Budget Statement

1999-2000

Presented by

The Honourable Alan Stockdale, M.P.

Treasurer of the State of Victoria

for the information of Honourable Members

Budget Paper No.2

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ABBREVIATIONS AND ACRONYMS

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
AHCA	Australian Health Care Agreement
Aluvic	Aluminium Smelters of Victoria
ANTA	Australian National Training Authority
ANTS	A New Tax System
AWOTE	average weekly ordinary-time earnings
BOO/BOOT	build-own-operate or build-own-operate-transfer
CFA	Country Fire Authority
CGC	Commonwealth Grants Commission
COAG	Council of Australian Governments
CPI	consumer price index
CRC	Commonwealth Research Centre
FBT	fringe benefits tax
FID	financial institutions duty
GBE	government business enterprise
GDP	gross domestic product
GFCE	gross fixed capital expenditure
GSP	gross state product
GST	goods and services tax
HFE	horizontal fiscal equalisation
IMF	International Monetary Fund

NCP	National Competition Policy
NEMMCO	National Electricity Marketing Management Company
OECD	Organisation for Economic Co-operation and Development
ORG	Office of the Regulator-General
PFE	public financial enterprise
PTC	Public Transport Corporation
PTE	public trading enterprise
R&D	research and development
SNA	system of national accounts
SPPs	specific purpose payments
S&P’s	Standard & Poor’s
TAC	Transport Accident Commission
TAFE	tertiary and further education
TCV	Treasury Corporation of Victoria
TEC	total estimated cost
VET	Vocational Education and Training
VFMC	Victorian Fund Management Corporation
VNSC	Victorian Network Switching Centre
VPC	Victorian Plantations Corporation
VPX	Victorian Power Exchange
VENCorp	Victorian Energy Networks Corporation
WCI	wage cost index
WST	wholesale sales tax

STYLE CONVENTIONS

Figures in the tables and in the text have been rounded. Discrepancies in tables between totals and sums of components reflect rounding. Percentage changes in all tables are based on the underlying unrounded amounts.

The notation used in the tables and charts is as follows:

LHS	left-hand-side
RHS	right-hand-side
s.a.	seasonally adjusted
n.a.	not available or not applicable
Cat. No.	catalogue number
1 billion	1 000 million
1 basis point	0.01 per cent

CHAPTER 1: OVERVIEW

- For the fifth budget in a row the Government is able to deliver real gains in services and reduced taxes to Victorians from within a sound financial framework.
- New service delivery initiatives totalling $383 million in 1999-2000 will centre on the high priority areas of education, health, police, and the science, engineering and technology sector.
- Taxation relief of $97 million (full-year basis) will come from a further 0.25 percentage point reduction in the payroll tax rate to 5.75 per cent from 1 July 1999, the third consecutive fall.
- New infrastructure spending with a total estimated cost of $1 357 million has been approved to start in 1999-2000 and will allow for the provision of better roads, hospitals, schools and other community facilities.
- A budget sector operating surplus of $129 million is forecast for 1999-2000. The sustainable cash surplus is projected to be $67 million in 1999-2000 and to average around $105 million over the forward estimates period.
- Public sector net debt is projected to fall to only $6.1 billion by 30 June 1999, less than a fifth of its level in June 1993. Victoria regained its triple-A rating from Standard & Poor's last year and Moody's has recently upgraded its rating outlook from stable to positive.
- Victoria has weathered the slowdown in the global economy well. Unemployment has fallen to an 8½ year low, and further jobs growth of 1 per cent is expected in 1999-2000, with growth strengthening in later years.
- The economic reforms introduced by the Government since 1992 have helped Victoria cope with recent difficulties in the world economy and have benefited Victorians through better services, lower household taxes and charges, reduced business costs, and increased jobs.

1999-2000 BUDGET INITIATIVES

The Government's fundamental aim is to make Victoria a better place to live, invest and do business. To achieve this vision the Government is pursuing a broad range of policies designed to meet two key strategic priorities. These are to:

- position the State so that it can achieve strong and sustainable rates of economic growth to ensure prosperity in the next century; and
- ensure all Victorians have the opportunity to share the benefits of this growth.

As a result of the Government's sound financial management of the past seven years, the 1999-2000 Budget continues to deliver further financial and service delivery gains to the community. Importantly, these gains are being delivered without compromising the Government's ongoing commitment to sound financial management and fiscal prudence. The 1999-2000 operating surplus is forecast to be $129 million compared to a revised 1998-99 estimate of $770 million.

The 1999-2000 Budget contains new service delivery initiatives which total $383 million this year. Key initiatives are:

- $62.6 million in 1999-2000 for education, including $17.2 million for IT technical support in schools and $18.1 million for growth in TAFE apprenticeship and traineeships;
- $33.1 million of initiatives in the justice system, including $11.9 million to recruit an additional 400 police officers over the next two years;
- $114.8 million new funding for health and welfare services, including $64.8 million for acute health care, $15.9 million for aged, community and mental health services, and $5.2 million for expansion of ambulance services;
- $5.6 million for new and upgraded metropolitan and rural bus services; and
- $21.1 million for natural resources and environment, including $10.6 million for the Growing Horizons program to assist meeting the Government's objective of achieving $12 billion in agricultural and food exports by 2010.

The Government recognises the importance of the creation of new knowledge and technologies, and their commercialisation, for wealth generation and economic growth in the next century. Consequently, the 1999-2000 Budget also provides funding to strengthen innovation, research and development in the important science, engineering and technology sector. The Government has committed $310 million to this sector over the next five years: $35 million in 1999-2000, $50 million in 2000-01 and $75 million thereafter. The aim of this program is to fund additional public sector research and development, as well as encourage increased private sector involvement. Funding will be directed towards projects which develop technology infrastructure of national significance, build Victoria's science, engineering and technology capacity and skill base, and promote the commercialisation of research.

Specific initiatives include:

- $12.4 million for research focussed on promoting growth in Victoria's agriculture and food exports towards a target of $12 billion by 2010;
- $8.0 million to expand and improve science, engineering and technology education in schools;
- $2.1 million for development of tertiary curriculum to support the semiconductor design and manufacture industry;
- $5.0 million support for commercialising promising research through the adoption of a technology 'incubator' approach; and
- $1 million to fund magnetic resonance technology for research into brain structure and function.

Further tax relief will be provided to Victorians in this Budget totalling $89 million in 1999-2000 and $97 million on a full-year basis. The payroll tax rate will be reduced from 6 per cent to 5.75 per cent from 1 July 1999.

This will be the third consecutive year of reductions in the payroll tax rate. Victoria's new rate of 5.75 per cent compares with 6.85 per cent currently in New South Wales, and 7.0 per cent in Victoria just three years ago. As payroll tax is the biggest state tax on business, these consecutive cuts in the tax rate will provide a significant boost to employment and the economic competitiveness of Victorian businesses.

In recent years the Government has improved Victoria's infrastructure base by boosting capital spending and by securing increased private sector involvement in large projects. Notably, the Melbourne City Link will open in 1999 and significantly improve access to the City centre and key strategic and business sites.

Major new infrastructure projects with a total estimated cost of $1 357 million will commence in 1999-2000 and include:

- $129.8 million for the upgrading, redevelopment and construction of schools, TAFE and other educational facilities;

- $200.3 million for new investment in health and welfare facilities, including $19.3 million and $15.4 million for redevelopment of Royal Melbourne and Wangaratta Base Hospitals, $20 million for new medical equipment in hospitals, and $31.4 million investment in the Royal Dental Hospital;
- $175 million for the Hallam Bypass on the Princes Highway;
- $118.5 million on the Geelong Road upgrade (with the Commonwealth to be asked for matching funding);
- $255 million on the Eastern Freeway extension to Ringwood;
- $18.8 million for the Cooper Street Corridor-Epping and $48.8 million for upgrades to outer metropolitan arterial roads;
- $41.9 million new capital expenditure on police, court and prison facilities;
- $18.0 million on land management and environmental facilities;
- $162.7 million on cultural and other public works, including $91.4 million for the State Library redevelopment; and
- $41.0 million for community, sports and recreational facilities.

Importantly, all these initiatives are funded within a sound financial framework. The 1999-2000 operating surplus is forecast to be $129 million, down from a revised 1998-99 estimate of $770 million before abnormals and $6 281 million after abnormal privatisation-related receipts are included. As Box 1.1 shows the starting point surplus for 1999-2000, before consideration of new initiatives, was $600 million. The new expenditure initiatives of $383 million and tax cuts of $89 million, have reduced this surplus to $129 million.

After allowing for temporary revenue streams and non-recurring transactions and the requirement to fund capital investment, the sustainable cash surplus is projected to be $67 million in 1999-2000 and to average around $105 million over the forward estimates period. This provides a prudent buffer against future uncertainties.

Box 1.1: 1999-2000 Budget – Where does the surplus go?

($ million)

1998-99 Operating surplus after abnormals	**6 281**
Less: 1998-99 abnormal items (privatisation proceeds)	5 512
1998-99 Operating surplus before abnormals	**770**
Less: Economic and financial parameter changes between 1998-99 and 1999-2000[(a)]	170
1999-2000 starting point surplus	**600**
Less: 1999-2000 Budget spending initiatives	383
1999-2000 Budget tax relief	89
1999-2000 Operating surplus	**129**
1999-2000 Sustainable cash surplus	**67**

Source: Department of Treasury and Finance

Note:

(a) Comprises the net impact of economic and financial parameters (such as wage and price inflation, economic growth and less buoyant property and financial markets) which result in growth in departmental operating costs and a decline in operating revenue. This is partly offset by lower interest costs as a result of debt reduction.

SHARING THE GAINS – HIGH PRIORITY SERVICES

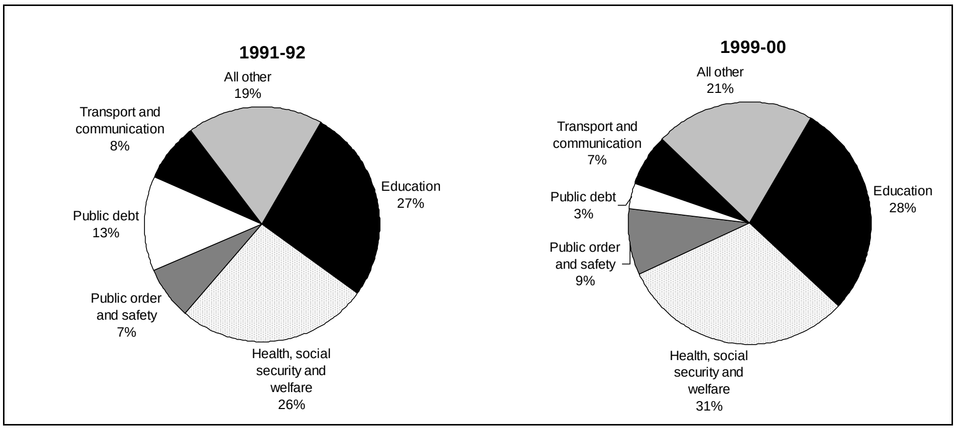
A key ingredient to the Government's vision of making Victoria a better place to live, invest and do business is to ensure that all Victorians have an opportunity to participate and share in the economic progress of the State. There are many channels through which this is occurring, including:

- the direction of state financial resources towards high priority services;
- increased job opportunities for Victorians; and
- lower prices, taxes and charges for the community as a whole.

As discussed in Chapter 2, *Budget Strategy*, the rewards from the fiscal prudence shown since the early 1990s are clearly evident in the Government's increased capacity to service the high priority needs of the community.

A key indicator of this is the sharp decline in the proportion of Victoria's budget current outlays which must be dedicated to servicing public debt, from 13.2 per cent in 1991-92 to an estimated 3.3 per cent in 1999-2000 (see Chart 1.1).

Chart 1.1: Government current outlays by purpose[(a)] – Victoria

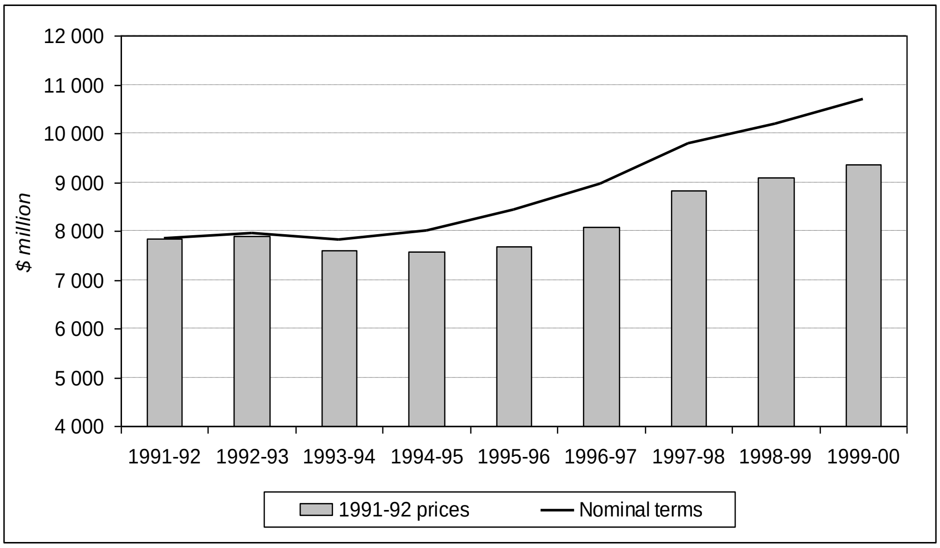


Sources: ABS Catalogue Number 5501.0; Department of Treasury and Finance

Note:
(a) General government sector. Education excludes funding for universities. Health, social security and welfare excludes funding for the Heidelberg Repatriation Centre.

As a result, government outlays in core social policy areas have increased sharply in recent years to record high levels. Chart 1.2 shows that total current outlays on education, health, social security and welfare, and law and order will rise 5.2 per cent in 1999-2000. In real terms these outlays will increase for the fifth consecutive year in 1999-2000 and will be 19.4 per cent higher than in 1991-92 (see Chapter 5, *Budget Sector Services* and Budget Paper No. 3 for details).

Chart 1.2: Current outlays on education, health, social security and welfare, and law and order [(a)]



Sources: ABS Catalogue Numbers 5501.0 and 6401.0; Department of Treasury and Finance

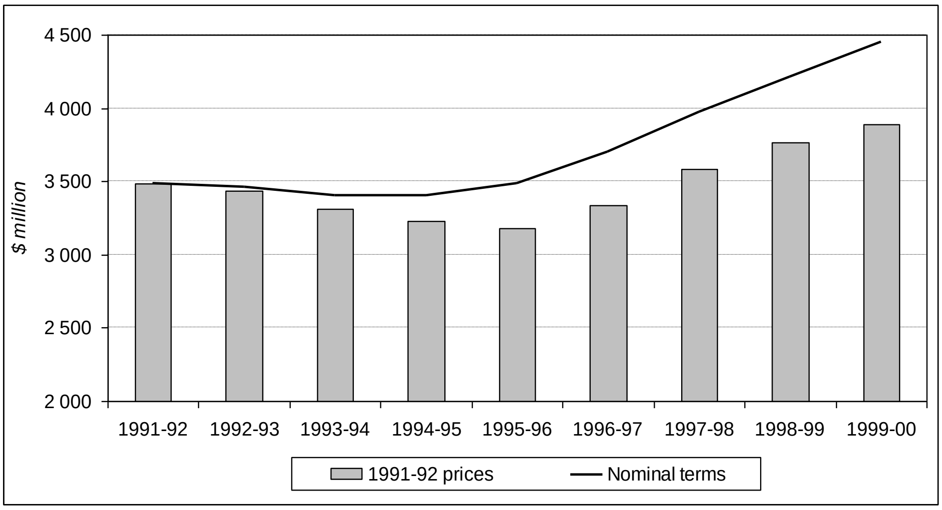
Note:
(a) General government sector current outlays (excluding funding for universities, Heidelberg Repatriation Centre and the gun buy-back scheme).

Education

Quality education remains one of the most potent investments Victorians can make for future personal fulfilment and prosperity. In particular, research indicates that strong educational outcomes in literacy and numeracy contribute significantly to employment prospects.

Current outlays on education (excluding universities) are forecast to rise 5.6 per cent to $4 446 million in 1999-2000. In real terms, this will be 11.7 per cent higher than in 1991-92 (see Chart 1.3), and compares with a slight fall in the student population of 0.3 per cent over a similar period.

Chart 1.3: Current outlays on education (excluding universities) [(a)]

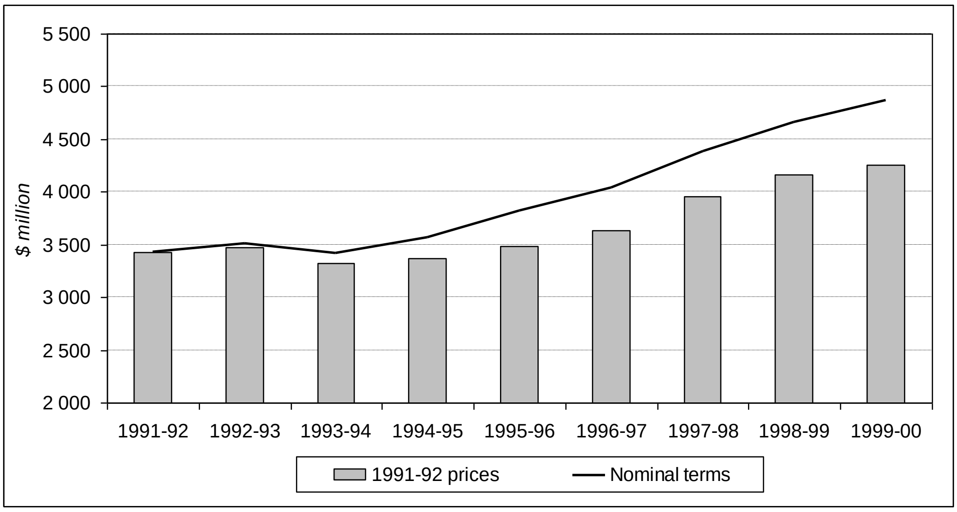


Sources: ABS Catalogue Numbers 5501.0 and 6401.0; Department of Treasury and Finance
Note:
(a) General government sector current outlays.

Health, social security and welfare

A primary goal of the Government is to improve the health and welfare services available to Victorians. To secure this objective, current outlays on health, social security and welfare are forecast to rise 4.5 per cent to $4 864 million in 1999-2000. In underlying terms the increase will be larger, around 5.4 per cent, because significant one-off expenditures on Y2K (the 'millenium bug') preparedness took place in 1998-99. In real terms, outlays on health, social security and welfare will be 24 per cent higher than in 1991-92 (see Chart 1.4).

Chart 1.4: Current outlays on health, social security and welfare (a)



Sources: ABS Catalogue Numbers 5501.0 and 6401.0; Department of Treasury and Finance

Note:
(a) General government sector current outlays (excluding funding for the Heidelberg Repatriation Centre).

Public order and safety

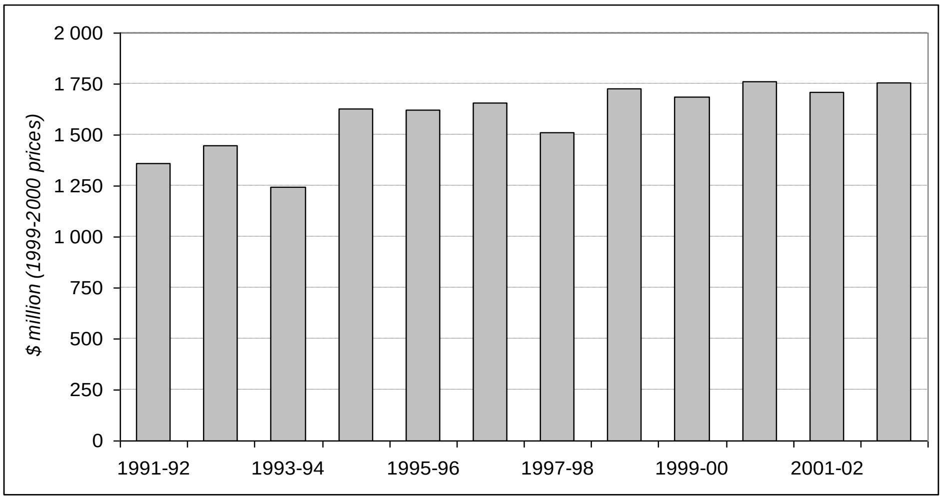
Victoria has the lowest rate of reported crimes against both property and person of all the Australian States and Territories. A strong commitment to law, order and public safety continues to be maintained. Current outlays are forecast to rise 6.5 per cent to $1 393 million in 1999-2000, with the major initiative of recruiting an additional 400 police officers over the next two years.

Social and economic infrastructure

Social and economic infrastructure is important in underpinning government service provision as well as promoting economic growth. Real *general government sector gross fixed capital expenditure* (including relevant privately financed budget-related infrastructure projects) has recovered strongly from its slump during the second half of the 1980s and early 1990s, and is expected to be 60 per cent higher in 1998-1999 than it was in 1991-92. The rebound would be even more pronounced if the $1.8 billion Melbourne City Link project were also included.

Chart 1.5 shows recent trends in real *budget-related infrastructure spending*, which is the subject of the Government's infrastructure target. This measure includes net purchase of fixed assets, capital grants to the Office of Housing and other non-budget sector agencies, expenditure on road rehabilitation and refurbishment, and expenditure on privately funded projects such as prisons and hospitals. As shown in the Chart, budget-related infrastructure investment in 1999-2000 is expected to be around 35 per cent higher in real terms than in 1993-94 and 24 per cent higher than in 1991-92 and to remain at historically high levels over the forward estimates period.

Chart 1.5: Victorian real budget-related infrastructure expenditure [(a)]



Source: Department of Treasury and Finance

Note:

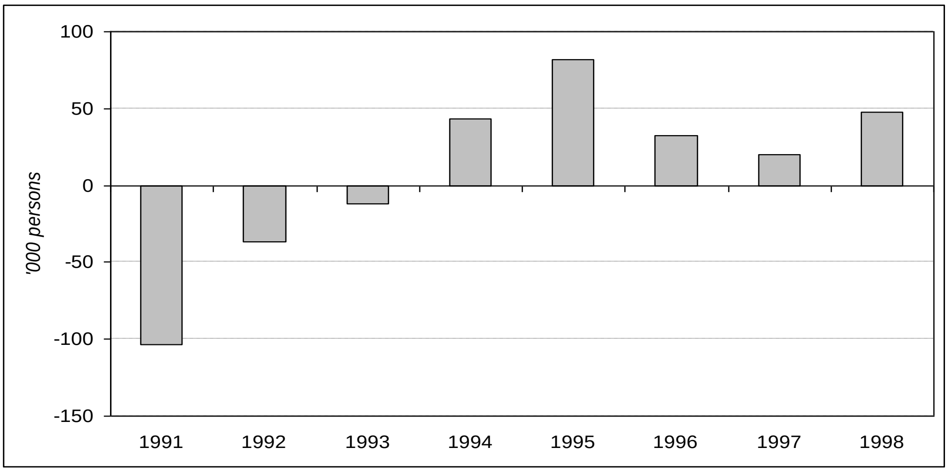
(a) *Includes net purchase of fixed assets, capital grants to the Office of Housing and other non-budget sector agencies, expenditure on road rehabilitation and refurbishment, and expenditure on those privately funded infrastructure projects which will recoup costs by charging government an annual service charge. Excludes Melbourne City Link and other projects that are user funded.*

SHARING THE GAINS — INCREASED JOBS FOR VICTORIANS

Increased job opportunities is one of the most direct ways of raising living standards, with associated benefits in many other social areas flowing to the community. The relatively strong labour market in Victoria in the past five years has greatly improved the personal circumstances of many Victorians.

Employment in Victoria reached record levels during 1998-99 and grew 1.6 per cent in the year to March 1999 (see Chapter 6, *An Economic Framework for Growth*). As a result, Victoria's unemployment rate was 7.3 per cent, an 8½-year low, and well down from its peak of 12.7 per cent during 1993. An additional 267 700 Victorians have jobs compared with February 1993. Chart 1.6 shows the annual changes in employment over the decade and highlights the turnaround in job creation since the early 1990s.

Chart 1.6: Annual change in employment — Victoria



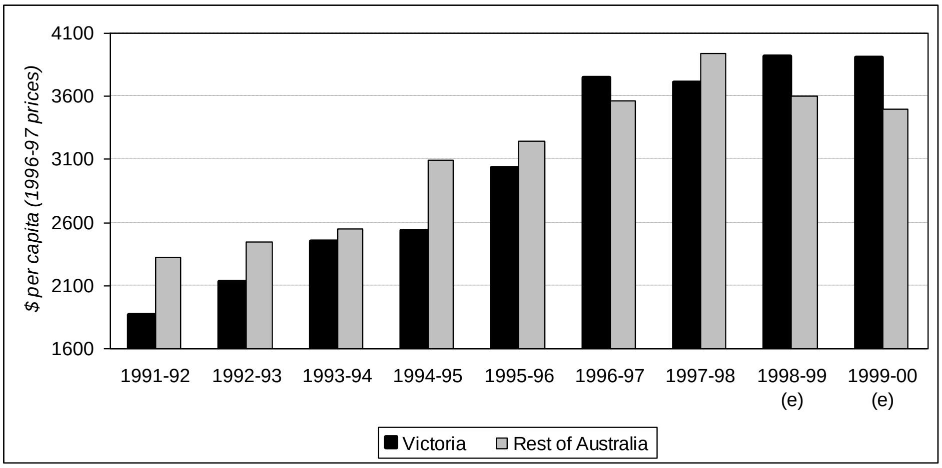
Source: Australian Bureau of Statistics, Cat. No. 6202.0

While national economic conditions have been important, the Government's policies directed at creating a world-class business environment are clearly encouraging the emergence of new opportunities for work and investment. Key evidence of the strong confidence in the Victorian economy can be seen in:

- record levels of private sector investment in the State. In 1998-99 per capita private sector investment is estimated to be more than double the level of the early 1990s and to exceed the rest of Australia by 9 per cent. Victoria's relative performance is expected to strengthen further in 1999-2000 (see Chart 1.7);
- the strongest growth in consumer spending in Australia. Retail sales in Victoria grew by 11.2 per cent in the year to February 1999 compared with 7.3 per cent nationally. Furthermore, the Westpac-Melbourne Institute index of consumer sentiment grew more strongly in Victoria in the year to March 1999 than elsewhere in Australia; and

- a massive swing in net interstate migration in Victoria's favour. Whereas the State was losing over 25 000 persons per year in the early 1990s, Victoria gained people from the rest of Australia for the first time on record in 1997-98 (see Chart 1.8).

Chart 1.7: Private business investment[(a)] — Victoria and rest of Australia



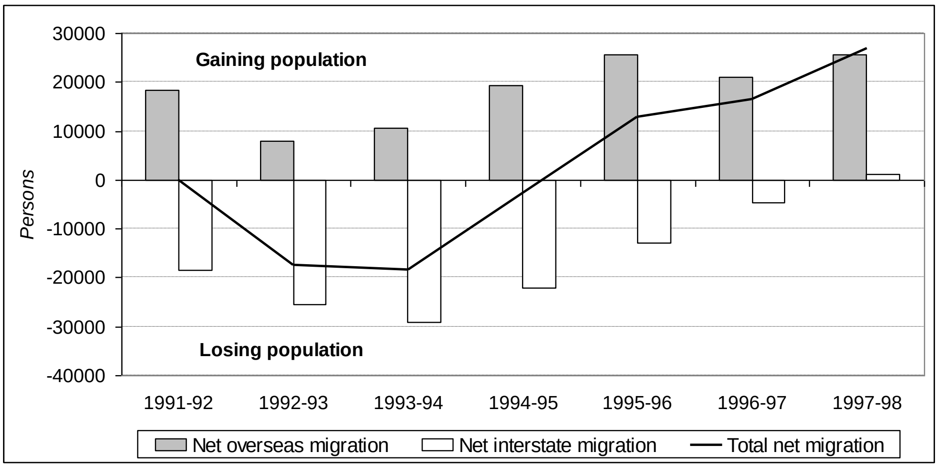
Sources: Australian Bureau of Statistics, Cat. Nos. 3101.0, 5242.0, 5646.0

Notes:

(a) Trend private gross fixed capital formation for non-residential buildings, machinery and equipment, livestock and intangible assets. Chain volume measures. Excludes major asset sales between the private and public sectors.

(e) Estimate obtained by applying five-year average realisation ratios to expected capital expenditure for the six States.

Chart 1.8: Net migration to Victoria



Source: Australian Bureau of Statistics, Cat. No. 3101.0

Victoria's general economic and employment growth are expected to remain solid over the projection period, which bodes well for job prospects and the prosperity of the community (see Chapter 6, *An Economic Framework for Growth*). In addition, the substantial fall in the payroll tax rate in recent budgets, and again in 1999-2000, will have a direct impact on job creation in Victoria as it reduces one of the most pervasive day-to-day business costs. It is estimated that the long-term impact of the cumulative cuts in payroll tax alone will be to create 18 000 new jobs in Victoria. Furthermore, programs such as this Budget's science, engineering and technology initiatives will help to position the State to take full advantage of opportunities in the high-growth and high-income sectors of the economy.

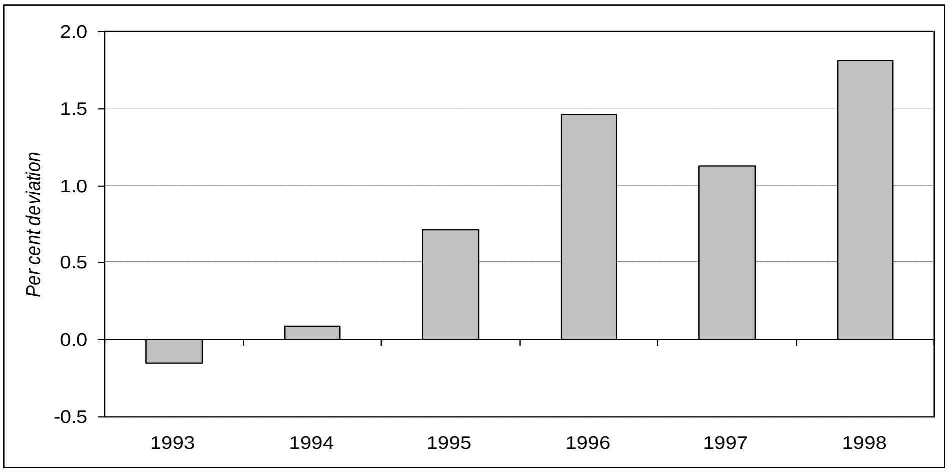
SHARING THE GAINS — LOWER PRICES, TAXES AND CHARGES FOR VICTORIANS

Victorian households and businesses are now receiving the benefits from the extensive reform program which the Government has pursued since the early 1990s. These policies and their impact are discussed in detail in Chapter 6, *An Economic Framework for Growth* and Chapter 7, *Improving the Performance of Victorian Industry and Services*. The Government has refocussed the public sector on core government functions, promoted private sector involvement, contestability and enhanced consumer choice, and improved market regulation.

As a result, the benefits to Victorians have been direct and substantial. They include significantly lower taxes, water and electricity prices, and constraints on gas prices, public transport fares and local government rates and charges.

The aggregate price effect of these reforms can be gauged by the Melbourne consumer price index (CPI) which has fallen 1.8 per cent relative to other Australian capital cities since 1992, thereby providing a real improvement in living standards for Victorians (see Chart 1.9).

Chart 1.9: CPI improvement[(a)] — Victoria versus rest of Australia



Source: Australian Bureau of Statistics, Cat No. 6401.0

Note:
(a) Per cent difference (cumulative) between CPI for weighted average of all capitals excluding Melbourne and CPI for Melbourne. Indexes rebased to 1992.

Cumulative annual tax savings to Victorian households and businesses since 1993-94 will benefit Victorians by $650 million in 1999-2000. Payroll tax has fallen $300 million, and the other tax reductions include residential and other stamp duties, land taxes and petroleum franchise fees (see Table 1.1 and Chapter 8, *Revenue and Grants*).

Table 1.1: Taxation policy measures

Year	Measure	Annual savings[b]
	($ million at 1999-2000 prices)[a]	
1993-94	Imposition of the better roads levy	-175
1994-95	Commission and tax structures on wagering simplified and tax rate on totalisators effectively reduced	76
	Land tax capping introduced	23
1995-96	State deficit levy abolished	204
	Lower cap on land tax removed	7
	Marketable securities duty for listed shares reduced	151
	Franchise fee rate for tobacco products increased	-151
	Mortgage duty exemption for re-financing business loans	1
1996-97	Rental duty halved	5
	Extension of first-home buyer and pensioner stamp duty concessions	6
	Removal of lucky envelope, bingo and raffle surcharge	6
	Mortgage duty exemption for re-financing non-business loans	1
1997-98	Payroll tax cut from 7 per cent to 6.25 per cent	106
	Petrol and diesel franchise fees cut	109
	Abolition of deed duty	1
	Land tax reforms[c]	43
1998-99	Payroll tax cut from 6.25 per cent to 6 per cent	97
	Increased thresholds for stamp duty on conveyancing	43
1999-00	Payroll tax cut from 6 per cent to 5.75 per cent	97
	Total	**650**

Source: Department of Treasury and Finance

Notes:
(a) After indexation to the Melbourne CPI.
(b) Estimated at time of announcement, unless otherwise indicated.
(c) Revised estimate.

In addition, the major non-taxation measures introduced since 1993-94 are set out in Table 1.2. These differ from the taxation measures in that, in most cases, they have been estimated relative to a hypothetical growth benchmark. In the case of electricity, gas and water measures, the savings are calculated on the assumption that charges would have otherwise grown in line with the CPI for Melbourne. For WorkCover, the savings have been estimated by allowing for growth in the total remuneration to which the relevant premiums are applied.

Table 1.2: Non-taxation policy measures

($ million at 1999-2000 prices)[(a)]

Year	*Measure*	*Annual savings*
1993-94	Water price increase on 1 July 1993[(b)]	-56
	WorkCover average premiums begin to decline from 3.0% in 1992-93 to 1.9% in 1999-2000[(c)]	543
1994-95	Electricity real price reductions commence[(d)]	280
	Gas real price reductions commence	71
	Water real price reductions commence	57
	Local government real rates decline commences following restructuring[(e)]	311
1995–96	Government port charges begin to fall[(f)]	35
1996–97	New water pricing reforms from 1 January 1998	422
	Total	**1663**

Source: Department of Treasury and Finance

Notes:

(a) After indexation to the Melbourne CPI.
(b) Upper limit of cost (precise amount difficult to quantify). Melbourne metropolitan customers only.
(c) Estimated from 1998-99 WorkCover remuneration and DTF forecast growth in remuneration for 1999-2000.
(d) Excludes savings achieved by contestable customers. Includes Winter Power Bonus which commenced in September 1998.
(e) Real decline in local government taxes on property between 1993-94 and 1997-98.
(f) Estimated full-year saving published in Budget Paper No.2 1997-98.

CHAPTER 2: BUDGET STRATEGY

- The 1999-2000 Budget service delivery and tax initiatives are funded within the Government's longstanding five-point set of budget objectives.
- In 1999-2000 a budget sector operating surplus of $129 million will fully fund infrastructure investment.
- Public sector net debt is projected to fall to only $6.1 billion by 30 June 1999, less than a fifth of its level in June 1993.
- New spending initiatives total $383 million in 1999-2000. Core spending on education, health, law and order will rise in real terms for the fifth year in a row to be 19 per cent higher than in 1991-92.
- Real spending on infrastructure is at historically high levels in 1998-99, estimated to be 60 per cent higher than in 1991-92.
- Victoria's taxation burden continues to be reduced towards the Australian average and remains lower than that of New South Wales.

LONG-TERM BUDGET OBJECTIVES

The substantial improvement in the State's financial position means that the Government can deliver the social and taxation benefits of its sound financial management to the Victorian community for the fifth budget in a row.

In response to the crisis reached in Victoria's financial position by 1992, the emphasis of budget policy in the early to mid-1990s was on the restoration of responsible financial management. Since 1992 the Government's budget strategy and associated economic, financial and management reforms have resulted in a significant turnaround in the State's budget position. Public sector net debt has been reduced by over 80 per cent and the Budget will be in a sustainable surplus position in 1999-2000 for the fifth consecutive year. The restoration of a sound financial position has contributed to, and been aided by, the improvement in the Victorian economy, as reflected in the solid economic and employment growth of recent years.

The Government uses a set of five long-term budget objectives to guide its budget strategy. These objectives, and associated medium-term operational targets, play several key roles: they guide budget formulation, reduce the possibility of financial and policy volatility that may arise from a succession of short-term targets, and allow Victorians to plan with confidence for the future.

The budget objectives and operational targets underlying the 1999-2000 Budget are set out in Box 2.1.

Box 2.1: Long-term budget objectives

Long-term objective	Medium-term operational target
Maintain a sustainable budget operating surplus sufficient to fully fund infrastructure investment	
Maintain public sector debt at levels consistent with a triple-A credit rating	Privatisation proceeds applied to reduce net debt and other liabilities
Provide quality, value-for-money services relevant to community needs	
Ensure adequate infrastructure to support service delivery and economic growth	Budget sector investment to be maintained at a minimum 1 per cent of GSP
Bring Victoria's tax rates into alignment with the national average	

The following sections provide a discussion of these budget objectives and targets, including a summary of progress to date.

SUSTAINABLE OPERATING SURPLUS

The Government's long-term objective is to maintain a sustainable budget operating surplus sufficient to fully fund infrastructure investment. This means that cash flows from operating activities must be at least sufficient to fund net additions to physical assets and other capital investment. This budget target ensures that the Government meets the cost of all resources used in the course of its operations during the year (including depreciation of capital stock) and is not required to borrow to fund its operating or normal investment expenditures.

Table 2.1 shows the outlook for the sustainable budget surplus over the forward estimates period. The operating surplus is expected to average $306 million over the four years to 2002-03. Adding back depreciation and other non-cash expenses and allowing for the cessation of one-off expenses and non-sustainable revenue streams produces the sustainable net cash flows from operating activities. These cash flows are required to finance budget-related capital investment, which rises from $966.9 million in 1999-2000 to $1 414.2 million in 2002-03, reflecting solid forecast growth in the State's infrastructure. This results in a sustainable cash surplus of $66.7 million in 1999-2000 and $105 million per annum on average over the remainder of the forward estimates period. (For more detailed information on the forward estimates and sustainable cash surplus see Chapter 3, *Budget Position and Outlook.*)

Table 2.1: Sustainable budget planning position

($ million)

	1999-00 Budget	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Operating surplus [(a)]	128.7	391.0	395.9	309.7
Add back: net non-cash expenses	1 112.5	1 146.2	1 151.3	1 211.9
Net cash flow from operating activities	**1 241.2**	**1 537.2**	**1 547.2**	**1 521.6**
Less: receipts to be discontinued	534.2	411.1	109.0	16.0
Plus: major one-off payments	326.7	106.3	- 7.4	- 7.4
Sustainable net cash flow from operating activities	**1 033.7**	**1 232.4**	**1 430.8**	**1 498.2**
Less: Sustainable budget-related investment	966.9	1 159.9	1 267.3	1 414.2
Sustainable cash surplus from operations	**66.7**	**72.5**	**163.5**	**83.9**

Source: Department of Treasury and Finance

Notes:
(a) Before abnormals.

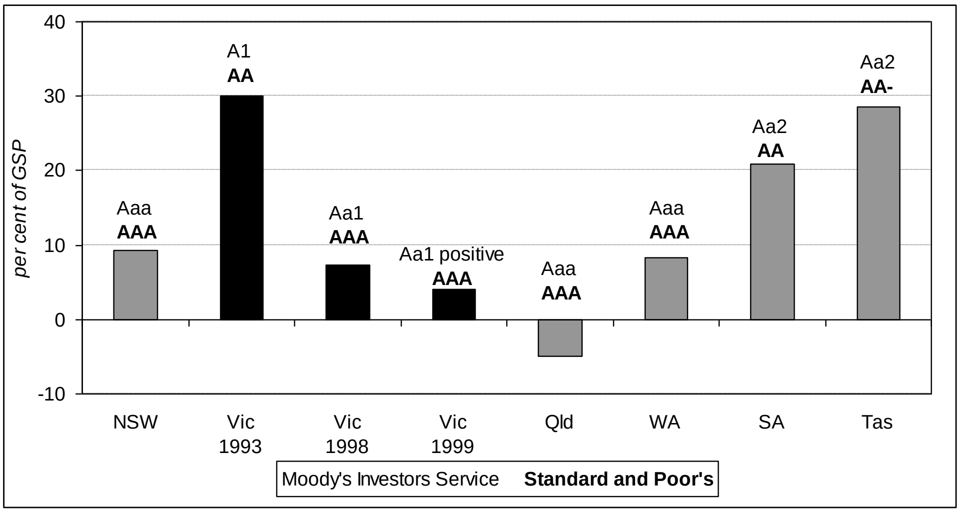
TRIPLE-A PUBLIC SECTOR DEBT

Victoria regained its AAA credit rating from the international credit ratings agency Standard and Poor's in April 1998 (shortly after the 1998-99 Budget). In March 1999 Moody's Investors Service announced that it was upgrading Victoria's Aa1 rating outlook from stable to positive.

Victoria's improved credit rating is a reflection of the significant reduction in state debt achieved by the Government. Victorian public sector net debt has fallen from $32.3 billion, or 30.0 per cent of gross state product (GSP) in June 1993, to an estimated $6.1 billion, or 4.1 per cent of GSP, by June 30 1999.

As Chart 2.1 shows, this level of debt is comparable to that of other triple-A rated States. (For more detail see Chapter 4, *Balance Sheet Management and Outlook.*)

Chart 2.1: State public sector net debt to GSP and Australian state ratings (a)



Sources: Australian Bureau of Statistics, Cat. No. 5513.0 & Cat. No. 5242.0; Department of Treasury and Finance

Note:
(a) State public sector net debt as at 30 June 1998, unless otherwise indicated.

In addition to running underlying surpluses in recent years, an important factor behind the reduction in net debt has been the use of privatisation proceeds for debt reduction. The Government is committed to ensuring that privatisation proceeds continue to be applied to reducing net debt and other liabilities.

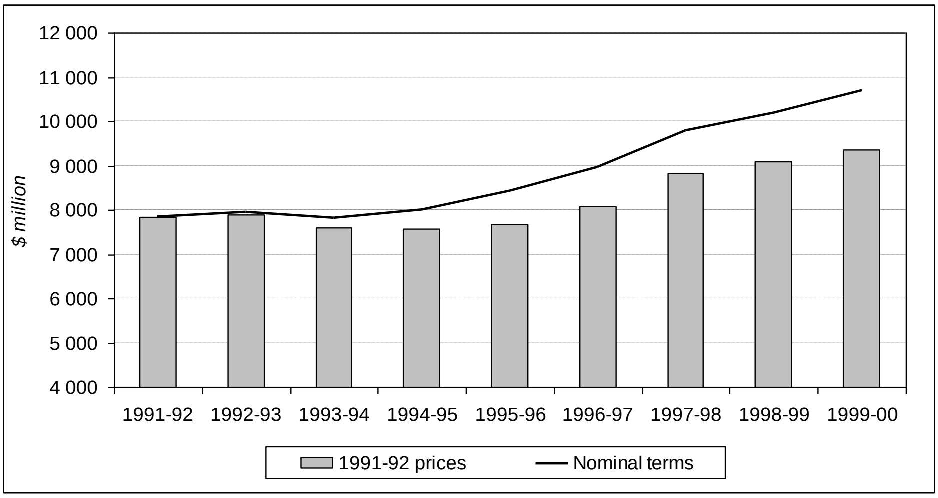
QUALITY, VALUE-FOR-MONEY SERVICE

With the State's financial position much improved and sustainable, scope exists for the Government to continue the effort of recent Budgets to direct resources towards priority service needs. In particular, with state debt substantially reduced, State finances are now in the position where the Government is able to boost service delivery in priority areas by operating with smaller, but still prudent, sustainable cash surpluses.

This, plus the further tax cuts discussed below, is effectively returning the hard-won budget surplus to the community.

Available benchmarks indicate that Victoria compares favourably with other States in the major areas of service delivery, not only because of enhanced resourcing but also due to improved service delivery efficiency. The $383 million of service delivery initiatives in the 1999-2000 Budget, will help to ensure that the Government continues to meet its objective of providing quality, value-for-money services relevant to community needs. The key spending initiatives of this year's Budget are highlighted in Chapter 1, *Overview* and discussed in more detail in Chapter 5, *Budget Sector Services* and Budget Paper No. 3. The focus of this year's spending initiatives remains on education, health and policing, together with a major new emphasis on science, engineering and technology.

Chart 2.2: Current outlays on education, health, social security and welfare, and law and order



Source: Department of Treasury and Finance

Chart 2.2 shows that current outlays in the core service areas of education, health, law and order will rise 5.2 per cent in 1999-2000. In real terms, these outlays will rise for the fifth year in a row and will be 19.4 per cent higher than in 1991-92.

INFRASTRUCTURE PROVISION

The Government's infrastructure objective is to ensure that there is adequate infrastructure to support service delivery and economic growth. This objective is unchanged from previous years, but the associated medium-term operational target has been revised.

In the 1995 Autumn Economic Statement a medium-term operational target of maintaining infrastructure spending at around 1¼ per cent of GSP was introduced for the period 1995-96 to 1998-99. The 1¼ per cent of GSP target was adopted against the backdrop of a large decline in infrastructure spending over the 1980s and early 1990s. By maintaining budget sector infrastructure spending at around the 1¼ per cent of GSP target level, there has been a significant boost in capital funding. Real general government gross fixed capital expenditure (including relevant privately financed budget sector infrastructure projects) is estimated to be at historically high levels in 1998-99, and around 60 per cent higher than in 1991-92. On a per capita basis the rise is 51 per cent. The rapid growth in public infrastructure is even more pronounced if allowance is made for other privately financed projects such as Melbourne City Link.

An operational target of a minimum 1 per cent of GSP, from 1999-2000 onwards, is now considered to be consistent with the long-term objective of ensuring that the State's infrastructure is adequate to support service delivery and economic growth. Expenditure that forms part of the target includes the net purchase of fixed assets, which are reported in the cash flow statement (see Appendix A, *Budget Sector Cash Flow Statement*) and flow through to the budget sector balance sheet.

However, a significant proportion of budget sector infrastructure expenditure does not lead to the creation of assets in the balance sheet. These expenditures, which include capital grants to the Office of Housing and other non-budget sector agencies, and expenditure on road rehabilitation and refurbishment, are therefore classified as operating expenses under accrual accounting standards. In addition, the budget sector infrastructure target takes into account estimated expenditure on privately funded projects such as prisons and hospitals (but does not include Melbourne City Link).

Table 2.2, which shows the composition of target infrastructure spending, indicates that total targeted infrastructure spending is expected to remain broadly unchanged in 1999-2000 and exhibit solid growth over the remainder of the forward estimates period.

Table 2.2: Targeted budget sector infrastructure expenditure

($ million)

	1998-99 Revised	*1999-00 Budget*	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Purchase of fixed assets	1 273.5	1 123.6	1 309.7	1 389.7	1 515.3
Less: Sale of fixed assets	118.0	132.2	121.1	93.3	76.8
Net purchase of fixed assets	1 155.5	991.4	1 188.6	1 296.3	1 438.4
Infrastructure spending classified as operating expenses [(a)]	472.8	556.9	487.0	466.6	453.6
Privately funded infrastructure [(b)]	63.3	136.0	130.0	34.1	..
Targeted budget sector infrastructure	**1 691.6**	**1 684.3**	**1 805.6**	**1 797.0**	**1 892.0**

Source: Department of Treasury and Finance

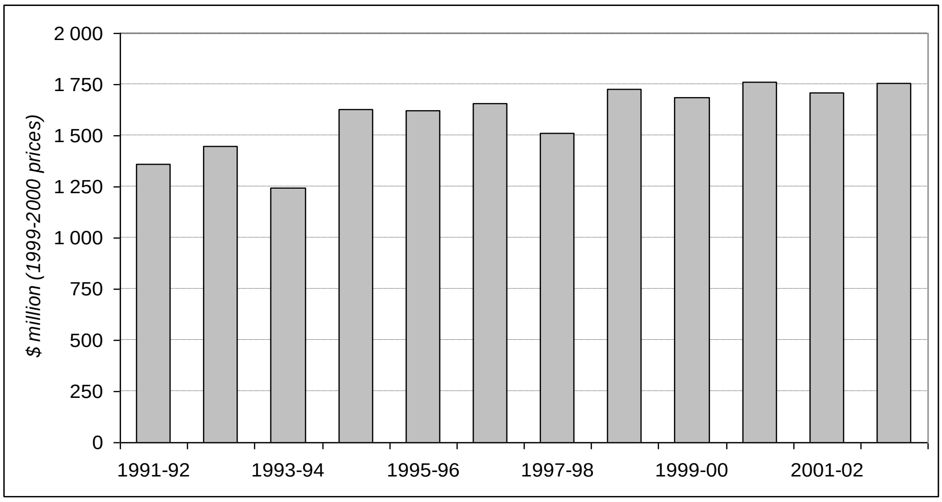
Notes:

(a) Includes capital grants to the Office of Housing and other non-budget sector agencies, and expenditure on road rehabilitation and refurbishment.

(b) Excludes Melbourne City Link.

The change to the infrastructure target reflects a number of factors. The 1¼ per cent target incorporated an implicit catch-up component to make up for previous under-investment in infrastructure. With the significant growth in budget-related infrastructure investment that has occurred since following the adoption of the target, there is no longer a need for a catch-up component. This is illustrated in Chart 2.3 which shows that budget-related infrastructure spending in 1999-2000 is expected to be 35 per cent higher in real terms than in 1993-94.

Chart 2.3: Real budget-related infrastructure expenditure (a)



Source: Department of Treasury and Finance

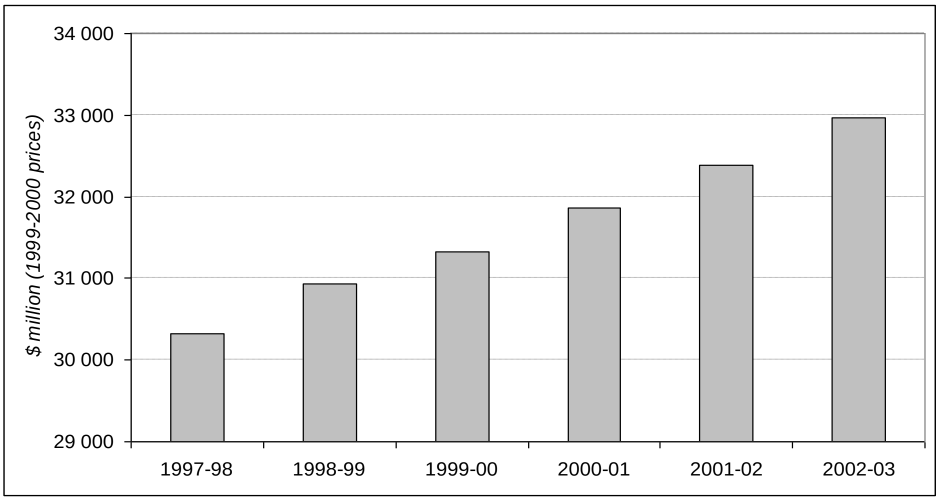
Note:

(a) Includes net purchase of fixed assets, capital grants to the Office of Housing and other non-budget sector agencies, expenditure on road rehabilitation and refurbishment, and expenditure on those privately funded infrastructure projects which will recoup costs by charging government an annual service charge. Excludes Melbourne City Link and other projects that are user funded.

Moreover, increased outsourcing of budget-related services also justifies a reduction in the target as the private provision of infrastructure reduces the level of budget-sector capital stock required to deliver any given level of services. In this context, the imminent franchising of public transport services will significantly reduce the budget sector capital expenditure requirement in relation to these services from 1999-2000.

Notwithstanding the changes to the operational target, Victoria's budget sector capital stock is projected to continue to increase by 7 per cent over the forward estimates period (about double the expected rate of population growth). This can be seen in Chart 2.4.

Chart 2.4: Real budget sector capital stock [(a)]



Sources: Financial Statements for the State of Victoria, 1997-98; Department of Treasury and Finance

Note:
(a) Budget sector capital stock augmented by Office of Housing.

REDUCED TAXATION BURDEN

The 1999-2000 Budget will be the third in a row in which the payroll tax rate has been cut. A further 0.25 percentage point reduction in the payroll tax rate to 5.75 per cent from 1 July 1999 will result in a tax cut for Victorian businesses of $97 million in a full year (see Chapter 8, *Revenue and Grants* for further details).

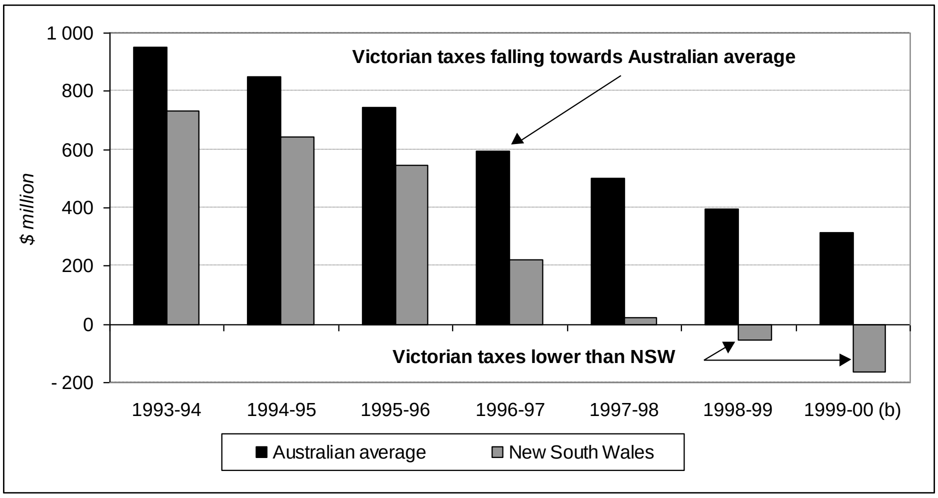
The cumulative tax savings introduced by the Government since 1993-94 now total $650 million. Payroll tax reductions over the past three years amount to $300 million, while other major initiatives include reductions in stamp duties and petroleum franchise fees. The three payroll tax reductions alone are forecast to create 18 000 new jobs over the long term.

The 1999-2000 Budget initiatives bring the Government closer to achieving its long-term budget objective of bringing Victorian tax rates into alignment with the Australian average. Chapter 8, *Revenue and Grants* examines three measures of Victoria's relative tax competitiveness: relativities assessed by the Commonwealth Grants Commission, per capita taxation revenue, and taxation revenue expressed as a percentage of GSP.

All three measures show Victoria making steady progress towards the Australian average. The analysis also shows Victoria's tax burden to be lower than that of New South Wales on the latter two measures.

Using the first measure, compiled by the Commonwealth Grants Commission, the tax burden imposed on Victorian businesses and households was the highest of all States in the early 1990s: $953 million above the national level in 1993-94 and $732 million above New South Wales. As indicated in Chart 2.5 the tax initiatives introduced in this Budget and in recent years will reduce Victoria's tax levels to $314 million above the national average. Victoria's tax burden has also fallen relative to New South Wales, to the point where in 1999-2000 it is estimated to be $164 million lower than that of New South Wales ($37 million below if New South Wales payroll taxes are reduced from 6.85 per cent to 6.4 per cent).

Chart 2.5: Victorian tax burden relative to Australian average and NSW[(a)]



Sources: Commonwealth Grants Commission Report on General Revenue Grant Relativities, 1999; Department of Treasury and Finance

Notes:

(a) Difference in tax effort, using the Commonwealth Grants Commission equalisation methodology, between Victoria and each of New South Wales and the Australian average. A positive tax effort indicates that Victoria has a higher tax burden than the other jurisdiction indicated, while a negative tax effort indicates that Victoria has a lower tax burden.

(b) Assumes no changes to taxes in other States in 1999-2000.

CHAPTER 3: BUDGET POSITION AND OUTLOOK

- The budget sector operating surplus is expected to fall to $129 million in 1999-2000.
- The sustainable cash surplus is forecast to be $67 million in 1999-2000 and average around $105 million per annum over the forward estimates period.
- The Budget incorporates the impact of significant new policy measures, including 1999-2000 service delivery initiatives and taxation relief worth $383 million and $97 million (full-year basis), respectively. In addition, new capital projects with a total estimated cost of $1 357 million will commence in 1999-2000.

The Victorian budget position has undergone a substantial turnaround since the early 1990s as a direct result of the Government's prudent financial management. The restoration of a sound financial position has enabled the Government in previous budgets to return substantial benefits to the community in the form of improvements in service delivery, taxation reductions and lower electricity, water and other charges.

The 1999-2000 Budget makes further significant headway in these areas, with new service delivery initiatives and tax cuts worth $383 million and $89 million, respectively, in the budget year (the latter costing $97 million on a full year basis).

The Victorian Government is an active supporter of the national taxation reform package agreed at the Premiers' Conference in April 1999. However, as the enabling legislation is yet to be passed by the Commonwealth Parliament, the budget and forward estimates discussed in this Chapter do not take into account the impact of implementation of the package. It should be noted that, although the proposed changes to the taxation system and Commonwealth-State financial arrangements will have a significant beneficial effect on the composition and level of state government revenues and expenses over the longer term, revenue guarantee arrangements endorsed by the Premiers' Conference mean that the taxation reform package is likely to have minimal impact on the Victorian Government's aggregate budget position over the forward estimates period. Chapter 9, *A New Era of Commonwealth-State Financial Relations* provides a detailed discussion of the national taxation reform package and its potential impact on the Victorian budget position and outlook.

Consistent with the move to accrual-based budgeting in the 1998-99 Budget, the discussion of budget and forward estimates in this chapter focuses on the projected operating statement and sustainable budget planning position. Detailed budget sector cash flow projections are presented and discussed in Appendix A, *Budget Sector Cash Flow Statement*.

1999-2000 BUDGET ESTIMATES

Table 3.1 presents the forecast 1999-2000 budget sector operating statement, incorporating a comparison with the 1998-99 revised estimates. For a detailed discussion of the 1998-99 revised estimates, including an explanation of the variation from the published 1998-99 Budget estimates, see Appendix B, *Revised 1998-99 Budget Outcome*.

The operating surplus before abnormals for 1999-2000 is forecast to be $128.7 million, or $640.8 million lower than the revised estimate for 1998-99.

The decline in the 1999-2000 operating surplus before abnormals mainly reflects the impact of the Government's major policy decisions affecting taxation revenue and operating expenses. These include additional funding to accommodate the service delivery initiatives of $382.7 million in 1999-2000 and taxation relief worth $89 million in 1999-2000. A moderate decline in underlying operating revenue (excluding the impact of the 1999-2000 tax relief) also contributes to the projected decline in the operating surplus in 1999-2000.

Table 3.1: 1999-2000 Budget operating statement

($ million)

	1998-99 Revised	*1999-00 Budget*	*Change*	*Change %*
Revenue				
Taxation [a]	8 597.9	8 691.0	93.1	1.1
Regulatory fees and fines	245.0	246.6	1.6	0.6
Public authority income [a]	955.4	646.8	- 308.6	-32.3
Current grants	7 004.6	7 155.5	150.8	2.2
Capital grants	443.9	451.2	7.2	1.6
Sales of goods and services	1 796.1	1 812.9	16.7	0.9
Net surplus from disposal of physical assets	22.8	32.0	9.2	40.4
Fair value of assets received free of charge	0.1	0.1	..	0.0
Other revenue	589.1	453.6	- 135.5	-23.0
Total revenue	**19 655.0**	**19 489.6**	**- 165.4**	**- 0.8**
Expenses				
Employee entitlements	7 116.0	7 418.9	302.9	4.3
Superannuation	1 559.7	1 437.4	- 122.3	-7.8
Depreciation	696.0	720.0	24.0	3.5
Amortisation	33.1	32.9	- 0.1	-0.4
Interest and other finance costs	697.1	532.1	- 165.0	-23.7
Current grants	2 463.8	2 608.6	144.9	5.9
Capital grants	832.2	700.7	- 131.5	-15.8
Supplies and consumables	5 487.5	5 910.2	422.7	7.7
Other	..	..	..	..
Total expenses	**18 885.4**	**19 360.9**	**475.4**	**2.5**
Operating surplus before abnormals	**769.5**	**128.7**	**- 640.8**	
Abnormal items [b]	5 511.8	..	-5 511.8	
Operating surplus after abnormals	**6 281.3**	**128.7**	**-6 152.6**	

Source: Department of Treasury and Finance

Notes:

(a) Excludes privatisation proceeds received as stamp duty and tax equivalent revenue.

(b) Includes privatisation proceeds (including proceeds received as stamp duty and tax equivalent revenue).

Total operating revenue is expected to decline by 0.8 per cent in 1999-2000. The decline in revenue in part reflects the impact of a reduction in the payroll tax rate announced in this Budget. This constrains growth in 1999-2000 taxation revenue, compared with the 1998-99 revised estimate, to 1.1 per cent. Growth in taxation revenue in 1999-2000 is also constrained by an expected slowdown in property market activity, contributing to a decline in receipts from property-related stamp duties. After allowing for the impact of the payroll tax cut, the underlying growth rate in 1999-2000 taxation revenue is 2.1 per cent and the underlying decline in total operating revenue is 0.4 per cent.

A $308.6 million decline in projected public authority income is the largest contributor to the overall decline in operating revenue in 1999-2000. The reduction in public authority income in 1999-2000 mainly reflects:

- the cessation of distributions from businesses privatised during 1998-99, including gas industry businesses, Ecogen, the Victorian Plantations Corporation and Aluvic; and
- a decline in projected dividends from the water industry and the Transport Accident Commission.

Revenue from current grants is expected to increase by only 2.2 per cent in nominal terms in 1999-2000. Allowing for projected price inflation, this represents a real increase of only 0.2 per cent. This small increase is mainly due to a decline of around $100 million in Victoria's share of the national financial assistance grants and health care grants pool due to the Premiers' Conference adoption of revised fiscal equalisation relativities recommended by the Commonwealth Grants Commission. The impact of this decision is in part offset by the commencement of the second tranche of National Competition Policy payments, which is expected to add an additional $56 million to general purpose grants to Victoria in 1999-2000.

Other revenues (which are comprised mainly of rent on Crown leases, coal and forest royalties and interest received) are projected to decline by $135.5 million in 1999-2000. This is partly attributable to a decline in interest received as a result of the application of privatisation to the reduction of the State's unfunded superannuation liability during 1998-99 (see Chapter 4, *Balance Sheet Management And Outlook*).

Budget sector operating expenses for 1999-2000 are expected to total $19 360.9 million, an increase of 2.5 per cent relative to the revised estimate for 1998-99.

Interest and other finance costs are expected to decline by $165.0 million (or 23.7 per cent) in 1999-2000, mainly reflecting the impact of additional interest savings to the Budget flowing from the application of 1998-99 privatisation proceeds to reductions in budget sector debt.

Excluding interest and finance costs, total operating expenses are expected to increase by $640.5 million or 3.5 per cent in 1999-2000. This increase reflects the combined effect of a number of changes, including:

- net additional funding totalling $372.2 million (after allowing for departmental savings of $10.5 million) for service delivery initiatives announced in this Budget;
- capital initiatives in the form of funding for projects outside the budget sector with a net impact on operating expenses of $80.8 million;
- the flow-through effect of spending initiatives announced in the 1998-99 Budget on 1999-2000 operating expenses ($38 million); and
- a 3.5 per cent (or $24 million) increase in depreciation expense, in line with projected growth in the budget sector asset base.

These increases are partly offset by:

- a reduction in superannuation expense of $122.3 million, mainly as a result of payments to the State Superannuation Fund in 1998-99 to reduce unfunded superannuation liabilities (see Chapter 4, *Balance Sheet Management and Outlook*); and
- the discontinuation of a number of one-off or non-recurring costs which are expected to boost current and capital grants in 1998-99 but do not impact on the 1999-2000 estimates. These include the final fiscal contribution payment to the Commonwealth Government ($74.4 million in 1998-99, bringing the total Victorian contribution to $387 million) and payments in relation to the termination of leasing and financing arrangements for the Monash Medical Centre ($170.0 million).

The remainder of the increase in 1999-2000 operating expenses ($492.2 million or 2.7 per cent) is broadly in line with expected growth in economy-wide price and wage inflation.

1999-2000 BUDGET INITIATIVES

The 1999-2000 Budget includes significant new service delivery initiatives and further taxation relief for Victorians. These initiatives make a further significant contribution towards the achievement of the Government's long-term budget objectives. They are also consistent with the Government's broader objective of returning to the community the social benefits that have accrued from sound financial management. Importantly, this has been achieved without compromising the Government's ongoing commitment to responsible financial management and fiscal prudence. More detailed information on these initiatives is provided in Chapter 5, *Budget Sector Services* and in Budget Paper No. 3.

Service delivery initiatives

This Budget takes into account the impact of new output initiatives totalling $382.7 million in 1999-2000. These initiatives have been partially funded by internal reviews within departments, leading to offsetting departmental revenues and savings (mainly in relation to head office or corporate infrastructure) of $10.5 million in 1999-2000, rising to $22.4 million in 2000-01. The remainder, totalling $372.2 million in 1999-2000, represents a net increase in departmental service delivery funding, of which $80 million has been allocated from the demand contingency provision built into the forward estimates.

Table 3.2: New service delivery initiatives

($ million)

Department	*1999-00 Budget*	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Education	62.6	74.9	71.9	65.1
Human Services	114.8	122.7	125.9	126.0
Infrastructure	70.7	12.7	10.7	13.7
Justice	33.1	42.0	40.2	40.2
Natural Resources and Environment	21.1	16.7	14.0	14.0
Premier and Cabinet	19.1	17.6	25.7	25.7
State Development	27.6	38.0	59.5	66.5
Treasury and Finance [(a)]	29.9	16.7	5.8	2.7
Parliament	3.8	2.3	2.4	2.5
Total	**382.7**	**343.6**	**356.1**	**356.4**

Source: Department of Treasury and Finance

Note:
(a) Net of funds recouped from privatisation proceeds.

Table 3.2 provides a summary of the 1999-2000 service delivery initiatives by department. The new service delivery initiatives focus on health, education and justice and include significant new funding over the next five years to support the Victorian Government's science, engineering and technology strategy. More detailed information on these initiatives is provided in Chapter 5, *Budget Sector Services* and in Budget Paper No. 3.

Taxation initiatives

The 1999-2000 Budget provides a further $89 million in tax relief ($97 million on a full-year basis) for Victorian business in the form of a 0.25 percentage point cut in the payroll tax rate from 6.0 per cent to 5.75 per cent. This represents the third successive annual reduction in the Victorian payroll tax rate.

As a result, the payroll tax rate facing Victorian businesses is among the lowest of all Australian States and Territories, in stark contrast to the situation prior to July 1997 when Victorian businesses faced the highest tax rate in the nation.

The reduction in the taxation burden afforded by this initiative brings to around $650 million the cumulative impact of taxation relief measures for Victorian business and households, including previous cuts in payroll tax, fuel taxes, land tax and stamp duties on conveyancing, announced by the Victorian Government since 1993-94. For further details, see Table 1.1 and Chapter 8, *Revenue and Grants*.

Investment in infrastructure

This Budget provides for the commencement in 1999-2000 of new infrastructure projects with a total estimated cost of $1 356.8 million. This includes first-year funding of $360.2 million in 1999-2000, of which $278.9 million represents funding for new budget sector asset investment projects.

The balance of the first-year expenditure ($80.8 million) represents funding for projects outside the budget sector such as capital grants for Station Pier rehabilitation, expansion of the Melbourne Sports and Aquatic Centre, development of the Geelong Water Sports Complex and various public transport infrastructure projects. Although these projects clearly improve the State's infrastructure, they do not lead to the creation of assets on the budget sector balance sheet. The associated capital grants are therefore treated as operating expenses in the budget sector operating statement.

Table 3.3 provides a summary of the 1999-2000 Budget infrastructure investment initiatives by department. Chapter 5, *Budget Sector Services* and Budget Paper No. 3 provide further details on the Government's infrastructure investment initiatives.

Table 3.3: New funding for infrastructure projects commencing in 1999-2000

($ million)

Department	*Total estimated cost*	*1999-00 Budget*	*Balance*
Education	129.8	71.0	58.8
Human Services	200.3	79.5	120.8
Infrastructure	743.3	129.0	614.3
Justice	41.9	9.6	32.3
Natural Resources and Environment[(a)]	18.0	9.7	8.3
Premier and Cabinet	162.7	33.1	129.6
State Development	41.0	16.6	24.4
Treasury and Finance	18.0	10.0	8.0
Parliament	1.8	1.7	0.1
Total	**1 356.8**	**360.2**	**996.6**

Source: Department of Treasury and Finance

Note:
(a) Total estimated cost excludes cost of ongoing projects.

FORWARD ESTIMATES 2000-01 TO 2002-03

Table 3.4 provides detail on the budget sector operating statement for the forward estimate years 2000-01 to 2002-03, using the 1999-2000 Budget estimates as the base. The forward estimates reflect the economic projections outlined in Chapter 6, *An Economic Framework for Growth.* They incorporate announced policy commitments, but exclude the effect of implementation of the proposed national taxation reform package. The forward estimates represent planning projections for future budgets based on an unchanged policy assumption.

The operating surplus before abnormals is forecast to rise from $128.7 million in 1999-2000 to $391.0 million in 2000-01, before falling to $309.7 million in 2002-03. The projected increase in the operating surplus in 2000-01 is mainly due to the cessation of a number of one-off expenses which boost 1999-2000 operating payments, and thus reduce the reported operating surplus in that year relative to the succeeding year in which the influence of these expenses is removed.

Growth in direct departmental running expenses (comprising employee entitlements, supplies and consumables, superannuation, depreciation and amortisation expenses) is expected to exceed revenue growth over the forward estimates period. However, this will be partly offset by more moderate growth in other operating expenses, including interest and finance costs and grants, resulting in only a moderate increase in total operating expenses over the forward estimates period.

Table 3.4: Budget operating statement 1999-2000 to 2002-03

($ million)

	1999-00 Budget	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Taxation	8 691.0	8 935.4	9 273.8	9 647.0
Regulatory fees and fines	246.6	238.1	199.8	200.0
Public authority income	646.8	690.9	500.0	426.4
Current grants	7 155.5	7 374.8	7 648.0	7 869.0
Capital grants	451.2	416.5	409.3	408.1
Sales of goods and services	1 812.9	1 819.0	1 833.2	1 854.0
Net surplus from disposal of physical assets	32.0	28.1	12.3	6.8
Fair value of assets received free of charge	0.1	0.1	0.1	0.1
Other revenue	453.6	460.8	458.3	458.2
Total revenue	**19 489.6**	**19 963.6**	**20 334.6**	**20 869.7**
Employee entitlements	7 418.9	7 665.4	7 884.3	8 155.7
Superannuation	1 437.4	1 558.7	1 567.7	1 655.0
Depreciation	720.0	751.2	807.0	853.2
Amortisation	32.9	28.4	30.9	30.9
Interest and other finance costs	532.1	527.8	507.2	484.4
Current grants	2 608.6	2 527.3	2 520.9	2 589.2
Capital grants	700.7	580.0	559.3	548.1
Supplies and consumables	5 910.2	5 933.8	6 061.4	6 243.4
Other	..	..	..	..
Total expenses	**19 360.9**	**19 572.6**	**19 938.7**	**20 560.0**
Operating surplus before abnormals	**128.7**	**391.0**	**395.9**	**309.7**
Abnormal items	..	..	..	..
Operating surplus after abnormals	**128.7**	**391.0**	**395.9**	**309.7**

Source: Department of Treasury and Finance

Operating revenue

Total revenue is projected to increase by 2.3 per cent per annum on average between 1999-2000 and 2002-03. This mainly reflects growth in taxation revenue, which is expected to average 3.5 per cent per annum over this period, well below projected annual average growth in nominal GSP of around 5¾ per cent.

The relatively low growth in taxation revenue is in part due to a more subdued property market outlook, which should reduce growth in conveyancing stamp duties, and an expected slowdown in the rate of growth of gambling taxes. The phasing out of electricity distribution company franchise fees by the end of 2000-01, following the introduction of full competition into electricity markets from 1 January 2001, will also constrain growth in taxation revenue over this period (for more detail see Chapter 8, *Revenue and Grants*).

The timing of further deregulation of electricity markets also explains the projected decline in regulatory fees and fines over the forward estimates period, with PowerNet licence fees expected to cease after 2000-01.

Revenue from sales of goods and services is assumed to exhibit only moderate (0.8 per cent per annum on average) growth over the forward estimates period. The impact of moderate growth in sales revenue on the budget bottom line is offset by a similar growth assumption for operating expenses related to this revenue.

Public authority income is projected to decline over the forward estimates period. The fall in revenue in 1999-2000 reflects lower distributions from the water sector and the Transport Accident Commission, as well as the cessation of income distributions from government business enterprises privatised during the 1998-99 financial year, including the Victorian Plantations Corporation, Ecogen, Aluvic and gas industry businesses. The decline in public authority revenue income over the remainder of the forward estimates period is due to the expected staged cessation of gas industry monopoly rent distributions following the expiration of existing gas supply contracts and the introduction of full competition into the gas market from 1 September 2001. Excluding non-sustainable gas sector distributions, growth in public authority revenue is expected to average 5.2 per cent per annum between 1999-2000 and 2002-03. Distributions from the metropolitan water sector and the Transport Accident Commission are expected to contribute a major proportion of this income.

Current grants are expected to grow by 3.2 per cent per annum on average between 1999-2000 and 2002-03. This reflects growth in own-purpose grants broadly in line with inflation and population and assumes more moderate growth in Commonwealth grants for on-passing. Since grants for on-passing are fully offset by matching operating expenses, this assumption has no impact on the budget bottom line.

Operating expenses

Growth in direct departmental running expenses (comprising employee entitlements, supplies and consumables, superannuation, depreciation and amortisation expenses), of around 3 per cent per annum, is broadly in line with projected economy-wide price and wage inflation.

After falling sharply in 1999-2000 and preceding years, interest and finance costs are expected to decline at a more moderate rate (3.1 per cent per annum on average) over the remainder of the forward estimates period. This reflects the expected completion of the Government's major privatisation program in 1998-99 and the forecast reduction in budget surpluses.

The small decline projected for current grants (0.2 per cent per annum on average between 1999-2000 and 2002-03) mainly reflects:

- the winding-up of the Winter Power Bonus program in 2000-01 following the introduction of full competition into retail electricity markets from 1 January 2001, resulting in a decline in associated budget sector expenditure; and
- assumed moderate growth in Commonwealth grants on-passed, which is offset by a similar assumption in relation to Commonwealth grants received.

Capital grants are also expected to decline over the forward estimates period as the capital projects currently under way and funded by these grants are completed.

SUSTAINABLE BUDGET PLANNING POSITION

The budget sector operating statement presented in this chapter takes into account all operating revenues and expenses incurred during the period (including non-cash costs such as depreciation and growth in unfunded employee superannuation obligations). It therefore reflects the full cost of resources consumed by the Government in the course of its budget sector operations during the period.

However, the operating statement does not take into account expenditure associated with funding budget sector investment in infrastructure assets and other budget sector assets. Total expenditure on budget-related capital investment, incorporating the purchase of physical infrastructure and other fixed assets, net of the proceeds from fixed asset sales and other budget-related investment returns, is expected to total $966.9 million in 1999-2000. Net budget sector asset investment expenditure is expected to grow strongly over the forward estimates period, reflecting the Government's commitment to maintain budget-related infrastructure spending at a minium 1 per cent of GSP.

One of the Government's key budget targets is to maintain an operating surplus at least sufficient to fully fund capital expenditure. The purpose of this target is to ensure that the Government is not required to borrow to fund either operating or budget-related capital investment activities. The target therefore requires that the net cash flow from operating activities (defined as the operating surplus plus net non-cash expenses) is at least sufficient to fully fund gross capital investment, including the purchase of fixed assets.

Full details on budget sector operating and investment cash flows over the forward estimates period are provided in Appendix B, *Budget Sector Cash Flow Statement*.

However, it is important to note that the forward estimates include a number of temporary revenue streams and non-recurring transactions that have a substantial impact on the budget position over the short to medium term, but do not persist over the longer term. In order to ensure responsible financial management, budget planners need to be aware of these temporary effects and focus on the underlying or sustainable budget planning position.

Table 3.5 and Chart 3.1 present the sustainable budget planning position over the forward estimates period. After removing the effects of temporary revenues and non-recurring expenditures, a small sustainable cash surplus from operations of $66.7 million is expected in 1999-2000. Apart from a temporary projected increase in 2001-02, the sustainable cash surplus is expected to remain fairly stable over the remainder of the forward estimates period and average around $105 million.

Table 3.5: Sustainable budget planning position

($ million)	1999-00 Budget	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate
Operating surplus [(a)]	128.7	391.0	395.9	309.7
Add back: Net non-cash expenses	1 112.5	1 146.2	1 151.3	1 211.9
Net cash flow from operating activities	**1 241.2**	**1 537.2**	**1 547.2**	**1 521.6**
Less : Cash receipts to be discontinued				
Gascor	362.6	303.8	89.0	0.0
PowerNet licence fee	50.0	40.0	0.0	0.0
Electricity franchise fees	101.6	47.3	0.0	0.0
Other	20.0	20.0	20.0	16.0
Total receipts to be discontinued	**534.2**	**411.1**	**109.0**	**16.0**
Add back: Major one-off or discontinuing payments				
Winter Power Bonus payments	115.2	117.3	0.0	0.0
Financial and other restructuring costs	184.1	0.0	0.0	0.0
Employee entitlements - timing effects	27.4	- 11.0	- 7.4	- 7.4
Total major one-off payments	**326.7**	**106.3**	**- 7.4**	**- 7.4**
Sustainable net cash flow from operating activities	**1 033.7**	**1 232.4**	**1 430.8**	**1 498.2**
Deduct: Net cash requirement for budget-related asset investment [(b)]				
Total budget-related asset investment	840.6	1 059.9	1 167.3	1 314.2
Add back: Non-recurring investment receipts [(c)]	126.3	100.0	100.0	100.0
Sustainable budget-related investment	**966.9**	**1 159.9**	**1 267.3**	**1 414.2**
Sustainable cash surplus from operations	**66.7**	**72.5**	**163.5**	**83.9**

Source: Department of Treasury and Finance

Notes:
(a) Before abnormals.
(b) Comprises net purchase of fixed assets and other net budget-related asset investment (excluding net proceeds from financial investment activities such as term and fixed deposits).
(c) Includes discontinuing receipts in respect of repayments of Gascor shareholder loan and interest-free advance to Office of Housing.

The projected improvement in the sustainable cash surplus in 2001-02 mainly reflects a pick-up in revenue growth expected in that year. This is mainly attributable to:

- the expected receipt of the third tranche of National Competition Payments, which is expected to add around $59 million to the State's revenue base from that year; and
- a projected acceleration in growth of conveyancing stamp duties, reflecting an expected moderate recovery in property markets.

The subsequent modest decline in the sustainable cash surplus in 2002-03 mainly reflects a combination of:

- an assumed return of revenue growth to trend levels following the increase in the revenue base in the previous year; and
- projected strong growth in budget-related capital investment expenditure, consistent with the Government's infrastructure target.

The average sustainable cash surplus around $105 million per annum over the period 2000-01 to 2002-03 represents, on an unchanged policy basis, the amount in excess of the minimum operating surplus required to meet the Government's target of an operating surplus sufficient to fully fund capital expenditure. This is lower than the $260 million average margin projected at the time of the 1998-99 Budget. The decline in projected sustainable cash surplus is mainly attributable to the impact of:

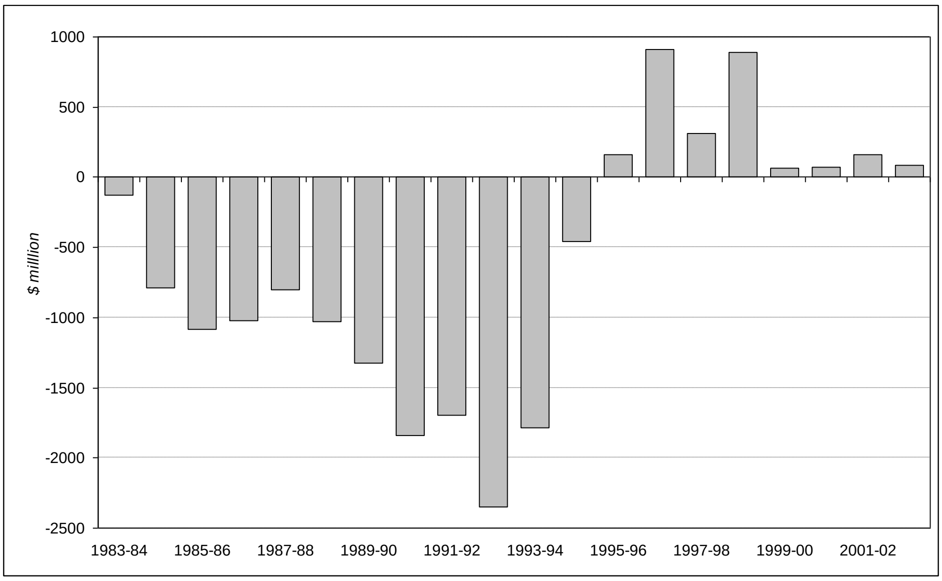
- the new taxation and service delivery initiatives announced in this Budget; and
- the decline in projected Commonwealth grants, relative to the previously published forward estimates, as a result the Premiers' Conference adoption of revised fiscal equalisation relativities recommended by the Commonwealth Grants Commission.

The reduction in the projected surplus attributable to these factors has been partly offset by:

- a reduction in projected capital expenditure (relative to the published 1998-99 Budget forward estimates) as a result of downward revision to the Government's medium-term minimum infrastructure spending target (see Chapter 2, *Budget Strategy*); and
- additional net interest savings arising from the reduction of net debt through application of privatisation proceeds received during 1998-99.

Maintaining the resulting average cash surplus of around $105 million per annum over the forward estimates period is prudent, given the uncertainties involved in preparing budget projections. For instance, the analysis in Appendix C, *Sensitivity of the Budget to Economic Conditions*, shows that if GSP growth is just one percentage point lower than expected, the Budget position would deteriorate by $53 million, thereby absorbing around half of the current cash buffer of $105 million.

Chart 3.1: Sustainable cash surplus



Source: Department of Treasury and Finance

The projected sustainable cash surplus confirms that the Victorian Budget remains in a sound and sustainable position. Furthermore, it reinforces the substantial turnaround in Victorian budget finances since the early 1990s (as illustrated in Chart 3.1) brought about by the Government's adherence to responsible financial management.

CHAPTER 4: BALANCE SHEET MANAGEMENT AND OUTLOOK

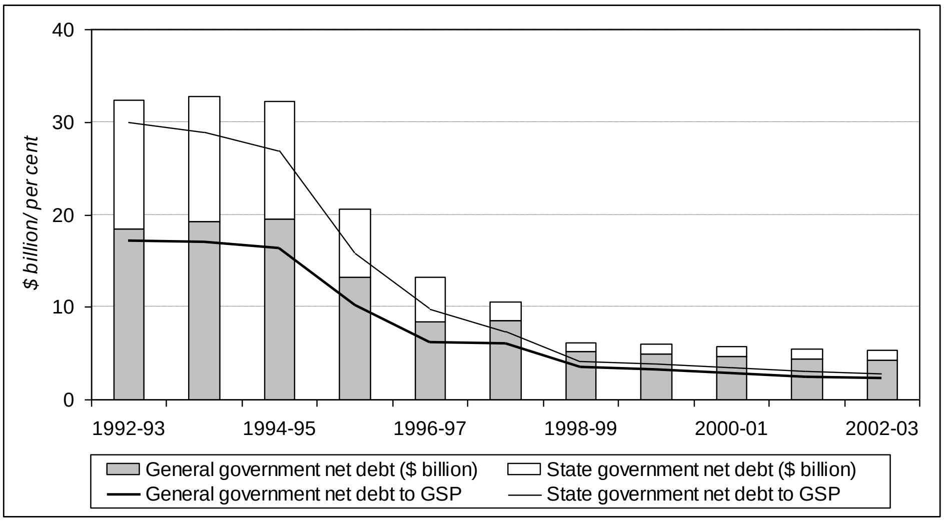
- The benefits from markedly lower levels of state debt are being manifested clearly in the State's reduced borrowing margins and a much lower interest burden on the community. In March 1999, Moody's Investors Service revised its rating outlook for Victoria from stable to positive. This follows Standard & Poor's upgrade to AAA last year, a significant milestone in the restoration of Victoria's financial reputation.
- With public sector debt substantially reduced, $2.5 billion of privatisation proceeds have been allocated to the State Superannuation Fund to reduce the State's unfunded superannuation liability.
- The introduction of accrual output-based budgeting has provided a framework for the budget sector and government businesses to intensify the focus on balance sheet management. A consolidated budget sector balance sheet is presented here for the first time.
- The net asset position of the budget sector is projected to increase steadily over the forward estimates period, reflecting strong growth in non-current physical assets and a continued decline in budget sector debt.
- To improve the management of state assets, an integrated set of management and investment evaluation policies has been implemented. Asset management reforms include decentralised accountabilities, capital charging and performance measurement.

STATE GOVERNMENT (NON-FINANCIAL PUBLIC SECTOR) NET DEBT

The Government's operational budget target is to use privatisation proceeds to reduce net debt and other liabilities consistent with the Government's long-term budget objective to maintain state government debt at triple-A levels.

Victoria's public sector net debt has declined by more than 80 per cent, from $32.3 billion as at June 1993 to an estimated $6.1 billion as at 30 June 1999 (see Chart 4.1 and Table 4.1). As a consequence, the Government has achieved its objective of regaining triple-A status for Victoria (see Box 4.1).

Chart 4.1: Public sector net debt[(a)]



Source: Department of Treasury and Finance

Note:

(a) State government net debt equals general government net debt plus public trading enterprises net debt, less intersectoral advances. As public trading enterprise forecasts are not available for the forward estimates period, the data for this sector have been held constant from the year 1999-2000.

The majority of the reduction in public sector net debt during 1998-99 occurred in the general government sector (see Appendix D, for details on classification coverage of various state government agencies). General government net debt is expected to fall from $8.5 billion as at 30 June 1998 to an estimated $5.2 billion by 30 June 1999 (see Chart 4.1 and Table 4.1).

Table 4.1: Victorian net debt and net debt to GSP

	1997-98 Actual	*1998-99 Revised*	*1999-00 Budget*	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
			$ billion			
State government net debt	10.5	6.1	6.1	5.7	5.5	5.4
General government net debt	8.5	5.2	5.0	4.6	4.4	4.3
			per cent			
State government net debt to GSP	7.3	4.1	3.8	3.4	3.1	2.9
General government net debt to GSP	6.0	3.5	3.1	2.8	2.5	2.3

Source: Department of Treasury and Finance

Box 4.1: The benefits of Victoria's financial strategy — a triple-A credit rating

Victoria has now achieved the Government's budget objective of restoring the State's triple-A credit rating.

On 22 April 1998, Victoria's long-term local currency rating was upgraded to AAA by the ratings agency Standard & Poor's (S&P). S&P cited "the moderate and still falling level of Victorian Government's debt burden, the very strong position of its ongoing finances, and the State's broad economic base, which should be durable and diverse enough to cope with the impact of the east Asian economic crisis without undue stress" as the main reasons for the upgrade. To date, only two jurisdictions worldwide have ever regained a lost AAA rating from S&P.

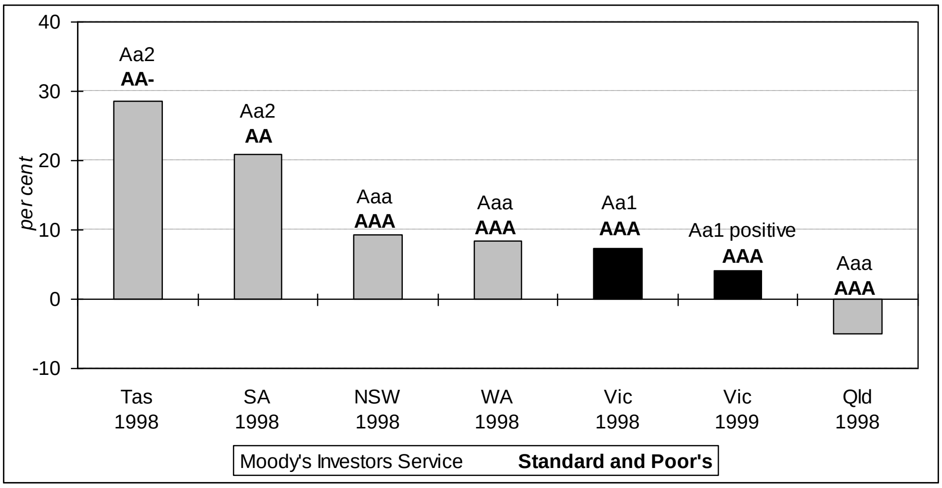
On 1 March 1999, Moody's Investors Service (Moody's) announced that it had revised its ratings outlook on Victoria's domestic currency credit rating from stable to positive. Moody's stated that the "change in outlook reflects the positive trends in the State's fiscal and debt profile".

Interstate comparison

Victoria's public sector net debt and debt servicing ratios are now substantially ahead of other triple-A rated Australian States. Victoria has realised the benefit of its lower debt and interest burden in the form of higher credit ratings and reduced borrowing costs (see Box 4.1 and Box 4.2).

Chart 4.2 compares Victoria's current rating status and net debt to gross state product (GSP) position as at 30 June 1998 with other Australian states, and also shows the improvement in Victoria's ratio of net debt to GSP between 30 June 1998 and 30 June 1999. The ratio of public sector net debt to GSP is forecast to fall from 7.3 per cent at 30 June 1998, to an estimated 4.1 per cent as at 30 June 1999 (see Table 4.1). This ratio is now substantially below those of Western Australia and New South Wales, last reported at 30 June 1998 at 8.4 per cent and 9.3 per cent respectively.

Chart 4.2: Comparison of public sector net debt to GSP and current Australian state ratings, as at 30 June



Sources: Australian Bureau of Statistics, Cat. No. 5513.0 & Cat. No. 5242.0; Department of Treasury and Finance

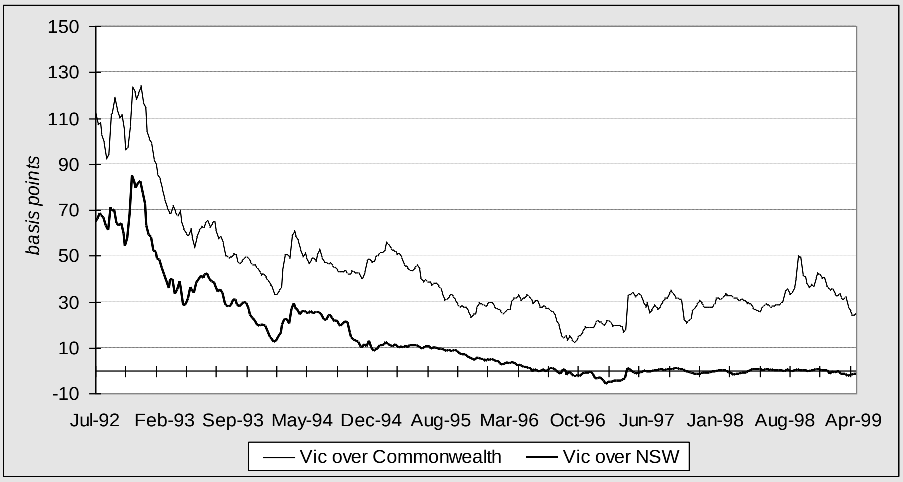
Box 4.2: Lower borrowing margins

One of the benefits of Victoria's lower debt levels has been lower borrowing margins on the cost of debt. This is best demonstrated by comparing the margin between the yields of Victorian ten-year bonds and those of the Commonwealth and New South Wales.

As can be seen in the Chart below, Victoria's borrowing margin peaked in November 1992, at 124 basis points and 85 basis points above the Commonwealth and New South Wales ten-year bond rates respectively. At that time Victoria was rated A1 by Moody's Investors Service and AA (negative outlook) by Standard & Poor's. With the exception of the December quarter 1998, Treasury Corporation of Victoria (TCV) has generally maintained Victoria's borrowing margins in a stable range of 20 to 35 basis points over Commonwealth ten-year bonds, and roughly zero against New South Wales ten-year bonds, since June 1997.

The increased spread to Commonwealth in October 1998 was a result of the Asian economic crisis and the associated global 'flight to quality', i.e. investor selling of non-sovereign securities which adversely affected Victorian and other state government guaranteed borrowers.

Victorian borrowing margins over Commonwealth and New South Wales ten-year bonds, weekly averages



Source: Treasury Corporation of Victoria

BALANCE SHEET MANAGEMENT AND POLICY ISSUES

Asset management and strategy

Impact of management reform

The principles driving asset management policies within the public sector are based on the Government's Management Reform Program. The asset management initiatives in 1999-2000 demonstrate the Government's continuing commitment to implementing a strategy that links asset management with service delivery needs. To achieve this, management practices are being directed towards:

- improving accountability for asset management;
- ensuring that the risks, benefits and costs of assets are evaluated over their entire life; and
- providing relevant and reliable information for decision-making.

The specific initiatives to give effect to these reforms are discussed below.

Specific asset initiatives

Valuation framework

An asset valuation framework is being developed to ensure that assets are assigned values that provide meaningful signals for pricing, investment and stewardship decisions. Decisions about the pricing of a service, or whether a service should be provided by government or outsourced, require a valuation framework that recognises the opportunity cost associated with the asset.

Risk management

Risk management in departments is improving as risk management strategies are implemented. Independent risk assessors have reviewed departmental risk management and concluded that it has reached a satisfactory standard. Further improvements are expected.

Regular monitoring and assessment

All departments have implemented an asset monitoring regime. In 1998-99, the Capital Assets Charge was introduced to ensure that output prices include the opportunity cost of capital. Incorporating the cost of capital into the price of outputs is fundamental to determining the full cost of outputs and to benchmark the costs of services against other providers, and is consistent with National

Competition Policy. The Capital Assets Charge is the first step towards the implementation of a capital charge regime based on the net assets of departments and agencies.

Maintenance evaluation

As part of an ongoing initiative, in 1999-2000 further consideration will be given to improving systems and processes for managing the maintenance of long-lived assets, such as infrastructure.

Redeployment, disposal and decommissioning

Beginning in 1999-2000, some departments will exercise the opportunity to retain the net proceeds from asset sales. This flexibility offers departments incentives to improve their asset stock to better meet service commitments, and adds to their sense of stewardship over assets under their control. Proposals for the disposal of assets and the redirection of funds introduce to departments a capacity to manage balance sheets at a local level. However, any decisions to increase the capital invested in a department are made in the context of the state budget.

Liability management and strategy

Budget sector debt

Management of the budget sector debt portfolio continues to be based on the key objectives of achieving relative certainty of interest costs, while minimising net borrowing costs and refinancing risk, and conservatively managing the financial and operational risks of the budget sector treasury operations. To achieve these policy objectives, budget sector debt management activities are focussed on increasing the flexibility and lengthening the maturity of the funding facilities provided by TCV.

The policy focus on liability reduction has locked in a lower sustainable level of debt for the future.

State superannuation administration

The Victorian Superannuation Board is responsible for the administration of the defined benefit schemes of the (now-closed) State Superannuation Fund, as well as the Victorian Superannuation Fund which is an accumulation scheme.

The policies, strategies and systems required to administer the Victorian Superannuation Fund, which has experienced high membership growth, are very different from those required to administer the contracting and more complex

State Superannuation Fund. As a result, separate administrators for each fund will be established from 1 July 1999.

The Victorian Government's policy for superannuation administration reform includes the transfer of public sector funds to Commonwealth supervision when fully funded. Direct government involvement in the fund is limited to paying employer contributions, as is the case with all other sponsoring employers. This policy reduces duplication of supervisory and legislative activity in an area where the Commonwealth has primary responsibility. The transfer also removes state-imposed competition and service delivery constraints, and provides important marketing opportunities in a choice-of-funds environment. Over the past twelve months the Local Authorities Superannuation Fund and the Hospital Superannuation Fund have been transferred to Commonwealth supervision.

The decision to establish separate administrators will allow the Victorian Superannuation Fund to be transferred to Commonwealth supervision from 1 July 1999. The State Superannuation Fund, will be administered by a new agency, the Government Superannuation Office. There will be no changes to existing rights and entitlements of members of either the State Superannuation Fund or the Victorian Superannuation Fund. The State bears an on-going financial liability of around $12.3 billion as at 30 June 1999, following the allocation in this budget of $2.5 billion of privatisation proceeds to the State Superannuation Fund.

The Government Superannuation Office will concentrate on the complex issues and services required by the members of the State Superannuation Fund, without the need to administer the Victorian Superannuation Fund. The Government Superannuation Office will also be able to focus on the management of the unfunded liability associated with the defined benefits schemes and ensure that returns are maximised and the risk exposure of the underwriter, i.e. the Victorian taxpayer, is minimised.

The administrative operations and activities of the Government Superannuation Office will be subjected to a contestability review and tendered to the most efficient provider within two years of establishment.

BUDGET SECTOR BALANCE SHEET

The focus of this chapter now turns to the budget sector balance sheet. Table 4.2 presents the budget sector statement of financial position for the years 1997-98 through to the end of the forward estimates period.

Budget sector net assets

The statement of financial position shows an increase in budget sector net assets from $2 820 million as at June 1998 to $10 319 million as at June 2003. The projected improvement in the net asset position is largely attributable to growth in budget sector assets, particularly non-current physical assets, combined with a significant reduction in debt and unfunded superannuation liabilities due to the large operating surplus in 1998-99, sourced mainly from privatisation proceeds. Net assets are projected to continue to increase over the period to June 2003 but at a more moderate rate, in line with the projected operating surpluses.

Budget sector assets

Growth in total assets is expected to average 1.0 per cent per annum between 1998-99 and 2002-03, due principally to expected growth in non-current physical assets. This is consistent with the Government's objective of ensuring adequate infrastructure to support service delivery and economic growth.

It should be noted that due to the increasing trend for the private sector to provide public infrastructure, in exchange for annual charges paid by government or users, the stock of all types of assets and infrastructure in public use is likely to grow by more than the above 1.0 per cent per annum. The most significant example is the Melbourne City Link project, which is privately owned and operated (and therefore outside the budget sector) but significantly adds to the stock of Victoria's infrastructure. Another example is the initiative in 1998-99 to implement the Mobile Data Network that will provide for the prompt and accurate dispatching of field resources of emergency services organisations.

Table 4.2: Budget sector statement of financial position[(a)]

($ million)

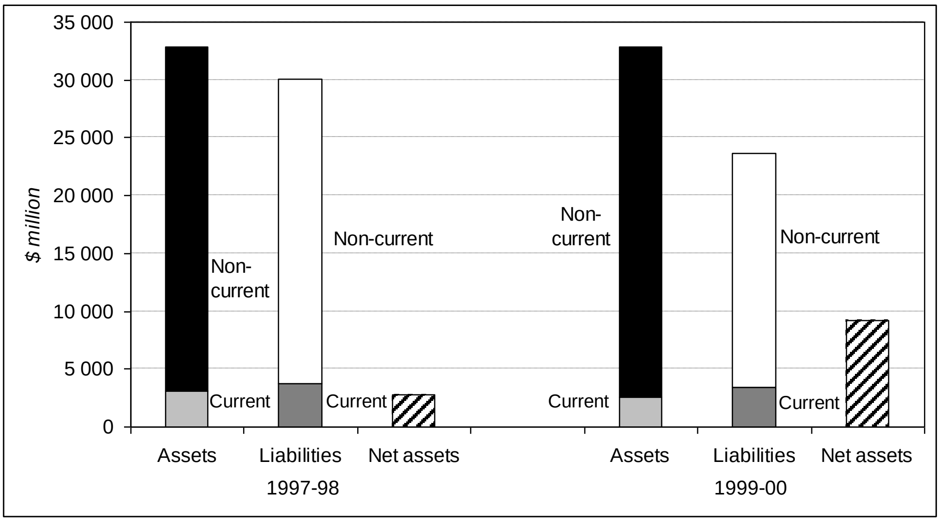
	1997-98 Actual	1998-99 Revised	1999-00 Budget	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate
Current assets						
Cash and deposits	919.2	844.9	846.2	865.1	882.3	906.9
Investments	1 253.6	942.3	891.9	863.6	835.4	811.4
Receivables	760.6	726.6	648.8	629.8	631.5	631.7
Prepayments	54.1	54.1	54.1	54.1	54.1	54.1
Inventories	117.4	117.4	118.4	118.6	119.0	119.6
Other	8.0	8.0	8.0	8.0	8.0	8.0
Total current assets	**3 112.9**	**2 693.3**	**2 567.4**	**2 539.2**	**2 530.2**	**2 531.6**
Non current assets						
Investments	440.8	430.8	430.8	430.8	430.2	430.2
Receivables	624.3	525.4	423.8	323.7	223.6	123.5
Physical assets and other [(b)]	28 725.0	29 174.3	29 444.9	29 882.1	30 353.0	30 914.2
Total non current assets	**29 790.1**	**30 130.6**	**30 299.5**	**30 636.6**	**31 006.7**	**31 467.9**
Total assets	**32 903.0**	**32 823.8**	**32 866.9**	**33 175.8**	**33 537.0**	**33 999.5**
Current liabilities:						
Payables	960.2	921.3	941.8	961.4	980.6	999.3
Borrowings	974.5	947.3	946.7	946.1	945.6	945.0
Employee entitlements	734.6	649.0	623.1	633.2	640.9	648.5
Superannuation	891.7	665.1	724.1	774.1	827.1	875.1
Other	230.9	171.4	170.6	169.8	169.0	168.2
Total current liabilities	**3 792.1**	**3 354.1**	**3 406.3**	**3 484.6**	**3 563.1**	**3 636.1**
Non current liabilities						
Payables	722.7	664.9	649.4	642.5	635.6	628.7
Borrowings	10 241.5	6 509.2	6 117.4	5 666.8	5 311.5	5 136.3
Employee entitlements	1 332.6	1 492.0	1 651.1	1 813.4	1 978.2	2 143.0
Superannuation	13 893.5	11 603.5	11 719.5	11 860.5	11 950.5	12 053.5
Other	100.7	106.7	100.7	94.7	88.7	82.8
Total non current liabilities	**26 291.0**	**20 376.4**	**20 238.2**	**20 077.9**	**19 964.6**	**20 044.4**
Total liabilities	**30 083.0**	**23 730.5**	**23 644.6**	**23 562.5**	**23 527.6**	**23 680.4**
Net assets	**2 820.0**	**9 093.3**	**9 222.3**	**9 613.4**	**10 009.3**	**10 319.1**

Source: Department of Treasury and Finance

Notes:
(a) As at 30 June.
(b) Includes, land, buildings, plant and equipment, road and other infrastructure, museum collections and other cultural assets, and intangibles.

Chart 4.3 shows the composition of the budget sector balance sheet for 1997-98 and the budget year 1999-2000. The growth in net assets and the large decline in non-current liabilities can be seen across the two years shown in the Chart.

Chart 4.3 Composition of the budget sector balance sheet



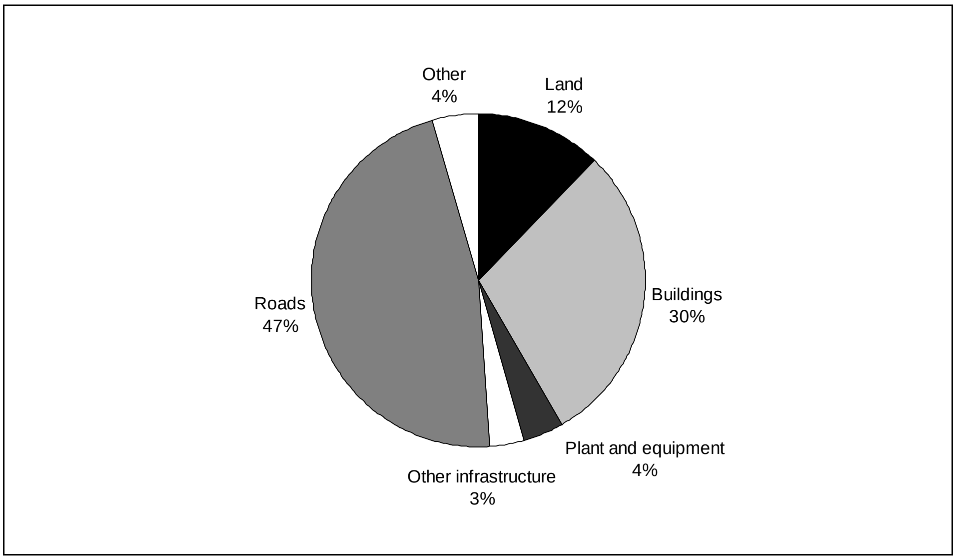
Source: Department of Treasury and Finance

Non-current physical assets

Non-current physical assets are estimated at 90 per cent of total assets as at 30 June 2000 and represent the most significant class of the budget sector's assets. Chart 4.4 shows the composition of non-current physical assets at 30 June 2000, with roads accounting for 47 per cent of these assets.

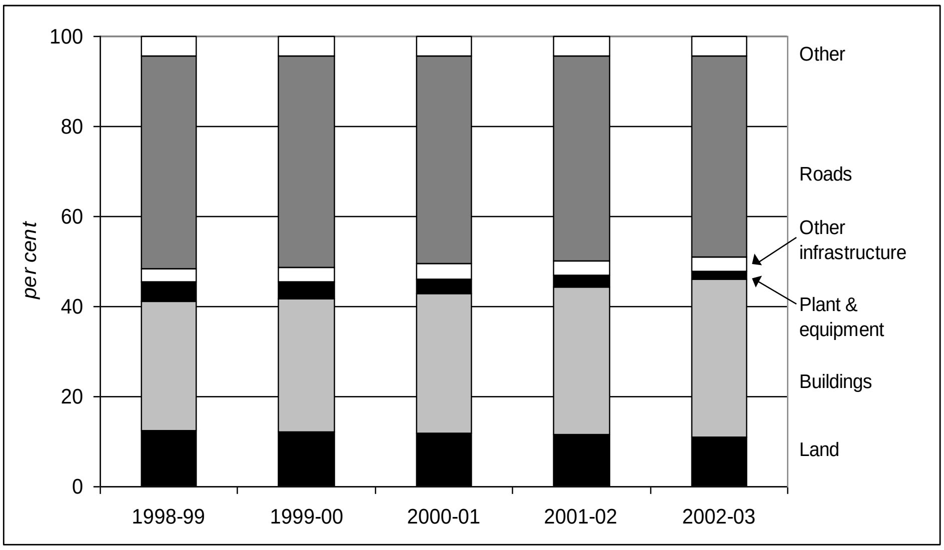
Chart 4.5 shows the expected movement in major classes of non-current physical assets between 1998-99 and 2002-03. The profile of non-current physical assets is expected to remain relatively constant.

Chart 4.4: Composition of budget sector non-current physical assets as at June 2000



Source: Department of Treasury and Finance

Chart 4.5: Expected non-current physical assets profile



Source: Department of Treasury and Finance

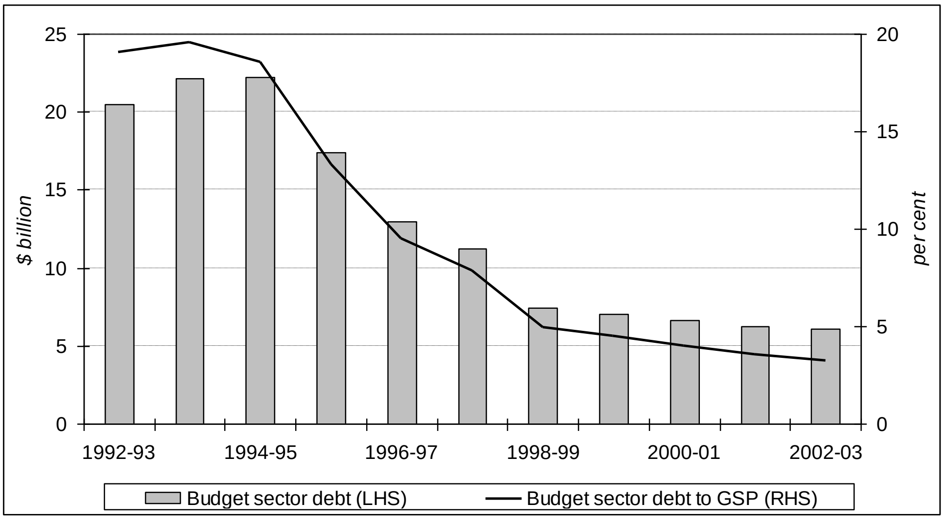
Budget sector liabilities

The main components of the budget sector's liabilities are debt and unfunded superannuation associated with the defined benefit schemes of the State Superannuation Fund. In contrast to total assets, total budget sector liabilities are forecast to decline by $6 403 million over the period June 1998 to June 2003, primarily due to the repayment of debt and reduction in unfunded superannuation liabilities from budget surpluses, including privatisations (most notably during 1998-99).

Budget sector gross debt

The focus on reducing the budget sector's debt through the use of privatisation proceeds and budget sector surpluses has resulted in a significant fall in budget sector (gross) debt from a peak of $22.2 billion as at 30 June 1995 to an estimated $7.5 billion as at 30 June 1999 (see Table 4.2 and Chart 4.6). Budget sector debt per person has fallen from $4 917 as at 30 June 1995 to an estimated $1 584 per person as at 30 June 1999.

Chart 4.6: Budget sector gross debt



Source: Department of Treasury and Finance

Over the forward estimates period, budget sector debt is expected to decline at a more moderate rate. This reflects the assumption in the forward estimates projections of no further privatisation proceeds and the projected decline, relative to recent years, in the budget sector cash surplus, as discussed in Chapter 3, *Budget Position and Outlook*. Budget sector borrowings are forecast to stabilise at around $6 100 million or $1 252 per person.

Impact of privatisations on budget sector liabilities

The Government's current financial policy requires privatisation proceeds to be allocated to the reduction of the State's net debt and other liabilities in pursuit of its long-term budget objective of maintaining public sector debt at levels consistent with a triple-A credit rating.

In 1998-99, cash proceeds received from the sale of Aluvic, Victorian Plantations Corporation, Westar/Kinetik, Multinet/Ikon, Stratus/Energy 21, V/Line Freight and Ecogen, totalled $6 759 million. Of this amount, $1 274 million has been used to repay the debt of the privatised entities provided by TCV; $3 124 million has been used to repay budget sector debt provided by TCV and the Commonwealth; $101 million has been used for the novation of the Aluvic foreign exchange book; and $105 million has been used to offset privatisation and reform expenses.

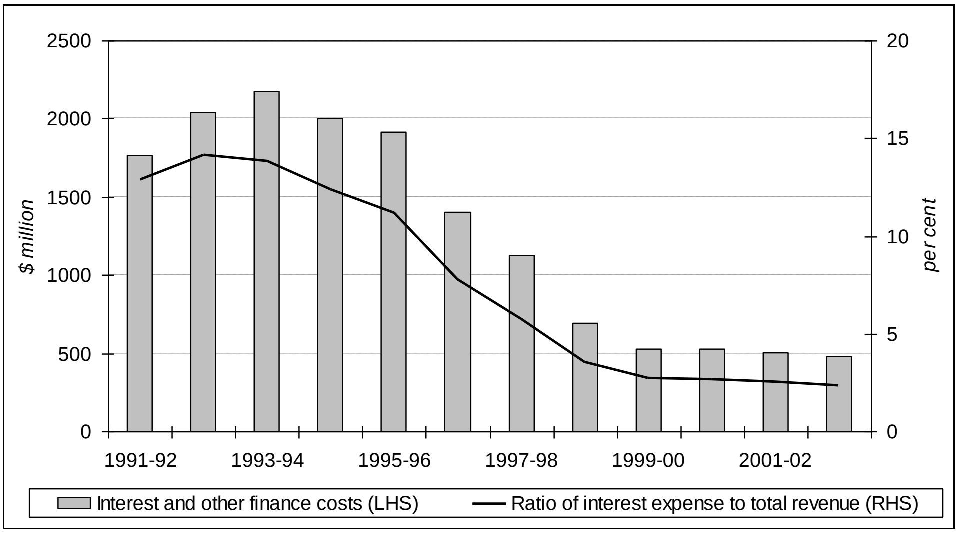
The remaining proceeds of $2 154 million combined with the November 1997 proceeds from the sale of Southern Hydro (a total of $2 538 million) have been allocated to reducing the State's unfunded superannuation liabilities.

Impact of debt reduction on budget sector interest burden

The reduction in budget sector debt directly impacts on the ongoing costs incurred by the Government and the flexibility of future budgets.

As a result of the significant debt reductions achieved, Victoria's interest burden has continued to fall. In addition, the lower debt levels and improved credit ratings have also reduced TCV's borrowing margins (see details above). Budget sector interest and finance costs are forecast to be $532.1 million in 1999-2000, and projected to absorb just 2.7 per cent of total revenue for that year, well down on the peak of 14.1 per cent of total revenue for the 1992-93 year (see Chart 4.7).

Chart 4.7: Budget sector interest and finance costs



Source: Department of Treasury and Finance

Superannuation liabilities

The unfunded liability of Victoria's superannuation schemes represents the present value of future benefits that its members have accrued during past service which are not covered by fund assets. Unfunded liabilities have arisen in Victoria's defined benefit superannuation schemes because the State's share of superannuation costs were not contributed as benefits accrued, but only when a benefit was actually paid.

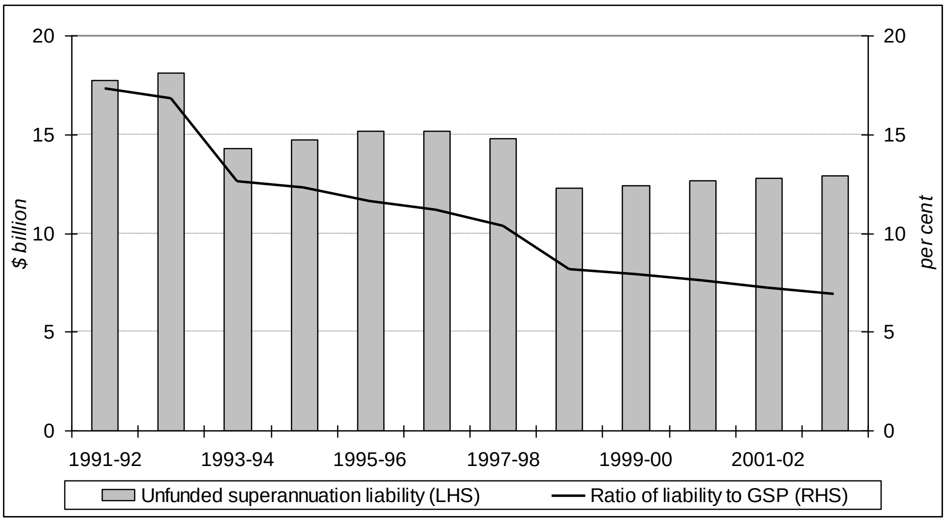
From November 1995, budget sector departments and agencies assumed responsibility for meeting the accruing superannuation cost through payments from their annual budget. The costs of prior service, however, remain the responsibility of the State and consequently appear on the budget sector's balance sheet. The prior service costs are currently funded via an annual 'top-up' payment that is based on the level of benefit payments that are expected to be made each year.

The superannuation liabilities reported in the budget sector's balance sheet exclude the Commonwealth's share of unfunded superannuation liabilities reported by universities. The Commonwealth is responsible for funding the majority of superannuation liabilities associated with universities. During a further review of the cost-sharing arrangements between the Commonwealth and the State, the Commonwealth has agreed to increase its share of funding. This resulted in the transfer of a further $40 million of unfunded liabilities to the Commonwealth during 1998-99.

On the assumption that costs will continue to be funded only as they crystallise as emerging benefit payments, the unfunded liability associated with state defined benefit schemes is expected to grow on a nominal basis over the forward estimates period to approximately $13.0 billion by 30 June 2003, an average annual rate of 1.3 per cent. However, this growth will be less rapid than the expected growth in GSP as shown in Chart 4.8.

The significant fall in unfunded superannuation liabilities in 1998-99 reflects the application of privatisation proceeds of $2 538 million.

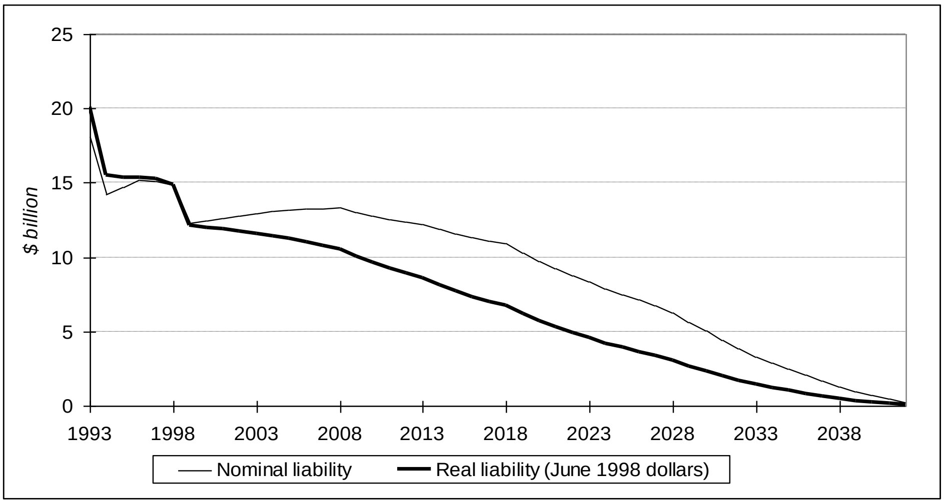
Chart 4.8: Unfunded superannuation liabilities



Source: Department of Treasury and Finance

Chart 4.9 shows that, on an unchanged policy basis, the level of unfunded superannuation liabilities measured in real terms (June 1998 dollars) is expected to continue to fall from 1998-99 as the impact of previous reforms takes effect. In nominal terms, the level of unfunded superannuation liabilities is projected to peak in 2008.

Chart 4.9: Unfunded superannuation liabilities – long-term projections



Source: Department of Treasury and Finance

Risk reduction through management of structured financing facilities

The reduction of significant contingent liabilities associated with indemnities and other support mechanisms provided by government in various structured financing transactions continues to be an important element of the State's liability management policy.

In 1987 the Victorian Public Authorities Finance Agency, TCV's predecessor, entered into a $200 million gold-based, structured financing arrangement with the FAI Group. Following adverse tax assessments, TCV terminated the transaction in 1996 and initiated legal action in the Supreme Court of Victoria to determine the appropriate termination payment because TCV disputed many elements of FAI's calculation methodology. In November 1998 the Court handed down its decision. During the hearing FAI abandoned the majority of its claims which, combined with a favourable settlement with the Australian Taxation Office, resulted in a substantial saving to the State of over $100 million when compared with the original termination payment claim.

A second structured financing transaction with the FAI Group, an annuity loan which matured in 1998, was also subject to state indemnities and had received adverse taxation assessments. Between 1989 and 1995 TCV lent FAI $55 million to meet these adverse assessments. FAI has reimbursed TCV $10.3 million following a settlement negotiated with the Australian Taxation Office.

The financing and leasing arrangements for the Victorian Accelerated Infrastructure Program, which funded a number of police stations and court complexes, Werribee Hospital and Dandenong Community Mental Health Centre, were put in place between 1990 and 1992. The restructuring of these arrangements to eliminate the liabilities entailed by the associated Treasurer's indemnity has been approved and negotiations initiated with relevant parties.

The termination of the financing and leasing arrangements for the Monash Medical Centre, which were entered into between 1983 and 1987, has also commenced. The State has purchased the special purpose leasing company and has retired its associated debt that had been used to fund the construction of the hospital. In 1999-2000, it is anticipated that the remaining steps to unwind the transaction and liquidate the company will be completed and all remaining liabilities eliminated.

Negotiations for the early termination of the former Public Transport Corporation leases entered into in 1989 and 1990 have been completed with Lease Underwriting and National Australia Bank, and are underway with Deutsche Bank. The final termination of these leases will reduce the State's finance lease liabilities and provide certainty on the ownership of the rolling stock as part of the Government's transport reform.

KEY BALANCE SHEET INDICATORS

The use of indicators including financial ratios to assess government performance is in its early stages in Australia. There are no generally accepted ratios to assess balance sheet performance in the public sector. The indicators and measures used by investors to assess the results of private sector entities tend to focus on matters such as profits, dividend yields and solvency. In contrast, governments do not seek profits as a primary aim, taxpayers do not receive dividends from the government, and the risk of insolvency is remote because of government access to tax revenues.

Taxpayers are likely to assess a government by criteria such as the effectiveness of its policies, the efficiency of service delivery, the levels of taxes and charges it imposes to fund its operations, and the distribution of benefits and costs to the community. Nevertheless, analysis of government financial statements can usefully focus on matters such as what is driving the costs of government operations, the level of taxation, and whether the funding of government activities is equitable between generations of taxpayers.

A number of indicators are set out below, although they are not presented as the definitive set for ongoing monitoring of Victoria's financial position. Analysis of the balance sheet cannot be undertaken in isolation from analysis of other key financial statements, particularly operating and cash flow statements. The time series of reliable data available for the budget sector's assets and liabilities is too short to make detailed and reliable comparisons of trends and performance. Over time some indicators may cease to be useful, while others may be included as superior measures of performance.

Box 4.3: Analysis of the movements in the balance sheet

The ratios used in Table 4.3 provide three perspectives on the budget sector financial position across time, i.e. growth, sustainability and flexibility.

Growth

These ratios reflect the additions to and deletions from the asset base to meet long-term service expectations.

Sustainability

These ratios reflect the nature of asset financing and the Government's capacity to maintain existing service potential and sustain government operations in the short to medium term, while at the same time maintaining appropriate borrowing levels.

The ratios are considered in the context of the Government's long-term budget objective to maintain a sustainable budget operating surplus sufficient to fully fund infrastructure investment and maintain debt at levels consistent with a triple-A credit rating.

Flexibility

These ratios indicate the State's ability to respond to unexpected events or opportunities, such as the impact on the State's economy of the Asian crisis.

The indicators, discussed in Box 4.3 and provided in Table 4.3, present, for the first time, a quantitative picture of the budget sector balance sheet in terms of financial movements over time.

Table 4.3: Analysis of movements in the budget sector balance sheet

	1997-98 Actual	1998-99 Revised	1999-00 Budget	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate
			per cent			
Growth						
Growth in non-current physical assets	9.4	1.6	0.9	1.5	1.6	1.9
Asset investment to non-current physical assets[(a)]	4.6	4.4	3.9	4.4	4.7	5.0
Sustainability						
Total liabilities to total assets	91.4	72.3	71.9	71.0	70.2	69.6
Total borrowings to total assets	34.1	22.7	21.5	19.9	18.7	17.9
Long-term borrowings to total assets	31.1	19.8	18.6	17.1	15.8	15.1
Total borrowings to GSP	7.8	5.0	4.5	4.0	3.5	3.3
Net debt to GSP[(b)]	6.0	3.5	3.1	2.8	2.5	2.3
Flexibility						
Debt servicing ratio[(c)]	5.8	3.5	2.7	2.6	2.5	2.3
Superannuation expenses to total revenue	6.9	7.9	7.4	7.8	7.7	7.9
			ratio			
Current assets to current liabilities	0.82	0.80	0.75	0.73	0.71	0.70
Quick ratio[(d)]	0.77	0.75	0.70	0.68	0.66	0.65

Source: Department of Treasury and Finance

Notes:
(a) Non-current physical asset opening balances are used.
(b) General government (a similar grouping to budget sector, see Appendix D) net debt.
(c) Interest and other finance costs to total revenue.
(d) Cash, current investments and current receivables to current liabilities.

The indicators shown in Table 4.3 are moving broadly in line with the Government's policy objectives in relation to the management of budget sector assets and liabilities. With adherence to current policy settings these trends can be expected to continue in future years.

Growth

As shown in Table 4.3, moderate annual growth in non-current physical assets of between 1 and 2 per cent is expected. This growth rate indicates the net change in the asset base after allowing for additions to, and disposals of, assets. The large increase in 1997-98 is broadly attributable to the recognition of assets for the first time and asset revaluations. The ratio of asset investment to non-current physical assets reflects additions to the asset base and is expected to remain within a range of 4-5 per cent over 1999-2000 to 2002-03.

Sustainability

The downward movement in total liabilities to total assets, particularly in 1998-99, reflects the strengthened financial position of the budget sector as a result of significantly reduced debt and unfunded superannuation liabilities. The downward movements in long-term borrowings to total assets, and in total borrowings to total assets, demonstrate the reduction in budget sector gearing and indicate an improvement in long-term budget sustainability.

The debt to GSP ratios in Table 4.3 show the Government's indebtedness relative to the size of the Victorian economy. These ratios are used by the rating agencies and are useful when comparing the financial condition of one State with another. The downward trend in these ratios indicates that debt is declining relative to the size of the economy and that the Government is therefore less reliant on tax revenues to service debt.

Flexibility

As a result of the reduction in debt levels, the debt servicing ratio continues to decline and is expected to fall to 2.3 per cent by 2002-03. The lower this ratio the greater is the Government's budget flexibility.

The ratio of superannuation expenses to total revenue remains relatively stable in the current budget and over the forward estimates period. At a rate of 6.9 to 7.9 per cent, superannuation expenses represent a significant proportion of budget sector revenue compared to interest and other finance costs.

Working capital ratios (current assets to current liabilities and the “quick” ratio) indicate capacity to meet short-term obligations. The ratios for the budget sector, while relatively low when compared to private sector entities, are considered adequate because governments require relatively low levels of working capital due to the constancy of cash flows from taxes and other charges and the ability of governments (as low-risk borrowers) to raise funds in the financial markets to meet liquidity needs.

CHAPTER 5: BUDGET SECTOR SERVICES

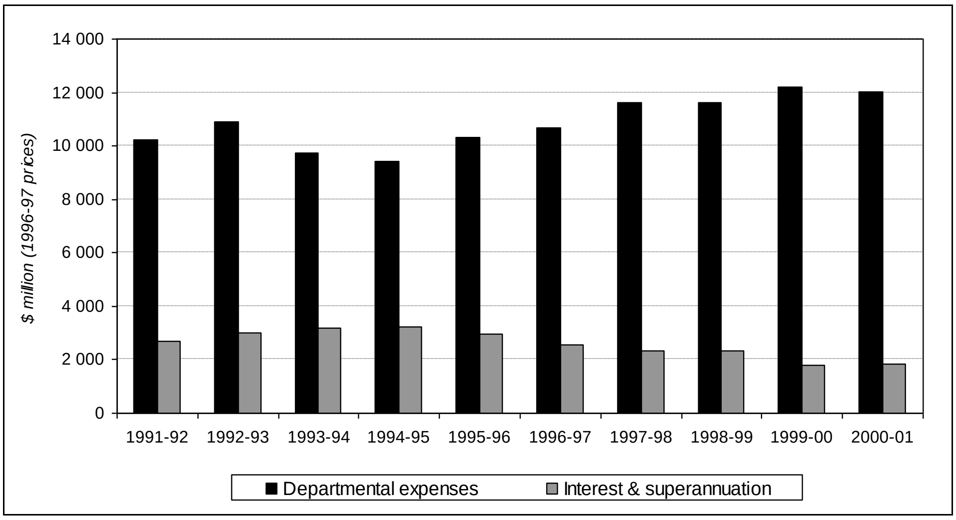
- In 1999-2000, the Government continues to direct the State's financial resources towards high priority services. Enhanced service delivery will continue to be achieved within a framework of ongoing sound financial management and service delivery reform.
- New spending initiatives total $383 million in 1999-2000 and will be concentrated on the priority areas of education, health, police, and the science, engineering and technology sector. In addition, new capital projects with a total estimated cost of $1 357 million will commence in 1999-2000.
- Service delivery highlights of the 1999-2000 Budget include:
  - $310 million to be spent over five years to build on Victoria's strength in science, engineering and technology research and development;
  - $94 million over the next four years to provide an additional 50 000 apprenticeships and traineeships in the TAFE sector;
  - increased support for using information technologies in schools;
  - improvement in the level of funded services from the State's hospital system;
  - funding to recruit an additional 400 police over the next two years; and
  - over $690 million for major connections to the Melbourne metropolitan strategic road network and to further integrate and enhance public transport.

Effective financial management and reform over the past seven years is delivering benefits to the Victorian community through enhanced service delivery and lower taxes.

Continued sound financial management means that only 3.3 per cent of government outlays in 1999-2000 needs to be directed to pay for debt, well down from 13.2 per cent in 1991-92 and provides increased scope to enhance services.

Reduced interest payments have enabled increases in spending to the key service delivery areas of education, health and welfare, public order and safety and transport. While expenditure on services was reduced in 1993-94 and 1994-95, government expenditure has increased steadily since then and is now well above 1991-92 levels (see Chart 5.1).

Chart 5.1: Total Expenditure[a]



Source: Department of Treasury and Finance

Note:
(a) Excludes grants on-passed, and special superannuation and separation payments.

The 1998-99 Budget delivered a commitment to continued sound management as well as improvements in social advantage. The 1999-2000 Budget continues this commitment to positioning Victoria for the 21st century and ensuring the gains from sound management of the State's finances can be shared among all Victorians.

In 1999-2000 the Government has committed $382.7 million for new output initiatives (see Table 5.1). The initiatives focus on continued delivery of improved services to Victoria.

Table 5.1: New funding for output initiatives announced as part of the 1999-2000 Budget

($ million)

Department	*1999-00 Budget*	*2000-01 Estimate*
Education	62.6	74.9
Human Services	114.8	122.7
Infrastructure	70.7	12.7
Justice	33.1	42.0
Natural Resources and Environment	21.1	16.7
Premier and Cabinet	19.1	17.6
State Development	27.6	38.0
Treasury and Finance[(a)]	29.9	16.7
Parliament	3.8	2.3
Total	**382.7**	**343.6**

Source: Department of Treasury and Finance

Note:
(a) Net of funds recouped from privatisation proceeds.

Several major asset investments will also commence in 1999-2000, at a total estimated cost of $1 357 million.

Table 5.2: Funding for new infrastructure projects to be commenced in 1999-2000

($ million)

Department	*Total Estimated Cost*	*1999-00 Budget*	*Balance*
Education	129.8	71.0	58.8
Human Services	200.3	79.5	120.8
Infrastructure	743.3	129.0	614.3
Justice	41.9	9.6	32.3
Natural Resources and Environment	18.0	9.7	8.3
Premier and Cabinet	162.7	33.1	129.6
State Development	41.0	16.6	24.4
Treasury and Finance	18.0	10.0	8.0
Parliament	1.8	1.7	0.1
Total	**1 356.8**	**360.2**	**996.6**

Source: Department of Treasury and Finance

WHOLE-OF-GOVERNMENT INITIATIVES

Each department has a role to play in contributing to the Government's strategic outcomes and priorities. These roles are reflected in the priorities of individual departments as outlined later in this chapter.

In addition to these, the Government has identified a number of whole-of-government priorities for the 1999-2000 Budget. These include:

- Science, engineering and technology;
- On-line Victoria 2001; and
- Rural Victoria 2001.

Science, engineering and technology

In July 1997 the Premier established a science, engineering and technology taskforce. The taskforce comprises leaders from the research and development community and advises Government on strategic approaches to the ongoing development of this important sector.

The work of the taskforce has resulted in Government committing $310 million over the next five years to boost Victoria's standing as a leading centre of excellence for science, engineering and technology research and development (R&D). This commitment recognises that wealth creation will be underpinned by the creation of new knowledge and technologies in the next century. Funding of $35 million has been allocated in 1999-2000, with $50 million committed for 2000-01 and $75 million for each of the following three years. This funding will be targeted at projects that can be categorised as follows:

- acquiring or developing technology infrastructure of national significance;
- building Victoria's science, engineering and technology capacity through:
  - developing science, engineering and technology programs within the schooling system to ensure students with potential have an avenue to develop that potential, e.g. programs such as 'chip skills' (i.e. silicon chip design and manufacture);
  - attracting elite scientists to participate in the planning and development of Victoria's science R&D effort; and
- programs to assist in the conversion of promising science research into commercial products, e.g. the establishment of R&D 'incubators' and the development of 'enterprise' modules to be included in postgraduate science courses.

The projects approved for 1999-2000 have been tested against criteria designed to ensure that they are properly targeted and represent value for money. To receive funding, projects must demonstrate the potential for:

- contributing to the advancement of Victoria's science, engineering and technology base;
- generating net benefits for Victoria; and
- promoting priority industry sectors and technologies.

The 1999-2000 allocation of $35 million will fund projects such as:

- government contribution towards new magnetic resonance technology for research into brain structure and function ($1.0 million);
- development of new curriculum and provision of enhanced equipment and support to schools to improve the standard of science, engineering and technology education in Victoria ($8.0 million);
- development of tertiary curriculum to support the semiconductor design and manufacture industry ($2.1 million);
- support for commercialising promising research through the adoption of a technology 'incubator' approach ($5.0 million); and
- new science projects targeted at promoting growth in Victoria's agriculture and food exports towards a target of $12 billion by 2010 ($12.4 million).

More detail on the above initiatives is contained in this chapter.

On-line Victoria 2001

On-line Victoria 2001 comprises a range of projects designed to significantly enhance the community's access to Government services. Departments are required to facilitate community access through the internet for all significant services.

To date, all departments have established internet web sites which provide access to a range of information on available services, advice and contacts. Many departments offer on-line commerce to allow electronic applications and payments. All departments now conduct tendering and procurement functions electronically, thereby providing enhanced convenience and access for businesses and also producing significant productivity savings for departments.

In 1999-2000 the Government will allocate $13.1 million for On-line Victoria 2001 to further improve community access to services including through the:

- Business Channel – including business licencing and registration services as part of a one-stop information service for business;
- Health Channel – including information about health conditions, life events, healthy living, support and advice, and incorporating a directory of health services;
- Education Channel – including the TAFE virtual campus and school distance education; and
- Tourism On-line – which will put all the State's tourist products and Tourism Victoria's advisory services on-line.

Further details on On-line Victoria 2001 initiatives for departments are provided by department in this Chapter.

Rural Victoria 2001

The Victorian Government recognises the significant contribution that regional and rural communities make to the quality of life enjoyed by every Victorian. This contribution ranges from wealth creation, through strong agriculture and food exports, to the maintenance of existing cultural and recreational amenities.

Rural Victoria 2001 provides a focus for government activities to ensure benefits for rural communities are actively considered in policy decision making and achieved through effective service delivery. Five regional forums established by the Government in March 1998 identified action areas relevant for their region and options for implementation.

A new $19 million Rural and Regional Strategy being funded in this year's Budget includes several targeted initiatives stemming from the regional forums:

- enhancement of opportunities for developing regional leadership skills;
- maintenance and strengthening of regional leadership networks and capabilities;
- improved information flows to enhance state and regional decision-making; and
- increased productivity, efficiency, and opportunities for rural and regional businesses, and increased investor confidence.

In addition, this Budget maintains the strong commitment to capital works in non-metropolitan areas, committing 36 per of new capital investment in health, and 36 per cent of new capital investment in education, to country Victoria.

Also the Government will this year add to the $354 million already provided for country roads from the Better Roads Victoria Fund since 1993. Under the new science, engineering and technology program, $12.4 million will fund additional agricultural research. A significant portion will be spent in our rural research centres.

This Budget also extends a range of assistance programs for farmers, delivered through the Rural Finance Corporation, including the productivity enhancement program and the Young Farmers' Finance scheme, which encourages young Victorians to make a career in agriculture.

These initiatives support the Government's philosophy that has always been to provide rural Victoria with a sound platform for self-reliance. This philosophy has resulted in country Victoria now seeing strong investment and increased confidence.

EDUCATION

The provision of quality education to Victorians is a key input to the achievement of the Government's economic and social goals. Quality education provides Victorians with the knowledge and competencies for work and society and the capacity for personal growth and fulfilment.

The Department of Education is responsible for the delivery of primary, secondary and TAFE education services, in addition to overseeing certain aspects of the non-government school and university education sectors.

Performance, priorities and strategies

Improving social advantage

Studies by the Australian Council for Educational Research indicate that the achievement of sound literacy and numeracy skills in schools can have a major impact on the employability of youth.

Government has set specific targets for literacy and numeracy outcomes in recognition of the key role these skills play in the future employability of young Victorians. It is the Government's intention for school children in Year 3 to achieve 100 per cent literacy proficiency in relation to the nationally agreed benchmarks by 2005. In addition, Victorian students are expected to be in the top five in the world in mathematics and science at Year 9 level by 2010.

The previous Budget provided major funding for early years literacy initiatives and seed funding to develop numeracy and science initiatives in schools. The 1999-2000 Budget provides $16.6 million over three years to finalise and implement the new Curriculum and Standards Framework 2000 in schools. Curriculum and Standards Framework 2000 will incorporate internationally benchmarked standards for student learning which, combined with statewide assessment through the Learning Assessment Program and the Victorian Student Achievement Monitor, will enable better assessment and reporting of the student learning progress.

International research has consistently found poor student performance and high levels of alienation and misconduct in a significant number of students in Years 7 to 9. A pilot Middle Years of Schooling program has been trialing a range of initiatives to improve student participation and learning outcomes in these years. Preliminary evaluation of these initiatives has provided promising results. As a result, funding of $3.4 million in 1999-2000 will be provided to extend this program from the current 12 schools to a further 50 secondary schools and to continue the research underlying the pilot school initiatives.

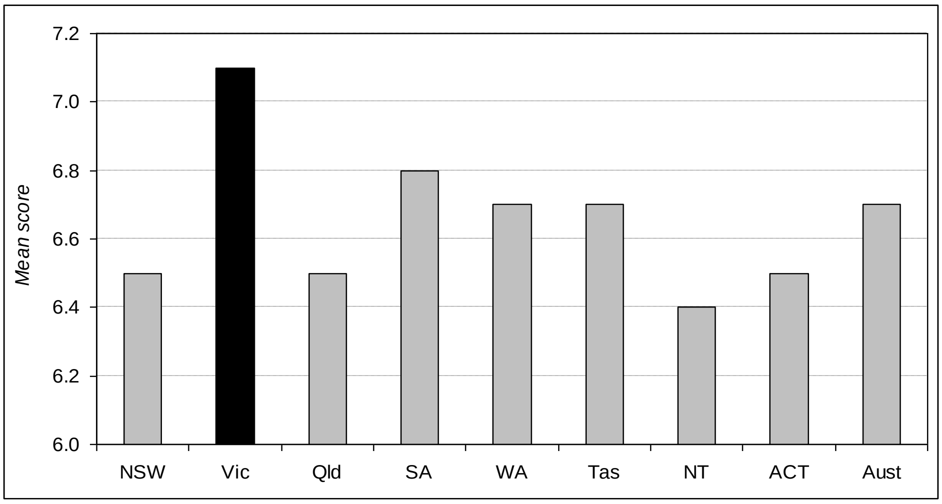
The TAFE sector will receive an additional $18.1 million in 1999-2000 ($26.3 million in a full year) to cater for the growth in demand by Victorians for apprenticeships and traineeships. This is consistent with Victoria's enviable position nationally of having the highest overall satisfaction of employers with vocational education training (see Chart 5.2).

In addition, new and upgraded facilities (at a total cost of $23.0 million) are to be provided within TAFE institutes including a technology centre at the Berwick campus of Chisholm TAFE Institute.

The Youth Employment Initiative, which commenced in 1997, has been highly successful with 90 per cent of completing trainees securing continuing employment. This Budget provides a further $2.4 million over the next two years to provide training opportunities for an additional 1 100 young Victorians.

The Government's 1996 election commitment to spend in excess of $1 billion over the following four years to improve school facilities will be completed in this Budget with $70.5 million being provided for the refurbishment and upgrade of schools. This will provide school facilities better suited to contemporary teaching methods. In total, $106.8 million has been committed to new projects for the school system in this Budget.

Chart 5.2: Satisfaction with vocational education training by State [(a)]



Source: National Employer Satisfaction Survey, 1997

Note:
(a) *Represents the mean score of satisfaction rankings given within each State, with 1 representing very unsatisfied and 10 representing very satisfied.*

Victoria's approach to integrating IT into school learning and curriculum development was nationally recognised as the pacesetter in a report by the Commonwealth Department of Education, Training and Youth Affairs last year. This innovative approach of focusing IT initiatives on both teachers and students will be enhanced with $17.2 million being provided to schools in 1999-2000 (increasing to $30 million in a full year). This will fund specialist technical support for the expanding and increasingly complex learning technologies and environments which now feature in many schools.

Science, engineering and technology in education

The achievement of quality education is a key component of the Government's economic growth strategy, recognising that strong educational outcomes in literacy and numeracy also contribute significantly to improve employment prospects.

This Budget provides $21.8 million over the next three years to expand the teaching of science, engineering and technology in schools. Major initiatives will include the development and design of exemplary teaching and learning models for primary and secondary educators and the establishment of best-practice science centres to provide support and professional development for schools.

Table 5.3: Output initiatives – Education

($ million)

	1999-00 Budget	*2000-01 Estimate*
Growth in apprenticeships and traineeships in the TAFE sector	18.1	23.1
Extending the Middle Years of Schooling program	3.4	0.0
Curriculum and Standards Framework 2000	7.1	8.0
Students with disabilities – increased enrolments	1.0	1.0
Victorian Student Achievement Monitor Implementation (Years 7 and 9)	1.4	1.4
Victorian Youth Development Program – increased participation	0.8	1.1
Extension of Youth Employment Initiative	1.4	1.0
VicOne – additional funding for state wide school network	1.8	2.4
Redevelop learning technologies – technical support for schools	17.2	27.0
Implementation of expansion of science, engineering and technology in schools[a]	8.0	6.9
Support for enterprise training in tertiary education[a]	0.3	0.0
Development of curriculum and training for semiconductor industry[a]	2.1	3.0
Total – Education	**62.6**	**74.9**
Less: Contribution to funding of initiatives from head office administrative efficiencies	-2.9	-9.4
Net budget impact – Education	**59.7**	**65.5**

Note:
(a) Science, engineering and technology program initiative.

In the tertiary sector, funding is also being provided to promote entrepreneurship training for postgraduate students in universities.

Computer chip design and manufacture is a growing industry which the Government is keen to attract to Victoria. Some $7.1 million is being provided over the next three years to develop a curriculum and set of learning modules to meet the full spectrum of the education and skills training requirements for the chip industry's workforce.

HUMAN SERVICES

The Department of Human Services is the largest budget agency and is responsible for some 34 per cent of government operating expenses. Acute health services account for 46 per cent of the Department's expenditure. Most services are delivered externally under funding and service agreements by agencies such as public hospitals, health care networks, public nursing homes, local government and a range of non-government organisations. The Department also delivers some services directly, in particular, public rental housing, intellectual disability accommodation, and child protection services.

The primary goals of the Department are to:

- improve health and welfare services for the most vulnerable sectors of the client population;
- improve and maintain high quality services and facilities for clients;
- strengthen population-wide prevention and early intervention strategies and outcome measurement;
- strengthen service integration to better tailor services to clients' needs;
- achieve a more adequate mix and equitable distribution of human services; and
- deliver further performance improvement in purchased and directly delivered services.

Performance, priorities and strategies

Management of demand growth

All areas of the Department continue to experience significant increases in demand for services due to population growth and ageing, changes in community health needs, and expectations and advancements in medical practice and technology. The Government is responding to these demand pressures by:

- providing significant funding for demand-growth – over $103 million in 1999-2000, including 3 per cent growth in funding for hospital services;
- prioritising clients to ensure that those with most urgent needs are assisted first, e.g. by aiming to treat all highest-priority, elective-surgery, patients within 30 days;

- delivering services more efficiently, such as by establishing electronic links with non-government service delivery agencies to streamline information exchange and reporting; and
- implementing preventative, early intervention and service redirection measures.

Expanded and efficient acute health services

Victorians have access to the most efficient public acute health system in Australia. As a result of funding increases and efficiency gains, funded case weight-adjusted separations have increased from 741 000 units in 1997-98 to 782 000 in 1999-2000, an increase of 5.5 per cent. In addition, the average cost of treating a patient in Victoria's public hospitals in 1996-97 was $2 304 compared with a national average of $2 496.

With the injection of additional funding in 1998-99 and 1999-2000 from state budgets and the new Australian Health Care Agreement, the overall level of funded service delivery from Victoria's hospitals has been significantly increased by more than 10 per cent. An additional $20 million for medical equipment in 1999-2000 will also ensure ongoing adoption of new and improved technology.

Prevention and redirection to community-based services

Victoria is committed to preventative strategies and community-based service delivery. This is reflected in the fact that some 31.4 per cent of total state health expenditure is delivered outside hospitals compared with a national average of 24.6 per cent. Victoria's performance for specific services is also impressive:

- a rapid increase in the proportion of mental health resourcing going to community-based services delivery (29 per cent in 1992-93 to 63 per cent in 1998-99);
- one of the highest proportions of disability accommodation clients receiving community-based support of any State (79 per cent); and
- levels of breast and cervical cancer screening and child immunisation among the best in Australia.

A number of programs aim to reduce demand for avoidable, high-cost acute health services. Funding is provided in this Budget for an additional 16 000 genetic testing and screening services for high-risk individuals in order to allow early identification and subsequent treatment. Needle and syringe exchange services will be boosted by an additional $1.2 million from 1999-2000 onwards to help prevent the transmission of blood-borne viruses such as HIV and Hepatitis C.

Prevention and redirection to community-based services will be supported in Victoria by the implementation of the Primary Health and Community Support redevelopment. Increasing the integration of providers in the Primary Health and Community Support sector will enable a greater emphasis on preventive strategies such as health promotion and early intervention. Creating integrated local Primary Health and Community Support service systems will also allow some health conditions to be more effectively treated and managed in the community rather than acute settings. The independence of clients will be maximised through the provision of high quality coordinated support services.

Local service delivery

New hospitals are being built and hospitals upgraded in areas of high demand growth so that services can be provided closer to where people live. The Northern Community Hospital (Epping) and the La Trobe Regional Hospital were opened in 1998 and construction of the Mildura and Berwick Community Hospitals will commence in 1999.

A number of projects involve private sector financing, building and subsequent service delivery management. These projects will:

- introduce private sector expertise into the public health care system;
- provide a means for assessing public and private performance in the delivery of public hospital services; and
- avoid the need for large public capital outlays.

There are now 20 Rural Healthstream agencies through which a broad range of services can be delivered in local communities. The services emphasise support for patients and their families in community and home-based settings in preference to traditional hospitals. Projects with a total estimated cost of $42 million will be funded in the 1999-2000 Budget to further strengthen the rural acute care infrastructure. Additional capital investments of $14 million will also be made available for non-metropolitan community services and other health facilities.

Small rural hospitals are continuing to achieve operational efficiencies which allow enhanced services by combining acute health care and aged bed-based care under the multi-purpose service model and by restructuring specialised services for older people which integrate acute, sub-acute and community health care.

Targeted housing and accommodation assistance

The Office of Housing is continuing to focus on giving priority assistance to those most in need. Highlights include:

- expenditure of $262 million over the past six years on facilities such as transitional housing, supported housing, Aboriginal housing, rooming houses and group houses specifically for particular target groups. In particular, spending of over $100 million over the past three years has increased the crisis and transitional housing stock to 2 000 units with a focus on the specific needs of homeless youth; and
- the introduction of segmented waiting lists to better target services to priority groups. The aim is for more than 55 per cent of public housing to be allocated to those on the priority housing list.

Children and youth at risk

Several elements of demand-growth funding in the 1999-2000 Budget focus on addressing the needs of children and youth at risk.

There is growth funding of $4.9 million for the expansion of child protection and placement services via an increase in the capacity of the placement service system. The emphasis is on more home-based services and more intensive services for high needs clients; improved quality of child protection services through enhanced screening and referral to other family services; and improved accuracy and timeliness of notifications through targeted community and professional education.

The Budget also provides for a range of targeted initiatives, from prevention and early intervention services at infancy and early childhood for high-risk families through to intensive treatment for the most at-risk groups of adolescents in Victoria.

Upgrading facilities

Major programs are underway to continue to upgrade health and welfare facilities to appropriate standards. A total of $18.6 million is to be spent to redevelop aged care facilities to bring them into line with Commonwealth standards to apply from 2000-01. In addition, $15 million is being spent on priority works identified as part of the Department's fire risk strategy.

Service initiatives proposed under the Metropolitan Health Care Services Plan to upgrade and improve public hospitals will receive funding of $38.5 million over the next two years. Major base hospitals in rural Victoria will also receive $27 million to upgrade and redevelop facilities over the same period.

Over the past six years, the Office of Housing has spent $400 million on major physical improvement and upgrade of its housing assets. The majority of the housing stock is now considered to be in good or excellent condition. Based on a recently developed housing stock condition index, which measures the cost of repairs and maintenance required to bring all public housing stock up to an adequate condition, Victoria had a satisfaction rating of 99 per cent compared to the national average of 95.6 per cent.

In addition to housing, for 1999-2000 the Government has committed $79.5 million for funding of Human Services asset initiatives at a total estimated cost of $200.3 million. Key asset investments include:

- further redevelopment of the Royal Melbourne (Parkville) Hospital ($4.8 million in 1999-2000) and the Wangaratta Base Hospital ($5 million in 1999-2000);
- relocation of the ambulance training centre ($3 million in 1999-2000);
- ambulance vehicle replacement ($7 million in 1999-2000); and
- Royal Dental Hospital redevelopment ($1.5 million in 1999-2000, total redevelopment cost of $31.4 million).

Table 5.4: Output initiatives – Human Services

($ million)

	1999-00 Budget	*2000-01 Estimate*
Acute health [(a)]	64.8	65.4
Aged, community and mental health [(a)]	15.9	16.1
Disability services	5.0	5.1
Child protection and placement services	4.9	5.0
Juvenile justice custodial service	5.2	6.4
Genetic testing and screening services	1.0	1.0
Needle and syringe exchange services	1.2	1.2
Expansion of ambulance services	5.2	5.3
Aged care – expansion of VICPACS personal response service	0.8	1.8
Mental health – establishment of depression and anxiety treatment service	0.5	2.6
Youth and family services – targeted strategy for health and development of children and adolescents	1.4	4.8
Relocation of MacFarlane Burnet Institute[(b)]	1.0	2.0
Brain Imaging Research Centre[(b)]	1.0	1.0
Future for young adults – expansion of continuing education program for disabled students	2.8	2.8
Air ambulance fixed wing upgrade	0.9	2.2
On-line Victoria 2001 electronic service delivery initiatives	3.1	0.0
Y2K rectification	0.1	0.0
Total – Human Services	**114.8**	**122.7**
Less: Contribution to funding of initiatives from head office administrative efficiencies	-2.7	-9.2
Net budget impact – Human Services	**112.1**	**113.5**

Notes:

(a) *Includes additional funding for health services provided by the Commonwealth Government under the new Australian Health Care Agreement.*

(b) *Science, engineering and technology program initiative.*

INFRASTRUCTURE

The Department of Infrastructure aims to support economic development and quality of life by:

- integrating planning and land-use strategies; and
- providing competitive infrastructure services.

The responsibilities of the Department of Infrastructure comprise roads, public transport, ports, major civic projects, statutory planning, local governance, and transport, marine and building regulation and safety. Infrastructure agencies include VicRoads, the Docklands Authority, the Melbourne City Link Authority, the corporatised rail and tram businesses, and a number of smaller regulatory authorities.

Performance, priorities and strategies

Over the past year, the Department has achieved significant progress in facilitating the integration of transport infrastructure and land use planning. This achievement is evidenced by the preparation of strategies that articulate a blueprint for future infrastructure development in Victoria. The Department has also strengthened its demographic and forecasting tools and databases to improve planning and ensure that investment is targeted to critical areas.

Enhancing public transport

The franchising of the public transport entities will reshape the Department's role from that of the provider of services to that of purchaser. The Director of Public Transport within the Department will be responsible for overseeing franchisee performance and managing the relationship between the Government and the franchisees. The Department is working with the Department of Treasury and Finance on the arrangements for public transport reform.

The charter, *Twelve Guarantees for Public Transport Passengers,* released by the Minister for Transport ensures that services will not only be improved, but in a multi-operator environment, will also be co-ordinated. The contracts with new private operators will include incentives to improve services and boost productivity. Also included are penalties for not meeting standards for punctuality, reliability and other quality measures. Further details on this reform program are discussed in Chapter 7, *Improving the Performance of Victorian Industry and Services.*

A key objective is to increase public transport patronage by 50 per cent by 2015. The Budget contains a number of initiatives that will enhance public transport services, particularly in providing improved linkages between buses, trains and trams. Major initiatives include:

- additional bus services in metropolitan Melbourne and rural Victoria and improved amenity on school, rural and metropolitan buses ($5.6 million in 1999-2000 rising to $13.7 million per annum by 2002-03);
- a two-year, $7 million pilot of the Smart Bus program is designed to dramatically improve service quality and reliability on strategic bus routes. Elements of this system are improved bus stop facilities and interchange points, information on bus arrival and departure times, and traffic management enhancements to give buses priority at major intersections;
- the upgrading of waiting, boarding and alighting bus facilities in the City of Casey ($0.3 million); and
- upgrading intermodal linkages in metropolitan and rural areas with a total estimated cost of $20 million. These proposals will significantly upgrade the comfort and convenience of transfers between buses and trains.

Roads

The efficient provision and maintenance of road infrastructure will ensure that business and industry can exploit opportunities to enhance the growth potential of Victoria. The Department's planning has identified a number of projects that will overcome strategic gaps in the road network and provide improved links between country and city areas, reducing travel costs and increasing safety. These benefits flow to both private and business road users.

- The Department's metropolitan road strategy focuses on an integrated network of radial and orbital roads. Radial roads provide the main carriage for vehicular traffic into and out of the city. Orbital roads provide convenient travel around the city, link major suburban centres and feed into the radial network. Major projects include:
- Eastern Freeway Extension - Springvale Road to Ringwood (total estimated cost $255 million) will form part of the metropolitan orbital transport corridor and ease congestion at Springvale Road;
- The Southern and Western links forming the Melbourne City Link will be open to traffic in 1999 and significantly enhance access to the city centre and key strategic and business centres. This project has been delivered by the private sector;

- The Geelong Road upgrade will reduce travel costs for both freight and passenger users by enhancing the link between Melbourne and the Ports of Geelong and Portland. The State's contribution of $118.5 million has been allocated from the Better Roads Trust Fund. The Government is seeking Commonwealth agreement to declaring the road to be a 'road of national importance' with upgrading to be funded on a 50:50 basis;
- Princes Freeway - Hallam Bypass (total estimated cost $175 million) will alleviate the high levels of congestion and conflict between through-traffic and traffic accessing local facilities in this growth area;
- Outer Metropolitan Arterial Upgrades (total estimated cost $48.8 million) will involve continued investment in a number of major projects aimed at easing congestion, improving safety and decreasing travel costs to both freight and passenger traffic in outer metropolitan areas; and
- Cooper Street Corridor - Epping (total estimated cost $18.8 million) will provide an upgraded link between the Hume Highway and High Street, reducing traffic congestion and improving access to business areas.

High quality local government facilities and services

The Department is working with local government to maintain and extend the significant improvements in service delivery and efficiency that have occurred over the past seven years. The Department and councils are currently developing and refining benchmarks that will measure performance and identify opportunities for improvement in service provision.

The Department fosters improvements in urban design and restoration of Victoria's heritage assets. The Budget contains initiatives to further this objective in 1999-2000, including:

- Public Heritage ($15 million over three years) to redevelop under-utilised heritage assets, predominantly in rural Victoria;
- Urban Design Fund - Pride of Place ($9 million over three years) to enhance the amenity and safety of streetscapes, mainly in rural Victoria; and
- Ballarat Camp Street development which will provide a focus for cultural activity within Ballarat and substantially enhance the amenity of the precinct. The Government has committed $1 million in 1999-2000 to progress planning and design works. Further funding will be subject to the outcome of this planning.

The Budget also contains funding for the refurbishment of Station Pier (total estimated cost $14 million). This investment will enable improved utilisation of the Pier for cruise shipping and enhance the business and tourism benefits arising from this growth industry. The Department's cruise shipping strategy seeks to increase the number of cruise ships visiting Melbourne. Each cruise ship visit is estimated to inject more than $1 million on average into the State's economy.

The Department has initiated a number of reforms to the way it delivers services. The integration of regional services across transport, planning and local government has given greater focus to the provision of services throughout Victoria. The Department is also streamlining business practices and provision of information through electronic service delivery.

Table 5.5: Output initiatives - Infrastructure

($ million)

	1999-00 Budget	*2000-01 Estimate*
New or improved metropolitan and rural bus services	2.3	4.7
Improved safety – school bus services	1.7	2.2
Air-conditioning metropolitan, rural and school bus services	1.2	2.6
Decrease rural student bus fares to Statewide Standard	0.4	0.4
Victorian Electronic Records Strategy – pilot for whole of government[(a)]	2.0	2.8
Public Transport – restructuring and wind-up costs	63.1	0.0
Total – Infrastructure	**70.7**	**12.7**

Note:
(a) Science, engineering and technology program initiative.

In 1999-2000 the Government has committed $129 million for the funding of Infrastructure asset initiatives at a total estimated cost of $743.3 million. Key asset investments are outlined above.

JUSTICE

The Department of Justice provides the primary organisational, policy and management focus for the five separate ministerial responsibilities within the Justice portfolio: Attorney-General, Minister for Corrections, Minister for Fair Trading, Minister for Police and Emergency Services, and Minister for Women's Affairs.

Key objectives of the Department of Justice are to enhance community safety and crime prevention, and to provide an accessible and affordable system of criminal and civil justice.

Performance, priorities and strategies

Over the past year, the Department has made considerable progress in enhancing service quality and generating efficiency gains in service provision.

Development of community partnerships

Stronger links are being forged with the community to ensure services are better targeted to community needs. Examples include:

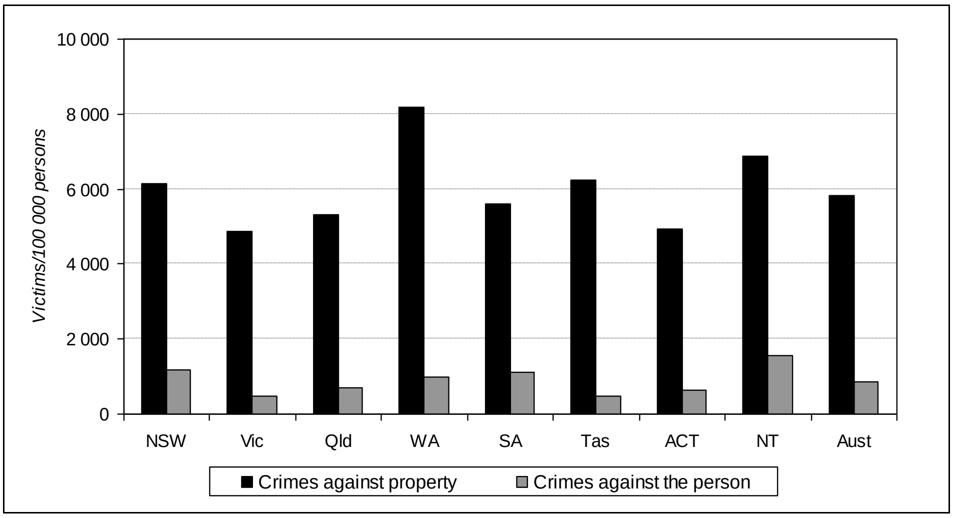
- Local Priority Policing which aims to increase involvement of the community in crime prevention and community safety; and
- the Country Fire Authority's Bushfire Blitz campaign which is making the community more aware of fire risks and will continue to educate the community about proactive strategies that can be undertaken to reduce the potential impact of fires.

Enhancing the service delivery capability of Victoria Police

Significant progress is being made by Victoria Police in reforming service delivery and business practices. Victoria has the lowest rate of reported crimes recorded both against property and person (see Chart 5.3), and is continuing to improve delivery to meet growing and changing service demands.

Funding will be provided to Victoria Police to recruit an additional 400 police over the next two years. Increased demand on policing resources together with the added complexity of addressing some crimes (particularly drug related) has led to the need to increase police resources.

Chart 5.3: Reported victims of recorded crimes, 1997



Source: Steering Committee of the Review of Commonwealth State Service Provision, Report on Government Services 1999

During 1998-99 a contract was signed with IBM to significantly upgrade police information technology and systems. Ultimately, this investment will enhance the productivity of community policing operations and provide a platform for better management information.

A further investment in police and other emergency services technology and equipment will be made through the implementation of the Mobile Data Network. The Mobile Data Network, when integrated with other communication services, will provide prompt and accurate dispatching of emergency services. This will lead to faster response times, improved operational responsiveness and increased safety and accessibility of police and emergency services personnel. Provision has been made in the Budget for this initiative. However, as contract negotiations are yet to take place, the funding amount to be provided is not available for publication at this time.

Several police facilities will also be upgraded as part of this year's budget.

Enhancing justice services

Victoria has an efficient court system with the highest turnover and percentage finalisation of cases for Magistrates' Courts in Australia. Ongoing efforts are being made to further reduce the length and cost of cases across the court system.

The criminal justice enhancement project (part of Project Pathfinder) is a major departmental initiative to redesign administrative processes and procedures across the criminal justice system. Funding of $14.5 million has been committed over a 3½-year period to implement the project. Benefits to the community include reduced court waiting time and a reduction in the costs associated with wasted preparation time.

During 1998-99 the Department finalised the integration and outsourcing of fines enforcement management and administration of the Traffic Camera Office and the Enforcement Management Unit. The benefits of this include the freeing up of police personnel for other activities and increased effectiveness of camera detection, ultimately contributing to greater safety on Victorian roads.

The Budget also contains an additional $4 million per annum to assist Victoria Legal Aid to meet demand for service and continue to provide legal aid to those in need.

Correctional services

Over the past three years there has been a significant increase in the overall prisoner population within Victoria such that prisoner numbers have reached or exceeded prison accommodation capacity. The challenge for Victoria is not only to meet the current demand but also to respond to the underlying causes of the problem and develop a long-term strategy.

In response to this challenge an innovative and comprehensive strategy has been developed by the Department and supported with budget funding. An additional $6.7 million will be provided in 1999-2000 to fund:

- expansion of prison capacity;
- piloting of diversion programs to provide further alternatives to prison; and
- substantial enhancement of the programs provided to offenders, particularly drug treatment and rehabilitation.

New streams of management and programs will be introduced catering for the changing mix in the prison population. Smaller units with intensive programs are being designed to break the cycle of re-offending. Pre-release programs that attempt to focus on establishing links with the community will also be facilitated.

Table 5.6: Output initiatives – Justice

($ million)

	1999-00 Budget	*2000-01 Estimate*
Additional 400 police officers	11.9	21.8
Police and emergency services Mobile Data Network	(a)	(a)
CFA enhanced fire safety – Protective clothing and training	0.4	0.4
Legal aid services	4.0	4.0
Diversion programs (from imprisonment)	1.8	1.8
Additional prison capacity and prisoner rehabilitation programs	4.9	14.0
Y2K rectification	10.1	0.0
Total – Justice	**33.1**	**42.0**
Less: Contribution to funding of initiatives from departmental savings and revenue initiatives	-4.9	-3.9
Net budget impact – Justice	**28.2**	**38.1**

Note:

(a) Table excludes funding for Mobile Data Network, which is subject to contract negotiation.

A range of new diversion programs targeted to specific categories of offenders will be trialed over the next two years. These programs seek to minimise an offender's progression through the criminal justice system by dealing with the social, economic and personal factors associated with criminal behaviour. The services will provide an alternative to imprisonment while addressing issues of community safety, and ensuring compliance with court orders.

In 1999-2000 the Government has committed $9.6 million for funding of Justice asset initiatives at a total estimated cost of $41.9 million. Key components have been highlighted earlier in this section.

NATURAL RESOURCES AND ENVIRONMENT

The Department of Natural Resources and Environment delivers a diverse range of services to the people of Victoria. It has responsibility for the protection and enhancement of Victoria's natural resources and attractions, for natural disaster management and for the improvement of the economic competitiveness and sustainable development of natural resource based industries.

The Department also provides a wide range of research and market development services to the community and industry in relation to Victoria's food and agriculture interests.

The Department has responsibility for managing crown land throughout Victoria including state forests, state national parks and significant metropolitan public parks and gardens.

Performance, priorities and strategies

Natural disaster management

During 1998-99, the Department responded quickly and effectively to major floods in East Gippsland and in the north-east. Funding of $52 million has been provided over two years in both areas to restore local infrastructure.

Looking forward, the Victorian Flood Management Strategy provides the blueprint for the Government's program over the next three years to upgrade flood management services. As part of the strategy, the Government will provide $0.5 million in both 1999-2000 and 2000-01 for planning the Lower Goulburn Floodplain rehabilitation.

The effectiveness of departmental fire-fighting on Victoria's public land has shown dramatic improvement over the past decade. Although approximately the same number of fires occurred in the periods 1979-88 and 1989-98, the area burnt in the 1989-98 decade was only 266 000 hectares compared with 1 355 000 hectares in the previous decade. Much of the improvement is due to improved fire management techniques, particularly the use of aircraft.

Agricultural industries

Victorian food exports reached over $4 billion in 1997-98, and the Government recently set a new policy objective of achieving $12 billion in agriculture and food exports by 2010.

As part of its science, engineering and technology policy the Government will provide an additional $12.4 million to food and agricultural research $1.8 million of which relates to asset investment. In addition to the income created through exports, these initiatives support the improved viability of regional economies and communities.

Land management and information

The land titles automation project will convert paper records to computer format during 1999-2000. Automation will allow customers to access title search information on-line, remotely and immediately. The current turnaround time is 24 hours. The turnaround for future registration of dealings will be reduced from three weeks currently to immediate or overnight during 2000.

Conservation and recreation

A recent environmental audit by an OECD panel chose Victoria as the State that could best indicate progress toward systemic biodiversity conservation in its activities and programs. New initiatives to further enhance its performance include:

- an additional $12.4 million over four years to improve community and visitor facilities in Victoria's national parks and rural crown reserves;
- $5.5 million per year over the next two years for a range of greenhouse program initiatives including Replanting Victoria ($3 million per year) and Energy Efficient Victoria ($2 million per year); and
- $5 million over three years to provide more improvements to community coastal infrastructure under the Government's Bringing the Bay to Life initiative.

Table 5.7: Output initiatives – Natural Resources and Environment
($ million)

	1999-00 Budget	*2000-01 Estimate*
Sustainable fisheries utilisation services: all-waters recreational fishing licence and commercial licence buy-back scheme	4.5	0.0
Lower Goulburn floodplain rehabilitation/flood prevention program – stage 1	0.5	0.5
Agricultural industries: Growing Horizons – Victoria's food industry[(a)]	10.6	10.7
Energy Efficient Victoria – greenhouse initiative	2.0	2.0
Replanting Victoria – greenhouse initiative	3.0	3.0
Energy Smart Business Cascade program – greenhouse initiative	0.3	0.3
Greenpower accreditation and facilitation scheme – greenhouse initiative	0.2	0.2
Total – Natural Resources & Environment	**21.1**	**16.7**

Note:
(a) Science, engineering and technology program initiative.

In 1999-2000 the Government has committed $9.7 million for funding of Natural Resources and Environment asset initiatives at a total estimated cost of $18.0 million. Key asset investments in addition to those discussed above include:

- ongoing annual funding for River Health and Water Quality of $5 million per year; and
- $1.7 million in 1999-2000 for the development of Coastal Board Action Plans (total estimated cost $3.3 million).

PREMIER AND CABINET

The mission of the Department of Premier and Cabinet is to lead in policy advice, to implement key projects and activities, and to provide high quality cultural programs, events and venues in order to create sustainable growth and a vibrant and innovative society for all Victorians.

It does this by providing policy advice, coordinating the implementation of government policy, and taking responsibility for the construction and management of world-class arts facilities, arts programming and events.

Performance, priorities and strategies

During 1998-99 the Department has continued to provide high quality advice to the Premier and Cabinet. Specific achievements include coordination of the Government's response to the Longford gas incident, commencement of a program to upgrade regional arts facilities, and coordination of contingency planning for dealing with the Y2K program.

In 1999-2000 the Department will be:

- continuing its central agency role of policy development and coordination;
- managing arts initiatives and preparations for utilisation of the Centenary of Federation; and
- coordinating new strategies for:
  - greenhouse strategy;
  - Indonesia assistance; and
  - rural and regional policy.

Initiatives associated with the rural and regional policy and greenhouse strategy will be undertaken by other departments with the Department of Premier and Cabinet monitoring the effectiveness of their progress.

The Department is also co-ordinating a 10-year assistance program which commenced in 1998-99, to assist with Indonesia's economic recovery, through training, development assistance and advice on matters of concern to the Indonesian Government.

The broad purpose of the program is to provide guidance and training in areas where Victoria has expertise, e.g. the reform of state-owned enterprises, food supply and production, and education and training. It will promote Victorian products, services and expertise in a wide range of areas, and will develop long-term links between Victoria and Indonesia at the public and business levels.

World-class arts facilities

In 1999-2000 the Department will continue to have responsibility for the construction and management of world-class arts facilities, arts programming and events.

The redevelopment of cultural facilities under the Agenda 21 Program will continue with additional capital funding (total estimated cost $91.4 million) being provided for the final phase of the State Library redevelopment. Additional operating funding for the State Library is being provided to enhance service delivery in recognition of the increased capacity provided by the redevelopment.

When completed, the new state-of-the-art library complex will celebrate Victoria's heritage and ensure that it continues to be recognised as a world-class cultural resource. It will serve as the centre of an excellent statewide library and information network, accessible to all Victorians.

The completion of phase 1 has already contributed to a 13 per cent increase in the expected level of visitors for 1998-99. The number of visitors is expected to double to three million visitors per annum on completion.

Another world-class facility to be completed in 2000 will be the new Melbourne Museum at Carlton Gardens. Additional funding will be provided to ensure its successful opening and continued success through marketing campaigns to encourage long-term interest in the new facility and generate a large membership and sponsorship base. This will be the culmination of the Government's investment of over $260 million in the new museum's development.

Table 5.8: Output initiatives – Premier and Cabinet

($ million)

	1999-00 Budget	*2000-01 Estimate*
Assistance package to Indonesia	1.0	1.0
Greenhouse initiatives	0.0	4.5
Museum of Victoria – promotion of community awareness	2.8	0.4
Rural and regional strategy	10.0	3.0
State Library Victoria – operating funding for expanded facilities	4.6	4.6
Museum of Australian Art	0.0	3.8
Grant to Australian Ballet	0.3	0.3
Y2K rectification	0.4	0.0
Total - Premier and Cabinet	**19.1**	**17.6**

In 1999-2000 the Government has committed $33.1 million for funding of Premier and Cabinet asset initiatives (total estimated cost $162.7 million), focusing on arts facilities. Key asset investments, in addition to those discussed above, include:

- Victorian Arts Centre Trust facilities upgrade funding of $2.7 million in 1999-2000 (total estimated cost $6.6 million); and
- Museum of Modern Art – Heide funding of $1.5 million in each of 1999-2000 and 2000-01.

STATE DEVELOPMENT

The Department of State Development's core responsibility is to promote Victoria's competitiveness in a world where competition continues to increase between regions and governments in order to build their base economies and secure quality jobs. Specifically, the Department aims to:

- facilitate growth, exports and investment by business;
- position Victoria in the global marketplace for tourists, investment and events;
- be the primary interface between industry sectors, business and government, as an information channel and as a policy advocate at the national level;

- foster workplace and business environment reform to cut the costs of doing business;
- build Victoria's capabilities for the information economy in both the public and private sectors; and
- promote sport, recreation and an improved lifestyle.

Performance, priorities and strategies

Business development

New investment facilitated by the Department in Victoria in 1997-98 totalled over $1 600 million. The projects resulting from this new investment were estimated to lead to the creation of over 4 000 long-term jobs and more than $560 million in annual exports. Investment, export, employment and tourism growth will continue to be high priorities for the Department in 1999-2000. Funding of $1.5 million has been committed on an ongoing basis to support the establishment of an Office of Business Migration. Funding of $3 million is being provided for Film Victoria investment incentives.

Science, engineering and technology

Co-ordination of the Government's science, engineering and technology program is a key new project for the Department in 1999-2000. Funding of $310 million has been committed over the next five years, with $35 million allocated for 1999-2000.

The type of projects being targeted are identified earlier in the chapter. The underlying objectives are to:

- facilitate the essential growth in ideas, technology and commercialised knowledge that will underpin Victoria's future economic security;
- draw the attention of international business investors to R&D in Victoria;
- stimulate and leverage private and public sector investment in science, engineering and technology; and
- complement the Government's emphasis on world-class education and skills building.
- In addition to overall co-ordination of this initiative, the Department of State Development will undertake:

- development and delivery of a strategy to identify Victoria's skills gaps in information and communications technologies and promote skills development across industries and the education and training sectors ($1 million in 1999-2000); and
- a technology commercialisation program ($5 million in 1999-2000) to provide high quality support services (e.g. in areas such as intellectual property management, legal, financial and marketing services) to foster the successful commercialisation of promising R&D.

Small business and regulation reform

Regulation reform remains a high priority. There has been considerable effort over the past few years to reduce both the number of existing regulations and the number of new regulations introduced. The number of principal regulations in force in Victoria has been reduced from 706 in 1992 to 432 in 1998.

Recent regulation reform activities of the Department include the freeing up of shop trading hours and liquor licensing reform. Victoria's new streamlined liquor licensing regime will simplify the procedures for business and boost tourism capabilities.

Reduced liquor licensing fees (recently enacted in the Liquor Control Reform Regulations) will generally be significantly lower than in New South Wales. For example, a licence for the sale of liquor without a meal in a restaurant will attract no licence fee in Victoria, compared with a fee of $15 000 in New South Wales.

The recent adoption of a sectoral approach to regulation review aims to ensure all administrative and legislative requirements impacting on businesses are reviewed in totality with the involvement of industry. Examples of reviews conducted to date include the Tourism Industry Sector Review in 1997 and the Aquaculture and Nursery and Cut Flowers Sectoral Reviews commenced in 1998. An accelerated program of sectoral reviews is proposed for the next two years with increased funding of $3 million to support up to 12 additional reviews.

Information technology and multimedia

Victoria continues to place emphasis upon the importance of its IT and multimedia policy. Through the On-line Victoria 2001 strategy, the community is being provided with on-line access to government departments, resulting in unprecedented immediacy of service to business and the public. The

Government remains committed to ensuring all appropriate government services are on-line by the year 2001 and has provided additional funding of $13.1 million in 1999-2000 to support this commitment.

The Government will also provide up to $6.6 million in 1999-2000 to facilitate the development of electronic commerce in Victoria.

Tourism

Victoria's recent improved tourism growth relative to other States is continuing with Victoria's market share of international visitor nights increasing during 1998. Despite a decline in Asian visitor nights in Victoria, significant growth has occurred in the number of visitor nights from the traditional markets of the United States, the United Kingdom and Germany.

The upcoming key challenge for the Department is to ensure that Victoria capitalises on the worldwide focus on Sydney in the lead-up to the 2000 Olympic Games. To this end, $2 million has been committed to a comprehensive pre-Olympic Games marketing strategy to be launched during 1999-2000.

To assist in the continued expansion and competitiveness of Victoria's tourist sector, the Department will also assist in the development of on-line facilities for the industry. This will include putting all the State's tourist products on-line and linking them to international travel sites, so as to provide a full booking capacity. The Government has committed a total of $7.4 million over the next two years for this purpose.

Sport

To support Melbourne's staging of the 2006 Commonwealth Games and ensure that Victoria maintains its high sporting profile, $11 million has been committed to the expansion of the Melbourne Sports and Aquatic Centre.

A total of $0.4 million per annum has been committed to enable Victoria to host an international sailing regatta on Port Phillip Bay annually from 2000 to 2004. This initiative builds upon the highly successful 1999 World Sailing Championships held in Melbourne. An additional $0.3 million will be provided to the Victorian Institute of Sport in 1999-2000 increasing to $0.8 million on an ongoing basis from 2000-01.

Table 5.9: Output initiatives – State Development

($ million)	1999-00 Budget	2000-01 Estimate
Science, engineering and technology program	0.0	16.4
Management of science, engineering and technology infrastructure support[(a)]	2.2	1.8
Information and Communication Skill Strategy[(a)]	1.0	0.0
Technology Commercialisation Support[(a)]	5.0	5.0
Information economy regulation – data protection for electronic commerce.	6.6	2.7
Accelerated regulation reform sectoral reviews	1.5	1.5
Y2K awareness campaign	0.5	0.0
Tourism – pre-Olympics marketing of Victoria	1.0	1.0
Sail Melbourne 2000	0.4	0.4
Victorian Institute of Sport	0.3	0.8
Public Service Games	0.3	0.0
Film Victoria investment incentives	3.0	3.0
Establishment of the Office of Business Migration	1.5	1.5
On-line 2001 – Business Channel 2.0 development	0.5	0.3
On-line 2001 – Victorian Tourism On-line	3.8	3.6
Total – State Development	**27.6**	**38.0**

Note:
(a) Science, engineering and technology program initiative.

In 1999-2000 the Government has committed $16.6 million for funding of State Development asset initiatives (total estimated cost of $41 million), focused particularly in the sports area. Asset investments in addition to those discussed above include:

- the Geelong Water Sports Complex with funding of $4.0 million in 1999-2000 (total estimated cost $9.4 million); and
- other community sport and recreational facilities worth $5 million in 1999-2000 (total estimated cost $20 million).

TREASURY AND FINANCE

The Department of Treasury and Finance provides strategic advice to the Government on financial, resource management and economic issues. The core central activities include government financial accounting, liability management, budget production and risk management.

The Department has also played a leadership role in designing and implementing the Government's privatisation program and various resource management reforms which have together fundamentally changed the way in which the public sector operates. A threshold has been passed with the essential architecture of these reforms now largely in place.

Performance, priorities and strategies

Nationally, Victoria has led reforms to the public transport, electricity, gas and water industries and to the planning and resource management frameworks under which departments operate. The focus of the Department's efforts in 1999-2000 is on managing:

- the full implementation of the reform programs to extract the maximum benefits for all Victorians; and
- two critical whole-of-government issues – national tax reform and the Y2K computer issues.

Extracting the benefits of reform

Franchising of the passenger businesses of the public transport system is expected to provide a better deal for the travelling public through better quality services. A Spencer Street Authority will be established to ensure the multi-use transit hub supports both public transport and the Docklands development.

Reform of the State's energy industry has been substantial with competitive markets now producing significant savings for large energy users. The reform agenda for 1999-2000 will see the benefits of deregulation of the energy industry being extended to more energy users. Funding of $8.7 million is being provided in 1999-2000 to achieve this, and for the Office of the Regulator-General to undertake an electricity distribution price review. The State's interest in the energy markets, particularly the new national energy market arrangements, will also be a focus in 1999-2000.

The Department has played the lead role in recent years in developing and implementing improvements to the frameworks which the public sector uses to manage and allocate resources. In 1999-2000, the Department will focus on embedding these improvements (such as accrual accounting and budgeting, output management and outsourcing) into the government decision making process in order to achieve maximum benefits for the community.

National tax reform

National tax reform is a major issue for the Government. The Department has overall responsibility for the development and introduction of policies and systems to support the implementation of national tax reform, including the impact of the GST, to the best advantage of all Victorians. Funding of $15 million over two years has been provided for policy development and implementation. National tax reform is discussed in more detail in Chapter 9, *A New Era of Commonwealth-State Financial Relations*.

Y2K computer issues

Y2K threatens the ability of government to deliver services. The Department is responsible for monitoring, and reporting to government and the public, those activities that are designed to ensure service delivery is not unnecessarily interrupted.

A further $10.6 million is being provided in 1999-2000 to fund Y2K remediation works across the budget sector. This brings the level of additional funding provided to the budget sector in 1998-99 and 1999-2000 for Y2K rectification works to $133.5 million.

Other initiatives

During 1999-2000, the Department will also complete implementation of the City Precinct Strategic Plan at a cost of $7.2 million. This initiative has rationalised government holdings of office accommodation and led to annual rental savings of $25.8 million.

Table 5.10: Output initiatives – Treasury and Finance

($ million)

	1999-00 Budget	*2000-01 Estimate*
Public transport reform — finalise franchising of passenger businesses [(a)]	27.0	0.0
Management of the State's post-privatisation energy interests [(a)]	3.7	0.0
Review of Electricity and Gas Distribution Prices by the Regulator-General	3.0	3.0
Development of frameworks for fully deregulated retail energy markets	2.0	2.0
Establishment of Spencer Street Authority	2.0	0.0
National tax reform implementation	10.0	5.0
Superannuation reform [(a)]	15.0	0.0
Information technology and telecommunications — operating costs	0.9	1.2
Targeted assistance to rural Victoria via Rural Finance Corporation of Victoria	0.0	5.5
Total – Treasury and Finance	**63.6**	**16.7**
Less: Funds recouped from privatisation proceeds	33.7	0.0
Net budget impact – Treasury and Finance	**29.9**	**16.7**

Note:

(a) These expenses ($15 million of the $27 million in the case of public transport reform) will be recouped from privatisation proceeds.

CHAPTER 6: AN ECONOMIC FRAMEWORK FOR GROWTH

- The microeconomic reforms introduced in Victoria since 1992 have delivered significant benefits to Victorians through lower consumer price inflation and lower costs for business. Indirect evidence of the benefits include the reversal of population losses to other States, a doubling of business investment, and the quick response of Victorian export industries to the Asian slowdown.
- The strength of Victoria's domestic economy has helped the State to weather the Asian economic slowdown. Consumer spending, housing and business investment contributed to GSP growth of 3.8 per cent in 1997-98. State economic growth is expected to be maintained at around 3 ¾ per cent in 1998-99 and to ease to 2 ¾ per cent in 1999-2000, before returning to around 3 ¼ per cent in later years.
- Victorian jobs growth has remained strong. A further increase in employment of 1 per cent is expected in 1999-2000, with higher growth in the following years.
- Medium-term projections for Victoria assume a modest recovery in world growth over the next few years, especially among our major Asian trading partners. Downside risks include persistent weakness in Japan, and asset price deflation and a slowdown in the United States. The outlook may be stronger if global activity lifts more quickly, or if net migration to Victoria continues growing.

This chapter outlines the broad economic benefits of the Government's reform program to date, recent economic trends, Victoria's economic outlook, including the implications of global developments, and the sensitivity of projections to both national tax reform and population projections.

THE BENEFITS OF REFORM

The Government's microeconomic reforms have been designed to improve living standards for Victorians. The introduction of competition to the provision of many services previously supplied by monopolies has improved efficiency and innovation, reduced costs and enhanced service quality for consumers. The disaggregation and privatisation of government suppliers within this newly competitive environment and the associated reduction in public sector liabilities have strengthened the State's finances and laid the groundwork for lower taxes. Improvements in government service provision through competitive tendering and outsourcing have also benefited households and businesses, as has an extensive program of regulation reform (see Chapter 7, *Improving the Performance of Victorian Industry and Services*, for further details).

The extent to which these reforms have improved the welfare of Victorians has become increasingly visible. The evidence includes lower consumer prices and business costs, population flowing into Victoria from other States, a sharper increase in business investment than elsewhere in Australia, and the capacity of Victorian exporters to redirect exports to alternative markets following adverse developments in Asia.

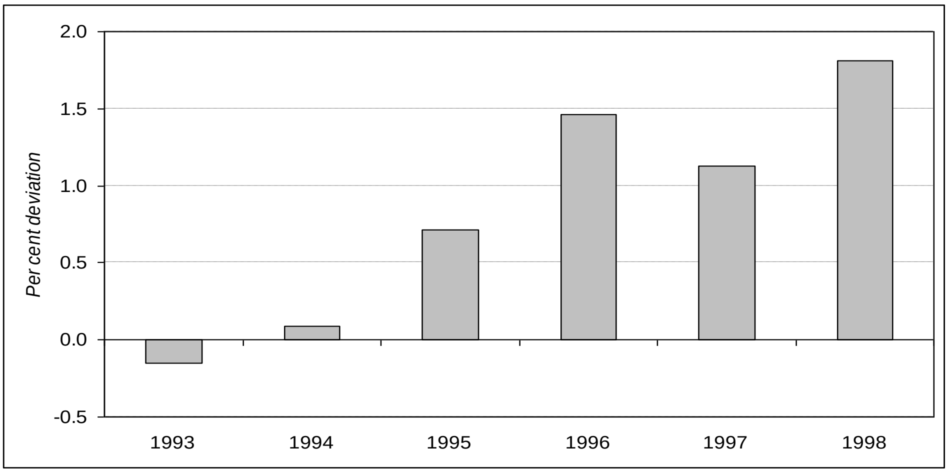
Consumer prices

In the seven years since 1992, the Melbourne consumer price index (CPI) has declined by 1.8 per cent relative to the weighted average of the other capital cities (see Chart 6.1). In effect, other things being equal, this has produced a corresponding improvement in real incomes for Victorians.

This better inflation performance has become more pronounced during recent years because of the impact of a number of government reform measures:

- Melbourne water prices declined in the first half of 1998. This was due to pricing reforms which introduced a new, fairer and more efficient system of user-pays charging, providing incentives to conserve water. The reforms delivered a reduction in bills to around 85 per cent of owner-occupied domestic properties.
- The Winter Power Bonus returned efficiency gains made by the newly privatised electricity businesses to electricity consumers in the second half of 1998. This is in addition to the extent to which regulation has kept utility price rises below the inflation rate.

Chart 6.1: CPI improvement[(a)] — Victoria versus rest of Australia



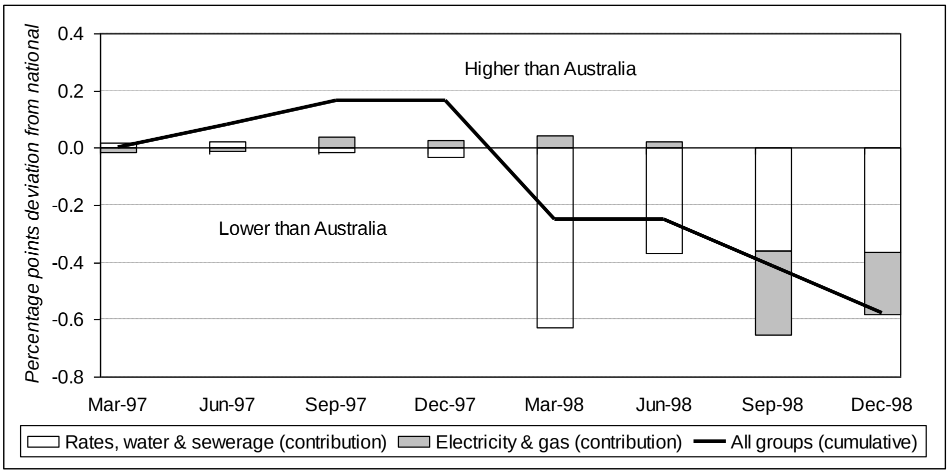
Source: Australian Bureau of Statistics, Cat No. 6401.0

Note:

(a) Per cent difference between consumer price index for weighted average of all capitals excluding Melbourne and consumer price index for Melbourne, indexes rebased to 1992.

During the two years ending December quarter 1998, the Melbourne CPI increased by almost 0.6 percentage points less than the national CPI. Much of this difference is attributable to declining water prices and the Winter Power Bonus. Chart 6.2 shows that the contribution of local government rates, water and sewerage to the Melbourne CPI declined sharply relative to their contribution to the national CPI in 1998. The impact of the Winter Power Bonus in Melbourne is also evident in the lower contribution to the CPI from electricity and gas. Local government rates and utilities prices (water, sewerage, electricity and gas) as measured in the CPI declined by 7.4 per cent in Melbourne over this period, compared with an increase of 0.6 per cent nationally.

Chart 6.2: Consumer price index — Melbourne versus Australia



Source: Australian Bureau of Statistics, Cat No. 6401.0

The extent of the decline in Melbourne electricity and gas prices is slightly overstated by the CPI as the Australian Bureau of Statistics (ABS) has now extended its target population to include social welfare beneficiary and superannuant households. Nevertheless, even after adjustment for this, the Department of Treasury and Finance estimates that the Melbourne CPI increased by over 0.5 percentage points less than the national CPI during the two years ending December quarter 1998. Other things being equal, this represents an increase in real per capita household income of over $110 per annum for Victorians.

The impact of past electricity reforms and current gas reforms is expected to impose further downward pressure on the Melbourne CPI, relative to the rest of Australia, over the next few years:

- Changes in domestic retail electricity prices are capped at a rate equivalent to 1 percentage point per annum lower than the Melbourne CPI inflation rate until 1 January 2001, when domestic users will be free to choose their own supplier.
- From 1 January 1999, increases in domestic gas prices will be restrained to 2.2 percentage points per annum below the national CPI inflation rate for peak usage, and 10 percentage points below the national CPI for off-peak usage above a specified limit.

Following these interim arrangements, charges for electricity and gas consumed will be competitively determined. Charges for the use of networks to deliver energy will be determined under a regulatory regime requiring efficiency gains achieved by network operators to be passed ultimately to consumers.

Business costs

Microeconomic reform in Victoria has also contributed to lower costs for Victorian businesses compared with their interstate counterparts. Table 6.1 shows movements in selected business costs in Victoria following the implementation of reform in four key areas: electricity, water, workers' compensation and port services.

Table 6.1: Movements in selected business costs – Victoria

Cost	*Type of business*	*Period*	*Per cent change*
Electricity	Average of contestable commercial and industrial customers	Between deregulation and April 1998	-23
Workers' compensation	Workers' compensation cost[(a)]	1993-94 to 1996-97	-19
Port services	Total port and related charges[(b)], Melbourne	2^{nd} half 1993 to 2^{nd} half 1998	-40

Sources: Australian Chamber of Manufactures, Outcomes of the Contestable Electricity Market of New South Wales and Victoria, June 1998; Australian Bureau of Statistics, Labour Costs, 1996-97; Commonwealth Bureau of Transport Economic; Waterline, various issues

Notes:
(a) Premiums paid and any other costs not reimbursed by insurers. Per cent of labour costs.
(b) Ship and cargo-based charges for loaded imports and exports, including conservancy, tonnage, pilotage, towage, mooring, berth hire and wharfage, $ per teu (twenty-foot equivalent container unit).

Survey evidence suggests that the average electricity cost reduction experienced by Victorian business customers following deregulation was about 23 per cent, (see Chapter 7, *Improving the Performance of Victorian Industry and Services*, for more information).

The shifting of Melbourne metropolitan water pricing to a usage basis has significantly reduced costs for the vast majority (85 per cent) of businesses. Those which use relatively little water and have a high net annual property value will have received particularly large reductions in their water and sewerage bills. For example, according to City West Water, water and sewerage charges for a hypothetical Melbourne City office building would have been reduced by 70 per cent because of the price reforms.

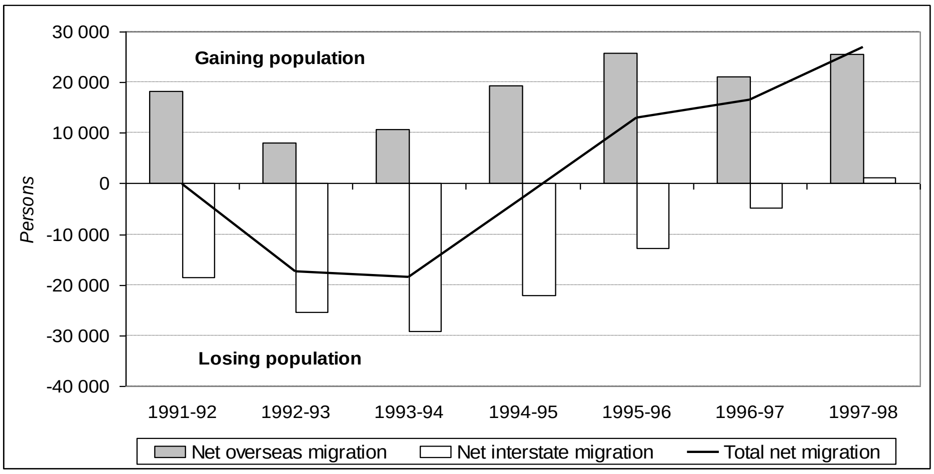
Workers' compensation reforms have involved the devolution of service provision to the private insurance and rehabilitation markets, improvements in workplace safety and return to work performance. ABS data indicate that Victorian employers faced the lowest workers' compensation costs, as a percentage of total labour costs, of any State in 1996-97. Moreover, Victoria was the only State to record a decline in workers' compensation costs, relative to total labour costs, during the previous three years (a reduction of 19 per cent compared with an increase of 11 per cent for the national average). The Australian Labour Ministers' Council found that, after adjusting for differences in industry composition, Victoria had the lowest work-related injury rate of any State except Tasmania.

Reforms to Victorian ports have included the introduction of contestability in the provision of port services, the separation of port services from regulatory functions and the introduction of price regulation. These reforms have contributed to a 40 per cent reduction in port and related charges in Melbourne between late 1993 and late 1998, according to the Commonwealth Bureau of Transport Economics. These charges in Melbourne are the lowest of the five major Australian ports. When other costs of moving freight through ports are included, such as stevedoring, customs brokers' fees and road transport charges, Melbourne's 'port interface costs' declined by 8 per cent for imports and by 7 per cent for exports over this period. These reductions were greater than for any other major Australian port, except for exports from Adelaide (which also declined by 7 per cent).

Net migration and population growth

The improvement in Victoria's economic performance is also apparent in the State's faster population growth rate, reflecting increased net migration to Victoria (see Chart 6.3). Victoria's population grew by 1.2 per cent during 1997-98, almost four times faster than during 1993-94. Migration has been the principal source of this acceleration. Total migration recorded a net gain of almost 27 000 in 1997-98, compared with a net loss of 18 500 in 1993-94, adding one percentage point to the annual Victorian population growth rate. Most of this improvement reflects the continuing swing of the balance of interstate migration in Victoria's favour. In 1997-98, Victoria gained migrants from the rest of Australia for the first time on record.

Chart 6.3: Net migration to Victoria



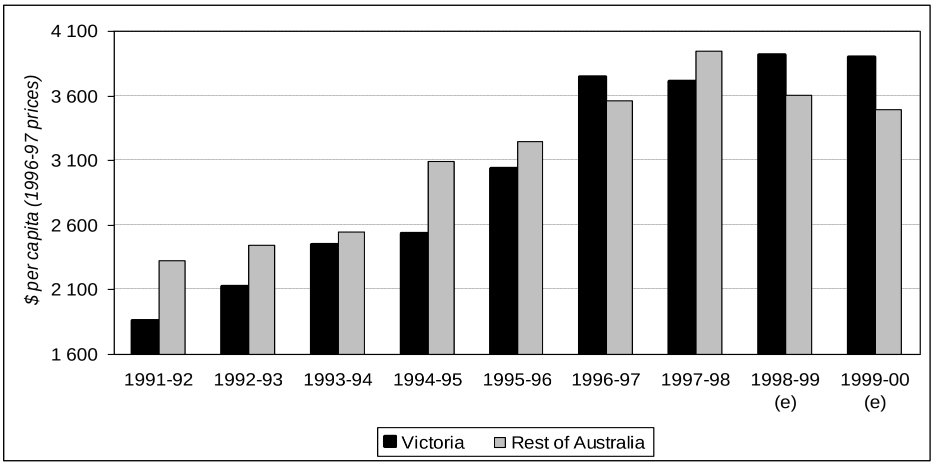
Source: Australian Bureau of Statistics, Cat. No. 3101.0

Business investment

Chart 6.4 shows that, whereas in 1991-92, Victorian per capita private business investment was 20 per cent lower than that for the rest of Australia, by 1996, it was restored to parity with the rest of the country and has remained broadly so since then. This has meant a significant increase in the growth rate of the Victorian economy's productive potential. It also implies a substantial improvement in business sentiment and confidence regarding the future economic outlook.

Capital expenditure expectations data suggest that business investment in Victoria is likely to improve further relative to the rest of Australia (see Chart 6.4). Substantial reductions in expenditure are expected in Western Australia (reflecting weakness in its mining sector), South Australia and Tasmania.

Chart 6.4: Private business investment[a] — Victoria and rest of Australia



Source: Australian Bureau of Statistics, Cat. Nos. 3101.0, 5242.0, 5646.0

Notes:

(a) Trend private gross fixed capital formation for non-residential buildings, machinery and equipment, livestock and intangible assets. Chain volume measures. Excludes major asset sales between the private and public sectors.

(e) Estimate obtained by applying five-year average realisation ratios to expected capital expenditure for the six States.

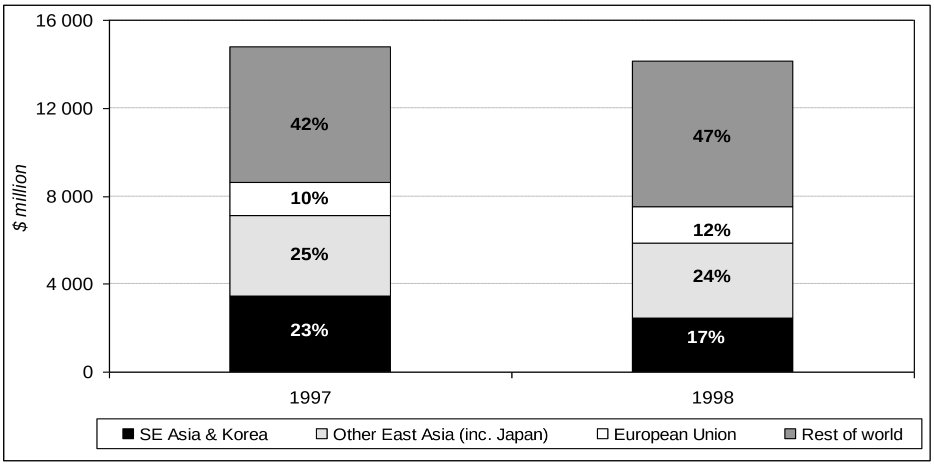
International trade

Microeconomic reforms have enhanced the ability of the Victorian economy to cope with severe external shocks, such as the slowdown in the Asian region.

Unfavourable global economic conditions saw the value of Victorian international merchandise exports (excluding gold) decline by 5 per cent in 1998. Most of this fall was due to a one-third decline in exports to the worst affected Asian economies, South-East Asia and South Korea. However, Victorian exporters have managed to redirect products away from these markets towards Europe, North America and other parts of the world. For example, exports to the European Union increased by 11 per cent in 1998, and exports to the United States rose by 21 per cent (Chart 6.5).

The extent of recent export diversion has varied widely by commodity type. Food exports have held up reasonably well in the past year, with large rises to Japan, Europe and United States. In contrast, there have been significant declines in exports of intermediate materials (e.g. textile fibres and petroleum products), reflecting lower commodity prices and weak global demand. Exports of manufactures have also weakened, with oversupply conditions in a number of product markets.

Chart 6.5: International non-gold merchandise exports[(a)] — Victoria



Source: Australian Bureau of Statistics, Cat. No. 5432.0 and unpublished data

Note:
(a) Excludes the sale of a $500 million ANZAC frigate to New Zealand in May 1997, as it is considered a Commonwealth export.

Service exports from Victoria have also been diverted away from slowing Asian markets. The number of short-term visitor arrivals in Victoria declined by 1.5 per cent through the year ending September quarter 1998, with a 16 per cent decline in the number of tourists from East Asia (including Japan) broadly offset by increased numbers from North America and Europe. International visitors also tended to stay longer in Victoria, with the number of visitor nights declining by only 0.7 per cent over the same period. Victoria's share of international visitor nights in Australia has grown from 14 per cent in 1993-94 to 19 per cent in 1997-98.

The number of international students in Victorian public higher education institutions grew by a robust 19 per cent between March 1997 and March 1998. Student numbers from East Asia grew at a similar rate during this period.

This enhanced ability of Victorian exporters to diversify away from areas of low demand reflects the State's more competitive and internationally focused business environment, the increased responsiveness and flexibility of Victorian labour markets, and the incentives provided by a floating exchange rate.

RECENT ECONOMIC TRENDS

Victoria, like most of Australia, has experienced strong domestic economic growth in the face of a weakening external trade situation. According to the latest preliminary estimates by the ABS, gross state product (GSP) grew by 3.8 per cent in Victoria in 1997-98, slightly higher than expected in the *Mid-Year Budget Review*. This represented an acceleration in growth compared with the previous year and reflected a more moderate than expected impact from the East Asian slowdown.

State final demand grew by 4.9 per cent in 1997-98, so that net exports, inventories and unidentified expenditure detracted from growth. Value estimates of state international merchandise trade for 1997-98 suggest that a substantial part of this detraction may be attributable to net overseas exports. This occurred despite the extensive diversion of exports away from Asian markets (see Chart 6.5). However, some of the recent deterioration in net exports is attributable to a reduction in crude oil exports (and an associated rise in oil imports) caused by the temporary cessation of Bass Strait production during and after the Longford incident.

More recent quarterly data indicate that domestic demand growth has continued strongly. Trend state final demand grew by 6.5 per cent through the year ending December quarter 1998, compared with 4.5 per cent for national domestic final demand. Growth was broadly based across the private and public sectors, with rising levels of both consumption and investment spending. Household consumer spending grew by 5.0 per cent through the year, supported by robust growth in real wages, low interest rates and wealth effects from the demutualisation of AMP and the partial privatisation of Telstra. Retail turnover in Victoria continued to grow strongly into the early part of 1999. Private business investment (especially non-residential construction) rose by 8.4 per cent in trend terms through the year, in contrast with national investment which was broadly unchanged. Victorian dwelling investment also grew more strongly than in the rest of Australia. While activity appears to have also been supported by strong increases in public sector expenditure, it is likely that the contribution to growth from this source has been overstated in the national accounts.

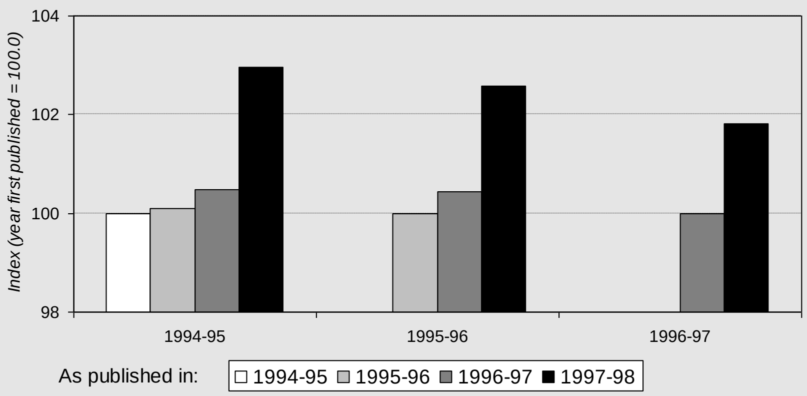
Box 6.1: Implications of SNA93 for measurement of GSP

In late 1998, the ABS introduced major changes to the Australian national accounts following the implementation of revised international standards in the *System of National Accounts, 1993* (SNA93). The adoption of SNA93 has affected the measurement of key national accounts data, including gross domestic product (GDP) and GSP. In particular, a number of SNA93 changes have raised the level of GSP:

- the imputation of employers' contributions implicitly required to fund future benefit payments from unfunded superannuation schemes;
- changes in handling workers' compensation premiums and claims;
- better measurement of the output of financial intermediaries; and
- various expenditures previously treated as consumption are now reclassified as capital formation.

Real estimates of the components of GSP are now produced using annually linked and reweighted chain volume measures, which are superior to constant price estimates. The main practical effect has been to reduce the measured real growth rate of computer equipment, affecting business investment and imports. The ABS has not yet published chain volume estimates of GSP, but has published chain volume estimates for state final demand and its components.

The chart shows revisions to Victorian GSP at current prices reflecting in part the adoption of SNA93.



The impact of the Longford incident on gross state product in 1998-99 is not yet known. Some manufacturing businesses may have been able to recover part of their lost production by working additional shifts, but other businesses are unlikely to have been able to do so.

The measurement of GSP and its components has been affected by the implementation of a new system of national accounts by the ABS (see Box 6.1).

Labour market

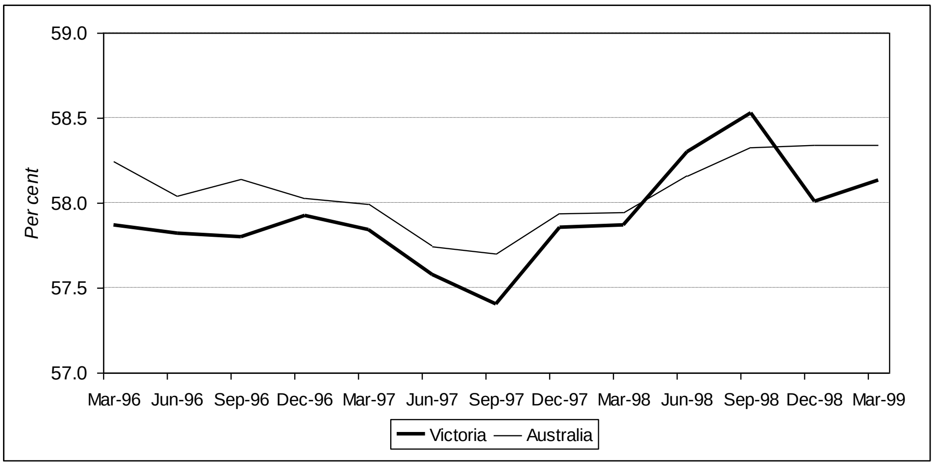
Victorian jobs growth has remained strong despite a temporary pause in late 1998, with employment reaching record levels in trend terms. Combined with a decline in the participation rate, this has pushed the Victorian unemployment rate down to around 7.5 per cent in March quarter 1999 (seasonally adjusted), its lowest level in 8 ½ years.

Victorian employment grew particularly strongly during the middle of 1998, outpacing national employment. An increasing proportion of the working age population gained jobs during this period (see Chart 6.6). Employment growth slowed in late 1998 but has since resumed its upward trend.

The strength of the labour market in the middle of 1998 encouraged increased labour force participation (see Chart 6.7). The temporary weakening in employment conditions in late 1998 may have contributed to a marked decline in the Victorian participation rate. However, the participation rate appeared to stabilise in early 1999, as employment growth resumed.

The Victorian seasonally adjusted unemployment rate has now declined from a peak of 12.7 per cent in August 1993 to around 7.5 per cent in March quarter 1999 (see Chart 6.8). The unemployment rate has fallen by a full percentage point since the March quarter 1998, through a combination of employment growth and lower participation rate.

Chart 6.6: Employment rate[a] (seasonally adjusted) — Victoria and Australia

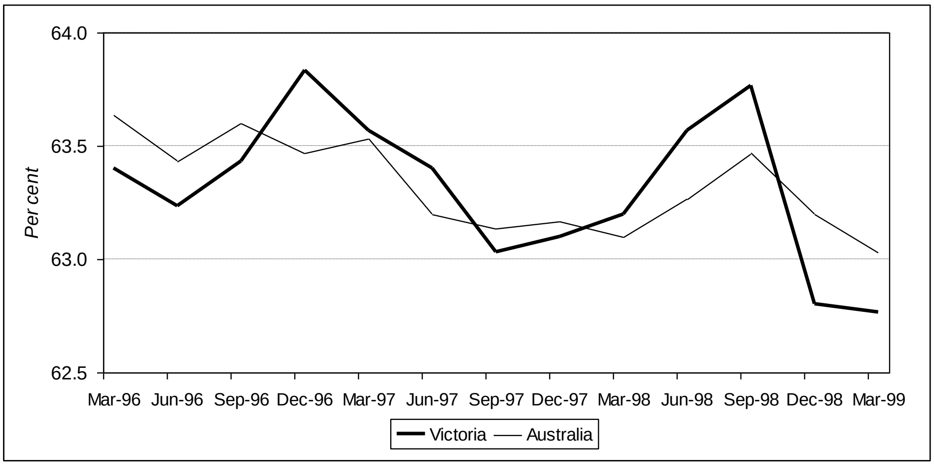


Source: Australian Bureau of Statistics, Cat No. 6202.0

Note:

(a) Civilian employment as a percentage of the civilian population aged 15 years and over, average of quarter.

Chart 6.7: Participation rate[a] (seasonally adjusted) — Victoria and Australia



Source: Australian Bureau of Statistics, Cat No. 6202.0

Note:

(a) Civilian labour force as a percentage of the civilian population aged 15 years and over, average of quarter.

Chart 6.8: Unemployment rate(a) (seasonally adjusted) — Victoria and Australia

Source: Australian Bureau of Statistics, Cat. No. 6202.0

Note:
(a) Average of quarter.

Forward indicators of the Victorian labour market are quite positive:

- the ANZ Bank's job advertisements in Victoria have risen steadily since early 1998; and
- the Commonwealth Department of Employment, Workplace Relations and Small Business' skilled vacancy index for Victoria in March 1999 was 17 per cent higher than a year earlier.

In metropolitan Melbourne, the unemployment rate (original data) declined from 9.0 to 7.7 per cent between the March quarters of 1998 and 1999. In regional Victoria, the unemployment rate declined from 9.3 per cent to 8.7 per cent between the March quarters of 1998 and 1999.

Victorian employment growth over the past year has been concentrated in the services sectors, especially property and business, health and community, and cultural and recreational services. Construction employment also grew strongly.

Business fixed investment

Private business investment has risen strongly in recent quarters (Chart 6.9). Building work on shops and other business premises rose strongly during 1998, and construction of industrial premises also increased. The recreation and entertainment sector has been underpinned by work on the Colonial Stadium in

Melbourne Docklands. Engineering construction has been supported by Melbourne City Link as well as work on railways, electricity infrastructure, pipelines, oil and gas engineering, and coal handling.

The rise in retail construction appears broadly based, with the value of approvals growing in inner and outer Melbourne, major regional centres and rural Victoria. Recently completed retail projects include the redevelopment of Westfield Shoppingtown (Airport West), the first stage of an extension to Chadstone Shopping Centre, construction of Berwick Marketplace, and extensions to Sunshine Marketplace and Woodgrove Shopping Centre (Melton). Work continues on extensions to the Southland and Knox shopping centres. A recent survey by Richard Ellis Pty Ltd indicated that retail floor space planned or under construction in metropolitan Melbourne amounted to almost 8 per cent of existing floor space.

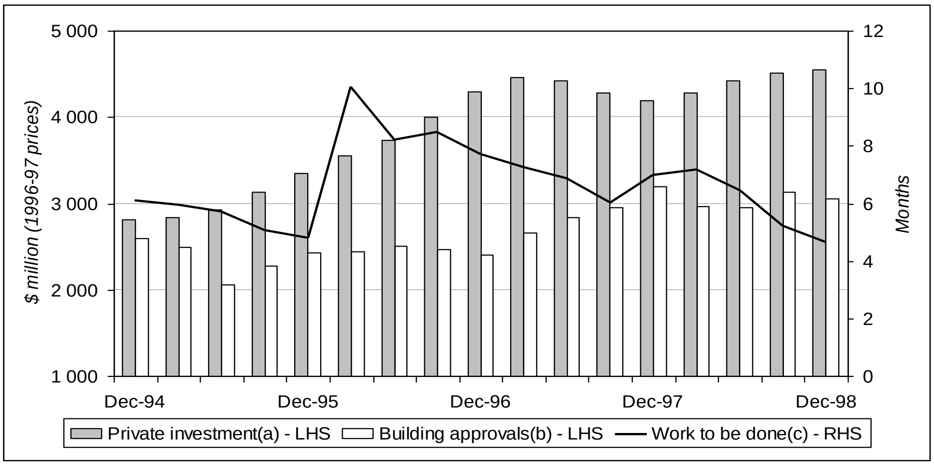
The following major commercial and industrial projects have been recently announced, commenced or completed:

- development of new vehicle models by Ford Australia and Toyota;
- establishment of a military aircraft systems design house by British Aerospace;
- bulk commodity facility at Appleton Dock by Grainco;
- plant expansion by McCain Foods;
- transfer of food manufacturing plants from interstate by Simplot;
- relocation of Australia Post's national data centre;
- upgrading of milk processing facilities by National Foods; and
- expansion of a dairy powder plant by Tatura Milk.

Four major gas infrastructure projects at various stages of completion represent between \$698 million and \$825 million worth of investment. The \$50 million interconnect pipeline between New South Wales and Victoria was opened in August 1998. In November 1998, the Government contracted the construction of the underground gas storage project at Port Campbell and the south-west pipeline to integrate the underground gas storage with Victoria's gas distribution system for winter 1999. Construction of the underground gas storage began in December 1998. An 800-kilometre, \$450 million pipeline between Bass Strait and Sydney is also planned.

Growth in approvals for new industrial construction has been focused on inner Melbourne. Transport improvements associated with the Western Ring Road have been important in encouraging new warehousing and distribution developments.

Chart 6.9: Business investment indicators — Victoria



Sources: Australian Bureau of Statistics, Cat. Nos. 5242.0, 8731.0, 8752.0

Notes:

(a) Private investment: private gross fixed capital formation, non-residential buildings and structures, equipment, livestock and intangible assets, chain volume measures, trend..

(b) Building approvals: non-residential building approvals, year to date, chain volume measure.

(c) Work to be done: work yet to be done divided by work done (year to date) multiplied by 12 for private non-residential construction and private (for total) engineering construction.

The value of non-residential construction approvals outside metropolitan Melbourne was 13 per cent higher in the second-half of 1998 than a year earlier. Strong growth was reported in Geelong (commercial, retail and public buildings), Bendigo (public) and Shepparton (commercial, industrial and retail).

The volume of private business investment yet to be completed, at current rates, has declined to levels last seen before the commencement of Melbourne City Link in early 1996. However, the value of Victorian private non-residential building approvals in 1998 was broadly unchanged compared with the previous year. In addition, Docklands projects in Melbourne valued at between \$4.5 billion and \$6.0 billion are anticipated, with completion dates extending to 2013. The \$430 million Colonial Stadium is expected to be completed by February 2000.

Work has also commenced on new premises for the Museum of Victoria, an upgrade of the National Gallery of Victoria, a new State Archives Centre, the redevelopment of the State Library, and a new multi-sport and entertainment venue in Melbourne. A major new hotel is also under construction on the site of the former Melbourne City Square.

Expectations data from the ABS capital expenditure survey suggest that Victorian business investment in this financial year and in 1999-2000 is unlikely to fall to below 1997-98 levels as higher equipment investment will compensate for an anticipated decline in building expenditure. The survey suggests that capital spending is likely to be concentrated outside the manufacturing sector in Victoria. Overall, Victorian per capita business investment remains high.

Housing

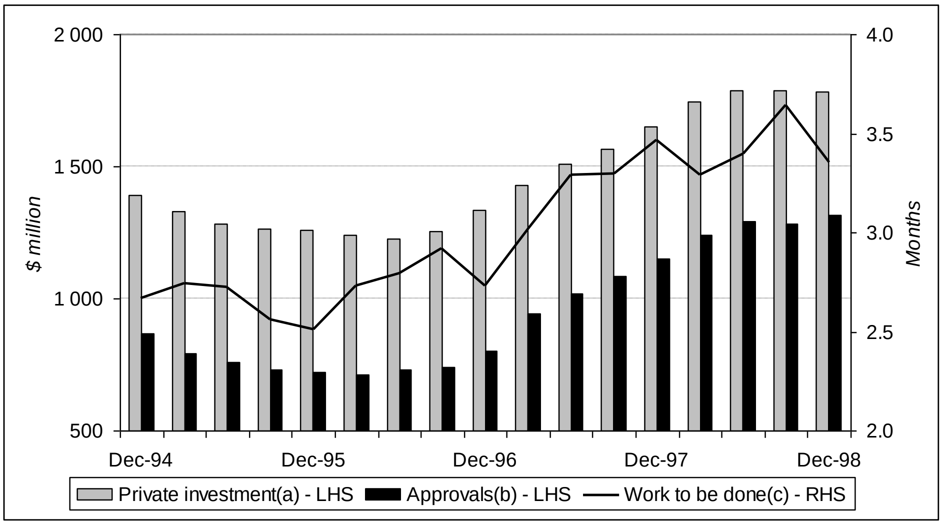
Private dwelling activity in Victoria has risen strongly since early 1996, being supported by low interest rates, a tight rental market, an improving labour market and a turnaround in net interstate migration. In response to the strength of demand, Melbourne housing prices have risen sharply relative to construction costs (even more sharply than in Sydney), encouraging new construction.

Conditions in the Melbourne residential rental market have continued to ease. The trend vacancy rate reached 2.9 per cent in the September quarter 1998, compared with 1.3 per cent in March quarter 1996. Nevertheless, median residential rents grew by 2.9 per cent in trend terms through the year ending December quarter 1998 in Melbourne and by 5.9 per cent in country Victoria.

In line with national developments, private investment began to trend down in late 1998. However, forward indicators of housing activity in Victoria remain firm and the investment pipeline appears relatively lengthy (see Chart 6.10). This may reflect a greater level of unsatisfied demand in Victoria than elsewhere in Australia and suggests that the expected downturn in the national housing cycle is likely to be less severe in Victoria.

Particularly strong increases in residential building approvals have been recorded in outer Melbourne, Geelong and Shepparton.

Chart 6.10: Housing indicators — Victoria



Sources: Australian Bureau of Statistics, Cat. Nos. 5242.0, 8731.0, 8752.0

Notes:

(a) Private investment: private gross fixed capital formation, dwellings, chain volume measure, trend.

(b) Approvals: value of total residential building approved (current prices), trend.

(c) Work to be done: work yet to be done divided by work done (year to date) multiplied by 12 for private residential building.

Rural and regional Victoria

Severe floods occurred in East Gippsland in late June 1998. State government assistance included funding for public infrastructure and lands, emergency services, community projects, catchment management, private land rehabilitation and land buyback. Concessional loans to farmers and small business were also provided.

Adverse local weather conditions in Victoria resulted in below-average wheat yields in 1998-99. Heavy frosts in late October caused significant crop damage in the Wimmera, north-central and north-east regions; and a lack of rainfall in the Mallee resulted in the worst crop yields since 1994. The state wheat and barley crops for 1998-99 are estimated to be down 10 per cent on the previous year. Frosts and dry weather also affected a number of other Victorian crops, including field peas and chickpeas. However, canola production reached record levels, with particularly high yields in southern Victoria.

Victorian wool production is estimated by the Wool Production Forecasting Committee to have increased slightly in 1998-99, despite a reduction in the state flock. Wool exports to major markets have declined reflecting contracting demand for Chinese textiles, financial difficulties in the South Korean textile industry and soft retail demand in Japan.

Victorian lamb, sheep meat and beef production increased in 1998. Rainfall north of the Dividing Range was below average for the year, and limited spring rain caused earlier lamb turnover and a contraction in late supply. Rainfall in the south-west was below average, but good winter growth allowed production to be maintained despite transfers of grazing land into crop production. In Gippsland stock numbers began the year at low levels due to drought conditions. The financial position of farmers made restocking difficult following the heavy rains in June. Overall, in Gippsland pasture production for the year was good but meat production was below average due to farmers' inability to restock.

Dairy exporters were sheltered from lower international skim milk prices by the depreciation of the Australian dollar in the second half of 1998. Exports to East Asia initially declined in the face of higher local currency prices, but had almost recovered to pre-slowdown levels by late 1998. Victorian wholemilk production rose by 4.5 per cent in 1998. Average seasons were experienced in dryland dairy production areas, while shortages of irrigation water were experienced in the Northern Irrigation Area. However, production in the Northern Irrigation Area was average to above average due to widespread purchasing of fodder. Overall state milk production levels are up compared to this time last year.

World wine grape production appeared to outpace demand in 1998-99. Wine grape yields in the north-east were affected by the October frost, while rain reduced yields from multi-purpose varieties in the Mildura region. Otherwise, seasonal conditions were favourable and a record intake of wine grapes is anticipated.

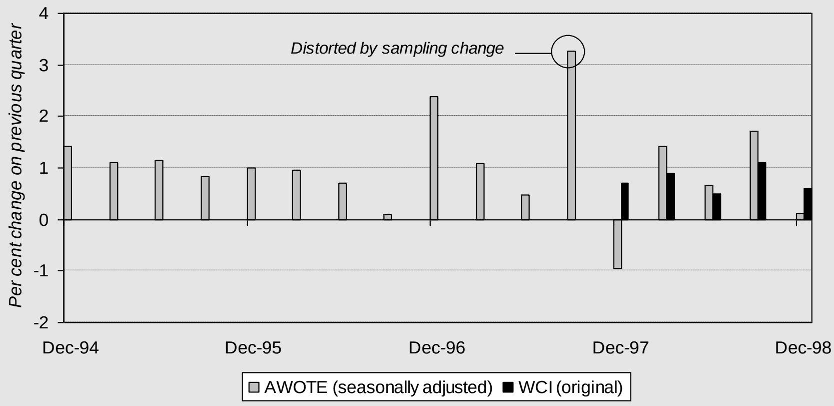
Box 6.2: Wage cost index

Three common measures of change in the cost of labour are provided by average compensation per employee, average weekly ordinary-time earnings of full-time adults (AWOTE) and the wage cost index (WCI).

Average compensation is calculated as total compensation of employees estimated in the national accounts divided by the number of wage and salary earners. It includes wages, overtime, bonuses, workers' compensation, employer superannuation contributions and redundancy payments. Although broad in scope, it has deficiencies as an indicator of movements in wage rates, being affected by changes in average hours worked and composition of wage and salary earners by industry, age and sex.

AWOTE is calculated as weekly earnings divided by the number of employees for a sample of employers. It excludes on-costs, is unaffected by variations in the proportion of part-time employment, but is affected by changes in average hours paid per full-time employee and the rolling of overtime payments into ordinary wages under enterprise or workplace agreements. Also, because the sample of employers varies each quarter, the series can be distorted by changes in the distribution of employees within and across occupations and industries (see chart below).

The WCI provides conceptually the best single measure of wage movements. It is constructed as a price index, based on hourly rates of pay for a representative fixed basket of employee jobs (similar to the methodology used to construct the consumer price index). Consequently, the WCI avoids the sample rotation problems inherent in AWOTE.



Prices and wages

Consumer price inflation, both nationally and in Melbourne, has been unexpectedly low. Melbourne consumer prices as measured by the CPI declined by 0.1 per cent in 1997-98. This reflected reductions in mortgage interest rates between mid-1996 and mid-1997.

As discussed above, reductions in utility prices have kept Melbourne's inflation rate below the national average. Consumer prices grew by 0.8 per cent through the course of 1998, compared with 1.6 per cent nationally.

Wages in Victoria, as measured by the ABS ordinary time WCI, grew by 3.1 per cent through the year ending December quarter 1998, the same as the national rate. It should be noted that the WCI is a more accurate indicator of wage pressures in the economy than average weekly earnings (see Box 6.2).

ECONOMIC OUTLOOK

The economic projections presented here make no allowance for the potential impact of national tax reform. In this sense, they have been prepared on a 'no policy change' basis. The implications for the projections of the taxation reform measures agreed by the Commonwealth, States and Territories at the April 1999 Premiers' Conference are examined at the end of this section.

Global outlook

According to the International Monetary Fund (IMF), global economic growth declined from over 4 per cent in 1997 to 2.5 per cent in 1998. The latest IMF projections, in April 1999, anticipate that global growth will remain just under 2 ½ per cent in 1999. The most recent consensus of private economic forecasts of world growth is more pessimistic, averaging around 1 ½ per cent for 1999.

This weakness in the global outlook is primarily attributable to East Asia, including Japan. The United States is expected to continue to underpin world growth, although a major risk to the outlook remains the possibility of a downward correction to US asset prices. The major European economies are likely to slow, with signs of weaker demand in Germany and France. However, European monetary policy was loosened in April, with interest rate cuts in the United Kingdom and by the European Central Bank. Some of the heavily recessed East Asian economies should begin to contribute modestly to world growth during the next year. While growth is expected to continue in China and Taiwan, there is little prospect that Japan will recover significantly in the near term given ongoing concerns about the state of its financial sector.

Developments in Latin America have been the most recent source of potential inter-regional economic instability.

Official and private forecasters anticipate some recovery in world growth in the longer term. For 2000, the IMF is expecting global growth of 3 ½ per cent, and the consensus of private forecasters is predicting 2 ¼ per cent.

National outlook

In its *Mid-Year Economic and Fiscal Outlook 1998-99*, released in December 1998, the Commonwealth Treasury expected the national economy to grow by around 3 ¼ per cent in 1998-99 and by 2 ¾ per cent in 1999-2000. Since then, private forecasters have generally become more optimistic about the near-term outlook, with GDP growth expected on average to exceed 4 per cent in 1998-99 and be around 2 ¾ per cent in 1999-2000.

Weaknesses in global industrial production and incomes are maintaining downward pressure on prices for most agricultural and mineral commodities exported by Australia. However, excess global industrial capacity (especially in East Asia) has contributed to reductions in world prices for many manufactured imports, restraining the decline in Australia's terms of trade.

Commonwealth Treasury expected national employment to grow by 2 per cent in 1998-99, before slowing to 1 ¼ per cent in 1999-2000. Recent private sector employment growth forecasts are slightly more optimistic, at around 2 ¼ per cent in 1998-99 and 1 ½ per cent or more in 1999-2000. Employment growth at these levels would see the national unemployment rate maintained at around 7 ½ per cent over the next two years.

Victorian outlook

The economic projections for Victoria are shown in Table 6.2.

In 1998-99, Victoria's growth is expected to continue at around the 3.8 per cent recorded in 1997-98. The strong domestic cycle evident in the second half of 1998 is assumed to maintain state final demand growth at a rate close to the 4.9 per cent recorded in 1997-98. Net international exports of merchandise are expected to continue to detract from growth, but activity is likely to be supported by net exports to other States.

A number of influences can be expected to moderate the strength of domestic demand during the course of 1999:

- consumer spending growth should ease as the wealth effects of the AMP demutualisation and Telstra partial privatisation begin to wane, and as pressure develops to increase currently low saving rates;
- as discussed earlier, housing activity is likely to moderate; and
- little further contribution to growth is likely from currently high levels of business investment.

As a result, state final demand growth is forecast to ease to less than 3 per cent in 1999-2000. However, net overseas exports may begin to recover at this time as import demand eases and the major East Asian economies begin to show signs of improvement. Victorian activity is expected to grow at around 2 ¾ per cent in 1999-2000.

Employment is expected to grow by around 1 ¾ per cent in Victoria in 1998-99, following strong growth through the course of the previous year. The domestic growth slowdown is forecast to reduce employment growth to about 1 per cent in 1999-2000. This is expected to leave the unemployment rate at around 7 ½ per cent by mid-2000.

With interest rates relatively stable since mid-1997, and highly competitive conditions among retailers, Melbourne consumer price inflation is expected to rise modestly to 1 per cent in 1998-99. Moreover, the influence of mortgage interest rates on the annual CPI will disappear in 1999-2000 because interest charges have been excluded from the 13th series CPI introduced in the September quarter 1998. Melbourne's annual inflation rate in 1998-99 is expected to be lower than the national rate by as much as one-half of a percentage point partly because of reductions in water charges and the Winter Power Bonus.

Melbourne consumer price inflation is expected to drift up to around 2 per cent in 1999-2000, but ongoing downward pressure on utilities prices means that this will be below the likely national inflation rate.

It is assumed that wages growth, as measured by the ordinary-time wage cost index excluding bonuses, will average around 3 ½ per cent in 1998-99 and 1999-2000. Labour costs to employers are likely to grow more strongly than this because of the increase in the Superannuation Guarantee Charge in July 1998.

The population projections are based on the ABS Series L which assumes, for Victoria:

- net interstate migration losses of 7 000 persons per annum; and
- net overseas migration gains of 21 500 persons per annum (a little less than one-quarter of the assumed national total of 90 000).

Of the range of population projections prepared by the ABS, Series L has the lowest level of net interstate migration losses from Victoria. However, given that Victoria is currently attracting population from the rest of Australia, it is likely that this will prove conservative over our projection period. Some indication of the potential impact of continuing net population gains by Victoria is provided at the end of this chapter.

Beyond 1999-2000, Victorian growth is expected to recover to around 3 ¼ per cent by 2001-02. This reflects a progressive recovery in global economic activity, with benefits for national and Victorian exporters, and an associated improvement in the terms of trade flowing through to domestic incomes.

Allowing for long-term annual labour productivity growth of about 1 ¾ per cent, employment growth is expected to rise to around 1 ½ per cent per annum. Annual Victorian population growth of around 0.8 per cent over the next few years is consistent with annual growth in the working age population of around 1.1 per cent. The labour force is projected to grow slightly more quickly assuming a modest rise in the participation rate, so there is expected to be a gradual reduction in the Victorian unemployment rate to around 7 ¼ per cent by mid-2002.

Consumer price inflation is assumed to converge on the middle of the Reserve Bank’s target range of 2 to 3 per cent per annum, while annual wages growth is expected to remain at around 3 ½ per cent. Employers face higher growth in labour costs in 2000-01 and again in 2002-03 because of scheduled increases in the Superannuation Guarantee Charge.

Table 6.2: Victorian economic projections[a]

	Actual *1997-98*	*1998-99*	*1999-00*	*Projections* *2000-01*	*2001-02*	*2002-03*
Gross state product	3.8[f]	3 ¾	2 ¾	3	3 ¼	3 ¼
Employment	1.5	1 ¾	1	1 ½	1 ½	1 ½
Unemploy-ment rate[b]	8.3	7 ½	7 ½	7 ½	7 ¼	7 ¼
Participation rate[c]	63.2	63	63	63 ¼	63 ¼	63 ½
Consumer price index	-0.1	1	2	2 ½	2 ½	2 ½
Wage cost index[d]	n.a.	3 ½	3 ½	3 ½	3 ½	3 ½
Population[e]	1.2	1.0	0.8	0.8	0.8	0.8

Source: Australian Bureau of Statistics; Department of Treasury and Finance

Notes:
(a) Per cent change on preceding year unless otherwise indicated.
(b) Estimate for June quarter, per cent.
(c) Year average, per cent.
(d) Ordinary time hourly rate excluding bonuses.
(e) Based on Australian Bureau of Statistics series L projections.
(f) Preliminary ABS estimate.

Sensitivity of projections

Impact of national tax reform

The Commonwealth proposes an extensive tax reform package to be implemented commencing July 2000 (see Chapter 9, *A New Era of Commonwealth-State Relations*).

As at April 1999, key aspects of the proposal likely to materially affect the projections include:

- reductions in personal income tax rates only partly offset by increases in indirect tax collections, resulting in a substantial fiscal stimulus; and
- rationalisation of the indirect tax system through the abolition of the Commonwealth's wholesale sales tax and a number of state indirect taxes and the introduction of a broadly based goods and services tax (GST) to be collected by the Commonwealth and distributed among the States and Territories.

If implemented, the fiscal stimulus associated with the package is likely to contribute to a significant temporary increase (relative to the package not being implemented) in national economic activity.

The package would also result in a permanent increase in the price level, with an associated temporary rise in the inflation rate. Commonwealth Treasury has estimated the impact on the price level to be 2.5 per cent in 2000-01, and 1.9 per cent in 2001-02 (excluding its impact on tobacco prices).

Overall, the impact of higher indirect taxes on the real incomes of employees is expected to be more than offset by reductions in rates of personal income tax and increases in social security benefit rates.

Population growth

The improved performance of the Victorian economy over the past few years has been associated with a reversal of population losses to other States. Although it is uncertain whether this trend will continue, the impact of changes in interstate population movements on the economic projections can be estimated.

At present, Victoria is gaining population from the rest of Australia at a net annual rate of a little over 1 000 persons, or 8 000 more than assumed in the ABS Series L, upon which the economic projections are based. In the absence of any other changes, it is estimated that a sustained improvement in net interstate migration of this amount would lead to Victorian population, employment and GSP growth being almost 0.2 percentage points per annum higher over the course of the projection period. By 2002-03, Victorian GSP and employment are estimated to be around 0.7 per cent higher than otherwise. The additional migration is estimated to have a significant effect on the Victorian housing construction sector, boosting annual investment spending by over 3 per cent.

CHAPTER 7: IMPROVING THE PERFORMANCE OF VICTORIAN INDUSTRY AND SERVICES

- The restructuring and reform of a range of industries have delivered tangible benefits to Victorian households and businesses through lower prices, better services and greater choices.
- The annual electricity bill of a typical household has fallen by about 15 per cent in real terms between 1993-94 and 1998-99. Since 1 July 1998, small businesses have been able to choose their supplier from among 24 competing electricity retailers.
- The Government's program of legislation review and regulation reform has improved the business environment in Victoria by removing outmoded regulations and unwarranted restrictions on business activities. Between 1992 and 1998, the number of regulations which impact on businesses has fallen 39 per cent from 706 to 432.
- Continuous improvements in the quality of social services will underpin a higher standard of living in Victoria in the next century. This can be best achieved by promoting and harnessing service delivery mechanisms selected through rigorous contestable processes. Recent examples include the franchising of public transport services and the private provision of hospital and waste water treatment services.
- The Government will continue to apply and refine its reform principles to strengthen Victoria's competitive advantage and to achieve sustained economic growth necessary to provide a better and more secure future for all Victorians.

Since 1992, the Victorian Government has implemented a concerted program of government business enterprise (GBE) reform to improve the delivery of government services. This program is part of a broader strategy of industry reform to create a more competitive and responsive business environment. In 1999-2000, the Government will continue to enhance the competitiveness of the Victorian economy and harness competitive market mechanisms, wherever appropriate, to deliver a greater diversity of high quality, better value services to the community.

This chapter outlines the rationale and principles that have and will continue to guide the Government's reform strategy. It highlights the recent achievements and benefits of reform, outlines the measures which the Government will employ to manage adjustment and transitional issues, and indicates the way ahead for making Victoria a better place to invest and do business.

REFORM RATIONALE AND GUIDING PRINCIPLES

The Government’s fundamental aim in pursuing industry reform is to stimulate economic growth, investment and job creation, thereby providing a better and more secure future for all Victorians. To achieve this objective, the Government has taken steps to create and sustain a more open and competitive economy. Businesses and industry have been given greater incentives to perform efficiently and to seek technological and market opportunities for improving the range and quality of products and services. For the individual citizen, a competitive economy translates into greater consumer choice and better value for money. In its role as a purchaser of services, governments at the state and local level will also have a greater ability to choose providers or services that are best tailored to community needs and expectations.

Guiding principles for reform

The Victorian approach to government business enterprise and industry reforms has been consistently formulated on the basis of an integrated set of guiding principles. The Government will continue to apply these principles in a coherent and structured manner to achieve the desired outcomes that will collectively provide the platform for an even better economic future for Victoria.

Focus public sector on core government functions and promote private sector involvement

Government has responsibilities for both the funding and delivery of a range of services to the community. However, this does not necessarily imply that it needs to be directly involved in the function of service delivery or the business activities related to the service. Once the dimensions of a particular service have been properly identified, government can frequently offer the private sector the opportunity to deliver the service to the community. This often means a lower cost, an improved service, or a service that is better tailored to community needs and requirements. The promotion of private provision does not diminish the accountability or responsibility of government for services.

Promote contestability in markets where the government has a direct or indirect involvement

The Victorian Government will harness market-based mechanisms wherever possible to improve resource allocation. This can be achieved by introducing contestability to a range of services provided by the public sector. Contestability is about making it easier for all capable public sector and private sector providers to meet the specific and identified needs of the community. A contestable environment which attracts a diversity of suppliers will improve outcomes for service users by creating consumer choice among suppliers. Service suppliers will have a greater incentive to provide client-focused services which are more appropriate to the needs of individuals. By promoting contestability, the Government can attain a better matching of service delivery with its equity objectives and the needs of the community, thereby achieving better value for Victorian taxpayers.

Promote effective consumer choice

A market in which there is only one service provider and limited service features is unlikely to satisfy the needs of a diverse community or be responsive to consumer demands. The Government will pursue contestable outcomes wherever it seeks to promote effective consumer choice and more satisfying purchasing decisions for the community.

Remove impediments to the effective operation of markets

The Government will remove all unnecessary impediments to the effective operation of markets. Typically, this involves the removal of regulations which unnecessarily constrain business investment or performance, or add unnecessary or excessive costs to business operations. It may also involve the removal of artificial restrictions set by law which impede the ability of the private sector to supply publicly funded services. Whilst in many cases regulations are necessary to protect community interests, regulations that are poorly considered or outdated can stifle initiative and innovation and impede economic growth and job opportunities. The Government will only maintain existing or introduce new regulations following clear exposition of their net benefits to the community.

Reduce risk to the State

The Government is committed to safeguarding the financial position of Victoria to avoid imposing any unnecessary tax burden on the community beyond reasonable revenue requirements. This requires that the State’s own financial businesses, such as funds management, insurance and trustee activities, be subject to efficient prudential frameworks. In cases where the private sector is involved in service delivery or the provision of infrastructure projects, the Government can transfer all construction, operational and business risks to the private sector which holds the necessary expertise to manage these risks.

Enhance the effectiveness of government policy intervention

A major focus of the public sector is policy formulation, implementation and evaluation, with a view to both short-term outcomes as well as longer-term prospects. In determining appropriate policy interventions, the Government will clearly define and prioritise its objectives, consider all relevant factors, identify and evaluate options, and then implement the desired policy at least cost. The Government’s interest is not confined to simply formulating least cost strategies, but implementing effective and efficient steps to deliver the desired outcomes for the benefit of the community. This involves consideration of outsourcing, privatisation, removal of unnecessary impediments and the introduction of market-based mechanisms.

REFORM ACHIEVEMENTS AND IMPACT ON VICTORIAN BUSINESSES AND HOUSEHOLDS

The Government has successfully achieved its reform objectives for a number of sectors and industries. Real and substantial benefits have been realised in a number of sectors, most notably the electricity and water industries. In other areas where reforms have just been implemented or are ongoing, the benefits are expected to materialise over the short to medium term.

Electricity industry reform

The Government's comprehensive electricity reform program has successfully transformed a vertically integrated state-owned monopoly into a competitive and dynamic industry. The reform program has lifted the performance of the industry, eliminated most of the commercial risks for government, and lowered the cost of a basic service and essential business input for the benefit of Victorian households and businesses.

During 1998-99, the Government has continued to withdraw from direct ownership and operation in the industry. In September 1998, the Government's stake in the Hume Power Station was sold for nearly $8 million to Pacific Power, thereby eliminating Victoria's future liabilities for maintenance and upgrade of the plant. In November 1998, the Victorian Network Switching Centre (VNSC) was sold to GPU PowerNet, owner of Victoria's high voltage network, for $8 million. VNSC controls the switching of the high voltage network. In March 1999, the Government announced the sale of the gas-fired power stations trading as Ecogen Energy for $350 million.

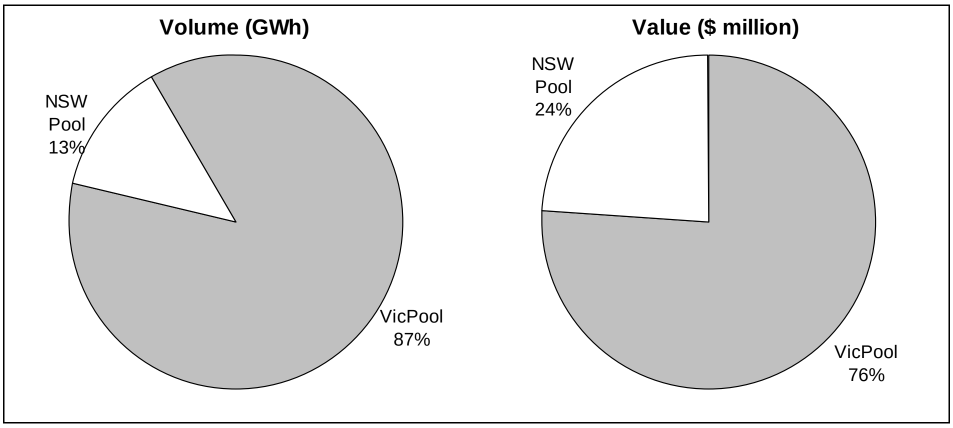
The competitiveness of the Victorian electricity industry was enhanced further in December 1998 with the commencement of the national electricity market. This market is an interconnected wholesale electricity market which operates across New South Wales, Victoria, Queensland, South Australia and the Australian Capital Territory. With the commencement of the national electricity market, the central market operating function of the Victorian Power Exchange (VPX) was transferred to the new National Electricity Market Management Company (NEMMCO). The role of electricity planning for Victoria will be the responsibility of the Victorian Energy Networks Corporation (VENCorp).

Victoria's participation in the national electricity market will generate benefits similar to those already delivered through the State's electricity industry reforms. Competitive trading through a single integrated market will create the necessary price and investment signals to promote more efficient and sustainable use of existing infrastructure. Furthermore, the integration of the existing state electricity networks improves system security, reduces reserve capacity needs and costs for individual States, and provides more accurate economic signals for future investment in network and generation assets.

In 1997-98, about 4 000 GWh of electricity worth approximately $48 million was traded between the interconnected wholesale markets in Victoria (VicPool) and New South Wales (NSW Pool). Victoria's share of the total inter-pool trade was 3 468 GWh or 87 per cent of total volume. The value of the electricity exported by Victorian generators was more than $36 million or 76 per cent of the total value of electricity traded (see Chart 7.1).

On 1 July 1998, another major segment of the Victorian electricity market was made contestable. Victorian electricity customers consuming greater than 160 MWh per annum (e.g. single-storey offices and fast-food restaurants) are now able to choose their electricity retailer. Twenty-four retailers competed during the year to supply electricity to these contestable customers. From January 2001, all Victorian electricity customers will be able to choose their retailer.

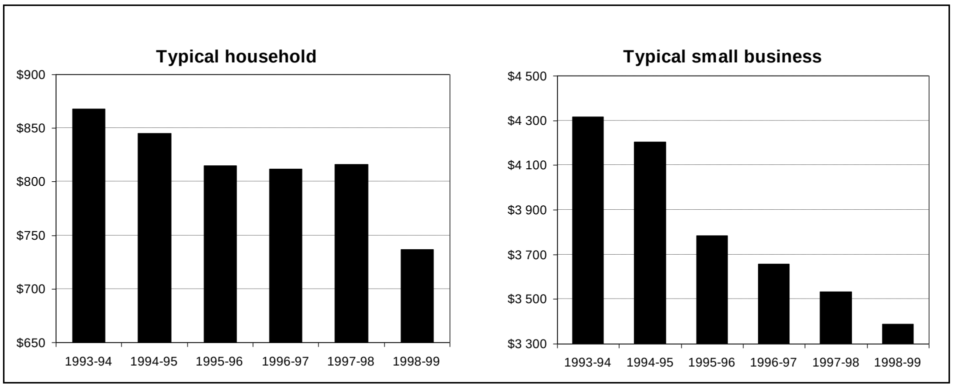
Chart 7.1: Share of inter-pool electricity trade, 1997–98



Source: Victorian Power Exchange, VicPool Annual Report, 1997-98

Electricity reform has benefited Victorians. Between 1993-94 and 1998-99, the real annual electricity bill (in 1998-99 prices) of a typical household (with an electric hot water system using an average 5 500 kWh per annum) fell by about 15 per cent from $868 to $737 (see Chart 7.2). Over the same period, the annual electricity bill of a typical small business customer (such as a fish and chip shop consuming an average of 25 000 kWh per annum) fell by more than 21 per cent in real terms from $4 317 to $3 389.

Chart 7.2: Real annual electricity bill of a typical household and small business (1998-99 prices)



Source: Department of Treasury and Finance

This reduction includes the first Winter Power Bonus, comprising a $60 reduction on householder and small business winter electricity bills announced by the Government in September 1998. The Winter Power Bonus will also apply to winter electricity bills in 1999 and 2000. It is estimated that Victorian consumers will enjoy $360 million in savings over the three years of the Winter Power Bonus program.

The Australian Chamber of Manufacturers undertook a survey of industrial and commercial customers in February 1998. It reported that over 91 per cent of firms stated they were better off as a result of electricity reforms, compared to 2 per cent of firms which considered themselves worse off. The average cost reduction experienced by Victorian business customers following the introduction of contestability from December 1994 was approximately 23 per cent or $24 per MWh.

The reliability of electricity supply to Victorian customers has continued to improve. For example, the Office of the Regulator-General (ORG) reported that during the first half of 1998 customers experienced an average of 108 minutes off supply, a reduction of 7 per cent from 116 minutes in the same period in 1997. The ORG also reported that the trend towards increased use of instalment plans for residential customers was maintained, helping those customers to budget for their bill payments. During the period January to June 1998, around 63 000 residential customers used budget instalment plans as a payment tool, a 5 per cent increase on the same period in 1997.

Box 7.1: An example of the benefits of electricity reform for Victorian manufacturers

The Wangaratta-based Bruck Textiles is Australia's largest manufacturer of fabrics for fashion, corporate, institutional and industrial wear. According to Bruck's General Manager, Mr M. White, the company's total costs (power plus distribution) fell by 27 per cent with the introduction of contestable power supply. This translated to a saving of approximately $330 000 per annum. Mr White says: "In the year of implementation of contestable electricity supply, Bruck Textiles reduced its average unit production costs by 8 cents per metre. The effect of the reduction in electricity tariffs obtained from contestable supply was 2 cents per metre. That is, 25 per cent of the productivity savings obtained by Bruck in 1997-98 can be attributed to electricity reform."

Source: *Mr M. White, General Manager, Bruck Textiles*

Water industry reform

Since 1995, the Government has introduced a series of structural reforms to lift the service and performance of the state-owned water businesses in Victoria. Melbourne Water was disaggregated into one wholesale business (Melbourne Water Corporation) and three retail businesses (City West Water, South East Water and Yarra Valley Water). Over 80 water authorities, which previously supplied Victoria's provincial towns, have been amalgamated into 15 state-owned businesses.

A new water pricing regime for all domestic and non-domestic customers in metropolitan Melbourne came into effect on 1 January 1998. A user-pays approach to water and sewage disposal charges was introduced. It replaced the rates charged on the basis of property value. Concessions for low-income households have been retained under the new pricing regime.

The continuing development of water trading in regional Victoria has also resulted in substantial benefits by moving water to where farmers and other primary producers can make a better return from their investments (see Box 7.3).

The ORG has reported that, as a result of the new metropolitan water pricing regime, the water and sewerage bill of an average household in owner-occupied premises in Melbourne has fallen by approximately 20 per cent or $135 a year (in 1997-98 prices). The pricing package includes reduced water and sewerage bills for around 200 000, or 90 per cent of all, pensioner households.

Water customers across regional Victoria received an average 18 per cent reduction in their bills as part of the Government's $450 million regional water reform package that also delivered improved water quality and environmental management. Under this package, which took effect from 1 January 1998, financial assistance for water and sewerage service charges has been provided for the first time to eligible not-for-profit bodies such as charities.

The benefits of lower water prices have been achieved alongside continuing improvements in the level and quality of services. In Melbourne, there has been continued improvement in the already high quality of drinking water (as measured by coliform bacteria levels) between 1996-97 and 1997-98. Tests for faecal coliform bacteria showed overall compliance with standards of 99.9 per cent (up 0.4 percentage points). According to data published in the Productivity Commission's 1998 report on the performance of government trading enterprises, the Victorian industry's compliance with water quality standards improved from just over 96 per cent in 1991-92 to close to 100 per cent in 1996-97.

According to the Water Services Association of Australia (a peak body of the industry), the average duration of interruptions in water supply has been reduced significantly by the three metropolitan water distribution companies in Victoria. In addition, Melbourne experienced a 10 per cent decrease in the number of water supply interruptions per 100 kilometres of water main in 1997-98.

Box 7.2: Water quality and service improvements for Victorian firms

According to Susan Matus, Project Engineer at Heinz Watties Australasia, the reliability and quality of the water supply is critical because water is used both as a cleaning agent and as a direct input in the production process. The quality of water is monitored continuously in all Heinz plants to ensure that its products meet with its own internal standards as well as the stringent external standards placed upon its export products. While Heinz had some initial concerns that the water industry reforms might adversely affect the quality of water supply, the experience has been to the contrary.

"Heinz has not experienced any supply reliability issues since the water industry reforms and we are confident that South East Water will continue to deliver what is required under its operating licence", says Ms Matus. Heinz has experienced a steady improvement in the level of service provided by the local water authority. Ms Matus says: "There is a far greater customer focus in South East Water compared to the previous water organisation."

Heinz's water bill accounts for about 22 per cent of all utility costs, with expenditure totalling approximately $560 000 per annum. "The new pricing structure means that Heinz is much more aware of the quantity of water used and the amount of sewage and effluent disposed of, and we have developed a thorough understanding of all charges and how we can change our operating practices in order to conserve the amount of water used. As Heinz is very conscious of this water usage, it has helped in the development of 'water saving programs' to minimise impact upon the environment", says Ms Matus.

Source: Ms S. Matus, Project Engineer, Heinz Watties Australasia

Box 7.3: Turning water into wine in regional Victoria

Reforms in water trading in the north-west region of Victoria have enabled the Wingara Wine Group, located in the Mildura area, to expand its production of high quality wines and establish its position as a premium supplier of wines to both domestic and export markets.

The Chief Executive of Wingara, Mr D Yunghanns says: “Had the water trading reforms not been introduced, Wingara would have been unable to procure sufficient water to enable a new development in the Sunraysia region to proceed. Wingara now has access to 6 300 megalitres of Murray River water in the form of a permanent water licence. The original 3 600 megalitres which existed prior to deregulation of the water trading market was insufficient for our needs, particularly when we considered our production expansion. However, water trading reforms enabled us to purchase an additional 2 000 megalitres at auction in 1993 and a further 700 megalitres has since been purchased privately.”

The expansion of the Wingara Wine Group has created significant economic benefits to the Sunraysia district in particular and to Victoria in general. Mr Yunghanns notes: “In 1999 we expect to produce 3 500 tonnes of winegrapes (valued at around $3 million), 700 tonnes of citrus (valued at $250 000) and 70 tonnes of avocados (valued at $70 000). Upon reaching full maturity, we anticipate that at today’s prices, the total value of production from this new development will be in the order of $5 million per annum. So far, this has generated ongoing employment for 15 more full-time employees on the farm and four more full-time equivalent employees in our winery. We anticipate employing three more full-time equivalent personnel in the citrus packing operation."

Source: Mr D. Yunghanns, Chief Executive, Wingara Wine Group

Gas industry reform

The Government has continued its competitive reform of the gas industry to deliver lower prices and better services and to ensure the long-term security of supply to gas consumers. In 1998-99, it is expected the Government will have privatised all of the state-owned businesses to lock in the benefits of market competition and to transfer risk away from taxpayers to the private sector.

The Government sold the three paired gas distribution retail businesses during 1998-99. Westar/Kinetik was purchased by Texas Utilities for $1.6 billion, Multinet/Ikon was purchased by Utilicorp United Inc and AMP for $1.97 billion, and Stratus/Energy 21 was purchased by Boral Energy and Envestra for $1.67 billion.

A wholesale spot market for gas has been developed and commenced operation on 15 March 1999. This market will provide gas industry participants with information to enable them to make better investment, consumption and operational decisions. Market and system operation rules for the gas market were authorised during the year by the Australian Competition and Consumer Commission (ACCC). The rules oversee the procedures for the operation of Victoria's spot gas market, and the method by which gas will be traded in the competitive market.

Following resolution of outstanding regulatory issues, the Government announced a staged timetable for introducing contestability in retail gas markets. Large contract customers with a load profile in excess of 500 000 gigajoules (GJ) per year, such as paper mills and brick manufacturers, will be able to choose their gas retailers from October 1999. Other large gas consumers with a load profile no less than 100 000 GJ per year, such as hospitals and hotels, will be made contestable from March 2000. Contestability for medium users (e.g. large restaurants) will commence from September 2000, and all gas customers will be able to choose their supplier from September 2001.

A new gas pricing structure for domestic customers came into effect on 1 January 1999. The gas supply charge will increase in line with Melbourne inflation. The change in domestic gas prices for peak winter usage will be pegged at 2.2 percentage points below the rate of inflation. At other times, the change will be set at 10 percentage points below inflation for gas consumption in excess of four gigajoules per two-monthly billing period. In 2001, this new pricing structure is expected to lower the annual bill of an average household by $45 in real terms.

One important aspect of the Government's gas reform strategy involves the extension of natural gas supply to parts of regional Victoria which had no previous access to gas. During 1998-99, the supply of natural gas was extended to Torquay, Jan Juc, Stawell and Horsham. The Government has also authorised the construction of a new 152-kilometre south-west pipeline to extend natural gas supply to new towns and provide additional supply security to western Victoria. The new pipeline is expected to be completed in time for the peak winter period of 1999.

In line with moves towards a national gas market, the Government opened the 151-kilometre interconnect pipeline between New South Wales and Victoria in mid-August 1998 to diversify the supply of natural gas and increase competition between primary gas producers (see Box 7.4). Furthermore, underground gas storage facilities are being developed by Texas Utilities Australia at Port Campbell in Victoria’s south-west. This project is expected to be completed by mid-2001 and will provide access to alternative sources of gas to improve the reliability of supply.

Box 7.4: The beneficial impact of gas market reform

The National Gas Pipelines Access Code, implemented under the national gas reform program, was a critical factor underpinning the construction of a $50 million interconnect pipeline between New South Wales and Victoria. This pipeline allowed emergency supplies of gas to flow into Victoria from interstate when gas supplies were interrupted following the Longford incident in September 1998. This facilitated a continuity of gas supply to Victorian hospitals. The interstate supply also enabled the maintenance of pressure in the Victorian gas network, thereby averting a collapse of the system which would have caused a longer shutdown of gas supplies in Victoria than was the case.

Source: National Competition Council, National Competition Policy: Some Impacts on Society and the Economy, January 1999

In the wake of the Longford incident which temporarily interrupted the supply of gas in Victoria, the Government has implemented a number of gas supply contingency plans for winter 1999. These include the commissioning of additional capacity for the interconnect pipeline between New South Wales and Victoria in April 1999, accelerating construction of the South-west pipeline, the contracting of additional gas supplies from alternative sources, and the promotion of demand-side management programs for industrial and commercial gas users. Up to $100 million has been budgeted for these contingency arrangements.

Aluminium smelter reform

Under the 1984 electricity supply agreements between the Government and Alcoa, the State was obliged to support the Portland and Point Henry smelters with a flexible electricity tariff regime. The State was also obliged to take up part ownership (25 per cent) of the Portland smelter.

In August 1998, Aluminium Smelters of Victoria (Aluvic), the holder of the State's interests in the Portland smelter, was sold for $502 million to the existing joint venture partners, CITIC and Marubeni. As part of the sale, the State settled the foreign exchange hedges held by Aluvic at a cost of $101 million. The sale of the State's aluminium interests has eliminated taxpayer exposure to commercial risks associated with fluctuations in world aluminium prices and foreign exchange rates.

In addition, the State’s flexible tariff obligations were restructured to eliminate budget funding of the difference between the cost of power purchased for the smelters by the SECV Shell and the payments for that power. Arrangements have been put in place to mitigate the expected future losses on these contracts and to allow the SECV Shell to fund any deficiencies. The estimated reduction in the present value of the payments from the Budget at the time of the transaction was $1.3 billion.

Timber industry reform

In March 1998, the Government announced its decision to privatise the Victorian Plantations Corporation (VPC) to improve investment and export prospects for the State’s timber industry. Privatisation was seen as a key initiative in facilitating the development of an internationally competitive environment conducive to increased investment, innovation and value-added processing in Victoria's timber industry. The privatisation also transferred the business risk from the public to the private sector.

In October 1998, the VPC was sold to Hancock Victorian Plantations Pty Ltd for $550 million. This represents a substantial premium to VPC’s book value of $352 million. The privatisation was facilitated by the sale of a licence to 170 000 hectares of land vested with the VPC. This licence grants to Hancock the right, in perpetuity, to operate a plantation business on that land.

The Australian timber industry, with a turnover in excess of $11.4 billion per annum, is a significant provider of jobs in regional south-eastern Australia. Victoria's share of this turnover is $3.4 billion, or about 30 per cent. International competition in the softwood timber industry has increased dramatically over the past five years as major timber producers in New Zealand and Chile intensify their search for export markets (including Australia) for their maturing plantations. In this context, it is vital that the Australian industry operate in accordance with world’s best practice to continue to supply the Australian market and to develop export markets as local supply starts to exceed local needs.

VPC, now Hancock, is an important supplier of softwood to the Australian market. As a direct result of the privatisation, customers of the privatised VPC can expect to benefit from being able to negotiate competitive timber prices and contract terms and conditions on a commercial basis. The privatisation has effectively freed up the supply side of the market to enable commercial price signalling.

The industry can also expect to benefit from the technology transfer associated with Hancock, which is one of the largest managers of plantation timber in North America.

Competition policy reforms

The Victorian Government's competitive reforms are underpinned by its commitment to National Competition Policy (NCP). NCP is an agreement by all States, Territories and the Commonwealth to systematically apply the principles of competition across all areas of the economy. In large part, the GBE and industry reforms in Victoria pre-date, but are otherwise consistent with, the structural reform and prices oversight principles of NCP.

Competitive neutrality

Competitive neutrality is one of the key principles of NCP. Under the Victorian Government's June 1996 *Statement of Competitive Neutrality Policy*, government businesses are required to either remove or offset any net competitive advantages which can be attributed to public ownership. A Competitive Neutrality Complaints Unit has been established in the Department of Treasury and Finance to investigate complaints from parties who claim to have suffered directly and materially from the competitive advantages enjoyed by a government business.

The benefits to local businesses and communities from application of the Government's competitive neutrality policy have become more apparent as a result of complaint investigations undertaken by the Unit (see Box 7.5). The Unit has found that proper application of competitive neutrality pricing to government businesses can:

- remedy the unfair competition which threatens the financial viability of small and often local businesses which compete in the same market; and
- potentially reduce the burden on taxpayers where government sees fit to withdraw from a market which can be served effectively and at a lower cost by a small business.

Review of restrictive legislation

As part of NCP, the Victorian Government is obliged to review and, where appropriate, reform all its laws which restrict competition. The guiding principle for reviews is that legislation should not restrict competition unless it confers a net benefit to the community and its objectives cannot be achieved by alternative (including non-legislative) means.

Box 7.5: An application of competitive neutrality policy

A private gym in regional Victoria was concerned that the local council-owned recreation centre may not have been complying with the Government's competitive neutrality policy. The recreation centre comprised aerobics, gym and creche facilities and a pool, while the private gym provided aerobics and gym facilities only.

The private gym was unable to compete with the recreation centre on price and noted that the costs of memberships in the industry were substantially higher than those at the council-owned centre. The private gym was concerned that the lower prices charged by the centre were due to cost advantages attributable to council ownership of the centre.

Management of the council-owned centre had been outsourced on a competitive basis. Under the terms of the contract, the contractor would operate the centre on a fully commercial basis and provide a rate of return to the council. Rather than providing a return to council, the contractor received a substantial subsidy to offset operating losses in one financial year, mainly because the pool activities incurred a cash deficit. This raised concerns that the gym and aerobics activities also may have benefited from the subsidy even though they returned a cash surplus.

The investigation by the Competitive Neutrality Complaints Unit revealed that competitively neutral costing and pricing principles were not being correctly applied. The activities the council wished to subsidise, such as the pool, should have been separated from commercial activities such as the gym and aerobics activities. At a minimum, these business activities should have had their own separate operating accounts and rate of return requirements. Failure by the council to correctly implement competitive neutrality resulted in a larger subsidy to the centre than would have otherwise been the case, thereby increasing the cost of the centre to ratepayers.

The lesson that can be drawn from this case study is that the application of competitive neutrality pricing can eliminate unfair competition thereby enhancing the financial viability of local business in regional Victoria.

Source: Competitive Neutrality Complaints Unit, Department of Treasury and Finance

Legislation review and regulation reform can free up the economy by removing business restrictions that no longer serve a useful purpose (e.g. regulation of shopping hours) and remove unwarranted impediments to the competitive supply of professional services (e.g. removal of ownership restrictions on dental practices and laboratories). Regulation reform can benefit the business sector directly by reducing regulatory uncertainties and by lowering compliance and other unnecessary costs for businesses. In Victoria, the number of regulations which impact on businesses has fallen by 39 per cent from 706 in 1992 to 432 in 1998. The wider community can also benefit when goods and services are made more accessible and affordable by the lower cost of doing business in Victoria.

Box 7.6: Legislation review and regulation reform: optometry

A review of the legislation which governs the practice of optometry in Victoria recommended lowering the entry barrier to the profession. Individuals with a narrower band of qualifications were permitted to perform certain services (such as eye testing) that were previously reserved for qualified optometrists. This reform of professional regulation has improved accessibility to the service by people in rural Victoria who would otherwise have to travel to a regional centre.

Source: Victorian Submission to the Senate Inquiry into the Socio-Economic Consequences of National Competition Policy

ADJUSTMENT AND TRANSITIONAL MECHANISMS

While the reforms implemented by Government are designed to deliver social and economic benefits, it is also recognised that the reforms may have an uneven impact across businesses, industry sectors and individuals. Furthermore, the expected benefits may not flow immediately to households and consumers. Segments of the community who are disadvantaged during the transition period may therefore need temporary assistance to adjust to the reforms.

To maintain the integrity and momentum of its reform agenda, the Government will continue to put in place transitional arrangements to ease the uneven impact of reform. Such arrangements are designed to assist clearly identified groups in the community who may be disadvantaged temporarily and materially by the reform in question.

Assistance to consumers

Enhancing the ability of consumers to make informed choices can assist the transition to newly competitive markets. This may occur through the direct provision of information to consumers or by strengthening the rights and remedies available to consumers in the event of inadequate service provision.

One approach would be for service providers or an independent regulator or Ombudsman to provide information to consumers, to enable them to monitor the efficiency and effectiveness of services and exercise informed choice between providers. For example, the ORG regularly publishes information on performance indicators for the water, electricity and gas industries.

Another approach would be to strengthen consumer rights and/or introduce a complaints mechanism to be used in the event that consumers are aggrieved. A Charter of Rights, including guarantees, helps give consumers the confidence that service standards are likely to be maintained or improved and can act as a vehicle through which complaints can be lodged. It may also include provision for redress for consumers left financially disadvantaged in the event of unsatisfactory service performance.

Consumer charters or codes were introduced as part of the reforms to water, gas, electricity and public transport. An Energy Ombudsman has been established to protect consumer interests and to resolve disputes between customers and energy businesses in the electricity (as well as gas) industry.

Box 7.7: Rebates on water and sewerage charges

As part of the metropolitan water reforms introduced in July 1998, full water and sewerage charges were applied to a number of previously exempt sectors (including local government, universities, charities and churches). The Government financed, on equity grounds, a rebate (to be paid by urban water authorities) of $260 per year on water and sewerage service charges, or actual service charges on a property, whichever is the lesser amount. Organisations eligible for the rebate must be ‘not for profit’ and include educational establishments, hospitals and nursing care institutions, churches, charities, war veterans organisations, and organisations involved in outdoor sporting and recreational activities.

Source: Water and Sewerage Rebate Scheme - For Community Service Organisations

Some consumer groups may be disadvantaged by the introduction of cost-based pricing of utility services, particularly if those consumers were subsidised in the past. There may be a case on equity grounds to maintain that subsidy for particular groups and the government will be examining these situations on a case-by-case basis. However, the means of providing that subsidy should be as transparent as possible.

Advisory programs

Strategic advice can be used to guide transition to a less regulated environment. Such advice may take the form of the development of advisory programs or business strategies and may or may not involve direct financial assistance.

Box 7.8: Transitional assistance to milk bar owners

In the lead up to the deregulation of shop trading hours in 1996, milk bars were identified as a sector potentially disadvantaged by the proposed reforms. To address concerns voiced by local milk bar owners, the Government, in conjunction with the Retail, Confectionery and Mixed Business Association, initiated a "Family Food Shop 2000 – Doing Better Business" program in September 1997 to provide advice on business strategies for milk bar owners. The advice provided includes: merchandising, shop layout, customer service, store promotions and identification of niche areas. Anecdotal evidence suggests that some milk bar owners have successfully transformed their businesses into 'family food stores'. Of the 284 milk bar owners assisted by Small Business Victoria, only one has subsequently left the sector since September 1997.

Source: Department of State Development

Targeted sectoral assistance

Targeted sectoral arrangements can involve a package of measures tailored to specific groups. Such assistance can be temporary and include phasing-in and staged adjustment, financial assistance and advisory services or, more typically, a combination of these.

Box 7.9: Reform of the tobacco industry

In 1993, the Government announced the replacement of the statutory marketing arrangements for tobacco with a quota retirement scheme. As the tobacco industry was concentrated in an area around Myrtleford, the reforms had the potential to impact adversely on a particular group and region. Targeted financial assistance was provided to ease the transition and to stimulate rationalisation of the industry. The Government provided $3 million to aid the removal of 1.5 million kilograms of quota by offering $2 per kilogram for the basic quota of those growers who left the industry. Generally, the growers targeted were those with low-grade leaf production, small quota holdings, small farm size, lower productivity or who were close to retirement age. In total, 68 tobacco growers accepted the Government's offer and departed the industry, leaving only 130 tobacco growers in Victoria.

Source: Department of Natural Resources and Environment, Working Paper Series, Number 9602

Carefully focussed financial assistance to existing industry participants could range from payment based on reform of current practices to encouragement of broader industry rationalisation. Such financial assistance has the advantage of transparency as regards the purpose, the targeted beneficiary and means of implementation. The phasing-in of reforms over a period of time may also assist groups affected by change to adjust or adapt to a new industry environment.

Limits to the use of transitional arrangements

Transitional arrangements are of limited use when they are expensive to implement. They are also inappropriate when industry participants are able to exploit alternative market opportunities. For example, assistance was not required when reforms in the dried fruit industry were introduced. Growers were able to exit the dried fruit market and enter the market for wine and table grapes, responding to market incentives rather than relying on government assistance.

The implementation of transitional programs also raises important equity considerations. Government initiated reform is only one source of change affecting industry. The economy is continually evolving in response to influences over the course of a business cycle, as well as to changes in consumer preferences and technology. A strong case needs to be advanced that parties disadvantaged by competitive reforms are a more deserving case for assistance than other parties disadvantaged as a result of other structural change (such as the introduction of a new technology or changes in consumer tastes).

Box 7.10: Reform of the barley industry

In 1998, the Victorian and South Australian Governments announced the replacement of the Australian Barley Board by a grower-owned entity and that the domestic statutory marketing arrangements would be dismantled over a period of time. Both governments acknowledged that the new entity would require some time to adjust to a commercial environment, particularly given the maintenance of single export desk arrangements in other jurisdictions. Restrictions relating to the sale, purchase and delivery of barley for domestic stockfeed were removed on 1 July 1998, while restrictions relating to barley for malting and other processing will be removed from 1 July 1999. The single desk arrangements for barley for export will continue until 1 July 2001.

Source: Second Reading Speech, Barley Marketing (Amendment) Bill 1998

A further consideration is that some sectors have enjoyed privileges (e.g. subsidised loans and protected markets) which are not available to other segments of the community. These privileges have often been sizeable and have accrued over a period of time. Where transitional assistance involves the preservation or protection of such privileges, it may seem inequitable for the wider community to continue to effectively compensate particular sectors for the loss of accrued privileges.

Transitional arrangements can help disadvantaged parties to adjust to a reformed environment, but they may also generate unforeseen costs. The crucial benchmark to assess reform is that the costs of reform (including the costs of implementing transitional arrangements, where required) are outweighed by the benefits of the reform.

THE WAY AHEAD

The reforms achieved to date are, by and large, driven by the Government's quest for a more efficient economy so that Victoria will be a better place to live, work and do business. As noted above, this quest for efficiency has delivered real and measurable benefits to the community and strengthened the competitiveness of business and industry in Victoria. The State is well positioned to take up new challenges to enhance the quality of life for Victorians in the next century.

Transport reform

One of these challenges is the provision of a safe, reliable and efficient public transport system. In 1992, the Government initiated an ambitious public transport reform program with the objective of creating a best-practice public transport service which meets the needs of the travelling public at an affordable cost for taxpayers.

According to the May 1998 Auditor-General's report *Public Transport Reforms: Moving from a System to a Service,* the Public Transport Corporation had, by the end of June 1996, "achieved total savings of $643 million in recurrent expenditure and ongoing savings per annum of at least $245 million" and the Government’s reforms have “established a sound foundation for the future long-term viability of public transport in Victoria”. The total amount budgeted for the purchase of train and tram services in 1999-2000 is $832 million. The comparable amount budgeted in 1998-99 was $823 million.

To make Victoria’s public transport system even better, the Government is in the process of letting franchise contracts for the operation of Victoria’s trains and trams. The preferred bidders for the contracts are expected to be announced around the middle of 1999.

Franchising will involve transferring the management of rail and tram operations to the private sector, with the Government buying back services on behalf of the public. Franchise contracts will vary in term; some may be of seven years' duration, others may last fifteen years where major new investment is planned. Under the contracts, operators will be required to continue to operate a full range of services according to fares and timetables determined by the Government.

Private sector bidders will compete with each other for the franchise contracts. This competitive pressure will drive up both the quality and the value which the community can expect to get from a franchised public transport system. The benefits of the incentives and local focus that franchising brings are already widely recognised in Warrnambool and Shepparton where private operators have been running trains since 1993.

There are a number of reasons why franchising is the logical next step in the transport reform process. It will provide new incentives, innovation, new investment, and service guarantees for passengers.

New incentives

The new private operators will have a direct incentive to attract new passengers on the public transport system, especially in the off-peak and at weekends. Each extra passenger who uses the system will bring in additional revenue, and conversely, each patron who turns away from public transport will translate into a loss of potential revenue. This creates a powerful motivation for operators to create a safe, clean, efficient system which is attractive to passengers.

The incentives that private ownership brings will also benefit the wider community. Road congestion, pollution and accidents can be reduced by encouraging commuters to substitute public transport for private transport. With this in mind, the Government intends to provide financial incentives for operators to attract extra customers. Operators who achieve specified targets for patronage growth will receive extra payments from the State. This direct incentive regime will reinforce the commercial motive of operators to create a powerful stimulus for further growth and expansion of Victoria's public transport system.

Innovation

There are many ways in which public train and tram services can be improved. The new operators of the Victorian system, many of whom will be established and experienced transport operators from Australia and overseas, can be expected to develop and introduce innovative approaches to customer service.

These fresh approaches need not be grand ideas, or even expensive to provide. Examples of some of the innovative customer-oriented services introduced by private rail operators in Australia and overseas include carriages set aside for families, the provision of complimentary tea, coffee and newspapers, extra discount tickets for families, and better customer care for elderly travellers.

New investment

New investment is vital to the long-term growth and quality of Victoria's public transport system. A great deal of investment has already gone into Victoria’s trains, trams and the station network. However, while the system remains under public ownership, public transport will always have to compete for funding with other vital services such as education and health. Franchising services to the private sector will open up a new avenue for funding investment, allowing operators to get on with investing in the long-term viability of the public transport businesses.

As conditions of the new franchise contracts, franchisees will be required to expand the public transport network. This will involve the extension of tram services to the Melbourne Docklands area from January 2000, construction of a new tram terminus in the corner of Clarendon Street and City Road by December 2000, electrification of the St Albans train line by December 2001, and extension of the Mont Albert tram services to Box Hill by June 2002. Other possible network expansion initiatives include the construction of a new V/Line station at Roxburgh Park, the extension of tram services to Station Pier at Port Melbourne, and the building of a new station at Camp Road on the Upfield Line.

Franchisees will also be required to undertake fleet modernisation and refurbishment programs. The Government has announced that new tram franchisees will be required to replace the current Z1/Z2-class trams with new low-floor trams between 2002 and 2004. The new trams will make services more accessible to all passengers, including those with disabilities. The existing fleet of Comeng electric trains will be refurbished by the end of 2002. The refurbishment program will involve the introduction of new passenger amenities such as air conditioning, interior and exterior information displays, closed circuit television monitoring, high quality interior lighting and on-train passenger alarms.

New guarantees for passengers

Franchising will remove the need for the State Government to be involved with the day-to-day affairs of public transport. Guarantees and other safeguards are provided through legally binding contracts which will ensure that the community will continue to receive an efficient, clean, punctual and affordable service.

These guarantees were outlined in the Passengers’ Charter, published in October 1998. The Charter contains a wide range of guarantees for passengers using Victoria’s trains and trams, such as quality of service, fares, punctuality and reliability. Compliance with the Charter will be monitored by the new Office of the Director of Public Transport, which will be responsible for ensuring that passengers’ interests are protected and services are improved. A new, independent Passengers’ Charter Committee, representing public transport users across Victoria, will be established to advise on all aspects of the Charter’s development and implementation.

Contestability and choice

The Government has introduced a number of initiatives aimed at delivering high quality and value-for-money services and infrastructure in the areas of social welfare, health, education and justice. The provision of budget sector services often involves complex issues of public accountability and responsibility. In the years ahead, the Government will continue to improve the way in which social services and infrastructure are provided without diminishing the Government's accountability or responsibility to the community.

Better services in the budget sectors can be delivered, in part, by introducing contestability. Contestability involves exposing service areas which are traditionally within the domain of government agencies to private sector providers. The ultimate aim of contestability is to improve the quality, efficiency and effectiveness of service provision.

The involvement of private sector providers may lead to more creative means of service delivery. It can also increase the range of choices available to consumers. Where consumers are able to exercise choice, private sector service providers are likely to focus on building customer loyalty by providing services which meet customer needs and requirements.

Government will retain full accountability for the service, however, by promoting contestability, Government will be able to reduce the operational and business risks involved in service delivery. Contestability can also clarify the roles of the Government as purchaser and provider and promote greater transparency in the delivery of government services. By choosing private sector providers who are best able to manage the operational and business risks in service delivery, the public sector can devote more time and effort to monitoring the service providers and ensuring that services meet the levels of standard and quality required by the community.

The public sector in Victoria has already accumulated a great deal of experience in contracting private provision of government services. Excluding the service agreements of the Department of Human Services, the total annual expenditure on contracting by all departments is currently estimated to be close to $1 billion, up from $840 million in 1996-97 and $650 million in 1995-96. The expenditure on contracting is evenly split between contracts for direct services to the community and contracts for services provided to departments and agencies. Over 90 per cent of these contracts, by value, are with private sector providers.

The Government will build on this experience to extend the use of build-own-operate (BOO) and build-own-operate-transfer (BOOT) arrangements for private provision of hospital services in Mildura and Berwick, waste water treatment services in Castlemaine and surrounding areas, water treatment services in the Coliban, Central Highlands and Grampians regions, traffic camera services, and a Mobile Data Network for emergency services calls in the greater Melbourne metropolitan area.

For the more significant and complex service delivery projects, the BOOT arrangement can often lead to the most cost-effective outcome for Victorian taxpayers. The BOOT arrangement integrates design, construction, operation and financing decisions, focuses on service outcomes and takes into account the total life-cycle costs of the project at the outset. Importantly, the Government can transfer all construction, operational and business risks to the private sector which holds the necessary expertise to manage such risks.

Competitive tendering is the best means of assessing and selecting potential private providers. Where the private sector has specialist skills which are demonstrably more efficient than the public sector, the use of private provision can result in lower costs, less risk and more efficient use of public sector resources. The community benefits from continued provision of the service, often at improved quality. Furthermore, cost savings can increase the financial ability of the Government to fund and provide more or better services. The promotion of private provision does not by itself diminish the role of government or its responsibility for funding services.

Box 7.11: The Victoria Police Air Wing helicopter service

Following an exhaustive tendering process, a seven-year agreement (extendable to ten years at Victoria Police's option) was finalised in July 1996 for the supply of three fully maintained and fuelled helicopters to deliver the Police Air Wing helicopter service which includes the metropolitan ambulance helicopter service. The successful contractor was Lloyd Offshore Helicopters Pty Ltd, a large helicopter service provider in Australia and South East Asia specialising in off-shore oil and gas support, search and rescue, emergency services operations and general chartering services.

The outsourcing arrangements solved three issues in a cost-effective manner without lowering the quality of service. Firstly, it facilitated replacement of the ageing and increasingly functionally inefficient Police Air Wing helicopter fleet. Under the terms of the agreement, Lloyd will phase in new replacement aircraft with better technology from July 2000. Secondly, the contract provided access to specialist service delivery expertise and a stronger skills base. Thirdly, it retained an equivalent level of service to that provided under the existing internal arrangement, but at a reduced cost. The Police Air Wing was a very significant cost centre with 50 staff and an annual expenditure of $7.2 million.

The total cash outlay for the seven-year agreement with Lloyd was significantly lower than delivering a new aircraft fleet internally. The cost savings, in net present value terms (assuming an 8 per cent discount rate) are estimated to be around $16 million. These savings come from avoiding capital outlays to replace the existing fleet and from a staff reduction of fifteen.

Source: Victoria Police

OVERALL IMPACT OF REFORMS

The competitive reforms implemented in Victoria have led to profound changes to industry structure and the organisation culture of private as well as state-owned businesses. The material benefits of these reforms are now being seen in lower prices, better services and greater choices for consumers. For Victorians, this translates to higher real incomes, higher living standards and a better quality of life.

The Government also recognises that benefits may flow unevenly across the community and, as a consequence, the reforms may have an unsettling impact on some segments of the community. Where this has been the case, the

Government has attempted to ease the adjustment to the reformed environment by putting in place appropriate transitional arrangements.

The Government is confident that contestability, properly harnessed, can be used to boost economic performance so as to deliver further benefits to the Victorian community. In this regard, the Government will continue to rely on its guiding principles of reform to build on the successes that have been achieved. Where necessary, the Government will refine these principles in ways that will strengthen Victoria's position in a competitive and dynamic global economy. The ability to adapt is critical if the State is to maintain its competitive advantage and achieve the sustained economic growth necessary to provide a better future with lasting benefits for all Victorians.

CHAPTER 8: REVENUE AND GRANTS

- The payroll tax rate will fall from 6 per cent to 5.75 per cent as from 1 July 1999. This is the third successive year in which the Government has lowered the payroll tax rate to enhance the competitiveness of the Victorian economy and raise employment prospects.
- Victoria has been able to pursue a strategy of tax reduction despite having to absorb a $100 million cut in Victoria's share of financial assistance grants from the Commonwealth.
- Victoria's taxation effort continues to fall relative to the Australian average and remains below that of New South Wales.

OVERVIEW OF REVENUE PERFORMANCE AND OUTLOOK

The restoration of the State's financial position since the early 1990s has meant that Victoria can offer lower taxes for households and businesses as well as improved service delivery.

In 1999-2000, Victoria will make further progress towards its long-term goal of aligning the State's taxation effort with the average of all Australian States. The Government will provide an estimated $97 million in tax relief (full-year basis) via a further cut in payroll tax to follow the cuts in the two previous budgets. The Government has targeted payroll tax because it is critical to the Government's key objectives of improving the State's economic competitiveness and boosting employment. Of the various state taxes, payroll tax has the most pervasive impact on the day-to-day costs of doing business.

The reductions in payroll tax and other measures since 1993-94, including land tax, conveyancing duty and petroleum franchise fees, bring the cumulative annual savings to Victorian businesses and households to $650 million. As a result, Victoria's tax competitiveness relative to the other Australian States, notably New South Wales, has improved markedly in recent years. Consequently, significant in-roads have been made in reducing Victoria's relative taxation towards the Australian average level and the State's taxation remains below that of New South Wales.

Victoria has been able to pursue its strategy of tax relief in this Budget despite the Commonwealth Government's acceptance of some unfavourable recommendations by the Commonwealth Grants Commission (CGC) in its *Report on General Revenue Grant Relativities 1999.* The Report recommended equalisation relativities that imply a decline of $100 million in Victoria's share of financial assistance grants.

Reflecting faster growth in the economy than anticipated in the 1998-99 Budget, Victoria's own-source revenues in 1998-99, excluding privatisation receipts, are now expected to be $12 206 million, which is $460 million or 3.9 per cent up on the original budget estimate. Own-source revenues are expected to fall to $11 883 million in 1999-2000, a decrease of $323 million or 2.6 per cent. This reflects the payroll tax reduction announced in this Budget and a decline in public authority income. The decline in public authority income is a result of lower distributions from the water sector and Transport Accident Commission and the sale of the gas, electricity and other businesses. Thereafter, revenues are expected to increase at an average annual rate of 2.0 per cent to 2002-03 (see Table 8.1).

The forward estimates of revenue and grants which are contained in these Budget Papers are based on the current framework of state taxes and Commonwealth grants. They do not reflect the proposed national tax reform package which was agreed at the Premiers' Conference on 9 April 1999 (see Chapter 9, *A New Era of Commonwealth-State Financial Relations*) as the Commonwealth Parliament is yet to pass the relevant Commonwealth legislation to implement the proposed package.

Table 8.1: Own-source revenue 1998-99 to 2002-03[(a)]

($ million)

	1998-99 Revised	*1999-00 Budget*	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Taxation	8 597.9	8 691.0	8 935.4	9 273.8	9 647.0
Regulatory fees and fines	245.0	246.6	238.1	199.8	200.0
Sale of goods and services	1 796.1	1 812.9	1 819.0	1 833.2	1 854.0
Public authority income	955.4	646.8	690.9	500.0	426.4
Other revenue	612.0	485.7	489.0	470.7	465.2
Total own-source revenue	**12 206.4**	**11 883.0**	**12 172.3**	**12 277.4**	**12 592.6**

Source: Department of Treasury and Finance

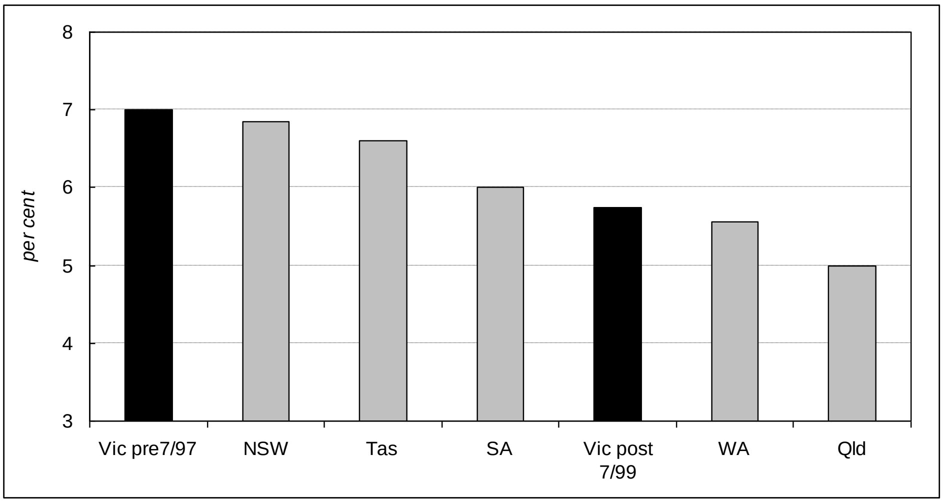
Note:
(a) Excludes privatisation proceeds.

PAYROLL TAX REDUCTION

This Budget introduces further payroll tax relief for Victorian businesses in 1999-2000 of $97 million in a full year. From 1 July 1999, Victoria's payroll tax rate will be reduced from 6 per cent to 5.75 per cent. This follows the 1997-98 rate reduction from 7 per cent to 6.25 per cent, at which time the payroll tax base was broadened to include employer superannuation contributions, and the 1998-99 reduction from 6.25 per cent to 6 per cent. The full year savings to Victorian businesses of these three cuts in payroll tax amount to $300 million.

Victoria is the first State to provide three successive reductions in the payroll tax rate. The reduction announced in this Budget means that the rate of payroll tax in Victoria will be lower than at any time since July 1984. Over a two-year period, the 0.25 per cent reduction in payroll tax announced in this Budget is expected to yield a sustained increase in GSP of about $100 million per annum in 1999-2000 prices and an accompanying increase of almost 2 000 jobs. Over the longer term (five years or more) this estimated gain to GSP rises to $385 million per annum in 1999-2000 prices, generating more than 5 400 jobs for Victorians. The long-term employment effect in Victoria from the three consecutive payroll tax reductions is estimated to be an additional 18 000 jobs.

Chart 8.1: Comparative headline payroll tax rates[(a)]

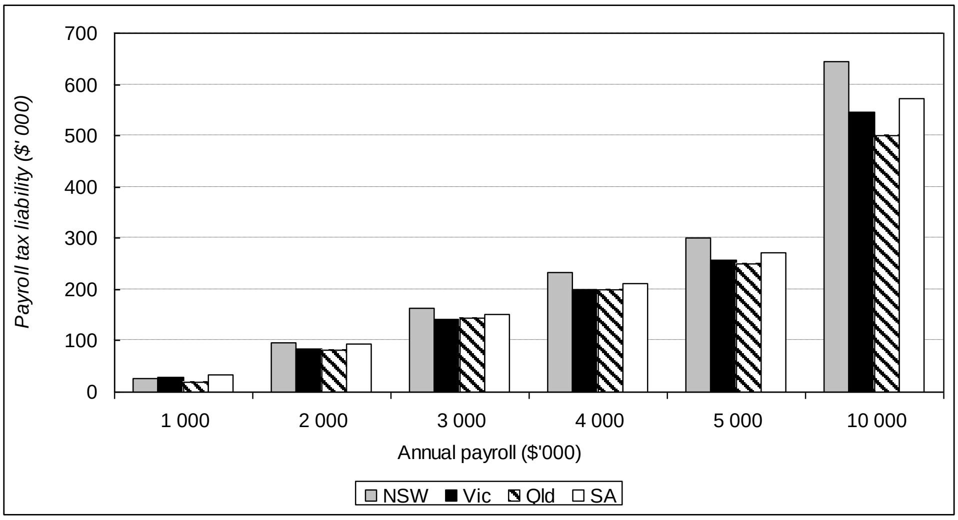


Source: Department of Treasury and Finance

Note:
(a) For Western Australia, the rate shown is that applying to payrolls in excess of $5 625 000. Single rates apply in other jurisdictions.

Prior to July 1997, Victoria's payroll tax rate was among the highest in Australia. As Chart 8.1 demonstrates, if Victoria had not acted to lower its rate since 1997, it would have been the highest in Australia. Victoria's three successive reductions in its payroll tax rate since July 1997 will mean that from 1 July 1999, its headline payroll tax rate will be above only that of Queensland and Western Australia. For medium-sized firms with payrolls between $2.6 million and $4 million Victoria's payroll tax is lower than Queensland's (see Chart 8.2).

Chart 8.2: Comparative annual payroll tax liability



Source: Department of Treasury and Finance

VICTORIA'S TAXATION COMPETITIVENESS

The competitiveness of Victoria's tax regime plays an important role in underpinning economic growth and investment. Victoria has a long-term budget objective of aligning the State's taxation effort with the national average. In this section three measures of Victoria's tax competitiveness are examined, all of which indicate that the State has been making steady progress in recent years towards the achievement of this target. These measures are:

- revenue relativities based upon CGC methodology;
- taxation revenue expressed on a per capita basis; and
- taxation revenue expressed as a percentage of GSP.

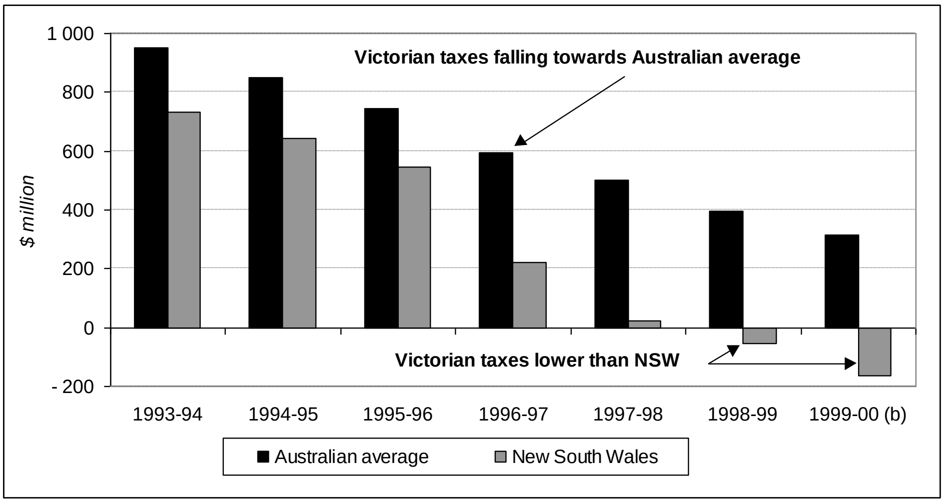
While Victoria's average is above the national figure on all three measures, there has been considerable convergence in recent years towards the Government's long-term goal of aligning Victoria's taxation effort with the national average. On the latter two measures, Victoria's tax competitiveness is clearly ahead of New South Wales.

Commonwealth Grants Commission measure of taxation effort

The CGC's current assessment of revenue relativities indicates that Victoria's taxation effort is $394 million above the national taxation effort in 1998-99, well down from $953 million above the national level in 1993-94. The turnaround has been more dramatic when Victoria is compared with New South Wales: from a taxation effort of some $732 million higher than New South Wales in 1993-94, Victoria now has a taxation effort which is $55 million below that of New South Wales (see Chart 8.3).

The reduction in payroll tax announced in this Budget is likely to lower these relativities even further in Victoria's favour, although the preliminary measures for 1999-2000 await the delivery of other State and Territory Budgets. If taxes neither fall nor rise in other jurisdictions, Victoria's taxation effort will be $314 million above the national average in 1999-2000 and $164 million below that of New South Wales. However, the New South Wales Government has announced its intention to reduce the payroll tax burden in that State by $170 million. If this intention were to be confirmed in the New South Wales 1999-2000 Budget, it is estimated that Victoria's taxation effort would be $37 million below that of New South Wales and $362 million above the national average.

Chart 8.3: Measures of relative tax severity – Commonwealth Grants Commission[(a)]



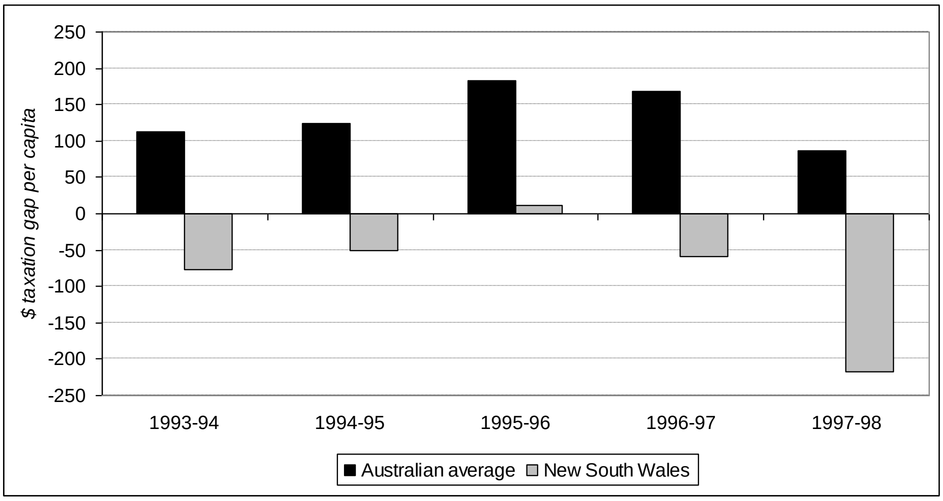
Sources: Commonwealth Grants Commission Report on General Revenue Grant Relativities, 1999; Department of Treasury and Finance

Notes:
(a) Difference in tax effort, using the Commonwealth Grants Commission equalisation methodology, between Victoria and each of New South Wales and the Australian average. A positive tax effort indicates that Victoria has a higher tax burden than the other jurisdiction, while a negative tax effort indicates that Victoria has a lower tax burden.
(b) Assumes no changes to taxes in other States in 1999-2000.

Taxation revenue per capita

State taxation revenue expressed on a per capita basis, as measured by the Australian Bureau of Statistics (ABS), represents an alternative measure of relative tax burden. The difference between Victoria's taxation per capita and the corresponding measure for New South Wales and all Australian States is depicted in Chart 8.4.

Chart 8.4: Measures of relative tax severity – Victoria's taxation differential per capita[a]



Sources: Australian Bureau of Statistics, Cat No. 5506.0; Department of Treasury and Finance

Note:

(a) The taxation differentials per capita reflect the differences between Victorian per capita taxation revenues (net of privatisation proceeds) and each of New South Wales and the Australian average.

In 1997-98, the latest year for which ABS data are available, Victoria's taxation revenue was $218 per capita lower than that of New South Wales, representing a dramatic widening in this measure when compared with the mid 1990s.

Compared with the average for all States, Victoria's taxation revenue per capita in 1997-98 was $87 higher, which is the first time since 1993-94 that this measure had been below $100.

These trends are likely to have continued in 1998-99.

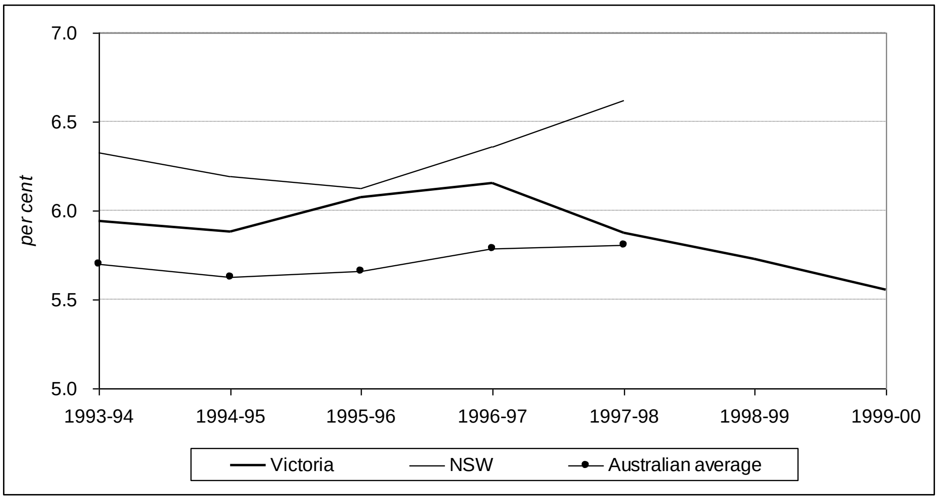
Taxation revenue relative to GSP

A third measure of the state taxation burden on state economies is taxation revenue expressed as a proportion of GSP. Victoria's taxation revenue expressed as a percentage of GSP has fallen from a peak of 6.2 per cent in 1996-97 to an estimated 5.7 per cent this year, and is forecast to fall further to 5.6 per cent in 1999-2000.

On this measure, Victoria's tax burden has been lower than that of New South Wales throughout the 1990s and only marginally above the national average in

1997-98, the last year for which data is available (see Chart 8.5). It is possible that with the tax cuts applying in Victoria in 1998-99, Victoria's ratio of state taxes to GSP has dipped under the national average.

Chart 8.5: Taxation as percentage of nominal GSP



Sources: Australian Bureau of Statistics Cat. Nos. 5506.0 and 5242.0; Department of Treasury and Finance.

OUTLOOK FOR OWN-SOURCE REVENUES

Revenue from state sources is now expected to total $12 206 million in 1998-99 compared with the April 1998 Budget estimate of $11 747 million, a variation of $460 million or 3.9 per cent. As explained in Appendix B, *1998-99 Revised Budget Outcome*, most of the variations are in revenues other than taxation. The main sources of upward revision to revenues in 1998-99 are in sales of goods and services by departments (up $109 million) and other revenue (up $229 million).

In 1999-2000, the total revenue to be derived from all state sources (including sales of goods and services) is forecast to fall to $11 883 million. This expected reduction mainly reflects forecast falls in public authority income (more information is provided below) and represents a decrease of $323 million, or 2.6 per cent. Over the three years to 2002-03, the average annual growth rate of own-source revenues is forecast to be 2.0 per cent. While some of the major revenue lines are expected to grow at a similar pace to nominal GSP, others show characteristics of declining or stagnant taxes (including some of the taxes to be abolished in 2001 under national tax reform proposals).

Taxation

Table 8.2 provides a summary of projected taxation revenue for the period 1998-99 to 2002-03. The average rate of growth in taxation over the four-year projection period is 2.9 per cent per annum. This compares with the assumed average rate of growth of nominal GSP of 5.6 per cent per annum. Without the payroll tax cut in this year's Budget, the annual growth rate of taxation would have been an estimated 3.2 per cent per annum over the forecast period.

Table 8.2: Taxation 1998-99 to 2002-03 [(a)]

($ million)

	1998-99 Revised	*1999-00 Budget*	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Payroll tax	2 192.5	2 231.5	2 357.3	2 496.3	2 646.5
Taxes on property	2 362.7	2 323.7	2 391.6	2 477.0	2 573.8
Gambling taxes	1 395.9	1 428.2	1 467.6	1 513.9	1 563.4
Taxes on insurance	352.2	365.6	378.5	394.5	408.6
Motor vehicle taxes	884.9	883.9	929.5	974.6	1 003.8
Safety net revenues/franchise fees	1 399.7	1 447.1	1 400.0	1 407.4	1 440.9
Other taxes	10.0	11.0	10.9	10.1	10.0
Total taxation	**8 597.9**	**8 691.0**	**8 935.4**	**9 273.8**	**9 647.0**

Source: Department of Treasury and Finance

Note:
(a) Excludes privatisation proceeds.

The pattern of payroll tax estimates to 2002-03 reflects:

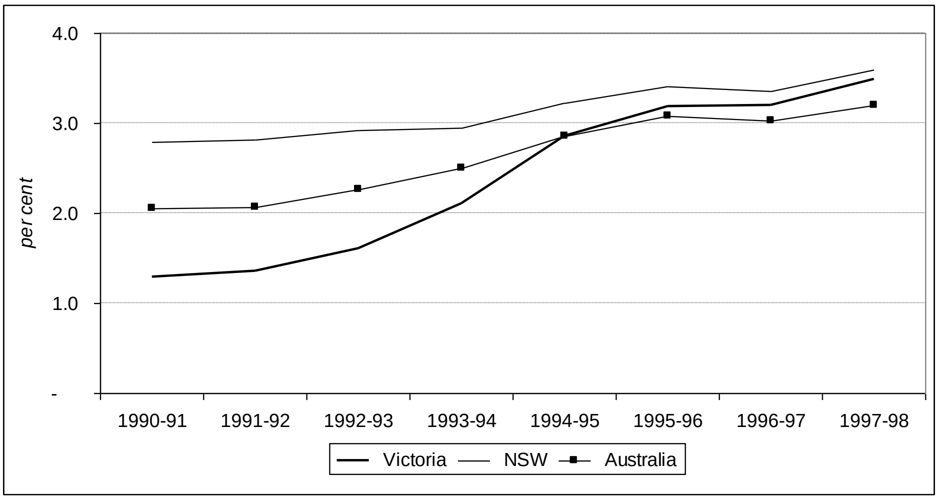
- growth in economy-wide employment and wages;
- the Government's cut in the payroll tax rate from 1 July 1999; and
- increases by employers to the Superannuation Guarantee Contribution in July 2000 and July 2002, as scheduled by the Commonwealth Government.

Reflecting the slowdown in the demand for housing during the second half of 1998-99 and the expected moderation in the rate of expansion of the economy in 1999-2000, conveyancing duty is forecast to be lower in 1999-2000, before steadily recovering over the following three years, as the economy picks up pace and interest rates remain close to current levels. That is, the projections for this important source of revenue reflect the cyclical nature of the property sector (especially housing) upon which conveyancing duty is based.

The projections of gambling taxation receipts are based on:

- the medium-term trends in gambling expenditure as a percentage of household disposable income (see Chart 8.6); and
- trends in the different forms of gambling activity (lotteries, electronic gaming machines, the casino, racing and minor games).

Chart 8.6: Gambling expenditure as a percentage of household disposable income



Source: Department of Treasury and Finance; Tasmanian Gaming Commission, Australian Gambling Statistics

While receipts from the gambling sector (especially with respect to gaming machines) have been underestimated in recent years, it is expected that growth in gambling receipts will moderate in 1999-2000 as revenue growth slows from electronic gaming machines.

The underestimation of revenue from electronic gaming machines in recent years has averaged around 9 per cent per annum. Rapid growth in demand for a new product, and responsiveness of demand as the permitted number of gaming machines increased, were difficult factors to predict. The estimate for 1999-2000 recognises that the number of machines in operation has stabilised but that operators, through marketing and adjustments to the allocation of machines across venues, will achieve modest growth in average turnover per machine.

The demand for motor vehicles has been strong in 1998-99 as a result of competitive car prices (reflecting the world's oversupply of cars), low interest rates, and the strength of general consumer confidence and economic activity. These forecasts assume a moderation in demand in 1999-2000, followed by further growth.

Safety net revenues, or revenue replacement payments, are collected by the Commonwealth in lieu of former state franchise fees which were abolished following a High Court decision on 5 August 1997. Forecasts of safety net revenues are provided by the Commonwealth Government.

Regulatory fees and fines

Revenue from fees and fines is expected to decline from nearly $250 million in 1998-99 to around $200 million in 2001-02, reflecting the cessation of electricity licence fees in that year.

Public authority income

Public authority income is expected to decrease from $955 million in 1998-99 to $647 million in 1999-2000. This decrease partly reflects higher than expected distributions received from some GBEs in 1998-99 (particularly from the water sector and the Transport Accident Commission). Another factor contributing to lower public authority income in 1999-2000 is the privatisation of gas businesses, electricity businesses and the Victorian Plantations Corporation during 1998-99.

Table 8.3: Public authority income 1998-99 to 2002-03

($ million)

	1998-99 Revised	*1999-00 Budget*	*2000-01 Estimate*	*2001-02 Estimate*	*2002-03 Estimate*
Dividends	788.4	496.8	528.1	407.4	365.0
Income tax equivalent receipts	159.2	143.8	157.4	87.3	55.9
Wholesale sales tax and local government rate equivalent receipts	7.8	6.2	5.3	5.3	5.5
Total public authority income excluding privatisation proceeds	955.4	646.8	690.9	500.0	426.4

Source: Department of Treasury and Finance

In subsequent years, distributions from most government business enterprises are expected to show a positive trend. However, this trend is more than offset by the decrease in the non-sustainable revenue from the gas sector. This decrease reflects two factors. The first factor relates to the profits accruing to Gascor resulting from arrangements with the privatised gas retailers for the supply of gas to non-contestable customers. As the gas market becomes more contestable, customers will gain through lower prices and Gascor's profits will decrease. With the introduction of full competition by September 2001, these profits will cease. The second factor relates to profits derived by Gascor from certain gas supply contracts with Esso/BHPP. These contracts will cease when the agreed aggregate volumes of gas have been purchased, which is expected to occur during 2001-02.

Sale of goods and services

Proceeds from the sale of goods and services are projected to increase from $1 796 million in 1998-99 to $1 813 million in 1999-2000 and thereafter grow at an average annual rate of less than 1 per cent.

Other revenues

Other revenues are comprised mainly of rent on Crown leases, coal and forest royalties and interest received. These revenues are forecast to decline slowly in the projection period from around $486 million in 1999-2000 to around $465 million in 2002-03.

OUTLOOK FOR COMMONWEALTH GRANTS

Commonwealth grants to Victoria (excluding grants for on-passing) comprise 35 per cent of total revenue. However, Victoria's reliance on Commonwealth payments increased following the 1997 High Court ruling that the States' business franchise fees were invalid. Arrangements were established for the Commonwealth to collect similar taxes to be forwarded to the States. When these safety net revenues are included, Victoria's reliance on Commonwealth payments (excluding grants for on-passing) increases to 43 per cent. When grants for on-passing are included, Victoria's reliance on Commonwealth payments is approximately 45 per cent.

The grants are provided for general purposes in the form of financial assistance grants and National Competition Policy (NCP) payments. In addition to general purpose grants, the Commonwealth provides tied grants to the States called specific purpose payments. There is a difference between specific purpose payments *to* the States (payments to the States for their expenditure) and specific purpose payments *through* the States (payments to be on-passed to other bodies such as local government and non-government schools). Between 1996-97 and 1998-99, the States have made fiscal contribution payments to assist the Commonwealth address its own budgetary problems.

Key outcomes from the April 1999 Premiers' Conference were:

- a reduction in Victoria's share of financial assistance grants by $100 million. This means each Victorian resident contributes $167 a year in subsidies to other States, the highest level of subsidy among the donor States; and
- an estimated increase of 2.0 per cent in specific purpose payments to Victoria in 1999-2000.

Table 8.4: Grants from the Commonwealth 1998-99 and 1999-2000

($ million)

	1998-99 Revised	*1999-00 Budget*	*Per cent Change*
General purpose grants	3 589.3	3 672.7	2.3
Specific purpose grants	2 857.5	2 914.7	2.0
Grants for own-purpose	**6 446.8**	**6 587.4**	**2.2**
Grants for on-passing	1 001.8	1 019.2	1.7
Current	977.6	994.6	1.7
Capital	24.2	24.7	2.0
Total Commonwealth grants	**7 448.6**	**7 606.6**	**2.1**
Less: Fiscal contribution payment [(a)]	74.4	..	-100.0
Net Commonwealth grants	**7 374.2**	**7 606.6**	**3.2**

Source: Department of Treasury and Finance

Note:
(a) Fiscal contribution is classified as an expense in the Budget operating statement.

Table 8.4 summarises the main components of grants received for the years 1998-99 and 1999-2000. Grants for own-purpose are expected to increase by 2.2 per cent in 1999-2000 as a result of anticipated moderate growth in both general purpose and specific purpose grants. General purpose grants are estimated to increase by 2.3 per cent in 1999-2000 due to a doubling of NCP payments and a 0.8 per cent increase in financial assistance grants.

Financial assistance grants

The total financial assistance grants pool for distribution to the States is increased each year to reflect population growth and inflation. This real per capita increase for financial assistance grants is part of a guarantee provided by the Commonwealth to the States at the April 1995 meeting of the Council of Australian Governments. That guarantee is conditional on the States meeting competition policy reform obligations including competitive neutrality policy and legislation review.

At the Premiers' Conference on 9 April 1999, it was agreed that the total financial assistance grants pool and the agreed amount of health care grants for 1999-2000 will be distributed on the basis of new relativities recommended by the CGC. Victoria's five-year relativity share declined from 21.9 per cent in the 1998 CGC Report to 21.4 per cent after the 1999 CGC Report. The application of the new relativities will result in a reduction of $100 million in Victoria's share of financial assistance grants in 1999-2000.

1999 Report on General Revenue Grant Relativities by the Commonwealth Grants Commission

Following a six-year review, the CGC released recommended relativities in its *Report on General Revenue Grant Relativities 1999*. The relativities in the 1999 Report were calculated using revised budget data from 1993-94 to 1997-98. The lower relativity for Victoria in 1999-2000 compared with 1998-99 is mainly due to revisions in methodology including the assessment of:

- depreciation, which has been included for the first time;
- urban transit, including revisions to the assessments of urban transit depreciation and debt charges; and
- roads.

Victoria's concern with the 1999 CGC Report includes the inconsistent application of accrual concepts to the assessment of a cash-based standard budget determined by the CGC for equalisation purposes. Depreciation, or the recurrent cost of capital, is a valid expense in an accrual budget. However, its incorporation into a standard budget was undertaken in the absence of state budgets published on an accrual basis. This has meant that the CGC's expenditure assessment for depreciation lacks a firm factual basis.

Despite this, the CGC continued to assess superannuation in the standard budget on a cash basis, benefiting less populous States at the expense of Victoria which has made substantial contributions towards reducing unfunded liabilities. It would have been more appropriate to recognise the accrual nature of superannuation liabilities in the same manner as that of depreciation.

With respect to the methodology underlying the assessment for depreciation, other concerns relate to the accuracy of the CGC's quantitative model and the validity of applying disability factors that have been traditionally associated with recurrent expenditures.

More fundamentally, Victoria believes that the CGC's assessments do not adequately recognise the scope for more efficient service delivery available to all States (e.g. through the application of new technology).

Horizontal fiscal equalisation

Financial assistance grants are distributed with the aim of achieving horizontal fiscal equalisation (HFE) among the States. Horizontal fiscal equalisation is based on the premise that each State is entitled to receive a share of general revenue funding from the Commonwealth enabling it to provide government services at Australia-wide standards. Interstate differences in revenue-raising capacity and in factors affecting the cost of delivering government services are claimed to be sufficiently pronounced to justify a complex system of horizontal fiscal equalisation as the basis for distributing grants.

The extent of horizontal fiscal equalisation relative to an equal per capita share of grants in dollar terms and in per capita terms using the 1999-2000 pool of financial assistance grants and health care grants is shown in Table 8.5 and Chart 8.7. This measure indicates the enormous annual subsidy being provided in 1999-2000 by residents of Victoria, New South Wales and Western Australia to residents of the Northern Territory, Tasmania, South Australia, the ACT and Queensland. This amounts to $793 million for Victoria or $167 per person. On average, each resident in the Northern Territory, Tasmania and South Australia will benefit by $4 659, $738 and $250 respectively. Despite the ACT having a less dispersed population and a relatively higher per capita household disposable income, some 24 per cent above that of Victoria, each ACT resident will benefit by $126.

Table 8.5: Impact of HFE on the distribution of financial assistance grants and health care grants in 1999-2000[(a)]

	Distribution using amended relativities[(b)] *($ million)*	*Distribution on an equal per capita basis*[(c)] *($ million)*	*Difference ($ million)*	*Difference ($ per capita)*
NSW	7 024	7 810	-786	-122
Vic	4 945	5 738	-793	-167
Qld	4 314	4 285	29	8
WA	2 158	2 277	-119	-63
SA	2 191	1 816	375	250
Tas	916	569	347	738
ACT	415	376	39	126
NT	1 144	236	908	4 659
Total	**23 108**	**23 108**	**0**	

Sources: Update of Table 3, p.18, of "Federal Financial Relations", Commonwealth Budget Paper No. 3, 1998-99, allowing for corrected CGC 1999 Report relativities

Notes:

(a) The total 1999-2000 pool of $23 108 million consists of $17 431 million in financial assistance grants and $5 677 million in health care grants.

(b) Relativities as recommended by the CGC in 1999 Report Vol II, Table 2-2, p. 6 and subsequently corrected for revisions to conveyance duty revenue data.

(c) Based on special ABS population projections at 31 December 1998 prepared for the 9 April 1999 Premiers' Conference.

Chart 8.7: Per capita subsidy under horizontal fiscal equalisation, 1999-2000

Sources: Update of Table 3, p.18, of "Federal Financial Relations", Commonwealth Budget Paper No. 3, 1998-99, allowing for corrected CGC 1999 Report relativities

Fiscal contribution payments

The States agreed at the June 1996 Premiers' Conference to make state fiscal contribution payments to the Commonwealth to assist in correcting its fiscal position. The size of this payment was set at $619 million in 1996-97, with further payments of $640 million in 1997-98 and $300 million in 1998-99, to be reviewed annually at the Premiers' Conference in light of the Commonwealth's fiscal position. Payments by the States are made on an equal per capita basis. Victoria made its final contribution of $74 million in 1998-99, bringing Victoria's total contribution to $387 million over the last three years.

National Competition Policy payments

NCP payments began in 1997-98 at $200 million in 1994-95 prices and are indexed and distributed among the States on an equal per capita basis. These payments are conditional on satisfactory progress with the implementation of National Competition Policy and related reforms. These include the review of legislative restrictions on competition and implementation of competitive neutrality policy, effective implementation of electricity reforms, free and fair trade in gas, effective observance of road transport reforms and sustainable reform of the Australian water industry.

The payments will double to an indexed $400 million in 1999-2000 and increase to $600 million in 2001-02 at 1994-95 prices. Victoria's share of the 1999-2000 NCP payments is estimated at $110 million.

Specific purpose payments

Specific purpose payments are made for particular policy purposes which are closely defined and in areas such as health and education. The provision of grants to the States in the form of specific purpose payments enables the Commonwealth to exert a policy influence in areas where an explicit constitutional role is not stipulated for the Commonwealth, and where the States are the primary service providers.

Specific purpose payments usually have various conditions attached, such as general policy requirements on States, compliance with agreements covering principles and service delivery mechanisms, project approval procedures, matching arrangements, performance measures and reporting requirements.

The allocation of specific purpose payments among the States is determined by many factors such as Commonwealth discretion, historical factors and formulae that attempt to reflect cost and demand factors.

Table 8.6 shows the total amount of specific purpose payments scheduled to be received from the Commonwealth by Victorian government agencies, excluding grants for on-passing. It shows that specific purpose payments to Victoria are expected to be 2.0 per cent or $57 million higher in 1999-2000 than in 1998-99.

Key factors affecting estimated specific purpose payments in 1999-2000 include:

- the ongoing effect of the Australian Health Care Agreement signed in 1998-99; and
- continuation of a 1 per cent efficiency dividend applied by the Commonwealth to most specific purpose payments.

Details on the full range of specific purpose payments received by Victoria, together with an explanation of the programs with which they are associated, can be found in Statement 3 of Budget Paper No. 3, *Budget Estimates 1999-2000.*

Table 8.6: Specific purpose grants by agency[(a)]

($ million)

	1998-99 Revised	*1999-00 Budget*	*Per cent Change*
Grants for Government Programs: Current			
Education	529.6	525.2	-0.8
Human Services	1 790.4	1 850.1	3.3
Infrastructure	2.8	2.8	..
Justice	42.4	41.2	-2.7
Natural Resources and Environment	50.1	50.4	0.6
Premier and Cabinet	5.0	10.0	100.0
State Development	3.3	1.7	-47.7
Treasury and Finance	14.2	6.9	-51.7
Total current grants	**2 437.7**	**2 488.2**	**2.1**
Grants for Government Programs: Capital			
Education	95.1	94.5	-0.7
Human Services	218.8	218.1	-0.3
Infrastructure	105.7	113.8	7.6
Natural Resources and Environment	0.1	0.1	..
Total capital grants	**419.7**	**426.5**	**1.6**
Total specific purpose grants	**2 857.5**	**2 914.7**	**2.0**

Source: Department of Treasury and Finance

Note:
(a) Excludes grants for on-passing

CHAPTER 9: A NEW ERA OF COMMONWEALTH-STATE FINANCIAL RELATIONS

- National tax reform has significant implications for Commonwealth-State relations. Under the reforms proposed by the Commonwealth Government, Victoria and the other Australian States and Territories will gain access to a broad-based revenue stream which will provide more scope for the States to meet their citizens' needs for services in the future.
- Financial assistance grants and nine inefficient state taxes will be replaced by goods and services tax (GST) revenue grants which will be freely available for use by the States for their own purposes. The Commonwealth will legislate to lock-in both the GST rate and base, as well as the arrangements for distribution of all GST revenue to the States.
- The Commonwealth has guaranteed that the States' budgetary positions will be no worse off during the transitional period.
- However, because the GST will be levied by the Commonwealth and will replace various state tax bases, it will reduce the States' own-source revenue, leaving them even more reliant on revenue from the Commonwealth.

OUTLINE OF NATIONAL TAX REFORM

On 2 December 1998 the Commonwealth Government introduced 16 new pieces of legislation into Parliament under the title *A New Tax System* (ANTS), paving the way for fundamental reform of the Australian tax system and a new era in Commonwealth-State financial relations.

The proposed tax reform package includes a broad-based 10 per cent GST from 1 July 2000, which replaces the Commonwealth's wholesale sales tax (WST) and nine state indirect taxes, including financial transaction taxes (financial institutions duty and debits tax) and a range of stamp duties. In addition, new diesel fuel arrangements for registered entities will be introduced, which effectively reduce diesel excise from 43 cents per litre to zero for off-road users and to 18 cents per litre for on-road users. The States will also adjust their gambling tax arrangements to take account of the impact of the GST on gambling operators.

States will receive the entire revenue generated by the GST as compensation for the abolition of nine indirect taxes, the elimination of financial assistance grants, and for assuming responsibility for the funding of local government and the new First Home Owners' Scheme. The Commonwealth will also cease to return the safety net revenues to the States from taxation on petrol, tobacco and liquor. Revenue generated by the GST will be centrally pooled and distributed by the Commonwealth Grants Commission according to horizontal fiscal equalisation principles, the same basis by which financial assistance grants are currently distributed (see Chapter 8, *Revenue and Grants*). The Commonwealth estimates that GST revenue will be around $27 billion in 2000-01 and will rise over time to enhance the overall budgetary position of the States by over $350 million in 2003-04 and $1 billion in 2004-05.

Under arrangements associated with the GST, the States will take over responsibility for the payment of financial assistance grants to local government from the Commonwealth as from 1 July 2000. It is proposed that these payments be maintained in real per capita terms on an ongoing basis. In addition, the reduction in costs to local government resulting from the removal of embedded indirect taxes, coupled with the GST-free status of municipal rates, should ensure that tax reform will provide significant benefits to this sector. Modelling undertaken by the Commonwealth suggests that the savings to local government across Australia from the removal of embedded WST in the products they purchase is in the order of $70 million per annum.

The Commonwealth will legislate to provide all of the GST revenue to the States. However, this is conditional upon the abolition of nine state indirect taxes. The taxes which the States have agreed to abolish, new expenditure responsibilities and the timing of these measures are listed in Box 9.1. The elimination of these state indirect taxes, with the exception of bed taxes, lags the introduction of the GST on 1 July 2000 by six to twelve months. This staggered approach is necessary as the estimated GST revenue in the first year is insufficient to fund the removal of these taxes.

Box 9.1: Agreed Commonwealth-State financial reform measures

New tax	Timing
GST	1 July 2000
Fringe benefits tax adjustments	
Reportable fringe benefits	1 April 1999
Reduction of public benevolent institution exemption	1 April 2000
Taxes to be abolished	
Wholesale sales tax	1 July 2000
Bed taxes (NSW and NT only)	1 July 2000
Financial institutions duty	1 January 2001
Debits tax	1 January 2001
Stamp duty on marketable securities	1 July 2001
Stamp duty on business conveyances (other than real property)	1 July 2001
Stamp duty on business conveyances (real property)	Staggered
Stamp duties on credit arrangements, instalment purchase arrangements and rental (hiring) agreements	1 July 2001
Stamp duties on leases	1 July 2001
Stamp duties on mortgages, bonds, debentures and other loan securities	1 July 2001
Stamp duties on cheques, bills of exchange and promissory notes	1 July 2001
Loss of other state revenue	
Financial assistance grants	1 July 2000
Gambling tax arrangements (partial reduction)	1 July 2000
Safety net arrangements	1 July 2000
New state expenditure responsibilities	
Local government	1 July 2000
First Home Owners' Scheme	1 July 2000

Source: A New Tax System, Commonwealth of Australia 1998

The original ANTS package released by the Commonwealth listed conveyancing duties on business property for abolition. However, after consultations with the States, the Commonwealth recognised that aggregate GST revenues would be insufficient to fund the removal of business conveyancing duties in the short term. As a consequence, the States have agreed to abolish stamp duties on the conveyance of property other than real property such as intellectual property and statutory licences from 1 July 2001, with the duty on real property (i.e. land and buildings) to be abolished at a future date. Present projections suggest that the duty on real business property will be removed in Victoria in 2004-05.

As an indication of the widespread commitment to the principles of national tax reform, at the Premiers' Conference on 9 April 1999, the Commonwealth and States signed an Intergovernmental Agreement detailing the arrangements for the reform of Commonwealth-State financial relations. At this meeting, the States gained a number of concessions from the Commonwealth which will further improve the States' financial positions. In particular, the States obtained extra Commonwealth compensation for the increased costs of public housing from national tax reform and for the loss of WST-equivalent payments. The Commonwealth will also provide more generous transitional guarantee arrangements from the third year of the transition period following the GST introduction and will allow local government to fully benefit from the removal of embedded indirect taxes. It is estimated that Victoria will gain around $110 million as a result of these improvements to the Commonwealth's proposals.

In an attempt to ensure that these new arrangements are not eroded over time by future governments, the Commonwealth and States intend to attach the Intergovernmental Agreement to legislation in each jurisdiction.

As part of the agreement, the Commonwealth has given the States a guarantee that, during the transitional years following the introduction of the GST, the budgetary positions of the States will be no worse off than they would have been without the reforms. The Commonwealth will make a combination of interest-free loans and grants to the States to ensure this is achieved.

For the first two years of the guarantee, the Commonwealth has underwritten the budget position of the States in aggregate. As such, States whose budget positions improve as a result of the introduction of the national tax reform package must, during the first two transitional years, compensate those States whose budget positions worsen. For example, in 2001-02, it is estimated that Queensland would contribute $67 million to the other States. Beyond the second year, States which gain can keep the surplus, with the Commonwealth providing all the funding to deficit States.

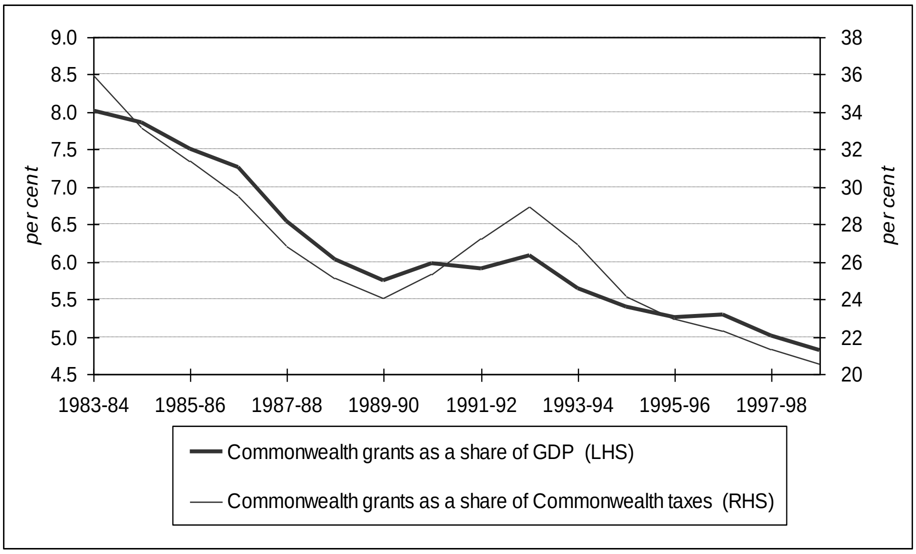
The benefits of the reform package to the States are substantial. The States will be able to abolish their most distorting and inefficient taxes. These “hidden” state taxes are applied to narrow bases and generally involve complicated compliance procedures. Together with the WST, the state taxes mostly apply to business inputs, making it more difficult for businesses to compete internationally. By comparison, the GST will be a broad-based, single-rate, transparent tax, which is borne by final consumers. Business input costs should fall as a result of the removal of the “hidden” indirect taxes, thereby improving international competitiveness of the Victorian and Australian economies.

Another benefit to the States is the certainty that will be delivered by access to the broad-based GST revenue stream. A 1997 High Court case relating to Section 90 of the Constitution denied the States the power to tax goods. This decision is symptomatic of the erosion of the States’ indirect tax bases. In contrast, the GST will increase with consumption growth in the economy. This will stabilise state finances and enhance the States’ ability to fund service delivery programs into the future.

COMMONWEALTH-STATE REVENUE IMPLICATIONS

Over recent years, financial relations have been dominated by a declining trend in Commonwealth payments to the States.

Chart 9.1: Commonwealth grants to all States as a share of GDP and of Commonwealth taxes

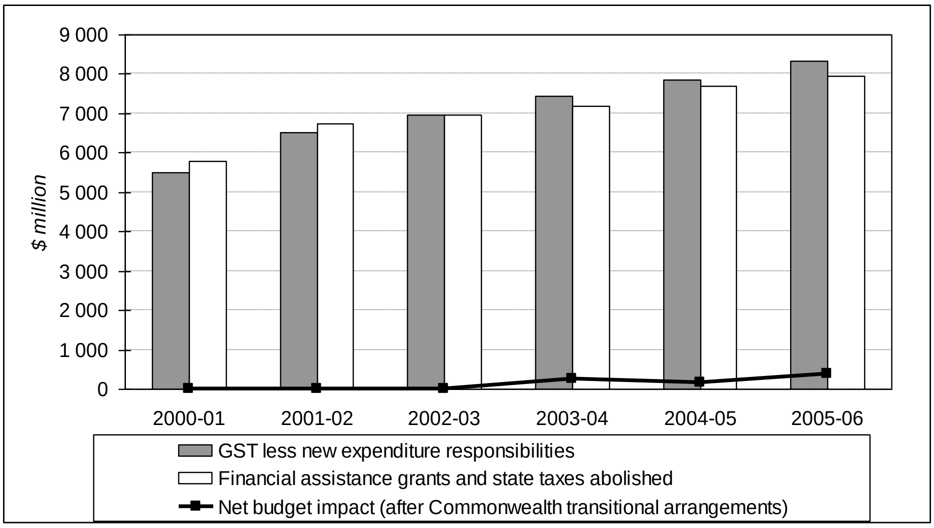


Source: Commonwealth Budget Papers, 1998-99 and earlier issues

As can be seen in Chart 9.1, the Commonwealth increased its level of grant funding in 1992-93 with the major impact of the Commonwealth's *One Nation Statement* occurring in that year. However, in the years following 1992-93, the sum of all grants to the States, including financial assistance grants, health care grants and specific purpose payments, declined from just over 6 per cent of GDP to an estimate of less than 5 per cent in 1998-99. Grants as a share of Commonwealth taxes also declined from 29 per cent in 1992-93 to below 21 per cent six years later. This is against the background of a longer term decline since 1983-84.

This historical trend can be contrasted with the revenue expected to be received from the GST in Chart 9.2.

Chart 9.2: Net cash flow impact on Victoria of the national tax reform package, 2000-01 to 2005-06 [(a)]



Sources: Estimates agreed by Commonwealth and States at 1999 Premiers' Conference

During the transitional years, GST revenue is expected to fall short of the existing revenue streams to be discontinued. As discussed above, the Commonwealth guarantee will ensure that the States' budgetary positions will be no worse after the reforms. In the long term, as GST revenue increases with growth in the economy, the GST revenue grants will far outweigh the revenue streams to be abolished and the additional expenditure responsibilities.

VERTICAL FISCAL IMBALANCE AND THE TAX DEBATE

The Federal Government's reform package clearly addresses the problems of the restricted and regressive tax bases currently available to the States. However, the reform package worsens the measure of vertical fiscal imbalance. The GST is a Commonwealth tax and the abolition of various state tax bases reduces own-source revenue controlled by the States.

One of the fundamental elements of an accountable, democratic system of government is its capacity to be responsive to the people who elect that government. It is difficult for one level of government to meet the diverse needs and expectations that arise in a country as vast as Australia. A federal system allows government to be flexible and responsive to the people within a framework that reflects common interests.

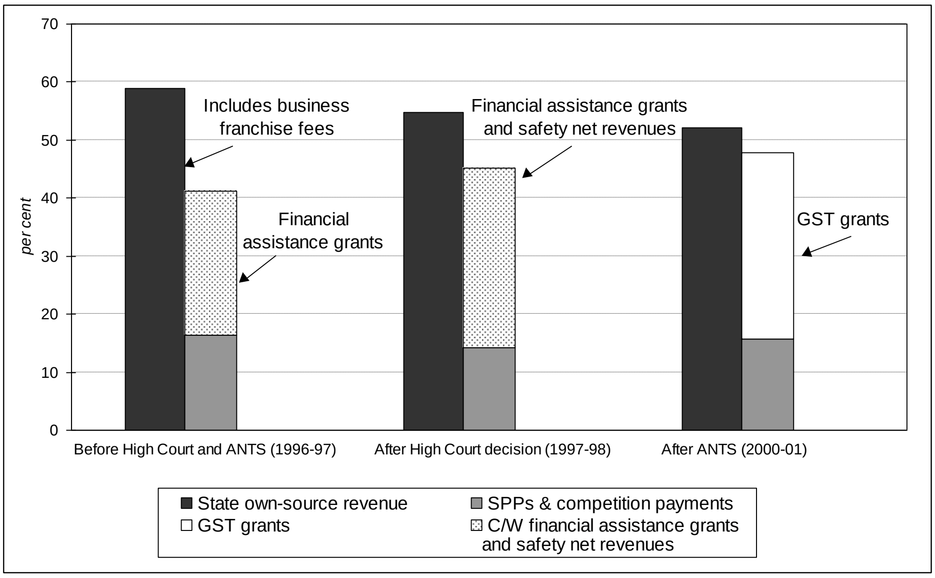
In the interests of greater accountability and efficiency, the States have consistently argued for a realignment of taxing powers and/or expenditure responsibilities to reduce the imbalance. The taxpayer has the right to expect, and to be able to see clearly, that Commonwealth Budget results are achieved through responsible financial management, rather than by withholding from States the funding needed for essential services.

However, the States must also be accountable. To ensure true accountability to the taxpayer, a clear and transparent link needs to be made between the money raised by governments through taxation and the range of services provided to the community.

At present, with various streams of revenue and expenditure and substantial transfer payments, it is not clear who pays for what. States should be held responsible for delivering services according to regional needs. States need direct access and control over a growth tax.

This will be partly achieved through the tax reform package. States will gain access to a broad revenue base that grows in line with the economy. The GST revenue grants will be freely available for use by the States for any purpose. It should be noted that the States will have no individual control over the amount of GST revenue they each receive. Nonetheless, constraints on adjustments to the GST rate and base are necessary to provide safeguards to the community as to the future stability of the GST arrangements.

Chart 9.3 State revenue sources – Victoria



Source: Department of Treasury and Finance

The change in the level of state own-source revenue is evident from Chart 9.3. In 1996-97, Victoria controlled almost 60 per cent of its revenue base, with the remaining 40 per cent sourced from the Federal government through financial assistance grants and specific purpose payments. As discussed earlier, in 1997 the High Court ruled that the States' business franchise fees were invalid. Arrangements were established whereby the Commonwealth collected similar taxes and forwarded the money to the States (safety net revenues). These arrangements reduced the level of Victorian own-source revenue to about 55 per cent.

After implementation of national tax reform, nine State taxes will be abolished and Victoria's own-source revenue will comprise only 52 per cent of total state revenue. GST grants will comprise approximately 32 per cent of total state revenue, and other grants (specific purpose payments and competition payments) will comprise approximately 16 per cent.

IMPLICATIONS FOR VICTORIAN PUBLIC SECTOR

Under the Commonwealth's proposed GST legislation, government activities are to be treated as any other business. The State Government will register under the system and the GST will apply to prices actually charged for goods and services, unless they are specifically exempt — i.e. those activities deemed to be GST-free which include certain areas of health, education, municipal rates, water and sewerage charges, as well as those government taxes and charges that are specifically exempted by the Commonwealth Treasurer.

Government will be able to claim input tax credits on any purchased inputs, the exception being input-taxed residential rents and financial services. It is anticipated that State governments will be in a net credit position where input tax credits outweigh the collection of GST. To alleviate the cash flow implications of this, the Commonwealth's legislation enables GST credits to be offset against other Commonwealth tax liabilities.

State and local government will benefit via savings on abolished taxes, which will accrue directly from savings on goods purchased, and indirectly from the removal of embedded taxes in prices charged by contractors and suppliers. The Commonwealth estimates that the cost to Australian governments at all levels will be reduced by more than $1 billion per year as a result of lower prices on purchased goods and services. The Commonwealth's guarantee arrangements assume that these savings are achieved by state governments; if they are not, their budget positions will deteriorate.

Tables 9.1 and 9.2 show the national tax reform impact on the Victorian cash flow and operating statements. In line with the conditions of the Commonwealth transitional guarantee, the reform package will have no impact, in aggregate, on the bottom line surplus over the forward estimates period.

Table 9.1: Net impact of the national tax reform package on Victorian cash flow statement

($ million)

	2000-01 Estimate	*2001-02 Estimate*	*2002-03 Estimate*
Change in revenue			
GST revenue	6 032.8	7 175.1	7 349.2
Growth dividend	51.3	76.5	102.0
FID and debits tax	- 260.6	- 642.0	- 659.7
Business stamp duties	- 12.9	- 349.9	- 391.0
Bed taxes	..	..	..
Gambling taxes	- 298.9	- 336.8	- 348.6
Safety net revenues	-1 415.5	-1 517.7	-1 555.2
Off-road diesel rebate	53.6	56.9	59.2
WST equivalent payments from GBEs	- 5.4	- 5.4	- 5.4
Financial assistance grants	-3 827.9	-3 957.3	-4 070.4
Total change in revenue	**316.5**	**499.4**	**480.1**
Change in expenditure			
Grants to local government	320.3	329.4	340.2
First Home Owners' Scheme	185.0	189.1	192.9
Embedded tax savings from reform package	- 100.4	- 107.4	- 115.0
Interest cost on changed Commonwealth payments	7.5	3.4	4.2
Reimbursement of ATO administration costs	173.6	74.2	71.6
Total change in expenditure	**586.0**	**488.7**	**493.8**
Net budget impact prior to Commonwealth transitional guarantee	**- 269.5**	**10.7**	**- 13.7**
Commonwealth guarantee arrangements			
Transitional loans, grants and distributions	269.5	258.9	13.7
Loan repayment	..	- 269.5	..
Net budget impact after Commonwealth transitional guarantee	**0.0**	**0.0**	**0.0**

Sources: Estimates agreed by Commonwealth and States at 1999 Premiers' Conference

Without the guarantee, in 2000-01 the Victorian cash surplus would have been reduced by an estimated $270 million. The Commonwealth's guarantee involves a loan of that amount to ensure that the State's budget position is maintained. In 2001-02, the State's estimated cash surplus would have been increased by $11 million. However, after the loan repayment, distributions between the States, and transition grants, Victoria is left in a neutral position. In 2002-03, the State's estimated cash surplus would have been $14 million lower, but the Commonwealth's transitional compensation ensures a neutral outcome.

The effect of the tax reform package on the operating statement is not neutral due to the fact that the loan in 2000-01 and loan repayment in 2001-02 are not recorded in the operating statement. As a result, the tax reform package is estimated to reduce the size of the operating surplus in 2000-01 by $270 million. However, in 2001-02, tax reform is expected to boost the State's operating surplus by $270 million. In the final year of the forward estimates period the operating surplus is unchanged due to receipt of the Commonwealth's guarantee grants.

After the initial three-year transitional period, the national tax reform package is expected to significantly improve both the Victorian budget position and the operating statement.

Table 9.2: Net impact of the national tax reform package on Victorian operating statement

($ million)

	2000-01 Estimate	*2001-02 Estimate*	*2002-03 Estimate*
Operating surplus before tax reform [(a)]	**391.0**	**395.9**	**309.7**
Change in revenue			
Taxes	-1 934.3	-2 789.5	-2 895.3
Public authority income	- 5.4	- 5.4	- 5.4
Grants	2 256.2	3 553.2	3 394.6
Total change in revenue	**316.5**	**758.2**	**493.8**
Change in expenses			
Interest and other finance costs	7.5	3.4	4.2
Grants	505.3	518.5	533.1
Supplies and other consumables	- 100.4	- 107.4	- 115.0
Other	173.6	74.2	71.6
Total change in expenses	**586.0**	**488.7**	**493.8**
Net change in operating surplus	**- 269.5**	**269.5**	**0.0**
Operating surplus after national tax reform	**121.5**	**665.5**	**309.7**

Sources: Estimates agreed by Commonwealth and States at 1999 Premiers' Conference

Notes:
(a) Operating surplus is drawn from Table 3.4.

Box 9.2: Impact of tax reform package on Victoria

Advantages

- States will gain access to a broad-based and increasing revenue stream, providing better scope to meet service delivery needs.
- Financial assistance grants will be replaced by GST revenue grants which will increase more strongly over time. These will be freely available for use by States for any purpose. The Commonwealth will legislate to lock-in both the GST rate and base, as well as the arrangements for distribution of all GST revenue to the States.
- Abolition of nine inefficient state indirect taxes, to be replaced by one broad-based consumption tax, will lead to a more competitive Victorian and Australian economy.
- The Commonwealth has guaranteed that the States' budgetary positions will be no worse off during the transitional period.

Disadvantages

- Individual States will not be able to alter the GST rate, leaving the States even more reliant on the Commonwealth and its revenue distribution mechanisms.

The advantages from national tax reform clearly outweigh its disadvantages to the State and Victoria fully supports the national tax reform package.

APPENDIX A: BUDGET SECTOR CASH FLOW STATEMENT

The cash flow statement provided in this Budget Paper has been revised since the publication of the 1998-99 Budget to be consistent with generally accepted accounting principles and, in particular, the requirements of Australian Accounting Standard 31 (AAS31).

Table A1 provides a summary projected cash flow statement for the 1999-2000 Budget and the forward estimates period to 2002-03.

Net cash flow from operating activities is expected to decrease by $241.6 million in 1999-2000 compared with the revised 1998-99 estimate, mainly reflecting a $120.6 million decrease in operating receipts and a $121.0 million increase in payments in relation to operating activities (see Table A1). By way of comparison, the 1999-2000 accrual operating surplus is expected to decline by $640.8 million, as reported in Chapter 3, *Budget Position and Outlook.*

The discrepancy between the decrease in 1999-2000 net cash flows from operating activities and the corresponding larger decrease in the operating surplus is largely attributable to timing effects in relation to the receipt of revenue earned, or payment of expenses incurred, in previous years.

For example, the $121.0 million projected increase in cash operating payments in 1999-2000 is lower than the corresponding increase ($475.4 million) in accrual operating expenses. This mainly reflects the impact of one-off cash superannuation payments in 1998-99 to reduce unfunded superannuation liabilities in respect of the Public Transport Corporation as part of the restructure and reform of that organisation. Since these cash payments reduce superannuation liabilities incurred over previous years, they are not reflected in the accrual operating result for 1998-99. Similarly, 1999-2000 operating receipts are expected to be bolstered (relative to the corresponding accrual revenue) by the receipt of state taxation equivalent payments of around $80 million earned in the previous year.

Table A1: Budget sector cash flow statement

($ million)

	1998-99 Revised	1999-00 Budget	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate
Taxation	8 662.3	8 690.4	8 934.8	9 273.1	9 646.3
Regulatory fees and fines	244.7	246.6	238.1	199.8	200.0
Public authority income	927.6	726.2	687.8	499.0	426.8
Grants	7 448.6	7 606.6	7 791.3	8 057.2	8 277.1
Sales of goods and services	1 796.0	1 810.4	1 816.8	1 831.0	1 852.0
Interest received	120.4	54.0	51.1	51.4	51.8
Other receipts	451.8	396.6	428.6	403.1	402.6
Total receipts from operating activities	**19 651.4**	**19 530.7**	**19 948.4**	**20 314.5**	**20 856.6**
Employee entitlements	7 042.2	7 285.6	7 493.1	7 711.8	7 983.2
Superannuation	1 592.7	1 262.4	1 367.7	1 424.7	1 504.0
Grants	3 324.5	3 307.7	3 105.7	3 078.6	3 135.6
Supplies and consumables	5 512.0	5 901.7	5 916.9	6 045.1	6 227.7
Interest and other finance costs	697.1	532.1	527.8	507.2	484.4
Other payments	..	..	..	..	..
Total payments from operating activities	**18 168.5**	**18 289.5**	**18 411.2**	**18 767.3**	**19 335.0**
Net cash flow from operating activities (a)	**1 482.8**	**1 241.2**	**1 537.2**	**1 547.2**	**1 521.6**
Net customer loans repaid	100.0	100.2	100.1	100.1	100.1
Net proceeds of investments	241.4	50.3	28.5	28.9	24.0
Term and fixed deposits	321.5	0.0	- 0.2	- 0.1	- 0.0
Net privatisation proceeds and other abnormals (b)	2 739.8	..	..	..	..
Sale of fixed assets	118.0	132.2	121.1	93.3	76.8
Purchase of fixed assets	-1 273.5	-1 123.6	-1 309.7	-1 389.7	-1 515.3
Other	0.9	0.3	0.0	0.0	0.0
Net cash flow from investing activities (a)	**2 248.1**	**- 840.6**	**-1 060.1**	**-1 167.3**	**-1 314.3**
Net proceeds of borrowings	-3 805.2	- 399.3	- 458.1	- 362.7	- 182.7
Other	..	..	..	..	..
Net cash flow from financing activities (a)	**-3 805.2**	**- 399.3**	**- 458.1**	**- 362.7**	**- 182.7**
Net increase in cash held	**- 74.3**	**1.3**	**19.0**	**17.2**	**24.6**
Cash at beginning of reporting period	910.7	836.4	837.7	856.6	873.8
Transitional adjustments	..	..	0.0	0.0	0.0
Cash at end of reporting period	**836.4**	**837.7**	**856.6**	**873.8**	**898.4**

Source: Department of Treasury and Finance

Notes:

(a) A negative figure denotes a cash outflow.

(b) For 1998-99, incorporates total cash privatisation proceeds of $5 277.8 million net of $2 538 applied to reduce budget sector superannuation liabilities.

Net cash outflow in relation to the purchase of fixed assets is expected to decline slightly to $1 123.6 million in 1999-2000, compared to an estimated $1 273.5 million in 1998-99. The allocation of $80.8 million of new 1999-2000 capital funding to projects outside the budget sector is the main factor contributing to this decline. Since these projects do not create assets on the budget sector balance sheet, expenditure on these projects is treated as an operating expense rather than as a purchase of fixed assets, thus reducing 1999-2000 purchase of fixed assets relative to the previous year.

Net proceeds of investments are expected to decline by $191.1 million in 1999-2000. This mainly reflects repayments received from Gascor in 1998-99 in respect of the bulk ($208 million out of a total of $234 million) of a shareholder loan created on incorporation of Gascor in December 1998.

Cash inflows in relation to term and fixed deposits are expected to decline by $321.4 million in 1999-2000. This reflects the application of funds ($2 538 million) to the reduction of the State's unfunded superannuation liability during 1998-99 (see Chapter 4, *Balance Sheet Management And Outlook*).

APPENDIX B: REVISED 1998-99 BUDGET OUTCOME

The revised 1998-99 Budget estimates take into account government decisions and economic developments impacting on both revenue and expenses since the presentation of the 1998-99 Budget to Parliament.

The revised operating surplus for 1998-99 is $769.5 million before abnormals (see Table B1), and $6 281.3 million after allowing for the proceeds of privatisations from the sale of the gas businesses, Aluminium Smelters of Victoria (Aluvic) and Victorian Plantations Corporation (VPC). These estimates are on an accrual basis consistent with generally accepted accounting principles, and are consistent with the estimates presented in the 1998-99 Budget Paper No 2.

REVISED 1998-99 OPERATING STATEMENT

The revised operating surplus for 1998-99 is presented in Table B1. In line with usual practice, the 1998-99 Budget estimates made no allowance for future privatisations. Therefore, after including abnormal receipts related to the privatisation of Aluvic, Ecogen, VPC and the gas businesses, the operating surplus rises to $6 281.3 million, which is $5 730.6 million higher than the Budget estimate. These privatisation proceeds are one-off receipts and are used to reduce state net debt and other liabilities.

Table B1: 1998-99 operating statement

($ million)	1998-99 Budget	1998-99 Revised	Change	Change %
Revenue				
Taxation(a)	8 491.5	8 597.9	106.4	1.3
Regulatory fees and fines	244.1	245.0	0.9	0.4
Public authority income[(a)]	940.5	955.4	14.9	1.6
Grants[(b)]	7 275.1	7 448.6	173.4	2.4
Sale of goods and services	1 687.4	1 796.1	108.7	6.4
Net surplus from disposal of physical assets	..	22.8	22.8	..
Fair value of assets received free of charge	..	0.1	0.1	..
Other revenue	382.9	589.1	206.2	53.8
Total revenue	**19 021.7**	**19 655.0**	**633.3**	**3.3**
Expenses				
Employee entitlements	7 145.1	7 116.0	- 29.1	- 0.4
Superannuation	1 622.4	1 559.7	- 62.6	- 3.9
Depreciation	762.7	696.0	- 66.7	..
Amortisation	22.2	33.1	10.8	..
Interest and other finance costs	821.9	697.1	- 124.8	- 15.2
Grants and transfer payments[(b)]	3 547.2	3 296.0	- 251.2	- 7.1
Supplies and consumables	4 549.5	5 487.5	938.1	20.6
Other expenses	..	..	..	..
Total expenses	**18 471.0**	**18 885.4**	**414.5**	**2.2**
Operating surplus before abnormals	**550.7**	**769.5**	**218.8**	**39.7**
Abnormal items[(c)]	..	5 511.8	5 511.8	..
Operating Surplus/(Deficit) After Abnormals[(d)]	**550.7**	**6 281.3**	**5 730.6**	

Source: Department of Treasury and Finance

Notes:

(a) Excludes net privatisation proceeds received as stamp duty and tax equivalent receipts and dividends.

(b) Includes grants for on-passing to local government and to non-government schools.

(c) Includes proceeds of privatisations from the sale of the gas businesses, Aluvic and VPC.

(d) The 1998-99 Budget operating surplus shown in this table is lower than the projected operating surplus published in the 1998-99 Budget papers ($767 million). The difference is due to the post-budget reclassification of a number of transactions (from investing activities to operating expenses) to ensure consistency with accounting standards.

Total operating revenue

Total estimated operating revenue for 1998-99 has been revised upward by $633.3 million, or 3.3 per cent, from the Budget estimate of $19 021.7 million. The revision is due to increases in current grants from the Commonwealth, taxation, sale of goods and services, and in other revenue.

Excluding privatisation receipts, total revenue from taxation is expected to be $8 597.9 million in 1998-99, $106.4 million (or 1.3 per cent) above the 1998-99 Budget estimate (see Table B2).

Table B2: Taxation 1998-99

($ million)

	1998-99 Budget	*1998-99 Revised*	*Change*	*Change %*
Payroll tax	2 236.0	2 192.5	- 43.5	- 1.9
Taxes on property	2 298.3	2 593.3	295.0	12.8
Gambling taxes	1 341.3	1 395.9	54.6	4.1
Taxes on insurance	364.3	352.2	-12.1	- 3.3
Motor vehicle taxes	873.3	884.9	11.6	1.3
Safety net revenues/franchise fees	1 368.3	1 399.7	31.4	2.3
Other taxes	10.0	10.0	0.0	0.0
Total taxation	**8 491.5**	**8 828.4**	**336.9**	**4.0**
Less privatisation stamp duties		230.6	230.6	
Total taxation excluding privatisation	**8 491.5**	**8 597.9**	**106.4**	**1.3**

Source: Department of Treasury and Finance

The single major variation expected in taxation, excluding privatisation proceeds, is due to the redirection of $65 million in revenue from the Metropolitan Improvement Levy through the Consolidated Fund. The remaining net balance, less than 1 per cent of taxation revenues, reflects

- stronger revenue from electronic gaming machines, due to increased player expenditure per machine, and higher
- tobacco safety net revenues; partially offset by
- lower payroll tax, because of higher than expected refunds and some employment agencies not paying payroll tax pending the outcome of the State Revenue Office's appeal of the Drake decision.

The total revenue to be derived from regulatory fees and fines (including electricity sector licence fees and traffic fines) is expected to be close to the budgeted figure of $244.1 million.

As shown in Table B3, public authority income is estimated to be $955.4 million in 1998-99 ($2 412.9 million including privatisation receipts). The $14.9 million variance from budget is largely the result of:

- increased distributions of $58.6 million expected from the Transport Accident Commission as a result of higher than expected investment returns for 1997-98;
- strong profitability by the water sector, with the key drivers being the dry climatic conditions and continued strength in property development activity, which led to increased distributions of $124.4 million;
- decreased distributions of $116.6 million from the gas sector.

It should be noted that the $207.7 million repayment by Gascor Pty Ltd (of part of the debt owing to the State which was created at the corporatisation of Gascor Pty Ltd) has been reclassified thus reducing the estimate for public authority income.

Table B3: Public authority income 1998-99

($ million)

	1998-99 Budget	*1998-99 Revised*	*Change*	*Change %*
Dividends	810.0	1 017.2	207.2	25.6
Income tax equivalent receipts	122.7	1 387.8	1 265.1	1 031.1
Wholesale sales tax and local government rate equivalent receipts	7.8	7.8	0.0	0.3
Total public authority income	**940.5**	**2 412.9**	**1 472.3**	**156.5**
Less: Privatisation proceeds		1 457.5	1 457.5	
Total public authority income excluding privatisation proceeds	**940.5**	**955.4**	**14.9**	**1.6**

Source: Department of Treasury and Finance

Proceeds from privatisations that have occurred to date, and are classified as public authority income, are expected to amount to $1 457.5 million. This includes $367.2 million from the sale of the VPC, and $1 090.3 million from the sale of gas businesses.

Grants are now expected to be $173.4 million higher than Budget. Around $87 million of this is due to increased funding from the new Australian Health Care Agreement which replaced the Medicare Agreement. Commonwealth grants to non-government schools and government schools increased by $63 million and $10 million, respectively. In addition, an extra $8 million was received through the provision of Commonwealth assistance in relation to the September 1998 Victorian gas emergency.

In 1998-99, revenues received from the sale of goods and services are up on Budget by $108.7 million. In general since revenue from sales of goods and services offsets expenditures made to provide these goods and services, such revenue and associated expenditures do not represent a net addition to Budget resources.

The 1998-99 Budget estimate for other revenue was $382.9 million while the revised estimate is $589.1 million, an increase of $206.2 million. The major components of this increase are:

- reclassification of the annual payments of $64 million by the Director of Housing to the Consolidated Fund as a result of a restructure to the housing loan agreements;
- rental leases of $22.7 million; and
- transfers to the Consolidated Fund of $25.1 million of building rental income from the Government Owned Rental Accommodation Trust Account, and of $19.1 million from the Estate Agents Guarantee Trust Account.

Total operating expenses

Total revised operating expenses for 1998-99 are now forecast to be $18 885.4 million, or 2.2 per cent ($414.5 million), above the Budget estimate of $18 471.0 million (see Table B1). The major variances are explained below.

The budget outcome for employee entitlements broadly reflects the published Budget. However, major variances within this line have occurred reflecting the reclassification of departmental expenses between items from those in the Budget. These variances largely offset each other.

The reduction of superannuation expenses of $62.6 million is largely due to the impact of the one-off payment of $490 million made at the end of 1997-98 to further reduce unfunded superannuation liabilities, and not anticipated at the time of the 1998-99 Budget.

Depreciation is $66.7 million below budget due to the adoption of the policy to value earthworks separately from roads as a non-depreciable asset.

Interest and other finance costs have been revised downward by $124.8 million. This is comprised mostly of:

- interest savings of $88.1 million from the application of privatisation proceeds and operating cash surpluses to debt retirement;
- the non-utilisation of the interest volatility allowance and the Structured Finance Facility termination allowance resulted in a further $67 million downward revision to the budget outcome;
- a rise in finance costs of $13.9 million due to net realised losses on debt retirement and early termination of transport leases; and
- the inclusion of finance lease costs relating to the State's motor vehicle fleet and the Accelerated Infrastructure Program totalling $15.8 million. These finance lease costs have been included under interest and other finance costs for the first time.

Grants and transfer payments have been revised downwards by $251.2 million mainly due to the reclassification (following the presentation of the 1998-99 Budget) of certain departmental expenses to supplies and consumables in order to more accurately reflect actual expenditure.

Supplies and consumables have been revised upwards by $938.1 million. Some factors behind this variance are:

- transfers from asset investments to operating expenses. The Department of Infrastructure transferred $152.6 million, mostly relating to changes in the way land under roads and road maintenance are treated (previously these items were capitalised but are now to be expensed). To partially offset this, $14.1 million Land Compensation expenditure has been transferred from operating expenses. Historically, this has mostly been of a capital nature;
- reclassification of expenses from grants and employee entitlements to more appropriately reflect expenditure;
- as a result of the increase in the sales of goods and services revenue, there has been an equivalent increase in supplies and consumables expenditure; and
- $87.8 million for an expected increase in funding requirements for Y2K compliance and assistance for East Gippsland flood relief.

Abnormal items

The net proceeds from privatisations of $5 511.0 million, as outlined under abnormal items in Table B1, are disaggregated in Table B4. In line with usual practice, the estimates in Table B4 include only proceeds from announced transactions and not forecasts for any future privatisations.

Table B4: Effects of privatisation on 1998-99 Budget

($ million)

	1998-99 Revised
Revenue	
Stamp duty	230.6
Tax equivalent receipts	1 228.7
Other(a)	462.8
Total revenue	**1 922.0**
Sale of investments	
Aluvic	486.8
Victorian Plantations Corporation	176.9
Multinet/Ikon	998.4
Stratus/Energy21	826.9
Westar/Kinetic	838.5
EcoGen/PTC	469.0
Total sale of investments	**3 796.5**
Operating expenses	
Budgeted costs of privatisation and reform	104.9
Aluvic foreign exchange loss	101.9
Total expenses	**206.8**
Net proceeds from privatisations	**5 511.8**

Source: Department of Treasury and Finance

Note:

(a) Includes non-cash revenue in the form of a $234 million shareholder loan created on incorporation of Gascor.

REVISED 1998-99 CASH FLOW STATEMENT

Table B5 provides a summary of the revised cash flow for 1998-99. The cash flow statement included in this paper has been revised since the publication of the 1998-99 Budget to be consistent with Australian Accounting Standard 31.

Net cash flow from operating activities is $15.6 million lower than the 1998-99 Budget estimate. This result is mostly due to large increases in grants of $173.4 million, sale of goods and services of $108.5 million, and taxation of $106.6 million. Other receipts of $185.4 million also affected the variation. This was mainly due to restructured housing loan agreements of $64 million and to rental leases of $22.7 million. Superannuation payments, grants and interest paid have been revised downwards by $93.6 million, $221.1 million and $124.8 million, respectively. An increase in supplies and consumables expenses of $944.0 million offsets the results of these receipts and expenses. These items are a reflection of movements in the operating statement as shown in Table B1.

Net proceeds of investments increased by $197.5 million as a result of a partial payment of debt owing to the State of $207.7 million by Gascor Pty Ltd. A payment of $70.9 million by the Director of Housing was the result of the restructuring of the housing loan arrangements.

A large reduction of $201.3 million occurred in the purchases of fixed assets. This was due to transfers to operating expenses as a result of a policy change in the method of treating items such as land under roads and road maintenance and rehabilitation.

Total cash privatisation proceeds for 1998-99 were $5 277.8 million. $2 538 million of this amount was applied to the State Superannuation Fund to reduce budget sector superannuation liabilities resulting in the figure of $2 739.8 million for net privatisation proceeds and other abnormals recognised in the cash flow statement.

Table B5: 1998-99 cash flow statement

($ million)

	1998-99 Budget	*1998-99 Revised*	*Change*	*Change %*
Taxation	8 555.7	8 662.3	106.6	1.2
Regulatory fees and fines	244.1	244.7	0.6	0.2
Public authority income	953.5	927.6	- 25.9	- 2.7
Grants	7 275.1	7 448.6	173.4	2.4
Sale of goods and services	1 687.4	1 796.0	108.5	6.4
Interest received	102.3	120.4	18.1	17.7
Other receipts	266.4	451.8	185.4	69.6
Total receipts from operating activities	**19 084.6**	**19 651.4**	**566.7**	**3.0**
Employee entitlements	6 964.4	7 042.2	77.8	1.1
Superannuation	1 686.4	1 592.7	- 93.6	- 5.6
Grants	3 545.6	3 324.5	- 221.1	- 6.2
Supplies and consumables	4 567.9	5 512.0	944.0	20.7
Interest paid	821.9	697.1	- 124.8	- 15.2
Other payments	..	..	..	..
Total payments from operating activities	**17 586.2**	**18 168.5**	**582.4**	**3.3**
Net cash flows from operating activities(a)	**1 498.4**	**1 482.8**	**- 15.6**	**- 1.0**
Net customer loans repaid	..	100.0	100.0	..
Net proceeds investments	43.9	241.4	197.5	449.4
Term and fixed deposits	..	321.5	321.5	..
Net privatisations proceeds and other abnormals(b)	..	2 739.8	2 739.8	..
Sale of fixed assets	115.3	118.0	2.7	2.3
Purchases of fixed assets	-1 474.8	-1 273.5	201.3	- 13.7
Other	- 0.1	0.9	1.0	-1 910.0
Net cash flows from investing activities(a)	**-1 315.7**	**2 248.1**	**3 563.7**	**- 270.9**
Net proceeds from borrowings	247.1	-3 805.2	-4 052.4	-1 639.7
Other	..	..	..	..
Net cash flows from financing activities(a)	**247.1**	**-3 805.2**	**-4 052.4**	**-1 639.7**
Net cash increase in cash held	**429.9**	**- 74.3**	**- 504.3**	**- 117.3**
Cash at beginning of reporting period	910.7	910.7	..	..
Transitional adjustments	..	..	..	..
Cash at end of reporting period	**1 340.6**	**836.4**	**- 504.3**	**- 37.6**

Source: Department of Treasury and Finance

Note:

(a) A negative figure denotes a cash outflow.

(b) For 1998-99 Revised, incorporates total cash privatisation proceeds of $5 277.8 million net of $2 538 million applied to reduce budget sector superannuation liabilities.

APPENDIX C: SENSITIVITY OF THE BUDGET TO ECONOMIC CONDITIONS

The key economic parameters affecting the budget balance include GSP, employment, wages and prices. The full-year effect of a one percentage point variation in each parameter on the budget over a four-year period is shown in Table C1. To differentiate the impact of changes to each economic variable, the Table has been prepared on an ‘other things remaining constant’ basis. For example, a one-off one percentage point increase in real GSP and employment in the first year yields a $69 million increase in total revenue and a $16 million increase in operating and capital expenditure, leaving a $53 million improvement on the cash budget balance. In practice, the economic variations listed in Table C1 are not independent and many combinations are possible. Scenario analysis can be used to illustrate the impacts of alternative economic environments.

Table C1: Impact on the forward estimates of a 1 percentage point increase in selected economic parameters in the first year [(a)]

($ million)

	Year 1	*Year 2*	*Year 3*	*Year 4*
GSP and employment				
Taxes, regulatory fees and fines	60	62	65	67
Other own-source income	9	9	10	10
Grants received	..	..	..	..
Operating and capital expenditure	16	14	12	10
Budget balance	53	57	62	67
Average weekly earnings				
Taxes, regulatory fees and fines	24	25	26	27
Other own-source income	..	..	..	..
Grants received	..	..	..	..
Operating and capital expenditure	74	79	84	90
Budget balance	- 50	- 54	- 58	- 63
Price inflation [(b)]				
Taxes, regulatory fees and fines	43	44	46	48
Other own-source income	9	9	10	10
Grants received	61	62	65	66
Operating and capital expenditure	78	77	78	78
Budget balance	35	39	43	46
Interest rates [(c)]				
Operating expenditure	2	4	8	12
Budget balance	- 2	- 4	- 8	- 12

Source: Department of Treasury and Finance

Notes:

(a) A positive number for the budget balance denotes an improvement in the budget position (increase in budget surplus or decrease in budget deficit).

(b) Assumes a 1 percentage point variation in both CPI and GSP deflator.

(c) Assumes a 1 percentage point increase in interest rates over the entire period.

APPENDIX D: NON-FINANCIAL PUBLIC SECTOR ESTIMATES

COVERAGE OF FINANCIAL ESTIMATES

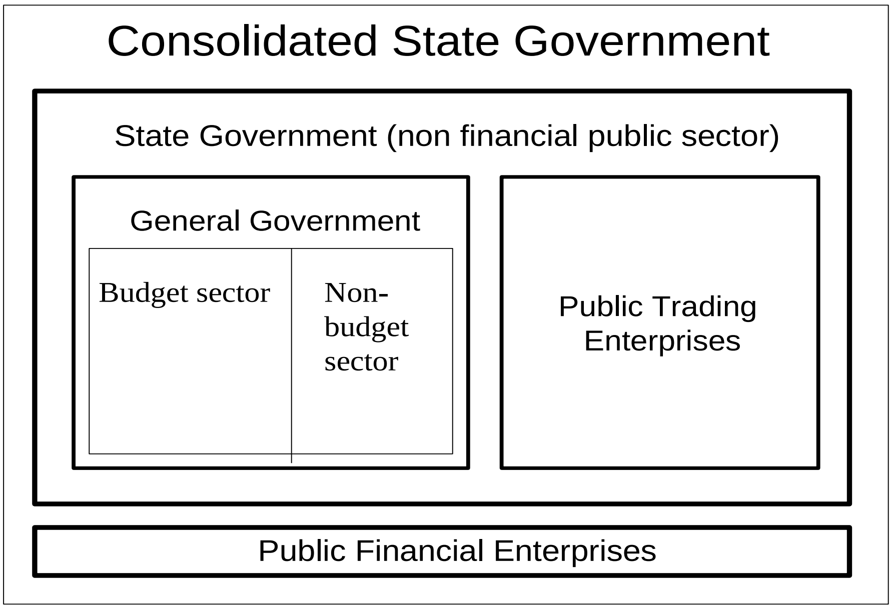
In the Australian Bureau of Statistics (ABS) classification scheme for Government Finance Statistics, all state public sector bodies are categorised into one of three institutional sectors: general government, public trading enterprises, and public financial enterprises. The first two of these, when brought together and consolidated, constitute the non-financial public sector. Consolidation of the public financial enterprises with the non-financial public sector represents the consolidated state government sector.

General government is the term used by the ABS for the combined core, tax-supported government bodies. For Victoria, the general government sector is essentially the same as the budget sector, except for the addition of a number of relatively small authorities and regulatory bodies. The largest of these are the Country Fire Authority, Metropolitan Fire and Emergency Services and Parks Victoria. Although predominantly funded through taxation or compulsory levies these bodies are non-budget dependent and are therefore excluded from the budget sector accounts.

Public trading enterprises provide goods and services which are mainly market, non-regulatory and non-financial in nature. They differ from general government bodies in that all or most of the production costs are recovered from consumers who receive goods and services in exchange for payment. The degree of commerciality of public trading enterprises varies, ranging from those which receive on-going operating subsidies from government (eg. transport and housing) to those which are generally net contributors to government (eg. water authorities).

A mark of public financial enterprises is that they perform central bank functions, accept deposits or incur liabilities and acquire financial assets in the market in their own right. Victorian public financial enterprises include Treasury Corporation of Victoria, Victorian WorkCover Authority, Transport

Accident Commission, Victorian Funds Management Corporation and the Rural Finance Corporation.



UNIFORM PRESENTATION OF GOVERNMENT FINANCE STATISTICS

Under the March 1997 *Uniform Reporting Framework Agreement* (URF) between the Commonwealth, States and Territories, all Australian jurisdictions are required to provide timely publication of government financial data consistent with ABS Government Finance Statistics (GFS) standards for cash-based reporting.

Features of the URF are the inclusion of estimates for the non-financial public sector (four forward years for general government and one year for public trading enterprises) and financial outcome information for the public financial enterprise sector. URF tables are published by jurisdictions at budget time, in a mid-year budget review report and in a budget outcome statement at year-end. Sectoral definitions and coverage for GFS reporting are in line with those used in the *Annual Financial Statement*, which follows the accounting standards for whole of government reporting. Public financial enterprise sector reporting is required for outcomes only and is therefore not included in the following estimates tables.

In URF Tables D2 to D6, financial information for the Victorian non-financial public sector for 1998-99 (revised) and 1999-2000 (and additional forward estimates for the general government sector) is presented on a cash GFS basis.

The presentation of the tables has been revised to take account of definitional changes incorporated into the latest ABS publications. The greatest impact is that net advances paid, previously categorised as capital outlays, is now included in financing transactions (ie 'below the line'). For the general government sector, the largest item included in net advances paid is the offsetting receipt of privatisation proceeds from the public trading enterprise sector. For this reason alone total financing transactions and the deficit for the general government sector will be substantially different from that published in the mid-year review. In addition, the former revenue category of taxes, fees and fines has been revised to include taxation items only. Regulatory fees are now netted off final consumption expenditure as part of sales of goods and services and fines are included in other revenue.

Consistent with the move to the presentation of financial information on an accrual basis by governments throughout Australia, the ABS is currently finalising a standard for accrual-based GFS. The first publication of these tables by the ABS on an accrual basis, for the 1997-98 year, is expected later in 1999. The new GFS framework is based on revised international statistical standards, and an information paper, incorporating definitions of terms and likely table formats, was published in 1997 - *Developments in Government Financial Statistics,* ABS Catalogue No 5516.0. Although based on economic rather than accounting concepts, the new GFS presentation will be very similar in layout and content to the main financial tables presented under Australian Accounting Standard *AAS31: Financial Reporting by Governments* elsewhere in this document. An 'in principle' agreement has been reached by all Australian governments to move the Uniform Reporting Framework to an accrual basis for the 2000-2001 budget.

The following summarised table identifies the sectoral classifications of the public sector agencies included in the URF tables. A comprehensive list of all Victorian government reporting agencies, including public financial enterprises, was last published in the *Financial Statements for the State of Victoria 1997-98*.

Table D1: Classification of public sector agencies

	General Government Sector(a)	Budget Sector(b)	Public Trading Enterprises(a)	Non-Budget Sector(b)
Parliament	*	*		
Education	*	*		
TAFE	*	*		
Human Services	*	*		
Hospitals, Health Services, Nursing Homes and Ambulance Service	*	*		
Office of Housing			*	*
Infrastructure				
Public Transport Network			*	*
Roads Corporation	*	*		
Other	*	*		
Justice	*	*		
Natural Resources and Environment	*	*		
Premier and Cabinet	*	*		
State Development	*	*		
Treasury and Finance	*	*		
Aluminium Smelters of Victoria (c)			*	*
Barwon Water			*	*
Central Gippsland Region Water			*	*
Central Highlands Region			*	*
City West Water Ltd.			*	*
Coliban Region Water Authority			*	*
Country Fire Authority	*			*
East Gippsland Region Water			*	*
Energy 21 (c)			*	*
Gas Service Business			*	*
GasCor			*	*
Gasmart			*	*
Goulburn-Murray Rural Water			*	*
Goulburn Valley Region Water			*	*
Grampians Region Water			*	*
Ikon Energy (c)			*	*
Kinetik Energy (c)			*	*
Melbourne and Olympic Parks Trust			*	*
Melbourne Port Corporation			*	*

Table D1: Classification of public sector agencies - *continued*

	General Government Sector (a)	Budget Sector (b)	Public Trading Enterprises (a)	Non-Budget Sector (b)
Melbourne Water Corporation			*	*
Metropolitan Parks & Waterways	*			*
Metropolitan Fire and Emergency Services Board	*			*
Minor Water Authorities			*	*
Multinet Gas (c)			*	*
North East Region Water			*	*
South East Water Ltd			*	*
Southern Rural Water Authority			*	*
Former State Electricity Commission of Victoria				
SECV Shell			*	*
Victoria Power Exchange			*	*
Generation Victoria (ECOGEN Energy Ltd) (c)			*	*
Stratus Networks (c)			*	*
Sunraysia Rural Water Authority			*	*
Transmission Pipelines Australia (TPA) P/L (formerly Gas Transmission Corporation)			*	*
Urban Land Corporation			*	*
Vic Energy Network			*	*
Victorian Channels Authority			*	*
Victorian Dairy Industry Authority			*	*
Victorian Plantations Corporation (c)			*	*
Victorian Rail Track Corporation			*	*
V-Line Freight Corporation (c)			*	*
Westar (c)			*	*
Western Region Water			*	*
Wimmera Mallee Rural Water Authority			*	*
Yarra Valley Water Ltd.			*	*

Source: Department of Treasury and Finance

Notes:

(a) As presented in ABS, Government Financial Estimates, Australia and the Financial Statements for the State of Victoria

(b) As presented in Victorian Budget Papers.

(c) Agencies sold during 1998-99.

Uniform Reporting Format Presentation

Table D2: General government sector transactions

($ million)	1998-99 Revised	1999-2000 Budget	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate
Current Outlays					
Final consumption expenditure	15 073.2	12 950.9	13 317.1	13 611.2	14 138.1
Interest and other financing costs	787.0	519.9	515.3	494.5	471.7
Subsidies to PTEs and PFIs	263.6	366.0	296.6	354.9	387.1
Current grants	1 628.0	1 649.7	1 685.5	1 745.8	1 771.6
Other current payments	248.6	276.7	216.5	214.7	213.8
Total Current Outlays	**18 000.4**	**15 763.2**	**16 031.1**	**16 421.0**	**16 982.4**
Capital Outlays					
New fixed capital expenditure	1 278.2	1 100.6	1 266.1	1 335.3	1 447.6
Expenditure on second hand assets (net)	- 8.8	- 11.4	- 18.1	- 3.0	27.0
Gross fixed capital expenditure	1 269.4	1 089.2	1 248.0	1 332.3	1 474.6
Capital grants	438.8	463.4	405.6	391.6	373.1
Other capital outlays	- 88.7	- 65.3	- 61.7	- 38.2	- 31.4
Total Capital Outlays	**1 619.4**	**1 487.3**	**1 591.9**	**1 685.7**	**1 816.4**
Total Outlays	**19 619.8**	**17 250.5**	**17 623.0**	**18 106.8**	**18 798.8**
Revenue and Grants Received					
Taxation	9 127.0	8 934.0	9 187.6	9 491.3	9 869.6
Interest received	123.2	56.8	54.0	54.4	54.9
Grants received	7 419.7	7 649.4	7 832.8	8 098.7	8 318.6
Dividends received from PTEs and PFIs	1 017.2	496.5	527.7	407.0	364.6
Other revenue	1 699.6	533.6	473.8	404.7	376.4
Total Revenue and Grants Received	**19 386.8**	**17 670.3**	**18 076.0**	**18 456.0**	**18 984.1**
Financing Transactions					
Advances received (net)	-1 415.6	- 0.7	- 0.7	- 0.7	- 0.7
Advances paid (net)	3 711.9	- 3.1	4.6	11.7	- 0.4
Net domestic and overseas borrowing	-2 380.8	- 398.6	- 457.4	- 362.0	- 182.0
Increase in provisions (net)	..	..	..	..	..
Other financing transactions	317.5	- 17.0	0.6	1.7	- 2.8
Total Financing Transactions	**233.0**	**- 419.4**	**- 453.0**	**- 349.4**	**- 185.9**
less increase in provisions (net)	..	..	..	..	..
Deficit	**233.0**	**- 419.4**	**- 453.0**	**- 349.4**	**- 185.9**
Net Debt	**5 233.2**	**4 976.7**	**4 617.0**	**4 355.4**	**4 267.3**

Table D3: Public trading enterprise sector transactions

($ million)

	1998-99 Revised	1999-00 Budget
Current Outlays		
Interest and other financing costs	241.4	195.9
Other Current Payments	2 261.5	688.8
Total Current Outlays	**2 502.9**	**884.7**
Capital Outlays		
Expenditure on new fixed assets	1 207.1	961.0
Expenditure on second hand assets (net)	- 200.9	- 60.3
Gross fixed capital expenditure	1 006.2	900.7
Capital Grants	2.3	2.4
Other capital outlays	13.6	- 4.1
Total Capital Outlays	**1 022.1**	**898.9**
Total Outlays	**3 524.9**	**1 783.6**
Revenue and Grants Received		
Net operating surplus of PTEs	465.7	687.7
Interest received	114.5	76.5
Grants received	292.9	265.2
Other revenue	20.1	12.7
Total Revenue and Grants Received	**893.1**	**1 042.0**
Financing Transactions		
Advances received (net)	-3 861.1	- 14.1
Advances paid (net)	6 725.3	81.6
Borrowing (net)	-1 257.7	18.2
Increase in Provisions (net)	449.0	463.2
Other financing transactions	576.4	192.7
Total Financing Transactions	**2 631.8**	**741.6**
less Increase in Provisions (net)	449.0	463.2
Deficit	**2 182.9**	**278.4**
Net Debt	**1 602.6**	**1 820.1**

Table D4: State non-financial public sector transactions

($ million)

	1998-99 Revised	*1999-00 Budget*
Current Outlays		
Final consumption expenditure	15 073.2	12 950.9
Interest and other financing costs	1 014.6	715.0
Current grants	1 674.5	1 698.1
Other current payments	517.8	646.4
Total Current Outlays	**18 280.1**	**16 010.4**
Capital Outlays		
Expenditure on new fixed assets	2 485.3	2 061.7
Expenditure on second hand assets (net)	- 209.7	- 71.8
Gross fixed capital expenditure	2 275.6	1 989.9
Capital grants	173.6	206.3
Other capital outlays	- 75.2	- 69.5
Total Capital Outlays	**2 374.1**	**2 126.7**
Total Outlays	**20 654.1**	**18 137.2**
Revenue and Grants Received		
Taxation	9 127.0	8 934.0
Net operating surplus of PTEs	465.7	687.7
Interest received	237.6	133.2
Grants received	7 445.2	7 655.1
Other revenue	558.2	406.6
Total Revenue and Grants Received	**17 833.7**	**17 816.6**
Financing Transactions		
Advances received (net)	-1 385.7	3.2
Advances paid (net)	6 534.6	58.5
Net Domestic and Overseas Borrowing	-3 638.5	- 380.4
Increase in provisions (net)	449.0	463.2
Other financing transactions	893.9	175.7
Total Financing Transactions	**2 853.3**	**320.3**
less increase in provisions -net	449.0	463.2
Deficit	**2 404.3**	**- 142.9**
Net Debt	**6 147.8**	**6 082.4**

Table D5: State non-financial public sector taxation

($ million)

	1998-99 Revised	*1999-00 Budget*
Employers' payroll taxes	2 182.3	2 221.1
Taxes on property		
Taxes on immovable property	527.3	468.3
Stamp duties	1 540.1	1 254.7
Financial institutions transactions taxes	597.4	608.3
Financial Accommodation Levy	9.9	5.4
Taxes on provision of goods and services		
Excises and Levies	..	..
Taxes on gambling	1 395.3	1 427.6
Taxes on insurance	524.7	547.7
Taxes on use of goods and performance of activities		
Motor vehicle taxes	864.4	863.5
Franchise taxes	1 475.8	1 526.5
Other	10.0	11.0
Total Taxation	**9 127.0**	**8 934.0**

Table D6: State non-financial public sector outlays by purpose

($ million)

	1998-99 Revised	*1999-00 Budget*
General Public Services		
Current outlays	4 631.5	1 858.6
Capital outlays	11.6	32.0
Total	**4 643.1**	**1 890.6**
Public Order and Safety		
Current outlays	1 320.1	1 393.2
Capital outlays	87.6	70.6
Total	**1 407.7**	**1 463.9**
Education		
Current outlays	4 213.9	4 448.0
Capital outlays	253.2	267.1
Total	**4 467.1**	**4 715.1**
Health		
Current outlays	3 506.4	3 652.5
Capital outlays	281.0	276.0
Total	**3 787.4**	**3 928.6**
Social Security and Welfare		
Current outlays	1 306.3	1 366.9
Capital outlays	44.2	45.7
Total	**1 350.5**	**1 412.6**
Housing and Community Amenities		
Current outlays	208.2	215.3
Capital outlays	890.5	772.5
Total	**1 098.7**	**987.8**
Recreation and Culture		
Current outlays	301.8	296.4
Capital outlays	248.5	167.1
Total	**550.3**	**463.5**

Table D6: State non-financial public sector outlays by purpose - *continued*

($ million)

	1998-99 Revised	*1999-00 Budget*
Fuel and Energy		
Current outlays	136.3	146.0
Capital outlays	-27.4	-37.8
Total	**109.0**	**108.3**
Agriculture, Forestry, Fishing and Hunting		
Current outlays	291.5	327.8
Capital outlays	18.2	14.6
Total	**309.7**	**342.4**
Mining and Minerals Resources, Manufacturing & Construction		
Current outlays	61.7	74.7
Capital outlays	0.6	..
Total	**62.2**	**74.7**
Transport and Communication		
Current outlays	904.4	1 099.9
Capital outlays	551.3	526.7
Total	**1 455.7**	**1 626.6**
Other Economic Affairs		
Current outlays	82.3	144.9
Capital outlays	11.6	13.3
Total	**93.8**	**158.2**
Other Purposes		
Current outlays		
Public debt - including interest	1 014.6	715.0
Other	301.0	271.0
Capital outlays	3.2	-21.1
Total	**1 318.8**	**965.0**
TOTAL OUTLAYS NON-FINANCIAL PUBLIC SECTOR	**20 654.1**	**18 137.2**

APPENDIX E: VICTORIA’S NOMINATED 1999-2000 LOAN COUNCIL ALLOCATION

Table E1, Loan Council Allocation (LCA), compares Victoria’s 1999-2000 LCA approved by Loan Council in April 1999 with the revised LCA based on the 1999-2000 budget estimates.

Victoria’s 1998-99 LCA outcome will be published in a separate outcomes report after the end of the 1998-99 financial year in line with the Uniform Presentation Framework.

Table E1: Loan Council Allocation

($ million)

	1999-00 Nomination	*1999-00 Revised*
General Government (+) deficit / (-) surplus [a]	-945	-417
Public Trading Enterprise Sector net financing requirement [a]	-193	211
Non-Financial Public sector (+) deficit / (-) surplus [a]	-1 138	-206
Memorandum Items [b]	249	249
Loan Council Allocation [c]	-890	43
Tolerance Limit (2% of non-financial public sector revenue)	353	353

Source: Department of Treasury and Finance

Notes:

(a) Includes net advances paid.

(b) Memorandum items are used to adjust the public sector deficit/surplus to include in LCAs certain transactions - such as operating leases – that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the public sector deficit/surplus certain transactions that Loan Council has agreed should not be included in LCAs - for example, the funding of more than employers’ emerging costs under public sector superannuation schemes or borrowings by entities such as statutory marketing authorities. The net borrowings of local government and universities are also included as memorandum items.

(c) Totals may not add due to rounding.

Listed below are details of Victoria's Infrastructure Projects with Private Sector Involvement where contracts are expected to be signed in the 1999-2000 financial year.

In line with the current Loan Council guidelines for the treatment of such projects, any termination liabilities as measured by the Government's contingent exposure, will be included as a footnote to the LCA.

As the following projects are still in development stage, full details about the extent and nature of actual payments, forward commitments and contingent liabilities associated with the projects cannot be provided at this stage, but will be included in the 1999-2000 LCA outcome.

Water and sewerage

In October 1997, the Government announced a series of water reforms aimed at benefiting all Victorians. The reform package included a $450 million allocation for capital projects outside the metropolitan area, designed to improve the quality of drinking water as well as upgrading wastewater management systems.

In order to promote the efficient delivery of these projects, the Government has encouraged the non-metropolitan urban water authorities to consider private sector involvement through Build-Own-Operate (BOO) or Build-Own-Operate-Transfer (BOOT) schemes. One further BOO/T project likely to be signed during 1999-2000 is for the provision of wastewater treatment facilities and services for the towns of Echuca and Rochester. Coliban Region Water Authority has committed to this approximately $20 million project.

Consistent with the model used for other BOO/T projects developed to implement the October 1997 reforms, it is expected that neither Coliban Water nor the Government will bear any contractual liabilities in the event of default by the private sector resulting in termination. Additionally, it is proposed that demand usage risk lie primarily with the contractor, with any fixed components in the toll being subject to reduction if performance obligations are not met by the contractor.

Health

Under the Government's Metropolitan Health Care Plan, the Department of Human Services is undertaking the redevelopment of the Austin and Repatriation hospitals as a BOO project. The project, which has a capital value of around $200 million, involves the transfer of the Austin and Mercy hospitals to the Repatriation Hospital site. Contracts for this project are expected to be signed late in 1999-2000.

Consistent with other Victorian Government hospital BOO projects developed under the Metropolitan Health Care Plan, it is not intended that the Government has any contractual liability to effect a termination payment in the event of default by the private sector contractor.

Additionally, demand risk, will be borne by the private operator. That is, payments will be dependent upon delivery of services.

Justice

The Bureau of Emergency Service Telecommunications is expected to seek the provision of Mobile Data Network (MDN) services on a BOO basis. A contract is expected to be signed during 1999-2000 with a service contract term of the order of 5 to 7 years. It is envisaged that the Government will have options but no contractual obligations upon termination caused by a private sector default.

GLOSSARY

Accrual accounting	Recognition of revenue, expenses, assets and liabilities when a transaction occurs, irrespective of the timing of the related cash flow. For example, revenue for sale of goods is recorded at the invoice date rather than the date on which payment is received.
Accrual output-based management	The Government, as purchaser, decides which outputs it will purchase at specified levels of quantity, quality and price on a full cost basis. As owner, it decides the investment required in departments in order to maintain their capacity to meet output delivery targets on a full cost basis.
Additions to the net asset base	An appropriation which provides authority to a department to increase the net capital base of its statement of financial position (balance sheet).
Amount appropriated	The limit of appropriation authority contained in the Appropriation Bill for each purpose, or the amount authorised under standing provisions of Acts (other than the annual Appropriation Act).
Annual Appropriation	The appropriations contained in the Appropriation Act and Appropriation (Parliament) Act. This appropriation lapses at the end of the financial year (30 June).

Annual Financial Statements	Operating statement, statement of financial position and cash flow statement of the State of Victoria for a given financial year. They are prepared by the Minister for Finance and forwarded to the Auditor-General for presentation to Parliament. The Auditor-General is required to audit the statements and may make a report to Parliament explaining the statements in full.
Appropriation	An authority from the Parliament to make payments or to incur expenses and obligations up to the limit of the amount appointed.
Assets	Service potential or future economic benefits controlled by an entity (e.g. a department) as a result of past transactions. Assets may be physical (e.g. plant, equipment or buildings) or non-physical (e.g. financial investments). Assets may also be current (having a store of service potential which is consumed in one year or less) or non-current (having a store of service potential which is consumed over a period of more than one year).
Australian Health Care Agreement	The Australian Health Care Agreement is a bilateral agreement between the Commonwealth and Victorian Governments for the funding of public hospital services. The current five-year agreement commenced in July 1998.
Advance to the Treasurer	An appropriation to the Treasurer to fund approved wage awards or determinations handed down after the Budget or to meet urgent expenditure claims that were unforeseen at the time of the budget.
BOO/BOOT	An abbreviation for Build-Own-Operate (BOO) or Build-Own-Operate-Transfer (BOOT). The terms refer to a method by which the private sector provides infrastructure e.g. prisons, hospitals and roads. After a process of tendering, a private sector company or consortium "builds, owns and operates" the facility according to the terms of a contract for a set period. After the period has expired it is either re-tendered publicly or "transferred" to the government.

Budget sector	The group of entities in the general government sector that each obtain 50 per cent or more of funding through appropriations and which are directly accountable, through Ministers, to Parliament.
Capital (account) balance	The difference (deficit or surplus) between capital outlays and capital revenue.
Capital Assets Charge	A charge on the written down value of assets within the budget sector which are departmental non-current physical assets. The charge is designed to reflect the full cost of service provision and to encourage the management of surplus or under-performing assets.
Capital injection	Contribution to the net worth of an entity made by its owner. A capital injection takes the form of a net increase in assets or a reduction in external liabilities, usually (but not necessarily) through the provision of cash to the entity. Once provided, a capital injection gives the entity additional resources which it may use to further its ongoing activities.
Capital outlays	Capital outlays comprise gross fixed capital expenditure, increase in stocks (inventories), net land purchases, capital transfer payments, and advances paid net of repayments.
Casemix funding	A method of allocating resources based upon the definition and measurement of a hospital's output. It uses measures which identify groups of diagnoses requiring a similar level of resources to treat a patient.
Cash accounting	The recording of receipts and payments as they occur. Cash accounting does not recognise products and services bought or sold on credit, or non-cash expenses (such as depreciation).
Cash-based budgeting	A budgeting system based on the funding and reporting of cash. It is primarily focused on inputs and does not account for accruing liabilities.

Cash flow statement	A statement that provides information on the cash inflows and outflows as they relate to operating, investing and financing activities of an entity. The net cash flow is added to the opening balance to report the cash on hand at the end of the reporting period.
Commonwealth Grants Commission	An independent authority established by the Commonwealth Government in 1933 to make recommendations to the Commonwealth concerning special grants to the less populous States. In recent years, its principal role has been to make recommendations for the distribution of financial assistance grants among the States.
Community service obligation	The non-commercial programs and activities of government business enterprises designed to meet community and social objectives determined by government.
Consolidated Fund	The Government's primary account, established by the *Financial Management Act 1994*, that receives all Consolidated Revenue under the *Constitution Act 1975* and from which payments appropriated by Parliament for government purposes are made. The Consolidated Fund, together with the Trust Fund, form the Public Account.
Consolidated Fund Revenues	These *revenues* are not retained specifically by the department that collects them, and are not related to the provision of departmental outputs.
Contingent liabilities	Obligations that become payable under certain circumstances. Examples include a guarantee given by the Government to secure borrowings made by a third party or an indemnity against loss or damage to travelling exhibits.
Contracting out	The use of external suppliers to deliver goods or services to, or on behalf of, governments or government-owned entities. The supplier is usually selected on the basis of competitive bidding.

Corporatisation	A process that aims to introduce commercial and market incentives to government business enterprises by establishing clear and non-conflicting commercial objectives similar to those that exist for private sector businesses. Key elements of corporatisation include an independent board of directors, explicit performance targets, dividend payments, explicit funding by the government of community service obligations (if any), tax-equivalent and dividend payments, and in many cases, compliance with the provisions of the Corporations Law.
Current (account) balance	The difference (deficit or surplus) between current outlays and current revenue.
Current outlays	Final consumption expenditure *plus* current transfer payments of general government.
Debt	A legal obligation to make payments of principal and, in most cases, interest, according to a predetermined schedule. See also *Liability*.
Debt-servicing payments	Costs associated with borrowings, such as interest payments and sinking fund contributions. Debt-servicing payments also include the interest component of rental payments under finance leases.
Debt-servicing ratio	The ratio of an entity's debt-servicing payments to a particular measure of its revenue. Commonly used debt-servicing ratios for state governments are the ratios of interest payments to total revenue. The debt-servicing ratio is indicative of the entity's capacity to meet its debt-servicing obligations.
Deficit	A commonly used term for the difference in the Government Finance Statistics framework between outlays and revenue. The difference between expenses and revenue is known as financing transactions, which in turn comprises the deficit (or surplus) plus the increase in provisions (for depreciation and employee entitlements). The deficit thus measures the requirement for additional resources or funding.

Depreciation	The allocation of the cost of an asset over the years of its productive life.
Domestic final demand	The total expenditure within a given period on final goods and services (excluding goods and services used up during the period in the process of production), less increase in stocks, bought by residents of a country. See also *state final demand*.
Entity	An accounting identity designed to define the legal bounds of the operation of a business unit.
Expenditure	Cash costs associated with the provision of services.
Expenses	Consumption or losses of future economic benefits in the form of reductions in assets or increases in liabilities resulting in a decrease in net worth during the reporting period.
Fees	Fees from regulatory services are levies not primarily designed to raise general revenue but which are associated with the granting of permit or privilege or for the regulation of activity. This distinguishes them from charges for services rendered to clients from sales of goods and services provided by budget sector agencies which are earnings netted against production and service costs. Charges for services are recorded in the financial statements as offsets to outlays (negative outlays) rather than as revenues.
Financial asset	Any asset that is cash; a contractual right to receive cash or another financial asset from another entity; a contractual right to exchange financial instruments with another entity under conditions that are potentially favourable; or an equity instrument of another entity.

Financial assistance grants	Grants made by the Commonwealth to State and Territory governments for expenditure by the latter according to their own priorities. Financial assistance grants are sometimes referred to as general revenue or general purpose grants. The distribution of financial assistance grants among the States and Territories is based, for the most part, on the recommendations of the Commonwealth Grants Commission.
Financial statements	Under Australian Accounting Standards (AAS29) departments are required to present three financial statements: cash flow statement, operating statement, and statement of financial position.
Fines	Civil and criminal penalties imposed on law breakers other than penalties imposed by tax authorities.
Franchising	The sale to an external party, usually on the basis of a competitive bidding process, of the right to distribute a particular good or service to a particular market for a defined period. In the public sector, franchising is often seen as a way of introducing competition into an industry that might otherwise be a natural monopoly.
General government sector	The part of government that provides goods and services for consumption by governments and the general public. As a general rule, fees and charges for goods and services should be set on a full cost recovery basis, unless there are explicit policy reasons or reasons relating to the public good for not doing so. The sector includes all budget sector agencies and a number of non-budget sector agencies such as the Country Fire Authority, Metropolitan Fire and Emergency Services Board, universities and colleges.

General purpose payments	Grants made by the Commonwealth to State and Territory governments that do not have to be spent on a specific program or in a particular area. For example, financial assistance grants, special revenue assistance, national competition policy payment.
Government business enterprise	A publicly-owned entity providing goods or services on commercial terms with the objective of recovering its costs of production and, in most cases, of providing some financial return to its owner.
Government Finance Statistics	The economic framework implemented by the Australian Bureau of Statistics (ABS) for the presentation of data on public sector outlays, revenue and financing transactions in a national accounting format, i.e. in accordance with the concepts and definitions used by the ABS to present estimates of national income and expenditure.
Grants for on-passing	Grants made by the Commonwealth Government to State governments to be passed on to third parties, such as non-government schools, universities and other tertiary institutions, and local governments.
Gross domestic product	The total market value of goods and services produced in a country after deducting the cost of goods and services used up in the production process, but before deducting the consumption of fixed capital. See also *gross state product*.
Gross state product	Gross domestic product for a State or Territory.
Health service agreements	Contracts developed on a purchaser/provider basis introduced into the Victorian public sector health system in 1985. They set out the operating and planning/development arrangements between a provider of health services (such as a hospital) and the Department of Human Services as purchaser or funder of the service. They aim to achieve an output and performance approach to the management and delivery of health services.

Horizontal fiscal equalisation

The principle that each State and Territory should be able to provide an average or ‘standard’ level of public services without being required to impose above-average taxes and charges. This principle is adopted in the distribution of financial assistance grants in accordance with the recommendations of the Commonwealth Grants Commission. The States and Territories that, according to the Commonwealth Grants Commission, must either incur higher per capita expenditures in order to provide public services at the average level of all States and Territories, or are less able to raise revenues by levying taxes and charges at the average level of all States and Territories, receive higher per capita financial assistance grants from the Commonwealth.

Identified funding grants

A grant from the Commonwealth to the states as a general purpose payment, but for an identified broad area of activity. The Commonwealth does not make these grants conditional upon specific performance conditions being met. Compare with s*pecific purpose payments*.

Level of service provision ratio

The ratio of actual expenditure to standardised expenditure as assessed by the Commonwealth Grants Commission. Level of service provision ratios may be calculated for individual categories of services expenditure, or for total expenditure. The level of service provision ratio measures the extent to which a State or Territory government is, in the Commonwealth Grants Commission’s assessment, spending more (or less) than is required to provide that category of service (or all services) at the Australian average level.

Liabilities	Future payments that an entity is presently obliged to make to other entities as a result of past transactions or other past events. 'Liabilities' is thus a broader concept than debt. It also includes obligations which do not have a pre-determined repayment schedule, and those which do not require payments of interest, such as unfunded liabilities of superannuation funds, liabilities in respect of other employee entitlements (long-service and annual leave), trade creditors, and provisions for deferred maintenance. See also c*ontingent liabilities*.
Loan Council	A body comprising the Commonwealth Treasurer (as Chair) and representatives of each of the State and Territory governments. It was established under the 1927 Financial Agreement to co-ordinate the borrowings of the Commonwealth and the States.
National accounting format	A general term for the presentation of data on public sector financial transactions in accordance with the definitions and concepts used by the Australian Bureau of Statistics to compile estimates of national income and expenditure. These are consistent with international statistical conventions. See *Government Finance Statistics*.
Net assets	The residual interest in the assets of an entity after deduction of its liabilities (the net worth of an entity).
Net debt	Gross debt minus liquid financial assets (cash, bank deposits, marketable securities and sinking fund investments).
Net financing requirement	The deficit (or surplus) less net advances received from other parts of the public sector (such as the Commonwealth or, in the case of the non-budget sector, from the budget sector). It therefore measures the sector's demand for funds from the private sector and from overseas. This measure is also sometimes known as the net public sector borrowing requirement.

Non-budget sector	Public sector entities that are not classified as "budget sector", e.g. the Country Fire Authority.
Non-current physical assets	Durable goods intended to be employed in the production process for longer than a year. Excluded are current assets and non-reproducible tangible assets (e.g. timber plantations) and intangible assets (e.g. trademarks).
Non-public account	Non-public account transactions are claimed as those of budget sector entities that do not transact their business or financial transactions through the State bank account (the Public Account).
Operating expenses	Expenses incurred in the provision of outputs during the specified period of time. As well as items such as employee payments, these may include stock used in the provision of outputs, the depreciation of assets, the servicing of debt, and grants made.
Operating revenue	Revenue obtained from the provision of outputs. This may include income from user charges, the sale of products and services, dividends and income from investments, and grants from other levels of government.
Operating statement	A statement providing information for the reporting period on the revenue and expenses and the surplus or deficit of an entity consistent with Australian Accounting Standards.
Operating surplus/(deficit)	The amount by which operating revenue exceeds/(falls short of) operating expenses incurred in the production of outputs and other trading activities for the reporting period.
Other revenue	Other revenue includes all non-tax unrequited transfers from private sources such as donations and unclaimed monies other than those classified as fees, fines or property income.

Outcomes	The government's intended impacts on the community as a result of the funding of services. Outcomes establish both the rationale and foundation for the budget. As purchasers of outputs, departments may contribute to government outcomes.
Output	A product or service supplied to external consumers, e.g. strategic policy advice, education services, and outpatient services. A product or service produced for departments or their agencies is not an output; a product or service delivered to ministers as clients is an output.
Output costing	The process of determining on a full accrual basis all direct and indirect costs of producing an output in a period.
Output group	The grouping of outputs which contribute to common outcomes for budget submission and reporting purposes. For example, the output group Acute Health Services comprises five outputs, three of which are: admitted, outpatient, and emergency services.
Output group statement	A report providing information on the total cost of an output group and sources of funds.
Output statement	A report that provides information on the links between government outcomes and departmental outputs, and information on performance measures and targets describing agreed service levels.
Output-based management	The process of planning for and providing products or services on behalf of government, in return for the allocation of budgeted resources. Under output management, the Government sets its strategic priorities or intended outcomes, and then commissions departments to deliver outputs that the department determines will best achieve these outcomes.
Own-source revenue	Revenues other than Commonwealth grants, i.e. taxes, fees, and fines, and property income and other revenue.

Payments on behalf of the State	An appropriation which provides authority to a department to on-pass payments of the State over which the department has no direct control with respect to the quantity of outputs delivered.
Performance measures	Measures of quantity, quality and timeliness used to describe how many, how well, when or how frequently the outputs that the Government intends to fund will be delivered.
Performance targets	Intended output delivery levels expressed in terms of each of the performance measures. Targets are used as a benchmark to assess performance in delivering budgeted outputs.
Property income	Property income includes income transferred from public trading enterprises and public financial enterprises in the form of dividends and tax-equivalent paymentns; interest on investments and advances outstanding; land rent and royalties received for use of mining, forestry and petroleum resources; and dividends from private sector enterprises.
Public authority dividend	A payment made by government business enterprises to the Victorian Government under the provisions of the *State Owned Enterprises Act 1992* or other industry specific legislation. Conceptually, public authority dividends are intended to represent a return to the Government on its investment in those enterprises. The amount and timing of the payments are determined by the Treasurer, after consultation with the relevant Minister and board of each enterprise.
Public financial enterprises	Government owned or controlled bodies primarily engaged in financial transactions in the market involving both the incurring of liabilities and the acquisition of financial assets. Included are central borrowing authorities, finance corporations, insurance offices and work-cover schemes. Public financial enterprises is a definition used in the Government Finance Statistics.

Public sector Non-financial public enterprises and public financial institutions that have government ownership or control.

Public trading enterprises Resident public enterprises mainly engaged in the production of goods and services of a non-financial nature for sale in the market place at prices which aim to recover most or all of the costs involved. Public trading enterprises is a definition used in the Government Finance Statistics.

Purchaser/provider split A structural separation of the funding and service delivery roles. Under this approach, funds are provided to selected agencies for the delivery of particular services on the basis of a contract, sometimes as the result of a tender process. The funding body is the purchaser of services for the community and the agencies contracted to provide the services to the community are the providers.

Real terms A monetary value expressed in constant prices, or adjusted to allow for inflation.

Receipts Cash amounts received by the State for any purpose.

Refunds Negative revenues by way of cash or credit against future revenues.

Revenue credited appropriations Appropriated limit which recognises either revenue or capital from:

- agreed user charges for the provision of outputs by a department directly to third parties in return for payment;
- specific purpose payments from the Commonwealth;
- payments from municipal councils; and
- proceeds from sale of assets.

Amounts are deemed to be appropriated upon receipt to the Consolidated Fund pursuant to Section 29 of the *Financial Management Act 1994*. Receipts credited appropriations are also referred to as annotated appropriations.

Revenues — Inflows or other enhancements or savings in outflows of future economic benefits in the form of increases in assets or reductions in liabilities that result in an increase in net worth during the reporting period.

Revenue-raising effort ratio — The ratio of actual revenue to *standardised revenue* as measured by the Commonwealth Grants Commission. Revenue-raising effort ratios may be calculated for individual revenue sources or for total own-source revenues. The revenue-raising effort ratio measures the extent to which a state or territory government is raising more (or less) revenue from a particular source (or in total) than it would by levying the tax (or taxes) at the Australian average rate on a standard revenue base.

Special appropriation — A standing authority, that remains in force until amended or repealed by Parliament, for ongoing payments which need to be made independently of the Government's annual budget priorities. Compare with *annual appropriation*.

Specific purpose payments — Grants made by the Commonwealth to State and Territory governments subject to terms and conditions laid down by the Commonwealth, generally with a view to ensuring that Commonwealth policy objectives (or national objectives agreed between the Commonwealth and the States) are met. In practice, the terms and conditions may simply require that the grants be spent in accordance with broad agreements covering principles and program delivery mechanisms. However, they may be more detailed, and include requirements for Commonwealth approval of individual projects or the commitment of matching funds by the State.

Standardised expenditure	The per capita expenditure which a State or Territory government would incur on a particular category of service provision (or across all categories) if it provided the Australian average level of service and operated at the Australian average level of efficiency. This measure is commonly used by the Commonwealth Grants Commission.
State final demand	Domestic final demand for a State or Territory.
Standardised revenue	The per capita revenue which a state government would collect from its own taxes and charges if it made the Australian average effort to raise revenue, i.e. if it imposed taxes and charges on a standard tax base at the average rate of all States and Territories. This measure is commonly used by the Commonwealth Grants Commission.
State government (non-financial public sector)	Includes general government and public trading enterprises (see also *government business enterprises*), but excludes public financial enterprises. State government (non-financial public sector) is a definition used in the Government Finance Statistics.
State owned enterprises	Widely used as an alternative term for Government Business Enterprises. Strictly speaking, however, a government business enterprise in Victoria is a State owned enterprise only if it has been declared by the Treasurer as such under the provisions of the *State Owned Enterprises Act 1992*.
State sector	Includes General Government, Public Trading Enterprises and Public Financial Enterprises.
State-source revenues	See *own-source revenue*.
Statement of financial position	A statement that provides information on the assets and liabilities of an entity. The statement also reflects the net worth of an entity for the reporting period. Also known as a balance sheet.
Subsidies	Payments made by governments to public trading enterprises or private sector organisations to enable them to provide goods or services at reduced cost.

Taxes	Compulsory levies imposed by government that are mainly designed to raise revenue. There is usually no clear and direct link between payment of taxes and the provision of goods and services.
Tax-equivalent payments	Payments which a government business enterprise is required to make in order to ensure that it has the same taxation obligations as private sector firms. For example, although government business enterprises are ordinarily exempt from Commonwealth income taxes, they are required by their owner governments to make payments calculated on the same basis as income tax.
Unfunded liabilities	Liabilities which are accruing but for which no explicit provision has been made for payment. For example, unfunded liabilities may exist in respect of employee entitlements (such as long-service and annual leave), and in respect of public insurance schemes (such as WorkCover).
Unfunded superannuation liabilities	The present value of future benefits, determined by actuarial assessment, that a superannuation scheme's members have accrued during past service which are not covered by fund assets. Unfunded superannuation liabilities arise when superannuation costs are not contributed as the members' benefits accrue.

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