



Review of the 2007/08 Victorian Government Budget

Overview

The 2007/08 Victorian budget is founded on an exceptionally strong revenue base, which has allowed the Bracks Government to provide a small number of additional measures to support Victorian industry. The Government also continues to lift investment in key areas of the State's economic infrastructure. However, consistent with the Government's re-election agenda, and with the Government also expected to release a comprehensive Industry Statement within the next month, the real emphasis of this budget is increasing service delivery in the education and health portfolios, and improving housing affordability.

The Government will also continue to meet all fiscal management criteria. While the operating surplus is budgeted to fall to \$622 million in 2006/07 (from \$825 million in 2005/06), and to fall again in 2007/08 to \$324 million, the projected surpluses remain above the government's target of \$100 million. Currently, the surplus is budgeted to average in excess of \$400 million in the three years to 2010/11.

Budget Analysis

A key feature of the 2007/08 budget is the continued underlying strength in State Government revenue growth. Total estimated operating income in 2006/07 has been revised up by over \$900 million (2.8%) since the previous budget, including a \$500 million (4.6%) upward revision to taxation revenue and a \$200 million (1.3%) increase in projected grants. The upward adjustment to the taxation forecast largely reflects the continuing strength of property and financial markets, and stronger employment growth.

This has contributed to a higher 'baseline' revenue estimate in 2007/08, and which has been further underpinned by a forecast 7.1% increase in Commonwealth Government GST grants. Revenues are further supported by an expected strengthening in real Gross State Product (GSP) growth, from an estimated 2.75% in 2006/07, to 3.25% in 2007/08 (as the effects of the drought on rural production unwind). While Ai Group broadly concurs with the Government's forecasts, it is important to note that State Government

revenues have become increasingly leveraged to movements in asset prices, rather than to growth in broader GSP.

Key Initiatives

The underlying strength in revenues has funded key pre-election commitments in education, health and housing, including:

- a modernisation program for state schools; additional funding for mathematics and science teaching; additional Teachers Assistants and welfare officers; and funding for the purchase of additional computers.
- Additional hospital services to treat more patients sooner, and to upgrade metropolitan and regional hospitals and ambulance services.
- The construction of an additional 800 public housing units; funding to enable housing associations to acquire 1,550 new dwellings; stamp duty relief for homes priced between \$115,000 and \$500,000; and an extension of the First Home Bonus until June 2009.

The extent of the continuing rapid growth in service delivery is most evident in general government employee benefit costs, which are budgeted to increase by 6.6% in the current year, following a 6.8% increase in 2005/06 (and much faster than growth in nominal GSP). However, the impact of the latest proposed increase in service delivery will be offset by a renewed government efficiencies initiative, which is expected to deliver savings of \$632 million over four years.

Nevertheless, the Government has also announced a number of new measures to support Victorian industry, building on earlier plans to bring forward a reduction in payroll tax (to January 2007), and following the complete abolition of nuisance taxes agreed as part of earlier tax reform. These initiatives also precede the expected release of an Industry Statement later this month, which is likely to include more specific measures to enhance industry competitiveness.

The initiatives announced in the budget are:

- A fourth consecutive cut of 10% in the average workers compensation premium (to 1.46%), saving employers a further \$167 million in 2007/08 (the three earlier cuts are estimated to save Victorian employers over \$1 billion over six years).
- Further reform of land tax, including an increase in the threshold from \$200,000 to \$225,000, cutting the top rate from 3.0% to 2.5%, and reducing the middle brackets from 1.8% to 1.3%, and from 1.2% to 0.8%. The Government estimates 40,000 taxpayers will save \$508 million over four years, and that Victorian businesses now pay the lowest land tax in Australia for all landholdings valued between \$0.4 million and \$4.5 million.

- A reduction to 2.5% in the effective duty rate on new passenger vehicles valued between \$35,000 and \$57,09, providing total relief of \$177 million over five years.
- An additional \$10 million over four years to expand the Opening Doors to Export program, and create a new Victorian Export Network to promote Victorian industry's capabilities in key export markets and establish collaborative export partnerships.
- Expanding the number of Industry Capability Network regional offices, specifically to make local sourcing and replacement services available to regional businesses.
- Establishing new Tiger Teams and Victorians Abroad programs, to chase overseas investment opportunities.

Capital Investment and Net Debt

The 2007/08 budget also provides for a further significant increase in infrastructure spending, including new projects with an estimated total investment of \$2.9 billion. This follows the release last year of the Meeting Our Transport Challenges package, which provided \$10.5 billion of new investment over 10 years.

Consistent with the Government's broader fiscal strategy described above, much of the new funding is directed towards modernising state schools, upgrading hospitals, purchasing new medical equipment; and public housing construction. However, the Government has also announced \$236 million of new funding to upgrade arterial roads and to extend the Geelong Ring Road, as well as a further \$709 million to improve Victoria's rail network.

Total general government capital expenditure is estimated at \$3.4 billion in 2006/07, fully 27% higher than in 2005/06. Whereas spending in 2005/06 was funded largely by internal cashflows (with an increase of just \$42 million in net debt), up to 40% of future investment will be financed by running down financial assets and increasing State Government borrowings. Net debt is estimated to increase by \$1.2 billion in 2006/07. With capital expenditure forecast to increase a further 6.0% in 2007/08, net debt is also budgeted to increase by an additional \$1.5 billion.

Nevertheless, the ratio of net debt to GSP is forecast to increase only moderately over the next four years. At a forecast 2.9% in June 2011, the ratio contrasts with 3.1% in 1999. Ai Group continues to welcome the prudent use of Government borrowings to fund effective economic infrastructure investment.