Public Accounts Committee
Parliament of New South Wales

Report on

Dividend Payments

Made by

Statutory Authorities

to the

Consolidated Fund

Report No. 60 April 1992

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Parliament of New South Wales

Public Accounts Committee

of the

Fiftieth Parliament

Report on

Dividend Payments Made by

Statutory Authorities

to the Consolidated Fund

Sixtieth Report

Inquiry pursuant to Section 57(1) of the Public Finance and Audit Act 1983, concerning Dividend Payments made by Statutory Authorities to the Consolidated Fund

(Transcripts of Proceedings are printed in a separate volume to this Report) April 1992

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TABLE OF CONTENTS

Chairman's Foreword vii
Executive Summary ix
Summary of Recommendations........ xiii

1. **Introduction**

a. Purpose of Report 1
b. Nature of Report 3
c. Method of Report........4

2. **Background**

a. Legislative Basis for Dividends........ 5
b. History of Dividend Payments since 1981........ **9**

3. **Basic Concepts behind Payment of Dividends**

a. Introduction 16
b. Rationales for Requiring Dividend Payments from GTEs........17
c. Framework for Determining Dividend Payments........29
d. Community Service Obligations........40
e. Agency Theory........44

4. **Findings of Inquiry**

a. General Findings 47
b. Criteria for Selection of Authorities to Pay Dividends........50
c. Consultation 56
d. Timing 60
e. Effect on Capital Investment Plans........62
f. Asset Valuations 66
g. Debt versus Equity Funding 73
h, Community Service Obligations........79

5. Conclusions........ **81**

Appendix: List of Witnesses

Glossary of terms

CHAIRMAN'S FOREWORD

The origin of this report lay with Volume 2 of the Auditor-General's Report **for** 1990-91, which drew attention to the $60 million dividend payment required at short notice from Sydney Electricity in the last days of the 1990 financial year. For the Committee of the forty-ninth Parliament, the current Committee's predecessor, this payment was instrumental in raising the entire question of the dividends required from statutory authorities, which were growing in size and importance. The Committee of the forty-ninth Parliament believed it was now time for scrutiny by Parliament of the principles and processes of dividend payment.

The Committee of the fiftieth Parliament, which was appointed in July 1991, followed up on the matter and in August 1991 resolved to prepare a report on the payment of dividends by statutory authorities.

In its investigation, the Committee found that many in government and among the public at large were unfamiliar with the terms and concepts behind the payment of dividends. There appeared to be numerous misconceptions about the reasons for claiming dividend payments, about the way they are worked out and about the factors that affect them. As a result, the Committee determined that, unusually for a PAC report, it would supply an initial chapter outlining these basic concepts. It was hoped that if read first, this chapter would help the general reader assess the actual practice of dividend payments, as described later in the report.

Thus one of the main aims of this report is an educative one, to help clarify for the general reader some of the principles involved in the payment of dividends.

Throughout its investigation, the Committee received full co-operation from all statutory authorities involved. They readily supplied all documents and those selected to testify spoke frankly and openly, as might have been expected.

Treasury's treatment of broad principles was more open than of specific instances of practice and implementation. The Committee acknowledges that in the area of dividend payments Treasury has often had to break new ground. The Committee has also taken into account the relative newness of Treasury's Government Trading Enterprises Monitoring Unit (GTEMU), which is responsible for negotiating dividend payments, and the consequent difficulties in presenting Treasury's viewpoint clearly for public discussion.

However, the Committee considered that there is now a need for greater openness and "transparency" from Treasury in its treatment of dividend payments. The Parliament should have a greater understanding of the principles and processes involved, and so should the public. Dividends are now approaching the billion dollar mark, and represent about 4.5% of the state's total revenue. They are a major source of the State's funds. Nothing can be lost from better information, more clearly presented, and more fully discussed.

The Committee would like to thank its secretariat, especially Ms P. Azarias, which spent long hours preparing this report. The secretarial contribution of Ms Margaret McGuire Blackburn was particularly valuable. The report was prepared during a time of staff shortages and the Committee is grateful for the dedication, under difficult circumstances, of all officers involved.

Jim Longley,*B.Ec.,* M.Ec., F.C.P.A., S.P.T.C., M.P.*Chairman*

EXECUTIVE SUMMARY

The purpose of this report is to examine the principles and processes of dividend payments by statutory authorities to Consolidated Fund. In particular, the Committee was concerned to explore:

- the principles according to which dividend amounts payable by statutory authorities are determined;

- the processes followed when dividends are negotiated and set;

- the effect of dividend payments on the current financial decisions and future plans of statutory authorities;

- the principles according to which statutory authorities are included on the list of those required to pay a dividend.

The nature of this report is twofold. First it seeks to express in clear, **non-technical** terms, for general readers, some of the terms, concepts and principles behind dividend payments. It is thus intended in part to play an educative role. Second, it seeks to bring to light how some of these principles have been put into practice over the last few years, and to recommend practical changes where necessary.

The policy of dividend payment has been adopted by Coalition and Labour governments alike. In 1981, for example, the State Bank was paying a dividend, and the list was further expanded in the mid-1980s. Dividend payments have grown steadily from $103 million in 1986-87 (0.8% of total State revenue), to an estimated $857 million in 1991-92 (4.4% of revenue).

Legislatively, the main basis for this growth has been the Public Finance and Audit Act 1983, which gives unfettered and absolute power to the Treasurer to demand dividends from statutory authorities. It provides him with a list of 154 authorities from which dividends may be claimed.

Conceptually, the growth in dividend payments has emerged from a change in Government's basic approach to government trading enterprises (GTEs). Until the mid-1980s, governments tended to provide ready subsidies to GTEs, although recognising that subsidies contributed to some of their undoubted inefficiencies. In this model, there was no real conceptual distinction drawn between Government and authority.

In the mid-1980s, however, in an attempt to reduce GTEs' inefficiencies, the Government began evolving a new conceptual approach which placed GTEs over a spectrum according to their degree of "commerciality". Those operating commercially were now viewed as subsidiaries of a holding company, that is, as being owned by the Government (on behalf of the taxpayers) in much the same way as subsidiaries of private companies are owned by their holding company parent.

As such they were considered as far more separate and independent entities than before. Dividends, for example, could Legitimately be demanded from them. Indeed it was considered desirable to require dividends because the obligation to pay them would help discourage GTEs from making excess investment and indulging in other inefficiencies.

Other reasons have been cited as justification for the government's claim to dividends: that the government will use those funds for more beneficial purposes than a GTE ever could; that the government is basically entitled to a dividend because it is the financial source of last resort in the event of any GTE failure, and can thus be considered as the GTE's true owner, and that just as private companies normally pay dividends, so should GTEs which operate commercially. These arguments are discussed in the report.

The actual method of calculating dividends can vary, from a blanket requirement of, say 4% of the valuation of assets or 50% of operating profits, to a more flexible approach that takes into account the enterprise's future capital needs and current operating requirements.

In principle, the funds available for dividend payment equal revenue minus, in turn, cash expenses like salaries and interest payments; non-cash expenses like depreciation (which can vary according to the method of valuing assets); tax equivalents if any; transfers to reserves to cover, for example, planned capital works, and retained earnings to pay for any unforeseen expenditures or increases in working capital.

The Committee was concerned to stress that it favoured a flexible, case-by-case approach to the blanket, unvarying method of calculating dividend payments. This would help ensure that an enterprise's financial requirements for the forthcoming year, for example for planned capital works, are fully aired and taken into account when the dividend is worked out.

This would clearly require a high degree of consultation between Treasury and the GTE. In practice, the Committee found that there was room for improvement in the consultation process. The Committee believed that initial consultation on dividend payments should take place at a higher level than has prevailed up to now; that consultation should as a matter of course cover the funds the enterprise believes it needs for capital works and operating costs; that it should allow flexibility for changes in circumstances.

So far this has not always happened, There have been instances like that of Sydney Electricity where large dividends were required at very short notice. This forced the enterprise to borrow to pay the dividend (not always a bad thing); there have been cases like that of the Water Board which considered that the payment of dividends unacceptably compromised their future capital works; there have been disagreements about the method of asset valuations and the consequent level of the dividend payments. Improved consultation would help to resolve these problems before they arise and as they occur.

A related finding of the Committee was that there existed considerable uncertainty among some authorities listed in the Public Finance and Audit Act as potential dividend payers as to whether they would in actual fact ever be called on to pay dividends. These included members of the Local Government Electricity Association. The Committee considers there is an urgent need for a reworking of the relevant provisions of the Act to ensure that its list covers only those authorities which are genuinely liable to pay dividends.

Consultation with all those authorities should accompany this amendment.

This should also be accompanied by a document prepared by Treasury for public discussion outlining its criteria for selecting an authority to pay dividends, and referring to specific authorities rather than being couched in general terms.

The document outlining selection criteria should be accompanied by other Treasury publications prepared for general discussion. In the Committee's view, probably the most important of these is a clear, non-technical exposition of what Treasury's general dividend policy is and how it works in practice, Again, this should refer to specific authorities rather than be couched in general terms. Treasury should also elucidate the effect on dividends of its asset valuation policy, and its approach to Community Service Obligations.

The Committee's general approach has been to encourage openness and transparency in the dividend payment process. The Committee found that among the community at large, and even for many in public service, there existed misconceptions and lack of information about dividend payments. This should be remedied. It is undesirable that an important source of State revenue like dividends should remain the comparative mystery that it is.

The Committee's second main concern has been to encourage a sensitive case-by-case approach to dividend payments rather than the adoption of any blanket formula.

The Committee recognises the comparative newness of some of the concepts, the difficulty for Treasury in obtaining general acceptance of some of them, and the impediments presented by staff shortages. The Committee also acknowledges with pleasure the progress that has already been made on some of these concerns.

This progress now needs to be followed up, to ensure that the community recognises the value of dividend payments and the fairness of the way they are worked out.

SUMMARY OF RECOMMENDATIONS

1. That Treasury articulate and implement its dividend policy with greater openness and transparency (p. 47 of the Report).

2. That Treasury prepare for public discussion an understandable, non-technical document clearly articulating:

- its dividend policy;

- the basis for its calculation of dividend levels (p. 48 of the

Report).

3. That this publication refer to specific authorities and not simply be couched in general terms (p. 48 of the Report),

4. That subclause 4(1)(h)(ia) of the Annual Reports (Statutory Bodies) Regulation 1985 be amended to read:

"where practicable, qualitative and quantitative measures and indicators of performance showing the level of efficiency and effectiveness, including where relevant the extent to which dividend targets have been met" (p. 49 of the Report).

5. That Treasury initiate the redrafting of Schedule 2 of the Public Finance and Audit Act 1983 so that it includes only those authorities which are genuinely liable to pay dividends (p. 54 of the Report).

6. That Treasury prepare a detailed publication setting out and thoroughly discussing the criteria for the selection of the authorities to pay dividends (p. 55 of the Report).

7. That this publication refer to specific authorities and not simply be couched in general terms (p. 55 of the Report).

8. That Treasury give adequate notice to all authorities selected to pay dividends, particularly to those selected for the first time (p. 57 of the Report).

9. That Treasury negotiate the amount of dividend payments with the selected authorities on a case by case basis rather than only on the basis of a fixed formula (p. 57 of the Report).

10. That in any future reworking of the Public Finance and Audit Act 1983, Treasury include a provision requiring the Treasurer to consult with authorities on their future liquidity and capital requirements when determining the amount of the dividend (p. 58 of the Report).

11. That the Chief Executive of the statutory authority paying a dividend and the Secretary of the Treasury participate at an early stage in the financial year in negotiations on the level of the authority's dividend target (p. 59 of the Report).

12. That Treasury build some flexibility into its timetable for dividend payments (p. 61 of the Report).

13. That thorough cost-benefit analyses be prepared for all large capital investment projects proposed by dividend-paying GTEs (p. 65 of the Report).

14. That these analyses beconsidered by Treasury when working out those authorities' dividends (p. 65 of the Report).

15. That Treasury clarify in a public document the implications for dividends of its preference for valuing assets at current cost (p. 68 of the Report).

16. That Treasury prepare a discussion document outlining:

(a) its own definition of a community service obligation (CSO) (b) its own preferred method of calculating a CSO

(c) its preferred source of funding for CSOs, with details of how

this preference has actually been applied in practice

(d) the criteria it employs when working out CSOs with a
dividend-paying authority

(e) the usual form of its CSO contract
(f) the effect on dividends of CSOs (p. 79 of the Report).

17. That in 12 months from publication of this report, the Committee prepare a study following up on its recommendations (p. 80 of the Report).

1. INTRODUCTION

a. Purpose of Report

One function of the Public Accounts Committee under s. 57(1) of the *Public Finance and Audit Act 1983* is to examine the Public Accounts transmitted to the Legislative Assembly by the Treasurer and to report to the Legislative Assembly from time to time upon any item in those accounts which it considers should be brought to its notice.

On 29 August 1991, the Committee resolved under s. 57(1)(d) to examine dividend payments by statutory authorities to the Consolidated Fund and to

report to the Legislative Assembly on the matter.

The Committee was concerned that the rise in dividend payments, with its significant implications for statutory authorities and for the budgetary process in general, had not yet been the subject of parliamentary scrutiny. It also noted that among the public at large and even for many in government, the rationale for requiring dividends, and the details of the dividend-setting process itself, appeared somewhat arcane and were poorly understood. In addition, there were questions about the propriety of the timing of some dividend payments, and concern about the effect of dividend payments on the assets, debts and investment plans of some authorities.

In particular, these were the issues the Committee was concerned to explore:

(i) the principles according to which dividend amounts payable by statutory authorities are determined;

(ii) the processes followed when dividends are negotiated and set;

(iii) the effect of dividend payments on the current financial decisions and future plans of statutory authorities;

(iv) the principles according to which statutory authorities are included on the list of those required to pay a dividend.

Section 57 of the Public Finance and Audit Act precludes the Committee from examining any issue of policy. The above issues relate not to the policy of requiring dividends from statutory authorities but to the way the policy has been articulated and implemented.

b. Nature of Report

The Public Accounts Committee prepares both investigative and "discovery" reports. The former investigate perceived administrative problems, the latter bring to light and analyse financial and administrative processes hitherto unfamiliar to the public. Both styles of report recommend improvements in management practices. The present report is largely but not solely a "discovery" report, with a partly educative role. Its main aim is to present to the public an account of the dividend-paying process - why it arose, how it works, and the effects it has on those paying the dividends. In other words, it aims to clarify the process.

The report includes a chapter (Chapter 3) which sets out and discusses the basic concepts and principles behind dividend payments. This chapter has been included because the Committee perceived a need for a clear exposition of the underlying factors determining dividend payments. The matters the Committee felt needed to be clearly explained included the rationales for requiring dividends in the first place, the theoretical framework for determining the ideal dividend, and the role of community service obligations and agency theory in the dividend-setting process. As well as providing an explanation of basic principles, that chapter is intended to provide a theoretical measure against which actual practice can then be tested.

Chapter 3 aims to be clear and non-technical for a broad general public and is offered in the hope that it may contribute something to a better general understanding of the practice of dividend payments.

Chapter 4 outlines the findings of the Committee, and the last chapter presents the report's conclusions.

c. Method of Report

On 26 August 1991 and 23 September 1991 the Committee wrote to sixteen authorities[1] asking the following questions:

- How was the amount determined of dividend payment(s) you made to the Consolidated Fund in 1989-90 and/or 1990-91?
- How was the timing of your dividend payment(s) arrived at?
- How has the payment of the dividend(s) affected your capital-reserve and debt positions?
- How is the amount of the dividend(s) related to your assets and profitability?
- Do you see any areas for improvement in dividend payments, e.g. changes in timing, levels, reporting methods?

Information was also sought from The NSW Treasury. All authorities replied. The replies were then analysed and nine bodies[2] were invited to give evidence at two sets of hearings, on 4 and 18 November 1991.

To prepare this report, the committee reviewed and analysed submissions, evidence and other data obtained from desk research.

[1] Sydney Cove Redevelopment Authority, State Bank, GIO, Maritime Services Board, Water Board,Land Titles Office, Electricity Commission, GrainCorp, Sydney Electricity, Sydney Market Authority, FANMAC, Zoological Parks Board, Waste Management Authority, Forestry Commission, Commercial Services Group, Treasury Corporation.

[2] NSW Treasury, Sydney Cove Authority, Electricity Commission of NSW, Water Board, Sydney Electricity, Zoological Parks Authority, Forestry Commission, Commercial Services Group, Local Government Electricity Association. For names of witnesses see Appendix 1.

2. BACKGROUND

a. Legislative Basis for Dividends

The current legislative basis for requiring dividends from statutory authorities is s. 59B of the *Public Finance and Audit Act 1983*. S. 59B took effect in May 1987. It provides that the Treasurer may at any time require a prescribed statutory authority to pay a dividend to the Consolidated Fund, in such a way and of such an amount as the Treasurer determines. It is "the key provision under which dividends have been sought from GTEs."[3]

Section 59B states:

> "(1) In this section, 'dividend', in relation to a statutory authority, means an amount calculated by applying a rate, determined by the Treasurer, to the assets, or some portion of the assets, of the statutory authority.
>
> (2) Notwithstanding any other Act, the Treasurer may at any time require a
>
> prescribed statutory authority to pay to the credit of the Consolidated Fund, at such times and in such manner as the Treasurer directs, such amount by way of dividend as the Treasurer may determine and notify to the statutory authority.
>
> (3) The Treasurer may require a statutory authority to prepare and submit to the
>
> Treasurer such accounting statements (if any), required for the determination of dividends payable by the statutory authority, in such manner (if any) and such form (if any) as the Treasurer determines.

[3] *Inquiry end Report by the Regulation Review Committee into a Regulation under the Public Finance and Audit Act 1983 Relating to Payment of Dividends of Statutory Authorities to the Consolidated Fund,* Report No. 12, April 1991, p. 5.

(4) A statutory authority shall comply with a requirement made in respect of it by the Treasurer under this section.

(5) Notwithstanding any other Act, the Treasurer may, in relation to a payment by a statutory authority under this section, make any one or more of the following determinations:

(a) that the payment shall be deemed to be payment or part payment of another amount, specified by the Treasurer, which the statutory authority is required to pay to the Treasurer;

(b) that the payment shall be paid in addition to any other amount which the statutory authority is required to pay to the Treasurer;

(c) that the payment shall be deemed to be an obligation of the statutory authority under the Act by which the statutory authority is constituted."

Under s. 59B it is the Treasurer who determines the amount, type and timing of all dividend payments. There is no requirement in that section for the statutory authority to be consulted or play any role in determining the amount, nature or the timing of its dividend payments. The Act does not specify a dollar amount for any dividend. It leaves up to the Treasurer how much a dividend should be, whether it should be an ordinary or a special dividend, and when it should be paid.

Subject to disallowance by Parliament, the Treasurer's power to require statutory authorities to pay dividends is unfettered and enforceable, as s. 59(B)(4) makes clear.

Other statutes with dividends provisions include *the Government Insurance (Amendment) Act 1985, the State Bank (Corporatisation) Act 1990, the Marine Administration Act 1989 and the Sydney Electricity Act 1990.* There is also the Sydney Cove Redevelopment Authority Act 1968, which requires the Authority to pay surplus funds to Consolidated Fund

It is interesting to note the differences between these Acts and the Public Finance and Audit Act, on the one hand, and among these five Acts themselves, on. the other. For example, the Public Finance and Audit Act does not include any provision for consultation, but the Marine Administration Act (s. 46(6)) states:

"The Treasurer must consult the Minister and the Board in connection with any determination to be made by the Treasurer under this section".

The Sydney Electricity Act (s. 25(3)) also obliges the Treasurer to consult the Minister and Sydney Electricity in connection with any [dividend] determination to be made by the Treasurer, although here it is not specified that the consultation should be with the Board.

There is differing treatment, as well, of the amount of dividend payable. The Public Finance and Audit Act, as seen above, leaves it up to the Treasurer's discretion. The Government Insurance (Amendment) Act (s. 7C) gives precise dollar amounts:

(a) "in respect of the year ended 30th June 1983 - a dividend in the sum of

$8,000,000 from the general insurance business division".

(b) "in respect of the year ended 30th June 1984 - a dividend in the sum of

$1,000,000 from the life insurance business division and a dividend in the sum of $9,000,000 from the general insurance business division".

Schedule 1 of The State Bank (Corporatisation) Act states:

cl. 2(1) Every dividend is to be of such amount, and paid at such times and in such instalments, as may be agreed between the voting shareholders and the board, or (failing agreement) as determined under subclause (2).

cl. 2(2) in the event of a failure to agree, the voting shareholders may by written

notice to the board, determine the matter, and the board must act in conformity with the determination.

The Marine Administration Act is the only one to outline the basis on which dividends will be calculated:

> s. 46[2] "The amount so determined shall be an amount equal to a percentage fixed by the Treasurer of the value of relevant assets of the Board".

A basic difference between the Public Finance and Audit Act and all the other Acts with dividends provisions is that the former includes a Schedule, Schedule 2, which lists all the authorities which are liable to pay dividends. There are 154 authorities on this list, ranging from the Water Board to the Board of Governors of the Conservatorium of Music. Chapter 4 discusses the appropriateness of this list.

b. History of Dividend Payments since 1981

Over the past eleven years both Labour and Coalition governments have required dividends from statutory authorities. The State Bank, for example, has been required to pay a dividend from its inception in 1981, and the GIg has "been subject to a dividend requirement"[4] since 1986.

In July 1986, the Premier of NSW made the first official announcement that dividends were to be required from statutory authorities on a broader basis than previously, and the Electricity Commission, the Water Board and the Hunter District Water Board were already paying dividends in the 1986-87 financial year. Since 1988, the Government has further expanded the list of dividend-paying authorities and has, in a series of circulars and internal

papers[5,6,7,8,9,10] elaborated extensively on the methods of setting dividends and on the rationale for requiring them in the first place,

Thus the payment of dividends by statutory authorities to Consolidated Fund has been a long-standing policy adopted by all major parties. The process began in the early 1980s, picked up steam in the mid-1980s, and by the late

[4] *A Policy Framework for Improving the Performance of Government Trading Enterprises,* A Report by the Steering Committee on Government Trading Enterprises, p. 34.

[5] *Performance of NSW Government Businesses: Microeconomic Reform,* NSW Government, September 1990.

[6] *Shareholder Reporting and Monitoring for GTEs and SOCs,* Briefing seminar for Chairman and CEOs, NSW Treasury (undated).

[7] *A Framework for National Performance Monitoring of GTEs,* Report to Special Premiers' Conference, July 1991, prepared by a Task Force on Monitoring Performance of GTEs, Reproduced by the NSW Treasury, August 1991.

[8] *Characteristics of a Fully Corporatised Government Trading Enterprise and Checklist for National Stocktake of GTE Reforms,* Background papers prepared by the Special Premiers' Conference Coordinating Task Force on GTE Reform. Reproduced by **the** NSW Treasury, August 1991.

[9] · *Government Trading Enterprises Monitoring Guidelines,* address by Percy Allan, Secretary of NSW Treasury, to 1990 Residential Seminar for tWOs, November 1990.

[10] *Dividends and Government Trading Enterprises,* GTE Monitoring Unit, NSW Treasury, March 1990.

1980s and early 1990s had developed into a fully-fledged system with sophisticated justifications and detailed procedures.

A major reason why the entire process gathered pace in the 1980s is that by then the inefficiencies apparent in some statutory authorities had become undeniable. Principal among these was a marked excess of capital resources. Underutilised plant, equipment and buildings, inherited facilities now redundant and lying idle, were not "earning their keep", and the authorities responsible for them required a continuing flow of subsidies if only to cover maintenance costs, The drain on Consolidated Fund represented by these subsidies made it imperative that some form of discipline be applied. The payment of dividends was felt to be one such discipline.

Furthermore, requiring a government trading enterprise (GTE) to pay a dividend was consonant with an entirely new approach to the relationship between Consolidated Fund and GTEs in general which gradually developed around the mid-1980s. Until then, the ready payment of subsidies by government to authorities tended to blur the conceptual distinction between the two. In the old view, the subsidies constituted simply a transfer from one arm of government to another. Dividends could therefore have been thought of as a logical absurdity: the government paying itself. Under this system there was little incentive for the authorities to eliminate the inefficiencies that required the subsidies in the first place.

The new approach conceived of the government as a much more separate entity from the authorities. It was now viewed as a "holding company" for the GTE, which was then responsible for managing its own affairs far more independently than before. The obligation of the' government to subsidise inefficiencies is considerably reduced under this new approach.[11]

So the first reason why dividend payments have grown is that they were viewed as a discipline to be imposed on an authority, which was now viewed as a far more independent entity than before, and correspondingly more liable to pay dividends.

[11] See *Checklist for National Stocktake of GTE Reforms*, NSW Treasury, August 1991. op. cit. p. 3.

The other, more obvious, reason dividend payments have been increasingly required is that they are a useful source of revenue to Consolidated Fund.

Indeed, they have become more and more useful over the years, as a quick snapshot reveals:

TABLE 1

DIVIDEND PAYMENTS

YEAR	*DIVIDENDS $'000*	*% INCREASE IN DIVIDENDS 0 VER PREVIOUS YEAR*	*RECEIPTS INTO CONSOLIDA TED FUND $'000*	*DIVIDENDS as % of receipts*
1986-87	103,201		12,165,000	0.8
1987-88	128,958	25.0	13,763,000	0.9
1988-89	261,374	102.7	14,679,000	1.7
1989-90	344,337	31.7	15,642,000	2.2
1990-91	590,085	71.4	17,556,000	3.4
1991-92 (projected)	857,000*	45.5	19,469,000	4.4

* Of which $409 million was collected by the end of February, 1992.

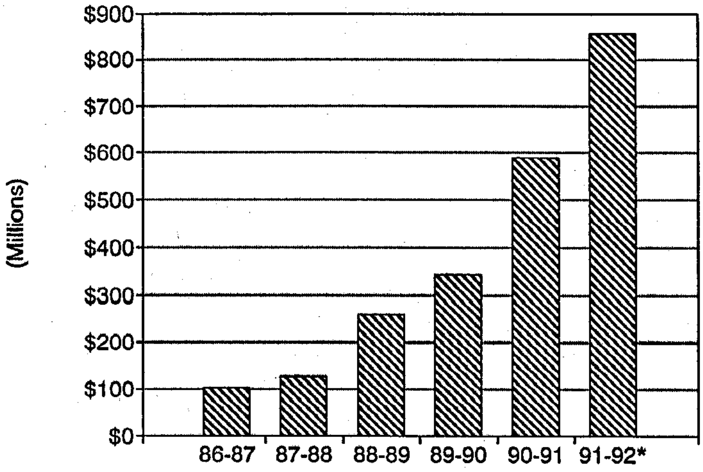
All the dollar figures in the table above are unadjusted for inflation. Therefore increases are lower in real terms.

Sources:	1986-87: Auditor-General's Report for 1986-87 Part 1, p. 29
	1987-88: Auditor-General's Report for 1987-88 Vol. 2 p. 143
	1988-89: Auditor-General's Report for 1988-89 Vol. 2 p. 124
	1989-90: Auditor-General's Report for 1989-90 Vol. 2 p. 45
	1990-91: Auditor-General's Report for 1990-91 Vol. 2 p. 45

The figures for 1991-92 are obtained from NSW Treasury, Budget Paper No. 2, 1991-92 p. 100, which lists projected dividend payments as $907,494,000 and projected receipts as $19,739,000, amended by the Premier's Press Release of :24 January 1992 which states that there will be a shortfall of $ 50 million for dividends and $270 million for receipts below the original estimates.

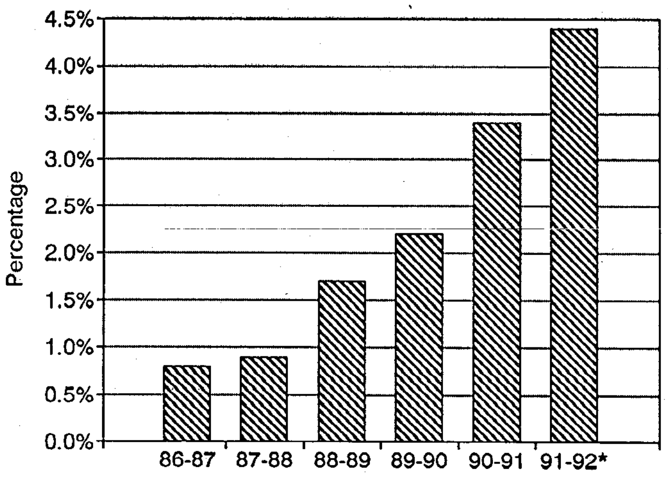
TABLE 2

DIVIDENDS PAYMENTS



* Proposed in 1991-92 Budget

TABLE 3 - DIVIDENDS AS A PROPORTION OF RECEIPTS



* Proposed in 1991-92 Budget

The revised figure of $857 million in dividends projected for 1991-92 represents 4.4% of the revised figure for total State receipts. Over six years revenue from dividends will have risen more than eightfold in dollar terms and 5.5 times as e proportion of receipts.

This increase in the amount of dividends paid has been achieved by two means:

- firstly, the rise in the number of statutory authorities paying dividends, and

- secondly, the year by year increase in the amounts paid by some individual statutory authorities, although others have experienced the occasional decline. A consolidated year-by-year list is shown on Table 4.

The Treasury classifies authorities into six categories[12] and specifies (in some cases) the category to which each authority should belong. These categories are set out below and the classification of each instrumentality is indicated in the last column of Table 4.

"A. Government Service: heavily subsidised monopolistic body (e.g. Department of Business and Consumer Affairs)

B. Semi Commercial Service: partly subsidised monopolistic body (e.g. Broken Hill Water Board)

C. Semi Commercial Business: partly subsidised semi competitive body (e.g. Urban Transit Authority)

D. Commercial Service: self sufficient monopolistic body (e,g. Sydney Water Board)

E. Commercial Business: self sufficient semi competitive body (e.g. TAB)

F. Commercial Enterprise: self sufficient fully competitive body (e.g. GIO, State Bank)."

It also includes a list showing the characteristics of various organisations. In this list[13], the payment of dividends is shown as applying only to categories E and F. However in practice, there has been an inconsistency: authorities classified by the document as 'C' and 'D' have also been required to pay dividends, as shown in Table 4.

[12] *Classification and Control of State Organisations*, June 1989, pp. 3-4.

[13] p. 40.

TABLE 4

State Instrumentalities Contributions

Instrumentality	1986-87 $'000	1987-88 8'000	1988-89 $'000	1989~90... 8'000	1990-91 $'000	Class- ifica- tion
Commercial Services Group					12,166	*
Electricity Commission of NSW	1,521	11,500	10,000	25,000	185,000	E
FANMAC Ltd					84	*
Forestry Commission of NSW					10,000	C
Government Cleaning Service				3,900	--	*
Government Insurance Office	45,056	51,411	105,978	99,271	108,248	F
GrainCorp				32	400*	E.
Hunter Water Board	--	3,000	2,000	2,364	10,000	D
Land Titles Office			12,000	6,821	9,140	E
Maritime Services Board	14,298	18,110	16,526	16,087	25,000	D
NSW Investment Corporation	--	459	5,230	-	-	*
NSW Treasury Corporation					3,016	*
State Bank of NSW	42,314	32,894	55.524	48,816	--	F
State Brickworks	--	84				*
Sydney Cove Redevelopment Authority				75,000	71,703	E
Sydney Electricity					60,000	E
Sydney Market Authority					400	E
Waste Management Authority					3,100	*
Water Board	-	11,500	54,116	67,046	84,748	D
Zoological Parks Board					115	C
Other	12					
TOTAL	103,201		128,958	261,376	344,337	590,085

Source: Auditor-General's Reports for above years.

The number of authorities paying dividends has risen from eight in 1987-88 to ten in 1989-90 to sixteen in 1990-91.

The number projected to pay dividends in 1991-92 is fifteen.

The rise in dividend payments has been accompanied by an increase in the resources which Treasury has devoted to the monitoring of GTEs, from a staff of one in the GTE Monitoring Unit in 1989 to an establishment of seven in early 1992. If the costs of this unit represent the largest part of the total costs of raising revenue from dividends, they must compare favourably with the costs of raising other forms of government revenue, such as payroll tax.

To sum up, the history of dividend payments reveals a steady increase both in the number of authorities making payments and in the actual amounts paid.

The contribution of dividends to Consolidated Fund is not likely to diminish in future: indeed, with the increase in the size and importance of Treasury's GTE Monitoring Unit, and with the shortfalls in tax receipts caused by recessionary conditions, dividend amounts and the number of dividend-paying authorities are likely to keep growing, although perhaps not quite so rapidly as in the past.

3. BASIC CONCEPTS BEHIND PAYMENT OF DIVIDENDS

a. Introduction

During its investigation, the Committee found that many of the terms employed in the dividend-setting process, many of the underlying concepts and much of the reasoning behind the requirement to pay dividends, were generally unfamiliar to the public, and even to some in government. The Committee observed that this unfamiliarity led to a number of misconceptions about the process itself. As a result, the Committee determined to include in its report a chapter on the concepts and basic principles behind dividend payments. It is hoped that this chapter will contribute to a better understanding of the practice. The issues which this chapter explores include:

- the rationale behind the requiring of dividend payments;
- what their place is in the overall financial structure of the statutory

authorities in general;

- the factors that should ideal y be taken into account when determining

the actual size of a dividend;

- how community service obligations (CSOs) affect dividend payments;
- the way agency theory affects and is illustrated in the management of a statutory authority, and by implication, the size and timing of its dividend payment.

b. Rationales for requiring dividend payments from GTEs

The fundamental right of the Government to claim dividends from statutory authorities has often been disputed. For example, when s. 59[B) was debated in 1987, it was described in Parliament as a "hollow log" device, one that would unjustifiably allow the Government to extract large sums from unwilling authorities, for its own, not always defensible, purposes, leaving the authorities without adequate retained profits for expansion or other needs.

This concern continues to be voiced, even after s. 59(B) has become law. For example, some press comment on the 1991-92 Budget claimed that some authorities "have been raided like a Pharaoh's tomb""" and that "some long-neglected hollow logs have been looted"[15] to bolster the Budget. There appears to be a widespread perception that it might somehow be fundamentally illegitimate for the Government to claim dividends from statutory authorities.

Since this is an issue which still arouses public concern, this report includes a section examining five basic arguments for the Government's claim to dividends and evaluating them critically. The following discussion covers only commercial businesses (self-sufficient semi-competitive bodies such as the TAB) **and** commercial enterprises (self-sufficient fully competitive bodies such as the GIO and State Bank).[16]

The five arguments are:

(i) The Government, on behalf of the State's citizens, is the 100 per cent shareholder in State enterprises, and as such is entitled to receive dividends.

(ii) Dividends can finance benefits like lower taxation, higher expenditure on services, lower borrowing and debt and increases in reserves.

[14] Telegraph Mirror, 20 September 1991, editorial.

As above.

[16] See *Classification and Control of State Organisations*, New South Wales Government June 1989, pp. 3-4.

(iii) In the absence of a share price, dividends represent the major financial return on their investment for the Government and the taxpayers.

(iv) Payment of a dividend constitutes a salutary financial and management discipline.

(v) Private competitors pay dividends. So should state enterprises.

Each of these arguments will be dealt with separately below.

(i) Government as 100 per cent shareholder

A frequently cited justification for the Government's claim of dividends from statutory authorities is that the Government, on behalf of the State's citizens, is the 100 per cent shareholder of them all[17]· Like any shareholder In any company, it therefore has the right to a dividend from the company's profits,

On Its own terms, this appears self-evident, However, again on Its own terms, there Is at least one major difference between the Government as a shareholder, on the one hand, and any other organisation or individual, on the other, Dividends are part of the reward the shareholder receives for taking the risk of investing in the company, Taking that risk implies that an alternative choice exists either to take no risk, or to choose another investment, Private organisations or individuals do have that choice and are in a position to exercise their judgement as to the risk-worthiness of a particular investment, Because there is a market in equities, they can move their funds to whatever investment they choose or judge to be profitable, If their judgement, and their choice, prove sound, a dividend is part of their reward,

The Government's ability to choose, on the other hand, is in practice heavily circumscribed. A Treasury publication[18] states that where "a public sector business fails to earn a commercial rate of return [and by implication, pay a commercial dividend] this legitimately raises the question of whether the scarce

[17] As the Premier pointed out in a 1990 speech to Chief Executive Officers of GTEs (see footnote 22),

[18] *Dividends and Government Trading Enterprises,* NSW Treasury, March 1990.

resources tied up in the operation could not be used more productively elsewhere"[19]. But in practice, the Government cannot move resources from one activity or statutory authority to another, with anything like the same freedom a private shareholder enjoys. It can of course bring about asset sales and staff reductions. But these are large exercises, very difficult to plan and execute, with major social, financial and political costs. The Government's hands can also be tied by statutes or simply by powerful traditions. Since its freedom of choice is limited, and since there is no equity market for authorities, its judgement cannot in practice be brought into play to anything like the same degree as that of a private investor.

Some would argue that as a result, it may be questioned whether the Government is fundamentally entitled to receive a reward in the form of a dividend for a risk it has not "really" taken and a judgement it has not "really" made. No risk, no reward.

A contrary view would be that the risk is actually greater for the Government, precisely because it cannot very easily move to limit its exposure. In this view, the logical outcome of this greater risk is that its basic entitlement to a dividend, as 100 per cent shareholder, is even more compelling than that of an individual investor, who can quickly limit his risk by selling up.

Furthermore, it is the sole bearer of that risk, particularly since it is financier of last resort. In other words, the Government is obliged to cover any failures of authorities because the withdrawal of an essential service from the public is impossible. This lends even more force to the argument. If one accepts this view, the Government is indeed entitled to a dividend on the basis of the risk it is obliged to take in investing in the authority.

The point can be looked at in another way, as follows: the Government has advanced capital funds to the authority. This may be called an investment, or it may be called a loan. D.A. Shand makes the point as it relates to the Commonwealth:[20]

[19] p. 3.

[20] "The Financial Structure and Objectives of Commonwealth Trading Undertakings: A Review", D. A. Shand, *Australian Journal of Public Administration*, March 1982.

"The point simply is this: whether the money advanced by **the Commonwealth** is advanced by way of "capital" or "advances" **or even "loans", the** Commonwealth requires some payment from the organisation for the **use of** these capital funds advanced to it. Whether this charge is called **interest or** a dividend it represents the same thing - **a charge for the use of capital funds**advanced".

Therefore if the Government had called its investment a loan, it would have been entitled to interest. It should not be denied a return in the form of a dividend simply because its injection of funds is termed a capital investment. No money made available to an authority, in other words, should be free.

This approach differs fundamentally from the one outlined earlier, according to which "the Government" and "the GTE" should not, philosophically, be considered as separate entities. Under this view, the Government's contribution to a GTE should be in the nature of a subsidy rather than a loan or an investment. And its claim to a dividend would thereby be nil.

However, the view that the two are indeed distinct, that the Government is a "holding company" linked to but separate from its GTE "subsidiaries", is the **one** which now firmly prevails over a wide spectrum of opinion.

If this view is accepted, it follows that the Government is entitled to **some** payment for funds advanced, as Shand asserts. And it follows further that, **as** the sole "advancer" of these funds (as, in other words, the 100 per cent shareholder), and GTEs' ultimate financial "rescuer", the Government is entitled to a dividend.

(ii) *The Government will* ***use the*** *dividends for beneficial purposes*

There is, perhaps unsurprisingly, a wide range of support for this view. For example, the Premier, in an address to chairmen and chief executive officers of

GTEs and SOCs[21] (state-owned corporations) stated: "ensuring that GTEs and SOCs earn an economic return on their assets and that they sell surplus assets, means that funds are available to achieve the Government's social objectives. In this context total dividends and tax equivalents from Government agencies in 1990-91 will amount to around $520 million compared with only $130 million three years ago. This will be used to assist the funding of schools, hospitals, courts and other social infrastructure and services"[22]. The Evatt Foundation agrees: "This return [dividends from public enterprises] should be paid to the Consolidated Fund and thereby made available for use in pursuit of the Government's overall programs and objectives, or to reduce state charges and/or taxes elsewhere, thus distributing the benefits according to the priorities of the community as a whole."[23]

Benefits potentially made possible by dividends might therefore include:

- lower state taxes

- increased expenditure on services

- lower borrowing

- plugging of gaps left by drops in Commonwealth contributions · increases in reserves.

Whether any or all of these have in fact occurred is a separate question. The argument is inherently difficult to prove or disprove. It might be argued that dividends have not led to lower taxes[24], but, on the other hand, taxes might have had to be even higher without them. The increase in payments to health, education and law and order might also be pointed to, but all this shows is that (if debt is not contained) dividends have been accompanied by rises in these

[21] "Shareholder Reporting and Monitoring for GTEs and SOCs", Briefing Seminar for Chairmen and Chief Executive Officers, organised and hosted by The NSW Treasury, 1990.

[22] pp. 12-13.

[23] *State of Siege: Renewal or Privatisation for Australian State Public Services*, Evatt Research Centre, Sydney 1989, p. 131.

[24] Which rose from $6.4 billion in 1988-89, to $7.4 billion in 1989-90, to $8.3 billion in 1990-91; Source: NSW Public Accounts, NSW Treasury, 1988-89, 1989-90 and 1990-81.

payments, not that they have been permitted by them. The rise might have been partly obtained by increases in taxation and Commonwealth payments[25]. So the assertion that dividends have somehow brought about benefits like those listed above is difficult to prove.

In fact, an opposite assertion in economic terms can equally well be made: that what they might well be in part financing is a set of inappropriate or inefficient programmes or projects. An important point though is that the Government has greater accountability than any GTE regarding its use of these funds.

In the end, although it is probably true that dividends finance benefits, the argument should not be accepted uncritically. The proposition that dividends are financing the Government's own priorities is, however, self-evident. Whether the Government's own priorities are in fact providing the optimum benefit to the state will always be open to debate.

(iii) *In the absence of a share price. dividends represent the major financial return on their investment for* ***the Government and the*** *taxpayers*

According to this argument, a shareholder in a private company chooses to invest in it because he expects two main benefits: an increase in the share price sometime in the future (capital gain), and the regular payment of dividends. The Government as 100 per cent investor in state enterprises mostly cannot expect to receive the benefit of a rise in the share price because unless the enterprise is privatised there are no shares. So a major financial return for the Government and the taxpayers on the investment they have made in an authority must be the dividends they receive from it.

This proposition needs to be treated with caution as well. Carrying the argument a little further, if any dividend is a good thing, a big dividend would be an excellent one. A big dividend would seem to point to big profits, tight

[25] Which rose from $5.3 billion in 1988-89 to $5.4 billion in 1989-90, to $5.6 billion in 1990-91 (this represents Commonwealth General Revenue Grants plus Commonwealth payments for specific recurrent purposes). Source: NSW Public Accounts, NSW Treasury 1988-89, 1989-90 and 1990-91.

management and efficient use of resources. This is not always true. Indeed, quite often the opposite is the case.

"There is no such thing as a 'right' payout ratio, even though it should be **noted** that the ratio tends to be somewhat the same for the bulk of firma within a particular industry. Industries with ample opportunities for growth at high **rates** of return on assets tend to have low payout ratios, and the reverse tends to be true for industries with limited reinvestment opportunities"?

In other words, the enterprise might often be able to invest (retained) profits more productively in its own operations than the Government would anywhere else in the economy.

For example, a high dividend payout ratio with low capital base can in fact severely hamper a company's growth. Australian Airlines in 1980-81 is a case in point. In that year, the Government directed it to pay a dividend representing almost all of its profits. This prompted a protest from the Australian National Airlines Commission in its 1980-81 Annual Report:[27]

"In the Commission's view the level of profit, $2.520m, is insufficient to warrant any dividend payment. Looked at in the light of commercial criteria, it would be more appropriate for the profit to be retained to augment the Commission's inadequate capital base. Nevertheless the Commission is of course bound by the Government's direction to pay a dividend of 15% or $2.250m."[28]

There is no doubt that, in the absence of a share price, a dividend is a useful yardstick of an enterprise's performance. But a low dividend payout ratio should not necessarily be viewed as an indicator of poor performance. A great deal depends on the maturity of the enterprise, on its opportunities for new investment, and on its position in the market, if any exists. It might be argued, for instance, that a mature monopoly with a stable cash flow should have a

[26] "Managerial Accounting", R.H. Garrison, 3rd Edion, Business Publications Ltd, New York, 1982 p. 45.

[27] Quoted in "The Capital Funding of Public Enterprise in Australia" H.V. Evatt Research Centre, 1988.

[28] op. cit. p. 212..

high payout ratio. But even these enterprises could well have major opportunities for new investment. As was stated in evidence:

> "If you are looking for a magic number, whether it is a fifty percent payout ratio or **sixty** percent, there isn't one because it depends on the nature of each business."[29]

A reasonable conclusion would probably be that each enterprise needs to be looked at separately and its individual capital needs evaluated carefully. If it proposes a low payout ratio, this is not necessarily an indicator of inefficiency.

(iv) *Payment of a dividend constitutes salutary discipline*

In brief, this argument goes as follows: requiring a statutory authority to set and meet a dividend target imposes a salutary financial and management discipline on it. It will help forestall "goldplating" (excess investment), retention of surplus assets or staff and concomitant uncorrected low factor productivity, inappropriately low pricing policies, and, especially, too low a rate of return on equity. It could also encourage it to move to an optimum capital structure by examining the possibility of borrowing for capital expansion rather than relying on retained profits.

In evidence it was stated:

> "[the dividend process] is a very important indicator of management financial performance and one of the very good incentives that are generated by this sort of process, is for people to effectively manage their assets and non-core assets which have previously just languished in balance sheets."[30]

Again, this argument is subject to qualification. The need for a dividend on these grounds, while undeniable, should not be turned into an excuse for rigidly requiring a fixed payout ratio from an authority. The example of Australian Airlines cited above is a case in point. A rigid/requirement (of 15% of equity) led to almost all of the airline's profits being paid out to the Government as a dividend.

[29] Dr P. Moy, Assistant Secretary, NSW Treasury at hearings of 4 November 1991.

[30] As above.

The Victorian Government, in its *Public Authorities (Dividends) Act 1983*, similarly sets a fixed ceiling:

> "There shall be transferred to the Consolidated Fund in the financial year ending on 30 June 1984 and in each subsequent financial year by each public authority a dividend of such percentage (not exceeding 5 per centum) of the public equity of the authority as is determined by the Treasurer after consultation with the Minister responsible for the public authority."[31]

In the Committee's view any proposal to require a permanently fixed dividend, or to impose a fixed payout ratio, needs to be examined very carefully indeed. Capital spending requirements change from year to year, an enterprise's position in the market may change from one year to the next, and its factor productivity may change as well. Circumstances alter cases. It is worth expending extra resources on monitoring if only to ensure that these changing requirements are respected.

Provided that these qualifications are met, however, dividend targets are a very useful tool in improving financial and management practices.

(v) Private Companies Pay Dividends- so should GTEs

This argument appears in simpler and more developed forms. In the simpler forms, tax is not mentioned. The argument simply runs: private companies pay dividends; so should GTEs. The somewhat more complex version includes tax and runs: private companies pay tax *and* dividends; most GTEs pay no tax, so a fortiori should be required to pay dividends, which can quite legitimately be imposed at a high level. There have even been proposals that this level be a "non-negotiable 50% of before (company) tax profits"[32], for those enterprises

[31] Section 5(1).

[32] *A Financial Distribution Policy for New South WaNs Government Trading Enterprises,* Draft by NSW Treasury, 1992.

which do not pay tax.[33] Thus, the dividend would in effect constitute the equivalent of taxation.

Proposals such as this fail to take into account the numerous disadvantages GTEs labour under by comparison with private companies; Several may be cited. The following is not an exhaustive list.

Many private companies have complex schemes for attracting back to the company amounts paid out as dividends. As much as 75 per cent of paid-out dividends may be attracted back to the company this way. Companies know before declaring a dividend that this is likely to happen, so the amount originally declared as a dividend may be artificially inflated. The amounts attracted back to the company can then be used for expansion, current needs, or whatever.

GTEs cannot of course ever develop such schemes. The Government is unlikely to channel back to the GTE any of the paid-out dividend. Thus, the GTE's dividend is a real one, not artificially inflated, and represents resources forever lost to the GTE itself. It can never use them for expansion or current needs in the future.

So this is one reason why direct comparison between private companies and GTEs may be misleading, and why an unselective requirement that all GTEs pay the same proportion of their profits may be less astute than a well-designed case-by-case approach.

Secondly, private companies have one major incentive to declare a high dividend which does not apply to GTEs: the hope that a high dividend will raise their share price.

Thirdly, private companies commonly evolve other complex schemes, for tax minimisation. Declared taxable earnings may well be lower than those the company has in fact genuinely made. It is not at all unusual for real earnings to

[33] In 1991-92, the only bodies which will pay tax equivalents are the GIO, the Grain Corporation and the State Bank. Their tax equivalents total $62,700,000, out of total receipts of $907,474,000. Source: Budget Information 1991-92, NSW Budget Paper No. 2, p. 98.

be substantially understated in this way. Thus the amount available for distribution has been artificially reduced.

GTEs cannot ever take advantage of schemes such as this. They might understate profits by inflating costs, but the scope of this device is usually far more limited than that of the tax-minimisation schemes.

Another disadvantage suffered by GTEs is that their hands are tied by many kinds of regulation. Their flexibility on staffing levels and rates is limited; their ability to sell off surplus assets is often hampered by strict rules; their financial and administrative procedures are often subject to legislation which does not apply to any private company. As well, political decisions may dictate inappropriate pricing policies, which affect their earnings, or regulatory requirements may force them into large capital expenditures which they find difficulty in resisting. All of this will materially affect their ability to pay dividends.

But perhaps the most important difference between an ordinary private company and most GTEs is that the latter are providing the public with an essential service. Ideally, a contemplated measure would not run an unacceptably high risk of compromising the quality and general public availability of the service. The requirement for dividends non-negotiably fixed at a high level needs to be examined carefully to make sure that such risk is minimised.

Another possible drawback of this proposal is that it severely curtails the role of the enterprise's Board in the determination of the dividend.

There is another consideration as well, related to that outlined in Part 3(a)(iv) above, It may be unwise to impose a fixed percentage, or a fixed ceiling, or a fixed floor, for that matter, on all GTEs' dividends, for the reasons pointed out above. A balanced, case-by-case approach could possibly be more appropriate than a blanket determination indiscriminately covering all authorities.

It may be more logical to require high fixed dividends from bodies such as the State Bank and the GIO (Category F), because these have numerous direct competitors which all pay tax and dividends themselves. It would be beneficial if the logic for requiring dividends from authorities with few or no direct competitors were spelled out clearly.

All these considerations would seem to indicate that the "level playing field" argument with respect to dividends might have limited application, and that a well-designed case-by-case approach may be wiser than a general, blanket determination.

c. Framework for Determining Dividend Payments

As noted earlier, the actual process of working out the amount of the dividend a statutory authority should pay appears to be somewhat of a mystery for the public at large and even for many in Government. There does not appear to be complete understanding of which elements should be included in the calculation, how they all interact with each other, and how they all result in a figure for a dividend. Yet given the current size of dividend payments and the growing proportion they now represent of Consolidated Fund receipts, it would seem important that there be greater general understanding of the process.

The following section presents a general dividend-setting model for the public sector. The model is given here as a basis for understanding what happens, or should happen, in practice. It is kept deliberately simple, and does not include other factors like political pressures which in practice may affect the level of a dividend.

Although NSW appears to be leading the field in the development of the concepts, so far no public sector body or authority in Australia has formally articulated a dividend-setting model. The following section is offered as a contribution to the discussion.

The model can be summarised in two simple statements that follow generally accepted accounting principles. The second statement follows the first in logical order. They are:

Statement :1

1. Revenue minus cash and non-cash expenses equals operating Surplus

Statement::2

2. Operating surplus is available for:

(i) transfers to reserves
(ii) retained earnings
(iii) taxation equivalents
(iv) dividends

From Statement 1,

(i) cash expenses traditionally include, among other things:

(a) staff-related expenses

(b) other operating costs e.g. maintenance

(c) payment of interest on debt

(ii) non-cash expenses traditionally include, among other things:

(a) *depreciation*

(b) *deferred superannuation*

From Statement 2,

(i) transfers to reserves could be available for, among other things:

(a) planned equipment replacement

(b) reduction of capital portion of debt (as specified in Clause 4 of Schedule 3 of the Public Authorities Financial Arrangements Act 1987)

(c) planned future expenditures on new items e.g. new capital

works

(ii) retained earnings could cover:

(a) *unplanned or unforeseen expenditures*

(b) *increase in working capital*

(iii) taxation equivalents:

for a government trading enterprise these take the place of company tax.

(iv) dividends.

Therefore in simple terms, funds available to pay dividends equal revenue minus, in order:

- cash expenses
- non-cash expenses
- tax equivalents
- transfers to reserves
- retained earnings

Some of these terms require further comment and explanation in the public sector context. Revenue, for example, depends heavily on prices; the level of depreciation (a non-cash expense) depends on the value placed on the authority's assets; tax equivalent payments are a relatively new and unexplored part of the system; and interest payments (a cash expense) depend on the level of the authority's debt.

Each of these elements is dealt with separately below.

Pricing policies and their effect on revenue

Dividends, as shown above, depend in the first instance on revenue, and in turn, revenue depends critically on the price an enterprise charges for its goods and services. So price considerations are of basic importance to dividends.

Ideally, an enterprise's price should not be too low or too high. If it is too high, the public's need to consume more of it (or of other goods and services) is not being satisfied. If it is too low, this leads to an over-consumption of **the** enterprise's goods and services and a consequent drop in resources needed to produce others required by the community. In neither case is the maximum amount of the community's wants being satisfied. That is, resources are not being allocated across the economy in the most efficient way possible. In economic terms, there is lower allocative efficiency.

A separate question is technical efficiency. This operates only within the enterprise itself, not within the economy as a whole, like allocative efficiency. Technical efficiency is obtained when an enterprise is making full use of its resources, both capital and human, and is producing its goods and services at the least cost possible. The price an enterprise charges needs to reflect the full, real cost of those resources.

"So, for a particular public enterprise, there are two pertinent questions: Is **the** product being produced at least cost? and is the product being sold at a price which reflects its cost?"3"

In NSW, many enterprises do not enjoy technical efficiency, particularly in their use of the capital resources at their disposal. (The productivity of labour has risen substantially in NSW over the 1980s and continues to improve.) Several have vast capital overcapacity and therefore a very low rate of capital productivity.

Ideally, these capital resources should be "earning their keep", that is, the price an enterprise charges should be high enough to provide an adequate return on

[34] *Efficiency Comes in Two Versions and the State Needs Both*, Ross Gittins, Sydney Morning Herald, 18 August 1990.

the capital invested in them. In practice this is not happening. Prices do not reflect the cost of the enormous capital resources tied up in the operations of many statutory authorities.

This has implications for dividends. If an authority's prices are too low (that is, the cost of production, including the cost of capital, is not being reflected in them), then, assuming surplus assets are not sold, earnings are too low and dividends will be lower than they would otherwise and ideally have been. On the other hand, there are social groups benefiting from these low prices (e.g. beneficiaries of cross-subsidies) for which higher prices would mean hardship.

If prices are too high, on the other hand, allocative efficiency theory might suggest that demand for another authority's goods and services may be artificially depressed, resulting in dividends that are lower than they would otherwise have been from that source. However, there is always, as the Commonwealth Treasury points out "the temptation to allow pricing above efficient pricing levels in order to help fund future investments"?

Many authorities have differential pricing for their output. Water and electricity are two well-known examples, where the prices paid by domestic customers are lower per unit than those paid by smaller businesses, which in effect subsidise domestic consumption. These cross-subsidies, which are basically the result of political decisions, are at present not obvious or "transparent" in most authorities' accounts. Yet they critically affect earnings, and introduce an allocative distortion in the enterprise's operations and in the economy.

Charges and prices set by all authorities should be regularly monitored by the Government to help ensure technical and allocative efficiency as well as the meeting of social needs. This applies particularly to monopolies, which are not prevented by legislation from charging high prices that do not reflect the cost of a service?

[35] *Financial Monitoring of GTEs: An Economic Framework*Australian Treasury 1990, p. 67.

[36] For, example, s .34(2) of the Water Board Act, which deals with determination of charges, contains nothing which would stop the Water Board imposing monopoly-level charges.

The establishment of the new Government Prices Tribunal will be very significant on these issues. It will determine the maximum price for monopoly services supplied by nominated Government agencies and will report on the pricing policies of those agencies.

Asset valuation

In simple terms, the level of depreciation charges is in direct proportion to the value of the assets which are being depreciated. If the value of the assets is high, then depreciation charges will be high too, and, other things being equal, less funds will be available for dividends. If the value of the assets is low, the depreciation charges are correspondingly low, and more funds are available to pay dividends. How assets are valued is therefore critical for dividends.

There are three widely discussed methods of asset valuation: historic cost, current replacement cost and market value.[37]

1. Historic Cost

Historic cost refers to the original purchase price of an asset. Some statutory authorities still employ this valuation.

2, Current Replacement Cost

This values the asset by reference to the cost of the most appropriate modern replacement facility.

[37] This section draws on*Policy Guidelines for Valuation of Physical Non-Current Assets in NSW Public Sector*,NSW Treasury Technical Paper, September 1990.

3. *Market Value*

This method uses the current cost as determined by reference to a currently obtainable market value for the asset or a current appraisal by a recognised authority. Sometimes this appraisal is based on a calculation of the present value of the asset's future income stream. This method is only meaningful if a market, that is a buyer for the asset, actually exists.

At present most authorities' assets are valued at their original cost (1 above), not at what they would cost now (2 above) or would fetch now (3 above). One advantage of not valuing assets at current replacement cost or their market valuation is that these could result in big swings, up or down, from one year to the next. Historic cost is usually the only unvarying figure available. Another advantage of not using the current replacement cost method is that in some cases it results in an astronomical figure which is unrealistic. The disadvantage of historic cost is that it may not reflect the underlying value of the asset if it was purchased many years ago, especially in times of high inflation (resulting in an understated value); or conversely, in times of rapid technological obsolescence (resulting in an overstated value).

There is considerable controversy surrounding the adoption of different methods. The method preferred by Treasury is:

As a general principle, assets should be brought to account at their current cost valuation measured by the lowest cost at which the service potential or future economic benefits of the asset could currently be obtained in the normal course **of** business.[38]

Having been brought to account at current replacement cost, the assets would then be depreciated. If the current replacement cost is higher than historic cost, then the resultant higher depreciation charges would in most cases mean that less funds would then be available for dividends.

Much depends on how Treasury sets its dividend target at the beginning of the financial year. If the (Treasury-set) dividend target is based only on the funds

[38] op. cit. p. 30

available for dividends, as described in the model above, then managers would tend to support regular upward revaluation of their assets because the result would tend to be less funds available for dividends. If, on the other hand, the .dividend target is based simply on the value of the assets, then managers would tend to support historic cost, which as a general rule is lower than replacement COSt,

A related issue is the asset revaluation reserve. This is not a reserve created by realised profits. It is more of a notional reserve which is created from a higher value now notionally placed on non-current assets which were previously bought for a lower price than the new value presently put on them. These gains arise from notional revaluations and are unrealised. However, recent case law considers them to be profits and therefore available for dividend payments. How to deal with this matter is discussed further in Chapter 4.

Debt/equity ratios

A virtue of dividends is that they may force an authority to review its capital structure as between debt and equity, so as to find the optimal mix. The proper mix of debt and equity is a typical issue dividing the Government and the managers.

GTE managers tend to view all debt as something devoutly to be avoided. One assumption behind this reluctance to enter into debt is that the GTE's returns could be reinvested *in the GTE's own operations* more profitably than elsewhere. This assumption may be false. A GTE may be able to get higher returns by investing elsewhere than the interest rate it would have to pay for borrowed funds for expansion. For example, if it could invest its profits and earn 15% on those funds, while at the same time borrowing at 12% some of the funds necessary for any expansion (which is projected to earn 13%), it is doing better than if it simply retained its own funds for expansion. A very simple calculation will illustrate: say a GTE at the end of one financial year had $1000 to invest for the next. If it loaned out its funds at 15%, it would get $150. If it borrowed at 12%, it would pay out $120, leaving a surplus of $30, If it neither loaned out or borrowed, but just reinvested in its own operations and earned 13%, it would end the year with $130. But if it loaned at 15% and borrowed at 12%, it would end up with the $130 it would earn from its year's operations, *plus the* $30 it earned by loaning and borrowing.

Thus equity may be effectively dearer than debt.

The Government is aware that it is only rarely that a GTE's own funds can earn the maximum possible amount if invested in the GTE's own future operations. It will usually be able to identify numerous other, more profitable, uses for the funds. Indeed the Government will have its own priorities, e.g. in health and education. This is why it will seek a dividend. The GTE however will be reluctant to give up its profits in the form of dividends, and will by the same token be reluctant to borrow, because its managers believe it can make the best possible use of retained profits in its own operations. Managers will also prefer the security and predicability of using their own funds rather than borrowing.

Demanding a dividend from an authority will remove from it some of the funds it might otherwise have been tempted to use for expansion. It will then be forced to examine its best possible debt/equity ratio, not necessarily a bad thing.

Taxation equivalent payments

In March 1992, Treasury circulated for comment a draft *Financial Distributions Policy for NSW GTEs.* It included a chapter entitled "Taxation Equivalent Payments". This began:

> "Ultimately, the Government's commercialisation process will see all GTEs subject to a notional taxation regime operated by the Office of State Revenue or a **nominated tax** collection agency (in some instances it may be the Australian Taxation Office, or a private-sector tax specialist). Within this regime the GTE is subject to all the **same** taxes that would prevail were it operating as a private-sector firm. In the case **of** Commonwealth taxes, including both company tax and sales tax, taxation equivalents are levied consistent with prevailing rulings of the Australian Taxation Office. GTEs within the notional taxation regime are also to be subject to all State and local Government taxes. Commonwealth taxation equivalents and State taxes are assessed and collected by the State government and are paid into the Consolidated Fund. Local Government taxes are assessed and collected by the relevant local government authorities and form part of their revenue base."

Earlier, the document also states:

"It is appropriate to dismiss the notion that within the capital structure/funding decision-making process dividends and capital expenditure are related to **one another** in a simple tradeoff. While there is a tradeoff, it is in fact a complex one between dividends, taxation (through dividend imputation), interest payments, debt and equity raisings, retained earnings and capital expenditure. In other words, dividends paid **are** not necessarily capital works foregone."

Without wishing to comment on policy, the Committee would observe that this does not clarify which authorities are likely to be liable to the notional tax regime and which are not, nor does it give the basis for including authorities in the notional tax regime, nor does it state when they are likely to be included. While the Treasury states that it considers that dividends paid are not necessarily capital works foregone, the Committee has found that many authorities believe on the contrary that that *is* the case, and so it would be expected that a further extraction from authorities' surplus in the form of Commonwealth, state and local taxes would also be considered by them to represent further capital works foregone. More examination and explanation **are** needed on these issues.

The 1991-92 Budget projects that three authorities will make taxation equivalent payments: the GIO ($38,300,000), the Grain Corporation ($4,400,000) and the State Bank ($20,000,000)[39]. From this one might deduce that only authorities operating within a competitive market should be paying taxation equivalents. Again, more explanation is needed on this issue.

Special Dividends

The above discussion does not deal with special dividends. In a circular,[40] Treasury distinguishes between the different types of dividends:

[39] NSW Budget Papers no. 2 p. 98.

[40] T91/1538C of 25 June 1991

There are three distinct types of distributions to the Government by trading enterprises. They are -

(a) normal dividend: a return the Government expects from the profits of an agency;

(b) special dividend: an additional return, which may exceed available profits but is not an "other capital return" (refer [c]), and

(c) other capital return: a reduction in the amount invested**in an** agency, i.e. a return of all or part of the original capital contributed.

SO far only three authorities have paid special dividends. Sydney Cove Authority paid $75 million in 1989-90, based on property sales, and 970 million in 1990-91, based on property sales and a cash disbursement; the Electricity Commission paid 965 million in 1990-91; and Sydney Electricity paid 960 million in 1990-91.

Special dividends should normally be paid only out of realised profits. However, in some Circumstances Treasury may wish to require an authority to pay a special dividend when there are insufficient retained profits to enable it to do so. In those cases[41] Treasury considers it appropriate to call upon the asset revaluation reserve mentioned above[42]. It outlines two conditions for the use of this notional reserve for dividend payments:

(a) the carrying value of the non-current asset, to which the asset revaluation reserve relates, must be based on a reliable, bona fide valuation and must not be expected to decline substantially in value in the long term or be subject to major short term fluctuations, and

(b) the payment of a dividend from the retained profits/accumulated surplus account following a transfer from the asset revaluation reserve must not place the agency in cash flow difficulties - that is, the agency must have sufficient cash resources available to finance its operational cash needs (including asset replacement and loan repayment when required) and growth plans, if any.

There needs to be vigilance that these conditions are adhered to in practice.

[41] See Chapter 4 for recommendations on the matter.

[42] p? 38 above.

d, Community Service Obligations

The link between dividends and community service obligations has not yet been fully explored in any publication, and the following is offered as an contribution to the discussion,

At present there are several definitions of community service obligations (CSOs). Some even hold that CSOs should not be conceptually separate from the general business of an enterprise and should not be separately defined at all.[43]

The Commonwealth Bureau of Transport and Communications Economics has defined a CSO as:

"A CSO is a Government requirement to provide products or services to **community** groups at a price less that the cost of supplying them";[44]

The EEC definition (for transport organisations) is:

"Obligations which the transport undertaking in question, if it were considering its **own** commercial interests, would not assume or would not assume to the same extent or under the same conditions".[46]

The Commonwealth Department of Transport and Communications has offered:

"A CSO is an obligation on anybody, including a GBE (Government Business Enterprise), to provide activities of a community nature."[46]

Telecom in 1989 provided this definition:

[43] For example, *Equity in Telecommunications* by Holly Raiche, University of New South Wales, and *Guaranteeing Social Objectives: A Community Perspective* by Adam Farrar, National Council of Social Service, papers presented at December 1991 conference on Community Services Obligations, Sydney.

[44] Quoted in *Keynote Address: Commercialisation Objectives and their Effect on CSOs.* Paper presented by Len Early, Department of Finance, at December 1991 Conference on Community Service Obligations, Sydney.

[45] As above.

[46] As above.

"activities or policies that Telecom would not choose to pursue on the same conditions if acting solely on commercial principles".[47]

Prospect Electricity has stated:

"in the context of a more market driven and commercialised public sector a "community service obligation" is a service, or some attributes of a service, which would not otherwise be available to the community or a section of the community if left to market forces alone; i.e. there needs to be some Government intervention and directive".

and proposes:

"A CSO consists of three essential features:

(a) a service

(b) obligatorily provided

earning insufficient revenue to fully recover direct costs thereby not making a positive contribution towards meeting joint or overhead costs" ?

Probably the most well thought-out definition can be found in *Out on the Table: the Cost of Community Service Obligations,* the thirty-second report of the Victorian Parliament's Economic and Budget Review Committee in November 1991. The report offers:

"A Community Service Obligation should be defined as arising when the Parliament or the executive government expressly requires a government business enterprise to carry out an activity which it would not elect to provide on a commercial basis, or which would only be provided commercially at a higher price".[49]

All of these are different, and the differences in definition will yield different values for CSOs, and consequently for dividends.

[47] As above.

HOW do you define a community service obligation? Paper presented by Gordon R. Douglass, General Manager, Prospect Electricity at above conference.

[49] p. xvii.

As far as dividends are concerned, there are two main questions*(a) Where are CSOs to be funded from?*

(b) How and by ***whom are they to*** *be calculated?*

With respect to funding sources for CSOs, there are two main possibilities: the enterprise's own funds, on the one hand, or the Consolidated Fund, that is, central funding, on the other.

If the enterprise's own funds are the source, the CSOs will self-evidently have to be paid for by the more profitable activities of the enterprise, in other words, by a cross-subsidy essentially covered by those who do not use the service. This will clearly leave less funding available out of profits for any payment of dividends. It also has the additional disadvantage of all cross-subsidies of not being obvious or "transparent" in the accounts of the enterprise.

If on the other hand the Consolidated Fund is the source, an enterprise's dividends should not be reduced to pay for its CSOs.

In New South Wales, the State-Owned Corporations Act 1989, for example, entitles a state-owned corporation to be reimbursed "from money advanced by the Treasurer or appropriated by Parliament for the purpose"[50] for any CSO activity it undertakes. in this case, the enterprise does not have to fund its own CSO's, cross-subsidy is avoided and dividends are not directly affected.

The usual method under this arrangement is that the enterprise enters into a contract with the government for the payment of its CSOs.

However, under this arrangement, Consolidated Fund has to pay for these loss-making activities out of the typically narrow tax base available to state governments. The government may not have the funds available, and it may be easier and more administratively efficient to have the enterprise calculate and pay for its own CSO's. This arrangement would then probably diminish dividends.

[50] s. 11 (3).

This leads to the second question,*"how and by whom are CSOs to be calculated?"*

There is vigorous debate at present about which of two main methods of estimating CSOs should be adopted: the "fully-distributed cost" method developed by Telecom in 1989 and the "long-run avoidable cost" method adopted by the Bureau of Transport and Communications Economics and most other authorities. Without going into the refinements[51] these two methods can yield radically different results. For example, using the fully-distributed costs approach, Telecom's CSOs were estimated to cost about $800 million, whereas using the avoidable cost approach, the BTCE estimated that Telecom's CSOs cost $240 million.

The implication for dividends is clear?

[51] For a detailed discussion, see the Victorian Parliament's Economic and Budget Review Committee Report op. cit.

[52] See Chapter 4 for recommendations on the matter.

e. Agency Theory

Agency theory, which was developed in the 1970s[53], is considered to be **of** relevance to GTE management and by extension to GTE dividends. Although in its refinements it can be quite complex, the basic premise of agency theory is simple: an agent (A) appointed by a principal (P) to carry out a task for P will tend to have and follow his (A's) own priorities, and these are not necessarily the same as P's. It follows that in order to make A follow P's priorities, P has to give A suitable incentives and to structure the task so that their interests, and the information available to both, coincide.

The management of GTEs seems to provide a neat illustration of this theorem. The Government is viewed as the principal, and the managers of the GTEs as the agents. The principal appoints the agents to manage GTEs on its behalf. It is entitled to do so because it is the 100% shareholder of all GTEs. Just as any shareholder effectively appoints the managers of a company he has invested in to run it on his behalf, so is the government entrusting GTE managers with its funds.

But GTE managers may not have the same priorities as the government. For example, the Government is interested in improvements in the productivity of the capital it has invested in GTEs, even when this may mean asset sales and staff reductions. It is also likely to be interested in higher dividend payments. None of these measures is likely to meet with the enthusiastic' approval of a GTE's managers, and indeed none have.

There are costs associated with the divergence of interest between P and A. For example, P has to spend effort, money and time monitoring A to make sure A does the job as P wants it done. There is also a more nebulous cost, usually called the "residual cost", which is P's. This is the loss P incurs simply because A is doing the job differently from the way P would have done it if P had had the same information and talents as A.

[53] By, among others, S. Ross(*The Economic Theory of Agency: The Principal's Problem, American Economic Review*63(2), May 1973, 134-9), M. Jensen(*Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, Journal of Financial Economics,* 3, 1976. 305-60, and J. Stiglitz*(Incentives and Risk Sharecropping, Review of Economic Studies,*41, April, 219-55) among others.

The "principal/agent problem" as it relates to GTEs is one which has received considerable attention from Government sources? The "problem" is essentially how to provide incentives to GTE managers so that they follow the government's priorities of technical and allocative efficiency, rather than just their own, more limited goals.

Dividends are considered to be one major incentive. If an authority has to pay a dividend, it is in this view less likely to retain surplus assets and staff which drain its resources and make paying a dividend more difficult than it would have been otherwise.

Asset valuations, as discussed above, provide yet another illustration of the principal/agent problem as it relates to dividends. GTE managers will see little incentive in valuing assets at current replacement cost instead of historic cost, when that means raising the basis for their dividend calculation. The government, however, wishes to obtain a (reasonable) dividend and this means, inter alia, changing the basis of asset valuations.

A third. illustration of the principal/agent problem is in the differing perceptions held by central government and managers of the ideal debt/equity ratio, as outlined above in Chapter 3(c).

The number of principal/agent problems in the government/authority relationship is legion. The information available to both seldom coincides exactly, and it is often difficult in practice for the government to design effective incentives for GTE managers so that they fulfil the government's own objectives rather than merely their own.

See "Characteristics of a Fully Corporatised Government Trading Enterprise and Checklist for National Stocktake of GTE Reforms", Background papers prepared by the Special Premiers' Conference Co-ordinating Task Force on GTE Reform. Reproduced by the NSW Treasury, August 1991.

Against this must be balanced the-need for managerial authority. As Don Nicholls points out:[55]

> "Regardless of how clear management's social objectives are, sound economic performance will not eventuate unless managers are given the authority to make the key production decisions required to achieve those objectives."

Having pointed out the need for managerial autonomy, the concept of agency theory nevertheless provides a useful framework for identifying problems in GTE financial management and then attempting to devise their solutions.

[55] In *Managing State Finance: The New South Wales Experience*, NSW Treasury, p. 74.

4. FINDINGS OF INQUIRY

a. General Findings (Recommendations 1, 2, 3 and 4)

In general, the Committee found that there was room for improvement in the openness and the clarity, or transparency, with which Treasury has articulated its dividend policy. Many in government, and among the public at large, had little clear idea of the reasons for Treasury's dividend policy, and indeed, of what the policy itself was. As a result, there exist numerous misconceptions of what the policy. is based on and of how it works. Often, those who most needed to know were the ones with the greatest lack of knowledge.

There has been little Parliamentary or public discussion of the policy or practices of dividend payments, which is disturbing in view of their size and importance for both the NSW Budget and the individual authorities.

Recommendation 1

That Treasury articulate and implement its dividend policy with greater openness and transparency.

Some of these deficiencies may be simply the result of the newness of Treasury's GTE Monitoring Unit. Operating for several years with very few staff, and in addition, breaking new conceptual and operational ground, it has only recently acquired enough resources to do its job effectively.

A beginning has already been made in achieving greater openness and clarity with the March 1992 discussion paper on distributions policy. This needs to be followed up. The Treasury now needs to start from the ground up in its articulation of its dividend policy. It should prepare for public discussion a series of documents couched in clear, understandable, non-technical terms. **The** first of these should be a general articulation of its dividend policy and of the basis for its calculation of dividend levels for individual authorities.

Recommendation 2

That Treasury prepare for public discussion an understandable, non-technical document clearly articulating:

- · *its dividend policy;*
- · *the basis for its calculation of dividend levels.*

Recommendation 3

That this publication refer to specific authorities and not simply be couched in general terms.

In this connection, the Committee does not believe that all the onus for **greater** openness on dividends should be on Treasury. The statutory authorities should also contribute to the process. One way for them to do so would be through an amendment of the Annual Reports (Statutory Bodies) Regulation 1985. Cl. 4(1)(h) presently requires a statutory authority to record in its annual report various details of its management and activities, including (subclause 4(1)(h)(ia)):

"where practicable, qualitative and quantitative measures and indicators of performance showing the level of efficiency and effectiveness;"

The Committee proposes that among these measures and indicators be included the extent to which a dividend-paying authority has met its dividend target as set at the beginning of the year,

Recommendation 6

That subclause 4(1)(h)(ia) of the Annual Reports (Statutory Bodies) Regulation 1985 be amended to read:

"where practicable, qualitative and quantitative measures and indicators of performance showing the level of efficiency and effectiveness, including where relevant the extent to which dividend targets have been met".

Recommendations for the preparation of further documents are set out below. The Committee believes there is nothing to be lost from open public discussion of the issues,

b. Criteria for selection of authorities to pay dividends (Recommendations 5, 6 and 7}

It was shown in Chapter 2 that Schedule 2 of the Public Finance and Audit Act consists of a list of 154 authorities which are liable under law to pay dividends. Because s. 59B of the Act gives such unfettered and unequivocal power to Treasury to claim dividends, it is very important that Treasury be absolutely clear, among other things, on which authorities should pay dividends, and that it enshrine its conclusions in law.

Unfortunately, up till now this has not been the case. First of all, the 154 authorities in Schedule 2 are not differentiated in any way or separated into categories.

Some of them are clearly trading enterprises, such as the Water Board or the Maritime Services Board. That is, they operate on a commercial basis, require payment for their goods and/or services, and actively aim not to lose money, Others, like the Chiropodists Registration Board and the Board of Governors of the New South Wales Conservatorium of Music, cannot ever be considered as operating on a commercial basis. Yet their inclusion in Schedule 2 renders them potentially liable to pay a dividend to Consolidated Fund.

In contrast, the number of authorities which have actually paid dividends has been limited to three in 1986-87, eight in 1987-88 and 1988-9, ten in 1989-90, and sixteen in 1990-91.

The Parliament's Regulation Review Committee, in its twelfth report to the Parliament, recommended after seeking advice from counsel that the relevant legislation, that is, Schedule 2 of the Public Finance and Audit Act, be amended so that "it includes only those authorities that operate on a commercial basis."[58]

In a major paper, *Classification and Control of State Organisations*, published in June 1989, Treasury divided authorities into six categories, according to the

[58] Regulation Review Committee, op. cit. p. 14.

degree to which they operate on a commercial basis.[59] The paper appears to suggest[60] (somewhat obliquely) that only those authorities in the last two categories, that is, those which are a commercial business (Category E) or a commercial enterprise (Category F), should be required to pay dividends. However in practice, authorities in categories "C" (Semi Commercial Business: partly subsidised semi competitive body (e.g. Urban Transit Authority)) and "D" (Commercial Service: self sufficient monopolistic body le.g. Sydney Water Board)) have been required to pay dividends, as shown in Table 4.

In a submission to the Committee[61] Treasury also stated that:

"While there is (sic) no formal criteria established for the implementation of a dividend paying regime on GTEs, there are four basic measures for selection which should be satisfied:

(1) Commercial in Nature: For GTEs to be considered for dividend payments they must have as a large component of their operations the provision of 'private' goods or services into a commercial environment. In practice many GTEs operate as monopolies and so ,their output market cannot strictly be defined 'competitive', however their outputs are tradeable and could be supplied by the private sector on a profitable basis.

(2) Not Reliant on Consolidated Fund:Dividend paving GTEs should be largely self funding and not be reliant on Government contributions for the majority of their revenue. A possible exception to this rule is when an organisation has a clearly identifiable business component as well as Government funding. In these circumstances a dividend may be paid from the commercial activity. This is considered preferable to allowing the organisation to cross-subsidize non commercial activities from the profits of its business activities.

(3) Ability to Pay:There is little to gain from applying a dividend paying regime to GTEs which are currently operating with significant deficits.

(4) Size: Within the outer Budget sector there are many small agencies which may fit many of the above criteria, however due to the small size of their operations have not been selected for the payment of dividends."

[59] See p. 18 above.

[60] p. 40.

[61] (Letter ref. T91/1884D) undated

If the criteria set out in the Regulation Review Committee's report and in Treasury's submission were adopted, only commercially-operating authorities would ever be liable in law to pay dividends, Regrettably, there does not seem to have been any attempt to refine the list in Schedule 2 so that it applies only to commercially-operating authorities, As it currently stands, it presents an occasionally ludicrous catalogue which is full of anomalies, It also arouses uncertainty and apprehension on the part of statutory authorities which have never yet been asked to pay a dividend but are still on the list of potential payers,

An example is the Local Government Electricity Association (LGEA), the employer association for the electricity distribution industry in NSW, with 24 members. The LGEA cited three reasons why its members should not appear in Schedule 2. One of these was that they did not operate for profit, but another, more fundamental, one was that the government did not "own" them. In a submission to the Parliament, the LGEA stated:

"The Local Government Electricity Association of NSW, believes that there is no ownership relationship between the State Government and electricity councils; **the** relationship is a regulatory one only.

Over the years, councils' operations and assets have been funded by the industry itself and its customers. The State Government does not have any equity or capital in distribution utilities. Such sinai payments as have been made from time to time have been to partially pay for community service obligations imposed by **the Government.**

Against this background, LGEA argues that there is no justification for any imposition of any taxation by way of a dividend to Government. Association policy is that any "excess funds" within a councils should be used, in the first instance, to reduce the cost of electricity to that council's customers and secondly, to benefit customers in other county districts,"

It also stated in hearings:

"It seemed to be saying, as I read it - and I am not a lawyer, I hasten to say - but it seemed to me that it was saying, "If the government is providing some benefits to **the** county councils, not necessarily by way of capital injection, that then that would be justified" - and one would have to accept that, but as we said, we do not believe the government really is providing those sorts of benefits It also then went on, as I read it again, to question whether - the difference between whether something was legally appropriate and whether it was appropriate in other reasons of course raised the question about whether or not the county councils were commercial organisations in that they were required not to make a profit over and above what was needed to **keep** the thing going."

Counsel advised the Regulation Review Committee:

"It seems to me difficult to conclude from the materials referred to in my earlier Memorandum that some specified element of "crown or public ownership" is a necessary precondition to the operation of s. 59B. In particular, it seems to me difficult to conclude that a county council must be outside the scope of s. 59B merely **because** the Government is not the sole shareholder. In other words, if it is assumed that a county council carries on trading activities for profit (a matter referred to further below), I do not think it would necessarily be exempt from the operation of s. 59 B ....

However, if a county council did make profit from trading activities and did so through the exercise of statutory powers and with the assistance of government financial support, it does not seem to be inconsistent with the objectives of s. 59B that The Treasurer should be permitted to require part of the profit to be paid to consolidated revenue. The mere fact that the government is not the sole shareholder would not, it seems to me, deprive the county council of the character of a public authority trading for commercial purposes. In other words, it seems to me to be within the contemplation of s. 59B that a statutory authority operating on a commercial basis and for this purpose utilizing specific statutory powers and governmental financial assistance, might be the subject of a direction in relation to dividends."

For the Government to claim a dividend, therefore, several conditions appear to have to be satisfied, according to counsel. First the authority must be trading for profit, then it must do by the exercise of statutory powers, and lastly it must have the assistance of government financial support.

Ownership is not a criterion by itself. So the fact that the government may not "own" the LGEA's members is not in itself enough to prevent the payment of dividends. However, the fact that the authorities do not trade for profit and that they do not receive direct assistance from government may be enough. This point needs to be clarified further and the discrepancy shown in Table 4 needs to be regularised.

In fact, there needs to be much greater clarity both in legislation and in the development of concepts as to the criteria for selecting authorities to pay dividends. The following three recommendations are to be taken together.

Recommendation 5

That Treasury initiate the redrafting of Schedule 2 of the Public ***Finance and*** *Audit Act so that it includes only those authorities which are genuinely liable to pay dividends.*

This would not necessarily deny Treasury any flexibility, Any alterations to the list could always be made simply, by regulation. The benefits of clarity would certainly outweigh any costs;

Treasury's submission to the Committee[62] states:

"While there is (sic) no formal criteria established for the implementation of a dividend paying regime on GTEs, there are four basic measures for selection which should be

satisfied ... "

and then briefly discusses these criteria,

However by itself this cannot be considered sufficient. The submission to the Committee was not a formal document for public discussion, and its brevity meant that several issues and their implications were not covered.

This absence of formal criteria is undoubtedly causing unnecessary distress and confusion among authorities and regulatory bodies alike, It seems time now for a detailed analysis of the criteria for paying dividends.

[62] Letter ref. T91/1884D undated. See footnote 61.

Recommendation 6

That Treasury prepare a detailed publication setting out and thoroughly discussing the criteria for the selection of authorities to pay dividends.

Recommendation 7

That this publication refer to specific authorities and not simply be couched in general terms.

c. Consultation (Recommendations 8, 9, 10 and 1 1)

"Our preference is for wide and extensive consultation", stated the Secretary for Treasury in a speech to GTE managers in 1990.

So far, however, this consultation has been limited to discussions on how much a dividend payment should be, and when it should be paid. There has been little consultation on whether a dividend should be paid or not.

Perhaps the clearest example of this is the $60 million special dividend required of Sydney Electricity in 1990.

On 18 June 1990, the Minister for Minerals and Energy directed the (then) Sydney County Council to pay a contribution of $60 million into the Electricity Development Fund on or before 30 June 1990. This direction was to facilitate payment to the credit of the Consolidated Fund by the Energy Corporation of NSW.

The intent of the direction was unambiguous, i.e. the contribution from the County Council was to be reflected as a Consolidated Fund receipt in the Treasurer's Public Accounts for 1989-90.

Following Treasury advice dated 27 June 1990, that the payment of the dividend would not be required in 1989-90, the Minister revoked the previous direction and instead directed that the contribution be credited to the Consolidated Fund on or after 2 July 1990, as a dividend. In fact, the actual date of payment into the Consolidated Fund was 6 July 1990.

The effect of this exercise was that Treasury held the sum of $60 million in Special Deposits at 30 June 1990, the end of the financial year, and eventually brought it in to the Budget result for 1990-91.

The Auditor-General in his report[63] stated that "...I have great difficulty in accepting that the accounting for this receipt item is appropriate..."

[63] 1990. Vol 2, p. 19.

A remarkable feature of this exercise was the lack of consultation with the Council. At about ten days' notice, it was simply directed to pay $60 million.

Committee: With the payment and special dividend going to Treasury, have you ever been placed in a situation where you have had to borrow money to pay for these dividends that have been paid?

Mr McIlwraith: In the short term we have. The $60 million that we paid last year because I only had ten days notice to raise the money, I had to borrow $30 million .....

The Forestry Commission in its evidence also described how it was not consulted about the payment of its first dividend:

Dr Drielsma: There is no doubt that in the first year it was very much done **without** consultation. It was simply placed on us at very short notice and we hadn't had any opportunity really in our financial planning to take it on board.

The difference between consultation about paying a dividend at all and consultation about the amount of the dividend was highlighted by the witness from the Zoological Parks Board:

Mr Smith: The dividend model was an imposition I guess more than an issue **of** consultation, in that I believe the Treasury made it quite clear to the Chairman of the Board and the Director that a dividend was to be paid. It was really only a matter of determining what the extent of the dividend was through consultation.

This was confirmed by the Sydney Cove Authority:

Committee: Are you comfortable with the fact that you can negotiate ...dividend payment to suit your own business operations?

Mr Mitchell: Well, it really wasn't in our hands in a sense. It was driven by Treasury.

None of this is illegitimate. As was seen in Chapter 1, the Treasurer has under s.59B of the Public Finance and Audit Act an unfettered and enforceable right to require a dividend of an amount and at a time of his own choosing.

The Committee found, however, that some authorities so directed were dismayed and indignant at the lack of consultation on the fact that a dividend was about to be required, particularly if this was the first time they had ever had to pay a dividend. With the list of dividend-paying authorities growing ever longer, a continuing lack of consultation with new payers would not be advisable.

Recommendation 8

That *Treasury give adequate* ***notice to*** *all authorities selected for the first time for dividend payment.*

Recommendation 9

That Treasury negotiate ***the amount*** *of such payments with* ***the selected*** *authorities on a case-by-case basis, rather than only* ***on the*** *basis of a fixed formula.*

The Committee found that consultation about the actual amount of the dividend has been much more extensive. It is noteworthy, however, that the authority which made the clearest statement of satisfaction with the consultation process was the Maritime Services Board, which enjoys a statutory right to consultation under s. 46(6) of the Marine Administration Act:

> Extensive consultation occurred in respect of the 1989-90 and 1990-91 dividends as required under the Act. Those consultations involved consideration of the MSB's liquidity, capital requirements, financial policies, profitability and return on assets.[64]

Recommendation 10

That in any future reworking of the Public Finance and Audit Act 1983 ***the*** *Treasury include a provision requiring the Treasurer to consult with authorities on their future liquidity and capital requirements* ***when*** *determining the amount of the dividend.*

[64] Letter to Committee dated 20 September 1991.

An interesting aspect of the consultation process was highlighted by the Commissioner for Forests:

Dr Drielsma: I guess some of the frustrations that I have' had with it (the dividend consultation process) are it has perhaps tended to be at too low a level. We have had Treasury officers talking direct with my accounting and finance people, where really these issues are strategic issues where I think I ought to be sitting down with senior officers from Treasury or perhaps with our respective Minister and negotiating a dividend based not only on performance, but also our capital requirements into the future...

and again,

Committee: That [$11m dividend] was the recommended figure by you or your Board to the Treasury?

Dr Drielsma: "Again it was arrived at in terms of this consultation process which I have indicated I am not entirely happy with, so it wasn't me directly negotiating directly with Treasury. It tended to be what our officers lower down arrived at...it has been very much not even a written process, it tends to be sort of phone calls between officers, officer level, and not a very formal negotiated position...

Recommendation 11

That the Chief Executive of the statutory authority paying a dividend and the Secretary of the Treasury participate at an early stage in the financial year in negotiations on the level of the authority's dividend target.

d. Timing (Recommendation 12)

The Committee noted a number of instances where a dividend was required with relatively short notice. The case of Sydney Electricity cited above is one. Here the Authority was given ten days' notice to pay a dividend of $60 million. As a result it came very close to being forced to borrow as its Chief Executive pointed out.

The Forestry Commission was another case in point.

"...a dividend of $14.5m was determined by Treasury for 1989-90. In subsequent negotiations with Treasury, this figure was reduced to $10m payable in two instalments on 28.9.90 ($6.3m) and 28.6.91 ($3.7m),in recognition of both the Commission's limited cash reserves and lack of prior consultation or notice which would have allowed proper financial planning for dividend payment."

Perhaps in recognition of some of these criticisms, Treasury in November 1991 issued a circular[64] entitled *The Timing of Dividend Recommendation, Consultation and Payment.*

"Overall Timeframe

Currently, dividends paid in a financial year are based on profitability in the previous financial year. The timing of payments have to date been negotiated separately between the organisation and Treasury. The Government is of the view that the negotiation process can be streamlined by establishing a unified timetable for all GTEs and SOCs and based on their respective financial year.

> The overall timeframe for payment of a normal dividend would be within six months of the end of the GTEs/SOCs' financial year. Additional dividends (formerly referred to as special dividends} are to be paid on a negotiated basis.
>
> Within the six month timeframe the following milestones are to apply:
>
> (1) The initial dividend recommendation by the Board is to be with the Treasurer within two months of the end of the GTEs/SOCs' financial year.

[64] G. 1991/43,

(2) Consultation as to the final dividend amount is to be completed within three months of the initial dividend recommendation being received, i.e. the final dividend amount is to be resolved within five months of the end of the GTEs/SOCs' financial year.

(3) Payment of the final dividend is to be made within one month of the agreed dividend amount being struck, i.e. final payment is to occur within six months of the end of the GTEs/SOCs' financial year.

Superimposed on this timetable is the requirement for GTEs/SOCs to provide {at least) three year forward estimates of dividends as input into the Budget cycle. The forward estimate process take place in three rounds with estimates being provided in February, April-and June."

Whether it is in fact possible to adhere to this timetable is questionable. Establishing a unified timetable has the virtue of predictability for both authorities and Government. However, circumstances change each year for practically every authority, so some flexibility, for example the provision of a range of dates, needs to be built into this system so that it does not collapse entirely or become irrelevant with minor departures.

Recommendation 12

That Treasury build some flexibility into its timetable for dividend payments.

e. **Effect on Capital Investment** Plans
(Recommendations 13 & 14)

Obviously if an agency is required to pay a dividend it must reduce its retained earnings or increase its borrowings. Either way the agency is left with the ability to invest [ess in capital projects. At various stages and for many different reasons, almost all agencies will need to make capital investments to renew obsolete equipment or to provide capacity increases. If the dividend requirement is imposed without sensitivity to these investment needs, it is possible that much larger investments may be needed to satisfy the needs in the long run.

It quickly became clear to the Committee that forward estimates of capital works expenditure are taken into account in the process of determining dividend payouts, As with asset valuations, it became evident that capital works estimates provide scope for "strategic behaviour" on the part of GTE's and Treasury, in the pursuit of lower and higher (respectively) dividend payouts.

Treasury was initially coy in admitting to its influential role in modifying an agency's capital works estimates. Chief economist Dr Jeffrey Bateson discounted the suggestion that Treasury "second guesses" these estimates. However Assistant Secretary Dr Paul Moy then expressed scepticism regarding the necessity of some programmed capital works projects:

"It is not our business nor do we have the capacity to second guess their capital works programme. You have touched on an important issue though. Capital works is always a very difficult issue with the public sector because as is recognised around the world, there is an incentive for gold plating or excess investments. That is why a number of our authorities have substantial excess capacity. Ultimately you could set up **another** bureaucracy to try to second guess them. I don't think that would be efficient. I think

ultimately the only way to make sure that capital works is appropriate, is to ensure that

all the authorities earn an economic rate of return on those capital works."

To counterbalance these concerns, the Committee heard from the Water Board of its ambitious expanded business plan and of the anticipated conflict this would cause with dividend policy;

"... as we go down the path of meeting our expanded business plan, our expanded capital works programme to improve the environment and clean up the waters of Sydney, there is going to be a very large drain on our cash resources **and on our** reserves and at that stage we have to look at our capacity to pay a dividend; because obviously if we continue to outlay money on a very large expanded business plan and we are still paying large dividends, then we are either going to run out of money **or we** will have to cut back on the business plan. So that the balance has to be do you want to cut back on the objectives that you and the Government have set to improve the environment, or do you want to cut back on the dividend."

In the case of the Water Board part of the expanded business plan was to meet regulatory requirements imposed on it rather than to goldplate for the sake of goldplating.

The Committee also heard from the Electricity Commission about its dissatisfaction with the way deferred capital expenditure was treated as profit by Treasury:

"There is probably one unresolved matter in that the Treasury occasionally seeks a special dividend and they have sought a special dividend this year, which we **are** challenging. They sought and we looked at reducing our capital expenditure in line with Government policy. We managed to cut $22,000,000 off our capital expenditure. It is a deferred expenditure, it is not cut completely. Inevitably we will have to spend that money. They believe having saved '$22,000,000' this year, that ought to come to them as a special dividend. We don't see mat as being equitable or being right, so we have indicated that we don't agree with that. It is up in the air at the moment."

Dr Moy from the Treasury replied that since the $22 million was not spent on capital works, that element of retained earnings was available for distribution. However he refused to guarantee that some compensation would be given to the Electricity Commission at a later date when the capital works could no longer be deferred.

Dr Bateson provided a fuller explanation of Treasury's perspective on the matter:

"The whole thing about the trade-off between capital works and dividends is one where a shareholder takes the view that the cash in the pocket, if you will, as a dividend is worth more to them than the expectation of growth in the business because the money is ploughed back in capital works. So it is not a simple relationship where you say, 'Well, if I take a dividend here, that is capital works money either foregone or it is debt I have to raise to make that capital works and that's a bad thing, so I won't pay a dividend.'

"It is a very complicated relationship, but ultimately it gets down to what is the value of the dividend versus capital works to the shareholder. And in this case, where we had the deferred capital works, if we can call it that - or that examination of the level of capital works, the shareholder in the form of the treasurer felt that dividends, cash payments were worth more to him as a shareholder today than the expectation of growth over some period of time through capital works expenditure."

In response to the Committee's questioning on investment plans generally, the Electricity Commission's General Manager dealt with the issue of gold plating in relation to Electricity Commission's current overcapacity situation:

"1 think we take account of the fact that we have got overcapacity and utilise that to enable us to get our plant in good condition, so that ultimately we will reduce the need for equipment in the future. We are looking to make sure that we don't have to spend additional capital unnecessarily to cover our load growth. Let me say and go back into the past many years ago, I think we were spending additional capital to overcome a number of problems, not the least of which were industrial problems and we weren't able to maintain the plant, so it was easier to spend capital and put new plant in rather than fix up the difficulties. I think we now have a good rapport with the unions to the point that we don't have that sort of industrial trouble any more. We are now able to put the resources into the plant so that the plant is being improved. That in turn means that we will be able to delay installation of new plant in the future.

"It is a nice balancing act that management has to do all the time to determine how much money should be put in to maintain the plant in a good condition, so that we**are** delaying future capital expenditure. We don't believe we are overspending on that at the moment. We are improving the plant to the point where it is now reaching the equivalent of international best practice in performance and you know I don't see that we are doing any gold plating by any means in this, but it does help us and we can show in actual figures how it has helped us to delay capital expenditure in the future, significant capital expenditure in the future,"

The pattern of "preventative maintenance" expenditure which Mr Flanagan described above is an example of how some capital spending can be time-critical. There are many other such examples. The point is that if this preventative expenditure is not made at the appropriate point in time, much more costly remedial expenditure may become necessary at a later date.

Therefore, the Committee wishes to sound a cautionary note with regard to the tendency to vigorously apply dividend policy with insufficient sensitivity to these time-critical capital spending issues.

A partial solution already exists, The Treasury at present prepares cost benefit analyses of many public works proposals. These should be extended to cover all proposed large capital investment projects by GTEs, These analyses should be taken into account when weighing up the value of the proposed asset's future income stream versus the value of a cash payment in the present, that is, a dividend.

Recommendation 13

That *thorough cost benefit analyses be prepared for all large capital investment projects proposed by dividend-paying GTEs.*

Recommendation 14

That *these analyses be* ***taken into account by Treasury when working out those*** *authorities' dividends.*

f. Asset Valuations (Recommendation 15)

In theory, dividends can be used to force an agency of government to put the assets under its control to the most productive possible use. According to the theory, it is necessary for the equity owners to demand a return on assets in the form of a dividend which is comparable to the return being achieved in the market generally for comparable types of assets. If, according to the theory, the managers of the enterprise do not achieve a large enough profit to pay the required dividend, it may be a signal that the managers have failed to put the asset to its most economical use. When such a problem occurs, the owners of the enterprise should either hire new managers who are more adept at making capital equipment pay dividends, or sell the assets to another owner who may make more profits by turning the assets to alternative uses. In this scheme of things, the fact that profits are too low to pay the recommended dividend is no excuse. It is the knowledge that the managers' jobs depend on providing a market return on assets which motivates them to manage well. It is the knowledge that the assets can always be put to an alternate use which reassures the shareholders that, one way or another, they will get their investment back.

Having outlined the theory, the Committee believes it is necessary to point out the many points at which the pure version of this theory fails as a guide for action in commercial public agencies. To summarise these points;

- placing a value on assets is difficult,
- negotiators engage in "strategic" behaviour,
- public sector agreements between managers and "shareholders" introduce new problems,
- public sector assets prove especially hard to value because of the difficulty of selling them, and
- when some of the assets are intangible it proves even more difficult to determine what dividend should be paid and to whom.

Capita investments have two characteristics which make them difficult to value. The first is that they typically have a long economic life. The second is that there is often no market in which particular capital assets can readily be traded.

Testimony before the Committee illustrated some of the problems encountered in valuing assets. The executive director of the Zoological Parks Board indicated that a valuation for the Taronga Park Zoo property was established by the Valuer General under certain assumptions about zoning and the value of parkland in the Mosman area. If there were a market for second-hand zoos this difficult procedure would not have been necessary.

The Director of the Local Government Electricity Association of New South Wales spoke of some problems with valuation of modern technology assets such as electricity distribution equipment. He pointed out that many of these assets would be replaced with different, newer technology when the time came to replace them. Here the life-span of the assets is long compared to the time required for technological change. Due to the march of technology, it is no longer possible to replace some of these assets with the same thing, since they are obsolete.

The Commissioner for Forests told the Committee that the Commission had recently changed its basis for valuing pine plantation assets. Formerly, this valuation had been based on an adjusted historical cost figure, but now the valuation is based on the market value of the timber growing on the plantations. Dr Drielsma explained what effect this changed basis of valuation had:

"Interestingly when we did the valuation this year for the pine, the difference between the market valuation that we did and that previous valuation that we carried in the accounts, while it was different by some $100,000,000 or something, it was not as far out as we might have expected."

The players in dividend negotiations tend to engage in "strategic" behaviour. Strategic behaviour is a euphemistic way of describing the pursuit of self interest. Treasury officials, on one hand, have a profound interest in revenue collection, and dividends are a growing source of revenue. Managers of public agencies, on the other hand, have an abiding interest in presiding over growth in the size, prestige, and importance of their agency. A big dividend payout could be seen as a win for Treasury, and retaining most of the earnings could be seen as a win for the agency's management. As has already been shown, the size of dividend payment is often linked to the asset base of an organisation, so the negotiation over dividends sometimes takes place in the guise of a debate on asset valuation.

Treasury's Chief Economist espoused a preference for current replacement cost valuation:

"1 think most of the organisations, in fact I would say all of the ones that I **am aware** of, welcome moving to a revalued asset base for current costs and a market value on **their** assets, as opposed to historical costs for the same reason."

The director of the Local Government Electricity Association did not welcome moving to a revalued asset base. Mr Miller stated that his members' depreciation charges have risen considerably as a result of a government directive to change accounting practices to reflect the current replacement cost of assets rather than the historical cost,

"... my personal view is that current cost accounting has not succeeded-has not found

> favour in the commercial world.......... **as the** sole indicator of financial performance I think it incorrectly indicates the financial status of an organisation ..."

The Committee believes that like the members of the Local Government Electricity Association, most agencies would face higher asset valuations under the current replacement cost approach than under the historical cost approach.

The Committee also considers that Treasury should spell out the implications for dividends of its preference for valuing assets at current cost.

Recommendation 15

That Treasury clarify in a public document the implications for dividends of its preference for valuing assets at current cost, referring to specific authorities.

Parenthetically, the Committee notes that if an agency's assets were cheaper to replace than they were to purchase originally (higher historical cost than current replacement cost), it could indicate that unwise investment decisions have been made in the past. Exceptions to this conclusion should be made for types of equipment which are undergoing technological advance: most personal computers purchased five years ago could be replaced today with cheaper and more powerful models.

In the public sector, special circumstances prevent the "shareholders" from pressing management to maximise profitability. Although the introduction of SES and CES employment contracts for public-sector executives has improved managerial rewards and sanctions, public executives still do not face the same high level of accountability that private-sector executives face. One justification for this difference is that, because few public-sector enterprises are purely commercial, there are many reasons (apart from poor management) why the given asset base may not be yielding a return comparable to private-sector counterparts. Whether it be because of an obligation to provide uneconomic services to remote customers, an inability to raise prices to a profitable level, or restrictions on how funds may be invested, the public sector organisations are unable to emulate their private-sector counterparts in unbridled pursuit of profit.

With regard to asset valuations particularly, there is one balancing consideration in the private sector which has no real counterpart in the public sector. A private sector executive may tend to understate the value of assets under his control when soliciting equity funding, however when the same executive is soliciting debt funding, it is in his interest not to understate the asset base since lenders are more likely to lend the more asset rich the organisation is, Since the assets must be revealed to both credit providers and equity providers on the firm's balance sheet, the executive is most likely to try to represent the asset values fairly.

Special circumstances also make public sector assets harder to value because of the restrictions on how and when (if ever) they can be sold. The land on which the Taronga Park Zoo is situated, for instance, cannot be converted to its most lucrative alternative use because it is zoned as special purpose parkland. Hypothetically, if this restriction did not apply to the site, the valuation of the land could be increased many times by developing luxury residential dwellings there. However, because there is no market for special purpose parkland, this asset proves difficult to value and the Government is restrained from putting it to its most economic possible use.

The public sector is rich in unique types of assets which are dedicated to particular (often sub-optimal in purely dollar terms) uses in order to serve Society's best interests. National Parks provide another example. At various times such alternate uses as mining, logging, and grazing have been proposed for National Parks. All of these alternatives would yield a higher economic rent on the land than the return the land achieves as National Parkland; however it has been Parliament's judgement that the State's best interests are served by retaining these areas as National Parks.

A further illustration of some of the dilemmas faced by the public sector in valuing its assets is provided by the Roads and Traffic Authority's accounting treatment of the land under roads and within road reserves. In the RTA's Annual Report for 1990-91 these assets are valued at $20.9 billion, which represents nearly half of the RTA's entire value of infrastructure assets. However, it is clear that these assets cannot be sold as long as the roads remain on top. An alternative valuation of zero for the land under roads could be argued credibly on this basis.

Thus far the problems noted with asset valuation have all related to tangible assets such as forests, land, equipment, buildings, etc. These problems become even more acute when the assets in question are intangible. Examples of intangible assets are monopoly franchises, exemptions from regulations, trademarks or trade-names, patents, copyrights, tax exemptions, and other exclusive rights granted by the Government.

The Local Government Electricity Association (LGEA), as the industry peak body for electricity distribution organisations, has raised objections to the levying of dividends by the State Government:

"What we are saying, as you have said, is that we do not believe that the state government in fact owns the assets on which a dividend could be imposed because the state government has not contributed towards those assets.

,If a dividend has to be paid, we would suggest it should be paid back to the people who did subscribe the capital to the body, which is the consumers, and we maintain that dividend is in fact being paid in the form of lower prices,"

Significantly, when the Committee asked the director of the LGEA to outline their constituent organisations' assets, Mr Miller mentioned only tangible assets, However, Dr Paul Moy, Assistant Secretary of the New South Wales Treasury, in describing the nature and extent of the State's equity holdings in the 25 electricity retailing authorities which comprise the LGEA made prominent mention of intangible assets:

"Fundamentally I guess, these are natural monopoly organisations that basically operate a franchise from the state. So in that sense the fundamental property right, the fundamental equity in these organisations is granted from the states and is the basis for the state's equity in these organisations."

Mr Miller did dispute the statement that LGEA members operate monopoly franchises on the basis of examples of where electricity competes with alternate energy forms, such as natural gas. However, the Committee found these arguments relatively unconvincing.

The public affairs manager of the LGEA, Mr MacCarthy, went on to question whether the right to operate an electricity supply monopoly was truly an asset or a liability:

"It is not a question of county councils having a right to make profits for a shareholder, it is an obligation to provide a service to the community that is entrenched in the legislation. We cannot refuse to supply. Our members cannot say that, 'This customer is unprofitable to us. We won't connect him or her.' We are obliged to do that. So that is just the same as a local council collecting garbage. You can say that Sydney City Council or somebody like that has a monopoly right to collect garbage, but that would hardly seem to be a basis for paying a dividend to somebody for that right, because essentially it is a duty imposed by the act."

Treasury's Chief Economist, Mr Jeffrey Bateson, introduced the concept of residual risk-bearing as the final argument in this difficult controversy:

"... if you woke up one day and North-West County Council said, for example, 'We're bankrupt. We're going to turn out the lights' the question that I ask is who would be asked to front up with the funds to bail the thing out so it would produce electricity? It is not the consumers and it is not some sort of pass the hat somewhere; it Would be the taxpayers of New South Wales through the consolidated fund.

"in that sense I think that is the cutting edge of ownership because the legal framework is just a cloak within which property rights operate, I think when we get down to the actual residual claimants and the residual risk-bearing, it is very much with the state government, so that, I think, is the essence of the equity ownership, if you will,"

g. Debt versus Equity Funding

All enterprises must determine their own ideal mix of debt and equity funding when seeking to expand their capital base. It is generally accepted that equity funding is more expensive in terms of expected returns, as pointed out in Chapter 3. However, when the State is the equity investor and the enterprise is a commercially-oriented public agency it appears to the Committee that the enterprise's managers often expect to receive equity funding at much less than market cost.

In intuitive terms, the two methods of raising funds for capital investment are quite distinct. Debt funding carries an obligation to make regular pre-determined repayments, but as long as the repayments are on schedule lenders exercise no managerial control over the enterprise. Equity funding is inherently riskier for the equity investor since "repayments" tend to be irregular and vary according to the profitability of the enterprise. Equity investors do exercise managerial control over the enterprise. A potential investor, faced with a choice between lending his funds or using them to buy shares in an enterprise will only buy shares if the expected return is higher than the return from lending, since the return from lending is much more certain.

Another way of looking at this debt/equity distinction is that the professional management of an enterprise takes a risk whenever it borrows funds (the risk that the enterprise will be unable to repay the loan and will be forced to liquidate assets or go bankrupt). However, when funds are raised through equity injections, the shareholders share the risk with the managers.

In light of these general principles, it seems hardly surprising to the Committee that managers of public sector enterprises display a marked preference for equity funding as opposed to debt funding for their capital works programs. In principle, these managers would be paying a higher price for equity funding and if the price were set so as to accurately reflect the risks then the managers would be indifferent as to the choice between debt and equity funding. However, in practice the Committee believes that the price of equity has been set too low relative to the price of debt. Dividend requirements are one of the most effective mechanisms for rectifying that imbalance and for making the cost of equity reflect the risks involved.

Assistant Secretary of the Treasury Dr Moy outlined the philosophical starting point of many agencies when the dividend process began:

"Most people now agree, I must admit it has been a pretty torrid battle over the last eighteen months, a lot of people did take a view that the appropriate rate of return on equity was zero, but I think most people now realise that that is not the case and given that the equity injections are funded by tax, the appropriate cost of the resources that are withdrawn by the taxation system is the rate of return that they would earn in other uses. It is very important to keep in mind that the full costs of their services is taken into account.

"1 think it is also true that there are still some misconceptions. When one deals in the area of debt, quite a number of people have expressed either directly or indirectly to us that the appropriate level of debt for Government trading enterprise is zero and that is clearly not the case. The appropriate capital structure entails a mixture of debt and equity and that is a matter which we are addressing in some detail in the dividend distribution paper that we will be finalising in the next few weeks."

Testimony before the Committee clearly indicated that few participants in the dividend debate would now claim that the proper return on equity is zero or that the ideal capital structure entails zero debt. Nevertheless, there was still a clear reluctance to move in the direction which dividend policy indicates-assuming more debt. The debate has become more sophisticated, but the negotiating parties cling to their beliefs.

The Chief Executive of Sydney Electricity, Mr Allan Gillespie, framed his desire to reduce Sydney Electricity's level of debt in terms of the slow growth of its markets:

"1 think Chairman we see ourselves as a mature organisation, we are not looking at a lot of growth and it is one of the factors we have taken into account in looking at the situation. We also need to decrease our debt level. We were put in a situation where we had to increase our debt level and the Government decided to take the money off us and we see a need to reduce that because as we see it we are a mature organisation, we are looking at the substantial capital requirements in our situation."

In numerical terms, Mr Gillespie stated that a capital structure involving 25% debt was desirable, whereas the present capital structure was said to entail about 70% debt. Sydney Electricity's accountant noted that if assets were valued on a historical cost basis then the fraction of capital represented by debt would be above the 70% figure.

However, when pressed to justify these figures, Mr Gillespie failed to provide any substantial reasoning behind them:

COMMITTEE: Under the regime you have just outlined you will have virtually a three or four to one incentive to reduce debt rather than pay dividends to the Government?

Mr SMITH: Yes.

COMMITTEE: What then do you have as your mechanism for deciding the optimal debt equity ratio, given that your position optimises at a zero debt level and clearly whilst that might optimise your position, it minimises the return for the Government. Given that the Government on behalf of the taxpayer clearly wants to optimise the return to the taxpayer, how do you go about satisfying the optimal debt equity level which is going to achieve your objective at one end, which is moving in one direction and the Government's objective which is clearly moving in the opposite direction on behalf of the taxpayer?

Mr SMITH: Yes.

Mr GILLESPIE: That comes into the argument of our capital efficiency I think. I don't know that there is any real answer to that. That is why I was saying because we are a mature organisation we would be looking at a debt equity ratio of twenty five rather than forty, as you would in an ideal situation for a company that is experiencing growth.

Some of the most sophisticated arguments against increasing the use of debt funding were presented by the Forestry Commission. Mr Dominic Staun, Director of Corporate Development for the Commission pointed out that in the public sector, debt finance is not as attractive as it is in the private sector because (in the absence of taxation) interest costs borne by public instrumentalities are not tax deductible.

The main thrust of the Commission's argument for equity funding of its capital works program, which is largely directed to establishment of pine plantations, was put to the Committee by Mr Staun:

"It is a philosophical point as much as anything. Equity, capital assets, pricing models and so one, equity is a residual risk taker. To my way of thinking you know the longer the term of an asset and before it actually generates income, then the higher the risk. Therefore, the more risky the asset to my way of thinking the more appropriate[ly] it should be funded through equity rather than debt. Debt has the capacity to pay a cost, an interest payment and if there is variability in income flows, they are a long way out, clearly you have to find the cash somewhere to finance those interest payments."

When challenged by the Committee, Mr Staun adhered to this point of view even though he recognised that equity funding is ultimately more expensive than debt funding:

COMMITTEE: What about the cost implications of that though? What you are in effect saying is that equity financing is a lot cheaper than debt financing and therefore, you have a much stronger incentive to use equity finance rather than debt finance.

Mr STAUN: No. Equity finance is more expensive than debt financing, even without the tax deductibility. The current debt financing is somewhere around about nine and a half to ten percent; equity will still be somewhere between seventeen or eighteen percent. In terms of management of that asset, management to my way of thinking means guarding against liquidity problems and so on in the course of it. The riskier**the** asset, the longer the term before the returns come in and the more prudently one finances it in a manner which obviates the finance risk and that to me mean**use** equity. You pay for that because you pay a higher return in the long run because equity is more expensive than debt.

Mr Staun did admit however that Treasury's target rate of return on equity investments in the Commission is the long term bond rate plus one percent, and that this price for equity did not fully reflect the risks:

"1 don't know, but I would have thought that perhaps the actual target rate should be something higher than that, to take into account the general riskiness associated with any asset over and above long term debt rate. One percent as a risk premium seems to me to be rather small."

A further issue was raised by the Commissioner, Dr Drielsma regarding the ability of plantation investments to make sufficient returns to attract the necessary capital at all:

> "... I know that at the end of the day forests only grow so fast and that tends to put a certain limit on the sort of rate of return that you can expect. I guess that raises some issues to me that haven't been properly resolved."

Treasury's reply to these more sophisticated arguments was summarised by Assistant Secretary Paul Moy in terms of agency theory:

"1 think the agency theory very muc h goes to incentive structures which I have been talking about extensively, I guess, and transparency, and clearly one of the issues that agency theory would bear on is the appropriate capital structure, because that determines in part the incentives that apply to management, and it is one of the reasons why you will find management arguing for a lower or zero debt level."

In several exchanges with the Committee, Treasury officials Dr Moy and Dr Bateson replied to the concerns raised by the Forestry Commission:

COMMITTEE: The committee has heard evidence from two authorities: the Forestry Commission and the Sydney Cove Redevelopment Authority, as to what they consider is the importance of equity funding as opposed to debt funding for at least two areas within their operations: in the case of the Forestry Commission plantations and in the case of the redevelopment authority for heritage projects. Given that you see dividends as being appropriate, whereas government do because they are a trading enterprise, regularly those sorts of corporations in the private sector would be expected to receive some degree of equity injection for those sorts of projects, often instead of further debt funding. What do you see as important about those balances?

> Dr MOY: They can in fact undertake that equity investment through retained earnings; it is all part of the process -nd in fact they do. I do not see that any of the systems that we have got in place prevents that sort of equity injection through retained earnings or debt write-off or a range of other possibilities as well as up-front - - -
>
> COMMITTEE: That is my point though. They would always be wanting to retain it for equity funding.
>
> Dr MOY: Yes. I think in some of these cases that point has been reached a long time ago, even though they have very low debt levels. We have to realise that dividends are a residual compared to interest cost on debt. Management are much more comfortable with equity funding of these things because they probably do not have to meet the obligations if they can find some way of negotiating out of it.

COMMITTEE: One of the reasons they gave for desiring to fund some of their operations from equity rather than debt was that their time-frame was 40 years and they said that realistically debt is not an appropriate mechanism for funding a 40-year level of investment and that equity was an appropriate funding. How would you respond to that sort of argument?

Dr MOY: I observe in the real world very large, long-term projects, such as the

North-West Shelf and the mining industry which are funded by mixes of debt **and** equity, and there are also private forestry that are funded by mixes of debt and equity. So I think by simple demonstration, the proposition that it should only be funded by equity is arguable.

Mr BATESON: They would probably have a point if they were in a business that **had** absolutely no assets right now except something on the ground that was continuing to grow. But I mean they have got a continuous flow of tree stock which is coming on to the market which allows them to earn revenue and pay mixes of debt interest **charges** and return to shareholders. (Ibid.)

A rigorous application of dividend policy gives Treasury considerable influence over an agency's decision as to how much reliance to place on debt versus equity funding. In the Committee's view, although some agency managers are reluctant to part with control over that important decision, it is clear that, for many reasons, these managers do have a distinct preference for equity funding from the State. This bias towards equity funding does seem to arise from the managers' desire to minimise their own risks, even though the risks to the State as a whole are thereby increased. On this issue, the Committee believes that Treasury is better placed than individual agencies to take a broad overview of what capital structures are most advantageous to the State as a whole.

h. Community Service Obligations (Recommendations 16 and 17)

It was shown in Chapter 4 above that at present there does not appear to one widely accepted way of identifying and measuring CSOs. This has, as was seen, led to a variety of different results, sometimes startlingly so. An example was the difference between $800 million and $240 million yielded by two different ways of measuring CSOs.

In evidence, Treasury stated:

"We are in a transition phase of trying to cost these (CSOs) and fund them properly, so the estimates come from the authorities themselves."

Given the variety of definitions and ways of measuring CSOs, the Committee questions whether there is presently very much consistency in the ways different authorities are presenting their CSO estimates to the Treasury.

What is needed now is that Treasury issue a detailed paper on CSOs, covering, among other things, definitions, ways of measuring them and the administrative processes involved.

Recommendation 16

That Treasury now prepare a discussion document outlining:

(a) its own definition of a CSO
(b) its own preferred method of calculating a CSO
(c) its preferred source of funding for CSOs, with details of how this preference has actually been applied in practice
(d) the criteria it employs when working out CSOs with a dividend-paying authority
(e) the usual form of its CSO contract
(f) the effect on dividends of CSOs.

Recommendation 17

That in 12 months from publication of this report, the Committee prepare a study following up on its recommendations.

5. CONCLUSIONS

Both the principle and the practice of dividend payments by statutory authorities to the Consolidated Fund have aroused controversy in NSW.

The Committee believes that the principle of the payment of dividends is an appropriate and important one which is justified on a number of grounds, as discussed in Chapter 3. However, the Committee has reservations about several aspects of the practice of dividend payments.

The Committee considers that a compelling argument in their favour is that the government on behalf of citizens and taxpayers should be considered to be the owner of these enterprises and as such should be entitled to a dividend. As financial source of last resort, the government bears the ultimate financial risk of any failure by the enterprise: its relationship to the enterprise is therefore closely analogous to that of a holding company which must bear the ultimate financial risk of a subsidiary's failure. In effect, as bearer of the ultimate risk, it is indeed the owner of the enterprise, just as a holding company owns one of its subsidiaries. As such, it is justified in claiming a dividend.

As well, the government has for decades been the sole provider of funds for GTEs' operations, through original investments and Subsequent subsidies, and, because there are no shares in most enterprises, the government is entitled to some kind of a return on this investment, for example, a dividend.

Another argument often cited in support of the principle of dividend payments is that they impose a desirable discipline on bloated, inefficient enterprises, and so help forestall "goldplating", that is, excess investment. Given the excess capital resources of many GTEs, this argument has a good deal of force.

However, an enterprise may simply raise its price to pay the dividend, or else overstate other costs to reduce its surplus, so that dividends are calculated out of a smaller base. Neither of these is of course a satisfactory alternative to making efficiency gains to pay dividends. The new independent Prices Tribunal will be closely examining GTEs' proposed price rises with these considerations in mind. As far as Treasury is concerned, the Committee believes each case should be considered separately.

While the principle Of dividend payments appears to the Committee to be an appropriate one, there are aspects of the practice which have aroused the Committee's concern.

One of these is the effect of dividend payments on the future plans of authorities.

This concern was by no means limited to one authority. Many of them in evidence voiced their disquiet at the effect of dividend payments on their future plans, for example, for new investment, It appears that, while declaring its sensitivity to any possible harm to an enterprise's future plans, the Treasury has in practice sometimes required dividends at a level which has forced some enterprises not only to curtail plans for the future, but also to borrow in the immediate present, simply in order to pay the dividend.

While borrowing may not always be undesirable for a GTE, as the report points out, the likelihood that a GTE will have to borrow to pay a dividend, and the effect that this borrowing will have on its operations, should be carefully taken into account when a dividend is required. The requirements of the Financial Arrangements (Public Authorities) Act 1987 make this particularly important. Again, each case should be considered separately.

Another aspect about which the Committee feels some disquiet is the lack of consultation at high levels. The Committee appreciates that the Treasury's GTE Monitoring Unit is still in its infancy, and that this could be one explanation for the dissatisfaction expressed with the consultative process by some authorities. It is clear that the Treasury understands the need for consultation. However, this has often been carried out at inappropriately low levels. The Committee believes that chief executives and the Secretary of the Treasury should personally discuss dividend policy at the beginning of each financial year, as a matter of routine.

The Committee also records its reservations about the lack of clarity and consistency in the legislative provisions pertaining to dividends. Recommendations have been made in the text for improvements.

One of the Committee's most serious reservations relates to the Treasury's new proposal that it impose a '"non-negotiable" dividend requirement of 50% of before-tax profits on enterprises that pay no tax equivalents. The Committee believes that no dividend payment as distinct from tax equivalents should be fixed and non-negotiable. (The Committee has not considered tax equivalents separately in this report). The counter-argument may be made that private companies pay a fixed rate of company tax; statutory authorities which pay no tax should pay a dividend fixed at a high rate just as private companies must pay a high fixed rate of tax.

The Committee believes that this argument is open to dispute. First, as has been pointed out above, it is risky to make analogies between GTEs and private companies. There are too many differences between them. Private companies can develop schemes to minimise declared taxable earnings and to attract back paid-out dividends; none of these are fully available to GTEs. As well, GTEs may be hamstrung by regulations which do not apply to private companies. Furthermore, and most importantly, most GTEs provide an essential public service, which private companies tend not to do. Because of this, great care and sensitivity must be exercised to ensure that the quality and general public availability of the service not be unacceptably compromised by the need to pay a dividend. As a result, it is all the more imperative to take a well-designed, case-by-case, sensitive approach to dividend policy, rather than advocate a blanket, unvarying, undiscriminating general series of measures.

In general, the Committee believes that a case-by-case approach to dividend payments by statutory authorities is wiser than a blanket unselective requirement that they should pay a fixed percentage of profits.

Following on from this, the Committee believes that there should be much more openness on numerous aspects of dividend policy, particularly (since a case-by-case approach is desirable) as they relate to individual authorities. The discussion paper on distributions policy is welcome, but it needs to be followed up. Major contributions to the greater openness advocated by the Committee should now be made by Treasury. The Committee believes that Treasury should now make available for public discussion a series of clearly expressed, non-technical, well-reasoned justifications (with case-by-case examples)**of:**

· the general policy of requiring dividends
· the selection of authorities (new and previously selected) to pay dividends · the level of the dividend required in each case

· its treatment of Community Service Obligations.

The Committee believes that the importance of the issue, and the size of the dividend payments require greater public knowledge and information than has obtained up till now, and that this information should be made available in a clear and accessible form.

The process of dividend-setting is relatively new for New South Wales. It is only in recent years that large sums have been required in dividend payments from statutory authorities, and that the Treasury has been able to devote sufficient resources to the task. There is still a great deal to be done in refining criteria for selection of authorities, in developing details of the policy, and in making the whole process as open as possible. The Committee believes that there is nothing to be lost from greater openness about the process, and welcomes the beginnings that have already been made.

GLOSSARY

Excerpted from *Managing State Finance: The New South Wales Experience* by Don Nicholls. Reprinted with permission.

Allocative Efficiency: The production of goods and services by an organisation at levels consistent with the mix of goods and services which will yield maximum consumption benefits to society over time. Allocative inefficiency may occur because of monopoly power (overcharging) or price controls (under charging).

Assets: General term covering financial resources (cash, securities, etc.), physical items (property, plant and equipment, etc.) or intangibles (patents, trademarks, etc.) capable of providing a future benefit to the organisation either by use or sale. Minor stores, etc. would be excluded from this concept.

Commercialisation: The process of making certain inner budget sector activities more financially self sufficient in order to reduce the level of support from the Consolidated Fund.

Community *Service Obligation:* An activity undertaken at the request or direction of government by a government trading enterprise (GTE) to provide some service or benefit to the community which, based solely on commercial considerations, would either not be provided by the GTE, or if provided, would be at a lower quality and/or higher price.

Consolidated Fund: An account of governmental revenue and payments of departments and certain authorities within the inner budget sector. Payments out of this Fund can only be made under Parliamentary authority.

Corporatisation: Corporatisation is the application of market disciplines to a government trading enterprise (GTE) to improve its productive and allocative efficiency. The five requirements of corporatisation are: clear and consistent management objectives; management autonomy and authority; independent performance monitoring; managerial rewards and sanctions; and competitive neutrality (i.e. removal of special advantages and disadvantages stemming from public ownership).

Dividend: A share of profits payable to the Consolidated Fund by government commercial services, businesses and enterprises.

Efficiency: See Allocative Efficiency and Productive Efficiency. Efficiency is a term frequently used in the context of program evaluation.

Equity: The value of interest held by the owners in the assets of an organisation as represented by the value of the assets of the organisation less external liabilities (e,g. borrowings from outside bodies),

Government Trading Enterprise (GTE): A unit within the public sector that produces goods or services which are, or could be, sold or tendered in the market place without compromising the government's economic or social objectives. GTEs include not only organisations engaged in trading activities, but also organisations which provide subsidised community services on a contractual basis.

Performance Indicator: Defines the measurement of a piece of important and useful information about the performance of a program expressed as a percentage, index, rate or other comparison which is monitored at regular intervals and is compared to a criterion or a number of criteria.

Privatisation: Privatisation is the transfer of activities or ownership of **assets** and operations from the public sector to the private sector.

Productive Efficiency: The production of a set amount of goods and services by using the least possible amount of resources (in value terms). Productive efficiency depends essentially on the quality of management performance in day to day operations and in making investment decisions.

*Productivity Dividends:*Reduction in expenditure achieved through increased efficiency while maintaining service levels.

Rate ***of return:*** A measure of the financial performance of an organisation derived by expressing income (after all expenses but before interest and **taxes)** as a proportion of the asset base (or a component of the asset base) of the organisation.

*State instrumentalities contributions:*Contributions to the Consolidated Fund by Government Trading Enterprises and State Owned Corporations.

*Statutory body (or authority):*An agency representing the Crown and set up under its own statute.

*State owned corporations:*Public sector authorities that have been corporatised and established as companies under the State Owned Corporations Act.

Tax: A compulsory payment to a government or government sponsored entity not resulting in a direct benefit to the payer. Taxes include regulatory fees and fines,

APPENDIX

LIST OF WITNESSES

PUBLIC HEARINGS 4 NOVEMBER 1991

Dr John Paul Moy, Assistant Secretary of the NSW Treasury

Dr Jeffrey James Bateson, Chief Economist of the NSW Treasury

Robert Stuart Mitchell, Chief Executive of the Sydney Cove Authority

Michael Charles Fileman, Financial Controller of the Sydney Cove Authority

' Barry Peter Flanagan, General Manager of the Electricity Commission

John Byrne, Management Accountant for the Electricity Commission

Anthony Graham Wright, Managing Director of the Water Board

Arthur William George Butler, Director of Corporate Finance

Allan John Gillespie, Chief Executive of Sydney Electricity

Alfred Herbert Smith, Accountant

Kerry Noel McIlwraith, Accountant

Glenn Neville Smith, Executive Director of the Zoological Parks Board Hunter Ian Rankin, Financial Controller of the Zoological Parks Board Johannes Hendrik Drielsma, Commissioner for Forests, Forestry Commission Dominic Hoeg Staun, Director Corporate Development

PUBLIC HEARINGS 18 NOVEMBER 1991

Gordon Frederick Messiter, Managing Director of the Commercial Services Group

Paul Bernard Lopert, General Manager of Commercial Services Group

John George Hall, Director of Finance Assistance Commercial Services Group Terry Laurence Miller, Director of the Local Government Electricity Association
Bruce Edward MacCarthy, Manager - Public Affairs of the Local Government Electricity

Association