



AUSTRALIAN CAPITAL TERRITORY

SUBMISSION TO THE COMMONWEALTH GRANTS COMMISSION'S 2010 REVIEW DRAFT REPORT: *ATTACHMENT 20 - CAPITAL*

September 2009



CAPITAL ASSESSMENT ISSUES OF CONCERN

The Commonwealth Grants Commission (the Commission) has proposed an expansion of fiscal equalisation from the operating statement to the balance sheet without sufficient justification.

The main reason given to support this expansion was that with State Budgets largely moving into surplus, the existing Debt charges assessment was no longer sufficient to fully capture State needs.¹ However, since that time State budgetary positions have deteriorated. This raises the question of whether the proposed expansion is still necessary.

If the Commission proceeds with its proposal, the financial ramifications will be considerable for all States. This can be demonstrated by the fact that in the 2004 Review, the Debt charges assessment redistributed \$37 million amongst the States when they were in deficit. At that time, the assessment was considered to adequately capture and meet State needs. In contrast, the proposed Capital assessment is expected to redistribute \$1.1 billion.

Evidence demonstrating that a better equalisation outcome can be obtained by focussing on large up-front acquisition costs, as opposed to financing costs, is yet to be presented. Until such time that evidence supporting the proposed change is forthcoming, the ACT shall continue to maintain its position that the key focus for equalising capital should be consumption, not acquisition.

Notwithstanding this position, the ACT has additional concerns relating to the application of the proposed Capital assessment. In this context, and working within the bounds of the proposed approach, the following changes are requested, with a view to improving the assessment to better capture State needs:

- change the assessment of *National Network Roads* funding (provided through the Nation Building Program) from an actual per capita (APC) basis to a differential needs basis;
- change the treatment of the *Nation Building plan for the Future* roads and ports funding (provided through the Nation Building Plan for the Future – Building Australia Fund) so that it is included in the investment component and differential needs assessed;
- change the treatment of the *Nation Building plan for the Future* transport (rail) payments made to Public non-financial corporations (PNFCs) so that they are included in the Transport assessment and assessed on an equal per capita basis consistent with the capital subsidies component; and
- recognise the benefits from population growth that offset the dilution effect on States' net financial worth in faster growing States by adopting a broader measure of needs.

¹ Commission Discussion Paper 2008/03, *The assessment of State capital needs*, paragraph 12.

Commonwealth Capital payments to the States

The Investment assessment attempts to provide all States with the capacity to acquire the same level of needs-adjusted capital stock per capita. Fiscal equalisation requires that where State capital investment is partly funded by the Commonwealth, this should be taken into account.

In this context, the Commission has noted that as capital grants are one of the main drivers of the current Debt charges assessment; are a significant source for capital stock; and vary considerably between States, they should impact on the relativities.² Otherwise, States receiving an above average share would be relatively better off.

The exception would be where Commonwealth funding:

- is provided for capital investment that does not contribute to State needs; or
- the distribution of funding between the States is exactly equal to the relative distribution of needs.

Capital payments for National Network roads and the Nation Building Plan for the Future do not exhibit either of these characteristics. Their appropriate treatment is discussed below.

Proposed treatment of National Network Roads as part of the Investment category factor

Background

Road Programmes and AusLink

In the 2004 Review, the Commission treated the National Highways component of the *Road Programmes Specific Purpose Payment* APC because:

- the payment met all expenses associated with the National Highways network; and
- States had little discretion over how National Highways funding was used.³

In 2004, the Commonwealth Government released its *AusLink White Paper*. The Paper proposed a new land transport program, the AusLink Program, which was introduced 1 July 2004.

Under the AusLink Program:

- *National Highways* became part of the *National Land Transport Network*;
- the way these roads were financed changed:
 - construction and maintenance became jointly-funded by the States; and

² Commission Discussion Paper CGC 2008/03 - The Assessment of State Capital Needs, paragraph 65, page 12.

³ Commonwealth Grants Commission – Staff Discussion paper 2007/31-S, page 1.

- States had greater discretion in determining which roads received funding and how much of their own-source funding they would allocate to each road.⁴

The new arrangements were outlined in the *AusLink (National Land Transport) Act 2005* and the bilateral agreements between the Commonwealth and the States.

In the 2008 Update the Commission acknowledged the new arrangements and began differentially assessing National Highway grants for a range of reasons, but most importantly, because States had greater discretion over which roads received funding and the Commonwealth and States jointly funded the roads.⁵

Nation Building Program

In 2009, the Commonwealth Government introduced the *Nation Building Program (National Land Transport) Amendment Bill 2009*, which amended the existing *AusLink (National Land Transport) Act 2005*, so that references to AusLink were replaced with references to the Nation Building Program.⁶

The Amendment Bill also provided for a number of other minor amendments. However, none of these changed the administration or provision of funding for major construction projects on the National Network.

In the 2010 Review Draft Report, the earlier 2008 Update decision to differentially assess these grants has been reversed, and an APC expenditure treatment is proposed.

The ACT strongly disagrees with this proposal. The appropriate treatment for these payments continues to be a differential assessment. Such an assessment should be undertaken through the Investment component of the Capital assessment.

The ACT's view is founded on the following:

- the needs for Commonwealth and State investment in National Network Roads (NNR) projects are the same. These needs are captured in the roads disabilities, reflected in the investment factor disability, and applied to all State capital investment in roads, including NNR projects; and
- States continue to develop and propose new NNR projects for construction funding, and determine their own-source contributions to each road, hence an APC treatment cannot be policy neutral.

Appropriate treatment of Commonwealth contributions toward National Network Roads projects

The drivers of need for NNR investment, whether funded by the Commonwealth or the States, are the same. They include population, use and cost influences. These

⁴ The AusLink White Paper noted extensively that as “*the National Network delivers clear benefits to States and Territories, there is an expectation that they will share some of the cost of upgrading and maintaining the National Network*”. Page X.

⁵ Commonwealth Grants Commission – 2008 Update, *Roads Assessment Results*.

⁶ Senate Rural and Regional Affairs and Transport Legislation Committee, Hansard Transcript, *Inquiry into the Nation Building Program Amendment Bill 2009*, 11 June 2009.

influences are already captured in the roads category factor and thus, the investment factor, and are used to assess State contributions toward NNR projects.

Evidence outlining how these disabilities influence Commonwealth and State capital investment in NNR and how they are captured and reflected in the investment component factor is provided below.

Population

The National Land Transport Network, which includes the NNR, comprises key road, rail and intermodal connections that link:

- State and Territory capital cities;
- State capital cities with regions of major commercial activity; and
- two or more regions of major commercial activity.⁷

In other words, the network connects the major population centres and areas of economic activity across the nation. Where a critical population mass exists, a stock of network infrastructure is required to deliver ‘connecting’ services. Importantly though, all States, irrespective of size, require a core stock of the NNR.

Similarly, the investment component assesses all States as needing a core stock of infrastructure, including roads, to deliver services to their populations.

Use

For many sections of the NNR, the level of vehicle use is likely to fluctuate or change permanently over time. This will influence the need for capital investment in those sections. The ACT considers this is largely driven by changed:

- use patterns due to population growth – reflected in volume of vehicles accessing NNR;
- lengths of urban and rural NNR due to population movement – reflected in new or duplicated roads and bypasses in cities, and linking roads for regional towns; and
- characteristics of vehicles accessing NNR due to economic or commercial circumstances – reflected in vehicle types.

In terms of, population growth, it is reasonable to expect that as a city or region’s population grows, congestion on its roads also grows. These cities or regions are likely to require greater NNR capital investment to address this problem.

This expectation is consistent with available evidence on the key drivers for jointly-funded NNR projects. See for example:

Traffic Management Systems for Australia Urban Freeways, consultancy report prepared for the Council of Australian Governments Review of Urban Congestion Trends, Impacts and Solutions, 2006 (COAG Report):

⁷ http://www.bitre.gov.au/publications/00/Files/BITRE_WP75.pdf, page 39.

*“The Australian Government formally recognised the importance of urban freeways in its 2004 AusLink White Paper, which heralded the establishment of a National Network funding program. One of the key strategic directions in AusLink is to address congestion on urban and outer metropolitan sections of the National Network.”*⁸

F3 widening (\$82.8 million):

*“To relieve congestion and cater for future traffic growth, the Australian Government has embarked on a major upgrading of the F3”*⁹

Ipswich Motorway (\$3,005.9 million):

*“The mainly four-lane motorway carries more than 80,000 vehicles a day. Traffic is congested in peak periods, while vehicle numbers will grow as the Ipswich region becomes home to 800,000 people under the Queensland Government strategy for the development of South East Queensland.”*¹⁰

Albury – Wodonga Hume Freeway upgrade (\$475 million):

*“The previous route through Albury contained five right-angle corners and 17 sets of traffic lights, with significant congestion during peak traffic periods. The Hume Freeway also forms part of the Albury-Wodonga arterial road system. This will significantly improve the safety and travel conditions for the people of Albury and Wodonga.”*¹¹

See also Queensland’s *AusLink Network Forward Strategy 2009-10 to 2013-14* (provided at **Attachment A**); and Western Australia’s *2007 Perth Urban Corridor Strategy: Building Our National Transport Future* (provided at **Attachment B**). Both publications focus principally on the need to invest in NNR projects to meet the demands of growing populations.

In this context, the ACT notes that a major driver of the investment disability factor is population growth. The factor recognises that faster growing States require a greater level of capital investment, which naturally extends to investment in a State’s NNR.

Additional influences, such as population movements from one geographic region to another, or changing economic or commercial circumstances, are captured through the inclusion of the roads expense category factor in the composite capital stock disability factor.

The use characteristics and disabilities measured in the Roads assessment are derived from data in the National Transport Commission’s *Heavy Vehicle Road Pricing Determination Technical Report* (NTC Report), and the ABS *Survey of Motor Vehicle Use* (SMVU). The data provided by both of these publications captures vehicles using NNR.

The NTC Report states:

⁸ http://www.bitre.gov.au/publications/56/Files/TMS_Urban%20Motorways.pdf, page 6.

⁹ http://www.nationbuildingprogram.gov.au/projects/ProjectDetails.aspx?Project_id=000632-06NSW-NP

¹⁰ http://www.nationbuildingprogram.gov.au/projects/ProjectDetails.aspx?Project_id=QNH021

¹¹ http://www.nationbuildingprogram.gov.au/projects/ProjectDetails.aspx?Project_id=VIC340

“The NTC obtains data on arterial road expenditure (including national highways) directly from State and Territory road authorities.”¹²

The explanatory notes for the SMVU indicate that participants are required to report on their use of selected motor vehicles over a 12 month period, without reference to the type of roads used.¹³ Consequently all travel, including travel on NNR, is captured and reported.

Therefore if one State’s section of NNR experiences an increase in heavy vehicle traffic, which leads to greater capital investment needs, those needs are captured through the roads expense category factor and reflected in the capital investment factor. This alone provides sound justification for assessing NNR capital investment using the investment component factor.

Cost

The cost of delivering capital projects differs both across States, and within the States themselves. For example, interstate cost differences may arise through differential wages or contracting costs, while intrastate differences may result from the cost of freighting materials to a given location or a location’s proximity to a manufacturing base.

In the Roads assessment, the Commission recognises that recurrent cost differences exist across States by applying a location factor to roads service expenses. In addition, several States also advised that the cost of road maintenance is significantly higher in remote areas, even after controlling for different road standards. The Commission thus recognised regional differences in wage and other costs by applying a regional location factor to services expenses related to rural road length.

These cost differences flow through to the composite capital stock disability and thus, the investment factor. The differences are included because they are considered to impact State needs for capital investment in road projects. Importantly, the assessment considers these influences also impact State contributions toward jointly-funded NNR projects.

Despite this, Commission staff have indicated that some concern may exist with applying the same investment factor to Commonwealth contributions toward jointly-funded NNR projects because some States, such as the NT, have high cost influences reflected in their factor.

From a cost factor perspective, the ACT considers that in regions where providing recurrent road services is more expensive than average, it is reasonable to expect it would also be more expensive to provide road construction services. In a similar vein, if a State’s investment in a particular NNR project is assessed as attracting higher costs, it is reasonable to expect the Commonwealth’s investment will also attract higher costs.

¹² National Transport Commission – Third Heavy Vehicle Road Pricing Determination Technical Report (October 2005), page 6.

¹³

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DSSbyCollectionid/1FF8657E5F8E2AC6CA256BD00027143D?opendocument>

In brief, the population, use and cost disabilities outlined above differ significantly between States, thus justifying a differential assessment. These disabilities are already captured and reflected in the investment component factor that is used to assess State contributions towards NNR projects.

Extending this factor to Commonwealth contributions provides a logical and consistent method for assessing the appropriate needs associated with these payments.

In support of the above views, the ACT notes that the *National Partnership Agreement on Implementation of the Nation Building Program in the Australian Capital Territory, 2009-2014* (NP) (provided at **Attachment C**), states:

*“The Nation Building Program sets out Commonwealth investment priorities. Many of the Commonwealth’s investment priorities closely reflect State and Territory priorities and interests.”*¹⁴

In other words, Commonwealth investment is provided where State and Commonwealth policy objectives (priorities and interests) align.

Where two governments invest in the same project and both streams of funding address a common, or shared, set of policy objectives - the same needs should be assessed.

As the Commission is satisfied that the investment factor better captures the needs associated with State investment in NNR projects than an APC assessment, the ACT considers this factor should be extended to the Commonwealth’s investment in those projects.

National Network road projects provide national benefits

The 2010 Review Draft Report also suggests that capital grants for NNR reflect the broader transport needs of the nation, rather than the circumstances of individual States.¹⁵

The ACT agrees that these payments do not perfectly reflect individual State circumstances. But it does not support the suggestion that in the first instance, NNR grants reflect the broader transport needs of the nation.

In light of this suggestion, the Commission’s attention is drawn to the joint funding arrangements underpinning the Nation Building Program. As an example, the Commonwealth has agreed to contribute \$2,451 million towards New South Wales’ proposal to upgrade the Pacific Highway, on the basis that New South Wales funds the remaining \$800 million in anticipated project costs, as well as meeting any additional costs that arise.¹⁶

¹⁴ National Partnership Agreement on Implementation of the Nation Building Program in the Australian Capital Territory, 2009-2014, pg 1.

¹⁵ Draft Report – *Attachment 20*, paragraph 76.

¹⁶

http://www.nationbuildingprogram.gov.au/publications/administration/pdf/MOU_List_NSW_19_08_2009.pdf.

The ACT cannot accept that the New South Wales Government would be willing to develop a proposal to upgrade a major highway through its State, and commit \$800 million in own source funding, for that project to primarily benefit the residents of surrounding States.

On the New South Wales Government's website, it notes that the projected Pacific Highway works, including the Commonwealth's contribution:

*"...form part of the NSW Economic Stimulus program to create jobs for NSW workers and build a better future for our state."*¹⁷

The website also states that the Pacific Highway is:

*"...one of the most critical roads in NSW, affecting the safety, wellbeing and livelihoods of local residents, truck drivers and holidaymakers."*¹⁸

There is further evidence from other States confirming that NNR projects primarily deliver benefits to the State undertaking the project. For example, Queensland's *AusLink Network Forward Strategy 2009-10 to 2013-14* (**Attachment A**), states:

*"All of the projects in this AusLink funding submission are a high priority for Queensland – for reasons of increased transport efficiency and industry competitiveness, reliable community access and safer roads for motorists."*¹⁹

A more specific example is Tasmania's Brighton Transport Hub, which involved the construction of a modern road-rail facility that allowed goods to be seamlessly transferred between road transport and rail.

Through the Nation Building Program, the Commonwealth agreed to contribute \$56 million toward the \$79 million cost of the Hub.²⁰ However, because of coordination delays, the Tasmanian Government agreed with the Commonwealth that it would fully fund the project.²¹

Under the proposed APC treatment of NNR grants (and prior to the Commonwealth's withdrawal from the project), only 30 per cent of the Hub's construction cost would have had capital investment needs assessed, because the remaining 70 per cent (Commonwealth contribution) would be considered to reflect the broader transport needs of the nation.

Following the Commonwealth's withdrawal, however, the same project is now considered to provide no national transport benefits, and thus, capital investment needs are assessed for its entire cost.

¹⁷ <http://more.nsw.gov.au/projects/pacific-highway-upgrade>.

¹⁸ <http://more.nsw.gov.au/projects/pacific-highway-upgrade>.

¹⁹ http://www.mainroads.qld.gov.au/About-us/Australian-Government/~/_media/Files/About%20us/Australian%20Government/Auslink/Auslink%20Forward%20Strategy%20%20%20Introduction%20and%20Executive%20Summary.pdf, pg 7.

²⁰ http://www.aph.gov.au/senate/Committee/rrat_ctte/estimates/sup_0809/infra/ii.pdf (pg 19)

²¹ http://www.nationbuildingprogram.gov.au/publications/administration/pdf/Tasmania_Major_Road_Rail_Projects.pdf

This outcome, although inconsistent, demonstrates that:

- NNR projects reflect State policies; and
- irrespective of who funds the projects (or respective funding shares), the investment needs that should be assessed for the entire project are the needs already assessed for States' contributions.

State discretion

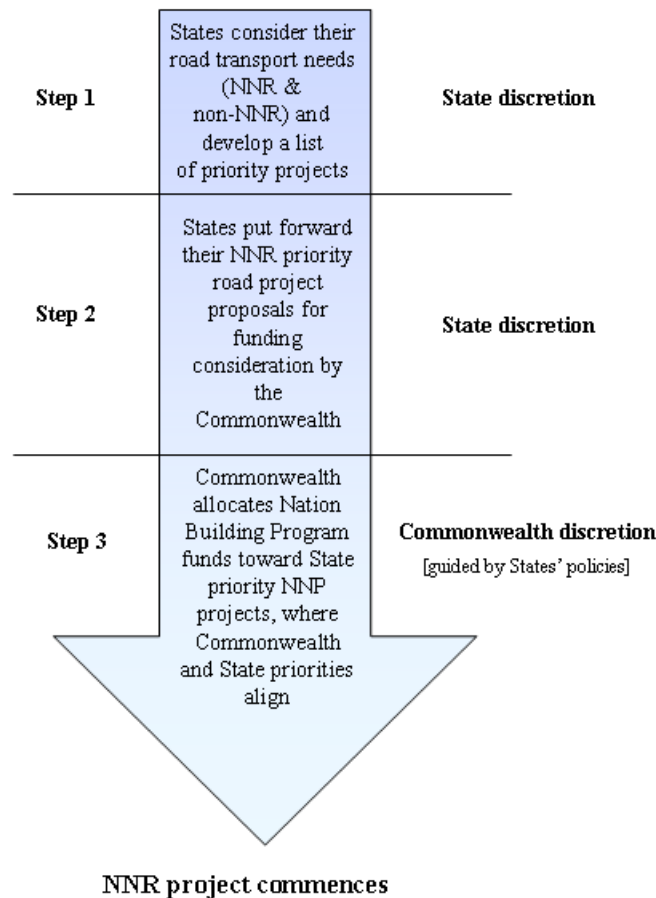
The ACT also considers that an APC treatment of Commonwealth investment in NNR projects is not appropriate because:

- States have discretion in proposing NNR projects, thus determining which roads receive funding and how much of their own-source funding to contribute;
- the funding allocations substantially reflect State policies, not circumstances; and
- the matters considered when determining the allocation are not always clear or consistent.

The appropriate treatment for Commonwealth capital investment in NNR projects is provided in the section above. However, it is considered both relevant and important to demonstrate why, in the first instance, Commonwealth investment reflects State policy.

The process that leads to the final allocation of NNR investment payments is considered to have three key decision steps. These steps are illustrated in the following diagram.

National Network Roads funding allocation process



It is acknowledged that step three – the allocation of funding – is the Commonwealth Minister’s decision. However, the Commonwealth funding is directed to projects that the States have identified as meeting their needs. States have complete discretion in developing and proposing NNR projects, and determining their own-source contribution to each road.

In addition to the project proposal process (steps one and two), State policies also directly and indirectly influence step three through the criteria used by the Minister to approve projects.

For example, the *Nation Building Program (National Land Transport) Act 2009* outlines the criteria that the Minister may consider (but is not limited to) when deciding on an appropriate funding allocation. These criteria include having regard for:

- a) *“the National Land Transport Plan;*
- b) *any relevant corridor strategy;*
- c) *the extent to which the project will improve the efficiency, security or safety of transport operations on the National Land Transport Network;*
- d) *the results of any assessment of the economic, environmental or social costs or benefits of the project;*

- e) *any other transport or land use plans that might be relevant to the project; and*
- f) *the extent to which persons other than the Australian Government propose to contribute funding to the project.”*²²

To demonstrate the potential for State influence, consider the safety aspect of c). According to that criterion, it is reasonable to expect that where a State has, in the past, chosen to provide a below average level of service, in respect of investment in the safety of its road network, that State will receive an above average share of NNR payments.

Similarly, f) suggests that if two States were to submit proposals for similar projects, each having the same need, but one State’s policy was to commit more own-source funding, that State’s project would be expected to receive NNR funding in preference to the other project.

These examples show how the allocation of NNR funding can be influenced by State policies. Therefore, the actual distribution of NNR payments is not policy neutral.

Proposed treatment of the Nation Building plan for the Future funding as part of the Investment category factor

In April 2008 the Commonwealth introduced the *Infrastructure Australia Act 2008*, which paved the way to establish Infrastructure Australia (IA). The purpose of IA was to develop a blueprint for the nation’s future infrastructure needs and in partnership with the State and Local Governments, facilitate its implementation.

Later in 2008, the Commonwealth introduced the *Nation-Building Funds Act 2008*, which specifically tasked IA with advising the Minister for Infrastructure on appropriate infrastructure projects that could be funded from the Building Australia Fund.²³

In its 2009-10 Budget, the Commonwealth announced the *Nation Building Plan for the Future – Building Australia Fund* (NBPF). The NBPF provided \$8.5 billion in Commonwealth contributions towards road, port and rail infrastructure projects, many of which had been recommended by IA.

The 2010 Review Draft Report proposes assessing no needs for the NBPF grants because they are considered ‘payments to third parties’. The ACT does not support this treatment for roads and ports project infrastructure funding²⁴ because:

- payments for roads (direct payments to the States), and ports (indirect payments to States) impact State fiscal capacities;
- these payments provide direct budget support for typical State services;

²² Nation Building Program (National Lang Transport) Act 2009, s11.

²³

[http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/7CFC70DA7149D585CA257527000049C/\\$file/BAFCriteriaInstrumentFINAL.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/7CFC70DA7149D585CA257527000049C/$file/BAFCriteriaInstrumentFINAL.pdf)

²⁴ The ACT also does not support the *Nation building plan for the future funds* for transport being excluded from the Transport assessment, however, this issue is discussed in the ACT’s transport submission.

- the allocation of funding is influenced by State policy (distributed based on State bidding via a submission process); and
- IA's measures of need vary considerably from the needs assessed by the Commission.

The appropriate treatment for NBPF road and port payments is for differential needs to be assessed using the investment factor. The principle underpinning a change in treatment is similar in nature to NNR.

Nation Building Plan for the Future payments for road and port infrastructure impact State fiscal capacities

IA has indicated that all payments for NBPF road projects (the Hunter Expressway, Kempsey Bypass, Bruce Highway and the Ipswich motorway) will be paid to the States because there is no potential for private sector involvement.²⁵

It is also noted that State governments are responsible for jointly funding some projects. For example, New South Wales is contributing \$200 million to the Hunter Expressway, while Queensland is contributing \$125 million to the Bruce Highway duplication.²⁶

In terms of port projects, the Darwin Port expansion is being undertaken by the Darwin Port Corporation, whose sole shareholder is the Northern Territory Government.²⁷ This project is also being jointly funded by the NT Government.²⁸

The ACT considers that these payments are made to the States, whether directly or indirectly, and clearly impact State fiscal capacities.

In Budget Paper 3 of the Commonwealth's 2009-10 Budget, the heading of the table in which forward year budget allocations for NBPF payments are detailed, reads: "*Payments to support State infrastructure services*".²⁹

NBPF payments support the acquisition of State infrastructure used to provide State services. These payments are not provided for obscure or unusual projects. They are provided for core infrastructure projects, which all States acquire in the usual course of business, and for projects that would otherwise need to be fully funded by the States.³⁰

Services provided through NBPF infrastructure will be the same as services provided through existing State infrastructure. For example, the \$1.65 billion Hunter Expressway (to be funded \$1.45 billion by the Australian Government, and \$200 million by NSW)³¹ is expected to:

²⁵ National Infrastructure Priorities, Infrastructure Australia, May 2009, page 23.

²⁶ Commonwealth 2009-10 Budget Papers, *Nation Building for the Future* Booklet, pp 18-21.

²⁷ http://www.nt.gov.au/dpa/about_dpc/management.html

²⁸ http://www.nt.alp.org.au/01_cms/details.asp?ID=28

²⁹ 2009-10 Budget Papers, Australia's Federal Relations, BP No. 3, 2009-10, Table 2.90, page 85.

³⁰ With the exception of ports infrastructure in the ACT.

³¹ Joint media Statement on the \$1.65 billion Hunter Expressway - The Hon Anthony Albanese MP Minister for Infrastructure, Transport, Regional Development and Local Government; Kevin Rudd Prime Minister; Wayne Swan Treasurer; and Nathan Rees, Premier of New South Wales, 14 May 2009. See: http://www.minister.infrastructure.gov.au/aa/releases/2009/may/aa160_2009.htm

- reduce congestion;
- reduce travel times for road users;
- improve freight access; and
- improve the safety of road users.³²

These are standard benefits and services that all States strive to provide when developing road projects.

Ensuring that NBPF road payments are differentially assessed in the investment component aligns with the Commission’s intention for capital grants to continue to be treated by inclusion as a source of funds available to meet State assessed needs.

In relation to NBPF port payments to PNFCs, the Commission outlined its intention to recognise some Commonwealth Own-Purpose Expenditures (COPEs) in the 2010 Review Draft Report. The Report states that in terms of payments outside the adjusted budget:

“We propose to recognise the indirect effects of COPEs on State budgets if:

- *There is a conceptual case that they reduce the level of services States must provide (which will require evidence that the Commonwealth funded services are close substitutes for States services); and*
- *There are reliable data to measure that impact and it is expected to be material.”*³³

The ACT considers there to be a strong conceptual case to suggest NBPF payments impact the level of State investment in their PNFCs, which justifies their inclusion.

Allocation of funding is influenced by State policy

In a similar fashion to NNR payments, State policies influence the amount of funding received under the NBPF.

Although IA had in place infrastructure assessment plans and a prioritisation methodology for determining the allocation of funding to projects, States were wholly responsible for developing and putting forward, at their discretion, any infrastructure project bids by way of submissions. Additionally, the scope of infrastructure projects that the States could propose was very broad.

The broad scope is evidenced by the wording adopted by IA in one of their Discussion Papers. IA sought submissions that:

“...identify nationally significant infrastructure problems that may hinder the achievement of economic, social, and environmental goals. Such problems could include, but are not limited to, infrastructure adequacy, regulatory environment, competition policy environment, level of market pricing, capacity, condition,

³² Commonwealth 2009-10 Budget Papers, *Nation Building for the Future* Booklet, page 18.

³³ Draft Report – Chapter 5, paragraph 121.

*operation, planning methods, financial issues, and infrastructure-related services.”*³⁴

Additionally:

*“Infrastructure Australia is interested in issues not only relating to specific types of infrastructure, but also other issues including (but not limited to) those of a social, environmental, regulatory, freight, network/intermodal, and/or geographic nature. Similarly, Infrastructure Australia will consider problems pertaining to both the current and potential future infrastructure environment.”*³⁵

The wide definitional scope of infrastructure projects that parties could propose, led to disparate views on what was considered a priority infrastructure project. Over 1,000 submissions were provided by the Commonwealth, State, Territory and Local governments, the business community and the wider public.³⁶

The ACT considers that as State project proposals guided the potential projects for consideration, it is unreasonable to suggest the allocation of funding, was not, to some degree, influenced by State policy.

Infrastructure Australia and the Commission’s measures of need differ

There is evidence to demonstrate that IA’s determination of infrastructure needs, which guided the distribution of NBPF payments, differed significantly from the Commission’s assessment of needs addressed through the Capital assessment.³⁷

By way of example, a major focus of IA’s December 2008 report was to:

*“...outline areas of infrastructure where urgent action was required to boost Australia’s productivity, protect the environment and enhance Australians’ quality of life.”*³⁸

These differences are also evident in the actual allocation of funding, which is provided in the following table, along with State population shares.

³⁴ Infrastructure Australia, Discussion Paper 1: *Australia’s Future Infrastructure Requirements*, paragraph 3.2.

³⁵ Ibid.

³⁶ Ibid, page 6.

³⁷ http://www.infrastructureaustralia.gov.au/files/DP1_OJ_1130_0109.pdf.

³⁸ Ibid, page 6.

Capital category funding – allocation of Nation building infrastructure project payments

| | NSW \$m | Vic \$m | Qld \$m | WA \$m | SA \$m | Tas \$m | ACT \$m | NT \$m | Aust \$m |
|--------------------------------------|-------------|------------|-------------|------------|-----------|------------|------------|-----------|-------------|
| Hunter Expressway | 1650 | | | | | | | | |
| Pacific Highway | 618 | | | | | | | | |
| Ipswich Motorway | | | 884 | | | | | | |
| Bruce Highway | | | 488 | | | | | | |
| Oakajee port | | | | 339 | | | | | |
| Darwin port expansion | | | | | | | | 50 | |
| Total | 2268 | 0 | 1372 | 339 | 0 | 0 | 0 | 50 | 4029 |
| Population share 07-08 | 32.7% | 24.8% | 20.0% | 10.1% | 7.5% | 2.3% | 1.6% | 1.0% | 100.0% |
| Nation building infrastructure share | 56.3% | 0.0% | 34.1% | 8.4% | 0.0% | 0.0% | 0.0% | 1.2% | 100.0% |

Source: Australian Government Budget, Nation building for the Future, May 2009, page 2.

The table illustrates that Victoria and Western Australia, whose populations are currently growing above the Australia average rate, receive considerably less than their population share. But a State with below average growth, such as New South Wales, receives a share of funding well above its population share. Clearly the focus of IA and the Commission differ in this respect.

To address this issue, the ACT considers it appropriate to differentially assess NBPF payments using the investment factor. Evidence supporting the extension of this factor to Commonwealth capital grants was detailed in the NNR component of the submission.

Proposed net lending assessment

The ACT has serious concerns with the proposed net lending assessment. These concerns are principally that the assessment:

- fails to capture the appropriate disability that reflects differential State capacities to acquire equity; and
- overlooks the benefits that faster population growth delivers through developer contributions.

Appropriate Disability

The net lending assessment considers that only the change in State populations affects State net lending requirements.³⁹ The ACT accepts that population growth may impact within year net lending requirements. However, the differential needs assessed for within year net lending form only a small proportion of the total needs assessed in the net lending component.

³⁹ 2010 Review Draft Report – Attachment 20 – paragraph 57.

The following table compares a simulated assessment outcome for 2007-08, where there is no within year net lending, to the actual assessment outcome as detailed in the 2010 Review Draft Report.⁴⁰

The simulated assessment holds NFA constant from the beginning to the end of the year.⁴¹ However, despite being held constant, 94.5 per cent of the total needs that are otherwise assessed continue to be recognised. This suggests that within year net lending has a marginal impact on States' overall assessed needs. Or in other words, the redistribution of per capita stocks of NFA according to relative population growth is the principal driver of needs.

The existing population dilution disability only partially captures differential State capacities to acquire per capita stocks of all NFA. Evidence demonstrating the shortcomings of relying solely on this disability is provided in the following sections.

⁴⁰ Ibid. Table 20-15.

⁴¹ Net financial assets per capita change to reflect aggregate population growth.

Comparison between simulated assessed net lending component and the Draft Report net lending component for 2007-08

| | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Aust |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Simulation with zero net lending | | | | | | | | | |
| End of year net financial assets | | | | | | | | | |
| Calculate average net financial assets (\$pc) | | | | | | | | | 6404.60 |
| Population 2007-08 (million) | 6.9 | 5.3 | 4.2 | 2.1 | 1.6 | 0.5 | 0.3 | 0.2 | 21.2 |
| Assessed net financial assets (\$m) (avg. net financial assets * popln) | 44473 | 33704 | 27173 | 13693 | 10206 | 3173 | 2191 | 1393 | 136005 |
| Start of year net financial assets | | | | | | | | | |
| Calculate average net financial assets (\$pc) | | | | | | | | | 6516.37 |
| Population 2006-07 (million) | 6.9 | 5.2 | 4.1 | 2.1 | 1.6 | 0.5 | 0.3 | 0.2 | 20.9 |
| Assessed net financial assets (\$m) (avg. net financial assets * popln) | 44693 | 33694 | 26976 | 13585 | 10273 | 3205 | 2197 | 1384 | 136005 |
| Simulated net lending calculation with zero net lending | | | | | | | | | |
| Difference in assessed net lending \$m (end yr - start yr) | -220 | 10 | 198 | 109 | -67 | -32 | -6 | 9 | 0 |
| Draft Report net lending calculation | | | | | | | | | |
| Difference in assessed net lending \$m (end yr - start yr) | -214 | 9 | 192 | 106 | -65 | -31 | -6 | 9 | 315 |
| Percentage assessed not attributable to within year net lending | 97.15% | 86.25% | 97.19% | 97.66% | 96.73% | 96.41% | 98.76% | 95.84% | 94.47% |

Available evidence

The following table provides the growth in States' combined net financial worth and equity for 1998-99 to 2007-08.

States' combined net financial worth and equity 1998-99 to 2007-08 \$million

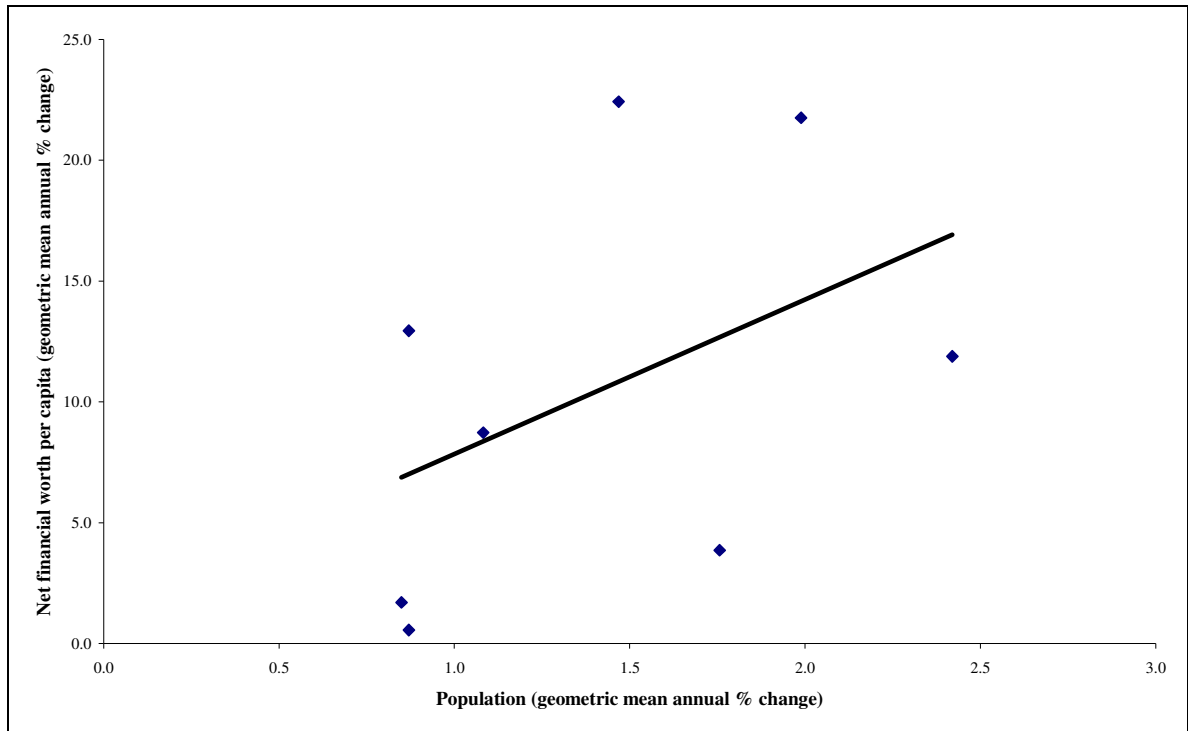
| Year | Total net financial worth | Total equity | Annual change in total net financial worth | Annual change in total equity | Total change in net financial worth accounted for by equity |
|--------------|----------------------------------|---------------------|---|--------------------------------------|--|
| 1998-99 | 42,985 | 111,644 | | | |
| 1999-00 | 56,513 | 116,598 | 13,528 | 4,954 | |
| 2000-01 | 61,538 | 121,584 | 5,025 | 4,986 | |
| 2001-02 | 60,913 | 123,488 | -625 | 1,904 | |
| 2002-03 | 77,231 | 144,741 | 16,318 | 21,253 | |
| 2003-04 | 95,217 | 157,310 | 17,986 | 12,569 | |
| 2004-05 | 108,656 | 166,605 | 13,439 | 9,295 | |
| 2005-06 | 104,983 | 170,342 | -3,673 | 3,737 | |
| 2006-07 | 125,856 | 185,640 | 20,873 | 15,298 | |
| 2007-08 | 131,694 | 204,670 | 5,838 | 19,030 | |
| Total | | | 88,709 | 93,026 | 105% |

Source: ABS catalogue no 5512.0

The table demonstrates that 105 per cent of the growth in States' net financial worth is explained by the growth in States' equity. Furthermore, States' positive net financial worth is entirely comprised of equity.

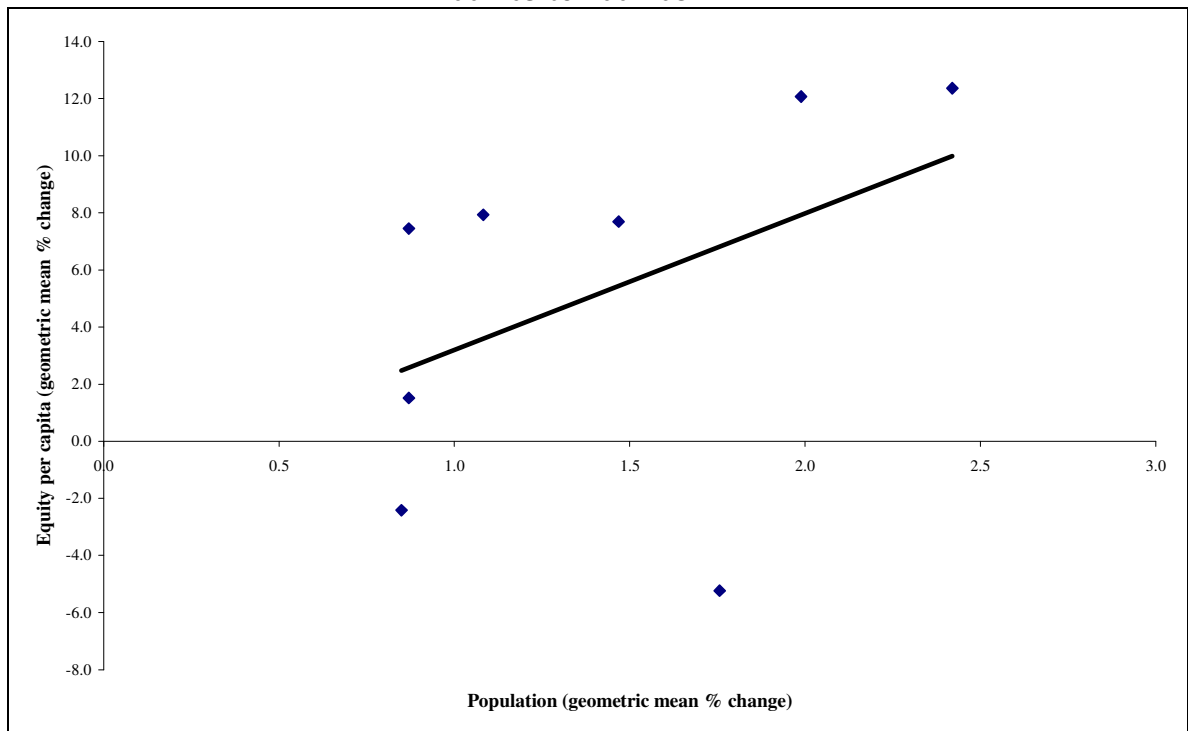
The following two charts expand on this by illustrating the interaction between growth in net financial worth and equity relative to State population growth.

**Average annual change in States' net financial worth relative to
annual changes in population
2002-03 to 2007-08**



Source: ABS cat 5512.0 and 3101.0.

**Average annual change in States' equity relative to annual changes in
population
2002-03 to 2007-08**



Source: ABS cat 5512.0 and 3101.0.

Both charts present a similar gradient, which is to be expected as growth in net financial worth is entirely explained by growth in equity. Most importantly though, the charts demonstrate that on average, faster growing States acquire equity, and thus, net financial worth at an above average rate.

If faster growing States acquire equity at an above average rate due to deliberate efforts (policy) to offset the impact of population dilution, then an assessment recognising these efforts would reflect what States do.⁴² On the other hand, if faster growing States acquire equity at an above average rate due to their natural circumstances (non-policy), then an assessment capturing those circumstances would be more appropriate. In an instance where both situations occur simultaneously, more than one assessment would be required.

Effort and circumstances

A range of financial data from a sample of PNFCs' balance sheets has been collected and is provided at **Attachment D**. The sample data were collected for all PNFCs that had easily accessible financial reports. Whilst acknowledging these PNFCs represent a sample of all entities and thus, not an exhaustive list, the 95 entities are considered to provide a reasonable reflection of the broader population.⁴³

It should also be noted that the sample includes transport providers in all States, with the exception of the ACT and the Northern Territory. This is important as transport providers are the PNFCs most likely to be operating in deficit, thus requiring equity contributions.

The data in the attachment disaggregates the total annual change in each PNFC's equity into four categories:

- *revaluation income* – income derived from revaluing tangible assets, such as property plant, land and equipment;
- *retained profits* – total annual profits (net of tax);⁴⁴
- *contributed equity* – equity funding provided by States; and
- *other* – reflects residual changes in equity, including dividend payments and intangible asset revaluations.

The data indicate that contributed equity, or States' deliberate efforts to acquire equity, accounted for 25.1 per cent of the total annual change in equity in 2006-07 and 7.5 per cent in 2007-08. On the other hand, tangible asset revaluations accounted for 74.3 per cent in 2006-07 and 79.7 per cent in 2007-08.

This indicates that revaluations are a much more important determinant of States' capacities to acquire the per capita stock of equity, when compared to deliberate State efforts (contributed equity). Combining this finding with the data presented in the

⁴² Alternatively, if faster growing States exhibited greater per capita dilution in their NFA (downward sloping line), this, likewise, would justify an assessment being undertaken to recognise this disability. However, in reality, the evidence does not support such a claim.

⁴³ It is noted that the total change in equity for PNFCs included in the list account for 62.5 per cent of the total change in State equity for 2006-07 and 64.6 per cent in 2007-08 when compared to total changes in equity provided in ABS cat. 5512.0.

⁴⁴ Retained profits do not capture revaluation income. Revaluations are generally recognised directly in the firm's equity, not through its operating statement.

charts above, indicates that faster growing populations possess a greater capacity to acquire per capita net financial worth than their slower growing counterparts.

Such an outcome raises the question of why the population dilution effect may seem reasonable and conceptually valid in theory, but there is no evidence of it in practice.

Distinct financial asset classes

An important step in developing the net lending assessment is to recognise that States' net financial worth is held in the form of two distinct classes of financial assets.

There are financial assets that provide fixed returns and cash flows (outflows or inflows), such as cash, deposits, loans and borrowings. And there are financial assets that provide uncertain returns and cash flows (dividends and capital gains), such as equity investments in PNFCs.

The drivers influencing State capacities to acquire per capita stocks of each class of asset differ significantly. The following example highlights these differences.

Suppose all States were given \$1 million to invest for one year. And suppose all States decide to invest their money in a term deposit earning 10 per cent per annum. The end outcome for all States is certain, and their returns are guaranteed.

When such a situation exists, all States will have the same capacity to generate an equal per capita return, when they are provided with an equal capacity to acquire the per capita stock of financial assets they can use to invest. A population dilution disability is valid in this instance.

Now suppose that instead of investing in term deposits, all States invested in land in their respective Capital cities. In such a situation, the end outcome for all States is uncertain, and no one earns a guaranteed return.

For example, NSW's investment of \$1 million in Sydney's property market may still be worth \$1 million one year later. At the same time, however, \$1 million invested in Perth, may be worth \$2 million at the end of the year.

The capital gains (or revaluations) earned on equity investments cannot be predicted with any certainty and are largely a function of prevailing market forces and economic circumstances.

Material differences exist between States' economic circumstances, and thus, their potential to realise equity gains through revaluations. Evidence provided in the earlier charts substantiate this case and indicate a positive relationship exists between population growth and equity gains (a reverse dilution effect).

Therefore, because the proportion of NFA that States choose to hold in equity is far greater than the proportion held in other forms of financial assets, the observable evidence of a population dilution effect will always be swamped by evidence of the benefits of population growth.

Due to the positive relationship between the benefits and population growth, the proposal to equalise State capacities to acquire NFA solely using a population dilution

disability, actually moves States further away from equalisation. Such an outcome is not desirable and needs to be addressed.

Proposed improvement to the net lending assessment

The net lending assessment assumes that faster growing States possess a below average capacity to acquire the per capita stock of (all classes of) financial assets and thus, require greater needs to be assessed.

As demonstrated above, this assumption does not hold for equity. Faster growing States naturally possess a greater capacity to benefit from revaluations and grow their per capita equity stock.

Accordingly, the ACT considers it appropriate to adopt an assessment approach which recognises that while population growth may adversely impact State capacities to acquire and earn a return from financial assets with fixed returns, it has the opposite effect on capacities to acquire equity.

To achieve this, and recognise both impacts simultaneously, the ACT proposes the Commission retain its existing population dilution disability, but limit its application to the per capita stock of net financial assets excluding equity. This will simply reduce the beginning and end of year NFA per capita values in the existing assessment.

At the same time, the Commission should assess differential needs for the per capita stock of equity using a simple gradient disability, similar to the approach used in the Transport assessment. The gradient could be constructed using ABS data, relating annual population growth to the acquisition of equity. The second chart provided in the previous section illustrates this relationship and the approach that could be adopted.

Fixed return investments and equity are two distinct forms of financial assets that have seemingly opposite drivers of need. The differences in these drivers should be acknowledged and treated accordingly. Failing to do so will result in an unbalanced assessment that does not reflect what States do, and runs contrary to available evidence.

Infrastructure contributed by land developers

As a condition for receiving planning approval for new subdivisions and developments, many land developers are required to contribute physical infrastructure to governments. These contributions are generally referred to as developer contributions and often take the form of roads, sewerage, drainage, water and electricity infrastructure.⁴⁵

All States have legislation enacted that enables them to receive these contributions.⁴⁶ Although the types of contributions and scope of infrastructure for which contributions may be levied differ amongst the States, it remains average State policy to receive developer contributions when subdividing and developing land.

⁴⁵ Productivity Commission, Public Infrastructure Financing, Ch 7 – Development contributions.

⁴⁶ Ibid, pp 118-120.

In most instances, State legislation enables local councils to determine required infrastructure contributions. But it is not always practical for the councils to receive that infrastructure. For example, in Western Australia, the *Town Planning and Development Act 1928*, underpins the development of land across the State and provides for State governments to impose conditions, such as requiring the developer to contribute water and electricity infrastructure, as part of their planning process.

However, in Western Australia, councils are not the primary providers of electricity and water services. These services are provided by PNFCs. As a result, infrastructure contributed by developers to facilitate the delivery of those services, is generally provided directly to PNFCs.

When developers contribute infrastructure to PNFCs, it increases the net assets, or equity, of those entities.⁴⁷ This increases State-held equity in PNFCs, and *net financial assets*.

The following table provides developer contributions made to water and power corporations in Western Australia, the Northern Territory and the ACT from 2004-05 to 2007-08. These entities are State owned PNFCs.

It is noted that the ACT and Northern Territory appear to have one primary water and power provider. Western Australia on the other hand, appears to have multiple providers.

⁴⁷ Typically, gifted infrastructure is recognised as revenue at fair value when received.

Developer Contributions to Water and Power Corporations

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
|-------------------------------------|---------|---------|---------|---------|
| | \$m | \$m | \$m | \$m |
| Australian Capital Territory | | | | |
| Actew | 10.0 | 6.6 | 6.1 | 9.0 |
| Western Australia | | | | |
| WA Water Corporation | 189.0 | 207.6 | 264.0 | 234.0 |
| Horizon Power | | 2.8 | 21.2 | 8.6 |
| Bunbury Water Board | 0.8 | 1.0 | 0.8 | 2.0 |
| Verve Energy | | 0.9 | 3.1 | 0.8 |
| Western Power Corporation | 109.8 | 39.5 | 147.5 | 155.4 |
| Northern Territory | | | | |
| NT Power and Water Corporation* | 14.0 | 10.8 | 13.0 | 13.1 |
| | \$pc | \$pc | \$pc | \$pc |
| Australian Capital Territory | 30.41 | 19.75 | 17.96 | 26.42 |
| Western Australia | 149.90 | 123.63 | 209.43 | 187.42 |
| Norther Territory | 68.79 | 51.73 | 61.29 | 60.22 |

Source: *Western Australia Water Corporations Annual Reports*, available from:

http://www.watercorporation.com.au/P/publications_annual_reports.cfm?uid=7683-1257-5137-2011

<http://www.aqwest.wa.gov.au/News/AnnualReports.aspx>

http://www.horizonpower.com.au/about_us/Horizon%20Power%20reports.html

<http://www.verveenergy.com.au/subContent/Our%20Company/annualReport.html>

http://www.wpcorp.com.au/subContent/aboutUs/publications/2006annual_reports.html

Actew Annual Reports, available from:

<http://www.actew.com.au/publications/default.aspx>

NT Power and Water Corporation Annual Reports, available from:

http://www.powerwater.com.au/searchresult?mode=results&queries_mainsearch_query=annual+report+2008

* NT values only include gifted network assets. Developers also make contributions 'in-kind' via cash. These amounts cannot be accurately determined so have been excluded. This understates the NT's per capita contributions.

The values of these developer contributions are significant. In 2006-07, for example, the entities received a combined \$455.7 million in contributions. This represents 36.9 per cent of the total net lending standard for that year.⁴⁸ The ACT also notes that the combined population share of these States is 13 per cent. In this context, if all States' developer contributions were tallied, they are likely to form a considerable share of the net lending standard.

Whilst acknowledging the table is not an exhaustive list, and that the services delivered by the PNFCs may differ, the table clearly demonstrates that material differences exist in the per capita value of developer contributions between the States. It also demonstrates that these differences are sustained over time.

The ACT considers that where developer contributions are associated with land development, it is reasonable to expect that the factors driving the differential rates of development, such as population growth, also drive the differential value of contributions. For example, Western Australia and the Northern Territory

⁴⁸ Calculated as \$455.7m / \$1235.0m. Source: ABS data and PNFC financial reports.

experienced above average population growth between 2004-05 and 2007-08, while the ACT experienced below average growth. Not surprisingly, over this period, Western Australia's and the Northern Territory's PNFCs received much higher per capita developer contributions than the ACT.

Developer contributions and the net lending assessment

The 2010 Review Draft Report notes that '*only the change in State populations is considered to affect State net lending requirements*'.⁴⁹ To this extent, the assessment considers that faster population growth 'dilutes' a State's per capita net financial assets, and therefore, faster growing States require an above average per capita amount of GST.

However, where population growth delivers benefits to a State, and those benefits offset the impact of dilution, the ACT considers those benefits should also be captured, in order to create a balanced assessment. The evidence presented in the table above demonstrates one such benefit. No data have been presented, to our knowledge, which supports an opposing view.

The ACT requests that the proposed net lending assessment be revised in order to recognise that those States growing at an above average rate, are also likely to be those receiving an above average per capita share of developer contributions. Failing to recognise this will result in an unbalanced assessment that overstates the dilution effect and the assessed needs for net financial assets of faster growing States.

The ACT considers that the proposed improvement to the net lending assessment outlined in the previous section, would adequately capture the different per capita values of developer contributions provided to the States.

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

⁴⁹ Draft Report – Attachment 20, paragraph 57.