth, therefore, is the containment of public servant numbers. Interest payments, as a result of the rapid accumulation of debt and, until the most recent period, high real interest rates, grew more rapidly than any other type or functional area of expenditure. The interest bill grew, on average, in real per capita terms, by 2.7 per cent per year in the general government sector; as a result, interest payments in 1992 consumed over 15 per cent of total outlays, and represented the second-largest functional area of spending after education.

Recurrent spending was not projected to grow in real per capita terms in the 1993 Budget. This was to be achieved by tight control over expenditure, a reduction in public servant numbers flowing from the special redundancy scheme introduced in 1992, a real reduction in public service wages, and sharply lower real interest rates. Although this forecast outcome may not be achieved, and implementation of the spending promises made during the 1993 election campaign would certainly put them in doubt, it does show the potential for restraint.

Capital Spending Has Been Restrained

In contrast with previous decades, and relative to recurrent spending, capital outlays were restrained during the 1982–92 period. Capital spending by the general government subsector did grow by 10 per cent over the 1982–92 period in real per capita terms, but all growth took place prior to 1987. Capital spending was actually cut in real per capita terms by 26 per cent between 1987 and 1992 as part of the government's response to the slowing in revenues. Data on total capital expenditure derived under the National Accounting framework must, however, be used with caution. In that framework, asset sales are treated as *negative* capital outlays; and given the increasing volume of asset sales over the 1980s, this method would give us an unreliable picture of new investment. Again under the National Account system, funds advanced to financial trading enterprises—such as the large volume of funds used to bail out the SGIO and the R&I Bank between 1990 and 1992—are treated as capital outlays. A better picture of the level of new investment can thus be derived from data on new fixed capital investment; though these data have their own limitations, one of which is that they do not include expenditure on land. As shown in Table 5.2, data on new fixed capita expenditure indicate that in real per capita terms investment was virtually stagnant between 1982 and 1992, and declined sharply (averaging 5 per cent per year) between 1987 and 1992.

Table 5.2 shows not only that capital spending has borne a disproportionate share of the fiscal restraint imposed on spending since 1987, but provides further support to the argument that borrowing during the 1987–92 period was used to fund increased recurrent rather than capital spending. During this period, debt in the general government sector more than doubled, whilst capital spending (even after excluding the cost of the bail-out of financial enterprises and other WA Inc losses) was cut by 29 per cent, and recurrent spending continued to grow, though at a slower pace.

The restraint imposed on capital spending during the latter half of the 1980s does not necessarily indicate, however, either an inadequate level of investment in public infrastructure or the existence of a pent-up need for such investment now. Capital expenditure tends to be 'lumpy', and during the late 1970s and early 1980s, the State government undertook a number of large capital works projects, such as the Dampier-to-Perth pipeline, the Muja power station, extensions to various teaching hospitals, and road construction, all of which resulted in excess capacity. In subsequent years, as these projects were completed, capital outlays appropriately declined. The State government, in response to fiscal stress, also began to use its physical assets more efficiently and rationally and in so doing was able to reduce total capital spending. The limited evidence that is available—and it is very limited—indicates significant scope for further improvement in the efficiency of existing infrastructure[67], which—in combination with privatisation—should allow capital spending to continue to be restrained. Moreover, the large increase in capital works scheduled to begin in 1993 will go a long way toward meeting any areas of inadequate investment. New fixed capital expenditure is estimated to grow by 30 per cent for the total public sector and by 16 per cent in the general government subsector in 1993, and this large level of capital works is expected to continue through 1994, as many of the capital initiatives are long-term projects.

Inter-State Comparisons of Spending

Although always controversial and greatly disliked by governments, public servants and interest groups, inter-State comparisons of spending are an important—indeed vital—tool in the assessment of public sector spending. The proponents of government programmes will almost invariably argue that their needs and programmes are

67 For example, using high school facilities at night for vocational training, and greater emphasis on developing multi-functional facilities, for instance, combining libraries and community centres with schools and day care centres.

unique and cannot be compared with those of any other jurisdiction; except of course if the other jurisdiction spends more—hence the popularity of Victoria as a benchmark during the 1980s. Although any such comparison must be done thoroughly and rigorously, the Australian States are sufficiently similar in the types of programmes provided, needs to be serviced, institutional arrangements and funding, that inter-State comparison can usefully be made.

Commonwealth Grants Commission

Data generated by the Commonwealth Grants Commission (CGC) provide an excellent starting point for comparing spending and revenue-raising of the States and Territories. In the process of recommending the distribution of Federal financial assistance grants among the States, the CGC undertakes a thorough and comprehensive assessment of recurrent spending of all States and Territories. This is conducted in a manner independent of State rivalries and with access to all data—financial and non-financial. The CGC's assessment is therefore unique and authoritative. The CGC assessment covers only recurrent spending, but it goes to great lengths to ensure that a common set of services is compared across the States.

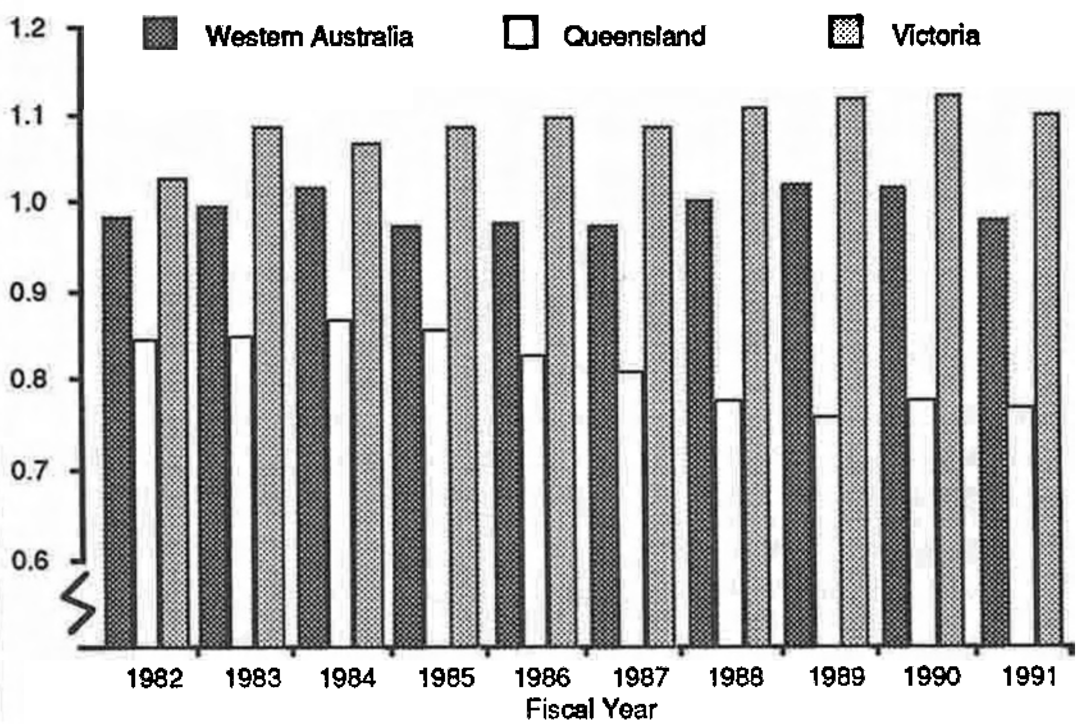
The central output of the CGC is the estimation of standardised expenditure levels for each State and for each category of recurrent spending. The standardised expenditure is estimated as the amount per head that is required to be spent by a State if it is to provide a level of service equal to the average of all States. The estimates of standardised expenditures are arrived at by adjusting actual per head spending for factors which are unrelated to policy or efficiency, such as distribution of population and economies of scale, and which make the cost of providing a given service in a State higher or lower than the average of all States or which increase the demand for government expenditure (for example, the relative size of the Aboriginal population). By comparing the actual level of spending on a per capita basis with the standardised level of spending, a prima-facie indication is obtained of whether a State is operating a service above or below the average level. However, a State that is spending more per head than its standardised amount is not necessarily providing a better-than-average quality service: the above-standard expenditure may simply reflect inefficiency in service delivery. In the CGC's terminology this ratio of actual to standardised spending is called the level of service provision. (A similar approach is undertaken for the various categories of State revenue and these data were used in Chapter 4 to compare the taxing policies of the State governments.)

A State's level of service provision ratio will be different from unity (1.0) if it pursues policies which are different from the average policy setting of all States. If a State's service provision ratio is greater than unity, it indicates that it has made a policy decision, whether explicitly or implicitly, to provide either a higher quality of service or a less efficient level of service. Although the CGC data do not allow differences in efficiency to be separated from differences, if any, in quality of service, a ratio above unity provides a basis for questioning the level of expenditure and for examining other data relevant to making a judgement as to the cause of the difference.

Relationship To National Average

The CGC data on service provision ratios (Figure 5.2) indicate a number of points of relevance to the spending policies of the new government.

Figure 5.2: Commonwealth Grants Commission Service Provision Ratio(a)



Source: Commonwealth Grants Commission, *Report on Tax Sharing Relativities*, Vol. II, 1985; *Report on General Revenue Grants Relativities*, Vol. II, 1988; *Report on General Revenue Grants Relativities*, Vol. II, 1989, 1990, 1991 and 1992—*Update*.

Note: (a) Service provision ratio is measured as the ratio of actual to standardised recurrent budget expenditures per capita; with standardised expenditure measured as the amount required by a State to provide a standard level of services adjusted for the State's special needs and disabilities.