



COMMONWEALTH GRANTS COMMISSION

DRAFT ASSESSMENT PAPER CGC 2003/14

CONTRIBUTIONS BY TRADING ENTERPRISES

Prepared for the Commission's 2003 Conferences on Draft Assessments

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NOTE

Included in this paper are the results of preliminary calculations based on the methods proposed throughout the paper and using the data currently available. Those results are indicative only and should be seen as work in progress. Ongoing changes are being made to standards and factor calculations as new data come to hand. Moreover, the calculations have been done using a prototype assessment system and are subject to ongoing revision as checking processes proceed.

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INTRODUCTION

1. This paper reviews the issues related to the assessment of Contributions by Trading Enterprises. Early in the Review, this category was designated as a no change category and a discussion paper was not released for it. This paper responds to comments in State submissions and at the 2002 conferences.

1999 REVIEW ASSESSMENT METHOD

Description of the category

2. This category comprises dividends, tax equivalent payments and other tax-like payments from government trading enterprises. It includes levies collected by them on the State's behalf. If the service was provided at a profit from within the general government sector, the profit was included.

3. The majority of revenue was collected from electricity and gas enterprises and water supply and sewerage authorities. However, the category also includes contributions from freight, non-urban passenger transport enterprises, forestry operations, ports and harbours, and marketing authorities.

Implications of tax reform

4. As part of the tax reforms associated with the introduction of the Goods and Service Tax (GST), the Australian and State Governments signed the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA)* in June 1999. Under the IGA, the Australian Government abolished wholesale sales taxes from 1 July 2000. Under the transitional arrangements of the IGA, update terms of reference since the 1999 Review have asked for two sets of relativities:

- (i) a set to distribute a combined pool of GST revenue and health care grants — hereafter called *the GST relativities*; and
- (ii) a set to distribute a combined pool of Financial Assistance Grants (FAG) and health care grants (based on the assumption of a continuation of the Australian—State Government financial arrangements which applied in 1999-2000) — hereafter called *the FAG relativities*.

5. For GST relativities, the category excluded wholesale sales taxes because the Australian Government abolished them from 1 July 2000. The Commission backcast the abolition of wholesale sales taxes by excluding those taxes from the category for years prior to 2000-01.

6. For FAG relativities, the category included wholesale sales taxes. An estimate had to be made of the revenue that would have been raised from FID for 2000-01 and 2001-02. So, the revenue standard for the FAG assessment was larger than the revenue standard for the GST assessment.

7. Table 1 shows the revenue standards for this category for both assessments. In 2001–02, Contributions by Trading Enterprises totalled \$4 341.5 million (or \$221.52 per capita) for the GST relativities. This represented 11.30 per cent of State own source revenue in the 2003 Update. For the FAG relativities, Contributions by Trading Enterprises totalled \$4 454.2 million (or \$227.27 per capita). This represented 9.13 per cent of State own source revenue in the 2003 Update.

Table 1 STANDARD REVENUE FOR CONTRIBUTIONS BY TRADING ENTERPRISES

		1997-98	1998-99	1999-2000	2000-01	2001-02
FAG relativities						
Standard revenue	\$pc	268.93	367.49	276.68	261.90	227.27
Percentage of own source revenue	%	12.96	15.55	11.43	10.77	9.13
GST relativities						
Standard revenue	\$pc	262.88	361.52	270.78	256.08	221.52
Percentage of own source revenue	%	15.65	19.00	13.94	13.22	11.30

Source: 2003 Update Working Papers, Volume 2, pages 20, 24, 252 and 260.

The revenue base

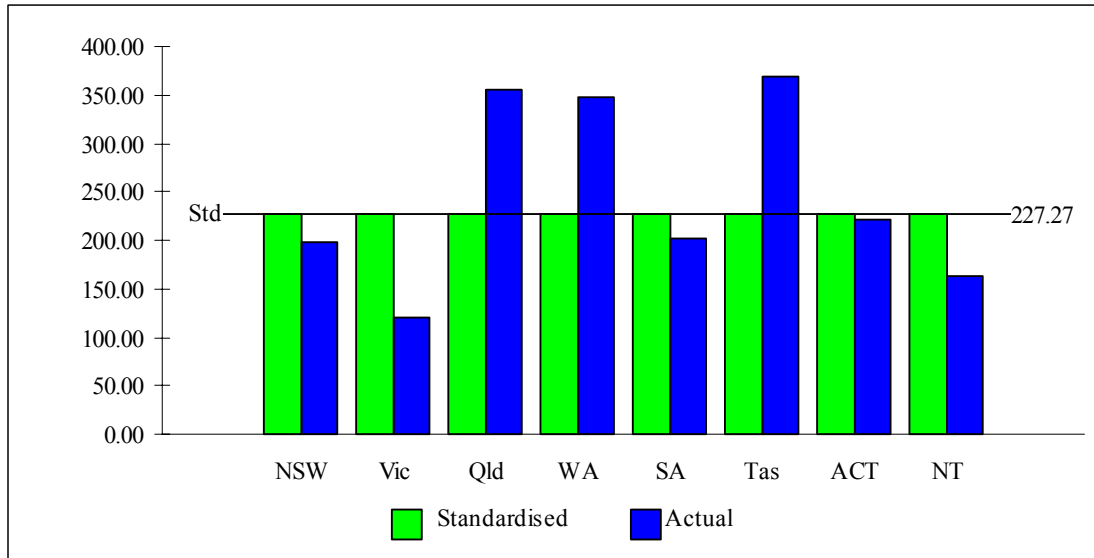
8. In the 1999 Review, this category was assessed using the Equal Per Capita (EPC) method. The Commission decided that rather than assessing the revenue raising capacity of trading enterprises, it would assess only the capacity of enterprises to pay dividends and tax equivalent payments to the budget. It said that such capacity was related to:

- (i) the level of investment of the State in the enterprise;
- (ii) the level of any subsidy the enterprise receives from the budget; and
- (iii) the enterprise's policy on charging for its services (which the Commission understood to be essentially cost recovery or better plus a market return on capital).

9. The Commission considered that the potential for government policy influence in each of these areas was large and given this, an EPC assessment was the most appropriate. Under the EPC method, mean resident population was used as the revenue base. The same method was used in the 2003 Update.

10. Figure 1 summarises the FAG assessment for 2001–02 in per capita terms from the 2003 Update.

Figure 1 CONTRIBUTIONS BY TRADING ENTERPRISES, ACTUAL AND STANDARD REVENUES PER CAPITA, 2001–02



Importance of the category

11. For the 2003 Update, the assessment of the Contributions by Trading Enterprises category had no effect on State relativities or on the distribution of implied grants because it was assessed on an equal per capita basis.

MAJOR DEVELOPMENTS SINCE THE 1999 REVIEW

12. The major development has been the introduction of the IGA and the agreement to abolish wholesale sales taxes from 1 July 2000.

CATEGORY DEFINITION FOR THE 2004 REVIEW

13. No State commented on the category definition and the Commission has found no reason to change the definition. The category will continue to comprise dividends, tax equivalent payments and other tax-like payments from government trading enterprises. It will include levies collected by them on the State’s behalf. If the service was provided at a profit from within the general government sector, the profit will be included.

ISSUES FOR THE 2004 REVIEW

Measure of the revenue base

14. ***Preliminary State views.*** *South Australia* opposed the use of an EPC assessment for this category. In particular, it argued that contributions by enterprises responsible for the transmission and distribution of electricity and gas should not be assessed EPC because:

- (i) States use contributions by enterprises as a revenue source;
- (ii) the revenue raising capacity of transmission and distribution activities is confined to the area within State borders;
- (iii) demand for electricity differs between States due to the location and structure of industries; and
- (iv) demand for electricity and gas is elastic and linked to income.

15. These arguments are also relevant for enterprises involved in water supply and sewerage activities. *South Australia* noted that to restrict the differential assessment to enterprises with certain responsibilities, the Commission would have to determine the relevant enterprises. It suggested a pro rata allocation of revenues would be appropriate in the case where an enterprise has additional responsibilities.

16. *South Australia* proposed Gross State Product (GSP) as the revenue base measure.

17. ***Tasmania*** also opposed an EPC assessment for this category. It said there is a strong link between the size of the market in which a trading enterprise operates and its capacity to contribute to the State budget. It argued that contributions by trading enterprises are determined by the profits that they are able to generate and profit is a reflection of the market in which they operate.

18. *Tasmania* said the Commission currently uses the EPC approach for this category because of the difficulty in obtaining consistent data on the activities of trading enterprises. While it generally supports an EPC approach in cases where data reliability is questionable, the strong link between market size and contribution capacity meant EPC was not appropriate. It also proposed GSP as the revenue base measure.

19. ***Analysis and evaluation.*** Both *South Australia* and *Tasmania* proposed using GSP as the revenue base. Table 2 shows that this change would redistribute \$243.6 million from New South Wales, Victoria, Western Australia, the ACT and the Northern Territory to Queensland, *South Australia* and *Tasmania*.

Table 2 REDISTRIBUTION EFFECT OF AN ASSESSMENT IF GSP USED AS REVENUE BASE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT Redist'n	
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
EPC assessment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GSP as revenue base	-102.5	-40.8	132.6	-69.1	71.7	39.3	-21.6	-9.6	243.6

20. This approach would not be consistent with the changes that have taken place in this area. Privatisations, particularly in the electricity and water sectors, have changed the revenues being generated by State governments. Figure 1 showed New South Wales, Victoria, the ACT and the Northern Territory had below average actual revenue. The proposed GSP assessment would attribute above average capacity to them.

21. Policy influences appear to be the major driver of the level of revenue that States can generate from trading enterprises. The major influences which affect the level of revenue States can generate are:

- (i) the level of ownership of trading enterprises. While privatisation has been widespread, the degree of privatisation varies from State to State; and
- (ii) the capital structure of trading enterprises. State choices on how they set up their trading enterprise determine the extent to which they can compete with other States' enterprises and private enterprises.

22. But there are other policy influences such as: the level of subsidy the government provided to the trading enterprise; the enterprise's policy on charging for its services; and the type and level of fees and levies applicable to the trading enterprise.

23. The development of the National Electricity Market means that, with the possible exception of Western Australia and the Northern Territory, transmission activities are no longer confined to the areas within State borders. The National Electricity Market is a wholesale market for the supply and purchase of electricity combined with an access regime for transmission and distribution networks.¹ Trading enterprises responsible for a State's electricity transmission network can transmit power between different types of clients and across State borders.

24. **Commission decision.** The Commission does not accept that a conceptual case has been made for a differential assessment for this category. The evidence suggests that State policies have a large influence on their revenue raising capacities. Consequently, the Commission has decided to retain an EPC assessment for the Contributions by Trading Enterprises category.

¹ Productivity Commission, *Financial Performance of Government Trading Enterprises 1996-97 to 2000-01*, p88.

PROPOSED ASSESSMENT METHOD FOR THE 2004 REVIEW

25. The assessment method for the 2004 Review will be the same as that for the 1999 Review. The revenue base will be assessed equal per capita.

2004 REVIEW DRAFT CALCULATIONS

26. Both the definition and the assessment method of this category have not changed. As a result, draft assessment results are not shown because there are no implications for the relativities and grant distribution.

Updateability

27. For the 2004 Review and subsequent updates, the Commission will ask States to provide actual revenue data for the last year of the assessment period. It will also ask States to confirm and/or amend the actual revenue data they provided for the previous assessment year. If there are any revisions to data for previous years, these revisions will be included. However, because this category is assessed by the EPC method, any update does not affect the relativities and hence grant shares.