



2005-06 BUDGET

INVESTING IN INFRASTRUCTURE



Delivering Our Commitments

Investing in Infrastructure

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Introduction

This publication outlines the Western Australian public sector's investment in infrastructure over recent years, as well as the Government's investment plan, as described in the Capital Works Program, out to 2008-09. It also explains the way the Government intends to manage public sector assets, and how it plans to fund its capital investment plan.

The Government has invested heavily in essential economic and social infrastructure in recent years. This has been aimed at providing capacity for the future growth of the State's economy, as well as ongoing improvement in lifestyle through enhanced service delivery.

The Government will build on this recent investment with a record \$4.7 billion Capital Works Program in 2005-06 and \$15.8 billion over the next four years. This program includes substantial expenditure in the areas of energy, water, health, education, law and order, roads, public transport and ports.

Operating surpluses are essential to the Government's ability to maintain public infrastructure spending at high levels within a responsible financial framework. In this regard, surpluses provide an important non-debt source of funds for capital works spending, helping to ensure appropriate levels of infrastructure investment within sustainable debt levels, and reducing the impact of debt servicing (interest) costs on the recurrent budget.

The operating surpluses forecast in the 2005-06 Budget are critical to the delivery of the Government's record infrastructure investment program in a financially responsible and sustainable manner.

It is likely that the Government's high level of capital investment has been a key factor in Western Australia avoiding the export bottlenecks that have been widely reported as occurring elsewhere in Australia. Recent examples of the Government's investment in infrastructure which will boost future export performance include a \$160 million investment in multi-user infrastructure on the Burrup Peninsula (with a further \$24 million committed subject to further investor commitment), and \$60 million towards the provision of infrastructure and services to support the \$1.4 billion Ravensthorpe nickel project.

To ensure that the Government makes the best investments within the limits of available funding, an Investment Advisory Group was formed in 2003 to provide relevant, strategic advice to Government on asset management and capital investment implications of delivering the State's priorities.

To further support delivery of its Capital Works Program, the Government has recently created a Major Government Projects Taskforce, with representation from the Treasurer, Minister for Housing and Works, Minister for Planning and Infrastructure and Minister for Justice.

These issues are discussed in more detail in the remainder of this publication, and highlight the significant role of public sector infrastructure investment in the ongoing development of the Western Australian economy.

2005-06 Capital Works Program

Overview

The total public sector Capital Works Program for 2005-06 is forecast to be a record \$4.7 billion, an increase of 21% over the 2004-05 Budget estimate and 45% larger than the 2003-04 program. These increases are indicative of the Government's commitment to maintaining and improving the State's infrastructure, particularly in the areas of energy, water, health, education, law and order, roads, public transport and ports.

Across the forward estimates period (2005-06 to 2008-09), the Government has committed a massive \$15.8 billion to its Capital Works Program.

The total public sector Capital Works Program encompasses all works in progress and new works as set out for each agency in Budget Paper 2: Budget Statements.

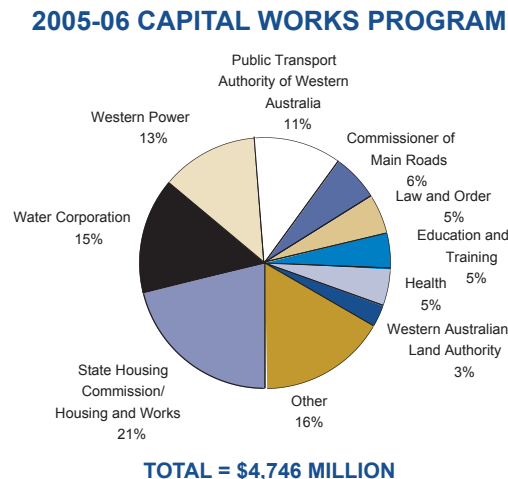
Table 1

PUBLIC SECTOR CAPITAL WORKS PROGRAM			
	2003-04	2004-05	2005-06
	Actual	Estimated	Budget
	\$m	Actual	Estimate
		\$m	\$m
Sector			
General Government	1,169	1,414	1,516
Public Corporations	2,115	3,100	3,230
GRAND TOTAL	3,285	4,514	4,746

Note: Columns may not add due to rounding.

As the following chart demonstrates, around 84% of the Capital Works Program for 2005-06 is to be undertaken by nine agencies.

Figure 1



Major Initiatives

The Capital Works Program for 2005-06 includes a substantial \$715 million on water infrastructure, almost \$600 million to improve the quality, reliability and safety of electricity supply, \$401 million on the New MetroRail project, \$302 million on improving and expanding the State and local road networks, \$228 million on various law and order-related projects, \$227 million on government schools and TAFE college infrastructure, \$220 million for the health sector, and \$101 million on Western Australia's ports. Further detail on the major initiatives is provided below.

Water

The Water Corporation has been allocated \$715 million in 2005-06 for water and wastewater services, up \$303 million or 74% from the estimated outturn for 2004-05.

New initiatives that the Water Corporation will undertake include the new wastewater schemes at Alkimos and East Rockingham to service the strong land development growth in the northern and southern coastal corridors respectively.

The Government has also approved additional funding of \$41 million for the construction of the Perth Seawater Desalination Plant, for a total capital cost of \$387 million. This project will enter its main construction phase in 2005-06, and is expected to be completed in 2006-07.

These initiatives are essential to providing high quality and reliable water and wastewater services, with the desalination plant expected to provide a climate independent 17% increase in the public water supply.

The four-year Capital Works Program for the Water Corporation is forecast to be a substantial \$2.1 billion.

Electricity

In addition to the \$230 million increase over four years allocated in the 2004-05 Budget, a further \$488 million has been committed in this budget to enhancements of the State's electricity system. The lion's share of this increase has been allocated to network improvements, including replacement of overhead service wires connecting homes and small businesses (\$52 million over four years), a program to reduce transformer loadings at metropolitan substations aimed at improving overall system reliability (\$88 million over four years), and connection of new generators and domestic and commercial customers, including expansion in network capacity (\$210 million over four years).

Western Power will also utilise the additional funding to undertake capacity enhancements in generation as well as delivering information technology and telecommunications projects which will, among other things, provide network operating efficiency improvements.



2005-06 Capital Works Program

Continued

The total Capital Works Program over the forward estimates is forecast at \$2.1 billion, of which \$599 million has been committed in 2005-06 (a 29% increase on 2004-05). This program is part of a longer term plan to improve the quality, reliability and safety of supply in both regional and metropolitan areas. It will also provide increased capacity to serve existing and new customers.

Health



The Department of Health's Capital Works Program continues to deliver on the infrastructure requirements of the recommendations of the Health Reform Committee, with \$220 million to be spent on capital works in 2005-06 (up \$22 million or 11% on the estimated outturn for 2004-05). Including election commitments, new initiatives include \$79 million over four years to provide significant upgrades to health facilities in the Kimberley region, as well as the bringing forward of construction of the \$65 million Hedland Hospital, and the \$20 million redevelopment of the Albany Hospital.

Other election commitments in the health area will see \$191 million spent over the next four years for Stage 1 of construction of the new Southern Tertiary (Fiona Stanley) Hospital (total cost of \$420 million), \$67 million to redevelop the Rockingham-Kwinana District Hospital, as well as allocations for a new Cancer Centre and a purpose built Community Mental Health facility in Bunbury (\$6.5 million and \$2.5 million respectively).

All up, the four-year Capital Works Program for Health is forecast at \$960 million.

Education and Training



The Government is engaging in its biggest ever investment in repairs and improvements to Western Australian schools. In 2005-06, the Government will spend \$227 million on government schools and TAFE college infrastructure, up \$30 million or 15% on the estimated outturn for 2004-05. Over the next four years, the Capital Works Program (\$878 million) plus expenditure on schools maintenance (\$304 million) will exceed \$1 billion.

The Government's capital works on education and training includes construction on the replacement for Kwinana Senior High School and the new Comet Bay College at Secret Harbour, as well as the commencement of four new high schools at Atwell, Dalyellup, Ellenbrook and Vasse, and a new senior college on the South West Regional College of TAFE site in Bunbury.

Law and Order

The Government is spending \$228 million on law and order projects in 2005-06. This represents a substantial \$94 million or 71% increase over 2004-05. Over the next four years, the combined capital works budget of the Police Service and the Department of Justice is \$765 million. Key projects include:

- the commencement of the new Perth Watch House/Perth Police Centre/Crime Headquarters. This project has an estimated total cost of \$81 million and will, among other things, facilitate a revitalisation of police presence in Northbridge;
- the continuation of construction on a number of new and replacement police complexes and stations predominantly in regional areas;
- the acquisition of two new fixed wing turbine engine pressurised aircraft to allow the Police Service to reach any location in Western Australia in all weather conditions;
- the Central Business District Courts construction and Central Law Courts refurbishment;
- the construction of new Juvenile Detention Centres in Kalgoorlie and Geraldton; and
- the provision of perimeter fencing for Wooroloo and Karnet prisons.



Public Transport

The Planning and Infrastructure portfolio continues to play a major role in the provision of key capital infrastructure for the State, with the Government's four-year Capital Works Program on public transport forecast at \$1.1 billion. This includes continuing activity on the New MetroRail project, with forecast expenditure of \$401 million in 2005-06. This expenditure includes continuation of construction on the Southern Suburbs Railway infrastructure, continuation of the City Projects works, commencement of construction on nine stations between Canning Bridge and Mandurah, and delivery of 39 electric railcars.



Roads

Over the next four years, the Government is committing \$1.4 billion to improving and expanding the State and local road networks. Of this, \$302 million will be spent in 2005-06, which includes:

- \$26.4 million on the Roe Highway (South Street to the Kwinana Freeway);
- \$21.8 million on the Tonkin Highway (Mills Road West to Thomas Road);
- \$19.4 million on the Eyre Highway (Caiguna-East to Balladonia); and
- \$16.2 million on the Mitchell Freeway (Hodges Drive to Shenton Avenue).



2005-06 Capital Works Program

Continued

Ports

The Government has a \$322 million four-year Capital Works Program in place for port facilities in the State. In 2005-06, \$101 million has been committed to projects including:

- \$40 million at Fremantle Port on projects such as the North Quay Rail Terminal and Rail Loop (to facilitate a shift in container movements from road to rail transport), the Kwinana Bulk Terminal and the North Quay Berth Upgrade;
- \$36.8 million at the Esperance Port on works including progression of construction of a sulphur storage shed, a dual purpose shore based crane to enable BHP Billiton to export from the Ravensthorpe nickel project, and completion of the bulk storage facilities; and
- \$5 million on the \$16.8 million extension of the Broome Jetty to enable Broome Port to service the rapidly growing trade needs of the West Kimberley region.



Regions

The Government's infrastructure investment program is spread across the entire State, with significant expenditure planned for regional areas. Major regional projects for 2005-06 include:

- \$36.8 million for construction of a sulphur storage shed, a shore based crane and completion of the bulk storage facility at the Esperance Port (as noted above);
- \$21.2 million on network connections associated with the Alinta Co-generation project at Pinjarra;
- \$19.4 million on the Eyre Highway (as noted above);
- \$18.8 million on significant upgrades to health facilities in the Kimberley region;
- \$16.9 million on infill sewerage works in the Peel region;
- \$15.4 million to complete Stage 1 of the Geraldton Southern Transport Corridor;
- \$14.2 million on additional water storage at Kalgoorlie;
- \$12.5 million for Stages 1 and 2 of the Department of Health's Hedland Regional Resource Centre replacement;
- \$12 million to commence construction and sealing of Stage 2 of the Karratha-Tom Price Link Road;
- \$10 million for the Albany Entertainment and Convention Centre;
- \$9.3 million to reconstruct the Great Eastern Highway from Hines Hill to Merredin;
- \$9.1 million for the Albany Waterfront redevelopment; and
- \$8.6 million in Port Hedland on upgrading the water distribution system.



Consistent with the increases in capital works activity noted in the various sectors above, the total Capital Works Program is expected to peak in 2005-06 and ease over the forward estimates period.

It should be noted that the forward estimates for capital projects are subject to revision from year to year and subsequent adjustments may be necessary to the outyears in order to accommodate changed circumstances and priorities. This would include changes associated with projects currently being planned or under consideration but for which reliable cost estimates are currently not available. As the business cases and cost estimates for such projects are further defined over time, they are likely to bolster the Capital Works Program across the forward estimates.



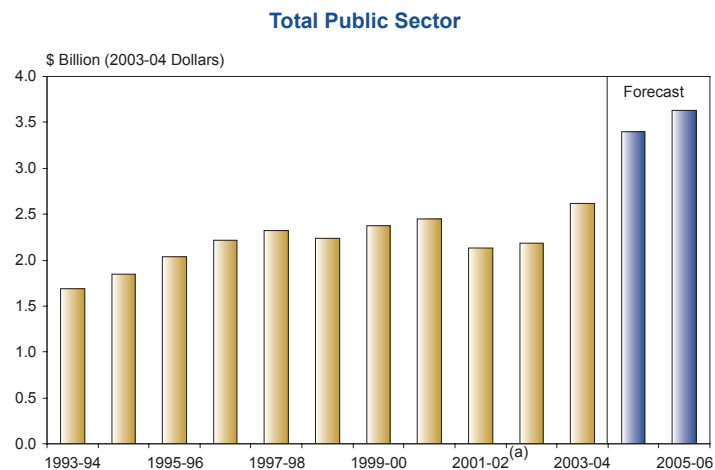
Trends in Capital Investment¹

Recent Performance

As shown in the following chart, there has been a steady upward trend in public sector infrastructure investment in Western Australia. Since 1993-94, real capital expenditure has grown at an annual average rate of 4.5%, leading to record public sector fixed asset spending of \$2.5 billion in 2003-04². Capital spending rose significantly in 2003-04, boosted by expenditure on the New MetroRail project and increased spending on roads, health and education infrastructure.

Figure 2

REAL CAPITAL EXPENDITURE IN WESTERN AUSTRALIA



^(a) Capital investment by AlintaGas and the Rail Freight division of Westrail were public sector functions up to their privatisations in 2000-01. The privatisations contribute to the decline in capital spending in 2001-02.

Public sector capital investment is expected to continue at high levels over the medium term, as shown in the Capital Works Program estimates elsewhere in this document and the 2005-06 Budget Papers, with significant works on the State's desalination plant, completion of the New MetroRail project and electricity network spending bolstering the investment profile over the forward estimates period.

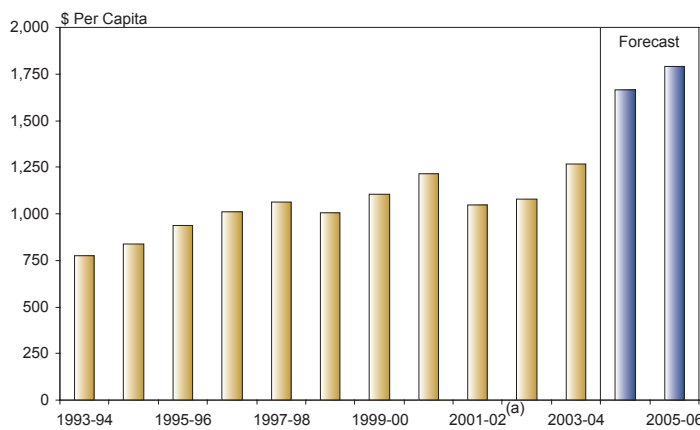
¹ The analysis in this section is based on aggregate public sector investment applied directly for the purpose of acquiring fixed assets to be owned and operated by, and reflected in the balance sheet of, the State. However, the Capital Works Program, referred to in the previous section, includes not only this form of spending but also some capital works expensed by agencies in the form of maintenance costs and grants for fixed assets acquisition by sectors outside government (e.g. grants assisting in the private sector construction of the Members Equity Sports Stadium), and the home loan activities of KeyStart. The fixed asset spending concept used in this section is available in a comparable form across all State, Territory and Commonwealth budget data, in line with agreed Uniform Presentation Framework financial reporting.

² The time period 1993-94 to 2003-04 was chosen because accrual government finance statistics data for Western Australia are only available from 1993-94, while 2003-04 is the most recent actuals year.

Western Australia has experienced a relatively high annual average population growth rate of 1.5% since 1993-94 and as the following chart shows, the Western Australian public sector has spent increasing amounts on capital investment over time. Per capita investment was a record \$1,270 in 2003-04, and is poised to substantially increase over the next two years, with the forecast for 2005-06 standing at \$1,789 per capita.

Figure 3

CAPITAL EXPENDITURE PER CAPITA Total Public Sector



^(a) Capital investment by AlintaGas and the Rail Freight division of Westrail were public sector functions up to their privatisations in 2000-01. The privatisations contribute to the decline in capital spending in 2001-02.

These levels of public sector spending reflect a conscious policy choice that in order to promote private investment and development in Western Australia, it is important for the Government to play a key role in contributing to essential infrastructure.

Major Areas of Spending

The general government sector accounts for around 40% of total public sector capital spending. Investment in roads, education, health and law and order typically account for a significant proportion of general government sector capital spending.

The public non-financial corporations sector in Western Australia accounts for almost all of the remaining 60% of total public sector capital spending. The major areas of capital expenditure by this sector include water infrastructure, electricity generation, ports and public rail services. These areas accounted for around 45% of total public sector capital spending in 2003-04 (see following chart)³.

³ 2003-04 is the latest year for which final data are available.

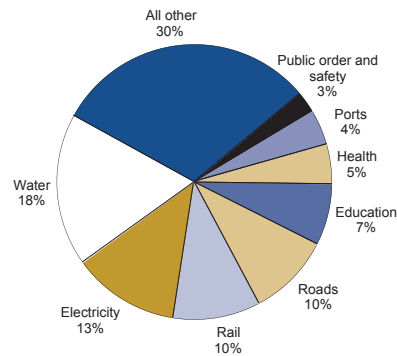
Trends in Capital Investment

Continued

Figure 4

CAPITAL SPENDING BY FUNCTION

Total Public Sector, 2003-04



TOTAL = \$2,502 MILLION

In 2003-04, total public sector capital spending in Western Australia totalled \$2.5 billion. Housing and community amenities, transport and communications, fuel and energy, education, and health accounted for 85% of this total⁴.

- Capital spending on housing and community amenities accounted for around 36% (\$910 million) of total public sector capital spending in 2003-04. Nearly half of this spending was undertaken by the Water Corporation on water, wastewater and drainage services across the State. A further \$243 million was spent by the State Housing Commission (Homeswest) on public housing construction and refurbishments, and around \$187 million was spent on land acquisitions and development by the Western Australian Land Authority, the Western Australian Planning Commission and various redevelopment authorities.
- Transport and communications spending of \$610 million represents nearly a quarter of total public sector capital spending. This is not surprising given the vast geographical size of the State. The Government has invested heavily in upgrading both country and metropolitan roads, as well as infrastructure for the New MetroRail project, which together totalled \$500 million in 2003-04. Also included in this category is spending by the State's port authorities, worth around \$101 million.
- Capital investment by Western Power of \$316 million accounted for 13% of total public sector capital spending in 2003-04. A large proportion of Western Power's program is spent on networks including transmission works such as substations, new connections, capacity enhancement and distribution in order to improve the quality and reliability of electricity supply across the State, and to increase capacity to serve existing and new customers.

⁴ These categories reflect functional spending classifications consistent with ABS Government Purpose Classification (GPC) definitions.

- Together, capital spending on health and education accounted for 12% of total public sector capital spending in 2003-04. The majority of spending in these areas has been on the construction of new educational and health care facilities, upgrades to existing facilities and the purchase of new equipment. Technological advances in equipment also contribute to a large proportion of spending, especially in health care.

Comparisons with Other States

Levels of Capital Expenditure

Western Australia has one of the highest public sector capital expenditure budgets in Australia, relative to both its population and the size of the State's economy.

The Government's commitment to infrastructure investment in Western Australia's transport (roads, rail and ports), electricity and water networks has contributed to strong economic growth in the State and safeguarded Western Australia from export bottlenecks.

The following table shows Western Australia's total public sector capital spending performance relative to the other States, along with information on each State's population and economic growth.

Table 2

COMPARISON BETWEEN JURISDICTIONS ^(a)					
	Capital expenditure per capita 1998-99	Capital expenditure per capita 2003-04	Capital spending annual average growth since 1998-99	Population annual average growth since 1998-99	Real economic annual average growth since 1998-99
	\$	\$	%	%	%
Western Australia	1,005	1,270	6.2	1.4	3.8
New South Wales	709	954	7.2	1.0	2.8
Victoria	626	697	3.4	1.2	3.3
Queensland	1,540	1,095	-4.7	2.1	4.8
South Australia	482	556	3.4	0.5	3.0
Tasmania	678	1,267	13.7	0.4	1.4

^(a) Data sourced from Australian Bureau of Statistics (catalogue 5512.0).

Western Australia has moved from having the second highest level of capital spending per capita in 1998-99 (behind Queensland) to the highest level in 2003-04. Tasmania, New South Wales and Western Australia have experienced much faster increases in capital spending than the other States, recording annual average growth rates of 13.7%, 7.2% and 6.2% respectively over the period 1998-99 to 2003-04.

Trends in Capital Investment

Continued

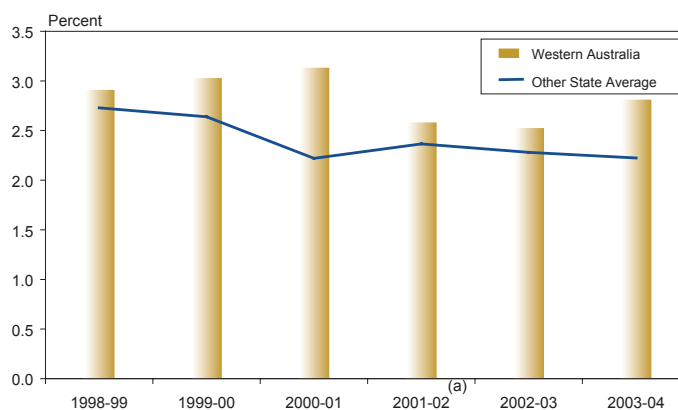
Extending the above period to 2005-06, annual average growth in public sector capital spending in Western Australia is estimated to be a strong 10.1%, highlighting the large growth in capital expenditure planned for the short-term. Moreover, capital expenditure per capita is forecast to reach \$1,789 by 2005-06 – an increase of over \$500 per person on 2003-04 levels.

Over recent years, Western Australia has experienced the second highest rate of population growth amongst the States (behind Queensland), placing additional demands on the development of public infrastructure such as electricity and water utilities, transport, health and education. In contrast, capital expenditure in Queensland has declined, despite having the highest economic and population annual average growth rates. This largely reflects a substantial drop in investment in Queensland between 1999-2000 and 2000-01, due primarily to the completion of some major projects such as the Pacific Motorway and the Hospital Rebuilding Program that ended in the late 1990s.

The following chart highlights Western Australia's consistently higher level of public sector investment as a share of overall economic activity compared with other Australian States.

Figure 5

TOTAL PUBLIC SECTOR CAPITAL EXPENDITURE Share of GSP



(a) Capital investment by AlintaGas and the Rail Freight division of Westrail were public sector functions up to their privatisations in 2000-01. The privatisations contribute to the decline in capital spending in 2001-02.

Variations in the magnitude of public sector investment between jurisdictions reflect a range of different, interrelated and complex issues. These include, but are not limited to, factors such as:

- conscious policy choices by government on the level of infrastructure spending;
- economic development;

- physical characteristics of each State;
- local demand for particular forms of infrastructure relevant to a jurisdiction;
- the level of private sector activity in infrastructure provision; and
- the structure of the public sector in each jurisdiction.

The infrastructure demands in Western Australia (with strong population growth and an area representing around one third of Australia with abundant remote mineral resource developments) are significantly different to a jurisdiction such as Tasmania, which hosts a much smaller population, with slower economic growth in a much smaller region.

Privatisation activities in Victoria mean that this jurisdiction does not experience the same demand for public investment in electricity as occurs in Western Australia. Similarly, public sector bus services in Queensland are predominantly the domain of local governments while in Western Australia the State bears the responsibility for bus fleet investment.

Western Australia also has a different infrastructure requirement from other States due to the size of its resource sector. For example, Western Australia's resource sector accounts for 18% of total activity compared with only 4.5% nationally. The capital-intensive nature of mining activities means that Western Australia is faced with a unique and difficult funding requirement. This results in a number of varied methods of financing activity to support State infrastructure, including:

- developer contributions to State infrastructure (such as water);
- State contributions to support large social and economic infrastructure (such as the Ravensthorpe nickel project); and
- direct government provision of infrastructure through the Capital Works Program.

Another method of infrastructure financing is Public Private Partnerships (PPPs). Western Australia's experience with PPPs has been fairly limited compared with larger jurisdictions such as New South Wales and Victoria. However, as the demand on State funds increases for large infrastructure projects, the Government is keen to explore PPPs as a method of infrastructure procurement, where the benefits for taxpayers are evident.

Areas of Capital Expenditure

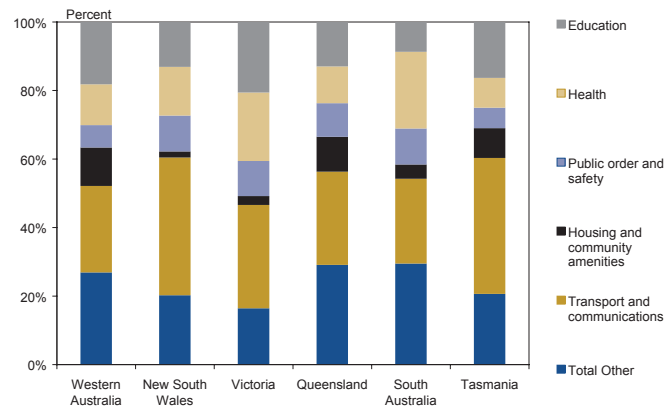
Comprehensive data for the total public sector by functional spending category is not available for all States. However, information on general government sector capital spending by functional area is available. The following chart compares general government capital spending by function for 2003-04 across the States.

Trends in Capital Investment

Continued

Figure 6

GENERAL GOVERNMENT CAPITAL SPENDING BY FUNCTION 2003-04



There are some similarities between States in terms of general government capital expenditure by functional spending area. For instance, all jurisdictions have similar spending profiles in education, health, public order and safety, and housing and community amenities, averaging around 45% of total general government sector capital spending.

Export Infrastructure Performance

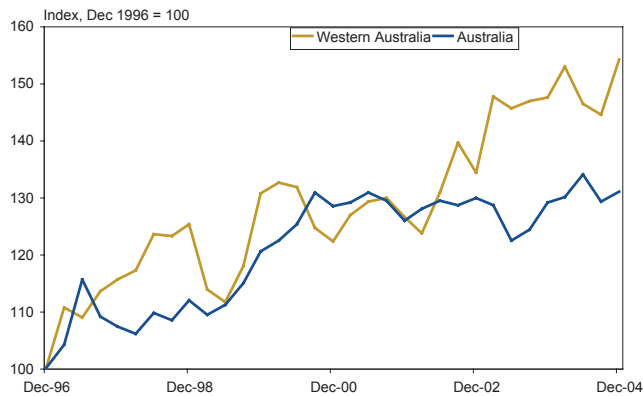
It is notable that strong capital investment (by both public and private sectors) has contributed to high annual average economic growth in Western Australia. A policy choice for a lower level of public investment spending may in part contribute to the development of export bottlenecks recently highlighted as an issue in other jurisdictions.

While significant infrastructure bottlenecks have been widely reported on the eastern seaboard, Western Australia has not experienced the same issues. This likely reflects the considerable infrastructure investment undertaken by both the public and private sectors in Western Australia in recent years. For example, over the four years to 2004-05, the Western Australian Government invested an estimated \$3.6 billion in ports, electricity and water facilities. Such investment is essential for economic development in general, and exports in particular.

Over the past two years, Western Australia's merchandise exports have increased by a cumulative 13.3%. This compares with growth in goods and services exports of just 1.6% nationally. In 2004, Western Australia's exports were 17.2% higher in volume terms than in 2000.

Figure 7

TOTAL EXPORT VALUE Chain Volume Terms



Examples of public sector infrastructure investment that has, or is expected to, facilitate export growth in Western Australia include:

- the \$108 million Port Enhancement Project at the Port of Geraldton, which was completed in November 2003. Without this project, which included a deepening of the harbour channel and basin, the export of iron ore from Mt Gibson Iron Ltd. to China would not have been possible. The first shipment of iron ore through the port since the mid-1970s occurred on 23 February 2004;
- the provision of \$160 million worth of multi-user infrastructure to support industrial projects on the Burrup Peninsula (with a further \$24 million committed subject to further investor commitment). The infrastructure includes a water supply system and construction of a bulk liquids jetty (at a cost of \$73 million) at the Port of Dampier;
- the Kwinana Bulk Terminal at the Port of Fremantle is undergoing a major upgrade worth \$30 million. The upgrade will allow the terminal to service Stage 1 of the HIs melt pig iron plant project. The facility will assist with coal and iron ore shipments and pig iron exports. Exports of pig iron are expected to commence this year; and
- the Government is investing \$60 million to provide infrastructure in support of the Ravensthorpe nickel project. This includes \$31 million allocated in 2005-06 at the Esperance Port, \$11 million on roadworks between the nickel mine and the port, and \$18 million on social infrastructure.

Strategic Asset Management Framework

In the current environment of record spending in the Government's Capital Works Program, there is a need to ensure that decisions to commit to new infrastructure are managed within sustainable limits, and are balanced against existing commitments and competing pressures that are likely to emerge in the short to medium term.

This will ensure that the Government can continue to invest in social and economic infrastructure to meet current needs and support economic growth over the medium to longer term, while continuing to manage the State's finances in a responsible and sustainable manner.

To support this, the Government recently implemented an integrated policy framework for asset management and capital investment across the public sector.

This Strategic Asset Management Framework has been developed by the Departments of Treasury and Finance and Housing and Works, with support from major infrastructure agencies and other selected agencies. It is an integrated, strategic approach to facilitate improved asset management and capital investment across the State that includes the review and update of existing asset management policies, and the development of new policies that are consistent with modern practice.

The implementation of a whole-of-government asset management strategy offers significant benefits, such as:

- support for making decisions to invest in, retain or divest assets that take into consideration the needs of current and future generations;
- making the best possible use of existing assets;
- maximising value for money when investing in new assets; and
- ensuring that assets that have outlived their useful lives, or can no longer provide appropriate functional support to the delivery of public sector outcomes, are disposed of in a timely manner.

To ensure that the best investments are made within the limits of available funding, the Government established an Investment Advisory Group in 2003 to provide relevant, strategic financial advice on asset management and capital investment implications of delivering the State's priorities.

In addition, the Government's recently established Major Government Projects Taskforce will establish a regime of accountability for the delivery of major infrastructure projects by establishing key project milestones, finding ways of removing obstacles that can arise with some projects, and monitoring compliance with project budgets and reducing major project timeframe slippage.

Sustainable Funding of Public Sector Infrastructure Investment

The Government's overall financial management policy is built around the provision of high quality recurrent services and infrastructure to the people of Western Australia, while living within the State's means.

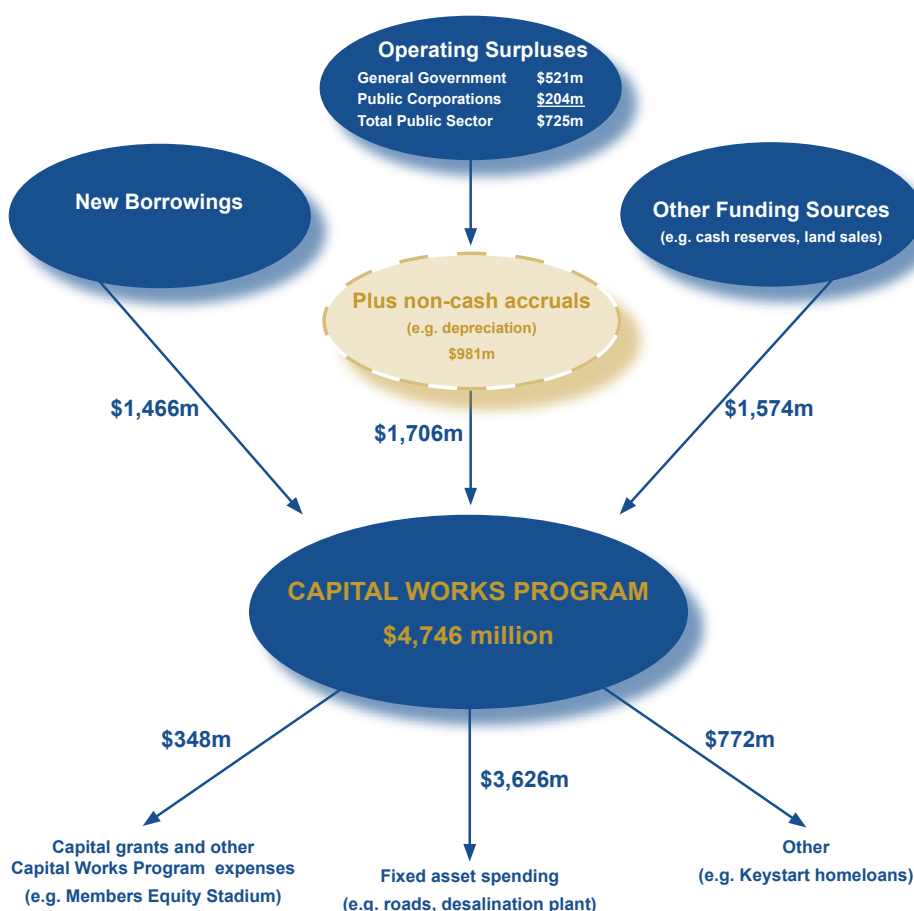
Like businesses, the public sector uses a combination of funds generated from its operations (i.e. operating surpluses) together with new borrowings to provide new infrastructure. The challenge for government is to strike the right balance in the size of the surplus it generates from its operating activities, the use of existing cash reserves, and the size of the borrowings program required to make up residual funding needs, such that public sector debt servicing responsibilities do not over-burden the State in future years.

The following figure shows how the Capital Works Program is to be supported from different sources of funds across the public sector in 2005-06.

Figure 8

THE CAPITAL WORKS PROGRAM AND THE TOTAL PUBLIC SECTOR

2005-06



Sustainable Funding of Public Sector Infrastructure Investment

Continued

In the first instance, the Government's whole-of-government financial targets, which are outlined each year in the Budget Papers, assist in measuring and managing the capacity of the State to provide those services the community expects and demands. The Government's current financial targets are to:

- maintain or increase real net worth of the total public sector;
- achieve an operating surplus for the general government sector;
- retain the State's triple-A credit rating, represented by the following specific targets:
 - maintain the net debt to revenue ratio for the total non-financial public sector at or below 47%; and
 - ensure that real per capita own-purpose expenses for the general government sector do not increase; and
- maintain Western Australia's tax competitiveness, as measured by maintaining tax revenue as a share of gross State product below the other States' average.

At a whole-of-government level, infrastructure funding is considered and assessed against the social and economic benefits expected to flow from the associated assets, and the impact on the financial targets as a result of changing the Capital Works Program.

In this manner, the Government seeks to maximise the value of public sector infrastructure spending within the context of sound financial management.

The Government seeks to satisfy these competing requirements by borrowing only where it is essential to support infrastructure spending. It minimises this borrowing requirement by making internal monies available as an alternative, non-debt source of funding.

From a policy perspective, the most significant and sustainable source of non-debt funding is the operating surplus.

Achieving operating surpluses across all sectors of government is an important feature of the 2005-06 Budget estimates. While the financial targets outlined above only focus on the general government operating surplus (as this sector is most responsive to changes in Government policy), public corporation sector surpluses also make an important contribution to infrastructure funding. In this regard, the forward estimates show total public sector operating surpluses in the range of \$423 million to \$976 million over the period 2004-05 to 2008-09 (\$192 million to \$631 million in the general government sector alone, with the balance coming from the public non-financial and financial corporations sectors).

Budgeting for (and delivering) operating surpluses of a reasonable magnitude serves three main functions:

- it ensures consistency with the legislated financial principle that the current generation should pay for the services it consumes;

- it provides a buffer against unexpected events outside of the Government's control, such as sudden fluctuations in commodity prices and/or the exchange rate (which can significantly affect the State's royalty revenue); and
- as noted above, it provides an important non-debt source of funds for capital works spending, helping to ensure appropriate levels of infrastructure investment within sustainable debt levels, and reducing the impact of debt servicing costs on the recurrent budget (thereby increasing the scope to address key service delivery priorities/initiatives).

The total public sector operating surpluses forecast in this budget represent around 3% of total public sector expenses. Based on the current size of the Capital Works Program, surpluses of this magnitude are needed to maintain the key net debt to revenue ratio below the 47% target limit across the entire forward estimates period (the ratio is projected to peak at 43.4% in 2007-08).

Public corporation sector operating surpluses are consistent with the commercial approach of agencies such as the Water Corporation and Western Power, which charge customers for current and capital services at a level appropriate to maintain ongoing essential infrastructure investment.

In relation to the general government sector, the Government seeks to ensure operating surpluses by regularly reviewing cost pressures and identifying opportunities to cut expenses in lower priority and administrative areas of public sector activity.

In addition to key initiatives such as implementation of the recommendations of the Functional Review Taskforce (which identified around \$750 million in on-going savings to the public sector) and efficiencies gained through streamlining the machinery of government, early repayment of public sector debt is one such example of reducing expenses.

As public sector borrowings are generally taken out over long maturity periods, often in the range of twenty to thirty years, it is often more cost effective (through reduced interest costs) to repay outstanding debt early with any surplus monies, rather than put the cash away for a rainy day in the future.

In August 2004, the Government authorised the use of \$481 million in surplus Consolidated Fund cash in just this manner, with the benefit of the early debt repayment reducing future interest costs to the State budget by around \$32 million per year.

In a similar way, surplus general government funds projected to be available by 30 June 2005 have been allocated in the 2005-06 Budget to the repayment of outstanding rail freight debt left over from the 2000-01 sale of the Freight Division of Westrail. By repaying this debt, general government expenses to support the servicing of the debt will be reduced by up to \$17 million per annum across the forward estimates.

Sustainable Funding of Public Sector Infrastructure Investment

Continued

Taken together, these two debt repayments have reduced ongoing expenses by almost \$50 million per year, contributing to the achievement of operating surpluses that can in turn be used to support additional capital investment.

Relative to the expected outturn for 2004-05, the 2005-06 Budget projections include allowance for a rise in total public sector net debt of around \$2.7 billion by 30 June 2009. This increase needs to be seen in the context of:

- the size of the public sector's overall net worth (this excess of assets over liabilities is projected to grow from \$46.1 billion in 2004-05 to \$51.3 billion by 2008-09);
- the affordability of this increase in net debt, demonstrated by the expectation that all of the Government's financial targets – including the net debt to revenue ratio target – will be achieved in each of the forward estimate years; and
- the increase in net debt is solely in support of construction and investment in assets which have a long life and which benefit the community and the State's economy in the longer term.

Thus, with the Capital Works Program expected to be a record \$4.7 billion in 2005-06, the level of debt support, supplemented by internally generated funds through projected surpluses, is appropriate and affordable in the context of the State's overall financial outlook, and through major road, health, education, public transport, port, water and electricity projects, supports the State's growing economy and population into the future.

Conclusion

Public sector infrastructure investment in Western Australia has been high in recent years compared with other jurisdictions, both in per capita terms and as a share of the economy.

Such levels of capital spending have been a significant factor behind Western Australia avoiding the export bottlenecks that are currently being reported in other Australian jurisdictions. Investment in Western Australia, by both the public and private sectors, has also contributed to strong economic growth, with the Western Australian economy growing by a record 7.5% in 2003-04 and expected to grow by 5.25% in 2004-05.

In 2005-06, the Western Australian Government's strong level of infrastructure investment is expected to continue, with a record \$4.7 billion Capital Works Program. This includes substantial investment in the State's water and electricity sectors, as well as public transport, roads, ports, education and health.

Through its commitment to the State's growth, responsible management of public sector finances, and development of the principles contained in the Strategic Asset Management Framework, the Government has a clear plan for managing future infrastructure investment while ensuring the State's finances remain strong. This plan will continue to sustain the growing economy while ensuring that essential infrastructure is available for the Western Australian community both now and into the future.

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