1996-97

ISSUES IN PUBLIC FINANCE

BUDGET PAPER No. 5

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CHAPTER 1

NORTHERN TERRITORY FISCAL MANAGEMENT

The core strategies and fiscal targets for the Northern Territory Government are that:

- *current expenditure per capita will not increase in real terms;*
- *fixed capital expenditure will be maintained at levels sufficient to meet the Territory's economic and social development needs;*
- *interest payments will be no higher than the level of payments in 1992-93;*
- *interest payments as a proportion of Territory revenue and Commonwealth grants will be no higher than the six State average proportion;*
- *Territory rates of taxes and charges will, except where special circumstances exist (such as the Liquor Levy), be no higher than the six State average level; and*
- *any new borrowings must be for repayment of Commonwealth advances or development of economic infrastructure, and by 1998 new borrowings will be undertaken only where there is sufficient economic return to meet debt servicing costs and redemption of borrowings involved.*

The only provisos are that:

- *in any given year, the percentage change in Commonwealth Grants to the Northern Territory is not significantly different to the change for the States; and*
- *the Territory receives adequate discretion in the application of funds to priorities determined by Territorians.*

This Chapter reviews performance against the targets and concludes that in every case the fiscal targets have been satisfied.

A single quantitative fiscal target was set in the 1993-94 Budget when the Treasurer indicated that interest payments would be no higher than 1992-93 levels. In the 1994-95 Budget, the Treasurer elaborated on the Territory's core strategies and fiscal targets in explicit terms. While this was essentially a continuation of past policies, a number of additional quantitative fiscal targets were announced.

The purpose of this Chapter is to review the actual outcome for 1995-96 and the Budget for 1996-97 against the fiscal targets.

The overall Budget position has developed as follows:

	1994-95 Actual	1995-96 Actual	1996-97 Budget
	$M	$M	$M
OUTLAYS			
Current Expenditure	1 329	1 401	1 466
Capital Expenditure	221	184	264
less			
RECEIPTS			
Territory Revenue	*379*	*410*	*457*
Commonwealth Grants	*1 150*	*1 228*	*1 241*
equals			
INCREASE IN NET DEBT			
Increase in Territory Debt	54	32	4
Decrease in Financial Assets	-33	-85	27

Analysis of the Territory's performance against specific targets follows.

- **Current expenditure per capita will not increase in real terms….**

The strategy is on a three year rolling basis, to ensure transfers of receipts and expenditure between financial years which are unrelated to policy changes do not affect the fiscal targets.

	1995-96 Actual	1996-97 Budget
Current Expenditure Growth	5.4%	4.6%
Combined Population and CPI growth	*5.9%*	*5.1%*

In 1996-97, current expenditure is expected to increase by 4.6 per cent, which is lower than the expected combined rate of inflation and population growth of 5.1 per cent and hence well within the fiscal strategy limits.

Similarly, the actual outcome for 1995-96 was 0.5 per cent below the maximum permitted by the strategy. (Inflation for the year to June 1996 was 3.1 per cent while population growth was estimated to be 2.7 per cent.)

As growth in current expenditure in both years is below the target for each individual year, no further analysis was necessary to average any year's result over a three year period as permitted by the strategy.

- **Interest payments will be no higher than the level of payments in 1992-93….**

	1992-93 Actual	1995-96 Actual	1996-97 Budget
Interest Paid	$220M	$205M	$205M

Some of the parameters which determine whether this target can be achieved are largely outside the Territory's control. Determinants are interest rates on new and refinanced debt, as well as the level of new borrowings. Fiscal restraint coupled with active debt management means interest payments in 1996-97 are expected at this stage to be $15 million lower than in 1992-93.

- **Fixed capital expenditure will be maintained at levels sufficient to meet the Territory's economic and social needs….**

	1995-96 Actual	1996-97 Budget
Expenditure on New Fixed Assets	$186M	$251M

There continue to be no quantitative targets for this element of the strategy. However, the Territory's requirement for capital infrastructure will continue to increase with population growth and economic activity particularly in the resource sector. There is a substantial increase in 1996-97. Most of the increase relates to the creation of new assets to cater for a growing population and economy with only limited expenditure associated with the replacement of assets. The new increases over 1995-96 are:

• Education (all sectors)	+$21M
• Port and related infrastructure	+$16M
• Railway	+$10M
• Utilities	+$ 6M

- **Interest payments as a proportion of Territory revenue and Commonwealth grants will be no higher than the six State average proportion....**

	1995-96 Actual	1996-97 Budget
Interest Paid	$205M	$205M
Total Revenue and Commonwealth Grants	$1 638M	$1 698M
Ratio of Interest to Revenue and Grants	12.5%	12.1%
Six State Average (est)	*14.6%*	*n.a.*

The Territory continues to compare favourably with the States on this measure although the position will be assessed again, later in the year when all State budgets have been presented. As there are unlikely to be significant movements in the six State average ratio of interest to revenue and grants, the Territory ratio is expected to remain below that of the States.

- **Territory rates of taxes and charges will, except where special circumstances exist (such as the Liquor Levy) be no higher than the six State average level....**

	1995-96 Actual	1996-97 Budget
Total Territory Revenue (per capita)	$2 320	$2 533
Six State Average (est)	*$2 381*	*n.a.*

It is difficult to obtain a comparison of State revenues which takes both revenue capacity and revenue effort into account. The comparison above, based on Australian Bureau of Statistics data, is a relatively unsophisticated comparison. A wide-ranging comparison of different tax rates and charges for the Territory and the States is contained in *Budget Paper No.3* which confirms that, on the whole, Territorians are subject to similar rates of taxes and charges to their interstate counterparts. The Commonwealth Grants Commission undertakes assessments of revenue capacities and effort but this is not comprehensive, especially for the States, where financial activities and some significant government enterprises are excluded from the Grants Commission's assessments. The focus is also mainly on taxes.

As any of the above measures are subjective, some judgement is required when comparing rates and levels of taxes and charges across States and Territories.

This year's Budget includes three material changes to taxes and charges policies as outlined elsewhere in the Budget documents, the largest of which is the nation-wide decision to raise heavy vehicle registration fees. These initiatives can be expected to increase revenue from Territory sources by less than 3 per cent in 1996-97.

- **The increase in Territory debt in any year will be no higher than 5 per cent of total expenditure....**

	1995-96 Actual	1996-97 Budget
Increase in Territory Debt	$32M	$4M
Total Expenditure	$1 585M	$1 729M
Ratio of Debt Finance to Total Expenditure	2.0%	0.2%

The increase in Territory debt is well within the fiscal strategy target.

- **Any new borrowings must be for repayment of Commonwealth advances or development of economic infrastructure, and by 1998 new borrowings will be undertaken only where there is sufficient return to meet debt servicing costs and redemption of borrowings involved....**

	1995-96 Actual	1996-97 Budget
Commonwealth Repayments(a)	$63M	$62M
Economic Infrastructure Expenditure(b)	$67M	$101M
Total	$130M	$163M
Territory Borrowings	$95M	$65M

(a) From *Budget Paper No.2.*

(b) Lands, Planning and Environment, Darwin Port Authority, Transport and Works Commonwealth and Territory funded roads, Northern Territory Railway, PAWA: Commercial Services expenditure from *Budget Paper No.4.*

As with last year, Territory borrowings continue to be less than expenditure on economic infrastructure and Commonwealth repayments. The Territory is well within the fiscal targets established by the strategy.

Fiscal Strategy Provisos

The core strategy and fiscal targets are also subject to two provisos:

- **In any given year, the percentage change in Commonwealth grants to the Northern Territory should not be significantly different to the change for the States….**

	1995-96 Actual	1996-97 Budget
Change in Commonwealth Funding:		
Northern Territory	6.8%	1.1%
Six State Average (est)	*5.0%*	*-2.4%*

Given the uncertainty about specific purpose payments, the Territory's position vis a vis the States on average is not accurately known. In determining the ratio for 1996-97 for the States, a 3 per cent reduction has been made to the estimated level of Specific Purpose Grants for 1995-96 and the remaining total was then added to general revenue grants.

- **The Territory should receive adequate discretion in the application of funds to priorities determined by Territorians….**

	1995-96 Actual	1996-97 Budget
Ratio of Specific Purpose to Total Grants	25.6%	25.0%

The ratio of general to specific purpose payments remains unclear, and the Commonwealth has advised details on specific purpose payments will not be available until some time after the Commonwealth Budget. It is likely however that the proportion of specific purpose payments will decline, not through a reclassification from specific to general purpose, but rather because of an absolute decline in the amount of specific purpose payments.

CHAPTER 2

RECENT FISCAL DEVELOPMENTS

Commonwealth financial assistance to the Territory has increased by 7.9 per cent in real terms over the period 1988-89 to 1995-96. However the Territory population has risen by 9.6 per cent over this time resulting in a decline in real assistance per capita. This has placed considerable pressure on the Territory Budget in providing a full range of services to the Territory public.

The Territory has responded to funding constraints by exercising considerable restraint in total expenditure. Current expenditure on services has increased only modestly over the period in review and the bulk of budgetary adjustment has been borne by capital expenditure, although it is expected to rise in 1996-97. Total expenditure has fallen by 0.1 per cent in real terms between 1988-89 and 1995-96 compared with an increase of 16.8 per cent in the six States.

Whilst total revenue has increased, the decline in real Commonwealth grants per capita has also necessitated a greater revenue raising effort by the Territory. This has resulted in an increase in Territory-source revenue of 55.2 per cent over the period from 1988-89 to 1995-96. Over the same period the increase in State-source revenue by the six States was 19.3 per cent, with Commonwealth per capita grants to the States increasing by 8.4 per cent. In 1996-97, Territory total revenue is expected to again increase as a result of growth in Territory-source revenue more than offsetting a decline in Commonwealth assistance.

A significant downward trend in total financing transactions is evident prior to 1991-92, reflecting the completion of major infrastructure projects, particularly Channel Island Power Station and the Yulara tourism complex. In the following period through to 1994-95, total financing has fluctuated reflecting new capital works, little change in the real level of Commonwealth assistance and a sharp fall in Territory revenue in 1992-93 due to falling interest receipts and lower surpluses of public trading enterprises. Low levels of capital expenditure assisted in producing a decrease in net debt in 1995-96 and estimates for 1996-97 show another decrease equivalent to 0.9 per cent of total expenditure.

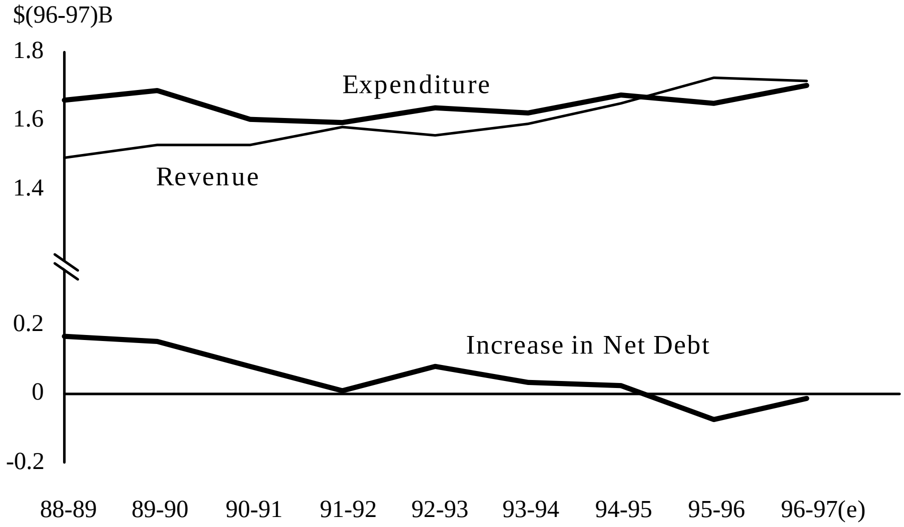
Background

The 1991 Premiers' Conference resolved that all governments move toward a uniform presentation of government financial statistics in budget papers. The information provided in this Chapter complies with these uniform standards, although it is re-presented in the economic transactions format (ETF) as described Chapter 9. A discussion of some aspects of this presentation is included in the Appendix to this Chapter.

Data for this Chapter is drawn from the Australian Bureau of Statistics Government Finance Statistics (GFS) database which is compiled from information supplied by Commonwealth, State and Territory Governments. All data is expressed in 1996-97 dollars, calculated using the rate of inflation adopted in the *National Fiscal Outlook, June 1996.* All State data for 1995-96 and Territory data for 1996-97 are estimates.

Figure 2.1

Northern Territory Budget



Source: *Government Financial Estimates,* ABS Cat. No.5501.0; and Northern Territory Treasury.

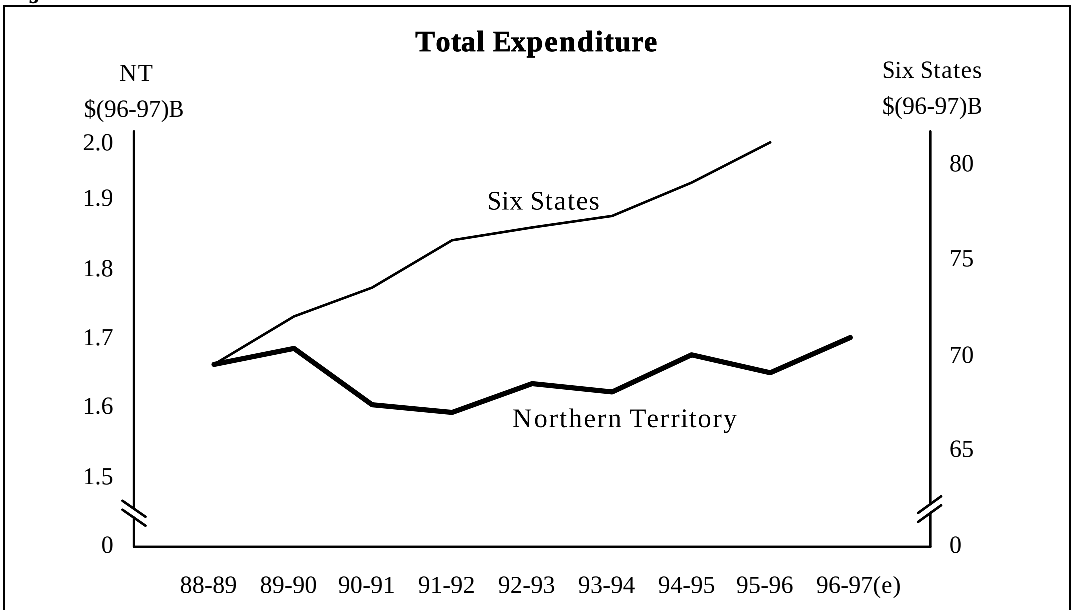
The fundamental underlying trends are:

- expenditure is rising in real terms at a slower rate than revenue; and
- as a result, the annual increase in net debt has been declining.

Expenditure

Between 1988-89 and 1995-96, total expenditure by the Territory public sector fell by 0.1 per cent, whereas total expenditure by the six States increased by 16.8 per cent. Had the Territory's expenditure increased since 1988-89 in line with the six States, total expenditure in the Territory would have been $288 million greater in 1995-96. Territory expenditure is expected to increase in 1996-97 predominantly as a result of an increase in capital expenditure.

Figure 2.2

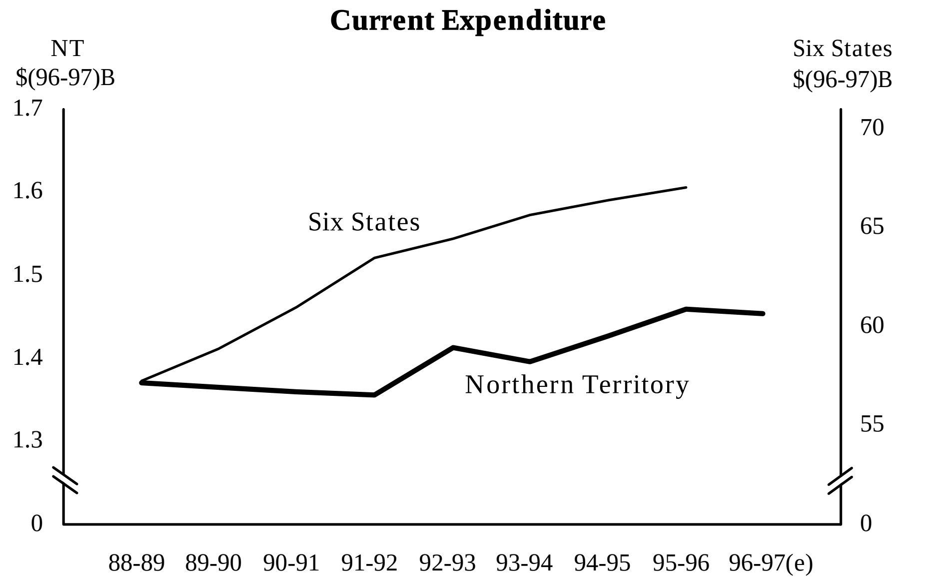


Source: *Government Financial Estimates,* ABS Cat. No.5501.0; and Northern Territory Treasury.

Total expenditure by the public sector can be divided into two major categories, current expenditure and capital expenditure. Current expenditure includes all running costs of government programs, with the major component being salaries. Capital expenditure encompasses outlays on capital equipment and public works.

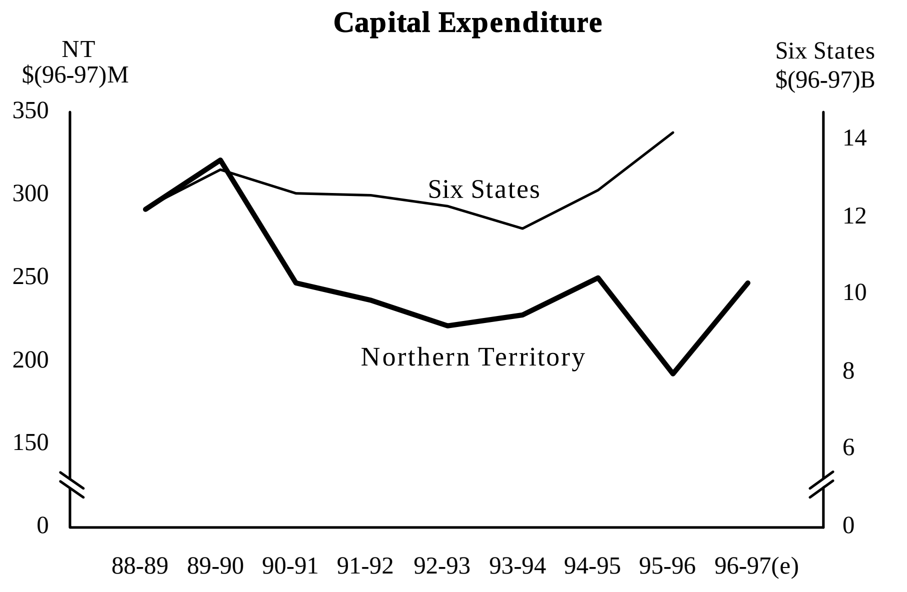
Over the period 1988-89 to 1995-96, current expenditure of the Territory public sector has increased by 6.5 per cent, whereas current expenditure of the six States increased by 17.0 per cent. Current expenditure in the Territory is expected to be $1.5 billion in 1996-97.

Figure 2.3



Source: *Government Financial Estimates*, ABS Cat. No.5501.0; and Northern Territory Treasury.

Figure 2.4



Source: *Government Financial Estimates*, ABS Cat. No.5501.0; and Northern Territory Treasury.

Capital expenditure has borne the bulk of budgetary restraint over the period 1988-89 to 1995-96. Territory capital expenditure has fallen 33.9 per cent compared with a rise of 15.7 per cent in the six States. In 1996-97 there is a significant increase in capital expenditure associated with the carry over of uncompleted projects from 1995-96 and new projects, many related to the faster rate of population growth.

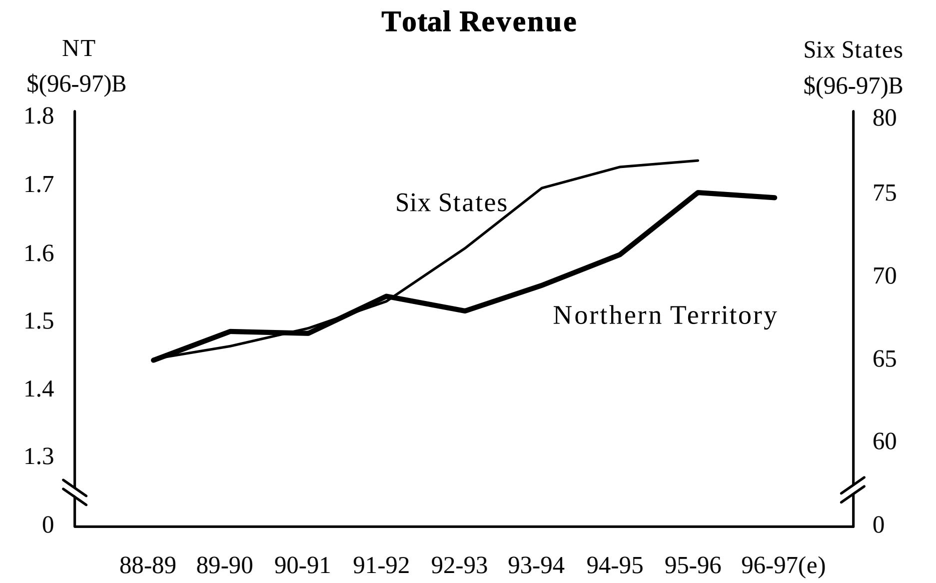
Revenue

Revenue received by the States and Territories is comprised of two major components:

- own-source revenue comprised of taxes, charges and royalties levied by each jurisdiction; and
- grants received from the Commonwealth.

Due to the fiscal imbalance which exists between the two tiers of government, State and Territory own-source revenues are supplemented by financial assistance grants from the Commonwealth.

Figure 2.5



Source: *Government Financial Estimates,* ABS Cat. No.5501.0; and Northern Territory Treasury.

Between 1988-89 and 1995-96, total revenue of the Territory public sector rose by

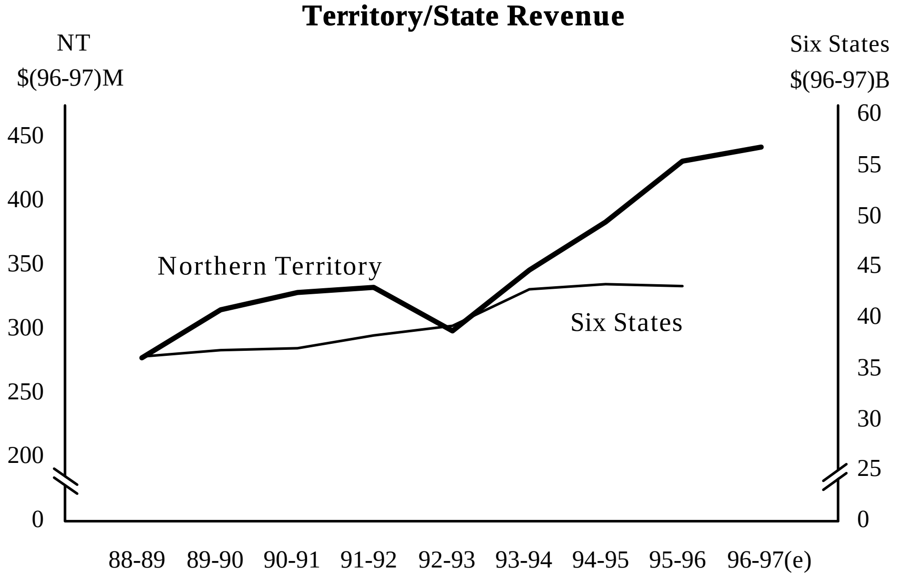
17.0 per cent. Over the same period, total revenue of the six States rose by 18.3 per cent. The variation is partly explained by the differential impact of Commonwealth funding decisions and partly by the fact that the Territory has a limited base from which to raise revenue, despite continued economic and population growth over the period.

Territory Revenue

To counteract the continued decline in Commonwealth grants, and to maintain average levels of service, the Territory public sector has increased its revenue raising efforts over recent years. As a result, Territory revenue rose 55.2 per cent over the period 1988-89 to 1995-96. During the same period the six States raised their revenue collections by 19.3 per cent. Revenue growth in the Territory reflects generally buoyant economic conditions and higher population growth, combined with measures to bring the rates of Territory taxes and charges more into line with those prevailing interstate.

Figure 2.6

Territory/State Revenue

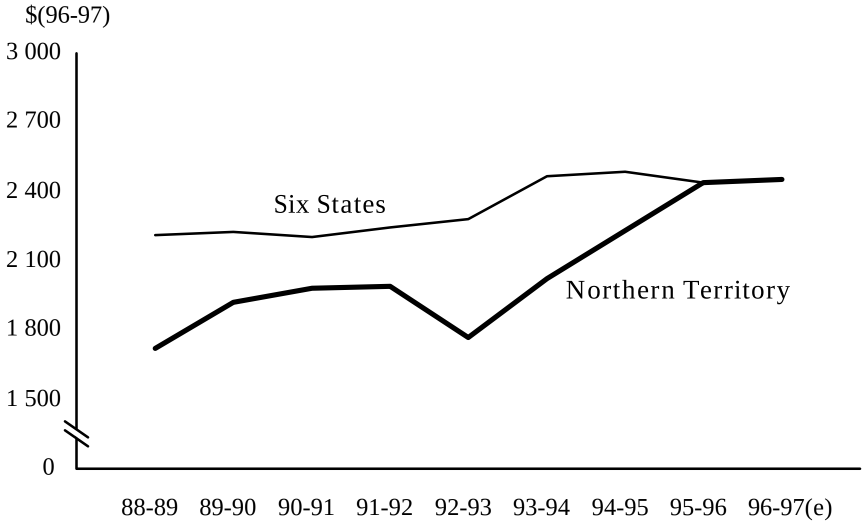


Source: *Government Financial Estimates*, ABS Cat. No.5501.0; and Northern Territory Treasury.

Territory revenue is budgeted to rise by 2.7 per cent in 1996-97, mostly due to increases in tax and charges revenue, and from an increase in the surplus of Public Trading Enterprises. Virtually all of the increase is a result of expansion in the size of the revenue base rather than increases in rates of taxes and charges. Figure 2.7 shows that the Territory's revenue per capita has approached the same level as the six States.

Figure 2.7

Territory/State Revenue Per Capita



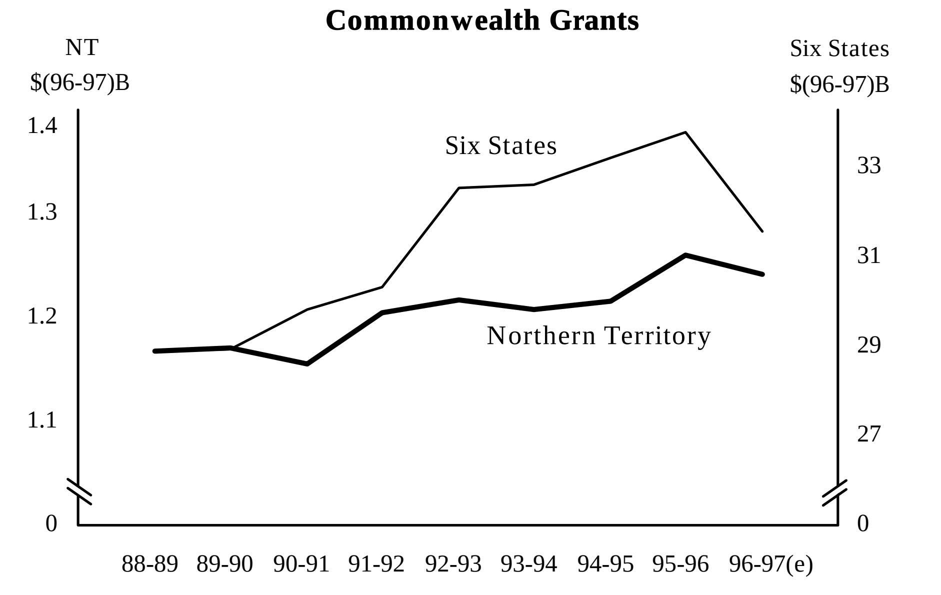
Source: *Government Financial Estimates,* ABS Cat. No.5501.0; and Northern Territory Treasury.

Commonwealth Grants

During the mid to late eighties the Territory experienced significant cuts in the level of assistance from the Commonwealth. Since 1990-91 the level of grants has improved but at a much slower rate than the six States. The overall increase between 1988-89 and 1995-96 was 7.9 per cent for the Territory compared with 17.0 per cent for the six States. A decrease in the real level of assistance is expected in 1996-97.

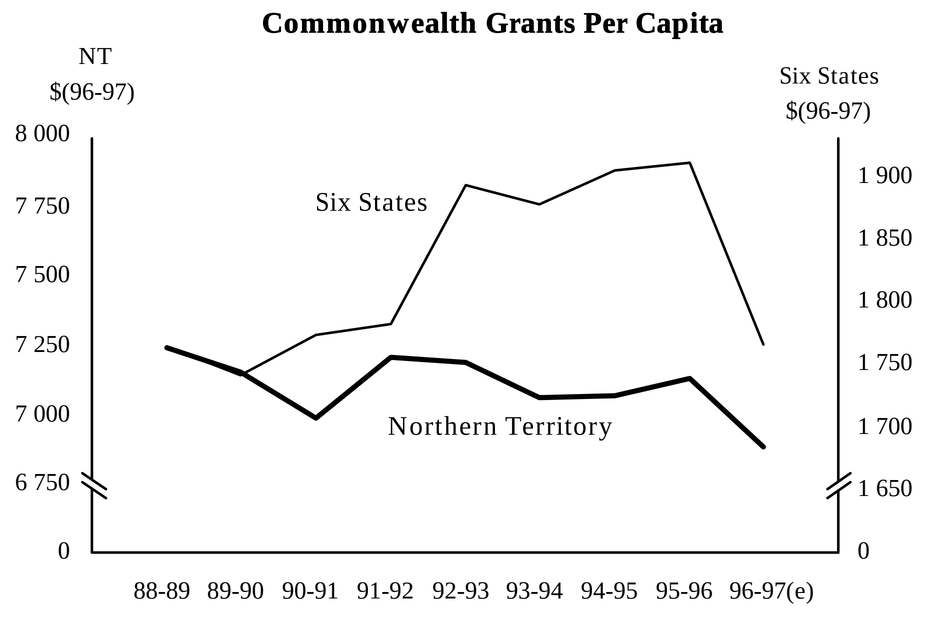
At the 1996 Premier's Conference it was agreed that the States and Territories would contribute $619 million to the Commonwealth's deficit reduction program in 1996-97. This amount is equivalent to the real per capita indexation of the base Financial Assistance Grants pool and will be distributed between the States and Territories on an equal per capita basis. As a result, the Territory's contribution is $6 million. Further, the Commonwealth announced its intention to cut Specific Purpose Grants by up to 3 per cent. Details of the cuts will not be provided until after the Commonwealth Budget is delivered.

Figure 2.8



Source: *Government Financial Estimates*, ABS Cat. No.5501.0; and Northern Territory Treasury.

Figure 2.9



Source: *Government Financial Estimates*, ABS Cat. No.5501.0; and Northern Territory Treasury.

This agreement will result in total grants to the States and Territories declining in real terms. The distribution of the grants between jurisdictions will also vary each year reflecting the impact of differing rates of population growth, changing Commonwealth Grants Commission (CGC) relativities and fluctuations in the level of Specific Purpose Grants.

Commonwealth Grants Per Capita

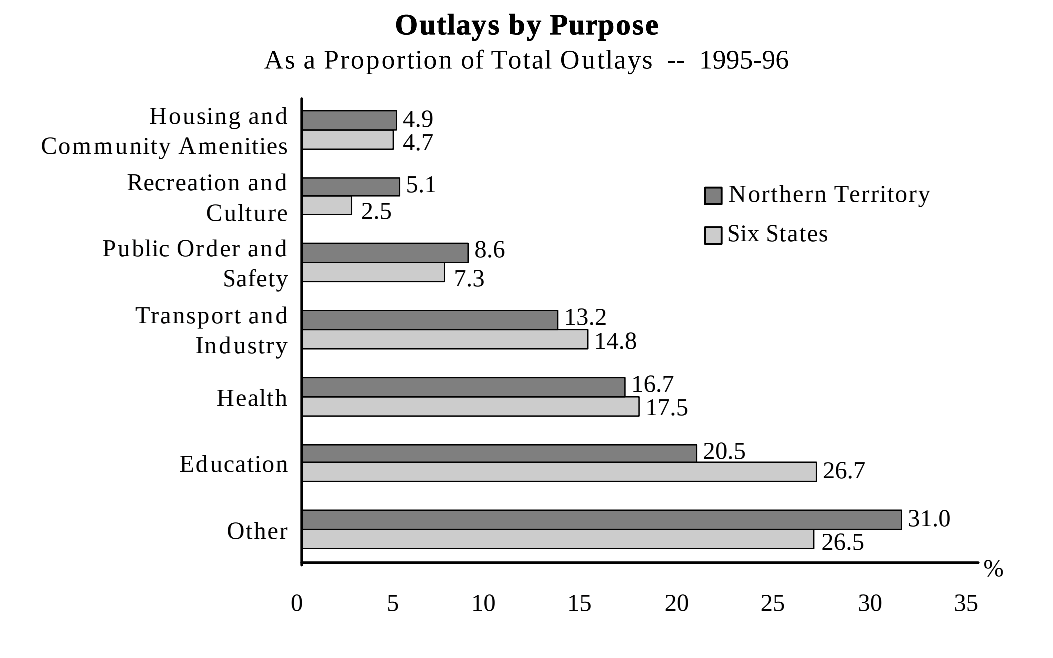
To account for the changes in population of the Territory and the six States, a comparison of Commonwealth grants per capita is useful. Over the period 1988-89 to 1995-96, Commonwealth grants per capita to the Territory fell 1.6 per cent in real terms and are estimated to fall even further in 1996-97. During the same period Commonwealth grants per capita to the six States increased by 8.4 per cent.

Outlays by Government Purpose

Figure 2.10 shows the breakdown of outlays into selected Government Purpose Classifications (GPC) as estimated by the ABS for 1995-96. The Other category includes general public services (which is the major component), defence, social security and welfare, other economic affairs and other purposes. The Transport and Industry category includes the fuel and energy, agriculture, forestry, fishing and hunting, mining, manufacturing and construction and transport and communications classifications.

The GPC figures show that the proportion of Territory outlays in the main functional categories is comparable with that of the six States in most areas. The two largest differences are in the Education and Other categories. The Territory spends 20.5 per cent of its budget on Education compared with 26.7 per cent by the six States. Conversely the Territory spends 31.0 per cent of its budget on Other in contrast to the six States which spend 26.5 per cent.

Figure 2.10



Source: *Government Financial Estimates,* ABS Cat. No.5501.0.

The differences between the Territory and the States can be explained by examining the CGC assessments. The CGC has identified a number of factors which significantly affect costs. While most of these factors, such as social composition, apply across most government functions and influence the level of total outlays, the scale factor significantly affects those areas where there is a high component of policy and head office functions as reflected in the Other category of Figure 2.10. The effect of the scale factor is sufficient to alter the proportions of expenditure between the main functional components when compared with the States distribution.

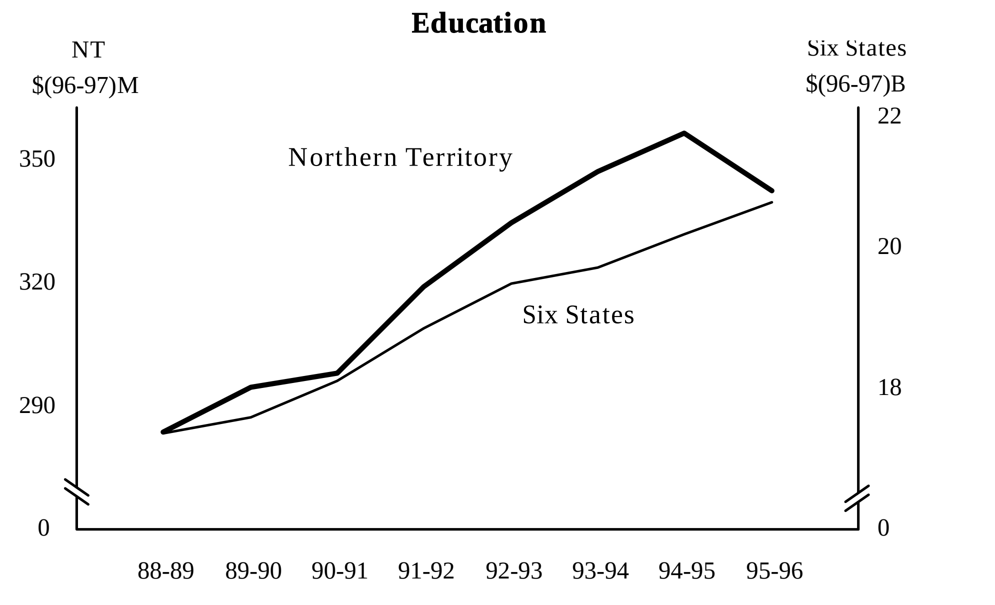
In the large service delivery areas of Health and Education, Territory outlays per capita are higher than for the six States. However, in Education where the services provided are roughly comparable to the States, the proportion of total outlays spent on this function is lower than the six States.

In Health, however, the situation is different because in key areas the services provided in the Territory are not comparable with the States. The almost complete absence of any private medical services outside of the two main centres in the Territory and the relative health status of the population in those areas requires significant additional Territory expenditure in this category. Even these additional resource requirements however are not sufficient to offset completely the above average proportion of outlays allocated to the Other category.

Figures 2.11 to 2.14 show outlays in real terms for selected categories over the years 1988-89 to 1995-96:

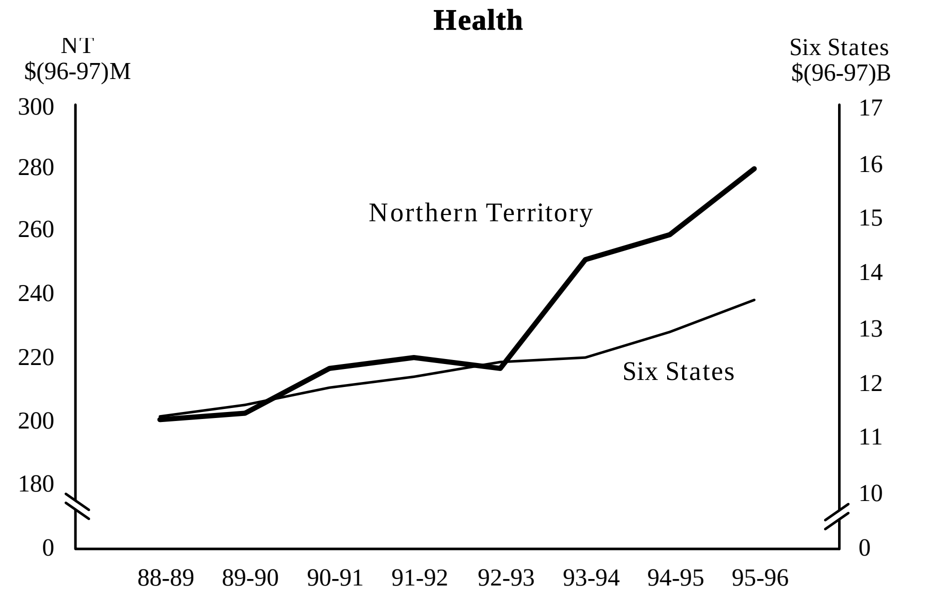
- in Education, the Territory and six States' spending has increased by 20.7 per cent and 19.0 per cent;
- Health spending in the Territory has increased 39.4 per cent over the period whereas expenditure of the six States has risen only 18.4 per cent over the same period;
- spending on Transport and Industry has fallen 44.1 per cent in the Territory and 4.7 per cent in the six States; and
- Territory spending on Public Order and Safety has increased 17.0 per cent compared with 24.5 per cent by the six States.

Figure 2.11



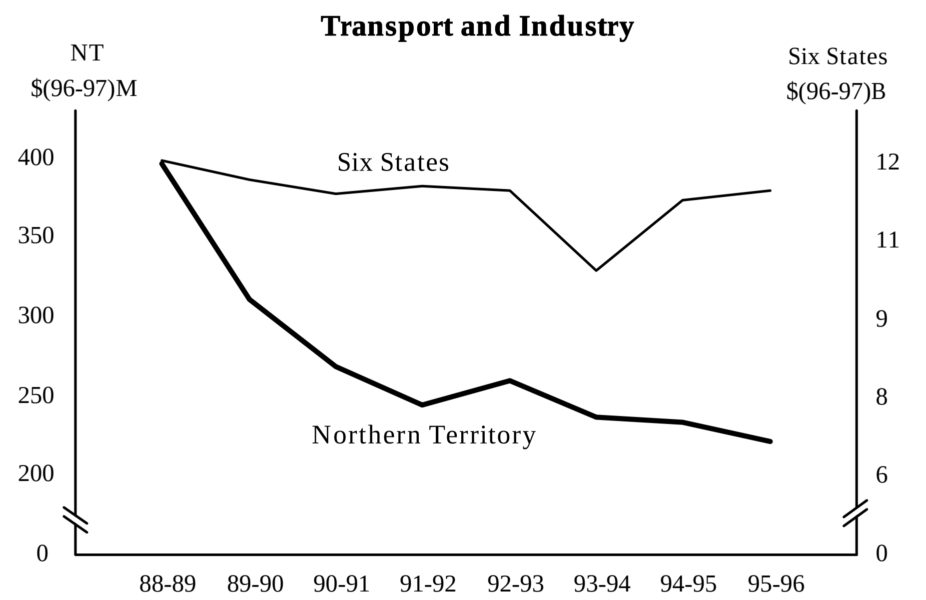
Source: *Government Financial Estimates,* ABS Cat. No.5501.0.

Figure 2.12



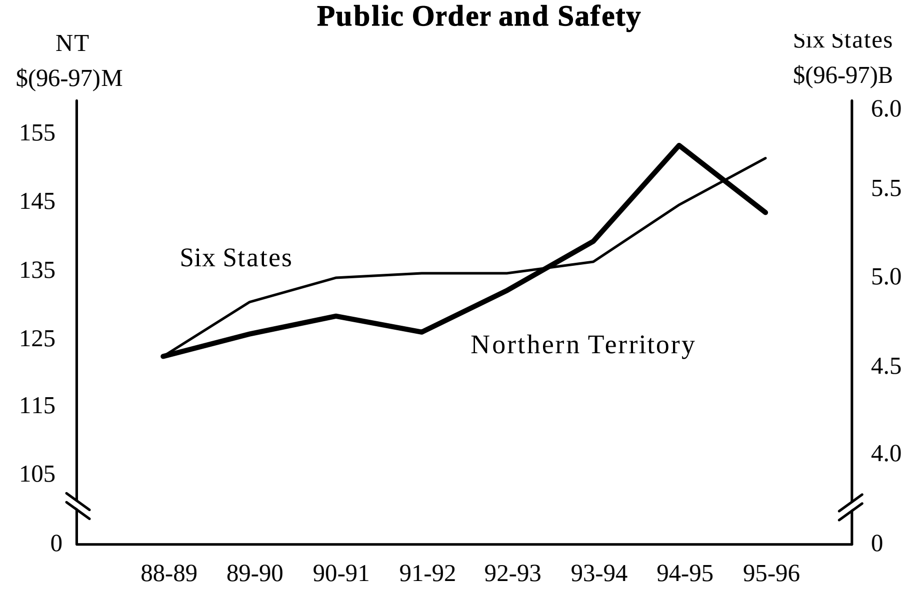
Source: *Government Financial Estimates,* ABS Cat. No.5501.0.

Figure 2.13



Source: *Government Financial Estimates,* ABS Cat. No.5501.0.

Figure 2.14



Source: *Government Financial Estimates,* ABS Cat. No.5501.0.

APPENDIX

Definitions and Assumptions

Financial estimates used are derived from the Australian Bureau of Statistics (ABS) Government Financial Statistics database. Figures for the Territory 1995-96 Budget outcome and 1996-97 estimates are taken from the 1996-97 Northern Territory Budget.

Adjustments have been made to the ABS format to conform with the Territory's preferred presentation, as outlined in Chapter 9. Capital advances, which are provided to local government and the private sector for capital purposes have been treated as lending, and therefore as financing transactions, rather than as part of Territory capital expenditure. Within the normal ABS format, these loans are treated as part of public sector capital outlays. The same adjustments have been made to the ABS data for the six States, to ensure that comparisons are made on a consistent basis. This adjustment is, however, identical to that undertaken by the ABS to derive the new measure they refer to as the ‘adjusted deficit’. (However, Figures 2.10 through to 2.14 showing Government Purpose Classifications are based on the usual ABS concept of outlays.)

For similar reasons, discussion of Commonwealth assistance in this Chapter deals with Commonwealth grants only. This is because the remaining component of net Commonwealth payments, net advances received, are included as part of the total financing requirement of the Territory. Movements in the level of net advances are integral to the assessment of changes in debt for each jurisdiction.

Population estimates used to calculate Commonwealth grants per capita are as at 31 December of each year, and for the year end 1995 are from the ABS *Australian Demographic Statistics* Cat. No. 3101.0. For 1996, population estimates are those prepared by the ABS for the Commonwealth Treasury.

All data has been expressed in 1996-97 prices using the gross non-farm product implicit price deflator. For the years to 1994-95, the deflator is derived from the latest available release of the ABS publication, *Australian National Accounts: National Income and Expenditure* Cat. No. 5206.0. For 1995-96 and 1996-97, the assumptions used in the *National Fiscal Outlook Report* of 3.2 per cent and 2.5 per cent respectively, have been adopted.

The charts in this Chapter showing comparisons between the Territory and the six States are constructed so that the two scales represent the same relative movement in each statistic from the base year of 1988-89.

CHAPTER 3

REFORMING COMMONWEALTH-STATE FINANCIAL RELATIONS

By virtue of its income tax powers, the Commonwealth controls by far the largest share of taxation revenues within the Australian federation, whereas the States are predominantly responsible for service provision. This vertical fiscal imbalance (VFI) has been criticised on efficiency and accountability grounds because of the separation of expenditure responsibilities from taxing powers.

However, a far greater threat to the efficient and equitable distribution of the nation's resources has been the Commonwealth's consumption of an ever increasing share of national revenues at the expense of the services provided by the States and Territories. The Commonwealth's dominant fiscal position has enabled it to override the States' and Territories' requirements in preference to its own, so that national economic benefits of competitive federalism and diversity are diminished.

Commonwealth own-purpose outlays are increasing at a more rapid rate than the national revenue base and total public sector outlays. To finance this growth, the Commonwealth has retained a greater share of the taxes it raises, and reduced the share provided to the States and Territories. At the same time, the proportion of tied grants to the States has been increasing, resulting in significant overlap and duplication in an attempt to impose uniformity across Australia by overriding the preferences of regional Australians. As a result, maintaining the fiscal integrity of the States is becoming increasingly difficult.

Major reform is required to ensure that:

- *the States and Territories receive a share of national taxation revenues commensurate with their responsibilities to deliver services at standards appropriate to the nation's wealth; and*
- *the great bulk of transfer payments from the Commonwealth to the States and Territories are untied.*

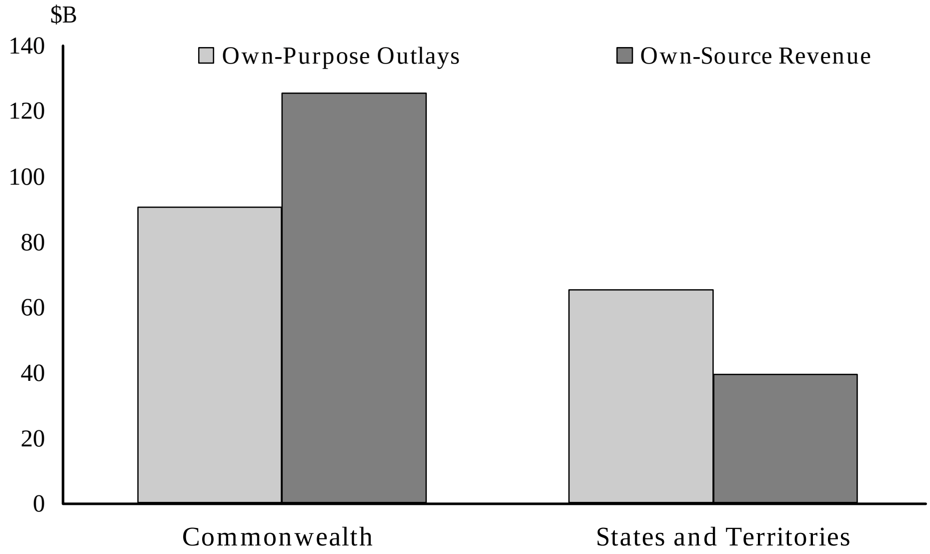
Options to achieve these goals are discussed in this chapter, including the creation of an expert body to recommend the appropriate allocation of national revenues among the tiers of government.

Vertical Fiscal Imbalance (VFI)

The Australian federation is marked by a high degree of vertical fiscal imbalance. In broad terms, the Commonwealth raises 74 per cent of the revenue collected by all tiers of government but accounts for only 54 per cent of total expenditure. The States depend on transfer payments from the Commonwealth to fund some 44 per cent of their outlays. Over half the payments from the Commonwealth are received by the States in the form of Specific Purpose Grants (SPGs) which provide little, if any, discretion for the States in determining individual priorities.

Figure 3.1

Vertical Fiscal Imbalance
1995-96



Source: *Government Financial Estimates,* ABS Cat. No.5501.0.

The existence of VFI has allowed the Commonwealth to pursue three key strategic directions:

- by restricting the growth in payments to the States and Territories, VFI has provided the Commonwealth with the capacity to increase expenditure on its own functions;
- the resultant larger share of the nation's resources retained by the Commonwealth has provided it with the opportunity to expand its areas of influence to a wider range of functions, some of which have traditionally and / or constitutionally been the preserve of the States; and

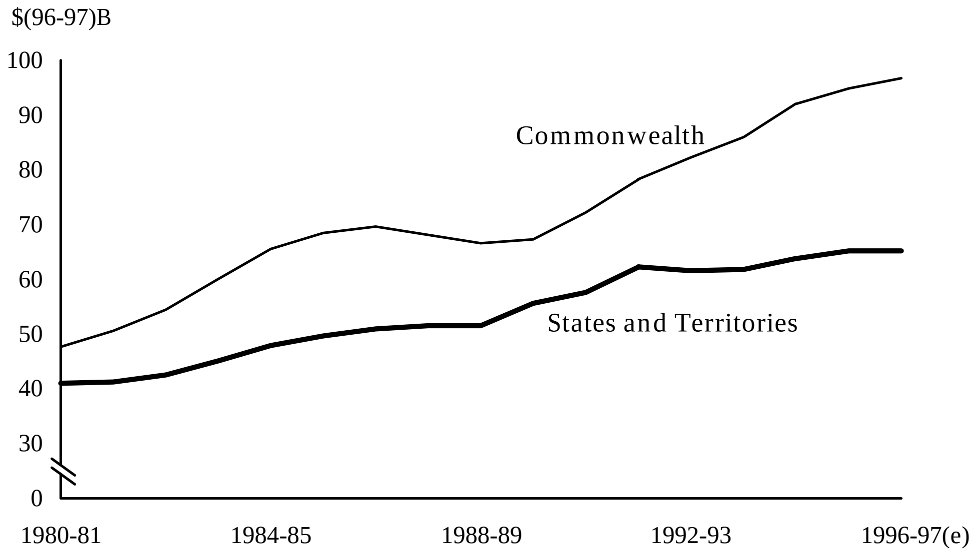
- VFI has enabled the Commonwealth to assume a more prominent role in coordinating policy, with the States and Territories increasingly seen as service providers.

Sharing The Nation's Resources

VFI has allowed the Commonwealth to determine the overall level of financial resources available to the States and Territories. As a result, State and Territory service delivery standards have been compromised. Australia has progressively moved to the point where the fiscal capacity of the States and Territories to provide their services is now well below the relative capacity of the Commonwealth to provide for its functions.

Figure 3.2

Real Own-Purpose Outlays



Source: *Government Financial Estimates*, ABS Cat. No. 5501.0.

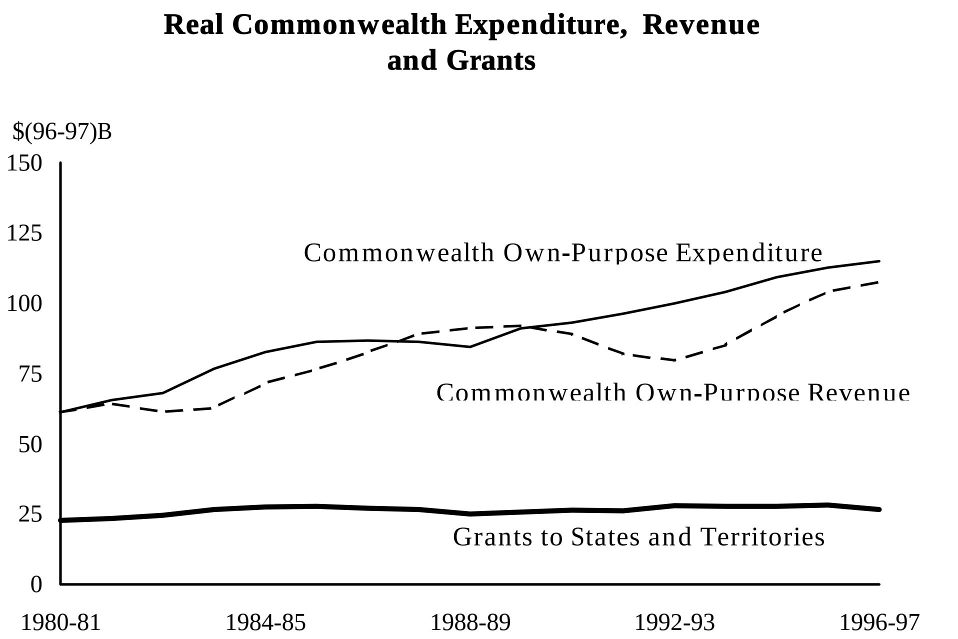
Figure 3.2 shows a comparison over time of Commonwealth real own-purpose outlays compared with that of the States and Territories.

The graph shows that Commonwealth general government outlays have risen significantly more than those of the States and Territories. The State and Territory own-purpose outlays include expenditure on State type functions such as health and education funded from Commonwealth SPGs. There is, therefore, no possibility that expenditure on State type functions is being maintained by the Commonwealth's increased spending on SPGs.

The conclusions remain the same when the whole of the public sector is considered.

Figure 3.3 compares Commonwealth real own-purpose expenditure adjusted for asset sales, retained Commonwealth revenue (after grants to the States have been paid) and grants to the States. It can be seen that since 1980-81 grants to the States have increased somewhat in real terms from $23 billion to an estimated $27 billion in 1996-97. By comparison Commonwealth expenditure has risen from $61 billion in 1980-81 to $115 billion in 1996-97. The amount of nationally raised revenue retained by the Commonwealth for its own purposes over that period has grown significantly from $61 billion to an estimated $108 billion.

Figure 3.3



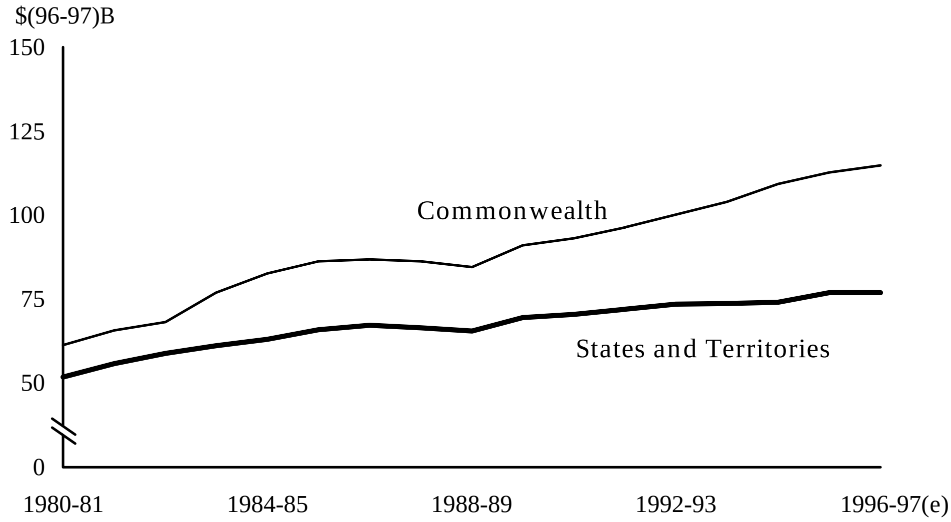
Source: *Government Financial Estimates*, ABS Cat. No. 5501.0; *Government Finance Statistics*, ABS Cat. No. 5512.0; and Northern Territory Treasury.

While some change in the expenditure responsibilities may have been expected over this period, it has not been demonstrated that the Commonwealth's responsibilities have almost doubled while those of the States and Territories have remained virtually unchanged.

Given the existing extent of VFI, there is limited capacity for the States and Territories to replace Commonwealth grants with revenue from their own sources. However, while State and Territory revenues have increased, the small size and inefficient nature of State and Territory revenue bases (which is why VFI is a problem) has resulted in these increases being insufficient to offset the reduction in Commonwealth grants.

Figure 3.4

Adjusted Own-Purpose Expenditure[(a)]



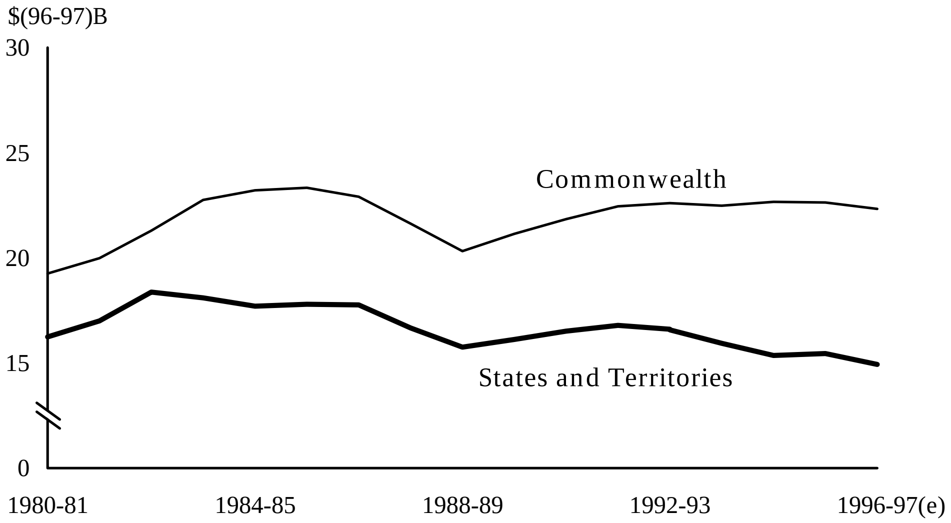
(a) Adjusted for Asset Sales.
Source: *Government Financial Estimates*, ABS Cat. No. 5501.0; *Government Finance Statistics*, ABS Cat. No. 5512.0; and Northern Territory Treasury.

The extent to which the Commonwealth has redirected nationally raised revenue to Commonwealth functions at the expense of State type functions can be seen in Figure 3.4 which compares Commonwealth expenditure with that of the States and Territories from 1980-81. At the beginning of the period Commonwealth expenditure was slightly above the combined States and Territories expenditure. However, the Commonwealth's expenditure increased significantly from $61 billion to $115 billion over the period compared with a change in States and Territories expenditure from $52 billion to $77 billion. Commonwealth expenditure is now 49 per cent above State and Territory expenditure.

If these figures are expressed as a percentage of Gross Domestic Product (GDP), the difference between the Commonwealth and States and Territories combined becomes more stark. Figure 3.5 shows that Commonwealth expenditure as a proportion of GDP rose from 19.3 per cent in 1980-81 to 22.5 per cent in 1991-92 and has stayed relatively constant since that time. Whereas State and Territory expenditure was 16.2 per cent of GDP in 1980-81, it has fallen to an estimated 15.0 per cent in 1996-97.

Figure 3.5

Adjusted Own-Purpose Expenditure[(a)]
as a Proportion of GDP



(a) Adjusted for Asset Sales.
Source: *Government Financial Estimates*, ABS Cat. No. 5501.0; *Government Finance Statistics*, ABS Cat. No. 5512.0; and Northern Territory Treasury.

The Commonwealth through VFI is able to determine the distribution of the nation's resources between the tiers of government, and as a result it is able, to some extent, to enlarge the degree of VFI. The basis for the distribution is largely at its discretion. The above tables provide clear evidence that the Commonwealth has restricted the level of grants provided to the States and Territories and then applied those funds to its own functions.

Given the services the States and Territories provide, this must have an impact on the structure of Australian society. There is no evidence to suggest the rebalancing of the nation's fiscal resources is the result of particular social or economic needs. Much more likely, it is the result of the ease with which the Commonwealth can avoid its responsibility for ensuring the nation's resources are shared equitably, by cutting payments to other levels of government.

Clearly this should not continue. Reforms should be directed at ensuring States and Territories receive a fair share of nationally raised revenues that would, firstly, provide them with the capacity to meet their service delivery responsibilities and, second, ensure that capacity grows in line with growth in the nation's wealth.

The new Commonwealth Government appears to acknowledge the problem. The extent of the corrective action it is prepared to take remains to be seen.

Specific Purpose Grants: The Need For Reform

Not only have the resources available to the States decreased relative to those available to the Commonwealth, but the type of funds provided to the States' has also shifted from being untied, and therefore able to be used at the States' discretion, to being tied funds subject to significant levels of Commonwealth control. This has further reduced State budgetary control and discretion, while enlarging administrative costs at the centre.

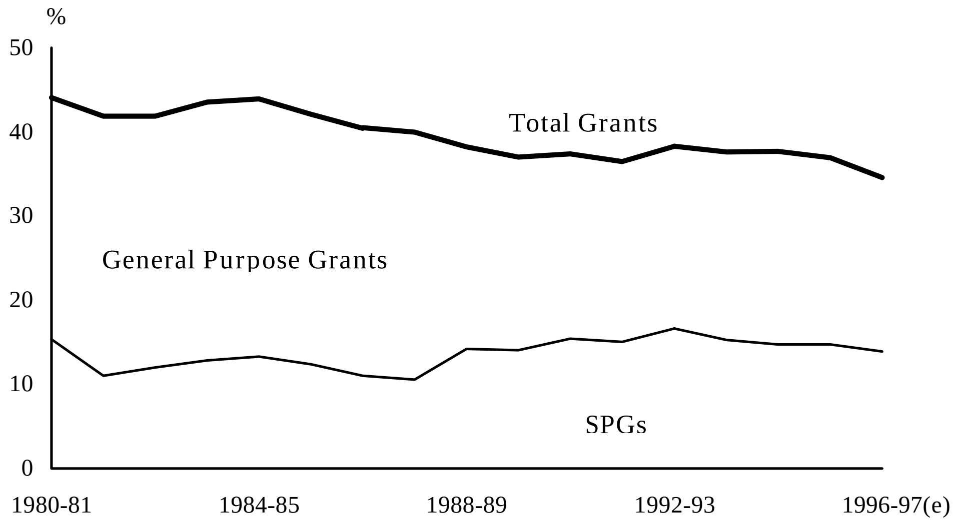
Over half of total net Commonwealth payments to the States are received in the form of SPGs. These tied grants have steadily increased, at the expense of general revenue grants, as a proportion of total Commonwealth payments to the States as illustrated in Figure 3.6.

In addition to the problem associated with the imbalance between tied and untied funds, SPGs are of themselves, not efficient mechanisms. There are numerous reasons why, in many cases, when compared with untied funds, SPGs are a more expensive and less efficient method of making Commonwealth payments to the States. For example, SPGs:

- are costly to administer as they are based on relatively small parcels of funds which have to be individually managed and accounted for. The costs incurred in meeting reporting and acquittal requirements for particular programs often exceed the amount funded. This is particularly so in small jurisdictions like the Territory;
- are based on generally complex arrangements which generate excessive levels of bureaucracy, duplication and waste; accountability is blurred leaving opportunities for buck-passing between levels of government; and
- contain maintenance of effort clauses which distort the usual processes of rational resource allocation in assessing the costs and benefits of either expanding or contracting the service. They also have an inappropriate emphasis on inputs, with no incentive or recognition for States to improve efficiency.

Figure 3.6

Commonwealth Grants to States and Territories
as a Proportion of State Expenditure



Note: Excludes grants paid through States and Territories.
Source: *Government Finance Estimates*, ABS Cat. No.5501.0; and *Commonwealth Budget Papers*, various issues.

Changes are required that will improve the administration and minimise the cost of SPGs. Clearer delineation of roles and responsibilities will improve accountability for moneys spent and outcomes achieved. SPGs which have been in existence for five years and when program objectives are clear should be absorbed into FAGs without delay. If there are policy reasons for not doing so, SPGs with similar or compatible program objectives should be broadbanded and inefficient restrictions removed.

The Commonwealth has a role in collecting, analysing and reporting on the relative and absolute standards of service in all jurisdictions, to facilitate informed decision making, especially by the electorate. This is quite different to the Commonwealth taking control over deciding standards of service from the States. By exploiting its domination of revenue raising powers and through an increasing reliance on SPGs, the Commonwealth has been able to expand its own position while diminishing the role of the States. Centralisation at the very least leads to duplication and at worst leads to unserved client groups.

While the States may advocate reforms in the area of SPGs, the power to implement any reform measures rests with the Commonwealth.

Correcting The Problems

There are a number of options available which would overcome the imbalance between the Commonwealth and the States and Territories' expenditure capacity which has developed as a result of VFI.

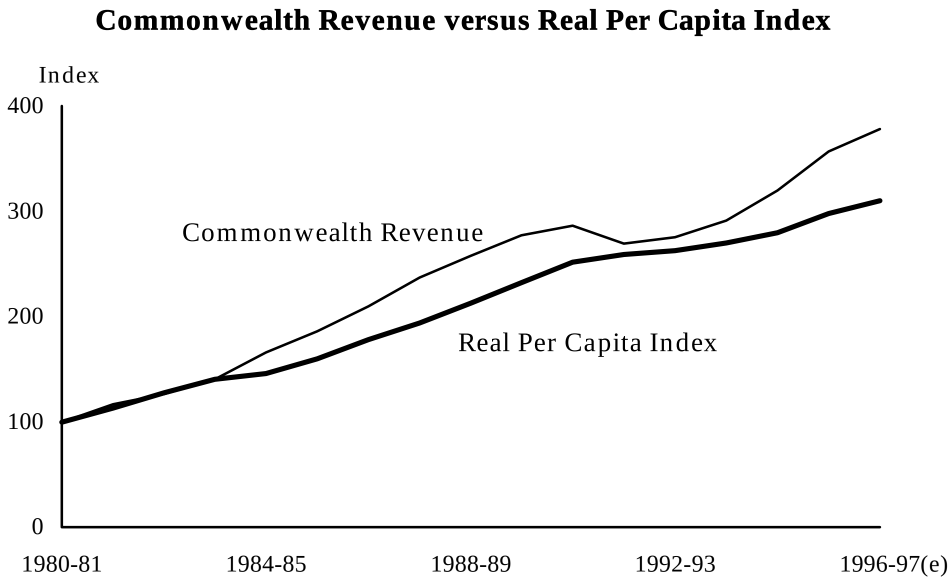
Some commentators and jurisdictions have proposed transferring greater tax powers to the States. The Territory has some reservations with this proposal, as its tax base is limited by the stage of economic development in the Territory compared with other jurisdictions and it has relatively high expenditure requirements due to the disabilities it faces in service delivery. However, this clearly is one solution which, with appropriate safeguards, the Territory continues to support.

Alternative proposals which have been supported by the States and Territories are:

- to provide to the tiers of government a fixed percentage share of tax revenues; or
- to continue with the real per capita growth commitment to the FAGs pool.

Both options carry advantages and disadvantages. Figure 3.7 compares the growth in total Commonwealth revenue since 1980-81 and growth in an index maintained in real per capita terms over the same period. Over the longer term, it is clear that growth in Commonwealth revenue has outstripped the real per capita index. It is only in exceptional circumstances (such as short term economic downturns) that growth in Commonwealth revenue fails to keep pace with combined price and population growth.

Figure 3.7



Source: *Government Financial Estimates,* ABS Cat. No.5501.0; and Northern Territory Treasury.

If grants to the States are maintained in real per capita terms while total Commonwealth revenue grows at a greater rate, then VFI between the Commonwealth and the States and Territories will continue to expand. In the short term, there may be some attraction to the real per capita guarantee as the Commonwealth has, for a short period at least, honoured that commitment. However, over the longer term, these arrangements will lead to a progressive deterioration in the States' and Territories' fiscal positions vis a vis the Commonwealth.

While providing States and Territories with a fixed percentage share of tax revenues would overcome the problem discussed above, this approach would result in grants varying with the condition of the economy. There is, therefore, a real risk that grants could decline in some years.

A further problem with either of these options is that unless the imbalance between the Commonwealth and the States is first corrected, it will be entrenched.

An alternative proposal which has not received a great deal of consideration is a fundamental examination of the distribution of expenditure responsibilities between the Commonwealth and the States and Territories compared with the revenue available to each tier of government to meet those responsibilities.

There already exists a great deal of information on the services provided by the States and Territories and their own-source revenues through the work of the Commonwealth Grants Commission. The National Commission of Audit has undertaken, to a degree, an examination of the Commonwealth's own functions.

It would not take a huge effort to bring that information together, supplement it where appropriate, and provide advice to Governments on the distribution of national revenue between tiers of government given certain expenditure responsibilities. Consideration could also be given to the balance between tied and untied grants to the States and Territories, though this is a lower priority.

Clearly, any recommended balance would alter over time as the major determinants of expenditure (eg demographic factors) change. This would require the appointment of an expert body, either on a standing or an occasional basis, as agreed by Governments. The considerable benefits of such a solution would be significantly improved accountability, expert independent advice on the allocation of national resources and increased data on which to base long term decisions on future revenue requirements and standards of service.

Any of these changes would not remove the need for the continuation of the principle of horizontal fiscal equalisation in determining the distribution of national revenue between the States.

The Commonwealth Government has the opportunity to commence genuine reform of intergovernmental financial arrangements without compromising its legitimate interest and involvement in the setting of national priorities and standards.

APPENDIX

The data in this Chapter has been prepared on a total public sector basis for both the Commonwealth and the combined States and Territories. Where possible data from *Government Finance Statistics* ABS Cat. No. 5512.0 has been used. Preliminary data for 1995-96 are from *Government Financial Estimates* ABS Cat. No. 5501.0, and 1996-97 estimates are based on the *1996 National Fiscal Outlook.* Data has also been supplemented with information from the Commonwealth Budget Papers to produce Figure 3.6.

To obtain measures of own-purpose expenditure and revenue that are better suited for comparison, the following adjustments have been applied to the ABS data:

- the effect of transfers between the Commonwealth and States have been removed to identify own-purpose outlays. Payments through States have been retained within Commonwealth outlays as they reflect Commonwealth expenditure priorities, not those of the States. As SPGs to the States reflect a mixture of Commonwealth and State priorities, they have been treated as State, rather than Commonwealth outlays;
- net revenue from asset sales has been added back to outlays so that a measure of underlying expenditure is identified; and
- like the data in the *1996 National Fiscal Outlook*, use of provisions has been added to revenues for the Commonwealth and States, so that the difference between expenditure and the adjusted revenues is equal to the deficit.

The adjusted data for the Commonwealth consolidated public sector has therefore been determined as follows:

Own-Purpose Expenditure	=	Total Commonwealth Outlays
(adjusted for asset sales)	*less*	*Grants paid to other governments*
	less	*Net advances paid*
	plus	Net proceeds of 2nd hand asset sales

Adjusted (Retained) Revenue	=	Total Commonwealth Revenue
	less	*Grants paid to other governments*
	plus	Provisions

Adjusted data for States and Territories consolidated public sector was derived as follows:

Own-Purpose Expenditure (adjusted for asset sales)	=	Total State and Territory Outlays
	less	*Grants paid to other governments*
	less	*Net advances paid*
	plus	Net proceeds of 2nd hand asset sales
Adjusted (Retained) Revenue	=	Total State and Territory Revenue
	less	*Grants paid to other governments*
	plus	Provisions

The values presented in real terms (constant 1996-97 prices) are calculated using the non-farm gross domestic product implicit price deflator as published by the ABS. For 1995-96 and beyond, the non-farm gross domestic product implicit price deflator from the *1996 National Fiscal Outlook* is used.

CHAPTER 4

1996 PREMIERS' CONFERENCE OUTCOME

The annual Premiers' Conference is the forum in which the Commonwealth, States and Territories agree to the distribution of Commonwealth grants. The redistribution of national revenue is necessary due to the degree of vertical fiscal imbalance that exists in Australia. That is, while the Commonwealth raises 74 per cent of all government revenues, it is responsible for only 54 per cent of all government expenditure.

The Territory's reliance, at this point of its development, on Commonwealth grants means decisions taken at the Premiers' Conference are critical in determining the level of services able to be provided in the Territory.

One of the most significant outcomes of the 1996 Premiers' Conference - and one that was unprecedented - was the commitment of the States and Territories to contribute over the next three years to the Commonwealth's Budget deficit reduction strategy. The States developed this proposal in preference to the option put forward by the Commonwealth to permanently impose sales tax on all State government operations. The States' proposal was developed in the national interest, notwithstanding the root cause of the Commonwealth's current fiscal problems lies in its poor performance in controlling expenditure.

The other key outcomes from the Conference include:

- *the Commonwealth commitment to maintain the Financial Assistance Grants pool in real per capita terms until 1998-99, thus providing some degree of funding certainty to the States over the next three years; and*
- *the Commonwealth indicating that the reduction in Specific Purpose Grants would not exceed 3 per cent in 1996-97.*

In recent years, Premiers' Conferences have been seen by States and Territories as dealing with two fundamental concerns:

- the size and distribution of the Financial Assistance Grants (FAGs) pool of untied funds; and
- the total amount of Commonwealth funding available, allowing States and Territories to formulate their budgets with certainty regarding the resources available.

The 'Offer Document' for consideration at this year's Premiers' Conference, focused only on the level of general revenue assistance, including FAGs. Consequently, prior to the Conference commencing, there was no clear indication to individual States and Territories of aggregate Commonwealth assistance.

General Revenue Assistance

The key features were:

- the Commonwealth agreed to maintain the FAGs pool in real per capita terms until 1998-99. On current estimates, this equates to increasing the pool by 4 per cent in both 1996-97 and 1997-98;
- the per capita relativities recommended by the Commonwealth Grants Commission were adopted and applied to the 1996-97 FAGs pool resulting in an increase of $14.3 million for the Territory;
- Special Revenue Assistance (SRA) for Medicare compensation to New South Wales and Victoria was continued;
- SRA of $10 million was to be paid to the Northern Territory in 1996-97, honouring a previous commitment by the former Commonwealth Government;
- Identified Road Grants (IRGs) were to be progressively absorbed into the FAGs pool. In 1996-97, two thirds will distributed according to the per capita relativities with the remainder being distributed by historical share. In 1997-98, all previous IRGs will be subsumed into the FAGs pool; and
- for the Territory, General Revenue Assistance would rise 2.1 per cent from 1995-96 to $929 million in 1996-97, an increase of $19.2 million.

Figure 4.1

General Revenue Assistance to the States and Territories, 1996-97

	FAGs	SRA	Identified Roads	General Revenue Assistance Level	General Revenue Assistance Change	
	$M	$M	$M	$M	$M	%
NSW	4 396	189	114	4 699	182	4.0
Vic	3 229	241	94	3 564	235	7.1
Qld	3 029	..	73	3 101	149	5.1
WA	1 546	..	41	1 587	-2	-0.1
SA	1 523	..	33	1 556	27	1.7
Tas	672	..	14	686	24	3.7
ACT	235	42	4	282	-9	-3.1
NT	**905**	**10**	**14**	**929**	**19**	**2.1**
Total	**15 534**	**483**	**386**	**16 403**	**626**	**4.0**

Source: *Premiers' Conference Communique*, Commonwealth Treasury.

The Territory's below average increase of 2.1 per cent is due primarily to the reduction in the Territory's relativity recommended by the Commonwealth Grants Commission which is discussed in Chapter 3.

Sales Tax Proposals and Negative Special Revenue Assistance

The 1996 Premiers' Conference was marked by the Commonwealth's proposal to impose wholesale sales tax on State and Territory Governments as a *quid pro quo* for maintaining the real per capita indexation of the FAGs pool. The tax was to be initially targeted at motor vehicles before being extended to other goods purchased by government. The Commonwealth argued that such a tax would remove existing distortions and anomalies in the tax regime leading to improved competitive neutrality between the public and private sectors.

The States and Territories opposed the proposal, claiming:

- agreement to impose tax equivalent regimes on State government trading enterprises had already been signed by the States and the Commonwealth in 1994. This satisfied the competitive neutrality principles as it was the public trading enterprise sector that was in direct competition with the private sector; and

- the imposition of sales tax would provide the Commonwealth with an increased revenue stream in perpetuity and this was inappropriate when the Commonwealth argued the revenue was needed for its deficit reduction program, a short term objective.

States worked co-operatively in developing an alternative proposal which would be acceptable to the Commonwealth. While a compromise was reached, the States emphasised that although they had been fiscally responsible in recent years, they were now being called upon to assist in rectifying the Commonwealth's budgetary problems, a function of the Commonwealth's own lack of expenditure restraint. Since 1991-92 Commonwealth expenditure on its own functions (that is, excluding payments to other levels of government) has increased by 23 per cent compared to only 12 per cent in the States.

The solution proposed by the States and Territories was that they would in effect receive negative Special Revenue Assistance (SRA) with no detrimental effect on long term State and Territory finances.

Figure 4.2

Net General Revenue Assistance to the States and Territories, 1996-97

	GRA	States' Fiscal Contribution	Net General Revenue Assistance			
			Level	Change from 1995-96		
	$M	$M	$M	$M	$p.c.	%
NSW	4 699	-209	4 490	-27	-4.4	-0.6
Vic	3 564	-153	3 410	82	18.0	2.5
Qld	3 101	-114	2 987	35	10.4	1.2
WA	1 587	-60	1 527	-62	-41.2	-3.9
SA	1 556	-50	1 506	-23	-13.3	-1.5
Tas	686	-16	670	8	17.3	1.2
ACT	282	-10	271	-20	-62.9	-6.7
NT	**929**	**-6**	**923**	**13**	**73.2**	**1.4**
Total	**16 403**	**-619**	**15 784**	**7**	**0.4**	**0.0**

Source: *Premiers' Conference Communique*, Commonwealth Treasury.

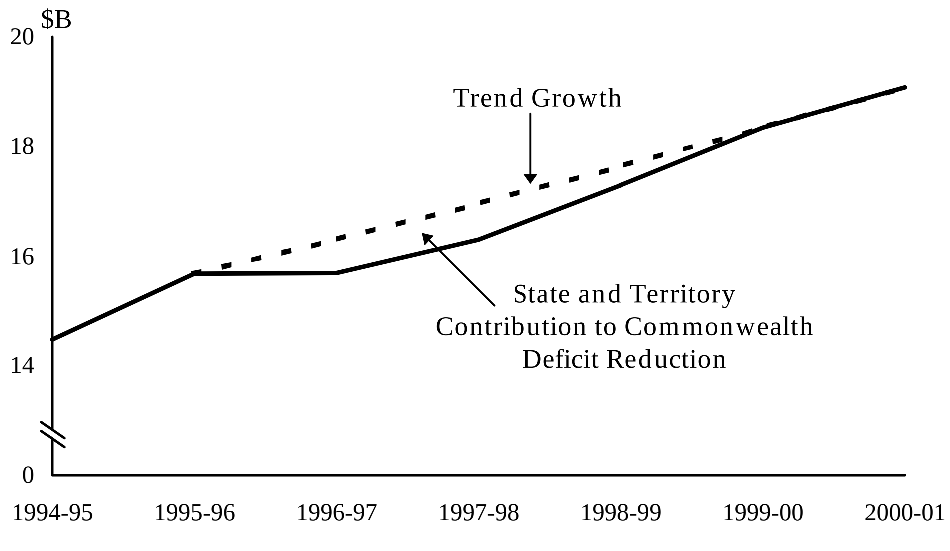
In 1996-97, the effective payment by the States and Territories to the Commonwealth will be $619 million, an amount equivalent to the anticipated 4 per cent real per capita increase in the pool. Individual State contributions are to be shared on a per capita basis with the Territory contributing $6 million, or roundly 1 per cent, comparable to the States' revenue capacities. In 1997-98 a total of $640 million will be 'paid' in negative SRA followed by $300 million in 1998-99. The FAGs pool will then return to its trend level from 1999-2000.

States and Territories are able to determine the method by which their contribution to the Commonwealth deficit reduction strategy is made. Figure 4.2 shows the effect on net general revenue payments between 1995-96 and 1996-97 to all jurisdictions if, for illustrative purposes, all the negative SRA were treated as a reduction to FAGs.

While net general revenue assistance for all States and Territories shows no increase in 1996-97, the Territory increase is 1.4 per cent or $13.1 million because the per capita distribution method used for the negative SRA has offset the reductions of the recommended relativities. Western Australia and South Australia received significant per capita reductions in net terms in their general revenue assistance. The Australian Capital Territory also recorded a large per capita decrease but this was mainly caused by an expected reduction in SRA related to its continuing transition to Self-Government.

Figure 4.3

Financial Assistance Grants



Source: *Premiers' Conference Communique*, Commonwealth Treasury.

Figure 4.3 illustrates the reduction in FAGs sustained by the States and how this assistance returns to the level it would have been in the absence of negative SRA.

Over the three year period the States still receive some increase in FAGs since the negative SRA does not influence the escalation of the FAGs pool.

Although the negative SRA was accepted as a substitute for sales tax, the Commonwealth still imposed a wholesale sales tax on general purpose road vehicles provided wholly or partly for private use as part of remuneration to employees by Commonwealth, State, Territory and local governments. This tax commenced on 11 June 1996. The cost to the Northern Territory is expected to be some $0.75 million annually.

Specific Purpose Grants (SPGs)

Detailed information was not provided at the Conference, however, the Commonwealth gave an assurance that the extent of the reductions to SPGs would be no more than 3 per cent. Subsequent information from the Commonwealth states that details on the size and distribution of SPGs will be provided after the Commonwealth Budget is delivered.

CHAPTER 5

CURRENT DEVELOPMENTS IN INTERGOVERNMENT RELATIONS

There have been a number of significant developments during 1996 in the financial relations between the Commonwealth and the States and Territories. Some of these had commenced before the election of the new Commonwealth Government, while others were initiated by the new Government. There is no doubt that following the Commonwealth Budget on 20 August 1996, there will be further changes.

Shortly after its election, the Coalition established a National Commission of Audit. The States and Territories made a joint submission to the Commission and the Northern Territory also provided additional information on matters of importance from the Territory's perspective. Although the Commission has reported, there has not yet been a comprehensive response from the Commonwealth Government.

The Council of Australian Governments (COAG) endorsed further work on reforms to public housing, and health and community services. Considerably more work is required before these reforms can be considered further. The next scheduled COAG meeting is in November 1996.

The Commonwealth Grants Commission is continuing its research program in the lead-up to its 1999 Review. It has also commenced its State Workplace Discussion Program. The Commission's analysis is of critical importance to the Northern Territory if it is to receive an adequate level of national resources to provide an average level and standard of government services to its citizens.

National Commission of Audit

One of the first initiatives of the incoming Commonwealth Government was to establish the National Commission of Audit (NCOA) in March 1996. The NCOA's terms of reference required it to investigate a range of matters concerning the operation and reporting of Commonwealth Government activities and programs and, where appropriate, to suggest improvements. The NCOA reported on 19 June 1996.

When the NCOA was first established, States feared widespread cuts to large areas of Commonwealth activity, with concerns that Special Purpose Grants (SPGs) would be particularly hard-hit. In response the Commonwealth indicated at the 1996 Premiers' Conference that any reduction to SPGs in 1996-97 would be limited to a cut of no more than 3 per cent of total tied grants paid. While this leaves open the strong possibility that entire programs may be abolished, the situation in relation to particular SPGs will remain uncertain until after the Commonwealth Budget is delivered. Even then, the longer term situation will remain uncertain.

The States prepared a joint submission to the NCOA, and the Territory also prepared two relatively short submissions addressing issues of particular concern to the Territory. These were:

- duplication and overlap in areas of unique importance to the Territory; and
- whole of government reporting on an accrual basis.

In writing its report, the NCOA asserted and applied a number of principles concerning the appropriate role of Commonwealth and State and Territory governments to a range of Commonwealth programs including, health, education and public housing. The report's main findings and recommendations in areas of Commonwealth-State financial relations are outlined below:

- the NCOA was in general agreement with States' views that there be a reassignment of roles and responsibilities between the Commonwealth and States, leading to either 'identified grants' with general purpose payments or the untying of tied grants and their absorption into Financial Assistance Grants (FAGs). The NCOA generally went further than the States had proposed in their joint submission in recommending a significantly reduced role for the Commonwealth, to the point of removing itself completely from a number of areas. Principles under which a delineation of roles and responsibilities should occur were identified;

- the States' proposal that all health grants should be untied and broadbanded into an identified health grant was supported as part of the NCOA's overall principles concerning SPPs. The Commonwealth's appropriate role would be to develop and report standards, benchmarks and clinical guidelines, with States responsible for managing health service delivery;
- in the area of education, States submitted that existing tied grants for government schools be paid as an identified grant. This was supported by the NCOA, which also implicitly acknowledged both the constitutional role of States in providing education services, and the fact that, over a range of areas (not just education), States are able to determine uniform/harmonised arrangements and broad priorities for government schools without necessary involvement from the Commonwealth;
- the report supported the Territory's submission that a complete overhaul of public housing arrangements was required to remove excessive Commonwealth intrusion and duplication; and
- it was recommended that the Commonwealth review its own programs to eliminate regulatory duplication and better control expenditure growth.

The NCOA report covers a range of other issues not discussed above, the focus of which was on those areas where there is clear scope for reforms that would lead to a better allocation of the nation's resources.

While the Territory agrees with many of the report's findings and recommendations, it holds a different view to the NCOA in a number of areas, in particular:

- the recommendation to simplify the current fiscal equalisation processes as conducted by the Commonwealth Grants Commission (CGC) cannot be at the expense of any of the principles underlying fiscal equalisation, especially given that the CGC's operational costs are modest;
- the NCOA, constrained by its terms of reference, did not address the issue of vertical fiscal imbalance, which remains a major problem in Commonwealth-State financial relations because of the past Commonwealth Government's fostering of this imbalance;
- with some (but not enough) qualifications, the NCOA recommended the adoption of full accrual accounting, budgeting and reporting by the Commonwealth. The Territory remains unconvinced that the benefits in general government (in contrast to business divisions) outweigh the costs;

- the States' views that a review of vocational education and training (VET) programs was required to remove duplication and inefficiencies was taken to its extreme by the NCOA which recommended VET become solely a Commonwealth responsibility, with appropriate adjustments to States' FAGs. The Territory considers this should remain a Territory function; and
- in areas of joint responsibility, it was proposed that funds be pooled. However, precedent suggests that this will lead to bilateral agreements and detailed control by bureaucrats (especially Commonwealth) and this is not an effective or efficient means to deliver programs.

Notwithstanding its comments, following the Report's release, that many of the recommendations related to longer term objectives and will require detailed consideration, the Commonwealth's commitment to reform will be demonstrated by the measures it takes in the short term to implement various recommendations made by the NCOA. In the absence of any immediate consideration and appropriate responses, the momentum for changes to Commonwealth-State financial relations that the NCOA report establishes will be lost.

Reform of Public Housing

In February 1994, the Council of Australian Governments (COAG) asked Commonwealth and State Housing Ministers to report on housing policy reforms that would clarify roles and responsibilities and to address the issues identified in the Industry Commission report on public housing released in 1993.

In April 1995 COAG endorsed a number of proposals presented in a Housing Ministers' report concerning roles and responsibilities under a revised Commonwealth State Housing Agreement (CSHA). These were:

- the Commonwealth accepting responsibility for housing subsidies and affordability; and
- the States and Territories taking responsibility for the management and delivery of public housing services.

A paper prepared by housing officials, titled *Long Term Housing Assistance Reform*, was noted by COAG at its meeting in June 1996. The paper suggests the following directions for reform:

- the Commonwealth taking responsibility for recurrent funding of income support (rental) subsidies:
  - the States would have flexibility in managing housing assets and with the private sector would be responsible for providing housing;

  - Commonwealth responsibility for directly funding clients would be consistent with its income security responsibilities;

- narrowing the difference between the level of assistance for public and private tenants with a common rent assistance payment for both in order to simplify administration and improve client choice, thereby reducing the waiting lists and pressures on public housing; and
- moving towards market rents for public housing to put housing authorities on a commercial basis, providing more appropriate pricing signals for consumers.

Consistent with these broad reform directions, it was proposed that, with the exception of the Aboriginal Rental Housing Program:

- the Commonwealth discontinue capital grants to the States under the CSHA;
- the Commonwealth extend eligibility for rent assistance at a higher than current level to public tenants, in turn boosting the cash flow of State Housing Authorities; and
- existing State and Territory funding requirements and restrictions be removed.

It was proposed at the June 1996 COAG meeting that the Commonwealth forward a detailed reform package to the States and Territories for consideration by the end of August 1996. In developing the package, the Commonwealth has indicated that it will have regard to the *Long Term Housing Assistance Reform* paper.

In recognising that a substantial amount of the detail of reforms is still to be negotiated between the Commonwealth and States, an interim agreement was introduced in July 1996 to run for up to three years; funding arrangements, however, have only been set for the first year (1996-97).

The interim model is a mixture of the old CSHA and some elements of the proposed longer term model. The Territory is concerned that the interim agreement retains, and in some cases increases, many of the worst features of the existing arrangements with bilateral negotiations and joint approvals processes which do little to clarify roles and responsibilities.

The longer term model involves a transfer of responsibilities between the States and the Commonwealth. As such, there will be an associated adjustment to the

FAGs pool to reflect the changed position. The adjustments will see funds transferred from the States to the Commonwealth, which will be assuming the responsibility for providing housing subsidies. The details of these transfers have not been agreed or clearly spelled out by the Commonwealth. However, the stated principle is that the States will not gain financially at the expense of the Commonwealth and vice versa, having regard to the outcome for both the State sector as a whole and for individual States.

The Territory agrees, in principle, with many of the reforms envisaged in the longer term model. However, the Territory's final endorsement of a renegotiated CSHA will be based on the following provisos:

- that the Territory is not financially disadvantaged; and
- a review is undertaken of the current inequitable distribution of Commonwealth funds for Aboriginal housing.

Reforms of Health and Community Services

Following the April 1995 COAG meeting, a draft paper was prepared proposing broad directions for reforms in the health and community services area. Health and Community Services Ministers broadly endorsed the directions and approach for reforms in May 1996, with COAG agreement provided in June 1996.

The paper stated there were several weaknesses in Australia's health system, with a major problem reported as being the (focus on providers and programs rather than on people and outcomes). It reported that there was: insufficient control of costs and inefficiencies between levels of governments; complex services with some individuals and groups not receiving either the services or the quality of services they need; excessive waiting times for heavily rationed services; and few inbuilt incentives for health promotion and illness prevention.

COAG principles require that reforms should lead to a clearer delineation of the separate roles of each level of government, reducing overlap and duplication of effort, with new service delivery structures that remove existing program boundaries to enable services to be coordinated with greater flexibility to meet people's needs.

While the Territory, in general, supports these principles and objectives, the reforms outlined in the paper are not necessarily reflective of the views of those that must take the decision. The proposals in the paper:

- fail to adequately clarify the roles and responsibilities of respective governments;

- support the concept of 'joint responsibilities' thus clouding accountability and continuing bureaucratic duplication and overlap; and
- indicate the need for separate bilateral agreements between the Commonwealth and individual States under the multilateral framework. For example, the merit of the proposal to convert specific purpose health grants into identified grants within the stream of State general purpose payments is diminished by the requirement for bilateral agreements defining broad objectives and specifying access and measures of output and outcome for broad functional areas within the health stream.

The paper is not a reasonable base from which further work can be done. It gives the Commonwealth a large role in imposing uniformity on the States and Territories and continues the overlap and duplication in existing arrangements.

Many of the problems caused by joint responsibilities for program delivery in health and other areas were also identified by the National Commission of Audit.

Commonwealth Grants Commission's Research Program

The Commonwealth Grants Commission (CGC) is a statutory authority given the task of recommending an appropriate distribution of general revenue grants among the States and Territories. In undertaking this task, the Commission derives a set of per capita relativities using a methodology that is both detailed and complex. The relativities are calculated according to the principle of horizontal fiscal equalisation, which requires the CGC to recommend a funding distribution that allows each State the capacity to provide the same standard of State-type public services provided it makes the same effort to raise revenues from its own sources and conducts its affairs with an average level of operational efficiency.

The Territory's per capita relativity as assessed by the Commonwealth Grants Commission (4.88) captures the significance of horizontal fiscal equalisation for the Territory. It means that, in the Commission's assessment, the Territory requires almost five times as much per capita as the States and Territories, on average, in the form of general revenue grants from the Commonwealth in order to provide the same standard of government services.

Since 1988 there has been one major five yearly review of the CGC's method which was finalised in 1993. The next major review is currently underway and the findings are to be reported in 1999. The 6 year period between major reviews has been allowed this time so that data from the 1996 Census will be available to the Commission, and negotiations with respect to the Medicare Agreements will be completed.

In a departure from previous procedures, the Commission commenced a Research Program in 1994, in conjunction with other parties involved in the fiscal equalisation process, as part of the preparation for the 1999 Review of Relativities. All parties to the relativities review are invited to participate in the research program by way of submissions and attendance at conferences at which views may be put forward and discussed.

The topics covered by the CGC's Research Program in 1995 were:

- scope and structure of the standard budget
- ABS-CGC integration of financial data collections
- mining revenue base
- stamp duties on conveyances revenue base
- road maintenance assessment
- urban transit assessment
- technical and further education assessment
- isolation assessment
- socio-economic composition and urbanisation factors
- measurement of administrative scale factors
- dispersion factors
- sensitivity and precision in calculations and results
- input costs factors - wages and salaries

The majority of these topics have carried forward to the 1996 Research Program. The significant new topics to be reviewed in 1996 are:

- Australia National Diagnosis Related Groups (AN-DRGs) and the Hospital Services Assessment - the review will cover two areas:
  - first, the possibility of using DRG cost weights to estimate the cost of servicing people of different demographic and socio-economic characteristics. This will complement the work on the health part of the socio-economic composition project which focuses on the demand for services but not the cost aspects;

  – second, review the present design of the Hospital Services assessment in light of new information provided by AN-DRGs.

- Mobility of State Revenues - this project arose from States' concerns about:

  – their capacity to raise revenues from transactions in the shares and marketable securities, financial institutions and gambling taxes categories; and

  – the appropriateness of the present measures of revenue capacity in these categories.

  The aim of the project is to address the problems in these three categories (such as tax competition and technology) and to recommend appropriate revenue bases for the 1999 Review. Part of the project will focus on reasons why States are unable to access all of the taxable capacity within their boundaries and the extent to which States can control the leakage of their taxable capacity. Investigation of this leakage (or mobility) could lead to an understanding of tax mobility with application to a wider range of revenue categories.

- Elasticity of State Revenues - the aim of the research on this topic is to develop a consistent method for assessments to reflect elasticities when these are found to be important. One aspect will be to examine, for each revenue category, whether elasticity effects are likely to exist, and whether any such effects are captured by the present revenue base measure. The project will address the following questions:

  – which categories are affected by elasticity effects? Are these effects large enough to warrant an elasticity adjustment?

  – can reasonable assumptions about the size of particular elasticities be made (at present, perfect elasticity of demand in mining and perfect elasticity of supply in tobacco are assumed)? and

  – can a suitable adjustment be calculated or should a different measure of the revenue base be sought?

- Aboriginal Community Services (ACS) Assessment - the main aims of this project are to:

  – decide whether the functions within this category should continue to be shown separately in the standard budget; and if so

  – find a better method of assessment for the ACS expenditure category, preferably using factor assessment.

All of these projects are of importance in improving the assessment methods used by the Commission in the 1999 Review. For the most part the Territory is not dissimilar to the States in respect of the issues which must be examined. There are however three projects where the Territory is very different from the States and hence the research projects are particularly important to the Northern Territory. These are the:

- Scale project (commenced in 1995) - the Northern Territory suffers quite extreme scale disabilities when compared to the States and the disability is compounded by the social composition of the population. It has been extremely difficult for the Commission to develop a satisfactory method to assess the influence of scale due to the lack of comparability in services, data deficiencies and the interaction of other factors;

- use of AN-DRGs in the hospitals assessment - an accurate hospitals assessment is critical to the Territory's overall assessment of needs. This is an area of service delivery where the Territory is, again, very different to the States because the high proportion of public patients and the fact that over half of the bed-days are used by Aboriginal patients. Preliminary work has shown that AN-DRGs cannot be applied to Aborigines with the same confidence as non-Aboriginal people simply because Aboriginal people are much sicker and require far greater levels of inputs as a result. AN-DRGs do not take the additional costs associated with Aboriginal patients into account and cannot be used in an unmodified form; and

- Aboriginal Community Service assessment - this is an area where the Territory stands out as providing a level of services which is greater than that provided by any other jurisdiction. As a result, the Commission has in the past had to use assessment methods which are different to those used for other categories of expenditure. It is therefore reasonable that as part of its research program the Commission reviews its approach.

The CGC has begun a series of Workplace Discussions in each of the States and Territories, with the Territory scheduled to be visited in 1997. Given the enormous workload entailed, both for the CGC and States and Territories, in preparing for the visits and writing submissions on the research topics and preparing the major review submission, it is likely that the list of research topics will be subject to change. Nonetheless, the Research Program will be of considerable benefit in improving the assessments to be made in the 1999 Review.

CHAPTER 6

SPECIAL FISCAL NEEDS OF THE NORTHERN TERRITORY

Immediately following the 1995 Premiers' Conference, the Prime Minister agreed to a Territory Government request that a joint Commonwealth Treasury/Territory Treasury paper on the Territory's fiscal disabilities be prepared, along similar lines to one prepared in 1989. The paper examined a number of issues which either lay outside the Commonwealth Grants Commission's so-called 'standard' budget, or were areas within the 'standard' budget where the Territory felt our unique fiscal circumstances were not adequately taken into account.

While a compromise between the Territory and Commonwealth perspectives was necessary in a joint report, the report did acknowledge that the Territory did have needs that were different to the States, and that the Territory's capacity to meet these needs had been eroded over time, largely due to the termination of the Commonwealth's general purpose-capital funding.

The joint paper, completed in February 1996, is reproduced below. However, the appendix on the Territory economy contained in the original report has been excluded, as these issues are covered in Budget Paper No.6. The paper was compiled using the best available data at the time, namely Government Financial Estimates, ABS Cat. No. 5501.0 of 1994, and the CGC's 1995 Update Report. While the data is now dated the overall conclusions of the report are still valid.

Background

At the time of the 1995 Premiers' Conference and the Council of Australian Governments (COAG) meetings, it was agreed that the Commonwealth and Territory Treasuries should jointly undertake a review of Special Revenue Assistance (SRA) to the Territory. It was subsequently agreed that the terms of reference for this review should be the same as those for the report prepared on the Territory's fiscal disabilities in 1989. These terms of reference are reproduced at Attachment A. In essence, they relate to the Territory's capacity to fund expenditures that are outside the scope of the Commonwealth Grants Commission's (CGC) assessments and options for funding such expenditures. The Territory Government estimates that the annual level of expenditure outside the CGC processes averaged $308 million over the five years to 1993-94, or 21 per cent of its total expenditure.

The distribution of the pool of general revenue assistance which the Commonwealth provides to the States and Territories each year is determined in the light of per capita relativities recommended by the CGC. The CGC's per capita relativities seek to achieve a measure of horizontal fiscal equalisation (HFE) by providing all States and Territories with the capacity to provide an average standard of State-like public services, assuming that their taxes and charges are imposed at average rates and their affairs are conducted with an average level of efficiency. The 'standard budget' methodology developed by the CGC incorporates the categories of State and Territory expenditure and revenue that are typically of a recurrent nature including the greater part of public sector expenditure (such as wages and salaries) and revenue (including own-source revenue) in most of the functional areas of State budgets (such as housing, non-tertiary education, policing and community services).

The current HFE arrangements do not cover some important categories of expenditure and revenue within the budgetary responsibilities of the States and Territories. On the expenditure side, these responsibilities include capital spending on infrastructure, payments to local government, State spending on tertiary education, and commercial operations and promotional activities of State and Territory governments. The categories of revenue that are not covered by the HFE processes include a significant proportion of Commonwealth specific purpose payment (SPP) funding, dividends and retained earnings of various Public Trading Enterprises (PTEs) and the relevant portions of interest, royalty and property income that are not attributable to areas included by the CGC in the standard budget. Although most PTEs are included in the CGC's standard budget relative capacities are not always assessed.

Summary

The Territory economy has generally grown at a much faster rate than the national average since the mid-1980s albeit with a considerable degree of volatility. Over the year to the June quarter 1995 the Territory economy grew by around three times the rate of the national economy in trend terms. (Developments in the Territory economy over the last decade were described in Attachment B of the original report.)

In accordance with the CGC's recommendations, the Territory receives around five times the average per capita amount of general revenue assistance. This will amount to $902m in 1995-96, or around $723m more than if the financial assistance grants (FAGs) pool was distributed on an equal per capita basis.

So long as the current HFE arrangements remain in force, the Territory will continue to receive a relatively large per capita share of general revenue assistance. The CGC has established that the Territory faces significant cost disabilities, which are likely to continue in the foreseeable future, in nearly all of the areas of expenditure that are covered by the horizontal fiscal equalisation (HFE) processes. These require it to spend around 2.7 times the per capita average of the States and Territories to provide an average standard of State-like services. The Territory's expenditure disabilities vastly outweigh a slightly above standard per capita own-source revenue raising capacity.

Since the Territory's inclusion in the general revenue assistance pool in 1988-89 the general revenue assistance received by the Territory has been supplemented in each year by the provision of SRA. The level of SRA has fallen over the period reflecting the Commonwealth's policy of easing the Territory's transition to State-like funding arrangements.

In addition to general revenue assistance and SRA, the Territory receives considerable funding from the Commonwealth in the form of SPPs. A significant proportion (around 40 per cent) of the total amount of SPPs received by the Territory is directed to activities and services that are outside the HFE processes, such as capital expenditure. The Territory received around $1 595 per head in total from SPPs in 1994-95 against the Australian average of around $945 per head. As is the case for the other States and Territories, the largest SPPs are for funding in the areas of health, education and housing and community amenities but the Territory also receives above average amounts of SPP funding in areas such as Aboriginal education and roads.

The extent of the Territory’s relative fiscal disabilities in areas outside the HFE processes cannot be quantified without data also being accumulated for the other jurisdictions. Nevertheless, it appears reasonable to assume that the main factors that give rise to large disabilities in areas covered by the standard budget are also significant in expenditure areas outside the standard budget. The extent of disabilities on the revenue side of the non-standard budget is more difficult to assess but the Territory has significantly improved its own-source revenue raising effort over the past six years.

The estimated amount of Commonwealth funding for the Territory outside the HFE processes fell by around 27 per cent in per capita terms in the five years to 1993-94, but still remained around 2.1 times the average level of Commonwealth funding for the States and Territories. Although most of the decline in funding for the Territory was attributable to a fall in SPPs for capital purposes, these payments to the Territory remain around 2.8 times the per capita average of the States and Territories and are directed to a number of areas where significant fiscal disabilities exist. Attachment C contains estimates of Commonwealth funding for the States and Territories outside the HFE processes over the five years to 1993-94.

The Territory’s revenue was substantially affected by the abolition of the Loan Council capital grants program from 1 July 1994. Although the loss of this program to the States and Territories in aggregate is being offset in a few years by the more generous indexation of FAGs introduced in 1994-95, the Territory was favoured by the historic distribution of capital grants and therefore disproportionately disadvantaged by their withdrawal. In 1993-94, Loan Council capital grants accounted for around 25 per cent of total Commonwealth funding for the Territory outside the HFE processes.

The Territory’s budget deficit has been reduced significantly in recent years, with a small surplus expected in 1995-96. This has allowed the Territory’s high net debt to GSP ratio to be wound back. The Territory's budgetary position has improved notwithstanding the reduced Commonwealth funding.

Although the Territory’s own-source revenue raising effort has been below the CGC’s assessed standard, the Territory has recently taken measures to expand and better utilise its tax base and has introduced measures to improve the performance of the PTE sector, most notably resulting in a substantial reduction in the level of subsidy provided to the Territory’s Power and Water Authority. However, the relatively limited earning capacity of the Territory’s PTE sector is a constraint on the Territory’s own-source revenue capacity.

The terms of reference seek options for moving the Territory's relative capacity to finance 'non-standard' expenditures towards that of the States. There are four options for addressing the Territory's current position:

- increase the level of debt financing;
- increase own-source revenues;
- adjust outlays; and
- increase Commonwealth payments.

They could be implemented either separately or as components of a strategy involving both Commonwealth assistance and policy initiatives by the Territory Government. In the long run, it is accepted that the Territory will have to exist within the Federal-State system without any special treatment from the Commonwealth. However, the Territory's ability to meet its expenditure responsibilities in the shorter term is sensitive to available funding at the margin.

The Northern Territory's Fiscal Position

Notwithstanding the greater volatility of the Territory economy and its greater fiscal disabilities, the Territory Government bears the same responsibility as the State Governments and the ACT Government for determining an appropriate fiscal strategy. This involves decisions concerning the type and level of provision of public services to be provided in the Territory, its revenue raising effort and the level of debt to be borne by the Territory. However, there are some factors which are of more significance for the Territory's fiscal arrangements than they are for the other States and the ACT:

- the Territory's relatively heavy dependence on Commonwealth payments (see Figure 7.1) means that its budgetary position is more affected by changes in Commonwealth funding than is the case for the other States and Territories; and
- the Territory receives a relatively high proportion of Commonwealth payments that are of a general purpose and untied nature (see Figure 7.2) in comparison to the other States and the ACT. (Nevertheless, the same proportion of total budgetary outlays is financed by tied Commonwealth payments in both the Territory and the States).

Figure 6.1

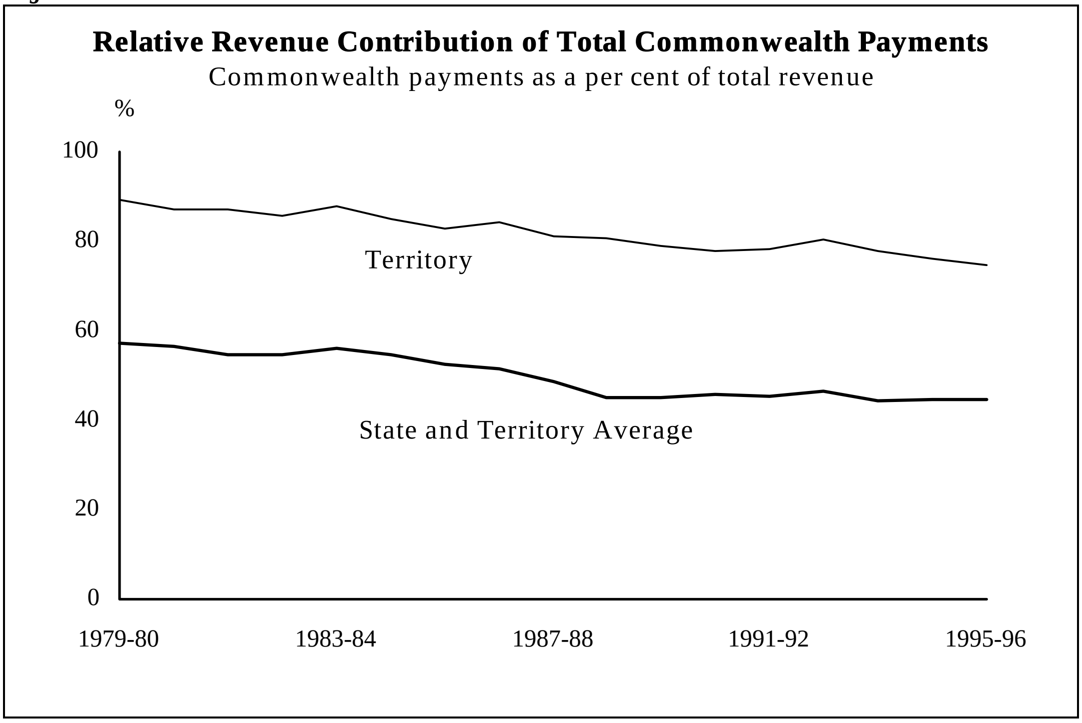


Figure 6.2

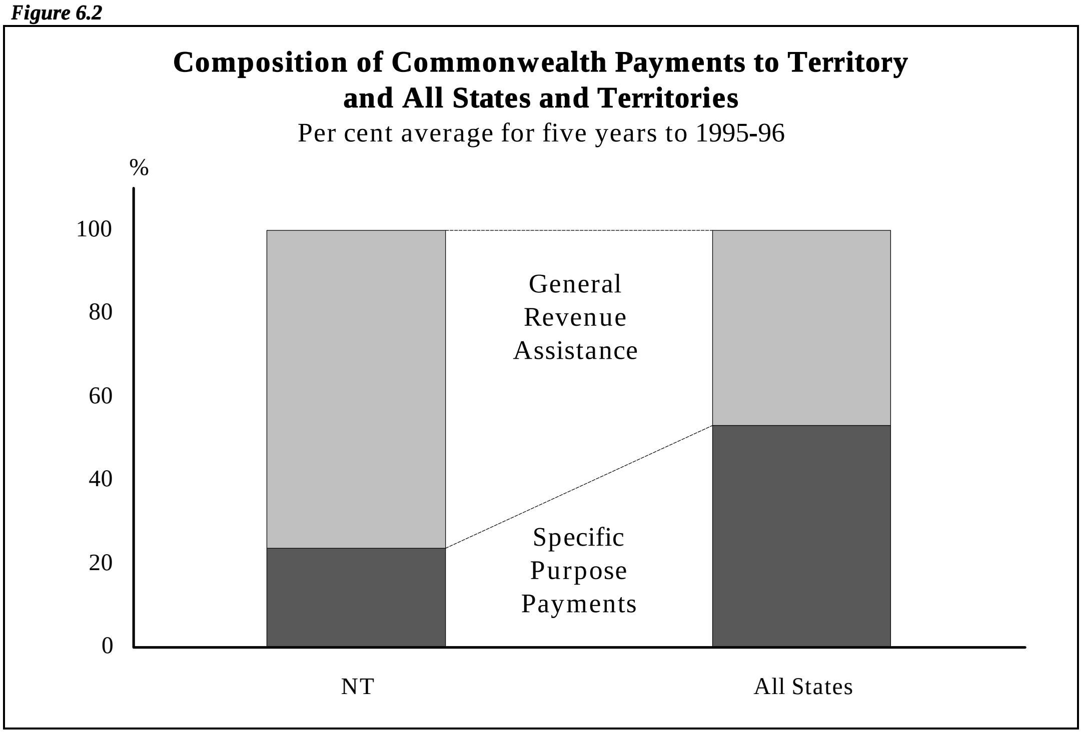
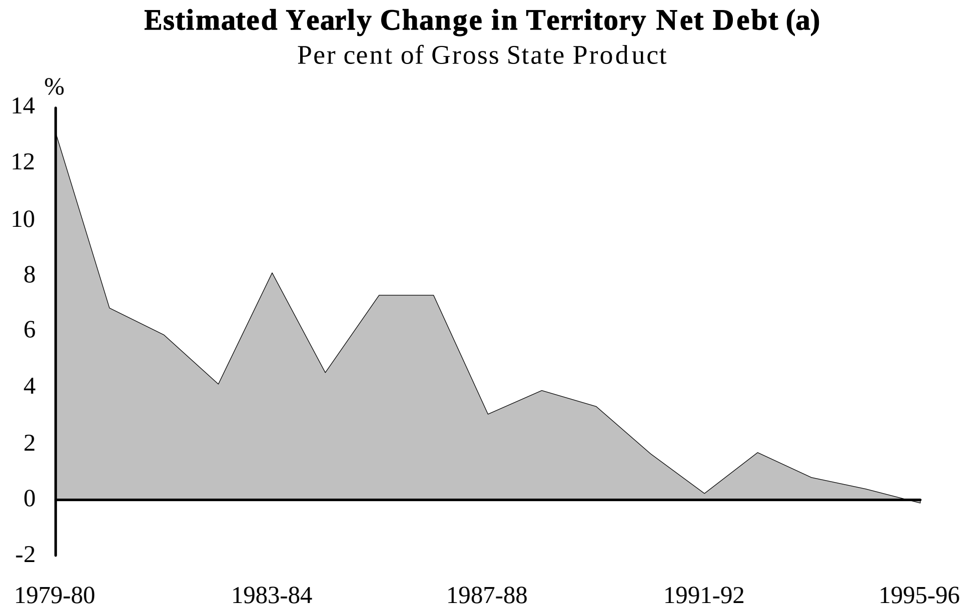
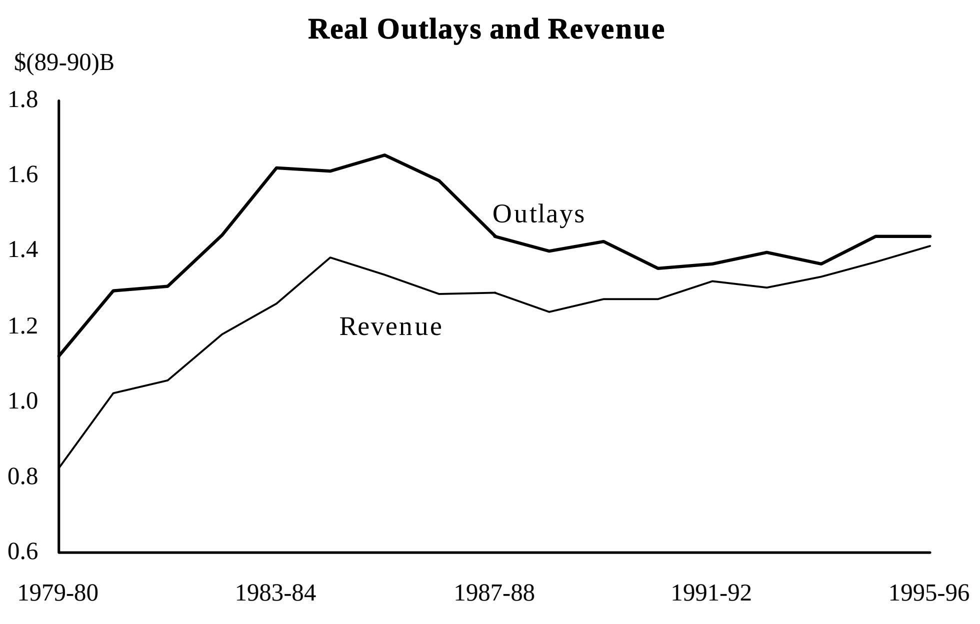


Figure 6.3



(a) Estimated by subtracting Net Territory Advances Repaid (mostly lending to and repayments from local government) from the ABS's GFS Territory deficit data. The difference from the ABS deficit data is small in most years and does not distort underlying trends.

Figure 6.4

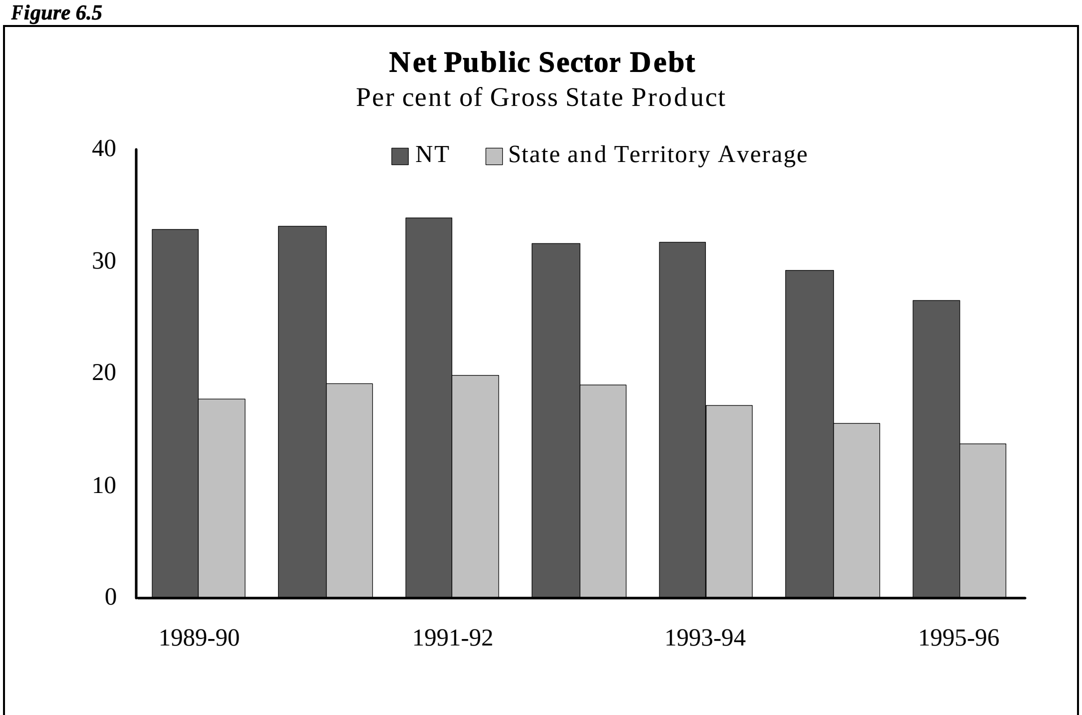


After the introduction of Self-Government in 1978, the Territory's fiscal position was characterised by a relatively large build-up in net debt (see Figure 7.3), with outlays significantly higher than revenue (see Figure 7.4). However, the growth in net debt has slowed significantly in recent years.

The budget deficits recorded by the Territory resulted in the build up of a substantial debt burden relative to other jurisdictions when measured on a net debt to Gross State Product (GSP) basis.

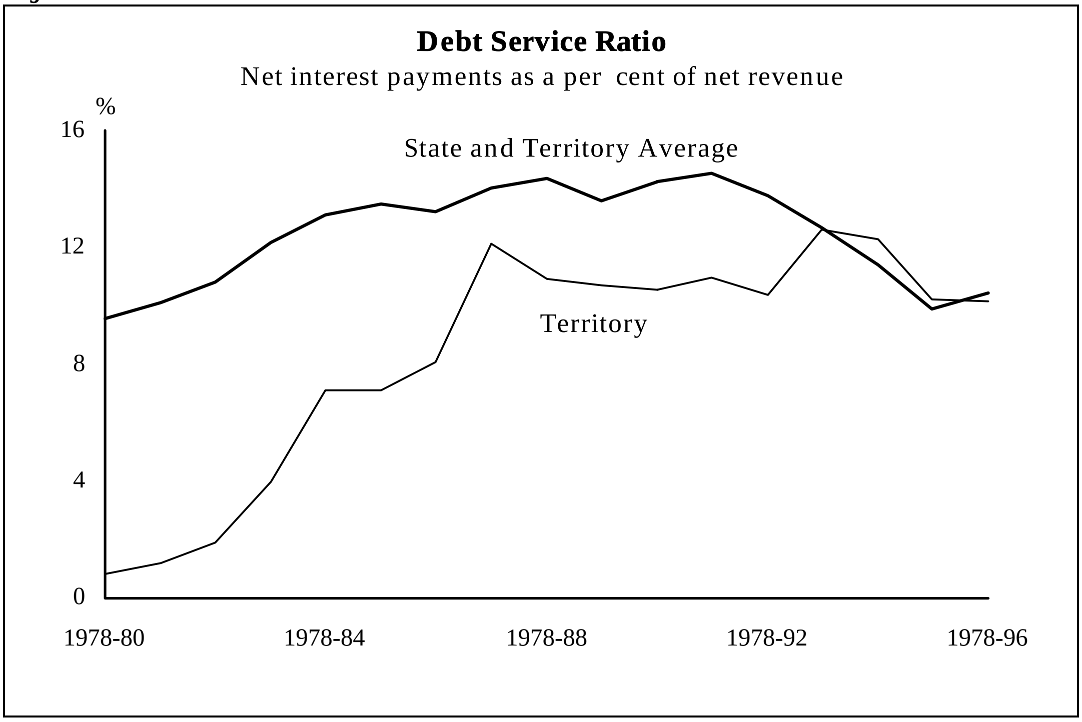
- The Territory's net debt to GSP ratio is expected to be around 26 per cent in 1995-96, compared with an expected State and Territory average of around 14 per cent (see Figure 7.5). Nevertheless, the Territory's net debt to GSP ratio has fallen significantly from its peak of 33.5 per cent of GSP in 1991-92 as the budget deficit was wound back.
- The Territory's debt service ratio (see Figure 7.6) has fallen from a peak of 12.6 per cent in 1992-93 to an expected 10.1 per cent in 1995-96, slightly below the expected State and Territory average of 10.5 per cent.

Figure 6.5



The greater part of the build-up in the Territory’s debt occurred during the first 10 years of Self-Government, when the Territory Government undertook a number of programs for major capital works projects. This investment in infrastructure was largely financed by a combination of Commonwealth grants and increases in debt. According to the CGC's assessments, the Territory's own-source revenue raising effort was generally below the State and Territory average during that period.

Figure 6.6

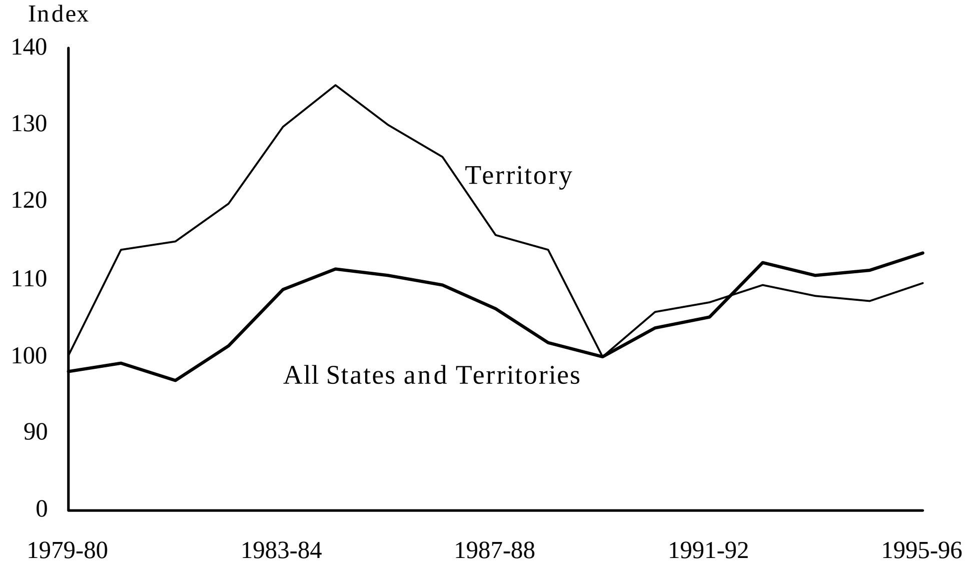


Through the mid and late 1980s, there were successive falls in the real level of Commonwealth payments to the States, reflecting the national economic imperatives of improving Australia's fiscal balance and restraining growth in domestic demand. The Territory experienced a decline in real Commonwealth payments of an average of around 6 per cent per annum through the late 1980s. This compared with an average decline of around 1 per cent per annum in total Commonwealth payments to the States (see Figure 7.7) which, given the Territory's reliance on Commonwealth funding, implied a larger fiscal adjustment than for the States. The decline in Commonwealth payments to the Territory was in part associated with a declining level of SPPs following the completion of some large infrastructure projects and the Commonwealth's policy of easing the Territory's transition towards State-like funding arrangements.

Figure 6.7

Real Total Commonwealth Payments to the Territory and All States and Territories

1989-90=100



The Territory's budgetary position has improved significantly in the 1990s notwithstanding the changes which have occurred in Commonwealth funding.

- After the strong rise and fall during the 1980s, the real level of Commonwealth payments to the Territory has increased at a rate slightly below, but broadly consistent with, real growth in total payments to the States (see Figure 7.7).
- As shown by Figure 7.4, real outlays growth by the Territory Government has been contained.
- The Territory's own-source revenue raising effort has been below the CGC's assessed standard. However, the Territory has recently taken measures to expand and better utilise its tax base, including through the introduction of poker machines to community venues, higher stamp duties on motor vehicles and increased franchise fees. These measures have lifted the Territory's revenue effort in the standard budget areas closer to the State and Territory average. The remaining difference between actual and assessed revenue-raising capacity mainly reflects the assessment procedures adopted by the CGC, which ascribe a revenue-raising capacity from the Territory PTEs that is higher than the Territory considers

appropriate given the Territory's small economic base and lack of economies of scale.

- The Territory has also introduced measures to improve the performance of the PTE sector, most notably resulting in a substantial reduction in the level of subsidy provided to the Territory's Power and Water Authority. The Territory has substantially reduced its subsidies paid to PTEs from $700 per capita in 1989-90 to $47 per capita in 1994-95. In comparison, the level of subsidies paid to PTEs in other jurisdictions has not altered significantly over the last 6 years.

In recent budgets the Territory has adopted an explicit fiscal strategy which includes a number of core fiscal targets. Subject to the percentage change in Commonwealth grants provided to the Territory not being significantly less than that for the States and there being adequate discretion in the application of funds, the Territory's fiscal strategy is as follows:

- no increase in current expenditure in real terms per capita;
- the maintenance of fixed capital expenditure at the level required to meet economic and social development needs;
- interest payments are pegged at the 1992-93 level;
- the rates of taxes and charges are to be no higher than the six States average (with the exception of the Liquor Levy);
- the annual increase in debt is to be no higher than 5 per cent of total expenditures; and
- new borrowings are to be used only for the repayment of Commonwealth advances or provision of economic infrastructure.

Fiscal Arrangements

The Territory was first included in the States' pool of Commonwealth general revenue assistance in 1988-89 as part of the transition to State-like funding arrangements. The size of the general revenue assistance pool is determined at the annual Premiers' Conference in the light of an offer from the Commonwealth Government. The current arrangements involve the indexation of the existing pool in real per capita terms. At the 1995 COAG meeting the Commonwealth agreed to guarantee that this arrangement would be continued on a rolling three year basis.

The distribution of the general revenue assistance pool among the States and Territories is determined in the light of per capita relativities recommended by the CGC. The CGC's per capita relativities seek to achieve a measure of HFE in the standard budget by providing all States and Territories with the capacity to provide an average standard of State-like public services, assuming that their taxes and charges are imposed at average rates and their affairs are conducted with an average level of efficiency.

The standard budget methodology developed by the CGC incorporates the categories of State and Territory expenditure and revenue that are typically of a recurrent nature including the greater part of public sector expenditure (such as wages and salaries) and revenue (mainly State tax collections, PTE dividends and mining royalties) in most of the functional areas of State budgets (such as housing, education, policing and community services). Where relevant, the CGC also takes into account Commonwealth SPP payments to the States for recurrent purposes and certain forms of Commonwealth own-purpose outlays (such as Aboriginal and Torres Strait Islander Commission (ATSIC) expenditure on recurrent services for indigenous communities). The major components of the Territory's 1993-94 per capita relativity are shown in Table 1.

Figure 6.8

Components of 1993-94 Per Capita Relativity for Territory

	NT Per Capita ($)	**State Average Per Capita ($)**
Expenditure Needs (a)	7 441	2 908
Relativity (b)	**2.7**	**1.0**
less		
Own Source Rev. Capacity	1 788	1 689
Relativity	**1.1**	**1.0**
less		
Included SPPs	679	222
Relativity	**3.1**	**1.0**
equals		
Financing Requirement	4 975	997
Per Capita Relativity	**5.0**	**1.0**

Source: CGC *1995 Update.*
(a) Expenditure needs include the CGC's standard budget result term.
(b) Relativities are calculated by dividing the Territory's $ per capita amounts by the State average $ per capita amounts.

The relativities (see Figure 7.9) adopted by the 1995 Premiers' Conference for 1995-96 in accordance with the CGC's recommendations justify, on horizontal fiscal equalisation grounds, the Territory receiving around five times the average per capita amount of general revenue assistance. This is higher than the per capita amount received by other jurisdictions. The amount of Commonwealth funding for the Territory in the form of FAGs, which account for 95 per cent of the general revenue assistance pool, is expected to be $902 million in 1995-96.

Figure 6.9

Estimated Distribution of 1995-96 FAGs (a)

Including Unquarantined Hospital Funding Grants

		Per Capita ($)			Total Level ($M)		
	CGC Relativit	Actual	Equal	Diff.	Actual	Pop. Based	Diff.
NSW	0.8743	897	1 027	-1.30	5 522	6 322	-800
Vic	0.8506	873	1 027	-154	3 947	4 645	-698
Qld	1.0435	1 071	1 027	44	3 545	3 401	144
WA	1.0521	1 080	1 027	52	1 886	1 794	92
SA	1.2047	1 237	1 027	209	1 830	1 520	310
Tas	1.5437	1 584	1 027	556	751	487	264
NT	**5.0332**	**5 163**	**1 027**	**4 136**	**902**	**179**	**723**
ACT	0.8916	916	1 027	-111	281	315	-34
Aust	1.0000	1 027	1 027	0	18 664	18 664	0

Sources: *CGC 1995 Update* and *Commonwealth 1995-96 Budget Paper No. 3.*

(a) Relativities adopted for distribution of 1995-96 FAGs are the average of the CGC's assessed annual relativities for the five years to 1993-94.

So long as the current HFE arrangements remain in force, the Territory will continue to receive a relatively large per capita share of Commonwealth general revenue assistance. The CGC assessments have established that the Territory faces significant cost disabilities in nearly all of the areas of expenditure that are covered by the HFE processes. This is mainly due to diseconomies of scale, the higher administrative overheads experienced by the less populous States and Territories, social composition and population dispersion which adds to the cost of providing standard services to rural or remote communities. These disabilities are likely to continue for the foreseeable future. Some notable areas of expenditure disadvantage for the Territory are in Aboriginal community services, housing, administration of justice, and national parks and wildlife. The Territory's expenditure disabilities vastly outweigh a slightly above standard per capita own-source revenue raising capacity (mainly in the areas of stamp duty on motor vehicle registrations, business franchise fees, mining revenue and electricity and gas).

The CGC's Report on general revenue grant relativities for 1995 indicated that the Territory's revenue raising capacity ratio averaged 101.9 per cent for the five years to 1993-94. The Territory's revenue raising effort ratio averaged 93.4 per cent. (These ratios measure the revenue raising capacity and effort of each State and Territory within the scope of the CGC's standard budget taking into account their relative disabilities.) On the expenditure side of the standard budget, the Territory's cost of services provision ratio averaged 272.9 per cent while its level of services provision ratio was 99.23 per cent. The Territory's relative cost disabilities are illustrated by the fact that the next highest cost of service provision ratio is that of Western Australia at 109.2 per cent.

The Territory also receives a significant amount of funding from the Commonwealth in areas that are outside the HFE processes. Around 40 per cent of the SPPs received by the Territory are directed to areas outside the scope of the standard budget. The allocation of SPPs is determined in accordance with the Commonwealth's national policy objectives, or with national policy objectives agreed between the Commonwealth and the States and Territories. In 1995-96, the Territory is expected to receive around $298 million in SPPs. As is the case for the other States and Territories, the largest SPPs are for funding in the areas of health, education and housing and community amenities. However, the Territory also receives above average amounts of SPP funding in areas such as Aboriginal education and roads. The Territory received around $1 595 per head in SPPs in 1994-95 against the Australian average of around $945 per head.

In a number of key areas a relatively large per capita share of Commonwealth own-purpose outlays are directed to the Territory. Again, the allocation of funding in these areas reflects national policy objectives. They include payments that are related to the provision of non-recurrent services for Aboriginal communities (such as infrastructure), reflecting the Territory's relatively large indigenous population, and defence. (ATSIC recurrent expenditures are included in the CGC assessments.) The Report of the Committee on Darwin noted that in the next five to seven years the number of Commonwealth defence personnel in the Territory is expected to grow by around 3 000 to 11 000 (or to around 9 per cent of total Territory employment) and the construction of new defence facilities, and associated repairs and maintenance, is expected to provide an estimated $500-700 million boost to building activity in the Territory, while increasing Territory budget expenditures required in areas such as health and education.

Since the Territory's inclusion in the general revenue assistance pool in 1988-89, the general revenue assistance received by the Territory has been supplemented in each year by the provision of SRA. The most significant amounts of SRA were provided in the years immediately following the Territory's inclusion in the pool. This reflected the Commonwealth's policy of easing the Territory's transition to State-like funding arrangements. In the absence of this transitional assistance the application of the CGC's recommended relativities would have caused a significant fall in funding for the Territory. Figure 7.10 shows the declining trend in SRA provided to the Territory since 1988-89.

Figure 6.10

Territory Special Revenue Assistance (SRA)

	SRA	SRA to Total Territory General Revenue Assistance
	$M	(%)
1988-89	59	7.7
1989-90	45	6.1
1990-91	50	6.2
1991-92	40	4.8
1992-93	40	5.0
1993-94	30	3.5
1994-95	29	3.4
1995-96	10	1.1

Source: Commonwealth 1995-96 *Budget Paper No. 3.*

Territory's Fiscal Disabilities in Areas Outside the HFE Processes

As noted above, the CGC's assessments of fiscal disabilities, and hence the extent of HFE, relate to the parts of State and Territory budgets which are within the scope of the standard budget. The standard budget reflects the views of the Australian Governments concerning the extent of HFE. This is a matter of debate among the States and Territories because it is manifested in the redistribution of resources between jurisdictions. Australian Governments most recently considered the rationale for HFE at the 1994 Premiers' Conference and concluded that the existing formal HFE arrangements should be retained.

The very substantial disabilities which have been assessed in relation to standard budget expenditure clearly underline the significance of developments in the HFE processes for the Territory. The CGC has extended the coverage of the standard budget in recent years to include a number of categories where the distinction between capital and recurrent expenditure is blurred, such as in road maintenance, housing and some debt charges. The inclusion of these categories in the standard budget reduces the Territory's expenditure burden in areas outside of the HFE processes. The CGC is again examining the scope of the standard budget (particularly the possible inclusion of some State tertiary education expenditure) which may have future implications for the assessment of the Territory's fiscal disabilities, both inside and outside the HFE processes.

The current HFE arrangements do not cover some important categories of expenditure and revenue within budgetary responsibilities of the States and Territories. On the expenditure side, these responsibilities include capital spending on infrastructure, payments to local government, State spending on tertiary education and commercial operations and promotional activities of State and Territory governments. The categories of revenue that are not covered by the HFE processes include a significant proportion (around 40 per cent) of Commonwealth SPP funding, various PTEs (although most PTEs are included in the CGC's standard budget relative capacities are not always assessed) and the relevant portions of interest, royalty and property income that are not attributable to areas included by the CGC in the standard budget. The Territory Government estimates that the annual level of expenditure outside the CGC processes averaged $308 million over the five years to 1993-94, or 21 per cent of its total expenditure.

While the CGC has developed a detailed methodology for the assessment of the areas covered within the standard budget there are no independent assessments of, or readily available comparative data on, the expenditure disabilities and revenue capacities of the States and Territories in the areas outside the HFE processes. This would involve a significant resource commitment (because it would need to ascertain disabilities in all the other jurisdictions as well as the Territory), and would need to overcome some difficult methodological and data problems. Indeed, the practicality of making comparisons in some areas is a factor which limits the scope of the standard budget. Nevertheless, it is possible to make some observations on the Territory's budgetary responsibilities in areas outside the HFE processes which offer some guidance concerning the Territory's fiscal disabilities outside the standard budget.

Expenditure

The Territory's responsibilities include the provision of infrastructure in remote regions which contain a significant proportion of the Territory's indigenous communities. In the CGC's standard budget, the factors that are associated with providing services to rural and remote communities make a significant contribution to the Territory's relatively large expenditure disabilities. Specifically, the CGC assesses that (as shown in Figure 7.8) in order to provide a

State-like standard of services in areas covered by the standard budget the Territory needs to spend around 2.7 times the per capita average of the States and Territories.

The Territory's per capita expenditure in areas not covered by HFE is significantly below the benchmark of 2.7 times the average of the States and Territories established for recurrent expenditures by the standard budget. The Territory Government estimates that in the five years to 1993-94 the Territory's per capita expenditure in areas outside the standard budget was around 1.5 times the State and Territory average. Moreover, it is logical to assume that the elements, notably dispersion, social composition and lack of economies of scale, which significantly influence the standard budget assessments are also significant in expenditure areas outside the standard budget. On the other hand, Commonwealth capital SPPs that are generally provided in areas of significant fiscal disabilities for the Territory are 2.8 times the Australian per capita average.

The Territory receives a relatively high proportion of Commonwealth payments that are of a general purpose and untied nature (see Figure 7.2) in comparison to the other States and the ACT. There is no constraint from the Commonwealth or the HFE perspective that would prevent a jurisdiction from making a policy decision to fund non-standard expenditure from standard budget revenue or vice versa. While HFE is designed to provide jurisdictions with the ability to provide the average level of State-like services in the standard budget, there is no constraint which prevents general revenue assistance from being spent in accordance with each jurisdiction's spending priorities. Actual spending patterns vary quite widely from State to State. However, such transfers must mean lower standards of service in the standard budget where the Territory has been assessed by the CGC as providing, on average, State-like standards of service.

Revenue

The standard budget may not provide a guide to the Territory's non-standard budget revenue raising capacity (as noted earlier, the CGC's assessments indicate that the Territory has an above average revenue raising capacity). Two important non-standard revenue sources for the Territory are Commonwealth assistance outside the HFE processes and the profitability of the PTE sector.

Commonwealth Payments

Estimated Commonwealth payments to the Territory outside the HFE processes fell in per capita terms by around 27 per cent in the five years to 1993-94, from around $1 300 per capita ($213 million) in 1989-90 to around $950 per capita

($163 million) in 1993-94. Although the Commonwealth's funding for the Territory outside the HFE processes was still around 2.1 times the State and Territory per capita average in 1993-94, this had declined significantly from an estimated 3.5 times the State and Territory average in 1989-90. Attachment C contains estimates of non-standard Commonwealth funding for the States and Territories over the five years to 1993-94.

A large part of the fall in Commonwealth funding for the Territory outside the HFE processes is attributable to a significant decline in Commonwealth SPPs provided to the Territory for capital purposes. Notwithstanding this decline, the Territory's revenue in areas outside the standard budget continues to be supported by a relatively large per capita share of Commonwealth SPP capital purpose funding. In 1994-95, the Territory received around $409 per capita in capital purpose SPPs, around 2.8 times the State and Territory average of around $149 per capita. These SPPs are directed to a number of the areas that appear to involve significant fiscal disabilities for the Territory, such as the provision of services to indigenous communities, housing and regional development. The trend in capital purpose SPPs also needs to viewed in the context of an increase in total Commonwealth SPPs to the Territory of around 18 per cent in real terms over the last decade as a consequence of growth in Commonwealth SPPs for current purposes.

The Territory's revenue position was adversely affected by the abolition of the Loan Council capital grants program from 1 July 1994. Loan Council capital grants were a significant source of revenue for the Territory which benefited from their historic distribution. In 1993-94, the Territory received a total of $43.8m in capital grants. These funds accounted for around 25 per cent of Commonwealth payments to the Territory outside the standard budget and were equivalent to around 19 per cent of the Territory's new fixed capital expenditure, compared with a State and Territory average of around 3 per cent. When the program was abolished, the Commonwealth was mindful that the associated loss to all States and Territories in aggregate would be increasingly offset in a few years by the more generous indexation of FAGs which was also introduced in 1994-95, particularly given that the nominal value of capital grants had remained unchanged since 1989-90. Despite the Territory being the major recipient in per capita terms of the more generous indexation of FAGs (due to its high per capita relativity), the greater significance of the Loan Council capital grants to the Territory means that this loss of funds will only be recouped over the longer term.

The Territory receives a relatively large share of the expenditure undertaken by ATSIC. It appears that the CGC has determined that around 60 per cent of ATSIC funding for the States should be treated as being for capital purposes and not as part of the standard budget. In total, the Territory was the destination of around 22 per cent ($157 million) of ATSIC spending in 1993-94. This was around 50 per cent higher than the Territory's 15 per cent share of the total Aboriginal and Torres Strait Islander population in Australia.

In comparison to the other States and Territories, the Territory economy receives the largest relative contribution from Commonwealth own-purpose outlays (apart from the ACT which is a special case because of expenditures associated with its role as the national capital). As noted earlier, the contribution of defence spending (as well as outlays required of the Territory Budget) will grow in the medium term under the current program of defence relocation to the Territory.

The Committee on Darwin has made a number of recommendations for further Commonwealth spending on matters related to the Territory which, if implemented, potentially amount to an additional $20 million over the next four years. The Commonwealth Government is considering those recommendations.

The following matters will further contribute to the Territory's revenue and the level of service provision in areas outside the HFE processes:

- the Commonwealth will provide a further $10 million in SRA from the FAGs pool in 1996-97;
- the Commonwealth is providing $15 million to the Territory over the next three years for the provision of health related infrastructure in remote communities;
- the Commonwealth is providing $16 million to the Territory over the next three years for a program for the construction of roads to remote indigenous communities;
- the cost of Commonwealth initiatives in response to the recommendations of the Royal Commission into Aboriginal Deaths in Custody is expected to exceed $400 million in the period up to 1996-97. A major part of these initiatives addresses the underlying causes of Aboriginal disadvantage, including access to education and health services. The Territory is expected to receive a substantial portion of these funds; and
- the Commonwealth committed an additional $250 million over four years to indigenous health in the 1995-96 Budget. The commitment includes an additional $103 million allocated to the Department of Human Services and Health for primary health care and an additional $86 million allocated to ATSIC for housing and infrastructure programs to improve environmental health. A substantial portion of these funds will be for the health advancement of the Territory's indigenous population.

Public Trading Enterprises

The Territory Government notes that it has a relatively limited earning capacity in the PTE sector and considers that this is not adequately incorporated into the CGC's standard budget assessment of PTEs.

- In 1993-94, the net operating surplus (less subsidies) of the Territory's PTE sector was $158 per capita, compared with a State and Territory average of $270 per capita. This earning capacity partly reflects the Territory's relatively small economy and the lack of scope for economies of scale.
- The PTE sector provides the major proportion (over 50 per cent) of gross fixed capital expenditure (GFCE - the major component of expenditure outside the HFE processes) in the State and Territory public sector. Partly reflecting its lower earning capacity, the PTE sector accounts for only around 33 per cent of GFCE in the Territory public sector.

Options for Addressing the Territory's Fiscal Disabilities in Areas Outside the HFE Processes

The terms of reference seek options for moving the Territory's relative capacity to finance 'non-standard' expenditures towards that of the States. There are four options for addressing the Territory's current position.

- increase the level of debt financing;
- increase own-source revenues;
- adjust outlays; and
- additional payments from the Commonwealth.

These options could be implemented either separately or as components of a strategy involving both Commonwealth assistance and policy initiatives by the Territory Government. In the long run, it is accepted that the Territory will have to exist within the Federal-State system without any special treatment from the Commonwealth. However, the Territory's ability to meet its expenditure responsibilities in the shorter term is sensitive to available funding at the margin.

Increase the level of debt financing

While an increase in debt financing is an option, it should be avoided because of the desirability of further reducing the Territory's debt servicing costs, which would improve the Territory's capacity over time to fund the provision of services in all areas of the Territory Budget. Refraining from an increase in debt financing would also assist the national policy objective of reducing the call of the public sector on capital markets.

Increase own-source revenues

This option could involve the Territory further improving its revenue raising effort in either the standard budget or the non-standard budget, or in both.

The Territory has an above average revenue raising capacity in the standard budget and, on the basis of the CGC's assessment for the period prior to 1993-94, a slightly below average revenue raising effort. However, recent measures undertaken by the Territory have lifted the Territory's revenue effort to close to the national average.

A significant increase in the Territory's revenue raising effort would involve rates and taxes above the State average. While some States have achieved own-source revenue efforts that are well above the State and Territory average (Victoria's own-source revenue effort was 28 per cent above the State and Territory average in 1993-94), the practicality of sustaining significantly higher taxes and charges over time is limited. The maintenance of a significantly higher level of taxes and charges would detract from efforts to make the Territory more competitive and to expand its economic base.

Adjust outlays

This option would involve reviewing the level and/or the relative priority of both current and capital outlays. In the latter case, this could involve the redirection of existing expenditures more towards 'non-standard' expenditures.

There is no constraint from the Commonwealth or the HFE perspective which would impede a decision to fund non-standard expenditure from own-source revenue comprehended by the standard budget or from Commonwealth general purpose funding. While HFE is intended to provide jurisdictions with the capacity to deliver the average level of State-like services within the standard budget, it does not constrain the manner in which general purpose payments are used. Actual spending patterns vary quite widely from State to State. However, if the Territory were to decide to increase the level of provision in non-standard budget areas by transferring resources from standard budget areas, this would mean that the Territory would have to provide services in some areas within the standard budget at levels below the average State-like standards.

Increase Commonwealth payments

The Commonwealth would need to weigh this option against other expenditure priorities, which are subject to expenditure review on an annual basis. The Commonwealth's national economic priorities are reflected in its commitment to improve national savings through the maintenance of appropriate fiscal policy settings over time.

If additional assistance were to be provided to the Territory, the Commonwealth may then wish to consider whether it should be tied to Commonwealth objectives or be provided as general budgetary support. The main areas of disability observed in this chapter particularly affect Aboriginal communities which are also an area of priority for Commonwealth spending and are being addressed directly through Commonwealth own-purpose outlays.

It would be necessary to establish a rationale for the provision of any ongoing budgetary support for the Territory, particularly if, in keeping with national savings objectives, this involves an offsetting reduction in payments to the other States and Territories (whether through reduced SPPs or pool funded SRA). The ACT is being required to move to State-like levels of funding and to do so in accordance with assessments by the CGC and there are some other jurisdictions which have not recently experienced strong economic growth. This rationale would also need to comprehend the Territory aspirations for statehood and independence.

In assessing the relative priority which the Commonwealth might afford to increasing funding for the Territory the Commonwealth would need to have regard to the level of other payments already in prospect. Under existing policies, additional Commonwealth support for the Territory is being made available for 1995-96 and several years thereafter. There is also the prospect of additional support flowing from reports under consideration.

Attachment A

Terms of Reference

The terms of reference for the joint review were as follows:

"The Working Party should examine the capacity of the Northern Territory, relative to the States on average, to finance expenditures on functions which are not included in Commonwealth Grants Commission assessments. In doing so, the Working Party should report on:

(a) the extent of Territory expenditures outside the 'standard budget', compared with the States;

(b) the capacity of the Territory to finance these 'non-standard' expenditures from sources other than general revenue assistance from the Commonwealth, compared with the States; and

(c) options for moving the Territory's relative capacity to finance 'non-standard' expenditures towards that of the States."

Attachment B

The Northern Territory Economy

See Budget Paper No. 6.

Attachment C

Estimated Non-Standard Budget Funding

The following two tables present the information contained in a singular table in the original report.

Estimated Commonwealth Non-Standard Budget Funding 1989-90 to 1993-94

$ million

Northern Territory	Non-Standard Current SPPs	Capital SPPs	Non-Standard Total SPPs	Gen Purpose Capital Grants L Council	Gen Purpose Capital Grants Better Cities	**Total**
1989-90	36	133	169	44		**213**
1990-91	42	132	173	44		**217**
1991-92	37	95	132	44	0.0	**175**
1992-93	35	107	143	44	0.5	**187**
1993-94	36	83	118	44	0.5	**163**
1993-94 (c)	*36*	*83*	*118*	*0*	*1.7*	***120***
All States and Territories						
1989-90	2 765	3 200	5 965	350		**6 314**
1990-91	3 162	4 034	7 196	330		**7 526**
1991-92	3 889	3 331	7 221	330	42	**7 592**
1992-93	4 233	4 393	8 627	330	168	**9 125**
1993-94	4 418	3 096	7 514	330	213	**8 057**
1993-94 (c)	*4 418*	*3 096*	*7 514*	*0*	*223*	***7 736***

$ per capita

Northern Territory	Non-Standard Current SPPs	Capital SPPs	Non-Standard Total SPPs	Gen Purpose Capital Grants L Council	Gen Purpose Capital Grants Better Cities	**Total**
1989-90	223	818	1 041	270		**1 312**
1990-91	254	798	1 052	266		**1 318**
1991-92	222	568	790	263	0	**1 053**
1992-93	209	638	847	260	3	**1 110**
1993-94	211	484	695	260	3	**958**
1993-94 (c)	*211*	*484*	*695*	*0*	*10*	***705***
% Change 89-90 to 93-94	-5	-41	-33	-4	na	**-27**
- without LC cap grants (c)	*-5*	*-41*	*-33*	*na*	*na*	***-46***
All States and Territories						
1989-90	163	189	352	21		**373**
1990-91	184	235	419	19		**438**
1991-92	224	192	415	19	2	**437**
1992-93	241	250	491	19	10	**519**
1993-94	249	174	423	19	12	**454**
1993-94 (c)	*249*	*174*	*423*	*0*	*13*	***436***
% Change 89-90 to 93-94	52	-8	20	-10	na	**22**
- without LC cap grants (c)	*52*	*-8*	*20*	*na*	*na*	***17***

Northern Territory Per Capita Relativities (b)

Northern Territory	Non-Standard Current SPPs	Capital SPPs	Non-Standard Total SPPs	Gen Purpose Capital Grants L Council	Better Cities	Total
1989-90	1.4	4.3	3.0	13.1		**3.5**
1990-91	1.4	3.4	2.5	13.8		**3.0**
1991-92	1.0	3.0	1.9	13.8	0.0	**2.4**
1992-93	0.9	2.6	1.7	13.8	0.3	**2.1**
1993-94	0.8	2.8	1.6	14.0	*0.2*	**2.1**
1993-94 (c)	*0.8*	*2.8*	*1.6*	*na*	0.8	***1.6***
Average	1.1	3.2	2.1	13.7	0.2	**2.6**
- without LC cap grants (c)	*1.1*	*3.2*	*2.1*	*na*	*0.2*	***2.5***

(a) For these estimates, 1989-90 SPPs include $40M of the $90M PAWA subsidy payment to the Territory on 30 June 1989.

(b) Northern Territory $ per capita amounts divided by the average State and Territory $ per capita amounts.

(c) 1993-94 data excluding Loan Council (LC) capital grants (abolished from 1 July 1994) and assuming that Better Cities capital grants are allocated in 1994-95.

CHAPTER 7

GOVERNMENT BUSINESS DIVISIONS

The Northern Territory Government has been reforming its commercial activities with the aim of improving their productivity and efficiency. This commenced with the establishment of Government Business Divisions (GBDs) under the Financial Management Act in April 1995 and has proceeded through 1995-96 with the introduction of comprehensive costing and pricing methodologies and appropriate commercial accounting and management structures.

This Chapter discusses the main policy issues associated with the commercialisation of GBDs and provides an overview of how these issues have been addressed over 1995-96. These developments include the introduction of policies to ensure that GBDs pay for the cost of all resources used in their operations, the introduction of efficient pricing methodologies which match costs, the development of costing and funding policies for Community Service Obligations (CSOs), the implementation of full commercial (accrual) accounting, and the development of appropriate managerial and ownership control mechanisms including prices oversight.

Finally, the Chapter looks at some of the policy issues which require further conceptual work and examines possible courses of action with respect to these issues. These include the potential removal of any requirements that agencies be 'tied' to using GBDs, the determination of appropriate rates of return for GBDs, examining the impact of regulations which do not apply equally to GBDs and the private sector, and the necessity of managerial rewards and sanctions to drive future improvements in GBD performance.

Introduction

In April 1995 the Northern Territory introduced a new *Financial Management Act* to replace the *Financial Administration and Audit Act*. One of the fundamental features of the new Act is the separate recognition of the Government's commercial and business operations as Government Business Divisions (referred to hereafter as Business Divisions or GBDs).

This separation of GBDs has facilitated the development of appropriate operational policies and procedures for GBDs, reflecting the fact that where the Government provides business like services, a commercial focus is required that is not appropriate for general government activities. While this commercial approach has been evident in many Government businesses for several years, the creation of GBDs has established a consistent platform for change across all business activities.

The 1995-96 financial year has seen a number of developments in the process of reforming GBDs in the Territory.

In November 1995, a set of Principles and Guidelines for the operation of GBDs were approved and noted respectively by Cabinet. In addition, Cabinet noted an information paper on the policy issues in relation to GBDs. Together, these documents set in place a broad framework within which the GBD reform process has developed.

A GBD Implementation Steering Committee, comprising representatives of Treasury, the Chief Minister's Department, the Department of Transport and Works and the Power and Water Authority (PAWA) was subsequently established to implement the GBD Principles and Guidelines.

As a result of this implementation process, each GBD has now developed an approved pricing methodology on which user charges are to be based, and negotiated funding for their Community Service Obligations (CSOs) and Government Service Obligations (GSOs). This has culminated in a series of once only budget transfers (to facilitate the charging of GBD services and the funding of CSOs and GSOs to proceed) being included in this Budget.

Despite the significant progress which has occurred over 1995-96 there remain significant policy issues which will require further work over 1996-97 and future years. These include the potential removal of any requirements that agencies be 'tied' to using GBDs, the determination of appropriate rates of return for GBDs, examining the impact of regulations which do not apply equally to GBDs and the private sector, and the need for managerial rewards and sanctions to drive improvements in GBD efficiency.

Background on GBD Reforms

Section 3 of the *Financial Management Act* defines a GBD to be “an Activity or group of Activities a significant proportion of the costs of which is recovered through charges on users and which is determined by the Treasurer to be a Government Business Division.” This definition encompasses the Territory’s true Public Trading Enterprises (PTEs), that is those external GBDs which supply market-like goods and/or services to the private sector, as well as the internal GBDs which supply their goods and/or services at this stage solely to other arms of government.

The definition also enables the inclusion of entities which may at some stage become PTEs, but because of either their size or the mixed nature of their functions could not yet be considered as PTEs. In this way, the classification of an activity as a GBD can be used as a means of developing the business focus in marginally commercial activities. The diversity in the nature and size of the GBDs can be seen from Figure 7.1 which lists all GBDs, together with their projected expenditure levels for 1996-97.

One consequence of applying commercialisation reforms to entities at differing stages of development is the likelihood that the GBD classification will be dynamic. Over time, activities which are identified as having commercial attributes will be classified as GBDs, and conversely, the process of reform may reveal that certain GBDs are of a nature that should more appropriately be brought back within the general government sphere.

The fundamental purpose of the GBD reforms is to facilitate efficiency improvements through market based means. This occurs on two levels. Firstly, making GBDs pay for the full cost of the resources they use and then charging cost reflective prices improves the efficiency with which existing resources are allocated to both the production (by GBDs) and consumption (by GBDs’ customers) of those services.

Secondly, the reform process is also designed to drive dynamic efficiency gains, that is, improvements in the productivity of GBDs in providing a level of output for a given level of resources. While the Territory has made some progress on these issues (for instance, the focus on changes in management practices and structures, the use of benchmarking and oversight, the funding methods for Community Service Obligations), it is in these mechanisms for dynamic efficiency gains that the majority of the work remains to be done. In this regard the predominant issues to be addressed are the need for contestable markets, managerial rewards and sanctions and rate of return requirements. Each of these issues is discussed below.

Figure 7.1

OUTLAYS BY BUSINESS DIVISIONS

	Budget 1996-97
	$000
Internal Providers	
NT Fleet	34 863
NT Construction Agency	24 479
Government Printing Office	8 196
NCOM	71 532
External Providers	
International Project Management Unit	4 136
Darwin Bus Service	6 629
Territory Wildlife Park	4 498
Darwin Port Authority	39 488
NT Housing Commission : Housing	67 262
NT Housing Commission : Lending	71 289
TAB	13 810
PAWA : Commercial Services	284 456
Total	**630 638**

While Government is likely to be a major beneficiary in the GBD reform process through budget efficiencies, the real benefit from the Territory's perspective is the potential for lowering the costs of government provided inputs for Territory business (and therefore improving the ability of Territory business to compete in domestic and overseas markets) and the cost of government services to domestic consumers.

Concurrent with the developments in the Territory, all Australian jurisdictions have for some time placed increased emphasis on improving the efficiency of their business enterprises. This focus has been given recent expression in the series of agreements known collectively as National Competition Policy, entered into by the Commonwealth, States and Territories at the Premiers' Conference in April 1995. (A more detailed discussion of National Competition Policy is provided in the following Chapter).

The Business Division reforms described in this Chapter have in part been pursued to meet the Territory's commitments to National Competition Policy. However, whereas the National Competition Policy applies only to governments' business dealings with external parties, the GBD reforms have been extended to include those commercial activities which provide goods and services only to other arms of government. This recognises that many of the same efficiency gains which can be achieved with external providers can also be achieved for these operations.

Developments in 1995-96

Effort in the last year has focused on establishing costing and pricing policies and accounting and management practices suitable for the GBDs' commercial operations. To provide direction to the reform process, in late 1995 Treasury prepared a Policy Paper on Government Business Divisions, setting out the key issues to be addressed over 1995-96. This paper is reproduced as an Appendix to this Chapter.

Following on from this, the Principles and Guidelines for GBDs establish a framework to enable implementation of the reforms. The key features in the development of this framework over 1995-96 are described below.

Cost Recognition

Recognising the allocative efficiency objective discussed above, full cost recognition and recovery is one of the key principles for the operation of GBDs.

To this end, a primary objective in 1995-96 was to ensure that the principle of cost recovery was applied with consistency across all GBDs. This has been achieved through determining the full range of costs which GBDs are required to recover and setting the mechanisms in place to ensure that this occurs. In many cases this process has simply formalised arrangements which were already there (for instance, most GBDs already paid payroll tax). However, in other cases it has required the establishment of new mechanisms to ensure that GBDs are required to pay for the cost of resources they consume. (For instance, GBDs will now pay the costs of leasing premises to the Government's Properties Division.)

As a result of this process, all GBDs are now required to pay the full cost of employing staff, including all salary and wages, superannuation, workers compensation and other employee entitlements.

GBDs are also required to pay all corporate overheads including the costs of leasing premises, auditing and legal costs, utility charges and insurance. It should be noted that with respect to insurance, the principle of self-insurance will apply to GBDs (like other agencies), but the capacity for GBDs to apply for supplementary funding for large insurable events will now attract a 'premium' payable to Treasury.

The costs of capital, which include interest on debt and a required rate of return on equity, will also be charged to GBDs. Debt costs will be charged at the cost to Northern Territory Treasury Corporation plus a margin of 50 basis points as a debt guarantee fee and administrative charge. Because of the complexity of the issues involved, a return on equity has not been required of GBDs in 1996-97. This is discussed further in the next section. As a partial offset to the capital charges, GBDs will also now receive interest on the cash balances they hold (refer Figure 7.3).

GBDs will also be required to pay the same taxes, fees and fines faced by the private sector. It is legally impossible to subject GBDs to Commonwealth income tax and wholesale sales tax. Because of this, a tax equivalent regime has been established to replicate the cost of these taxes to GBDs. For certain GBDs, this regime must fulfil the Territory's commitments to a national agreement on the taxation treatment of State and Territory trading enterprises. For these entities the regime is more rigorous than that applying to other Business Divisions.

In addition, for some Territory taxes the administrative complexity of applying the tax is far in excess of the benefits to be gained from more accurate costing. In this small number of cases, GBDs have not been subjected to the tax. This is consistent with the principles of operation for GBDs which require that full cost recovery only be pursued where it is considered that the benefits of administering the arrangements outweigh the costs.

As noted above, GBDs have not previously paid many of these costs and, where they did do so, this was not on a consistent basis. Figure 7.2 shows the total level of increased expenditure (intrasector payments) by each of the GBDs as a result of the implementation of full costing and increased dividend payments. It should be noted that, for the Housing Commission: Housing and Lending GBDs, the change in costs is negative due to the removal of non-commercial functions as part of the GBD implementation process.

Figure 7.2

ONCE-ONLY GBD OUTLAY ADJUSTMENTS (1996-97)

	Increased Costs	Increased Dividends
	$000	$000
NT Fleet	1 556	
NT Construction Agency	6 535	
Government Printing Office	711	
NCOM	4 590	
International Project Management Unit	260	
Darwin Bus Service	417	
Territory Wildlife Park	542	
Darwin Port Authority	20	1 648
NT Housing Commission : Housing	(2 015)	
NT Housing Commission : Lending	(370)	8 592
TAB		
PAWA : Commercial Services	3 688	12 949
Total	**15 934**	**23 189**

Business Division Pricing

Consistent with the focus on efficient pricing methodologies, GBDs have generally adopted a two-part pricing structure based on a reasonable apportionment of their fixed and variable costs. This has required GBDs to undertake an analysis of their fixed and variable costs and then set their prices to match these costs. Where GBDs have been able to show that two-part pricing is not suitable to a particular good or service (for instance, because it is impractical to levy), they have adopted alternative approved pricing arrangements based on an understanding of their fixed and variable costs.

Because the concept of efficient pricing is new to many of the GBDs, the implementation of this aspect of the reform process has taken considerable effort over 1995-96. This has involved Treasury working with the GBDs to understand their cost structures and develop two-part prices where appropriate.

As noted above, the focus of the GBD reforms to date has been on ensuring full cost recovery, in order that the GBDs and the Government can fully understand the cost structures of their operations. As such, a critical feature of the regime is the need for independent review of GBD pricing. To this end, all GBD pricing methodologies have and will continue to be subject to appropriate review processes.

With respect to some GBDs (and particularly internal GBDs), there have been many services provided either below cost or free. The introduction of comprehensive charging has meant that the intrasector receipts for these GBDs will increase substantially over 1995-96. The budgeted increases for each of the GBDs as a result of comprehensive charging is shown in Figure 7.3.

Figure 7.3

ONCE-ONLY GBD REVENUE ADJUSTMENTS (1996-97)

	User Charges	CSOs / GSOs	Interest
	$000	$000	$000
NT Fleet	1 080	384	91
NT Construction Agency	6 297		210
Government Printing Office	600	111	
NCOM	31 672	97	70
International Project Management Unit	85		175
Darwin Bus Service	404		5
Territory Wildlife Park		2 574	
Darwin Port Authority		1 668	
NT Housing Commission : Housing		5 698	2 100
NT Housing Commission : Lending		7 722	500
TAB			
PAWA : Commercial Services		16 550	
Total	**40 138**	**34 804**	**3 151**

Community Service Obligations/Government Service Obligations

CSOs and GSOs arise where the Government requires a GBD to carry out activities relating to outputs or inputs which it would not elect to do on purely commercial terms.

As the name would suggest, Community Service Obligations are directed to ensuring that, in pursuing efficiency objectives, Business Divisions' dealings with the community are appropriately balanced by the Government's social and equity objectives. Consequently, most examples of CSOs involve a requirement for a Business Division to provide goods or services to the public at less than cost. Government Service Obligations, on the other hand, relate to the Government's internal requirements of GBDs as government owned enterprises.

The method of costing and funding these obligations is designed to allow the wider objectives of Government to be met while still retaining the commercial focus for the GBDs. To this end, the Business Divisions have had to identify all activities which they consider to be CSOs or GSOs and make a case for their separate funding. To qualify for funding, these have to meet the definition established by the Steering Committee for National Performance Monitoring.

Approved CSOs and GSOs are funded from the Budget with the level of funding agreed up-front. This approach prevents later cost-padding, and enables dynamic efficiency gains by creating an incentive for the GBD to seek to minimise the costs of providing the particular service. Figure 7.3 provides a break-up of each GBD's approved CSO and GSO funding for 1996-97.

Where a Business Division provides price concessions for particular services as a result of Government direction, the funding provided is based on their pricing policies. This approach has been adopted because it minimises the distinction between the Government directed activities and commercial activities, will generally reflect the avoidable cost associated with providing the services, and prevents GBDs using the activities to cross-subsidise other segments of their business.

The source of funding for CSOs and GSOs will in all cases come from a 'purchasing' agency which has policy responsibility for the particular activity in question. For instance, the Darwin Port Authority undertakes substantial marketing to attract cruise ships and part of this expenditure is generally agreed as a GSO. The funding for this activity has been provided to the Northern Territory Tourist Commission as 'purchaser' of the marketing.

In the limited number of cases where a CSO represents broader Government-wide interests rather than particular portfolio responsibilities, Treasury will be the responsible agency for providing funding.

These purchaser/provider arrangements aim to reinforce the discipline on GBDs to acquit CSOs and GSOs in an efficient manner, by enabling 'purchasing' agencies to provide policy input into the uses to which the funding is directed.

Management Structures and Processes

A key feature of the reforms to date has been the establishment, both internally and externally, of management structures and processes appropriate to commercial organisations.

As part of this process, most GBDs have moved to establish Management Advisory Boards comprising the GBD and, where appropriate, user, central agency, and private sector representation. In addition, GBDs have (or are in the process of) developing charters of operational objectives and strategies confirming the scope and standard of services to be supplied. These will be publicly available documents. As part of this business planning process, each GBD will establish a set of performance measures which are to be reported annually to Cabinet.

External to the GBDs, a set of financial performance measures has been established (based on the measures developed by the Steering Committee on National Performance Monitoring). These will also be reported annually. While at this stage there are no benchmarks attached to these measures, this is simply a reflection of the fact that there is no track record of performance to allow inter-temporal comparisons and also the need to further develop policies with respect to the rates of return required of GBDs.

GBDs are required under section 10(2) of the *Financial Management Act* to prepare financial statements based on commercial (accrual) accounting principles. All GBDs will produce accrual financial statements for the 1995-96 financial year.

In addition, most GBDs are in the process of adopting the deprival valuation methodology for the valuation of their non-current physical assets (with PAWA having already revalued its assets on this basis). Deprival valuation has been chosen because it seeks to value an asset based on the economic (rather than historic) cost employed by a GBD. This will facilitate more meaningful reporting of the resources employed by GBDs and thereby improve the quality of internal and external performance assessments (both for individual assets and the GBDs as a whole).

Budget Transfers

In implementing comprehensive charging for those GBD services provided to the rest of Government, it has been necessary to undertake a series of once-only reallocations within the Budget to provide agencies with the capacity to pay for the level of service which they previously received either free or at a price less than the true cost. These reallocations are included within this Budget and have resulted in an increase in expenditure on GBD services by the general government sector. These changes are summarised in Figure 7.3.

In determining the reallocations required, the fundamental criterion which has been observed is budget neutrality. (Over time, of course, the dynamic efficiency gains in GBD operations should in fact ensure that the reforms deliver a positive budget outcome.) Budget neutrality can be achieved because the cost of internal GBD services has always been met within government and, as such, the introduction of comprehensive user charging should not require the injection of new funds within the system, but should instead involve the reallocation of existing funds.

In the main, this simply required the removal of funding from the GBDs (who previously met the costs) and the transfer of these funds to the GBDs' customer agencies (in proportion with each agency's level of service).

However, Budget transfers have also been necessary to give effect to the CSO policies outlined above. For internal service providers, CSOs have in the past either been funded via cross-subsidisation or by direct transfer. The reallocations have therefore transferred these funds from the GBD to the 'purchasing' agency and as such are budget neutral. For external providers, CSOs have previously been funded through reduced rates of return. Consequently, direct funding of these CSOs will have no net budget effect as they will be offset by higher dividend and tax equivalent payments by the GBDs.

Issues for Future Consideration

While the implementation process has proceeded with some pace over 1995-96, there remain many conceptual policy issues which will require continued work over the coming year and future years). As noted above, these issues relate predominantly to instituting mechanisms to achieve dynamic efficiency in GBD operations. That these matters require further work is a reflection of the need to ensure that the right incentives are created to achieve the desired gains.

Tied Clients

In many cases, Government agencies are 'tied' to using GBDs for the supply of goods and services. At a conceptual level, if a good or service is truly market-based in nature, then there should be no impediment to the GBD operating in open competition with the private sector for the supply of the good or service to agencies. Where 'untying' of clients is possible, it offers distinct advantages to the reform process because of the efficiency incentives which open competition creates.

However, in the initial stages of the reform process it is inappropriate to attempt to open up internal GBD markets to private sector competition for the following reasons:

- many GBDs are in the early stages of commercial operations having previously operated under very different institutional arrangements. This requires a change not only in management focus but also requires a change to many of the operating systems for day to day management of the business. In this period of significant change, it is considered that open competition will not realise significant benefits and could in fact prove counter-productive. This is particularly the case for those GBDs whose services are at the margin of being commercial in nature;
- full cost recognition for GBDs is in the early stages of development and is likely to require refinement over time. Introducing competition without confidence in the rigour of the costing bases would run the risk that private sector competitors are not being assessed on a like basis, introducing an inherent bias in the competitive process; and
- at this stage, internal service providers do not have access to private sector markets. If GBD markets were open to private sector competition, without the reverse also occurring, they are likely to face ever dwindling markets with no outlets to channel excess capacity.

Despite these constraints, it is likely that some internal service providers will in future be subject to private sector competition. This should be the case since one of the predominant purposes of instituting a comprehensive costing framework for these activities is to allow a comparison of the costs of alternative forms of service delivery (that is, internal provision or contracting out).

However, it should be noted that a direct comparison of costs will not always provide a complete basis for deciding whether a particular service should be provided internally to Government via a GBD or through the private sector. This simply recognises that in many cases the services provided by GBDs have external whole of government benefits which are not incorporated in their prices. For instance, agencies may be able to source some of their information technology requirements at prices lower than NCOM's. However, these suppliers would not provide the benefits (for example, in terms of security and being able to aggregate information at a whole of government level) offered by NCOM's service.

Where there are external benefits associated with a GBD providing a particular service, this does not necessarily mean that the service should not be open to competition. This will depend on whether the external benefits from tying clients are greater than the extra benefits agencies could gain from using an outside provider. While this may result in clients remaining tied, the reform process enables this decision to be taken on a rigorous assessment of the relative merits of either approach and to be reviewed regularly as circumstances change.

It may also be necessary to consider whether the external benefits could be gained without tying clients to an internal service provider. This would be possible where these benefits could be internalised into the prices charged by outside competition. This could occur, for instance, where it was possible to include in the contract specifications for external providers, the provision of the ‘external’ benefits offered by the GBD.

One reason often advanced for retaining GBD ‘monopolies’ is that economies of scale can be realised through using a sole provider. However, this is generally not a sufficient argument for requiring agencies to be tied to GBDs. If GBDs are able to benefit from economies of scale, they should be able to attract clients through being able to offer lower prices (which result from the economies of scale) without requiring the protection of a regulated monopoly.

Finally, in looking at the contestability of GBD markets it is important to remember that the GBD process is dynamic. Through commercialising GBDs with protected markets, Government is able to gain a better understanding of the issues involved in introducing competition, with some GBDs being further exposed to competitive pressures and, as noted previously, some potentially being wound back into general government.

Returns on equity and GBDs’ equity/debt structure

Reflecting the complexities of the issues involved, the pricing methodologies for GBDs for the 1996-97 financial year do not require the inclusion of a component for a return on equity (or profit). Instead, this issue will be further considered over 1996-97 for incorporation into prices in future years.

The necessity to incorporate a return on equity into GBD prices reflects the fact that the Government has committed a certain amount of capital (aside from debt) into the GBDs which has an opportunity cost. Since, at the minimum, these funds could be used to retire debt, the base cost of equity which should be included in the GBDs’ prices should be the government’s long term cost of debt.

However, in the private sector the returns on debt and equity tend to be different, reflecting the different taxation consequences of each form of financing and their respective priorities in payment in the case of winding up. For government owned commercial enterprises, these regulatory influences are largely absent. All debt and equity is provided by government so bankruptcy priorities are irrelevant. For taxation, the government is both owner and tax assessor so there is no advantage in choosing a tax preferred capital structure.

In these circumstances the distinction between debt and equity becomes unclear and it could be argued that the returns required on debt and equity should be equal.

This approach is also supported by the fact that in practice GBDs have minimal control over the structure of their capital base. Charging differential rates of return for debt and equity would create incentives to prefer one form of financing over another, but without control over their capital structure, these incentives would have limited impact. Instead, certain GBDs would benefit through the historical accident of being established with a relatively cheaper capital structure.

Against these arguments, it is important to ensure that GBDs have no competitive advantage over private sector entities by virtue of their government ownership. However, as mentioned above, the relative costs of debt and equity in the private sector are largely driven by institutional factors which are absent for GBDs. Matching the costs of capital, without being able to match the determinants of those costs, would simply create a new set of distortions and not improve the level of competitive neutrality.

Regardless of whether uniform or differential costs of debt and equity are developed, the determination of the required rates of return should involve a consideration the riskiness of the investment, with riskier businesses requiring higher rates of return. While there are asset pricing models (such as CAPM) to determine appropriate risk adjusted rates of return, the size of most Territory GBDs mitigates against using such complex and costly formulations. Instead appropriate rates of return for GBDs should be set in light of the Government's cost of capital, and the average cost of capital for similar private sector firms.

Regulations applying to GBDs

Currently GBDs have to comply with certain legislation that does not apply to the private sector, for example, public sector conditions of employment, procurement regulations and Government budgeting and financial management policies.

While in some cases this legislation may impose additional costs to GBDs it has wider objectives, providing benefits to the Government or economy as a whole. It is therefore unlikely that GBDs will gain exemptions from the key features of the Government's administrative framework in the short term.

There are two possible approaches to this situation. Firstly, where a GBD can identify that non-uniform application of government legislation creates a very real competitive disadvantage a case can be made for CSO funding to cover this cost. Such an approach would provide true competitive neutrality and should be adopted where a GBD has actual private sector competition in public markets.

Alternatively, it could be argued that to the extent that the government's legislation creates differences in the cost of internal supply and private sector supply, these costs should be fully borne by the GBDs to facilitate meaningful comparison of alternative service delivery options. This approach should therefore be adopted where clients are internal to government.

It is also important to note that the nexus between the application of government legislation and the cost to a GBD is not always clear cut. For instance, although public sector conditions of employment alter the structure of the remuneration package that GBDs pay staff compared to potential private sector competitors, it is unclear whether, comparing skill levels, this makes the level of remuneration that GBDs pay substantially different from potential private sector competitors. Also, to the extent that there is cost substitution (for instance, lower remuneration costs replaced by higher staff turnover costs), there is potential that the assessment of cost is not done on a like basis.

As a final point, it is recognised that there are some legislative requirements of private sector firms which are not applicable to GBDs (for instance, the corporations law). While instances are minimal, the costs faced by the private sector in complying with such regulation should be taken into consideration when determining any net disadvantage to GBDs.

Rewards and sanctions

One problem common to all commercial organisations not directly managed by owners is the agency cost associated with the divergence of owners' objectives and the objectives of management. Whereas owners wish to maximise the value of their organisation, managers generally wish to maximise their personal wealth.

The traditional approach in the private sector to this problem is to link managerial wealth to the firm's wealth, for instance through performance bonuses linked to share value or profits.

One criticism levelled at commercialisation reforms is that because public sector conditions of employment prevent such performance based pay structures, there is limited incentive for managers to improve efficiency and productivity.

Given that it is unlikely that GBDs will be exempt from public sector conditions of employment in the short term, it is relevant to ask to what extent this diminishes the incentives for dynamic efficiency improvements in the Territory's GBD regime.

While it may be true that the absence of direct performance based remuneration reduces the efficiency incentive, there are nevertheless strong indirect links between financial performance and future remuneration. These indirect links, established through reputational effects (that is, the prospect of future promotions and/or alternative employment), are arguably as strong as direct incentives. The increasing use of contract positions (and the consequent loss of tenure) at the management levels of GBDs reinforces these incentives. Consequently, it is likely that the absence of performance linked remuneration is not of critical importance in the process of driving efficiency improvements in GBDs.

APPENDIX

POLICY ISSUES FOR GOVERNMENT BUSINESS DIVISIONS

Costs

Many costs are currently not borne by GBDs, for example, superannuation, workers compensation, professional indemnity, other insurances and capital costs. In order to promote the commercial position of GBDs and to provide a greater degree of competitive neutrality between GBDs and the private sector it is appropriate that these costs be recognised by GBDs and incorporated into their prices. Where a GBD is deemed not to be in competition with the private sector, prices will not necessarily need to reflect these costs, but will need to be reported in annual financial statements.

Pricing

GBDs will be required to implement a pricing regime based on an assessment of their fixed and variable costs (so called two part-pricing.) The advantage of this approach to pricing is that those consuming the goods and services produced by GBDs face prices which closely reflect the costs they impose on the GBD. Such a pricing approach ensures that consuming agencies take account of the cost of their consumption without being required to subsidise other users or over consuming services which at present are underpriced or free.

In this way, pricing places a discipline on both the supplying GBD and the consuming agency which should encourage efficiency in the supply of goods and services as well as in the use of those goods and services.

Two-part pricing has been utilised by numerous Government instrumentalities (for example, Telstra) and is not an uncommon basis for charging in the private sector (suppliers will often quote a basic fixed cost plus hourly rate).

A two-part pricing system is held to offer the greatest benefits for the Territory. However, it is also recognised that there may be instances where the benefits of adopting a two-part pricing system will not be sufficient to warrant its use. In these circumstances alternative approaches could be considered.

Community Service Obligations

Community Service Obligations (CSOs) are the means by which the Government, as owner of the GBDs, can require them to provide services which would not be provided if assessed on a purely commercial basis. In order to maintain the commercial focus of the GBDs, it is appropriate that CSOs be funded directly from the Budget. In this sense, the Government is both owner and customer of the GBD.

As owner of the GBD, the Government is entitled to pursue its broader policy objectives by exercising its rights of ownership and requiring the GBD to provide certain non-commercial services. As a customer of the GBD, the Government has a right to negotiate the best price it can for the performance of those services.

By negotiating a price for the provision of CSOs the Government can also ensure that the cost of providing these services is minimised and that the GBD has an incentive to perform these services in an efficient manner.

It is therefore proposed that Treasury negotiate, on behalf of the Government, the price to be funded directly from the Budget for any CSOs imposed on a GBD and report the outcome of these negotiations to Cabinet. In some cases other agencies would also be involved in these negotiations where the particular CSO was closely related to their policy responsibilities and funding may eventually pass through those other agencies (for example, Territory Health Services would be involved in negotiation of concessional transport fares and would continue to be the ultimate provider of funding).

Government Service Obligations

GBDs may also perform some functions which relate directly to their role within the Government. These would not include CSOs but reflect other responsibilities associated with their position within Government. For example, some GBDs may be required to undertake some regulatory responsibilities, to represent the Territory in certain forums or to provide advice to Government on areas in which they have recognised expertise. In addition, the Government has in certain instances determined as a matter of policy that some GBDs will provide central services to other areas of Government.

These cases should be treated in a similar manner to CSOs where the Government negotiates a price for the provision of these services and funds this cost directly from the Budget.

Assets

Most, if not all, GBDs will have under their control a range of depreciable assets. These assets will either be consumed in the process of supplying goods and services or be surplus to requirements. To the extent that they are consumed, this cost should be recognised within the costs of the GBD. To the extent that they are surplus to requirements, they represent a non-productive investment which could be better utilised elsewhere.

In order to arrive at a cost for these assets, it is necessary that GBDs maintain an appropriate asset register. The valuation of assets on that register should be in accordance with the deprival value method of asset valuation as recommended by the Steering Committee on National Performance Monitoring of Government Trading Enterprises.

Dividends/Return on Equity

As with all owners of commercial endeavours, the Government is entitled to receive a dividend or return on its equity investment. As a *quid pro quo*, it is appropriate that GBDs be released from any requirement to meet the Budget efficiency dividend or be subject to other budgetary restraint measures which might be introduced.

Performance Monitoring

Integral to the increased commercialisation of GBDs is some form of performance monitoring. A national system of performance monitoring has been instituted for most major government trading enterprises. In the Territory, PAWA and the Darwin Port Authority participate in that process. The purpose of performance monitoring is to provide owner governments and the community with some measure of the relative performance of government trading enterprises. This may reflect performance over time of an individual organisation, performance relative to other organisations in the same activity or performance relative to best practice. It would be appropriate that similar arrangements were put in place to cover GBDs. It is therefore recommended that a system of performance measures be developed to provide meaningful measures of financial and non-financial performance.

Taxation Equivalent Regime

The Northern Territory, along with other State and Territory Governments, has entered into an agreement with the Commonwealth, whereby the Commonwealth has agreed to exempt Territory Government entities from Commonwealth income tax and wholesale sales tax. In return, the Territory has committed itself to introducing a taxation equivalent regime to apply to its trading enterprises.

Once this regime is established, consideration should be given to applying tax equivalents to a wider range of GBDs. Where similar goods or service could be sourced from the private sector, this would enhance the degree of competitive neutrality between GBDs and the private sector in competing for available business.

CHAPTER 8

COMPETITION POLICY AND COMPETITIVE NEUTRALITY

At the April 1995 Council of Australian Governments meeting, the Northern Territory, the States and the Commonwealth signed a series of agreements to implement a National Competition Policy. Under these agreements the Territory, like the other jurisdictions, has committed to implement a series of reforms designed to improve the level of competition in a wide range of sectors in the economy.

This Chapter describes the key reforms to which the Territory has committed and the progress the Territory has made in implementing these reforms.

A key element of the requirements under the agreements is the publication of a Policy Statement on Competitive Neutrality. The Territory's statement is attached to this Chapter. Competitive neutrality, like much of the National Competition Policy, is concerned with putting in place measures which promote competition generally, but with the particular objective of facilitating competition between public enterprises and the private sector on an equal basis.

Under the National Competition Policy agreements, the receipt of certain Commonwealth Government funding by the States and Territories is dependent upon the jurisdictions implementing the measures contained in the agreements by set target dates. The Chapter concludes that the Territory's progress to date should ensure that it participates in the first tranche of Commonwealth payments due in 1996-97.

Introduction

In April 1995 the Commonwealth, State and Territory Governments agreed to a National Competition Policy (NCP). The Policy is embodied in three agreements signed by Heads of Government at the April 1995 Council of Australian Governments meeting: the Competition Principles Agreement (CPA); the Conduct Code Agreement; and the Agreement to Implement the National Competition Policy and Related Reforms.

The broad purpose of NCP is to remove a range of institutional impediments which inhibit competition within sections of the Australian economy. These changes recognise that in a market based economy, it is competition as much as any factor which will create productivity and efficiency gains.

In recognition of the fact that the task of the States and Territories in implementing the NCP reforms results in a significant revenue benefit to the Commonwealth, the NCP agreements provide for payment of 'competition dividends' by the Commonwealth, conditional upon effective implementation of the States' and Territories' commitments. These dividends are payable in tranches, with the first tranche (due in 1997-98) worth approximately $2 million to the Territory.

This Chapter provides an overview of the Territory Government's commitments under each of the NCP agreements and describes the progress which has been made toward implementing these commitments and qualifying for the first tranche of payments.

Competitive Neutrality Statement

Clause 3 of the CPA sets out a number of principles to be adopted by parties in the development and implementation of a competitive neutrality policy. The concept of competitive neutrality is that governments' business activities should not enjoy any net competitive advantage or disadvantage as a result of their ownership. The objective of such a policy is to facilitate competition between public and the private sector businesses on a like with like basis.

There are now many industries where government owned enterprises operate in direct and indirect competition with private sector entities. In these circumstances, the competitive neutrality reforms are designed to ensure that this competition occurs on a level playing field.

A related outcome is that the commercial management and operating systems, which governments institute within their business enterprises in implementing competitive neutrality policies, can in themselves lead to productivity and efficiency improvements in the business activities.

The principal response of the Territory to its competitive neutrality commitments has been through the establishment of Government Business Divisions and associated reforms described in the previous Chapter. To qualify for the first tranche of competition dividend payments under the CPA, the Territory is (among other things) required to publish a policy statement on competitive neutrality. The Territory's statement is provided as an Appendix to this Chapter.

Legislation Review

Clause 5 of the CPA requires that each party review, and where appropriate, reform all existing legislation (including Acts, Ordinances and Regulations) that affect competition.

The nature of governments' licensing and regulatory functions means that it is quite common for legislation to restrict competition. It should be noted that the CPA does not require that all competitive restrictions be removed. Rather, in conducting a review, the guiding principles to be followed are that legislation should not restrict competition unless it can be shown that:

- the benefits to the community of the restriction outweighs the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

In order to qualify for the first tranche of competition dividends, the Territory was required to develop by 30 June 1996 a timetable for the review of all legislation by the year 2000. The Territory review timetable was developed in consultation with all agencies and, while quite extensive, it is anticipated that the level of legislative amendment required will not be large.

In conducting reviews it is proposed that primary carriage of the review will rest with the agency which has responsibility for the relevant legislation. Where necessary, expert advice will be provided by Treasury and the Attorney-General's Department.

Apart from existing legislation, the CPA also contains a requirement that any new legislation or amendments be consistent with the principles set out for the review of existing legislation. As of 30 June 1996, administrative arrangements have been introduced in the Territory to ensure that all new legislative proposals address this requirement.

Competition Policy Reform (NT) Act

The main feature of the Conduct Code Agreement is the requirement of States and Territories to legislate to provide for an extended application of the pro-competitive provisions of the *Trade Practices Act* (TPA). In broad terms this will result in Part IV of the TPA applying to the activities of government and unincorporated businesses. Until now such entities were generally immune from the operation of the TPA because of constitutional limitations on the Commonwealth's legislative powers.

With the passing of the *Competition Policy Reform (NT) Act* earlier this year, the Territory has now satisfied this requirement. Passage of the legislation had limited significance in the Territory, since unincorporated businesses in the Territory have always been subject to the provisions of the TPA (due to the Commonwealth's special legislative powers with respect to the Territory). However, as a result of the legislation, the activities of the Territory Government (which was previously not subject to the provisions of the TPA) will now be subject to the competitive disciplines of Part IV of the TPA.

Other Features of NCP

The above developments represent the major Territory initiatives with respect to NCP over 1995-96. However, the agreements cover a far broader range of matters which have not required significant action in the Territory since their signing in April 1995. The more important of these issues are described below.

Access to Significant Infrastructure Facilities

Clause 6 of the CPA provides for States and Territories developing effective access regimes for significant infrastructure facilities. Access regimes are a form of regulation intended to ensure third party access (on commercial terms) to assets with natural monopoly aspects. The regimes allow owners of monopoly assets the right to earn appropriate rates of return on their assets but prevent those owners from excluding third party access for the purpose of limiting competition in downstream or upstream markets.

While the Territory is able to develop its own access regimes, with the exception of a specific access regime for gas pipelines, no generic access regime will be developed in the Territory at the present time. This decision reflects the view that:

- there are limited target assets in the Territory which would warrant the expense of developing the regulatory regime; and

- in any event, where a Territory regime does not apply, the Commonwealth regime contained in Part IIIA of the TPA will apply to assets in the Territory which are considered to be of national significance.

The only exception to this is with respect to gas pipelines, where the Territory is in the process of developing an access regime consistent with the Council of Australian Governments' agreements on the free and fair trade in gas.

Structural Reform of Public Monopolies

Clause 4 of the CPA sets out a number of guiding principles for situations where Parties introduce competition in an industry traditionally served by a public sector monopoly. The guidelines do not of themselves require any reforms to be undertaken.

The only significant public monopoly in the Territory is the Power and Water Authority. While there is significant private participation in aspects of the electricity supply industry, the level of infrastructure development at present mitigates against the extent to which further tangible benefits from open competition in this sector can be achieved. However, this situation will be reviewed on an ongoing basis.

Application of the Principles to Local Government

A key feature of the CPA is the requirement that States and Territories ensure that the principles contained within the agreement are applied to local government activities within their respective jurisdictions. To this end the Territory has, in conjunction with the Northern Territory Local Government Association, developed a policy statement on the application of the CPA to local government. However, given the limited scope of activities undertaken by local government in the Territory, this policy is unlikely to lead to significant change.

Prices Oversight of Government Business Enterprises

Where a party chooses to establish an independent prices oversight body for its business activities, Clause 2 of the CPA sets out a number of characteristics which such a body should possess. However, the agreement does not require parties to develop an independent pricing body. It is not proposed to establish such a body in the Territory at this time because the number, size and scope of Territory government business activities is not large enough to warrant the cost of such a body. Instead, independent prices oversight will be performed by Treasury.

APPENDIX

NORTHERN TERRITORY STATEMENT ON COMPETITIVE NEUTRALITY

Introduction

The Northern Territory is a party to the agreements on National Competition Policy signed by all State, Territory and Commonwealth Heads of Government on 11 April 1995. These agreements set out a uniform approach to competition reform in Australia.

One aspect of competition reform is the development by each party of a competitive neutrality policy, a requirement which is set out in the Competition Principles Agreement (CPA). The overriding objective of competitive neutrality, as explained in the CPA, is "the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: government businesses should not enjoy any net competitive advantage simply as a result of public sector ownership."

Each party to the National Competition Policy agreements is required to publish a policy statement on competitive neutrality, including an implementation timetable and a complaints mechanism.

This document is the Northern Territory's policy statement on competitive neutrality.

Subject Entities

Competitive neutrality policy is to be applied to:

(a) government business enterprises - those enterprises classified as Public Trading Enterprises and Public Financial Enterprises under the Government Finance Statistics (GFS) classification. For these entities, subclause 3(4) of the CPA applies; and

(b) significant business activities undertaken by agencies as part of a broader range of functions. For these entities, subclause 3(5) of the CPA applies.

In April 1995, a new *Financial Management Act* was enacted which established a category of activities called Government Business Divisions (GBDs). A GBD is defined under section 3 of that Act as "an Activity or group of Activities a significant proportion of the operating costs of which is recovered through charges on users and which is determined by the Treasurer to be a Government

Business Division."

All Government business enterprises (except for the Territory Insurance Office) and significant business activities have been designated as Government Business Divisions (GBDs) under the *Financial Management Act*. A complete list of Government business enterprises and significant business activities in the Territory is provided below:

- Territory Insurance Office (TIO);
- TAB;
- Northern Territory Housing Commission : Housing;
- Northern Territory Housing Commission : Lending;
- Darwin Bus Service;
- Darwin Port Authority;
- Power and Water Authority : Commercial Services;
- International Project Management Unit;
- Territory Wildlife Park;
- NCOM;
- NT Fleet;
- Northern Territory Construction Agency;
- Government Printing Office.

The GBD classification encompasses not only those Activities which supply goods and services to external clients, but also Activities which supply the Northern Territory Government exclusively. Of the above entities, NCOM, NT Fleet, Northern Territory Construction Agency and Government Printing Office only provide goods and services to clients internal to Government.

While the CPA does not require that competitive neutrality policies be applied to purely internal service providers, the approach of the Territory is to introduce guidelines and principles of operation for all GBDs which incorporate the fundamental principles of competitive neutrality as set out in the CPA.

The means by which the guidelines and principles for the operation of GBDs, and other policies of the Territory Government, meet the competitive neutrality requirements of the CPA are described below.

Corporatisation

Subclause 3(4)(a) of the CPA states that, where appropriate, parties will adopt a corporatisation model for Government business enterprises. The approach of the Territory is to corporatise (as distinct from privatise) only the larger Government business enterprises, that is, the Territory Insurance Office, the Power and Water Authority (PAWA) and the Darwin Port Authority.

Each of the corporatised Government business enterprises mentioned above has a separate legal entity achieved via legislation, and each will comply fully with the commercialisation policies detailed in the next section. The Darwin Port Authority, the Territory Insurance Office and the Power and Water Authority are separate entities established under their own Acts of Parliament. The Power and Water Authority includes Power and Water Authority: Commercial Services, the GBD. The other activities of PAWA are non-commercial in nature and are funded to PAWA as Community Service Obligations (CSOs). The Housing Commission is a separate legal entity created under the *Housing Act*, with the activities of the Housing Commission comprised by the two GBDs.

The Territory Government has adopted a course of commercialisation rather than corporatisation for other Government business enterprises because of their small size. This is in accordance with subclause 3(6) of the CPA, which provides that the competitive neutrality principles are only required to be implemented to the extent that the benefits from implementation outweigh the costs. The main features of the Territory's commercialisation policies are described in the next section.

The CPA does not require that significant business activities be corporatised. Rather, paragraph 3(5)(b) of the CPA only requires that these activities are subject to government regulations on an equivalent basis to the private sector, and the prices charged for the goods and services provided recognise full cost attribution. The appropriateness of corporatising other GBDs will be considered on a case by case basis.

General Commercialisation Principles

The Territory's commercialisation policies will be implemented during 1996-97 and are described below.

Government Business Divisions

- GBD prices will reflect the cost of resources used. The prices will be subject to independent review by Treasury and be approved by Cabinet.

- GBDs will pay the cost of resources used including employee costs (superannuation, workers compensation and leave entitlements), property rental, insurance, and legal and auditing costs.
- The Northern Territory Treasury Corporation will charge debt costs, including debt guarantee fees (discussed below) and will pay GBDs commercial rates of interest on cash balances held.
- GBDs will, in principle, be required to earn a return on equity. The return required of each GBD will take into account the level of (potential or actual) competition in the market(s) which the GBD serves, and any CSOs which impose constraints on the pricing policies of the GBD. Where, because of a CSO, a GBD is unable to recover the full cost of services provided from users, this CSO may be funded (in whole or in part) through a reduction in the rate of return otherwise required.
- GBDs will be required to identify and cost all CSOs. The definition of CSO utilised in the Territory accords to the definition developed by the Steering Committee on National Performance Monitoring. Approved CSOs will be funded from the Budget or, as mentioned above, through a reduction in the rate of return otherwise required.
- GBDs will adopt commercial accounting practices including accrual accounting, and deprival valuation for non-current physical assets.
- GBDs will report annually on performance to Cabinet via a core set of performance measures. The financial performance measures which are required accord with those developed by the Steering Committee on National Performance Monitoring, supplemented where necessary by specific performance measures reflecting the differing responsibilities of individual GBDs.
- Each GBD is to establish an Audit Committee.
- GBDs will be required to have a formally approved and published charter of operational objectives and strategies stating the scope and standards of service to be supplied.
- Currently, the Power and Water Authority and the Darwin Port Authority have management advisory councils which include independent members. Where appropriate, other GBDs will establish management advisory boards.
- GBDs will comply with a tax equivalent regime (discussed below).

Territory Insurance Office

TIO has not been established as a GBD because it already operates on a fully corporatised basis. It is a separate legal identity, has an independent board of directors, recovers full costs, pays dividends to the Government, pays tax equivalents for income tax and wholesale sales tax, pays all Territory taxes and is subject to a regime of prudential supervision.

Taxation Equivalents, Debt Guarantee Fees, Government Regulation

The CPA requires that Government business enterprises and, where appropriate, significant business activities be subject to:

(a) full Commonwealth and Territory taxes or tax equivalents (sub paragraph 3(4)(b)(i));

(b) debt guarantee fees (sub paragraph 3(4)(b)(ii)); and

(c) government regulations on an equivalent basis to the private sector (sub paragraph 3(4)(b)(iii)).

Tax Equivalents

For income taxation, PAWA : Commercial Services, Darwin Port Authority and TIO will, from 1 July 1996, be subject to tax equivalents applied on the basis of the substantive provisions of the *Income Tax Assessment Act*. All other GBDs will pay tax equivalents of 36 per cent of accounting profits, as the compliance costs associated with a full tax equivalent regime are considered to exceed the benefits of greater accuracy of taxation payments.

For wholesale sales tax, PAWA : Commercial Services, Darwin Port Authority, and TIO will pay tax equivalents based on an average rate model. The TAB is currently subject to Commonwealth wholesale sales tax and will remain so. Other GBDs will only be subject to tax equivalents where they would not otherwise be exempt. For those GBDs which exclusively supply services to the public sector, no wholesale sales tax equivalents will be levied as equivalent private sector suppliers to Government would also be exempt.

GBDs and the TIO are subject to all Territory taxes, with the exception of Financial Institutions Duty (FID) and stamp duty (which are only charged to TIO). As GBDs operate within the Government's general banking arrangements, there are administrative difficulties in determining the charge for FID to allocate to each Activity. Additionally, there are very few transactions entered into by GBDs which would attract stamp duty. Since for both taxes, the potential charges are small in nature, the benefits from charging (in terms of correct attribution of cost) are not outweighed by the administrative cost.

Debt Guarantee Fees

All GBDs will be required to pay debt guarantee and administration fees on all debt provided by Northern Territory Treasury Corporation.

The TIO receives the benefit of a Government guarantee for deposit holders and insurance policy holders, but does not currently pay for this facility. The guarantee is legislative and will be reviewed as part of the general review of legislation required by clause 5 of the CPA.

Equivalent Application of Government Regulation

The general approach of the Territory is to minimise regulatory distortions on the behaviour of Government businesses. This has two components. Firstly, Government businesses are required to meet all regulations to which the private sector is subject (with the exception of the Corporations Law). While the Territory has not undertaken a specific review with respect to the application of regulation to Government businesses, instances of exemptions (excluding the Corporations Law) are minimal . The review of legislation and regulations required under clause 5 of the CPA will be used to identify any remaining regulations which exempt Government businesses.

Secondly, it is generally intended that Government businesses only have to comply with regulations that the private sector complies with. However, there is legislation and regulations which apply across the Northern Territory public sector (such as public service conditions of employment) where it is currently not considered appropriate to exempt Government businesses. Where a GBD can identify regulations to which the private sector is not subject, a case can be made for offsetting CSO funding.

Implementation Timetable

The Northern Territory's commercialisation policies, guidelines and procedures will be implemented by 1 July 1997. These will be assessed and refined on an ongoing basis as the size and number of the organisations which are subject to competitive neutrality increases.

Complaints Mechanism

Given the small size of the Northern Territory economy and the limited number of Government business activities involved, the costs of setting up and staffing a separate body to handle complaints are considered to be greater than any additional benefits that would ensue. Consequently, Northern Territory Treasury will be the body dealing with complaints regarding competitive neutrality.

Complaints can be made by parties that claim to have suffered a direct and material disadvantage due to Territory Government business enterprises or activities having a net competitive advantage arising from their public sector ownership. All complaints should be addressed to the Under Treasurer, GPO Box 1974, Darwin NT 0801.

CHAPTER 9

ALTERNATIVE BUDGET PRESENTATIONS

In preparing Budget material, Treasury attempts to identify and serve the needs of multiple users, including those of the Legislative Assembly, the Northern Territory Government, individual Government agencies, the media and the general public.

No single budget presentation can serve all these needs. A variety of different budget presentations, based essentially on the same body of budget data, is therefore necessary.

This Chapter presents an alternative view of the conventional budget information in accordance with national statistical standards and frameworks.

Since 1988-89, the Northern Territory Budget Papers have presented budget information in a form consistent with the system of Government Finance Statistics promulgated by the Australian Bureau of Statistics (ABS). A decision made at the Premiers' Conference in May 1991 has resulted in this process being accelerated Australia-wide.

The 1996-97 Budget estimates are presented in this Appendix (along with 1995-96 Actuals) in accordance with the national standards to produce:

- *the Economic Transactions Framework;*
- *the Government Purpose Classification; and*
- *dissection of taxes, fees and fines.*

These classifications are explained in more detail in the ABS Classifications Manual for Government Finance Statistics, Australia (Cat. No. 1217.0).

Conventional Budget Summary

Figure 9.1 presents the conventional Budget summary according to outlays by category of cost, receipts by source and use of public account balances.

Figure 9.1

BUDGET

NORTHERN TERRITORY PUBLIC SECTOR

GROSS OUTLAYS AND RECEIPTS

	1995-96 Actual	1996-97 Budget
	$M	$M
OUTLAYS FROM PUBLIC ACCOUNT	**2 372**	**2 669**
Agency Operating Accounts	1 853	2 039
Business Division Operating Accounts	519	630
OUTLAYS BY CATEGORY OF COST	**2 372**	**2 669**
Personnel Costs	752	773
Operational Costs	729	806
Capital Expenditure	201	276
Grants and Subsidies	298	385
Interest	271	273
Advances	121	148
Advances to the Treasurer		8
RECEIPTS INTO PUBLIC ACCOUNT	***2 482***	***2 651***
Consolidated Revenue Account	*1 285*	*1 357*
Agency Operating Accounts	*705*	*670*
Business Division Operating Accounts	*492*	*624*
RECEIPTS BY SOURCE	***2 482***	***2 651***
Taxes, Fees and Fines	*271*	*296*
Charges	*435*	*498*
Miscellaneous Receipts	*43*	*41*
Sale of Land	*17*	*13*
Capital Receipts	*40*	*54*
Property Income	*31*	*41*
Interest Received	*54*	*51*
Advances Received	*40*	*34*
General Purpose Commonwealth Grants	*914*	*931*
Other Commonwealth Grants	*314*	*310*
Territory Borrowing	*95*	*67*
Intrasector Receipts	*228*	*315*
USE OF PUBLIC ACCOUNT BALANCES	**-110**	**18**
Consolidated Revenue Account	-33	-15
Agency Operating Accounts	-50	26
Business Division Operating Accounts	-27	7

Whilst the Budget information presented in this way is necessary for resource allocation decision making, it is not in a form which allows either an assessment of the impact of the Territory's budgetary and financial strategies upon the economy, or a valid comparison with the States.

Economic Transactions

Figure 9.2 provides the 1995-96 Northern Territory public sector Budget outcome and the 1996-97 Budget estimates in an Economic Transactions format.

Figure 9.2

BUDGET
NORTHERN TERRITORY PUBLIC SECTOR
ECONOMIC TRANSACTIONS

	1995-96 Actual	1996-97 Budget
	$M	$M
CURRENT EXPENDITURE	**1 400**	**1 465**
Final Consumption Expenditure	989	1 048
Current Grants and Subsidies	206	212
Interest Paid	205	205
CAPITAL EXPENDITURE	**185**	**264**
New Fixed Assets	187	251
Capital Grants	38	46
Other Net Expenditure	-40	-33
less		
TERRITORY REVENUE	***410***	***457***
Taxes, Fees and Fines	*271*	*296*
Property Income	*31*	*41*
Interest Received	*54*	*51*
Unsubsidised Surplus of Business Divisions	*54*	*69*
COMMONWEALTH GRANTS	***1 228***	***1 241***
General Purpose Grants	*914*	*931*
Other Grants	*314*	*310*
equals		
INCREASE IN TERRITORY DEBT	**32**	**4**
Territory Borrowing	95	65
Commonwealth Advances	-63	-61
DECREASE IN FINANCIAL ASSETS	**-85**	**27**
Net Territory Advances Repaid	25	7
Use of Balances	-110	20

The main adjustments made to move to this Economic Transactions presentation of the Budget are:

- expenditures are dissected into current and capital;
- transfers within the public sector are removed from both expenditure and receipts;
- charges and recoveries and asset sales are netted against expenditures so that only the net impact on the Budget is shown; and
- borrowings and net advances are treated as financial transactions.

Figure 9.2 differs in several respects from the standard Government Finance Statistics (GFS) format:

- Northern Territory Housing Commission : Lending is included in the Budget as a business division, whereas in the GFS format it is excluded on the grounds that it is a public financial enterprise;
- all business divisions are treated as trading enterprises in the Budget, whereas in the GFS format business divisions that are trading in the market place such as Power and Water Authority are treated as public trading enterprises and others such as NCOM and NT Fleet that trade within Government are treated as general government;
- the distribution of funds from TAB is treated as an intrasector transaction, whilst it is currently treated by the ABS as operational expenditure by a public enterprise and an indirect tax received by general agencies;
- whilst the coverage of government entities in the Northern Territory Budget has been expanded to cover the bulk of the public sector, the GFS also covers the Conditions of Service Trust, the Ayers Rock Resort Corporation, the Ayers Rock Resort Company Limited and the Grain Marketing Board. Extension of scope in this way also converts some Budget transactions into intrasector transactions;
- the Budget is on a cash basis, whereas the public trading enterprises are included in the GFS on an accruals basis and thus include provisions such as depreciation; and
- payments for corporate services between business divisions and general agencies are treated as intrasector receipts and payments, whilst the ABS treats these receipts and payments as final consumption expenditure or surplus for those business divisions classified as public trading enterprises.

A reconciliation between the Budget Economic Transactions format and that of the GFS is provided at Figures 9.3 and Figure 9.4. The estimates in GFS format are presented in Figure 9.5. It should be emphasised that this represents a change in form rather than content, dictated by the somewhat different analytical and presentational purposes of the Northern Territory Budget process.

Figure 9.3

NON BUDGET GFS
GENERAL AGENCIES GFS ADJUSTMENTS
ECONOMIC TRANSACTIONS

	1995-96 Actual	1996-97 Estimate
	$M	$M
CURRENT EXPENDITURE	**-8**	**-10**
Final Consumption Expenditure	17	-10
Current Grants and Subsidies	-25	
CAPITAL EXPENDITURE	**7**	**11**
New Fixed Assets	20	24
Other Net Expenditure	-13	-13
less		
TERRITORY REVENUE	***19***	***15***
Taxes, Fees and Fines	*7*	*7*
Property Income	*-4*	*-4*
Interest Received	*16*	*12*
equals		
INCREASE IN TERRITORY DEBT	**-1**	**-1**
Territory Borrowings General Government	-1	-1
OTHER TRANSACTIONS	**-19**	**-13**
Net Territory Advances Repaid		1
Use of Balances	-5	-8
Net Intrasector Interest and Advances		
Other Net Intrasector Receipts	-14	-6

Figure 9.4

NON BUDGET GFS
BUSINESS DIVISIONS GFS ADJUSTMENTS
ECONOMIC TRANSACTIONS

	1995-96 Actual	1996-97 Estimate
	$M	$M
CURRENT EXPENDITURE	**-17**	**-41**
Operating Expenditure	-1	-24
Current Grants and Subsidies		-1
Interest Paid	-16	-16
CAPITAL EXPENDITURE	**-4**	**-27**
New Fixed Assets	-17	-20
Other Net Expenditure	13	-7
less		
TERRITORY REVENUE	***-56***	***-70***
Operating Revenue	*-16*	*-55*
Interest Received	*-15*	*-15*
Capital Grants from General Government		
Operating Subsidy	*-25*	
equals		
INCREASE IN TERRITORY DEBT	**1**	**-2**
Territory Borrowings	1	-2
OTHER TRANSACTIONS	**34**	**4**
Net Territory Advances Repaid	-23	-14
Use of Balances	10	-19
Net Intrasector Interest and Advances		
Other Net Intrasector Receipts	14	3
Use of Provisions	33	34

Figure 9.5

GOVERNMENT FINANCE STATISTICS *NORTHERN TERRITORY GOVERNMENT* ECONOMIC TRANSACTIONS		
	1995-96 Actual	1996-97 Estimate
	$M	$M
CURRENT EXPENDITURE	**1 418**	**1 454**
Final Consumption Expenditure	1 007	1 037
Current Grants and Subsidies	206	212
Interest Paid	205	205
CAPITAL EXPENDITURE	**188**	**247**
New Fixed Assets	190	255
Capital Grants	38	45
Other Net Expenditure	-40	-53
less		
TERRITORY REVENUE	***415***	***443***
Taxes, Fees and Fines	*278*	*303*
Property Income	*28*	*37*
Interest Received	*71*	*65*
Subsidised Surplus of Trading Enterprises	*38*	*38*
COMMONWEALTH GRANTS	***1 228***	***1 241***
General Purpose Grants	*914*	*931*
Other Grants	*314*	*310*
equals		
INCREASE IN TERRITORY DEBT	**32**	**1**
Territory Borrowing	95	62
Commonwealth Advances	-63	-61
DECREASE IN FINANCIAL ASSETS	**-102**	**-18**
Net Territory Advances Repaid	3	-7
Use of Balances	-105	-11
USE OF PROVISIONS	**33**	**34**

Figure 9.6 and 9.7 present the total public sector Economic Transactions estimates, already shown in Figure 9.5, disaggregrated into the general

government and public enterprise components respectively.

Figure 9.6

GOVERNMENT FINANCE STATISTICS
GENERAL GOVERNMENT
ECONOMIC TRANSACTIONS

	1995-96 Actual	1996-97 Estimate
	$M	$M
CURRENT EXPENDITURE	**1 422**	**1 452**
Final Consumption Expenditure	1 007	1 037
Current Grants and Subsidies	210	210
Interest Paid	205	205
CAPITAL EXPENDITURE	**183**	**213**
New Fixed Assets	153	195
Capital Grants	61	45
Other Net Expenditure	-31	-27
less		
TERRITORY REVENUE	***419***	***447***
Taxes Fees and Fines	*278*	*302*
Property Income	*28*	*37*
Interest Received	*113*	*108*
COMMONWEALTH GRANTS	***1 228***	***1 241***
General Purpose Grants	*914*	*931*
Other Grants	*314*	*310*
equals		
INCREASE IN TERRITORY DEBT	**40**	**-12**
Territory Borrowing for General Government	103	49
Commonwealth Advances	-63	-61
OTHER TRANSACTIONS	**-82**	**-11**
Net Territory Advances Repaid	3	-1
Use of Balances	-88	3
Net Intrasector Interest and Advances Other Net Intrasector Receipts	3	-13

Figure 9.7

GOVERNMENT FINANCE STATISTICS *PUBLIC TRADING ENTERPRISES* ECONOMIC TRANSACTIONS	1995-96 Actual $M	1996-97 Estimate $M
CURRENT EXPENDITURE	**379**	**400**
Operating Expenditure	331	350
Current Grants and Subsidies	1	1
Interest Paid	47	49
CAPITAL EXPENDITURE	**28**	**34**
New Fixed Assets	37	60
Other Net Expenditure	-9	-26
less		
TERRITORY REVENUE	***402***	***394***
Operating Revenue	*369*	*388*
Capital Grants from General Government	*4*	*6*
Operating Subsidies	*5*	
Capital Subsidies	*24*	
equals		
INCREASE IN TERRITORY DEBT	**-8**	**13**
Territory Borrowing for Business Divisions	-8	13
OTHER TRANSACTIONS	**13**	**27**
Net Territory Advances Repaid		-6
Use of Balances	-17	-12
Use of Provisions	33	34
Net Intrasector Interest and Advances		
Other Net Intrasector Receipts	-3	11

Taxes, Fees and Fines

Figure 9.8 presents a further dissection of the transactions classified as taxes, fees and fines according to type.

Figure 9.8

GOVERNMENT FINANCE STATISTICS
NORTHERN TERRITORY GOVERNMENT
TAXES, FEES AND FINES COLLECTED

	1995-96 Actual	1996-97 Estimate
	$M	$M
TOTAL TAXES, FEES AND FINES	**278**	**303**
TAXES ON EMPLOYERS' PAYROLL AND LABOUR FORCE TAXES	**68**	**71**
TAXES ON PROPERTY	**49**	**54**
Stamp duties on financial and capital transactions	31	35
Financial institutions' transactions taxes	18	19
TAXES ON THE PROVISION OF GOODS AND SERVICES	**36**	**45**
Taxes on gambling	30	38
Taxes on insurance	6	7
TAXES ON USE OF GOODS AND PERFORMANCE OF ACTIVITIES	**105**	**128**
Motor vehicle taxes	12	33
Franchise taxes	87	88
Other	6	7
FEES	**18**	**3**
FINES	**2**	**2**

Reconciliation to Australian Bureau of Statistics (ABS) Format

In order to present in the current ABS format, the following variations are needed:

- capital advances are included in Net Advances Repaid as financing transactions by the Territory whilst the ABS includes these advances within Other Capital Outlays;
- grants paid by the Department of Education to school councils are treated as grants by the Territory, however, ABS classifies these payments as final consumption expenditure; and
- the capital grants classification is used by the ABS for local government grants only, whereas the Territory includes all capital grants.

A reconciliation between the Territory's GFS and the ABS format is provided at Figure 9.9.

Figure 9.9

Reconciliation Adjustments to Move From Table 9.5 to the ABS Presentation in Catalogue 5501.0

	1995-96 Actual	1996-97 Estimate
	$M	$M
CAPITAL ADVANCES (net)	**-3**	**7**
Omit from / Add to Capital Expenditure "Advances Paid (net)"	-3	7
Omit from / Add to "Net Territory Advances Repaid"		
CURRENT GRANTS TO STATE SCHOOLS	**29**	**39**
Add to "Final Consumption Expenditure"	29	39
Omit from "Current Grants and Subsidies"		
LOCAL GOVERNMENT GRANTS	**31**	**48**
Add to "Capital Grants"	31	48
Omit from "Other Capital Outlays"		

Budget Presentation of Expenditure by Government Purpose Classification

The Economic Transactions Framework presentation does not indicate the economic or social purpose for which government expenditure is undertaken, particularly when making comparisons over time and between governments. Administrative arrangements can and do change over time, and comparison between jurisdictions is difficult at this level, because each has its own administrative and hence budget framework.

The ABS standard classification by 'government purpose' overcomes this drawback.

Figure 9.10 provides a summary of Northern Territory Budget expenditure by Government Purpose Classification. The allocation to functions is consistent with ABS methodology.

The estimates in Figure 9.10 have been compiled by allocating Activities and, where appropriate, Programs within those Activities, to the ABS purpose classifications and economic transactions.

Figure 9.10

GOVERNMENT FINANCE STATISTICS
NORTHERN TERRITORY GOVERNMENT
EXPENDITURE BY GOVERNMENT PURPOSE CLASSIFICATION

	1995-96 Actual	1996-97 Estimate
	$M	$M
TOTAL OUTLAYS	**1 606**	**1 701**
CURRENT EXPENDITURE	**1 418**	**1 454**
General Public Services	163	154
Public Order and Safety	139	144
Education	316	330
Health	313	320
Social Security and Welfare	1	1
Housing and Community Amenities	35	52
Recreation and Culture	65	65
Fuel and Energy	2	-9
Agriculture, Forestry, Fishing and Hunting	48	52
Mining and Mineral Resources, Other than Fuels; Manufacturing	20	23
Transport and Communication	61	59
Other Economic Affairs	55	62
Other Purposes	200	201
CAPITAL EXPENDITURE	**188**	**247**
General Public Services	4	11
Public Order and Safety	12	7
Education	25	49
Health	19	20
Social Security and Welfare		
Housing and Community Amenities	28	25
Recreation and Culture	24	19
Fuel and Energy	5	19
Agriculture, Forestry, Fishing and Hunting	1	6
Mining and Mineral Resources, Other than Fuels; Manufacturing		
Transport and Communication	62	82
Other Economic Affairs	5	6
Other Purposes	3	3