



CAPITAL

***SUBMISSION BY SOUTH AUSTRALIAN
DEPARTMENT OF TREASURY AND FINANCE***

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SOUTH AUSTRALIAN SUBMISSION ON CAPITAL

South Australia has been provided with a report by the Centre for International Economics (CIE) commissioned by the NSW Treasury 'The Commonwealth Grants Commission's capital assessment methodology – a critique and proposed alternative'.

SA supports the analysis and recommendations in that Report as follows:

- The assessment of needs for the services of physical assets, currently based on depreciation expense, should be augmented by the inclusion of an imputed holding cost expense (see p26 of the CIE Report).
- The holding cost expense amount can be calculated as the prevailing yield on long term CPI linked State government debt applied to the value of physical assets (see p24). (Note that currently prevailing yields are around 3.5% p.a.)
- Holding cost and depreciation can be assessed together on a functionalised basis (see p23).
- There is no need for an arbitrary discounting of depreciation disability factors in the holding cost model (see p16).
- Although there is a conceptual case for assessing population dilution needs for interest earnings on accumulated wealth derived from the operating surpluses of the general government sector, arising in connection with the core business of providing services, it is apparent that such an assessment involving the reconstruction of past net wealth balances is not straightforward to implement (see p25).
- An assessment of needs for the services of physical assets is not related to an assessment of population dilution needs on physical asset balances. Population growth *per se* does not change the per capita cost of providing services (see p26, 27).
- A dilution needs assessment is not supported – whether on an 'over time' or 'upfront' basis. It is unclear that fiscal equalisation outcomes are improved by implementing a dilution needs assessment, given that there may be offsetting advantages of higher population growth that have not been considered adequately in the equalisation framework (see p25). State public sector land valuation gains (including those realised on past sales) are essentially generated by population growth.
- Assessing population dilution needs in respect of equity in PNFCs and PFCs, largely comprising accumulated valuation gains, is particularly problematic (see p20, 21).

If the conclusions of the CIE report are not accepted by the Commission, and the Commission proposes a population dilution needs assessment in respect of net financial worth which is inclusive of equity, then SA supports the assessment of

other economic flows which give rise to the stock of equity, as per the recent Tasmanian proposal (i.e. reflecting that high growth states experience an advantage in the accumulation of equity).

SA also notes that an 'over time' approach to the assessment of needs for the services of physical assets, and an 'over time' approach for dilution needs is to be preferred to an 'upfront' approach in either instance. GST grant shares are thereby more predictable and less dependent on forecasts of population share and data revisions for expenditure disability factors.

Further technical issue. On a technical point not covered by the CIE report, holding cost and depreciation of physical assets arising from National network roads grants in the holding cost model should be assessed equal per capita (i.e. no needs assessed). National network roads grants should be assessed actual per capita. This preserves the intended allocation of national infrastructure resources to meet primarily national transport requirements.

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