2018

Review of the ACT Budget 2018-19

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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 ACT Legislative Assembly Select Committee on Estimates 2018-19 to assist the Committee in its deliberations in relation to the 2018-19 ACT Budget.

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

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Executive Summary

The Budget Papers present a headline operating surplus of $36.5 million in 2018-19 and a budget balance that remains in surplus through the forward estimates period. The immediate fiscal outlook is positive and sustainable. However, despite the expected operating surplus, the longer-term balance sheet position is slightly weaker than in previous years. A number of risks are attached to the forecast surpluses.

Overview

This report has been prepared by Pegasus Economics (Pegasus) to assist the ACT Legislative Assembly's Select Committee on Estimates in its consideration of the 2018-19 ACT Budget.

While the economic estimates for 2017-18 and forecasts for 2018-19 contained in the ACT Budget generally appear reasonable, projections for ACT final demand, employment growth, the Wage Price Index and population growth in the out-years may be vulnerable to pressure as a result of Commonwealth Government fiscal restraint and the impact of ACT Government tax changes. Pegasus also suspects that policies and practices pursued by the ACT Government may have locked in slightly higher levels of inflation than experienced in the other capital cities.

The Budget Papers present a headline operating surplus of $36.5 million in 2018-19 and a budget balance that remains in surplus through the forward estimates period. The fiscal position is sustainable. However, despite the expected operating surplus, the longer-term balance sheet position is slightly weaker than in previous years.

Net debt and net financial liabilities are rising at a faster rate than net worth, 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 $8.5 billion by 2021-22, around $1 billion dollars higher than forecast last year, as a result of a change in the discount rate assumption.

Revenue is expected to increase by $247.2 million from an estimated outcome of $5.4 billion in 2017-18 to almost $5.7 billion in 2018-19. In contrast to the last two budgets, in this budget the ACT Government is moving closer towards a hard budget constraint whereby it is responsible for raising most of its additional revenue. On the other hand, it does appear the ACT Government will become increasingly dependent on the Commonwealth Government in the out years to fund increases in revenue and thus may escape the incentives and disciplines imposed by a hard budget constraint. 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.

Expenditure is forecast to grow over the budget and forward estimates from $5.8 billion in 2017-18 to $6.5 billion in 2021-22. Health, General Public Services and Education spending constitute the largest part of the Territory's budget through the Budget and forward years. The Budget contains just under two hundred separate expense initiatives totalling $363.9 million (net of the heath funding growth envelope) over the budget and forward years.

Issues that may benefit from further investigation

In its examination of the 2018-19 ACT Budget, Pegasus believes the following issues are worth further investigation by the Committee:

- Information on the sensitivity of the Budget aggregates to higher or lower growth, and the sensitivity to changes in assumptions regarding wages, population and employment.
- Advice on the expected schedule of revenue and expenses relating to the Large-scale Generation Certificates over the Budget and forward years and, given the uncertainties surrounding the national electricity market, what reference point was used to determine a reliable value for these certificates and how much uncertainty should be attached to the estimates of economic value embedded in the Certificates?
- Information to explain the reduction in dividends of $55.4 million from the City Renewal Authority (CRA) and the Suburban Development Agency (SDA) in 2021-22.
- Whether a more detailed break-down of expenses by function into the standard sub-functional categories and whether it is practical to provide historical information on the same basis as employed in this year's Budget.
- While the level of transparency in reporting on the delivery of the Safer Families package is commendable, why this level of transparency is not extended to other new initiatives announced in previous Budgets?
- Information on the number, duration and location of unsold blocks under the Asbestos Eradication Scheme, to assist in an understanding of the potential for slippage.
- Information on the expected expenditure on repairs and maintenance of the public housing stock over the budget and forward years.
- Given the significant variations in out-year estimates of the capital works program across successive budgets, the nature of the planning conducted for the capital works program.
- Further information on the potential expense and capital implications of Stage 2 of the Light Rail project for future Budgets.
- Confirmation that Australian Accounting Standards Board (AASB) standard 1049 was adopted as the basis of accounting in preparing the budget financial statements.
- Information on why, unlike other Australian jurisdictions, the basis of accounting, key accounting policies and a disaggregation of key assets and liabilities are not disclosed in notes accompanying the financial statement provided in Budget Paper 3.
- Advice on issues in relation to the accounting treatment in the Budget for Public Private Partnerships including:
  - why AASB 1059 *Service Concession Arrangements: Grantors* has not been adopted for the Light Rail – Stage 1 and the Law Courts PPP projects?
  - the impact on the budget balances if AASB 1059 had been adopted?
  - the implications for the Territory balance sheet and Budget if AASB 1059 were applied to Stage 2 of the Light Rail project
- Information on the sensitivity of the budget aggregates to a 1 percent variation in the actual return on the Territory's superannuation investments.
- The Budget impacts, if any, arising from splitting the Health Directorate into two new agencies and the indirect costs associated with the achievement of Budget initiatives in the Health area and the achievement of offsets required within the Health funding envelope.
- The Committee should note that some of these issues are highly technical and Pegasus Economics is available should clarification be required.

1 Introduction

This draft report has been prepared by Pegasus Economics to assist the ACT Legislative Assembly's Select Committee on Estimates 2018-2019 in its consideration and review of the 2018-19 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 2018-2019 to assist the Committee in its deliberations in relation to the 2018-19 ACT Budget.

1.2 Background

Pegasus Economics (Pegasus) was engaged by the Legislative Assembly on 21 May 2018 to assist the Select Committee on Estimates 2018-2019 with its assessment of the 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 Committee in its consideration of the 2018-19 Budget.

The report does not provide a complete or comprehensive summary of the 2018-19 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 Wednesday 30 May 2018.

The report is based on a desk-top review of the ACT Budget documentation presented to the Assembly on 5 June 2017. 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 Economic Forecasts

While the economic estimates for 2017-18 and forecasts for 2018-19 contained in the ACT Budget generally appear reasonable, Pegasus suggests that projections for ACT final demand, employment growth, the Wage Price Index and population growth in the out-years may be optimistic for a number of reasons including ongoing Commonwealth Government fiscal restraint and ACT Government tax changes. Pegasus also suspects that policies and practices pursued by the ACT Government may have locked in slightly higher levels of inflation than experienced in the other capital cities.

A summary of current economic trends alongside the economic estimates and forecasts contained in the 2018-19 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 2018[1]	ACT Budget 2017-18 estimates	ACT Budget 2018-19 forecasts
State Final Demand[2]	3.2	4	3
Employment[3]	2.2	3	2
Wage Price Index	1.9	2	2½
Consumer Price Index	2.4	2¼	2¼
Population[4]	1.8	1¾	1¾

1. Year to the end of March 2018 and through the year unless otherwise stated
2. In year average seasonally adjusted terms
3. Though the year to the end of May 2018 in trend terms (as seasonally adjusted figures are not provided for the ACT)
4. Through the year to the end of September 2017

Sources: Australian Bureau of Statistics (ABS) (2018; 2018a; 2018b; 2018c; 2018d) and ACT Government (2018a).

2.1 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.

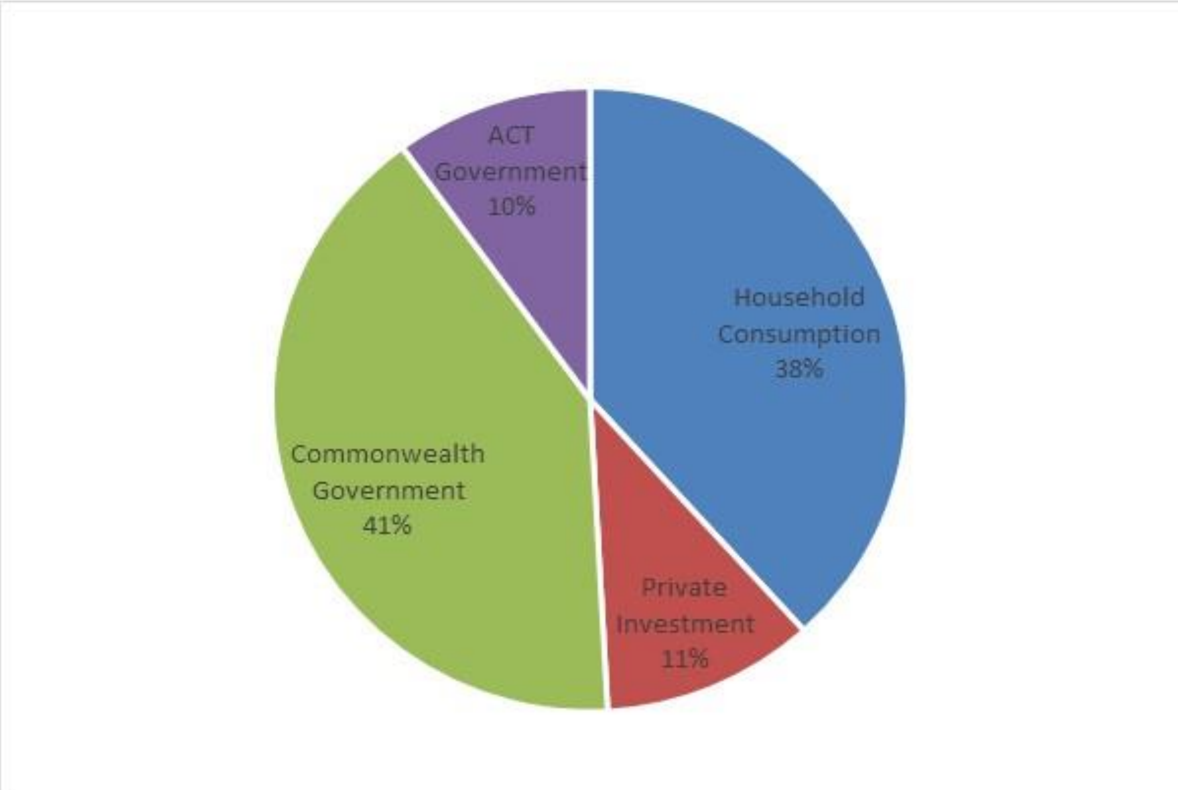
In the March 2018 national accounts released by the Australian Bureau of Statistics (ABS) (2018a) on 6 June 2018 (the day after the ACT Budget was delivered), the ACT recorded a contraction in demand of 0.8 per cent in seasonally adjusted terms during the March quarter, largely driven by a contraction in general government final consumption expenditure. This compared to a modest result for the national economy where demand grew by 0.6 per cent.

In light of the contraction in demand recorded in ACT final demand in the March quarter, growth in final demand is now currently tracking well behind the Budget forecast for 2017-18 of 4 per cent growth. In light of this, the estimate of final demand growth of 4 per cent in 2017-18 is highly unlikely to be achieved. Growth in demand for the June quarter 2018 would need to reach 6 per cent for the Budget estimate for 2017-18 to now be realised, although the ACT has twice surpassed growth rates of this magnitude since 2000 during June quarter 2010 and the March quarter 2011.

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 this regard, it should be noted the Australian Bureau of Statistics (ABS) has revised its methodology so that social benefits to households such as Medicare, the Pharmaceutical Benefits Scheme and the National Disability Insurance Scheme are now allocated to each of the States and Territories using the estimated resident population rather than Commonwealth Government wages and salaries (ACT Government, 2018).[1]

This has resulted in a substantial downward revision to the ACT's final demand and has also affected historical growth rates for final demand, as well as the Commonwealth Government's contribution to ACT final demand. Despite this, in the year to the end of March 2018, the Commonwealth still represented almost 41 per cent of total demand in the ACT economy, compared to household consumption that made up just over 38 per cent, private investment of almost 11 per cent, and 10 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 2018

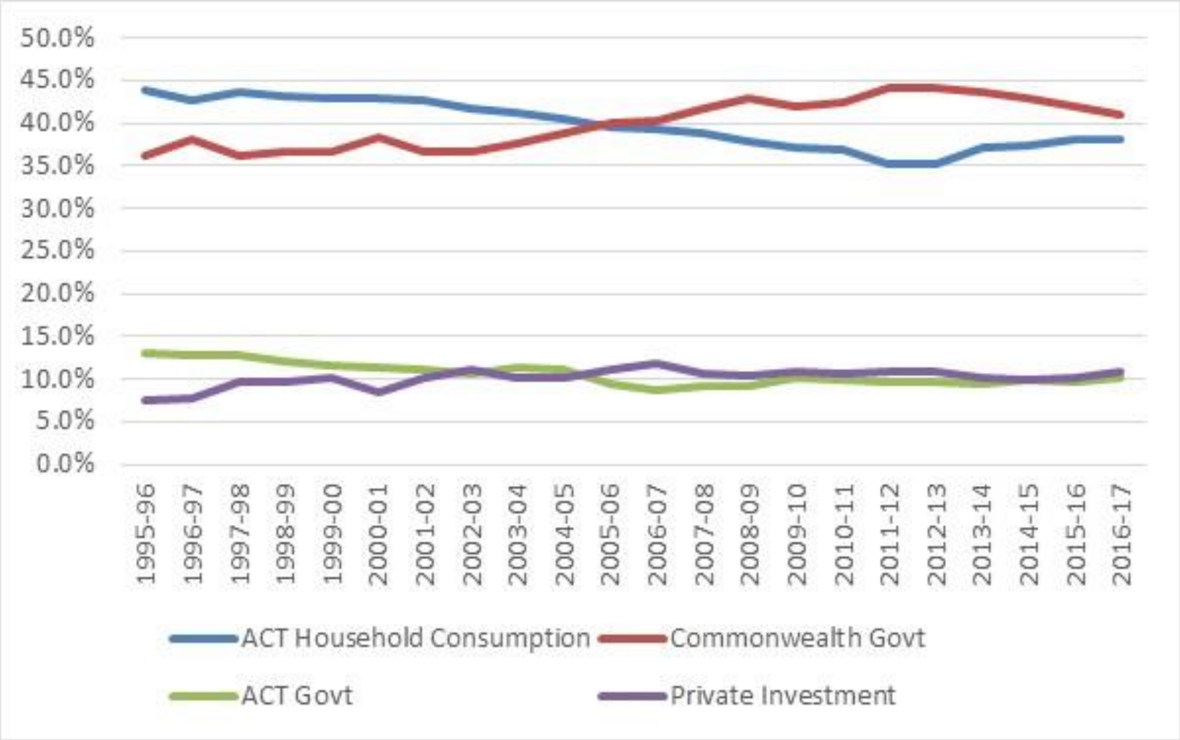


Source: ABS (2018a)

Using the revised ABS methodology, the historical relative shares of ACT final demand are provided in Figure 2 below.

[1] See ABS (2017b).

Figure 2: Relative shares of ACT Final Demand – 1995-96 to 2016-17

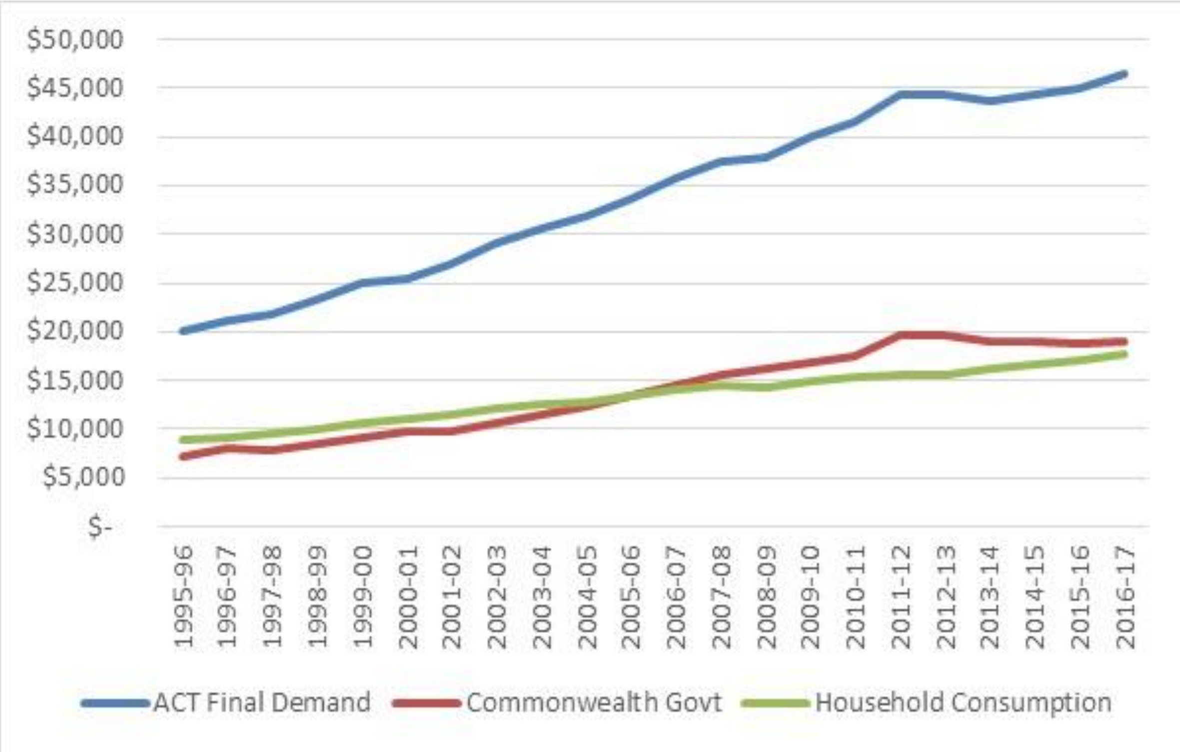


Source: ABS (2018a)

On the basis of the revised methodology, 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, although household consumption and Commonwealth Government spending are now converging. The contribution of the ACT Government to final demand has been hovering at around 10 per cent on average since 2009-10, while private investment has been hovering at around 10.5 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 making up in excess of 50 per cent of final demand.

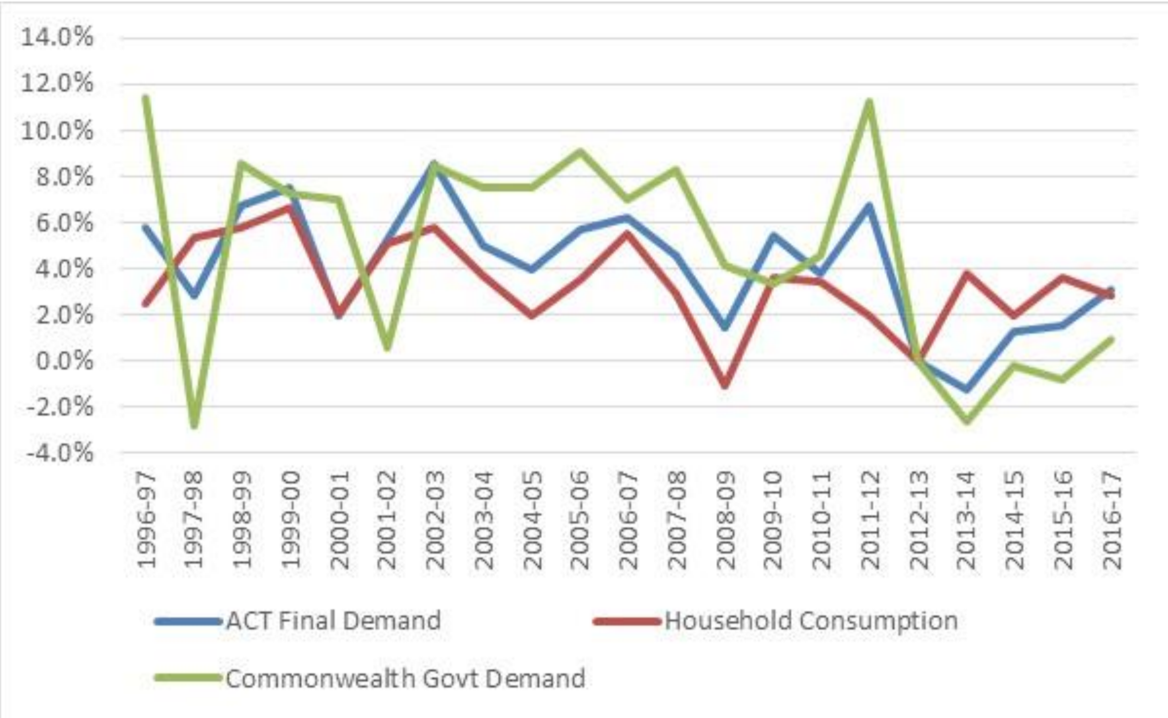
There is a close relationship between ACT final demand, Commonwealth Government expenditure and household consumption, as outlined in 3 below, as well as between growth in ACT final demand and the growth of Commonwealth Government expenditure and household consumption, as outlined in Figure 4.

Figure 3: ACT Final Demand and the contribution of the Commonwealth Government and Household Consumption – 1994-95 to 2015-16 ($ million, constant 2015-16 dollars)



Sources: ABS (2018a)

Figure 4: Percentage Growth in ACT Final Demand, Commonwealth Expenditure and Household Consumption – 1996-97 to 2016-17



Sources: ABS (2018a)

In the 2018-19 Commonwealth Budget, Commonwealth Government payments are expected to increase in real terms by 2.7 per cent in 2017-18, by 3.1 per cent in 2018-19, before moderating to 0.2 per cent in 2019-20, 1.1 per cent in 2020-21 and 1.9 per cent in 2021-22 (Commonwealth of

Australia, 2018a, p. 6.5). Given there is sufficient growth in Commonwealth Government payments to support continuing growth in demand for the ACT economy in 2018-19, Pegasus has no reason to question the ACT Budget estimate of 3 per cent demand growth for the ACT economy in 2018-19.

However, 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, 2018a, p. 2). However, Pegasus 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 2019-20 based on 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 largely 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 (2018b, p. 6):

> Through careful management of the nation's budget, average annual real expenditure growth remains below two per cent, which is the lowest of any government in the last 50 years. Average growth in real payments is expected to average 1.9 per cent over the period 2013-14 to 2021-22.

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 towards surplus. While it could be argued that Commonwealth Government expenditure restraint is a temporary measure likely to fall away as the country moves towards the next federal election, the threat of a credit rating downgrade is likely to continue to impose ongoing fiscal discipline upon the Commonwealth Government.

Pegasus believes that ACT final demand projections of around 2½ in 2019-20 and 3 per cent growth in 2020-21 and 2021-22 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 in the ACT Budget.

2.2 Employment

Employment growth through the year to the end of May 2018 for the ACT was running at 0.1 per cent in original terms and 2.2 per cent trend terms (Australian Bureau of Statistics, 2018c). According to the ABS (2018c), 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). The significant discrepancy between employment growth in original and trend terms can be explained by the significant ratcheting up of employment between September and December 2017 with employment growth going into reverse so far during 2018.

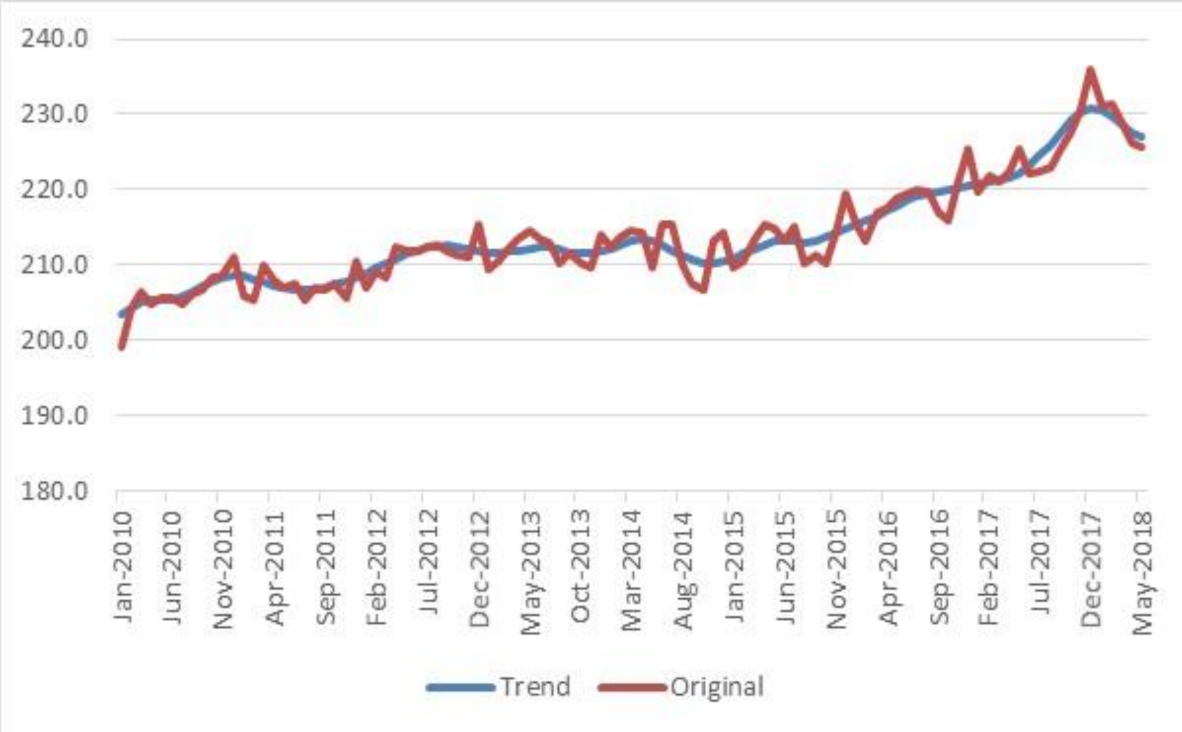
Reflecting the increase in employment from September to December 2017, the ACT Government (2018, p. 16) observed in its mid-year *Budget Review* that:

The ACT's labour market conditions have been stronger than expected at the time of the 2017-18 Budget, with over 10,000 jobs created over the year to December 2017. This 4.6 per cent growth rate is well above the ten year average rate of growth of 1.4 per cent.

Based on these reflections, the ACT Government (2018, p. 17) revised up its forecast of employment growth for 2017-18 to 4.5 per cent in its mid-year *Budget Review*.

As the trend estimate of employment relies on the smoothing of the data and is thus backward looking, it has yet to fully catch up with the reversal in employment growth that has occurred so far during 2018. 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 2018



Source: ABS (2018c).

Given the results of the most recent Labour Force Survey (Australian Bureau of Statistics, 2018c) that revealed employment has continued to fall since December 2017, the estimate of employment growth of 3 per cent in 2017-18 is now unlikely to be realised. With ACT demand forecast to slightly moderate in 2018-19, one would also generally expect to observe some moderation in employment growth. On this basis, a forecast of employment growth of 2 per cent in 2018-19 may appear to be slightly on the upside, although not unreasonably so.

In 2018-19 the employment situation for the ACT is only likely to receive a very modest boost from the Commonwealth Government (2018, p. 17) if anything at all. While the civilian workforce of the Commonwealth Government is expected to grow with an overall net increase of 912 positions across Australia, some 540 new positions will be created in the National Disability Insurance Scheme Launch Transition Agency that is located in the Victorian regional city of Geelong. Also, while the Commonwealth Government's full-time military workforce is expected to increase by almost 1,200 full-time positions in 2018-19, this will largely be offset by a reduction of just over 1,100 full-time positions in the civilian workforce of the Department of Defence.

There are also two major risks to the outlook for employment growth posed by the Commonwealth Government. The first risk is the Commonwealth Government's decentralisation program that was announced in April 2017 by the then Minister for Regional Development who commented:

> Departments will need to either indicate that they're suitable to move to the regions or justify why all or part of their operation is unsuitable. (Nash, 2017)

The Commonwealth Government (2018d, p. 146) has already relocated the Rural Industries Research and Development Corporation from Canberra to Wagga Wagga, and is currently in the process of relocating 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, 2018d, p. 147). However, there appear to be some mitigating factors regarding the impact of the Commonwealth Government's decentralisation program on the ACT. First, the Commonwealth Government Ministers who were most outspoken public proponents are no longer Ministers. Second, the extent relocations announced so far are relatively modest.

The second risk is the outcome of the Independent Review of the Australian Public Services (APS) announced by the Prime Minister and the Minister Assisting the Prime Minister for the Public Service in May 2018 (Turnbull & O'Dwyer, 2018). The review will focus on the medium and longer term to ensure that the APS remains fit for purpose for the coming decades and will make practical recommendations to ensure the APS's culture, capability and operating model are suited to harness opportunities for a transforming Australian society and economy (Commonwealth of Australia, 2018, p. 4).

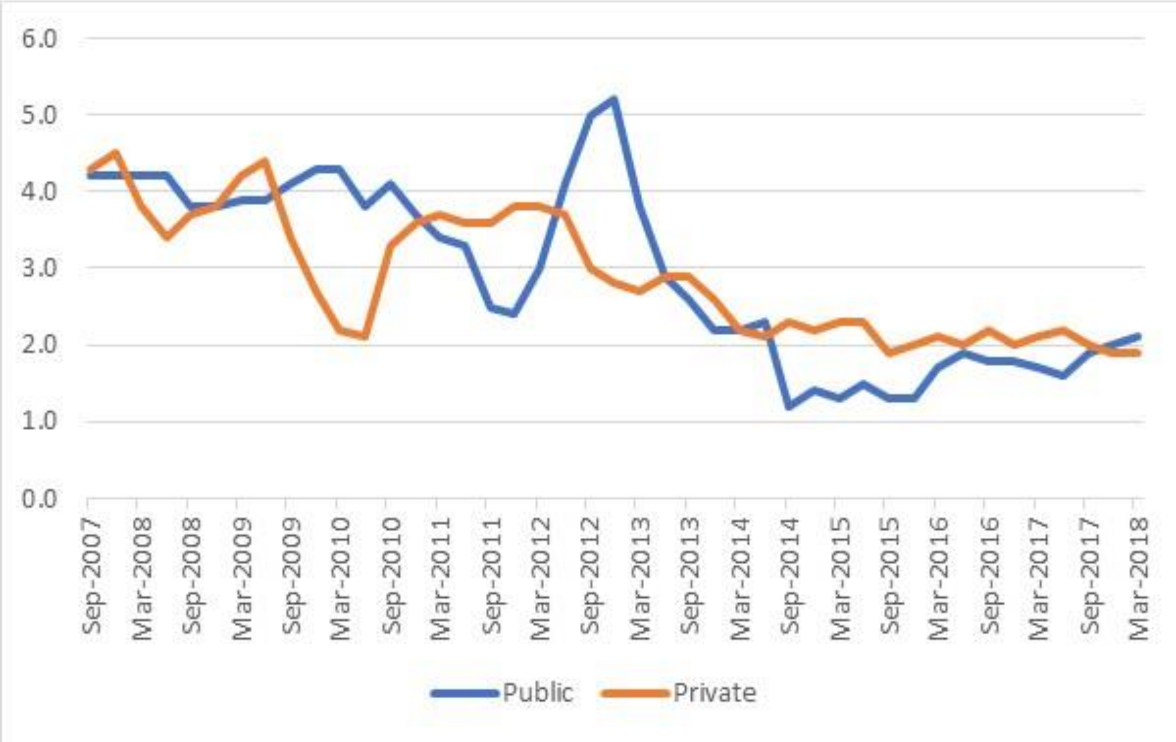
In light of the importance of the Commonwealth Government to the ACT economy, and given the current constraints on real payments growth by the Commonwealth Government (2018b, p. 6), ongoing employment growth for the ACT in the order to 1½ per cent arguably represents an upper limit on what is realistically possible in the out-years.

2.3 Wage price index

The Wage Price Index (WPI) is currently running at 1.9 per cent through the year to the end of the March quarter 2017 (Australian Bureau of Statistics, 2018d), which is consistent with the ACT Budget estimate of 2 per cent for 2017-18.

Since 2013 wages growth in the private sector has generally outstripped that recorded within the public sector within the ACT, although this situation has recently reversed in both the December quarter 2017 and the March quarter 2018 as outlined in Figure 66 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 2018



Source: Australian Bureau of Statistics (2018d)

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 2018-19 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 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 2¼ per cent for the WPI in 2018-19 may not appear unreasonable, it does appear on the high side and the projections of growth in excess of 2 and eventually 3 per cent in the out years does appear overly optimistic. Outcomes around 2 per cent for growth in the WPI for the estimate in 2018-19 and projections in the out-years would be more realistic in our opinion.

2.4 Consumer price index

The Consumer Price Index (CPI) percentage change through the year to the end of the March quarter 2018 for Canberra was 2.4 per cent (Australian Bureau of Statistics, 2018b). While this is consistent is consistent with the 2018-19 ACT Budget estimate of 2¼ per cent change through the year in 2017-18, Canberra is currently enduring the highest rate of growth in the level of consumer prices or inflation across all capital cities, compared to a weighted national average of 1.9 per cent.

The ACT Government has responsibility over many of the areas recording the highest price growth pressure in the year to the end of the March quarter 2018, including:

- Property rates and charges up 8.0 per cent;
- Utilities up 12.3 per cent with gas up 17.8 per cent, electricity up 10.6 per cent and water and sewerage up 8.3 per cent;
- Medical and hospital services up 6.8 per cent; and
- Primary education up 4.8 per cent and secondary education up 4.6 per cent.

Together these services account for around 12 per cent of the weight in the CPI for Canberra.

The large price increase in property rates though 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 2017-18 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 and similar price pressures are evident across the entire country. On the other hand, the ACT Government is responsible for the provision of water and sewerage services in the ACT through its ownership of the monopoly service provider Icon Water Limited. However, Icon Water is subject to independent price oversight regulation from the ACT Independent Competition and Regulatory Commission (ICRC) (2017, p. 1) that can determine the maximum prices that Icon Water can charge for its regulated water, sewerage and miscellaneous services. There can be significant annual variations in price changes in relation to water and sewerage charges with annual CPI price changes ranging from an increase of 12.1 per cent in 2011-12 to a fall of 4.1 per cent in 2013-14. While water and sewerage charges rose significantly in 2017-18, based on the recent price determination of the ICRC (Independent Competition and Regulatory Commission, 2018) it appears water and sewerage charges will undergo a price reduction during 2018-19.

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 55.6 per cent compared to the national average of 45.5 per cent, ACT residents are paying twice the national average in out-of-pocket payments for hospital medical services, at an average $280.99 for each patient in an ACT hospital compared to a national average of $167.05 (Australian Prudential Regulation Authority, 2018).[2] Similarly, the ACT's hospital system has the lowest proportion of specialist services with no gap, at just 79.5 per cent, compared with the national average of 88.5 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).

In relation to primary and secondary education, the ACT Government is directly responsible for the education of around 62 per cent of all enrolled students through it public school system (ACT Government Education Directorate, 2018, p. 2).

Another major driver of price growth for which the ACT Government has no responsibility nor control over is automotive fuel that was up 8.1 per cent in the year to the end of the March quarter 2018 and would similarly impact across all capital cities.

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[2] 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).

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 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 in the ACT than in any other jurisdiction in Australia except the Northern Territory of $18,172 in 2015-16 per student compared to a national average of $15,262 (Productivity Commission, 2018). The ACT also spends more recurrent expenditure per person on public hospital services than any other jurisdiction in the country of $3,674.9 per person in 2015-16 compared to a national average of $2,440.9, although the ACT expenditure is overstated to some degree as ACT public hospitals also service New South Wales residents.

For 2018-19, the budget forecast is for the CPI to remain constant in 2018-19 at 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. On this basis, a CPI forecast in 2018-19 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 setting them equivalent.

2.5 Population growth

Only one quarter of population data is available for the 2017-18 financial year. The ACT recorded population growth of 1.8 per cent through the year to the end of the September quarter 2017 (Australian Bureau of Statistics, 2017) which is consistent with the ACT Budget estimate of 1¾ per cent growth in 2017-18.

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. On this basis, the 2018-19 Budget forecast and projections in the out-years for constant population growth of 1.5 per cent appear somewhat optimistic.

There are two potential risks to ACT population growth posed by the Commonwealth Government. Those are the Commonwealth Government's decentralisation program and the Independent Review of the APS previously discussed above in relation to employment.

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 15 years. The Housing Industry Association warned earlier this 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 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)

3 Fiscal Position

The Budget Papers present a headline operating surplus of $36.5 million in 2018-19 and a budget balance that remains in surplus through the forward estimates period. The immediate fiscal outlook is positive and sustainable. However, despite the expected operating surplus, the longer-term fiscal position is slightly weaker than in previous years. Net debt and net financial liabilities are rising at a faster rate than net worth, and the ratio of net worth to gross state product (GSP) is in decline.

3.1 Operating Statement - Headline Operating Balance

The Budget Papers present a headline operating surplus of$36.4 million for 2018-19 and a budget balance that remains in surplus through the forward estimates period, after an adjustment to reflect superannuation returns.

Table 2: General Government Sector Headline Net Operating Balance

	2017-18 Est. Outcome $'000	2018-19 Budget $'000	2019-20 Estimate $'000	2020-21 Estimate $'000	2021-22 Estimate $'000
Revenue	5,424,088	5,671,305	5,854,703	6,108,325	6,335,102
Expenses	-5,566,218	-5,818,171	-6,004,634	-6,290,286	-6,505,509
Superannuation return adjustment	174,017	183,325	193,887	207,883	222,901
HEADLINE NET OPERATING BALANCE	**31,887**	**36,459**	**43,956**	**25,922**	**52,494**

Source: ACT Government (2018a, p. 39)

Table 2 shows that revenue and expenses are expected to increase relative to the 2017-18 estimated outcome, and to continue to grow at relatively stable rates over the forward estimates period.

Revenue growth of $247.2 million in the Budget in 2018-19 over the estimated 2017-18 outcome primarily reflects expectations of higher proceeds that own-source revenue will increase by $176.6 million, increases from contributed assets of $54.9 million,[3] increased distributions from the GST of $35.9 million, and higher revenues from the sales of goods and services of $23.7 million, partially offset by reductions of $18.2 million in other miscellaneous revenue, $13.3 million from dividends and income tax equivalents, and $11.8 million from Commonwealth Government grants.

The forecast expenses of $5.8 billion in 2018-19 are $252.0 higher than the expected outcome for 2017-18. Expenses are forecast to grow by 16.9 percent over the Budget and forward year period compared with the estimated 2017-18 outcome, reflecting increases in spending on general public services, health and education.

[3] Contributed assets are assets transferred to the General Government sector without a transfer of approximately equal value to the party providing the contribution. Gains from contributed assets in the 2018-19 Budget mainly relate to land development infrastructure and Large-scale Generation Certificates (previously referred to as Renewable Energy Certificates).

The Budget forecasts a surplus in 2018-19, which is in line forecasts in recent Budgets. The forecast surplus of $36.5 million in 2018-19 compares with a forecast of the surplus for that year in the 2016-17 Budget of $33.3 million and a forecast surplus in the 2017-18 Budget of $9.8 million.

Detailed comment on the superannuation return adjustment is provided in Appendix A.3.

3.2 Medium term forecasts

The 2018-19 Budget delivers the return to surplus that has been foreshadowed in successive Budgets since 2012-13.

The return to surplus is consistent with the Government's fiscal strategy of balancing the budget over the medium term (ACT Government, 2018a, p. 37).

The earlier than expected surplus in 2017-18 and the Budgeted surplus in 2018-19 have been achieved through an increase in the Territory's own-source revenue, growth in Commonwealth grants, and economic transfers.

The planned return to surplus rests on a number of assumptions. The economic forecasts that underpin the Budget assume that increased Commonwealth spending will drive a strong ACT economy in the forward years, whereas in our view real growth in Commonwealth Government payments is likely to be somewhat more modest based on the Commonwealth Government's forward estimates.[4] The achievement of an operating surplus in the Budget and forward years also requires continued growth in grants from the Commonwealth (goods and services tax and specific purpose payments), growth in own taxation revenue and the generation of large increases in other economic inflows, as well as the achievement of significant offsets against planned increases in expenditure. 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.

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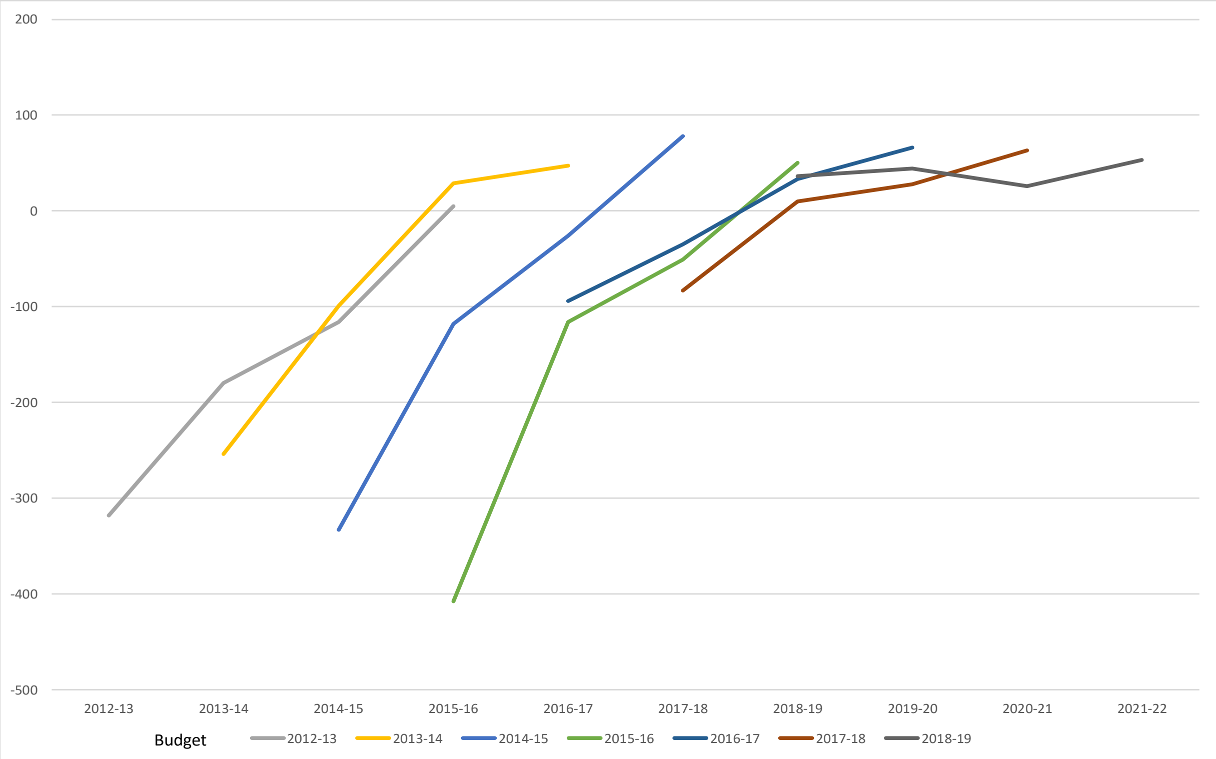
[4] See Commonwealth of Australia (2018a, p. 6.5).

Figure 7: Forecast returns to surplus ($ million)



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

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

The forecast return to surplus will provide confidence that the ACT Government remains committed to the achievement of its announced fiscal strategy. However, the forecast surpluses fall short of the declared target of generating a "strong operating balance over the medium term" and do not yet balance the deficits experienced in recent years (ACT Government, 2018a, p. 45).

Achievement of the fiscal strategy will require sustained revenue growth and expenditure constraint into the medium-term.

3.3 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[5]

	2017-18 Est. Outcome $m	**2018-19 Budget $m**	**2019-20 Estimate $m**	**2020-21 Estimate $m**	**2021-22 Estimate $m**
Net debt (excluding super)	1,357.0	2,108.3	2,627.7	2,894.7	2,834.9
Net financial liabilities	5,713.4	6,609.2	7,120.4	7,394.2	7,466.9
Net worth	17,262.1	17,634.3	17,848.2	18,072.4	18,351.9

Source: ACT Government (2018a, p. 291)

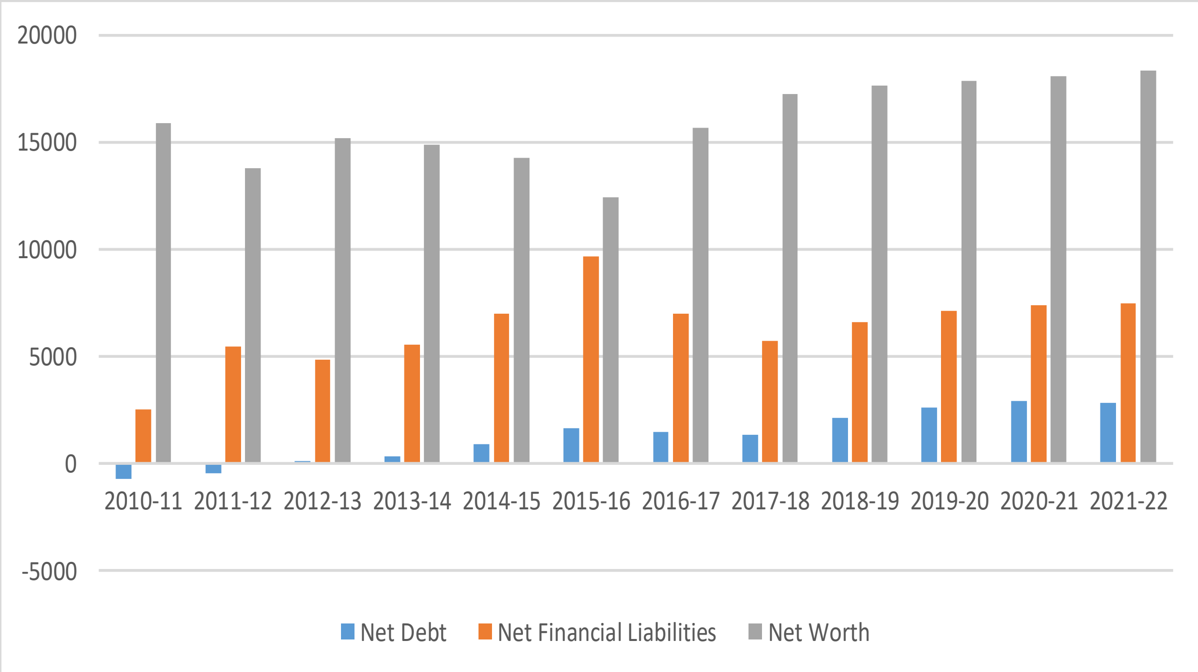
[5] Definitions and further discussion of the application of these measures are provided in section 7 of this report.

Net worth is positive and is forecast to increase from $17.6 billion to $18.4 billion across the budget and forward estimates, an increase of 4.1 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 worth raise some concerns.

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 (2018a, p. 399)

Net debt and net financial liabilities remain relatively low compared with net worth. However, they are both growing much faster than net worth. Net worth is expected by 201-22 to be 6.3 percent higher than in 2017-18. However, by the end of the forward estimates period in 2021-22, net financial liabilities are expected to be 30.7 percent higher than in 2017-18 while the level of net debt is expected to be more than double the estimated outcome in 2017-18 and 33.8 percent higher than the forecast for 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.

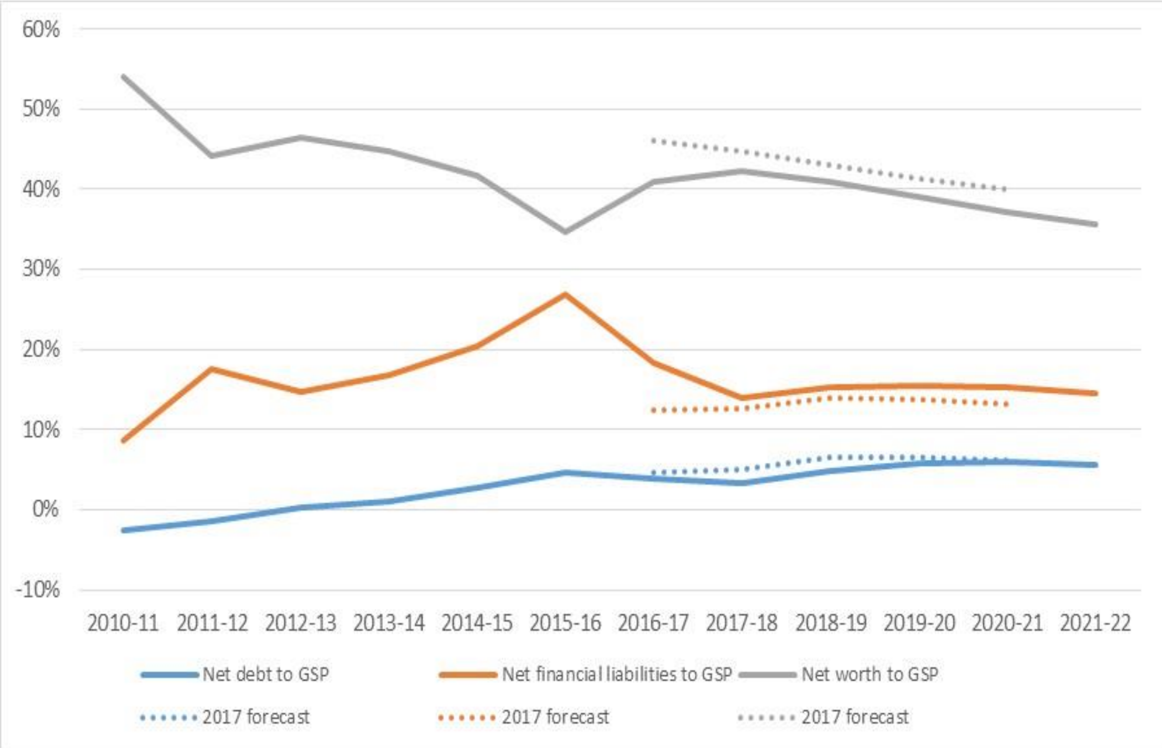
Table 4: Key balance sheet measures as a percentage of Gross State Product

	2017-18 Est. Outcome	2018-19 Budget	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
Net debt to GSP (%)	3.3	4.9	5.7	6.0	5.5
Net financial liabilities to GSP (%)	14.0	15.3	15.5	15.2	14.5
Net worth to GSP (%)	42.3	40.8	39.0	37.2	35.6

Figure 9 illustrates the change over an extended period of these measures relative to GSP, along with a comparison with the forecasts presented in the 2017 Budget document. While net debt to

GSP has improved slightly compared to the previous year's forecast, both net financial liabilities to GSP and net worth to GSP ratios have worsened.

Figure 9: Assets and liabilities to GSP



Source: ABS (2017a), ACT Government (2018a; 2017)

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.

3.4 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 ($17.6 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 2.4 times. However, it should be noted that borrowings, other than leases, increase over the forward years.

While an overall cash deficit is reported ($-39.9 million), a positive General Government net cash from operations is reported ($435.7 million). These reflect improvements on the previous budget positions. (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.

4 Revenue

Revenue is expected to increase by $247.2 million from an estimated outcome of $5.4 billion in 2017-18 to almost $5.7 billion in 2018-19. In contrast to the last two budgets, in this budget the ACT Government is moving closer towards a hard budget constraint whereby it is responsible for raising most of its additional revenue. On the other hand, it does appear the ACT Government will become increasingly dependent on the Commonwealth Government in the out years to fund increases in revenue and thus may escape the incentives and disciplines imposed by a hard budget constraint. 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.

4.1 Overview

ACT Budget revenue is expected to increase from an estimated outcome in 2017-18 of $5.4 billion to almost $5.7 billion in 2018-19.

The 2017-18 estimated outcome is $82.6 million higher than originally forecast. The increase is primarily due to higher revenues being received from the goods and services tax (GST) of $67.8 million due to higher GST receipts and an increase in the level of Commonwealth Government grants of $42.9 million, partially offset by a decrease in own-source revenue of $30.4 million.

The forecast revenue of $5.7 billion in 2018-19 is $132.6 million higher than the estimates for 2018-19 in last year's Budget and $82.9 million higher than forecast in the 2017-18 Budget Review. The growth relative to the 2017-18 Budget includes the effect of changes in parameters and technical adjustments, increases in dividends and economic transfers associated with the Suburban Land Agency and City Renewal Authority; increased GST revenue and increases in Commonwealth grants.

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

Table 5: General Government Sector Revenue

	2017-18 Est. Outcome $'000	2018-19 Budget $'000	2019-20 Estimate $'000	2020-21 Estimate $'000	2021-22 Estimate $'000
Own Source Taxation	1,721,625	1,898,190	2,027,968	2,141,654	2,261,017
Goods and Services Tax	1,292,414	1,328,348	1,373,103	1,450,763	1,525,111
Commonwealth Grants	994,799	982,921	976,152	1,024,965	1,077,016
Gains from Contributed Assets	165,659	220,515	219,125	166,973	201,991
Sales of Goods and Services	518,432	542,093	556,286	567,675	578,279
Interest Income	124,363	118,534	120,907	121,082	123,401
Distribution from Financial Investments	33,206	38,633	47,412	50,839	54,517
Dividends and Income Tax Equivalents	410,776	397,462	390,777	436,411	367,865
Others	162,814	144,609	142,973	147,963	145,905
Total	**5,424,088**	**5,671,305**	**5,854,703**	**6,108,325**	**6,335,102**

Source: ACT Government (2018a, p. 232)

Table 5 shows that the increase revenue of $247.2 million in the Budget in 2018-19 over the estimated 2017-18 outcome primarily reflects higher proceeds from own-source revenue that will increase by $176.6 million, increases from contributed assets of $54.9 million[6], increased distributions from the GST of $35.9 million, and higher revenues from the sales of goods and services of $23.7 million, partially offset by reductions of $18.2 million in other miscellaneous revenue, $13.3 million from dividends and income tax equivalents, and $11.8 million from Commonwealth Government grants.

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.

4.2 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.

For the last two budgets the ACT Government has not been confronted by a hard budget constraint as it has not raised more revenue even at the margin. For example, based on the expected outcomes for the 2017-18 Budget some 91.5 per cent of the increase in revenue for the ACT Government over the 2016-17 financial year has come from the Commonwealth Government.

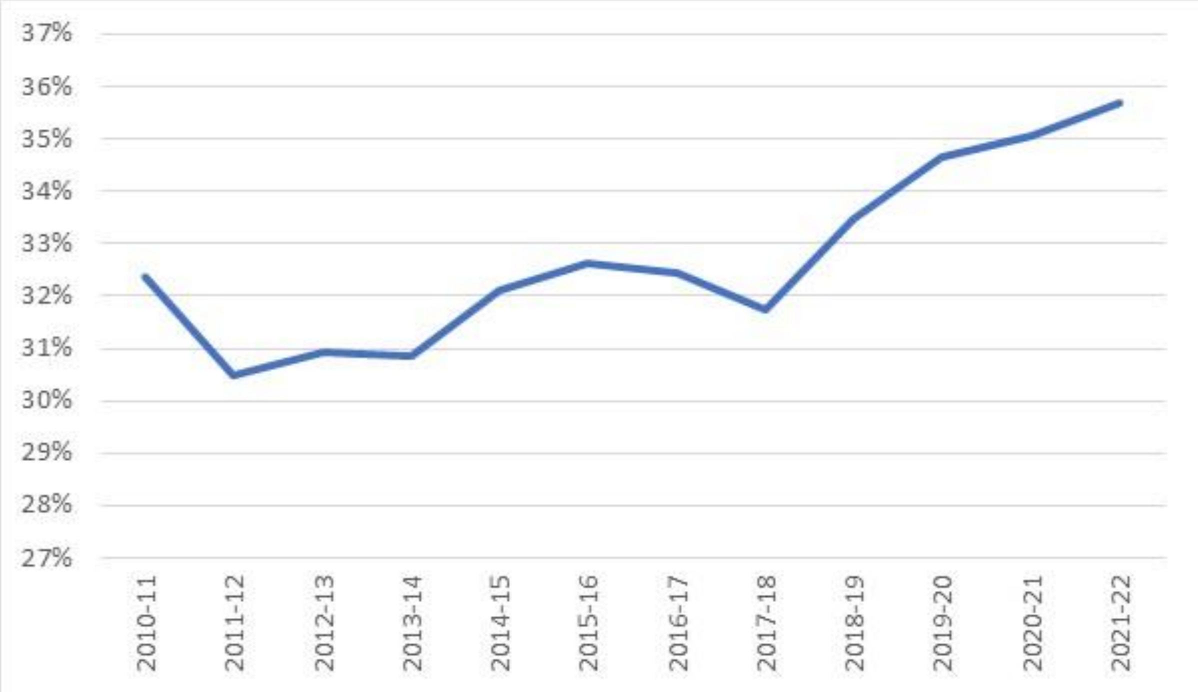
In the event that it is not possible to completely overcome the problem of vertical fiscal imbalance, the importance of sub-national governments having responsibility *at the margin* for raising their own revenues has also been strongly emphasised in the literature (Bahl & Bird, 2008, p. 8; Oates, 2008, 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).

The 2018-19 Budget the ACT Government is moving toward these conditions, with the Commonwealth Government contributing only 9.7 per cent of the additional revenue expected to be collected in 2018-19 over and above the previous financial year with some 71.4 per cent of the increase being funded through increases in own source revenue.

[6] See definition on page 13.

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.

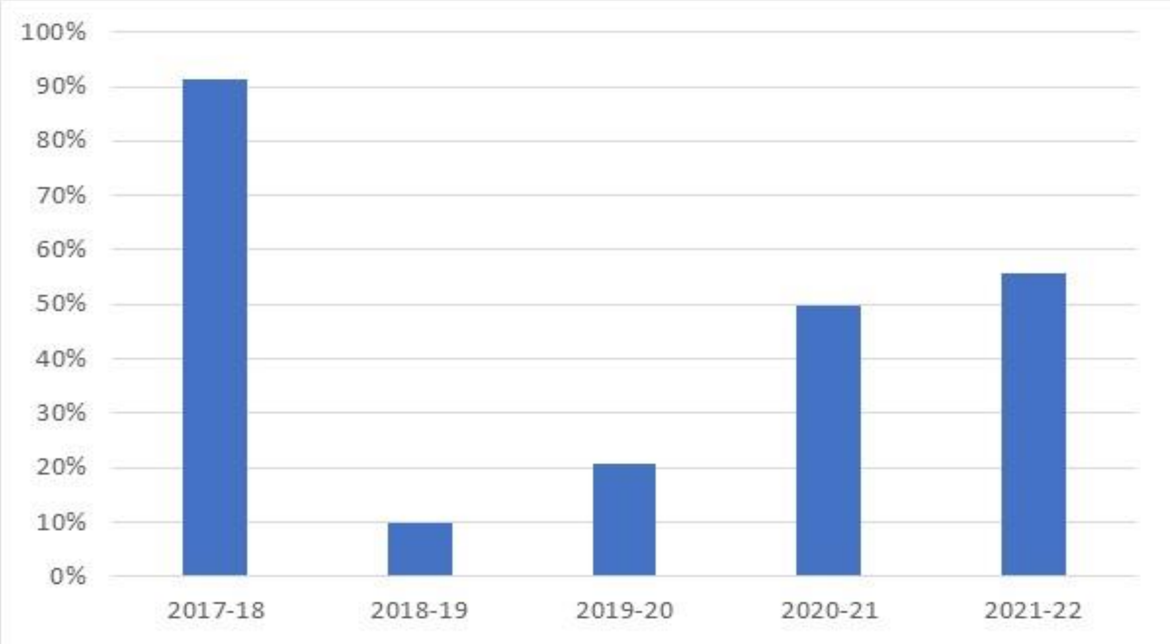
Figure 10: Percentage of ACT Government Revenue from Own-Source Taxation – 2010-11 to 2021-22



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

On the other hand, based on the forward estimates, it does appear the ACT Government will become increasing dependent once again on the Commonwealth Government in 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 (2017; 2018a)

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, 2018c). As such, the ACT Government's forward estimates in relation to proceeds from GST revenue could be subject to significant change. In relation to Commonwealth Government grants for specific purposes, at the time the Commonwealth Government budget was delivered the State and Territory allocations for a number of programs had not yet been determined and this may still be the case. As such, Commonwealth Government grants for the budget year and over the forward estimates could also be subject to significant change.

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.

4.3 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.

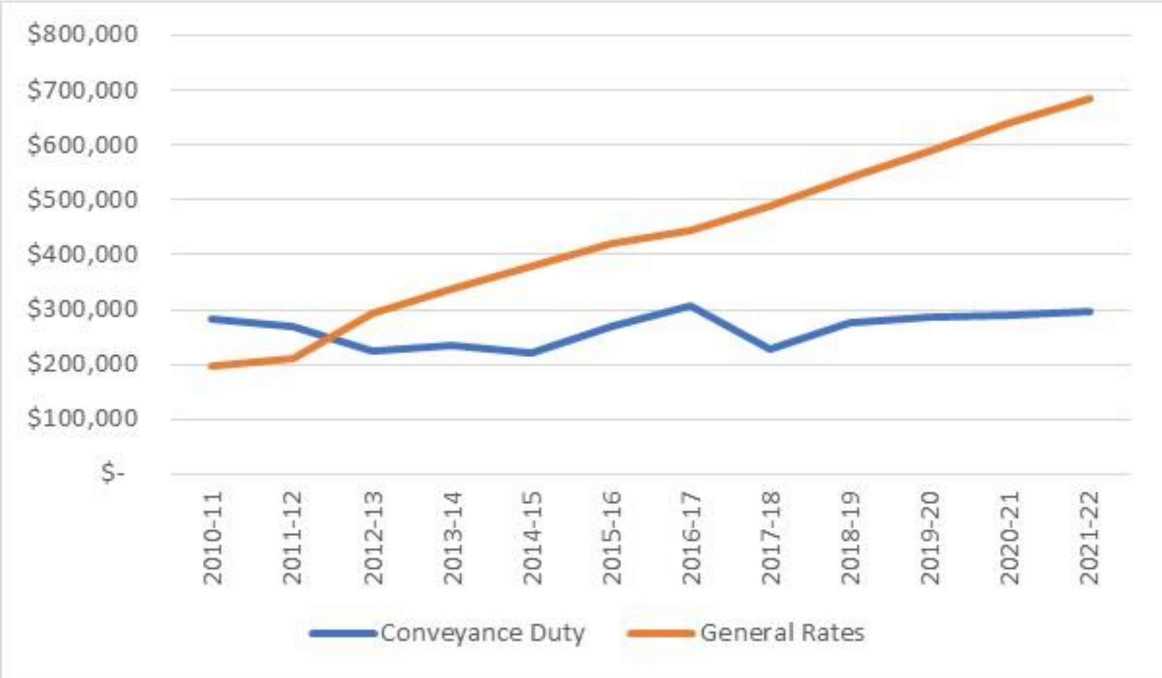
The phasing out of stamp duties and the phasing in of the new general rates system over the course of 20 years will be implemented through a series of four separate five year plans to avoid a shock to the property market and to enable the change to be revenue neutral (Reardon & Hopkins, 2018, p. 4). At the end of 2017-18 we will be at 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 just under $700 million at the end of the forward estimates. This is outlined in Figure 12 below.

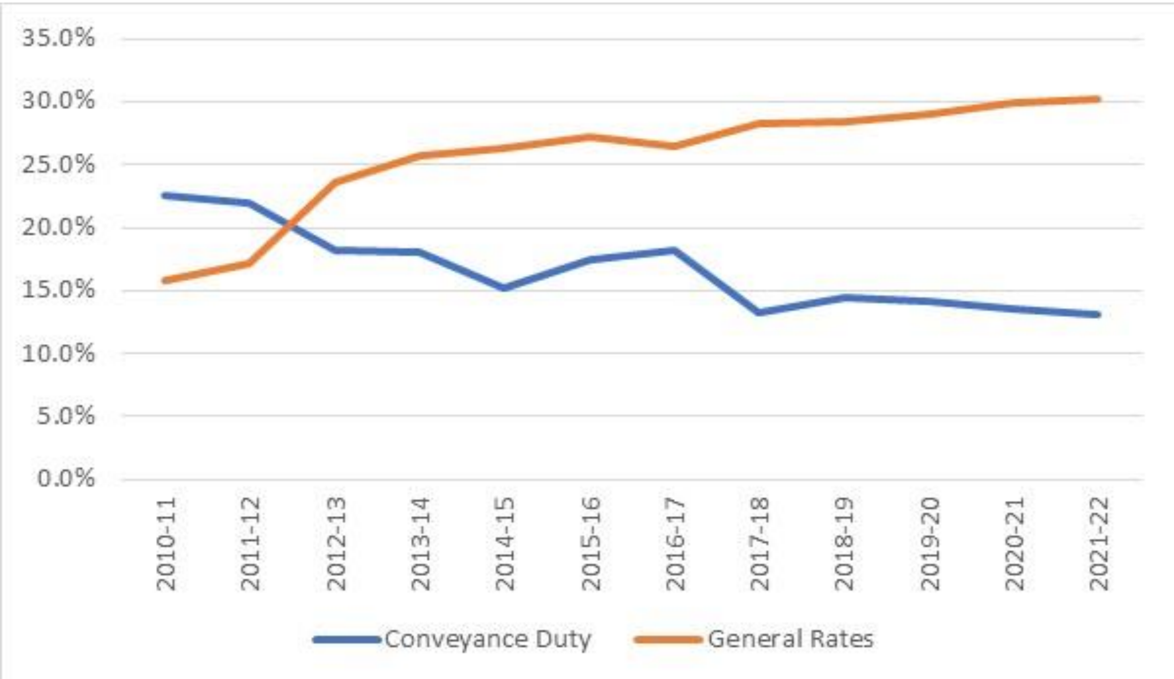
Figure 12: ACT Government Revenue from Conveyance Duty and General Rates – 2010-11 to 2021-22 ($'000)



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

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 30.3 per cent at the end of the forward estimates in 2021-22, while over the same period the relative contribution of conveyance duty has fallen from 22.5 per cent to 13.1 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 (2018a)

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, and is expected to rise again during 2018-19. On this basis, the Housing Industry Association earlier this year 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 the 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.

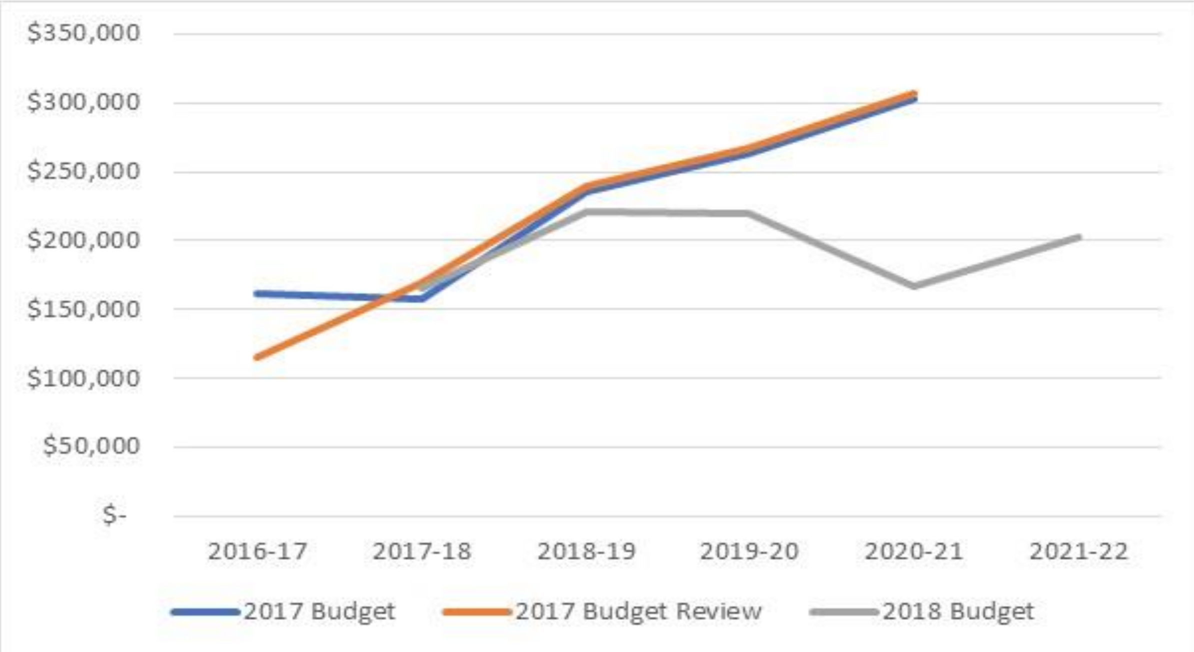
4.4 Contributed Assets and Dividends

Contributed assets

The Budget forecasts revenue from contributed assets of $220 million in 2018-19, an increase of $54.9 million or 33.1 percent over the estimated outcome for 2017-18. Contributed assets are non-financial transactions that represent the estimated value of assets received by the ACT Government from other parties without an obligation to provide approximately equal value to the party providing the contribution. In the 2018-19 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.[7]

There have been significant changes in the revenue estimates in the 2018-19 Budget from both the 2017-18 Budget and the 2017-18 Budget Review through the reprofiling of revenue from contributed assets in the out-years. Between the 2017-18 Budget and the 2017-18 Budget Review, the gains from contributed assets have decreased by $44.5 million in 2019-20 and by $136.2 million in 2020-21. The revenue profiles from the three most recent budget updates are provided in Figure 14 below.

Figure 14: Estimated Revenue from Contributed Assets ($'000) – 2016-17 to 2021-22



Sources: ACT Government (2017; 2018; 2018a)

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

Up until the 2018-19 Budget explanations of contributed assets had related exclusively to the value-added component of land sales. This related to that part of land revenue attributed to development activity undertaken on the land that has contributed to an increase in the value of the land (ACT Auditor-General, 2015, p. 69). This is also consistent with the following observation from the 2017-18 Budget:

[7] The 2018-19 Budget Papers refer in different places to Renewable Energy Certificates and Large-scale Energy 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).

> Contributed assets largely relate to land development infrastructure assets transferred to the General Government Sector (GGS) from the Land Development Agency and private developers (ACT Government, 2017, p. 237).

However, the 2018-19 Budget now indicates that Large-scale Generation Certificates made up some 45.6 per cent of the revenue generated from contributed assets.(ACT Government, 2018a, p. 246).

The treatment of the Large-scale Energy Certificates in the 2018-18 and 2018-19 Budgets raises a number of timing and valuation issues that merit additional explanation. A more detailed discussion of the budget treatment of the Certificates is provided in section 4.5.

Dividends

Total dividends in 2018-19 are expected to be $266 million, a decline of $15.3 million from the level expected to be collected in 2017-18. Dividends are expected to increase in 2019-20 to $281.8 million and then to 314.3 million in 2020-21, before falling to $268.2 million in 2021-22.

Table 6 provides a summary of dividends received from the Territory's Public Trading Enterprises (PTEs).

Table 6: Dividends from ACT Public Trading Enterprises

	2017-18 Est. Outcome $'000	2018-19 Budget $'000	2019-20 Estimate $'000	2020-21 Estimate $'000	2021-22 Estimate $'000
Dividends					
Dividends – Icon Water	89,852	63,907	68,038	73,765	78,719
Dividends – CIT Solutions	500	500	500	500	500
Dividends – City Renewal Authority and Suburban Land Agency	134,188	145,169	158,013	180,795	125,396
Dividends from Financial Investments	56,885	56,516	55,287	59,283	63,572
Total Dividends	**281,425**	**266,092**	**281,838**	**314,343**	**268,187**

Source: ACT Government (2018a, p. 252)

Table 6 reveals that the major reason for the decline in dividends in 2018-19 is the expected fall in dividends from Icon Water of $25.9 million. The fall in Icon Water dividend in 2018-19 is mainly due to decreased energy revenues from the one-off impact of the feed-in-tariff gain in 2017-18 and the Independent Competition and Regulatory Commission's final determination on water and sewerage prices for the next five years from 1 July 2018 (ACT Government, 2018a, p. 252).

The major driver of the fall in dividends in 2021-22 is a reduction in dividends of $55.4 million from the City Renewal Authority (CRA) and the Suburban Development Agency (SDA). It is difficult to understand the profile of expected dividends across the Budget and forward years from the Budget Papers and in particular the influence of planned land developments on the earnings generated by the CRA and SDA.

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.

4.5 Large-scale Generation Certificates

The 2018-19 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.

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

The normal 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.

The Budget Papers indicate that, given recent developments in the national electricity market and significant uncertainty in relation to the National Energy Guarantee, the ACT Government has deferred the surrender of its Large-scale Generation Certificates until 2020-21 (ACT Government, 2018a, p. 44).

The change in timing of the surrender of the Certificates are expected to have a large, positive impact on the Budget position over the Budget and forward years. The deferral of the surrender will reduce expenses by $72 million in 2018-19 and $127,620 in 2019-20, effectively reversing the adjustments to incorporate the Large-scale Generation Certificates in the 2017-18 Budget (ACT Government, 2017, p. 34) .

As the value of Large-scale Generation Certificates are subject to price fluctuations arising from supply and demand within the market, it is likely that the current value of the Certificates are somewhat different from the value at which the revenue for Certificates received in 2017-18 was recorded.

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; and
- 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?

5 Expenditure

Expenditure is forecast to grow over the budget and forward estimates from $5.8 billion in 2017-18 to $6.5 billion in 2021-22. Health, General Public Services and Education spending constitute the largest part of the Territory's budget through the Budget and forward years. The Budget contains just under two hundred separate expense initiatives totalling $363.9 million (net of the heath funding growth envelope) over the budget and forward years.

5.1 Overview

Forecast expenses of $5.8 billion in 2018-19 represent an increase of $185.8 million, or 4.5 per cent, over the expected 2017-18 outcome.

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

	2017-18 Est. Outcome $'000	2018-19 Budget $'000	2019-20 Estimate $'000	2020-21 Estimate $'000	2021-22 Estimate $'000
Expenses	**-5,566,218**	**-5,818,171**	**-6,004,634**	**-6,290,286**	**-6,505,509**

Source: ACT Government (2018a, p. 39)

Table 7 shows that expenses are expected to grow over the Budget and forward estimates period to $6.5 billion in 2021-22. This represents growth of 16.9 per cent over the estimated 2017-18 outcome, or an average rate of 4.2 per cent per annum, over the estimated 2017-18 outcome.

The forecast expenses of $5.8 billion in 2018-19 are $109.0 million higher than the estimates for 2018-19 in last year's Budget and $53.9 million higher than forecast in the 2017-18 Budget Review.

The main reasons for the increase in the 2018-19 forecast since the last Budget include additional investments in health services, additional educational funding, the reprofiling of agency expenses, and an increased provision for depreciation. These increases are partially offset by a decrease in expenses associated with the Large-scale Generation Certificates.

Overall, General Government sector expenses are forecast to grow by 16.9 percent over the Budget and forward year period compared with the estimated 2017-18 outcome.

5.2 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 2018-19.

Table 8 sets out the estimates of General Government Sector expenses by function for the period 2017-18 to 2021-22.

Table 8: Budget and forecast expenses, by function, 2017-18(est.), 2018-19 and 2019-20 to 2021-22

	2017-18 Est. Outcome $'000	2018-19 Budget $'000	2019-20 Estimate $'000	2020-21 Estimate $'000	2021-22 Estimate $'000
General Public Services	1,225,465	1,322,986	1,401,491	1,443,562	1,496,852
Public Order and Safety	416,035	460,232	467,287	473,200	486,899
Economic Affairs	97,045	101,511	93,806	198,836	141,353
Environmental Protection	117,381	119,519	101,054	100,917	100,845
Housing and Community Amenities	90,594	92,360	89,712	90,097	91,782
Health	1,516,428	1,530,917	1,600,042	1,667,701	1,783,940
Recreation, Culture and Religion	217,289	229,911	235,799	242,298	252,091
Education	1,186,913	1,229,655	1,266,321	1,305,296	1,369,791
Social Protection	400,217	375,448	386,642	386,893	390,091
Transport	298,852	355,631	362,481	381,484	391,867
Total Expenses	**5,566,218**	**5,818,171**	**6,004,634**	**6,290,286**	**6,505,509**

Source: ACT Government (2018a, p. 186)

The Committee should note that changes have been made to the presentation of functional information in this year's Budget to align the presentation with the classification adopted by other States and Territories. This will support cross-jurisdictional analysis, but as the Budget Papers do not provide a historical series against the new classification, it is regrettable given the intended purpose of this classification system that it is not possible to provide reliable analysis of the Budget and forward years against the estimated 2017-18 outcome or actual outcomes in previous years.

The Committee may wish to seek advice from officials on the practicality of providing historical data on the new classification system.

The major areas of growth in expenses over the Budget and forward estimates occur in Health, General Public Services and Education. This growth is the consequence of activity and cost pressures and discretionary policy decisions:

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

- Health – the forecast increase in expenses from 2018-19 is mainly due to growth in activity and costs for general hospital expenses.
- Education – the forecast increase in expenses from 2018-19 is primarily driven by enrolment growth and the operational costs of schools in line with general wage and price inflation.
- General Public Services –the forecast increase in 2018-19 is mainly due to the inclusion of public debt transactions in the new functional presentation.
- Transport – the forecast increase in 2018-19 is largely due to the commencement of service payments in relation to the Light Rail Stage 1 from the commencement of operations expected in late 2018.

- Public Order and Safety – this includes police and fire protection services, law courts and prisons; the forecast increase in 2018-19 primarily reflects new initiatives in these areas, such as the Commonwealth Redress Scheme.

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.

5.3 New initiatives

The Budget contains just under two hundred separate expense initiatives totalling $363.9 million (net of the heath funding growth envelope) over the budget and forward years. This includes $47.5 million expenses related to capital and revenue initiatives.

The new initiatives include:

- a range of Health-related initiatives totalling $10.6 million (after offsets) over four years in net terms, including increased capacity for elective and emergency services across the Territory, funding for acute care services at Canberra Hospital including additional in-patient hospital beds and expansion of the *Hospital in the Home* service;
- additional Education funding, including an additional $31.1 million over four years to employ the equivalent of 66 full-time learning professionals and support staff, additional funding of $18.2 million to support students with disability and an investment of $9.2 million to develop a future education strategy;
- funding for a range of justice and social inclusion measures including an additional $13.0 million over four years for better resourcing of the Alexander Maconochie Centre, $12.7 million for implementation of the Commonwealth Redress Scheme for Institutional Child and Sexual Abuse, additional resourcing for the Director of Public Prosecutions and ACT Police and funding to support the engagement of an additional magistrate;
- an additional $19.1 million over four years to support Access Canberra to improve customer satisfaction and application processing times;
- additional funding of $6.5 million over four years to provide more frontline homelessness services, including additional places at frontline shelters (ACT Government, 2018a, pp. 74-81).

5.4 Light Rail project

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 2018-19.

Table 9 below summarises the impact of the Light Rail project on expenses.

Table 9: Light Rail impact on headline operating balance

	2018-19 Financial Year $'000	2019-20 Financial Year $'000	2020-21 Financial Year $'000	2021-22 Financial Year $'000
Maintenance/Operating Costs	-21,216	-25,722	-26,172	-27,294
Interest	-15,922	-18,901	-18,275	-17,664
Depreciation	-10,559	-14,079	-14,079	-14,079
Total HNOB Impact	**-47,697**	**-58,702**	**-58,526**	**-59,037**

Source: ACT Government (2018a, p. 348)

In cash terms, the Government expects to make a $375 million lump sum payment to the private consortium at the end of construction, and monthly service and lease payments over a period of 20 years. Under the terms of the lease arrangement, service payments are expected to total around $37.1 million in 2018-19, rising to $54.3 million in 2019-20, $54.7 million in 2020-21 and $55.8 million in 2021-22.

A detailed discussion of the accounting treatment for the Light Rail project is provided at Appendix A.5 of this report.

5.5 Safer Families

The 2018-19 Budget allocates a further $9.3 million over four years for initiatives that complement Safer Families initiatives announced in previous years, bringing total funding for the Safer Families package to $24.1 million over four years (ACT Government, 2018a, p. 411).

The cost of the Safer Families package is mostly funded through a Safer Families Levy introduced in the 2016-17 Budget. The $30 annual levy is applied to all residential and rural properties. In the 2018-19 Budget, the levy is expected to fund $19.7 million of the $24.1 million investment in Safer Families initiatives.

The Budget Papers include a report on progress with the Safer Families initiatives introduced over the past three Budgets (ACT Government, 2018a, p. 411). This includes a table showing funding and expenditure of the Safer Families initiatives included in the 2017-18 Budget. Of the total 2017-18 allocation of $6.6 million, agencies have spent $5.5 million and unspent funds have been reprofiled to 2018-19 (ACT Government, 2018a, p. 414).

While previous last year's Budget Paper 3 provided information on how funds had been spent, the 2018-19 Budget Papers provide additional information on where and how the program design has changed as a result of the experience gained through early implementation of the initiatives and on some of the outcomes achieved.

The level of transparency in reporting on the delivery of these initiatives is commendable, and there is scope to extend this model to other initiatives.

5.6 Asbestos Eradication

The Asbestos Eradication Scheme continues to have an impact on expenses, though the impact on the headline balance is relatively small, and lower than expected in previous Budgets.

Table 10 below provides a summary of the impacts of the Asbestos Eradication Scheme on the headline operating balance.

Table 10: Asbestos Eradication Scheme impact on headline operating balance

	2017-18 $'000	2018-19 $'000	2019-20 $'000	2020-21 $'000	2021-22 $'000
2017-18 Budget					
Financial Assistance Package	-400	-20	-80	0	0
Other Costs	-8,910	-4,877	-4,481	-4,488	0
Purchase Costs	-1,114	-102	-154	-200	0
Contingency	-1,265	-1,265	-1,265	-8,856	0
Total HNOB Impact (including contingency)	**-11,690**	**-6,264**	**-5,980**	**-13,545**	**0**
2018-19 Budget					
Financial Assistance Package	-400	-200	-482	-291	0
Other Costs	-6,796	-4,284	-4,267	-4,102	0
Purchase Costs	-514	-114	-131	-200	0
Contingency	0	-3,144	-3,144	-4,192	0
Total HNOB Impact (including contingency)	**-7,710**	**-7,742**	**-8,024**	**-8,785**	**0**

Source: (ACT Government, 2018a, p. 406) These figures do not include the financial implications of stamp duty waivers exercised by impacted homeowners.

The table points to an improvement in the expected budget impacts when compared with the 2017-18 Budget. The impact on the headline operating balance is now expected to remain relatively stable over the forward estimates. The major factor driving the improvement in the forecasts is the washing out of contingency provisions that had been provided in previous year Budgets.

The Budget papers indicate that the differences reflect an acceleration of the demolition schedule over initial plans and a bring forward of sales from the out years to match the availability of inventory. Compared with the 2017-18 Budget, the estimated number of properties sold has decreased by 5 in 2017-18, increased by 55 in 2018-19 and 22 in 2019-20 and decreased by two in 2020-21 (ACT Government, 2018a, p. 405).

In order to understand the potential for slippage against these forecasts, the Committee may wish to seek further information on the number, duration and location of unsold blocks.

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

6 Capital Works and Infrastructure

The Budget includes a substantial capital works and infrastructure program over the Budget and forward years. The Government will invest $2.8 billion in infrastructure in the ACT over the next four years. While the budget forecasts indicate a decline in capital and infrastructure investment in the forward years, historic trends and the commitment to commence work on Stage 2 of the Light Rail project suggest that additional infrastructure spending is likely to be announced in future Budgets.

6.1 Overview

The Budget Papers indicate that the ACT Government (2018a, p. 201) intends to invest $2.8 billion in infrastructure in the ACT over the next four years to 2021-22.

Table 12 below summarises the capital works and investment program.

Table 11: Summary of investment and capital works program – 2018-19 to 2020-21

	2018-19 Allocation $'000	**2019-20 Allocation $'000**	**2020-21 Allocation $'000**	**2021-22 Allocation $'000**
New Capital Works	181,613	184,018	114,651	71,765
Works-in-Progress	564,792	421,154	72,330	24,212
TOTAL CAPITAL WORKS PROGRAM	746,405	605,172	186,981	95,977
Infrastructure Investment Provisions	40,419	264,733	429,083	389,652
Capital Delivery Provision	-148,000		148,000	
CAPITAL WORKS PROGRAM FORECAST	638,824	869,905	764,064	485,629
PUBLIC PRIVATE PARTNERSHIPS	38,011	190	0	0
TOTAL INFRASTRUCTURE INVESTMENT INCLUDING PROVISIONS	**676,835**	**870,095**	**764,064**	**485,629**

Source: ACT Government (2018a, p. 202)

The investment and capital works program includes:

- A Capital Works Program: funding of $1.6 billion over the four years to 2021-22.
- Capital provisions: these provisions apply to the Capital Works Program and have two elements:
    - Infrastructure Investment Provisions: These provisions total $1.1 billion over four years to 2021-22. They set aside resourcing for significant capital works projects for which budgets are yet to be settled, or which are commercially sensitive; and
    - Capital Delivery Provision: This provision forecasts the cash flow profile of the aggregate Capital Works Program within the four-year period, based on past expenditure trends. The provision is made at a whole of government level and has a zero net impact over the four years to 2021-22.
- Public Private Partnerships (PPPs): A total of $344 million over the four years to 2020-21.

6.2 Capital Works Program

The Capital Works Program forms the largest component of the Infrastructure Investment Program, with funding of $746.4 million in 2018 19 and $1.6 billion over the four years to 2021 22. This includes:

- $126.4 million in 2018-19 and $302.7 million over four years for new capital works;
- $564.8 million in 2018-19 and $1.1 billion over four years for works-in-progress; and
- $55.2 million in 2018-19 and $249.3 million over four years for the Better Infrastructure Fund.

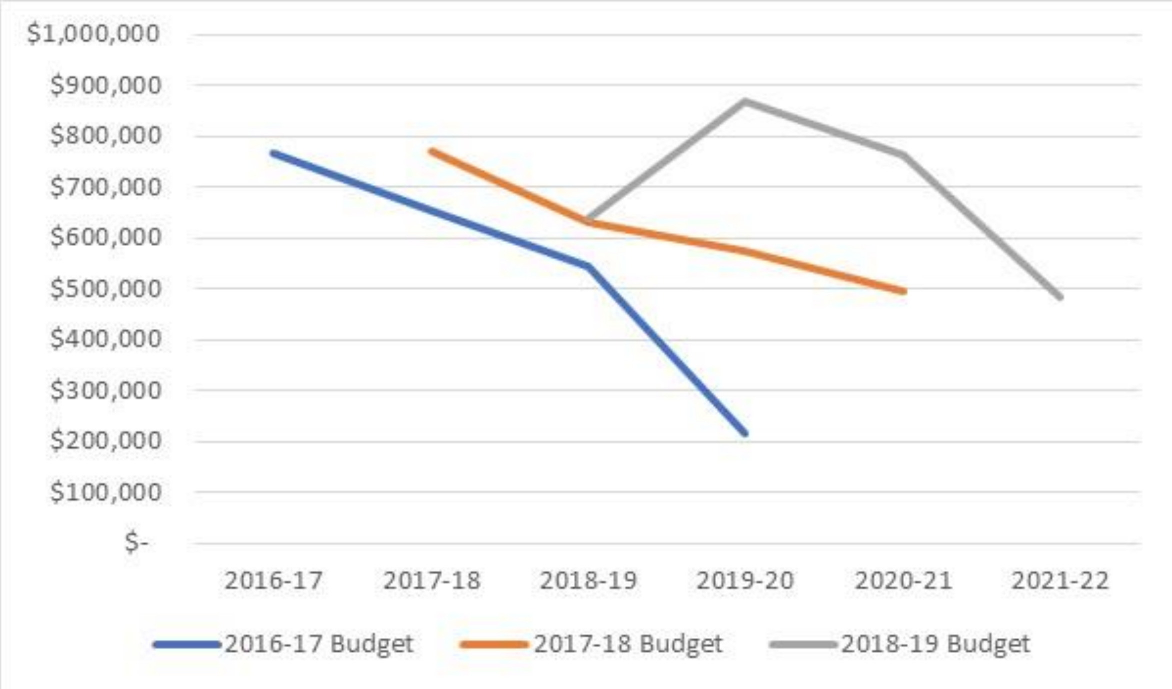
The Committee expressed a particular interest in provisions within the capital budget for investment in public housing. The Capital Works Program identifies provision for $31.3 million over 4 years for Housing ACT, including $11.3 million for new capital works (ACT Government, 2018a, p. 205). In 2018-19, Housing ACT is expected to invest $37 million to purchase, construct and refurbish properties, which is similar to the activity levels of the past few years. This is in addition to the Public Housing Renewal Program that will invest in 1,288 new homes across Canberra (ACT Government, 2018a, pp. 28,214).

The Financial Statements for Housing ACT in Budget Statement G identify a provision of $37.2 million for depreciation and amortisation in 2018-19 but does not seem to identify the expected expenditure on repairs and maintenance of the public housing stock over the budget and forward years. The Committee might wish to seek that information from officials.

The 2018-19 Budget continues the recent trend of ratcheting up the capital works program forecasts in the out years. For example, when the first budget capital works program forecast appeared for 2019-20 in the 2016-17 Budget it was $215 million (ACT Government, 2016, p. 188), just two years later the third budget capital works program forecast for 2019-20 has now jumped to $869.9 million (ACT Government, 2018a, p. 202), a fourfold increase in the space of two years.[8] The ratcheting up of the capital works program forecasts in the last three ACT Budgets is outlined in Figure 15 below.

[8] The 2016-17 Budget capital works program forecasts have been adjusted to include expenditure on information and communication technology, and plant and equipment as these items were only included in the capital works program for the first time in the 2017-18 Budget.

Figure 15: Capital Works Program Forecasts – 2016-17 to 2020-21 ($'000)



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

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.

6.3 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 12: Public Private Partnerships – ACT Law Courts Facilities and Light Rail – Stage 1 – Capital Expenditure Schedule

Project	2018-19 Forecast $'000	2019-20 Forecast $'000	2020-21 Forecast $'000	2021-22 Forecast $'000	Total $'000
ACT Law Courts Facilities	22,658	0	0	0	22,658
Light Rail – Stage 1	15,353	190	0	0	15,543
Total	**38,011**	**190**	**0**	**0**	**38,201**

Source: ACT Government (2018a, p. 209)

The infrastructure program includes capital components of the ACT's two major public private partnerships; the Light Rail project and the Law Courts redevelopment.

The impact of these projects on the major budget aggregates are set out in section 7 of this report.

The Budget Papers also indicate that the ACT Government (2018a, p. 197) is now investing in the planning and preparatory works for Stage 2 of the Light Rail project to connect Woden and the City. The Committee may wish to seek further information on the potential expense and capital implications of this project for future Budgets.

7 Assets and Liabilities

The Territory's balance sheet is healthy, with a positive net worth rising from $17.6 billion to $18.4 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 GSP is in decline. The Territory's defined benefit superannuation liability has been revised upward, to $8.5 billion by 2021-22, and the unfunded component is now estimated to be over $1 billion dollars higher than forecast in last year's Budget.

7.1 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 13: General Government Sector Key Balance Sheet Measures

	2017-18 Est. Outcome $m	2018-19 Budget $m	2019-20 Estimate $m	2020-21 Estimate $m	2021-22 Estimate $m
Net debt (excluding super)	1,357.0	2,108.3	2,627.7	2,894.7	2,834.9
Net financial liabilities	5,713.4	6,609.2	7,120.4	7,394.2	7,466.9
Net worth	17,262.1	17,634.3	17,848.2	18,072.4	18,351.9

Source: (ACT Government, 2018a, p. 291)

The table shows that net worth is positive and is forecast to increase from $17.6 billion to $18.4 billion across the budget and forward estimates, an increase of 4.1 percent.

However, the forecast levels for net financial liabilities and net worth over the Budget and forward years have deteriorated since the 2017-18 Budget. And while net debt is now expected to be slightly lower over the Budget and forward years than expected in last year's Budget, the level of net debt is forecast to grow rapidly over the forward estimates and by 2021-22 is expected to be more than double the estimated outcome in 2017-18.

By 2021-22, net financial liabilities are expected to be 30.7 percent higher than in 2017-18. The Territory's superannuation liability has also been revised upwards and is now expected to be over a billion dollars higher by 2021-22 than was forecast in last year's budget. The unfunded superannuation liability is now estimated to be over $1 billion dollars higher than forecast in last year's Budget.

7.2 Net Debt

Net debt is a key balance sheet measure in the Government Finance Statistics framework.

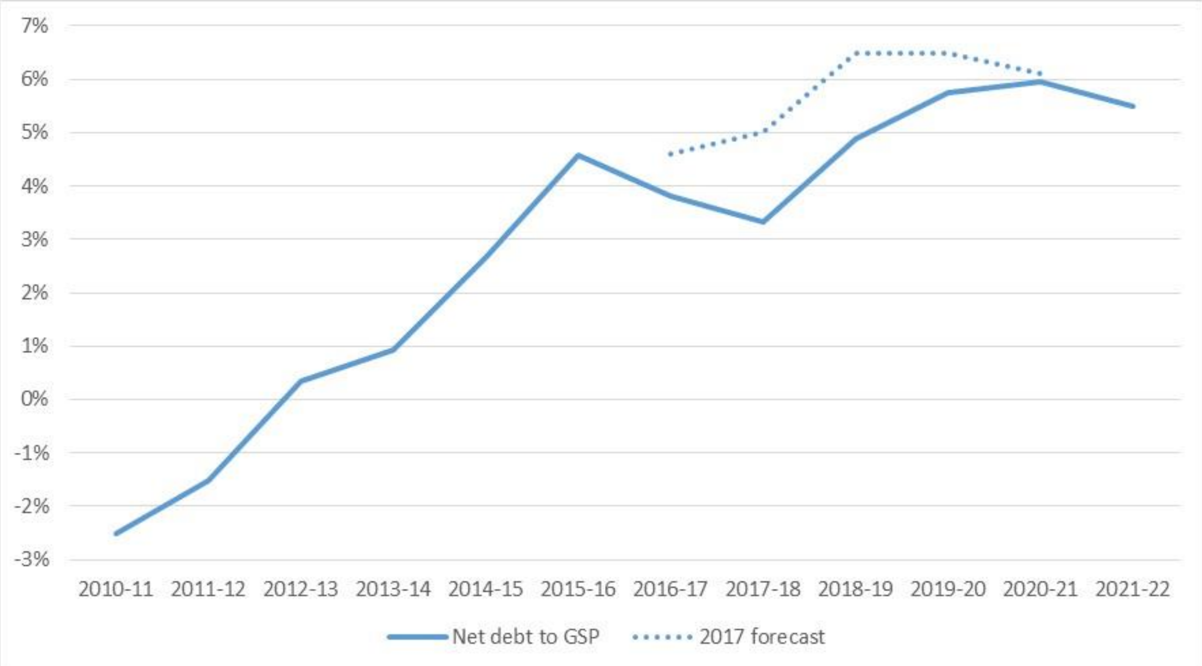
It represents the sum of deposits held, advances received and borrowings less the sum of cash and deposits, advances paid, investments, loans and placements.[9] The measure of net debt employed by the ACT Budget Papers excludes super liabilities.

The estimated level of net debt in 2017-18 and 2018-19 is considerably lower than forecast at the time of the 2017-18 Budget due to additional Commonwealth grants revenue, as well as a return of capital from the ACT Insurance Authority. However, net debt is expected to increase over the forward years to a forecast level of $2,834.9 million in 2021-22 largely due to the impact of policy initiatives and the inclusion of capital provisions in the forward estimates for the Government's investments in transport and infrastructure (ACT Government, 2018a, p. 292).

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 2021-22 (per cent)



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

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).

[9] 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.

Although the Budget is now moving into surplus, the ratio of net debt to GSP continues to increase up to 2021-22. The Budget Papers do not indicate any long-term strategy for paying down the stock of accumulated debt.

7.3 Net financial liabilities

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

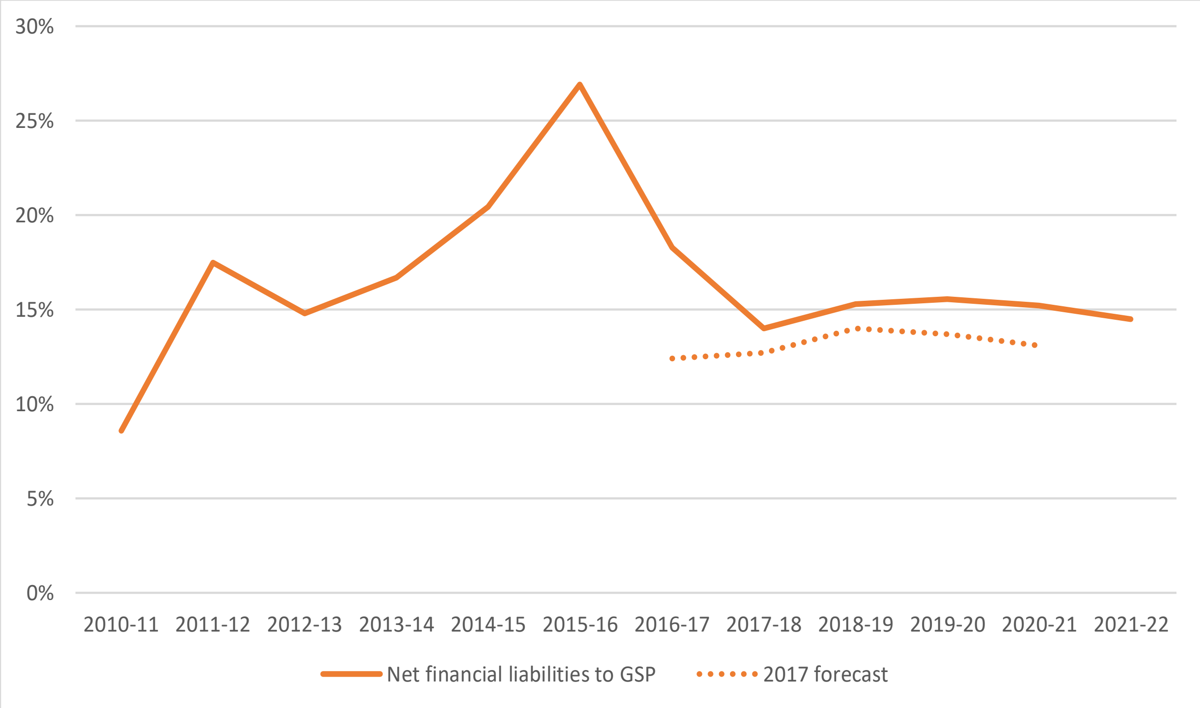
Net financial liabilities are calculated as total liabilities (including net debt and superannuation liabilities) less financial assets (such as cash reserves and investments), excluding the value of equity held by the General Government sector in public corporations. Changes in net financial liabilities 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 $606.3 million higher in 2017-18 than forecast in the 2017-18 Budget. This is despite the significant decrease in estimates of net debt for 2017-18 described above and are mainly due to an increase in the Territory's estimated superannuation liabilities based on the most recent actuarial review of the Commonwealth Superannuation Scheme and Public Sector Superannuation Scheme (ACT Government, 2018a, p. 292).

Net financial liabilities are also expected to grow over the Budget and forward estimates period to $7.5 billion by 2021-22. 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 2021-22 (percent)



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

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).

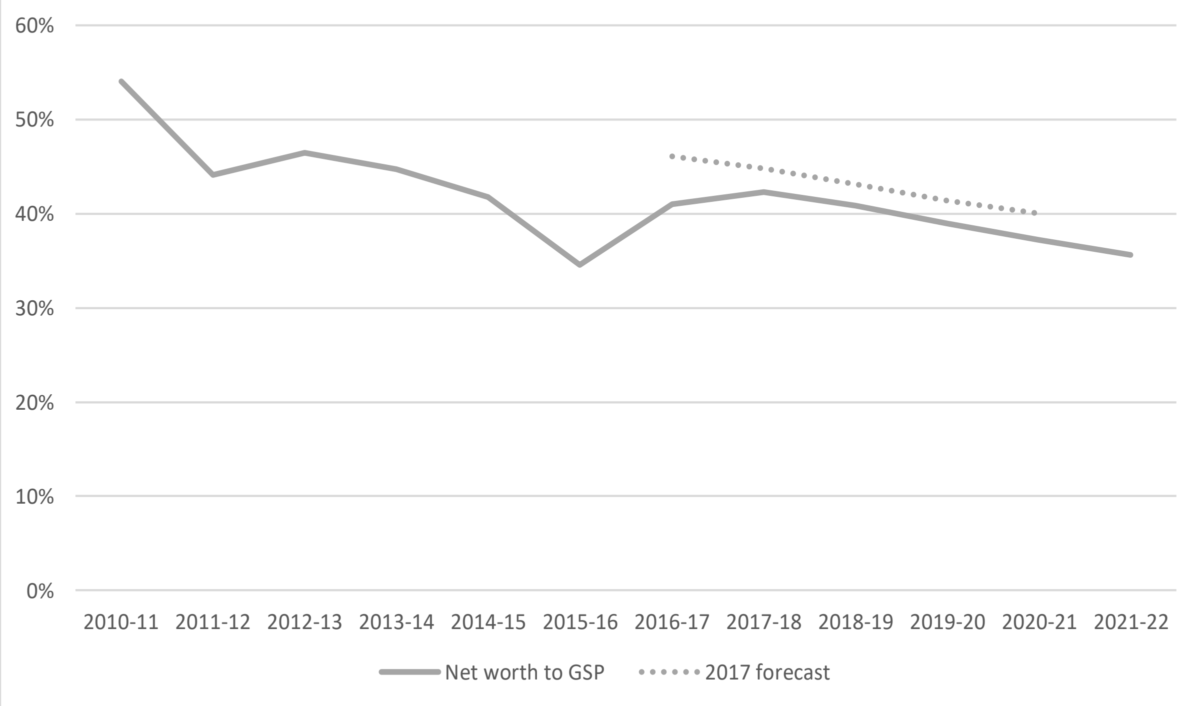
7.4 Net worth

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 $18.4 billion in 2021-22. However, net worth as a proportion of GSP falls over the period, from 40.8 per cent in 2018-19 to 35.6 per cent in 2021-22.

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 2021-22 (percent)



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

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

7.5 Superannuation

The ACT continues to carry a significant liability associated with the superannuation entitlements of past and present employees.

Approximately 8,000 current full-time employees are members of Commonwealth defined benefit superannuation schemes including the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS). Both of these 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, 2017, p. 283).

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

Table 14: Defined Benefit Superannuation Liability

	2017-18 Est. Outcome $'000	2018-19 Budget $'000	2019-20 Estimate $'000	2020-21 Estimate $'000	2021-22 Estimate $'000
Opening liability	**8,571,724**	**7,539,369**	**7,801,570**	**8,048,716**	**8,281,360**
Service cost	204,606	153,205	145,675	138,940	132,827
Interest cost	303,750	378,066	390,317	401,867	412,667
Benefit payments	-242,076	-269,070	-288,846	-308,163	-329,869
Actuarial (Gain)/Loss[1]	-1,298,635	0	0	0	0
Closing liability	**7,539,369**	**7,801,570**	**8,048,716**	**8,281,360**	**8,496,985**

Source: (ACT Government (2018a, p. 299)

Table 15 shows that the Territory's defined benefit superannuation liability is estimated to grow to approximately $8.5 billion by 30 June 2022. The current estimates of the superannuation liability are around $1 billion dollars higher than 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 salaries, pension indexation, crediting rates and exit rates from the scheme.

The increase in the estimates of the superannuation liability reported in the 2018-19 Budget is due primarily to the reduction in the long-term discount rate assumption. Changes in demographic assumptions such as increases in pension election rates, mortality improvements, benefit retention and resignation rates have had a second order impact.

The large reduction between the opening and closing liability in the estimated 2017-18 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.

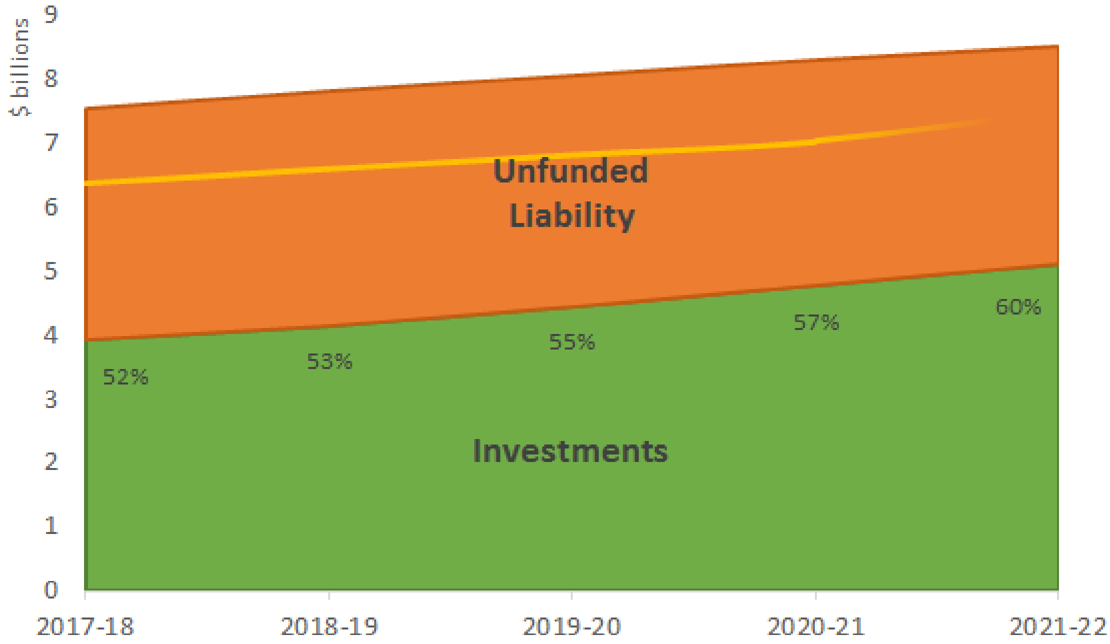
Table 15: Defined Benefit Superannuation Liability Funding

	2017-18 Est. Outcome $'000	**2018-19 Budget $'000**	**2019-20 Estimate $'000**	**2020-21 Estimate $'000**	**2021-22 Estimate $'000**
Superannuation Liability[1]	7,539,369	7,801,570	8,048,716	8,281,360	8,496,985
Investments	3,931,057	4,136,388	4,435,232	4,755,947	5,100,146
Unfunded Liability	3,608,312	3,665,182	3,613,484	3,525,413	3,396,839
Funding Percentage	**52%**	**53%**	**55%**	**57%**	**60%**
Funding Percentage (2017)	**60%**	**61%**	**62%**	**64%**	**67%**

Source: (ACT Government, 2018a, p. 301) The estimated liability is as at 30 June of the financial year and is calculated using the long term discount rate of 5% p.a..

The table shows that the unfunded superannuation liability is expected to increase slightly in absolute terms in 2018-19 and then to fall over the forward estimates period. This information is illustrated in Figure 19. The yellow line on the figure represents the level of total liabilities estimated in the 2017-18 Budget.

Figure 19: Defined Benefit Superannuation Investment Assets and Unfunded Liability



Source: ACT Government (2018a, p. 301)

The projection of the value of investments in the Superannuation Provision Account is virtually unchanged from the 2017-18 Budget. However, the change in the long-term discount rate has resulted in a substantial increase in the estimated liability and this feeds directly into an increase in the unfunded liability. As a result, the estimated unfunded liability has grown since 2017-18 by over $1 billion dollars due primarily to the. change in the long-term discount rate. For the same reason, the proportion of the liabilities covered by investments has dropped significantly since last year's Budget. Over the forward estimates period, the funding percentage – that is, the proportion of the superannuation liability that is covered by investments – is projected to increase gradually.

While change in long term discount rate has resulted in a deterioration in the reported funding position, 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. In particular, it is important to note that the projections of benefit payments are virtually unchanged from the 2017-18 Budget.

At the same time, 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 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).

8 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.

8.1 Overview

The 2018-19 provides for a series of small surpluses over the Budget and forward years. The positive Budget outlook is however vulnerable to a number of risks. If one or more of these potential adverse events occur, the Territory 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, 2018a, pp. 421-430).

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.

8.2 Risks to the economic outlook

While the economic estimates for 2017-18 and forecasts for 2018-19 contained in the ACT Budget appear reasonable, previous sections of this report have suggested that projections for ACT final demand, employment growth, the Wage Price Index and population growth in the out-years may be somewhat optimistic.

If ACT final demand is closer to around 2½ in 2019-20 and 3 per cent growth in 2020-21 and 2021-22, 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.

In light of the fact the Commonwealth Government represents just over 40 per cent of ACT final demand, the statement of risks acknowledges the policy decisions of the Commonwealth Government remain a significant source of risk to the ACT economy (ACT Government, 2018a, p. 421).

In particular, the statement of risks highlights the Commonwealth Government's decentralisation program. Some additional transfers of public service functions were announced in the 2018-19 Commonwealth Budget. However, for reasons outlined in section 2.2 of this report, the risks of significant additional public service relocations out of Canberra appears somewhat less than last year.

While the statement of risks highlights a couple of other risks that are generic to the Australian economy such as high levels of household debt and general economic conditions in China, 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 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.

8.3 Fiscal risks

Overview

A number of risks attached to the fiscal position are outlined in the Budget papers.

The 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 (2018a, p. 426) 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, 2018a, p. 426). However, there remain risks regarding the extent to which sales proceeds will offset the cost of the buyback and remediation activities. In turn, market absorption and take up rates could affect land sales prices.

Public Private Partnerships

The ACT Government (2018a, p. 428) has pursued two projects through Public Private Partnership (PPP) arrangements: the ACT Law Courts and Light Rail – Stage 1. In 2018-19, the ACT Government (2018a, p. 209) will invest $38 million in these two PPP infrastructure projects.

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 (ACT Government, 2018a, p. 429). 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, specifically;
  - patronage risk; and
  - *force majeure* for specified unforeseen events which impact on the project.

There are also potential risks to the fiscal position arising from any changes in the application of relevant accounting standards to the Budget treatment of the Territory's Public Private Partnerships.

The Government has adopted an accounting policy for these projects that results in their being accounted for in the Budget as finance leases (Budget Paper No. 3, Chapter 9, Appendix B). The treatment of these projects as finance leases impacts on the way they are described in the budget.

As outlined in Appendix A.5, in July 2017, the Australian Accounting Standards Board issued AASB 1059, Service Concession Arrangements: Grantor. AASB 1059 is applicable to projects that have or will become operational from 1 January 2019.

AASB 1059 does not treat PPP arrangements as leases, but instead, requires the assets and liabilities to be recognized 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.

Pegasus understands that the appropriate accounting standard for the treatment of Public Private Partnerships has been under consideration by the Heads of Treasury for some time but has not yet been resolved. Should the Heads of Treasury adopt AASB 1059 there are likely to be consequences for the Budget aggregates reported in the Budget Papers.

Whether the approach adopted in recognizing and valuing the projects assets and liabilities in the budget balance sheet for 2018-19 accords with the requirements of AASB 1059, is uncertain. In addition, had AASB 1059 been adopted, the impact on the budget balances is also uncertain.

This, however, is an issue on which the Committee could seek further information from officials.

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 (ACT Government, 2018a, p. 425). Lower than expected demand or sale prices would reduce the amount of revenue that could be generated for the ACT Government. The risks discussed above in relation to the economic outlook will have a major bearing of the extent of the 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 (2018a, p. 426) 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.

Accounting practice is to record the certificates as revenue at market value upon receipt in the financial year in which they are created and recognised (ACT Government, 2018a, p. 44). Given the current uncertainty in relation to the future development of the national electricity market, there is a risk that the Certificates will not realise the valuation applied when they were recognised in the Budget.

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 with negotiations between the Commonwealth and the States and Territories still ongoing on funding arrangements still ongoing (ACT Government, 2018a, p. 442);
- risks to the provision of Specific Purpose Payments for failure to meet specified targets under the National Health Reform Agreement and conditions of funding under the Quality Schools program, the Housing and Homelessness package, and the Skilling Australians Fund have not yet been fully developed; and
- 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.

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 (ACT Government, 2018a, p. 425). Furthermore, higher interest rates will result in higher borrowing costs for new borrowings.

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). Due to the complex nature of this liability, small variations to the long-term financial or demographic assumptions can lead to large impacts on the accrued liability valuation estimate for the Territory. The valuation of the liability is most sensitive to the discount rate (referenced to the yield on a suitable long-term Commonwealth bond), inflation, wages growth, rates of retirement and resignation, investment returns, benefit stream election, and mortality 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, 2018a, p. 425). Aside from 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.

Tax Leakage from Tax Reform

One item not contained in the statement of risks is a medium-term risk arising from the ACT Government's tax reform. As previously discussed, in continuing to pursue tax reform, the ACT Government runs 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.

Changes to ACT Health Directorate

The ACT Government has announced its intention to split the 7000-employee health directorate into two new agencies; one focused on policy and the other on operations (Burdon D. , 23 March 2018). Officials have indicated that the decision came too late to be incorporated in the Budget and that the cost implications of this initiative have not yet been fully identified.

There is the potential for direct costs arising from the creation of new agencies and indirect costs associated with the achievement of Budget initiatives in the Health area and the achievement of offsets required within the Health funding envelope.

The Committee could seek further information from officials but it is likely that the full cost impacts on the Budget will not be available until the 2018-19 Budget Review.

Appendix A 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.

A.1 Overview

The 2018-19 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.

A.2 Disclosure of Key Accounting Policies

The Budget financial statements, including the budget surplus, and associated tables, are presented in Chapter 9 of Budget Paper No. 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, 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.

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

A.3 Superannuation return adjustment

As in previous recent Budgets, the presentation of the headline operating balance for 2018-19 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 does not allow capital growth on financial assets to be included as a transactional revenue in the net operating balance (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.

The superannuation return adjustment appears to have been based on the long-term return objective of Consumer Price Index (CPI) plus 4.75 per cent per annum (ACT Government, 2018a, p. 305). This is probably a reasonable assumption for long-term forecasting purposes. The Budget Papers note that over the past 22 years (1996-97 to 2017-18), the Superannuation Provision Account portfolio has generated a nominal investment return of 7.8 percent per annum, or CPI plus 5.2 percent (ACT Government, 2018a, p. 305). However, this has been a period of historically high investment returns and given current market conditions a lower expectation would be justified. The return objective has been reduced by the Government in the 2017-18 Budget from CPI plus 5 per cent (ACT Government, 2017, p. 293). The most recent Future Fund mandate, for example, requires an average return of at least the Consumer Price Index (CPI) plus 4 to plus 5 per cent 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.[10]

The Committee might wish to seek information on the sensitivity of the budget aggregates to a 1 percent variation in the actual return on the Territory's superannuation investments.

A.4 Superannuation liability valuation

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 reduced from the 6 percent employed in the 2017-18 Budget to 5 percent per annum. This rate is consistent with the long-term

[10] While the Budget Papers note that the actual investment return achieved for the 2017-18 year was 10.2 percent, or CPI plus 8.2 percent, generating investment earnings of $345 million (ACT Government, 2018, p. 305), the actual return in 2015-16 was only 2.7 percent, with investment earnings of $96 million (ACT Government, 2017, p. 293).

discount rate used by the Commonwealth Government to estimate the liability valuation for its own defined benefit employer superannuation liabilities (ACT Government, 2018a, p. 298).

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 2017 utilised a discount rate assumption of 3.51 percent (ACT Government, 2018a, p. 299).

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 2018 will, as in 2017, be considerably higher than the figure forecast in the Budget Papers and the service cost for the Budget year will also be somewhat higher. There will, however, be an offsetting reduction in the interest cost.

Based on the figures reported in Budget Paper 3 (ACT Government, 2018a, p. 299), 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.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 superannuation expense in the headline net operating balance by $26 million in 2017-18 and $23 million in 2018-19. The table is replicated below.

Table 16: Impact of a 1 percentage point decrease in the discount rate on superannuation expense

	2017-18 $'000	2018-19 $'000	2019-20 $'000	2020-21 $'000
Superannuation Provision Account	**26,000**	**23,000**	**20,000**	**17,000**

Source: (ACT Government, 2018a, p. 435)

Further discussion of the impact of the changes in the superannuation liability are provided in section 7.5 on superannuation liabilities and section 3.3 on balance sheet measures of the fiscal position.

A.5 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, 2018a, p. 347).

The Committee would be aware that the Government has adopted an accounting policy for these projects that results in their being accounted for as finance leases (Budget Paper No. 3, Chapter 9, Appendix B). The treatment of these projects as finance leases impacts on the way they are described in the budget.

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

It is noted 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. 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 has been adopted. This particular standard treats such arrangements as leases.

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

In July 2017 the Australian Accounting Standards Board issued AASB 1059, Service Concession Arrangements: Grantor. AASB 1059, which is based on IPSASB 32, is applicable to projects that have or will become operational from 1 January 2019.

AASB 1059 does not treat PPP arrangements as leases, but instead, requires the assets and liabilities to be recognized 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.

In terms of the accounting policy hierarchy in choosing the most appropriate accounting treatments 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 adopt AASB 1059. This is particularly so in respect to the Light Rail – Stage 1 project, given that the ACT Transport Minister publicly indicated on 5 June 2018 that this project would be operational from 18 December 2018. That is, the Light Rail - Stage 1 project assets, liabilities and cash flows will be controlled by the Government within the budget year.

Whether the approach adopted in recognizing and valuing the projects assets and liabilities in the budget balance sheet for 2018-19 accords with the requirements of AASB 1059, is uncertain. In addition, had AASB 1059 been adopted, the impact on the budget balances is also 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 for the Light Rail – Stage 1 and the Law Courts PPP projects?
- What impact on the budget balances would have been had AASB 1059 been adopted.

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

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