

Our Reference: TRO 09349

Mr G Banks
Chairman
Productivity Commission
Locked Bag 2
Collins Street East
MELBOURNE VIC 8003

Dear Mr Banks

I refer to the Commission's current research study of the Economic Implications of an Ageing Australia and the invitation for interested parties to provide feedback to the Commission in relation to the draft report released in November 2004.

A key issue for the Queensland Government is the sharing of the economic and fiscal impacts of ageing across the federation. In particular, the allocation across jurisdictions of the fiscal gap, which is projected to occur in the absence of policy changes, is a matter of concern. While the body of the draft report suggests it is far from clear where the burden of this fiscal gap will be borne, the report's key points indicate that the Australian Government will bear most of the burden.

Ultimately, how this fiscal burden is shared across levels of government remains an open question and one to be resolved by all governments. It is therefore important that the Commission be seen to reflect this uncertainty in its presentation of the distribution of the future fiscal burden of ageing.

Accordingly, the presentation of this issue could be improved in the Commission's final report. It would be helpful if the Commission presented other plausible projections of both the fiscal gap and distribution of such a gap across levels of government. The attachment to this letter includes an alternative presentation of the potential fiscal gap and distribution of the fiscal gap.

The attachment identifies additional aspects of the draft report which may benefit from further consideration and responds to requests from the Commission for further information.

Yours sincerely

TERRY MACKENROTH
Encl.

The Queensland Government response to the Productivity Commission's draft report on the Economic Implications of an Ageing Australia

Presentation of the fiscal gap

The Queensland Government considers that presenting a single projection of the fiscal gap that Australian governments are likely to face may lead to the projection being viewed as a forecast, with an associated greater degree of certainty placed in the outcome than merited. Section 13.3 of the Commission's draft report indicates this perception is not the intention of the Commission.

As the terms of reference do not require a single point estimate of the fiscal gap, the Commission could address this in its final report by including a number of scenarios that identify the effects of important variables and present a range of fiscal outcomes. An alternative presentation of this information, which could be incorporated in the Commission's final report, is provided below.

Alternatively, the Commission may be able to indicate more clearly, in the introduction to Chapter 13, the level of uncertainty in the 'basecase' projection.

Presentation of the relative fiscal burdens

The Commission's draft report identifies, in the first key point for Chapter 13, "... the best single measure of fiscal pressure is for all Governments combined". The Queensland Government would prefer this point be made in the key points for the entire report.

Further, the key points could specify that the fiscal gap, identified in the report, will be borne by all governments and that the extent of fiscal pressure faced by different levels of governments will depend on:

- their expenditure responsibilities;
- revenue raising capacities; and,
- perhaps most importantly, decisions made by governments on inter-governmental funding arrangements.

Additionally, the areas of the report where the key fiscal results are presented should contain a clearer distinction between the pressure projected for particular *expenditure categories* and projections of the incidence of that pressure on the different levels of government. In particular, sections of the report such as Table 13.1 could be augmented with the projected fiscal pressure results from each of the SPP growth scenarios in Appendix J. An example of how this information could be presented in the Commission's final report is provided below.

An alternative presentation of the fiscal gap and relative fiscal burdens

The following tables are proposed as a replacement for the existing Table 13.1 in the Commission's draft report. Separating the tables would allow the presentation of a range of possible projections of the fiscal gap and the fiscal burden on jurisdictions.

Presenting the information in this way would support, and emphasise, the Commission's points that: "the Commission's assessment of the impacts of ageing are based on projections, not forecasts" and "... the fiscal position of different tiers of government is sensitive to varying assumptions about the rate of growth of SPPs, whereas the fiscal position of combined governments is not".

How much fiscal pressure will there be?

Age-related government spending to GDP ratios

	Low			Medium			High		
	Differences from medium						Differences from medium		
	2002-03	2044-45	Difference	2002-03	2044-45	Difference	2002-03	2044-45	Difference
	Percentage points			Percentage points			Percentage points		
All Government summary									
Health	5.7	X.X	X.X	5.7	10.7	5.0	5.7	X.X	X.X
Aged care and carers	1.0	X.X	X.X	1.0	2.3	1.3	1.0	X.X	X.X
Education	4.8	X.X	X.X	4.8	3.7	-1.1	4.8	X.X	X.X
Social safety net	6.5	X.X	X.X	6.5	8.1	1.6	6.5	X.X	X.X
Total	18.1	X.X	X.X	18.1	24.9	6.8	18.1	X.X	X.X

Where might fiscal pressure be borne?

Age-related government spending to GDP ratios

	Case A			Case B			Case C		
	in real per capita terms			Special Purpose Payments growing at a constant 2% of GDP			in line with service needs		
	2002-03	2044-45	Difference	2002-03	2044-45	Difference	2002-03	2044-45	Difference
	Percentage points			Percentage points			Percentage points		
Commonwealth Government summary									
Health	3.9	X.X	X.X	3.9	X.X	X.X	3.9	7.7	3.8
Aged care and carers	0.9	X.X	X.X	0.9	X.X	X.X	0.9	2.1	1.2
Education	1.9	X.X	X.X	1.9	X.X	X.X	1.9	1.5	-0.4
Social safety net	6.5	X.X	X.X	6.5	X.X	X.X	6.5	8.1	1.6
Total	13.3	17.7	4.4	13.3	18.7	5.4	13.3	19.4	6.1
Combined States summary									
Health	1.8	X.X	X.X	1.8	X.X	X.X	1.8	3.0	1.2
Aged care and carers	0.1	X.X	X.X	0.1	X.X	X.X	0.1	0.2	0.1
Education	2.9	X.X	X.X	2.9	X.X	X.X	2.9	2.2	-0.7
Total	4.8	7.2	2.4	4.8	6.2	1.4	4.8	5.5	0.7

Fiscal pressure on individual States?

Age-related government spending to GDP ratios

	Based on Case C: SPPs growing in line with service needs		
	2002-03	2044-45	Difference
	Percentage points		
Individual States (spending)			
NSW	4.5	4.9	0.5
VIC	4.3	4.8	0.6
QLD	5.1	5.7	0.6
WA	5.2	6.6	1.4
SA	5.8	6.9	1.1
TAS	8.3	10.8	2.5
NT	9.3	12.4	3.1
ACT	4.9	5.8	0.9

Revenue

As noted above, the ‘burden’ associated with the fiscal gap faced by governments is affected by vertical fiscal imbalance. Existing vertical fiscal imbalance leads to States being dependent on Commonwealth Government funding for approximately half of state revenues. This limits the flexibility of States to raise additional funds in response to added expenditure pressure and means that state revenues may not directly benefit from policies to enhance economic growth. On the other hand, the Commonwealth Government has greater flexibility to raise additional funds, receives the full benefit of higher economic growth and has significant discretion in the amount of funding provided to the States.

In this context, the Queensland Government considers that the final report could place more emphasis on the impact of available revenue bases on the ability of governments to fund any fiscal gap. For example, the report could analyse the impact of a declining GST base, as a percentage of GDP, on the States’ capacity to fund any fiscal gap.

Education

Society generally, and governments in particular, have increasingly recognised the importance of education as a driver of better employment and social outcomes, productivity growth and higher living standards. This has been reflected in a range of policies aimed at increasing retention rates and higher educational attainment of young people. For example, the Queensland Government is implementing its Education and Training Reforms for the Future (ETRF) programs to advance public education to meet the challenges of the knowledge economy.

The Commission’s draft report recognises the impact of education on labour force participation and productivity. However, in the education chapter, it does not appear to account for the increasing focus of governments on education, as indicated by growth in school education expenditure in excess of GDP growth. This issue is explored below in response to the Commission’s request for additional information on education.

At the Roundtable in December 2004, the Commission requested information on the large increase in schools expenditure in the late 1990s – in particular, 1998-99. The 1998-99 schools data appear to be unrealistically high, but the issue is clouded somewhat by an apparent increase in the growth rate of schools spending starting in 1997-98. Prior to this, it appears that expenditure per student increased broadly in line with GDP per capita.

The increase appears to have occurred across all States, but not for the Commonwealth. Statistical analysis of the aggregate Government Financial Statistics (GFS) General Purpose Classification (GPC) data indicates that a weakly significant structural break, in terms of the rate of growth rather than a shift in the level, exists in the school expenditure series. However, while the reason for the break is not clear, it may be related to adjustments to GFS data associated with the introduction of accrual accounting, or to policy changes by governments around that time.

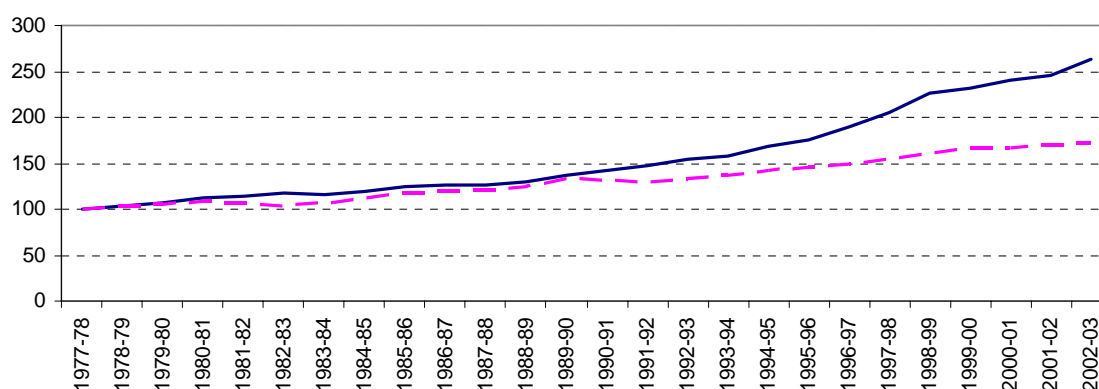
Queensland Treasury's understanding is that no agreed data set is available which spans both the pre- and post-accruals period. In this context, it should be noted that all jurisdictions implemented new systems to capture accrual information from 1998-99, and the GPC information entered into such systems in the early stages of the transition to accrual accounting was problematic. In Queensland Treasury's view, there remain significant problems with the pre- and post-accrual GPC time series data and consequently any inferences drawn from increases spanning these two periods should be treated with extreme caution.

Despite these data issues, as school expenditure accounts for around two-thirds of government spending on education, the Commission's projections of the likely growth of per school student funding is likely to have a substantial impact on education expenditure and any 'fiscal relief' that governments may have in the future. Because of the importance of schools expenditure, the Commission's final report could benefit from a discussion of the non-demographic growth assumptions used in its projection.

Law and Order Expenditure

The Commission also sought further information on the historical growth of the Public Order and Safety (POS) GFS expenditure category. Analysis of historical GFS data suggests that per capita POS spending by the States has grown significantly faster than per capita GDP, particularly from the early 1990s (Figure 1).

Figure 1. Growth in real States' Public Order and Safety expenditure per person and per capita GDP, 1977-78 to 2002-03
(Index = 100, 1977-78)



(Figure 1 shows a possible anomaly in 1998-99, similar to that for schools expenditure. However, statistical tests of the aggregate data show no evidence of a structural break in 1998-99.)

Trend analysis shows that POS spending has grown at an average of 1.6 per cent per annum faster than GDP since 1977-78, and 3.0 per cent per annum faster than GDP since 1989-90. The relatively strong historical growth in POS spending appears to be related to crime rates. For example, the Centre of Independent Studies publication, *The Thinning Blue Line*, shows that the overall Australian crime rate has increased steadily since the early 1960s.

It is perhaps unlikely that the trend towards higher growth rates in POS expenditure will continue for the next forty years, particularly if crime rates remain lower for older age cohorts. However, this issue illustrates the fiscal risks faced by the States in non-health-related demographic responsibilities. Accordingly, it would be beneficial if the Commission examined law and order issues more closely in its final report.

The link between income and government spending

In preparing the draft report, the Commission has assumed that, as incomes rise, so too does the demand for government services. However, if demand rises at the same rate as incomes, it implies that governments are not able to address demand management through policy. The Queensland Government would prefer to see more research on this issue, and/or a discussion on alternatives to the assumption and how this would impact on the results.