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DEBT AND THE STATE'S CREDIT RATING

Net debt

Limiting growth in net debt, while still delivering the high quality services and infrastructure demanded by a growing population, remains a key budget challenge, particularly in light of the State's rapidly declining GST revenue.

Although general government operating surpluses are projected in each year of the forward estimates period, these surpluses are not large enough to fully fund the Government's infrastructure program, with further borrowings needed to fund the infrastructure required to service the State's expanding population.

As a result, total public sector net debt is projected to increase from \$22 billion at 30 June 2014 to \$29.4 billion by 30 June 2018. As a share of the economy (or Gross State Product), net debt is projected to increase from 8.4% in 2013-14 to 9.2% in 2017-18.

New revenue and savings measures implemented in this Budget have reduced pressure on net debt levels by an estimated \$2 billion over the forward estimates period. These measures, which build on last year's Fiscal Action Plan, have assisted in keeping the State's net debt burden affordable, with total public sector net interest costs expected to represent 2.7% of total public sector revenue in 2017-18, compared with 2.2% in 2013-14.

In addition, based on recent Mid-year Review projections to 30 June 2017 (the latest consistent data for other States), Western Australia's projected net debt burden as a share of revenue is not substantially different to other Australian States and is below the levels forecast for New South Wales and Victoria, which are triple-A rated jurisdictions (see Figure 1).

It is important to note that net debt is an important tool for spreading the cost of infrastructure over generations of users. Although net debt will increase across the forward estimates period, the cost of that debt is shared by those who will use the assets today and those who will use them into the future.

Western Australia's Credit Rating

On 18 September 2013, Standard & Poor's (S&P's) announced that it was adjusting down Western Australia's headline credit rating by one notch, from AAA (negative outlook) to AA+ (stable outlook). Moody's rates Western Australia as Aaa (negative outlook). A key concern of S&P's was the growth in total public sector gross borrowings.

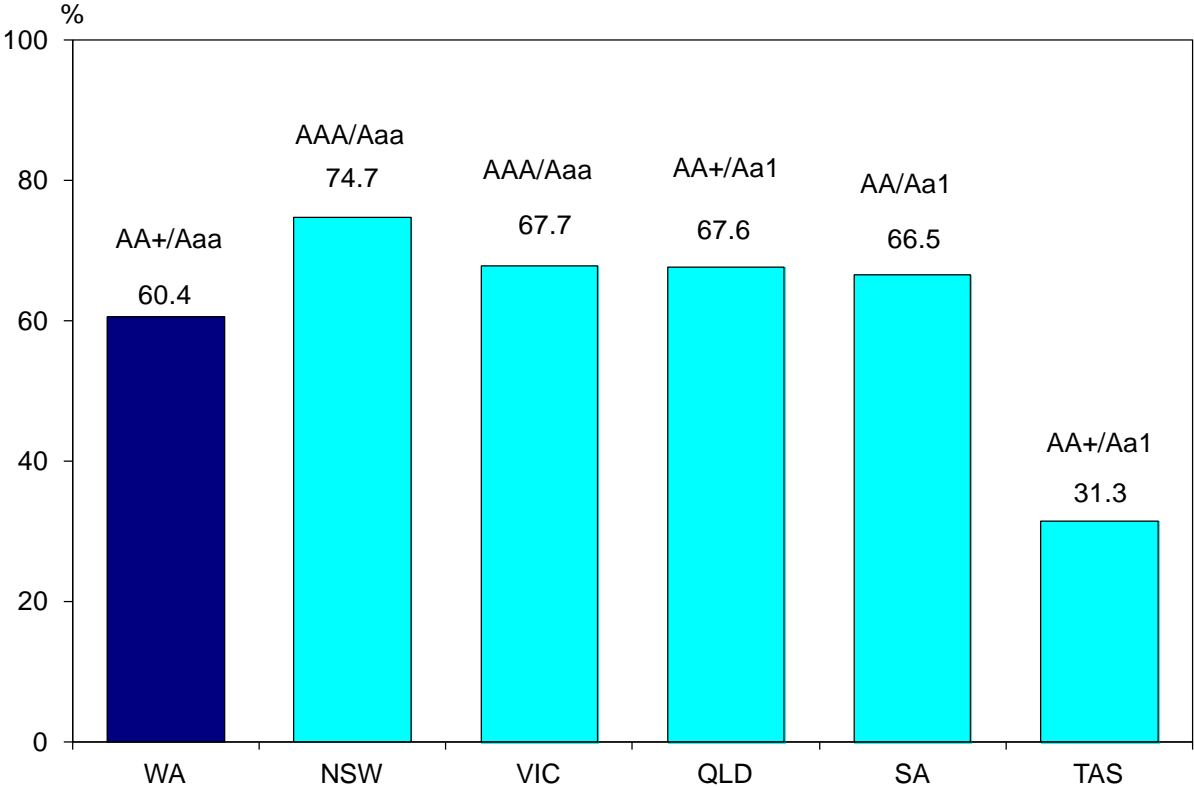
In response, Government decisions have slowed the growth in gross borrowings to 30 June 2018 by around \$5.3 billion since the September 2013 downgrade, reflecting:

- changes to the Consolidated Account borrowing levels detailed in the 2013-14 Mid-year Review (\$2.4 billion to 30 June 2018);
- the transfer of excess agency cash (beyond working capital and cash held for restricted purposes) to the Consolidated Account (estimated to be in the order of \$250 million); and
- introduction in this Budget of a \$1 billion cap on annual spending by the Royalties for Regions program, as well as implementation of the statutory \$1 billion cap on the balance of the Royalties for Regions Fund (\$2.7 billion to 30 June 2018).

In addition, the Government is intending to pursue an orderly program of asset sales. The revenue generated from asset sales will be used to reduce debt levels (and in some cases, contribute to the costs of assets under construction). The debt projections in this Budget do not include the impact of potential asset sales over the next three years. Asset sales proceeds will only be brought to book upon successful completion of the sales transactions.

Figure 1

**STATES' CREDIT RATING STATUS^(a) AND
NET DEBT AS A SHARE OF REVENUE – 2016-17**
Total Non-Financial Public Sector



(a) Standard & Poor's rating / Moody's rating (e.g. Western Australia AA+ / Aaa).

Source: 2013-14 Mid-year Review data for all jurisdictions except for Western Australia, which is based on 2014-15 Budget data.



KEY AGENCIES' RECURRENT APPROPRIATION AND EXPENSE MOVEMENTS

The following tables outline changes in the recurrent appropriations and expenses of key service delivery agencies for 2014-15. Appropriations represent State Government funding (provided from the central pool of State tax revenue, royalties and 'untied' Commonwealth grants) to assist agencies to provide services to the community. Expenses represent the total cost of providing these services. In addition to appropriations, expenses may also be funded by other sources, such as specific-purpose Commonwealth grants or agency fees and charges.

Because expenses comprise all funding sources, they are considered to provide a more comprehensive view of agencies' activities. Expense movements also directly impact the 'headline' net operating balance.

Table 1

RECURRENT APPROPRIATION Western Australia

	2013-14 Estimated Actual \$m	2014-15 Budget Estimate \$m	Change \$m	Change %
WA Health	4,220.5	4,700.9	480.3	11.4
Education	3,602.4	3,802.7	200.4	5.6
Western Australia Police	1,180.7	1,253.7	73.0	6.2
Commissioner of Main Roads	816.3	863.0	46.7	5.7
Corrective Services	768.5	791.6	23.1	3.0
Public Transport Authority of Western Australia ^(a)	712.5	747.4	34.9	4.9
Disability Services Commission	639.4	692.2	52.9	8.3
Mental Health Commission	565.6	620.7	55.1	9.7
Child Protection and Family Support	529.2	560.8	31.6	6.0
Training and Workforce Development	469.9	424.1	-45.8	-9.7
Attorney General	340.4	343.3	2.9	0.9
Parks and Wildlife	209.7	199.5	-10.2	-4.9
Transport ^(b)	64.4	52.5	-11.9	-18.4
Fire and Emergency Services	36.9	31.9	-5.0	-13.6

(a) Comprises the operating subsidy and the appropriation for salaries and allowances.

(b) Motor Vehicle Registration Recording Fee and Motor Driver's Licence Fee revenue will be collected under a net appropriation arrangement from 2014-15. This will result in a substantial reduction in the level of service appropriation provided to the Department of Transport, offset by an equivalent increase in retained revenue. The 2013-14 Estimated Actual financial data has been backcast for comparability purposes.

RECURRENT EXPENSES
Western Australia

	2013-14 Estimated Actual \$m	2014-15 Budget Estimate \$m	Change \$m	Change %
WA Health	7,562.8	8,009.5	446.7	5.9
Education	4,387.9	4,575.6	187.7	4.3
Commissioner of Main Roads	2,074.0	1,969.3	-104.8	-5.1
Western Australia Police	1,260.0	1,343.5	83.5	6.6
Public Transport Authority of Western Australia	1,227.7	1,291.7	64.1	5.2
Disability Services Commission	800.6	873.5	72.9	9.1
Corrective Services	854.5	870.3	15.7	1.8
Mental Health Commission	745.9	791.6	45.7	6.1
Training and Workforce Development	726.0	686.0	-40.0	-5.5
Child Protection and Family Support	591.2	624.7	33.5	5.7
Attorney General	532.5	535.8	3.3	0.6
Transport	383.8	378.1	-5.8	-1.5
Fire and Emergency Services	346.0	334.2	-11.8	-3.4
Parks and Wildlife	292.9	286.0	-6.9	-2.4

Further detail on the budget outlook for agencies is available in Budget Paper No. 2: *Budget Statements* available at www.ourstatebudget.wa.gov.au.



MEETING THE GROWTH IN KEY SERVICE DELIVERY

Strong growth in Western Australia's population, driven by the migration of over 1,000 people per week in 2012-13, has fuelled unprecedented demand for government services. The State Government has met this challenge with significant funding increases in priority areas, including health, education, social services and law and order.

Health

Health spending has grown to \$8 billion in 2014-15, an increase of \$3.2 billion (or 68%) compared to 2008-09, primarily driven by increased costs and growing demand for hospital services. To address this, the Government is injecting a further \$204 million to fund hospitals in 2014-15, increasing total annual hospital spending to around \$5.4 billion.

This increased hospital spending will enable an additional 15,000 patients to be treated in hospital, 33,000 more patients to attend our emergency departments, and an additional 66,000 people to receive treatment as outpatients.

Annually, Western Australia's public hospital system will now treat over 607,000 inpatients, process one million emergency department attendances, and deliver over two million outpatient procedures.

Education

A total of \$4.6 billion will be spent on public education services in 2014-15, an increase of \$1.3 billion (or 40%) compared to 2008-09, including an additional \$188 million to address student enrolment growth. It is predicted that the public school system will see an increase in enrolments of around 11,000 students in the 2015 school year. This includes a permanent structural increase of around 5,700 students due to the graduation of the half-year cohort of Year 12 students in 2014. Over the four years from 2014-15 to 2017-18, additional expenditure of \$812 million has been provided amid projected enrolment growth of 11.6% (or 33,000 students) between the 2014 and 2018 school years. This additional expenditure funds an estimated 1,458 extra teachers over the next four years, including an estimated 550 teachers in 2015.

Mental Health

In 2014-15, \$792 million will be spent on delivering mental health services in Western Australia, an increase of \$321 million (or 68%) compared to 2008-09.¹ This annual spend includes around \$315 million to deliver treatment for mental health patients in hospitals (through WA Health). To meet the ongoing demand for mental health hospital services, the Government has committed an additional \$33 million in 2014-15 (for a total of \$144 million over the four years to 2017-18) to deliver inpatient care for people with a mental illness.

The Government is also providing an additional \$29 million from 2014-15 to 2016-17 to continue the State-wide Specialist Aboriginal Mental Health Service. Aboriginal people with severe mental illness will receive culturally-informed support and clinical case management through this initiative.

¹ The 2008-09 figure is based on WA Health expenditure data as mental health and drug and alcohol services had not been disaggregated for budget purposes at that point in time.

Other mental health reforms include increasing the availability of 'Step-up/Step-down' treatment facilities to relieve the pressure on hospitals. Suicide prevention and mental health court diversion programs have also been extended for a further year.

Disability Services

The number of clients receiving disability services is expected to increase by 1,145 to around 24,000 in 2014-15, with a further 1,927 new clients expected to benefit from the commencement of National Disability Insurance Scheme (NDIS) and My Way trial sites from 1 July 2014.

The Government is providing an additional \$28 million in 2014-15 to meet expected growth in demand for existing disability services outside the NDIS trial sites. This will see the total spend on disability services in Western Australia increase to \$873 million in 2014-15, an increase of \$439 million (or 101%) since 2008-09.

Child Protection

The growth in demand for child protection services remains high, with the number of children in care increasing by an average of 6% per annum since 2008-09, and forecast to grow at a similar rate in 2013-14 and 2014-15.

A total of \$625 million will be spent on child protection and family support services in 2014-15, an increase of \$272 million (or 77%) compared to 2008-09, including an additional \$22 million (for a total of \$90 million over the four years from 2014-15 to 2017-18) to meet higher demand for services.

In 2014-15, the Department for Child Protection and Family Support will provide support to over 4,000 children and young people in care, assess the safety of an estimated 18,500 children who are the subject of child protection concerns, and support an estimated 80,000 at-risk and vulnerable families.

Law and Order

In 2014-15 expenditure on law and order will increase to \$2.7 billion, an increase of \$798 million (or 41%) compared to 2008-09. Approximately \$103 million will be spent on meeting growth and costs in community safety and justice services and provide for an additional 180 officers to be recruited in 2014-15 as part of the Government's commitment to boost officer numbers by 550 by 2016-17.



2014-15 BUDGET REVENUE AND SAVINGS MEASURES

A new package of revenue and savings measures has been implemented in this Budget to ensure the delivery of general government operating surpluses and to limit the growth in debt levels. The new measures build on last year's Fiscal Action Plan and have enabled additional spending to be directed towards front-line services, including health, education, disabilities and child protection services.

The new revenue and savings measures implemented in the 2014-15 Budget improve the State's net operating balance position by an estimated \$446 million in 2014-15 and reduce net debt by around \$2 billion by the end of the forward estimates period.

Table 1

FINANCIAL IMPACT OF ALL REVENUE AND SAVINGS MEASURES

	2013-14 \$m	2014-15 \$m	2015-16 \$m	2016-17 \$m	2017-18 \$m	Total \$m
General Government Net Operating Balance						
Recruitment Freeze	21	-	-	-	-	21
Advertising Freeze	7	-	-	-	-	7
15% Procurement Reduction	-	169	-	-	-	169
Ports Interim Dividend	-	93	18	5	-	116
Motor Vehicle Registration Fee Concession	-	43	46	48	51	189
Perth Parking Levy	-	10	20	20	22	73
First Home Buyer Transfer Duty Concession	-	54	55	56	57	222
Land Tax	-	72	79	87	96	334
Landfill Levy	-	10	41	42	44	137
Management of Royalties for Regions	-	-7	34	-24	54	56
Recovery of Excess Cash Balances	-	-	-	-	-	-
Interest Savings from Measures	-	1	23	39	55	118
TOTAL NET OPERATING BALANCE IMPACT	29	446	316	273	378	1,443
Asset Investment Program (AIP)	-					
5% AIP Efficiencies	-	-130	-113	-116	-119	-478
2017-18 AIP Deferral/Re-cashflow	-	-	35	9	-287	-243
Management of Royalties for Regions	-	14	-5	-16	19	12
TOTAL AIP	-	-116	-83	-123	-387	-709
IMPACT ON NET DEBT AT 30 JUNE^(a)	-29	-498	-879	-1,270	-2,035	

(a) The implementation of the Ports Interim Dividend does not impact net debt.

Note: Columns may not add due to rounding.

Without these revenue and savings measures, the Budget would show a general government operating deficit of \$271 million in 2014-15. Instead, a general government operating surplus of \$175 million is now expected.

An estimated \$250 million of excess cash held in agency bank accounts is to be returned to the Consolidated Account in 2014-15, reducing gross borrowings by an equivalent amount. A further \$2.7 billion in gross borrowings will no longer be required by imposing a \$1 billion spending cap and implementing the statutory \$1 billion cap on the balance of the Royalties for Regions (RfR) Fund.

Advertising and Recruitment Freeze

- From 16 April 2014, the Government immediately froze all general government agencies' advertising expenditure and recruitment activity until the end of 2013-14, unless agencies can demonstrate an adverse impact on front-line service delivery. This is estimated to save around \$29 million.

15% Procurement Reduction

- In 2014-15, general government agencies will be required to reduce non-essential procurement by 15%, delivering a saving of \$169 million. Although this saving only represents 0.6% of total general government expenditure, it represents almost all of the estimated surplus in 2014-15.
- Non-essential procurement includes expenditure on communications, consultants, consumables and staff travel. The procurement savings do not apply to contracts and services purchased from the not for profit sector, nor to direct school purchases or patient support costs. The savings measure only applies to agencies where the estimated savings are above \$200,000.

Ports Interim Dividend

- The Government will introduce a 75% interim dividend for the State's port authorities, which will bring forward an estimated \$93 million in dividend payments into 2014-15. The payment of interim dividends does not affect the port authorities' capacity to undertake functions and seeks to bring earlier recognition of revenue resulting from profits earned. The Water Corporation pays a similar interim dividend, but it is set at 98% of the total forecast dividend. This measure is subject to the passage of the Port Legislation Amendment Bill 2013, which is currently before the Parliament.

Motor Vehicle Registration Fee Concession

- From 1 July 2014, the \$36 private motor vehicle registration fee concession will be abolished, which is expected to save the Government around \$189 million across the forward estimates period.
- This concession is poorly targeted, being available for all vehicles used for non-business purposes, regardless of the value of the vehicle or how many kilometres are travelled.
- Despite the abolition of this concession, the 2014-15 registration fee (including Compulsory Third Party insurance) in Western Australia will be the second lowest of all States and Territories, increasing from \$510.38 (on a typical 6 cylinder vehicle) to \$582.90. The 2014-15 registration fee (including Compulsory Third Party insurance) in other States and Territories ranges from \$494 in Tasmania to \$1,021.30 in the ACT.

Perth Parking Levy

- The Perth Parking Levy (PPL) will increase by \$365 (or around \$1 a day), phased in over the next two years. This will raise an estimated \$73 million across the forward estimates period. The additional revenue earned from this measure will be used to facilitate better public transport in the city centre by partially funding the building of the Perth Busport, a key component of the Perth City Link Project. The Government is also bringing forward expenditure of \$17 million from 2017-18 to 2015-16 and 2016-17 for the replacement of CAT buses.
- Even after the change, Perth's tenant parking licence fee of \$1,093.70 in 2015-16 (up from the current \$728.70) compares favourably to current rates in Sydney (\$2,160) and Melbourne (\$1,300).

First Home Buyer Transfer Duty Concession

- The first home buyer transfer duty exemption will be adjusted to provide a full exemption for home purchases of \$430,000 or less, down from the current exemption of \$500,000. The concession will then phase out between \$430,000 and \$530,000 (down from the current \$600,000). The new threshold better represents the value of homes being purchased by first home buyers in Western Australia. It is estimated that this will save the Government \$222 million over the four years to 2017-18.
 - First home buyers will continue to be exempt from duty on purchases of vacant land valued up to \$300,000, with the concession phasing out at \$400,000 (unchanged from current arrangements).
- Western Australia's first home buyer transfer duty concession still remains generous compared to other States and Territories.
 - In all other States and Territories (other than Queensland), duty currently payable for a first home buyer of a \$450,000 established home ranges from \$11,382 to \$20,057, compared to first home buyers in Western Australia who will pay just \$3,838 (see Attachment A).
- First home buyers of properties valued up to \$750,000 (or \$1 million for those north of the 26th parallel) remain eligible for the First Home Owner Grant of \$3,000 for established homes and \$10,000 for new homes.
- This measure will commence from 1 July 2014, subject to the timely passage of legislation.

Land Tax

- Land tax rates will increase by 10% across the board from 2014-15 to offset lower than expected land tax and Metropolitan Region Improvement Tax collections from weaker than forecast growth in land values.
- This measure is forecast to raise an additional \$72 million in 2014-15 and a total of \$334 million over the four years to 2017-18.
- The vast majority of Western Australian property owners will not be affected by this increase due to the application of exemptions, such as that for private residences, and the fact that land tax is only payable once unimproved land values exceed \$300,000.
- Even for those taxpayers that will be affected by the rate increases, around 80% of them – those with land with an unimproved valued up to \$1 million – will experience a land tax increase of no more than \$70.

- Despite the increase in rates, Western Australia's land tax will remain significantly below that of other jurisdictions for land with an unimproved value up to \$10 million. For example, for a landholding with an unimproved value of \$1 million, land tax payable in Western Australia will increase from \$700 to \$770, substantially below the amount payable in New South Wales (\$9,508), Victoria (\$2,975), Queensland (\$4,500) and other States (see Attachment B).

Landfill Levy

- From 1 January 2015, the landfill levy rate at putrescible¹ and inert² landfills will increase from \$28 to \$55 per tonne and from \$8 to \$40 per tonne respectively. These increases, which are designed to divert waste away from landfill to recycling options and support a wide range of environmental initiatives, are estimated to raise \$17 million in 2014-15 and a total of \$202 million over the four years to 2017-18. Of this revenue:
 - \$51 million across the forward estimates period will be allocated to the Waste Avoidance and Resource Recovery Account to fund waste diversion programs;
 - \$15 million across the forward estimates period will be allocated to fund the Office of the Environmental Protection Authority's services; and
 - \$137 million across the forward estimates period will help fund other Government priorities.

Asset Investment Program

- A 5% reduction in most agencies' Asset Investment Programs (AIPs) has been implemented in recognition of recent low growth in building and construction costs, which is expected to continue over the medium-term. This provides favourable conditions for agencies to deliver construction and asset replacement at a lower cost than initially estimated without a reduction in scope. Individual program savings will be detailed as part of the 2014-15 Mid-year Review.
- This measure will save an estimated \$478 million over the four years to 2017-18 estimates period.
- In addition to the 5% AIP efficiency measure, a review of the achievability and priorities of the State's AIP has resulted in the deferral of \$243 million in asset investment spending to beyond the forward estimates period. These changes in timing build on the \$1.9 billion review of the Government's infrastructure program reflected in the 2013-14 Mid-year Review.

¹ Putrescible waste includes household food waste, green waste and certain commercial and industrial wastes that easily decompose.

² Inert waste is waste, such as sand and concrete, which is neither chemically nor biologically reactive and will not decompose.

Table 2

**INTER-JURISDICTIONAL COMPARISON OF TRANSFER DUTY PAYABLE
BY FIRST HOME BUYERS**

Established Home – July 2014

Property value	WA Current \$	WA 1 July 2014 \$	NSW ^(a) \$	VIC \$	QLD \$	SA \$	TAS \$	ACT \$	NT \$
\$100,000	-	-	1,990	1,290	-	2,830	2,435	2,200	2,157
\$200,000	-	-	5,490	3,822	-	6,830	5,935	4,400	5,628
\$300,000	-	-	8,990	6,822	-	11,330	9,935	8,100	10,414
\$400,000	-	-	13,490	9,822	-	16,330	13,998	12,600	16,514
\$450,000	-	3,838	15,740	11,382	-	18,830	16,123	14,850	20,057
\$500,000	-	13,433	17,990	13,182	-	21,330	18,248	17,100	23,928
\$550,000	11,255	20,140	20,240	14,982	10,600	24,080	20,373	19,600	27,225
\$600,000	22,510	22,515	22,490	18,642	12,850	26,830	22,498	22,100	29,700
\$750,000	29,740	29,740	29,240	40,070	19,600	35,080	28,935	29,600	37,125

(a) New South Wales provides a duty concession for new homes, which exempts from duty homes valued up to \$550,000 phasing out at \$650,000.

Table 3

TRANSFER DUTY PAYABLE

Property value	Duty payable by first home buyers before 1 July 2014 \$	Duty payable by first home buyers from 1 July 2014 \$	Duty payable by other home buyers \$	Saving for first home buyers from 1 July 2014 \$
\$430,000	-	-	14,440	14,440
\$440,000	-	1,919	14,915	12,996
\$450,000	-	3,838	15,390	11,552
\$460,000	-	5,757	15,865	10,108
\$470,000	-	7,676	16,340	8,664
\$480,000	-	9,595	16,815	7,220
\$490,000	-	11,514	17,290	5,776
\$500,000	-	13,433	17,765	4,332
\$510,000	2,251	15,352	18,240	2,888
\$520,000	4,502	17,271	18,715	1,444
\$530,000	6,753	19,190	19,190	-

Table 4

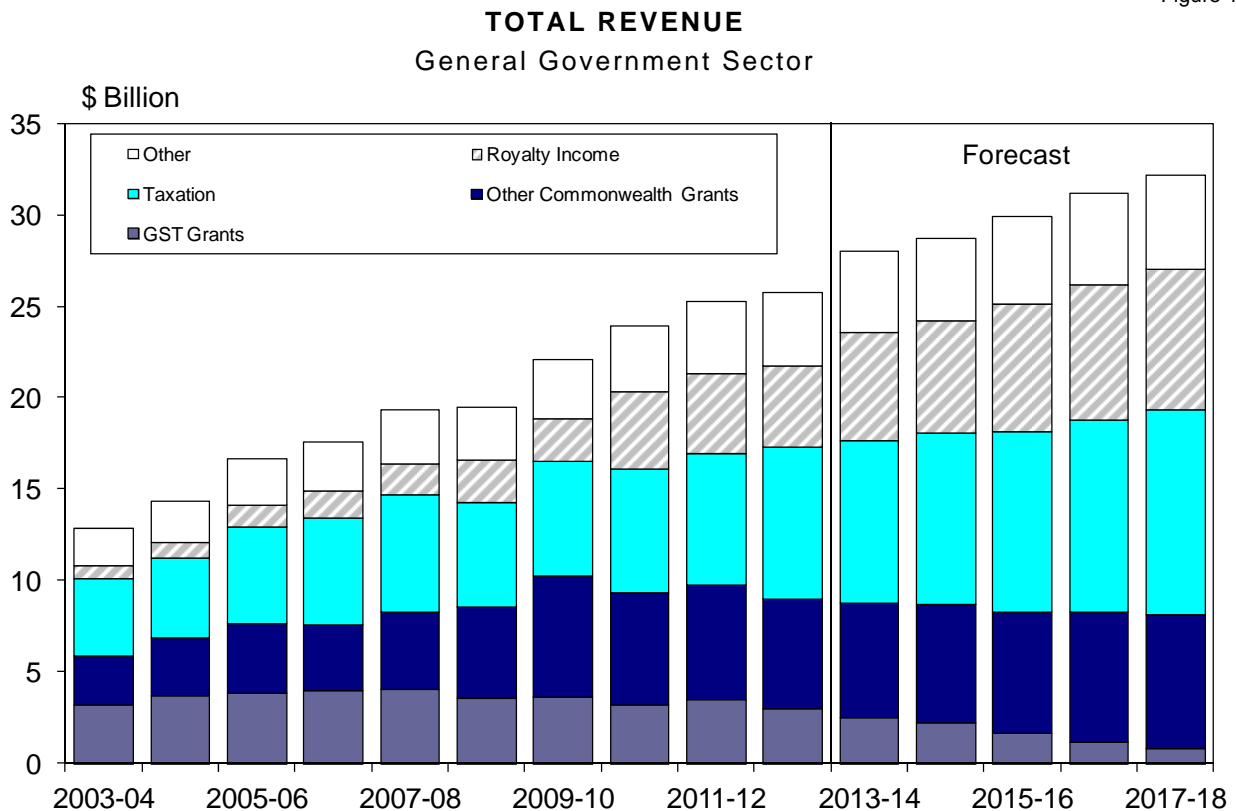
INTER-JURISDICTIONAL COMPARISON OF LAND TAX PAYABLE

Land Value	WA Current \$	WA New \$	NSW \$	VIC \$	QLD \$	SA \$	TAS \$	ACT \$
\$100,000	-	-	-	-	-	-	463	625
\$200,000	-	-	-	-	-	-	1,013	1,420
\$300,000	-	-	-	375	-	-	1,563	2,538
\$400,000	100	110	-	575	-	420	2,588	4,338
\$500,000	200	220	1,508	775	-	920	4,088	6,138
\$1,000,000	700	770	9,508	2,975	4,500	9,447	11,588	15,138
\$3,000,000	18,020	19,810	43,432	24,975	37,500	82,771	41,588	51,138
\$5,000,000	45,420	50,010	83,432	69,975	62,500	156,771	71,588	87,138
\$10,000,000	126,070	138,560	183,432	182,475	150,000	341,771	146,588	177,138
\$15,000,000	239,670	263,360	283,432	294,975	237,500	526,771	221,588	267,138

REVENUE VOLATILITY

The composition of the State's revenue has changed significantly in recent years, with an increasing reliance on own-source revenue such as State taxes and royalty income. For instance, royalty income has increased from 6% of total revenue in 2004-05 to an estimated 21.5% in 2014-15. In stark contrast, GST revenue has fallen from 25.4% of total revenue in 2004-05 to an estimated 7.7% of revenue in 2014-15, and is expected to be just 2.5% by 2017-18.

Figure 1



A consequence of these changes is that the State has become increasingly reliant on volatile revenue sources, with almost a third of the State's revenue now accounted for by mining revenue and property transfer duty, compared with less than 20% a decade ago.

Mining revenue, including royalty income and North West Shelf grants, is driven by changes in the \$US/\$A exchange rate and commodity prices, which are inherently volatile, as well as production volumes.

In 2013-14 to date, the \$A has traded from a low of US86.8 cents to a high of US97.1 cents, a range of US10.3 cents. Based on the exchange rate sensitivity for 2014-15 (see Table 1), an appreciation of this magnitude would, if sustained for a full year, reduce annual mining revenue by around \$824 million.

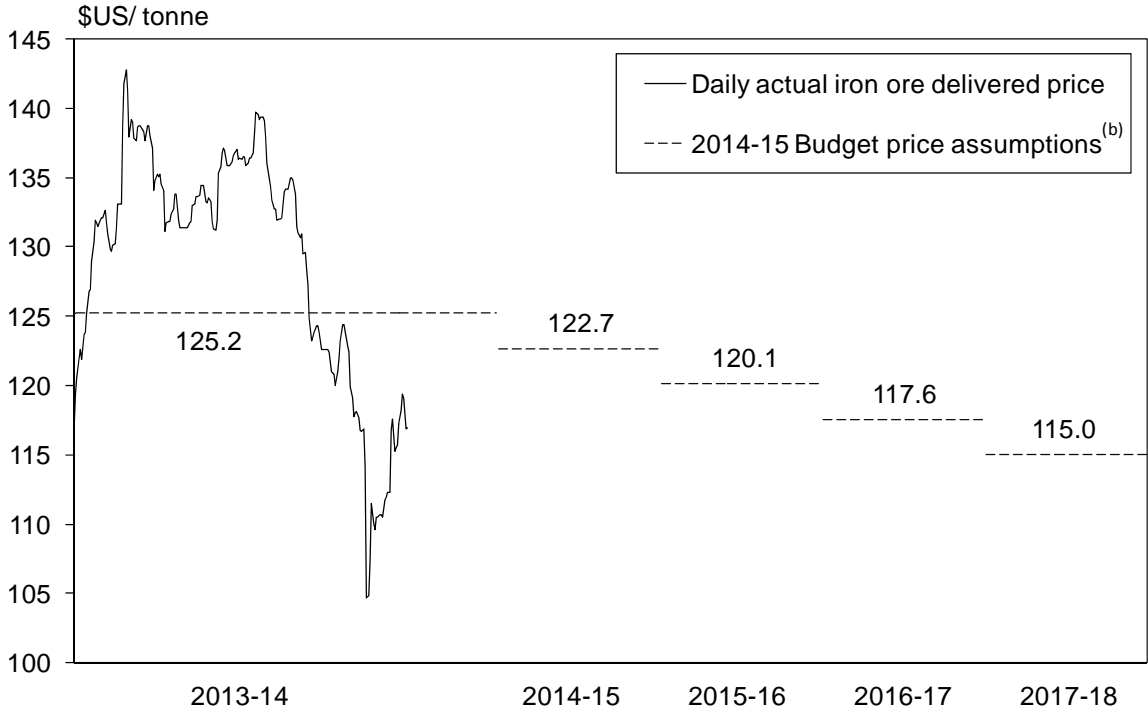
General government revenue is also highly sensitive to the iron ore price, with iron ore royalties projected to account for 19.7% (\$5.6 billion) of total revenue in 2014-15. The iron ore price has been especially volatile following the Global Financial Crisis and the breakdown of the annual benchmark pricing system. For example, in the 2013-14 year to date, the iron ore price has fluctuated between a high of \$US142.8 per tonne and a low of \$US104.7 per tonne. Based on the iron ore price sensitivity for 2014-15 (see Table 1), a movement of this magnitude would, if sustained for a full year, reduce annual royalty revenue by an estimated \$1.9 billion.

The iron ore price assumptions for the 2014-15 Budget are determined in a way that is designed to reduce the influence of short term price volatility on annual price assumptions and estimated royalty collections. Specifically, the benchmark iron ore price over the budget period is assumed to decline in a linear fashion from the average expected price in 2013-14 (based on actual prices over the year to date and forward prices for the remainder of the year) to a long term price assumption, based on the average expected price from a survey of market analysts.

This approach means that the spot iron ore price can be significantly higher or lower than the budget assumed price at any period of time within a financial year, but the volatility tends to smooth out over the course of a year, as highlighted in the following figure.

Figure 2

**AUSTRALIA TO CHINA IRON ORE 'FINES' 62% IRON CONTENT SPOT PRICE
CFR^(a)**



(a) CFR is the price inclusive of freight costs and is the commonly quoted delivered price of iron ore.
 (b) CFR price up to budget cut-off date of 14 April 2014.

Transfer duty revenue from residential property depends on the number of transfers that take place in any given year, and the value of the property that is transferred, both of which are impacted by fluctuations in the demand for housing.

The volume of property transfers is particularly volatile, with changes in transaction volumes having exceeded plus or minus 10% in four of the past five years. These variations have a material impact on transfer duty revenue, with a 10% change annually in the number of property transactions estimated to be worth around \$140 million per annum in transfer duty.

Property prices can also vary significantly over time. Since 2008-09, annual changes in the Perth median house price have ranged between an increase of 12.2% and a decline of 6.1%.

The number, or size, of high value commercial transactions, such as transfers of mining tenements or commercial property, can also vary greatly from one year to the next, further adding to revenue volatility.

Table 1

APPROXIMATE PARAMETER SENSITIVITY OF REVENUE ESTIMATES
2014-15

	Variability (\$m)	Detail
Royalty income and North West Shelf grants	±80	For each US1 cent decrease/increase in the \$US/\$A exchange rate (royalty income is inversely related to the \$US/\$A exchange rate)
Iron ore royalties	±49	For each \$US1 per tonne increase/decrease in the price of iron ore
Transfer duty		
Prices	±15	For each one per cent increase/decrease in average property prices
Transactions	±14	For each one per cent increase/decrease in transaction levels

The increasing reliance on more volatile own-source revenue means that it is imperative that the Government take action to ensure general government operating surpluses are achieved over time, and that the size of these surpluses is sufficient to provide a buffer against adverse movements in commodity prices, the exchange rate and other key revenue (and expenditure) parameters.

The Government will also continue to argue strongly to reform the way in which GST revenue is distributed among the States, and look at options to provide the States with more sustainable and efficient sources of revenue as part of the Commonwealth Government's White Paper processes for national tax reform and reform of the Federation.



UTILITY CHARGES AND THE HOUSEHOLD MODEL

Utility Charges

The State Government has implemented modest increases in utility charges to strike a balance between ensuring utility prices better reflect the cost of service provision, responsibly managing the State's finances, and minimising impacts on households. Effective from 1 July 2014, these changes include:

- a 4.5% increase in residential electricity tariffs;
- a 6% increase in the Water Corporation's total water tariffs (water, wastewater and drainage);
- a 4% increase in public transport fares (rounded to the nearest ten cents), with the exception of the 50 cent student fare, which has increased to 60 cents;
- a 3% increase in drivers licence fees;
- abolition of the \$36 per year concession for registering a private motor vehicle and a 3% increase in vehicle registration fees;
- a 3.7% increase in compulsory third party insurance premiums; and
- a 5% increase in the Emergency Services Levy.

Impact on Household Model

Total expenditure by the 'representative household' on this basket of government goods and services in 2014-15 is \$5,224.53. This represents an increase of \$324.18, or 6.6%, on 2013-14 levels.

Even after the increases outlined above and prior to other jurisdictions releasing their 2014-15 Budgets, the representative household in Western Australia has amongst the lowest expenditure on State Government goods and services compared to other jurisdictions. For example:

- Western Australia's 2014-15 utility charges remain lower than the national average, even prior to other jurisdictions announcing any increases;
- public transport fares will remain significantly lower than those in Queensland and New South Wales, and will remain competitive with other jurisdictions; and
- motor vehicle charges will remain amongst the lowest in Australia, particularly with respect to compulsory third party insurance premiums.

Assistance for Households (Including Operating Subsidies¹ for Utilities)

The State Government recognises that some individuals and families need assistance to pay utility bills, and will provide \$12 million in 2014-15 to fund the Hardship Utilities Grants Scheme (HUGS) to help people in financial difficulty to pay water, gas and electricity bills so that supply is not suspended. To apply for HUGS, customers can contact their electricity, gas or water supplier.

¹ The operating subsidies in this fact sheet are drawn from Appendix 8 of Budget Paper No. 3.

In addition, the Government provides a range of targeted subsidies, concessions and rebates to reduce the cost of living for eligible Western Australians. These include:

- \$190 million in 2014-15 and \$787 million from 2014-15 to 2017-18 for free, concessional and school-based public transport arrangements for eligible members of the community including seniors, pensioners and students;
- \$141 million in 2014-15 and \$626 million from 2014-15 to 2017-18 for various water related concessions, rebates and subsidies, including supply charge rebates and concessional pricing arrangements provided to eligible consumers;
- \$67 million in 2014-15 and \$282 million from 2014-15 to 2017-18 for various other electricity concession and subsidy programs including the dependent child, account establishment and air conditioning rebates and the Feed-in Tariff scheme; and
- \$59 million in 2014-15 and \$272 million from 2014-15 to 2017-18 for the Cost of Living Assistance Payment (CoLA) payment to assist eligible Western Australian families pay energy bills. In this regard, the CoLA payment will increase to \$217.36 from 1 July 2014, in-line with the residential electricity tariff increase outlined earlier.

General Subsidies

In addition to the above eligibility-based concessions, the cost of providing electricity, water and public transport services remains heavily subsidised. The operating subsidies paid to the Government's utilities include:

- Public Transport - \$558 million in 2014-15 and \$2.5 billion over the next four years;
- Electricity - \$489 million in 2014-15 and \$1.9 billion over the next four years; and
- Water – \$442 million in 2014-15 and \$1.8 billion over the next four years.

Total Subsidies

Combined the household assistance and operating subsidies provided to utilities total \$1.9 billion in 2014-15 and \$8.2 billion over the next four years (see Table 1 below).

Further other subsidies totalling \$48 million in 2014-15 and \$155 million over the four years to 2017-18 are provided to the utilities for various other electricity, water and public transport services, including the Transperth Free Transit Zone and the State Underground Power Program. These are detailed in Appendix 8 of Budget Paper No. 3.

Table 1

TOTAL ELECTRICITY, WATER AND PUBLIC TRANSPORT SUBSIDIES

	2014-15 \$m	2015-16 \$m	2016-17 \$m	2017-18 \$m	Total \$m
Electricity	616	597	640	624	2,477
Water	583	597	628	643	2,451
Public Transport	747	795	843	861	3,347
SUB-TOTAL (OPERATING SUBSIDIES)^(a)	1,946	1,989	2,112	2,128	8,175
Other Subsidies					
Electricity	5	5	5	5	20
Water	21	10	10	10	51
Public Transport	22	20	21	21	83
SUB-TOTAL (OTHER SUBSIDIES)^(b)	48	36	35	36	155
TOTAL SUBSIDIES	1,994	2,025	2,147	2,164	8,330

(a) Operating Subsidies include Assistance for Households and General Subsidies.

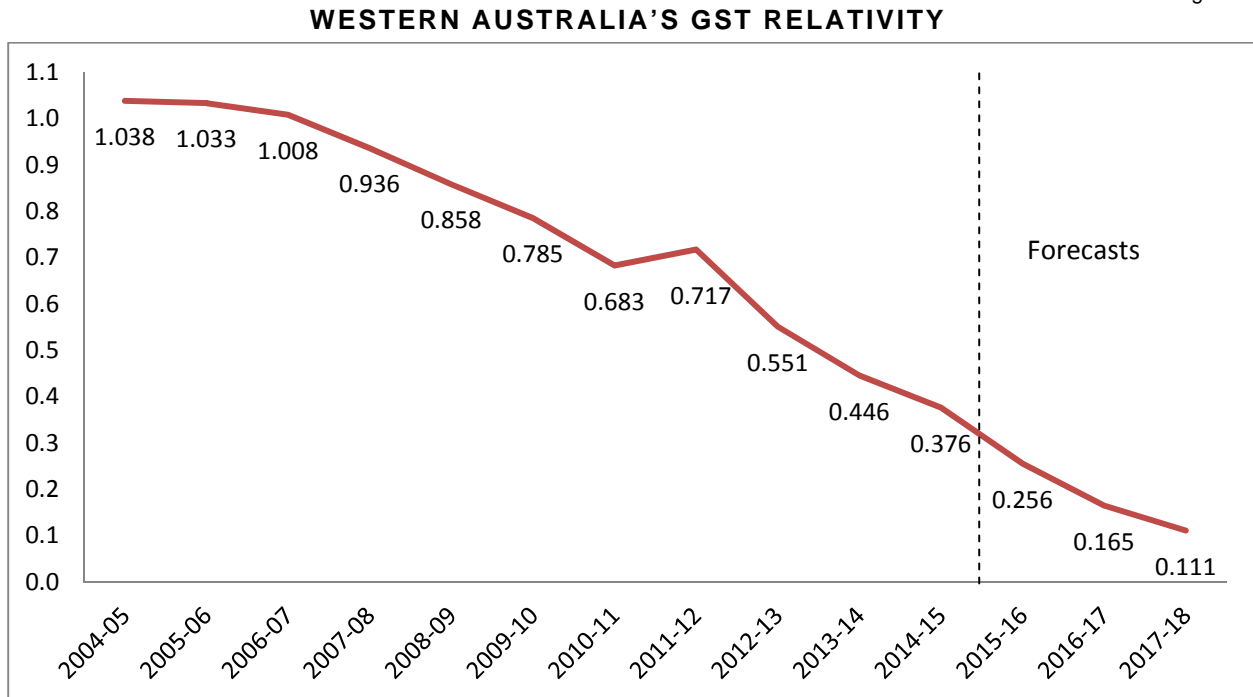
(b) Other subsidies as reported in Appendix 8 of Budget Paper No. 3.

Note: Columns may not add due to rounding.

WESTERN AUSTRALIA'S GST REVENUE

Western Australia's population share of the GST will fall from 44.6% in 2013-14 to a new historic low of 37.6% in 2014-15, and is forecast to continue falling to 11.1% by 2017-18. This will see Western Australia's GST revenue fall from \$2.5 billion in 2013-14 to just \$799 million by 2017-18.

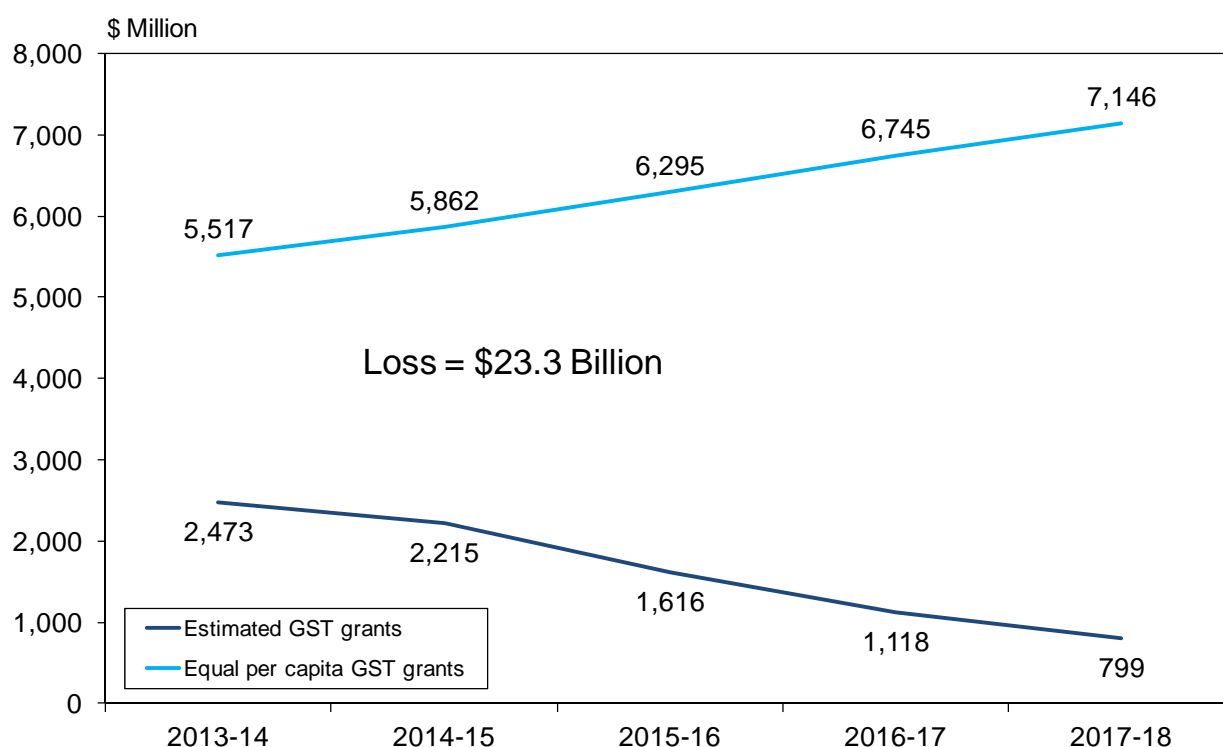
Figure 1



Source: Commonwealth Grants Commission Updates and Department of Treasury estimates.

Over the period 2013-14 to 2017-18, Western Australia will lose \$23.3 billion in GST grants compared to receiving its population share of the national GST pool – a massive penalty for Western Australia's economic success (see Figure 2 below).

WESTERN AUSTRALIA'S GST REVENUE LOSS AGAINST EQUAL PER CAPITA SHARE



Source: Department of Treasury estimates.

Commonwealth Grants Commission's 2015 Methodology Review

In June 2013, the Commonwealth Government issued its terms of reference for the Commonwealth Grants Commission's (CGC's) 2015 Methodology Review, which is due to provide a draft report for consideration by the Commonwealth and State Treasurers in June 2014 and a final report by 28 February 2015.

The CGC has been instructed to have regard to a number of the recommendations from the final report of the independent GST Distribution Review,¹ including by progressing as a matter of priority:

- the development of a new mining revenue assessment;
 - the GST Distribution Review indicated specifically that the new assessment should avoid excessively large GST share effects, such as when a commodity (e.g. iron ore 'fines') moves between groups under the current assessment (i.e. between 'low rate' and 'high rate' royalty groups); and

¹ On 30 March 2011, the then Prime Minister, the Hon Julia Gillard MP, announced a review of the arrangements for distributing GST revenue grants among the States. The review was conducted by the Hon Nick Greiner, the Hon John Brumby and Mr Bruce Carter, with assistance from the Commonwealth Treasury. The final report was released by the then Commonwealth Government on 30 November 2012.

- consideration of the appropriate treatment of mining-related expenditure;
 - the GST Distribution Review recommended (effectively) discounting the mining revenue assessment by 3% from 2013-14 in order to compensate for mining related needs of the resource States that are not fully recognised by the CGC (at least until the CGC had completed its 2015 Methodology Review). However, the then Commonwealth Government did not accept this recommendation.

The results of the CGC's 2015 Methodology Review could have significant impacts (in either direction) on Western Australia's GST grant from 2015-16 onwards.

The views of the CGC Commissioners on proposals for change will not be known until they release their draft report in June 2014.

Longer-Term Reform

The GST Distribution Review final report put forward a long-term vision of an equal per capita distribution of GST grants, with the Commonwealth Government providing top-up equalisation payments to the smaller States (similar to a joint proposal by Western Australia, New South Wales, Victoria and Queensland).

The vision also included a reduction in Australia's vertical fiscal imbalance,² which would be achieved by reducing the level of specific purpose funding to the States, and more closely matching revenue raising and expenditure responsibilities.

Such a model would help address many of the problems in Australia's federal financial relations but requires a commitment to reform from the Commonwealth Government. The State Government will continue to actively participate in the Commonwealth Government's White Paper processes for reform of the Federation and national tax reform, including arguing strongly for reforms to the way in which GST revenue is distributed among the States.

² Vertical fiscal imbalance is the mismatch between the revenue raising powers and expenditure responsibilities between the Commonwealth Government and the States.

WHERE THE MONEY COMES FROM AND WHERE IT GOES

A general government operating surplus (i.e. a surplus on the day-to-day operations of the general government sector) of \$175 million is forecast for 2014-15. This is the difference between forecast revenue of \$28.7 billion and recurrent spending (or expenses) of \$28.5 billion.

The outlook for the general government operating surplus is shown in Table 1 below. An operating surplus is important in that current tax payers are paying for the services they consume and surplus cash provides a non-debt source of funding for infrastructure spending. Nevertheless, at less than 1% of total general government revenue, these surpluses are modest and provide a limited buffer against fluctuations in key revenue parameters such as the exchange rate or iron ore price, and provide a limited source of funding for the State's infrastructure program (which is forecast to total \$23.7 billion over the next four years).

Table 1

GENERAL GOVERNMENT OPERATING SURPLUS

	2012-13 Actual	2013-14 Estimated Actual	2014-15 Budget Estimate	2015-16 Forward Estimate	2016-17 Forward Estimate	2017-18 Forward Estimate
GENERAL GOVERNMENT SECTOR						
Net Operating Balance (\$m)	249	183	175	5	50	283
Revenue (\$m)	25,718	27,970	28,683	29,901	31,159	32,162
Revenue Growth (%)	2.0	8.8	2.6	4.2	4.2	3.2
Expenses (\$m)	25,468	27,787	28,508	29,896	31,109	31,879
Expense Growth (%)	3.7	9.1	2.6	4.9	4.1	2.5

Revenue

Total general government revenue is forecast to be \$28.7 billion in 2014-15, an increase of 2.6% or \$714 million relative to 2013-14.

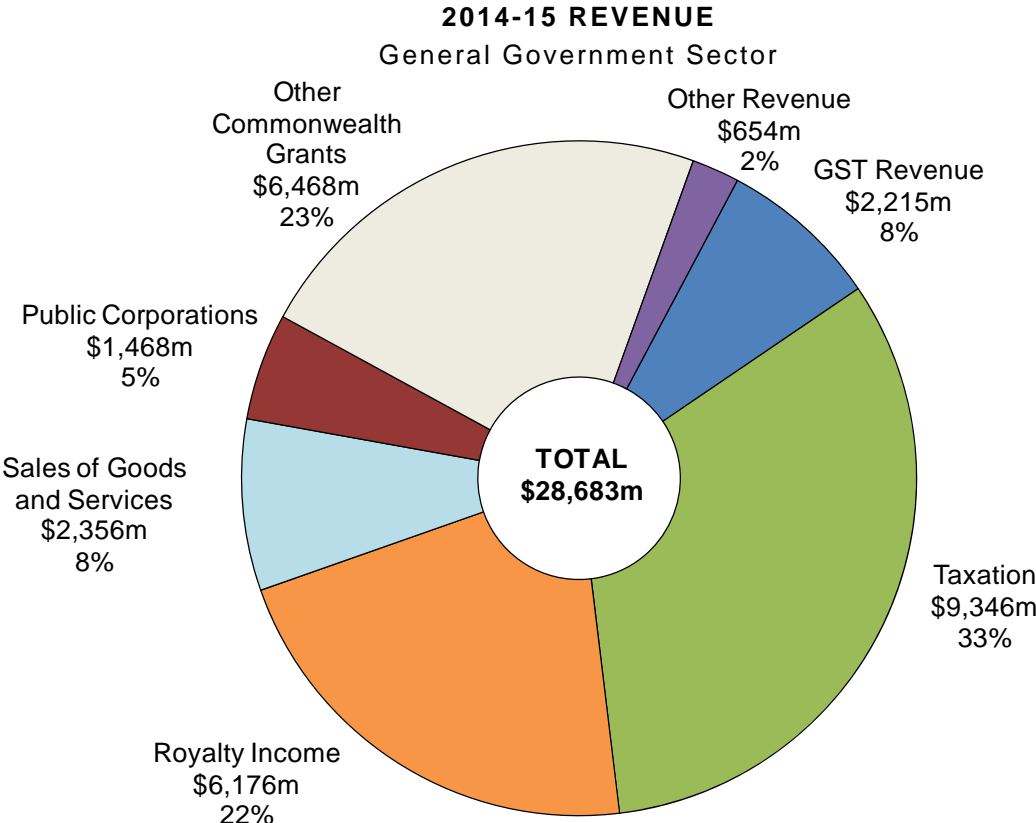
This increase is partly driven by new revenue measures totalling \$289 million in 2014-15, including:

- a 75% interim dividend for the State's port authorities;
- a 10% increase in land tax rates to offset lower than expected land tax and Metropolitan Region Improvement Tax resulting from weaker than forecast growth in land values;
- changes to the first home buyer transfer duty concession, providing a full exemption for home purchases of \$430,000 or less (down from the current exemption threshold of \$500,000), phasing out between \$430,000 and \$530,000 (down from the current \$600,000);
- abolition of the \$36 private motor vehicle registration fee concession from 1 July 2014; and
- a \$365 increase in the Perth Parking Levy, phased in over the next two years.

If these measures were not put in place, revenue would have grown by only \$424 million (or 1.5%). This increase reflects modest growth in taxation collections (up \$296 million, or 3.3%) and higher royalty income (up \$265 million, or 4.5%), driven by iron ore production increases. These increases are offset by GST revenue grants, which are expected to fall by \$258 million in 2014-15, with Western Australia's share of national GST revenue falling to just 37.6% of our population share – an all-time low for any State or Territory.

The major sources of revenue for 2014-15 are shown in the following figure.

Figure 1



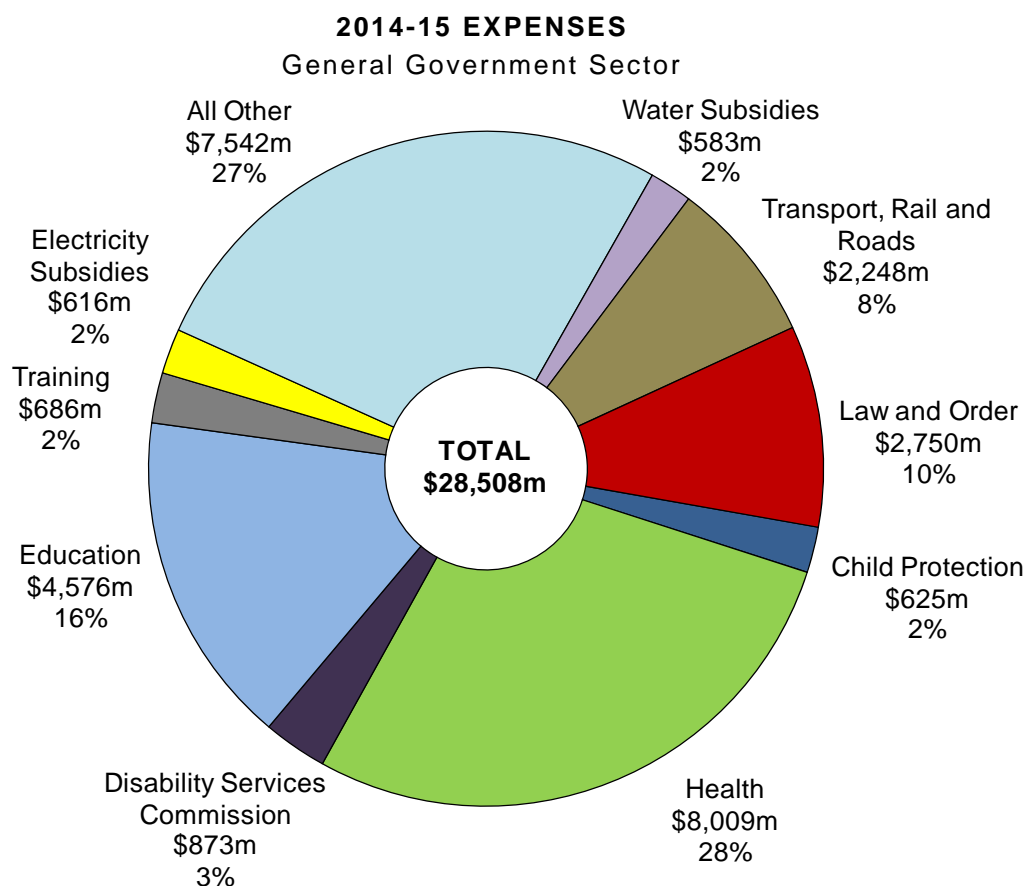
Source: 2014-15 Budget.

Even with the new revenue measures, general government revenue is forecast to grow by an average of just 3.6% per annum across the four years 2014-15 to 2017-18, well down on average growth of 8.1% over the past decade. This modest growth is based on the expectation of a pick-up in payroll tax and steadier levels of transfer duty revenue as the domestic economy gradually improves. Royalty income is also forecast to rise over the forward estimates period due to further increases in iron ore production.

However, a continuing sharp decline in the State's GST grants from the Commonwealth significantly dampens the revenue outlook, with total GST collections forecast to fall from \$2.5 billion in 2013-14 to just \$799 million by 2017-18.

Expenses

General government expenses are forecast to total \$28.5 billion in 2014-15, an increase of \$722 million (or 2.6%) relative to the estimated outturn for 2013-14. The following figure provides a breakdown of expenses in 2014-15, and shows the key service delivery areas of health, education and law and order comprise over half of expenses for the sector (53.8%).



Source: 2014-15 Budget.

The Budget includes significant increases in expenditure for front-line services in 2014-15, including:

- \$447 million (or 5.9%) for WA Health to reflect revised activity and cost projections, primarily for hospital services;
- \$188 million (or 4.3%) for the Department of Education to meet student enrolment growth;
- \$84 million (or 6.6%) for Western Australia Police to meet increasing demand for policing services, including the recruitment of additional officers in line with the Government's commitments;
- \$73 million (or 9.1%) for the Disability Services Commission to meet growth in demand and commence the My Way trial site for the National Disability Insurance Scheme;
- \$46 million (or 6.1%) for the Mental Health Commission to meet activity growth and continue the State-wide Specialist Aboriginal Mental Health Service; and
- \$34 million (or 5.7%) for the Department for Child Protection and Family Support to meet projected growth in demand, continue the Hardship Utilities Grant Scheme, and maintain the current level of homelessness services.

Expenses are budgeted to increase by an average 3.5% per annum over the four years 2014-15 to 2017-18 (in line with expected revenue growth). Achieving this rate of growth is dependent on transitioning to the national efficient price for hospital services over the next four years and limiting increases in public sector wages and conditions to projected growth in the Perth Consumer Price Index.