



**Leader of Opposition Business
Shadow Treasurer
Shadow Minister for Trade,
Energy and Water Supply,
Main Roads, Aboriginal and Torres
Strait Islander Partnerships,
Sport and Recreation**

www.curtispitt.com.au
www.facebook.com/curtis.pitt

AN ANALYSIS OF THE COSTELLO COMMISSION OF AUDIT'S JUNE 2012 INTERIM REPORT AND TREASURER'S JULY INTERIM RESPONSE

Before the March 2012 state election the LNP, led by Campbell Newman, promised to conduct an 'independent' Commission of Audit into the state's finances. This promise was in line with commitments made in the past few decades by conservative political parties at the federal levels and in other states.

All of these audits had one thing in common — they were politically motivated exercises designed to blame former Labor Party governments as an excuse for new governments breaking their election promises, cutting government jobs, and scaling back services.

The LNP's audit has been a blatantly political exercise, being headed by former federal treasurer and still-active Liberal Party identity, Peter Costello.

Unable to find a black hole, the report criticises the May 2012 Treasury Forward Estimates Update that confirms the accuracy of the budget position released by the previous Labor Government.

The audit and its findings would have carried more weight if its work had been left to the two other Audit panel members — Dr Doug McTaggart and Prof Sandra Harding. As it stands, in his interim report Mr Costello has delivered what the LNP wanted — a document based on flawed assumptions and reverse-engineered conclusions that it will use in its efforts to play the blame game for as long as it can.

The audit and all but one of its recommendations have been embraced fully by the LNP government. That means the audit and consequent job losses, cuts to frontline services, broken promises, and rises in taxes, fees and charges belong wholly and solely to the Newman Government.

It is their audit. Decisions flowing from it are owned entirely by the Newman Government.

From the time it was handed down on Friday 15 June 2012, Peter Costello's audit has become the financial strategy of the Newman Government and should always be seen as such.

The Treasurer's interim response to the Costello audit puts a sword to the LNP's promises to pay down debt and their claim of a mythical \$100 billion debt.

The LNP have now promised to commit to the same level of debt at \$85 billion as projected by Treasury in 2014-15 prior to the election. The response sets out that \$4 billion in savings are needed to prevent debt going higher after "policy decisions are implemented".

Electorate Office
T J Ryan Building
94-96 Norman St (PO Box 314)
Gordonvale Qld 4865
Ph. **07 4056 3175**
Fax. **07 4056 3340**
mulgrave@parliament.qld.gov.au

Before the election the Treasurer set out that the LNP's policy decisions would cost \$4 billion and be met by limiting public sector expenses through natural attrition - hiding job cuts before the election.

The interim response from the Treasurer provides further evidence that the LNP's \$4 billion in cuts are to pay for LNP promises and not to pay down debt.

The facts are that Labor left gross State debt at \$62 billion and that is the standard set for the LNP - not some dreamed up scenario from Peter Costello.

The LNP have refused the Opposition's request to be briefed by the Commissioners or the Chief Executive Officer of the Costello audit. The only briefing offered has been from the Treasurer underlining that this is a political exercise. I have enclosed the relevant correspondence in this analysis.

This analysis of the audit and interim response attempts to set out Mr Costello's key findings, the flawed assumptions on which they were based, as well as rebut his arguments designed to blame Labor and to give cover to the LNP's plans to break its election promises, justify sacking its own workers, and abdicate its responsibilities to maintain frontline services contrary to its stated commitments.

A handwritten signature in black ink, appearing to read 'Curtis Pitt'.

Curtis Pitt MP
Shadow Treasurer
Member for Mulgrave
23 July 2012

Executive Summary

Debt myth

The headline figure of a \$100 billion state debt by 2018-19 is a myth generated by the Costello audit by using flawed assumptions (see below). Since the audit's release LNP MPs have been misleading Queenslanders by quoting the figure as being the current state debt without saying how the Costello audit had to exaggerate assumptions to achieve the figure. The LNP has now committed to the same level of debt that was projected prior to the election of \$85 billion in 2014-15.

Budget surplus

The Costello audit confirms that the position of the previous government, outlined in the January 2012 Mid-Year Budget review, was correct including a return of the budget to surplus in 2014-15.

LNP's \$5.7 billion 'black hole'

The Costello audit identifies the LNP's inability to find \$5.7 billion in savings to fund its election commitments without resorting to "downsizing of the workforce". It said funding budgeted by the previous government for more Health, Education and Communities staff "would be inconsistent" with the LNP's election savings (pages 195, 197). The Premier has flagged job cuts to help fund the \$5.7 billion in savings despite he and the Treasurer saying before the election they had identified sufficient savings by natural attrition and no forced redundancies.

Flawed assumptions

The Costello audit makes a number of assertions to question Treasury's assumptions for both the Mid-Year Review and the May 2012 Forward Estimates Update under the LNP Government. They were:

- that any government elected at the March 2012 poll would do nothing to further address debt and outlays — that it would "take its hands off the wheel". That was never an option and Labor in Government had already committed to \$737 million in net savings in the Budget Mid-Year Review. Only by making this assumption can the audit come up with a projection for \$100 billion in gross debt at a point seven years in the future; and
- economic circumstances in the next five years should be considered as a repeat of the past five years — in other words, the next five years would see a repeat of the Global Financial Crisis (GFC) and a repeat of record drought and the summer of disastrous floods and cyclones that required heavy spending to repair communities across the state. The report assumes that economic growth and taxation revenue would not materially rise above rates of growth in the years after the GFC.

The Treasurer in his interim response to the audit has admitted that he has taken the unprecedented step of instructing Treasury to change their forecasts to reflect the Costello political narrative.

The Costello audit criticises Treasury's May 2012 transfer duty forecast of 14% per annum. Transfer duty increased by 25% a year from 2000-01 to 2005-06 (page 71).

These are criticisms, without corroborating evidence, of Treasury transfer duty forecasts that are well below growth prior to the GFC.

Infrastructure Spending

The Costello audit makes the claim that the forecast decline in infrastructure spending is unrealistic while at the same time detailing Treasury's advice of why there is a decline, including a ramp down in rebuilding from natural disasters (page 122).

The Treasurer's interim response then claims that there is a need to reduce the capital program at the 2012-13 Budget (page 3). This is more proof of the political bias of the Costello audit. Each cut of \$1 million in infrastructure spending will cost 6.7 jobs in the private sector according to Queensland Treasury (Source 2011-12 Budget Paper 3).

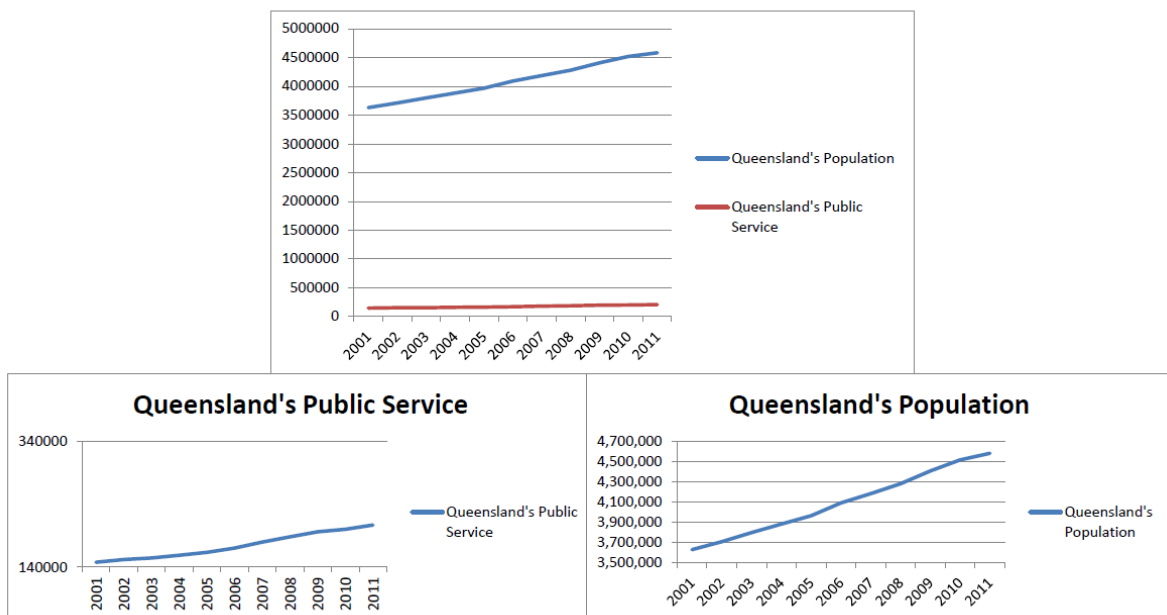
Size of the Public Service

The Premier has been using the Costello Audit to claim that the Government is borrowing to pay wages of 20,000 public servants. Nowhere is this substantiated as this is untrue.

Labor delivered 7 budget surpluses over the last 10 years including a surplus in 2009-10 prior to natural disasters (Source 2010-11 Report on State Finances). For the Premier's statements to be true it would mean previous Auditor-Generals (including Len Scanlan who signed off on the LNP's election promises), would be guilty of fraud.

Queensland's public service to population ratio was 4.5% equal to the other fast growing decentralised State of Western Australia and lower than South Australia and Tasmania. Queensland is the second largest State in Australia behind Western Australia and the most decentralised State with Melbourne located closer to Brisbane than Cairns. The Premier and Treasurer claim that Queensland should have a similar number of teachers, doctors, nurses and police to population as a much smaller centralised State like Victoria.

Figure 1 below shows the real growth of Queensland's public service relative to population with this separated out on a consistent basis.



Fiscal deficit

The Treasurer talks of a 'fiscal' deficit of \$10 billion in 2012-13. Not only — as the Costello audit mentions — is this overinflated by more than \$3 billion from natural disaster costs, but a 'fiscal' position (including net infrastructure spending), is not used by any other State Government, and if it were all Conservative Governments in Australia would be in 'deficit'. The Commonwealth uses a 'fiscal' position, but refers to net debt rather than gross debt. Queensland's net debt at the Mid-Year Review was \$24.92 billion. A fiscal operating position factors in the proceeds of asset sales and is a political means of justifying asset sales. The Treasurer's commitment in his interim response of a fiscal surplus in 2014-15 means that the LNP Government is expecting to receive asset sales proceeds in 2014-15 but won't reveal what will be sold.

Interest expenses

The report claims that interest expense is the fastest growing expense. This represents interest expense coming off a low base. Public interest expense has increased from 2% of expenses to 3% over the last decade, compared with social welfare, housing and other community services spending rising from 9% to 13% of expenses. The Premier left Brisbane City Council with interest expense growing fastest with debt growing over the two years to 2011 by 200% compared with the state's debt growing by 19% (Source Queensland Treasury Corporation Brisbane City Council Credit Review 2011).

Queensland Treasury Corporation have stated that *"the amount of money spent by Queensland on interest payments, when expressed as a share of revenue, is also low relative to its international peers, according to Standard & Poor's"* (Source QTC Investor Booklet June 2012).

Context

The LNP inherited an economy from Labor that was growing at 7.8% over the year to the March quarter the strongest year to March result since before the GFC, with the second highest investment pipeline in the nation, unemployment at 5.5% and a return to surplus projected for 2014-15.

The 7.8% figure for economic growth for Queensland in the Australian National Accounts for March Quarter was far ahead of the nation at 5% and NSW at 2.1% which has already undergone slash-and-burn public sector cuts (Source <http://www.oesr.qld.gov.au/products/briefs/national-accounts-state-details/index.php>).

Labor left Queensland with a 12% debt-to-GSP ratio for general government (used by the IMF to compare debt). Comparative figures are: Canada 85%, USA 107%, Italy 124%, Greece 153% (Source <http://www.imf.org/external/data.htm/>)

Labor left expenditure settings (3.85%) at lower than inflation-plus-population-growth (4.88%) over the next three years (Source Mid-Year Review page 18).

Queensland Treasury's Mid-Year Review in January 2012 had the budget tracking to surplus in 2014-15.

Despite Mr Costello's best efforts to present worst-case scenarios, the fact remains that the May 2012 Treasury update in the audit confirms the forecast of a surplus in 2014-15.

In other words, Labor's budget strategy — signed off by the same Treasury Department — was set to achieve the same outcome claimed by the LNP government — a budget surplus in 2014-15.

Labor's budget strategy increased infrastructure investment from \$1,241 per person in 1997-1998 to \$3,172 per person over the last financial year, maintaining the largest infrastructure spend per person on average of any state in the nation over the last decade while creating and saving jobs.

Since its election in March 2012 the LNP has embraced for publicity purposes several of the major infrastructure projects initiated and delivered under Labor's budget strategy — the same strategy the LNP criticises.

The logical conclusion is that the LNP would not have started those major projects that include many new or refurbished public hospitals.

Labor's strategy supported the creation of 740,000 jobs across the Queensland economy with over two-thirds being full-time jobs (Source ABS Labour Force).

Labor oversaw the largest fall in unemployment in the nation from a peak of 10% when the LNP was last in government down to 5.5% (Source ABS Labour Force).

Most importantly and singled out in the Commission of Audit Interim Report, Labor maintained a building program through the financial crisis that kept over 100,000 Queenslanders in jobs (Source 2008-09 Budget Paper 3; ABS Labour Force).

As quoted by the Costello audit (page 57) ratings agency Standard & Poor's at the time said:

"The state's capital program is substantial. Given the significant decline in operating revenue as a result of a weakening economic environment and the state's commitment to its large capital program, Queensland's balance sheet is unlikely to remain consistent with a 'AAA' rating."

Labor in government avoided the same mistakes as the last LNP government which cut infrastructure investment during an economic downturn and let unemployment hit 10 per cent across the State in 1997 — levels similar to those reached in the United States during the global financial crisis.

Public sector job cuts and infrastructure cuts are now threatening the economic recovery in the US (Source <http://www.guardian.co.uk/business/2012/may/31/public-sector-cuts-us-economy>).

Flawed assumptions

It is clear from the audit report that Mr Costello was unable to find a “black hole” in the state finances and blame it on the former government.

Instead he took the path of basing his assessments on flawed assumptions that would deliver him a ‘headline’ figure for state debt to be used by the LNP government for political purposes.

The key flawed assumptions were:

- that any government elected at the March 2012 poll would do nothing to further address debt and outlays — that it would “take its hands off the wheel”. That was never an option and Labor in government had a plan in place rejected by the LNP to improve the Budget position.
- economic circumstances in the next five years should be considered as a repeat of the past five years — in other words, the next five years would see a repeat of the global financial crisis and a repeat of record drought and a summer of disastrous sequence of floods and cyclones that required heavy spending to repair communities across the state.

The Costello audit then proceeds to attack the Treasury May forward estimates update (which is performed each year to prepare for the State Budget). This update occurred under the current Treasurer and the Premier and affirmed that the figures in the Mid-Year Review were correct and that there had been some minor developments since this time (detailed on pages 34-35). This is evidence of the political nature of the Commission of Audit.

The Treasurer has now taken the unprecedented step of asking Treasury to change their forecasts to reflect the Costello political narrative.

Labor in office would have continued taking measures to reduce debt and expenditure.

For example at the time of its last Mid-Year Review Labor locked in \$737 million in net savings, that is savings after new spending.

Labor also took steps to reduce public service expenses, but through voluntary redundancy packages (mentioned as being successful in the Costello Audit), not the sackings planned by the LNP.

Before the election the LNP opposed all the measures Labor took to restore the Budget position over the last term of government.

Selective quoting

The Costello audit selectively quoted (page 30) a 2011 report by ratings agency Standard & Poor’s where it said:

“Queensland’s budgetary performance is the weakest of all the Australian States.”

What the Costello audit failed to mention was this quote from S&P in the same report:

“We consider limited budgetary flexibility as a credit weakness of all Australian states, including Queensland.”

This was because most of the tax and revenue options rest with the Commonwealth, not the states and territories.

The same S&P report continued:

"Queensland's financial management is excellent, in our view."

It continued:

"An upgrade in the medium-to-long term is possible once the structural improvements introduced by the Queensland government begin to be reflected in the state's budgetary performance and debt burden..."

..... much of Queensland's capital expenditure is due to generational rebuilds, the state's rising population or is a result of the 2011 natural disasters ..."

Hard-hit by natural disasters over the past year, the Australian state of Queensland remains a strongly rated government entity on a globally comparable basis."

The title of the S&P research update was: *Ratings on State of Queensland affirmed on strong financial management — outlook stable.*

The report confirmed that Labor had placed the State on the path to a AAA rating which had been delayed by the summer of natural disasters. When Standard & Poors downgraded the Brisbane City Council's credit rating to lower than Queensland in 2007 Campbell Newman as Lord Mayor sacked them.

State debt

Labor left office with a gross debt across the entire government of \$62 billion as detailed in the January 2012 Treasury Mid-Year Review. That included \$30.2 billion held by government-owned corporations much of which is self-sustaining through future profits, eg: port authorities would receive revenue from resources companies (not taxpayers) to help pay down debt.

Gross or total debt when Labor left office was \$13,480 per person (including self-supporting debt held by GOCs), compared with assets of \$59,783 per person.

Equally, it has to be acknowledged that Labor provided more than \$54 billion in infrastructure over the last four years including once-in-a-generation projects such as hospital upgrades and major roads projects including the Gateway Bridge duplication.

Labor left Queensland's balance sheet with a net worth (or the value to which assets exceed debt) of \$171.28 billion growing to \$178.2 billion in 2014-15.

That represents a net worth, or assets exceeding liabilities, per Queenslander of \$37,235 and on track to increase to \$38,738 over the next three years.

Nothing in the Costello audit disputes these figures.

The LNP's 'black hole'

One of the key revelations in the Costello audit is the explicit link between the LNP's unfunded election commitments and sackings of government workers.

Despite knowing the true financial position of the state, the LNP drafted a set of election costings that proposed a series of expenditure and revenue cuts worth \$4 billion on the LNP's own calculations.

Labor announced election promises totaling \$1.8 billion with \$745 million of this funded from existing initiatives.

The Costello audit (page 37) identified job cuts as the major source of the \$5.7 billion in savings to fund the LNP's election commitments.

"In general terms, the election commitments comprised a range of expenditure increases and revenue reductions, largely funded by restricting the growth in employee expenses to 3% per annum from 2012-13 to 2015-16."

The LNP is yet to release any costings by Treasury of its election promises.

This is despite both the Premier and Treasurer saying before the election that they had already identified the necessary savings.

With the economic recovery underway, and as Queensland gathers strength, it is the LNP that is the biggest financial risk to the state economy by proposing to cut public and private sector jobs to fund their promises.

State taxes

Labor maintained the lowest transfer duty of all mainland states, the highest threshold for payroll tax and the lowest rate, as well as the lowest rate of duty on general insurance in the nation – taxation \$440 below the national average.

These figures were backed up by the Costello audit which stated (page 33) that Queensland under Labor was *"a low taxing state"*.

The Costello audit itself also refuted (page 56) claims by the LNP that Labor "went bust in a boom" and "squandered rivers of gold" by stating that revenue growth from property and mining was offset by weakness in other taxes and GST.

Growth in the public service

When it comes to the growth of the public service, the Costello audit said Labor had been providing more frontline staff including teachers, nurses, doctors and police.

To quote the report (page 8):

"On a fulltime equivalent (FTE) basis, public service numbers have increased by 40% since June 2000. Almost half of this increase (28,633) was in health, with the next largest contributor being (13,889) education."

The Premier has said there is a need for a more sustainable public service. However, the report details (page 104) that:

"As a proportion of the population, the Queensland public sector (4.5%) is similar to Western Australia (4.5%)."

The report said that Labor was successfully managing the number of non-frontline positions (page 104):

"The voluntary separation program... will have primarily reduced the 'rest of the public service' category, as the program excluded front-line services, and was focussed primarily on back-office administration and support functions."

Through its management of the public sector Labor in government delivered:

- 11,151 new teacher and teacher aides
- 3,850 extra police — an increase 57% higher than population growth
- 14,300 additional nurses
- and in the last four years of government, 5,000 extra doctors nurses and allied health professionals.

Government negativity

It is unfortunate that Premier Newman and Treasurer Tim Nicholls will use the audit to continue spreading negativity about the Queensland economy.

The Premier in particular keeps talking about the state economy being on “a power dive into the abyss”.

The State’s Borrowing entity the Queensland Treasury Corporation meanwhile has been describing recent investor interest in Queensland’s debt as a flock to safety with the cost of borrowing on international markets the lowest in years.

While the LNP is continuing to talk down our state’s economy, Labor has tremendous confidence in Queensland’s future.

But we need a government that will not sacrifice sensible economic and financial management for short-term political point-scoring.

The current political campaign by the LNP to apportion blame for state debt does nothing but trash Queensland’s economy and talk down investor confidence.

The debate should be about how we continue to manage our investment in much-needed social infrastructure into the future and how we continue to fund it as a Federation.

The Premier’s and Treasurer’s efforts to talk down the economy should stop if business confidence is to be maintained.

On his first overseas trade mission in July the Treasurer is no doubt giving a totally different — and more realistic — picture to potential overseas investors.

Labor’s achievements 1998 - 2012

The budget strategies of Labor governments from June 1998 to February 2012:

- invested in necessary infrastructure
- expanded essential services
- lowered the unemployment rate by more than any other State or Territory
- cushioned the impact of the global financial crisis while creating new jobs or securing existing jobs
- supported the rural sector through historic drought, and
- rebuilt communities and jobs following an unprecedented and costly sequence of natural disasters.

That was achieved without the need for forced redundancies or cutbacks to frontline jobs and services.

Labor delivered jobs for Queenslanders and built the modern diversified economy and infrastructure we all enjoy today.

The Costello audit highlighted (page 102) Labor's investment in the following:

- introducing a Prep Year into schooling
- significantly increasing child safety and funding for disability services
- increasing hospital bed numbers
- substantially increasing wages and conditions for doctors, nurses and clinical staff
- and increasing public transport and infrastructure services

At page 9 it further outlines:

- the South East Queensland Infrastructure Plan
- the upgrade of the electricity distribution network, following the recommendations of the Somerville Review
- the upgrade of the water infrastructure network
- the "more beds for Queensland" hospital rebuilding and expansion program.

The Costello audit report itself mentions that spending on health:

"has more than tripled in the 10 years to 2010-11" (page 99).

It also said:

"...expenditure in housing and communities almost doubled between 2005-06 and 2010-11, more than double the growth rate of the previous five years..."

These were all investments in essential social services and infrastructure that presumably the LNP would not have made.