STANDING COMMITTEE ON ESTIMATES AND FINANCIAL OPERATIONS

2015–16 BUDGET ESTIMATES HEARINGS

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 15 JUNE 2015

DEPARTMENT OF TREASURY

Members

Hon Ken Travers (Chair)
Hon Peter Katsambanis (Deputy Chair)
Hon Martin Aldridge
Hon Alanna Clohesy
Hon Rick Mazza

Hearing commenced at 10.10 am

Mr MICHAEL BARNES
Under Treasurer, examined:

Mr MICHAEL COURT
Acting Deputy Under Treasurer, examined:

Mr RICHARD MANN
Executive Director, Strategic Projects and Asset Sales, examined:

Mr RICHARD WATSON
Acting Executive Director, Economic, examined:

Ms KAYLENE GULICH
Acting Executive Director, Infrastructure and Finance, examined:

Mr ALISTAIR JONES
Acting Executive Director, Strategic Policy and Evaluation, examined:

The CHAIR: Good morning. Welcome to our first hearing for the 2015–16 budget estimates hearings in the Legislative Council. On behalf of the Legislative Council Standing Committee on Estimates and Financial Operations, I welcome you to today's hearing. Can the witnesses confirm that they have read, understood and signed the document headed "Information for Witnesses"?

The Witnesses: Yes.

The CHAIR: Thank you. Witnesses need to be aware of the severe penalties that apply to persons providing false or misleading testimony to a parliamentary committee. It is essential that all your testimony before the committee is complete and truthful to the best of your knowledge. This hearing is being recorded by Hansard and a transcript of your evidence will be provided to you. The hearing is being held in public, although there is discretion available to the committee to hear evidence in private, either of its own motion or at the witness's request. 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 before answering the question. Government agencies and departments have an important role and duty in assisting Parliament to scrutinise the budget papers on behalf of the people of Western Australia and the committee values your assistance to do this.

I might start with congratulating Mr Barnes on his appointment as Under Treasurer since the last time we saw him.

Mr Barnes: Thank you very much.

The CHAIR: Does any witness wish to make an opening statement? If not, I am sure that we have plenty of questions.

Mr Barnes: There will be no opening statement, Chair.

Hon ALANNA CLOHESY: I go to page 112 of budget paper No 3. Specifically, I want to talk about payments for specific purposes in the budget. There are national specific purpose payments, national partnership payments and national health reforms. I want to get clear which PSPs will be expiring this financial year, which are expected to expire next financial year, and the term of life of some of the other national specific payments. I also want to look at the figures for each of those.

The way in which they are reported is still fairly broad and there are some items that do not appear to be reported as a line item. If we could go through each of those in particular, starting with my first question: what specific payments are due to expire this financial year?

Mr Barnes: If I could just clarify, we will have to take some of this on notice or supplementary information—I am not sure how we can best provide that. I think there are five national specific purpose payments. They are the old SPPs. They are the large ones at the top of that table for skills and workforce development, disabilities, affordable housing, health reform and Students First, which is the old education SPP. Those five SPPs are ongoing in nature. The finite funding agreements are the national partnership agreements. There is a large number of national partnership agreements and they all have differing timetables. I do not believe that we have that level of detail at our fingertips in terms of when those individual national partnership agreements expire, but I am more than happy to provide that information to you as supplementary info or on notice.

[*Supplementary Information No A1.*]

Hon ALANNA CLOHESY: So A1 is the complete list of national partnership agreements.

Mr Barnes: Of expiring national partnership agreements.

Hon ALANNA CLOHESY: Actually, if we could have the complete list of national partnership agreements and the dates on which they expire, how much is in the 2015–16 budget and how much was received in 2014–15.

Mr Barnes: I am happy to provide that.

Hon ALANNA CLOHESY: Supplementary information A1 is the national partnerships agreements.

The CHAIR: Do you now know whether the ones that are expiring are getting renewed or not?

Mr Barnes: Based on the commonwealth budget, we do.

The CHAIR: Is whether they have been renewed or not a key part of the answer?

Mr Barnes: What we can do in the information that we provide is have a list of those national partnership agreements and the assumptions underlying our state budget in terms of expiring funding. Then we can update that for the information that was presented in the subsequent commonwealth budget and give you a complete picture.

The CHAIR: That is all supplementary information A1.

Hon ALANNA CLOHESY: That is the national partnership agreements. The national specific purpose payments—for example, skills and workforce development is $164 million—can I get a breakdown of how that will be allocated and the budget actual for 2014–15?

Mr Barnes: We can certainly give you the 2014–15 estimated funding under each of those national specific purpose payments. These five national specific purpose payments are—I will not say untied—a little bit different; they are much broader than national partnership agreements. National partnership agreements go to a specific initiative; these specific purpose payments go to a specific area, say, education and health. They are not tied to specific initiatives within health or education or disabilities, so exactly how and where that funding is expended by those relevant agencies is probably best asked of those relevant agencies.

Hon ALANNA CLOHESY: They do come with some conditions.

Mr Barnes: Do they come with some conditions? Yes, they do; but they are quite different in nature to the national partnership agreements, which are very specific and finite. As I said before, these are basically the commonwealth's ongoing funding contributions to those five key service delivery areas. We can certainly provide you with the 2014–15 estimated funding under each of those payments. I am not sure whether we have that available now—do we?

Mr Watson: We do. Table 3.1 on page 251 contains the 2014–15 budget estimates for national and specific purpose payments.

Hon ALANNA CLOHESY: Is that for 2014–15?

Mr Watson: Yes.

Hon ALANNA CLOHESY: That is for 2014–15. Where is the national funding to Aboriginal affairs?

Mr Jones: My understanding, member, is that we do not receive specific funding for the Department of Aboriginal Affairs from the commonwealth. There is obviously commonwealth funding for Aboriginal programs, and the state through its various agencies funds Indigenous programs. For example, if there was a program for Indigenous health, that money would be funded directly by the commonwealth or Closing the Gap items. Under that agreement, the state has to run its own programs, and in that case there is not. Other departments I would have to take on notice, and I could provide you with a list of those, but often they are given as national partnership agreements, not the broader funding, and therefore a specific item—for example, health—has quite a lot and they may be for items ranging from $40 000 to tens of millions of dollars, and in the list that the Under Treasurer said that he would provide you with, you should get a list of all those for 2014–15.

Hon ALANNA CLOHESY: And 2015–16?

Mr Jones: For 2015–16, if they actually have a 2015–16 component, and some may, and some may even have a 2016–17 component. Across the forward estimates, the information that we will provide you will have the life of those agreements and what the cash flows are for each of those years.

Hon ALANNA CLOHESY: Why, in policy terms, do they not come through as national specific purpose payments?

Mr Barnes: I am not sure that I can answer that question, other than to say that they are the subject of negotiations between the commonwealth and the states, often dictated by the commonwealth, so as Mr Jones indicated, in the Indigenous space it is through specific national partnership agreements; for example, there is a National Partnership Agreement on Remote Indigenous Housing, which I believe was extended in the recent commonwealth budget, but that will be part of the information that we provide you under A1.

Hon ALANNA CLOHESY: The national partnership agreements list?

Mr Barnes: Yes.

Hon ALANNA CLOHESY: But the other bit that I asked for?

[*Supplementary Information No A2.*]

The CHAIR: While the member is gathering her thoughts, are you monitoring or do you have a figure for the exact amount we have lost over the past couple of years in terms of specific purpose payments or national partnership agreements that have now been cancelled by the commonwealth government? What has been the net loss of revenue to Western Australia in terms of the policy decisions over the past year and a half, of the federal government withdrawing from national partnership agreements, specific purpose payments, and the like? I would have thought it was something that Treasury would be monitoring to know what impact Canberra is having on Western Australia. Do we have a figure?

Mr Barnes: I do not think we have a cumulative tally. Budget by budget we certainly monitor that. We do not keep a cumulative tally, if you like, but it is an issue that we have raised on numerous occasions with the commonwealth—both the short-term nature of these national partnership agreements, which makes it very difficult to budget and deliver services under those agreements when there is such uncertainty hanging over the future funding arrangements. We have raised, on numerous occasions, the short-term nature of the agreements, the expiry of those agreements, and often the unannounced expiry of those agreements. Each year the state Treasuries do a coordinated exercise where we put in a report to the commonwealth Treasurer in about September of each year on all expiring national partnership agreements that are due for expiry in the next 12 months or so and we put forward a recommendation to the commonwealth Treasurer to inform the commonwealth budget process as to whether the states believe these national partnership agreements should continue, whether they should be rolled over into a specific purpose payment or otherwise. Unfortunately, that report, which we have been doing for a few years now, has not had much of an impact on the commonwealth budgeting process, I have to say.

The CHAIR: That is all the more reason I am surprised that you would not be running a cumulative tally of what the net cost to Western Australia has been from the commonwealth government walking away from national partnership agreements. Some are initiated by the states, but many are initiated by actions of the commonwealth government, which then gets the states to go partners and then says, "Now you have to run the whole service." I am just amazed that we do not have, in terms of the whole debate about goods and services tax—I am sure that if I asked you how much we have lost in GST funding over the past couple of years, you would be able to rattle it off like that. I am just surprised that we do not have a similar figure in everyone's head about the impact of commonwealth policy decisions on the revenues of the state.

Mr Barnes: We can certainly take that on notice. We certainly monitor it, budget by budget and agreement by agreement. Off the top of my head, I can only think of a couple of national partnership agreements that the commonwealth has unilaterally terminated. For example, in the 2014–15 budget there was a national partnership agreement around seniors and pensioners concessions that was unilaterally terminated by the commonwealth. That is a good example. There have not been a lot of those, although there have been some. It would not be a big ask for us to pull those together and come up with a figure.

The CHAIR: To put that into dollar terms, how much did we lose as a result of that unilateral termination?

Mr Barnes: It was approximately $100 million over the forward estimates.

Mr Jones: It was about $22 million a year.

The CHAIR: You can take on notice what has been the total loss of revenue in the last two financial years, and over the forward estimates.

Mr Barnes: Under terminated national partnership agreements?

The CHAIR: Yes, where the commonwealth government has clearly terminated a national agreement, or reduced the payments. They may not have terminated it, but they may have significantly reduced it. I think we still have our national agreements on Aboriginal affairs, but some of them have clearly been significantly reduced. It is the loss of revenue across national partnership agreements.

Mr Barnes: Yes, we can pull that together.

[*Supplementary Information No A3.*]

The CHAIR: I am still struggling to find where, in the budget, apart from a line item, the major new stadium appears as a capital work. There used to be a separate budgeted capital works item for it. Where does it now appear in the budget?

Mr Barnes: I will ask Mr Mann to answer that question.

Mr Mann: It is complex, because the project budget is in several components, as you would be aware. Essentially, it is in two places. The bulk of it is a finance lease valuation as a non-current asset liability within the VenuesWest budget. That reflects the costs that have been delivered under the design, build, finance and maintain contract with Westadium. The remaining non-DBFM costs—so the costs that the state is procuring, such as preconstruction site works, project management et cetera—and contingencies that are not contained in that contract are within the Department of Sport and Recreation's budget allocation. There is $150 million, essentially, of capital works allocation within sport and recreation.

The CHAIR: I found the sport and recreation bit and I found the part in the PTA. I cannot understand why there is not, though, an asset investment program. Even though there may be a lease component to it, I cannot find where the asset investment program is that lists the major stuff. There was previously.

Mr Mann: There was, and it had financial close. Once we execute the design, build, finance and maintain contract, then accounting standards require that we report that value as a non-current asset liability as a finance lease value, and that must be reported as a non-current asset liability on the commencement date of the stadium, which is 2017–18. The reason is that accounting standards require it to be reported in that way.

The CHAIR: Are we not now purchasing an asset, in terms of building an asset? Even though the financing mechanism is through a lease arrangement, surely we are still building the asset, which is somewhere part of the asset investment program? There is a capital budget allocation for it.

Mr Mann: The reasoning behind the accounting standard and the requirement for the treatment I cannot comment on, only to say that the accounting standards require us to report it in the budget papers in that fashion.

The CHAIR: So there would be no other similar projects where we have entered into those sorts of arrangements where that would be shown as an asset investment program?

Mr Mann: Eastern Goldfields Regional Prison is reported in the same way, and the CBD courts was also a DBFM project and was reported in the same way. Numerous examples exist.

The CHAIR: Where do the ongoing payments to the joint venture partners that will be made once the stadium opens appear in the budget?

[10.30 am]

Mr Mann: There are two components to those ongoing payments. They are met as monthly service payments that commence once the stadium starts operation, which is scheduled for early 2018. The first component—the capital component—is paid down against that finance lease valuation, so the finance lease value actually decreases progressively over time as the capital payments are made. The second component of that payment is the facilities management component, which is maintenance, services and life cycle replacement costs. Those costs are currently assumed to be met from operating revenue so there is no net financial impact to the state. Once the stadium revenues are confirmed and once an operator is appointed and user agreements with the main stadium users have been agreed confirming revenues, any adjustment to be made to the new operating budget will be made at that time.

The CHAIR: Surely until you reach that point, there should either be a line item showing revenue in and expenditure out or a potential liability until you firm up the revenue. Where does that occur in the budget papers?

Mr Mann: In the 2013–14 budget, it was recognised as exactly that—an explanatory note, with the assumption that operating revenues would meet operating expenditures but was recognised in the Treasury papers as a contingent liability.

The CHAIR: Where is that now in the budget papers? Where does it currently appear in the budget papers?

Mr Barnes: There is an item in "Treasury administered". Go to page 581 of budget paper No 2, volume 2. You will be aware that we have a special purpose account established for the new Perth Stadium. That account was established some years ago. On page 581 under the heading "Other" is "Item 149 The New Perth Stadium Account". Those are the appropriations from the consolidated account into the new Perth Stadium account.

The CHAIR: That is for the capital component. It does not go beyond 2017–18.

Mr Barnes: That is the capital component.

The CHAIR: Where are the ongoing operational payments shown in the budget papers and why are they not shown in the budget papers? They are now a liability on the state. We have a contractual agreement. Where in the budget papers are they shown?

Mr Mann: The capital component is shown as the up-front finance lease valuation in the VenuesWest paper. The operational payment is not shown because of the assumed net zero financial impact with revenue matching expenditure.

The CHAIR: Would you not then have revenue in and revenue out if that is your assumption? Hundreds of agencies are yet to have retained revenues and they are shown in the budget papers as "Details of Controlled Grants and Subsidies" or retained payments. There should still be an accounting treatment in the budget, I would have thought, that shows estimated revenue in and estimated revenue out. Until you have reached a financial close, I am surprised that you can be so confident as to not at least also include some disclosure of potential liability somewhere in the budget papers. Why is it not there?

Mr Mann: Which we did in the 2013–14 papers.

The CHAIR: Yes, but that does not go away; it is still there. Each budget is treated separately.

Mr Mann: We would need to take that as a supplementary—if we can provide some further information as to the rationale behind the reporting this year.

Mr Barnes: Chair, I think you are right. The accounting treatment should be that we show the gross sides of both the revenue in and then the expenditure out rather than just showing the net zero. I think the answer is that the budget implicitly assumes that the operating payments will be offset by revenue, hence a nil net financial impact. We should show both sides of that. We are not yet ready to do so in this budget largely because negotiations around the operation of the stadium are ongoing, so those revenue estimates are yet to be firmed up.

The CHAIR: Are you saying that it is not there because of commercial confidentiality arrangements?

Mr Barnes: I think that is part of the answer, is it not?

Mr Mann: It may be but I cannot definitively say.

The CHAIR: Assuming that it is under the basis of commercial in confidence that you have withheld it from the budget papers, can you tell me where in the budget papers it makes reference to that in accordance with the requirements of the Government Financial Responsibility Act 2000?

Mr Barnes: I cannot point you to any such statement.

The CHAIR: Can you also point me to the section 82 certificate that you have lodged with the Auditor General to say that you have withheld information from Parliament because of commercial grounds?

Mr Barnes: No.

The CHAIR: Why not? There are clear rules around the preparation of budgets. There is provision for you to maintain confidentiality for commercial reasons but there has to be a statement to the effect that, somewhere in the budget papers, that is what you have done.

Mr Barnes: To trigger section 82 of the FMA, somebody has to ask the question and somebody has to then say, “We can’t provide it because it is commercial in confidence.”

The CHAIR: No. You have withheld information that should have been provided to Parliament. If you have taken the decision to withhold the information because it is commercial in confidence rather than follow the normal accounting treatments, I would have thought there would be a statement, firstly, in the budget papers that that is what you have done and, secondly, a section 82 certificate for the Auditor General to verify whether that is appropriate.

Mr Barnes: Chair, as I said, I cannot point you to any such statement in the budget papers.

The CHAIR: You tell us that you are making the assumption that the revenue from the stadium will be sufficient to meet the ongoing operational payments. Can you tell me what has significantly changed since the Major Stadia Taskforce did its financial modelling that indicated that you could only achieve that if you had a single stadium policy in Western Australia and also at that stage the competing stadiums, such as Subiaco, being closed? What have been the material changes? We now have a two-stadium policy in Western Australia. As far as I am aware, we have no agreement yet with the West Australian Football Commission to close Subiaco as a venue. How do we arrive at the assumption that revenue will be able to meet operational costs?

Mr Mann: My understanding is that what we are assuming now is exactly consistent with the Major Stadia Taskforce in that life cycle replacement costs and maintenance costs would have been recovered from revenue, certainly not capital costs, and no contribution to an ongoing sinking fund. I would need to review that.

The CHAIR: Was that not if you had a single stadium policy?

Mr Mann: No; in respect of the two-stadium policy, which was the recommendation of the task force. I would need to review that but I think the current assumption is consistent.

The CHAIR: That also assumed Western Force using it. The Major Stadia Taskforce, under the single policy, assumed that Western Force would be using it. Are we likely to see it moving to the major stadium? I have not heard of any suggestion. I am not even aware of you negotiating with it to move there.

Mr Mann: No. We would assume that provincial rugby games would be played at our dedicated rectangular sports stadium. Major rectangular sports internationals et cetera will be played at the major stadium.

The CHAIR: Maybe you could provide as supplementary information a reconciliation between all the revenue assumptions that were made with the Major Stadia Taskforce and what is now the current situation. If assumptions were made that provided revenue had been taken off, if you can indicate to us where you expect to find alternate revenues to make up for that loss of revenue.

Mr Mann: I understand.

[*Supplementary Information No A4.*]

Hon PETER KATSAMBANIS: Just on the stadium contract and the ongoing maintenance payments, they are an obligation, correct me if I am wrong, from the government to the organisation that is building the stadium.

Mr Mann: That is correct.

Hon PETER KATSAMBANIS: There will be a separate agreement between the government and an operator of the stadium for a payment that will include recoupment of those ongoing costs. Is that correct?

Mr Mann: Essentially. The revenue will flow from the users of the stadium. The hire charges for the users of the stadium are managed by the operator under an operator agreement. Those revenues then would meet the contractual payments made by the state for maintenance.

Hon PETER KATSAMBANIS: Throughout the entirety of the period of these agreements, that would create some form of contingent liability on the state that ought to be recognised within the budget papers, ought it not, given that you are relying on one agreement to provide the revenue for a completely separate agreement?

Mr Mann: Going back to the discussion we had earlier, it certainly was recognised as that in the 2014 papers. We agree to undertake a review and confirm why there is an apparent inconsistency in the reporting this year.

Hon PETER KATSAMBANIS: I look forward to seeing it next year.

[*Supplementary Information No A5.*]

The CHAIR: Are you saying that part of the contingent liabilities of this budget include the contingent liability or has it now been removed from the contingent liability because of this budget?

Mr Barnes: We have not updated the contingent liability for the stadium, as far as I am aware. Whether we still have an amount in there for the stadium, we would need to check. We will pick that up as part of the answer to A5.

Hon RICK MAZZA: On page 11 of the midyear review, you refer to the payroll tax changes, so the threshold going to $850 000 has been delayed by 12 months from 2016 to 2017. There is now a clawback mechanism so as they rise through the different thresholds up to $7.5 million; the threshold effectively gets extinguished at $7.5 million. I have a couple of questions. Firstly, why in the midyear review were both those mechanisms not reported?

Mr Barnes: Sorry?

Hon RICK MAZZA: They have not been separated in the midyear review commentary on it. All you have said is that there is a change to the payroll tax. You have not separated those two things. I do not have a calculator with me now but it would seem that someone who had a payroll of say $3.5 million to $4 million might be paying a higher percentage rate on their marginal employees than someone at $7.5 million.

Mr Watson: In terms of the midyear review treatment—I do not have that document here—my understanding was that both referred to the deferral of the increase in the exemption threshold and the clawback of the exemption threshold—two measures. I should point out that that deferral of the exemption threshold increase was subsequently not proceeded with. So, in the legislation that recently went through Parliament, that only implemented the clawback of the exemption threshold.

Hon RICK MAZZA: So the $850 000 will be effective from 2016?

Mr Watson: That is correct.

Mr Barnes: That was announced in the 2015–16 budget and is referred to on page 93 of budget paper No 3, where it states —

> The Government will now proceed with the original timing of 1 July 2016 …

So that is the threshold increase to $850 000.

Hon RICK MAZZA: That is a small concession for payroll tax.

Mr Barnes: If you are trying to separate the revenue impact of the two measures. In the midyear review, the 12-month deferral of the increase in the exemption threshold, which is now not proceeding, was estimated at the time to save around $21 million. I do not have the midyear review in front of me, but whatever revenue impact is stated in the midyear review, $21 million of that was for the 12-month deferral of the threshold increase.

Hon RICK MAZZA: Getting back to the first part of my question, is it right that if someone has a payroll of $3.5 million to $4 million, their marginal employees would be paying a higher percentage rate than someone with a payroll of $7.5 million?

Mr Barnes: Because of the phase-out of the exemption threshold?

Mr Watson: That is correct.

Hon RICK MAZZA: You say there is a revenue increase of some $418 million. Is that based on the current wages and salaries in Western Australia, and other states as I take it? Is that based on current figures? Has any modelling been done on what reduction in employees there may be through increasing the payroll tax?

[10.45 am]

Mr Barnes: No. In that case we would not have assumed any behavioural response. As at the midyear review, that costing would have been based on the current estimated payroll of liable employers, with no assumed behavioural response, which is generally our typical assumption when it comes to costing revenue measures.

Hon RICK MAZZA: So, it is quite possible there could be a reduction based on the fact that people are reluctant to put on more employees because they might be up for more payroll tax?

Mr Barnes: I could not comment. The only comment I would make though is, from memory—I do not have the midyear review in front of me—the full phase-out of the exemption threshold —

The CHAIR: A copy has been passed to you. Someone has a copy of the midyear review there, I think.

Mr Barnes: — had a maximum impact of about $44 000 and that was only for firms above that $7.5 million threshold. For firms of that scale, my view would be that a $44 000 increase in their payroll tax liability is not that significant and I would not expect that it would have a large behavioural impact in terms of their hiring intentions.

Hon RICK MAZZA: That would be at $7.5 million, but maybe some of the smaller ones at, say, three or four could affect them?

Mr Barnes: Yes, but again, the dollar amount on those would be substantially less than $44 000, so it is a maximum impact of $44 000 for large firms at or above a $7.5 million payroll. For firms with, say, a $3 million payroll, the dollar impact would be substantially less than the $44 000. I do not have that scale in front of me.

The CHAIR: I want to double check before we go too far away from the major stadium and the assumptions on revenue. Did the assumption that you will be able to break even in the revenues to the ongoing annual payments continue to assume that all the sporting codes will be better off at the stadium than they are in terms of their financial arrangements? That was one of the key assumptions done in the modelling for the major stadium task force. Is that still assumed?

Mr Mann: There is no such commitment in the current negotiations.

The CHAIR: Your assumption on making revenue match payments is potentially at the expense of the sporting codes in Western Australia, unlike the assumptions in the original task force modelling.

Mr Mann: The government has made no commitment that the sporting codes would be better off. That said, the government has made a very firm commitment to ensure that the sporting codes are sustainable and successful and, obviously, final arrangements will have due regard to the nature of any existing arrangements in the revenues they enjoy through those existing arrangements. There is no commitment that they will be better off. It is certainly our intention that they would be; whether that is achieved is another matter.

The CHAIR: You said that you had made the assumptions that the revenue for the stadium would match the outgoing payments and I am asking: in developing those assumptions, is there still an assumption that the sporting codes will be better off or does it assume that they may have a loss in revenue for you to achieve the assumptions you have made in terms of ongoing revenue?

Mr Mann: To fully answer that question, I would start testing the bounds of the confidentiality of the current negotiations. So I reiterate, one, there is no commitment by government that the codes will be better off. The government has, however, strongly committed to their ongoing sustainability and success. It will certainly be our intention and desire that they are financially better off. The second part of the answer to that question is that “better off”, of course, is more than just financial outcome and profitability. There are other benefits of moving to a new facility and moving away from the liabilities, for example, associated with a very ageing and substandard facility that parts of Subiaco are now that are more than just purely financial benefits.

The CHAIR: You raised the issue there and, obviously, one of the issues in the past has been the impact on the financial solvency of the Football Commission and the current stadium at Subiaco in terms of its book value held for it and what happens if that is written off as a result of a move to a new stadium. Is that part of the current ongoing negotiations to resolve that potential issue for them?

Mr Mann: It is a separate discussion with the Department of Sport and Recreation which the stadium team is not directly involved in. It is certainly being addressed and it is an important consideration.

The CHAIR: It is pretty material to getting an agreement on the stadium I would have thought.

Mr Mann: Absolutely. But there is some uncertainty about the Football Commission’s future and the stadium operator process currently underway that is being dealt with separately by Sport and Recreation.

The CHAIR: My apologies for interrupting. Hon Martin Pritchard, would you like to have your first go at estimates?

Hon MARTIN PRITCHARD: Thank you. As the Chair indicated, this is my first opportunity. I want to raise an issue that is quite close to my heart with regard to my history, being from the union movement. In budget paper No 1, page 7, the minister talks about the wages policy for public sector workers. Can you tell me what the policy is and how it was derived?

Mr Barnes: The current wages policy for the public sector is to cap wage and conditions increases at projected growth in the Perth consumer price index. The policy is quite simple. How it was derived—through a decision of cabinet.

Hon MARTIN PRITCHARD: Any particular quarter with regards to where it was capped?

Mr Barnes: The policy came into effect from November 2013. As an EBA comes up for renewal, the policy is based on the most recent published CPI forecast, usually in the budget or the midyear review in December. It depends on which stage in the year an EBA comes up for renewal. If an EBA came up for renewal in June, for example, the policy would require that increases under that EBA be capped at the CPI forecast in the May budget.

Hon MARTIN PRITCHARD: There was a recent decision of the Western Australian Industrial Relations Commission with regards to health salaried officers, which exceeded that. You might refer me somewhere else for this but I was going to ask: I spent a lifetime listening to the independent umpire—the commission—and it was suggested within the speech that this was an unsatisfactory outcome; an unfair outcome. On what basis would that have been seen as unfair or unwarranted if it was determined by the independent umpire?

Mr Barnes: I do not have the budget speech in front of me but, from memory, the statement was simply that it was an outcome in excess of the government’s wages policy given that the increases awarded by the Industrial Relations Commission were in excess of the CPI forecast.

Hon MARTIN PRITCHARD: I think the same speech went on to suggest that the Department of Health would then need to make cuts to compensate for that. Would you have any idea of what cuts they are determining to make?

Mr Barnes: No, I do not. From memory the quantum of the above CPI increase awarded by the Industrial Relations Commission was $96 million across the forward estimates period. The Department of Health has been directed to absorb that cost from within its current budget parameters. Exactly how it is going about doing that would need to be asked of the Department of Health itself.

Hon MARTIN PRITCHARD: Can I ask what other agreements since that policy was introduced may have exceeded?

Mr Barnes: As far as I am aware—correct me if I am wrong—every other EBA since the policy came into effect from November 2013 has been settled at CPI, consistent with the policy.

Hon MARTIN PRITCHARD: Thank you.

Hon MARTIN ALDRIDGE: I have some general questions around the budget. Can you remind me what the date was for closure of the preparation of the budget papers?

Mr Barnes: It was 21 April, which I remember very well because it was both my birthday and the date I was appointed to the Under Treasurer role.

Hon MARTIN ALDRIDGE: Congratulations on both accounts.

The CHAIR: Two out of three ain't bad!

Hon MARTIN ALDRIDGE: With respect to significant changes, I remember last year when we had our state budget—was our state budget last year prior to the federal budget?

Mr Barnes: Yes, it was.

Hon MARTIN ALDRIDGE: We had a number of significant changes as a result of, I guess, outcomes that we discovered in the federal budget and I guess this time we had our federal budget a week prior to the state budget, so those changes would not have been reflected in our budget papers or the appropriation bills.

Mr Barnes: Correct.

Hon MARTIN ALDRIDGE: Can you identify the significant changes that have occurred since that close-off date of 21 April and where we stand today, particularly in relation to, I guess, outcomes of the federal budget and the announced cash injection from the federal government of $499 million?

Mr Barnes: The single biggest change since our budget cut-off date of 21 April was finalisation of that agreement with the commonwealth on the additional $499 million of funding for road projects. That $499 million was designed to offset the reduction in our GST relativity from 0.376 in 2014–15 to 0.3 in 2015–16. That agreement was finalised after 21 April, so it is not reflected in the numbers in our budget. We may have finalised last week the agreement with the commonwealth and we expect to receive that funding this week, I believe.

Hon MARTIN ALDRIDGE: We will receive all of the money this coming financial year?

Mr Barnes: This current financial year, 2014–15, yes.

Hon MARTIN ALDRIDGE: When will we spend the money?

Mr Barnes: The money will be spent in accordance with the construction time frames of those, I think, nine road projects, from memory, that make up the $499 million. We will receive the $499 million by 30 June—I believe this week. We will put that $499 million into a special purpose account—basically bank it—and it will be spent along with the state's own funding contributions on those projects as and when required.

Hon MARTIN ALDRIDGE: That will be over a number of financial years I expect.

Mr Barnes: Yes; correct.

Hon MARTIN ALDRIDGE: Did the $499 million directly offset projects we had already committed to and had already placed in our budget papers; that is, there were no new projects as a result of the $499 million?

Mr Barnes: There was, from memory, nine existing and approved projects already in our forward estimates. That $499 million will come straight off the state's net debt position.

Hon MARTIN ALDRIDGE: You mentioned that the agreement for that money has been finalised in the last week. Were there any conditions on that funding agreement for other economic reforms in Western Australia?

Mr Barnes: No.

Hon MARTIN ALDRIDGE: So it was purely an agreement between the state and commonwealth to receive funding for these nine road projects?

Mr Barnes: Yes. The only condition, if you like, was that that money be spent on those identified road projects.

Hon MARTIN ALDRIDGE: Are there any other significant changes as a result of the federal budget that will have a significant impact on the appropriation bills before Parliament?

Mr Barnes: That is by far the biggest change. There are a few other changes, mainly of a parameter nature rather than a policy nature. The Treasurer has undertaken to table in Parliament Treasury's analysis of the impact of the commonwealth budget on the state budget. I do not believe he has done that just yet but will be doing so imminently. I might leave it to that if I can.

Hon MARTIN ALDRIDGE: This week is probably his last opportunity. Does anyone have any questions on that line of questioning?

Hon ALANNA CLOHESY: How were those projects identified?

Mr Barnes: They were identified in negotiation with the commonwealth. This was a bilateral negotiation between WA and the commonwealth. Treasury and Main Roads identified those projects where they were already approved and reflected in the state's forward estimates and where the commonwealth's funding contribution was currently below 80 per cent and the $499 million is designed to get the commonwealth's funding contribution up to 80 per cent on each of those nine projects. That was the proposal that WA came up with. We submitted that to the commonwealth and the commonwealth accepted it.

Hon ALANNA CLOHESY: The nine projects were part of the Main Roads 2014–15 strategic plan?

Mr Jones: They would be, given they were already committed projects.

Hon ALANNA CLOHESY: The idea was to pick nine out of that whole strategic plan. Do you know how those nine were identified out of the 2014–15 strategic plan?

Mr Barnes: No. They were identified by Treasury and Main Roads primarily based on the commonwealth's current funding contribution. The commonwealth is already funding 80 per cent of the cost of some road projects already approved in the forward estimates. These nine projects fit the bill in getting the commonwealth's funding contribution up to that maximum 80 per cent, if you like, and adding up to the required dollar amount, being the $499 million to offset the reduction in the GST relativity. They were the two key criteria that Treasury and Main Roads used, one, getting up to 80 per cent for the commonwealth funding contribution and, two, coming up to the dollar amount that added up to that required $499 million.

Hon ALANNA CLOHESY: Out of the full range of the Main Roads 2014–15 strategic plan that is based on need, on risk and on safety, the nine projects that were identified were identified in order to make the commonwealth's contribution increase; so as a maths exercise, if you like, as distinct from a safety exercise?

Mr Barnes: Yes.

Hon MARTIN ALDRIDGE: We already had prioritised them in our state budget.

Hon ALANNA CLOHESY: It was really just to bring it up to the 80 per cent rather than saying that this project is more of a priority than this project?

Mr Barnes: We did not undertake any sort of prioritisation, if you like, from a safety or any other perspective because we looked only at projects already approved and funded in the forward estimates.

[11.00 am]

Hon ALANNA CLOHESY: There were more than nine in the forward estimates.

Mr Barnes: Yes, of course, but a lot of those are already at that 80 per cent commonwealth funding contribution so the commonwealth would not —

Hon ALANNA CLOHESY: What percentage were not at the commonwealth—80 per cent?

Mr Barnes: I cannot say, but these nine would have been the vast majority of them.

Hon ALANNA CLOHESY: Can I take that on notice?

Mr Barnes: Sure.

[*Supplementary Information No A6.*]

Hon PETER KATSAMBANIS: Whatever mechanism was used to get to the $499 million, that was essentially an agreement to stave off the reduction in the GST relativities?

Mr Barnes: Correct.

Hon PETER KATSAMBANIS: Is that now considered to be a one-off or is there a possibility that that could happen again in subsequent years?

Mr Barnes: The discussions and negotiations with the commonwealth have clearly indicated that on our current projections WA will be in a similar boat next financial year. Our GST relativity in 2016–17 is still below the 37.6 per cent that it is for this current financial year, 2014–15, so we have indicated to the commonwealth that like the commonwealth has done for 2015–16, where they have, through this road funding mechanism, effectively maintained our GST relativity at the current 37.6 per cent, we will be coming back to them again next year seeking a similar negotiated outcome to effectively maintain our relativity at the current 37.6 per cent.

Hon PETER KATSAMBANIS: What sort of time frame would we be looking at to conclude that sort of discussion?

Mr Barnes: I would expect the same time next year.

Hon PETER KATSAMBANIS: The same time.

Mr Barnes: Probably through the COAG process.

Hon PETER KATSAMBANIS: On a more overarching scale to fix this issue, so we are not going cap in hand every year, I notice on page 583—which is part of “Significant Issues Impacting the Agency”—there is a discussion about Treasury’s involvement with commonwealth federation and taxation white papers. It talks about Treasury devoting its expertise to helping ensure that Western Australia has a strong input into those two processes that are running almost parallel. It discusses reform of the GST distribution process for fairness and efficiency. What specific areas of the GST distribution process would Treasury be looking at recommending change?

Mr Watson: The federation and white paper process, which is being led by the Department of the Premier and Cabinet in terms of the working party involved in the states and the commonwealth, unlike the methodology review that the CGC just completed and reported on earlier this year, is an opportunity to make the case for fundamental reform of the GST distribution process. The state has a position of wanting to move to an equal per capita grant over the longer term. In terms of what we might also pursue through the white paper process, it might be a transition towards an equal per capita grant in the long term via an increasing floor over time. The current arrangement with the commonwealth, which gives us the extra $499 million, in effect that is establishing a floor of about 37.6 per cent in terms of relativity, so an argument could be made in terms of moving to an equal per capita share and increasing that floor as our relativity increases over time, which it is projected to do. It will get up to around 60 per cent relativity by the end of the forward estimates period based on the recent falls in iron ore prices and the resulting fall in royalties.

Mr Barnes: If I can add to that, there is a raft of potential reforms in the spectrum of potential reforms ranging from sticking with the current system and the current methodology but making changes within that—I will come back to that in a minute—to effectively abolishing the Commonwealth Grants Commission process and shifting to an equal per capita sharing of the GST pool with some special arrangement for the current recipient states. In argument of the second option, I would make the point that the GST currently raises approximately $56 billion a year in revenue and only about $6 billion or $7 billion of that is currently redistributed through the Commonwealth Grants Commission process. The other $50 billion is effectively already distributed on an equal per capita basis. When you have a look at all —

Hon PETER KATSAMBANIS: An unequal per capita basis.

Mr Barnes: Yes. When you have a look at that quite small proportion of the total GST pool that is the subject of all of this time, effort and expense that we go through with the Commonwealth Grants Commission process to achieve outcomes that, frankly, no-one is happy with, there is a fair bit of ammunition there for a fundamental overhaul of the system. At the less ambitious end of the spectrum, if we are stuck with the current system and the current methodology, our key issues remain what we believe is inadequate recognition by the grants commission of the cost of economic development, both infrastructure costs and ongoing recurrent costs. We do not believe they are adequately recognised. We have put forward various options to deal with that, including a discount of up to 50 per cent on the mining revenue assessment. The grants commission is so heavily data driven, they have always complained that they do not have sufficient data to accurately measure the cost of economic development. If that is the case, our argument is apply a discount to your mining revenue assessment, so discount the amount that you redistribute from WA because of our higher capacity to raise mining royalties, which they do in other categories. They have not accepted that argument either. There are areas within the current system and the current methodology where we will continue to argue the case and at the same time we will argue some of those more ambitious reforms that I mentioned as well. In between those two extremes, there are other options such as setting a floor on the relativities of 75 per cent, for example.

Hon PETER KATSAMBANIS: I am on record as saying that I think the entire basis of using the Commonwealth Grants Commission for this GST distribution process is flawed and well past its use-by date. I hope we get to that stage one day. In relation to the broader issues that are discussed around changes to GST, does the state have a position in relation to things like either the base or the rate of GST?

Mr Barnes: That is probably a policy position to be asked of government, I think.

Hon PETER KATSAMBANIS: Do we have any indication of what the total additional amount would be if, for instance, the base was broadened to get rid of the current exemptions?

Mr Barnes: I do not have a figure I can give you, but the commonwealth put out a discussion paper on tax reform several months ago. In that discussion paper it did highlight that the coverage of Australia's GST base is very low by OECD standards because of the various exemptions that are in place. I cannot remember the figure, but it was very low compared to other international jurisdictions.

Hon PETER KATSAMBANIS: From a Western Australian perspective any broadening of the base would mean that we would be missing out on more of the additional income at the same rate as we are missing out now if the Commonwealth Grants Commission relativities were not changed.

Mr Barnes: Yes. The state government's clear priority has been to try to fix, if you like, the distribution of GST revenue ahead of any arguments around a broadening of the base.

Hon PETER KATSAMBANIS: In relation to both federation and taxation, has any work been done on taxation areas outside of GST?

Mr Barnes: There is work going on around a range of taxes between the commonwealth and the state. The commonwealth's discussion paper that I mentioned earlier, that they released a few months ago, also canvassed state taxes, for example. The commonwealth is of the view that states in general underutilise their tax bases, particularly their land tax base but also their payroll tax base. That is an ongoing discussion we are having with the commonwealth, and all states are having with the commonwealth. The commonwealth is keen to see states utilise their own tax bases better than is currently the case.

Hon MARTIN PRITCHARD: Just on that, you mentioned earlier in your answer a number of decisions that nobody is happy with. Is the problem not that other states are happy with some of the decisions that are made and it is generally Western Australia that is not that happy with the decisions made? Is that not our problem, convincing other states to change the mechanism when there is no benefit in them doing so?

Mr Barnes: Essentially, that is the nature of the problem with the GST distribution; that it is a zero-sum game. If WA benefits by $1 billion, then all of the other states collectively will be worse off by $1 billion. That is the nature of the problem and why reform has, to date, proven to be so difficult. When I said no-one is entirely happy, if you asked every state whether they are entirely happy with the grants commission process, they would all say no. They would all identify what they see as problems or inequities with the current system.

The CHAIR: New South Wales, I think, have been consistent from the day the original agreement was signed. They tried to get our support back in 1999 for a per capita distribution of it and I do not think they have ever deviated from arguing for that in the 16 years since it was signed. Is not the fundamental issue here the fact that the whole GST agreement and its interrelationship with the Commonwealth Grants Commission that it actually reduced the number of own-source revenue streams that states had and more and more of our revenue is now dependent upon that distribution system rather than own-source revenues? Is not the ultimate real solution to go to a system where you get rid of the vertical fiscal imbalance and you have states, through their own taxation system, raising their own revenues and being in control of the income and expenditure of their own destiny?

Mr Barnes: I could not have said it much better myself, Chair.

The CHAIR: I do not hear that debate being made publicly any more. It was made very strongly prior to the 1999 agreement and then we ended up with an agreement that did the exact opposite of what was argued by both sides of politics in Western Australia prior to the signing of the agreement. I do not hear anyone arguing that it is about vertical fiscal imbalance and actually allowing states to have control over their own revenue streams rather than having a distribution system.

Mr Barnes: Treasury and Premier and Cabinet are pushing the issue of vertical fiscal imbalance through the federation white paper process. That certainly still looms large on our radar. We are pushing it as hard as we can. I have to say getting traction on vertical fiscal imbalance is not easy, largely because out there in the community I am not sure that it actually really resonates. It is proving difficult to get traction on that issue but we are still pushing it.

The CHAIR: Do you agree that the GST agreement sent us backwards in that way? It removed our capacity for own-source revenue streams. A whole range of state taxes may have been inefficient, but in doing so we removed options for generating our own sources of revenue.

Mr Barnes: Almost, by definition, it did, by abolishing those sorts of nuisance taxes like the bank accounts debits tax and the financial institutions duty. We did remove some of our own-source revenue items but they were, as you indicated, clearly inefficient taxes and, at the time at least, growth in the GST was meant to far outstrip growth in those abolished taxes. Whether that has proven to be the case or not may be arguable.

The CHAIR: If you do it on a national basis and collect up all of the inefficient taxes that all the states were collecting and all of the taxes that the GST has collected, I am sure the GST is well ahead. Our problem was our royalties went up faster than anything else.

Mr Barnes: Yes.

Hon PETER KATSAMBANIS: Certainly the cost of collecting the GST from a whole-of-government perspective is lower than all of those nuisance taxes including the various stamp duties.

[11.15 am]

Mr Barnes: I would expect so, given that the GST is collected centrally by the Australian Taxation Office, whereas all of those nuisance stamp duties were individually collected by the various state revenue offices—yes.

Hon RICK MAZZA: If the discussion is that we are under-utilising our state-based taxes, does that mean that on the horizon we are looking at increases in stamp duty and payroll tax?

Mr Barnes: Not necessarily.

Hon RICK MAZZA: Is that something you are looking at doing?

Mr Barnes: I think that is part of the argy-bargy between the states and the commonwealth. The states—for example, Western Australia has argued for quite a while, including in our submission to the National Commission of Audit, that the states should have access to a share of the personal income tax base to address the issue of vertical fiscal imbalance and to give us access to a predictable and growing tax base. The states have typically put the onus on the commonwealth and is saying, "Commonwealth, give states access to one of your good growth tax bases, like the personal income tax base." The commonwealth, I think, is keen to protect its own tax bases, and in so doing is trying to put the onus back onto the states and is saying, "Well, okay, you guys actually have some half decent tax bases yourselves; our concern"—the commonwealth—"is that you're not properly utilising those tax bases."

Hon RICK MAZZA: When the GST was sold 15 or 16 years ago there was a fair bit of emphasis on the fact that it would reduce state taxes, such as stamp duty. In fact, there was talk of abolishing stamp duty at one point, and here we are now: the commonwealth is suggesting that we should actually increase our state-based revenues.

Hon MARTIN ALDRIDGE: That is happening at the same time as it is criticising us about housing affordability.

Hon RICK MAZZA: In fact, I think one of the land councils put out something today that said that stamp duty was impacting severely on developers, transactions and that sort of thing, and holding back the amount of supply we have on the market, which affects affordability.

Mr Barnes: The commonwealth is clearly not talking about increasing stamp duty. It has acknowledged that stamp duty is a highly inefficient tax. It is talking more about land tax—annual land tax—and payroll tax.

The CHAIR: It is talking about the poll tax, effectively, because it is about broadening the base to include all land rather than land that is held for investment. That is the only way we could significantly enlarge the land tax base; so it is like the English poll tax of the 1980s.

Hon MARTIN ALDRIDGE: That is what they are doing in South Australia.

Hon PETER KATSAMBANIS: Yes; I was going to say that the South Australians are taking up that option.

Mr Barnes: The ACT is as well.

Hon MARTIN ALDRIDGE: Under Treasurer, you mentioned that you were seeking assistance from the commonwealth government in the 2016-17 financial year in a similar way we did this financial year. Based on the projected relatively, do you know what amount of money would be required from the commonwealth to maintain that 0.376 relativity?

Mr Barnes: It would be less than the $499 million. The $499 million was effectively the difference between this year's relatively of 37.6 per cent and the 2015–16 relativity of 30 per cent. In 2016–17 our current forecast is that our relatively will reach about 34 per cent. We will be seeking the difference between that 34 per cent and the 37.6 per cent, which will be something less than the $499 million.

Hon ALANNA CLOHESY: In budget paper 3 you outline a number of potential spending risks, in particular around health reform and population growth, but there were also some specific projects or issues identified that might affect the budget bottom line. One of those was the essential and municipal services to remote communities, in which the federal government had in the past made specific payments to WA for the provision of essential and municipal services—that was around $90 million—and that payment, as we talked about earlier today, stopped in October or September or sometime last year. In the budget papers you identified that that is obviously a potential risk and that some work was being done on identifying that if the state has to pick up those payments, what that cost will be. What work has been done on that since September or October last year to identify those costs?

Ms Gulich: There is ongoing work being done to try to identify the total cost of the expenditure in these communities. The national agreement in this space was around the funding that went mostly to the housing authority from municipal services: so identifying what the housing authority spends; what Horizon spends particularly on power supply in those communities; where the funding is spent; and which number of state agencies are involved and which number of commonwealth agencies are involved. It is really about an itemising exercise at this point. A lot is being run by the Department of the Premier and Cabinet and is part of that broader look of remote Indigenous communities.

Hon ALANNA CLOHESY: When did that work commence?

Ms Gulich: It has been ongoing for quite a while; about the time you mentioned—October last year—I would say.

Hon ALANNA CLOHESY: Once the decision was made, then the expenditure review thing started—the itemising started to happen?

Ms Gulich: It is ongoing work; yes.

Hon ALANNA CLOHESY: Was it from October last year?

Ms Gulich: I am not definitive on the time. It is something that we are closely involved in at this stage. As I said, it is data of the individual agencies, so it is probably more a question for either them or premier and cabinet.

Hon ALANNA CLOHESY: So Treasury is not involved in that itemisation process?

Ms Gulich: It is not involved at this point. There will be a point when we do become involved once the numbers firm up and once there is some analysis around them, but in terms of collecting the information, collecting the contracts that are in place, who pays what and when, and when we get to the point in time to look for where the efficiencies are in the contracting side of it and the expenditure side, we will be involved.

Hon ALANNA CLOHESY: At what point do you think you will become involved when you look for those efficiencies? How long will it be?

Ms Gulich: It should be later this year.

Hon ALANNA CLOHESY: What will be the impact on the 2014–15 budget if we do not find that out until later this year?

Ms Gulich: The 2014–15 recognises the receipt of the $90 million final payment from the commonwealth—so it has an actual favourable impact in 2014–15; that has been put into the special purpose account—and in 2015–16 $25.63 million has been approved to be drawn down against that $90 million to continue the ongoing service delivery whilst that work is underway.

Hon ALANNA CLOHESY: Would we be looking at that in the next midyear financial review?

Ms Gulich: It will be midyear and into budget I suspect, given that the funding position for 2016–17 ongoing is exactly what that risk is highlighting.

Hon ALANNA CLOHESY: One of the other spending risks identified was around the Square Kilometre Array project; $138 million has been committed to the project. There were other costs that are expected to be associated with that project around native title, around road upgrades and operational costs. Where are we at with identifying what those additional costs are? Also, can I get a sense of why those costs were not identified when the project was originally conceptualised and implemented, which is going back years now?

Ms Gulich: With regard to the first question, obviously these risks are cast as at 31 April when we closed down the budget statements. We identified a risk where the work is obviously ongoing but not definitive enough to be factored into the forward estimates. The risks here reflect that there is ongoing work. I am not too sure exactly when we will finalise those. A lot of it is around the land assembly, about the positioning of the physical infrastructure and the final agreements that the state and the commonwealth commit to in regards to the Square Kilometre Array project. There are still those negotiations—SKA projects.

Hon ALANNA CLOHESY: It is an excellent project. I love it!

Ms Gulich: I am not sure why the total costs were not envisaged at the time that the project was being conceptualised; that predates my time. The state has been assembling land in that area for quite a while and it has been positioning itself to be able to compete on the international market for this project, and the costs continue to become crystallised as the project evolves. Whilst there are still unknown costs, we will continue to have a risk statement of this nature in the budget papers.

Hon ALANNA CLOHESY: Can I get a project update on that? Can I take on notice the development of that project? I am particularly concerned about why some of those issues could not have been identified much earlier in the project development process and why they are only now being identified?

Ms Gulich: It is run through the Office of Science, as part of the Department of the Premier and Cabinet. It has a lot more detail on how the project is evolving and the point in negotiations now is defined in the project's scale and size.

Hon ALANNA CLOHESY: If I were Treasury, I would be saying, "Look, we knew these roads would be needed. Why haven't they been identified earlier and what are the costs?"

Ms Gulich: I think it is as much about the cost-sharing arrangement that is going to be in place with those roads as well. We are obviously negotiating with the commonwealth as much as the international community that funds the SKA in terms of who pays for what and what portion the state is actually liable for. Part of it is around the ongoing negotiation of the project.

The CHAIR: We will make that A7.

Mr Barnes: I think we were saying that that project update would need to be sought from the Department of the Premier and Cabinet, through its Office of Science which is running the project.

Hon ALANNA CLOHESY: If you are happy do that; I am sure you get them regularly.

Mr Barnes: Yes; they are managing the project anyway.

The CHAIR: Are you saying that you cannot provide it and we need to go elsewhere?

Mr Barnes: I think it would be better if the committee asked that of Premier and Cabinet.

The CHAIR: What I might do is make it A7, and if there is any information that you are aware of as an agency that you can provide us about the work you did on it —

Mr Barnes: We would be seeking a project update directly from Premier and Cabinet.

The CHAIR: All right.

Hon ALANNA CLOHESY: I wanted to go to some of the other planning assumptions that are in the budget papers—budget paper No 3—around tariffs. As part of the planning process, obviously the government identifies tariffs and fees and charges for services that are provided. I am referring to budget paper No 3, pages 304 and 305. A number of new fees are identified in the budget to be introduced and there are some existing fees which are below cost-recovery levels. Can I get a list of fees that are contained in the budget first of all, by agency perhaps?

Mr Barnes: Can I ask that be narrowed down, because there are literally thousands of individual fees and charges that Treasury does not have a central database for but are individual fees and charges.

Hon ALANNA CLOHESY: I am particularly looking at utilities costs to consumer-type fees.

Mr Barnes: Water and electricity?

Ms Gulich: We can refer you to appendix 8 on page 288 of budget paper No 3. Table 8.2 details the non-contestable tariff assumptions and increases for 2015–16 for electricity. The following page details the water tariffs. The page after contains the public transport assumptions. They are considered our major household tariff fees and charges.

Hon ALANNA CLOHESY: Which of those are being increased on the basis of the need to exceed cost recovery levels?

Mr Barnes: Electricity is clearly currently significantly below cost recovery, hence the need for an operating subsidy for Synergy and Horizon Power. I suppose that is the reason the 4.5 per cent electricity tariff increase is above the CPI rate. Similarly, water is currently below cost-recovery levels; so, again, we are looking at a 4.5 per cent increase in water tariffs in 2015–16, which is above CPI. Notwithstanding that public transport is also substantially below cost recovery—we only recover about 31 per cent of the operating cost of the public transport system through fares—we are looking at an across-the-board 2.6 per cent increase in public transport fees, which is in line with the reference rate of inflation.

[11.30 am]

Hon MARTIN ALDRIDGE: How much did you say we recover from public transport?

Mr Barnes: Through fares, we recover about 31 per cent of the cost of operating the public transport system.

Hon MARTIN ALDRIDGE: Is that statewide?

Mr Barnes: Yes.

The CHAIR: I want to go to the budget financial targets and your compliance with them. As far as I am aware, they are included in the budget papers because of a requirement of the Government Financial Responsibility Act.

Mr Barnes: Yes.

The CHAIR: The act outlines that we have to indicate if we intend to meet the target and if we are not, there is a range of issues that we are required to do to indicate when we expect to meet the targets. I particularly want to go to "maintain total net public sector net debt at or below 55 per cent of revenue". We will start with that one as the first target, because there is no year when we meet the target in table 9 on page 66 of budget paper No 3. Turning to page 70, there is an explanation of the impacts on our revenues in the 2014–15 financial year, but last year's budget paper No 3 also has a string of noes for that target in many of the years, and for the year before that it is a string of noes. When will we meet our target in respect of total net-debt-to-revenue ratio target—TNPS—at or below 55 per cent?

Mr Barnes: It will certainly not be within the current forward estimates period. I should note that as per the last paragraph on page 70, those projections do not include any provision for anticipated asset sale proceeds. The government announced a program of asset sales which we estimate to be worth somewhere in the range of $3.4 billion to $5.2 billion. There are no provisions in the forward estimates for those sale proceeds. We will reflect the proceeds only when the transactions are actually finalised. When those sale proceeds are received, they will come straight off net debt and reduce the net-debt-to-revenue ratio accordingly.

The CHAIR: What is the net loss of revenue from those asset sales? You just gave us what you expect to achieve in terms of the sale of the assets. What do we estimate will be the loss of revenue to the public sector as a result of the sale of those assets?

Mr Barnes: Substantially less than that, and that is part of the due diligence process. Assets will only be sold where the sale value is in excess of the retention value, and the retention value reflects effectively the net present value of the forgone income stream.

The CHAIR: What work have you already been done to identify that?

Mr Barnes: It is in progress.

The CHAIR: So we have made a decision to sell assets without doing even some exploratory work on whether we can sell them for more than they return.

Mr Barnes: If you check the wording of the budget speech, the decision is that the government will proceed to detailed due diligence for those identified assets. A big part of the detailed due diligence will be the assessment of the potential sale value versus the retention value of the asset.

The CHAIR: So we are exploring it as an option to bring down TNPS to below 55 per cent.

Mr Barnes: We will not sell an asset if the sale value is less than the retention value.

The CHAIR: What is our strategy if it turns out that that is not the case?

Mr Barnes: Again, that is a policy question for government.

The CHAIR: It is also a requirement under the Government Financial Responsibility Act. I draw your attention to section 11, which has implications for the Under Treasurer.

Mr Barnes: It sure does.

The CHAIR: Section 11 states —

> (2) A Government Financial Strategy Statement is to —
>
> (a) set out the Government's medium-term targets in relation to the financial element or elements relevant to each target;
>
> (b) explain how the targets are to be achieved;
>
> (c) indicate how the targets are related to the financial management principles;
>
> (d) contain a statement and summary under section 10(3), if required; and

(e) indicate the time frames proposed for achieving the targets.

I have read this year's budget papers, last year's and the years before, all of which had no, no, no, no, no, and I have not seen a statement that indicates the proposed time frames for achieving these targets. When are we going to achieve the targets?

Mr Barnes: The other part of the GFRA is that we are only required to produce four years of forward estimates, so the GFRA does not require us to produce estimates beyond the four-year forward estimates period.

The CHAIR: No, but it does require you to give a time frame for achieving your targets. I think that is a separate matter. You may not give us the forward estimates, but you should be able to say to us that you will achieve these issues. My sense is that even if you sell all those assets, you are still not going to get below 55 per cent, are you?

Mr Barnes: I do not know.

The CHAIR: So we do not know even with those asset sales whether we will achieve the target of 55 per cent.

Mr Barnes: All I can say to you at the moment is that within the four-year forward estimates period that we are required to report on under the GFRA, we are not meeting that target as was transparently indicated in the budget papers.

The CHAIR: I understand you are only required to report on four-year forward estimates, but separately under section 11(2)(e) you are required to indicate the time frames proposed for achieving the targets.

Mr Barnes: Sure. I guess what I am saying is that that needs to be read in conjunction with the four-year forward estimates.

The CHAIR: No, it is a standalone statement that you have to give us time frames. If it said that you should give us the forward estimates, it would say that. Clearly, Parliament wanted you to give us a time frame. If the legislation stated indicate over the forward estimates what will happen, it would be a different matter. That asks for time frames.

Mr Barnes: How can we give a time frame when we have no estimates beyond the forward estimates period?

The CHAIR: Because you should have a financial strategy. If you go back to the whole purpose of the Government Financial Responsibility Act, which is stated in the legislation —

(a) funding for current services is to be provided by the current generation;

…

(c) financial risks are to be managed prudently;

(d)spending and taxing policies are to be formulated and applied with consideration to the effect of these policies on employment and the economic prosperity of the State.

Mr Barnes: So your question is?

The CHAIR: Clearly the whole purpose of the Government Financial Responsibility Act is to not just look at a four-year snapshot of what is happening in government, but to ensure that what we are doing in that four-year period does not have implications for people into the future. That is why the statement in section 11 that you should give time frames does not limit you to telling us over the forward estimates what will happen. It clearly indicates that if you are not complying with your strategy, you are supposed to be able to explain to us how you will comply with your financial strategies and when you expect to—and that you should have a strategy for reaching those targets. That is what I am asking for: do you have a strategy in place to reach those targets; and, if so, by what year?

Mr Barnes: In terms of strategy, that is probably more a question for government because it goes down to government policy.

The CHAIR: I am not asking you to explain — to justify the strategy; I am asking: do we have a strategy? Does the government have a strategy for achieving those targets at some point in the future?

Mr Barnes: Clearly the government's strategy is number one, asset sales, and number two, containing growth in recurrent expenditure, particularly salaries expenditure. Currently they are the two major areas of focus. In terms of the time frame when those measures will see achievement of these financial targets, I cannot give you an answer other than beyond the current forward estimates period. The other point I would make is that we have liaised with the Office of the Auditor General in terms of whether the disclosure in budget paper No 3 meets the requirements of the GFRA. At officer level at least, the OAG advised that they are comfortable that it does meet the requirements of the GFRA. If the Auditor General himself has a different view, I am sure he will not hesitate to make that known. We have asked those questions of the OAG at officer level.

The CHAIR: I would have thought that having a proper strategy to achieve that is a fairly fundamental issue—having asset sales that you have not even completed your due diligence to work out whether they provide a net return. As part of that due diligence, when you make an assumption about selling those assets, what assumptions will be used in terms of the revenue streams from those assets? For instance, every port authority that has been sold around Australia has seen significant increases in the fees charged to the end users of that port. It is somewhere in the order to 600 per cent to 800 per cent in many cases in states where ports have been leased or sold. When you do your due diligence, will you do it based on the current revenue streams achieved out of those ports or the potential for the private sector to increase the fees and charges and therefore if we were to do the same, what the benefit to the state would be relative to selling that asset?

Mr Barnes: That analysis would certainly be done on the basis of the current revenue streams that the ports are earning in accordance with the government's rate of return requirements on the port authorities, because effectively that is the opportunity cost of selling the asset, and that is what we are trying to measure.

The CHAIR: Are we not then just selling an asset for someone else to increase the fees and charges by 600 per cent or 800 per cent. We might have been able to increase them by 300 per cent and still got more out of the asset than if we had sold it. It is a better deal for the state taxpayer to have that money going into paying down the debt that has been left to them, than it is to sell the asset and allow someone else gain that benefit.

Mr Barnes: I will ask Mr Mann whether he wishes to add anything.

Mr Mann: Only that the key policy decision will be the extent to which tariffs and fees are regulated. That has been a key issue in some of the sales that you have alluded to previously. That is a significant consideration. The second is for the private sector to be able to invest in the asset, whereas the government would find it difficult to make that investment, which would contribute to increased efficiency of the asset thereby also driving down costs.

The CHAIR: Why would the government find it difficult to make the investment when the private sector does not? If there is a sound business case, why would the government not make that investment?

Mr Mann: The private sector may well have investment capital available that the government, particularly in the current circumstances, does not.

The CHAIR: Is the government's real debt problem at the moment in the general government sector not the non-financial public sector where the assets are held? The growth area of debt is in the general government sector with the ongoing operational costs of government, is it not?

Mr Barnes: General government debt is growing—there is no doubt about that—but the largest stock of debt remains in the public corporations. Our single largest chunk of current debt is held by Western Power.

The CHAIR: But in terms of total, next year the general government sector overtakes the non-financial public sector for the first time in WA's history, does it not?

Mr Barnes: No doubt it is growing.

The CHAIR: According to your budget papers it overtakes it, does it not?

Mr Barnes: I cannot recall the exact numbers, but we can quickly find that out. Total public sector net debt at 30 June 2016 is estimated to be $31 billion in round terms. The general government sector component of that is estimated to be $19.2 billion. So that is $19.2 billion out of $31 billion. Yes, you are correct, Chair—by the end of the next financial year, the stock of general government debt is expected to exceed the stock of debt held by public corporations.

The CHAIR: If you look in terms of the relative size of the economy compared with where we were seven years ago, as a percentage of the economy, the total non-financial public sector debt is probably equal to or less than where it was seven years ago. The big growth category of debt has been in the general government sector.

Mr Barnes: Yes.

The CHAIR: Is the debt for the stadium incorporated into that net debt figure or is that now treated as an operating cost?

Mr Barnes: No, that is reflected in the net debt figures. A finance lease is a debt liability.

The CHAIR: So it does get reported. Will the PPP for schools be included in the net debt figure?

Mr Barnes: Yes, it is the same treatment.

[11.45 am]

The CHAIR: And the railcars, when they are purchased on hire purchase?

Mr Barnes: They should get the same treatment as a finance lease.

The CHAIR: Traditionally, because we build four new schools every year in a growing economy, and next year we will build at least four primary schools, and the year after we will build four primary schools, should primary schools be built out of operating costs, not debt and transferring the liability to future generations? We are not effectively carrying any past debt for the construction of primary schools. It is not like the port, which might last for 100 years. In a growing economy—the state government is still planning on 3.5 million population for Perth—that means that each year we will be buying and building a block of new schools. How do we justify transferring that cost to future generations by way of debt rather than picking them up as a cost in today's budget?

Mr Barnes: I guess the simple answer in the current environment is that the operating revenue has dried up, so the only source of funding has effectively become debt. From last year's budget to this year's budget, we have had to revise down the general government revenue estimates over four years by $10.2 billion, which is driven primarily by the iron ore price. So, with that quantum of revenue evaporating and the requirement to build schools and other infrastructure of that nature still present, there is no alternative other than to debt fund that infrastructure.

The CHAIR: Are we not better off, then, trying to look at those assets in that total non-financial public sector, and how we can potentially increase their returns to the state via payments in the way of dividends and the like, rather than necessarily selling them off—I do not see that there is much work being done on what that is—and still keeping the total cost to the consumer in Western Australia below what it otherwise might be if you sell the assets?

Mr Barnes: From our point of view, Chair, I guess our work program has been determined by cabinet, and cabinet has made a policy decision that it wants us to investigate the sale of these assets, including Fremantle port, so that is what we are doing.

The CHAIR: And part of that work does not include examining those other options of keeping the assets and increasing their rate of return to the state, but still maintaining it below what the private sector might seek to achieve from that asset. That is not part of what you are doing at the moment.

Mr Barnes: Effectively, that is right, so our analysis will be a comparison of the sale value with the retention value, and the retention value will be based on the forgone income stream to the state, which in turn will effectively be business as usual.

The CHAIR: I do not expect you to provide views here, but I will certainly make the statement that in my view that is very sloppy analysis, but I understand that that is what you have been directed to do.

In terms of the rating agencies, if we were borrowing money to expand a port that provides for the long-term economic benefit of Western Australia, would they treat that differently to the way they would treat debt in the general government sector?

Mr Barnes: Moody's ratings agency certainly does. Moody's make a distinction between what they call self-supporting debt, which is effectively the debt you are referring to in the public corporations sector, where the public corporations can service that debt through user charges, so they do make that distinction. Standard and Poor's tend not to make that distinction.

The CHAIR: So it is the old argument about good debt versus bad debt.

Mr Barnes: Yes.

The CHAIR: That is why I would have thought that the capacity for us to borrow the money, so long as there is a sound business case underpinning it, is still valid for the non-financial public sector. I would have thought there would be some ongoing concerns if we continue to ramp up the general government sector debt.

Hon MARTIN PRITCHARD: Earlier you were talking about recovery with regards to transport and such. I note that in budget paper No 1 on page 6, the government made a commitment to extend free public transport for seniors, aged and disability pensioners, and carers, between 7.00 pm and 6.00 am. I can find on page 804 of the *Budget Statements* the cost for student fare concessions but I cannot find anything that would suggest what the current policy during the day costs and what extending the concessions to the hours between 7.00 pm and 6.00 am costs. Do you have any idea?

Mr Barnes: We will take the second part of that question first, which is the extension from 7.00 pm to 6.00 am. That was a decision of cabinet that was made after the 21 April cut-off date for the budget, hence it is not reflected in these budget papers, though it was mentioned in the budget speech that you read out. In terms of the first part of your question, which goes to the cost of the current concession —

Hon MARTIN PRITCHARD: It is more the second cost I am looking for. Do you know what extending that service costs?

Mr Barnes: We do not, but we expect it will be negligible. The decision was made on the basis that no further operating subsidy would be provided to the Public Transport Authority for the cost of that service.

Hon MARTIN PRITCHARD: So they absorb it?

Mr Barnes: They do.

Hon MARTIN PRITCHARD: Was it thought that it would be little used?

Mr Barnes: That is my assumption.

Hon MARTIN PRITCHARD: Anecdotally, I agree with you. Between 7.00 pm and 6.00 am I cannot imagine too many jumping on trains at nine or 10 o'clock at night.

Mr Barnes: In the context of the total operating subsidy that we provide to the Public Transport Authority, which is getting up to $700 million to $800 million a year, the cost of this extension will be negligible in that context.

Hon PETER KATSAMBANIS: I am sorry that we are going back, but Mr Mann said earlier about the stadium that the contingent liability in relation to the ongoing management expenses of the stadium were reflected in the 2013–14 budget papers, or the report on state finances.

Mr Mann: My recollection is that there was an explanatory note in the 2013–14 budget papers. We will address that in the relevant question.

Hon PETER KATSAMBANIS: If you could. There would be no point in taking it on separately, but in that A3, A4 and A5, if you could include a specific pointer to that, I would appreciate it.

I have one other area of questioning, if that is okay. In relation to some of the savings measures identified on page 583, there is the agency expenditure review, where the first stage savings of $137 million, which is good—I am supportive of that—are reflected in the budget that was recently tabled. Could you give us an idea of some of the "highlights" of that $137 million in savings.

Mr Barnes: Yes, I will ask Mr Court to comment on that.

Mr Court: In terms of this initiative, eight agencies were asked to identify savings that would meet a target based on either 1.5 per cent or 3.5 per cent of their expenditure. In six of those agencies, the government approved the measures that were in place to deliver the $137 million, and two agencies have gone through to do some further analysis as part of a second stage. Each of those six agencies—the Department of the Attorney General, the Department of Agriculture and Food, the Department of Commerce, the Department of Fisheries, the Department of Training and Workforce Development and the Department of Parks and Wildlife—has identified the programs where they are going to achieve those savings in their budget statements, so there will be a line item in their recurrent spending changes table in the statements. For example, commerce was achieving savings across a number of its businesses—the Building Commission, consumer protection, EnergySafety, industry and technology and labour relations—so if you were to go through the budget statements for each of those six agencies, you would find a line item for the savings.

Hon PETER KATSAMBANIS: That line item would say it was part of the agency expenditure review?

Mr Court: Yes.

Hon PETER KATSAMBANIS: Who sits on the independent governance board?

Mr Court: That is the other two agencies that were asked to do the second stage reviews, so that is the Department of Finance and the Department of Culture and the Arts. The government has appointed an independent chair, Mr David Tune, an ex-commonwealth public servant, who is heading up these reviews, and the project board that he is chairing for both of those includes the director general of the department, an executive from Treasury, an executive from the Department of the Premier and Cabinet and the Public Sector Commission, and another peer from across the public sector.

Hon PETER KATSAMBANIS: Is there any sort of projected target for the savings that are expected to be generated?

Mr Court: They will still be required to achieve, in the case of finance 3.5 per cent, and for culture and the arts 1.5 per cent, reflecting the financial circumstances each department is in.

Hon PETER KATSAMBANIS: And they are the only two agencies at the moment at that second stage?

Mr Court: Yes.

The CHAIR: In the public financial corporations in the balance sheet, it shows the net surplus for the public financial corporations increasing over the forward estimates at well above the rate of inflation, and in the final year by just under 10 per cent. I refer to page 227 of budget paper No 3. Traditionally, that debt grows quite slowly. I am trying to understand that. Is that in part because of the no-fault insurance that will see larger sums of cash held by ICWA that will be seeing the surplus funds grow?

Mr Barnes: Yes, that is correct.

The CHAIR: The surplus held there is reducing the total public sector debt. If we were not seeing that growth in the ICWA retained earnings for the third party insurance, that debt would not be reducing by quite as much in that final year of the forward estimates.

Mr Barnes: Yes, that is correct. There is a feature box on page 58 of budget paper No 3 that highlights that exact issue. On page 58 and 59 of budget paper No 3 there is a feature box on the no-fault CTP insurance scheme. Table 7 on page 58 highlights the impact on total public sector net debt for precisely the reason you are noting.

The CHAIR: I just want to go back to where we started with the stadium. In terms of the assumptions of revenue meeting ongoing operating costs for the stadium, does that include venue memberships? Are you working on the assumption of a clean stadium, or are there assumptions about signage rights, venue memberships or other things to arrive at that modelling where you say you can get the revenue to meet the ongoing operating costs?

Mr Mann: There is a whole range of revenue streams and their distributions. There has been no firm decision of venue memberships at this point. Certainly, one of the mechanisms under consideration in the issue there is whether that revenue is optimised by being controlled by the operator or by the users, and that is part of the ongoing negotiations. The government has indicated that it is under consideration. In respect of the overall size of the pie that is generated by the revenue streams, that is the most important consideration, and the state is confident that the overall size of the pie would be sufficient to not only cover operating costs but also ensure that all of the users have a more than sustainable return as well. In terms of the final distribution of those rights, that is still subject to ongoing negotiation and has not been concluded at this point.

[12 noon]

The CHAIR: If you have not made those sorts of decisions in terms of making assumptions when you do that calculation of revenue to expenditure, how are you confident that your revenue will meet your ongoing expenses?

Mr Mann: Because the overall revenue is about attendance and yields, not necessarily about who controls those yields. It is the overall size of the pie that is the fundamental consideration. The secondary consideration is who owns the various slices. In the overall scheme of things, venue memberships are a relatively minor component relative to the overall revenue pie. The justification of my statements is that we do have a very good idea of what overall attendances are across the year and the yields for those attendances. The tricky bit, I guess, is deciding who owns those revenue streams. Some things are very, very easy. Membership income obviously belongs to the users. Other things such as all those rights you have talked about, the catering incomes and how they are distributed, and signage are all the subject of the negotiations now.

The CHAIR: Naming rights of both the internal and external features of the facility?

Mr Mann: There has been a clear decision on overall naming rights but, yes, internal naming rights et cetera need to be worked through as well. They are all potential revenue-generating streams.

The CHAIR: Ultimately, one of the arguments for stadium memberships in the original stadium task force was that it gives security to the stadium operator in terms of their income streams.

Mr Mann: Absolutely, and that is an important consideration for the state because it then enables them to have flexibility in their operations and potentially helps them in maximising content, attracting other events. That is an absolutely important driver in us considering stadium memberships. If the users were able to demonstrate that another way is better in the overall scheme of things, we would certainly be open to that. You are absolutely right. It is one of the reasons why most venues in Australia have stadium memberships in some form.

The CHAIR: You are increasing the capital guarantee charge for local governments. Do you know what it is currently—what they pay over and above the standard interest rates?

Mr Barnes: The loan guarantee fee?

The CHAIR: I get different arguments about what they currently pay. I am just wondering if you know what they currently pay.

Mr Barnes: Currently, local governments pay a loan guarantee fee on borrowings through the Treasury Corporation of 10 basis points.

The CHAIR: So it is going up from 10 to 70.

Mr Barnes: That is correct.

The CHAIR: What consultation was done prior to that with local government? What consultation occurred prior to that being announced?

Mr Barnes: None from Treasury's point of view.

The CHAIR: Are you the lead agency for that decision? Does it come under your responsibility or should some other agency have done that consultation?

Mr Barnes: It comes under the Treasurer's portfolio. The fee is collected by the WA Treasury Corporation and then remitted to the consolidated account.

The CHAIR: I would not have thought that WA Treasury Corporation would do that sort of consultation. It might be referred to you as an agency.

Mr Barnes: They would not. At the bureaucracy level, if there was going to be any prior consultation, it would have been from Treasury, but there was no consultation from Treasury. I guess what I am getting at is that I do not know if there was any consultation at a political level.

The CHAIR: Was any assessment done about what that may have meant in terms of the impacts on local governments and what that might follow on to in terms of their rates and what that might mean for them in terms of rates? I saw informed sources of the lower house out there attacking local governments for increasing their rates the other day, yet I would have thought that many of the increases that local governments are facing are driven by state government charges, that being one of them. Do we have any idea of what the quantum of that is on a local government per ratepayer? Is it $2 per person that it ends up applying through that?

Mr Barnes: We did not do any analysis of the potential impact on rates. Our view is that the increase in the loan guarantee fee from 10 basis points to 70 basis points will still result in a competitive interest rate for local governments that decide to borrow through the WA Treasury Corporation. Of course, that is their choice. They do not have to borrow through Treasury Corporation; they can borrow from a commercial lender, and they do. If they come to the view that the new interest rate they will be charged by the Treasury Corporation inclusive of this higher guarantee fee is no longer competitive, they can source their borrowings from elsewhere.

The CHAIR: Can we lend them money from the future fund?

Mr Barnes: Not for 20 years.

The CHAIR: No, lend them. Do you not have the future fund money invested somewhere earning interest?

Mr Barnes: We do, indeed; yes.

The CHAIR: Do they meet the criteria for being able to borrow funds held in the future fund?

Mr Barnes: No, they do not.

The CHAIR: Was any risk assessment done? Local governments are now riskier, so do you have to increase the guarantee fee because the risk has increased with them?

Mr Barnes: No. It was really around equity with the loan guarantee fees that the state's own trading enterprises pay, which is 70 basis points. It is to bring local governments and universities into line with that 70 basis points fee that our own GTEs already pay.

The CHAIR: That was a recent increase in itself, was it not?

Mr Barnes: A couple of years ago.

The CHAIR: Yes. It used to be around 20 basis points for most of the port authorities.

Mr Barnes: Yes. We were concerned that at that previous—I think it was 20—basis point fee, and at the current 10 basis point fee for local governments and 20 for universities, that that significantly underprices the value of the state government's guarantee on the borrowings.

The CHAIR: That is why I asked whether a risk assessment was done. You say that it undervalues. What risk assessment was done? When was the last time a local government defaulted on its borrowings?

Mr Barnes: Not in recent memory.

The CHAIR: Where is this increased risk that generates the argument that they should be paying more?

Mr Barnes: It is not a question of increased risk; it is a question of the fee that they are currently paying not being reflective of the value of the state's guarantee, and the value of the state's guarantee is reflected in the difference between the WA Treasury Corporation borrowing rate and a market rate.

The CHAIR: So it is simply about you profiteering—getting greater profits for the WA Treasury Corp for handling their loans?

Mr Barnes: This was a revenue-raising measure and was described as such in the budget. We did not hide that fact. It was a revenue-raising measure—one of the suite of new revenue and savings measures in the budget. It will certainly put local governments on an equal footing with our own government trading enterprises, and we think it will still offer them a market competitive interest rate on their borrowings.

The CHAIR: Yes, but it also might mean that they have to put up rates.

Mr Barnes: It may or it may not. That is a call for the local governments.

The CHAIR: They either have to cut services or increase rates. You cannot get a new fee charged that you were not expecting because there was no prior consultation—that is on existing borrowings, is it not? It is not on new borrowings.

Mr Barnes: It is on both.

The CHAIR: It is on borrowings that they took out. They might have taken a decision two years ago on an assumption that the rate was going to be X, and now you have increased it arbitrarily by 60 basis points.

Mr Barnes: True.

The CHAIR: You either have to cut back other services or increase your rates, I would have thought.

Mr Barnes: Or reduce their costs.

The CHAIR: I am sure they are already doing that to cover the waste levy and the power prices for street lighting. I could go on if you want.

I wanted to focus on the future fund. I think in the lower house you said you still expect to be making a net of 40 basis points.

Mr Barnes: Yes; 39 basis points has been the average to date.

The CHAIR: Going forward, what do we expect it to be?

Mr Barnes: We do not expect it to differ markedly from that. That 39 basis point differential between the earnings rate on the future fund and the cost of funds has been remarkably constant since the inception of the future fund. It has been at around that 39 to 40 basis point differential every quarter since it was established. We do not expect it to differ markedly.

The CHAIR: What I cannot work out—maybe you can explain it to me—is when I go to table 10 in budget paper No 3, which has your key budget assumptions, you have the public bank account interest earnings, which shows you get 2.1 per cent, and for your consolidated account borrowings, you get 3.4 per cent. I am not sure how you account for it but I assume, particularly in years when we are having a deficit, we have to borrow money to place it in the future fund. If we were not putting the money into the future fund, our borrowings would be lower. I think it is reasonable to assume that to create the future fund in the current environment, we need to be borrowing that money. When you do your calculation of that 39 basis points, do you make the assessment that all money going into it is borrowed or only part of the money going into it is borrowed?

Mr Barnes: I would challenge the assumption that the money is borrowed. To date, the future fund has been established by seed capital funded from the royalties for regions fund. That seed capital totals $933 million, which includes the last remaining contribution from royalties for regions in 2015–16 of $126 million. That will bring the total RFR contribution to $933 million. In fact, I would argue that had the future fund not been set up, that $933 million in royalties for regions money would have been most likely spent somewhere else under the RFR program. Instead of that $933 million being spent under the RFR program, it was deposited into the future fund and has not been spent.

The CHAIR: Well, no, it would not have been, because you would have hit the $1 billion cap.

Mr Barnes: Maybe or maybe not.

The CHAIR: You would have! You would have hit the cap. It would have meant that that money was not spent; it was lost.

Mr Barnes: My point is I think the description that borrowing money to put into the future fund is not correct.

The CHAIR: At last we are putting money into the future fund and at the same time we are borrowing money. The net effect of that is that we are borrowing money for the future fund. If we did not put the money into the future fund and used it to reduce the amount of borrowings that we had, that is the real impact.

Mr Barnes: Our gross borrowings would be lower.

The CHAIR: Yes, by the equivalent of what was put into the future fund. When you calculate that 39 basis points, what assumption do you make on the cost of the money in the future fund? Is it that the full amount is costing us 3.4 per cent or is it on some other mechanism that you are arriving at that 39 basis points?

Mr Barnes: This is a calculation done by the WA Treasury Corporation, which manages the future fund on our behalf. When we make a deposit into the future fund—say, this final instalment of RFR of $126 million that will go in around 1 July—the WA Treasury Corporation works out at that point in time what is the cost of its funds. If it had to go out to market and borrow $126 million on 1 July, what would the cost of that $126 million be? That is how it calculates the cost of funds.

The CHAIR: That is on the full amount going in.

Mr Barnes: Yes. It calculates it at that point in time. Again, it is like an opportunity cost assessment. If that money was not going into the future fund and we had to borrow it instead, what would the cost of that borrowing be on that day?

The CHAIR: How does it account for the interest earnings side of it?

Mr Barnes: Just on the actual earnings received.

The CHAIR: Assuming that the average is 3.4 per cent for the borrowing cost, which is your assumption in the budget, that would mean that to be getting 39 basis points, the future fund is then lending that at 3.79 per cent, plus whatever it costs in administrative costs, I would have thought. I assume the future fund does not pay a capital guarantee charge; it just pays an administration fee.

Mr Barnes: That is an idea!

The CHAIR: I am surprised that you have not picked up royalties for regions with one yet! If the assumption for the public bank account interest earnings is only 2.1 per cent for this year, how are you achieving 3.79 per cent plus administration costs from the future fund? How are they then achieving that in terms of their lending when they are restricted in terms of AAA rated instruments, of which I do not think there are any state governments left, are there?

Mr Barnes: No. New South Wales and Victoria are still AAA rated.

The CHAIR: So you can lend it to them.

[12.15 pm]

Mr Barnes: The future fund forms part of the overall public bank account, but it is invested separately to the rest of the public bank account. The rest of the public bank account is invested effectively in cash—very short term, very liquid investments. We need that money on hand to meet bills throughout the course of the year. We do not lock it away in long-term investments. As a result of that, the rest of the public bank account earns a very low—a figure you read out—rate of return. They are highly short term, highly liquid investments—effectively term deposits. Even though the future fund forms part of the public bank account, it is invested under a separate framework and a separate bucket from the rest of the public bank account. It can still invest only in those high-grade investments. It can invest in any semi-government bond; it does not have to be AAA, and it can invest in highly rated corporate bonds as well—bonds issued by the big four banks, for example, which are A-rated. The investments of the future fund also have a much longer tail—a much longer term to maturity. I cannot recall off the top of my head but it is an average of about three and a half to four years, I think. Because of the upward sloping yield curve, the future fund earns a higher rate of return than the rest of the public bank account.

The CHAIR: When you borrow that money in the assumption that you make on cost of the interest at the time of borrowing, what length of time are the borrowings taken out over?

Mr Barnes: I do not have that detail, Chair. We will have to chase it up through the Treasury Corporation.

The CHAIR: Would it be short-term borrowings or long-term borrowings in the main?

Mr Barnes: We will confirm this for you, but I think the answer is: Treasury Corporation has a portfolio of debt, obviously, some of which is short term and some of which is long term. It is increasingly shifting to longer term. I think on the day that a deposit is made into the future fund when they do this cost-of-funds calculation, they are calculated on the basis of the whole portfolio of their debt, and the split between short and long term. I am happy to confirm that with the corporation and get back to you.

The CHAIR: Of course, if that debt is short term it may not always stay at that rate, if you are constantly rolling it over.

Mr Barnes: That is right. With the Treasury Corporation, we are increasingly moving its debt portfolio to longer-term debt to avoid that repricing risk in rolling over short-term debt.

The CHAIR: I assume you can pick the day you put money into the future fund when the interest rate borrowings are lower than otherwise might be the case.

Mr Barnes: That is cynical, Chair.

The CHAIR: Are we doing any calculations on the risk of that over the life of the project, for the 20 years, before you can start spending that money?

Mr Barnes: We have an investment framework for the future fund that sets both a return objective and a risk objective. The return objective is to exceed that cost of funds, which to date, we have achieved. The risk objective is that the fund does not have a negative return measured on a historical yield basis in any five-year rolling period. It is still a very risk-averse fund and at the moment is only investing in other semi-state government bonds and highly rated corporate bonds. It is picking up that extra yield because of the longer maturity of those investments.

The CHAIR: If we were investing in the new port facility and the long-term rate of return was five or six per cent, would we not do even better?

Mr Barnes: Probably, but we are constrained by the financial management regulations. The future fund act, which went through Parliament three years ago, requires that investments in the future fund be in accordance with the financial management regulations. We are constrained by those regulations.

The CHAIR: I understand you are constrained by what they allow you to do, but you could potentially get a far higher rate of return by investing in the government's own income-producing assets with that money.

Mr Barnes: Potentially, but then I guess you are undermining the objective of a future fund to park that capital away for 20 years.

The CHAIR: Not if you park it to produce revenue for the future—if it creates more revenue in the future.

Hon MARTIN PRITCHARD: Forgive me for being quite new, but regarding the direct impact with regard to Standard and Poor's putting you on watch, I believe it has been taken care of within the budget or seen in the budget. Do you know what the impact of that has been in dollar terms?

Mr Barnes: Yes; we can estimate it. What we observed since Standard and Poor's made that announcement on 14 April is that the spread on our bonds, which is basically the rate we pay on our bonds relative to other jurisdictions—I will use Victoria as the comparison because it is one of the only two remaining AAA-rated states—the spread on our bonds compared with Victoria's bonds has increased by six basis points on our three-year bonds, up to about 10 basis points on our longer-term 10-year bonds. An increase of about six to 10 basis points is what we have observed since Standard and Poor's made that announcement in April. In terms of what that translates to in dollars, we estimate that translates to approximately an extra $15 million a year in additional interest costs, or $60 million over the four-year forward estimates period. The spreads are relative to another jurisdiction; in that case, Victoria. At the same time as we have seen our spreads increase, absolute borrowing costs have come down significantly as interest rates worldwide have come down. The absolute level of interest rates has come down and well and truly exceeded the increase in our spreads from the Standard and Poor's announcement.

Hon MARTIN PRITCHARD: I think they are making a determination in July on that credit watch?

Mr Barnes: Yes, by mid-July we expect a determination.

Hon MARTIN PRITCHARD: If it were to reduce it down, there would be no further impact on that decision in the revenue or costs.

Mr Barnes: That is our belief. It is our view and the Treasury Corporation's view that the market has effectively already priced in a downgrade from AA-plus to AA.

Hon MARTIN PRITCHARD: If we continue to be put on watch at that point, do you believe the cost would be similarly quite small?

Mr Barnes: We would not be put on watch again. We are on credit watch now.

Hon MARTIN PRITCHARD: If the result of that watch is that you go down to the next lower grade, which would be AA—say, that is a possibility, and it is obviously a possibility—you are saying that in the next two or three years we could not go on credit watch again based on AA?

Mr Barnes: Of course, that is possible.

Hon MARTIN PRITCHARD: You similarly think that the effect will be relatively small, as this one has been?

Mr Barnes: I believe so, yes.

Hon MARTIN PRITCHARD: So you are the saying credit rating really does not impact on the state much?

Mr Barnes: In this case, as I said, the announcement of the negative credit watch by Standard and Poor's we estimate has increased our annual interest cost by approximately $15 million, so it is not insignificant. That is from a negative credit-watch announcement. We think, and what we are hearing from the market, that they have already effectively priced in a downgrade.

The CHAIR: They have read the budget papers themselves.

Mr Barnes: I have been talking to a number of investors in our government bonds in the last week or two and their view seems to be that this increase in our spreads that I mentioned before is more to do with the uncertainty hanging over us as a result of this negative credit watch announcement. They believe that as soon as Standard and Poor's make a determination one way or the other, our spreads may reduce just by removing that uncertainty that is currently hanging over us.

Hon MARTIN PRITCHARD: You would say that the decision of Standard and Poor's and Moody's has relatively little impact on the state?

Mr Barnes: In terms of total interest expenses, correct. That has been the experience in this particular example, yes.

The CHAIR: That is at times of record low interest rates though, is it not? What would be the impact if we go back to historical interest rates? I assume Treasury is not hoping for the WA economy and the Australian economy to stay in the situation where the Reserve Bank keeps interest rates at around two per cent forever and a day. That is a really bad sign for the economy if it does!

Mr Barnes: It is indeed. It is a bit hypothetical but my assumption is that if the absolute level of borrowing costs increased, which, inevitably, it is going to at some stage, then the spreads will likely increase as well.

The CHAIR: Which will give a double whammy at that point. We will have to pay more to cover our interest costs but the amount we pay because we do not have a AAA credit rating will be even higher again.

Mr Barnes: If there were to be a further downgrade down the track, which is hypothetical.

The CHAIR: Even the current AA-plus will mean that in those circumstances there will be a greater cost than if we had a AAA rating when those interest rates start to go up. You talk about not doing forward estimates but you used to do a 10-year projection going out. How are we tracking in regard to those?

Mr Barnes: We did that exercise just that one time in the 2013–14 budget, which was to show the long-term impact of the fiscal action plan that was announced at that time. We have not updated those estimates since. It is an area of work I think we need to do. I am keen to do it. To be frank, we have not had the resource capacity to do so since then. We have been very busy on other things.

The CHAIR: I am sure you have. If there are no other questions from members, I will close the hearing.

The committee will forward any additional questions it has to you via the minister in writing in the next couple of days, together with the transcript of evidence, which includes the estimates questions you have taken on notice. Responses to these questions will be requested within 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 as possible before the due date. The advice is to include specific reasons as to why the due date cannot be met. If members have any unasked questions, I ask them to email them to the committee as soon as possible. Again, on behalf of the committee, I thank you very much for your attendance today.

Mr Barnes: Thank you, Chair.

Hearing concluded at 12.25 pm