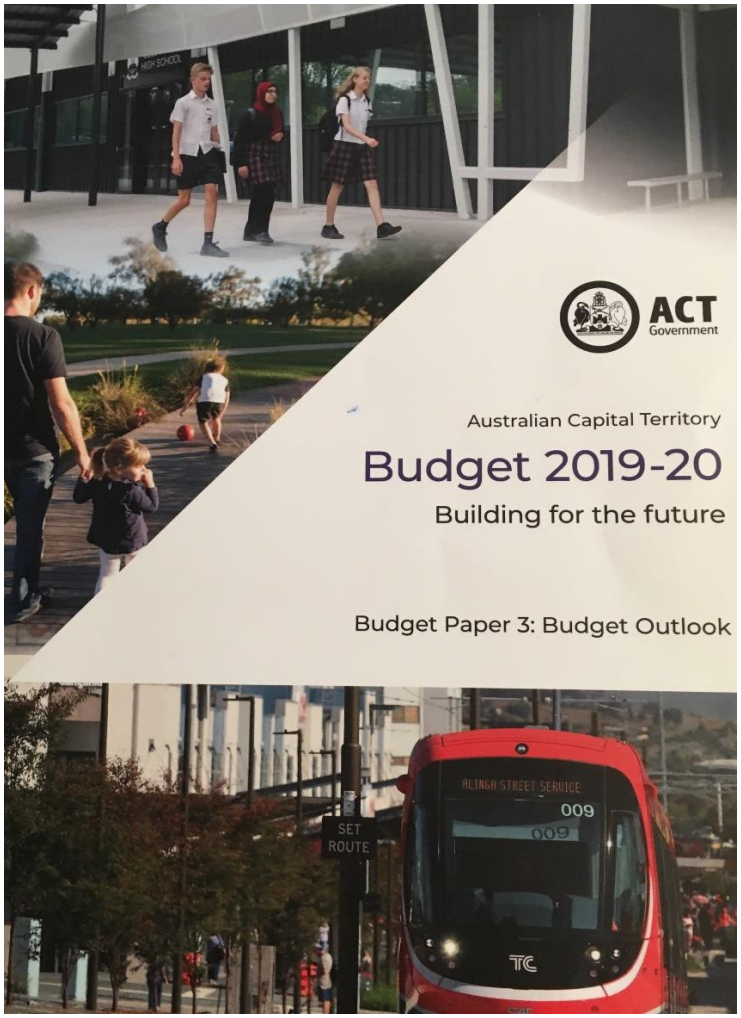
Pegasus Economics

2019

Review of the ACT Budget 2019-20



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Pegasus Economics

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Pegasus Economics is a boutique economics and public policy consultancy firm that specialises in strategy and policy advice, economic analysis, trade practices, competition policy, regulatory instruments, accounting, financial management and organisation development.

This report has been commissioned by the ACT Legislative Assembly Select Committee on Estimates 2019-20 to assist the Committee in its deliberations in relation to the 2019-20 ACT Budget.

The views and opinions expressed in this report are those of the authors.

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Photograph on the front cover is taken from the front cover of *Budget Paper 3: Budget Outlook* from the 2019-20 ACT Budget.

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Executive Summary

Overview

This draft report has been prepared by Pegasus Economics to assist the ACT Legislative Assembly's Select Committee on Estimates 2019-2020 in its consideration and review of the 2019-20 ACT Budget. The draft report was required to be produced within a week of the presentation of the Budget to the Assembly. It is based on a desk-top review of the available documentation supported by some consultation with ACT Government officials.

There is a new and overtly political tone in this year's main ACT Budget Paper in Budget Paper 3 that has not been apparent in past ACT Budget Papers that strikes a shrill tone. In other parts of Budget Paper 3 it demands greater engagement on the part of the Commonwealth Government that seems rather incongruous to the earlier negative comments about the Commonwealth. The political commentary in Budget Paper 3 is unbecoming for a small jurisdiction that wants to be taken seriously.

While the economic estimates for 2018- 19 generally appear reasonable, forecasts for 2019-20 contained in the ACT Budget for ACT final demand, employment growth, the Wage Price Index and population growth and the projections for the out-years may be optimistic for a number of reasons including ongoing Commonwealth Government fiscal restraint as well as ACT Government tax reform. Pegasus also suspects that policies and practices pursued by the ACT Government may have locked in slightly higher levels of inflation than the national average.

The Budget Papers present a headline net operating deficit of $89.1 million in 2019-20 and a budget balance that returns to surplus in 2021-22 ($135.2 million). The expected return to surplus will be reliant on fiscal discipline – that is, Government minimising new initiatives or finding savings to offset new spending. The estimated 2021-22 surplus would be at risk in the event of unexpected spending pressures or shortfalls in revenue. Net debt (excluding superannuation) grows substantially in 2019-20 (by $532 million, or 24 per cent) and is not projected to reduce until 2022-23.

Revenue is expected to increase by $224.7 million from an estimated outcome of $5.6 billion in 2018-19 to almost $5.9 billion in 2019-20. In contrast to 2018-19 where the ACT Government was moving closer towards a hard budget constraint whereby it was responsible for raising most of its additional revenue, in 2019-20 and the out years it is moving away yet again from a hard budget constraint and becoming increasingly dependent on the Commonwealth Government to fund increases in revenue. The lack of a hard budget constraint for the ACT Government reduces the incentives and disciplines to provide more efficient service delivery. In continuing to pursue its tax reform, one potential pitfall the ACT Government needs to be aware of is the risk of tax leakage across the border to New South Wales from those seeking to escape the impost of higher general rates in the ACT.

Expenses are forecast to grow over the budget and forward estimates from $6.2 billion in 2019-20 to $6.8 billion in 2022-23. Health, Education and General Public Services each account for more than 20 per cent of the total and together they comprise more than two thirds of Territory expenses. Growth in spending is driven mainly by growth in demand for services, debt servicing and wage costs. New programs are a secondary driver of growth. The net total for new initiatives in 2019-20 is $108 million, 1.75 per cent of total expenses. Health has by far the largest number of new initiatives, with 46, and remains the largest single function in the Territory.

The Budget includes a substantial capital works and infrastructure program over the Budget and forward years. The Government will invest $3 billion in infrastructure in the ACT over the next four years. Almost half the proposed program is in provisions, with detailed estimates not for publication. The most significant of these provisions relates to the proposed SPIRE project at The Canberra Hospital. The peak year for infrastructure spending is 202-21 ($877 million), falling to $$581 million

in 2022-23; however, experience suggests new capital projects are likely to be proposed which would maintain a continuing level of high infrastructure investment.

The Territory's balance sheet is healthy, with a positive net worth rising from $17.5 billion to $18.1 billion over the Budget and forward estimates. However, net debt and net financial liabilities are rising at a faster rate than net worth over the same period, and the ratio of net worth to Gross State Product (GSP) is in decline. The Territory's defined benefit superannuation liability has been revised upwards, to $8.7 billion by 2022-23, and the unfunded component is now estimated to be nearly $1 billion dollars higher than forecast in last year's Budget.

There are a number of risks and uncertainties attached to the Budget estimates. These include economic and fiscal risks. The Budget is based on assumptions about the future level of Commonwealth spending in the ACT and about the level of Commonwealth Government grants to the ACT that have some attached risk. The Budget aggregates are sensitive to technical assumptions including those related to the rate used to measure the present value of superannuation payments in future years.

Valuation effects, accounting treatments and timing issues continue to have large impacts on the budget aggregates and on the reported budget balance.

Issues that may benefit from further investigation

In its examination of the 2019-20 ACT Budget, Pegasus believes the following issues are worth further investigation by the Committee:

- Reasons for why there is a doubling in the estimate of gains from contributed assets in 2022-23 over the estimate in 2021-22.
- An explanation for a range of technical adjustments as part of the 2018-19 Budget Review in relation to dividends received from the Suburban Land Agency (SDA), the City Renewal Authority and Icon Water.
- In relation to the Large-scale Generation Certificates:
  - the expected schedule of revenue and expenses relating to the Certificates over the Budget and forward years
  - given the uncertainties surrounding the national electricity market, what economic value is embedded in the Certificates and what reference point was used to determine a reliable value for these certificates
  - details on the technical adjustment undertaken in the 2018-19 Budget Review.
- Underlying reasons for the 15 per cent increase in traffic infringement fines in 2019-20.
- Reasons as to why there has been considerable variation between for the estimated budget outcome for 2018-19 in relation to functions as compared to what was originally budgeted for. Increases in Health, Education, Social Protection and Transport have been to a large extent offset by lower expenses than budgeted in the General Public Services function. The Budget papers do not provide an explanation for these large variations.
- Provision of a more detailed break-down of the functional table into the standard sub-functional categories.
- How the $23.2 million provision included in additional funding for out of home care services ($39.8 million over four years) will be drawn down in practice.

- Whether the budget allocation for the Safer Families initiatives in 2019-20 is likely to be fully expended in light of previous history and re-profiling.
- Clarification on whether there is likely to be any further slippage in relation to the Loose-Fill Asbestos Insulation Eradication Scheme. The Scheme is anticipated to have no further impact on the net operating balance from 2021-22 onwards, however, there is a chance that there could be further slippage if the current approach towards property sales is maintained.
- Further exploration of the operation of the new Capital Works Reserve of $140 million, including:
    - Processes for reporting usage
    - Criteria established to assess claims on the reserve
    - Authority to approve such claims
    - Assembly assurance over the usage of the appropriation.
- How far into the future the planning timeframe for the capital works program extends?
- To help assess the risks attached to the economic forecasts, estimate of the risk to the budget from higher or lower growth, and the sensitivity of the Budget to changes in assumptions regarding wages, population and employment.
- Whether the Project Delivery Report for Light Rail Stage 1 has brought to the surface risks which had previously not been reported or anticipated.
- Further exploration of a number of issues in relation to the accounting treatment in the Budget for Public Private Partnerships (PPP), including:
    - Was AASB 1049 adopted as the basis of accounting and presentation in preparing the budget financial statements?
    - Why, unlike other Australian jurisdictions, are the bases of accounting, key accounting policies and a disaggregation of key assets and liabilities not disclosed in notes accompanying the financial statement?
    - Why *AASB 1059, Service Concession Arrangements: Grantors* has not been adopted early for the Light Rail Stage 1 and the Law Courts PPP projects?
    - In any case, why AASB 1059 was not adopted in respect to the Budget forward years?
    - What impact on the budget balances would have been had AASB 1059 been adopted?
- Explanations for a series of "Technical Adjustments" in the Budget and supporting documents. Some of these adjustments appear to move transactions and balances across years, including from 2018-19 to the Budget year and visa versa. Although footnoted, these adjustments are not explained, indeed some are tagged not for publication.
- Further information on the calculation of the superannuation return adjustment for 2019-20, particularly in light of the sensitivity of the budget aggregates to variations in the actual return on the Territory's superannuation investments.

1. Introduction

This draft report has been prepared by Pegasus Economics to assist the ACT Legislative Assembly's Select Committee on Estimates 2019-2020 in its consideration and review of the 2019-20 ACT Budget. The draft report was required to be produced within a week of the presentation of the Budget to the Assembly. It is based on a desk-top review of the available documentation supported by some consultation with ACT Government officials.

1.1 Introduction

This report has been prepared for the ACT Legislative Assembly's Select Committee on Estimates 2019-2020 to assist the Committee in its deliberations in relation to the 2019-20 ACT Budget.

1.2 Background

Pegasus Economics (Pegasus) was engaged by the ACT Legislative Assembly on 14 May 2019 to assist the Select Committee on Estimates 2019-20 with its assessment of the 2019-20 ACT Budget. Pegasus was required to prepare a draft report on the Budget within seven days of its presentation to the Assembly and to be available as required to assist the Committee in its subsequent deliberations.

1.3 Purpose

This report has been produced to assist the ACT Legislative Assembly's Select Committee on Estimates in its consideration of the 2019-20 Budget.

The report does not provide a complete or comprehensive summary of the 2019-20 Budget, nor attempt to provide an assessment of the appropriateness of the spending, revenue and investment decisions reflected in the document.

Rather, the report seeks to explicate elements of the Budget and points to areas that the Committee may wish to explore or to seek further information in its consideration of the Budget.

1.4 Approach

The range of matters covered in this report relates to subjects raised by Committee members at a meeting with Pegasus consultants on Thursday 30 May 2019.

The report is based on a desk-top review of the ACT Budget documentation presented to the Assembly on 4 June 2019. We have also consulted other documentation in the public domain including Commonwealth Government Budget Papers, previous ACT Budget documents, reports of the ACT Auditor-General, reports by the Productivity Commission, various Ministerial statements, Departmental reports and other research literature.

Pegasus was also able to consult with ACT Government officials at the Community Stakeholder Budget briefing on the day of the release of the Budget. We are grateful for the opportunity to attend this briefing and wish to thank the ACT Government officials at the Community Stakeholder Budget briefing for their assistance in responding to our queries and questions.

2. Tone of the Budget Papers

There is a new and overtly political tone in this year's main ACT Budget Paper in Budget Paper 3 that has not been apparent in past ACT Budget Papers that strikes a shrill tone. In other parts of Budget Paper 3 it demands greater engagement on the part of the Commonwealth Government that seems rather incongruous to the earlier negative comments about the Commonwealth*. The political commentary in Budget Paper 3 is unbecoming for a small jurisdiction that wants to be taken seriously.*

There is a new and overtly political tone in this year's main ACT Budget Paper in Budget Paper 3 that has not been apparent in past ACT Budget Papers. In particular, there are numerous references to the Coalition Government at the Commonwealth level in several places in Budget Paper 3. For example, Budget Paper 3 strikes a shrill tone with the following political commentary:

> *The past six years have been characterised by a lack of investment in Canberra by the Coalition Government. The ACT has received just 0.8 per cent of national infrastructure funding during the Coalition's last two terms. This translates to around half what our per capita share would be, a shortfall of about $307 million since the Coalition took office. Public service job cuts, decentralisation and unequal funding deals in key areas like health and education have underlined the Coalition's disregard for Canberra.*
>
> *With the Coalition having recently been returned for a further term in government, there is little prospect of this situation changing in the next three years. But with Canberra growing by around 8,000 people a year, we cannot allow local services and infrastructure to fall behind as our community continues to grow.*
>
> *So just as we did five years ago in the face of Tony Abbott's cuts and the Mr Fluffy crisis, we will step up and invest in Canberra. (ACT Government, 2019, p. 37)*

In another part of Budget Paper 3 the ACT Government strikes a rather different and arguably contradictory tone with an editorial style commentary calling for more engagement on the part of the Commonwealth with the states and territories:

> *A more collaborative and consultative approach from the Commonwealth in conjunction with the states and territories is required. At the start of a new term of parliament, we urge the Commonwealth to reset its financial relationship with the states and territories and return to a more consultative approach which recognises our shared responsibilities and capabilities in delivering services for all Australians. (ACT Government, 2019, p. 262)*

It appears rather incongruous for the ACT Government to be both disparaging as well as demanding greater engagement on the part of the Commonwealth Government. The political commentary in Budget Paper 3 is unbecoming for a small jurisdiction that wants to be taken seriously.

3. Economic Forecasts

While the economic estimates for 2018- 19 generally appear reasonable, forecasts for 2019-20 contained in the ACT Budget for ACT final demand, employment growth, the Wage Price Index and population growth and the projections for the out-years may be optimistic for a number of reasons including ongoing Commonwealth Government fiscal restraint as well as ACT Government tax reform. Pegasus also suspects that policies and practices pursued by the ACT Government may have locked in slightly higher levels of inflation than the national average.

A summary of current economic trends alongside the economic estimates and forecasts contained in the 2019-20 ACT Budget are provided in Table 1 below.

Table 1: Current outcomes and economic estimates and forecasts in the 2018-19 ACT Budget, percentage change

Indicator	Current outcomes to the end of March 2019[1]	ACT Budget 2018-19 estimates	ACT Budget 2019-20 forecasts
State Final Demand[2]	4.4	4¼	3
Employment[3]	-0.1	1	1½
Wage Price Index	2.1	2¼	2½
Consumer Price Index	1.8	2	2¼
Population[4]	1.9	2	1

1. Year to the end of March 2019 and through the year unless otherwise stated.
2. In year average seasonally adjusted terms.
3. Though the year to the end of April 2019 in trend terms (as seasonally adjusted figures are not provided for the ACT).
4. Through the year to the end of September 2018.
Sources: Australian Bureau of Statistics (ABS) (2019; 2019a; 2019b; 2019c; 2019d) and ACT Government (2019, p. 10).

3.1 ACT Final Demand

The best and most immediate indicator of economic activity within the ACT is final demand. Estimates of gross state product (GSP) are only published annually with a significant time delay following the end of the financial year and quarterly estimates are not available. Because there is no timely way to get a gauge on GSP, it will not be considered further.

In the March 2019 national accounts released by the Australian Bureau of Statistics (ABS) (2019a) on 5 June 2019 (the day after the ACT Budget was delivered), the ACT recorded a mild contraction in demand of -0.2 per cent in seasonally adjusted terms during the March quarter, largely driven by a sharp drop in government consumption and investment. This compared to a slight increase for the national economy where demand grew by a very modest 0.1 per cent.

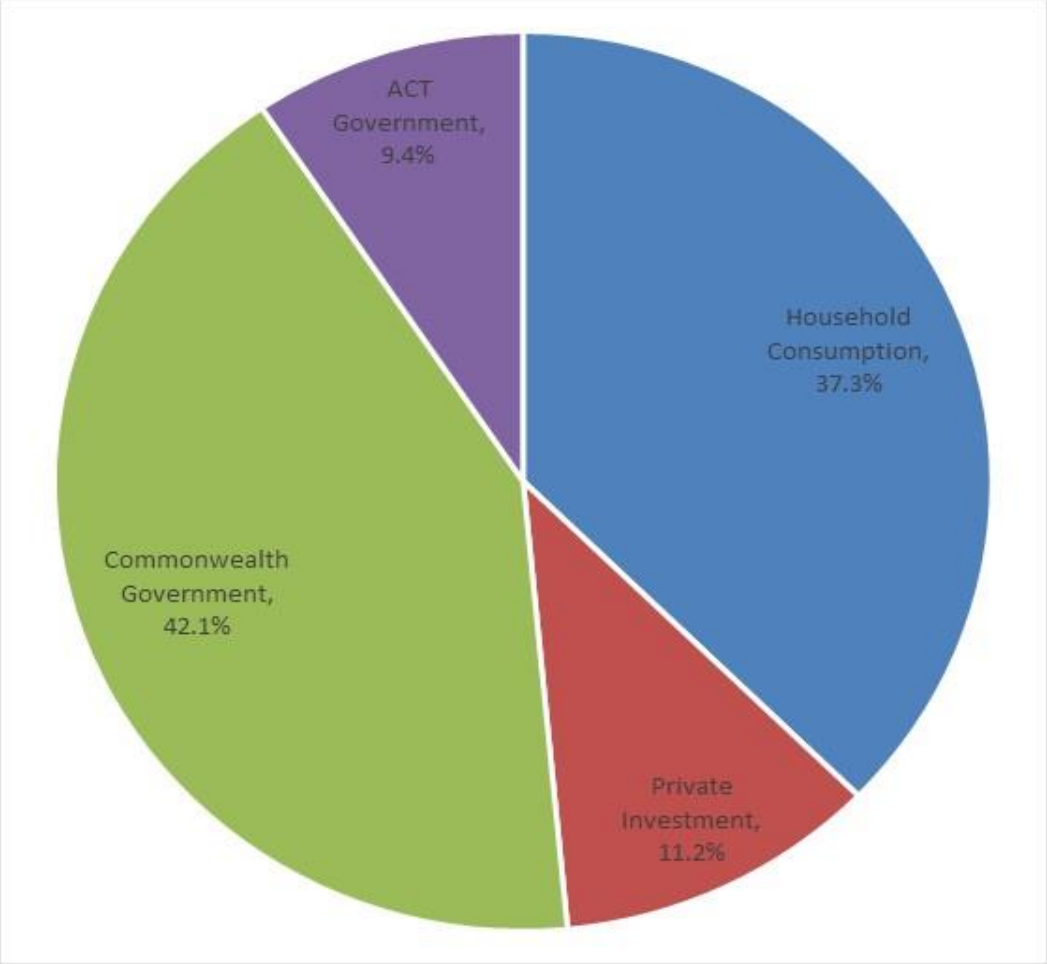
Despite the contraction in ACT final demand during the March quarter 2019, growth in final demand for the year ending March 2019 was 4.4 per cent, entirely consistent with the Budget estimate for an increase in ACT final demand of 4¼ per cent for 2018-19. In order to reach the Budget estimate

outcome for ACT final demand for 2018-19, it will need to grow by 1.5 per cent during the June quarter 2019. Although final demand growth of this magnitude during a quarter for the ACT economy is not unprecedented, in the current subdued economic environment the balance of probabilities are that the Budget estimate for ACT final demand for 2018-19 is likely to fall short.

Economic forecasting in a modern mixed economy is usually focused on the largest components of economic activity, which are generally composed of household consumption and private investment. However, the ACT, as the seat of the Commonwealth Government, is heavily dependent on the consumption and investment decisions of the Commonwealth Government.

In the year to the end of March 2019, the Commonwealth represented 42.1 per cent of total demand in the ACT economy, compared to household consumption that made up 37.3 per cent, private investment of 11.2 per cent, and 9.4 per cent for the ACT Government as illustrated in Figure 1 below.

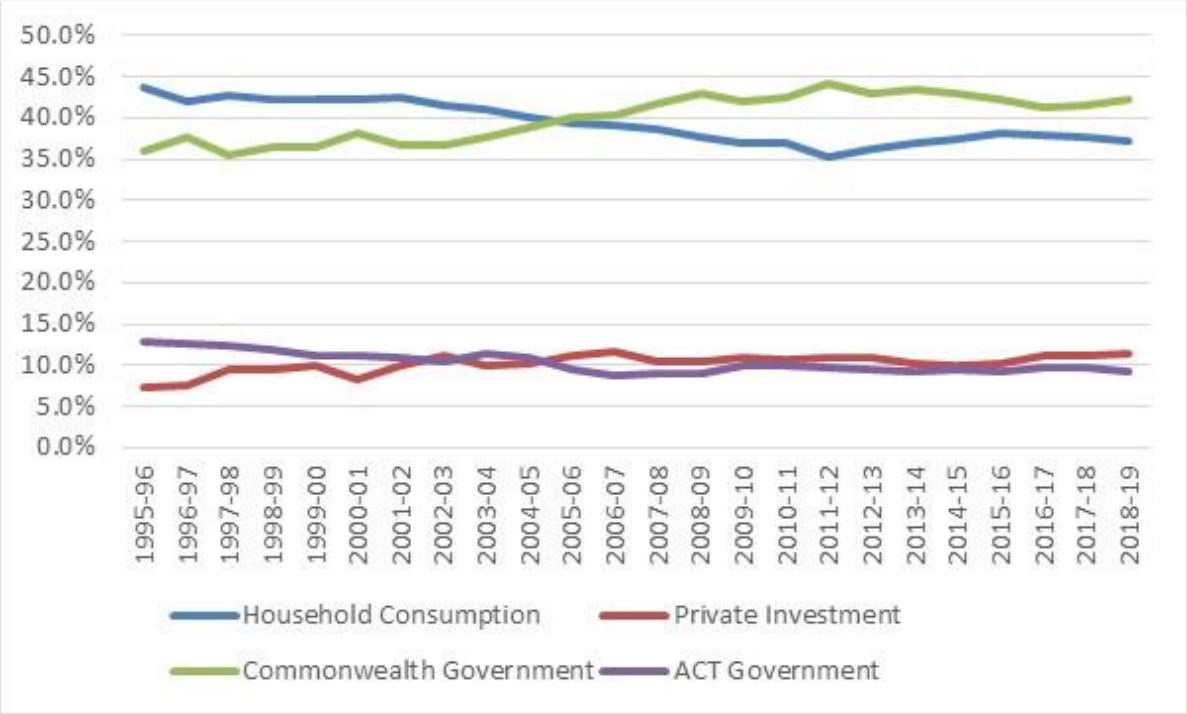
Figure 1: Components of Final Demand for the ACT economy, year ended March 2019



Source: ABS (2019a).

The historical relative shares of ACT final demand are provided in Figure 2 below.

Figure 2: Relative shares of ACT Final Demand – 1995-96 to 2017-18

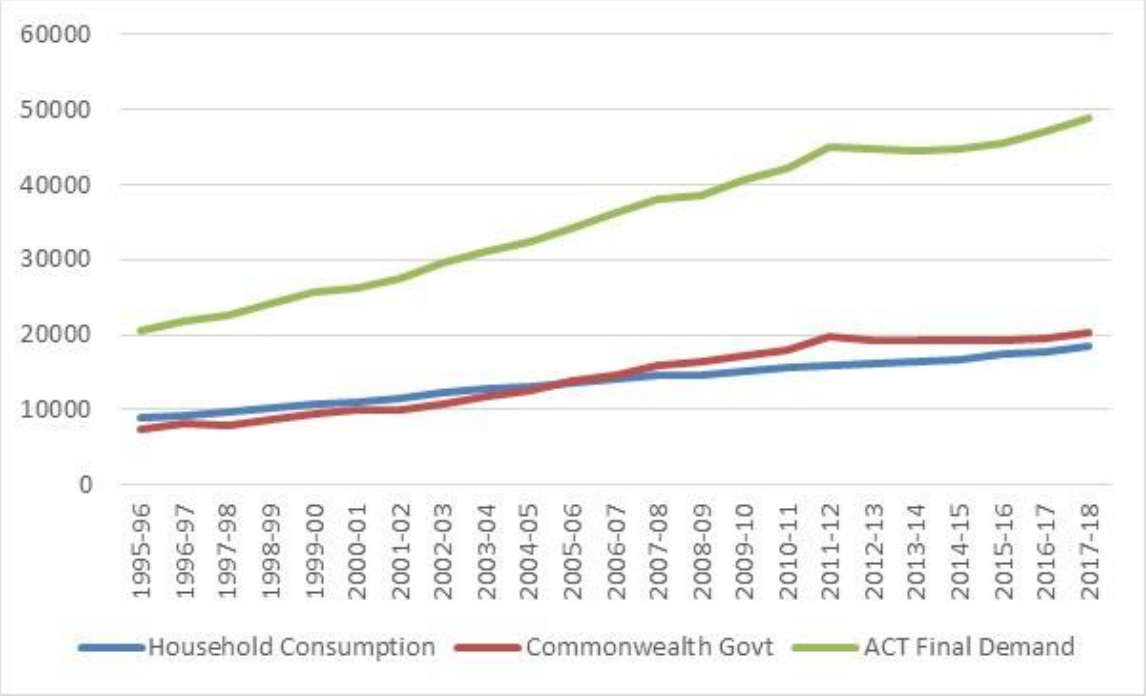


Source: ABS (2019a).
Note: Results for 2018-19 are for the year to date.

Household consumption now appears to have constituted the largest component of ACT final demand up until 2005-06 when it was superseded by the Commonwealth Government. The contribution of the ACT Government to final demand has been hovering at around 9½ per cent on average since 2009-10, while private investment has been hovering at around 10¾ per cent on average over the same period. Overall, there is no evidence to suggest there has been a dramatic shift in the drivers of ACT final demand over recent years, with the combined public sector (composed of both the Commonwealth Government and the ACT Government) still constituting in excess of 50 per cent of final demand.

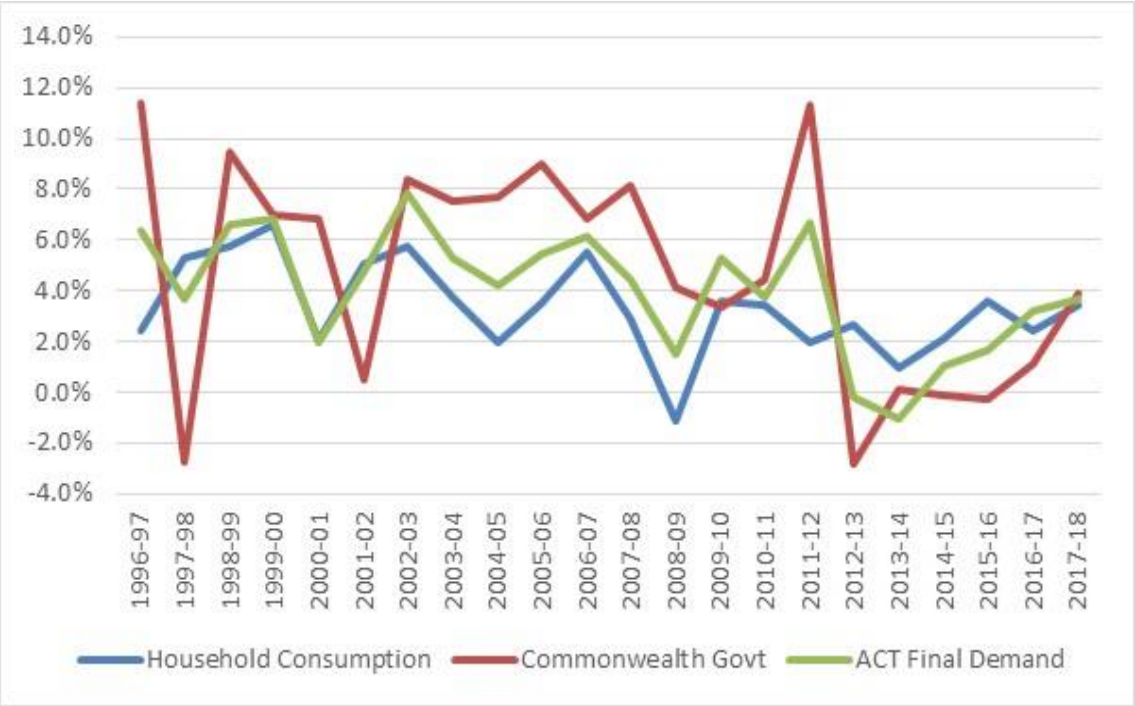
There is a close relationship between ACT final demand, Commonwealth Government expenditure and household consumption, as outlined in 3 below, as well as between growth in ACT final demand and the growth of Commonwealth Government expenditure and household consumption, as outlined in Figure 4.

Figure 3: ACT Final Demand and the contribution of the Commonwealth Government and Household Consumption – 1994-95 to 2017-18 ($ million, constant 2016-17 dollars)



Sources: ABS (2019a).

Figure 4: Percentage Growth in ACT Final Demand, Commonwealth Expenditure and Household Consumption – 1996-97 to 2017-18



Sources: ABS (2019a).

In the 2019-20 Commonwealth Budget, Commonwealth Government payments are expected to increase in real terms by 4.9 per cent in 2018-19, before moderating to only increase by a paltry 0.1 per cent in 2019-20, before gradually increasing again to 1.3 per cent in 2020-21, 1.9 per cent in 2021-22 and 2.0 per cent in 2022-23 (Commonwealth of Australia, 2019a, p. 5.5). There does not appear to be sufficient growth in Commonwealth Government payments to support continuing

robust growth in demand for the ACT economy during 2019-20. On this basis, Pegasus believes the forecast for growth in demand for the ACT economy of 3 per cent maybe overly optimistic.

The ACT Budget papers contain projections for ACT final demand that converge back towards a long-run trend rate of growth in excess of 3 per cent in the out years (ACT Government, 2019, p. 12). However, Pegasus also has reservations as to whether it is feasible to assume that ACT final demand will eventually return to long-run trend growth in excess of 3 per cent, especially in light of the Commonwealth Government forward estimates of the growth in payments.

As can be seen in Figure 3 above, growth in Commonwealth ACT expenditure has moderated in real terms since 2012-13 and growth in ACT final demand appears to have moderated in turn. Figure 4 suggests that in recent years there has been a downward structural shift in the level of growth in Commonwealth ACT expenditure, that in turn raises questions as to whether ACT final demand will eventually return to long-run trend growth in excess of 3 per cent per annum, particularly in light of ongoing fiscal restraint exercise by the Commonwealth Government. According to the Commonwealth Government (2019a, p. 3.9):

> *As a result of decisions to control growth in government spending, average annual real growth in payments over the four years from 2019-20 is expected to be 1.3 per cent and 1.9 per cent over the period since the Government was elected in 2013 – the lowest of any Commonwealth government in 50 years.*

Growth in ACT demand will also not be assisted by an increase in the efficiency dividend announced by the Coalition parties during the federal election if they were re-elected to government. During the recent federal election, the Coalition parties announced that it would reduce departmental funding to government agencies by $1.5 billion over the forward estimates by increasing the efficiency dividend (Liberal Party of Australia, 2019). If it carries through on this, the re-elected Coalition Government will reduce departmental funding by $136 million in 2019-20, $379 million in 2020-21, $506 million in 2021-22, and $493 million in 2022-23.

While growth in ACT final demand along with Commonwealth ACT expenditure can be expected to oscillate, we believe that the rate of growth for these aggregates has in all likelihood settled around a lower trend line than in the past, especially as the Commonwealth Government moves back into surplus. While it could be argued that Commonwealth Government expenditure restraint is a temporary measure likely to fall away as national economic growth moderates, the threat of a credit rating downgrade is likely to continue to impose ongoing fiscal discipline upon the Commonwealth Government.

It is noted that there is a continuing strong pipeline of work in relation to housing construction that will continue into 2019-20 before moderating thereafter (ACT Government, 2019, p. 32). While housing construction has provided some support for private investment in the ACT economy, it does come at a time when there appears to have been a moderation in the level of growth in household consumption. Over the course of the last 12 months to the end of May 2019, the Canberra residential property market has been the most buoyant capital city across the nation recording price growth of 2.4 per cent compared to a national average of a decrease of 8.4 per cent (CoreLogic, 2019), although there are recent signs of it moderating. It is acknowledged in the Budget there are signs of a softening in the ACT's housing market, which it attributes as likely due to a reduction in confidence based on trends nationally and a tightening in credit availability (ACT Government, 2019, p. 20).

Pegasus believes that ACT final demand projection increases in the order of around 2¾ to 3 per cent from 2020-21 onwards may be more realistic for future projections in the current environment and that reference back to long term trends in an environment of generally improving budgetary conditions and favourable parameter changes for the Commonwealth Government no longer provides the most useful reference point for longer-term projections used for the ACT Budget.

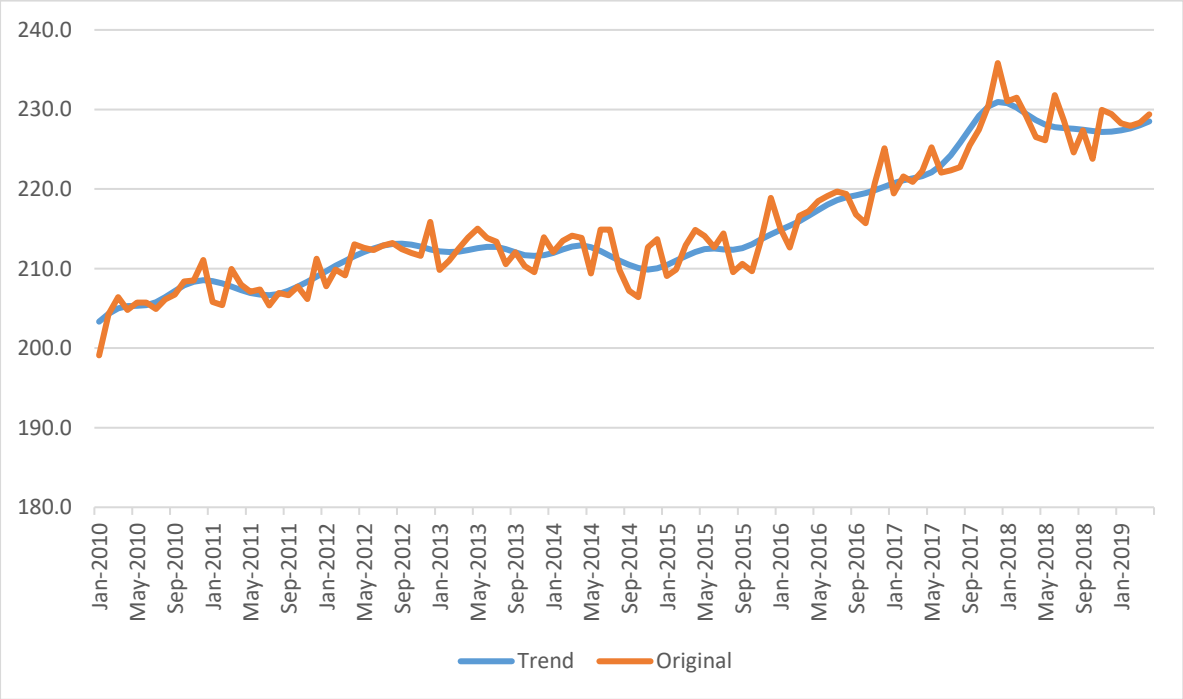
3.2 Employment

Employment growth through the year to the end of April 2019 for the ACT was running at - 0.1 per cent in trend terms and at 1.0 per cent in original terms (Australian Bureau of Statistics, 2019c). According to the ABS (2019c), trend data provides the best measure of underlying behaviour in the labour market as it avoids problems of inherent sampling variability in the original data series. Employment is traditionally seen as a lagging indicator of economic activity (or an indicator that follows an economic event).

In the 2019-20 ACT Budget the ACT Government is estimating employment growth of 1 per cent in 2018-19, and forecasting employment growth of 1½ per cent in 2019-20. Although through the year employment growth is marginally negative in trend terms at the present time, it is still eminently feasible the budget estimate for employment growth of 1 per cent in 2018-19 is still attainable as such an outcome only represents a net increase in employment of less than 2,300 for the year on the outcome for June 2018 – which represents an increase in employment of only around 1,600 on the outcome for April 2019. As the level of ACT employment in trend terms has recently been increasing, it is quite possible the estimate for employment growth in 2018-19 will be achieved.

The level of employment in both original and trend terms for the ACT is provided in Figure 5 below.

Figure 5: ACT Employment – January 2010 to April 2019



Source: ABS (2019c).

With ACT demand forecast to moderate in 2019-20, one would generally expect to observe some continued moderation in employment growth rather than a mild pick-up. On this basis, a forecast for a mild pick-up in employment growth of 1½ per cent in 2019-20 may appear to be on the upside, although not unreasonably so.

In 2019-20 the employment situation for the ACT is only likely to receive a very modest boost, if anything, from the Commonwealth Government (2019, p. 177). The civilian workforce of the Commonwealth Government is expected to grow with an overall net increase of almost 1,300 positions across Australia. Some of the largest increases in net employment amongst Commonwealth Government agencies is taking place in agencies that are geographically spread across the country, including:

- Australian Taxation Office (an increase of 668 in average staffing levels)
- Department of Home Affairs (an increase of 425 in average staffing levels)
- Australian Federal Police (an increase of 312 in average staffing levels)
- Department of Defence (an increase of 262 in average staffing levels).

There are also three major risks to the outlook for employment growth posed by the Commonwealth Government. First, as already discussed, the 2019-20 Commonwealth Budget reveals that Commonwealth Government payments are expected to increase in real terms by a paltry 0.1 per cent in 2019-20, before gradually increasing again to 1.3 per cent in 2020-21, 1.9 per cent in 2021-22 and 2.0 per cent in 2022-23 (Commonwealth of Australia, 2019a, p. 5.5). There does not appear to be sufficient growth in Commonwealth Government payments to support continuing robust employment growth for the ACT economy in 2019-20.

The second risk is the Commonwealth Government's decentralisation program that was announced in April 2017 (Nash, 2017). The Commonwealth Government (2018a, p. 146) has already relocated the Rural Industries Research and Development Corporation from Canberra to Wagga Wagga, and relocated part of the Australian Pesticides and Veterinary Medicines Authority from Canberra to Armidale. The Commonwealth Department of Infrastructure, Regional Development and Cities has also announced that positions for the Indian Ocean Territories and positions for the Inland Rail unit will also be decentralised (Commonwealth of Australia, 2018a, p. 147).

In the 2019 Commonwealth Budget, the recently re-elected Coalition Government recommitted itself to decentralisation. Under the decentralisation agenda, all Australian Government departments and agencies have undertaken a thorough assessment of their functions to identify opportunities to locate appropriate functions and staff closer to communities and relieve the pressure on capital cities (Commonwealth of Australia, 2019c, p. 11). As part of the decentralisation agenda, the Commonwealth Government (2019c, p. 12) has announced a series of relocations of Commonwealth public servants, including the following:

- 76 positions to be relocated within the Murray-Darling Basin Authority from Canberra to Griffith, Mildura, Murray Bridget and Goondiwindi
- 25 Department of Infrastructure, Regional Development and Cities positions will move to Orange
- Indigenous Business Australia will relocate 10 Canberra-based positions to IBA Regional Offices in Western Australia, Queensland and New South Wales
- The Department of the Prime Minister and Cabinet's Indigenous Affairs Group will relocate 35 positions from Canberra to Broome, Coffs Harbour and Alice Springs
- The Australian Financial Security Authority will move 15 Canberra, Sydney and Melbourne positions to Perth, Hobart and Brisbane
- 69 new and relocated positions with the Australian Maritime Safety Authority will be moved to regional areas, including a new regional headquarters in Coffs Harbour and a new office in Airlie Beach
- as previously outlined in the 2018-19 Budget, five agencies have or will move 98 positions to locations outside of Canberra, inner Sydney and inner Melbourne.

As discussed above a third risk to employment growth in the ACT economy arises from the announcement during the recent federal election by the Coalition parties to increase the level of the Commonwealth Government efficiency dividend in the event it was re-elected. During the election, the Coalition parties announced that it would reduce departmental funding to Government agencies by $1.5 billion over the forward estimates through an increase in the efficiency dividend (Liberal Party of Australia, 2019). As part of this plan, the re-elected Coalition Government has announced its intention to reduce departmental funding by $136 million in 2019-20, $379 million in 2020-21, $506 million in 2021-22, and $493 million in 2022-23.

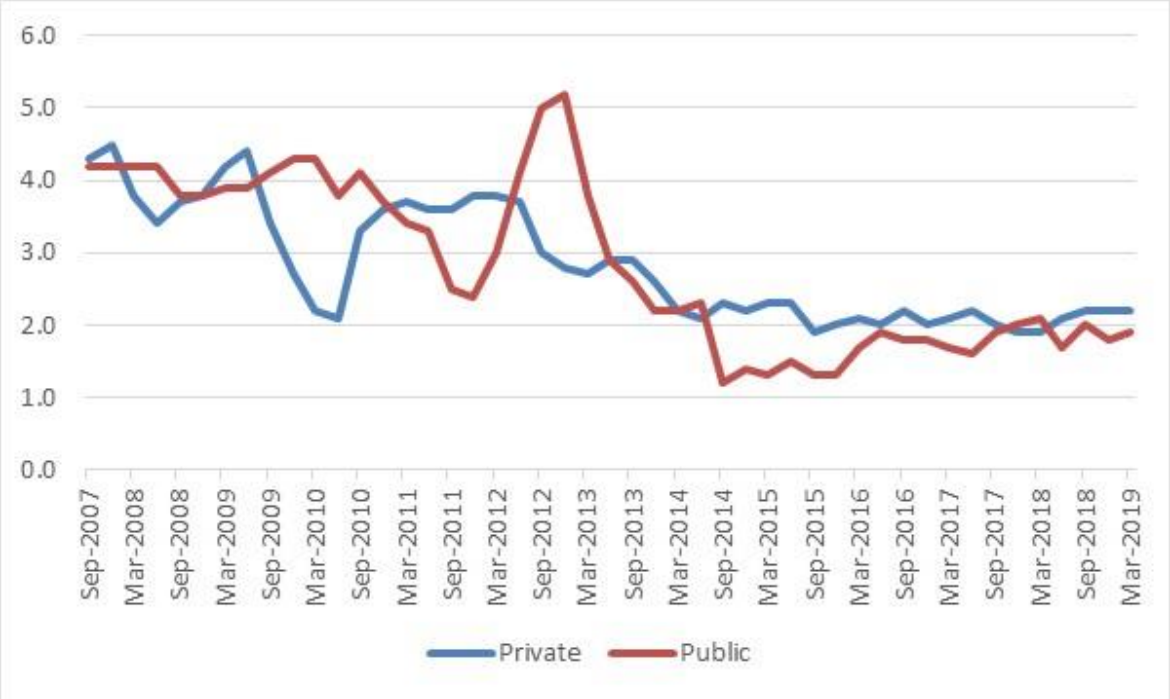
In light of the importance of the Commonwealth Government to the ACT economy, and given the current constraints on real payments growth by the Commonwealth Government, ongoing employment growth for the ACT in the order of 1½ per cent arguably represents an upper limit on what is realistically possible in the out-years.

3.3 Wage price index

The Wage Price Index (WPI) is currently running at 2.1 per cent through the year to the end of the March quarter 2019 (Australian Bureau of Statistics, 2019d), which is consistent with the ACT Budget estimate of 2¼ per cent for 2018-19.

Since 2013 wages growth in the private sector has generally outstripped that recorded within the public sector within the ACT as outlined in Figure 6 below.

Figure 6: Percentage Change in the ACT Wage Price Index for the Private and Public Sectors from Corresponding Quarter of Previous Year (Total hourly rates of pay excluding bonuses) – September quarter 2007 to March quarter 2019



Source: Australian Bureau of Statistics (2019d).

In light of the importance of the Commonwealth Government to the ACT economy, and given the current fiscal environment where real payments growth for the Commonwealth Government over the forward estimates from 2019-20 is expected to be the lowest in almost fifty years, it is extremely difficult to see improved wage outcomes for Commonwealth Government public servants in the immediate future. Furthermore, the Commonwealth Government's wages policy sets an upper limit on remuneration increases of 2.0 per cent per annum (Australian Public Service Commission, 2018).

In light of the Commonwealth Government's restraint in payments growth and its stated wages policy, a WPI outcome of 2 per cent for the ACT arguably represents an upper limit for the foreseeable future. On this basis, while a forecast outcome of 2½ per cent for the WPI in 2019-20 may not appear unreasonable, it does appear to be on the high side. Furthermore, projections of growth in excess of 2 per cent, eventually rising towards an annual increase of 3¼ per cent in the out years, appear to be overly optimistic. Outcomes around 2 per cent for growth in the WPI for the forecast in 2019-20 and projections not exceeding 2¼ per cent in the out-years would be more realistic.

3.4 Consumer price index

The Consumer Price Index (CPI) percentage change through the year to the end of the March quarter 2019 for Canberra was 1.8 per cent (Australian Bureau of Statistics, 2019b). While this is consistent with the 2019-20 ACT Budget estimate of 2¼ per cent change through the year in 2018-19, Canberra is currently enduring the highest rate of growth in consumer prices or inflation across all capital cities except Hobart, compared to a weighted national average of 1.3 per cent.

The ACT Government has responsibility over some of the areas recording price growth pressure in the year to the end of the March quarter 2019, including:

- Property rates and charges up 7.9 per cent
- Utilities up 5.9 per cent with electricity up 11.2 per cent and gas up 6.8 per cent (partially offset by a reduction in water and sewerage charges of 5 per cent)
- Medical and hospital services up 2.8 per cent
- Secondary education up 4.6 per cent
- Other services in respect of motor vehicles up 3.6 per cent (composed of some ACT Government charges including motor vehicle registration, roadworthiness tests, driver licence fees and parking fees).

Together these services account for 13 per cent of the weighting for the Canberra CPI.

Continuing large price increases in property rates reflects the rebalancing of the ACT tax base through an ongoing process of gradually reducing and eventually eliminating various taxes on conveyances (sometimes referred to as stamp duty on the sale of land) over a 20-year period and replacing the shortfall through an increase in the general rates system. During 2018-19 this expenditure class had the lowest increase since the rebalancing commenced in 2012-13.

The ACT Government's capacity to exert much influence over wholesale electricity and gas prices is virtually non-existent as similar price pressures are evident across the other capital cities.

In relation to medical and hospital services, most of the price pressure is largely beyond the responsibility of the ACT Government and the public hospital system that treats Australian citizens and Medicare card holders enrolled as public patients for free. Despite the ACT having the highest level of private health insurance hospital coverage in Australia at 54.2 per cent compared to the national average of 44.5 per cent, ACT residents are paying almost twice the national average in out-of-pocket payments for hospital medical services, at an average $270.69 for each patient in an ACT hospital compared to a national average of $155.47 (Australian Prudential Regulation Authority, 2018).[1] Similarly, the ACT's hospital system has the lowest proportion of specialist services with no gap, at just 78.7 per cent, compared with the national average of 87.5 per cent. However, some of the price pressure will be related to private patients treated within the ACT's public hospitals. Private health insurance covered the costs of almost 10 per cent of patients discharged from ACT public hospitals in 2016-17 (Australian Institute of Health and Welfare, 2018, p. 241).[2]

In relation to secondary education, the ACT Government is directly responsible for the education of around 56 per cent of all enrolled students through its public school system (ACT Government Education Directorate, 2018, p. 2).

The relative inefficiency of ACT Government service provision in relation to health and education could be driving higher prices coupled with the rebalancing of the tax base appears to be locking in

[1] The "gap", or out-of-pocket payment, is the difference between what Medicare and private health insurance cover, and the actual fees hospital specialists charge, that a private patient pays (Burdon, 2017).

[2] Breakdown by State and Territory for 2017-18 not yet available.

higher rates of inflation for the ACT over and above other price pressures in the economy. More government recurrent expenditure is spent per student in government schools at both the primary and secondary level in the ACT than in any other jurisdiction in Australia except the Northern Territory in 2016-17 (Productivity Commission, 2019). In relation to primary school students the cost is around 16 per cent higher than the national average, while for secondary students it is 20 per cent higher. The average cost of providing care for an admitted patient (overnight stay or same day) adjusted for casemix in public hospitals was almost 12 per cent higher for the ACT than the national average in 2016-17 (Productivity Commission, 2019).[3]

An example of the ACT Government's indifference towards efficient service delivery in education is its budget decision to transition externally contracted school cleaning services to a Territory-run service by establishing a cleaning workforce within the Education Directorate. Essentially, the ACT Government is bringing school cleaning services previously contracted out to the private sector inhouse and locking itself into self-service provision at an additional cost of almost $4.9 million over the next four years. By locking itself into self-service, the ACT Government is more susceptible to negative outcomes that result from the provider's self-interested behaviour. Absent lock-in problems, the ACT Government could simply replace an opportunistically behaving service provider with a more suitable one. The presence of lock-in problems weakens the disciplining power of markets and makes inefficient outcomes much more likely (Kim & Brown, 2012, p. 689). It also reduces the ACT Government's flexibility in terms of future service delivery.

For 2019-20 the budget forecast is for the CPI to remain constant at around 2¼ per cent growth, consistent with the Commonwealth Government's national forecast of around 2¼ per cent. While the forecast is not unreasonable, Pegasus suspect that ACT Government policies and practices may have locked in slightly higher inflation for the ACT than experienced in the other capital cities through tax reform and inefficient service delivery. On this basis, a CPI forecast in 2019-20 of 2½ per cent may be more realistic. In relation to the out-years, projections about ¼ per cent higher than the national forecasts from the Commonwealth Government Budget may be more appropriate rather than an equivalent setting.

3.5 Population growth

Only one quarter of population data is available for the 2018-19 financial year. The ACT recorded population growth of 1.9 per cent through the year to the end of the September quarter 2018 (Australian Bureau of Statistics, 2018) which is consistent with the ACT Budget estimate of 2 per cent growth in 2018-19.

In light of the importance of the Commonwealth Government to the ACT economy and given the current fiscal stance of the Commonwealth Government, it is difficult to see how population growth for the ACT will not moderate to some degree in the years ahead. On this basis, the 2019-20 Budget forecast and projections in the out-years for continuing population growth of 1¾ per cent appear to be overly optimistic, especially given that it appears employment opportunities within the Commonwealth Government in the ACT appear to be dwindling. Population growth in the order to 1¼ to 1½ per cent may be more realistic.

There are three potential risks to ACT population growth posed by the Commonwealth Government. Those are ongoing Commonwealth Government, fiscal restraint, the Commonwealth Government's decentralisation program and the increase in the efficiency dividend previously discussed above in relation to employment.

[3] Casemix adjustment takes account of variation in the relative complexity of the patient's clinical condition and of the hospital services provided, but not other influences on length of stay.

Another potential risk to population growth for the ACT over the medium term arises from the ACT Government's policy to phase out conveyance taxes on property (stamp duty on property purchases) and replace it with a new general rates system that has been ongoing for five years so far and has a further phase-in period over the next 14 years. The Housing Industry Association warned last year that a point could be reached where residents / employees of the ACT seek relief from ACT Government general rate increases through relocating to New South Wales:

> *… as the employment centres in the ACT are close to the NSW border it is possible to avoid the tax changes by relocating across state borders. If NSW does not change the application of stamp duty retains rate capping, interest rates remain low and the ACT continues to increase rates then there will be a point at which the tax burden on households could create an incentive to avoid ACT property taxes, in preference for NSW based property taxes. For example, the annual cost of borrowing $20,000 over 25 years to incur NSW stamp duty to purchase a $550,000 home, will be less than the annual increase in ACT rates.*

This means that for households that do not need to live close to the centre of Canberra, there could eventually be a tax advantage in relocating to NSW to avoid the relative high annual rates in the ACT by incurring the cost up-front imposed by NSW stamp duty (Reardon & Hopkins, 2018, p. 7).

4. Fiscal Position

The Budget Papers present a headline net operating deficit of $89.1 million in 2019-20 and a budget balance that returns to surplus in 2021-22 ($135.2 million). The expected return to surplus will be reliant on fiscal discipline – that is, Government minimising new initiatives or finding savings to offset new spending. The estimated 2021-22 surplus would be at risk in the event of unexpected spending pressures or shortfalls in revenue. Net debt (excluding superannuation) grows substantially in 2019-20 (by $532 million, or 24 per cent) and is not projected to reduce until 2022-23.

4.1 Operating Statement - Headline Operating Balance

The Budget Papers present a headline net operating balance of -$89.1 million in 2019-20, and a further deficit of -$66.8 million in 2020-21, after which the balance returns to a surplus.

Table 2: General Government Sector Headline Net Operating Balance

	2018-19 Est. Outcome $'000	2019-20 Budget $'000	2020-21 Estimate $'000	2021-22 Estimate $'000	2022-23 Estimate $'000
Revenue	5,646,494	5,871,208	6,161,739	6,526,479	6,982,651
Expenses	-5,799,285	-6,157,966	-6,440,570	-6,618,635	-6,813,259
Superannuation return adjustment	196,563	197,703	212.019	227,381	243,868
HEADLINE NET OPERATING BALANCE	**43,772**	**-89,055**	**-66,812**	**135,225**	**413,260**

Source: ACT Government (2019, p. 41)

Table 2 shows that revenue and expenses are both expected to increase relative to the 2018-19 estimated outcome, with spending growth higher than revenue in 2019-20 and 2020-21.

Revenue growth over the Budget and forward years largely reflects growth in higher ACT own-source taxation, increased GST revenues and increases in Commonwealth grants. There is also a doubling in the estimate of gains from contributed assets in 2022-23 over the estimate in 2021-22, for which the Committee may wish to seek an explanation from officials.

Forecast expenses of $6.2 billion in 2019-20 represent an increase of $358.7 million, or 6.2 per cent, over the expected 2018-19 outcome of $5.8 billion. This reflects increases in spending on general public services, health and education. Underlying expenses in forward years are forecast to grow at a rate of 4 per cent annually, a higher rate than in 2018-19.

The estimated surplus in 2018-19 is $43.7 million. The Budget estimates the balance will return to surplus in 2021-22, based on continuing revenue growth and a moderation in the rate of growth in expenses.

Detailed comment on the superannuation return adjustment is provided in this report below at subsection 10.4.

4.2 Medium term forecasts

The 2019-20 Budget is in deficit largely due to increased spending on services and infrastructure. There has been no drop in revenue, which remains on a steady growth path.

The Government's maintains it is committed to balancing the budget over the medium term, and has pointed to the past year's surplus and the estimated surpluses in the last two forward years as evidence of this commitment (ACT Government, 2019, p. 37).

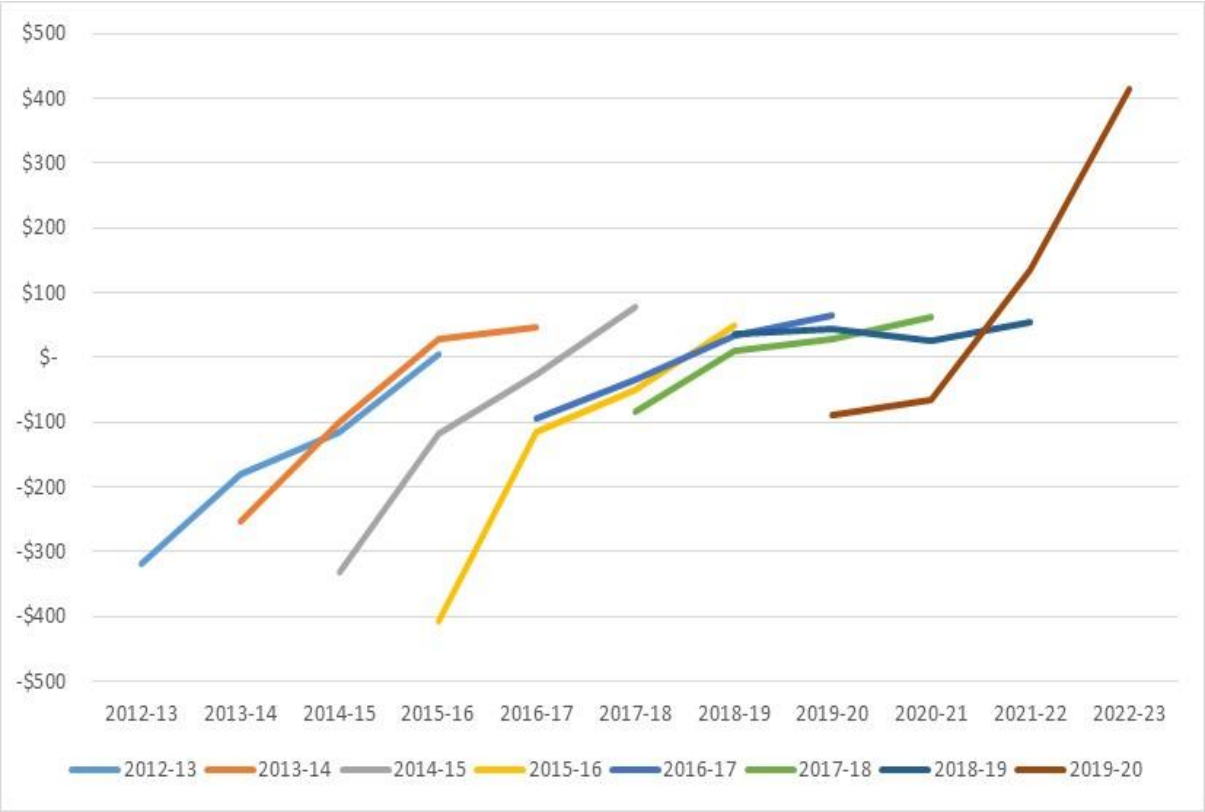
The ACT Government (ACT Government, 2019, p. 38) has also suggested in the Budget papers that its new revenue structure makes the ACT Budget more resilient to changes in the property market, because stamp duty now makes up a lower proportion of revenue. During the transitional stages to fully phasing out stamp duty by 2031-32 the Budget forecasts include both sources of revenue. The revenue changes are intended to "broadly revenue neutral over time". While the new approach is an improvement in fairness and reliability over the long term, the impacts on individual ratepayers can be very different in any one year depending on where they stand in the property market.

The planned return to surplus rests on a number of assumptions: the Australian economy continuing to grow at around 3 per cent per annum (2.75 per cent in 2019-20); ongoing Commonwealth payments in a range of areas currently covered by specific purpose payments; continuing population growth and associated land releases; continuing high levels of exports of education services. In our view the balance of risks to these assumptions is negative – that is, growth could be slower; there is a chance of a fall in Commonwealth payments; and there may be shifts of major public service functions out of the ACT, which would reduce population growth. Should overall Australian growth slow, there will also be a reduction in payments of goods and services tax, which would reduce grants to States and Territories.

The achievement of an operating surplus in the 2021-22 Budget and later would require revenue to continue to grow at historical rates, and a moderation of the Government's own spending in future years. To a large extent the estimated 2021-22 surplus is an artefact of the Budget assumption of "no policy change" – that is, the estimates are based on policies current at the time of the Budget and do not assume further new spending initiatives. History suggests governments will introduce new programs, or be faced with pressures on existing programs, which will require additional expenses in future Budgets. Without a strategy to offset these pressures with savings in other parts of the Budget, it is difficult to see a return to surplus as a realistic prospect. These and other risks to the fiscal outlook are set out in section 8 of this report.

Figure 7 compares the predicted trajectory of the fiscal balance presented in successive Budget Papers since 2010-11.

Figure 7: Forecast returns to surplus ($ million)



Sources: ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019)

The figure shows that over successive Budgets, forecast surpluses have tended to recede in time.

The forecast return to surplus in 2021-22 will provide confidence that the ACT Government remains committed to the achievement of its announced fiscal strategy. However, the combination of deficits in the coming two years and deficits experienced in recent years suggest that over a longer time period the ACT still falls short of achieving its aim of a budget balance.

4.3 Balance sheet measures

The Budget Papers offer a number of balance sheet measures of the Territory's fiscal position.

Table 3 presents the key balance sheet measures for the General Government Sector (GGS).

Table 3: General Government Sector Key Balance Sheet Measures[4]

	2018-19 Est. Outcome $m	2019-20 Budget $m	2020-21 Estimate $m	2021-22 Estimate $m	2022-23 Estimate $m
Net debt (excluding super)	2,181.7	2,713.9	3,257.6	3,363.5	3,019.2
Net financial liabilities	6,571.0	7274.9	7,809.4	8,047.0	7,981.8
Net worth	17,635.1	17,503.7	17,555.1	17,728.9	18,132.0

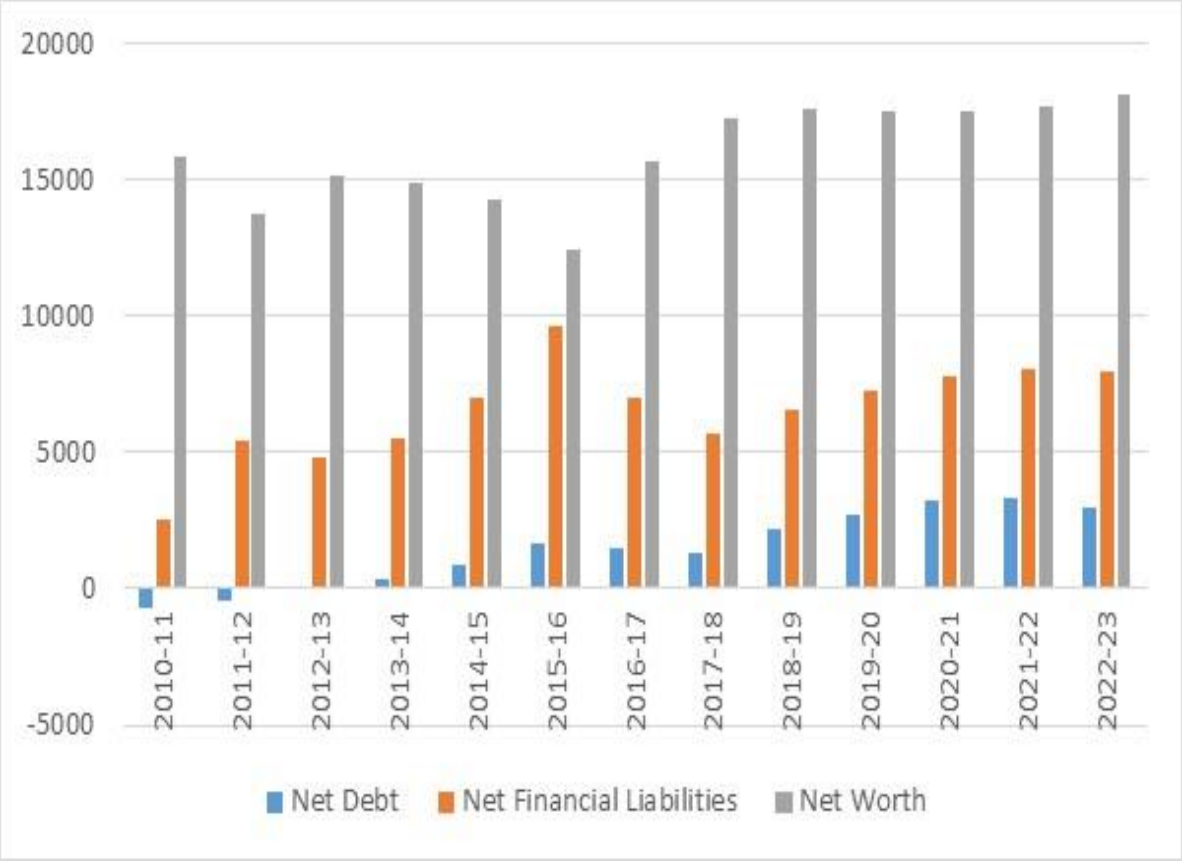
Source: ACT Government (2019, p. 293)

Net worth is positive and is forecast to increase from $17.5 billion to $18.1 billion across the budget and forward estimates, an increase of 3.3 percent.

While the Territory's balance sheet measures indicate a reasonably healthy fiscal position, the trends in the growth of net financial liabilities and net debt raise some concerns. Net worth across the Budget and forward years has deteriorated since the Budget of 2018-19 in which net worth was projected to increase by 4.1 percent.

Figure 8 illustrates the scale of changes in net debt and net financial liabilities relative to net worth over time.

Figure 8: Assets and Liabilities



Source: ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019)

[4] Definitions and further discussion of the application of these measures are provided in section 7 of this report.

Net debt and net financial liabilities remain relatively low compared with net worth. However, they are both growing much faster than net worth, particularly in respect to the Budget and the 2020-21 and the 2021-22 forward years. Net worth is expected by 2022-23 to be 2.8 percent higher than in 2018-19. However, by the end of the forward estimates period in 2022-23, net financial liabilities are expected to be 18 percent higher than in 2018-19, and the level of net debt is expected to be 28 percent higher than in 2018-19.

The Territory's balance sheet can be compared to the size of the economy it serves, typically measured by the gross state product (GSP). Table 4 shows the ratios of net financial liabilities, net debt, and net worth to GSP.

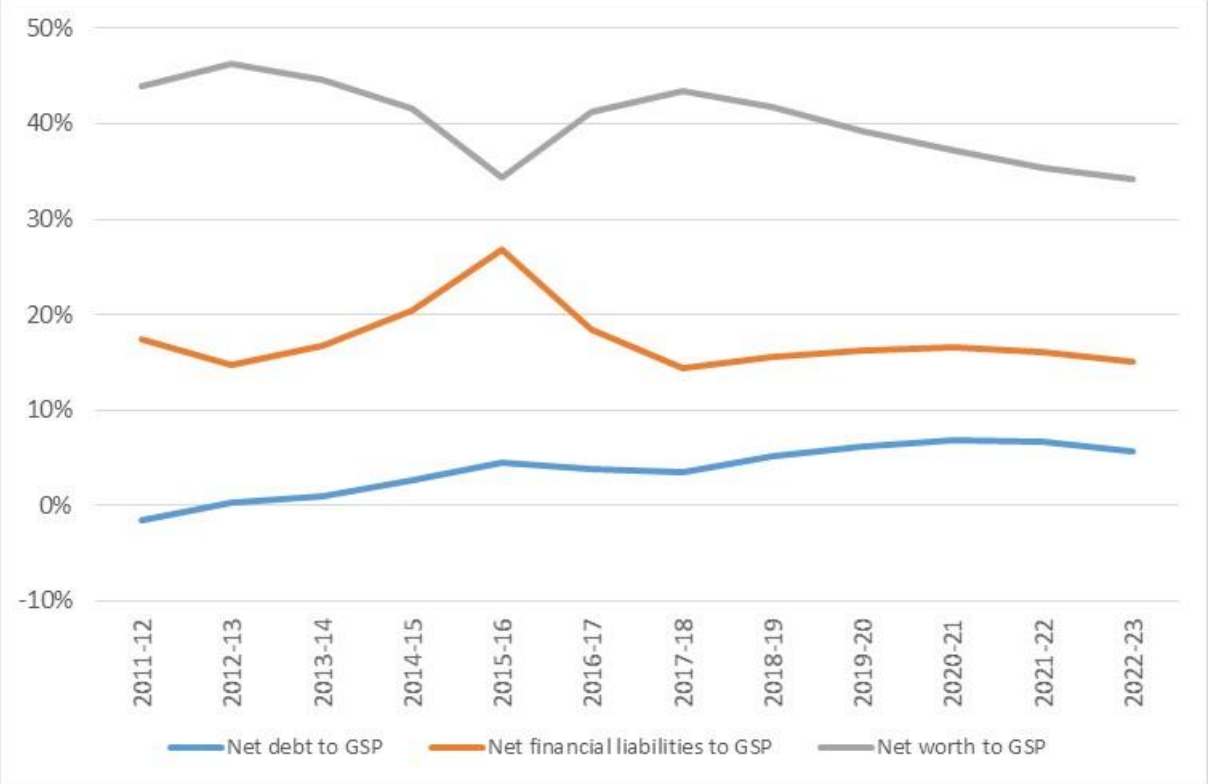
Table 4: Key balance sheet measures as a percentage of Gross State Product

	2018-19 Est. Outcome	2019-20 Budget	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Net debt to GSP (%)	5.2	6.1	6.9	6.7	5.7
Net financial liabilities to GSP (%)	15.5	16.3	16.6	16.1	15.0
Net worth to GSP (%)	41.7	39.3	37.2	35.4	34.2

Source: ABS (2018a), ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019)

Figure 9 illustrates the change over an extended period of these measures relative to GSP. Net debt to GSP and net financial liabilities to GSP are expected to worsen over the next two years through slight increases while net worth to GSP ratio is expected to deteriorate over the course of the budget year and the out years.

Figure 9: Assets and liabilities to GSP



Source: ABS (2018a), ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019)

Over the long-term, the Territory's balance sheet measures have continued to deteriorate when expressed as a proportion of GSP.

There is no doubt that the Territory's fiscal position is sustainable, when measured in terms of the Territory's ability to service its borrowings and other liabilities on a no policy change basis without incurring an excessive debt accumulation (Blanchard, Charouaqui, Hagemann, & Sartor, 1990).

However, a continued build-up of net debt and financial obligations over time is not desirable, and can leave future governments vulnerable to external shocks.

It is noted that the increase in financial liabilities is due to a mandatory change in the way leases are accounted for, whereby leases are now brought onto the balance sheet, including the ongoing lease payment obligations.

4.4 Immediate financial position

It would be desirable if future Budgets were to provide additional measures of the Territory's capacity to meet its obligations.

In recent financial audits, the ACT Auditor-General has employed measures such as:

- Assets to liabilities coverage;
- Short term assets to short term liabilities coverage; and
- Financial assets to liabilities coverage (ACT Auditor-General, 2015, pp. 12-13).

The benefit of these measures is that they provide an indication of the Territory's capacity to meet its obligations over the short and medium-term. As part of this review, Pegasus undertook analysis of the capacity of the General Government sector to meets its financial obligations using similar ratios.

The General Government balance sheet indicates a positive net assets/net worth position ($17.5 billion). Short terms assets are generally increasing across the budget and forward years. Financial assets exceed net financial liabilities by approximately 2.2 times. Short term liquid assets exceed short term liquid liabilities by approximately 1.5 times. However, it should be noted that borrowings, other than leases, increase over the forward years.

While an overall cash deficit is reported ($-509.9 million), a positive General Government net cash from operations is reported ($204.9 million). However, the cash deficit has increased substantially compared to the revised forecast for 2018-19 and the net cash from operations has reduced since 2018-19. Nevertheless, these positions generally improve over the forward years. (The deficit is derived after accounting for both the net position from operations and investments in non-financial assets.)

Overall, this analysis indicates a positive position in terms of the General Government sector's capacity to meet its immediate obligations.

5. Revenue

Revenue is expected to increase by $224.7 million from an estimated outcome of $5.6 billion in 2018-19 to almost $5.9 billion in 2019-20. In contrast to 2018-19 where the ACT Government was moving closer towards a hard budget constraint whereby it was responsible for raising most of its additional revenue, in 2019-20 and the out years it is moving away yet again from a hard budget constraint and becoming increasingly dependent on the Commonwealth Government to fund increases in revenue. The lack of a hard budget constraint for the ACT Government reduces the incentives and disciplines to provide more efficient service delivery. In continuing to pursue its tax reform, one potential pitfall the ACT Government needs to be aware of is the risk of tax leakage across the border to New South Wales from those seeking to escape the impost of higher general rates in the ACT.

5.1 Overview

ACT Budget revenue is expected to increase from an estimated outcome in 2018-19 of $5.6 billion to almost $5.9 billion in 2019-20.

The 2018-19 estimated outcome is $24.8 million lower than originally forecast. Lower revenue than originally forecast in last year's budget arose from:

- a $63.6 million reduction in contributed assets
- a $25.9 million reduction in dividend and income tax equivalents
- a $19.9 million reduction in goods and services tax
- a $16 million reduction in interest income.

Lower revenue from these sources was partially offset by:

- increased revenue from own-source taxation of $51.8 million
- increased revenue from Commonwealth grants of $14.6 million
- increased other revenue of $36.8 million largely arising from a gross-up of the GST on non-government school funding that was previously included in Commonwealth grants.

The forecast revenue of almost $5.9 billion in 2019-20 is only slightly higher than the estimates for 2019-20 contained in last year's Budget.

The main sources of revenue over the Budget and forward years are summarised in Table 5 below.

Table 5: General Government Sector Revenue

	2018-19 Est. Outcome $'000	2019-20 Budget $'000	2020-21 Estimate $'000	2021-22 Estimate $'000	2022-23 Estimate $'000
Own Source Taxation	1,949,994	2,051557	2,178,546	2,301,715	2,416,781
Goods and Services Tax	1,308,498	1,410,123	1,475,401	1,568,639	1,657,438
Commonwealth Grants	997,552	995,381	1,049,918	1,106,452	1,178,262
Gains from Contributed Assets	156,950	142,292	132,818	145,165	297,119
Sales of Goods and Services	541,533	568,005	582,000	591,425	604,312
Interest Income	102,574	115,138	109,705	111,350	110,288
Distribution from Financial Investments	36,465	45,330	50,040	53,561	57,314
Dividends and Income Tax Equivalents	371,536	350,124	390,043	452,723	460,959
Others	181,392	193,258	193,268	195,449	200,178
Total	**5,646,494**	**5,871,208**	**6,161,739**	**6,526,479**	**6,982,651**

Source: ACT Government (2019, p. 226).

Revenue growth over the Budget and forward years largely reflects growth in higher ACT own-source taxation, increased GST revenues and increases in Commonwealth grants. There is also a curious doubling in the estimate of gains from contributed assets in 2022-23 over the estimate in 2021-22.

5.2 Vertical fiscal imbalance

Vertical fiscal imbalance refers to circumstances in which one level of government spends less than it collects in taxes and charges, while other levels of government spend more than they raise from taxes and charges. In Australia, sub-national governments typically spend more than they collect in revenue and rely on transfers from higher levels of government to finance part of the revenue shortfall. It is widely perceived that the heavy reliance of state and local governments on transfers from above undercuts incentives for responsible fiscal decision-making (Oates, 1999, p. 1143).

The degree to which a sub-national government would be held accountable for the revenues at its disposal would increase with the extent of financing through taxes and charges imposed on constituents by that government. Ideally, taxation and charging effort by the sub-national government would be closely matched to revenue requirements. Sub-national taxes should at least be large enough to impose a noticeable burden on constituents.

A 'hard budget constraint' is one under which the sub-national government may only increase or decrease spending by increasing or decreasing revenues in a way that they are publicly responsible for (Bird & Smart, 2010, p. 78), where decisions to expand expenditure programs are made with regard to the political and economic costs of raising the revenue to meet them.

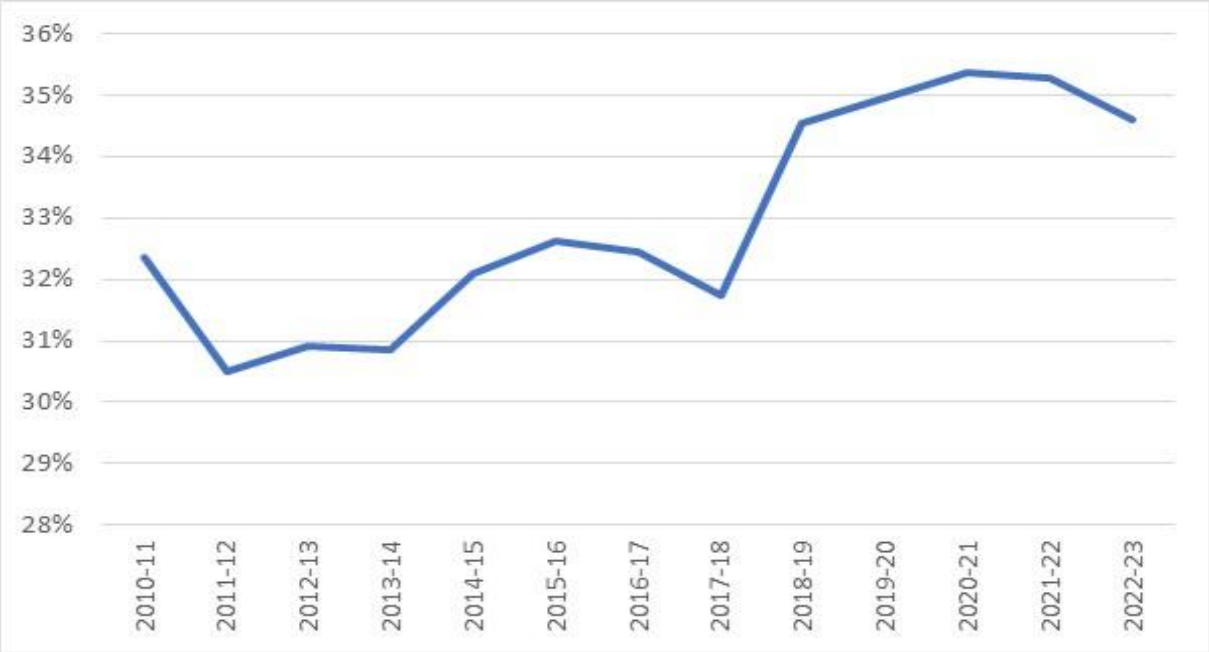
In the event that it is not possible to completely overcome the problem of vertical fiscal imbalance, the importance of sub-national governments having responsibility at the margin for raising their own revenues has also been strongly emphasised in the literature (Bahl & Bird, 2008, p. 8; Oates, 2008, p. 326). In this case, decisions to expand government expenditure programs would be made having full regard to the additional political and economic costs of raising the revenue. The critical requirement

is that, regardless of the form of sub-national taxation, sub-national governments should control the effective tax rate at the margin (Bird & Smart, 2010, p. 78).

In the 2018-19 Budget the ACT Government moved toward these conditions, with the Commonwealth Government contributing only 8.5 per cent of the additional revenue collected in 2018-19 over and above the previous financial year with the increase being more than funded through increases in own source revenue.

The forward estimates also exhibit some encouraging signs that the ACT Government is ameliorating the extent of vertical fiscal imbalance in future years through assuming greater responsibility for raising its own source taxation at the margin as outlined in the Figure 10 through increasing the percentage of its revenue that it raises through from own-source taxation except for a slight moderation towards the end of the forward estimates.

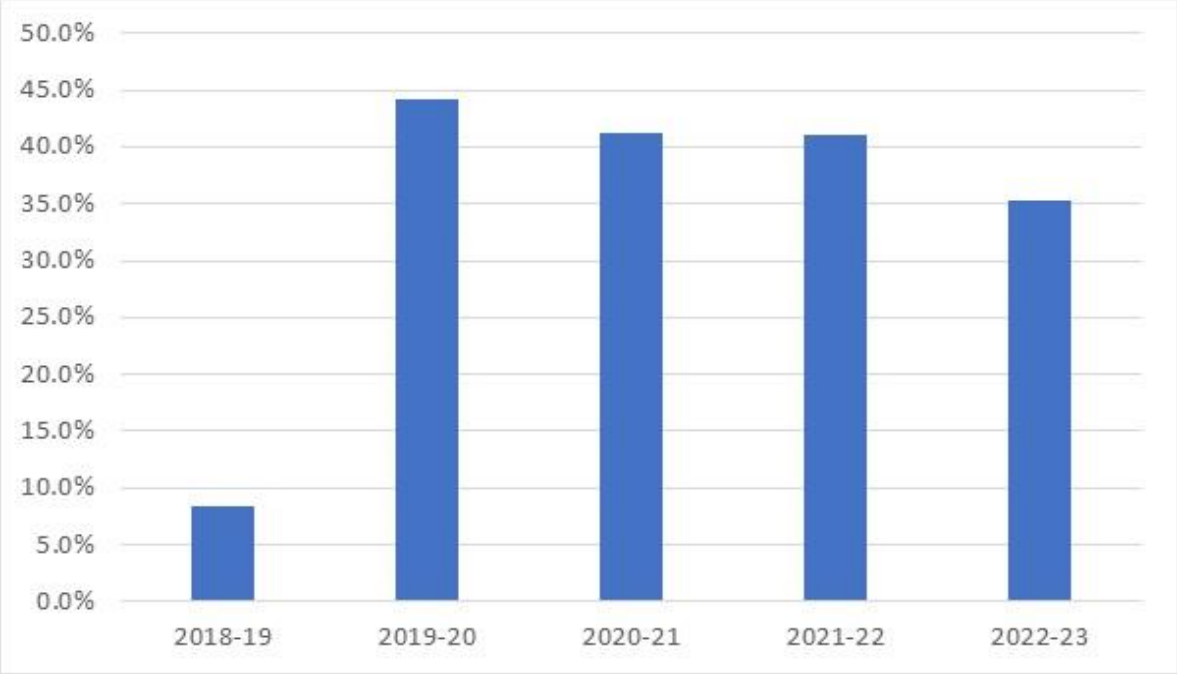
Figure 10: Percentage of ACT Government Revenue from Own-Source Taxation – 2010-11 to 2022-23



Source: ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019).

On the other hand, following 2017-18 it does appear the ACT Government will become increasingly dependent once again on the Commonwealth Government in the Budget and the out years, through GST tax revenue and Commonwealth Government grants, to fund increases in its revenue and may thus escape the incentives and discipline imposed by a hard budget constraint. This is outlined in Figure 11 below.

Figure 11: Percentage of Increased ACT Government Revenue Funded by Increases in Commonwealth Government Funding



Sources: ACT Government (2019, p. 226).

The major caveat on this is that the amounts of Commonwealth Government funding within the budget year and over the forward estimates can be subject to major revision. In relation to the proceeds of GST revenue, State and Territory allocations are dependent upon the GST sharing relativities for that financial year as determined by the Commonwealth Grants Commission and these relativities are not forecast beyond the Budget year (Commonwealth of Australia, 2019b, p. 5). As such, the ACT Government's forward estimates in relation to proceeds from GST revenue could be subject to significant revision. Agreements between the Commonwealth, States and Territories regarding health and education are also set to expire, and as such, Commonwealth Government grants for specific purposes in relation to health and education in the forward estimates could be subject to significant revision as new agreements come into effect. Similarly, ACT Government revenue from Commonwealth Government grants related to the National Partnership Agreements could be curtailed if expiring agreements are not renewed.

Pegasus (Davey & Fisher, 2017, p. 17) has previously suggested that the lack of a hard budget constraint on the ACT may explain the relative inefficiency of the ACT Government in relation to the provision of public health and education services. The move towards a hard budget constraint for the ACT Government would provide an incentive to ensure that it pays much greater attention to the cost and relative efficiency of the services that it provides.

5.3 Tax reform

In the 2012-13 Budget, the ACT Government committed itself to rebalancing its tax base through an ongoing process of gradually reducing and eventually eliminating various taxes on conveyances (sometimes referred to as stamp duty on the sale of land for residential and commercial purposes) over a 20 year period and replacing the shortfall through an increase in the general rates system and has already abolished taxes on insurance premiums. In relation to Conveyance Duty the ACT Government (2012, p. 46) commented at the time:

> *The Government will abolish Conveyance Duty over a 20-year period. Over the next five years, tax rates will be progressively reduced to phase out Conveyance Duty in the longer term.*
>
> *The reduction in the marginal tax rate will focus on the lower tax brackets. …*
>
> *The tax brackets and reduced tax rates will be applicable to both residential and commercial sector transactions.*

In relation to general rates, the ACT Government (2012, p. 47) commented at the time:

> *The Government will improve the progressivity of the General Rates system with the introduction of a number of tax brackets and increasing marginal tax rates.*

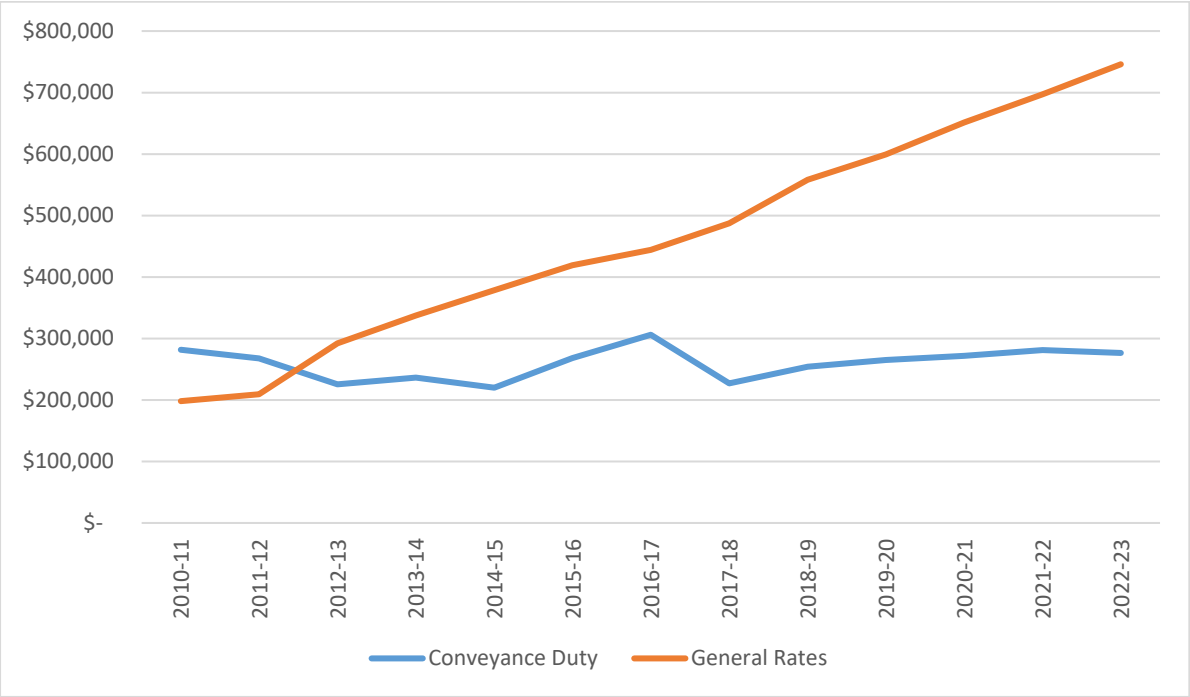
The phasing out of stamp duties and the phasing in of the new general rates system over the course of 20 years will be implemented through a series of four separate five year plans to avoid a shock to the property market and to enable the change to be revenue neutral (Reardon & Hopkins, 2018, p. 4). At the end of 2017-18 saw the end of first five year plan.

The report entitled *Australia's Future Tax System: Report to the Treasurer* (Henry, Harmer, Piggott, Ridout, & Smith, 2010a, p. 473), more commonly known as the Henry Tax Review, was of the view that stamp duty on conveyancing discouraged people from changing their housing to better suit their requirements because of the high transaction costs imposed by stamp duty for doing so:

> *Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system. Recognising the revenue needs of the States, the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those on broad consumption or land bases. (Henry, Harmer, Piggott, Ridout, & Smith, 2010, p. 263)*

Examination of revenue generated from conveyance duty and general rates since 2010-11 through to the out years for the current budget reveals that revenue from conveyance duty has generally been flat since the reform was introduced, hovering at and below the $300 million mark, while revenue from general rates has increased from just under $200 million in 2010-11 to almost $750 million at the end of the forward estimates. This is outlined in Figure 12 below.

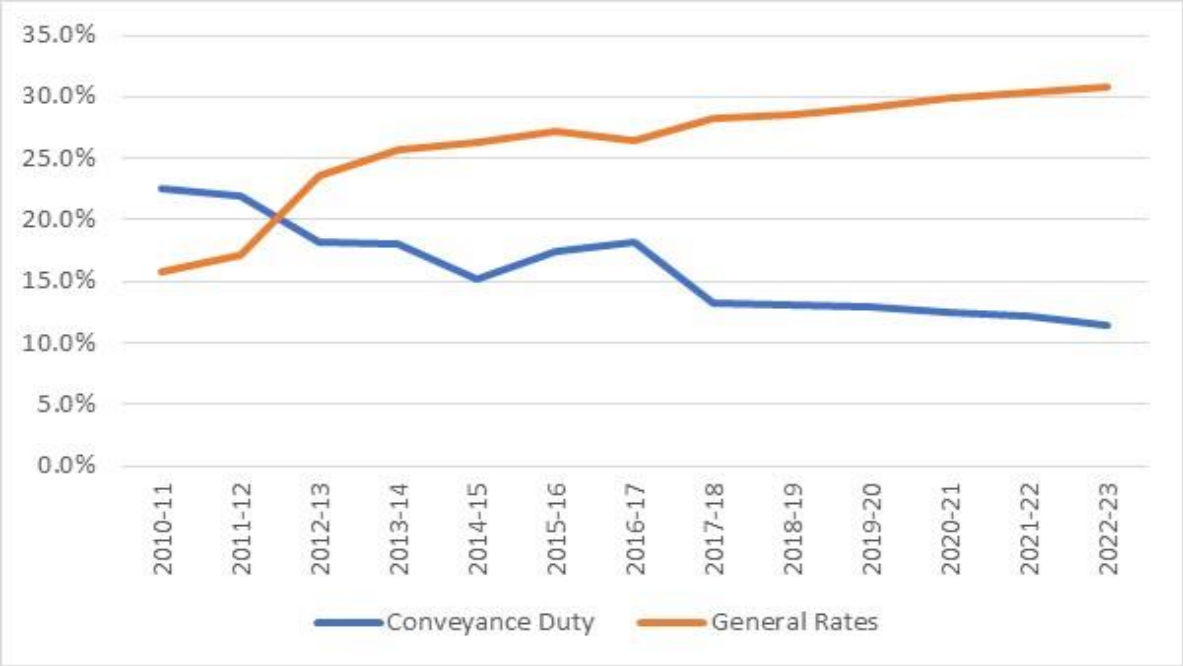
Figure 12: ACT Government Revenue from Conveyance Duty and General Rates – 2010-11 to 2022-23 ($'000)



Source: ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019).

When contributions of conveyance duty and general rates to ACT Government own source revenue is examined, it can be seen that general rates is almost expected to double from 15.8 per cent of own source revenue in 2010-11 to 30.9 per cent at the end of the forward estimates in 2022-23, while over the same period the relative contribution of conveyance duty has fallen from 22.5 per cent to 11.4 per cent. This is outlined in Figure 13 below.

Figure 13: Percentage Contribution of General Rates and Conveyance Duty to ACT Government Own Source Revenue – 2010-11 to 2021-22



Source: ACT Government (2019).

Rather perversely, due to bracket creep associated with rising ACT property prices, the relative contribution to own source revenue from conveyance duty actually rose during 2015-16 and 2016-17. On this basis, the Housing Industry Association has previously summarised the impact of the first five year plan in the following terms:

> *Lower-value homes (under $300,000) are the cohort that has experienced material stamp duty reductions, while the increases in general rates for these lower-value homes has been relatively modest. At the same time, higher value homes in the ACT have seen the applicable rates of stamp duty fall only modestly and general rates obligations increase substantially.*
>
> *The average house price in Canberra exceed $670,000 in January 2018. The average price of units exceed $431,000. The majority of homes are also likely to have an unimproved land value exceeding $300,000.*
>
> *Consequently, from the perspective of the overall market, the structure of the reform can more accurately be described as a process of first phasing in the new rates system and then phasing out stamp duties. The former has occurred (although not concluded) during this first stage of the reform program, while the latter has yet to occur in a material way.*

In continuing to pursue its tax reform, one potential pitfall the ACT Government needs to be aware of is risk of tax leakage across the border to New South Wales from those seeking to escape the impost of higher general rates. The Housing Industry Association has warned that a point could be reached where residents / employees of the ACT seek relief from ACT Government general rate increases through relocating to New South Wales:

> *… as the employment centres in the ACT are close to the NSW border it is possible to avoid the tax changes by relocating across state borders. If NSW does not change the application of stamp duty retains rate capping, interest rates remain low and the ACT continues to increase rates then there will be a point at which the tax burden on households could create an incentive to avoid ACT property taxes, in preference for NSW based property taxes. For example, the annual cost of borrowing $20,000 over 25 years to incur NSW stamp duty to purchase a $550,000 home, will be less than the annual increase in ACT rates.*
>
> *This means that for households that do not need to live close to the centre of Canberra, there could eventually be a tax advantage to relocate into NSW to avoid the relative high annual rates in the ACT by incurring the cost up-front imposed by NSW stamp duty. (Reardon & Hopkins, 2018, p. 7)*

The ACT may need to pay careful attention to avoid any unintended consequences arising from its tax reform.

5.4 Contributed Assets and Dividends

Contributed assets

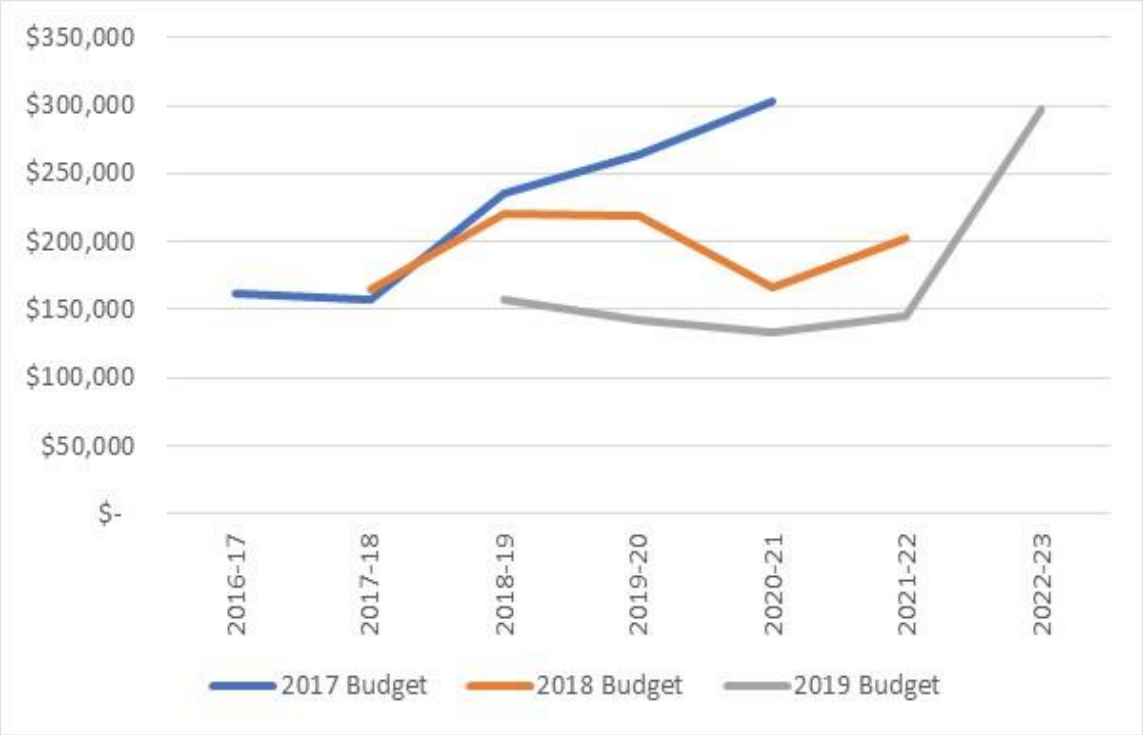
The Budget forecasts revenue from contributed assets of $142 million in 2019-20, a decrease of $78.2 million or 36 per cent over the 2018-19 Budget and a decrease of 9 per cent over the estimated outcome for 2018-19. Contributed assets make up approximately 2.4 percent of total revenue. These assets are non-financial transactions that represent the estimated value of assets received by the ACT Government from other parties (generally Government entities outside of the General Government sector) without an obligation to provide approximately equal value to the party providing the contribution. In the 2019-20 Budget, gains from contributed assets mostly relate to

land development infrastructure assets transferred to the General Government sector from the City Renewal Authority, Suburban Land Agency and private developers, and the Large-scale Generation Certificates received by the ACT Government for the generation of renewable electricity under the Commonwealth Government's Large-scale Renewable Energy Target.[5]

There have been significant changes in the revenue estimates from the 2018-19 Budget Review through the re-profiling of revenue from contributed assets in the out-years. Gains from contributed assets other than Large-scale Generation Certificates, increase significantly across 2020-21 to 2022-23. However, gains from Large-scale Generation Certificates tappers off over these years.

The revenue profiles from the four most recent budget updates are provided in Figure 14 below.

Figure 14: Estimated Revenue from Contributed Assets ($'000) – 2016-17 to 2022-23



Sources: ACT Government (2017; 2018a, 2019).

The Budget treatment of revenue from contributed assets and dividends is not fully transparent and requires some explanation.

The treatment of the Large-scale Generation Certificates in the 2019-18 and 2018-19 Budgets raises a number of timing and valuation issues that merit additional explanation. Further information on the Large-scale Generation Certificates is provided below in subsection 5.5.

Dividends

Total dividends in 2019-20 are expected to be $246 million, a decline of $19.7 million from the level expected to be collected in 2018-19. Dividends are expected to increase in 2020-21 to $290.4 million and then to $336.3 million and $348.1 million in 2021-22 and 2022-23 respectively.

[5] The 2019-20 Budget Papers refer in different places to Renewable Energy Certificates and Large-scale Generation Certificates. Our understanding is that Renewable Energy Certificates (RECs) were the primary commodity in the Renewable Energy Target (RET) prior to 1 January 2011 and that from 1 January 2011 RECs were split into types: Small-scale Technology Certificates (STCs) and Large-scale Generation Certificates (LGCs). RECs is still used as a general term covering both STCs and LGCs (Clean Energy Regulator, 2018).

Table 6: Dividends from ACT Public Trading Enterprises

	2018-19 Est. Outcome $'000	2019-20 Budget $'000	2020-21 Estimate $'000	2021-22 Estimate $'000	2022-23 Estimate $'000
Dividends					
Dividends – Icon Water	69,521	60,388	61,235	69,050	73,741
Dividends – CIT Solutions	500	500	500	500	500
Dividends – City Renewal Authority and Suburban Land Agency	104,698	106,779	142,841	174,716	175,256
Dividends from Financial Investments	75,760	78,623	85,837	92,036	98,640
Total Dividends	**250,479**	**246,290**	**290,410**	**336,302**	**348,136**

Source: ACT Government (2019, p. 250).

Table 6 reveals that the major reasons for the decline in dividends in 2019-20 of $4.2 million is the expected fall in dividend from Icon Water of $9.1 million partially offset by increased dividends from financial investments and the City Renewal Authority (CRA).

The fall in Icon Water dividend in 2019-20 is mainly due to decreased energy revenues from the one-off impact of the feed-in-tariff gain in 2018-19, and the impact of the Australian Electricity Regulator draft decision on electricity prices causing reductions in the weighted average cost of capital from 1 July 2019 (ACT Government, 2019, p. 250).

Dividends from the Suburban Land Agency (SDA), Icon Water and CRA were the subject of a range of technical adjustments as part of the 2018-19 Budget Review. These adjustments are not explained and accordingly, the Committee may wish to pursue this with officials.

It is further noted that dividends from financial investments has increased by $19.2 million in 2018-19 from the original budget estimate and continues to grow in the Budget year and across the out years. This is primarily due to a higher weighting on shares within the investment portfolio.

More generally, there is a case for greater transparency in the presentation and explanation of the flows expected through contributed assets and dividends.

The Committee may wish to seek further information on these matters from officials.

5.5 Large-scale Generation Certificates

The 2019-20 Budget reflects the expense and revenue components associated with Large-scale Generation Certificates. These include credits that are received for the generation of renewable electricity under the Commonwealth Government's Large-scale Renewable Energy Target and the expense associated with the Certificates when they are sold and transferred to other individuals and businesses, or voluntarily surrendered to the Clean Energy Regulator.

The Budget papers indicate that revenue from the Certificates has reduced significantly. The 2018-19 Budget indicated a gain of $131.9 million which was revised downwards in the Budget Review to its current estimate of $68.2 million. The Budget records revenue of $51.4 million in 2019-20, down significantly from last year's budget estimate of revenue of $110.4 million for 2019-20. The major reductions in 2018-19 to 2019-20 from last year's budget are due to net market reductions in both the value of the Certificates and surrender values, which are recorded as technical adjustments (ACT Government, 2019a, p. 28).

The ACT began accounting for Large-scale Generation Certificates in the 2017-18 Budget (2017, p. 411).

Conventional accounting practice would be to record the Certificates as revenue at market value upon receipt in the financial year in which the Certificates are created and recognised and to create an expense that reflects the market value of the Certificates when they are surrendered.

Given developments in the national electricity market and significant uncertainty in relation to the National Energy Guarantee, the Government has deferred the surrender of Certificates until 2020-21.

The change in timing of the surrender of the Certificates is expected to have a large, positive impact on the Budget position over the Budget and forward years. A deferral of the surrender will reduce expenses, effectively reversing the adjustments to incorporate the Large-scale Generation Certificates in previous Budgets. The value of Large-scale Generation Certificates is subject to price fluctuations arising from supply and demand within the market, as discussed above.

The Committee may wish to ask officials to provide advice on:

- the expected schedule of revenue and expenses relating to the Large-scale Generation Certificates over the Budget and forward years
- given the uncertainties surrounding the national electricity market, what economic value is embedded in the Certificates and what reference point was used to determine a reliable value for these certificates
- details on the technical adjustment undertaken in the 2018-19 Budget Review.

5.6 Traffic Infringement Fines

One curious feature contained in the category of other revenue is a 15 per cent increase in traffic infringement fines that is expected to increase from $28.3 million in 2018-19 to $32.5 million in 2019-20. The increase in 2019-20 has been attributed to "to the reactivation of suspended traffic cameras and indexation" (ACT Government, 2019, p. 252). Presumably the reactivation of suspended traffic cameras refers to cameras along Flemington Road and Northbourne Avenue that were suspended due to the construction of Light Rail Stage 1. The Committee may wish to seek clarification on the 15 per cent increase in traffic infringement fines in 2019-20.

6. Expenditure

Expenses are forecast to grow over the budget and forward estimates from $6.2 billion in 2019-20 to $6.8 billion in 2022-23. Health, Education and General Public Services each account for more than 20 per cent of the total and together they comprise more than two thirds of Territory expenses. Growth in spending is driven mainly by growth in demand for services, debt servicing and wage costs. New programs are a secondary driver of growth. The net total for new initiatives in 2019-20 is $108 million, 1.75 per cent of total expenses. Health has by far the largest number of new initiatives, with 46, and remains the largest single function in the Territory.

6.1 Overview

Forecast expenses of $6.2 billion in 2019-20 represent an increase of $358.7 million, or 6.2 per cent, over the expected 2018-19 outcome of $5.8 billion.

Table 7 sets out the forecasts for aggregate expenses for the budget and forward years.

Table 7: Budget and forecast expenses, 2017-18(est.), 2018-19 and 2019-20 to 2021-22

	2018-19 Est. Outcome $'000	2019-20 Budget $'000	2020-21 Estimate $'000	2021-22 Estimate $'000	2022-23 Estimate $'000
Expenses	**-5,799,285**	**-6,157,966**	**-6,440,570**	**-6,618,635**	**-6,813,259**

Source: ACT Government (2019, p. 41).

Table 7 shows that expenses are expected to grow over the Budget and forward estimates period to $6.8 billion in 2022-23. This represents growth of 17.5 per cent over the estimated 2018-19 outcome, or an average rate of 4.4 per cent per annum growth to 2022-23. This is marginally higher than the rate of growth forecast last year although broadly consistent with growth in recent years.

The estimated outcome of $5.8 billion in 2018-19 is as forecast in last year's Budget. The Budget year estimate of $6.2 billion is, however, higher than the $6.0 billion forecast in the 2018-19 Budget and 2018-19 Budget Review.

The main reasons for the increase in 2019-20 forecast since the last Budget are: additional health services, including expanding the Centenary Hospital for Women and Children, expansion of services at Canberra Hospital, and increased disability services; educational funding including support for individual student needs; policing, which grows rapidly over the forward estimates; and increases in wages and superannuation for the ACT government workforce. Interest costs are estimated to rise by 22 per cent from $179 million in 2018-19 to $218 million in 2019-20, driven primarily by increased debt. Partly offsetting these increases are reduced expenses as past years' programs such as the Asbestos Response Taskforce near completion.

6.2 Expenses by function

The Budget Papers include a classification of expenses by the functions, or socioeconomic objectives, that general government units aim to achieve through various kinds of outlays. This classification is intended to allow trends in government outlays on particular functions or purposes to be examined over time (International Monetary Fund, p. 75).

In the ACT, General Government Sector expenses are dominated by spending on health, general public services and education. Together, these functions account for around 70 per cent of all government expenses in 2019-20.

Table 8 sets out the estimates of General Government Sector expenses by function for the period 2018-19 to 2022-23.

Table 8: Budget and forecast expenses, by function, 2018-19 (est.), 2019-20 to 2022-23

	2018-19 Est. Outcome $'000	2019-20 Budget $'000	2020-21 Estimate $'000	2021-22 Estimate $'000	2022-23 Estimate $'000
General Public Services	1,192,642	1,353,880	1,413,631	1,456,889	1,479,428
Public Order and Safety	467,717	502,676	511,279	527,389	539,656
Economic Affairs	94,293	86,274	159,589	99,184	101,386
Environmental Protection	116,810	118,272	113,626	116,182	119,930
Housing and Community Amenities	65,436	61,709	60,221	61,039	62,698
Health	1,582,327	1,634,232	1,713,791	1,791,648	1,846,405
Recreation, Culture and Religion	201,538	208,968	211,115	215,706	219,667
Education	1,282,111	1,305,338	1,360,646	1,420,649	1,484,603
Social Protection	417,810	465,674	462,612	477,481	495,042
Transport	378,601	420,944	434,062	452,469	464,444
Total Expenses	**5,799,285**	**6,157,966**	**6,440,570**	**6,618,635**	**6,813,259**

Source: ACT Government (2019, p. 184).

As in the previous budget, the major areas of growth in expenses over the Budget and forward estimates are Health, General Public Services and Education. This is the consequence of activity (itself in many cases a function of anticipated population growth), cost pressures such as wages and - to a lesser extent in this Budget than in recent years - discretionary policy decisions.

Major expense trends by function across the forward estimates include the following:

- Health – ongoing increase in activity, the Centenary Hospital for Women and Children and additional disability services
- Education – primarily, enrolment growth and increases in operational costs of schools in line with general wage and price inflation
- General Public Services – increase mainly due to employee costs and interest payments

- Transport – the forecast increase in 2019-20 includes service payments in relation to the Light Rail Stage 1, where the increase reflects lower expenses in 2018-19 due to later than budgeted commencement of operations.

- Public Order and Safety – this includes police and fire protection services, law courts and prisons; the forecast increase in 2018-19 includes additional policing.

The budget papers also provide figures for the 2018-19 Budget by function, which allows for a comparison between the budgeted number and the estimated outcome, as outlined in Table 9 below.

Table 9: 2018-19 expenses by function, comparison between 2018-19 Budget and 2018-19 estimated outcome

Function	2018-19 Budget	2018-19 estimated outcome	Variance	Variance
	$'000	$'000	($)	(%)
General Public Services	1,322,986	1,192,642	-130,344	-9.9
Public Order and Safety	460,232	467,717	7,485	1.6
Economic Affairs	101,511	94,293	-7,218	-7.1
Environmental Protection	119,519	116,810	-2,709	-2.3
Housing and Community Amenities	92,360	65,436	-26,924	-29.2
Health	1,530,917	1,582,327	51,410	3.4
Recreation, Culture and Religion	229,911	201,538	-28,373	-12.3
Education	1,229,655	1,282,111	52,456	4.3
Social Protection	375,448	417,810	42,362	11.3
Transport	355,631	378,601	22,970	6.5
Total expenses	5,818,171	5,799,285	-18,886	-0.3

Although the comparison shows the sum total for expenses is very much in line with the original budget, there is considerable variation between functions. Increases in Health, Education, Social Protection and Transport are to a large extent offset by lower expenses than budgeted in the General Public Services function. The Budget papers do not provide an explanation; the Committee may wish to ask officials for an explanation of these variations.

While the presentation of expenses by function is useful, it is necessarily at a very high level and does not provide a great deal of detail for interested readers on how funds are being spent across more specific areas of activity. The standard classification system employed by the ACT Government does however provide for more detailed dis-aggregations of expenditure at the sub-functional level.

A presentation at the sub-functional level would enable readers to examine the Recreation, Culture and Religion function, for example, to see the level of spending attached to cultural services, as opposed to recreational and sporting services or other community services.

The Committee may wish to seek advice from officials a more detailed break-down of the functional table into the standard sub-functional categories.

6.3 Trends in Operating Expenses

Expenses in the General Government Sector are dominated by wages and superannuation, which comprise more than half of total expenses. Employee expenses are estimated to grow by 3 per cent between 2018-19 and 2019-20, while superannuation (discussed separately in this report) grows by a much larger 28 per cent.

There are three other areas of significant growth in operating expenses: depreciation, interest costs and "other operating".

Depreciation and amortisation expenses grow by $61.8 million between the 2018-19 expected outcome and 2019-20, due mainly to the completion of capital works – notably, Light Rail Stage 1. The 2018-19 expected depreciation expense is however $21.1 million lower than at the 2018-19 Budget largely due to delays in completion of Light Rail Stage 1.

Interest payments in 2019-20 are 22 per cent, or $38.8 million, higher than in 2018-19 mainly due to higher borrowing. This follows from the Budget moving into deficit.

A large increase from 2018-19 to 2019-20 in "other operating expenses" of $43.4 million (18.8 per cent) is primarily due to the recognition of workers compensation claims following creation of a Public Sector Workers Compensation Fund.

The Committee may wish to observe that a growing percentage of ACT Budget expenses are "locked in" – that is, they are made up of payments which are not discretionary and which a future Government is obliged to meet. Interest payments are a first call for government spending because if a government does not meet these payments as they fall due it will lose the confidence of financial markets. Other non-discretionary expenses include wages and salaries and related costs such as superannuation and workers compensation. In the 2019-20 Budget the ACT Government has at the margin reduced its discretion over future expenses through moving more categories of staff from contract to permanent employment.

6.4 New initiatives

There are fewer new expense initiatives in the 2019-20 Budget than there were in 2018-19 (some 165, compared with almost 200 in 2018-19). Health comprises more than a quarter of the 2019-20 new initiatives.

Significant expenses initiatives include:

- Expanding services at The Canberra Hospital (TCH), with 12 new inpatient and 4 new Intensive Care Unit beds and additional senior staff specialists, at a total cost of $47.1 million over four years
- Funding for a range of mental health initiatives including expanding inpatient mental health care at TCH ($7 million over four years), a mental health consultation liaison service ($4.6 million), alternative justice pathways for people with mental illness ($3 million), public healthcare services for eating disorders ($2,2 million), electroconvulsive therapy service at TCH ($25m) and strengthening mental health care in public schools ($3 million, appearing under Education)
- Implementing the recommendations of the review of workplace culture in ACT public health services ($10.5 million over four years)
- Increases to education funding including $41.6 million over four years for staff to support students with additional needs such as disability, and $4.9 million to move from externally contracted school cleaning to a cleaning workforce within the Education Directorate
- Establishment of a Motor Accident Injuries Commission with expenses of $17.6 million over four years, matched by corresponding revenue

- Increased disability services (a net $40.6 million over four years)
- A replacement HR information management system ($22.4 million over four years)
- Recruitment of more than 60 additional police personnel ($34.3 million over four years)
- Additional funding for out of home care services ($39.8 million over four years). Included in this is $23.2 million as a provision – the Committee may wish to inquire from officials how in practice this provision will be drawn down.

There are no savings initiatives in the budget: the new expense initiatives are funded from growth in ACT revenue and a return of the Budget balance to deficit.

A striking feature of many initiatives is that they closely mirror 2018-19 initiatives: for example, increased funding for hospital services, additional support staff for school students, $4.2 million for implementation of the future of education strategy (in 2018-19 $9.2 million was allocated to develop that strategy); funding for additional staff at the Alexander Maconochie Centre.

Other jurisdictions (e.g. NSW) include generic growth funding in their budgets for functions such as health on the basis that expansion of services is expected each year. The ACT practice of identifying such additions to the budget as new initiatives, even though they are partially demand driven and not discretionary, provides greater transparency and is a better approach.

6.5 Light Rail project

Light Rail Stage 1 became operational on 20 April 2019.

Under the accounting treatment adopted for the Territory's Public Private Partnership arrangements, the Light Rail project only begins to have significant impacts on expenses from 2019-20. It is noted that the initial payment by the Government to the Canberra Metro consortium of around $20 million, was deferred from 2018-19 to the budget year due to rectification work delaying the operational date.

Table 10 below summarises the impact of the Light Rail project on expenses.

Table 10: Light Rail impact on headline operating balance

	2019-20 Financial Year $'000	2020-21 Financial Year $'000	2021-22 Financial Year $'000	2022-23 Financial Year $'000
Maintenance/Operating Costs	**-25,967**	**-26,424**	**-27,553**	**-27,560**
Interest	**-18,901**	**-18,275**	**-17,664**	**-17,664**
Depreciation	**-14,079**	**-14,079**	**-14,079**	**-14,079**
Total HNOB Impact	**-58,947**	**-58,778**	**-59,296**	**-59,303**

Source: ACT Government (2019).

In cash terms, the final cost to the Government was approximately $675 million.

The Budget provides around $670 thousand for a new Stage 1 station at Mitchell and around $2.3 million for initial planning in respect to Stage 2.

A detailed discussion of the accounting treatment for the Light Rail project is provided subsection 10.5 of this report.

6.6 Safer Families

The 2019-20 Budget continues to allocate funding for Safer Families initiatives, building on initiatives since the program began in 2016. A further $24 has been allocated to the Safer Families package over four years to 2022-23 (ACT Government, 2019, p. 417).

The cost of the Safer Families package is mostly offset by revenue from the Safer Families Levy introduced in the 2016-17 Budget. The $30 annual levy is applied to all residential and rural properties. The 2019-20 Budget estimates the levy will raise some $20.2 million over four years, with further spending to be met from general revenue.

Over the four years the key initiatives are a Family Safety Hub at $6.1 million, expansion of the Room4Change program aimed at prevention of family violence ($4.2 million), the safer families team ($3.1 million) and training ACT government workers to respond to family violence ($2.8 million). Spending in 2018-19 was less than budgeted, by $669,000 (ACT Government, 2019, p. 420), and funding has been shifted from 2018-19 to 2019-20 for both the Family Safety Hub and training. This follows a similar pattern of re-profiling reported in the 2018-19 Budget (at that time, some $1.1 million). The Committee may wish to inquire of officials whether the budget allocation for 2019-20 is likely to be fully expended, given this pattern.

The Budget Papers at Appendix J report on progress with the Safer Families initiatives from 2016-17 to 2018-19 and complement this with a discussion of new approaches for the future and 2019-20 priorities. This is a further improvement on reporting in past Budget Papers. This kind of reporting is helpful in understanding the details of a program, the key drivers of spending, outcomes achieved and outcomes planned. It is commendable practice, and could be applied to other initiatives.

The contribution to the costs of Safer Families is shown against the various initiatives documented in the Budget Papers as an expense offset. This is arguably a misleading presentation. The offsetting amount is revenue, not an expense saving. Presumably the intention is to indicate a source of funds for the initiatives; however, the net effect is to understate the total for expense initiatives.

6.7 Asbestos Eradication

Appendix I of the Budget Papers provides information on the Loose-Fill Asbestos Insulation Eradication Scheme. It shows the Scheme will continue to 2020-21 (ACT Government, 2019, p. 410).

Table 11 below provides a summary of the impacts of the Asbestos Eradication Scheme on the headline operating balance.

Table 11: Asbestos Eradication Scheme impact on headline operating balance

	2018-19	2019-20	2020-21	2021-22	2022-23
	$'000	$'000	$'000	$'000	$'000
2018-19 Budget					
Financial Assistance Package	-200	-482	-291	0	0
Other Costs	-4,284	-4,267	-4,102	0	0
Purchase Costs	-114	-131	-200	0	0
Contingency	-3,144	-3,144	-4,192	0	0
Total HNOB[6] Impact (including contingency)	**-7,742**	**-8,024**	**-8,785**	**0**	**0**
2019-20 Budget					
Financial Assistance Package	-309	-120	-140	0	0
Other Costs	-3,306	-4,092	-4,774	0	0
Purchase Costs	-162	-66	-77	0	0
Contingency	-7085	-3,476	-3,538	0	0
Total HNOB Impact (including contingency)	**-10,861**	**-7,754**	**-8,528**	**0**	**0**

Source: ACT Government (2019, p. 412).

The impact on the headline operating balance has varied between last year's and the current Budget primarily due to delays in property sales. The Budget Papers indicate there are fewer property sales in the current year and an anticipated increase in property sales of 43 in 2019-20 and 55 in 2020-21. This reflects longer settlement timeframes, with the Taskforce responsible for the Scheme taking account of "moderation in the Canberra property market". The estimates may continue to show volatility, depending on conditions in the ACT residential property market in future years. While the Scheme is anticipated to have no further impact on the net operating balance from 2021-22 onwards, there is a chance that there could be further slippage if the current approach towards property sales is maintained. The Committee may wish to seek clarification from the officials concerned about this.

Although the impact of the Scheme on the headline balance is relatively small in the context of the overall ACT Budget, its continuing operation does have an opportunity cost in terms of the time and effort involved by the public servants concerned.

A discussion of risks attached to these estimates is provided at section 9 of this report.

[6] Headline Net Operating Balance

7. Capital Works and Infrastructure

The Budget includes a substantial capital works and infrastructure program over the Budget and forward years. The Government will invest $3 billion in infrastructure in the ACT over the next four years. Almost half the proposed program is in provisions, with detailed estimates not for publication. The most significant of these provisions relates to the proposed SPIRE project at The Canberra Hospital. The peak year for infrastructure spending is 202-21 ($877 million), falling to $$581 million in 2022-23; however, experience suggests new capital projects are likely to be proposed which would maintain a continuing level of high infrastructure investment.

7.1 Overview

The Budget Papers indicate that the ACT Government (2019, p. 197) intends to invest $3.0 billion in infrastructure in the ACT over the next four years to 2022-23.

Table 12 below summarises the capital works and investment program.

Table 12: Summary of investment and capital works program – 2018-19 to 2020-21

	2019-2020 Allocation $'000	2020-21 Allocation $'000	2021-22 Allocation $'000	2022-23 Allocation $'000
New Capital Works	294,419	343,848	229,110	115,699
Works-in-Progress	475,249	235,845	115,078	27,975
TOTAL CAPITAL WORKS PROGRAM	769,668	579,693	344,188	143,674
Infrastructure Investment Provisions	**6,226**	**297,800**	**448,709**	**436,994**
CAPITAL WORKS PROGRAM FORECAST	775,894	877,493	792,897	580,668
PUBLIC PRIVATE PARTNERSHIPS	5,058			
TOTAL INFRASTRUCTURE INVESTMENT INCLUDING PROVISIONS	780,952	877,493	792,897	580,668

Source: ACT Government (2019, p. 197).

In 2019 the ACT Government amended the *Financial Management Act 1996* to introduce a new mechanism, the Capital Works Reserve, to allow agencies to manage their capital program by advancing funds during the financial year should their capital appropriation be exceeded. Funds drawn from the Reserve will be deducted from the forward estimates for the project(s) concerned in later years. The 2019-20 Budget has allocated $140 million for this Reserve, with a corresponding reduction of $140 million in the 2020-21 forward estimates. The Treasurer has to provide the Legislative Assembly with a reconciliation of any amounts approved for payment from the Reserve (under section 26 of the *Financial Management Act 1996*).

The investment and capital works program includes:

- A Capital Works Program: funding of $1.8 billion over the four years to 2022-23.
- Infrastructure Investment Provisions: These total $1.2 billion over four years to 20212-23. They set aside resourcing for significant capital works projects for which budgets are yet to be settled, or which are commercially sensitive; and
- Public Private Partnerships (PPPs): with the completion of Light Rail Stage 1, the only remaining PPP is the ACT Law Courts Facilities.

7.2 Capital Works Program

The Capital Works Program forms the largest component of the Infrastructure Investment Program, with funding of $775.9 million in 2019-20 and $2.3 billion over the four years to 2022-23. This includes:

- $229.2 million in 2019-20 and $494.5 million over four years for new capital works
- $475.2 million in 2019-20 and $378.9 million over four years for works-in-progress
- $65.2 million in 2018-19 and $194.2 million over four years for the Better Infrastructure Fund.

In 2019 a new Capital Works Reserve of $140 million was established under the *Financial Management Act 1996*. The reserve permits agencies to advance their capital works program during the financial year and draw on the reserve should existing appropriation be exhausted. The ACT Government has indicated it will provide the Assembly with details as part of its quarterly reporting processes. Essentially, the reserve is an appropriation mechanism allowing flexibility for agencies to advance capital projects, and appears to be similar to a previous Capital Delivery Provision. At this stage the reserve is only available during the Budget year.

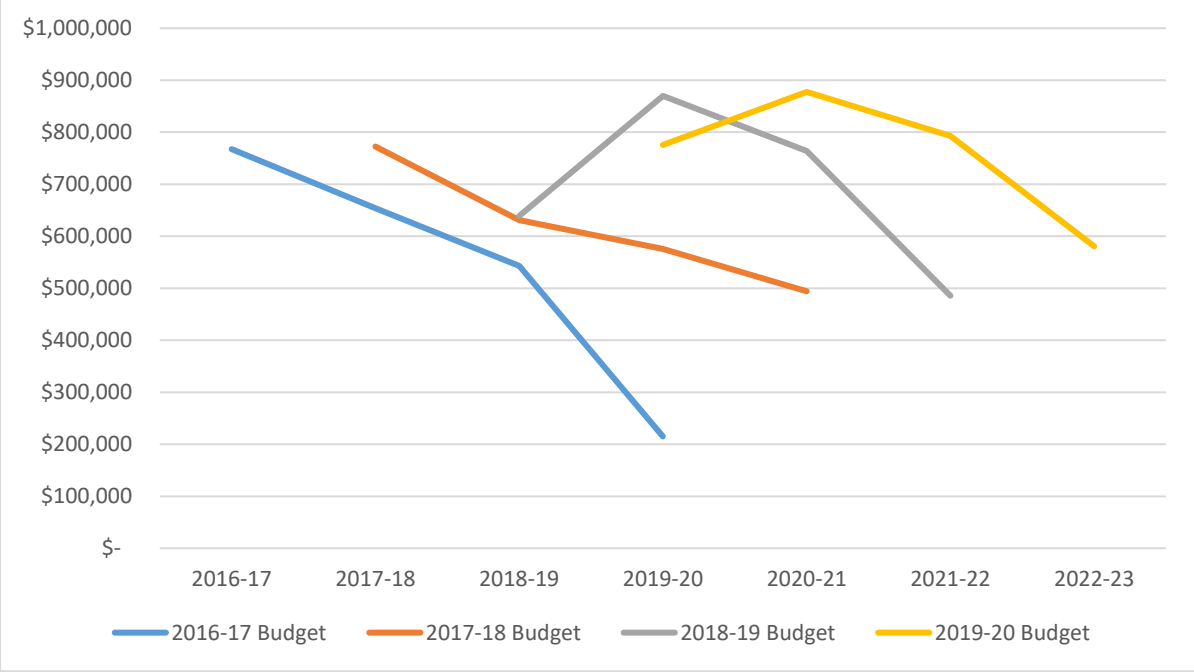
The Committee may wish to explore the operation, including processes for reporting usage of the reserve. In particular, given this arrangement is an appropriation mechanism, Pegasus is of the view the Assembly requires a level of control and assurance over the proper use of this mechanism to ensure appropriate accountability and transparency over the use of funds. In this regard, Pegasus strongly suggests it explores with the ACT Government and officials:

- Criteria established to assess claims on the reserve
- Authority to approve such claims
- Assembly assurance over the usage of the appropriation.

In regard to the latter, the Committee may wish to approach the Auditor-General to review the usage of the Reserve.

The 2019-20 Budget continues the recent trend of ratcheting up the capital works program forecasts across the budget and forward years. The 2018-19 Budget forecast funding of $1.6 billion over the then four years. The 2019-20 Budget forecasts a total funding envelope for the capital works program of $3 billion, an increase of 46 percent. It is noted, however, the funding tappers off across the last two out years. The ratcheting up of the capital works program forecasts in the last five ACT Budgets is outlined in Figure 15 below.

Figure 15: Capital Works Program Forecasts – 2016-17 to 2021-22 ($'000)



Source: ACT Government (2016, p. 210; 2017, p. 194; 2018a, p. 202, 2019, p. 197).

One consistent pattern in the forward estimates for capital works program forecasts is the eventual dramatic decrease in spending across the forward years that is never actually realised. The Committee might wish to inquire of officials how far into the future the planning timeframe for the capital works program extends.

7.3 Public Private Partnerships

The infrastructure program outlined in the Budget includes capital components of the ACT's two major public private partnerships.

The investment associated with these projects is set out in the Table 13 below.

Table 13: Public Private Partnerships – ACT Law Courts Facilities and Light Rail Stage 1 – Capital Expenditure Schedule

Project	2019-20 Forecast $'000	2020-21 Forecast $'000	2021-22 Forecast $'000	2022-23 Forecast $'000	Total $'000
ACT Law Courts Facilities	**5,058**	**0**	**0**	**0**	**5,058**
Light Rail Stage 1	**0**	**0**	**0**	**0**	**0**
Total	5,058	0	0	0	5,058

Source: ACT Government (2019).

The infrastructure program includes the capital component of the ACT's major ongoing public private partnership; the Law Courts redevelopment. Light Rail Stage 1, has been completed, becoming operational on 20 April 2019. Consequently, it should be noted that Light Rail Stage 1 has been transferred from General Government to the Public Trading Enterprises sector.

The ACT Law Courts capital component relates to contract payments as the project moves to completion. It is noted this is a substantial increase to the forecast amount that was zero as set out in the 2018-19 ACT Budget for 2019-2020.

The impact of the ACT Law Courts project on the major budget aggregates are set out in section 8 of this report, and the expenses associated with the Light Rail new Mitchell station and planning for Light Rail Stage 2 are discussed in section 6 of this report.

8. Assets and Liabilities

The Territory's balance sheet is healthy, with a positive net worth rising from $17.5 billion to $18.1 billion over the Budget and forward estimates. However, net debt and net financial liabilities are rising at a faster rate than net worth over the same period, and the ratio of net worth to Gross State Product (GSP) is in decline. The Territory's defined benefit superannuation liability has been revised upward, to $8.7 billion by 2022-23, and the unfunded component is now estimated to be nearly $1 billion dollars higher than forecast in last year's Budget.

8.1 Overview

The Budget Papers include information on management of the Territory's assets and liabilities.

Table 14 presents the key balance sheet measures for the General Government Sector (GGS).

Table 14: General Government Sector Key Balance Sheet Measures

	2018-19 Est. Outcome $m	2019-20 Budget $m	2020-21 Estimate $m	2021-22 Estimate $m	2022-23 Estimate $m
Net debt (excluding super)	2,181.7	2,713.9	3,257.6	3,363.5	3,019.2
Net financial liabilities	6,571.0	7,274.9	7,809.4	8,047.0	7,981.8
Net worth	17,635.1	17,503.7	17,555.1	17,728.9	18,132.0

Source: ACT Government (2019, p. 293).

The table shows that net worth is positive and is forecast to increase from $17.6 billion to $18.1 billion across the budget and forward estimates, an increase of 2.8 per cent.

However, the forecast levels for net financial liabilities and net worth over the Budget and forward years have deteriorated since the 2018-19 Budget. Net debt is now expected to be higher over the Budget and forward years than expected in last year's Budget, and the level of net debt is forecast to grow rapidly over the forward estimates to 2021-22 and by 2022-23 is expected to be nearly $1 billion dollars more than estimated in 2018-19. By 2022-23, net financial liabilities are expected to be 21.5 per cent higher than in 2018-19.

8.2 Net Debt

Net debt is a key balance sheet measure in the Government Finance Statistics framework and in the Uniform Presentation Framework agreed by Treasurers in all Australian jurisdictions as the standard for presentation of information in budget papers.

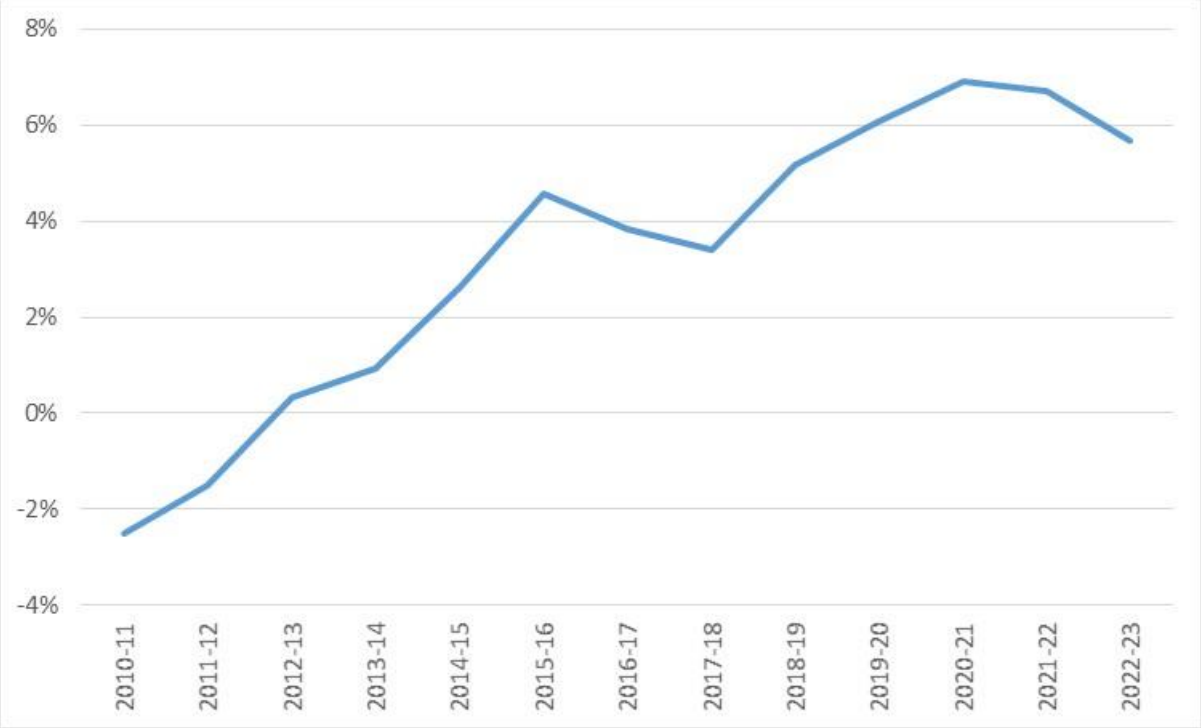
It represents the sum of deposits held, advances received and borrowings less the sum of cash and deposits, advances paid, investments, loans and placements.[7] The measure of net debt employed by the ACT Budget Papers excludes super liabilities.

The estimated level of net debt rises rapidly over the forward estimates to 2021-22, reducing in 2022-23 with the forecast return of the budget balance to surplus. Net debt is driven by ongoing levels of debt repayments remaining stable and new debt required to finance deficits in 2019-20 and 2020-21. A significant contributor is ACT Government investments in transport and infrastructure.

The Territory's level of net debt has deteriorated since 2010-11, when General Government sector cash reserves and investments were some $735.9 million higher than gross debt liabilities (ACT Government, 2018a, p. 399).

It is useful to compare levels of net debt to the size of the economy that will be required to service that debt. Figure 16 illustrates the growth in net debt since 2010-11 as a proportion of the Gross State Product (GSP).

Figure 16: Net debt as a proportion of Gross State Product – 2010-11 to 2022-23 (per cent)



Sources: ABS (2018a), ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019)

The growth in the stock of debt over time reflects the borrowings necessary to finance a history of accumulated budget deficits as well as borrowings to finance infrastructure investments. The large increase in net debt to GSP in 2015-16 was related to the loan provided by the Commonwealth to support the Asbestos Eradication Scheme and a provision for the Light Rail that was subsequently procured through a PPP, removing the requirement to debt fund the capital cost of the project (ACT Government, 2015, p. 251; ACT Government, 2016, p. 288).

The ratio of net debt to GSP continues to increase up to 2020-21. The Budget Papers do not indicate any long-term strategy for paying down the stock of accumulated debt.

[7] Net debt takes account of gross debt liabilities, which include market and Commonwealth borrowings, and liabilities such as those associated with the impact of public private partnerships such as the Light Rail project, as well as financial assets, such as cash, deposits and investments.

The ACT will need to refinance debt progressively over the next decade: around $500 million of Treasury bonds reach maturity every two years between 2020 and 2028 (ACT Government, 2019, p. 311). While Australian interest rates are at historical lows the ACT's net debt is manageable, and indeed there is a case for refinancing existing debt, if possible, at lower rates. If, however, interest rates were to rise in future years the ACT would be faced with higher public debt interest bills and the Budget would come under significant stress.

8.3 Net financial liabilities

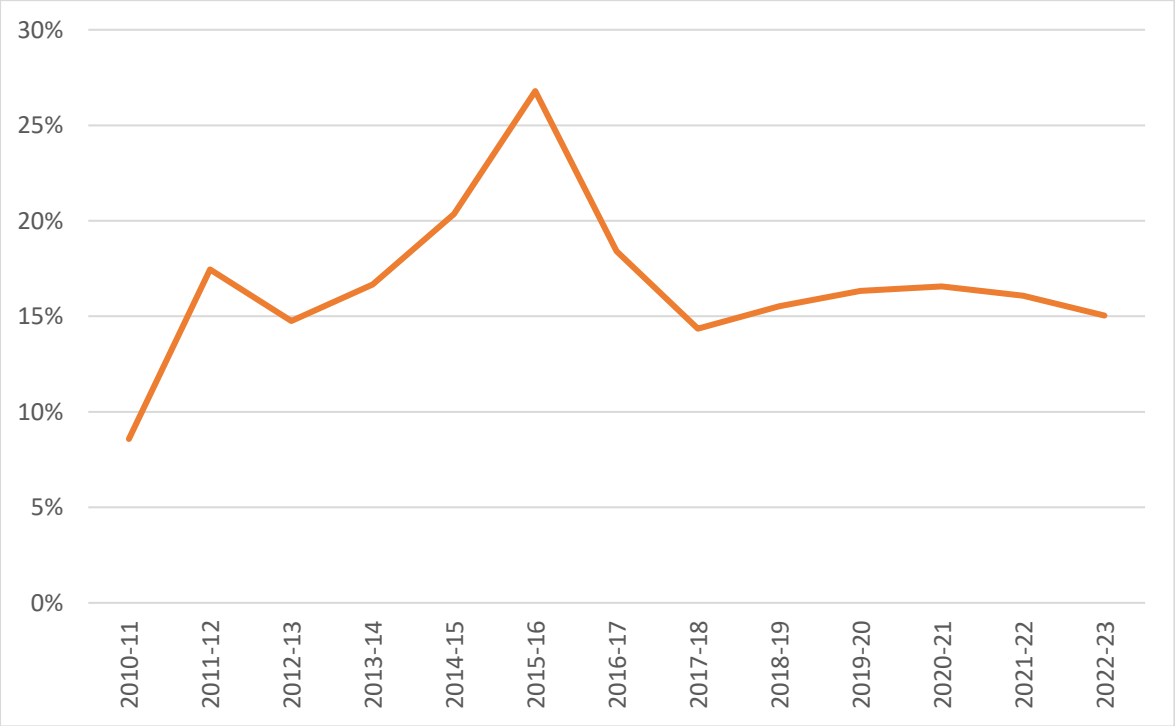
Net financial liabilities provide a broad measure of the General Government sector's financial obligations to others.

Net financial liabilities are calculated as total liabilities (including net debt and superannuation liabilities) less financial assets (such as cash reserves and investments), excluding the value of equity held by the General Government sector in public corporations. Changes in net financial liabilities are therefore influenced by variations in the net debt figures discussed in the previous section.

The Territory's net financial liabilities are estimated to be some $154.5 million higher in 2019-20 than forecast in the 2018-19 Budget. Net financial liabilities are also expected to grow over the Budget and the 2020-21 and 2021-22 forward estimates period to $8.0 billion, before a slight reduction to $7.9 billion in 2022-23. Forecast growth in the level of net financial liabilities over the Budget and forward years reflects the increases in net debt discussed in the previous section, estimated growth in the superannuation liability and the lease liabilities associated with the Light Rail and ACT Law Courts Facilities.

The ratio of net financial liabilities to GSP provides an indicator of the sustainability of a jurisdiction's debt (ACT Government, 2015, p. 252). Figure 17 illustrates the growth in net debt since 2010-11 as a proportion of GSP.

Figure 17: Net financial liabilities as a proportion of Gross State Product – 2010-11 to 2022-23 (per cent)



Sources: ABS (2018a), ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019).

The ACT Government has indicated that it is desirable that the ratio of net financial liabilities to GSP should remain broadly stable over time while maintaining sustainable levels of borrowings (ACT Government, 2015, p. 252). The ratio of net financial liabilities to GSP has risen since 2010-11. The large spike in 2015-16 was related to a higher forecast superannuation liability and capital provisions to account for some capital projects that were subsequently procured through a PPP (ACT Government, 2016, p. 289).

8.4 Net worth

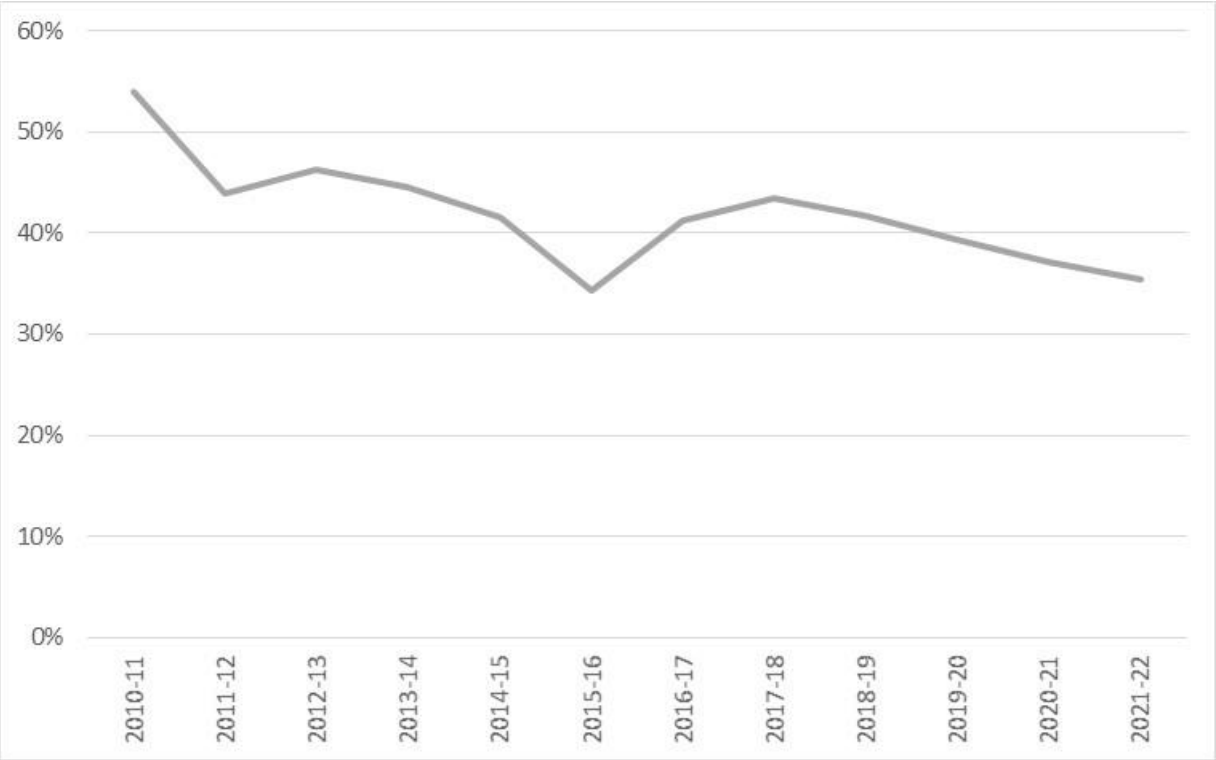
Net worth is an economic measure of wealth that reflects the value of all financial and non-financial assets (such as land, plant and equipment) less liabilities, including superannuation liabilities.

Net worth is forecast to continue to grow over the Budget and forward years, to $18.1 billion in 2022-23. However, net worth reduces by $131.4 million from the 2018-19 estimated outcome to the Budget year estimate, before increasing across the forward years.

Also, net worth as a proportion of GSP falls over the period, from 39.1 per cent in 2019-2020 to 34.0 per cent in 2022-23. It is noted that net worth as a portion of GSP has also reduced since the 2018-19 Budget.

Figure 18 illustrates the change in net worth as a proportion of GSP since 2010-11.

Figure 18: Net worth as a proportion of Gross State Product – 2010-11 to 2022-23 (per cent)



Sources: ABS (2018a), ACT Government (2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018a, 2019).

While the Territory maintains a sound net worth position, and net worth continues to grow over the forward estimates period, net worth as a proportion of GSP has been on a long-term decline since 2010-11.

8.5 Superannuation

The ACT continues to carry a significant liability associated with the superannuation entitlements of past and present employees who are members of the Commonwealth defined benefit

superannuation schemes, the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS).

Approximately 7,000 current full-time employees are members of these schemes. In addition, the ACT has liabilities in the two schemes in relation to a further 29,000 former ACT Government employees. Both the CSS and PSS schemes are closed to new members. Since 1 July 2005, new employees have had access to defined contribution scheme arrangements under which the Government makes fortnightly payments to each employee's designated superannuation fund (ACT Government, 2019, p 298).

Table 15 below sets out the most recent estimation of the Territory's superannuation liability.

Table 15: Defined Benefit Superannuation Liability

	2018-19 Est. Outcome $'000	2019-20 Budget $'000	2020-21 Estimate $'000	2021-22 Estimate $'000	2022-23 Estimate $'000
Opening liability	**9,733,981**	**7,808,989**	**8,061,526**	**8,299,805**	**8,520,761**
Service cost	229,074	151,397	144,260	137,765	131,852
Interest cost	205,767	390,951	402,759	413,815	424,077
Benefit payments	-269,070	-289,811	-308,740	-330,624	-350,770
Actuarial (Gain)/Loss[1]	-2,190,763	0	0	0	0
Closing liability	**7,808,989**	**8,061,526**	**8,299,805**	**8,520,761**	**8,725,920**

Source: (ACT Government (2019, p. 300).

Table 15 shows that the Territory's defined benefit superannuation liability is estimated to grow to approximately $8.7 billion by 30 June 2023. The current estimates of the superannuation liability are virtually unchanged from those forecast last year.

The service cost associated with the accrual of employee superannuation benefits is forecast to decrease over time as ACT employee members leave the schemes through resignation or retirement. However, the interest cost (due to the unwinding of the discount rate as past benefits accrued by ACT employee members come closer to payment) is forecast to increase reflecting the increase in the estimated liability.

These calculations depend critically on the discount rate used to calculate the present value of superannuation payments in future years and other assumptions regarding future salary growth, pension indexation, crediting rates and exit rates from the scheme. These assumptions are reviewed on a triennial basis by the actuaries advising the Commonwealth Government, with the next full actuarial review due in 2020.

The minimal changes in the estimated liability and service cost reflect the fact that the updates between the triennial reviews only take account of changes in the membership data, which, for closed schemes, tend to have a minor impact.

The large reduction between the opening and closing liability in the estimated 2018-19 outcome is due to the reversion to the long-term discount rate in the calculation of the estimated superannuation liability at the end of the financial year.

The ACT Government has chosen to contribute funds to a Superannuation Provision Account with the objective of extinguishing the Territory's unfunded defined benefit superannuation liability by 2030. The unfunded superannuation liability, representing the difference between the superannuation liability and investment assets, is shown in Table 16 below.

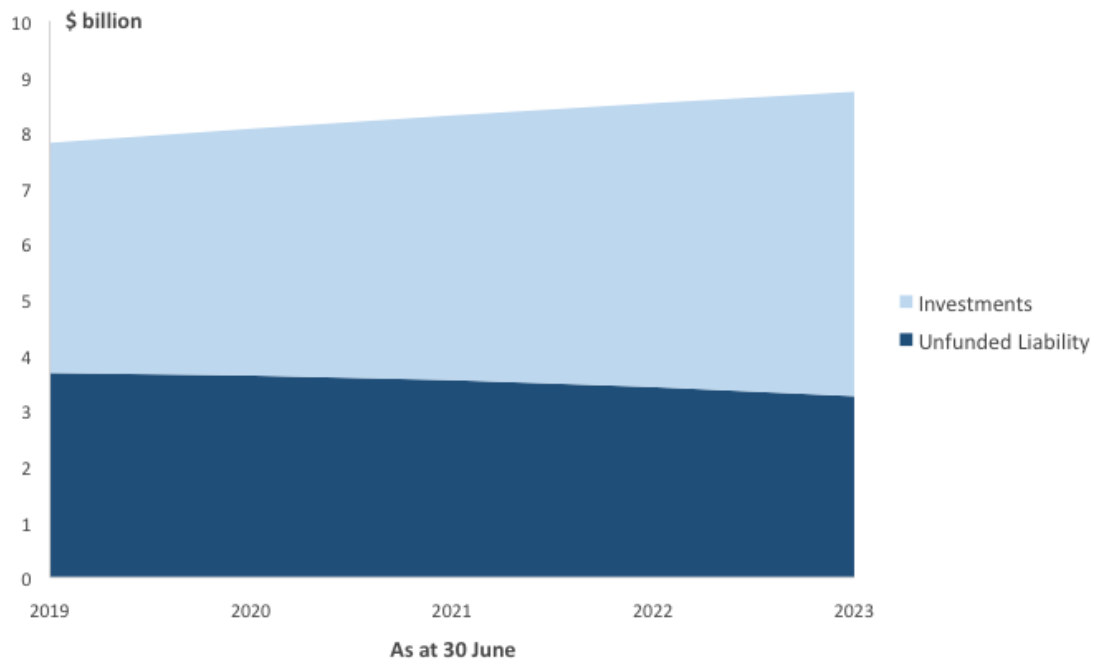
Table 16: Defined Benefit Superannuation Liability Funding

	2018-19	2019-20	2020-21	2021-22	2022-23
	Est. Outcome	Budget	Estimate	Estimate	Estimate
	$'000	$'000	$'000	$'000	$'000
Superannuation Liability[1]	**7,808,989**	**8,061,526**	**8,299,805**	**8,520,761**	**8,725,920**
Investments	4,133,080	4,432,361	4,753,512	5,098,196	5,468,140
Unfunded Liability	3,675,909	3,629,165	3,546,293	3,422,565	3,257,780
Funding Percentage	**53%**	**55%**	**57%**	**60%**	**62%**

Source: (ACT Government, 2019, p. 303). The estimated liability is as at 30 June of the financial year and is calculated using the long term discount rate of 5 per cent per annum.

Table 16 shows that the unfunded superannuation liability is expected to gradually decline in absolute terms from its peak in 2018-19. This information is illustrated in Figure 19.

Figure 19: Defined Benefit Superannuation Unfunded Liability and Investment Assets



Source: (ACT Government, 2019, p. 303).

The projection of the value of investments in the Superannuation Provision Account is very similar to that included the 2018-19 Budget. While investment returns for the 2018-19 year are estimated to be below the rate assumed in the 2018-19 Budget, the opening balance was around $70 million higher than the closing balance reported for 2017-18 in the 2018-19 Budget, largely compensating for the lower than anticipated returns.

The return on investments for 2018-19 is estimated at 5.4% or CPI plus 3.3 percentage points. This is lower than the long-term return objective of 4.75 percentage points above the CPI. Given the risks to the Australian and global economy, there must be some question as to whether this target can be met in the short to medium term. Without a significant increase in investment returns or additional contributions, the ACT Government seems unlikely to achieve its goal of full funding of the superannuation liability by 2030.

The ACT Government has acknowledged in the past that, for the planned reduction in the Territory's unfunded superannuation liability to occur, interest rates would need to return to around their long-term level (ACT Auditor-General, 2016, p. 2). This seems unlikely in the near to medium term.

Despite these reservations, there is no indication that the ACT will have any difficulties in meeting its unfunded superannuation obligations, which will emerge as a requirement to meet benefit payments over a period of more than 50 years. The projections of benefit payments are virtually unchanged from the 2018-19 Budget.

9. Risks

There are a number of risks and uncertainties attached to the Budget estimates. These include economic and fiscal risks. The Budget is based on assumptions about the future level of Commonwealth spending in the ACT and about the level of Commonwealth Government grants to the ACT that have some attached risk. Previous sections have also pointed to the sensitivity of the Budget aggregates to technical assumptions including those related to the rate used to measure the present value of superannuation payments in future years.

9.1 Overview

The 2019-20 ACT Budget provides for a headline deficit over the upcoming Budget year and the first year of the forward estimates after which there is a significant turnaround with a headline budget surplus ratcheting up in the last two years of the forward estimates. The turnaround and improving Budget outlook is, however, vulnerable to a number of risks. If one or more of these potential adverse events occur, the ACT will once more be exposed to a risk of continuing budget deficits.

The Budget Papers provide a statement of the risks attached to the outlook over the Budget and out years in Appendix K (ACT Government, 2019, pp. 425-436).

However, the Budget Papers do not quantify the sensitivity of the Budget aggregates on a number of important risk factors, and a number of the additional risks and pressures can be identified.

9.2 Risks to the economic outlook

The statement of risks in Appendix K acknowledges the vulnerability of the ACT economy to policy decisions of the Commonwealth Government, making the following observations:

> *Commonwealth Government policy decisions continue to be a significant source of risk to the ACT economy. The Commonwealth Government's recent election commitment to cut $1.5 billion in Australian Public Service spending over the next four years represents a downside risk to the ACT's economic outlook, as does its ongoing decentralisation agenda. (ACT Government, 2019)*

We concur with the statement of risk regarding the downside threat posed to the ACT economy from the increase in the Commonwealth Government efficiency dividend that will reduce departmental funding to Commonwealth Government agencies by $1.5 billion over the forward estimates as well as the decentralisation agenda.

However, the statement of risks appears to overlook the more immediate threat to the short-term outlook to the ACT economy arising from ongoing fiscal restraint exercised by the Commonwealth Government. In 2019-20 Commonwealth Government payments are expected to increase in real terms by only a paltry 0.1 per cent in 2019-20, before gradually increasing again to 1.3 per cent in 2020-21, 1.9 per cent in 2021-22 and 2.0 per cent in 2022-23 (Commonwealth of Australia, 2019a, p. 5.5). This may not be sufficient to support growth in gross state product and state final demand in the order to 3 per cent for the ACT in 2019-20.

The ACT Government (ACT Government, 2019, p. 427) attempts to downplay the overall risk posed by the Commonwealth Government through arguing the ACT economy is becoming increasingly less vulnerable to reductions in Commonwealth spending as it becomes more diverse. However, Figure 2

that looks at the composition of the ACT economy of the course of the last 24 years would suggest there is no long-term trend towards greater diversity within the ACT economy.

If ACT final demand is closer to around 2½ in 2019-20 and around 2¾ to 3 per cent in the out years there would be a dampening effect on ACT revenue and a consequential impact on the Budget balance.

While the Budget Papers provide a very useful statement of the sensitivity of the estimates to changes in the underlying parameters, they do not provide an indication of the sensitivity of the estimates to changes in the real economy.

It would add to the transparency of the Budget if the Budget Papers were to include an estimate of the risk to the budget from higher or lower growth, and the sensitivity of the Budget to changes in assumptions regarding wages, population and employment.

To help assess the risks attached to the forecasts, the Committee might wish to seek this information from officials.

While the statement of risks highlights a couple of other risks that are generic to the Australian economy such as a softening of consumer confidence leading to lower household consumption arising from a downturn in house prices and ongoing trade tensions between China and the United States, there is a medium-term risk posed by the ACT Government's tax reform agenda that could dampen population growth with flow on effects for economic activity. As previously discussed, the Housing Industry Association (Reardon & Hopkins, 2018) has previously warned in relation to the ACT Government's policy to phase out conveyance taxes on property (stamp duty on property purchases) and replace it with a new general rates system that a point could be reached where residents / employees of the ACT seek relief from ACT Government general rate increases through relocating to New South Wales.

9.3 Fiscal risks

Overview

As noted above, the major fiscal risk to the ACT is Commonwealth funding. In addition to the economic risks discussed in the previous section, there are risks in relation to specific purpose payments and national partnership agreement payments.

Major risks and uncertainties are outlined below.

Asbestos Eradication Scheme

There are risks associated with the Loose-fill Asbestos Insulation Eradication Scheme by the ACT Government (2019, p. 431) to buy back, demolish and remediate all houses in the ACT affected by loose-fill asbestos insulation with the remediated blocks of land being sold to defray some of the overall Scheme costs.

As the buyback phase is effectively complete, and the demolition and sales phases are well underway, the risks for these phases have significantly diminished (ACT Government, 2019, p. 431). However, there remain risks regarding the extent to which sales proceeds will offset the cost of the buyback and remediation activities.

Public Private Partnerships

The ACT Government (2019, p. 433) has pursued two projects through Public Private Partnership (PPP) arrangements: the ACT Law Courts and Light Rail Stage 1.

Under a PPP, the private party bears certain risks associated with designing, building and operating the infrastructure and the public sector retains those risks that it can manage for less than it would

have to pay the private party to bear them. Risks that are commonly retained or shared by the public sector include:

- adverse site conditions that are not known or reasonably foreseeable;
- artefacts and heritage claims;
- Native Title claims;
- obtaining specified planning approvals;
- changes in the price of the utilities;
- changes in law and policy which impact on the project;
- patronage risk; and
- *force majeure* for specified unforeseen events which impact on the project.

With the start of operations for Light Rail Stage 1, there is the potential for some risks to be realised, and for others to diminish. The Budget Papers indicate a Project Delivery Report will be prepared which among other things will outline the Territory's retained risks from the project. These should appear as risks in the 2020-21 Budget Papers. However, the Committee could seek further information from officials on whether work to date on the Project Delivery Report has brought to the surface risks which had previously not been reported or anticipated.

Land Release Program

The ACT Government's land release program is subject to risks related to the capacity of the ACT residential property market to grow and sustain the sale of all released land at forecast prices. The land release program is also highly sensitive to projections of ACT population growth. Should population growth fall, or unemployment increase, there is likely to be a reduction in revenues from land releases. The risks to the economic outlook discussed above are the major factors impinging on fiscal risks associated with the Land Release Program.

Large-scale Generation Certificates

As a consequence of its investment in renewable electricity generation, the ACT Government (2019, p. 431) has received Large-scale Generation Certificates, which are credits received for the generation of renewable electricity under the Commonwealth Government's large-scale renewable energy target. Once created and recognised, Large-scale Generation Certificates can be sold and transferred to other individuals and businesses, with their price being determined through the open market. As the value of a Large-scale Generation Certificates held by the ACT Government will be subject to price fluctuations arising from supply and demand within the market.

Commonwealth Government

There are various fiscal risks for the ACT Government associated with funding it receives from the Commonwealth Government, including:

- the size of the GST grants provided to the ACT are associated with the buoyancy of the national economy and any moderation or downturn could lead to less GST revenue overall, as well as any annual revisions to the State and Territory relativities by the Commonwealth Grants Commission
    - creating further uncertainty is that the methodology behind the calculation of State and Territory relativities for the division of the GST revenue has also recently been subject to recently completed review by the Productivity Commission

- the level of future Commonwealth funding for the National Disability Compensation Scheme
- risks to the provision of Specific Purpose Payments
- a risk to the ACT Budget in forward years relating to the uncertainty over Commonwealth funding for National Partnership agreements beyond their current expiry dates.

Various processes underway which affect these risks include:

- A review of the methodology for funding non-government schools, which may have an impact on both Commonwealth and Territory budgets (ACT Government, 2019, p. 272)
- A cap on national health funding (where the Territory bears a risk if the national funding cap of 6.5 per cent is breached)
- Asset Recycling, where future subsidies for asset recycling are by no means guaranteed
- Expiring partnership agreements in areas such as legal assistance, public dental services, family advocacy and support services (ACT Government, 2019, p. 275)
- Universal Access to Early Childhood Education, where the agreement with the Commonwealth has been extended for one year only. The ACT Budget papers note the unsatisfactory nature of regular extensions to the agreement.

ACT Government investments and borrowings

The ACT Budget is susceptible to the performance of global financial markets and changes in interest rates, and as such, investment returns below those estimated will have a negative impact on revenues. Furthermore, higher interest rates will result in higher borrowing costs for new borrowings (see discussion on net debt previously in this report)

The value of accrued superannuation liabilities is calculated as the present value of the future payment of benefits that have actually accrued in respect of service at the calculation date (ACT Government, 2018a, p. 425). Most of the liability now rests with former employees and is largely accrued. While the estimate of the liability at a point in time is very sensitive to the discount rate used, this does not change the projected benefit payments or affect the ACT Government's capacity to meet these payments. Given the relatively small number of active contributors, the risks around future benefit payments relate primarily to pensioner longevity and pension indexation rates.

As is evident from this Budget, the estimated value of the superannuation liability and the cost of associated expenses are extremely sensitive to the value of the long-term discount rate. Tables L.5 and L.6 in Appendix L of Budget paper 3 indicate that a one percentage point reduction in the discount rate on the superannuation liability would increase the estimated superannuation liability by $1.4 billion and the associated expense by $21.4 million in 2019-20.

Icon Water

Icon Water is subject to potentially significant risks arising from factors outside of its control that affects its operating environment (ACT Government 2019, p.430). In addition to its water and sewerage business, Icon Water also part owns ActewAGL, the ACT electricity and gas distributor and retailer. As a provider and owner of monopoly infrastructure services, Icon Water's revenue streams and thus dividend payments to the ACT Government are subject to the determination of price regulators, such as the ACT Independent Competition and Regulatory Commission. In addition, retail electricity market competition and extreme weather events can affect its operations. There are also potential liabilities should there be catastrophic failings in electricity infrastructure.

10. Budget accounting, classification and valuation issues

Valuation effects, accounting treatments and timing issues continue to have large impacts on the budget aggregates and on the reported budget balance.

10.1 Overview

The 2019-20 Budget reflects decisions on a number of accounting, classification and valuation issues.

The following sections provide comment on the budget accounting and classification issues that have material impacts on the Budget aggregates and how they are presented.

10.2 Disclosure of Key Accounting Policies

The Budget financial statements, including the budget deficit, and associated tables, are presented in Chapter 9 of Budget Paper 3. The statements are titled "GFS/GAAP HARMONISED FINANCIAL STATEMENTS" suggesting that Australian accounting standard AASB 1049 Whole of Government and General Government Sector Financial Reporting has been adopted as the key basis for the preparation of the statements. The presentation format of the statements suggests this is the case. AASB 1049 requires compliance with all other applicable accounting standards in the preparation of the statements.

Unlike several other Australian jurisdictions, including the Commonwealth, the basis of accounting and the key accounting policies adopted in preparing the statements, except in respect to Public Private Partnerships, Appendix B, have not been disclosed. In addition, and whilst key revenue streams and key expenses are detail at Tables 9.5 to 9.11, there is no disclosure of key assets such as investments and loans, investments in other public sector entities, and produced and non-produced property plant and equipment, nor key liabilities such as advances received, borrowings, superannuation and employee benefits.

Although some of these items, such as liabilities associated with Public Private Partnership arrangements, are described elsewhere in the Budget Papers, typically the financial statements would be accompanied by a series of notes, describing the accounting policies adopted and providing a breakdown of key financial statement items. By way of comparison, some other jurisdictions include a statement of significant accounting policies and forecast assumptions and include disclosure of the likely impact of new or amended accounting standards applicable in the future.

Such an approach enhances accountability and transparency for the user/s of the statements.

The Committee may wish to explore with officials a number of issues in relation to the accounting treatment in the Budget for Public Private Partnerships. These include:

- Was AASB 1049 adopted as the basis of accounting and presentation in preparing the budget financial statements?
- Why, unlike other Australian jurisdictions, are the bases of accounting, key accounting policies and a disaggregation of key assets and liabilities not disclosed in notes accompanying the financial statement?

10.3 Technical Adjustments

The Budget and supporting documents contain a series of "Technical Adjustments". Some of these adjustments appear to move transactions and balances across years, including from 2018-19 to the Budget year and visa versa.

Although footnoted, these adjustments are not explained, indeed some are tagged not for publication.

As discussed above, Pegasus is of the view that that to enhance accountability and transparency for the user/s, such adjustments should be explained.

Accordingly, we encourage the Committee to seek explanations from officials.

10.4 Superannuation return adjustment

As in previous recent Budgets, the presentation of the headline operating balance for 2019-20 includes an adjustment for long-term expected superannuation investment earnings.

The 2016-17 Budget Papers argued that a superannuation return adjustment was necessary because, although the Government Finance Statistics (GFS) reporting framework requires the inclusion of superannuation interest costs and other superannuation expenses in the operating balance, it only allows for interest income and dividends to be included as a transactional revenue item in the net operating balance, ignoring the capital growth on the assets in the Superannuation Provision Account (ACT Government, 2016, p. 42).

The superannuation return adjustment is problematic in terms of the accounting standards adopted for the Budget. However, given that the emerging costs associated with the superannuation liability are included in the Budget, it is reasonable that the Budget Papers also show the economic flows associated with closely matched investments. In a partially funded superannuation scheme, the assets of the scheme would be netted off the gross liability and the interest cost would arise only on the unfunded component of the liability. This effectively allows for assets to earn a rate of return equal to the discount rate. However, by using the projected total investment return to calculate the superannuation adjustment return, the ACT is adopting a more aggressive assumption that has the effect of improving the budget balance.

The superannuation return adjustment has been based on the long-term return objective of Consumer Price Index (CPI) plus 4.75 per cent per annum (ACT Government, 2019, p. 302). The Budget Papers note that over the past 23 years (1996-97 to 2018-19), the Superannuation Provision Account portfolio has generated a nominal investment return of 7.7 percent per annum, or CPI plus 5.2 percentage points (ACT Government, 2019, p. 302). However, this has been a period of historically high investment returns and given current market conditions a lower expectation would be justified. The annual return objective was reduced from CPI plus 5 percentage points to the current return objective of CPI plus 4.75 percentage points in the 2018-19 Budget (ACT Government, 2018, p 305). This is consistent with the most recent Future Fund mandate, which requires an average return of at least the Consumer Price Index (CPI) plus 4 to plus 5 percentage points per annum over the long term as the benchmark return on the Fund (Commonwealth of Australia, 2017a).

However, the Committee should note that the return assumption in this adjustment has the potential to materially shift the budget aggregates and that variations in investment returns from the Territory's Superannuation Provision Account can by themselves be significant enough to swing the balance from surplus to deficit.

There is a particular issue with the superannuation return adjustment for the 2018-19 estimated outcome. The figures provided in Table 2.2.1 suggest that capital growth in the Superannuation

Provision Account amounted to $196.6 million over 2018-19 (ACT Government, 2019, p. 41). However, the total return for the year shown in Table 8.3.3 is only $213.2 million (ACT Government, 2019, p. 303). This would imply that interest and dividend income was only $16.6 million for the year. This appears very low and out of line with future projections.

It seems more likely that the superannuation return adjustment has not been adjusted for the lower than anticipated return on the Superannuation Provision Account. If the interest and dividend income were in line with the assumptions for future years and amounted to approximately $100m, the superannuation return adjustment would be reduced to $113.2 million and the HNOB for the year would be -$40 million, altering the outcome from surplus to deficit.

The Committee might wish to seek information on the calculation of the superannuation return adjustment for 2019-20, particularly in light of the sensitivity of the budget aggregates to variations in the actual return on the Territory's superannuation investments.

10.5 Superannuation liability valuation and service costs

The discount rate used to calculate the present value of the Territory's superannuation liability has a significant impact on the estimated value of the superannuation liability and related superannuation expenses.

It is also important to note that the Budget forecasts for the superannuation liability and associated expenses are calculated using a different discount rate from that used in reporting for the Territory's financial statements. The Budget forecasts use a long-term discount rate while for financial reporting the prevailing Government bond rate is used.

The long-term discount rate utilised in the 2018-19 Budget has been maintained at the 5 per cent per annum employed in the 2019-20 Budget. This rate is consistent with the long-term discount rate used by the Commonwealth Government to estimate the liability valuation for its own defined benefit employer superannuation liabilities (ACT Government, 2019, p. 300).

Reporting at the end of the financial year in the financial statements is required under the Australian Accounting Standards (AASB 119) to be prepared on the basis of the yield on a suitable Commonwealth Government bond. The liability valuation at 30 June 2018 utilised a discount rate assumption of 3.11 percent (ACT Government, 2019, p. 301).

Notwithstanding the reduction in the discount rate adopted for the 2018-19 Budget, bond rates remain well below 5 percent per annum. It would, therefore, be expected that the reported superannuation liability as at 30 June 2019 will, as in 2018, be considerably higher than the figure forecast in the Budget Papers.

Table L.5 in the Appendices to Budget Paper 3 indicates that a 1 per cent decrease in the discount rate from the long-term budget assumption of 5 per cent would increase the estimated liability by over $1 billion.

Table 17: Impact of a 1 percentage point decrease in the discount rate on superannuation expense

	2019-20	2020-21	2021-22	2022-23
	$'000	$'000	$'000	$'000
Superannuation Provision Account*	**1,323,957**	**1,343,638**	**1,359,484**	**1,371,636**

Source: (ACT Government, 2019, p. 441)

*As described in Budget Statement 3, p 441. The item actually describes the additional superannuation liability.

The lower discount rate will also have an impact on the service cost, which would be expected to be somewhat higher, with an offsetting reduction in the interest cost. Based on the figures reported in Budget Paper 3 (ACT Government, 2019, p. 300), the net effect of these adjustments to the service and interest costs appears unlikely to be material in the Budget year. However, this will not always be the case, and the Committee should be aware that in the prevailing interest rate environment, the application of a higher discount rate to the Budget estimate of the Territory's superannuation liabilities will generally have the effect of decreasing the estimate of the superannuation liability and service costs. There is thus a trade-off between achieving consistency between budget and forward year figures and the need for a subsequent revision of the estimates when the final outcome for the year is known.

Table L.6 in the Appendices to Budget Paper 3 indicates that a 1 per cent decrease in the discount rate from the long-term budget assumption of 5 per cent would increase the superannuation expense in the headline net operating balance by $24 million in 2019-20 and $20 million in 2020-21. The table is replicated below.

Table 18: Impact of a 1 percentage point decrease in the discount rate on superannuation expense

	2019-20	2020-21	2021-22	2022-23
	$'000	$'000	$'000	$'000
Superannuation Provision Account*	**-23,803**	**-20,015**	**-16,388**	**-12,946**

Source: (ACT Government, 2019, p. 441)

*As described in Budget Statement 3, p 441. The item actually describes the additional superannuation expense.

Further discussion of the impact of the changes in the superannuation liability are provided in section 8.5 on superannuation liabilities and section 3.3 on balance sheet measures of the fiscal position.

10.6 Public Private Partnerships

The ACT is currently engaged in two Public Private Partnerships (PPP) projects: the ACT Law Courts Facilities, and Light Rail Stage 1 (ACT Government, 2019, pp. 200-201).

The Committee would be aware that the ACT Government has adopted an accounting policy for these projects that results in their being accounted for as leases on a risk and rewards approach (ACT Government, 2019, p. 349). The treatment of these projects as leases impacts on the way they are described in the budget.

The value of the leased assets, and the corresponding lease liabilities, are recognised in the balance sheet at the commencement of the lease term, which will be when the assets are ready for the provision of services. The ACT Government's initial direct costs are capitalised when incurred and will be added to the final lease assets at the commencement of the lease term.

It is noted that Light Rail-Stage 1 commenced services on 20 April 2019 and that lease assets, liabilities, maintenance costs and service payments have been accounted for in the budget financial statements for the budget and forward years.

Appendix B of Budget Paper 3 indicates that at the end of the construction contracts, the infrastructure will become ACT assets (ACT Government, 2019, p. 349). This is taken to mean that once the projects are operational, the infrastructure is owned by the Territory.

Appendix B also indicates there is currently no applicable Australian accounting standard relating to these arrangements from the perspective of the government as grantor and accordingly, similar to

other Australian jurisdictions, a United Kingdom accounting standard and application note has been adopted (ACT Government, 2019, p. 349). This particular standard treats such arrangements as leases.

In 2011 the International Public Sector Accounting Standards Board (IPSASB) (2011) issued IPSASB 32, Service Concession Arrangements: Grantor. This standard established the accounting for PPP arrangements from the grantor's (government's) perspective. In terms of the hierarchy of accounting policies, this standard is relevant.

In July 2017 the Australian Accounting Standards Board (AASB) (2017) issued AASB 1059, Service Concession Arrangements: Grantor. AASB 1059 is based on IPSASB 32. In October 2018 the AASB (2018) issued an amendment standard that deferred the commencement of AASB 1059 from 1 January 2019 to 1 January 2020. Specifically, AASB 1059 applies to reporting years commencing on or after this new date. This change is reflected at Appendix B. Accordingly, AASB 1059 does not apply to the Budget year but becomes applicable to the first of the forward years being 2021 and onwards. Notwithstanding the application date, AASB 1059 can always be early adopted and this is a matter of judgement for the ACT Government as preparer of the Budget and the budget financial statements.

AASB 1059 does not treat PPP arrangements as leases, but instead, requires the assets and liabilities to be recognised in the balance sheet and valued at current replacement cost, when the government gains control of these assets and liabilities, generally taken to be when the project becomes operational. Any intangible assets such as intellectual property rights, must be included in the aggregate of project assets.

The critical issue is which accounting treatment, leases, AASB 1059 or an approach similar to AASB 1059, appropriately reflects the substance of the transaction.

In terms of the accounting policy hierarchy in choosing the most appropriate accounting treatments (AASB 108) and as AASB 1049 appears to have been adopted which, as indicated above, requires the application of all other accounting standards, it would in our view have been appropriate to early adopt AASB 1059. This approach more faithfully reflects the substance of the transactions. This is particularly so in respect to the Light Rail Stage 1 project, given that the project became operational on 20 April 2019. That is, the Light Rail Stage 1 project assets, liabilities and cash flows were controlled by the Government from that date.

Had AASB 1059 been adopted, the impact on the budget balances is uncertain.

It is currently unclear as to what approach other Australian jurisdictions will adopt for these arrangements as their budgets are yet to be presented.

The Committee may wish to explore with officials a number of issues in relation to the accounting treatment in the Budget for Public Private Partnerships. These include:

- Why AASB 1059, Service Concession Arrangements: Grantors has not been adopted early for the Light Rail Stage 1 and the Law Courts PPP projects?
- In any case, why AASB 1059 was not adopted in respect to the Budget forward years?
- What impact on the budget balances would have been had AASB 1059 been adopted?

The Committee should note these are complex issues and Pegasus is available should clarification in private, be required.

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