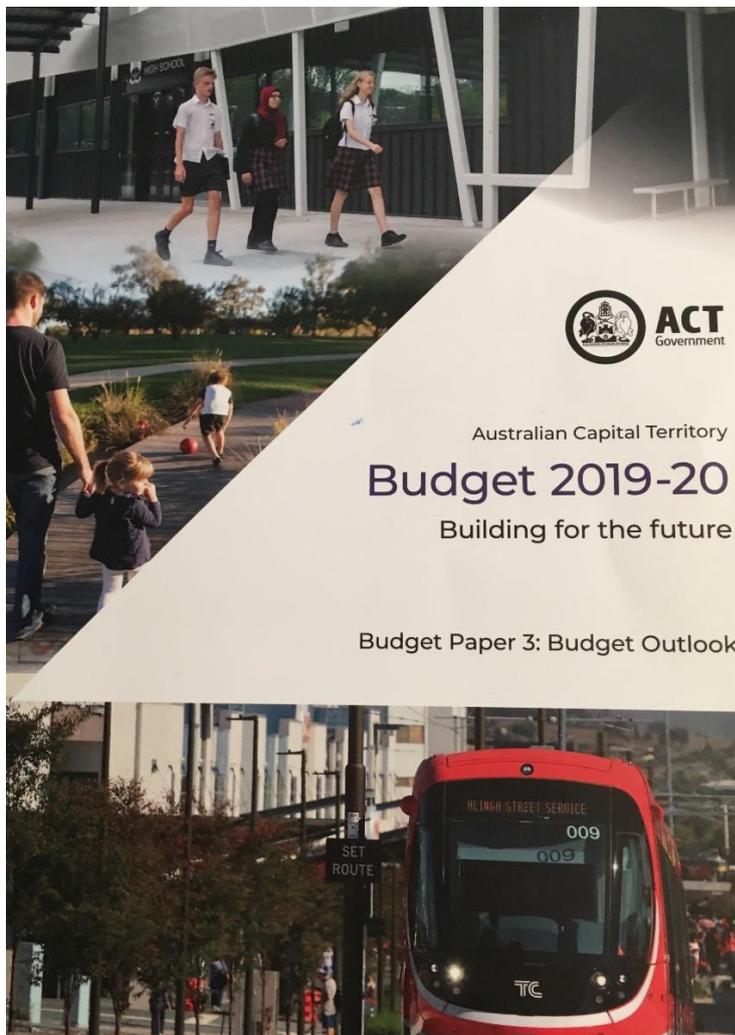




2019

Review of the ACT Budget 2019-20 Follow-up Issues



Alistair Davey and Brett Kaufmann

Pegasus Economics

July 2019



Pegasus Economics • www.pegasus-economics.com.au • PO Box 449 Jamison Centre, Macquarie ACT 2614

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

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

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

For information on this report please contact:

Name: Dr Alistair Davey

Telephone: + 61 2 6100 4090

Mobile: 0422 211 110

Email: adavey@pegasus-economics.com.au

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

Table of Contents

1. Introduction	1
2. Economic Questions	2
2.1 Using ACT Final Demand Versus ACT Gross State Product	2
2.2 Measuring the Diversification of the ACT Economy	5
3. Accounting Standards	9
3.1 Overview	9
3.2 Budget Accounting and Financial Reporting Framework	9
3.3 Accounting Standards Used/Not Used	9
Bibliography	11

Figure 1: ACT Final Demand and Gross State Product – 1997-98 to 2017-18 in Current Price Terms (\$ millions)	4
Figure 2: Components of Final Demand for the ACT economy, year ended March 2019	5
Figure 3: Relative shares of ACT Final Demand – 1995-96 to 2018-19	6
Figure 4: Percentage Increase in Gross Value Added for Selected Industry Sectors for ACT Gross State Product – 2017-18 (Real Terms)	7

1. Introduction

Pegasus Economics (Pegasus) was engaged by the ACT Legislative Assembly on 14 May 2019 to assist the Select Committee on Estimates 2019-20 with its assessment of the 2019-20 ACT Budget. As part of this project, Pegasus was required to prepare a draft report on the Budget within seven days of its presentation to the Assembly and to be available as required to assist the Committee in its subsequent deliberations. Pegasus provided its draft report on the 2019-20 ACT Budget to the Select Committee on Estimates on 11 June 2019 and provided its final report on 14 June 2019.

This report has been prepared for the ACT Legislative Assembly's Select Committee on Estimates 2019-2020 in order to respond to questions and issues raised by Committee members following the delivery of the Pegasus report. It follows a meeting between the Select Committee with Pegasus on 3 July 2019.

2. Economic Questions

The Estimates Committee had two follow-up questions/issues relating to economic issues following comments made by ACT Chief Minister and Treasurer, Mr Andrew Barr, before the Estimates Committee.

2.1 Using ACT Final Demand Versus ACT Gross State Product

The first follow-up question/issue received by Pegasus relates to the use of ACT final demand as opposed to ACT gross state product (GSP) in assessing the state of the ACT economy. In comments before the Estimates Committee on Monday 17 June 2019, the ACT Chief Minister and Treasurer, Mr Andrew Barr, reflected on Pegasus preferring to focus on ACT final demand rather than GPS in the following terms:

I know they refuse to look at GPS (sic), and I think that is criminal oversight in terms of what you guys have paid them to look at it. It is data available annually. They should look at it, and it does show diversification. So I contest that one of many elements of their commentary. (Legislative Assembly for the Australian Capital Territory, 2019, p. P149)

In a further exchange before the Estimates Committee, Mr Barr reiterated on his earlier comments:

THE CHAIR: *Before we adjourn, I have one matter that has been brought to my attention. Earlier today, Chief Minister, when we were discussing the Pegasus Economics independent review into the budget, you accused Pegasus of criminal oversight in their assessment. Can I ask you to explain what you meant by that?*

Mr Barr: *By not including GSP analysis in their commentary in relation to diversification. That was the context in the discussion at the time. I was asked whether I agreed with their assessment and I said no. You guys, the committee, are paying that group to give you analysis, but for them simply to say that an annually produced budget cannot be assessed against an annually produced GSP analysis I do not think is reasonable. That is my position. I do not agree with everything they say in their report. I have not every year. Some things they say I agree with; other things I do not.*

MRS JONES: *I guess that is why it is a different perspective, isn't it?*

Mr Barr: *Yes, indeed. They are entitled to put a view and I am entitled to put a view. I think they should look at GSP. (Legislative Assembly for the Australian Capital Territory, 2019, p. P221)*

Gross domestic product (GDP) measures gross value added for all resident institutional units for the whole economy (Australian Bureau of Statistics , 2015, p. 108). Gross value added is the difference between output and intermediate consumption for each institutional unit and thereby measures the value created by production. Value added represents the contribution of labour and capital to the production process.

There are three methods used for estimating GDP:

- the production approach referred to as GDP(P) as GDP is the gross value added component for each industry sector;
- the income approach referred to as GDP (I) as GDP is also equal to the sum of primary incomes distributed by resident producer units (Australian Bureau of Statistics , 2015, p. 43); and

- the expenditure approach referred to as GDP(E) as GDP can be derived as the sum of all final expenditures, changes in inventories of finished goods, work-in progress and raw materials, and the value of exports of goods and services less the value of imports of goods and services (Australian Bureau of Statistics , 2015, p. 174).

GDP(E) is comprised of the following components:

$$GDP(E) = \text{Final consumption expenditure} + \text{Gross Fixed Capital Formation} + \text{Changes in Inventories} + \text{Exports} - \text{Imports}$$

(Australian Bureau of Statistics , 2015, p. 174)

Removing exports and imports (or net imports) from GDP(E) gives you domestic final demand (DFD), which measures the total demand for goods and services within the national economy.

Gross state product (GSP) is the equivalent of GDP for a region of a national economy (Australian Bureau of Statistics , 2015, p. 467). The Australian Bureau of Statistics (2015, p. 467) does not produce quarterly estimates GSP, however, quarterly state final demand (SFD) is calculated. SFD is directly comparable to domestic final demand at the national level. It is a partial measure of GSP measured by the expenditure approach, in that this measure excludes both international and interstate trade, as well as changes in inventories.

The major difference between the compilation of GDP and GSP is that the income and expenditure approaches are combined to overcome measurement issues in relation to GSP (Australian Bureau of Statistics , 2015, p. 469). Consequently, there are only two methods used to estimate GSP:

- the production approach referred to as GSP(P); and
- the combined income/expenditure approach referred to GSP(I/E).

For the ACT economy, final demand during 2017-18 was around \$9.8 billion higher than GSP in current price terms (Australian Bureau of Statistics, 2018a). There were three items in 2017-18 that all reduced GSP as compared to ACT final demand:

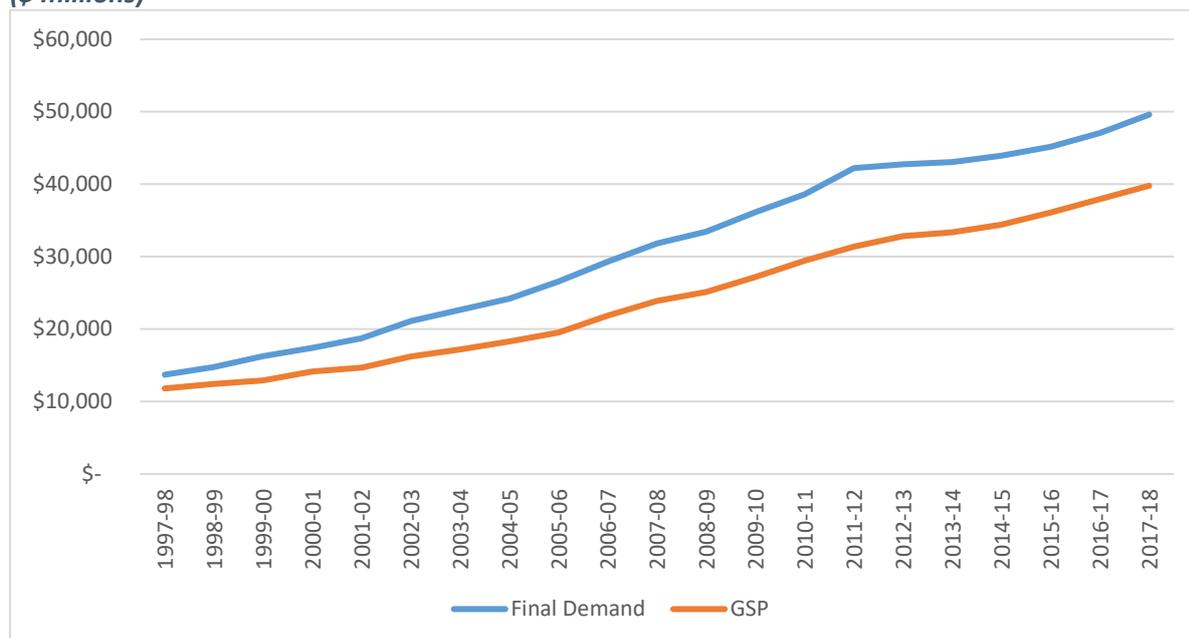
- the balancing item composed of net interstate trade (interstate exports minus interstate imports) and changes in inventories that reduced GSP by almost \$7.3 billion¹;
- the statistical discrepancy that reduced GSP by around \$2 billion²; and
- net exports (international exports minus international imports) that reduced GSP by around \$500 million.

It is likely that net interstate trade is the primary detraction from GSP for the ACT economy as compared to final demand rather than change in inventories. A comparison of ACT final demand as compared to GSP is provided in Figure 1 below.

¹ See ABS (2015, p. 470).

² The statistical discrepancy ensures that the different estimates of GSP are equivalent. See ABS (2015, p. 471).

Figure 1: ACT Final Demand and Gross State Product – 1997-98 to 2017-18 in Current Price Terms (\$ millions)



Source: ABS (2018a).

For this year and in previous years Pegasus has focused on ACT final demand or SFD in its report on the ACT Budget as it is the most readily available measure of economic activity for the ACT economy as the Australian Bureau of Statistics (ABS) only publishes estimates of GSP once a year with a considerable time delay. Last year, the ABS published its estimates for GSP for 2017-18 on 16 November 2018, around four-and-a-half months following the end of the 2017-18 financial year.³ In contrast, quarterly estimates of GDP as well as SFD are provided by the ABS in just over two months following the end of a quarter.

Consistent with the approach adopted by Pegasus, the ACT Budget papers previously targeted growth in SFD as an indicator of economic growth. According to the 2010-11 ACT Budget:

Economic growth in the ACT, as measured by State Final Demand (SFD) is forecast to moderate in 2010-11. (ACT Government, 2010, p. 227)

In its response to the then ACT Assembly Select Committee on Estimates report on the 2010-11 ACT Budget, the then ACT Government (2010a, p. 2) commented:

The Government notes the Committee has again sought external advice on the Territory's Budget. The ACIL Tasman Review of the Budget provides some pleasing observations.

The Review endorses the approach of ACT Treasury in using demand to gauge the strength of the ACT economy ...

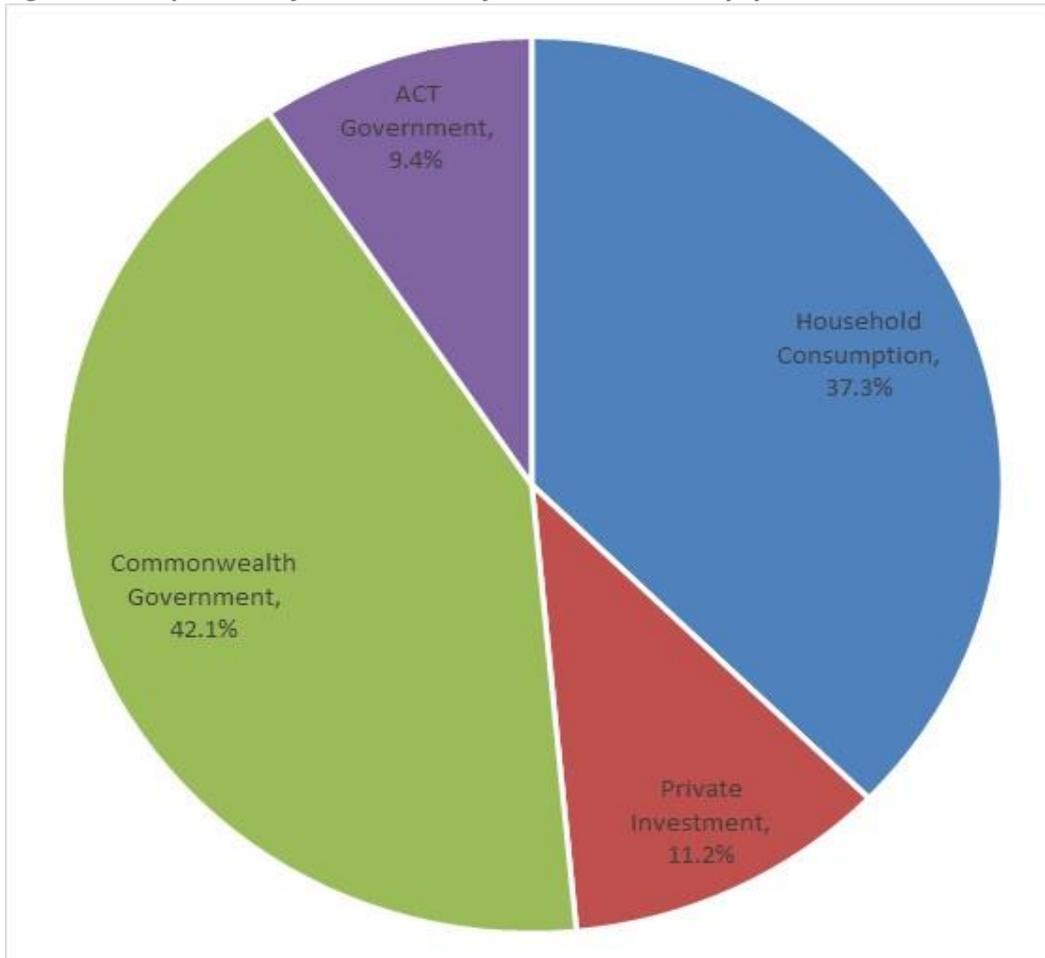
³ See ABS (2018a).

2.2 Measuring the Diversification of the ACT Economy

The second follow-up question/issue received by Pegasus related to the extent of the diversification of the ACT economy and the use of GSP to measure the extent of diversification as compared to ACT final demand, following on from Mr Barr's comments before the Estimates Committee on Monday 17 June 2019 as outlined above.

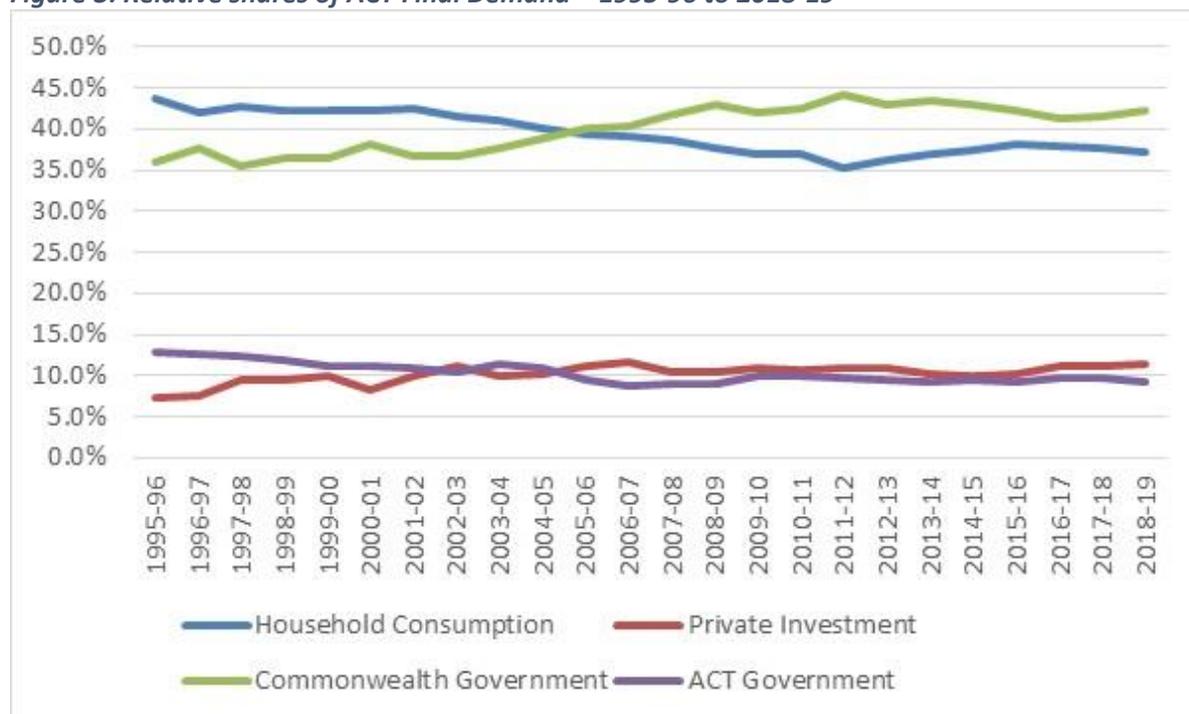
In the Pegasus report (Davey, Kaufmann, Bartos, & Antcliff, 2019, pp. 4-5) diversification of the ACT economy was measured according to the aggregated components of ACT final demand. The relevant figures from our original report are reproduced below.

Figure 2: Components of Final Demand for the ACT economy, year ended March 2019



Source: ABS (2019a).

Figure 3: Relative shares of ACT Final Demand – 1995-96 to 2018-19



Source: ABS (2019a).

Note: Results for 2018-19 are for the year to date.

In response to the claim made by the ACT Government (2019, p. 427) that the ACT economy is becoming increasingly less vulnerable to reductions in Commonwealth spending as it becomes more diverse, the Pegasus report (Davey, Kaufmann, Bartos, & Antcliff, 2019, p. 24) commented that:

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

Pegasus would also note that the approach it has taken in measuring the diversity of the ACT economy is entirely consistent with the approach taken by the ACT Government as outlined in the ACT Budget Papers in discussing diversification within the ACT economy.⁴ On this basis, Pegasus was initially rather perplexed as to the exact point Mr Barr was attempting to make regarding measuring the diversification of the ACT economy using GSP rather than final demand, especially in light of the fact that final demand is the major component of GSP(I/E).

However, the point that Mr Barr was attempting to make became clearer on examination of his comments before the Estimates Committee on Tuesday 18 June 2019. According to Mr Barr on Tuesday 18 June 2019:

Real state gross product has been growing faster in the ACT than in any other state or territory. Our economy continues to diversify. Professional, scientific and technical services grew by 11.2 per cent in the 2017-18 fiscal year; that was a contribution of 0.9 percentage points to the four percentage point growth. So around a quarter of the territory's GSP growth in 2017-18 came through professional, scientific and technical services. We have also seen strong growth in health care and social assistance, by 8.5 per cent. That is tied in with the ramp-up

⁴ See Figure 1.2.2 (ACT Government, 2019a, p. 13).

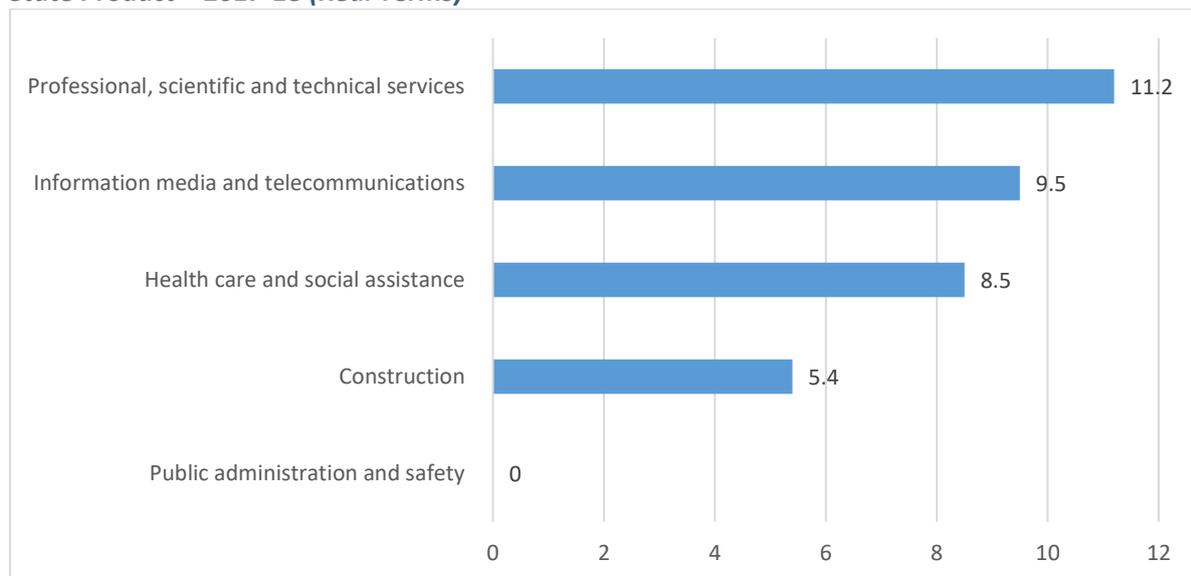
of the NDIS scheme. Construction and information, media and telecommunications also grew, by 5.4 per cent and 9.5 per cent respectively.

Interestingly, public administration and safety had no change; it did not grow. All of our GSP growth in 2017-18 came from sectors outside of public administration and safety, which, though, remains our single largest contributing sector. But there could be no clearer evidence of diversification and change than the fact that public administration and safety did not grow and yet our economy grew at the fastest rate in this nation. It was all of the other industry sectors that contributed.

That is why this data needs to feature. It is annual data, like an annual budget, and it needs to feature in an analysis of the territory economy. Thank you for raising the question. (Legislative Assembly for the Australian Capital Territory, 2019a, p. P314)

It is apparent from Mr Barr's comments above that he was referring to GSP as measured by the production approach or GSP(P) rather than GSP as measured from the income and expenditure approach or GSP(I/E) of which final demand is the major component. This can be seen in Figure 4 below.

Figure 4: Percentage Increase in Gross Value Added for Selected Industry Sectors for ACT Gross State Product – 2017-18 (Real Terms)



Source: ABS (2018a).

The problem and oversight in relation to Mr Barr's comments from Tuesday 18 June 2019 is that public sector involvement amongst the various industry gross value added industry sectors for GSP(P) is not just isolated and confined to the *public administration and safety* industry sector but extends across to numerous other industry sectors.

There is substantial public sector involvement throughout the Australian economy, beyond what may necessarily be apparent. There is public sector involvement in all of the industry sector examples cited by Mr Barr on Tuesday 18 June 2019 as quoted above, with the estimates of industry gross value added for GSP(P) having been originally derived through the estimation of GDP(P).

The industry gross value added for *professional, scientific and technical services* industry sector of GDP(P) has as one of its two main data sources Government Finance Statistics (Australian Bureau of Statistics, 2015, pp. 147-148). In relation to this component the ABS (2015, p. 148) has commented:

Government Finance Statistics data relating to gross expenditure by government classified according to purpose are used to derive government output by industry.

The industry gross value added for *health care and social assistance* industry sector for GSP(P) also contains public sector involvement. According to ABS (2015, p. 152):

The public sector output estimates are based on the costs of production recorded for government final consumption expenditure on health care and social assistance related products, but before any receipts from sales are netted off.

The industry gross value added for the *information media and telecommunications* industry sector for GDP(P) also has Government Finance Statistics as one of its main data sources (Australian Bureau of Statistics, 2015, p. 140). In relation to this component the ABS (2015, p. 140) has commented:

[Government Finance Statistics] data relating to gross expenditure by government classified according to purpose are used to derive government output by industry.

Finally, there is also public sector involvement in the industry gross value added *construction* industry sector for GDP(P). According to the ABS (2015, p. 133):

The construction output for the general government sector is estimated using the ABS publication, Engineering Construction Activity, Australia (cat. no. 8762.0). Total engineering construction by the public sector for the public sector (less engineering construction for the telecommunications and electricity industries) is added to total construction output. The telecommunications and electricity engineering construction activity is removed as this is included in the output of the telecommunications industry and electricity industry respectively.

General government consumption of fixed capital is also included in output sourced from the Perpetual Inventory Method.

In order to appropriately measure the extent of diversification within the ACT economy using GSP(P) (and presumably away from public sector activity), it would be necessary to unpack the various constituent parts of public sector involvement in all of the various industry sectors that go to make up GSP(P).

3. Accounting Standards

The Estimates Committee had one follow-up query in relation to the accounting standards used/not used in the ACT Budget.

3.1 Overview

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

The following sections provide comment on the accounting standards adopted or not adopted in the preparation of the Budget.

3.2 Budget Accounting and Financial Reporting Framework

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

Background

In 2002 the Australian Accounting Standards Board (AASB) was tasked with developing a financial reporting framework for Whole of Government and General Government Sector financial reporting that harmonised Government Finance Statistics (GFS) reporting and traditional Generally Accepted Accounting Principles (GAAP) reporting. GFS is an accounting framework based on traditional GAAP principles and developed by the International Monetary Fund for application in preparing national accounts. In Australia, the GFS framework is maintained by the ABS.

Although the AASB develops standards primarily for end of financial year statutory reporting, this project was endorsed by Australia’s Heads of Treasuries (HoTs) with the view to using the new framework for budget and associated reporting.

A harmonised standard, AASB 1049, was issued in 2007 which was immediately accepted by HoTs with its Uniform Presentation Framework amended by adopting AASB 1049. AASB 1049 requires compliance with all other applicable accounting standards in the preparation of the statements. The new framework requires assets and liabilities to be measured (valued) at current value, not original cost and accordingly, values must be up to date for each reporting period.

3.3 Accounting Standards Used/Not Used

As outlined in Section 10 of the Pegasus report (Davey, Kaufmann, Bartos, & Antcliff, 2019), unlike several other Australian jurisdictions, the basis of accounting and the key accounting policies adopted in preparing the budget statements, except in respect to Public Private Partnerships, Appendix B, were not disclosed. As indicated above, it is not entirely clear that AASB 1049 has been adopted. This can only be assumed given the presentation of the budget financial statements follows this standard. Consequently, it is difficult to determine which applicable standards have or have not been applied.

Set out below are those key standards that a user would reasonably expect to have been adopted for the ACT General Government and its activities:

- AASB 1049 Whole of Government and General Government Financial Reporting;

- AASB 1059 Service Concession Arrangements – applicable to Public Private Partnerships;
- AASB 116 Property, Plant and Equipment Assets – applicable to non-current physical assets, including cultural and heritage assets;
- AASB 13 Fair Value Measurement – applicable to asset valuations and accounting for revaluation adjustments;
- AASB 136 Impairment of Assets – applicable to impairment assessment and adjustments;
- AASB 116 Leases – applicable to leased property, plant and equipment assets, including vehicles;
- AASB 138 Intangible Assets – applicable to controlled intellectual property rights and qualifying research and development costs and trade marks;
- AASB 118 and AASB 1004 Revenue and Contributions – applicable to all revenue, including the timing of recognition of grant funds received;
- AASB 119 Employee Benefits – applicable to in-employment salary and vesting leave entitlements, and post -employment arrangements, that is, superannuation, including the relevant discount rate to be used in valuing superannuation obligations;
- AASB 9 Financial Instruments – applicable to tradeable instruments such as Large Scale Generation Certificates and valuing and revaluing government debt;
- AASB 10 Consolidated Financial Statements – applicable to the consolidation of those entities within the general government to prepare the general government financial statements;
- AASB 102 Inventories;
- AASB 107 Cash Flow Statements – the method to be applied in preparing the cash flow statement;
- AASB 123 Borrowing Costs – applicable to the treatment of the costs associated with raising government borrowings; and
- AASB 137 Provisions and Contingent Liabilities – applicable to determining when a liability is to be recognised on the balance sheet as distinct to note disclosure only.

Set out below are those key standards that would not apply to the General Government:

- AASB 1 First Time Adoption – applicable only to first time financial reporting;
- AASB 2 Share-based Payments – applicable to share-based remuneration arrangements;
- AASB 3 Business Combinations – applicable to mergers and acquisitions;
- AASB 4 Insurance Contracts – applicable only to smaller general insurance arrangements;
- AASB 5 Assets Held for Sale – applicable only in the event of a privatisation;
- AASB 6 Extractive Industries – applicable only to oil, gas, and mineral resource exploration and extraction; and
- AASB 141 Agriculture – applicable only animal husbandry and cropping activities.

It should be noted that in respect to the application of accounting standards, the University of Canberra does not form part of the General Government sector. The ABS and HoTs classify universities as multi-jurisdictional, meaning no single government controls these entities. This is because key funding is contributed by a combination of Commonwealth and State or Territory sources.

Bibliography

- ACT Government. (2010). *2010-11 Budget Paper No. 3*. Canberra.
- ACT Government. (2010a). *Government Response to the Report of the Select Committee on Estimates 2010-2011 on the inquiry into the Appropriation Bill 2010-2011*. Canberra.
- ACT Government. (2019). *Australian Capital Territory Budget 2019-20 Building for the Future - Budget Paper 3: Budget Outlook*. Canberra.
- ACT Government. (2019a). *Australian Capital Territory Budget 2018-19: Budget Review*. Canberra.
- Australian Bureau of Statistics. (2015). *Australian System of National Accounts: Concepts, Sources and Methods Australia 2015 - ABS Cat. no. 5216.0*. Canberra.
- Australian Bureau of Statistics. (2018a). *Australian National Accounts: State Accounts, 2017-18: ABS Cat. no. 5220.0*. Canberra.
- Australian Bureau of Statistics. (2019a). *Australian National Accounts: National Income, Expenditure and Product, Mar 2019 - ABS Cat no. 5206.0*. Canberra.
- Davey, A., Kaufmann, B., Bartos, S., & Antcliff, S. (2019). *Review of the ACT Budget 2019-20*. Canberra.
- Legislative Assembly for the Australian Capital Territory. (2019). *Select Committee on Estimates (Reference: Appropriation Bill 2019-2020 and Appropriation (Office of the Legislative Assembly) Bill 2019-2020): Proof Transcript of Evidence, Monday 17 June 2019*. Canberra.
- Legislative Assembly for the Australian Capital Territory. (2019a). *Select Committee on Estimates (Reference: Appropriation Bill 2019-2020 and Appropriation (Office of the Legislative Assembly) Bill 2019-2020): Proof Transcript of Evidence, Tuesday 18 June 2019*. Canberra.