Government
of South Australia

Sustainable Budgets:
Principles and Processes

First report by the
Sustainable Budget Commission

December 2009

24 December 2009

The Honourable Kevin Foley MP
Treasurer
State Administration Centre
200 Victoria Square
Adelaide SA 5000

Dear Treasurer

Enclosed is the first report of the Sustainable Budget Commission.

It deals with the 'Initial Task' elements of the Commission's terms of reference, including a recommended date for the presentation of the 2010-11 Budget.

Much of the report is devoted to general principles and processes that the Commission believes would support the restoration of sustainable State finances, and help to maintain them over time.

In particular, if adopted, the Commission believes that these principles and processes will support the achievement of the savings targets announced by the Government as part of the 2008-09 and 2009-10 Budgets.

In some cases, the Commission may wish to refine some of the conclusions in this report in the light of its development of Budget Improvement Measures – the second phase of its work.

The Commission wishes to record its appreciation of the excellent efforts of the Commission Secretariat, led by its Executive Officer, Andrew Francis, in preparing numerous briefing papers and analyses for the Commission's consideration at its meetings over the last six months, and for its organisation and coordination efforts supporting the Commission's activities.

Yours sincerely

Geoff Carmody
(Chair)

Monsignor David Cappo AO

Professor Jennifer Westacott FAICD

Bruce Carter

Chris Eccles

Jim Wright

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SUMMARY

The Sustainable Budget Commission (the Commission) has been established to assist the Government to move the State's finances back to a sustainable position following the Global Financial Crisis.

This is the Commission's first report. It develops a framework of principles and processes supporting sustainable State finances, and advises on the timing of the 2010-11 Budget. Fourteen specific recommendations are presented at the end of this report summary.

After the 2010 State Election, the Commission will identify a menu of specific budget measures from which affirmative decisions would be sufficient to achieve the sustainable budget savings target announced in the 2009-10 Budget. The Government will decide which specific measures should be adopted in the 2010-11 Budget.

The Commission will also examine opportunities to reform the delivery of government services and to improve public sector productivity.

The specific budget improvement measures will be the subject of the Commission's second report later in 2010.

Economic context and the savings challenge

The global financial and economic downturn has helped push South Australia's budget and financial position into a potentially unsustainable position, in the absence of corrective action.

This is temporary. Ratings agencies recognise this. For now, the State retains its triple-A credit rating.

Economic recovery will help restore the State's finances. But more is needed.

The Government has announced a savings target to restore financial sustainability.

The Commission's role is to advise the Government how it can achieve that savings target.

Sustainable Government finances are important.

South Australia would be a less attractive investment destination without them. Weaker economic and employment growth would be the result.

Unsustainable Government finances also 'cost' South Australians in the form of higher taxes and less services (eg, for health and education).

Sustainable State finances: principles and processes

This report develops a number of sustainable budget principles and processes, as well as recommending a timetable for presentation of the 2010-11 Budget.

The Commission's specific recommendations are set out below.

Based on existing definitions of sustainable financial performance, these principles and processes are relatively straightforward and largely common sense.

Applying them rigorously in practice is the real challenge.

Encouraging compliance with sustainable budget principles

A Sustainable Budget Cabinet Committee (SBCC), led by the Premier, the Treasurer, and at least one other senior Minister, as active participants, should enforce compliance with sustainable budget principles and processes.

Securing sustainable State finances over time provides a firm foundation for durable provision of productive Government programs to the South Australian community.

Recommendations

Recommendation 1: Continue to use existing budget performance indicators

The Commission recommends that current budget performance indicators: the net operating balance, net lending or borrowing, the net financial liabilities to revenue ratio and net debt, should continue to be the basis of budget sustainability assessments.

Recommendation 2: Budget management principles

The Commission recommends that the Government endorse the Sustainable Budget Framework's four budget management principles. These are:

1. Financial sustainability
2. Policy priorities
3. Accountability for budget and performance outcomes
4. Process transparency, certainty and compliance

Recommendation 3: Decision-making criteria — expenditure proposals

The Commission recommends that the Government endorse the six expenditure decision-making criteria presented in this report to evaluate priority expenditure proposals. These are:

1. Community benefits
2. Productivity / competitiveness
3. Cost recovery
4. COAG and multi-jurisdictional initiatives
5. Social Inclusion
6. Managing current service demands

Recommendation 4: Decision-making criteria — savings proposals

The Commission recommends that the Government endorse the six budget decision-making criteria presented in this report to apply to savings proposals. These are:

1. Duplication
2. Service levels and costs
3. Economic rationale
4. Social Inclusion and equity
5. Lower priority
6. Balance sheet efficiency

Recommendation 5: Chief Executive accountability

The Commission recommends that Chief Executives should be accountable for compliance of their agency budget bids and for setting out how the success of these should be measured. Their performance appraisals should take this into account.

Recommendation 6: Sustainable Budget Cabinet Committee (SBCC)

The Commission recommends the establishment of a Sustainable Budget Cabinet Committee (SBCC), at least to drive the formulation of the 2010-11 Budget, and possibly permanently. It should comprise the Premier, the Treasurer, and at least one other senior Minister as active participants to ensure rigorous application of sustainable budget principles and processes.

Recommendation 7: Themes for Commission advice to the Government

The Commission recommends the Government note the preliminary findings of the Commission on the ‘key themes’ on which it will provide its advice and make recommendations on budget reforms. These are:

1. Policy priorities
2. Budget improvement measures
3. Budget process
4. Chief Executive accountability
5. Measurement, reporting and evaluation
6. Implementation oversight and decision making
7. Machinery of government

Recommendation 8: Timing of the 2010-11 Budget

The Commission recommends that the 2010-11 Budget should be tabled in September 2010 to allow the Commission sufficient time to discharge its Terms of Reference, deliver its Phase 2 report, and allow time for the new Government to decide its budget responses to the Commission's reports.

Recommendation 9: Bilateral meetings should be discontinued for 2010-11

The Commission recommends that the current practice of bilateral meetings should not be continued as part of the 2010-11 Budget process.

Recommendation 10: Sustainable Budget processes for 2010-11

The Commission recommends that proposals developed for the 2010-11 Budget should be limited to the agreed list of election commitments, already-announced measures to achieve the net savings task, and specific new budget improvement measures to achieve that savings target.

Recommendation 11: 'Normal' budget timing

The Commission recommends that in a normal (non-election) year the State budget should be presented to Parliament as per the current timing (ie, the first Thursday in June) with the timing of the budget in an election year a function of the issues that need to be considered in that budget.

Recommendation 12: Bilateral meetings should be discontinued beyond 2010-11

The Commission recommends that the current practice of bilateral meetings should cease.

Recommendation 13: Better articulated agency proposals

The Commission recommends that the quality of information that is provided with budget proposals be significantly improved. This would be supported through the development of detailed minimum information requirements.

Only budget proposals complying with sustainable budget principles, and meeting minimum information requirements, should be considered as part of the budget process.

Recommendation 14: Application of the Sustainable Budget Framework

The Commission recommends that proposals developed/submitted to the annual budget process should be limited to the agreed policy priority areas developed by the Government, or proposals fully offset by savings, or accepted by the SBCC as exceptionally important ‘back-door’ bids.

SECTION 1: REPORT FOCUS AND STRUCTURE

Key Points

This is the Sustainable Budget Commission's first report. It presents the Commission's assessment and recommendations about the timing and processes for the 2010-11 Budget.

A second Commission report will be prepared next year. This will recommend specific policy measures for the 2010-11 Budget to give effect to the Government's budget savings targets.

It may also identify other reform options that emerge during this second phase of the Commission's work.

1.1 Sustainable Budget Commission and Terms of Reference

The Sustainable Budget Commission (the Commission) was announced by the Government on 4 June 2009.

The Commission Members are:

- Mr Geoff Carmody (Chair);
- Mr Bruce Carter;
- Monsignor David Cappo AO;
- Professor Jennifer Westacott;
- Mr Chris Eccles; and
- Mr Jim Wright.

The Commission is supported by a secretariat from the Department of Treasury and Finance and the Department of the Premier and Cabinet.

The Commission's Terms of Reference are as follows:

> ***"****The functions of the Commission will be to report to the Government on proposals to reform the budget determination process and to identify budget improvement measures to return the State Budget to a sustainable net operating surplus.*
>
> ***Initial Task***
>
> *The initial task of the Commission will be to report to the Government on an appropriate process including timelines for the development, consideration, agreement and delivery of the 2010-11 State Budget. The Commission may also recommend changes to Budget and Cabinet processes to better support the full critical analysis of financial decisions of the Government.*
>
> *The Commission will also advise the Government on the appropriate date for the presentation of the 2010-11 Budget.*
>
> ***Budget Improvement Measures***
>
> *Building on already identified savings, the Commission will recommend measures to the Government to achieve the savings targets contained in the budget forward estimates. The Commission will have the capacity to review all Government expenditures and revenues.*
>
> *To assist in that task the Commission may:*
>
> - *Review the efficiency and effectiveness of Government service delivery and seek to identify any opportunities to save costs through removal of duplication of resources to achieve policy outcomes.*
> - *Identify expenditures in areas of diminishing priority against the priorities outlined in South Australia's Strategic Plan and outcomes and objectives agreed under funding arrangements with the Commonwealth Government".*

1.2 Commission's reporting arrangements

The Commission intends to produce two reports for the South Australian Government.

This first, or Phase 1, report presents the Commission's findings and recommendations concerning the initial task set out in its Terms of Reference.

The report recommends a delayed date and changed processes for the preparation of the 2010-11 Budget, taking account of the 2010 State Election (20 March) and the detailed work on budget improvement measures required of the Commission in Phase 2 of its work.

This first report also presents broad recommendations about processes for subsequent budgets. Further process reforms may be proposed in the Commission's second, or Phase 2 report, when the Commission has had further time to assess their merits.

This report also presents the Commission's findings on more general principles and criteria that should support the achievement and maintenance of sustainable budget outcomes over time. Where appropriate, the Commission's Phase 2 report will expand on these findings.

1.3 Phase 2 savings task and future state budgets

In Phase 2 of its work, the Commission is required to recommend specific action ('budget improvement measures') that, if adopted by the Government, would achieve the savings targets factored into the budget forward estimates.

The targets are as follows:

- the 2009-10 Budget announcement requiring (net) savings of $150 million in 2010-11, $250 million in 2011-12 and $350 million in 2012-13; and

- the 2008-09 Budget[1] announcement requiring (net) savings of $75 million in 2010-11, $150 million in 2011-12 and $225 million in 2012-13[2].

The Commission notes the requirement for Government departments to achieve other savings, including through the reduction of 1600 full-time equivalent employees (FTEs), and the ongoing requirement for agencies to achieve efficiency savings of ¼ per cent per annum of total employee expenses.

The Commission also notes the Government's desire to limit salary and wage increases across the public sector to no more than 2.5 per cent per annum. If future wage outcomes are limited to 2.5 per cent per annum, the saving in 2012-13 alone is estimated at $290 million.

1.4 Structure of this report

The remainder of this report is organised as follows:

- Section 2 outlines the economic situation as currently seen and summarises the Government's announced plan to restore budget sustainability.

- Section 3 reviews ratings agency processes and 'trigger points' as an element relevant to assessing budget sustainability.

- Section 4 presents an operational definition of budget sustainability as the starting point for the Commission's work.

- Section 5 builds on Section 4, defining financial sustainability performance indicators.

- Section 6 presents high-level principles for a sustainable budget policy approach and related budget decision making criteria.

- Section 7 discusses some key themes that support the Commission's report.

- Section 8 translates the material in Section 6 into practical budget procedures for the 2010-11 Budget.

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[1] Specific measures to achieve the first tranche of savings worth $25 million each year from 2009-10 have already been identified and disclosed in the 2009-10 Budget papers.

[2] Only estimates up until 2011-12 were published in the 2008-09 Budget. The 2009-10 Budget announced an additional $75 million for the target in 2012-13.

- Section 9 replicates the material in Section 8, but as applied to a ‘normal’ (ie, non-election) budget year.
- Section 10 outlines the initial background data collection and information gathering process needed for the Commission’s Phase 2 work.
- Section 11 summarises the next task for the Commission and the challenge for the Government.
- Appendix A presents a full listing of the Commission’s Phase 1 report recommendations.
- A glossary and explanation of acronyms are appended to the report.

SECTION 2:
ECONOMIC CONDITIONS AND THE SAVINGS TASK

Key Points

South Australia has faced an economic downturn, adversely affecting budget revenues, the budget 'bottom line', and threatening budget sustainability.

Economic recovery seems to be underway but is still subject to downside risks later as economic stimulus measures are wound back.

The Government has announced substantial budget savings over the forward estimates period to restore sustainable State finances.

While included in the budget estimates, these savings will only be achieved when specific saving measures have been identified and implemented.

Specific budget improvement measures to be identified by the Commission in Phase 2 of its work will require the Government to make difficult decisions, and accept trade offs between programs competing for scarce budget resources.

2.1 Budget effects of the economic downturn

The 2009-10 Budget was prepared when the world economy faced almost unprecedented financial market difficulties. The developed world was entering a severe, synchronised, recession: the worst since the Great Depression.

Global economic interdependence means financial and business shocks in one part of the world can quickly be transmitted more widely.

South Australia was not immune from the problems facing the rest of the world. State Government revenues were reduced. GST receipts suffered as Australian economic growth slowed significantly. Forecasts of growth, employment, wage increases and consumption spending were revised down for South Australia as well.

This downturn adversely affected the South Australian Budget, including a reduction of $3.8 billion in total revenues over the forward estimates period.

The economic downturn put pressure on the State's finances. The Government response to this challenge came as part of the 2009-10 Budget.

2.2 The path back to a sustainable state budget

The Government announced a plan to restore State budget surpluses by 2010-11, and a path of debt reduction beyond that, in the 2009-10 Budget.

The Commission notes the projections in the 2009-10 Budget, including the announced savings measures, assume no net new spending over the forward estimates period.

The budget estimates already assume that the savings task is achieved in broad terms.

The Commission's task, in the second phase of its work, is to identify specific savings options that ensure the savings target is actually achieved.

Many of these options will require difficult decisions.

Sound financial management and financial sustainability support durable provision of needed services to South Australians, and ensure the State is well placed to react to future economic shocks.

SECTION 3:
RATINGS AGENCY RATINGS AND 'TRIGGER POINTS'

Key Points

The Government's policies include prudent financial management and retaining the State's triple-A credit rating.

This rating was confirmed following the release of the 2009-10 Budget. It is contingent, in part, on meeting the savings targets announced in the 2009-10 Budget.

Achievement of the Government's savings targets is already included in ratings agencies' assessments of the State.

Credit ratings are an external guide to the sustainability of a state's finances.

A ratings downgrade increases borrowing costs for Governments, has to be paid for by taxpayers and would reduce the attractiveness of the State as a competitive investment destination, in an increasingly competitive environment for attracting scarce investment funds.

In practice, getting back on the top ratings rung can be much harder than staying there.

3.1 Managing public finance risks

The Commission notes one of the Government's objectives is:

> *"To ensure that risks to state finances are managed prudently to maintain a triple-A rating".*

In this context, the 2009-10 Budget stated that:

> "*It is recognised that in the current environment it has been necessary for the Government to take short-term steps that may put the rating at risk. However, by continuing to invest in critical infrastructure the Government is supporting the state's economy and providing jobs for South Australians. As the economy enters the recovery phase debt reduction measures and savings initiatives will help to restore the state's finances".*

3.2 Ratings agencies' assessments of the SA Government

Ratings agencies are private sector organisations that advise investors on the risks of investments in financial assets, including those sold by Governments.

The credit rating applied to issuers of financial assets is based on an assessment of their capacity to pay the amounts owing to investors.

South Australia is currently assessed by two credit ratings agencies, Standard & Poor's, and Moody's Investors Service (Moody's).

Both agencies upgraded South Australia to a triple-A credit rating in 2004, following a period of sustained debt reduction. At present, both have maintained South Australia's triple-A credit rating following the release of the 2009-10 Budget.

The ratings agencies indicated South Australia's triple-A credit rating reflects a relatively low debt burden, a positive record of fiscal discipline, an adequate operating performance, and the strong support provided to all states by the Commonwealth Government.

The press releases from both Moody's[3] and Standard & Poor's[4] after the 2009-10 Budget indicate achievement of the announced savings is necessary to maintain the current rating.

3.3 How do ratings agencies make their assessments?

Ratings agencies consider various factors, both quantitative and qualitative, in making credit assessments.

Standard & Poor's now publishes 'trigger point' financial performance indicators. These are only part of its ratings process.

It uses a net financial liabilities (NFL) to revenue ratio for the non-financial public sector as a debt and debt servicing 'trigger point'. A NFL to revenue ratio of 80-90 per cent is regarded as an upper limit for South Australia.

The 2009-10 Budget estimated the NFL to revenue ratio for South Australia would peak at 105.9 per cent in 2011-12.

This is above the 'trigger point' that could result in downgrading South Australia's triple-A credit rating. However, for now, Standard & Poor's[5] has left South Australia's rating unchanged for three key reasons:

1. *"The peak in NFL is only temporary and Standard & Poor's believes that the ratio will decrease in the medium term as projected by the Government. The savings announced by the Government will support the state's operating position and thereby reduce the state's need to borrow additional funds.*

2. *The increase in NFL partly reflects changes to the discount rate. Using a comparable discount rate[6] for the unfunded pension liability results in NFL peaking at about 85 per cent of revenue — a level close to that recorded when Standard & Poor's changed South Australia's rating to 'AAA' in 2004.*

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[3] Moody's Investor Service Global Credit Research Announcement, "Moody's says South Australia's Aaa rating unlikely to change following the budget release", 4 June 2009.

[4] Standard & Poor's press release, "BULLETIN South Australia's AAA/A-1+ Ratings Unaffected by State Budget", June 4 2009.

[5] Standard & Poor's press release, "BULLETIN South Australia's AAA/A-1+ Ratings Unaffected by State Budget", June 4 2009.

[6] The unfunded superannuation liability is estimated at any date by discounting future superannuation benefit payments by a relevant discount rate. The discount rate reflects the risk-free interest rate and is based on the longest-dated Commonwealth Government bond. A discount rate of 5.2 per cent (effective annual rate) was used in the 2009-10 Budget. The discount rate changes in response to the economy and financial market conditions. Small changes in the long term bond rate can have large effects on the reported liability. For example, a 1.0 percentage point increase in the long term bond rate decreases the liability by approximately $1.6 billion.

3. *Like most states, South Australia has a history of capital expenditure under-spending and is therefore less likely to achieve its forecast debt levels."*

While breaching the Standard & Poor's 'trigger point' NFL to revenue ratio did not reduce South Australia's credit rating to date, it might yet do so.

Achieving the Government's announced savings targets in net terms is central to retention of South Australia's triple-A credit rating by Standard & Poor's.

Moody's is less explicit in identifying specific 'trigger points' for a ratings review.

It considers a wide range of financial and economic indicators as part of its overall credit assessment.

3.4 The effect of a credit rating downgrade

A lower credit rating for South Australia would directly increase Government borrowing costs, borne by taxpayers.

Other indirect costs of a ratings downgrade potentially would be more important.

A triple-A credit rating tells investors the Government is managing the State's finances and economy in a responsible manner. It's an indicator of a stable investment environment.

In May 2009, Moody's downgraded Queensland's credit rating from a triple-A to Aa1. This reflected Moody's concerns about the State's deteriorating financial performance and the perceived absence of a medium-term strategy to restore sustainable finances.

Credit ratings guide Governments about the sustainability of their finances. By maintaining a triple-A credit rating, a Government obtains independent advice that it is managing its resources prudently. The triple-A credit rating also anchors public expectations that the government will maintain fiscal discipline, the absence of which may lead to unsustainable levels of debt and interest obligations that will reduce the capacity to provide services to the public.

Once a credit rating has been downgraded it can be hard to restore it.

Standard & Poor's reduced South Australia's credit rating from triple-A to AA+ in 1991 and Moody's reduced it from Aa1 to Aa2 in 1992 in response to the financial problems faced by the State Bank of South Australia.

It took around 13 years for South Australia to regain its triple-A credit rating (2004), following a sustained period of debt reduction, including the sale of electricity assets and the delivery of substantial budget surpluses to reduce the State's level of debt.

SECTION 4: SUSTAINABILITY — WHAT DOES IT MEAN?

Key Points

Governments are rightly concerned about a variety of sustainability concepts.

The Commission's focus is on public sector financial sustainability.

Public sector financial sustainability is a means to other sustainability ends — it is a necessary condition for their maintenance over time.

Governments are responsible for public sector financial sustainability: their decisions directly influence South Australia's public finance sustainability.

Sustainable South Australian public finances[7] are the focus of the Commission's work.

From a State Budget perspective, a ***sustainable*** net operating surplus and, related to that, a ***sustainable*** net financial liability position, are key ingredients of this focus.

4.1 Defining sustainability

'Sustainability' is a position or process that can be maintained indefinitely.

From a public finance perspective, several sustainability concepts are relevant:

- *Financial sustainability* — ensuring a Government's present and future policy settings are not threatened by an untenable operating balance and/or balance sheet position. This definition has short, medium and long-term dimensions.
- *Tax stability/sustainability* — ensuring a reasonably stable tax and other revenue-raising system without regular tax rate increases. This affects intergenerational sustainability (see below), and South Australia's competitive position as an investment destination.
- *Intergenerational sustainability* — a 'fair' sharing of the budget's collection and distribution of scarce resources across successive generations.
- *Policy and program sustainability* — ensuring a Government's priority expenditure programs are durable.

Governments are concerned about other sustainability concepts as well.

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[7] In what follows, it is assumed that sustainability also refers, as appropriate, to the public non-financial and public financial corporations sector as well as the general government sector. Where this is not made explicit, it is assumed. In some cases, the reference to 'debt' is interpreted to cover net financial liabilities, such as employee-type benefits including unfunded superannuation and recurrent costs attributable thereto.

These include:

- *Social sustainability* — This is hard to quantify, rests on value judgements, and generates considerable political debate. However, large parts of Government activity are devoted to it, including policies on education, public health, other 'social safety net' programs, and other redistributive measures.
- *Environmental sustainability* — This is increasingly a major Government responsibility. Broad environmental policy, resource conservation, waste reduction, appropriate disposal, and recycling of waste products, are examples.

Financial sustainability allows Governments to apply effective policy responses to external shocks (see below). The Commission also concludes that financial sustainability is the foundation for delivering other sustainability concepts over time.

4.2 External influences on financial sustainability

The South Australian public sector doesn't operate in a vacuum.

It's affected by the State (and broader) economic environment.

These external effects limit the Government's choices.

They affect the financial sustainability of the budget:

- The State competes with other Australian States and Territories, as well as overseas competitors, for scarce financial resources and economic activity.
- This competition limits Government choices about tax levels, public spending, public debt, and the cost of paying for debt.
- These choices must be politically 'acceptable' and economically competitive.
- South Australia is subject to assessments of its competitive strengths and weaknesses from a range of actual and potential investors and ratings agencies.
- Ratings agencies assessments are covered in Section 3 above.

State Governments aren't completely free to make policy decisions without allowing for these influences. Ignoring these economic constraints can lead to untenable budget positions.

4.3 Financial sustainability is a core Government responsibility

Governments are responsible for sustainable public finances in South Australia.

Their policy decisions are key influences on the financial position of the State.

Government decisions giving financial sustainability top priority will be crucial to the achievement of the Government's announced savings targets.

Over time, these decisions will also support, rather than undermine, the other concepts of sustainability noted above.

SECTION 5:
MEASURING FINANCIAL SUSTAINABILITY

Key Point

Current budget performance indicators: the net operating balance, net lending or borrowing, the net financial liabilities (NFL) to revenue ratio, and net debt, should continue to be used for sustainable budget performance assessments.

5.1 Financial sustainability indicators

Given the 'sustainability' definition in Section 4, governments need practical measures of the sustainability of their budgets and public finances.

The following indicators are used to assess the financial sustainability of budgets:

Broad indicators averaged over the economic cycle

- Acceptable and competitive taxation and other revenues as percentages of the economy.
- Acceptable public debt interest (PDI) payments and net financial liabilities as percentages of total budget revenues.
- Acceptable budget spending as a percentage of the economy.
- Acceptable levels for (i) the budget net operating balance, (ii) net lending or net borrowing requirements as percentages of total budget revenues.
- Appropriate general government (net) debt as a percentage of budget revenues.

Broad indicators of change averaged over the economic cycle

- A budget net operating balance that is stable, when averaged over the course of the economic cycle as a percentage of total budget revenues.
- A budget revenue share of the economy that is stable, when averaged over the course of the economic cycle without the need for regular changes in tax rates, or other revenues.
- Budget outlays as a percentage of the economy that are reasonably stable over time.

Budget net operating balances are affected by the servicing costs associated with borrowing undertaken to support the Government's capital expenditure program.

They are also affected by depreciation allowances associated with capital assets and expenditure.

Monitoring these indicators should cover the general government sector, the non-financial public sector and also public sector financial corporations.

5.2 Sustainable budget indicators

The current budget performance indicators published as part of the Budget and Mid Year Budget Review are appropriate indicators for assessing budget sustainability. They are:

- Net operating balance;
- Net lending or net borrowing;
- Net financial liabilities to revenue ratio; and
- Net debt.

The Commission will not recommend quantitative targets for each of these four indicators.

This is a Government responsibility.

However, the Commission notes that a golden rule is that Governments should fund ongoing recurrent expenditure out of annual revenues. It should not in the medium to longer term borrow to fund operating activities as is required when the budget has a net operating deficit. This is consistent with the Governments stated objective to *"return the State Budget to a sustainable net operating surplus"*.

Governments must decide what weight to give to these measures in deciding what are ‘acceptable’ or ‘reasonable’ levels of taxation, other revenues, outlays and public sector debt.

Recommendation 1: Continue to use existing budget performance indicators

The Commission recommends that current budget performance indicators: the net operating balance, net lending or borrowing, the net financial liabilities to revenue ratio and net debt, should continue to be the basis of budget sustainability assessments.

SECTION 6: SUSTAINABLE BUDGET POLICY FRAMEWORK

Key Points

The Commission proposes a Sustainable Budget Framework, based on four core budget management principles, and supported by specific budget decision-making criteria for the assessment of expenditure and savings proposals.

Budget formulation should be conducted as a 'top down' process. The Government should articulate its policy objectives at the commencement of the process, with financial sustainability an overriding constraint.

Budget proposals outside of priority policy areas should only be developed in exceptional circumstances, and then only where consistent with budget management principles.

Chief Executives should be accountable for submitting budget proposals (expenditure, savings, and revenues) that are consistent with the Government's agreed policy priorities.

6.1 Sustainable Budget Framework

Durably delivering sustainable budgets requires processes encouraging such outcomes.

To this end, the Commission proposes a Sustainable Budget Framework (Framework) based on (i) high level principles for budget management; and (ii) supporting these, budget decision-making criteria for assessing expenditure and savings proposals.

The Commission concludes current budget processes could be improved. It proposes specific reforms to strengthen the weighting given to sustainable budget outcomes.

Elaboration on the items contained in Diagram 6.1 follows in the remainder of Section 6.

Diagram 6.1: Sustainable Budget Framework

Budget management principles

1. Financial sustainability
2. Policy priorities
3. Accountability for budget and performance outcomes
4. Process transparency, certainty and compliance

Budget decision-making criteria

Expenditure criteria	Savings criteria
1. Community benefits	1. Duplication
2. Productivity / competitiveness	2. Service levels and costs
3. Cost recovery	3. Economic rationale
4. COAG and multi-jurisdictional initiatives	4. Social Inclusion and equity
5. Social Inclusion	5. Lower priority
6. Managing current service demands	6. Balance sheet efficiency

6.2 Budget management principles

The Framework is based on four budget management principles, discussed in turn below.

1. Financial sustainability

Financial sustainability should be the priority Government objective. It is a necessary condition for achieving the Government's broader sustainability objectives (relating to tax/revenue, intergenerational equity, policy/program sustainability, and social and environmental sustainability).

2. Policy priorities

Given principle 1, the budget process should then focus on the Government's policy priorities.

The Government should rank its policy priorities as clearly as possible up-front. This provides a framework against which competing spending (or revenue reduction) proposals can be assessed. Expected benefits from policy initiatives should be clearly specified. As far as possible, these should be quantifiable.

Subject to principle 1, there should be sufficient flexibility to meet the evolving needs of the community. South Australia's Strategic Plan, and other cross-government plans (eg, 30 Year Plan for Greater Adelaide, Water for Good), should serve as broad statements of policy objectives and expressions of long term goals, driving the development of more specific policy priorities at the commencement of each annual budget process.

The statement of policy priorities should act as a 'filter', ranking specific proposals considered as part of budget formulation.

3. Accountability for budget and performance outcomes

Chief Executives should be accountable for budget management and for achieving anticipated program benefits, both to the Government, and to the public.

Lines of accountability for Chief Executives for development and management of budgets must be clear. The Chief Executive Accountability Framework provides the foundation for these arrangements, but should be strengthened to deliver greater accountability to Cabinet.

4. Process transparency, certainty and compliance

The budget processes should be stable, predictable, and involve a clear sequence of events. Budget decisions should be transparent, made considering all competing priorities, and decision makers should have access to timely and relevant performance data.

Agreed processes should be complied with in full as a key ingredient in delivering budget discipline.

6.3 Deterministic budget process

The financial sustainability and policy priority principles deliver a more 'top-down' or 'deterministic' budget process. This process contrasts with the more 'evolutionary' model that has been the *de facto* approach in South Australia in recent years.

The prioritising of policy initiatives must be robust, credible, inclusive of all competing options, and be a durable ranking held by the Government.

This is vital to ensure the most important initiatives fit within the sustainable budget envelope, given limited resources.

This will facilitate agencies' planning activities and ensure that the preparation of budgets and associated proposals are appropriately focussed on policy priorities.

This is considered further in Section 6.4 below.

Recommendation 2: Budget management principles

The Commission recommends that the Government endorse the Sustainable Budget Framework's four budget management principles.

6.4 Decision-making criteria — expenditure proposals

The Commission has identified a number of budget decision-making criteria to guide analysis of budget proposals. Budget decision-making criteria are important to ensure 'value for money' is achieved. The Commission proposes six *expenditure* criteria to be applied when evaluating new spending proposals from 2011-12.

Only proposals consistent with policy priorities should be developed for consideration. Further, all proposals should be considered as part of the overall budget process. This ensures decisions are made consistent with budget sustainability.

For the 2010-11 Budget, the Government's short term priorities will reflect its 2009-10 Budget position, plus any new commitments made subsequently (including during the 2010 State Election campaign).

The expenditure criteria are discussed below.

1. Community benefits

Proposals should detail their benefits and costs. Only those bids demonstrating net benefits to the community should be considered.

Benefits and costs should be specified as clearly as possible. The Department of Treasury and Finance *Guidelines for Evaluating Public Sector Initiatives* should be applied rigorously.

2. Productivity / competitiveness

Proposals must clearly identify any net productivity or competitiveness benefit (or cost) to the economy and contribute to sustainable economic growth.

3. Cost recovery

Proposals involving Government fees and (properly-defined) user charges must adhere to principles of full cost recovery. Opportunities to recover costs from the users or beneficiaries of services should be explored in the development of proposals.

4. COAG and multi-jurisdictional initiatives

Proposals in this area must demonstrate direct links to Council of Australian Governments (COAG) initiatives and must justify why additional funding is required to achieve stated benefits.

5. Social inclusion

Relevant proposals must demonstrate defined benefits that contribute to the Government's Social Inclusion objectives.

6. Managing current service demands

Proposals may be developed for demand management strategies, to achieve productivity improvements, or to maintain existing levels of service delivery in Cabinet-endorsed areas.

Recommendation 3: Decision-making criteria — expenditure proposals

The Commission recommends that the Government endorse the six expenditure decision-making criteria presented in this report to evaluate priority expenditure proposals.

6.5 Decision-making criteria — savings proposals

The Commission proposes to apply six savings criteria to identify and assess budget improvement measures in Phase 2 of its work. These criteria should also be relevant for future reviews of spending where it is necessary to identify saving opportunities. The criteria are discussed below.

1. Duplication

Areas of duplication from within the South Australian Government sector should be eliminated or minimised. Duplication of services also provided by the Commonwealth or Local Governments, or by the private sector, should cease where they demonstrate no net benefit.

2. Service levels and costs

Service levels or costs above national averages should be brought into line with relevant benchmarks where appropriate, unless better outcomes can be justified and are being delivered.

3. Economic rationale

Programs/proposals should be based on a solid economic rationale for government intervention, their continuation, or inception (for new proposals). For example, programs/proposals should involve provision of public goods, exist due to the presence of other significant externalities causing market failure, to satisfy information requirements, or to fulfil regulatory functions.

4. Social Inclusion and equity

Savings measures should consider the impact on Social Inclusion objectives and deliver lower cost alternatives (eg, movement to Non Government Organisations where appropriate) and, possibly, consider opportunities to cease ineffective services.

5. Lower priority

Existing commitments will need to be prioritised. It may be necessary to cease lower priority and less effective programs.

6. Balance sheet efficiency

All government asset holdings should be justified, and disposed of where assets are not being held by the government for essential service delivery requirements or strategic purposes. Employee liabilities should also be proactively managed (where already incurred) or avoided/minimised (especially where unsustainable).

Recommendation 4: Decision-making criteria — savings proposals

The Commission recommends that the Government endorse the six budget decision-making criteria presented in this report to apply to savings proposals.

6.6 Decision-making criteria — revenue

The Terms of Reference for the Commission allow it to look at revenue initiatives.

The first priority of the Commission will be to look at the expenditure side of the Budget.

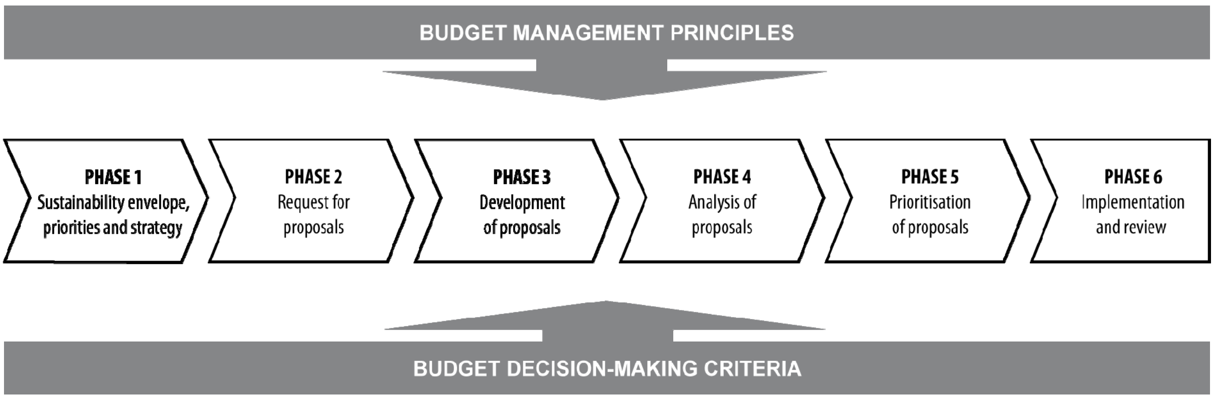
Revenue initiatives may be considered in the Commission's Phase 2 report. This will include an examination of programs to ensure that appropriate cost recovery is being applied.

6.7 Budget cycle: applying the principles and criteria

Application of the Sustainable Budget Framework is summarised in Diagram 6.2 below.

For each phase of the annual budget cycle, administrative arrangements will need to be established to support the budget process.

Diagram 6.2: Budget cycle overview



Phase 1	—	Determining budget sustainability envelope, policy/program priorities and strategy (Cabinet)
Phase 2	—	Request for proposals in priority areas
Phase 3	—	Development of proposals against statement of policy priorities and budget decision-making criteria
Phase 4	—	Analysis of proposals against statement of policy priorities and budget decision-making criteria
Phase 5	—	Prioritisation of proposals against statement of policy priorities and budget decision-making criteria
Phase 6	—	Implementation and review (by service delivery and central agencies)

SECTION 7:
KEY SUPPORTING THEMES

Key Points

The Commission has identified seven themes in which to group its advice to Government. These themes cover the Commission's preliminary assessment of the advice it will provide in this report and the next. Additional themes may emerge during the Phase 2 process.

One key recommendation is the establishment, at least for the formulation and delivery of the 2010-11 Budget, of a Sustainable Budget Cabinet Committee (SBCC) to drive compliance with the proposed Sustainable Budget Framework. The Premier and Treasurer and at least one other senior Minister should be active members of the SBCC.

7.1 Commission advice to Government: key themes

The Commission has identified seven themes in which to group its advice to the Government:

- Policy priorities
- Budget improvement measures
- Budget process
- Chief Executive accountability
- Measurement, reporting and evaluation
- Implementation oversight and decision making
- Machinery of government

These themes cover the Commission's preliminary assessment of the advice it will provide in this report and the next. Additional themes may emerge during the Phase 2 process.

Each theme is summarised below.

7.2 Policy priorities

Consistent with sustainable budgets, more emphasis on a 'top down' process for deciding new spending proposals is required.

Policy priorities should be agreed by Cabinet at the start of the budget process to focus the preparation of spending proposals, as noted above. Compliance with these policy priorities, and keeping total spending decisions within budget sustainability limits, will be crucial.

Such an approach might involve:

- A ‘statement of policy priorities’ (or similar) to provide a ‘top down’ ranking of the Government’s policies and programs to guide budget decision-making.

- A process for determining the ranking of policy priorities that is robust, credible, allows for all competing options, and be durably-held by decision makers. The list must be reasonably short to ensure it is manageable.

- The preparation only of budget proposals consistent with this statement of policy priorities. All other agency operations should continue within the funding levels identified by the forward estimates (as adjusted from time to time to take into account parameter changes).

- The requirement to specify how their success or otherwise should be evaluated.

- A process to handle expenditure proposals brought forward outside of the approved priorities (where no offsets are identified). A **Sustainable Budget Cabinet Committee** is one option to deal with such proposals (this is discussed below).

- A process for unexpected, or ‘last minute’, highly desirable projects to be advanced, and considered in a whole-of-budget context, not in isolation.

7.3 Budget improvement measures

This will be the focus of the Commission’s Phase 2 Report.

7.4 Budget process

The Commission has been asked to provide advice to the incoming Government on the timing of the 2010-11 Budget, minimum data requirements, and the budget process.

This is covered in Section 8.

7.5 Chief Executive accountability

The ‘top down’ budget approach relies on adherence to the priorities set by Cabinet.

As the Government, Ministers collectively must set priorities for Budget programs, and ensure compliance with Cabinet-agreed Budget processes when considering proposals.

Operationally, the Commission believes Chief Executives and their agencies should be accountable for compliance of their agency budget bids, including savings and revenue proposals. Chief Executives should be responsible for setting out how the success of agency bids should be measured. The extent to which their budget proposals actually deliver the expected outcomes should be a factor in their performance appraisals.

Ideally, quantitative measures of success should use existing data collections, and agency annual reporting. In addition, Report on Government Services (ROGS) data, and Commonwealth Grants Commission (CGC) data should be used wherever possible to assess performance.

There should also be increased use of cost-benefit analysis (before the event) and the existing *Guidelines for the Evaluation of Public Sector Initiatives*, to evaluate proposals. In addition, post-implementation evaluation of whether the intended benefits were realised should be undertaken.

Recommendation 5: Chief Executive accountability

The Commission recommends that Chief Executives should be accountable for compliance of their agency budget bids and for setting out how the success of these should be measured. Their performance appraisals should take this into account.

7.6 Measurement, reporting and evaluation

A greater focus on measurement, reporting and evaluation is needed to judge the effectiveness of programs.

Better outcomes are not necessarily correlated with spending more money. It is how money is applied that has the greater influence on whether outcomes are superior or not.

The Commission is compiling an extensive database on current expenditure programs including their costs and benefits (see Section 10 below). This will be a sound starting point for a more comprehensive examination exercise. It will also help identify possible savings post the 2010 State Election. For budgets covered by the proposed new processes, this reporting should be against the success indicators nominated as part of the budget bid.

This encourages agencies to improve the quality of program design in the policy development process, to ensure evaluative criteria are identified in bids, and to encourage subsequent collection of data. This reporting should continue annually until the success or otherwise of the initiative is clear.

A long term aspiration of the Government should be a more comprehensive evaluation framework for all of its programs.

7.7 Implementation oversight and decision-making

A ***Sustainable Budget Cabinet Committee*** (SBCC) should be established to drive implementation of the Commission’s recommendations.

The Commission believes the SBCC should comprise a small group of senior Ministers, ideally including, at least, the Premier, the Treasurer, and one other senior Minister.

The SBCC should be supported by the Under Treasurer and the Chief Executive of the Department of the Premier and Cabinet.

Initially, the SBCC should drive the development of the 2010-11 Budget:

1. considering the Commission’s recommendations for budget improvement measures;

2. approving new spending proposals if consistent with election commitments;

3. acting as gatekeeper on any ‘back-door’ bids; and

4. monitoring implementation of other Commission recommendations.

The existing Expenditure Review Budget Cabinet Committee (ERBCC) would continue to function for monthly monitoring, reviewing draft Cabinet submissions, and for Chief Executive accountability purposes.

Some functions of the SBCC, such as the gatekeeper role, will be required in years beyond 2010-11.

There are two options.

The first is to establish the SBCC as a permanent committee with a permanent budget formulation role.

The second is to allow its functions to revert to the Treasurer or ERBCC.

Recommendation 6: Sustainable Budget Cabinet Committee (SBCC)

The Commission recommends the establishment of a Sustainable Budget Cabinet Committee (SBCC), at least to drive the formulation of the 2010-11 Budget, and possibly permanently. It should comprise the Premier, the Treasurer, and at least one other senior Minister as active participants to ensure rigorous application of sustainable budget principles and processes.

7.8 Machinery of government

The Commission's Phase 2 report may also recommend machinery of government changes where these could deliver budget savings. Machinery of government relates to how the government organises public sector activities amongst departments and the accountability of those agencies to Ministers. Typically this relates to the grouping of like activities (whether service delivery, regulation, or policy) to concentrate on the administrative objectives of efficiency, effectiveness, or access to services.

The Commission believes the principles against which machinery of government arrangements should be based are to:

- achieve budget savings where possible;
- maximise program efficiency and effectiveness;
- promote a strong client orientation;
- reflect clear delineation of policy formulation and implementation roles;
- facilitate achievement of the Government's policy priorities;
- provide Ministers with an appropriate range of responsibilities and control; and
- where appropriate and cost-effective, allow for decentralisation of service delivery responsibilities to regions and local government (noting that decentralisation must be set within a robust accountability framework).

In addition:

- strategic policy coordination should be focussed within central agencies, with sectoral policy formulation undertaken by line agencies;
- accountabilities and mandates should be clearly defined, grouping like activities while avoiding ambiguity, duplication and overlap; and
- portfolios ideally should be grouped where there are closely related or complementary policy objectives.

Recommendation 7: Themes for Commission advice to the Government

The Commission recommends the Government note the preliminary findings of the Commission on the 'key themes' on which it will provide its advice and make recommendations on budget reforms.

SECTION 8: PROCEDURES FOR THE 2010-11 BUDGET

Key Points

The 2010-11 Budget should be presented in September 2010 to allow the Commission sufficient time to discharge its Terms of Reference and deliver its Phase 2 report, and to allow time for the Government to develop its budget responses to the Commission's reports.

The current practice of bilateral meetings should not occur for the 2010-11 Budget.

Proposals for the 2010-11 Budget should be limited to the agreed list of election commitments, already-announced measures to achieve the Government's net savings task, and specific budget improvement measures to achieve that savings target.

8.1 Tabling of the 2010-11 Budget

The Commission has been asked to recommend an appropriate date for the tabling of the 2010-11 Budget.

The timing of the 2010 State Election (20 March), and the work the Commission must do after that as an input into the 2010-11 Budget, necessitate a delay from the 'normal' Budget timing (June). A delay is not unusual in an election year, given the fixed (March) timing of State Elections.

The Commission's Phase 2 work can only commence after the 2010 State Election. A June Budget would not allow the Commission sufficient time to prepare its Phase 2 report.

It would not allow the new Government time to decide which Commission recommendations it would adopt.

The Commission recommends that the 2010-11 Budget should be tabled in September 2010. Government agencies will function in a business as usual fashion from 1 July 2010, while having regard to the overall size of the savings task.

In order to ensure that the activities of Government can continue post-1 July 2010, and pending the tabling of the 2010-11 Budget and subsequent passage and assent to the 2010 Appropriation Bill, it will be necessary for Parliament to pass a Supply Bill in May/June 2010 covering an extended period.

In years where the Budget is tabled in June the Supply period extends for 3 months to allow for the passage of the appropriation legislation.

In the case of a delayed Budget it will be necessary to extend the Supply period for a further period (nominally 2 months) to allow for the funding of government programs for the period 1 July 2010 through to the assent of the new Appropriation Bill.

Recommendation 8: Timing of the 2010-11 Budget

The Commission recommends that the 2010-11 Budget should be tabled in September 2010 to allow the Commission sufficient time to discharge its Terms of Reference, deliver its Phase 2 report, and allow time for the new Government to decide its budget responses to the Commission's reports.

8.2 Budget bilateral meetings

The existing process for consideration of budget bids in South Australia comprises 2 stages.

First, the Treasurer meets with individual Ministers and their advisors to discuss budget bids (these are referred to as bilateral discussions). South Australia is the only Australian jurisdiction that holds such bilateral meetings.

Second, Ministers proposing new expenditures appear before the Expenditure Review and Budget Cabinet Committee (ERBCC) to discuss a preliminary decision set of proposals.

This preliminary decision set reflects the Treasurer's first attempt to rationalise all of the budget submissions into those that can, and cannot, be accommodated within the forecast budget limits and the priorities of the Government.

In other Australian jurisdictions, only at this stage (if at all) do Ministers have an opportunity to argue the merits of their budget proposals.

For the 2010-11 Budget, the focus must be the delivery of the already-announced (net) savings task, the formulation of specific budget improvement measures to achieve these savings, the costing (and financing) of the election commitments of the new Government, and the identification of extra budget savings to offset any new election commitments.

The Commission concludes bilateral meetings should not be held during the 2010-11 Budget process.

Should Ministers have problems with the preliminary decision set (arrived at without the bilaterals but based on the assessment of better-compiled proposals) they can put their case for amendments before the relevant Budget Committee of Cabinet. For the 2010-11 Budget, the Commission recommends that this be the Sustainable Budget Cabinet Committee (SBCC).

Recommendation 9: Bilateral meetings should be discontinued for 2010-11

The Commission recommends that the current practice of bilateral meetings should not be continued as part of the 2010-11 Budget process.

8.3 Sustainable Budget Framework and the 2010-11 Budget

Section 6 proposed reforms to the budget process to:

1. ensure the development and delivery of specific measures to achieve the net savings target already announced and contained in the budget forward estimates; and

2. provide a process encouraging financially sustainable budgets over time.

The additional administrative implications of adopting the Sustainable Budget Framework recommended by the Commission for the 2010-11 Budget process are briefly reviewed here.

Phase 1 — Budget sustainability envelope, policy/program priorities and strategy (Cabinet)

As outlined in Section 6, the Commission recommends the adoption of a 'top-down', or 'deterministic' budget process. The priorities of the Government are established and communicated to the bureaucracy first. Only proposals consistent with these priorities should be developed and submitted under the budget process.

For the 2010-11 Budget, the 'normal' budget priority and strategy process should be suspended. The focus should be on specific savings measures delivering the net savings targets already announced, and delivering known election commitments.

As to the latter, the priorities of the Government as revealed through the Election campaign, should be 'signed off' by the new Government at the outset. The relevant Chief Executives should be formally advised of these priorities.

For the 2010-11 Budget, the Commission recommends that only election commitments should be developed and considered.

Phase 2 — Request for proposals in priority areas

The Commission recommends the Premier and/or the Treasurer write to Ministers and agency Chief Executives inviting them to submit formal proposals consistent with the costed election commitments document. Chief Executives will be accountable for submitting only compliant proposals (ie, consistent with the request).

Phase 3 — Proposals developed in line with policy priorities and decision-making criteria

Chief Executives should submit in accordance with the Premier's/Treasurer's request the necessary details as per the minimum information requirements as defined by the Department of Treasury and Finance guidelines. These guidelines should be further strengthened and compliance should be strictly enforced.

Phase 4 — Analysis of proposals against policy priorities and budget decision-making criteria

The Department of Treasury and Finance and the Department of the Premier and Cabinet should review budget submissions, to ensure minimum information requirements have been met, and assess the risks associated with program delivery.

Phase 5 — Ranking proposals against policy priorities and budget decision-making criteria

The only new expenditure proposals that should be considered in the 2010-11 Budget are new election commitments. Prioritisation is not considered necessary for these, although they will need to be financed as a component of the savings task (ie, the already-announced savings task plus new spending offsets).

Ministers and Chief Executives/Agencies should not develop and submit proposals outside of 2010 Election commitments.

Phase 6 — Implementation and review

The Commission has no particular concerns about the existing budget implementation process. The Department of Treasury and Finance's established role in preparing budget papers, based on the final budget decision sets, should continue in its current form.

Existing monitoring arrangements should also continue in their current form (albeit with a general focus on continuous improvement), except for:

- additional reporting against financial sustainability indicators, pending the outcome of further work by the Commission in this area; and
- additional reporting by agencies to the Department of Treasury and Finance against proposals' evaluative and results criteria (see Section 7.6).

Recommendation 10: Sustainable Budget processes for 2010-11

The Commission recommends that proposals developed for the 2010-11 Budget should be limited to the agreed list of election commitments, already-announced measures to achieve the net savings task, and specific new budget improvement measures to achieve that savings target.

SECTION 9:
PROCEDURES IN BUDGET YEARS AFTER 2010-11

Key Points

In a normal (non-election) year the State budget should be tabled on the first Thursday in June, as is current practice. In an election year after 2010-11, budget timing should be determined by the issues that need to be considered in that budget.

The current practice of bilateral meetings should be discontinued.

The quality of information that is provided with budget proposals should be improved. This would be supported through the development of detailed minimum information requirements.

Proposals developed and submitted as part of the annual budget process should normally be limited to Government policy priority areas. Non-complying (ie, 'back-door') proposals accepted by the SBCC as exceptional and important, and/or proposals fully offset by savings may also be considered.

9.1 'Normal' budget timing

In South Australia the State budget in non-election years is tabled on the first Thursday in June. Other State Governments table their budgets about the same time (ie, May–June).

The Commission notes fixed-term elections are held every four years in South Australia (March).

As a result every fourth budget (eg the 2014-15, 2018-19 Budgets) may need to be delayed, as is the case for the 2010-11 Budget.

For non-election years, the Commission concludes the State budget should be tabled at the 'normal' time (ie, on the first Thursday in June). This enables the Government to allow for effects of the Commonwealth Budget (usually tabled in May). It also ensures the Government can deliver its programs for the next financial year (ie, from 1 July).

Recommendation 11: 'Normal' budget timing

The Commission recommends that in a normal (non-election) year the State budget should be presented to Parliament on the current timing (ie, the first Thursday in June) with the timing of the budget in an election year a function of the issues that need to be considered in that budget.

9.2 Budget bilateral meetings

The Commission concludes that the bilateral process should be discontinued. It judges that these are neither efficient nor consistent with sustainable budget processes.

Should Ministers have problems with the Treasurer's preliminary decision set (arrived at without the bilaterals but based on his assessment of better-compiled proposals) they can address these at the Budget Committee of Cabinet[8].

Recommendation 12: Bilateral meetings should be discontinued beyond 2010-11

The Commission recommends that the current practice of bilateral meetings should cease.

9.3 Better articulated agency proposals ('budget bids')

The preparation and submission of budget bids commences the process of considering individual spending proposals against competing priorities.

Only budget proposals consistent with Government policy priorities should be developed by agencies. The information accompanying these proposals should clearly indicate their priority within the Portfolio concerned, and provide sufficient detail to enable an assessment to be made of their costs and benefits.

Proposals that are fully offset by savings or additional revenue may also be developed and submitted by agencies.

These proposals would then be prioritised by the Treasurer and provided to Ministers and Chief Executives who would be invited to appear before the SBCC/ERBCC.

The Commission has been advised that proposals submitted to the current budget process often lack detail, vary in quality, fail to align with strategic priorities, and rarely provide details on how the success of the proposal is to be evaluated.

Many proposals fail adequately to make the case for new spending, fail to provide sufficient information for central agencies to test proponents' arguments, and hamper provision of adequate advice to the Treasurer, SBCC/ERBCC and Cabinet.

In short, the Commission is advised that insufficient information is submitted in some instances to enable appropriate analysis and informed decision-making.

While it is impractical to provide full business cases for each proposal considered by the Government, it remains imperative that summary and high-level indicators of proposals' benefits are provided by agencies and are evaluated by the Department of Treasury and Finance and the Department of the Premier and Cabinet in accordance with the applicable frameworks, if quality decisions are to be made. This is particularly important for tight budgets where there is minimal opportunity for new spending.

[8] The Budget Committee of Cabinet should be either the SBCC or the ERBCC.

To provide information necessary to support sound policy decisions, the Commission recommends development of new minimum information requirements to accompany all agency bids, using the existing instructions as a base.

These requirements should emphasis the importance of quality information, and that adherence to the requirements will be strictly enforced.

Recommendation 13: Better articulated agency proposals

The Commission recommends that the quality of information that is provided with budget proposals be significantly improved. This would be supported through the development of detailed minimum information requirements.

Only budget proposals complying with sustainable budget principles, and meeting minimum information requirements, should be considered as part of the budget process.

9.4 Application of the Sustainable Budget Framework

The following summarises the specific implications of adopting the Sustainable Budget Framework recommended by the Commission (see Section 6 above) for 2011-12 and beyond.

Phase 1 — Budget Sustainability Envelope, Policy/Program Priorities and Strategy (Cabinet)

The Commission concludes a 'top-down' (deterministic) budget process, where the Government's priorities are established and communicated to agencies via Chief Executives at the commencement of the budget process, is preferable to the current process.

Government priorities should be agreed by Cabinet at the start of the budget process.

Phase 2 — Request for proposals in priority areas

The Commission recommends that the Premier and/or Treasurer then write to Ministers/Chief Executives inviting budget proposals, provided they are strictly consistent with the Government's policy priorities (ie, Chief Executives can only submit bids where they are invited to do so). Chief Executives will be accountable for submitting only compliant proposals (ie, consistent with the request).

Phase 3 — Development of proposals against policy priorities and decision-making criteria

Chief Executives and their agencies should only develop new spending proposals in accordance with the Government's policy priorities. Chief Executives are best-informed about their agency's operations and therefore are best-placed to develop such proposals.

The Commission recognises there will be some unexpected budget bids that fall outside of the Government's priority areas that may, nevertheless, need to be considered. Before such bids are developed and submitted, the relevant Minister should have to seek the formal endorsement of the SBCC/ERBCC. Such endorsement should only be provided in exceptional circumstances.

Proposals that are fully offset by savings or additional revenue may also be developed and submitted by agencies.

The information provided by portfolios should be in accordance with the minimum information requirements to be developed by the Commission.

Phase 4 — Analysis of proposals against policy priorities and budget decision-making criteria

The six expenditure criteria proposed in Section 6 should be applied to all spending proposals.

It is not envisaged that every proposal will meet all of these criteria. It is important that agencies focus on proposals that promote service delivery efficiency and effectiveness, and clearly identify any net productivity or competitiveness benefits to the economy. The six savings criteria proposed in Section 6 should be used to assess all savings proposals.

Phase 5 — Prioritisation of proposals against policy priorities and decision-making criteria

The Commission recommends the prioritisation process, development of the preliminary budget proposal decision set, and consideration of proposals by Cabinet, should continue in its current form.

To support this process, budget information and analysis should be presented in a well-structured, and as far as possible, evidence-based manner, that assists decision-makers.

Analysis and advice should be in budget-specific terms. It should include, but not be limited to, impacts on budget aggregates, consistency with policy priorities, and risks and opportunities to stated benefits, costs and implementation.

Phase 6 — Implementation and review

The Commission has no particular concerns about the existing budget implementation process. The Department of Treasury and Finance's established role in preparing budget papers, based on the final budget decision sets, should continue in its current form.

Existing monitoring arrangements should also continue in their current form (albeit with a general focus on continuous improvement), except for:

- additional reporting against financial sustainability indicators, pending the outcome of further work by the Commission in this area; and
- additional reporting by agencies to the Department of Treasury and Finance against proposals' evaluative and results criteria (see Section 7.6).

Recommendation 14: Application of the Sustainable Budget Framework

The Commission recommends that proposals developed/submitted to the annual budget process should be limited to the agreed policy priority areas developed by the Government, or proposals fully offset by savings, or accepted by the SBCC as exceptionally important 'back-door' bids.

SECTION 10: DATA AND INFORMATION COLLECTION PROCESS

Key Point

Detailed information on agencies' existing operations will be collected to provide the Commission with information about how and why agencies apply their existing budgets.

To do its job the Commission needs information about existing Government policy and programs, and how these are reflected in Government agencies' expenditures and revenues.

The Government has agreed with this approach.

The Commission has asked agencies to provide purely factual data explaining how and why agencies apply their existing budgets.

The Program and Sub-Program details of agency expenditures and revenues are published in the budget papers at a high level of aggregation.

The Commission needs a more detailed breakdown.

It has requested such information on what each agency does, why it does it, how much it costs, and who receives the benefit.

The examination of this information will help the Commission to consider options for the Government in Phase 2 of its work after the 2010 State Election.

The Commission recognises this request adds to agency workloads. However, in most cases agencies should be undertaking similar work as part of their internal financial management practices anyway.

An information template has been developed using a format understood by agencies. The requested information is for the 2009-10 Budget year only. Information for the forward estimates years may be requested later.

Agency Chief Executives and Senior Finance Officers were advised of the data collection exercise in November.

Agencies have been given until late January 2010 to complete the exercise.

SECTION 11:
THE COMMISSION'S NEXT TASK

Key Points

The South Australian Government has set an ambitious budget savings task to restore sustainable State finances.

Developing specific budget improvements to deliver the Government's savings target is the Commission's next task, commencing after the 2010 State Election.

The new Government will need to make tough policy decisions to achieve the savings target.

However, not meeting that challenge would lead to larger, more pervasive problems later.

11.1 Commission's next task and the Government's challenge

After the South Australian Government's response to this report, the Commission will move to its next task: developing budget improvement measures to achieve the Government's net savings target. This starts after the 2010 State Election and leads up to the 2010-11 Budget.

Tough savings policy options will be needed and their effective implementation essential.

A uniform slashing of all programs is neither sensible nor, probably, sustainable.

The Commission will make a careful and detailed evaluation of existing policies and programs. From this, a set of savings options will be prepared for Government consideration.

For the new Government after 20 March 2010, choosing policy options that add up to the designated net savings target will be difficult.

The alternative — unsustainable Government finances — would have much more pervasive consequences for the South Australian community and those elected to represent them.

South Australia has experienced that reality in the past. The global financial and economic crisis is a much larger, more pervasive, and still unfolding reminder of the need for sound finances.

APPENDIX A

Recommendations

Recommendation 1: Continue to use existing budget performance indicators

The Commission recommends that current budget performance indicators: the net operating balance, net lending or borrowing, the net financial liabilities to revenue ratio and net debt, should continue to be the basis of budget sustainability assessments.

Recommendation 2: Budget management principles

The Commission recommends that the Government endorse the Sustainable Budget Framework's four budget management principles. These are:

1. Financial sustainability
2. Policy priorities
3. Accountability for budget and performance outcomes
4. Process transparency, certainty and compliance

Recommendation 3: Decision-making criteria — expenditure proposals

The Commission recommends that the Government endorse the six expenditure decision-making criteria presented in this report to evaluate priority expenditure proposals. These are:

1. Community Benefits
2. Productivity / competitiveness
3. Cost recovery
4. COAG and multi-jurisdictional initiatives
5. Social Inclusion
6. Managing current service demands

Recommendation 4: Decision-making criteria — savings proposals

The Commission recommends that the Government endorse the six budget decision-making criteria presented in this report to apply to savings proposals. These are:

1. Duplication
2. Service levels and costs
3. Economic rationale
4. Social Inclusion and equity
5. Lower priority
6. Balance sheet efficiency

Recommendation 5: Chief Executive Accountability

The Commission recommends that Chief Executives should be accountable for compliance of their agency budget bids and for setting out how the success of these should be measured. Their performance appraisals should take this into account.

Recommendation 6: Sustainable Budget Cabinet Committee (SBCC)

The Commission recommends the establishment of a Sustainable Budget Cabinet Committee (SBCC), at least to drive the formulation of the 2010-11 Budget, and possibly permanently. It should comprise the Premier, the Treasurer, and at least one other senior Minister as active participants to ensure rigorous application of sustainable budget principles and processes.

Recommendation 7: Themes for Commission advice to the Government

The Commission recommends the Government note the preliminary findings of the Commission on the 'key themes' on which it will provide its advice and make recommendations on budget reforms. These are:

1. Policy priorities
2. Budget improvement measures
3. Budget process
4. Chief Executive accountability
5. Measurement, reporting and evaluation
6. Implementation oversight and decision making
7. Machinery of government

Recommendation 8: Timing of the 2010-11 Budget

The Commission recommends that the 2010-11 Budget should be tabled in September 2010 to allow the Commission sufficient time to discharge its Terms of Reference, deliver its Phase 2 report, and allow time for the new Government to decide its budget responses to the Commission's reports.

Recommendation 9: Bilateral meetings should be discontinued for 2010-11

The Commission recommends that the current practice of bilateral meetings should not be continued as part of the 2010-11 Budget process.

Recommendation 10: Sustainable Budget processes for 2010-11

The Commission recommends that proposals developed for the 2010-11 Budget should be limited to the agreed list of election commitments, already-announced measures to achieve the net savings task, and specific new budget improvement measures to achieve that savings target.

Recommendation 11: 'Normal' budget timing

The Commission recommends that in a normal (non-election) year the State budget should be presented to Parliament as per the current timing (ie, the first Thursday in June) with the timing of the budget in an election year a function of the issues that need to be considered in that budget.

Recommendation 12: Bilateral meetings should be discontinued beyond 2010-11

The Commission recommends that the current practice of bilateral meetings should cease.

Recommendation 13: Better articulated agency proposals

The Commission recommends that the quality of information that is provided with budget proposals be significantly improved. This would be supported through the development of detailed minimum information requirements.

Only budget proposals complying with sustainable budget principles, and meeting minimum information requirements, should be considered as part of the budget process.

Recommendation 14: Application of the Sustainable Budget Framework

The Commission recommends that proposals developed/submitted to the annual budget process should be limited to the agreed policy priority areas developed by the Government, or proposals fully offset by savings, or accepted by the SBCC as exceptionally important ‘back-door’ bids.

GLOSSARY

Assets: Resources controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Depreciation: The systematic allocation of the cost of an asset less its residual value over its useful life.

Efficiency: Measures of program efficiency consider the ratio of program inputs (costs such as salaries and purchase of goods and services), to program outputs. In its simplest example, the average unit cost of performing a service.

Effectiveness: Program effectiveness relates to the achievement of program objectives or outcomes.

Equity: The interest in the assets of an entity after deducting all liabilities.

Expenses: Total value of all of the resources consumed in producing goods and services or the loss of future economic benefits in the form of reductions in assets or increases in liabilities of an entity.

General government: The sector of government that includes all government agencies that provide services free of charge or at prices significantly below the cost of production or provide regulatory services.

Liabilities: Present obligations arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Net debt: The sum of deposits held, advances received and borrowing (ie, liabilities); minus the sum of cash and deposits, advances paid, and investments, loans and placements (ie, assets).

Net financial liabilities: Total liabilities less financial assets, other than equity in non-financial public corporations and in public financial corporations. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

*Net lending/borrowing positio*n: A measure of the net operating balance less net capital investment. Thus it includes the impact of net expenditure (effectively purchases less sales) on non-financial assets rather than consumption (depreciation) of non-financial assets.

Net operating balance: A measure of the operating result of a sector of Government. It is measured as revenues less expenses. If revenues exceed expenses it is referred to as a net operating surplus (and net operating deficit where expenses exceed revenues).

Non-financial public sector: The combination of the general government sector and the public non-financial corporations sector.

Public financial corporation: Government-controlled entity that is mainly engaged in financial intermediation or the provision of auxiliary financial services.

Public non-financial corporation: Government controlled entity that is mainly engaged in the production of market goods and/or non-financial services, which recovers a significant portion of its costs through user charges.

Revenue: Revenue is an inflow of economic benefit which arises in the course of the ordinary activities of the entity.

Unfunded superannuation liability: The amount by which the liabilities of a superannuation scheme or schemes (measured as the present value of expected future superannuation benefits that have accrued to members) at the reporting date exceeds the value of assets held by the superannuation scheme or schemes to meet those benefits.

ACRONYMS

CGC — Commonwealth Grants Commission

COAG — Council of Australian Governments

ERBCC — Expenditure Review and Budget Cabinet Committee

FTE — Full time equivalent

MYBR — Mid Year Budget Review

MYEFO — Mid Year Economic and Fiscal Outlook

NFL — Net Financial Liabilities

PDI — Public debt interest

ROGS — Report on Government Services

SBCC — Sustainable Budget Cabinet Committee

Government
of South Australia