INDUSTRY
COMMISSION

GTE DIVIDEND AND INCOME TAX PAYMENTS: 1990-91 TO 1995-96

Prepared in Competition Policy Branch

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March 1998

Overview

Governments are increasingly requiring their trading enterprises (GTEs) to pay dividends.

Part of the motivation has been budgetary. Over time, dividend payments by GTEs have become an increasingly important source of revenue for governments.

But there have also been efficiency rationales. For example, a requirement to pay dividends can help to discipline the commercial performance of GTEs and provide a basis for monitoring performance. It can also help managers of these enterprises to set efficient prices for their outputs. In turn, this may help to promote 'competitive neutrality' between GTEs and their private competitors.

The link between a requirement for GTEs to pay dividends and the achievement of competitive neutrality is often taken for granted.

However, on closer examination, the relevance of dividend policies to the achievement of competitive neutrality is less clear. For the most part, competitive neutrality is about ensuring that government ownership does not lead to underpricing of goods and services through a failure to incorporate all of the input costs faced by a private supplier. While it is important that prices make provision for a return on investments, the way in which that return (ie profit) is distributed is of much less significance. That is, the primary focus for assessing underpricing claims should be on a GTE's rate of return, rather than on the portion of that return paid as a dividend.

Some might argue that a failure to appropriate at least part of a GTE's return as a dividend to shareholders (ie the government), will give it an advantage over private competitors. For example, it will provide the GTE with an additional, and seemingly low cost, source of capital to expand its business.

But such reinvestment of earnings will also have to earn a rate of return. Hence, in principle, the retention of earnings by GTEs should not of itself lead to breaches of competitively neutral pricing. Conceptually, increasing the scale of the business through reinvestment is little different from increasing it through borrowing.

In practice, the level of dividend payments may have some minor effects on market prices. For example, the lower debt equity ratio made possible by funding investments from retained earnings may lower a GTE's cost of debt. But against this, a lower debt equity ratio will, other things equal, tend to increase the weighted cost of capital. This is because the cost of equity — even to government — is usually higher than the cost of debt. Suffice it to say that any advantages that 'excessive' retention of retained earnings might confer on a GTE would be relatively minor. Thus, they are unlikely to be a significant issue in a competitive neutrality complaint.

In any event, most of the recent concerns about dividend requirements for GTEs have related to over, rather than under, appropriation of profits by governments. That is, there is a perception that governments have used their GTEs as 'milch cows'.

Where GTEs have a monopoly over the provision of goods or services, there is clearly potential for owner governments to set rates of return that exceed competitive norms. In these circumstances, there is effectively a tax component in the prices paid by consumers.

However, if governments require GTEs operating in competitive markets to earn excessive rates of return, then those enterprises will simply lose business to their private competitors.

Moreover, in assessing the milch cow argument, it is important to differentiate between an excessive rate of return and the portion of an appropriate rate of return distributed in the form of a dividend. If the rate of return is broadly appropriate, then a high percentage dividend is unlikely to place a GTE at a significant disadvantage. That is, the GTE could simply increase its level of borrowing with relatively little impact on overall financing costs.

Similar arguments also apply in relation to the requirement for GTEs to pay income tax or make equivalent payments. Taxes are paid from profits — that is, from an enterprise's rate of return. To owner governments, it will matter little whether the payments it receives from a GTE are called a dividend or a tax. Therefore, a requirement for GTEs to pay income tax is unlikely to affect prices for their outputs — meaning that such payments are not an issue as far as competitive neutrality is concerned. As Sieper (1995) commented:

> it is difficult to understand how the Treasury can hail the relabelling of dividends as income taxes under a TER as 'an important microeconomic reform within the public sector'... The decision to implement uniform tax equivalents regimes ... would seem better described as a cumbersome and expensive non-solution to a non-existent problem, which could at best be defended as making some contribution towards the broader goal of instilling a 'corporate culture' in the management of GTEs.

Against this background, the paper focuses largely on factual information on GTE dividend and income tax arrangements. Specifically it:

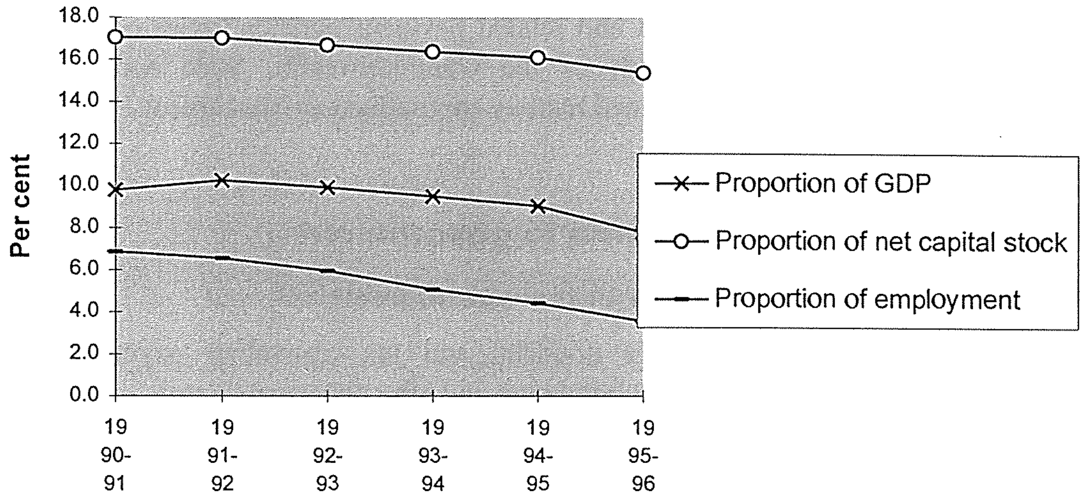
- outlines the dividend and tax requirements applying to government businesses in the Commonwealth and each of the states;
- describes recent trends in dividend and income tax payments by GTEs. In so doing, it augments previously published data from the Steering Committee on National Performance Monitoring of GTEs with published and unpublished ABS data; and
- discusses the effect that capital structures and requirements to deliver community service obligations can have on a GTE's dividend payments.

GTE DIVIDEND AND INCOME TAX PAYMENTS: 1990-91 TO 1995-96

1. Dividend policies of governments

Government trading enterprises (GTEs) are a significant part of Australia's economy despite recent major privatisations. In 1995-96, they accounted for about 8 per cent of GDP, 15 per cent of the net capital stock and close to 4 per cent of total employment (see Figure 1).

Figure 1 GTEs share of GDP, net capital stock and total employment: 1990-91 to 1995-96



Source Capital stock and production data from ABS, Australian *National Accounts: National income, expenditure and product*, Cat. No. 5204.0 (various years).
Employment data from ABS unpublished data.

Recent years have seen added pressure on GTEs to return dividends to their owner governments. Among the reasons for this are that dividends:

- discipline performance by requiring GTEs to earn and pay a rate of return on equity capital;
- provide a basis for monitoring performance; and
- help introduce competitive neutrality between government business activities and their private sector counterparts.

As part of the move to competitive neutrality between government and private business activity, GTEs are also being subjected to a similar tax burden to their private competitors.

Dividends can be broadly defined as payments by a business out of profits to its shareholders as a return on their equity in that business. Where current profits are inadequate, GTEs may be required to make payments out of retained profits from previous years. Dividends from GTEs have also taken the form of special cash payments to owner governments and a number of GTEs pay an annual statutory contribution or state government levy, rather than a dividend payment. These are generally treated as dividends for reporting purposes.

Dividend policies are generally included in annual financial performance agreements between GTEs and governments, based on commercial considerations (SCNPMGTE 1997, p.6). In the majority of jurisdictions, however, the final responsibility for determining dividend payments rests with the Treasurer.

Most governments have generally applicable guidelines suggesting benchmark payout ratios. For example, Victoria and Tasmania have a target dividend payout ratio of at least 50 per cent of after-tax profit, and a dividend and tax equivalent payout ratio of, respectively, at least 65 and 70 per cent of pre-tax profits. By contrast, the NT government determines dividends on a case-by-case basis. Similarly, Western Australia applies a consultative, judgemental process rather than a formula for a preferred percentage of profits. Reflecting these differences in approach, publicly available information on dividend and related payment policies varies considerably across governments. (The policies of the Commonwealth, State and Territory governments for dividends and related matters are outlined at Attachment 1).

2. Trends in GTE payments to government

Two indicators of trends in GTE payments to governments are:

- payout ratios (dividends or dividend and tax equivalent payments as a proportion of operating profit before tax and after abnormals); and,
- aggregate dividend and tax equivalent payments to government.

Dividend payout ratios by sector and jurisdiction

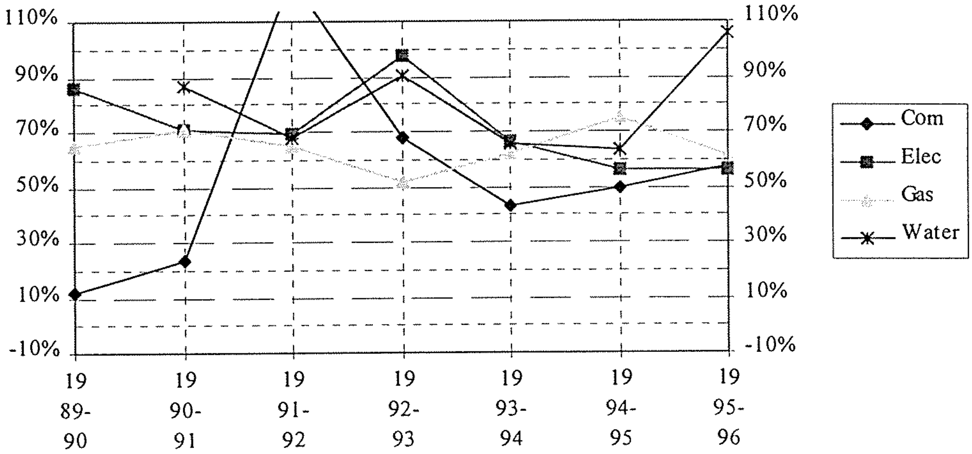
Data on dividend payout ratios of selected GTEs in core industries has been published by the Steering Committee on National Performance Monitoring of Government Trading Enterprises (SCNPMGTE). The composition of the GTEs covered by the SCNPMGTE project has changed during the life of the project, predominantly due to enterprise restructurings and privatisations. These changes are outlined at Attachment B of SCNPMGTE 1997.

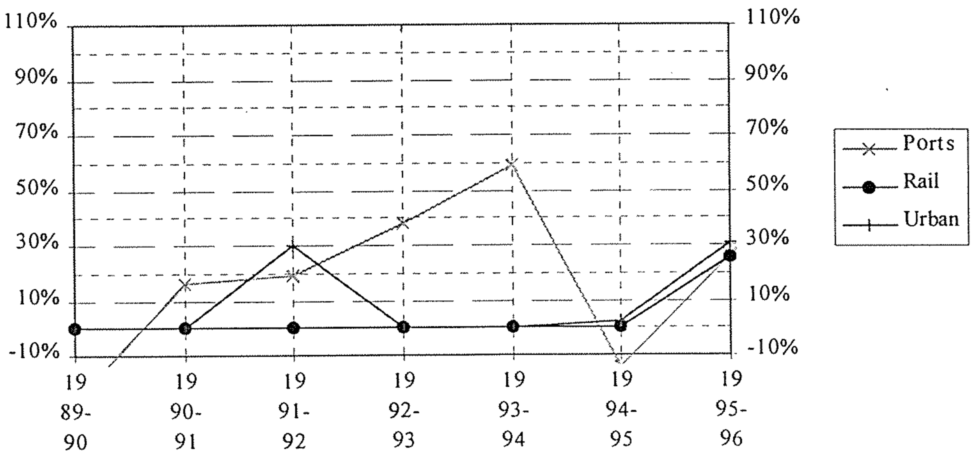
The ratios for industry sectors and for individual government jurisdictions in the period 1989-90 to 1995-96 are summarised in Figures 2a, b and Figures 3a, b, c respectively.

There is considerable variation between sectors in the level of payout ratio and their year to year fluctuations (see Figures 2a and 2b). Rail and urban transport have generally delivered much lower payout ratios than other sectors. At the other extreme, water, gas, electricity and Commonwealth GTEs have generally delivered higher payout ratios. The ports and water GTEs have experienced the most significant annual fluctuations in payout ratios.

During the first half of the 1990s growth in the dividend payout ratio was strongest for the ports and Commonwealth sector. Within the latter — comprising Airservices Australia, Australian National Line Limited, Australia Post, Federal Airports Corporation and Telstra — the dividend behaviour of Telstra dominates the picture, accounting for almost 90 per cent of dividends paid by this group of GTEs in 1995-96.

Figures 2a, b Average dividend payout ratio by sector, 1989-90 to 1995-96



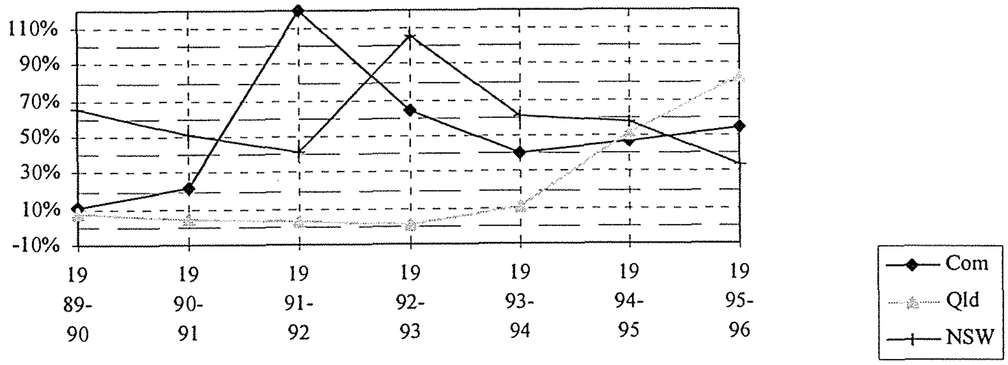


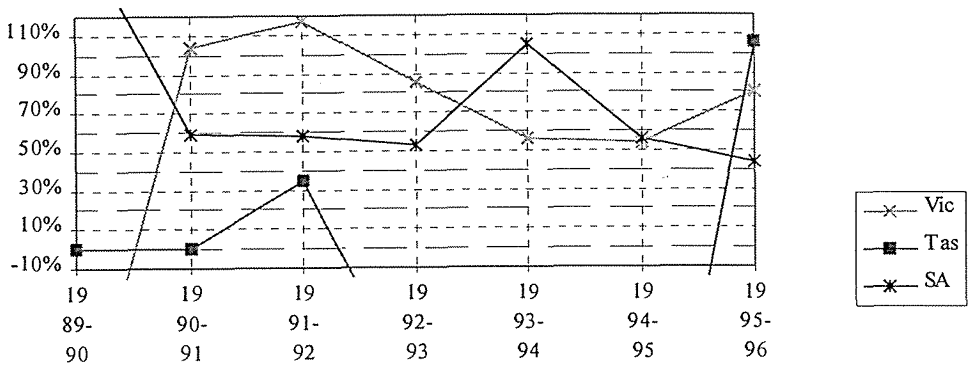
Notes: A payout ratio in the negative zone means dividends were paid when losses were incurred. A ratio greater than 100 per cent means payments exceeded operating profit before tax and after abnormals

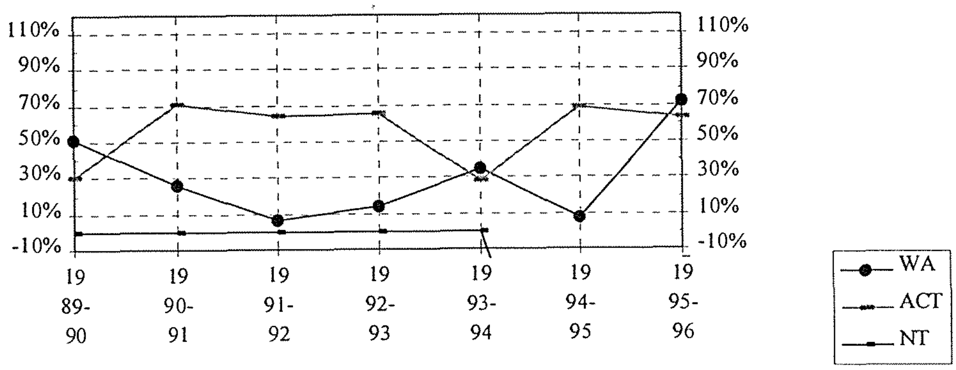
Source: SCNPMGTE, *GTE Performance Indicators*, various years

At the jurisdictional level, average dividend payout ratios cover a wide range and, from year to year, vary considerably within and across jurisdictions (see Figures 3a, b and c). The last two years have, however, seen a compression in the range for most jurisdictions.

Figure 3a, b, c Average dividend payout ratio by jurisdiction, 1989-90 to 1995-96





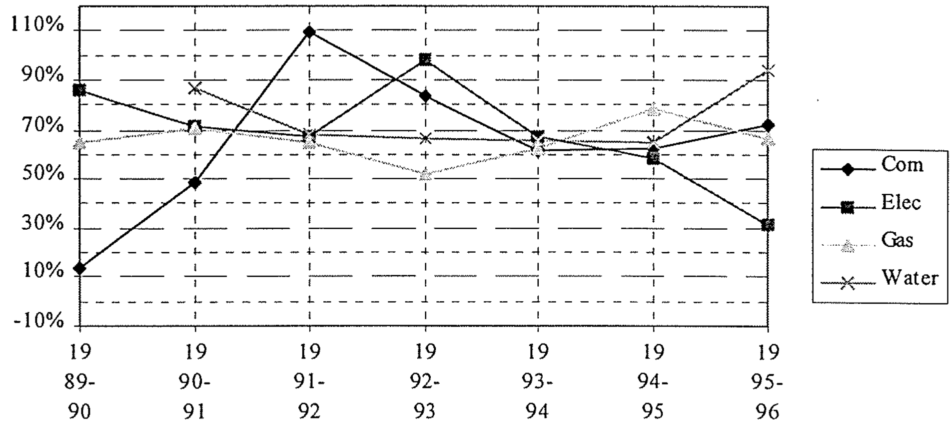


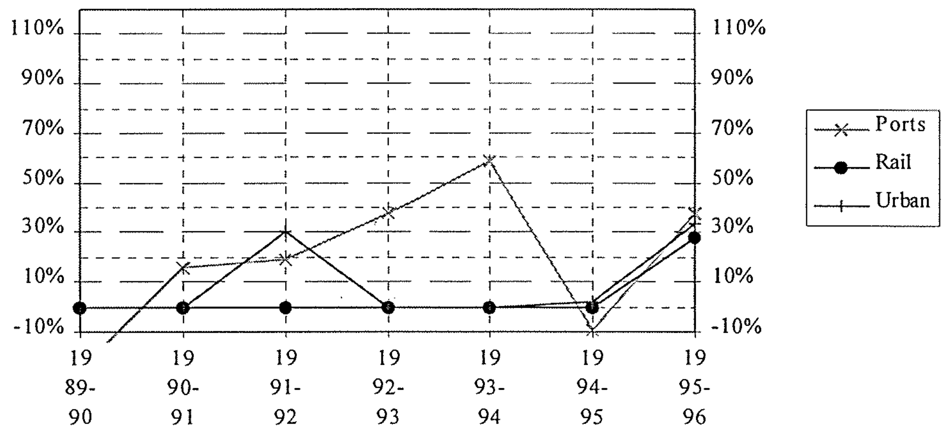
Notes: A payout ratio in the negative zone means dividends were paid when losses were incurred. A ratio greater than 100 percent means payments exceeded operating profit before tax and after abnormals.

Source: SCNPMGTE, *GTE Performance Indicators*, various years

As noted above, GTEs have also increasingly been required to make income tax and tax equivalent payments to owner governments. However, except for Tasmania, the behaviour of the payout ratios of *dividends and income tax or tax equivalents* to total operating profit before tax and after abnormals (see Figures 4a, b and 5a, b, c) is, broadly similar to the dividend only payout ratios.

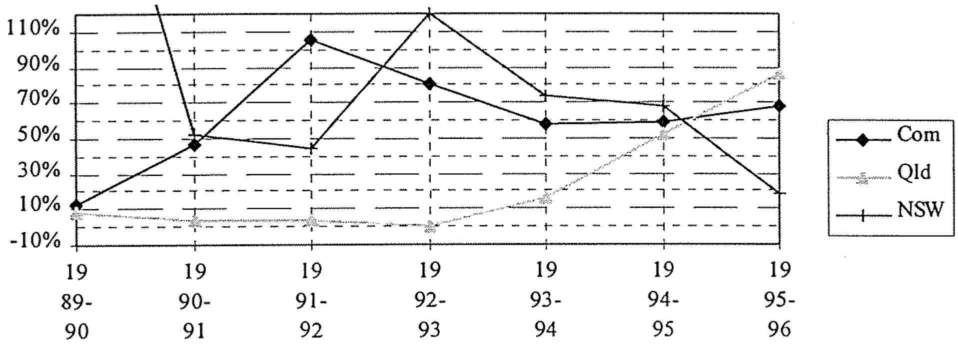
Figure 4a, b Average dividend and income tax ratio by sector

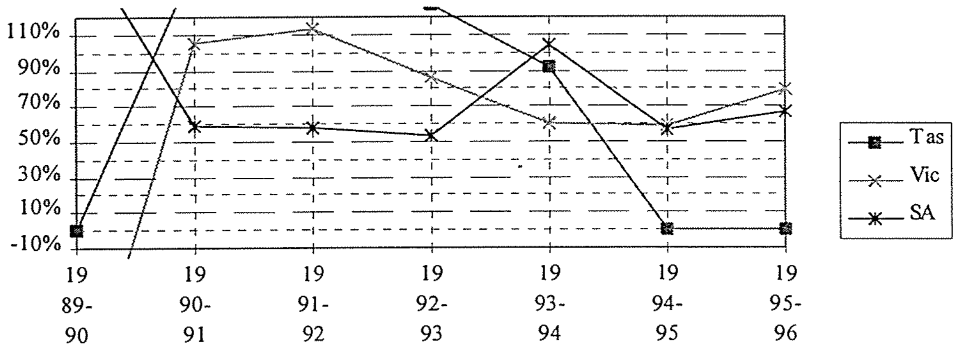


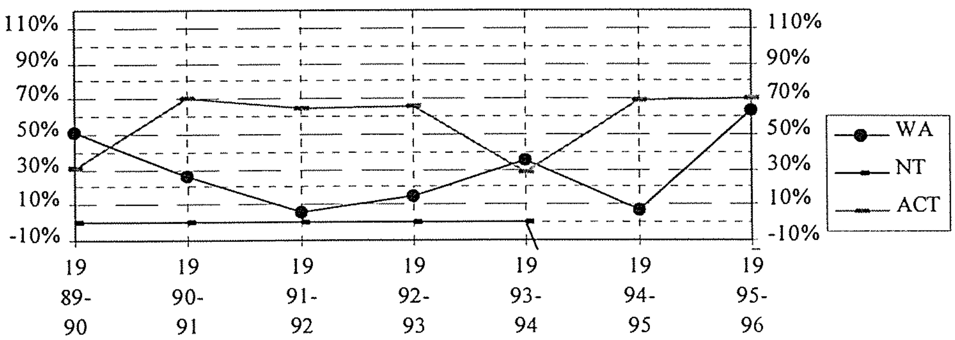


Source: SCNPMGTE, *GTE Performance Indicators*, various years

Figure 5a, b, c Average dividend and income tax ratio by jurisdiction







Source: SCNPMGTE, *GTE Performance Indicators*, various years

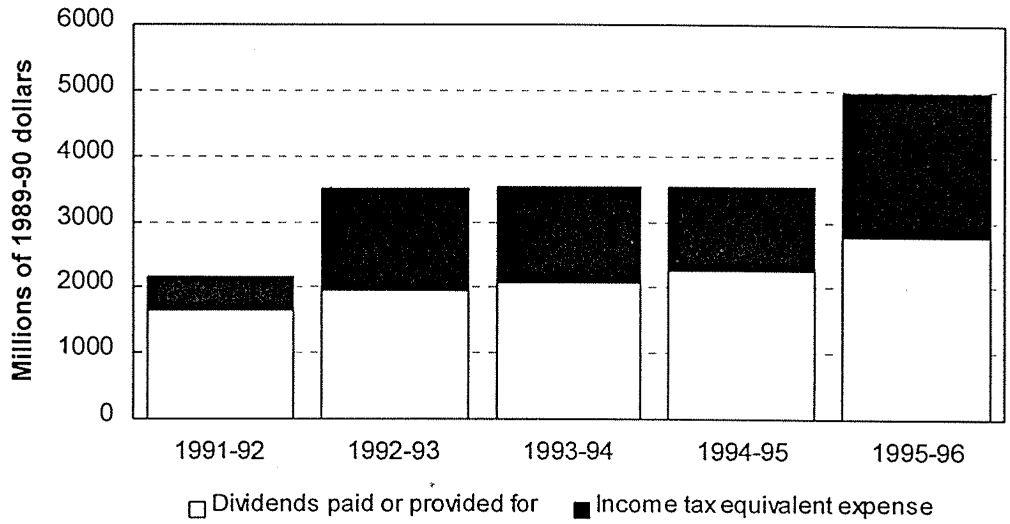
Aggregate GTE payments: composition and share of budget revenue

As well as publishing information on payout ratios, the SCNPMGTE (1997) has published information on dividend and income tax equivalent payments by selected GTEs for 1991-92 to 1995-96.

The committee's data show that from 1991-92 to 1995-96, aggregate real payments to governments more than doubled (from about $2.2 billion to almost $5 billion). This aggregate picture is, though, dominated by Commonwealth dividend and tax payments which, in turn, are heavily influenced by Telstra's payments.

Dividends in that period rose nearly 70 per cent (from about $1.6 billion to $2.8 billion) while income tax and tax equivalent expenses rose over 300 per cent (from just over $500 million to around $2.2 billion). Reflecting this much higher growth, tax payments have increased their share of aggregate payments (see Figure 6).

Figure 6 Real payments to government (dividends and income tax and tax equivalent expense)



Notes *Dividends paid and provided for* is defined as the total amount included in GTE profit and loss statement for dividends. It includes normal and specific dividends and statutory levies on profits and revenues (especially), but excludes returns of capital. *Income tax expense*, or *income tax equivalent expense*, on operating profit before tax (including abnormal items) is calculated using tax effect accounting (AAS3).

Source SCNPMGTE 1997, p.171

This increase in taxes' share of payments is especially marked at the state and territory level. While the growth in aggregate GTE payments to state and territory governments was less than at the Commonwealth level (about 110 per cent versus 150 per cent), tax payments rose over 2600 per cent ($37 million to just over $1 billion). In contrast, growth at the state and territory government level in dividend payments was around 30 per cent (from about $1.1 billion to $1.5 billion) over this period. By comparison, Commonwealth tax payments rose just under 150 per cent and dividends about

160 per cent. Details of payments to governments by jurisdiction for the period are in Table A.1 at Attachment 2.

This change in the composition of payments reflects the emphasis being placed on *competitive neutrality*, where GTEs are now required to pay all taxes and charges that private companies pay. Where a GTE is owned by a state or territory government, it is required to pay to the state or territory government the same income tax (an *income tax equivalent*) as it would were it subject to Commonwealth income tax (SCNPMGTE 1997, p.172). However, as discussed in the overview, there is little policy significance in this change in the composition of payments. That is, it matters little for prices whether the return to government is labelled as a dividend or a tax payment.

Aggregate data on payments to individual governments and their contribution to budget revenue for a more comprehensive range of GTEs is available from the ABS (Cat. No. 5512.0, various years). While differing definitions and bases for collection preclude comparability of the two data sets, the overall story emerging from ABS data is similar to that from SCNPMGTE data.

ABS data indicate aggregate dividend and tax equivalent payments by Commonwealth, state and territory GTEs showed a consistent and significant increase in each of the five years to 1995-96. That said, there were major variations between jurisdictions in the rate of increase both year-on-year and over the five year period. Details of the payments experience of the jurisdictions may be found in Table A.2 in Attachment 2.

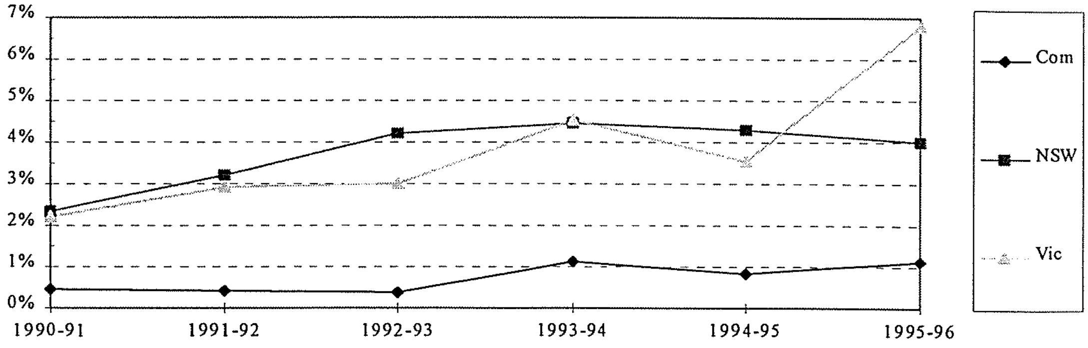
ABS data also indicate that dividend and tax equivalent payments have generally increased as a share of Budget revenues for all jurisdictions over the period 1990-91 to 1995-96 (see Figures 7a, b, c). This increase was particularly marked for New South Wales (from 2.3 to 4.0 per cent), Victoria (2.1 per cent to 6.8 per cent), Queensland (0.2 per cent to 4.7 per cent) and South Australia (1.0 per cent to 4.7 per cent). This general increase was especially notable as it has occurred in the face of significant privatisation (see Box 1).

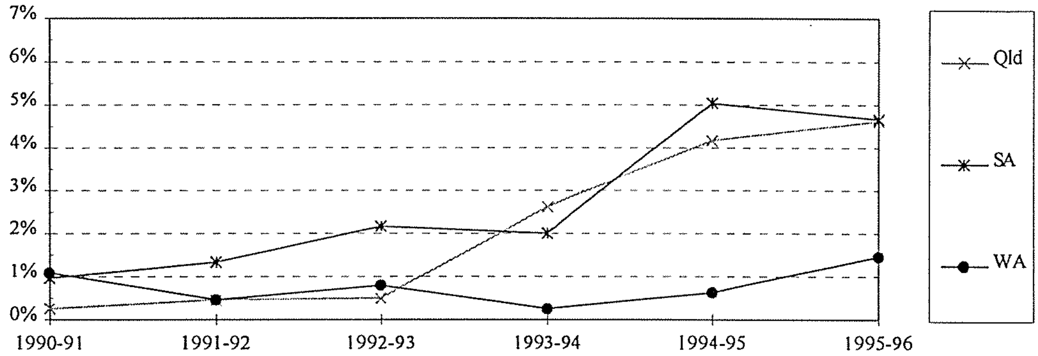
Box 1 Privatisation of GTEs

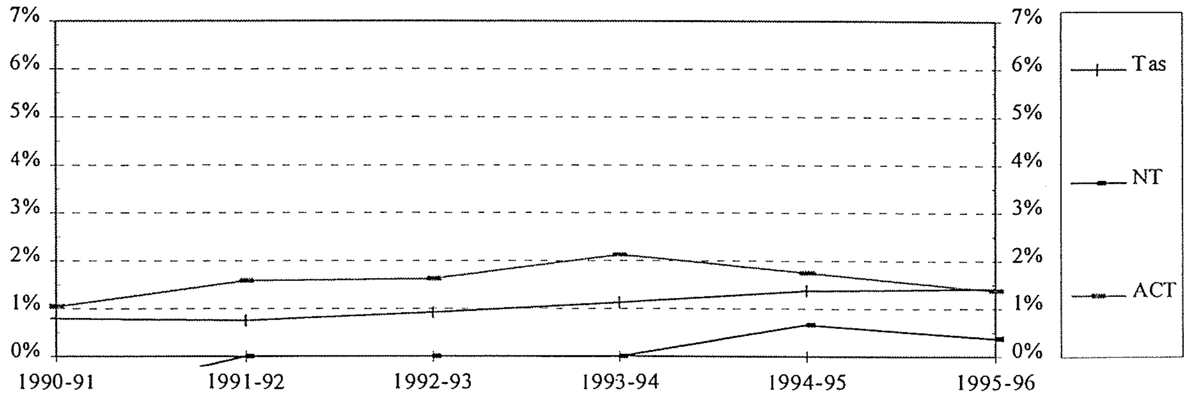
A major influence on aggregate dividend and income tax payments to governments in recent years has been the privatisation of GTEs. Self evidently, privatisation reduces dividend and income tax payments to governments.

The Reserve Bank (1997) estimated the value of GTE privatisations by Commonwealth, State and Territory governments since 1990 at around $61 billion. Victoria, for example, has been particularly active in privatising its electricity GTEs (sold for around $23 billion), which formerly made substantial dividend and tax payments to the government. The spate of privatisations during 1990-91 to 1995-96 means comparisons between jurisdictions, industry sectors and years will not be comparing like with like.

Figures 7a, b, c Dividends and income tax equivalent payments as a proportion of Budget revenue, by jurisdiction: 1990-91 to 1995-96







Source: ABS, Cat. No. 5512.0

Box 2 Are GTE payments to government excessive?

The increased importance of GTEs as a source of budget revenue suggests governments may have an added incentive to extract 'excessive' payments from their GTEs — for example, by not passing on to consumers efficiency gains via lower prices or by taking dividends in excess of any private sector equivalent. Alternatively, governments may have an incentive to go slow on the reform process if it led to reforms which reduced transfers from GTEs to government (eg lower prices from lower but more accurate asset valuations).

A discussion of issues relating to this concern may be found in the Commission's Annual Report for 1992-93 (IC 1993, appendix k) and BIE 1995 (p.91). Those discussions note many GTEs have reduced prices in real terms while others have continued to make losses for their owner governments. For those GTEs in profit, their dividend payout ratios are broadly similar to the private sector. In summary the case for 'excessive' payments appears weak in the main.

3. Influence of capital structure and CSOs

Changes in the capital structure (the debt–equity ratio) of a GTE and the basis for reimbursing it for any community service obligations (CSOs) it discharges may have a significant affect on the enterprise's dividend and income tax payments. They can also influence the effectiveness of dividends as a financial discipline, as a performance monitoring tool and as a measure to introduce competitive neutrality between government and private sector business activities.

Capital structure

Broadly speaking, a GTE may finance its operations by borrowing (ie debt) or by an injection of owner capital (ie equity).

A change in the debt–equity ratio for a GTE of any given size will tend to change the absolute level of dividends (ie raise it for lower levels of debt and commensurately higher equity, and vice versa). But, in the transition period to, say, lower debt, dividends will tend to be lower as revenue is used to retire debt rather than contribute to profits and pay dividends. Thus, any explanation of changes in the level of dividends between sectors and jurisdictions should take account of any changes in the debt–equity ratios of GTEs. (Changing the debt–equity ratio of a GTE will not of itself alter the dividend payout ratio as this ratio is not a function of the size of profits and dividends).

Data collected by the SCNPMGTE shows that, for 59 GTEs for which a time series was available for all or part of 1991-92 to 1995-96, 41 reported a decrease in their debt–equity ratio, 13 reported an increase and five showed no significant change (SCNPMGTE, 1997, vol.2). Of itself, this trend would be expected to lead to higher absolute dividend payment and may provide part of the explanation for the increase in the level of aggregate dividends paid by GTEs over this period.

Community Service Obligations

Governments frequently require their GTEs to deliver community service obligations; that is, to provide goods and services to some consumers at a price which does not cover all the costs of supply. Where GTEs are required to provide CSOs, this may have a significant effect on the dividend payable by the organisation.

If a GTE is overcompensated (undercompensated) for any CSOs it discharges, this has the potential to inflate (deflate) its revenue and, hence, its profits and dividends. An example of how significant this may be is given in the Commission's submission to the NCC review of the Australian Postal Corporation Act (IC 1997b). In that submission, the Commission estimated that 'compensation' afforded Australia Post in 1995-96 for its universal service function ranged from $254 million to $355 million. As Australia Post has estimated the cost of that CSO at $67 million, the impact of CSO arrangements is likely to be more than just marginal. Indeed, the estimated overcompensation ($187 m to $288 m) compares with Australia Post's operating profit of $344 million for that year. Of course, overcompensation may be dissipated in a variety of ways of which dividend reparation is only one.

Commonwealth, state and territory governments have all initiated programs to review CSO policies as part of the broader GTE reform agenda (IC 1997a and 1997b). However, the progress made in reviewing and reforming CSO policies (eg to separately identify CSOs, to properly cost them and to fund them directly) varies considerably across jurisdictions. The SCNPMGTE has noted that 'In many cases there is no basis of determining whether the CSOs have been costed appropriately, or if they have been costed at all.' (1997, p.7)

ATTACHMENT 1

An outline of Commonwealth, State and Territory government policies on dividend and related payments

Commonwealth

The Commonwealth's *Governance Arrangements for Commonwealth Government Business Enterprises (June 1997)*, set dividend policy in the context of the desired capital structure (ie, the debt–equity balance) for the GTE. A GTE's level of estimated dividends (and forecast payout ratio) is agreed annually between the directors and the Shareholder Ministers (the portfolio Minister and the Finance Minister) through the corporate plan consultation process and included in the corporate plan.

Whilst the agreed dividend payout ratio relates principally to capital structure, profitability and agreed future capital expenditure, the payout ratio is to take account of the Government's preference for dividends over capital gains (a payout ratio greater than 60 per cent of profits after tax and abnormals is mentioned as an indicative figure).

Dividend policy for partly owned GTEs has regard to the same principles, as well as to the extent of Government ownership and the views of other shareholders.

New South Wales

NSW's dividend policy is laid out in *A Financial Distribution Policy for NSW Government Trading Enterprises* (NSW Government, August 1992) and the *Capital Structure Policy for NSW Government Trading Enterprises* (NSW Government, August 1994). Dividend policy sits in the context of target returns on equity and total assets. The essence of the policy is stated to be 'subjecting GTEs to the discipline of meeting a number of financial distributions thereby making more transparent the opportunity cost of the capital employed in the businesses'.

GTEs are generally subject to a target payment to Government of at least 50 per cent of pre-tax profit. This 'pre-tax profit distribution' consists of dividend payments and (where applicable) Commonwealth tax equivalent payments. Structuring the payout target on a pre-tax basis is said to explicitly recognise the Government's roles as both shareholder-owner and tax collector, and to discourage tax-avoidance measures.

A debt guarantee levy — termed a 'credit-rating-based fee on outstanding debt guaranteed by the Government' — is an additional element of 'financial distribution'. As GTE debt is sourced mainly from borrowings through the NSW Treasury Corporation, the Government effectively provides both debt and equity funding. Debt funding, in combination with DGLs and a TER, is seen as reducing the discretionary component of GTE financial distributions and thus providing greater certainty to both the government and GTE managers and imposing a discipline on management.

At the minimum pre-tax profit distribution requirement, dividends would effectively be the residual from the tax equivalent payments (TEPs) component. However, many GTEs make financial distributions in excess of 50 per cent: an *after-tax* dividend payout of 50 per cent would correspond to a *pre-tax* profit distribution of around 70 per cent, whereas the 1995-96 dividend payout ratios for NSW electricity GTEs ranged from over 75 per cent to around 100 per cent of *after-tax* profits.

Where pre-tax profit distributions are in excess of the 50 per cent minimum, the policy notes that these performance levels would be expected to continue and improve. The onus is placed on the GTE to demonstrate why the government (as shareholder–owner) should not seek a higher pre-tax distribution; and the policy declares a preference for cash distributions rather than capital gain, arising from the difficulty the government has in realising capital gains. It was noted that the 50 per cent minimum for TEPs and dividends combined is below the comparable private sector average of around 70 per cent of pre-tax profits (which would reflect an *after tax* dividend payout of around 50 per cent). However, GTEs are free to make a case for a lower payout ratio to allow increased reinvestment of profits.

In addition to 'normal' dividends — that is, cash distributed from accumulated net profits (of current or past years) — 'special dividends' (possibly in excess of accumulated profits) and 'capital returns' may be required. Special dividends may be paid from asset revaluation reserves. Capital returns would normally derive from realising part of owner's equity through the sale of assets (usually assets surplus to needs).

GTEs enter these arrangements upon agreement between the Treasurer and the relevant portfolio Minister. These agreements may include transitional arrangements (eg, an exemption from the TER) on a case-by-case basis, to take account of how far the GTE has progressed along the commercialisation/corporatisation path. Financial targets, including pre-tax profit distribution (in dollars), are set in a Statement of Financial Performance for each GTE, determined in the context of the GTE's strategic planning cycle and endorsed by the Treasurer and portfolio Minister. Actual payments are made in the Budget year to which the target applies, subject to revision in the following year after final financial results are available.

Victoria

The Treasury and Finance paper *Corporatised Government Business Enterprises — An Overview of the Government-Board Relationship* (November 1995) views the distribution of dividends as 'a key element of the incentive structure for GTEs, since it underlines the responsibility of Boards to practise good financial management and focus on commercial targets'.

Dividends are determined by reference to two benchmarks: 50 per cent of after-tax profit as dividends, and 65 per cent of pre-tax profit as dividends plus TEPs. After consultation with the Board and the relevant Portfolio Minister, the Treasurer approves the dividend policy applied to a GTE and issues determinations for actual dividend payments. In negotiating with the Board to determine dividend distributions appropriate to the GTE's circumstances, the Government expects that commercial principles will be applied. The 1997-98 Budget Estimates state that 'commercial considerations' include the views of the GTE Board, retained earnings, gearing, forward cash flow projections and the budgetary requirements of the State.

Queensland

Under the Treasury White Paper *Corporatisation in Queensland — Policy Guidelines* (March 1992), dividend policy is primarily set with regard to desired capital structure and target rates of return. Within this context, the policy recognises the role of dividends in preventing capital investments that are not likely to yield adequate economic benefits. The policy also says that, even where all profits could be beneficially reinvested, competitive neutrality suggests that dividend policies of Government Owned Corporations (GOCs) should be similar to those of comparable public-sector bodies and private-sector firms.

As part of the corporatisation process, the policy calls for a review, supervised by the Treasury GOC Unit in conjunction with the relevant Portfolio Department, to determine an appropriate capital structure and dividend policy for any newly corporatised unit. The GOC Monitoring Unit then ensures regular review and appropriate changes in the light of new developments.

Each GOC must publish a *Statement of Corporate Intent* which would cover indicative dividend payments.

Under the *Government Owned Corporations Act 1993*, the GOC Board in consultation with the shareholder Ministers (the GOC Minister and the portfolio Minister) makes a dividend recommendation after the financial year when the financial position of the GOC is clear. The Treasury GOC Unit would be involved in the dividend determination process. The shareholder Ministers may approve that recommendation or specify a different amount. The shareholder Ministers may also require an interim dividend during the financial year.

Queensland's dividend policy is presently under review.

South Australia

In South Australia an annual dividend recommendation is made by the Board of each Government business, based on a percentage of after-tax profit agreed with the Government over a rolling four year period. This is designed to give some certainty to financial planning for Government businesses and to tie in with the Budget Forward Estimates. Under the *Public Corporations Act 1993* the Treasurer, after consultation with the relevant Minister, has the final say on the dividend (or interim dividend) the Corporation's Board has recommended.

The indicative dividend benchmark for government businesses of 60 per cent of after-tax profit (based on audited financial statements) is used for consultation purposes for each business. This is subject to a minimum distribution (by way of tax equivalent payments and dividends) of 75 per cent of pre-tax profits in cases where tax accounted for in the profit and loss statement of a business materially exceeds actual tax paid to the Government under a TER.

Western Australia

The Western Australian Government's *Reform and Renewal — a Policy Discussion Paper on the Corporatisation of Government Trading Enterprises* (June 1991) states:

> GTEs should be required to pay dividends to government in a similar manner to which private enterprises pay dividends to their shareholders. Dividends represent a return to equity holders on their investment, including a reward for bearing risk. (p.25)

An increased capacity of GTEs to pay dividends formed part of the rationale for the corporatisation process, supported by higher retained earnings — and hence less call on injections of Government financing. As a transitional measure, existing statutory corporation levies — which required GTEs to remit a set proportion of their previous year's *revenue* to the consolidated revenue fund — were retained to 'protect the amount and stability of government revenues from GTEs'. An active role for Government in dividend determination was justified on the basis that, unlike an ordinary shareholder, it cannot easily realise its preference between income and capital growth by transferring ownership.

A consultative, judgemental process is used, rather than the application of a formula (such as a specified percentage of revenue, profit or equity).

Australian Capital Territory

Until recently, the ACT's corporatisation model was provided by the *Territory Owned Corporations Act (1990)*, which generally subjects GTEs to:

- target rates return at levels equivalent to private sector counterparts or interstate Government businesses; and
- dividend payments usually based on a benchmark of 50 per cent of after tax profits or 70 per cent of before tax profits.

However, the 1997-98 Budget reported that from 1997-98 ACTEW dividends (the source of virtually all ACT Government dividends) will be based on 100 per cent of profit after tax. This policy replaces one which had ACTEW dividends based on 70 per cent of gross profit averaged over three years, subject to variations to achieve a minimum rate of return on equity. For 1997-98, an interim dividend arrangement brings forward the payment of a proportion of dividends payable in the subsequent year, without altering the total level of payment.

Milk Authority dividends are based on 50 per cent of operating profit. ACTTAB's corporatisation arrangements provided for prescribed minimum amounts in 1996-97 and 1997-98; dividends are projected to increase beyond this, reflecting improved operating performance since corporatisation.

Tasmania

The Treasury & Finance paper *Government Business Enterprises (GBEs) in Tasmania — Legislative Reform* (November 1995) notes that the *Government Business Enterprises Act 1995* overarches the legislation establishing each GBE. As a general rule, GBEs are expected to earn economic rates of return at least sufficient to justify long term retention of the assets in the business, and to pay commercial dividends from those assets. Financial targets are set annually for each GBE as part of the corporate planning process, which involves the Stakeholder Minister (responsible for the GBEs Act), the Portfolio Minister and the Board. The Stakeholder Minister and the Portfolio Minister may jointly give directions in relation to the financial performance targets of a GBE, including dividend proposals. Debt guarantee fees and TEPs are the province of the Treasurer.

The June 1997 *Guidelines for Dividend Returns of Government Business Enterprises* set a dividend distribution target of at least 50 per cent of after-tax profits as a benchmark for all GBEs. A secondary benchmark stipulates that dividends plus tax equivalent payments should equal at least 70 per cent of pre-tax profits. (A 50 per cent dividend payout ratio in conjunction with a TEP at 36 per cent would be equivalent to a 68 per cent distribution of pre-tax profit — a figure similar to the All Companies' figure for 1981-82 to 1989-90). A higher payout ratio would be considered where depreciation charges (which reduce profit) are based on current valuation methods (such as current cost accounting), since retained earnings would not be needed to finance maintenance of the capital stock.

Dividends are set each year, having regard to these benchmarks, the views of the GBE Board, the capital requirements of the GBE and the budgetary position of the State. The Act requires GBEs to prepare annual corporate plans covering at least three years and including an estimate of the dividend for each of the years. GBEs make a final dividend recommendation after the end of the associated financial year. This recommendation may be overruled by the Ministers. These arrangements replaced those in the *State Authorities Financial Management Act 1990*, under which dividends were set in advance.

The aim of the target return and dividend policy framework is 'to ensure that the share of Tasmania's economic resources which is devoted to GBEs is used efficiently and not dissipated'. The inability of the Government to realise capital gains except through privatisation is given as a rationale for a preference in the short to medium term for GBE earnings to be distributed as cash dividends.

Special dividends, not related to current year profits, can be required by agreement of the Portfolio Minister and Stakeholder Minister and Parliament. Special dividends may exceed accumulated profits and/or capital returns, and may be in the nature of a return of excess reserves or provisions.

Continued improvement in returns from GBEs forms a significant part of the Government's Fiscal Strategy, which specifically aims to reduce debt, debt servicing costs and State taxation and provide more value for money in the delivery of services. The Treasurer's Instruction for corporate plans contains proposed financial targets for

GBEs, including a requirement to make specified improvements to distributions to the Government by the year 2000.

Northern Territory

Dividends for specific Government Business Divisions are determined on a case-by-case basis as part of the Budget process. Overall dividend policy is presently under review.

Section 36 of the *Financial Management Act 1995* gives the Treasurer the power to require a Government Business Division to pay a dividend or return of equity from its operating account to the Treasury, subject to any terms and conditions that the Treasurer thinks appropriate.

ATTACHMENT 2

Table A.1 **Real payments to government (dividends and income tax or tax equivalent expense), by jurisdiction, (millions of 1989–90 dollars)**

Industry	*1991–92*	*1992–93*	*1993–94*	*1994–95*	*1995–96*
Real dividends paid or provided for					
New South Wales	750	475	617	524	497
Victoria	204	414	316	207	328
Queensland	20	124	130	199	422
Western Australia	61	63	79	81	75
South Australia	97	139	138	237	115
Tasmania	6	6	9	10	24
Australian Capital Territory	18	22	10	33	17
Northern Territory	0	0	0	5	2
Commonwealth	500	701	782	951	1 301
All real dividends paid or provided for	*1 656*	*1 944*	*2 082*	*2 246*	*2 781*
Real income tax equivalent expense					
New South Wales	23	350	337	298	381
Victoria	0	0	105	123	183
Queensland	0	0	90	108	296
Western Australia	0	0	0	22	74
South Australia	0	0	0	0	56
Tasmania	15	23	24	30	36
Australian Capital Territory	0	0	0	0	13
Northern Territory	0	0	0	0	0
Commonwealth	480	1 195	884	696	1 158
All real income tax equivalent expense	*517*	*1 568*	*1 440*	*1 277*	*2 196*
Total real payments to government	**2 173**	**3 511**	**3 522**	**3 523**	**4 976**

Source: derived from SCNPMGTE 1997

Table A.2 PTE dividends and income tax transferred to general government, 1990-91 to 1995-96 ($ millions) in nominal dollars

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	Δ $m	Δ %
Com	450	405	339	1 117	919	1 371	921	205
NSW	456	702	911	992	1 012	978	522	114
Vic	292	448	436	712	581	1 243	951	326
Qld	21	49	53	308	505	604	583	2 776
SA	48	74	128	128	329	298	250	521
WA	59	28	46	15	43	107	48	81
Tas	14	15	18	23	29	31	17	121
NT	-12				10	6	18	−150
ACT	12	19	20	25	21	16	4	33
TOTAL	890	1 335	1 610	2 202	2 530	3 283	2 393	269

Source: ABS, Cat. No. 5512.0

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