



COMMONWEALTH GRANTS COMMISSION

DRAFT ASSESSMENT PAPER CGC 2003/43

CONCESSIONS AND OTHER PAYMENTS — GENERAL ISSUES AND ELECTRICITY AND GAS

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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 presents the draft assessment for the 2004 Review for Electricity and Gas. It is in two parts. The first part deals with the general issues which affect the three Concessions and Other Payments (COP) categories. The second part sets out the assessment for Electricity and Gas.

PART 1: GENERAL ISSUES

2. The States raised general issues that relate to the assessment of the three COP categories. They were:

- (i) the assessment framework;
- (ii) the treatment of debt charges and depreciation; and
- (iii) the treatment of cross-subsidies.

Assessment framework

3. **1999 Review.** The COP categories were all assessed as net impact on the budget categories — that is, they covered expenses incurred by the States in providing subsidies and other payments to, or on behalf of, corporatised service providers. They were new assessments and the categories did not have a common assessment structure. In its 1999 Review Report, the Commission said that these assessments, which dealt with concessions and community service obligation (CSO) arrangements that States have entered with service providers, would benefit from further attention¹.

4. **Priority Issues.** The Commission issued *Discussion Paper CGC 2001/18, A Concession Approach to Concessions and Other Community Service Obligations*, in which it:

- (i) explained what was done in the 1999 Review;
- (ii) outlined broadly how the States supported the services included in the COP group of categories; and
- (iii) proposed an approach for the assessment of the functions.

5. In summary, the Commission proposed that each category could include three components covering payments relating to:

¹ Commonwealth Grants Commission, *Report on General Grant Relativities 1999, Volume 1*, p.84.

- (i) general services to industry, including regulation and economic development;
- (ii) infrastructure subsidies and grants; and
- (iii) concessions and/or subsidies, including those relating to services to Indigenous communities.

6. **Preliminary State views.** Victoria said that no assessment should be made for general subsidies because, under National Competition Policy (NCP) guidelines, the trend was towards a reduction of State funding obligations as competitive pricing and full-cost recovery were achieved. Queensland, Western Australia and South Australia argued that NCP requirements did not preclude subsidies.

7. The ACT said that some subsidy expenses may be providing support for commercial ventures where needs were not currently assessed. It was concerned that the new structure might result in a widening of the sphere of activities for which needs were assessed. It argued that the subsidies for which needs were to be assessed should be restricted to those with a welfare purpose.

8. **Staff proposals.** In *Discussion Paper CGC 2002/35, Concessions and Community Service Obligations*, staff proposed that the assessments for the COP categories would be based on four expense components:

- (i) **Services to Industry.** General government expenses reflecting general services to industry such as administration, planning and regulation.
- (ii) **Concession Payments.** Payments made for the benefit of specific sub-groups of the population (for example, pensioners).
- (iii) **General Subsidies.** Payments in the nature of a subsidy made for the benefit of all users of a service (for example, supplying a minimum level of water in all inhabited areas). This would include CSOs covering all or part of the operating deficits of a provider, capital grants and any depreciation expenses incurred directly by the general government sector on behalf of a provider. Staff argued that a general subsidy component should be included because it was standard policy for States to provide such subsidies and, to the extent that the States have implemented NCP principles, these will influence the assessments through changes in the standard.
- (iv) **Industry Assistance.** Payments in the nature of economic development assistance for industry. Staff proposed that this component would be assessed in a manner consistent with the treatment of economic development expenses in other categories.

9. **Further State views.** Queensland, South Australia, Tasmania and the Northern Territory argued that NCP requirements did not preclude subsidies.

10. The ACT supported the view expressed by Victoria in its main submission that no differential assessment of needs should be made for the general subsidy payments that States provide to their Public Trading Enterprises (PTEs). It argued that all States would fully implement NCP in the long run and the rate at which it was introduced was not relevant to the application of horizontal fiscal equalisation. It said that methods of service delivery continued to change, resulting in a reduction of State funding obligations as competitive pricing and full-cost recovery were achieved.

11. Queensland argued that, at this stage, there was little merit in a separate industries assistance component and that all identifiable subsidies should be included within the general subsidies component. In support of its view, it raised the following arguments:

- (i) direct CSO type payments in the nature of economic development are difficult to identify, in many cases are not of a significant magnitude, are volatile from year to year, and are often subject to confidentiality limitations eg Townsville Power Station Project; and
- (ii) the identification of indirect expenses having a flow-on effect on industry would be subject to a large degree of judgment.

12. The Northern Territory supported, in principle, the proposed assessment method for the three categories. Like Queensland, however, it thought the need for the industry assistance component was unclear. The Territory suggested that if specific industries were assisted, it could be more appropriate to assess this expense separately. It argued that it may be difficult to distinguish between payments made for the prime purpose of economic development (industry assistance component) and payments made for the benefit of all users (general subsidies). It argued that the difficulty was likely to arise from the problem of defining an economic development expense.

13. **Analysis.** The two issues raised regarding this framework were:

- (i) whether assessing general subsidies was appropriate in the light of NCP guidelines; and
- (ii) whether an industries assistance component should be included.

14. **NCP.** The Productivity Commission confirms that there is no conflict between NCP and the process of providing CSOs. It has stated that:

Perusal of the intergovernmental agreements indicates that State and Territory governments...can continue to deliver CSOs — for example, the water reform agreements specify that a water service can be delivered at less than full cost, provided that the subsidy is disclosed and ideally paid to the provider of the CSO...²

15. The Australian Government Treasury also said that ‘NCP commitments did not explicitly prohibit, discourage or encourage ... subsidies’, although there was broad

² The Productivity Commission, *Report on the Impact of Competition Policy Reforms on Rural and Regional Australia*, September 1999, pp317-8.

acceptance that unjustified subsidies should be removed. It said that a key NCP principle was that where subsidies were provided, 'they should be transparent, appropriately costed and directly funded by governments'³.

16. In any case, examination of State funding arrangements indicates that payment of subsidies is standard policy⁴. Any changes over time in the level of subsidies paid would be reflected in the expense standards as data for more recent years become available.

17. The Commission has concluded that undertaking assessments relating to State general subsidies is consistent with what States are doing.

18. **Economic Development.** *Discussion Paper CGC 2003/5, Economic Development*, outlines the Commission's general approach to treatment of economic development expenses. The decisions made in that paper impact on the assessments required in the economic activities categories, including the COP categories.

19. Expenses on items identified as industry assistance in *Discussion Paper CGC 2002/35* fall within the parameters of the Commission's definition of economic development. For consistency, these expenses will be referred to as economic development.

20. At present, only a small amount of economic development expense exists for Electricity and Gas. However, this may change. Queensland has indicated that in the future it may have expenses for energy projects, but those expenses cannot be ascertained at present.

21. While it may prove problematic to identify expenses that relate specifically to economic development, combining the economic development and general subsidies assessments would be appropriate only if the same disabilities were thought to apply to them. This is not the case.

22. General subsidies are directed at the provision of essential services to individuals in particular circumstances recognised by States as requiring a subsidy. The provision of subsidies in rural areas to keep prices across a State at similar levels is a common reason. Economic development expenses are usually more targeted and may be related to policy choice. The assessment of needs for providing services of an essential nature requires a different approach from that for economic development. For this reason, the assessment of economic development expenses in a separate component is preferred. This approach would be consistent with that adopted across all other economic activities categories.

23. Because the amounts involved may fluctuate appreciably from year to year, it will be necessary to identify the expense amounts and update the component weights of the categories on a yearly basis. Some of the amounts involved can be identified by

³ Commonwealth Treasury Submission, May 2003, p 5.

⁴ Performance indicators of PTEs, as outlined in Productivity Commission, *Financial Performance of Government Trading Enterprises, 1996-97 to 2000-01*, show CSO funding is used substantially by States across a range of industry sectors.

examining GFS data and State budget papers but it is likely that a special return will be required from the States for each update to ensure that all relevant expenses are found.

24. Decisions made in relation to the assessment of administrative scale (*Draft Assessment Paper CGC 2003/60, Administrative Scale*) impact on the structure required in the COP categories. The services to industry component proposed in Discussion Paper 2002/35 will be split into two components:

- (i) fixed costs; and
- (ii) regulation.

25. **Commission's decisions.** The Commission considers that a conceptual case exists for a needs assessment of five common components in each of the Electricity and Gas; Water, Sanitation and Protection of the Environment; and Non-urban Transport categories. The conceptual case is supported by evidence that States incur expenses for different purposes and that it is likely that there are different influences on each group of expenses.

26. Table 1 summarises the Commission's decisions regarding the assessment structure of the COP categories. Five components will be recognised:

- (i) **Fixed costs.** Expenses on providing the minimum administrative structure required for service delivery.
- (ii) **Regulation.** Administration and regulation costs (not including fixed costs), including expenses on:
 - ensuring the welfare of industry employees and consumers; and
 - ensuring the industry and its producers adhere to standards and protect State environments and natural resources.
- (iii) **Concessions.** Payments made for the benefit of specific sub-groups of the population (for example, pensioners).
- (iv) **General subsidies.** Subsidies made for the benefit of all or a major group of users of a service (for example, supplying a minimum level of water in all inhabited areas).
- (v) **Economic development.** Payments to improve the market position or financial circumstances of industries or specific firms, including expenses on:
 - delivering training to industry producers — including the provision of extension programs, and the production and distribution of industry publications — to increase their use of improved production techniques and the quality of their products;

- undertaking pure and applied research, including market research, which supports the industry as a whole;
- grants and subsidies paid to encourage firms to establish, expand or move from other States or nations;
- infrastructure for the specific benefit of firms or a region;
- price support and marketing schemes aimed at specific firms;
- schemes to encourage or restrict output of particular products to improve the market position of firms; and
- advertising and other promotional programs.

Table 1 COMMISSION DECISIONS — ASSESSMENT FRAMEWORK — CONCESSIONS AND OTHER PAYMENTS CATEGORIES

Decisions	Reason
<p>To use five components in the assessments of Electricity and Gas; Water, Sanitation and Protection of the Environment; and Non-urban Transport categories:</p> <ul style="list-style-type: none"> (i) fixed costs; (ii) regulation; (iii) concessions; (iv) general subsidies; and (v) economic development. 	<p>States provide subsidies to public trading enterprises. While these policies persist, it is appropriate to assess disabilities for a general subsidies component. If, in the future, States do not pay general subsidies, then the Commission will remove this component from the assessment.</p> <p>The purpose of economic development expense is different from general subsidies, warranting a separate assessment. A separate component makes the assessment transparent.</p>
<p>To have additional components in the assessment of the Water, Sanitation and Protection of the Environment category:</p> <ul style="list-style-type: none"> (i) isolation; (ii) land rights; and (iii) native title. 	<p>States have indicated that they are incurring expenses relating to isolation, land rights and native title when subsidising Water, Sanitation and Protection of the Environment related services.</p>

Treatment of depreciation and debt charges

27. **1999 Review.** Payments made by government on behalf of PTEs for depreciation and debt charges were to be in the category.

28. **Preliminary State views.** Victoria argued that all needs relating to depreciation and debt charges should be assessed in the general depreciation and debt charges categories. Victoria considered that including depreciation and debt charges in the COP categories would increase the complexity of the assessments, with no apparent gain in accuracy and transparency. In the case of debt charges, the accuracy of any category-

specific assessment would be substantially compromised by the need to rely on judgment to determine an appropriate allocation of total debt charges to each category.

29. **Staff proposals.** In *Discussion Paper CGC 2002/35, Concessions and Community Service Obligations*, staff noted that because of the implementation of NCP by the States, most depreciation and debt charges expenses now reside in PTEs and private entities providing the services covered by these COP categories. However, in practice there will be some residual debt charges and some depreciation in the general government sector. Staff proposed that residual debt charges not be allocated to the COP categories because they could not be identified.

30. For depreciation, staff proposed adding the depreciation expenses of the general government sector classified in GFS as Electricity and Gas; Water Sanitation and Protection of the Environment; and Non-Urban Transport to those categories. The feasibility of this proposal was subject to closer examination of GFS data.

31. **Further State views.** The States did not comment on the proposed treatment of debt charges. Tasmania said that depreciation expenses incurred by the general government sector relevant to the COP categories would be negligible and not readily identifiable in the GFS data. Queensland said that it would be more transparent to include depreciation within the COP assessments.

32. **Analysis.** The data are not available to measure or estimate the amount of debt charges expense incurred on behalf of PTEs.

33. It is possible to identify depreciation expenses associated with the COP categories in the GFS data. Table 2 shows the general government expenses on depreciation for these categories. The amounts involved are relatively small. There are, however, some questions about Queensland's Non-urban Transport expenses, South Australia's Water, Sanitation and Protection of the Environment expenses and the ACT's Electricity and Gas expenses⁵.

Table 2 GENERAL GOVERNMENT EXPENSES ON DEPRECIATION, 2000-01

Category	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
Electricity and Gas	136	349	237	25	83	0	7 323	54	8 207
Water, Sanitation and Protection of the Environment	5 126	4 079	3 153	4 842	-2 558	737	1 749	30	17 158
Non-urban Transport	0	485	6 840	0	0	582	0	806	8 713

Source: ABS GFS data.

34. **Commission decisions.** The Commission considers that a conceptual case exists for including debt charges and depreciation expense incurred by the general

⁵ Commission staff will continue to examine the data for Queensland, South Australia and the ACT.

government sector on behalf of PTEs in the standard for the COP categories. This is because any expense incurred by the general government sector on infrastructure used by those industries is equivalent to a subsidy.

35. There is adequate data to identify depreciation expenses associated with the COP categories. The data indicate that depreciation expenses have a material impact on State budgets. The Commission therefore proposes to add the relevant depreciation expenses of the general government sector to the Electricity and Gas; Water Sanitation and Protection of the Environment; and Non-Urban Transport categories.

36. However, data are not available to separately identify debt charges associated with the COP categories. Therefore, the Commission cannot include debt charges incurred by the general government sector on behalf of PTEs in the standards for the COP categories.

37. Table 3 summarises the Commission’s decisions regarding the treatment of depreciation and debt charges in the COP categories.

Table 3 COMMISSION DECISIONS — TREATMENT OF DEPRECIATION AND DEBT CHARGES — CONCESSIONS AND OTHER PAYMENTS CATEGORIES

Decisions	Reason
Debt charges incurred by the general government sector on behalf of PTEs will be included in the Debt Charges category.	It would be desirable for all debt charges expenses incurred by State governments on behalf of service providers to be included in the COP categories, but the data are not available.
Depreciation expenses incurred by the general government sector on behalf of PTEs will be included in the relevant categories.	Any depreciation expense incurred by the general government sector on infrastructure used by these industries is equivalent to a subsidy and should be included in the relevant category.

Cross-subsidies

38. **1999 Review.** Cross-subsidies expenses were not included in the standard budget.

39. **Preliminary State views.** In its main submission, Western Australia said the cost of subsidies should be included even if the accounting arrangements differ from those of other States.

40. **Staff proposals.** Staff proposed in *Discussion Paper CGC 2001/12 Scope and Structure of the Standard Budget* that the scope of the equalisation budget would be defined on an accounting basis. It would be similar to the scope of the ABS GFS operating statement. *Discussion Paper CGC 2002/35, Concessions and Community Service Obligations* similarly said that the COP categories would be defined on a net impact on the budget basis.

41. **Further State views.** Western Australia said that the Commission should include all subsidies to high cost areas in its equalisation budget. It argued that cross-subsidies were a legitimate way of funding uniform tariff arrangements under NCP. Western Australia said it had established arrangements which would continue uniform tariffs and fund them through a tariff equalisation fund. It argued that the practical effect of the process was the same as directly funding lower tariffs in remote areas through a direct subsidy process. In particular, Western Australia opposed staff proposals to limit the standards for the COP categories to the direct impacts on State budgets, as shown in GFS operating statements. Western Australia said the Commission should add its cross-subsidy to the GFS data.

42. **Analysis.** The Commission has decided as a general principle that it will confine the equalisation budget to activities that have a direct impact on State operating statements.

43. In general, differences in accounting treatments should not by themselves affect the assessments. However, as noted by the Australian Government Treasury, a key principle of NCP is that subsidies should be 'directly funded by government'. Cross-subsidies are not funded by the government (tax payers), but by users. Cross-subsidies may be part of State policy, but they do not have direct impacts on State budgets. The process is contained solely within the transactions of the service providers.

44. In addition, there are practical difficulties in incorporating cross-subsidy payments. Cross-subsidisation is not confined to Western Australia, South Australia and Tasmania, as suggested by Western Australia. In New South Wales, the profit expectations that the State government places on the PTEs varies⁶. This variation in profitability expectation has a direct impact on tariffs. In Victoria, the service providers within their regions adopt some forms of cross-subsidy arrangements, although this is the internal policy of the service providers⁷.

45. While the Western Australian equalisation fund might provide reliable figures to build into GFS for future years, this is not true for the other States providing cross-subsidies. The Commission would need to rely on estimated data from each State. How reliable they would be is difficult to assess. For example, New South Wales would find it difficult to unravel the various influences on PTE profitability, while Victoria may experience confidentiality barriers when requesting information from non-government service providers.

⁶ Data published by the Productivity Commission (*Financial Performance of Government Trading Enterprises, 1996-97 to 2000-01*, pp 101-121) indicate that in New South Wales, the energy distributors servicing the North, South and West of the State are less profitable than energy distributors servicing the major cities, the Central Coast and the Central West. On 1 July 2001, the New South Wales government merged NorthPower, Great Southern Energy and Advance Energy to form Country Energy. As a result, analysis of profit expectations of service providers in particular regions will be more difficult to perform for the years 2001-02 onwards.

⁷ The Victorian government does not set tariffs, which are instead set by energy companies, subject to the Essential Services Commission (ESC) regulation of network tariffs and government's reserve power to regulate retail tariffs to small customers. Some metro-regional cross-subsidies are built into the tariffs by adjustments of the price caps, and regional-rural cross-subsidies exist as a policy of the suppliers, not as a requirement of policy or regulation.

46. The Commission’s methods will give each State the financial capacity to provide the Australian average level of explicit subsidies given the disabilities it would face in doing so (which is essentially the above or below average proportion of the population who would receive them). The Australian average level of explicit subsidies is lower than it would be if all States provided subsidies rather than cross-subsidies. Attachment A compares the impact on the assessment of treating the Western Australian arrangements as if they were explicit, budget-funded subsidies.

47. **Commission decision.** The Commission considers that a conceptual case has not been made for including cross-subsidies within the equalisation budget. Cross-subsidies do not impact on State budgets and their economic effects may not be the same as those of subsidies because they impact on consumers, not on taxpayers. In any event, the Commission is not confident that data on all cross-subsidies can be obtained. For these reasons, the Commission proposes not to include any cross-subsidies in the equalisation budget.

48. Table 4 summarises the Commission’s decision regarding the treatment of cross-subsidies in the Concessions and Other Community Service Obligations categories.

Table 4 COMMISSION DECISION — TREATMENT OF CROSS-SUBSIDIES

Decision	Reason
No cross-subsidies will be included in the equalisation budget.	This treatment is consistent with the approach of confining the equalisation budget for each State to activities that have a direct impact on State operating statements.

PART 2: THE ASSESSMENT FOR THE ELECTRICITY AND GAS CATEGORY

THE 1999 REVIEW METHOD

49. In the 1999 Review, the Electricity and Gas category comprised costs to the State budget sector of payments made to, or on behalf of, undertakings providing electricity and gas services. More specifically, it included all costs associated with the reimbursement of concessions, subsidies and payments of CSOs. Payments made by government on behalf of PTEs for depreciation and debt charges were also included. Where the service operated as part of the general government sector, and did so at a loss, that loss was also included.

50. Table 5 shows the gross standard expenses for six completed financial years. In 2001-02, the per capita standard for this category was \$16.38. This represented 0.33 per cent of total gross standard expenses.

Table 5 ELECTRICITY AND GAS — GROSS STANDARD EXPENSES, 2003 UPDATE

	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
\$pc	39.91	18.92	17.39	16.65	16.78	16.38
% of total gross standard expenses	1.08	0.49	0.38	0.36	0.35	0.33

Structure of the assessment

51. The assessment structure used in the 1999 Review is summarised in Table 6. The component weights were estimated from State budgetary data.

Table 6 1999 REVIEW ASSESSMENT STRUCTURE

Expenditure component	Component weight	Factors	Basis of calculation
%			
1993-94 to 1995-96			
Electricity and gas services	100.00	Socio-demographic composition	Based on the numbers of persons in receipt of a Commonwealth Pension.
1996-97			
Electricity and gas services	62.00	Socio-demographic composition	Based on the numbers of persons in receipt of a Commonwealth Pension as well as numbers of persons residing in remote centres (except Indigenous people in remote communities) and other remote places.
Other subsidies	38.00	None	Equal per capita.
1997-98 to 2001-02			
Electricity and gas services	88.00	Socio-demographic composition	Based on the numbers of persons in receipt of a Commonwealth Pension as well as numbers of persons residing in remote centres (except Indigenous people in remote communities) and other remote places.
Other subsidies	12.00	None	Equal per capita.

52. Compared with an equal per capita assessment, the Electricity and Gas assessment redistributed about \$15 million away from New South Wales, Victoria and the ACT to Queensland, Western Australia, South Australia, Tasmania, and the Northern Territory in the 2003 Update.

2004 REVIEW CATEGORY DEFINITION AND STRUCTURE

Scope of the category

53. The Commission proposes to define the Electricity and Gas category as comprising costs to the State budget sector of payments made to, or on behalf of, undertakings providing electricity and gas services. It includes all costs associated with the reimbursement of concessions, subsidies and payments of CSOs. Payments made by government on behalf of PTEs for depreciation are also included. Where the service operates as part of the general government sector, and does so at a loss, that loss is also included.

54. This definition differs from that used in the 1999 Review in one respect: payments made by government on behalf of PTEs for debt charges have been classified to the Debt Charges category.

55. **Special Purpose Payments (SPPs).** In *Draft Assessment Paper CGC 2003/78, Treatment of Specific Purpose Payments*, the Commission proposed including expenses relating to the following SPP Concessions for Commonwealth Seniors Health Card Holders (CSHC) in the Electricity and Gas category for the 2004 Review. This is a new payment not relevant to the 2003 Update.

Assessment structure and component weights

56. **State views.** States did not raise any issues specifically concerned with the assessment structure for this category.

57. **2004 Review.** The Commission's decision on the component structure for all Concessions and Other Payments categories is set out in Paragraph 8.

58. **Analysis.** Data in States' data returns, GFS data, States' budget reports and service provider annual reports were used to help allocate the expenses in the category to the components. Table 7 summarises the data.

Table 7 EXPENSE DATA USED IN CALCULATING THE COMPONENT WEIGHTS, 2004 REVIEW

Component	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)
Fixed costs and regulation	28.50	24.08 ^(a)	16.00	17.50	8.90	5.25	1.00	1.53	102.76
Concession payments	81.00	55.00	44.40	31.00	15.21	9.57	3.00	3.35	242.53
General subsidies and economic development	0.00	0.00	157.00	11.50	0.00	6.17	0.00	34.41	209.08
Total									554.37

(a) Data were not available from Victoria, an estimate of the fixed costs and regulation expenses was used. This estimate was based on the average per capita expenses of other States.

Source: States' data returns, GFS and States' budget papers.

59. States' data returns and service provider annual reports identified specific projects that conform with the Commission's definition of economic development. However, the associated expenses were not necessarily identified. Projects included upgrading power generation and transmission facilities.

60. **Commission decisions.** The Commission's decisions on component weights are summarised in Table 8. These decisions are based on:

- (i) the decisions on category structure recorded in Table 1;
- (ii) decisions made in relation to administrative scale (see *Draft Assessment Paper CGC 2003/60, Administrative Scale*); and
- (iii) data in Table 7.

61. For this category fixed costs were estimated at \$16 million. This represented 2.85 per cent of the total category expense based on GFS expense data. The component weight for regulation was calculated as the residual using the data in Table 7.

62. The component weights for general subsidies and economic development were estimated using judgment. These estimates recognised that some of the expenses identified by the States in Table 7 as general subsidies were in fact economic development expenses.

63. Because the level of subsidies may change substantially from year to year, the component weights will be reviewed in each update. This will ensure the assessment is consistent with the current circumstances of the States.

Table 8 COMMISSION DECISIONS – CATEGORY DEFINITION, ASSESSMENT STRUCTURE AND COMPONENT WEIGHTS

Recommendation/Decision	Reason
Assessment structure and component weights:	Data provided by States in their submissions, States' budget data and GFS data support these estimates.
• fixed costs: 2.85%	
• regulation: 15.15%	
• concessions: 44.00%	
• general subsidies: 33.00%	
• economic development: 5.00%	

FIXED COSTS COMPONENT

64. This component consists of expenses on core head office functions relating to the administration, planning, regulation and subsidisation of the electricity and gas industry. The costs of these activities are inevitably greater in per capita terms in less populous States. Administrative scale and input costs factors have been assessed for the fixed cost component of this category. This component was not separately identified in the comparable 1999 Review category because the Commission thought the costs were included in the Regulatory and Other Services category.

Administrative scale — fixed cost component

65. **2004 Review.** *Draft Assessment Paper CGC 2003/60 Administrative Scale* discusses the issues raised by the States regarding the assessment of this factor. The paper sets out the Commission's decisions on the general method of assessment adopted for the 2004 Review and on the size of the fixed cost component in each category. The States did not raise issues specific to this category.

66. The Commission has decided that administrative scale will be assessed for this category. The factor will recognise the unavoidable costs each State would incur to provide the infrastructure necessary to administer, plan, regulate and subsidise the electricity and gas industry, regardless of the size of the task.

67. The administrative scale factors for this category, shown in Table 9, have been calculated using the 2004 Review general method. Fixed costs for this category have been estimated to be \$2 million per State. Total fixed costs for the category are \$16 million which represents 2.85 per cent of the category standard.

Table 9 ADMINISTRATIVE SCALE FACTORS — FIXED COSTS COMPONENT, 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
1997-98	0.36858	0.50382	0.68027	1.28668	1.56812	4.92560	7.52310	12.32319
1998-1999	0.36853	0.50445	0.67767	1.28097	1.57795	4.99478	7.55742	12.25346
1999-2000	0.36854	0.50478	0.67478	1.27836	1.58830	5.05782	7.57230	12.19839
2000-01	0.36846	0.50489	0.67161	1.27768	1.60144	5.12202	7.57722	12.18130
2001-02	0.36891	0.50461	0.66745	1.27717	1.61320	5.17750	7.59249	12.25311

68. The factor, which is based on State estimated resident populations, and the component weight will be updated annually.

Input costs — fixed cost component

69. **2004 Review.** *Discussion Paper CGC 2003/04 Input Costs* sets out the issues raised by the States regarding the assessment of wages and salaries costs. The paper sets out the Commission's proposals for the general method of assessment to be adopted for the 2004 Review. *Draft Assessment Paper CGC 2003/79 Input Costs - Electricity and Accommodation* sets out the issues raised by the States regarding the assessment of input costs relating to accommodation and electricity. The paper sets out the Commission's decisions on the general method of assessment to be adopted for the 2004 Review and on the size of the standard expense proportions in each category for accommodation.

70. The Commission considered that the prices of labour, accommodation and electricity used in providing scale-affected services differ across States for reasons beyond the control of individual States. It has therefore decided that input costs will be assessed for this component.

71. The input costs factors for the fixed cost component of this category, shown in Table 10, have been calculated according to the 2004 Review general methods. The standard expense proportions applied were 80 per cent for wages and salaries, 2 per cent for accommodation and 1 per cent for electricity.

Table 10 INPUT COSTS FACTORS — FIXED COSTS EXPENSES COMPONENT, 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
1997-98	1.03086	0.98776	0.98243	0.98229	0.97405	0.93225	1.00817	1.11439
1998-99	1.03267	0.98876	0.98050	0.97883	0.97213	0.92981	1.01243	1.10979
1999-2000	1.03546	0.98791	0.97763	0.98082	0.96857	0.92317	1.01680	1.10513
2000-01	1.03603	0.98930	0.97573	0.98076	0.96738	0.92031	1.01603	1.10244
2001-02	1.03498	0.99044	0.97446	0.98186	0.97135	0.92001	1.01306	1.09897

72. The factors will be updated annually. The proportions represented by wages and salaries, accommodation and electricity will not be re-examined until the next review.

REGULATION COMPONENT

73. This component consists of costs relating to the administration, planning, regulation and subsidisation of the electricity and gas industry (not including fixed costs). The Commission considered per capita costs in this component would vary between States in accordance with the size of the task and has assessed an economic environment factor to reflect that effect. Because costs in the component are dominated by wages and the services are provided throughout each State, it has assessed input costs and dispersion cost factors.

Economic environment

74. **1999 Review.** Economic environment disabilities were not assessed for any component of this category in the 1999 Review.

75. **Preliminary State views.** Queensland said that, in the interests of simplicity and consistency, the assessment framework for the Services to Industry component (now the two components of fixed costs and regulation) should mirror that proposed in *Discussion Paper CGC 2001/16, Administrative Scale*, regarding fixed and variable costs.

76. **Staff proposals.** Staff proposed that the economic environment factor would be assessed to recognise the size of the task. It proposed that the factor would be based on either the number of businesses per capita or the number of customers per capita.

77. **Further State views.** Queensland preferred that a differential assessment be applied to only the fixed costs, and that variable costs be assessed equal per capita.

78. South Australia said that the number of connections would be a reasonable policy neutral indication of the size of the administrative/regulatory task.

79. The Northern Territory supported the use of customer numbers in preference to provider numbers to determine the factor. It argued that provider numbers were not

suitable because they could be influenced by policy, with some States implementing policies which have increased provider numbers and separated the functions of supply.

80. **Analysis.** Finding a policy neutral measure of size of industry is difficult. The Commission considers that the number of providers could be subject to State policy influences. Numbers of consumers is policy neutral, reflects the level of activity in the industry and is linked to the size of the regulatory task. It appears to be the best available basis for the factor. Table 11 shows the States' estimated per customer expenses for regulating electricity. The regulation costs in New South Wales, Queensland, Western Australia and South Australia appear to be roughly proportional to the number of consumers.

Table 11 COST OF REGULATING ELECTRICITY PER CUSTOMER

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Expense per customer (\$)	9.01		8.45	9.86	9.27	13.10		

Source: States' data returns and ESAA, *Electricity Australia 2002*, Table 4.1.

81. **Commission's decision.** The Commission has concluded that a conceptual case exists for assessing an economic environment factor because State government expenses on regulatory services and planning are influenced by the size of the service being regulated. The Commission considers that the impact of inter-State differences on State budgets is material.

82. After considering the influence that States' policies have on the alternative measures of activity, the Commission has decided to use the number of electricity customers per capita in each State as the policy neutral measure of disability. There are consistent and comparable data to measure the number of electricity customers in each State. The Commission therefore proposes to assess an economic environment factor using the number of electricity customers per capita in each State.

83. The Commission's decision concerning the economic environment factor is summarised in Table 12.

Table 12 COMMISSION DECISION —ECONOMIC ENVIRONMENT FACTOR —REGULATION COMPONENT, 2004 REVIEW

Decision	Reason
To assess the economic environment costs based on the per capita number of customers in each State.	The number of customers is a reasonably policy neutral measure.

84. **Method and results.** The economic environment factors for this component are shown in Table 13. They have been calculated from the number of electricity customers per capita in each State.

Table 13 ECONOMIC ENVIRONMENT FACTOR — REGULATION COMPONENT, 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Customers – electricity ^(a) ('000)	2 940	2 219	1 656	811	744	248	136	72	8 825
Population ('000)	6 641	4 855	3 670	1 918	1 519	473	323	200	19 599
Customers per capita	0.44270	0.45705	0.45123	0.42284	0.48980	0.52431	0.42105	0.36000	0.45033
Factor	0.98318	1.01505	1.00211	0.93906	1.08776	1.16442	0.93509	0.79951	1.00000

(a) Gas Customers have not been included on the assumption that they are a subset of electricity customers.

Sources: Electricity Supply Association of Australia Limited (ESAA), *Electricity Australia 2002*, Table 4.1. ESAA data on New South Wales and ACT customers in Table 4.1 were combined. ActewAGL data was used to disaggregate the data.
ABS 2001 Census.

85. **Updateability.** In an update, the factor will change to reflect changes in the total number of electricity customers in each State and changes in the mean resident population. The relevant information is easily accessible — mean resident population from the ABS and electricity customers from the Electricity Supply Association of Australia Limited.

Input costs — regulation component

86. **1999 Review.** Input costs were not assessed separately for this component in the 1999 Review.

87. **2004 Review.** The input costs factors for the regulation component have been calculated according to the general method outlined in *Discussion Paper CGC 2003/04 Input Costs* and in *Draft Assessment Paper CGC 2003/79 Input Costs – Electricity and Accommodation*. The standard expense proportions applied were 80 per cent for wages and salaries, 2 per cent for accommodation and 1 per cent for electricity. The input costs factors shown in Table 10 have been applied in this component.

Dispersion

88. **1999 Review.** Dispersion disabilities were not assessed for any component of the comparable category in the 1999 Review because the category was considered to consist primarily of payments to individuals and service providers.

89. **2004 Review.** *Draft Assessment Paper CGC 2003/63 Dispersion* discusses the issues raised by the States regarding the assessment of the dispersion factor. The paper sets out the Commission's decisions on the general method of assessment adopted for the 2004 Review and on the size of the standard expense proportions estimated for each of the

nine elements of dispersion-affected expenses. Western Australia said that dispersion was a key driver of regulation costs.

90. The Commission noted that the expenses incurred in providing regulation services included costs that are affected by population dispersal. It has therefore decided that a dispersion disability would be assessed.

91. The dispersion factors for regulation have been calculated according to the 2004 Review general method. There were nine indexes within the dispersion factor for the 2004 Review. Table 14 shows the proportions of standard expenses estimated for each of the nine elements of dispersion-affected expenses for this component.

Table 14 DISPERSION COST WEIGHTS - REGULATION COMPONENT, 2004 REVIEW

Telecommunication		Freight, General	Air Travel	Road Travel		Repairs and Maintenance	Remote Staff Turnover	Locality Allowances
Voice	Non-voice			Inter Regional	Local			
0.0047	0.0005	0.00	0.0024	0.0030	0.0021	0.00	0.00	0.00

92. Table 15 shows the dispersion factors assessed for regulation for the 2004 Review.

Table 15 DISPERSION FACTORS - REGULATION COMPONENT, 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
1997-98	1.00021	0.99678	1.00388	1.00167	0.99744	0.99980	0.99118	1.02068
1998-99	1.00020	0.99677	1.00387	1.00166	0.99743	0.99979	0.99118	1.02067
1999-2000	1.00019	0.99677	1.00386	1.00165	0.99742	0.99978	0.99117	1.02066
2000-01	1.00019	0.99676	1.00386	1.00165	0.99742	0.99978	0.99116	1.02066
2001-02	1.00018	0.99676	1.00385	1.00164	0.99741	0.99977	0.99116	1.02065

93. Neither the factor nor the dispersion costs weights will be updated before the next review⁸.

⁸ Different factor values are shown for each year because the factor is rebased to the mean resident population each year.

CONCESSIONS COMPONENT

94. This component consists of payments made for the benefit of specific sub-groups of the population (for example, pensioners). A socio-demographic factor has been assessed.

Socio-demographic composition

95. **1999 Review.** In the 1999 Review, concessions were assessed on the basis of the relevant population receiving concessions on service charges. Those in receipt of an Australian Government pension were eligible for tariff concessions. People in remote areas (except Indigenous people in remote communities) were provided with subsidised services. The populations of these two groups were pooled to assess the socio-demographic composition factor.

96. **Priority Issues.** In *Discussion Paper CGC 2001/18, A Concession Approach to Concessions and Other Community Service Obligations*, the Commission proposed assessing needs associated with concessions payments by measuring:

- (i) the size of the **relevant population**;
- (ii) **use weights** based on propensity to use services; and
- (iii) **cost weights** based on differences in the unit cost of the subsidy.

97. **Preliminary State views.** Victoria said that none of the methods used to assess disabilities associated with the provision of concessions in the economic activities assessments should include measures of propensity to use services, because consistent data were not available from the States.

98. Queensland and the ACT also argued against use weights, because there were limited differences between the States in the take up of the concession.

99. Western Australia said that the cost of providing concessions to disadvantaged individuals in Western Australia was high compared with other States because of the relatively high cost of services and because harsh climatic conditions raised consumption.

100. **Staff proposals.** Staff proposed that Australian Government Pensioner Concession, Health Care and Seniors Health Care Card holders be used as the relevant population for this component, with no differential weight for use or cost differences. After considering State views, staff concluded that an adjustment for propensity to use services was not required because, in practice, little difference across States was expected. No adjustment for the rate of concession was proposed because the average policy was to provide a capped level of concession.

101. **Further State views.** Western Australia said that the different costs of providing services across States (in both metropolitan and dispersed areas) had a material

impact on the cost of concessions for these services. It suggested that the following would improve the assessment:

- (i) apply a cost weight to each State's concession card holders based on differences in residential electricity prices across Australia; and
- (ii) provide an additional weight for concession card holders living in extreme climates⁹.

102. South Australia and the Northern Territory did not support the inclusion of the Australian Government Seniors Health Care Card holders in the concessions factor as it is not yet standard policy to provide concessions to them.

103. **Analysis.** It is a common policy across all States to provide concessions for certain groups of consumers, principally concession card holders. Although the Australian Government has offered funds to the States to encourage them to extend concessions to Australian Government Seniors Health Care Card Holders, we understand that the States have not yet decided to treat this group as eligible for concessions on electricity and gas consumption.

104. States that have a policy of providing concessions based on a percentage discount on the unit consumption price also have other policies which ensure that the impact on their budgets is capped. In some cases, this is achieved by giving the concessions on fixed supply charges as well as energy consumption charges. The concessions paid on fixed supply charges are significant. For example, Aurora Energy in Tasmania has a concession of 48.4 cents per day on the supply charge, but no concession on energy consumption. Secondly, where the concession is applied to consumption, a maximum level is set. In most States, most concessions are paid at the maximum level.

105. Table 16 shows the concession amounts paid by the States and the average residential customer electricity consumption.

⁹ Western Australia provided cost data based on nominal electricity prices published in Electricity Supply Association of Australia (ESAA) Ltd, *Electricity Prices in Australia, 2001/2002, Table A1*. The Commission did not use this data in its analysis because the general footnotes to the table in the 2002/2003 version of Table A1 states that the prices shown do not necessarily represent customer average prices in the regions presented and comparison between regions can be misleading. For analysis purposes, the Commission used regional data published in the ESAA publication's Table 1.1.1 (*ibid.*, p 12).

Table 16 ELECTRICITY CONCESSIONS

	NSW	Vic	Qld	WA ^(a)	SA	Tas	ACT	NT
	\$pa	\$pa	\$pa	\$pa	\$pa	\$pa	\$pa	\$pa
Pensioner concessions – Electricity and Gas	94	100	102	93	70	176	155	50% of bill – up to \$365
Average residential electricity consumption (kWh)	7 528	5 338	6 965	6 429	5 466	8 733	9 071	7 901
Pensioner concession per average kWh electricity consumption (cents/kWh)	1.25	1.87	1.46	1.45	1.28	2.02	1.71	2.30

(a) WA also has an additional concession for pensioners in hotter climates and for pensioners with dependent children. Pensioners with dependent children are about 20 per cent of pensioners.

106. The table shows that there is a relationship between concession paid and average consumption in Queensland, Western Australia, South Australia and Tasmania¹⁰. However, this is not the case for New South Wales, Victoria, the ACT and the Northern Territory. This suggests that State policies, including those that affect prices, are also having some influence. Because of this, the Commission does not accept that it could apply a differential assessment of concession payments based on the propensity of customers to consume electricity in a policy neutral way or with any degree of confidence.

107. The Commission is confident that the number of concession households is a policy neutral measure of the need for concession payments. It is not confident that relative unit costs of energy consumption or relative amounts consumed are policy neutral or that States' costs are necessarily influenced by these differences.

108. **Commission's decisions.** The Commission has concluded that a conceptual case exists for assessing the concessions component using a socio-demographic composition factor. This is because State government expenses on concessions to eligible users of services are influenced by the size of the concession population being subsidised. The Commission considers that differences in the numbers of concession card holders across States means that the different impact on State budgets of providing concessions is material. Reliable data are available annually to measure the number of concession card holders.

109. Since it is not as yet the States' standard policy to provide concessions to holders of Australian Government Seniors Health Care Cards, the Commission does not propose to include holders of Australian Government Seniors Health Care Cards in the eligible concession population. If at a future date States' extend the coverage of concessions to include holders of Australian Government Seniors Health Care Cards, then we will include them in the eligible concession population at that time. It has decided to

¹⁰ For those for States the relationship between concession paid and consumption is given by the equation:
 Concession paid = 0.033*electricity consumed – 117.

base the factor on numbers of Commonwealth Pensioner Concession and Health Care card holders.

110. The Commission considers that a conceptual case does not exist for differentially assessing concessions on electricity and gas services based on the different costs of providing these services. The evidence indicates that it is the standard policy of States to provide a similar level of concession for each eligible concession customer in the State.

111. The Commission's decisions are summarised in Table 17.

Table 17 COMMISSION DECISIONS — SOCIO-DEMOGRAPHIC COMPOSITION, CONCESSIONS COMPONENT

Decisions	Reason
Assess a socio-demographic composition factor for the concessions component based on the number of people in receipt of a Australian Government Pensioner Concession Card or a Australian Government Health Care Card.	It is the standard policy of States to provide concessions to people in receipt of a Australian Government Pensioner Concession and Health Care card.
Not to differentially assess concessions based on the different costs of providing these services.	The different costs of providing services across States do not have a material impact on the cost of concessions for these services. Any differences in level of concessions paid is due to State policy decisions.

112. *Method and results.* Table 18 illustrates the calculation of the factor.

Table 18 CALCULATION OF SOCIO-DEMOGRAPHIC COMPOSITION FACTOR — CONCESSIONS — ELECTRICITY AND GAS, 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Health Care Card holders	477 612	417 167	339 010	167 306	134 522	54 223	17 176	24 607	1 631 623
Pensioner Concession Card holders	1 025 958	762 399	572 140	268 480	285 828	93 006	30 007	17 893	3 055 711
Total concession card holders ^(a)	1 503 570	1 179 566	911 150	435 786	420 350	147 229	47 183	42 500	4 687 334
Mean resident population ^(b)	6 640 909	4 854 989	3 670 473	1 918 199	1 518 642	473 177	322 671	199 939	19 598 999
Proportion	0.22641	0.24296	0.24824	0.22718	0.27679	0.31115	0.14623	0.21256	0.23916
Factor	0.94668	1.01588	1.03795	0.94992	1.15735	1.30100	0.61141	0.88879	1.00000

(a) As at 1st October 2002.

(b) ABS, 2001 Census.

Source: Department of Family and Community Services, Special Data Return and ABS 2001 Census.

113. **Updateability.** In an update, the factor will change to reflect changes in the total number of concession card holders in each State and changes in the mean resident population. The relevant information is easily accessible — mean resident population from the ABS and concession card holders from the Commonwealth Department of Family and Community Services.

GENERAL SUBSIDIES COMPONENT

114. This component consists of those payments in the nature of a subsidy made for the benefit of all users of a service (for example, supplying a minimum level of energy supply in all inhabited areas) A socio-demographic factor has been assessed.

Socio-demographic composition

115. **1999 Review.** Persons residing in remote areas were included with pensioners as part of the socio-demographic composition factor for the category as a whole.

116. **Preliminary State views.** New South Wales suggested that the Commission consider the possibility that diseconomies of large scale may be present in the delivery of services, but presented no evidence.

117. Queensland asked that the scope of the general subsidies component be as comprehensive as possible. It said that it was important to take account of the full range of factors that influenced the relative amount of general subsidies required. It said that the impact of socio-demographic composition and the economic and physical environments on the cost of services should be recognised.

118. The Northern Territory highlighted the diseconomies of small scale it faced in providing electricity services. Lacking cheaper options such as coal, the Territory used gas and diesel to generate electricity. Full redundancy was built in to ensure services were continued when there was a failure or the need for maintenance to occur. Data were provided to substantiate the Northern Territory's higher costs and its need to provide a CSO for power in most areas of the Territory.

119. **Staff proposals.** *Discussion Paper CGC 2002/35* proposed that a socio-demographic composition factor¹¹ be adopted for the assessment of this component for the 2004 Review. The factor would be based on States' total populations, with a cost

¹¹ Referred to as a service delivery scale factor in that paper.

weight applied to populations in different ARIA+¹² regions. Cost data provided by States would be used to derive the appropriate weights. The costs weights proposed were:

- (i) major city: 0.0;
- (ii) inner regional: 0.2;
- (iii) outer regional: 0.5;
- (iv) remote: 1.0; and
- (v) very remote: 2.0.

120. **Further State views.** Queensland supported the proposed factor. It suggested the factor could be improved if locations with unique disabilities received additional weighting, whether or not they were within metropolitan or non-metropolitan areas.

121. Tasmania said that the proposed weight of 2.0 to be applied to very remote regions was too low. It suggested that special recognition should be given to islands, irrespective of their ARIA+ classification.

122. The Northern Territory favoured a more comprehensive assessment of general subsidies. It argued that using region alone as the measure may not adequately capture the different influences on cost. The Northern Territory's major concern was that the proposed factor would not capture its higher generation costs and its need to provide a CSO for power in most areas of the Territory. The Northern Territory argued that its data indicated that remote and very remote regions required a greater weight than that proposed. Data supplied by the Northern Territory indicated that electricity costs to very remote regions in the Northern Territory are, on average, 2.2 times higher than the cost in Darwin¹³.

123. **Analysis.** Overall, there is a common policy across the States that electricity supply costs are at least covered in major cities by tariffs and subsidised in other regions. The factor should reflect that common policy.

124. *Discussion Paper CGC 2002/35* used data from Queensland to derive some illustrative weights that allowed for the effects of remoteness on the average level of subsidy provided. Regional weights can be calculated now to better reflect costs in more States because a more comprehensive set of regional cost data is now available. Table 19 shows the regional cost weights for subsidies. These were calculated by reference to data provided by States on the subsidies, the overall costs of providing electricity and the tariff revenue. They reflect the observation that major cities recover costs and no subsidies are

¹² ARIA is an index of accessibility commissioned by the Commonwealth Department of Health and Aged Care and developed by the National Key Centre for Social Applications of GIS (GISCA). GISCA is presently undertaking some work for the Commission to compile a State based index. The regions used in this factor may therefore change when this work becomes available.

¹³ Northern Territory Concessions Data Return Table 4.4.

provided. Zeros in the table indicate that the States are not providing subsidies from their general government budget to operators in those regions.

Table 19 REGIONAL SUBSIDY LEVELS BY STATE, 2001

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Weighted average	Regional weights ^(b)
Major city	0	0	0	0	0	0	0	0	0	0.00
Inner regional	0	0	0.15	0	0	0	0	0	0.04	1.00
Outer regional	0	0	0.22	0	0	0	0	0	0.07	1.98
Remote	0	0	0.88	0	0	0	0	1.15	0.35	9.65
Very remote	0 ^(a)	0	3.32	0	0	2.0	0	1.75	1.03	28.25

(a) In previous years New South Wales provided a subsidy for service to very remote regions. GFS data indicate that this subsidy was not provided in 2001

(b) Calculated by expressing the weighted average for each region as a proportion of the weighted average for the inner region.

125. **Commission's decision.** The Commission has concluded that a conceptual case exists for assessing a socio-demographic composition factor because consumers outside the major city regions are generally subsidised and the level of subsidy increases with remoteness. That is, subsidies vary with the number of people living outside of major cities and where they live.

126. The conceptual case is supported by data that establish how subsidies vary, on average, with remoteness and where people live. The Commission is satisfied the data are representative and provide a reasonable basis for measuring States' relative disabilities in the provision of general subsidies.

127. The Commission's decision is summarised in Table 20.

Table 20 COMMISSION DECISION — GENERAL SUBSIDIES EXPENSES — SOCIO-DEMOGRAPHIC COMPOSITION FACTOR

Decision	Reason
A socio-demographic composition factor will be assessed based on regional cost weights which reflect the additional subsidies provided to dispersed populations.	The subsidies which States provide increase with remoteness and State population settlement patterns differ materially.

128. **Method and results.** The socio-demographic composition factor measures differences in regional costs of providing subsidies because of differences in the relative costs of providing electricity to different regions in each State. The regional weights included in the factor reflect the Australian average relative levels of subsidies paid in each region. The regions are based on the Accessibility/Remoteness Index of Australia

(ARIA)+. The ARIA+ populations have been adjusted to exclude the populations of remote and very remote Indigenous communities because the provision of essential services to these populations is assessed in the Services to Indigenous Communities category.

129. The relevant population in each region is shown in Table 21. The populations are based on an ARIA classification which confines the indexes to reference points within State borders. The regional populations in the Tasmania classification have been adjusted by classifying Hobart as major service centre. Similarly, the regional populations in the Northern Territory classification have been adjusted by classifying Darwin as a major service centre. This index is being developed for the Commission by the National Centre for Social Applications of Geographical Information systems (GISCA) and is subject to further changes.

Table 21 RELEVANT POPULATION DISTRIBUTION BY ARIA

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Major city	4483	3315	1959	1302	1062	161	311	101	12694
Inner regional	931	1079	909	211	200	258	1	9	3597
Outer regional	887	244	646	183	161	35	0	15	2171
Remote	52	6	71	86	32	0	0	27	276
Very remote	7	0	36	38	7	2	0	14	104
Total ^(a)	6361	4644	3621	1820	1461	456	312	166	18841

(a) The relevant population excludes Indigenous populations in remote and very remote areas.
Source: ABS 2001 Census data and ARIA special data set.

130. The regional cost weights shown in Table 19 were used in the factor calculation. Table 22 shows details of the factor calculation.

Table 22 CALCULATION OF SOCIO-DEMOGRAPHIC COMPOSITION FACTOR
— GENERAL SUBSIDIES — ELECTRICITY AND GAS

Region	Weight	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
State Population ('000)										
Major city	0.00	4483	3315	1959	1302	1062	161	312	101	12694
Inner regional	1.00	931	1079	909	211	200	258	0	9	3597
Outer regional	1.98	887	244	646	183	161	35	0	15	2171
Remote(a)	9.65	52	6	71	86	32	0	0	27	276
Very remote(a)	28.25	7	0	36	38	7	2	0	14	104
Total population		6361	4644	3621	1820	1461	456	312	166	18841
Weighted population		124	59	141	90	37	14	0	25	491
Per Capita		0.01945	0.01270	0.03901	0.04933	0.02563	0.03156	0.00000	0.15206	0.02605
Factor		0.74657	0.48743	1.49764	1.89384	0.98387	1.21171	0.00000	5.83770	1.00000

(a) Expenses on essential services provided to remote Indigenous communities are not included in this category, the population living in such communities have been deducted from these totals.

Source: (i) Regional classifications: ABS, Preliminary Local Government Area (LGA) populations (at 30 June 2002) and Outcomes of ABS Views on Remoteness Consultation 1244.0.00.001, 2001. (ii) Population: ABS, 2001 Census data.

131. **Updateability.** The ARIA+ data are Census based but annual estimates of population by ARIA region will be available. An annual update will require yearly data returns from the States outlining regional cost differences. For this reason, we do not propose to update these factors between reviews.

ECONOMIC DEVELOPMENT COMPONENT

132. This component consists of expenses intended to improve the market position and/or the financial circumstances of industries, specific firms or regions.

133. **1999 Review.** The assessment did not specifically refer to economic development. However, such expenses were grouped with other, non-welfare concession payments in a component titled 'Other Subsidies'. It was assessed by the equal per capita method.

134. **Preliminary State views.** No State commented.

135. **Staff proposals.** In *Discussion Paper CGC 2003/35*, staff proposed that any decision the Commission made in relation to the assessment of economic development would be applied in this component.

136. **Analysis.** *Discussion Paper CGC 2003/5, Economic Development*, was distributed to States on 18 June 2003. It said: the Commission staff would recommend to the Commission that economic development expenses continue to be assessed by the equal per capita method.

137. **Commission decision.** Based on the conclusions in *Discussion Paper CGC 2003/5, Economic Development*, the Commission proposes to assess the economic development component equal per capita, as shown in Table 23.

Table 23 COMMISSION DECISION — ECONOMIC DEVELOPMENT EXPENSES

Decision	Reason
Economic development expenses will be assessed equal per capita	This treatment is consistent with the general approach adopted for economic development expenses.

TREATMENT OF USER CHARGES

138. Expenses for this category are net of user charges. Any dividend receipts, tax equivalent payments or licence fees deemed to be tax equivalents have been allocated to the Contributions by Trading Enterprises category.

PROPOSED ASSESSMENT FOR THE 2004 REVIEW — ELECTRICITY AND GAS EXPENSES

139. Table 24 summarises the assessment structure for the draft assessment for the 2004 Review.

Table 24 ELECTRICITY AND GAS, ASSESSMENT STRUCTURE PROPOSED FOR THE 2004 REVIEW

Component	Component weight	Factors	Basis of calculation
	%		
Fixed costs	2.85	Administrative scale	General method.
		Input costs	General method with weights of 80% for wages, 2% for accommodation and 1% for electricity.
Regulation	15.15	Economic environment	Based on the proportion of customers in State mean residential populations.
		Input costs	General method with weights of 50% for wages, 2% for accommodation and 1% for electricity.
		Dispersion	General method.
Concessions	44.00	Socio-demographic composition	Based on the proportion of people who have a Australian Government Health Care Card or a Pensioner Card.
General Subsidies	33.00	Socio-demographic composition	A cost weight applied to State populations by region.
Economic development	5.00	None	Equal per capita.

Calculating the category factor

140. Table 25 summarises the components, component weights and disability factors assessed for this category for the 2001-02. It shows the calculation of the category factor.

Table 25 DERIVATION OF CATEGORY FACTOR — ELECTRICITY AND GAS

Factors	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Fixed Costs (fc_comp) (component weight =2.85%)								
Administrative Scale Factor	0.36891	0.50461	0.66745	1.27717	1.61320	5.17750	7.59249	12.25311
Fixed Costs Input Costs Factor	1.03498	0.99044	0.97446	0.98186	0.97135	0.92001	1.01306	1.09897
Component factor	0.38252	0.50072	0.65162	1.25634	1.56990	4.77221	7.70596	13.49087
Cont. to category factor	0.01090	0.01427	0.01857	0.03581	0.04474	0.13601	0.21962	0.38449
Regulation (reg_comp) (component weight =15.15%)								
Dispersion Factor	1.00018	0.99676	1.00385	1.00164	0.99741	0.99977	0.99116	1.02065
Input Costs Factor	1.03498	0.99044	0.97446	0.98186	0.97135	0.92001	1.01306	1.09897
Economic Environment Factor	0.98318	1.01505	1.00211	0.93906	1.08776	1.16442	0.93509	0.79951
Component factor	1.01860	1.00288	0.98118	0.92432	1.05465	1.07189	0.93981	0.89588
Cont. to category factor	0.15432	0.15194	0.14865	0.14004	0.15978	0.16239	0.14238	0.13573
Concessions (conc_comp) (component weight =44%)								
Socio-demographic Composition Factor	0.94668	1.01588	1.03795	0.94992	1.15735	1.30100	0.61141	0.88879
Component factor	0.94668	1.01588	1.03795	0.94992	1.15735	1.30100	0.61141	0.88879
Cont. to category factor	0.41654	0.44699	0.45670	0.41797	0.50923	0.57244	0.26902	0.39107
General Subsidies (gensub_comp) (component weight =33%)								
Socio-demographic Composition Factor	0.74657	0.48743	1.49764	1.89384	0.98387	1.21171	0.00000	5.83770
Component factor	0.74316	0.48521	1.49080	1.88520	0.97938	1.20618	0.00000	5.81105
Cont. to category factor	0.24524	0.16012	0.49197	0.62211	0.32320	0.39804	0.00000	1.91765
Economic Development (ecodev_comp) (component weight =5%)								
EPC Factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Component factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Cont. to category factor	0.05000	0.05000	0.05000	0.05000	0.05000	0.05000	0.05000	0.05000
CATEGORY FACTOR	0.87719	0.82346	1.16598	1.26582	1.08680	1.31777	0.67899	2.87515

Calculation formula

141. The following formulas were used to calculate the contribution of each expenses component to the overall category factor. In each case, the contributions are calculated as the expenses component weight multiplied by the component factor (the bracketed terms in the formulas). Each contribution to category factor was rescaled to

ensure that, for each of them, the sum of standardised expenses equals the sum of actual expenses.

$$\begin{aligned}
 \text{fc_comp} &= 0.0285 (s * \text{ic_fc}) \\
 \text{reg_comp} &= 0.1415 (e * [d + \text{ic_OTH} - 1]) \\
 \text{conc_comp} &= 0.450 (\text{sdc}) \\
 \text{gensub_comp} &= 0.330 (\text{sdc}) \\
 \text{ecodev_comp} &= 0.050 (\text{epc})
 \end{aligned}$$

$$\text{Category factor} = \text{fc_comp} + \text{reg_comp} + \text{conc_comp} + \text{gensub_comp} + \text{ecodev_comp}$$

Comparison of category factors

142. Table 26 shows the category factors calculated for the draft assessment for the 2004 Review compared with the category factors assessed in the 2003 Update.

Table 26 COMPARISON OF CATEGORY FACTORS, 2003 UPDATE AND THE DRAFT ASSESSMENT FOR THE 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2003 Update	0.94494	0.93036	1.07048	1.09265	1.14297	1.19040	0.67844	1.31954
Draft Assessment - 2004 Review	0.87719	0.82346	1.16598	1.26582	1.08680	1.31777	0.67899	2.87515

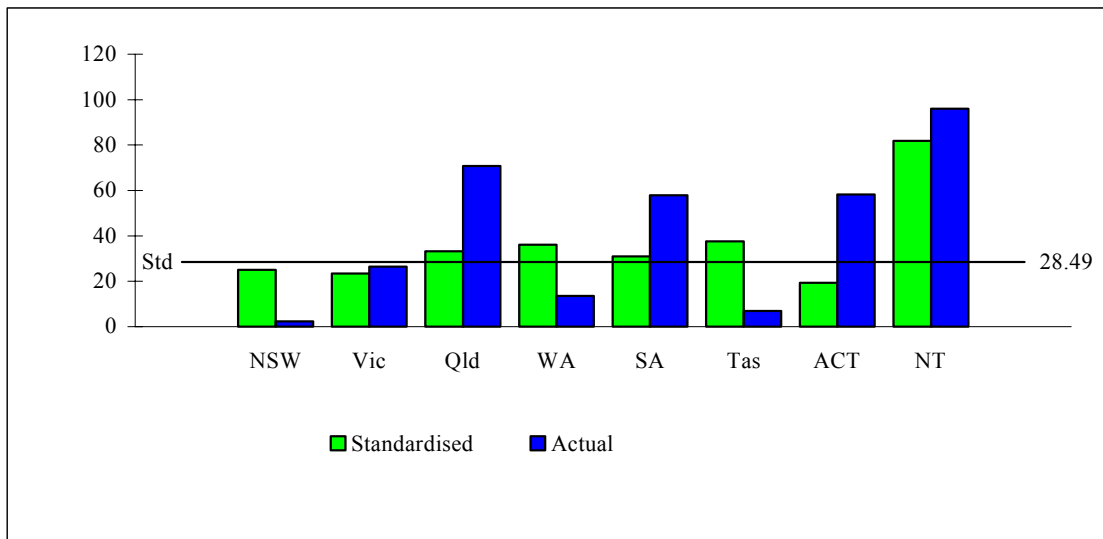
Standardised expenses

143. Table 27 shows the standardised expenses assessed for this category for 2001-02 in the draft assessment compared with those assessed in the 2003 Update.

Table 27 ACTUAL AND STANDARDISED EXPENSES

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2003 Update -									
Estimated expenses									
\$m	321.10	49.14	19.81	157.17	42.40	33.09	9.78	3.85	5.86
\$ per capita	16.38	7.4	4.08	42.82	22.11	21.79	20.67	11.92	29.33
Standardised expenses									
\$m	321.10	102.81	74.01	64.38	34.34	28.44	9.23	3.59	4.32
\$ per capita	16.38	15.48	15.24	17.54	17.90	18.73	19.50	11.12	21.62
2004 Review									
Estimated expenses									
\$m	558.32	15.84	128.19	261.95	28.34	90.90	3.23	18.77	20.66
\$ per capita	28.49	2.35	26.40	70.74	13.48	57.81	6.83	58.18	96.03
Standardised expenses									
\$m	558.32	165.95	113.89	121.92	69.17	47.02	17.76	6.24	16.38
\$ per capita	28.49	24.99	23.46	33.22	36.06	30.96	37.54	19.34	81.91

144. Figure 1 shows the gross expenses per capita for 2001-02 in terms of standardised, estimated and gross standard expenses.

Figure 1 ELECTRICITY AND GAS — GROSS EXPENSES PER CAPITA — STANDARDISED, ESTIMATED AND STANDARD, 2001-02

Effect of assessment on grants

145. Table 28 shows the change in the redistribution of grants between the assessment in the 2003 Update and in the draft assessment for the 2004 Review.

146. Compared to an equal per capita assessment, the 2004 Review draft assessment redistributed about \$65.8 million away from New South Wales, Victoria and the ACT to Queensland, Western Australia, South Australia, Tasmania and the Northern Territory, \$50.3 million more than in the 2003 Update.

147. The main reasons for the change in grants were:

- (i) the increase in the size of the category because of the inclusion of depreciation;
- (ii) the EPC component weight being reduced from 12 per cent to 5 per cent; and
- (iii) the higher cost weights applied to populations in the more remote areas of States.

Table 28 EFFECT OF ASSESSMENT ON GRANT DISTRIBUTION —
ELECTRICITY AND GAS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Contribution to 2003 Update relativities^(b)	-6.3	-6.8	5.3	3.4	3.9	1.7	-2.5	1.2	15.6
Contribution to 2004 Review draft assessments relativities^(b)	-34.2	-28.2	25.8	13.6	8.4	6.5	-3.4	11.5	65.8
Total Change	-27.9	-21.5	20.4	10.2	4.5	4.8	-0.9	10.3	50.3

(a) Total redistribution.

(b) Assuming same pool and a constant population.

(c) This figure shows the change in the amount redistributed among the States between the 2003 Update and the 2004 Review draft assessment. It does not necessarily equal the difference in the total contributions to the relativities between the two inquiries.

ATTACHMENT A

EFFECT OF INCLUDING WESTERN AUSTRALIAN CROSS-SUBSIDY FOR POWER IN ASSESSMENTS

Background

1. Western Australia mediates tariffs across regions through the use of a tariff equalisation fund. The fund is treated as an expense by the service provider, Western Power. It therefore reduces the dividend equivalent payments that Western Power makes to the Western Australian government. At the same time, it reduces the need for the Western Australian government to provide a CSO payment to Western Power to implement the tariff policy.

2. In its rejoinder submission, Western Australia opposed staff proposals to limit the expense standards for the COP categories to the direct impacts on State budgets as shown in GFS operating statements. It said that the Commission should include all subsidies to high cost areas in its equalisation budget. It argued that cross-subsidies were a legitimate way of funding uniform tariff arrangements under NCP. Western Australia said it had established arrangements which would continue uniform tariffs and fund them through a tariff equalisation fund. It argued that the practical effect of the process was the same as directly funding lower tariffs in remote areas through a tax process

Implementing the Western Australian Proposal

3. Implementing the Western Australia proposal would require two changes to the equalisation budget:

- (i) increasing the expense standard for the Electricity and Gas category by the amount of the cross-subsidy — \$200 million; and
- (ii) increasing the revenue standard for the Contributions from Trading Enterprises category by the same amount.

4. Incorporating Western Australia's cross-subsidies in the expenses for the electricity and gas assessment would increase Australia-wide total expenses from \$558 million to \$758million. Because this additional expense is attributable to general subsidies only, the component weight for general subsidies within the electricity and gas assessment would increase. No change in disability factors would be required because the Western

Australian approach to providing subsidies does not affect the groups of people eligible to receive subsidies.

Standards

5. Table A-1 shows the gross standard expenses¹⁴ for the last six completed financial years, **excluding** the Western Australian cross-subsidy. In 2001-02, the per capita standard for this category was \$28.49. This represented 0.58 per cent of total gross standard expenses.

Table A-1 ELECTRICITY AND GAS — GROSS STANDARD EXPENSES, 2004 REVIEW DRAFT ASSESSMENTS

	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
\$pc	19.18	18.95	37.45	30.99	30.14	28.49
% of total gross standard expenses	0.46	0.46	0.82	0.67	0.62	0.58

6. For these illustrative calculations, it was assumed that the expense standard would increase in each year by the amount of the identified cross-subsidy in 2001-02. Table A-2 shows the gross standard expenses¹⁵ for the last six completed financial years, **including** an estimate of the Western Australian cross-subsidy. In 2001-02, the per capita standard for this category would then be \$39.18. This represents 0.78 per cent of total gross standard expenses.

Table A-2 ELECTRICITY AND GAS — GROSS STANDARD EXPENSES, INCLUDING WESTERN AUSTRALIAN CROSS-SUBSIDY

	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
\$pc	30.03	29.68	48.05	41.46	40.48	39.18
% of total gross standard expenses	0.73	0.73	1.05	0.90	0.83	0.78

7. The revenue standard for the Contributions from Trading Enterprises category was assumed to increase by \$10.69 per annum as well.

¹⁴ The gross standard expenses for 1998-99 to 2000-01 have been revised. For an explanation of these revisions please see the 2003 Update, *Supporting Information*, Chapter 2.

¹⁵ The gross standard expenses for 1998-99 to 2000-01 have been revised. For an explanation of these revisions please see the 2003 Update, *Supporting Information*, Chapter 2.

Assessment

8. Because the cross-subsidy amounts would be included in the general subsidy component of the electricity and gas assessment, the component weights would change. The alternative component weights are shown in Table A-3.

Table A-3 ALTERNATIVE COMPONENT WEIGHTS

Component	Weights	
	Excluding WA's notional cross-subsidy expenses	Including WA's notional cross-subsidy expenses
	%	%
Fixed costs	2.85	2.85
Regulation	14.15	10.15
Concessions	45	32
General subsidies	33	50
Economic development	5	5

9. The category factors using the alternative component weights are shown in Table A-4.

Table A-4 ALTERNATIVE CATEGORY FACTORS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Excluding WA cross-subsidies	0.87719	0.82346	1.16598	1.26582	1.08680	1.31777	0.67899	2.87515
Including WA cross-subsidies	0.83881	0.73375	1.24571	1.42620	1.06183	1.31422	0.56066	3.71536

10. The changes in the category factor occur because inclusion of the Western Australian cross-subsidy payments increases the component weight for the general subsidies component at the expense of other components. This gives greater weight to the factors assessed for general subsidies in the derivation of the category factor. It will increase the category factors for States with general subsidies. The factors for general subsidies are shown in Table A-5. Queensland, Western Australia, Tasmania and the Northern Territory have general subsidies factors above 1.

Table A-5 GENERAL SUBSIDIES FACTORS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Factors	0.74657	0.48743	1.49764	1.89384	0.98387	1.21171	0.00000	5.83770

11. Table A-6 compares changes in standardised expenses and revenues.

Table 29 ACTUAL AND STANDARDISED EXPENSES (\$ per capita)

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2004 Review Estimated Expenses									
Excluding WA cross-subsidy	28.49	2.35	26.40	70.74	13.48	57.81	6.83	58.18	96.03
Including WA cross-subsidy	39.18	2.35	26.40	70.74	117.75	57.81	6.83	58.18	96.03
Difference	10.69	0	0	0	104.27	0	0	0	0
2004 Review Draft Assessment - Standardised Expenses									
Excluding WA cross-subsidy	28.49	24.99	23.46	33.22	36.06	30.96	37.54	19.34	81.91
Including WA cross-subsidy	39.18	32.86	28.75	48.81	55.88	41.60	51.49	21.97	145.57
Difference	10.69	7.87	5.29	15.59	19.82	10.64	13.95	2.63	63.66
2004 Review Draft Assessment - Standardised Revenues - (Contributions by Trading Enterprises)									
Excluding WA cross-subsidy	223.56	223.56	223.56	223.56	223.56	223.56	223.56	223.56	223.56
Including WA cross-subsidy	234.25	234.25	234.25	234.25	234.25	234.25	234.25	234.25	234.25
Difference	10.69	10.69	10.69	10.69	10.69	10.69	10.69	10.69	10.69
Net effect	0.00	-2.82	-5.40	4.90	9.13	-0.05	3.26	-8.06	52.97

12. This analysis shows that including the Western Australian cross-subsidy payments in the equalisation budget would affect needs and therefore the relativities and State grant shares. This is because the expense needs change but the revenue needs do not (because Contributions by Trading Enterprises is assessed EPC). The expense needs change because the standard and the component weights change, which increases the input of the disabilities for general subsidies within the overall category factor.