What Should Governments Do?

Auditing the National Commission of Audit

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Preface

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On June 19th 1996, the Treasurer Mr Costello received the report of the National Commission of Audit. Establishment of the Commission on March 12th was one of the first acts of the new Government. The Commission was required to report to the Government on the finances of the Commonwealth and measures to improve its fiscal position. The terms of reference mentioned the impact of demographic changes on finances, the state of infrastructure, financial performance targets, service delivery arrangements and a charter of budget honesty. The Commission was asked to investigate these issues 'with the objective of restraining the growth of total outlays and improving the quality of public expenditure'.

Establishment of an audit commission to review the state of finances and to make recommendations on how to improve them has become a standard practice for incoming governments. In the nineties, there have been 'audits' commissioned by new governments in all states.

One of the noteworthy features of the Commonwealth's audit report is the extremely short period over which it was conducted. This contrasts with an earlier review of Commonwealth programs by the Whitlam Government's Priorities Review Staff, which was an on-going process. The short time allowed the Commission does not appear to have been an impediment to it in recommending far-reaching changes to the way government is conducted in Australia and specific changes to social and other programs that have been built up over decades.

The Government has stressed several times that it would like to see wide public debate of the recommendations of the Audit Commission. In organising the seminar that led to this publication, The Australia Institute made strenuous efforts to get a member of the Commission or a representative of the Government to present the main findings of the report. Regrettably, no-one was in a position to attend.

The papers published in this discussion paper provide a thorough critique of the underlying assumptions of the Audit Report and of many of the specific recommendations it makes. As the report of the National Commission of Audit is likely to provide the rationale for many radical changes that the new government seems determined to make, these papers are an important contribution to public debate on the future of Australia.

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ACCOUNTING FOR GOVERNMENT IN THE NCA REPORT

R. G. Walker[2]

The report of the National Commission of Audit (NCA) is in many ways fairly predictable, at least to those familiar with the genre. In 1988, the incoming Greiner Coalition Government established the 'Curran' Commission of Audit to report on the state of NSW's finances. Subsequently similar exercises have been undertaken in South Australia, Victoria, Western Australia and Tasmania. All of these importantly titled 'Commissions of Audit' pursued a familiar theme. The incoming government had inherited a financial crisis. The financial cupboard was bare. There was a high level of debt. There was a need to cut a range of programs and reduce the size of the public sector.

Nick Greiner, when speaking at the launch of a book describing the recent history of Coalition government in NSW, was happy to retrospectively describe the Curran Commission of Audit as a 'political stunt'. Apparently the prescriptions outlined by the Curran Commission (and which were repeated for three years in Greiner's own Budget speeches to Parliament) were not to be taken seriously. According to Greiner, the exercise in establishing a Commission of Audit was undertaken to create a climate in which the community would accept change.

One wonders whether the authors of the current exercise will be prepared to be as frank, if not now, then seven years hence. After all, the work described as an 'audit' is little more than a recital of familiar themes, and many known (or previously published) facts.

1. The 'audit' does not comply with professional standards

The report of the NCA is not an 'audit' in the sense that the accounting profession uses the term to describe examinations of financial statement. Nor could it properly be described as a 'performance audit'. The chairman and one of the members of the Commission are distinguished members of the accounting profession. Yet, on my reading of the report, the Commission appears to have failed to even attempt to follow the precepts set out in one of the accounting profession's rules, which are supposed to be binding on members of that profession.

The Australian Auditing Standard AUS 806 on 'Performance auditing' states that professionals should make clear the criteria they are using to evaluate performance – in this case, the funding arrangements and program performance agencies established by the previous government.

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What the Commission has done is to enunciate not criteria but a set of 'principles'. These 'principles', on close inspection, are ideological propositions about the role of government in modern society.

The methodology used in the report thus becomes a process of ticking off whether the funding and operational arrangements established in terms of the previous government's policies are consistent with the Commission's views about the role of government. Not surprisingly, in many cases they are not.

The Commission's views about what considers constitutes 'best practice' in government include the following:

- program beneficiaries should (always) be given choice (with illustrations ranging from the choice of hospital, school or university);

- governments as far as possible should operate as funders of programs, with funding separate from the actual delivery of services involved; and

- service delivery should be as competitive as possible (p. viii).

The Commission's stance is quite extreme. Take the proposition that governments should be funders rather than providers of services. Many would agree that there are circumstances in which governments may be better off funding services than seeking to provide them within the public sector. But the Commission does not suggest that private sector service delivery should be undertaken as far as is *practicable* or even as far as is *cost effective*. The Commission takes an extreme position: there should be private sector delivery as far as *possible*.

The ultimate effect of the Commission's statement of 'principles' is that we would move towards 'virtual government', in which the public sector simply funds certain activities which are to be provided within the private sector. The public sector 'would exist only to the extent needed to arrange for private organizations to provide public services'[3].

While the National Commission of Audit is singing this song – a song well aired over the past decade in the United States, the United Kingdom and New Zealand – other observers are sceptical. Management writer Henry Mintzberg has suggested that the 'motto of this model might be Privatise, Contract and Negotiate'. It contains a questionable assumption that the best government is no government. The model 'represents the great experiment of economists who have never had to manage anything'.[4]

Mintzberg argues that governments need to choose from a range of models, selecting specific models which suit specific activities – and argues that there is a case for greater emphasis on a normative control model of government, in which management pursue visions rather than simplistically-stated objectives, control is rooted in shared

[3] H. Mintzberg, 'Managing government or governing management?', *Harvard Business Review*, May/June 1996.
[4] Ibid.

values and beliefs, and reliance is placed on human dedication to achieve a vision of service to the community.

The National Commission of Audit is a bit short on visions. It explicitly assumes that government should only be involved in two main areas: the pursuit of social or equity goals, and second where there is 'insufficient or excessive production of certain commodities'.

In this regard, the Commission does not highlight some other commonly-encountered views about the role of government, as seen from a simple economic perspective: that there is a need to regulate the activities of those with market power; a need to intervene in cases where the unfettered activities of private firms could lead to externalities (such as a polluted environment), and a need to intervene to ensure that private firms provide sufficient information about their activities or products to ensure that some of the basic conditions of competitive markets are actually in place. Nor does the Commission offer any exploration of the 'social equity' goals of government, beyond passing acknowledgments that there is a 'case' for government intervention in some areas of education and health services, and where the community demands that governments some provide services to those in genuine need (described as the 'genuinely needy').

The Commission's articulation of the role of government seems simplistic and superficial. But the assumptions which the Commission adopts about the role of government then predetermine most of the Commission's recommendations (or 'findings').

2. Findings based on evidence?

Alongside the extreme nature of the Commission's assumptions about the role of government is a decided reluctance to examine *evidence*. Indeed, the key recommendations of the report do not flow from any 'findings', in any formal sense. A feature of the report is not just the *absence of evidence* to support its recommendations. It is a deliberate effort to *ignore evidence* which might be inconsistent with its assumptions and its recommendations.

Take the case for distinguishing between 'funders' and 'providers'. We have had years of experience with the practical application of this approach to government. Has it worked?

There is some evidence that application of the funder/provider model has been associated with reductions in costs – notably in areas like garbage collection of bulk cleaning contracts. But in examining even these cases, only ideologically-blinkered researchers would attribute cost savings to competitiveness or structural change alone. There is a difference between associations and causal relationships. My own view is that many of the so-called success stories of contracting out may reflect better management, changed incentive structures and a more attractive workplace environment. Arguably these changes could be replicated in the public sector.

Indeed, there is some evidence that implementation of the funder/provider model in government has actually led to increased costs without any corresponding increase in the volume of quality of services delivered, particularly where this structural arrangement was introduced whereby one government agency was the ‘funder’ and another the principal ‘provider’. The reason? Application of the funder/provider model may have led to higher overheads, as larger groups of bureaucrats prepare and administer contracts and then monitor the performance of those other groups of public servants who have been contracted to engage in service delivery.

3. Promotion of accrual accounting

Another section of the report where evidence is conspicuously lacking is that dealing with the promotion of the merits of accrual accounting. I had a feeling a deja vu when reading this stuff as so much of the Commission’s report echoed the claims made by the ‘Curran’ Commission of Audit in NSW in 1988. Back in 1988 it was claimed that accrual accounting would provide the means for disclosing the ‘true cost’ of government programs, and for showing the ‘truth’ about governments’ financial position (and changes in financial position).

After about seven years of experience with the application of accrual accounting to general government agencies in the public sector, we have learned that public sector accounting can be as creative as anything seen from entrepreneurial private sector corporations in the 1980s. Ironically, while some commentators were recommending that the public sector replace its cash accounting methods with accrual methods, in the private sector it has been recognised that cash flow statements (unknown in 1988) were highly desirable forms of reporting and could serve as an antidote to creative accrual accounting. The accounting profession, under pressure from the Australian Stock Exchange and international developments, was pushed into issuing standards requiring cash flow reporting in 1991.

The Commission is nevertheless happy to claim that accrual accounting is not only better, it ‘is essential if the accountability requirements of Parliament and the taxpayer ... are to be met’ (p. 211). In one sense this was an easy claim to make, since the Commission made no effort to describe or delineate the supposed ‘accountability requirements of Parliament and the taxpayer’. The Commission then went on to claim that accrual accounting is ‘essential’ as a complement to the structural and cultural change that the Government is seeking to introduce. But the Commission made no effort to analyse the evidence to see whether its claims stack up.

What has the introduction of accrual accounting to general government agencies actually achieved? In NSW, the Council on the Cost of Government, which supports the use of accrual accounting, has reluctantly concluded that accrual accounting has not been used to make the public sector more productive. Moreover, it is not possible to track trends in spending from the accrual accounting systems introduced, because of a lack of integrated management information systems, changing charts of accounts, and the loss of financial histories when agencies are restructured or programs are redefined. Since then, the NSW Public Accounts Committee (PAC) has concluded that an investment of $140 million in introducing accrual accounting was poorly planned and managed. Ironically, the PAC could not obtain its estimates of $140 million from the newly introduced accrual-accounting accounting systems; that information had to be compiled by survey.

Without bothering to examine available evidence, the National Commission has gone a step further, and advocated the introduction of *accrual budgeting*. The Commission reports that it has relied on information provided by the Department of Finance, but in publishing the Department of Finance's well-worn statements about the virtues of accrual accounting the Commission has not only endorsed these arguments, it has gone so far as to recommend the introduction of accrual budgeting in the Commonwealth arena as a matter of urgency.

In the process, the Commission has offered a series of extraordinarily naive statements about the merits of accrual budgeting. In essence, it argues that cash budgeting is distorted because it produces different figures than those which might be produced by accrual budgeting. Therefore it argues, with devastating clarity and logic, that accrual budgeting will eliminate distortions.

A second and related theme is that accrual budgeting will show the 'full costs' of providing services. 'Full cost' represents one product of accrual procedures. Readers are cautioned that there are as many ways to calculate 'full cost' as there are of tracing costs to specific activities, of allocating different categories of common costs to programs, of estimating the economic life of an asset, of estimating the residual or scrap value of an asset, or of choosing depreciation methods. Correction, there are as many methods of showing 'full cost' as there are permutations of all of those methods (and there can be dozens of possibilities within each of those categories).

In the course of its advocacy, the Commission selectively refers to New Zealand as an authority to support its claim that accrual budgeting is a good thing. The Commission neglects to refer to a recent major study from the Government Accounting Office in the USA which says the opposite, arguing that readers will be confused by the inclusion in budgets of arbitrary depreciation figures.

Nevertheless the Commission claims that accrual budgeting would ensure that 'agencies' budgets and their financial statements would reflect costs and revenues on a consistent basis'. My response is that we should wait until pigs are sighted engaging in aeronautics.

4. Lack of understanding of key concepts

Arguably the most disturbing feature of the Commission's report is its evident misunderstanding of some of the key concepts that it invokes to support its rhetorical recommendations. We are told that application of the Commission's principles, coupled with the introduction of the techniques of accrual accounting and accrual budgeting, will contribute to a cultural change in which public sector managers are devoted to ensuring that the public sector is efficient and effective.

Yet time after time the authors of the report display their lack of understanding of the key concepts of 'efficiency' and effectiveness'. These terms have been used in the literature for decades: indeed, it is customary to refer to the three 'e's: economy, efficiency and effectiveness. 'Economy' relates to the question of whether goods and services are acquired at good prices; it is concerned only with 'inputs'. 'Efficiency', on the other hand, relates inputs to outputs. One agency might be adjudged more efficient than another if it provides the same services at a lower cost, or more services for the same cost. In contrast, 'effectiveness' relates to outcomes. An agency might be efficient, but the programs it is conducting may not be producing the outcomes they were intended to achieve. (For example, a program of school education may have an extremely low cost per student, yet may not be performing well in developing students' cognitive and non-cognitive skills).

Despite its free use of terms like 'efficiency' and 'effectiveness', the Commission demonstrates an alarming lack of understanding of their meaning. The following illustrations are indicative:

- it is suggested that recent changes from the use of cash-based statements to accrual-based statements reflect a focus on 'efficient and effective outputs and outcomes' (p. 214), yet accounting statements are concerned with 'inputs' (eg. the financial results of the activities of agencies, possibly disaggregated in terms of programs or functional activities). In most instances, evidence of 'outcomes' will not come from accounting systems but from other sources (eg. results of customer satisfaction surveys, data on changes in public health, and so forth).

- it is claimed that the use of 'full cost accrual accounting' is necessary to assess efficiency (p. 224), yet 'full cost accrual accounting' is but one way of tracking inputs, and may involve the arbitrary allocation of head office overhead costs to programs. Indeed, the use of full cost accrual data could produce quite spurious indicators of the efficiency with which programs are delivering services to the community.

A recurrent theme in the report is a concern with the *cost of programs*. It is suggested that the introduction of full accrual accounting will shed light on the 'true' or 'full' cost of these programs, that there is a need to benchmark these costs against the cost of private sector delivery and so forth.

Now I must admit to having made the same error of elevating the importance of trying to identify the costs of programs. That was before I had examined the way in which agencies go about identifying activities as 'programs', and the way that changes over time. Agencies are regularly restructured, and this leads usually leads changes in program definition. Even those agencies whose responsibilities are relatively stable over time (for example, most state health and education departments) will still change the way they divide their activities into programs.

So when the Commission promotes the idea of using accrual accounting to report on the true or full cost of programs, it is only promoting a set of reporting arrangements which may be of little more than symbolic value. For serious analysts, reports on the cost of programs will be of limited usefulness if there are regular changes in program identification.

In my view, effective monitoring of public sector requires not only the capacity to track expenditures on programs, but also the capacity to restate financial histories when program descriptions change. Effective monitoring also depends on the capacity to track spending on areas of activity (such as spending on 'corporate services') or on line items of expenditure (such as travel, overtime, or maintenance contracts). Well designed management information systems will not only provide the capability for upstream reporting across the whole of government, but will also provide managers and central agencies with the capability of undertaking downstream enquires. That enables managers to search for information relating to areas of spending in order to seek ways of improving financial performance.

In other words, the public sector needs a much more sophisticated approach to the design of management information systems across the whole of government than that outlined by the Commission in its invocation of well-worn claims about the merits of accrual accounting for the purpose of annual budgeting and formal annual reporting.

5. 'Whole of government' reporting using accrual accounting

The Commission made much of the supposed virtues of accrual accounting and the benefits which are likely to flow from use of this system of reporting. It then had the opportunity to demonstrate these virtues with its presentation and interpretation of a balance sheet for the Commonwealth public sector.

Commonsense seems to have prevailed, for the Commission was wary of making extravagant comments which could damage the credit rating of Australian government securities. Hence its discussion of the balance sheet – which shows a deficit of some \$73 billion – was quite restrained.

Indeed, the Commission commented that it preferred not to describe the report as a 'balance sheet' but as a statement of assets and liabilities. Yet balance sheets are statements of assets and liabilities – with the difference between the dollar value of assets and the dollar value of liabilities being reported as the extent of the owners' equity. Apparently the Commission wanted readers to place no great weight on the reported deficiency of \$73 billion.

It was left to commentators and politicians to draw a series of policy inferences: with a deficiency of \$73 billion, the Commonwealth cannot afford to maintain current levels of spending on health or education. It has also been left to others to restate the Commission's findings in the following form:

> With a balance sheet deficiency of \$73 billion, the Commonwealth would be unable to pay its debts as and when they fall due, were it not for the Commonwealth's powers to levy tax.

Given that the primary source of the Commonwealth's revenues is its taxing power, this is a bit like saying that if Woolworths did not sell anything, its shops would go broke. It's a meaningless statement.

Quite properly, in my opinion, the Commission did not endeavour to attribute a dollar value to the Commonwealth's major brand name, 'Australian Tax Office'. But it may be worth recording that if multinational companies like Coca-Cola Amatil and News Corporation did not attribute a dollar value to 'bottlers' agreements' or 'mastheads and television licences' then they would have similar looking balance sheets to that compiled by the Commission.

However, given that the Commission argues that trends in the balance sheet figures are more important than the values arrived at in a single year, it may be worth considering the way some of the figures in the balance sheet were arrived at. The following comments are by no means exhaustive.

Liabilities include $18.5 billion 'currency on issue'. While the recognition of 'currency on issue' as a liability has been used by the New Zealand Government when it prepared a whole of government balance sheet, it is a contentious treatment. Certainly several years ago, member states of the European Community were questioning whether currency on issue should be counted as a 'liability' for the purpose of monitoring the financial position of member states. I am also aware that the US Treasury chose not to count currency on issue as a liability when it pioneered the preparation of whole of government financial statements in 1976 and 1977.

Money is the unit of measurement for accounting purposes. But, in my opinion, it is wrong to include the quantum of currency on issue as a 'liability' in this form of accounting statement, which are intended to reflect the stewardship of governments in their management of the public sector. It doesn't make sense to distort these reports by reporting changes in the volume of money on issue.

Liabilities include $71 billion in unfunded superannuation commitments. The terms of reference of the Commission included examination of unfunded superannuation commitments. Some commentators have applauded the Commission for revealing the scale of these liabilities. Yet the fact is, this information has been on the public record for some years, in reports issued by the Loan Council. One might perhaps ponder the reasons why this task was formally made part of the Commission's terms of reference. Possibly the strategy was to re-announce the figures, and then argue that it had been discovered that it was too expensive to continue offering defined benefit superannuation schemes to newly-recruited public servants.

It should be recorded that while the estimate is described in the report as an actuarial assessment, it is more correctly described as an updated estimate of an actuarial assessment undertaken in 1993 (using data from earlier years). The Commonwealth Government Actuary has yet to produce a valuation based on 1995 or 1996 data.

A further cautionary note is that estimates based on such out-of-date data may be seriously astray. For example, with movements of staff into and out of the public sector each year, the estimates used in the Commission's balance sheet could prove to be seriously astray. (For example, with 2%-3% annual staff turnover, estimates of the proportion of those staff who have left without vested entitlements may be materially different from the proportion assumed on the basis of pre-1991 experience.) Time (and a more up-to-date report from the government actuary) will eventually tell.

Valuation of assets. Reported assets include $42.5 billion of infrastructure, plant and equipment, yet the basis of valuation is said to be primarily at historical cost, less depreciation. The notes to the accounts are remarkably silent on how figures were assessed for such items as defence equipment. (It is understood that in New Zealand the Department of Defence and Treasury had estimates $NZ 1 billion apart, so they just split the difference).

While this is not the time to canvass arguments in favour of alternative methods of asset valuation, it is worth noting that the whole of government balance sheet does not appear to have applied the same methods of asset valuation as are advocated by the Steering Committee on National Performance Monitoring of Government Trading Enterprises (GTEs). The Steering Committee had supported the use of 'deprival values', an approach which places heavy reliance on the use of current replacement values. When used by GTEs, this approach leads to higher asset values than would have otherwise have been reported. The decision not to use this approach for general government agencies produced lower asset values (and a higher deficiency) than might otherwise have been reported.

Heritage assets are at nil value. One has to look deep in the footnotes to discover that the whole of government balance sheet has not assigned any values to so-called 'heritage assets', like museums and monuments, as well as items of cultural or geographical significance. This is also inconsistent with the approach advocated by the Steering Committee on National Performance Monitoring of GTEs. Once again, a choice of accounting policy means lower aggregate assets than might otherwise have been reported with different policies, and contributes to the $73 billion deficit.

Scope of consolidation. The whole of government balance sheet is confined to the Commonwealth public sector, on the basis of the Australian accounting profession's argument that the scope of these reports should be limited to agencies which are subject to common 'control'. In the USA, the Governmental Accounting Standards Board asserts that the scope of consolidated statements should encompass all agencies which are financially dependant on a parent entity, and which are linked to the parent entity by formal relationships of accountability.

To make the implications of this distinction more concrete, the Commonwealth spends much of its funds on allocations for spending on health and education programs operated by the states and territories, and some part of that money has been spent on capital works. Arguably, there is a relationship of financial dependence between (say) universities and the Commonwealth. Yet the balance sheet does not include the value of state-based hospitals, universities and schools. (Ironically, the Commission makes a series of recommendations on the need to vary the financial arrangements for funding education and health services, even though it has presented financial reports which don't encompass the assets of agencies engaged in delivery of health and education services).

In sum, given the Commission's overblown rhetoric about the merits of accrual accounting, one might have expected more analysis of the whole of government financial reports than that which has been presented. It is difficult to avoid the conclusion that the publication of a balance sheet in this form was once again in the tradition of state-based commissions of audit. The story was to be that the government had inherited high levels of debt, which was unaffordable, and that it was necessary to institute cuts in Commonwealth spending. It is also difficult to avoid the conclusion that other accountants could have produced a whole of government balance sheet which showed a significant surplus without departing from Australian Accounting Standards, but by using different approaches to liability recognition and asset valuation than those adopted in this report.

6. Final comments

Overall, the report from the National Commission of Audit should not be taken seriously as an ‘audit’. The report does not rely on evidence in any formal sense. Its findings largely reflect the Commission’s ruminations on how a set of extreme assumptions about the role of government might be applied to the Australian public sector.

Its recommendations are not founded on any analysis of the experience of other Australian governments which have already experimented with implementation of some of the ideas which have been aired again in the Commission’s report.

Its comments on the merits of introducing accrual accounting and accrual budgeting to the Commonwealth general government sector pursue well-worn themes. But the proposals in their current form are unlikely to produce the outcomes nominated, which demand a much more sophisticated approach to the design of management information systems.

Finally, the Commission’s pioneering balance sheet for the Commonwealth is of limited value, but could be the foundation of more informative reporting in future years. The Commission itself recognises that caution must be exercised in interpreting the $73 billion deficit as a meaningful indicator of financial position. Different accounting policies could have produced quite different results.

EFFICIENCY, SMALL GOVERNMENT AND FISCAL TARGETING

Fred Argy[5]

I want to focus on four important themes of the NCA Report, its advocacy of more efficient delivery of services, smaller government (fewer services and programs), fiscal targeting and on-going budget surpluses.

The report quite rightly insists on value for money in the delivery of government programs, including best practice, transparency, separation of policy and funding from service delivery, and contestability. It also advocates a rational allocation of functions and programs between various levels of government to minimise duplication, overlap, cost shifting, and to improve service delivery and accountability.

These principles are unchallengeable. Note however that they call for case by case analysis rather than across-the-board spending cuts, they do not necessarily point to any particular fiscal outcome, and the report itself has not demonstrated that there are currently big efficiency gaps in the delivery of government services. That said, the Commission's treatment of efficiency is the strongest part of the report.

1. Smaller government

As well as improving government efficiency, the report wants the Government to substantially reduce the role of government. Although taxation was not part of its terms of reference, the Commission explicitly expresses a preference for cuts in outlays rather than tax increases (p. 135), and this preference pervades the whole report.

The case for smaller government is nowhere cohesively and systematically argued, but implicitly it seems to be based on three premises:

- higher taxes affect incentives and economic performance;
- many government programs cannot be justified in cost-benefit terms; and
- much of the Government's redistribution effort simply involves wasteful ‘churning’ of taxes.

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How tax levels and small government impact on *economic performance* is still a controversial area in economics. There may be some incentive effects on work and saving, but if so they are more often found at the lower end of the income spectrum (in relation to welfare withdrawals) than at the upper end. In any case, tax increases and cuts in outlays have very different distributional effects and this should be part of any comprehensive cost-benefit evaluation.

The report rightly questions the *cost-benefit rationale* for a number of government programs; but it is not always consistent in its approach. It adopts a highly sceptical view of business assistance programs such as export market development grants and related programs (pp. 23 ff). It does so (it seems) on two grounds. First, it argues that there is no evidence of market failure. Such evidence is always hard to find, but the Commission has no difficulty accepting there is failure in the saving market (p. 151), yet general export support programs (of the kind which assist with information, coordination and networking) are really the other side of the coin to saving-enhancement programs. To have one but not the other runs a risk that we will achieve saving-investment balance at a very low level of economic activity and employment. In both cases there are macroeconomic externalities, a form of market failure.

The second reason given for opposing business assistance programs of this kind is that the private sector captures most of the benefits of these programs. But surely the same argument applies to saving, eg. concessions on superannuation help the retirees.

The narrow non-interventionist line is also evident when the report discusses infrastructure. It recommends that where users of services can be identified, pricing of services should reflect full resource costs, including an appropriate return (p.178). This is a narrow accounting view of infrastructure pricing policy. Many projects (eg. a transport project which relieves congestion costs or facilitates development), have benefits which go well beyond those captured by users and should be under-priced relative to cost. Others may have environmental effects which justify setting price above cost.

More generally, the Commission questions the rationale for any Government involvement in infrastructure (p. x & p. 204), but it is relatively uncritical of private sector involvement, even when (as now) such involvement carries generous government subsidies. The EPAC Private Infrastructure Task Force report (September 1995) was much more open-minded on this issue of private sector subsidies and financing. In particular, it recognised that:

- private urban road financing may have gone beyond the point where it could be justified on cost efficiency grounds;

- if the concern about public sector financing related purely to the macro-economic effects, then this concern was misplaced because private sector funding had exactly the same effects; and

- there were some questions about the level of accountability of privately financed projects.

The third reason for small government is that redistribution involves a lot of *wasteful churning*, in other words, many people who now receive benefits pay for them through their own taxes, with some useless bureaucracy in between.

There is more than a modicum of truth here, but it is overdone. Most of the bureaucracy is involved in means testing rather than straight churning of widely available benefits and means testing is likely to increase under the NCA proposals.

Another concern I have is that the Commission's view of the proper redistributional role of governments is a very limited one. It sees the aim of income support as targeting only the 'genuinely needy' and as ensuring 'an absolute standard of living rather than maintaining relative standards of living'. Above this basic safety net, benefits presumably need to be withdrawn. In short, the Commission is saying is that it is acceptable for many people in the lowest income quintile to be made worse off in the name of economic reform and for many 'genuinely needy' people to be denied a share in the benefits of reform. I find this system of values very hard to stomach.

Another concern about the Commission's treatment of distribution is that it fails to acknowledge that tighter targeting of welfare and community services will create serious marginal disincentive effects on saving and work at the lower end of the income spectrum, where – as the report itself notes (p.151) – such effects are really important.

2. Specific fiscal targeting

A third key message of the report is the need for fiscal targeting. No one disputes the need for regular fiscal forecasts and the announcement of a broad, medium-term fiscal strategy. But why have specific short-term fiscal targets, as the Commission appears to favour?

One perceived advantage is reduced uncertainty. But the Commission acknowledges that specific targeting has a cost too, i.e. less policy flexibility and reduced ability to respond sensibly to changing economic circumstances. That is why it has (rightly in my view) moved away from legislative enforcement. Given that, and given that it wants to give the Government a lot of let-outs for unusual economic circumstances, one is left with a half-way house that does nothing to reduce uncertainty.

Another more persuasive argument for specific fiscal targeting is that it will improve accountability. That is reasonable in itself. But if the Commission is so concerned about government accountability, shouldn't it have recommended targeting of employment, real incomes and social and quality of life indicators, which are after all the ultimate ends of government intervention? Fiscal targets are only one of several *means* to these ultimate economic welfare ends. I think there is a lack of perspective there.

I suspect the main reason why the Commission is so keen on specific fiscal targets is that, to use its own words, it will act ‘as a counterbalance against spending pressures’, i.e. to assist its aim of smaller government. This is an aim I have already questioned.

3. Budget surplus as fiscal benchmark

The Commission is unclear as to what the fiscal benchmark should be. In the Executive Summary it is clearly arguing for an on-going budget surplus; elsewhere it is ‘underlying balance’ and elsewhere again it is simply ‘an appropriate contribution to national saving’ (Chapter 11). I have no objection to the latter at all but I do object to the budget surplus or balance benchmark.

The Commission puts forward three major arguments for deficit reduction, to enhance saving, to ensure intergenerational fairness, and to avoid risks in the future.

One can broadly accept that a reduction in fiscal deficits will tend to enhance *national saving*. However, the following points are important:

- there are enormous complexities and uncertainties in the relationship which are ignored in the report;
- one should look at the public sector as a whole when assessing the contribution of governments to national saving;
- one must remove investment-type spending from the accounts;
- one must focus on the structural component of the fiscal deficit, which is the part relevant to long-term saving and only accounts for about half the present deficit (the rest is the result of under-full employment and should not be a target *per se*); and
- finally, our national saving problem should be addressed over the medium term. It certainly does not require early achievement of a fiscal surplus (and hysteria about our monthly current account deficits is quite ludicrous and should be discouraged rather than encouraged by official ministerial statements).

The report argues that ‘budget surpluses’ are also needed to ‘avoid imposing unfair burdens on future generations’ (pp. xvi & 146). The concern is that the taxes future Australians will have to pay over their lifetime as a result of present and future government activities and liabilities will exceed the transfers and receipts they are likely to receive i.e their net tax burden will increase. This concern is very thinly based.

For one thing, the big increase in dependency ratios of which the Commission is so fearful are still at least 20 years off, and estimates beyond 25 years from now must depend on many tenuous assumptions, eg. concerning labour force participation rates.

In the meantime (over the next two decades) the ‘middle-aging’ of the population will actually promote private saving.

More fundamentally, the authors acknowledge that the only serious work in Australia on the subject is by Ablett,[6] who concludes that because of Australia's relatively low and stable public debt levels relative to GDP, ‘demographic change will not impose a public finance burden on future generations so large as to result in intergenerational inequities; in fact the results are marginally favourable to future generations’ (p. 144). Ablett’s results need to be refined and are inconclusive; but the specious arguments used by the NCA (on pages 144-5 of the report) to muddy the inter-generational inequity argument are really unworthy of the authors.

The report also has a reference to some later unpublished work by Ablett which incorporates private transfers and consumption. The Commission sees this as evidence of ‘a major structural deficiency in national saving’. But this work is very preliminary and its methodology has been seriously questioned, including its failure to recognise the essential endogeneity of growth rates and their dependence on rates of capital accumulation. In any case it does not alter the conclusions in Ablett’s first paper.[7]

The Commission has produced a trial 1994-95 balance sheet which shows an alleged deficiency of assets over liabilities but as a guide to intergenerational equity the figure is, as the report itself concedes, of very limited value.

All in all there is no strong case on intergenerational grounds for running a budget surplus in the short term.

Perhaps because of these complications, the Audit Commission falls back on a fine ‘balance of risks’ type of argument. It concludes that ‘confidence in the public sector and normal prudence require that the long-term viability of fiscal policies be established with a reasonable degree of certainty rather than the balance of probabilities’. The Commission appears to be saying that, while there does not appear any looming inter-generational problem, we need to take early fiscal action *just in case one emerges*. I believe this is an unconvincing basis for their advocacy of an early and sustained budget surplus.

I also believe that any future research on inter-generational equity and its implications for fiscal policy should distinguish between various forms of government outlay. In particular it should take into account not only capital expenditures but also investments in human quality, including education, health and so. The Commission says some of the benefits from this investment can be appropriated by the present generation and they should pay for these investments themselves. But there are also wider externality benefits to future generations (through a more productive, literate and healthy work force), and it is surely legitimate for governments to pay for the public good elements, in part at least, by borrowing.

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[6] J. Ablett, ‘Intergenerational Accounting and Saving in Australia’, Discussion Paper, University of NSW, Sydney, 1995

[7] J. Ablett, ‘A set of generational accounts for Australia: One way of assessing the intergenerational effects of fiscal policy’, Discussion Paper, University of NSW, Sydney 1994

4. Concluding comment

The Audit Report provides a useful analytical framework for evaluating the efficiency of government programs and it points the way towards a more transparent and hopefully more meaningful system of government accounting and reporting.

But it is a pity that the Commission did not strive for greater balance and detachment, that its value judgments were not made a little more transparent, and that its recommendations did not achieve greater consistency and cohesiveness.

SOCIAL POLICY AND THE NCA:
Old Whines in New Bottles?

Deborah Mitchell[8]

The National Commission of Audit (NCA) Report of June 1996 re-visits a number of long-standing themes in the conservative agenda for social policy in Australia. In the discussion which follows I show that – despite the re-packaging of some dated political positions in the guise of a set of new-found 'guiding principles' and a re-statement of existing public sector management techniques – the NCA has delivered a report which is fairly predictable in its recommendations and disappointing in terms of setting a social policy agenda for the medium term.

The discussion in this paper starts with a brief analysis of the thinking which underpins the principles espoused by the NCA. The second section questions a number of the assumptions made by the NCA about the policy environment in which government will operate beyond the turn of the century. In the third section I have selected two areas of social policy in which the NCA has made substantive policy recommendations to illustrate the limitations of the Commission's approach to social policy issues. The concluding section sets out a political assessment of the policy arenas in which the NCA's findings are likely to have an impact.

1. Public sector reform and the guiding principles

The first five chapters of the NCA Report are essentially a summary of Department of Finance reforms of the past ten years. There is very little in this report which can be distinguished from practices already established under the Financial Management Improvement, Program Budgeting and Performance Monitoring reforms that have been in place in the Australian Public Service (APS) since the mid-80s. Similarly, concepts and objectives such as *client-focussed services*, *best practice* and *benchmarking* have been adopted by public sector managers across many portfolios. Despite the NCA's insistence that the public sector has much to learn from the private sector, there is very little in this report which represents an advance on existing public sector management practices. The report introduces some apparently new notions such as *market contestability* but again, these have already been given expression in contracting out, corporatisation and privatisation of many government services.

Indeed, many public sector managers reading the NCA Report must be wondering why the NCA has chosen to re-state many of these concerns. Part of the reason for this, I believe, lies in the Report's assumption that the public sector in Australia performs poorly whether in comparison to the private sector and in international

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terms. Similarly, there is a touch of cultural cringe when private sector or international best practice or benchmarking issues are discussed without adequate recognition of the fact that in many areas Australian public services are often held to be examples of best practice by many supra-national bodies. For example, the World Bank's appraisal of pension arrangements in Australia; the World Health Organisation's ranking of our blood products service; or the International Air Safety Standards Commission constant commendation of Australian practices.

I think it is also worth commenting on the nature of the principles which have guided the assessment of various programs by the NCA and which they hold up as criteria for future reviews, viz:

- deciding whether or not government involvement is warranted;
- setting and following of program objectives; and
- efficient application of resources.

The discussion of these principles in the report (pp. 10-18) seems to be very much in keeping with Pusey's (1991) critique of 'economic rationalism' in two respects: first, they are presented as though they are neutral and objectively defined principles which are above politics; second, that they obey a set of economic laws over which governments have no control.[9] By contrast, my view – and that of many other commentators – is that the first two "principles" are essentially political decisions; while only the third has the character of an administrative or technical decision and even here there is a great deal of subjective political input. Other contributors to this workshop have already commented on these issues, so I will limit my comments on these issues to begin with, but will return to them in Sections 3 and 4 of where I discuss how useful these guiding principles are in resolving contentious issues in the social policy arena.

2. Setting the policy context: the NCA creates a crisis

Moving to the environment in which the NCA sees its recommendations operating, there are two contextual scenarios which I believe should be challenged vigorously as a basis for future policy-making. At the outset of Chapter 2, where the NCA sets out the principle guiding its analysis, we find an extensive quotation from a recent OECD document on public sector management reforms.[10] According to the OECD, there are a number of factors which have come together to make government sector reform a 'burning' issue in the OECD nations. Among its lengthy list of concerns we find the impact of globalisation, a perception that public sector performance is inferior to that of the private sector, a concern that the public sector is squeezing out the private sector, limits to the growth of the public sector give budgetary constraints, a decline in

[9] Pusey, M. (1991) *Economic Rationalism in Canberra.* CUP: Cambridge.
[10] OECD (1995) *Governance in Transition: Public Sector Management Reforms in OECD Countries.* OECD: Paris. p. 19 ff.

public confidence in the ability of government to solve economic and social problems, and so on.

The NCA (p. 9) remarks that 'these same pressures apply in Australia and require a fundamental re-think of government activity.' Further, the NCA notes that governments will have to balance demands for new services with the 'community's willingness to pay higher taxes or face reductions in other areas of services.' The first comment I would make here is to dispute the extent to which Australia is subject to these allegedly universal pressures. Australia is one of the lowest taxing and lowest spending nations in the OECD. As Figure 1 shows, throughout the 1990s Australia's total tax take as a percentage of GDP was around 10 % below the OECD average. Since 1990 we have been in the bottom three taxing nations. In terms of welfare expenditures, whether measured in per capita or GDP terms we have been, thanks to our means-tested social security system, at the bottom of the OECD table for well over 20 years. We rival only Japan and the US as a low spending nation on social programs.

Moreover, the pattern of the 1990s is not short-term. Australia's taxing and spending behaviour since 1960 (Figure 2) indicates that with each passing decade the gap between the OECD average and our taxing and spending has grown. Thus, for the NCA to present OECD prescriptions for the high taxing and big spending nations – such as Denmark, Sweden and the corporatist nations of Western Europe – as a justification for government stringency, stretches credulity.

Turning to some of the other factors mentioned in the OECD report, for example, the perception that public services are inferior to those of the private sector, it is my view that in Australia at least, the public sector has continuously set the standard in welfare service provision. These have become the industry standard in many areas, eg. child care, rehabilitation services, and nursing home and allied health care services. The Australian experience generally is that meeting public provision standards requires an upgrade in service standards for the private sector, whereas de-regulated or self-regulated service industries generally set standards below that of the public sector.

The impact of globalisation gets a regular press as part of 'scary future' scenarios especially as regards national competitiveness. This seems to be a much favoured shock tactic at the moment and yet it is not borne out by empirical evidence. Recent work which I have completed suggests that – as far as welfare state programs are concerned – the impact of globalisation measured in various ways is dwarfed by demographic considerations.[11] In fact globalisation as measured by freedom of capital movement and the degree to which individual countries are linked into

[11] Garrett, G. and Mitchell, D. (1995) *Globalisation and the Welfare State: Income Transfers in the Industrial Democracies, 1965-1990.* Centre for Economic Policy Research Discussion Papers, No: 330. Canberra: ANU.

commodity import and export markets, is positively associated with the affordability of income transfer programs.

Let me now turn to Chapter 6 which deals with demographic change and is the most substantive policy discussion in the Report insofar as specific policy concerns are raised. Much of the empirical evidence presented here comes from the Retirement Income Modelling task force (RIM) of the Commonwealth treasury. The projections and estimates of the task force will no doubt provide a useful guide for future policy-making. However, the way in which the NCA has used the RIM task force work is less than edifying and is reminiscent of the way in which the Fowler Review of the UK social security system in 1984 used worst case scenarios to justify the scrapping of the State Earnings Related Pension Scheme (SERPS), a decision which many bureaucrats and politicians regretted within 10 years.

As an example of how the NCA has misused the RIM models, we need only consider the NCA's use of labour force participation projections to the year 2059 to estimate worst case scenarios of dependency ratios. According to the NCA (pp. 130-131):

- the aged/working population dependency ratio will rise from its present level of around 0.28 to 0.54 i.e. for every 100 people of working age, there will be 54 aged people;

- the non-working/working ratio will rise from 0.77 at present to 0.91 in 2059 ie. about even numbers of working and non-working people.

This sounds quite worrying. Should we be concerned? There are several reasons why I think the NCA's conclusions here should be rejected. First, how robust can such assumptions be? We are speaking here of estimates nearly 65 years into the future, and I very much doubt that we can be confident about projections beyond 2020. If we think about this another way, try to imagine how useful predictions based on 1930's labour force participation patterns would be for the Australia of the 1990s. I think that such projections would be wrong on almost all counts whether we examine the rise in women's participation, the fall in older men's participation or the delayed participation rates of young people.

Second, dependency ratios are highly amenable to policy correction over the medium term. Governments can increase participation rates if sufficiently motivated and re-define, almost at will, classes of dependency. To illustrate this, let me give an example of how dependency ratios in 2031 could be corrected by government policies implemented ten to fifteen years in advance. Table 1 is based on the projected population levels for various age groups, estimated by the Australian Bureau of Statistics. The right hand side of the table shows the dependency ratios which would operate when retirement age varies from its current setting at 65 years.

What we see is that extension of retirement to 70 years can have a significant impact on lowering dependency ratios to present levels. These estimates are on the high side as we cannot assume that there will be a 100% participation rate by those in the 65-69 years age group, but the point here is that dependency ratios can be targeted for government action. Moreover, an extension of working life is a feasible policy option given the improving health position and life expectancy of older Australians.

Table 1 Population Projections Australia, 2031

Age	Males (‘000)	Females (‘000)	Total (‘000)	Old age dependency ratio, retirement at:		
0-19	2480	2450	4930	*Age 60*	*Age 65*	*Age 70*
20-59	5910	5910	11820	0.56	0.37	0.24
60-64	790	790	1580			
65-69	690	690	1380	**Total dependency ratio with retirement at:**		
70-74	610	700	1310	*Age 60*	*Age 65*	*Age 70*
75-79	410	580	990	0.97	0.74	0.58
80+	510	810	1320			

Source: ABS (1995) *Estimated Resident Population by Sex and Age: States and Territories of Australia*. (3201.0)

Third, even if the projections used by the NCA turn out to be correct, the Report betrays a lack of imagination about the extent to which high dependency ratios may be affordable in 65 years time. Economic growth, technological change and social preferences are not static and no amount of high-tech modelling can predict what dependency may mean so far into the future.

So to present a scenario of doom and gloom and to prescribe long-run policy changes in relation to areas such as health and social security on such a shaky basis is at best irresponsible and at worst scare-mongering.

Leaving such assessments aside, is there a message in these projections? Unlike the NCA, I draw some comfort from a number of these projections. For example, the NCA tells us that by the year 2041, health care costs will absorb an additional 8.6% of GDP, i.e. roughly a doubling of current expenditure levels.

My response to these projections is that if this really is an accurate assessment of what we are in for, then we are doing quite well in comparison with other OECD nations. Let’s look at some comparisons. In the USA, health care costs are currently around 12-13% of GDP and are expected to rise to 22% by 2025 when the greatest demographic pressure is predicted to hit their system. Across the European Union, health care costs at the height of their demographic crunch points are estimated to lie between 15% and 20% of GDP. At a projected height of 17% of GDP, we will be well on the lower side of the OECD average.

Second, the NCA is not in a position to judge what the Australian community in 2040 may desire in the way of public expenditure patterns. That judgement will be delivered via the ballot box – and not by a reading of what is currently the practice.

Third, we shouldn't forget that at the same time as these allegedly unsustainable costs will be mounting on our budgets, declines will be taking place in other areas especially in relation to public expenditures on children and young adults, eg. income transfers, child care, education, health. In addition the RIM task force figures (cited on p. 326) show that after 2032 age pension outlays will themselves be declining.

In summary, while it is important for the NCA to bring to our attention the impact of demographic changes – the NCA's approach of constructing a long-run view 50 to 60 years into the future as a basis for current policy-making – is neither robust, nor anywhere near as useful as an undertaking which looks 20 to 25 years into the future. What we have here is not a considered view of the long-run, but crystal ball gazing.

3. Resolving the crisis: scorched earth policies

This last set of comments brings me to a discussion of some of the specific social policy issues raised by the NCA Report. Given my preceding comments, I start with the area of aged care and health policy. These two areas, as we have seen, are strongly connected policy arenas in terms of future outlook.

While Australia will experience a demographic crunch - starting in 2015 and rising most strongly in the decade 2020 to 2030 - we have several things going for us: our pressure points will be 10 to 15 years behind those of most other OECD nations and so we will have much policy experience to draw on in making corrections to our social programs. We already have a social security system which to date has kept us from the problems of the unfunded pension schemes which most of the European and Scandinavian systems face; and through the institution of the Superannuation Guarantee Charge we will stave off some, but not all, of the critical growth in outlays in the period after 2020. We also face the future with a much better starting position on health care expenditures for the aged.

This last observation leads me to a concern about the NCA's recommendations in respect of the Medicare system. On pp. 54-55 the Report, the NCA takes the view that the extension of Medicare co-payments 'should be seen as a prelude to the development of a more comprehensive strategy aimed at the development of health cover through private health insurance.' What worries me about this statement is not the standard debate about the merits of public versus private provision, but rather the implications that somehow private provision is more efficient or economical than public provision, and that the net cost to GDP will be lower under private arrangements.

It is the case that in terms of GDP shares going to health, the issue of public versus private is irrelevant in terms of the total expenditure picture. What is important to stress – especially in the light of the experience of the US and more recently the UK and Japan – is that high levels of private insurance appear to be strongly correlated with growing shares of health expenditure in GDP, even when demographic factors are controlled for. Put simply, it is private health insurance systems which are most strongly associated with out-of-control expenditures *not* public systems, as the NCA implies.

The NCA is quite correct in pointing out a number of areas in social provision where there is undue complexity, overlap and duplication of services. One of those areas which I have concerns about is the proliferation of payments which provide support for families with children whether in the form of child care related payments, income transfers and supplements or other dependency payments. In some recent work I have shown that low income families with children are potentially eligible for assistance from between 8 to 13 programs administered by three different departments. Unlike the NCA, however, I am not at all concerned with the smaller non-means-tested component of these programs. Indeed my argument is that the blind pursuit of means-testing has been the root cause of the proliferation of these payments.

Essentially, the removal of the universal provisions of the original Family Allowance payments in 1986 gave rise to a range of political responses and the formation of diverse coalitions of interest to recoup this loss of horizontal equity via other means. In particular, working women as tax-payers sought to have their child care costs recognised and partially offset by government. The fact is that the child care rebate – the subject of the NCA – is, in expenditure terms, only a fraction of the net gain to Commonwealth tax revenues generated by the growth in married women's employment over the past ten years.

It is my view that the NCA should not be concerned with trifling arguments about the non-means-tested nature of such programs. *Instead*, they should be seeking a consolidation of the various payments made in respect of children and looking for a much more efficient administration of a universal payment.

All things considered, such a policy approach meets more of the NCA's stated aims and principles than does a witch hunt for non-means-tested programs of government. Similar arguments can be made in relation to other areas of transfer programs dealt with by the NCA.

4. A political assessment: the 'Razor Gang' revisited

As the authors acknowledge, the Audit Report was prepared in a very short time span which has limited the breadth and scope of the issues which could be covered. In this respect the report contains many recommendations for further studies and reviews which should take place before major decisions are taken. With this in mind, I want to conclude my commentary with an assessment of what are the politically possible and likely outcomes from the NCA Report. For the most part, I am not concerned about some of the big ticket recommendations of this report. For example, I believe that some of the far-fetched figuring in relation to demographic projections will not precipitate lasting – or damaging – policy correction responses. Between now and 2059 – the year favoured by the NCA for its doom and gloom scenarios – no less than 21 governments will rise and fall. The electorate will have plenty of opportunity to express its dissatisfaction with governments which implement health care and income policies which are out of step with the needs of middle Australia.

What does concern me though are two broad classes of recommendations that are likely to get a guernsey under the present government and which may slip through the policy net as demonstrations of the current government's ideological commitments.

The first class of recommendation is the "penny wise and pound foolish" type of policy change which has minimal electoral impact over the short term, but which may have severe longer term implications. To give an example, consider the NCA's pronouncement (p. 55, Recommendation 4.16) on 'Blood products'. The recommendation reads:

> Pricing mechanisms should be introduced relating to the distribution and use of blood products.

By any definition this is a small ticket item, so what is the Commission's concern here, and indeed why should we be concerned by such a recommendation?

First, it must be noted that Australia is recognised by the World Health Organisation as being an example of best practice as a supplier and producer of clean blood. Since the early 1980s Australia has been held up as a model of efficient and effective blood product delivery service. So what would the creation of a quasi-market in blood products in Australia bring us? Cheaper blood supplies? Most likely, no. The unit costs of many blood products in Australia are well below those of countries, such as the US, where private markets operate.

So where is the gain? In addition to efficiency losses we run into a whole lot of other problems to do with loss of quality control and public health problems and potential litigation costs associated with quality failures such as in the USA, France and Japan.

We have to ask why the NCA has chosen to make such a recommendation. On paper it goes against the grain of many of its views in relation to efficiency, best practice, benchmarking and social need. In my view this recommendation can be traced back to the guiding principles of the report i.e. the NCA's judgement that government involvement is not warranted. This exposes the political nature of this guiding principle.

The second type of proposal which is likely to be adopted by government are those which affect disenfranchised groups. On p. 33 of the Report, the NCA recommends that the program delivery role of the Aboriginal and Torres Strait Islander Commission (ATSIC) should be withdrawn. It is true that the delivery of some services through ATSIC has been less than efficient and has occasionally failed (eg. health related services). In other areas, ATSIC has performed well, eg: legal, and in some states, housing services.

In examining this issue and making its recommendations, however, the NCA has neglected to ask why the service delivery role of ATSIC came about in the first place – understanding this history is central to an assessment of service delivery to indigenous communities. It should be recalled that prior to the creation of ATSIC and its expanded role in service delivery, many of these responsibilities rested with the states. It would be fair to say that the states were at best indifferent to, and at worst wilfully neglectful of, the needs of indigenous communities. Under successive administrations in Queensland, the Northern Territory and Western Australia funds ear-marked for indigenous communities were frequently under-spent. In the general purpose payments area these communities were similarly neglected, despite their obvious needs.

If the NCA's recommendation is followed and responsibility for some aspects of service delivery to these communities is once again vested in the hands of the states, there is no doubt that poor outcomes will again ensue.

In response to the NCA recommendations that in some areas of services ATSIC should become a broker or purchaser, but not a supplier, of services, we need to recognise that there are policy aims and social values other than efficiency to be considered. ATSIC should not be viewed as merely a conduit of funds; it is also a peak body for indigenous communities which expresses political and social concerns of these communities. It is also a key part of reconciliation strategies, and provides some measure of autonomy for these previously neglected communities vis-a-vis state governments.

The fact that the NCA has failed to recognise the multi-faceted objectives of ATSIC exposes two main weaknesses in the Report's guiding principles. First, it is often the case in social policy that a government's choice is not so much between a program of internationally accredited best practice and an inefficient delivery system, but rather a choice between two less-than-ideal sets of circumstances.

Moreover, social programs often have several conflicting policy objectives. Here, arid prescriptions which give weight only to efficiency objectives do not lead to effective outcomes on other fronts. What counts in the policy-learning process in relation to a body such as ATSIC, is continued government support of a group of public sector managers who are best-placed to reconcile the myriad needs of their clients with the demands of efficiency.

‘MISOTELY’ AND THE NATIONAL COMMISSION OF AUDIT

Clive Hamilton[12]

When launching the report of the National Commission of Audit (NCA), the Treasurer, Mr Costello, stressed more than once that it should be seen not as a set of short-term policy proposals but as a set of longer-term objectives. This has been interpreted as Mr Costello distancing the Government from some of the politically unpalatable recommendations of the Report.

But the composition of the Commission and its terms of reference should leave us in no doubt that the NCA Report does indeed spell out the Coalition Government’s longer-term strategy for radically transforming the public sector and the role of government in Australia.

Despite its authoritative name and the trappings of gravity surrounding the report, there is little in it that could be considered impartial, analytical or objective. It is apparent to everyone that the Commission of Audit has been an attempt by the new conservative government to provide a rationale and blueprint for a radical assault on the public sector consistent with the clearly stated political position of Mr Howard and Mr Costello.

1. The NCA view of society and the public sector

In this paper I would like to examine the view of society and the public sector that underlies the NCA Report, while making reference to some of the report’s recommendations and arguments, particularly with respect to ‘reform’ of the Australian Public Service (APS).

The NCA Report reflects a particular perception of the public sector, one in which:

- public sector organisations are conceived of as producers that convert inputs into outputs of goods and services;
- the public act as ‘consumers’ or ‘customers’ who consume these outputs;
- the efficient delivery of outputs is the principal measure of success, where greater efficiency is achieved by reducing the resource cost of producing a given quantity of goods or services; and

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- competition among providers or producers is the best way of maximising efficiency.

This worldview is taken directly from economics textbooks and reflects the theoretical assumptions of neoclassical economics. It conceives of society as being comprised of individuals whose welfare is derived principally from the consumption of goods and services. Social welfare is therefore maximised by a well-functioning economy that delivers goods and services in the most efficient way. The primary function of government is thus to facilitate the operation of markets by ensuring that 'market failures' are minimised, either by providing the framework for competition to operate effectively in private markets or, where absolutely essential, by public provision of goods and services that private markets cannot provide, or cannot provide efficiently.

This worldview is a comparatively recent way of interpreting the world, one that has become entrenched in Australian public life only over the last 10-15 years. Yet it is often believed by its advocates to be not a particular worldview but simply how the world is. In some instances, the principles of this worldview have relevance, but in many others they lead to distortions and misunderstanding. The NCA Report fails to recognise this and assumes that there is only one way to understand the world, one that the Commission attempts to impose on areas where it is quite inappropriate and which heralds grave dangers.

The Report is unusually explicit in setting out this worldview and devotes Chapter 2 to defining what government should and should not do. Most of the rest of the report is devoted to the latter. The government should confine itself 'to areas that the private sector cannot adequately deal with and, within these, focusing more on outcomes for clients and best practice delivery of government services' (p. 7).

The Commission sets out the circumstances in which government may be involved in the community's activities. It concedes, somewhat reluctantly, that there is 'a social case' for government involvement:

> Some law and order activities, social welfare assistance to individuals in genuine need, and some education and health services, are examples where governments are generally regarded as having a legitimate role to play (p. 10)

The Commission does not say that it regards these as legitimate roles, only that in general they are so regarded. Notice also that it says that only *some* law and order activities, and assistance to the *genuinely* needy are legitimate.

The Commission feels more comfortable with the second case, the 'economic case', for government involvement, for here it can rely on the market failure arguments of orthodox economic theory. But the examples it uses betray its minimalist approach to the public sector, referring to national defence, air safety and drink driving as areas in which competitive markets fail to provide an adequate supply (in the case of defence and air safety) or supply too much (in the case of drink driving). For ordinary people, it is bizarre to characterise any of these as market failures. Maintaining armies, regulating air safety and taking drink drivers off the road are simply things that citizens do to protect their collective interests. To argue that they would be supplied at equilibrium levels if it were not for imperfections such as information failure and external effects looks like, and is, an economist's perversion.

To justify government involvement the report insists that there must be 'clear evidence' of market failure. But even this is not enough. 'Even where markets fail, or social concerns require government involvement, there is a need to ensure that the benefits of government involvement outweigh the costs' (p. 11). Much of the rest of the report, where it bothers to adduce any evidence in support of its recommendations, is devoted to understating the benefits and exaggerating the costs of government involvement.

In essence, the Commission perceives government as an institution whose function is to fill in the cracks in the system of private markets. Government is seen as the provider of the residual. This view is entirely consistent with the belief that society essentially consists of self-seeking individuals pursuing their interests in private markets, a world in which civil society is, if not otiose then certainly secondary, and in which the public sector always represents a potential threat to individual liberty.

When government is conceded a role by the NCA, then it must carry it out as if it were a private enterprise operating in a private market. The report exhorts government organisations to be 'client focused' so as to 'empower consumers'. These are not services provided collectively by citizens to the citizenry through their elected governments; they are services delivered by corporations to individual customers. Like private firms that must compete for clients, government activities must be 'contestable' in order to maximise efficiency. Better still, rather than provide these services to clients, government would do better to purchase them from the private sector.

In an unusually frank statement, the public choice theorist James Buchanan has referred to Government's 'Leviathan-like proclivities' and observes, in a statement that describes the view of the NCA, that:

> Governments are viewed as exploiters of the citizenry, rather than the means through which the citizenry secures for itself goods and services that can best be provided jointly or collectively.[13]

By viewing governments as exploiters of the citizenry, the National Commission of Audit has more in common with Marxism than liberalism.

Critics might argue that many of the report's recommendations fly in the face of democracy by limiting the opportunities for future governments to respond to the wishes of the citizenry. Even zealots must genuflect to democracy, even if they privately believe that the system has led to a corruption of government and public administration. This is why manufacturing a crisis is so critical to the Howard-Costello Government; extraordinary times require extraordinary measures including the introduction of measures that are manifestly opposed by the electorate. A crisis neutralises opposition in the community and allows a government of enthusiasts to

[13] James Buchanan, quoted in Hugh Stretton & Lionel Orchard, *Public Goods, Public Enterprise, Public Choice: Theoretical Foundations of the Contemporary Attack on Government* (St. Martin's Press, New York, 1994) p. 152.

introduce radical reforms that, once entrenched, would take another crisis to undo. This was the path pursued by Roger Douglas in New Zealand in 1984.[14]

Gordon Bergsten argues, in the journal *Public Choice* (of all places), that in business 'reliably honest and truthful behaviour can minimize administrative and transaction costs and reduce uncertainty' and such is the case in government too. 'A culture of honest, responsible service' can do more for the quality of government than 'the most elaborate ... system of hierarchical surveillance and accountability'. As a result of the importance of ethical and social motivations and impacts, economic efficiency should not be our test of market or government failure. If we do use that narrow criterion, then we may 'enhance business or government efficiency in the short run but directly or indirectly inhibit the development and maintenance of human qualities and norms which are conditions of the highest efficiency, and independently valuable for other reasons'.[15]

Going beyond the constricted focus on economic efficiency – determined by comparisons of measurable inputs with measurable outputs – we must consider the broader social and economic impacts of the down-sizing of government so ardently advocated by the Commission.

2. Cutting back the public service

The Commission asserts that there is substantial opportunity for 'efficiency gains' (read: budget cuts) in the Commonwealth Public Service and calls for all government agencies to be 'fundamentally reviewed to assess the scope to rationalise and restructure its operations to deliver efficiency gains and improved outcomes' (p. 115). But the Commission is unwilling to wait for such a review and argues that cuts of 20% over three years should be sought from agencies that can 'deliver large efficiency gains' and that 'minimum across the board efficiency targets of at least 10 per cent should be set over 3 years from 1996-97 for the administration of all Commonwealth programs' (p. 115).

No analysis or evidence is offered for the existence of efficiency gains across the board and the circumstances of the agencies that should be cut by 20% are nowhere identified. In fact, the Commission does not argue that these cuts should be made because there are efficiencies to be had, but because they would be the driving force in achieving 'fundamental shifts in the way in which the public sector delivers services' (p. 116).

To advocate radical cuts in a range of government departments without any analysis of the existence of efficiency gains or the impact of such cuts on the services provided by these agencies is irresponsible in the extreme. It is, however, entirely consistent with the rest of the report which is most notable for its implicit faith in economic dogma.

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[14] See Jane Kelsey, *Economic Fundamentalism: The New Zealand Experiment -- A World Model for Structural Adjustment* (Pluto Press, London, 1995)

[15] Summarised in Stretton and Orchard *op. cit.*, pp. 173-176.

One gets the impression that the authors are so convinced of the verities of economic rationalism that evidence is redundant. Indeed, some of the ‘analysis’ of the report is almost laughable for its naivety and for the transparency of its ideological purpose. Other parts of the report are a farrago of platitudes. For example:

> Responsibility must be devolved to public sector managers and employees to empower and require them to achieve results. Managers need flexibility in employment matters to enable them to cope with a new public sector management environment based on contestability and a focus on outcomes. To deliver quality services in a rapidly changing and more demanding environment means, more than ever, getting the best person for the job (NCA 1996, p. 88)

It is little wonder that members of the Commission have been reluctant to engage in robust public debate over the report and that the Coalition Government, despite its ideological congruence with the Commissioners it selected, has (for the time being) distanced itself from it.

The fervent determination of the Commission to unearth reasons to cut the public sector is betrayed in the language it employs. Thus after reporting EPAC figures suggesting that efficiency gains of 5 to 10% are possible in the Commonwealth public sector, the report observes that savings of 14.6% are achievable in ‘the Department of Defence *alone’* (p. 87). Of course, the use of the word ‘alone’ in this context is a *non sequitur* since the savings are averages not additive. The report also applies estimates of putative efficiency gains to be had in government business enterprises (GBEs) to government administrative and policy advisory departments, ignoring the fact that they are dramatically different in purpose, organisation and culture.

3. Performance pay

Nowhere is the determination to ignore the facts more apparent than in the Commission’s discussion of management of the Australian Public Service. The Commission advocates a wholesale transformation of employment conditions for the APS so that they match those in the private sector. This transformation includes:

- changes to remuneration arrangements and inefficiency and termination procedures;
- extension of the use of contract employment, including fixed term appointments especially at senior levels; and
- setting pay levels at departmental or agency level.

The Commission believes that there are widespread problems with motivation and efficiency in the work of APS, and its answer is to tie measured performance to financial reward. It argues for ‘a stronger link between pay and performance’ (p. 93). Indeed, the Commission’s beliefs about the management of the work of public servants are identical to those put forward in support of the system of performance-based pay in the APS – to motivate better individual performance, to improve organisational goal setting, and to retain good staff in a competitive labour market.

The system of performance pay was introduced into the APS for senior executives and senior offices in 1992. The experiment was subsequently assessed by the Senate Standing Committee on Finance and Public Administration in 1993, and it is fair to say that the report was a trenchant critique of the assumptions that underlie the idea of performance pay in the public sector. It concluded that there was no evidence that performance pay would achieve its objective of motivating employees to improve their performance.[16]

The Senate report noted that:

- the system was introduced without adequate consideration of its merits and in the face of 'strong and well-argued opposition from a wide range of individuals and organisations';

- the system rests on assumptions about motivations and the nature of work in organisations which are not valid or appropriate for much of the APS;

- the international studies that were said to provide evidence of the value of performance pay 'contained little evidence of successful use of performance pay in the public sector overseas ... and highlighted the considerable difficulties experienced in many such schemes';

- the system relied 'on highly subjective judgements which were devolved to an extraordinary degree'; and

- the system created inequities, was contrary to EEO principles, was 'divisive and destructive of team effort', was based on principles rejected by modern management theory, undermined effective performance appraisal, increased the cost of appraisal, and forced managers into unrealistic precision.[17]

The Senate Committee recommended that the performance pay system be abandoned as soon as practicable.

The Commission of Audit must have been too embarrassed to advocate openly the introduction of performance-based pay since the system has just failed so miserably. But this failure appears to have made no impact on the way in which the Commission understands the role and workings of the APS.

The experiment with performance pay in the APS can only be described as a debacle, and is yet further proof that the application of Chicago ideas on the economic explanation of human motivation is not only contrary to the lived experience of almost everyone but is disastrous when applied in practice. There is overwhelming evidence, reviewed exhaustively in Robert Lane's book *The Market Experience*, that in rich

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[16] Senate Standing Committee on Finance and Public Administration, *Performance Pay* (Senate Printing Unit, Parliament House, Canberra, December 1993), p. 18.

[17] *Ibid.*, pp. 59-60

countries for people with incomes above a reasonable level, the experience of work contributes much more to their happiness than their money income.

Staunch advocate of performance pay and former Secretary of PM&C, Mike Keating, is said to have described the introduction of performance pay as like D-Day in its importance to public service reform. John Nethercote replied that, if we insist on military analogy, the Charge of the Light Brigade might be more appropriate.

The introduction of an incentive regime designed to promote competition among senior officers was alien to public service modes of operation and was corrosive of collegiality.

Indeed, if performance pay had worked – that is, senior public servants began working harder because they were lured by performance bonuses – then there would have been grounds for serious concern about the future of the service. If the APS is to be staffed at senior levels by people whose principal motivation is higher incomes then the fundamental ethos of public service would be lost, and the citizenry would be the losers. Half-conscious of the critical importance of the ethos of public service in the APS and the threats to it from the rewriting of employment conditions and the shift to private sector institutional norms, the Commission of Audit resorts to the code of ethics recently developed by the Management Advisory Board of the APS.

> These principles are written in just over a page and should be easily understood by public servants ... They represent a best practice method of setting the ethical standards for the public service (pp. 91-92).

Even ethics, it seems, can be re-engineered, benchmarked and best practiced. Why not contract out for ethical standards; if the market is contestable then competitive tendering should get us a set on the cheap.

The impact of the proposals for 'reform' of the APS would be to create not a culture of efficiency but a culture of fear in which public servants would forever be looking over their shoulders for the judgement of external authority rather than feeling a bond to civic society, in addition to their direct responsibility to their Minister and the Government. If we create a public service that is modelled on a private sector ideal of output-focused efficiency, customer satisfaction and financial reward for personal performance, then we will see the APS begin to display some of the most undesirable features of corporate life, including fraud and corruption.

Indeed, rather than attempting to remake the public service in the image of the modern corporation and 'current management philosophy', we should be looking at ways in which some of the managerial excellence of the public sector can be passed on to the private sector.[18] The Australian public service has been 'benchmarked' against public services of similar countries and found to be very efficient.

The extent to which the Commission refuses to understand the role and motivations of public servants, and the extent to which it uncritically imposes an idealised model of the private sector onto organisations where it is patently inappropriate, is revealed in

[18] I am indebted to John Nethercote for this point.

two paragraphs that canvass the possibility that a shift to fixed-term contract employment might undermine the independence of the public service (p. 93). The Commission states that there is little evidence that the frequency of contract renewal will deter public servants from giving frank and fearless advice and that it is enough to state the need for an apolitical public service in a new Public Service Act to bring it about.

The Commission goes further, arguing that the existing employment arrangements are more likely to undermine the political independence of the APS since senior public servants have very little chance of getting jobs in the private sector. 'Coupled with relatively limited opportunities to amass wealth, there is the potential for even greater capture to ensure their continued employment.'

4. An alternative worldview

The ideological position of the NCA Report is easy to identify. Articulating an alternative view of the role of government and the public sector is more difficult. It is more difficult because the alternative to the crude nostrums on which the NCA Report is based must reflect the subtleties and complexities of human motivation and social institutions.

The overriding intent of the NCA Report is to place restrictions on government and the public sector. The fundamental motivation behind the report is a deep hostility to government, a psychological predisposition that I here dub 'misotely', the hatred of government.[19] Economic rationalism's celebration of private enterprise is matched by its denigration of the public sector and government. The NCA Report itself betrays the fact that it the denigration of the public sector simply cannot be sustained by empirical evidence. It is thus more ideology than analysis. Psychologically, for people like John Howard, mistrust of government has its roots in the celebration of individual freedoms, the primacy of the battler against big government. For others, the newer breed of neo-liberals, it would appear that the commitment is much more to the *idea* of private enterprise and the textbook benefits of the competitive market. Either way, it emphasises the individualistic aspects of humans at the expense of their citizenship, and it is in the notion of citizenship that the roots of an alternative view naturally lie.

The defence of the public sector is not motivated so much by the need to defend the public sector as such, but by the need to defend that aspect of ourselves that we refer to as the citizen. The alternative view of the role of government reflects an alternative understanding of the structure of society and leads to very different conclusions about the size and role of the public sector. This alternative worldview begins with the idea that people are both consumers and citizens, that they act and think differently in these

[19] Derived from the Greek 'misos' meaning hatred and 'teli' meaning the constituted authority with the power to raise taxes (as in 'philately'), what 'misotely' lacks in elegance it makes up for in etymological pedigree. 'Archephobia', derived from 'arche' meaning government and 'phobia' meaning fear, might be an alternative. I am grateful to Dr Colin Mayrhofer of the ANU Classics Department for assistance with these neologisms.

two roles, and that measures to improve the welfare of individual consumers do not necessarily improve the welfare of citizens.[20]

In this worldview, the role of government is principally to serve the needs of citizens, although it also provides the legal and administrative framework for private markets to operate effectively. While consumers act principally to maximise their own (and their families') welfare from the optimal spending of their income on goods and services in the market, citizens in a democratic society do a number of things that are outside of the realm of the consumer. These are discussed below, drawing heavily on the excellent paper by Alford.[21] In addition to having legal rights and exercising their democratic right to vote, citizens:

- contribute to public deliberation;
- 'consume' public value; and
- co-produce public value.

While some politicians (such as the Victorian Premier) are wont to claim that if people do not like the government's decisions then they can vote it out at the next election, a strong democracy includes all sorts of formal rights which provide for accountability beyond periodic elections. These include channels of appeal, grievance and redress, various rights, access to information and so on. Citizens also contribute to public deliberation in many ways, such as by writing letters to the editor, joining political and community groups and taking part in protests. The last two activities of citizens are especially important in the context of the attack on the public sector mounted by the NCA.

Citizens also 'consume' public value. 'Consume' is perhaps an inappropriate word to use; 'absorb', 'participate in' or 'benefit from' might be better. Public value refers essentially to all of those things that are collective values as opposed to private values. They are values that are necessarily consumed collectively by the citizenry. The 'public goods' of neoclassical economics are a form of public value, but public value is much broader than a set of well-defined 'goods and services' that happen to be non-excludable and non-rival in consumption. It includes, for instance, the provision of a secure and stable social structure, the creation of a society that is fair and equitable, and the creation of institutions and enterprises – such as the ABC and the public education system – that help bind the community together. These are impacts on people's welfare that go well beyond notions of market failure, not least because these public values are not so much 'outcomes' or 'outputs' that are produced, but processes in which people participate simply by being citizens.

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[20] The distinction between consumer and citizen is here drawn sharply to make the contrast with economic rationalism's enthronement of the consumer. In practice, in our consumer behaviour we are influenced by our citizen nature (such as when we pay more for environmentally friendly goods or invest ethically) and in our roles as citizens we pay attention to our financial interests (by legitimately demanding that public funds be used efficiently and effectively).

[21] John Alford, 'The impact of contracting out on citizens' in The Australia Institute, *Citizens in the Marketplace: The implications of competition policy for citizenship*, Discussion Paper Number 6 (March 1996)

In contrast to private value, which is value consumed by individuals, public value is something that is necessarily partaken of collectively. In addition, because of the nature of these values, the task of ensuring that such public value is created and distributed falls to government. Government may not set out specifically to create these public values, but the act of providing public services (such as policing, social welfare and a national postal service) creates public value beyond the benefits specific to those services.

Finally, citizens have a role in actually ensuring that public value is created. Although governments generally decide on and lead the production of public value, much of the work of actually producing it is done by citizens in their various capacities. In many different ways citizens create civic society. Community policing, a great deal of which is done by people in neighbourhoods and public areas, creates a public value, a society that is safe and enjoyable. Another example, among a great number, is Landcare which above all concerns bringing rural communities together to solve collectively common environmental problems. It is the coming together of communities that is the essential strength of Landcare, something that cannot be produced by any other means.

The work in which citizens co-produce public value is done for a variety of motives, but running through all of the motives there is an element of commitment to community. To the extent that they co-produce public value or support the creation of public institutions that generate public value, citizens do so because they see it as intrinsically worthwhile. It would be a gross distortion to argue that it is somehow motivated by self-interest in the same way that consumers are said to pursue their own interest through consumption behaviour.

This understanding of the role of citizens stands in stark contrast to the public-as-consumer model which is the political and ideological thread that runs through the NCA Report. Although there is often scope for efficiencies in the delivery of public services, the functions of many public (and indeed private) services go well beyond the simple provision of goods and services to be 'consumed' by individuals or households.

The worldview that lies behind this alternative view is not an ideology that inflates the importance of government. It is not rooted in the opposite of misotely – 'philotely', a love of the public sector for its own sake – but is based on the recognition that we are not simply self-centred consumers, but complex moral beings. Just as humans are a mixture of motives and desires, so the economy and society naturally reflect that mixture. In this view, there is a legitimate role for a more or less extensive public sector, one that meets the aspirations of citizens for the provision of public goods and the generation of public value and through which citizens can express their commitment to providing services for the citizenry. Recognising this, it was not so long ago that we spoke unblushingly of the mixed economy. Now, if we are to take the NCA Report seriously in its explicit statement that public interest arises only when markets fail,[22] every form of public enterprise must be justified against the efficiency criteria of the private sector.

5. In conclusion

The report of the NCA is as much about the functioning of our democracy as it is about efficiency and accountability. The elected Parliament is accountable for the extent and performance of the public sector, but the NCA lays most of the 'blame' for the problems it perceives at the door of the bureaucracy. The role of Parliament is not mentioned in the Report, for to attack Parliament is to attack democracy, something the Commissioners are not willing to do in their report. Stretton and Orchard make a telling observation with respect to public choice theory, a theory whose ideological underpinnings are shared by the NCA.

> Like the old critics of monarchical misrule who ascribed the misrule never to the king but always to his evil advisers, public choice theorists blame big government not on the people who vote for it but on the bureaucrats who, through their politicians, con them into voting for bigger government than they need, then contrive by bureaucratic machination to make it bigger still.[23]

Of course, we must always be vigilant that government does not become isolated from, and act contrary to the interests of, the citizenry. But the NCA's unreasoning fear of government – to the point where it must be rolled back at every opportunity, no matter what the social costs both directly and in terms of the public bonds that bind the community together – is dangerous and subversive of civic communities.

After a decade or two of the grand experiment with economic rationalism – which the NCA's misotely seeks to take to an extreme – it is now time to reassert our roles as citizens committed to sustaining a just and equitable society, a society to which we belong through our participation in public values, and to recognise that private consumption in private markets – no matter how competitive and efficient they might be – cannot buy us strong communities and an enduring civic culture.

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[22] See p. 6. In fact, it says the 'public interest' *largely* implies that there is some market failure, but there is no mention of circumstances in which public interest arises when markets are perfect.

[23] Stretton and Orchard *op. cit.*, p. 152

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