STANDING COMMITTEE ON
ESTIMATES AND FINANCIAL OPERATIONS

2010–11 GOVERNMENT MID-YEAR FINANCIAL PROJECTIONS STATEMENT

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
FRIDAY, 7 JANUARY 2011

Members

Hon Giz Watson (Chair)
Hon Philip Gardiner (Deputy Chair)
Hon Liz Behjat
Hon Ken Travers
Hon Ljiljanna Ravlich

Hearing commenced at 10.07 am

MARNEY, MR TIMOTHY
Under Treasurer, Department of Treasury and Finance, sworn and examined:

KANNIS, MR ANTHONY
Acting Deputy Under Treasurer, Department of Treasury and Finance, sworn and examined:

The ACTING CHAIR: Welcome to the meeting. Before we begin, I ask you to take either the oath or affirmation.

[Witnesses took the oath.]

The ACTING CHAIR: You will have signed a document titled "Information for Witnesses". Have you read and understood that document?

The Witnesses: I have.

The ACTING CHAIR: These proceedings are being recorded by Hansard. A transcript of your evidence will be provided to you. To assist the committee and Hansard, please quote the full title of any document you refer to during the course of this hearing for the record, and please be aware of the microphones and try to talk into them. I remind you that your transcript will become a matter for the public record. If for some reason you wish to make a confidential statement during today's proceedings, you should request that the evidence be taken in closed session. If the committee grants your request, any public and media in attendance will be excluded from the hearing. Please note that until such time as a transcript of your public evidence is finalised, it should not be made public. This prohibition does not, however, prevent you from discussing your public evidence generally once you leave this hearing.

I also offer the apologies of our Chair, Hon Giz Watson, who is not well. Would you like to make an opening statement to the committee?

Mr Marney: No, I would not. I am happy to proceed straight to questions.

Hon KEN TRAVERS: As a general question, were there any changes in the methodology or the parameter settings that were incorporated into this midyear review that were different to previous budgets or midyear reviews?

Mr Marney: Do you mean parameter settings in terms of key revenue parameters around exchange rate, iron ore price and that sort of thing?

Hon KEN TRAVERS: Right.

Mr Marney: From memory, there were no major changes in methodology between the budget and midyear review. The construct is like for like in terms of methodology.

Hon KEN TRAVERS: Were the parameters, say, for Australian dollars, set using the same methodology as in previous budgets?

Mr Marney: Correct. If ever we change those methodologies, we would try to make that fully transparent so that people can interpret the forward estimates taking that into consideration. Obviously, we try to change those as infrequently as possible to ensure that the aggregates can be compared over time.

Hon KEN TRAVERS: My next question is: in looking at the major economic parameters, it strikes me that you are predicting a stronger economic growth over the full period of the forward estimates. I note that in “business growth” you are expecting an increase in business investment, at least for the next two years and then a drop-off in the final year. First, I am interested in why you are expecting that drop-off. When one looks at things like the *Prospect* magazine, which the government produces in-house, it suggests that there is a longer stream of business investment that will be coming on in Western Australia. What is it that makes Treasury think there will be that drop-off in that third year?

Mr Marney: Essentially, our view of the aggregates is that with business investment we were previously expecting it to be spread over a four to five-year period, concentrated in the back end of that period. However, from what we can identify in terms of commitment, a number of those projects that were to occur in the back end of that four to five-year period have now been brought forward. When we formed the economic projections back in March–April 2010, there was still some uncertainty around global economic conditions. We have greater certainty, and so do producers and investors, to the extent that a lot of those commitments have been brought forward relative to the timing we previously expected. That explains the lift in business investment in the earlier years. In terms of the pipeline of investment, a lot of projects are in prospect both literally, in terms of the magazine, and figuratively, in terms of they are likely or they are on the drawing board. We do not factor those in project by project towards the end of the forward estimates unless there is real, solid commitment. What we do is model the trends in business investment over a long period of time. What we are seeing is the aggregates and the growth rates for business investment trending back to something that is the historical norm, as opposed to continuing to factor in projects that are of lesser and lesser probability as we move out in the forward years.

[10.15 am]

Hon KEN TRAVERS: I guess that raises a couple of questions. The first is: if we are bringing forward that investment, does the Western Australian economy have the capacity to manage that investment if those investments that were previously expected in the out years are brought forward into the next two years? Does it physically have the capacity to take that business investment and also the government’s own capital works investment?

Mr Marney: I think in terms of the government’s own capital works investment, that remains, across the forward years, around the $7 billion to $8 billion mark in the overall capital program. It is pretty stable, albeit it has ramped up substantially in the last two to three years. A big chunk of that investment is $1.2 billion alone in the Building the Education Revolution investment, which phases out over the next few months, so there is capacity kind of being released back into the market as that phases down. Whether or not in the private sector there is capacity, I think it is inevitable that we will hit capacity constraints; the question is how the market will respond to that, and the response will be through reallocation of resources as well as price. But if we have the strength in business investment that we are expecting in the coming years, it is likely that there will be some capacity issues. Having said that, there is excess capacity in the WA economy at the moment. What we saw during the downturn was employers reluctant to shed staff at the risk of not being able to find them again when things picked up. There is spare capacity within the industry at the moment, on the basis of the labour market aggregates that we have seen over the past 18 months, which is probably why the fall in the unemployment rate is not what we would expect, given where we have travelled this financial year.

Hon KEN TRAVERS: We are expecting that pickup and growth, and potential pressures on the market, and you say that there is spare capacity, but the sense I get about the economy is that the skilled areas of the market are pretty much at capacity; certainly in large areas of skilled labour, we are already at capacity again. That is where you run the risk that the response of the market is to use price, but I do not see that factored in anywhere in the forward estimates, in terms of the government's own expenditure and cost pressures within the outlying years of the budget, if we are to see that start to occur. Am I wrong there, or is it built into the budget somewhere, and can you point it out to us if it is?

Mr Marney: We have accelerated the projections for wage price growth significantly above what was expected at budget time. That flows through to a range of different parameters within the budget, including our own provisions for wage escalation, in accordance with the government wages policy over the forward years.

Hon KEN TRAVERS: Where would I find that increase in the government's wages bill, considering that wages is always one of the big components of government expenditure? Where is that demonstrated in the actual allocation of money to different agencies?

Mr Marney: It is more likely that it is allocated centrally as a provision for wages policy than allocated to individual agencies at this point, because we do not know who is going to draw down that allocation, but we do know we need to have that buffer in the numbers.

Hon KEN TRAVERS: How much is allocated there for wages growth, and where in the forward estimates is it allocated as a result of the new calculations?

Mr Marney: It would be within our broad provisions for expense growth in the net operating balance, and it would be consistent with the wage price index, but I am happy to take that question on notice and give further detail around exactly what we have factored in, in terms of a provision in the aggregates for wages growth in the forward years.

The ACTING CHAIR: That is identifying in the broad economic parameters where the expected wage growth is going to be identified.

[*Supplementary Information No A1.*]

Hon LJILJANNA RAVLICH: Can I just ask a follow-on question, Under Treasurer? The accelerated wages growth would suggest that there has been some change to the government's wages policy, because I am assuming that the accelerated wages growth is to cater for wages being granted over and above that which was set as part of the policy structure. Can you give us some feedback on that?

Mr Marney: To answer the question, I probably need to clarify the nature of the policy. The policy refers to two key parameters, being the consumer price index and the wage price index. If those parameters change, the provisions to fund wage increases changes accordingly. What we have done as part of the midyear review is revise one of those key parameters to a reasonably significant extent.

Hon LJILJANNA RAVLICH: Which one? That would be the wage price index.

Mr Marney: The wage price index, yes. That forecast, in the current year, has been revised up from 3.75 per cent to 4.25 per cent. As wages policy refers to that parameter, therefore the provision should rise in accordance. There has been no change to government wages policy.

Hon LJILJANNA RAVLICH: You are saying that the flexibility was provided for within the policy itself, so this is simply reflecting the increase in the wage price index?

Mr Marney: Yes.

Hon LJILJANNA RAVLICH: Okay.

Mr Marney: The policy itself does not refer to a fixed number, it refers to those indices; the justification being that it keeps pace, in broad terms, with what is happening in the economy in terms of inflation and broader wages growth.

Hon LJILJANNA RAVLICH: That makes sense.

The ACTING CHAIR: Can I just take these broad numbers a little further? In the budget papers, on page 2, there is reference to increases in revenue occurring in part from higher payroll tax collections of $178 million, reflecting the strength of the labour market. My question really is whether you can reconcile that back to the broad economic parameters on page 3, where we have employment growth, which has increased from 1.75 per cent, as you say, to 3.5 per cent. Does that increase reconcile roughly to that payroll increase, and do you conduct those kinds of reconciliations to the parameters on an ongoing basis?

Mr Marney: Yes, the payroll revenue receipts have accelerated ahead of what was expected at budget time, in accordance with the acceleration in employment growth, which we have revised up in the current year from 1.75 per cent to 3.5 per cent, and in accordance with the wage price index growth going from 3.75 per cent to 4.25 per cent. It is consistent with the increase in parameters, but taking into consideration issues of thresholds and the potential movement of employers through thresholds, which tends to give a greater increase in payroll tax receipts than just those parameters alone.

The ACTING CHAIR: What would be the variation outside the reconciled numbers? Is the reconciliation that you might make with those broad parameters within plus or minus half a per cent of wages growth and half a per cent of wage price index?

Mr Marney: I would have to take that question on notice and get back to you. The coverage of employment growth and wage price index growth is the whole economy; payroll tax is a subset, therefore there are inevitably variations between the growth rates of the two, but I am happy to give you some further information on the divergence between the aggregate of employment growth, wage growth and payroll tax growth.

The ACTING CHAIR: Thank you very much. That is the extent of the divergence in the reconciliation between measures such as increased revenue from higher payroll tax collections, employment growth and wage price index growth.

[*Supplementary Information No A2.*]

Hon LJILJANNA RAVLICH: I do not know where I saw it in these papers, but my understanding is that this adjustment has been made because of the increase in wages that were paid to nurses, doctors and utility workers.

Mr Marney: There have been increases in expense associated with enterprise bargaining agreement outcomes for nurses, doctors and, I think, miscellaneous —

Hon LJILJANNA RAVLICH: Okay, yes; miscellaneous workers.

Mr Marney: Having said that, they are not what drives the broad WPI growth across the economy, but they are consequential flow-ons from wages policy, linking back to the wage price index.

Hon LJILJANNA RAVLICH: My question is: are there likely to be others that have not been factored in as part of the adjustment?

Mr Marney: Those are the agreements that have been struck between budget and midyear review. Going forward, there will be various rounds of renegotiations; I think the general public sector agreement number five is due to expire next month. There is also police and prison officers —

Hon LJILJANNA RAVLICH: Could you provide the committee with a list of all of those that will expire between the time that this midyear review was done and the end of the financial year?

Mr Marney: Yes, I am happy to provide that.

[*Supplementary Information No A3.*]

Hon KEN TRAVERS: I will follow on from the issue raised by Hon Ljiljanna Ravlich and come back to the other one. On page 87 there are the expense changes that include those three areas—nurses, doctors and support workers—as major changes that have been added into the budget.

Again, my understanding is that you always have a provision in the general overall government, under Treasury, for wage increases. Is that over and above what you previously provided for, or is this what is now provided to them should there be a subsequent reduction of the general allocation under Treasury for wages growth?

Mr Marney: This is the expense impact on the individual agency itself. It is more than likely that most of those increases would have been funded out of that general wages provision, so it is a drawdown from that provision, and then allocated to that specific agency.

Hon KEN TRAVERS: Right. If you tallied up all the expenses up under that area, it would not necessarily correlate with an increase in that total expenditure in the budget.

Mr Marney: It depends on how much of that provision has been drawn down, and it may be that we have actually retained some of that provision, noting that we have at least three or four other agreements to deal with in the current year.

Hon KEN TRAVERS: Obviously one of the cost pressures as a result of that strong economic growth is wages; we have talked about that and you are going to provide that as supplementary information. The other one is obviously the cost of capital works. I am interested in what you have factored in. Total capital works is declining because the number of projects is declining, but I am interested in the individual projects. What sort of escalation have you calculated for capital works over the period of the forward estimates, and has that changed as a result of the midyear review, or is it still the same as was calculated at the time of the budget?

Mr Marney: From memory, it has not changed substantially from the escalation that was built in at budget time. The tender outcomes that we have still been receiving as recently as the past few weeks are still favourable. They are still coming in under our pre-tender estimates, based on the best work of our quantity surveyors. On that basis, we have not varied the escalation rates substantially. Having said that, we do not make those rates known in a highly visible public sense, the risk being that tenderers will factor in those rates as a given and we will lose the benefit of the competitive process within the tender processes. But I can confirm that the rate has not moved much.

Hon KEN TRAVERS: In light of the pressures that we were talking about earlier, you are saying that to hit full capacity in the WA economy, the level of business investment is there and that a large chunk of that will be in capital investment. In fact, I suspect, certainly in the commencement of it, it will almost all be in capital investment.

[10.30 am]

Surely, you must be expecting some pressure on that construction market to lead to some increase in escalations over the period of the forward estimates over and above what was there 12 months ago in light of the fact that you have changed all of those other parameters.

Mr Marney: That is a risk. The extent to which that risk eventuates depends not only on the volume of capital works that we undertake, but also the way in which we procure it, so on that basis it is very difficult to anticipate what that likely escalation is going to be. But, as you have pointed out, it is fair to say that in a strengthening investment environment, a strengthening wages environment is likely to flow, and I think we flag the wages risk in the risk statement. With that escalation on capital works is a potential risk; it is always a potential risk.

Hon KEN TRAVERS: I guess it is a heightened risk, though, when you are predicting the sort of business investment growth—there is always potential for that—but when you are predicting the sort of employment growth and investment growth then, obviously, it becomes a short-backed favourite rather than a long-odds favourite sort of thing. Your odds of it happening shorten substantially.

Mr Marney: And we do have escalation built in. What is hard to know is: should it be five per cent or should it be 10 per cent or should it be 13? I think we have a ways to go to get a better read on that. At the moment it is a risk, we know it is a risk, but we cannot really quantify it all.

Hon KEN TRAVERS: With things like salaries, you actually have a general provision for escalation of salaries; you do not have a general provision for escalation on capital works. You actually factor it into each individual capital works, do you not?

Mr Marney: Yes. I mean, if we stick to the strategic asset management framework, that deals with the escalation through the process of the life of a project. In the very heated environment back in 2007–08 and 2008–09, we did build in central provisions for escalation because it was so heated. Part of the difficulty in dealing with escalation in capital projects, particularly in a heated environment, is distinguishing between that which is escalation in price and that which is inflation in scope. It is fair to say during that heated period there was some propensity to take advantage of the heat to increase the escalation to accommodate increased scope.

The ACTING CHAIR: I will just take that a bit further. Again, on page 2 with your key financial ratios it is clear that the net-interest-cost-to-revenue and the financial-liabilities-to-revenue is not the constraint upon how much is going into infrastructure investment. That is obviously being constrained by capacity issues. When you have a strong private sector—which I think you said before is gaining strength—with investment, what advice does Treasury give to government in terms of how to balance the pressure you can add to the economy based on the infrastructure that is needed in the economy compared with what the capacity is? Can you give some idea of how you frame that advice and how you kind of constrain those things?

Mr Marney: I think in answer to the question, the government has articulated a desire to remain below $20 billion in overall net debt, and that is its primary target at the moment.

Hon LJILJANNA RAVLICH: Pretty close to it though, are we not?

Mr Marney: Correct. At budget time we were just over $20 billion in net debt; midyear review we are just under $20 billion in net debt—sneeze and we are over, basically. So that is the guiding parameter for government. Our job is to deliver on government's objectives, so in essence our advice is geared towards the necessary actions to ensure government remains within that stated objective. Obviously, in framing advice to government we take into consideration market circumstance, pricing circumstance and capacity to deliver within the constraints of on time, on budget, and as the market heats up, both of those things come under increasing pressure. Trading those factors off with government's stated objectives in terms of delivery of various elements of infrastructure, I can assure you we always give the best advice we can give in the interests of what is best value for money, but at the end of the day, it is government's decision and government's commitments that drive the nature of the capital program.

The ACTING CHAIR: Just on the $20 billion net debt, I was not aware of that number being set but I presume that is advice coming from yourself to government saying that this is an amount that we should put as a ceiling for the time being. What would cause you to modify that particular number to a lesser number?

Mr Marney: It is actually not strictly speaking our advice to government that that be the target; that is the government's desire. Government's view is that $20 billion is a threshold that it does not want to go beyond. It is very difficult to estimate what the optimal level of net debt is for the state. It is an issue that we have struggled with for at least 15 years or so that we have been working together. It is very difficult, it is subjective and in essence it is government's judgement that it does not want to exceed that $20 billion net debt figure or thereabouts.

The ACTING CHAIR: And that supersedes the ratio—I thought there was a net financial liabilities revenue ratio, something like was it 90 —

Mr Marney: Ninety per cent is driven by Standard and Poor's expressed threshold at which they would start to have a very close look at AAA rating.

The ACTING CHAIR: Okay, so the government —

Mr Marney: Essentially, the targets work in concert; they try to ensure that debt is under control, that our ability to service debt is under control and that our expenditure growth is under control. It would be, I think, erroneous to rely on just one target, so a suite of targets is the most prudent way to ensure a robust set of financial outcomes.

The ACTING CHAIR: The relative emphasis on those items in that suite of targets is going to change from time to time, so really the borrowing rating for the state is not the driver in this particular case; there are other drivers that are governing what our net level of debt should be.

Mr Marney: Yes, I would say the targets and the rating are all complementary. The rating is an outcome of the achievement of targets—not the fact that government has targets and is taking actions to live within those targets is manifesting in a rating outcome.

Hon KEN TRAVERS: You make the comment that the target at the moment that is set by the government is to remain under that $20 billion, and it is currently $19.886 billion, I think it is, so it is basically sitting just below it. We talked earlier about the potential escalation in costs that could occur. It would strike me that the other potential area of escalation is if there is significant business investment, for which there needs to be corresponding investment in state infrastructure to service the private sector investment, particularly in areas like power, ports and transport infrastructure. It again strikes me that there is a range of projects that are potentially not listed here that could occur within the next four-year period if we are to see that sort of business investment. I just wonder if you have done any analysis of that as a Treasury of where that business investment is likely to occur over the next four years and whether or not we have the necessary state infrastructure, either currently under construction or planned, and therefore factored into the budget, to meet the needs of the private sector.

Mr Marney: That analysis is done as part of framing advice to government in terms of the risks and issues that government will have to deal with across the forward estimates period. The analysis is done in part through aggregating the various infrastructure demands identified by some of the key agencies that provide those economic infrastructure facilities, such as Western Power, Horizon Power and so on. It is fair to say there are always projects on the books for those large entities that respond to demand, whether it be of industry or even population growth itself, and those are factors that are constantly before government whenever it considers the economic parameters.

Hon KEN TRAVERS: But is there a list of the major private sector investment that we expect to occur over the period of the forward estimates and corresponding state infrastructure that will be required to match that private investment?

Mr Marney: It tends not to be that closely linked; it tends to be that you get a number of private sector projects and then you have to expand the power network and generation by X. It is not one project leads to an X expansion in the power network and X expansion in generation; it happens in larger lumps, so it tends to be driven by broader aggregate projections of demand rather than project by project. Having said that, there are specific projects that come with identified specific infrastructure demands.

Hon KEN TRAVERS: But do we have a list of those collective private sector projects and what state infrastructure will be required for them to proceed where it has not currently been programmed into the forward estimates?

Mr Marney: We have identification of those infrastructure needs through the various budget bids of those infrastructure provision agencies. So, really, part of the budget process is to consolidate that list and bring that to a set of decisions for government.

Hon KEN TRAVERS: It strikes me that I can go through, just off the top of my head a few. The Perdaman resources project in Collie potentially requires an upgrade of the Collie–Bunbury line. I guess my concern is that at the end of the day if we are already sitting at $19.886 billion, how do we actually—for instance, there are two potential risk factors with Oakajee, I would have thought. One, the state government's investment in Oakajee is going to have to be higher than currently factored into the budget because the cost of construction will go up; and, secondly, the other big area, I would have thought, is potentially the power requirements for Oakajee and its ancillary developments that go on. There is Bunbury, Port Hedland, the outer harbour development; all those things. I note from the statement of corporate intent you have put very strong restrictions on any of the port authorities doing any capital investment without the express approval of the Treasurer. You could start to go down to Albany port and the developments down there. It strikes me that none of those projects are actually going to be able to proceed because we are already at the cap. If we are already at the cap and we need to make those projects proceed, how do we do it? Based on this, Oakajee cannot develop because you will not be able to find the additional money for the increase in cost of Oakajee or to provide the necessary power, so how does Oakajee proceed if we are already at the $20 billion cap?

Mr Marney: All of the items you have mentioned are possible eventualities; they are risks and they are not certain at this point. Even on a project-by-project basis, you know, the power upgrade to Collie is a potential requirement. Until such time as the requirement is an actual requirement, it is not factored into the numbers, so that is the first point. The second point is: you look at the $20 billion worth of spend and start to prioritise. The nature of putting together the capital program and the budget in its entirety is you try to make things fit. Having said that, I acknowledge that there is limited capacity between the number as it stands now and the $20 billion figure.

[10.45 am]

Hon KEN TRAVERS: So what you are telling me is that for us to proceed with any of those substantial projects—another $100 million here might be able to be factored in—and any of those projects require significant additional state expenditure, the only way they will be able to proceed and stay under the $20 billion cap is to then get rid of other projects that are currently in the capital works project and push them out. You might say, "Well, at that point the Perth waterfront development becomes a luxury. It is more important to develop Oakajee port, so we ditch the Perth waterfront project." Actually that is probably not a good example because I do not think there is actually any money for capital works in Perth waterfront, so I might have to try to think of another project that you could quickly dispose of!

Mr Marney: There are probably a few steps you would take first. The reality is that the $7.5 billion to $8 billion capital program is a very ambitious program. In that sense, some of the key capital expenditure agencies have consistently demonstrated that their eyes are bigger than their bellies and they are unable to spend their aspirational capital programs within a given year or, indeed, across the forward estimates.

It is inevitable that there will be some underspend of such a large capital program. The first step would be to look at where we are really at in the cash flows around the existing projects in that program. If after that we exhaust that source of potential freeing-up of capacity, it is really a matter for government to look at the priority of the projects within the existing program relative to its commitment to a $20 billion target. It may be that there are some lesser priority projects. It may be that everything is of such a sufficient priority that it feels the need to go beyond that $20 billion target. That is a decision for government.

Hon KEN TRAVERS: I was just going to say, in terms of that underspend—in this midyear review you have already factored in quite a significant level of underspend for this financial year—for this midyear review, have you also factored in underspend into the out years as well on what is currently listed?

Mr Marney: The underspend that is factored in, my recollection is that that flows through the out years. The underspend provision in the current year is $750 million out of a $7.5 billion–$8 billion program. Just to put that into context, same time last year we factored in $750 million; the underspend from memory ended up around $1.2 billion. The $750 million we have factored in in this midyear review is conservative in terms of what might be the eventual outcome.

Hon KEN TRAVERS: But that then gets flowed out into the out years. There is a lag but you have only got a short period of lag. If those projects are still priorities then you have got to keep moving them through. For instance, if your larger agencies with the bigger mouths than the bellies to digest it are in things like health or education, those demands are still going to be there for additional health facilities, additional educational facilities, to meet population growth again based on the sort of projections we have got here. Because, again, one of the responses has got to be to manage wages growth is the greater number of people coming and living in Western Australia so your population has got to grow too. I am still not sure how we actually manage those projects in those out years. I would have thought that there is a risk for projects like Oakajee and Perdaman. They are just two examples; if I had the *Prospect* magazine I could probably go through an even more substantial —

Mr Marney: There are always heaps of examples.

Hon KEN TRAVERS: Upgrade number five for BHP, Robe River. All of that will require state government expenditure infrastructure, I would have thought, to match it.

Mr Marney: Some of those bigger ones do not; it is all pretty much self-contained private investment. But you are right; as the economy strengthens, the need for economic infrastructure to support that growth increases. Such are the challenges of juggling the competing needs and wants within a budget process within overall financial parameters.

Hon KEN TRAVERS: I guess my final question on this point is you made a comment there that those projects like Perdaman and Oakajee were still only proposals; they were not definites at this stage.

Mr Marney: If I can be a little bit more precise —

Hon KEN TRAVERS: That was why I was going to ask you, because it struck me that was a fairly interesting comment from the Under Treasurer about those projects.

Mr Marney: Yes, because you might have just got me in a whole heap of crap around the likelihood of Oakajee proceeding.

Hon KEN TRAVERS: That is why I am trying to let you dig yourself out of it!

Mr Marney: Thanks for that opportunity. In terms of Oakajee, what you have highlighted has been risks around increased cost, not whether or not the project will proceed. It is a substantial investment by the state and indeed by the Commonwealth and a far more substantial investment by the private proponent. There are always risks of escalation. What one factors in in terms of those risks depends on the certainty or the probability of those risks emerging and what we actually know about those risks. For the purpose of midyear review we did not know anything over and above what we knew at budget time to change our assessment in that regard. Come budget time, next budget, that may be a different story. But again, that is the juggling act of putting budgets together, trying to make everything fit.

Hon KEN TRAVERS: I guess that is right in terms of the cost escalation side of it, of which there is a substantial risk and potential for the state to have to pick up any escalations in cost.

Mr Marney: Potentially, but, again, at this point, we do not have certainty as to who will bear those escalation risks and to what extent.

Hon KEN TRAVERS: Is that not part of the state agreement with the proponents as to who will bear that risk?

Mr Marney: My understanding is that there is still negotiation as part of the firming up of the project as to who bears what risk in the project. That is normal.

Hon KEN TRAVERS: Even for the common-user infrastructure?

Mr Marney: That is my understanding, yes. It is an ongoing negotiation process, so the certainty around who bears what risk, the magnitude of that risk and the probability of its realisation are all factors that —

Hon KEN TRAVERS: With all due respect, if it is not locked down at the start of that agreement, and the government has said it wants that project to go ahead, there is only going to be one person who is going to end up bearing that risk; it is going to be the government, I would have thought.

Mr Marney: I think, with respect, that is a fairly simplistic view. There are always, through the process of firming up these sorts of projects, things that the proponents want that probably were not anticipated at the time of the original agreement and there are trade-offs through that process. If there are things that proponents want and they are prepared to pay for them and take some of that risk, in the state's interest we will pursue that.

Hon KEN TRAVERS: I guess the other side of the Oakajee development, though, is the power and that is not a risk. It is clear that there is not sufficient power into the Mid West at the moment for the proposals that are required for Oakajee to proceed or those other proposals to proceed. So there is absolutely a requirement for power upgrades that do not seem to be factored into the budget at the moment. So that is money that we know is going to need to be provided and I would imagine will be done through debt, because I cannot see how else we would fund it.

Mr Marney: There are a number of power projects that are directed towards making steps towards provision in the Mid West and there are some provisions associated with, I think, the recommendations of the ERA around capital expenditure for power. We have some of that covered, but it would be fair to say that that is a subject for the budget process to address as opposed to the midyear review to try to quantify in advance.

Hon LJILJANNA RAVLICH: Just on the line of debt, are you, Under Treasurer, concerned that the level of debt has increased from $9.8 billion in 2009–10 to the projected $19.8 billion in 2013–14? Is it of concern to you?

Mr Marney: The short answer is no.

Hon LJILJANNA RAVLICH: You are not concerned?

Mr Marney: Given the nature of the investment, the population growth that we have experienced, the economic growth that we have experienced and looking forward at what we are likely to experience, my view would be that investment is appropriate. Secondly, given our ability to service that debt, as evidenced by our net-interest-costs-to-revenue ratios and our net-financial-liabilities-to-revenue ratios, I think we can comfortably service that level of debt at the $20 billion, or thereabouts, mark.

Hon LJILJANNA RAVLICH: How much more in your professional opinion can we go into debt beyond the $20 billion that has been set as the limit by the current government? If you are not concerned and there is not a problem here and this is all okay—it is more than double the debt limit—then how much further do you think that we can go?

Mr Marney: I think I am precluded from offering my opinion in this forum as opposed to dealing with matters of fact in the midyear review. Having said that, I would give you an opinion if I had a well-formed one. Again, I know an outside estimate of what debt could go to in a fiscally responsible way would require significant analysis, and I do not have that analysis to ready to hand.

Hon LJILJANNA RAVLICH: Can I just say to you, Under Treasurer, I have to say that I find it a bit hard you would be called upon to give your advice to government in respect of these matters. This is a pretty fundamental question and no doubt it impacts in all sorts of areas and primarily our AAA credit rating and our capacity to borrow and so on and so forth, and you have just advised the committee that you do not have an opinion on this and you have not really turned your attention to it.

Mr Marney: I do not believe that is what I said. I think I said, firstly, that in this forum I am precluded from providing an opinion. Secondly, I said that to come up with a figure would require considerable analysis of the debt-servicing capacity of the state going forward and what that then translates back to in terms of an aggregate net debt figure. What we do have is a good sense of what the net-interest-costs-to-revenue should stay within and what the net-financial-liabilities-to-revenue should stay within. What that means in terms of an aggregate net debt figure changes as the broad parameters of revenue change over time, but those two parameters reflect the ability to service a given level of debt. That is what drives our advice to government in terms of what is a sustainable set of financial parameters.

Hon LJILJANNA RAVLICH: Can I just ask you then: have you undertaken the debt servicing analysis going forward? Has that work been done by Treasury and what does that work show?

Mr Marney: That work has been done and the outcome of that work is reflected in the financial targets that are in chapter 2 of the midyear report.

Hon LJILJANNA RAVLICH: Under Treasurer, is it possible for this committee to be provided with the analysis that was undertaken by Treasury that looks at the debt servicing going forward and, in addition to that, is it possible for you to provide to the committee the interest rate figures that are paid by Western Australian taxpayers in relation to the level of debt that we currently have and also over the forward estimates period so that we can get a picture of what we might be paying when we get close to that—when we reach that $20 billion target? That is two things: the analysis in relation to the debt servicing going forward and the actual interest rate payments to Western Australian taxpayers currently on the outstanding level of debt that we have, which is about $14 billion, and then over the forward estimates till we get to that $20 billion in 2013–14.

Mr Marney: In terms of the latter component, I am happy to provide our actual cost of funds and our projected cost of funds through to the end of the forward estimates period. I am happy to provide our actual interest costs and projected interest costs in dollar terms out to the end of the forward estimates period. In terms of the analysis around the fiscal targets, the interest-costs-to-revenue and the net-financial-liabilities-to-revenue, my recollection is that it is advice to cabinet in terms of the formulation of its fiscal targets. I would have to confirm whether or not there is analysis outside of that advice to cabinet that is available to be provided to the committee, so I will take it on notice.

[11.00 am]

Hon LJILJANNA RAVLICH: And you will let us know whether it is cabinet or not.

Mr Marney: Yes.

The ACTING CHAIR: Thank you, Under Treasurer.

Mr Marney: Having said that, the net-financial-liabilities-to-revenue ratio is largely guided by the parameters indicated to us by the two major ratings agencies—Moody’s Investor Services and Standard and Poor’s—as to their trigger points for AAA rating reconsideration.

Hon LJILJANNA RAVLICH: Can you just give us the current figure?

The ACTING CHAIR: Supplementary question A4 is the analysis that has led to what the debt servicing level is and should be, I think it is; and the second one is the interest rates which are currently paid on debt by the Western Australian government.

Hon LJILJANNA RAVLICH: Actual and projected.

The ACTING CHAIR: Actual and projected.

Mr Marney: Sorry; and there was also the aggregate dollar interest cost.

Hon LJILJANNA RAVLICH: That is right.

The ACTING CHAIR: And the aggregate dollar interest cost.

Hon LJILJANNA RAVLICH: Actual and projected in all cases.

[*Supplementary Information No A4.*]

Hon LJILJANNA RAVLICH: Under Treasurer, in terms of the debt-to-revenue ratio, can you advise the committee what that currently stands at?

Mr Marney: Sorry, the net-financial-liabilities-to-revenue ratio currently stands at as at June 2010?

Hon LJILJANNA RAVLICH: Yes.

Mr Marney: At 54.6 per cent.

Hon LJILJANNA RAVLICH: Just before you go on: what did it stand at in 2008?

Mr Marney: I do not think I have that to hand, but we will try to find that for you.

Hon LJILJANNA RAVLICH: My recollection was that it was in the order of 47 per cent, if that—possibly lower.

Mr Marney: There have been some changes in the nature of the target. The previous target was a narrower definition, so the 47 per cent target is different to the current two net interest cost targets.

Hon LJILJANNA RAVLICH: Could you provide us with the information I seek in relation to 2008 and in relation to the current ratio; and can you also provide us with an explanation of the variation, if you like, in the way in which that ratio is determined now, compared with how it was determined in 2008?

Mr Marney: In terms of the S&P's net financial liabilities ratio as a share of revenue, which is one of the current targets, as at 30 June 2008 the ratio was 42.9 per cent; as at 30 June 2010, the ratio has hit 54.6 per cent. Our revision at midyear review for June 2011 is 63.6 per cent.

Hon LJILJANNA RAVLICH: Thank you very much.

As a follow-on question, I am referring here to page 2 of the budget papers. Down the bottom, under the key aggregates table, it refers to the state's four-year asset investment program, which has been revised upwards from $26.7 billion, and it has been revised up by $1.7 billion since the 2010-11 state budget. The new projects included are the new children's hospital, valued at $563 million over four years; the Pilbara desalination plant, $370 million over four years; the upgrade to the grain freight network, $202 million over four years; and the electricity infrastructure, $342 million over four years. Can I just ask you why they were not included in the 2010-11 budget?

Mr Marney: In all of those cases government was yet to make a decision on the nature of those projects and the final scope of those projects, and therefore it was not possible to factor in a specific level of expenditure on those projects. Having said that, I think, in the case of at least the new children's hospital, it was flagged as a risk in the statements in budget paper No 3. At the time of budget it was acknowledged that decisions were yet to be taken on that project but were likely in the near future, and therefore would impact the forward estimates.

Hon KEN TRAVERS: That figure you quoted, the —

Hon LJILJANNA RAVLICH: The 63.6 per cent, June 2011.

Hon KEN TRAVERS: Was it 2011 or 2012?

Mr Marney: It was 2011.

Hon LIZ BEHJAT: For 2012 it is 66.6 per cent.

Mr Marney: It is on page 2, table 1.

Hon KEN TRAVERS: That is the net-financial-liabilities-to-revenue ratio. Do you have the figures there of what the net-debt-to-revenue ratio would have been?

Mr Marney: I do not think I have. No, I do not have them to hand, I am afraid.

Hon LJILJANNA RAVLICH: Why?

Mr Marney: Why?

Hon LJILJANNA RAVLICH: Yes.

Mr Marney: Because it is not a target of this government. The net-financial-liabilities-to-revenue ratio is a broader measure of the state's total liabilities, so it is slightly broader than net debt. The rating agencies have increasingly focused on that broader measure, as opposed to net-debt-to-revenue ratio. In accordance with their focus as to what would trigger a reconsideration of the state's AAA credit rating, the government has realigned to that broader measure of debt to revenue rather than the previous target of net-debt-to-revenue ratio.

The ACTING CHAIR: Can you just remind me, Under Treasurer: the net debt differs to the net financial liabilities in terms of the corporations of the state in the net financial liabilities as opposed to net debt—is that the difference?

Mr Marney: Yes, it is a broader definition. Certainly the infrastructure corporations of the state were in the previous net-debt-to-revenue ratio; it is my recollection that financial corporations were in as well. It is the additional liabilities outside of that that S&P's, particularly, take into consideration. I am happy to give you a reconciliation between the two measures in terms of what they encompass.

Hon KEN TRAVERS: Unfunded superannuation is a large component of the net liabilities over the net debt.

Hon LJILJANNA RAVLICH: Yes, that is right.

The ACTING CHAIR: Yes.

Mr Marney: Yes, because it is a liability of the state. If you focus just on the net-debt-to-revenue ratio, you are missing some of those inevitable payments that will have to be made by the state.

The ACTING CHAIR: Supplementary question A5 is a reconciliation between the net debt, as opposed to net financial liabilities.

[*Supplementary Information No A5.*]

Hon KEN TRAVERS: Although I note it is no longer a target of the government, is it still something that, internally, you calculate and monitor?

Mr Marney: Not particularly, because the net financial liabilities is a much more comprehensive measure.

Hon KEN TRAVERS: But in terms of that, when you say you are going to give us a reconciliation, are you saying you will give us the figure of what the current net-debt-to-revenue ratio is and what it would be?

Mr Marney: If you want that net-debt-to-revenue ratio, both historically and what it would be on the current forward estimates, I am happy to provide that as supplementary information A6.

Hon LJILJANNA RAVLICH: Yes.

The ACTING CHAIR: A6 is the net-debt-to-revenue ratio.

Hon KEN TRAVERS: I was just looking at an old budget here, and I think it is for the total non-financial public sector, so it would not have included the public financial entities but it would have included the GTEs.

The ACTING CHAIR: Can we have that for 2008–09, 2009–10; 2010-11?

Hon KEN TRAVERS: Over the forward estimates, if possible.

The ACTING CHAIR: So 2008–09, through to the forwards estimates.

[*Supplementary Information No A6.*]

Hon KEN TRAVERS: My only question in that sense is that I understand the issues about the liabilities being a better measure of the financial impacts on the state, but I guess the other thing, though, that the net-debt-to-revenue ratio did was that it was also a constraint on ensuring that the amount of your annual budget that is actually servicing debt, as opposed to being spent on recurrent expenditure and the activities of the here and now, was kept at a manageable level. I guess there is always a danger, if you change it, that you allow it to go higher and a greater percentage of your annual budget is actually going to repaying debt, rather than providing services. That, I think, has a potential intergenerational equity issue involved—that is not to say that unfunded liabilities for super do not also have that intergenerational equity issue. But it struck me that that was also one of the roles that that target did; because it was a lower target, in terms of the percentage, it also meant that it placed a constraint on governments to not start to put huge burdens of interest rates on future generations and to make sure that they were paying their own way. Am I right in that, or am I completely wrong in that regard?

Mr Marney: It is a leading question, really.

Hon KEN TRAVERS: Feel free.

Mr Marney: I think your concern is valid. That concern is addressed by having a supplementary target, which is the net interest cost to revenue, which specifically focuses on the impost on the budget of the interest cost of a given level of net debt. So not only are we focusing on the ratio of financial liabilities to revenue, but also we are focusing on that direct interest cost and how much of the state's revenue is being drawn down to service a level of net debt. I guess both those targets, together, are a refinement of the previous target, trying to address the exact concerns that you are raising. In some respects you do not get the opportunity to revise these targets too often, and you should not because you should not be moving the targets around on a frequent basis to accommodate whatever your circumstances are. We have taken the opportunity, I think, following the last election—I think even the one before that—to reset targets for the new term of government, regardless of what government that is. In doing so, we have refined those targets to better focus on what is a sustainable level of net debt from an intergenerational perspective, and a level of net debt that is appropriate to the economic and demographic circumstance of the state, along with what is a sustainable and reasonable impost on the budget in terms of interest costs.

Hon KEN TRAVERS: I guess the thing that I am interested in then is that when we have—I think the target was 49 per cent net —

Mr Marney: I think it was 47 per cent.

Hon KEN TRAVERS: A net-debt-to-revenue ratio of 47 per cent. Do we have any idea of what that would have translated to in terms of the net interest to revenue—what that would have translated to as a percentage for net interest?

Mr Marney: I think, in part, we will pick that up in supplementary information A5 and A6, A5 being the reconciliation of the two measures. If I can suggest, in addition, within A5, we will actually recast the net interest back to a consistent —

Hon KEN TRAVERS: The net interest of cost to revenue, and what 47 per cent would have meant in terms of a net-interest-cost-to-revenue target. The issue I have concerns about is that we end up just constantly increasing and the Parliament has to pay off the debts of this one.

The ACTING CHAIR: That is in addition to supplementary question A5.

Hon LJILJANNA RAVLICH: I quickly want to turn to page 29, which deals with the expenses, and I want to specifically deal with the issue of education expenses. According to the financial projections, the Department of Education is currently projecting to exceed its approved expense limit in 2010-11. My first question is: by how much?

[11.15 am]

Mr Marney: My answer is: I do not know.

Hon KEN TRAVERS: Just the education department?

Mr Marney: Is that a genuine question?

The ACTING CHAIR: No, I think that one is off the record.

Mr Marney: Damn!

Hon KEN TRAVERS: We have had them in; we know the answer to it!

Hon LJILJANNA RAVLICH: Do you have a global—are we talking about $10 million or $100 million, or do you have no idea at all?

Mr Marney: What we do know is that the education department has had trouble meeting its efficiency dividend, and from memory that was a figure of around $60 million. How far beyond that or indeed beneath that they will land come budget time and then actuals for 2010–11, I cannot tell you at this point. I suggest they cannot tell you at this point because they do not know. The matter is one that will be subject to intensive scrutiny through the budget process.

Hon LJILJANNA RAVLICH: The education department is the only one listed here. Are you confident that every other agency will in fact meet or stay within the approved expense limit for 2010–11?

Mr Marney: Within the existing parameters set by government—the existing policy decisions of government—I am confident that all other agencies will manage within their set expense limits, including the Department of Health.

Hon LJILJANNA RAVLICH: In relation to the Department of Education, it appears unlikely that the corrective measures will avoid this outcome. What corrective measures have been applied by the agency under instruction from you or anybody else?

Mr Marney: That is probably a question of detail for the agency itself. In my capacity, I do not have the authority to instruct anyone to do anything, unfortunately. That is a matter for the minister and the director general. Having said that, there was a comprehensive value for money audit undertaken, which identified a range of internal controls issues and I know that has been a particular area of focus for them since that audit was undertaken. That is probably the area I have greatest awareness of; beyond that I apologise, but you would have to ask the department.

Hon LJILJANNA RAVLICH: Do you know who undertook that audit?

Mr Marney: The value for money audit?

Hon LJILJANNA RAVLICH: Yes.

Mr Marney: From memory it was undertaken by PricewaterhouseCoopers.

Hon LJILJANNA RAVLICH: I understand that it is expected that the government will be required to assess if a structural realignment of the Department of Education budget and forward estimates is necessary as part of the 2011–12 budget process. I am really asking: what does that structural realignment of the Department of Education budget mean? What are we talking about?

Mr Marney: I think that is Treasury code for tipping in more money.

Hon KEN TRAVERS: Giving up on getting the three per cent efficiency dividend out of them?

Mr Marney: Basically, if we cannot get their cost structure back in line with their expense limit, we are going to have to acknowledge that their cost structure is X plus Y, not X, and tip in the plus Y.

Hon LJILJANNA RAVLICH: Is this part of a new policy; that is, if agencies do not live within their means, you just keep tipping in taxpayers' money?

Hon LIZ BEHJAT: It is hardly a question for the Under Treasurer.

Hon LJILJANNA RAVLICH: I think it is a fair question, honourable member, because it sounds as though, "Well, they haven't been able to contain their expenses, et cetera, so how are we going to fix this? We are just going to chuck a bucket of money in."

Hon LIZ BEHJAT: I do not think that is a fair question for you to be even be asking the Under Treasurer. You are asking him form an opinion on that.

Mr Marney: I am happy to respond.

The ACTING CHAIR: The Under Treasurer is capable of responding.

Mr Marney: I am happy to respond. It is not Treasury's preferred approach under any circumstances. The accountability of expense limits, as set by Parliament, we take extremely seriously. Let there be no confusion in that regard. However, if government takes a policy decision to allocate additional resources to an agency, we administer that policy decision. If government fails to take policy decisions to ensure an agency lives within its expense limit then, equally, we have to factor that in. But expense limits and resource agreements that enshrine those expense limits in contractual agreement between the minister, the Treasurer and the director general of relevant agencies are a fundamental accountability construct of our system of governance, and are crucially important to the sound and prudent management of the state.

Hon LJILJANNA RAVLICH: Are you expecting to be asked to find some money for the Carnarvon flood issue?

Mr Marney: That is a matter for decision of government. Obviously, circumstances there are fairly extreme and there will be appropriate government response to those circumstances when government —

Hon LJILJANNA RAVLICH: Have you been asked?

Mr Marney: Not at this point, no.

Hon KEN TRAVERS: If one read the TAA act, you could argue that that is the sort of thing the TAA is for, not for overruns by agencies.

Hon LJILJANNA RAVLICH: That is right.

Hon KEN TRAVERS: But anyway, talking about the expense risk of the education department and their budget blow-outs, obviously there is the issue about not being able to meet their three per cent efficiency dividend. The other thing is: what are the other new cost pressures? Looking at the recent Auditor General's report, the top five energy-consuming agencies within government are education, health, corrective services, culture and the arts, and police. They use something like 76 per cent of the total power consumption—energy consumption—in government. I assume that the increase in energy costs that have flowed on to consumers have also flowed on to those agencies.

Mr Marney: Correct.

Hon KEN TRAVERS: Has their budget been adjusted, and if it has not been adjusted, what impact is the increases in power and water utility prices having on their budgets, and is there any factoring-in of those into the midyear review?

Mr Marney: There is no factoring-in into the midyear review explicitly, other than through the normal escalation of the various government agency inputs. That, however, was set at budget time so it exists within the forward estimates. Whether or not there are specific allocations to agencies associated with increasing power bills, there is nothing additional for them—from my recollection at budget time—explicitly for that.

Hon KEN TRAVERS: So is that a factor that is causing problems for agencies? I know education is one of the top five. Is a pressure that is applying to that agency that it is having to find money for significant increases in energy, and is that having an impact on its ability to come in on budget? Is that one of the factors that will be having an impact on its ability to come in on budget?

Mr Marney: It is one of a likely range of pressures. In recent years, there have been some, if you like, systemic pressures across the entire general government sector in terms of cost growth. Areas like RiskCover insurance, costs of accommodation, lease rates, power and others are those general inputs for which there is escalation within the budget and the forward estimates. I think it would be unfair to say that that is a factor leading to education’s expense overrun, given that the other 89 agencies in the sector are not in that circumstance.

Hon KEN TRAVERS: But as I understand it, those other four that I mentioned use something like 76 per cent—according to an Auditor General’s report—of the total energy consumption. So I would imagine that it is a disproportionate amount of their expenditure, and I think that is probably because of the structure—you know, the number of schools and the type of agencies that they are. For police it is the number of police stations and for health it is the sheer volume of and the needs for hospital operations. Culture and the arts always intrigues me, but I presume they have got a lot of venues that they have got to run and the like. So it would strike me, when you say that it was factored in—I do not know whether their costs over two years have gone up by 46 per cent, but for the consumer it was 46 per cent—was their budget increased by that 46 per cent to allow for that, or are they expected to absorb it, or was it a smaller amount and are they then expected to absorb that greater increase by cutting other areas of their core business?

Mr Marney: I doubt that it was the 46 per cent, because they would more than likely be on business tariffs rather than on domestic residential tariffs. So the increase is likely to be different and it is likely to have occurred earlier than it has done for residences. But I could stand corrected on that. There is no explicit allocation for agencies costs of energy bills. That is the short answer to your question.

Hon KEN TRAVERS: So depending on what percentage of their total budget they spend on power, it is quite possible that that is one of the factors that is causing them to have difficulty meeting their budget, and I suspect that for those other four agencies it has the potential to have an impact on them as well.

Mr Marney: It is one of a large range of cost structures pressures, yes.

Mr Kannis: It would be creating a pressure for the agency but when we decide to increase electricity charge—when the government decides to increase electricity charges—there is not an allocation provided to agencies to meet additional costs associated with that. It is a pressure that the agency may be feeling, but there is no allocation made to the agency when that decision is made

Hon KEN TRAVERS: How is an agency then expected to meet that increased cost pressure without affecting frontline services?

Mr Marney: Every budget, agencies put forward a list of cost pressures associated with growth in various input parameters; a constant in managing any business is managing the cost of inputs into a business. That is a reality of large organisations. It place places pressure on them; there is absolutely no question about that.

Hon KEN TRAVERS: But we have not quantified what that is at the moment.

Mr Marney: No.

The ACTING CHAIR: We will break for morning tea shortly. But just one last question on the same topic, Hon Ljiljanna Ravlich.

Hon LJILJANNA RAVLICH: Just on the same topic: has any economic assessment been made on the impact on the government agencies of lifting tariffs to cost-reflective levels? That is my first question.

Mr Marney: No.

Hon LJILJANNA RAVLICH: No. My second question is: has any economic assessment been made on the impact upon households of lifting tariffs to cost-reflective levels?

Mr Marney: I understand that assessment was done as part of providing advice to the EERC and cabinet at budget time, and would be a combination of advice from Department of Treasury and Finance and—particularly in the context of the household model and its impact on a representative household, however defined—work by the Office of Energy and, quite possibly, also the Economic Regulation Authority.

Hon LJILJANNA RAVLICH: So no economic assessment has been made of the impact on government agencies and, for example, schools of what the likely impact to school budgets or hospital budgets might be.

Mr Marney: Correct.

Hon LJILJANNA RAVLICH: Okay, thank you.

Proceedings suspended from 11.28 to 11.37 am

The ACTING CHAIR: On page 3, just a couple of issues. One interesting one: in the forward projections from the US dollar – Australian dollar exchange rate is expected to depreciate, based on your estimates. That intrigues me about what the assumptions are or whether that is taken from commonwealth projections?

Hon KEN TRAVERS: Sorry, I was about to answer the question!

Mr Marney: You go; I will watch!

Hon LIZ BEHJAT: Would you like to be the Under Treasurer now, Ken!

The ACTING CHAIR: This time the Chairman is in control! The Under Treasurer.

Mr Marney: The methodology for incorporating an exchange rate parameter into the forward estimates is as follows: we take—I will stand corrected by Hon Ken Travers if I get any of this wrong!—the six-week average of the exchange rate prior to the cut-off date. We then project that through to the long-run average of the exchange rate at the end of the forward estimates period. So, what we do is we take the most recent month and a half of the exchange rate, and we assume that that is the starting point. We then let that slide back to the long-run average of the exchange rate over the forward estimates period. The reasoning behind that is covered in a review of forecasting methodology that we did, I think around the end of 2007, and reflects our concern around that time that extreme positions of the exchange rate, in either direction, artificially inflate or deflate the revenue projections across the forward estimates and potentially lead to overreaction in terms of policy response by government. The extremes we are talking about, and we have seen them in the last two and a half years, are down by 30 per cent, up by 30 per cent, up by 30 per cent, down by 20 per cent, up by 22 per cent—that sort of bounce in the exchange rate over that period. If you let those extremes flow across the forward estimates and hold them constant, which is what the commonwealth does, your revenues get bounced around by the order of $2 billion to $3 billion simply as a result of fluctuations and higher than usual volatility in the exchange rate. Hence the adoption of the methodology which sees us drift back to a long-run average exchange rate. On that basis, the exchange rate drifts back to around 74.5c by 2013–14, which is consistent with my understanding of what the Reserve Bank has in mind in terms of the long-run exchange rate—sorry, I think that has actually been revised to 79.6c. Twelve or 18 months ago, that figure, that 79.6 per cent long-run average, was more like 72c, so it is quite possible that what we are seeing in terms of the Aussie–US dollar exchange rate is a significant structural shift. It is too early to read anything definite into that, given the volatility, still, in global economic circumstances. When we undertook the review of forecasting methodology back in, I am pretty sure it was 2007, we considered a range of various methodologies for estimating the exchange rate parameter. I would emphasise that this is not a forecast; it is a parameter assumption. We tested a range of methodologies; we back-cast them on the actual exchange rate and this was found to be the most reasonable methodology to pursue.

The ACTING CHAIR: Thank you very much; it does help.

Hon LIZ BEHJAT: Just on the USA dollar exchange rate, some economic forecasters are predicting that—we are seeing it at parity, a little bit of it below today, I think—over the decade it could get as high as $1.10. Using that as part of the major economic parameters, if there is such a change in the dollar rate, how is that going to affect our budget? Would you then have to rethink these parameters and when would you do that?

Mr Marney: Every time we publish a set of financial aggregates, we rerun that methodology, so the aggregates are always updated for the latest data. It may be the case that some economists are predicting $1.10, even $1.15, over the next 10 years. I have heard as recently as October–November that some economists were predicting $1.10 to $1.15 by the end of March this year. I would like to ask the question: how many of them have got their houses bets on that? There are reasons they take those positions publicly. They are in the financial markets; it is a game. I take with a pinch of salt what they say. Having said that, the sensitivity with respect to the exchange rate, in terms of our revenues, is in the order of $58 million to $60 million per annum for every 1c appreciation in the exchange rate. So, if the exchange rate appreciates by 10c, we roughly lose $600 million per annum. Likewise, if it depreciates by 10c, we pick up $600 million per annum.

The ACTING CHAIR: The reason why, I suppose, we were just asking that was really part of a bigger thing. The fiscalisation issue with the commonwealth, and the royalty increases that we have, is really where I was coming to. The royalty increases that are referred to in the course of this review, I presume that they must all be—well not all, but certainly on the iron ore—they are above what would be regarded as a standard royalty level, which they define as whereby below that royalties are distributed, but above that, the royalties remain with Western Australia. Do I have that basically right?

Mr Marney: In terms of the removal of the concessional rates, I think you have got it right. Having said that, there were changes in methodology by the Commonwealth Grants Commission in March, which put a lot of confusion in this space by reclassifying royalties into a lower and upper grouping of royalty rates. We are still trying to get certainty on the implications for us, going forward, of that reclassification, and indeed, certainty in regard to any future increases in royalty rates that may follow.

The ACTING CHAIR: So, the royalties that I mentioned in here as contributing to revenue, is there uncertainty about that particular number? The negotiation for the fines and the negotiation for the higher levels—the $390 million, for example, referred to on page 1?

[11.46 am]

Mr Marney: That is the direct impact of the removal of concessions.

The ACTING CHAIR: So, there is no ambiguity about that coming into state revenue?

Mr Marney: Correct. There remains some ambiguity about the Commonwealth Grants Commission treatment of that.

The ACTING CHAIR: There still is ambiguity about how much will come to us and how much might go into the fiscal equalisation process; is that correct?

Mr Marney: It comes to us with certainty, but how much of that gets equalised away is a matter of ongoing discussion with the commonwealth and with the grants commission.

The ACTING CHAIR: That means that when it comes to the projections in this review, our review may be compromised by judgements that the grants commission might make?

Mr Marney: Yes; we would have some of that factored in though in terms of our estimates of the grants that we would receive.

The ACTING CHAIR: That is the intriguing part.

Mr Marney: I am happy to clarify exactly the existing treatment—the impact of the grant and the sharing of that revenue associated with equalisation—as we understand it at this point in time. I am happy to provide that as supplementary information.

The ACTING CHAIR: I would appreciate that. That is A7; an outline of the equalisation policy applied by the Commonwealth Grants Commission at present.

The ACTING CHAIR: Could you also, Under Treasurer, explain what modifications are being considered or were agreed to in the March conclusions with the Commonwealth Grants Commission in relation to royalty?

Mr Marney: I am more than happy to outline the stupidity of their methodology changes.

The ACTING CHAIR: That is in *Hansard*, thank you.

[*Supplementary Information No A7.*]

Hon LJILJANNA RAVLICH: On this issue of fiscal equalisation, we have a major problem; we recognise that. Every year we get less and less of our GST share back to the state, and so on and so forth. In reality, though, what is Western Australia’s chance of getting some redress in this issue?

Mr Marney: It is hard to say what our chance is, but we are arguing at every opportunity for a fundamental rethink of the way in which equalisation is implemented in the Federation. I do not think that anyone would have anticipated the extreme that Western Australia will drop to in its share of GST revenues. Having said that, we were beneficiaries, for a long time, of this methodology—of the grants commission process, not necessarily of the current methodology.

Hon LJILJANNA RAVLICH: That is right.

Mr Marney: But, fundamentally there is a need for a rethink, given the extremes of where we have come to and also the perverse incentives introduced into the state’s own policy decision making and, indeed, revenue collection effort. It is now the case, perversely, that in some circumstances it would be in our best financial interests to back off on revenue collection for certain revenue items.

Hon LJILJANNA RAVLICH: That is exactly right.

Mr Marney: It is absurd. In light of those absurd and perverse policy outcomes and the extremes that we are at, I know that the heads of Treasuries around the country have been asked to have a look at the way in which the grants commission operates with a view to its next five-year review process.

Hon LJILJANNA RAVLICH: Is it true that all the other states and territories would have to agree for there to be a change, and given that they are in large part the beneficiaries of the structural inequity that currently exists, it is highly unlikely that they would come to a position whereby they would give up their benefit for the advancement of Western Australia?

Mr Marney: The difficulty in reforming the grants commission processes is that across all jurisdictions it is a zero-sum game and the commonwealth takes the decision. It is not that the states have to agree, but the commonwealth is unlikely to create a war by virtue of its decision making, so its default position traditionally has been if the state and territory jurisdictions come up with a solution to recast things, then it will consider it. But because it is a zero-sum game, as soon as we start to change the rules, there are winners and losers. That is where it gets very ugly. The reality is we need to stand back from that whole process and ask the question at a national level, "What are we trying to achieve out of the Federation?", and in turn, "What is the national interest in terms of equalisation?"

The ACTING CHAIR: Would you consider making public in this forum the papers that you are currently thinking of doing?

Mr Marney: Yes, once we get those working papers to sufficient completion. We have a number of works in progress at the moment in which we will kind of provide the evidence in support of the arguments we will prosecute through February and March as part of discussions scheduled on these sorts of issues. Having said that, at the last methodology review of the grants commission we provided, I think, 24 submissions over a two and a half year period on a whole raft of elements of grants commission methodology, some of which go to 40 pages of mathematical equation solution stuff. I doubt that the committee would want to have a look at that, but I am pretty sure this is on our web site.

Hon LJILJANNA RAVLICH: We will understand it; it is okay!

Mr Marney: I am glad you do!

Hon LJILJANNA RAVLICH: I am just joking.

The ACTING CHAIR: Are those considerations broad enough to consider whether we should devolve the raising of taxes on revenue back to the states with a contribution back to the commonwealth, instead of the commonwealth doing it with respect to the states? Are you going that far in the consideration of alternatives?

Mr Marney: The work we are doing at the moment is focused purely on how to divide the GST pie. That is the boundary of the grant commission. The broader issue you mentioned is really going to the issue of vertical fiscal imbalance between the commonwealth and the states and territories. We canvassed that issue in our submission to the Henry tax review, along the lines of ensuring that there is alignment between the function of the level of government and the fiscal capacity of each level of government. If you are looking for our view in that regard, it is captured in that submission, which I think is also on the webpage.

Hon KEN TRAVERS: I may have missed the answer to this, if you said it. Are we doing work that would demonstrate a better distribution that can actually grow the pie? The problem you are always going to face in a zero-sum game is that no-one is going to agree to a reduction in their share so that someone else can increase their share. But if you can demonstrate a better formula, for instance, that takes note of the capital works pressures that we talked about earlier today and the ability to invest in them and therefore the ability to grow the total pie that is available to everyone to be shared, surely that is a stronger argument that will be able to convince the Treasuries in other parts of the country that the current formula is strangling the goose rather than assisting the goose to prosper? Are we doing any work in that regard?

Mr Marney: I think we have done some work. The transmission mechanisms from distribution of the GST pool through to increased consumer spending are long and diluted, so it is hard to prosecute that case, especially with the cynical audience of other Treasury officers in other jurisdictions. That is because Treasury officers can be quite cynical and harsh in their evaluation of the proposals of others, apparently. It is more an issue of: how do you equitably divide the pie? On your point of recognition of the capital investment required to continue to grow the pie, we did prosecute those arguments as part of the last review and we had a win, and other jurisdictions actually did lose out because we were able to achieve better recognition of the requirements of capital investment by the state—by any state—associated with stronger economic growth and stronger population. We have prosecuted the argument, and we won the argument.

Hon KEN TRAVERS: Was that last year or prior to last year?

Mr Marney: No, it was last year. The methodology changes in March incorporated what you are saying.

Hon KEN TRAVERS: Are they the ones you referred to as idiotic and that you were going to give us an explanation?

Mr Marney: No. That was part of a whole raft of methodological changes. That was a good one, but it was more than offset by a really bad one around royalties, which came about late in the review process. We are talking about a four-year review process. There was a change in the royalty methodology made in the last 14 days of that process, which creates, as I said, perverse incentives for the state in terms of revenue system, administration and policy.

Hon KEN TRAVERS: That is why I think that our strength is to argue the ability to grow the pie. The pie is not just in terms of consumer demand; it is also payroll tax. I am not sure whether the payroll tax from the fly in, fly out workers who are based in Victoria or New South Wales and who come into Western Australia comes to us or would go to their local Treasuries.

Mr Marney: It would come to us, because the economic activity is in the state, and the tax is based on where the employer is and not the employee.

Hon KEN TRAVERS: I think that was in the last set of changes as well.

Mr Marney: Yes. We did prosecute those arguments around capital investment, and we won the argument, and other states lost out because of that.

Hon KEN TRAVERS: And distrust?

Mr Marney: My cynical view is that the royalty change methodology came about late in the process to counteract the loss that other jurisdictions were suffering because we won that argument.

Hon KEN TRAVERS: It still strikes me that is where our strength will be. As far as I can tell, the best time would be to find the opportunities when there is a major wholesale reconstruction. The last big one was the GST, and it would appear that we missed the opportunity; or, if we noted the opportunity, we did not understand it to factor it in at that time. We can go back to that decision.

[12 noon]

Mr Marney: I think if we went back to that period in time, our share was probably still in our favour; it was not running against us.

Hon KEN TRAVERS: So we took a short-term view of the world rather than a long-term view of the world, and signed up to a deal that has got us to where we are today.

Mr Marney: It would have been very difficult to anticipate that we would be dropping to below 0.5 on relativity within a 10-year period. Had we anticipated that, it would have meant that we would have anticipated the boom, the bust, and the subsequent boom, and we would have been very bright and rich people.

Hon KEN TRAVERS: I guess the other thing is what are the other points of opportunity. I would have thought that the next opportunity would have been when the government was renegotiating the deal that was put through Parliament on 2 December that is not factored in here, but is mentioned in the midyear review. That was another time when a significant additional chunk of money was going to flow into the coffers and have a national impact. That, again, was another time, in the same way as the North West Shelf; the deal that was done over that was done as part of the negotiations to get the North West Shelf up and running. Did we do any negotiations with the other states to say, "Hang on, we're about to try to enter into a deal with BHP and Rio that will significantly increase the money that we receive, but we're not going to do that if it all just gets redistributed off to yourselves"? As you say, the perverse argument is: why did we bother doing it if all the end result is that we get 10 per cent of it and the other 90 per cent goes off around the country?

Mr Marney: Those negotiations were extremely active through the last 12 months with other jurisdictions.

Hon KEN TRAVERS: Specifically using the deal with BHP and Rio?

Mr Marney: Yes, or in concept, policy moves such as that, and the potential benefit for other jurisdictions that would flow from us taking some policy decisions.

Hon KEN TRAVERS: But then we ended up doing it without ever getting an agreement from the other jurisdictions.

Mr Marney: Correct.

Hon KEN TRAVERS: Even though we know that it was an opportunity.

Mr Marney: We did make the most of the opportunity. The opportunity was not actually to reach agreement with the other jurisdictions; the opportunity was to prosecute the arguments, and we did, but at the end of the day, their short-term self-interest prevailed. Plus there were a number of electoral cycles through last year that we had to factor in.

Hon KEN TRAVERS: There is another question I will come back to. I know you are going to give us some information, but I am interested in whether we can work out, of the additional revenues that are coming in, particularly royalties and payroll tax over the period of the forward estimates, how much you predict will be redistributed. I do not know whether the earlier information you agreed to give us will cover that, but I am interested in exactly how much of the additional revenue is going to be redistributed, in terms of your predictions. Is that something we can have?

Mr Marney: It is not captured by the previous supplementary information number, A7.

The ACTING CHAIR: That is the redistribution of revenues resulting from the Commonwealth Grants Commission.

Hon KEN TRAVERS: How much in each year. I did one calculation that we were getting an extra $600 million and losing $600 million, and we were not keeping anything. I think last year you came before the subcommittee and said that we should be retaining around 30 per cent.

Mr Marney: Yes, that was specifically on royalties; that game has changed substantially because of the methodology review, but if I could have your indulgence to run through the major heads of revenue—royalties, payroll tax and land tax—rather than everything, and give you a sense of what that sensitivity is.

The ACTING CHAIR: That is fine, thank you.

[*Supplementary Information No A8.*]

Hon KEN TRAVERS: In terms of that, it is a back task over the previous five or seven years.

Mr Marney: It is now down to an average period of three years.

Hon KEN TRAVERS: Three years, right. The forward estimates, in some respects, until we get to the point that it happens, will not impact on us. Our forward estimates do not impact upon how they calculate the grants; it is based on retrospective.

Mr Marney: Again, there was a change in methodology in March. Previously, the grants, going forward, were based on the previous five-year average performance in revenue-raising effort, with a one-year lag because of data collection, which meant that the changes that flowed because of that assessment did not hit within the forward estimates. In March, the grants commission recommended the commonwealth adopt a three-year averaging process, and the commonwealth adopted it. Again, there was a one-year lag, which means that the changes in assessment that flow now impact pretty much on the last year of the forward estimates.

Hon KEN TRAVERS: But in terms of the calculations, it is all based on the actual figures received in the previous four years.

Mr Marney: Based historically, yes.

Hon KEN TRAVERS: There is another final question in this area that I want to cover. We talked earlier about the exchange rate and bringing it back down to the long-run average. In terms of calculating royalties, the two other factors are volumes, being throughput, and also the commodity prices. I know that somewhere in there you talked about it being to some degree a natural hedging effect that if the commodity price comes down, you would expect a corresponding decrease in the Australian dollar.

Mr Marney: Yes.

Hon KEN TRAVERS: I may have missed it when I went through, but I am trying to work out whether the iron ore price that you have factored in over the forward estimates comes back to a long-run iron ore price, or remains high over the forward estimates.

Mr Marney: Similar to the exchange rate parameter methodology, the iron ore price comes back to a long-run average. Over the forward estimates, I think we have the iron ore fines price in US dollars per tonne at $US128 in 2010–11, sliding back to $US87 a tonne. The argument is not just in terms of avoiding getting caught in a game of trying to forecast the iron ore price that far out, but the economic argument behind that methodology as well is that the substantial investment that you have highlighted, not only here but in other iron ore producing areas, should see a substantial expansion in supply in response to prices where they are now which should, over time, bring the price back.

Hon KEN TRAVERS: But correspondingly, if prices remain high, the chances are that the Australian dollar will remain high and so, in theory, everything will remain consistent in the overall outcome for us.

Mr Marney: Yes.

Hon KEN TRAVERS: That is what I thought. What is your prediction of volumes of iron ore commodities based on? Is it based on existing volumes or is there a factoring-in of the rapid expansion of the two majors, without even worrying about all the miners operating? Is that factored into the estimates, or is it based on current volumes?

Mr Marney: We do factor in increased volumes, based on our surveying of the major producers. Every year, the Department of Mines and Petroleum undertakes a survey at about this time of what the producers expect to produce going forward—what their expansion activities are likely to translate to in terms of tonnage, and the timing of that, and we then factor that in and do a bit of quality control on it, to make sure that it is making sense, and we factor in those volume projections to our royalty estimates. It is not based just on today’s volumes.

Hon KEN TRAVERS: Are we able to get the figures for your expected volumes over the forward estimates?

Mr Marney: Yes.

The ACTING CHAIR: That is the projected volumes of iron ore production included in the forward estimates.

[*Supplementary Information No A9.*]

Hon LJILJANNA RAVLICH: I refer to page 29. I am looking at expenses and, in particular, subsidies for electricity and water. We know that the government is trying to achieve cost reflectivity in both those areas. I understand that there is currently a subsidy forecast for utility tariffs in 2010–11 estimated at $502 million, and that the Department of Treasury and Finance is currently reviewing operating subsidy requirements associated with electricity tariffs. My first question is: why is the department doing this?

Mr Marney: The answer to that question is: the subsidy required reflects the gap between what the tariffs currently collect and what the costs of those entities are. Those costs are determined by many factors, including their investment profiles. We are examining, as a normal part of the budget process, all elements of cost projection associated with those utilities so that we are not either setting tariffs too high or subsidising those utilities to an extent greater than necessary. The first point is to ensure that their costs are efficient; that is what that work is about.

Hon LJILJANNA RAVLICH: Do those agencies understand their own cost drivers? Do they have a clear understanding of what each of their cost components contribute to the whole cost structure?

Mr Marney: I think they have a reasonable understanding of what those cost drivers are. Having said that, their ambitions or expectations in terms of increasing demand is probably the major area of contention that requires our validation.

Hon LJILJANNA RAVLICH: Okay. Can I just go on further? I understand that there was a review that was not completed in time for inclusion in the midyear review. Has that review now been completed?

Mr Marney: No, not yet.

Hon LJILJANNA RAVLICH: No. What is the time frame for completion of that review?

Mr Marney: We would have to have it completed by mid to late March, as part of feeding into advice to the EERC as part of its decision making around tariffs and subsidies, as part of the budget process.

Hon LJILJANNA RAVLICH: Okay. The point I am really trying to get to is the issue about whether the review is likely to be affected by the interaction between Synergy and Verve Energy through the new energy supply contract, ES10. The impacts of ES10 and related parameter changes are not included in either of the corporations' midyear review position. Can I ask why that is the case?

Mr Marney: At this point, the attribution of costs to each entity that flows from ES10 is not fully understood, and that is the work we are undertaking now to get a better sense of who is bearing what costs as a result of recasting these contractual arrangements.

Hon LJILJANNA RAVLICH: Okay. When was ES10 signed, do you know?

Mr Marney: I do not recall offhand.

Hon LJILJANNA RAVLICH: It is a recent contract; okay.

Mr Marney: From memory, it would have been around October.

Hon LJILJANNA RAVLICH: The financial impact of the ES10 contract represents a risk to the midyear financial review estimates. Can you explain why that is the case? In your view, what is contained in ES10 that would provide a level of risk that you are uncomfortable with?

Mr Marney: It is more the uncertainty of cost that flows from a recasting of those contracts—who bears that cost, and whether or not some of that cost needs to be borne centrally by the consolidated fund.

Hon LJILJANNA RAVLICH: Are you talking about one contract here, or a number of contracts? Who is the energy supply contract with? Is it with Synergy or Verve, or both? Do they have a contract with each other?

Mr Marney: The contracts we are talking about replace the vesting contracts between Synergy and Verve. They have been recast and replaced by ES10, which is a new contractual relationship between Synergy and Verve.

Hon LJILJANNA RAVLICH: Why does the contract represent a risk to the midyear review estimates?

Mr Marney: Correct me if I am wrong, Anthony, but the previous contract meant that any losses associated with electricity retail activity were passed back through to Verve. There was an assignment of cost back through the chain.

[12.15 pm]

That has been recast. We do not know yet—we are doing the detailed work now—whether or not as a result of recasting those relationships there is a cost impost or even possibly a saving to the consolidated fund associated with that resetting of the relationship.

Mr Kannis: The major part of this discussion is that the costs of the electricity chain are the major issues that are the risk in this situation. There is some possibility, and perhaps we are anticipating some benefit coming from the new ES10, but it is a risk and it could be an up or downside risk that could offset some of the other risks. We are not necessarily saying it is a downside risk to government, but we are saying that it just needs to be better understood before we actually put in to give the numbers.

Hon LJILJANNA RAVLICH: What is the value of this contract, do we know?

Mr Marney: I do not know offhand, sorry.

Mr Kannis: Not off the top of my head—I do not know the number.

Hon LJILJANNA RAVLICH: I wonder whether you could take that on notice and provide the committee with that information.

Mr Marney: I think the question, if I can suggest, maybe more appropriately phrased: what is the value of the total transaction between Synergy and Verve on an annual basis?

Hon LJILJANNA RAVLICH: Yes, great.

Mr Kannis: The only risk I might add to that is: these entities are under commercial legislation, so we need to understand it is subject to us being able to provide that; we will do so, but there may be some restriction on that.

[*Supplementary Information No A10.*]

Hon KEN TRAVERS: You mention in the midyear review that the operating subsidy to the Water Corporation is $337 million and for the electricity corporation $165 million. I am just trying to reconcile that. Does that appear as a specific item in the budget or is that rolled in to the community service obligations under administrative transactions of the Department of Treasury and Finance?

Mr Marney: It would be captured within the community service obligations administered items under Department of Treasury and Finance.

Mr Kannis: There is a table in budget paper No 3 which illustrates the payments from the general government sector to entities. The community service obligation payments or subsidies are outlined in that document in budget paper No 3 as at the time.

Hon KEN TRAVERS: So that $337 million is the operating subsidy and, obviously, I think the total payment to the Water Corporation in the budget was somewhere in the order of $492 million, so on top of that would be the pensioner discounts and those discounts.

Mr Marney: Other non-commercial activities that are set by government policy decision, yes.

Hon KEN TRAVERS: When we do the Water Corporation, as I understand it, that $337 million is specifically broken down into CSOs or the operation of specific water, drainage and sewerage services, mainly in rural general Western Australia, and they actually calculate what the cost of providing that service is and the costs they recoup from the tariffs, and it is about providing equalisation between metropolitan Perth and regional WA. Am I correct in that it is actually specifically calculated by the subsidies that are paid for services outside of the metropolitan area?

Mr Kannis: You are right to say that—I am trying to find the page in budget paper No 3 in fact—it is actually clearly identified as a regional subsidy. The view is that we are achieving cost reflectivity in the metropolitan area and that is a subsidy for regional customers, but I am happy to find the page in the budget paper.

Hon KEN TRAVERS: I am just trying to see if I can find it for you doing an electronic search, which will be quicker! As I understand it, for the electricity corporation that is not done in terms of identifying out a community service obligation for regional areas; the SWIS is taken as a total package and we do not actually try to work out what the subsidy is to regional Western Australia and then subsidise the energy corporation for that.

Mr Kannis: Under current arrangements when the ERA does its assessment of the access arrangement every three years, it takes into account costs that are associated with Horizon Power to provide electricity to regional areas. That subsidy, if you like to call it, is included in the network tariff that is paid for electricity transmission.

Mr Marney: So to drill down to understand the extent of that subsidy probably requires reference to ERA rather than to us.

Hon KEN TRAVERS: But I guess my point is that it strikes me that inherent in what is happening at the moment with energy and water prices is that there has actually been a policy shift that has not been completely articulated, whereas previously the government policy was to subsidise regional water supply, now what we are saying is we expect the Water Corporation to produce enough profit to cover that subsidy, whereas before that subsidy was just taken from the consolidated revenue streams. Is that —

Mr Kannis: In the case of the Water Corporation, the subsidy is actually labelled as a "subsidy for regional", so the CSO that is paid is for the loss it incurs in providing regional water.

Mr Marney: So is it separate from the $337 million general operating loss?

Mr Kannis: That $337 million is the subsidy for regional water. The point here is, I think, with electricity if the current assumptions for the increase in electricity and water in the budget do not occur, there will be an increase in the operating subsidies paid to those entities.

Hon KEN TRAVERS: Yes, but the point I am trying —

Mr Marney: Yes, I understand your point —

Hon KEN TRAVERS: The point I am trying to get to is that we have always subsidised regional water and we accept that as part of our community service obligations as a community. Why are we now having to reach cost reflectivity for water? It strikes me that there has been a specific policy change that now we want the Water Corporation to actually cover the cost of that community service obligation as opposed to taking it out of consolidated revenue, and that is the driver of the increases in water costs. It is not about getting cost reflectivity; it is actually a policy change of government.

Mr Marney: We can probably answer that question by getting back to you with the detail of the elements of cost that are incorporated in the move to cost-reflective pricing. That will clarify whether it covers or does not cover the subsidy to regional provision and, therefore, in your words, if it is an implicit policy shift.

The ACTING CHAIR: That is an identification of those costs that have been identified in the issue of cost reflectivity of water.

[*Supplementary Information No A11.*]

Mr Kannis: Can I just add something?

The ACTING CHAIR: Yes.

Mr Kannis: On page 237 of budget paper No 3—I have not actually found the schedule for now—there is a line in there for "Country Water, Sewerage and Drainage Operations", and in 2010–11 that subsidy is $337 million. We are not suggesting in this risk statement that that policy is going to change. What we are saying is: inherent in that is there are assumptions about increases in water supply charges across the state that if they are not applied, there will be an increased operating subsidy.

Mr Marney: So there is not a shift in policy implicitly or explicitly, but there are budgeting assumptions that we have in terms of how that subsidy is funded. Government is yet to take a decision on tariffs and therefore yet to take any decision in the nature of policy in that regard.

Hon KEN TRAVERS: That is what I am trying to get to: traditionally we have paid a subsidy to operate regional water systems and that has come out of consolidated revenue. I am trying to find out, in the past, was the Water Corporation required to make sufficient profit for the government to cover the cost of that operating subsidy or is that a new parameter that you operate within as Treasury to seek the Water Corp to recoup from the rest of its operations sufficient revenue to cover that regional operating subsidy?

Mr Kannis: My understanding is that this is a continuation of existing policy.

Mr Marney: As committed under A11, I am happy to provide you the detail on what we define as the cost which one would seek to recover. Having said that, I would qualify that information by stressing the government is yet to take a policy decision and will do so as part of the budget process in terms of how far it moves towards cost reflectivity however costs are defined.

Hon KEN TRAVERS: I guess the other side of that for me is also if we accept that we pay a subsidy for the cost of operating regional water services, why do we also not accept that we should pay a subsidy for operating regional power services? Again as I understand it, the difference once you get on to power is we do not try to aggregate out what the cost of providing power to the regional towns within the south west grid is, it just gets aggregated across the whole of the south west grid, so the people in Perth are paying a higher electricity charge so that Synergy can provide the energy to the more expensive users. It would strike me that we should be doing the same thing for power as we are doing for water; that is, identifying what the regional subsidies are and funding that out of consolidated revenue, so at least it is clear what the subsidy is for regional operations rather than just rolling it in to one big global figure. Arguably the people of Perth are having their power increase, not because the cost of their power is more expensive but because they are expected to pick up the subsidy for regional power users, as opposed to having that subsidy picked up out of the general consolidated revenue.

Mr Marney: I understand your argument. Essentially, it is a policy decision of government as to how it chooses to subsidise regional consumption of power or water. All I would point out is that, again, this is a zero-sum game; either the people of Perth subsidise regional power consumption via increased tariffs or they subsidise it via increased taxation revenue. One way or another, the public pays. It is a policy decision of government as to which form of payment it imposes.

Hon KEN TRAVERS: Or the government cuts its take to pick up the subsidy and keeps its other expenditure down rather than imposing tariff increases, which is the third option available to government.

Mr Marney: All the while responding to the unlimited needs and wants of the community with a finite revenue source. It is pretty straightforward really, is it not?

Hon KEN TRAVERS: Yes, but if one is having a great impact then you might make that an area that is able to take that impact better than through power prices.

Mr Marney: All of which is the policy deliberations and —

Hon KEN TRAVERS: I accept it is policy but I am just trying to understand how it actually currently operates, and I think you are allowed to tell us that. I think you have confirmed for me that for power the subsidy is just rolled in to it; with water it is actually separated out. I find it an interesting thing that we treat power differently from water. I also find it interesting and I look forward to the information as to whether or not we are actually seeking to make the Water Corporation generate the profits to cover that subsidy compared with how it has happened in the past.

Mr Marney: I am happy to make that transparent as part of our response to A11.

The ACTING CHAIR: Thank you. In the statement of risks on page 27 a risk is not mentioned that I know consideration has been given to concerning the interest-bearing deposits that local governments may wish to make. There has been consideration of defining that local governments can invest their surpluses only into entities who have a Standard and Poor's rating of A1 for short-term and AA for long-term. Has Treasury given advice to government about that particular issue?

Mr Marney: We have provided through the Western Australian Treasury Corporation various elements of advice to the Department of Local Government and in its previous incarnation as the Department of Local Government and Regional Development on the appropriate setting of prudent financial requirements for local government authorities. That stems from the activity of the Western Australian Treasury Corporation in lending funds to local government authorities and concerns that we had in the security of those lendings associated with the financial behaviours of local government entities. Long story short, they can borrow pretty cheaply from us, invest in high-risk but potentially high-return deposits elsewhere, we bear the risk of their default and they get the upside. We were concerned. We have provided advice, as I said, to the relevant department over a period of time with respect to that activity.

[12.30 pm]

The ACTING CHAIR: With the advice being given, I can understand the issue that you raise and I can understand the relevance of having some prudential guidelines for what local governments should be allowed to invest in, not just from that point of view of trying to increase their revenue but also from a prudential point of view of not losing the money. If there is any advice that is suggesting that they should not be investing in anything lesser than AA long term or whatever it is short-term, it is a blunt ruling, which has got other implications. For example, there is a bank which is well known, Bendigo Bank, which works very closely with communities, which would be excluded from receiving those kind of deposits from the local government authorities. Is consideration being made to take into account the Bendigo Bank's situation in those circumstances?

Mr Marney: Consideration is based on what are the normal prudential requirements for commercial investment activity. The social or community good associated with a particular entity is not something that enters into those considerations, and nor should it. At the end of the day, Bendigo Bank is a profit-making institution, albeit its heart might be in the right place. If that poses greater risks to state finances than is acceptable, then they would be excluded from that activity by virtue of that risk.

The ACTING CHAIR: Accepting that if one is going to rely on rating agency ratings, that has similarly added great traps for local government authorities in the past, such as the Lehman and the collateralised securities or the other securities that had AAA rating, which ended up going down and losing money for local government authorities. My question is really that the rating agencies' ratings may not be the appropriate benchmark to put our hats on because of the history that has already caused local government authorities to lose money.

Mr Marney: I think in the circumstances of the deposit instruments that local governments invested in, they were unrated instruments. That is my recollection, but I could be wrong. The ratings of rating agencies are not the perfect indicator of risk but they are about the best we have got and they are objective across the board. On that basis, it is a relevant reference point to impose prudential requirements on any entity, whether it be the investment of local authorities or indeed the investment of the liquid deposits of the Treasury Corporation or the investment of the public bank account. In imposing prudential investment requirements on local authorities they in essence mirror those that apply to the public bank account and the deposits of the Treasury Corporation more broadly.

The ACTING CHAIR: Accepting that rating agencies often take into account size, is size necessarily an account of prudence? As we have seen in the last global financial crisis, the smaller bank may satisfy all the APRA requirements better than, maybe, some of the larger banks and yet be excluded. I guess what I am suggesting is that if there is advice being given, it not just be based on rating agencies and the issue the size might have in rating agency ratings. APRA, I think, makes specific requirements on ADIs, approved deposit-taking institutions, and I would urge that that be considered even more strongly than rating agency ratings.

Mr Marney: I am not here to argue the methodology on behalf of Standard & Poor's and Moody's, but they do take into consideration the APRA prudential requirements associated with entities and those prudential requirements are scaled. That is, they apply on a scale basis to small entities and large entities alike. The methodologies, as I understand them, take into consideration those scale issues, but that would be the extent of my knowledge on it. I take your point.

Hon LIZ BEHJAT: There is a whole range of comments you could make about bigger-sized matters, but anyway.

Hon LJILJANNA RAVLICH: Page 30 refers to the community sector funding gap. I wonder if you can just give us a bit of a history of how that actually occurred because it seems to me that there seems to have been a shortfall of government funding to the sector and they cannot meet their responsibilities given that funding shortfall and now what we are doing is going back to try to work out what the level really should be of funding so they can get on with the job of providing the services to the community that they do. I wonder if you could provide the committee with a bit of a history of how this emerged, because it seems to be an issue that is affecting a lot of community groups out there and a lot of service users, if you like.

Mr Marney: If I was a politician, I would blame the previous government, but I am not, so I will not!

Hon LJILJANNA RAVLICH: You would be a very bad politician in those circumstances, I have to say!

Hon LIZ BEHJAT: He would be astute, I would say!

Mr Marney: Hence my vocation as a public servant! The community sector funding gap both reflects the historical, if you like, underfunding of service delivery loosely contracted from non-government organisations. It also reflects the ASU claim nationally, going forward, which is pending. There are two issues. We are dealing with past mismatch and what is being debated through a wage case nationally at the moment. The risk identified relates to both those things.

Looking at the past component, what we found through the economic audit process is that the relationship between government departments and non-government organisations is poorly defined, highly variable and, in many cases, puts the non-government organisations in a very poor position in terms of the agreements that are eventually struck. Circumstances, for example, where an agency will tender for certain service delivery, the tender prices from NGOs will come in, the agency will shortlist, select a preferred provider and then tell them the price they are prepared to pay. That is how you end up with a funding gap—that is, agencies essentially short-changing the service cost that they are purchasing from the non-government sector. That is one element.

Another element, as has long been argued, is a pay differential between the workers in the non-government organisations who perform like roles to their counterparts in public sector organisations, so that is another element of gap.

That latter element is really what the ASU case is seeking to address. That is, if you like, the forward risk to the budget, but also the forward opportunity to correcting the poor financial and contractual relationship between state government agencies and non-government organisations. Historically, also there has been indexation policies put in place by the previous government that sought to fund the emerging costs on a fair and equitable basis through the NGOs. It is not clear to us, and certainly the NGOs argue very strongly that, despite having a robust policy by which indexation monies were passed to agencies, that money never got to the NGO; that is, the agency did not pass that on. It has been hard to get to the bottom of whether or not that is the case and we have undertaken a review of five key areas of relationship with NGOs and depending on the analysis, the differential in funding gap ranges from five per cent to 25 per cent. It is very hard to get to the bottom of it. What that highlights for me is that we need to completely recast our relationship with non-government service providers and adopt a more mature and robust contractual arrangement with them more akin to what we do with commercial contracts; that is, there are rise-and-fall provisions, it is robust in terms of variations and pricing, and limits the extent to which on both sides of the fence NGOs can over-commit—over-promise what they will deliver with the funds that are being offered. Similarly, it limits the extent to which agencies can underfund what they are actually purchasing.

Hon LJILJANNA RAVLICH: Under Treasurer, when is that review due for completion?

Mr Marney: Which one?

Hon LJILJANNA RAVLICH: The one that has a look at —

Mr Marney: The gap?

Hon LJILJANNA RAVLICH: Yes, the gap.

Mr Marney: The elements of that review—it has been completed. The review was provided through to the partnership forum that the government has established.

Hon LJILJANNA RAVLICH: Is that a public document?

Mr Marney: I do not know that it is.

Hon LJILJANNA RAVLICH: If it is available, could you pass a copy to the committee because that would be very handy?

The ACTING CHAIR: That is a copy of the report to the partnership forum.

Mr Marney: Qualified by “if available”.

[*Supplementary Information No A12.*]

Hon LJILJANNA RAVLICH: The other issue is the funding that may be required to close that gap. Is there a ballpark which has been talked about or under consideration?

Mr Marney: That is really a matter for the budget process. It is also going to be determined by the direction of the ASU case, which is not due for completion or to be handed down until probably the second half of this calendar year. At this point I cannot give you an accurate read on that. It is fair to say that it is probably substantial.

Hon KEN TRAVERS: I have a couple of other questions on this. My first one is: do we have a time line for resolving it?

Mr Marney: That is really a matter for government.

Hon KEN TRAVERS: I guess one of the reasons I ask that is that there would appear with it to be an expectation in the community sector that it was going to be resolved prior to the midyear review, whereas obviously your comments here suggest clearly that it was not. Are you able to advise us as to why it was not able to be resolved in time for the midyear review and why that expectation would have been out there?

Mr Marney: Essentially, the reason it is not in the midyear review is because a figure was not agreed. It is a pretty complex issue in trying to deal with both past funding gap and what might be expected to be a funding gap that will emerge subsequent to an ASU determination on that case. So agreement was not met. The other issue in amongst that is: how do you actually divvy that money up across a very disparate group of service provision agencies, some of whom would have a substantial funding gap, some of whom arguably may be underfunded, albeit very few would be underfunded —

Hon KEN TRAVERS: Over-funded.

Mr Marney: Sorry, over-funded, yes. But that is the spectrum. There are some that are clearly grossly underfunded, some that are well funded or adequately funded, some that are probably overdone.

Hon KEN TRAVERS: Or some that may have a program over-funded, but use that to subsidise programs that are underfunded, so if you take it off the over-funded program, you have got to make sure that it goes to the underfunded.

Mr Marney: So how do you actually roll that money out? The aim was not to do that as part of midyear review but to acknowledge the validity of a gap with a provision in midyear review recognising that there is a commitment to address this issue. We were not able to progress the matters to a significant degree of confidence to be able to say, "Well, we should set aside X." Although that is what we tried to do, we were not able to get to that point and we will be hopeful that we will continue discussions and negotiations in coming months ahead of the upcoming budget.

[12.45 pm]

Hon KEN TRAVERS: You made the comment earlier about the argument that agencies had been given the indexation by the previous government, but the sector is arguing that that money has then not flowed on to the sector. I guess the other argument I get is that where indexation has flowed on to the sector, it has not necessarily flowed on to the wages, which is, as you pointed out, the ASU claim—I think there are probably quite a few other unions involved in the sector as well, so it would not just be the ASU claim.

Mr Marney: Yes.

Hon KEN TRAVERS: Is there any work, as part of this, in ensuring that if the money is about making sure that there is equity in wages between the government and non-government sector, that when the money flows through to those agencies, they will ensure that if it is for the purposes of getting equity in wages, it actually flows on to the workforce?

Mr Marney: There is work around that issue. It is a question of how you would tackle that from a policy perspective. If I look at the way we contract with commercial providers, we require them to meet all relevant legislation in terms of remuneration of their employees; why would we do anything any different with NGOs? That does not mean we say, "You must spend X on paying your level 4 officers this amount of money"; what they do is up to them. If they have industrial issues, we have provided enough money to cover—we have asked them to tender a price that covers them complying with relevant legislation and awards; the rest of the issue is up to them. That is, I guess, the approach that a more mature contracting framework would take. We do not get into arguments of, "But that level 4 over there gets paid that, and I do similar, so let's do that", and we do a job evaluation work value claim to compare the two. To be honest, it is not a mature way of doing business, and if we are going to be stuck in arguing about inputs at various levels, then we are never actually going to get to the key issue, which is what is the outcome that the community is getting.

Hon LJILJANNA RAVLICH: Fair enough.

Hon KEN TRAVERS: I understand that, and I understand the complexities.

Mr Marney: Oh, it is complex.

Hon KEN TRAVERS: The other difficulty is that now, in a lot of industries, EBAs have overtaken and the awards have fallen behind.

Mr Marney: Yes.

Hon KEN TRAVERS: So if your expectation is that if you apply, they have to pay the award conditions, that may be actually below what's occurring with respect to the EBAs as well.

Mr Marney: Just to be precise, what I said was that in normal contractual terms we would say, "You must meet the obligations of relevant legislation and awards." That does not preclude them from paying double the award.

Hon KEN TRAVERS: No, but it may mean that their funding is not sufficient to meet the expectations of what the EBAs in that industry are at that point in time.

Mr Marney: But we would not set the funding in accordance with the award; we would set the funding in accordance with the price that they tendered for that service.

Hon KEN TRAVERS: So they would have to factor in the EBAs that they wanted to offer as part of that.

Mr Marney: Exactly. They take those decisions; we do not force it on them.

Hon LJILJANNA RAVLICH: Yes, but hang on: is there not a problem there? It is usually the lowest tender that wins. I know you will say, "Well, that's not necessarily so", but it is a key issue when tenders are awarded, and so there is a risk that NGOs will tender low, just to make sure that they secure base funding, and then not have sufficient money to pay their workers at an award rate, and so you start this downward spiral whereby they say, "Well, you can have a job, but you're just going to have to accept these conditions and rates of pay", so on and so forth, because the tendered price would not allow the organisation to offer any better.

Mr Marney: There would be two potential outcomes. Again, if you look at a commercial contract, which does exactly that, the two potential outcomes would be, firstly, if they are not paying in accordance with relevant awards and legislation, they are in breach of contract. Secondly, if they do not pay enough to secure the workforce that is required, then obviously—often in these circumstances it is labour-intensive work; it is people dealing with people service issues—if they cannot get the right people, they are going to default on performance in terms of achievement of outputs and outcomes. So, again, a mature contracting framework is what protects against that. Having said that, all of this I hope you take as my thinking in how to move forward in addressing this issue. This is not government policy, it is not a cabinet decision; it is what we are exploring in terms of procurement reform to try to ensure that if we do fix a funding gap, as the risk statement has highlighted, we do not end up with another one in five years' time.

Hon LJILJANNA RAVLICH: The only comment I would make is that that all sounds very good, very plausible and very practical, but we know that, in theory, it often does not actually translate the same in practice. That is the only point I would make in relation to that.

Mr Marney: Point taken.

Hon LJILJANNA RAVLICH: I just want to quickly turn to Royal Perth Hospital redevelopment. We are over two years down the track and there has only been an investment of $10 million allocated for up-front planning processes—am I correct?

Mr Marney: Correct.

Hon LJILJANNA RAVLICH: Can you just explain why this is all taking so long, given that it was a key election commitment, and why there is no urgency about this?

Mr Marney: That would be a question for the Minister for Health, I suspect.

Hon LJILJANNA RAVLICH: Okay; that is a fair call.

Hon KEN TRAVERS: Just on Royal Perth, when you talk about the risk here, it would imply that the actual capital cost of the risk is in the capital expenditure required.

Mr Marney: Correct.

Hon KEN TRAVERS: Is there also an operating cost expenditure risk?

Mr Marney: Correct. The risk identified here is with respect to infrastructure investment; it is not with respect to operating expenditures required. My understanding is that the operating expenditures have been factored into the clinical services framework and the whole-of-health cost model, which drives the forward estimates for the Department of Health. The short answer is that the expense side, as I am informed by the Department of Health, is now factored in.

Hon KEN TRAVERS: So if we want to drill down into that, talk to health?

Mr Marney: But they are telling me it is covered.

Hon LJILJANNA RAVLICH: They are telling you what, sorry?

Mr Marney: It is covered—keeping Royal Perth operating and Fiona Stanley Hospital commencing operation, as was questioned in this forum probably about two years ago and which got me into a little bit of hot water.

Hon LJILJANNA RAVLICH: Yes, I remember that.

Mr Marney: I am now being told that the operation of both those facilities is incorporated within the existing forward estimates.

Hon KEN TRAVERS: Oh well, we will look forward to following up with health how they explain that one.

Hon LJILJANNA RAVLICH: Under Treasurer, what about the capital? We have seen some preliminary early plans of what a redevelopment may look like, and there have been a couple of options put on the table, and so on and so forth. We are talking about substantial capital infrastructure, and that has to have a bearing on the debt limit, surely.

Mr Marney: That is why it is flagged as a risk.

Hon LJILJANNA RAVLICH: Right; okay.

Mr Marney: But until such time as government makes a decision on what it is going to do—it could decide to do nothing or it could spend a billion dollars, but until it makes a decision, I cannot put anything in the numbers. All I can do is highlight for you that it is an issue that has not yet been factored in.

Hon LJILJANNA RAVLICH: But are you saying that the government is not really taking action, and that, apart from the $10 million that has been allocated to the planning process, the government has been inactive on this issue? That is what I am hearing you say.

Mr Marney: No; and, as you have just said, there are plans of various forms of redevelopment of the facility that are well developed. At this point, government has not made a decision as to which of those plans it wants to implement.

Hon LJILJANNA RAVLICH: Have you seen those plans?

Mr Marney: I have seen a version of redevelopment about three weeks ago.

Hon LJILJANNA RAVLICH: Okay. Do you have a ballpark figure about —

Mr Marney: Sorry; just for Hon Ken Travers: that is post–midyear review cut-off, because he was working hard on that.

Hon LJILJANNA RAVLICH: He is always working hard.

Hon KEN TRAVERS: I would worry if I was you about trying to get into my mind.

Hon LJILJANNA RAVLICH: Do we have a bit of a ballpark figure on what a redevelopment of this magnitude might cost?

Mr Marney: Not at this point.

Hon LJILJANNA RAVLICH: You have no idea at all?

Mr Marney: Well, because I do not know what government's preferred option is because it has not made a decision, but, as I said, it could vary from $10 million to a billion.

Hon LJILJANNA RAVLICH: Of course, if it was a billion, it would be a problem, would it not, for the $20 billion debt limit?

Mr Marney: In terms of government's consideration of how it fits within that $20 billion cap, that would be an issue.

[1.00 pm]

Hon KEN TRAVERS: I just wanted to go back to something you were saying. I just want to clarify that you are saying that the operating costs are already contained within the health budget, but that there is no increase in the health budget to accommodate that, so it will be from within the existing budget allocations that are given to them. Is that right? I mean, is there something in the budget that provides for an increase once Fiona Stanley comes on and Royal Perth remains open?

Mr Marney: The budget for the Department of Health was recast substantially last budget on the basis of the clinical services framework, and the whole of health cost model. So that incorporates the cost of the whole system. How the system is configured and what services are delivered where and to what levels of activity is really the business of the health department. They are telling me, in their estimation of the configuration of service delivery and the levels of activity, that their funding parameters are consistent with the whole of health cost model, which in turn is driven by the clinical services framework and that that is what their current forward estimates reflect.

Hon KEN TRAVERS: That would require them to react—to work with the resources they had. So it may well be that the driver of keeping Royal Perth Hospital open would be the driver of the clinical services framework; for instance, changing the number of beds that will end up being at Joondalup hospital, as part of that.

Mr Marney: Yes. That is a question for them in terms of how they juggle demand within the overall system and also how —

Hon KEN TRAVERS: But there was not a quantum leap in funding to accommodate it; it is working within the existing funding, but —

Mr Marney: It is also a question of how they juggle acuity and the distribution of acute versus subacute, and all those issues.

Hon KEN TRAVERS: Can I just finish off on that capital works? It goes back to the questions we had a bit earlier in terms of power, water, all of those pressures from the growth in the mining industry et cetera and we now have Royal Perth Hospital capital and we have the HICT. For all of these risks, including Perth waterfront, there is a fairly significant block of capital works. Then we have those other ones that are sitting there, where the state will—in terms of transport, power and infrastructure in particular—meet the needs of the private sector investment. How does the private sector actually know what the state government's plans are for that infrastructure so that they can tailor their private sector investment? Is there a document there that they can go to to say that this is the state government's plans at the moment, other than over the forward estimates, the budget?

Mr Marney: Like a state infrastructure strategy?

Hon KEN TRAVERS: Yes.

Hon LJILJANNA RAVLICH: Yes, like that. There is —

Hon KEN TRAVERS: Maybe I can put the question this way. Without a state infrastructure strategy, how does the public sector know what the priorities of government are and where they will be putting their infrastructure expenditure so that they can match their private sector expenditure to that, and time their private sector expenditure in with the state government's expenditure?

Mr Marney: The factual answer to that question is the forward estimates provide detailed breakdown of the capital works program over the budget year and subsequent forward estimate years; other agencies put out and publish longer projections of their capital works program. Those are the available bits of information to inform private sector investors.

Hon KEN TRAVERS: Is the department still doing any work on a state infrastructure strategy, or is that now finished?

Mr Marney: We are not actively working on that at the moment.

Hon LJILJANNA RAVLICH: But are you going to be?

Mr Marney: It is not in our forward work program.

Hon LJILJANNA RAVLICH: It would be helpful to us, too. Have you finished?

Hon KEN TRAVERS: Yes, on that.

Hon LJILJANNA RAVLICH: On the health information communication technology project, the $335 million HICT project, readiness remains a significant risk for the department's substantial infrastructure reconfiguration including Fiona Stanley Hospital and the new children's hospital. Can you explain to us what those risks are?

Mr Marney: We might not have systems to run the hospital.

Hon LJILJANNA RAVLICH: You may not—so you may actually end up with new hospitals, but they may not be able to operate?

Mr Marney: The new systems that are proposed by that investment may not be delivered in time for the commissioning of those facilities. That is not to say that there will not be existing systems that can be brought across, but it is the new systems that are proposed with that $335 million ICT investment as identified in the Reid reforms back in 2005, I think it was. There is risk that those new investments will not be completed in time for the commissioning of those new facilities.

Hon LJILJANNA RAVLICH: Okay. Well I suppose, you know, if you are being optimistic, they may come early. Well, I suppose they cannot come early before the buildings, so that is wrong!

Mr Marney: Well they can because they are "whole of health system" systems; in fact, you would hope that they would actually be in place prior to the commissioning of the new facilities so you can run through the teething problems. There are risk-mitigation strategies in place, however, if those systems are not available.

Hon LJILJANNA RAVLICH: Okay.

Hon KEN TRAVERS: As I understand it, currently the hospitals all operate on fairly independent systems within each hospital and —

Hon LJILJANNA RAVLICH: This will be integrated now.

Mr Marney: There are —

Hon KEN TRAVERS: If you do not have the new system in place, how would you actually get Fiona Stanley up and operating without the new ICT to operate it? I do not know that you can transfer the Royal Perth system or the Charlies' system over there.

Mr Marney: You copy and paste it on to a USB stick.

Hon LIZ BEHJAT: You mirror the system; it is easy.

Hon LJILJANNA RAVLICH: No. This is all high tech—really high-tech technology—so it cannot run on the old system; it has to have a new system.

Mr Marney: There are some core systems across the health facilities, like patient administration systems, that are shared; you are right, there are some tailoring as per requirements of each site, but there are some core shared systems that are relied upon. It does not mean there will not be systems come the opening of the facilities; it just means that there will not be the new systems.

The ACTING CHAIR: We are almost to the end, if I could just ask one last question. In the statement of risks, under the expense area I would have thought that it is coming close to time when one should consider including risks associated with global warming and the impact that that may or may not be considered to have on things like intensity of events and the emergencies which we see happening in the eastern states, some of which are happening here also. Whether they are relate to global warming is a question, but it is a risk that at some stage the state has to consider. Is that something that you would consider as being worthy of consideration about being included in the expense risks that the government is facing down in the future?

Mr Marney: Not at this point; the difficulty being drawing a link between a broad heading of global warming versus natural events that impose costs upon the state. I mean, a catch-all risk would be, yes, there are floods, fires, droughts, and they always potentially —

The ACTING CHAIR: Rising sea levels—that kind of thing?

Mr Marney: I am not sure that is a risk that we would identify would be realised within the forward estimates period.

The ACTING CHAIR: That is the risk. It is when the time line brings that in? Yes.

Mr Marney: On that vein, we would should probably add bizarre acts of God and unforeseen apocalyptic events. I do not know how you factor that stuff into risk, other than assume that that stuff happens and that you deal with it when it happens.

The ACTING CHAIR: Accepting the frequency with which it might happen. But it is not for me; each one has got to make up their own mind about the impacts from global warming. One thing is that global warming is almost scientifically irrefutable. It is the implications of that. Someone needs to try to give an assessment of the risks to this state, in the same way that Bangladesh has to make its own assessment about what happens over there. Obviously, that has not been considered yet.

Mr Marney: No, it has not; we will take that into consideration.

The ACTING CHAIR: That brings us to the time, unless there are any burning questions.

Hon LJILJANNA RAVLICH: No; that was very informative.

The ACTING CHAIR: Thank you very much for the contribution of such a broad-ranging set of issues, or sub-issues to the papers we have in front of us. Any additional questions that the committee —

Hon KEN TRAVERS: I'll go through the ones I've already asked and —

Hon LJILJANNA RAVLICH: Yes.

The ACTING CHAIR: Okay, and we will be forwarding them, writing via the minister, in the next couple of days with a transcript of evidence, which includes the questions you have taken on notice.

Mr Marney: Sorry.

The ACTING CHAIR: If there are any unasked questions, they will be submitted via the committee clerk and responses to these questions will be requested within the normal 10 working days of receipt of the questions. Should you be unable to meet this due date, please advise the committee in writing as soon possible before that due date and the advice is to include specific reasons as to why the due date cannot be met. Thank you very much for the contribution that you have made this morning.

Mr Marney: Thank you. Can I just clarify that we have 12 items of supplementary information requested?

The ACTING CHAIR: We have a reconciliation!

Mr Marney: Excellent; thank you.

Hearing concluded at 1.05 pm