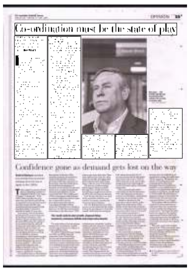

Australian Financial Review
Monday 27/4/2009
Page: 55
Section: General News
Region: Australia Circulation: 86,158
Type: National
Size: 462.50 sq.cms.
Published: MTWTFS

Co-ordination must be the state of play

State fiscal strategies in these critical times must not undermine those of the federal government, argues **Ben Wyatt**.

In its submission to the 2009-10 budget, the Business Council of Australia called for the federal and state governments to co-ordinate their fiscal strategies. It noted the inconsistency between the strategy taken by the federal government and the responses to deteriorating fiscal settings in Queensland, NSW and South Australia in particular.

Much has been said of the role of the federal government in times of economic downturn. However, not so much has been said of the role of state governments in the current climate.

In Western Australia, the government is in a strong budgetary position relative to most. No net general government debt and a strong AAA credit rating mean the government has great flexibility in formulating its response.

However, the capacity for state governments, even one in as enviable a position as Western Australia, to use debt is extremely limited.

When Geoff Gallop was elected WA premier in 2001, increasing government debt was a real concern and the amount of state revenue going to interest payments was rapidly closing in on 3 per cent. The amount of revenue going to interest payments now 1sits at 0.6 per cent.

As noted in the 2008-09 budget papers, the reduction of debt over the past eight years has resulted in an annual interest saving of about $248 million. This is money that the government has to spend on its core service delivery.

State governments that use debt to fund their operations rapidly become burdened by the drain the interest payments have on government revenue.

Unlike the federal government, where the benefits of stimulus may rapidly appear in increased taxation returns, it is the experience in WA that when state governments spend on infrastructure projects, the problem of vertical fiscal imbalance means the benefits largely accrue to the federal government, leaving the state government with the debt burden and no large consequential result in increasing revenue flow.

I have argued that the focus of increased spending in WA should be on areas such as public housing and school maintenance, areas which have an immediate result for the local employment market.

Helen Ridout, chief executive of the Australian Industry Group, has also been making similar arguments.

As Australia and New Zealand Banking Group's chief economist, Saul Eslake, has pointed out, it is not the role of the state government to run counter-cyclical fiscal policy. In these times, the role of state governments is not to increase debt to unsustainable levels, as deficits at the state level tend to be protracted and very difficult to return to surplus.

Rather, states need to support the federal government by targeted local spending within parameters that ensure interest payments do not rapidly eat up increasing chunks of the revenue base.

In Western Australia, this parameter has been, for some time, to keep the net debt-to-revenue ratio below 47 per cent. However, this has recently been abandoned by the government of Premier Colin Barnett and no alternative financial parameters have yet been published.

Counter-cyclical spending at the state level largely results in an increase to net debt that takes a long time to repay as the increased revenue flow largely ends up with the federal government.

In the current economic times, state governments need to focus on balancing their budgets and not putting a further drain on their economies by increasing debt levels.

The federal government's decision to guarantee state borrowing will aid the ability of state governments to access debt, but may also result in states abandoning fiscal discipline as the price of debt is linked to the federal government and not the creditworthiness of the particular state.

The Business Council of Australia is correct in that the fiscal policy of states must, at the very least, not inhibit what it is that the federal government is trying to do with its stimulus packages.

However, we all must be aware that state governments are constrained by a largely set revenue base and limited direct capacity to independently raise their own revenue (in WA, the state government's direct taxes account for about 30 per cent of the revenue base).

In these circumstances, and in the case of WA, where the GST returns are plummeting to lows of 5.7 per cent, state governments cannot embrace excessive debt as the option of stimulating their economy.

Only through prudent management of the revenue base and limited use of debt to fund local, targeted capital works programs can state governments effectively co-ordinate themselves with the federal government.

■ *Ben Wyatt is the shadow treasurer of Western Australia.*

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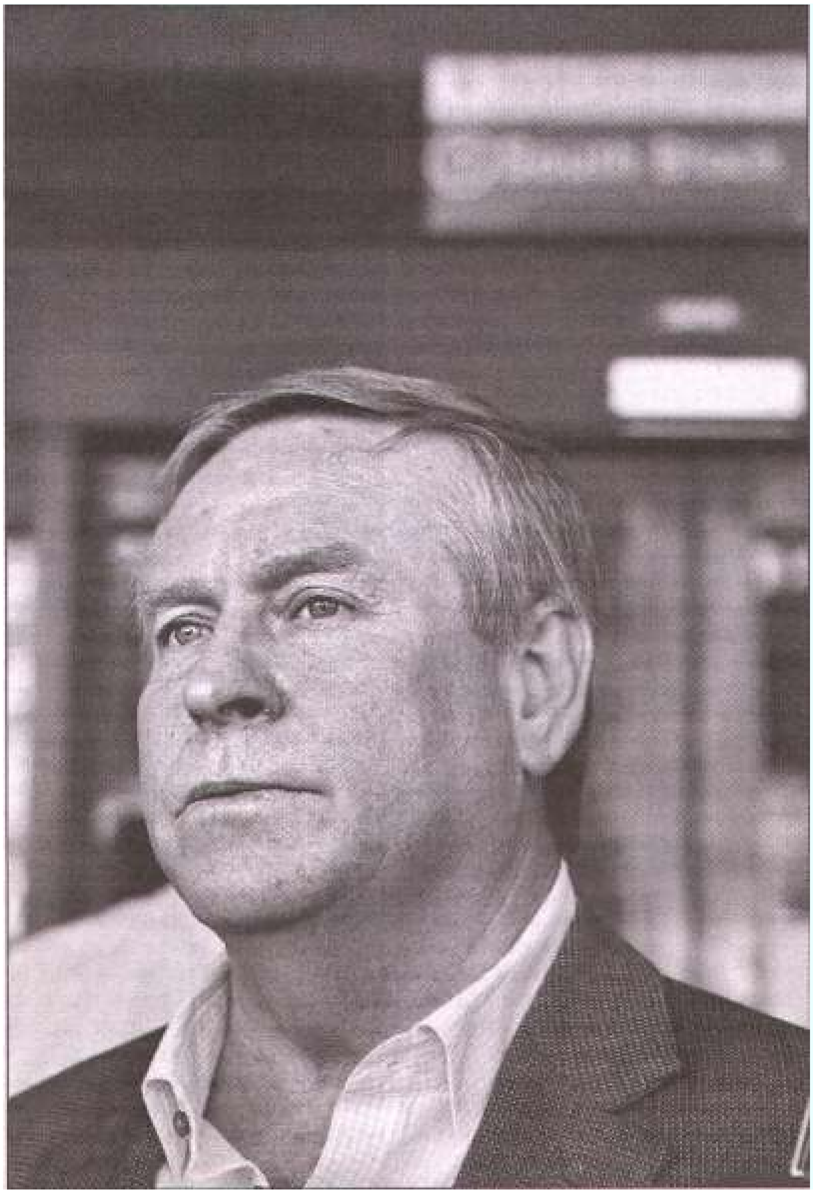

New game . . . WA Premier Colin Barnett has abandoned the ceiling on the net debt-to-revenue ratio.
Photo: KATE GERAGHTY