

Western Australia State Budget 2008-09

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Have money, will spend (it is an election year after all)

Of the many words you could use to describe the 2008-09 Western Australian state budget, 'restrained' is certainly not one of them. Tax cuts, significant increases in spending in the key areas of health, law and order and education, and a record capital works program headlined Premier Carpenter's and Treasurer Ripper's latest fiscal offering. A cynical observer might be tempted to link the budgetary largesse to the next state election, due within the next year.

Of course, the government's capacity to open its coffers has been enabled by the ongoing stimulus from the commodity boom. A surge in mining royalties associated with expectations for further increases in iron ore prices accounts for the bulk of revenue growth of 5.5% forecast for 2008-09. Meanwhile, the state's economy has continued to lead the nation, with expected growth of 7.5% in 2007-08 and 6.25% in 2008-09, around twice the national average. As result, the government has been able to deliver a very healthy operating surplus of \$1.855bn in 2008-09, notwithstanding a 7.7% increase in expenses.

The commodity boom has also enabled the government to embark on an unprecedented capital works program, worth \$7.6bn in 2008-09 and a staggering \$26.1bn over the next four years. And this doesn't even include the bulk of the money required for the government's 'vision' projects – including the new 60,000 seat stadium at Kitchener Park, the museum on the site of the former East Perth power station and the redevelopment of the Perth Waterfront – which will largely be constructed on the other side of the four-year estimates period. To fund this program, state debt will more than double, to \$11.4bn by 2011-12.

The real question is what happens when the boom ends, as it almost certainly will at some point? To some extent, the government has factored this in, which is why it forecasts revenue growth to slow to zero by 2011-12, the operating surplus to shrink to a mere \$203mn, and public sector net debt to increase to 43.9% of revenue (just below the state's target maximum of 47%).

But if the commodity price cycle turns a little nastier than currently expected, these financial aggregates will no longer look so benign: the budget balance will almost certainly move into deficit – possibly quite significantly – and the net debt burden will increase sharply relative to revenue.

To be sure, much of the increase in debt is associated with supply-enhancing capital works projects that should yield a healthy return. But the increase in the state's recurrent spending is clearly unsustainable, and predicated on current once-in-a-generation boom conditions continuing. It may well do so. But then again, it may not. The fiscally prudent approach would have been to slow growth in expenditures. Clearly the Western Australian government has other priorities in the year ahead.

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Budget aggregates

The budget surplus is expected to be very healthy at \$1.855bn in 2008-09, but will ease thereafter...

...as revenue growth slows to a standstill and expenses growth continues unchecked

The general government operating balance is projected to be a very healthy \$1.855bn in 2008-09, down only slightly from an expected surplus of \$2.1bn in the current fiscal year. Thereafter, the surplus is expected to narrow more rapidly, falling to a relatively meagre \$203mn by 2011-12.

Revenues are expected to grow by 5.5% in 2008-09, with most of this (some 4.6 percentage points) accounted for by a 34% increase in mining revenue to \$3.4bn. This, in turn, has been driven by a massive 69.4% increase in iron ore royalties, largely reflecting expectations for iron ore contract prices for the current year. Further forward, revenue growth is expected to slow to a standstill by 2011-12 on the assumption that the commodity price cycle plateaus and eventually turns negative in coming years.

While such assumptions about commodity prices cycle are prudent from a budgetary perspective at this stage in the cycle, the same can't be said about expenses growth. Operating expenses are expected to grow by 7.7% in 2008-09 and by an average of around 4½% over the subsequent three years. This follows growth of around 9% per annum in recent years. In other words, expenses growth has risen above growth in revenue, the latter of which may or may not be permanent, leaving the state's finances exposed to the possibility of a sharper than expected reversal in the commodity price cycle.

In addition to rising recurrent spending, the state is embarking on a massive capital works program, worth \$7.6bn in 2008-09 and a total of \$26.1bn over the next four years. With surpluses expected to decline, the WA government is increasingly resorting to debt to fund its plans. Total public sector net debt is expected to rise from \$4.7bn (23.9% of revenue) in 2007-08 to \$11.4bn (43.9% of revenue) by 2011-12.

Key budget aggregates

	2007-08	2008-09	2009-10	2010-11	2011-12
Revenues (\$mn)	18,829	19,872	20,600	20,687	20,694
% ch.	7.1	5.5	3.7	0.4	0.0
Expenses (\$mn)	16,736	18,017	18,930	19,614	20,491
% ch.	9.2	7.7	5.1	3.6	4.5
Operating balance (\$mn)	2,093	1,855	1,670	1,073	203
Net debt (\$mn)	4,711	7,911	9,028	9,489	11,443
% of revenue	23.9	34.8	36.9	38	43.9

Source: WA budget papers

Tax cuts, major spending increase and a \$26bn capital works program are the hallmarks of this budget

Key measures

- Tax cuts worth \$238mn in 2008-09 and \$1.2bn over the next four years. This includes land tax and metropolitan region improvement tax cuts of \$558mn and the introduction of a concessional transfer duty scale for residential property transactions worth \$487mn over the next four years.
- Major increases in spending on health services (\$247mn or 5.8% growth), law and order (\$138mn or 8.3%), education and training services (\$135 million or 3.9%), and child protection services (\$48 million or 16.5%).
- A capital works program worth \$7.6bn in 2008-09 and \$26.1bn over the next four years. Spending in 2008-09 includes \$1.2 billion on electricity infrastructure, \$1.1bn on water, wastewater and drainage services, \$810 million on road construction and maintenance, \$502 million on health infrastructure, \$377 million on port infrastructure, \$347 million on schools and TAFE colleges and \$211 million on law and order-related projects.

WA's economy is likely to remain amongst the strongest in the nation

Economic outlook

Nowhere is the effect of the commodity boom more apparent than in Western Australian economy. Having led the national economic growth table for the past few years, Western Australia is expected to again top the charts, with the government forecasting growth of 7.5% in 2007-08. It expects growth to slow marginally, to 6.25% in 2008-09. But to put this in context, growth is still expected to remain well above the state's long term average growth rate of 4.5%.

Not surprisingly, against such a strong economic backdrop, the government expects the labour market to remain strong, with employment growth of 3.75% this year and 2.5% next, and the unemployment rate remaining around historic lows of between 3 and 3.25% over the next year. With such a tight labour market, wages growth will remain elevated, at around 5.75% in 2007-08 and 5.25% in 2008-09.

Overall, we agree with the broad thrust of the government's forecasts. While we expect that the state's growth will slow a little more sharply in 2008-09 as the effects of tighter financial conditions take hold, we expect Western Australia to remain amongst the strongest performers, with the ongoing stimulus from the commodity boom providing a buffer.

Western Australian economic forecasts

	2007-08	2008-09	2009-10	2010-11	2011-12
Real Gross State Product	7.5	6.25	5.75	4.5	4.5
Employment	3.75	2.5	2.25	2.5	2.5
Unemployment rate	3.0	3.25	3.25	4.25	4.25
Consumer Price Index	3.25	3.25	3.0	2.75	2.75
Wage Price Index	5.75	5.25	4.5	3.5	3.5

Source: WA budget papers

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