

Ensuring Responsibility in Australian Budgets

Robert Albon

By 'fiscal responsibility' I mean the commitment on the part of government to reducing heavy debt burdens on future generations, or, where existing debt is low, to avoiding such burdens. I assume throughout that it is desirable to reduce debt.

Proposals for making governments more responsible are receiving a measure of public attention in both Australia and New Zealand. Whereas in New Zealand such proposals have progressed to legislative actions on budget presentation and commitment to debt reduction, in Australia they have made little legislative headway. However, the governments of both New South Wales (NSW) and Victoria have proposed balanced budget constraints, and the Commonwealth initiated a 'deficit reduction plan' in its 1993/94 budget. (Prime Minister Paul Keating has since dismissed those seeking a more rapid elimination of the Commonwealth deficit as 'deficit Daleks'.)

None of these three governments acknowledges that the form of budget presentation — in particular, the actual meaning of the bottom-line 'deficit' — is important to the debate. But discussion about proposals to approach or achieve budget balance naturally reflects, whether explicitly or implicitly, the current Australian concept of 'deficit' or 'surplus'. This is the so-called Government Finance Statistics (GFS) convention, adopted by all nine Australian governments at the 1991 Premiers' Conference. The adequacy of this convention as an indicator of change in a government's net economic position, and the reliability of the accounts in conveying the complete fiscal picture, are major concerns of this article.

It doubtless appears responsible to commit to a 'balanced budget'. But the degree of responsibility depends on the details of the commitment, the accounting standard against which the commitment is assessed, and the context in which it is made. If a 'balanced budget' means a zero GFS deficit, it could be consistent with substantial increases in superannuation debt, and some of the revenue contributing to the balance could flow from a conversion of tangible assets into monetary ones. More important, even if there were no underlying debt creation or asset conversion, a balanced budget could mask massive debt accumulated in the past.

I have argued elsewhere (Albon, 1994) for a format of budget presentation that both reveals the government's overall net economic position and indicates where

Robert Albon is Senior Lecturer in Economics in the Faculty of Economics and Commerce at The Australian National University.

the deficit or surplus represents a change in the government's net economic position.¹ This concept, which is necessary for assessing the prevailing degree of fiscal responsibility, is only obliquely related to the welfare of present and future citizens. Thus, an improvement in the government's net economic position does not necessarily mean that social welfare has in some sense been enhanced. Further, as the economic literature on 'generational accounting' makes clear, the existence of a deficit or a surplus bears little relation to the impact of the budget on future citizens.²

As noted, the New Zealand government has actually committed itself to fiscal responsibility through legislation (the Fiscal Responsibility Act 1994). This was preceded by the adoption of a new framework of presentation — 'full accrual' — introduced following passage of the Public Finance Act 1989. These processes faithfully reflect both the totality of, and change in, the government's net economic position. They provide a model for Australia to follow.

Australian Practice

The traditional practice of Australian Commonwealth and State governments was to present their annual budgets on the 'Consolidated Fund' basis: summing up dollar outlays of all kinds and total revenues of all kinds, and expressing the difference between these as a deficit or surplus. The different treasuries adopted their own variations of this practice, resulting in a poorly defined non-uniform approach. But, as noted, in 1991 the new GFS convention of government budget accounting was adopted. Some jurisdictions, such as Victoria, were already using the GFS, while others agreed to phase it in.

The budget has both a narrow dimension ('general government'), which focuses on departments, and a broader dimension ('whole-of-government'), which includes the activities of public trading enterprises. Since the GFS, like the Consolidated Fund, has both these narrow and broad dimensions, at least four different official measures of the 'deficit' apply during the phase-in. Further, some authorities define 'whole-of-government' very broadly, while others are less inclusive.

¹ Some commentators argue that the deficit should reflect the public sector borrowing requirement (PSBR). Others regard the PSBR as of dubious value to macroeconomic management. Irrespective of the rights and wrongs of this debate, the PSBR has only a national or aggregate relevance, and is of little value in connection with the accounts of a subnational government. Details of the aggregate PSBR are published in the Australian Bureau of Statistics, Catalogue Number 5501.0, and the National Fiscal Outlook (1994).

² Public discussions in the United States about 'generational accounting' centre on the impact of budgetary decisions on the welfare of current and future citizens; see Auerbach, Gokhale and Kotlikoff (1994) and Haveman (1994). Adoption of a broad accrual based system is an important step towards accommodating generational concerns.

Reflecting Changes in the Net Economic Position

If the government reveals the complete GFS deficit on a whole-of-government basis, how well does this reflect changes in its net economic position?

The essence of the GFS approach is that outlays that are transfers into special accounts are not counted as expenditures. Such items are usually called 'provisions'. For example, in some jurisdictions some outlays from the Consolidated Fund go into a superannuation fund or a debt retirement fund. Under the new format, these are treated as transfers rather than net outlays.

With respect to sums going into accounts to provide for debt retirement, the move to GFS marks another small improvement. Treating these as transfers rather than net outlays is correct, since, on the other side of the ledger, the government's current borrowing or 'debt creation' (which adds to government's liabilities) is already taken into account. The GFS deficit or surplus is an accurate representation of the change in the government's general debt position. Suppose the government actually spends \$1 billion more than it raises in revenue, but at the same time puts \$500m into a debt retirement fund. If it has no reserves to draw on, the government would have to borrow \$1.5 billion to finance its 'deficit', but its net economic position would have declined by only \$1 billion, the deficit on GFS.

Thus, the GFS treatment of debt picks up the borrowing liabilities of government. But this symmetry breaks down with respect to superannuation. A payment into the fund is not an outlay, as explained in the following statement on superannuation in the 1993/94 ACT Budget Papers (No. 2, p.245):

Some recurrent expenditure from the Consolidated Fund is excluded. For example, payments to the Superannuation Provisions Trust Account are treated as recurrent expenditure from Consolidated Fund but, in the Economic Transactions framework, these are treated as inter-account transfers which do not impact on final consumption expenditure as they do not add to outlays but rather represent additions to financial assets.

But although it is reasonable to treat payments into the superannuation fund as transfers rather than outlays, this ignores the accumulation of superannuation liabilities. In any normal year the entitlements accruing to members of the scheme are likely to increase, representing a rise in the government's liabilities. These liabilities — or debt accumulation — detract from the government's economic position. Both sides of the ledger should be reflected in the 'deficit' or 'surplus'.

An asymmetric approach is also observed in the treatment of asset sales. As explained in the Commonwealth's presentation set out in Statement No. 7 of Budget Paper No. 1 of 1994/95:

Consistent with UN [1968] treatment adopted by the ABS [1989], receipts from sales of physical assets are recorded as offsets within outlays to assist in the measurement of the net stock of capital assets in the economy. Un-

der the IMF [1986] treatment such receipts would be classified as capital revenue.

However, while the receipts from asset sales are regarded as a positive item in the budget, the fall in the stock of asset holdings does not register as a negative one. Further, any run-down of asset values through inadequate maintenance does not enter the budget.

The American economist, Robert Eisner (1989:75) reflects the consensus in criticising what he describes as 'the nonsense of counting sale of real or financial assets as "receipts" (or as offsets to expenditures). . . Such sales are . . . essentially portfolio changes, having no first-order effect on the net debt or net worth of government . . .' That is, Eisner insists that account must also be taken of the negative impact of the government's loss through the diminution of its stock of assets. The failure of the current system is clear when an asset worth \$100m and sold for \$10m shows up as a net improvement of \$10m rather than a deterioration in the government's net economic position of \$90m.

Governments can also show an illusory gain through inadequate maintenance of their assets. While this saving is a 'positive' item in the budget, the loss through the running down of the quality and value of assets should (but does not) enter on the other side of the ledger. Further, if asset values are written down (or up) for whatever reason, this should show up as a change in the government's position.

It must be concluded that the GFS standard used by Australian governments does not provide an accurate indication of the change in a government's net economic position. In particular, a surplus can be consistent with a fall in the government's net economic position, while a deficit can be consistent with an improvement.

Reflecting the Total Net Economic Position

Under Australian practice, the total picture of the government's economic position is not particularly transparent, although it has improved since the 1991 agreement. In particular, it has been difficult to discover the extent of a government's total debt, especially that with respect to superannuation.

In accordance with the Uniform Budget Presentation Standards agreed in 1991, governments are now required to present a comprehensive debt account. Other problems aside, the GFS deficit or surplus is an accurate indicator of the change in a government's net economic position with respect to debt related matters. It is desirable to have the aggregate position and the flow of borrowing and repayments set out clearly in one place. The obligations on governments to provide a mass of information about their debt position in a consolidated format makes it easier to evaluate the totality of the government's net economic position with respect to debt. Victoria's practice (see Chapter 6 of Budget Paper No. 2) is a good example.

The position with respect to superannuation is less revealing. Not only can governments effectively hide the accumulation of superannuation debt in their standard budget presentation; it has been extremely difficult to determine the total debt.

But the position is improving rapidly, and governments are now introducing explicit superannuation accounts in their budget papers (for example, NSW Budget Paper No. 2, 9.3). These accounts should eventually reflect the total superannuation position on a fully funded basis. Payments of employer contributions into the fund would, as under GFS, remain a transfer in the ordinary budget. In the superannuation account itself, this transfer plus employee contributions and income from interest and dividends on fund investments would all appear on the positive side of the ledger. On the other side would appear the actuarially determined increase in liabilities accrued during the period plus payments out of the fund to superannuants. The difference between these positive and negative accruals represents the net change in the government's superannuation position during the period. As most Australian governments have large unfunded superannuation liabilities (Queensland appears to be an exception), over a transition period (that is, until the fund became fully funded) payments to superannuants out of consolidated revenue funds would remain an outlay, showing up in the general budget.

Finally, there is the problem of assets. The asset position can be clarified only by the creation of a comprehensive asset account, which would ideally contain all assets and reflect the influence of appreciations and depreciations on particular asset values, as well as disposals and acquisitions. However, valuation problems would be substantial, as there is no generally agreed approach and valuation is particularly difficult for assets that are not traded (Blejer & Cheasty, 1991). Practical approaches differ; New Zealand has adopted a pragmatic approach (including the use of historic cost for some assets), NSW uses a current cost basis, and Western Australia's new Government Property Office is compiling a register of government assets. The formation of an asset account would have the added advantage of providing a basis for improved asset management.

An Accrual Approach

These considerations make a case for accrual accounting on a whole-of-government basis, as adopted in New Zealand and as experimented with through the production of alternative accounts in NSW.

New Zealand's Public Finance Act 1989 required that accrual accounting be adopted for all public accounts by 1991 (see anon., 1994). Because both the public and private sectors must use it, accrual accounting is also known in New Zealand simply as 'generally accepted accounting practice', or GAAP. The government assesses and reports changes with respect to all of its assets and liabilities, allowing it to determine its true net worth. Changes in the net worth over a year are an indication of the change in the government's net economic position, and represent the analogue of the traditional notion of 'deficit' or 'surplus'.

Under accrual accounting, each of the nine Australian governments would be required to emphasise or 'headline' the change in its net economic position, taken across the whole of government. Its appropriate bottom line would be the sum of three items: its GFS deficit or surplus, the net change in its superannuation position from the superannuation account, and the net change in the value of the asset ac-

count. This would be *the* deficit or surplus, giving a ready guide to the change in the government's position. Analysts could go to the specific accounts for more information. A single indicator would achieve not only consistency across States, but also consistency within States over time.

The NSW Balanced Budget Proposal

The commitment to a balanced budget in NSW surfaced in the 1994/95 Budget Papers, which announced an intention to 'phase-in a sustainable balanced budget . . . as early as possible within the next term of the Government' (No. 2, 1-5). This commitment was later strengthened with a proposal to ask the electorate whether it was prepared to alter the constitution to require the NSW government to balance its overall budget, perhaps over a business cycle. The proposal has received a considerable amount of public attention (see McGuinness, 1994; Robinson, 1994; Walker, 1994a).

If balance were to be defined according to the standard used for budget presentation, the commitment could appear to be met when in reality it was not, and *vice versa*. In keeping with the Uniform Budget Presentation Standards agreement between all Australian governments, NSW adopted the GFS standard in 1991, because it provides 'information on the economic impact of the budget and facilitates intergovernmental comparisons of budget policy' (cited in Mackintosh, 1993). However, as it does not provide a very good account of the change in the government's net economic position (for reasons already set out), a GFS balance could mask either a surplus or a deficit.

In 1993/94, NSW almost achieved budget balance on a total State basis (the deficit was only \$138m).³ Whether this reflected an actual balance depends on movements in a number of other, more obscure accounts. There appears to have been a small improvement in the superannuation account, with unfunded liabilities falling by about \$400m. Receipts from asset sales (amounting to \$430m) are not included as 'negative outlays' in NSW, and therefore do not necessitate any adjustment. In the absence of other liabilities that may have accumulated with respect to certain off-budget arrangements, the NSW government appears to have enjoyed a small net economic improvement of around \$260m in 1993/94.

If it is serious about the successful introduction of a meaningful balanced budget constraint, NSW would use its alternative accounts to assess its performance in meeting the commitment. NSW is sometimes cited as an example of a jurisdiction that practises accrual accounting: for example, in his 1992 Annual Research Lecture in Government Accounting, Ian Mackintosh (1993) referred to the 'NSW practice of accrual accounting'. This is a reference to the inauguration in 1988 of the publication of a separate set of accrual accounts. However, these are presented

³ The Treasurer and the 1994/95 Budget Papers actually headlined the 'general government' deficit, which was greater than that of the total government.

in a non-accrual format in the government's annual budget. Robert Walker (1994b) has asked, 'If accrual is better, why not flaunt it?'.

The Victorian Balanced Budget Proposal

The Victorian proposal, which first appeared in the Treasurer's 1994/95 budget speech, is much weaker than that of NSW, in two respects. First, it involves a legislative change rather than a constitutional one, making it much easier for a future government to discontinue the practice. Second, it refers only to the current account, not the total budget, when most governments have found it easy to run current account surpluses even during the recession.

The Victorian government has used the GFS basis for budget presentation since 1989/90. It budgeted for a GFS deficit of \$3.663 billion in 1993/94. The effects of expenditure cuts on the deficit were expected to be delayed because of plans to make large one-off redundancy payments to former employees as part of the rationalisation program (\$1.3 billion in 1993/94) and the payment of sums owing to various superannuation funds withheld by the previous government (\$1.4 billion in 1993/94). However, a variety of factors worked in favour of the 1993/94 GFS deficit outcome of only \$572m (Budget Paper No. 2, 2-3). The position appears better than this if some crude adjustments to an accrual basis are made.

The Victorian government moved to cut back its superannuation liabilities by redundancies and adjustments to entitlements. These measures, together with the payment (counted as an outlay) of \$1.4 billion into the superannuation fund, meant that between 1992/93 and 1993/94 the unfunded superannuation liability fell from \$18.7 billion to \$14.9 billion. This represents a net gain to the government of about \$2.4 billion; the deficit for 1993/94 should be adjusted downwards by this amount. On the other hand, the treatment of asset sales as 'negative expenditures' leads to an overstatement of the improvement in the Victorian budgetary situation, as there is no downward adjustment in the asset account. Direct asset sales in 1993/94 resulted in receipt of only \$384m, including the proceeds of the Casino licence. However, the government also repatriated capital of \$1.2 billion from the Transport Accident Commission.

The sum of these items indicates that 1993/94 was a year of substantial net economic improvement for the Victorian government. After making these adjustments the government's net economic position appeared to improve by about \$250m, rather than declining by \$572m as suggested by the official deficit. It is somewhat ironic that the Victorian government over-achieved an even stronger balanced budget target in 1993/94 than the one it is contemplating setting itself in future years.

Yet although the adjusted accounts are now showing a net improvement, the aggregate position remains parlous. There are massive unfunded superannuation liabilities of nearly \$15 billion, and net debt with respect to past borrowings stands at over \$32 billion. The improvement in 1993/94 was relatively small. A great deal of net improvement over many years will be necessary to repair the aggregate position.

The Victorian government envisages a commitment to balance only its current budget. This would allow the accumulation of debt to continue. But fiscal responsibility in Victoria demands persistent debt reduction rather than budget balance (however defined). Indeed, the Victorian Treasurer has displayed a concern with debt reduction. The true position may become easier to decipher in future years with 'the eventual development of "whole-of-government" financial reporting . . . of the assets and liabilities of the State' (Budget Paper No 2, 1994/95, p. 7-7).

The Commonwealth's Deficit Reduction Program

The Commonwealth's commitment is to a deficit reduction program that is even weaker. As described on page 1.3 of the 1994-95 Budget Paper No. 1:

The Government made a commitment prior to the 1993-94 Budget to reduce its budget deficit to around 1 per cent of GDP by 1996-97. . . This year's Budget consolidates . . . [the 1993-94] progress indicating that the budget should be approaching balance by 1997-98.

This commitment does not impose any constitutional or legal discipline on the government; it does not envisage eliminating the deficit (or balancing the budget) even on the current account and as measured; and it does not require the government to retain any low deficit that might be achieved. It does not involve any serious reduction in the structural deficit, but merely allows economic recovery to trim it.

The statement of the Commonwealth accounts is conceptually an inaccurate indicator of changes in the government's net economic position. The published deficit is large, and adjustments with respect to superannuation and asset sales appear to make the position worse. The Commonwealth quite possibly does not fully fund its superannuation scheme on a year-to-year basis. In recent years a substantial program of asset sales has been implemented, the one-sided budget treatment of which has helped disguise the true deterioration in the Commonwealth government's net economic position. If the proceeds of asset sales are subtracted, the deficit is increased by the same amount.

What is also clear is that the size of Commonwealth government debt is large. Vincent FitzGerald (1994) has drawn attention to the superannuation debt and argued that the aggregate debt situation has been understated at Commonwealth and State levels. A promise to reduce the rate of accumulation of debt — and not even this is assured given the way the deficit is defined — is a long way from 'fiscal responsibility' in view of the magnitude of the acknowledged debt problem.

Conclusion

It is refreshing to witness the start of a semblance of debate on fiscal responsibility. But two ingredients are missing. First, there is insufficient attention to the rules and presentation of the accounts produced by Australian governments. The accumula-

tion and total level of government debt are, respectively, not fully revealed and not highlighted in the GFS budget accounts. Second, there is too much concern in the target-setting proposals about the (albeit incorrectly measured) accumulation of debt at the expense of the totality of that debt.

Despite real progress since 1991, there is still a long way to go towards presenting accounts in a way that reflects the government's net economic position. Governments should not be permitted to run up superannuation liabilities without presenting them as negative budget items or to continue to treat asset sales in a totally illogical way. At the very least, additional features need to be grafted on to the GFS presentation so that it approximates an accrual basis, and the total debt situation must become a central part of the budget.

There must also be more focus on total debt. Merely slowing down or even eliminating the growth of debt is a feeble response to the enormous accumulations of debt in Victoria, NSW and the Commonwealth. These governments are all starting from weak economic positions, and improvements that seem large in themselves may have little effect on debt totals. Significantly, both Victoria and NSW showed improvements on their corrected accounts in 1993/94. But future Victorians and New South Welshpersons remain saddled with the costs of the fiscal profligacy of their forebears.

The Prime Minister is perhaps unwittingly correct in his dismissal of the 'deficit Daleks'. What we really need is an army of 'debt Daleks' dedicated to the extermination of debt.

References

- Albon, R. (1994) 'Evaluating Changes in a Government's Net Economic Position', *1994 Research Lecture in Government Accounting*, Australian Society of Certified Practising Accountants, Melbourne.
- Anon. (1994), 'Rules leave no room for Budget secrets', *Australian Financial Review*, 30 June.
- Auerbach, A., J. Gokhale & L. Kotlikoff (1994), 'Generational Accounting: A Meaningful Way to Evaluate Fiscal Policy', *Journal of Economic Perspectives* 8(1): 73-94.
- Australian Bureau of Statistics (ABS) (1989), *Classifications Manual for Government Finance Statistics Australia, 1989*, AGPS, Canberra (Cat. No. 12170).
- Blejer, M. & A. Cheasty (1991), 'The Measurement of Fiscal Deficits: Analytical and Methodological Issues', *Journal of Economic Literature* 29: 1644-78.
- Eisner, R. (1989), 'Budget Deficits: Rhetoric and Reality', *Journal of Economic Perspectives* 3(2): 73-93.
- FitzGerald, V. (1994), 'Saving, Investment and Growth: A Retrospective on the Debate', paper presented to the 23rd Conference of Economists, Surfers Paradise, 28 September.

Haveman, R. (1994), 'Should Generational Accounts Replace Public Budgets and Deficits?', *Journal of Economic Perspectives* 8(1): 95-111.

International Monetary Fund (IMF) (1986), *A Manual on Government Finance Statistics*, Washington, DC.

McGuinness, P. (1994), 'Government balancing acts and the 'deficit Daleks'', *The Age*, 1 November.

Mackintosh, I. (1993), *Accrual Accounting for Departments and the Whole of Government: Costs, Benefits and Opportunities*, 1992 Annual Research Lecture in Government Accounting, Australian Society of Certified Practising Accountants, Melbourne.

National Fiscal Outlook (1994), *Report to the Premiers' Conference 25 March 1994*, prepared by a Working Party of Commonwealth, State and Territory officials.

Robinson, M. (1994), 'Those artificially "balanced" budgets can't change reality', *Australian Financial Review*, 18 October.

United Nations (UN) (1968), *A System of National Accounts*, New York.

Walker, R. (1994a), 'Electing to bluff about balanced budgets', *New Accountant*, 29 September.

—— (1994b), 'If accrual is better, why not flaunt it?', *New Accountant*, 17 February.

I am grateful to two anonymous referees for their comments, and to Matthew Bengé, David Hughes and Paul Klumpes for discussions on budget presentation.