The 2014/15 Western Australian State Budget

On track or still off the rails?

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1. Introduction

The 2014/15 Western Australian State budget's main political goal was to put the State back on track to receive a AAA credit rating from all the major rating agencies, which was lost in 2012. In this briefing note I begin by setting out the Government's fiscal goals and then consider outcomes. I show that the Government has not in fact made much progress in meeting its own fiscal targets, largely because it has been unable to reign in non-salary expenses, which continue to increase faster than revenues as a whole and despite a much better than expected distribution of GST revenues from the Commonwealth.

I will focus this report on what is being budgeted for 2014/15[1]. It points to a Government struggling to control non-salary expenses, while trying to point the blame at the Commonwealth government because of declining GST revenues. As we shall see, the issues are more complex.

2. Fiscal goals

As set out in the budget papers (see Budget Strategy and Outlook 2014/15, Budget Paper Number 3: 64ff). the Government's financial goals are to:

- ensure that general government sector expense growth does not exceed revenue growth;
- maintain a cash surplus from operating activities for the general government sector of at least 50% of infrastructure spend per year;
- maintain the total non-financial public sector (TNPS) net debt to revenue ratio at or below 55%;
- maintain a cash operating surplus for the TNPS of at least 5% of operating cash receipts; and
- provide a fair and efficient taxation system that is competitive with other Australian States.

Does this budget move the Government in the direction required?

3. The bottom line:

Table 1 shows the budget aggregates for 2013/14 and 2014/15. It also shows the revised estimates published in the budget compared to the estimates published in the Budget update last December. The Table shows that compared to last December, revenues and expenses are both higher than expected. Revenues are to grow 2.5% relative to 2013/14, and will grow faster than was projected (also 2.5%). Expenses will grow faster than revenues (2.6%). The operating budget balance next year will both be smaller than projected last December and also smaller than this year. The key aggregates are moving in the wrong direction for the Government to regain a AAA. The question is: what has gone wrong?

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Table 1: Operating budget aggregates, 2013/14-2014/15, Budget and Budget compared to December 2013 Estimates ($m).

	2014	2015	Change	%
Revenues	$27,978	$28,267	$289	1.0%
% change	8.8%	1.0%		
Revised revenues	$27,970	$28,683	$713	2.5%
Difference	-$8	$416		
% difference	0.0%	1.5%		
% change		2.5%		
Expenses	$27,592	$27,830	$238	0.9%
% change	8.3%	0.9%		
Revised expenses	$27,787	$28,508	$721	2.6%
Difference	$195	$678		
% difference	0.7%	2.4%		
% change		2.4%		
Balance	$386	$437	$51	13.2%
Revised	$183	$175	$8	-4.4%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

3.1 Revenues

The Government has consistently pointed to the Commonwealth government as the source of its financial woes, arguing that large reductions in GST revenues have cause WA unnecessary financial stress.

Table 2 shows changes in the composition of budget revenues over the course of the next financial year.

Table 2: Revenue by source, 2013/14-2014/15 (budget), nominal and constant prices ($m)

	Nominal			**Constant Prices**		
	2014	2015	Change %	2015	Difference	Change %
Taxation	$8,881	$9,346	5%	$9,096	$215	2%
GST	*$2,473*	*$2,215*	*-10%*	*$2,156*	*-$317*	*-13%*
Other grants	*$6,276*	*$6,468*	*3%*	*$6,295*	*$19*	*0%*
Total grants	$8,749	$8,683		$8,451	-$298	-3%
Sales of goods and services	$2,267	$2,356	4%	$2,293	$26	1%
Interest	$212	$210	-1%	$204	-$8	-4%
Revenue from public corporations	$1,374	$1,468	7%	$1,429	$55	4%
Royalties	$5,911	$6,176	4%	$6,011	$100	2%
Other	$576	$444	-23%	$432	-$144	-25%
Total	$27,970	$28,683	3%	$27,915	-$55	0%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

The Table shows overall zero real growth in total revenues. While GST revenues will fall in real terms by 13%, they make up less than one third of total Commonwealth grants. Total grants will only fall by 3%. These falls will be compensated for by growth in own source revenues, largely due to new policy decisions to increase taxes and charges by an estimated $290m ($282m in real terms) next year. Revenue from public corporations will be the fastest growing source of revenue, increasing in real terms by 4% as a result of increased dividend payments (mainly newly announced interim dividends from Port Authorities).

While GST revenues will fall in real terms, it is important to bear in mind that they will not fall nearly as rapidly as was projected last December. Revised estimates in the most recent Commonwealth Grants Relativities Update released last month have resulted in WA seeing its GST revenue increase substantially relative to what was previously budgeted, not just next year, but throughout the forward estimates (see Table 3). Given that the much larger reductions in GST revenues were built into the budget, this much better than expected outcome is the single most important budget improvement, the equivalent of over three quarters of the revenue improvement compared to December last year and exceeding the total value of the new revenue initiatives.

Table 3: GST Revenues, original versus revised ($m), 2013/14-2016/17

	2014	2015	2016	2017
Original	$2,489	$1,858	$1,080	$626
Revised	$2,473	$2,215	$1,616	$1,118
Difference	$16	$357	$536	$492
%	-1%	19%	50%	79%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

The budget includes an important change to the Royalties for Regions fund, which up until now has received one quarter of mining royalties. The Government has announced that spending from the fund will be capped at $1b and it will implement a $1b cap on the balance of the funds. With royalty revenue tipped to be $6.2b in 2014/15, the percentage of this money effectively being available for the Fund will be only 16%, and the proportion will continue to fall as the amount of royalty revenue increases. The balance of funds will be used to reduce Government borrowings by an estimated $2.7b over the forward estimates.

3.2 Expenses

Table 4 shows movements in the main categories of expenses for the period from 2013/14-2014/15 in nominal terms and adjusted for projected inflation.

Table 4: Expenses, 2013/14-2014/15, nominal and real change ($m).

	Nominal			Constant Prices	
	2014	2015	% change	$	%
Salaries	$11,038	$11,345	2.8%	$11,041	0.0%
Superannuation	$1,409	$1,472	4.5%	$1,433	1.7%
Other employee costs	$473	$472	-0.2%	$459	-2.9%
Total salary	*$12,920*	*$13,289*	2.9%	$12,933	0.1%
% of total	*46.5%*	*46.6%*			
Depreciation	$1,248	$1,289	3.3%	$1,255	0.5%
% of total	4.5%	4.5%			
Services and contracts	$2,227	$2,337	4.9%	$2,274	2.1%
% of total	8.0%	8.2%			
Other operating	$4,820	$5,036	4.5%	$4,901	1.7%
% of total	17.3%	17.7%			
Other interest	$508	$538	5.9%	$524	3.1%
% of total	1.8%	1.9%			
Current transfers	$5,259	$5,454	3.7%	$5,308	0.9%
% of total	19%	19%			
Capital transfers	$804	$565	-29.7%	$550	-31.6%
% of total	3%	2%			
Total expenses	$27,786	$28,508	2.6%	$27,745	-0.1%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

The Table shows that salary expenses will barely increase in real terms, and will fall as a percentage of total expenses. The largest growth will occur in services and contracts (2.1% real), other operating costs (1.7%) and interest (3.1%), the latter reflecting continued growth in net debt. The growth in services and contracts and also other operating costs is thought to reflect the Government's policy position to outsource more activities. However, the lack of detail in the budget papers makes it difficult to be precise. Whatever the drivers, this is proving costly, with other operating expenses being the fastest growing component of expenses since 2007/8 (see Table 5).

Table 5: Other operating costs, constant prices and as % of total expenses ($m) (deflated by the CPI for Perth. 2011/12=100)

	2008	2009	2010	2011	2012	2013	2014	2015
Other operating costs	$1,704	$1,829	$3,082	$3,764	$4,656	$4,610	$4,587	$4,665
% change		7.3%	68.5%	22.1%	23.7%	-1.0%	-0.5%	1.7%
% of total	9.3%	8.9%	14.0%	16.7%	18.9%	18.6%	17.3%	17.7%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

In sum, the main cost pressures on the budget are from non-salary sources, and that is despite the main single expense saving measure being focused on public service procurement (projected to save $170m next year).

4. Government infrastructure spending: up or down?

AS Table 6 shows, the Government has increased its planned level of gross and investment for 2014/15 and has lifted its use of debt as the main means of doing so. Net debt is therefore increasing as a % of the economy both year-on-year and relative to the original projections, when the Government's goal is for it to move in the opposition direction.

Table 6: Gross and net investment, non-financial public sector and borrowings ($m)

	2014	2015
Gross original	$7,319.0	$6,264.0
Revised	$7,089.0	$6,720.0
Difference	*-$230.0*	*$456.0*
Net	$3,091.0	$1,469.0
Revised	$3,678.0	$2,160.0
Difference	*$587.0*	*$691.0*
Cash borrowing	$3,303.0	$2,076.0
% of gross investment	45%	33%
revised	$4,308.00	$2,507.00
% of revised gross investment	61%	37%
Net debt	$23,969.0	$26,336.0
% of GSP	8.8%	9.2%
Revised	$24,140	$27,134
% of GSP	8.9%	9.5%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

4.1 The State's balance sheet: is it worth more?

It follows from the foregoing that the 2014/15 budget has not been good for the State's balance sheet. Slight declines in the operating surplus, increases in net debt, and real falls in net infrastructure spending have ensured that as a percent of the economy the State's net worth will decline from 43% to 41.9%.

Table 7: Changes in assets and liabilities, non-financial public sector, 2013/14 and 2014/15 ($m)

	2014	2015
Assets	$169,309	$175,975
% of GSP	62.7%	61.8%
Revised	$169,312	$175,851
% of GSP	62.7%	61.7%
Liabilities	$52,584	$56,211
% of GSP	19.5%	19.7%
Revised	$53,188	$56,558
% of GSP	19.7%	19.8%
Net worth	$116,725	$119,764
% of GSP	43.2%	42.0%
Revised	$116,124	$119,294
% of GSP	43.0%	41.9%
Net debt	$23,969	$26,336
Revised	$24,140	$27,134
% of GSP	8.9%	9.5%

Source: WA Government (2014), Budget Strategy and Review, Budget Paper Number 3 and WA Government (2013), Government Mid-Year Financial Projections Statement, 2013/14.

Targets		2014		2015	
1 Expense growth less than revenue	Expenses		9.1%		2.6%
	Revenue		8.8%		2.5%
2. cash surplus more than 50% of infrastructure spending	cash operating surplus	$1,230	As % of:	1256	As % of:
	infra gross spend	$3,168	39%	3169	40%
	infra net spend	$1,910	64%	1804	70%
3. TNPS debt burden	Net debt	$24,140	% of revenue:	$27,134	% of revenue:
	Revenue	$42,509	57%	$44,366	61%
4. TNPS cash op surplus as % of cash receipts	cash surplus	$2,229	As % of receipts:	2448	As % of receipts
	cash receipts	$43,881	5.1%	45772	5.3%

5. Conclusion

On most of the measures by which the Government wishes its performance to be judged, the 2014/15 budget has made little difference or moved it backward (see Table 8). The one area where this is not so concerns the operating surplus of the non-financial public sector as a percentage of its cash receipts. This improvement is largely as a result of increases in user charges facing users of the State's utilities more than anything else. This will have two important effects. The first is to shift the burden of adjustment on to lower income earners, for user charges are regressive in their effects. Also, to the extent it improves the profitability of the utilities, it renders them a more likely candidate for privatization, a point I shall return to presently.

Expenses continue to grow at or faster than income, and this is because of non-salary expenses associated with outsourced activities, interest on growing debt and depreciation on increased infrastructure. It is not because of salaries and associated expenses, which are falling as a share of total expenses.

The State's balance sheet is not traveling well, with liabilities increasing faster than assets in real terms. The State's net worth is falling as a percent of the size of the economy.

Faced with these circumstances, it is difficult to see how the Government will be able to turn its finances around without a radical change of direction. The option that no doubt it will be partial to is privatization, for that might offer a quick and ready route to repairing some of the financial indicators on which it wishes its performance to be assessed. The budget papers do not include estimates of proceeds from their sale, but suggest that up for consideration include water and power and port infrastructure, as well as the TAB and various parcels of hospital land. Sales of government businesses generate proceeds, but they also deny the budget dividend payments (estimated to be almost $1.1b by 2017/18) that can outstrip the interest savings from any debt reduction, if it they are used for this purpose. This is likely to be so when interest rates are low, as is the case right now. West Australians could expect to see the Government commence the privatisation of these assets in coming months. This is particularly likely with the Federal

government now offering financial inducements for the states to recycle funding from asset sales for other investments.

The Government might also be giving consideration to further public private partnerships. There is scant evidence to show privatisation offers a financial solution to government budget problems and as the Productivity Commission recently reminded us, PPPs are no "magic pudding" solution to the problem of financing public infrastructure (Productivity Commission (2014), Public Infrastructure, Volume 1, Draft Report, Canberra, March).

It is essential that before any decision is made to dispose of a major public asset or to commission another large PPP, a broad ranging public discussion be encouraged and enabled.

The 2014/15 WA Budget has made little progress in meeting the Government's political goal of restoring the State's AAA rating, and it is by no means clear that it has advanced a broader social agenda. The Government is continuing to struggle to get its budget on track.

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