

# **GENERAL PURPOSE STANDING COMMITTEE No. 1**

**Tuesday 18 November 2008**

**Examination of proposed expenditure for the portfolio area**

## **TREASURY**

**The Committee met at 10.00 a.m.**

### **MEMBERS**

Reverend the Hon. F. J. Nile (Chair)

The Hon. K. F. Griffin  
Dr J. Kaye  
The Hon. M. R. Mason-Cox

The Hon. G. Pearce  
The Hon. P. G. Sharpe  
The Hon. I. W. West

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### **PRESENT**

#### **Treasury**

**Mr J. Pierce**, *Secretary*

**Mr K. Cosgriff**, *Deputy Secretary, Fiscal and Economic*

**Mr M. Ronsisvalle**, *Deputy Secretary, Budget and Financial Management*

**Mr M. Schur**, *Deputy Secretary, Office of Infrastructure Management*

**Mr S. Brady**, *Deputy Secretary, Environment and Economic Services*

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## **CORRECTIONS TO TRANSCRIPT OF COMMITTEE PROCEEDINGS**

**Corrections should be marked on a photocopy of the proof and forwarded to:**

**Budget Estimates secretariat  
Room 812  
Parliament House  
Macquarie Street  
SYDNEY NSW 2000**

**CHAIR:** I declare this hearing for the inquiry into budget estimates 2008-09 open to the public. The hearing will be conducted from 10 a.m. until approximately 12 p.m. I thank those witnesses who have returned for the supplementary hearing, particularly Mr Pierce, secretary of Treasury. Today the Committee will examine the proposed expenditure for the Treasury portfolio. Before we commence I will make some comments about procedural matters. In accordance with the Legislative Council's guidelines for the broadcast of proceedings, only Committee members and witnesses may be filmed or recorded. People in the public gallery should not be the primary focus of any filming or photographs. In reporting the proceedings of this Committee you must take responsibility for what you publish or what interpretation you place on anything that is said before the Committee. The guidelines for the broadcast of proceedings are available on the table by the door.

Any messages from attendees in the public gallery should be delivered through the Chamber and support staff or the Committee clerks. I remind witnesses that they are free to pass notes and refer directly to their advisers while at the table. I remind everyone to turn off their mobile phones. For the information of witnesses, the House has resolved that answers to questions on notice must be provided within 21 days or otherwise as determined by the Committee and the Committee has not varied the 21-day time frame. Transcripts of this hearing will be available on the website from tomorrow morning.

**JOHN PIERCE**, Secretary, New South Wales Treasury,

**MARK RONISVALLE**, Deputy Secretary, New South Wales Treasury, and

**MICHAEL SCHUR**, Deputy Secretary of Infrastructure Management, New South Wales Treasury, on former oath:

**STEPHEN BRADY**, Deputy Secretary, Environment and Economic Services, New South Wales Treasury, and

**KEVIN COSGRIFF**, Deputy Secretary, Fiscal and Economic, New South Wales Treasury, sworn and examined:

**CHAIR:** I declare the proposed expenditure for the portfolio of Treasury open for examination. Mr Pierce, do you wish to make any opening comments?

**Mr PIERCE:** No, thank you. I have a longstanding speaking engagement for today, which will unfortunately mean I will have to, with your permission, excuse myself at about 11.30 to meet that commitment. I will not make an opening statement in the usual way. I would like to make some comments about the relationship between the State's budget and the economy, that being something which has been commented on post the mini-budget, and I suspect that I will have the opportunity to make those comments in response to questions, but in case it does not come up, if I could be so bold to perhaps reserve a bit of time towards the end?

**The Hon. GREG PEARCE:** Please tell us now.

**CHAIR:** If members of the Committee have no objection, we will treat that as a question.

**Mr PIERCE:** Sure. This being the last time that I will be sitting in this chair, I would like to take a moment at the end to offer a comment or two. Going to the question of the relationship between the State's budget and the economy and economic activity, it seems to me that a lot of the commentary on that that I have seen mixes up a whole bunch of issues. It mixes up the role of the Commonwealth Government vis-a-vis the State, the role of national government versus sub-national government, a bunch of microeconomic issues with macroeconomic management issues, the demand side of the economy and the supply side, as well as cyclical events and structural events.

I think it is necessary to unpack those issues in a way to establish what would be the appropriate criteria for judging the appropriateness of the State's budget—and when I say the State's budget I am referring more to its aggregate, rather than necessarily individual components, which reflects policy decisions of government. If I could take a moment to unpack some of those issues, it is necessary to start by pointing out that when you boil it down State governments really do three things: they provide services; through legislative powers, they regulate private sector activity, occupational health and safety laws, planning laws and those sorts of things; and they fund those activities by raising revenue from their own taxes. Of course, in our situation, 40 per cent of our revenues come from grants from the Commonwealth.

Fundamentally, the State Government is in the service delivery business and responsibility for macroeconomic policy, income distribution, transfer payments, income support and that sort of thing rests with the Federal Government. Although I would never expect politicians and journalists to express it in this fashion, State governments are primarily concerned with microeconomic issues on the supply side of the economy, the efficiency of the service delivery, the appropriateness of regulations and the efficiency of the tax measures that are available to them. It is the Federal Government that really has both the tools and the responsibilities for managing aggregate demand in the economy and if our Federal structure has one advantage it is perhaps in setting up that division of responsibilities between the national and sub-national governments.

That of course does not mean that State governments are or should be indifferent to macroeconomic questions around employment and economic growth. However, if you were to ask what was the best thing that a state government could do to influence those macroeconomic variables, I would suggest that the best thing it could do would be to do those three functions it has as well as possible. That necessarily means focusing on supply-side issues and the structure of its budget, which tends to be a longer-term question rather than a short-term one.

Economic cycles obviously come and go and what happens when we go into a downturn is that at the Federal level the revenue growth drops and their expenditure also tends to increase because of the responsibility they have for income support and transfer payments—unemployment benefits and those sorts of things. At a state government level, the expenditure side of the budget is not very sensitive at all to what is happening in the broader economy. The demand for the sorts of services that we provide and the policy decisions around those services and the provision of those services will not vary much if State final demand or gross State product is growing at 1 per cent or 3 per cent. Rather the determinants of the expenditure side of a State budget tend to be driven by longer-term variables around demographic change and longer-term economic development.

The revenue side of our budget, however, is very much tied into what is happening in the economy, but not the whole economy by any means. It is tied into specific sectors such as the property market. From a State Government viewpoint what tends to happen is that expenditure growth tends to be fairly stable and not vary much with economic cycles whereas revenue can be highly volatile. The best thing to do in those circumstances is to be prepared. Being prepared means having a strong balance sheet to start with and a structurally balanced budget where trend revenue growth and expenditure growth are close to being equal to one another. If you can start the downturn in that position it enables you to maintain service delivery and expense growth through the cycle and allow the cyclical downturn revenues to be reflected in the budget bottom line, that is, have a deficit, and essentially use the State's balance sheet through increasing debt as a shock absorber. If you can start in the right position you can avoid the situation of having to reduce service delivery just because the property market has gone into a downturn.

Of course if you do not start the cycle in that sort of structurally strong position you need to take corrective action where that corrective action is targeted at the structural position rather than trying to be counter-cyclical or pro-cyclical in the language that a macro economist would use. In practical terms the reality is of course that we were facing starting this process with the mini-budget with a mix of both structural issues and cyclical ones. From an aggregate viewpoint a lot of the measures in the mini-budget were designed to address the structural position, the trend rate of growth in revenues vis-a-vis expenses in the structural balance sheet. It was the state of the balance sheet and the risks to that as you go into a cyclical downturn that were causing the concern of the rating agencies.

Attempts by State Governments to do, if you like, fiscal stimulus tend to be doomed to failure. Attempts in other jurisdictions in the past, most notably in the early 1990s recession, give us some evidence for that. The leakages out of the State to other parts of Australia and indeed overseas are such that most of the effects of an explicit stimulus package would not be felt within New South Wales. Hence, sticking to the things that we do and trying to do them as well as possible is the best thing we can do to underpin growth in the future.

There are ways of measuring the degree of fiscal stimulus and if you were of a mind to ask what is the degree of fiscal stimulus provided by the State budget, this is a very traditional way of doing it: you would look at the total State sector not just the general government sector, and you would look at the total State net lending result as distinct from the general government operating result, which is commonly referred to in this jurisdiction as the budget result, and compare that in 2008-09 with the result in 2007-08. It is the change in the net lending result which would be the measure of the fiscal stimulus. We did not publish that total State net lending result in the mini-budget because of pressures of time in putting the documents together, but they will be published in the mid-year review in a few weeks. There will be full sets of financial statements. That net lending result will increase significantly, or the size of the deficit will increase significantly, from 2007-08 to 2008-09. I think we can give some orders of magnitude of that. Mark has the notes.

In 2007-08 the net lending deficit on a total State basis was \$4.7 billion and in 2008-09 it would be in the order of \$8.7 billion. On any traditional measure of fiscal stimulus, that would be classified as expansionary, in the sense that the gap in total government expenditures—recurrent, capital and revenue—has increased between the two years.

**The Hon. GREG PEARCE:** Mr Pierce, did you walk or were you pushed?

**CHAIR:** You indicated earlier that you were going to make a personal comment at the end of the hearing.

**Mr PIERCE:** Yes; that was of a different nature to Mr Pearce's question. The Treasurer has issued a statement. On Friday night I issued a statement to my colleagues in Treasury and to the CEOs across the agencies. I am happy to pass over the statement that I put out. As both of those statements indicate—

**CHAIR:** If the statement is brief, would you like to read it?

**Mr PIERCE:** If you wish, yes.

Following discussions between the Treasurer, the Hon. Eric Roozendaal, and myself, the Treasurer has released a statement earlier this evening that I will be leaving the NSW public sector at the completion of the upcoming COAG negotiations.

It was agreed with the Treasurer that I would remain to assist with the transition of the new Government, the preparation of the Mini-Budget and participate in the upcoming COAG meeting.

As you know, I have led the New South Wales Treasury for almost twelve years, and have occupied senior roles both in Treasury and Pacific Power for over 20 years.

Twelve years is a long time for anyone to be at the helm of any organisation, and more than twelve years is perhaps too long. You have to go back 86 years to find a Treasury Secretary that has occupied the position for longer.

Leading the New South Wales Treasury has been an enormous privilege.

I have been assisted by a great team, which I believe is second to none among Australian public sector agencies.

I am extremely grateful to my Treasury colleagues, and those in other agencies, for their cooperation and invaluable advice and support over many years.

I have also been privileged to witness at close range the workings of our very robust system of political democracy and to work closely with political leaders and parliamentarians of all political persuasions.

Public servants and Parliamentarians bring their own unique skills, attributes and perspectives to their work.

But it has always been my experience, almost without exception, that they share a genuine commitment to the common good and the well being of our State.

The Treasurer has agreed that Mr Michael Schur will Act as Treasury Secretary until such time that a permanent appointment is made.

With thanks and best wishes,

John Pierce.

**The Hon. GREG PEARCE:** So you were pushed?

**Mr PIERCE:** As both the Treasurer's statement and my statement indicate, my departure is an agreement between the Treasurer and myself and I do not think I need to say anything on that.

**The Hon. GREG PEARCE:** With respect, Mr Pierce, we are in the middle of an unprecedented international financial crisis, we have the ratings agency placing New South Wales on negative outlook, we have a mini-budget which is supposed to be a response to all these crises, we have the ratings agencies expressing concern about the inexperience, ability and political willingness of the current Treasurer and Premier, and the head of Treasury is pushed out. How does that reflect in terms of confidence in the New South Wales Government's ability to run its budget?

**Mr PIERCE:** As I said, my departure has been agreed between the Treasurer and myself. What other people choose to read into that is not something that I can control. The nature of this position, as a former occupier of it said at his departure, is a position that absorbs your life. Once you deal with one issue, there is always the next issue. It does not matter what circumstances prevail at the time, there is a continuous demand on the person that occupies this position and a continuous set of issues that you have to move on to.

From a ratings agency's perspective—and, as you might imagine, I have certainly spoken to Standard and Poor's, and I will be having a discussion in the next 24 hours with the folk in New York—change of personnel is a non-issue. What matters to them is whether the objectives, the frameworks and the processes that their jurisdiction is undertaking continue. The only relevance of a change of personnel, in their view, is whether that indicates a change of approach. I think you can appreciate that in an institution as strong, and with its frameworks that have been developed over many years—and I hope I have made some contribution to that—that would continue irrespective of who takes over from me.

**The Hon. GREG PEARCE:** Did you initiate your departure?

**Mr PIERCE:** I have had five Treasurers. The sort of conversations, as you might expect, that I have had with four of them—that is, all those other than the Treasurer who appointed me—were all the same. That is because the relationship between the Treasurer and his Treasury Secretary needs to be based on an understanding of having different but complementary roles. I always respected the right of the Government to have the Treasury Secretary that they are comfortable with, and comfortable to have that sort of relationship with. Hence, with each of my Treasurers, first conversation I had with them was indicating that that was my understanding, and that I would be willing, in if it was thought to be in the best interests of the Government and the organisation, to depart. That is, I think, an appropriate conversation to have. As I said, I have had it with each of the Treasurers. Sometimes that is a very short conversation. In this case, the Treasurer expressed a very strong desire for me to assist with the mini-budget and the COAG negotiations, and we agreed that we would review how things were going after those two events.

**The Hon. GREG PEARCE:** But the COAG negotiations have not finished.

**Mr PIERCE:** No, they come to a head the weekend after next. The timing of making the announcement was neither the Treasurer's nor my choosing; it was really in response to becoming aware on Friday of there being speculation in the media about my position, and when we became aware of that we had a discussion about whether it was in the best interests of both the Government and, from my viewpoint particularly, the Treasury, not to allow that sort of speculation and uncertainty to hang around, and we thought we should make that announcement that I would be departing, as something that was agreed between the two of us.

**The Hon. GREG PEARCE:** When did the Treasurer first indicate to you that he wanted you to go?

**Mr PIERCE:** The Treasurer—

**The Hon. GREG PEARCE:** You are under oath at this hearing.

**Mr PIERCE:** I do not need to be reminded of that, Mr Pearce.

**CHAIR:** You do not need to do that, Mr Pearce. It is offensive.

**The Hon. GREG PEARCE:** I will ask the question. When did the Treasurer first indicate to you that he wanted you to go?

**Mr PIERCE:** The Treasurer phoned me on Friday afternoon to indicate that that sort of speculation was about and asked me what I would like to do. I was actually out of the office at the time, so I said I would come in and we would have a discussion about it. That discussion was in its structure no different to thousands of other discussions I have had with Treasurers, "Here is the situation". I would outline what I thought the options were, and the characteristics of those options, and the Treasurer would then indicate which of the options he preferred. My response would then either be "Yes, I agree, Treasurer" or, in other cases, "A brave decision, Treasurer". In this case, I was in total agreement that it was the correct course of action to take.

**CHAIR:** Can we move on to other questions, Mr Pearce?

**The Hon. GREG PEARCE:** I am moving on to Mr Ronsisvale, but I would be happy to keep going with those questions if I wanted to, Mr Chair. Did you have any luck in finding those expense figures that we were asking you about yesterday?

**Mr RONSISVALLE:** Yes, I received them just prior to this meeting. To be honest I would probably need to spend a little bit of time checking them to make sure I do not mislead the Committee.

**The Hon. GREG PEARCE:** So you will forward them to the Committee in the next couple of days?

**Mr RONSISVALLE:** Yes.

**The Hon. GREG PEARCE:** Mr Cosgriff, what is the Government's current plan in relation to its electricity assets?

**Mr COSGRIFF:** The Government has announced the sale of the retail businesses of the three electricity distributors EnergyAustralia, Integral Energy and Country Energy. It has announced the sale of the development sites—

**CHAIR:** You have a very quiet voice so you need to speak into the microphone.

**Mr COSGRIFF:** Thank you. It has announced the sale of the development sites owned by the electricity generators. It has announced the transfer of the trading rights of the electricity generators to the private sector.

**The Hon. GREG PEARCE:** Who developed the proposals or options?

**Mr COSGRIFF:** The options—

**The Hon. GREG PEARCE:** Did you or the electricity companies or advisers develop them? Where did they come from?

**Mr COSGRIFF:** The option on retail was obviously part of the Owen Inquiry—it was a recommendation of Professor Owen that the Government accepted at that time. The genesis of the trading arrangements probably came from some advice that the Government received—I cannot exactly remember when—it could have been three or four years ago from advisers. Given that consideration, the Government decided to proceed with that as part of the revised energy strategy.

**The Hon. GREG PEARCE:** So it came from some advisers three or four years ago?

**Mr COSGRIFF:** Yes.

**Mr PIERCE:** If I may? I was deeply involved in that at the time. I can probably claim some responsibility for wanting to look at it and, hence, to get some advice on how it could be done. It is done in different forms in other parts of the world. At the time we looked at it quite closely and got some advice from AB AMRO—I think, from memory. At that time it was being looked at in isolation, just by itself. It was decided against taking that particular course of action, for a range of reasons. The key thing that is different now to then—there are really three key differences. One being the well-trodden or well-canvassed issue about the need for new investment; the second being the putting in place of these contracts to trade the capacity of our existing fleet, together with the sale of retail and the sale of the sites. As a package it is qualitatively different to what was being considered a number of years ago. Given the need to address the investment demand and the inability to get support for the Government's original electricity proposal, it then becomes like the next best option that is available to the Government.

**The Hon. GREG PEARCE:** So it is the next best option, is it?

**Mr PIERCE:** I think that is the way that the Government would express it.

**The Hon. GREG PEARCE:** What advice have you had in relation to the likely proceeds of the transactions?

**Mr PIERCE:** The evaluation work—obviously previously we had advice on the evaluations for different parts of the sector—for this new model has not been undertaken as yet or completed.

**The Hon. GREG PEARCE:** The evaluation work has not been completed?

**Mr PIERCE:** No, we do not have evaluations of the potential transaction proceeds available.

**The Hon. GREG PEARCE:** Do you have a Treasury guesstimate?

**Mr PIERCE:** No, what we do have—and there is a reason for this in the context of the effort that was being focused on the mini-budget process—as I have explained to the Committee before, these transactions have



two impacts on the budget results: one being the avoidance of the need for the public sector to fund the investment—and that is by far and away the more important one—and the second being the transaction proceeds. From the viewpoint of preparing the mini-budget, that having some confidence that that sort of structure will work, in the sense that the transactions can be affected and, as a consequence of them being affected when you look at it as a package with the retail and the sites, we can have a high degree of confidence that the private sector will invest in new capacity—that is what we needed for the mini-budget. That allowed us to take out of the numbers any cash flows associated with building the first baseload power station.

**The Hon. GREG PEARCE:** What is the capacity of that first one that you have been working on?

**Mr PIERCE:** In general terms, I think it is two 500 megawatt units or something of that nature.

**The Hon. GREG PEARCE:** That is what you refer to as the first tranche in the mini-budget?

**Mr PIERCE:** Yes. Now someone may build something of a different configuration, such as put four 250 megawatt units rather than two 500 megawatts—the important thing is that the first bit of kit gets there. That is what we needed for the mini-budget and we are now in the process of developing the sale strategies, with questions such as do you do it sequentially or simultaneously, staple bits together or do it separately? It is in conjunction with that, when you have got the sales strategy nailed, that you would then complete the evaluation work and have expected transaction proceeds, retention values and reserve prices, and those sorts of things, before you go to market with the first transaction. We did though—I think we expressed it in the mini-budget documents—take a conservative approach to the way in which private-sector investment would merge on the back of this set of transactions, recognising that perhaps it is not as optimal as the original transaction that was proposed. And the 10-year capital expenditure numbers that will be published soon will make allowance for the public sector to fund a baseload power station within that 10-year period.

**The Hon. GREG PEARCE:** With what sort of capacity?

**Mr PIERCE:** Again it would be two by 500s, four by 350s. That is really up to the people who have more engineering experience than me to decide. The timetable that you referred to, we would hope that we would have an initial view about the sales strategy and the way in which the various components might fit together, at least be able to specify the options and characteristics of those options, within maybe three or four weeks before Christmas and then have the full sales strategy developed, probably it will be February/March with the expectation of being able to complete the transactions by the end of 2009. But, of course, that timetable is contingent on further work we have to do in relation to testing bidder interest, undertaking an extensive road show. I would hope that we could interest a group of people particularly in the trader model who would not necessarily have been interested in actually running the power stations themselves. Somebody else is going to do that for them. We might be able to attract a broader range of interests.

And then there is, of course, the general state of markets, which has been an issue that some people have referred to. Although I would point out that a lot of bidders and potential bidders have done a lot of work in the expectation of New South Wales entering into these transactions to strengthen their own balance sheet positions and, hence, be able to take a larger amount of the funding of these transactions themselves. They are being openly reliant on debt markets. The experience in recent transactions in Singapore, for instance, which had been undertaken during this period of financial market turmoil, is that there is still strong interest in these sorts of assets, but there are still healthy prices being paid for them. What has changed is the way in which they are funded, that is, higher amounts of equity in this debt. When the financing relies more heavily on equity, we find that bidders become a lot more interested and are keen in analysing the risks that have been taken on, hence, the due diligence process that we prepared for is much more extensive. That is really the only difference.

**CHAIR:** We will now move to questions from Dr John Kaye. For your information, Dr John Kaye, the Secretary of Treasury has indicated that he has to leave at 11.30 a.m. So, could you direct your questions to him first while he is available.

**Dr JOHN KAYE:** It would be my pleasure.

**Mr PIERCE:** I would be disappointed if it were otherwise, Dr Kaye.

**Dr JOHN KAYE:** We are going to miss you.

**Mr PIERCE:** I wish I could say the same.

**Dr JOHN KAYE:** Mr Greg Pearce asked you a question about evaluations, sale assets and so on. You then answered in terms of valuation, potential proceeds and so on. Which parts of those will be in the public domain? Which parts will you release publicly?

**Mr PIERCE:** What I would expect to happen in the normal course of events is that before we start transaction around any of these assets we would have a retention value, a reserve price if you like, which would be prepared and documented but, obviously, kept by the steering committee. We would share that with the Audit Office. Then when you get the bids in you obviously compare it with your retention value. However, I would point out that it is rarely a case of just comparing two numbers and seeing which one is bigger. You have to unpack them to understand the risk allocation that has been assumed within the calculation or retention value compared to that which has come forward in the bids and be able to value that so you are comparing like with like, with a decision then being made. Then being able to report to the Audit Office the difference between the two.

In the past when the Audit Office has done its ex-post evaluation of the transactions it has reported, obviously, the two numbers and can comment on. I expect that to be a similar sort of process as we go through. If there are sequential transactions, the public release of the reserve price or, if you like, transaction one, I would be concerned that that would have an impact on the bids that we receive for transaction two. Hence, I would argue that the reserve prices should only be published at the end of the process, but that we make the reserve price and the way in which it was calculated available to the Audit Office.

**Dr JOHN KAYE:** So the answer is that none of those figures would be in the public domain prior to the completion of the sale?

**Mr PIERCE:** It would not be in the taxpayers' interests, I suggest, to do that.

**Dr JOHN KAYE:** Sure. I was just clarifying your answer.

**Mr PIERCE:** In terms of giving people confidence in the probity and appropriateness of the process, we would be providing it to the Audit Office before we used those numbers in anger.

**Dr JOHN KAYE:** In another answer to Mr Greg Pearce you mentioned that you are planning a thousand megawatts, roughly speaking, of baseload capacity in the 10-year capital expenditure plan?

**Mr PIERCE:** What we are doing is making allowance in the funding envelope to accommodate that. Whether it is actually used for that or for something else is a decision that we made a number of years into the future. But in terms of projecting, the purpose of doing that was to project debt levels.

**Dr JOHN KAYE:** I understand that. So, you are leaving, as you put it, an allowance in the funding envelope? Are you doing that on the basis of combined cycle gas turbines or on the basis of coal fired?

**Mr PIERCE:** I think we would do it on the basis of the most capital-intensive form of generation.

**Dr JOHN KAYE:** That would be coal fired then?

**Mr PIERCE:** It would be, in order to make sure that there was enough room in the capital program. When it actually came time to make that decision, if that decision was to be made by the public sector, whether it was a combined cycle or coal or God knows what else by the time we get there, that will be made on the best information that is available at the time. We are really just making an allowance in a set of numbers.

**Dr JOHN KAYE:** In the spirit of Tony Owen, are you making allowance in your figures for improved environmental performance?

**Mr PIERCE:** Because we—I have not got used to not using that pronoun—because the public sector will continue to own the existing fleet of power stations, within the numbers contains in the mini-budget, and hence the forward estimates period, there is an increase in capital expenditure compared to budget time because we continued to own them, so we need to continue to put capital into them. No doubt there will be aspects of that which have characteristics of improved environmental performance to do what it has done in, say, water

usage or improvements in thermal efficiency. The main numbers that Tony Owen was looking at related to making allowances for carbon storage and capture. The view then, and it seems to be a consensus view in the world not just here but elsewhere, is to expect that sort of technology to be available in the commercial sense from about 2020. Of course, 10 years from now is pre-2020; hence, if you look, I expect to see that reflected in future studies and infrastructure strategy.

**Dr JOHN KAYE:** What about in terms of carbon capture-ready technologies? Will you be making allowances in that for additional costs associated with it?

**Mr PIERCE:** Sensibly we have to make an allowance in the 10-year program for, like, the second baseload coming on in the State. The costing of that would be on the basis of being carbon capture-ready.

**Dr JOHN KAYE:** But the first one would not. The first tranche of the 1,000 megawatts would not.

**Mr PIERCE:** The first is on the basis of the strategy that the Government has put forward. Our capex numbers reflect the capital required to go into our existing fleet. The view is, with the successful implementation of the strategy, that that should provide very strong incentives—I am not just making this up; I have had discussions on feedback from bidders—for the private sector to undertake that first baseload investment.

**Dr JOHN KAYE:** I can understand that. The Owen inquiry spoke about, from recollection, \$6 billion to retrofit existing power stations effectively with carbon-capture storage. That is beyond the 10-year horizon that you are planning when that technology would be ready, I understand.

**Mr PIERCE:** Yes.

**Dr JOHN KAYE:** So there is no allowance for that. That \$6 billion or \$7 billion from the Owen inquiry is not part of, or has no impact on, the forward planning.

**Mr COSGRIFF:** The number that Tony Owen used was \$3 billion to \$4 billion, and it was about retrofitting existing power stations with carbon-capture technology that he expected to be available around the end of the next decade—beyond, effectively, the State infrastructure planning period, which ends in 2018.

**Mr PIERCE:** Dr Kaye, you might recall the days when it was thought to be appropriate to have 30-year generation expansion plans. The processes by which people thought that perhaps the level of knowledge and certainty we have of how the world will turn out, that sort of period of time, is a bit long for those plans to be all that useful.

**Dr JOHN KAYE:** I do recall those, Mr Pierce.

**Mr PIERCE:** Ten years—we would be fairly brave in going out to 10 years. The main purpose is not to drive individual investments that would be made in the future: The main purpose is to judge whether the financial numbers we have over the forward estimates period would seem to be consistent with that 10-year view.

**Dr JOHN KAYE:** Thank you for that. Can we talk now about the trader models and transferring the power stations to the private sector? I take your attention to two Treasury discussion documents, one dated 2001—"A Risk Management Proposal for New South Wales Electricity Business"—and the other being a further consultation paper dated May 2004 with a similar title. Do the proposals mentioned in the min-budget rightly or specifically conform to the proposals outlined in those two papers?

**Mr PIERCE:** They have similar characteristics. What is similar is that we are talking about entering into a contract that provides the private sector with the right to trade the capacity of the station.

**Dr JOHN KAYE:** The capacity, or the output?

**Mr PIERCE:** In practical terms, it will be the same thing.

**Dr JOHN KAYE:** I am not sure I agree with that.

**Mr PIERCE:** Well, they will decide. You can imagine that the trader will say to the operators, "This is the number of megawatts I want available over the next bid period, and this is the energy I expect to be able to trade associated with that capacity in the intervals that NEMMCO requires the bids to be lodged." But as I said before, the key difference between what was discussed at that period and now is doing this in conjunction with the sale of the sites and the retailers on the one hand. The key issue at the time that that was being thought through was what term should these contract exists for. That is something we are revisiting and reconsidering now in putting a strategy together.

At that time it was thought that the term applied to any one station would be the same for all of its capacity and output. One option which we are looking at is rather like a bond program. You do not necessarily have to have a single term. You could break it up. If you own a station with a thousand megawatts and expect to have availability of X and capacity factors of Y, you can break it down into units and have contracts which relate to slivers of that capacity and output. You can also have a portfolio that is structured so that the high level of the contract over a relatively short period of time trails off to a long period.

That would then leave, while there would be one sort of big bang option at the beginning over three or five years, the capacity and the trading rights that could be re-optional, rather like you do when you have a maturing bond program. That is just an option. That is something that is being considered at the moment, and considered against the objective of how do we (a) make this as attractive as possible to new entrants and (b) how does it give us strongest incentives for investment in new capacity.

**The Hon. GREG PEARCE:** In this model of selling the trading rights, does that mean that the State will continue to have the obligation for maintaining and investing in any existing generators?

**Mr PIERCE:** Yes. The property right for the existing station rests with the State. Like any contract, you have a principal-agent relationship. The State's obligation would need to include—and this is why you do not do this quickly—a very detailed risk assessment and a very detailed consideration of the options about how these contracts will be structured. It does not remove from the State all the risks associated with being in this business. You have to make sure that, regarding the risks that are left with the State in terms of maintenance of the plant and the way in which is operated, you have confidence that they are going to be managed.

You might imagine something like the trader and the people running the station agreeing on, let us say, a planned maintenance schedule and agreeing in terms of (a) what has to be done, (b) how long will it take and (c) how much is going to cost. The obligation of the State is to meet those three things. If it ended up costing more than what was agreed at the beginning of the year or season, then that risk would rest with the State. I would imagine that is something like getting availability payments from the trader, but we might have to structure these to have the right incentive both for the State and the trader.

Hence, to some degree, I would expect there to be a continuing dividend stream out of those assets because we continue to own them, although that dividend stream would obviously be less than the expected dividend stream that you would get by being in the business to its fullest extent.

**The Hon. GREG PEARCE:** Just to finish that off. On one view the risk to the State might be greater with these trading arrangements because if the State is unable to supply in accordance with the trading obligations it will not only have a problem of not supplying electricity but it will also incur penalties under the trading arrangements, I would have thought.

**Mr PIERCE:** In this business there is a parallel with physics in that risks are neither created nor destroyed; they are in total the same risks that we have at the moment and the question is just how they are allocated. A lot of risks that people have raised with us about the trader model are risks that we have anyway and it is just a case of which of those we want to keep and which ones it is sensible to transfer to the private sector because they are in a better position to manage it. All that happens is that risks which are implicit and people do not get to see you do get to see and get the opportunity to address explicitly.

But the expectation is clearly that new investment would be undertaken by the private sector and they would own and operate those assets themselves and of course it would be up to them—they might fund it and own it. In terms of operations, they might want to enter into a contract with one of our corporations to man it and operate it. That is a possibility as well.

**The Hon. MATTHEW MASON-COX:** Just to clarify in that regard, Mr Pierce, insofar as your level of confidence that the private sector will take up those opportunities to invest, has that been market tested with some of the potential bidders—a new package, that is?

**Mr PIERCE:** I have had discussions with some of them myself, and our advisers have, and indications back are positive. But they have been fairly informal discussions. When the sales strategy is fully developed so that we can present the sales strategy in its entirety to potential bidders I would expect that to be a far more structured and formal feedback process and that would include a sector that we have not approached now because unless you are actually in the business here now you cannot really expect to get a sensible response from them until you present them with a fully structured process.

**Dr JOHN KAYE:** Can you just clarify that very briefly? Was that answer in respect of the trading rights?

**Mr PIERCE:** The package.

**Dr JOHN KAYE:** The whole package?

**Mr PIERCE:** The whole package.

**Dr JOHN KAYE:** But nothing in your discussion says that people will actually build base-load generators?

**Mr PIERCE:** No, there is nothing in the discussion so far that tells me that they will not build generators. They are saying to me if we get hold of the retail books, if we get hold of the sites and if somebody in the public sector is trading the existing capacity or the capacity of the existing stations, then we will object.

**The Hon. MATTHEW MASON-COX:** If I could take you to page A-9 of the mini-budget in relation to the deferral of network and non-network capital expenditure, which totals about just over \$850 million over the next four years. Is there going to be any impact in relation to the reliability of electricity supply by these deferrals—cutbacks?

**Mr PIERCE:** The advice that we have had from the business is absolutely not, and you can rest assured that when we sought that advice from the businesses that was a key criteria that we laid out at the very beginning, that we did not want to see anything that raised that possibility, that obviously the judgements about that and the assessment about it is best done by the businesses themselves rather than by Treasury.

**The Hon. MATTHEW MASON-COX:** I just want to ask you about the mini-budget process itself. I presume that the respective departments put forward the savings identified in the appendix and that they were tested by Treasury?

**Mr PIERCE:** Yes. We ran two parallel processes through this first mini-budget. One covered the whole public sector where there was, in a sense, a fairly traditional asking for submissions from Ministers and their agencies of options that were available to reduce the rate of growth of expenditure or to reconfigure the capital program. That was one process. The other, which is also very important and repeated in here, was referred to as an expenditure review process where we sat down with nine of the largest agencies and said that this process for you is not just about putting up options to find savings which can then be reflected in the State's bottom line, it is equally important that when we produce a set of values that we have a higher level of confidence or as high a level of confidence as we can that when we get to year three that the actual expenditure levels will be very close to what we are saying now today.

So that was more of the let us have a look at the risks inherent in your current budget and your forward estimates, identify those and then go through a process of explicitly addressing them so that we have higher confidence in the budget numbers going forward. So their budget might not have actually been reduced. An example of that was in relation to health. The savings that were identified here and documented do not flow through to the budget bottom line. The average health budget has not been changed; they just seem to be getting savings, which can then be recycled back into health. But both those processes are important, both in getting the right numbers but also having confidence in those numbers.

**The Hon. MATTHEW MASON-COX:** I might take you to one particular example of savings initiatives that was put forward. You will be aware of the Gaden Trout Hatchery in Jindabyne—a very small saving.

**Mr PIERCE:** I have visited that facility in a leisure capacity. I have some knowledge of its locality.

**The Hon. MATTHEW MASON-COX:** I would have presumed in relation to that specific expense item that was a saving put forward by the Department of Primary Industries. That would be a fairly correct presumption, I would think. Is that your understanding?

**Mr PIERCE:** It would fit the model on which this process is operated.

**The Hon. MATTHEW MASON-COX:** Were you surprised when the member for Monaro went public that he was opposed to the closing of this hatchery and that it was Treasury's intention to close it? He identified that has been the concern he had. Were you surprised with that statement?

**Mr PIERCE:** I was neither surprised nor—I do not really have a response to those sorts of reactions. I take comfort in the fact that there is a responsible Minister for that area and it is up to the Minister.

**The Hon. MATTHEW MASON-COX:** You would expect the Parliamentary Secretary for Primary Industries to be aware of an expense cut in his own electorate, would you not?

**Mr PIERCE:** One of the things that over the years has allowed me to do my job is an understanding with Treasurers, and indeed with Ministers, that we move on where Labor might be leading us, and it is based on this premise that I do not insult them by telling them how to do their job and I appreciate it when they do not try and tell me how to do mine. My involvement in this process was very clear and I am quite happy to allow Ministers and Parliamentary Secretaries and those involved in the executive government to do theirs.

**The Hon. MATTHEW MASON-COX:** In your opening statement you mentioned that all the Government can do is be prepared for a change in economic cycle of the nature we are seeing at the moment.

**Mr PIERCE:** That is not quite right. I said that you need to be prepared but with everything that has happened I indicated what I regarded the appropriate response to be.

**The Hon. MATTHEW MASON-COX:** That was part of what you said. You also said that if the budget is in a structurally strong position you can deal with these changes to an economic cycle, and that the mini-budget addressed the structural problems with the budget, particularly in relation to expense growth outstripping revenue growth. My question to you is: Why was the budget not in a structurally strong position before now in order to deal with the economic cycle changing?

**Mr PIERCE:** The position that the budget is in structurally is not new and does not emerge in the course of one budget cycle. It has been an issue for a number of years. It was raised a number of years ago in the lead up to something that was called, I think it was called the audit of expenses, the Burdekin Stokes review. As I said, it does not emerge over a short period of time; neither does one single action address it. What the State does is a dynamic process and, like all things that move, in order to get it to that structural position and keep it there requires constant adjustments. As long as you are doing that constantly, your adjustments can be earlier and smaller; if you do not do it, then the adjustments you have to make down the track are naturally larger and more difficult and more disruptive to service delivery.

**The Hon. MATTHEW MASON-COX:** Which is what has happened here. Was it Treasury's view that this structural problem in the budget should have been addressed years ago?

**Mr PIERCE:** I think if you read the budget papers over the past couple of years it has been a constant theme and a constant issue that Treasury has been raising. It has been something that we have continuously tried to address with each budget, and the Government's decisions are reflected in the budget results.

**The Hon. MATTHEW MASON-COX:** The Government failed to listen. The Government has made its own decisions on its own—

**Mr PIERCE:** You also have to be aware that there is this variable called time. You can make a decision today but the consequences of that decision, be it to start a program, to line back a program or to restructure an agency in order to deliver the same services at lower cost—there is generally a lag between the decision and when that starts to take effect. So what is reflected in the numbers today is like the sum over a reasonably long period of time, a whole bunch of decisions that were made in the past, and I expect that the mini-budget will be reflected in budget results for a number of years to come.

**The Hon. MATTHEW MASON-COX:** Do you think the Government has been negligent in not acting earlier to address the structural problems, in your professional view?

**Mr PIERCE:** You do not expect me to answer that.

**The Hon. MATTHEW MASON-COX:** I just thought that as you are on your way out it might be good to reflect on what the Government—

**Mr PIERCE:** I think you can take it as evidence that the fact that I am leaving does not change at all the way I approach my job or the way in which I advise the Government.

**The Hon. MATTHEW MASON-COX:** I respect your professionalism to the very end.

**The Hon. GREG PEARCE:** To pick up that structural issue, if you take the year-on-year expenses growth in the mini-budget, it is 5 per cent for 2008-09, 6.1 per cent for 2009-10, 5.6 per cent for 2010-11, and then it drops magically to 3.1 per cent in 2011-12. So have you really done anything at all about addressing these structural problems in terms of the expenses growth in particular?

**Mr PIERCE:** I think the conclusion you could reach is that the task is not complete, but the mini-budget has made a significant contribution to that task. My view, which I am happy to say I have expressed to the Government, is that, after the sort of intensity and review processes that have gone on through the mini-budget process, you can then say, "Well, that is done and that is completed. Now let us go and do something else." It is a constant process—and no-one should be surprised by that—and one that will require a constant degree of effort and energy on the part of everyone who was involved in the mini-budget process. It never ends. The expenditure review process that I referred to, which was quite intensive during the mini-budget process, I expect the Government will continue into the future.

**The Hon. GREG PEARCE:** Is this not just a continuation of the con job that we have seen in the past? The drop to 3.1 per cent in the last year, as you know, is achieved by cutting rail grants to get you to a position where you can report that expenses are growing at about the same rate as revenues. But the reality is that those earlier years, after all these cuts, you still have expenses growing at over 6 per cent.

**Mr PIERCE:** We are not taking a view about the structural position because one problem is that both the trend levels in revenue and the trend levels in expenditure, the issue of expenditure spiking in a particular year, whether that is a concern or not depends on what is driving it. As I said, decisions made today have impacts over that sort of time period, and the decisions in the mini-budget have resulted in those expenditure growth rates and that drop that you have referred to in the last year. What will be important is whether the decisions made in the next budget and the budget after result in that expense growth in the final year being met or being exceeded. That is up to future decision making.

**The Hon. GREG PEARCE:** So it is just a manipulation of the numbers again.

**Mr PIERCE:** It is the decisions that underpin the expense numbers in each of the years in the forward estimates period. As you referred to the rail grants, that is a real decision.

**Dr JOHN KAYE:** I take you back to the issue of the electricity traders, the trader model. I will run you through a scenario so that we are clear on how this operates. A trader has sold forward contracts for a specific period at a reasonable price—the sort of price you would sell a forward contract for—and it turns out that the day is hotter than was previously expected so the price goes up. It turns out that there is a simultaneous failure of another unit in the system and also the trader's unit so the price has gone up to, say, \$1,000 a megawatt hour, and the trader's unit collapses.

**Mr PIERCE:** The trader has contracts at \$300.

**Dr JOHN KAYE:** Am I correct in saying that the trader then loses \$700 a megawatt hour? If that is for an hour, they have lost a substantial amount of money if they are trading for 1,000 megawatts, for example.

**Mr PIERCE:** Given that they would have been expecting to supply, irrespective of what the stock price was doing—if we exclude volume risk for the moment—the loss of revenue on their contracts, the 300, they would have had to meet their contracts with retailers at 1,000 megawatts and hence lost 700, as you say. But it is precisely because of those sorts of risks that the tendency in the industry is for some degree of vertical integration to manage exactly that risk. So that risk of having to go into the market and buy 1,000 megawatts is reduced. It is also precisely the sort of issue that will need to be addressed in the way in which these trader contracts are structured, and the risk allocation in them, because that sort of event is, as you know, not unusual and the same sort of things we are working through at the moment is: what are the sorts of things that N-1, N-2 sorts of criteria can be applied to and reflected in these sorts of contracts? It may be that if that event happens once, you can accommodate that within the contract. It is whether that event happened on a systemic basis because of something that was amiss in the way in which the plant was being maintained, and the standards against which it was being maintained then that would be an appropriate risk to come back to the public sector.

**Dr JOHN KAYE:** I take away from that that you are saying that this model might not transfer all of the performance risk, as it were, to the private sector?

**Mr PIERCE:** It cannot, no. Hence you have to identify exactly what is a reasonable allocation of risk to be left to the public sector and what the private sector is willing to take on. There will be a continuum, if you like, a frontier which has value and risk, and it will have to be an explicit—I see part of the role of the advisory team as to define what those options are and then articulate the nature of the risk so that they can be understood by the Government and the Government decide where it wants to sit on that frontier.

**Dr JOHN KAYE:** The models proposed in this document, in 2004 and 2001, were about all of the risk being held by the private trader. The model you are talking about now is sharing the risks, so what is being proposed in 2008 is not really about transferring all the risk to the private sector?

**Mr PIERCE:** No, and I do not think it was to be characterised accurately as all of the risk being transferred to the private sector in previous arrangements. While ever you have responsibility for operating the plant then you cannot avoid some of it. From the Government's viewpoint you come up with a taxonomy of risk, if you like, to be allocated which would include things like credit risk of the counterparties we are dealing with, a whole bunch of industrial relations sorts of issues and where the industrial relations risks lie as well as the technical ones to which you are referring to. That is not a trivial process nor is it an unachievable process. Similar sorts of risk allocation processes have been undertaken not just overseas but elsewhere within Australia as people have entered into similar sorts of arrangements. Similar sorts of arrangements operate between a number of private sector parties now. In more familiar terms, if you like, you would just take the structure of a PPA contract and, in a sense, invert it. It is a similar sort of structure in risk allocation you have to go through.

**Dr JOHN KAYE:** Is there a fiddle-factor that allows the Government to adjust the risk that it takes versus the risk taken by the private sector?

**Mr PIERCE:** Explicit judgments will have to be made about the trade-offs that the Government is willing to make between risk and reward, and that is no different to any other contractual relationship.

**Dr JOHN KAYE:** The reward factor is to provide sufficient reward to the contracting party to the private sector risk manager to make sure that they are attracted into buying this risk?

**Mr PIERCE:** On the one hand, but also on the other the risk allocation is such that what they want to do in a trading sense can be reasonably and adequately managed in a production sense. I would suggest that we would be wanting to have the trader actively involved in the operational and management decisions about how the plant is operated down to maintenance schedules and whether the economiser is replaced every five or seven years, and if they agree it is every seven and something happens in year six, the trader bears part of that cost.

**Dr JOHN KAYE:** How will that be done in the context of a publicly owned power station and a privately owned trader? Will you have negotiations about things like boiler tube maintenance, induced draught fans, forced draught fans?



**Mr PIERCE:** Yes.

**Dr JOHN KAYE:** Effectively what you are doing is you are putting private sector operators in public sector power stations?

**Mr PIERCE:** You need to involve the private sector in, as you say, very detailed decisions about how the plant is being operated because the public sector in this relationship is essentially the agent of the private sector. That is far better than just treating them as the trader just being interested in trading and not having an interest in how the plant is being operated and maintained.

**Dr JOHN KAYE:** It would be essential. Is it not therefore true that this proposal in part privatises the operations of the power station by handing it over to private sector agencies? Crucial decisions that are currently made in the public sector about investment in maintenance and refurbishment will now have to be made by private sector operations?

**Mr PIERCE:** They would need to be necessarily part of the decision-making process. It would have to be an agreement. Every contract has to be an agreement. That is, if you like, a far better alternative than the trader just being interested in trading. At the moment a bunch of operational people in these corporations, and separately a group of traders, and internally within the organisation they sort out these issues. What we would be doing in one sense is turning those processes that occur within the corporations now into a contract. That is basic theory.

**Dr JOHN KAYE:** "Into a contract", so you are going to specify decisions? You are going to have private sector parties specifying key operational decisions about public sector power stations? How is that different to partial privatisation?

**Mr PIERCE:** I would expect that we would have the public sector and the private sector agreeing about what the performance is going to be.

**Dr JOHN KAYE:** Agreeing because they are all jolly good chappies and they like to agree on things or agreeing because there is a financial relationship in which the private sector has control over public sector operations within the power station?

**Mr PIERCE:** No, the public sector will have to agree on the performance measures, the KPIs and things of that sort of nature, knowing that it will be their responsibility to meet those. So, if you like, the incentive in the negotiations on the public sector people will be to have the highest level of confidence that they can meet those KPIs.

**CHAIR:** On page 2-2 of the mini-budget it speaks about the credit rating of New South Wales. It quotes Standard and Poor's that the negative outlook will be returned to stable if the State can re-prioritise its capital program. You have re-prioritised it by cancelling many major projects. When do you expect Standard and Poor's will remove the negative category and return it to stable?

**Mr PIERCE:** Standard and Poor's put out a release on 10 November and my interpretation of it is they said what I would have expected to happen all along, one, yes, you have got to do the mini-budget and, second, they need to have confidence that it is actually going to be delivered. The issue with Canberra to the fore, one thing is about numbers, the other is confidence that it is going to be delivered. I expect that having done the budget and saying yes, that is fine, now we want to see it happen for real. They would be watching it, using the deviation from the parameters outlined in the mini-budget in the near future, either, first, as a result of the COAG negotiations or, second, as a new set of numbers post-COAG, when we put out the media review. Then, as they are indicating here, they will be watching to see what the outcome of the next budget is. Really, they are saying they are going to reserve their position and keep it on negative outlook to see that the next full budget is consistent with this mini-budget. I would expect they would pass their judgement one way or another.

**CHAIR:** So, that negative aspect will remain until May or June next year?

**Mr PIERCE:** Yes. As you will recall from our previous discussions, there is always the possibility of something unexpected.

**CHAIR:** In the mini-budget papers under "Infrastructure Australia Priorities," the State is seeking substantial funding for the M4 and M5 extensions, and we have no criticism of that. What puzzles me is are the two other major projects—the North West Metro and the south-west rail link—which are absolutely essential for the future, particularly the North West Metro with the huge population increase in that region, which cannot be shifted by buses, as to why those two projects were not included in that application to the Commonwealth Government's Building Australia Fund?

**Mr PIERCE:** First of all, it should make reference to the CBD Metro. The CBD Metro you could view as part of a western metro. Whilst in terms of people and trips that is the corridor where there is greatest demand, on the advice we have, and the greatest capacity constraints, we have allowed here for the State to fully fund the CBD Metro and put to the Commonwealth that it might fund the western metro. If the Commonwealth said no, it wants to fund the CBD Metro then the State's funding set aside for the CBD component, I would expect, to be then shifted over to the western metro, so it is one project and it is just a case of which part gets labelled as State funded and Federal funded. In relation to those two specific issues, perhaps Michael could speak on that as he has much greater involvement in the Infrastructure Australia submissions.

**Mr SCHUR:** The North West Metro and the south-west rail link were not included in the original submission. I think the view of government was that they would not have met the criteria for submission, in other words, being projects of national significance and having national impact. Firstly and secondly, they were at the time fully funded by the State Government. The projects that were submitted were projects that had not received a commitment from the State Government for funding and they were believed to be the projects that were amenable to the criteria set out in the Infrastructure Australia framework for consideration as projects of national significance.

**CHAIR:** It seems strange to me that they are not regarded as of national significance, when they deal with huge populations in Australia's major city. So, whether you should have had more faith to put the application in and see how generous the Federal Government could be in the allocation of funds.

**Mr SCHUR:** I think you would see in our submission the quantum of funding we are seeking is pretty significant in relation to the size of the overall Building Australia Fund. We would not expect the Federal Government to necessarily fund all of those projects, but we have chosen projects that we think best meet its criteria. In two instances we have submitted projects where we have received Federal funding to do the feasibility studies. This is the M5 expansion and the western metro. We think they are projects that are very likely to be given serious consideration both by Infrastructure Australia and the Commonwealth Government.

**Mr PIERCE:** I would suggest that the comparative characteristics of these different types of transport projects are really best addressed by people from the Ministry of Transport, whose submissions to us in the mini-budget process are what drove the decisions that are reflected here. If I can be excused, Reverend Nile?

**CHAIR:** We thank you for your attendance and we appreciate your personal situation as well.

**Mr PIERCE:** I just wanted to say at the last of these hearings I will be attending that you, Reverend Nile, have been the chair of this Committee, during the whole 12 or whatever years it is I have been appearing here. I express my appreciation for the way in which you have chaired them and the nature of the way in which you have questioned. I have always found it to be the case that your questions were genuine in nature and cast in a way that presumed the responses were going to be genuine as well. I always intended to be as informative and as helpful as possible.

Public servants have a very distinct role. I appreciate that this process, by its nature, has some element of political theatre around it, and that is just the reality. I have always found that you have understood the difference between the role of the political arm of government and people such as us and respected that we are not necessarily participants in that theatre. Public servants do not have anything to be concerned about in appearing at these types of Committees. In fact, it gives us an opportunity to discuss and explain some of the things we do, and as long as that is done in an atmosphere of mutual respect it does not have to be a traumatic process and hopefully it can be an informative one. Under your chairmanship I have found that to be the case. So, thank you very much.

**CHAIR:** Thank you, and may God bless you in your future role, whatever that may be.

**(Mr Pierce withdrew)**

**The Hon. GREG PEARCE:** Mr Ronsisvalle, in relation to the COAG process, on page 4-3 you have included increased special purpose funding of nearly \$2 billion over the forward estimates period. What is the basis on which you have done that? Are they agreements that have already been reached?

**Mr RONSISVALLE:** I would refer that question to Mr Cosgriff.

**Mr COSGRIFF:** Currently the Commonwealth and States are in negotiation around various aspects of the special purpose payments. Various proposals will be discussed at the COAG. They come in two forms. One is debate around base funding indexation of the special purpose payments, and the second form is a series of proposals for national partnership payments. In some cases those national partnership payments bring with them potential obligations on the States in terms of funding and much of the costs reflect a potential estimate of what those potential costs are for New South Wales in terms of the revenue we might get from the Commonwealth and the expenses that would flow from that.

**The Hon. GREG PEARCE:** So the almost \$2 billion is a guesstimate at the moment?

**Mr COSGRIFF:** It is literally that, yes. We are not in a position where the Commonwealth has advised any of the States the sums of money that might be on the table. I would expect that to be something that the Commonwealth Treasurer discusses with the State Treasurers when they meet next week.

**The Hon. GREG PEARCE:** It is potentially a big hole, if the Commonwealth tightens—

**Mr COSGRIFF:** No, it is not a big hole for our budget because the revenue and expenditure in large measure are matching here, so to the extent that we do not get the increase in revenue we will not incur the increase in expenditure.

**The Hon. GREG PEARCE:** Potentially there is \$2 billion of expenditure that is not going to happen?

**Mr COSGRIFF:** Yes. If the revenue is not forthcoming then the expenditure would not occur.

**The Hon. GREG PEARCE:** What areas is that expenditure marked down for? Is it mostly Health?

**Mr COSGRIFF:** It is mostly Health and Education. There is a range of national partnership proposals, which generally are in the health and education areas.

**The Hon. GREG PEARCE:** Could you give us details of that on notice?

**Mr COSGRIFF:** Yes.

**The Hon. GREG PEARCE:** How those figures are broken down?

**Mr COSGRIFF:** Yes.

**The Hon. GREG PEARCE:** There are a number of revenue expectations for the sale of surplus land, which total—having quickly done the numbers, so I might have got it wrong—nearly \$250 million in the year 2011-12. What was the basis of coming up with those figures for expected land sales? It is across Arts, Department of Ageing, Disability and Home Care, Department of Community Services, and the big one is schools—\$200 million in the last year?

**Mr SCHUR:** Mr Pearce, this would have been based on advice we got from individual agencies as well as our assessment of the veracity of those estimates. As you say, it does not come from any one single agency, it comes from a multitude of agencies and would have been based on a fairly conservative estimate of the land values as well as our ability to get those sales away in that time period.

**The Hon. MATTHEW MASON-COX:** May I take you to a couple of line items that I would like more detail on, particularly at appendix A-3, "Establish whole of Government 'One Stop Shops' at up to 129 motor registries". I note that is something in the order of \$45 million in cuts. I would have expected that there would be a cost to government in establishing new shopfronts inside motor registry offices. What cuts are going to occur insofar as moving existing government service centres and the like? Can you identify those?

**Mr RONISISVALLE:** At this stage the specifics of that rationalisation have not been determined. They are broad estimates of what could be achieved by the rationalisation of points of access to government services through the extension network that the Roads and Traffic Authority has. It may involve the RTA actually collocating with NRMA or something like that as well.

**The Hon. MATTHEW MASON-COX:** How can you come up with a figure if you do not know where the cuts are going to be made?

**Mr RONISISVALLE:** I think, as I outlined yesterday, budgets are based on many assumptions and this sort of estimate was provided to us by the RTA in the course of the mini-budget based on what they felt was a reasonable expectation of what could be provided.

**The Hon. MATTHEW MASON-COX:** Did you test that in any way or just take their word for it?

**Mr RONISISVALLE:** We tested it in the sense of, you know, do the estimates look reasonable or not? These estimates look reasonable, but ultimately this sort of saving will occur across a number of agencies. Five years from now we will be able to give a better estimate of what actually transpired.

**The Hon. MATTHEW MASON-COX:** What agencies do you think are going to collocate in an RTA office?

**Mr RONISISVALLE:** I could not say. People access government services, various agencies, in many places, in many rural towns and provincial cities, and that rationalisation would need to be looked at on a location-by-location basis.

**The Hon. MATTHEW MASON-COX:** That is exactly my concern: these cuts will be to country and regional areas by their very nature. Is that really what you are confirming?

**Mr RONISISVALLE:** I think various government agencies will need to get together to actually—

**The Hon. MATTHEW MASON-COX:** That is what a mini-budget is about, various government agencies getting together and working out where they can make expenditure cuts. It is pretty clear here. We have \$45 million identified, but you cannot tell me where it is coming from.

**Mr RONISISVALLE:** This is an estimate. Budgets are based on certain assumptions and this is an estimate.

**The Hon. GREG PEARCE:** You said an estimate, not a guesstimate?

**Mr RONISISVALLE:** No, it is an estimate of the likely savings that could be achieved.

**The Hon. MATTHEW MASON-COX:** A number of these savings initiatives have left a number of business peak organisations, and indeed the Opposition, gobsmacked at how simple, obvious and self-evident they are, yet unavailable in previous years. It is extraordinary. One is, "Standardise patient billing and referral practices across public hospitals". We are talking about a pretty fundamental and obvious change and we are talking about \$300 million over four years. Why has it taken 13 years to find such an obvious saving in the budget?

**Mr RONISISVALLE:** I think that is probably a question better referred to the Minister for Health or the Department of Health. It is my experience that nothing in the health sector is as simple as it first appears.

**The Hon. MATTHEW MASON-COX:** If I could take you to my personal favourite, which is in relation to Rail Corporation, "Manage all non-operational property on a commercial basis". By managing property on a commercial basis we are going to save \$17 million. What was happening before now? Was it managed on a non-commercial basis?

**Mr RONISISVALLE:** Again I think it is a matter that should be referred to the Minister for Transport.

**The Hon. MATTHEW MASON-COX:** It sounds like another matter to be referred to ICAC more than anything.

**The Hon. PENNY SHARPE:** You are free to do that.

**The Hon. MATTHEW MASON-COX:** RailCorp has had so many inquiries it is probably past saturation point.

**The Hon. GREG PEARCE:** Could I take you to the growth figures in the table at page 1-4? Given the Reserve Bank's latest outlook, which anticipates growth down to 1½ per cent—gross state product [GSP] of 1½ per cent from 1¼ per cent in 2008-09—how do you justify the 1½ per cent shown for gross state product in 2009-10? I know it is a year average, but what gives the confidence that New South Wales is going to grow at 1½ per cent in that year?

**Mr COSGRIFF:** In the context of preparing the mini-budget the Commonwealth put out the mid-year economic and fiscal update and the Reserve Bank, shortly before we published the mini-budget, put out their forecast for the economy. The mid-year economic fiscal update that the Commonwealth Treasury put out had Australian growth in 2008-09 at 2 per cent and in 2009-10 at 2¼ per cent. Our budget forecast by contrast had New South Wales GSP growth at 1¼ per cent and 1½ per cent, so that is three-quarters of a per cent below the Commonwealth mid-year economic update. That reflected that potentially the economy in New South Wales could be a bit slower than you would deduce strictly from the Commonwealth forecasts. My sense is that broadly our forecasts are consistent with where the bank is—1.5 per cent in 2008-09 and 1.75 per cent in 2009-10. We are a little less for New South Wales in both years.

**The Hon. GREG PEARCE:** In the last four or so years New South Wales has not made 2 per cent growth, has it? It has certainly been way behind the national figures.

**Mr COSGRIFF:** It has generally been behind the national figures, somewhere in the order of half a per cent. I can get the exact numbers for you so you have that. Potentially the New South Wales economy could recover more quickly than the Australian average.

**The Hon. GREG PEARCE:** I am trying to get a feeling of confidence in these numbers. What has given you the confidence to go forward with those figures of 1.25 and 1.5 per cent?

**Mr COSGRIFF:** Basically the state of the economy reflects those sorts of numbers. Other forecasts by the Commonwealth, the International Monetary Fund and the Reserve Bank are coming in with numbers of the order of 1.5 to 2 per cent for 2008-09 and 1.75 to 2.25 in 2009-10. That suggests that the economy, while slowing, is not going to be as severely impacted as some overseas economies, so there is still a lot of strength in the Australian economy and we have reflected that in our forecasts.

**The Hon. GREG PEARCE:** I do not want to go through every line item in the appendix but other than having submissions sent to you by various agencies what sort of modelling did Treasury do to these various savings figures to verify them? You have talked about generally deciding whether they were reasonable or not, but what actual testing did you do on these numbers?

**Mr RONSISVALLE:** Generally costings have been provided by the agencies and Treasury has again tested whether they think these numbers are reasonable. In essence the agencies have got most of the information that would allow them to do the most accurate costings.

**The Hon. GREG PEARCE:** So you basically rely on the agencies to give you the costings and you give them a bit of a sniff test?

**Mr RONSISVALLE:** It is probably a little bit more than what you would characterise as a sniff test. We do actually test whether we think they are reasonable or not but fundamentally the material the agencies have is much greater than we have access to to work out the costings.

**The Hon. GREG PEARCE:** What sort of modelling or testing did you do on the various revenue measures, such as the land tax measures and so on, and the likely impact of those additional taxes and charges on the economy?

**Mr COSGRIFF:** The revenue measures were modelled according to the standard revenue models we have for our tax calculations, so the forecast of what is happening on prices and those sorts of things—potential changes in volumes and changes in prices—is fed through into an aggregate picture.

**The Hon. GREG PEARCE:** What about the mineral royalties? How did you test those figures?

**Mr COSGRIFF:** There are coal contract prices that you get observable independent data for so it is reasonably easy to calculate in this year what the coal contract prices are, denominated in US dollars. You then have to make an assumption about the exchange rate to get an Australian dollar calculation of coal prices and you can deduce royalties from that in percentage terms. Looking forward you have to make a forecast of where you think international coal prices are going. We have a graph showing what we think, particularly in US dollar terms for thermal coal, which is the bulk of our exports, which is that those prices will soften over time. We have made a different exchange rate assumption from the exchange rate assumption we had at budget time, reflecting the current much lower value of the Australian dollar. The graph in the budget papers reflects both the combination of weakening US dollar denominated forward coal prices offset by the lower exchange rate.

**The Hon. GREG PEARCE:** What page is that graph?

**Mr COSGRIFF:** Page 4-4.

**The Hon. GREG PEARCE:** Is that similar to the Baltic report that comes out? I am interested in how you got the forward years onto that graph. I have seen another graph that shows the fall is a much greater decline.

**Mr COSGRIFF:** There are various market participants—coal analysts and merchant banks for instance—who will do forecasts of international coal prices and that essentially is the pattern we have taken from their forecasts for a decline.

**The Hon. GREG PEARCE:** So that is your interpretation of a number of other forecasts?

**Mr COSGRIFF:** Our interpretation of a number of other forecasts of the combination of US dollar denominated coal prices and the exchange rate.

**The Hon. GREG PEARCE:** I notice that the ratings agencies, particularly Standard and Poor's are using total State sector net financial liabilities to operating revenues. Have you calculated those figures for the forward estimates period based on these new mini-budget numbers?

**Mr RONISISVALLE:** I do not have that data here but it can be calculated. Their estimate of what they include in that ratio is a bit different from what we have been publishing in the past.

**The Hon. GREG PEARCE:** They do that based on figures you publish. I am just wondering why you would not have published those figures in the mini-budget, because it is self-fulfilling that Standard and Poor's would not have been able to re-assess their rating without having all the numbers. It is a question of why you did not provide those numbers in the mini-budget.

**Mr RONISISVALLE:** I suppose the short answer to that is that this document was prepared under an extreme amount of pressure and it does not contain everything that we would normally contain in a document of this nature.

**The Hon. GREG PEARCE:** It just seems quite odd to me, given the principal objective of this was to maintain the triple-A rating, that you do not publish the numbers that Standard and Poor's needs to actually re-assess the rating.

**Mr RONISISVALLE:** We are in discussion with Standard and Poor's on a regular basis these days. We can have those discussions with them.

**The Hon. GREG PEARCE:** Have you given them the numbers or not?

**Mr RONISISVALLE:** John is the person who has been talking to the rating agencies.

**The Hon. GREG PEARCE:** So you do not know?

**Mr RONSISVALLE:** No, I do not know.

**The Hon. GREG PEARCE:** Could you take that on notice and let me know?

**Mr RONSISVALLE:** Yes.

**CHAIR:** Standard and Poor's are not restricted to just the information in this mini-budget document.

**Mr RONSISVALLE:** Treasury has regular discussions with the rating agencies.

**The Hon. GREG PEARCE:** They need the numbers to be able to assess—

**CHAIR:** I assume if they asked them they would provide them.

**The Hon. MATTHEW MASON-COX:** I take you back to the line items. I have a few more questions I want to ask. I refer to suspending five minor country regional network services under the Rail Infrastructure Corporation. Can you confirm that these five minor network services are indeed grain lines in country New South Wales?

**Mr RONSISVALLE:** I think that is probably the case but it is something you should discuss with the Minister for Transport. These are lines that are not used very regularly.

**The Hon. MATTHEW MASON-COX:** Perhaps you could provide the details of what lines will be closed in relation to this?

**Mr RONSISVALLE:** I think it is probably a more appropriate question for the Minister for Transport.

**The Hon. MATTHEW MASON-COX:** You should have the information, should you not?

**Mr RONSISVALLE:** If something has been signed off as part of the mini-budget, yes.

**The Hon. MATTHEW MASON-COX:** If you could provide me with that detail, that would be great.

**CHAIR:** Is that possible?

**Mr RONSISVALLE:** Yes.

**The Hon. MATTHEW MASON-COX:** I want to ask you about the student travel to school scheme. I know that is a political decision and it is outside the realm of any comments you would like to make. Who is going to collect this money?

**Mr RONSISVALLE:** I understand the Department of Education and Training is looking at mechanisms to collect the money. I am not familiar with the exact mechanisms they are putting in place.

**The Hon. MATTHEW MASON-COX:** I understand that they are looking at the schools collecting the money. Are you aware of that?

**Mr RONSISVALLE:** I have heard stories that they are looking at a contractor collecting the money.

**The Hon. MATTHEW MASON-COX:** That would be interesting. No doubt we will hear about correspondence on that issue in due course. Would you be able to provide us with a break-down of the regional development assistance package of \$85 million, which is spread amongst a whole range of items? Would you be able to provide us with details on each of those items?

**Mr BRADY:** We do not have a full break-down in the papers. We would have to seek the details from the Department of State and Regional Development and bring that back to you. We will take that on notice.

**Dr JOHN KAYE:** Mr Cosgriff, I wish to pick up on a statement made by Mr John Pierce before he left relating to the contractual relationship between the public sector power station operators and the private sector traders. Will those contracts include aspects of industrial relations within the power station?

**Mr COSGRIFF:** I expect the contracts will have to include a discussion of the events that might lead to outages in the power station. So, in that context, industrial relations is one of the potential issues that the risk of industrial relations issue would have to be addressed contractually, yes—in the same way that the risks from an unforced outage from one of the units would have to be addressed.

**Dr JOHN KAYE:** What will happen under this arrangement is that aspects of industrial relations within the power stations will be specified within the contract between the trader and the power stations?

**Mr COSGRIFF:** It is a little early to say exactly what provisions we would have in a contract. In fact, it will be a decision for the Minister to make, relative to the award trade-off that John mentioned earlier. Nevertheless, that is a conversation that has to be had, and a decision needs to be made on that in the lead-up to the drafting of the contracts.

**Dr JOHN KAYE:** Mr Brady, in respect of Tillegra Dam, a project that I understand was costed at \$406 million, was it on the list of projects—like the North West Metro and the southeast rail extension—that were put up and discussed as to whether they were of sufficient priority to be funded?

**Mr BRADY:** It really proceeds in three steps. We look at the individual projects and the quality of those projects, and we provide advice to the Government as to whether they are projects that are meritorious. We also provide advice to the Government on the available envelope for funding for the entire infrastructure program. The third step is really a policy decision for Government as to which projects it chooses to fund within that envelope.

Our advice to the Government was that Tillegra Dam was a project which would secure the long-term water for the lower Hunter, and that given the current assessment of the sustainable yield in the lower Hunter, it was a project which, if required, would be the lowest-cost solution for securing the long-term water supply for that region, that it was a worthwhile project for the Government to consider. The Government then makes its own policy decision as to whether it would include that project within the State infrastructure strategy.

**Dr JOHN KAYE:** To summarise, in the first step you provide advice saying, "This is a good project and it is worthwhile"?

**Mr BRADY:** Yes.

**Dr JOHN KAYE:** In doing so, did you consult with Hunter Water at all?

**Mr BRADY:** Yes, we did.

**Dr JOHN KAYE:** In doing so, did you look at the now difficult-to-obtain 2003 Hunter Water resource statement?

**Mr BRADY:** I would have to refer to my analyst, who provided advice to me on that. What is the specific issue?

**Dr JOHN KAYE:** In the 2004 document it specifically says that Tillegra Dam was not needed, that it was the second most expensive option—second only to desalination. That was an \$86 million Tillegra Dam. If you feed into their data a \$406 million dam, it is roughly three times as expensive as desalination. Can you tell us what has changed in that period?

**Mr BRADY:** Certainly our assessment of the costs incurred for the provision of water in that area indicates that Tillegra Dam is the lowest-cost option. For us to proceed with desalination, the evaluation we had was that it would be a higher capital cost and also a much higher operating cost—

**Dr JOHN KAYE:** I am sorry to interrupt you. Let us not compare Tillegra Dam with desalination; let us compare it with Grahamstown augmentation and with water efficiency options.



**Mr BRADY:** Water efficiency options are something that are occurring across the entire portfolio of the State's water supply. But, given the current sustainable yield in the Hunter area and the current supply that we have, and the growth of the population base in the area, we do not have sufficient water to cater for the existing population, let alone the population growth that is forecast in the lower Hunter.

**Dr JOHN KAYE:** Your analysis is that Tillegra Dam is there for population growth, not for drought?

**Mr BRADY:** No. What I said was that even under the current population base the long-term sustainable yield is not adequate.

**Dr JOHN KAYE:** So it is drought relief?

**Mr BRADY:** It is to provide sufficient water security for the existing population base, and also to provide for population growth over time.

**Dr JOHN KAYE:** It is both population growth and drought relief?

**Mr BRADY:** And sustainable water security.

**Dr JOHN KAYE:** I am confused by the second part of that. Given that in the drought that we are hopefully emerging from now the lower Hunter had no water restrictions, and given that the last time I looked the lower Hunter's water supply was at about 97 or 98 per cent capacity, what drought are we talking about?

**Mr BRADY:** Whilst the dams and the water supply in the lower Hunter at the moment are relatively high, their supply is quite small.

**Dr JOHN KAYE:** The storage is small, do you mean?

**Mr BRADY:** The storage is relatively small. Therefore, you can have a situation where you have a rapid decline in the storage levels.

**Dr JOHN KAYE:** Can you tell us the last time there were water restrictions in the lower Hunter?

**Mr BRADY:** I do not have that information available to me.

**Dr JOHN KAYE:** It has not been this decade. Was there any sense in which you analysed the alternative data—not the Hunter Water data, but the other things that are being said about Tillegra Dam?

**Mr BRADY:** We were provided with a range of advice—

**Dr JOHN KAYE:** From Hunter Water?

**Mr BRADY:** Primarily it was Hunter Water's proposal. Obviously, the agencies put forward proposals and Treasury evaluates those proposals.

**Dr JOHN KAYE:** At no stage did you look at advice that the cost might be more than \$406 million, that it might blow out to \$1 billion during construction?

**Mr BRADY:** We have a range of water supply entities within the New South Wales Government, so we have the ability to crosscheck the types of costs that individual agencies provide to us. Therefore we are in a position to have a sanity check against whatever individual agencies put forward. It is our understanding that this was not an unreasonable set of assumptions that Hunter put forward.

**Dr JOHN KAYE:** Based on broad-spectrum experience with dams in New South Wales, you figured that \$406 million was about right for a dam of that size—?

**Mr BRADY:** No. There are consultants' reports and detailed evaluations. This project went through a gateway review, as do all our major projects.

**Dr JOHN KAYE:** All those consultants' reports were paid for by Hunter Water?

**Mr BRADY:** That is the appropriate way of assessing—

**Dr JOHN KAYE:** When you made the—

**Mr BRADY:** This is where the gateway review comes into it. It provides an independent peer review of the project—how it has been developed and the rigour with which the estimates have been put together. It looks at the consultants' reports, and basically gives the Government an assurance that there has been an appropriate level of rigour in the planning and evaluation of the project.

**Dr JOHN KAYE:** With no on-the-ground independent advice or no technical advice as to the cost of building a dam?

**Mr BRADY:** Did we go in and appoint a consultant to re-evaluate the cost proposals put forward by Hunter Water? No, we did not.

**CHAIR:** The Budget Papers state in the new electricity reform package that the Government will be transferring to the private sector power station development sites. Which one of you can answer this line of questions?

**Mr COSGRIFF:** I can answer.

**CHAIR:** Where are the development sites? Do you have a list of them?

**Mr COSGRIFF:** There is a list of sites but Delta and Macquarie Generation in particular have a number of sites that are at various stages in the development application process. For instance, Delta are currently building a gas-fired power station at Colongra and Macquarie Generation has a proposal at Tomago for a gas-fired power station—

**Dr JOHN KAYE:** These are all open cycle, are they not?

**Mr COSGRIFF:** There appears to be a mix of open cycle and closed cycle. The Bamarang Plant west of Nowra, which I was just about to refer to, is another site that Delta owns and has development approval for either an open cycle 300 megawatts or a peaking or combined cycle of 450 megawatts. There is a site at a Marulan that is big enough for there to be two proposals, one of which is being managed by EnergyAustralia, for an open-cycle plant, and the other by Delta which is a combined cycle of 400 megawatts. There is also potentially the expansion of Mount Piper, given that it was originally planned as a four-unit station, you could develop Mount Piper to three and four units.

**CHAIR:** Those sites are at different levels of development? They are not simply empty land?

**Mr COSGRIFF:** No, they are not empty land—or there might well be empty land but they are certainly sites that, in some cases, have gone right through the development application process and have development applications for specific technologies. Particularly, the Bamarang and Marulan's of this world close to gas supply and close to transmission—particularly Bamarang, which is a very suitable site for inclusion in the next increment of either peaking or combined cycle gas generation to be built in New South Wales.

**CHAIR:** If a private sector company purchased a site, would they then be bound to use it for a power station? If they owned it would they have the option to use it for redevelopment—put houses or units on it?

**Mr COSGRIFF:** We have not worked through that exactly but I think you would find there would be some obligations to use it for power-development purposes.

**CHAIR:** There would be a restriction on the sale?

**Mr COSGRIFF:** When the Government sold the Tallawarra site, there was a clear understanding that there would be a power station built there. So they did not have the option of redeveloping the site for, say, residential or industrial use—there had to be a power station and there had to be a buffer and there was an area of land in the end which was redeveloped—I cannot recall exactly what land-use it was put to—but the

expectation was that given there was a power station site there and the Government was selling it as a consented power station site that one should be built.

**CHAIR:** There would be a covenant-type arrangement on the sale restricting its future use?

**Mr COSGRIFF:** Consideration would have to be given to exactly the form of arrangements that were given. Clearly if you are putting a number of sites out you want to be a bit careful about exactly what should you put on them collectively.

**Dr JOHN KAYE:** In the period since the State was put on negative outlook, what has been the change in the prime interest rate, and in which direction? Nobody knows?

**Mr COSGRIFF:** The bank has cut interest rates recently down to 5.25 per cent and market expectations arguably are to go down to 4.25 per cent, so recently there has been quite a bit of downward pressure—

**Dr JOHN KAYE:** About a 3.5 per cent drop, would you say? Or conceivably a 4.5 per cent drop? If New South Wales was downgraded from triple-A to the next step down, we would get a 0.25 per cent increase in the interest that we pay on loans, is that correct?

**Mr RONSISVALLE:** That is the estimate that City Corp. has given Treasury, yes.

**Dr JOHN KAYE:** Am I not correct in saying, at least on new loans or re-negotiated loans, that a 0.25 per cent increase would not be noticeable given the falling interest rates?

**Mr RONSISVALLE:** Certainly the reduction in interest rates over time would be greater than the impact of the loss of triple-A, yes.

**Dr JOHN KAYE:** Greater by a factor of 12?

**Mr RONSISVALLE:** Interest rates in five years time could be at a very different rate from what they are today.

**Dr JOHN KAYE:** Certainly, and that is likely, but am I not correct in saying that a 0.25 per cent change in interest rates is actually fairly small compared to the fluctuation in interest rates imposed on the State by the market?

**Mr RONSISVALLE:** Interest rates do move up and down by reasonable sort of margins, yes.

**Dr JOHN KAYE:** So the triple-A rating was about avoiding an interest rate increase that is less than one-twelfth of the decrease in the prime interest rate?

**Mr RONSISVALLE:** It still ends up being a cost to the State budget, even if the actual underlying interest rate is at a lower level it is still a cost of the State budget.

**Dr JOHN KAYE:** But it is one-twelfth of the benefit to the State budget that we have gained by falling interest rates?

**Mr RONSISVALLE:** If you are prepared to assume that interest rates will stay at that level over the next 20 years.

**Dr JOHN KAYE:** But it might be one twelfth of the total cost if the interest rates go back up again? Do you not accept that it is a small percentage of the total fluctuation in market interest rates?

**Mr RONSISVALLE:** Yes.

**(The witnesses withdrew)**

**The Committee proceeded to deliberate.**

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