There are better ways to ensure State's future

Putting $4.7 billion into a WA Future Fund, as announced last week, is not the best policy, says Stephen Kirchner

The WA Future Fund announced in the State Budget last week is based on two related but fundamentally flawed ideas. The first is that the State’s mineral resources are finite and will one day be exhausted. The second idea, which is seen to follow from the first, is that the revenue currently accruing to the State Government from the mining sector should be hoarded in financial assets for the benefit of future generations.

The State’s mineral resources are not finite in any economically meaningful sense. We can always improve the efficiency with which we extract and consume resources. This means that the future availability of a given resource is limited only by our ingenuity. Since our ingenuity is unlimited, our resources should also be inexhaustible. Long before any given resource could be exhausted, price signals from global commodity markets will have induced both consumers and producers to substitute out of that resource, rendering it economically unimportant. This process occurs over very long periods of time, allowing plenty of time for an economy to adjust.

Commodity prices go through cycles that can last many years, if not decades. The recent boom in Australia’s commodity export prices is unprecedented but so was the preceding slump in the late 1990s. Managing the budgetary implications of commodity price cycles is made difficult by the uncertainty about future developments in these prices. State governments should run Budget surpluses in good times and ensure that the State has a strong balance sheet to withstand future economic adversity.

This requires a disciplined approach to fiscal policy but a Future Fund is neither a necessary nor sufficient condition for fiscal discipline. The State Government expects to earn about $230 million a year from the $4.7 billion it expects to accumulate in the fund by 2031-32. The Government argues that these earnings can then be used for "industrial infrastructure, technology infrastructure, health or research infrastructure — whatever is in the best interests of the State at the time".

But there is no guarantee that future governments will take a similar view of the "best interests of the State" and spend the income from the fund responsibly. Also, if these things are good enough for future generations, why doesn’t the Government spend more on these investment priorities today?

Spending on high-quality infrastructure that yields a stream of future public services is an equally effective way of sharing the proceeds from the recent boom in commodity prices with future generations, while also benefiting West Australians today. It also prevents future governments from spending the revenue accumulated in the fund irresponsibly.

West Australians might also question whether proceeds from the mining boom couldn’t be used to help fund a reduction or abolition of inefficient State taxes. The future growth dividend from such tax reform is another way of sharing the proceeds of high commodity prices with future generations.

Productivity growth and technical progress mean that West Australians 20 years hence will already enjoy a higher standard of living than today. They may wonder why people in 2012 thought it was necessary to put aside $4.7 billion of funds that could have been put to better use.

On the positive side, the WA Future Fund avoids some of the mistakes former Federal treasurer Peter Costello made in setting up the Federal Future Fund in 2004. The WA Future Fund will be managed by State Treasury and WA Treasury Corporation rather than establishing another expensive government agency that would duplicate existing capabilities. As the State Budget papers note, the Federal Future Fund incurred management costs of $44 million in 2010-11. Yet the Future Fund duplicates portfolio and reserve asset management infrastructure that already existed in the Australian Office of Financial Management and the Reserve Bank.

The WA Fund will invest in cash and government bonds, from which it expects proceeds of high commodity prices with future generations. Other ways of sharing the proceeds from the recent boom in commodity prices with future generations, while also benefiting West Australians today, are through tax reform.

Whether the fund can achieve a similar rate of return with a lower level of risk remains to be seen. In any event, the prospective returns on the State Future Fund would seem poor compensation for the opportunities being forgone today to invest in the State’s future.

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