Queensland Government Spending: Implications for Fiscal Sustainability and Inflation

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Adept Economics

Adept Economics

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Glossary

AiP	Australian Institute for Progress
ABS	Australian Bureau of Statistics
CAPEX	Capital expenditure
CPI	Consumer Price Index
FTE	Full-time equivalent
EOFY	End of financial (or fiscal) year
FY	Financial (or fiscal) year - i.e. 2024-25 is FY25 and 2025-26 is FY26
GOC	Government-owned corporation
GRP	Gross Regional Product
GSP	Gross State Product
MYEFO	Mid-Year Economic and Fiscal Outlook
NFA	Non-financial assets
NFPS	Non-financial public sector
NSW	New South Wales
PNFC	Public non-financial corporation
QLD	Queensland
SA	South Australia
TAS	Tasmania
VIC	Victoria
WA	Western Australia
WPI	Wage Price Index

Overview

Queensland Government budget policy is on an undesirable trajectory and has contributed to inflation. On current budget projections, net debt per Queenslander will be 481% higher in 2028 than when the Government took office, at around $9,150 compared with $1,575 per Queenslander (in 2024 dollars) in 2015. Given nearly ten billion dollars in new Government commitments since the June budget, net debt will ultimately be significantly higher. Today S&P Global Ratings warned that another downgrade of Queensland's credit rating is possible. This is highly likely.

Budget discipline has been abandoned

Regarding the state of public finances, the Queensland Government is:

1. Violating the 'Golden Rule of Public Finance' by running budget deficits in its operating budget, in at least this financial year and next, and hence borrowing to pay recurrent expenses (e.g. wages);

2. Running primary budget deficits (that is, the fiscal balance excluding net interest expenses), risking an accelerating path of public debt accumulation; and

3. Failing to abide fully by its own fiscal principles, which it weakened a few years ago after failing to abide by its original principles, and as a result rapidly worsening Queensland's net state debt.

As a consequence, budget revenue is increasingly being diverted to paying interest to bondholders rather than funding frontline services. Over two decades, Queensland will have gone from paying bondholders less than one in every 100 dollars to one in every 20 dollars of its revenue.

The public service is growing rapidly

Queensland's public service is growing at a rate faster than population (28% vs 17% over the Palaszczuk-Miles Government's term), which seems counterintuitive given the potential of new technology, especially artificial intelligence, to result in labour savings. In the 12-months to 31 March 2024, it added 11,700 public servants, a growth rate of 4.8%, nearly twice the growth rate of the population at 2.5%. Unsurprisingly, the Government has

abandoned its previous commitment to limiting public service growth to population growth over the medium-term.

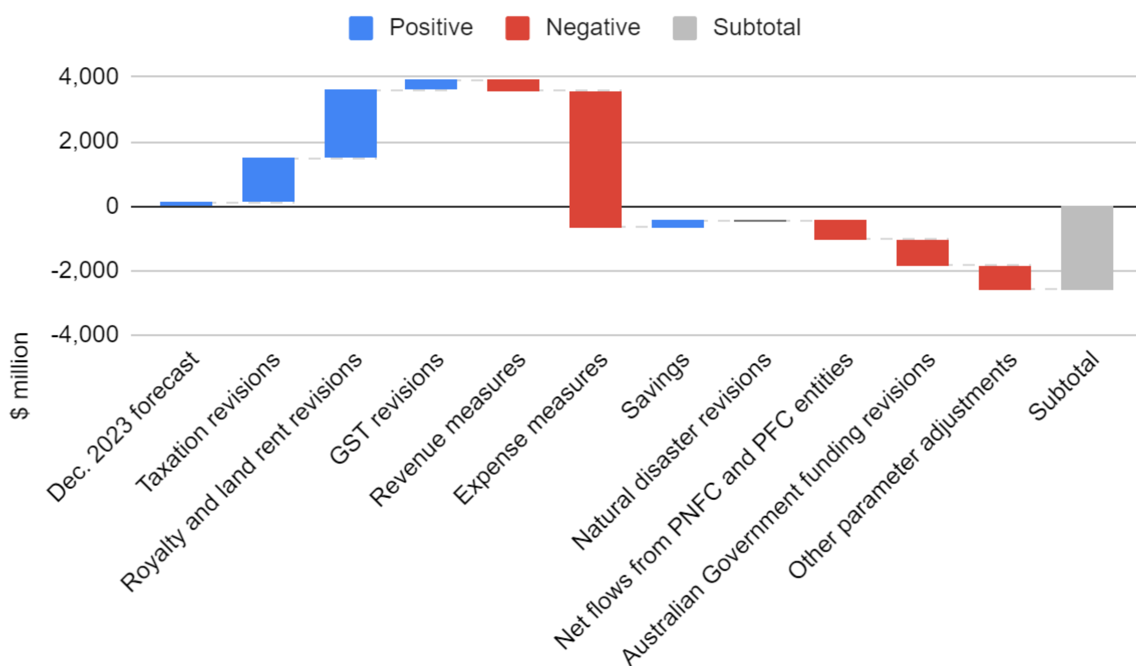
It is extraordinary that, despite the known facts and outlook, both the Government and Opposition have committed to new ongoing expenses, including the 50-cent public transport fares commitment.

Incidentally, the current Queensland Government has engaged in various tricks to disguise the true state of the debt, such as shifting debt onto Government Owned Corporations in 2015-16 and, more recently, undertaking a pretend privatisation of the Titles Registry.

State Government is contributing to inflation

Given the economic outlook, the Queensland Government's fiscal policy settings are excessively expansionary, meaning they will add to inflationary pressures. Discretionary policy measures of $4.6 billion in 2024-25 on such things as cost-of-living relief amount to nearly 1% of Gross State Product (GSP). Discretionary expense measures of $4.2 billion are largely responsible for reversing what was previously a forecast 2024-25 operating surplus of $122 million to a deficit of $2.6 billion (Figure A).

Figure A. Change in the 2024-25 operating balance forecasts between December 2023 and June 2024, contributions from non-discretionary and discretionary sources



Source: Queensland Government Budget Strategy and Outlook 2024-25, Table 3.3., p. 79.

The Government is forecasting a reasonably consistent economic growth rate, and there is no macroeconomic justification for a big-spending budget to provide fiscal stimulus. However, the Queensland Government is running a fiscal deficit of 2% of GSP in 2024-25. That is, its injections into the economy via spending exceed the leakages associated with its revenue by 2% of GDP (or around $11 billion), at a time when there is not significant excess supply in the economy that can readily absorb this additional demand without inflationary pressures. For instance, in Queensland, the unemployment rate has remained well below the long-run average, at 4.2% in August 2024 compared with the average since 2000 of 5.7%.[1]

The Queensland Government has contributed to inflation in two ways:

1. Its excessive cost-of-living subsidies have relaxed household budget constraints and contributed to aggregate demand for private sector goods and services at a time when the Reserve Bank of Australia (RBA) is trying to reduce aggregate demand with a view to bringing inflation back to the target band of 2-3%.
2. Its excessive capital expenditure (CAPEX) program is contributing to rising construction costs as well as overall higher aggregate demand.

Corrective measures are required post-election

Whichever party wins government on 26 October, the incoming state government will need to work hard and make tough decisions to get control of the budget. As of this paper's publication date, the Queensland Opposition has not yet released its budget plan, so assessing its budget policy's sustainability is impossible. Given it has promised to abide by the Government's commitments over the next four years, as well as making some new commitments of its own, the critique of current Queensland Government fiscal policy applies to both the current Government and the Opposition.

[1] ABS Labour Force, Australia seasonally adjusted estimates.

1. Introduction

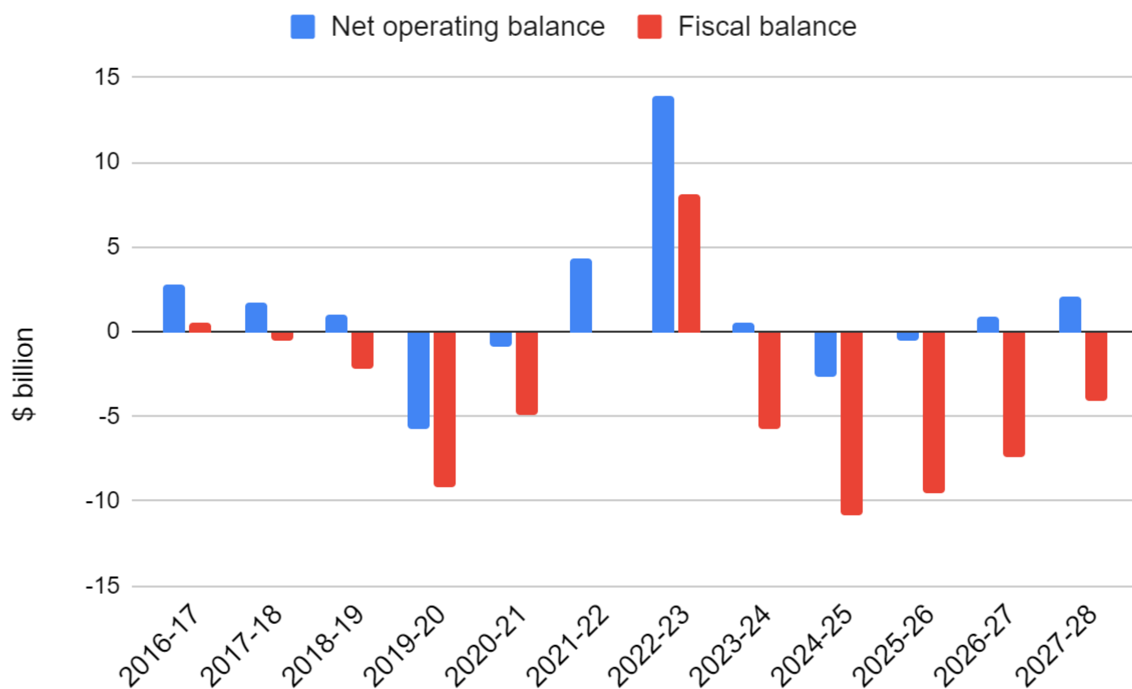
The Australian Institute for Progress (AiP) has commissioned Adept Economics to analyse the impacts of Queensland Government spending on fiscal sustainability and inflation. This is important for Queensland, given it is an election year and there is a risk of even more spending being announced prior to the election on 26 October, and there is ever-increasing state debt and persistent inflation nationally.

2. Budget analysis

2.1. Current Queensland Government budget outlook

The Queensland Government is projected to run large fiscal deficits over the budget forward estimates and operating deficits over 2024-25 and 2025-26 (Figure 2.1).[2]

Figure 2.1. Queensland government budget balances, General Government

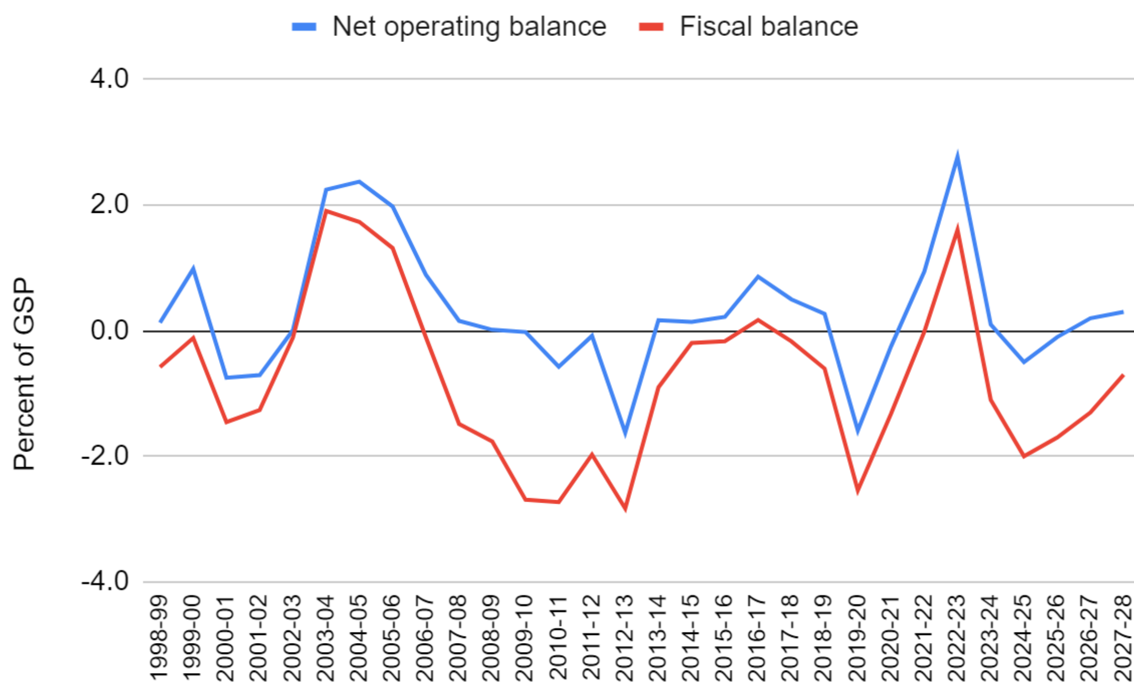


Source: Queensland Government 2024-25 Budget Paper no. 2, Appendix D: Fiscal aggregates and indicators.

[2] These estimates will probably end up being worse than in the chart because of additional spending the Queensland Government and Opposition have committed to since the time of the 2024-25 Budget in June, notably a continuation of 50-cent public transport fares beyond the initial six-month trial.

It is even forecast to run deficits in its operating budget in 2024-25 and 2025-26, violating the so-called Golden Rule of Public Finance, as discussed in section 3.2.1 below. In nominal terms, the fiscal deficits in 2024-25 and 2025-26 exceed the fiscal deficit in 2019-20, when the pandemic battered the state economy. Adjusting for inflation and economic growth since then, they have been slightly smaller in percentages of GSP, although not markedly so (Figure 2.2).

Figure 2.2. Queensland Government budget balances as a percentage of GSP



Source: Queensland Government 2024-25 Budget Paper no. 2 combined with data used in Tunny (2018) which was sourced from ABS Government Finance Statistics data.

The fiscal deficits are large in historical comparison when measured as percentages of GSP. In 2024-25 and over the budget forward estimates (2025-26 to 2027-28), the fiscal deficit will average 1.4% of GSP. That compares with a historical average this century prior to 2024-25 of 0.7%. That is, the Queensland Government is running deficits twice the historical average. The projected deficits also starkly contrast with the sizable surpluses run over 2003-04 to 2005-06 during Beattie Government Treasurer Terry Mackenroth's stewardship.

2.2. Debt accumulation

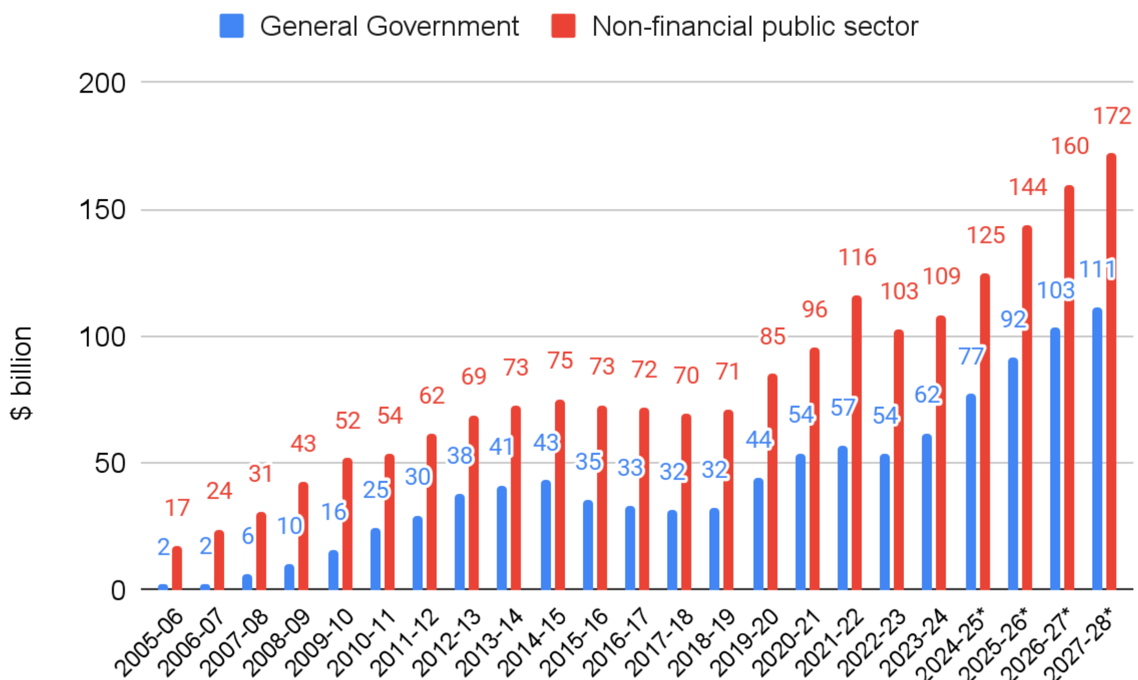
Queensland has gone from a situation of very low debt in the early 2000s to one of high and ever-increasing debt, which is on a path to $111 billion of general government and $172

billion of Non-Financial Public Sector (NFPS) debt by the end of 2027-28 (Figure 2.3). This has been associated with an abandonment of the first element of the previous bipartisan commitment to the so-called ‘fiscal trilogy’:

1. Only borrowing for infrastructure that delivers an economic return and can pay for itself;
2. Full funding of superannuation liabilities; and
3. Maintaining Queensland as a low-tax state.

The commitment to the first element above was maintained by Queensland Government administrations from Sir Joh Bjelke-Petersen’s through to the Beattie Government, although signs of a relaxation of the commitment emerged under Beattie. The commitment was fully abandoned by the Bligh Government and has not been respected by the current government. This is not to say a strict application of the first principle is necessarily desirable, as some borrowing may be justified even if the investment does not yield an economic return to the government, but the abandonment of the principle was a key explanation for the debt build up since the mid-2000s.

Figure 2.3. Gross Queensland Government debt, General Government and NFPS



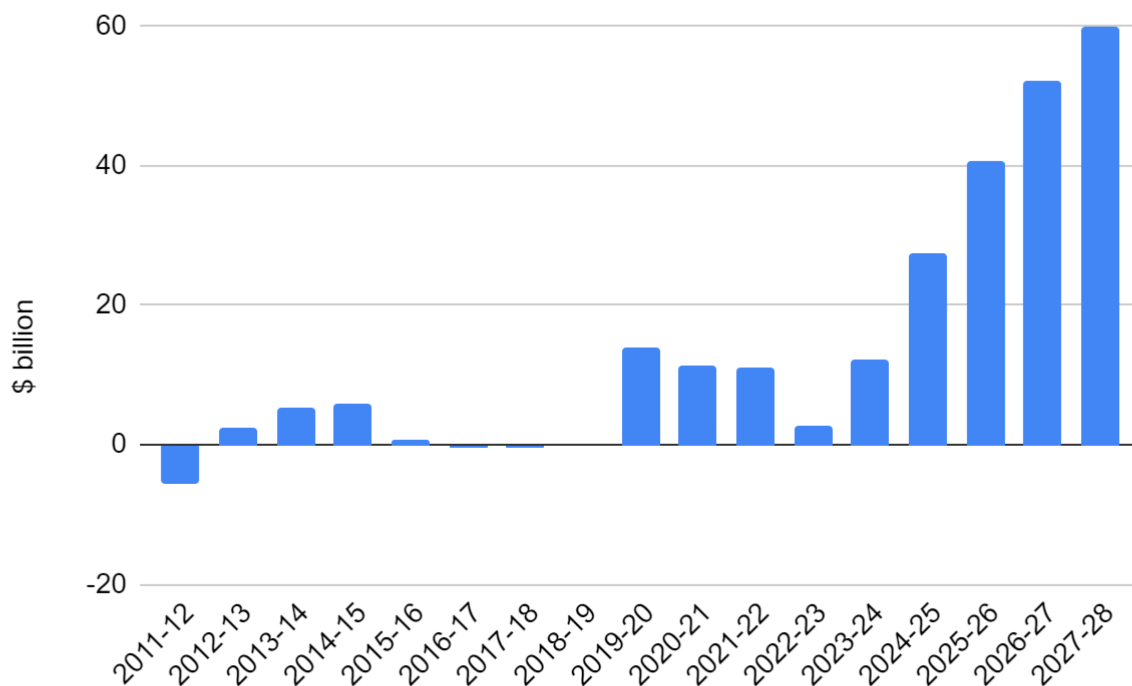
Source: Queensland Government budget papers.

The usually reported State debt figure relates to the NFPS, comprising the general government sector and non-financial GOCs. This is done because including public financial

corporations could give a misleading picture of the state's debt obligations for banking activities undertaken by state institutions. Total state debt, inclusive of debt taken on by QTC for lending activities and by other public financial corporations, is higher than this. The 2022-23 Report on State Finances (pp. 5-2) reported a gross debt figure for the total state sector of $132 billion at 30 June 2023, compared with the estimate for the NPFS in the budget papers of $103 billion.

Even on the Queensland Government's preferred debt measure, general government net debt, there is a rapid increase in recent years (Figure 2.4). It is projected to reach $60 billion in 2027-28, up from practically zero net debt in 2018-19 before the pandemic. Net debt is gross debt, less liquid financial assets, which could be used readily to pay off the debt. This largely comprises assets set aside to meet the Government's defined-benefit public service superannuation liabilities. These assets are managed by the Queensland Investment Corporation (QIC). Total 'Investments, loans and placements', largely the QIC-managed investments but now also include the Titles Registry (controversially as discussed below), amounted to around $50 billion as at 30 June 2024.

Figure 2.4. Net debt, Queensland, general government

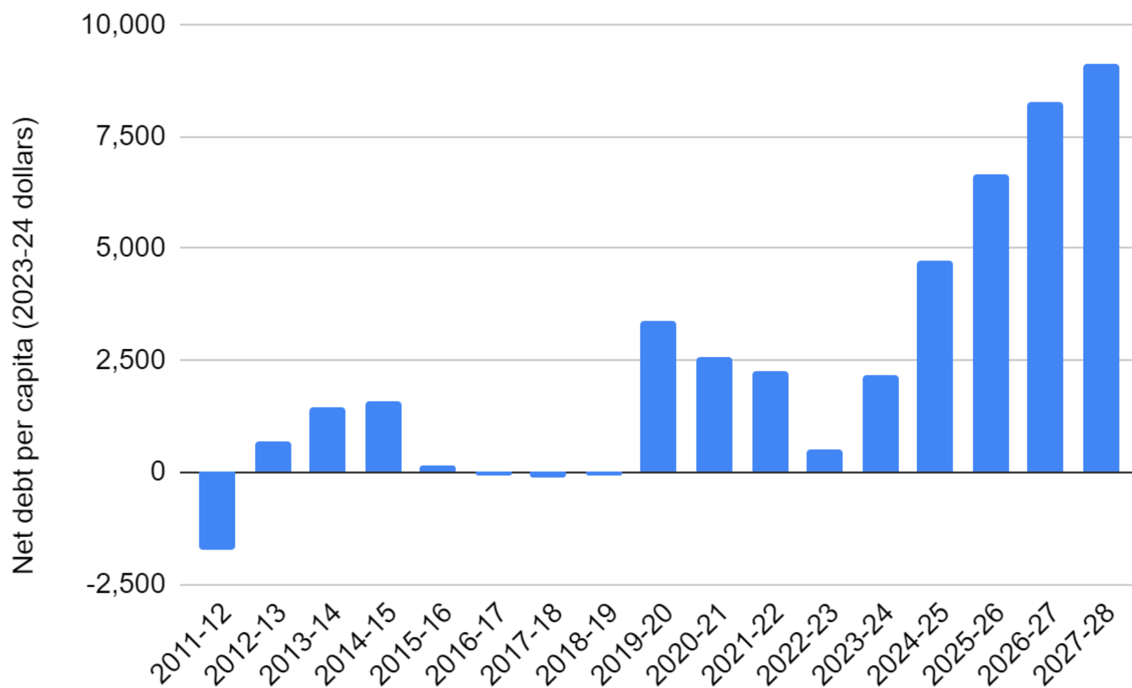


Source: Queensland Government budget papers.

Queensland historically has had low and, at times, negative net debt (i.e., liquid assets above debt) thanks to the historical decision to fund the state's defined benefit

superannuation liabilities fully. The projected rapid increase in net debt is extraordinary in Queensland's history. In per capita terms in 2024 dollars, net debt at the end of 2023-24 equalled $2,184 compared with $1,575 in 2014-15 (i.e. 39% higher in real per capita terms), when the Palaszczuk-Miles Government began, and is projected to increase to $9,148 in 2027-28 (Figure 2.5). That would be an increase in real net debt per capita of 481% since the Government took office.

Figure 2.5. Net debt per capita, 2024 dollars, Queensland, general government



Source: Adept Economics calculations using ABS data. Note: Projections of CPI and inflation are based on historical ABS data and Table 2.2 Queensland economic forecasts/projections, Budget Strategy and Outlook 2024–25, p. 40.

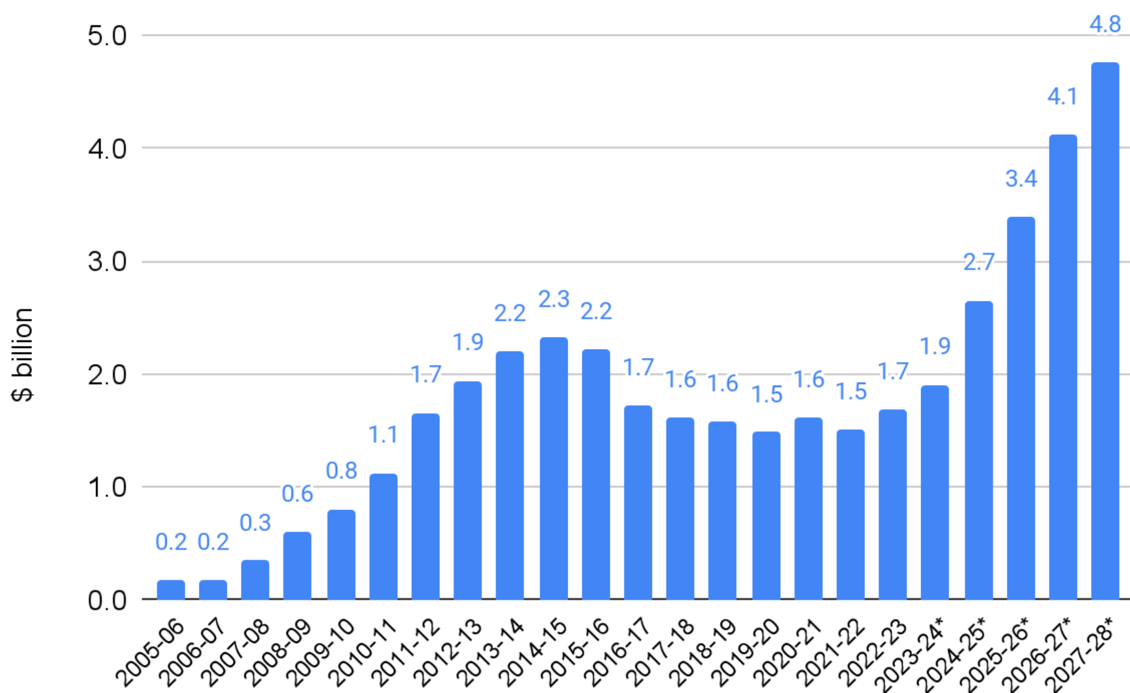
The impact of the debt burden on the budget comes through the interest paid on the debt. This was once relatively low. For example, it was $180 million per year in nominal terms (around $290-300 million in 2024 dollars) in 2006-07 during the Beattie Government, prior to the debt take-off under the Bligh Government. Interest expenses are now on a path towards $5 billion annually (Figure 2.6). While interest expenses only absorbed 0.6% of government revenue in 2006-07, they will absorb 3.0% in 2024-25, and this will increase to 5.0% in 2027-28.[3] Another way of saying this is that over the last two decades, Queensland has gone from

[3] Adept Economics calculations based on current and historical state government budget data.

interest payments of less than $1 for every $100 of revenue to being on track to pay $1 out of every $20 of revenue.

To further illustrate the implications of this higher interest bill, consider that the $2.7 billion the Queensland Government will pay in interest out of the budget in 2024-25 exceeds the $2.0 billion it is expected to receive in motor vehicle registration fees or the $2.5 billion it receives in land tax. If the Queensland Government had kept interest expenses at the same level as in the mid-2000s (i.e. $290-300 billion in 2024 dollars), it could have funded substantial tax cuts or the abolition of specific tax categories.

Figure 2.6. Interest expenses, Queensland, general government



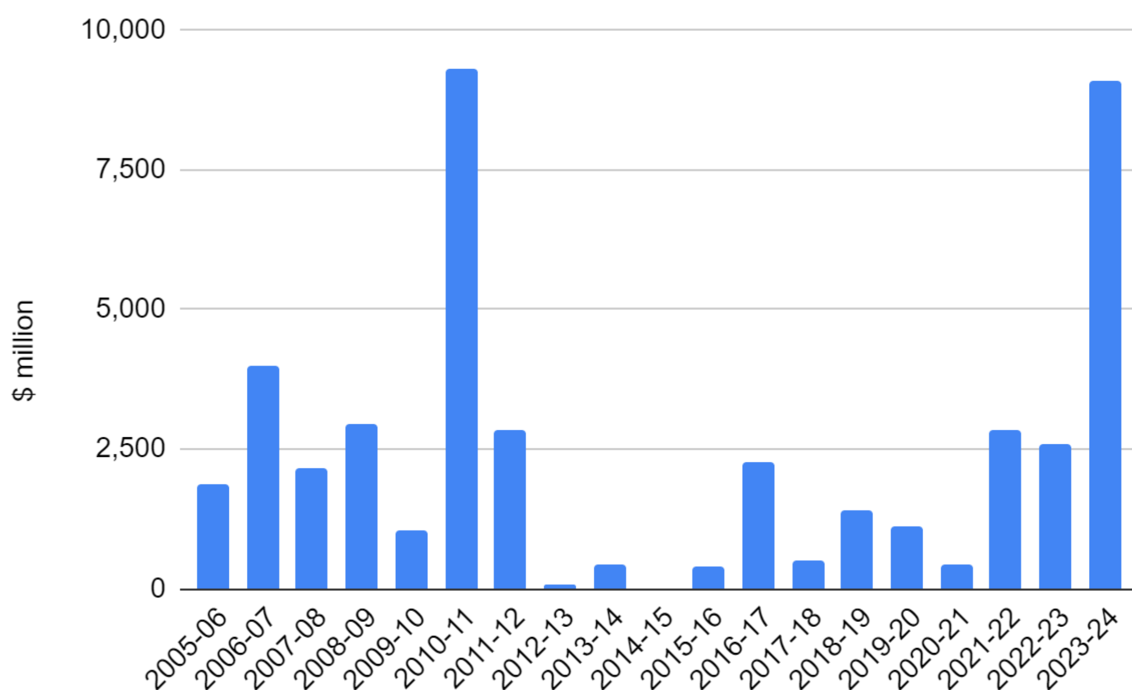
Source: Queensland Government budget papers.

The bondholders must be paid before the government can spend money on other priorities, so the additional interest expenses mean less money for health and education priorities, for example. Debt and related interest expenses may be justified where the debt is used to invest in essential infrastructure (i.e. good debt), but the problem for Queensland is starting to incur significant amounts of debt to cover operating deficits, and significant amounts of its capital expenditure are probably on uneconomic investments.

2.3. The impact of unforeseen expenditure

The actual debt situation is worse than described in the previous subsection because of the impact of unforeseen expenditure in 2023-24, which was disclosed in the *Consolidated Fund Financial Report 2023–24* tabled in Parliament by the Queensland Treasurer in mid-September. The level of unforeseen expenditure, around $9.1 billion in 2022-23, is at an unmatched level since the Bligh Government (Figure 2.7). According to the *Courier-Mail* the Government claims some of this unforeseen expenditure can be partly explained: " half of the expenditure was cash that had been centrally held in anticipation of being allocated to departments for projects or staffing across health, energy, and roads" and that "a significant portion of the extra spend – $6.15bn – was outlined in July as part of the budget estimates process."[4] However, this explanation leaves around $3 billion unexplained. This likely means the state government did not run an operating surplus of $564 billion in 2023-24, and the fiscal deficit was $8-9 billion in 2023-24 compared with the estimated $5.7 billion deficit published in the 2024-25 Budget in June.

Figure 2.7. Unforeseen expenditure, Queensland Government



Source: Queensland Government Consolidated Fund Financial Reports cited in McCormack (2024).

[4] McCormack (2024).

2.4. How the Government has attempted to disguise the state debt situation

In this section, we review two instances of how the current Queensland Government has attempted to disguise the true situation regarding state debt: the debt transfer to GOCs in 2015-16 and the 2021-22 Titles Registry fake privatisation. The collective impact of these dubious transactions is that general government net debt would be in the order of $10 billion higher if the government had not undertaken these transactions.

2.4.1. Debt switch

Instead of its originally proposed *Debt Action Plan* announced prior to the 2015–which incorrectly assumed it could use GOC earnings already accounted for in the budget to pay down debt–the government proposed to shift debt from the general government sector to the GOCs, specifically the energy businesses Energex, Ergon, and Powerlink. It tried to confuse observers by presenting it as a technical financial exercise in “re-gearing” the GOCs. The re-gearing plan involved the government increasing the gearing ratio—in this context, the ratio of debt to total assets on the balance sheet—for the energy network businesses, Energex, Ergon and Powerlink, from an average of 55% to 70% for Ergon and Energex and 75% for Powerlink.

The Palaszczuk Government’s equity extraction from the GOCs can be seen in reported equity movements in the Cash Flow Statement. The 2015-16 Budget recorded a fall in equity for the Public Non-Financial Corporation (PNFC) sector in 2014-15 of $3,170 million, with the vast majority of that from the electricity generation and network GOCs.[5] This was labelled in the budget papers as “the return of equity from the PNFC sector to the General Government Sector associated with the Debt Action Plan.” Then, in 2015-16, there was a $3.3 billion negative net cash flow out of the PNFC sector, in the line item labelled “Net cash flows from investments in financial assets for policy purposes.” This would form the bulk of the positive net cash flow of $3.8 billion recorded by the general government sector that year.

The cash injection allowed the general government sector to pay back some of the debt it owed to QTC. But to allow it to make this cash transfer to the general government sector, the GOCs had to borrow money from QTC. The debt switch was managed by QTC, which is the cash and debt manager for the general government and GOCs.

[5] Queensland Government 2015-16 Budget Paper no 2, p. 131.

2.4.2. Titles Registry

The fake privatisation of the Titles Registry in mid-2021 gave the Queensland Government political cover to take on billions in additional debt, while breaching fundamental principles of government budget reporting.

The Titles Registry, previously legally part of the Department of Resources, was legally changed to a Pty Ltd company, owned by multiple investment funds of the Queensland Government, just prior to 30 June 2021. In the lead up to the legal manoeuvres, the Government had obtained a valuation for the Titles Registry from government-owned funds manager QIC of around $8 billion.

The Queensland Government is now claiming the Titles Registry is a private company, although it ultimately owns it, and it is claiming the Titles Registry is no longer in the general government sector, for which budget aggregates are reported. The surplus of the Titles Registry, which is hundreds of millions of dollars annually (given annual revenue is around $350 million and operational costs are likely only in the tens of millions) is earmarked to support the purposes of the Queensland Government investment funds which own it, such as the Debt Retirement, Housing Investment, Path to Treaty, and Carbon Reduction Funds. Of course, money is fungible, and the Titles Registry earnings are still supporting the Queensland budget, because they alleviate the need for the money spent on these purposes coming out of Consolidated Revenue.

The beauty of the Titles Registry trickery, from the Government's perspective, is the fake improvement it allows the Government to claim on its balance sheet. The Titles Registry trickery allows the Government to pretend net debt and it appears gross debt, too, as discussed below, are lower than otherwise, giving the Government additional "fiscal space". It is being used by the state government to pretend it has uncovered a hitherto untapped source of financing, providing new money for the government to spend without going further into debt, which is wrong.

In 2021-22 Budget Paper 2 (p. 69), the Government notes:

> "General Government Sector net debt at 30 June 2021 is forecast to be nearly $10 billion lower than anticipated at the time of the 2020–21 Queensland Budget. This is primarily due to faster than anticipated improvements in the domestic and national economies leading to a softer impact on gross borrowing requirements, and the contributed valuation for the Titles Registry, being greater than anticipated."

The Titles Registry has been used as a vehicle by the Government for borrowing an additional $2.1 billion "off-budget", so to speak, in that the amount does not show up in the borrowing line for the general government. However, it would reduce the value of the Titles Registry which is carrying the debt (i.e. it would partly offset the $8 billion valuation). Here is how the Queensland Audit Office in its *Establishing the Queensland Future Fund report* (p. 7) published in December 2021 described the manoeuvre:

> "On the same day the Queensland Titles Registry operations transferred to the Debt Retirement Fund, $2.1 billion was borrowed. This occurred in a company within the Queensland Titles Registry structure to provide liquidity to the fund and support the state's credit rating."

This was a very clever, though dubious, way to attempt to conceal an additional $2.1 billion of government borrowings. Note that the Debt Retirement Fund is part of the Queensland Future Fund. It definitely appears that the state government has set this up to both facilitate its creative accounting and also to confuse the public.

What's wrong with including the Titles Registry in investments, loans and placements? To summarise, there are at least two problems with the inclusion of the Titles Registry in investments, loans and placements.

1. The Titles Registry valuation dubiously includes the capitalised value of a general government taxation power that could not possibly be sold, at least in the modern world.
2. The Titles Registry does not qualify as a liquid asset, given it is not something where the Government would readily sell its shares to others. It cannot be used to pretend the Government has a lower net debt than otherwise. Incidentally, the fact that equity in GOCs such as Energy Queensland is not liquid is why the $31 billion the Queensland Government has of equity in "Investments in other public sector entities" is not figured in the net debt calculation. Why would equity in GOCs be excluded but the equity in the Titles Registry be included in the Government's estimation of its net debt? It does not make any sense.

2.5. Interstate comparison

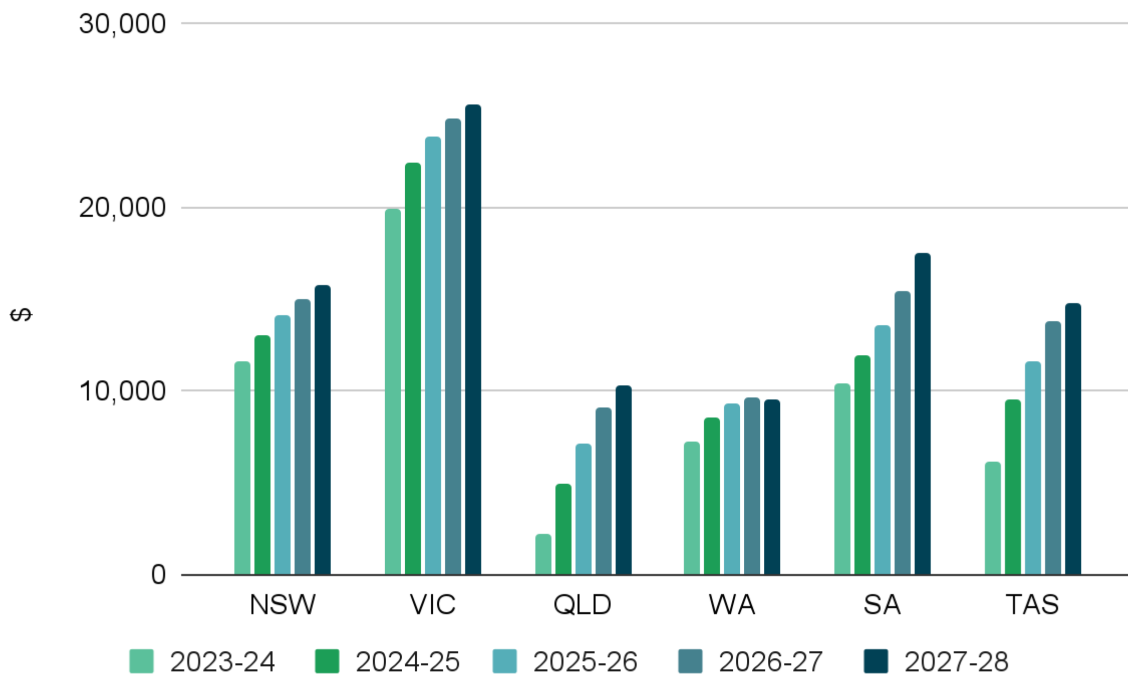
Queensland's debt burden is lower than Victoria's but similar to NSW's in gross NFPS terms (Figure 2.8), but that should not allow us to be complacent for reasons I have already stated and elaborate on in section 3 assessing fiscal sustainability.

Figure 2.8. Gross NPFS debt per capita

Source: State government budget papers and Adept Economics' calculations using ABS data and budget population projections.

Historically, we have had low net debt owing to strong fiscal performance of governments up to the Bligh Government, but we are now rapidly increasing our net debt (Figure 2.9).

Figure 2.9. Net debt per capita, general government



Source: State government budget papers and Adept Economics' calculations using ABS data and budget population projections.

2.6. Additional commitments since the 2024-25 Budget in June

This paper has largely relied on figures from the 2024-25 Budget published in June. These figures already show unsustainable budget policy settings. Ultimately, the figures are very likely to be much worse, considering large announcements and commitments made by the Queensland Government since the time of the budget. As illustrated in Table 2.1, taking into account the impact of public debt interest, these commitments will mean an additional $9-10 billion of debt at least, so total NFPS debt in 2027-28 could end up at least $181 billion rather than $172 billion. Because the Government is already running fiscal deficits, any additional spending means additional borrowing and additional interest expenses, which it will need to borrow additional amounts to cover. S&P is right to warn today that another downgrade of Queensland's credit rating is possible.[6] This would further increase borrowing costs.

[6] Lynch and Elks (2024).

Table 2.1. Debt impact of significant Queensland Government announcements since 2024-25 Budget in June 2024

	2024-25	2025-26	2026-27	2027-28	Total
	$ million	$ million	$ million	$ million	$ million
50-cent fares extension	125	300	300	300	1,025
Copperstring cost blowout	1,200				1,200
Bribie Island bridge duplication		200	300	200	700
Bulk-billing GP clinics	65	100	100	100	365
Free school lunches	200	400	400	400	1,400
Barron River Bridge	75	150	150	75	450
Satellite hospitals	137	137	137	137	548
Other commitments	444	959	859	1,034	3,296
Sub-total (before interest)	*2,246*	*2,246*	*2,246*	*2,246*	*8,984*
Additional public debt interest	45	135	225	314	719
Increase in public sector debt	**2,291**	**2,381**	**2,471**	**2,560**	**9,703**

Sources: https://www.stevenmiles2024.com/costings, Queensland government and LNP promise to make 50 cent public transport fares permanent - ABC News, Full list of LNP and Labor party promises ahead of Qld state election | The Courier Mail, Premier Steven Miles pledges to build second bridge to Bribie Island | The Courier Mail, Cost of living crisis: Premier's bulk-billed medical election promise revealed | The Courier Mail, Qld election: Labor throws down gauntlet to LNP with costings for $4.8bn in spending promises | The Courier Mail

Notes: Assumptions have been made regarding the spread of spending commitments over financial years. For simplicity of exposition, it is assumed all the committed spending occurs over the current forward estimates, while in reality some will be beyond the forward estimates. Also, for calculating additional public debt interest associated with these commitments, a 4% borrowing rate is assumed.

3. Assessment of fiscal sustainability

3.1. What do public finance theory and evidence tell us

Two important macro-principles to guide government budgeting are:

1. **Do not borrow for operating expenses** (e.g. wages)–the so-called golden rule of public finance (Box 1), which in the Queensland context means targeting a net operating balance or surplus and only running a fiscal balance deficit to "borrow to build"; and

2. **Achieve a sustainable or falling ratio of debt-to-GSP or debt-to-revenue**, avoiding explosive trajectories and corresponding to an acceptable level of interest payments in the budget (i.e. one which does not absorb too many funds that could be better spent on health and education).

Broadly speaking, lower levels of debt are more desirable, all else being equal, but it is difficult to define either an optimal level of government debt or a level that is risky to exceed. That said, we can say that Queensland Government debt is much higher than would be required to get the AAA credit rating back. If Queensland is to regain its AAA credit rating, it would probably require the debt-to-revenue ratio for the NFPS to fall to near or below 100%, compared with its 2024-25 level of 127%. It is currently projected to grow to 157% in 2027-28.[7] The general government debt-to-revenue ratio is projected to increase to 117% by 2027-28, up from 88% in 2024-25. These rising debt levels, along with higher interest rates, mean general government interest expenses are rising as a share of total revenue, from 2.4% in 2023-24 to 4.1% in 2026-27.

Box 1. The Golden Rule of Public Finance

An uncontroversial rule is that governments should not consistently borrow to cover recurrent expenses such as wages; that is, they should run operating surpluses. This rule is so widely agreed upon that it has been labelled the Golden Rule of Public Finance.[8]

Governments should only borrow money to finance new infrastructure. Spending on new infrastructure can be justified for two reasons.

1. Long-lived infrastructure can benefit the community for many years to come, and it can be efficient and equitable in spreading the burden over time, including over different generations.

2. By expanding the public capital stock, new infrastructure spending can improve GDP and, hence, generate additional tax revenue, which can contribute to recovering the infrastructure costs.

[7] See the discussion of the “trigger band of around 100-110% for a AAA rating” in the Queensland Commission of Audit Report June 2012, p. 4.

[8] See Tanzi and Davoodi (1998, p. 2), although the authors believe the rule can still generate a bias towards excessive capital investment. That is, the Golden Rule is a necessary but not sufficient condition for fiscal sustainability.

We were careful to refer to new infrastructure, or more specifically, net acquisitions of non-financial assets, because depreciation of public capital is included as an expense in the operating statement. It is ideally funded by operating revenues because it is the asset's usage by current taxpayers that is contributing to its depreciation in value. Only net additions to the capital stock should be financed through borrowings, not refurbishments to offset depreciation.

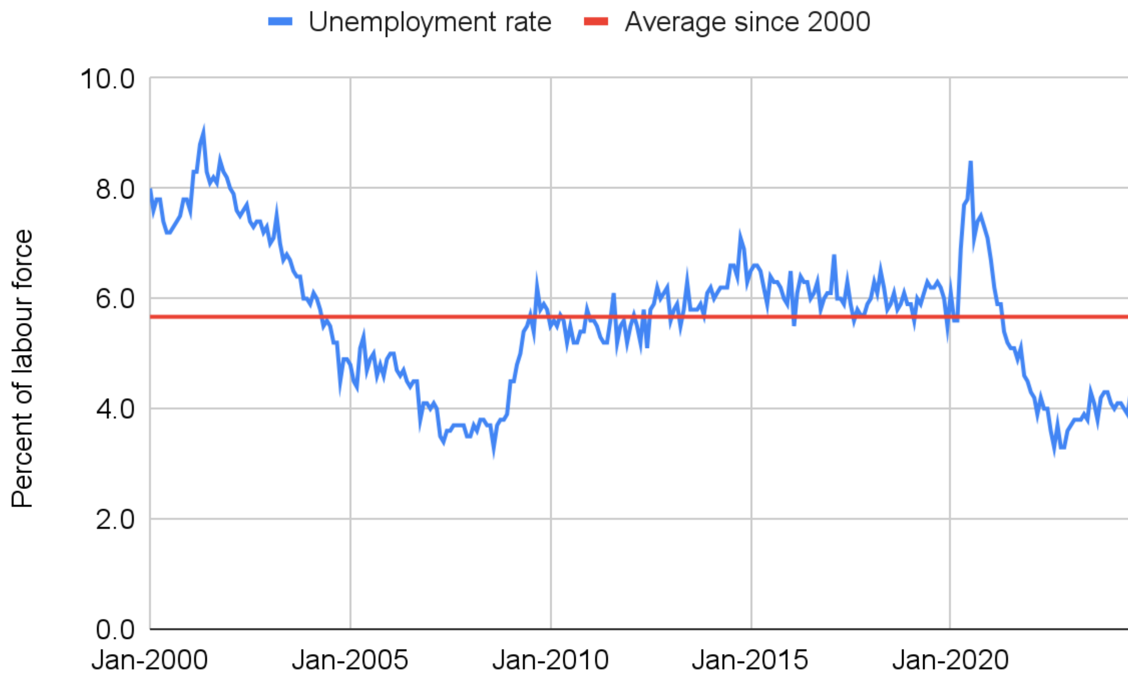
3.2. Government's performance against traditional fiscal principles

3.2.1. Golden Rule of Public Finance

As noted in section 2.1, the Queensland Government is running operating deficits, not just fiscal deficits (considering net capital expenses), in 2024-25 and 2025-26 on current forecasts. This violates the golden rule. Furthermore, it lacks the only legitimate excuse for doing so, which is that the net operating deficit is due to a downturn in the economy, in which case running an operating surplus could be a perverse fiscal policy. However, the state government is not forecasting an economic downturn. It is forecasting 2024-25 (i.e. the year of the large net operating deficit) GSP growth to be 3%, the same rate as in 2023-24.[9] Furthermore, unemployment is still significantly below the historical average, at 4.2% in August 2024, compared with the average since 2000 of 5.7%. Queensland Treasury expects it to only increase to 4.75% over the budget forward estimates (Figure 3.1).

[9] Queensland Government Budget Strategy and Outlook 2024-25, Table 1, p. 4.

Figure 3.1. Unemployment rate, seasonally adjusted, Queensland



Source: ABS Labour Force Statistics.

The operating deficit is not unavoidable due to economic circumstances. It is a policy choice. For instance, in 2024-25, the operating budget has deteriorated from the previously forecast surplus of $122 million to a deficit of $2.6 billion, overwhelmingly due to additional discretionary expenditures of $4.2 billion. The additional discretionary expenditure in 2025-26 is forecast at $2.8 billion.

The Government claims it is to help Queenslanders with the cost of living. That is a noble objective, but it cannot be accomplished without violating a fundamental public finance principle. The operating deficit tells the government that the measures are unaffordable. It would be ludicrous for the Government to justify operating deficits due to both economic downturns, as it did during the pandemic, and inflation or the cost-of-living crisis, as it is doing now. That is a recipe for perpetual operating deficits.

In other words, the state government has no credible justification for running operating deficits in 2024-25 and 2025-26. They are bad policy from the perspectives of both fiscal sustainability and inflation, as discussed in section 4.

3.2.2. Primary balance

Generally, a stable debt-to-GSP or GDP ratio requires the government to avoid a deficit on its primary budget balance, which is the budget balance excluding net interest expenses.[10] The primary budget balance tells us whether the government runs a balanced budget before considering interest payments. The Queensland Government also violates this well-understood public finance principle, suggesting its fiscal deficits are too large (Table 3.1).

Table 3.1. Primary budget balance, Queensland Government, general government

	2023-24	2024-25	2025-26	2026-27	2027-28
	$ million	$ million	$ million	$ million	$ million
Fiscal balance (A)	-5,717	-10,790	-9,547	-7,341	-4,054
Net interest expenses* (B)	-840	-88	698	1,340	1,859
Primary balance (C=A+B)	*-6,557*	*-10,878*	*-8,849*	*-6,001*	*-2,195*

Source: Adept Economics calculations based on Queensland Government budget estimates.

*Net interest expenses are calculated as other interest expenses plus superannuation interest cost less interest income.

[10] This assumes the government's borrowing rate is approximately equal to the long-run average economic growth rate, which is a common assumption in economic modelling, including the Australian Treasury's Intergenerational Report modelling.

3.3. Government's performance against its fiscal principles

3.3.1. Performance against 2015 principles

The current Queensland Government failed to meet three of its original fiscal principles (Table 3.2). For two of the failures, it could legitimately blame the pandemic, but it was failing on its principle regarding debt even prior to the pandemic.

Table 3.2. Current Queensland Government's performance against original principles

Principle	Assessment
1. Target ongoing reductions in Queensland's relative debt burden, as measured by the General Government debt to revenue ratio.	Failed even prior to the pandemic. The debt to revenue ratio was already increasing over the forward estimates prepared in 2019.
2. Target net operating surpluses that ensure any new capital investment in the General Government Sector is funded primarily through recurrent revenues rather than borrowing.	Failed during the pandemic, but that was understandable, given the economic shock and the necessity of a fiscal response to some extent.
3. The capital program will be managed to ensure a consistent flow of works to support jobs and the economy and reduce the risk of backlogs emerging.	There is no objective way of evaluating performance against this principle.
4. Maintain competitive taxation by ensuring that General Government Sector own-source revenue remains at or below 8.5% of nominal gross state product, on average, across the forward estimates.	The Government met this principle over the period it was in place. However, it could no longer keep it in the 2021-22 Budget due to soaring royalty revenue (e.g. own-source revenue was 10.5% of GSP in 2022-23).
5. Target full funding of long-term liabilities such as superannuation and WorkCover in accordance with actuarial advice.	Met.
6. Maintain a sustainable public service by ensuring that overall growth in full–time equivalent (FTE) employees, on average over the forward estimates, does not exceed population growth [introduced in 2016-17].	Failed during the pandemic.

Source: Queensland budget papers for 2015-16 and 2016-17 and Adept Economics' assessment.

The biggest failing of the Government was its failure to keep its principle regarding debt, even prior to the pandemic. The Government failed to meet its first fiscal principle, which was to "Target ongoing reductions in Queensland's relative debt burden, as measured by the General Government debt to revenue ratio," prior to the pandemic. The 2019-20 Mid-Year Fiscal and Economic Review published in December 2019 projected (on p. 22) the General Government debt-to-revenue ratio to increase from 54% in 2018-19 to 78% in 2022-23. The rate of increase was slowing toward the end of the forward estimates, but it was still increasing from 76% in 2021-22 to 78% in 2022-23.

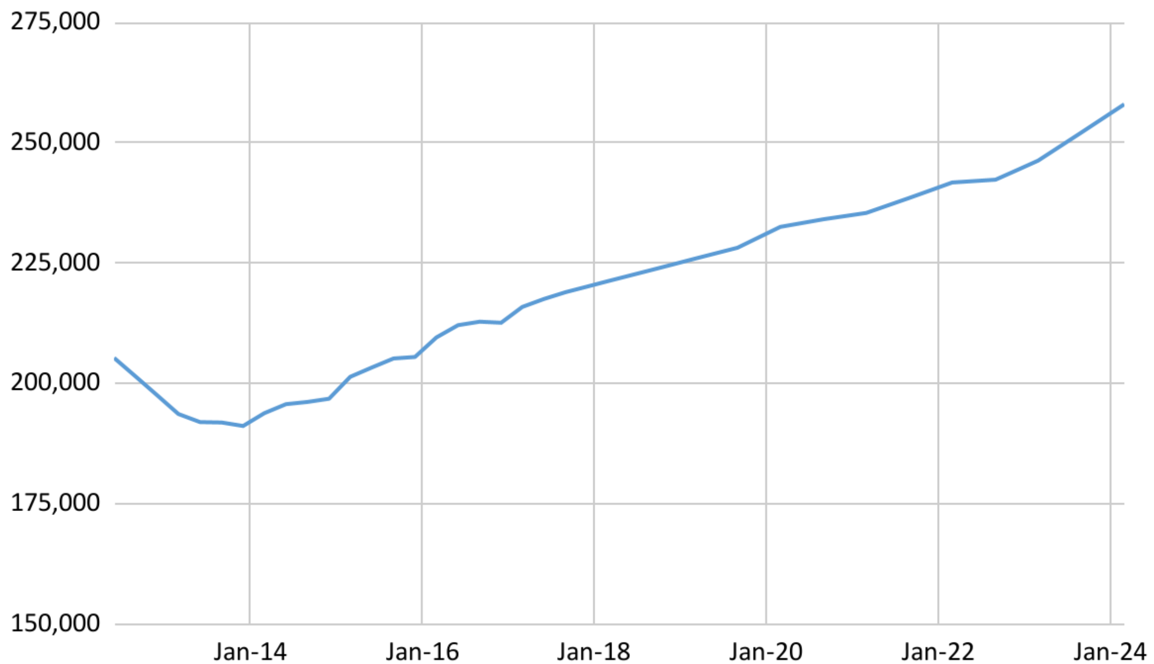
The Government could no longer target “ongoing reductions in Queensland’s relative debt burden, as measured by the General Government debt to revenue ratio”, given this had blown out (refer to Figure 1). It has now set what it may see as the much easier target of the stabilisation of net debt to revenue in the medium term and a reduction in net debt to revenue over the long-term, presumably over 10 years or more.

Furthermore, the Government abandoned its public service growth principle, which it had breached and did not want to be constrained by in the future. In its last budget using the previous principles (i.e. 2020-21), the Government noted (on p. 101): “The overall average annual growth rate over 2019-20 to 2023-24, based on current estimates, is 1.83%. This compares to an estimated Queensland population growth of 1¼ % annually.”

Incidentally, since March 2015, Queensland public service FTE numbers have increased by 28% compared with growth in Queensland’s population of 17% (Figure 3.2). In the twelve months to 31 March 2024, public service FTEs increased by 4.8% compared with total employment (FTE) growth of 3.5% and population growth of 2.5%. Over the twelve months to 31 March 2024, the workforce growth has been disproportionately in corporate (i.e. back office) jobs (up 9.3%) rather than key frontline jobs (up 3.5% or frontline and frontline support jobs (up 6.1%).[11]

[11] Queensland Public Service Commission (2024) State of the Sector Report, p. 15.

Figure 3.2. Queensland Government Public Service, FTE numbers



Source: Queensland government workforce statistics, various issues. Note: data for some quarters have been interpolated given the relevant agency does not make reports for quarters prior to September 2019 available online and they are available by request only. The data prior to September 2017 are from the author's records and were used in his book "Beautiful One Day, Broke the Next."

During the pandemic, the Government could temporarily no longer target net operating surpluses or funding capital works largely with operating cash surpluses, but that was understandable given the economic shock. In the 2020-21 Budget (Paper 2, p. 16), the Government noted:

> "The COVID-19 pandemic has resulted in some of Queensland's fiscal principles not being met, and appropriate revisions will be considered ahead of the 2021-22 Budget."

Finally, the Government had to modify the principle of keeping its own source revenue below 8.5% of GSP because of surging royalty revenues. This principle was arguably poorly designed in the first place, and the new principle of keeping Queensland taxation per capita below the Australian average is arguably superior. This is a principle that Queensland Governments have easily met given our relatively lower tax rates and our greater reliance on royalty revenue than other states.

3.3.2. Performance against current principles from 2021-22

After revising its fiscal principles in 2021-22, the Government now appears to have failed on its revised net debt and capital funding principles–i.e. its first and third principles (Table 3. 3).

Table 3.3. Queensland Government performance against 2021-22 principles

Principle	Assessment
1. Stabilise the General Government Sector net debt to revenue ratio at sustainable levels in the medium term, and target reductions in the net debt to revenue ratio in the long term.	Arguably, the Government has breached this principle, given the net debt to revenue ratio is surging. Over the five years from 30 June 2023 to 30 June 2028, this ratio will have increased from 2.9% to 62.8%. NB. The Government does not define medium term anywhere, but it should arguably refer to a period of around five years but less than ten years.
2. Ensure that the average annual growth in General Government Sector expenditure in the medium term is below the average annual growth in General Government Sector revenue to deliver fiscally sustainable operating surpluses.	The Government is currently meeting this principle based on 2024-25 budget estimates, but the full budget impact of the unforeseen expenditure discussed in section 2.3 remains to be seen.
3. Target continual improvements in net operating surpluses to ensure that, in the medium term, net cash flows from investments in non-financial assets (capital) will be funded primarily from net cash inflows from operating activities. The capital program will focus on supporting a productive economy, jobs, and ensuring a pipeline of infrastructure that responds to population growth.	The government would have difficulty arguing that it is “primarily” funding capital spending with net operating cash flows, which should mean more than 50% is funded by net operating cash flows. Over 2024-25 to 2027-28, it is only funding 37% of capital spending this way, and that assumes a significant budget improvement in 2026-27 and 2027-28. In 2024-25, this metric is 13%, and in 2025-26, it is projected to be 31%.
4. Maintain competitive taxation by ensuring that, on a per capita basis, Queensland has lower taxation than the average of other states.	Met. There is no risk of not meeting this principle.
5. Target the full funding of long-term liabilities such as superannuation and workers’ compensation in accordance with actuarial advice.	Met. There is no risk of not meeting this principle unless the Government withdraws further funds from schemes.

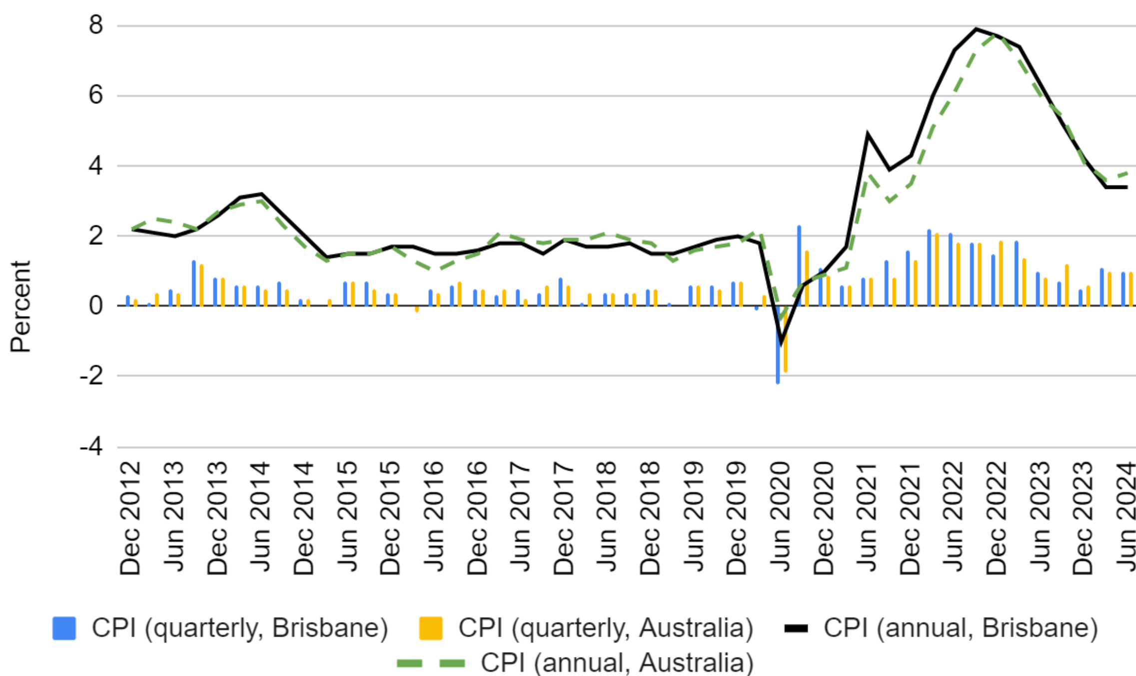
Net debt is ever increasing, and it is implausible that we would end up with a stabilised or even a falling net debt to revenue ratio based on current policy settings. Regarding its third principle on capital funding, the Government needs to avoid operating deficits, which it will run in 2024-25 and 2025-26, and run larger operating surpluses than currently projected after that.

4. Impacts on inflation

4.1. Inflation and government budgets

Inflation has proven persistent (Figure 4.1). Unlike in the US and UK, which are now experiencing interest rate reductions, disinflation in Australia is taking much longer, and there is a risk that inflation gets stuck significantly above the 2-3% inflation rate target band. While the most recent monthly CPI figure from the ABS for August 2024 has headline inflation at 2.7%, the reduction to the target band was due largely to temporary electricity subsidies from federal and state governments. Core inflation, measured by the annual trimmed mean, remains outside the target band at 3.4%.[12]

Figure 4.1. Measures of inflation—Consumer Price Index, QLD and Australia



Source: ABS, Consumer Price Index, Australia, June 2024.

Partly substantial public sector cost-of-living relief and infrastructure spending programs have contributed to this. This is due to its impact on aggregate demand, the total amount of

[12] https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/monthly-consumer-price-index-indicator/aug-2024

goods and services governments, households, and businesses desire to purchase in a given period.

The Queensland Government has contributed to inflation in two ways:

1. Its excessive cost-of-living subsidies have relaxed household budget constraints and contributed to aggregate demand for private sector goods and services at a time when the Reserve Bank of Australia (RBA) is trying to reduce aggregate demand to bring inflation back to the target band of 2-3%.
2. Its excessive capital expenditure (CAPEX) program is contributing to rising construction costs.

Given the economic outlook, the Government's fiscal policy settings are excessively expansionary. The Government is forecasting a slightly lower economic growth rate but not to the extent that a big-spending budget is required to provide fiscal stimulus. Queensland is running a fiscal deficit of 2% of the GSP. That is, its injections into the economy via spending exceed the leakages associated with its revenue by 2 percentage points at a time when there is no excess supply in the economy that can readily absorb this additional demand without inflationary pressures. For instance, in Queensland, the unemployment rate has remained well below the long-run average, at 4.2% in August 2024, compared with the average since 2000 of 5.7%.[13]

4.2. The contribution of government spending to aggregate demand and inflationary pressures

Robert Carling, Senior Fellow at the Centre for Independent Studies (CIS), has explained:

> "The RBA explained that aggregate demand is too high to be met by the economy's current productive capacity without strain and is therefore leading to stubbornly high inflation above the target of monetary policy."[14]

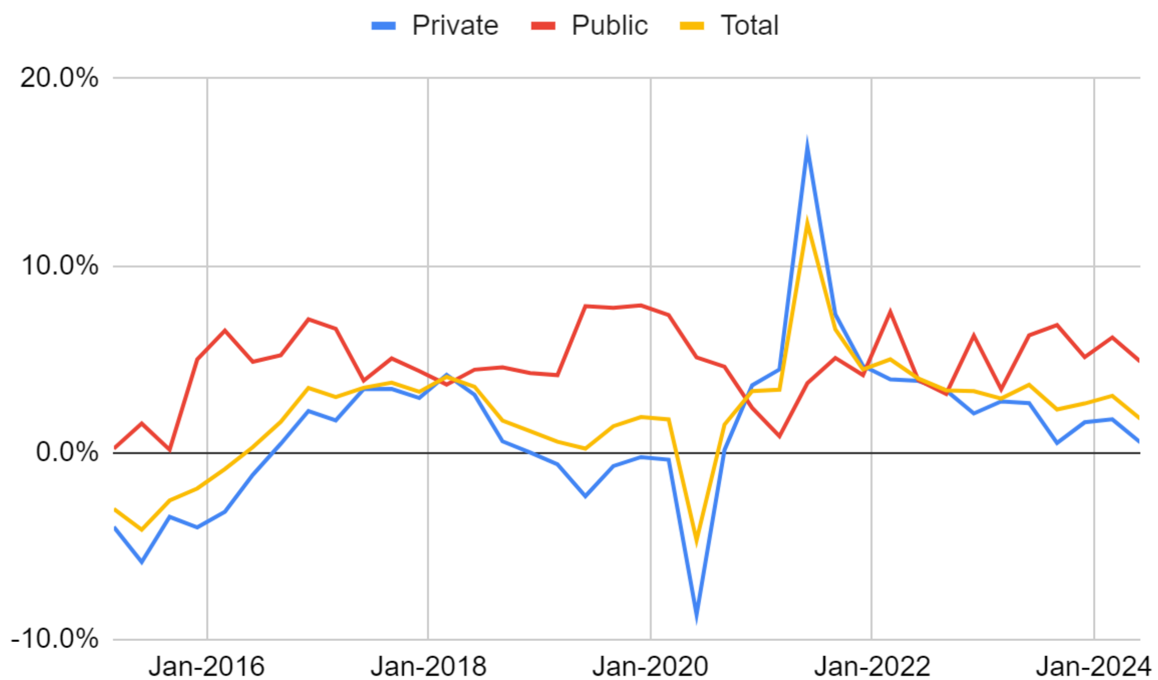
The RBA operates according to a model in which the level of aggregate demand, through its influence on the unemployment rate gap, the difference between unemployment and its long-run natural rate, influences the inflation rate, as do recent inflation data and

[13] ABS Labour Force, Australia seasonally adjusted estimates.
[14] Carling (2024, p. 10).

expectations of future inflation.[15] Historically, the influence of aggregate demand via the unemployment rate on inflation was known as the Phillips curve or the Output-Inflation tradeoff. Expectations matter, and the Phillips curve is not a stable curve but shifts upwards if inflation expectations become higher. This was the experience of the 1970s and 1980s periods of stagflation and why it is important to nip inflation expectations in the bud.

Within Queensland, total public demand (across all levels of government) has consistently grown at a faster rate than the private sector demand (Figure 4.2). Queensland Government spending accounts for around two-thirds of total public demand in the state.

Figure 4.2. Aggregate demand by private and public sectors, Queensland, seasonally adjusted, chain volume measures, through-the-year percentage changes

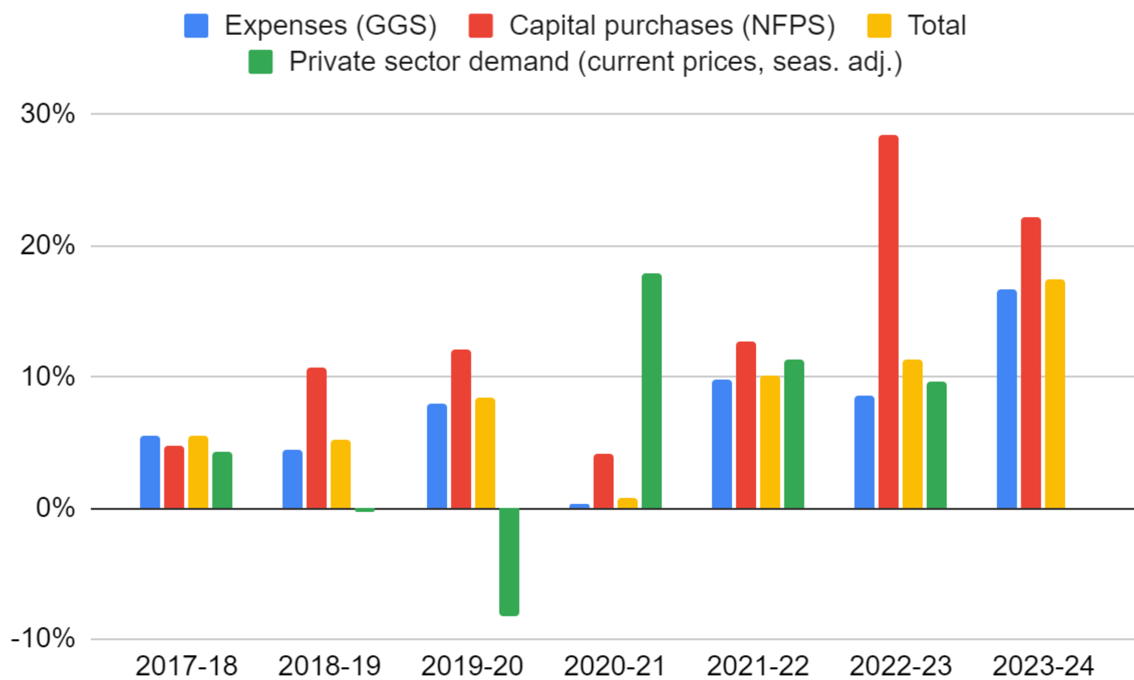


Source: ABS National Accounts data.

Looking at Queensland Government spending specifically, we also see a faster rate of growth than private sector spending (Figure 4.3).

[15] Ballantyne et al. (2019, p. 26).

Figure 4.3. Queensland government spending vs private sector spending, percentage changes, yearly



Source: ABS National Accounts data and Queensland Government Budget papers.

Queensland Government discretionary fiscal policy measures in 2024-25 amount to nearly 1% of GSP (Table 4.1). This is a sizable fiscal stimulus at a time of remaining inflationary pressures.[16] Hence, it is a poor policy from a macroeconomic perspective, as fiscal stimulus is undesirable during times of inflation.

[16] Relative to the size of the economy, it is around half the size of the Rudd Government's 2009 National Building and Jobs Plan, which amounted to 2% of GDP in 2009-10. See the Australian Government 2009 Updated Economic and Fiscal Outlook, p. 3.

Table 4.1. Reconciliation of previous budget forecasts with current forecasts, Queensland general government

	2023–24 $ million	2024–25 $ million	2025–26 $ million	2026–27 $ million
2023–24 Budget Update net operating balance	**-138**	**122**	**91**	**621**
Taxation revisions	460	1,379	1,321	1,339
Royalty and land rent revisions	1,381	2,128	563	382
GST revisions	185	287	40	-57
Revenue measures	-1	-384	212	276
Expense measures	-3,640	-4,233	-2,803	-2,118
Savings		300	750	1,000
Natural disaster revisions	224		-376	-158
Net flows from PNFC and PFC entities	65	-666	-314	-428
Australian Government funding revisions	241	-774	329	198
Other parameter adjustments	1,787	-790	-328	-168
2024–25 Budget net operating balance	**564**	**-2,631**	**-515**	**887**
*Total discretionary measures**	*3,641*	*4,617*	*2,591*	*1,842*
Discretionary measures as % of GSP	0.7%	0.9%	0.5%	0.3%

Source: Queensland Government Budget Strategy and Outlook 2024-25, Table 3.3., p. 79 and Adept Economics' calculation of total discretionary measures.

*Total discretionary measures is the sum of revenue and expense measures multiplied by -1.

4.3. The impacts of Queensland's infrastructure building program

One long-standing feature of government infrastructure spending is its potential to 'crowd out' other activities. There can be pressure on input costs where demand grows faster than the supply capability of the sector.

There is evidence of significant real cost inflation during periods of significant elevated capital expenditures–e.g. during the 2000's mining boom. In a 2011 study, GHD reported that while global impacts of oil and fuel prices were more significant in the period considered:

> "Movements in input material costs and labour wage costs appear to have played a modest role in driving movements in Australian infrastructure construction costs. The strong growth in the amount of infrastructure construction work done in Australia during

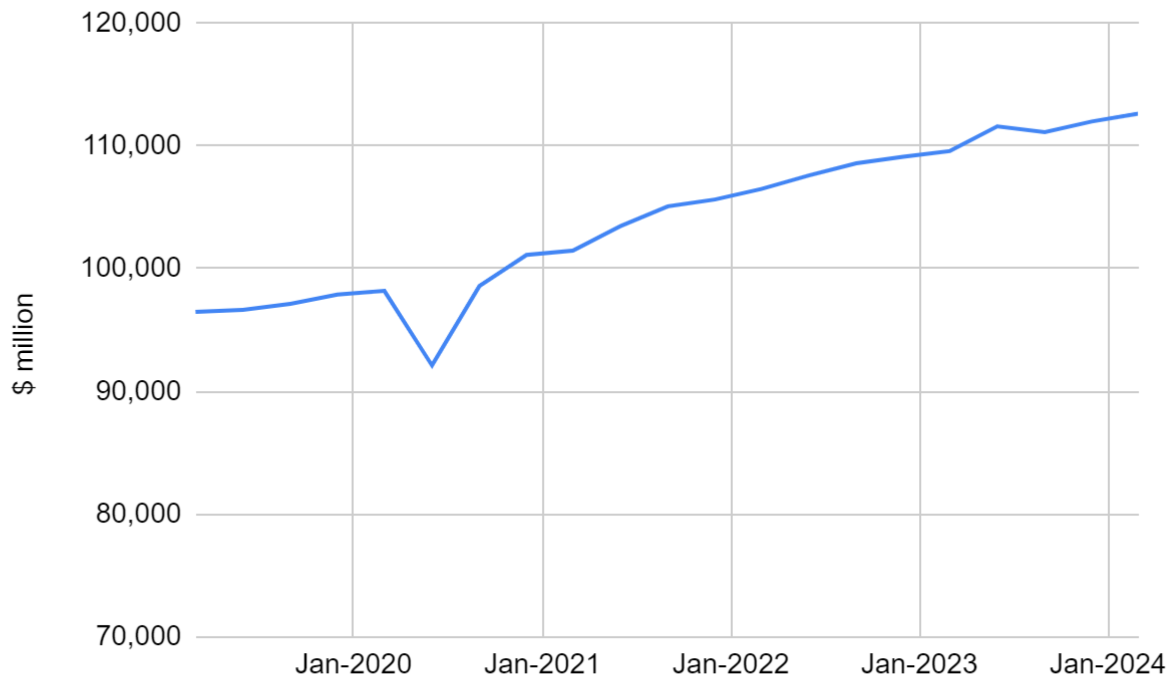
> the early and mid 2000s appears to have contributed to the 2004 – 2008 period of above-CPI increases in infrastructure construction costs."[17]

How the construction sector responds to a demand shock (e.g., a significant increase in state government capital spending) depends on the state of the supply side and its current utilisation level. Because of interstate and international border closures, the supply side was restrained in 2020 and 2021.

Furthermore, the post-COVID recovery was stronger than many expected, including the Queensland Government, based on its budget forecasts discussed above (Figure 4.4). Arguably, plans made at the height of concerns over the economic impact of COVID-19 should have been reassessed in early to mid-2021, when it became clear the economy was recovering strongly. The Queensland Government's extensive capital spending program was partly motivated by a desire to stimulate the economy. To the extent the economy recovered more strongly than expected, there was less need to engage in such fiscal stimulus.

[17] GHD (2011) Evidence Based Comparative Analysis of Major Infrastructure Construction Costs in Australia and Internationally, Final Report, April 2011, report prepared for Infrastructure Australia, p. 5.

Figure 4.4. Queensland State Final Demand, quarterly, seasonally adjusted chain volume measure



Source: ABS Australian National Accounts: National Income, Expenditure and Product, March 2024, Table 25. State Final Demand, Summary Components by State: Chain volume measures.

On 7 September 2020 the Queensland Government published its *COVID-19 Fiscal and Economic Review*. It forecast GSP growth of ¼% in 2020-21. In December, the Queensland Government published the 2020-21 state budget, which maintained the ¼% forecast for 2020-21 and added forecasts of 3½% for 2021-22 and 2 ¾% for 2022-23 and 2023-24.

The Queensland Government noted on p. 6 of Budget Paper no. 2 of the 2020-21 state budget that "As at October 2020, Queensland is the only state where employment and hours worked have rebounded to above their pre-COVID-19 levels, highlighting the extent of the recovery in the state's labour market." There were signs that Queensland was recovering strongly from COVID-19 in late 2020.

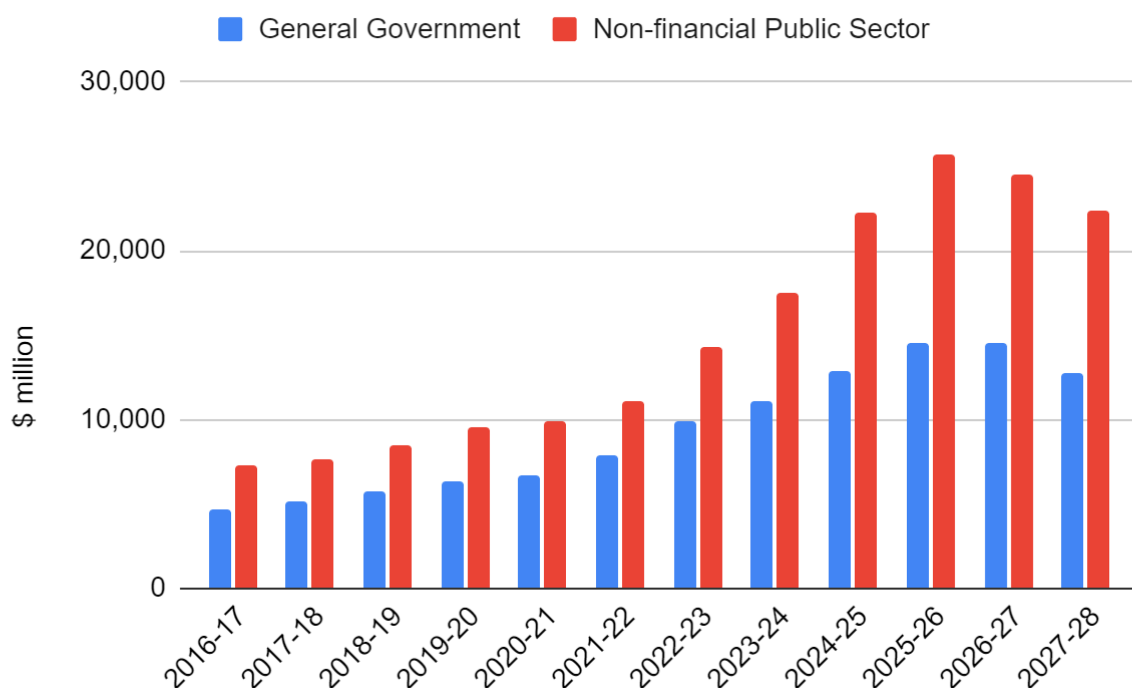
In the 2021-22 state budget, published in June 2021, the Queensland Government had upgraded its forecast of GSP growth in 2020-21 to 3¼%, up from ¼% forecast in the 2020-21 budget published in December 2020. As Budget Paper 2 for 2021-22 (p. 10) notes: "Reflecting the improved domestic conditions, GSP is forecast to rebound 3¼ per cent in 2020–21, significantly stronger than the 1⁄4 per cent growth expected at the time of the 2020–21 Budget."

At the time of the *COVID-19 Fiscal and Economic Review* in September 2020, the Queensland Government framed its large capital works program, “the largest 4-year capital spend in nearly a decade”, effectively as a fiscal stimulus. The Review (on p. 22) noted, “Capital projects have been fast tracked to immediately support construction jobs and invest in infrastructure that supports our recovery, resilience and future economic growth.”

Given the substantial improvement in economic forecasts between the September 2020 *COVID-19 Fiscal and Economic Review* and the June 2021 2021-22 Budget, the Queensland Government should have reconsidered its capital spending plans. This is because the fiscal stimulus was thought to be desirable as of September 2020, but it was probably no longer desirable in June 2021. To the extent additional capital spending was motivated by fiscal stimulus, it should have been slowed down or scaled back once the signs of a robust recovery were apparent.

Given the strength of the economic recovery and stimulus from the federal government and the RBA, the significant scale of additional Queensland Government capital expenditure could easily have crowding-out effects, bidding up input costs for competing public and private projects in nominal terms (Figure 4.5).

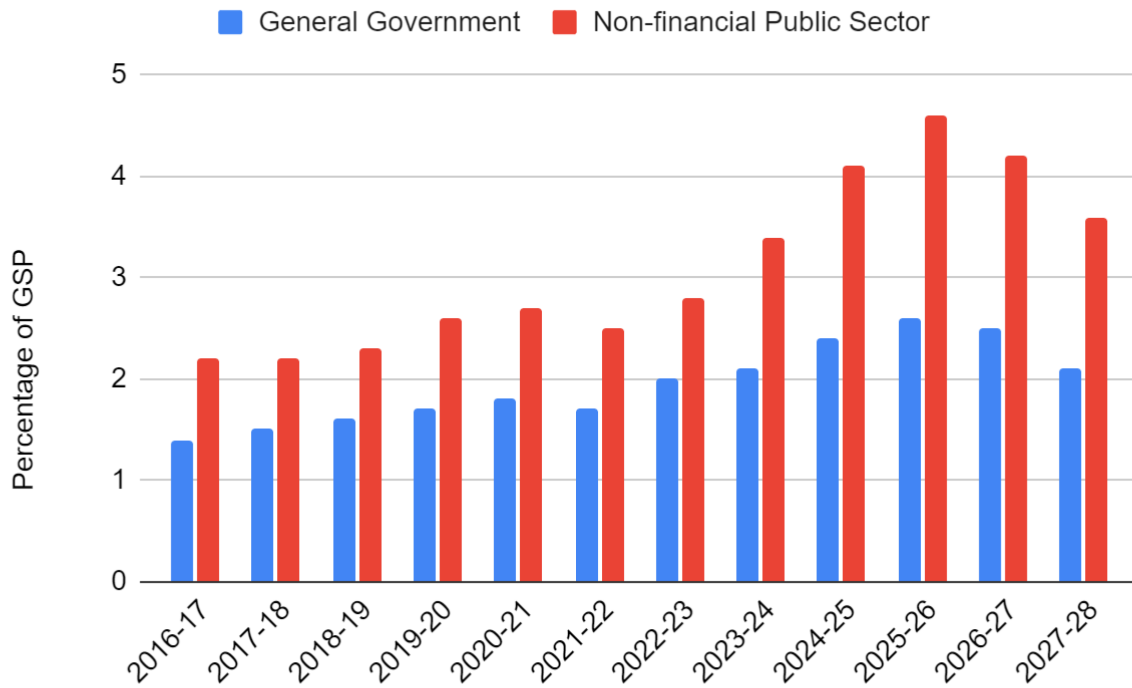
Figure 4.5. Queensland Government capital purchases by financial year, $ million



Source: 2024-25 Queensland Government Budget Paper no. 2, Appendix D: Fiscal Aggregates and Indicators, pp. 254-255.

As a percentage of GSP, there is also a noticeable impact, although it is masked to some extent by high coal prices pushing up nominal GSP in 2021-22 and 2022-23 (Figure 4.6).

Figure 4.6. Queensland Government capital purchases by financial year, % of GSP



Source: 2024-25 Queensland Government Budget Paper no. 2, Appendix D: Fiscal Aggregates and Indicators, pp. 254-255.

Another way to assess the potential impact of the Queensland Government's capital spending is to compare it with the total construction work done in Queensland over the financial years 2019-20 to 2022-23 (Table 4.2). There is a sizable proportional increase in the Queensland Government's demand as a percentage of total activity of nearly three percentage points in 2022-23.

Table 4.2. Queensland Government capital purchases compared with total construction activity

	Building work done	Engineering work done	Total	QLD Gov't capital purchases	Proportion of total
	$ million	$ million	$ million	$ million	Percentage
2019-20	20,533	20,117	40,650	9,482	23.3%
2020-21	21,193	19,322	40,515	9,877	24.4%
2021-22	24,490	21,096	45,586	11,130	24.4%
2022-23	27,971	24,341	52,313	14,300	27.3%

Sources: ABS Building Activity, Australia, March 2024; ABS Engineering Construction Activity, Australia, March 2024; Queensland Government Budget Paper no. 2, Appendix D: Fiscal Aggregates and Indicators, pp. 254-255.

The ultimate impact on prices will depend on the supply responsiveness or elasticity of construction activity in Queensland.

There is good reason to say that the sector was at a high level of utilisation when Queensland Government capital purchases were increasing, and supply had reduced capacity to respond. This would have resulted in significant cost increases. Further research and economic modelling would be required to provide a reasonable estimate of the impact.

It is instructive to consider Queensland Treasury's assessment of the state of the sector as at the time of the 2022-23 Budget in June 2022, just before the large increase in capital purchases in the 2022-23 financial year. This assessment would suggest the supply-side of the market may struggle to respond to a large increase in demand from the Queensland Government, noting Queensland Government capital purchases were 28.5% higher in 2022-23 than 2021-22 (in nominal terms).[18] Budget Paper no. 2 for 2022-23 observed:

a. "Despite the easing of overall population growth, strong net interstate migration and higher population growth in some key regions has contributed to the strength of activity in the housing and residential construction sector."[19]

b. "Engineering construction, which primarily involves longer-term projects, held up well during the past 2 years and a considerable pipeline of committed work is yet to be done. Survey measures of business investment intentions have been revised higher while other leading indicators such as non-residential

[18] This is the estimate for the non-financial public sector based on the data in Table 4.1. The 25.6% increase for the general government sector in 2022-23 compared with 2021-22 was very high, too.
[19] Queensland Government 2022-23 Budget Paper no. 2, p. 43.

> building approvals also remain strong. Finally, the prevailing tight labour market may also encourage firms to substitute capital for labour.” [20]

ABS National Accounts data suggest that Queensland has experienced cost increases in state and local general government capital investment of 23% since June 2020 and 14% since June 2022 (Table 4.2).[21] Queensland’s proportional increase for state and local general government capital investment is around 1-2 percentage points higher than the increases in NSW and Victoria.

Table 4.2. Implicit construction cost increases to the June quarter 2024, seasonally adjusted, State and local government capital spending, Queensland, NSW and Victoria

	QLD	NSW	Victoria
Changes since June quarter 2020			
Current prices (A)	38.2%	47.4%	43.7%
Chain volume measures (B)	12.2%	20.6%	19.1%
Implicit price or cost increase: (1+A)/(1+B)-1	23.1%	22.2%	20.6%
Change since June quarter 2022			
Current prices (A)	27.0%	10.3%	10.7%
Chain volume measures (B)	11.7%	-3.2%	-2.2%
Implicit price or cost increase: (1+A)/(1+B)-1	13.7%	13.9%	13.2%

Source: ABS Australian National Accounts: National Income, Expenditure and Product, June 2024, Tables 26 to 28.

In its latest report published November 2023 on the Australian construction industry, IBISWorld notes:

> “Some large prime contractors and specialist trade contractors have derived substantial stimulus from constructing landmark road and rail developments, including the WestConnex motorway in Sydney and the Cross River Rail in Brisbane. Similarly, conditions have been strong for contractors working on non-residential building projects, particularly accelerated growth in construction of industrial warehouses and distribution facilities.”[22]

[20] Ibid., p. 44.
[21] This is assuming that price increases and cost increases are proportionally the same.
[22] IBISWorld (2023) INDUSTRY REPORT Construction in Australia Nov 2023, p. 12.

Concerns about impacts on construction costs from the pipeline of construction work funded by governments across Australia have been forthcoming from several economists. For example, regarding infrastructure construction, Oxford Economics Australia analysts wrote around November 2023:

> "Government-funded infrastructure projects are propelling engineering construction activity, with a substantial 18.8% increase in publicly funded transportation construction work, reaching a record $30.1 billion in the twelve months to June 2023. Forecasts predict a peak of $34.8 billion in government-funded transportation work by FY25. Concerns arise about the feasibility of the announced pipeline due to industry capacity constraints and rising input costs, with an upcoming independent review expected to align with these concerns, potentially prompting a government downgrade of their pipeline."[23]

4.4. Summary of government spending impacts on inflation

To conclude this section, state government budget policies have contributed to inflation by adding to aggregate demand and contributing to the phenomenon of 'too much money chasing too few goods.' This has occurred for consumer goods and services, which have experienced higher demand than otherwise, as the Queensland Government and the federal government have extended cost-of-living relief and construction projects. Higher costs for construction projects will ultimately mean higher prices for consumers.

5. Conclusions

This paper has highlighted the deterioration of Queensland's state government finances, especially since the pandemic but starting before then, and its implications for fiscal sustainability and inflation. There are strong reasons to conclude that high state government spending contributes to persistent inflation, even if it is difficult to estimate the exact magnitude of the contribution.

Queensland's budget policy settings must change regardless of which party wins the election. The growth in spending must be arrested, and debt metrics should be stabilised. Queensland must get its fiscal house in order.

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[23] https://oxfordeconomics.com.au/construction-sector-analysis-in-australia/, accessed on 29 August 2024.

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