Pegasus Economics

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Review of the ACT Budget 2017-18

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Pegasus Economics

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

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Executive Summary

The Budget Papers present a headline operating balance of -$83.4 million, moving to a forecast modest surplus of $9.8 million by 2018-19 with surpluses gradually increasing thereafter. Significant reprofiling of revenue items associated with the land release program other non-financial transactions, valuation effects and other technical adjustments make a significant contribution to the attainment of a surplus in 2018-19. There are considerable risks in the outlook. Projections for final demand, employment growth, the Wage Price Index and population growth in the out-years are overly optimistic given Commonwealth Government fiscal consolidation.

Overview

This report has been prepared by Pegasus Economics (Pegasus) to assist the ACT Legislative Assembly's Select Committee on estimates 2017-2018 in its consideration and review of the 2017-18 ACT Budget.

The economic estimates for 2016-17 and forecasts for 2017-18 contained in the ACT Budget appear reasonable based on current trends. However, Pegasus has reservations regarding claims to the effect that the ACT has made progress in diversifying the ACT economy particularly in relation to greater private sector involvement.

The Budget Papers present a headline operating balance of -$83.4 million, moving to a forecast modest surplus of $9.8 million by 2019-20 with surpluses gradually increasing thereafter. The significant reprofiling of revenue items associated with the land release program items – namely contributed assets and dividends from the Land Development Agency and its successor agencies – make a significant contribution to the attainment of a surplus in 2018-19.

The Territory's balance sheet remains healthy, with a positive net worth rising from $18.0 billion to $18.6 billion over the Budget and forward estimates. However, net debt is forecast to increase from $2.0 billion to $2.8 billion and net financial liabilities are expected to increase from $5.1 billion to $6.1 billion over the same period.

Revenue is expected to increase from an estimated outcome in 2016-17 of $5.17 billion to $5.34 billion in 2017-18. Revenue growth over the Budget and forward years largely reflects assumptions of continued growth in own-source taxation, Commonwealth grants, and gains from contributed assets (essentially returns from land sales).

There are a number of risks attached to the outlook. Projections for final demand, employment growth, the Wage Price Index and population growth in the out-years are optimistic given Commonwealth Government fiscal consolidation. The outlook also relies on the achievement of a large number of savings and offsets measures.

Issues requiring further investigation

In its examination of the 2017-18 ACT Budget, Pegasus believes the following issues are worth further investigation by the Committee:

- Whether projections for ACT final demand, employment growth, the Wage Price Index and population growth in the out-years are optimistic in light of Commonwealth Government fiscal consolidation.
- In light of committing an additional $17.7 million over four years to support Canberra businesses to diversify, grow and innovate, whether these industry policy initiatives will focus on letting 'losers' go through phasing out support.
- Why CPI plus 4.75 per cent per annum has been chosen as a return objective for the Government's superannuation investments.
- The reason behind the significant reprofiling of revenue items associated with the land release program items – namely contributed assets and dividends from the Land Development Agency and its successor agencies.
- Measurable outcomes expected to be achieved from the Safer Families initiatives.
- Further information on the location, quantum and timing of the claimed savings and offsets and their expected impacts on service levels.
- A reconciliation of savings actually achieved in the 2016-17 Budget year.
- Further information on the potential expense and capital implications of Stage 2 of the ACT's light rail network to connect Woden and the City for future Budgets.
- Seek advice on the application of a broader set of sustainability measures across the budget and forward years, including:
  - assets to liabilities coverage;
  - short term assets to short term liabilities coverage; and
  - financial assets to liabilities coverage.

1 Introduction

This report has been prepared by Pegasus Economics to assist the ACT Legislative Assembly's Select Committee on estimates 2017-2018 in its consideration and review of the 2017-18 ACT Budget. The 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. There has been no consultation with officials or staff of the Assembly on the contents of the report.

1.1 Introduction

This report has been prepared for the ACT Legislative Assembly's Select Committee on estimates 2017-2018 to assist the Committee in its deliberations in relation to the 2017-18 ACT Budget.

1.2 Background

Pegasus Economics (Pegasus) was engaged by the Legislative Assembly on 28 April 2017 to assist the Committee with its assessment of the Budget. Pegasus was required to prepare a 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 2017-18 Budget.

The report does not provide a complete or comprehensive summary of the 2017-18 Budget, or 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

This report is based on a desk-top review of the ACT Budget documentation presented to the Assembly on 6 June 2017. Pegasus has consulted other documentation in the public domain including reports of the ACT Auditor-General, various Ministerial statements, Departmental reports and research literature.

The range of matters covered in this report relates to subjects raised by Committee members at a meeting with Pegasus consultants on 29 May 2017. There has been no contact with officials or staff of the Assembly in the preparation of the report. In some areas, where additional technical information would be helpful in understanding the budget classification of an item, or trends in the reporting of a budget aggregate, the usefulness of this report would have been improved if contact with officials had been possible.

2 Economic Forecasts

While the economic estimates for 2016-17 and forecasts for 2017-18 contained in the ACT Budget 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 given Commonwealth Government fiscal consolidation. Pegasus also has reservations regarding claims that the ACT has made progress in diversifying the ACT economy particularly in relation to greater private sector involvement.

A summary of current economic trends alongside the economic estimates and forecasts contained in the 2017-18 ACT Budget are provided in Table 1 below.

Table 1: Current outcomes and economic estimates and forecasts in the 2017-18 ACT Budget, percentage change

Indicator	Current outcomes to the end of March 2017[1]	ACT Budget 2016-17 estimates	ACT Budget 2017-18 estimates
State Final Demand[2]	6.5	5	3¼
Employment[3]	1.5	1¼	1½
Wage Price Index	1.8	1¾	2
Consumer Price Index	2.3	2½	2¼
Population	1.5	1½	1½

1. Through the year unless otherwise stated
2. In year average terms
3. Though the year to the end of April 2017 in trend terms (as seasonally adjusted figures are not provided for the ACT)

Sources: Australian Bureau of Statistics (ABS) (2017; 2017a; 2017b; 2017c; 2017d) and ACT Government (2017)

2.1 ACT Final Demand

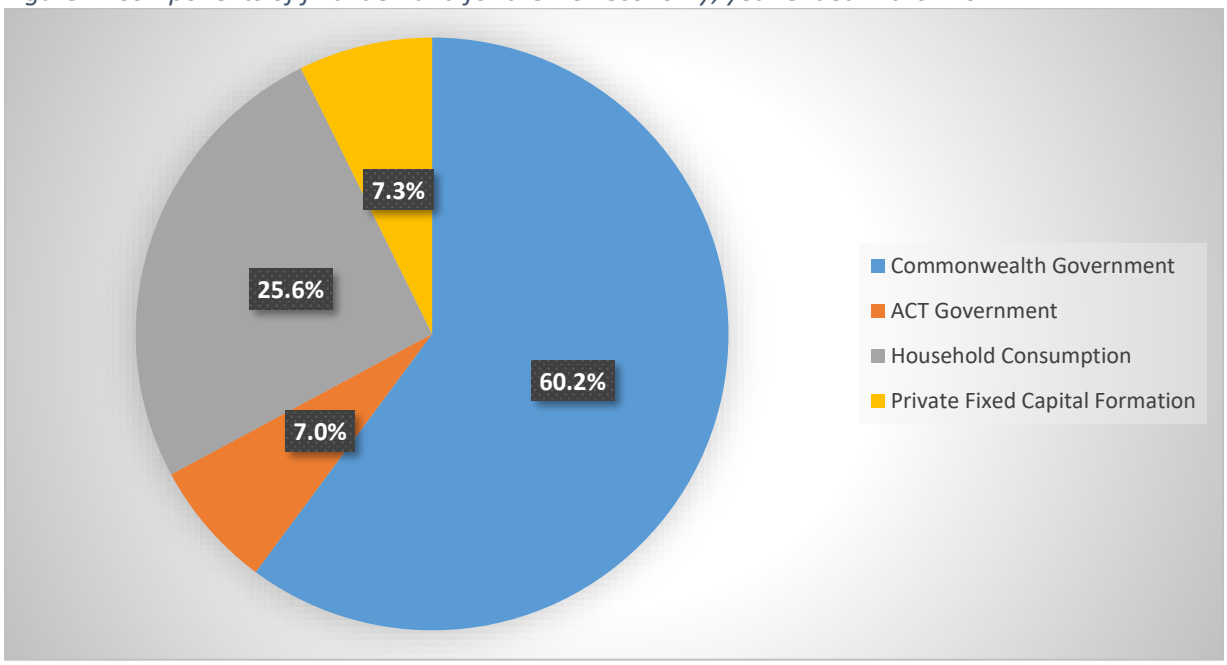
The best and most immediate indicator of economic activity within the ACT is final demand. Estimates of gross state product (GSP) are only published annually with a significant time delay following the end of the financial year and quarterly estimates are not available. Because there is no timely way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

In the March 2017 national accounts released by the Australian Bureau of Statistics (ABS) (2017a) on 7 June 2017, the ACT recorded reasonably strong demand growth, growing by 0.5 per cent in the March quarter, compared to 0.3 per cent across the country as a whole. In light of the reasonably strong level of growth recorded in ACT final demand in the March quarter along with year average growth of 6.5 per cent for the year ended March 2016, growth in final demand is currently tracking ahead of the 2017-18 Budget forecast for 2016-17 of 5 per cent growth. In light of this, the estimate of final demand in 2016-17 is consistent with current trends.

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 an economy whose outcomes are heavily dependent on the consumption and investment decisions of the Commonwealth Government. In the year to the end of March 2017, the Commonwealth represented 60.2 per cent

of total demand in the ACT economy, compared to household consumption that made up 25.6 per cent, private investment of 7.3 per cent, and 7.0 per cent for the ACT Government as illustrated in Figure 1 below.

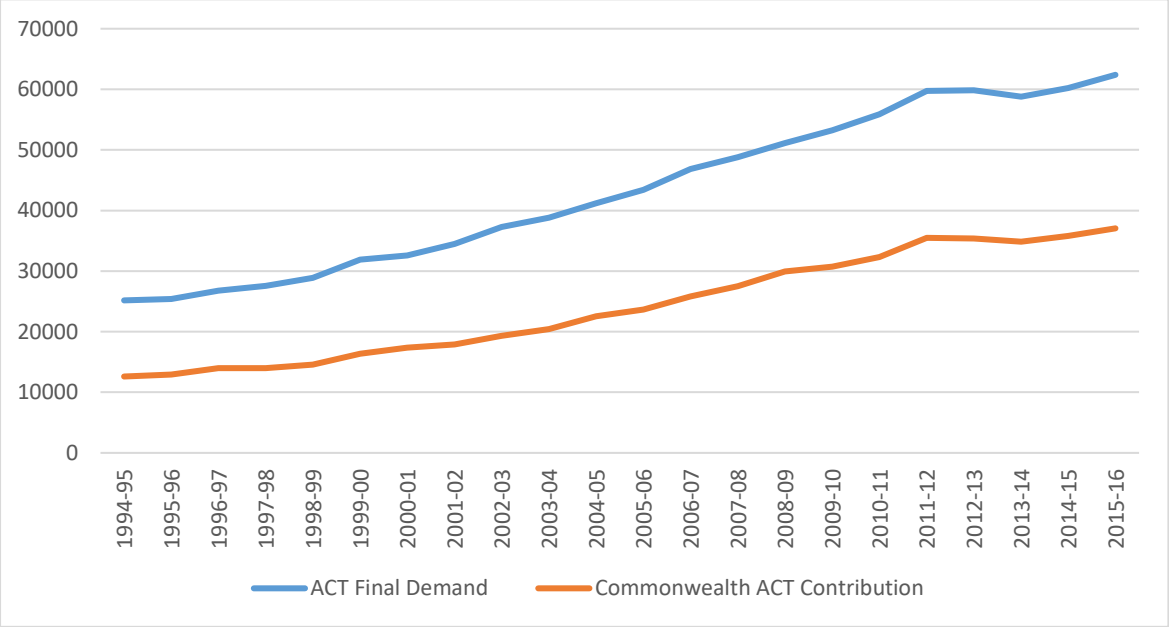
Figure 1: Components of final demand for the ACT economy, year ended March 2017



Source: ABS (2017a)

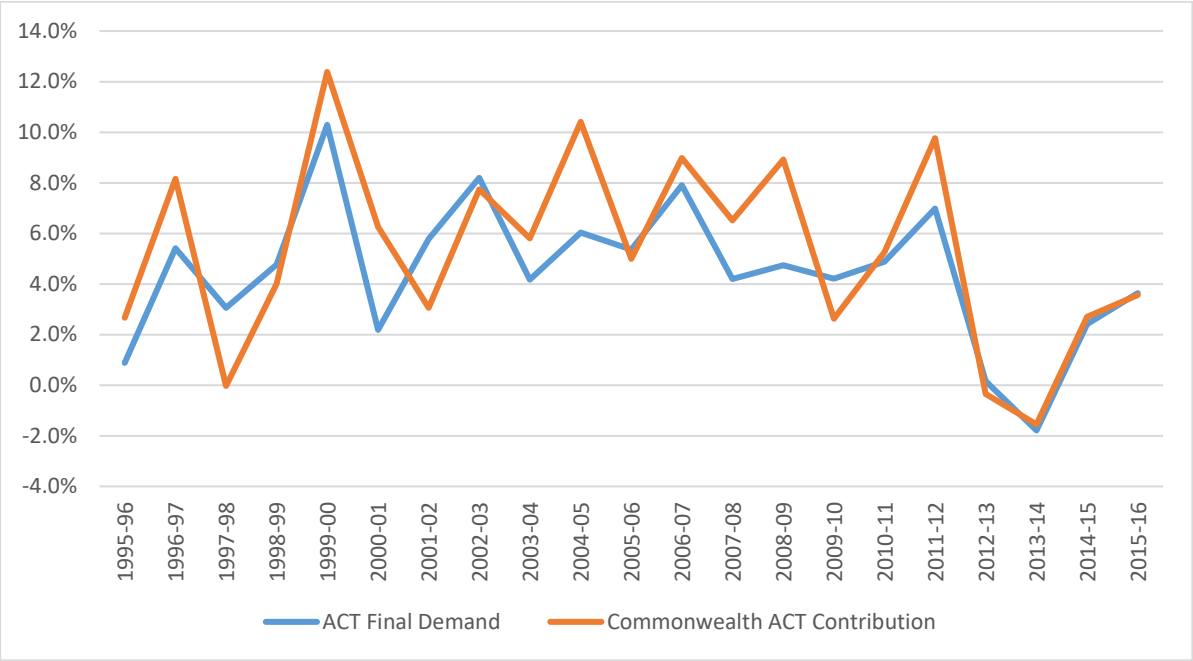
There is a close relationship between ACT final demand and the contribution of the Commonwealth Government to ACT final demand, as outlined in Figure 2 below, as well as between growth in ACT final demand and the growth of Commonwealth Government expenditure in the ACT, as outlined in Figure 3.

Figure 2: ACT final demand and Commonwealth ACT contribution – 1994-95 to 2015-16 ($ million, constant 2014-15 dollars)



Sources: ABS (Australian Bureau of Statistics, 2017a)

Figure 3: Percentage Growth in ACT final demand and Commonwealth ACT Expenditure – 1995-96 to 2015-16



Sources: ABS (2017a)

In the 2017-18 Commonwealth Budget, Commonwealth Government payments are expected to increase by 2.3 per cent in 2016-17, 2017-18 and 2018-19 in real terms, before moderating to growth of 0.9 per cent in real terms in 2019-20 (Commonwealth of Australia, 2017, p. 6.5). Continuing increases in Commonwealth Government payments should be sufficient to support ongoing growth in demand for the ACT economy in the foreseeable future. On this basis, Pegasus has no reason to question the ACT Budget estimate of 3¼ per cent demand growth for the ACT economy in 2017-18.

However, the ACT Budget papers contain projections for ACT final demand that converge back towards a long-run trend rate of growth of 4 per cent in the out years (ACT Government, 2017, p. 2). Pegasus has reservations as to whether it is feasible to assume that ACT final demand will eventually return to long-run trend growth of around 4 per cent.

As can be seen in Figure 2 above, growth in Commonwealth ACT expenditure has moderated in real terms since 2012-13 and, as a consequence, growth in ACT final demand appears to have largely moderated in turn. Figure 3 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 of 4 per cent per annum, particularly in light of the fact that real payments growth for the Commonwealth Government (2017, p. 3.21) over the forward estimates from 2017-18 is expected to be 1.9 per cent per annum on average over the forward estimates, the lowest average real growth in spending in almost fifty years (Morrison, 2017). The ACT Budget papers gloss over this fact by referring to 3.5 per cent growth in Commonwealth Government expenditure in current prices or in nominal terms (ACT Government, 2017, p. 11). However, it is growth in real terms that counts from an economic perspective rather than in nominal terms which isn't adjusted for inflation and changing price levels.

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 given the Commonwealth Government is facing a

challenging fiscal environment in its planned move back towards surplus. While it could be argued that Commonwealth Government moves towards fiscal consolidation are a temporary measure likely to fall by the wayside as the country moves towards the next federal election, the threat of a credit rating downgrade is likely to continue to impose some fiscal discipline upon the Commonwealth Government. While the Commonwealth Government maintained its AAA credit rating amongst the various credit rating agencies following the 2017-18 Budget, ratings agency Standard & Poor's has retained the negative outlook that it imposed following last year's federal election.

Pegasus believes that ACT final demand projections of around 3 per cent growth 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 budgetary purposes.

2.2 Employment

Employment growth through the year to the end of April 2017 for the ACT was running at 1.5 per cent in trend terms (Australian Bureau of Statistics, 2017c). Employment is traditionally seen as a lagging Indicator of economic activity (or an indicator that follows an economic event). With ACT demand forecast to moderate from 5 per cent in 2016-17 to 3¼ per cent in 2017-18, one would also generally expect to observe some moderation in employment growth. On this basis, an estimate of employment growth of 1¼ per cent in 2016-17 appears reasonable while the forecast of growth of 1½ per cent in 2017-18 may appear to be slightly on the upside although not unreasonably so.

In 2017-18 the employment situation for the ACT will be assisted by the Commonwealth Government (2017b, p. 137) workforce slightly increasing, with an overall net increase of 588 positions in 2017-18 across Australia for an average staff level of 258,958 (including military and reserves). The ACT accounts for just over 37 per cent of Commonwealth Government employees (excluding military and reserves) (Australian Public Service Commission, 2016, p. 6) and increases in employment within the Defence portfolio should more than offset employment reductions elsewhere across the Commonwealth Government such as the Department of Health, the Department of Immigration and Border Protection, and the Department of Human Services.

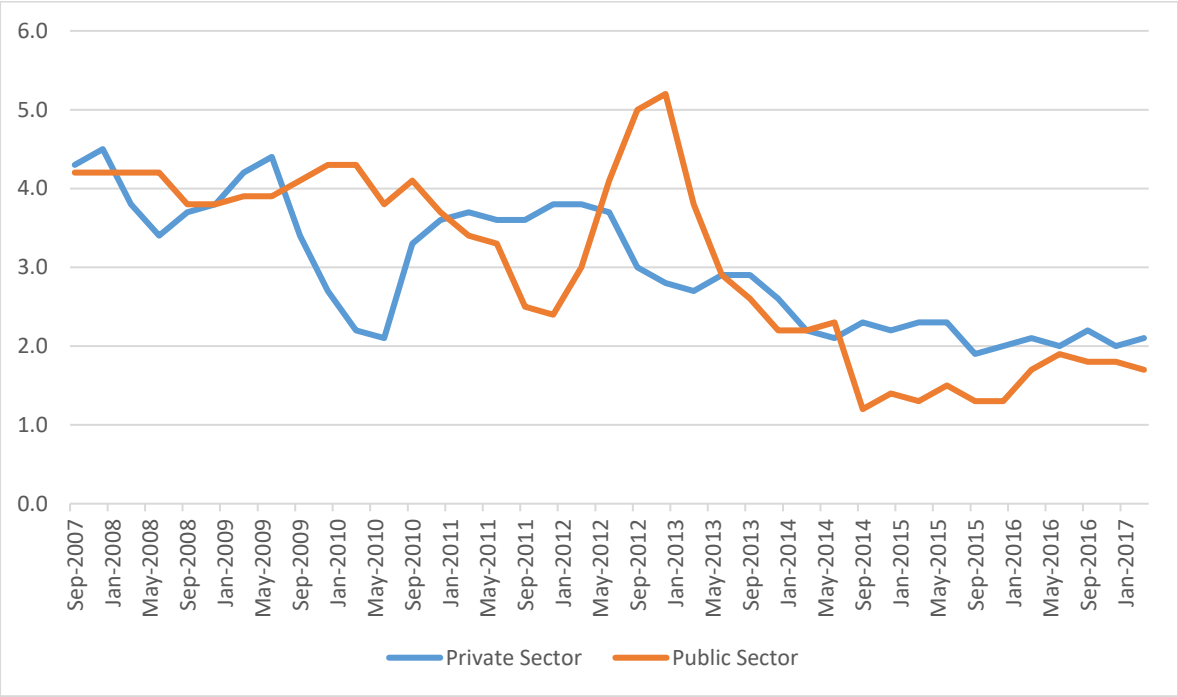
In light of the importance of the Commonwealth Government to the ACT economy, and given the current constraints on real payments growth by the Commonwealth Government (2017, p. 3.21), ongoing employment growth for the ACT in the order to 1½ per cent arguably represents an upper limit on what is realistically possible and somewhat optimistic in the out-years.

2.3 Wage price index

The Wage Price Index (WPI) is currently running at 1.8 per cent through the year to the end of the March quarter 2017 (Australian Bureau of Statistics, 2017d), which is consistent with the ACT Budget estimate of 1¾ per cent for 2016-17.

In reverse of an ongoing national trend, wages growth in the private sector has generally been outstripping that recorded within the public sector within the ACT since 2013, as outlined in Figure 4 below.

Figure 4: 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 2017



Source: Australian Bureau of Statistics (2017d)

The reversal of the national trend between the private and the public sectors within the ACT arguably reflects a shift in the bargaining position of public sector workers relative to their counterparts in the private sector. 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 2017-18 is expected to be the lowest average real growth in spending in almost fifty years, it is extremely difficult to see improved wage outcomes for Commonwealth public servants in the immediate future.

In light of the Commonwealth Government's restraint in payments growth, 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 2 per cent for the WPI in 2017-18 may not appear unreasonable, it does appear the projections for growth in the WPI of 2½ per cent in 2018-19 and 3 per cent in 2019-20 and 2020-21 appear overly optimistic. Outcomes around 1¾ per cent for growth in the WPI for the estimate in 2017-18 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 2016 for the ACT was 2.3 per cent (Australian Bureau of Statistics, 2017b), which is consistent with the 2017-18 ACT Budget estimate of 2½ per cent change through the year in 2016-17. For 2017-18, the budget forecast is for a slight moderation from the outcome for 2016-17 to 2¼ per cent growth, consistent with the Commonwealth Government's national forecast of around 2 per cent. There is no reason for the CPI within the ACT to greatly diverge from the national outcome, hence the ACT Budget forecast appears entirely reasonable.

2.5 Population growth

Population is an indicator that is not particularly timely in its release by the ABS, as there is currently only one quarter of data available for the 2016-17 financial year. The ACT recorded population growth of 1.5 per cent through the year to the end of the September quarter 2016 (Australian Bureau of Statistics, 2017) which is consistent with the ACT Budget estimate of 1.5 per cent growth in 2016-17.

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 2017-18 Budget forecast and projections in the out-years for constant population growth of 1.5 per cent appear somewhat optimistic.

2.6 The ACT as a diversifying economy?

In the 2017-18 Budget the ACT Government (2017, p. 21) outlines its economic strategy to diversify the economy and claims that progress on diversifying the ACT has already been achieved:

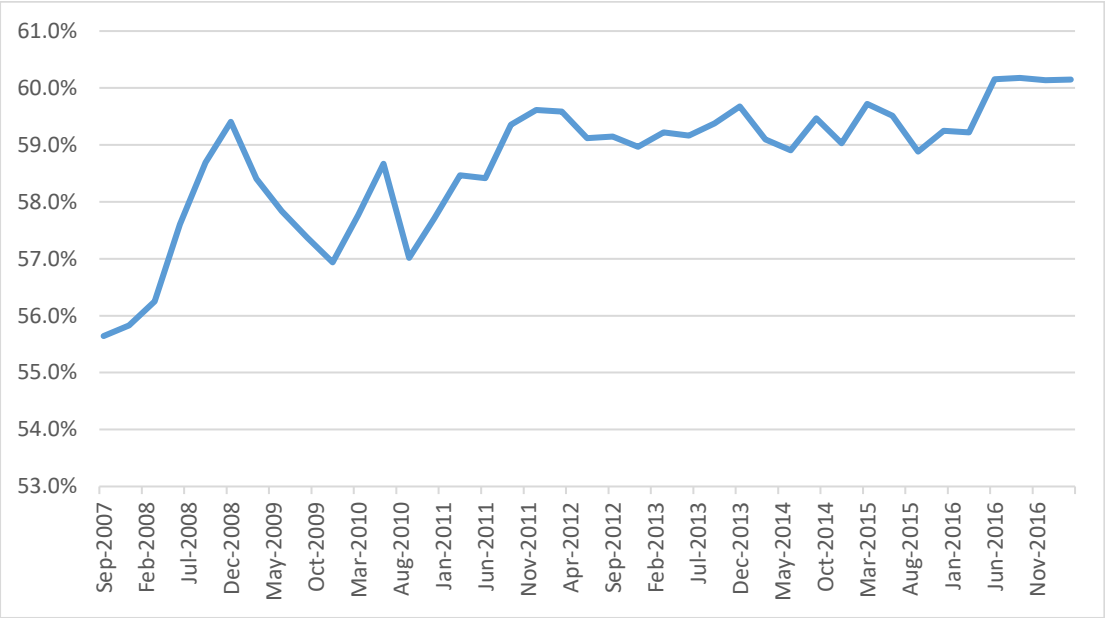
> Jobs growth is expected in a range of industries including construction, education and research, defence and intelligence, tourism, and sectors associated with household consumption. **This is further evidence of the progress being made through the ACT Government's efforts to diversify the Territory's economy.** (ACT Government, 2017, p. 7)[1]

Pegasus has significant reservations regarding any claims made to the effect that any progress has been made in diversifying the ACT economy, particularly in relation to greater private sector involvement in the ACT economy. A diversified economy is one that has multiple sources of income. A diversified economy is considered desirable as it reduces the dependence on any one sector of the economy as a source of income in the event of a shock and/or downturn in that sector. As already seen above, the ACT economy is heavily dependent on the public sector, especially the Commonwealth Government.

Analysis of the available data suggests the ACT economy remains very much a 'company town' highly dependent on the Commonwealth Government. An examination of the latest national accounts reveals that over the past decade the ACT economy has in fact become even more dependent on the Commonwealth Government as outlined in Figure 5 below. The contribution of the Commonwealth Government to total final demand in the ACT economy has increased from 55.6 per cent in the September quarter 2007 to 60.1 per cent in the March quarter 2017.

[1] The emphasis through bolding was added by the authors of this report.

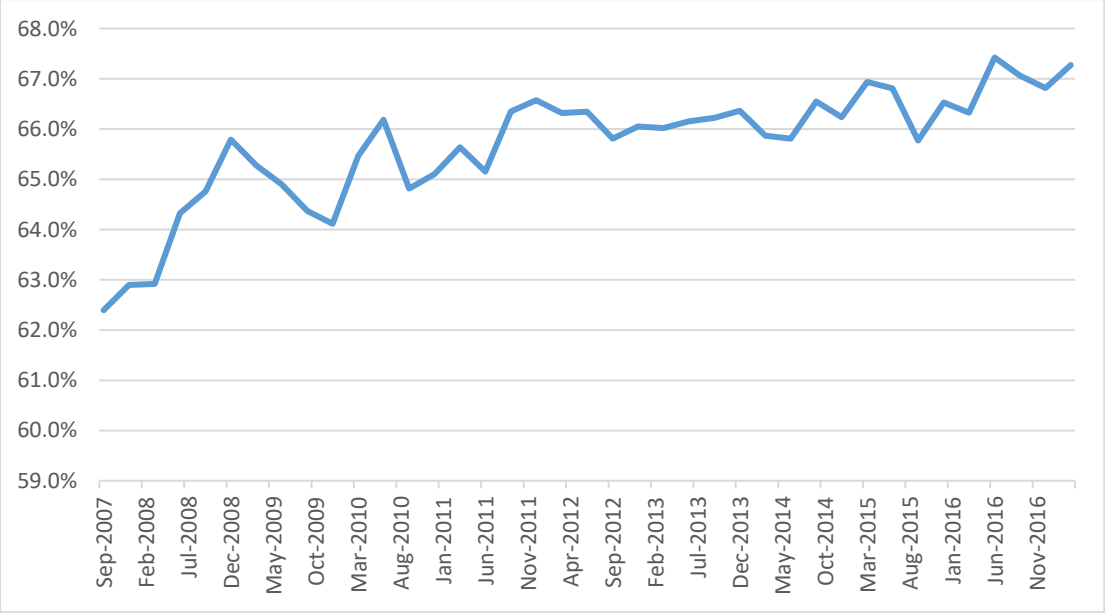
Figure 5: Percentage contribution of the Commonwealth Government to ACT final demand – September quarter 2007 to March quarter 2017



Source: Australian Bureau of Statistics (Australian Bureau of Statistics, 2017a)

Rather than becoming more diversified over the last decade, the ACT economy has become far less diversified as the public sector – composed of both the Commonwealth and ACT governments – have increased their overall contribution to ACT final demand from 62.4 per cent in the September quarter 2007 to 67.3 per cent in the March quarter 2017 as outlined in Figure 6 below. Given the public sector growth experienced over the past decade, which now accounts for over two thirds of ACT final demand, any claim that the ACT is becoming a more diversified economy appears is difficult to justify. While the Commonwealth Government has been the main contributor towards a less diversified economy for the ACT, the ACT Government has also been a slight contributor in trend terms as well.

Figure 6: Percentage contribution to ACT final demand from the public sector – September quarter 2007 to March quarter 2017



Source: Australian Bureau of Statistics (Australian Bureau of Statistics, 2017a)

The ACT Government (2017, p. 21) announced in its budget that it is committing an additional $17.7 million over four years to support Canberra businesses to diversify, grow and innovate. In its attempt to diversify the economy, it would appear the ACT Government is committing itself to a modest industry policy package. Professor Dani Rodrik (2004, p. 2) of Harvard University has defined industry policy as restructuring policies in favour of more dynamic activities generally, regardless of whether those are located within industry or manufacturing per se.

In the ACT Government's attempt to diversify the ACT economy, Pegasus would draw the Committee's attention to the warnings of Professor Michael Grubb (2004) of University College London to the dangers of trying to pick winners:

> Critics – especially economists – can point to long lists of government-sponsored technology failures, some of them astonishingly expensive, due to phenomena that social scientists well recognise in terms of institutional capture. As one cynic put it, 'governments are bad at picking winners, but losers are good at picking governments'.

Professor Rodrik (2008, p. 29) argues that governments shouldn't try to pick winners, but should instead focus on the capacity to let the losers go through phasing out support. While this could be hard to achieve, it is far less demanding of the government than full omniscience. According to Professor Rodrik (2004, p. 12):

> ... a good industrial policy will prevent ... failures from gobbling up the economy's resources indefinitely, and it will ensure that they are phased out. The trick for government is not to pick winners, but to know when it has a loser.

3 Fiscal outlook

The Budget Papers present a headline operating balance of -$83.4 million, moving to a forecast surplus of $9.8m by 2018-19 and progressively increasing surpluses through the forward years. The forecast return to surplus is driven by expected growth in ACT own-source revenue collections, higher contributed assets and increases in Commonwealth grants, partially offset by expected increases in expenses. However, valuation effects, the classification of some large financial flows and other technical adjustments continue to have large impacts on the budget aggregates.

3.1 Overview

The Budget Papers present a headline operating balance of -$83.4 million for 2017-18, including various adjustments, moving to a forecast surplus of $9.8 million by 2018-19 and remaining in surplus thereafter.

Table 2: General Government Sector Headline Net Operating Balance

	2016-17 Est. Outcome $'000	**2017-18 Budget $'000**	**2018-19 Estimate $'000**	**2019-20 Estimate $'000**	**2020-21 Estimate $'000**
Revenue	5,165,836	5,341,439	5,538,705	5,800,362	6,040,337
Expenses	-5,410,579	-5,596,370	-5,709,181	-5,965,018	-6,183,579
Superannuation return adjustment	170,812	171,522	180,269	192,584	206,514
HEADLINE NET OPERATING BALANCE	**-73,931**	**-83,409**	**9,793**	**27,928**	**63,272**

Source: ACT Government (2017, p. 32)

Table 2 shows that revenue and expenses have increased relative to the 2016-17 estimated outcome, and continue to grow at relatively stable rates over the forward estimates period.

The major drivers of revenue growth over the Budget and forward estimates are the expectations of higher ACT own-source revenue collections, higher contributed assets and increases in Commonwealth grants. The major growth item in the revenue forecasts is "contributed assets", which are expected to grow by 92.1 per cent over the Budget and forward years. Contributed assets are non-financial transactions that represent 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).

Growth in expenses across the Budget and forward years is a consequence of growth in a range of functions, including Health, Education, Fuel and Energy and Transport and Communications.

The Budget forecasts a return to surplus in 2018-19. The forecast surplus of $9.8 million in 2018-19 compares with a forecast of the surplus in that years in the 2016-17 Budget of $33.3 million.

3.2 Budget classification and presentation issues

The budget aggregates incorporate the effects of various budget classification and presentation decisions. These adjustments can have significant impacts on how the Budget aggregates are interpreted and understood.

The following sections provide comment on the major adjustments and changes in presentation in the Budget aggregates.

Super return adjustment

The presentation of the headline operating balance for 2017-18 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 Budget Papers concluded that an adjustment for expected superannuation returns is required to provide an accurate assessment of the longer-term sustainability of the budget position.

The superannuation return adjustment is problematic in terms of the formal GFS reporting framework. However, given the nature of the Territory superannuation schemes, it is reasonable that the Budget documents should make some provision for the emerging cost of these schemes and that the provisions be expressed in terms of closely comparable revenue and expense items as far as possible.

The Budget Papers indicate that the superannuation return adjustment is consistent with a long-term expected return objective of the Consumer Price Index (CPI) plus 4.75 per cent per annum (ACT Government, 2017, p. 293). The return objective has been reduced by the Government in this Budget from CPI plus 5 per cent. A reduced rate is more in line with current market conditions. However, given the prevailing low interest rates, this still appears to be a more aggressive earning rate than most actuaries would typically be using for the purposes of determining employer contribution rates to ensure that benefits accruing with service are being adequately funded. 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).

The Committee might wish to pursue with officials the reason why a return objective of CPI plus 4.75 per cent per annum has been chosen as a return objective for the Government's superannuation investments.

Superannuation Liability Valuation

Last year's Budget Paper 3 included a superannuation liability adjustment of around -$90 million.

The superannuation liability adjustment sought to anticipate the difference between current interest rates used in the formulation of budget estimates and the long-term discount rate used to value the Territory's superannuation liabilities (ACT Government, 2016, p. 31).. The Australian Accounting Standards currently require superannuation liabilities in financial statements to be prepared on the assumption of a 6 per cent bond rate. While this assumption reduces volatility in the preparation of accounts, in the case of a long-period liability such as superannuation, it can imply a misleadingly low value for the present value of the government's superannuation liabilities. The technical adjustment to align the interest rate assumption with the Accounting Standards had traditionally not been made until the actual outcomes for each year were published. In recent years this adjustment had reduced the bottom line by a material amount due to the low interest rate environment. To compensate for this, the 2016-17 Budget provided an adjustment to account for the difference in discount rate assumptions.

There is no similar adjustment to the 2017-18 Budget Estimate. The discussion of the superannuation valuation liability in chapter 8 of Budget Paper 3 points to an apparent change in the treatment of this item for the 2017-18 year. In 2016-17, the liability valuation at 30 June 2016 utilised a discount rate assumption of 3.2 per cent and the liability valuations for the forward years from 30 June 2017 utilised a long-term discount rate assumption of 6 per cent (ACT Government, 2016, p. 296). In this year's Budget Papers the long-term discount rate assumption of 6 per cent appears to have been applied across the budget and forward years (ACT Government, 2017, p. 286). As a consequence, there was a superannuation liability adjustment to the estimated 2016-17 estimate to align the budget presentation with accounting standards, but no adjustment has been made for the 2017-18 Budget Estimate.

The change in the treatment of this item in the 2017-18 Budget reduces the gap between budgeted and end-year statement estimates of superannuation liabilities and service costs. The Committee should be aware, however, that in the prevailing interest rate environment, the application of a lower discount rate for the 2017-18 Budget Estimate of the Territory's superannuation liabilities that more closely approximates current interest rates would have the effect of increasing the budgeted superannuation service costs. Table L.6 in the Appendices to Budget Paper 3 indicates that a 1 per cent decrease in the discount rate from the long-term budget assumption of 6 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 3: 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 (2017, p. 423)

It is not clear why the government has changed the treatment of the Superannuation Liability Valuation in this year's Budget. This is a technical accounting adjustment that does not necessarily reflect actual changes in the ACT's superannuation obligations, or the Territory's ability to meet benefit payments as they become due. However, as the accounting treatment of this item does impact on the presentation and understanding of the Territory's budget from year to year, it would be useful for the Committee to understand the reason for the apparent change in the treatment of this item in the current Budget.

Given the prominence attached to the forecast return to surplus in 2018-19, it would also be useful to know what treatment the Government intends to apply to the 2017-18 Budget.

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, 2017, p. 192)

The Committee will be aware that the Government has adopted an accounting policy for these projects that results in their being accounted for as finance leases (ACT Government, 2017, p. 339). 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 recognised 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 capitalised when occurred and will be added to the final lease assets at the commencement of the lease term

Under these arrangements, the government will make contract service payments to private consortia over the life of the contracts, covering the costs incurred in constructing, financing, maintaining and operating the assets. The Territory's service payments will be apportioned between a financing component, maintenance and operation costs, and a provision for reductions in the lease liability over time. The financing component is calculated at the rate implicit in the lease and is accounted for as an interest expense. The portion of the payment related to the maintenance/operating costs is accounted for as a supplies and services expense. In addition, the leased assets are depreciated over their useful life with depreciation expenses being recognised.

The interest, maintenance/operating costs and depreciation expenses will all affect the operating statement and the headline net operating balance (ACT Government, 2017, p. 340).

Table 4 summarises the impact of the Light Rail project on the headline operating balance.

Table 4: PPP Impact on Budget Headline Net Operating Balance

	2017-18 Financial Year $'000	**2018-19 Financial Year $'000**	**2019-20 Financial Year $'000**	**2020-21 Financial Year $'000**
Light Rail Stage 1				
Maintenance/Operating Costs	-	-21,216	-25,722	-26,172
Interest	-	-15,922	-18,901	-18,275
Depreciation	-	-10,559	-14,079	-14,079
Total Impact Light Rail Stage 1	0	-47,697	-58,702	-58,526
Law Courts				
Maintenance/Operating Costs	-2,368	-5,808	-6,306	-6,464
Interest	-5,288	-12,194	-12,680	-12,495
Depreciation	-1,623	-3,808	-4,006	-4,006
Total Impact Law Courts	-9,279	-21,810	-22,992	-22,965

Source: ACT Government (2017, p. 340)

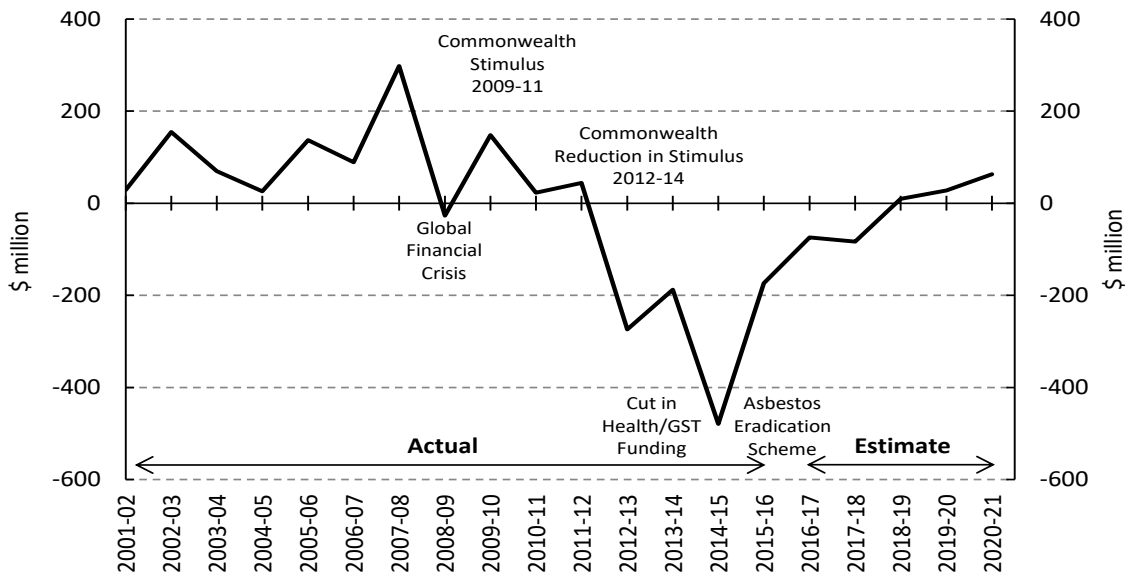
As Table 4 shows, one consequence of the accounting treatment of the Territory's major Public Private Partnerships arrangements will be to defer the immediate impacts on the headline net operating balance and spread the costs over many years into the future.

3.3 Medium term forecasts

The Budget Papers indicate that the government is pursuing a fiscal strategy that achieves an operating balance over time, offsetting temporary deficits with surpluses in other periods (ACT Government, 2017, p. 41)

Figure 7 illustrates the actual and forecast fiscal trajectory since 2001-02.

Figure 7: Headline Operating Balance



Source: ACT Government (2017, p. 41)

The Budget Papers claim that the Government remains is on track to return the budget to balance in 2018-19, with a continued strengthening of the ACT economy and forecast improvements in the fiscal position over the forward years.

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. This is problematic. The achievement of an operating surplus in 2018-19 also requires growth in grants from the Commonwealth, growth in own taxation revenue and the generation of a large increase in other economic inflows, as well as the achievement of significant offsets against planned increases in expenditure.

Comment on the risks and uncertainties against these assumptions is set out in later sections of this report.

3.4 Return to surplus

Territory governments have articulated variations of the current fiscal strategy since at least 2010-11. However, successive Budgets have failed to achieve the forecast return to surplus.

The Budget Papers indicate that the Government's fiscal strategy first indicated a return to surplus in 2018-19 in the 2015-16 Budget (2017, p. 41). However, the size of the projected surplus has been repeatedly reduced in successive budgets since that time; from $50.3 million in 2015-16, to $33.3 million in 2016-17 and $9.8 million in 2017-18.

Figure 8 compares the predicted trajectory of the fiscal balance presented in successive Budget Papers since 2010-11.

Figure 8: Forecast returns to surplus ($ million)

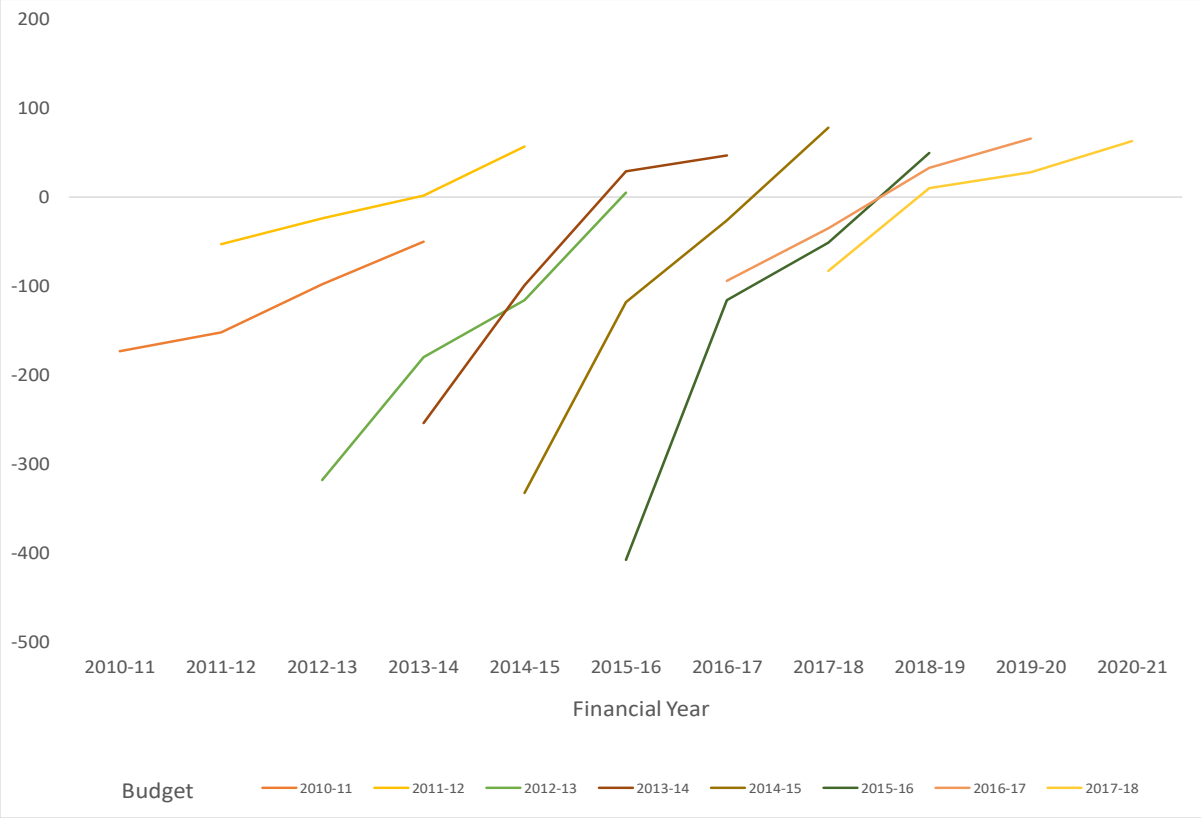


Figure 8 shows that:

- Every year up to 2017-18, the budget has been forecast to return to a small surplus in the last or second last of the forward years;
- After 2011-12, the balance has been revised downwards for each budget and forward year in each year up to 2017-18 except for 2013-14, and the 2015-16 surplus forecast in that year was reversed in subsequent budgets;
- After 2011-12 up to the 2016-17 Budget, the expected deficit worsened at each successive Budget; and
- In each year between 2010-11 and 2016-17 the climb back to surplus became longer and steeper.

The figure also shows, however, that since the 2016-17 Budget the gap between the budget year and forward estimates has narrowed and the slope of the climb back to surplus has flattened.

In commenting on previous Budgets and Budget outcomes, independent commentators, including the ACT Auditor-General (2015, p. 12), have indicated that the achievement of planned operating surpluses have depended on achieving large reductions in the deficits in the net operating balance while generating large increases in other economic inflows. Similar comments could be applied to the 2017-18 Budget and forward estimates.

To date, these requirements have proven difficult to achieve.

4 Revenue

Revenue is expected to increase over the budget and forward years from an estimated outcome of $5.2 billion in 2016-17 to $5.3 billion in 2017-18. Revenue growth over the Budget and forward years largely reflects assumptions of continued growth in own-source taxation, Commonwealth grants, and gains from contributed assets (essentially returns from land sales). There is also significant reprofiling of revenue items associated with the land release program – namely gains from contributed assets and dividends from the Land Development Agency and its successor agencies.

4.1 Overview

ACT Budget revenue is expected to increase from an estimated outcome in 2016-17 of $5.2 billion to $5.3 billion in 2017-18.

The 2016-17 estimated outcome is almost $108 million higher than originally forecast. The increase is primarily due to higher revenue received from increases in dividends and tax equivalent payments from Public Trading Enterprises ($66 million), higher own-source taxation (almost $43 million), and higher revenue from sales of goods and services (almost $13 million) partially offset from lower Commonwealth grants ($36 million).

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

Table 5: General Government Sector Revenue

	2016-17 Est. Outcome $'000	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Own Source Taxation	1,676,673	1,752,032	1,887,304	1,990,347	2,099,964
Commonwealth Grants	2,050,968	2,176,485	2,230,022	2,280,200	2,365,659
Gains from Contributed Assets	161,915	157,868	235,987	263,610	303,223
Sales of Goods and Services	492,229	520,623	535,008	547,609	560,129
Interest Income	124,521	125,124	112,053	119,268	115,406
Distribution from Financial Investments	34,738	36,851	45,265	48,089	51,568
Dividends and Income Tax Equivalents	472,182	407,963	343,243	403,577	391,773
Others	152,610	164,493	149,823	147,662	152,615
Total	**5,165,836**	**5,341,439**	**5,538,795**	**5,800,362**	**6,040,337**

Source: ACT Government (2017, p. 229)

Table 5 shows that the increase of almost $176 million in the Budget in 2017-18 over the estimated 2016-17 outcome primarily reflects increased current grants from the Commonwealth of $126 million, higher own-source taxation of $75 million, a $28 million increase from sales of goods and services and increases in other revenue of almost $12 million. Offsetting these increases are lower dividend and tax equivalents income ($64 million).

Revenue growth over the Budget and forward years largely reflects growth in higher ACT own-source revenue collections, higher contributed assets 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. Typically, the central government is the one that spends more than it collects in revenue. It is widely perceived that the often 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.

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).

If sub-national governments are to be expected to act responsibly and in the interests of their residents they should face what is known as a so-called 'hard budget constraint': that is, they should be able to increase or decrease spending only by increasing or decreasing their revenues in such a way that they are publicly responsible for the consequences of their actions (Bird & Smart, 2010, p. 78). With more explicit sub-national taxes that actually touch their pockets directly there may be both more incentive and more opportunity for citizens to figure out what is going on—and, in a democracy, perhaps even hope to do something about it.

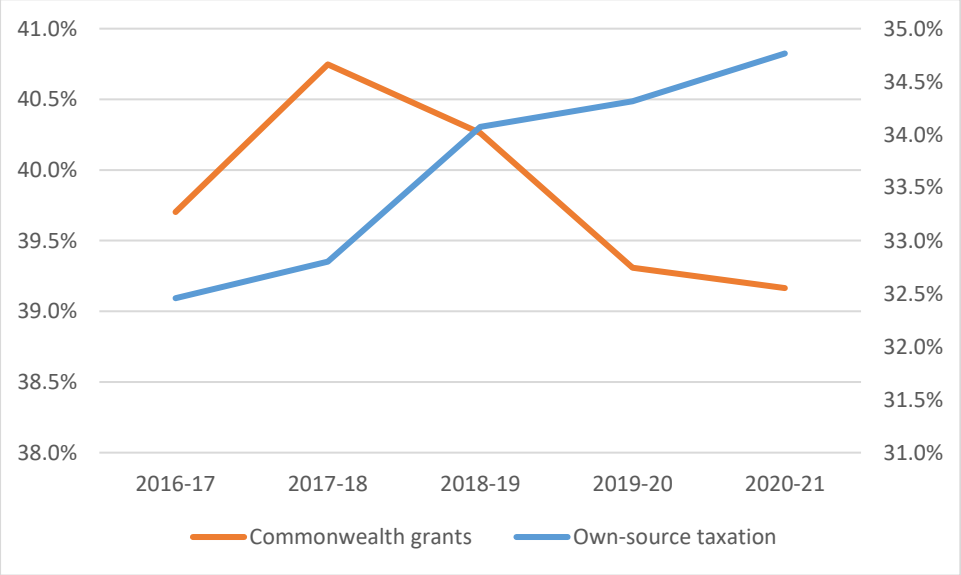
A branch of the fiscal federalism literature has emphasised that heavy reliance on intergovernmental transfers could undermine the fiscal discipline and cost scrutiny linked to accountability. The concept of *soft budget constraints* refers to situations where sub-national governments can look to authorities at higher levels, typically the central government, to bail them out of their fiscal problems of continuing deficits and a growing stock of public debt (Oates, 2008, p. 319). The concept was originally developed as the cause of significant inefficiency within socialist economies (Kornai, Maskin, & Roland, 2003, p. 1097). A soft budget constraint undercuts the incentives for more responsible fiscal behaviour and provides less focus on product innovation, productive efficiency and cost restraint.

As was the case with last year's budget, the 2017-18 Budget once again reveals that the ACT Government does not face a hard budget constraint as it fails to raise revenue even at the margin, with 71 per cent of the expected increase in revenue in 2017-18 coming from the Commonwealth. 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 that is briefly touched on below.

However, the forward estimates suggest that the extent of vertical fiscal imbalance for the ACT will be ameliorated in the forward-years and that the ACT Government will assume greater responsibility

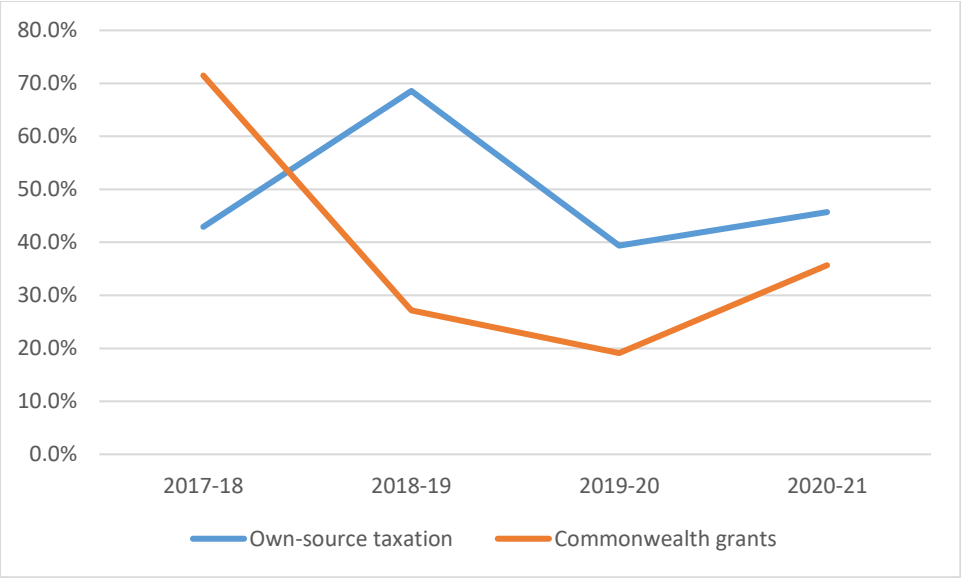
for raising its own revenue at the margin as outlined in the Figures 9 and 10 below. Figure 9 reveals that while the overall contribution of Commonwealth grants towards ACT Government revenue is diminishing over time in percentage terms, an increasing contribution is coming from own-source taxation. Figure 10 reveals the ACT Government is taking on a greater share of the burden for raising their own revenue at the margin as the percentage contribution from own-source taxation to the annual increase in revenue exceeds that of Commonwealth grants in the out-years. In turn, hopefully this will improve incentives towards greater fiscal discipline and scrutiny of expenses on the part of the ACT Government.

Figure 9: Percentage contribution to ACT Government revenue from Commonwealth grants and own-source taxation – 2016-17 to 2020-21



Source: ACT Government (2017)

Figure 10: Percentage contribution to the increase in annual ACT revenue from Commonwealth grants and own-source taxation – 2016-17 to 2020-21



Source: ACT Government (2017)

4.3 Cost of living statement

In its cost of living statement, the ACT Government (2017, p. 50) appears to confuse the provision of high quality public services across the Territory with increases in public expenditure:

> The ACT Government continues to provide high quality public services across the Territory. Government expenditure on health services has increased by around 8.4 per cent per year over the decade to 2015-16, and spending on education grew by 6.3 per cent per year over the same period.

The available evidence suggests in the case of both health and education that high levels of public expenditure by the ACT Government do not necessarily equate with quality service provision.

While it is not possible to provide any recent updates on the performance of the public health system in the ACT due to ACT Health's well documented problems with reporting performance data, the available evidence suggests the ACT public health system is not efficient when compared to other jurisdictions nor on par in terms of performance despite being the highest cost system in the country on a per capita basis. In particular:

- out of all the jurisdictions in 2014-15, the ACT recorded the worst performance overall for emergency waiting times against the benchmarks set by the Australasian Triage Scale (Productivity Commission, 2016); and
- while there has been a dramatic reduction in waiting times for elective surgery within public hospitals since 2011-12 and since 2012-13 the ACT no longer has the worst waiting lists in the country at the 50th percentile (surpassing the performance of New South Wales),[2] the ACT in 2014-15 still lagged around 29 per cent behind the national average (Productivity Commission, 2016).

In relation to education, the ACT Auditor-General recently concluded:

> ACT public schools are performing below similar schools in other jurisdictions despite expenditure on a per student basis for public schools being one of the highest in the country. Since 2014 reviews of ACT public schools have consistently identified shortcomings in their analysis of student performance information and their use of data to inform educational practice. These shortcomings indicate a systemic problem. (ACT Auditor-General, 2017, p. 1)

Given the available evidence in relation to the two largest portfolio areas for the ACT Government in Health and Education, it would appear that ACT taxpayers are in effect subsidising the provision of inefficient and less than effective public services. To the degree that the ACT Government is providing inefficient public services, it is placing additional yet unnecessary financial burdens upon ACT residents.

The cost of living statement provides five case studies of the impact of the ACT Budget on households. Examining the case studies reveals differing impacts from changes in ACT Government taxes and fees. A summary of the average impacts revealed in the case studies is provided Table 6 below. Fees for utilities have been excluded from consideration for, as the cost of living statement observes, prices are largely outside the control of the ACT Government. While we accept this to be

[2] The 50th percentile represents the time it takes for 50 per cent of patients on elective surgery waiting lists to be admitted.

the case, the ACT Government is the beneficial owner, and receives dividends, from a number of the relevant utilities. Exclusion of utility price increases from the cost of living statement has the effect of reducing the apparent impact of the Budget on the case studies.

Table 6: Summary of percentage price changes in the cost of living statement – 2017-18

Category	Percentage change
General Rates	8.9%
Fire and Emergency Services Levy	20.2%
Safer Families Levy	0.0%
Transport Fees	1.7%

Source: ACT Government (2017)

The 8.9 per cent average increase in general rates across three of the case studies is well in excess of the CPI, but an increase of this magnitude is excusable as it is largely related to tax reform and the abolition of taxes on conveyances that is discussed below. The big standout in terms of percentage changes is the greater than 20 per cent increase is the Fire and Emergency Services Levy. No explanation is provided in the ACT Budget papers for an increase of this magnitude. The Safer Families Levy and changes in transport fees raise no issues.

4.4 Tax reform

The ACT Government has 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) 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.

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:

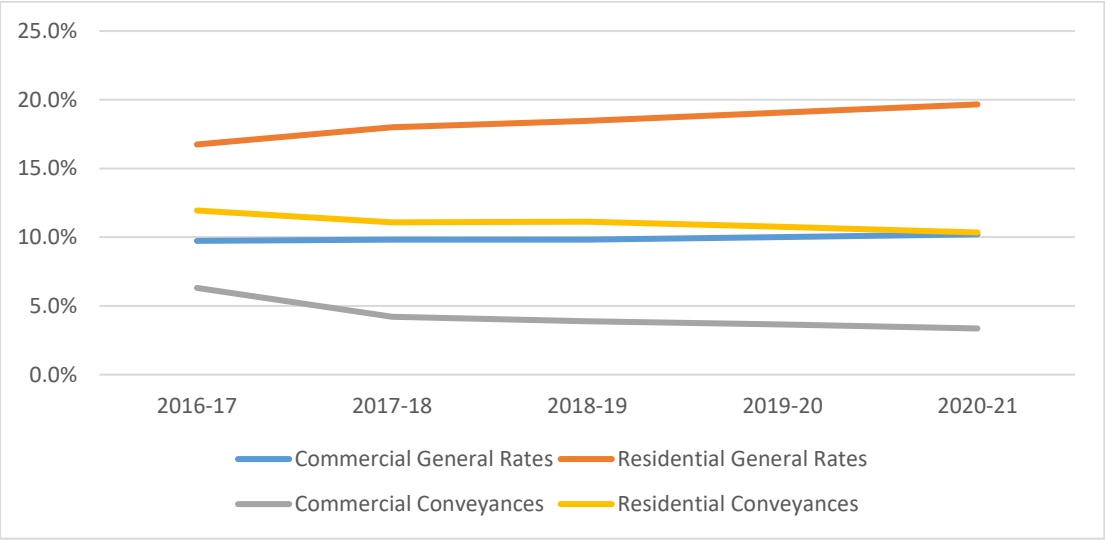
> Ideally, there is no place for stamp duty in a modern Australian tax system. Stamp duty generate large efficiency costs, as they discourage turnover in property and tax improvements as well as land. The tax also imposes a higher burden on people who need to move, which is not equitable. (Henry, Harmer, Piggott, Ridout, & Smith, 2010, p. 263)

The Henry Tax Review recommended the abolition of stamp duty on conveyancing and its replacement with other taxes:

> 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)

The ACT Government is continuing its long-term tax reform process as taxes on conveyances are gradually making a diminishing contribution to own-source revenue while general rates are gradually making an increasing contribution, as outlined in Figure 11 below, although it appears to be a very long and drawn out process.

Figure 11: Percentage contribution to own-source taxation from commercial and residential conveyances and commercial and residential general rates – 2016-17 to 2020-21



Source: ACT Government (2017)

Although not necessarily politically popular, the ACT Government should be applauded for its courage in pursuing this tax reform.

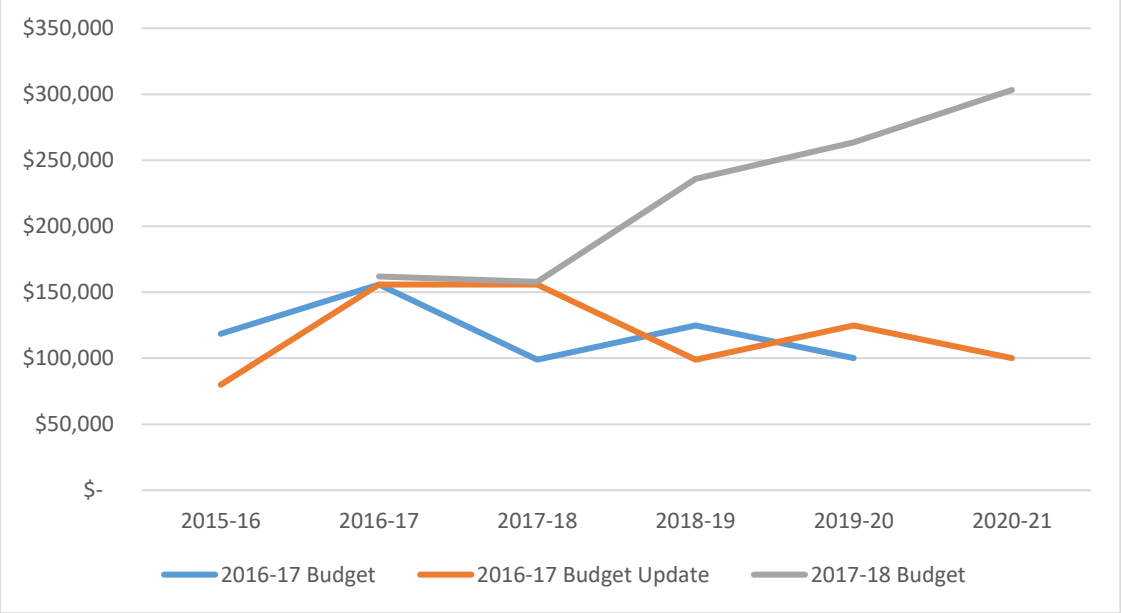
4.5 Contributed Assets and Dividends

One of the significant changes in the revenue estimates in the 2017-18 Budget from the 2016-17 Budget and the 2016-17 Budget Update concerns the profile of revenue from contributed assets in the out-years. Between the 2016-17 Budget and the 2017-18 Budget, there has been an increase of $59 million in revenue from contributed assets for 2017-18, and an increase of $111 million in revenue from contributed assets in 2018-19.

While both the 2016-17 Budget and the 2016-17 Budget Update revealed a revenue profile from contributed assets that was decreasing over time, the 2017-18 Budget shows a dramatically increasing revenue profile over the forward years.

The revenue profiles from three recent budget updates are provided in Figure 12 below.

Figure 12: Estimate revenue from contributed assets ($'000) – 2015-16 to 2020-21



Sources: ACT Government (2016; 2016a; 2017)

According to the Budget papers, variations across the forward estimates period mainly reflect revisions to the land release program (ACT Government, 2017, p. 237)

Contributed assets is a non-financial transaction and refers to the value-added component of land sales and is 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).

Total dividends in 2017-18 are expected to be $275.7 million, a decline of $41 million from the level expected to be collected in 2016-17. Dividends are expected to fall again in 2018-19 to $233.9 million, before rising again to $295.4 million in 2019-20, and then falling again to $280.7 million in 2020-21.

Table 7 provides a summary of dividends received from the Territory's Public Trading Enterprises (PTEs) and financial investments.

Table 7: Dividends from ACT Public Trading Enterprises

2016-17 Budget $'000		**2016-17 Est. Outcome $'000**	**2017-18 Budget $'000**	**2018-19 Estimate $'000**	**2019-20 Estimate $'000**	**2020-21 Estimate $'000**
	Dividends					
71,774	**Dividends – Icon Water**	**73,702**	**67,112**	**77,957**	**84,609**	**93,525**
500	**Dividends – CIT Solutions**	**1,000**	**500**	**500**	**500**	**500**
149,273	**Dividends – Land Development Agency, Suburban Land Agency and City Renewal Authority**	**190,962**	**155,802**	**104,105**	**155,833**	**128,189**
50,990	**Dividends from Financial Investments**	**51,043**	**52,255**	**51,333**	**54,536**	**54,481**
272,537	Total Dividends	316,707	275,669	233,895	295,478	280,695

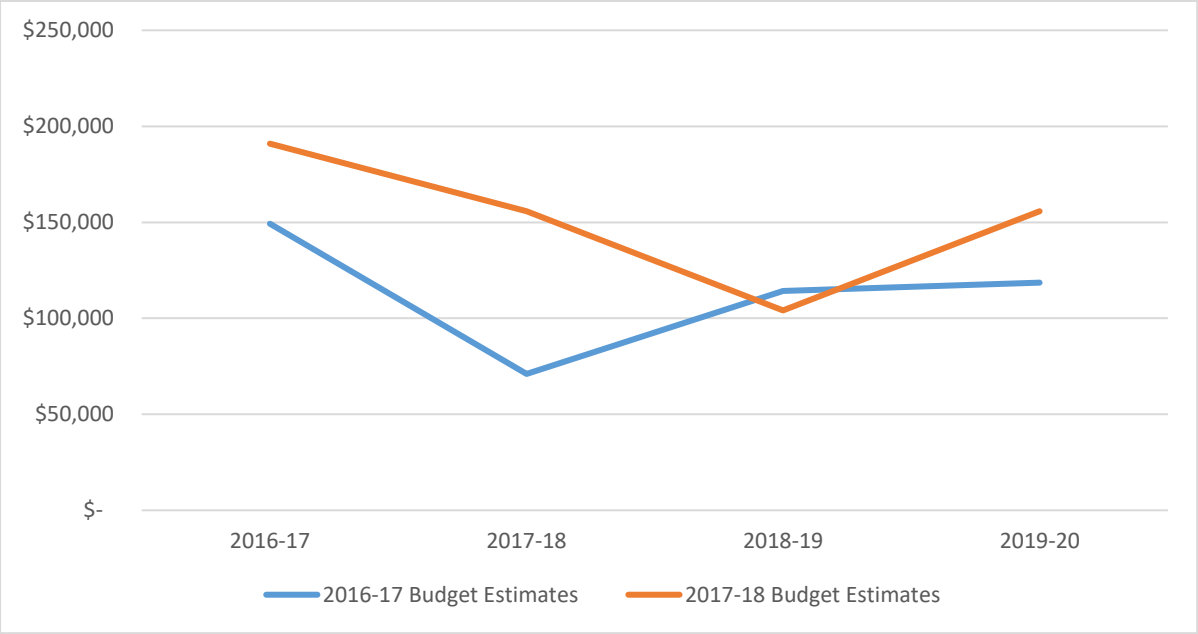
Source: ACT Government (2017, p. 244)

Table 7 shows that the major driver of changes in total dividends across 2017-18 and the forward estimates is the variations in expected dividends from the Land Development Agency (LDA) and its successor agencies in the Suburban Development Agency (SDA) and the City Renewal Authority (CRA).

The Budget Papers attribute the $41.7 million variation in the estimated outcome for the LDA dividend in 2016-17 against the original 2016-17 Budget estimate to a number of factors, including changes in the timing of settlements and lower development costs (ACT Government, 2017, p. 244).

Although the dividends forecast to be generated by the successor agencies to the LDA in 2017-18 are expected to fall by $35.2 million as compared to the estimated outcome for 2016-17, the forecast dividends in the 2017-18 Budget for 2017-18 are still some $84.8 million higher than the forward estimate contained in the 2016-17 Budget for 2017-18. This is outlined below in Figure 13.

Figure 13: Comparison of the estimated dividends from the Land Development Agency and successor agencies from the 2016-17 Budget with the 2017-18 Budget ($'000)



Sources: ACT Government (2016; 2017)

The drivers underlying these flows are not fully transparent. Changes in dividend payments by Public Trading Enterprises can be driven by a number of factors: operating improvements, valuations effects, the capital requirements of the business, taxation policies, changes in the requirements of shareholders and other factors. It is not clear, however, what factors are driving the changes in the dividend estimates in the Budget. The dramatically altered revenue profile for contributed assets coupled with changes in the level and timing of dividends provided by the LDA and its successor agencies warrants much greater transparency and is deserving of further scrutiny by the Committee.

The reprofiling of these revenue items between the 2016-17 and the 2017-18 Budget associated with land release adds an additional $144 million to revenue in 2017-18 and $101 million in 2018-19.

5 Expenditure

Expenditure is forecast to grow over the budget and forward estimates from $5.6 billion in 2017-18 to $6.2 billion in 2020-21. Health and Education spending represent around half of the Territory's budget through the Budget and forward years, though Transport and Communications is growing as a share of the total. A large number of new initiatives have been announced. While offsets have been identified, they are often unspecific and general in nature, and it is difficult to assess their robustness.

5.1 Overview

Forecast expenses of $5.6 billion in 2017-18 represent an increase of $185.8 million, or 3.4 per cent, over the expected 2016-17 outcome.

Table 8 sets out the aggregate expenses for the budget and forward years.

Table 8: Budget and forecast estimates for expenses, 2016-17(est.), 2017-18 and 2018-19 to 2020-21

	2016-17 Est. Outcome $'000	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Expenses	-5,410,579	-5,596,370	-5,709,181	-5,965,018	-6,183,579

Source: ACT Government (2017, p. 32)

Table 8 shows that expenses are expected to grow over the forward estimates period to $6.2 billion in 2020-21. This represents growth of 10.5 per cent, or an average rate of 3.5 per cent per annum, over the 2017-18 Budget estimate. This excludes any adjustment to account for the Superannuation Liability Valuation in the forward years.

5.2 Expenses by function

Expenses can be analysed by their economic or social function.

Table 9 sets out the estimates of General Government Sector expenses by function for the period 2016-17 to 2020-21.

Table 9: Budget and forecast estimates for expenses, 2016-17(est.), 2017-18 and 2018-19 to 2020-21

	2016-17 Est. Outcome $'000	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
General Public Services	603,719	506,887	493,943	504,432	520,467
Public Order and Safety	431,867	446,898	446,040	452,720	469,374
Education	1,117,912	1,149,346	1,188,366	1,222,526	1,251,383
Health	1,467,927	1,524,492	1,568,197	1,636,815	1,718,233
Social Security	344,366	319,218	328,974	359,426	372,419
Housing and Community Amenities	239,152	285,355	250,013	244,030	230,933
Recreation and Culture	222,161	231,611	218,912	223,415	229,337

Fuel and Energy	19,174	65,579	95,227	148,991	190,407
Agriculture, Forestry, Fishing and Hunting	4,816	3,799	3,421	3,359	3,747
Mining and Mineral Resources other than Fuels, Manufacturing and Construction	24,939	25,133	26,125	27,088	27,921
Transport and Communications	347,192	355,350	409,613	428,440	442,556
Other Economic Affairs	87,130	84,736	80,224	80,751	81,210
Other Purposes	500,225	597,967	600,126	633,028	645,594
Total Expenses	**5,410,579**	**5,596,370**	**5,709,181**	**5,965,018**	**6,183,579**

Source: ACT Government (2017, p. 174)

For the ACT, General Government Sector expenses are dominated by spending in the health and education functions. Together, these functions account for almost 50 per cent of all government expenses in 2017-18. Transport and Communications, is, however, growing as share of the total.

The major areas of growth in expenses over the Budget and forward estimates occur in Education, Health, Fuel and Energy, Transport and Communications and "Other Purposes" category. This growth is the consequence of activity and cost pressures and discretionary policy decisions:

- The forecast increase in Education expenses from 2017-18 is primarily driven by an expected increase in enrolment numbers and growth in the operational costs of schools.
- Health expenses are expected to increase as a result of growth in activity and costs.
- The forecast increase in Fuel and Energy expenses in 2017-18 and the forward years is largely due to the inclusion of Large-scale Generation Certificates expected to be surrendered to the Clean Energy Regulator.
- Transport and Communications expenses are forecast to increase from 201819 due to payments associated with the Light Rail Public Private Partnership.
- The increase in Other Purposes expenses over the forward estimates largely reflects an increase in interest costs associated with increased borrowings for Icon Water and the general government sector, and interest costs for lease liabilities associated with Public Private Partnerships. An increase in interest costs of $17.2 million, or 9.4 per cent, is expected in 2017-18.

5.3 New initiatives

The Budget contains just under two hundred separate expense initiatives totalling $272.7 million (or $249.5 million after allowance is made for Health funding envelope offsets) over the budget and forward years.

The new initiatives include:

- a range of Health-related initiatives totalling $71.8 million (after offsets) over four years in net terms, including funding for more nurse-led Walk-in Centres, additional funding for mental health, and an expansion of services at Canberra Hospital;

- an additional $43.8 million over four years to strengthen support for vulnerable children and young people by providing increases to funding for child protection and out of home care services;
- additional Education funding, including an additional $14.2 million over four years to employ more school assistants in public schools and an additional $3 million in 2017-18 to support students with disability in ACT public schools;
- an additional $14.7 million over four years to grow and diversify Canberra's economy through funding for a range of high impact innovation programs, key industry sector development, Canberra brand marketing and outreach, trade and investment facilitation, and the Office for International Engagement;
- an additional $4.8 million (and $2.4 million in capital) to oversee the development of properties under the Public Housing Renewal Program;
- additional funding of $4.1 million to promote Canberra as a holiday and business tourism destination (ACT Government, 2017, pp. 68-75).

5.4 Light Rail project

The Light Rail project will begin to have significant impacts on the Budget from 2018-19.

Payments that impact on the headline operating balance will consist of a financing component, maintenance and operation costs, and a provision for reductions in the lease liability over time.

Table 10 below summarises the impact of the Light Rail project on the main Budget aggregates.

Table 10: Light Rail impact on headline operating balance

	2017-18 Financial Year $'000	**2018-19 Financial Year $'000**	**2019-20 Financial Year $'000**	**2020-21 Financial Year $'000**
Headline Net Operating Balance (HNOB) Impact				
Maintenance/Operating Costs	-	-21,216	-25,722	-26,172
Interest	-	-15,922	-18,901	-18,275
Depreciation	-	-10,559	-14,079	-14,079
Total HNOB Impact	0	-47,697	-58,702	-58,526
Assets and Liabilities				
Lease Asset[2]	-	693,393	679,314	665,235
Lease Liability	-	330,029	320,383	310,111
Total Impact on Net Assets	0	363,364	358,931	355,124
Payments to Canberra Metro				
Service Payments	-	-37,138	-54,269	-54,719
Capital Contribution	-	-375,000	-	-
Total Payments	0	-412,138	-54,269	-54,719

Source: ACT Government (2017, p. 352)

In cash terms, the Government expects to make a $375 million lump sum payment to a 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 and $54.7 million in 2020-21. These amounts are slightly lower than the $40.4 million in 2018-19 and $55.4 million in 2019-20 forecast in last year's Budget (ACT Government, 2016, p. 352).

5.5 Safer Families

The 2017-18 Budget allocates an additional $2.2 million over four years to Safer Families initiatives, announced in the 2016-17 Budget, to help address family violence. This brings the total Safer Families package for the 2017-18 Budget to $23.5 million over four years (ACT Government, 2017, p. 399).

The Budget Papers provide a summary of the spending against each of the major Safer Families initiatives announced in the 2016-17 Budget. Of a total budget allocation of $5.6 million, agencies spent $4.7 million, which was fully covered by the Safer Families Levy (ACT Government, 2017, p. 404). A proportion of the unspent funds is to be rolled into 2017-18 to continue Safer Family initiatives, about a third of the funds will be reprofiled to offset new initiatives. While the transparency in reporting on expenses is welcome, the Committee may wish to seek further information on the outcomes achieved.

The Committee should note that the majority of the Safer Family initiatives identified in Table J.2 represent measures announced in the 2016-17 Budget.

5.6 Asbestos Eradication

The Asbestos Eradication Scheme continues to have an impact on the Territory's Budget.

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

Table 11: Asbestos Eradication Scheme impact on headline operating balance

	2016-17	2017-18	2018-19	2019-20	2020-21
	$'000	$'000	$'000	$'000	$'000
2016-17 Budget					
Financial Assistance Package	-2,000	0	0	0	0
Other Costs	-9,912	-6,028	-5,936	-4,557	-4,534
Purchase Costs	-2,561	-2,008	-1,006	-221	0
Contingency	-3,509	0	0	0	-19,884
Total HNOB Impact (including contingency)	**-17,981**	**-8,036**	**-6,942**	**-4,778**	**-24,417**
2017-18 Budget					
Financial Assistance Package	-2,256	-400	-20	-80	0
Other Costs	-8,985	-8,910	-4,877	-4,481	-4,488
Purchase Costs	-1,486	-1,114	-102	-154	-200
Contingency	0	-1,265	-1,265	-1,265	-8,856
Total HNOB Impact (including contingency)	**-12,728**	**-11,690**	**-6,264**	**-5,980**	**-13,545**

Source: (ACT Government, 2017, p. 397)

Table 11 shows an improvement in the 2016-17 outcome when compared with the 2016-17 Budget, but a deterioration in the impact on 2017-18 and the forward years. While in the 2016-17 Budget the negative impact on the operating balance was forecast to decline over the budget and forward estimates from $18.0 million in 2016-17 to $4.8 million in 2019-20, the 2017-18 Budget shows growth from $11.7 million in 2017-18 to $13.6 million in 2020-21.

The Budget papers indicate that the differences reflect an acceleration of the demolition schedule over initial plans and a bring-forward of property sales from the out-years (ACT Government, 2017, p. 395). At the same time, the Budget papers point to a reduction in expected demolition costs in 2016-17. The Committee should note that the changed profile also reflects the provision for contingencies and other costs in the final forward year that were not available in last year's Budget.

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

5.7 Savings and offsets

The Budget includes over forty individual expense savings and offsets totalling around $150 million over four years.

Individual savings measures across each Directorate totalling $63.3 million are identified in chapter 3 of Budget Paper 3. Table 12 summarises the major savings measures.

Table 12: Expense savings, 2016-17(est.), 2017-18 and 2018-19 to 2020-21

	2017-18 Budget $'000	**2018-19 Estimate $'000**	**2019-20 Estimate $'000**	**2020-21 Estimate $'000**
Chief Minister, Treasury and Economic Development Directorate				
Smarter government spending – Centralising property custodianship	-17	-1015	-2236	-4639
Smarter government spending – Reducing expenditure on excess staff	0	-3134	-3211	-3277
Smarter government spending – Smart Modern Strategic Procurement Reform extension	0	-4500	-6000	-6000
Building a better city - Civic and Dickson office accommodation	0	0	-1915	-7246
More and better jobs - Improving Manuka Oval broadcast and media facilities	0	-700	100	200
More and better jobs - Ensuring continuity of the Human Resources Information Management System	0	-110	-718	-1196
Environment, Planning and Sustainable Development Directorate				
Building a better city - Staff funded through the Renewable Energy Innovation Fund	-565	-730	-770	-775
More and better jobs - Sustainably managing our forests	-500	-500	-500	-500
Smarter government spending - Googong Foreshore access gate upgrade	-76	-81	-85	-91

Smarter government spending - Improving efficiency in biodiversity management	-250	-253	-257	-260
Smarter government spending - Streamlining customer service delivery	-152	-154	-156	-158
Smarter government spending - Streamlining master planning processes	-125	-127	-128	-130
More and better jobs - Ensuring continuity of the Spatial Data Management System	0	-72	-75	-79
Justice and Community Safety Directorate				
Smarter government spending – Portfolio efficiencies	-748	-1236	-1455	-1451
Transport Canberra and City Services Directorate				
Smarter government spending – Portfolio efficiencies	-308	-1312	-1816	-1820

Source: ACT Government (2017, pp. 68-75)

In addition, expense offsets to expense, revenue and capital measures have been identified totalling $88.4 million, as set out in Table 13 below.

Table 13: Offsets, 2016-17(est.), 2017-18 and 2018-19 to 2020-21

	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Chief Minister, Treasury and Economic Development Directorate				
Better support when it matters - Helping injured employees back into work	-150	-350	-450	-450
More and better jobs - Growing the tourism industry	-50	0	0	0
More and better jobs - Sporting capital (expenses)	-807	-90	-90	-90
More and better jobs - Sporting capital (capital)	-150	0	0	0
More and better jobs - Improving Manuka Oval broadcast and media facilities	0	-700	0	0
Building a better city - Macarthur House Data Centre decommissioning program	-2097	-3996	-1063	-1115
More and better jobs - Ensuring continuity of the Human Resources Information Management System	0	-610	-2218	-3196
Community Services Directorate				

	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Better support when it matters - Disability Justice Strategy	-150	-152	0	0
Better support when it matters - Recognising Canberra's carers	-50	0	0	0
Better support when it matters - Support for new and emerging Aboriginal and Torres Strait Islander organisations	-25	-25	-25	-25
Education Directorate				
Better schools for our kids - Investing in our teachers - STEM and language scholarships	-125	-250	-250	-250
Better schools for our kids - More support for teachers	-1928	0	0	0
Better schools for our kids - Safe Schools program	-50	-50	-50	-50
Better schools for our kids - Safe workplaces for teachers, educators and support staff	-310	-317	-324	0
Better schools for our kids - Non-government school infrastructure upgrades	-3750	-3750	-3750	-3750
Environment, Planning and Sustainable Development Directorate				
Better services in your community - Enhancing environmental stewardship	-200	0	0	0
More and better jobs - 3D Canberra Planning Tool - Supporting urban renewal	-200	-200	-200	0
More and better jobs - Canberra International Airport - Guarding against the spread of pests and diseases	-10	-10	-10	-10
Health Directorate				
Better care when you need it - Expanding Hospital in the Home	-136	0	0	0
Better care when you need it - Helping patients navigate the health system	-100	0	0	0
Better care when you need it - More nurses for Canberra	-4492	-7977	-10894	-12638
Better care when you need it - Improving health facilities	-844	0	0	0
Justice and Community Safety Directorate				

	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Better support when it matters - Better mental health services for emergency services personnel	-201	-204	-207	-209
Better support when it matters - Community Legal Centres	0	-283	-286	-289
Better support when it matters - Diverting offenders from the justice system	-226	0	0	0
Better support when it matters - Equipping more ACT Police with TASERs	-219	0	0	0
Better support when it matters - Family Safety Hub	-358	0	-587	-701
Better support when it matters - Planning for the future of policing in the ACT	-461	-468	0	0
Better support when it matters - Enhanced security for ACT Policing	-73	-74	0	0
Transport Canberra and City Services Directorate				
Better services in your community - Increasing recycling and reducing waste	-20	0	0	0
Better services in your community - Investing in community transport	-424	-435	-445	-457
Better services in your community - Revitalising Woden Library	-71	-73	-76	-78
Building a better city - Bus service improvements	-3800	-1025	-1050	-1077

Source: ACT Government (2017, pp. 76-124)

The Government provides some general information on the planned savings and offsets. As part of the 2017-18 Budget process, the Government reviewed the operating costs of all Directorates to offset the cost of new initiatives, identify areas where efficiencies could be made by taking advantage of technological advances and ensure that processes and procedures reflect the best value for money (ACT Government, 2017, p. 183). The Budget papers refer to changes in internal processes and service delivery arrangements within the Environment, Planning and Sustainable Development Directorate, investments in new technology, structural and activity based reforms in the Health Directorate and investments in new HR systems in the Treasury and Economic Development and the Justice and Community Safety Directorates. The Government has indicated that offsets within the Health Directorate will not impact on the quality of care, safety standards, or patient outcomes (ACT Government, p. 103), but provides limited information on where from within the Directorate these offsets will be sourced and how they will be achieved.

While more information is provided on savings in other Directorates, the measures differ in the level of detail provided. Some measures provide some explanation as to how the savings will be

achieved. The Government has indicated, for example, that a quarter of a million dollars a year will be saved by "improving efficiency in biodiversity management." The measures statement indicates that these savings will be achieved "through prioritising work directly relevant to the ACT and introducing more efficient engagement on biosecurity matters" (ACT Government, 2017, p. 100). While the measures description provides some detail as to the nature of the savings offset, it is not clear how the biodiversity work will be prioritised, or what impact the savings measure will have on the outcomes achieved or the nature of the engagement that the public might expect on biodiversity matters.

For some other measures, less information is provided. It is unclear, for example, how a measure entitled "More and better jobs – Sustainably managing our forests" will generate savings of half a million dollars over the budget and forward years by increasing the harvesting and re-planting of softwood in the ACT Forest Estate (ACT Government, 2017, p. 99). The description of the item entitled "Smarter government spending – Portfolio efficiencies", simply indicates that "the Government will implement a number of administrative improvements … to deliver more efficient services to the community" (p. 115). For these measures, the source and impact of the savings are unclear.

In the absence of further information on the nature and likely impacts of these offsets, and how they have been costed, it is difficult to assess the quality of these measures in terms of their impacts, or how achievable and sustainable some of them may prove to be. The Committee may wish to seek further information on the location, quantum and timing of the claimed savings and offsets.

No information is provided on the achievement of the large number of separate savings measures identified in last year's Budget. The 2016-17 Budget identified savings of $129.8 million within the health funding envelope to offset new policy initiatives and other claimed expense and capital offsets totalling $103.8 million over the Budget and forward years (ACT Government, 2016, p. 71). The Committee may wish to seek further information on the extent to which these savings were achieved and their impacts. In this context, it is worth noting that the estimated outcome for the Health function in 2016-17 is about 2.1 per cent lower than the Budget estimate but that the estimated outcome for General Public Services is some 22.7 per cent higher than the Budget estimate.

Further discussion of savings is provided in the risks section 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, building from the substantial investment announced in the 2016-17 Budget. 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 Government will invest $2.8 billion in infrastructure in the ACT over the next four years (ACT Government, 2017, p. 191).

Table 14 below summarises the capital works and investment program.

Table 14: Summary of investment and capital works program, 2017-18 and 2018-19 to 2020-21

	2017-18 Allocation $'000	2018-19 Allocation $'000	2019-20 Allocation $'000	2020-21 Allocation $'000
New Capital Works	**174,670**	**194,307**	**159,323**	**95,522**
Works-in-Progress	**712,977**	**308,966**	**36,389**	**24,999**
TOTAL CAPITAL WORKS PROGRAM	**887,647**	**503,273**	**195,712**	**120,521**
Infrastructure Investment Provisions	16,000	163,371	248,858	338,075
Capital Delivery Provision	-131,176	-35,548	131,176	35,548
CAPITAL WORKS PROGRAM FORECAST	**772,471**	**631,096**	**575,746**	**494,144**
PUBLIC PRIVATE PARTNERSHIPS	**309,082**	**34,441**	**190**	**0**
TOTAL INFRASTRUCTURE INVESTMENT INCLUDING PROVISIONS	**1,081,553**	**665,537**	**575,936**	**494,144**

Source: (ACT Government, 2017, p. 194)

The investment and capital works program includes:

- A Capital Works Program: funding of $1.7 billion over the four years to 2020-21.
- Capital provisions: these provisions apply to the Capital Works Program and have two elements:
  - Infrastructure Investment Provisions: These provisions total $766 million over four years. 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 2020-21.
- Public Private Partnerships (PPPs): A total of $344 million over the four years to 2020-21.

6.2 Capital Works Program

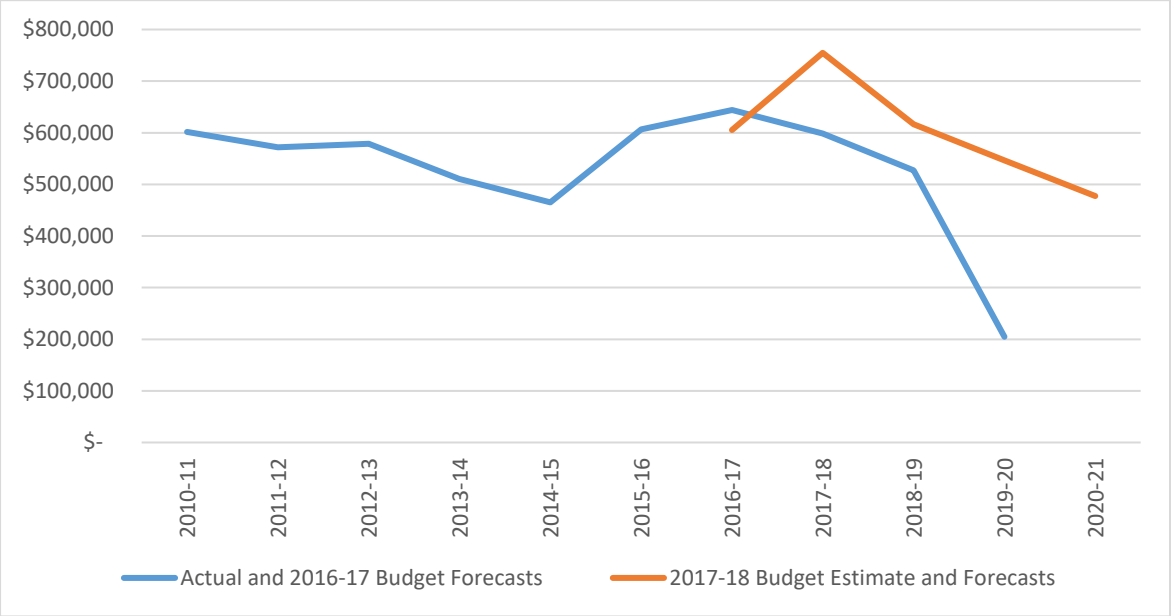
The Capital Works Program forms the largest component of the Infrastructure Investment Program, with funding of $888 million in 2017 18 and $1.7 billion over the four years to 2020 21. This includes:

- $114 million in 2017-18 ($375 million over four years) for new capital works;
- $713 million in 2017-18 ($1.1 billion over four years) for works-in-progress; and
- $60 million in 2017-18 ($249 million over four years) for the Better Infrastructure Fund (ACT Government, 2017, p. 195).

Forecasts of capital works have grown in recent years from an expected outcome of $606.3 million in 2015-16 to a record expected outcome of $605.2 million in 2016-17 (ACT Government, 2016, p. 210). The forecast level of capital works of $772.5 million in 2017-18 represents a further substantial increase of $174.0 million over the 2017-18 level forecast in the 2016-17 Budget.

The actual and forecast level of capital works expenditure over a 10-year period is summarised in Figure 14 below.

Figure 14: Actual and Estimated Capital Works Expenditure Summary – 2010-11 to 2020-21 ($'000)



Source: ACT Government (2015, p. 183; 2016, p. 210; 2017)
Note: Figures exclude expenditure on Information and Communication Technology, and Plant and Equipment as the 2017-18 Budget is the first time these items have been included in the Capital Works Program.

One noticeable aspect of the forward estimates for capital works expenditure is the fall in spending across the forward years. This trend was more dramatic in 2016-17 but is still evident in the 2017-18 Budget forecasts for 2018-19 and beyond.

Table 15: Estimated Capital Works Expenditure 2016-17 to 2020-21

2016-17 Estimated $'000	2017-18 Estimated $'000	2018-19 Estimated $'000	2019-20 Estimated $'000	2020-21 Estimated $'000
$605,230	$772,471	$631,096	$575,746	$494,144

Source: ACT Government (2017, pp. 194, 203)

Note: Figures for 2016-17 exclude expenditure on Information and Communication Technology, and Plant and Equipment while the 2017-18 Budget is the first time these items have been included in the Capital Works Program.

The projected budget surpluses in the out years are predicated on capital works expenditure in 2020-21 being some $111.1 million less than the estimated outcome in 2016-17 and some $278.4 million less than the 2017-18 estimate. While some reduction in the level of capital works expenditure is not without precedent, the steep decline in estimated capital works expenditure in 2020-21 million from current levels is difficult to reconcile with historical trends and the Government's stated commitments in the Budget papers to support the city's growth and employment opportunities through an expanded infrastructure program (ACT Government, 2017, p. 187).

Expense items associated with a ratcheting up of capital works expenditure in 2019-20 would have implications for the projected return to surplus in the forward years.

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 16 below.

Table 16: Public Private Partnerships – ACT Law Courts Facilities and Light Rail – Stage 1 – Capital Expenditure Schedule

Project	**2017-18 Forecast $'000**	**2018-19 Forecast $'000**	**2019-20 Forecast $'000**	**2020-21 Forecast $'000**	**Total $'000**
ACT Law Courts Facilities	59,456	19,088	0	0	78,544
Light Rail – Stage 1	249,626	15,353	190	0	265,169
Total	**309,082**	**34,441**	**190**	**0**	**343,713**

Source: ACT Government (2017, p. 201)

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 indicate that the Government will commence work on Stage 2 of the ACT's light rail network to connect Woden and the City (ACT Government, 2017, p. 36). 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 $17.7 billion to $18.6 billion over the Budget and forward estimates. However, net debt and net financial liabilities are rising at a faster rate over the same period. The Territory's defined benefit superannuation liability is estimated to continue to grow to approximately $7.0 billion by 30 June 2021. Calculations of super liabilities however depend significantly on the rate used to measure the present value of superannuation payments in future years.

7.1 Overview

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

Table 17 presents the key balance sheet measures for the General Government Sector (GGS).

Table 17: General Government Sector Key Balance Sheet Measures

	2016-17 Est. Outcome $m	2017-18 Budget $m	2018-19 Estimate $m	2019-20 Estimate $m	2020-21 Estimate $m
Net Debt (excluding super)	**1,746.5**	**2,001.1**	**2,746.9**	**2,866.1**	**2,826.9**
Net Financial Liabilities	**4,768.7**	**5,107.1**	**5,879.6**	**6,057.4**	**6,092.3**
Net Worth	**17,701.0**	**18,002.3**	**18,168.7**	**18,344.8**	**18,578.1**

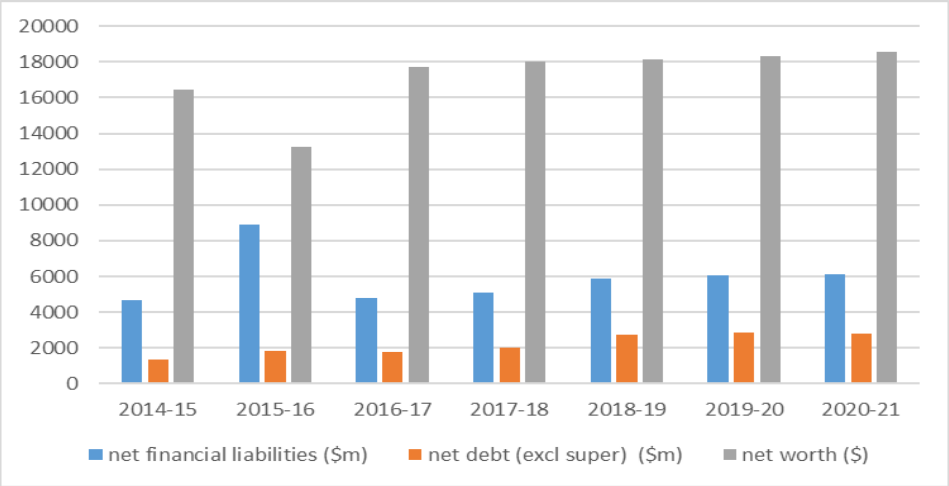
Source: ACT Government (2017, pp. 279,280,281)

Net worth is positive and is forecast to increase from $17.7 billion to $18.6 billion across the budget and forward estimates.

However, net debt (excluding superannuation) and net financial liabilities are also forecast to continue to grow over the same period, and at a faster rate. The level of net debt in 2020-21 is expected to be 61.9 per cent higher than the estimated outcome in 2016-17.

Figure 15 illustrates the scale of changes in net debt and net financial liabilities relative to net worth over time.

Figure 15: Assets and liabilities



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. 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. It should be noted however that the ACT Budget measure of net debt excludes super liabilities.

Measures of net debt can be influenced by valuation effects and policy choices regarding the financing of major projects. The projections of net debt have changed considerably since the 2015-16 Budget due primarily to the removal of provisions for the Light Rail project, which was included as a debt-funded capital project in the 2015-16 Budget, as well as higher capital distributions in relation to forecast sales under the land rent scheme (ACT Government, 2016, pp. 288-289).

The estimated net debt for 2016-17 and forecasts of net debt in 2017-18 and 2018-19 are slightly lower than was forecast in the 2016-17 Budget, largely reflecting changes in the land release program and higher distributions in relation to the land rent scheme (ACT Government, 2017, p. 279).

However, net debt in 2019-20 is forecast to increase compared to the 2016-17 Budget, and continues to increase across the Budget and forward years, reflecting an increase in the gap between the Territory's financial assets and gross financial liabilities. The Budget Papers suggest that growth in net debt in 2019-20 relative to previous forecasts is largely due to the inclusion of capital provisions in the forward estimates, relating to the Government's significant investments in health, schools, and transport infrastructure (ACT Government, 2017, p. 280). However, the growth in the stock of debt over time up to 2017-18 also reflects the borrowings associated with a history of accumulated budget deficits.

Over a longer time-period, net debt has deteriorated from -$735.9 million in 2010-11 (in which General Government sector cash reserves and investments were higher than the Territory's gross debt liabilities) to a forecast level of $2,826.9 million in 2020-21 (ACT Government, 2017, p. 389).

7.3 Net financial liabilities

Net financial liabilities provide an indicator of the Territory's fiscal sustainability.

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.

Estimated net financial liabilities in 2016-17 are some $727.8 million lower than forecast in original 2016-17 Budget. This is mainly due to the variation in net debt described above, revised estimates in relation to the Asbestos Eradication Scheme, and an improvement in actuarial valuations of the superannuation liability, reflecting a reduction in the long-term salary growth assumptions as well as salary growth and pension indexation being lower than previously assumed.

Nevertheless, net financial liabilities are forecast to increase over the Budget and forward estimates period. This largely reflects forecast growth in the Territory's superannuation liabilities and lease liabilities in the Budget and forward years associated with Public Private Partnerships.

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 increase from $17.7 billion to $18.6 billion across the budget and forward estimates.

This is an improvement in the position reported in last year's Budget, in which net worth was not forecast to reach $17.7 billion until the end of 2020. The Committee should be aware, however, that measures of net worth are sensitive to valuation effects and budget classification issues. Measures of net worth increased in 2016-17 over the levels previously reported due to the revaluation of superannuation liabilities, changes in the estimated timing of settlements for the Asbestos Eradication Scheme and revised financing arrangements for the Light Rail project.

The forecast improvement in the net worth position in this year's Budget mostly reflects changes in assumptions relating to the Asbestos Eradication Scheme and the revaluation of the Territory's superannuation liabilities.

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 ACT employee members. From 1 July 2005, new employees have accessed defined contribution scheme arrangements under which the Government makes fortnightly payments to each employee's designated superannuation fund (ACT Government, 2017, p. 283).

Table 18 below sets out the most recent estimation of the Territory's superannuation liability.

Table 18: Defined Benefit Superannuation Liability

	2016-17 Est. Outcome $'000	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Opening liability	**10,714,570**	**6,127,350**	**6,366,512**	**6,595,981**	**6,814,083**
Service cost	309,294	122,627	117,809	113,083	108,592
Interest cost	293,498	367,684	381,208	394,123	406,389
Benefit payments	-230,525	-251,149	-269,547	-289,103	-308,044
Actuarial (Gain)/Loss[1]	-4,959,486	0	0	0	0
Closing liability	**6,127,351**	**6,366,512**	**6,595,981**	**6,814,083**	**7,021,019**

Source: ACT Government (2017, p. 286)

Table 18 shows that the Territory's defined benefit superannuation liability is estimated to grow to approximately $7.0 billion by 30 June 2021. 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 is forecast to increase due to the unwinding of the discount rate as past benefits accrued by ACT employee members come closer to payment.

These calculations depend critically on the rate used to measure 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 difference between the opening and closing liability in the estimated 2016-17 outcome is largely due to the reversion to the long-term discount rate in the calculation of the superannuation liability at the end of the financial year. The 2017-18 estimates for the superannuation liability and emerging cost payments are also lower than forecast in last year's Budget due to updated assumptions regarding salary growth and pension indexation (ACT Government, 2017, p. 287).

The ACT Government currently 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 19 below.

Table 19: Defined Benefit Superannuation Liability Funding

	2016-17 Est. Outcome $'000	2017-18 Budget $'000	2018-19 Estimate $'000	2019-20 Estimate $'000	2020-21 Estimate $'000
Superannuation Liability	6,127,351	6,366,512	6,595,981	6,814,083	7,021,019
Investments	3,689,720	3,877,533	4,079,046	4,374,049	4,690,652
Unfunded Liability	2,437,631	2,488,979	2,516,935	2,440,034	2,330,367
Funding Percentage	**60**	**61**	**62**	**64**	**67**

Source: (ACT Government, 2017, p. 289).

The table shows that the unfunded superannuation liability is expected to increase slightly in absolute terms in 2018-18 and decline through the remaining forward years, while falling as a percentage of the overall superannuation liability through the Budget and forward years.

Changes in the unfunded superannuation liability and investment assets can be seen in Figure 16, which shows the extent to which superannuation liabilities are projected to be covered by investment assets over the Budget and forward estimates period.

Figure 16: Defined Benefit Superannuation Investment Assets and Unfunded Liability

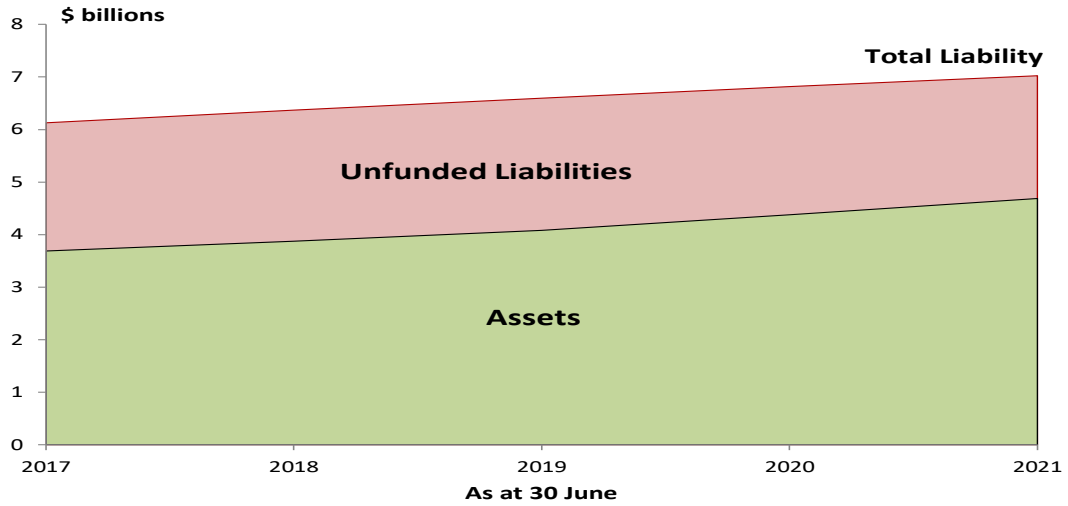


Figure 16 shows the unfunded liability narrowing slowly over time.

The Committee should be aware, however, that estimates of the Territory's superannuation liability and investment assets are influenced by the choice of discount rates and investment return assumptions, as explained in section 3.2 of this report. The Budget papers point out that superannuation liability valuations from 30 June 2017 utilise a long-term discount rate assumption of six per cent while the actual discount rate at 30 June 2016 was 2.7 per cent (ACT Government, 2017, p. 289). A lower discount rate would generate a higher liability valuation estimate. Table L.5 of Budget Paper 3 sets out the impact of a 1 per cent decrease in the discount rate from the long-term budget assumption of 6 per cent on the impact to the defined benefit superannuation liability valuation. The table suggests that a 1 percentage point decrease in the discount rate would increase the valuation of the superannuation liability by $1.1 billion in 2017-18 in each of the Budget and forward years. The table is set out blow.

Table 20: Impact of a 1 percentage point decrease in the discount rate on the superannuation liability

	2017-18 $'000	**2018-19 $'000**	**2019-20 $'000**	**2020-21 $'000**
Superannuation Provision Account	1,083,000	1,105,000	1,125,000	1,141,000

Source: ACT Government (2017, p. 423)

The ACT Government has acknowledged that, for the expected 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. Fiscal sustainability

Net debt and net financial liabilities impose a relatively small burden on the overall Territory economy. However, net debt is growing steadily through the Budget and forward estimates period and has increased significantly since 2010-11, outstripping growth in net worth over the same period. The Government has forecast a return to surplus in 2018-19. However, a comparison of previous budget forecasts shows that governments have consistently deferred the return to surplus while posting increasingly larger operating deficits.

8.1 Overview

The concept of fiscal sustainability refers to the capacity of a government to meet its financial obligations as they arise in the future.

In the short-term fiscal sustainability requires that a government can meet all of its immediate spending programs, income transfer programs, and debt servicing commitments. An indicator of short-term fiscal sustainability is the level of budget deficit, which is the shortfall between government expenditure and revenue. For fiscal policy to be sustainable over the long-term, there is generally a presumption that a government which has debt outstanding must sooner or later be prepared to turn around its budgetary position by running budget surpluses in order to able to pay back its loans.

Over the longer term, fiscal sustainability has been defined as the ability of government to meet all of its financial obligations into the future based on current policy settings without incurring an excessive debt accumulation (Blanchard, Charouaqui, Hagemann, & Sartor, 1990).

8.2 Measures of sustainability

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

These include measures of net debt, net financial liabilities and net worth (ACT Government, 2017, p. 279). Net debt is expected to rise from $1.7 billion in 2016-17 to $2.8 billion to 202-12, an increase of 61.9 per cent. Over the same period, net financial liabilities are expected to increase from $4.8 billion to $6.1 billion. Both measures are growing faster than net worth.

To provide an indication of the scale of these measures in relation to the Territory's economy as whole, these measures are expressed as a percentage of Gross State Product (GSP) in Table 21 below.

Table 21: General Government Sector Key Balance Sheet Measures as a percentage of Gross State Product

	2016-17 Est. Outcome	2017-18 Budget	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
Net Debt to GSP (%)	**4.6**	**5.0**	**6.5**	**6.5**	**6.1**
Net Financial Liabilities to GSP (%)	**12.4**	**12.7**	**14.0**	**13.7**	**13.1**
Net Worth to GSP (%)	**46.1**	**44.8**	**43.1**	**41.4**	**40.0**

Source: ACT Government (2017, pp. 279,280,281)

Table 21 shows that although net debt and net financial liabilities are growing rapidly, by 2020-21 they will still only represent a relatively small proportion of the overall Territory economy.

The ratios are, however, moving in the wrong direction. While net debt and net financial liabilities are rising as a share of the economy, net worth is declining, from 46.1 per cent of GSP in 2016-17 to 40.0 per cent in 2017-18. As noted in a previous section of this report, net debt has deteriorated over a longer time-period from -$0.7 billion in 2010-11 (in which General Government sector cash reserves and investments were higher than the Territory's gross debt liabilities) to a forecast level of more than $2.8 billion in 2020-21 (ACT Government, 2017, p. 389).

Figure 17 below provides an illustration in the movement of these ratios over time.

Figure 17: Movements in key balance sheet indicators

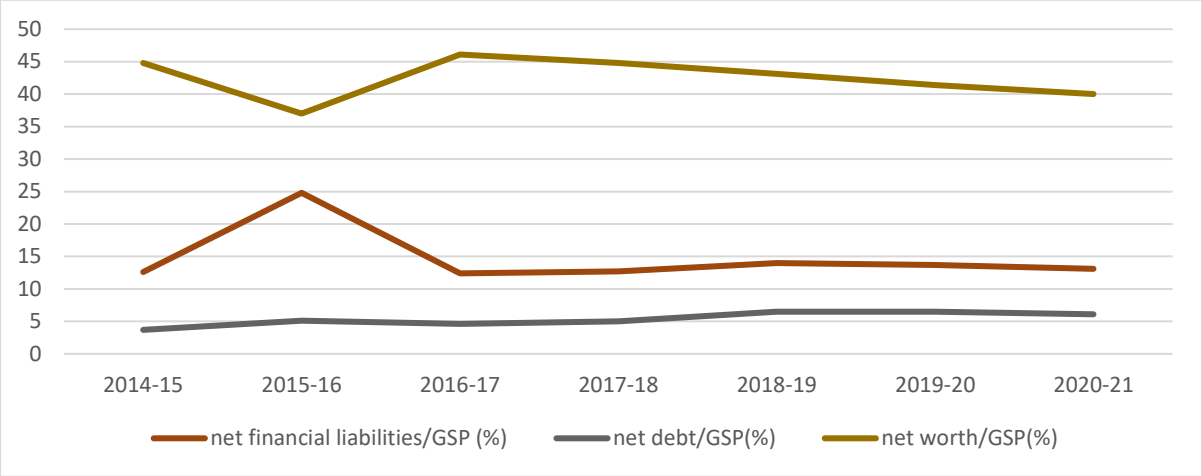


Figure 17 shows steady growth in the ratio of net debt to GSP since 2014-15.

Figure 17 also illustrates the extent to which the Budget Paper measures based on net worth and net financial liabilities have been influenced by changes in the accounting treatment of the Territory's Public Private Partnerships between 2015-16 and 2016-17. The Light Rail project was initially included in the 2015-16 Budget as a debt-funded capital project (ACT Government, 2016, pp. 288-289).

8.3 Other indicators

Other ratios might provide better indicators of the capacity of the Territory government to maintain its budget position.

One primary measure of the fiscal position relates to the level of the Territory's interest expenses. Interest expenses have grown by 9.4 per cent in 2017-18 over 2016-17 and are expected to grow by 25.4 per cent between 2016-17 and 2020-21.

However, in measuring the sustainability of the Government's fiscal position, the capacity to service debts is more important than the absolute level of interest payments. It is therefore relevant to consider the relationship between anticipated interest expenses and the Territory's own substantial holdings of financial assets and capacity to raise revenue. Table 22 sets out the relationship between the Territory's interest expense, total revenue and financial investments.

Table 22: General Government interest, revenue and financial investments

	2016-17 Est. Outcome	2017-18 Budget	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
Interest on borrowings ($m)	183.5	200.7	211.5	234.5	230.1
Total revenue ($m)	5,165.8	5,341.4	5,538.7	5,800.4	6,040.3
Total financial jnvestments ($m)	4,901.1	4,841.5	5,077.3	5,436.7	5,778.3
Interest to revenue (%)	3.6	3.8	3.8	4.0	3.8
Interest to financial investments (%)	3.7	4.1	4.2	4.3	4.0

Source: ACT Government (2017, pp. 292,303)

Table 22 suggests that the Government's capacity to service its debts are not expected to change substantially over the budget and forward estimates period.

A critical measure of sustainability relates to the Territory's ability to service its borrowings and other liabilities. ACT Budget Papers up to 2013-14 provided indicators of the Territory's fiscal position expressed as a proportion of government revenue. The ACT Auditor-General has also used a broader range of measures in recent reports on its financial audits including:

- 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. The Auditor-General found in 2016 that although the Territory is expected to retain a strong capacity to pay its liabilities, its short-term assets are expected to reduce over the medium term (ACT Auditor-General, 2016, p. 8).

The Committee may wish to seek the advice of officials on the application of these ratios across the budget and forward years.

9 Risks

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

9.1 Overview

The planned deficit in the net operating balance in 2017-18 and then gradually increasing surpluses results over the forward years from 2018-19 to 2020-21 mean that, if unexpected adverse events occur, the Territory is 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 forward years.

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

9.2 Risks to the economic outlook

A tighter Commonwealth fiscal policy in the out-years poses medium term risks to the ACT government's own source taxation arising from reduced population growth flowing through into lower collections from general rates as well as from the sale of ACT Government goods and services.

To the extent that fiscal consolidation at the Commonwealth level impacts on ACT land values, a tightening in Commonwealth fiscal policy in the out-years does pose a threat to revenue for the ACT Government in the medium term from the Land Release Program that in turn could reduce the flow of dividends from the Land Development Agency and successor agencies.

Aside from the risks posed to ACT population growth from a Commonwealth fiscal consolidation, another risk to ACT population growth posed by the Commonwealth Government is the decentralisation program announced in April by the Commonwealth Minister for Regional Development and the Minister for Local Government and Territories Senator Fiona Nash. According to Minister Nash (2017):

> [Commonwealth] 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.
>
> All portfolio Ministers will need to report back to Cabinet by August on which of their departments are suitable to be moved to regional Australia, and relevant Ministers will need to report to Cabinet with robust business cases for decentralisation by December.
>
> …

> Shifting to the country makes sense both for government departments and capital city residents.

The Budget Papers acknowledge both of these risks posed by the Commonwealth Government upon the ACT economy:

> Downside risks to the ACT economy centre on any potential impact of the Commonwealth Government's de-centralisation agenda or other adverse policy decisions which reduced the 57,549 Australian Public Service staff currently based in Canberra (ACT Government, 2017, p. 8).

> Commonwealth Government policy decisions remain a significant risk to the ACT economy, as does the possibility of the relocation of segments of the Australian Public Service. (ACT Government, 2017, p. 409)

Another risk to the economic outlook for the ACT economy recognised in the Budget papers is that of a significant correction in national house prices and flow-on effects to economic activity and financial market stability that in turn would lead to downturns in household consumption and private investment activity in the ACT (ACT Government, 2017, p. 409).

9.3 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 some risks associated with the Loose-fill Asbestos Insulation Eradication Scheme to buy back, demolish and remediate all houses in the ACT affected by loose-fill asbestos insulation (ACT Government, 2017, p. 409). The remediated blocks of land are 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. 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 (2017, p. 409) has pursued two projects through Public Private Partnership (PPP) arrangements: the ACT Law Courts and Light Rail – Stage 1. In 2017-18, the ACT Government will invest $309 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, 2017, p. 410). Risks that are commonly retained or shared by the public sector include:

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

Land Release Program

The ACT Government's land release program is susceptible 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, 2017, p. 411). Lower than expected demand or sale prices would reduce the amount of revenue that could be generated for the ACT Government. The risk discussed above to the economic outlook will have a major bearing of the extent of the fiscal risks associated with the Land Release Program.

Renewable Energy Certificates

As a consequence of its investment in renewable electricity generation, the ACT Government (2017, p. 411) 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, the impact estimates contained in the 2017-18 Budget are subject to risk in that they have been entered into the budget on the assumption that the original value for the certificates hold, and that they are not re-valued between when they are recognised and when they are surrendered.

Commonwealth Government

There are various fiscal risks for the ACT Government associated with the Commonwealth Government, including:

- the size of Goods and services tax (GST) grants to the ACT associated with a general downturn in the national economy leading to less GST revenue overall, and annual revisions to the state and territory relativities by the Commonwealth Grants Commission;
- the level of future Commonwealth funding for the National Disability Compensation Scheme;

- risks to the provision of Specific Purpose Payments for failure to meet specified targets under the interim 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, 2017, p. 415). 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, 2017, p. 415). 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.

9.4 Other risks

Savings and offsets

The Budget includes around forty individual savings and offsets against expenses.

However, the offsets are very general in nature, and in some cases the proposed savings measures are not fully explained. In the absence of further information on the nature and likely impacts of the offsets incorporated in the Budget and forward estimates, and how they have been costed, it is difficult to assess how achievable and sustainable they may prove to be.

The ACT Budget provides limited information on the Government's past record in delivering planned savings, and does not generally provide a reconciliation of past savings achieved against claimed offsets. We note that the 2016 Budget also claimed savings and offsets in excess of $200 million. While the 2016-17 Budget provided some information on past efficiencies achieved in administrative functions, these savings were not generally quantified or traced to specific savings initiatives or time-periods (ACT Government 2016, p.181). The 2017-18 Budget arguably provides less information on performance in delivering past savings.

We note, however, that overall expenses exceeded the initial 2016-17 Budget estimate by some 5.5 per cent.

The delivery of savings and offsets as planned represents a risk to the Budget and could potentially jeopardise the planned return to surplus.

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