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QUEENSLAND PUBLIC FINANCE IN THE NINETIES

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Consistent with a policy commitment to raising the level of public services, Queensland has been increasing current expenditure at a significant rate since late 1989. At the same time, the Labor government has claimed to have eliminated State debt and to have honoured promises to keep down taxes. This paper challenges both those claims. It also suggests there are strong *prima facie* grounds for the view that public capital expenditure has been inadequate in the face of burgeoning population pressure, and that there has been a marked imbalance between capital and current expenditure. Part of the reason for this has been the Queensland Government's stringent debt policy. It is argued that Queensland debt policy goes beyond what is required by financial responsibility, and has hampered effective policy making in the State.

1. INTRODUCTION

In late 1989, an ALP Government was elected in Queensland. To win office, it was essential for Queensland Labor to rebut or at least neutralise the charge repeatedly made by leaders of the then National party government that a vote for Labor in Queensland was a vote for Victorian-style fiscal irresponsibility (eg *QPD*, 26 September 1989, pp 612-14; 3 October 1989, pp 1006-7). Once in office, Queensland Labor watched as financial crisis increasingly engulfed the South Australian and Western Australian Labor Governments. The obvious imperative was to avoid any hint of similar practices and problems in Queensland.

The strategy chosen by Labor was a familiar and politically understandable one. It "took the pledge" and committed itself very publicly to the causes of fiscal responsibility and conservatism.

To this end, Labor developed a financial strategy with four key elements. The first was firm tax restraint – initially in the form of a commitment not to introduce new taxes and not to increase the overall tax burden. The second was continued full funding of superannuation and workers compensation liabilities. The third was to

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fund out of taxation receipts rather than debt all expenditure directed to the creation of "social" capital assets (ie. assets, such as schools, which would not or could not be financed out of charges imposed upon users). The fourth policy element was the overall reduction of State debt.

These fiscal policy principles were, in a sense, a rejoinder to the long-time National party themes of low tax and low debt. In fact, the new government consciously outdid the National government in fiscal conservatism. On debt policy, the Nationals had in Government regarded it as sufficient that a "majority" (rather than totality) of social infrastructure be financed from revenue (*QPD*, 7 September 1989, p.596), and it was with evident relish that that Labor's Treasurer subsequently attacked this alleged irresponsibility (eg *QPD*, 28 April 1992, p.4558; Queensland, 1991a, p.11).

Throughout its two terms in office, Queensland Labor stuck closely enough to its four fiscal principles to have built up a reputation for "sound" financial management. It won the applause of the credit-rating agencies and the financial markets more generally. It consolidated this reputation with its announcement, in September 1994, that the State had become "net debt free" (Queensland, 1994c, p.1).

The apparent mystery of all this is that, at the same time, the Government maintained an explicit policy of substantially increasing public expenditure. Under the Nationals, the counterpart of the low-tax policy was a level of service provision well below that of most other States (CGC, 1993, p.292-398). In Opposition, Labor argued that this meant the neglect of public services in areas such as education and health. It pledged to raise the standard of public services in Queensland, and although Labor was subject to criticism for not moving fast enough to honour its expenditure promises, Government leaders defended the expenditure record, citing expenditure data to demonstrate that Queensland has rapidly moved towards the national standard of service provision in key areas (*Australian*, 29 March 1994, p.7). At the same time, the State budget papers in recent years have displayed charts showing the rapid growth of public capital expenditure, and favourably contrasting Queensland capital expenditure with that of other States (Queensland, 1994e, p.27).

How can a government substantially increase public expenditure and the standard of services while containing taxes and eliminating debt? The present paper investigates this issue. It then seeks to assess the costs and appropriateness of the fiscal policy principles to which Queensland Labor committed itself.

2. CURRENT EXPENDITURE

Current expenditure increased rapidly under Labor. The average annual real per capita rate of growth of conventionally-measured "current outlays" over Labor's first term (ie comparing 1989-90 to 1992-93) was 3.4 per cent, with this slowing a little to 2.7 per cent over the first two years of its second term. This, however, understates the true growth. Conventional "current outlays" is a net concept which excludes current expenditure which is financed by user charges. As discussed below, Labor substantially increased user charges. Reflecting this, if

we were to add that portion of current expenditure back to conventional current outlays to obtain a measure of "gross" current outlays, the first term annual average growth rate in real per capita terms would increase to about 4.4 per cent.

Whichever measure one adopts, it is clear that there has been sustained long-term growth in current spending, and that this growth has accelerated since the election of the Labor Government.

3. REVENUE COMMITMENTS

Given that this growth in current expenditure was, according to the Queensland Budget Papers, matched by capital expenditure growth, one would naturally expect difficulties in reconciling such expenditure growth with a policy of tax restraint. A starting point in assessing this apparent paradox is, to review the nature of Labor's tax policy.

Labor went into the 1989 election with a commitment that "there will be no new taxes .... and increases in all existing taxes and charges will be held at or below the inflation rate" (*Courier Mail*, 20 November 1989, p.11). In the new Labor Government's first budget, the "no-new-tax pledge" was confirmed, together with a commitment "that existing taxes and charges would not rise, on average, faster than the rate of inflation" (Queensland, 1990a, p.7).

The "no-rise-faster-than-inflation" part of the tax pledge could be taken to mean that *revenue* from taxes or charges would not increase in real terms, or it could be assumed to refer in some way to an average tax *rate*. Although Queensland Government sources have asserted that the latter is the correct interpretation, it seems clear that it was the former meaning which was intended. By contrast to this possible ambiguity, there is no ambiguity that the wording of Labor's revenue commitment covered not only taxes (which are unrequited payments), but also charges (which are payments made in return for some good or service).

This first-term pledge was subject to further redefinition in the Government's second budget (Robinson, 1994b, pp.41-42). More importantly, in the 1992 election campaign, Labor sought to give itself more tax flexibility. The first-term revenue commitment was replaced with a broader commitment to "maintain Queensland as a low tax State" (*QPD*, 4 November 1992, p.22; Queensland, 1993, p. 4; Queensland, 1994a, p.4). No longer was the government formally bound by a campaign commitment not to introduce new taxes. The Government has not, however, treated this as a licence to introduce new taxes or to raise the rates of existing taxes. The key tax increase after the election – a substantial increase in the tobacco tax – was an explicit campaign plank, and was therefore in every sense part of the Government's "mandate".

4. REVENUE PERFORMANCE

Notwithstanding these revenue policy commitments, Queensland Government revenue increased substantially, during both the first and second term in office. The explanation of this is not to be found in Commonwealth grants. Rather, as Figure 1 demonstrates, the Queensland Government has increased its own budget sector revenues. For example, during Labor's first term (ie, from 1989-90 to 1991-92),

FIGURE 1

GROSS CURRENT OUTLAYS
Queensland Budget ("General Government") Sector
Real per capita dollars

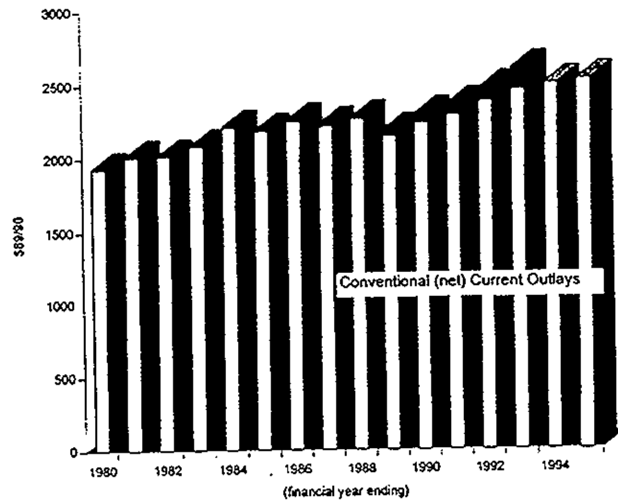
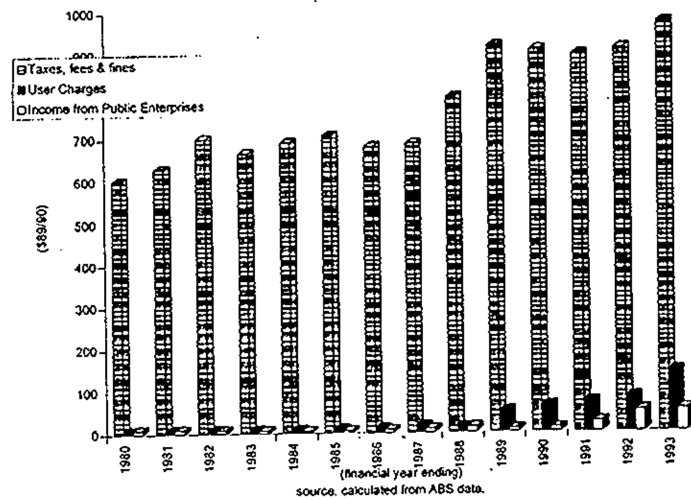


FIGURE 2

MAIN OWN-SOURCE REVENUE CATEGORIES
Queensland Budget ("General Govezrnment") Sector
Real per capita dollars



Queensland own-source revenue, including user charges, rose in real per capita terms by around 7 per cent. This can be contrasted with a small (and temporary) rise in Commonwealth grants of about 2 per cent, making an overall increase in real per capita total State revenue of about some 5 per cent.

Figure 2 highlights trends in three components of gross budget sector revenues – "taxes, fees and fines", user charges and income from public enterprises. Data limitations restrict this analysis to the period up to 1992-93. There was no real per capita growth in "taxes, fees and fines" during Labor's first term, but there is certainly significant growth after the 1992 election. However, the restraint in that category of revenue has been underpinned by a rapid increase in non-tax sources of budget sector revenue. User charges imposed by budget sector agencies have escalated very rapidly, experiencing an average real per capita increase of over one-third annually from 1989-90 to 1992-93. Income received by the budget sector from public enterprises, from being negligible, also made an important contribution to the overall increase in own-source revenue.

This record is compatible with the "no new tax" part of Labor's revenue policy commitments. The only breach during the Government's first term was a minor one, the introduction of a tax on gaming machines. The rapid growth of user charges is not, by contrast, consistent with Labor's first-term pledge, quoted above, "that existing taxes and charges would not rise, on average, faster than the rate of inflation". That 'user pays' was explicit government policy (Queensland, 1994b, p.43) does not change this judgement.

A key attraction of user charges to governments is that the magnitude of user charge receipts is not indicated, or fully indicated, by standard government accounting. As indicated above, in the standard national government accounting format, budget documentation reports "current outlays" on a net basis after the deduction of that portion of current expenditure which is financed by user charges. For the spending and revenue sides of the financial statement to balance, user charges are then omitted from the corresponding revenue figures. Budget papers provide other data, in non-standard form, but this gives only partial information on user charges (see, eg, Economic and Budget Review Committee, 1990, Section 12.2).

5. DEBT POLICY AND FISCAL BALANCES

Given the Labor Government's debt policy, revenue growth was particularly crucial because revenue, rather than borrowing, was required to cover new superannuation liabilities and expenditure on "social" infrastructure as well as current expenditure. The policy of setting aside reserves each year to match the increase in the overall superannuation liability reflects a creditable determination to cover all the costs of current service provision. On the other hand, given that tax-supported ("social") infrastructure is essentially the responsibility of the budget sector of government, the social infrastructure funding policy is essentially a restatement of the traditional 'balanced budget' doctrine (Robinson, 1995).

As an approximation, these policies imply that in any year the overall budget surplus, measured according to the national conventions, should equal the

increase in superannuation liabilities in that year. As a further approximation, this would mean that net debt – which is defined as debt minus financial assets – would reduce over time in line with the growth in those superannuation reserves. This is, at least on the surface, what happened in the Queensland budget sector. Between 1990 and 1994, net budget sector debt dropped by $2938 million, while superannuation liabilities increased by approximately the same amount ($2652 million).

However, Queensland Labor debt policy went beyond the "social infrastructure" policy. It was accompanied by a policy of debt reduction. Total State net debt was reduced from $4213 million in 1990 to zero (or, more precisely, to minus $242 million) in 1994, an achievement which the Treasurer told Parliament was "a milestone in Australian public sector financial management" (*QPD*, 6 September 1994, pp.9210, 9211). The measure of State net debt which the Labor Government constantly referred to was one which encompassed the net debt of the public trading enterprise sector as well as that of the budget sector, and the 'elimination' of State net debt reflected reductions in both budget sector and public trading enterprise sector net debt. The relevance of this is that the capital expenditure of the public trading enterprise sector is "economic" rather than "social" infrastructure. The social infrastructure policy does not, therefore, constrain the use of debt for public trading enterprise investment, and therefore implies nothing about the trajectory of total State debt (as distinct from the debt of the budget sector in isolation). So it is not possible to explain the reduction in the net debt of the State or of the public trading enterprise sector by reference to the social infrastructure policy.

Although the Treasurer claimed that the Government "was not pursuing a debt reduction strategy" (Queensland, 1994e, p.4; *QPD*, 6 September 1994, p.9211; *QPD*, 31 August 1993, p.4185), his disclaimers lack plausibility. In his very first budget, the Treasurer pointed to "reducing debt" as a key means of "creating an investment climate" (Queensland, 1991b, p.3). He also referred to debt reduction as the "inevitable outcome" of the Government's financial management strategy (Queensland, 1994e).

The twin debt policies imply a need to run large current account surpluses if a public capital expenditure program of any magnitude is envisaged. Figure 3 below shows Queensland budget sector and public trading enterprise sector current account surpluses in real terms. It shows that these current surpluses were much greater under Labor than under the earlier National Party Government during the 1980s, reflecting the adoption by Labor of a more conservative debt policy.

This raises the question of public capital investment in Queensland. Given the tight constraints of Queensland debt policy, and the substantial growth rate of current expenditure, how adequate has capital expenditure really been? Before examining this crucial issue, the implications of the large superannuation liability and similar liabilities for debt levels need to be examined further.

6. NET DEBT VS NET LIABILITIES

The "elimination" by 1994 of Queensland net debt was an achievement in which the Queensland Government took pride. Unfortunately, the "net debt" measure – which deducts the government's financial asset holdings from its outstanding (gross) debt – is a poor one. The problem is with what is counted as gross debt. It is now widely recognised that the liability for future superannuation payments, and other similar liabilities, are more or less equivalent to debt. Narrow measures of gross debt which exclude such liabilities are therefore inadequate (Bohn, 1992; South Australia, 1994, pp.104, 111; Victoria, 1993, p.18; WA, 1993, pp.88-90). Largely reflecting this point, a number of States publish measures which add these liabilities to conventional gross debt before deducting financial assets. It is convenient to refer to this measure as "net liabilities". Most States agreed at a Head of Treasuries meeting on 8 July 1994 to further developments in this direction.

In the Queensland case, the misleading nature of net debt measures in isolation from these liabilities is particularly clear. In the Queensland budget sector, a large portion of financial asset holdings is comprised of reserves built up to cover superannuation liabilities. Yet net debt is measured by netting off these financial asset holdings from a gross debt figure which ignores the superannuation liability. So the official measure of budget sector "net debt" is lopsided in that it includes the asset side of the superannuation balance sheet without the liabilities side.

The problem deepens when one takes into account that the official government accounting system treats the public trading enterprise sector differently from the budget sector, with the consequence in Queensland being that public enterprise superannuation reserves as well as superannuation liabilities are excluded in the calculation of net debt. In other words, the official net debt measure for the public trading enterprise sector is conceptually equivalent to a "net liabilities" measure in the budget sector. This means that the official aggregation of the "net debt" of the two sectors to produce a figure for the public sector as a whole is really a case of adding apples and pears.

We can make an approximate estimate of net liabilities by adding budget sector superannuation liabilities to the reported net debt figures. This tells us that net liabilities stood at $5.2 billion as at 30 June 1994, having been reduced rather than eliminated since 1990. The reduction involved ($1.8 billion) was, moreover, significantly less than the reduction in conventional net debt ($4.4 billion). The 'elimination' of net debt in Queensland is therefore an illusion produced by the use of an inferior accounting measure.

Having clarified the debt position, we can return to capital expenditure.

7. CAPITAL EXPENDITURE

The Queensland Government staked its reputation in the area of capital expenditure on two facts. The first was that capital expenditure levels increased under Labor. The second was that per capita capital expenditure now compared very favourably with other Australian States (Queensland, 1994e, p.27).

FIGURE 3

QUEENSLAND CURRENT ACCOUNT SURPLUSES
Real dollars

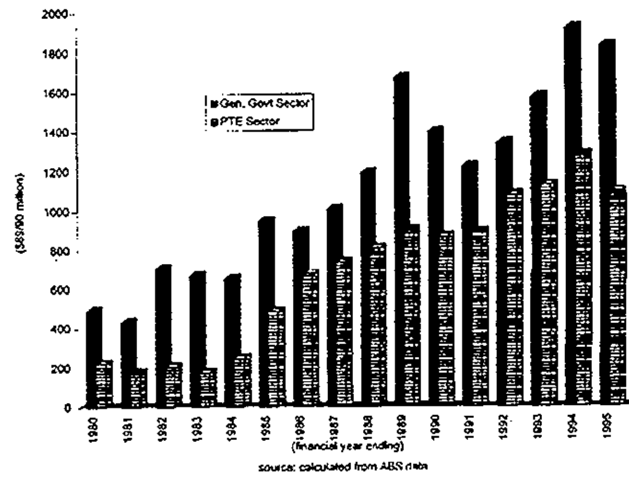
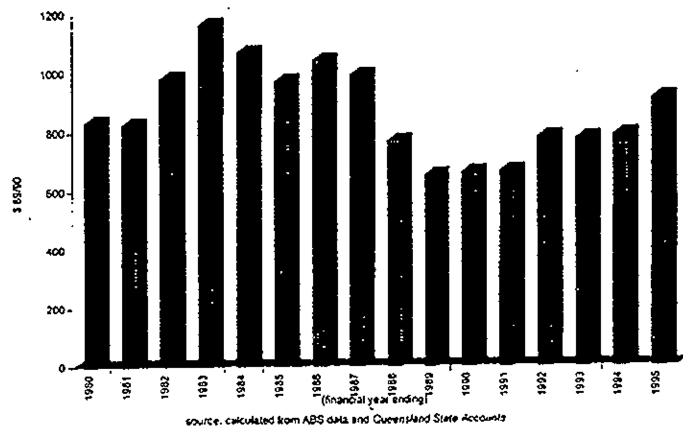


FIGURE 4

EXPENDITURE ON NEW FIXED ASSETS
Queensland State Government
Real per capita dollars



Whilst literally correct these points are misleading. As can be seen in Figure 4, although public investment indeed increased under Labor, this was only because it had reached a low point prior to the change of government. Viewed over the medium term, per capita capital outlays have been low relative to the levels which prevailed in the 1980s.

The favourable interstate comparisons made by the Government also are misleading for several reasons. Firstly, capital expenditure by Australian States as a whole has been depressed since the late 1980s, on top of a longer-term decline (Australia, 1994, p.6.18). There is considerable agreement across the political spectrum that considerable problems may result, and that there must be an "inevitable surge ... in public investment in order to catch up with the provision of infrastructure needed to service growing demand from other sections of the economy" (Moore, 1990, p.30).

The second reason why the interstate comparison is misleading is that Queensland's population growth has been very much faster than the national rate (nearly seventy per cent higher over the last twelve years to 1993). To maintain a constant standard of services from public infrastructure requires, as an approximation, the maintenance a constant per capita capital stock (or, alternatively, a constant ratio of capital stock:output). It follows from this that the required level of capital expenditure is a function of the *rate of change*, rather than the level, of population or gross product.

A concrete sense of the implications of these growth differentials is given by the fact that in a simple "steady state" growth model Queensland would have to maintain on a long-term basis a level of real per capita capital expenditure about 20 per cent above the national average simply to *maintain* the Australian national average level of per capita public capital stock, assuming that the State started with that national average level in the first place. Spending would have to be significantly higher again if there were in addition a catch-up effort to boost the State's per capita capital stock from a level below the national average.

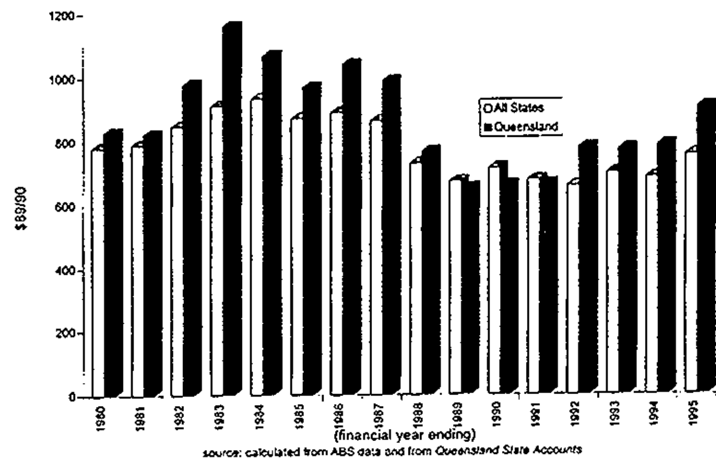
It is constructive, in the light of this, to compare trends in Queensland public investment with those in other States. This is done in Figure 5.

This Chart indicates that there are strong prima facie grounds to hypothesise that Queensland public investment has not compared well with the average of Australian States as a whole, once population growth rate differences are taken into consideration. This is, moreover, under circumstances where State public investment has been at its lowest point for decades. It is also noteworthy that Queensland reduced public investment more sharply from the late eighties than the average of other Australian States, given its rapid population growth and the fact that it was under less fiscal stress and therefore had a greater capacity to maintain investment.

At the national level, factors which have been adduced to explain the reduction in public infrastructure expenditure include the reduction of excess electricity capacity, and the national demographic factors which have led to a reduction in school enrolments and thence to a greatly reduced need for capital spending in the education sector (EPAC, 1990, p.24; Australia, 1994, p.6.19). The argument has been that Australia does not need much public capital spending

FIGURE 5

EXPENDITURE ON NEW FIXED ASSETS
Queensland vs All Australian States
Total State Government Sector – Real per capita dollars



source: calculated from ABS data and from *Queensland State Accounts*

at present. Whatever the merits of this argument at a national level, these factors cannot explain Queensland trends. In respect of education and other social infrastructure, Queensland is experiencing pressure of the type felt by the nation as a whole in the 1960s. Moreover, the substantial reduction in investment spending has occurred in both the public enterprise sector and the budget sector for instance.

This provides *prima facie* evidence at the aggregate statistical level that public capital expenditure in Queensland has been inadequate in this period given the pressures facing the State. This can be supplemented by evidence concerning specific major sectors of the public capital stock. In respect of Queensland public hospitals, studies by John Deeble in 1991 and 1993 demonstrated that at that time there was both undercapitalisation and an investment shortfall below even maintenance levels (Deeble, 1993, pp.1,50). The SEQ 2001 study noted that the provision of social infrastructure such as new schools "is currently subject to significant lags in some growth areas" (RPAG, 1993, p.27). Urban transport is widely regarded in Queensland as an area with a considerable capital expenditure backlog, with community debate focused not on whether substantial capital expenditure is necessary, but rather upon the appropriate allocation of that expenditure between roads and public transport.

8. ESCAPING THE STRAIGHTJACKET?

Queensland's debt policy has, then, created a "fiscal straightjacket" which has impacted severely upon standards of capital infrastructure. One important consequence of this has been to create increasing pressure for the use of artifices to loosen the constraints of this straightjacket upon necessary infrastructure provision while maintaining the *appearance* of consistency with stated fiscal policy.

There are two relevant categories of artifice. The first is designed to circumvent the policy that debt will not be used to fund social infrastructure. The second aims to artificially reduce total public sector debt.

Three means of circumventing the "social infrastructure" policy can be mentioned. The first, and best known, is the technique of transmuting "social" public capital expenditure into "economic" public capital expenditure by substituting debt servicing via user charges for traditional debt servicing via taxes. A good example of this is a toll road constructed and operated by the government itself.

The other two methods involve the public enterprise sector borrowing money and paying it to the budget sector of government in a form which the latter treats as income rather than borrowings, and which is then used to fund social infrastructure. This is essentially a form of creative accounting. The newest and most 'innovative' means by which this is being done is the so-called 'recapitalisation' of Government enterprises. This appears to have first been done as part of the Queensland Infrastructure Financing Fund (QIFF), announced in 1994. The QIFF is designed to fund infrastructure which is partly 'social' in nature. The Government declared that, consistent with its policy of not funding social infrastructure with debt, it would fund the social component of QIFF projects through 'equity' contributions from the budget. Senior ministers claimed that, because of this "equity" role, QIFF will be entirely consistent with the Government's debt policy (*Australian*, 2 June 1994, p.4). However, one of the three sources of the initial QIFF 'equity' was in fact simply indirect debt. The Government required its commercialised car fleet, Q-Fleet, to borrow substantially (with the putative objective of giving it a 'commercial' gearing ratio) and pass the money for use as QIFF "equity". The result was that Q-Fleet had the debt and the Government had some "equity" which it could use for social infrastructure while claiming consistency with its financial management strategy (Queensland, 1995a, 1995b).

The same strategy was subsequently employed in a bigger way in the 1995-96 budget. In response to growing political criticism about the condition of infrastructure, the budget announced an Expanded Social Infrastructure Program. The State Treasurer claimed that, consistent with the social infrastructure policy, this Program would be funded by "cold, hard cash" rather than debt. This cash, he said, would come from "ongoing debt servicing savings" which were the fruit of "good financial management" (Queensland, 1995d, pp.5,7). The reality, however, was that nearly all of the so-called debt servicing savings came from what the budget papers refer to a "progressive capital restructuring of government

owned enterprises (GOCs) as they are provided with commercial capital structure" (Queensland, 1995c, p.59) – that is, from the recapitalisation device – rather than from interest savings arising from genuine debt reduction.

The other means by which public enterprise borrowings have been transmuted into budget sector 'cash' is through dividends and 'tax-equivalent payments'. As discussed earlier, these increased greatly under Labor. In many cases, these increases were expressly identified as for the purposes of funding social infrastructure (eg Queensland, 1994a, p.52). The government claimed that this reflected great improvements in efficiency and profitability as a consequence of corporatisation. However, ABS government finance data suggests that there had been no equivalent increase in profitability. It is reasonable to regard increases in dividend payments to the budget sector which are unsupported by increases in public enterprise profitability as tantamount to a transfers of debt from the latter sector to the former.

These devices have the effect of circumventing the social infrastructure policy. However, they do this not by changing the level of public sector debt, but rather by redistributing debt from the budget sector to the public enterprise sector. This is where the other category of artifice – designed to artificially reduce public sector debt – comes into play. Concretely, this involves asset sales and private provision of public infrastructure. Over the past decade fiscally-stressed Australian States have made increasing use of these strategies. Queensland has recently moved in the same direction despite the fact that, as the State's Treasurer himself acknowledged, "because of its very sound financial position, Queensland is free from the financial imperatives driving other States to involve the private sector in infrastructure provision" (*QPD*, 5 May 1992, p.4787). Notwithstanding government protestations that it was motivated solely by potential efficiency gains, it is a reasonable inference that a principal motive was the need to escape the self-imposed debt policy constraints.

Queensland has already used asset sales to great short-term effect in ameliorating the fiscal dilemma. The outstanding example has been the sale of the Gladstone power station during 1993-94 for about $800 million. This asset sale has been a crucial factor in reconciling significant recent increases in budget sector capital expenditure with the Government's debt policy. (The sale of Gladstone also accounted for about half of the reduction in public trading enterprise sector net debt under Labor.) In addition, a major source of the initial QIFF "equity" in addition to the "recapitalisation" transfers discussed above has been asset sales – in particular, the sale of the Queensland Government's Greenvale nickel holding. Most recently, the Government has announced its intention to privatise the State Gas Pipeline – a move for which it has not felt compelled to offer any efficiency rationale (Queensland, 1995e, p.39).

The Government first indicated its desire to encourage the private financing and construction of infrastructure in May 1992, as part of the major economic statement "*Leading State*" (Queensland, 1992, pp.47-48). Queensland Treasury policy documentation made public under Freedom of Information has revealed that Department's support for the wide application of the principle of private

provision on a contracting basis from its current application to private prisons through to assets such as schools, hospitals and ports (*Australian*, 18 February 1994, p.2).

There is increasing concern around the country that Australian States are employing asset sales and private infrastructure provision as financing techniques even when they are more expensive than the conventional options of government borrowing and government ownership (eg NSW Auditor-General, 1994; EPAC, 1995). The primary reason that this has been occurring has been Commonwealth-imposed fiscal constraints. This has, however, been reinforced by the fact that these devices produce a lower government debt figure for any given set of tax and expenditure policies. There has been a preoccupation with debt levels without regard to net worth, the consequence of which has been a willingness to 'lower' debt by means which are inferior to debt in terms of their impact upon the government balance sheet.

The Queensland Government has itself publicly identified these risks (eg Queensland, 1992; *QPD*, 28 April 1992, p.4560). It has set out guidelines to ensure that any private infrastructure provision makes sense when relative cost and risk are taken into account. Perhaps partly for that reason, there has been little 'progress' in the area of private infrastructure provision to date, with the consequence that asset sales have been left to do most of the work of providing 'debt-free' funding to date.

9. EVALUATING QUEENSLAND DEBT POLICY

It would appear that the costs to Queensland of maintaining its chosen debt policy are great, given the circumstances faced by the State. Why, then, has that policy been so steadfastly maintained? No reasoned rationale for Queensland debt policy appears to have been stated. Ministers seem to regard it as self-evidently good for Queensland to be "net debt free". As for the social assets policy, the Queensland Treasurer publicly described the use of debt finance for social assets as "immoral". He did not, however, appear to have explained why this was the case. Yet not even rating agencies have any *in principle* difficulty with tax-supported borrowing. The basis of this policy would appear to be nothing more sophisticated than the naive political appeal of 'net debt free' status. However, as the Government had been discovering to its own cost, there is a considerable political downside to an unwillingness properly to fund infrastructure.

The Queensland stance differed markedly from the conventional "intergenerational equity" approach to the funding of budget sector capital expenditure. The intergenerational equity approach applies the "benefit" principle of public finance to the choice between tax financing and debt financing of public expenditure, a choice which it conceptualises as one between present taxation and deferred taxation (see, for example Musgrave, 1988). It proposes that the mix of tax and debt be set so as to spread the costs of public expenditure over time in line with the intertemporal distribution of benefits.

By definition capital expenditure gives rise to flows of benefits into the future, so it is in the financing of capital expenditure that debt finance has a legitimate role

from the intergenerational equity perspective. By contrast, expenditure on the provision of current services should be covered by taxes, because by definition the benefits of current services are enjoyed in the present. For the same reason, according to the intergenerational equity approach, taxes should also pay for the consumption by the present 'generation' of pre-existing capital (as measured by depreciation). Broadly speaking, the intergenerational equity approach suggests that debt may be added as new capital assets are constructed, but should at the same time be reduced as assets are depreciated. The relevant conclusion of the "intergenerational equity" approach is, therefore, that it is justifiable to increase debt if the capital stock is being increased.

The intergenerational equity approach is thus closely related to the view that medium and long-term fiscal policy should be guided by the principle of maintaining government net worth (see, for example, Odling-Smee and Riley, 1985), rather than by a preoccupation with debt. This "net worth" view is moreover, in no sense a heterodox policy position. As two International Monetary Fund economists noted recently:

> There is now an academic consensus, at least, that an accurate assessment of [fiscal] sustainability would require the replacement of the annual deficit with a measure of changes in government net worth (ie, the change in the government balance sheet from year to year. (Blejer and Cheasty, 1992, p.42; Blejer and Cheasty, 1991)

While real-world complexities inevitably call for a number of modifications of the pure intergenerational equity principle, this is less so at the State than at the national level. This is also particularly true in respect of States such as Queensland where there is no question of debt having become excessive relative to the revenue base and current expenditure, and where, as a consequence, one does not have to deal with the policy complexities of the debt reduction imperative (eg Robinson, 1994a).

It is not at all clear on what precise grounds Queensland policy-makers dissent from the intergenerational equity stance. The recent Queensland Government Financial Management Strategy offers a hybrid of the intergenerational equity and 'social assets' approaches by arguing that "recurrent service outlays – including outlays for social capital items – should generally be funded from recurrent revenue sources" (Queensland, 1994b, p.31). This employs intergenerational equity reasoning to rationalise the 'social assets' policy through an erroneous characterisation of one type of capital expenditure as equivalent to current expenditure. One interpretation of this approach is that it reflects a failure to recognise the stream of benefits over time which arise from social assets. These benefits are presumably neglected because they do not take the form of a financial return. This interpretation is supported by the frequent assertion made by senior ministers that interest payment to support debt-financed social assets is simply "dead money" which crowds out current expenditure (eg *Courier Mail*, 27 July 1994, p.14). This contrasts with the intergenerational equity view that the costs of servicing debt incurred in the construction of social assets is part of the price paid for a stream of benefits, rather than simply a deadweight burden.

In recent years, debates about the appropriate fiscal policy of Australian governments have been influenced by the rise of "national savings" as a federal government policy preoccupation (Fitzgerald, 1993). Drawing upon this, Queensland has suggested that compliance with the national savings agenda requires the States to run overall budget surpluses (QPD, 31 August 1993, p.4184; Queensland, 1994a, pp.10,108; *QPD*, 6 September 1994, p.9210). It is, however, an obvious error to identify a Government's overall budget surplus, rather than the current surplus, as its contribution to national savings (see, eg, Gramlich, 1991, p.252). To do so is effectively to ignore public sector savings which are used to finance public sector investment.

It is possible Queensland policymakers believe that the debt policy is necessary if the State is to avoid a growth in interest commitments to levels which would compromise budgetary "flexibility" and place pressure upon tax levels. However, one can apply the intergenerational equity rule to the funding of capital expenditure needs arising from an increasing population and a growing economy while preventing interest commitments from rising beyond moderate levels. There will be no problems as long as one avoids a level of public asset creation which is out of balance with the revenue base and current expenditure needs. Put differently, budgetary flexibility and tax restraint may be safeguarded by combining intergenerational equity funding principles with sufficient borrowing restraint to ensure that debt servicing does not become excessive in relation to the revenue base.

In sum, Queensland Labor pursued a financial management strategy dominated by an entirely understandable determination to distance itself from allegations of fiscal irresponsibility. In the process, it adopted a policy of excessive fiscal conservatism, going well beyond the requirements of fiscal responsibility. In the Queensland context of rapid population growth, this policy is causing serious problems in the provision of capital infrastructure and has produced a strong incentive for the increasing use of techniques of fiscal evasion for infrastructure funding.

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