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SENATE

SELECT COMMITTEE ON STATE GOVERNMENT FINANCIAL MANAGEMENT

Reference: Commonwealth, state and territory fiscal relations and state and territory government financial management

THURSDAY, 12 JUNE 2008

PERTH

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SENATE SELECT COMMITTEE ON

STATE GOVERNMENT FINANCIAL MANAGEMENT

Thursday, 12 June 2008

Members: Senator Ian Macdonald *(Chair)*, Senators Bushby, Chapman, Forshaw and Polley

Participating members: Senators Abetz, Adams, Barnett, Bernardi, Birmingham, Mark Bishop, Boswell, Brandis, Bob Brown, Carol Brown, Campbell, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Eggleston, Ellison, Fielding, Fierravanti-Wells, Fifield, Fisher, Heffernan, Hogg, Hurley, Hutchins, Johnston, Joyce, Kemp, Kirk, Lightfoot, Lundy, Sandy Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Murray, Nash, Nettle, O'Brien, Parry, Patterson, Payne, Ronaldson, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Watson, Webber and Wortley

Senators in attendance: Senators Bushby, Chapman, Cormann, Kirk, Ian Macdonald and Polley

Terms of reference for the inquiry:

To inquire into and report on:

Commonwealth and state and territory fiscal relations and state and territory government financial management, including:

a. Commonwealth funding to the states and territories – historic, current and projected;

b. the cash and fiscal budgetary positions of state and territory governments – historic, current and projected;

c. the level of debt of state/territory government businesses and utilities – historic, current and projected;

d. the level of borrowing by state/territory governments – historic, current and projected;

e. an examination of state/territory net government debt and its projected level – historic, current and projected;

f. the reasons for any government debt including an analysis of the level and efficiency of revenue and spending;

g. the level of investment in infrastructure and state-owned utilities by state and territory governments;

h. the effect of dividends paid by state-owned utilities on their ability to invest;

i. present and future ownership structures of current and former state-owned utilities and the impact of ownership on investment capacity; and

j. the effect of investment by state-owned utilities on Australia's capacity constraints.

WITNESSES

Committee met at 9.32 am

THOMAS, Dr Steven Caldwell, Member for Capel, Western Australian Parliament

CHAIR (Senator Ian Macdonald)—I declare open this fourth public hearing of the Senate Select Committee on State Government Financial Management. The committee was established by the Senate on 14 February to inquire into the fiscal relationship between the Commonwealth and the states and territories, as well as state and territory financial management. We have received 39 submissions. They have been authorised for publication and are all available on the committee's website. These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera.

This is a parliamentary committee and all witnesses are protected by parliamentary privilege. If any witness objects to answering a question, the witness should state the ground on which the objection is taken and the committee will determine the issue. I would ask all witnesses, when they are first called upon, to give their name and the capacity in which they appear.

I now welcome our first witness, Dr Steve Thomas, the member for Capel, shadow Treasurer here in Western Australia. Dr Thomas, we appreciate that parliament is sitting and it is a busy time for you, so thank you very much for coming along. It does require a bit of effort to put these submissions together. Your submission has a particularly West Australian influence—which is of course appropriate and why we are here—and I note your suggestion about returning surpluses to states. That then raises the issue of states doing it. Dr Thomas, we invite you, if you would like, to make an opening statement and then subject yourself to questions from the committee.

Dr Thomas—First of all, I apologise for my lateness. I was partaking in a grievance debate in relation to the services for disabled students and autistic students and, unfortunately, it is one of those things of competing interests. So my apologies; no disrespect meant to the committee in relation to my late arrival.

I have a couple of brief comments. My submission referred to the history of state and federal relations and particularly the taxation revenue. Interestingly, we are talking about taxation bills in parliament at the moment and we dealt yesterday with payroll tax and changes to the payroll tax system, many of which are uniform, and there will be uniform payroll tax systems in the future. The debate turned to the history of payroll tax, and I did not specifically refer to it in my submission but, interestingly, payroll tax was introduced in 1941 as a Commonwealth tax and was then eventually handed back to the states in 1971. It is a tax that has gone in the reverse direction.

The debate again turned to the income taxing powers that were originally state powers and then were transferred to the Commonwealth. The states have the ability to impose an income tax now; that would be on top of and in addition to Commonwealth income taxing powers rather than a replacement, and we decided that that would be a very politically unwise move to try and promote.

In relation to my submission, the point that I was trying to make was that, historically speaking, because of the way Federation was formed, the Commonwealth generally has had the upper hand in relation to most of the taxation issues. It does so on the basis of the formation of the High Court of Australia, which generally reinforces Commonwealth powers and institutions.

I raised the issue yesterday that it would be extremely interesting if that had not occurred and that the Commonwealth was forced to go cap in hand to the states for funding, as opposed to the states going cap in hand to the Commonwealth. It is an interesting, and generally a particularly Western Australian, angle on things, but I do not think we need to get bogged down in those issues. We are where we are at the moment. I think there are a couple of issues that we really need to talk about today and those are the issues of tied grants and how they have been tied, the outcomes, and the way they have been managed. That is probably one of the key areas in relation to state financial management.

I have brought in a heap of information in relation to the functioning of our state. Our state is per capita the highest taxing state in Australia. Some of that relates to mining and the boom that Western Australia is experiencing, and it is interesting at the moment to compare the various states of Australia. Western Australia and Queensland, it appears, will continue to have a mining boom and drive the economies of the country. That gives these states—and our state in particular, from my perspective—the ability to garner increased royalties, and I am happy to talk to you about the royalty impact in some detail.

These are some issues that I would like you to take on board. This is the taxation mid-year review that occurred in December in all states across Australia; I have not included the territories. As you can see, per capita Western Australia’s taxation is far and beyond those of the other states. If you look at where you might end up in the February review, Western Australia is over $3,000 per capita and the other states are still significantly below that; in fact, we are increasing our lead as we go.

You might say that the government has introduced some taxation relief in relation to taxes: obviously the big ones are conveyance duty, far and away bigger than the rest, and payroll tax, which is the next biggest. The changes after the budget for taxation duty can be represented like this. That is the tax relief that was offered during the current 2007-08 budget period. As you can see, I have described it as a fingernail of relief, which is roughly what it is. You can note that Western Australia’s internal taxation will, for one year, effectively start to moderate and then, as we expect generally the economy to continue to move at a rate which we think will be higher than the rest of the country—a minimum of five to seven percent, which is far greater than most of the other states—we will continue to advance that line and be further than anywhere else.

The first point I would like to make is that, from Western Australia’s perspective, we remain the highest taxed state. If you would like to compare that generally on a historical basis, which is this chart, in the period of time for the 2000s, the bright blue line is where, in 2001, Western Australia’s taxation levels were, and per capita we were running third. We were in the middle of the pack.

Queensland continues to be the benchmark for the country. Western Australia, though, was at least competitive. By 2006-07 the situation got worse. You can see that Western Australia now leads the pack, with the highest taxing rate. We have had a significant increase and, again, if we wanted to say that there were some taxation relief measures in the current budget—because there were—on that chart, those are the taxation relief measures that were promoted. As you can see, we are still far and away ahead. So those are key.

I make the point, before we move off the states' own taxing regimes, that there is no doubt Western Australia is in the middle of a boom. Commodity prices will remain high, although they may not grow at the rate they were. If you are not aware of the boom in Western Australia, the iron ore price is doubling, the natural gas price is doubling and the domestic gas price has quadrupled over the last couple of years. All of those things mean that the economic outlook for Western Australia is very good, but as you would be aware, being an economic based committee, the fiscal outlook, the government expenditure outlook, is a slightly different story.

This is best demonstrated by this particular chart, which—I apologise—I demonstrated to somebody else and scribbled on, but the details are still there. You start in 2001. The blue line is revenue and this is the growth in revenue. Western Australia experienced a significant boom in fiscal revenues—that is, revenues to the government—and, in all honesty, it surprised everybody. It surprised the government of the day. The government in 2001 was the new Gallop Labor government. Everybody was surprised at the level of additional revenue that was coming into the state.

Unfortunately, over time, increases in revenue are expected to decline—not for the state, remember, but for the fiscal economy of the state, the government revenue. In fact, by 2011-12, at the end of the forward estimates, revenues are expected to flatline. There might be some variation in this but, generally, both sides of politics are agreed that revenue has continued to flatline. The problem is the expenditure, which is the red line. The growth in expenditure initially was mirroring the growth in revenue, so at some point we were basically running about even. We had an explosion of revenue, our expenditure jumped around a bit, but we were pretty level. Growth in expenditure, though, has remained high, and the problem for Western Australia fiscally in a government sense is that, as the growth in revenue tails off, the growth in expenditure actually starts to rise back up again. It starts to put Western Australia in a difficult position.

What we have seen is the period of greatest opportunity for the state of Western Australia and, let me say, probably one of the periods of greatest opportunity for any state in the history of Australia. It is certainly the third great boom of Western Australia. After the gold rushes 100-odd years ago, and the iron ore development in the sixties—which was largely the result of the work of Sir Charles Court, bless him—this is the third great boom, effectively, that Western Australia has had. Our problem is that this time of opportunity has not been converted into dealing with all of the things that the people of Western Australia are facing.

One of the things that should have been done with this opportunity was to convert the boom into long-term prosperity, and the issue that Western Australia faces is: in a period of declining revenues and declining areas of opportunity, is it too late for us now? I do not mean to convert the economic boom, because we have been converting the economic boom for some period of time, and Western Australia, in a personal and private sense, is doing okay, but to fiscally develop this boom, put the infrastructure in place that will future proof the state of Western Australia—that is, to make sure that you can get your resources out adequately.

Look at an area like Karratha, for example, which is the Pilbara hub for natural gas. Rents there are $2,000 a week in some places—amazing rents. The hospital struggles and transport issues are significant. The era of opportunity for Western Australia might pass us by without us being able to put the infrastructure in place that would develop those resources well into the future. Let me say, just as a parochial Western Australian, that all of Australia does very well out of the natural gas resources in Australia's north-west, and you as a Commonwealth group obviously get the lion's share of all of the royalties that come out of that.

I am hoping at some point that there will be an additional mechanism for the Commonwealth to engage in the construction of that infrastructure. We will look very carefully at Infrastructure Australia, the new group which is providing infrastructure. We will be watching that very carefully. If its agenda is to provide resources and infrastructure for high population density areas and if it ends up building roads between Brisbane, Sydney, Melbourne and Canberra and does not look at future proofing the country and investing in infrastructure which builds the country, in the north-west of Western Australia in particular, and also to some degree, I suspect, in Queensland and the Northern Territory, then Infrastructure Australia will be one of the great failures of Australian history. If it does the job that we think it should do, it may be one of the greatest success stories we have ever seen. I could go on for some hours, Mr Chairman, but I suspect that we should give the committee an opportunity to ask questions.

CHAIR—Thank you very much for that. As you are aware, the Department of Treasury and Finance will be giving evidence following you and, no doubt, will comment on some of the issues you have raised. You say that the expenditure is projected to go up higher than the revenues?

Dr Thomas—The thing is that the growth in expenditure will be higher than the growth in revenue. At some point, in absolute terms, expenditure will start to exceed revenue. Expenditure exceeding revenue, as we all know, is not necessarily the end of the world; many governments in Australia and around the world have operated on that basis. The difficulty for Western Australia is that, at a time when revenues have never been higher and the growth in revenue has never been higher and we have never been taxed more highly, that is going to tail off and we have not converted that boom. So it is about the growth of revenue.

CHAIR—Where has the money gone then?

Dr Thomas—Bear in mind that this expenditure does not include the capital works program, which I am happy to talk about in a minute. There is a $26 billion capital works program outside of this. This is general government expenditure and, unfortunately, it has been impossible to rein in general government expenditure. About 50 per cent of that increase goes into Public Service wages, obviously. Western Australia is in a difficult position because we are a state with a very small population with a large area and resources and so it is a very competitive market for labour and, no matter who was in government, there would be increasing demand on wages related to the lack of ability to get people on the ground here.

Senator POLLEY—What then did the previous government do to try to overcome the skills crisis that WA in particular has?

Dr Thomas—Remember that the previous government from 1993 to 2001 did not have the same skills shortages. In fact, we were dealing with unemployment at a completely different level. The employment dearth has occurred because of the explosion in the resources sector. Realise that nickel was $1,000 a tonne and you could not make a profit; it has gone up to $60,000 a tonne and everybody is making a fortune. You can afford to pay the person who sits in the wet bar $80,000 to $100,000 a year. That is the sort of wage they are getting to basically just hand out cans of beer. The difference between 1993 and 2001 was that it was an economy in Western Australia which, in a couple of those years, contracted and unemployment was at a higher level and so wages were more able to be kept under control.

On a political basis, I could say that the Liberals kept wages under control better than Labor, but the reality is that that was largely as a result of the economies that each inherited. The Liberal Party had a shrinking economy during the Richard Court government from 1993 to 2001. Geoff Gallop came in right at the end of that. In all honesty, in 2001 I thought that the Gallop government maintained their fiscal regimes relatively well. It was the explosion of the resources boom after that that meant that all of a sudden wage pressures exploded. Suddenly there was an enormous demand. Even things like local government and the Public Service, which are traditionally high-end areas of employment and relatively well regarded, are now struggling to find anybody to fill roles because it is just so easy to take someone on a $60,000 or $70,000 wage as a planner in a local government and have them serving beers behind a bar at $100,000.

There is a completely different set of economic circumstances that has occurred between those two periods of time. Both governments have tried to address the issue to some degree. The current government has done some reasonably good work in relation to training for trades, for example. It is not an absolute bagging session. There has been some positive work in relation to skills training and, in particular, apprenticeships. The previous government did more work in relation to professions and upskilling in relation to tertiary education, and you have seen a bit of a switch there.

What we need to see in Western Australian terms, to be honest, is a significant increase in immigration of some form, whether temporary or permanent, to fill lots of those jobs. At the moment we do not have a future proofed north-west. Ideally, we would be moving people into the north-west to fulfil those jobs long term. At the moment I think we are looking at short term, which is not the best outcome.

CHAIR—That is something I would like to take up with you later. You say all this money comes from Perth. I like to say it all comes from Northern Australia, as a Northern Australian myself.

Dr Thomas—I did not say Perth; I said Western Australia. I do not live in Perth. No, we think that we can beat Perth.

CHAIR—Could I direct you to the level of investment in infrastructure which you said you would have some comments on.

Dr Thomas—Yes.

CHAIR—You have been concerned about that?

Dr Thomas—Yes, absolutely. I have significant concerns. I am the Deputy Chairman of the Legislative Assembly Public Accounts Standing Committee, and we have just finished a paper, which I commend to you, in relation to infrastructure and its requirement in the development of the resources. The iron ore industry generally is very strongly state focused. The natural gas industry is the other big growth industry. We effectively have two boom industries which are driving in large part what is going on. We have a lot of other industries—for nickel, aluminium, bauxite and a lot of other things—but it is really the iron ore industry, through the Pilbara and increasingly now the mid-west, which will drive the boom and also the natural gas industry, which is currently derived out of Karratha and the Pilbara but will actually move north. The Browse Basin is particularly important. What we lack in the north-west, in particular, is infrastructure, and natural gas is putting extreme pressures on our ability to—

CHAIR—Do you mean specifically mining infrastructure?

Dr Thomas—Both. Let us divide it out into hard and soft infrastructure. Let us look at hard infrastructure first because that is the thing people talk about. Ports and transport are the two big ones. At the moment Western Australia is struggling in relation to its ability to get iron ore to port and having port facilities to get that iron ore on a ship and out of the country.

You might be aware that in the mid-west we are trying to build the Oakajee port. The Oakajee port will be important for the mid-west. It is a different type of iron ore there. It is not as economically viable as the Pilbara iron ore, for example, but it is still with the current iron process.

CHAIR—Is that infrastructure that the mining companies should be building, or should the state be building it?

Dr Thomas—When you deal with Rio Tinto and BHP, or what might eventually be a merged process—and we could talk about that to some extent—either one of those has the capacity to build and develop port infrastructure, and they prefer to do it themselves. They build their own railways; they do their own thing; they get effectively to a port which they manage; and away they go.

The problem that you face is that the world is not just BHP and Rio Tinto and there are a number of smaller players which require assistance to get their product to port. You might be aware at the moment of court cases where BHP and Rio Tinto are being required to share their rail infrastructure. Eventually that is not going to be sufficient, and the government has to involve itself, both at a state level and a federal level, to make sure that players in the iron ore industry can get their product to market, and that will include investment in port and transport infrastructure. That is a key component for the iron ore industry, and that is the thing that the state government should be looking at much more. Most of the iron ore royalties go to the state. The state government has to some degree dropped the ball on this over time. Oakajee, for example, which is just north of Geraldton and will be the mid-west iron ore port—a brand-new port which will be developed and built by the private sector—was first mooted a decade ago.

Senator CHAPMAN—We had evidence from an academic in Tasmania who has done quite detailed research on the issue that one of the detrimental impacts of the mining boom has been the escalation of the value of our currency.

Dr Thomas—It has had an impact; yes, absolutely.

Senator CHAPMAN—He said that there was a real danger in increasing our capacity to export minerals in terms of providing additional infrastructure because what had happened over the last three or four years in, effectively, the trebling in the value of these minerals is equivalent to trebling our exports of them anyway in terms of what was previously happening.

Dr Thomas—For the value of our exports, that is right.

Senator CHAPMAN—He said if you further increase our capacity to export that is going to be further detrimental to our currency in terms of causing a rise in the value of the dollar, which has other detrimental consequences. What is your response to that?

Senator BUSHBY—Dutch disease is a potential consequence.

Dr Thomas—You are right, and the Dutch gas experiment is probably one of the best examples of that occurring. In relation to the exchange rate, the American dollar and what is going on in the American system will have a far greater and more far-reaching effect than the level of our exports. Remember that even though we talk in Western Australia about massive export levels, and about massive revenues because of that, in terms of world players only in some areas are we particularly big, and we are in a fiercely competitive market.

The danger you face at the moment, which I think is a greater danger, is that as commodity prices start to ease—and commodity prices will ease in terms of iron ore—my expectation is that natural gas will continue to rise on the basis that the world will start looking for carbon-constrained economies. Natural gas will continue to get more expensive, only up to a point. We are now talking about $13 a gigajoule for gas in the domestic market, which is now getting close to the LNG market that we can export to. There is an end point for that too, but it will continue to rise. The iron ore market will actually ease over the next couple of years as demand in China slows—and it is starting to slow already—and the Chinese economy starts to normalise and other countries start to compete for those marketplaces.

The Dutch were in a much bigger market and were much bigger players in that market, and I think that there is a greater risk of us missing the boat in relation to iron ore than there is with the gas market as the Dutch did. The other thing to remember in terms of the gas market is that Western Australia is a much smaller player than many other places in the world. Indonesia has gas, and the biggest gas reserves are still in the Middle East. At the moment we are basically trying to make hay while the sun shines in relation to those things. We do not know what the outcome of that will be. Iron ore will start to ease. Who knows? In 10 years time, if the world embraces something like nuclear technology, gas might do it as well.

CHAIR—In relation to the point Senator Chapman made, do you agree that making exports easier physically could be detrimental to the economy?

Dr Thomas—Only if you flood the market. I suspect there is a greater risk of that with coal in New South Wales and Queensland than there is with iron ore in Western Australia.

CHAIR—Fair enough. Can you make a brief comment on the soft infrastructure.

Dr Thomas—The soft infrastructure is the other half of the money. Soft infrastructure relates to all of those things that support human commitment to those things—schools, hospitals and all of those support services. The hospital in Karratha is probably a good example of that. There is a difficulty in us being able to provide the level of service that is required for people to move to a town. This is a chicken and egg argument in a completely apolitical sense. If you want Karratha to grow and be a significant hub, you have to invest in the social services that will attract people and often you have to do that before the people turn up.

CHAIR—Are you saying that is not happening?

Dr Thomas—That is not happening at a sufficient level. Karratha Hospital is probably a prime example. In terms of obstetrics, for example, any difficult births are being shunted a four-hour drive away to another hospital. You cannot provide high-level obstetric services in every hospital, but Karratha is an example of where we need additional investment in soft infrastructure. With natural gas in particular being the driver of Karratha's growth, there is probably some point for negotiation between the state and federal treasuries for a special case to be provided in some of these high-infrastructure areas.

Senator CORMANN—In relation to the hospital infrastructure, one of the measures in the recent federal budget was the establishment by January 2009 of three funds with $41 billion in them.

Dr Thomas—Yes.

Senator CORMANN—One of them was for hospital infrastructure, which traditionally is a state responsibility. Is that something that you would welcome, as shadow Treasurer at a state level, in addressing the sorts of issues that you raise, or do you think it is a concerning trend, inasmuch as it is again the states being put into a position where they have to go cap in hand to the Commonwealth for funding for areas that they are essentially responsible for?

Dr Thomas—The creation of the funds themselves I do not have a problem with. As a shadow Treasurer, let me say that they are a very clever tool to generally hide your expenditure into the future so you do not have to balance the books today. Every state does it and every government does it. That is not necessarily the issue. The issue with the infrastructure fund and the health fund is how it is expended into the future. My expectation is that you would show that you put $41 billion aside. I presume you are not going to spend the capital on that, so you are going to live off the interest.

Senator CHAPMAN—No. It is different to the future fund.

Dr Thomas—Okay, you spend the capital. So there are significant dollars available. With the infrastructure fund, it depends whether it is going to provide infrastructure that will future proof the country and provide infrastructure in places like Karratha, or whether it will be a Brisbane, Sydney, Melbourne highway, freeway and rail fund. The health fund is the same: everything depends upon how it is expended. I would have thought, particularly in relation to health, that the states have a particular interest in negotiating how that funding should be spent. Again, we come back to whether the states have to go cap in hand to ask for particular outcomes or whether there is a genuine intent to invest those funds in areas of need. I would have said that Karratha hospital is a prime example of a place that required investment.

Senator CHAPMAN—The graph that you had on tax revenue per capita, is that purely directly state-raised revenue or does that include the states' proportion of GST?

Dr Thomas—No. I am glad you raised the point of the states' GST. That chart is purely state-raised revenue in each of those states. That does not include GST revenues. GST revenues are a key issue for the state of Western Australia. As our general economy is doing particularly well, GST revenues are relatively good, but it also means that the Commonwealth Grants Commission basically re-evaluates our ability to raise our own taxes and our Grants Commission and GST revenues fall.

For the first time in my recollection—and for any state, in my recollection—Western Australia not only received a reduction in GST payments on percentage terms in relation to the share of the states but Western Australia this year was the state that received an absolute reduction in GST payments. That is a reflection of our ability to raise funds in relation to the size of our economy and, in reality, Western Australia has spent far more time in the Commonwealth as a mendicant state—that is, a state which has received more money than it has been putting back—and so I do not have a personal objection to that occurring.

Interestingly, the Treasurer spent a lot of time in the lead-up to the federal election making sweeping comments about what a disaster that was and Western Australia subsidised the rest of the states to the tune of $2½ thousand a head. But I have to say that I do not have a particular problem with that, as long as the Commonwealth recognises that, in order to be able to be one of the driving forces of the Commonwealth in relation to the economy, Western Australia needs the Commonwealth to assist in that reinvestment, particularly in infrastructure, both hard and soft.

We believe that we hold a special place in relation to the needs of the Commonwealth to look at the investment that we require. We do not mind the money going over, as long as you recognise that you have to put some of that back into key infrastructure, which will eventually send more money over. If the Commonwealth and the state can work together, particularly in relation to infrastructure, then Western Australia can be a driving force in the economy for probably 10, maybe 20 years to come. After that, resources will vary. But this is the time of opportunity, and it would be a shame to see it let go.

Senator CHAPMAN—In your submission you acknowledge the record surpluses enjoyed by Western Australia.

Dr Thomas—Yes.

Senator CHAPMAN—You also criticise the level of spending. Can you identify where that spending has occurred that you regard as unsatisfactory? Is it, for instance, as a consequence of the need for public sector wages to stay competitive with other sectors of the economy in this boom state, or is it as a result of the state government employing more public servants than you regard as necessary? You talk about the need for infrastructure spending. Is the government, in your view, misallocating its resources and, if so, where is it spending when it should not be spending? Where should it be spending?

Dr Thomas—Every opposition would always say, 'The government misallocates.' It does not matter whether you are state or federal, Liberal or Labor, that would be the case. And you are right: there is a combination of factors that involve nearly all of the things that you have mentioned. Wage pressures are significant in Western Australia, probably more significant than in a lot of other states. That has an impact on the blow-out of expenditure. Having said that, of the additional public servants that are now employed, only a small proportion of those are front-line public servants and there is a significant rise of backroom Public Service operators. It is interesting that, when you see an economy booming, it is a bit like Murphy's Law: the amount of work for social workers effectively expands to fill the number of social workers you have got, and the same applies in relation to the general government sector. If the money is there, the departments are spending it and there is significant wastage in relation to additional public servants.

If you look at the advertising budgets, for example, they are rising constantly. If you look at the number of people sitting in offices that are providing policy direction, for example, they are expanding daily, and the number of public servants who are fulfilling roles that are not front-line public servants is increasing. There has been an increase in police, an increase in nurses and an increase in teachers, and they are all very welcome, but at the same time there has been a fourfold increase on top of that of everybody else. There are priorities there that are very difficult.

There are also some projects that we struggle with, particularly blow-outs in projects. In Western Australia we do have an issue about blow-outs in major projects. We are talking about a $26 billion infrastructure building program. I will give you some examples. The Perth to Mandurah railway blew out by 30 to 40 per cent. In a billion-dollar project, that is a significant blow-out. The Office of Shared Services, which was an $84 million project, has now blown out by about 450 per cent. There are significant projects out there that are not necessarily the best priorities. All of those things are part of the process.

There is an appropriate and necessary increase in the Public Service to provide front-line services; there is a small section to support those people, which is also appropriate and necessary; there is a large increase of assistance effectively being spent because the money is available to spend, and it is not being converted to front-line services. That is a key issue.

Senator CHAPMAN—Given your criticism of the level of spending, are there areas where you believe that this massive growth in revenue should be allocated back to tax reductions? If so, in which areas?

Dr Thomas—We had the state tax review that occurred a couple of years ago. That review identified and prioritised the areas of taxation relief. Let me give the government a small plug: the first level of taxation relief, and the one that probably was the most restrictive, was conveyance duty on residential housing, and some of that relief has occurred. The government in its budget process has announced some relief and, in fact, we have just about finished putting the bill through parliament this week in the lower house in relation to that particular component. So there was some relief for conveyance duty.

There was basically no relief for the business community and there are various arguments about how much is required. There was no relief effectively for payroll tax, or very minimal relief. You could not actually mark it on a chart. So the business community would like to see additional payroll tax relief. My personal position is that, rather than having a significant policy of taxation relief, the great failing that we encompass in this state is that, at a time when effectively the economy has never been bigger and our ability to tax has never been greater, and the ability of industry and people to absorb those taxes has never been greater, we have not converted those taxes into future-proofing the state, and that is a key component.

Senator CHAPMAN—In some of the other states where we have had hearings, evidence has been presented to us that state governments have been misdescribing some of their activities. In schools, for instance, what should properly be described and accounted for in revenue terms as maintenance has been described as capital works to get it off the revenue budget. Do you have any evidence of that happening here?

Dr Thomas—In Western Australia, because it is in very good economic times, I suspect you will find that there is a minimal amount of that type of shifting or juggling of the books. There is some other significant juggling of the books. I personally have been looking at the energy supply issue, and this is probably a good example. Western Australia’s energy system and Verve Energy, its energy producer, is losing money, interestingly, at a time when it is very rare for that to occur.

The government is going to effectively squirrel away $1 billion into that system and also raise prices 10 per cent a year over eight years, and it will turn around the non-government financial sector from an expected $200 million loss in the 2008-09 financial year to a $420 million profit. So there is a $620 million turnaround, where the government is taking money which it has at the moment because it cannot spend it. The last of the boom is being hidden away in the energy sector. When the government moves the public non-financial sector in one year from a $200 million loss to a $420 million profit, obviously the government takes half of those profits back as revenue. So it goes from a situation where there is no money loss to an income of $200 million, which will grow over the years exponentially after that.

That is probably the only example. It is not a cost shifting within departments, but the last of the boom has effectively been hidden away to increase revenues into the future. Under that circumstance, the growth in expenditure which cannot be controlled has to have some matching growth in revenue, and that growth in revenue to some degree will be the government squirreling away some money eventually in Verve Energy through its community service obligations through Synergy. That is probably the one significant example of money being shuffled from one side to the other.

Senator POLLEY—In terms of your criticism of the government’s advertising expenditure, you are probably taking a leaf out of the former federal government’s book—

CHAIR—I’m not sure that that’s a question that requires an answer!

Dr Thomas—You might well be right, Senator Polley.

Senator CORMANN—I remember Geoff Gallop’s criticism of the Court government’s advertising. It was much less than they ever did.

Dr Thomas—I suspect it is one of those constant issues. We have all seen at a state and a federal level advertisements which are discreetly followed by—or not so discreetly—'authorised by' the state or federal government, Perth or Canberra. It is a good way to get your name out there. A very good example is the advertisement in relation to cane toads here.

CHAIR—I don't really think it required an answer!

Dr Thomas—I will give you an answer about cane toads some other time.

Senator POLLEY—But it is something that the public is concerned about.

Dr Thomas—Absolutely.

Senator POLLEY—The public has a genuine interest in how the money is spent, and I think they have every right to be concerned about it—

Dr Thomas—Yes, at both levels.

Senator POLLEY—no matter which side or where it comes from.

Dr Thomas—Yes, I agree.

Senator POLLEY—Where do you source the graphs used in your submission? There is no sourcing reference here. So in terms of how much weight we put on these, if you could take that on notice, we would appreciate it.

Dr Thomas—Yes, absolutely. Graphs like that come from the department of treasury in each state. Most of the graphs come from the department of treasury.

CHAIR—I think they are in the department's submission later on.

Dr Thomas—Yes. You will find that about half of the stuff that I have used is from the WA Department of Treasury and Finance who, might I say in case there is any press, are very good and we have great and enormous respect for them.

Senator POLLEY—In your submission you raise your concerns in relation to how the Commonwealth government has used the Corporations Law.

Dr Thomas—Absolutely.

Senator POLLEY—Then you talk about how it undermines the independence of states. I take it then you would have had the same concerns, although I do not recall them ever being expressed, in how the government used the same laws for Work Choices, for instance.

Dr Thomas—I think you will find that in the Western Australian parliament it was expressed very firmly by both sides of parliament.

Senator CORMANN—Yes. I can confirm that.

Dr Thomas—Western Australian is a little different to most other states in that our parochialism outweighs our party allegiances. In the last three years I personally have spoken on the issue probably half a dozen times. We raised significant concerns. Part of the driving force for the Public Accounts Committee—and it was an investigation I initiated—was in relation to what was happening under the Corporations Act. I think that the High Court of Australia has always had a vested interest in supporting the Commonwealth government over the state, and in my opinion that has resulted in the outcome which you see in relation to the Corporations Law. The decision in Corporations Law was, in my non-legal opinion, very dangerous and I think it will rewrite the entire federal system that we face, certainly to the detriment of the state and, in my personal belief, to the detriment of the communities that those states serve.

Senator BUSHBY—Interesting to see how you use Fuelwatch in that sense!

CHAIR—I noticed in your submission you made a point of that. I think most lawyers would disagree with you very strongly on your comments about the High Court.

Dr Thomas—I accept that is the case.

Senator POLLEY—You raised the issue in relation to the funding from federal to state, and we had a discussion this morning about whether or not states should have to come cap in hand to the federal government and whether or not there has been an investment by the Commonwealth. Coming from Tasmania, certainly many of us feel that the previous Commonwealth government interfering in the health system has been to the detriment of the Tasmanian system when it comes to the Latrobe hospital. But you would certainly, I would have thought, be welcoming the just over $13 million that has been given in additional funding on top of the $28.6 million that was allocated to slash the waiting lists here in WA, because in every other community that I hear from there is a real issue in relation to accessing health services.

Dr Thomas—Absolutely. Any funding that goes into the health system—and particularly in terms of waiting lists—is welcome. We welcome any additional funding.

Senator CORMANN—Except that $270 million went out of the system as a result of the Medicare levy surcharge.

Dr Thomas—I am happy to let the committee debate the issues about where it has come in and where it has gone out. Every additional piece of resource that we have to engage in those areas is welcome. That is a positive.

Senator POLLEY—But do you acknowledge that there was a reduction here over the last 12 years, in terms of the health budget, coming from the federal government to all states? Every other state will acknowledge the fact that there was a reduction by the Commonwealth over many years, which has led to the long waiting lists.

Senator CHAPMAN—State governments do.

Senator POLLEY—Yes.

Senator CORMANN—Labor state governments.

Dr Thomas—In relation to the overall funding, as a proportion of health funding, the level that the Commonwealth spent compared to the states decreased, yes. Yes, I agree with that. The question you would ask, I guess, is whether the states were then funded elsewhere, and this is one of the issues I have with both sides of federal parliament in relation to tied grants. The GST funding goes into the health system. Other funding that comes from the states goes into the health system. Some of it is tied; some of it is not. How much of that is apportioned to the state government is a thing for state to state.

We would always like to see the Commonwealth government invest more in the state. The general thing in Western Australia is that we are parochial and we would like to see them hand it over without strings. That is not always going to be the case. My personal preference is for a reduction significantly in the tying of those grants, but every dollar that comes into the state is welcome. In relation to the specific health dollars coming from the Commonwealth, I agree with you that in relative terms compared to state expenditure it has decreased. The argument as to whether the state should have found that money from an alternative source is a moot one.

Senator POLLEY—Your assertion in your submission is that WA is the highest taxing state.

Dr Thomas—Per capita, yes.

Senator POLLEY—Yes, but you have a very healthy surplus. I would assert that over the last 12 years the federal government has done very little in terms of investing in rural infrastructure around the country. Where do you see that that money needs to come from now? Can the state can fund it or are you expecting the Commonwealth government to invest in infrastructure?

Dr Thomas—The state can fund some of its own infrastructure. As I have said, this is the key part of this graph—that is, between 2002 and 2007, and probably to 2008-09. To that point is the boom period in which the state should have been investing in infrastructure, which is why I draw that line in texta marker. The government will argue that it has, but my argument is that the government has not invested in infrastructure that future proofs the state. The arguments will go on as to whether the state would be better served by the infrastructure on the government's agenda or whether the state would be better served in the long term by developing infrastructure in regions which actually provide resources into the future. But you are right: the state has never had a greater opportunity to provide its own infrastructure than in that period 2001 to 2008-09, and in my opinion it has failed to do so adequately. When you talk about the north and those developments, iron ore royalties predominantly hit the state. Converting those into future proofing the state was the agenda for the current government in the current period of time, in that period when iron ore prices boomed.

Senator BUSHBY—You have mentioned that taxes are the highest per capita. Would you say that the services that are delivered by the government are also the best per capita in the country?

Dr Thomas—No. The services that we provide are probably somewhere in the middle. There are probably some disasters, potentially, in New South Wales, but there are certainly areas that provide better services than us. This is one of the issues that the people of Western Australia generally have to face: that, as the highest taxed—and not just 'the highest taxed' but significantly the highest taxed—people in the country, their expectation is to have significantly the best services in the country, and the feeling amongst the people of Western Australia is that that is not the case. There are a number of reasons for that. One is the competition with the private sector; another is the management of those systems in the state. In relation to law and order, the people of Western Australia feel no safer in their houses. The government conducts its own survey of satisfaction in relation to the community. It surveys thousands of people and it does it every few years. The interesting outcome of that is that health was probably the prime example. In a period of time when they have never been taxed higher, people's view of the health system is that it has significantly declined.

Senator BUSHBY—You touched on some of the reasons before, including the additional number of public servants in the back rooms rather than in the front room, but essentially you have a situation where the state government has record revenues. It has never before had access to anything like what it has at the moment, and yet it has not used that revenue to the best purpose for the people of Western Australia.

Dr Thomas—No, it is not a complete bagging session. In some areas the government has performed relatively well, but across the board in some of those key sectors—health, education, and law and order in particular—there is a feeling in the community and a feeling amongst the opposition, who reflect, obviously, what is being felt out there, that the services have not kept pace with the level of taxation that the government has enjoyed. There are numerous examples of governments picking winners and losers, and that is a dangerous thing for both Commonwealth and state governments. Some areas end up in winning situations, and a lot of other areas end up with a loss. The number of people who consider themselves to be in the areas that have lost out by far predominate.

Senator BUSHBY—What has actually caused you to go to the position where you are now the highest taxing? Was it specific new taxes or was it structural, caused by the property boom effect on rates, taxes and land taxes?

Dr Thomas—There are a number of reasons. The biggest contributor is conveyance duty and the rise in the price of buildings et cetera in Western Australia. There are a number of reasons for that. One is that people have more money, so they can afford to pay more. A major significant reason is that for a period of time there has been a blockage in releasing land. The land price has been driven up. Because the government could not get blocks of land on the ground between 2003 and 2006, effectively it drove up the price of land. Those blocks remaining were in competition. It drove the price of land up. At the end of that process, when in 2008 we finally started to get land on the market at a better level, everybody had such an investment in the land being at that higher price that nobody was willing to allow the price to drop. The greatest increase in revenue of the state has, effectively, been the increase in land sales, which are related to the planning process. Land prices here, as in many other places, have skyrocketed, and Perth was the least affordable city in the country.

Senator BUSHBY—That is probably what I expected. What has the government been doing with its surpluses? Has it been retiring debt? Are you debt free in a general government sense?

Dr Thomas—In a general government sense we are net debt free. The government has retired some debt and it has also invested significant money in major pieces of infrastructure. For example, it paid for the majority of the Perth to Mandurah railway up-front. It has put $1 billion aside for the Fiona Stanley Hospital. Depending on your version of accounting, those are good or average actions. A lot of that money, though surpluses, has gone into those areas. The Perth to Mandurah railway is a good example. You have paid for it up-front, so apart from—

CHAIR—Yes. Can I just confine you to the question. We really are running out of time.

Dr Thomas—Yes.

Senator BUSHBY—Are government business enterprises debt free as well?

Dr Thomas—No. The non-financial government sector occupies significant debt. Western Power corporation, which is the lion, owes about $2½ billion. Verve Energy, which is the black hole in terms of operating costs, owes $1 billion. I think close to another $10 billion is owed all up.

Senator BUSHBY—Has the government been taking dividends out of those companies?

Dr Thomas—Where there is an accrual profit basis they do. They do, for example, take a profit out of the Western Power network, despite the fact that it owes $2½ billion.

Senator BUSHBY—Are you saying that they only take dividends where there are profits?

Dr Thomas—Yes. Verve Energy provides no dividends because it is making a significant loss at the moment.

Senator BUSHBY—It is not the case in WA, then, that the government has helped pay off its debt by shifting the debt effectively into government business enterprises?

Dr Thomas—Only in this one form. Government pays off its debt by increasing its revenue. It increased its revenue significantly perhaps by having a land increase and increasing its conveyance duty. That conveyance duty requires people to borrow to pay for it, so the government is effectively paying off a large portion of its debt by having the private sector go into that debt in relation to its revenue. I think that is the only real way that there has been a cross subsidy.

CHAIR—I think we can explore that with the department later. They have some graphs on that.

Senator KIRK—Thank you very much for your submission here today, Dr Thomas. On page 10 of your submission you talk about 'Where to from here?' and a number of these matters we have already canvassed. I want to ask you just a bit about point 1, which talks about how the tying of grants politicises service and infrastructure delivery.

Dr Thomas—Yes.

Senator KIRK—I think what you are trying to say is that, in your view, a better approach is to hold the state government to account for its expenditure within its own electoral cycle.

Dr Thomas—Yes, absolutely.

Senator KIRK—Can you explain what you mean by that.

Dr Thomas—My opinion is that, rather than tying the grant at the start of the process and saying, ‘It will deliver this outcome’—and often it does not—it would be better to say, ‘Here is the grant. We expect to see improvement in this general area. If you don’t do it, we will simply advise the community of the fact that you haven’t done so.’ Rather than what you think is the outcome you require, require a more general outcome and then allow the state government to succeed or fail on its own terms and be judged accordingly. If it is a case of taking out a full-page ad and saying, ‘We gave $300 million for this environmental outcome. The government has failed completely,’ then such is life. Normally you would find that that would be made obvious anyway. But there is a natural way in which a state government is held to account. In this state government, that is my job. I do not believe that it is the Commonwealth’s job to tie the grants to make sure that they get an outcome that the Commonwealth requires.

CHAIR—Both the Chamber of Commerce and you, I think, are saying that the states should raise their own money, spend it how they like and be held accountable by their electors.

Dr Thomas—Not entirely, but to a large degree. You have obviously got to tie some outcomes, but the state should be held far more to account.

CHAIR—I think this is Senator Kirk’s question: how do you do that? Do you want to take the income tax powers back?

Dr Thomas—I do not think the states do. Me, personally, yes, I think it would be a good idea, but we will not go there because it is probably impossible to manage.

Senator POLLEY—That would be okay while you have got a boom.

Dr Thomas—Yes, that is right; it could come and go. But that is not the process.

CHAIR—Isn’t that the principle, though?

Dr Thomas—No.

CHAIR—You raise it, you spend it and, if you mess it up, the electors take their retribution.

Dr Thomas—Well, it does. But whether the Commonwealth raises it and passes it off for a grant and says, ‘We raised certain levels of taxes. This part is GST. This part is income tax. This part is business tax. Of that, we send this much to the state,’ we expect a certain amount to be paid up by the Commonwealth, in relation to the health agreement, for example. But what you find at the moment is that, yes, we do that for the health agreement, and then we have 20 or 30 different little pockets of money that the Commonwealth decided they wanted spent on this, spent on that, often to the detriment of the states’ programs.

What the Commonwealth needs to do is to look at it and say, ‘Overall, health funding should be about here. We’ve picked two or three major targets that we expect you to meet’—and I actually agree with setting targets for performance: ‘We expect you to meet certain performance targets, but we’re not going to tell you exactly how you tie your money in.’

Senator KIRK—Just to clarify: when you talk about that accountability, is that done by the state opposition, as it is today, or by the Commonwealth?

Dr Thomas—The ultimate accountability is to the actual electorate, to the state. So the state community and the state voters have the ultimate accountability. The state position is only as good as the opposition you have got at the time. The accountability from the Commonwealth is, I think, probably the least valuable of the three. I think it is ultimately the electors and the community which need to be the final arbitrators of whether those services are provided adequately or not.

Senator KIRK—But who is meant to raise whether or not the standards have been met or the outcomes have been achieved? Is that the Commonwealth?

Dr Thomas—An opposition would raise it constantly, if it was doing its job, and the Commonwealth, if it was doing its job, would do the same thing—‘We have set standards. We expect certain parameters to be met.’ The state can then say, ‘We’ve met them,’ or, ‘We haven’t met them and we think they’re inappropriate,’ or, ‘We haven’t met them and we just can’t do our job.’ It would be appropriate for the Commonwealth to set some parameters in which it wants to see outcomes. It would then be for the state to debate whether those outcomes were appropriate and whether they could meet them.

Senator CORMANN—I do think that is really the crux of the issue, and the chairman has pretty well summed it up. The problem with tied grants is that he or she who controls the pot of gold sets the rules and the Commonwealth obviously, if it raises revenues, is accountable for how it spends the revenue. My question in that context is: as Treasurer of Western Australia, what would be your template for reforming Commonwealth-state financial relations? In relation to that, what is your view on suggestions that there ought to be a broadening of the revenue base of the states—not increasing taxes but a broadening of the revenue base of the states—so that they could be more truly accountable for their own performance, rather than having to rely on the Commonwealth raising revenue on their behalf, effectively, which is then sent back to the states with, as you say, strings attached? What would be your template for reforming that sort of interrelationship and what are your thoughts on broadening the revenue base for the states?

Dr Thomas—In terms of the raising of revenue or a revenue base, I do not have a moral objection to it being raised in one area and transferred to another. My whole agenda here is to talk more about the outcomes that you get for that tax raising ability than how you raise the tax. My personal preference is to see the state being able to raise more of its own revenue and have greater accountability for it, but I accept that that is probably unlikely. In the longer term, I suspect that what we need to do is have a greater level of communication between Commonwealth and state governments, and that means less control of each other’s actions and more demand for accountability. As a Treasurer, I would be particularly interested in working with the Commonwealth, because I expect to see fewer tied grants. I expect you to see set performance parameters which I would then argue, to the general public, whether they are appropriate or not, and then I would expect you to be able to comment on whether I had met them or not and have the debate at that point.

I agree with broadening the state taxation base. We were talking about the growth of taxation and the growth of revenue. States have done relatively well compared to local government but by far the increase in revenue at Commonwealth level has outstripped everybody. The argument then comes back as to how you distribute that fairly and equitably.

Senator CORMANN—The issue at the end of the day—and I will sum up on this—is that whoever raises the revenue is going to be accountable to the public as to how they are going to spend it. If the Commonwealth raises the revenue, whether or not they send it down to the states for them to administer in relation to certain policy areas of responsibility, ultimately the Commonwealth is going to be responsible for that expenditure and how that is being spent. If the states are going to be truly responsible, surely they have to be responsible both for the revenue raising side of it and the spending side of it. If the Commonwealth raises revenue and transfers funds in whatever way to the states, there are always going to be some strings attached to it, and that is what I hear you object to.

Dr Thomas—I understand what you are saying but I disagree at one level on the principal supposition—that is, the Commonwealth, in raising the revenue, has to control the expenditure and cannot pass that back to the states to control. I disagree with that parameter. The Commonwealth took over income taxing powers, but it is not necessarily the case that control has to be handed over to the Commonwealth in respect of all that those taxes might pay for. The Commonwealth, to my mind, to a large degree usurped income taxing powers.

Senator CORMANN—I agree. I do not think it is a good thing.

Dr Thomas—One of the options is to hand the same taxing powers back to the states. I think that is one way in which the state could have a better outcome in relation to maintaining its own affairs. The only other possibility that I see is for the Commonwealth to say, ‘Well, part of our role is to raise taxes and income for the states. It is not our role to control how the states spend that but, because we have usurped the income taxing powers and other state taxes—we gave some back; there has been some ebb and flow over the last 100 years—because we have taken over and we have the greatest taxing power, part of our role is to give some of that money back to the states. It is not our role to control that.’ In fact, in some areas of state control—and health, as the senator mentioned, is a good example—it is far more problematic for the Commonwealth to take control, and I think the Commonwealth, if it had any sense, would step back rather than step forward. We probably agree on lots of those issues.

I think there are two options: one is for the state to take over more of its own taxing powers or revenue powers; the other is for the Commonwealth to accept that the state has a role to play and accept that, as part of its role as an income collecting group, it has to actually transfer that money back. And it originally did so. If you look at history, back in the first half of the 20th century, the Commonwealth taxed on the basis that it would return money, without strings attached, to the states. It has in the last 20 years, starting with the Hawke and Keating Labor governments, expanded beyond doubt to an incredible level under the Howard government and is continuing now. You have this massive involvement of the Commonwealth in state affairs. It does not have a historical basis for that.

CHAIR—Yes. You have mentioned that in your submission, which we have read, and also the chamber of commerce have some very interesting papers, which we will follow up, on this theme. Dr Thomas, thanks very much. It is a shame we did not have half a day to talk to you because I think, in a non political partisan way, we could have had a very good discussion between all of us; not too many of us agreeing on too much. Thanks very much for coming along. It is good to get the views of yourself, representing a substantial part of the Western Australian population. Thank you for your time, and all the best for the future.

Dr Thomas—Thank you.

[10.38 am]

BARNES, Mr Michael, Executive Director (Finance), Department of Treasury and Finance, Western Australia

MARNEY, Mr Timothy, Under Treasurer, Department of Treasury and Finance, Western Australia

CHAIR—Welcome. We apologise for our late start and for keeping you waiting, appreciating that your time is very valuable.

The Senate has resolved that an officer of a department of a state need not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to the minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. I assume you have all previously been before committees and understand that these are committees of parliament, with privilege et cetera, which I will not go through.

Before I invite you to make an opening statement, I particularly want to thank you for your submission, which I found very helpful, very useful, with a lot of the information that the committee is seeking. I have a lot of questions which I will not be able to get through, and I suspect that other committee members will have the same problem. If you would like to make an opening statement, we will then have a look at some of the material you have provided.

Mr Marney—Thank you very much. Thank you for the opportunity to be here. I will keep the opening statement pretty brief and rely on your questions. That may be the more productive way to go, because we are a little bit behind schedule.

There are three areas that I would be keen to focus on. Firstly, there is our legislative and reporting framework. Hopefully you have had the opportunity to examine our budget papers. We are proud of our budget presentation and its transparency and accountability.

CHAIR—For the benefit of non Western Australians, I assume since your paper was written that the budget has come down.

Mr Marney—Yes.

CHAIR—When was the budget?

Mr Marney—It was 8 May.

CHAIR—Thank you.

Mr Marney—Our legislative framework supports that transparency and accountability through the Government Financial Responsibility Act. Through that act, we publish quarterly financial results and reports and, consistent with other jurisdictions, a mid-year review, financial projections report and an annual report on state finances. In addition to these, we publish monthly reports of general government finances. All of those reports receive quite a degree of scrutiny in the state and usually get some media interrogation as well, which we think is particularly healthy.

It is also worth noting that Access Economics until recently produced an annual report on their assessment of the transparency and accountability of financial reporting in the jurisdictions and consistently rated Western Australia's budget presentation and legislative framework as the most transparent. That is the framework.

In terms of the next key issue, infrastructure, there was some discussion around that in the previous session, and we can probably look to questions to deal with most of the particular issues there. The shadow Treasurer was calling for infrastructure for future proofing. If you look through the budget that was brought down on 8 May, there is substantial investment in that regard—for example, a new power transmission line to Geraldton in the state's mid-west, which is part of feeding the growth in the smaller iron ore producers in the mid-west region and complements expansion in the Geraldton port that was undertaken a number of years ago. All of that is about ensuring the state's economic infrastructure capacity stays one step ahead of the demands of the economy rather than being in a situation of bottleneck.

Similarly, Utah Point at Port Hedland is undergoing major expansion. That is $216 million to expand the capacity to ship iron ore through Utah Point and Port Hedland port. Electricity is a major investment of the state. To put it into context, this year's budget provides for expansion in electricity transmission in the state equivalent to running a new set of 330 kV lines from Melbourne to Canberra. That is the extent of investment that is going on at the moment. I would argue that that is—

CHAIR—As a public servant, you don't need to argue with politicians! You just give us the facts.

Mr Marney—Okay.

CHAIR—We do not want to put you in a position where you—

Mr Marney—I will leave you to conclude, on the basis of those facts, whether or not the infrastructure is future-proofing the state.

CHAIR—Sure.

Mr Marney—The last point I will touch on very briefly is the Commonwealth grants process and the issue of the net fiscal subsidy from Western Australia to the rest of the nation. We estimate that the balance between what is collected in terms of revenue by the Commonwealth from Western Australia versus what is spent by the Commonwealth in Western Australia is a deficit of around $6 billion—that is, when we compare the revenue benefit out of the state and what the state gets back out of the federation, it is about a $6 billion loss for Western Australia.

CHAIR—This year?

Mr Marney—Annually.

CHAIR—What was it 20 years ago?

Mr Marney—I am not sure what it was 20 years ago.

CHAIR—I would simply make the point that these things change.

Mr Marney—Yes. It has increased substantially over the last eight years. I think we used to estimate that it was in the vicinity of $1½ billion to $2 billion per annum probably a decade ago.

CHAIR—I am from Queensland, and Queensland and New South Wales have done very well over the terms of federation, but in the last few years we have started paying more than our way.

Mr Marney—I believe in the economic underpinnings of federation and the Grants Commission processes. I think there are some enhancements to those processes that are necessary to recognise what the state must spend to generate Commonwealth revenue and that broader sharing of wealth across the nation. We are working with the Grants Commission in its current review process to seek to achieve greater recognition of that infrastructure requirement, both in terms of economic infrastructure and social infrastructure.

CHAIR—Thanks very much, Mr Marney. You mentioned the net debt to revenue ratio of the total non-financial public sector as below 47 per cent. How does that rate across Australia and across the world? Is that good, bad or indifferent?

Mr Marney—It is a level which the government has decided is consistent with prudent management of the state's balance sheet.

CHAIR—How does it compare to the rest of the states?

Mr Marney—On the basis of the recent budgets from all other states, it is probably about the middle of the pack now. From memory, South Australia is significantly lower; Victoria is accelerating and will be above that by the end of the forward estimates period; New South Wales is significantly above; Queensland was substantially lower.

CHAIR—By international government standards, is that a ballpark figure?

Mr Marney—For an AAA rated state or jurisdiction, it is comparable.

CHAIR—In relation to the graph on page 9 of your submission entitled 'Impact of dividends and tax equivalent expenses', I was working these out on the plane coming over, without a calculator. As I calculate, just in the 2005-06 and 2006-07 years, if my calculations are right, the return of net operating surpluses is something like 70 per cent in the first of those two years and 61 per cent in the next year. Is that correct? Am I doing the right sums?

Mr Marney—That is about right, and it reflects the fact that a key component of that is the dividend payout ratio, which is set almost uniformly across the board at a 50 per cent rate, except for Water Corporation.

CHAIR—So you are saying that 70 and 61 is an averaging of the 50 plus the 85.

Mr Marney—Yes, plus the tax equivalents.

CHAIR—That curtails what is left in these corporations for investment into infrastructure. 'Curtails' is probably a pejorative word, but is that a reasonable—again across Australia and across the world—result? Just for comparison purposes, is that good, bad, indifferent, shocking, horrifying, brilliant or what?

Mr Marney—Again, it is about middle of the pack. They are not excessive ratios in terms of dividend payout. I would argue, however, that that dividend payout goes back into the net debt position of the state as a whole, or is considered in the context of the net debt position of the state as a whole, and the owner of those entities, and financier, being the executive of government, then takes discrete decisions about how to invest that net debt capacity. It does not curtail their investment but it takes the decision making, in terms of their investment, back to the financier.

CHAIR—You are getting revenue from a certain area. You are not hypothecating it to that area necessarily. You are giving it to the general funds and then letting governments make broad decisions as opposed to reinvesting it on where you are making the money.

Mr Marney—And at this point in time, if we constrained them or curtailed them to investment in accordance with their dividend payouts, their investment profiles would be drastically reduced compared to what is being invested through those entities at the moment.

CHAIR—What, by the general government revenue? If you took a 10 per cent dividend instead of a 70 per cent dividend, doesn't that mean that your water infrastructure would be absolutely the best in the world, if you are investing 90 per cent of the profits?

Mr Marney—That may be the outcome if our water entity is profitable.

CHAIR—I picked the wrong one.

Mr Marney—Yes.

CHAIR—Take one of the others.

Mr Marney—Take one of our power entities, Verve: if they were constrained to their dividend payout, then they would not have any investment at all at the moment. It is necessary at times to rebalance the level of investment in accordance with priorities on the basis of cost-benefit for the state. That means we have to consider in relative terms investment in water versus investment in electricity versus investment in hospitals.

CHAIR—If, say, you only charged a 10 per cent dividend on one of the profitable corporations, that means you would have 90 per cent investment in infrastructure or you would be reducing your income by cutting your prices to your consumers.

Mr Marney—Or they may be reducing their debt holdings.

CHAIR—Yes.

Mr Marney—Yes, that is a fact.

CHAIR—And so it is a matter of government policy that the government makes its revenue not just from taxing but from these government corporations who are actually selling services or goods.

Mr Marney—Yes.

Senator BUSHBY—Is the level of the dividend that is taken from those organisations decided in accordance with a set policy or formula, or is it just an ad hoc decision by government?

Mr Marney—It is based on a 50 per cent payout ratio, which is a decision by government based on analysis of what is a competitive payout ratio relative to similar entities in other jurisdictions and what is appropriate to their balance sheets; hence there is a different payout ratio for the Water Corporation.

Senator BUSHBY—But it is a formulaic approach of some sort?

Mr Marney—Yes, but it is ultimately a decision of government. They come to a landing, and that is it.

Senator BUSHBY—So at the next budget they might say, ‘Well, we’ve got to alter it this time. We’ve got to take more money out of this particular one.’ Is that something that potentially could happen?

Mr Marney—It potentially could happen, but historically it has not happened.

Senator CORMANN—How often do they stick to the formula?

Mr Marney—My recollection is that this current government has changed its dividend payout ratios on probably only two occasions in eight years.

Senator CORMANN—So all other occasions are fifty-fifty?

CHAIR—Except for the two that you have specified.

Mr Marney—They are very stable. We try and ensure that those entities have the right payout ratios appropriate to their balance sheet and we try and keep them stable.

CHAIR—The Gold Corporation is 60 and the Water Corporation is 85.

Mr Marney—Yes.

CHAIR—But the others are all 50.

Mr Marney—Yes, that is correct.

CHAIR—I would like to know what the Gold Corporation does, but that is for another time!

Senator KIRK—Thank you very much for your submission, gentlemen. I am interested to learn more about the Strategic Asset Management Framework that has been implemented, in particular the way in which it operates. There is a suggestion on page 3 of your submission that Western Australia has not suffered the sorts of bottlenecks experienced in other places and I wonder whether or not you attribute that to the state Strategic Asset Management Framework.

Mr Marney—Thank you. I could be overly congratulatory of that framework and say, yes, it is attributable, but in fact it is not. I think there has been a lot of good luck, to be honest, in being ahead of the demand requirements of the state's economy. I think, though, our planning for infrastructure has been reasonably robust and there have been some investments in capacity which have been long term. If I went back to our advice at the time, probably it would have been, 'Yes, maybe that's a bit early,' and it has proven to be timely, so I think that it has been quite strategic of government to place greater emphasis on expansion of the productive capacity of the economy as opposed to recurrent spending on an ongoing basis. The framework itself I think is quite robust. Implementation of the framework is something that we are continuing to work on.

Senator KIRK—When was it first introduced?

Mr Marney—I think it was three or four years ago.

Senator KIRK—Is it reviewed on an annual basis or is it a framework that is set for a period of time?

Mr Marney—It is set, but, in the context of pressures in delivery of major capital projects, we are currently reviewing various aspects of delivery, and greater integration of the Strategic Asset Management Framework with methodologies like the gateway process of reviews is something that we are working on at the moment.

Senator KIRK—You mention also that the government has a—

... commitment to develop a State Infrastructure Strategy (SIS) to guide the planning and provision of infrastructure in Western Australia over the next twenty years.

I know that you wrote this submission some time ago. You say that the white paper in relation to the SIS is expected around the time of the budget, and I understand from what you have said that the budget has been delivered here, so I wonder about the status of the SIS.

Mr Marney—The State Infrastructure Strategy is in its final stages of preparation and we expect that it will be publicly released by the government within the next eight weeks. It is a substantial document that seeks to outline the entire capital works program of the state in detail over the next five years, in a lesser degree of detail over the next 10 years, and then directional statements on the horizon from 10 to 20 years, incorporating information from local government, Commonwealth government and the private sector so that there is a combined sense of where infrastructure in the state is headed, so that we can all align in light of that information.

Senator KIRK—To date, has there been very much interaction in this process with Infrastructure Australia or the Council of Australian Governments—COAG—Infrastructure Working Group?

Mr Marney—Infrastructure Australia and the COAG Working Group have come at the tail end of the infrastructure strategy. My objective is that the infrastructure strategy itself will then help us inform COAG and Infrastructure Australia about what some of those infrastructure priorities are for Western Australia and where those priorities are of national importance as opposed to just state importance; so it will feed into those processes going forward, as opposed to having been informed by those processes in its formulation.

Senator KIRK—Do you think the two will be complementary?

Mr Marney—Absolutely, yes. We would be at a significant disadvantage in those processes without the State Infrastructure Strategy.

Senator CORMANN—Mr Marney, I would like to ask you a couple of questions around the issue of Commonwealth-state financial relations. Obviously there is a series of areas of responsibility, but there is overlap between the states and the Commonwealth, and, if there is a significant policy change at one level or the other, it can have an impact on the funding requirements or service delivery at the other levels and to some extent you are exposed to some sovereign risk.

I will give you an example and ask you some questions. I think that is particularly the case in the area of health. The Commonwealth government has made a decision to increase the Medicare levy surcharge. When I asked questions of the Commonwealth Treasury in relation to that, as to whether they have costed or modelled or assessed the impact on states and territories and their capacity to fund the required levels of public hospital service delivery, essentially I was told, ‘Well, no. These are second-round effects. We don’t cost second-round effects.’ But looking at statements by the health minister here in Western Australia, Jim McGinty, clearly there is an expectation that there is going to be an impact on this state, and I think other state health ministers have made similar comments. In fact, Jim McGinty thought there was a clause in the Australian Health Care Agreement which would lead to automatic funding increases which, as it turns out, there is not. Have you made any assessment of the impact of that policy change?

Mr Marney—No, not at this point.

Senator CORMANN—Is that something that you expect that you will do?

Mr Marney—It is something that I expect our Department of Health will do and inform us as to the implications. That would be something, again, I would expect to be on the table in the negotiations of the next national health care agreement.

Senator CORMANN—This is not a partisan comment: both sides of politics have made statements over the years, state and federal, that there was a level of cost-shifting between states and the Commonwealth. If there is a significant impact on your spending commitments, isn't that something that you would, as a state Treasury, have to assess?

Mr Marney—Yes, and we will do that in conjunction with our Department of Health and feed that into our negotiation of the next Australian Health Care Agreement. Health is probably the most problematic area of interaction of Commonwealth and state responsibilities, in terms of funding and in terms of jurisdictional control at various levels within the system. With the Commonwealth controlling primary care and pharmaceuticals and aged care and the state dealing with tertiary and secondary, in the middle, any movements at the margin have substantial implications for other levels.

Senator CORMANN—I appreciate what you are saying in terms of movement at the margins. But if you have a look at—and I invite you to do this—page 33 of Budget Paper No. 2, you will see that the Commonwealth expects to save, over the forward estimates, $959.7 million as a result of the people they expect to leave health insurances because they will no longer have to pay the 30 per cent rebate. Now, the 30 per cent rebate obviously is only a proportion of the overall revenue that is going to go out of the health system. If you do a quick extrapolation of that $959.7 million, if that is 30 per cent rebate, that is $3.2 billion worth of funding for hospital treatment in private and public hospitals that is no longer going to be available. That is a big figure. Even if you make adjustments for health fund costs of administration and net margins, I would put it to you that the amount of funding going out of the health system nationally is $2.7 billion which, rule of thumb, 10 per cent Western Australia, has a $270 million impact on your bottom line. That is not at the margin, is it?

Mr Marney—No, it is not. But it is, I guess, one of many factors that impact on our modelling of demand for health services in this state and for the demand that impacts on the public health system. It is a factor that, as I have said, we will seek to understand both from a forecasting perspective and also, as that impact emerges, the implications of that, and we will feed that into our negotiations with the Commonwealth.

Senator CORMANN—Would you share the assessment by Commonwealth Treasury? This is now from a general policy point of view in state-Commonwealth financial relations. Are you comfortable with the statement at Commonwealth Treasury level that, 'This is just a second-round effect. We don't really have to worry about this,' or would you actually prefer that Commonwealth-state relations were structured in a way that gives you some sort of reasonable expectation of what is coming your way; that there ought to be some sort of process of consultation or discussion when matters like these are pursued between the state and Commonwealth, feeding into your forecasting?

Mr Marney—I think we have that process through the negotiation of the Australian Health Care Agreement.

Senator CORMANN—Once every five years.

Mr Marney—Yes, but there are amendments to those agreements from time to time, and I would expect, if there are significant shifts in the landscape or where a line in the sand is drawn between Commonwealth and state responsibilities, that those agreements provide for renegotiation around those parameters.

Senator CORMANN—So you would expect, as part of the next Australian Health Care Agreement, that there would be an increase in base funding to compensate for any policy impacts, any demonstrated policy impact, of the Medicare levy surcharge change?

Mr Marney—I would expect that that would be one of our points of argument. Whether or not that eventuates is another question.

Senator CORMANN—Thank you.

Senator BUSHBY—In New South Wales I understand that when Bob Carr became Premier they introduced an act which essentially required the government to invest surpluses in good times in a way which would increase the ability for the state government to continue delivering the same standard of service when times are not so good, without undermining the financial position of government. You mentioned the Government Financial Responsibility Act. Do you have anything in that act, or any other act, in WA that has a similar obligation?

Mr Marney—My recollection is that the Government Financial Responsibility Act has requirements of the government to set financial targets and to report on the achievement of those targets. Those targets, I think, have to be tabled in parliament as part of the budget process. They are therefore required as part of the parliamentary process. Adherence to those targets needs to be reported in the annual report on state finances. So the framework is all there. I guess the difference is that we do not, in this state, have legislation that predetermines those targets. The nature of those targets is at the discretion of the government of the day and subject to parliamentary debate.

Senator BUSHBY—I think New South Wales's legislation is quite unique. But there is no obligation here to basically put things away in good times so that you can continue on an even keel in bad times?

Mr Marney—The obligation is through the requirement to set targets. Whether or not those targets are geared towards that or, in different circumstances, geared towards something other than saving for a rainy day, that is the discretion of the government of the day.

Senator BUSHBY—Obviously, a lot of what is going on in Western Australia at the moment has been based on the boom that has been going for the last five or six years, in terms of its revenue and its capacity to deliver services. How dependent are Western Australians, in terms of the delivery of the services that they receive, on the current economic conditions? What would happen if GSP growth did reduce dramatically or even down to zero per cent? What effect would this have on the budget bottom line and the ability of the state government to deliver the services that they currently do?

Mr Marney—It would depend greatly on the composition of that change in growth. Our revenues tend not to reflect the economy in aggregate but reflect trends particularly in housing transactions and in royalty growth and so on. It would depend on the nature, as to how big the impact would be. The financial management strategy that the government has pursued throughout this period of historically high prosperity is, indeed, not to commit to recurrent expenditure to the same extent as the revenue is flowing in. That has been a substantial challenge in terms of expectations management, and what the community expects to be done with that revenue and to be done in terms of quality of service delivery. However, the government has taken the opportunity, consistent with its financial targets, to strengthen the balance sheet of the state, which is a very important element of future-proofing. So it has taken the opportunity to fund major pieces of economic and social capital debt free, and I think the shadow Treasurer mentioned the New MetroRail project; also the Fiona Stanley Hospital project. Both of those have been funded debt free. The implication, therefore, if our revenues fell out of the sky, is that our balance sheet is in a very strong position. We should be in a position to sustain our recurrent expenditure without too many dramas.

Senator POLLEY—Could you put in perspective the government's net debt in historic terms—where it is at and where it has been.

Mr Marney—Yes. Net debt at the moment is around $3 billion as at the end of the last financial year and over the next four years is projected to grow to just over $11 billion, so it will triple over the next four years or so. That reflects the magnitude of the capital works program that the state is embarking on, which is around $26 billion over the next four years.

In terms of history, the previous peak in net debt was probably in the mid-nineties at around $8 billion, from memory.

Senator POLLEY—In terms of the boom that WA is in at the moment, what is the projected time frame for that? Having been over here fairly recently in relation to migration and the shortage of skills, in particular, in WA, it does not matter where you drive around here you see a truck and 'drivers wanted'. You go past stores, whether they are restaurants or shops—and I try and help the local economy as much as I can—and there is always 'help wanted'. In terms of this boom, what is the projected time frame now?

Mr Marney—I am sorry to be pedantic, but it is a question of what is your definition of a boom? Is it the rapid growth in exports? Is it employment performance? Broadly speaking, we expect that there is enough work in the pipeline in terms of construction activity and new investment activity to sustain growth for at least the next three years. Over that period we expect investment that has been undertaken in the past few years and over the next few years to flow through to a rapid increase in export volumes.

Surprisingly, the volume of our exports has not grown that much in net terms over the last few years, because that investment activity, if anything, has actually hampered our export volumes. As people are trying to rapidly expand their operations, they are having to shut down components of them for that expansion process.

Over the next few years our export volumes should increase dramatically. It is not until probably four years out that we see some softening in that export performance because of stability in prices, particularly iron ore, which is a big factor for us at the moment in our revenues. As production volumes increase worldwide, hopefully we will see some moderation in price growth. The price growth has been quite remarkable over the last three years or so.

In terms of other sectors of the economy, the housing construction sector is probably the softest it has been in Western Australia now for four or five years, and we expect a moderate improvement in that sector over the next three to four years but nothing too dramatic.

Senator POLLEY—Are there any strategies in place to make housing more affordable for families? The prices here are incredible.

Mr Marney—Yes. Probably the biggest strategies the government implemented have been to increase the level of first home owner concession on conveyance duties, to be the most generous in the country, and then in the most recent budget making changes to conveyance duty more broadly to result in a total cut of around 15 per cent. That has been to both owner occupied and non owner occupied residences, to also try and assist the rental market, because rental pressure is acute as well.

There has also been substantial investment in public housing in recent years, including an additional $450 million in public housing in this year's budget to maintain a build of public housing units of around 900 per annum. Unfortunately, the heat in the economy is such that that $450 million does not buy us any additional homes; it just keeps pace with the cost growth in the construction.

Senator POLLEY—In terms of investment in infrastructure, we heard from the opposition earlier this morning—and you were here—in terms of whether or not that responsibility should be solely with the state government or reliant upon federal funding. What is the appropriate mix for a private investment in infrastructure, like building ports? Should that fall solely on states and the federal government to prop up businesses who are making a lot of money in Western Australia?

Mr Marney—My view would be neither the Commonwealth nor the states should prop up private industry in any way, shape or form. Either it is in commercial interests and therefore in the economy's interests or it is not, and it is not the role of government to intervene in that process. I think where governments have sought to do that over history, that history has a trail of dramatic failures in government's attempts to pick winners.

There is, however, a role for government where infrastructure is appropriately required to be provided to more than one user. There are numerous ports in the state that are state owned because they are accessed by a number of users. There are also ports, and berths within ports, which are solely privately owned because they are for the sole usage of one entity. I think the mix of private versus public financing of that sort of infrastructure depends on the access that is intended, but increasingly we will need to rely upon private investment, and rightly so, to provide some of that key infrastructure, particularly in the state's north.

Senator POLLEY—I do not expect you to talk about the government's policy, but in terms of reducing the state debt—and I know in my home state of Tasmania when the new Labor government there inherited enormous debt, their priority was to repay that debt, and Tasmania is actually looking pretty healthy these days—has that been a priority of this government?

Mr Marney—In the case of Western Australia, it is obviously a rapidly developing economy, so it is not a question of reductions in net debt. The question is: what is an appropriate level of net debt to operate at that is fiscally responsible and also responsible in terms of the expansion of the economy? That has really been the focus of the government and its self-imposed target of a net debt to revenue ratio of 47 per cent, which it judges is appropriate to ensure that the state's debt burden can be serviced on an ongoing basis through the ups and downs.

Senator CORMANN—Has that percentage of net debt to revenue changed over the last 10 years?

Mr Marney—The target was introduced at 45 per cent when this government came to power, so eight years ago.

Senator CORMANN—What was the arrangement under the previous state government?

Mr Marney—There were not, from memory, fiscal targets of that nature.

Senator CORMANN—What was the same ratio under the previous government?

Mr Marney—Even under this government, that ratio has been as low as, I think, 17.9 per cent. That is probably about the lowest it has been historically.

Senator CORMANN—But you project for it to go up to 47?

Mr Marney—No, it is projected to go up to 43.9 per cent.

Senator CHAPMAN—That is a significant change.

Mr Marney—It is, but it is a significant environment, and in order to keep pace and ensure that we do not constrain the productive capacity of the state's economy, and indeed the national economy, given that we now export more than South Australia, New South Wales and Victoria combined—

Senator CORMANN—Sorry, I do not mean to interrupt, but I am sure we are going to run out of time. How much of that 43½ per cent goes into productive capacity as opposed to non-productive capital investment?

Mr Marney—We would argue that all our capital investment is productive.

Senator CORMANN—Is it?

Mr Marney—I believe so.

CHAIR—It depends on the definition of 'productive'. Putting up a stadium is not necessarily going to assist your—

Senator CORMANN—With a railway, you sort of spend out of the surplus. The Perth to Mandurah railway, as much as it is a decision by government, is not a productive, capacity-enhancing investment.

Mr Marney—I would argue strongly against that statement. It is both social and economic productivity. Efficient transport systems have been proven to be a major enhancement to productivity of economies. In fact, I think there are numerous studies of the eastern states which demonstrate the cost of congestion to state economies.

Senator CORMANN—There is no tangible impact on revenue or future economic growth. You might say that it is nice to have efficient transport et cetera, and you would have some investment that would have a tangible impact on growth in the economy and growth in revenue, but—

Mr Marney—Yes. Some investments have greater impact than others, but even in the case of the New MetroRail project it has released a workforce from major population centres in Rockingham, Kwinana and Mandurah that now are able to access opportunities in the city.

Senator CORMANN—I am not saying it was a bad investment. What I am trying to find out is how much of your capital investment do you expect—significant, relevant, or whatever definition you like to use—in productive capacity of this type moving forward.

Mr Marney—The bulk of the investment is in that productive capacity, particularly in energy, in roads, in water and in wastewater treatment.

Senator CORMANN—What is the definition of ‘bulk’?

Mr Marney—I could probably give you that breakdown. In terms of our net debt position, all of our net debt is held by the public commercial trading enterprises, and their investments are based around the cost benefit and expansion of infrastructure, which then has a fee structure. Probably the only exception in that set of commercial trading enterprises would be the Public Transport Authority, which is subsidised, for social and environmental reasons, to get people onto public transport, which is the New MetroRail project in that portfolio. Having said that, New MetroRail does not feature in that net debt because it is different.

Mr Barnes—I would like to add one comment about the projected increase in the net debt to revenue ratio from 17.9 per cent in 2006-07, which was a record low, to 43.9 per cent. The comment was made that that is a very significant increase, which it is. As Mr Marney said, the capital works program is a major driving factor of that. The other major factor is the revenue outlook, particularly the GST outlook. Our share of GST grants over that period is projected to decline from 10 per cent in 2006-07 to 6.2 per cent by the end of the forward estimates period. Over that four-year period that reduction in our share of GST grants is worth a cumulative $6 billion in lost revenue. The government has to borrow that $6 billion in lost revenue to fund its infrastructure program. That is worth more than 20 percentage points on that net debt to revenue ratio.

Senator CORMANN—It also reduces the revenue.

Mr Barnes—Yes, exactly.

Mr Marney—Yes. So it is a double whammy on that ratio.

Senator CHAPMAN—What is your view of the principle that, to ensure intergenerational equity, long-lived infrastructure—whether it is economic or social in nature—should be paid for over the several generations that are going to benefit from that infrastructure and therefore it is appropriate to provide that infrastructure out of borrowings rather than out of recurrent revenue?

Mr Marney—Fundamental economics would suggest that the consumers of the asset should be those who pay for that consumption, and therefore the cost of major assets with a 30-year life should be amortised over that period and therefore out of borrowings rather than out of surpluses

Having said that, that is very much an economic perspective. A prudent financial management perspective would be, if you have cash, to minimise your debt holdings to ensure that the burden of interest payments is not excessive and to ensure that, if there is the need to draw on the capacity in your balance sheet at a later point, you have that capacity there. So there are pros and cons, and it is really a judgement call as to how flexible your balance sheet is or, ideally, how flexible you want your balance sheet to be.

Senator CHAPMAN—Even though we just talked about this escalation in net debt, looking at the figures on page 5 it seems there is a substantial amount of long-term infrastructure items that are being paid for out of current revenue. I wonder where the balance lies between doing that and returning that to the citizens in the form of tax relief, given concerns about things like conveyance duties and the like.

Mr Marney—Part of the difficulty in taking those assessments is really having confidence in how long these circumstances are going to last, and I think it was really in this most recent budget where that confidence of the government was such that they were able to commit to substantial tax relief on an ongoing basis. I think this was, however, the fifth round of tax relief of the current government. While it could be argued that expectations are that more tax relief is possible, the government has actually undertaken five rounds of tax relief in the last four years, I think, and that tax relief has been substantial.

While it has focused on delivering tax relief, it has done so with a view to ensuring that service delivery is sustainable and in line with the expectations of the community also. In essence, state governments are about providing services to the community, and that remains the priority of this government in terms of key areas of service delivery like health—and everyone expects more from the health system—like child protection, which has been a substantial area of investment of this government over the past two years, and areas such as law and order.

While the shadow Treasurer argued that the state collects per capita far more in tax than any other jurisdiction, it is also the case that, for example, in law and order the state spends far more than any other jurisdiction, because that is what the community expects. When the government came to power, there was significant dissatisfaction with law and order services, particularly police services. Since that time, expenditure per capita on police in Western Australia is now around 20 per cent higher than the average of the other states and burglary rates have dropped 45 per cent. Car theft has dropped 46 per cent.

CHAIR—I think we get the point!

Senator POLLEY—They are very good points, I might add.

CHAIR—They are very good points.

Mr Marney—There is reason for spending money.

Senator CHAPMAN—I understand that, but on page 1 of your submission you say—

Mr Marney—I promise to behave myself!

Senator CHAPMAN—you aim to be better than the average of the other states in relation to taxation competitiveness, and yet the shadow Treasurer earlier said and the Chamber of Commerce submission says—and we are yet to hear their evidence—that Western Australian taxes are uncompetitive. Is the government failing in its objectives in that regard, as set out in your submission?

Senator POLLEY—People are still flocking here to live, though, aren't they?

Mr Marney—In terms of outcome, I think we are still attracting people here to live, albeit with housing affordability issues right upon us. In terms of outcome, our economy is doing okay, so it is hard to argue that payroll tax is a ball and chain on the growth of the state. Indeed, our payroll tax settings are very competitive relative to other jurisdictions. The measure that was used by the shadow Treasurer and, I suspect, that will be discussed by the representative from the Chamber of Commerce and Industry, is a per capita measure. We do not collect taxes from individuals; we collect taxes from the economy. Therefore, the appropriate measure of tax burden, in our view—and a view that is supported internationally by various publications, such as OECD and International Monetary Fund measures—is that it is our tax collections as a proportion of the state's gross product that is the appropriate measure. On that measure, the government's target is to maintain its ranking relative to the average of all other states, and it is meeting that measure. On that basis I would say, no, the government has not failed in that regard. I would further say that, if people are making comparisons around taxation per capita or per head, then the flip side of that argument is: what are people's incomes per head? Income per head, as measured by gross state income in Western Australia, is around 33 per cent higher than the average of all other states.

Senator CORMANN—What is the average income in Western Australia?

Mr Marney—I will dig that out for you.

Senator CORMANN—Thank you.

Mr Marney—But the relevant point is that, if you want to compare per head on taxation, you need to compare per head on income and that is 33 per cent higher. The average income in Western Australia in 2006-07, measured in gross domestic income per capita, was just under $65,000 compared to a national average of just over $48,000.

CHAIR—The Chamber of Commerce say in their submission that tax as a percentage of GSP has increased in Western Australia quite dramatically by comparison to the weighted average in other states, which has remained relatively unchanged, but which has gone down a bit. Do you agree with that?

Mr Marney—I do not have the figures to hand in terms of what tax relative to GSP has done.

CHAIR—Yes. You are just saying that that is the right measure to use.

Mr Marney—Yes.

CHAIR—But on that measure yours is increasing. I might say, in fairness, that it has increased quite dramatically but it is still lower than the weighted average of other states.

Mr Marney—Yes. Part of that increase is driven by our reliance on transactions: commodity transactions, royalties on our exports, and also on property transactions through our stamp duty base. Part of that is driven by the values underpinning those transactions. That value growth has been extremely aggressive over recent years and that is part of the underpinning. So, while the GSP measure, I suspect, is, in real terms, in that ratio, there are some value trends in that and it is a reflection of the massive increase in wealth that is embodied in those value increases.

Senator CHAPMAN—When you said you do not tax individuals, you tax the economy, that is not really true. It is individuals, or corporations who are made up of individuals, who pay all of the state tax.

Mr Marney—It is entities.

Senator CHAPMAN—Which are made of people.

Mr Marney—Payroll tax is paid by businesses. It is not paid by—

Senator CHAPMAN—Businesses are people.

Mr Marney—Yes, but it is not paid by—

Senator CHAPMAN—They are owned by people.

Mr Marney—If I can finish: it is not paid by mum, dad, the 10-year-old son and the five-year-old daughter in a household, and that is what a per capita measure is about. That is the justification for that argument.

CHAIR—With the $6 billion that you are going to 'lose', in inverted commas, has any work been done by the Western Australian government on what would be a fairer system? I am not necessarily asking you for what conclusion you are coming to. A lot of the submissions—from the Chamber of Commerce and from the shadow Treasurer and from others—have been about a whole new source of state revenue that the states are responsible for, and then they are responsible for their own spending, without having it imposed from Canberra. Are you doing work on that, in the light of your $6 billion hole, apart from looking at debt?

Mr Marney—It is work that we are doing in accordance with government's policy settings and that is around seeking to achieve greater recognition of the infrastructure spend required to generate revenue that goes to other states through the Grants Commission process. That is really where we see the main deficiency in the process at the moment. We are not doing work on introducing a state income tax or anything of that nature. Essentially, the issue of vertical fiscal imbalance that you are talking about either means a shift in revenue responsibility or a shift in service delivery responsibility from the state to the Commonwealth to correct that. I do not see anything on the agenda at this point in time that is major in that regard, but there are substantial reforms underway, in which grants are allocated to the states through specific-purpose payments. That is work that we have been leading nationally for some time. It is good to see that come to fruition and that should address some of the accountability issues in the interactions between the levels of government.

CHAIR—Okay. If you or the Treasurer would be interested in sharing some of that with the committee, that is really one of the things that we are looking at, and you might get a support group from here if there is a particular message or idea that you or the Treasurer had. If you would like to write to us, we would be happy to have that.

Mr Marney—I would be very grateful for that opportunity.

CHAIR—That is the sort of thing we are looking at: is there a better way of doing it?

Mr Marney—Yes. Can I just make—

CHAIR—A very brief final comment? Yes.

Mr Marney—Yes. I have one further comment and it is in response to something the shadow Treasurer mentioned around energy and community service obligation payments. I think the implied message was that there was something less than transparent about those transactions, and that there was an injection of CSO payments that flow through in profitability down the track, so there was a bit of an implication of fudging to deal with current surpluses and shore up future revenue flows. The analysis that he provided essentially can be summarised as the state spending $780 million to receive a dividend payment down the track of $300 million. I can assure you that that is not the sort of investment decision that we are prone to making or advising government on and the community service obligation is really about making the cost of less-than-cost-reflective price setting transparent.

CHAIR—Okay, that is on the record. I am sure he was not suggesting you were fiddling the books. He might have been suggesting someone else was, but certainly not you people.

Senator CORMANN—On average income, your 2006-07 figures are the most recent you have got, obviously?

Mr Marney—Yes, that is the most recent figure. It is based on gross state income measures, which is the national accounts—

Senator CORMANN—When will the 2007-08 figures come out?

Mr Marney—There is a considerable lag on those figures. It would be probably nine months.

Senator CORMANN—You do not work with estimates in terms of your budget forecasts and what you expect?

Mr Marney—We do provide forecasts of the wage price index but not really an average income. Average weekly total earnings is probably your best current measure of the sort of average income in the state at the moment.

CHAIR—Okay. Thank you very much. Again, we could have spent a much longer time, and we very much appreciate your paper, which, as I said before and I repeat, was very thorough and very useful to the committee. Thanks very much for doing that. We really do appreciate it. Sorry to keep you longer than you might have anticipated.

Mr Marney—Thank you very much for the opportunity. Can I commend our budget papers to you as well.

CHAIR—Yes.

Senator CORMANN—We commend the Commonwealth budget papers to you!

Mr Marney—And if we can help in any way, please do not hesitate to contact us again.

CHAIR—Thank you very much.

[11.42 am]

NICOLAOU, Mr John Andrew, Chief Economist, Chamber of Commerce and Industry of Western Australia

CHAIR—Thank you very much for coming along and waiting patiently. I am hoping that we are not going to have to curtail you because, as I have indicated and you have probably picked up from some of the questions that we have asked, your papers have been very useful. Again, I would like to talk to you about them for a couple of days, rather than a couple of minutes. We will see how we go. Some of us will have to leave because of travel arrangements. I invite you to make an opening statement. I think you have probably given evidence before. This is a parliamentary committee and parliamentary privilege applies. If you need to say anything in camera, that can be asked of us. Would you like to make—could I urge you—a brief opening statement and then we can address some of the issues that you have raised in your paper. Thank you.

Mr Nicolaou—Thank you for the opportunity to speak this morning. I will keep it very brief, considering there are time issues, but my intention this morning was really just to talk through the two papers that I attached to the letter that we submitted to the committee: one in relation to a federalism discussion paper and a second one in relation to our pre-budget submission to the state government. There are a whole series of issues which directly relate to what I think you are trying to uncover in your research, so I would be happy to leave it at that and start taking questions from here.

CHAIR—Thanks very much, Mr Nicolaou. That is very convenient for me. If I do have to leave, I will ask Senator Chapman—who is the most senior member of our committee—to take over the chair. Your paper is very useful. It mirrors what I not nastily say is a West Australian view which comes from where you are and how much you contribute to the economy, and what little is perceived by West Australians to be got. Does the chamber have a view on what the best result would be? I note in one of the papers you had some alternative state taxes, which I will not be able to put my hand on now, but you would know the area I am talking about. What is your long-term view about the overall funding of states?

Mr Nicolaou—Within the context of Federation, the chamber certainly believes in the federation and the role of the states and the Commonwealth. The purpose of that paper was really to look at the imbalance that seems to have occurred over time between funding responsibilities and expenditure responsibilities between the Commonwealth and the states. It was from that that we took a fulsome view into what the issues are in relation to Australia's federation and try and come up with some ways forward. In the end, it really does come down to the issues of vertical fiscal imbalance. Given that the Commonwealth collects 75 per cent of the revenues but the states are responsible for over half of the expenditure responsibilities, this imbalance is quite significant and really does impact on the economy of the states and weakens accountability, and so forth. If you think that it is a parochial perspective in terms of WA, it was not really the intention. It was more the audience that we were presenting the paper to.

CHAIR—Yes. Do not get me wrong: I am not being critical about that. There is a view, because of the ‘isolation’ of Western Australia, that is always a very robust one. As a North Queenslander, I share many of the Western Australian views.

Mr Nicolaou—To finish off and try to answer your question, the three or four main issues that came out of the federalism paper were in relation to vertical fiscal imbalance, and we really need to understand or, to take this issue forward, we need to look at whether there needs to be a change in funding responsibilities, and we certainly would support a look into the possibility of the states getting another revenue source, which not only would allow greater autonomy but will also allow the states to abolish some of the more inefficient taxes. Alternatively, we need to look at the allocation of expenditure responsibilities between the Commonwealth and the states and, within that, look at it in the context of the principle of subsidiarity, which I think is very important in terms of looking at the federation.

The second issue is the equalisation process that exists between the Commonwealth and the states, and certainly that is a key aspect of an efficiently running federation; there needs to be some redistribution between high-growth or richer states and the poorer states. We certainly support that, but there are some real issues coming out of that, particularly in relation to GST grants, as the previous witnesses would attest to, which really limit the capacity of a state to invest wisely and also fund its expenditure priorities.

Specific-purpose payments came up in the paper. There have been some really good reforms that have come out recently in relation to SPPs, primarily to simplify the arrangements and also to make them more outcome focused, which is very important. Finally, in regard to infrastructure provision, there really needs to be a look at the Commonwealth potentially taking a greater responsibility in the delivery of important infrastructure in the states.

CHAIR—Thanks very much for that. I might pass on to Senator Polley for any questions that she needs to raise before she departs.

Senator POLLEY—Thank you for your submission. I am interested to know how you see the responsibility for future infrastructure investment. Do you see it as primarily the responsibility of the state government or does there need to be a partnership between the state and federal governments, and what are the responsibilities for the business community?

Mr Nicolaou—I think that both the Commonwealth and states have a responsibility. The states really are responsible for the basic delivery of key infrastructure because many of the deliverers of infrastructure are government owned entities, and certainly I agree with that. But in relation to infrastructure that is not owned by the state per se, I think that the Commonwealth can take a bigger role. We only have to highlight some of the perverse incentives that are created if the Commonwealth gets significant amounts of revenue and benefits from infrastructure provision while the states at the same time have to fund that infrastructure and get far less in terms of revenue. Clear examples of that are the infrastructure on the Burrup, and the Gorgon project when that comes on stream, and even the Ravensthorpe nickel project. Those are areas where the state has a responsibility to provide common user infrastructure, but the majority of the revenue benefits go to the Commonwealth in terms of royalties, income tax and so forth.

Senator POLLEY—In your submission you obviously highlight the concerns that your members have in terms of the labour shortages. I could not find anything here about the investment that your membership has made over the last decade in skilling up the workforce via apprenticeships. Could you on notice—unless you have figures with you—the changes that have happened, and how many apprentices there are in the areas that your membership covers? That is as opposed to what is happening now, which is obviously having a huge impact on the economy.

Mr Nicolaou—Certainly labour shortages are the most pressing issue facing our economy today and, as you articulated before, there are 'help wanted' signs everywhere. That makes it very visual. It is having a significant impact on business. Business does have a responsibility to look at ways to attract and retain a workforce over the longer term, and they are exploring different methods, including apprenticeships and traineeships, reskilling and upskilling of existing workers, and other means. But, in terms of the labour shortage issue, there are Commonwealth government and state government responsibilities as well, which we are very keen to push forward, particularly in relation to growing the population.

The most immediate way we can do that is through immigration programs, and that is a Commonwealth responsibility. Similarly, short-term visas are a Commonwealth responsibility. We advocate a human capital strategy that brings business and government together to look at ways to expand the workforce over the longer term. Otherwise, the significant train of investment projects that exist in the state could fall away because we do not have an available workforce.

Senator POLLEY—We heard this morning from our first witness about the shift from apprenticeships to higher education in the professional areas. For instance, accounting firms offer a head-hunting fee to get an accountant to come in. One of the companies I am familiar with offered $5,000 as a head-hunting fee to bring on board an accountant. We also have to be mindful that we are in a global economy and that those people are changing all the time. In terms of having to bring in migrants and short-term workers, would you then be happy with the direction the Rudd government is taking in terms of the increase in migration?

Mr Nicolaou—We certainly support the direction. I think more could be done in relation to the immigration programs. The skilled migration stream and the focus on that is certainly welcome and really adds to our human capital and the productive base of the economy, but we need to be more flexible in our approach, particularly to short-term visas. We could really expand the scope of that to allow for different classes of workers to come in at various times to meet the demands, because some of the most significant constraints facing our workforce today are in relation to lower skilled workers. I do not want to say unskilled, because I think it is a rather demeaning concept—I think everyone has skills of some value—but we need to look at that narrow range of occupations that can qualify under that program and look at expanding that to meet the needs, because there are explicit needs that are certainly evident in this state.

Senator POLLEY—I have had evidence on the migration committee in relation to, particularly, the agricultural industry and trying to get people to come to more of the remote areas. As you said, they are very highly skilled people in their specialist areas, but getting those people to move to remote areas and having the support and infrastructure is a huge issue. What is the chamber's view on whether the state debt is sitting at an appropriate level currently?

Mr Nicolaou—Debt in itself is not a problem, particularly if it is used for productive purposes. In terms of the level of the debt, we do not have a particular concern at this stage, because it is within an AAA credit rating framework. So from that perspective we do not have a particular concern. As was said before, it is important that it is productive and that it is used to expand the capacity of the economy, particularly at a time when capacity constraints are now having a noticeable impact. In terms of the debt being borrowed, I certainly support that for intergenerational equity reasons. I think future generations should play a role in paying off debt that they utilise, and from that perspective I think borrowings are efficient when they are for productive investment.

Senator BUSHBY—I note in one of your papers you mention housing affordability as an issue in Western Australia. We have heard from the Under-Treasurer that the property boom has been a significant driver of the increased revenues that the state has enjoyed over the last few years, and part of the reason why they have enjoyed increased revenues out of property is because the prices have gone up. You suggest that maybe the states should take a role in doing what they can to bring prices down. Do you see that there is a conflict of interest that the state has in terms of trying to take the heat out of the property market, which effectively means that it takes the heat out of its revenue growth, at least? It could even decrease its revenue if the sales numbers drop off. Is that something that you see as a challenge that can be overcome?

Mr Nicolaou—If the labour shortages are the key priority, then housing affordability is secondary, because, if we cannot house people, we will not get them. In terms of what the state government can do, what the Under-Treasurer did articulate were ways in which it can influence demand. We would attest that the other side of the equation has not really been addressed, and one of the key reasons why we have this housing affordability crisis is because of land releases and the lack of supply that is coming on stream. At a time when the economy is booming and demand is skyrocketing, we have constraints in supply. The combination of those two produced the outcome that we have today, and it is going to take a long time for us to get back to where we were when we were a relatively affordable state and a relatively attractive state in which to live and work. The government does have a responsibility in terms of supply and addressing the supply constraint issues.

Senator BUSHBY—Is it taking that responsibility seriously, or do you think that the fact that it relies so heavily on property based income means that it is trying to create a balance where it maintains its income but does not go too hard on actually improving the circumstances that lead to more affordable housing?

Mr Nicolaou—It is certainly an issue that they have to grapple with. I would be worried if they were worried that, if they brought more land onto the market, it would decrease the revenue base. I would argue almost the contrary—that it would stimulate demand and actually increase revenue. I do not think that they are thinking that way. I hope they are not, but it does highlight that they are very much reliant on property revenues now to function efficiently.

Senator CORMANN—On that same point, when it comes to housing affordability, the main focus always is, obviously, on home ownership. But there is a component to housing affordability which relates to rental. Has the CCI done an assessment of the impact of land tax and the way land tax has developed over the years and the supply of affordable rental accommodation?

Mr Nicolaou—Not at this stage, but they do go hand in hand.

Senator CORMANN—Have you got a view about land tax and the way that has developed over the last eight years? Has it impacted on the supply?

Senator BUSHBY—Yes, it must have. Given what you are saying about a secondary impact, labour shortage is an issue. People cannot afford to come over here and find employment, and a lot of those people when they come here initially would rent.

Senator CORMANN—So the land tax—

Senator BUSHBY—Yes, so the land tax feeding into that would obviously be a huge—

Mr Nicolaou—It is certainly an issue, and we would be happy to look further into that.

Senator CORMANN—Can you quantify that? Maybe take it on notice and see whether you can provide us with some assessment, from your point of view, of the impact of the land tax arrangements on rental and housing affordability and the way they have developed over the last couple of years.

Mr Nicolaou—Yes, I am happy to take that issue on notice. I will make one quick comment: land tax revenues have grown and, as a result, the government generally tries to wind back those revenues to a more manageable rate of growth because, without that, bracket creep would see land tax revenues explode and have really significant impacts. As the Assistant Treasurer announced earlier, there have been tax cuts made in successive budgets, but really it is in relation to bracket creep adjustment more than anything else. That is where the significant amount of so-called lost revenue comes from. It is in relation to lost revenue from properties going into higher tax brackets.

Senator CORMANN—There are essentially two sources of rental housing. One is public housing—and the number of houses available in public housing has essentially remained stable in the context of a growing population—and the only other source of rental accommodation is going to be private supply. There clearly is a relationship between taxing arrangements like land tax et cetera and whether there is private investment in the private supply of housing. That is what I am interested to get your assessment on.

Mr Nicolaou—I think that is part of the picture. There are other aspects that are important. As I said before, there are land releases and the regulatory hurdles that land developers have to go through to get land to market quickly. There is also local government: local government has a role to play there and developer charges and other taxes at a local government level really do impact on the efficient supply of land to market.

Senator BUSHBY—We have heard the shadow Treasurer talk about how Western Australia is the highest taxed state on a per capita basis. Treasury defended the government's approach to an extent by looking at different measures for assessing the severity of taxation. Your papers also address this. What are your views on the position that Treasury put?

Mr Nicolaou—There is a lot of talk about competitiveness measures, and we certainly do not subscribe to one or the other. What we are here to see is a more competitive tax regime. That is the central message that we have been trying to articulate for some time now. On a per capita basis, Western Australia is clearly the most uncompetitive state. In relation to tax as a percentage of the total economy, which Treasury now use as their benchmark, we do rank middle-of-the-road, but that percentage is increasing, so we are moving up in terms of overall tax burden. The Commonwealth Grants Commission use a tax effort ratio and we rank as the highest taxing state.

Further, while there might be some arguments that would suggest that tax per capita is not a great measure and, let us say, tax as a percentage of the economy is not a great measure, I would also like to suggest that the measure of tax as a percentage of the economy is flawed in many ways. In many ways it distorts the figure for Western Australia, which has a very significant resource base or export base, which does start to skew the results a little bit. If we take away the external sector of Western Australia and the other states and compare it on the domestic economy—and it is the domestic economy, not the export sector, which is taxed—then the results are far different. Over time, Western Australia has gone from one of the lowest to the second highest last financial year, of tax as a percentage of state final demand. There are numerous measures that you can use and, if you take them collectively rather than looking at one in isolation, it does not paint a terrific picture about where Western Australia sits.

Our other concern is that other states which have a far less robust budget position than Western Australia, other states that have a tighter budget position, are still implementing tax cuts to payroll tax et cetera. At the same time, the state government has been resistant to that, and that comes even after a 2½-year state tax review. I was a member of that reference group.

Senator BUSHBY—Have they ignored the findings on that?

Mr Nicolaou—Essentially, they ignored the findings. There were recommended reforms that were articulated in that paper. It was a report that was really the responsibility of Treasury and finance. There was a reform package, or a series of reform packages, which involved cuts across the board on different taxes.

Senator BUSHBY—So that is completed?

Mr Nicolaou—That is completed. It is publicly available.

Senator BUSHBY—I think we should get a copy of that. Has the government responded to it?

Mr Nicolaou—Not officially.

Senator BUSHBY—Will they be officially responding?

Mr Nicolaou—I do not know. I do not think they will officially respond, because it was released some time ago now.

Senator BUSHBY—But they have responded in an unofficial capacity, presumably, on the floor of parliament?

Mr Nicolaou—Yes.

Senator BUSHBY—Or in general responses to general probing of their likely reaction to it?

Mr Nicolaou—Yes. It was really disappointing. They announced this whole state tax review, we took it on in good faith—and there were a lot of different industry groups and other representatives around the table that put a lot of effort in and around that—and the report itself was very thorough and very well put together by Treasury and finance. But in the end none of the recommendations were accepted.

Senator BUSHBY—What was the summary of the recommendations?

CHAIR—Just before you answer that: Mr Nicolaou, with apologies to you and others who have had to leave, I will have to leave, but I do not want to shut down the committee because I know that Senator Chapman has some questions. I suspect that we might go on for another 10 minutes or so, and Senator Cormann will be back. The acting chairman will thank you formally but, again, can I thank you for your submission. I am going to carry those two papers with me and refer to them in the Senate over the next year or so, so thank you very much.

If you will just excuse me for a moment, for the record at this stage I want to pay a particular tribute to Senator Grant Chapman, for whom this will be the last meeting of this committee of the parliament. Senator Chapman leaves us on 30 June. People will say nice things about him in the federal parliament—

Senator CHAPMAN—You hope!

CHAIR—in the next two weeks, but I just want to take the opportunity of thanking Senator Chapman for his contribution to this committee—a contribution which will continue, I would hope, from afar as we conclude our remarks. I would hope that Senator Chapman may be able to input into our final recommendations. Senator Chapman has also been a very significant contributor to the economic debate in Australia over the 18 years that I have been in the Senate and have observed him, and, I understand, has also taken a very active role in, particularly, the economics area in the 24 years he has been in the Senate.

Senator CHAPMAN—Twenty-one years in the Senate and 7½ years in the Reps.

CHAIR—Twenty-one years in the Senate and 7½ years in the House of Representatives—a quite magnificent contribution that Senator Chapman has made to the parliament and, through the parliament, to the people of Australia, particularly in this economic area. I wanted to place that on record at the last formal meeting of this committee, and extend the honour, such as it is, of now asking Senator Chapman to take over chairmanship of the committee for the rest of today's meeting.

Senator CHAPMAN—Thank you, Chair, for your very kind remarks. I appreciate those greatly. Bon voyage back to Queensland.

CHAIR—Thank you.

ACTING CHAIRMAN (Senator Chapman)—Do you wish to continue, Senator Bushby?

Senator BUSHBY—Yes. In summary form, what were the main recommendations of the tax review?

Mr Nicolaou—I would be happy to provide that after this hearing today. Essentially, there was a package of reforms recommended by Treasury that cost various amounts of money. That included cuts to payroll tax, stamp duty on property, and adjustment to the scales on motor vehicle duty, and adjustments to land tax as well, from memory. It did not go all the way in terms of true reform from a chamber perspective but it was, nonetheless, a package of reform and relief that—

Senator BUSHBY—That, on balance—

Mr Nicolaou—Yes—would help the WA economy and the taxpayers of the WA economy. We have not really seen those outcomes come through. There have been tax cuts, as the Under Treasurer articulated earlier, but they have been in areas where it really was paramount that they do that. The last thing I think you would want is to see a 100 per cent increase in land tax revenues over one year because of the property boom. They are the sorts of things that are absolutely necessary, otherwise we will have significant affordability issues. I am happy to provide that after the event.

Senator BUSHBY—I think we will get a copy of that.

Mr Nicolaou—Essentially, it looked at a whole range of things and made some recommendations around some reform and some relief.

Senator BUSHBY—That is very interesting. The Under Treasurer referred to the $6 million that they will lose from changes to the GST proportion that the state will receive. My understanding—and I profess not to be an expert—is that, if they are receiving a reduction in GST as a percentage of what is coming in, that is because the state is better able to fund itself, or its revenues are better. Effectively, it is not necessarily a net loss of $6 million; it is a loss of $6 million that they might otherwise have got but they are not getting it because they are getting the money from elsewhere. Is that a true summary?

Mr Nicolaou—Essentially, that is the case. In the end, GST revenues are still increasing over time and the revenue base is still expanding over time, according to the budget papers. But it is constraining the rate of growth in the revenue base because certain revenue heads are forecast to moderate over that forward estimates period.

Senator BUSHBY—It is a loss compared to forward estimates, as opposed to an actual loss in terms of dollars?

Mr Nicolaou—The loss has not been realised, no.

Senator BUSHBY—As I said, the Commonwealth Grants Commission process would be looking at saying, ‘Well, you don’t need this money because you’re going to have it anyway, so we’ll give it to another state that doesn’t have the same rate of growth in other areas of income, because you're doing all right anyway.' I would have liked to have asked the Under Treasurer this, but I did not have an opportunity. How then does that mean that they need to borrow the extra money? He was explaining that they were going for a 17.9 per cent debt ratio to 43 per cent because they were not going to have that $6 million. But if they are getting the money elsewhere, it really comes back to policy decision making of the government: they are choosing to borrow the money to fund this stuff, rather than using the other money that they are getting from elsewhere to fund it.

Mr Nicolaou—Yes, I would agree. It really comes down to what is necessary, and that infrastructure program is based on necessary essential infrastructure. That is what is driving debt up, more so than anything else, rather than revenue.

Senator BUSHBY—And blaming the Grants Commission process is not the correct reason for it. It is a policy decision.

Senator CORMANN—A political decision.

Senator BUSHBY—Yes, exactly. That is right.

Mr Nicolaou—Yes.

Senator BUSHBY—My last question is about public-private partnerships. I also would have liked to have asked Treasury this but I did not have a chance. In response to Senator Chapman's questions about pushing the responsibility for paying for infrastructure over the generations that will actually use it, an alternative way of doing it is public-private partnerships, is it not? Effectively, the people using it over the years will be actually paying the private sector who financed it in the first place. What is the chamber's view on public-private partnerships? Could some of this infrastructure be on a greater level? I do not know the extent to which PPPs are used in Western Australia, but if they are not widely used, could they be better used to deliver the same outcomes without the government having to go into the debt situation that they are looking at?

Mr Nicolaou—It is a difficult one. We have not had much success as a state in public-private partnerships. There really is only one case—or two—that we can use to highlight what they achieve. I do not think there is any predisposition against that from a government perspective; if anything, I think they are trying to encourage greater private sector engagement through PPPs. The chamber certainly supports that because we fundamentally believe that business or the private sector can produce infrastructure more efficiently than government can, because there is a bottom line imperative attached to that. But, unfortunately, for some reason or another, they have not been widely used in this state.

Senator BUSHBY—Do you have any toll roads here?

Mr Nicolaou—No. I guess there is a policy against that.

Senator BUSHBY—Yes, that is right. There are political consequences for starting that.

Mr Nicolaou—That is right.

Senator BUSHBY—Once you have got them, it is easier to put another one in, but if you do not have any at all, that first one is very hard.

Mr Nicolaou—Yes.

Senator BUSHBY—But you do not even need to have user-pays for public-private partnerships. For example, this new hospital could be built by private enterprise and then the government could lease it back.

Mr Nicolaou—Yes.

Senator CORMANN—We do have a form of that in the Joondalup Health Campus.

Mr Nicolaou—Yes. The central law courts were, in one form or another, a public-private partnership as well. There are examples of that.

Senator CORMANN—Government has done it on a number of occasions.

Mr Nicolaou—Yes.

Senator BUSHBY—Thank you.

ACTING CHAIRMAN—Your submission, as has already been mentioned, is very comprehensive and very worthwhile, and I thank you for that. Referring particularly to your pre-budget submission, where you outline a number of recommendations to the state government, how many of those recommendations did the government implement, either fully or in part, and how many have they failed to implement? Perhaps you could identify which, if any, have been implemented fully or in part, or not implemented.

Mr Nicolaou—I will go to the end first, which is in relation to infrastructure development. Since the presentation of our submission, the government has announced some key social and economic infrastructure development in relation to the outdoor stadium, the foreshore development, Indian Ocean Drive, and some arts and culture funding, including the development of a new museum, and we have supported them publicly on that. They are important pieces of social infrastructure. Many would be alarmed that the chamber as a business organisation would be supporting social infrastructure development, but it really goes to the heart of the issue of the day, which is labour shortages and attracting people to live and work in the state. We need to create a vibrant metropolis, and a metropolis that supports people living here, and these are certainly aspects of that. I will not go any further into the infrastructure discussion.

In relation to spending and taxation, the answer is, no, they have not really taken on board any of our issues and both of those issues are the fundamentals of their financial management policies. We have been somewhat disappointed in them not really heeding our call, especially for expenditure restraint. Spending constraint is really the cornerstone of good financial management; it was a missing link in the discussions beforehand in relation to concerns about levels of debt and taxation competitiveness. Those sorts of issues are very important. The reason for that is that spending is growing at unsustainably high levels and it is placing an increasing burden on the state’s taxpayers to fund this increasing spending. We would certainly be continuing to press the state government to look at spending reforms that deliver a more efficient state government, because double-digit growth in spending cannot be sustained.

ACTING CHAIRMAN—You refer in your submission—and it has also been referred to in questions—to the state tax review. I gather from your submission and answers to questions that the state treasury played a significant role in the recommendations that came out of that review, as well as the input from members of the review panel or whatever it was called.

Mr Nicolaou—I can give you a bit of background to the whole process. The announcement of a state tax review was announced by the Treasurer back in 2005 and it was going to be a report or a review that was undertaken by the Department of Treasury and Finance. But to assist with the development of the review, a reference group was formed of industry and other stakeholders.

That reference group then debated the merits or otherwise of reforms and presented their own submissions on key reforms. Those recommendations or suggestions certainly did not have to be taken into account, because in the end it was a Treasury publication, but the reference group was there to be a sounding-board and also to help try and influence Treasury in the development of its final recommendations.

ACTING CHAIRMAN—Obviously the chamber was represented on the reference group. What other organisations were?

Mr Nicolaou—It was a wide range of organisations—key peak industry associations. There was the chamber; the other peak chamber, the Chamber of Minerals and Energy; the Motor Trades Association; the property industry associations—so REIWA, Property Council and so forth. There was the Taxation Institute. There was UnionsWA and a few others. There was a representative body of the broader community.

ACTING CHAIRMAN—And you said the government has not implemented those recommendations and has not responded to them.

Mr Nicolaou—Not officially. The report was presented and there has been no official response.

ACTING CHAIRMAN—So the government is ignoring not only the recommendations that arose from significant players in the domestic WA economy but also the recommendations endorsed by its own treasury.

Mr Nicolaou—Our argument is that Treasury did present a package of reforms costing different amounts of money, and those reforms did not result in anything in the budget last year, when the report was available.

ACTING CHAIRMAN—Since the handing down of that report, has there been any public debate on its recommendations? You say the government has not formally responded. Have any reasons been given by the government as to why it is not implementing the recommendations? Is there any public debate to lobby for the recommendations to be implemented?

Mr Nicolaou—We certainly continue to press on that. Our budget submission, which you have in front of you, does articulate the position that we presented as part of the state tax review, and certainly other industry associations have been active as well. I guess the government's response is, in the end, that it needs a revenue base that will allow it to fund essential services and infrastructure development. We would like to come back and look at those issues in relation to spending and infrastructure development because, if that is the reason, then we need to look at ways of streamlining the public service to make it more efficient and allow for necessary reform to the state tax system, which is having an impact.

I would like to come back to the comment on payroll tax being relatively competitive. Three other major states have decreased the rate of payroll tax, so now we are at the higher end, but we have a booming economy and we have high average weekly earnings and high incomes, so the ability for businesses to recruit more people, small businesses in particular, is constrained because, on the basis of the threshold at the moment—

Senator BUSHBY—It pushes you over the threshold very quickly.

Mr Nicolaou—Today, the bracket creep results in only 11 employees being able to be recruited on average wages before the business is hit with payroll tax. That is certainly different to other states and it is having a noticeable impact on the small business community. Payroll tax is not a big business issue and it is a furphy to suggest that it is. It is a small business issue and it is having an impact at the margin on small businesses that are struggling to meet increased costs.

Senator BUSHBY—And, as you note in your submission, the boom does not have the same effect on all industries everywhere. There are some small businesses in certain areas that are struggling and, if they have payroll tax as well, it is another matter.

Mr Nicolaou—That is exactly right.

ACTING CHAIRMAN—In relation to the government's response, you made the point that, 'Well, we need funds for various purposes.' You would expect that the Treasury, being part of government, would be mindful of that and would have taken that into account in its recommendations, but would still regard its recommendations as achievable.

Mr Nicolaou—I would have thought so. In the end, it imposes discipline on the government, as well, if they announce reforms that not only help the economy but also constrain the revenue in some way. It imposes that fiscal discipline that they need. As you can see, we have had very strong revenue growth, but equally strong expenditure growth. Expenditure has been able to grow in line with revenue growth and has not imposed that discipline that government has needed and, as a result, we now have a bloated government public sector. We need to look at ways of streamlining public service delivery. It is not efficient. Certainly, if you look at the Productivity Commission report on government services, the Western Australian delivery of key services does not rank well in a number of areas.

Senator BUSHBY—That was where I was going to direct my next question: where do you think government spending has been excessive or wasteful? Is it in the unnecessary employment, as you see it, of additional public servants or is it, as might have been suggested earlier, that, to remain competitive in the Western Australian labour market, the government has had to pay higher wages because of the economic growth in the state?

Mr Nicolaou—I certainly would not argue against pays being attractive to allow the best and brightest to go to the public service. There is an issue, though, in relation to the size of the workforce in the public service and in relation to the spending programs. This is obviously just a rule of thumb but, in terms of essential services, which are health, education, and law and order—and it is certainly articulated by the government as to what their essential services are—there has been far less growth than in the remainder. What we could say is that there has been a double-digit growth rate in government spending in the area of non-essential services for the last few years and it is expected to be double-digit going forward. It is far higher than the growth in essential services. To me, that highlights that there is some inefficiency inherent in the delivery of government services across the board.

ACTING CHAIRMAN—What is your general view of the way in which the Western Australian government has managed its budget over recent years?

Mr Nicolaou—I think the WA government has been fortunate in many ways. It has been presiding over a once-in-a-lifetime economic boom, and that has certainly been reflected in the revenue growth that has been achieved, and during its first term it did a lot of good things. It implemented the Machinery of Government Review, which led to some moderation in expenditure growth, but, as time has gone on, spending growth has ratcheted up in terms of percentage increase year on year. That highlights a government that needs to take a new look at its spending programs and at implementing a new wave of reforms in the public sector. We are missing out on opportunities for meaningful reform. We are missing out on opportunities for further infrastructure development.

ACTING CHAIRMAN—To what extent has the Western Australian government eliminated or reduced the state taxes which were expected to be eliminated or reduced with the introduction of the goods and services tax?

Mr Nicolaou—They have. They will effectively have abolished those listed to be abolished under the GST agreement, with the exception of stamp duty on non-residential conveyances, and I think most states have not agreed to implement that reform; so they have met the terms of the agreement from a state perspective. Non-residential conveyances, non-residential stamp duty, remains very high in terms of the overall rates, and it is interesting that in the last budget they decided to provide relief on stamp duty for residential property but not for non-residential property, so now we have two stamp duty regimes that exist for property on the basis of whether it is non-residential or residential.

That certainly was a disappointment from the business perspective because businesses are being impacted in the same way as households by property prices and so that impacts on the longevity of businesses, their ability to grow and expand, and it comes at a time when they have implemented a review of a new stamp duty regime. A new duties act will come into effect at the start of the financial year which dramatically simplifies the current arrangements. But now, following the outcome of the budget, we have almost a contradiction.

They have simplified the duties regime as part of the stamp duty review but are now making it more complicated by introducing a new scale. That was certainly a disappointment in terms of non-residential conveyances, which is that final issue on the GST agenda.

ACTING CHAIRMAN—You might have heard me ask a quick question of Treasury about their comment that the economy pays taxes, not individuals, and then they said, ‘Well, entities pay the tax. It’s not the mums and dads and the kids at home.’ Given the nature of state taxation, isn’t it, in the end, paid by the mums and dads and the kids at home, because all of those state taxes are taxes which add to the costs of doing business or costs of production, or whatever, which would add to the price of goods and services?

Mr Nicolaou—I would totally agree. One of the arguments that Treasury often raise in relation to payroll tax is that it is akin to a consumption tax and that costs are passed on in the form of higher prices. To the extent that payroll tax has remained high, under that logic it is being passed on to mums and dads.

Senator CORMANN—I have some questions on a totally different area. Going into the Commonwealth-state relations area—and I have raised this with Treasury—there are obviously areas of responsibility where there is overlap and where there always is the risk of cost-shifting from one level of government to the other, and you broadly talked about that in your submission on federalism. Are you aware of the proposed change in the federal budget for the Medicare levy surcharge?

Mr Nicolaou—I am aware of it but we have not done any analysis on it.

Senator CORMANN—I would not have expected you to do any analysis but I would have expected federal Treasury and state Treasury to have done analysis on the impact on each other as part of their overall costing. If you look at good governance and good public policy, at a federal level I think the government ought to be conscious about its decisions having a flow-on effect on the states’ capacity to deliver services. Once the states become aware of certain budget decisions at a federal level, I would have thought that they ought to go through a process of assessing how it impacts on them. Would you agree with that?

Mr Nicolaou—I would certainly agree with that. The Department of Treasury and Finance have an intergovernmental relations area which devotes a lot of energy and time at looking at the GST arrangements and the carve-up of the GST pie to ensure that the state is getting its fair share in areas where there may be some incorrect decisions in terms of what our allocation should be. I would expect that, for any funding that comes into the state from the Commonwealth, there would be that sort of analysis undertaken.

Senator CORMANN—I am not making this up; this is according to the federal budget papers. The Medicare levy surcharge change is going to result in a saving at the federal level of $960 million, roughly, over the forward estimates, representing the 30 per cent rebate. So we are talking about $3.2 billion. You would have heard what I said to Treasury: the net impact on loss of funding for hospital treatment is $2.7 billion nationally. When I asked Treasury, ‘Did you cost, assess, model the impact on state governments and public hospitals?’ they said, ‘No, we didn’t, because they’re second-round effects.’ When I asked Prime Minister and Cabinet and their intergovernmental relations area, they said, ‘No, that’s not something that we would usually do.’

Isn’t that an area where we ought to seriously improve the relationship between the Commonwealth and state responsibilities in the way they are funded?

Mr Nicolaou—I would agree with you in that regard, yes.

Senator CORMANN—Is that something that you have previously assessed or made recommendations about—the relationship between Commonwealth and state overlapping policy responsibilities?

Mr Nicolaou—That really goes to the heart of the federalism debate, which we have articulated in our submission. The blurred responsibilities and the impacts of one policy decision on another can have these sorts of revenue effects.

Senator CORMANN—We are talking big dollars.

Mr Nicolaou—We are, yes. I think we have come to a time now where we need to have a renewed look at the expenditure responsibilities of the Commonwealth and the states, because there is overlap which leads to inferior outcomes, at least, with cost-shifting and blame-shifting. I think we are out of time and we really need to look at that again.

Senator CORMANN—Thank you very much. No further questions.

ACTING CHAIRMAN—If there are no further questions, Mr Nicolaou, I thank you for your appearance before the committee, as well as your very comprehensive submission. It has been very helpful to the inquiry by this committee. That is the conclusion of today’s public hearing. As the chairman mentioned earlier, this is the last public hearing that I will be attending as a member of the Senate because there will not be any further public hearings before 30 June when my Senate term ends. I have certainly appreciated the opportunity to be a member of the select committee over the past few months, and I think it will make a worthwhile contribution to good governance when it finalises its hearings and its report. The next hearing of the committee will be when it reconvenes in Brisbane on 17 July. I now declare this hearing closed.

Committee adjourned at 12.35 pm