A Progressive Budget for Queensland

Jon Stanford[1]

Introduction

Discussion of the Queensland government finances over the last three years has been dominated by propositions which stem from the doctrinaire views of the US Tea Party and which are at complete variance with progressive ideas in Australia.

At the heart of these antediluvian views is 'debt phobia' that governments should not incur deficits and should not owe debt and, if they do have outstanding debt, it should be repaid quickly without regard to what effects this may have on the economy. In a modern world such ideas are silly: they have no analytical justification, only a highly specific political dogma to support it, and they fly in the face of global experience.

The facts are that governments generally do regularly run deficits and always have outstanding debt. Governments rarely have surpluses and do not try to repay their outstanding debt. Government debt is prized in private financial markets: it is the 'risk-free' asset; the benchmark for pricing private debt and is required for the bond futures market in which more sophisticated pricing standards exist. There are some conventions which attempt to place limits on deficits and debt; the European Union's convergence criteria require member countries not to incur deficits greater than an amount equivalent to three per cent of Gross Domestic Product (GDP) and not to have outstanding debt to GDP of 60 per cent.

Debt Phobia

Australia's experience in attempting to eliminate government debt, through the policy actions of then Treasurer, Peter Costello, the leading exponent of 'debt phobia', illustrate graphically these propositions.

In 2002, Philip Baker reported that the federal government's promise to pay off all government debt (using the proceeds of the sale of Telstra) 'is creating alarm in the heart of Australia's financial markets'[2] and that The Sydney Futures Exchange - which has up to 60 per cent of its business at risk if the $50 billion Commonwealth bond market is shut down - and big bond market operators are lobbying Treasurer Peter Costello to keep the market alive. In 2002-03 the results of a Government review of the bond market were announced:

> After extensive consultations with interested stakeholders, the Review concluded that an efficient Treasury Bond market should be maintained. It considered that, given the state of development of Australia's financial markets and the lack of effective alternatives to CGS, the

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[2] http://evatt.org.au/papers/bond-traders-take-costello.html

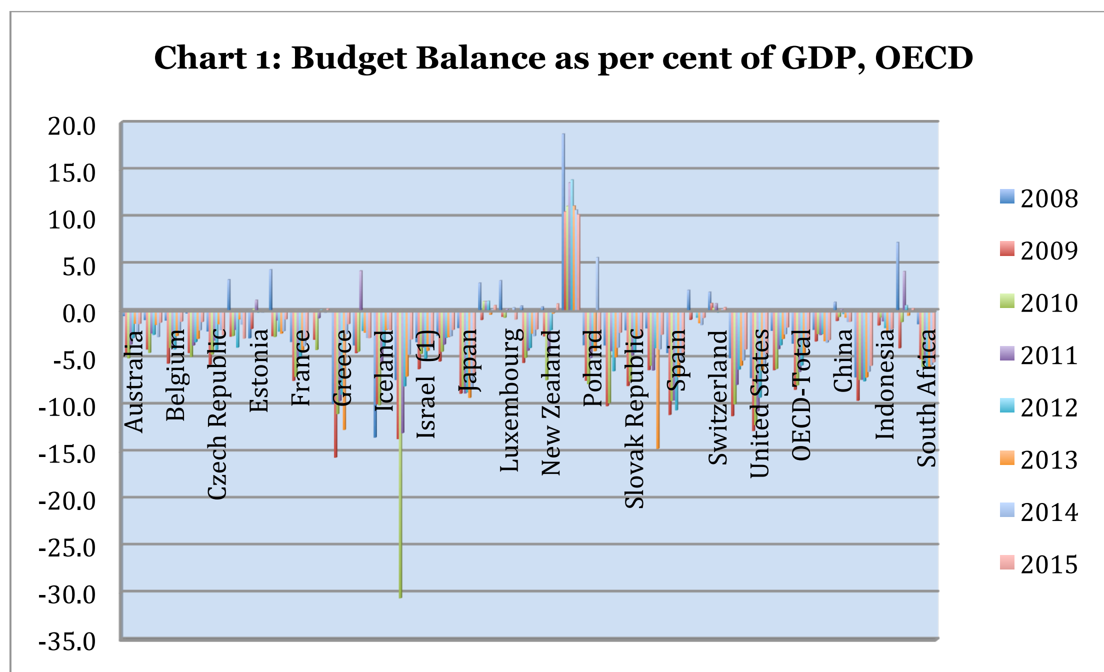
> higher costs associated with managing interest rate risk without a Treasury Bond futures market would add slightly to interest rates in Australia. Further, the Australian financial system might become less diversified and more vulnerable to shocks during periods of instability. The Government announced in the 2003-04 Budget that it would maintain sufficient Treasury Bonds on issue to support the Treasury Bond futures market.[3]

The government continued to issue Commonwealth government securities with a coupon rate of five and a half per cent, and to lodge the proceeds with the Reserve Bank as a term deposit paying two and three-quarters per cent. This was obviously not a good financial investment for the government.

In 2011 Stephen Koukoulas wrote that:

> Never once during the Howard government during which Costello was Treasurer for the whole time did Australia achieve the triple-A credit rating from all major credit rating agencies and that the Howard government never had an objective for the budget to be in surplus. On the contrary – in the 1996 Charter of Budget Honesty, the Howard government objective for the Budget was "to maintain budget balance, on average, over the course of the economic cycle." No mention of surplus. The "balance on average" means that an occasional surplus would be met with an occasional deficit – which is exactly how fiscal policy should be run when there is a business cycle to contend with.[4]

The recent experience of OECD countries with respect to government debt and deficits shows how uncommon it is for government to run surpluses. Chart 1 shows the position over the period 2008-2015 (projected).



The key features are the number of bars below the line (deficits) compared with those above the line (surpluses).

There are some outliers in the data. Large deficits were incurred in Iceland and Ireland which had catastrophic banking failures during the GFC requiring government bailouts on a massive scale. The only country which consistently made surpluses over the entire period was Norway. Norway, we should remember, has a sovereign wealth fund with a balance of USD 75,000 for each Norwegian. The fund holds the proceeds of the taxes levied on the

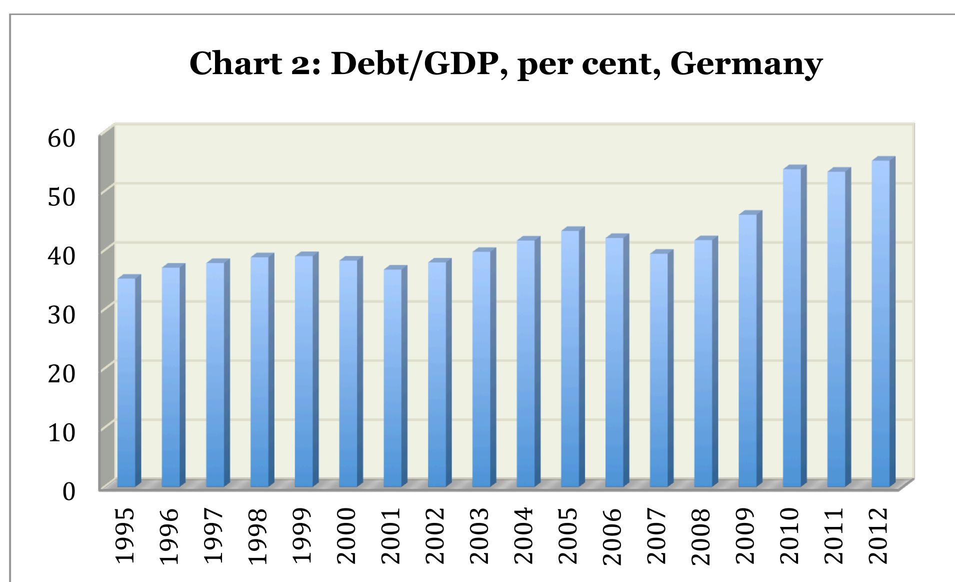
[3] http://archive.aofm.gov.au/content/publications/reports/AnnualReports/2007-2008/html/04_Feature_article.asp
[4] http://www.marketeconomics.com.au/1343-peter-costello-speaks-with-forked-tongue-2

mining companies which exploit its reserves of oil and gas. The taxes are levied at the rate of 78 per cent of the companies' profits. Germany, usually regarded as a hallmark defender of government fiscal rectitude, has run deficits in each year since re-unification in 1990 until 2013. As Newsweek reported it:

> The surplus works out as 0.6% of German gross domestic product (GDP) in 2014, up from 0.1% GDP in 2013. It's a remarkable turnaround from the -4.6% of GDP recorded 2010.[5]

Incidentally, the -4.6 % result breeched the EU protocol for restricting deficit to no more than three per cent of GDP.

Germany has consistently had a high level of debt outstanding as shown in Chart 2 (based on World Bank data) below:



It would be easy, but tiresome, to give more evidence of the fiscal position of governments all around the world but this evidence would refute the following propositions:

Governments normally:

a. incur deficits;
b. borrow;
c. have government securities outstanding (these securities serve an important purpose for private financial markets);
d. rarely have surpluses.

Budget Principles

The first budgetary principle is that it should contain the taxation and other revenue measures which have been approved by Parliament. Taxation is a unilateral payment made to the government by its citizens without expectation of a *quid pro quo*. Payment of taxation is not voluntary; it is enforced by the coercive powers of the State the more commonly employed for tax evaders are monetary fines and imprisonment.

The Parliament will also authorise expenditure by the government and the raising of finance by way of loans. A modern role, supplementing this traditional role, is the government policies of correcting for market failure, providing for re-distribution of income and stabilising

[5] http://europe.newsweek.com/germany-posts-eu18bn-budget-surplus-economy-grows-309137

the economy. The latter is macro-economic policy which is the prerogative of the national government. Correction of market failure is undertaken by way of regulation, taxes, and subsidies.

Government will also provide the non-market goods of public goods, such as defence, administration of justice; and merit goods. Re-distribution is carried out through social welfare transfer payments such as pensions and the provision of 'merit goods'. An example is Medicare, under which health care was explicitly designed to be provided outside the market on the basis of citizen entitlement.

The inter-temporal allocation of resources is affected by government borrowings, and macro-economic factors determine budget deficits (good design of fiscal instruments incorporates 'built–in stabilisers' so that during recessions taxation receipts (income and company tax) will decline and expenditure (more correctly, outlays on such transfers as social security benefits) will increase.

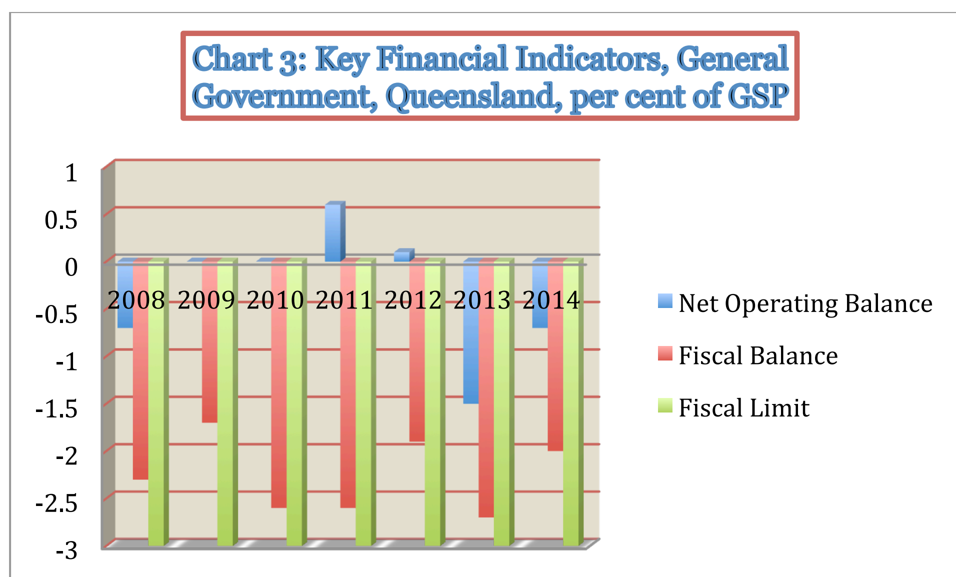
The Queensland Budget

The Queensland budget is not concerned with macro-economic policy, the sole prerogative of the Commonwealth government, and also social welfare transfers. Since the Commonwealth has priority in the collection of income tax, Queensland has limited taxing powers and is partly dependent on fiscal equalisation grants from the Commonwealth. Nevertheless the scope for local revenue raising (and expenditure) is substantial.

The first progressive principle for the Queensland budget is that the Queensland government needs to raise more taxation and revenue from State sources. The current level of taxation is held deliberately low with the inevitable results that the level of services provided in Queensland is low and their quality poor.

In Chart 3 there are three indicators: (i) Net Operating Balance, NOB; (ii) Fiscal Balance, FB; and (iii) 'Fiscal Limit', FL. The NOB is the indicator of the current balance (receipts *minus* expenditure) of the Queensland budget. The FB indicates the amount available from current operations of government to fund capital expenditure; and the FL equal to three per cent of Gross State Profit (GSP), the maximum allowed under the EU convergence criteria.

Measures (i) and (ii) indicate that, in recent years, the government is incurring a deficit on current operations making no contribution to capital works; and (iii) indicates that the position is not serious.



Some correction is needed but not urgently. An increase in State taxation and other State receipts is required in the future to fund an increase in the present the low level of services provided by the government. In contrast to the LNP's 'Strong Choices', presented for the 2015 election, and the Commission of Audit in 2013, it is necessary to increase borrowing to fund capital expenditure by the government. At this time, Queensland would be able to borrow on capital markets which are awash with funds, at a long term bond rate of barely more than inflation. A target for borrowing would need to have outstanding borrowings for social projects not greater than 40 per cent of GSP (i.e. at the current level of GSP up to $100 billion).

The State government is more constrained in its budgetary options than the national budget in two main ways. The first is that it has no powers to issue currency, and the second is that its ability to raise taxes is circumscribed - the Commonwealth having priority in income tax, and the GST requiring agreement between the States to change rates. In addition, much of the revenue of the State government comes from grants from the Commonwealth, some under agreements but some at the discretion of the Commonwealth.

In the 2014-15 Commonwealth budget some intergovernmental agreements were unilaterally terminated before their expiry date by the Commonwealth government such as:

- the National Partnership for Certain Concessions for Pension Concession Card and Senior Card Holders;
- the Improving Public Hospital Services National Partnership Agreement (without the adjustment of the national hospital funding baseline as previously agreed);
- removal of hospital funding guarantees and a reduced rate for indexation of hospital funding from 2017-18 (contrary to agreed funding arrangements in the National Health Reform Agreement);
- a reduced rate in the indexation of school funding from 2018 (contrary to arrangements agreed with some states; and
- a three year pause in the indexation of financial assistance grants to local government.[6]

The level of State taxes in Queensland is low both by absolute standards and in comparison with those of other states. This has been a deliberate policy to maintain a competitive tax environment for business which 'is therefore fundamental to the Government's commitment to job creation and sustainable development'.[7]

> Queensland's tax effort, as measured by the Commonwealth Grants Commission, was more than 11% below the national average in 2012-13 while taxation as a share of GSP is below that of other states.[8]

There is no doubt that low State taxes benefit the businesses which escape them, but there is doubt about whether low taxes contribute to development. Chart 4 below shows the Australian Bureau's data for real GSP for Australia, Western Australia and Queensland. Queensland economic development lags WA by a substantial amount and the general level in Australia by an increasing amount. It is time to consider other strategies in relation to State taxes.

[6] Queensland Budget Paper No 2, Budget Strategy and Outlook 2014-15, 107.
[7] Budget Strategy and Outlook 2014-15, 61.
[8] Budget Strategy and Outlook 2014-15, 62.

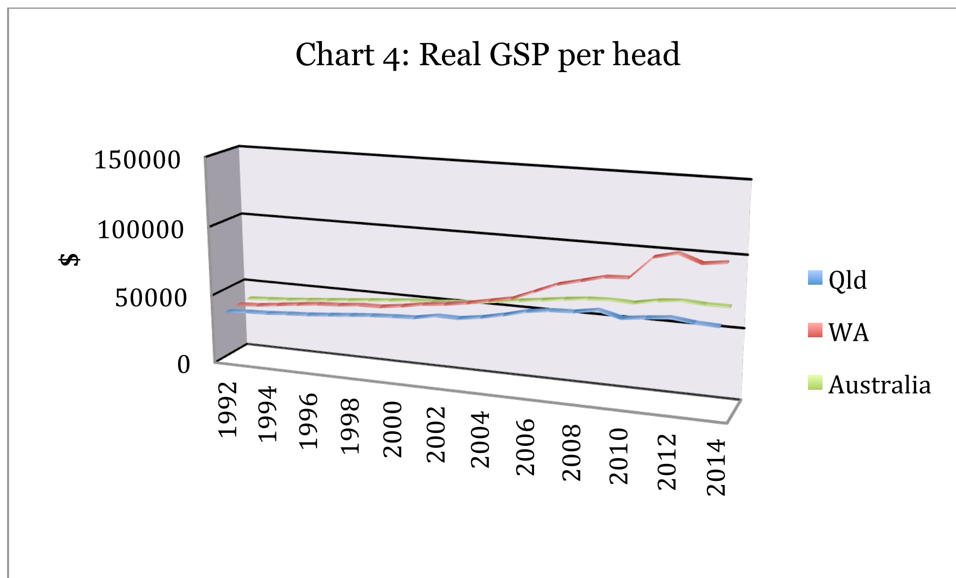
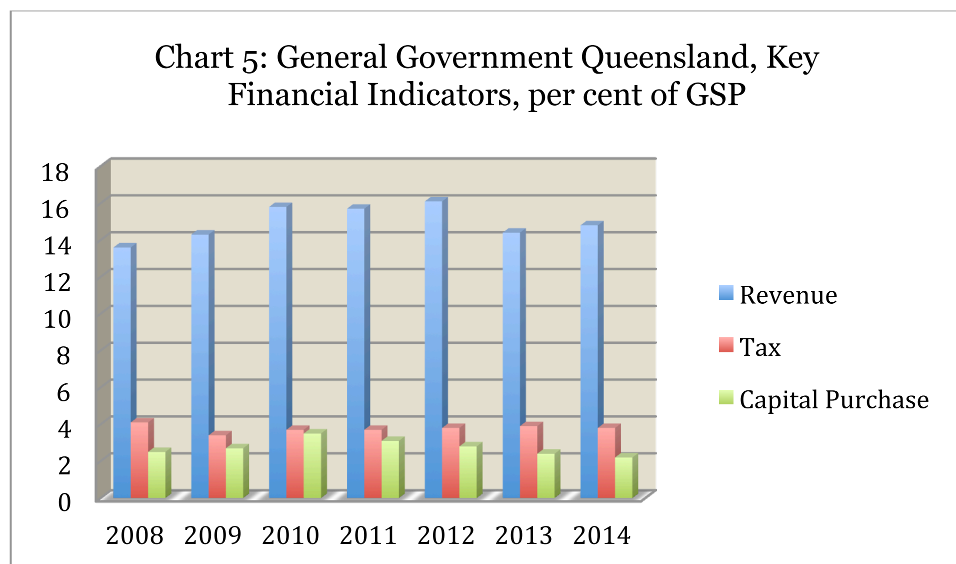


Chart 5 below shows three key financial indicators as a percentage of GSP[9]: Revenue, Tax (State) and Capital purchase (infrastructure spending). It is clear that low state taxes *equals* low level of services and contributes to a low increase in the State infrastructure. The costs of low taxes to the community are lower living standards and poor quality public assets such the road network.



There are three major avenues for the State to increase revenue: state taxes, state charges and mining royalties. Saying the level of taxation in Queensland is too high is a statement from the class of statements which includes 'Global warming is not caused by burning fossil fuels'.

A progressive view of taxation is that this low level should be increased as a policy goal to at least four per cent of GSP (and preferably five per cent). How might this be done? A first approach to achieving this objective would be for an around uplift of tax rates by a reasonable proportion of 10 per cent. Some taxes need to be increased by a greater amount. Land tax, which is levied on landowners' aggregated holdings of freehold land in Queensland on 30 June, contains exemption levels which could be critically examined. The principal place of residence is exempt but, in a time when residential housing is considered an investment rather than provision of basic shelter could be included and be subject to the

[9] Budget Strategy and Outlook 2014-15, 185.

residents' general exemption of $600,000 which is still greater than the exemption for others of $350,000. Much of Queensland's land is government owned and leased for a variety of purposes; an increase in leasing fees would assist in the most efficient use of land.

The government has many charges which are imposed to meet some of the costs of government regulation.[10] It is too much to review all these here but an indication of what might be done to align the charges with the costs incurred by the activities charged is given by the licensing charges applying to hotels. A suggestion by Rob Katter, the member for Mt Isa, for a reduction in licencing fees paid by hotels in rural areas, because they are community centres which provide other benefits such a meeting place for local residents, is worth exploring. Likewise urban hotels which trade over extended hours (up to 5am) create a civic nuisance when their patrons leave the premises the worst for wear and engage in anti-social behavior in the surrounding streets could be charged a fee which fully reflect the costs of the Safe Night Out program the budgetary provision for which in 2014-15, for the next four years, was $29 million in new funding and reallocation of over $15 million.[11] Motor vehicle registration could be altered to reflect the external costs created by large personal motor vehicles and trucks which take up more road space, parking, reduce visibility for other vehicles. Hence larger vehicle would pay relatively more in registration.

The amount of revenue obtained from mining is ludicrously low. I have previously demonstrated that the government can increase its net revenue for mining by not building specialised mining infrastructure or, alternatively, if it does recover in full the costs from mining companies; increasing the rate of royalty to the international standard of one-eighth or 12.5 per cent; and auctioning the right to exploit coal deposits.[12] It is difficult to make precise estimates of the increased revenue from these measures but a conservative one would be eight billion dollars a year; enough over a decade like the previous one to wipe out the accumulated debt.

Application of these principles to coal seam gas would increase the take from royalties by a similar amount especially as:

> The ramp up in LNG production is forecast to lead to a surge in overseas exports of 22½% in 2015-16 which, combined with improvement in the domestic sector, is forecast to boost economic growth to an 11-year high of 6% in that year.[13]

This would leave the mining and gas companies in a highly profitable position as the State fails to obtain all the economic rent arising from natural resource exploitation. Some of the gains from these actions would be lost through lower Commonwealth revenue grants through the principle of horizontal fiscal equity. But we shouldn't be dog-in-the-manger about this.

Land tax

Land tax is a highly suitable tax base for the State. It provides a large base for a tax which is very difficult to avoid. The base for land tax is the taxable value of the landowner's aggregated holdings of freehold land owned in Queensland as at midnight on 30 June each year. Resident individuals are generally liable for land tax if the total taxable value of the freehold land owned by that person as at 30 June is equal to or greater than $600,000. Companies, trustees and absentees are liable for land tax if the total taxable value of the freehold land owned as at 30 June is equal to or greater than $350,000.

At present, the principal place of residence is exempt from land tax. This exemption should

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[10] An incomplete list is Office of Liquor and Gaming Regulation Fees and charges, Queensland liquor licensing; Queensland Building and Construction Commission Plumbers and drainers: Schedule of fees; and Department of the Environment and Heritage Protection Summary of fees for environmentally relevant activities.
[11] https://publications.qld.gov.au/storage/f/2014-06-10T06%3A29%3A58.142Z/safe-night-out-faq.pdf
[12] Research Report 15 Pt1: What are the benefits of mining in Queensland? And Research Report 15 Pt 2: How to get a fair return for the community by auctioning mining licences in Queensland.
[13] Budget Strategy and Outlook 2014-15, 30.

be removed and the other exemptions should be retained until a full review of the tax base carried out. The rate of land tax should be raised by a significant amount, say of the order of 15-20 per cent. The current land tax is slightly progressive (a good thing) but has very low rates. An illustration from the Office of State Revenue shows that a property valued at $640,000 would be subject to a land tax of $1,300 or 0.2 per cent; a property valued at $6,400,000 is levied $87,000 or 1.35 per cent.[14] The Queensland government also collects payments in respect of leasehold land; these payments should be increased.

Urban congestion

Urban congestion in south-east Queensland is increasing, and the costs of such congestion through inefficiency (there is nothing efficient about sitting in a traffic jam). Previous traffic and road planning has been poor and the costs of constructing more roads is becoming prohibitive.

The solution is to use a market mechanism to allocate road space to competing uses by pricing. At zero private cost on the roads, each driver imposes negative externalities (costs of delay) on each other driver. A system of road pricing will allocate the space to those whose demands are the most urgent.

I would advocate a road pricing system with variable rates during the day, not a barrier charge as applies in London and Stockholm. The outline of the system would provide for three rates on major roads: 'peak', 'shoulder' and 'off peak'. An illustrative system would apply peak pricing to apply on Monday to Friday between, for example, 7-9am and 4-6pm; shoulder between 6-7am, 9-10 am, 3-4pm and 6-7pm; and off-peak all other times.

The introductory charges, to be applied to any vehicle travelling on designated roads, would be of the order of five dollars peak and three dollars off peak. Charges would be applied to a number of major thoroughfares so that one journey could attract more than one charge. The advantage of the charge would be to ensure the efficient use of road space, and to provide important information about the willingness of motorists to pay for road journeys; identifying the motorists who are willing to pay these or higher rates would enable road planning to proceed on a firmer basis than on the dishonest estimates of demand used to justify construction of the Clem7 and Airport tunnels.

The technology to collect road congestion charges is currently installed in nearly all motor vehicles driving in SE Queensland in the transponders used to collect toll tunnel and bridge charges. It would be necessary to subsidise public transport to a greater extent.

A Capital Budget for Queensland

Over recent years, public capital works in Queensland undertaken on an *ad hoc* basis without initial evaluation by standard analytical techniques or indeed any objective criteria. The result is that they incur excess costs, do not come to fruition, are not accounted for in a transparent way and are an inadequate solution for the problem they are supposed to solve.

Some case studies are considered below (unfortunately there are more; one project currently being criticised for poor planning, cost over-runs and general ineffectualness is the new Children's Hospital).

- **The Busway Project**

Busways are dedicated roadways that separate buses from general traffic. A number have been constructed in Brisbane at a cost, to date, of $2 billion.

[14] https://www.osr.qld.gov.au/land-tax/about-land-tax/land-tax-rates.shtml

Tanko and Burke report that informants in their study of decision making about the Busways project were clear that technical analysis was often employed only to back up the gut feeling of a political champion and the judgement of the senior decision-makers, after key decisions had been taken. They further report that one informant succinctly described the planning process as *'ex-post facto rationalisation on a decision already made'* and that the 'enormous battery of transport investment evaluatory techniques' that has long been available to transport planners was not harnessed to compare the Busways proposal with a Light Rail alternative, nor a bus-rail interchange plan that made better use of the existing large CityRail network.[15]

- **The PPP Tunnel projects**

The Clem7 tunnel was placed in the hands of liquidators in 2011 after the actual number of vehicles using the tunnel was significantly less than the forecasted traffic flow made at the time of the float of the public company building and operating company. The owners of the Airport Link tunnel, BrisConnections, in 2012 asked for their shares to be suspended from trading on the stock exchange after it was realized that the value of the company was less than the outstanding debt after the projected traffic flows using the tunnel proved to be grossly over-optimistic. The losses to investors were of the order of $3 billion.

Generally speaking projections of traffic on toll roads have been overly optimistic as shown in the Department of Infrastructure and Transport report, *Review of Traffic Forecasting Performance of Toll Roads*.[16] The result of these two debacles for shareholders was a widely held belief that no further projects would be financed by this method.

- **The South East Queensland (SEQ) Water Grid**

The South East Queensland (SEQ) Water Grid[17] was designed in times of a severe drought to transport between dams in the region and, amongst other structures a desalination plant at a cost of $9 billion but was not subject to an overall evaluation. Since its construction SE Queensland has not experienced drought conditions and the water grid remains largely unused.

- **Traveston Crossing Dam**

In 2006 the Traveston Crossing Dam proposal was announced and was to cost $1.7 billion but was opposed by community and scientific groups; in 2008, it was announced that project would be delayed for delayed for two years; in 2009 the Commonwealth Minister for the Environment rejected the proposal. The State government had acquired many properties and was required to sell them.[18] The estimate of the costs of the project was $460 million.

- **1 William street**

More recently the Newman government undertook the construction of a grandiose 45 story building to provide office accommodation for some 4,000-7,600 public servants, with seven stories reserved for private sector occupancy and the ground floor for a number of retail outlets. The building was to be constructed in a 'dead end' location where there is no public transport and no ready access. The building was to be constructed as a PPP. The

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[15] Michael Tanko and Matthew Burke, 'How Did Brisbane Get it's Busways? Findings of a study into mode-choice in Brisbane', *Australasian Transport Research Forum 2013 Proceedings* 2-4 October 2013, Brisbane, http://atrf.info/papers/2013/2013_tanko_burke.pdf.

[16] http://www.infrastructure.gov.au/infrastructure/infrastructure_reforms/files/Attach_A-BITRE_Literature_Review.pdf.

[17] http://www.statedevelopment.qld.gov.au/resources/publication/past-annual-report/DIP_Annual_Report_web_full.pdf.

[18] http://www.smh.com.au/environment/timeline-of-the-traveston-crossing-dam-proposal-20091110-i8bb.html.

government undertook to pay $1,144 billion in leasing costs over a 15 year period after construction.

However, in June 2015, the current government announced that it would take the whole building for office space as it had proved impossible to find private sector companies which would sub-lease. The arrangement was designed to keep the cost of the building off the balance sheet. If the government had financed the building by borrowing this borrowing would appear in the balance sheet but as the project is classified as an 'economic PPP' the balance sheet is unaffected.

The Auditor General explains how PPPs are accounted for:

> The accounting for PPPs is complex, involving multiple accounting standards and guidance papers. There are two forms of PPP arrangement: economic and social, each with different accounting treatment. The key difference between the two is typically that the user pays in an economic PPP, while the taxpayer or ratepayer pays in a social PPP.[19]

However, in the case of William street the State will pay all the revenue making it look like a social PPP; the real point of the PPP being structured in this way is to keep the asset off the government's book and also the cost of financing it. The costs of financing ($1.144 billion in total over 15 years) will appear in the current expenditure in the year in which it is incurred.[20]

Principles of a Capital Budget

A Capital Budget should be in two parts: one for projects to be carried out by general government; and the second for projects undertaken by non-financial public corporations.

The projects funded by general government should show explicitly the impact on the government current account. The projects of non-financial public corporations should be funded from profits from sale of goods and services, and borrowings on a commercial basis; any community service obligations should be explicitly financed from taxes and revenue.

General government projects should only be accepted after a rigorous process of asking (and answering satisfactorily):

- What policy goal is to be achieved?
- What are alternatives ways to achieve this?
- What are the costs of each of these?
- How do we decide to select one?
- How would we know if the goals had been achieved?

A proposed project should be examined against alternative projects by standard objective evaluatory techniques. Once selected the project financing should be explicitly stated. Annual updates of progress and financing should be provided at part of the Budgetary process.

[19] Report 7: 2014–15, Queensland Audit Office 13.
[20] Report 7: 2014–15, Queensland Audit Office 14.

Conclusion: A Progressive Budget Strategy

The general strategy for a progressive budget in Queensland would be:

1. to increase State taxation, royalties and charges:

    a. State taxation to five per cent of GSP;

    b. Royalties (and other revenue) from mining by at least 300 per cent;

    c. Uplift all State charges by at least 10 per cent but preferably 15 per cent; and

    d. Remove the exemption of the principal place of residence from State land tax; and

    e. Raise the rate of land tax.

2. to maintain and increase the current level of services;

3. to keep the Net Operating Budget to less than two per cent of in any year;

4. to fund capital works by borrowing (after presenting a transparent, rigorously evaluated capital budget distinguishing between capital expenditure by public non-financial corporations and general government); and

5. to maintain the level of outstanding borrowings in respect of general government at less than 40 per cent of Gross State Profit; and

6. to reduce urban congestion by the introduction of a congestion tax using the proceeds to subsidise further public transport.