

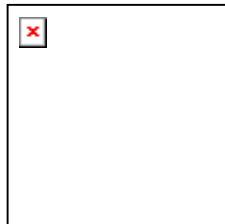


AUSTRALIAN CAPITAL TERRITORY

SUBMISSION TO THE COMMONWEALTH GRANTS COMMISSION'S POSITION PAPER 2009/03:

TREATMENT OF COMMONWEALTH PAYMENTS

November 2009



TREATMENT OF COMMONWEALTH PAYMENTS

Introduction

The ACT is supportive of the revised assessment guidelines outlined in the Commonwealth Grants Commission's (the Commission) Position Paper *Treatment of Commonwealth Payments CGC 2009/03*.

It is noted that the guidelines clarify how the Commission will treat Commonwealth payments made to the States, and have been revised as a response to the views expressed by States in their submissions to the 2010 Review. This is evidence of the iterative process working. Of particular importance to the ACT in recent times has been the treatment of Commonwealth payments to public trading enterprises (PTEs), and the revised guidelines in this regard are particularly welcomed.

The ACT supports the Commission's view that Commonwealth payments through States to PTEs or direct to PTEs should impact on the relativities if the payment supports affects State fiscal capacities and needs are assessed. This is clearly the case for payments made to transport authorities consistent with the ACT's transport submission to the Draft 2010 Review Report.

Treatment of payments to public trading enterprises

Position Paper *Treatment of Commonwealth Payments CGC 2009/03* indicates that the assessment of capital subsidies in the transport category is currently being reviewed. The Commission has noted that if needs were to be assessed for these subsidies, it would be difficult to make a case that Commonwealth payments through or directly to public trading enterprises should not have an impact on relativities.¹

The ACT is encouraged by the Commission is reviewing this issue and has made this comment. This is particularly the case given the relative importance of this matter as decisions made on how to treat the rail transport payments made to selected States under the *Nation Building Plan for the Future* programme will have a significant impact on the redistribution of the GST.

The Commission should treat all Commonwealth payments consistently, irrespective of the quantum of the payments being made to the States. That is, ensure that all payments made directly to government, through States to PTEs or direct to PTEs, and which impact on State fiscal capacities and have needs assessed [including a deliberative equal per capita (EPC) needs assessment] affect the relativities.

It is considered that the most appropriate treatment of transport capital subsidies is a deliberative EPC assessment, with associated Commonwealth payments affecting the relativities. The ACT is concerned that any other form of differential assessment would:

- be inconsistent with the Commission's current interpretation and assumptions concerning financial assets, which underpin the proposed net lending assessment;
- fail to recognise that capital subsidies only alter the composition of States' holdings of net financial assets (NFA), not their ability acquire these assets; and
- result in double counting of disabilities.

¹ Commonwealth Grants Commission, Position Paper CGC 2009/03 *Treatment of Commonwealth Payments*, October 2009, paragraph 23, page 4.

Transport authorities, other public trading enterprises (housing, water and electricity authorities) and the net lending assessment

States, on average, choose to incorporate their public transport authorities outside the general government sector. They do this for a range of reasons, but it means that these authorities typically take the form of a PTE. When States transact financially with PTEs, it is usually through an equity injection, recurrent or capital grant.

PTEs form an important part of States' net financial worth. Their value, or financial worth, is generally reflected in an equity investment account on States' general government sector balance sheets. In broad terms, these equity investments are accounted for as financial assets.

PTE financial assets, as well as all other types of financial assets and liabilities are the focus of the Commission's net lending assessment. The objective of this assessment is to provide States with the capacity to maintain the same NFA per capita. By providing States with the same per capita NFA, the Commission considers States then have the same capacity to earn revenues from those assets.² The assessment is framed on the expectation that only changes in State populations are considered to affect net lending.³ In the context of the net lending assessment, it should be noted that consistent with the ACT's capital submission to the 2010 Review Draft Report, the ACT is opposed to the proposed net lending assessment in its current form as detailed data and other evidence indicates that the faster growing States benefit from the growth in their PTE equity.

Importantly though, the net lending assessment makes no distinction between different types of financial assets. Rather, it assumes that each 'unit' of financial assets has the same potential to generate revenues or returns for a State. Therefore, by equalising the stock, States are given the same ability to earn revenues (flows) from those assets.⁴

The ACT considers that State transport capital subsidies are, in their simplest form, an investment in financial assets. A deliberative EPC assessment of these payments aligns with the Commission's treatment of financial assets in the net lending assessment, where an EPC assessment is undertaken at both the beginning and end of a year.

As transport capital subsidies are an expenditure flow and not a stock, a deliberative EPC assessment is only required at the end of the year to be consistent with the net lending assessment. This approach captures population growth over time. For example, if Queensland continues to experience above average population growth, its EPC needs for transport subsidies would also increase. Similarly, its assessed total population share of Commonwealth grants would likewise increase.

If State and Commonwealth transport capital subsidies were not assessed deliberative EPC, it would suggest that:

- States are unable to generate the same average revenues from different classes of financial assets and thus, those States forced to hold a greater share of their financial assets in less profitable asset classes (which may include transport PTEs) require a further disability to be assessed (in addition to population dilution); or

² Commonwealth Grants Commission, 2010 Draft Report on State Revenue Sharing Relativities, *Attachment 20: Capital*, paragraph 56.

³ *Ibid*, paragraph 57.

⁴ It is noted that some States argued that population growth or other economic factors may lead to certain States having greater abilities to generate revenues or higher returns from their PTEs. The Commission dismissed this claim noting it was not convinced that PTEs in faster growing States generated higher profits from a growing customer base. The Commission indicated that there was no evidence available to support this claim.

- the net lending population dilution disability fails to capture State needs when it comes to acquiring the average per capita stock of equity in transport PTEs; or
- the Commission is prepared to accept double-counting where changes in PTE equity for transport providers are captured in both the net lending assessment and the capital subsidies component of the transport assessment– see the double counting section for a more detailed discussion on this matter.

The ACT notes that the former explanation is fundamentally inconsistent with the assumptions underpinning the net lending assessment. If States cannot earn an average amount of revenue from all each different type of financial asset (irrespective of whether they take the form of cash, equity or other), equalising the stock of financial assets fails to capture State needs.

If this were the case, and the Commission differentially assessed needs (other than deliberative EPC) for capital subsidies in the transport category, the ACT would request that the Commission examine each individual class of financial assets represented in the net lending assessment to determine whether other disabilities have also been overlooked.

Alternatively, if the population dilution disability failed to capture State needs in respect of the acquisition of equity in transport PTEs, and a different disability were assessed in the transport category, the ACT requests that the Commission separate State held equity in transport PTEs from total NFA and remove these amounts from the net lending assessment.

In a broader sense, the ACT is concerned there also appears to be other areas of service delivery such as housing and welfare and services to communities whose differential needs assessments of capital related expenses might also undermine the logic on which the net lending assessment has been framed.

For example, capital payments for housing authorities appear to be included in the net lending assessment, as well as in the welfare and housing category assessment. However, the capital payments included in the former are assessed using only population growth as the disability, while the latter is premised on a disability that captures Commonwealth benefit recipients.

To avoid double counting / an inconsistent assessment, the ACT considers that either an EPC component should be introduced into the welfare and housing assessment, the proportion of which should be based on capital expenses, or all of the welfare and housing capital expenses should be included in the net lending assessment. A similar approach should also be adopted for the services to communities assessment. The ACT thinks that the former is more transparent. This approach would ensure that these assessments align with the transport assessment approach, and allow the Commission to retain the intent of its net lending assessment.

A concise list of these areas and the ACT's concerns with double counting / inconsistency are provided at **Attachment A**. It should be noted that this does not represent an exhaustive list, and other PTEs may be excluded from this list.

Capital subsidies alter the composition of State net financial assets

The ACT is concerned that an assessment method, other than deliberative EPC, ignores the fact that State transport capital subsidies merely alter the composition of financial assets. They do not affect a State's ability to acquire financial assets nor do they affect its overall fiscal position.

The following illustrative example demonstrates how a typical capital subsidy might be provided to a transport PTE. It also highlights why subsidies do not impact the overall fiscal position of a State, and the interaction with the net lending assessment.⁵

The table below provides a concise reflection of the ACT's actual General Government Sector balance sheet as at 30 June 2009. The shaded column to the right provides a simulated balance sheet.

Under the simulated balance sheet, the ACT has provided a capital subsidy of \$37 million to its transport PTE at some point throughout the 2008-09 financial year. It can be seen that although the cash balance is lower, reflecting the payment of the subsidy, an offsetting gain is made in the financial worth of the ACT's investment in other public sector entities. These changes can be readily seen in blue text.

The offsetting entry is made because the PTE's worth increases simultaneously with the decrease in the cash balance of the general government sector because the entity uses the subsidy to acquire transport infrastructure, for example buses or trains.

AUSTRALIAN CAPITAL TERRITORY GOVERNMENT GENERAL GOVERNMENT SECTOR BALANCE SHEET AS AT 30 JUNE 2009			
	GGS Notes	2008-09 Actual \$m	2008-09 Simulated \$m
Financial Assets			
Cash and deposits	29	212	175
Advances paid	30	719	719
Investments, loans and placements	31	2,983	2,983
Receivables	32	514	514
Equity			
Investments in other public sector entities	33	5,006	5,043
Total financial assets		9,434	9,434
Non-financial assets		11,220	11,220
Total assets		20,654	20,654
Total Liabilities		6,167	6,167
Net assets		14,487	14,487

In actuality, capital subsidies may not always be funded through a State's cash account, and could be, for example, funded by debt. However, irrespective of how the transaction is funded, there is always an exact, offsetting transaction within the net assets of the PTE, which is subsequently recognised in the general government equity asset account.

⁵ This example is provided for illustrative purposes only. The ACT's transport authority is not a PTE and hence is not incorporated outside the general government sector.

It is acknowledged that how States choose to account for this transaction may give rise to an expense item in the operating statement. For example, in the tables below, the \$37 million subsidy is considered a grants expense for operating purposes, rather than an investment.

AUSTRALIAN CAPITAL TERRITORY GOVERNMENT GENERAL GOVERNMENT SECTOR OPERATING STATEMENT FOR THE YEAR ENDED 30 JUNE 2009		
	GGS Notes	2008-09 Actual \$m
Total revenue	13	3,414
Expenses		
Employee expenses	15	1,175
Superannuation expenses	16	379
Depreciation and amortisation	17	243
Interest expense	18	63
Other operating expenses	19	980
Grant expenses	20	634
Total expenses		3,478
UPF net operating balance		-64

NOTES TO AND FORMING PART OF THE FINANCIAL REPORT FOR THE YEAR ENDED 30 JUNE 2009															
20	<p>GRANTS EXPENSES</p> <p>Grants are amounts provided to Public Trading Enterprise agencies and no-ACT Government entities for general assistance or for a particular purpose. Grants may be for capital, one-off or ongoing purposes and the name or category reflects the use of the grant.</p>														
	<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;">Government grants and purchased services:</th> <th style="text-align: right;">\$m</th> </tr> </thead> <tbody> <tr> <td style="padding-left: 20px;">Grants to non-government schools</td> <td style="text-align: right;">172</td> </tr> <tr> <td style="padding-left: 20px;">Grant payment (education and community services)</td> <td style="text-align: right;">49</td> </tr> <tr> <td style="padding-left: 20px;">Purchase of health services from Calvary hospital</td> <td style="text-align: right;">117</td> </tr> <tr> <td style="padding-left: 20px;">Other grants</td> <td style="text-align: right;">259</td> </tr> <tr> <td style="padding-left: 20px;">Appropriation payments to PTE agencies</td> <td style="text-align: right;">37</td> </tr> <tr> <td style="padding-left: 20px;">Total grants expense</td> <td style="text-align: right;">634</td> </tr> </tbody> </table>	Government grants and purchased services:	\$m	Grants to non-government schools	172	Grant payment (education and community services)	49	Purchase of health services from Calvary hospital	117	Other grants	259	Appropriation payments to PTE agencies	37	Total grants expense	634
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Nevertheless, the expense always gives rise to an offsetting gain in the equity asset accounts of the general government sector, which leaves States' net worth unchanged.

The ACT considers that a deliberative EPC assessment is the appropriate way to differentially assess needs associated with these grants. Such an assessment is consistent with the Commission's logic and assumptions outlined above. Most notably, that States hold financial assets to generate revenues, and these revenues can be earned equally if States are provided with the capacity to acquire the same per capita stock of financial assets.

The ACT also notes that the Commission ‘seeks to give States the capacity to have the same net financial worth per capita. How States hold these assets (for example, equity in PTEs or cash) is their policy choice’.⁶

This statement suggests that any movement within financial asset accounts should not influence the outcome of the net lending assessment therefore supporting a deliberative EPC assessment of these subsidies.

Double counting

The ACT is also concerned that a differential assessment of needs, other than deliberative EPC, for capital subsidies in the transport category may give rise to double counting.

The Commission considers the proposed net lending assessment provides States with the capacity to acquire the average per capita stock of NFA. Because the assessment equalises the stock of NFA, the Commission recognises there is no need for a ‘flow assessment’ (such as the 2004 Review debt charges assessment), as this would result in double counting.

The ACT considers that differentially assessing needs (other than EPC) in the transport category would introduce an instance of double counting.

It is noted that in Queensland’s transport submission to the 2010 Draft Report, Queensland accepts the Commission’s proposed EPC treatment for capital subsidies, but suggests that ideally the capital component of the transport assessment should recognise the increased demand for public transport services faced by States with rapidly growing populations.

If the Commission were to assess a population growth disability for capital subsidies it would lead to double counting. This is because the values of transport capital subsidies are reflected in both the stock of NFA and the flow of capital subsidy expenditure. To the extent this expenditure is capitalised through States’ equity investments in PTEs, the disability would ultimately be applied to 200 per cent of the expenditure value.

A deliberative EPC assessment avoids the risk of double counting by ensuring consistency in application across the transport and capital assessments.

National Network Roads – Nation Building Program

The ACT notes that the Position Paper indicates the Commission is yet to decide on an appropriate treatment of Commonwealth payments for capital projects on national network roads (NNR). In its Capital submission to the 2010 Draft Report, the ACT outlined its proposed differential assessment for these payments within the investment category.

The ACT’s proposal was based on evidence demonstrating that the payments:

- were State policy influenced;
- were jointly funded by States; and
- the needs associated with national network roads were captured and reflected in the roads category factor (via the NTC framework and SMVU survey data).

⁶ Commonwealth Grants Commission, 2010 Draft Report on State Revenue Sharing Relativities, *Attachment 20: Capital*, paragraph 31.

The ACT continues to consider an actual per capita revenue assessment and a differential expenditure assessment in the investment component of the Capital assessment to be the most appropriate treatment for these payments.

Federal Financial Relations Unit
Investment and Economics Division
Department of Treasury, ACT

INCONSISTENT TREATMENT OF CAPITAL DISABILITIES FOR PUBLIC TRADING ENTERPRISES

SPP / NPP	SPP / NPP included in capital net lending / net investment component and assessed differentially ?	SPP / NPP included in category assessment and assessed differentially ?	Double counting ?
Transport payments to PNFCs (Transport Authorities) that include capital funding			
<ul style="list-style-type: none"> Nation Building Plan for the Future Project NPP. 	Changes in PTE equity for transport providers are captured in the net lending assessment, and also register in the net investment assessment – population growth the basis for differential assessment.	Consideration by the CGC is being given to differentially assessing capital subsidies, such as for population growth, in the transport category assessment.	Population growth is assessed as the disability in the net investment assessment for transport (capturing the capital stock impact), and if population growth is assessed in the transport category assessment (main driver of transport needs) to capture the flow impact, then there will be double counting of capital needs.
Welfare and Housing payments to PNFCs (Housing Authorities) that include capital funding			
<ul style="list-style-type: none"> Commonwealth-State Housing Agreement SPP. National Affordable Housing SPP. (a) Community Housing SPP. Housing Assistance for indigenous people SPP. Social Housing Project NPP. (a) Nation Building and Jobs Plan – Invest in social housing Project NPP. (a) Crisis Accommodation Assistance SPP. 	Changes in PTE equity for housing providers are captured in the net lending assessment, and also register in the net investment assessment – population growth the basis for differential assessment.	CGC has equalised capital payments in the welfare and housing category assessment largely based on the SDC factor (per capita number of Commonwealth pension / benefit recipients residing in each State).	Population growth is assessed as the disability in the net investment assessment (capturing the capital stock impact) and an SDC disability is also being applied to capital funding in the Welfare and Housing Category (capturing the flow impact). This results in an inconsistent / double counting of capital needs.
Water payments to PNFCs (Water Authorities) that include capital funding			
<ul style="list-style-type: none"> Great Artesian Basin Sustainability Initiative (GABSI) NPP Project – capital payments such as for replacement of open drains with piping - data shows that under the first three years of GABSI - 144 bores had been controlled (rehabilitated or 	Changes in PTE equity for water and electricity providers are captured in the net lending	CGC intends to equalise these payments in the Services to Communities category	Population growth is assessed as the disability in the net investment assessment (capturing the capital stock impact) and a

Attachment A

<p>plugged); and 3,541 km of bore drains had been replaced, by 5,644 km of piping. (b)</p> <ul style="list-style-type: none"> • Renewable Remote Power Generation NPP Project - capital payments (rebates) such as for the Renewable Energy Water Pumping (REWP) sub-program to support government install renewable energy water pumping systems in areas which are not close to the electricity grid. (c) • The Living Murray NPP Project - infrastructure payments includes regulating structures, water delivery channels and fishways. The program also funds complementary works and measures to enable water to be delivered to the icon sites. (d) • Water for the Future NPP Project - capital payments made to State governments and water utilities, for example, for the National Urban Water and Desalination Plan that will provide an investment of \$1 billion for desalination, water recycling and stormwater harvesting projects to assist major towns and cities in securing their long term water supply. (e) 	<p>assessment, and also register in the net investment assessment – population growth the basis for differential assessment.</p>	<p>assessment based on population living in smaller communities outside highly accessible areas.</p>	<p>disability measure based on population living in smaller communities outside highly accessible areas is being applied to capital funding in the Services to Communities category (capturing the flow impact). This results in an inconsistent / double counting of capital needs.</p>
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- (a) The CGC's *Draft Report Attachment 13 – Welfare and Housing*, page 275 notes that while these payments are for the most part of a capital nature, the average State policy is for the general government sector to expense them as a recurrent transfer to Housing Authorities.
- (b) See: <http://www.environment.gov.au/water/publications/agriculture/pubs/review-gab-sustainability-initiative.pdf>
- (c) See: <http://www.environment.gov.au/settlements/renewable/rrpgp/index.html>
- (d) See: http://www.thelivingmurray.mdbc.gov.au/programs/environmental_works_and_measures.
- (e) <http://www.environment.gov.au/water/programs/urban/stormwater-harvesting.html>