2015-16 State Budget commentary

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Summary

The Budget recognises the vital economic contribution of the resources sector to the Western Australian economy and has confirmed there are no royalty increases as a result of the mineral royalty rate analysis across the forward estimates.

Despite recent falls for a number of key commodities, revenue from royalties will be $4.44 billion in 2014-15 and estimated to be $3.67 billion in 2015-16 – contributing 14 per cent to total State revenue.

Revenue write downs of $10.2 billion are forecast over the forward estimates however, the Government continues to increase its spending.

Disappointingly, government expenditure has continued to increase despite the forecast and actual significant write down in government revenues. This is not sustainable and there is not a pathway back to surplus outlined.

Positives

Despite its dramatic fall in projected revenue over the forward estimates, the Budget has not directly sought to re-coup this lost revenue from the resources sector through additional royalties and taxes.

Funding remains for vital resources sector programs including the Exploration Incentive Scheme and the Western Australian Minerals Research Institute however this needs to be extended beyond 2016-17. Increased funding, to be matched by the Federal Government, in expanding the Perth Core Library will also benefit the industry.

Proposed asset sales are welcomed.

Negatives

It is disappointing to see cost recovery in environment assessment fees at a time when the government should increase its focus on in its own departmental spending.

This Budget does not sufficiently address how the government will curb its continued expenditure.

Net debt will reach a record $36.3 billion in 2018, before declining to $35.8 billion by the end of the forward estimates. This will increase the cost of state borrowings and continue to have a detrimental impact on Western Australia’s international credit rating.

What next?

Asset sales, while not factored into the Budget estimates, will be critical in addressing the State’s debt.

The government will need to ensure it sticks to its forecast reduced expenditure measures and is able to meet its subdued revenue projections to ensure any lift in business and consumer confidence this year, vital to achieving the reasonable economic growth targets in the forward estimates.

Overview

The Western Australian State Budget provides a summary of the State's economic and fiscal outlook, budget initiatives and the government's strategic priorities and objectives.

Western Australia's economy is predicted to grow at 2 per cent in 2015-16, contracting again from 3.25 per cent in 2014-15 and 5.5 per cent growth in 2013-14. Across the forward estimates, economic growth is projected to increase to 3.5 per cent in 2016-17 before again contracting in 2017-18 and 2018-19.

Given $10.2 billion in revenue write downs from the 2014-15 Budget, an operating deficit will exist for 2014-15 ($1.28 billion) and 2015-16 ($2.76 billion) with a projected return to net operating surplus in 2017-18. Revenue growth is predicted to decline only in 2014-15 and 2015-16, returning to an operating surplus by 2016-17.

Tabled below are some of the key economic indicators from the 2015-16 Budget:

Indicator	**2014/15 (estimated actual)**	**2015/16 Budget estimate**	**2016/17 Forward estimate**	**2017/18 Forward estimate**	**2018/19 Forward estimate**
Real GSP growth (%)	3.25	2.0	3.5	2.75	2.75
Unemployment rate (%)	5.5	6.25	6.0	5.75	5.25
Consumer price index (%)	2.0	2.25	2.5	2.5	2.5
Headline iron ore price (US$ per tonne CFR)	68.8	47.5	50.7	56.3	61.8
Iron ore volumes (million dry tonnes)	716	748	772	797	799
Exchange rate (US cents)	83.3	75.9	75.0	74.3	73.9

Revenue from **royalty receipts** is expected to reach $3.67 billion equating to 14 per cent of state revenue for 2015-16. It is forecast to rise to $4.9 billion, given movements forecast predominantly by changes in the iron ore price, by the end of the forward estimates.

Pleasingly, the State has used an iron ore projection figure of US$48 p/t (as has federal government), compared to the overly optimistic US$120 p/t relied upon in 2013-14.

Revenue from North West Shelf grants has also decreased from the prior Budget due predominantly to decreases in oil prices. Revenue will decrease 20 per cent to $762 million in 2015-16, bringing combined mining and oil and gas revenue to the State to $4.43 billion.

The **unemployment rate** is expected to grow to 6.25 per cent in 2015-16 before moderating and decreasing regularly over the forward estimates. This deterioration has been expected with the dampening of global economic forecasts and as the resources sector continues to transition from construction-focussed growth to exports-focussed growth.

Net exports are expected to continue to be a key economic driver of growth in the economy and are forecast to increase in real terms from $136.9 billion in 2014-15 to $165.6 billion in 2018-19 – an increase of almost $30 billion or 20.9 per cent. Iron ore exports are expected to grow at a moderate rate of approximately 8 per cent from 748 million tonnes in 2015-16 to 799 million tonnes in 2018-19.

Key initiatives

Key spending and revenue measures in the State Government's 2015-16 Budget are below:

Revenue raising and savings measures over the next four years:

- Revised land tax scales - $826 million
- Reforms to social concessions - $199 million
- Increase in loan guarantee fee payable to the State Government - $149 million
- Initial agency expenditure review savings - $137 million
- Reduction of First Home Owners Grant - $109 million

Note: Projected revenue estimates of between $3-$5 billion for sale of assets will not be included in revenue measures until a sales transaction has occurred.

Spending commitments:

- Delivering an additional 1,000 social housing commitments - $560 million
- Additional funding for hospital activity for WA Health - $417 million
- Growth in demand for core child protection services - $172 million
- An increase in the operating subsidy paid to the Public Transport Authority - $122 million
- Additional safety and reliability works for Western Power - $140 million

CME Position

While the outlook for new major project investment has peaked as predicted, investment is expected to remain at historically high levels throughout the forecast period returning to $45.7 billion in 2018-19, around the same level recorded in 2009-10.

While not directly targeting the resources sector with additional taxes, changes to land tax rates, and increases in vehicle registrations and other consumption fees and charges will likely hurt consumer and business confidence, having a negative impact on growth.

CME is disappointed with the limited budget savings measures announced. Savings from public sector efficiencies are welcomed although appropriate service levels for key agencies should be maintained in order to deliver efficient and effective service, including approvals processes.

CME will be reviewing the Budget in more detail over the next few days and delivering specific analysis to members through our CME Standing Committees.

Royalties

The government should be commended on completely removing increases in royalty rates for any commodities across the Budget forward estimates, after a three year review of the mineral royalty rates has now been completed.

Total royalty income is estimated to decrease by 26.3 per cent from $6 billion in 2013-14 to $4.4 billion in 2014-15, due mainly to the iron ore price impact on royalty revenue. The price impact is however, somewhat offset by higher iron ore production and a lower $US/$A exchange rate.

In 2015-16 revenue from royalties is predicted to be $3.7 billion, or 14 per cent of all state government revenue. Anticipated higher iron ore production volumes, a lower rate and a predicted modest recovery in commodity prices will underpin a gradual rise in royalty income to $4.9 billion by 2018-19.

Importantly, 2015-16 royalty revenue remains three times the percentage return to government, than 10 years earlier.

Commonwealth grants

Total Commonwealth Grants to be received by Western Australia for 2015-16 will decrease $458 million from 2014-15 levels to $8.39 billion. Western Australia is the only state or territory to have its total payments from the Commonwealth decrease over this period.

There is a 45 per cent reduction in GST revenue from 2014-15 to 2015-16 which will return to increases once the 3 year lag of the GST distribution methodology recognises the fall in Western Australia's equalised royalty revenue. GST returned to Western Australia will then increase 24 per cent in 2016-17 and move to a 48 per cent increase in 2018-19.

Infrastructure

CME welcomes the expansion of the asset sales program. This includes the long term lease of the Fremantle Port Authority, absorbing the existing process for the sale of the Kwinana Bulk Terminal.

CME supports the sale of individual generation assets identified as non-core assets of Western power and individual generation assets of Horizon power and Synergy. Sales were recommended by the Steering Committee undertaking phase one of the Electricity Market Review. The investigation into the proposed sale of only non-core assets of Western Power's falls short of considering the sale of the entire utility.

Any sale of these assets should be accompanied by suitable contractual or legislative frameworks to prevent abuse of any monopolistic position, ensuring reasonable commercial rates of return are enshrined in any lease or privatisation arrangement.

CME suggests a significant component of sales proceeds be recycled into further infrastructure projects, as recommended in CME's Investment in Resources Sector Infrastructure report. This approach will enable the State to access funding through the Federal Government's Asset Recycling Initiative.

Roads

The State Government has announced nine projects will be funded through the Federal Government's Budget allocation of $499 million, which was provided to offset the State's declining share of GST revenue. Road infrastructure is critical to the safe and efficient transportation of equipment and commodities throughout the state and expenditure on roads in regional areas is welcomed.

While the additional funding was agreed between the State and Federal Governments too late to be included in the Budget, it will result in a $499 million reduction in net debt at the bottom line.

Ports

Specific Budget allocation for the refurbishment of berth 4 at the Mid West Ports Authority is welcomed compared to funding the refurbishment through the introduction of additional fees on port users.

The Integrated Marine Operations Centre at the Pilbara Ports Authority now has government approval (forecast to cost around $70 million) and will be funded through a Port Improvement Rate (PIR) introduced at the port in 2013.

CME does not support the current application of the PIR at the port and calls for any future capital projects, proposed to be funded by users through a PIR, to meet the requirements of the government's approved PIR policy, endorsed in 2014. This will ensure future projects are identified in consultation with port users, projects are approved by the government prior to introducing the PIR, and a sound business case is developed, including the term and quantum of PIR being clearly identified.

Investment in training facilities and initiatives

The announcement of the $7.8 million for a Centre of Specialisation for Electrical Instrumentation at the Pilbara Institute's Karratha campus is welcomed. Whilst the industry's overall workforce is declining as we continue our transition to a production environment, there will be developing areas of skill needs as the industry becomes higher tech and higher skilled into the future – particularly with foundations in science, technology, engineering and mathematics (STEM).

Industry would like to see government focus on initiatives aligned to increasing the awareness of the importance of STEM amongst learners and the community and also improving the capability of the education and training sectors to deliver STEM-related programs to build the future workforce.

Support for initiatives aligned to increasing the awareness of the importance of STEM amongst learners and the community, and also improving the capability of the education and training sectors to deliver STEM-related programs, has again been overlooked in the Budget. Industry would like to see government fund initiatives to build the future workforce, as identified in the recently released State Science Statement.

The reduction of funding for Industry Training Advisory Arrangements in the forward estimates is of concern. Under this program, the Resources Industry Training Council, hosted jointly by CME and APPEA, plays a crucial role in informing government of the current and future skilling needs of industry and in leading industry collaboration on training initiatives.

Cost-recovery in environmental regulation

CME is disappointed the government is progressing with the Environment Assessment Fees to recover costs associated with the Department of Mines and Petroleum Reforming Environmental Regulation Initiative, which will generate $2.7 million in 2015-16, increasing over the forward estimates.

Royalties for Regions

CME supports the return of a proportion of mining revenue to the regional communities in which they operate given the importance of this revenue in providing necessary economic and social infrastructure requirements in regions. Specifically we are pleased to see the establishment of new health facilities in Bunbury, Karratha and Laverton to address shortfalls in government sub-acute mental health services in those centres.

The continuation of the $1 billion Royalties for Regions Fund cap, while not necessary in 2015-16, is welcomed given the restraint needed in overall State expenditure. CME calls for detailed economic analysis and full risk assessments undertaken relating to funding provisions for revitalisation funds, regional blueprints and the Pilbara cities programs to ensure funding is most appropriately allocated to provide the greatest return to the regions without duplicating efforts.

State taxes

The government has reversed its deferred start date for increasing the payroll tax exemption threshold to $850,000 which will now commence from 1 July 2016.

Proposed land tax changes will result in a new, flatter land tax scale. While the exemption threshold and top marginal rate will remain unchanged, the rates within the bands have increased. The changes will distribute the land tax burden more evenly amongst tax payers and, the Budget claims, will keep Western Australian rates competitive with other states.

Please do not hesitate in contacting Shannon Burdeu Manager – Economics & Tax (s.burdeu@cmewa.com or 08 9220 8514) or your CME contact for further information.