COMMERCIAL IN CONFIDENCE

FINAL REPORT

Review of the 2014-15 ACT Budget

Prepared for
The ACT Select Committee on Estimates 2014-15

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THE CENTRE FOR INTERNATIONAL ECONOMICS
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Summary

The 2014-15 ACT Budget continues a reasonably bullish program of capital works spending and seeks to offset some potential softening effects of Commonwealth Government cutbacks on the ACT economy. The result is a scaling back of the expected budget balance, which will not achieve a surplus over the forward estimates period. This is reflected in higher expected costs of living for ACT residents.

Budget balances revised down over the forward estimates period

Budget balances have deteriorated by a total of $454 million between 2014-15 and 2016-17 relative to what was forecast in the 2013-14 Budget. There are four key drivers of these downward revisions:

- a reduction in Commonwealth grants due to cuts to health funding ($161.2 million)
- a reduction in Land Development Authority (LDA) dividend payments following a scale back in the land release program to take account of lower demand following Commonwealth Government staff cuts ($181.4 million)
- a reduction in ACTEW dividend payments following a lower than expected retail price setting for water and sewerage ($103.6 million), and
- increases in investments to help stimulate the ACT economy.

The budget balance is forecast to gradually improve after 2014-15, though a budget surplus is not expected to be achieved over the forward estimates period.

Impact of the 2014-15 Commonwealth Budget

ACT Budget

The cuts in spending and employment announced in the 2014-15 Commonwealth Budget are expected to have both direct and indirect impacts on the ACT Budget over the forward estimates period. The two most significant factors are expected to be:

- cuts to the health funding guaranteed by the previous government, and
- a reduction in LDA dividends following a reduction in the land release program to take account of lower demand following the Commonwealth Government staff cuts.

Taken together, these factors are expected to reduce revenue by $492 million over the forward estimates period relative to the 2013-14 ACT Budget.

In addition, the 2014-15 Federal Budget is likely to have a number of indirect impacts on ACT revenue over the next four years as reductions in employment and economic activity affect taxation revenue and sales of goods and services revenue.

The ACT Treasury estimates that taxation revenue forecasts reduced by close to $40 million between 2014-15 and 2016-17 as a direct result of the Commonwealth Government's Budget. This reflects downward revisions to:

- payroll tax forecasts by around $5 million per annum due to a lowering of expected employment growth, and
- conveyance revenue forecasts by around $6 million per annum due to a lowering of expected price growth in the property market.

Economic outlook

Cuts to the Australian Public Sector and contractionary fiscal policy at a federal level are considered to lead to a softening in economic fundamentals, with weakening Gross State Product, State Final Demand, and wage growth. Spending has been increased to replace lost funding, such as for example the Emergency Services funding supplementation. The Budget aims to absorb the impact of declining economic conditions to the budget bottom line, rather than decrease spending to improve the fiscal position.

The loss of Australian Public Service jobs is likely to lead to an increase in interstate migration outflows, which would result in a decrease in the rate of population growth. The boost to economic activity in the ACT from investment initiatives is likely to be tempered by parts of the spending flowing to other states. Employment for the construction of infrastructure may be sourced from NSW or Victoria, and therefore some of the government funds invested in the construction of capital works may flow to those states.

Substantial new expenditure is mainly focussed on the Health Directorate and capital works

The 2014-15 Budget includes substantial new expenditure on health and expenses related to capital works, with large expenditure on the Secure Mental Health Unit and the Alexander Maconochie Centre. Spending has increased significantly since the 2013-14 Budget. Capital works expenditure must be justified on the merits of the project itself and the value it provides to the Territory. There is a lack of sufficient cost-benefit analysis and detail in the Budget for the Capital Metro.

Impact of revenue initiatives in 2014-15 Budget

The costs associated with investment initiatives have been partly offset by a number of revenue initiates announce in the 2014-15 Budget which are expected to increase future revenue by $121.8 million over the forward estimates period. Over 80 per cent of the expected revenue generated from the initiatives is due to reform to land tax, payroll tax,

and the Fire and Emergency Services Levy (FESL). General rates on existing residential and commercial properties are expected to increase by around 10 per cent in 2014-15, with total revenue increasing by close to 13 per cent.

The revenue initiatives in the 2014-15 Budget are generally efficient and contribute to greater stability in the sense that they do not focus on transactions or insurance. In addition, a number of the initiatives including payroll harmonisation are broadly in line with the recommendations of the 2012 Quinlan Review.

The revenue projections associated with new initiatives related to parking fines and payroll harmonisation are key sources of uncertainty given the nature of the reform and the assumption required to quantify their impact.

Savings are conservative and relate to enhanced use of digital technology for service delivery and government organisation

Savings estimates are conservative, with only $96.3 million over four years, and largely relate to expanded use of digital and online technology for service delivery and internal organisation. This might result in low-skilled work at physical service locations being replaced by high-skilled ICT work, which would not necessarily be sourced from within the ACT. Provisions have been made for the initial expenditure required to achieve the savings yielded by greater use of technology in government service delivery.

Impact of the Budget on the cost of living

The transition to a more efficient tax base and the revenue initiates required in the 2014-15 Budget to help offset Federal Government cutbacks will raise the cost of living for a number of ACT households. The main drivers of this rise in the cost of living are a:

- 10 per cent rise in general rates in 2014-15
- 8 per cent rise in the FESL for residential households
- 7 per cent increase in utility costs for households who are not eligible for concessions[1], and
- 6 per cent increase in motor vehicle registration in 2014-15.

Reductions in the duties paid on car and contents insurance have helped to partly offset these additional cost of living expenses.

The average net change in expenses for the five hypothetical households included in the cost of living statement due to these taxes, fees and concessions was $327. While a number of households will receive benefits from the ACT Government during 2014-15 that will help to offset these cost increase (e.g. home buying concessions), a large proportion of non-pension homeowners are likely to see a noticeable increase in their cost of living during 2014-15.

[1] This figure is based on the households featured in the cost of living statement

A triple bottom line analysis of key Budget initiatives is provided at appendix A.

Has an appropriate amount of stimulus been provided to the ACT economy?

There are two components to this question. Firstly, has the right level of stimulus been provided to the ACT economy? Secondly, are the spending initiatives likely to be effective in stimulating economic activity?

In making a judgment about whether the right level of stimulus has been provided it is important to consider whether the level of stimulus:

- is sufficient to avoid unnecessary falls in activity and employment
- is sustainable (this will in part depend on the types of investments made), and
- does not adversely affect the credit rating of the ACT Government.

It is worth noting that the ACT Government's balance sheet was in a relatively strong position leading into the 2014-15 Budget which provided some scope for expansionary fiscal policy. While the spending initiatives in the 2014-15 Budget have increased the level of net debt and liabilities over the forward estimates period, these remain broadly in line with the levels of other states with an AAA credit rating. In addition, the Budget is projected to approach a budget balance over the medium-term.

Taken together, these facts suggest that the spending initiatives have not been excessive and have not put the sustainably of the Budget or the Government's credit rating at risk.

However, this does not mean that the spending works themselves are financially sound. Each project must be assessed on its own merits and deliver a net gain to ACT residents in order to be justifiable and appropriate.

Where does the balance of risks lie?

The Statement of Risk in the 2014-15 Budget outlines a number of risks to the expenditure and revenue projections. Overall, we judge the risks are broadly balanced, with a number of 'up-side' and 'down-side' risks (i.e. a 'down-side' risk is associated with a deterioration in the budget balance). Four of the most significant risks to the projections are outlined below:

Down-side risks

- a more pronounced slowing in the residential property market than what is currently expected which would lead to lower revenue from both conveyance taxes and dividend payments from the LDA, and
- more modest funding from the Federal Government's Asset Recycling Initiative than what is currently expected due to the capped funding pool and competitive nature of the scheme.

Up-side risks

- greater dividend payments from ACTEW due to a successful appeal against recent regulated prices of water and sewage, and.
- further tax reform by the ACT and possibly other state governments to help offset the reductions in Commonwealth Government funding.

Economic outlook

Cuts to the Australian Public Sector and contractionary fiscal policy at a Federal level are expected to lead to a softening in economic fundamentals, with weakening Gross State Product, State Final Demand, and wage growth.

The loss of Australian Public Sector jobs is likely to lead to increase net interstate migration outflows, which would result in a decreased rate of population growth. The boost to economic activity in the ACT from investment initiatives is likely to be tempered by parts of the spending flowing to other states and possibly overseas.

Overall, the ACT economy is expected to soften, partly as a result of fiscal consolidation at the Commonwealth level. The ACT economy is expected to underperform the national average over the coming years, and weaken slightly over the forward estimates, although growth is expected to remain positive at 1.75 per cent in 2014-15.

The 2014-15 Budget provides a forecast of the financial position of the ACT Government from 2013-14 to 2017-18, which aside from the spending, savings, and revenue measures in the budget, reflects a number of macroeconomic variables. Table 2.1 shows the forecasts for changes in key macroeconomic variables in 2014-15, compared to estimates for parameter growth in 2013-14 and 2012-13. It shows that the ACT is experiencing softening the economic fundamentals, with lower levels of Gross State Product (GSP), employment, and State Final Demand (SFD) growth in 2014-15 compared to 2013-14.

As table 1 shows, the budget relies on long run averages for the projection years 2014-15 to 2016-17.

While it is appropriate to use long run averages for planning purposes, in order to meet budget targets for the forward period, in practice, year-on-year fluctuations will occur to accommodate actual economic circumstances, and the consequent impact on revenue. For instance, conveyance duties, land sales and payroll tax revenue are significant components of the budget that are sensitive to the performance of the ACT economy and therefore, whether long run average economic performance is achieved in 2014-15.

Growth and demand outlook for the ACT and Australia

GSP in the ACT for 2013-14 is expected to be 2.25 per cent, which is 0.5 less than the forecast growth in Australian Gross Domestic Project (GDP) of 2.75 per cent. In contrast, in 2014-15 GSP is forecast to grow at 1.75 per cent, which is 0.75 less than the forecast GDP growth of 2.5 per cent.

1 ACT Economic outlook

	Actual	Forecast 2014-15		Projections		
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
ACT						
Gross state product	2.7	2.25	1.75	2.5	2.5	2.5
Employment	1.9	0.75	0.50	1.5	1.5	1.5
State Final Demand	0.4	1.75	1.25	4.0	4.0	4.0
Consumer Price Index	1.9	2.25	2.25	2.5	2.5	2.5
Wages Price Index	3.7	2.75	2.50	3.5	3.5	3.5
Population	1.7	1.50	1.50	1.5	1.5	1.5
Australia						
Gross domestic product	2.6	2.75	2.50	3.0	3.0	3.0

Source: ACT Budget 2014-15

The ACT Treasury's GDP growth forecasts are consistent with the expectations of key economic institutions, which forecast GDP growth for 2014-15 between 2.5 and 2.75 per cent (including the midpoint of the RBA forecast being 2.75 per cent). Table 2 gives a comparison of forecasts of Australian GDP growth produced by different economic agencies.

2 Comparison of Australian GDP growth forecasts

	2013-14	2014-15f
ACT Budget	2.75	2.5
Federal Budget	2.75	2.5
OECD forecast	2.5	2.75
RBA forecast	2.75	2.25-3.25
IMF forecast	2.5	2.7

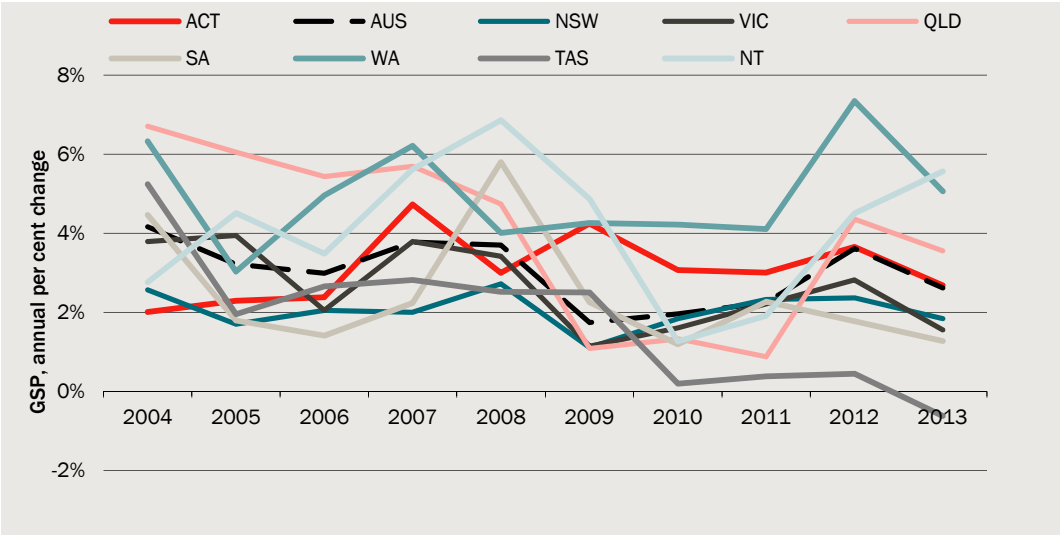
Note: OECD and IMF estimates are average of the calendar year growth figures to produce financial year figures.

Source: RBA Economic Outlook, May 2014. Treasury Budget 2014-15. OECD Real gross domestic product – forecasts, May 2014. IMF World Economic Outlook Database, April 2014.

The growth trajectory of Australian GDP and the ACT GSP have been very similar over time (see chart 3). However, a differential of 0.75 per cent between GSP and GDP is reasonably pronounced when compared with the historical differential between the economic performance of the ACT economy compared to the Australian economy as a whole.

Hence the ACT economy is expected to underperform the national level of growth. The mining states are expected to continue to perform above the national average, Queensland GSP is expected to grow 3 per cent in 2014-15 and 6 per cent in 2015-16, above the national averages of 2.5 and 3 per cent for those periods. Cuts to the public service by the Commonwealth government are a significant downside risk to the economic outlook in the ACT.

3 Comparison of GSP growth between states



Data source: Australian Bureau of Statistics Mar 2014, *Australian National Accounts,* Cat. No. 5206.0, ABS, Canberra.

The forecast of moderating growth in ACT GSP is believed to be reasonable, given several important risks that will affect the ACT economy in 2014-15:

- *decreased Commonwealth expenditure and cuts to the public service*. Contractionary fiscal policy at the Federal level is likely to constrain economic growth of the territory, with public service cuts having a particular effect on the ACT, for which about one third of GSP is accounted for by the public sector. Cuts to the public sector affect employment growth and may be expected to lead to an increase in the net migration outflow of the ACT.
- *low employment growth*. The Budget factors in weaker employment growth, forecast at 0.5 per cent in 2014-15, compared to actual growth of 1.9 per cent in 2012-13 and forecast growth of 0.75 per cent in 2013-14. The growth projections are at the lower end of employment growth rates realised over the past decade, which have ranged between 0.25 and 4.5 per cent. The downward trend in employment growth is due to coincident difficulties in the public and private sector, with the construction sector in particular experiencing job losses.
- *lower levels of investment and consumption*. State Final Demand (SFD) is forecast to grow by 1.25 per cent in 2013-14, compared to 1.75 per cent in 2013-14. SFD figures for the past three years have been substantially below historical levels.

Employment growth

ACT Employment growth has significantly declined from 1.9 per cent growth in total employed persons in 2012-13 to forecast growth of 0.75 per cent and 0.5 per cent in 2013-14 and 2014-15 respectively. Worsening employment growth is expected because of sluggish economic growth and contractionary fiscal policy at a federal level. In particular, 6500 jobs in the ACT are estimated to be cut from the APS.

Slowing employment growth is plausible, with the uncertainty created by the Federal Budget likely to impact on consumer confidence and lead to wider labour market impacts, affecting business hiring decisions and delaying recruitment plans.

ACT unemployment is at historically low levels and is significantly lower than the national level. The ACT unemployment rate in April 2014 was 3.6 per cent, which is substantially lower than the national level of 5.9 per cent.[2]

ACT Budget expenditure including capital works may have a diminished positive impact on employment because of inter-state leakage of benefits of expenditure. For example, the Capital Metro may create jobs, but there may be significant imports required for the project, which represents a leakage of expenditure to other states/overseas. It is efficient for the ACT government to source inputs for capital works projects from best-value sources, rather than choosing more costly options simply because they are from within the ACT (or Australia more generally).

Expenditure on capital works will benefit the construction industry, which is currently experiencing a contraction due to the completion of existing projects (such as the Ben Chifley (ASIO) building) and the decline in the value of work to be completed. If changes in the construction sector are temporary, stimulatory spending could be effective counter-cyclical policy. It is not clear that changes in the construction industry are temporary or warrant counter-cyclical expenditure. The benefits of smoothing employment in the construction sector may be outweighed by the costs of inefficient spending.

For example, with regard to the residential building market, The Budget argues that dwelling investment has been at record high levels. This would indicate that recent softening in dwelling investment is bringing it to long-term average levels, rather than it being a temporary shock to the construction sector which should be corrected for by government expenditure.

Savings measures which reduce physical service deliver (e.g. iConnect) may have negative consequences for unemployment. However, the replacement of relatively low skilled work related to interaction with recipients of government services at physical locations may be balanced by the high-skilled ICT work created by such savings programs. This work may not necessarily be performed by people located in the ACT, and thus there is some leakage of the benefits of these programs to the States.

Outlook for inflation and wage growth

Inflation is expected to be well contained in the short term, with slowing output, employment and household consumption growth expected to result in inflation remaining within the 2-3 per cent target band. Continuing investment in infrastructure is expected to provide stimulus to cost inflation, despite the conservative outlook for employment growth and demand.

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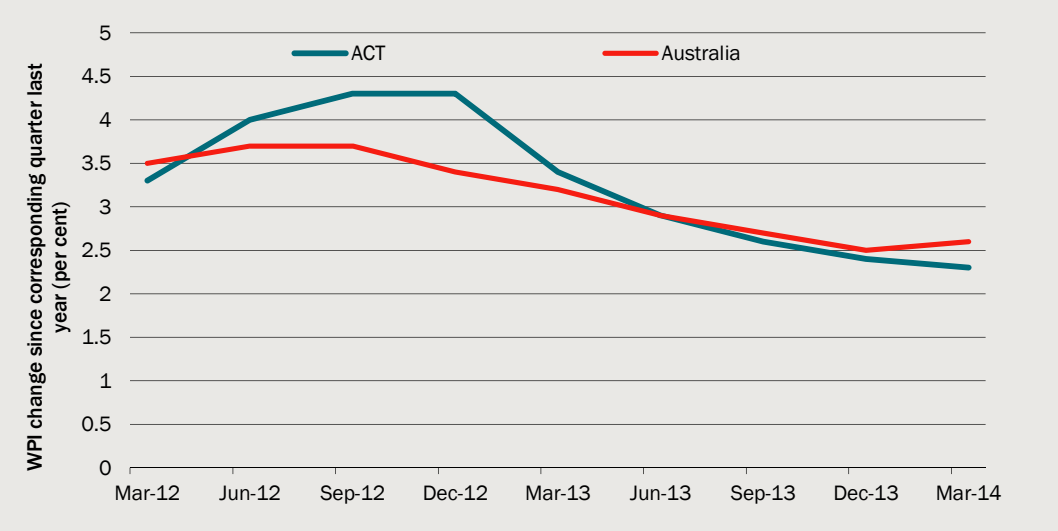
[2] For more information please see:
http://www.ausstats.abs.gov.au/ausstats/meisubs.nsf/0/E2C14B0655D6A059CA257CD100137B8E/$File/62020_apr%202014.pdf

The use of measures of core inflation in the ACT Budget is reasonable, given that although prices of food and energy have substantial effects on the CPI, they are often quickly reversed and dependent on factors such as droughts or oil price shocks. Therefore, they are not relevant for fiscal policy decisions, which mostly operate over longer timeframes than the variations in prices.

Wage inflation represents a significant cost driver, due to the significant labour cost component in the services delivered by the government. Wage inflation is expected to rise by 2.75 per cent in 2013-14 and by 2.5 per cent in 2014-15. The Wage Price Index (WPI) increased by approximately 2.2 per cent in both the public and private sectors in the year ending March 2014[3]. Below trend wage growth is expected in the short term, however the path of wage growth in the ACT has been falling below the Commonwealth trend. Chart 4 shows the evolution of the WPI over the past two years.

4 Wage Price Index



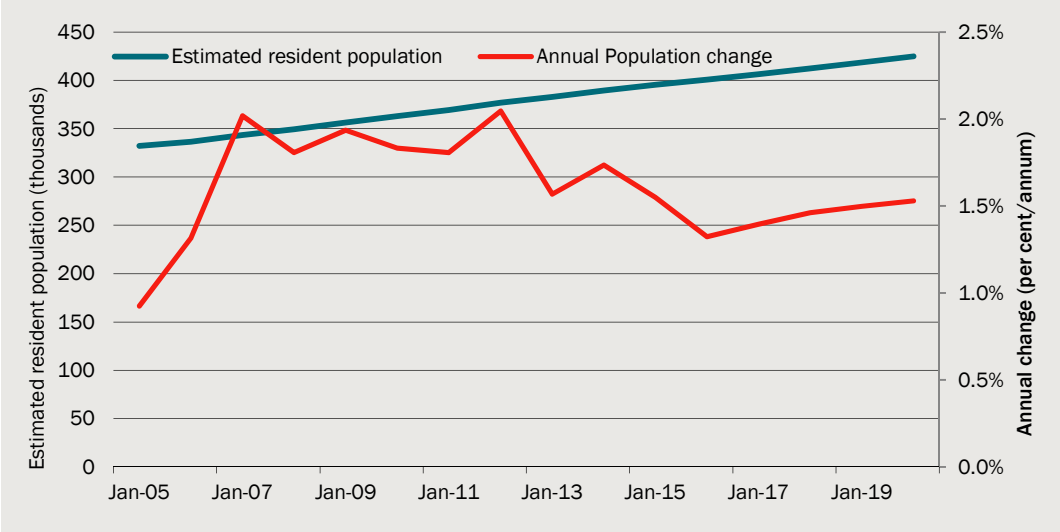
Data source: Australian Bureau of Statistics Mar 2014, *Wage Price Index,* Cat. No. 6345.0, ABS, Canberra.

Outlook for population

The population of the ACT is expected to continue to grow, but with growth to continue at a moderated rate. Chart 5 shows historical data and forecasts of the estimated residential population of the ACT.

3 Australian Bureau of Statistics Mar 2014, *Wage Price Index,* Cat. No. 6345.0, ABS, Canberra.

5 Recent and forecast employment for the ACT

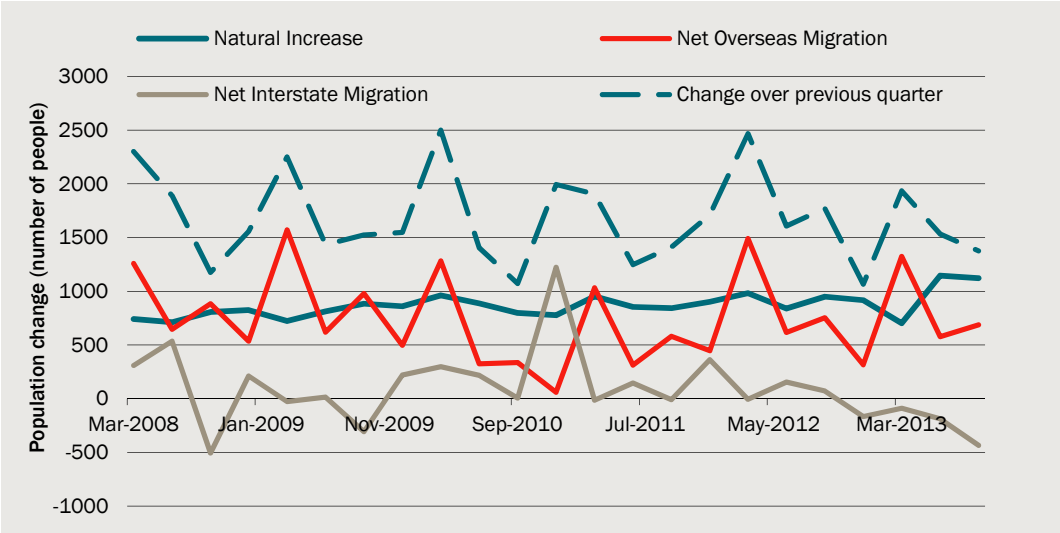


Data source: Australian Bureau of Statistics Sep 2013, *Australian Demographic Statistics*, Cat. No. 3101.0, ABS, Canberra.

The short term variation in population is driven by changes in net interstate and overseas migration level. It is argued in the ACT Budget that 'The ACT's population growth will be predominantly influenced by natural increases and net overseas migration, with net interstate migration projected to make little contribution to overall population growth'. Chart 6 shows the components of population growth, which are net interstate migration, natural increase and net overseas migration, and how they sum to give the level of overall population growth (the dotted series named

Net interstate migration has been negative for the most recent four quarters. This has a non-negligible impact on the overall rate of population growth. Given the cuts to the Australian Public Service, we expect the rate of net interstate migration outflow to increase and thus declining population growth relative to what might have been the case without Commonwealth Government cutbacks.

6 Migration flows for the ACT



Data source: Australian Bureau of Statistics Sep 2013, *Australian Demographic Statistics*, Cat. No. 3101.0, ABS, Canberra.

The substantial reduction in the size of the Indicative Residential Land Release Program supports the conclusion that Commonwealth cuts to the APS will likely lead to weakened population growth. The Indicative Land Release Program has reduced in size by 3000 dwelling sites over the next 3 years based on a belief that demand will not exceed the revised sales targets.

Two potential fiscal policy responses to declining population growth are:

- relatively expansionary policy (greater spending) to stimulate an economy during a trough in the business cycle
- relatively contractionary/neutral policy to account for the decreased rate of growth of demand for services.

The spending decisions in the Budget reflect the former. If it is expected that population growth will slow, and that this is not a temporary change, spending should be adjusted to account for the decreased growth of demand for government services.

Budget Aggregates

A general slowing in economic activity, particularly in the property sector, and the more recent reduction in Federal Government spending and employment have significantly lowered revenue projections. In the 2014-15 ACT Budget, and Government has judged that more Territory spending is required to help stabilise economic growth. This has resulted in a noticeable downward revision to budget balances over the forward estimates period.

This is reasonable only if the chosen investments are financially sound and well aligned to the needs (including unmet needs) of ACT residents.

Drivers of the change in GGS headline operating balances

The 2014-15 General Government Sector (GGS) headline operating balance is expected to deteriorate $233 million relative to what was forecast in the 2013-14 Budget (see table 7). There are four key drivers of this downward revision:

- a reduction in Commonwealth grants due in part to cuts to health funding
- a reduction in LDA dividend payments following a reduction in the land release program to take account of forecast lower demand for land following the Commonwealth Government staff cuts
- a reduction in ACTEW dividend payments following a lower than expected retail price setting for water and sewerage reduction, and
- increases in investments to help stimulate the ACT economy, which were in part offset by revenue initiatives in the Budget.

7 Change in GGS Headline Net Operating Balance from 2013-14

	2013-14	2014-15	2015-16	2016-17
	$m	$m	$m	$m
Commonwealth revenue	17.4	-40.8	-30.1	-24.4
Financial market	-32.2	2.4	-12.0	-24.9
Economic Activity	-62.0	-116.7	-153.2	-119.7
ACTEW / LDA dividends	-37.0	-78.5	-138.3	-118.7
Other	78.5	5.4	36.5	52.4
Policy impacts	-13.4	-83.6	11.7	43.3
Total	**-11.7**	**-233.3**	**-147.1**	**-73.3**

Source: ACT Budget 2014-15

The first three of these drivers continue to hamper revenue growth over the forward estimates period. In particular:

- downward revisions to dividend income from LDA and ACTEW relative to the previous Budget total close to $335 million between 20141-15 and 2016-17
- downward revisions to commonwealth grants revenue total close to $95 million over the same period.

The ACT Government Budget 2014-15 invests in significant new capital works and expenditure initiatives to bolster the ACT economy. New expense initiatives of $182.7 million (net of the health funding envelope) and $415.2 million in capital works spending are included in the Budget over the forward estimates period.

Overall, the profile of expenditure is stimulatory, with a focus on spending within the Health Directorate and the Justice and Community Safety Directorate.

The increases in investment spending outlined above are partly offset by revenue initiatives in the 2014-15 Budget that are expected to increase revenue by $121.8 million over the forward estimates period. Over 80 per cent of the expected revenue generated from the initiatives is due to reform to land tax, payroll tax, and the fire and emergency services levy.

Current projections of the GGS headline operating balances

The key drivers highlighted above have contributed to the Budget deficit in 2014-15 being revised down to $446 million (see table 8). The budget balance gradually improves after 2014-15, though a Budget surplus is not achieved over the forward estimates period.

The relatively strong increase in revenue over the forward estimates period is largely due to growth in taxation revenue in response to:

- the need to find substitute tax sources to Commonwealth grants, and
- a number of the revenue sources being indexed over time and less sensitive to changes in economic activity e.g. motor vehicle registration.

8 General Government Sector Net Operating Surplus/Deficit

	2013-14	2014-15	2015-16	2016-17	2017-18
	$m	$m	$m	$m	$m
Revenue	4 245	4 412	4 654	4 912	5 177
Expenses	4 586	4 858	4 894	5 070	5 242
UPF Net Operating Expenses	**-341**	**-446**	**-241**	**-158**	**-64**

Source: ACT Budget 2014-15.

A key driver of the increase in expenses over the forward estimates period is a substantial amount of expenditure on the University of Canberra Public Hospital, Capital Metro and the Courts project ($1.3 billion). No detail on total costs or cost rollout have been provided thus far. While this information is deemed to be commercially sensitive, it

makes it difficult to make an assessment about the merits of the investment, or the impact of such investments on the financial strength of the ACT Budget.

In growth terms, expenditure is increasing at a compound annual growth rate (CAGR) of 3.4 per cent over the forward estimates period. This is a continuation of the rate of growth from the previous Budget (3.5 per cent) and is mainly due to growth in employee wages and, to a lesser degree, superannuation related expenses.

Risks to the budget balance projections

The budget balance projections are subject to various risks. While these are recognised, they are not anticipated to pose an unmanageable threat to the Budget forecasts.

Land Release Program

The uncertainty created by the Commonwealth Government's continued fiscal consolidation creates risk around the capacity of the market to purchase all sites released under the land release program at the prices currently forecast in the 2014-15 Budget. Lower than expected demand or revenue would negatively impact on the Land Development Agency's dividend and the Government's net operating balance. Other risks to the program include achieving statutory clearances and the capacity of industry to deliver infrastructure and estate works.

Asset recycling initiative

The 2014-15 Budget contains a provision for involvement in the new Asset Recycling National Partnership Agreement (NPA). As this NPA involves a capped funding pool to be allocated to States and Territories on a first-come, first-served basis, there are risks to the ACT's potential to participate in the initiative from delays in bringing forward asset sale proposals.

Regulated prices of water and sewage

There is still some degree of uncertainty surrounding the future regulated prices of water and sewage following the Auditor-General's review into the ICRC's pricing decision. If an appeal is successful, and prices are moved more in line with prior expectations, this could significantly increase revenue and more specifically the projected dividend payments from ACTEW.

Future tax reform

In the 2014-15 Federal Budget the Commonwealth has made significant unilateral changes to the National Specific Purpose Payments (NSPPs) for Health and Education. The Commonwealth's approach has undermined the stability and certainty of the Specific Purpose Payments (SPP) which had previously been assured by the Intergovernmental Agreement on Federal Financial Relations (IGA FFR), significantly raising the level of risk to state and territory budgets.

The decisions to cap SPP funding in Health and Education, and to apply indexation based on the CPI and population growth, create a major risk that Commonwealth SPP payments will not keep pace with future increases in cost and demand, which are already at risk for all state and territory governments,. As a result, there will be greater pressure on future ACT Budgets to implement measures to control costs and to manage demand for these services, or otherwise more substantive increases in revenue will be required, most likely from mooted increases in the GST.

Debt and Liabilities

There a number of metrics that can be used to assess the financial health of the Budget:

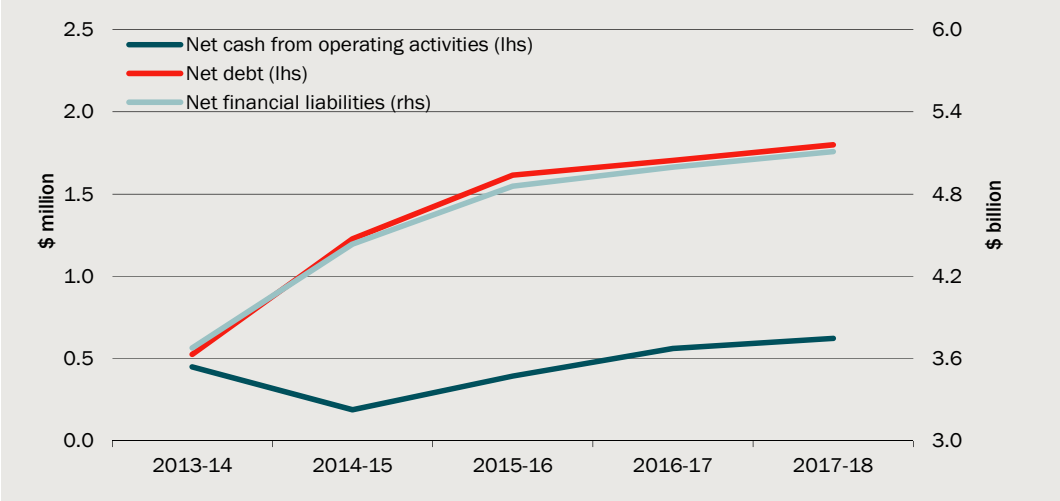
- net debt, which includes the sum of selected financial liabilities, net of financial assets such as cash reserves and investments
  - it does not include accrued superannuation liabilities
- net financial liabilities, which is more encompassing, taking into account all financial liabilities including accrued unfunded superannuation liabilities, and
- net worth compares the level of net assets with the level of net liabilities.

The relative importance of each measure in assessing the health of a government balance sheet is probably determined by the weight placed on them by rating agencies and financial markets in determining a government's credit worthiness. In addition to these measures, the credibility of the profile of future budget balances is perhaps equally important.

Chart 9 illustrates that the sharpest rise in net debt and liabilities occurs in 2014-15 due in part to the fact that 66 per cent of the new expenditure initiatives in the Budget occur in this year.

Debt and liabilities continue to increase strongly in 2015-16, though at a more modest rate than the previous year, due to continued expenditure initiatives and sharp falls in

9 Net cash from operating activities and liabilities

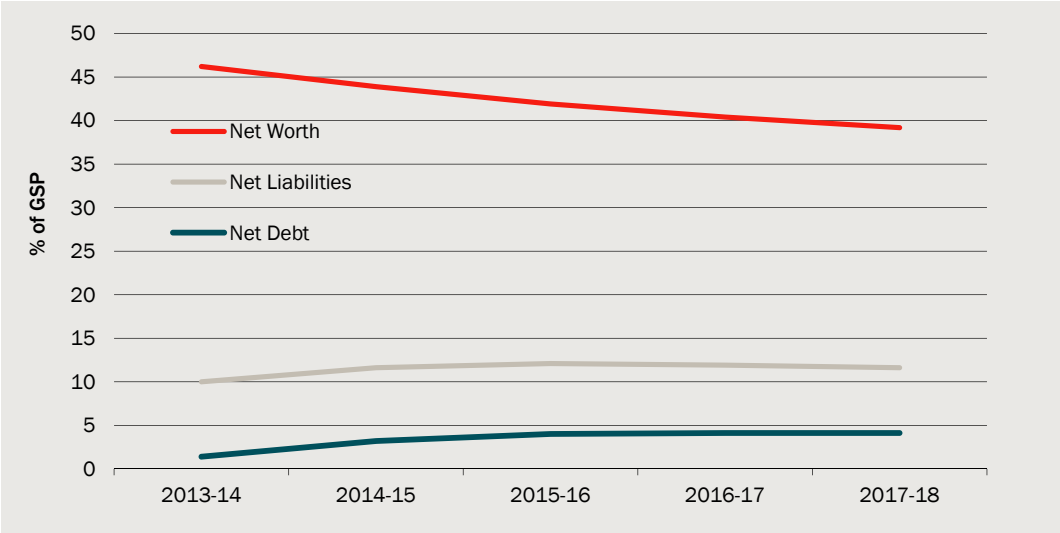


Data source: 2014-15 ACT Budget

expected revenue due to reductions in LDA and ACTEW dividends and National Health Reform Agreement Grants. Increases in net debt and liabilities are more modest in the remainder of the forward estimates period.Net cash from operating activities continues to be positive over the forward estimates period, which illustrates that a key driver of the increase in debt is investments made by the Government.

Chart 10 shows net debt, net liabilities and net worth measured as a share of gross state product. Net debt and net financial liabilities are forecast to increase in both 2014-15 and 2015-16 before remaining broadly stable thereafter. Encouragingly, the level of net debt and net financial liabilities measured as a share of GSP over the forward estimates period is still broadly in line with the current levels of other state governments that have an AAA credit rating.

10 Net liabilities and net worth as a share of GSP



Data source: ACT Budget 2014-15

The fall in net worth from 45.6 per cent of GSP to just under 40 per cent of GSP by 2017-18 partly reflects the strategy of the ACT government to use public asset sales to finance investments and expenditure. There is currently some degree of uncertainty surrounding the value of ACTEW's assets in light of the possibility of a review into the IRCR's final pricing decision of water and sewerage prices.

If the appeal is successful, and sewage and water prices are set more in line with prior expectations, this would help to improve the value of ACTEW's assets.

Superannuation liabilities

Accounting practices

The majority of General Government Liabilities are made up of unfunded superannuation (54.4 per cent) and borrowings (32.3 per cent). Borrowing is undertaken through the issuance of debt securities in the domestic markets with long-term fixed interest and short-term discount securities with a mix of durations.

Superannuation is incorporated into the Budget in several areas:

- The Government established a Superannuation Provision Account (SPA) for the purpose of holding and investing financial assets set aside to meet the emerging cost payments associated with the Government's employer superannuation benefit obligations[4]. Interest earned on the SPA is incorporated into the interest income component of revenue.
  - In order to smooth out the returns over the long run, the Budget bottom line utilises an adjustment to interest income on the superannuation account to bring interest levels in line with the long run expectations. A small amount of revenue is also received by the PTE sector and external sector (ActewAGL) which are based on annual actuarially determined employer contribution rates.
- Superannuation expenses that are incurred in each period are also contained in the expenditure items of the Budget.
- Accrued superannuation liabilities are factored into the Budget through the reporting of Net Financial Liabilities. The total 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.

Recent developments

The superannuation liabilities at the end of 2014-15 are expected to reach $5.7 billion, with close to 56 per cent of this liability (or $3.2 billion) funded by investments, and reach $6.5 billion by the end of the forward estimates period.

Table 11 below shows the forecast rise in superannuation liabilities over the forward estimates period as well as the proportion of these liabilities that are expected to be funded. The estimated total liability and unfunded liability in aggregate terms increases over the Budget, while the share of liabilities that is funded increases from 55 per cent in 2013-14 to 62 per cent in 2017-18.

11 Superannuation liability funding

		2013-14	2014-15	2015-16	2016-17	2017-18
Superannuation liability	$m	5.4	5.7	5.9	6.3	6.5
Investments	$m	3.0	3.2	3.5	3.7	4.0
Unfunded liability	$m	2.4	2.5	2.5	2.5	2.5
Funding percentage	**%**	**56**	**57**	**58**	**60**	**62**

Source: ACT Budget 2014-15.

It is worth noting that the projected superannuation liabilities are uncertain and sensitive to the assumptions used. The Budget Statement of Risk suggests that the estimated superannuation liability is most sensitive to inflation, wages growth, rates and patterns of

[4] These obligations are from superannuation owing under the Defined Benefit Superannuation Schemes and the Public Sector Superannuation Scheme whereby the benefit is unfunded by the employer and the benefit is not required to be paid until a member takes their benefit entitlement.

retirement and resignation and the proportion of benefits taken in pension form. In addition, the superannuation liability is affected by the assumed discount rate, which reflects the estimated average timing of the benefit payments and the time value of money.

The Net Financial Liabilities reported in the Budget has been prepared using an estimate of the 20-year average discount rate of approximately 6 per cent to reflect the long-term nature of superannuation investment, whereas the current discount rate measured as the Commonwealth Government long-term bond rate is approximately 4 per cent. If the discount rate remains at around 4 per cent, the value of the liability at the end of 2012-13 increases by approximately $2 billion. Changes to the discount rate would also flow through to defined annual superannuation expenses.

Revenue

Over the past 18 months, four key factors have influenced the level and composition of revenue collected by the ACT Government:

- slowing economic activity, particularly in the property sector

- reductions in Federal Government spending and employment

- lower than expected regulated prices for water and sewage, and

- continued tax reform initiated by the Quinlan review.

The first three factors outlined above have reduced the level of taxation and other revenue and required a number of new revenue initiatives to be announced in the 2014-15 Budget. The fourth factor, the taxation reform program started in 2012-13, has changed the composition of the revenue collected away from conveyance and insurance based taxes towards more broad-based efficient taxes such as general rates. This change in the composition of tax revenue will help to improve the stability of tax income in future years and reduce the risks associated with the central revenue projections.

While these initiatives have been necessary to improve the efficacy of the taxation system, they have resulted in a noticeable rise in the taxes and fees payed by households in 2014-15. It will be important to ensure that a sufficient level of targeted concessions is available to help protect low-income households.

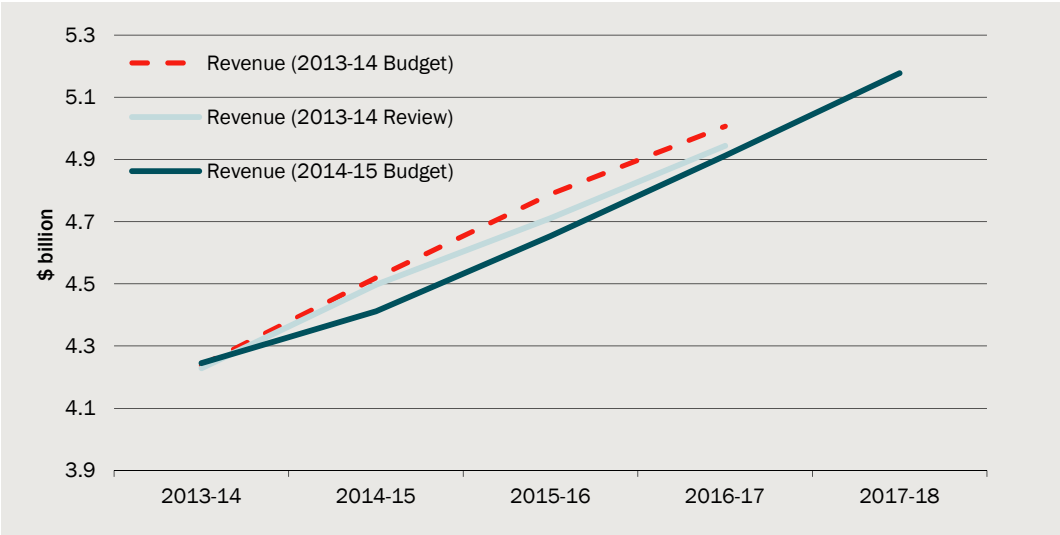
Revenue projections relative to 2013-14 Budget

Revenue projections have been progressively revised down since the 2013-14 Budget (see chart 12 below).

The estimated outcome for taxation revenue in 2013-14 is $1.3 billion, which is $11.6 million (0.9 per cent) above the original Budget. The main reason for the upward revision is higher than expected commercial conveyance revenue that was partly offset by lower payroll tax collection. Downward revisions to revenue projections over the three-year period between 2014-15 and 2016-17 total $337 million. This represents 2.4 per cent of the total revenue currently projected over this period. The $337 million downward revision to projected revenue is evenly distributed across the forward estimates period, with revenue expected to decline:

- by $107 million or 2.3 per cent in 2014-15
- by $135 million or 2.7 per cent in 2015-16
- by $95 million or 1.8 per cent in 2016-17.

12 Progression of revenue projections



Data source: ACT Budget 2014-15

Key drivers of the decline in revenue projections

As noted in the 2012 Quinlan taxation review, one of the key vulnerabilities of the ACT Budget is its sensitivity to changes in Federal Government expenditure, investment and employment.

In the 2014-15 Budget, a large proportion of the downward revisions to revenue are directly or indirectly due to the National Health Reform Agenda and reductions to Federal Government spending and employment .[5] In addition, revisions to water and sewerage prices by the ICRC have significantly reduced projected dividend payments from ACTEW. These factors have contributed to a:

- downsizing of the land release program by 3 000 dwelling units
- a revision to LDA dividend payments and contributed assets of close to $200 million
- reduction in commonwealth grants of $161.2 million
- decline in expected dividend payments from ACTEW of $103.2 million
- downward revisions to taxation revenue forecasts totalling $40 million as a direct result of the Commonwealth Government's Budget.

Significant factors that have helped to offset these reductions in revenue projections are:

- revenue initiatives in the 2014-15 Budget, including land tax reform and payroll harmonisation, that are expected to increase revenue by $87.1 million
- commonwealth grants for infrastructure investment and environmental works are expected to increase by $71.3 million.

[5] Federal Government staff cuts are expected to affect 6 500 jobs in the ACT.

Impact of 2014-15 Commonwealth Budget

The cuts in spending and employment announced in the 2014-15 Commonwealth Budget are expected to have both direct and indirect impacts (i.e. reductions in economic activity that will indirectly impact taxation revenue) on the ACT Budget over the forward estimates period. ACT Treasury has quantified a number of these impacts.

Direct impacts

Table 13 summarises the estimated direct impact of the 2014-15 Federal Budget on ACT revenue projections. The two most significant factors are expected to be:

- the National Health Reform Agenda (see box 14 below)
  - including cuts to the health funding guaranteed by the previous government.
- a reduction in LDA dividends and income tax equivalent payments following a reduction in the land release program to take account of forecast lower demand for land following the Commonwealth Government staff cuts.

13 Impact of Commonwealth Government decisions on ACT revenue

	2014-15	2015-16	2016-17	2017-18
	$m	$m	$m	$m
Land release (LDA dividend)	-40.3	-86.0	-55.1	-62.5
National Health Reform Agenda	-39.7	-53.0	-68.5	-86.7
Financial assistance Grants	-1.8	-4.0	-6.3	-6.5
General Revenue Assistance	8.3	9.4	10.7	11.8
Other grants	6.1	31.9	33.3	24.3
Total	**-67.4**	**-101.6**	**-86.1**	**-119.6**

Source: ACT Budget 2014-15.

Taken together, these factors are expected to reduce revenue by $492 million over the forward estimates period relative to the 2013-14 ACT Budget. These downward revisions to revenue have been offset in part by additional funding for infrastructure investment and environmental works that total close to $85 million over the forward estimates period.

Given the weakness in the residential property market prior to the Federal Government Budget it is unclear the extent to which the reduction in the land release program can be fully attributed to announcements made in the 2014-15 Budget.

In-direct impacts

The Commonwealth Government decisions highlighted above are also likely to have a number of indirect impacts on revenue over the next four years as reductions in employment and economic activity affect taxation revenue and sales of goods and services revenue.

While quantifying the full scale of these effects is behind the scope of this report, ACT treasury estimates that taxation revenue forecasts have reduced by close to $40 million

14 National Health Reform Agreement (NHRA)

New funding arrangements under the NHRA came into operation for all States from July 2012. For 2012-13 and 2013-14, these arrangements included the continued provision of funding by the Commonwealth to the level which would have applied under the previous National Healthcare SPP.

From 1 July 2014 the NHR funding is directly linked to the level of services delivered in public hospitals in each State. From 2014-15 to 2016-17, the Commonwealth will maintain its previous percentage of base funding and fund 45 per cent of volume growth, both at the national efficient price (which is determined annually by an independent authority).

In the 2014-15 Commonwealth Budget, however, the Commonwealth announced a number of major unilateral changes to the provisions of the NHRA which will significantly reduce the payments the ACT had expected to receive under the agreement.

The first major impact results from the abolition of the growth and 'no worse off' guarantees formerly provided under the NHRA. This change results in NHRA payments to the ACT falling between 2013-14 and 2014-15, compared with the expected increase of around $40 million that the ACT could have expected if the guarantees had been honoured. Over four years, the ACT's expected NHRA payments from the Commonwealth have been reduced by around $240 million through the removal of the guarantees.

The second major change is that from 1 July 2017 the Commonwealth will index its contribution for public hospitals funding by the Consumer Price Index and population growth. This change jettisons the previous Commonwealth commitment to fund 50 per cent of efficient growth from 2017-18 and introduces a cap on the Commonwealth contribution. The effect of this change is that funding will no longer be determined by the actual level of services delivered by public hospitals. Instead, allocation of public hospital funding for 2017-18 and beyond will be capped and distributed on an EPC basis.

between 2014-15 and 2016-17 as a direct result of the Commonwealth Government's Budget.[6] This reflects downward revisions to:

- payroll tax forecasts by around $5 million per annum due to a lowering of expected employment growth.
- conveyance revenue by around $6 million per annum due to a lowering of expected price growth in the property market.

[6] And by $50 million dollars over the four years between 2014-15 and 2017-18.

Impact of revenue initiatives in 2014-15 Budget

Overall, revenue initiates in the 2014-15 Budget are expected to increase future revenue by $121.8 million between 2014-15 and 2017-18. The expected impact of the four most significant revenue initiatives in terms of income generated are outlined in table 15.

15 Impact of revenue initiatives

	2014-15	2015-16	2016-17	2017-18
	$m	$m	$m	$m
Land tax reform	10	10	10	10
Payroll harmonisation	10	10	10	10
Fire and emergency levy	4.7	4.7	4.7	4.7
Traffic and parking fines	1.1	2.2	3.4	3.6
Net impact of other initiatives	-0.2	1.0	5.5	6.4
Total impact	**25.6**	**27.9**	**33.6**	**34.7**

Notes: Payroll harmonisation will be partly offset by an increase in the payroll threshold.
Source: ACT Budget 2014-15

Over 80 per cent of the expected revenue generated from the initiatives is due to reform to land tax, payroll tax, and the fire and emergency services levy. These reforms are outlined below.

Land tax reform

Land tax is levied on residential investment properties. The Government will introduce a new rating structure for land tax in the 2014-15 Budget. This structure will comprise a fixed charge component and lower marginal rating factors, in the calculation of land tax. Table 16 illustrates the impact of this reform on the land tax payed by investment property owners.

While increases in land taxes are an efficient method of raising revenue, as land is immobile, the size of the tax increases should be considered in light of:

- the increase in fees and taxes associated with investment owners' principle place of residence
- the relative increase in land tax compared to other jurisdictions.

16 Change in land tax by average unimproved value

Average unimproved value (AUV)	2013-4	2014-15
	$	$
50 000	300	1 106
150 000	350	1 568
250 000	445	2 178
350 000	900	3 257

Source: ACT Budget 2014-15

Fire and Emergency Services Levy (FESL)

A FESL is charged on all rateable properties in the ACT. Revenue from the levy provides funding to offset the cost of providing fire and emergency services in the Territory.

The FESLwill increase on average by $10 for residential and rural properties and by $1 030 for commercial properties in 2014-15. This translates to an increase of 8.33 per cent for residential and rural properties and a 35.0 per cent increase for commercial properties. In addition, the 2014-15 Budget will introduce progressivity into the calculation of FESL for commercial properties.

These changes are expected to increase FESL revenue from existing properties by 21.6 per cent in 2014-15.

Payroll harmonisation

The ACT is the only jurisdiction where a genuine employer exemption[7] exists in the calculation of payroll tax for employer agents. Under the current legislation, the criteria for establishing a genuine employer for this purpose are not clear, which has made the tax legislation complex and difficult to interpret.

The Payroll Tax Act 2011 will be amended to remove the genuine employer exemption to bring the ACT more in line with other jurisdictions.

The benefits from removing this exemption are partly offset by the threshold of $1.75 million per annum being increased to $1.85 million per annum as part of the Government's revenue initiatives in this Budget.

Parking revenue

Parking revenue from fees and fines is expected to increase by 30.8 per cent, equivalent to an estimate of $7.1 million, in 2014-15 and by a further 8 per cent in 2015-16. The particularly sharp increase in expected parking revenue in 2014-15 reflects expectations of a 30 per cent increase in parking fee revenue and a 32 per cent increase in parking fine revenue (see chart 17). While a number of parking-related initiatives have been announced in this Budget, all the assumptions underpinning these strong revenue projections have not been made clear. This section reviews the explanations provided in the Budget and other factors that may influence parking revenue in 2014-15.

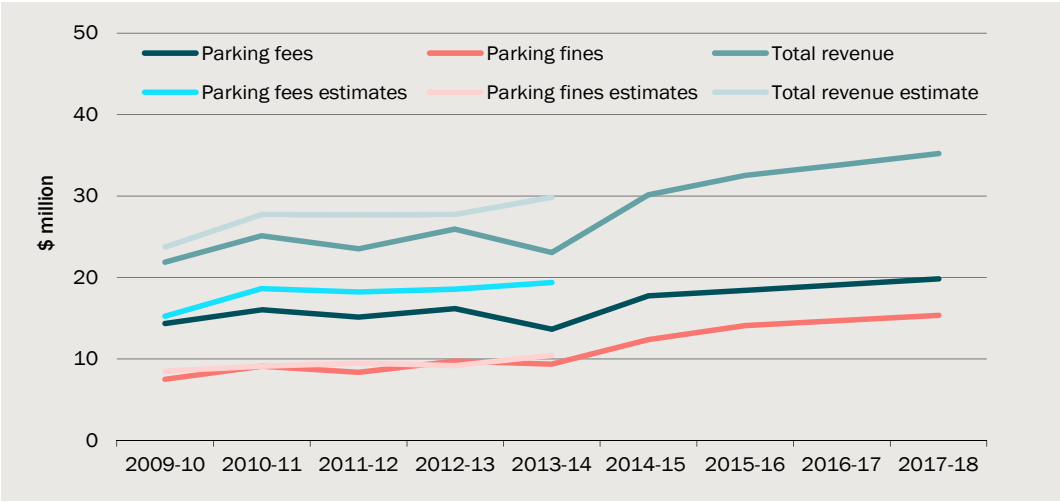
Parking fee revenue

The 2014-15 Budget states that:

> In 2014-15, parking fee revenue is expected to increase to $17.8 million [from $13.8 million], due to increases in parking fees on 1 July 2014.

[7] Relates to contractors employed through recruitment agencies.

17 Recent developments in parking revenue



Data source: ACT Budget 2014-15

While parking fee increases have been announced, these seem unlikely to be the key driver of the projected increase in parking fee revenue. An expected rebound in parking fee revenue following a sharp decline in 2013-14 may be a more important factor (see chart 4.6). However, the rationale for this rebound in parking revenue was not provided.

Parking fee revenue projections may have also been affected by Government announcements to:

- introduce paid parking in the Parliamentary Triangle
- replace 994 on-street single bay parking meters with 150 new solar powered machines that are equipped to take credit cards.
  - This investment may help to increase parking fee revenue given that the 2013 ACT Auditor-General's Report into ACT Government Parking Operations found that:

    The Audit Office conservatively estimates there has been approximately $3 million lost in revenue due to faulty machines in the three years to 2011-12, noting this estimate does not include leakage due to inoperable parking meters. This leakage may be reduced if the smart parking technology, which the ACT Government is currently considering is implemented.

Lastly, it should be noted that budget estimates have systematically over-estimated parking fee revenue by an average of 15 per cent over the past three years (see chart 4.6), suggesting that actual revenue may come in below expectations.

Parking fines

The 2014-15 Budget states that:

> Parking fine revenue is expected to increase from $9.4 million in 2013-14 to $12.4 million mainly due to new initiatives and indexation.

The new initiatives and indexation relate to:

- traffic and parking fines indexed at 6 per cent in 2014-15 and over each year of the forward estimates
- eight additional parking inspectors and two office support staff.

The addition of new inspectors is expected to increase revenue by $1.6 million in 2014-15 which represents just over half of the expected increase in revenue. In addition to this increase in revenue and the result of the new indexation, there appears to be additional drivers of the increase in revenue that are not identified in the budget papers. One of these may be the introduction of paid parking in the Parliamentary Triangle.

General rates and lease variation charge

While not technically revenue initiatives in the 2014-15 Budget, changes to general rates and the lease variation charge (which was part of the Government's construction sector stimulus program) are also expected to have a significant impact on revenue.

On 6 March 2014, the Government announced a package of initiatives designed to provide confidence and economic stimulus for the ACT building and construction industry. The initiatives include the release of four civil contracts for estate works in Moncrieff, reforms to the lease variation charge (LVC), reforms to extension of time (EOT) commence and complete development fees, and measures to facilitate major projects across the ACT.

The changes to the LVC included:

- all codified LVC fee and remissions schedules being frozen at the current rate and remission level for the next 2 years
- for non-codified variations, the remission rate will be increased from 25 per cent to 50 per cent for the next 2 years
- a further 25 per cent remission is available for developers who incorporate high standards of sustainable design and adaptable housing into their projects.

In 2014-15, revenue for the LVC is forecast to remain stable at $14.6 million, as the impact of the changes to the LVC outlined above are expected to be offset by an increase in activity.

On average, general rates on existing residential and commercial properties will increase by around 10 per cent in 2014-15, which is expected to help boost revenue overall by 12.6 per cent (this will include increased revenue from new properties).

An assessment of tax initiatives

Tax changes are generally assessed against four criteria:

- equity — are they fair?
- efficiency — do they distort economic activity?
- stability — is the revenue stable over time?
- administrative costs — it is costly to administer and collect?

The revenue initiatives in the 2014-15 Budget are generally efficient and contribute to greater stability in the sense that they do not focus on transactions or insurance. In addition, a number of the initiatives including payroll harmonisation are broadly in line with the recommendations of the 2012 Quinlan Review (see the box 18 below).

18 Key recommendations from the Quinlan Review

With regards to long-term structural reform, over a period of time that is adequate for appropriate transition:

- abolish duty on conveyances and retain a form of tax on payroll to maintain a diversified tax system
- abolish duty on general insurance and life insurance
- adopt a broad-based land tax as a base for revenue replacement.

- Duty on motor vehicle transfers should be continued. A road user charge system would be best progressed through a national agreement between all the States and Territories.
- Pursue the introduction of parking fees in the Parliamentary Triangle.
- Abolish conveyance duty. In doing so:
  - pursue at least a 10 year, and up to a 20 year, transition plan to ameliorate the impact of the change on households
  - have due regard for conveyance duty paid in the years leading up to the change
  - recognise the significance of the change and consult with the community on the
  - transition plan.
- Address the impacts on low income households from the substitution of the tax through the concessions system, with a possible expansion of the current rebate scheme.
- Expand the Home Buyer Concession Scheme by progressively reducing the Continue a Pensioner Duty Concession Scheme over the transition period, and adjust the property value thresholds to support ageing in place and access to housing choices within an area.
- Extend the eligibility criteria for the duty deferral scheme and provide an option to amortise duty over a period of ten years.
- Support ageing in place through expanding the duty deferral scheme and deferral of rates, with outstanding tax liabilities recovered at the time of sale.
- Work towards national harmonisation of the payroll tax system.
- Over time, abolish residential land tax in its current form.
- Transfer the commercial component of land tax to general rates on commercial properties.
- Abolish duty charged on general insurance and life insurance premiums, with the general rates as the revenue replacement source.
- Retain the Ambulance Levy, however, review its administration.

Consider increasing gambling machine taxes, having regard to the impacts of the prospective reform at the national level, and the contribution clubs make to the community.

The revenue projections associated with parking fines and payroll harmonisation are ley sources of uncertainty given the nature of the reform and the assumption that need to be made in order to quantify their impact.

Provisions for asset sales

The 2014-15 Budget includes a provision for future revenue based on the sale of assets as part of the Commonwealth's Asset Recycling Initiative.

The initiative aims to encourage the sale of existing assets to create capacity on the Territory's balance sheet to invest in productive infrastructure. Under the agreement, the Commonwealth will provide a financial incentive of 15 per cent of the amount of proceeds from asset sales that are invested into productive infrastructure.

Proceeds from asset sales (including gains from land rezoning) are treated as capital distributions and only profits from development and marketing activities are recognised as dividend revenue. The ACT Government will enter negotiations with the Commonwealth Government in 2014-15 to pursue opportunities to participate in the Asset Recycling initiative and has made provision in this Budget for revenue from potential asset sales over the forward estimates period.

While the revenue expected to be generated from the initiative was not separately identified in the Budget, it appears that the Government has made a provision for close to $20 million (see table 19).

19 Provisional income from asset recycling initiative (ARI)

	2014-15	2015-16	2016-17	2017-18
	$'000	$'000	$'000	$'000
Investment in roads – inc. ARI	1 405	13 114	2 187	1 117
Roads to recovery – inc. ARI	5 600	11 200	5 600	5 600
Black Spots Project – inc. ARI	966	2 577	2 576	966

Source: ACT Budget 2014-15

Revenue projections

The previous section examined the key drivers of the downward revision to revenue projections from the 2013-14 Budget. In this section, we examine the drivers of the revenue projections in the current Budget over the forward estimates period.

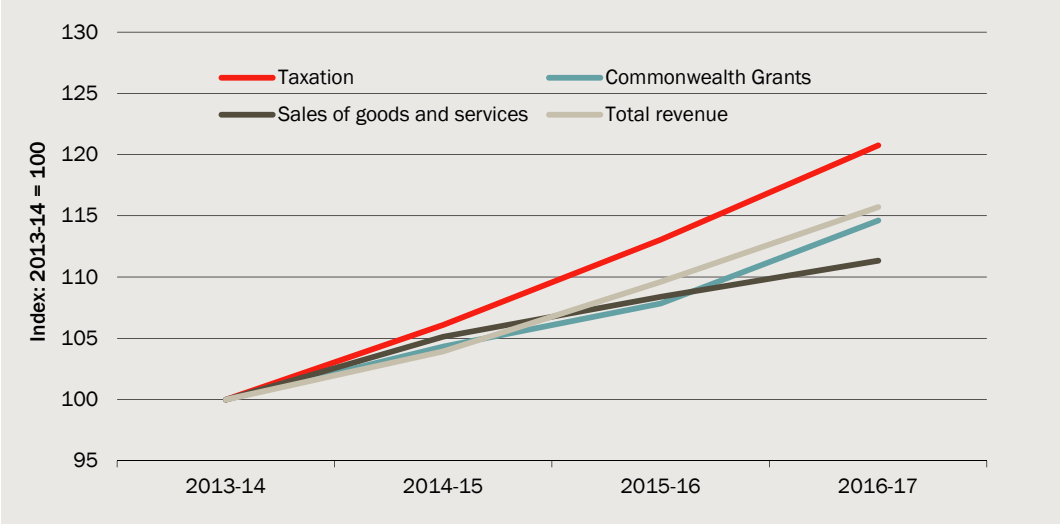
Chart 20 illustrates that taxation revenue is expected to record relatively strong growth compared to other revenue components over the following 4 years. This is principally due to:

- the general tax reform program outlined above
- the need to find substitute tax sources to Commonwealth grants, and

- a number of the revenue sources being indexed over time and less sensitive to changes in economic activity e.g. motor vehicle registration.

Revenue from commonwealth grants and sales for goods and services is expected to record relatively modest over the following 4 years. This is principally due to reductions in health funding guaranteed by the previous government.

20 Growth in key revenue components



Data source: ACT Budget 2014-15

Risks to the future revenue projections

As outlined earlier, there are a number of risks to future revenue projections. Overall, the risks are judged to be broadly balanced.

Land Release Program

The uncertainty created by the Commonwealth Government's continued fiscal consolidation creates risk around the capacity of the market to purchase all sites released at the prices currently forecast in the 2014-15 Budget. Lower than expected demand or revenue would negatively impact the Land Development Agency's dividend and the Government's net operating balance. Other risks to the program include achieving statutory clearances and capacity of industry to deliver infrastructure and estate works.

Asset recycling initiative

The 2014-15 Budget contains a provision for involvement in the new Asset Recycling NPA. As this NPA involves a capped funding pool to be allocated to States and Territories on a first-come, first-served basis, there are risks to the ACT's potential to participate in the initiative from delays in bringing forward asset sale proposals.

Regulated prices of water and sewage

There is still some degree of uncertainty around the future regulated prices of water and sewage following the auditor-general's review into the pricing decision. If an appeal is successful, and prices are moved more in line with prior expectations, this could significantly increase revenue and more specifically the projected dividend payments from ACTEW.

Future tax reform

In the 2014-15 Federal Budget the Commonwealth has made significant unilateral changes to the NSPPs for Health and Education. The Commonwealth's approach has undermined the stability and certainty of the Specific Purpose Payments which had previously been assured by the IGA FFR, significantly raising the level of risk to State and Territory Budgets.

The decisions to cap SPP funding in Health and Education, and to apply indexation based on the CPI and population growth, create a major risk that Commonwealth SPP payments will not keep pace with future increases in cost and demand. As a result, there will be greater pressure on future ACT Budgets to implement measures to control costs and to manage demand for these services.

Expenditure

The 2014-15 Budget includes substantial new expenditure on health and expenses related to capital works, with large expenditure on the Secure Mental Health Unit and the Alexander Maconochie Centre. Spending has increased significantly since the 2013-14 Budget with $347 million in total expense initiatives and $415 million in new capital expenditure initiatives.

While the Budget commentary links the need for large scale expenditure to the need to offset the Commonwealth cuts to the Australian Public Service, this is not necessarily a case for sizeable spending. Reductions in Commonwealth Government spending are likely to contribute to a softening in population growth, which would weaken demand for public services and capital works. The merits of spending need to be broader than the need to offset the impacts of Commonwealth Government cutbacks, and in the case of health infrastructure, this is more clearly the case.

Savings estimates are conservative, with only $96.3 million over four years, largely relating to expanded use of digital and online technology for service delivery and internal organisation. This is a decline on savings in the 2013-14 Budget.

The ACT Government Budget 2014-15 invests in significant new capital works and expenditure initiatives to bolster the ACT economy, which in 2014-15 is projected to be in a worse economic position than in 2013-14. New expense initiatives of $182.7 million (net of the health funding envelope) and $415.2 million in capital works spending is included in the Budget over the forward estimates period.

Overall, the profile of expenditure is stimulatory, with a focus on spending within the health directorate and the Justice and Community Safety Directorate.

A substantial amount of expenditure on the University of Canberra Public Hospital, Capital Metro and the Courts project has been provisioned ($1.3 billion), although no detail on total costs or cost rollout have been provided. While this information is deemed to be commercially sensitive, it makes it difficult to make an assessment about the merits of the investment, or the impact of such investments on the financial strength of the ACT Budget. At this stage, these expenditure works are only highlighted as a future cost risk.

In growth terms, expenditure is increasing at a compound annual growth rate (CAGR) of 3.4 per cent over the forward estimates period. This is a continuation of the rate of growth from the previous Budget (3.5 per cent) and is mainly due to growth in employee wages and, to a lesser degree, superannuation related expenses. Employee expenses account for approximately 35 per cent of total expenses in the 2014-15 Budget and superannuation expenses are about 7 per cent.

The path of expenditure is consistently positive, with expenses up 5.9 per cent in 2014-15, and continuing to increase over the forward estimates.

The estimated expenditure outcome for 2013-14 came in at $4,586 million, which was $8 million higher than expected this time last year. This is primarily a reflection of higher than expected employee and superannuation expenses (excluding superannuation interest costs, which are lower than expected for 2013-14).

A large proportion of new spending is for healthcare, which accounts for 49.9 per cent of new expense initiatives over the forward estimates period, and 28.2 per cent in 2014-15.[8] Most of this (51.2 per cent) is accounted for by Health Directorate expenditure (over the four years) for by the expansion of elective surgery procedures and the provision of additional beds at Canberra and Calvary Public Hospitals.

As would ordinarily be the case, the vast bulk of spending for new capital works announced in this Budget will be spent in the immediate period, with 91 per cent of funding for newly announced capital initiatives being spent over the first two years of the forward estimates period.

Expenditure projections

Total expenditure in the General Government Sector is estimated to increase by 5.9 per cent in 2014-15 to $4.858 billion — stronger than the previous years' growth of 3.5 per cent.

The forward estimates period also expects expenditure growth to ease, (0.7 per cent in 2015-16 and 3.6 per cent in 2015-17) before picking up more strongly in 2016-17 (4.3 per cent growth). The stagnation in expenditure in 2015-16 is largely because of the decreased Supplies and Services expenditure and smaller increases in the other expenditure items.

Employee expense and Almost half (47 per cent) of expenditure relates to employees' wages and superannuation and functionally 50 per cent will go to health and education (including vocational education), which is lower than in 2013-14.

A summary of the components of expenditure over the forward estimates period is set out in table 21.

Key Expenditure Drivers

Employee expenses (including superannuation payments) are a largely stable driver, and superannuation interest costs and expenses are another primary driver of the level of General Government Expenditure.

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8 Based on Health Directorate spending compared to total expense initiatives in Table 3.2.2 – Expense Initiatives, *ACT Budget Paper 3*, June 2014.

21 Summary of General Government Expenditure

2013–14 Budget $'000	Expenses	2013–14 Est. Outcome $'000	2014–15 Budget $'000	Var %	2015–16 Estimate $'000	2016–17 Estimate $'000	2017–18 Estimate $'000
1 583 362	Employee expenses (including employee superannuation)	1 633 843	1 688 492	3	1 741 733	1 818 072	1 883 912
313 777	Superannuation Interest cost	299 563	334 958	12	351 456	367 587	383 253
242 113	Other Superannuation expenses	306 225	259 202	-15	262 650	271 674	273 981
338 863	Depreciation and Amortisation	332 897	359 889	8	374 056	385 579	390 350
149 775	Interest expense	148 259	168 474	14	193 892	206 825	215 651
919 472	Supplies and services	860 498	980 443	14	934 003	945 033	988 120
199 788	Other operating expenses	173 096	197 813	14	200 454	207 515	216 087
830 726	Grants expenses	831 809	869 077	4	836 420	868 435	891 026
4 577 876	**Total expenses**		**4 858 348**	**6**	**4 894 664**	**5 070 720**	**5 242 380**

Source: ACT Government Budget 2013-14: Budget Paper 3.

- ***Employee expenses.*** Revised wage parameters from the 2013/14 Budget have led to an upwards revision of $50.5 million for the employee expenses component of General Government Expenditure (GGE). Employee expenses are forecast to increase by $54.5 million (3.3 per cent) due to the effect of indexation on employee expenses and growth in health related expenses. Employee expenses are a stable component of GGE and are forecast to increase consistently. Given they are the largest component of GGE this is the main driver of future increases in total GGE.
- ***Superannuation interest costs and expenses***. Superannuation interest costs and expenses should be considered together because they represent defined benefit liabilities and other superannuation arrangements and are driven by the same factors. The increase of the 2013-14 estimated outcome of $49.9 million is due to the lower than estimated discount rate of 4.3 per cent (compared to the long-run average used in Budget forecasts of 6 per cent). Hence, while other superannuation expenses increased significantly between the 2013-14 Budget estimates and the estimated outcome for 2013-14 from the 2014-15 Budget, this is not necessarily reason to believe that the forecasts of superannuation expenses are understated. It is reasonable to use the long-run average discount rate. In general, the trend of increasing total superannuation expenses is a driver of GGE.
- ***Depreciation and amortisation***. Depreciation and amortisation costs largely reflect the timing (and delays) of major infrastructure projects. While depreciation and amortisation costs are marginally lower than the estimated cost in last year's Budget, they are forecasted to rise gradually in future years, reflecting the completion of capital projects.

- ***Interest expenses***. The timing profile of required borrowings has led to lower borrowing interest costs and therefore a downwards revision in the estimated interest expenses of $1.5 million. A forecasted increase of $20.2 million in 2014-15 is due to higher levels of borrowings.
- ***Supplies and services***. Expenditure on supplies and services (such as pharmaceuticals, repairs and maintenance, consultants and contractors expenses and payments for ACT Policing) have been substantially lower than expected in the 2013-14 year $59 million lower than expected). However, the implementation of new initiatives in the current Budget will push these costs up in 2014-15 when they are forecast to rise by $119.9 million or 13.9 per cent. These costs have a substantial impact on total expenditure costs, forecast to account for 20.2 per cent of total expenses in 2014-15. This means that even small proportional revisions will have a relatively large impact on the expenses line. There is significant variation in Supplies and Services expenditure however there is no substantial increase over the forward estimates predicted, with the expenditure item falling $46 million in 2015-16.
- ***Grants expenses.*** Grant expenses are sizeable, accounting for 18.1 per cent of total expenses in 2013-14 (with little change from the 2013-14 Budget forecasts to the 2014-15 Budget estimate). The anticipated growth in the health funding envelope and reprofiling of education related grants account for the forecast increase in grants expenses of $37.3 million. Given the current and expected softening in underlying economic activity in the ACT, the increase in grant expenses (assuming they are prudent) is likely to be an appropriate stimulus to economic growth in the ACT.

Overview of major areas of substantial new spending

The 2014-15 Budget is a Budget of significant spending and capital works investment. It contains $347 million of net new spending initiatives, offset against a conservative savings level of $93.6 million (discussed further below).

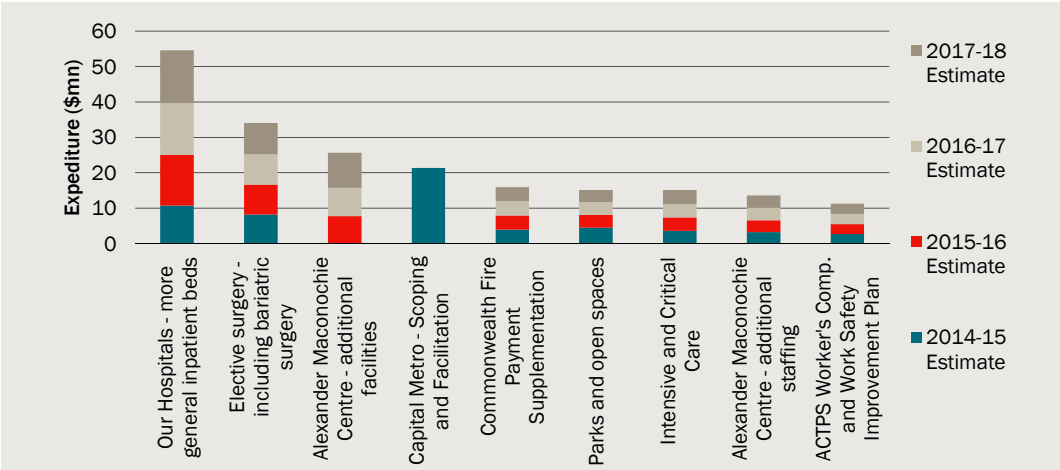
The vast majority of new expense initiatives are concentrated within the following three directorates:

- Health Directorate — $173 million
- Justice and Community Safety Directorate — $86 million
- Territory and Municipal Services Directorate — $59 million.

Combined spending in these Directorates accounts for 78.5 per cent of total expense initiatives (before savings of $59 million) over the forward estimates.

Chart 22 provides an overview of the largest expenditure based policy announcements, ranked in order of total expenditure over the forward estimates.

22 Largest expense initiatives



Data source: ACT Government (2014) Budget Paper 3, 2014-15, Table 3.2.2

Big spending for health care

The 2014-15 Budget across the forward estimates period is a big spending Budget for health care.

Health care (through the Health Funding Envelope) accounts for 38.6 per cent of expenditure over the forward estimates period and 28.3 per cent in 2014-15.[9]

The ACT Government's healthcare Budget targets a number of areas of improved service delivery and facilities. Over the forward estimates, expenditure targets:

- an expansion in general in-patient beds
- improved access to elective surgery (including bariatric surgery), expanding services for intensive and critical care, and
- expansion in emergency medicine facilities and frontline medical services.

The major capital initiatives being proposed to support these expenditures include upgrades to Calvary Public Hospital, continuation of the Health Infrastructure Program (HIP), redevelopment of The Canberra Hospital, and the construction of a secure mental health unit. Additionally provision has been made in the Budget for the University of Canberra Public Hospital, which as commercially sensitive project does not have specific cost details.

Table 23 provides a summary of the key healthcare policy initiatives by new expenditure initiatives and capital works requirements.

Expenditure on additional general inpatient beds (16 at Canberra Hospital, 15 at Calvary Public Hospital, and the equivalent of 6 beds through the hospital in the home program) will account for $54.6 million in spending, which is 31.6 per cent of Health Directorate spending over the forward estimates.

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[9] The Health Funding Envelop is funded through ACT Government revenue, the major sources of which are Commonwealth Government grants (mainly GST) and Own Source Revenues. Its purpose is to fund indexation and growth funding for the Health Directorate.

23 Major Health Directorate expenditure and capital works items

Expenditure initiative		Capital works	
Total Health Directorate expenditure	**$44m 2014-15 $173m forward estimates**	**Total Health Directorate capital works**	**$37.5m 2014-15 $71.7m forward estimates**
General inpatient beds and hospital in the home	$10.8m in 2014-15 $54.6m forward estimates	Secure mental health unit	$3.8m in 2014-15 $30.6m in 2015-16 $43.5m forward estimates
Access to elective surgery	$8.3m in 2014-15 $34.1m forward estimates	Health Infrastructure Program – program management continuation	$13.2m in 2014-15 $27.7m forward estimates
Intensive and critical care services expansion	$3.7m 2014-15 $15.1m forward estimates	The Canberra Hospital Redevelopment	$3.1m in 2014-15 $13.0m in 2015-16 $21.2 forward estimates
Belconnen Health Centre and Walk-in Centre	$2.3m 2014-15 $9.4m forward estimates	Calvary Public Hospital – car park and refurbishments for more beds	$16.8m in 2014-15 $18.5m forward estimates

Source: ACT Government (2013) Budget Paper 3, 2013-14, Table 5.2.2 and Table 6.4.3

Large health infrastructure projects, like any large projects, can pose some Budgetary risk to the Budget, often impacting on the timing of large capital spending initiatives.

The health infrastructure commitments are notoriously susceptible to delays because of their complexity and sequencing needs to ensure that patient outcomes are not impacted by the work program.

Non-specific provisions have been made for construction of the Capital Metro

The Budget provides $1.3 billion for the future capital works of the University of Canberra Public Hospital, Capital Metro and the Courts Project. The Budget does not estimate the cost of the Capital Metro individually given it is a commercially sensitive and high value project. ACT Government publications do not formally estimate the cost of the Capital Metro. but costs are expected to be approximately $620 million over 3 years.[10]

A total of $21.3 million has been allocated for 2014-15 towards the development of Capital Metro including preparing the project to an investment ready stage and commencing the procurement and delivery of the light rail service and its operation.

An additional $20 million is provided for the improvement of the Gungahlin to Civic corridor to prepare for the light rail. This includes $8 million in 2014-15 and $12 million in 2015/16 as part of the Territory and Municipal Services Directorate.

The Gungahlin to City corridor has a rapidly growing population, with an average growth in the Gungahlin district of 7.4 per cent per annum between 2003-2013.[11]

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10 http://www.canberratimes.com.au/comment/act-light-rail-commitment-will-pay-major-dividends-20140605-zryif.html

11 Australian Bureau of Statistics 2013, *Regional Population Growth, Australia*, cat. No. 3218.0, ABS, Canberra.

Promoting population density in Canberra can have significant social benefits in reducing social exclusion created by distance to City, and preventing service access issues.

However, given expected cuts to the Australian Public Service by the Commonwealth Government, we expect population growth to soften further for the ACT. Australian Public Service (APS) jobs in the ACT are at historically elevated levels, and a decrease in public service jobs is not necessarily a temporary shift. Increased migration outflows from the ACT due to declining APS would not support the case for the construction of the Capital Metro.

The construction of the Capital Metro, in part, would reflect and assumption that the trends in population are temporary, and this is not evident. While population growth in Gungahlin may be relatively high, overall ACT population growth is soft, and thus the justification for the construction of the Capital Metro may rely on uncertain grounds.

The Capital Metro has not been placed on the Infrastructure Australia "National Priority List", it may not present good value for money. The Capital Metro is not included in even the "Early Stage" national priorities, which requires those intiatives to "address a nationally significant issue or problem".[12]

The funding of the Capital Metro has not been made clear, however press reports[13] have emerged suggesting funding may be through a levy on home-owners living within a certain distance of the metro line. While it is prudent that the cost of the metro be borne more by those who obtain a private benefit from it (i.e. those who own property which would appreciate in value due to the construction of the Metro), this presents a risk and source of uncertainty given that the funding arrangement has not yet been detailed.

Housing demand has weakened in Canberra and outlook for the ACT real estate market is for more moderate conditions[14], which adds to the uncertainty for homeowners created by the lack of detail on funding arrangments.

The delivery of transport infrastructure projects is often subject to potentially large risks that may jeopardise delivery and acceptability of these projects, which can add substantially to project costs. Many problems and cost over-runs of major infrastructure projects have been shown to be due in large part to under developed Terms of Reference, inadequate understanding of community expectations and anticipated usage, as well as uncertain or ineffective risk sharing arrangements across governments, head contractors and subcontractors. This makes it difficult to anticipate total costs of a project such as this and any consequent impact for the underlying Budget position.

However, concerns are being expressed in the media[15] about a tendency for costs of light rail programs to exceed expectations. In particular, the ACT government has expressed

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12 https://www.nics.gov.au/Home/PriorityProjects

13 http://www.canberratimes.com.au/act-news/act-government-considers-levy-and-special-rating-zone-to-pay-for-capital-metro-light-rail-20140509-zr7xl.html

14 http://canberratimes.domain.com.au/real-estate-news/property-prices-head-south-20140602-39d2z.html

15 http://www.canberratimes.com.au/act-news/trams-make-a-comeback-around-australia-20140607-zrzxr.html

the difficulty in estimating the cost of the Capital Metro[16]. The cost of the Capital Metro is subject to a high degree of uncertainty and is a source of risk for the fiscal position of the ACT.

Expenditure on the Capital Metro, as a very large item of capital works spending, would be expected to have some effect in stimulating private sector activity, through stimulating aggregate demand. This effect would be dependent on the project being 'shovel-ready' in order to have effect now. Therefore, if there are significant delays to the project, it will not have the stimulatory effect immediately, and therefore will not be effective in closing an output gap (gap between actual and potential output) in the short-term.

Justice and Community Safety Directorate is a significant component of total new expense initiatives

A combined total of $42 million over the forward estimates is provided for improvements and additional staff at the Alexander Maconochie Centre (not including capital works expenditure). This is almost half of total expenditure within the Justice and Community Safety Directorate. The additional funding is associated with an increase in costs due to an increase in average detainee numbers.

Another significant element of the Justice and Community Safety Directorate is funding to employ additional parking inspectors, which is expected to generate $10.4 million in additional revenue over the forward estimates.

The Commonwealth Fire Payment Supplementation is $4 million of funding for each of the four years estimated in the Budget. This is to offset a reduction in government expenditure on fire brigade services. The increase in the false alarm and commercial building development control fees allow for additional revenue to be collcted by the Emergency Services Agency protect services against the decrease in Commonwealth funding.

Community Service Obligations

The2014-15 Budget makes allowance for Community Service Obligations (CSOs) to allow Public Trading Enterprises, or Public Non-Financial Corporations to carry out activities with identified public benefit objectives, which it would not elect to do on a commercial basis.

In 2014-15, the ACT Government has identified $129 million of CSOs for the financial year, equivalent to $338.15 per ACT resident. This is an increase from the $117 million of funding in the 2013/14 Budget ($313.74 per resident). These are drawn from the activities of ACTEW, ACTION, Yarralumla nursery, ACT forests, Exhibition Park Corporation and the Public trustee.

Comparisons across States and territories of CSOs are not always straightforward. As identified by the Productivity Commission in 2008, 'The clarity of CSO payment

16 http://www.capitalmetro.act.gov.au/news-and-publications/frequently-asked-questions

information in State and Territory Budget papers varies considerably'.[17] Some States such as Victoria do not publish details of public non-financial corporations separately within the Budget, and other States such as New South Wales, while discussing the operations of Public Trading Enterprises, do not specifically mention CSOs.

Both Queensland and the Northern Territory publish clearly identifiable statements for CSO payments across their financial year Budgets. In 2014-15, Queensland has identified a total of $2.219 billion of CSOs[18], equivalent to $474.51 per person. This is down from $2.278 billion for 2013-14. The Northern Territory has identified a total of $100 million, equivalent to $413.93 per person.[19]

Both the Queensland and Northern Territory Budget allocations are slightly higher than the ACT Government identified CSO per person for 2014-15.

Savings measures

The savings measures in the 2013-14 Budget are moderate — totalling $93.6 million over four years, mostly (80.6 per cent) achieved in the last two years of the forward estimates period.

However, saving expectations are more conservative and less ambitious than they were in last years' Budget, particularly in the outer years of the forward estimates period.

- **2013-14** Budget savings are estimated at **$0.06 million** compared to $29.6 million expected in last years' Budget;
- **2014-15** Budget savings are estimated at **$18 million** compared to $41.0 million expected in last years' Budget;
- **2015-16** Budget savings are estimated at **$31.0 million** compared to $50.2 million expected in last years' Budget;
- **2016-17** Budget savings are estimated at **$44.4 million**.

There is no guidance on where savings are expected on an agency-by-agency basis, with savings affecting the whole of government. Savings include administrative efficiency savings and various ICT initiatives, which require initial expenditure to lead to savings.

Table 24 sets out the only information available on where savings are expected to be made.

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17 Productivity Commission (2008) Financial Performance of Government Trading Enterprises 2004-05 to 2006-07. Productivity Commission Research Paper, p47.

18 Includes Transport Service Contracts (TSCs), which were previously reported as Community Service Obligations.

19 Queensland Government (2013) Budget Strategy and Outlook 2013-14, page 134 and Northern Territory Government (2013) The Budget 2013-14, Budget Paper No. 3 p 332

24 2014-15 Budget savings initiatives

	2014–15 Budget $'000	2015–16 Estimate $'000	2016–17 Estimate $'000	2017–18 Estimate $'000	Total $'000
Administrative Efficiencies	60	10 560	13 060	13 460	**37 140**
Digital Dividend Investment Strategy and Transformational Service Delivery	0	5 000	10 000	15 000	**30 000**
iConnect	0	500	4 020	10 109	**14 629**
Other ICT initiatives	0	1 996	3 996	5 836	**11 828**
Total 2014-15 Budget Savings	**60**	**18 056**	**31 076**	**44 405**	**93 597**

Source: ACT Government Budget 2013-14, Budget Paper 3.

- Administrative efficiencies are expected to account for 39.7 per cent of total savings over the forward estimates. They require $3.1 million in expenditure over the forward estimates in order to deliver total savings of $34 million.[20] While they intend to reduce overlap across government entities, the total Full Time Equivalent staffing level for the ACT Public Service will remain above 2013/14 levels. To implement these savings the Government will undertake a review of existing directorate structures to identify duplication and inefficiencies.
- 32.1 per cent of savings are expected from the Digital Dividend Investment Strategy and Transformational Service Delivery. This focusses on expanding digital service delivery (which is substantially lower in cost that physical service delivery) where appropriate. Seed funding will allow the development of projects with greater use of digital/online technology. These savings require $5 million in expenditure to be implemented.
- iConnect will deliver $9.7 million in net savings across agencies, but this does not include capital expenditure. The program provides a secure online portal to provide access to government services and facilitate payment transactions. The gross savings from the project are 15.6 per cent of total gross savings. iConnect requires expenditure in order to deliver savings, and has a negative net impact on the fiscal position (discussed below in 'ICT, plant and equipment expenditure'). Spending on capital will provide benefits (savings associated with iConnect rather than existing methods of service delivery) beyond the forward estimates period, and thus eventual benefits are likely to exceed costs.
- Other ICT initiatives (related to hybrid cloud computing and desktop computer and printer energy management initiatives) comprise the remaining 12.6 per cent of total gross savings.

20 This is based on the difference between gross savings (ACT Budget (2014) Paper 3, Table 4.2.1) and the net impact on expenses in ACT Budget (2014) Paper 3, Table 3.2.2.

Capital works program

Capital expenditure is significantly higher in 2014-15 than previous years, with significant provisions for the Health, and Justice and Community Safety Directorates.

Capital works spending much be justified on the merits of the infrastructure provided, rather than merely the employment generated by the program. Capital works spending is only suitable stimulatory spending if the employment generated by the program is aligned to sectors where there is excess capacity, with benefits of spending potentially leaking to the states.

Expenditure has been committed for high value and commercially sensitive projects, including the Capital Metro, however little detail has been provided on these provisions. While the trend of declining capital works expenditure has been reversed for 2014-15, expenditure per capita continues to decline over the forward estimates period.

Expenditure on new capital initiatives in the Budget is $415.2 million over the forward estimates, and for those capital works that are not detailed in the Budget, the government has provided $1.319 billion over four years. The value of projects in progress from previous years is $716.2 million over the forward estimates period. Table 25 gives a summary of the infrastructure program in the 2014-15 Budget.

25 Summary of the 2013-14 Budget Infrastructure Program

	2014-15	2015-16	2016-17	2017-18	Total Investment
	$'000	$'000	$'000	$'000	$'000
Capital works initiatives	126 569	165 771	23942	847	**317 129**
ICT initiatives	32 475	30 827	9 329	2 858	**75 489**
Plant and equipment initiatives	22 280	0	0	0	**22 280**
Capital associated with expense initiatives	257	0	0	0	**257**
Total new infrastructure and capital initiatives	**181 581**	**196 598**	**33 271**	**3 705**	**414 155**
Associated expenses (new capital works)	8 341	12 659	8 905	1 727	**31 632**
Feasibility studies and grants (operating impact)	12 065	570	0	0	**12 635**
Expenses (depreciation)	546	7 645	15 178	20 564	**43 933**
Total operating impact	**20 952**	**20 874**	**24 083**	**22 291**	**88 200**

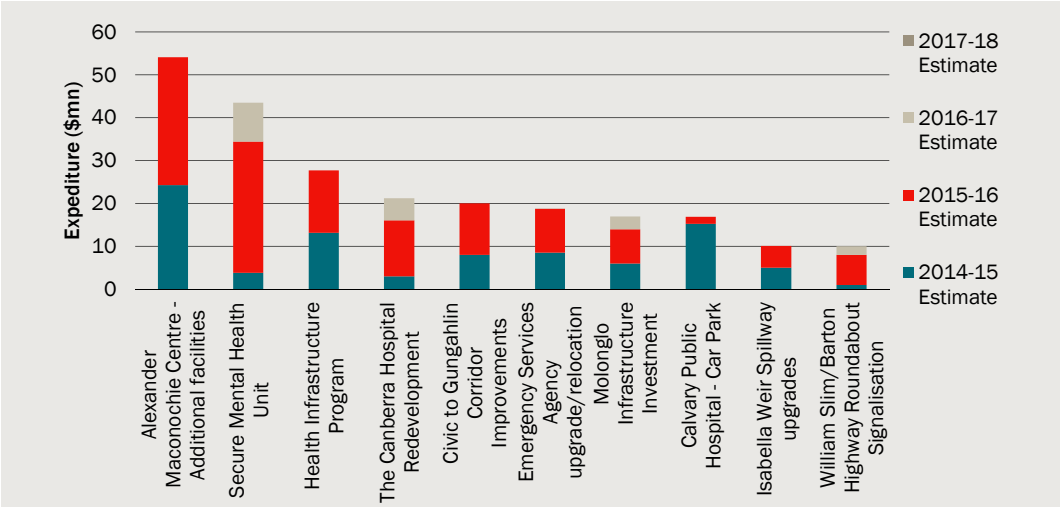
Source: ACT Government Budget Paper 3.

Expenditure on capital initiatives is highly focussed in the first two years of the four-year estimates period. This reflects that new capital initiatives are considered and announced in each Budget so that the vast bulk of commitments from the 2014-15 Budget are provisioned for in the more immediate period. Additionally, expenditure for which detailed annual expense estimates are not provided (including the University of Canberra Public Hospital, Capital Metro) is expected to fall over the later part of the forward estimates period, if not afterwards.

For example, the majority of the expenditure on the Capital Metro is not expected to be incurred in 2014-15, but rather over some subsequent years which have not been defined.

Chart 26 is an overview of the largest capital works initiatives in terms of total expenditure over the forward estimates. This does not include The University of Canberra Public Hospital, Capital Metro or the Courts projects.

26 Largest capital works initiatives

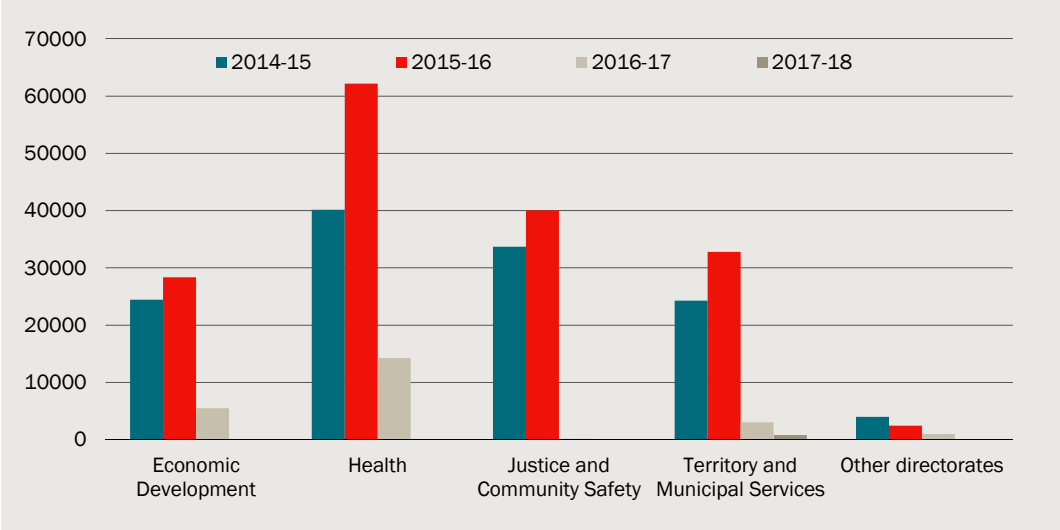


Data source: ACT Budget Paper 3, Table 3.3.2.

A breakdown of annual expenditure on new capital initiatives by directorate is presented in chart 27. This illustrates the concentration of spending in the first and, to a greater degree, second years of the Budget cycle. Additionally it identifies the major directorates in terms of expenditure for new capital initiatives.

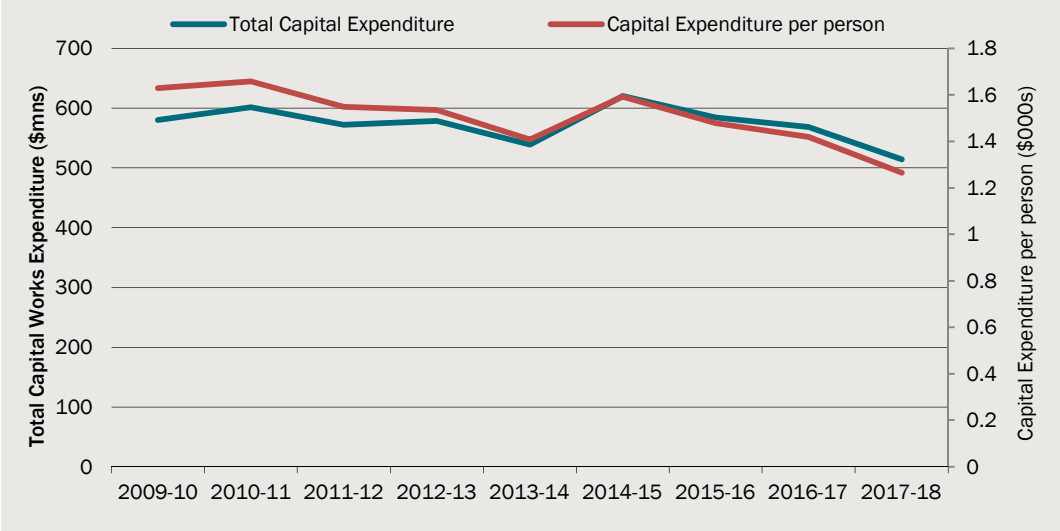
Capital spending is expected to increase the value of the Territory's total physical assets from $20.7 billion to $21 billion. Capital expenditure has decreased in the years preceding the 2014-15 Budget cycle and is estimated to continue to decrease in the years following 2014-15. Chart 28 shows expenditure on capital works (including existing projects) for the years 2009-10 to 2017-18. 2014-15 is a year of historically high capital works expenditure, however, in per capita terms, it is lower than the expenditure in 2009-10 and 2010-11.Whether the estimation of expenditure on capital works in those years includes an estimate of expenditure on new capital works initiatives not yet announced is unclear from Budget Paper number 3.

27 New capital initiatives by directorate



Data source: ACT Budget Paper No. 3, Table 3.3.2.

28 Total and per person expenditure on capital works



Note: Capital expenditure figures for 2015-16 onwards are estimates including provisions for commercially sensitive projects (e.g. Capital Metro, University of Canberra Public Hospital and the Courts project) and capital upgrades.

Data source: ACT Budget Paper No. 3, table 5.3.2.

High value and commercially sensitive projects

The 2014-15 Budget makes provisions of $1.3 billion for high value projects with Budgets that are not settled or projects that are commercially sensitive. This includes the following:

- the University of Canberra Public Hospital
- the new ACT Courts Facility
- Capital Metro.

Little information has been provided about these expenditure items, and that creates difficulty in assessing their value or impact on the fiscal position.

Expenditure in support of the land release program

A substantial amount of expenditure on capital works relates to capital investments in support of the objects of the Indicative Land Release Program. This includes expenditure on:

- Molonglo Infrastructure Investment ($17 million)
- Throsby — Access road and western intersection ($5.3 million)
- Isabella Weir Spillway Upgrade ($10.1 million)
- Majura Parkway to Majura Road — link road ($9.9 million)
- Dickson Intersections Upgrade ($3.4 million).

There are $56.4 million in projects funded in the 2013-14 Budget, which will continue to be delivered in 2014-15.

The Stimulus Package of civil works at Moncrieff (announced before and separately to the Budget) intends to support the construction industry. Support of the construction industry is prudent if there is a belief that the industry is in a cyclical trough, and thus requires temporary support to prevent attrition of skills and other consequences of the temporary decline of the industry.

The land release program has been written down by 3000 dwellings over the forward estimates period. Moderating the extent of the land release program is a prudent approach to declining demand resulting from cuts to the APS.

ICT, plant and equipment expenditure

In addition to the focus of savings being on Information and Communication Technology (ICT) adaptation and efficiencies, there is $75.5 million of expenditure on new ICT initiatives, concentrated mostly in the first two years of the four-year Budget cycle.

There are three main expenditure items relating to information and communication technology:

- iConnect: The building of a digital platform for ACT government service delivery will generate net savings for the government, however the capital expenditure associate with it is $15.9 million (21 per cent of total spending on new ICT initiatives). As mentioned above, the net impact of iConnect on the fiscal position (capital expenditure, depreciation and other expenses minus savings) is $7.9 million.
- Revenue collection transformation: Replacement of existing revenue collection systems will allow for more efficient tax collection however is at a cost of $30 million in capital expenditure (40.0 percent of total expenditure on new capital initiatives) and

is the largest new expenditure initiative for ICT. Most of this spending (66.5 per cent) is provided in 2015-16.

- Digital infrastructure for schools: Includes upgrades and ongoing maintenance to school ICT infrastructure, including more wireless access points in ACT public schools. The 2014-15 Budget provides $9.2 million on digital infrastructure for schools, all of which is in the 2014-15 financial year. This accounts for 12.2 per cent of total expenditure on new ICT initiatives.

Spending on new initiatives related to plant and equipment is $22.3 million in total in 2014-15, with no expenditure in the other years of the forward estimates. The fitout of the ACT Government Office Building in Gungahlin accounts for $17.3 million (77.7 per cent) of new plant and equipment expenditure. This spending will fund the design and installation of the fitout, with only associated expenses of $0.5 million in the 2015-16, 2016-17 and 2017-18 years combined.

Capital Works expenditure as stimulatory spending

Capital works spending should be justified on the merits of the infrastructure provided, rather than merely the employment generated by the program. Increased spending on capital works should seek to generate employment in sectors where there is a temporary shortfall in demand or employment.

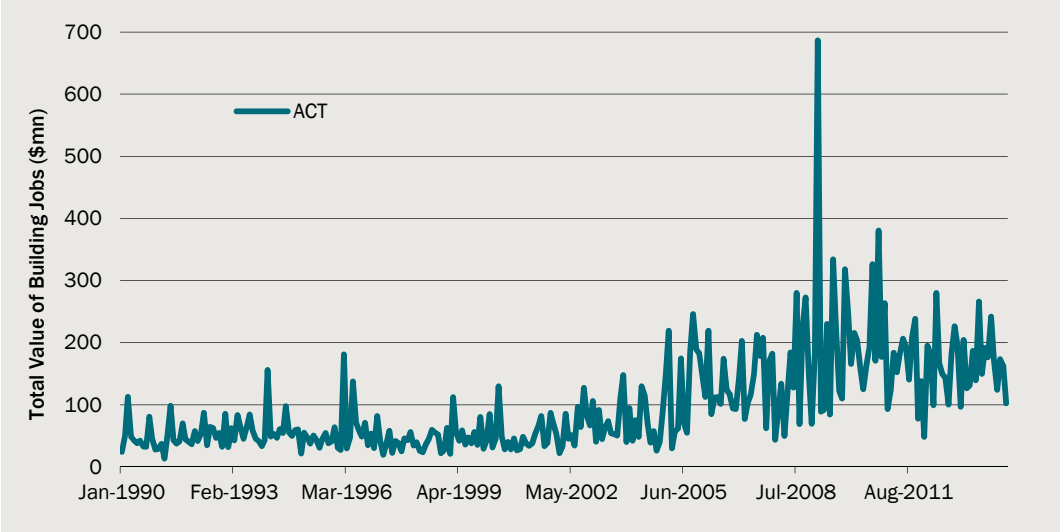
However, as discussed in the 'Economic Outlook' chapter of this report, the construction sector is not necessarily experiencing a temporary downturn. Dwelling investment has been at record high levels, and existing large capital works projects (such as the Ben Chifley building) are nearing completion. This indicates there may be decreased construction demand, but it does not necessarily indicate that this will be a temporary change.

Decreased levels of APS employment may lead to a permanent decrease to demand for capital works (and therefore construction) if they lead to an increase in net migration outflow.

Chart 29 shows the total value of building works to be completed in the ACT. It shows that while total value has fallen in recent years, this is falling from the levels around 2009 which substantially above long-term averages. The boom in the sector at that time may be due to expansionary monetary policy and expansionary Federal fiscal policy as reactions to the Global Financial Crisis.

Expansionary fiscal policy at the level of the ACT Government is not as effective at closing an output gap as Federal policy. This is because increased investment by the ACT government may have benefits that flow interstate. Employees for the construction of infrastructure in the ACT may be sourced from NSW or Victoria, and therefore the wages paid by the ACT government will partially be spent in those states rather than the ACT. This will reduce the effect of the fiscal expansionary policy in closing an output gap in the ACT, and thus weakens the argument that the ACT should have a strongly expansionary fiscal position.

29 Total Value of Building Jobs in ACT



Data source: Australian Bureau of Statistics Apr 2014, *Building Approvals, Australia*, cat. No. 8731.0, ABS, Canberra.

Impact of the Budget on cost of living

Slowing economic activity and a transition towards a more efficient tax system has led to a number of revenue initiatives over recent years including in the 2014-15 Budget. These tax initiatives as well as other changes to fees and concessions are likely to have a noticeable impact on ACT households and their cost of living over the forward estimates period. Overall, the impact on cost of living is likely to be moderate.

Findings from the 2014-15 cost of living statement

The cost of living statement in the 2014-15 Budget illustrates the impact of changes to taxes, fees and charges on five hypothetical households with differing characteristics and circumstances. While this approach does provide a sense of the various channels that households throughout the community can be affected by the Budget, it also makes it difficult to make generalised statements about how the cost of living of representative households in the ACT will change.

This section aims to make a general statement about how the cost of living for typical ACT households will change in 2014-15 by focusing on the net changes in taxes, concessions and fees that commonly affected the five hypothetical households featured in the cost of living statement.[21] The average net increase in expenses faced by these households in 2014-15 was $327 (see table 30).[22] The main drivers of this average cost increase were:

- 10 per cent increase in general rates in 2014-15 introduced in the 2012-13 Budget
- 8 per cent rise in fire and emergency services levy for residential households
- 7 per cent in utility costs for households who are not eligible for concessions[23]
- 6 per cent increase in motor vehicle registration in 2014-15.

Reductions in the duties on car and contents insurance helped to partly offset these additional cost of living expenses.

While a number of ACT households will receive benefits from the Government during 2014-15 that will help to offset these cost increases such as home buying concessions, a

[21] More specifically, we have accounted for savings from reduced duty on life, car, and contents insurance, rewards for safe driving program, and utility concessions. And increased expenses due to general rate increases, the FESL, motor vehicle registration, utility prices and parking. Household 3 and 5 in table 1.1 were made up of pensioners and low-income earners who had access to concessions.

[23] This figure is based on the households featured in the cost of living statement.

30 Change in the net cost of taxes, fees and concessions, 2014-15

	Household 1	Household 2	Household 3	Household 4	Household 5
	$	$	$	$	$
General property rates, fire and emergency services levy	-	105.1	103.8	152.7	-
Duty on life and content insurance	- 7.2	-34.7	-31.5	-34.7	-
Transport fees	86.7	124.9	34.6	249.4	51.3
Duty on car insurance	- 14.7	-14.7	-14.7	-14.7	-
Rewards for safe driving	- 6.7	-13.8	-	-13.4	-
Utility fees	270.8	274.6	16.0	366.9	3.6
Total	**328.9**	**441.4**	**108.2**	**706.2**	**54.9**

Source: ACT Budget 2014-15, Cost of living statement.

large proportion of non-pension homeowners are likely to see a noticeable increase in their cost of living during 2014-15.

How does the current methodology compare with other agencies?

The ACT Government is one of the few governments both domestically and internationally that regularly includes a cost of living statement in their Budget papers. Section 11(1)(f) of the Financial Management Act 1996 states that the Territory is required to provide a statement about the effect of Territory taxes and fees on households and the concessions that offset these. This is currently achieved through developing a number of case studies that show how households with different characteristics and circumstances are directly affected by changes in taxes, fees, and concessions (as distinct from being indirectly affected by taxes placed on payrolls for example). It is worth noting that it is not particularly clear what the selection process is to ensure that the households featured are in fact 'representative'.

Distributional analysis is one alternative approach to that currently adopted by the ACT Government and is part of the UK Government's Budget reporting practices. Distribution analysis differs from the use of household case studies in that it analyses the impact of changes to taxes, tax credits, and benefits on household income deciles. This allows for a more generalised assessment of the impact of Budgetary changes on households and the variation of the impact across households with different income levels and standards of living. One of the main benefits of this form of analysis is that it enables Budgetary changes to be analysed from a social equity point of view, which is primarily concerned with how income and opportunities are distributed across society.

Other research agencies have adopted this approach when analysing the social impacts of Budgets. For example, the National Centre for Social and Economic Modelling (NCSEM) completed distributional analysis on the 2014-15 Federal Budget (see table 31) which was the basis of the following finding:

> The results clearly demonstrate that low-income families with children are the main family group to be impacted by this Budget. The Budget impact is relatively moderate in 2014-15 but becomes more significant by 2017-18. High-income families and singles and couples without children are shown to be largely unaffected by this Budget in the short term or longer term.

31 Distribution analysis of 2014-15 Federal Budget

	Households	Change in mean disposable income	
	million	$	per cent
Income quintile 1	2.5	294	-1.3
Income quintile 2	2.4	621	-0.6
Income quintile 3	2.5	924	-0.7
Income quintile 4	2.5	1 345	-0.2
Income quintile 5	2.5	2 490	-0.3
Total	**12.2**	**1 134**	**-0.4**

Source: NATSEM Budget 2014-15 Analysis

A Triple bottom line analysis of key Budget initiatives

A.1 Triple bottom line analysis of key Budget initiatives

Budget Measure	Financial and economic impact		Environmental impact		Social impact	
Recurrent Initiatives						
Capital Metro Agency						
Capital Metro – scoping and facilitation	$21.3 million to prepare the development of the project Further unspecified expenditure as part of the $1.3billion total allocation on high value projects	●	Light rail has low emissions per person relative to road transport.	●	Promotes social equity and reduces social exclusion caused by distance to City.	●
Chief Minister and Treasury Directorate						
ACTPS Workers' Compensation and Work Safety Improvement Plan	$11.3 million on this Plan which will lower pressure on Workers' Compensation costs	●		●	Reduces costs of work injury to the individual	●
iConnect	$6.1 million net cost to build a digital platform for service delivery and payments.	●	Reduces requirements for physical locations (and thus resource use) and paper transactions.	●	Improves access for disabled ACT residents.	●
Commerce and Works Directorate						
ICT Transformation – Hybrid cloud computing	$8.4 million in net savings from hybrid cloud infrastructure platform to reduce data storage and management costs	●		●		●
Revenue collection transformation	$34 million in total expenditure on replacing the existing revenue collection systems providing for more efficient tax collection and reducing the risks of dated technology	●		●		●
Economic Development Directorate						
Isabella Weir Spillway - upgrades	$10.2 million to upgrade the spillway and dam embankment	●		●		●
Majura Parkway to Majura Road – Link road construction	$10.0 million to construct a link road allowing access to commercial land sites	●		●		●

Positive	●	No discernible impact	●	Negative	●

Budget Measure	Financial and economic impact		Environmental impact		Social impact	
Molonglo Infrastructure Investment	$17 million to construct a dual carriageway from John Gorton Drive into Molonglo	●		●		●
ACT Government Office Building – Gungahlin fitout	$17.8 million to provide a fitout for the new Government Office Building and ongoing maintenance	●		●		●
Education and Training Directorate						
Coombs P-6 School Construction funding	$47.3 million for the construction of the Coombs primary school in Molonglo (initiative was including in the 2013-14 Budget	●		●	Improved provision of primary level education	●
Sustaining Smart Schools – digital infrastructure for our schools	$9.2 million to upgrade and maintain school ICT infrastructure including wireless access points	●		●		●
Health Directorate						
Belconnen Community Health Centre and Walk-in Centre – more services, more staff	$9.4 million for additional health services and employment of health staff	●		●	Improved healthcare service delivery for Belconnen area	●
Calvary Public Hospital – car park	$19.1 million to develop a new car park to meet future increased demand for hospital services due to the expansion of the hospital.	●				
Canberra Region Cancer Centre – more services, more staff	$8.5 million for more services to meet increasing demand	●		●	Improved services for non-inpatients, which improves equality of access for less able patients	●
Centenary Hospital for Women and Children – expanding services	$8.8 million for extra beds in paediatric and maternity departments to meet increased demand	●		●	Better paediatric and maternal services	●
Elective Surgery – including bariatric surgery	$34 million for increased number of elective surgeries (improved waiting times)	●		●	Improved access to treatment for morbidly obese patients and improved waiting times for elective surgery	●
Health infrastructure program – project management continuation	$29.5 million for the redevelopment and expansion of hospital and community based health infrastructure to meet future demand	●				
Intensive and critical care – expanding services	$15.1 million to provide 3 additional ICU beds to meet increased demand	●		●	Improved critical care services	●

Positive	●	No discernible impact	●	Negative	●

Budget Measure	Financial and economic impact		Environmental impact		Social impact	
Our hospitals – more general inpatient beds	$54.6 million on more general inpatient beds to meet increased demand	●		●	More hospital in the home bed equivalents which improve access to hospital services for those less able to seek treatment in the hospital	●
Outpatient and imaging services – expanding services	$9.0 million increased volume of outpatient services	●		●	Increases services for patients less able to get to a hospital/clinic	●
Secure Mental Health Unit	$43.5 million for a new 25 bed Mental health unit	●			Accommodates patients with severe mental illness	●
The Canberra Hospital Redevelopment	$24.3 million to undertake refurbishments of Canberra hospital and provide additional beds	●			Ensures continuity of in-patient services while infrastructure redevelopments take place.	●
University of Canberra Public Hospital	An amount Not for Publication is being spent to develop a new hospital on the University of Canberra campus	●				
Justice and Community Safety Directorate						
ACT Courts project	Not for Publication expenses for redevelopment of the Supreme Court building	●				
Alexander Maconochie Centre – Additional facilities	$79.6 million (including associated expenses) on capital works for new buildings and associated staffing and detainee related costs.	●			Alexander Maconochie Centre designed to meet human rights obligations	●
Alexander Maconochie Centre – additional staffing	$13.6 million for additional staff in response to increased costs due to increased average detainee numbers	●		●	Alexander Maconochie Centre designed to meet human rights obligations	●
Commonwealth Fire Payment supplementation	$16 million provision of additional funding to emergency services agency to offset reduction in Commonwealth funding. Increased fire alarm and commercial building development control fees and Fire and Emergency services levy.	●				
Emergency Services Agency Station upgrade and relocation – Aranda Station	$20.9 million on the construction of new emergency services buildings	●			Improved provision of emergency services	●
Parking operations – more inspectors	$7.0 million in net revenue from more parking inspectors	●		●		●
Revenue associated with expense initiatives	$10.4 million in revenue	●				

Positive	●	No discernible impact	●	Negative	●

Budget Measure	Financial and economic impact		Environmental impact		Social impact	
Strengthening Emergency Services Agency's response capability – improving TRN and CAD replacement program	$8.8 million to replace critical elements of the Emergency services agency	●				
Territory and Municipal Services Directorate						
Bushfire Management Capacity	$8.8 million to continue bushfire management activities	●	Improved bushfire environmental management	●		
Civic to Gungahlin Corridor Improvements	$20 million to invest in improvements and renewal which will help prepare for the Canberra Metro light rail	●				
Increased municipal services	$9.6 million to improve provision of municipal services to accommodate growth associated with land release	●			Improved municipal services such as waste services, street lighting, etc.	●
Parks and open spaces – maintaining amenity	$15.2 million on improving urban amenity	●	Improves national parks and reserves, and maintains existing green areas and shopping centres	●		
William Slim/Barton Highway Roundabout Signalisation	$10 million to upgrade the intersection, including signalisation, additional lanes and other works.					
Whole of Government						
Administrative efficiencies	$34 million in savings associated with review of existing structures and duplication	●		●		●
Digital dividend investment strategy and transformational service delivery	$25 million in savings through greater application of electronic and online technologies	●	Less requirements for physical locations	●		
Fire and Emergency Services levy	$19 million in revenue to cover additional costs incurred by the Emergency Services Authority in providing services; recovering funding lost through the cessation of a National Partnership Payment scheme	●				
Land Tax Reforms	$40 million in revenue	●				
Payroll tax harmonisation	$40 million in revenue	●				
Increase to payroll tax threshold	$9.4 million in lost revenue	●				
Regulatory Service Fees	Establishes a 4 per cent rate of indexation of regulatory service fees	●				

Positive	●	No discernible impact	●	Negative	●

Budget Measure	Financial and economic impact		Environmental impact		Social impact	
	for each year of the forward estimates					
Traffic and Parking Fines	Indexation of these fines of 6 per cent for each year of the forward estimates	●				
Canberra Institute of Technology						
CIT Campus Modernisation – Tuggeranong Campus	Not for Publication expenses to develop a campus modernisation strategy and the allocation of funds for the provision of infrastructure	●		●	Improved outcomes for young people studying at CIT	●

Source: The CIE.

Positive	●	No discernible impact	●	Negative	●

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