

Sustaining Growth

Reforms for
Tasmanian Prosperity

Sinclair Davidson
Julie Novak



December 2008

TCCI FOREWORD

For many people in our community, Tasmania is the greatest place on earth to live and raise a family. Our people share a rich heritage of pride and self reliance. In Tasmania hard work and effort are rewarded. This is complemented by our sense of compassion, where those who fall on tough times are always given a hand up.

Yet our institutions and our economy do not always reflect the culture and ambitions of our community. Despite over 75 reports into the Tasmanian economy and unprecedented prosperity, our economy is still unable to fulfill the aspirations its citizens hold dear. This is most evident when thousands of our best and brightest young people leave the State every year in search of opportunities they have concluded are not present in their local community. In a 1926 report, Lockyer found that “there was substantial out migration of people of prime working age because of limited employment opportunities.” It is the unfortunate fact that this finding still largely rings true some 80 years later.

The Tasmanian Chamber of Commerce and Industry (TCCI) is Tasmania’s peak employer body and represents around 2 500 businesses employing over 75 000 Tasmanians. The TCCI is determined to play its part in building a sustainable and prosperous society. A place where there are more people coming than going and a place where anyone with the right attitude can make their ambition a reality.

The TCCI commissioned this review of taxation and expenditure to inform its objective of building an environmentally, socially and economically sustainable Tasmania. This report forms part of the Chamber’s new policy engagement and commitment to evidence-based policy. We will not be swayed in our objectives, but we will listen to informed debate and opinion and engage with all the stakeholders to find the best path to help us get to where we need to be.

Professor Sinclair Davidson and Julie Novak have produced a report which provides a scholarly, and at times damning, assessment of the economic and social status of Tasmania. On a positive note, they see great potential for the State and have provided us with some ideas and recommendations to turn potential into reality.

Our natural competitive advantages mean there are some things we can do better than anywhere else in the world. These advantages will become more apparent as the world transitions to a carbon constrained economy. Our institutions and our leadership need to act in a manner that is consistent with capitalising on these opportunities.

Tasmania’s demographics alone mean that we simply cannot afford to continue with the status quo. We are a rapidly ageing community and within a few years there will be more people leaving the Tasmanian workforce than entering it.

It is pleasing to see that the demographic challenges we face are being confronted in an inclusive and transparent manner. The Demographic Change Advisory Council has provided the community with a substantial body of research to help inform the debate.

The next step is to convert this debate into action, because a do-nothing approach is not an affordable option and would lead Tasmania down a path of poverty.

With this in mind we need to construct our policy settings toward sustainable growth. While taxation is a particular focus of this report, the issue needs to be considered as only one factor that contributes to our overall relative competitiveness. Typically we benchmark our tax competitiveness with other jurisdictions and look to achieve a tax burden lower than the national average. However, this ignores the reality that taxation is only one input into overall business and economic competitiveness.

Tasmania has inherent disadvantages in terms of geography, demography, labour force and productivity. Given these factors we need to ask the question is it good enough to maintain a tax system which is only marginally more competitive than the national average?

Similarly, is it good enough to have an education system or a health system that on good days performs on a par with national benchmarks? Or is it good enough for Tasmanians to be invested in government-owned businesses that do not perform at commercially acceptable rates of return?

This report provides much material to assist the debate, however it does not seek to answer these questions - that task is for the Tasmanian community. Through its series of policy papers and community events, the TCCI seeks to be an active participant and facilitator of this discussion.

This report was drafted during the greatest global economic crisis since the Great Depression. One harsh lesson from the crisis is the value of financial independence and the need to live within one's means.

Tasmania relies more heavily on Commonwealth transfers than any other State. Own source revenue only contributes around one third of the State Budget, the residual made up of Goods and Services Tax (GST) allocations and specific purpose transfer payments. This means that our fiscal health is subject to the performance of our mainland counterparts. Through no fault of our own, we suffer severe consequences when other jurisdictions mismanage their finances and economies. When the New South Wales economy goes into recession the consequence is diminished revenues to our State Government.

Consistent with the TCCI's objective of sustainability, we have a long term goal for the Tasmanian economy to achieve fiscal independence. This can only be done responsibly by growing our domestic economy in concurrence with reforms to fiscal federalism that move to correct the vertical fiscal imbalance between the Commonwealth and the States. The Chamber specifically rejects any suggestion that the State tax burden be increased or that Tasmania's current circumstances not be factored into the Commonwealth Grants Commission GST allocations.

Professor Davidson commences his report with an analysis of the Tasmanian economy, an economy that has achieved significant growth over the past decade. This growth has improved business and employment opportunities along with higher living

standards. Yet on any measure, Tasmania is still the poorest State in the Commonwealth. We are heavily reliant on social security payments, which allow for only the most basic quality of life. This is why we must continue the quest for further economic growth on an equitable basis.

Despite strong gains in recent years, the State has consistently recorded lower productivity levels than mainland Australia. As the key determinant of long run living standards, productivity must be a centre of our economic strategy.

Consistent with improvement in our economic circumstances, Tasmania's fiscal situation has improved markedly over the past decade. A strong budget position is important for business and investor confidence. The current State Government can rightly be proud of delivering budget surpluses and putting our finances in a no net debt position.

However, the report also draws attention to Tasmania's large and growing unfunded superannuation liability. This must be recognised as a debt and an ongoing fiscal challenge. The Tasmanian Government should meet its full employment costs like every other employer. The business community would be critical of any government that adopted a policy of further delaying extinguishment of this debt.

The Government also owns a large and varied portfolio of businesses on behalf of the community. Professor Davidson finds that many of these businesses are not performing to an acceptable level. This is reason for concern, as it threatens the State's fiscal position. The community should expect that assets owned on its behalf be well managed and efficiently operated. The TCCI strongly endorses the recommendation that corporate administrators be appointed to examine those companies which are underperforming and provide advice on how best to realise the full value of these assets.

The third chapter of the report outlines the principles of a good tax system and then compares them to the situation in Tasmania. The State's taxation system is broadly similar to the mainland States, although as Professor Davidson notes there are some specific areas of the system that are uncompetitive and can deter investment. The report confirms the business community's long standing view that taxation revenue in Tasmania is raised on from very narrow base.

The analysis on the expenditure side of the equation prompts important questions about the optimal scope and scale of government in Tasmania. There is concern that the Government may have over extended the scope of its activities with negative implications for the delivery of core services. The superior delivery of quality services in health and education has the potential to be a competitive advantage for Tasmania. It presents an opportunity to attract newcomers to the island, particularly those with young children or looking to start a family. However, this requires that the Government use its limited resources in the most efficient manner possible. Despite some gains, there is still substantial room for improvement on this measure.

The report observes the significant growth of the bureaucracy in recent years. Tasmania proportionately spends more money on public sector employee expenses than any other jurisdiction. The TCCI has a vision for a small, flexible, highly skilled

public sector with the knowledge and capacity to work cooperatively and engage with the business and non-government sectors. This vision requires that public servants be properly remunerated. Our concern is not so much the level of remuneration but the sheer size and scale of the bureaucracy. With the availability of skilled labour representing the biggest constraint on business growth in Tasmania, there is a need to consider whether public sector labour resources could be better employed in the productive private sector to grow the economy.

The final chapter of the report is titled ‘Challenging the Assumptions: Proposals for Radical Reform.’ This is because a radical departure from current policy settings is required if Tasmania is to continue its journey on the road to prosperity. Even on the most optimistic demographic projections the State will face significant challenges with an older and declining share of the nation’s population.

Radical policies do not mean reckless and risky decisions. In the Tasmanian context it can simply mean moving away from long standing policies that have not delivered the best outcomes for the Tasmanian community. An example of this is maintaining an education system distinctly different from other higher performing States - one that forces our children to enrol in a new institution if they want to continue education past year 10.

The TCCI does not necessarily agree with every policy proposal in the report but believes Professor Davidson has provided useful material to initiate the debate. While agreeing with the principal of reducing fiscal dependence, the TCCI does not agree with the proposal for a State-based income tax. We do not favour taxation of inputs to production or of commercial transactions by way of duties. While there may be constitutional difficulties at the State level, our strong preference is for levying tax on consumption rather than production.

The proposal for a ‘Royalties for Forest Scheme’ has merit and deserves further investigation. The carbon storing capacity of trees is now well established in science. Tasmania has the highest proportion of forest areas in the nation and is providing an environmental benefit to the rest of country. This benefit has an economic value and Tasmania should be compensated accordingly. With the inevitable transition toward a low carbon economy, Tasmania must not be constrained from exploiting its natural competitive advantages for the benefit of the planet.

The twenty-first century promises to be one of enormous change and development. As a regional economy with many natural advantages the times should suit Tasmania. The world will place a higher value on the things we can do best. With our vast water and forest reserves, fresh air and clean energy the opportunities extend beyond the imaginable. However, just as the progress we have made over the past decade did not occur by accident, we will need to make intelligent long term decisions to realise our full potential.

The TCCI has a vision of Tasmania as a thriving regional economy providing high quality goods and services to an increasingly urbanised and demanding global populace. Complacency is the greatest enemy to realising this aspiration. We must be smarter and more entrepreneurial than our competitors. Every Tasmanian needs to be fully equipped to meet the challenges of the new century.

Professor Sinclair Davidson and Ms Julie Novak have provided us with much food for thought. Let us embrace their report in the good spirit for which it is intended.

A handwritten signature in blue ink, appearing to be 'AS', with a long horizontal flourish extending to the right.

Andrew Scobie
TCCI Chairman

Chapter Four

Expenditure

Highlights

- Tasmania spends most of its budget on Education and Health.
- Most spending is on merit goods and not public goods.
- The Tasmanian taxpayer effectively pays for the core public goods only.
- The number of bureaucrats in Tasmania has increased over time.
- Tasmanian government employee expenses are the highest for all states as a percentage of GSP.
- It is not clear the Tasmanian community is getting value for money in expenditure terms.

Recommendations

- The Tasmanian government needs to develop a clear view as to the role it will play in society.
- The Tasmanian government needs to consider exiting some areas of current activity.
- The Tasmanian government needs to undertake actions that will grow the Tasmanian economy to create opportunities to move individuals from the public sector to the private sector.
- The Tasmanian government needs to initiate broad ranging public debate as to these matters.

As Nobel Laureate James M. Buchanan has indicated, 'Most of us, save for a few anarchists, recognize the need for the state to exist and also recognize that there are goods and services which can be best provided by the government'.¹ The difficulty economists have in the area of public expenditure is identifying which goods and services are best provided by government. As we show in this chapter, government provides more goods and services, and a greater variety of goods and services, than can be justified by economic theory.

This chapter first sets out the principles of public expenditure and then compares how well Tasmania performs against those principles. The chapter also considers whether

Tasmanians get value for money from the public expenditure undertaken, especially in the areas of Health and Education.

A Theory of Public Expenditure

The standard public finance economic literature suggests that government should provide public goods, merit goods, and correct for market failure.² This literature is countered by the public choice literature that suggests that government itself is subject to various failures that undermine the benefits of public intervention in the economy.³

Goods and services can be categorised according to two characteristics; excludability and rivalry. Excludability relates to the ability of person x preventing person y from consuming a good or service. Rivalry relates to person x's consumption reducing person y's ability to consume the same good or service. Figure 4.1 shows Rivalry and Excludability in a two-by-two matrix. The combinations of either of the two characteristics determine the nature of each type of good or service. Whether a product is rival or non-rival is largely a function of the characteristics of the product and, to a lesser extent, technology. Excludability will depend on property rights and technology.

Figure 4.1: Product Characteristics

		Rival		
Non-Excludable		Congestion Good	Private Good	Excludable
		Public Good	Club Good	
		Non-Rival		

Each of the four quadrants in the figure shows different combinations of rivalry and excludability. Some economists describe all the goods and services characterised by the quadrants other than that containing private goods as exhibiting a 'market failure'. This approach can be misleading. For example, consider congestion goods; here consumption of the good is rival but non-excludable. An example of such a good might be a busy road. The fact that the owner of the road does not levy a toll cannot be described as being a 'market failure'. Public goods are both non-rival and non-excludable, while pure private goods are rival and excludable. There are very few goods and services that can be described as being pure public goods. National security is one such good, but it is difficult to imagine many other goods and services that meet the criteria of public good.

The notion of 'merit good' was developed to explain the difficulty that there are many goods and services that are provided by government that are not public goods per se. Merit goods are all those goods and services that the 'community' believes should be provided on some communal basis and not provided strictly by the market. In practice, merit goods encompass all four quadrants in figure one and very often are

conflated with so-called market failure. The difficulty with merit goods, however, is that there is no generally accepted underlying theory that describes when a government may choose to provide a good or service and when it does not.

In short, while government plays a huge role in modern economies, economists have few well-defined principles to determine what goods and services government will provide to the market. Some goods that are provided will be pure public goods; other merit goods may be provided to overcome so-called market failure, or to achieve 'social justice' aims, or for vote-buying activity.

Adam Smith, again, set out important principles for government expenditure. In the first instance he spoke of the need for national security and then the administration of justice. He then set out the type of activity the government should fund as follows: '... though they may be in the highest degree advantageous to a great society, [they] are, however, of such a nature, that the profit could never repay the expense to any individual or small number of individuals'.⁴ It is easy to misinterpret this quote. Smith is not saying government should fund any and every loss-making project in society. Publicly funded activities must be 'advantageous to a great society', yet be unprofitable to the private sector. Smith provides two examples of this type of good: in modern terms they are infrastructure and public education – but not just schooling. Smith suggests that public expenditure should strictly occur for goods and services that have public good characteristics. Public education broadly defined, however, is now recognised as being a 'club good'.

It is possible to operationalise Smith's argument in a matrix. Figure 4.2 sets out private and public returns, and also shows the costs of private and public funds.⁵ Returns are defined as both financial and non-financial benefits that flow from undertaking a particular expenditure. Any private project with an expected return greater than the cost of private funds will be undertaken and financed by the private sector. Similarly, any public project with an expected return greater than the cost of public funds will be undertaken and financed by the public sector. Those projects with expected returns less than the private cost of funds and less than the public cost of funds should not be funded. In order for the public sector to finance a particular project, given Adam Smith's criteria, two conditions must be met. First, the project must not provide a private return in excess of the cost of private funds, and second; the project must provide a return greater than the cost of public funds.

Figure 4.2: Private and Public Spending Matrix

Private Returns	Cost of Private Funds	Private Funding	Private Funding
		Nobody should Fund	Public Funding
		Cost of Public Funds	

Public Return

Source: Adapted from Brown (1998, pg. 45).

There are, at least, two components to the cost of public funds. First, we must consider the cost of those funds if the project were undertaken by the private sector. Second, we must consider the ‘deadweight cost’ of taxation. In other words, the cost of public funds is equal to the cost of private funds (for a project of similar risk and duration) *plus* the deadweight cost of taxation.

The notion that government funding is ‘cheaper’ than private sector funding is simply wrong. The argument is often made that government can borrow at cheaper rates than the private sector can either borrow, or provide equity finance. At face value, this is correct. Governments, however, have to repay their loans, usually by levying taxes in future. Borrowing simply postpones the deadweight costs of taxation into the future. The opportunity cost of funds is a function of the project being financed and is invariant to the identity of the project originator.

Well-known techniques can be employed to establish the cost of private funds – indeed, second-year undergraduates are taught these techniques. To establish the costs of public funds, we need to gross-up the private costs for any given public project by the deadweight cost of taxation.

Alex Robson surveys the literature on the estimated deadweight costs of taxation.⁶ Estimates in the US for the deadweight loss on personal income tax are as high as 200 percent! Similar estimates for Australia are in the order of 19 to 65 percent. That means that the public cost of finance is equal to the private cost grossed up by a factor of between 1.19 and 1.65. For example, if the private cost for a particular project were 20 percent, the public cost would be between 23.8 percent and 33 percent.

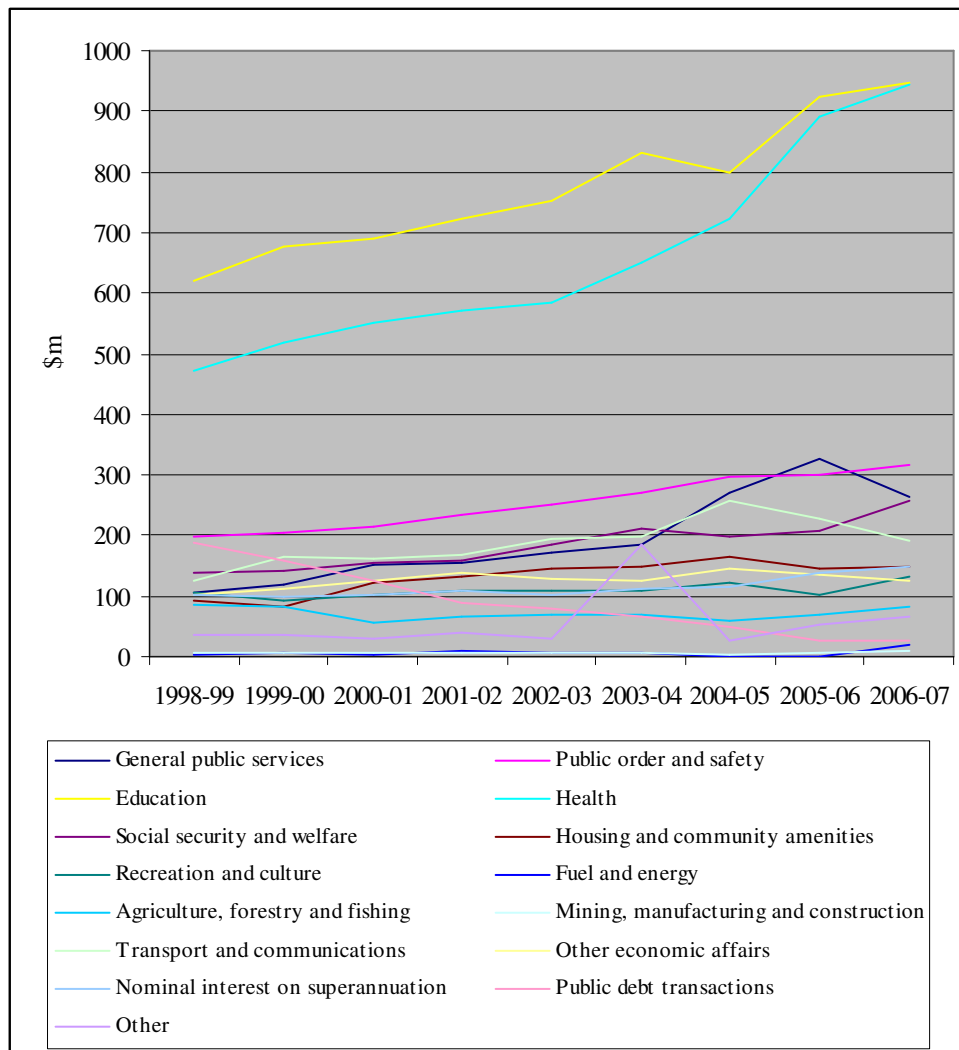
In the context of States and Territories, however, it is less clear what the deadweight costs of state taxation are. In a 1998 Staff Research Paper, the Productivity Commission estimated that the deadweight costs of payroll taxation were between 3 percent and 12 percent, while a more recent analysis undertaken at the Centre of Policy Analysis at Monash University found that the deadweight costs were about 10 percent of payroll collections in Victoria.⁷

Current theory also predicts that government expenditure is likely to grow over time. Wagner’s Law, for example, suggests that the demand for merit goods increases as income increases, while the Baumol effect indicates that government services will increase in price as they are highly labour intensive. Both of these concepts are disputed in the literature – nonetheless it is quite clear that government function and size has increased over the past century. As we document below, the size of the Tasmanian bureaucracy has also increased over the past decade.

Tasmanian Budget Expenditure

The Tasmanian government spends most of its budget in the areas of Health and Education. Figure 4.3 shows the dollar amounts of expenditure over the period 1998 – 99 to 2006 – 07. Health in particular has seen a dramatic increase in expenditure since 2002 – 03.

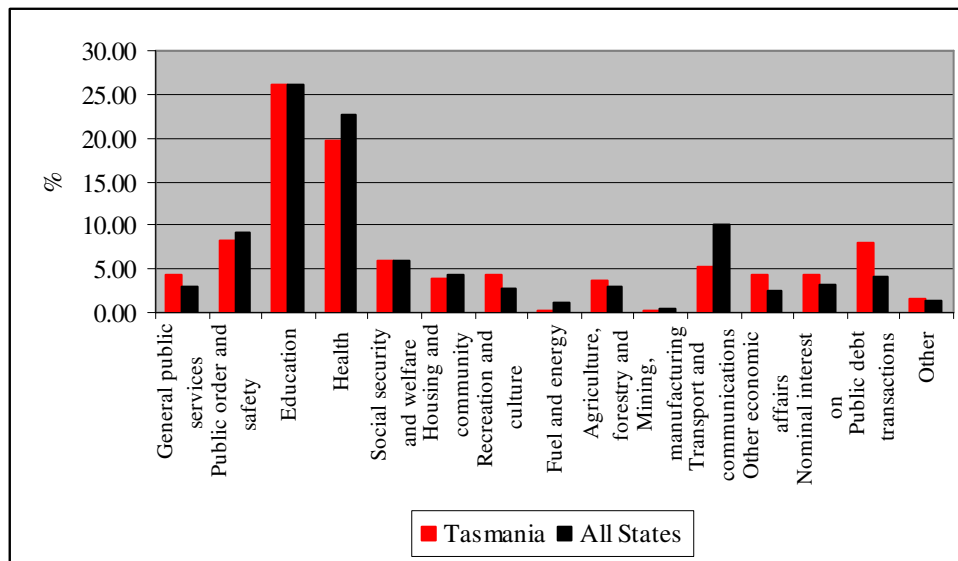
Figure 4.3: Tasmanian Government Spending



Source: ABS Cat. 5512.0

A comparison between Tasmanian expenditure and the other States and Territories shows little difference. Overall, the Tasmanian government spend money in much the same way as do the other States and they spend money on much the same sort of mix of goods and services. There are some minor differences, for example Tasmania spends more on average on Recreation and Culture than do the other States and a bit less on Health.

Figure 4.4: Comparison between Tasmania and All States



Source: ABS Cat. 5512.0

Just as we calculated Herfindahl indices to establish how many equally sized revenue sources each State has so too we calculate how many equally sized expenditure items each State had. Previously we saw that Tasmania had fewer sources of revenue. Tasmania has 6.29 equally sized items of expenditure while all Australian States and Territories had 6.16 equally sized items – confirming that Tasmanian State expenditure is little different from the other States and Territories.

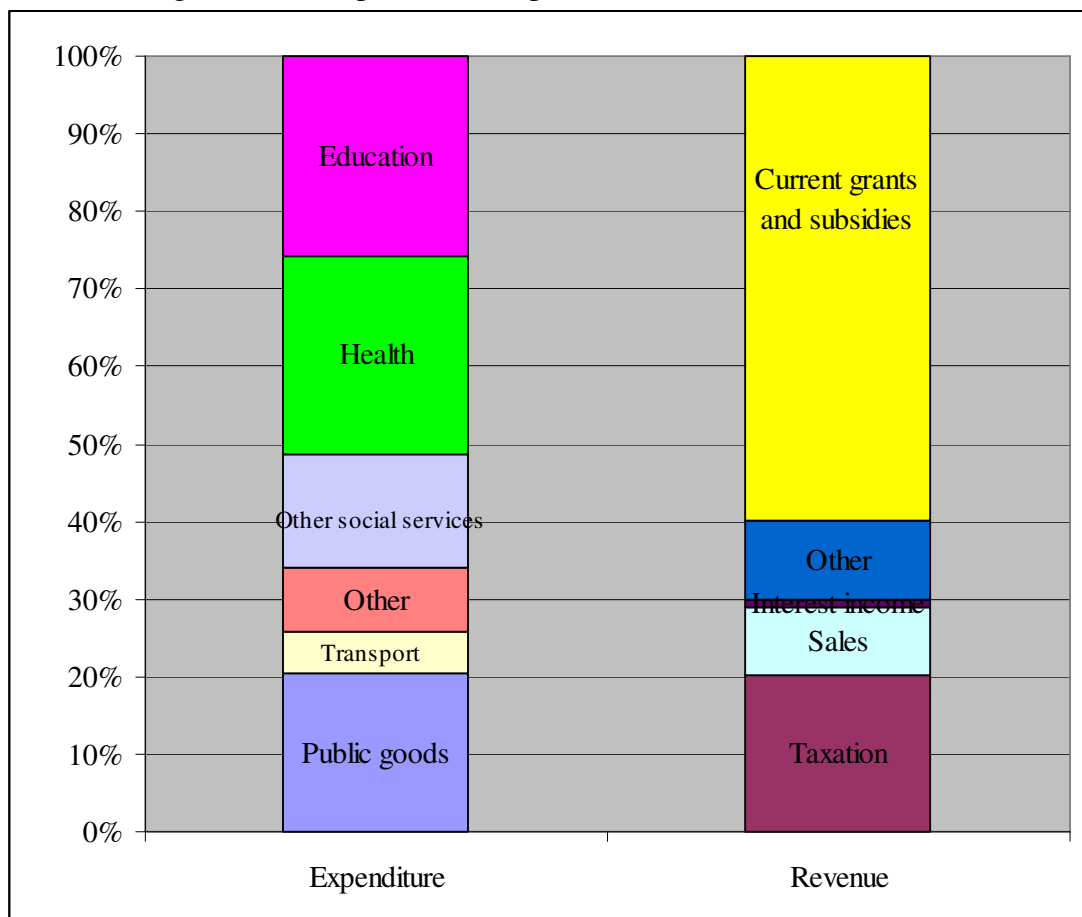
The Expenditure Challenges

Tasmania faces two important challenges. First the Tasmanian State government is living beyond its means. Second, there are some very fragile assumptions that underpin the type of analysis shown above. Tasmania does not have enough own-tax revenue and it is not clear Tasmanians are getting value of money for the own-tax revenue they do have.

When we break up Tasmanian government expenditure into public goods and merit goods, we see that Tasmanian government own-tax revenue barely covers the public good expenditure. We have defined ‘public good’ generously to include ‘General Public Services’, ‘Public Order and Safety’, ‘Public Debt Transactions’ and ‘Nominal Interest on Superannuation’. In 2006 – 07 these items cost \$756 million and the State government raised \$748 million in own taxation. The Tasmanian taxpayer pays for just Tasmanian public goods. All the merit goods provided to Tasmanians are paid for by somebody else. The \$2.9 billion is raised from the sale of goods and services (consumers and tourists to Tasmania), interest and dividends received, and Commonwealth grants. To be sure, the bulk of Commonwealth grants are Tasmania’s share of the GST revenue – nonetheless that income is not a State tax, it is a Commonwealth tax. This illustrates the extent of fiscal dependence afflicting the State.

Figure 4.5 makes this point diagrammatically. The two largest expenditure items are Health (\$944m) and Education (\$948m) with the largest revenue source being Commonwealth Grants (\$2.2 bn).

Figure 4.5: Comparison of Expenditure to Revenue (2006 – 07)



Source: ABS Cat. 5512.0

To place this result in stark terms, the Tasmanian taxpayer effectively makes no contribution to the State health system, or to their education system. The figure is somewhat different for all States and Territories where own – tax revenue covers public goods and some merit goods. Most importantly grants and subsidies from the Commonwealth do not cover all of Health and Education expenditure in the other States and Territories.

There are two very important assumptions that underpin this type of expenditure analysis. These assumptions are that public expenditure can be considered to be an output, and that public service quality across the States and Territories are equal. Both these assumptions are – at best – fragile. So simply looking at the expenditure choices reveals that the Tasmanian government is making the same expenditure choices as are all the other Australian State and Territory governments. Yet that hardly provides any guidance as to the quality of public services that Tasmanians actually receive from their government. There can be substantial quality differences across the States and Territories. For example, the latest Productivity Commission Report of Government Services shows that 88.6 percent of Tasmanian year 7 students achieved the appropriate reading benchmark (in 2002 – the latest data available)

compared to 91.1 percent in the ACT and 74.9 percent in the Northern Territory (with an overall Australian average of 89.1 percent).⁸

Bureaucracy

The size and growth of the bureaucracy servicing the Tasmanian State Government has long been a source of public discussion. Unfortunately, much public discussion of bureaucracy is inherently negative and pejorative. Bureaucrats and bureaucracy are important for a functioning viable system of government. To make our position entirely clear; a competent and professional bureaucracy is a vital component of good government. That position, however, does not preclude an understanding that bureaucracy can, and often does, grow beyond its usefulness.

A bureaucrat is an employee of a bureaucracy, a non - profit organisation which is financed by appropriations from government.⁹ There are a limited set of instances where the application of government bureaucracy is appropriate. Since bureaucratic activities do not have a cash value on the market, it is not possible for government entities to attain profits as would private businesses. Consequently, bureaucratic control ought to apply to the provision of pure public goods.

The economist Ludwig von Mises explains the distinction between bureaucratic and profit managements by way of a simple example:¹⁰

A police department cannot be operated according to the methods resorted to in the conduct of a gainful enterprise. A bakery serves a definite number of people –its customers – in selling them piecemeal what it has produced; it is the patronage of its customers that provides the social legitimacy – the profitability – of the bakery’s business. A police department cannot sell its ‘products’; its achievements, however valuable, even indispensable as they may be, have no price on the market and therefore cannot be contrasted with the total expenditure made in the endeavours to bring them about.

As a bureaucracy cannot operate on the basis of competitive market prices and the profit – and - loss metric, it must instead rely on clear and consistent rules of service delivery fixed by government. These rules are, in turn, underpinned by two fundamental principles of western governance – the primacy of the rule of law, and budgetary accountabilities to taxpayers through the parliament.

Government would tend to be small and circumspect when its bureaucracies deliver the limited suite of public goods in accordance with the strict rules and regulations accorded to them. Significant problems, however, arise when government activities, and hence bureaucratic management, expands beyond public goods into the provision of merit goods. In particular, private sector activities would tend to be crowded out, with stifling rules and regulations imposed on those businesses that remain. Furthermore, the presence of large bureaucracies in economic life would tend to interfere with the free prices formed by the competitive interaction of supply and demand.

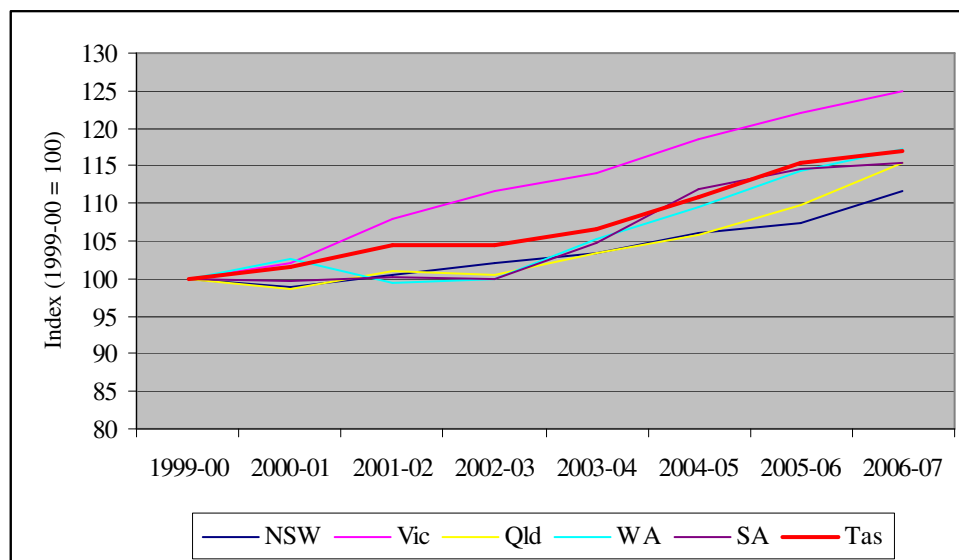
The American economist Gordon Tullock defined the situation where government bureaucracy grows outside of limited bounds as ‘bureaucratic free enterprise’. This is

where ‘the bureaucracy will do things, will take actions, not because such actions are desired by the ultimate authority, the centre of power, in the organization, but because such things, such actions, develop as an outgrowth of the bureaucracy’s own processes’.¹¹ Any additional functions accorded to such a bureaucratic arrangement would be economically inefficient, as well as further undermining the vitality of the private sector.

To see how Tasmania fares against these principles, it is necessary to examine the size and growth of the public sector and its wages bills. The ABS provides information on the total number of State public servants. In 2006-07 there were about 37,000 bureaucrats employed by the Tasmanian government. This represented an increase of about 5,300 compared to 1999-2000 (the first full year of the State Labor government), or an average annual growth rate of about two per cent.

Compared with other States, the growth in Tasmanian public sector employment was the third highest after Victoria and Western Australia (see figure 4.6).

Figure 4.6: Public sector employment growth (1999-2000 to 2006-07)



Source: ABS, Cat. 6248.0.55.001.

The difficulty with increased public sector employment in Tasmania comes from the fact that it has grown faster than the total and working age populations (Table 4.1). Of greater concern is that it has also grown faster than total employment, and, by implication, the growth of private sector employment, over the period 1999-2000 to 2006-07. On all three indicators, Tasmania had the highest proportion of bureaucrats of all the States.

Table 4.1: Tasmanian public sector as proportion of total population, working age population and total employment, per cent, 2006-07

	NSW	Vic	Qld	WA	SA	Tas
Total population						
1999-2000	5.4	4.6	6.4	6.3	6.0	6.7
2006-07	5.7	5.3	6.3	6.6	6.5	7.4
Working age population						
1999-2000	8.2	6.9	9.5	9.3	9.0	10.2
2006-07	8.6	7.8	9.3	9.7	9.8	11.3
Total employment						
1999-2000	11.9	10.0	13.7	13.0	13.3	15.8
2006-07	11.9	10.7	12.5	12.8	13.7	16.3

Source: ABS, Cat. 3105.0.65.001; ABS, Cat. 6202.0.55.001; ABS, Cat. 6248.0.55.001.

The Office of the State Service Commissioner prepares an annual report of the number of bureaucrats employed by the 'core State Service' – including holders of prescribed offices, senior executives and employees of government departments and several authorities.

Excluding the employees of public authorities, the number of departmental bureaucrats increased by about 6,900 people from 1999-2000 to 2006-07. This represents an increase of 34 per cent over the period, or an average annual growth rate in the number of departmental employees of about four percent. The growth in the number of State Service personnel in core government departments exceeds the general growth of the total Tasmanian public sector.

Table 4.2: Tasmanian State Service Employees, number, 1999-2000 to 2006-07

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Dept Economic Devt				216	211	228	253	273
Dept Education	9,410	9,296	9,421	9,489	9,645	10,931	11,042	11,077
Dept Health & Human Services*	6,979	7,871	8,568	8,786	9,124	9,943	10,116	10,478
Dept Justice					792	824	1,054	1,076
Dept Justice & Industrial Relations	668	689	707	754				
Dept Infrastructure, Energy & Resources#	633	702	723	739	748	740	617	625
Dept Police & Emergency Management^							917	949
Dept Police & Public Safety~	374	406	437	430	452	474		
Dept Premier and Cabinet	289	301	305	311	326	328	341	360
Dept Primary Industries & Water							1,124	1,152
Dept Primary Industries, Water & Environment	1,466	1,490	1,528	1,191	1,224	1,252		
Dept State Development	162	360	512					
Dept Tourism, Arts & Environment							889	823
Dept Tourism, Parks, Heritage and Arts				618	700	717		
Dept Treasury and Finance	278	295	305	315	323	333	335	340
Total	20,259	21,410	22,506	22,849	23,545	25,770	26,688	27,153

Source: Office of the State Service Commissioner, annual reports.

Notes: * includes Tasmania Fire Service from 2001-02. # includes Forests Tasmania from 2000-01 onwards. ^ includes Tasmania Fire Service from 2005-06. ~ Excluding members of police force.

It is important to note that these ‘core State Services’ do not correspond with our definition of pure public goods. We categorise the following departments as providing public goods (and making the generous assumption that the entire department does so); Department of Justice, Police and Emergency Management, Department of Premier and Cabinet, and Treasury and Finance. Those departments between them employ 2,725 employees; this implies that only just over 10 percent of Tasmanian ‘core State Service’ employees can be described as providing pure public goods.

The Tasmanian Auditor General releases a comprehensive annual statement to State Parliament on government departments and public bodies. This includes data on a comparable basis regarding employment (expressed as full - time equivalents, or FTEs) in government business enterprises (GBEs) and State-owned corporations (SOCs).

Despite the Tasmanian government privatising a number of GBEs the combined number of employees for the two sectors still increased by over 600 additional employees over the period 1999 - 00 to 2006-07.

Table 4.3: Tasmanian GBE and SOC employees, FTE, 1999-2000 to 2006-07

	1999- 00	2000- 01	2001- 02	2002- 03	2003- 04	2004- 05	2005- 06	2006- 07
Government business enterprises								
Civic Construction Services Corporation	99	129	130	140	7			
Egg Marketing Board	5	5						
Forestry Tasmania	559	564	532	542	570	560	516	502
Hydro-Electric Commission	628	639	722	763	800	829	832	781
Motor Accidents Insurance Board	36	37	36	36	38	39	37	37
Port Arthur Historic Site Management Authority	74	82	80	80	89	85	85	85
Printing Authority of Tasmania	71	59	58	56	55	57	50	44
Rivers and Water Supply Commission*	6	7	7	4	5	4	7	12
Southern Region Cemetery Trust	16	16	14	14	14	13		
Stanley Cool Stores Board	2	2	2	2	2			
Tasmanian Grain Elevators Board	8	10	8	12				
Tasmanian International Velodrome Management Authority	7	7	7	7	7	7	4	2
Tasmanian Public Finance Corporation	14	14	14	13	14	13	14	14
The Public Trustee	49	49	49	46	49	50	50	49
State owned corporations								
Aurora Energy Pty Ltd	841	810	820	845	881	981	1,042	1,069
Hobart International Airport						20	22	24
King Island Port Corporation						11	11	13
Metro Tasmania Pty Ltd	378	371	367	363	357	366	361	367
TOTE Tasmania Pty Ltd	98	102	112	115	114	122	136	132
Transend Networks Pty Ltd	52	91	113	125	157	183	185	194
TT-Line Pty Ltd	347	345	366	527	635	636	634	521
Tasmanian Ports Corporation Pty Ltd*	260	246	237	235	265	116	264	210
Total	3,446	3,451	3,544	3,785	4,052	4,092	4,250	4,056

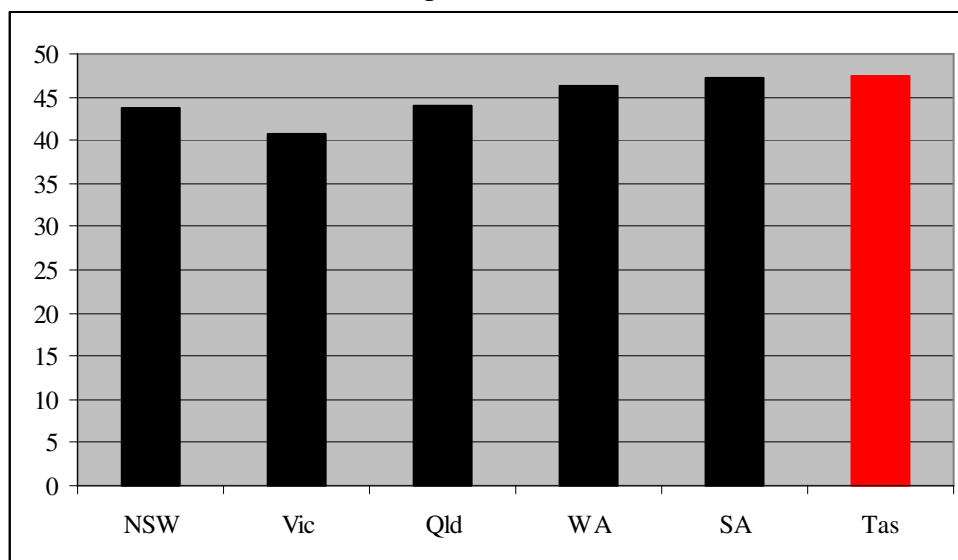
Source: Tasmanian Audit Office, *Government Departments and Public Bodies*, annual reports. Note: * Information for Hobart Ports Corporation, a subsidiary of the Tasmanian Ports Corporation, was not published in 2004-05.

Most of these additional individuals are employed by energy concerns such as Hydro Tasmania and Aurora Energy, in line with Tasmania's participation in the National Energy Market, and by TT - Line which operates passenger, vehicle and freight shipping between Tasmania and the mainland.

The increase in the number of bureaucrats employed by the Tasmanian government has had a significant impact on the State budget through increased labour costs. According to ABS government finance statistics, employee expenses of the total Tasmanian public sector increased by about \$2.3 billion from 1999-2000 to 2006-07. This represented an increase of about 66 percent over the period (or average annual growth of 8 percent). In 2006-07, Tasmanian total public sector employee expenses were about 10 per cent of GSP, the highest proportion for all States.

In 2006 – 07, employee expenses for Tasmanian bureaucrats accounted for about 48 percent of the general government sector budget. This was the highest figure recorded for all States.

Figure 4.7: Employee expenses as proportion of total expenses, general government sector, per cent, 2006-07



Source: ABS Cat. 5512.0.

Part of this increase was accounted for by increases in gross earnings per employee (including superannuation and leave). Whereas Tasmania had the second lowest level of remuneration of all the States, the growth in earnings from 1999-2000 to 2006-07 was the second highest (about 35 per cent) after Queensland (about 42 per cent).

The growth in earnings of recent years has been driven by wage agreements struck between the State government and public sector unions. This trend is set to continue after the unions accepted a pay offer from the government to increase bureaucratic wages by between 18 and 24 per cent over the next three years. This increase is rationalised on the basis of providing Tasmanian bureaucrats 'pay parity' with State bureaucrats on the mainland.

With about 11,000 bureaucrats reported to benefit from these potential wage increases, a conservative estimate is that the offer would cost State taxpayers an additional \$79 million over the life of the agreement.

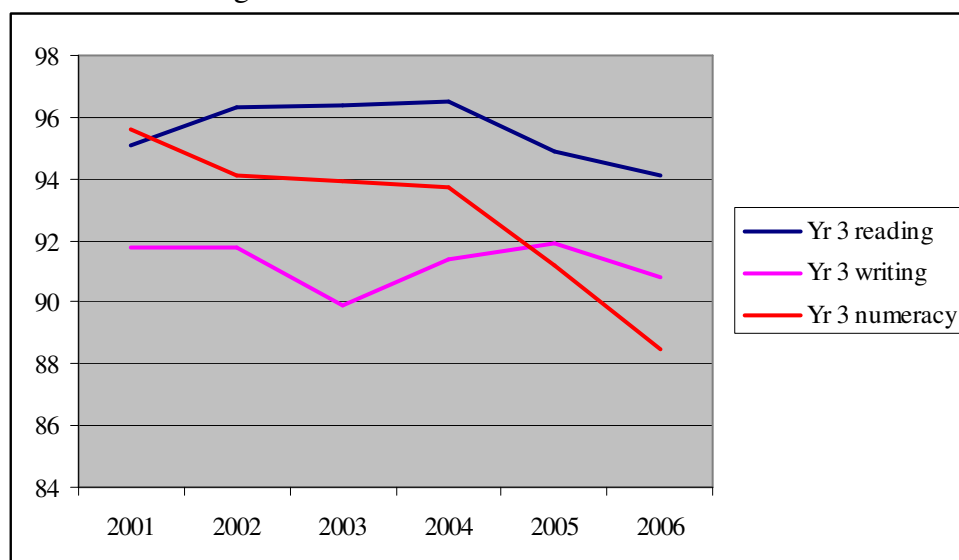
The available evidence presented here strongly suggests that the Tasmanian bureaucracy is exhibiting features of the ‘bureaucratic free enterprise’ model outlined by Gordon Tullock in 1965. In other words, the size of bureaucracy in the State is such that it has exceeded the limits of reasonable control, and is not performing the functions for which they were originally organised.

One way to look at the consequences of this is to consider what Tasmanians are receiving for the growing utilisation of bureaucratic management. Consider, for example, the performance of public hospital service provision. According to the Australian Institute of Health and Welfare, despite an increase in public hospital beds per 1,000 population:

- the percentage of public hospital elective patients who had to wait for more than twelve months for treatment increased from 7.6 percent in 2000-01 to 9.2 percent in 2006 – 07.
- the proportion of public hospital emergency patients seen on time declined from 68 percent in 2004-05 to 64 percent in 2006 – 07.
- the median waiting time for treatment in emergency departments had risen from 24 minutes in 2004-05 to 27 minutes in 2006 – 07.

Similar issues have arisen in school education, another area dominated by bureaucratic management by the Tasmanian government. Despite a reduction in student-to-staff ratios in schools (11.2 in 2001 to 10.3 in 2006, the performance of Tasmanian students against eight of the nine reading, writing and numeracy skill benchmark tests have deteriorated since 2001. Figure 4.8 is indicative of the decline in school performance.

Figure 4.8: Year Three Student Performance



Source: Productivity Commission; MCEETYA

An examination of public servant numbers for the Education Department shows that the number of government school teachers – in other words, those directly responsible for delivering education services to children – has declined from about 5,700 in 1999-2000 to about 5,500 in 2006-07. On the other hand, the total number of staff in the department has risen by over 1,500 over the same period. This implies that the number of supervisory and administrative personnel have increased within the government education system – a strong indication of bureaucratic free enterprise dynamics at work.

In these, and other, cases, increases in bureaucrat numbers and growth in their wages and salaries appear unrelated to the achievement of productivity outcomes in government service provision. Therefore, it can be argued that a State with a relatively small population base, such as Tasmania, does not require such increasing numbers of bureaucrats to the degree experienced over the last few years.

More fundamentally, it is clear that the State's bureaucracy is well beyond the point required for the provision of essential services with the public good characteristics described above. These would include the provision of law and order, courts and policing services. At a stretch, they might also include the whole-of-government coordinative functions provided by the Department of Premier and Cabinet and Treasury and Finance, even though a case could be made for staff reductions for those agencies.

The rationale for maintaining certain departments, such as education and health, with their current size is open to question. This is because of the availability of non - governmental alternatives such as not - for - profit schools, and for - profit and not - for - profit hospitals. Measures supporting greater customer choice amongst the diverse range of competing providers in these areas can potentially allow for significant reductions in the number of education and health bureaucrats, particularly in administrative or supervisory positions.

There is an even stronger case for the elimination of bureaucratic activities undertaken through the Department of Economic Development and Tourism, and the portfolios of Parks, Heritage and the Arts; Energy and Resources; and Primary Industries.

Governments have a historically poor record of 'picking industry winners', including the identification of 'growth industries' of the future and identifying worthwhile business ventures for government funding. Many of the functions provided by these departments also essentially cater for politically powerful special interest groups, such as the environmental lobby, and deliver little value to general taxpayers.

As noted above, Tasmania currently operates a number of government enterprises in commercial markets including primary industries, port operations, transport, financial services, construction, forestry and utilities. However, in 2006-07 Forestry Tasmania, Metro Tasmania, Transend Networks and TT-Line, did not achieve a return on their assets in excess of the risk-free rate of return.¹²

Given the Australian and international empirical evidence in support of privatising assets (for example, Victoria's electricity network), there is a compelling case to

transfer ownership, and consequently staffing, of Tasmania's GBEs and SOCs to the private sector.

Recommendations concerning the size of bureaucracy are a function of broader proposals concerning the activities of the Tasmanian government itself. Given our view that a more effective public sector can be achieved through the elimination of certain government functions, it follows that the number of State public sector employees would be streamlined to a size more efficiently and effectively suited to the size and circumstances of Tasmania.

Recommendations for Reform

Government has had a tendency to expand over time. The proportion of merits goods to (true) public goods is now very high. The Tasmanian government needs to have a clear view as to what it believes government should do, as opposed to what government can do. This position involves substantial debate and discussion within the Tasmanian community. It is important that community values are reflected in government policy making; it would be entirely inappropriate for a policy elite consensus to dictate government involvement in the community.

The bulk of government expenditure occurs in two areas, Education and Health. We discuss those two areas in some detail in Chapter Five. In most expenditure areas the Tasmanian government tends to make the same or similar decisions as do other States and Territories. The Tasmanian government, however, should consider carefully where it can exit areas of activity or make savings in those areas. We do not support across-the-board savings in all areas. The notion of every government department having to make an x percent cut in costs is popular but inappropriate. Good government is not cheap, and government functions should be well done, if at all. Consequently expenditure cuts should be highly targeted in those areas where government should be less active and not targeted in those areas where government should be more active. Indeed, those areas may well expand, rather than contract.

It is our view that Tasmania is not getting value for money from the existing bureaucracy. We do not, however, recommend 'mass sackings' or radical downsizing of the bureaucracy in the short – term. It is not feasible or plausible to simply dismiss public servants. In the first instance, the Tasmanian private sector is not large enough to accommodate a massive influx of workers. Rather we are of the opinion that the Tasmanian private sector economy must be grown in order to provide sufficient and lucrative employment opportunities to entice individuals out of the public sector and into the private sector.

Appendix: The performance of Tasmanian government companies

The Tasmanian Auditor-General publishes a report each year examining the performance of both Government Business Enterprises (GBEs) and State-Owned Companies (SOCs). This provides a more detailed analysis than does the ABS. Looking at the latest Auditor-General report for the financial year 2006–07 we observe that while many Tasmanian GBEs and SOCs seem to earn accounting profits that they do not cover their implied costs of capital. Table A.2.1 contains selected data collected from the Auditor-General report. It also includes an implied beta for each GBE and SOC that we have calculated.

Table A.2.1: Selected Financial Data for Tasmanian GBEs and SOCs

	Operating Margin	Return on Assets	Return on Equity	Implied Beta
GOVERNMENT BUSINESS ENTERPRISE				
Forestry Tasmania	1.13	5.1	5.0	-0.19
Hydro-Electric Corporation	1.62	3.0	8.5	0.35
Motor Accidents Insurance Board	2.41	13.8	38.5	4.96
Port Arthur Historic Site Management Authority	0.96	-2.7	-13.1	-2.98
Printing Authority of Tasmania	1.01	1.5	0.2	-0.93
Rivers and Water Supply Commission	0.47	-7.6	-35.2	-6.38
Tasmanian International Velodrome Management Authority	0.43	-52.8	6.8	0.08
Tasmanian Public Finance Corporation			17.4	1.72
STATE OWNED CORPORATIONS				
Aurora Energy PTY LTD	1.06	6.3	8.8	0.39
Metro Tasmania PTY LTD	1.0	0.8	0.7	-0.85
TOTE Tasmania PTY LTD	1.03	3.4	3.2	-0.47
Transend Networks PTY LTD	1.32	4.3	3.3	-0.45
TT-Line Company PTY LTD	1.03	2.9	5	-0.19
Tasmanian Ports Corporation PTY LTD	1.18	6.8	4.7	-0.24
Hobart International Airport PTY LTD	1.54	11.6	13.1	1.05
King Island Ports Corporation PTY LTD	1.06	13.5	17.6	1.75

Source: Tasmanian Auditor-General and author calculations

The Auditor-General suggests that an appropriate benchmark for the Operating Margin be unity (one) and that the benchmark return on equity be in the range 6 percent to 7.5 percent. We are not convinced that the latter figures are correct. Rather we prefer the range nine percent to 11.5 percent.¹³ What is important is that the Auditor-General sets out an expectation that GBEs and SOCs performance be measured against their cost of capital. Unfortunately, the report itself does not actually state what the various GBEs and SOEs costs of capital actually are. Our own analysis suggests that the performance of only four of sixteen GBEs and SOEs exceeds their cost of capital.

Box A.2.1: The Cost of Capital

The cost of capital is the opportunity cost of the capital that is tied up within a firm. It represents the minimum return on investment that will ensure that all stakeholders, including the providers of capital, earn a return on their investment. Establishing the cost of debt is normally quite simple. Debate rages over the appropriate measure for the cost of equity. The Tasmanian Auditor-General has chosen to employ the capital asset pricing model – the work horse of modern finance theory.¹⁴ This is a simple and well-known model that can be expressed as follows:

$$R_i = R_f + \beta_i(R_m - R_f)$$

Where R_i = the required rate of return;

R_f = the risk-free rate;

R_m = the market portfolio return;

β_i = the risk of the asset relative to the risk of the market portfolio (beta).

In coming to an expected required rate of return for GBEs and SOEs the Auditor-General makes some assumptions about the values of the risk-free rate (6.25 percent) and the risk premium (6.5 percent) that implies that the relative risks of these organisations lie in the range 0.5 – 1.0. These assumptions are sensible and we broadly agree with the argument.¹⁵ Theoretically, the relative risk of government organisations is likely to be low, so again we tend to agree with this assessment.

The overall cost of capital, known as the weighted average cost of capital, is the after-tax cost of debt weighted by the proportion of debt plus the cost of equity weighted by the proportion of equity.

In table A.2.1 we have calculated an implied relative risk (beta) for all the GBEs and SOEs given the Auditor-General's assumptions and the actual return on equity that the organisation actually achieved. We substitute the Auditor-Generals assumptions and the reported return on equity into the CAPM equation and solve for the beta. We acknowledge that this is a rough and ready measure, nonetheless we note that many of the implied beta scores are negative or below the range of 0.5 – 1.0. That implies that those GBEs and SOEs are not covering their cost of equity capital. In other words, the Tasmanian community is not getting a fair return for the capital tied up in those organisations.

There are some GBEs that are unlikely to cover their costs of capital, for example the Port Arthur Historic Site Management Authority does not exist to earn money for the Tasmanian community. To the extent that it does earn money from tourism activities that is a bonus, but nobody would ever suggest that the site be abandoned or not maintained. To the extent that the Port Arthur site is of national significance, not just local significance, we believe the Commonwealth should assist the Tasmanian government in funding the maintenance and upkeep of the site. On the other hand, some of the other GBEs and SOCs can and should be operated on purely commercial grounds. Irrespective of the mode of ownership, it is not unreasonable to expect that these organisations should be well-managed and profitable, or to at least break-even. To the extent that government wishes to operate some activities at a loss, it should be required to make an explicit commitment to doing so and declare that intention in the budget papers.

We did examine the debt – ratios of the GBEs and SOCs; similar private organisations can be expected to have debt holdings and there is no reason why these organisations should not also use debt in their capital structure. It would be appropriate, however, if the Auditor-general would show debt-ratios for similar organisation either on the mainland or internationally, so that Tasmanians can form an opinion as to the appropriateness of the capital structures adopted by these firms. Similarly, we are not concerned that some of these organisations pay dividends to the Tasmanian government. We are concerned, however, that some organisations paid dividends while not actually meeting their costs of equity capital. It is possible to earn an accounting profit, while still not meeting the cost of capital and so be legally able to declare a dividend.

It is our view that only those GBEs and SOCs that earn in excess of their cost of capital pay a dividend – otherwise the organisation is effectively paying a dividend out of capital. This constraint, however, implies that the cost of capital be known – there are organisations and individuals within Australia who calculate and provide such information. GBEs and SOCs should report their cost of capital in their financial statements and the Auditor-General should report whether or not firms have exceeded their cost of capital.

For those firms that currently earn less than the cost of capital and where an expectation is that they should exceed their cost of capital we recommend that the Tasmanian government appoint company administrators to those companies to advise the Tasmanian government on how to best realise the value of the assets. We acknowledge that administrators are usually appointed by creditors when a company is insolvent and these companies are not insolvent. Furthermore, we are not suggesting that the companies actually be liquidated or sold off. Rather we believe that the Tasmanian government should approach those experts who specialise in determining the best value for underperforming assets to get a better understanding of how to revitalise these organisations. In other words, that the Tasmanian government appoint administrators on a consultancy basis to investigate the operations and performance of GBEs and SOCs.

Extract of Chapter Five

Challenging the Assumptions: Proposals for Radical Reform

Constraining Public Sector Growth

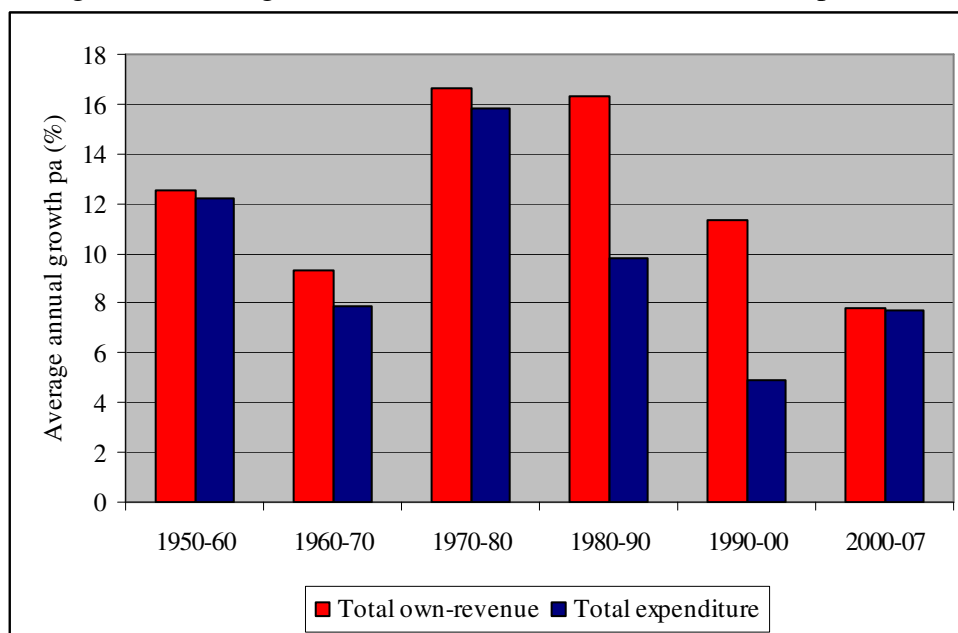
A Tax Constitution

It is well known in the economics literature that when government imposes taxes and other imposts to acquire revenue, it tends to discourage economic activity. Not only do the different forms of revenue-raising take money away from the private sector, but they can reduce incentives to work, save, innovate and invest.

Government compulsorily acquires revenue in order to spend it. However, as international empirical studies demonstrate, as government spending increases economic productivity declines as the disincentive effects of high taxation and government crowding out begin to dominate.¹⁶ Overall, a large and growing government is not conducive to better long term economic performance.

A comparison of Tasmanian own-revenue and spending growth over the past few decades show that most periods (with the exception of 1980–2000) were characterised by a pattern whereby successive governments tended to spend as much revenue as they can get (see figure 5.5).

Figure 5.5: Change in Tasmanian total own-revenues and expenditure



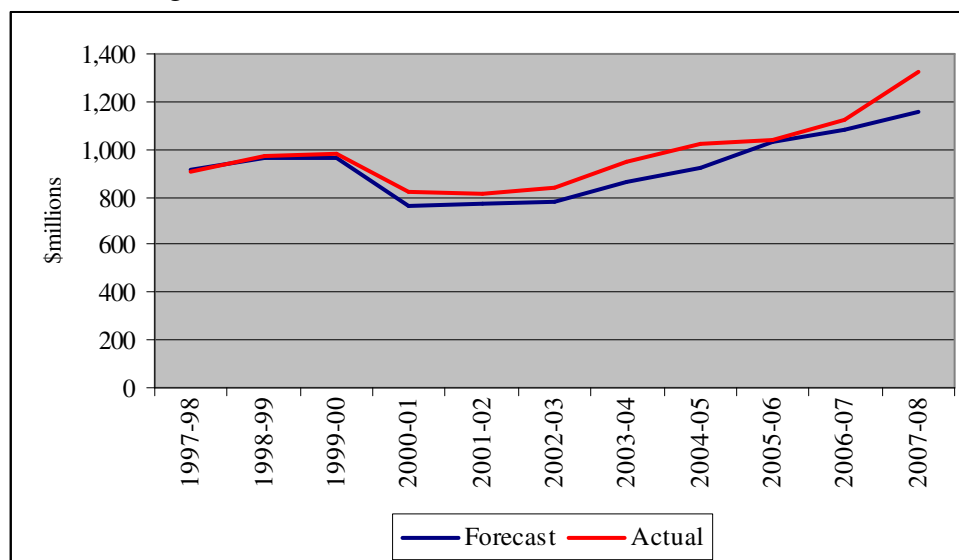
Source: ABS State and Local Authority Finance; Government Financial Statistics.
Data for 1960-70 excludes data for 1969.

There is also evidence that the provision of GST growth revenues from the Commonwealth since 2000 have not led to fundamental reforms to how the State government operates. Despite the abolition of some transactions taxes, the level of tax and total own revenues in 2006-07 had exceeded that which existed prior to the change to Commonwealth-State relations. Increases in Tasmanian government spending had also continued unabated.

In effect, the extra grant funding from the GST has encouraged Tasmania to spend the windfall ‘on more of the same: more highly paid staff, more services, more programmes, more studies, more publicity and more infrastructure. Value for money has become a forgotten concept’.¹⁷

Another point of concern is that the Tasmanian Treasury has consistently underestimated revenue collections over the past decade (figure five), with these ‘unexpected’ revenues used to subsidise additional government spending. As one of the authors has previously suggested, this situation also does little to alleviate the relatively high degree of ‘fiscal illusion’ affecting citizen-voters.¹⁸

Figure 5.6: Forecasted versus actual total own-revenue



Source: Tasmanian Budget Papers.

Existing constraints – such as political competition, economic policy frameworks and interstate and global resource mobility – appear to have been insufficient to constrain the ‘tax-and-spend’ approach of the State government. To strengthen overall fiscal discipline, it will be necessary to limit the government’s ability to raise revenue.

Accordingly, we propose the long run introduction of a fiscal rule that total State public sector revenue growth in a given quarter shall not exceed the (real) growth rate of the economy applying in the previous four quarters (fiscal year) less a factor of x .¹⁹ Consistent with this rule are the following conditions:

- The value of x is to be determined by the government of the day, and must be set in advance of the following fiscal year. This value cannot be set at, or less than, zero.

- If real GSP growth in a given quarter equals zero, or is less than zero, then permissible revenue growth in that quarter shall be set at zero.
- If real GSP growth in a given quarter is greater than zero, but less than the value of x , then permissible revenue growth in that quarter shall be set to x .²⁰

To enforce the revenue rule, it is also proposed that State own-revenues attained in the previous fiscal year that exceeded the relevant real GSP minus x applying to that year must be returned to statutory taxpayers in the form of an equi-proportional refund. Households can use this refund in accordance with their own purposes, with no specific conditions attached by government.

In recent years, the Tasmanian government has maintained a strategy aimed at promoting fiscal responsibility. As part of this, the government has committed to maintaining the general government sector net operating surplus and fiscal balance in surplus on average over a four-year rolling period. In a self-congratulatory manner, the State government has given itself a big tick against these targets in recent budget statements.

However, the case can be made to strengthen the existing budget rule. A budget surplus condition for a set period is less likely to be achieved during a period characterised by volatile swings in economic conditions. From a political economy perspective, it is inappropriate for government to be hoarding excess revenues, and not returning these additional takings back to taxpayers. Finally, the existing rule for Tasmania covers only the general government sector and does not apply to government trading enterprises.

To strengthen this budget rule for the benefit of current and future generations it is proposed that a year-on-year budget balance rule be instituted. In conjunction with the real GSP minus x revenue rule, this provides an implicit growth rule for government spending providing greater certainty for taxpayers.

A persistently high level of public sector debt has been a both a feature and determinant of the 'Tasmanian problem'. The 1992 Curran Report diagnosed the problems arising from the State's indebtedness:

[Tasmania] has a serious debt problem, with debt and liabilities of the inner budget sector equivalent to \$15,000 per household, and debt of statutory authorities in the order of \$14,950 per household. The burden of debt financed from the state budget has increased from \$5,632 in real terms per household in 1981 to \$7,846 in 1991. This increase has resulted in Tasmanians paying the equivalent of 40% more in debt charges than other states. ... These debts have basically arisen from governments having spent more than was raised in revenue. ... As a result of past free-spending financial policies ... Tasmania is now a high taxing state with above average spending (Peter Curran, 1992, *Tasmania in the Nineties*, p. 13).

In recent years Tasmania has made great strides in reducing general government sector net debt. Net debt for the sector declined from about 12 percent of GSP in 1998-99 to zero in 2004-05.

Now that Tasmania has eliminated net debt for the general government sector, we propose a rule that total public sector net debt equals zero. This will eliminate any incentive for current generations to impose fiscal burdens upon future generations of Tasmanians, including through off-budget activities.

Given the long term benefit of these rules, it is inappropriate that they be given merely legislative effect. Therefore, the *Constitution Act 1934* should be amended to include the terms and conditions of the requirements set out above. A transitional mechanism for the enforcement of the fiscal rules, say ten years, should give the Tasmanian government sufficient time to reduce its taxation, expenditure and public debt in advance of the rules coming into effect.

Tasmania has long had a history of fiscal profligacy, at enormous cost to its people. Therefore, explicit constraints preventing government from raising excess revenue, increasing net public sector debt and flouting budgetary balances should help prevent a continuation of the ‘tragedy of the State fiscal commons.’

Efficiency in Service Delivery

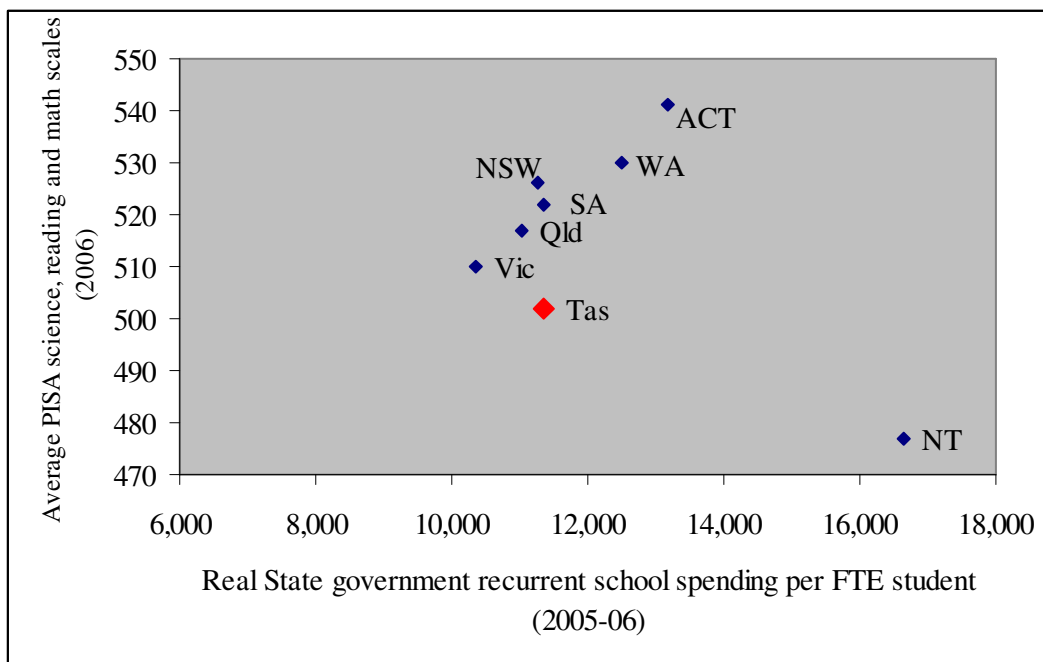
1. Education Reform

If the Tasmanian economy is to forge ahead in the long run, it must embrace excellence in the delivery of goods and services. This is certainly true in the case of education provided to children of schooling age, where there is currently significant investment by the State government.

A critical driver of the so-called ‘Tasmanian problem’ has been the State’s poor performance on a range of education performance indicators; in other words, the ‘Tasmanian education problem’. As noted previously, the proportion of Tasmanian school students who have achieved eight of the nine national reading, writing and numeracy skill benchmarks have declined since 2001. This has been in spite of a significant reduction in the student-to-staff ratio in schools across the State.

Another way to look at the issue is to compare a broad measure of student academic outcomes against a broad measure of taxpayer support for schools. Figure Seven compares the average of the 2006 Programme for International Student Assessment (PISA) scores (for scientific, reading and mathematical literacy) against real recurrent spending by State governments toward schools (for 2005-06).

Figure 5.7: Value for school education spending, States and Territories



Source: Thomson, Sue, and De Bortoli, Lisa, 2008, Exploring scientific literacy: How Australia measures up: The PISA 2006 survey of students' scientific, reading and mathematical literacy skills; Productivity Commission, 2008, Report on Government Service Provision.

To be sure, the Tasmanian State government spends more on school education than NSW, Victoria and Queensland. Nonetheless, the evidence suggests that Tasmanians are not receiving an adequate return on their school education investment, if the relatively low student scores against the PISA tests are any guide.

Compounding the academic outcomes achieved by students in Tasmania is the relatively fewer students staying on through senior schooling, compared to those in other States. According to the State government's own figures, the apparent retention rate (i.e., the proportion of students remaining from Year 10 through to Year 12) was about 65 percent in 2006. Nationally, the same figure was about 76 percent. Further, student completion rates of a qualification by Year 12 in 2006 were 52 percent in Tasmania compared to 67 percent across Australia.

It is important to stress that not all young people are suitable for white collar professional employment or for service employment in tourism and retail, and can find suitable jobs, say, in the trades or in primary and secondary industries. For some people, progression to Year 12 is not an optimal strategy to maximize lifetime earnings. However, there is a long term tendency for a large number of highly skilled young Tasmanians to leave the State for further study or lucrative jobs, either interstate or overseas. This represents a loss of human capital, and can potentially raise the State's 'dependency ratio' (i.e., the proportion of people aged 65 years and over relative to those aged 15-64 years).

The international empirical literature clearly indicates that school reforms, based on greater flexibility and competition, encourage individual schools to become more responsive to student needs, and from this flow better learning outcomes.²¹ The rest of

this section describes the general reform principles cited by the literature and identifies, where applicable, suggests improvements for consideration by the Tasmanian government.²²

Freedom of entry

Low obstacles to entry into the school system enable new schools, as circumstances change, to tailor services for students that are not available from existing schools. The potential entry of new schools can also discipline existing education providers, such as government schools, to provide high-quality services.

As the owner and manager of Tasmanian government schools, the State Education Minister has significant powers over the entry, exit and expansion of these schools. According to Section 18 (1) of the *Education Act 1994* (the Act), the Minister may establish any government school necessary for the purposes of the Act. In effect, the government can establish a new government school anywhere and anytime, subject to general budgetary constraints.

Different standards apply to non-government schools operating in Tasmania. The Schools Registration Board was established to register all non-government schools, and to ensure that they comply with standards set down by the Minister for Education. It also provides for inspection and annual reporting processes to ensure compliance of existing schools with the registration standards.

The Board can affect the freedom of non-government school entities to enter, and remain in, the education system. In particular, the body is obliged under the Act (Section 53 (1)) to assess ‘the likely impact of the registration of the school of existing schools in the same geographic area’. This is reminiscent of the former Hawke-Keating Labor Federal government’s restrictive ‘New Schools Policy’, which effectively shielded government schools from direct competition by other schools and stunted the growth of the non-government school sector.

The Board sets a range of other compliance requirements that, other things being equal, increase the difficulty of entry for new non-government schools and place bounds on existing schools. These include:

- requirements concerning the minimum number of students that must attend the school;
- information on the kinds of students expected to attend, taking into account factors such as age, boarding students, overseas full-fee paying students and so on;
- requirements relating to the minimum ratios of registered teachers to students;
- provision of business plans providing a three-year projection of income and expenditure, including anticipated Commonwealth government capital grants;
- documentation to demonstrate that the application for a new school ‘is founded upon a realistic assessment of the financial support which the school will be able to generate from its supporting community’;
- information on the governance and administrative structures of the school; and
- statements to prove that the facilities and materials for a new or existing school are acceptable and appropriate to the educational programs being offered.

Some of these guidelines may provide the Board with flexibility regarding their interpretation. Nevertheless, in the interests of competitive neutrality between school sectors, we propose that the non-government school registration standards of the School Registration Board be limited to teacher qualifications, curriculum, enrolments and grievance procedures.

Government funding non-discrimination

An important condition for a more efficient, responsive school system is that the same base amount of taxpayer funding be allocated to each pupil, regardless of family income and school corporate financial status, at the school selected by the child's parents. This type of competitively neutral and portable support effectively gives parents control of the subsidy allocation. This base funding can then be weighted by additional loadings based on the cost of educating children with special education needs (for example, students with disabilities).

In practice, the Tasmanian government provides a hodgepodge of payments to schools reflecting various policy statements and priorities. In addition to general administrative payments, these include funding for literacy and numeracy strategies (including the 'Raising the Bar and Closing the Gap' initiative), reduction of class sizes from Years 2 to 7, and dedicated resources for special needs students. The Education Department also has a rolling Capital Investment Program for works in government schools.

Non-government schools receive base funding under the General Educational Grant Scheme. This provides per capita funding to each school based on the number of full-time equivalent students enrolled, and is consistent with good school funding principles outlined above.

In addition to this, non-government school students are eligible for funding defraying the cost of school books and compulsory levies, and assistance to cover the cost of providing children with spectacles. Non-government schools also receive funds under the Capital Assistance Scheme (which replaced the previous Loan Interest Subsidy Scheme), which is administered by the Catholic Education Office and Association of Independent Schools Tasmania.

There is no question that the government provides substantive funding to the school education sector. However, we think that the State education funding model should be one whereby all recurrent and capital funds for all school systems (government, Catholic and independent) are pooled together. The amount of actual funding distributed to each school would then be based on the number of students (including those with special needs) enrolled, with local schools given the discretion to spend funds on educational priorities as they see fit. Apart from maintaining the probity of dispensed funds, the Education Department will no longer have a role in micro-managing schools.

A funding model based on these principles would permit greater choice amongst the set of schools, thus encouraging them to compete against each other in providing high-quality education that attracts students.

School autonomy

Devolving decision-making powers to principals, as school managers, to administer finances and assets, develop curriculum strategies and manage human resources, enables schools to tailor education to the needs of local students. School autonomy also promotes better resource allocation, and creates diversity in education so that operational standards differ amongst individual schools.

As acknowledged by Brian Caldwell, one of the architects of the former Kennett Victorian government's self-governing schools reform, 'Tasmania was a world leader in decentralising budgets to schools in the 1970s'.²³ In 1994 the then Coalition government amended the 1994 Act to provide additional powers to principals within the context of self-managing schools, and gave legal status to school councils to reinforce parental involvement in teaching and learning programs. In 1997, Premier Tony Rundle introduced a 'Directions in Education' policy, designed to foster additional local decision-making and flexibility in school operations. This included a system whereby individual schools and their communities, in partnership with government, could determine the learning outcomes to be delivered.²⁴

The State Labor government has generally maintained previous school autonomy reforms; although in 2003 it amended the Act to abolish school councils. These were replaced by parent associations, with arguably less decision-making powers within the schooling structure.

It should also be noted that certain groups in the Tasmanian community, including the Greens Party, teacher unions and education bureaucrats, have in the past resisted the trend towards greater autonomy for government schools. For example, a 2006 departmental discussion paper on school leadership stated that 'the promotion of self-managing schools encouraged enterprise and levels of autonomy that perhaps undervalued the values of belonging and connectedness to our larger system of State education'.²⁵ To these groups, an emphasis on uniformity in service provision seems to be of greater value than the gains that could be achieved through greater school self-management.

There is scope to further empower local government schools throughout Tasmania to customise services, for the betterment of their enrolled students. In countries such as the United States, United Kingdom, New Zealand, Canada, Chile, Netherlands and Sweden, reforms have been introduced to enable individual government schools to operate independently.

These schools, known as 'non-systemic government schools' or 'charter schools', are freed from the regulations applied by the education department to standard government schools, typically in exchange for certain accountability requirements. They remain eligible for government funding, but may be operated by bodies such as non-profit groups, charities, corporations or parent-teacher collectives. This model has been found to be successful in raising educational standards, including in disadvantaged communities.²⁶

Adoption of this model to the Tasmanian government school sector will provide school leaders with the autonomy to meet the needs and expectations of local

communities. Given the systemic underperformance of Tasmania's education system to lift educational outcomes to at least the standard of the States and Territories, innovations that allow schools to 'opt out' of failed centralised education standards should reap significant benefits over the longer term.

Publicly available information

Publicly available reporting to parents and the general community of financial, operational and academic performance at the individual school level, in an objective, clear, complete and accurate manner, is also important. This would enable parents to gain knowledge of schooling alternatives to make informed, effective choice that satisfy educational demands.

In November 2008 the Tasmanian government released school performance data online, on the back of a commitment earlier in the year by Premier Bartlett to provide the most comprehensive suite of information in Australia. The School Improvement Reports provide information about individual government school performance in 2007 against a range of policy priority areas, including early years education, literacy and numeracy, student retention, school improvement and equity.

We support such measures in the interests of public accountability and transparency, and commend that additional information be included in subsequent releases, such as student performance against the 2008 national literacy and numeracy tests when they become available. We also suggest that the government work with Catholic and independent schools to publish a comparable set of indicators for non-government schools.

School closures

Issues concerning the viability of government schools in Tasmania have been raised over many years. Apart from the cost of providing education for students in the more remote parts of the State, such as the west, north-west and Flinders and King Islands, questions have been raised about the apparent 'school on every street corner' effect in the major cities of Hobart and Launceston.

According to ABS schools data, Tasmania had the second lowest number of students per government school (278 students per school) across the States in 2007, and was about 27 per cent lower than Queensland, with the highest number of students per school. The latest Productivity Commission report on government service provision shows that 10 per cent of Tasmanian secondary government schools enrol more than 1,000 pupils, the lowest of all the States.

In its assessments of school expenditure, the Commonwealth Grants Commission has indicated that Tasmanian per capita spending in primary and secondary education is above the national average, reflecting diseconomies of scale in provision. The CGC also found that a higher proportion of small secondary schools in rural areas drove up schooling costs in the State.

The Tasmanian Demographic Advisory Council has recently investigated the impact of demographic change on schooling.²⁷ It found that 57 of 139 primary schools in the

State had less than 200 pupils, and 12 secondary schools have less than 400 pupils. If Tasmania operated the same school size density as Australia as a whole, it would have approximately 180 schools rather than the 214 schools in 2007.

The study also found that schools generally have an occupancy rate of about 60 per cent, which is likely to decline towards 50 per cent over the next decade. It identified a range of issues associated with small schools, including the lack of administrative and other support for a school principal, and insufficient numbers of experienced staff to deliver the syllabus.

There is a continuing debate in the education literature as to what constitutes an optimal size for a school. In his assessment of the available research, Brian J. Caldwell, a key architect of the school choice reforms of the former Kennett Victorian government, suggests that an effective size for a primary school is about 300-400 students and 400-800 students for a secondary school.²⁸ We note that the average size of all government schools in Tasmania is currently below these thresholds.

We recognise that issues concerning school size, and the closure and amalgamation of small, costly schools, are emotive topics throughout the community. In our recommended system of non-systemic government schools with the freedom to enter and exit the education system, decisions to close or amalgamate non-viable schools will be entirely a matter for the school and its local community. This is consistent with the notion that local people are best placed to understand their local circumstances.

It is noted that the *Education Act 1994* currently includes the provision that the State Education Minister has the power to amalgamate or close any government school. When doing so, however, the Minister must consult the relevant school community and report on the impacts of such changes.

Consistent with this legislative requirement, we suggest that the Department of Education inquire into, and report on, the financial and educational viability of existing government schools. It should also investigate ways in which schools can share facilities with other providers such as non-government schools and libraries, and engage the community on any closures or amalgamations needed. We recommend that any changes affecting existing government schools be put into effect prior to the introduction of long run school choice reforms suggested in this report.

In summary, we recognise that there is no single ‘magic bullet’ solution for resolving Tasmania’s problems. Indeed, many potential drivers of performance in education systems are difficult for policymakers to resolve, if at all. These include the effect of low socio-economic status on performance, different intellectual capabilities of children, student academic aptitude, and so on.

Nonetheless, we consider that greater competition within the school education system can provide a substantive long run antidote to the poor educational performance observed over many years. The international evidence pointing to the beneficial effects of greater schooling competition for children is clear. Tasmanian parents implicitly understand the benefits of school choice, showing a preparedness to move their children away from government schools towards Catholic and independent

schools. In 2007, about 28 percent of the State's full-time school students were enrolled in non-government schools (an increase of three percent since 2000), with enrolments in government schools declining by a similar amount.

In some respects, Tasmania has been a forerunner for school reform in Australia. However, in an increasingly competitive global economic environment, there is always more to do. We are confident that the combination of light-handed school regulation and strong performance reporting frameworks will foster educational excellence through a greater focus on the learning needs of children.

In tandem with a strategy to foster the growth of Tasmania's market economy, we envisage that implementation of the cited education reform principles will transform the State's schooling.

2. Health Reform

Multiple levels of governments are involved in the financing and provision of health services across Australia. The States have constitutional responsibility for these services, and thus contribute funding for, and deliver, a range of services such as public hospital services, public health programs, community health services, public dental services, mental health programs and services supporting these functions. They also regulate, inspect, license and monitor premises, institutions and health sector personnel.

The Commonwealth government has played an increasingly major role in the health sector. This includes funding to the States and Territories through the Australian Health Care Agreement (AHCA) to deliver public hospital services. Further, the Commonwealth provides rebates to patients for general practice and specialist medical services, rebates for members of private health insurance schemes, and subsidises the cost of certain pharmaceutical products. Other services, including for indigenous people and war veterans, are funded by the Commonwealth.²⁹

It is well known that this complex division of health care roles has led to confusion among patients and the general community, cost shifting between levels of government, and the now-infamous 'blame game' as governments point to each other as the culprit for system underperformance.

In the lead-up to negotiations for a new five-year AHCA, there was much toing-and-froing between the parties on the growth indexation arrangements to apply to Commonwealth public hospital funds. In the 2003-08 AHCA between the Commonwealth and Tasmania, it was agreed that the State increase its own-source funding for public hospitals at a rate at least matching that of the Commonwealth. At the COAG meeting of 29 November 2008, the Commonwealth and States agreed to a new AHCA of \$64.4 billion over five years.

For its part, the Tasmanian government has claimed that 'the States have carried a heavy burden of hospital funding for too long' and has called on the Commonwealth to increase its share of funding.³⁰ It seems that the mendicant mentality of the State government respects no bounds, not even when it comes to funding its own constitutional responsibilities.

The AHCAs provide the Commonwealth with other opportunities to impose conditions on States in return for funding. For example, the Federal Health Minister Nicola Roxon has flagged that States provide consistent data on health service costs, quality and results.³¹ The Minister also suggested, in the longer term, incentives to encourage greater competition between States and public and private hospitals to deliver better services.

Selected hospital performance indicators

Differences in the usage of hospital inputs and outputs reflect a multitude of complex factors. These include the health, socioeconomic and health profiles of people residing in a jurisdiction, decisions taken by medical staff about the appropriate types of care to be provided, and accessibility to non-public hospital services such as primary care, private hospitals and care in the home. Other issues including the cost of new technologies as well as the cost of hospital sector labour are also important. Policy decisions pursued by the Tasmanian and Commonwealth governments can also influence the performance of hospital systems.

Given the inherent complexities associated with the delivery of hospital services, a suite of indicators need to be used to obtain indicative information on performance.³² A number of the indicators cited in this section are subject to definitional changes and methodological limitations, so caution should be applied when interpreting changes in the indicators over time.

Health status of Tasmanians

The ABS Social Indicators report (cat. no. 4102.0) provides general indicators of the health status of people residing in Tasmania. The life expectancy at birth for males in 2006 was 77.4 years, and 82.3 years for females. These are slightly lower than the life expectancy at birth at a national level (78.7 years for males, and 83.5 years for females).

The standardised death rate for Tasmanians was 6.8 per 1,000 people in 2006, compared to six nationally. At the other end of the scale, the infant mortality rate (per 1,000 live births) was lower in Tasmania (3.9) than for Australia (4.7).

Some major causes of death, such as cancer and heart disease, are more prevalent in Tasmania than in Australia as a whole. Asthma is also more prevalent in Tasmania. Moreover, important risk factors such as high blood pressure and overweight/obesity (for females) are higher in Tasmania. These factors, other things being equal, are more likely to lead to a relatively greater demand for Tasmania's health services.

Service provision and performance

Number of hospitals

As in other jurisdictions, hospital services in Tasmania are delivered by the State government (as the owner and manager of public hospitals) as well as the private (for-profit and not-for-profit) sector. In 2006-07, there were 27 public (24 acute and

three psychiatric) hospitals and eight private (free-standing day hospitals, acute and psychiatric) hospitals throughout the State.

Available hospital beds

The number of available or licensed beds in Tasmanian public hospitals per 1,000 people has increased from 2.4 in 1999-2000 to 2.8 in 2006-07. By contrast, the number of beds per 1,000 people nationally has fallen from 2.8 to 2.7 over the same period.

The number of beds in private hospitals, across Tasmania, has declined marginally from 2.1 in 2001-02 to 1.9 in 2006-07; although the provision of beds by the private sector has been much higher than in Australia as a whole (1.3 beds per 1,000 people in 2006-07).

Patient separations

According to the Australian Institute of Health and Welfare (AIHW), patient separations are defined as the number of episodes of care for admitted hospital patients. This can include total hospital stays (from admission to discharge, transfer or death), or portions of hospital stays beginning or ending in a change of type of care (for example, from acute to rehabilitation) that cease during a given period. Same-day procedures are also included in separation statistics. This statistic provides an indicator of the level of service provision.

While the percentage growth of public hospital separations in Tasmania exceeds that of Australia as a whole from 2000-01 to 2006-07 (21 percent compared to 11 percent, respectively), Tasmania has a below average rate of public hospital separations compared to the national public hospital total. In 2006-07, there were 188.5 separations per 1,000 people from Tasmanian public hospitals compared to 218.8 separations per 1,000 people nationally.

There is no publicly available information on private hospital separations through the AIHW since 2002-03.³³ Previous data shows that Tasmanian private hospital separations per 1,000 people exceeded the rate for private hospitals nation-wide. For example, in 2001-02, Tasmania's rate was 145.3 compared to Australia's 124.8.

The lower than average rate of episodes of care in Tasmanian public hospitals, combined with the growth in the hospital bed rate to above the national average, might suggest that hospital resources are sub-optimally allocated. However, this statement would need to be confirmed against other data as discussed below. For example, on one measure of efficiency (the proportion of public hospital separations which are same day and do not involve an overnight stay), the State has shown improvement. The proportion of same-day separations to the total has increased from 45.3 percent in 1999-2000 to 50.2 percent in 2006-07 (above the national average for that year).

The AIHW also provide data on the proportion of public hospital separations by age cohort. It is of interest to note that, in 2006-07, the proportion of people that received episodes of care in Tasmanian public hospitals from the 65 years and over age bracket

was 34.8 percent. This was lower than NSW (38.4 percent), Victoria (37.2 percent), South Australia (37 percent) and the ACT (35 percent). There is little question that Tasmania is projected to experience a significant growth in the proportion of older people over the next decade or two, the figures dispel the myth that Tasmanian public hospital separations are currently predominated by older people.

Patient length of stay

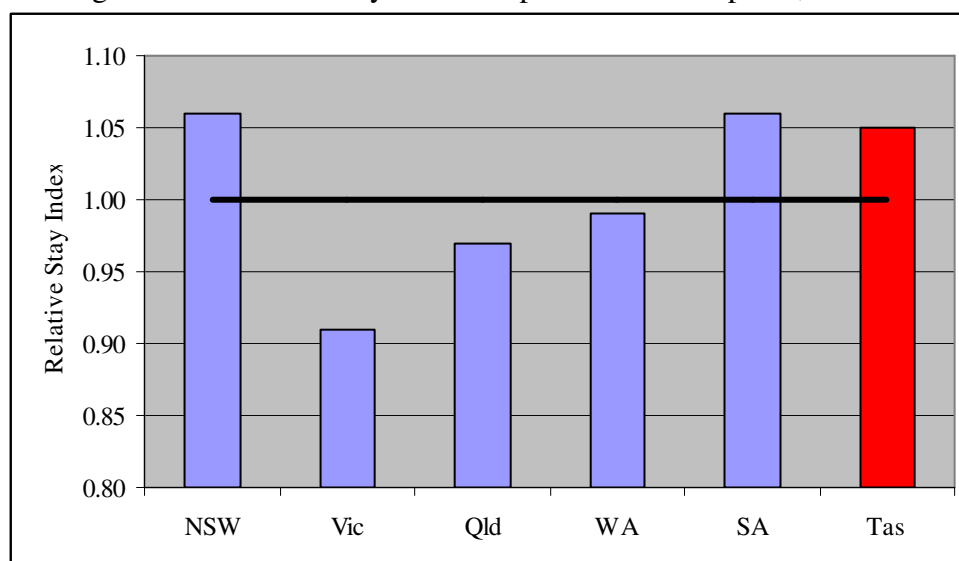
The average length of stay (ALOS) in hospital for a patient provides another proxy indicator of efficiency. From 1999-2000 to 2006-07, the ALOS (including same-day separations) for patients in Tasmanian public hospitals declined from 4.7 days to 4.2. By comparison, the ALOS for all Australian public hospitals declined from 4.2 days to 3.7.

Again, there is a lack of recent data for private hospitals. However, the 2001-02 ALOS figure of 3.1 days for private hospitals in Tasmania was significantly lower than the average stay length of 4.6 days in public hospitals for that same year.

Another indicator used in the health performance literature is the relative stay index (RSI). This measure calculates the actual number of patient days for separations in selected Australian Refined Diagnosis Related Groups (AR-DRGs) medical procedure code divided by the expected number of patient days, and standardised for casemix (in other words, the types of services being provided in hospitals). A RSI for Australia for all public and private hospitals is one, and so a RSI value greater than one indicates that the average length of stay is higher than expected given the jurisdiction's casemix distribution.

Figure 5.8 illustrates the RSI values State public acute hospitals in 2006-07. Tasmania's RSI was the second highest of the States after NSW and South Australia (which both share the highest RSI value), and greater than unity. In other words, the State's public hospitals are less efficient at managing length of stay for their casemix than would normally be expected.

Figure 5.8: Relative Stay Index for public acute hospitals, 2006-07



Source: Australian Institute of Health and Welfare (AIHW), 2008, *Australian Hospital Statistics 2006-07*.

As acknowledged in the May 2008 update of the State Health Department's Clinical Services Plan, 'if each Tasmanian public acute hospital was able to achieve the length of stay of the best-performing peer hospitals for high volume diagnosis-related groups (DRGs), 15,307 fewer overnight bed stays would be required'.³⁴

Waiting times

Waiting time statistics for emergency department treatment and elective surgeries are commonly used to gauge the degree of access to public hospital services. This is important because public hospital services are rationed as a means of handling the over-demand for services resulting from the provision of free services under Medicare.³⁵ In general terms, waiting times indicate the amount of time lapsed between a patient being clerically recorded or triaged on a hospital admission list and actual treatment.

Since 2000-01, the proportion of public hospital emergency patients seen on time in Tasmania has increased. For patients categorised under triage category two (i.e. patients required to be seen within 10 minutes), the proportion seen on time has risen from 55 percent to 72 percent. This is a dramatic improvement, albeit below the national average proportion of 78 percent in 2006-07.

According to the August 2008 Progress Chart, published by the Department of Health and Human Services, the percentage of triage two emergency patients seen on time at the Royal Hobart Hospital and Launceston General Hospital have declined from 2005.

On the other hand, the proportion of emergency patients seen on time in Tasmanian public hospitals, across all triage categories, has declined slightly (from 65 percent to 64 percent). At a national level, the proportion of patients seen on time has increased from 65 percent in 2000-01 to 70 percent in 2006-07.

Another indicator of accessibility to public hospital services is the amount of waiting time for public patients on elective surgery lists. In Tasmania the percentage of patients waiting more than 365 days for treatment has risen – from 7.6 percent in 2000-01 to 9.2 percent in 2006-07.

The median waiting time to be treated in Tasmania's public hospital emergency departments has increased from 24 minutes in 2004-05 to 27 minutes in 2006-07.

Unplanned readmissions

Information on unplanned readmissions to hospital is an important indicator of hospital safety. They show the percentage of patients who require an unexpected and unplanned readmission to hospital within 28 days of being discharged.

The Department of Health and Human Services indicates that the unplanned readmission rate for Royal Hobart Hospital has increased slightly from 3.3 percent to 3.6 percent from 2005 to 2008 (twelve months ended June). The North West

Regional Hospital (NWRH) in Burnie recorded a sharp increase in unplanned readmissions, from 4.9 percent to 6.8 percent over the same period. The Department states that a combination of relatively high emergency department presentations and older patient clientele contributes towards this result for the NWRH.

Launceston General Hospital had a reduction in the percentage of unplanned readmissions from 2.8 in 2005 to 2.4 in 2008.

Hospital staffing

The availability of labour is an important determinant not only of the capacity of hospital systems to deliver health care to patients, but also influences costs.

Staff numbers in the State's public hospitals have grown over time across all categories.³⁶ The average number of salaried medical officers and nurses (FTE basis) has increased from 2,160 in 2000-01 to 2,764 in 2006-07, an increase of 28 percent over the period. Almost all of this increase has occurred since 2003-04.

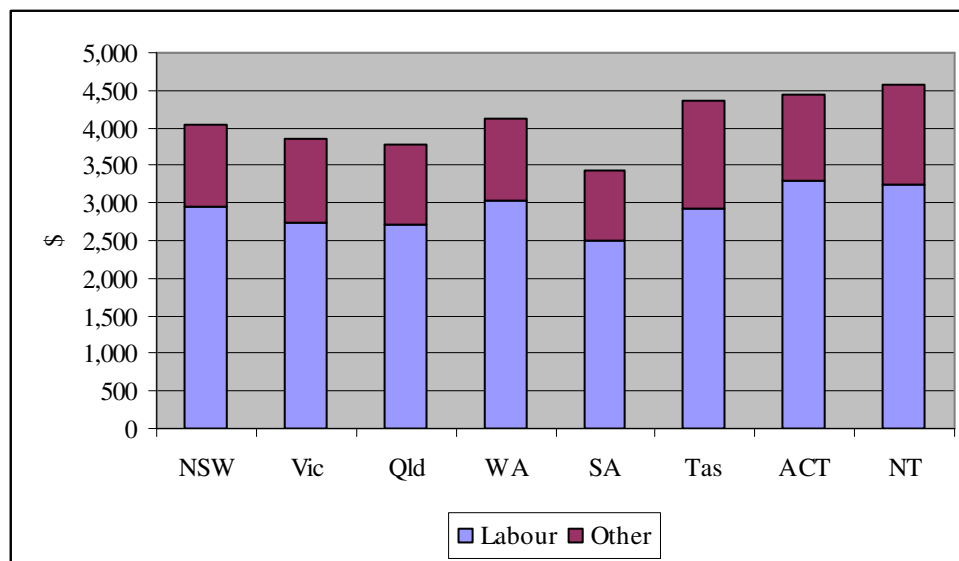
The number of administrative and clerical staff within public hospitals has also risen over the same period – from 549 people to 733, or an increase of 34 percent. In other words, there has been faster growth in administrative staff compared to headline medical staff within the Tasmanian public hospital system.

Hospital costs

The cost per casemix-adjusted separation is a commonly used indicator of the cost efficiency of public hospitals. This indicator is calculated using the total cost divided by the number of separations adjusted to account for the relative complexity of different episodes of care.

The total recurrent cost per casemix adjusted separation (incorporating medical and non-medical labour costs, and other costs such as medical supplies and materials) was highest of all the States for Tasmanian public hospitals in 2006-07 (Figure 5.8). The total cost of \$4,354 for Tasmania was about 11 percent higher than the national average.

Figure 5.8: Recurrent cost per casemix adjusted separation, 2006-07



Source: Australian Institute of Health and Welfare (AIHW), 2008, *Australian Hospital Statistics 2006-07*.

The Productivity Commission estimates cost per casemix-adjusted separation that incorporate capital costs, including depreciation and the user cost of capital. An analysis of data for the latest available year (2005-06) shows that capital costs in Tasmania (\$328 per casemix-adjusted separation) were the second lowest in Australia. However, even after taking capital costs into account Tasmania remained the highest cost public hospital provider amongst the States (i.e., excluding ACT and NT).

Expenditure on hospitals

Spending on hospitals represents a major driver of expenditure of State budgets. With the development of new and costly medical technologies, and the projected increase in the share of older people in the population, it will become increasingly important to seek spending efficiencies in this area.

According to the annual AIHW Health Expenditure series, expenditure by Tasmanian State (and local) governments on public hospitals in 2006-07 was about \$308 million. In comparison, spending in 1999-2000 was about \$173 million. This represents an increase of about 78 percent over the period.

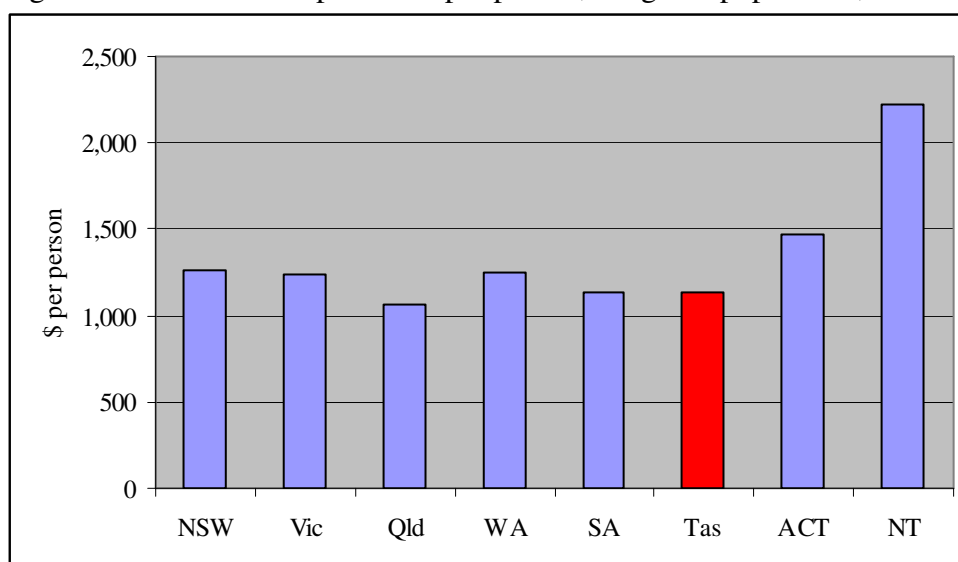
Unlike New South Wales, Victoria, ACT and the NT, Tasmania provides State (and local) government funding to private hospitals. In 2006-07, this funding totalled about \$17 million – or about 5 percent of expenditures on hospitals by the State. In 2002-03, the amount of funds appropriated by the Tasmanian government to private hospitals was about \$20 million.

Due to the lack of published information on hospital separations by sector in Tasmania, it is not possible to assess the adequacy of this funding treatment of private hospitals against standard measures of service provision. In 2007, about 43 percent of Tasmanian residents have private health insurance whereas in 2001-02 private hospital separations accounted for 47 percent of the State's total. Assuming that

demand for private hospital services has been maintained in recent years, then clearly private hospitals are not receiving State government funding entitlements on par with the public hospital system.

In spite of the growth in total State government spending towards its public hospitals, there is some information to suggest that Tasmania is a relatively low spender on recurrent hospital services, on a per capita basis (Figure 5.9).

Figure 5.9: Recurrent expenditure per person, weighted population, 2006-07



Source: Commonwealth Department of Health and Ageing, 2008, *The State of Our Public Hospitals*.

The AIHW also provides data on the source of funds for public and private hospitals across Australia (Table 5.4). The financial contribution of the Tasmanian government towards its own public hospitals (54 percent of total public hospital spending) was the second lowest of the States and Territories. It is notable that Tasmanian public hospitals are treating private patients, as indicated by the flow of \$11 million into public hospitals from health insurance funds.

Approximately 47 percent of the funds received by private hospitals are from insurance funds, with 36 percent from the Commonwealth government. Expenditure by the Tasmanian government towards private hospitals (nine percent of total private hospital spending) was the second highest in the Commonwealth, behind Western Australia (20 percent).

Table 5.4: Hospital expenditure by source of funds, 2006-07, \$ millions

	Public hospitals							
	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Commonwealth government	3,724	2,631	1,958	1,026	903	252	129	140
State and local governments	5,127	3,013	2,718	1,378	1,144	308	360	285
Health insurance funds	228	110	29	33	33	11	16	1
Individuals	45	9	13	68	5	3	1	-
Other	463	508	132	42	42	25	43	7
Total	9,588	6,271	4,850	2,548	2,127	599	548	432
	Private hospitals							
	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Commonwealth government	774	672	679	283	185	66	12	9
State and local governments	-	-	32	195	5	17	-	-
Health insurance funds	941	864	723	356	270	85	55	14
Individuals	56	83	86	45	28	4	6	18
Other	215	125	93	63	20	9	8	2
Total	1,987	1,744	1,613	943	509	181	81	44

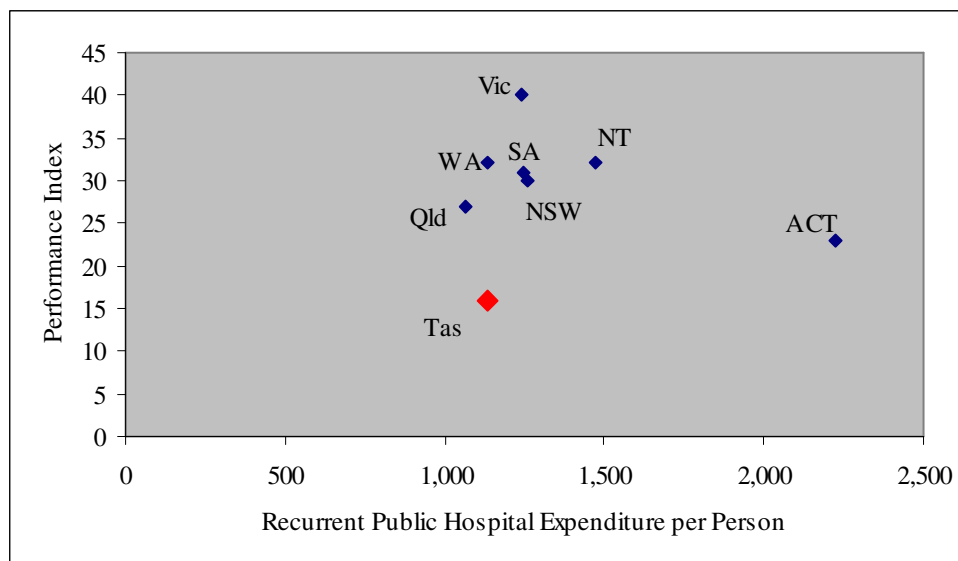
Source: Australian Institute of Health and Welfare, 2008, *Health Expenditure Australia 2006-07*.

Are Tasmanian public hospitals a value-for-money proposition?

To provide an overall measure of public hospital performance in Tasmania we looked at the Australian Medical Association (AMA) Public Hospital Report Card for 2008. In that report the AMA provides index scores on a number of criteria, for example Public Bed per 1000 of weighted population and Percentage of Elective Surgery Patients seen within Recommended Time. They also include an index score for Recurrent Public Hospital Expenditure per Person; this is an input measure not an output measure while the other index scores are output measures.

The AMA index scores are shown from 1 – 8 (best to worse), and we convert that into a worst to best score by subtracting each index score from 9 (9 – score). We then sum all the output scores and plot them with the Recurrent Public Expenditure per Person score. The results of this exercise can be seen in Figure 5.10.

Figure 5.10: Public hospital value for money index, 2006-07



Source: AMA Public Hospital Report Card; Commonwealth Department of Health and Ageing, 2008, *The State of Our Public Hospitals*; Authors calculations.

As can be seen Tasmania performs poorly compared to the other States and Territories, ranked last according to the index developed by the authors. According to the AMA's Public Hospital Report card, it performs poorly in the areas of public hospital admissions and elective surgery waiting times. Together with the relatively high costs of providing services in Tasmanian public hospitals and other factors, such as unplanned readmissions in major hospitals, there are grounds for concern about the State's public hospital performance.

On the other hand, a positive area of performance for Tasmanian public hospitals noted by the AMA study was the percentage of emergency department patients seen within the recommended time of 30 minutes.

Hospital sector reform principles

Tasmania has had a good record of introducing reforms to improve hospital efficiencies and invoke competitive pressures within the system. For example, in 1996-97 the Rundle Coalition government followed Victoria's lead and introduced casemix funding in the public hospital sector. This model ensures that funds more closely reflect the costs of different types of treatments undertaken in hospitals.³⁷

A range of initiatives have been undertaken to promote the involvement of the private sector in the delivery of public hospital services. The Hobart Private Hospital was established in 1999 following the decision of the then Coalition State government to privatise the maternity wing of the Royal Hobart Hospital. To this day, the Hobart Private Hospital is co-located with the Royal Hobart Hospital (Tasmania's largest public hospital) sharing patient care and support services.³⁸ The private sector is under contract with Royal Hobart to deliver public ophthalmology services.

At Launceston General Hospital, the private sector is contracted to provide public ophthalmology and nuclear medicine services. Private sector entities deliver

maternity services, ophthalmology services and diagnostic pathology and imaging at North West Regional Hospital (NWRH, with campuses at Burnie and Latrobe).

The Burnie campus of NWRH shares its premises with the North West Private Hospital, and is contracted to provide services for public patients. In the mid-1990s the State government franchised the Latrobe campus of NWRH (otherwise known as the Mersey Hospital) to a private health care company. Under the arrangement, the private entity was responsible for the entire management of the hospital. This arrangement remained until 2004, when control was returned to the State government.

The Tasmanian government's 2007 Clinical Services Plan proposed to redefine the roles of the Burnie and Latrobe NWRH campuses, with Burnie to specialise in high acuity inpatient and emergency services and Mersey providing rehabilitation, obstetrics and paediatric services, emergency care, and high-volume medical and day-only surgical services. This led to the former Howard Federal government to propose that it directly fund a full range of services at the Mersey Hospital, managed by a community controlled trust. In September 2007 the Commonwealth and State governments signed an agreement to transfer the hospital to the Commonwealth.

The Rudd Commonwealth government in March 2008 that it would seek a charitable or private sector entity to operate the Mersey as a public hospital from 1 July 2008, but has recently transferred responsibility for the hospital back to the State.

It is clear from this account that Tasmania has embraced experimentation in hospital services delivery in the past, and should continue to do so. We note that the government has recently advocated greater integration between the public and private hospital sectors in the delivery of health services, and greater private sector investment in areas of need. For instance, it has called for the incorporation of private sector services within its proposed 'integrated care centres' that will provide a range of non-emergency, sub-acute health services.

As a general principle, if the operational independence of the private sector is respected then calls for greater integration (especially on funding issues) appear to be unexceptional. Nonetheless, our concern is that integration could mute incentives for competition within the hospital sector. Given the lagging performance of public hospitals throughout the State, direct competition with robust private sector hospitals holds out the most promise for long term health system improvement. In addition, there is a risk that a future government could leverage the integration already in existence to impose prescriptive regulations on private operators.

Therefore, it is our strong recommendation the government investigates further ways in which public hospital functions can be transferred to an autonomous private sector on a competitive basis. This should encourage the delivery of more cost-effective provision of services at reasonable standards.³⁹

Consistent with this, public hospitals should (to the greatest extent possible) absolve themselves from accepting private patients. In 2005-06, it is estimated that almost 17,000 private patients were admitted in public hospitals for treatment.⁴⁰ The current policy does not appear appropriate in circumstances where there are public patients waiting to be treated in the State's public hospitals.

Another reform proposal that we recommend is that the allocation methodology of State recurrent and capital hospital funding be altered so that it does not discriminate between different hospital ownership types. As was first proposed by Milton Friedman in 1955 with respect to school education, the best way to achieve this objective is to ensure that hospital funds ‘follow the patient’ to his or her preferred hospital, with the funding entitlement potentially adjusted for the cost of the treatment to be provided.

Such a voucher scheme would be particularly empowering for public patients, some of whom are on lower incomes. As an alternative to a comprehensive voucher funding system, the State government should offer funding vouchers allowing public hospital patients languishing on waiting lists to get more immediate treatment in a Tasmanian private hospital.

To enable consumers to become well informed in making choices amongst the competing set of hospitals, the Tasmanian government should follow its own recent example concerning school education and publish a comprehensive suite of hospital performance indicators.

According to a recent analysis by Ross Fox, there is considerable scope for Tasmania to provide additional information to inform consumers (figure eleven). Even for the purpose of the analysis in this report, we have found that the lack of comprehensive information on private hospitals and medical error rates (for example, relating to surgical site infections, and the like) has hampered an ability to investigate the State’s hospital sector in greater detail. In other words, more information is better than less, and is in turn better than none at all.

Figure 5.11: Public hospital performance reporting information, available online

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Admissions								
no. of admissions	Y	Y	Y	Y	Y	Y	Y	Y
no. of renal dialysis admissions	N	N	N	Y	N	N	N	N
mental health admissions	N	N	N	Y	N	N	Y	N
no. of mental health admissions	N	N	N	N	N	N	Y	N
Elective Surgery								
elective surgery phone line	Y	Y	Y	Y	N	N	Y	N
search for doctors' waiting times	Y	N	N	N	N	N	Y	N
search for procedure waiting time	Y	Y	N	N	N	N	Y	N
waiting times by procedure (NT, by category)	Y	Y	Y	Y	Y	N	Y	Y
waiting times by hospital	Y	Y	Y	Y	Y	N	N	N
no. of patients waiting for surgery	Y	Y	Y	Y	Y	Y	Y	Y
no. of patients waiting by surgical specialty	N	N	N	N	Y	N	N	N
no. of patients waiting longer than 12 months	Y	N	N	Y	N	N	N	N
average (median) waiting time	Y	N	Y	Y	Y	Y	Y	N
no. of patients treated	N	Y	Y	Y	Y	Y	Y	Y
no. of hospital initiated postponements	N	N	N	N	N	N	Y	N
Emergency Department Care								
hospital admissions from emergency department	Y	Y	Y	Y	Y	N	N	N
emergency department presentations	Y	Y	Y	Y	Y	Y	Y	Y
no. of patients seen within recommended time by triage category	Y	Y	Y	Y	N	Y	Y	Y
no. of patients requiring hospitalisation not admitted within 8 hours	N	N	N	N	N	N	Y	N
Other Hospital Level Information								
private hospital activity	Y	N	N	N	N	N	N	N
total bed days	Y	N	Y	Y	Y	N	Y	Y
average length of stay	Y	N	N	Y	Y	N	Y	Y
daily average of inpatients	Y	N	Y	N	Y	N	N	N
mental health services	Y	N	Y	N	N	N	N	Y
non-admitted care	Y	N	Y	N	N	N	N	N
psychiatric hospitals	Y	N	N	N	N	N	N	N
waiting times for dental services	N	Y	N	N	N	N	N	N
no. of newborns	N	N	Y	Y	N	N	N	N
no. of palliative care services	N	N	Y	N	Y	Y	N	N
outpatient services	N	N	Y	N	N	N	N	Y
no. of patients attending GP after hours clinics	N	N	N	Y	N	N	N	N
ambulance response times	N	N	N	N	N	Y	N	N
Safety and Quality of Care								
patient satisfaction	N	N	N	N	Y	N	N	N
no. of unplanned readmissions within 28 days	N	N	N	N	N	Y	Y	N
no. of mental health readmissions	N	N	N	N	N	Y	Y	N
no. of mental health patients seen within 7 days post discharge from hospital	N	N	N	N	N	N	Y	N
no. of unplanned returns to operating theatre	N	N	N	N	N	N	Y	N
Outpatients								
no. of mental health services	N	N	Y	Y	N	Y	N	N
no. of women screened for breast cancer	N	N	Y	N	N	Y	Y	N
no. of public dental clinic visits (TAS, no. of dental appointments)	N	N	N	Y	N	Y	N	N
no. of ambulatory surgery initiative cases	N	N	N	Y	N	N	N	N
dental clinic waiting times	N	N	N	Y	N	N	N	N
oral health waiting list (ACT, no. of patients waiting for dental services)	N	N	N	N	N	Y	Y	N
no. of allied health services	N	N	N	N	N	N	Y	N

Source: Ross Fox, 2008, *Taking the Pulse: Reform Initiatives for the WA Health System*, Institute of Public Affairs & Mannkal Economic Education Foundation.

In summary, Tasmania's population is ageing with the proportion of people aged 65 and over expected to increase from 10 percent in 2006 to 17 percent in 2026. Older people tend to require significantly more health services per person, and hence increase the pressures on the State's hospital system.

The public hospital sector will doubtlessly play an important role in the future, as it caters for those who cannot afford to pay for their own medical treatments. A key challenge will be to ensure that pro-market policy settings are put in place so that public hospitals are well funded into the future. Even so, public hospital managers and the State government must be relentless in pursuing avenues to improve cost and operational efficiencies. If not, then public hospitals will present an ever-greater burden on hard-working Tasmanian taxpayers as the population ages.

The State's public hospitals need to be complemented by a strong and vibrant set of for-profit and not-for-profit hospital entities if Tasmania is to adequately cope with the age-related demand pressures for health services that are expected to lie ahead.

Within this framework, both sectors need to compete against each other to rein in costs, expand consumer choices and encourage greater innovation in medical services delivery. Indeed, it is reasonable to argue that a growing private hospital sector in itself is needed to allow customers to escape the poor performance of public hospital providers.

If the Tasmanian government pursues a reform agenda consistent with the principles outlined above then it should fully expect the realization of a hospital system that delivers world-class health care for its citizens.

¹ James M. Buchanan, Democratic values in taxation, In *Debt and Taxes: Volume 14, The Collected Works of James M Buchanan* (Liberty Fund: Indianapolis, 2001), pg. 38.

² The classic book in this area is Richard Musgrave (1959) *The theory of Public Finance: A Study in Public Economy*, McGraw-Hill. He also wrote a series of textbooks with Peggy Musgrave entitled *Public Finance in Theory and Practice*.

³ James Buchanan is the founder of the public choice school. A comparison of the public finance and public choice schools can be found in James M. Buchanan and Richard A. Musgrave (1999) *Public Finance and Public Choice: Two Contrasting Visions of the State*, The MIT Press.

⁴ Adam Smith, 1776, *An inquiry into the nature and causes of the wealth of nations*, Chicago: Chicago University Press, 1976, Volume II, pg. 244.

⁵ Adapted from Kenneth M. Brown, Kenneth, 1998, *Downsizing science: Will the United States pay a price?* The AEI Press: Washington, D.C., pg. 45.

⁶ Alex Robson, 2006, 'How high taxation makes us poorer', In Peter Saunders (ed), *Taxploitation: The case for income tax reform*, Sydney: The Centre for Independent Studies.

⁷ Owen Gabbitas and Damien Eldridge, 1998, *Directions for State Tax Reform*, Productivity Commission Staff Research Paper, AusInfo, Canberra and Peter Dixon, Mark Picton and Maureen Rimmer, 2004, Payroll taxes: Thresholds, firm sizes, dead-weight losses and Commonwealth Grants Commission funding, *The Economic Record*, 80(250) 289 – 301.

⁸ SCRGSP (Steering Committee for the Review of Government Service Provision) 2008, *Report on Government Services 2008*, Productivity Commission, Canberra.

⁹ Niskanen, William, 1971 (2007), *Bureaucracy and Representative Government*, p. 15.

¹⁰ Ludwig von Mises, 1944, *Bureaucracy*, Preface to 1962 edition, Liberty Fund: Indianapolis, 2007), pg. xv.

¹¹ Tullock, Gordon, 1965 (2005), *The Politics of Bureaucracy*, Liberty Fund Edition, p. 179.

¹² The average rate of return on ten-year Commonwealth Government bonds in 2006-07 was 5.8 per cent. This is commonly used as a benchmark for the risk-free rate of return, against which GBE and SOC returns can be assessed.

¹³ The difference between our view and that of the Auditor-General is in the treatment of Commonwealth corporate taxation. It is our view that by discounting the required rate of return by the corporate tax rate, the Auditor-General is implying that these organisations do not pay the corporate tax – in face they do not pay the tax, but do pay an equivalent fee to the Tasmanian Treasury as if they did pay the tax.

¹⁴ The capital asset pricing model is discussed extensively in most finance textbooks. See Thomas Copeland and Fred Weston, 1988, *Financial theory and corporate policy* third edition, Addison-Wesley for a particularly thorough but assessable treatment.

¹⁵ See Elroy Dimson, Paul Marsh and Mike Staunton, 2002, *Triumph of the optimists: 101 years of global investment returns*, Princeton University Press, for a discussion of appropriate values of the risk-free rate and risk premium.

¹⁶ Mueller, Dennis, 2003, *Public Choice III*, Cambridge University Press, Cambridge.

¹⁷ Nahan, Mike, 2006, 'The GST: Good try, but no banana', *IPA Review* July: 4-6.

¹⁸ Sinclair Davidson, 2007, *Fiscal illusion: How big government makes tax look small*, Perspectives on Tax Reform (15). CIS Policy Monograph 81.

¹⁹ A potential criticism of this type of rule is that it would constitute a pro-cyclical fiscal policy on the part of the State government. We are not convinced, however, that the sub-national governments should be engaging in macro-economic stabilisation activities. In addition, we are not convinced that fiscal policy should be employed for these purposes either. See Tony Makin, 15 December 2008, Beware the spending spree, *Australian Financial Review*, pg. 55.

²⁰ It could be argued that this rule creates a perverse incentive for State governments. It is unlikely, however, that a State government that consistently acted to reduce growth in order to maximise revenue would survive electoral challenges in the face of a determined and credible opposition.

²¹ For some of the more prominent studies in the recent school reform literature see, for example, Caroline Hoxby, 2000, 'Does Competition among Public Schools Benefit Students and Taxpayers?', *American Economic Review* 90: 1209-1238; and Ludger Woessmann, 2007, 'International Evidence on School Competition, Autonomy, and Accountability: A Review', *Peabody Journal of Education* 82 (2/3): 473-497.

²² The general principles outlined in this section are based on Julie Novak, 2006, 'Choice Matters: What Needs to Change to Make Schools Competitive?', *Policy* 22 (1) (Autumn): 23-28.

²³ Caldwell, Brian J., 'Why Not the Best Schools for Tasmania?', Speech to the Tasmanian Chamber of Commerce and Industry (TCCI), <http://www.educationaltransformations.com.au/files/Why%20not%20the%20best%20schools%20for%20Tasmania.pdf>.

²⁴ Caldwell, Brian J., 1998, *Administrative and regulatory mechanisms affecting school autonomy in Australia*, Department of Employment, Education and Youth Affairs (DETYA), Canberra.

²⁵ Tasmanian Department of Education, 2006, *C21st Educational Leadership: A Discussion Paper on the Role of the Principal*, School Leadership Development Project, February.

²⁶ For a summary of the effects of charter schools, see Mark Harrison, 2004, *Education Matters: Government, Markets and New Zealand Schools*, New Zealand Education Forum, Wellington.

²⁷ Tasmanian Demographic Advisory Council, 2008, *Tasmanian Demographic Change: Impact on State Schools*, Discussion Paper, April.

²⁸ Brian J. Caldwell, 2007, 'Research on School Size: An Educational Transformations Briefing Paper',

<http://www.educationaltransformations.com.au/files/publishedpapers/briefing%20paper%20school%20size.pdf>.

²⁹ The preceding paragraphs were drawn from Productivity Commission, 2008, *Report on Government Services*, Part E.

³⁰ Hon. Lara Giddings MP, 2008, 'AMA Report Shows Pressure on Hospitals', Media Release, 12 November.

³¹ Siobhain Ryan, 2008, 'Radical plan to rate hospitals', *The Australian*, 23 October.

³² Unless otherwise specified, the definitions and statistics outlined in this section are drawn from the yearly *Australian Hospital Statistics* reports provided by the Australian Institute of Health and Welfare (AIHW).

³³ The ABS recently published a statistical compendium on Australian private hospitals, with information for the 2006-07 financial year. However, data for Tasmania was merged with that for the Territories to protect the confidentiality of smaller hospitals in those jurisdictions.

³⁴ Department of Health and Human Services, 2008, *Clinical Services Plan: Update*, p. 51.

³⁵ As explained more generally by Milton Friedman, 'legislation cannot repeal the non-legislated law of demand and supply. The lower the price, the greater the quantity demanded; at a zero price, the quantity demanded becomes infinite. Some method of rationing must be substituted for price and that invariably means administrative rationing' ('How to cure health care', *The Public Interest*, 2001).

³⁶ The discussion on hospital staff numbers excludes the policy and administrative personnel within the core Department of Health and Human Services.

³⁷ There are some studies to suggest that casemix has delivered efficiency gains to public hospitals.

³⁸ It is proposed that the Royal Hobart Hospital will be relocated to the Macquarie Point railyards site on Hobart's waterfront, with a new private hospital also to be built at the site.

³⁹ For an exhaustive survey of the empirical literature comparing the cost of provision by public and private firms, see Dennis Mueller, 2003, *Public Choice III*.

⁴⁰ Commonwealth Department of Health and Ageing, 2007, *The State of Our Public Hospital: Fact Sheet Tasmania*.