

Sands in the Hourglass: the WAPF Shadow Budget 2008/9

Executive Summary

- The Government needs to realize that WA is stronger in the short to medium term (especially from commodity price strength) but weaker in the long term than it has recently been forecasting.
- The Government's programme really depends on the rate at which non-GST Commonwealth grants escalate. WAPF has presumed an average 15%, compared to 20% last year.
- Infrastructure investment must therefore be met now, through a combination of debt and utilization of the surplus.
- The Government's decision to fund a great deal of WA's capital works programme on an 'iconic' new Perth stadium which cannot support any significant debt or equity and the WA Museum, is poor value for money.
- The time for further tax relief – especially for motorists – is undoubtedly over.
- A moratorium on new road construction for five years would save A\$3.5bn and cost the State nothing in economic growth.
- MetroRail should be dramatically expanded with some of the savings
- WACOSS social service budget recommendations (except housing) could cost as little as A\$50m and would bring tremendous social cohesion benefits to the State.
- Payroll tax should be adjusted downwards for 'green firms' and for other important economic development objectives such as training if overall tax take exceeds forecasts
- If WAPF's revenue and expenditure proposals were adopted, state net operating revenues would remain positive over the forecast period, reaching 2006/7 levels again by 2011/12.
- WA needs a Sovereign Wealth Fund explicitly to invest the accumulated surplus – with a clear State environmental and development mandate and regular reporting

The WAPF Shadow Budget¹ is accompanied by a WAPF summary projection of how the State finances could look if WAPF's recommendations were accepted. See www.wapolicyforum.org.au

¹ This Shadow Budget has been put together by a group led by Julian Roche

Introduction

It is commonplace to describe economies as at 'crossroads' of one sort or another. The metaphor of the hourglass would be a more accurate one to describe the WA economy.

With the tax cuts already agreed, WAPF projects² that the Government's budget (net operating) surplus in 2007/8 will be \$1.9bn, somewhat more than the Government expected in its mid-year review³ but over the next five years, on the basis of current Government expenditure plans, this surplus can be expected further to decline: the mid-year review suggested \$1.25bn by 2010/11, and impacts on revenue and expenditure since then have been broadly neutral. WAPF is a little more optimistic on growth – as described below government forecasts have been consistently on the pessimistic side for the last five years, and on Commonwealth Grants, whilst for reasons described below WAPF's expenditure projections are close, or even a little less, than those of the Government – albeit differently focused. WAPF's projections are for a net operating surplus of \$2.2bn by 2011/12.

Budget surpluses are therefore shrinking in the short term, and what is done with them now will determine the way in which the current State Government is viewed by history as having spent the largest single series of State Government surpluses in Australian history. In the longer term, as commodity prices ease and WA's spectacular boom glides down, the investment decisions taken now will determine the competitiveness, and attractiveness, of WA for decades to come. The Government's response has been to lash out on major infrastructure projects, in particular the stadium, the WA Museum, Main Roads, Northbridge theatre and of course the proposed Foreshore development. Is what is likely to be done wise? Could the Government do better?

Revenues – the overall picture

In the last Budget, revenues were forecast to rise by just 1.8% when inflation is at 4.8%. That would have been a significant contraction of the State Budget in real terms. The Government chose last year to hand out tax cuts which will take effect not just this year but over the next five years, constraining the ability of Departments to make capital investments in new technologies and environmental solutions. Fortunately, growth was stronger than forecast – the mid-year review suggested 6.1% and WAPF also believes that on the basis of the last monthly review the eventual figure will be about 6%. This does not reflect the State economy exactly, as revenues are also critically dependent on the property market which has underperformed the economy as a whole: for example as recently as the last Budget the Government forecast Gross State Product to rise at only 4.5%, revising this upwards to 7% in the

² On the basis of pre-Budget data. These projections will be altered once Budget data are issued

³ \$1,453bn. WAPF's 2007/8 forecasts are qualitative expert judgements. In future WAPF will probably produce an econometric model although there is scant evidence to presume that forecasting the WA economy based on such models is much better than qualitative expert judgements

mid-year review. There are some good tidings: despite a 2006 review of forecasting methods, the oil price forecast made at the time of the Budget was \$66.4/barrel, being revised up to \$86.9/barrel mid-year⁴. It is certainly possible that both the dollar/A\$ exchange rate and the oil (and iron ore) price will have a beneficial effect on revenues throughout the forecast period: WAPF is assuming revenue growth rates short of double figures until 2011/12 but even this may well turn out to be too pessimistic.

The Government published an extremely useful guide to the impact of forecast parameters in the mid-year financial review, which goes some way to explaining why the original forecast was too pessimistic.

Fig 1: Parameter Sensitivity of Revenue Estimates

| PARAMETER SENSITIVITY OF REVENUE ESTIMATES | | |
|--|--|------------------------------------|
| Revenue Type | Parameter Change | Budget Impact (\$m) ^(a) |
| Taxation revenue | For each 1.0 percentage point increase in projected growth in nominal State final demand | +34 |
| Total mining revenue ^(b) | For each US1.0 cent increase in the \$A/\$US exchange rate | -32 |
| Petroleum royalties ^{(b)(c)} | For each \$US1 increase in the price of a barrel of oil | +5 |
| Iron ore royalties | For each 1.0 percentage point increase in the price of a dry metric tonne of iron ore | +15 |

(a) First full-year impact (2008-09).
 (b) Includes North West Shelf petroleum royalties.
 (c) The oil price sensitivity varies according to the extent of the flow-through to LNG prices. This flow-through depends on the aggregate effect of contract specific pricing arrangements.

Source: Government mid-year estimates, p 23

Assuming these parameter sensitivity results are approximately correct, WAPF believes that the forecast of State final demand growth at 4.75% in 2007-8 and 4% in the following year may be underestimates. The Government has after all already revised its 2007/8 forecast up from 3.5%. Oil price underestimation, too, will have a further positive effect on State revenues, especially this year – although WAPF does not see oil prices⁵ falling precipitately over the next few years either, benefiting State (but not necessarily Commonwealth) revenues. The impact on taxation revenue is however relatively slight: it is clear that policy, not growth, is the main determinant of tax revenues. This is why tax relief announced in last year’s Budget was such an important (and retrograde) step in terms of the Government’s ability to press ahead with capital works without damaging the State’s AAA credit rating by increasing debt above the 47% debt: revenue target.

WAPF is therefore forecasting that this year State Government revenues will have increased by only 6% from last year’s outturn⁶. After that, WAPF expects that growth

⁴ Not quite as wrong as it seems – this is the average annual price, not the spot price in May 2008

⁵ Or iron ore prices

⁶ WAPF forecasts subsequent years’ expenditure and revenue based on the previous year’s estimate of outturn and modifies this throughout the year: actual figures for the current year are never yet available when the Budget is delivered as the financial year is not yet even ended.

in the WA economy will slow, but by somewhat less than the Government expects. The combination of continued high resource prices and inward investment, especially personal investment – which the Government never seems much to take into account – is the explanation for the difference⁷.

Nevertheless this gross revenue forecast should be viewed in the light of inflation. Almost all of the increase in gross revenue in 2007/8 was swallowed up by pay rises for the public sector – perfectly justified, but leaving little room for the expansion of capital investment, given tax cuts already announced. In inflation adjusted terms, net revenues will have crept up by barely 2% this year and will probably fall over the next few years.

Fig 2: WAPF Gross Revenue Forecast

| Year | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 | 2011/12 |
|---------------|--------|--------|--------|---------|---------|---------|
| Gross Revenue | 17451 | 18513 | 19867 | 21447 | 23178 | 25445 |

As the Treasurer has already indicated, increases of this magnitude are simply insufficient to support the infrastructure investment that the State requires. Opportunities to make this investment have *already* been lost, but the consequence of meeting infrastructure need will now be increased public debt.

Commonwealth Grants: not a pretty picture

Whilst the idea that WA’s resources boom has put more money into the Treasurer’s pockets is not wrong, there is at least one adverse compensating factor.

The State Government tells us that under the Intergovernmental Agreement that accompanied the introduction of the GST, the Commonwealth distributes all GST revenues to the States according to the Commonwealth Grants Commission’s “fiscal equalisation” recommendations. So a State whose revenue bases are assessed to have grown faster than other States, or whose relative costs of providing a ‘standard’ level of services has declined, will have its grant share cut. The Grants Commission updates its calculation of State grant shares annually, using the latest available data. There is a significant lag between changes in Western Australia’s fiscal circumstances and changes in its grant share, as the Grants Commission uses a rolling five year average of States’ fiscal circumstances.

This will almost certainly mean that, as the Government pointed out in its last Budget, Western Australia is forecast to lose over \$3 billion in GST grants over the next four years compared to its 2005/6 baseline, including \$1.4 billion in 2010-11 alone (this

⁷ Why is the Perth housing market not falling in the same dramatic way as, for instance, Florida? A useful parameter for the Government to produce in its next mid-year review would be the fiscal impact of every 1000 immigrants (approximately 0.03%) on State final demand and Gross Product.

has been revised up from the estimate of \$1.2 billion published in February 2007, reflecting latest estimates of State taxes and royalties). There is no denying that most of this cut is due to Western Australia's revenue raising capacity having grown faster than that of the other States between 2000-01 and 2005-06, especially for stamp duty on property transactions. The forward estimates of Western Australia's GST grants (i.e. from 2008-09) are for a large decline in Western Australia's GST grant share, down from 9.4% in 2007-08 to 7.5% by 2010-11. Absolutely nothing can be done about this, and arguably, as part of the Commonwealth, nothing should be, although it is further clear evidence of the way that viewed dispassionately, WA shoulders progressively more of the share of Commonwealth expenditure. All that the State could possibly argue for is less lag: if a really massive commodity price fall, and recession, were to hit WA, the existing procedures would take years to compensate State revenues. In addition, perhaps, GST revenue allocation ought to take account of infrastructure investment that benefits Commonwealth, as well as State, revenue and economic development and environmental protection: WA has a longer coastline, for instance, than any other State.

As for other Commonwealth grants, these have actually ended up in 2007/8 higher than the Government originally forecast, though only by some \$15m. WAPF has projected that they grow on average by 15% over the forecast period. This assumption is probably the most critical of the entire budget process, and it would be extremely useful if the Government made an explicit forecast.

Fig 3: WAPF Commonwealth Grant Forecast

| Year | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 | 2011/12 |
|--------------|--------|--------|--------|---------|---------|---------|
| GST Grants | 3960 | 3963 | 3969 | 3787 | 3505 | 3500 |
| Other Grants | 3643 | 4355 | 5008 | 5759 | 6623 | 7617 |

State Taxation: not much joy there either

Whereas in the period to 2005/6 revenues from stamp duty, payroll tax, motor vehicle tax and land tax rose consistently in nominal terms, this financial year, 2007/8 for the first time saw a reversal of that trend. A very limited amount of forecasting is available from the State Government on its revenues from taxation. In its mid-year review the Government forecast taxation overall revenues for 2007/8 would be \$755.7m, rising to \$872.3m in 2008/9 and \$974.2m in 2010/11.

If the Government undertook now not to make any more tax concessions to the motoring and other lobbies, however, there would be significant opportunities to garner additional taxes which could certainly be put to good use. With a guarantee of no more reductions in stamp duty, or motor vehicle duties, and given only slightly more robust State economic growth than the Government currently predicts, State taxation revenues could look a great deal more rosy.

Fig 4: WAPF Taxation Projection

| Year | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 | 2011/12 |
|------------------|--------|--------|--------|---------|---------|---------|
| Taxation Revenue | 5718 | 6422 | 6878 | 7630 | 8499 | 9474 |

Payroll tax

The rapid growth of employment in WA has led to dramatic increases in payroll tax. In 2007-8 alone payroll tax receipts were revised upwards by \$237m just between the Budget and the mid-year review – over a 10% upwards revision. The State Government remains consistently cautious about the rise of employment in WA and its taxation implications. WAPF believes that the Budget of 2008-9 will repeat this mistake, and that payroll taxes will reach almost \$2.1bn when the final tally for 2007-8 is made⁸. WAPF believes that payroll taxes will reach \$4bn by 2011/12, whilst the Government is *much* more cautious in its forecast, There are two important implications from this difference of view.

Firstly, the payroll tax system should be actively used by the Government to encourage certain types of employment and certain firms. An incentive scheme could be used, biased towards the end of the financial year⁹, so that windfall gains in payroll taxes could be redistributed to those firms working, for example, in green buildings.

Mining Royalties

The resources boom has led to a rapid and sustained increase in mining royalties. WAPF does not believe that the commodities boom is likely to end in the near future (with oil prices over US\$110 at the time of writing) and therefore has made a relatively robust assumption as to the rise of mining royalties over the next five years. Mining royalties will likely reach \$1.3bn this year and will in WAPF's view continue to climb over the forecast period, reaching \$1.65bn by the end of the forecast period¹⁰. This assumption is, admittedly, very dependent on the continuation of high oil prices.

Stamp Duty

Everyone agrees that the major factor in the slowing rate of growth for State Government revenues in the next few years is the weakness of the State's residential

⁸ This compares to an original forecast of just \$1.7bn in the last Budget.

⁹ A cross between a tax rebate and a lottery win. Government has always been reluctant to be flexible, but here is an opportunity: let *green* firms benefit from State economic growth. This would also, of course, help Government to achieve its forecast targets more easily.

¹⁰ At least one commentator on the draft of this SSB has suggested that the number could rise substantially above this.

property market, with house prices forecast by REIWA to remain flat in 2007-08, and turnover only forecast not to decline as a result of commercial, rather than residential, transactions. As a result of this, and the tax relief measures announced in the last 2007/8 budget, WAPF expects¹¹ that stamp duty on conveyances is forecast to fall by \$190 million in 2007-08 (relative to the outturn for 2006-07). This is one of the most difficult – and critical – aspects of the budget forecast. The rate of recovery in the WA property market will dramatically affect the latitude that the Government has to spend.

Land tax and Metropolitan Region Improvement Tax (MRIT)

Many Western Australians have benefited from significant increases in land values, unlike their poorer compatriots who have not, yet the Government apparently believes, following the State Tax Review led by in-principle tax cutters, that in principle that it is wrong that increasing land values can push land holders into higher land tax brackets¹². In recognition that land values have risen significantly, the 2007-08 land tax scale was adjusted to reduce bracket creep. According to Government estimates, leaving the land tax and Metropolitan Region Improvement Tax (MRIT) scales unchanged would have resulted in the State collecting an additional \$1.5 billion in revenue over the Budget and forward estimates period. This alone would have been sufficient to have afforded the majority of the WACOSS and WAPF ESC proposals discussed below, but it is too late now to reverse this decision without significant discontent. What can be done is to prevent the same opportunity being missed again. The Government can and should announce a freeze on the land tax scale for five years – it was not changed between 2002/3 and last year and need not now be changed again for another five years. The fact that the Western Australian property market is currently flat will significantly diminish the impact of this announcement but it may raise an estimated \$1bn above indexation tax revenue levels, depending on land price escalation. Gradual tax increases on undeveloped land also serve as a constructive incentive to landowners not to speculate. In the last budget a land tax exemption for private aged care providers was introduced; a report on the extent to which this exemption has been utilized, and the attractiveness of any similar exemptions, should be commissioned.

Sale of Goods and Services

Government seems hard pressed to forecast this number correctly. Throughout the year the estimate has been rising – up by \$80m in the mid-year estimate and again by a further \$48m by February 2008. That much of this revenue arises from ‘recoups in the health and education sector’ may seem troubling, although taxi licence rises are just a consequence of additional demand. WAPF expects that Government can expect

¹¹ On the basis of the Government’s February 2008 revision of the mid-year estimate for stamp duty, which stated that conveyancing monies had risen by \$263m above originally forecast in the 2007/8 Budget.

¹² The same logic is evidently not applied by the Commonwealth Government to other forms of capital gains, such as shares or gold.

to see this line item continue to rise at a greater than inflation rate over the next five years, topping \$2bn by the end of the forecast period.

Revenue from public corporations

WAPF has set these parameters – dividend and other income - to rise at 5% during the forecast period.

Tax Cuts – in whose interests?

There are times, Keynes argued, when governments have to grit their teeth and introduce tax cuts – fiscal stimulus – to create demand in an economy which is in the grip of a depression. Deficit financing might have its place, but it is hard to imagine Keynes recommending that course in WA’s current condition.

It is important to note that the increase in tax allowances made in the 2007/8 Budget came on top of a series of tax allowances made in previous Budgets. Far from retaining an enormous percentage of resources in State hands, the Government has in fact engaged in a widespread and systematic policy of handing out tax concessions to a variety of special interest groups, most notably motorists but also:

Fig 5 Does this look wise to you? Tax incentives between 1 July 2004 and the 2007 Budget

| MEASURES IMPLEMENTED OR ANNOUNCED BETWEEN 1 JULY 2004 AND BUDGET DAY | | | | | |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| Business Tax Review Measures from 1 July 2004 ⁽²⁾ | -122.3 | -122.8 | -124.6 | -126.6 | -496.3 |
| 2004-05 Budget Measures | -132.3 | -140.4 | -150.5 | -161.3 | -584.5 |
| October 2004 Tax Package | -252.2 | -267.2 | -282.5 | -298.8 | -1,100.8 |
| 2005-06 Budget Measures | -117.0 | -124.1 | -132.2 | -140.8 | -514.1 |
| 2006-07 Budget Measures | -157.0 | -242.4 | -262.1 | -431.7 | -1,093.2 |
| SUB-TOTAL – PREVIOUS MEASURES | -780.7 | -896.9 | -952.0 | -1,159.4 | -3,788.9 |
| TOTAL | -1,214.0 | -1,381.4 | -1,497.5 | -1,754.1 | -5,846.9 |

Doubling the first home buyer (FHB) stamp duty exemption threshold to \$500,000 for home purchases made WA’s FHB stamp duty exemption the most generous in the nation, allegedly helping to boost home ownership and address housing affordability.

What cutting stamp duties *actually* achieves is insufficient to prevent a major correction in the housing market (as is happening now) but quite enough to deprive

the State of significant revenues. Government estimates were that the first time buyer stamp duty exemption cost \$433m in 2007/8. As an indication of what level of opportunities has been missed, the entire WACOSS program of additional expenditure could for example have been paid for by just a small reduction in these tax incentives. In particular environmental benefits could have been achieved by introducing a differential stamp duty tax for environmentally friendly houses.

As to the impact on the property market, genuinely poor people rent; they cannot afford to buy and their credit rating is insufficient for them to be able to raise a mortgage anyway, especially after banks recoil from sub-prime lending. Even the majority of first home buyers will be buying at the lower end of the market. What did this move achieve? The Government claimed that: "This measure will assist prospective home buyers and will also reduce pressure in the current tight rental market, as more renters move into home ownership." The evidence is that increased interest rates affected the lower segments of the market much more than those trading more expensive houses, with the predictable result that the average value of houses traded increased and the main beneficiaries of the reduction in stamp duty were those who could already afford a home. The number of properties under A\$300k sold was never very great anyway.

In retrospect the stamp duty reduction was a poorly targeted, largely regressive tax change which was, in retrospect, simply a mistake. Nevertheless the intention was good, and when the market recovers, provided that the Government does not take the opportunity then to raise the thresholds significantly, the reduction in stamp duty should be an incentive to greater home ownership. *WAPF suggests a clear policy statement that there will be no more changes for the next five years.* If the housing market recovers slowly, and there is no recurrent boom (and bust) that will be to the Government's credit, not its disadvantage.

Motor Vehicle Stamp Duty

According to the Australian Bureau of Statistics Motor Vehicle Census¹³, the number of vehicles on WA roads rose by 4.7% between 2006 and 2007. That is an extra 75,929 vehicles on WA roads. As if there were not enough cars on WA roads already, the Government announced changes in the last Budget in regard to motor vehicle duty – tax cuts worth \$197 million over the four years to 2010-11, with \$27 million in 2007-08, and \$43 million in 2008-09. From 1 July 2007, the single flat 3% stamp duty rate for new heavy vehicles was extended to used heavy vehicles, and caravan purchases (together with camper trailers) were made exempt from stamp duty. This measure was said to improve the competitiveness of the Western Australian caravan industry and make Western Australia a more attractive caravan touring destination by removing the tax incentive to purchase caravans when holidaying in other States (where a full exemption is widely available). What has happened? Nothing, predictably.

¹³ <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/9309.0Explanatory%20Notes131%20Mar%202007?OpenDocument>

This was all a tax move in completely the wrong direction. The opportunity was completely missed to use motor vehicle stamp duty both to increase the revenue opportunities for Government and to create an environmentally positive vehicle tax policy. Other countries are beginning to do this – by creating extra charges for 4x4 vehicles and other heavy users of fuel. WAPF recommends that the Government instigate a thorough review of the motor vehicle taxation system. As has been adopted elsewhere and has been recommended here, motor vehicle taxation¹⁴ should be based on pollution (CO₂) output. Whilst the detail of such a policy will require intensive dialogue with stakeholders¹⁵, a target of an annual 5% rise in overall domestic per-vehicle taxation should be set, which would automatically have the effect of creating additional demand for public transport, raising public transport revenues and reducing the need for Government funding. Smaller, lower polluting vehicles (eg hybrids) could actually see their road tax fall, but the overall aim would be to see taxes raised from motor vehicles rise by **10%** annually. This figure could be adjusted upwards if vehicle registrations warranted it: the Government should not be afraid to use motor vehicle taxes as a method of regulating road use.

State Expenditure: problems and prospects

Looking at State expenditure; there seem to be two problems. Firstly, the primary responsibilities of the State Government are Education and Training, Health and Public Order and Safety. Yet a look at how the State spends its money suggests that only some 60% of the State's 2007/8 Budget, and quite likely a similar percentage over the next five years, will actually be spent on these key areas.

The State Government rather seems to be intent on leaving its mark by constructing a few large 'iconic' developments at enormous cost rather than addressing peoples' actual daily needs. Two obvious examples are the new stadium and the WA Museum to be managed by the new Office of Strategic Projects. The original 2006 KPMG estimate for the stadium was \$480m in capital costs alone with the Kitchener Park option costed at \$565m in all. Two years on, the cost is now at an estimated \$1.1bn overall with construction costs estimated at \$800m. The Government says it will seek funding from the Commonwealth, business and the sporting codes to help build the stadium but the annual budget cost to the Government over the next five years cannot be less than \$50m even with the best possible help from those sources.

The East Perth Power Station site, which was also in the running to replace Subiaco Oval, will become the new home of the WA Museum. The new museum, to be built at East Perth, will cost around \$500 million and is supposed to be completed by late 2015. This at the same time when the Fremantle Motor Museum is closing for the

¹⁴ And not just for new vehicles, either, but for *all* vehicles. New vehicles form only a small percentage of the vehicle stock and are anyway less polluting on the whole.

¹⁵ The system introduced in the UK in the last Budget, with thirteen bands depending on emissions and a maximum annual tax of approximately \$1000, looks both too complex, and too high a tax level for WA, although it is along the right lines.

absence of a subsidy which would have been a fraction of this amount – and which will attract more visitors? It is not even certain.

Back in 2002 the Government claimed that ‘Western Australia’s outlays for infrastructure are demand driven’¹⁶ but since then the PPP concept seems to have been quietly shelved in favour of government risk-taking and, with the stadium, a project which KPMG said as long ago as 2006 possessed ‘limited capacity to fund any significant levels of debt or equity’¹⁷. Moreover, the inflationary pressure generated by the resources absorbed by these projects is another, uncosted, factor. WAPF has reluctantly presumed in its projections that these projects go ahead but that the Treasurer makes a key commitment in the 2008/9 Budget that there will be no more.

Secondly and by dramatic comparison, expenditure on key issues such as environmental protection, social services and indigenous affairs remains at a very low level. Yet money is found for a series of agencies and commissions – it would be invidious to single out any one particular organization or agency but there are many, which have a responsibility for regional development but whose role often seems to lack clarity and whose results are, to say the least, hard to measure.

What is remarkable is how much that could be achieved to make Western Australia a more inclusive, successful, admirable community with so little money. WAPF calculates that WACOSS’s recommendations¹⁸ would require additional State Government spending in 2008/9 of just A\$50m. In the context of a State Budget which will exceed \$19bn next year this is virtually a drop in the ocean, yet a great deal could be achieved by it.

Moreover, there are some expenditures, especially capital spending on Main Roads, that can actually be cut back without, WAPF believes, a significant negative impact on the State’s economic growth.

Fig 6: WAPF Projection on Expenditure Growth

| Year | 2005/6 | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 | 2011/12 |
|---------------------|--------|--------|--------|--------|---------|---------|---------|
| Overall Expenditure | 14% | 7.70% | 6.74% | 2.21% | 3.64% | 4.86% | 5.11% |

Education and Training

¹⁶ http://www.dtf.wa.gov.au/cms/uploadedFiles/pub_priv_partners.pdf p5

¹⁷ http://www.dsr.wa.gov.au/dsrwr/_assets/main/lib50137/mstf%20volume%202-4.pdf, p 19

¹⁸ With the exception of their recommendation that the the State Government increase funding to restore public housing stock to 6% of the total housing stock in Western Australia.

The State Government knows that time is running out to improve public education in WA. Already an ever-larger percentage of WA's children are being educated privately, with private schools, according to the ABS¹⁹ now taking 33% of the education market in 2006 – 6% more than a decade before. More expenditure on the state school system is part of the answer to reversing that ugly trend. A capital works programme of \$295m on new schools and TAFE Colleges will be insufficient to cope with deterioration in facilities over the next five years, and WAPF proposes that this be doubled. Spending in total amounts to \$4270m, which WAPF would like to see rise by at least 5% annually for the next five years. Discretionary use of the budget surplus for training would also assist in this task.

Health

A great deal of attention has been focused on the increase in costs for the Fiona Stanley hospital, although as the Treasurer himself pointed out, an increase in costs is inevitable in an economy growing as quickly as that of WA. Both current and capital expenditure on health must rise more rapidly than inflation, or revenue growth, to meet expectations and demand over the next five years²⁰. A new, state-of-the-art children's hospital, 400 more staffed hospital beds and increased training places for medical graduates should head the list of health priorities when the WA Government delivers its State Budget next month, according to the AMA (WA). In addition the AMA (WA) wants more recurrent spending, particularly for staffing, nurses and equipment replacement, and more training places for graduates. Total health spending by the Government is expected to rise, but WAPF's projections allow for just over 10% growth in annual current expenditure, and a very significant increase in capital works expenditure which would meet the requirements of the AMA as well as Professor Gavin Mooney's advocacy of a closure of RPH as soon as possible and further aircraft for the Flying Doctor service.

Public Order and Safety

The Government spends 11% of revenues on this category of expenditure. WAPF has assumed that this expenditure grows at approximately the rate of inflation.

Transport and Communication

There is both an environmental and an economic rationale for reducing road use, not expanding it, but the WA Government still does not seem to understand this. A quick comparison of the monies planned on capital expenditure for Main Roads and MetroRail indicates where the Government's priorities really are. \$706m was

¹⁹ <http://www.abc.net.au/news/newsitems/200702/s1858107.htm>

²⁰ As long ago as 2004 the Government projected that ageing alone would require an increase of 2.2% of Gross State Product annually over the next four decades. http://www.pc.gov.au/_data/assets/pdf_file/0003/14349/sub039.pdf

originally allocated in the 2007-8 Budget for *capital investment* in road investment, a figure which was increased by a further \$53m in the mid-year review²¹. This is an *annual* figure, which can on current trends be expected to continue. Actually, a moratorium on new road construction for five years would make sense. A comparison suggests that for much less expenditure, MetroRail could easily be paid to commence the construction of a light rail from Perth to UWA and Fremantle to Cockburn as the first links in a new Metro system.. If this seems unduly biased in favour of metropolitan rather than country WA, it should be remembered that much of WAPF's proposed additional social expenditure, especially on the Native Australian community, would be directed at country WA.

The MetroRail project is a good example, despite the huge cost overruns and the delays, of what vision in Government can actually achieve. Much more remains to be done in Transport and Communications, not least the expansion of MetroRail to the south and east, yet budget allocations will be hard to secure. Government needs actively to present the case for public transport and not simply respond to the case for the motorist.

Housing and Community Amenities

WA has slid behind in the provision of public housing. The original target was for 6% of the housing stock to be affordable. WACOSS estimated last year that at a steady increase of 2,380 dwellings per year, it would cost an average of \$758m per year for the next 15 years to reach 6% of all stock, using an average cost per house of \$239,990. Since then the number of houses has increased and the cost to build per house has also significantly jumped: that \$758m now is probably well over \$800m. As a result, the solution to this problem cannot now be budgetary: there is, and will now always be, insufficient money in any reasonable projection to meet the original target²².

That said, a modest increase in public housing provision can and should be contemplated. WAPF envisages in its projections at least an extra \$100m annually on public housing.

Social security and welfare

The Government says that it intends to spend \$417 million to be spent over the next four years towards making housing in Western Australia more affordable, and \$21 million for an electronic Land Development Program. There is also a plan to spend

²¹ This change was, however, largely attributable to a change in the mix of expensed and capitalised road works

²² This is not to say, however, that there are not other ways to achieve the target. Developers, for instance, could be mandated to include a percentage of social housing in new projects.

\$101 million over the next five years on climate change, including establishing a Low Emission Energy Development Fund to support technology breakthroughs that cut greenhouse gas emissions. The WAPF's Environmental Sub-Committee estimates that a feed-in tariff of 50c/kWh on all renewable energy produced, with the scheme to be reviewed when 10 MW capacity is reached, would cost only a maximum of \$7 million pa when 10MW installed capacity is reached²³. The ESC has also suggested that the Water Corporation be required to run the desalination plant on Natural Power and pay the price of the REC's in their contract, which would cost only \$9 million per year, and should be funded by increased water prices.

WAPF projects that it will be possible for the Government to increase spending on capital works by over \$1bn in the following year overall, and by \$2bn over the forecast period without impugning the Government's AAA debt rating. This may further be increased depending on the pricing policy of public corporations.

Revenues and Expenditures 2008/9: the impact on the Household

If WAPF's proposals are accepted, with electricity and Transperth prices rising at least in accord with inflation, above inflation increases in motor vehicle fares, and insurance, emergency services, sewerage and draining, as well as water charges, rising as per Government's already announced plans, in 2008/9 spending by the 'representative household' on the basket of State government goods and services would rise by approximately \$160. This represents an increase which would be slightly above the overall inflation rate.

However, it is not necessarily right for the State to calculate the impact of its budgetary decisions on the 'representative household'. The impact of what the State Government spends, and how it raises its taxes, on low income households is simply more important than on households that already have sufficient income. It would therefore be an excellent idea if the Department of Treasury and Finance also calculated the impact of changes in State Government tariffs, fees and changes on a *representative low income* household²⁴. Increasing motor vehicle duty would not have any impact on such a family.

Uses of the Budget Surplus

The original estimated Budget surplus in 2007/8 was \$1.453bn. This represents the difference between forecast revenue of \$17,593 million and expenses of \$16,141 million. Even if this estimated surplus turns out to be exaggerated – and the forecast

²³ Based on 1400 kWh per annum for each 1 KW installed capacity

²⁴ One definition of such a household would be: consumers 4567 kilowatt hours of electricity per annum, and 275 kilolitres of water per annum. Purchases ten standard 2-zone Tranperth fares and ten Transperth school fares each week. Does not own a car. Rents eg from Homeswest, with no insurance. WAPF will work with ABS on refining this concept.

has in the past turned out to be an underestimate to the extent of as much as 10% this is the single largest surplus in the history of WA. WAPF is projecting a net operating surplus of almost \$1.9bn.

Fig X: WAPF Budget (Net Operating) Surplus Projection

| Year | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 | 2011/12 |
|----------------------|--------|--------|--------|---------|---------|---------|
| Budget Surplus | 2303 | 1885 | 1748 | 1789 | 1837 | 2263 |
| Net Debt/ Revenue | 0.17 | 0.28 | 0.43 | 0.46 | 0.46 | N/A |

It was a wise decision to invest this surplus rather than return it as tax cuts. Wise politically, in that the word on the street in Perth is not of an electorate aching for another 50c in their pockets, but of deep concern about infrastructural investment, environmental problems and social divisions within WA. And wise economically, because increased infrastructure will bring commensurate investment from the private sector. Countries with a consistent record on infrastructure succeed in attracting investment: those that fail, do not.

The government decision to invest the surplus in the construction of the new Fiona Stanley Hospital as well as NewMetroRail must therefore in principle be commended. Government says that the surplus on the consolidated account (a subset of general government sector expenditure) is used for the Fiona Stanley Hospital at A\$1.69bn. Also the NewMetroRail project at \$1.613bn and the Treasurer is very proud of the fact that this has been achieved without government borrowing.

Financing and Borrowing

The Government has reduced State borrowing down to approximately \$5bn and now intends to let it rise again. WAPF projects that if the revenue and expenditure proposals above were adopted, the State's net debt would rise to approximately \$10.5bn by 2011/12. WAPF expects that the Treasurer's own proposals, with the huge expenditure on iconic projects and Main Roads, will result in a net debt that is actually higher than this and that therefore some of the Government's proposals will actually, in the event, have to be scaled back.

Fig 7: WAPF Net Debt Projection

| Year | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 |
|----------|--------|--------|--------|---------|---------|
| Net Debt | 2984 | 5258 | 8487 | 9824 | 10581 |

There are a number of issues that flow from this. Firstly, projections made at the time of this Budget for Commonwealth grants will be critical for the Government's ability

to deliver programmes, as the Treasurer will always want to ensure the State's continued AAA rating. At present there is approximately \$3bn extra that could be invested in infrastructure, on current revenue and expenditure planning, between now and 2010/11 without prejudicing that rating. One of the key advantages of the numerous small proposals advanced by organizations such as WACOSS is that, unlike iconic projects, they can be expanded and contracted depending on economic outturn.

Secondly, the State remains a net creditor. What is being done with the surplus? The logic behind the creation of a WA Sovereign Wealth Fund is that it would be able to achieve a better return (properly managed) as equity, than would be achieved by borrowing. Singapore has done this for years, very successfully: borrow (partly admittedly to maintain a government bond rate and rating) and also invest, highly successfully, through institutions like GIC and Temasek. Singapore, however, aims primarily at a wholly commercial return on investment, largely overseas as the number of substantial and profitable domestic opportunities is not especially high and the Government seeks to diversify its sources of income. WA's Sovereign Wealth Fund, on the other hand, funded by a mixture of budget surpluses and diverted resources created by limited borrowing, would be aimed primarily domestically at creating sustainable environmental outcomes, combined with a limited overseas investment with WA's trading partners aimed at improving overseas living standards and stimulating fair trade with WA.

Conclusion

The State Labor Government is attempting to play a game of fiscal moderation, and risks being remembered as the administration that squandered the largest State tax revenue in WA's history on tax cuts in favour of flagship infrastructure projects and pandering to an ever rising tide of affluent motorists and unsuccessful attempts to stimulate the property market. No Labor Government should want that reputation.

Instead, the Carpenter Government should tell the electorate of WA that the time for tax cuts is over: the diminishing budget surpluses of the next few years, together with expanded borrowing, need to be applied to WA's huge need for transport and environmental infrastructure and continuing urgent social needs. All the advance warnings we have received suggests that the Treasurer will borrow to finance infrastructure, especially for the health sector but the flagship projects will absorb a huge percentage of expenditure and push the State debt higher than necessary. The sands in the hourglass are running out fast.