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ACT Financial Management: Victim or Villain?

Chris Uhlmann

In the months following the release of the 2006-07 Australian Capital Territory (ACT) Government budget there was a recurring theme in the reaction: people were shocked by the extent of the cuts to services and the steep increases in taxes. They should not have been. Since late 2005 the Stanhope Labor Government had been hinting at significant change and it had initiated a review of the territory bureaucracy and all its services. In his budget speech, Chief Minister and Treasurer Jon Stanhope made no apology for the pain his budget would cause, saying he was tackling issues left untended since the territory achieved self-government in 1989. The territory had been living beyond its means for too long, he said, enjoying services that were on average 20 per cent more expensive than the Australian standard. Successive territory government's had been 'complicit in this history' and his would be the first with the courage to address the problem (ACT Budget Speech, 2006:1-2).

There was truth in what Stanhope said. The territory's expensive set of services is an overhang from the days when it was run by the Commonwealth and structural change is overdue. However, this alone does not explain the Stanhope Government's dramatic fiscal tightening halfway through its second term. This paper contends that the immediate cause of the large budget deficit, which drove the drastic correction, was mismanagement. It also contends that the Government was slow to realise the depth of the problem because its ministers did not understand flaws in the budget's accounting system, which served to disguise the magnitude of the financial problem by including a menu of items that turned an underlying deficit into a headline surplus. That system was abandoned in this year's budget and the territory adopted something approaching the accepted national standard.

The Deficit

Between June 2002 and June 2004, the Stanhope Government turned a modest surplus of \$12m into a deficit of \$291m, when measured in national accounting terms (Australian Bureau of Statistics — ABS, 2006a). By the same measure, the Government (ACT Treasury, 2006a and ACT Budget, 2006-07) forecasts deficits of \$123m when the books finally close on the 2005/06 financial year and \$147m at the end of 2006/07. (These figures are drawn from the nationally accepted standard, Government Finance Statistics (GFS). Until this year the ACT Government used a different accounting standard, which will be discussed later.

Chris Uhlmann is a Canberra-based freelance writer and media consultant.

From 2006/07 it is using its own variation of GFS, which includes as revenue expected-long term capital gains on superannuation investments. By that standard, the deficit for 2005/06 is $91m and a deficit of $80m is projected for 2006/07.)

Listen to the Government and its predicament is entirely due to structural problems that have haunted the territory since it achieved self-government in 1989. Others put it down to the Stanhope Government's financial ineptitude. There is truth on both sides, although it is hard to attribute the recent, spectacular decline to anything other than negligence.

The Good Times

Labor won government in October 2001. It was re-elected in 2004 and, for the first time in the short history of self-government in the ACT, Stanhope won a majority in the 17-seat Legislative Assembly. That was not his only piece of good fortune, for he was governing at a time of remarkable economic prosperity.

The Economist (2005) has described the international rise in house prices from the late 90s on as the 'biggest bubble in history', dwarfing 'any previous house-price boom, larger than the global stock market bubble in the late 1990s or America's stock market bubble in the late 1920s'. The ACT joined the worldwide exuberance for property and, between March 2001 and 2006, Canberra's median house price rose by 87 per cent, from $203,500 to $380,000 (All Homes, 2006). The spike in house prices saw the Government reap windfall gains from stamp duty receipts. It got $51m more than expected in 2001/02, $23m extra in 2002/03 and $70m more in 2003/04 (ACT Budget, 2001/02-2005/06). By dint of its unique history the ACT Government is the monopoly supplier of land in the territory and land sales are an important part of its revenue. At the height of the property boom, in 2003/04, the Government received $92 million more in revenue from land sales than it had anticipated (ACT Budget, 2003/04 and 2004/05).

At the same time the Goods and Services Tax was beginning to deliver on its promise as a growth tax. In 2003/04 the ACT was one of the first jurisdictions to receive more from the GST than the Guaranteed Minimum Amount (GMA)[1], and the revenue from it has exceeded expectations in every year since (ACT Budget, 2003/04). The territory's share of the GST in 2005/06 was $713m, $45m over the GMA. In 2006/07 it is estimated at $760m, or $63m more than anticipated (Australian Treasury, 2006).

On the jobs front the main engine in the territory, Commonwealth Government employment, was humming. The Coalition's election in 1996 had been accompanied by a vigorous bout of cost cutting which drove the territory economy into recession and saw public service numbers drop to a low of 47,400 by February 1999. Thereafter employment began to climb and, by February 2006, the number of Canberra-based, Commonwealth public servants had risen 32 per

[1] The GMA ensured no state or territory would be worse off after the introduction of the GST, with the Commonwealth underwriting an agreed figure for each state and territory.

cent to 63,000 (ABS, 2006b). This was a level of Commonwealth employment not seen in the territory since August 1989.

The rapid growth in the public sector saw the demand for new office space jump. In 2003, 52,500 square metres of new or refurbished stock was added to the city, following 81,400 square metres in 2002. Most of the space, 67 per cent, was occupied by government tenants (Jones Lang La Salle, 2004). Another 135,000 square metres is under construction.

These weren't just good times, these were unprecedented times and the Stanhope Government was clearly benefiting from all the activity. Measuring Government revenue expectations against outcomes between 2001/02 and 2005/06 shows the territory received an average of $210m, or about 10 per cent, more money each year than it anticipated. Total extra revenue over that time was just over $1 billion (ACT Budget, 2001/02-2006/07).

To this the ACT Government responds that it also had a series of unexpected costs during its tenure. The largest was the January 2003 bushfire, followed by inquires which demanded significant extra funding for disability services and child protection. In the Chief Minister's 2006/07 budget speech he details these costs from the time they were incurred until 'the end of this budget estimates period' or 2009/10 (Stanhope, 2006a:12). This is misleading as some of those dollars are yet to be spent, while the gains mentioned above have already occurred. Bearing that in mind, the Government estimates the additional costs of the bushfire at $154m, disability services at $76m and child protection at $134m (Stanhope, 2006a:12). That would reduce its windfall gain to $636m: still a handy sum in a territory which expects total revenue in 2006-07 to be $2.6b (ACT Budget, 2006/07).

The Fall

This happy set of circumstances should have seen the ACT in a strong financial position and if you followed the Government's headline budget figure each year that was the story it told. But the Government's way of calculating the number was deceiving everyone, including its ministers. According to the tables at the front of ACT Budget Papers, the territory was in surplus by $61m in 2002/03, by $93m in 2003/4 and by $52m in 2004/05 (ACT Budget, 2002/03-2005/06). But the ABS (2006) says the surplus was $12m in 2002/03, followed by deficits of $197 and $291 million. The difference is due to two sets of accrual accounting standards. The territory was using Australian Accounting Standard No 31 (AAS31) and the ABS was tracking the numbers through Government Finance Statistics, the uniform national standard.

AAS31 was issued in 1996 and the territory adopted it when it moved its books from cash to accrual accounting (ABS, 2000; Barton, 2005). However, because it treated money from land sales, rises in the value of its assets such as infrastructure, and hikes in its share portfolio as income, no different to taxes or grants from the Commonwealth, it served to disguise the slide in the territory's financial position (Access Economics, 2005:63). So, while the territory was inflating its bottom line with money it could not spend, real money was

haemorrhaging from Government coffers. Between 2001/02 and 2005/06 expenses grew by 28 per cent (ACT Budget, 2002/03-2006/07).

The money was largely going on a rapidly expanding public service and significant wage rises. Between its election in October 2001 and May 2005 the Stanhope Government increased the public sector workforce by 2300, from 17,300 to 19,600 (ABS, 2006b). At the same time it was pushing up public sector wages, arguing that the previous Liberal Government had unfairly suppressed them. In the 21 months to March 2006, teacher salaries were increased between 15.5 per cent and 18.7 per cent and other wages followed a similar trajectory (ACT Department of Education and Training, 2004). Spending on public sector wages in the ACT over this period has been described by economist Dr Mike Nahan (2006:7) as 'out of control'.

Although it is the seat of federal government, few serious analysts concern themselves with what many deride as Canberra's 'toy-town' parliament and very little real scrutiny is applied to how it conducts its affairs. However, a small but significant group was watching, with growing alarm. Access Economics (2005:3) noted:

> unlike other States and Territories the ACT's annual general government operating expenses are currently being funded, to a significant extent, by asset sales and investment windfalls. … Such a financing strategy is not sustainable in the medium to long run.

Writing in the *Australian Financial Review*, former NSW Auditor General, Tony Harris (2006:46) said the Stanhope Government was forecasting a deficit for 2005/06 of $356m or 'more than $1000 a person':

> For larger governments, a deficit of $356 million might be worrying, but it would not be calamitous. … But for the ACT, its forecast deficit is sizeable. If NSW had a similar per-capita budget outcome, it would have a deficit of $7 billion. And, in spite of soothing forecasts, the ACT's problem seems persistent.

More importantly, the credit ratings agency Standard & Poor's (2005:6) had its eyes fixed firmly on the GFS figures and saw 'disturbingly high general government operating deficits'. In March 2006, Danielle Westwater, an associate in the agency's Sovereign and International Public Finance Ratings Group, issued a public warning to the Government. Speaking to *The Canberra Times* (Uhlmann, 2006:3), she said the strength of the territory's balance sheet gave it some headroom for dealing with its operating deficit, 'although this strength only buys so much time'. She went on to say:

> Standard and Poor's has been warning for the last few years that the operating deficit is a concern and that persistent operating deficits are not consistent in the long term with a AAA credit rating.

Who Knew?

There is some evidence the now-retired Treasurer, Ted Quinlan, was warning his fellow ministers that their spending was unsustainable. In a letter to the then Minister for Urban Services, Bill Wood, he expressed concern at a capital works program Wood's department was proposing. Quinlan (2002) said he was committed to ensuring capital works costs did not continue to increase. 'This is important as we do not have cash capacity in future years' budgets to continue to fund large capital works programs'. In interviews since his retirement, Quinlan (2006) has indicated he also raised the issue of runaway recurrent spending in Cabinet but his protests were ignored.

There is no evidence Stanhope realised there was a problem until a Cabinet meeting in 2005. There, confronted with figures on the surge in public service numbers, he reportedly expressed anger and disbelief. When questioned about this on ABC Radio, in April 2006, he admitted he had been 'somewhat alarmed' by the increase (Stanhope, 2006b:1039). It was a remarkable admission and, when questioned about it in the Assembly, he said (p. 1040):

> I was, and remain, surprised by some of the level of growth within the ACT public service over the last four years – actually over the last three years because it has not grown at all in the last year.

This jolted Stanhope into action and, in late 2005, he unilaterally decided to establish the Functional Review of the ACT Public Sector and Services, while Quinlan was overseas.

The Correction

The review was led by the former head of the Department of Foreign Affairs and Trade Mike Costello and economist Greg Smith. It was tasked with benchmarking government expenditure 'against other jurisdictions and to identify options to improve efficiency through more effective government structures' (ACT Treasury, 2006b). The review was also asked to make recommendations for reducing expenditure, or increasing non-taxation revenues.

The report of the Functional Review has been kept secret but Stanhope gave a reasonable summary of the ground it covered in an article in *The Canberra Times*. There he laid out his view that the key problem with territory finances was historical over-servicing. Stanhope (2006c) noted that the territory's younger, healthier, better educated population should make delivering services cheaper than elsewhere. In practice the reverse was true.

> The cost per hospital separation is 20 per cent higher than the national average. … On pre-school education we spend almost double the national benchmark. On tourism we spend 72 per cent more per capita than the national benchmark. Our spending on community health is 34 per cent higher, our spending on general public services almost double

> and our expenditure on superannuation almost 140 per cent higher than in other jurisdictions. Since 2000/01 the number of teachers in our government schools has risen by 6 per cent. In the same period the number of students has fallen by 7 per cent. Expenditure per student is about 20 per cent above the national average.

The content of the review is perhaps best judged by how it shaped the 2006/07 Budget. After years of lax fiscal management the Government signalled a dramatic turn: raising taxes; slashing services; cutting public sector jobs; dropping its employer superannuation contributions from 15.4 per cent to 9 per cent; and, reorganising the bureaucracy, creating a central shared services centre (ACT Budget, 2006/07). Dominating the headlines since is the proposed closure of 17 schools and 22 preschools between 2006 and 2008 (ACT Department of Education and Training, 2006a).

The Shadow of the Past

Despite the obvious shortcomings of his Government, Stanhope does have a point when he raises structural problems that have dogged the territory since 1989. They are partly the result of planning decisions made in the 1960s and 1970s when the territory was run by the Commonwealth. Although the ACT was established in 1911 and Parliament moved in after the 1926 election, its development was arrested by wars, depression and apathy. But once the Menzies Government committed to moving central departments to Canberra the city expanded rapidly. It grew from a population of 28,300 in 1954 to 144,000 in 1971, taking it from the 19th ranked Australian city by size to the 8th largest. Between 1961 and 1972 the population grew at an average of 10 per cent a year (John Patterson Urban Systems, 1972:1).

The National Capital Development Commission (NCDC) coordinated the planning for growth, devising Canberra's distinctive Y-plan and dispersing the relatively small population into a series of town centres, separated by vast tracts of open space and connected by 2422 kilometres of road (Committee of Inquiry into the Assets and Public Debt of the Australian Capital Territory, 1990). Each centre was surrounded by suburbs and each suburb had a little hub of a neighbourhood primary school and some shops.

This was a command economy at work. Then the NCDC (1964) could dictate where Commonwealth agencies set up and its vision was that each town-centre would have a government employment centre, 'to provide working places for a significant proportion of the residents of that town and also encourage balancing flows of commuter traffic between town centres'. NCDC documents show that its ambitions for Canberra grew with the city. In 1964 it speaks of a city of 250,000 (NCDC, 1964). Six years later it was planning for a population in excess of 600,000 by the year 2000 (NCDC, 1970).

If the population growth of the 60s and early 70s had continued in the 80s and 90s, Canberra would have easily bettered the commission's expectations. But the

growth was entirely dependent on government policy, and governments change. The arrival of the Fraser Government saw Canberra's annual population influx drop from about 12,000 a year in 1976 to 3000 in 1981. In 1981, the population went backwards for the first time in 27 years, with a net loss of 300 people (NCDC, 1983:2). Those coming to Canberra during its rapid expansion were a relatively homogeneous group of young adults and children with 'immediate needs for preschools, schools, health services and retail facilities' (NCDC, 1983:9). So the NCDC kept building on its established pattern, flinging expensive infrastructure about with abandon, long after it should have become obvious that this was unsustainable.

The Move to Self-Government

In the lead-up to self-government, the Commonwealth Grants Commission (CGC) began unravelling the territory's finances from those of the Federal Government through a series of inquiries. In 1988, the commission's third report on financing the ACT found the territory was getting $76m more in grants from the Commonwealth than the commission deemed necessary to provide an Australian standard of service. It also found the territory's revenue raising effort was about 83 per cent of the national average (CGC, 1988).

The CGC found territory services were above the Australian average just about everywhere it looked but, for simplicity, schools can stand as an example for all. The report said the territory spent double the average on pre-schools, 16 per cent over the average on primary schools and 20 per cent more on secondary schools (CGC, 1988). It is of course open to any jurisdiction to spend more on services than the grants commission determines is necessary to deliver the Australian standard but that jurisdiction, not the Commonwealth, has to fund the difference.

The grants commission's findings can be interpreted in different ways and, as the issue persists to this day, it is still a matter of debate. It could be that the ACT is paying for services that are among the best in Australia, or it could be a sign of waste. It is probably a bit of both. The current government's decision to close 39 schools suggests it believes at least some of the money is being wasted and, as we shall see, there is plenty of evidence to support that view. In pushing the territory into self-government, some in the Hawke Government were clearly motivated by a belief that the cost of Canberra was over the odds and it was time for ACT residents to pay their way. Former finance minister Peter Walsh, told the author in 1999 that the Commonwealth excised the territory because it had become too expensive to keep.

The Hawke Government's plan for clawing back money from the capital was to shift responsibility for putting a lid on its finances to the new local government. It disentangled the territory's running costs and administration from the Commonwealth and set a timetable for winding back grants to state-type levels over a 10-year transition period. Shortly after self-government arrived in 1989, two inquiries were tasked with examining the state of the territory's finances and

suggesting a way forward. The first was the Committee of Inquiry into the Assets and Public Debt of the Australian Capital Territory and the second was the Priorities Review Board. The first was led by former grants commission chair Justice Rae Else-Mitchell and the second by a director of Westpac Bank, Robert White. Both raised serious concerns about the level of over-servicing across the board.

Else-Mitchell's committee was critical of the way the transition to self-government had been handled and said the Commonwealth had run down assets in the years before the handover. It identified a $25m maintenance backlog and criticised the NCDC's planning (Committee of Inquiry into the Assets and Public Debt of the Australian Capital Territory, 1990:12). Of the territory's vast road system the committee said (p. 35):

> these assets were produced by the NCDC with minimum concern for long-term maintenance considerations. The committee was of the view that the national capital standards imposed by the NCDC may not have been those a territorial or municipal government would have chosen for a city of comparable size.

On schools, Else-Mitchell's committee found the system 'presently has an excess capacity of 20 per cent, representing 13,000 spaces available in the Department's primary and secondary schools'. It was pleased to hear that the Education Department would 'seek to continue its policy of consolidation with between 15 and 25 school sites to be closed over a period of four years' (p. 20).

White's committee noted the 'significant and continuing demographic changes in the ACT over the past decade', leading to declining enrolments, and recommended the closure of 21 schools over six years (Priorities Review Board, 1990:131). It never happened. The Alliance Government proposed closing 20 schools, succeeded in closing three and promptly lost office. The incoming Follett Labor government re-opened two schools. Since then, ACT governments have had little appetite for reform of the school system.

As a result, the decline in the number of school aged students, combined with a significant shift to the private sector, has seen the problem first identified in the early 1980s get much worse. When the committees reported in 1990 there were 40,552 students attending 97 government schools (Harrison 1993:164). There are now 35,463 attending 95 (ACT Department of Education and Training, 2006:1)

The ACT Government is now fighting an education battle on two fronts, trying to close schools and limit teachers' wage increases. This is just one of a number of fights it must win if it is to meet the ambitious savings targets in this year's budget and bring its deficit under control.

Conclusion

The Stanhope Government has argued its financial plight is largely due to structural problems left untended in the 17 years of self-government. In this

construction it is both victim and hero: the present budgetary problems are not of its making; and, it is the first government in the short history of the territory to have the courage to make painful changes. There is some merit in this argument but it doesn't bear a lot of scrutiny. If the government had truly been alive to structural problems it would have begun to make changes in its first term, not halfway through its second. And, if these problems were entirely the cause of its current woes then why did the dramatic plunge into deficit appear so rapidly, some 14 years into self-government. Earlier territory governments have been in deficit, albeit by smaller amounts, and worked their way into surplus. They worked with the same structural problems and in much tougher economic climates.

The evidence available shows the Government is largely the author of its own woes. It suggests the Government believed its own rhetoric when it claimed, year after year, to be in surplus. It is speculation but a reasonable person could conclude that some members of the Stanhope cabinet did not understand the flaws in the accounting system over which they were presiding. Certainly the Chief Minister's astounding admission that he was surprised by a 13 per cent increase in the size of the public service under his watch does nothing to encourage the view that he has a firm grasp of the consequences of his decisions.

There is some good news. The first is that the territory has abandoned AAS31 and is now using a GFS-like measure. The ACT version includes expected-long term capital gains on superannuation investments as revenue, which makes the headline deficit appear better than the nationally accepted standard. However, it is a vast improvement on what went before and means that the public and the Chief Minister are less likely to face nasty surprises in future. The second piece of good news is that, no matter what standard you apply, there has been an improvement in the budget bottom line. ACT Treasury's June Quarter Financial Report (ACT Treasury, 2006a) showed an improvement in the outcome for 2005/06 of over \$71m, no matter how you measure it. Unfortunately, the Government used the report to give the flattering AAS31 numbers one more public outing, even though it abandoned the standard in this year's budget. On August 15 a front page story in *The Canberra Times* claimed that the Government had recorded a surplus of 2005/06 of \$176m, the largest in the territory's history (Mannheim, 2006). Under the Government's new standard the figure was a deficit of \$91. Using pure GFS it was a deficit of \$123m. And politicians wonder why people don't trust them.

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The author wishes to acknowledge the help of three anonymous referees and urges economists in Canberra to take an active interest in ACT Government financing. At present there is almost no expert, independent, scrutiny of this jurisdiction.