

State of play Building a new Queensland

*A response by PwC to
the Costello
Commission of Audit
Interim Report
released 15 June 2012*

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Need for new ideas and action

Ratings agencies, academics and the Queensland Commission of Audit agree that the Queensland Government is faced with a significant budget challenge in the short term.

The Queensland Commission of Audit (Commission) projected that state debt will climb to \$100 billion by 2018 if drastic action is not taken immediately.

It recommended two priorities to get Queensland's financial position 'back on track':

- restore the state's AAA credit rating
- achieve sustainable surpluses over time.

According to the Commission, Queensland needs to reduce its current debt levels by \$25-\$30 billion to get back to the AAA rating zone (see Figure 1). This will require the State Government to deliver a debt/revenue ratio of around 60% by 2017-18.¹

The current condition of the state's balance sheet is clearly not optimal. PwC has prepared this response to the Commission's report in order to stimulate discussion on how all stakeholders can contribute to getting the state back in the black.

While improving the state's financial position is a priority for the new Government, it is also important to maintain confidence in Queensland's future economic strength. Fixing the problem will require new ideas, innovation and disciplined action from both federal and state governments, as well as a willing business sector.

In order to achieve a healthy balance sheet and increase consumer and investor confidence in Queensland we have identified the following five priorities for the Government to consider:

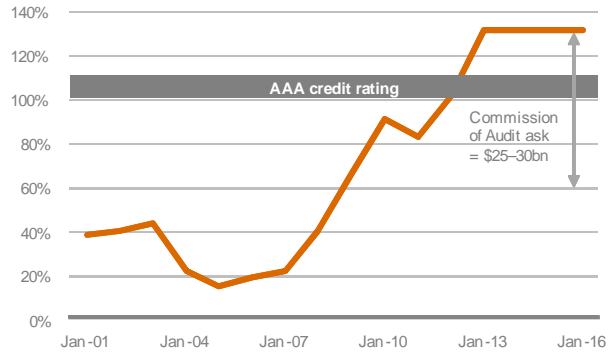
- 1 Recognise there is no 'silver bullet'
- 2 Focus on reducing costs and improving productivity as the number one priority, including reassessment of core business
- 3 Immediately explore options for optimising asset value, including efficiency gains, selling, ceasing, partnering and rationalisation
- 4 Seek a public mandate for targeted asset sales before the next election

¹ Queensland Commission of Audit Interim Report, June 2012

- 5 Stimulate the private sector, (also a responsibility of the Federal government).

These priorities are each explored in greater detail in the remainder of this document.

Figure 1: Reduction in existing debt levels



Source: Queensland Government Commission of Audit Interim Report

No silver bullet

Queensland Treasury's revenue projections for the short to medium term suggest a steady increase of 15 per cent from 2011/12 to 2015/16.² The Commission has raised concerns, however that some of the assumptions underlying these projections are optimistic. It further highlighted that these increases in revenue will not translate to an operating surplus until 2014/15.

While achieving the level of debt recommended by the Commission is feasible, it will require more than a single debt reduction strategy. A long term focus and discipline is needed from the Queensland Government.

Given the current economic climate and the Premier's commitment to reduce the cost of living, deep consideration and a strong case is required if taxes, royalties or levies are increased or new ones introduced. Expenditure reduction and asset sales are the most likely short term options to achieve improvement quickly.

Reduce costs, increase productivity and reassess core business

Effective spending reductions require bold and radical thinking. The first task for Government is to identify strategic areas of potential cost efficiencies and resist broad-brush, unstructured budget cuts. Approaches

² Queensland Commission of Audit Interim Report, June 2012

that are poorly thought through can lead to longer term pain of increased costs and risk of leaving agencies unable to deliver essential services.

The public sector workforce is a key resource and makes up a significant proportion of the Government's service delivery cost base. While reducing employee expenditure is a complex and often controversial approach to reducing spending, the Government must assess whether departments are making optimal use of their resources.

Government needs to be able to swiftly and efficiently allocate resources to areas of service need and place greater emphasis on productivity. This includes identifying areas where skills and capabilities do not meet the current and future need for services.

A response to this challenge could be reducing expenditure through innovative workforce planning, performance management and industrial arrangements.

Debt reduction in the UK

The UK Government has set a target to reduce spending by 19 per cent in real terms from 2011/12 to 2014/15.

Health and International Development are quarantined from this target.

The National Audit Office (UK) noted that "The scale of cost reduction means that departments need to look beyond short-term cost cutting measures and make major organisational changes".³

In 2010/11, the main reductions were:

- a decline in back-office spending of £1.5 billion.
- a further net fall of £4.8 billion in other expenditure within the departments' direct control.⁴

While significant cost savings can also be achieved through effective service delivery and a strong focus

on performance management, over time some services may become unnecessary or inefficient.

By regularly re-assessing its core business and defining service delivery priorities the Government will ensure it is responsive to community and industry needs. This process will also help it determine what services are lower value/higher cost.

Re-assessing service priorities would also provide the Government with the ability to determine which services are best delivered via the private sector, the not-for-profit sector or a combination of sectors.

Commercialised business units

An area with more complexity and worth exploring is the merit of the Government's commercialised business units. Not to be confused with commercial businesses in a corporate sense, these entities provide services internally to government, albeit in a managed commercial setting.

While the intent is that commercial business units employ commercial discipline, they are not subject to the full rigours of competitive market reality – or – regulatory oversight. Currently, these arrangements, coupled with their ownership structure within government departments, provide little incentive to truly behave commercially and provide optimum value to their 'clients'. That said, commercial business units can achieve objectives for government provided there is a commitment by the responsible agency to regularly re-assess the entity's relevance and efficiency.

This raises further questions regarding what efficiencies can be gained by opening up these types of services to the market. Contracting out commercial business units that provide internal services to Government to generate efficiencies should be considered.

Government owned corporations

Another area worthy of investigation is determining the efficiency and effectiveness of the Government's commercial assets (Government owned corporations). These organisations are generally established to provide services in a commercial setting. Compounding the need for efficiency, these entities operate in a heavily regulated environment with strict oversight by the shareholder.

A number of these organisations have wisely already commenced efficiency and effectiveness programs. For those entities that have not commenced these programs yet, it should be a matter of "when" rather than "if".

³ Cost Reduction in Central Government: Summary of Progress, 2012

⁴ *ibid*

The Newman Government's commitment to "no asset sales" for this term of Government provides an opportunity to take an active role as shareholder and work with the entities to understand and create efficiencies and potential value. This would help the Government better position the entities for greater efficiency and value for sale as well as contributing to keeping the cost to the public as low as possible.

Explore options for optimising assets

Governments often find themselves in the position of having to either fulfil a service or intervene to prevent a market failure. This generally can take the shape of a commercial asset. As circumstances and economies change, however, the question arises whether the government remains the most appropriate owner.

The heavily regulated environments under which government's commercial assets operate raises significant questions of ownership relevance. In many circumstances, government may be better able to secure the benefits of competition for the public and the economy in a regulator role than as the shareholder of an asset.

There is strong public interest and diverse views on the potential sale or rationalisation of government assets. In order for the Queensland Government to work effectively with the community it must engage openly, expansively and in a timely manner on all the options, including efficiency gains, selling, ceasing, partnering and rationalisation.

The Government should commence engaging the public on potential asset sales now with a view to securing a public mandate at its earliest opportunity either prior to, or at the next election.

Stimulate the private sector

Stimulating the private sector is essential for reducing state debt levels but requires cooperation of the State and Federal Governments to promote new business opportunities and reduce red tape. A result of this will be increased revenue streams without the needs to introduce new fees, charges or levies, or increasing existing ones.

Another opportunity for stimulating the private sector is through considering its role in providing essential infrastructure. Government can create value by securing private sector investment in new infrastructure where there is no compelling reason to suggest that the state is the best owner. Given the cost of debt, particularly in the current economic climate, the Government would also need to provide incentives and certainty to attract private sector interest.

Unlike economic infrastructure that has the potential to provide commercial returns, (e.g. tolls), stimulating attractive private sector investment for social infrastructure is a significant challenge for government. This would require a step change from the Government's traditional design and construct and managing contractor procurement models.



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