

GOVERNMENT OF WESTERN AUSTRALIA
SUBMISSION TO
THE SENATE SELECT COMMITTEE ON
STATE GOVERNMENT FINANCIAL MANAGEMENT

March 2008

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Introduction

This submission summarises the State Government's financial management framework, recent performance, and current challenges impacting the State's finances, particularly aspects of Commonwealth-State financial relations. Unless otherwise stated, data quoted in this submission are consistent with the 2007-08 *Government Mid-year Financial Projections Statement* (mid-year review), which was released on 27 December 2007.

Financial Strategy and Targets

Western Australia's *Government Financial Responsibility Act 2000* (GFRA) requires the Government to release a Financial Strategy Statement at least once each year (traditionally included in the Budget Papers), together with a set of medium-term financial targets.

The Government's financial strategy has remained broadly unchanged since coming to office in February 2001. It is firmly based on achieving general government sector operating surpluses sufficient to maintain a Capital Works Program that meets the State's needs for essential social and economic infrastructure, while also containing net debt to affordable and sustainable levels.

This strategy is expressed through a range of medium-term financial targets, which are to:

- maintain or increase real net worth of the total public sector;
- achieve an operating surplus for the general government sector;
- retain the State's triple-A credit rating, which is 'operationalised' by:
 - maintaining the net debt to revenue ratio for the total non-financial public sector at or below 47%; and
 - ensuring that real per capita own-purpose expenses for the general government sector do not increase; and
- maintain Western Australia's tax competitiveness, as measured by maintaining tax revenue as a share of Gross State Product (GSP) below the average of the other States.

The targets guide the Government's resource allocation decision-making and – combined with the State's strong economic performance in recent years – have resulted in strong balance sheet outcomes. These outcomes have been recognised by the major international credit rating agencies (Moody's and Standard and Poor's), both of which have reaffirmed the State's triple-A credit rating in recent months.

In addition to requiring a Financial Strategy Statement and a set of financial targets, the GFRA also requires the publication of *Quarterly Financial Results Reports* (within 60 days of the end of the quarter), a *Government Mid-year Financial Projections Statement* (by 31 December each year), and an *Annual Report on State Finances* (within 90 days of the end of the financial year).

These reporting requirements, together with the level of disclosure and detail in Western Australia's budget papers, have resulted in Access Economics consistently ranking Western Australia the most fiscally transparent State or Territory.

Capital Works Program

While the financial targets provide the framework for financial management, the focus of the Financial Strategy Statement goes beyond achievement of targets. In this regard, and with the State enjoying an unprecedented period of strong economic growth, the central feature of the budget is a record \$25.1 billion Capital Works Program (CWP) over the period 2007-08 to 2010-11.

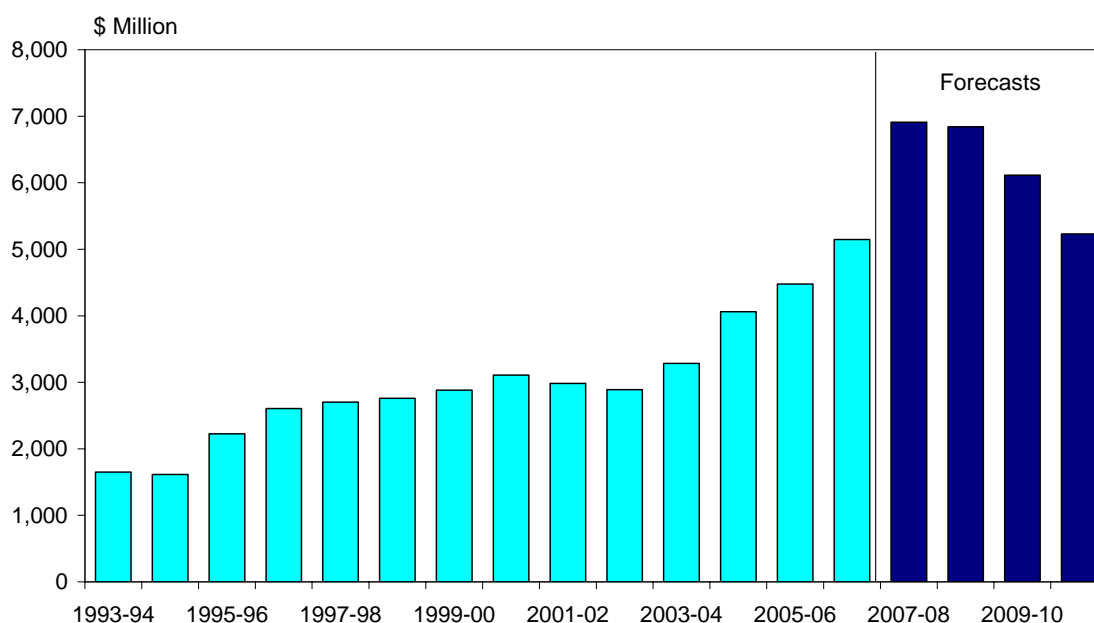
The CWP includes some very significant economic and social infrastructure projects to accommodate the State's fast growing population and economy, including the:

- \$1.76 billion Fiona Stanley Hospital;
- \$955 million Southern Seawater Desalination Plant;
- \$631 million New Perth-Bunbury Highway;
- \$459 million Central Tertiary Hospital (Stage 1);
- \$411 million Alkimos Wastewater Scheme;
- \$335 million Perth Arena;
- \$225 million Muja Power Station; and
- \$52 million Fremantle Port Outer Harbour Upgrade.

These projects follow the recent commissioning of the \$1.66 billion New MetroRail project and the Perth Seawater Desalination Plant (completed in 2006-07 at a cost of \$387 million).

Figure 1

CAPITAL WORKS PROGRAM Western Australia



The nature of the State's growing economy results in significant demand for infrastructure investment of this type. However, while demand for infrastructure is strong, the State has not suffered the sort of bottle-necks experienced in some other jurisdictions.

Given the impact of the CWP on the budget, the Government has implemented a Strategic Asset Management Framework to ensure that decisions on new infrastructure are balanced against existing commitments and competing pressures. This framework provides an integrated, strategic approach to facilitate improved asset management and capital investment across the State public sector. This includes better planning of procurement processes to minimise delays associated with community consultation and planning approvals, which continue to be essential components of the procurement process for capital projects.

The Government has also recognised that it is important for infrastructure planning to take a long-term view, and for the public and private sectors to work together more effectively to meet the infrastructure needs of the State. This is reflected in the Government's commitment to develop a State Infrastructure Strategy (SIS) to guide the planning and provision of infrastructure in Western Australia over the next twenty years. The White Paper of the SIS is expected to be released around the time of the State's 2008-09 Budget.

It is hoped that these processes will be further enhanced by the recent establishment of Infrastructure Australia and the Council of Australian Governments (COAG) Infrastructure Working Group.

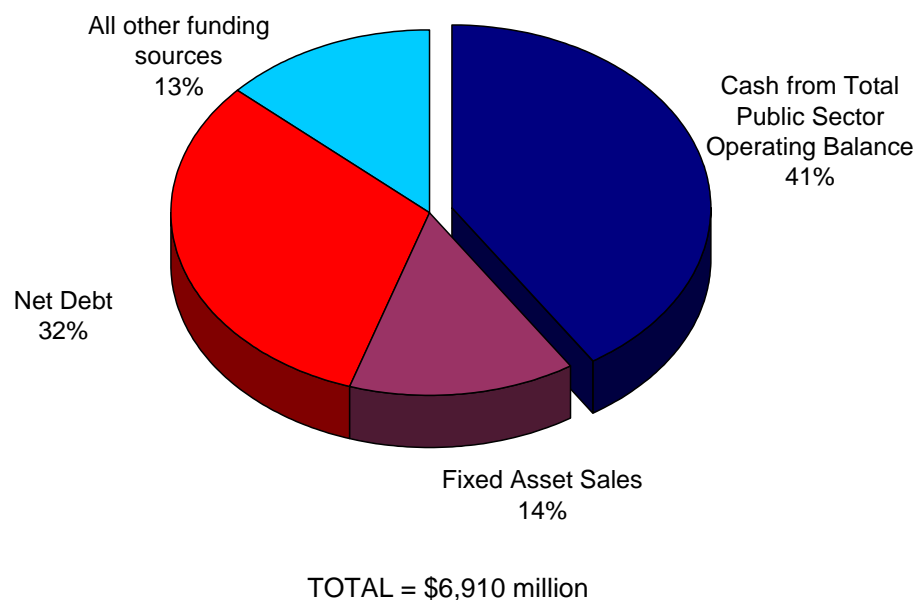
Funding the Capital Works Program

Funding of the CWP is sourced from a combination of the State's operating surpluses, borrowings, and the proceeds of asset sales (e.g. land) as part of the normal turnover of assets.

The following chart illustrates these key funding sources for the 2007-08 year.

Figure 2

FUNDING THE CAPITAL WORKS PROGRAM 2007-08 ^(a)



(a) Based on 2007-08 mid-year review estimates.

Net Operating Balance

The operating balance is the difference between recurrent income and expenses for the year. It is measured in accrual terms (i.e. it includes non-cash costs such as accruing superannuation entitlements and depreciation).

Significant and growing operating surpluses, particularly in the general government sector, have provided a key source of funds in support of the CWP and the management of debt more generally.

Illustrating this point, the general government sector has recorded operating surpluses totalling \$7.0 billion between 2001-02 and 2006-07. Broadly, the Government has used these surpluses to:

- fund the delivery of key strategic infrastructure projects; and
- retire high cost long-term borrowings.

Table 1

APPLICATION OF SURPLUS CONSOLIDATED ACCOUNT CASH

	Debt Repaid or Avoided \$m	Estimated Annual Interest Saving \$m
2003-04 SURPLUS FUNDS		
Consolidated Account debt	481	32
2004-05 SURPLUS FUNDS		
Consolidated Account debt	244	23
Residual rail freight debt	322	16
2005-06 SURPLUS FUNDS		
Full debt-free funding of New MetroRail	1,275	76
Remaining Consolidated Account debt	49	3
Agency-specific debt	59	4
2006-07 SURPLUS FUNDS		
Full debt-free funding of Fiona Stanley Hospital	1,089	64
Equity injection for additional New MetroRail costs	50	3
Western Australian Building Management Authority debt	116	8
Fire and Emergency Services Authority debt	33	4
TOTAL	3,717	233

Note: Columns may not add due to rounding.

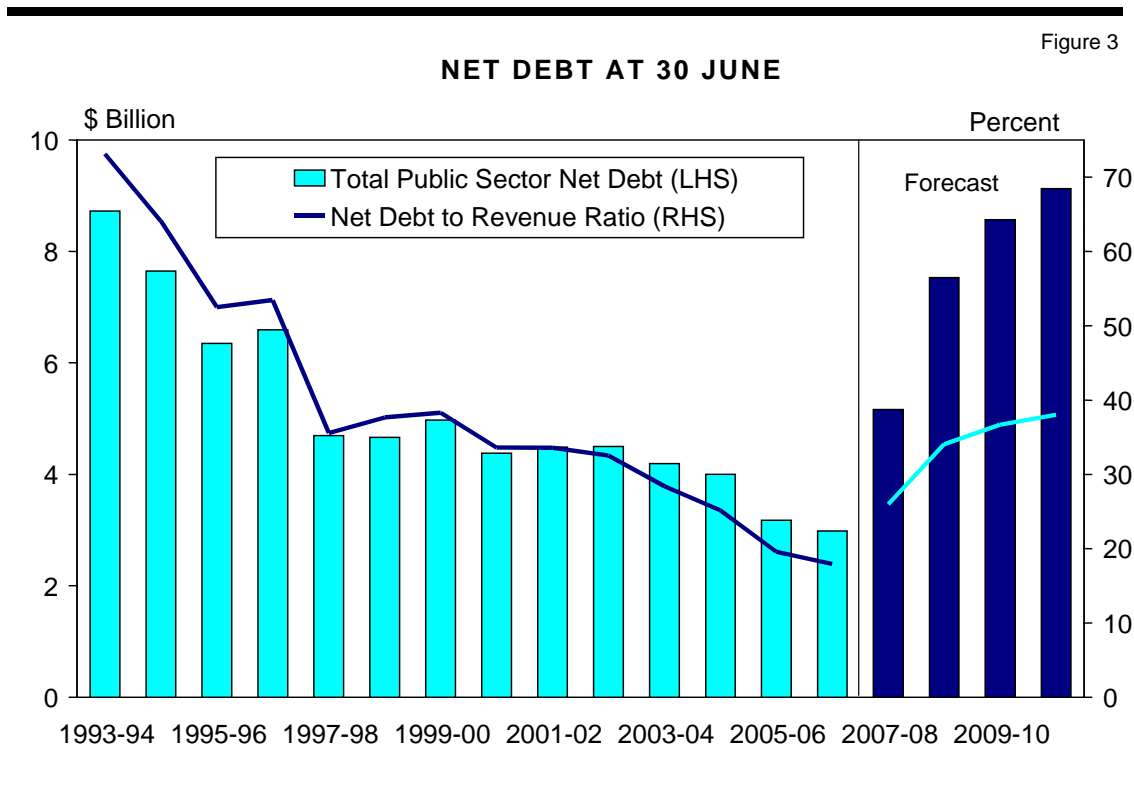
Debt retirement has strengthened the State's balance sheet (in terms of interest rate risk) and provided an increased capacity to address priority spending areas (through lower debt servicing costs).

In terms of infrastructure funding, proceeds from the 2005-06 and 2006-07 surpluses fully funded the debt-free construction of the New MetroRail public transport project (worth \$1.66 billion) and the new Fiona Stanley Hospital (\$1.76 billion), which is the centre-piece of the Government's health reform agenda.

These injections of surplus cash have reduced the call on new borrowings to fund the CWP, and in so doing have contained growth in debt and associated debt servicing costs to sustainable levels.

Net Debt

In the outyears, current projections show the benefit of the boom easing, reflected in slower revenue growth and smaller operating surpluses (by 2010-11, the general government sector operating surplus is projected to decline to around 6% of general government revenue, down from 13% in 2006-07). Accordingly, the State expects an increased reliance on debt funding to support its infrastructure program in the medium term.



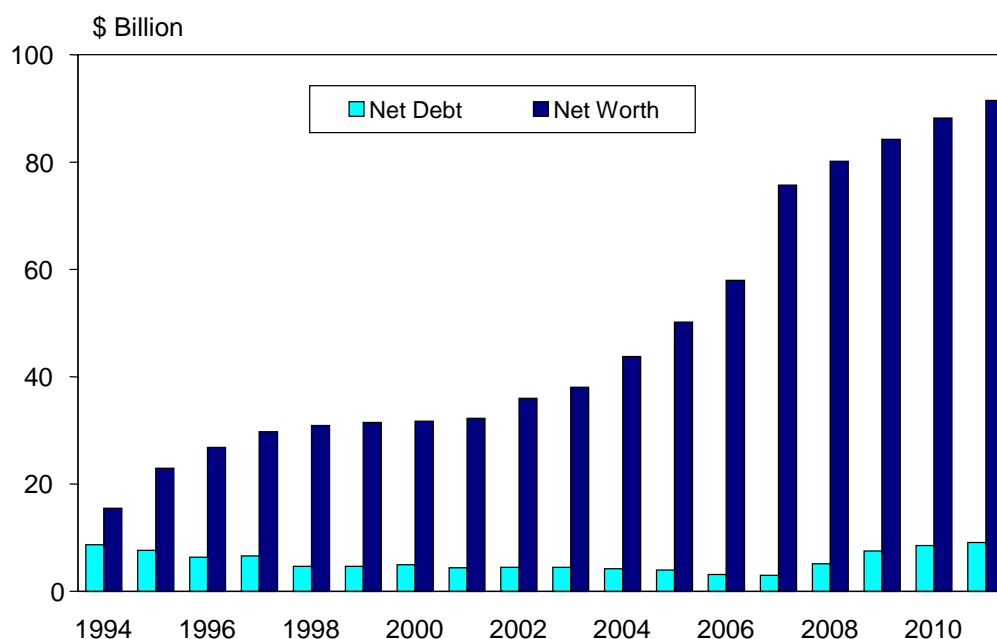
The level of total public sector net debt is projected to increase from a record low of \$3.0 billion at 30 June 2007 to \$9.1 billion by 30 June 2011. Whilst a significant increase (in dollar terms), this level of net debt is affordable and sustainable for the State, with the net debt to revenue ratio forecast to reach a maximum of 38% in 2010-11 – well below the Government's 47% target limit.

In addition, the following chart indicates that the projected net debt levels remain modest in the context of the overall strength of the State's balance sheet (as measured by net worth).

Figure 4

TOTAL PUBLIC SECTOR NET DEBT AND NET WORTH

At 30 June



Public Corporation Performance

Of particular note, the majority of the State's economic infrastructure is delivered by the public non-financial corporations (PNC) sector.

Together with the public financial corporations (PFCs)¹, the PNCs operate on a largely commercial basis. They are run by boards and, in the case of corporatised entities such as ports, electricity and water utilities, are subject to dividend arrangements with the general government sector.

For those entities subject to dividend arrangements, dividend payout ratios are reviewed periodically by Government in the context of Strategic Development Plans and Statements of Corporate Intent to ensure such arrangements continue to be sustainable.

¹ Only two PFCs are significant in whole-of-government terms. These are the Western Australian Treasury Corporation (the State's central borrowing authority) and the Insurance Commission of Western Australia.

Table 2

REVENUE FROM PUBLIC CORPORATIONS
Dividend Payout Ratios

	2006-07 %	2007-08 %
Horizon Power	50.0	50.0
Synergy	50.0	50.0
Verve Energy	50.0	50.0
Western Power (Networks)	50.0	50.0
Water Corporation ^(a)	85.0	85.0
Western Australian Land Authority (LandCorp) ^(b)	50.0	50.0
Gold Corporation	60.0	60.0
Western Australian Treasury Corporation	50.0	50.0
State Port Authorities	50.0	50.0

(a) The after-tax value of handover assets from developers is excluded from the calculation of the Water Corporation's dividend payments.

(b) Adjusted for the need to maintain adequate land stocks.

Dividend arrangements are struck such that these entities can provide an appropriate return on the community's investment (in the form of dividends), while still operating on a commercially sustainable basis, which allows for ongoing investment in essential economic infrastructure. That is, while dividends provide a contribution back to the community to fund other services, they are not levied at an unsustainable rate that prevents the successful operation of these commercial entities.

As indicated in the above table, a higher dividend payout ratio of 85% is applied to the Water Corporation, which reflects the substantial Community Service Obligation payments (subsidies) provided by the general government sector, and the financial structure of the corporation (the corporation has a very low level of debt gearing, despite significant levels of infrastructure spending).

Table 3

IMPACT OF DIVIDENDS AND TAX EQUIVALENTS EXPENSES
Western Australian Public Corporations ^(a)

	Net operating surplus before dividends and TERs			Dividends and tax equivalents expenses			Net operating surplus after dividends and TERs		
	PNCs	PFCs	Total	PNCs	PFCs	Total	PNCs	PFCs	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
1993-94	714	277	991	125	30	154	590	248	837
1994-95	594	230	824	125	49	174	470	181	650
1995-96	432	237	669	226	110	336	206	127	333
1996-97	687	244	932	386	0	386	301	244	545
1997-98	869	51	920	480	0	480	389	51	440
1998-99	908	298	1,206	570	10	580	338	288	625
1999-00	809	104	913	571	16	587	239	88	326
2000-01	783	255	1,039	753	10	763	31	246	276
2001-02	776	47	823	627	15	643	148	32	181
2002-03	675	78	753	627	7	634	48	71	119
2003-04	1,003	135	1,138	744	15	758	259	120	379
2004-05	1,012	247	1,259	753	7	760	259	239	499
2005-06	897	297	1,194	836	12	848	61	284	346
2006-07	950	284	1,235	712	55	767	238	230	468

(a) Public non-financial corporations (PNCs) and Public Financial Corporations (PFCs).

Commonwealth-State Financial Relations

Western Australia has experienced strong growth in own-source revenue in recent years, due to strong growth in the State's economy (driven, in large part, by soaring commodity prices). However, in coming years, much of this success will be redistributed to other States and Territories as a result of the lagged Commonwealth Grants Commission (CGC) process.

Based on the latest CGC recommendations, Western Australia's share of national GST revenue is expected to be reduced to just 5.8% by 2011-12, compared to the State's 10.2% share of the national population. At the same time as this is happening, prices of major commodities such as iron ore are expected to decline as supply and demand balance is restored to the respective markets.

This trend is placing pressure on net debt growth to fund the State's infrastructure investment program, with increased borrowings effectively substituting for reduced GST revenue.

At the same time that GST grants are being reduced, Western Australia is providing a substantial net fiscal subsidy to the nation, with the total take from Commonwealth taxes collected in the State much higher than the return through grants and other Commonwealth spending in Western Australia.

The Western Australian Department of Treasury and Finance has estimated this net outflow at around \$5.0 billion in 2005-06, up significantly on \$3.3 billion just two years earlier.

Table 4

**COMPONENTS OF WESTERN AUSTRALIA'S NET CONTRIBUTION TO THE
COMMONWEALTH**

Relative to Western Australia's Population Share

	2003-04	2004-05	2005-06
	\$m	\$m	\$m
Personal Income Tax	146	567	538
GST collections	-239	-191	-181
Company Tax	940	1,067	1,893
Fuel Excise (net of rebates)	473	365	362
Taxes and Royalties on Petroleum Extraction ^(a)	725	1,155	1,290
Commonwealth Services ^(b)	674	865	985
Personal Benefit Payments	544	580	645
Grants to State and Local Governments ^(c)	173	-114	-191
Other	-181	-321	-376
Total	3,255	3,973	4,965

(a) Net of the share of North West Shelf royalties passed on to Western Australia by the Commonwealth.

(b) Departmental expenditures, including defence.

(c) Includes GST revenue grants. Excludes North West Shelf royalties paid as grants to Western Australia.

Source: Department of Treasury and Finance estimates, using a range of data sources including the Commonwealth *Final Budget Outcome* publications and ABS Catalogue Nos. 3101.0 and 5220.0. Results are based on the latest available data. In some cases, data has been proxied by escalating earlier data using relevant economic indicators.

For Western Australia to continue to generate such wealth for the nation as a whole, it is vital that the State Government continue investing in essential economic and social infrastructure in a financially responsible and sustainable manner. Increased recognition by the CGC of the role (and cost) of infrastructure provision in generating economic growth is essential to Western Australia's – and the nation's – continued economic success.

Attachments

The attachments to this submission provide data series relating to the Select Committee's Terms of Reference.

GOVERNMENT OF WESTERN AUSTRALIA

MARCH 2008

GROSS AND NET DEBT - WESTERN AUSTRALIAN PUBLIC SECTOR

The following table summarises gross and net debt liabilities of the Western Australian public sector.

Whole-of-government data consolidates the general government sector and public corporations into a single entity, eliminating internal assets and liabilities between these sectors.

Table A1

GROSS AND NET DEBT AT 30 JUNE

Western Australian Public Sector

	General Government			Public Non-Financial Corporations		
	Gross debt \$m	Financial assets \$m	Net debt \$m	Gross debt \$m	Financial assets \$m	Net debt \$m
1994	5,644	2,895	2,750	6,712	1,198	5,514
1995	5,655	3,067	2,588	6,468	1,319	5,148
1996	4,241	2,809	1,432	6,313	1,149	5,163
1997	3,997	2,610	1,388	6,322	1,020	5,302
1998	2,912	2,512	400	5,602	1,090	4,512
1999	2,913	2,496	417	6,096	1,355	4,741
2000	2,906	2,180	726	6,461	1,590	4,871
2001	3,072	2,613	458	6,127	1,520	4,607
2002	3,002	2,530	472	6,280	1,663	4,617
2003	3,004	2,608	396	6,769	2,006	4,764
2004	2,677	2,969	-291	7,390	2,219	5,170
2005	2,202	3,199	-997	8,271	2,533	5,738
2006	1,931	4,668	-2,737	9,572	2,594	6,978
2007	1,805	4,521	-2,716	9,173	2,269	6,904
2008	1,990	4,415	-2,424	11,100	2,253	8,846
2009	2,028	4,486	-2,458	13,749	2,437	11,312
2010	2,117	4,863	-2,746	15,403	2,706	12,697
2011	2,216	5,350	-3,135	16,567	2,849	13,718

Table A1

GROSS AND NET DEBT AT 30 JUNE (CONT.)

Western Australian Public Sector

	Public Financial Corporations			Total Public Sector		
	Gross debt \$m	Financial assets \$m	Net debt \$m	Gross debt \$m	Financial assets \$m	Net debt \$m
1994	22,752	22,295	458	25,018	16,292	8,726
1995	19,913	19,999	-86	21,942	14,297	7,645
1996	10,265	10,505	-240	12,163	5,810	6,353
1997	10,895	10,989	-93	12,447	5,851	6,596
1998	9,675	9,895	-220	10,897	6,205	4,692
1999	10,982	11,477	-495	11,716	7,053	4,664
2000	12,289	12,913	-624	12,463	7,488	4,974
2001	12,367	13,051	-684	12,462	8,081	4,381
2002	12,107	12,705	-598	11,983	7,492	4,491
2003	13,002	13,664	-662	12,576	8,079	4,497
2004	13,491	14,175	-685	12,926	8,732	4,194
2005	14,377	15,117	-739	13,460	9,458	4,001
2006	13,957	15,018	-1,061	13,512	10,333	3,179
2007	14,087	15,292	-1,205	13,922	10,939	2,984
2008	15,647	16,906	-1,259	15,780	10,617	5,163
2009	17,039	18,363	-1,323	17,492	9,962	7,530
2010	17,906	19,290	-1,384	18,340	9,773	8,567
2011	18,478	19,936	-1,458	18,869	9,743	9,126

PUBLIC SECTOR INFRASTRUCTURE SPENDING

The following table summarises infrastructure spending by sector, for the Western Australian public sector. The Capital Works Program includes direct infrastructure spending by State agencies, together with loans to home buyers through Keystart, and expensed assistance to third parties to assist with private sector infrastructure construction (i.e. capital grants).

Table B1

PUBLIC SECTOR INFRASTRUCTURE SPENDING
Western Australian Public Sector

	Purchase of non-financial assets				Other spending ^(a) \$m	Capital Works Program \$m
	General government \$m	Public non-financial corporations \$m	Public financial corporations \$m	Total Public Sector \$m		
1993-94	463	837	12	1,311	338	1,649
1994-95	656	763	22	1,441	171	1,612
1995-96	800	912	20	1,639	585	2,224
1996-97	560	1,240	2	1,802	804	2,605
1997-98	636	1,291	2	1,928	773	2,702
1998-99	728	1,120	2	1,850	912	2,761
1999-00	838	1,222	3	2,058	825	2,882
2000-01	1,110	1,184	6	2,300	809	3,109
2001-02	894	1,110	5	2,010	974	2,984
2002-03	794	1,294	6	2,094	796	2,890
2003-04	992	1,507	3	2,502	783	3,285
2004-05	1,092	1,788	3	2,883	1,178	4,061
2005-06	1,161	2,448	5	3,562	917	4,479
2006-07	1,610	2,588	7	4,169	976	5,145
2007-08	2,385	3,353	8	5,662	1,248	6,910
2008-09	2,390	3,277	4	5,598	1,238	6,836
2009-10	2,369	2,748	4	5,068	1,045	6,113
2010-11	1,996	2,192	4	4,131	1,100	5,231

(a) Keystart home lending, infrastructure grants and other CWP spending.