



COMMONWEALTH GRANTS COMMISSION

DRAFT ASSESSMENT PAPER CGC 2003/72

ACT SPECIAL FISCAL NEEDS

Prepared for the Commission's 2003 Conferences on Draft Assessments

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NOTE

Included in this paper are the results of preliminary calculations based on the methods proposed throughout the paper and using the data currently available. Those results are indicative only and should be seen as work in progress. Ongoing changes are being made to standards and factor calculations as new data come to hand. Moreover, the calculations have been done using a prototype assessment system and are subject to ongoing revision as checking processes proceed.

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INTRODUCTION

1. The terms of reference for the 2004 Review ask the Commission to:

‘... review whether the allowances for special circumstances granted to the Australian Capital Territory continue to be necessary and, if so, make appropriate allowances.’
2. Special fiscal needs make provision for one type of special circumstances. Special fiscal needs allow for differences between the Commonwealth’s financial arrangements with the ACT and the financial arrangements it has with the other States. They have been assessed since 1992.
3. The special fiscal needs payments to the ACT are additional to its share of GST and other general revenue. They do not affect the relativities.
4. This paper presents a draft assessment of ACT Special Fiscal Needs for the 2004 Review. It builds on the staff proposals set out in *Discussion Paper CGC 2002/05, Cross-border Disabilities and Special Circumstances of the Australian Capital Territory* and State comments provided in the 2003 Rejoinder Submissions.

THE 1999 REVIEW ASSESSMENT

5. In the 1999 Review, special fiscal needs were assessed for:
 - (i) family law matters; and
 - (ii) corporate affairs compensation.
6. A transitional allowance to recognise that the ACT had little effective control over some of the costs of providing police services was also assessed.
7. In the period between the 1999 Review and the 2003 Update, the following changes occurred with regard to the special fiscal needs and transitional allowances:
 - (i) The family law matters allowance was discontinued because, with the introduction of the Federal Magistrates Service in mid-2000, the ACT’s involvement in family law matters diminished.
 - (ii) The police allowance changed from being a transitional allowance to a special fiscal need because the ACT indicated that its relationship with the Australian Federal Police (AFP) was of a more permanent nature. This change was reflected in the 2001 Update.

- (iii) The corporate affairs compensation allowance continued because the other States continued to receive a Specific Purpose Payment (SPP) for revenue foregone following the establishment of the national scheme of companies regulation.

8. Thus, in the 2003 Update, special fiscal needs allowances were assessed for:
- (i) corporate affairs compensation; and
 - (ii) police.

Importance of current assessment

9. Table 1 summarises the ACT special fiscal needs for 2003-04 as assessed in the 2003 Update. It also compares them with the allowances assessed for 2002-03.

Table 1 SPECIAL FISCAL NEEDS ALLOWANCES, 2002-03 AND 2003-04

	2002-03	2003-04
	\$m	\$m
Corporate affairs compensation	4.0	4.1
Police	10.7	10.9
Total	14.7	15.0

Source Commonwealth Grants Commission, 2003 Update.

PROPOSED 2004 REVIEW APPROACH

10. ***1999 Review.*** As noted above, special fiscal needs allowances were assessed because of differences between the Commonwealth’s financial arrangements with the ACT and the Commonwealth’s arrangements with the other States. When self-government was instituted, these arrangements were intended to be temporary, but no alternative permanent arrangements have been introduced for the two allowances remaining in the 2003 Update.

11. ***State views.*** The ACT asked for the special fiscal needs allowances for corporate affairs compensation and police to be continued. No new allowances were sought.

12. ***Staff proposals.*** In *Discussion Paper CGC 2002/05, Cross-border Disabilities and Special Circumstances of the Australian Capital Territory*, staff proposed that, if the Commonwealth continued to treat the ACT differently from the other States with regard to financial arrangements, then the Commission should continue to assess special fiscal needs for the ACT in the 2004 Review.

13. ***Analysis.*** Different arrangements still exist for corporate affairs and police.

14. **Commission decision.** The Commission accepts that a conceptual basis exists for special fiscal needs allowances. However, it considers that sufficient time has elapsed since self-government for the Commonwealth and the ACT to have aligned the financial arrangements between themselves with those between the Commonwealth and the other States. It has therefore decided to take the following approach to the assessment of special fiscal needs allowances for the 2004 Review:

- (i) Commonwealth cost legacies inherited by the ACT after self-government will be assessed as special fiscal needs allowances. These may arise from:
 - differences between the Commonwealth's financial arrangements with the ACT and the financial arrangements the Commonwealth has with the other States; or
 - other Commonwealth policies which have had a different impact on the ACT compared with other States, excluding national capital influences;
- (ii) equalisation should not apply to these items (that is, any allowances assessed should be paid outside the GST pool arrangements); and
- (iii) special fiscal needs allowances should be phased out over an appropriate number of years.

CORPORATE AFFAIRS COMPENSATION

15. **Background — the States.** Until 1991, States regulated companies through their individual Corporate Affairs Commissions. They received fees from companies for this purpose.

16. In 1991, the primary responsibility for corporate regulation was transferred from the States to the Commonwealth, administered by the Australian Securities Commission — now the Australian Securities and Investment Commission (ASIC). The Commonwealth collects the fees and funds the regulator.

17. A consequence of the transfer of corporate regulation responsibility was that States no longer raised revenue. As part of the new arrangements, the Commonwealth agreed to compensate the States (except the ACT) for this permanent loss of revenue. Payments to States are made through an SPP (Compensation – Companies Regulation) under the auspices of the Corporations Agreement (2002) (superseding the 1991 agreement) which was signed in November 2001 by the Prime Minister and State Premiers. The arrangement is for an indefinite period.

18. **Background — the ACT.** The Commonwealth was responsible for the Corporate Affairs Commission in the ACT before responsibility passed to ASIC.

19. During the Commission's 1991 inquiry on financing the ACT, the ACT argued that it had a special fiscal need with respect to corporate affairs compensation because it had been excluded from the arrangements following the formation of the Australian Securities Commission. At that time, the Commonwealth said that the general revenue assistance to the ACT included a component analogous to the reimbursement received by the States.

20. The Commission assessed special fiscal needs to ensure the ACT retained that funding once it was integrated into the general revenue funding arrangements that applied to the other States and the Northern Territory. The assessment of special fiscal needs was considered consistent with the Commonwealth's intention that the new arrangements for corporate regulation would not affect the general revenue assistance paid to the States. That is, it was related to matters outside the scope of equalisation.

21. There have not been any subsequent changes to the arrangements for corporate affairs. Update terms of reference have, in the past, asked the Commission to review the special fiscal needs annually. Consequently, a special fiscal needs assessment for the ACT for corporate affairs has been made each year at the time the Commission undertook the annual update of general revenue sharing relativities.

22. **Preliminary State views.** The ACT supported a continuation of the assessment of special fiscal needs in the 2004 Review for corporate affairs compensation. There are no negotiations pending to replace the existing arrangements.

23. **Staff proposals.** In *Discussion Paper CGC 2002/05, Cross-border Disabilities and Special Circumstances of the Australian Capital Territory*, staff proposed that, if the differences in financial arrangements relating to corporate affairs compensation persisted, then the Commission should continue to assess special fiscal needs for the ACT in the 2004 Review, using similar approaches to those in the 2002 Update.

24. **Further State views.** There were no further State views.

25. **Analysis.** In 1991, the Commonwealth assumed the responsibility for corporate affairs regulation in all States and the ACT. The ACT was excluded from the revenue sharing arrangements between the Commonwealth and the States introduced at that time. The special fiscal needs were introduced to ensure the ACT received revenue analogous to that received by the States through the SPP for Compensation – Companies Regulation.

26. The Commonwealth also excluded the ACT from the Corporations Agreement (2002), which superseded the 1991 agreement. The Corporations Agreement (2002) was signed in November 2001.

27. Therefore, the Commission has concluded that the Commonwealth has been treating, and continues to treat the ACT differently from the other States with regard to corporate affairs compensation.

28. **Commission decision.** The Commission considers that a conceptual basis exists for assessing this allowance. This is because the corporate affairs compensation

payment meets the Commonwealth Treasury definition of arrangements, outside the scope of horizontal fiscal equalisation, that are ‘designed precisely to create analogous arrangements to those that — for historical reasons — already apply to other jurisdictions (and can best be seen as an attempt to ensure comparable treatment among jurisdictions)’. The Commission has decided to continue the assessment of a corporate affairs compensation allowance as part of the ACT special fiscal needs assessment for the 2004 Review.

29. However, it is not clear why the ACT was not to be included in the new arrangements that the Commonwealth entered into with the States in 2001.

30. **Method and results.** In the 2003 Update, needs were estimated by inflating the payments for 1989-90 to 2002-03 prices. This method is similar to that used to derive the corporate affairs compensation SPP amounts that are paid to the States. The CPI used was the Treasury estimate, excluding the effects of the GST. The amount assessed for 2003-04 was \$4.1 million. The Commission proposes to continue that approach.

31. **Updateability.** The allowance is updated annually using the latest estimates of inflation.

POLICE

32. **Background.** In the ACT, police services are provided by the AFP. All other States have their own police forces.

33. In the annual updates prior to the 1999 Review, the Commission assessed a number of transitional allowances for the ACT to recognise constraints on the ACT budget arising from policies inherited from the Commonwealth at self-government. Such an allowance was assessed for police. During the 1999 Review, the ACT argued the transitional allowance should be continued because it still had little effective control over the provision of police services.

34. Information received by the Commission at that time confirmed that the ACT had little effective policy control over policing. However, the Commission noted that stage two of a Commonwealth-ACT review of policing was due to be completed in mid-1999. That review was expected to lead to revised arrangements which would include accountability mechanisms and greater capacity for the ACT to provide policy direction. The Commission decided to continue to assess a transitional allowance pending the outcome of that review.

35. In the 2001 Update, the Commission concluded that the new policing agreement between the Commonwealth and the ACT gave the ACT greater policy influence than it had in the past. However, the ACT still had no power to influence policy on the terms and conditions of AFP employees. The Commission decided to cease assessing a transitional allowance and begin assessing a special fiscal need.

36. The allowance was calculated in the 1999 Review as the current value of:

- (i) the estimated salary costs for a notional ACT police force — based on the 1995-96 Australian average number of police per 100 000 people multiplied by the actual ACT salary cost per police officer; less
- (ii) the estimated salary costs for a same-sized notional ACT police force — based on the Australian average salary per officer, adjusted for some disabilities.

37. The allowance calculated in the 1999 Review was adjusted in subsequent annual updates using inflation rates. In the 2003 Update, the allowance was \$9.5 million for police service salary costs. A further allowance was made for the consequential increases in superannuation and debt charges. This amounted to \$1.4 million in the 2003 Update. Thus, the total police allowance assessed in the 2003 Update, for 2003-04, was \$10.9 million.

38. **Preliminary State views.** The ACT supported a continuation of the assessment of special fiscal needs in the 2004 Review for police as it continued to have limited control over the costs of policing due to constraints on determining the pay and conditions of the AFP.

39. **Staff proposals.** In *Discussion Paper CGC 2002/05 Cross-border Disabilities and Special Circumstances of the Australian Capital Territory*, staff proposed that, if differences in Commonwealth-ACT arrangements relating to police operations persisted, then the Commission should continue to assess special fiscal needs for the ACT in the 2004 Review, using similar approaches to those in the 2002 Update.

40. **Further State views.** The ACT provided an update on the outcome of inter-governmental relations since the 1999 Review. It said that the ACT continued to have limited control over the costs of policing due to constraints on determining the pay and conditions of AFP employees, notwithstanding the new Policing Arrangement put in place in March 2000. The ACT therefore asked for a continuation of the police special fiscal needs in the 2004 Review.

41. **Analysis — legislation.** When ACT self-government was instituted in 1989, the provision of police services to the ACT by the AFP was intended to be a temporary arrangement.

42. For the 2001 Update, the Commission continued to assess an allowance for police services, but as a special fiscal need. The basis for the assessment and the move away from it being treated as a transitional allowance was the ACT's argument that 'the ACT cannot employ another police force as the AFP is responsible for the provision of the policing function in the Territory'¹. This introduced an element of permanence to the ACT-AFP relationship.

43. Section 8 (1) and Subsection (1A) of the *Australian Federal Police Act 1979* refer to the functions of the AFP:

¹ Letter to the Commonwealth Grants Commission from the ACT Department of Treasury and Infrastructure, dated 17 August 2000.

- 8(1) ...the functions of the Australian Federal Police are:
- (a) subject to subsection (1A), the provision of police services in relation to the Australian Capital Territory; and
 - (1A) The Minister and the Australian Capital Territory may enter into arrangements for the provision of the police services in relation to the Australian Capital Territory that are in respect of Territory functions as defined by section 3 of the *A.C.T. Self-Government (Consequential Provisions) Act 1988*, and, where the arrangements have been entered into, the provision of those services shall be in accordance with the arrangements.

44. These extracts do not appear to preclude the ACT from using alternative policing service providers.

45. **Analysis — purchaser-provider relationship.** The provision of police services to the ACT by the AFP is formalised through two documents.

- (i) A five-yearly Arrangement between the ACT Government and the Commonwealth of Australia. The current Arrangement, signed on 15 March 2000, sets out the terms and conditions for the provision of police services to the ACT.
- (ii) An annual Purchase Agreement between the ACT Minister for Police and Emergency Services and the Chief Police Officer for the ACT. The 2002-03 Agreement covers all the goods and services to be purchased by the ACT, and includes outputs, price per output, outcome, performance measures and performance targets.

46. The nature of the arrangement for the provision of police services is therefore a purchaser-provider one. There is a purchaser of police services (the ACT) and a provider of those services (the AFP). The signed documents indicate an acceptance by both parties of the terms and conditions of the contract, the range of services and the price.

47. The 1990 Arrangement between the ACT and the AFP contained clauses that set out the funding base for the provision of police services. Some of those clauses made explicit reference to the Commonwealth Grants Commission and its role in compensating the ACT for above-standard costs. The current Arrangement makes no reference to the Commonwealth Grants Commission.

48. The 2000 Arrangement includes a provision for handling a disagreement on price or service (clause 13.1). However, this appears to provide the ACT with the capacity to influence the range of AFP services and resource levels for a one-year period within the five-year arrangement.

49. Other clauses in the Arrangement (5.1, 5.2, 9.1) indicate that the ACT Police Minister has some power to give directions, but not over the terms and conditions of employment of AFP employees.

50. *Analysis — salary and staff levels.* Table 2 provides comparative staff and salary data for police services in each State for 2001-02.

Table 2 POLICE SERVICE STAFF AND SALARY LEVELS, 2001-02

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Sworn police staff:									
Number	13 716	9 926	7 995	4 778	3 702	1 094	584	954	42 749
Number per 100,000 pop'n	206	204	218	249	244	231	181	477	218
Average salary cost (\$)	74 001	73 342	68 953	72 072	72 547	61 586	70 318	83 144	72 398
Unsworn police staff:									
Number	4 019	2 222	3 199	1 179	978	359	197	206	12 359
Number per 100,000 pop'n	61	46	87	61	64	76	61	103	63
Average salary cost (\$)	57 252	40 364	42 500	53 323	36 576	50 886	69 858	49 646	48 275
Total police staff:									
Number	17 735	12 148	11 194	5 957	4 680	1 453	781	1 160	55 108
Number per 100,000 pop'n	267	250	305	310	308	307	242	580	281
Average salary cost (\$)	70 205	67 309	61 393	68 361	65 029	58 942	70 201	77 195	66 988

Source: Productivity Commission, *Report on Government Services 2003*, Tables 5.1, 5A.1 to 5A.8.

51. In the 2003 Update, the special fiscal needs allowance for police service salary costs was \$9.5 million. This allowance was estimated using 1995-96 staff and salary level data as the baseline. That baseline was adjusted for inflation.

52. To derive a more accurate and up-to-date estimate, the Commission has recalculated the special fiscal needs for police service salary costs using the 2001-02 staff and salary data (from Table 2) and the existing calculation method.

53. The resulting allowance is estimated to be \$6.2 million for police service salary costs. This is a decrease of \$3.3 million compared with the 2003 Update assessment.

54. *Analysis — superannuation and debt charges.* For simplification, additional on-costs (superannuation) have been calculated at 20 per cent of the estimated police allowance for salary costs, which provides an estimate of \$1.2 million. An allowance for other additional on-costs (debt charges) was included in the police special fiscal needs for previous years. However, it is not clear that ACT debt charges are affected by the arrangements and we propose discontinuing that aspect of the allowance for the 2004 Review.

55. **Commission decision.** While the past understanding was that the ACT was bound to use the AFP, the Commission considers that there is no longer any legal impediment to the ACT:

- (i) obtaining services from another police service; or
- (ii) negotiating a bilateral agreement with the AFP that is acceptable to both parties and that would no longer require the Commission to assess an allowance.

56. The current Arrangement excludes any needs funding mechanism explicitly involving the Commonwealth Grants Commission. The services provided by the AFP to the ACT are purchased entirely according to the agreed contract. That contract empowers the ACT to refine and negotiate outputs, service specifications and performance measures, which all influence price. However, the ACT has limited control over the pay and conditions of the AFP.

57. The Commission accepts that a conceptual basis exists for continuing the allowance because the ACT is bound by the current contractual arrangement it has with the AFP. The available data show that the extra costs associated with the current contractual arrangement continue to be material. Data are available to estimate the additional costs with good levels of confidence. The Commission proposes to assess special fiscal needs for the 2004 Review.

58. While the Commission has decided to continue the allowance in the 2004 Review, it sees no justification for continuing the police allowance indefinitely. Nor can it see any reason why the terms and conditions of the policing agreement cannot be renegotiated to bring them into line with the other States. The Commission has concluded, therefore, that it would be appropriate for the allowance to be reviewed and possibly discontinued following expiry of the existing policing agreement.

59. **Method and results.** In terms of the method used to calculate the special fiscal needs, the Commission considers that the recent Productivity Commission data provides a more recent and more accurate basis for the calculations than the escalated costs used in the 2003 Update. It proposes to use the Productivity Commission data in the assessments for the 2004 Review. It accepts that an on-cost component for superannuation should also be calculated. However, at this stage, it does not see a basis for continuing the on-cost allowance for debt charges.

60. The allowance calculated using Productivity Commission data is estimated to be \$6.2 million for police service salary costs. The consequential allowance for superannuation on-costs is estimated as \$1.2 million. Thus, the total police allowance assessed for the 2004 Review draft assessment, is \$7.4 million.

Updateability

61. The allowance can be updated annually using Productivity Commission data.

SUMMARY OF RESULTS

62. Table 3 compares the special fiscal needs assessed for the ACT for 2003-04, in the 2003 Update and the 2004 Review draft assessment.

Table 3 SPECIAL FISCAL NEEDS ALLOWANCE, 2003 UPDATE AND 2004 REVIEW DRAFT ASSESSMENT, 2003-04

	2003 Update	2004 Review draft assessment
	\$m	\$m
Corporate affairs compensation	4.1	4.1
Police	10.9	7.4
Total	15.0	11.5

Source Commonwealth Grants Commission, 2003 Update and 2004 Review draft assessment.