



## **Review of the 2006/07 Victorian Budget**

### **Overview**

The 2006/07 Victorian budget sustains the Bracks Government's broad economic and fiscal thrust of recent years. The Government continues to exploit a benign economic outlook (as well as earlier conservatism in revenue forecasts) to lift service delivery in key community portfolios, in addition to substantially increasing infrastructure spending and further reducing business taxes, levies and regulatory compliance costs.

Against the backdrop of heightened competitive pressures, Ai Group's Pre-Budget Submission proposed a comprehensive series of State Government measures to strengthen the competitiveness of Victorian industry. The Government has adopted many of Ai Group's key proposals, and which combined with previous initiatives offer substantial support for industry.

### **Major Initiatives**

The major new economic measures are summarised below.

#### ***Business Taxes and Levies***

- Broadly consistent with Ai Group's Pre-Budget Submission, payroll tax will be reduced from 5.25% to 5.0% over three years. The rate will be reduced to 5.15% on 1 July 2006, followed by a cut to 5.05% on 1 July 2007 and to 5.0% on 1 July 2008. The cut is forecast to save Victorian businesses \$533 million over the next four years, and bring Victoria closer to Queensland (which, at 4.75%, has the lowest payroll tax rate in Australia).
- Following a major overhaul in the 2005/06 budget, the Victorian Government will move further to lower the burden of land tax. The cut in the top rate to 3.0% will be brought forward by two years (to 2007), while the middle rates will also be reduced further (with the 1.0% rate cut to 0.8%, the 1.5% rate lowered to 1.2% and the 2.25% rate cut to 1.5%). The total cost is estimated at \$167 million over four years.

- The average WorkCover premium will be cut a further 10% in 2006/07 (to 1.62%), the third such reduction in the same number of years (and also a key Ai Group proposa). The reduction in premiums will save Victorian employers \$170 million in 2006/07.
- These latest cuts follow wide-ranging reductions in these and other taxes introduced in 2005/06 budget, and which Ai Group estimated would deliver \$700 million in savings to Victorian taxpayers in a full year. The full savings of all measures announced in the past two budgets are expected subsequently to total almost \$1 billion in a full year.

### ***Increased Infrastructure Investment***

- The budget provides funding for new social and economic infrastructure with a total estimated cost of \$4.9 billion. Among the new projects are those announced in the *Meeting our Transport Challenges* statement earlier this month (and which committed \$8.8 billion of new capital expenditure on the Victorian transport system over the next 10 years).
- Total spending on infrastructure is forecast to rise 16.0% to a record \$3.2 billion in 2006/07, and a further 7.7% in 2007/08 to \$3.4 billion. The Victorian Government's capital stock is forecast to increase by 11% over the next four years.
- The State Government will continue to increase borrowings to partly fund the enhanced infrastructure program. On the basis of the Government Financial Statistics (GFS) Framework, the general government net borrowing requirement will fall from \$1.2 billion in 2005/06 to \$0.6 billion in 2006/07, but subsequently increase to \$0.9 billion in 2007/08 and \$0.8 billion in 2009/10. General Government net financial liabilities will increase from 6.3% of Gross State Product (GSP) in 2005/06 to 7.1% in 2009/10.
- In its pre-budget submission, Ai Group strongly advocated the prudent use of government borrowings to fund increased infrastructure spending (particularly to relieve road traffic congestion and improve the efficiency of freight logistics and supply chains). To this end, Ai Group notes the recurrent costs accompanying the increased borrowing are comfortably covered by operating revenues (see below), with little threat to the State's AAA credit rating.

### ***Other measures***

- In addition to the release of the *Maintaining the Advantage: Skilled Victorians* package released earlier this year (capital funding for which has been provided in this budget), the Government will also introduce a \$500 bonus to apprentices who successfully complete their first year of training, and choose to re-enroll in Year 2. The measure is designed to slow drop-out rates after the first year of training.

- The Government has also set aside \$24 million over four years for a package of new small business programs, including initiatives to facilitate the development of business management skills (advocated by Ai Group) and measures to simplify interactions with government.
- The Government will also establish a new business office in Bangalore, India.

By contrast, the Government has eschewed the opportunity to strengthen or review assistance programs for Victorian manufacturing.

Importantly, however, and consistent with a key proposal in the Ai Group pre-budget submission, the Government has announced a three-step plan to reduce the regulatory compliance burden on businesses:

- A reduction in the administrative burden of regulation by 15% over three years, and by 25% over five years.
- Ensuring all new regulation is met by an ‘offsetting simplification’ in the same area (i.e. ‘one-in, one out’).
- Reviewing the compliance burden of regulation, specifically the costs of change required to achieve the desired new outcomes.

The Government’s initiative builds on the regulatory reform strand agreed by all Australian governments at the Council of Australian Governments meeting in February 2006. At this stage, there are few additional details accompanying the proposal. Nevertheless, the budget includes \$42 million of new funding over four years to encourage departmental and agency reviews of ‘regulatory hot spots’, and to reward reductions in the compliance burden (similar to the incentive payments under the National Competition Policy). Indeed, in Ai Group’s view, the proposal re-affirms the Victorian Government’s determination to take the lead in reducing regulatory compliance costs on business.

### **Key Budget Aggregates**

On a GFS basis, the budget operating surplus (net result from transactions and excluding capital items) is forecast to narrow to \$317 million in 2006/07, from an estimated \$450 million in 2005/06. Expenses are forecast to increase by 4.5% (considerably less than forecast growth in nominal GSP), while revenue is budgeted to increase by 4.0%.

The surplus is also forecast to remain slightly above \$300 million in each of the three years to 2009/10.

The projected 2006/07 surplus is essentially unchanged in size from the 2005/06 *Budget Update*, published earlier in the year. However, it masks substantial changes arising from the new measures announced in the budget, as well as economic ‘parameter variations’. Specifically:

- Economic and demographic variations have increased forecast 2006/07 revenue by \$481 million, largely reflecting higher estimates of land transfer duties, payroll tax receipts, and dividends and income tax equivalent payments from State Government enterprises.
- Estimates of Commonwealth grants have been increased by \$240 million, principally to the increase in the Victorian Government's share of the GST revenue pool (announced by the Commonwealth Grants Commission earlier this year).
- By contrast, factors other than new policies have increased forecast expenditure in 2006/07 by \$208 million. Much of the increase reflects higher departmental expenses and service delivery payments.
- The total impact of new measures announced in the budget (and since the mid-year update) have increased forecast expenditure in 2006/07 by \$423 million, and reduced revenue by \$133 million.

### **Economic Forecasts**

Gross State Product is forecast to strengthen to 3.25% in 2006/07, from an estimated 2.5% in 2005/06 (and 2.3% in 2004/05). Growth is forecast to strengthen further to 3.5% in 2007/08, before settling back to the long-run forecast of 3.35% in the ensuing outyears.

The budget increase in infrastructure spending will contribute substantially to GSP growth in 2006/07, and to a lesser extent in 2007/08. Much of the forecast strengthening in growth, however, is attributable to an expected revival in consumer spending growth and a diminishing drag from net exports. In Ai Group's view, there are considerable downside risks to these forecasts, hinging primarily on the accompanying inflation risks and ensuing uncertainty over the future direction of interest rates.