STANDING COMMITTEE ON ESTIMATES AND FINANCIAL OPERATIONS

Supplementary Questions

7 January 2011

Department of Treasury and Finance

Question No. A1 (Page 3) Hon K. Travers: How much is allocated for wages growth, and where in the forward estimates is it allocated as a result of the new calculations (for Wage Price Index)?

Answer: The Government's wages policy provides for:

- a base increase in line with the expected growth in prices (as measured by the Perth Consumer Price Index(CPI)); and
- higher increases capped at projected growth in the Western Australian Wage Price Index (WPI). Increases beyond the base CPI level (up to WPI) require efficiency and/or other workplace reform-related improvements.

The Government's wages policy thus guarantees that the income of public sector employees keeps pace with increases in the cost of living as a minimum. Higher outcomes can be achieved, but under the policy these require productivity improvements.

Agencies are currently funded to cover existing Enterprise Bargaining Agreements (EBAs) and CPI-growth once those EBAs expire.

The forward estimates also include a general provision to reflect higher than expected salary costs in agencies across the outyears (2012-13 and 2013-14). This provision is reflected in consolidated general government sector salaries and superannuation estimates and is on top of individual agency salary projections. This provision is justified to provide a sufficient buffer to absorb above-CPI wage outcomes where employees negotiate a higher outcome in line with the Government's wages policy, and to address long-run growth in staff numbers as new policy initiatives or alternative service delivery models emerge in the outyears. This brings general government salaries growth in the outyears to 6.5% and 5.6% respectively. The estimates for general government salaries are found in Table 1.1 on page 55 of the 2010-11 mid-year review.

It is not intended that these provisions will finance or pre-empt the outcomes of future wage negotiations. Rather, the purpose is to capture issues that impact Government's biggest recurrent costs, but that are outside the capacity of agencies to recognise in their approved estimates.

It should be noted that outyear salary provisions have been included in the forward estimates in most of the State's full accrual whole-of-government budget disclosures, which began in the current format in 2000-01.

Question No. A2 (Page 4) Hon P. Gardiner: What is the extent of the divergence between measures such as increases in revenue from payroll tax collections, employment growth and wage price index growth?

Answer: There is generally a strong relationship between growth in payroll tax revenue and growth in economy-wide indicators of employment and wages ('total earnings'). However, growth in these aggregates can diverge, mainly due to the existence of various payroll tax exemptions. These include exemptions for charities and government agencies, as well as exemptions for small businesses with payrolls under the prevailing threshold (currently $750,000 per annum).

It follows that compositional changes in the State's labour market can result in different growth rates for payroll tax and total earnings. For instance, if employment growth (or wages growth) is concentrated in smaller businesses, then growth in payroll tax will be lower than growth in total earnings (holding other factors constant). Conversely, if employment growth (or wages growth) mainly occurs in larger businesses operating above the exemption threshold, then payroll tax growth will exceed growth in earnings.

The following table compares growth rates in payroll tax (adjusted for policy changes) and compensation of employees (a broad measure of all payments to workers) over the past two decades.

	Growth in Compensation of Employees (%)	Growth in Payroll Tax (Policy Adjusted) (%)
1990-91	2.5	4.3
1991-92	4.7	0.4
1992-93	2.8	2.8
1993-94	8.6	8.9
1994-95	6.7	5.4
1995-96	6.2	10.6
1996-97	6.9	7.4
1997-98	5.2	5.7
1998-99	6.2	6.7
1999-00	6.9	1.6
2000-01	4.9	8.7
2001-02	6.9	3.4
2002-03	9.8	11.5
2003-04	6.9	13.5
2004-05	8.1	15.6
2005-06	10.5	11.9
2006-07	14.2	18.8
2007-08	14.6	20.5
2008-09	11.0	15.8
2009-10	4.4	2.5

Source: ABS, DTF.

Question No. A3 (Page 5) Hon L. Ravlich: Could you please provide the committee with a list of all of those (EBAs) that will expire between the time that this mid year review was done and the end of the financial year?

Answer: The EBAs expiring in the period 1 December 2010 (the mid-year review cut-off date) to 30 June 2011 are listed below.

31 December 2010

Theatrical Employees (BOCS) Ticketing and Marketing Services – Department of Culture and the Arts – Agreement 2008

31 January 2011

Public Transport Authority (Transwa) Enterprise Agreement 2009

23 March 2011

Public Transport Authority Railway Employees (Trades) Industrial Agreement 2009

31 March 2011

Public Transport Authority Railway Employees Industrial Agreement 2009

Public Transport Authority Salaried Officers (APEA) Agreement 2008

Public Transport Authority Salaried Officers Agreement 2008

1 April 2011

Public Service General Agreement 2008

Government Officers Salaries Allowances and Conditions General Agreement 2008

Department of Education and Training Ministerial Officers General Agreement 2008

Social Trainers General Agreement 2008

Government Officers (Insurance Commission of Western Australia) General Agreement 2008

Electorate and Research Employees General Agreement 2008

Family Resource Employees and Parent Helpers General Agreement 2009

Country High School Hostels Authority Residential College Supervisory Staff Agreement 2008

Department for Child Protection Country Residential Services General Agreement 2009

Department of Corrective Services Juvenile Custodial Officers' General Agreement 2008

Department of Justice Jury Officers Agreement 2005

25 May 2011

Western Australian Fire Service Enterprise Bargaining Agreement 2008

30 June 2011

Western Australian Police Industrial Agreement 2009

Health Services Union – WA Health State Industrial Agreement 2008

Dental Technicians Industrial Agreement 2009

Question No. A4 (Page 12) Hon L. Ravlich: What analysis has led to what the debt servicing level is and should be, and what is the interest rate which are currently paid on debt by the Western Australian government.

Answer: The Government has a net debt affordability financial target to maintain net interest costs as a share of revenue below 4.5% for the total non-financial public sector (comprising both general government sector agencies and public non-financial corporations such as Western Power, the Water Corporation and the port authorities).

This target was adopted by the Government in the 2009-10 Budget. As has consistently been the case since financial targets became a statutory requirement in 2000, the Government adopted the target after receiving analytical advice from the Department of Treasury and Finance on the existing targets that prevailed at the time it came to office.

That advice was provided to the Economic and Expenditure Reform Committee of Cabinet and is therefore confidential. However, in relation to this target, the following analytical considerations were pertinent at the time and informed the Department of Treasury and Finance's advice to the Government.

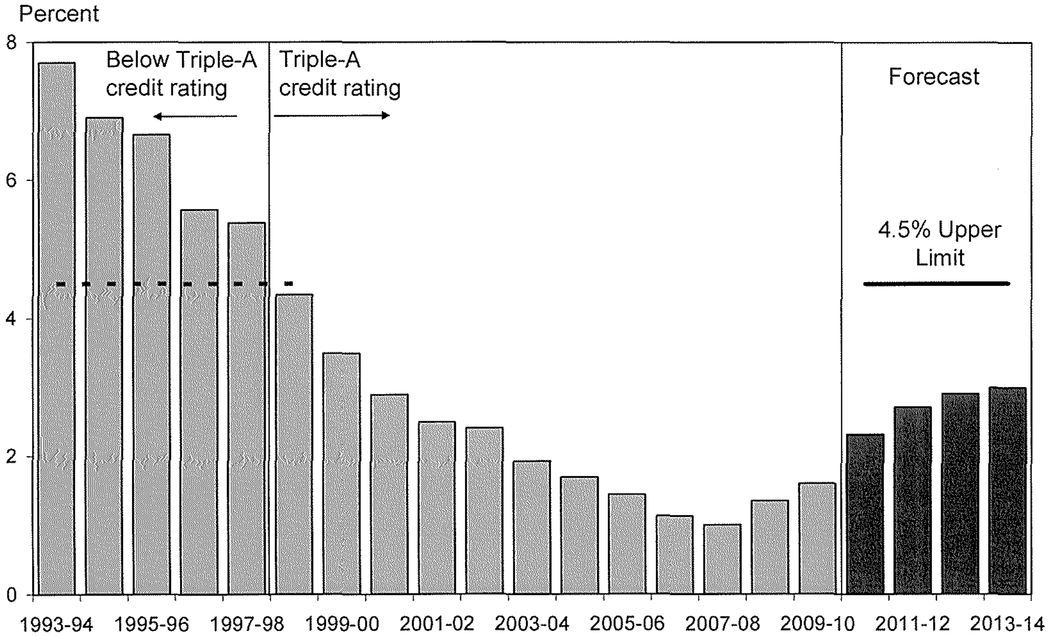
- The previous net debt to revenue financial target (with an upper bound of 47%) was becoming less effective. In this regard:
    - the upper limit of the net debt to revenue target was becoming out-dated, in part due to changes in accounting standards, which brought certain electricity contracts within the scope of the measure (resulting in both leased assets and financial lease liabilities being recognised on the public sector's balance sheet, with the latter impacting the net debt target).
    - The net debt to revenue target was more a measure of the stock of debt, and the net interest cost is seen as a more contemporary target that measures the affordability of debt.
- Net interest costs are the value of interest costs on gross debt liabilities, less the value of interest earnings on financial assets. This financial target ratio is based on the total non-financial public sector, which includes all State agencies involved in the delivery of centrally funded services (i.e. general government agencies) and the Asset Investment Program (i.e. general government agencies and public non-financial corporations).
- Public financial corporations (such as the Western Australian Treasury Corporation and Insurance Commission of Western Australia) are excluded from the target (as they were under the previous net debt to revenue target), given the volatility of interest revenue and expense flows on the financial instruments which they trade. This is consistent with the analytical framework used by credit ratings agencies.
- The resulting net interest measure, taken as a share of revenue, represents a direct measure of affordability and indicates the level of resources available in the current year to pay for projected net debt levels.
- At the time of the original advice, it was shown that the ratio of net interest costs to revenue was above 5% during the period in the early 1990s and before triple-A ratings were restored by both Moody's (in 1995-96) and Standard and Poor's (in 1997-98). This is shown in the chart below.
- Accordingly, 5% was recognised as a reasonable benchmark for affordability.

- The 5% level was revised down to 4.5% in the 2010-11 Budget to reflect an accounting change in the Gold Corporation's estimates. This was documented in Chapter 3 of the Budget Paper 3: *Economic and Fiscal Outlook*.
- The mid-year review shows that this target is expected to be met in the current year and across the forward estimates (see chart below).

Figure 1

NET INTEREST COSTS AS A SHARE OF REVENUE

Total Non-Financial Public Sector



No single interest rate applies to agency debt. Almost all debt is borrowed through the Western Australian Treasury Corporation. Some debt is long term (e.g. 30 year terms), while some is short term (e.g. a matter of months).

Interest costs will vary with the term, the time the debt is raised and other variables.

The weighted average interest rate on interest-bearing debts was 5.3% at 30 June 2010. The current weighted average interest rate estimate is 5.7% and it is expected to rise to 6.7% over the forward estimates.

Central borrowings raised for the Consolidated Account assume the following interest rates in the forward estimates.

Table 1

INTEREST COSTS

	2009-10	2010-11	2011-12	2012-13	2013-14
Consolidated Account interest rate projections (%) [(a)]					
2010-11 Budget	4.4	6.2	7.1	7.3	6.7
2010-11 Mid-year Review	5.3[(b)]	5.7	6.5	6.8	6.7
Total non-financial public sector net interest costs ($m)					
2010-11 Budget					
Interest expense	1,197	1,546	1,743	1,832	1,863
Interest revenue	684	783	735	743	778
Net interest cost	*513*	*763*	*1,008*	*1,088*	*1,085*
2010-11 Mid-year Review					
Interest expense	936	1,360	1,667	1,882	1,987
Interest revenue	389	527	619	695	716
Net interest cost	*547*	*833*	*1,048*	*1,186*	*1,270*

(a) Source: Unpublished data from the Western Australian Treasury Corporation.

(b) This represents a weighted average interest rate (those categorised as general government and public non-financial corporation) using debt outstanding as at 30 June 2010. Note, this is an approximation only and does not take into consideration that different products have different compounding conventions in expressing the interest rate.

Note: Columns may not add due to rounding.

Question No. A5 (Page 13) Hon P. Gardiner: Please provide a definitional and statistical reconciliation between net debt and net financial liabilities.

Answer: Net debt is defined as the sum of deposits held, advances received and borrowings, less the sum of cash and deposits, advances paid, investments, loans and placements and convergence differences that affect net debt. In effect, it consists of interest bearing debt liabilities less cash and liquid assets.

Net financial liabilities, as defined by Standard and Poor's, are equivalent to net debt, adjusted for some assets that the credit rating agency considers are less liquid than implied by the standard Australian Bureau of Statistics definition of net debt, plus unfunded superannuation liabilities.

The Australian Bureau of Statistics also has a net financial liabilities definition, which is included in all States and Territories' whole-of-government balance sheet disclosures. The key difference with the Standard and Poor's measure is the inclusion of accounts payable in the Australian Bureau of Statistics aggregate.

The financial analysis in the mid-year review and the other related publications focus on the Standard and Poor's aggregate given the prominence of this measure in analysis of jurisdictions' credit ratings.

The following table reconciles the total non-financial public sector net debt estimates with the Standard and Poor's net financial liabilities aggregate for the mid-year review estimates.

Table 2

RECONCILIATION OF NET DEBT AND NET FINANCIAL LIABILITIES

Total Non-Financial Public Sector

	2009-10 Actual	2010-11 Mid-year Revision	2011-12 Forward Estimate	2012-13 Forward Estimate	2013-14 Forward Estimate
	$m	$m	$m	$m	$m
Net debt	11,007	15,193	18,037	19,675	21,364
plus Adjustment for non-liquid assets excluded by Standard and Poor's	281	286	281	277	272
plus Unfunded superannuation	7,375	7,400	7,374	7,545	7,716
Equals					
S&P's net financial liabilities	**18,663**	**22,878**	**25,692**	**27,497**	**29,353**

Source 2010-11 *Government Mid-year Financial Projections Statement*, p. 62.

Question No. A6 (Page 14) Hon P .Gardiner: Please provide the net debt to revenue ratio from 2008-09 to 2013-14.

Table 3

TOTAL NON-FINANCIAL PUBLIC SECTOR

	2008-09 Actual	2009-10 Actual	2010-11 Mid-year Revision	2011-12 Forward Estimate	2012-13 Forward Estimate	2013-14 Forward Estimate
Net debt at 30 June ($m)	7,715	11,007	15,193	18,037	19,675	21,364
Net interest cost ($m)	377	547	833	1,048	1,186	1,270
Net financial liabilities ($m)[(a)]	15,206	18,663	22,878	25,692	27,497	29,353
Total revenue ($m)	27,960	34,161	35,976	38,582	40,821	42,416
Net debt as a share of revenue (%)	**27.6**	**32.2**	**42.2**	**46.7**	**48.2**	**50.4**
Net interest costs as a share of revenue (%)	**1.3**	**1.6**	**2.3**	**2.7**	**2.9**	**3.0**
Net financial liabilities as a share of revenue (%)	**54.4**	**54.6**	**63.6**	**66.6**	**67.4**	**69.2**

(a) As defined by Standard and Poor's for the purposes of credit rating assessments.

Source: 2010-11 *Government Mid-year Financial Projections Statement*, pp. 61-62.

Question No. A7 (Page 20) Hon P. Gardiner: What is DTF's assumption on the Grants Commission treatment of the additional revenue raised from the removal of royalty concessions.

Answer: DTF has projected Western Australia's GST grant share on the basis of the Grants Commission's methods as described in its February 2010 methodology report. For mining royalties, the Grants Commission made an assessment for 'low royalty rate' minerals and another assessment for 'high royalty rate' minerals. Minerals were classed as 'low rate' or 'high rate' depending on whether the national average effective royalty rate applied to the mineral (i.e. royalty collections divided by value of production) was below or above 5%. Iron ore fines were classified as 'low rate' on the basis of Western Australia's concessional rates, which applied in the three data years (2006-07 to 2008-09) that were averaged to provide the Grants Commission's assessment of GST shares for 2010-11 (in its February 2010 report).

The decision to distinguish between 'low rate' and 'high rate' minerals in this way was made very late in the Grants Commission's methodology review, without consulting States.

In projecting the GST shares beyond 2010-11, DTF has assumed that the Grants Commission will not change the classification of minerals if States change their royalty rates. Hence DTF has assumed that iron ore fines will continue to be assessed as a 'low rate' mineral, even though the national average royalty rate on fines now exceeds 5%. The Grants Commission is expected to make a decision on this issue in its February 2011 Annual Update report, after considering submissions from all States. DTF has provided submissions to the Grants Commission arguing (among other things) that the minerals must not be reclassified when royalty rates change, to preserve the "policy neutrality" of its assessments and to avoid giving States perverse incentives to modify their royalty regimes to maximise their GST grants. Nevertheless, there is a risk that the Grants Commission may reclassify the fines. We have written to both the Federal Treasurer and the Secretary of the Federal Treasury, asking for the classification of iron ore fines to be 'frozen', but have received no response.

In the mid-year review, DTF projected that the removal of iron ore royalty concessions from 2010-11 (expected to generate around $390 million in 2010-11 and slightly lower amounts in subsequent years) would reduce Western Australia's GST grant share by $91 million in 2012-13 and $183 million in 2013-14 (and larger amounts in subsequent years). The delayed impact and slow-build up of the GST grant impacts reflects the three year lagged average of data years used by the Commission. Over time, we expect around 60% (in net present value terms) of the additional iron ore fines revenues to be lost through GST grant reductions.

Question No. A8 (Page 23) Hon K. Travers: What is the redistribution of revenues resulting from the Grants Commission (that is, what is the additional revenue that is coming in [from the removal of royalty concessions], particularly royalties and payroll tax over the period of the forward estimates, how much do you predict will be redistributed).

Answer: The tax and royalty revenue received by Western Australia and other States over the forward estimates period 2010-11 to 2013-14 will affect GST grants over the period 2012-13 to 2017-18. Based on mid-year review projections, we expect to lose over time - through reductions in GST grants - the following proportions of revenue received in the forward estimates period (measured in net present value terms):

- Mining royalties – 70%
- Land tax – 43%
- Payroll tax – 18%

The variations reflect two factors:

- the relative size of Western Australia's per capita revenue base compared to other States (which is especially large for mining royalties but also significantly above average for land tax and payroll tax); and
- Western Australia's relative taxing effort compared to other States (e.g. Western Australia's relatively low land tax rates are a significant contributor to the high proportion of land tax revenue we lose through reductions in GST grants).

Question No. A9 (Page 25) Hon K. Travers: What is the projected volumes of iron ore production included in the forward estimates?

Answer: The mid-year review estimates assume a total increase in the volume of iron ore production of 27% over the period 2010-11 to 2013-14. This is based on information from a range of sources.

Question No. A10 (Page 26) Hon L. Ravlich: What is the value of the ES10 contract between Synergy and Verve?

Answer: Verve Energy and Synergy have advised that this information is commercial in confidence.

Question A11 (Page 28) Hon K.Travers: What are the elements of cost that are incorporated in the move to cost reflective pricing.

Answer: For water, the Economic Regulation Authority (ERA) undertakes a major pricing inquiry every three years at the Treasurer's request to review tariff rates and structures and the efficient operating and capital costs underpinning the revenue requirements of the Water Corporation, Aqwest and the Busselton Water Board. The last inquiry by the ERA was completed in August 2009 and recommended water, wastewater and drainage tariffs for 2010/11 to 2012/13 and a number of tariff reforms.

Tariffs are recommended that will generate sufficient revenue for the provider to meet the efficient costs of providing services and encourage customers' efficient use of water through pricing signals. The ERA calculates charges based on the total cost of each scheme with its pricing models aiming to balance total revenue with total costs over a number of years (currently 2005/06 to 2018/19). As the ERA's pricing includes forward cost projections, it reviews the Water Corporation's future cost estimates and includes any forecast expenditure that is considered efficient.

The ERA makes recommendations on tariffs that are considered by the Government as a part of the budget process.

All metropolitan tariffs are based on the cost of providing the services to the metropolitan area only. It is noted that water tariffs in the metropolitan area currently recover approximately 83% of costs, although the full cost for the period 2005/06 to 2018/19 will be recovered should the ERA's price path be implemented.

In response to the ERA's recommendations, the Government has agreed that country tariffs be determined on the lower of metropolitan tariffs (where the uniform pricing policy applies) and the actual cost of the country service for each individual scheme (i.e. the cost of supply to some regions is lower than the metropolitan area).

The Community Service Obligation (CSO) is then determined based on the difference between the actual cost and the revenue collected. Regional water tariffs currently recover on average 49% of costs.

The loss made on providing regional water below cost is not recouped through higher metropolitan tariffs, and hence, no cross-subsidisation occurs for water tariffs between metropolitan and regional customers.

The Water Corporation makes a profit as its total revenue, including the CSOs received for regional tariffs, is set at a level that recovers all of its operating and capital costs.

This approach has not changed since being implemented in 2005 by the then Government and reflects a common approach to regulated utility cost recovery adopted across Australia and internationally.

With respect to electricity, the State Government has a Uniform Tariff Policy which determines the electricity tariff residential and small commercial customers pay outside the service area covered by the South West Interconnected System (SWIS). This area is serviced by Horizon Power.

Horizon Power is subsidised by two funding mechanisms as a result of the State Government's Uniform Tariff Policy. Horizon Power receives an operating subsidy funded by taxpayers, which compensates Horizon Power for the difference between the uniform tariff it charges its customers and the cost reflective tariff in the SWIS (this is the same arrangement as for Synergy in the SWIS). Horizon Power also receives an additional subsidy funded by electricity users in the SWIS (called the Tariff Equalisation Fund (TEF)), which compensates Horizon Power for the difference between the cost reflective tariff in the SWIS and the additional costs Horizon Power face due to the fact that the cost of providing electricity in regional areas is greater than that within the SWIS. The TEF is paid by Western Power, which recovers this cost through its network charges.

However, because electricity tariffs within the SWIS are below cost reflective levels, the majority of the TEF cost flows back to taxpayers through Synergy's operating subsidy. This is due to the fact that the TEF is built into network costs, which are a significant (approximately 40%) component of the SWIS cost reflective tariff.

It is noted that the ERA is currently conducting an inquiry into Horizon Power's funding requirements. In its draft report the ERA has recommended that the above funding mechanism be amended. The State Government will respond to the ERA's recommendations in due course.

Question No. A12 (Page 31) Hon L.Ravlich: If it is available, could you pass a copy (of the Community Sector Funding Review) to the committee because that would be handy?

Answer: The Community Sector Funding Working Group's report to the Partnership Forum is to be considered as part of Cabinet deliberations and thus, cannot be released at this point in time.