Issues arising from Telepresence meetings with CGC Commissioners

At the meeting between the SA Acting Under Treasurer and CGC Commissioners on 29 October 2014, South Australia undertook to provide Commission staff with comments or material on two issues:

- Contemporaneity proposals put forward by Western Australia; and
- Urban road infrastructure

Western Australian contemporaneity proposal

States and territories have been asked to consider the Western Australian contemporaneity proposal.

South Australia has always been supportive of proposals to improve contemporaneity and is open to an examination of reducing the averaging period from three to two years. However, we do not support assessments based on the use of estimates with subsequent adjustments or the sole use of a single year's actual data.

Use of estimates

- South Australia does not support assessments being based on budget estimates as each state and territory formulates estimates using their own forecast assumptions and there would not be consistency in forecast methodologies.
- The use of estimates for the application year with a subsequent correction reflecting actual outcomes introduces another layer of complexity and volatility.
- Under the current three-year averaging arrangements, two years data is based on Australia Bureau of Statistics GFS data and the latest year's data is supplied by states and territories. Data supplied by states and territories is replaced with ABS GFS data in subsequent updates. This process provides an independent review of states data, albeit with a lag.
- There would be no data review processes if application year forecasts are the basis of assessments. Without independent review of data by the ABS there is the potential for states to game the system.
- Western Australia has suggested that a Commonwealth agency could provide forecast assumptions for use by the states, especially for mining revenue forecasts or undertake some form of review process. This assumes that the relevant Commonwealth agency has a better understanding of forecasts for production levels, commodity prices, exchange-rates and local operational issues than state governments. This is not the case.

Reduction in the averaging period

- Given the issues associated with using estimates, the only other alternative to improve contemporaneity is to reduce the current three year averaging period to two years or one year.
- The sole use of the most recent completed financial year's data carries significant risk. The data would lack transparency as final GFS data compiled by the Australian Bureau of Statistics (ABS) would not be available in time for the annual Update. The CGC would have to rely on GFS data provided by the states which would never be subject to ABS review as ABS adjustments to data sets would never be reflected in assessments.
- Assessments based on a single year could be extremely volatile and not just from revenue fluctuations. Expenditure items could also produce large variations. Recent natural disaster expenditure for flooding in Queensland is a recent example.

- South Australia would support further examination of a reduction in the averaging period to two years.

Scope of contemporaneity changes

- Western Australia has suggested that contemporaneity changes could be quarantined to one or two categories.
- South Australia questions selective application of contemporaneity changes as this immediately raises a consistency issue and potential “cherry-picking” of assessments to achieve particular outcomes. This would have the potential to compromise the equity objectives of current HFE arrangements.

Concluding comments

- To the best of our understanding, Western Australia did not raise contemporaneity concerns during its mining production/revenue growth phase where they benefited from lags in the system.
- South Australia questions whether it is appropriate for significant contemporaneity changes to be incorporated at this stage of the 2015 Review. The issue should be examined at the next available opportunity for methodology review.

Urban road infrastructure

At our meeting with Commissioners, South Australian officials discussed the Commission’s view that larger cities required proportionately greater investment in public transport assets which produces an upward sloping gradient in public transport assets per capita as city size increases.

South Australia believes that the converse of this argument is that the roads investment assessment should take account of a downward sloping gradient for road assets per capita as city size increases. This implies that as cities get larger some degree of modal switch takes place and they spend more on public transport assets and relatively less on road infrastructure.

Another way of expressing this is that there are fixed costs in establishing and maintaining an urban road network for a smaller city, or there is a minimum efficient scale for a road network.

Commissioners noted that congested roads are a signal and driver of roads investment. However, if it is established that congestion is worse in larger cities than smaller cities, this in itself is evidence of a lower road capital stock to population ratio in larger cities and a higher road capital stock to population ratio in smaller cities.

More definitive research on this issue is necessary but we believe that the Commission should give consideration to reflecting the fixed cost component that states with smaller cities face in having an urban road network.