LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

REPORT

SELECT COMMITTEE ON THE TERRITORY'S SUPERANNUATION COMMITMENTS

February 1999

Resolution of appointment

On 26 November 1998 the ACT Legislative Assembly resolved that:

(1) the committee be appointed to inquire into and report on the Territory's superannuation commitments, with special reference to:

(a) the adequacy of the Towers Perrin reports, entitled Report on the Development of Alternative Superannuation Arrangements for the Australian Capital Territory Public Sector and Report on the Financial Management of the ACT Government Financed Superannuation Liabilities as a guide to the magnitude of the Territory's superannuation commitments;

(b) the efficacy of the proposed one-off funding option to settle the Territory's unfunded superannuation liability;

(c) any alternatives to the proposed one-off funding option;

(d) the potential downstream impacts on the ACT economy of each of the alternatives identified for meeting the Territory's unfunded superannuation liability effects; and

(2) the committee report by the first sitting day of February 1999, and the Government take no action on the final ownership aspect of ACTEW until the Assembly has considered the Government's response to the Select Committee report.

On 10 December 1998 the Assembly authorised the Speaker to give directions for the printing, circulation and publication of the committee's report if the Assembly is not sitting when the committee has completed its report.

Committee membership

Mr Ted Quinlan MLA (Chairman)
Mr Paul Osborne MLA (Deputy Chairman)
Mr Harold Hird MLA
Ms Kerrie Tucker MLA

Secretary
Bill Symington

Assistant Secretary
Beth Irvin

Administrative Assistant
Kim Blackburn

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The committee recommends that the Assembly takes careful note that the level of the unfunded superannuation liability may have been overstated by anything up to $250m by the use of conservative assumptions. 15

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2.3.9. The committee recommends that all future work on superannuation assumes a 'realistic' and consistent discount rate assumption. In addition the committee recommends that the use of a consistent base year should be used for accuracy in comparison of various options. 24

Recommendation 3 27

2.5.7. The committee recommends that the Assembly take note of Mr Ford's suggestion that the costs should be spread over a long time period. The committee believes that this is an objective to be strived for by the Assembly. 27

Recommendation 4 29

3.2.8. The committee recommends that the Government develop strategies to mitigate the retail risk associated with the ownership of Actew. When these strategies are developed the committee requests that the results be presented to the Assembly for debate. 29

Recommendation 5 30

3.3.9. The committee recommends that legislation be introduced to ensure funds dedicated to superannuation remain dedicated. The committee also recommends that the legislation contain clauses which require a majority of votes in the assembly for a change in the use of funds dedicated for superannuation purposes. 30

Recommendation 6 30

3.3.10. The committee recommends that the Assembly take note of the potential risks involved with investing the potential Actew sale proceeds in the highly volatile equity market. 30

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Recommendation 9 **42**

4.5.4. The committee recommends that the government develop a strategy, from within those presented here, which: **42**

(i) minimises the net impact on the budget; **42**

(ii) provides a timed approach to funding the unfunded portion of the liability; **42**

(iii) includes a repatriation from Actew to increase the current SPU coverage to above 30%; and **42**

(iv) utilises the income stream from Actew to contribute towards the unfunded liability. **42**

Recommendation 10 **53**

5.2.41. The committee recommends that the Assembly takes note that the sum of positives from the sale of Actew will most likely be outweighed by the sum of the negatives leaving the economy in a bad state compared to the retention of ownership. **53**

Recommendation 11 **61**

5.5.4. The committee recommends that the Assembly undertake a full and wide ranging inquiry into the ACT Government's 'revenue adequacy' and expenditure priorities. The committee further recommends that the inquiry be given adequate time and resources to reach definitive solutions and conclusions. **61**

CHAPTER 1. INTRODUCTION AND BACKGROUND

1. INTRODUCTION

1.1.1. The Assembly tasked the committee to address wide ranging terms of reference dealing with superannuation liability issues of considerable complexity over several weeks including the Christmas/New Year period.

1.1.2. The timing of the inquiry has presented obvious difficulties for the committee in accessing broad community views and opinions on the issues. The committee was fortunate to receive evidence from several informed persons and organisations. However, because of the limitation on time, some vital information emerged quite late in the course of committee deliberations. Several parties, including Towers Perrin and the Australian Government Actuary, are to be congratulated for their efforts and assistance. The work carried out by The Australia Institute has been of great value.

1.1.3. Examination has shown that reports tabled in support of the Government's proposal have not provided a balanced picture to aid the Assembly's deliberations. The Towers Perrin reports include valuations of the superannuation liability only at the high end of the range of possibilities that would normally be prepared by an actuary. The Fay Richwhite report omits to point out that the only changing risk to Actew's viability impacts on a very limited part of its total operations. Finally, the ABN AMRO report continues the exaggeration of risk and goes to considerable lengths to support the "sell Actew" option.

1.1.4. The committee considers it is of vital importance that the long term investment of Territory funds in the Superannuation Provision Unit be subject to far more detailed study than is possible within the committee's terms of reference. A detailed study is necessary of all the variables of risk exposure implicit in the investing of a major Territory asset in the equity and money markets over an extended period of years.

1.1.5. The committee agrees with the Government's assessment that the superannuation liability must be addressed. Since the inception of self-government, and particularly over the past few years, far too little in the way of funding has been provided to reserves. This is building a legacy that future generations will find impossible to manage. At the same time the committee wishes to see that the Assembly is informed of the best estimates of the liability and emerging costs, not simply those that reinforce a particular strategy.

2. ROLE OF THIS COMMITTEE

1.2.1. Prior to the appointment of the select committee there had been considerable public and Assembly debate about the Territory's unfunded superannuation liability and, in particular, the proposal that the sale of ACTEW could fund the liability through investment of the sale proceeds.

1.2.2. The superannuation liability and the extent to which it is of direct relevance to the governance of the ACT is a matter for legitimate consideration in the development of public policy. In the normal course, it would be appropriate for the liability to be addressed in terms of options for keeping it within manageable limits with those options including budgetary provisions and alternative superannuation provisions.

1.2.3. The ACT Government has not been alone among Australian governments in having to face up to the fact of an emerging and increasing liability, but the committee is disappointed that it has been less willing than other governments to canvass a broader range of solutions beyond the controversial one of funding the liability through the sale of the Territory's major publicly owned asset, Actew.

1.2.4. Linking the proposed sale of Actew as the sole means of directly funding the superannuation liability has complicated what should be an orderly progress towards resolving a matter of public policy. The confusion arises from a clash of competing objectives between funding the liability and the proposed sale of Actew.

Public and other input to the inquiry

1.2.5. Public notices in the ACT print media invited submissions and comment from interested persons and organisations. The committee also approached a wide range of business and community organisations for input to the inquiry. Seven submissions were received and a public hearing on the issues was held on 19 January 1999.

1.2.6. The committee benefited from briefings by officers of the Chief Minister's Department and the Towers Perrin organisation.

1.2.7. The complexity of the issues obliged the committee to seek expert assistance as a client from the Australian Government Actuary and from Towers Perrin on defined terms of reference.

1.2.8. The terms of agreement with the AGA provided for the Actuary to provide:

(i) a review of the Towers Perrin reports on ACT Government superannuation dated 16 April 1998 and 29 April 1998. The Office of the Australian Government Actuary may query and clarify issues with Towers Perrin directly where appropriate; and

(ii) an analysis of alternative strategies for meeting superannuation commitments if ownership of ACTEW were to be retained by the ACT Government. This will involve looking at the projected cash flows arising from the superannuation liabilities and the revenue derived from ACTEW if Government ownership is retained. One strategy to be investigated is ACTEW borrowing $300m to be paid as a special dividend to the ACT Government. This dividend would be used to fund part of the accrued unfunded superannuation liability.

The AGA report to the committee on the agreed terms is attached.

1.2.9. Towers Perrin was asked to model the emerging cost of the "New Scheme" if unfunded, provide an update on the costs of the new scheme if fully funded and a range of modelling requested by the committee. The options are presented in chapter four and results of the modelling are presented graphically in appendix 2.

ACTEW - proposed sale and committee's role

1.2.10.The lack of time available, and the limitations imposed by the Terms of Reference, have restricted examination of issues which are directly relevant to the proposed sale of Actew even though it has been directly linked to the superannuation liability. Nevertheless, the committee has sought to present a well rounded examination of the superannuation commitments.

Broader community consultation by the committee

1.2.11.The time constraints on the inquiry, and its coincidence with the Christmas/New Year holiday period, has markedly affected the capacity of some interested persons and organisations to provide meaningful input and analysis to the inquiry.

1.2.12.By comparison, the committee noted that the Federal Senate Select Committee on Superannuation examined superannuation and the financial system over a period of 18 months in 1991-92. With all the substantial support resources of the Senate, it was unable to receive sufficient evidence on unfunded public sector superannuation liabilities nor take the time to carry out any far reaching investigation of the issues.[1]

1.2.13.ACTCOSS which, although it recognised the significance of the unfunded liability which needed to be addressed, argued that a decision on strategies should not be rushed or made ion a climate of political pressure. ACTCOSS argued that the liability should not be examined in isolation of other government priorities and social

[1] Third Report of the Senate Select Committee on Superannuation, October 1992, p32

policy needs or against a single one-off solution such as the sale of the ACT's major asset, Actew.[2]

1.2.14.ACTCOSS reiterated its position as put to government that there be wide community consultation on all the issues relative to both the sale of ACTEW and the entire revenue base in order to ensure that there is inter-generational equity in financial planning.[3]

1.2.15.The committee has sympathy with this view. It notes that the public forum sponsored jointly by the ACT & Region Chamber of Commerce and Industry and the ACT Trades and Labour Council on 20 June 1999 attracted considerable public attention. The debate between ABN AMRO and The Australia Institute on the sale of Actew was described by the sponsors as one of the most contentious issues affecting the ACT in many years.

1.2.16.The committee considers the level of community concern and interest as evidenced by the unique association of the sponsors of the debate, the debate itself, the response to it and the continuing expressions of opinion by the community expressed through the ACT media is sufficient to indicate that the Assembly should proceed with its consideration of the superannuation liability and means of funding it, and especially the proposal to sell Actew, with extreme care and sensitivity.

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[2] ACTCOSS submission to committee

[3] ACTCOSS transcript of public hearing, pp28-30

3. OVERVIEW OF FINDINGS

1.3.1. During the course of the inquiry the committee has been able to draw several findings relating to the terms of reference. Each one, listed below, will be expanded upon in the course of the report:

(a) The Towers Perrin report on superannuation funding options is not adequate as a guide to the Territory's superannuation commitments. They have published only one end of the range of outcomes that actuaries typically produce. The report should have provided evaluations of total liabilities, emerging costs and accruing liabilities across the range from "conservative" to "optimistic". Instead they include only those predictions that give the greatest force to the Government's proposals

(b) The proposed one-off funding option, the sale of Actew, is not the only and not necessarily the best course open to address the superannuation liability

(c) There are alternatives that do not involve the loss of the valuable public asset that Actew represents. These generally involve the dedication of varying amounts of the earnings of Actew as well as taking a substantial capital contribution

(d) Potential negative downstream economic impacts on the ACT economy definitely exist under the sale of Actew option. There have been claims that the sale could stimulate the economy, but these are more tenuous.

Committee Note

1.3.2. The committee echoes the sentiments of members of the community that the sale of Actew and the funding of superannuation are separate issues. It is disturbing to think that they were linked in the first place, however it is important that the Assembly and the Government recognise that the issue are not inextricably linked.

4.. BACKGROUND TO THE SUPERANNUATION ISSUE

1.4.1. Under current superannuation financing arrangements the annual emerging cost payments to meet the Territory's Commonwealth Superannuation Scheme (CSS) and Public Sector Superannuation Scheme (PSS) liabilities were estimated to increase to a maximum of approximately $138m in about year 2023. Unfunded liabilities, (some $773m actual at 30 June 1998[4]), were estimated to peak in year 2013 at $1700m (1997 values) and return to present levels after year 2030.[5]

1.4.2. The estimate of the unfunded liability is dependent on the underlying assumptions, particularly the real rate of return on investments and the implied discount rate used in calculating the net present value (NPV). The Australian Government Actuary (AGA) has qualified some of the figures being used. With only 1997 details to work with, the AGA stated that a figure of $660m estimated as the unfunded liability at 30 June 1997 could be an over estimation. The AGA asserted that "...the required amount was probably of the order of $400m to $650m".[6]

1.4.3. It is extremely important that the Assembly is fully aware that it, and the public at large, has been provided with only the pessimistic end of the probable range of valuations that an actuary would typically produce. The liability could be overstated by up to $250m if an optimistic view is taken. A fair figure probably lies in the middle of the range, say $525m. This implies an overstatement of $135m - a very substantial difference.

1.4.4. The absence of any indication that only pessimistic forecasts were being published has meant that much of the debate on the superannuation liability has been conducted on the basis of biased data. It is appropriate here to quote Dr Clive Hamilton of The Australia Institute who observed, when appearing before the inquiry, that "(he has) never been involved or watched a public policy dispute where figures have been manipulated so wantonly as they have been in this debate over the past few months over Actew - manipulated by the Government".[7]

1.4.5. As to the future, new entrants to the ACT Public Service from I July 1999 will be given the opportunity to nominate a superannuation "fund of choice" for payment of the employer contribution.[8] The Government is establishing a default scheme for those

[4] Chief Minister's Department 1998-99 Annual Report, operating statement for the Superannuation Provision Unit (SPU) at 30 June 1998, p354. It should be noted that the annual report is prepared some time after the budget so that the SPU reconciliation is the authoritative liability. The 1998-99 figures on the unfunded liability differ. For example 1998-99 Budget Paper No3, p214 shows a liability of some $700m, although the 1998-99 Budget Paper No4, p68 shows the liability at just above $764m. The ACT Government submission to committee at p7 gives the liability as $765m.

[5] 1998-99 Budget Paper No3`, p214

[6] AGA report, p8

[7] Hearing transcript, P49

[8] Budget 1998-99, op cit

entrants who do not nominate a fund, and the AMP company has been reported as securing the tender for that purpose.[9] From I July 1999 it is intended that for these employees the ACT will pay contributions into Master Trusts to secure defined contribution superannuation benefits on a fully funded basis.

Recommendation 1

The committee recommends that the Assembly takes careful note that the level of the unfunded superannuation liability may have been overstated by anything up to $250m by the use of conservative assumptions.

Emerging costs of superannuation entitlements

1.4.6. With effect from 1 July 1989 the ACT Government became responsible to the Commonwealth for the employer financed portion of superannuation benefits accruing under the CSS and PSS for employees of the ACT Government. The ACT reimburses the Commonwealth for the emerging cost of superannuation entitlements and the Commonwealth meets the portion of the liabilities relating to service by ACT Government employees before 1 July 1989 (that is, effectively for service by employees before the ACT attained self-government).

1.4.7. The proportions of benefits relating to ACT service are relatively small at present but as the CSS and PSS members reach the ages when benefits are paid and the period of ACT service lengthens, the size of the reimbursements will increase substantially.[10]

1.4.8. Benefits under the "productivity component" are guaranteed by the Commonwealth through the ACT Government fully funding the current 3% contribution rate. Benefits arising do not add to the unfunded superannuation liability.

Superannuation Provision Unit (SPU)

1.4.9. The ACT Government established the SPU to assist in the financial management of the unfunded CSS and PSS liabilities and the coverage of emerging costs. As at 30 June 1997 the SPU had assets of $322.1m.

1.4.10.The 1998-99 ACT budget provided for the extension of payment of employer contributions to include budget-funded agencies, with the additional amounts to be retained within the SPU to be $40m in 1998-99. Budget papers forecast that additional

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[9] The Canberra Times, 6 January 1999

[10] Mr John Ford, submission to committee

amounts to be retained for superannuation provision will be $40m in 1999-2000, $50m in 2000-01 and $70m in 2001-02.[11]

1.4.11.The reconciled account for the SPU at 30 June 1998 showed a net unfunded liability of $773m.[12] This figure is subject to the qualification that the Australian Government Actuary applied to the 1997 figure - it is at the pessimistic end of the estimated range of possibilities and probably overstates the extent of the potential burden.

Components of superannuation

1.4.12.With regard to the ACT's present and future superannuation liabilities the various components of the costs and liabilities need to be differentiated. The components of superannuation are:[13]

- (i) existing superannuation liabilities which accrued between 1989 and 1998 under the unfunded defined benefit CSS and PSS schemes
- (ii) liabilities which will accrue under the CSS and PSS schemes in the future until all current members either reach retirement age or leave the ACT public service or join an accumulation scheme
- (iii) the emerging costs which will need to be paid on an annual basis until members of the CSS/PSS have exhausted their entitlements
- (iv) contributions which will be required under the new ACT Government accumulation scheme.

1.4.13.Although existing liabilities of the first component have already been accrued, they refer to payments which may be made to retired employees up to 50 years into the future. Having regard to the fact that funds can be invested to yield a positive rate of return, using the present value of money shows the amount that would need to be put aside today to yield the required amount of money at a future date.

5. INTERSTATE COMPARISON OF SUPERANNUATION

1.5.1. In contrast with private sector superannuation which is usually fully funded, most public sector schemes in Australia are, or have been, unfunded or partially funded defined benefits schemes. Lump sum and pension payments pledged by governments to retirees are usually made from current revenue. There has been minimal actual funding of the employer contribution towards employee superannuation entitlements.

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[11] 1998-99 Budget Paper no 3, p216

[12] Chief Minister's Department1998-99 Annual Report, operating statement for the Superannuation Provision Unit (SPU) at 30 June 1998, p354

[13] The Australia Institute, op cit, p3

1.5.2. During the 1990s the approach by governments to superannuation has changed in three main ways:

- (i) future superannuation liabilities have been explicitly accounted for in public sector financial statements through the adoption of the system of accrual accounting
- (ii) governments have increasingly moved towards full funding of accruing superannuation liabilities
- (iii) existing defined benefit schemes have been, or are scheduled to be, closed to new entrants and replaced by defined contribution or accumulation schemes (in which both employers and individual employees contribute to a fund that is invested on the employee's behalf).[14]

Public sector superannuation liabilities

1.5.3. Most Governments have moved to limit the growth of unfunded liabilities and most have now closed off their defined benefits schemes for new public sector employees. As an alternative these governments have moved to accumulation schemes and private superannuation funds. These new schemes limit returns to members to earnings on contributions from employees and employers and calculations of entitlements are made on the basis of the employer contributions being fully paid up.[15]

1.5.4. The Commonwealth closed the CSS to new members in 1989 and established the PSS with significantly reduced liability projections. In September 1997, the Commonwealth Government announced its intention to close the PSS to new members from 1 July 1998 although the necessary legislation to do so has yet to be enacted.

1.5.5. Most Australian jurisdictions have an unfunded superannuation liability. The extent of the liability is different across jurisdictions. Table 1 demonstrates the most recent position of each jurisdiction:

Table 1: Comparison of Unfunded Liabilities (Present Value and Proportionate)[16]

[14] The Australia Institute submission to committee dated 24 December 1998

[15] Bankers Trust, Unfunded Superannuation, Accrual Accounting and Public Sector Liabilities, 1998

[16] All monetary figures are as recorded in the separate State Budgets. The source for these figures is each State Budget and ABS 5206.0.40.001 (September 1998).

	Unfunded Liability	*Year*	*%age of SFD*
ACT	773,500,000	30 June 98	4.4
NT	849,500,000	30 June 97	13.4
TAS	1,398,000,000	30 June 97	11.8
SA	4,088,000,000	30 June 97	10.9
WA	5,485,000,000	30 June 98	9.2
NSW	14,700,000,000	30 June 97	8.1
VIC	15,200,000,000	30 June 97	11.7
COMMONWEALTH	68,000,000,000	30 June 97	8.9

1.5.6. Queensland is the only jurisdiction that has funded its superannuation from day one and as a result they have to date acquired a superannuation asset of about $400m.[17] The committee believes that these figures demonstrate that the ACT is not unique in having an unfunded superannuation liability.

1.5.7. Each Jurisdiction has had to develop a strategy to deal with their own unfunded liability. The committee has prepared Table 2 to display the funding strategy employed in the different jurisdictions.

1.5.8. The committee notes that there is no single method to fund accruing superannuation liabilities which stands out as being more suitable than another, and that the ACT Government has only embraced one option to date, the sale of Actew.

Table 2: Comparison of Strategies to Fund Superannuation

Government	Fully funded accrual liability	Fully funded backlog
Commonwealth	no, met on emerging basis	no, met on emerging basis
NSW	yes, by year 2020	yes, by year 2045
Victoria	yes	yes, after 2047
South Australia	yes	yes, after 2025
Queensland	yes	yes
Western Australia	yes, by 1999	no, met on emergingbasis
Tasmania	no	no, by one-off payments
Northern Territory	no, met on emerging basis	no, met on emergingbasis

1.5.9. It should be noted that the Northern Territory Government's stated view is that at this stage to fully fund the liability would divert funds away from necessary Territory economic development.[18]

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[17] Queensland State budget and ABS 5206.0.40.001 (Sept 1998)

[18] ibid

1.5.10.The committee notes also that the ACT unfunded superannuation liability is among the lowest in Australia. Further, that once a strategy has been developed the growth in the unfunded liability will be slower than other jurisdictions given the low starting base.

CHAPTER 2. ADEQUACY OF TOWERS PERRIN REPORT - SUPERANNUATION FUNDING OPTIONS

1. THE ROLE OF TOWERS PERRIN

2.1.1. The Government asked Towers Perrin to examine superannuation arrangements for the ACT Public Service as a result of which the company outlined six possible options for financing the unfunded superannuation liability as well as financing future emerging costs.

Towers Perrin options and assumed effects

2.1.2. The options, and consequent effects of each option, considered by Towers Perrin were:[19]

Option 1 full funding of future annual accruing liability and funding of the existing unfunded liability on the current emerging cost payments basis

Effects: Total superannuation payments of up to approximately $141m would be required at the outset to meet the annual accruing CSS/PSS liabilities, the 3% productivity and 9% of salaries for new entrants (after 1 July 1999). Payment of the annual accruing cost would contain the level of the unfunded liability at the 1 July 1998 level before falling to zero by the year 2041.

The unfunded liability would be contained because the future annual accruing liability would be met from the budget and fully funded by 2041 due to existing accumulated assets in the SPU.[20]

Option 2 full funding of future annual accruing liability and an immediate payment during 1998-99 of the unfunded liability

Effects: Future annual superannuation liability would be met in the year in which the liability accrued. Past service liability would be met by an immediate lump sum payment in 1998-99 of $870m (in 1997 dollar values) to bring the unfunded liability to zero in 1999.

Option 3 full funding of future annual accruing liability and an immediate payment during 1998-99 of the unfunded liability by borrowing the amount of the unfunded liability

[19] Towers Perrin, op cit, pp7,8

[20] ibid, p34

Effects: This option is similar to option 2 except that the immediate payment would be via debt financing. This would effectively exchange the unfunded superannuation liability on the balance sheet with debt of an equivalent amount.

Option 4 full funding of future annual accruing liability and funding the unfunded liability over a period of 25 years

Effects: The future annual accruing liability would be met in the year in which it accrued. Past service liability would be extinguished over a 25 year period to reach zero unfunded liability by 2024. This option is similar to option 1 but rather than discharging the unfunded liability at the emerging cost payments rate, it would target full funding over 25 years.

Option 5 partial funding of 70% of the future annual accruing liability, the unfunded liability and the balance of the future annual accruing liability met on an emerging payments basis

Effects: This option would reduce growth rate of the unfunded liability by increased funding in future years. Again it is a modification of option 1 with annual appropriations meeting 70% of future annual superannuation liability in the year in which it accrued.

Option 6 partial funding of 70% of the future annual accruing liability and an immediate payment during 1998-99 of 70% of the unfunded liability, the balance paid on an emerging cost payments basis.

Effects: Similar to option 5, this option would make an immediate payment of 70% of unfunded liability and have a significant impact in reducing the level of the unfunded liability.

2.1.3. For each option the present value of the projected annual appropriations for superannuation were calculated using a discount rate of 7% pa. and 9% pa.

2. AUSTRALIAN GOVERNMENT ACTUARY REVIEW OF THE TOWERS PERRIN REPORT

2.2.1. The Australian Government Actuary (AGA) was engaged to provide expert advice to the committee, that advice was to include the committee's terms of reference dealing with the adequacy of the Towers Perrin reports.

2.2.2. In summary,[21] the AGA recognises the accepted position that the ACT Government will face a significantly increasing strain on its budget as a result of superannuation commitments and should have in place a strategy to cope with the cash flow strain.

2.2.3. The AGA noted that the payment of Actew sale proceeds into the SPU does little more than rearrange the Territory's asset mix, and a net reduction in government debt. This would come at the price of reduced income through the loss of Actew income and essentially mean the trading of one cash flow stream for another.

2.2.4. The AGA observed that if Actew were not sold, the income stream it provides could logically be allocated to meeting superannuation liabilities. It should be possible to meet emerging superannuation commitments through the sale of Actew or, equally, through the application of the Actew income stream. It is important to not that under most strategies money will be diverted away from general revenue through either the loss of the Actew dividend stream, or additional funding requirements from the budget.

3. AGA - SPECIFIC CONCERNS REGARDING TOWERS PERRIN

Accruing costs of the CSS/PSS

2.3.1. The AGA noted that accruing costs, using the Towers Perrin assumptions for the currently unfunded component of CSS/PSS could be expected to be about 16% of salaries or roughly $105m on a payroll of $660m and the Government should be aware of this cash flow strain in its future financial planning. The AGA noted that funding is only one, and not the only, strategy for ensuring that cash flow requirements can be met.[22]

2.3.2. Assumptions basically fall into two categories being demographic and economic:

(a) Demographic assumptions cover things such as mortality, disability rates, resignation rates, the proportion of resignations which take preserved benefits, proportions married, promotional salary increases and so on.

(b) Economic assumptions include things such as assumed investment returns, estimated salary inflation and predicted movements in the Consumer Price Index.

[21] AGA report to committee pp15,16

[22] ibid, pp3,4

2.3.3. The AGA advised that economic assumptions have more effect on estimated costs than the demographic assumptions. Actuaries typically assume a real rate of investment return over price inflation in the range of 3%-5.5% per annum. A 3% per annum real rate of return assumption is regarded as conservative, with a 5.5% per annum assumption being regarded as optimistic.[23]

2.3.4. The AGA expressed concern that the Towers Perrin report had included results based on a 3% per annum real rate of return only, leaving the reader with only the most conservative of final estimates. More conservative assumptions increase the estimate of the value of accrued liabilities and hence inflate the assessed level of unfunded liabilities.

2.3.5. The AGA suggested that the use of a more optimistic real rate of return of 5% per annum would reduce the estimate of the unfunded liability by around $250m. The required amount to fund existing liabilities is subject to considerable uncertainty. In the opinion of the AGA the estimated required amount which would have needed to be set aside at June 1997, to fund the superannuation liability, was probably of the order of $400m to $650m.[24] Government budget papers included only the high end of that range, using an amount of $660m.

2.3.6. The single most important element of the AGA review is their conclusion that the extent of the superannuation liability has, in all reasonable probability, been substantially overstated.

Committee Note

2.3.7. The committee is concerned with the variability in assumptions for the models presented by various participants. Each assumption is important to the longer run costs of superannuation. As an example the committee has prepared Table 3 to illustrate the difference in discount rates assumed by different participants in the debate on the extent of the liability.

Table 3: Variations in Discount Rates for Superannuation and Actew

	Nominal	Inflation	Real
Superannuation			
Government (25 Jan)	0.09	0.04	0.05
Australia Institute	0.07 , 0.09	0.04 , 0.04	0.03 , 0.05
Towers Perrin	0.07 , 0.07 , 0.09	0.025 , 0.04 , 0.04	0.045, 0.03, (0.065, 0.05)
Government Submission	0.08 , 0.09 , 0.1	0.04	0.04 , 0.05 , 0.06

[23] ibid, p5

[24] ibid and p7

OFM (15/10/98)	0.075	0.025 , 0.04	0.05 , 0.035
AGA Conservative	0.07	0.04	0.03
AGA Optimistic	0.095	0.04	0.055
Committee Options	0.08	0.04	0.04

ACTEW	**Nominal**	**Inflation**	**Real**
Government (25 Jan)	0.016 - 0.069	0.00 - 0.025	0.003 - 0.069
Australia Institute	0.07	0.04	0.03
Government Submission	0.09	0.04	0.05

2.3.8. This clearly demonstrates the difficulty the committee has had in assessing each of the options presented. In addition to the discount rate problem the committee notes that figures have also been based in the terms of 1997, 1998 and 1999 dollars. This has hindered a direct comparison because the figures will be skewed by one year.

Recommendation 2

2.3.9. The committee recommends that all future work on superannuation assumes a 'realistic' and consistent discount rate assumption. In addition the committee recommends that the use of a consistent base year should be used for accuracy in comparison of various options.

Financial management of superannuation liabilities

2.3.10.With regard to off-budget agencies which fund their superannuation through payment of contributions to the SPU, the AGA noted that the Towers Perrin report assumes no further off budget agency funding through the SPU. If off-budget funding continued, greater drawdowns could be made from the SPU to lower peak superannuation payments.[25]

4.. ADEQUACY OF THE TOWERS PERRIN REPORT

2.4.1. The AGA found that key messages in the Towers Perrin report stood up to scrutiny. Assessments and comparisons of different funding strategies have been accepted . However, the AGA expressed concerns about certain methodological issues in the report - the declining real salary base for the ACT and the exclusion of any future funding of superannuation liabilities by off-budget agencies.

[25] ibid

2.4.2. With regard to demographic assumptions, the AGA noted that the Towers Perrin valuation of the superannuation liability assumed a stable number of ACT Government employees long term but did not use the accepted Average Weekly Earnings (AWE) as a deflator in assessing the total salary bill for the ACT in wage adjusted terms. The AGA noted that the interaction of the assumptions adopted on promotional salary increases and salary distribution of new entrants leads to a gradual decline in the total salary bill for the ACT in wage adjusted terms. In other words, the average employee salary as a percentage of average weekly earnings declines.[26]

2.4.3. Towers Perrin provided the AGA with a spreadsheet setting out the results of the 1995 projection of emerging costs but did not provide spreadsheets relating to the modelling of the options presented in its report. As a result, the AGA analysis has been limited both by the very tight time constraints and the limited data, and the AGA has only been able to comment primarily on the current arrangements as set out in the Towers Perrin report.

Costs as a percentage of salaries

2.4.4. The AGA noted that costs as a percentage of salaries (page 65 of the Towers Perrin report) are not equal to costs divided by salary as shown on the spreadsheet provided by Towers Perrin. It appears that for both CSS/PSS and total superannuation outlays, the percentage of salary columns may have been displaced by two years so that, for example, the figure reported for 1997 actually related to 1995.[27]

Use of assumptions

2.4.5. The AGA concluded that, contrary to Towers Perrin's statement that separate long term and short terms assumptions have been used, the figures available revealed that the short term CPI assumptions have not been used in calculating the value of salaries, outlays and liabilities in 1997 dollar terms. Accordingly, the AGA was unable to determine whether the short term assumptions have been used elsewhere in the calculations.[28]

Implicit accruing costs

[26] ibid, p7

[27] ibid, p9

[28] ibid

2.4.6. The AGA noted that neither the report nor the spreadsheet provided give any explicit figures on the accruing costs under the CSS/PSS. However, the AGA observed that figures for accruing costs varied more from year to year than would be expected and, in later years, gave negative results. This should not be possible and suggests that at least one of the accrued liability or emerging cost figures must have been mis-stated.[29]

Employer costs for future service

2.4.7. The AGA noted that it is not clear how the figure representing the present value of employer contributions for future service in the table on page 43 of the Towers Perrin report has been derived. An upper bound of the future liability in relation to the CSS/PSS should be able to be calculated by summing future emerging cost payments plus the residual accrued liability at 2045 (the final year of the projections) discounted to 1998 less the accrued liability as at 1998. The AGA arrived at a figure of $938m using a 7% discount rate compared to the $1051m quoted in the report.

5. AN ALTERNATIVE ASSESSMENT OF THE TOWERS PERRIN OPTIONS

2.5.1. The committee benefited from views offered on the Towers Perrin options by a former Australian Government Actuary, Mr John Ford, although it should be noted that Mr Ford did not have access to Towers Perrin's detailed figures.

2.5.2. Mr Ford made the point that the professional standards of the Institute of Actuaries of Australia make quite clear that any unfunded liability does not have to be covered when comparing one fund to another. Mr Ford strongly recommended the adoption of a long term plan which is aimed at maintaining the costs year by year at a constant percentage of gross salaries paid.[30]

2.5.3. Mr Ford proffered the view that Towers Perrin Options 1, 3 and 4 are not effective in removing the unevenness of costs, while Option 2 would bring forward costs. Mr Ford considered that more desirably, Towers Perrin Options 5 and 6 would produce a reasonably even progression of costs.[31]

2.5.4. He noted that under Towers Perrin Options 5 and 6 the ACT would make sufficient payments into a fund to cover 70% of future liabilities under the CSS/PSS as they accrue, with:

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[29] ibid, p10

[30] Mr J Ford , transcript p52 and submission to committee

[31] Mr J Ford, submission to committee

(i) under Option 5, the balance of the costs of the CSS/PSS being met as benefits are actually paid; and

(ii) under Option 6, 70% of the unfunded past service liability being paid up front and the balance of the costs of the CSS/PSS that remain being met as benefits are actually paid.

2.5.5. Mr Ford further noted that 70% is an arbitrary figure chosen by Towers Perrin to illustrate the effect of funding part of the capital values of accrued liabilities.

2.5.6. In his view, he saw Towers Perrin Option 5 as spreading the cost over the long term but made the point that the unfunded liability should not drive decisions as to what plan is adopted.[32]

Recommendation 3

2.5.7. The committee recommends that the Assembly take note of Mr Ford's suggestion that the costs should be spread over a long time period. The committee believes that this is an objective to be strived for by the Assembly.

6. COMMITTEE'S QUALIFICATION AND COMMENTS

2.6.1. The committee shares the view that unnecessary focus has been brought to bear on the dramatic numbers associated with the unfunded superannuation liability. The committee recognises that capacity to meet emerging costs, and the desirability of containing payments within a relatively constant range, should have received greater prominence in the debate.

2.6.2. There is sufficient doubt raised by the AGA as to the accuracy/veracity of figures in the Towers Perrin report to warrant considerable caution in extrapolating the Towers Perrin costing options in the development of the Government's preferred funding proposal to meet the superannuation funding liability.

[32] Mr Ford, transcript, p52

CHAPTER`3. EFFICACY OF A ONE-OFF FUNDING OPTION

1. OVERVIEW

3.1.1. The committee sees this term of reference as requiring an assessment of the viability and effectiveness of using the sale proceeds of Actew to fully fund the past service superannuation liability. Some of the conclusions of this section will necessarily cross-over the findings on the downstream economic impact.

2. ACTEW'S MONOPOLY POSITION

3.2.1. In the main, Actew operates as an income producing natural monopoly and is subject to minimal competition.

3.2.2. The primary reason for the proposed sale of Actew advanced by the Government has been the impact of competition arising from the implementation of National Competition Policy and the establishment of the National (electricity) Grid. It is argued by the Government that Actew, as a relatively small distributor of electricity, could be out of its league and may not be able to compete with the much larger players in purchasing bulk energy and retailing it to customers.

3.2.3. In the generation and wholesaling of bulk electricity there has been fierce competition and this has rippled through to the benefit of distributors and to larger customers. However, to date Actew has also secured quite favourable extended contracts for bulk supplies.

Retail electricity business

3.2.4. With the retention of Actew in public ownership, the Government will need to maintain and continually monitor strategies to minimise risk exposure in electricity retailing. The committee considers that the available options might include the forming of strategic alliances, franchising the distribution business, phasing Actew out of the higher end of the market where competition is strongest and fluctuations in volume sales could be significant.

3.2.5. Actew's forward estimates, embraced by consultants ABN-AMRO, show very low projected returns from the retail business, but an overall steady and healthy stream of profits. These profits are expected from electricity distribution (delivering electricity via poles & wires etc.) and from water and sewerage services, all of which do not face significant risk.

3.2.6. To put the retail business in perspective, the committee notes that Actew last year expended less than $100m on bulk electricity purchases while it made an overall operating profit in excess of $80m before interest and taxes.

3.2.7. Actew could turn the competitive environment into an advantage by setting itself up as an agency providing meter reading, local maintenance, billing and receipting, and customer inquiry services for any outside distributors on fee for service basis. This could maximise the benefits of competition to ACT residents and businesses, retain jobs in Canberra and virtually eliminate risk altogether. It owns the metering, the data processing software and the customer data base; there is a distinct opportunity here for a progressive Actew.

Recommendation 4

3.2.8. The committee recommends that the Government develop strategies to mitigate the retail risk associated with the ownership of Actew. When these strategies are developed the committee requests that the results be presented to the Assembly for debate.

3. RISK ASSOCIATED WITH DISPOSAL

3.3.1. The committee is concerned that the one-off funding option will would carry with it a significantly increased financial risk for the Territory. The financial risk is associated with holding a financial asset in a scheme involving equity market investments. Any scheme for superannuation will face such risk, but the larger the fund - the greater the risk. Selling Actew to immediately build the fund to the maximum level will bring the maximum exposure to the risks associated with speculative investment.

3.3.2. To achieve the returns anticipated in the Government’s proposal it will be necessary to invest a significant proportion of the fund in the equities markets. Despite some assertions that Actew faces a whole battery of risks, it is fair to say that, retail electricity excepted, it is less exposed than a portfolio of share market investments.

3.3.3. If a sizeable proportion of a billion dollars is held in liquid assets such as stocks and bonds the risks of market downturn put the ACT Government’s superannuation assets in the hands of private investors. While it is recognised that the asset would be diversified, it is also recognised that stock market corrections and devaluations, including significant ‘crashes’ occur from time to time. The superannuation fund will be needed indefinitely. The probability of it experiencing fluctuations in share price indices is extremely high.

3.3.4. So much work has gone into the assessment of the risks facing Actew, but no analysis exists of the potential for downturn in the superannuation asset account. To

understand the reality of the potential losses one need look no further than the Government's Financial Management Report for November 1998. It states that "Other Revenue is negative for the month of November due to a decrease in the market value of equity investments held by the Superannuation and Investment Unit (SPIU). Similar losses occurred during August and September."[33]

3.3.5. It has been suggested by Mr Ford in his appearance before the committee, that the money could be paid directly to the Commonwealth. This would obviate any direct market risk to the SPU. This is one option which may be explored, but one which the committee considers unlikely.

3.3.6. It is to be remembered that strategies implemented following this debate will be intended to remain in place over 50 years and beyond. The committee believes that the greater the level liquid, and semi-liquid, assets held by governments over that expanse of time, the greater the temptation draw from them for shorter term ends.

3.3.7. A responsible approach would include ensuring that funds dedicated to meeting long-term liabilities are not readily able to be dissipated before those liabilities mature. If there is a choice between real assets and negotiable assets, that is relatively neutral as regards anticipated returns, then the real assets ought be selected.

3.3.8. At the end of the day, the committee believes that the sale of Actew to provide a one-off funding option for superannuation is not a preferred option. The long run income stream from a properly managed Actew will be lost along with any potential taxation equivalents and community expenditure by the company. There has been no analysis of the potential down-side risk of investing in the equity market, and the committee considers that account of this risk versus the limited market risk faced by Actew has not been recognised.

Recommendation 5

3.3.9. The committee recommends that legislation be introduced to ensure funds dedicated to superannuation remain dedicated. The committee also recommends that the legislation contain clauses which require a majority of votes in the assembly for a change in the use of funds dedicated for superannuation purposes.

Recommendation 6

3.3.10.The committee recommends that the Assembly take note of the potential risks involved with investing the potential Actew sale proceeds in the highly volatile equity market.

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[33] ACT Government; *ACT Consolidated Financial Management Report for the Month and Financial Year to Date ending 30 November 1998*. (December 1998). p 10, *n* 4.

4. WATER & SEWERAGE SERVICES

3.4.1. The committee is concerned that the Government's proposal to franchise the use of Actew's dams and water, and sewerage treatment plants, while selling the interconnecting pipe networks is not fully understood, nor has it been a focal point in the debate regarding the proposed sale of Actew.

3.4.2. This aspect of the sale proposal has to be questioned. The committee believes that the sale of the network would effectively render the dams and plants entirely useless to anyone other than the owner of the network, at the expiration of the franchise period. It is therefore a virtual sale of the total water and sewerage systems, as control of critical elements are surrendered forever, effectively relinquishing total control. It is a bizarre arrangement.

3.4.3. The justification for the privatisation of water and sewerage services has received little attention. The implications for the protection of the ACT's basic water resources, for environmental protection, and for general community health are considerable, fraught with so many unknowns that it would be irresponsible for the committee and the Assembly to seriously contemplate the proposal.

3.4.4. Again the committee notes that these assets will be sold off to put funds into a high risk investment fund. The committee believes that this approach is not prudent.

5. ACTEW - ACTUARIALLY PROJECTED CASH FLOWS

3.5.1. The committee asked the Australian Government Actuary to make an analysis of alternative strategies based upon continued public ownership of Actew. In particular the AGA was asked to look at projected cash flows and a special dividend of $300m raised by borrowing by Actew and payable to the Government.

3.5.2. In summary, the AGA, report attached, advised that it should be possible to meet the accrued unfunded superannuation liabilities through the use of the Actew income stream if Actew is retained in public ownership.

3.5.3. More specifically, the AGA noted that Actew's earnings before interest and tax (EBIT) are estimated at $72m for 1998-99. Using published Actew information in its annual reports and Statement of Corporate Intent, and on the basis of certain assumptions, including the Towers Perrin stated CPI assumptions, the AGA calculated Actew's income streams in nominal and 1997 dollar terms.

3.5.4. The AGA assumed that 30% of Actew's EBIT needs to be reinvested to maintain its EBIT in real terms. that existing debt will have an assessed interest burden,[34] that any new debt will have an interest burden of CPI + 3% and any earnings

[34] AGA report to committee, p13

after deductions for reinvestment and interest payments will be paid to the ACT Government.

3.5.5. Accordingly, the AGA estimated Actew's income stream rising from $73.8m in 1999-00 to $121.1m in 2012-12 to $392.8m in 2042-43 with income for payment to the Government (after reinvestment and interest) of $41.0m in 1999-00 rising to $45.2m in 2012-13 to $48.0m in 2042-43.[35]

Committee comment

3.5.6. The committee contends that Actew clearly has the potential to provide revenues to the ACT indefinitely with very limited risk exposure, and that any actual risk exposure should have been the subject of greater analysis than has taken place to date.

3.5.7. Actew's water and sewerage services do not face competition. Like electricity distribution, they are also natural monopolies, and will remain so regardless of the ownership question. There is no compelling reason to sell the water and sewerage business. There are very sound reasons for retaining it in public hands - public health, environmental protection, resource conservation, and so on.

Recommendation 7

3.5.8. The committee believes that the sale of Actew should not proceed to finance a one-off funding option for superannuation.

[35] ibid, p14

CHAPTER 4. ALTERNATIVE FUNDING PROPOSALS

1. OVERVIEW

4.1.1. The time available has not permitted refinement of alternative models to the point where the committee would unequivocally recommend one individual version as absolutely preferred.

4.1.2. As recently as Wednesday, 27 January 1999 information supplied by Towers Perrin was being refined and inconsistencies were being ironed out. With the last few days of report preparation having been taken up by the committee seeking to gain general agreement on its contents, it was necessary to close off work on the alternatives prematurely.

4.1.3. The considerable amount of work done does clearly demonstrate that the outright sale of Actew is far from the only solution. The work and the report of the Australia Institute have confirmed this. It is also intuitively logical. Changing the form of assets held cannot in itself dramatically alter future prospects, unless the returns derived from one form of the assets are somehow markedly different from another. No such expectation has been identified.

4.1.4. The model for addressing the unfunded superannuation will, in all probability, include some but not all of the following elements:-

(i) A sizeable immediate repatriation of capital from Actew - in the range of $250m to $400m.

(ii) An income stream of dividends from the continued operation of Actew.

(iii) The budget contributions identified in the early years in the Government's proposal - probably reduced by an amount equal to the interest that will not be saved because Actew is not sold and existing debt is not retired.

(iv) A possible further capital contribution from Actew in 12 or so years hence. This would have built up through the application of taxation avoidance measures now being used. Alternatively, Actew's capacity to employ taxation avoidance strategies may well diminish and taxation equivalents could then become directly available. This element may be rendered unnecessary when more probable commencing estimates are factored into calculations.

(v) Continuing budget payments to meet superannuation contributions of the future as they accrue.

(vi) A recognition that they is a residual level of superannuation liability that may never need to be fully funded, only contained at a constant real level.

4.1.5. The degree to which all of these elements are required is dependent upon the objectively assessed magnitude of the existing and emerging liabilities. The revelation that data provided in consultants' report was almost exclusively based on the worst case scenarios means that there is a whole body of calculations that must be reworked to provide a fair picture of the present and the future.

4.1.6. Modelling done before the bias in the figures provided was identified has shown that, even in the extreme case, the superannuation liability can be managed. The following section includes some of that work. It is presented with the qualification that more work is required, ie. modelling of the more reasonable estimates of the magnitude of the superannuation problem.

Committee Note

4.1.7. The committee believes it is critical to recognise that the superannuation figures will be reviewed by ComSuper in the triennial review in 1999. The effect of the triennial review is uncertain and that exacerbates the problems with the modelling put forward by the AGA.

2. ACT GOVERNMENT FUNDING OPTIONS

4.2.1. The Government advised that the 1998-99 budget introduction of full funding of employer contributions for new entrants to the ACTPS from 1 July 1999 and additional funding of $200m over four years to the SPU was consistent with Towers Perrin Option 5, and that the proposed investment in the SPU of $765m from the sale of Actew would be consistent with Towers Perrin Option 2.[36]

4.2.2. In its submission to the committee the Government selected four modelling options to take account of its aim of full or close to full funding, the Government's stated intention of investing $765m in the SPU and alternatives canvassed publicly including a one-off investment of between $200m and $300m. They represent a refinement of some of the broad options presented by Towers Perrin.[37]

[36] Government submission to committee, p22

[37] ibid, p29

4.2.3. The modelling options provide for:

Option A. investment of $765m in 1999-2000 with annual funding of $30m in following years
Option B. investment of $765m in 1999-2000 in addition to budgeted funding and continued annual funding of $70m
Option C. investment of $250m in 1999-2000 with annual funding of $30m in following years until SPU is exhausted, then meet emerging costs
Option D. funding as per budget with continued annual funding of $70m

Government's Options A & B - sale of Actew with annual payments of $30/$70m

4.2.4. As already well known and referred to earlier in this report, the Government's preferred option is to sell Actew and invest $765m from the proceeds in the SPU. The Government advised that the NPV cost of doing this had a number of components including the cost of surplus sale proceeds assumed to be invested with a real return of 5%, the costs of Actew dividends foregone, and the cost of additional budget funding from 2000/01 to 2007/08.[38]

4.2.5. The Government found it difficult to accurately estimate the likely Actew dividend payments over the next 40 years, but concluded that $44m a year could be expected. However, it did concede that dividends of $47.3m in 2000-01 and $54m in 2001-02 had been forecast by Actew.[39]

4.2.6. The committee was advised that Option A and SPU investment earnings would be sufficient to fund 100% of emerging cost payments for the CSS/PSS from 1999-2000 onwards, maintain a reserve equal to at least 85% of the total CSS/PSS liability and require no further budget funding for the CSS/PSS commitments beyond 2007-2008. The Government stated that total superannuation outlays would range between 6% and 9% over the period compared with the long run cost of superannuation of 9% of salary under the Superannuation Guarantee.

4.2.7. Under Option B the Government would expect annual payments of $70m until 2002-2003, a payment of $21m in 2003-2004 and no further payments after that. Reserves would be within 85% and 100% of liabilities over the period. As a percentage of salaries, the annual costs would peak at 14% initially, drop to 5% and gradually increase to 9% long term.

Government's Option C - invest $250m plus budget funding of $30m a year

[38] ibid, p51

[39] ibid

4.2.8. This option is based upon a capital repayment from Actew. As with Option A and B, the NPV cost of this option would have a number of components including the cost of surplus sale proceeds assumed to be invested with a real return of 5%, the costs of part of the Actew dividends foregone and the cost of additional budget funding in the future.

4.2.9. Option C would have funding reach 55% of the CSS/PSS liabilities in the first few years then decline to the point where it coincided with the peak in CSS/PSS costs requiring funding of $115m in 2033-34 to meet emerging CSS/PSS costs. Total outlays for both the CSS/PSS and the new scheme employees would exceed $200m in 2033, equivalent to 20% of salaries.

Government's Option D - budget funding of $70m a year

4.2.10.As with the other options the NPV cost of this option would include the surplus sale proceeds assumed to be invested with a real return of 5% and the cost of additional budget funding in the future

4.2.11.Option D would require no budget payments for CSS/PSS emerging costs after 2023-24 as investment earnings and contributions from non-budget funded agencies would be sufficient to meet those costs. Total superannuation payments would be 14%-16% of salaries through 20 years with long term costs of 9% under the new entrant scheme.

3. THE AUSTRALIA INSTITUTE OPTION

4.3.1. With regard to the superannuation liability, the Australia Institute proposed that Actew make an immediate payment of $400m to the ACT Government, to be allocated to the SPU, and that future dividends of $25m per year (in 1998 values) be similarly allocated until the existing liability is fully funded.

4.3.2. The Australia Institute recommended as a part of their option that all future accruing costs for the CSS/PSS and the new scheme employees should be fully funded.

4.3.3. The Institute offered two main reasons for the initial lump sum payment. First, that Actew's debt-equity ratio is currently very low and the proposal would make Actew's capital structure comparable to that of other utilities. (The Institute noted that the ABN AMRO report argued that Actew should take on an additional $300m in debt in order to make its debt/equity ratio similar to other utilities).

4.3.4. The Institute argued that while it is essential to achieve full funding of emerging liabilities, a more detailed consideration of the timing of emerging liabilities and the expected budget position may show that partial funding is desirable for an initial period so as to ease the adjustment to full funding.

4.3.5. The Institute argued this would ease the budgetary difficulties generated by the 'baby boom hump' in superannuation payments over the next 15-20 years and that the issue is one of the timing of payments and revenues so as to minimise the impact on the provision of public services.

4.3.6. The Institute demonstrated that under its proposal the accumulated value of a $400m payment (from Actew) combined with subsequent dividend contributions from Actew could finance the elimination of the existing unfunded superannuation liability within between 12-21 years depending on whether the rate of investment return was 7% or 9%. In addition the assumption of fully funding accruing liabilities means that there would be no growth in the unfunded liability. Thereafter, the earnings of Actew would be available to finance public expenditures or reductions in taxation.

4.3.7. The Institute argued that its proposal would allow for Actew to retain earnings of around $10m per year (in 1997 values) to finance new investment or to retire Actew debt, whereas, the earnings of Actew would be permanently lost if the body was sold.[40]

Committee comment

4.3.8. The committee thought it was fair to point out that the proposal put forward by The Australia Institute did not have a $1b "black hole" as claimed by the Government. In fact the model assumed that the liabilities accruing as of 1999 could be fully funded meaning that in Net Present Value terms only the current unfunded liability would require treatment.

4.3.9. The committee recognises the drain on the resources that this option would cause, however thought it was fair to state for the record that the report does not have any holes in it as far as the superannuation modelling is concerned.

4. COMMITTEE OPTIONS

4.4.1. As mentioned the committee benefited from a briefing from Towers Perrin. As a result of this briefing Towers Perrin agrees to run a serious of proposals put forward by the committee.

4.4.2. The purpose of the funding options proposed was to smooth the call on the budget on a year by year basis. Towers Perrin has provided the results to the

[40] ibid, pp 7-9

committee. However as recently as 27 January 1999, the secretary of the committee was still receiving data from Towers Perrin that required serious qualification.

4.4.3. Following the guidelines set out in the introduction to this section the committee determined several possible scenarios for funding superannuation that did not involve selling Actew. Those options are listed under Table 4. The committee also suggested modelling on the new service scheme funding options. When modelling the options the committee also requested figures for a mirror PSS scheme for new service employees.

Table 4: Options Requested from Towers Perrin

One-Off Contribution - yr. 1999	One-Off Contribution - yr. 2012	Annual Contribution
$250 million	-	$33 million
$250 million	$200 million	$33 million
$300 million	-	$33 million
$300 million	$200 million	$33 million
$250 million	-	$40 million
$250 million	$200 million	$40 million
$300 million	-	$40 million
$300 million	$200 million	$40 million
$400 million	-	$25 million
$400 million	$200 million	$25 million

Committee Comment

4.4.4. The committee emphasises that all of the options spread the costs over time in line with Mr Ford's recommendations. Unfortunately, not all of these models succeed in funding the entirety of the call on budget. For the purposes of the discussions on downstream effects the committee has chosen three of the options above as viable alternatives. Those that were rejected have been compiled into graphs and attached at Appendix 2.

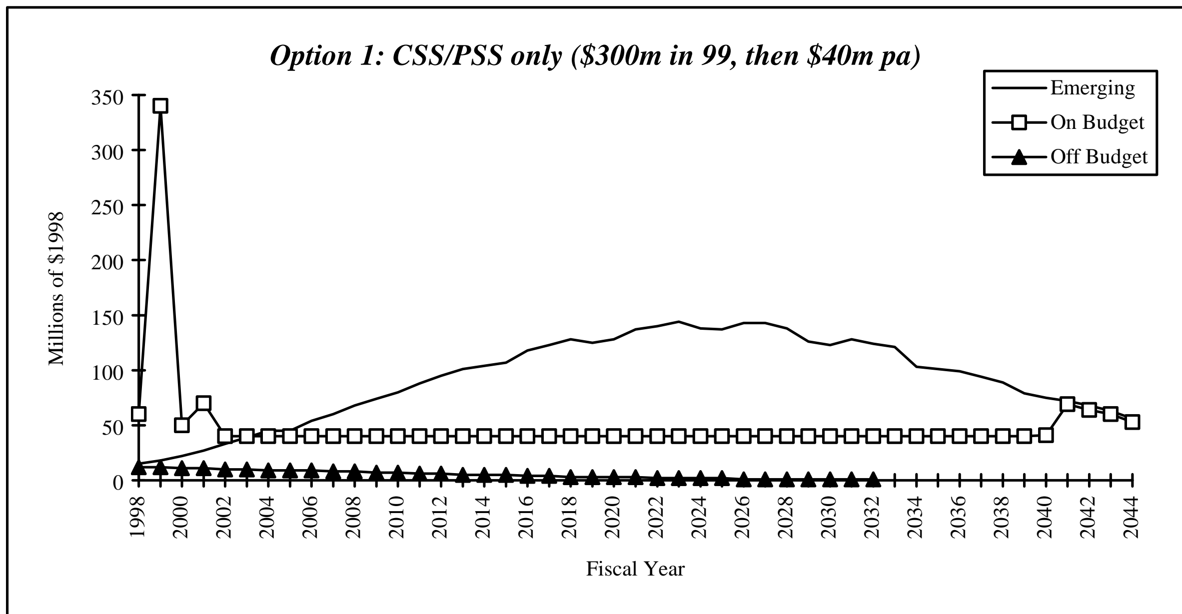
4.4.5. The three viable options are listed under the titles of Option D, E and F in the downstream effects section, however they include the following payments strategies.

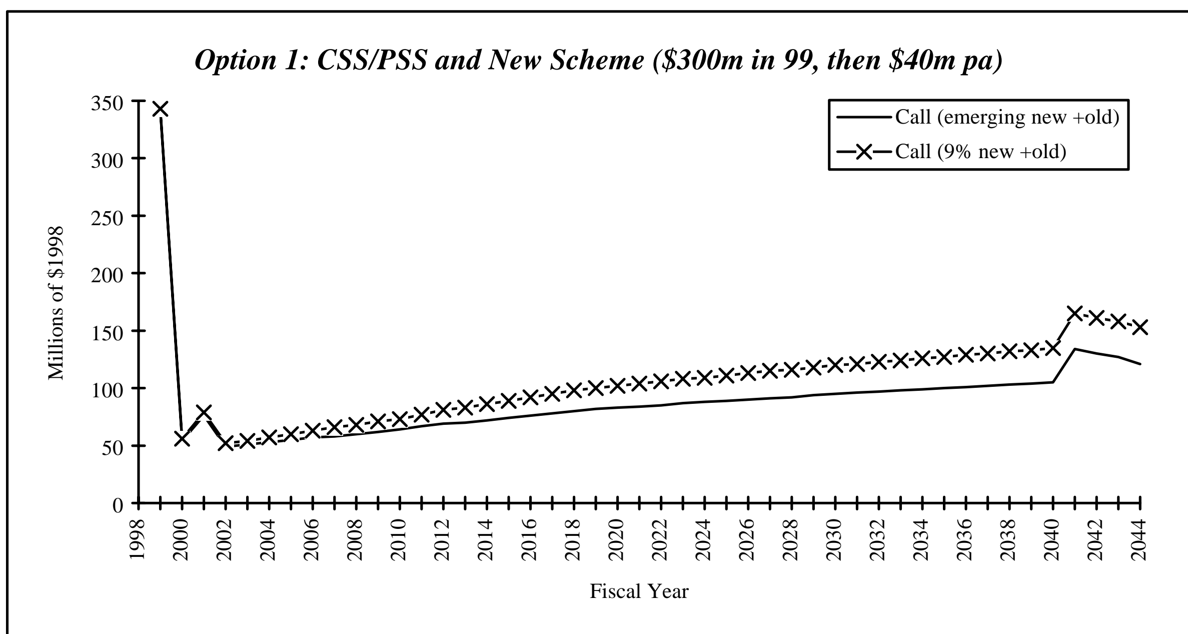
Option 1: $300m in 1999, then $40m per annum
Option 2: $300m in 1999, $200m in 2012, then $40m per annum
Option 3: $250m in 1999, $200m in 2012 and $40m per annum.

Descriptions and effects

Option 1

4.4.6. The committee requested a two stage process whereby Actew would repatriate $300m initially, and then provide $40m per annum. The annual call remains at $40m per annum until 2040. The problem with this option is that the SPU runs out of assets in the same year. The figures were prepared by Towers Perrin and have not been audited. So it is possible that the assets will last longer. The charts below indicate that the cost is 'smoothed' except when the funding theoretically runs out.

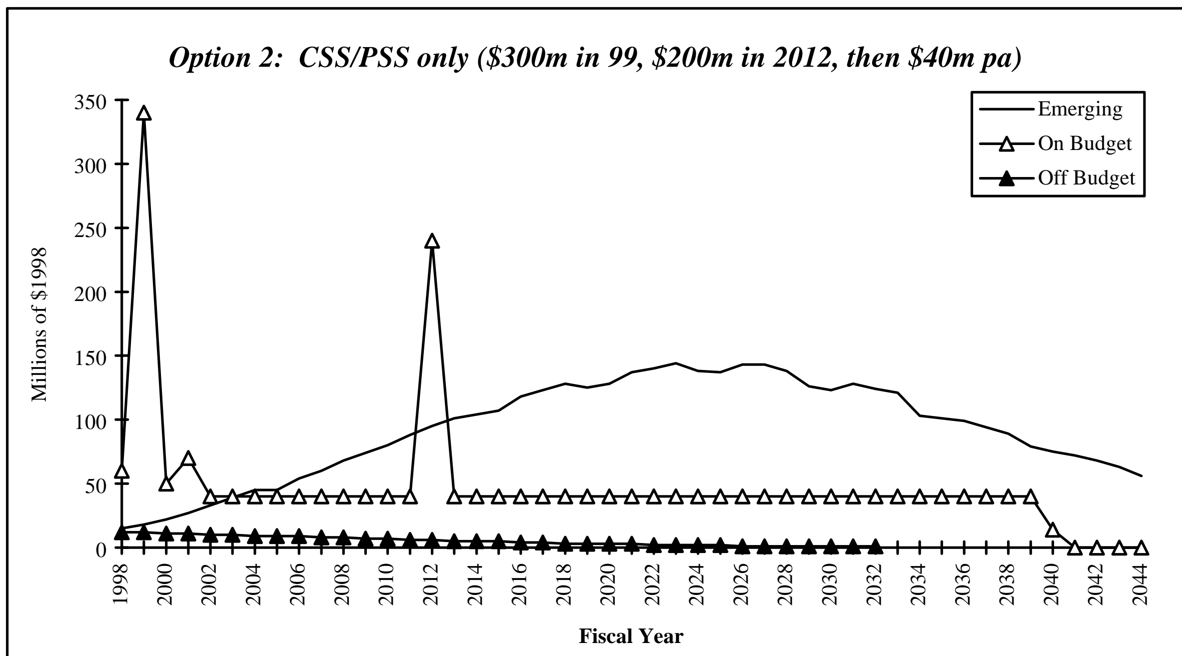


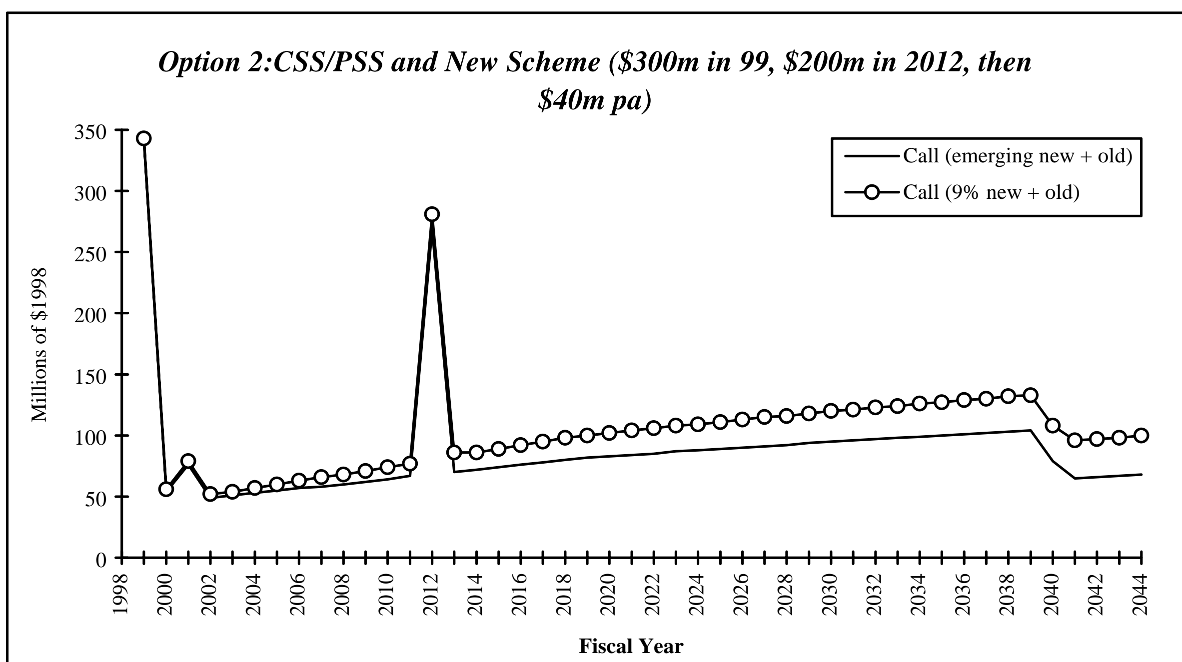


Option 2

4.4.7. This strategy involves the same repatriation as option 1, except it includes a second injection of $200m in 2012. The second repatriation would re-gear Actew at a period where it is assumed the original loan would be paid off by Actew. The $40m per annum is not necessary after 2038. Again the strategy would be likely to succeed in full funding earlier due to the possibility of poor modelling.

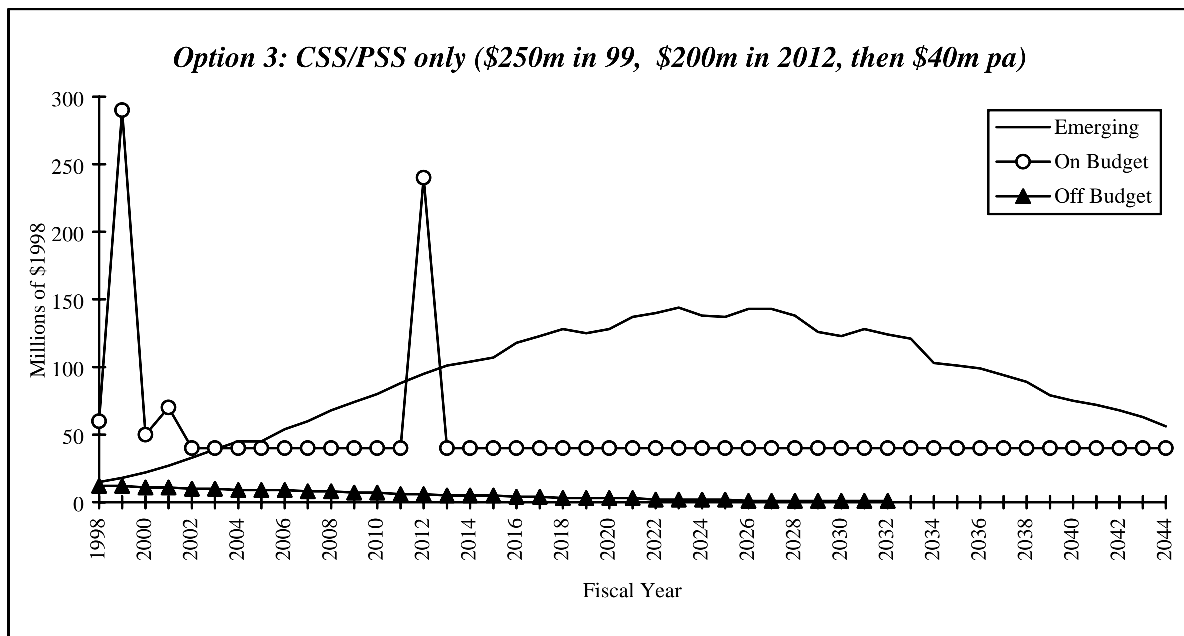
4.4.8. The two graphs below show the effects of this strategy relating to both the CSS/PSS and the new scheme under both the full funding strategy and the mirror PSS scheme.

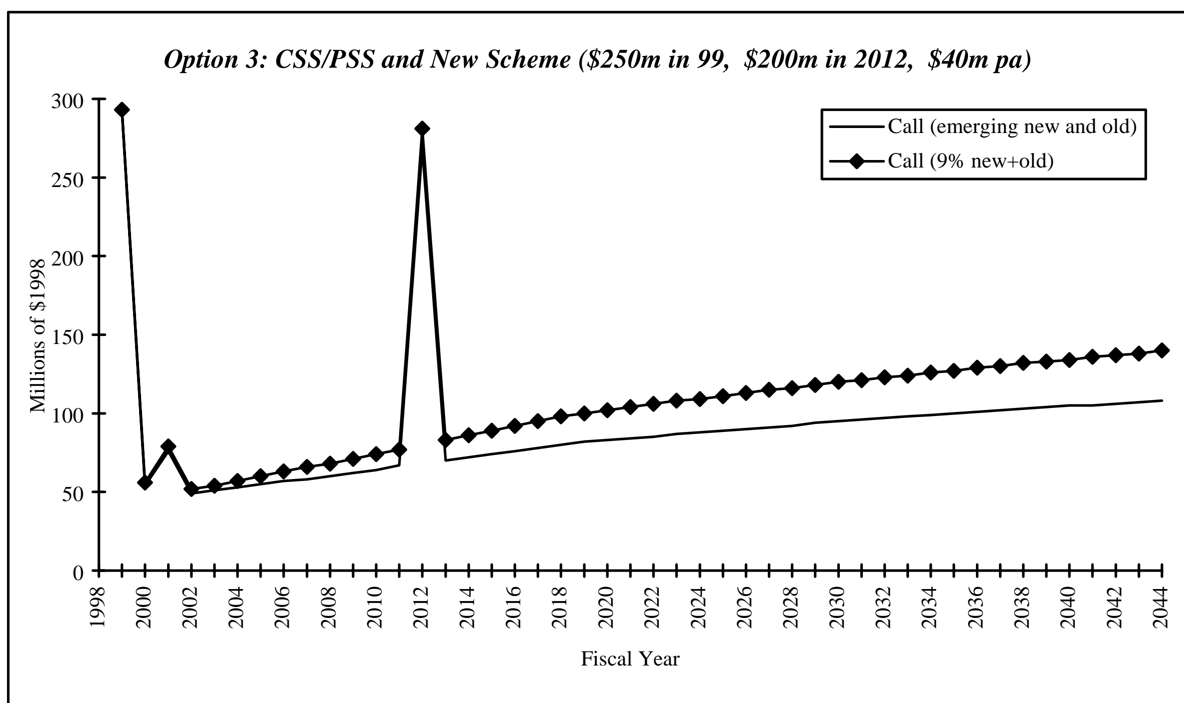




Option 3

4.4.9. Option three reduced the original repatriation to $250m, but contains the same elements as option 2 regarding the annual contribution and the latter repatriation. The effects of these models are listed below.





5. CONCLUSION

4.5.1. The committee is not surprised to see that there are a multitude of possible options that the ACT Government could adopt to address the unfunded portion of the superannuation liability.

4.5.2. It is strongly recommended by the committee that once the most recent ComSuper data becomes available that each of these options is remodelled and considered as an option to fund the liability to date.

Recommendation 8

4.5.3. The committee recommends that the Australian Government Actuary be engaged to remodel all options presented here and the Government table the results in the Assembly once the triennial review has been completed.

Recommendation 9

4.5.4. The committee recommends that the government develop a strategy, from within those presented here, which:

- **(i) minimises the net impact on the budget;**
- **(ii) provides a timed approach to funding the unfunded portion of the liability;**
- **(iii) includes a repatriation from Actew to increase the current SPU coverage to above 30%; and**
- **(iv) utilises the income stream from Actew to contribute towards the unfunded liability.**

CHAPTER 5. DOWNSTREAM ECONOMIC EFFECTS

1. THE METHOD USED TO ASSESS DOWNSTREAM EFFECTS

5.1.1. The sale of Actew has been presented by the Government as the only workable method of funding the unfunded superannuation liability.[41] Accordingly there is a need to consider the effects of selling the asset.

5.1.2. In assessing the impact of the sale of Actew on the wider economy the Government's Actew sale consultants suggested "such an analysis would require the assessment of the position of the ACT regional economy with and without the sale of Actew...In the view of ABN AMRO/DGJ Projects such an assessment would at best be highly speculative."[42]

5.1.3. The committee agrees that the assessment may be highly speculative, but necessary nonetheless. The Government submission to the committee provided an interesting starting point with the use of a standard academic five sector national income model.[43]

5.1.4. The committee is of the view that it is necessary to be more rigorous with the impact of the variables in the model. The committee has adopted this model, but in a qualitative manner, looking mostly at the relational impact of each option proposed.

5.1.5. For the benefit of the Assembly the committee has constructed a very general overview of this model. The introduction in Panel 1 below will be the basis of the discussion in this chapter.

Committee Note

5.1.6. It should be noted that the complexity of the issues has prevented the committee discussing the social, environmental and regulatory issues as a part of the downstream effects on the economy.

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[41] CARNELL PR: Proceeds to be invested for all Canberrans. Oct 98

[42] ABN AMRO, Scoping Study, p v.

[43] Gov Sub, pp 54.

Panel 1: Downstream Impact Model

Government suggested income model: $\boldsymbol{Y = C + I + (G\text{-}T)+(X\text{-}M)}$

Y = Gross State Product, C= Consumption, I= Investment, G= Government Expenditure, T= Government taxation (income), X= Exports and M= Imports.

The equation represents the theoretical flow of resources between five key sectors of any economy. It is an expenditure based model. The five sectors represented by this relational equation are the household sector, the 'business' sector, the Government sector, the finance sector and the international/external sector.

A key part of the model is that each variable has a multiplier component. Accordingly when one dollar is lost, it perpetuates through the entire economy. This also works on reduction in jobs and so-on. This will become more clear in the discussion.

1. The household sector represents the 'mums and dads' and other private citizens in the economy. These units are responsible for some of each of the elements in the equation because they are taxed, they spend money on food (consume) and put money in the bank. Ultimately they are represented in each part of the 'equation'.

2. The 'firms' sector includes all businesses actively participating in the economy. Electricians, plumbers, consultants and actuaries would be included within this category. As with the household sector, firms participate in most parts of the equation by spending money on production, saving, investing and importing foreign parts or exporting goods and services.

3. The Government sector in the ACT is more peculiar than other economies because we have both the ACT Government and a relatively large proportion of total Territory revenue being provided by the Federal Government. The Government taxes, spends, invests and saves, and also has an impact on the decisions of the household and firms sector.

4. The finance sector represents the total inflow and outflow of the banks, insurance and credit industries. In the ACT the primary players in this sector are private sector players. This is because we have the Central Finance Unit as our equivalent to the Reserve Bank, and the CFU mostly administers money, rather than trading in it (except as far as government investments are concerned).

5. Finally the international/external sector represents how much, as an entire economy, we send out of the Territory or bring back into the Territory. For example if a household buys a new car it is imported and money is exported to the State economy where the producer is located. The decisions taken across the other four sectors impact on this part of the economy.

NB: The committee notes that this is a very brief overview. For a more detailed introduction to the workings of the model adopted by the Government's submission interested parties are recommended to consult with an introductory economics text.

2. DOWNSTREAM EFFECTS OF OPTIONS INVOLVING THE SALE OF ACTEW

Option A: $765m into SPU, then $30m onwards

Household Sector

5.2.1. The committee believes that there will be two key indirect economic effects created by the sale of Actew being prices and employment. The indirect effect on households of a new owner taking over Actew have been assumed away by the Government submission. In fact they state that "...the Government's approach to pricing regulation is ownership neutral and therefore will not be affected by a change from public to private ownership."[44] The committee believes that this is a dubious assumption.

5.2.2. The Act that governs the work of the pricing regulator allows the Commissioner to determine a suitable rate of return to the utility owner making an application. A private owner will require a return on an investment of $1 billion. According to the Under-Treasurer the return sought would range between 10 and 12% per annum. The Australia Institute believe that the figure is likely to be 10%. We will settle on 10%.[45] According to ABN AMRO projections Actew makes, and will make, a return on assets (ROA) in the order of about 5%.[46]

5.2.3. The effect of requiring a 10% rate of return on a billion dollar investment will be that Actew in private hands will need to make $100m per annum in earnings before interest and tax.[47] At current the entity makes around $80m.[48] That leaves two options for the owner, reduce costs or seek a price rise.

5.2.4. If a 'benchmarking' approach to pricing is used by a new owner then there is no doubt held by the committee that the Commissioner would have justification for a price rise. According to Graph 1, the ACT has the lowest electricity prices in Australia. If average Australian prices are sought, and gained, then a price rise of 2.5 cents per kilowatt hour (or 35.7%) is entirely possible.

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[44] Gov Sub, p47

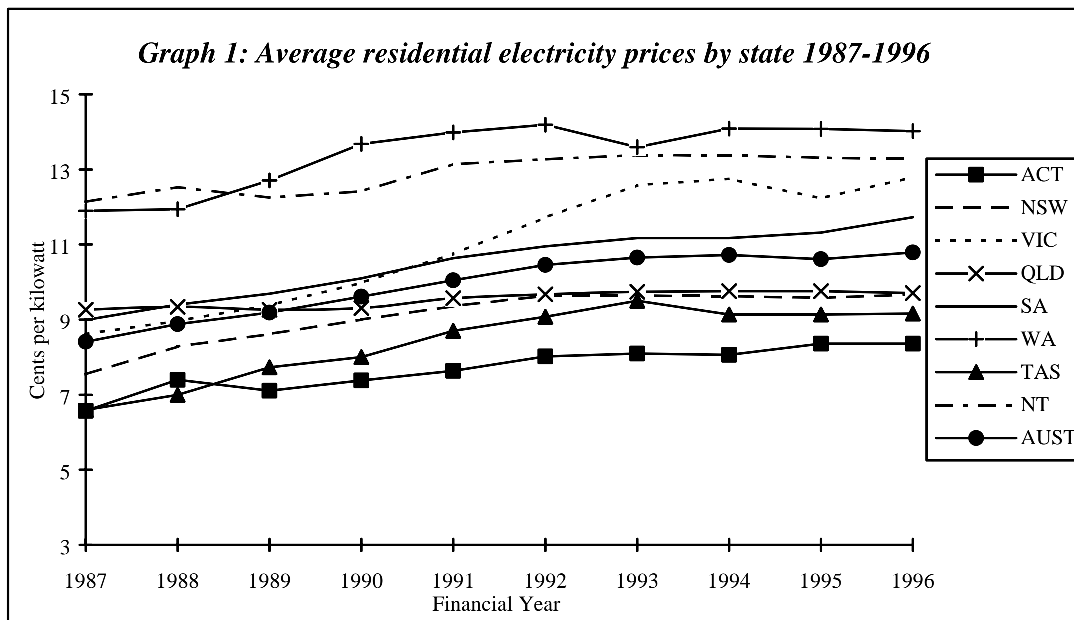
[45] Hearing transcript, pp4 & 39

[46] ABN AMRO, exec sum

[47] Earnings Before Interest and Tax is used as required under the Return on Assets (ROA) equation: ROA = EBIT/Total Assets.

[48] annual rep, 97, p??

5.2.5. Accordingly it will be necessary for the household sector to reduce its disposable income by an amount that will allow for coverage of more expensive power and possibility water and sewerage bills. This naturally diverts funds away from other private expenditure areas, or savings and investment.



Sources: Electricity Prices in Australia 1998/99, Electricity Supply Association of Australia Ltd, 1998, pp 76-78.

5.2.6. Accordingly the committee believes that the sale of Actew will provide justification for a price rise application which will lead to a contraction in either disposable income or savings. Thus the first downstream effect of selling Actew to provide $765m to funding superannuation that the committee notes, on the qualitative evidence available, is that prices may rise which will lead to a contraction in disposable income due to the inelastic demand for electricity services.[49]

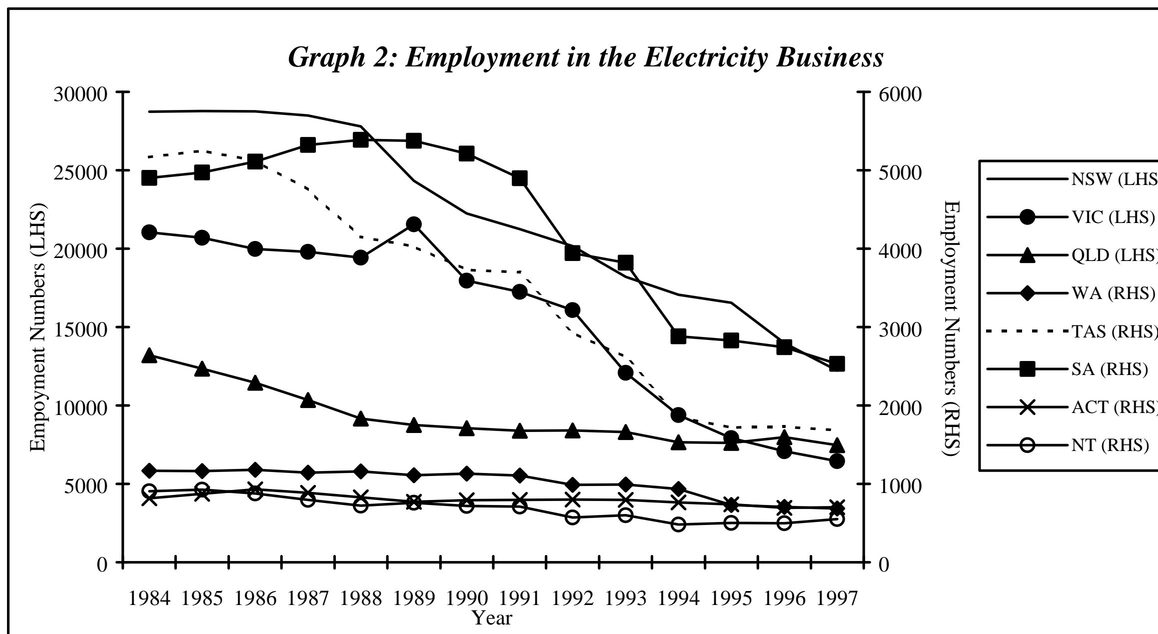
5.2.7. The second level indirect effect of the removal of the Actew asset from public hands is the magnitude of possible job losses. The history of electricity privatisation and corporatisation indicates that cost efficiencies are primarily sought through the reduction of staff. Evidence that this is the case is displayed in Graph 2.

5.2.8. Victoria is a case in point for the committee's purpose. The Victorian Government began to corporatise their electricity assets in 1993. From being 100% Government owned and operated to being corporatised the employment level dropped by 24.7%. In the process from corporatisation to complete privatisation the full reduction from original government ownership and control was 46.7%.[50]

[49] Inelastic demand means that customers value electricity highly and they would be unlikely to stop using it because the price has risen. The implication is that the additional costs of a price rise will be absorbed by a households existing disposable income.

[50] Data from the ESAA annual statistics. Victoria corporatised in 1993, and completed full privatisation by November 1997.

5.2.9. It is clear from the Victorian experience that more jobs will go under privatisation, despite cuts under corporatisation. As a reference point for members in 1984 the employment level in electricity utilities in Victoria was 21,046, by 1997 it had dropped to 6,441 (or a fall of 69.4%).



Graph 2: Employment in the Electricity Business

Source: Data compiled from ESAA annual statistics.

5.2.10. The committee also recognises the point made by the Australia Institute that the reduction in employment will have a significant multiplier effect. As one job is lost then there is less money to be spent. If 400 jobs are lost then there will be significantly less expenditure in the economy (net of other government transfers and accrued employee expenses).

5.2.11. The Australia Institute claims that the ACT Government has formerly used a multiplier of 1.8.[51] This means that for every job lost another 0.8 jobs are lost from the economy. It is difficult to quantify the total jobs loss from the sale of Actew, however a trade sale assumes that Actew will be absorbed into a larger organisation with an existing management and administrative structure.

5.2.12. If Actew were to lose the same proportionate amount as Victoria did through privatisation the effects would be disastrous. The committee has completed Table 5 which displays the sensitivities of the employment base to differing staff reduction scenarios.

5.2.13. What this table shows is, for example, if the trade sale leads to a 50% reduction of the workforce, or around 450 staff, then the multiplier substantially increases the true loss from the economy. In fact the multiplier leads to a loss of around 823 jobs. In terms of Average Weekly Earnings this could mean a loss in gross income terms of

[51] Dr Clive Hamilton, speech, The Great Debate, National Press Club.

$31,001,422 per annum from the ACT economy.[52] The committee believes that this is an unacceptably high loss of economic activity in the economy.

Table 5: Gross Annual Average Weekly Earning Losses to the ACT Economy Under Differing Staff Reduction Scenarios

Percentage Loss	Direct Loss	Total Loss	AWE Equivalent
10%	91	164	$6,245,907
20%	183	329	$12,529,899
30%	274	493	$18,775,806
40%	366	659	$25,097,883
50%	457	823	$31,343,790
60%	548	986	$37,551,612
70%	640	1152	$43,873,689
80%	731	1316	$50,119,596
90%	823	1481	$56,403,589
100%	914	1645	$62,649,496

Note: Some of the loss will be made up by Commonwealth social security payments. The committee has been unable to net these figures. Total Loss is the direct loss times by the multiplier. AWE equivalent puts the job loss in terms of the lost average income from the economy.

Business Sector

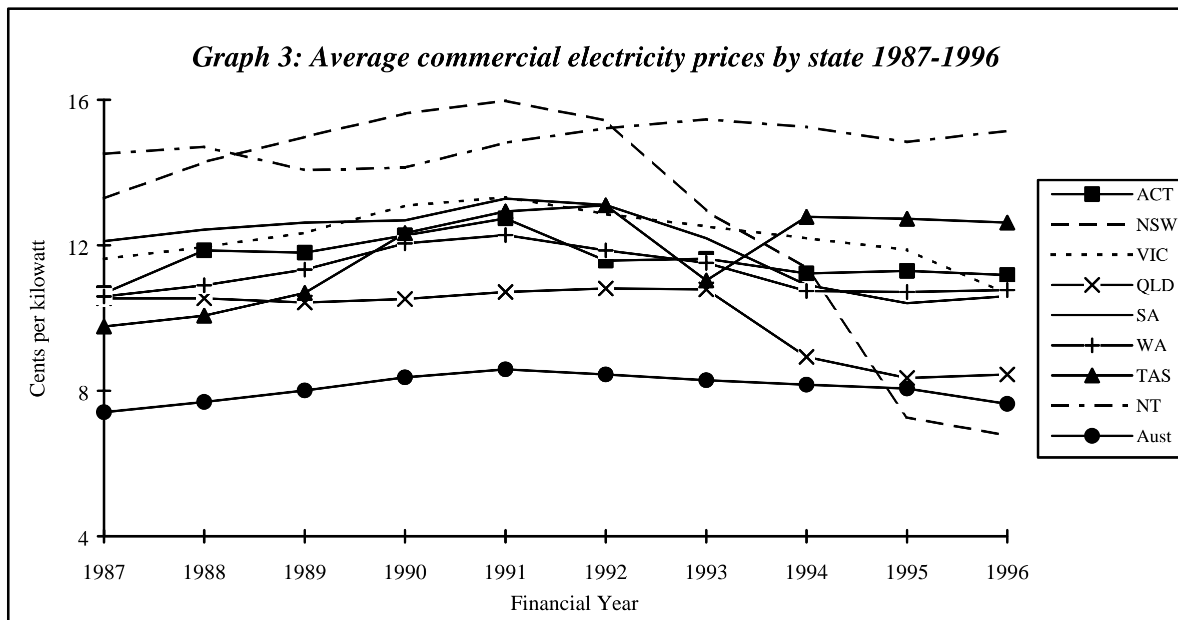
5.2.14. The business sector in the ACT is vital to economic growth. From the 'equation' the committee believes there will be three primary effects of the sale of Actew. These are a price effect, a loss of business activity in the ACT (transferred interstate) and a further contraction in employment.

5.2.15. The price effect on the business sector is likely to be negative. Anecdotal evidence from the Electricity Supply Association of Australia indicates that most states have gone through a process of removing cross subsidisation which would generally lower the price of commercial electricity. The Australian average price and the Victorian post-privatisation price have been falling in recent periods. The committee has constructed Graph 3 to display the state of play.

5.2.16. A move towards comparability with other states to ensure a competitive price structure will most likely bring a reduction. The full effect of the fall would be between one and three cents per kilowatt hour. The committee understands that the decrease may lead to a slightly higher level of business income, but the quantum of losses from the household sector will most likely erase the full benefit of the cost

[52] Average Weekly Earnings (trend) for all persons are $732.4. ABS 1303.8, *Business Indicators* (December 1998), p12.

savings to business. Ultimately the net effect of the two price effects will be zero to negative on the economy as a whole.



Graph 3: Average commercial electricity prices by state 1987-1996

Sources: Electricity Prices in Australia 1998/99, Electricity Supply Association of Australia Ltd, 1998, pp 76-78.

5.2.17. The committee is also concerned about the potential for a large contraction in expenditure by Actew in the local economy. Actew is one of the largest ACT-owned and operated businesses. Actew's home page includes the following statement by of the Managing Director of Actew Energy "the corporation spends between $40 and $50 million on goods and services in the ACT...Any loss of business that Actew suffers tends to flow back into the local economy."[53] .

5.2.18. If Actew's ownership is located outside of the ACT it is logical to assume that the purchasing decisions will not be made locally. Loss of business is subject to an economic multiplier in the same manner as job losses.

5.2.19. In addition, Actew acts as a "good corporate citizen" providing benevolent community support in the form of sponsorship worth over a million dollars per year.

5.2.20. As for the employment loss possibilities the committe has constructed Table 6 to estimate the range of possible losses to the economy of a contraction in expenditure. If we assume for the moment that that a 50% contraction in expenditure occurs Actew would spend $25m less than at current.

5.2.21. The table puts this into perspective showing that the loss is equivalent to 656 full time employees being paid at the Average Weekly Earnings level. The committee sees this as an unacceptably high level of potential losses to the local business sector.

[53] Alan Morrison, Actew Corporation Homepage. http://www.actew.com.au/business/success_stories/default.htm.

5.2.22. The Government has argued that it will seek to have additional investment clauses in the sale contract. It is difficult to believe that this is possible. The new entity will be seeking cost cutting measures as it absorbs Actew into a larger organisation. Accordingly, the committee believes that the prospect of reduced lower local expenditure clearly exists.

Table 6: Potential Contraction in Business Expenditure and the Effects on Gross AWE Incomes Within the ACT Economy

% Loss	Direct Loss	AWE Jobs	Total Jobs	AWE Equiv.
10%	$5m	131	236	$8,988,012
20%	$10m	263	473	$18,014,110
30%	$15m	394	709	$27,002,123
40%	$20m	525	945	$35,990,136
50%	$25m	656	1181	$44,978,149
60%	$30m	788	1418	$54,004,246
70%	$35m	919	1654	$62,992,259
80%	$40m	1050	1890	$71,980,272
90%	$45m	1182	2128	$81,044,454
100%	$50m	1313	2363	$89,994,382

Note: The base for local expenditure is $50m. AWE Jobs brings the money value back into the amount of average earnings jobs that could be lost. Total jobs is AWE jobs times by the multiplier. AWE Equivalent is the total contraction in personal incomes possible at the rate of average weekly earnings.

5.2.23. The application of the multiplier effect to this number is reasonable, because these jobs are lost as a result of the reduction in expenditure by Actew, rather than cost rationalisation. Accordingly the total job loss attributable to the contraction in jobs could be as high as 1180 if a 50% wage component is assumed. Again in wage equivalent terms this equates to a gross income, in terms of average weekly earnings, of $22.5 million per annum. Again this is unacceptably high in terms of the ACT economy's limited base.

5.2.24. The committee is concerned that no reasonable analysis has been conducted into the full effects on the business sector. Accordingly we believe that the full downstream effects of the sale needs to be recognised in any decision in this overall debate.

Government Sector

5.2.25. The sale of Actew is supposed to provide $765m to the SPU, $190m towards debt reduction and $100m to an unspecified 'Community Fund'. As a result the community loses the Actew asset, the flow of dividends and the loss of taxation revenue through the potential contraction in employment (payroll tax, stamp duties and possibly rates through net migration). The net figure is difficult to assume or derive.

5.2.26. The committee hopes that the full $765m would be dedicated to the SPU, and we would suggest that legislation be written to ensure that the account cannot be drawn upon for general expenditure. This would effectively tie over a billion dollars into a financial asset that would be used solely for superannuation purposes.

5.2.27. The Government has stated, in its submission that an additional $30m per annum would be required from the budget until 2016/17 to 'top the account up.' So in effect the use of these proceeds provides no useable budget money, but does flatten the payment requirements in the 'baby boomer hump' years. Accordingly any interest that is earned is dedicated to the asset account and is not available for government expenditure until an indeterminate point in the future.

5.2.28. In effect this means that the Actew dividend stream will in fact be lost out of consolidated revenue. Accordingly the Government will be required to find up to $74m per annum out of existing budget resources, even with the superannuation account being self funding. This amount will be countered by the interest savings from the retirement of debt. A figure as high as $10m has been put forward by the Government.

5.2.29. In addition there may be an additional $7m in revenue from the community fund. The net effect in cash flow terms, is that the Government will require an additional revenue equal to approximately $57m per annum until 2016/17.[54] This equates to $184.50 per head of population per annum.

5.2.30. The effect on the economy will either come from a reduction in the 'G' component, meaning a reduction in expenditure or an increase in the 'T' component, meaning an increase in taxation. Either way the net effect will be either extra expenditure from households or a reduction in transfers (such as subsidies bus rides and community service payments). This reduction should be countered to some degree by the additional payments being made for superannuation out of the SPU, however the limited resources of the committee prevents the crucial quantitative analysis required to prove whether the net outcome on the economy would be positive or negative.

Finance Sector

5.2.31. The committee agrees with the Government submission which puts forward the idea that the market capitalisation in Australia will be unaffected by the financing of a billion dollar investment.[55] However, the issue of additional expenditure on interest earned and received and the increase in net Territory debt has not been approached by the Government or consultants working on their behalf.

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[54] After 2016/17 the requirement to find the $30m will be removed and this figure will reduce to $27m.

[55] ACT Government Submission, pp 56-57.

5.2.32. It is beyond the capabilities of the committee to compute the full effect of the purchase of Actew on the ACT finance sector. Intuitively there will be two key effects which will lead to a contraction in ACT savings, and indeed the propensity (or likelihood) to save. At one level net Territory debt will increase by the full amount borrowed to finance the purchase, net of the Governments debt repayment. This is conjectural because it is uncertain where the borrowings will occur, however the debt will be carried within Actew, which is located physically within the ACT.

5.2.33. The effect on the probability of savings flows from the potential price effects outlined earlier. Less money in the hands of the public means a lower probability of savings and this problem is compounded by the fact that taxes are likely to increase as a result of the loss of Actew dividends and other income flows. The committee believes, on the anecdotal evidence at least, that the net effect will be negative on the overall economic activity in the Territory.

International/External Sector

5.2.34. The obvious concerns of the committee in regards to the inflow and outflow of money in the Territory relate to profit or dividend repatriation and the possibility of further negative net migration. Both of these eventualities will add to potential negative effects outlined previously.

5.2.35. In the first instance, it is widely held that the purchaser of a privatised Actew would live outside of the Territory. The purchase would be likely to be made by another larger company which would have an existing management and capital structure, into which Actew would be incorporated. Parallel to this would be a requirement that the money flow into existing finance department and investment projects.

5.2.36. The committee believes that it would be possible for some additional investment in the ACT, but in total there would be a net outflow of profits and thus dividends. These monies would be dissipated to existing owners, some of whom may be resident in the ACT, but most of whom would not undertake any value adding expenditure in the Territory. The committee is concerned that this additional cash outflow ill contract some of the expenditure in the economy, and again this is not supported.

5.2.37. Finally the committee recalls the existence of negative net migration after the federal public sector cuts during the previous assembly. There is no reason to believe that if we have a contraction in employment in the vicinity that the committee sees as possible that some of these residents will migrate out of the Territory. This phenomenon would ultimately lead to lower investment and expenditure in the Territory and is unacceptable.

Overall Impact

5.2.38. The overall impact of the trade sale of Actew to fully fund superannuation in the short term will most likely be negative. That is, the committee believes that the sum of the negatives outweighs the sum of the positives, and there is no reliability on the claims made by various commentators that the economy will be better off with Actew in private hands.

Option B: $765m to SPU then $70m onwards

5.2.39.The committee is of the opinion that this option would provide similar downstream effects as the option above. The key difference would be that the Government would need to find an additional $40m per annum in the early years to maintain the funding they have modelled. The committee sees no reason to conclude differently from the above analysis.

Committee Note

5.2.40. It is intuitively logical that for any gain there is necessarily a loss from the economy. The sale of Actew does not represent a windfall gain, rather a transfer of asset form.

Recommendation 10

5.2.41. The committee recommends that the Assembly takes note that the sum of positives from the sale of Actew will most likely be outweighed by the sum of the negatives leaving the economy in a bad state compared to the retention of ownership.

3. RETAINING PUBLIC OWNERSHIP WITHOUT A CAPITAL REPATRIATION

5.3.1. The Government recommended that in the likelihood that Actew was not sold that it would be possible to continue with its current model. In its submission the Government advocated a model which provided the $40m in the current budget and then $40/50/70m in the subsequent years. The additional funding would be provided by adding $70m to the SPU until 2023-24. The committee considers that this is the Government’s alternative or ‘fall back’ position and accordingly sees the necessity to consider the downstream effects of the model.

Option C: Continue with $70m per annum ($40/40/50/70m then $70m onwards)

Household Sector

5.3.2. The effects on the household sector would be limited to how the additional contributions are sourced from within the Government sector. Assuming that taxes would need to be raised there is no doubt expressed by the committee that there would be a contraction in the spending patterns of the household sector. Tax increases would be further discussed in the Government sector section below.

5.3.3.The committee agrees with the statements made by ACTCOSS, who have called for a community debate on ‘revenue adequacy’.[56] Such an inquiry would be able to facilitate a comprehensive assessment of options to raise the additional money to fund superannuation.

5.3.4. Another unfortunate consequence could be a contraction in the Actew work force of 10% according to the Actew CEO. If this occurs then the household sector would see a contraction of direct jobs in the vicinity of 91 jobs. Applying the mutiplier effect leads the committee to believe that the full job loss figure could be as high as 164 jobs. The committe notes that jobs loses are bad in general however this figure is significantly lower than under the sell Actew option.

5.3.5. For the purposes of comparison the committee reiterates that over $30m would be lost if Actew is sold in AWE terms. The retention option would lead to a loss of $6,245,907 in equivalent terms (Table 5 puts the comparisons into perspective). The committee is concerned about this level of job loss, but see that the loss is clearly less than that associated with the sale of Actew

Business Sector

5.3.6. There has been no indication of the future of Actew’s expenditure in light of the company remaining in Government ownership. Accordingly anything that the committee discusses would be entirely conjectural. However the committee reiterates its finding under the ‘loss of Actew’ scenario, and that is if Actew reduces expenditure in the local economy there would be associated job losses. Again for the purposes of the analysis Table 6 outlines the job loss equivalent figures for a reduction in Actew expenditure in the local economy.

5.3.7. The one thing that the committee is certain about is that the economy would be better off with an ACT owner. The only scenario under which this has been proposed by the Government with regards to superannuation is in this option. The committee believes that there will be some reductions in local expenditure but Table 6 clearly demonstrates that the smaller that reduction is the better for the economy as a whole.

[56] ACTCOSS, Transc. PP??

5.3.8. To offset these job losses within the business sector there may be the removal of some cross subsidies. Again this is contingent upon what happens to Actew. However this superannuation option assumes that the corporation remains in public hands and the committee is unable to evaluate any potential price changes.

Government Sector

5.3.9. Under this funding option the Government sector is subject to the most variability. However the committee notes its comments earlier that the changes in the Government sector, particularly in taxation would effect the likelihood of the other sectors to save, spend and invest. So each effect dealt with here should be read in conjunction with those in each other sector.

5.3.10.The initial call on budget has been factored into the forward projections of the current budget. Accordingly the effects of this option occur when there is a need to find $70m within the current budget on a permanent basis.

5.3.11.There would be no loss of dividend stream as a result of selling Actew under this option. The dividends are put into general revenue and are spent across all agencies and through that funding the money flows back to the SPU. Accordingly the committee believes that moving to a scenario of full employment costing in Government Departments would allow more accountability as to the source of the additional payments to the SPU. Similarly the increase in taxation required to cover this option would be the dividend stream of Actew less $70m. The Government has assumed a constant $44m dividend stream.

5.3.12.Based on this logic the funding of this option would require an additional $26m per annum. The operating loss, a problem caused primarily by the accruing losses to the SPU, would be reduced over time through the additional payments to the SPU reducing the accrual loss in this agency, with additional interest earnings minimising the impact on the budget. Accordingly, the committee believes that an additional $26m in revenue from the general revenue pool combined with accurate employment costing in Departments would also address the operating loss over time.

5.3.13.Based on an ACT population of some 309,000 the cost per capita of this increased taxation is insignificant at $66 per annum per head of population. There should be no real consequent effects on the household or business sector as a result of this decision, assuming that the cost is spread across taxation sources.

5.3.14.In addition the government sector would be progressively increasing expenditure over time through the SPU account and would thus be adding additional money to the economy as a result of this funding option. Interestingly this option would, in the committee's view, allow additional monies to be freed up with the use of Actew, to allow additional capital expenditure by the Government.

Finance Sector

5.3.15.The committee considers that this option does not cause a significant effect on the finance sector. In a worst case scenario net savings would be reduced by the amount raised in taxation. In addition if expenditure decreased in the economy as a result of job loss then there would obviously be some loss of interest revenue and ACT specific revenue. Overall the impact does not warrant consideration.

International/External Sector

5.3.16. The committee considers that there would be no real effects on the international/external sector due to the fact that Actew remains in the ACT. The only effects could be an increase in negative net migration due to a reduction in employment. Again the Actew CEO believes that around 91 jobs could be lost as a result of Actew remaining in public hands. However in the context of the total ACT population, 91 job losses is relatively insignificant considering the sale of Actew alternative.

5.3.17. However there would some outflow of revenue if Actew retail is sold off interstate. It is assumed by the committee that if the retailing arm of electricity is sold it will be bought an entity outside of the ACT. Accordingly the potential profit repatriation effects under the sale of Actew scenario would eventuate in this case as well, except the full effect would be significantly less than if the whole entity was sold.

Overall Impact

5.3.18. The committee believes that a full assessment of the downstream effects of this funding option are too difficult to calculate given that the future of Actew is dependant upon what the Government does with the entity. However the overall impact would be about zero on economic growth as a whole. This is because the increase in taxation would effectively be equalled out by the increase in superannuation spending, thus creating a zero effect on the 'G' and 'T' components of our equation.

5.3.19. There may be a negative effect on disposable income for households with an external supplier of retail, however the full effect is indeterminate. The committee believes that this option may strain the annual payments by requiring the sum of the new service liability with an additional $70m per annum. However the overall impact on the broader economy will be minimal to zero.

4. A PUBLICLY OWNED ACTEW AND A CAPITAL REPATRIATION

5.4.1. During the course of the inquiry the committee requested a number of models for funding superannuation. Towers Perrin obliged in providing results for most of the options. While we are prepared to discuss the potential downstream effects of the options it is noted that the figures have not been audited independently. We express concerns that the numbers may be inaccurate in light of the AGA's comments on previous reports and state that each discussion below is based upon this qualification.

5.4.2. Each option requested involved a different up-front contribution being made available by a capital repatriation to the ACT Government. ABN AMRO indicated that by borrowing additional money Actew could gain a closer to market level of debt to equity without significantly effecting its credit rating. Accordingly the committee requested a number of 'scenarios' in which Actew would make a payment to the Government. It should be noted that the up front figures do not represent a call on budget, but rather an additional sum provided by Actew and the call on budget would actually be the annual payment stream.

5.4.3. The results of the options requested are attached for the purpose of comparison. Several of the options failed to adequately minimise the impact on the budget in the outyears of the projections. Accordingly there are only three worth discussing here and each is listed below. In addition the committee will consider the impacts of The Australia Institute model.

5.4.4. It is likely that the analysis of these options, below, will be the same for all of the option recorded in Appendix 2. That is, wherever the retention of Actew is involved the same costs will eventuate across all options.

5.4.5. The committee notes however that the key differences will be the effects on the Government sector and the commensurate effects on the household and business sectors. The list below gives the options that the committee consider reasonable and each is dealt with collectively under the sector by sector impact.

Committee and Australia Institute Options

Option D: $300m in 1999, then $40m per annum
Option E: $300m in 1999, $200m in 2012, then $40m per annum
Option F: $250m in 1999, $40m per annum and $200m in 2012
Option G: Australia Institute ($400m, then $25m per annum, full funding of accruing liabilities)

Household Sector

5.4.6. The household sector would only be effected to the same degree as in Option C above. The key differences would depend upon the action taken regarding Actew and the additional effects on taxation and expenditure by the Government sector. The committee cannot speculate on these effects because of its resource constraints.

Business Sector

5.4.7. As for the household sector, the effects on the business sector would depend upon the strategies for Actew in public hands. The tables provided in the sale of Actew options above give a reasonable indication of what could happen under a range of scenarios. Additional effects would be caused by whatever decisions are taken regarding taxation and expenditure within the Government sector.

Government Sector

$250m Repatriation, $200m in 2012, then $40m per annum

5.4.8. This option puts $250m from an Actew recapitalisation into the superannuation account. The account earns interest and is compounded by $40m per annum. In the short term the only call on budget is the $40m per annum. It should be noted that this figure is exactly the amount provided in this years budget. The current dividend from Actew covers that amount (by flowing into general revenue, then to Departments, and then from Departments into the SPU).

5.4.9. Associated with the repatriation of capital through borrowings would be a lower dividend stream. Modelling provided by the AGA indicates that the repatriation would reduce the dividend stream to around $30m per annum over the period of the loan. This option also requires an additional capital payment of $200m in 2012.

5.4.10. The committee is of the opinion that once the original $250m has been repaid it is likely that Actew would be under-geared. As a result a repatriation of $200m would continue to subject the corporation to the discipline of the debt market. As far as reinvestment capital is concerns Actew would have the equivalent of the accrued, but unpaid tax equivalents and the sum of the accrued depreciation. These funds should be sufficient to maintain the network and upgrade infrastructure as Canberra expands.

5.4.11. The net cost on the economy, in the committee's view, would be additional government sector revenue in the order of $10m. This represents the difference between the dividends stream and the $40m per annum. Once again the operating loss will begin to be addressed by applying relevant costing to employment and a lower to balanced result for the SPU account. A figure of $10m per annum represents around $32.40 per head of population per annum.

$300m Repatriation, $200m in 2012, then $40m per annum

5.4.12. Assuming Actew were to take on an additional $300m in debt at 30 June 1999, with the $300m paid as a special dividend and credited to the SPU, the AGA estimated

the Actew income payments to the Government (after reinvestment and net interest) of $25.3m in 1999-00, $33.0 in 2012-13 and $44.3m in 2042-43.[57]

5.4.13. The effect of this option would be as in the above option except that the higher loan would reduce the dividend by around another $5-8m per annum. Thus the requirement to plug the revenue loss would be in the order of $25m. This equates to around $81 per head of population per annum. Clearly even this option has a lower impact on the household sector than the 'Sale of Actew' option.

$300m Repatriation then $40m per annum

5.4.14. The downstream consequence of this option is exactly as above. The key difference is that the second repatriation is unlikely to be required and this would make the dividend stream of Actew higher than the annual appropriation requirement as of the end of the loan. Accordingly the committee believes that the Actew dividend could continue to be used through the Government budget to the SPU for the funding of this option.

$400m Repatriation then $25m pa, with Full Funding of Accrued Liabilities

5.4.15. The Australia Institute option addresses the liability for the CSS/PSS portion of superannuation by dedicating $400m to the SPU and then an additional $25m per annum to cover the remainder. The assumption of funding all accruing costs from 1999 is the part of the option that would cause considerable stress on the budget and thus the government sector.

5.4.16. The need to fully fund all superannuation would put an immediate strain on the budget in the order of $120-156m per annum depending on which analysis of superannuation is relied upon. Accordingly the committee considers that this option puts too much strain on the budget in the short term and would not be considered as a viable alternative to the other three listed above.

5.4.17. After all is considered the committee sees the merit in smoothing the funding while keeping Actew in public hands. The costs are affordable in the context of the current budget and the downstream impacts are not significant enough to prevent other economic activities from flowing. As with all the other options the increases in taxation will be netted out by the increases in Government expenditure on superannuation. At the end of the day these options may in fact cause growth in the economy, and this is something the committee sees as essential.

[57] ibid, p15

Finance Sector

5.4.18. There should be no effects on the finance sector from this strategy. In effect the borrowing will mean that some private investors may be 'crowded out' by the borrowings. However the Government submission points out that the global capital market is virtually unlimited and the committee doubts that any real effects will be caused by Actew borrowing money.

International/External Sector

5.4.19. As for Option C the committee considers that the impact on the economy from the international/external sector would depend on the decisions taken regarding Actew. The only other visible impact is that the borrowings may be sourced outside of the Territory. Accordingly the committee believes that some additional capital outflow may occur as a result of the decision to borrow against Actew. The impact should not be significant.

Overall Impact

5.4.20. In total the committee believes that the sum of the negatives from these options would be outweighed by the sum of the positives. More simply these options would either cause growth in the economy or would maintain the status quo. Regardless of which option is chosen the full effects on the economy will not be computable until the future plans for a publicly owned Actew are known in some detail.

5.4.21.The committee is pleased to add that these options also fit the principles of what Mr Ford considered a conservative approach to superannuation. Each option increases the ratio of assets to the liability, makes the call on budget affordable and each one addresses the 'baby boom hump' while providing time for the Government to initiate a plan for the funding of the new service employees. In choosing these options the committee has achieved a plan which saves Actew for future generations while not displacing any generation through excessive funding of superannuation.

5. CONCLUSIONS

5.5.1. It is difficult to predict with accuracy what would happen if Actew is not sold. The committee understands the Government intends to cut employee numbers, but the full extent is unknown at this stage. Similarly strategies to mitigate the retail risk would be introduced, however there are no plans available to the committee on how this would happen. Accordingly it is difficult to predict with accuracy the downstream effects of keeping Actew in public hands to fund superannuation. However the committee does believe it is a more sensible strategy given that the sale of Actew presents more negatives than positives.

5.5.2. As with all qualitative analysis the committee has had to consider a wide range of issues. By separating the economy into its constituent elements the committee believes that it has treated the realistic options for funding superannuation in a fairly vigorous, if not rigorous, manner.

5.5.3. At the end of the day the downstream impact of the decision to sell Actew to fund superannuation can only be negative for the ACT economy. We believe that the other options presented provide a better alternative due to the evidence provided, which displays at worst a status quo impact, with at best a positive effect on the overall economy.

Recommendation 11

5.5.4. The committee recommends that the Assembly undertake a full and wide ranging inquiry into the ACT Government's 'revenue adequacy' and expenditure priorities. The committee further recommends that the inquiry be given adequate time and resources to reach definitive solutions and conclusions.

CHAPTER 6. CLOSING COMMENTS

6.1. Nothing in this report seeks to down play the seriousness of the problem that the superannuation liability represents to the Australian Capital Territory. There remains a substantial amount of work to be done to arrive at an appropriate set of strategies to redress the very real predicament that we face. The body of this report includes identification of the possible elements of a solution.

6.2. Major deficiencies in the information provided through the course of the public debate have been identified by The Australia Institute, by the Australian Government Actuary, and by non-government members of the Assembly. Members of the Assembly, and the public at large, have a right to consider themselves profoundly let down.

6.3. It is clear that the proposed solution put forward by the Government is definitely not the only solution, and is probably an inferior strategy when compared to more structured and reasoned proposals. The report accepts that the Actew Corporation, and the revenues that it produces, obviously figure in the financial position of the Territory and therefore figure in the deliberations of any strategy to combat the problem.

6.4. Where perceived risk faced by Actew would be obviated by the sale, it would be replaced by the financial risk inherent in holding liquid and semi-liquid investments. The Territory's financial position would be more exposed than it is now to fluctuations in the stock and financial markets over an extended period of years. Any stock market "meltdown" could cost the Territory hundreds of millions of dollars.

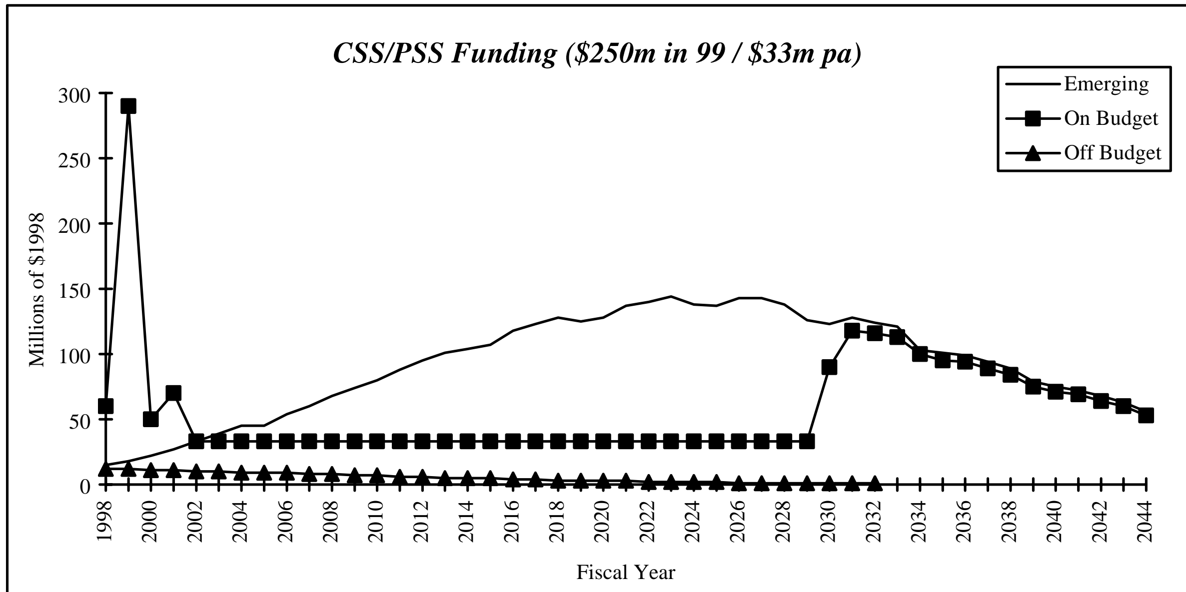
6.5. A further risk lies in the temptation to which future governments will be exposed as they "sit on" huge cash or negotiable reserves. This Assembly has a responsibility to put in place measures that guarantee, to the maximum possible, that the assets of the Territory are maintained for the benefit of future generations, and are not expended for the expedient benefit of any particular government.

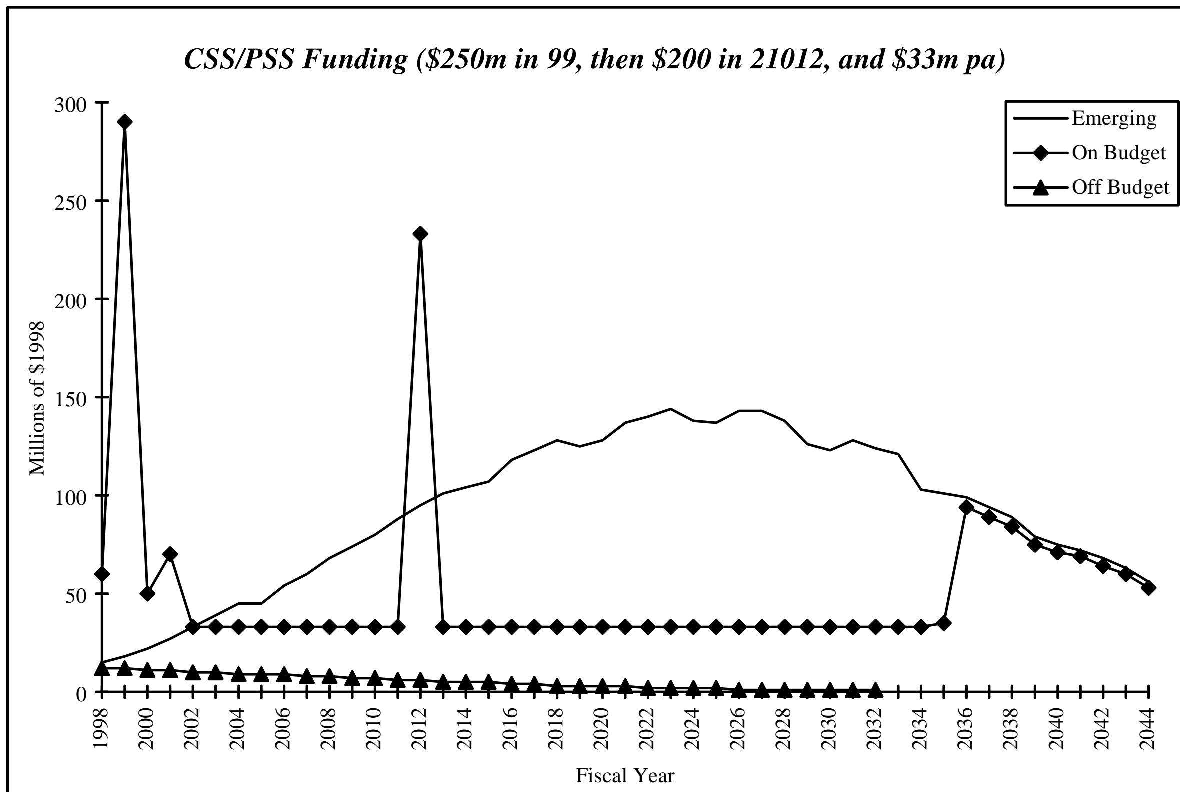
6.6. The Actew sale would have carried with it down side effects that have been ignored in the Government's extensive suite of consultants' reports that were designed to support the case for the Actew sale as a method of funding superannuation. The work of this committee, plus the very real interest shown by Assembly members and other parties, have been very useful in teasing out those effects, and in bringing perspective's that were in short supply earlier in the debate.

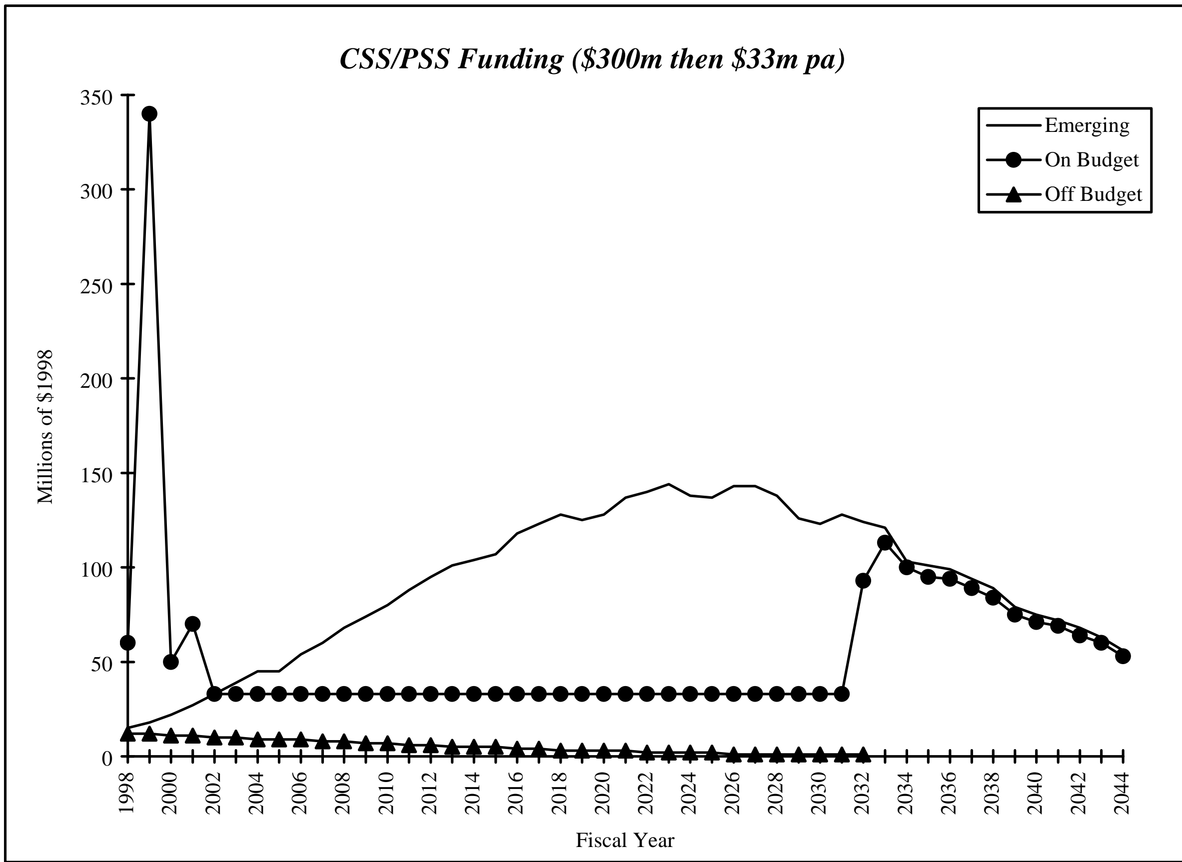
6.7. The committee has concluded that, although a very serious financial threat to the Territory, the superannuation liability can and must be tackled. The simple proposal to sell off Actew to meet the debt is not the optimal solution.

APPENDIX 1 REJECTED MODELLING GRAPHS

CSS/PSS Funding Options






CSS/PSS Funding ($300m then $33m pa)
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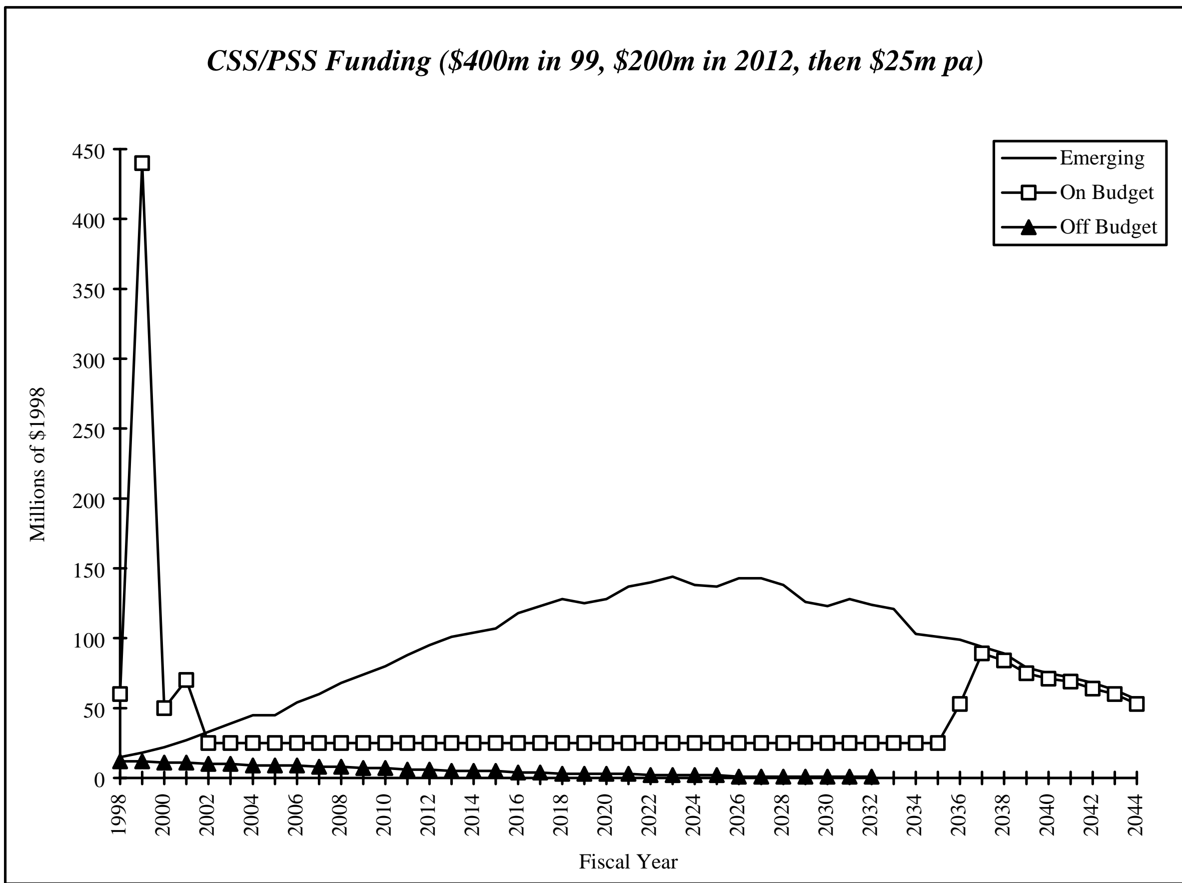
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Off Budget
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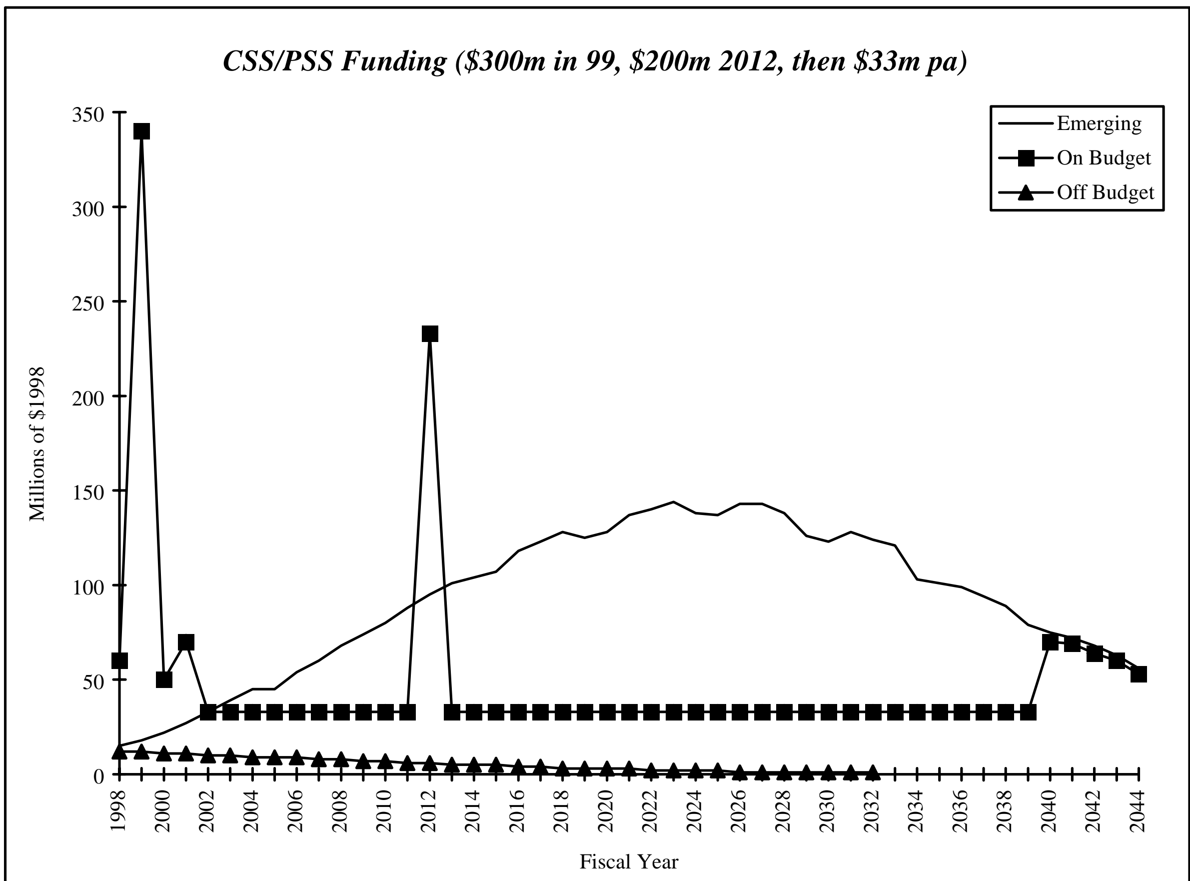
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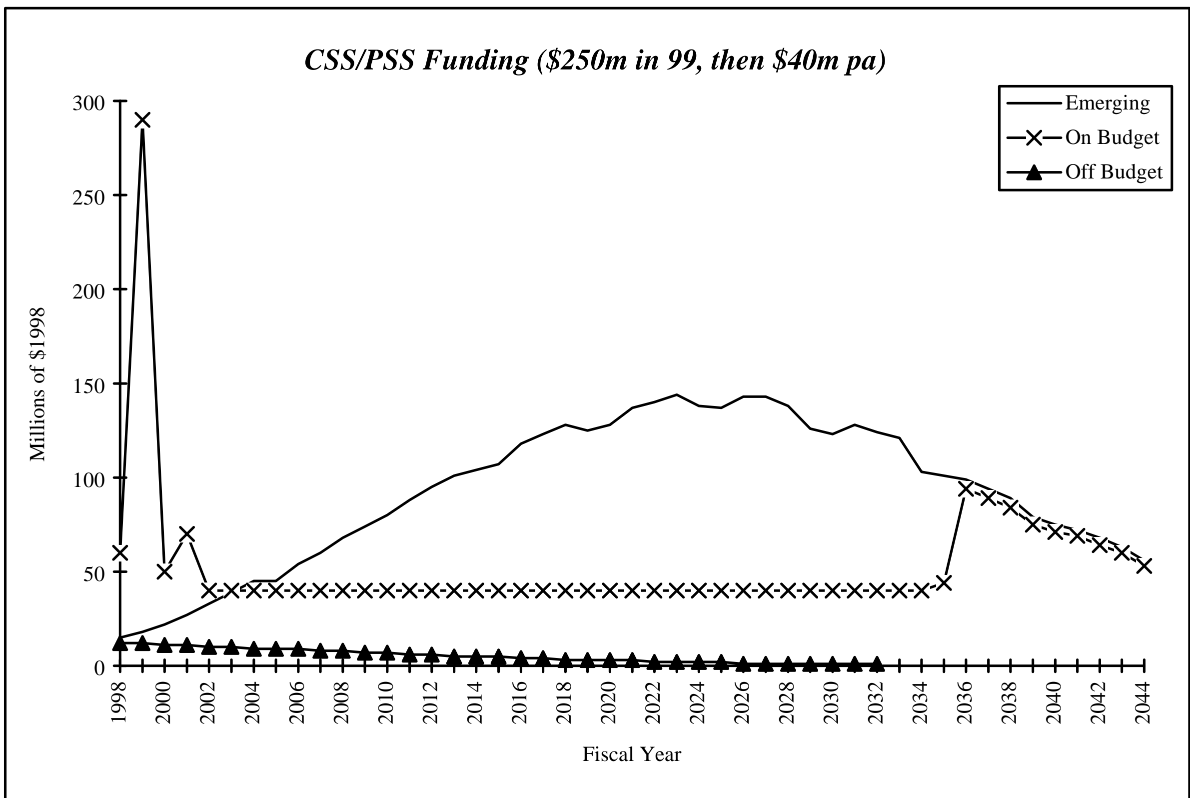
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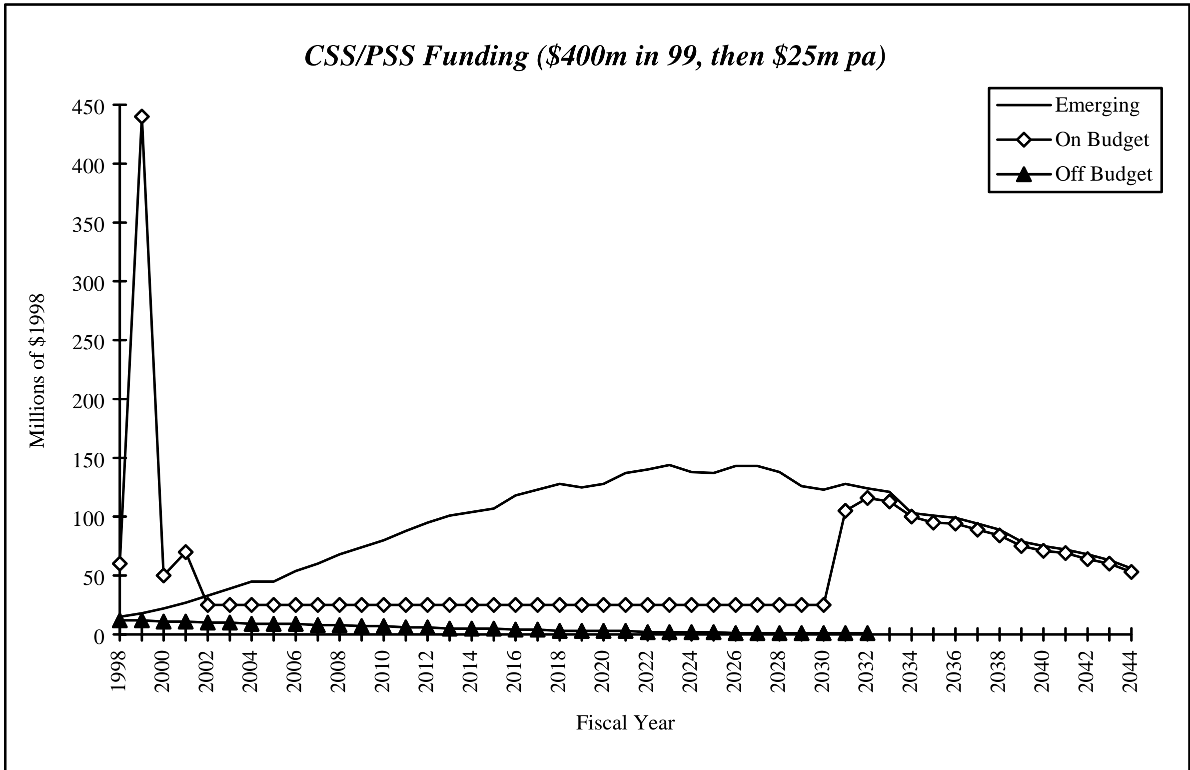
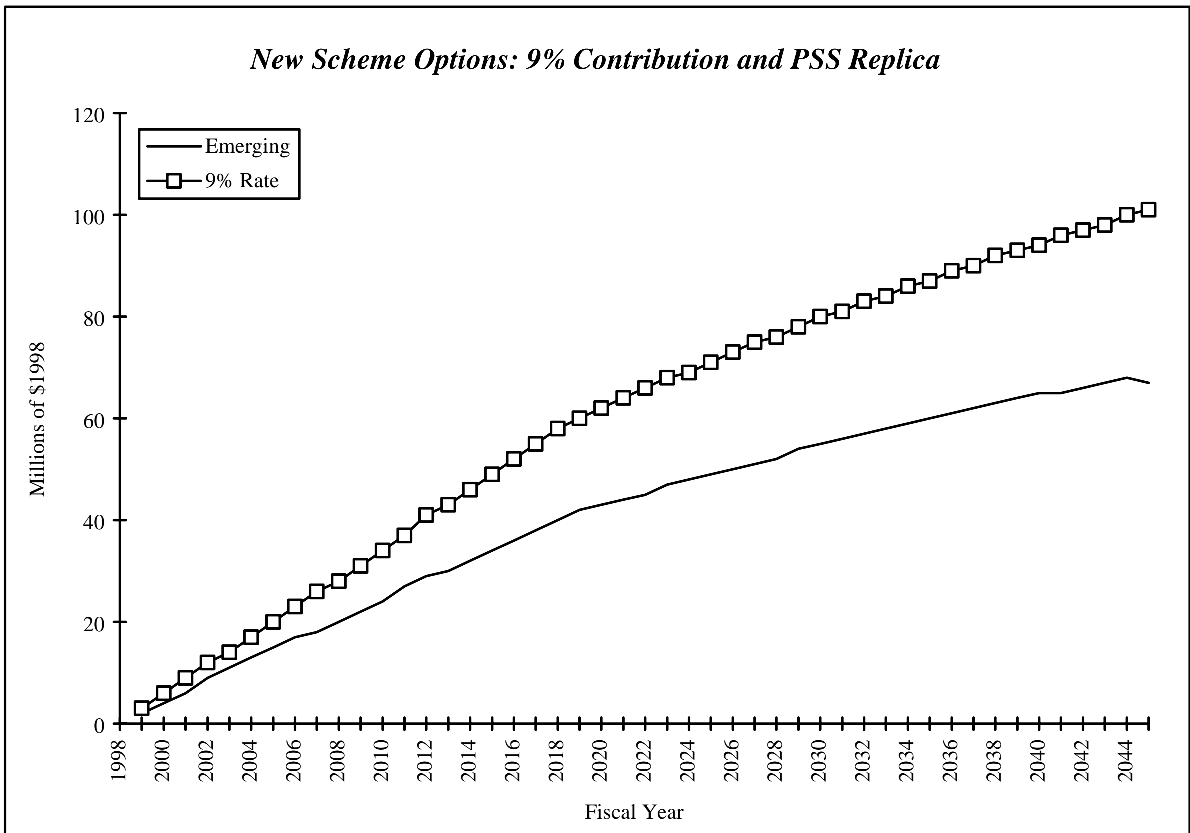


NEW SERVICE OPTIONS



APPENDIX 2 SUBMISSIONS RECEIVED AND WITNESSES

Mr L V Lisle
The Australia Institute Ltd
Master Plumbers, Drainers and Gasfitter's Assn of the ACT
ACT Government
ACT Council of Social Service Inc
Mr J R Ford
Canberra Business Council Inc

PUBLIC HEARINGS

Chief Minister's Department
Mr M Lilley
Mr G Dawson
Mr I Keightley

The Australia Institute Ltd
Dr C Hamilton
Dr J Quiggin

The ACT Council of Social Service Inc
Ms L Morgain
Mr W Smith

Mr J Ford

Master Plumbers, Drainers and Gasfitter's Assn of the ACT
Mr R Edwards

APPENDIX 3 AUSTRALIAN GOVERNMENT ACTUARY

REVIEW OF THE ACT GOVERNMENT'S SUPERANNUATION COMMITMENTS

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REVIEW OF THE ACT GOVERNMENT'S SUPERANNUATION COMMITMENTS

1. INTRODUCTION

1.1 The Legislative Assembly for the Australian Capital Territory resolved in late 1998 to establish a Select Committee to inquire into and report on the Territory's superannuation commitments, with particular reference to the proposed sale of ACTEW to fund the liabilities.

1.2 The terms of reference for the Committee's inquiry included a requirement to report on the analysis of superannuation commitments by Towers Perrin and to examine alternative mechanisms for funding the superannuation liabilities.

1.3 Mr Bill Symington, the Secretary to the Committee, sought the services of the Office of the Australian Government Actuary (AGA) to provide specialist actuarial advice on these matters.

1.4 Under the terms of the agreement between AGA and the Clerk of the Legislative Assembly, AGA is to provide:

(i) a review of the Towers Perrin reports on ACT Government superannuation dated 16 April 1998 and 29 April 1998. The Office of the Australian Government Actuary may query and clarify issues with Towers Perrin directly where appropriate; and

(ii) an analysis of alternative strategies for meeting superannuation commitments if ownership of ACTEW were to be retained by the ACT Government. This will involve looking at the projected cash flows arising from the superannuation liabilities and the revenue derived from ACTEW if Government ownership is retained. One strategy to be investigated is ACTEW borrowing $300m to be paid as a special dividend to the ACT Government. This dividend would be used to fund part of the accrued unfunded superannuation liability.

1.5 This report presents the results of our analysis.

1.6 The report has been prepared for the use of the ACT Assembly's Select Committee on the ACT's Superannuation Commitments only. It should not be relied upon by the other parties without first seeking the approval of AGA.

1.7 The time available to complete the analysis and report was very limited. Accordingly, it should be noted that our comments and calculations are highly dependent on the information that has been supplied to us. There has not been sufficient time to carry out comprehensive checks on the information supplied. This particularly applies in relation to the projections of payments and unfunded liabilities prepared by Towers Perrin which are crucial to this process.

1.8 We gratefully acknowledge the assistance of Towers Perrin, particularly, Mr Bill Humphreys, ACT Government officials and the Assembly Committee, particularly Mr Bill Symington.

2. BACKGROUND

2.1 Employees of the ACT are covered by a number of superannuation arrangements with the main ones being the Commonwealth Superannuation Scheme (CSS), the Public Sector Superannuation Scheme (PSS) and the Australian Government Employees Superannuation Trust (AGEST).

2.2 AGEST is a fully funded arrangement and once employer contributions are paid to AGEST there is no further employer liability in respect of accrued service. Relatively few ACT employees are covered by AGEST.

2.3 The vast majority of the ACT's superannuation costs relate to the CSS and PSS. When the ACT Government was set up in 1989, both employees transferring from the Commonwealth public service and new employees of the ACT Government were allowed to participate in the CSS – the scheme open at that time. Subsequently, the CSS was closed and the PSS became the superannuation scheme for new Commonwealth and ACT employees.

2.4 The CSS and PSS are largely unfunded, with only the member financed component and the productivity component (approximately 3% of salaries) being funded. The member contribution and funded productivity component are paid to the scheme administrator, ComSuper, at the time salaries are paid. The funds are invested and the accumulated benefits paid out when an individual's superannuation becomes payable.

2.5 The cost of the remaining unfunded component of the benefit is met at the time when the benefit is actually paid to the individual. The ACT Government is responsible for the cost relating to superannuation benefits which have accrued since 1 July 1989. The Commonwealth

remains responsible for benefits accrued before this date. The process is the same whether the benefit is paid as a pension or a lump sum. The split between the Commonwealth and the ACT Government is done on the basis of the proportion of service before and after 1 July 1989 relative to total service at the date of ceasing employment.

2.6 The unfunded nature of most of the CSS and PSS benefits has important financial implications for the ACT Government. In a funded scheme, benefit costs are met as they accrue. Put simply, the cost of an additional year's service in terms of the additional benefits which will ultimately be payable is funded at the time that service occurs. As a result, costs from year to year tend to be fairly stable in a funded scheme. Accruing costs, using Towers Perrin assumptions, for the currently unfunded component CSS/PSS could be expected to be about 16% of salaries, or roughly $105m on a payroll of $660m.

2.7 In an unfunded scheme, costs are met at the time benefits are paid. (These payments are referred to as emerging cost payments.) This means that early on in a new scheme, costs are very low both because there are few beneficiaries and those people who have exited have relatively short periods of service and hence relatively low accrued benefits. This is particularly the case when costs are measured as a percentage of the salaries of contributory members.

2.8 The costs arising from ACT Government participation in the CSS/PSS from 1 July 1989 behave in the same way as a new scheme. As a result, the emerging costs for the ACT have been very much less than the accruing costs since the ACT's participation began. The excess of the accruing costs over the emerging costs becomes an unfunded liability for the ACT.

2.9 As an unfunded scheme matures, costs increase as more members reach retirement and their accrued benefits on retirement increase with longer service durations. Eventually, if the contributory membership remained constant, emerging costs as a percentage of salary would be expected to level off.

2.10 If, however, the scheme is closed to new membership, as is proposed for the PSS in the ACT, the emerging costs will eventually decline but will lag considerably behind the decline in salaries.

2.11 It is very important for the ACT Government to be aware of this cash flow strain in its future financial planning. It should have in place a strategy for coping with this strain so that benefits promised can be paid. It should be noted that funding is just one, and not the only, strategy for ensuring that cash flow requirements can be met.

3. CURRENT FUNDING OF CSS/PSS

3.1 When the ACT Government became responsible for superannuation provision, it established a Superannuation Provision Account (SPA) to partially fund the accruing benefits. I understand that allocations of about $70 million in 1990/91 and around $30 million in each of the next three years were made from the budget to the SPA. This was possible because of the low level of benefits being paid. There have been no further general allocations since 1994.

3.2 In addition to general allocations, off budget agencies such as ACTEW were charged an amount which represented the employment cost to the agency of superannuation. These amounts were also set aside in the SPA. This means that off budget agencies are fully funded in respect of their superannuation liabilities accruing since 1989. The amount of funding from this source in 1997/98 was about $12 million.

3.3 The SPA is invested in a similar manner to a private sector superannuation fund. That is, it is invested in a broad range of assets, including Australian and International equities, property and fixed interest securities. At 30 June 1997, the SPA assets were $273 million. At 30 June 1998, they were $321 million. In both cases, using the figures in the Towers Perrin report, SPA assets represented about 30% of accrued (or past service) liabilities at the relevant time.

3.4 The ACT Government was also meeting **all** emerging cost payments, including the emerging costs arising from off budget agency employees, in addition to the funding set out above. This arrangement results in a small degree of funding in the SPA for on budget agencies. This is because when an off budget agency benefit becomes payable it is already fully funded. However, because the amount is not drawn down from the SPA but paid for by the ACT Government this represents de facto ACT Government funding.

3.5 From 1998/99, the ACT Government has decided to partially fund accruing benefits. The intention is, over a period of time, to move from partial funding to full funding of accruing benefits. This represents a very significant increase in the funding of benefits compared to 1997/98. The ACT Government will still need to put in place a strategy for dealing with unfunded liabilities accrued to date, and the unfunded component of benefits that will accrue in future.

4. ACTUARIAL REVIEWS

4.1 Periodic actuarial reviews are carried out for defined benefit funds such as the CSS/PSS. With defined benefit funds, it is only possible to know what benefits were taken and when, after the event. Similarly it is only

possible to know what investment returns were, with the benefit of hindsight. It is thus only possible to definitively know the **true cost** of providing benefits after the last benefit has been paid.

4.2 It is, however, possible to make actuarial estimates of the costs. This involves making assumptions about the future experience of the scheme. Assumptions basically fall into two components:

- Demographic assumptions.
  These cover things such as mortality, disability rates, resignation rates, the proportion of resignations which take preserved benefits, proportions married, promotional salary increases and so on.

- Economic Assumptions.
  These cover:
  - the assumed investment return
  - the assumed rate of salary increases due to salary inflation
  - the assumed rate of price increases (CPI).

4.3 The economic assumptions are derived as a set rather than individually. The cost of benefits is very sensitive to the relationship between these rates rather than the absolute level of the rates. In the very long term, as would be expected the three appear to exhibit a reasonable degree of correlation.

4.4 Generally the economic assumptions have more effect on the estimated costs than the demographic assumptions. Actuaries, typically, assume a real rate of investment return over price inflation in the range of 3 – 5.5% per annum. A 3% per annum real rate of return assumption is regarded as being conservative, with a 5.5% per annum assumption being regarded as optimistic.

4.5 Once assumptions have been made, periodic reviews (usually every 3 years) are carried out to see how the scheme is performing against the assumptions. If experience is favourable, liabilities relative to assets will not have increased as fast as had been expected. Similarly if experience is unfavourable, relative liabilities will have increased more quickly than anticipated.

4.6 Thus, while the 1995 actuarial review by Towers Perrin projected an accrued liability of $960m as at June 1997, a subsequent estimate taking account of experience in the intervening period put the accrued liability at $925m.

4.7 It should be remembered that real costs will depend upon the actual experience, both economic and demographic, and are unaffected by actuarial assumptions. Actuarial assumptions only affect the estimates of the costs and not the costs themselves. To the extent that these

assumptions are not borne out in practice, real costs will deviate from the actuarial estimates of the costs.

5. TOWERS PERRIN REPORT ON FINANCIAL MANAGEMENT OF ACT GOVERNMENT FINANCED SUPERANNUATION LIABILITIES

Key Messages

5.1 The Towers Perrin report has a number of key messages:

- Assuming the CSS/PSS is closed to new employees, emerging cost payments will significantly increase over the next 30 years to reach a peak in the mid 2020's. This also applies to the total ACT Government superannuation expenditure if current arrangements continue unchanged.
- The more that is paid now the less that needs to be paid later and vice versa.
- With a partially or fully funded defined benefit scheme, the more that can be earned on scheme assets, the less it costs. This is evidenced by a decrease in the unfunded liabilities if a higher rate of return is assumed.
- If you can earn a greater rate of return than the cost of borrowing money, then you are better off borrowing to invest.

These are very reasonable propositions.

Stated Assumptions for the Actuarial Valuation

Economic Assumptions

5.2 Towers Perrin have quoted both short term and long term economic assumptions as shown below.

	1997/98 %	Short Term (to 2001) %	Long Term (post 2001) %
CPI growth	1.75	2.5	4.0
General wage growth	3.25	4.0	5.5
Investment Earnings	7.0	7.0	7.0

5.3 Of these, the long term assumptions are far more important. A 3% per annum real rate of return has been assumed (investment returns of 7% per annum compared to price inflation of 4% per annum). This is at the conservative end of actuarial assumptions. More conservative

assumptions increase the estimate of the value of accrued liabilities and hence the unfunded liabilities. An assumption of a 5% per annum real rate of return would be towards the optimistic end of actuarial assumptions. The use of this more optimistic assumption would probably reduce the estimate of the unfunded liability by around $200-250 million.

5.4 In practice, this means that the amount required to fund existing liabilities is subject to considerable uncertainty. Only with retrospective knowledge of the actual rates of return earned on the fund assets, can the amount which should have been put aside be determined. At June 1997, the required amount to fund the unfunded liabilities was probably of the order of $400m to $650m.

Demographic Assumptions

5.5 Brief details of the demographic assumptions adopted for the valuation were provided in the Towers Perrin report on the projected stream of emerging costs as at 30 June 1995. These assumptions generally follow the 1993 AGA report on long term costs for the PSS and CSS as a whole. This was the most recent report available at the time.

5.6 The valuation assumes a stable number of ACT Government employees. That is, for every employee who leaves a new one will join. The interaction of the assumptions adopted on promotional salary increases and salary distribution of new entrants leads to a gradual decline in the total salary bill for the ACT in wage adjusted terms. That is, the average employee salary as a percentage of Average Weekly Earnings declines. The fall is approximately 20% over a period of 40 years.

5.7 If ACT employees' salaries were to keep pace with general wage inflation, future benefit payments in 1997 dollars would be higher but the costs as a percentage of salary would be lower.

5.8 The report assumes closure of the PSS on 1 July 1998. Closure of the PSS will not occur until at least 1 July 1999. This will have a relatively small effect on the figures.

Presentation of Results

5.9 The valuation results have been deflated using price inflation and presented in 1997 dollars. This is not unreasonable. However, it may not be the most appropriate presentation of the results. Over a long period of time, Australia's Gross Domestic Product (GDP) should grow in real terms. If the ACT were to benefit from this growth, as would seem reasonable, projected payments in the future may be more affordable than would first appear. (In preparing reports on the long term costs of the CSS and PSS in the past, AGA has provided

projections of costs as a percentage of GDP in order to give the Commonwealth Government an idea of the likely future affordability of the schemes.)

5.10 CSS/PSS and total superannuation costs are also reported as a percentage of total salaries. These costs do not increase as much in relative terms as costs expressed in 1997 dollars.

5.11 Off budget agencies are currently funding their superannuation through payment of contributions to the SPA. The ACT Government also meets all of the emerging cost payments. The Towers Perrin report figures for the current arrangements **assume no further off budget agency funding through the SPA.** If off budget agency funding continued, greater drawdowns could be made from the SPA to lower peak superannuation payments.

5.12 This approach overstates the impact on the ACT budget of continuing the current arrangements (if off budget agency contributions ceased to the SPA, the ACT Government would have about $12 million extra to spend on other projects). Essentially the starting point is understated and the peak overstated from an ACT budget perspective.

Credibility of the Report

5.13 As noted above, we have some concerns about two methodological issues: the declining real salary base for the Territory and the exclusion of any future funding of superannuation liabilities by off budget agencies.

5.14 We also have a number of concerns about the detail of the numbers provided in the report which are set out below. In order to carry out our analysis of the report, Tower Perrin provided us with a spreadsheet setting out the results of the 1995 projection of emerging costs. This spreadsheet was, however, only able to be provided on January 19. We were not provided with any of the spreadsheets relating to the modelling of the options presented in the report. As a result, our analysis has been limited both by the very tight time constraints and the limited data and our comments relate primarily to Scenario 1 Current Arrangement. We have only had a cursory look at other figures.

5.15 Our concerns could well be of a minor nature and may not affect the veracity of the underlying analysis. However, they do mean that we are not in a position to vouch for the accuracy of the analysis. We have raised our problems with Towers Perrin to allow them to respond.

<u>Costs as a Percentage of Salaries</u>

5.16 The costs reported as a percentage of salary (see page 65 of the report) are not equal to costs divided by salary as shown on the spreadsheet provided. It appears that for both CSS/PSS and total superannuation outlays, the percentage of salary columns may have been displaced by two years so that, for example, the figure reported for 1997 actually relates to 1995.

Use of Stated Assumptions

5.17 The report states that separate long term and short term assumptions have been used. The figures that we are able to check reveal that the short term CPI assumptions have not been used in calculating the value of salaries, outlays and liabilities in 1997 dollar terms. We are unable to determine whether the short term assumptions have been used elsewhere in the calculations.

Accrued Liability Figures

5.18 The unfunded accrued liability is a critical element in consideration of superannuation liabilities and is derived by deducting the SPA from the estimated accrued liability. The report cites both the original 1995 projections of accrued liabilities in the Appendices (and presumably in the charts included in the body of the report) and a revised estimate for 1997 elsewhere in the report. The difference between the two estimates is roughly $35m for 1997 ($924.7m on page 26 of the report and $960.2m on page 65). No reference has been made in the report to the discrepancy or the reasons for it.

5.19 I have also carried out an **extremely crude** calculation of the accrued liability as at 30 June 1997. Very roughly, I estimate that this figure was around $850m as at 30 June 1997. This compares with the estimate of $960.2m included in the Towers Perrin report. Given the extremely rough nature of my estimate, these numbers are not necessarily inconsistent, although the Towers Perrin figure is higher than I would have expected.

Implicit Accruing Costs

5.20 Neither the report itself nor the spreadsheet provided give any explicit figures on the accruing costs under the CSS/PSS. These figures should, however, be able to be calculated from the accrued liabilities and emerging costs using the following relationship

$$AC_t = \frac{AL_{t+1}}{1+i} - AL_t + EC_t$$

where *AC* is the accruing cost, *AL* is the accrued liability, *EC* is the emerging cost and *i* is the interest rate.

5.21 Applying this relationship to the Towers Perrin spreadsheet figures yielded accruing costs which varied more from year to year than would be expected and, in later years, gave a negative accruing cost. This should not be possible and suggests that at least one of the accrued liability or emerging cost figures may have been mis-stated.

5.22 Option 1, as described in the report, involves funding both the accruing and emerging costs from 1998/99. The difference in expenditure between the emerging cost for pre-1998 accruals of benefits and the expenditure under this option should therefore give an indication of the accruing cost. The additional expenditure in 1998/99 is, however, only $63.1m. This is well below any reasonable estimate of accruing costs, being less than 10% of salaries. It is also considerably less than the $98m set aside in the Budget Estimates 1998/99 for accruing costs.

Employer Costs for Future Service

5.23 The table on page 43 of the report includes a figure representing the present value of employer contributions for future service. It is not clear how this figure has been derived. An upper bound of the future liability in relation to the CSS and PSS should be able to be calculated by summing future emerging cost payments plus the residual accrued liability at 2045 (the final year of the projections) discounted to 1998 less the accrued liability as at 1998. This gives a figure of $938m using a 7% discount rate compared to the $1,051m quoted in the report.

5.24 It should also be noted that the table on page 43 assumes changes take place on 1 July 1998 and the figures relate to CSS/PSS only.

5.25 For the remainder of this report, we have used the Towers Perrin figures on salaries, emerging costs and unfunded liabilities as supplied and the economic assumptions as set out in their report (see paragraph 5.2 of this report). Our comments in this section set out our concerns regarding the Towers Perrin figures. If these concerns are justified, our analysis based on the figures may be compromised.

6. TOWERS PERRIN REPORT ON DEVELOPMENT OF ALTERNATIVE SUPERANNUATION ARRANGEMENTS FOR THE ACT PUBLIC SECTOR

6.1 This report deals with what can be termed the mainly administrative issues in setting up new superannuation arrangements for ACT Government employees following closure of the PSS. It covers items such as the choice of fund legislation, selection of default fund, benefit design issues and so on. As these are mainly administrative issues they are not really relevant to the Committee which is looking at superannuation commitments.

6.2 The report does, however, cover the level of employer support to be paid to the new arrangements. This is relevant to the ACT Government's superannuation commitments. The main options discussed were:

- Setting up a defined benefit PSS 'replica' (either funded or unfunded).
- A fully funded accumulation arrangement with employer support with roughly the equivalent rate of employer support as the PSS (contributions of 13% of salary).
- A fully funded accumulation arrangement with employer support at the fully phased in Superannuation Guarantee level (contributions of 9% of salary).
- A fully funded accumulation arrangement with employer support at the minimum level to meet Superannuation Guarantee requirements (currently contributions of 7% of salary rising in stages to 9% of salary from 2002/03).

6.3 From a superannuation commitment perspective clearly the lower the rate of contributions the lower the future commitment.

7. ASSUMPTIONS USED IN VALUING ACTEW

7.1 This Office does not claim expertise in the valuation or assessment of the prospects of electricity and water companies. For the purposes of this exercise it is necessary to make assumptions about the sale proceeds of ACTEW and their use. It is also necessary to make assumptions about the future income stream the ACT Government would receive if ACTEW were retained. Like all assumptions, they are unlikely to be borne out exactly in practice. The Committee will need to take this uncertainty into account and also form its own view on the appropriateness of the assumptions.

ACTEW Sale Proceeds

7.2 A statement by the Chief Minister assumed proceeds from the sale of ACTEW of $1,055 million. The proceeds to be apportioned as follows:

- $765 million to the SPA for superannuation
- $190 million debt reduction

- $100 million to a Community fund.

7.3 We have assumed that this will be the amount of money raised and that it will be used in this manner. It has also been assumed that the transaction will take place on 1 July 1999 and the interest saved would be at the rate of CPI +3% ie 5.5% to 30 June 2001 and 7% from 1 July 2001.

ACTEW Income Stream

7.4 The ACT Government receives income from ACTEW in one of two main ways:

- Dividend payments
- Payments of the equivalent of corporation tax.

7.5 As far as the ACT Government is concerned there is no difference between the two and we will refer to ACTEW income to cover both types of payment. That is, from an ACT Government perspective, both forms of income are interchangeable. At the moment, the ACT does not receive tax payments but a dividend of all the profit after tax is paid. The tax not paid can be used as reinvestment by ACTEW. If the ACT decided to collect its tax and ACTEW needed to reinvest, ACTEW would have to retain some of its profit after tax and so could not pay a dividend of all of the after tax profit. Assuming that ACTEW needs to reinvest some of its earnings, this means the more the ACT receives in tax payments the less it will receive in dividends and vice versa.

ACTEW Earnings before Interest and Tax

7.6 An estimate of Earnings before Interest and Tax (EBIT) for 1998/99 has been derived from ACTEW's Statement of Corporate Intent. This estimate has been derived as follows:

		$000
Net Profit before tax		63,441
Add net interest paid		
- Interest income	1,800	
- Interest expense	(10,492)	
Net interest paid		8,692
EBIT		72,133

ACTEW Debt

7.7 Again from the Statement of Corporate Intent, ACTEW is projected to have net debt of around $100 million assuming that the streetlight transaction does not go ahead. I am informed that about half of the debt is fixed interest debt carrying a coupon of 11.3% which matures in 2010/11 and half is variable rate debt with interest payable at a rate similar to the bank bill rate. Our assumed interest rates on the debt are:

- Fixed interest debt

  11.3% to 2010/11
  CPI +3% (or 7%) from 2011/12

- Variable rate debt

  CPI +3% (5.5% to 30 June 2001, 7.0% from 1 July 2001)

ACTEW Income Stream Assumptions

7.8 In order to project ACTEW payments to the ACT Government, it is necessary to make assumptions about future reinvestment rates and debt. We have made the following assumptions:

- ACTEW will have EBIT of $72 million in 1998/99;
- 30% of ACTEW's EBIT needs to be reinvested to maintain ACTEW's EBIT in real (CPI) terms;
- existing debt will have an interest burden as described in the previous paragraph;
- any new debt will have an interest burden of CPI +3%; and
- any earnings left after deducting money for reinvestment and interest payments will be paid to the ACT Government.

7.9 The following table sets out the resulting income stream, both in nominal and 1997 dollar terms using the Towers Perrin stated CPI assumptions.

Table 1: ACTEW Income Stream, No Additional Loan

Financial Year	EBIT $m	Net Interest $m	Reinvest-ment $m	Income† Nominal $m	Income 1997$m
1998/99	72.0	8.4	21.6	42.0	40.8
1999/2000	73.8	8.4	22.1	43.3	41.0
2000/01	75.6	8.4	22.7	44.6	41.2
2001/02	78.7	9.2	23.6	45.9	41.1
2002/03	81.8	9.2	24.5	48.1	41.4
2003/04	85.1	9.2	25.5	50.4	41.7
2004/05	88.5	9.2	26.5	52.8	42.0
2005/06	92.0	9.2	27.6	55.3	42.3
2006/07	95.7	9.2	28.7	57.9	42.6
2007/08	99.5	9.2	29.9	60.5	42.8
2012/13	121.1	7.0	36.3	77.8	45.2
2017/18	147.3	7.0	44.2	96.1	45.9
2022/23	179.3	7.0	53.8	118.5	46.5
2027/28	218.1	7.0	65.4	145.7	47.0
2032/33	265.4	7.0	79.6	178.8	47.4
2037/38	322.9	7.0	96.9	219.0	47.8
2042/43	392.8	7.0	117.8	268.0	48.0

† Note that columns may not add exactly due to rounding

7.10 At 1 July 1999 we have projected a past service unfunded liability in 1997 dollars of the order of $830 million. For consistency, the following has been assumed.

- Towers Perrin projected accrued liability figure at 1 July 1999 of $1,174 million

- AGA projected SPA of $342 million at 1 July 1999
  - using actual SPA assets at 30 June 1998, and
  - assuming funding of projected emerging cost payments and full funding of off budget agencies. (Note actual funding for 1998/99 is likely to be higher than this.)

The value of the ACTEW income stream is sufficient to fund this unfunded liability over the period 1999/2000 to 2028/29 on the assumptions made.

7.11 The equivalent figures to section 7.10 assuming a 5% (as opposed to a 3%) real rate of return would be, very roughly, an unfunded liability in 1997 dollars of $500 million which could be funded, using the ACTEW income stream, over the period 1999/2000 to 2017/18.

7.12 Equivalent figures are set out below assuming ACTEW takes on an additional $300 million in debt at 30 June 1999. The $300 million will be paid as a special dividend and credited to the SPA.

Table 2: ACTEW Income Stream, Additional $300m Loan

Financial Year	EBIT $m	Net Interest $m	Reinvestment $m	Income† Nominal $m	Income 1997$m
1998/99	72.0	8.4	21.6	42.0	40.8
1999/2000	73.8	24.9	22.1	26.8	25.3
2000/01	75.6	24.9	22.7	28.1	25.9
2001/02	78.7	30.2	23.6	24.9	22.3
2002/03	81.8	30.2	24.5	27.1	23.3
2003/04	85.1	30.2	25.5	29.4	24.3
2004/05	88.5	30.2	26.5	31.8	25.3
2005/06	92.0	30.2	27.6	34.3	26.2
2006/07	95.7	30.2	28.7	36.9	27.1
2007/08	99.5	30.2	29.9	39.5	28.0
2012/13	121.1	28.0	36.3	56.8	33.0
2017/18	147.3	28.0	44.2	75.1	35.9
2022/23	179.3	28.0	53.8	97.5	38.3
2027/28	218.1	28.0	65.4	124.7	40.2
2032/33	265.4	28.0	79.6	157.8	41.9
2037/38	322.9	28.0	96.9	198.0	43.2
2042/43	392.8	28.0	117.8	247.0	44.3

† Note that columns may not add exactly due to rounding

7.13 At 1 July 1999 we have projected a past service unfunded liability in 1997 dollars of the order of $540 million assuming $300 million is paid to the SPA on 1 July 1999. For consistency, the following has been assumed.

- Towers Perrin projected accrued liability figure at 1 July 1999 of $1,174 million

- AGA projected SPA of $630 million at 30 June 1999
  - using actual SPA assets at 30 June 1998, and
  - assuming funding of projected emerging costs payment and off budget agencies. (Note actual funding for 1998/99 is likely to be higher than this.)

The value of the reduced ACTEW income stream is sufficient to fund this unfunded liability over the period 1999/2000 to 2025/26 on the assumptions made.

7.14 The equivalent figures to section 7.13 assuming a 5% (as opposed to a 3%) real rate of return would be very roughly a unfunded liability in 1997 dollars of $200 million which met by funding using the reduced ACTEW income stream period 1999/2000 to 2009/10.

8. ANALYSIS OF OPTIONS

8.1 This section looks at the budget impact of various options. The analysis considers the effect of the options on superannuation costs, the ACTEW income stream and debt service costs in deriving an overall budget impact.

8.2 The analysis is based on the economic assumptions set out earlier in the report and has used the salary, emerging cost and accrued liability figures supplied by Towers Perrin. In this context, the Committee should bear in mind the comments in paragraph 5.25 of this report. While we believe that costs as a percentage of salaries is a more appropriate form of presentation, we have presented costs in 1997 dollar terms for consistency with the Towers Perrin report.

Comparison of CSS/PSS Emerging Costs, Towers Perrin Smoothed Costs for the CSS/PSS and AGA Smoothed Costs for the CSS/PSS

8.3 The figures below related to the unfunded component of the CSS and PSS only. They do not include productivity contributions or new scheme contributions (at the rate of 9% of salary). This analysis has been prepared to illustrate the impact of assuming that off budget agencies cease funding their superannuation liabilities (Towers Perrin smoothed costs) relative to the assumption that the current arrangements continue (AGA smoothed costs). This issue was discussed in paragraphs 5.11 and 5.12. The shaded figures show the additional budget allocation required relative to the 1997/98 including off budget funding ie $23,342.

Table 3

Year Beginning	Emerging Costs		Towers Perrin Smoothed		AGA Smoothed	
	Outlay 1997$'000	Budget Difference 1997$'000	Outlay 1997$'000	Budget Difference 1997$'000	Outlay 1997$'000	Budget Difference 1997$'000
01/07/1997	11,342	(12,000)	11,342	(12,000)	23,342	-
01/07/1998	13,863	(9,478)	13,863	(9,478)	25,753	2,411
01/07/1999	17,132	(6,209)	17,132	(6,209)	28,462	5,120
01/07/2000	20,388	(2,954)	20,388	(2,954)	31,144	7,802
01/07/2001	25,318	1,977	25,318	1,977	35,546	12,204
01/07/2002	30,950	7,608	30,950	7,608	40,780	17,438
01/07/2003	36,434	13,092	36,434	13,092	45,862	22,521
01/07/2004	42,209	18,867	42,209	18,867	51,234	27,892
01/07/2005	41,896	18,554	41,896	18,554	50,510	27,168
01/07/2006	49,807	26,466	49,807	26,466	58,013	34,671
01/07/2007	55,855	32,513	55,855	32,513	63,636	40,294
01/07/2008	63,572	40,230	63,572	40,230	70,915	47,573
01/07/2013	93,991	70,649	93,991	70,649	99,260	75,918
01/07/2018	118,658	95,316	120,438	97,096	100,162	76,820
01/07/2023	133,516	110,174	114,207	90,865	91,547	68,206
01/07/2028	128,268	104,927	101,551	78,209	83,901	60,560
01/07/2033	112,341	88,999	81,401	58,060	76,648	53,306
01/07/2038	82,296	58,954	64,922	41,580	69,895	46,553
01/07/2043	58,298	34,956	39,779	16,437	58,298	34,956

8.4 The difference between the emerging cost figures and the Towers Perrin smoothed figures is due to drawdowns from the existing SPA. The difference between the Towers Perrin smoothed figures and the AGA smoothed figures is due to assuming continuing off budget agency contributions to the SPA and different pattern of drawdowns from the SPA. The AGA smoothed contributions have been set so as to cap the total superannuation cost, including productivity and new scheme contributions at around $160 million. As would be expected, the AGA figures start higher due to the off budget agency contributions.

Base Scenario

8.5 We have used the AGA smoothed figures from Table 3 to construct a set of figures shown in Table 4 which we will refer to as the Base Scenario. These figures have been based on the following assumptions:

Off budget agencies:

- will continue to pay superannuation costs on an accruing basis;
- funding of accruing costs is $12 million in 1997/98 declining in line with CSS/PSS salaries. This contribution is paid to the SPA;
- have a payroll of one eighth of the total payroll. This is used for determining productivity and new scheme contributions (3% and 9% of salaries respectively);

On budget agencies:

- have a payroll of seven eighths of total payroll;
- unfunded liabilities are met on an emerging cost basis;

The SPA is drawn down to meet part of the unfunded component of benefits smoothing peak expenditures.

Table 4: AGA Base Scenario Budget Outlays

	OffBudgetAgencies				OnBudgetAgencies				Grand Total
Year Beginning	CSS/PSS 1997 000's	Productivity 1997 000's	New Scheme 1997 000's	Off budget Total 1997 000's	CSS/PSS 1997 000's	Productivity 1997 000's	New Scheme 1997 000's	On budget Total 1997 000's	1997,000's
01/07/1997	12,000	2,478	-	14,478	11,342	17,343	-	28,685	43,163
01/07/1998	11,889	2,455	-	14,344	13,863	17,183	-	31,047	45,391
01/07/1999	11,330	2,339	376	14,045	17,132	16,375	2,630	36,137	50,182
01/07/2000	10,756	2,221	727	13,703	20,388	15,545	5,087	41,021	54,724
01/07/2001	10,227	2,112	1,055	13,394	25,318	14,781	7,387	47,486	60,881
01/07/2002	9,830	2,030	1,391	13,250	30,950	14,207	9,734	54,890	68,140
01/07/2003	9,428	1,947	1,743	13,117	36,434	13,626	12,198	62,259	75,376
01/07/2004	9,025	1,863	2,078	12,966	42,209	13,044	14,545	69,798	82,764
01/07/2005	8,614	1,779	2,429	12,822	41,896	12,450	17,002	71,348	84,170
01/07/2006	8,206	1,694	2,753	12,653	49,807	11,860	19,270	80,937	93,590
01/07/2007	7,781	1,607	3,085	12,472	55,855	11,246	21,593	88,694	101,166
01/07/2008	7,343	1,516	3,426	12,285	63,572	10,613	23,979	98,164	110,449
01/07/2013	5,269	1,088	5,209	11,566	93,991	7,615	36,461	138,067	149,633
01/07/2018	3,542	731	6,941	11,214	96,620	5,119	48,589	150,328	161,542
01/07/2023	2,190	452	8,128	10,771	89,357	3,166	56,897	149,420	160,190
01/07/2028	1,162	240	9,168	10,570	82,739	1,680	64,173	148,592	159,162
01/07/2033	485	100	10,130	10,715	76,163	701	70,907	147,770	158,485
01/07/2038	131	27	11,003	11,160	69,764	189	77,018	146,971	158,131
01/07/2043	-	-	11,819	11,819	58,298	-	82,735	141,032	152,852

Note: Columns may not add exactly due to rounding

8.6 The increase in costs shown in Table 4 gives a good idea of the likely future strain on the ACT budget with no change to the current arrangements. On the assumptions made, costs are expected to rise, relative to 1997, by about $120 million (in 1997 dollars) to peak in the mid 2010's. This is likely to place a significant strain on the ACT budget and the ACT Government should be aware of both the magnitude and the timing.

8.7 This pattern of outlays arises from the combination of two factors:

- as noted in Section 2, emerging costs increase substantially from a low base as a new unfunded scheme matures; and
- new scheme benefits are assumed to be fully funded;

The net result of these two factors is that the benefits of two generations of employees are being funded simultaneously.

Sale of ACTEW with Full Funding of Past and Accruing Liabilities

8.8 Under this scenario, ACTEW is sold and the proceeds are used as described in paragraph 7.2 to fund currently unfunded liabilities and reduce Territory debt by $190 million. Future service liabilities are assumed to be funded on an accruing basis.

8.9 As a result of this transaction, the ACT Government has:

- a different stream of superannuation payments;
- lost the ACTEW income stream; and
- reduced its debt;

Table 5 shows the net effect of these items on the ACT Government's cash flows. All figures are in 1997 dollars.

Table 5: Budget Impact of Sale of ACTEW

Year Beginning	CSS/PSS Accruing Costs 1997$'000	Productivity & New Scheme 1997$'000	ACTEW Income Stream 1997$'000	Debt Saving 1997$'000	Net Cost to Budget 1997$'000	Base Scenario 1997$'000	Difference from Base Scenario 1997$'000
01/07/1999	99,808	21,720	40,099	(9,686)	**151,941**	50,182	(101,759)
01/07/2000	94,752	23,580	40,289	(9,450)	**149,171**	54,724	(94,447)
01/07/2001	90,096	25,335	40,514	(11,734)	**144,210**	60,881	(83,330)
01/07/2002	86,592	27,360	40,824	(11,283)	**143,493**	68,140	(75,354)
01/07/2003	83,056	29,514	41,123	(10,849)	**142,844**	75,376	(67,467)
01/07/2004	79,504	31,530	41,410	(10,432)	**142,012**	82,764	(59,248)
01/07/2005	75,888	33,660	41,686	(10,030)	**141,203**	84,170	(57,033)
01/07/2006	72,288	35,577	41,951	(9,645)	**140,171**	93,590	(46,581)
01/07/2007	68,544	37,530	42,206	(9,274)	**139,007**	101,166	(37,841)
01/07/2008	64,688	39,534	42,452	(8,917)	**137,757**	110,449	(27,307)
01/07/2013	46,416	50,373	44,729	(7,329)	**134,189**	149,633	15,444
01/07/2018	31,200	61,380	45,416	(6,024)	**131,972**	161,542	29,570
01/07/2023	19,296	68,643	45,980	(4,951)	**128,968**	160,190	31,222
01/07/2028	10,240	75,261	46,444	(4,070)	**127,876**	159,162	31,287
01/07/2033	4,272	81,837	46,826	(3,345)	**129,590**	158,485	28,895
01/07/2038	1,152	88,236	47,139	(2,749)	**133,778**	158,131	24,353
01/07/2043	-	94,554	47,397	(2,260)	**139,691**	152,852	13,160

Note : ACTEW income stream figures in section 7 and debt savings deflated to start of year figures to be consistent with other figures in the table.
Columns may not add exactly due to rounding

8.10 These figures required a number of assumptions to be made:

- accruing costs for the unfunded CSS/PSS benefit are 16% of salaries. As noted in paragraph 5.21, accruing costs were not supplied in the Towers Perrin spreadsheet and the values derived from the emerging costs and accrued liabilities were not considered reliable. We suspect that 16% may be an overstatement of the true figure over the whole projection period;

- interest saved as a result of retiring debt is calculated at the rate of CPI plus 3%. That is, 5.5% to 30 June 2001 and 7.0% from 1 July 2001;

- the sale proceeds are sufficient to fund the unfunded accrued liability as at 30 June 1999. Note that this figure is unknown but could be expected to be around $80 million greater than the $765 million cited by the Chief Minister. Given the difficulty in making a robust estimate of the liability, we have ignored the need to fund the additional amount.

8.11 This option makes a very rapid transition from emerging costs to full funding. As a result, there is a very substantial cost to budget in the period following the change. Eventually, there are significant savings relative to the Base Scenario. The transition from cost to saving relative to the Base Scenario occurs in 2011.

Retention of ACTEW, ACTEW Income Stream paid to SPA until Accrued Liabilities are Fully Funded, Accruing Costs Paid in Full

8.12 Under this scenario, ACTEW is retained, its income stream is paid to the SPA until full funding is attained. Accruing benefits are fully funded using the same assumptions as described in paragraph 8.10.

8.13 As a result of these transactions, the ACT Government has:

- a different stream of superannuation payments; and
- lost the ACTEW income stream until 1 July 2021.

8.14 Table 6 shows the new superannuation expenditure split between funding for accruing cost, productivity and new scheme contributions, lost ACTEW income stream and net cost taking account of all of these items. For comparison, the Base Scenario and Sale Scenario figures are also shown together with the impact relative to these two scenarios.

Table 6:

Year Beginning	Accruing Costs 1997$'000	Productivity & New Scheme 1997$'000	Lost ACTEW Income 1997$'000	Net Cost to Budget 1997$'000	Base Scenario 1997$'000	Difference from Base Scenario 1997$'000	Sale Scenario 1997$'000	Difference from Sale Scenario 1997$'000
01/07/1999	99,808	21,720	40,099	**161,627**	50,182	(111,445)	151,941	(9,686)
01/07/2000	94,752	23,580	40,289	**158,621**	54,724	(103,897)	149,171	(9,450)
01/07/2001	90,096	25,335	40,514	**155,945**	60,881	(95,064)	144,210	(11,734)
01/07/2002	86,592	27,360	40,824	**154,776**	68,140	(86,636)	143,493	(11,283)
01/07/2003	83,056	29,514	41,123	**153,693**	75,376	(78,316)	142,844	(10,849)
01/07/2004	79,504	31,530	41,410	**152,444**	82,764	(69,680)	142,012	(10,432)
01/07/2005	75,888	33,660	41,686	**151,234**	84,170	(67,064)	141,203	(10,030)
01/07/2006	72,288	35,577	41,951	**149,816**	93,590	(56,226)	140,171	(9,645)
01/07/2007	68,544	37,530	42,206	**148,280**	101,166	(47,114)	139,007	(9,274)
01/07/2008	64,688	39,534	42,452	**146,674**	110,449	(36,225)	137,757	(8,917)
01/07/2013	46,416	50,373	44,729	**141,518**	149,633	8,115	134,189	(7,329)
01/07/2018	31,200	61,380	45,416	**137,996**	161,542	23,546	131,972	(6,024)
01/07/2023	19,296	68,643	-	**87,939**	160,190	72,251	128,968	41,029
01/07/2028	10,240	75,261	-	**85,501**	159,162	73,661	127,876	42,375
01/07/2033	4,272	81,837	-	**86,109**	158,485	72,376	129,590	43,481
01/07/2038	1,152	88,236	-	**89,388**	158,131	68,743	133,778	44,390
01/07/2043	-	94,554	-	**94,554**	152,852	58,298	139,691	45,137

Note : ACTEW income stream figures in section 7 and debt savings deflated to start of year figures to be consistent with other figures in the table.
Columns may not add exactly due to rounding

8.15 This approach has a very substantial budget impact in the period following the change. The short term strain is greater than the sale proposal. In the very long term there is a gain because eventually the ACTEW income stream is available to the ACT Government. Note that the past service unfunded liability in the figures is paid off by 2021 whereas in section 7.10 it would be expected to be paid off by 1 July 2029. The two should be the same. The difference may be explained by the 16% estimate of accruing cost being higher than the actual accruing cost or by the accrued liability and emerging cost figures being inconsistent (see section 5).

Retention of ACTEW, $300 million Loan taken out to pay Special Dividend to the SPA, Allocation of Residual ACTEW Income Stream to the SPA to Fund Past Liability and Full funding of Accruing Costs.

8.16 Under this scenario ACTEW is retained, a $300 million loan is taken out to fund a special dividend to the SPA, the residual dividend is also allocated to the SPA until the past liability is funded. Accruing benefits are fully funded using the same assumption as in section 8.10.

8.17 As a result of these transactions the ACT Government has

- a different stream of superannuation payments
- lost the old ACTEW income stream
- gained a reduced ACTEW income stream (from 1 July 2018) when unfunded liability fully funded.

8.18 Table 7 shows the new superannuation expenditure split between funding for accruing cost, and the productivity and new scheme contributions, the lost ACTEW income, the reduced ACTEW income stream gained and net cost taking account of all the items. For comparison, the Base Scenario and Sale Scenario figures and relative impacts are shown. Figures are in 1997 dollars.

Table 7

Year Beginning	CSS/PSS Accruing Costs 1997$'000	Productivity & New Scheme 1997$'000	Lost ACTEW Dividend 1997$'000	**Net Cost to Budget 1997$'000**	Base Scenario 1997$'000	Difference from Base Scenario 1997$'000	Sale Scenario 1997$'000	Difference from Base Scenario 1997$'000
01/07/1999	99,808	21,720	40,099	**161,627**	50,182	(111,445)	151,941	(9,686)
01/07/2000	94,752	23,580	40,289	**158,621**	54,724	(103,897)	149,171	(9,450)
01/07/2001	90,096	25,335	40,514	**155,945**	60,881	(95,064)	144,210	(11,734)
01/07/2002	86,592	27,360	40,824	**154,776**	68,140	(86,636)	143,493	(11,283)
01/07/2003	83,056	29,514	41,123	**153,693**	75,376	(78,316)	142,844	(10,849)
01/07/2004	79,504	31,530	41,410	**152,444**	82,764	(69,680)	142,012	(10,432)
01/07/2005	75,888	33,660	41,686	**151,234**	84,170	(67,064)	141,203	(10,030)
01/07/2006	72,288	35,577	41,951	**149,816**	93,590	(56,226)	140,171	(9,645)
01/07/2007	68,544	37,530	42,206	**148,280**	101,166	(47,114)	139,007	(9,274)
01/07/2008	64,688	39,534	42,452	**146,674**	110,449	(36,225)	137,757	(8,917)
01/07/2013	46,416	50,373	44,729	**141,518**	149,633	8,115	134,189	(7,329)
01/07/2018	31,200	61,380	9,512	**102,092**	161,542	59,450	131,972	29,880
01/07/2023	19,296	68,643	7,818	**95,757**	160,190	64,434	128,968	33,211
01/07/2028	10,240	75,261	6,426	**91,927**	159,162	67,236	127,876	35,949
01/07/2033	4,272	81,837	5,281	**91,390**	158,485	67,094	129,590	38,199
01/07/2038	1,152	88,236	4,341	**93,729**	158,131	64,402	133,778	40,049
01/07/2043	-	94,554	3,568	**98,122**	152,852	54,730	139,691	41,569

Note : ACTEW income stream figures in section 7 deflated to start of year figures to be consistent with other figures in the table
Columns may not add exactly due to rounding

8.19 This approach has a very substantial budget impact in the period following the change and in the short to medium term is the same as the previous proposal. The short term strain is greater than the sale proposal. In the very long term there is a gain because eventually a reduced ACTEW income stream is available to the ACT Government. Note that the past service unfunded liability in the figures is paid off by

2018 whereas in section 7.13 it would be expected to be paid off by 1 July 2026. The two should be the same. The difference may be explained by the 16% estimate of accruing cost being higher than the actual accruing cost or by the accrued liability and emerging cost figures being inconsistent (see section 5).

Sale of ACTEW, $765 million Allocation to SPA, $190 million Reduction of Debt and Smoothed Funding of Emerging Costs

8.20 Under this scenario ACTEW is sold, $765 million paid to the SPA and there is a reduction of $190 million in debt. However in contrast to the previous proposals considered emerging costs are smoothed using the SPA. The objective of this proposal is to smooth the impact of increasing costs in order to give the ACT Government time to adjust to the strain.

8.21 As a result of these transactions the ACT Government has

- a different stream of superannuation payments
- lost the old ACTEW income stream
- gained from a reduced interest burden

8.22 Table 8 shows the new superannuation expenditure split between smoothed emerging costs, and the productivity and new scheme contributions, the old lost ACTEW income stream less debt saving and the net cost taking account of all of the items. For comparison, the Base Scenario and Sale Scenario figures and the relative impacts are shown.

Table 8

Year Beginning	Emerging Costs & Off Budget 1997$'000	Productivity & New Scheme 1997$'000	Lost ACTEW Dividend Less Debt Saving 1997$'000	**Net Cost to Budget 1997$'000**	Base Scenario 1997$'000	Difference from Base Scenario 1997$'000	Sale Scenario 1997$'000	Difference from Base Scenario 1997$'000
01/07/1999	28,462	21,720	30,413	**80,595**	50,182	(30,413)	151,941	71,346
01/07/2000	31,144	23,580	30,839	**85,563**	54,724	(30,839)	149,171	63,608
01/07/2001	35,546	25,335	28,779	**89,660**	60,881	(28,779)	144,210	54,550
01/07/2002	40,780	27,360	29,541	**97,681**	68,140	(29,541)	143,493	45,812
01/07/2003	45,862	29,514	30,274	**105,650**	75,376	(30,274)	142,844	37,194
01/07/2004	51,234	31,530	30,978	**113,742**	82,764	(30,978)	142,012	28,270
01/07/2005	50,510	33,660	31,655	**115,825**	84,170	(31,655)	141,203	25,378
01/07/2006	58,013	35,577	32,306	**125,897**	93,590	(32,306)	140,171	14,275
01/07/2007	63,636	37,530	32,933	**134,099**	101,166	(32,933)	139,007	4,908
01/07/2008	70,915	39,534	33,535	**143,984**	110,449	(33,535)	137,757	(6,227)
01/07/2013	59,096	50,373	37,400	**146,869**	149,633	2,764	134,189	(12,680)
01/07/2018	46,362	61,380	39,392	**147,133**	161,542	14,408	131,972	(15,162)
01/07/2023	37,747	68,643	41,029	**147,419**	160,190	12,771	128,968	(18,451)
01/07/2028	30,101	75,261	42,375	**147,737**	159,162	11,425	127,876	(19,861)
01/07/2033	22,848	81,837	43,481	**148,166**	158,485	10,319	129,590	(18,576)
01/07/2038	16,095	88,236	44,390	**148,721**	158,131	9,410	133,778	(14,943)
01/07/2043	9,646	94,554	45,137	**149,337**	152,852	3,514	139,691	(9,646)

Note : ACTEW income stream figures in section 7 deflated to start of year figures to be consistent with other figures in the table
Columns may not add exactly due to rounding

8.23 This approach smooths the impact of the budget strain to give the ACT Government time to adjust. However, even with this smoothing, there is still a substantial strain with costs increasing over the projection period by over $60 million in 1997 dollars.

Retention of ACTEW, $300 million Loan to Fund Special Dividend to SPA, and Smoothed Funding of Emerging Costs.

8.24 Under this scenario ACTEW is retained, a $300 million loan is taken out to fund a special dividend to the SPA. Emerging costs are smoothed using the SPA. The objective of this proposal is to smooth the impact of increasing costs in order to give the ACT Government time to adjust to the strain.

8.25 As a result of these transactions the ACT Government has

- a different stream of superannuation payments
- lost the old ACTEW income stream

- gained a reduced ACTEW income stream (ACTEW has less income to distribute because of the interest burden on the loan)

8.26 Table 9 shows the new superannuation expenditure split between smoothed emerging costs, and the productivity and new scheme contributions, the old lost ACTEW income stream, the new reduced ACTEW income stream and the net cost taking account of all of the items. For comparison, the Base Scenario and Sale Scenario figures and the relative impacts are shown.

Table 9

Year Beginning	Emerging Costs 1997$'000	Productivity & New Scheme 1997$'000	Lost ACTEW Dividend 1997$'000	Net Cost to Budget 1997$'000	Base Scenario 1997$'000	Difference from Base Scenario 1997$'000	Sale Scenario 1997$'000	Difference from Base Scenario 1997$'000
01/07/1999	28,462	21,720	15,294	**65,477**	50,182	(15,294)	151,941	86,464
01/07/2000	31,144	23,580	14,921	**69,645**	54,724	(14,921)	149,171	79,526
01/07/2001	35,546	25,335	18,528	**79,408**	60,881	(18,528)	144,210	64,802
01/07/2002	40,780	27,360	17,815	**85,955**	68,140	(17,815)	143,493	57,538
01/07/2003	45,862	29,514	17,130	**92,506**	75,376	(17,130)	142,844	50,337
01/07/2004	51,234	31,530	16,471	**99,235**	82,764	(16,471)	142,012	42,777
01/07/2005	50,510	33,660	15,838	**100,008**	84,170	(15,838)	141,203	41,196
01/07/2006	58,013	35,577	15,228	**108,819**	93,590	(15,228)	140,171	31,353
01/07/2007	63,636	37,530	14,643	**115,809**	101,166	(14,643)	139,007	23,198
01/07/2008	70,915	39,534	14,080	**124,529**	110,449	(14,080)	137,757	13,228
01/07/2013	89,896	50,373	11,572	**151,841**	149,633	(2,208)	134,189	(17,653)
01/07/2018	77,162	61,380	9,512	**148,053**	161,542	13,488	131,972	(16,082)
01/07/2023	68,547	68,643	7,818	**145,008**	160,190	15,182	128,968	(16,040)
01/07/2028	60,901	75,261	6,426	**142,588**	159,162	16,574	127,876	(14,712)
01/07/2033	53,648	81,837	5,281	**140,766**	158,485	17,719	129,590	(11,177)
01/07/2038	46,895	88,236	4,341	**139,472**	158,131	18,659	133,778	(5,694)
01/07/2043	40,446	94,554	3,568	**138,568**	152,852	14,284	139,691	1,123

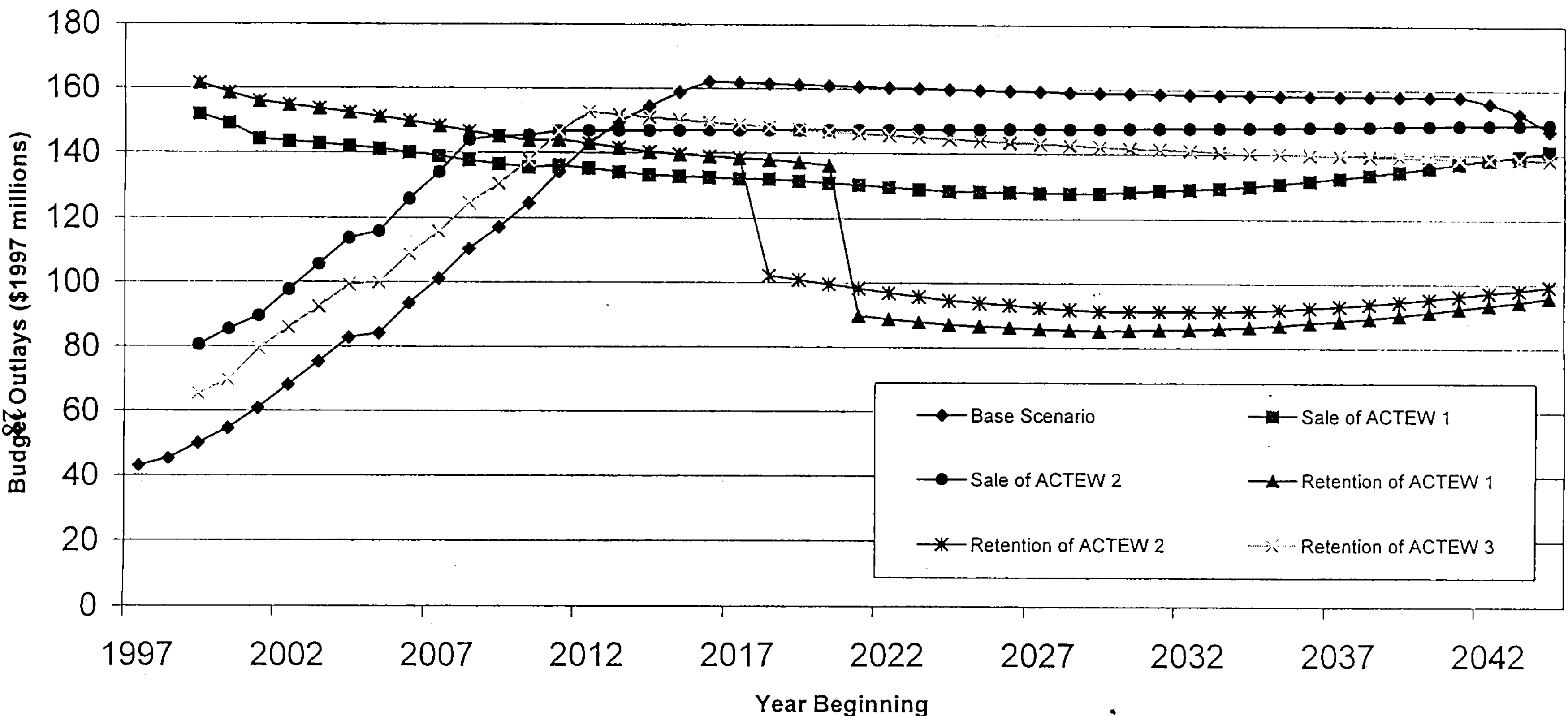
Note : ACTEW income stream figures in section 7 deflated to start of year figures to be consistent with other figures in the table
Columns may not add exactly due to rounding

8.27 This approach smooths the impact of the budget strain to give the ACT Government time to adjust. However, even with this smoothing, there is still a substantial strain with costs increasing over the projection period by over $80 million in 1997 dollars.

8.28 *Results*

A chart summarising the results in 1997 dollars is set out on the next page.

Australian Government Actuary



Base Scenario	Off budget funding continues, smoothed funding of emerging costs (Table 4)
Sale of ACTEW1	ACTEW sold, full funding of past and accruing liabilities (Table 5)
Sale of ACTEW2	ACTEW sold, $765m paid to SPA, smoothed funding of emerging costs (Table 8)
Retention of ACTEW 1	ACTEW retained, full funding of accruing liabilities, ACTEW income used to fund past unfunded liabilities (Table 6)
Retention of ACTEW2	ACTEW retained, full funding of accruing liabilities, $300m loan, reduced ACTEW income to fund past liabilities (Table 7)
Retention of ACTEW3	ACTEW retained, $300m loan, smoothed funding of emerging costs (Table 9)

9 CONCLUSION

9.1 The Towers Perrin report shows that the ACT Government will face a significantly increasing strain on its Budget as a result of its superannuation commitments. This is because the CSS/PSS are primarily unfunded superannuation arrangements where benefits are funded as they are paid out. The ACT Government participation in CSS/PSS from 1989 is like starting a new unfunded scheme. Initially benefit payments are low but increase significantly over a period of time.

9.2 This strain is exacerbated by the closure of the PSS and funding of the new superannuation arrangements which means that both accruing costs for new employees and emerging costs for existing employees will be met over the same period.

9.3 Apart from the off budget agencies, which have fully funded their superannuation liabilities, there has been relatively little advance provision for the emerging cost payments for CSS/PSS. From 1998/99, some partial advance funding for accruing liabilities will be made for on budget agencies. The intention is that over a period of time, partial funding will become full funding of accruing liabilities.

9.3 The ACT Government should have in place a strategy to cope with the cash flow strain. This may, but does not necessarily have to, involve funding of the liabilities.

9.4 The ACT Government has proposed the sale of ACTEW as part of a strategy to meet its superannuation commitments. The majority of the ACTEW sale proceeds would be paid into the SPA to fund unfunded accrued liabilities. Part of the proceeds would be used to reduce debt. It should be borne in mind that this process has just exchanged one set of assets – ACTEW for another set of assets – a portfolio of assets in the SPA and a net reduction in debt.

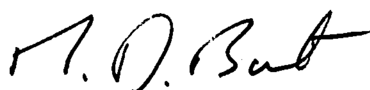
9.5 The consequence of this approach is that the ACT Government has reduced its potential expenditure on superannuation commitments and debt servicing. This has come at the price of reduced income through the loss of ACTEW dividends/taxes. Essentially one cash flow strain has been traded in for a different cash flow strain.

9.6 Section 8 has shown that, on the assumptions made, the income stream from ACTEW could be allocated to funding the accrued unfunded superannuation liability.

9.7 Thus, on the assumptions made, it should be possible to meet the accrued unfunded superannuation liabilities either through the sale of ACTEW or through the use of the ACTEW income stream if ACTEW is retained. With either option, there is a cash flow strain on the Budget at some stage.

9.8 A number of proposals have been considered in Section 8. The common feature of all options, including the status quo, is a **substantial strain on the ACT budget at some stage. This applies to all of the options considered, whether they involve sale or retention of ACTEW.** This is reflected in the chart at the end of section 8. The primary difference between the options is the timing of that strain.

9.9 It is important to note that this report has been largely based on information supplied to AGA, and in particular, on information contained in the Towers Perrin reports and supplied by Towers Perrin to us. As has been mentioned earlier, we have concerns about some of the information supplied. As we have used this information, our report has to be qualified in this regard. Given our concerns, the Committee may wish to consider whether Towers Perrin should be requested to double check the appropriate figures or that an independent check be carried out on the relevant figures.



Michael Burt, FIAA
Actuary

28 January 1999

APPENDIX 4

DISSENTING REPORT BY MR HAROLD HIRD MLA FROM THE REPORT OF THE SELECT COMMITTEE ON THE TERRITORY'S SUPERANNUATION COMMITMENTS

I wish to record my dissent from from the general tone, content and conclusions of the report. **I dissent from the report as a whole**. The failure of the majority of the Select Committee to propose any solutions to funding the ACT's superannuation liabilities reflects their refusal to consider options which did not accord with their current political agenda. It also reflects their distortion and misrepresentation of information placed before the Committee. These issues are elaborated in the following dissenting remarks.

Para 1.1.2 There were no "obvious difficulties" – as claimed in the report – in accessing broad community views and opinions on the issues. Indeed, the issues relating to the Territory's superannuation commitments have been canvassed widely in the community over several years. The issues have also been thoroughly examined by Towers Perrin, the ACT Auditor-General and in previous ACT budgets. The timeframe for the Committee was definitely not an impediment to its task, given the amount of prior work done on this matter.

The favourable reference to the Australian Government Actuary is misplaced. As the AGA has explained, the purpose of its submission was:

> "*to help the Assembly Committee understandand the nature of the ACT's superannuation commitments and the uncertainty involved in making actuarial estimates.*" [AGA correspondence, 29 January 1999.]

That is, the purpose was to illustrate to the Committee the arithmetic effect of using various assumptions, but the Committee has either confused the example with a projection or wilfully misused the AGA's illustration.

In illustrating the impact of varying assumptions for real growth in returns the AGA used a range from 3% real to 5.5% real. These, of course, are different from those it published (3% real or 3.5% real) in its assessment of the long term cost of the PSS and CSS schemes. Until the 1999 Triennial Review is completed there is no reason to depart from the published financial assumptions of the AGA and there is no suggestion that the AGA is going to revise its financial assumption to 5% real. This is a serious and fundamental error by the Committee.

Indeed, the AGA's own words should sound as a warning to the Committee about using the AGA's illustrative example instead of the assumptions actually used by the AGA <u>and</u> the ACT government:

> "*I regard the figures quoted in the ACT superannuation accounts as having been calculated using a reasonable basis for accounting purposes.*" [AGA correspondence, 29 January 1999.]

That observation clearly endorses the governments approach and, therefore, demolishes the Committee's assertion that the unfunded superannuation liability may be overstated by up to $250 million – a calculation achieved by using an assumption of 5% real growth.

The favourable reference to the Australia Institute is also clearly without objective basis and reflects the bias of the Chairman. The Australia Institute, of course, was paid by the ACT Trades and Labour Council to do the bidding of the Labor Party so it can hardly be regarded as credible. As the Committee is well aware, there are a number of inconsistencies and contradictions in the work carried out by the Australia Institute, especially relating to financial assumptions. For example, the evidence given by the Australia Institute at the public hearings directly contradicts its own modelling in its December 1998 report on the sale of ACTEW. (As the Committee knows, this contradiction was the subject of correspondence from the Under Treasurer to the Committee Chair.) This inconsistency should have been noted in the Committee's report – but it wasn't – along with the exposure of the serious errors by the Australia Institute in its attempt to prevent the sale of ACTEW, as covered in the Government response.

The draft report is deficient in not drawing attention to the above points and should have been redrafted to include them.

In light of the contradictions referred to above there is clearly no basis for the comment that "the work carried out by the Australia Institute has been of great value". The comment is wrong – because the Australia Institute has been misleading – and should have been deleted.

Para 1.1.3 There is no basis for the assertion that the government has "not provided a balanced picture", and I strongly disagree with it. In preparing the Government submission to the Committee a range of assumptions and options was modelled in order to provide a balanced picture.

The assumptions used by Towers Perrin are taken directly from the Australian Government Actuary's long term financial planning assumptions. It is blatantly false to state that the liability forecasts are "only at the high end of the range of possibilities that would normally be prepared by an actuary". Instead, the report should state that the estimates are consistent with the planning assumptions set by the Australian Government Actuary.

The report reveals an ignorance on the part of the Committee Chairman (who presumably drafted the report) of what estimates are and what their purpose is. Estimates may be either understated or overstated, depending on actual experience, and indeed the AGA in the report to the Committee alternately suggests both overstatement and understatement of the size of the liability. Far from making the groundless accusation that valuations of the superannuation liability are exaggerated, the Committee itself should have noted that the AGA report (at page 21) to the Committee states that the <u>unfunded liability could be expected to be $80m higher than forecast by the government.</u> (My emphasis).

I proposed, and still stand by, the following amendment to 1.1.3

"Examination has shown that reports tabled in support of the Government's proposal have provided a balanced picture to aid the Assembly's deliberations. The Towers Perrin reports adopted financial assumptions set by the Australian Government Actuary and reflect a prudent approach to financial planning on such a significant issue. The Fay Richwhite and ABN AMRO reports canvas the full range of risks carried by the taxpayer whilever ACTEW remains in public ownership."

Para 1.1.4 The paragraph is totally redundant because – not surprisingly – risk profile is already taken into account in the investment of SPA funds. Consistent with sound management, the risk profile is regularly reviewed, and will be reviewed again in 1999 in the normal course of events. These facts should have been noted in the Committee report in place of the present paragraph.

Para 1.1.5 The words "and particularly over the past few years" are wrong and should have been deleted because the current budget outlines unprecedented funding for superannuation provision.

Paras 1.1.7 and 1.1.8 I disagree with all words after 'liability' in 1.1.7 The remainder of the two paragraphs should have been deleted and replaced with:

[Remainder of 1.1.7] *"Since coming to office the government has consistently highlighted the significance of the superannuation problem and what failure to provide for future liabilities means for the living standards of Canberrans in the years ahead. Because of this concern the government had already adopted a strategy of injecting an additional $200 million over the next four years into superannuation investments prior to, and totally independent from, its proposal to sell ACTEW."*

1.1.8 *"The Committee agrees with the government's position that the case for selling ACTEW stands alone on grounds of business growth and job opportunities, unrelated to the question of funding superannuation liabilities. It also agrees that once the proceeds from the ACTEW sale are received, the best use for those funds is to reduce debts of Territory and provide for future superannuation commitments"*.

Para 1.2.10 The Committee was neither asked nor required to consider the sale of ACTEW. It is not within the terms of reference. The Committee spent a great deal of its time focusing instead on broader issues relating to the sale of ACTEW. This has contributed greatly to the pressure on committee members in the limited time available, and to the production of a poor standard report.

As clarified in amended paragraph 1.8 above, the case for the sale of ACTEW rests on business growth and job opportunities, not funding superannuation. The so-called 'direct link' between the two is only held by those with political opposition to the sale of ACTEW.

Paras 1.2.11 and 1.2.12 These paragraphs are just a vacuous complaint and serve no useful purpose. As I have already covered in comments on paragraph 1.1.2 above, the issues relating to the Territory's superannuation commitments have been the subject of several reports and have been canvassed widely in the community over several years. It appears some members of the Committee wanted to reinvent the wheel but, given the amount of high quality information already available, it is just not credible to complain that the Committee did not have the time to do its job properly.

Paras 1.2.13 – 1.2.16 Inclusion of these paragraphs contradicts the rush to release the report. If the Committee genuinely believes this, it should have delayed release of the report to allow more time for examination. They should be deleted.

Para 1.3.1

(a) The assertion – masquerading as a 'finding' – in (a) is wrong and misleading. The fact is that the Towers Perrin report into the management of our superannuation liabilities is based on the Actuary's assumptions, and the Actuary warned that the government may have actually understated the size of the accrued liability by up to $80 million. So it is not correct to say that Towers Perrin has produced "only one end of the range of outcomes that actuaries typically produce". Actuaries typically produce conservative forecasts, not "optimistic" scenarios. The suggestion that the Government should base its budget planning on "optimism" is irresponsible to the point of absurdity. (a) should have been redrafted to give an accurate and balanced assessment of Towers Perrin, along the following lines:

"The quality of the work done by Towers Perrin has been acknowledged by groups as diverse as the Australia Institute and the Acting Australian Government Actuary, Mr Kevin Deeves, who has rejected suggestions that the Towers Perrin analysis misrepresented the superannuation liability. Mr Deeves confirmed that the analysis was based on assumptions set by the Australian Government Actuary, that it represented a prudent approach and that they presented a "realistic" idea of the superannuation liability."

(b) No-one has ever said – least of all the government – that the sale of ACTEW is the only option for funding superannuation liabilities, and it is therefore disturbingly disingenuous of the Committee to imply that to be the case. Moreover, the Committee has failed to recognise that the government presented a range of options for consideration. To make matters worse, there is nothing in the Committee's report to rebut the government's argument that using revenue from the sale of ACTEW is the best course of action in terms of overall cost, annual affordability and prudent financial planning. (b) should have been redrafted to spell out these points:

"The proposed one-off funding option, the sale of ACTEW, is not the only possible method of funding superannuation but is clearly the best option in terms of cost to the taxpayer and budget affordability."

(c) Contrary to the ideological position adopted in the draft report – again reflecting the prejudices of the Chairman – the sale of ACTEW does not "involve the loss of the valuable public asset" but rather maintaining the value that taxpayers have invested in ACTEW by converting it into a financial asset. The report should have been redrafted to point out that to keep ACTEW in government ownership would see it lose value:

"*The alternatives to the one-off funding option involve higher cost to the taxpayer, greater risk from continued ownership of ACTEW, erosion of the value of a major public asset and a greater call on the budget.*"

(d) Potential negative economic impacts exist under any superannuation funding option, as clearly spelled out in the government submission. It is biased and misleading to suggest that negative economic impacts exist only under the sale option. Clearly they do not, and the report should have spelled out why that is so:

"*Given that each funding option involves significant government outlays and as a result, higher taxation, all will have economic impacts. However by minimising the cost to the taxpayer, the economic impact is minimised. Therefore funding superannuation via the sale of ACTEW is clearly the best option.*"

Re: Committee Note

This note may reflect the prejudices of the Chairman, but it is incorrect and should be deleted. I have already dealt with this issue by proposing the new paragraph 1.1.8 above, viz. "*The Committee agrees with the government's position that the case for selling ACTEW stands alone on grounds of business growth and job opportunities, unrelated to the question of funding superannuation liabilities. It also agrees that once the proceeds from the ACTEW sale are received, the best use for those funds is to reduce debts of Territory and provide for future superannuation commitments*".

Para 1.4.2 The report should make it clear – which it does not – that the AGA's submission to the committee says that the estimated unfunded liability could be either an overestimation or an underestimation. As I have pointed out in earlier comments, the AGA notes (page 21) that by 30 June 1999 the unfunded accrued liability "could be expected to be around $80m greater than the $765m cited by the Chief Minister". The report should have been redrafted to emphasise this observation.

The AGA's illustration using a 5% financial assumption for demonstrating the impact on liabilities is different from its published financial planning assumptions which use 3% or 3.5%. The Acting Australian Government Actuary Mr Kevin Deeves clarified this point in his letter to the Under Treasurer of 29 January 1999 and on ABC Radio when he made it clear that the AGA backed the figures used by the ACT Government, confirmed that they were based on AGA assumptions and advised the use of conservative estimates for prudent financial planning.

The report should have pointed this out, instead of using the untested figure of 5% to push its own agenda at the expense of a balanced and credible assessment. A further review of long term costs will be published in late 2000 based on data up to 30 June 1999, but there is no suggestion that the financial assumption will be revised upwards to 5%. Hence the report's "optimistic" estimate of a liability $250 million less than predicted by the government can only be described as a misrepresentation of the actuary's position. That is why it should have been deleted from the report.

Para 1.4.3 For the reasons outlined above, the figures cited of $250 million and $135 million have no basis in fact or analysis and should therefore have been deleted. At no point does the AGA use the term "pessimistic" to describe the 3% financial assumption. This is blatant misquoting of the AGA report.

Para 1.4.4 The quotation from Clive Hamilton should have been dropped. The evidence presented by the Australia Institute completely contradicted its earlier work on the sale of ACTEW, a fact which the Committee report failed to explain, let alone acknowledge. The decision to include this quotation can have no other basis than cheap political point scoring. It adds nothing of value to the report and is certainly not within the terms of reference, so should have been deleted.

Recommendation (1.4.6). The recommendation [...***that the Assembly takes careful note that the level of unfunded superannuation liability may have been overstated by up to $250m by use of the conservative assumptions***.] should have been deleted because it is based on the assumption of 5% real growth in yields, compared with the more realistic assumption of 3.0-3.5% used by the AGA for the CSS/PSS. To include this recommendation in the report is to confuse an illustration with practice to knowingly mislead the Assembly and the public.

The recommendation should have read:

"The committee recommends that the Assembly takes careful note that the estimated level of unfunded superannuation liability is based on appropriate actuarial advice. While it may understate or overstate the actual liability it is an appropriate estimate to use as the basis for prudent financial planning."

Para 1.4.3 The second sentence is false and must be dropped. Instead, the report should have noted that the audited accounts are based on liability projections calculated using the financial assumptions provided by the Australian Government Actuary. In no way has the AGA disputed the veracity of the ACT Government's audited financial statements.

5 INTERSTATE COMPARISON

Para 1.5.5 Table 1 is extremely misleading without the qualification that unlike other states and the Commonwealth, the ACT has only been accumulating an unfunded liability since 1989. Other jurisdictions have "mature" schemes with a stable level of liabilities whereas the ACT is experiencing rapid growth in its unfunded liability. In addition, presenting the unfunded liability as a percentage of State Final Demand is less relevant than as a percentage of total revenue (given that the liability will need to be funded from ACT Government revenue which relies on a very narrow tax base).

The table should have replaced the "% of SFD" column with "% of revenue" and added the following amplification:

"While the ACT's unfunded liability as a percentage of revenue is in line, or lower than, other jurisdictions this masks the extent of the problem. The ACT has only been accumulating an unfunded liability for nine years and the liability is growing rapidly, in contrast to other states and the Commonwealth which have "mature" schemes and relatively stable, or falling, liabilities."

Para 1.5.8 This paragraph completely misses the point. Each jurisdiction has put together a strategy suited to their own particular circumstances. By rejecting the one-off funding option the committee has rejected a solution suited to the ACT's circumstances in favour of a 'second best' approach.

The paragraph should have been deleted and replaced with:

"The committee notes that each jurisdiction has developed strategies to deal with superannuation liabilities suited to their own particular circumstances. The ACT should not necessarily follow a solution adopted by another jurisdiction but should look for the strategy bested suited to the ACT's circumstances."

AGA REVIEW OF TOWERS PERRIN REPORT

Para 2.6 The AGA makes it clear that it does not have expertise in valuation or assessment of the prospects of electricity and water companies. Therefore AGA analysis of ACTEW's business prospects must be disregarded.

Para 2.9 There is no evidence presented to back the statement that actuaries "typically assume a real rate of investment return over price inflation in the range of 3% - 5.5%". The AGA has used real returns of 3% or 3.5% only in its estimation of the long term costs of the PSS and CSS.

The following paragraph was suggested by me and should have been included:

"While the AGA report suggests that actuaries typically assume a real rate of investment return over price inflation in the range of 3% - 5.5%, no evidence was presented to support this statement. It is in conflict with the AGA's published assessments of the long term costs of the CSS and PSS schemes, which use

assumptions of 3% real return (in the 1993 review) or 3.5% (in the 1996 review). The Australian Government Actuary Mr Kevin Deeves has confirmed that the estimations used by the ACT Government are appropriate, do not misrepresent the extent of the liability and reflect prudent financial judgement."

Para 2.10 This paragraph blatantly misrepresents the AGA report which does not "express concern" at the Towers Perrin modelling. Indeed the AGA has since confirmed that the Towers Perrin modelling is appropriate.

Paras 2.11, 2.12 Similar to above. The AGA has in no way suggested the ACT Government has misrepresented the size of the superannuation liability. Delete.

ADEQUACY OF TOWERS PERRIN REPORT

This section should not have been published in its current form without providing Towers Perrin with the opportunity to respond to the issues raised by the AGA. At the very least it should have been noted that the AGA report, at paragraph 5.15, states that "Our concerns could well be of a minor nature".

Suggested Amendment:

Paragraphs 2.15 - 2.21 should not be published until Towers Perrin has an opportunity to respond to the issues raised by the AGA. If the report is to be published before such a response is possible, they should be deleted.

Recommendation 2.30 - Suggested Amendment:

Delete second sentence. No supporting evidence is presented to demonstrate why this is "an objective to be strived for". It smacks of putting off the problem to another day.

COMMITTEE QUALIFICATION AND COMMENTS

Para 2.29 This is clearly a misrepresentation of the AGA's position. The AGA in fact has confirmed that the Towers Perrin modelling uses AGA assumptions, that it does not misrepresent the size of the superannuation liability and that it constitutes a prudent approach.

It should have been replaced with:

"The prudent approach adopted by the Government and by Towers Perrin provides a good basis for assessment of the superannuation liability and measures to fund the ACT's superannuation commitments. The approach has been endorsed by the Australian Government Actuary as financially responsible and has been fully audited by the ACT Auditor-General."

EFFICACY OF ON-OFF FUNDING OPTION

Paras 3.1 - 3.6 These have no place in this report. They focus on ACTEW's business viability which was not part of the committee's terms of reference. The assertions made are highly questionable and have been thoroughly dealt with in other reports from experts in this field.

Risk Associated with Disposal

It is wrong to state that no work has gone into risk assessment relating to the ACT's superannuation investment. The current strategy of dividing the investment between 5 funds managers, in different areas of investment, represents diversification to minimise risk. Further analysis of the risk profile is being undertaken in 1999 and would be completed before decisions were taken regarding the investment of the ACTEW proceeds.

It must also be remembered that these investments will be for an extremely long period. Share market cycles will occur within the life of these investments but that is no reason to refuse to invest in the share market. All major superannuation funds invest a portion of their funds in the equities market and take a long term view. Suggesting that no superannuation funds should be invested in the equities market would be to deny members significant returns. Even after significant market "crashes", such as in 1987, equities markets rebound. In the 1990's, returns have been very high. The risk profile for superannuation investments must take into account the long time frame of the investment.

The claim that ACTEW is less exposed to risk than a diversified investment portfolio is not supported by any evidence. In fact the evidence would suggest the opposite.

Paras 3.7 - 3.9 These paragraph have no relevance to the committee's terms of reference and should therefore have been deleted.

Paras 3.10 - 3.14 Given the AGA's statement that it has no expertise in the valuation or assessment of the prospects of electricity and water companies it is inappropriate to include this section. This is quite apart from the fact that it goes well beyond the committee's terms of reference. If the committee wanted expert assessment of ACTEW's income stream it should have consulted with an expert in the field, not take the views of someone who admits no expertise.

ALTERNATIVE FUNDING PROPOSALS

In the third paragraph the committee destroys its own arguments and effectively supports the case for the funding of superannuation via the sale of ACTEW. It states "Changing the form of asses held cannot in itself dramatically alter future prospects, unless the returns derived from one form of the assets are somehow markedly different from another. No such expectation has been identified".

In fact, most of the committee report is based upon an argument for a 5% real investment return to be factored into the calculation of superannuation liabilities. The real return from ACTEW is forecast to range between 1.6% and 2.1% over the next four years. In other words the committee is arguing that a "realistic" estimation of the return from a financial asset (5%) is two to three times higher than the return from ACTEW. This underlines why the sale of ACTEW and investment of the proceeds in superannuation provision is the best solution.

On Page 31, the paragraph below numbered point (vi) deliberately misrepresents the work done by the Australian Government Actuary. There has been no "revelation that data provided in consultants' report was almost exclusively based on the worst case scenarios" or that there is a "bias in the figures". These two paragraphs must be deleted.

Alternatively, if the committee adopts a 5% real return as a reasonable long term planning assumption then its conclusions must support the case for the transfer from an infrastructure asset (ACTEW) to a financial asset (superannuation investment) due to the much higher returns from the financial asset.

Para 3.21 The Government submission drew no such conclusion. It concluded that the dividend could not be forecast to be any higher than $44m per year and that there was a reasonably high probability that it would be below this level.

Para 3.32 The existence of the billion dollar hole in the Australia Institute proposal has been confirmed by Government analysis. Either the committee should confirm that the billion dollar hole exists or note that the Australia Institute, by assuming away the future accruing liability, has ignored the greater part of the superannuation problem. All other analysis, including the committee's own analysis, identifies the future accruing liability as a major part of the superannuation issue.

DOWNSTREAM ECONOMIC IMPACTS

The Committee has adopted the model of the economy put forward in the Government's Submission, but has enhanced it through discussion of the linkages between the various sectors of the economy. This proves the adage that "a little knowledge is a dangerous thing". The committee has allowed itself to become bogged down in calculations, which whilst academically an interesting exercise, ignores the bigger picture.

The Committee's analysis of the various options is predicated on ACTEW behaving differently under public and private ownership. In particular, the Committee believes that employment in ACTEW will be higher under public ownership, and that this somehow represents an economic benefit.

It appears that the Committee cannot see the forest for the trees. There is no economic benefit in having two people do a job where one will do. Obviously the marginal product of the second person is zero. There is an associated opportunity cost in that the second person could be productively employed elsewhere.

Economics is concerned with producing the maximum amount of benefit with the least resources. Wasting resources through inefficiencies is clearly a burden on the economy. Any analysis which presents this additional burden as a benefit has clearly lost sight of the fundamentals.

ACTEW in private ownership will aim to use the least possible resources, including labour, whilst maintaining output. ACTEW in government ownership will do exactly the same. To do otherwise would be to impose a burden on the economy. If ACTEW can be more efficient in private hands than in public hands then this must be economically beneficial, as it further reduces the deadweight burden of inefficiency.

The Committee's report ignores the benefits of the removal of this burden. On page 42 of the report it notes that "the business sector in the ACT is vital to economic growth," yet on the very next page it disregards the effects on business of reduced electricity prices. Reduced electricity prices will make business more efficient, allowing it to create productive employment across the economy. To suggest that unproductive employment in ACTEW is better than productive employment across the whole economy is bizarre.

Pages 38 and 39 address the issue of reduced local expenditure by a privatised ACTEW. The committee believes that it is apparently impossible for the government to put additional investment clauses into the sale contract. Why this is impossible is not explained.

On pages 42 and 43, when considering the SPU account under the Government's preferred option, the committee complains that it would "tie over a billion dollars into a financial asset that would be used solely for superannuation purposes. ... in effect the use of these proceeds provides no useable budget money." On page 49, discussing the same account under a different option, the committee apparently believes that "increasing expenditure over time through the SPU account ... would thus be adding additional money to the economy as a result of this option." Either the committee is being deliberately misleading or it does not understand the concepts it is dealing with. This is further illustrated on page 50 in paragraph 3.51.

The Committee has failed to understand the basic relationship (G-T) in the equation of the economy. To suggest that there is some automatic link between them is to misunderstand the nature of 'G' as it relates to superannuation. 'G', that is, the government's spending on superannuation, is the emerging cost. It is the amount paid out in benefits to superannuants as they retire. As such, it is completely independent of any method of funding, and can be effectively disregarded when comparing the merits of the various options.

The Government stands by the analysis in its submission, which is based on consistent assumptions for all options. The option that will be best for the economy is the option that will minimise the additional tax burden 'T'. Using net present value analysis to take account of the different timing of payments, the option that result in the smallest increase in 'T' is the sale of ACTEW option.

Unlike the committees' report, this analysis is consistent in its approach to the effects on the budget of the SPU account.

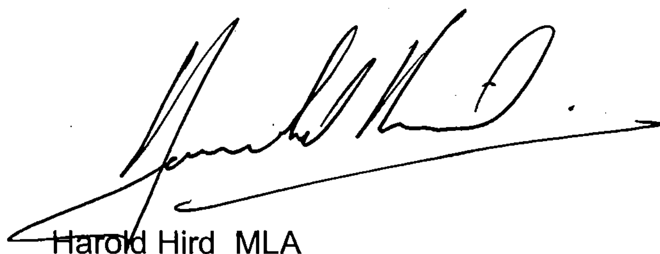
The report confuses the issue by partially incorporating the effects of job losses within ACTEW without considering the improved efficiencies. It further muddies the waters by assuming that the government would be prepared to allow an inefficient ACTEW to use more resources than necessary and force the economy and the government to carry the costs.

Pages 45 and 46 show that the Committee is also confused about the role of the finance sector in the sale. On page 45 the committee states that "net Territory debt will increase by the full amount borrowed to finance the purchase", yet on the next page it states the widely held belief "that the purchaser of a privatised ACTEW would live outside the Territory".

In any case, the sale of ACTEW is designed to eliminate a liability which the government owes to its employees in the form of superannuation.

In its conclusion the Committee states that it has treated the options for funding in a vigorous, if not rigorous manner. This is one of the few correct statements in the analysis. However, by equating vigour with useful output the Committee has applied the same misconception to itself as it has done to ACTEW. Unproductive activity is not beneficial to a debate any more than it is to an economy.

For the reasons outlined above I believe the report of the Select Committee is most inadequate and in places, either through neglect or wilfulness, seriously wrong and misleading.



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