Budget Statement

1998-99

Presented by

The Honourable Alan Stockdale, M.P.

Treasurer of the State of Victoria

for the information of Honourable Members

Budget Paper No.2

Budget Statement 1998-99

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Table of Contents

Table of Contents - *continued*

Table of Contents - *continued*

Table of Tables

Table of Tables - *continued*

Acronyms and Abbreviations

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACH	Annual Curriculum Hour
AHCA	Australian Health Care Agreement
Aluvic	Aluminium Smelters of Victoria Pty Ltd (trustee and manager of Portland Smelter Unit Trust)
ANTA	Australian National Training Authority
AWE	Average Weekly Earnings
AWOTE	Average Weekly Ordinary Time Earnings
BEST	Bureau of Emergency Services Telecommunications
BOOT	Build-Own-Operate-Transfer (an arrangement for facilitating private sector involvement in the provision of infrastructure)
CAC	Capital Assets Charge
CFA	Country Fire Authority
CGC	Commonwealth Grants Commission
COAG	Council of Australian Governments
CPI	Consumer Price Index
CSHA	Commonwealth-State Housing Agreement
CSO	Community Service Obligation
DFD	Domestic Final Demand
EGM	Electronic Gaming Machines
FAGs	Financial Assistance Grants
FID	Financial Institutions Duty

GBE	Government Business Enterprise
GDP	Gross Domestic Product
GFCE	Gross Fixed Capital Expenditure
GFS	Government Finance Statistics
GPP	General Purpose Payment
GSP	Gross State Product
GTC	Gas Transmission Company
HACC	Home and Community Care
HFE	Horizontal Fiscal Equalisation
IFG	Identified Funding Grant
LCA	Loan Council Allocation
NFR	Net Financing Requirement
NPV	Net Present Value
NSW	New South Wales
PAC	Public Authority Contribution
PAD	Public Authority Dividend
PAI	Public Authority Income
PRRT	Petroleum Resource Rent Tax
PTC	Public Transport Corporation
PTE	Public Trading Enterprise
PNV	Power Net Victoria
RFC	Rural Finance Corporation
RGSP	Report on Government Service Provision
RRT	Resource Rent Tax
SECV	State Electricity Commission of Victoria
SPP	Specific Purpose Payment
SFD	State Final Demand
TAC	Transport Accident Commission
TAFE	Technical and Further Education (post-secondary colleges)
TCV	Treasury Corporation of Victoria

VCE	Victorian Certificate of Education
VCGA	Victorian Casino and Gaming Authority
VDP	Voluntary Departure Package (redundancy payment)
VET	Vocational and Educational Training
VFI	Vertical Fiscal Imbalance
VWA	Victorian WorkCover Authority

Style Conventions for Charts and Tables in the Budget Statement

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	1000 million
1 basis point	0.01 per cent

Chapter 1: Highlights

Budget summary

The 1998-99 Victorian Budget involves two major initiatives:

- substantial tax reductions and a major shift in priorities to emphasise key service delivery programs, especially in health and education; and
- the introduction of full accrual accounting into the Budget.

Key features of 1998-99 Budget include:

- new spending initiatives totalling $233 million in 1998-99, rising to $271 million in 1999-2000;
- taxation relief totalling $132 million in a full year, including a further cut in payroll tax and reductions in stamp duty on residential and other property purchases;
- new infrastructure projects with a total estimated cost of $755 million;
- a budget surplus on the old cash budgeting basis of $165 million in 1998-99;
- on the new accrual basis, an operating surplus of $767 million in 1998-99 - revenues rise by 1.6 per cent on the revised estimate for 1997-98 and expenses rise by 3.9 per cent;
- public sector net debt falling to around $10 900 million by 30 June 1999, one-third its level in 1994, before any allowance is made for the use of further privatisation proceeds; and
- a projected slowdown in economic growth to 2 ¾ per cent in 1998-99 as the difficulties in East Asia make their impact. Nevertheless, jobs growth of 1 ½ per cent is projected in 1998-99.

The introduction of full accrual accounting has major impacts on the presentation of the State Budget. Depreciation, the increase in unfunded superannuation entitlements and other non-cash costs are included as expenses for the first time. However, unlike the treatment under traditional cash budgeting, gross investment in assets is not included as an expenditure item in the budget operating statement. Since asset investment exceeds the aforementioned non-cash expenses, the reported budget operating surplus will generally exceed the traditional cash-based surplus. The difference between the two measures reflects the contribution that the operating surplus must make to fund gross investment in assets; a contribution formerly directly covered in the traditional cash-base Budget.

As in previous years, the budget data also includes a number of one-off expenses and temporary revenue streams that have a substantial impact on the budget position over the forward estimates period but not beyond it. In order to ensure responsible financial management, budget planning decisions exclude these temporary effects and focus on the underlying or sustainable position. To understand the future sustainable position it is necessary to remove these one-off and temporary effects.

Table 1.1 sets out the budget results throughout the forward estimates period and allows a comparison with the sustainable surplus on a cash basis as reported in previous years.

Table 1.1: Sustainable Operating Surplus Required to Fund Gross Investment in Assets

$ million

	1998-99 Budget	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Operating Surplus (excluding Abnormals)	767.3	970.9	920.9	949.2
Less : One-off expenses & temporary revenue streams	66.2	316.5	185.3	..
Sustainable Operating Surplus	701.1	654.4	735.5	949.2
Less : Contribution to fund capital	153.8	366.7	508.8	687.8
Sustainable Cash Surplus	547.4	287.7	226.8	261.4

In line with the Government's long-term budget objective that infrastructure spending and other investment in assets not be debt funded, the sustainable operating surplus under the new accrual system needs to be large enough to finance that part of investment in assets which is not being financed through depreciation and other provisions (which form part of operating expenses). With growth in the latter sources of funds being outstripped by the Government's infrastructure program this call on the operating surplus rises from $154 million in 1998-99 to $688 million in 2001-2002.

The sound financial platform established in recent years has allowed the Government to implement the $276 million of net new spending and tax initiatives in this Budget without compromising the long-term budget objective that investment in assets not be debt funded. This objective is met with $260 million per annum of sustainable cash surplus to spare over the forward estimates period.

An operating surplus in excess of the target is considered prudent over the medium term, given the uncertainties and risks associated with making projections for the budget outlook a number of years into the future. The possibility that events in East Asia and Japan may have a bigger impact on the Victorian economy than currently forecast is an example of the type of risks that could impact on the budget outlook.

Key initiatives

The success of the Government's sound financial management of the past six years means the 1998-99 Budget can deliver further benefits to the community. These benefits include new spending initiatives in health and education, and further tax cuts, following measures announced since the 1997-98 Budget to lower electricity and water charges, and cut land tax.

This Budget includes new spending initiatives which total $233 million in 1998-99, rising to $271 million in 1999-2000 with the full impact of education initiatives to commence in the calendar 1999 school year. These are designed to respond to community demands, in particular, for enhanced health and education services and include:

- an additional $100 million in operational funding for health and welfare services to meet increased demand, support new initiatives and improve the quality of existing services;
- an additional $27 million in 1998-99, rising to $50 million in 1999-2000, to improve literacy by expanding the Keys to Life program and implementing a Reading Recovery Program and Literacy 2001 Action Plan;

- an additional $20 million in 1998-99, rising to $22 million in 1999-2000 to enhance Multimedia learning in schools, by providing multimedia notebook computers to teachers, boosting funding for computers in schools to reduce the student computer ratio to 1:5 by 1999-2000, and to assist with implementing the VicOne network to link some 1900 educational sites across Victoria;
- over $6 million a year to support expanded education service delivery for students with disabilities and impairments;
- $31.5 million over two years, with $19.5 million ongoing, to purchase additional education services to meet the anticipated demand as a result of Commonwealth eligibility changes to its youth allowances;
- funding for a State-wide police computer network which will provide connections between all Victoria Police locations and provide personal computers with a range of software applications critical for operations in a 21st century environment;
- $4 million in 1998-99 to the Victoria Police to support implementation of a new framework in the *Firearms Act 1996*, designed to prevent the misuse of firearms in domestic violence, youth suicide and accidental death and injury;
- over $4 million in 1998-99 to stimulate primary industry production, including initiatives to facilitate development of the Victorian aquaculture industry, to improve the returns to wool growers through electronic marketing arrangements, to promote increased participation of rural women in business and decision making, and to promote improvements and opportunities to develop new high-value irrigation projects throughout Victoria.

The increase in base funding for health and education will enable Ministers to implement new programs and expand existing programs in priority areas and will enable Ministers to deal with individual instances of stress on service delivery arising during the year.

Tax relief measures announced in this Budget totalling $132 million in a full year include:

- a fall, from July 1998, in Victoria's payroll tax rate to 6 per cent – the third lowest of all States and Territories for payrolls over $5 million;
- $39 million in stamp duty relief on conveyancing, with the greatest proportionate gains going to home-buyers purchasing properties in the median house price range, and to smaller businesses purchasing properties around this value range;

- expansion of the stamp duty concession for first home-buyers through an increase in the threshold at which the maximum concession of $2 560 (up from $2 200) begins to taper out;
- expansion of the stamp duty concession for pensioners through an increase in the threshold at which at the maximum pensioner concession applies, which will lift the value of the maximum concession from $1 480 to $2 200 at an estimated cost of $2.3 million in 1998-99; and
- full exemption from Financial Institutions Duty and Debits Tax whenever closure of a local bank branch forces customers to move their accounts.

The payroll tax rate reduction will be at a cost to revenue of $83 million in 1998-99 and $90 million in a full year and together with the 1997-98 measures will bring the total value of payroll tax relief to Victorian firms over the two years to $193 million. Successive reductions in Victoria's payroll tax burden relative to other States will improve the cost competitiveness of local firms and industries, especially those affected by the difficulties in East Asia, and make the State a more attractive place in which to invest and do business. In time, this should benefit all Victorians through increased employment opportunities.

The burden of taxation on Victorians is now well below that applying in New South Wales. Following the measures introduced in this Budget, it is estimated that Victoria's revenue-raising effort will be more than $350 million below that of New South Wales. Victoria's revenue-raising effort will still exceed the national average but only by $220 million – down from $900 million just three years ago.

In recent budgets the Government has restored the infrastructure base by boosting spending to achieve a level of budget sector investment of around 1¼ per cent of GSP. Government investment is over 40 per cent above 1993-94 levels in real terms. The State has also used innovative techniques to involve the private sector in financing a number of large infrastructure projects.

Major new infrastructure projects with a total estimated cost of almost $755 million will commence in 1998-99 and include:

- widening of the West Gate Freeway, and works on the Western Port Highway and the Springvale Bypass (total investment $73 million);
- improvements to Public Transport Corporation facilities (total investment in excess of $24 million) and upgrading the Warrnambool-Geelong rail track (total investment $10 million);
- an urban traffic improvement program (total investment $20 million);
- Health Care network projects and hospital equipment upgrades (total investment $169 million);

- computer and technology-related projects in education (total investment $24 million);
- upgrading of school facilities (total investment $78 million);
- new TAFE projects (total investment $15 million);
- the Sports and Entertainment Precinct Infrastructure Upgrade (total investment of $37.5 million);
- Agenda 21 and Community Support Projects (total investment $145 million), including redevelopment of the Sidney Myer Music Bowl, upgrading regional performing arts centres, construction of a velodrome/multi-purpose venue and Royal Park sports facilities; and
- construction and upgrading of police stations and courts in both urban and rural areas (total investment $35 million).

Priority to key service delivery responsibilities

The State Government's major service delivery responsibilities are in health and community services, education, public transport and police and other law and order programs.

The greater emphasis on output budgeting in 1998-99 has led to a sharper focus on these key spending priorities.

This year definite priority has been given to key service responsibilities, especially in health and education. This emphasis is apparent from the 'key initiatives' list above which reflects the priority given to preventative programs in health, and literacy and numeracy programs in education.

These important policy initiatives have been funded by reallocation of resources across portfolios and by a surplus lower than it would otherwise be.

Efficiency savings and a reassessment of expenditure priorities of all budget sector agencies have made available $125 million, in a full year, to help fund the highest priority programs. Around one-third of the savings are derived from a redirection of the Community Support Fund ($25 million) and strict adherence by agencies to the Government's wages growth policy ($20 million). The budget sector has been achieving impressive gains in productivity and the reallocation of resources is expected to have minimal impact on services to the public across the budget sector as a whole. Indeed, in most areas, departments and other agencies have initiated significant reallocation of funds to the highest-priority programs.

Benefits of the Government's fiscal strategy

The recent announcement by Standard & Poor's that it has placed Victoria on CreditWatch Positive, the penultimate step in returning Victoria's credit rating to triple-A status, provides independent recognition that the State's finances have been restored to a secure position. The improvements in the State's financial position in the past six years are documented in Chapters 2, 3 and 6.

When the Government first came to office immediate action was required to turn the budget position around. Cuts in spending and tax increases were initially required to arrest the situation. However, in recent years, the ongoing benefits to the budget from privatisation and reforms to improve service delivery efficiency have returned a social benefit to the community. This has been in terms of increased expenditure in priority service delivery areas and of measures to ease the tax burden.

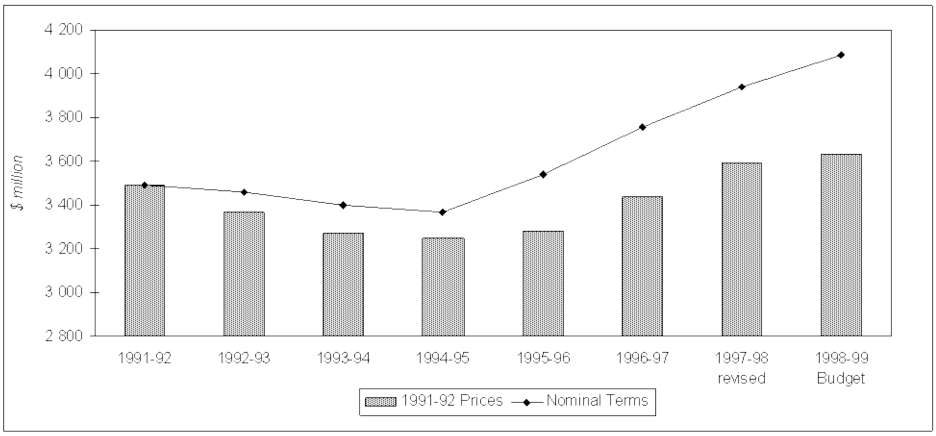
Charts 1.1 to 1.2 show that, while expenditure was cut in 1992-93 and 1993-94, spending has increased in key priority service delivery areas since 1994-95:

- the level of spending on education is now above 1991-92 levels (by 17.0 per cent in nominal terms and 4.0 per cent in real terms); and
- spending on health, social security and welfare (rising by 33.1 per cent in nominal terms and 18.3 per cent in real terms).

Similarly, while taxes were initially increased, tax relief has been provided in the last four budgets and significant progress has been made in reducing the gap between the average revenue-raising efforts of the other States and Victoria.

The important difference between the situation in 1991-92 and today is that, having achieved a return to underlying budget surplus, expenditure settings are sustainable into the future.

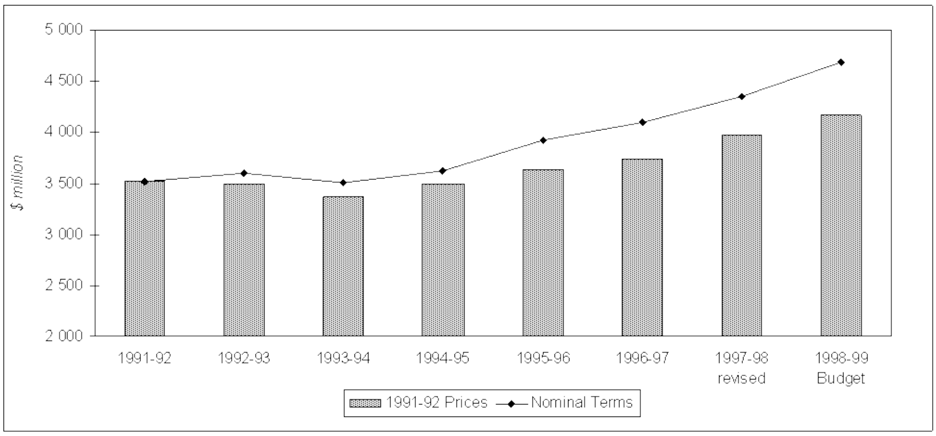
Chart 1.1: Expenditure on Education (excluding Universities)



Source: Department of Treasury and Finance.

Note:
Uniform Presentation Format consistent with Australian Bureau of Statistics Government Finance Statistics (GFS) standards.

Chart 1.2: Expenditure on Health, Social Security and Welfare



Source: Department of Treasury and Finance.

Note:
Uniform Presentation Format consistent with Australian Bureau of Statistics Government Finance Statistics (GFS) standards.

Table 1.2: Expenditure on Priority Service Delivery Areas

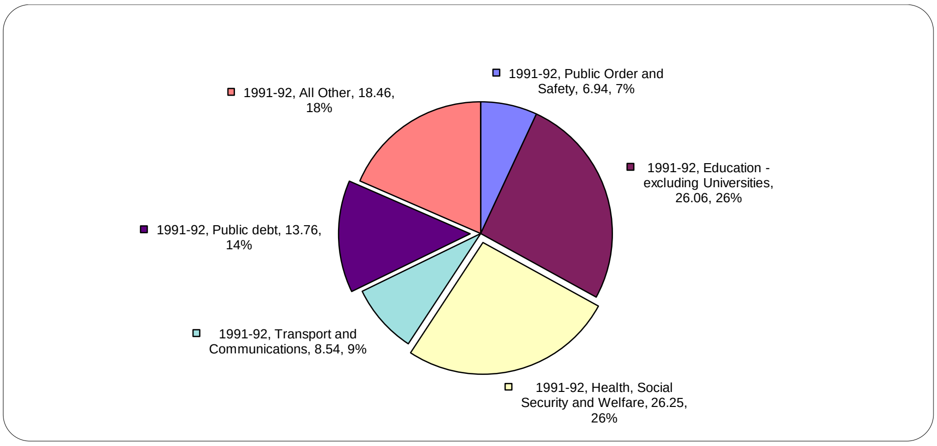
		$ million							
		91-92	*92-93*	*93-94*	*94-95*	*95-96*	*96-97*	*97-98 Revised*	*98-99 Budget*
Education (excluding Universities)									
	Nominal	3 494	3 458	3 402	3 365	3 542	3 758	3 943	4 088
	Real	3 494	3 366	3 271	3 247	3 279	3 435	3 595	3 634
Health, Social Security and Welfare									
	Nominal	3 520	3 593	3 503	3 618	3 927	4 095	4 350	4 685
	Real	3 520	3 497	3 368	3 490	3 635	3 743	3 966	4 165

Source: Department of Treasury and Finance.

Note:
Uniform Presentation Format consistent with Australian Bureau of Statistics Government Finance Statistics (GFS) standards.

Action by the Government to dramatically reduce debt levels has cut the State's interest payments and created scope for new service delivery initiatives. In 1991-92 interest payments accounted for 14 per cent of current outlays. By 1998-99 the proportion of spending on interest payments will be halved, allowing the share of spending on health, social security and welfare to increase from 26 per cent in 1991-92 to a forecast 30 per cent in 1998-99.

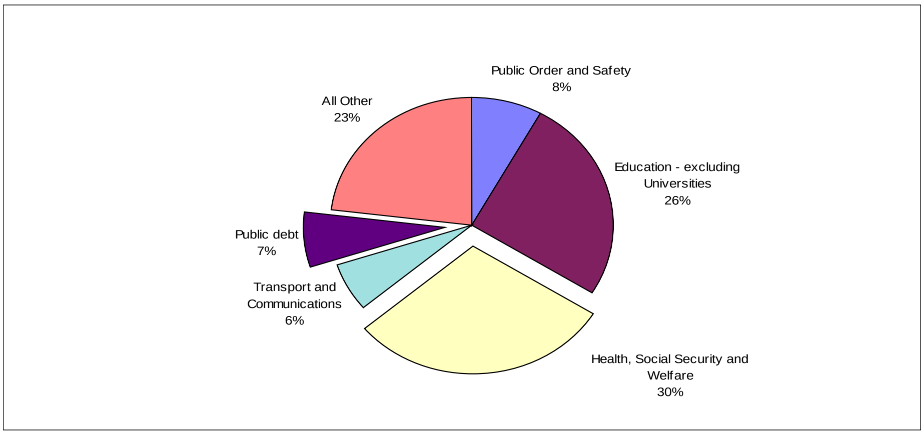
Chart 1.3: Proportion of Current Outlays by Purpose: Victoria 1991-92



Source: Department of Treasury and Finance.

Note:
Uniform Presentation Format consistent with Australian Bureau of Statistics Government Finance Statistics standards.

Chart 1.4: Proportion of Current Outlays by Purpose: Victoria 1998-99 (Estimate)

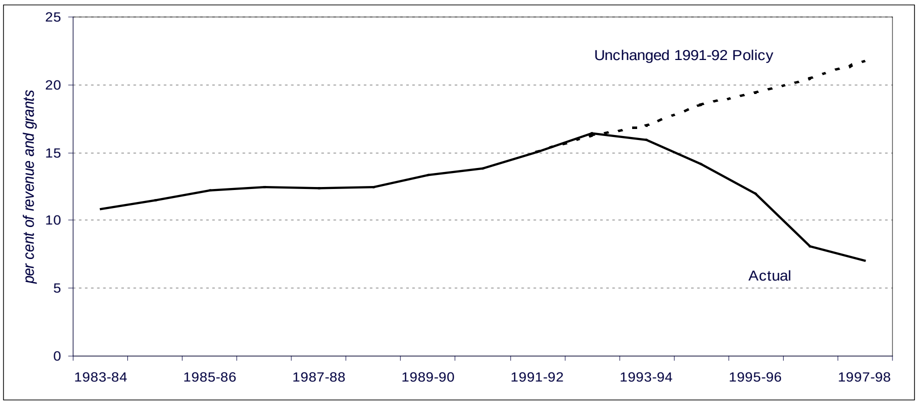


Source: Department of Treasury and Finance.

Notes:
Uniform Presentation Format consistent with Australian Bureau of Statistics Government Finance Statistics (GFS) standards.
The 'All Other' category includes Superannuation which has been boosted in 1998-99 by the restructuring of the Public Transport Corporation. This accounts for a 2 percentage point increase in the 'All Other' category share.

Had these policies not been implemented, public sector net debt would have grown to around $48 billion and budget sector net debt would have increased to $33 billion by June 1998. This is around $37 billion and $25 billion higher, respectively, than the current estimated debt levels. As illustrated in Chart 1.5, this would have led to further rapid rises in debt servicing costs with an ever-increasing proportion of revenue required to meet interest costs. The consequences of this would have been dramatic cuts in services and substantially higher taxes. It is estimated that Government policies implemented since 1992 have resulted in interest savings to date (relative to unchanged pre-1992 policy settings) of over $2 000 million per annum or around $450 per person.

Chart 1.5: Budget Sector Debt Servicing Burden *(a)(b)*



Source: Department of Treasury and Finance forward estimates (actual) and Department of Treasury and Finance estimates (unchanged 1991-92 policy).

Notes:

(a) Unchanged 1991-92 projections are Department of Treasury and Finance projections based on assumed continuation of 1991-92 Budget policies of the previous government. While removing the impact of 1992-93 initiatives proposed by the previous government, the projections assume continuation of its overall budgetary and financial management policies. The projections are consistent with unchanged 1991-92 policy projections published in the October 1992 Statement on Victoria's Financial Management Strategy *(Restoring Victoria's Finances, A Beginning). However the projections have been adjusted to reflect the impact of subsequent growth in Commonwealth Grants, partly offset by the inclusion of recurring budget obligations in respect of the flexible tariff arrangements for the aluminium industry.*

(b) Budget sector interest costs as a proportion of revenue and grants.

By contrast, sound financial management and the substantial improvement in the budget position has allowed the Government not only to increase spending in priority areas, but also to consistently ease the tax burden, after initial adjustments to taxes and charges in 1992-93 to address the Budget deficit.

A list of discretionary taxation policy measures introduced since 1993-94 is set out in Table 1.3. 'Annual savings' represent the annual full-year reduction in revenue earned from the measures, estimated at the time the measure was introduced (a negative number indicates an increase in revenue).

As is usual practice these estimates do not take into account changes in the behaviour of taxpayers (except in certain isolated instances). Consequently, any changes in economic activity induced by the tax changes are generally ignored.

Estimates have also been converted into constant 1998-99 prices by indexing to the consumer price index for Melbourne. This is only an approximate means of expressing the measures on a common basis. The relevant tax bases are also affected by changes in wage rates, employment, the size of the Victorian economy and other factors. None of these effects have been taken into account in Table 1.3.

Table 1.3: Taxation policy measures

$ million at average 1998-99 prices [(a)]

Year	*Measure*	*Annual savings*[(b)]
1993–94	Imposition of the Better Roads Levy.	-174
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 increased.	-151
1996-97	Mortgage Duty Exemption for re-financing business loans.	1
	Halving of rental duty.	5
	Extension of first home-buyer and pensioner stamp duty concessions.	5
	Removal of lucky envelope, bingo and raffle surcharge.	6
1997–98	Payroll tax cut from 7% to 6.25%.	106
	Petrol and diesel franchise fees cut.	109
	Exemption from duty on refinancing non-business loans.	1
	Elimination of energy consumption levy.	1
	Abolition of deed duty.	1
	Land tax reforms.[(b)]	34
1998-99	Payroll tax cut from 6.25% to 6%.	90
	Increased thresholds for stamp duty on conveyancing.	42
	Total	**537**

Note:

(a) After indexation to the Melbourne consumer price index.

(b) Estimated at time measure announced.

Major non-taxation measures introduced since 1993-94 are set out in Table 1.4. 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 consumer price index 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 1.4: Non-taxation policy measures

$ million at average 1998-99 prices[(a)]

Year	*Measure*	*Annual savings*
1993-94	Water price increase on 1 July 1993. [(b)(d)]	-56
	WorkCover average premiums begin to decline from 3.0% in 1992-93 to 1.9% in 1998-99.	511
1994–95	Electricity real price reductions commence. [(c)]	124
	Gas real price reductions commence.	33
	Water real price reductions commence. [(d)]	56
	Local Government rate reductions commence.	281
1995–96	Government port charges begin to fall. [(e)]	35
1997–98	New water pricing reforms from 1 January 1998.	420
1998-99	Winter Power Bonus. [(f)]	120
	Total	**1 524**

Notes:
(a) After indexation to the Melbourne consumer price index.
(b) Upper limit of cost (precise amount difficult to quantity).
(c) Excludes savings achieved by contestable customers.
(d) Melbourne metropolitan customers only.
(e) Estimated full-year saving published in Budget Paper No.2 1997-98.
(f) Estimated full-year saving for first year of reduction — 3-year initiative.

Benefits of competition and service delivery reforms

While the restoration of the State's finances has attracted most attention, the benefits flowing from the competition and service delivery reforms introduced over the past six years have also had a pervasive influence.

The Victorian economy has grown by almost 25 per cent since the 1991-92 recession and private business investment has more than doubled. The labour market has improved markedly. Structural reforms have led to an underlying productivity growth in Victoria that outstrips that for the rest of Australia.

Service delivery reforms have improved the quality and range of public services available to Victorians in many areas:

- provision of health services (number of patients treated) has increased by 45 per cent since 1990-91 and the State now has no patients with urgent needs (Category 1) waiting longer than 30 days for hospital admission. An independent survey shows that patients' satisfaction with the care they receive in public hospitals in Victoria is the second highest in Australia. According to the *Report on Government Service Provision* Victoria recorded the lowest cost per casemix-adjusted separation of all States in 1995-96;
- in education, after falling below the national average in 1989 to 1992 Victorian literacy levels are now back above the national average. Victoria has the second highest retention rate from Year 7 to Year 12 and the number of government school students receiving the Premier's Victorian Certificate of Education Award has increased by 14 per cent over the past five years;
- the Victorian TAFE system is now the most efficient, most widely used and most highly rated by employers in the country;
- Victoria has the highest level of Home and Community Care (HACC) service provision of any State;
- Victoria spends more on services for people with disabilities than any other State and meets a higher proportion of the estimated potential population for accommodation and support services than any other State except South Australia; and
- Victoria's 1996 crime rate for major offences was the lowest of all Australian States.

National tax reform

The States' revenue autonomy has been further compromised by the High Court decision on business franchise fees. The Commonwealth's actions in implementing the safety-net arrangements averted major losses to the States' revenue flows. However, the new constraints on the States' revenue-raising ability and the refusal by the Commonwealth to return an appropriate share of its total revenues to the States are severely restricting our ability to deliver services to the community.

While demands for State services have continued to grow, the Commonwealth has reduced the share of its taxation revenue provided to the States from 27 per cent to 21 per cent since 1993-94. This represents a funding shortfall to Victoria of around $1 700 million in 1997-98.

The inadequacy of the Commonwealth's health funding offer highlights the growing problems with the existing division of tax and spending powers between the Commonwealth and the States. Clearly, national tax reform must address the States' need to gain access to a tax base that grows in line with the service needs of the community. National tax reform must also address the need to replace some of the States' most distortionary indirect taxes.

Chapter 2: Budget Strategy

Introduction

The Victorian Government's overriding objective is to make Victoria a better place to live, to invest and to do business. To achieve this objective, the Government is pursuing a broad economic strategy focused on creating a world-class business environment conducive to investment and job creation, and a more efficient and effective State public sector.

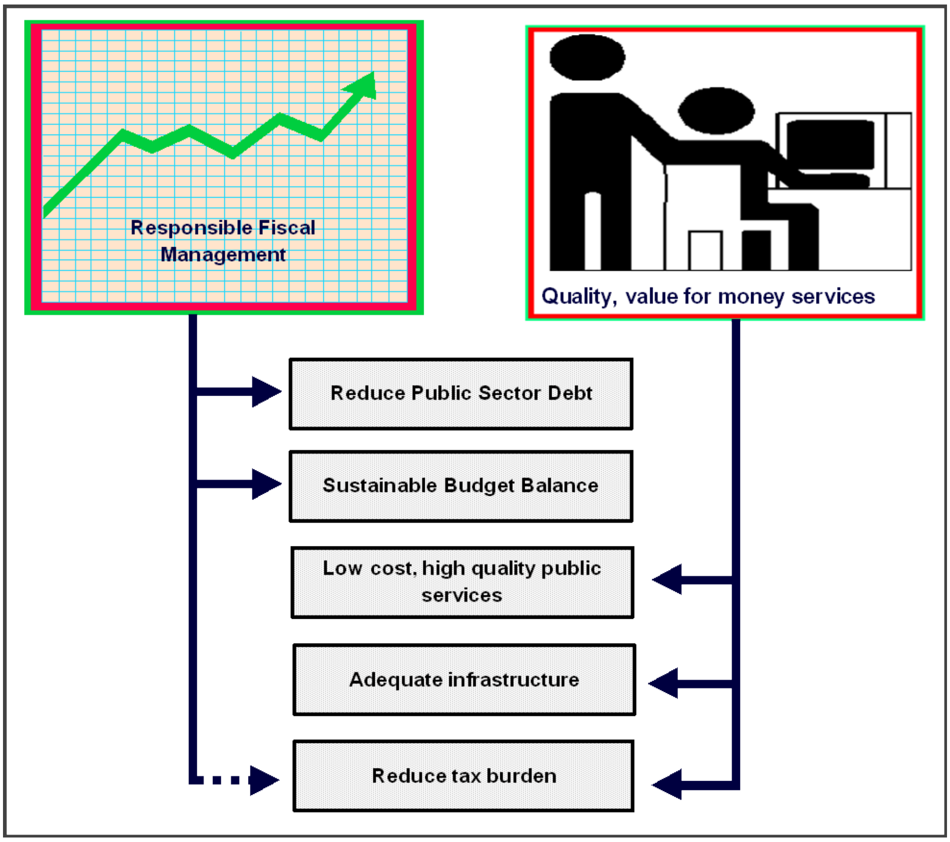
The Budget's role within this broader strategy has been to ensure:

- financial discipline and responsible fiscal management; and
- the delivery of quality, value-for-money public services and infrastructure for the community.

Chart 2.1 illustrates the relationship between these dual cornerstones of the Victorian Government's fiscal strategy and the related long-term budget targets.

When the Government came to office in October 1992, it was faced with a major financial crisis. This was evidenced by escalating structural budget deficits resulting in burgeoning public sector debt and debt servicing levels, and a growing State tax burden. Because of the urgent need to reduce debt levels and to repair the budget problems, the restoration of *financial discipline and responsible fiscal management* was a major priority of budget strategy. As indicated in Chapter 1, without corrective action to restore the State's finances, the Government's ability to deliver quality public services and infrastructure to the Victorian community would have been seriously jeopardised.

Chart 2.1 : Budget Strategy Framework



The strategy to arrest spiralling public sector debt and budget deficits required significant initial recurrent expenditure savings, supported by a commitment to ongoing expenditure restraint and regular reassessment of spending priorities to ensure that Government services were best targeted, within available resources, to meet community needs. At the same time the Government also implemented major service delivery reform initiatives which produced significant efficiency and output improvements. As a result, service delivery *outcomes* have generally remained steady or have actually improved across core service delivery functions despite the expenditure restraint. (See Chapter 4, *Service Delivery*, for information on Victorian service delivery achievements in recent years.)

The Government's budget strategy and associated economic, financial and management reforms implemented since 1992 have resulted in a significant turnaround in the State's budget position. Public sector net debt has been reduced by two-thirds and the budget is now in a sustainable surplus position.

To protect these gains and guard against spiralling debt, the Government must maintain its commitment to financial discipline and responsible fiscal management. However, in recent years substantial improvement in the underlying budget position has enabled the Government to deliver the social benefits of its sound financial management to the Victorian community. This is reflected in 1998-99 Budget initiatives that include:

- new recurrent spending initiatives totalling $271 million in a full year, targeted to high priority needs in the health and eduction sectors; and
- tax cuts totalling $132 million in a full year, building on the $211 million of tax cuts announced in the 1997-98 Budget.

The following section provides further information on the Government's specific long-term budgetary objectives and targets.

Long-term budget objectives

The budget strategy has been guided by a number of long-term budget objectives and medium-term operational targets. These objectives and targets were designed to overcome the major financial crisis facing Victoria in the early 1990s. They were formulated within a budget sector financial reporting framework that focused on cash transactions rather than full cost reporting, and which provided limited balance sheet information.

The specific targets have been modified slightly since 1992 as initial benchmarks have been achieved. The Government's decision to shift to a more transparent, accrual-based budgeting and reporting framework in this Budget requires further minor modification to the budget targets. (A detailed explanation of the new reporting framework is contained in the *Guide to the 1998-99 Budget Papers*). In particular, the *budget balance* target needs to be redefined to reflect the new reporting framework. Nevertheless, the underlying budget objectives, which are summarised in Table 2.1, remain broadly unchanged.

Table 2.1: Long-Term Budget Objectives

Long-Term Target	Medium-Term Operational Target
Maintain public sector debt at levels consistent with triple-A credit rating	Privatisation proceeds applied to reduce net debt and other liabilities
Maintain a sustainable budget *operating surplus* sufficient to fully fund infrastructure investment	
Low cost, high quality service delivery	
Ensure adequate infrastructure to support service delivery and economic growth	Budget sector investment to be maintained at around 1¼ per cent of GSP
Bring Victoria's tax rates into alignment with the national average	

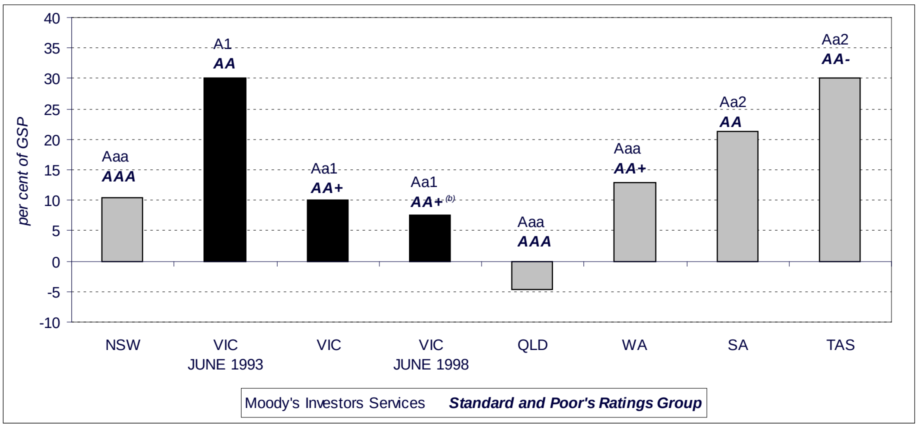
The following sections provide a discussion of these budget objectives and targets, including a summary of progress to date.

Public sector debt

The Government has made significant progress towards achieving its target of reducing State debt to levels consistent with restoration of a triple-A credit rating. Public sector net debt has declined from $32.9 billion (or 30.7 per cent of GSP) in June 1993 to an estimated $11.1 billion (7.9 per cent of GSP) by 30 June 1998. Chart 2.2 shows that this is well within the range of triple-A rated States. As a result, Victoria now enjoys favourable borrowing costs compared with other States.

The application of privatisation proceeds to debt reduction has made a significant contribution to the overall reduction in public sector debt over this period. The Government is committed to ensuring that privatisation proceeds continue to be applied to reducing net debt and other liabilities to generate the best return for Victorian taxpayers.

Chart 2.2: State Government Net Debt to Gross State Product (a) and Current Australian State Ratings



Source: ABS Catalogue No. 5513 and 5542.0, Department of Treasury and Finance estimate for 1998.

Notes:

(a) State Public Sector Net Debt as at 30 June 1997, unless otherwise indicated.

(b) Victoria was placed on CreditWatch Positive on 27 March 1998 by Standard & Poor's.

Sustainable budget balance

In the 1997-98 Budget, the Government announced its long-term target of achieving a *sustained budget balance*, with a surplus on current account at least sufficient to meet depreciation expenses. Because this budget balance target was based on a cash accounting framework, it has been revised slightly to reflect the shift to a full accrual-based financial reporting framework for the Victorian budget sector.

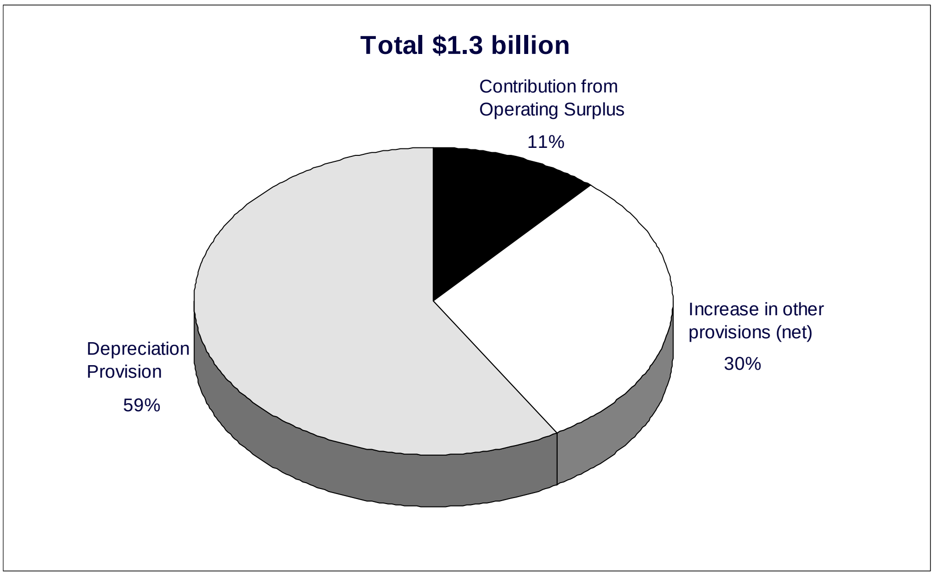
Under accrual accounting standards, the budget operating statement (and therefore the reported 'budget balance') takes into account all operating revenue and expenses incurred during a period, and hence reflects the full cost of resources consumed by the Government during this period. The operating statement includes non-cash costs such as the depreciation of fixed assets during the period and growth in superannuation obligations to employees, but excludes the cost of funding net increases in budget sector infrastructure and other additions to net assets.

To ensure that the Government is able to fully fund its capital expenditure program without borrowing, the Government needs to run an operating surplus. This is illustrated in Chart 2.3, which shows, in broad terms, the source of funding for 1998-99 budget sector investment in infrastructure and other assets. Growth in depreciation and other provisions reduce the reported accrual operating surplus, but since they do not involve immediate cash outlays, the funds are available to partly fund capital expenditure. As shown in the Chart, an operating surplus is required to fund the balance of investment expenditure.

Over the long term, the Government's target is to maintain *a sustainable budget operating surplus sufficient to fully fund budget sector infrastructure investment*. This revised budget target is *equivalent* to the previous target of achieving a sustained (cash) budget balance with a surplus on current account at least sufficient to meet depreciation expenses. Both targets effectively ensure that the Government:

- meets the cost of all resources 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.

Chart 2.3: Budget Operating Surplus - Contribution to Funding Gross Investment in Assets



Source: Department of Treasury and Finance.

On an unchanged policy basis, the Government is projected to achieve a sustainable operating surplus of around $701 million in 1998-99 rising to $949 million by the end of the forward estimates period. As indicated in Table 2.2, this is in excess of the operating surplus required under the Government's revised budget target. Over the forward estimates period, the contribution of the operating surplus to funding gross investment is expected to increase significantly. This is reflected in the decline in the margin between the target and forecast sustainable operating surplus from $547 million in 1989-99 to an average of around $260 million over the forward estimates period. This margin is equivalent to the sustainable cash surplus.

Table 2.2: Investment Funding and Target Operating Surplus *[(a)]*

	1998-99 Budget	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Direct Gross Investment in Assets [(b)(c)]	1 339	1 519	1 630	1 804
Less :				
Depreciation	785	795	812	836
Increase in other provisions (net) [(d)]	400	357	309	281
Equals Required Operating Surplus	154	367	509	688
Forecast Sustainable Operating Surplus	**701**	**654**	**736**	**949**

Source: Department of Treasury and Finance.
Notes:
(a) For more detailed information on the forward estimates and sustainable operating surplus, see Chapter 3, Fiscal Position and Outlook.
(b) Gross investment, before allowance for depreciation of existing fixed assets. Excludes abnormal capital expenditures and receipts (such as capital restructuring costs and one-off capital repatriations).
(c) Excludes budget capital transfers to Office of Housing and PTC, which are classified as operating expenses under current accounting standards.
(d) Includes increase in creditors, employee entitlement and superannuation liabilities, less increase in accrued revenue and other receivables.

An operating surplus in excess of the target is considered prudent over the medium term, given significant risks and uncertainties associated with budget planning a number of years into the future. The possibility of economic instability associated with the economic situation in East Asia and Japan is an example of the type of risk that may impact on the budget outlook. Chapter 7, *Economic Outlook,* provides details on the economic assumptions underlying the 1998-99 Budget, which allow for a moderate slowdown in the rate of Victorian economic growth due to the impact of the deterioration in the East Asian economies. There is a risk, however, that the Asian economic situation could have a more pronounced impact on Australian and Victorian economic activity than anticipated. It is therefore appropriate and prudent to maintain a 'risk premium' in the Budget's operating surplus to allow for such risks and uncertainties.

Service delivery

The underlying level of spending on departmental service delivery has been reduced from obvious ‘overspending’ at the beginning of the 1990s to levels around the average for other States as assessed by the Commonwealth Grants Commission (CGC). A significant part of the savings has been derived from efficiency improvement and available output benchmarks suggest that Victorians are enjoying service standards at least on a par with other States.

The $271 million in service delivery initiatives announced in the 1998-99 Budget are directed mainly to high priority projects in the education and health sectors. These initiatives are funded in part by the reprioritisation of expenditure across other departments totalling $125 million in 1998-99. This reprioritisation of expenditure ensures that Government spending is targeted, within available resources, to best meet community needs. The 1998-99 spending initiatives will thus ensure that the Government makes further strides toward achieving its objective of high quality, value-for-money service delivery. (For further information see Chapter 4, *Service Delivery*).

Taxation

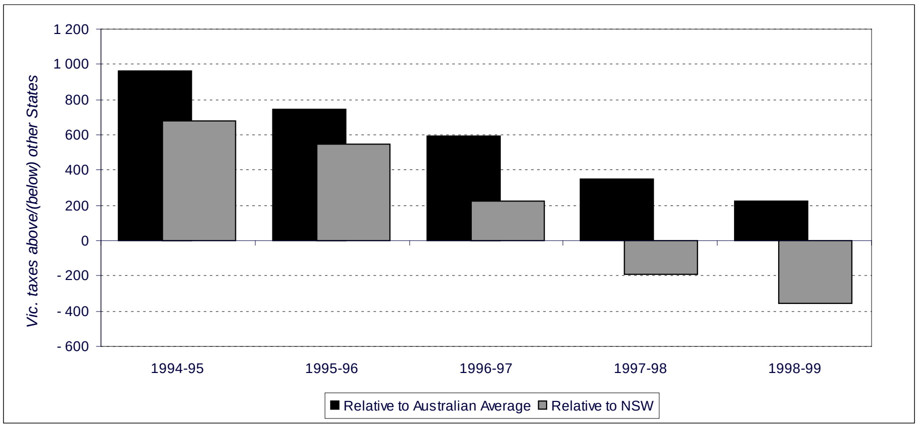
The $132 million tax relief package announced in the 1998-99 Budget represents a further major reduction in State taxes imposed on Victorian households and businesses. It follows other tax reduction initiatives introduced since 1995 at a total cost to revenue of over $400 million, including a reduction in payroll and fuel taxes and the abolition of the State Deficit Levy and a number of stamp duties. The 1998-99 Budget initiatives therefore take the Government a step closer to achieving its long-term budget objective of bringing Victorian tax rates into alignment with the Australian average.

In addition, the 1998-99 Budget includes funding to enable a reduction in household and business electricity charges. Household and small business consumers will receive a Winter Power Bonus, which will reduce their electricity bills by $60 per annum for the next three years.

This builds on water industry pricing reforms announced in October 1997 which are projected to deliver an average 18 per cent reduction in domestic water charges across Victoria. Chapter 8, *Competitive Victoria*, provides further information on savings in utility charges achieved as a result of the Government’s broader public sector reform program.

In the early 1990s the tax burden imposed on Victorian businesses and households, as assessed by the Commonwealth Grants Commission was clearly the highest of all States. As indicated in Chart 2.4, the impact of Victorian tax initiatives introduced in recent years has reduced Victorian tax levels to well below those applying in New South Wales. It is estimated that further reductions in Victorian State taxes of around $220 million would be required to match the national average tax effort. Continued progress on the Government's taxation objective will depend on the Government's ability to maintain and improve its underlying sustainable budget position.

Chart 2.4: Victorian Tax Levels Relative to New South Wales and Australian Average ($ million)



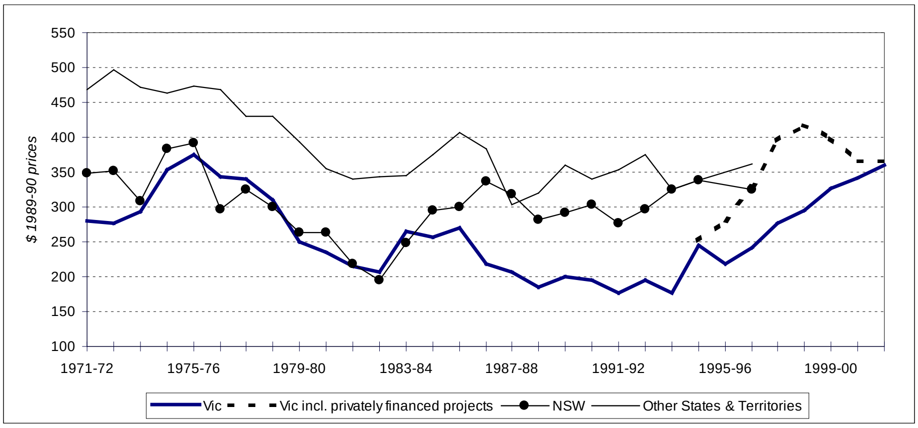
Source : Commonwealth Grants Commission, Report on General Revenue Relativities 1998 Update and Victorian Department of Treasury and Finance estimates (1997-98 to 1998-99).

Infrastructure

Adequate infrastructure spending is required to support sustained economic growth and service delivery. As illustrated in Chart 2.5, Victoria's real per capita spending on general government sector infrastructure declined significantly over the 1980's and early 1990's to levels well below the average of other States and Territories. More recently, the Government commitment to maintain budget sector infrastructure spending at around 1¼ per cent of GSP has resulted in a significant boost in capital funding.

Real per capita spending on general government sector infrastructure in 1998-99 will be around 57 per cent above the 1992-93 level and is expected to grow over the forward estimates period. A number of major projects involving private financing and construction of infrastructure, including the Melbourne City Link and upgrades to the Metropolitan Health Care Network, will provide a further boost to the capital stock over the projection period.

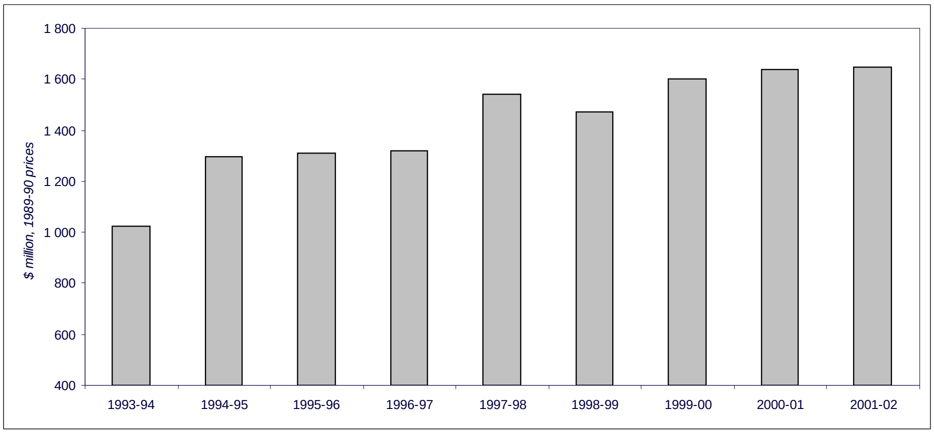
Chart 2.5: Real Gross Fixed Capital Expenditure Per Head, General Government Sector



Sources: ABS Catalogue Numbers 5501.0 (Government Financial Estimates) and 3101.0 (Australian Demographic Statistics). Department of Treasury and Finance forward estimates and estimates beyond 1997-98.

Chart 2.6 illustrates recent trends in gross budget sector infrastructure investment, which includes capital allocations for public housing and public transport. Although consistent with the Government's infrastructure target, the level of budget infrastructure investment in 1998-99 is expected to fall slightly in real terms, reflecting the above-target infrastructure expenditure undertaken in 1997-98. Nevertheless, budget infrastructure investment in 1998-99 will be around 44 per cent above the 1993-94 level in real terms. As shown in the Chart, budget sector investment will continue to grow in real terms over the remainder of the forward estimates period, consistent with the GSP-related target, and this will ensure that budget sector capital stock grows at least in line with the level of economic activity and population.

Chart 2.6: Real Gross Budget Sector Infrastructure Investment (a)



Source: Department of Treasury and Finance.

Note:

(a) Includes budget sector GFCE (direct additions to public infrastructure net of sales of fixed assets), capital grants to the PTC and Office of Housing and approved privately funded projects, the services of which the government will be the major client.

Chapter 3: Fiscal Position and Outlook

An accrual output-based budget

This is the first Victorian Government Budget to be presented in an accrual output-based format.

Accrual output-based budgeting recognises revenues and expenses as they are earned or incurred, rather than when cash is received or disbursed. The advantage of accrual-based budgeting is that it takes into account the full costs of providing outputs. This change will improve the management of the State's resources, as the relationship between outputs and the inputs that are used to produce the outputs is better recognised.

The use of accrual output-based budgeting will also improve accountability and transparency in reporting of the Budget to Parliament and to the wider community and will bring the budget sector in line with conventional accounting practices. The full cost of services will be fully transparent, as it will no longer be possible to delay the recognition of costs by deferring cash payments. Parliament must approve and Government must report all costs, including obligations to incur future cash payments.

To provide a meaningful yardstick against which the 1998-99 Budget can be compared, the published 1997-98 Budget estimates have been converted from their original cash format into the new accrual basis (see Appendix A for details).

Revised 1997-98 budget outcome

Table 3.1 provides an overview of the 1997-98 Budget aggregates and summarises revisions to the 1997-98 Budget estimates. As discussed above, the 1997-98 Budget estimate has been adjusted to a full accrual basis. An operating surplus (before abnormals) of $1 153.1 million is now expected for 1997-98, compared with the Budget estimate of $548.9 million. This improvement is the result of both stronger than expected revenue growth and lower than expected interest and financing expenses.

The operating surplus (after abnormals) for 1997-98 is now expected to be $2 691.6 million with $1 873.0 million in privatisation receipts. This was partially offset by a $334.4 million abnormal loss on the mark-to-market revaluation of metropolitan water borrowings, assumed by the budget sector as part of the October 1997 water industry reforms.

Table 3.1: 1997-98 Budget Summary

$ million

	1997-98 Budget	*1997-98 Revised*	*change*
Total Revenue [(a)]	18 337.6	18 650.4	312.8
Less Expenses	17 788.7	17 497.3	291.3
Net Operating Surplus (before abnormals)	548.9	1 153.1	604.2
Plus: Net Privatisation Proceeds		1 873.0	
less: Realised loss on borrowings		- 334.4	
Operating Surplus (after abnormals)	**548.9**	**2 691.6**	

Source: Department of Treasury and Finance.
Note:
(a) Adjusted for the effect of privatisation receipts.

Table 3.2 provides additional detail on revisions to the 1997-98 Budget estimates.

Table 3.2: Revised 1997-98 Operating Statement [(a)]

$ million

	1997-98 Budget	*1997-98 Revised*	*Change*
Net Operating Result			
Taxes [(b)]	8 417.6	8 316.1	- 101.5
Regulatory fees and fines	179.1	233.4	54.4
Sales of goods and services	1 730.3	1 703.3	- 27.0
Public authority income [(b)]	683.5	944.8	261.2
Current grants - own purpose	5 665.0	5 762.1	97.1
for on-passing	863.4	902.0	38.6
Capital grants - own purpose	492.1	488.0	- 4.2
for on-passing	24.6	23.0	- 1.6
Profit on sale of secondhand assets	- 2.8	0.0	2.8
Other revenue	284.6	277.7	- 7.0
Total Revenue	**18 337.6**	**18 650.4**	**312.8**
Less Expenses			
Gross operating expenditure			
Depreciation	757.3	757.7	0.3
Superannuation	1 531.9	1 500.2	- 31.7
Employee entitlements & other operating expenses	11 086.2	11 189.4	103.1
Total gross operating expenditure	**13 375.5**	**13 447.2**	**71.8**
Interest Expense	1 121.4	821.3	- 300.2
Current grants	1 960.4	1 898.7	- 61.7
Capital transfers	443.4	405.1	- 38.2
Grants on-passed	888.0	925.0	37.0
Total Expenses	**17 788.7**	**17 497.3**	**- 291.3**
Operating Surplus/(Deficit) before abnormals	**548.9**	**1 153.1**	**604.2**
plus: Privatisation receipts - current [(c)]	..	199.7	
plus: Privatisation receipts - proceeds of sale	..	1 673.2	
less: Realised loss on borrowings	..	- 334.4	
Operating Surplus/(Deficit) after abnormals	**548.9**	**2 691.6**	**2 142.7**

Source: Department of Treasury and Finance.

Notes:

(a) Includes grants for on-passing.

(b) Excludes privatisation proceeds received as stamp duty and tax equivalent receipts.

(c) Includes privatisation proceeds received as stamp duty and tax equivalent receipts.

Total operating revenue is expected to be $312.8 million higher than the Budget estimate. Interpretation of the movements in individual revenue categories is complicated by some special factors.

In particular, the decline in taxation revenue masks strong underlying growth flowing from the strengthening in the property market and higher than expected gambling revenue, mainly due to higher use of electronic gaming machines (EGMs). However, this underlying strength in taxation revenue has been offset by:

- one-off losses of $155 million in the switch from business franchise fees to replacement 'safety net' tax collections (following the High Court invalidation of franchise fees); and
- the abolition of the public authority contribution from December 1997, representing a reduction in taxation receipts of $201.4 million in 1997-98 (largely offset by an increase in public authority income).

Public authority income is higher than expected due to increases in dividends from government business enterprises, in large part reflecting the abolition of the public authority contribution, and first time tax equivalent payments from Aluvic.

The increase in own-purpose current grants is due in part to the commencement of the Commonwealth National Heritage Trust program and higher than forecast TAFE funding. Own-purpose capital grants for schools and road infrastructure are also forecast to be higher than 1997-98 Budget estimates.

Total operating expenses are projected to be $291.3 million lower than the 1997-98 Budget estimate. The major influence is an expected reduction in interest and financing expense as a result of favourable restructuring of some major financial transactions, as well as the use of privatisation proceeds from PowerNet Victoria to retire debt (which was not included in the 1997-98 Budget estimates).

Current grants are now expected to be lower than the 1997-98 Budget estimate, mainly due to an anticipated reduction in payments to the Flexible Tariff Management Unit Trust (FTMUT), as a result of higher aluminium prices which act to reduce the subsidy.

Reduced capital transfers reflect lower payments for housing assistance than originally estimated.

Partially offsetting these reductions is higher than forecast other operating expenses resulting from the reclassification of transactions from investment in assets to expenses. These reclassifications include $65 million of Microeconomic Reform Program (MER) funds used to provide separation payments to facilitate service delivery re-engineering.

Impact of privatisation on the 1997-98 Budget

Table 3.3 details the effects of privatisation on the 1997-98 Budget. The revised operating surplus after abnormals for 1997-98 is now estimated to be $2 691.6 million. It has been boosted by the inclusion of the privatisation proceeds of $1 873.0 million from the sale of PowerNet Victoria and Southern Hydro.

Table 3.3 Effects of Privatisation on the 1997-98 Budget

$ million

	1997-98 Budget	*1997-98 Revised*
Revenue		
Stamp duty	0.0	15.1
Other (including tax equivalent receipts)	0.0	184.7
Total Revenue	0.0	199.7
Receipts		
Power Net Victoria	0.0	1 518.2
Southern Hydro	0.0	155.1
Total Receipts	0.0	1 673.2
Net proceeds of privatisations	0.0	1 873.0

Source: Department of Treasury and Finance.

In line with Government policy, the direct proceeds of privatisations are to be used to reduce net State debt and other liabilities. Privatisation proceeds and other net financing results, will reduce budget sector debt by an estimated $1.9 billion to $8.7 billion (6.2 per cent of GSP) by 30 June 1998, and public sector debt will decline by an estimated $3.2 billion to $11.1 billion (7.9 per cent of GSP). Further details are provided in Table 6.2 of Chapter 6.

1998-99 Budget estimates

The 1998-99 Budget position and outlook discussed in this Chapter take account of Government decisions impacting on both revenue and expenses. Table 3.4 compares the forecast 1998-99 operating surplus with 1997-98 revised estimates.

The operating surplus, before abnormals, for 1998-99 is forecast to be $767.3 million or $385.7 million lower than the revised estimate for 1997-98.

A number of factors impact on individual revenue and expense items (these are explained in some detail below). However, in essence the reduction in the 1998-99 operating surplus before abnormals compared to the revised 1997-98 estimate can be accounted for by the Government's major policy decisions affecting revenues and service delivery. These comprise the service delivery initiatives announced in this Budget worth a net $108 million in 1998-99, the tax relief measures worth $125 million in 1998-99 and the Winter Power Bonus worth $134 million in 1998-99.

Total operating revenue is expected to increase by 1.6 per cent. The tax relief provided in this Budget restrains growth in taxation revenue. The abolition of the public authority contribution from December 1997, resulting in a $201.4 million reduction in taxation receipts and a related increase in public authority income, affects the analysis of individual revenue components. Other revenues decline by $63.2 million influenced by the non-recurrence of one-off revenues associated with the transfer of former SECV land to the budget sector following the sale of Southern Hydro. More details are provided in Chapter 5, *Revenue*.

The rise in own-purpose current grants is effectively only 2.0 per cent after allowance is made for the decline in the State fiscal contribution to the Commonwealth Government from $158.2 million in 1997-98 to $74.4 million in 1998-99.

Total operating expenses for 1998-99 are expected to rise to $18 187.8 million, an increase of 3.9 per cent over the revised estimate for 1997-98. This includes an increase in gross operating expenditure of 4.6 per cent or $619.1 million reflecting:

- a 3.6 per cent increase in depreciation expense in line with an increase in the asset base;
- an 8.1 per cent increase in superannuation expenses, which is faster than growth in employee entitlements and other operating expenses, reflecting an

increase in the minimum superannuation contribution rate from 6 to 7 per cent under the Superannuation Guarantee Charge arrangements.

Table 3.4: 1998-99 Budget Operating Statement

$ million

	1997-98 Revised	*1998-99 Budget*	*change*
Net Operating Result			
Taxes [(a)]	8 316.1	8 483.6	167.4
Regulatory fees and fines	233.4	250.5	17.1
Sales of goods and services	1 703.3	1 744.8	41.5
Public authority income [(a)]	944.8	940.5	- 4.2
Current grants - own purpose	5 762.1	5 964.2	202.1
- for on-passing	902.0	924.3	22.4
Capital grants - own purpose	488.0	401.6	- 86.4
- for on-passing	23.0	23.7	0.7
Profit on sale of secondhand assets	0.0	7.5	7.5
Other revenue	277.7	214.5	- 63.2
Total Revenue	**18 650.4**	**18 955.2**	**304.8**
Less Expenses			
Gross operating expenditure			
Depreciation	757.7	784.9	27.3
Superannuation	1 500.2	1 622.4	122.2
Employee entitlements & other operating expenses	11 189.4	11 659.0	469.6
Total gross operating expenditure	**13 447.2**	**14 066.3**	**619.1**
Interest Expense	821.3	806.3	- 15.0
Current grants	1 898.7	1 968.5	69.8
Capital transfers	405.1	398.8	- 6.4
Grants on-passed	925.0	948.0	23.0
Total Expenses	**17 497.3**	**18 187.8**	**690.5**
Operating Surplus/(Deficit) before abnormals	**1 153.1**	**767.3**	**- 385.7**

Source: Department of Treasury and Finance.
Note:
(a) Excludes 1997-98 privatisation proceeds received as stamp duty and tax equivalent receipts.

The remaining $469.6 million increase in employee entitlement and other operating expenses includes:

- the $108 million of net budget initiatives;
- transfers from capital to operating expenses ($33 million), in particular, road maintenance; and

- the full year impact of policy decisions from 1997-98 due in particular to education initiatives which are linked to the school year ($45 million).

After allowance is made for these factors the underlying increase in employee entitlements and other operating expenses is reduced to around $280 million or 2½ per cent. This is in line with economy-wide inflation and wage growth trends.

Interest expense declines by only $15.0 million on the revised 1997-98 estimates reflecting the fact that debt is forecast to fall only marginally in 1998-99. Consistent with past practice, and to protect the State's negotiating position, no estimate has been made of proceeds and liability reductions flowing from future privatisations.

Current grants increase by $69.8 million in 1998-99 compared to the revised 1997-98 estimates which includes the introduction of the Winter Power Bonus payments and one-off payments associated with the restructuring of the Public Transport Commission (PTC). The impact of these has been partially offset by the removal of the subsidies from the Budget under the Flexible Tariff Management Unit Trust (FTMUT) as this liability is now being managed by the SECV Shell. The SECV Shell is in a financial position to do this as a consequence of risks transferred to the private sector as part of the Loy Yang power station sales.

1998-99 Budget initiatives

As stated in the Governor's Speech at the re-opening of Parliament on 17 February 1998, the major objective of this Budget is to return to the community social benefits which are available due to the Government's sound financial management. This will be achieved without compromising the Government's ongoing commitment to sound fiscal management of the State. The net impact of new service delivery proposals provide an additional $145.0 million (or 1.0 per cent of gross operating expenses) in a full year, and taxation measures will reduce the tax burden by $132 million in a full year.

Service delivery initiatives

New service delivery initiatives increase operating expenses by $233.4 million in 1998-99 and $271.4 million in 1999-00. This has been partially funded by the re-prioritisation of resources across departments of $125.2 million in 1998-99 (increasing to $126.6 million in 1999-00). The balance represents a net increase in departmental funding, including $75 million allocated from the demand contingency provision built into the forward estimates. The new initiatives are focused on health and education.

Table 3.5 provides a summary of the 1998-99 Budget initiatives by department. Details of these initiatives are discussed in Chapter 4, *Service Delivery*.

Table 3.5: New funding for service delivery initiatives announced as part of the 1998-99 Budget

$ million

Department	*1998-99 Budget*	*1999-00 Estimate*
Education	63.5	100.1
Human Services	100.0	117.6
Justice	30.5	22.7
Infrastructure	5.9	..
Natural Resources and Environment	9.0	10.1
Premier and Cabinet	9.3	8.8
State Development	15.2	12.1
Treasury and Finance	..	..
Total	233.4	271.4

Source: Department of Treasury and Finance.

Tax initiatives

This Budget provides a further $132 million in tax relief for Victorian firms and households. This is in addition to the $209 million in payroll and fuel tax cuts and $2 million in stamp duty relief announced in the 1997-98 Budget and an estimated $33 million in land tax relief as estimated at the time the land tax reforms were announced in November 1997. The Budget provides for:

- an additional $90 million cut in payroll tax;
- a $42 million reduction in stamp duty on conveyancing; and
- full exemption from Financial Institutions Duty and Debits Tax whenever closure of a local bank branch forces customers to move their accounts.

Full details on the 1998-99 tax measures are provided in Chapter 5, *Revenue.*

Winter power bonus

The Government has also announced plans to provide to household and small business electricity consumers in Victoria a Winter Power Bonus in the form of a $60 yearly reduction on winter electricity accounts over the next three years. This initiative will cost around $369 million. It will be funded by a reduction in revenue of approximately $85 million from the remaining franchise fees receivable from the electricity distribution businesses, and cash payments of approximately $284 million to those businesses by the State.

Investment in infrastructure

New infrastructure projects amounting to a total estimated cost of $755 million will commence in 1998-99. Table 3.6 provides a summary of the 1998-99 Budget initiatives by department. Budget Paper No. 3 provides additional details on these projects.

Table 3.6: Funding for new infrastructure projects to be commenced in 1998-99 [(a)]

$ million

Department	*Total Estimated Cost*	*1998-99 Budget*	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Education	114.7	66.4	48.2	..	..
Human Services	168.9	64.0	84.1	19.9	..
Infrastructure [(b)]	188.0	63.9	85.0	26.0	10.5
Justice	47.1	18.7	19.0	9.4	..
Natural Resources and Environment	41.4	15.4	15.4	9.6	1.0
Premier and Cabinet	147.0	50.1	33.6	29.8	33.5
State Development	5.7	5.7	..	..	..
Treasury and Finance	39.6	22.2	13.9	3.5	..
Parliament	2.8	2.8	..	..	..
Total	**755.1**	**309.2**	**299.2**	**98.2**	**45.0**

Source: Department of Treasury and Finance.
Notes:
(a) Includes funding from all sources such as Microeconomic Reform Program, Agenda 21, Community Support Fund and the Better Roads Trust Fund.
(b) Includes projects for the Public Transport Corporation.

Cash flow statement

Table 3.7 provides a summary of the Budget cash flow for 1997-98 and 1998-99.

The revised cash surplus, excluding privatisation proceeds, rises to $707.4 million for 1997-98, $263.7 million higher than estimated in the 1997-98 Budget. Current revenue has increased by a larger amount than current expenditure with little change occurring in total capital expenditure.

Table 3.7: 1998-99 Cash Flow Statement [(a)]

($ million)

	1997-98 Budget	1997-98 Revise	1998-99 Estimate
Revenue			
Taxes, regulatory fees and fines [(b)]	8 592.9	8 544.7	8 797.3
(% change)			*3.0*
Sales of goods & services	1 112.0	1 686.3	1 727.3
(% change)			*2.4*
Public authority income [(b)]	675.0	1 001.5	953.5
Commonwealth grants - State own purpose	6 111.1	6 250.1	6 365.7
Commonwealth grants - for onpassing	888.0	925.0	948.0
Other revenue	201.9	277.7	208.5
Total Revenue and Grants	**17 580.9**	**18 685.2**	**19 000.4**
(% change)			*1.7*
Expenditure			
Superannuation	1 280.4	1 250.2	1 686.4
(% change)			*34.9*
Operating expenses [(b)]	10 299.4	11 059.7	11 513.9
(% change)			*4.1*
Total gross operating expenditure	**11 579.8**	**12 309.9**	**13 200.3**
(% change)			*7.2*
Interest & other financing costs	1 121.4	1 155.7	806.3
Current grants, subsidies and transfer payments	1 869.2	1 907.9	1 973.8
(% change)			*3.5*
Current grants onpassed	863.4	902.0	924.3
Total Current Expenditure	**15 433.9**	**16 275.4**	**16 904.6**
(% change)			*3.9*
New fixed assets, land and stocks	1 544.4	1 456.4	1 456.0
less sales	*- 128.8*	*- 298.7*	*- 115.3*
Expenditure on fixed assets, stocks and land (net)	1 415.6	1 157.7	1 340.7
Grants	284.0	309.0	346.4
Other capital expenditure (net) [(b)]	- 20.9	212.8	220.3
Capital grants onpassed	24.6	23.0	23.7
Total Capital Expenditure	**1 703.3**	**1 702.4**	**1 931.1**
(% change)			*13.4*
Total Budget Surplus excluding privatisation	**443.7**	**707.4**	**164.6**
plus: Privatisation receipts	..	2 047.0	..
Budget Surplus including privatisation proceeds	**443.7**	**2 754.4**	**164.6**

Source: Department of Treasury and Finance.

Notes:

(a) Percentage change 1998-99 Budget on 1997-98 revised estimate.

(b) Excludes the proceeds of privatisation.

Sales of goods and services are $574.3 million higher than the 1997-98 Budget estimate. This is largely due to the inclusion of revenues associated with school council activities and activities of hospitals associated with their commercial and community-funded operations. However, the impact on the Budget cash outcome is offset by an equivalent rise in operating expenses.

Excluding this increase, current revenues are 3.0 per cent higher than forecast in the 1997-98 Budget. Interpretation of the changes in individual revenue components is again affected by the abolition of the public authority contribution from December 1997, which reduced tax receipts but resulted in an increase in public authority income. One-off losses on safety net revenues have also reduced 1997-98 tax receipts. Abstracting from their influences, tax collections have been revised upward reflecting the strengthening in the property market and higher than expected gambling revenue. Other revenue is higher than estimated due to the transfer of land valued at $67.7 million from the SECV to the budget sector following the sale of Southern Hydro. This transfer was to ensure that these lands could continue to be used for public recreational purposes. (Although essentially a balance sheet item, this transfer was from outside the budget sector and must therefore be recognised as revenue in order to be added to the budget sector balance sheet.)

As noted above, the change in the treatment of sales of goods and services by schools and hospitals is offset by the inclusion of associated operating expenditures, which account for most of the upward revision to total current expenditure for 1997-98.

Total capital expenditure in 1997-98 is little changed from the Budget estimate. Expenditure on fixed assets is now lower due to expected underspending on 1997-98 projects and car fleet sale proceeds (which were not included in the budget estimates) that reduce recorded net capital expenditure. However, other capital expenditure has been increased by a similar amount due to the one-off cost of the water industry restructuring.

The Budget cash surplus, excluding privatisation proceeds, is forecast to decline by $542.8 million in 1998-99, to reach a level of just $164.6 million. This is larger than the decline of $385.7 million in the accrual-based operating surplus. Total current revenues and total current expenditure move broadly in line with total operating revenues and total operating expenses. The larger decline in the cash surplus is attributable to a strong 13.4 per cent pick-up in capital expenditure.

Other main differences between trends in the accrual and cash-based items between 1997-98 and 1998-99 are the larger movements in the cash-based expenditures on superannuation and interest and other financing costs compared to the accrual measures. Cash-based superannuation expenditure in 1998-99 increases by 34.9 per cent boosted by cash payments associated with the restructuring of the PTC. The impact on growth in total current expenditure is substantially offset by a $349.4 million reduction in interest and other financing costs. Interest and other financing costs for 1997-98 include the realised loss on the mark-to-market revaluation of metropolitan water borrowings which is treated as an abnormal item not included in the accrual-based interest expense.

Forward estimates 1999-00 to 2001-02

Table 3.8 provides detail on the budget sector operating statement for the forward estimate years 1999-00 to 2001-02, using the 1998-99 Budget estimate as the base. The forward estimates reflect the economic projections outlined in Chapter 7, *Economic Outlook* and incorporate announced policy commitments, but exclude the effect of potential future privatisations. The forward estimates represent planning projections for future budgets and should not be interpreted as forecasts.

The operating surplus before abnormals is forecast to rise from $767.3 million in 1998-99 to $949.2 million in 2001-02.

Gross operating expenditure should rise faster than revenue but this will be more than offset by a reduction in interest expense as cash surpluses are used to reduce debt levels and other expenses are reduced.

Growth in total revenue is projected to average 2.0 per cent a year from 1998-99 to 2001-02.

Annual growth in taxes, fees and fines is expected to average 2.3 per cent over the 1998-99 to 2001-02 period, well below projected annual growth in nominal gross state product (GSP). The main explanations for this apparently subdued outlook are the expected return of the property market to more normal levels after peaking in 1998-99 and the phasing out of electricity franchise fees by 2000-01. Growth in gambling taxes is also expected to moderate relative to recent years (for more detail see Chapter 5, *Revenue)*.

Table 3.8: Budget Sector Operating Statement - Forward Estimates 1998-99 to 2001-02 *[(a)]*

$ million

	1998-99 Budget	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Net Operating Result				
Taxes *[(b)]*	8 483.6	8 679.3	8 880.3	9 142.4
Regulatory fees and fines	250.5	252.1	238.1	198.1
Sales of goods and services	1 744.8	1 749.6	1 743.5	1 758.4
Public authority income *[(b)]*	940.5	862.9	863.6	665.2
Current grants - own purpose	5 964.2	6 259.0	6 468.9	6 720.6
- for on-passing	924.3	945.2	957.2	969.5
Capital grants - own purpose	401.6	402.8	404.0	405.1
- for on-passing	23.7	24.2	24.6	25.1
Profit on sale of secondhand assets	7.5	0.0	0.0	0.0
Other revenue	214.5	203.0	204.7	202.2
Total Revenue	**18 955.2**	**19 378.0**	**19 785.0**	**20 086.6**
Less Expenses				
Gross operating expenditure				
Depreciation	784.9	795.1	812.3	835.8
Superannuation	1 622.4	1 652.9	1 719.4	1 778.8
Exployee entitlements and other operating expenses	11 659.0	12 126.1	12 500.1	12 740.1
Total gross operating expenditure	**14 066.3**	**14 574.1**	**15 031.8**	**15 354.7**
Interest Expense	806.3	754.6	706.4	684.2
Current grants	1 968.5	1 785.2	1 840.3	1 810.8
Capital transfers	398.8	323.9	303.7	293.1
Grants on-passed	948.0	969.3	981.9	994.7
Total Expenses	**18 187.8**	**18 407.1**	**18 864.1**	**19 137.4**
Operating Surplus/(Deficit) before abnormals	**767.3**	**970.9**	**920.9**	**949.2**

Source: Department of Treasury and Finance.
Notes:
(a) Includes grants for on-passing.
(b) Excludes privatisation proceeds received as stamp duty and tax equivalent receipts.

Forecast sales of goods and services are assumed to exhibit little growth over the forward estimates period in response to arrangements whereby departments can retain receipts earned once approved by the Treasurer. The impact on the Budget bottom line is offset by a similar assumption for operating expenses related to the sale of goods and services.

Public authority income will decline over the forward estimates period – the decline in 1999-00 reflects lower projected dividends from the electricity industry reflecting the fact that most of the electricity businesses have now been privatised (Generation Victoria being the only electricity utility remaining in Government ownership). The further fall in 2001-02 is due to an expected reduction in gas authority dividends following the expiration of existing gas supply contracts and the introduction of full competition into the gas market from 2000-01.

Current own-purpose grants are expected to increase in line with real per capita growth but less than projected annual growth in Commonwealth revenues.

Total expenses are estimated to increase over the forward estimates period by an average of 1.7 per cent per year and are held down by a decrease in interest expenses, current grants and capital transfers. Total gross operating expenditure is estimated to grow at the faster average rate of 3.1 per cent. This is around the benchmark comprised of economy-wide cost inflation of around 2½ per cent plus population growth of around ¾ of a percentage point.

Interest expense should decline from $806.3 million in 1998-99 to $684.2 million in 2001-02, reflecting the use of cash surpluses to reduce net debt. The decrease in current grants in 1999-00 reflects the one-off costs associated with public transport reform in 1998-99.

Capital transfers are expected to decline over the forward estimates due to the completion of various capital projects.

Table 3.9 provides the Budget Sector Cash Flow Statement over the forward estimates period.

Differences in the movements over the forward estimates between the cash-based Budget surplus and the accrual-based operating surplus largely owes to solid growth in capital expenditure which reduces the cash based measure but not the accrual operating surplus. There is a larger improvement in the cash-based surplus in 1999-00 reflecting a number of one-off balance sheet transactions in 1998-99 which did not impact on the accrual operating surplus. These include PTC restructuring, debt restructuring and capital repatriations from government businesses.

Table 3.9: Budget Sector Cash Flow Statement - Forward Estimates 1998-99 to 2001-02

$ million

	1998-99 Estimate	1999-00 Estimate	2000-01 Estimate	2001-02 Estimate
Revenue				
Taxes, regulatory fees and fines	8 797.3	8 927.0	9 143.4	9 339.3
(% change)	*3.0*	*1.5*	*2.4*	*2.1*
Sales of goods & services	1 727.3	1 732.6	1 726.5	1 741.4
(% change)	*2.4*	*0.3*	*-0.4*	*0.9*
Public authority income	953.5	866.2	862.7	663.2
Commonwealth grants - State own purpose	6 365.7	6 661.8	6 872.9	7 125.7
Commonwealth grants - for onpassing	948.0	969.3	981.9	994.7
Other revenue	208.5	197.0	198.7	196.2
Total Revenue and Grants	**19 000.4**	**19 353.9**	**19 786.0**	**20 060.4**
(% change)	*1.7*	*1.9*	*2.2*	*1.4*
Expenditure				
Superannuation	1 686.4	1 427.9	1 549.4	1 638.8
(% change)	*34.9*	*-15.3*	*8.5*	*5.8*
Operating expenses	11 513.9	11 979.1	12 350.1	12 587.5
(% change)	*4.1*	*4.0*	*3.1*	*1.9*
Total gross operating expenditure	**13 200.3**	**13 407.0**	**13 899.5**	**14 226.3**
(% change)	*7.2*	*1.6*	*3.7*	*2.4*
Interest & other financing costs	806.3	754.6	706.4	684.2
Current grants, subsidies and transfer payments	1 973.8	1 779.6	1 826.1	1 796.5
(% change)	*3.5*	*-9.8*	*2.6*	*-1.6*
Current grants onpassed	924.3	945.2	957.2	969.5
Total Current Expenditure	**16 904.6**	**16 886.4**	**17 389.3**	**17 676.5**
(% change)	*3.9*	*-0.1*	*3.0*	*1.7*
New fixed assets, land and stocks	1 456.0	1 642.5	1 772.4	1 926.3
less sales	*- 115.3*	*- 89.0*	*- 93.0*	*- 72.0*
Expenditure on fixed assets, stocks and land (net)	1 340.7	1 553.5	1 679.4	1 854.3
Grants	346.4	310.8	288.9	278.2
Other capital expenditure (net)	220.3	- 41.8	- 54.3	- 55.2
Capital grants onpassed	23.7	24.2	24.6	25.1
Total Capital Expenditure	**1 931.1**	**1 846.6**	**1 938.6**	**2 102.4**
(% change)	*13.4*	*-4.4*	*5.0*	*8.5*
Total Budget Surplus	**164.6**	**620.8**	**458.2**	**281.4**

Source: Department of Treasury and Finance.

The sustainable budget planning position

The forward estimates include a number of temporary revenue streams and one-off transactions that have a substantial impact on the budget position over the forward estimates period, but not beyond it. In order to ensure responsible financial management, budget planning decisions exclude these temporary effects and focus on the underlying or *sustainable budget planning position.*

Over the long term, the Government's target is to maintain a sustainable operating surplus sufficient to fully fund gross asset investment. Table 3.10 presents the sustainable budget planning position. The sustainable planning surplus is expected to increase from $701.1 million in 1998-99 to $949.2 million by 2001-02. After allowance is made for the funding of investment, the sustainable cash surplus averages around $260 million over the period 1999-00 to 2001-02.

This $260 million represents, on an unchanged policy basis, the excess over the Government's target to maintain a sustainable operating surplus sufficient to fully fund gross asset investment. As detailed in Chapters 1 and 2, this is considered prudent given the uncertainties involved in preparing such forward projections. For example, recent developments in Asia could have a more significant impact on the State economy than anticipated.

Table 3.10: Sustainable Budget Planning Position

$ million	1997-98 Revise	1998-99 Budget	1999-00 Estimate	2000-01 Estimate	2001-02 Estimate
Operating Surplus/(Deficit) before abnormals	1 153.1	767.3	970.9	920.9	949.2
Revenue sources to be discontinued					
PAC/temporary Gas Industry dividends	- 276.3	- 308.0	- 277.0	- 237.0	..
Electricity Licence fee (PowerNet)	- 37.5	- 50.0	- 50.0	- 40.0	..
Electricity franchise fees	- 153.7	- 90.6	- 104.3	- 25.1	..
Total revenue to be discontinued	**- 467.5**	**- 448.6**	**- 431.3**	**- 302.1**	**..**
Removal of major one-off expenses					
Contribution to Commonwealth deficit reduction	159.0	74.4	..	..	..
Winter Energy payments	..	134.0	114.7	116.7	..
One-off costs of financial & PTC restructuring	48.0	174.0	..	..	..
Total major one-off expenses	**207.0**	**382.4**	**114.7**	**116.7**	**..**
Sustainable Operating Surplus (GFS accrual basis)	**892.6**	**701.1**	**654.4**	**735.5**	**949.2**
Contribution to fund capital	125.4	153.8	366.7	508.8	687.8
Sustainable Cash Surplus	**767.2**	**547.4**	**287.7**	**226.8**	**261.4**

Source: Department of Treasury and Finance.

Chapter 4: Service Delivery

Introduction

The restoration of the State's finances and improved service delivery efficiency mean that the Victorian Government can now provide secure, sustainable levels of service delivery. In order to ensure ongoing social benefits to the community in line with these achievements, all new legislation and initiatives brought before Parliament will be required to undergo the test of social advantage. This was announced in the Governor's Speech re-opening Parliament on 17 February 1998.

By providing increased operational and capital funding for health and welfare services as part of the 1998-99 Budget, the Government is working to improve the health and well-being of all Victorians. The increased expenditure will enable hospitals and other major services to meet increased demand.

This Budget includes new spending initiatives on outputs totalling $233.4 million in 1998-99 and $271.4 million in 1999-00, targeted in particular to addressing high priority needs in the health and education areas.

These initiatives are funded in part by efficiency gains and a reassessment of expenditure priorities across other departments totalling $125.2 million in a full year and a reallocation of resources within the Departments of Human Services. The remainder represents a net increase in departmental service delivery output funding, of which $75 million has been allocated from the demand contingency provision built into the forward estimates.

The service delivery measures are part of the Government's overall strategy to deliver quality, value-for-money public services and infrastructure to the community.

Further, the initiatives reflect the social gains to the community from the Government's sound financial management and reforms designed to deliver value-for-money services that meet the needs of the community.

Service delivery reforms have included the introduction of increased competition through outsourcing and contract management where services can be provided better or at a lower cost by the private sector. The introduction of market disciplines as a result of competitive tendering, and financial management reforms have resulted in a greater focus on service outputs rather than inputs of service delivery.

Victoria was clearly overspending on service delivery relative to other States in the early 1990s without achieving enhanced outcomes. Initiatives since 1992 have focused on using the State's resources more productively, by delivering better quality services more efficiently. Initiatives to achieve this have included:

- amalgamating smaller schools to improve student access to enhance curriculum choices and facilities whilst reducing the fixed costs of education. Proceeds from the sale of surplus assets have been reinvested in schools;
- introducing per capita funding and increasing user choice providing an incentive to schools to improve the quality of educational service delivery and better target delivery to student needs;
- decision-making powers and associated funding being devolved to schools. Schools have more flexibility to match curriculum priorities, class structures, staffing arrangements, school facilities and funding to student needs;
- funding hospitals on the basis of the mix of services provided, i.e. casemix funding, rather than on historical expenditure basis. As a consequence, waiting lists for elective surgery have been dramatically reduced; and
- moving services from institutional to home and community-based care in all human service areas. This is not only what people want, in some instances it is also less costly.

Departmental initiatives

Table 4.1 sets out by department the gross expenditure on new output initiatives for implementation in 1998-99.

In gross terms operating expenses will increase by $233.4 million in 1998-99 and $271.4 million in 1999-00. This will be partly offset by re-prioritisation of resources across all departments of $125.2 million and $126.6 million in these two years. These additional resources have been made available through reducing outputs in lower priority service areas. A further $75 million of demand contingency funding previously included in the forward estimates has also been used to offset the cost of these initiatives.

In addition, $59.5 million ($23.4 million recurrent and $36.1 million non-current) has been reallocated within the Department of Human Services for 1998-99 from existing resources to fund initiatives across all output groups.

Table 4.1: New funding for output initiatives announced as part of the 1998-99 Budget

($ million)

Department	*1998-99 Budget*	*1999-00 Estimate*
Education	63.5	100.1
Human Services	100.0	117.6
Justice	30.5	22.7
Infrastructure	5.9	..
Natural Resources and Environment	9.0	10.1
Premier and Cabinet	9.3	8.8
State Development	15.2	12.1
Treasury and Finance	..	..
Total	**233.4**	**271.4**

Source: Department of Treasury and Finance.

Table 4.2 summarises the new infrastructure expenditure of departments approved as part of the 1998-99 Budget.

Table 4.2: Funding for new infrastructure projects to be commenced in 1998-99 *[(a)]*

($ million)

Department	*Total Estimated Cost*	*1998-99 Budget*	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Education	114.7	66.4	48.2	..	..
Human Services	168.9	64.0	84.1	19.9	..
Justice	47.1	18.7	19.0	9.4	..
Infrastructure [(b)]	188.0	63.9	85.0	26.0	10.5
Natural Resources and Environment	41.4	15.4	15.4	9.6	1.0
Premier and Cabinet	147.0	50.1	33.6	29.8	33.5
State Development	5.7	5.7	..	..	..
Treasury and Finance	39.6	22.2	13.9	3.5	..
Parliament	2.8	2.8	..	..	..
Total	**755.1**	**309.2**	**299.2**	**98.2**	**45.0**

Source: Department of Treasury and Finance.

Notes:

(a) Includes funding from all sources such as Micro-Economic Reform, Agenda 21, Community Support Fund and the Better Roads Trust Fund.

(b) Includes projects for the Public Transport Corporation.

Table 4.3 provides a summary of the change to departmental operating expenses between the 1997-98 Revised Budget and the 1998-99 Budget.

Statement 2 of Budget Paper No. 3 provides details on departmental budgets. It also includes a listing of the outputs to be provided together with the associated performance measures and targets for 1997-98 and 1998-99.

Table 4.3: Total operating expenses

($ million)

Department	*1997-98*	*1998-99*
Education	4 746.6	4 915.1
Human Services	6 095.9	6 409.2
Justice	1 504.4	1 489.5
Infrastructure	1 728.3	1 713.3
Natural Resources and Environment	619.7	645.8
Premier and Cabinet	226.8	235.5
State Development	206.5	194.3
Treasury and Finance	2 347.1	2 584.2
Parliament	86.9	89.7
Total	**17 562.2**	**18 276.6**

Source: Department of Treasury and Finance.

The following section provides an outline of the major initiatives by department.

Education

The Government is committed to providing young people with the basic building blocks of knowledge that qualify them for work, equip them to be full participants in society, and give them the capacity for personal growth and fulfilment.

As announced in the Governor's Speech, the Government has adopted the following targets for education:

- 100 per cent literacy proficiency for school children at Year 3 by 2005; and
- Victorian students to be in the top five in the world in mathematics and science at the Year 9 level by 2010.

To allow the achievement of these targets, as well as meet the Government's broad education objectives, this Budget contains funding of $63.5 million in 1998-99 for new education output initiatives. These initiatives include:

- expansion of the highly successful Keys to Life program ($26.1 million in 1998-99 growing to $50.0 million ongoing in 1999-00) which will enable all schools to introduce balanced and structured classroom literacy programs and a Reading Recovery program which will target intensive teaching to students who require additional assistance. These programs will ensure that students have the opportunity to reach their full potential through the achievement of appropriate literacy skills;

- implementation of the Literacy 2001 Action Plan, funding being $0.5 million in 1998-99, to complement the Keys to Life program and assist Victoria meet its national literacy commitments. The funding will be used to implement pre-school assessments of students entering primary schools and target intervention strategies for students in the middle years of schooling. Preschool assessment will ensure that every student receives the appropriate level of assistance from their first day of school;
- support for the national Literacy 2001 strategy to complement the Keys to Life program, an additional $0.2 million to be provided in 1998-99, to ensure that both parents and students are properly informed about the new literacy initiatives and student achievements; and
- a comprehensive strategy costing $2.2 million over 2 years to improve the quality of teaching and learning in science from Year prep to Year 10 leading to enhanced knowledge and skills in science for both students and teachers.

The Government places a high priority on information and multimedia technology in schools and in the vocational education and training sector. Developing young people with appropriate multimedia skills, is essential for the economic future of the State. 'Break through' initiatives to achieve these objectives include:

- $67.7 million over seven years to make available to every government school teacher a subsidised multimedia notebook computer, as part of a structured learning technologies strategy, which will improve teacher skills in using learning technologies, delivery of the curriculum and productivity;
- $12.8 million over two years for the VicOne network which will link some 1900 educational sites across Victoria, including all TAFE institutes and all schools. As a result, every student in a government school will have access to the internet and other on-line learning opportunities;
- establishment of the Victorian Digital Resource Centre at a cost of $2.5 million over 2 years as a core information repository for the delivery of on-line information to provide high quality digital education materials for schools and the Vocational Education and Training sector; and
- $15 million over two years to boost funds for computers in schools. Computers will be funded on a 25 per cent subsidy basis, as with the highly successful 'Classrooms of the Future' project which was over subscribed.

The combined impact of these four new initiatives will put Victoria into a leading position to deliver multimedia education.

Further initiatives include:

- implementing the *Schools of the Third Millennium* initiative which builds on the *Schools of the Future* reforms. The Government has allocated $12.9 million over four years to enable selected schools to increase management flexibility in order to facilitate greater choice, contestability and enable enhanced service delivery choices to be made at the local level;
- a further $6.3 million a year to support expanded education service delivery for students with disabilities and impairments; and
- $31.5 million over two years, with $19.5 million ongoing to purchase additional educational services to meet the anticipated demand as a result of Commonwealth eligibility changes to its youth allowances.

Table 4.4: Output initiatives - Education

($ million)

	1998-99 Budget	*1999-00 Estimate*
Expansion of the Keys to Life Program	26.1	50.0
Implementation of Literacy 2001 Action Plan	0.5	..
Victorian Initiatives to Support Literacy 2001	0.2	..
Establishing Schools of 3rd Millennium	3.6	7.5
VicOne/Education Network Access for 1900 educational sites	7.8	5.0
Notebooks for Teachers initiative	4.9	9.2
Science Education - Strategy Development	1.1	1.1
Additional resources for Students with Disabilities and Impairments	6.3	6.3
Increased education services due to Commonwealth eligibility changes to youth allowances	12.0	19.5
Establishment of a Digital Resource Centre	1.0	1.5
Total - Education	**63.5**	**100.1**

Source: Department of Treasury and Finance.

The Government has also approved capital projects for Education of $66.4 million in 1998-99 (total estimated cost $114.7 million), with approximately 30 per cent of this investment to be used to relocate or merge schools and for computers or technology related projects. The Government is providing this funding as part of its 1996 commitment to spend $1 000 million of a capital nature in schools by the year 2000.

Human Services

To maintain its commitment to improving the health and well-being of Victorians, the Government is providing increased operating funding of $263 million in 1998-99. The major component of this increase is $100 million in 1998-99 ($118 million in 1999-00) provided to address demand growth and implement a number of policy initiatives. This will enable hospitals, and other major health and welfare services provided by the Department of Human Services, to meet additional demand and also raise the quality of new and existing services.

Demand growth funding has been provided for a range of important services including:

- increased funding for public hospitals ($47.8 million) to meet demand in output growth of 1.6 per cent, growth in treatments associated with new technology, and provision for the additional medical costs and loss of private patient revenue associated with the continuing decline in private health insurance;
- $10.5 million for growth in the Home and Community Care Program and specialist aged care services; and
- $6.6 million for additional disability support services including aids and equipment.

In addition to demand growth, Budget funding has been provided for a number of new initiatives which will better tailor services to meet individual needs and improve public health outcomes. These include:

- $12.9 million to improve the quality of maternity support services for women and their babies prior to, during and following childbirth, including additional services for women with special needs;
- expansion of Medical and Public Health Research to enhance Victoria's leadership in this area ($4 million);
- establishment of a new food quality agency known as Food Safety Victoria to ensure Victorian food is of the highest quality and meets international safety standards ($2.4 million); and
- accommodation and support for the most urgent clients on the Disability Service Needs Register ($3.2 million).

The demand growth and policy initiatives for each output group are summarised in Table 4.5. Further details are provided in Budget Paper No. 3.

Table 4.5: Output initiatives – Human Services

($ million)

	1998-99 Budget	*1999-00 Estimate*
Acute Health Services	60.7	64.8
Ambulance Services	1.7	1.7
Aged Care Services	10.5	10.5
Disability Services	9.9	17.4
Public Health Services	7.2	7.2
Mental Health Services	2.0	7.2
Youth and Family Services	8.1	9.0
Total – Human Services	**100.0**	**117.7**

Source: Department of Treasury and Finance.

These initiatives will complement existing innovative programs which aim to better tailor human services to people’s needs. The Hospital in the Home program, for example, will provide an increased level of service in 1998-99 with up to 67 000 bed days being provided for people whose clinical conditions can be treated in their own homes.

The Government is also providing funds to the Department to support investments in telemedicine and information technology by health services providers. The sale of Health Computing Services will allow an additional $17.5 million to be committed in 1998-99 for information technology projects in acute care, aged care and mental health output groups. These projects will help improve the quality and speed of health services delivery in metropolitan and rural areas. A further $8.8 million of the increased operating funding in 1998-99 relates to the implementation of the Suicide Preventative Task Force Recommendations. The balance is due to increased operating costs across all service areas.

To further support the service delivery initiatives and the provision of departmental outputs the Government has committed $64 million in 1998-99 for the funding of capital projects with a total estimated cost of $169 million.

These will enable the upgrade of community health, hospital and aged care services in rural and metropolitan areas, including $6.5 million on Geelong hospital improvements and $6 million for Ballarat Health Services redevelopment. The quality of hospital services state-wide will be enhanced through the provision of $11 million for hospital equipment upgrades. Access to emergency services by rural Victorians will be improved through an increased state-wide air ambulance capacity.

Justice

The major initiatives announced for the Department of Justice cover both the Victoria Police and other areas of the Department and are aimed at improving the efficiency of the Department's service delivery. Total funding for new initiatives provided for 1998-99 for the Department of Justice is $30.5 million.

Strong support for law and order is also reflected in the provision of additional funding in 1998-99 for Victoria Police.

Victoria Police will receive a major injection of funds for state-of-the-art computer technology, which will provide connections between all Victoria Police locations via a state-wide police computer network. It will support standardised desktop personal computers fitted with a range of software applications critical to the operations of a 21st century police force.

The upgrade of the police computer system will provide many benefits over the coming years, including:

- information access from and to all police facilities 24 hours a day, 365 days a year via standardised desktop PC systems linked to both local area networks and the state-wide area network with the ability to relay audio, visual and digital information;
- faster police response times and improved operational responsiveness by seamless access to mainframe data bases and other agencies information including operational and offender data bases;
- releasing police from the burden of paperwork to engage in more visible and community-based policing work; and
- more efficient case management and dispute resolution by providing single point access to information and once-only data entry for all police and other staff.

Funding of $4 million in 1998-99 has also been provided to the Victoria Police to support implementation of the new framework in the *Firearms Act 1996*, which is designed to prevent the misuse of firearms in domestic violence, youth suicide and accidental death and injury.

Other Justice initiatives to be funded in 1998-99 include:

- investment of a further $0.5 million in Community Support Facilitators who assist with the recruitment of Country Fire Authority (CFA) volunteers, support administrators and otherwise assist local CFA brigades;
- the Bureau of Emergency Services Telecommunications (BEST) undertaking phased initiatives to enhance the emergency response and

management capabilities of Victorian emergency service organisations. This will include a feasibility study into extending computer-aided dispatch to country Victoria, further work on the introduction of mobile data functionality into emergency service organisation cars and appliances and an upgrade of computer-based systems;

- funding of $0.4 million a year for five years to allow Victoria to participate in the National Motor Vehicle Theft Task Force which is aimed at reducing the level of motor vehicle theft by approximately 20 per cent over the first five years and 40 per cent over the next decade;
- establishment and operating costs associated with the implementation of the Victorian Civil and Administration Tribunal and Business Licensing Authority. This initiative rationalises the structure of tribunals and will achieve operational improvements; and
- funding for the implementation of the transfer of responsibility for administering regulations for Second Hand Dealers and Pawnbrokers from local government to the Department of Justice.

A number of capital projects valued at $18.7 million (total estimated cost $47.1 million) will also commence in 1998-99. The major initiatives are discussed below:

- a new 24-hour police station and court complex with a total investment of $9.4 million will proceed in Wodonga to replace the current poor facilities;
- the strategic program of police station rationalisation will continue with redevelopment of the existing stations in the Kew, Hawthorn and Camberwell areas (total investment $7 million). New police stations at Mordialloc (total investment $3 million) and Caulfield (total investment $3.6 million) have also been approved to proceed;
- further police station upgrades in rural Victoria will occur at Avoca, Birregurra, Briagolong, Cavendish, Charlton, Dunolly, Glenrowan, Katamatite, Lismore, Loch, Lorne, Maffra, Malmsbury, Meredith, Port Campbell, Rupanyup, Terang, Werrimull, and Yarrum over the next two years at a total investment of $5 million;
- funds have been provided to allow Victoria to participate in the National Automated Fingerprint Identification System. This major investment of $7.7 million will enable a national, coordinated approach to the investigation and solving of crimes within optimum timeframes;
- an upgrade of perimeter security at Ararat prison will proceed (total investment $1.4 million) as well as an accommodation upgrade at Langi Kal Kal Prison (total investment $0.7 million); and

- funds have also been provided for the upgrade of accommodation of the Institute of Forensic Medicine (total investment $2 million).

Infrastructure

The major initiatives for the Department of Infrastructure announced as part of this Budget are related to capital expenditure with a total value of $188.0 million. The Government has also announced some changes to output funding providing an additional $5.9 million in 1998-99.

The major capital projects to be commenced in 1998-99 to support more efficient and effective provision of services are:

- the Sports and Entertainment Precinct Infrastructure Upgrade with an investment of $37.5 million. This project will integrate the transport infrastructure of the precinct to support the world-class facilities securing Melbourne's premier role in sport and entertainment. It involves relocation of tramlines, improving links to rail stations, upgrading pedestrian links, expanded and enhanced taxi and bus parking areas as well as upgraded amenity through landscaping and design. A new terminating facility for the Flinders Street tram will also be constructed to enhance this precinct upgrade (investment $1.6 million);
- investments focusing on safety and system integrity of public transport services will be made in a Hitachi train brake safety upgrade ($3.5 million), an upgrade of the Flinders Street Rail Viaduct ($15 million), upgrade of the Warrnambool to Geelong rail track ($10 million), refurbishment of the Melton viaduct constructed in 1886 ($2.5 million) and upgrade of the Caulfield electrical sub-station which is a critical link in the Dandenong and Frankston rail lines ($2.2 million);
- enhancing the client focus, flexibility and efficiency of the current driver licensing system and district payments collection system, by developing an integrated system, which will have significant benefits for both users and taxpayers (investment $19.2 million);
- the road network will be enhanced and current congestion levels addressed by decisions to proceed with the following projects:
  - Westgate Freeway widening from three to four lanes from the Grieve Parade ramp to the West Gate Bridge will relieve the increased traffic congestion and safety risk and help reduce freight transport costs for key export industries located in this region (investment $13 million);
  - Western Port Highway upgrade to a four lane divided arterial road from the South Gippsland Freeway to Thompsons Road including a

grade separation of the Cranbourne railway line. This will reduce the significant traffic congestion delays and accidents currently being experienced (investment $23 million);

- Springvale Road Bypass where a six lane divided arterial road will be constructed on Westall Road together with an overpass of the railway line. This will complete the arterial road bypass of Springvale relieving high levels of congestion and poor access for commercial and residential properties abutting Westall Road from Heatherton Road to Centre Road (investment $37 million);

- Urban Traffic Improvement Program of high priority projects in metropolitan and regional areas to reduce congestion, improve freight efficiency, improve access to industry and restore residential and environmental amenity (investment $20 million); and

- Road Rehabilitation and Reconstruction Program will be enhanced with major projects to rehabilitate road surfaces in both urban and rural areas (annual investment of $17 million).

Key policy initiatives for 1998-99 include:

- the development of the Government's long-term Rural Policy, coordinated by the Department of Premier and Cabinet. The Department of Infrastructure is managing a consultation process with other agencies across government and with community leaders;
- the introduction of a comprehensive and effective local government performance management regime integrated with planning reforms to ensure improved overall outcomes, with the preparation of municipal strategic statements being a key element; and
- completion of the co-location of local government, planning and road expertise in regional areas which will enhance service provision to the Victorian community.

The Government has frozen public transport fares twice in the past three years. The current freeze is due to expire on 31 December 1998. From 1 January 1999, public transport fares will increase by an average of 3 per cent.

During the period 1 January 1996 to 31 December 1999 public transport fares will have increased by 6.4 per cent, while over the same period it is expected that the CPI will increase by 7.1 per cent. Accordingly, public transport passengers will have experienced an increase in fares over this four-year period 0.7 per cent below the rate of inflation.

The Government has committed that as public transport services are privatised fares will not rise beyond the rate of inflation.

Natural Resources and Environment

The major new projects for the Department in 1988-99 will be the implementation of the Government's Port Phillip Bay Initiative. This will include the development of a new research facility for the Marine and Freshwater Resources Institute, the consolidation of two freshwater research facilities at Snob Creek and the improvement of infrastructure around Port Phillip Bay to provide world-class facilities for the 1999 World Sailing Championship as well as enhanced recreational facilities for community use (total investment $19.5 million).

Victoria's primary industry production will be further stimulated through initiatives to facilitate development of the Victorian aquaculture industry ($1.5 million in 1998-99); to improve returns to wool growers through electronic marketing arrangements ($1.1 million in 1998-99), to promote increased participation of rural women in business and decision making ($0.5 million in 1998-99) and an initiative to improve irrigation efficiency and promote opportunities to develop new high value irrigation projects throughout Victoria ($1.0 million in 1998-99).

To provide a more effective radio communications system for emergency services, particularly fire suppression services, funding of $1.0 million in 1998-99 (and for the next four years) is to be provided for a VHF Incident Channel Repeater Network.

Other projects to be commenced in 1998-99 include:

- the development of the groundwater resources of Victoria for sustainable, higher value uses (total investment $2.0 million);
- the further development of the Victorian Initiative for Minerals and Petroleum (VIMP) 2001 which will stimulate investment in exploration by providing geological data, marketing and project facilitation, particularly for natural gas (total investment $7.0 million);
- the upgrading of ageing infrastructure at Wilson's Promontory, to meet environmental standards and to improve visitor facilities (total investment $3.5 million); and
- significant enhancements to Victoria's land information services including the commencement of the automation of land titles data, the development of the electronic service delivery based Land Channel (total investment $6.5 million) which will provide a wide range of land information data and

the extension of the State Digital Road Network which will improve state-wide computer aided dispatch systems for emergency services (total investment of $2.9 million).

Premier and Cabinet

The Department of Premier and Cabinet will again focus on coordinating the implementation of government policy and managing the Government's commitment to providing world-class arts programming, events and facilities.

The Department will coordinate the celebrations of the millennium and the centenary of federation for Government via the Millennium and Centenary of Federation Committee. The Committee, launched in December 1997 by the Premier and headed by Sir Gustav Nossal, will coordinate planning for the celebrations in Melbourne and regional and rural Victoria in 1998-99.

Delivery of cultural services will be enhanced with $2.8 million being provided to the State Library of Victoria to expand acquisition and exhibition programs and improve access to collections in targeted areas. Ongoing operating funding ($1.4 million in 1998-99) has been committed to the Immigration Museum and Hellenic Archaeological Museum as well as funding ($0.8 million in 1998-99) to establish a leading contemporary dance company in Melbourne.

The program under the Government's Agenda 21 strategy to redevelop key cultural facilities continues with additional capital funding being provided for:

- upgrade and refurbishment of cultural icons including the Sydney Myer Music Bowl ($14.5 million) and the Royal Exhibition Building ($4.5 million);
- a $17 million program over four years to upgrade performing arts centres in regional Victoria (including Colac, Traralgon and Albury/Wodonga); and
- construction of a temporary exhibition facility for the National Gallery of Victoria ($8.5 million), at the State Library of Victoria site to ensure continued access to the Gallery's collections during the redevelopment of the Gallery.

State Development

The Department of State Development will commit a total of $15.2 million in 1998-99 for new initiatives and $5.7 million in capital primarily for new and upgraded sporting facilities.

Business development

Developments in Asia present the Victorian Government with a twofold leadership opportunity: to work with existing exporters to maximise opportunities for diversification, and to work with new and potential exporters to take advantage of current opportunities and prepare to compete in Asian markets once the recovery begins.

The Department is consequently focusing its industry assistance strategy to fully integrate export assistance with its range of business improvement programs, in particular for small to medium size enterprises.

Reflecting the expectation that trading and investment attraction will become more difficult globally, and the fact that North America remains the largest source of foreign direct investment into Australia, Business Victoria and Multimedia Victoria will jointly work to establish strong networks in North America during 1998-99.

A client communication strategy is also being developed for implementation in 1998-99 which aims to offer a single integrated communication channel and a single point of entry to all divisions of the Department for businesses of all sizes and from all industry sectors. Two key components - Victorian Business Centres and the Business Channel - will be fully implemented during 1998-99.

Tourism

During this period of economic adjustment in Asia, Tourism Victoria will continue to maintain a strong marketing presence in various Asian markets in order to maximise opportunities to secure continuing visitation to Victoria. This program will be complemented by increased marketing activities in the high yield markets of the United Kingdom, Europe and North America, designed to exploit favourable currency exchange rates for the Australian dollar.

Building on Victoria’s excellent facilities and reputation as a high quality venue for conferences and exhibitions, a Business Events Strategy has been developed to attract and facilitate industry and economic events which can significantly contribute to the development and profile of Victoria’s industry sectors.

Multimedia

In response to the accelerating change in the information economy, the Department continues to play a key leadership role, in partnership with the private sector and the community, to encourage sophisticated and widespread use of on-line services. Through the Victoria 21 Strategy, the Government is committed to ensuring all appropriate Government services are on line by the year 2001.

Following the establishment of the Victoria 21 Strategy, in particular the VicOne Government network and Electronic Service Delivery (known as *maxi*), this year funding of $27.2 million in total will be provided to implement the Government's multimedia strategy.

Sport and recreation

Reflecting Victoria's international sporting profile, the Victorian Government has successfully negotiated the staging of two new key sporting events. Resources will be devoted to supporting Victoria's hosting of the 2002 World Masters Games and the 2000 Olympic Football (Soccer) Tournament.

In order to support Melbourne's bid for the 2006 Commonwealth Games and ensure that the State maintains its profile as a venue for major international sporting events and training camps in the lead up to the Sydney 2000 Olympic Games, the following major new projects will be undertaken by the Department in 1998-99:

- establishment of an integrated State Gymnastics Training Centre ($3.0 million);
- establishment of a State Weightlifting Centre ($1.0 million);
- upgrading of the Werribee Park Equestrian Centre ($0.7 million); and
- upgrading of Wellsford Forest Park, Bendigo ($0.7 million).

Science, engineering and technology

Following the release of the Government's science, engineering and technology policy statement *Creating Our Future* in July 1997, a key task of the Department is to support the Premier's Science, Engineering and Technology Taskforce to complete, by the end of 1998, a review of public sector expenditure in this area, and prepare advice on priorities and policy directions.

Treasury and Finance

The Department's strategic policy initiatives are aimed at creating an environment where the benefits of past reforms are locked in and made self-sustaining, and at recommending and implementing major Government policy decisions to stimulate economic reform to deliver tangible community benefits. Specific initiatives are:

Locking-in past benefits

- implement accrual output based management;
- define contestability principles and promote their use;

- develop a fiscal responsibility mechanism.

Economic reform

- develop tax reform alternatives;
- reform and privatise public transport, Aluvic, gas businesses and the Victorian Plantations Corporation;
- develop a menu of options to create a competitive economy.

Core activities of financial, risk and resource management and regulatory and taxation management services make up a little over half the department's total output costs. The department's objective is to achieve excellence in these activities. Ongoing management efficiencies, together with a smaller and less risky State balance sheet, have enabled cost savings to be made in these areas.

Service delivery performance and benchmarks

In recent years, Victoria has been at the forefront of service delivery reform. Productivity improvements have been achieved in all service delivery areas in Victoria through measures such as rationalisation of corporate support functions, elimination of unproductive work practices, targeted application of output-based funding, contracting out of non-core activities, and introduction of new labour saving technologies.

The performance of Victorian service delivery has been compared to other States using Commonwealth Grants Commission (CGC) estimates, and more recently, the Report on Government Service Provision (RGSP) published in early 1998, as well as from other relevant authorities.

Victoria's performance in delivering its major services is discussed in brief below using national averages and State estimates as benchmarks. Service delivery performance must be assessed both in terms of efficiency (costs relative to inputs) and effectiveness (i.e. how services are impacting on outcomes for the community).

Education

Victoria has achieved significant reform in the delivery of educational services. The discussion below indicates how various benchmarks compare to national data and to other States according to data collected from a range of sources including from the National Schools Statistical Collection (NSSC).

School services

Literacy

Data collected by the Australian Council for Educational Research over the past 20 years indicates that until 1980 Victorian literacy levels were above the national average. Surveys undertaken from 1989 to 1992 showed Victoria had fallen behind the national average. The 1995 survey again showed that Victorian students had achieved better than the national average. Learning Assessment Project data, (1995 to 1997) also clearly shows a consistent pattern of achievement in literacy and numeracy and progress in reducing the number of students falling behind between years three and five.

Achievement in Years 11 and 12

At the upper secondary level, during the previous decade, the performance of government schools in the very highest levels of tertiary entrance achievement was poor. The number of very high performing government school students has risen significantly between 1992 and 1997. The percentage of Government school students receiving the Premier's Victorian Certificate of Education (VCE) Award has increased over the last five years, markedly from 20 per cent in 1992 to 34 per cent in 1997.

Similarly, government schools across the State have performed strongly in the top ten per cent of students in VCE subjects. Applying value added criteria, which take into account ability and socio-economic factors, the effectiveness of the efforts of government schools is even more apparent, e.g. with government schools serving rural areas and disadvantaged urban areas getting recognition for performing among the best in the State.

Retention rates

Victoria has the second highest apparent retention rate from Year 7 to Year 12 in Government schools. Australia Bureau of Statistics 1996 data shows that Victoria with a rate of 69.4 per cent was only marginally behind Queensland, and 3.6 per cent above the national average.

Student–teacher levels

The 1996 Student-Teacher ratio for Victoria of 18.2 students to one teacher compares favourably with all other States and is 0.4 of a student above the Australian average of 17.8 students.

It is expected that a number of the new initiatives, funded as part of the 1998-99 Budget, such as the literacy and numeracy projects, will reduce this ratio in the next year.

Average school size

The average size of a Victorian Government primary school has increased from 195 students per school in 1992 to 226 students in 1996. This remains below that of four other States, including New South Wales and the Australian average, 268 and 248 students respectively.

Similarly, in secondary schools, Victoria has seen an increase from 630 students per school to 716 students. This average also remains below that of New South Wales and the Australia average.

Students per computer

The average computer to student ratio was 1:7.7 as at February 1997. Victoria's ratio is lower than all other States and is expected to fall further to 1:5 by 2000. This trend is in line with world-best practice and will ensure that Victorian students have appropriate access to multimedia technology and gain essential skills for a successful and fulfilling life.

Vocational and Educational Training

Victoria now has the most efficient, widely used vocational education training system in Australia. The effectiveness of Victorian training is also rated highly by Victorian employers, with 93 per cent saying that training was at least mostly relevant to the industry. These results are 4 per cent above the national average.

Victoria has the lowest costs per adjusted annual curriculum hour (ACH), compared to all other States. In 1995, Victoria costs were $9.20 per hour (16.5 per cent less than New South Wales) and in 1996, $9.64 per hour (16.0 per cent less than New South Wales).

The Victorian ACH price is the result of Victoria's long-term reform program in the Vocational and Educational Training (VET) sector which has seen the development of autonomous TAFE institutes, the significant growth and development of a private provider VET market, and the tendering out of government funded training places. The implementation of the recently announced reforms contained in the Ministerial Review of the Provision of TAFE in the Melbourne Metropolitan Area will also deliver further improvements in efficiency and effectiveness.

Victoria's percentage of the population sector aged 15 to 64 years who participate in VET, is 10.6 per cent in 1995 and 12.1 per cent in 1996. This the highest participation rate in Australia (only equalled by the Northern Territory in 1996). These figures are above the national average in both 1995 and 1996.

Human Services

Acute care services

Victorian hospitals have increased throughput (number of separations) by 45 per cent since 1990-91. The State has no patients with urgent needs (Category 1) waiting longer than 30 days for public hospital admission. According to RGSP, Victoria had the lowest cost per casemix adjusted separation of all States. This makes Victorian hospitals the most cost-efficient in Australia.

A recent survey (1997) by Total Quality Assurance Research, an independent research/survey company, shows that patients' satisfaction with the care they receive in public hospitals, is the second highest in Australia.

Aged care services

Victoria continues to lead Australia in helping aged people receive the care and support they need to remain in their own homes. Victoria has the highest level of Home and Community Care (HACC) service provision of any State, and the continued expansion of HACC services is crucial to preventing inappropriate admissions to high cost residential care. The government is providing for a further 6 per cent growth this year in response to demand for this program.

As the population ages, the number of people with specialist support needs is increasing. Additional funding is being provided in 1998-99 for additional specialist rehabilitation and palliative care services to improve the quality of life for this group.

Victoria has a high proportion of nursing home beds managed by the State government relative to other States. The transfer of non-core services to the private and voluntary sectors is part of a strategy to improve the quality of stock and provide local, accessible and high quality services to older Victorians with high care needs. Approximately one-third of the existing beds (1500) will be transferred to private and community sector organisations by 2000-01.

Disability services

The 1998 RGSP shows that Victoria's expenditure under the Commonwealth State Disability Agreement on services for people with disabilities is greater than any other State. The range of services provided is large and includes accommodation and/or support to people in group homes or their own homes, respite for carers, day programs, flexible brokerage packages and other specialist services.

Victoria meets a higher proportion of the estimated potential population for accommodation and support services than any other State except South Australia. A high proportion of services are targeted to people with severe or profound disabilities, and the unit cost of community accommodation and care places is lower than New South Wales.

Housing

Housing has been developing reforms aimed at better customer service, enhanced accountability and improved mechanisms for linking housing with other government and support services. The report on Government Service Provision (RGSP) indicates that Victoria has the third lowest administration costs of any State ($780 per dwelling). The report also indicates Victoria had a higher than average number of satisfied clients in 1997. In addition Victorian stock was rated higher than the national average by tenants in assessing the condition of their home.

The number of priority assistance allocations, aimed at assisting those most in need, has risen from 26 per cent of allocations in 1995-96 to 33 per cent in 1996-97, whilst average waiting time for priority assistance has dropped from 3.3 months to 2.5 months.

Assistance to the homeless and those in crisis has been growing significantly. The number of households assisted with short and medium term housing has more that doubled over the past five years to reach almost 8 000 households in 1996-97.

Assistance to those with supported housing needs has also been a priority. The number of households receiving long term housing assistance linked with support services in the Supported Housing program has been increased from 320 at June 1996 to 570 at June 1997.

Mental health

Victoria is continuing to provide a high level of support to enable Victorians with a mental illness to live in the community. On average, each mental health patient received more community support in 1997 (almost 36 contacts per client) than in 1994 (30 contacts). In 1998-99, this trend will continue and particular focus will be placed on developing service models particularly suited to young people (such as transitional rehabilitation in-group housing settings).

The establishment of the Forensic Health Institute in 1998-99 will address the lack of a secure forensic facility for the treatment and monitoring of seriously mentally ill offenders and ensure they are not placed inappropriately in prisons. The first stage of commissionary of this new facility will allow the closure and replacement of existing facilities at Rosanna (56 beds) and the opening of an additional service specifically designed to meet the needs of women.

Justice

Police

Victoria's 1996 major offences crime rate of 5 259 reported victims per 100 000 population was the lowest of all Australian States. Victoria's crime rate, at 6 497 reported victims per 100 000 population, was also 19 per cent below the national average rate in 1996. The rate has not increased significantly since then.

In addition Victorian Police enjoy the highest rate of public satisfaction in Australia with 74 per cent of the Victorian public being satisfied with police effectiveness.

Courts

Victoria was the second highest in Australia in terms of the volume of activity coming into the court system with 737 400 new matters coming into the court system in 1996-97.

The Victorian Magistrates Court had the highest rate of finalisation of civil matters within six months in Australia in 1996-97. At the same time the Supreme and County Courts were above the national average for civil cases.

Prisons

In 1996-97, Victoria had approximately 70 per cent of its prisoners employed in some kind of commercial business activity or internal prison service, which compared well with other jurisdictions. This has since risen to around 80 per cent. Victoria also has a commendable record in minimising escapes with only 0.5 per 100 prisoner years in 1996-97 being the lowest of all Australian States. In relation to the key effectiveness indicator of re-offending or recidivism, Victoria is broadly in line with other States at 35 per cent of prisoners re-offending.

Infrastructure

Transport

Public transport patronage in Melbourne has grown by 8.5 per cent since 1993-94, returning to its historically high levels. Reliability of train services has also increased steadily over the past five years with 95 per cent of train services arriving/departing within five minutes of scheduled time during 1996-97. At the same time, public transport costs have fallen by some $245 million since 1991-92. However, despite progress in these areas there is great potential to deliver a higher quality, lower cost public transport service to the community. (For further details of public transport reform measures see Chapter 8, *Competitive Victoria*.)

Roads

Victoria's road construction projects in recent years compare favourably with other States in terms of achieving the costs and benefits targeted in project proposals with Victoria generating some of the highest benefits in road projects of all States. Victoria also compares favourably with New South Wales in both efficiency and effectiveness of road maintenance expenditure.

In terms of road safety Victoria is also commendable on a national level with the lowest road fatalities per 100 million vehicle kilometres of all States. The success of the Victorian partnership between VicRoads, the Transport Accident Commission and Victoria Police in implementing the State's road safety strategy was recognised by a Prime Minister's Award for innovation in 1997.

Local Government

At the end of the 1996-97 financial year $1 450 million of local government work had been market tested. This represents about 56 per cent of the aggregate operating expenditure of all Victorian councils.

Natural Resources and Environment

Parks

Victoria's parks contain eight of the State's top 15 tourist attractions. They contribute significantly to regional employment and generate around $1 billion a year in tourism over the last 12 months. In excess of 80 per cent of Victorians visited our National, State or Metropolitan parks or one of the piers on Port Phillip or Westernport Bays.

Water

Non metropolitan urban water authorities have been reduced to 15 in 1997. Accompanying these reforms has been a rise in the number of country water supplies meeting World Health Organisation quality standards from 27 per cent to 60 per cent, and the near elimination of untreated sewage discharge to ocean outfalls. Water authorities have improved their efficiency by more than 20 per cent or $100 million per year since 1992.

State Development

Business development

In 1996-97 Business Victoria and Multimedia Victoria assisted 57 significant projects and a range of smaller investment projects for projected new investments totalling $1 457 million. Of these projects, 34 per cent were in rural Victoria.

Regulation reform

Significant reduction in regulation has been achieved over the past few years in the number of existing regulations and new regulations introduced. The number of regulations have fallen 60.2 per cent from 1 241 in 1987 to 494 in 1996. At the same time, the number of new regulations introduced each year has fallen by 40.3 per cent from 278 in 1993 to 166 in 1996. The total of 869 regulations introduced between 1993 and 1996 was 43.8 per cent lower than 1 546 introduced between 1989 to 1992. Additionally, during 1996, a regulation reform strategy based on sectoral reviews was developed followed by a regulatory review of the tourism industry which was completed at the end of 1997.

Tourism

Tourism Victoria has been successful in marketing Victoria both domestically and overseas. Following a significant decline in 1994, the number of international visitor nights to Victoria has grown at an average annual rate of 22.0 per cent over the period 1994 to 1997. This compares with average annual growth rates of 11.9 per cent in New South Wales and 7.8 per cent in Queensland during the same period. Over the same four-year period, Victoria's market share has increased at the expense of the more popular northern States, in particular Queensland.

Sport and recreation

Victoria's sport and recreation industry has recorded a decade of pace setting employment growth, growing at around five times the growth rate averaged by all Victorian industry. Increased physical activity generates substantial benefits for the community by improving health and reducing medical and associated health costs.

Major sporting events staged in Victoria in 1997 are estimated to have directly stimulated the economy by in excess of $500 million, with events held in Victoria accounting for four of the 'top 5' national sporting events.

Chapter 5: Revenue

Introduction

The $209 million reduction in payroll and fuel taxes announced in the 1997-98 Budget, and the major reforms to land tax subsequently announced in Spring 1997, took Victoria a significant way towards bringing its overall revenue-raising effort into alignment with the average of the Australian States. Tax increases in New South Wales and some other States meant that Victoria's tax burden fell well below that of New South Wales and within $350 million of the State/Territory average.

The 1998-99 Budget provides for a further $132 million in tax cuts which will further improve the competitiveness of Victorian firms and will bring relief to home-buyers. This will reduce Victoria's revenue-raising effort to an estimated $350 million below that of New South Wales and reduce the gap between Victoria and the average of the States to an estimated $220 million - down from $900 million just three years ago.

Revenue safety net arrangements negotiated between the States and the Commonwealth averted major revenue losses during 1997-98 following a High Court ruling which led to the loss of State and Territory business franchise fees on tobacco, fuel and alcohol. Since 6 August 1997, the Commonwealth has collected equivalent revenues on these products on behalf of the States and Territories.

Although the loss of franchise fees will result in some one-off revenue losses in 1997-98, this will be more than offset by gains from other sources. A strong recovery in Victorian property markets has contributed to stronger than expected revenue gains this year and in 1998-99.

Importantly, these cyclical revenue gains will not be relied upon to finance this year's tax cuts, which have been made possible by the improvement in the underlying budget position achieved through debt reduction and service delivery reforms.

Relative to the original Budget estimate of $11 292.3 million, State own-source revenues, excluding privatisation receipts, are now expected to be $11 475.3 million, an upward revision of $183 million or 1.6 per cent.

Privatisations during the year to date have yielded additional one-off receipts totalling $199.7 million, comprised of $15.1 million in stamp duties, $178.7 million in additional tax equivalent payments, and $6 million in earned land rent.

After allowing for the tax cuts announced in this Budget, revenue from all State sources (including sales of goods and services) is projected to increase to $11 641.4 million in 1998-99, an increase of $166.1 million or 1.4 per cent on the revised 1997-98 estimate. Thereafter, revenues are projected to grow at an annual average rate of 0.9 per cent to June 2002 (Table 5.1)

Table 5.1: Revenue Estimates 1997-98 (revised), 1998-99 Budget and Forward Estimates to 2001-02

($ million)

	1997-98 Revised Estimate[(a)]	*1998-99 Budget Estimate*	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Taxes, fees & fines	8 549.5	8 734.1	8 931.4	9 118.4	9 340.5
Public Authority Income	944.8	940.5	862.9	863.6	665.2
Sales of Goods and Services	1 703.3	1 744.8	1 749.6	1 743.5	1 758.4
Other Revenue	277.7	222.0	203.0	204.7	202.2
Total State Sourced Revenue	**11 475.3**	**11 641.4**	**11 747.0**	**11 930.2**	**11 966.2**

Source: Department of Treasury and Finance.

Note:
(a) Excludes privatisation receipts.

Tax relief

1998-99 Tax initiatives

This Budget provides a further $132 million in tax relief for Victorian firms and households. Building on the $209 million in payroll and fuel tax cuts and $2 million in stamp duty relief announced in 1997-98, the Budget provides for an additional $90 million cut in payroll tax together with a $42 million reduction in stamp duty on conveyancing. This will benefit first home-buyers, pensioner home-buyers and purchasers of median-priced homes. In addition, a full exemption from financial institutions duty and debits tax is to be provided whenever closure of a local bank branch forces customers to move their accounts.

Table 5.2: Summary of 1998-99 Tax Relief Measures

Description of measure	*Estimated Revenue Cost*	
	1998-99 $ 000	*Full year $ 000*
• Reduce payroll tax rate from 6.25% to 6%	83 000	90 000
• Extend range over which 2.4% conveyance duty rate applies by raising threshold from $100 000 to $115 000	39 000	39 000
• Raise threshold for maximum conveyance duty concession for first home buyers from $100 000 to $115 000, and for partial concession from $150 000 to $165 000	800	800
• Raise threshold for maximum conveyance duty concession for pensioners from $70 000 to $100 000, and for partial concession from $100 000 to $130 000	2 300	2 300
• Exempt from financial institutions duty and debits tax bank account transfers forced by branch closures	na	na
Total	**125 100**	**132 100**

Source: Department of Treasury and Finance.

Payroll tax cut

From 1 July 1998, Victoria's payroll tax rate will fall to 6 per cent. This follows last year's rate reduction from 7 per cent to 6¼ per cent. It will mean a further 4.0 per cent reduction in tax liability for all Victorian businesses currently paying payroll tax and will affect some 15 200 employers.

At an estimated cost to revenue of $90 million in a full year, this further rate cut brings the value of payroll tax relief to Victorian firms over the two years to a total of $193 million. Prior to July 1997 Victoria's payroll tax rate was among the highest in Australia for medium-to-large sized firms. From 1 July 1998, Victoria will have the third lowest rate on payrolls of $5 million and over. These successive reductions will make Victoria more attractive to new investments and improve the cost competitiveness of existing local firms and industries. Because Victoria has a strong manufacturing export base and is also a net exporter of goods and services to other States, increased business flowing from improved competitiveness will translate into stronger growth in the Victorian economy. In time, this boost to growth should also flow through to increased employment, to the benefit of all Victorians.

This measure is to take effect with respect to wages paid or payable from 1 July 1998 at an estimated cost to revenue of $83 million in 1998-99 and $90 million in a full year.

Stamp duty on conveyancing

This Budget contains significant conveyance duty relief for median price home-buyers by extending the range over which the lower marginal rate of 2.4 per cent applies from the current $100 000 threshold to $115 000. This will reduce conveyance duty payable on properties with values in the range $100 000 to $870 000, and offer savings of $540 on all properties in the value range $115 000 to $760 000.

The greatest proportional gains will go to those purchasing properties in the median house price range (approximately 50 per cent of all property sales). Information from the Valuer-General indicates that in Melbourne in 1997 the median price of a house was $135 000 and that of an own-your-own flat was $120 000. Some 72 000 property purchasers are expected to benefit each year from this measure.

Smaller businesses purchasing properties within this value range will also benefit. This will further enhance the already very competitive regime of stamp duties on business conveyances in Victoria which, unlike other States, does not include the value of either goodwill or stock-in-trade. As a result, stamp duty payable on business property transfers is typically much lower in Victoria, despite higher marginal rates.

The reduction in conveyance duty will facilitate greater mobility of labour by reducing the cost to individuals and households of moving to areas of greater employment opportunity. By reducing the transactions costs associated with moving house as accommodation needs change, it will also assist in promoting more efficient use of existing housing stock.

This measure will have an estimated cost to revenue of $39 million in 1998-99 and will have effect for contracts entered into on or after 21 April 1998. The new rate scale which takes effect from that date is set out in Table 5.3.

Table 5.3: Conveyance Duty Rates and Thresholds

Value of Property Transferred ($)	*Stamp Duty Payable*
0 - 20 000	1.4% of the value of the property
20 001 - 115 000	$280 plus 2.4% of the excess over $20 000
115 001 - 870 000	$2 560 plus 6% of the excess over $115 000
Above 870 000	5.5% of the value of the property

Source: Department of Treasury and Finance.

First home-buyers stamp duty concession

The threshold at which the maximum concession on stamp duties for first home-buyers tapers out is also to be raised. Since 9 August 1988, certain low income families with dependent children have been eligible for a stamp duty concession on the purchase of their first home. A full exemption (with a benefit of $2 200) applies to homes valued up to $100 000 and the concession tapers out to zero for purchases of homes valued at $150 000. These thresholds were last adjusted in April 1996.

To protect the value of the first home buyer concession from rising property prices, the threshold for a maximum concession will increase from $100 000 to $115 000, while the upper threshold for a partial concession will rise from $150 000 to $165 000. As a consequence, the value of the maximum concession will increase from $2 200 to $2 560. These adjustments will take effect for contracts entered into on or after 1 July 1998 by eligible first home buyers.

As a result, an estimated 300 additional families are expected to qualify for the full concession and an additional 110 for a partial concession. All home buyers eligible for the concession also receive a full refund of mortgage duty associated with the home purchase. The cost to revenue is estimated at $800 000 in 1998-99.

Pensioner home-buyers stamp duty concession

Since 24 September 1985, a stamp duty exemption or refund has been available for holders of a pensioner concession card or health care card who purchase properties up to $100 000 in value. A full exemption or refund of $1 480 was payable for homes up to $70 000 in value and a reducing benefit was available for homes between $70 000 and $100 000. All eligible purchasers also receive a full refund of any mortgage duty associated with the purchase. These thresholds were last adjusted in 1996.

The threshold at which the maximum pensioner concession on conveyance duty applies will be lifted from $70 000 to $100 000 and the upper threshold for a partial concession from $100 000 to $130 000. This will significantly increase the value of the maximum concession from $1 480 to $2 200.

An estimated additional 1 050 pensioners are expected to qualify for a full concession and an additional 740 for a partial concession. The new thresholds will come into effect for contracts entered into on or after 1 July 1998 at an estimated cost of $2.3 million in 1998-99.

FID and debits tax exemptions on forced bank transfers

Financial institutions duty (FID) is levied on most deposits made to financial institutions while debits tax applies to withdrawals from cheque accounts or bank accounts with cheque facilities.

With the rationalisation currently occurring in the financial institutions sector, the Government has become concerned that some households and small businesses are having to pay FID and debits tax when the closure of the local branch of their regular bank forces them to transfer their accounts. In particular, when bank branches close in rural and provincial towns, depositors may feel they have little option but to transfer their accounts to another bank in order to continue to conduct their banking business locally.

To alleviate this problem, the Government has decided to provide a full exemption from FID and debits tax on inter-bank transfers by bank customers forced to close their account due to the closure of a bank branch. This will reduce the cost for individuals and businesses wishing to transfer to another bank. The exemption will also apply to cross-border transactions into Victoria when, for example, a branch is closed in Albury and the depositor transfers funds to a branch of another bank in Wodonga. This measure will be implemented as soon as practicable following consultation with financial institutions.

In addition, from 1 July 1998, a specific exemption from FID is to be allowed when an amount is credited to an account held with one bank that has been deposited via another Victorian bank. This will eliminate the possibility of double taxation and enable depositors to continue to conduct transactions through another bank in the local area following the closure of their own branch.

1998 Land tax reforms

While 1997 land tax assessments for metropolitan land were based on 1990 land valuations equalised to June 1995, assessments in 1998 will be based on 1994 valuations equalised to June 1996. The 1997-98 Budget stated that the 1998 land tax structure would be determined following an analysis of the impact of the 1994 revaluations on land tax assessments. That analysis highlighted several major deficiencies in Victoria's land tax system.

Following valuation increases, a large number of taxpayers would have faced increases of 50 per cent or more in their land tax liability as a result of the 15-fold rise in the marginal tax rate, from 0.2 per cent to 3.0 per cent, for properties with a site value of $540 000 or above.

Capping arrangements were no longer effective in protecting taxpayers from such large increases, and were leading to growing inequities between taxpayers. Capping of individuals' land tax liabilities was introduced in 1994 as a temporary measure to protect them from large increases when the Government was forced to raise land tax rates to maintain revenues against a general fall in property values. These arrangements linked existing taxpayers' liability to 1993 land values and to the lower tax rates applying in that year. Properties which had values below the tax-free threshold in 1993, but which had since increased in value and become liable for land tax did not benefit from capping. By 1998, this had led to a highly inequitable situation where, for quite arbitrary reasons, landowners with properties of equivalent value would have been liable for vastly different amounts of land tax.

Up to 1998, most principal places of residence had been protected by Victoria's relatively high tax-free threshold. (Unlike other States, Victoria did not allow a land tax exemption for the principal place of residence.) By 1998, however, the general appreciation in land values reflected in the 1994 re-valuations would have made a growing number of principal places of residence liable to land tax, even though no income was being earned on those properties.

To remedy these deficiencies the Government announced in November 1997 a major package of reforms to the land tax structure for introduction in the 1998 land tax year. The major elements of the package are:

- the introduction of a smoother rate scale to overcome the steep jump in marginal rates at the $540 000 threshold;
- the removal of capping to restore equity to the system; and
- the introduction of a full exemption for the principal place of residence, in tandem with a reduction in the tax-free threshold from $200 000 to $85 000 for land used for other purposes.

Land used for primary production continues to be exempt from land tax.

Legislation to give effect to the changes in the tax rate, the tax-free threshold and the minimum tax payable was passed in Spring 1997. A comparison between the new and the old rate scale is provided in Table 5.4.

Table 5.4: Comparison of New and Old Land Tax Rates

Site Value ($)	*Old marginal tax rates (%)*	*New marginal tax rates (%)*
less than 85 000	0.0	0.0
85 000 - 200 000	0.0	0.1
200 000 - 540 000	**0.2**	0.2
540 000 - 675 000	**3.0**	0.5
675 000 - 810 000	3.0	1.0
810 000 - 1 080 000	3.0	1.75
1 080 000 - 1 620 000	3.0	2.75
1 620 000 - 2 700 000	3.0	3.0
over 2 700 000	**5.0**	5.0

Source: Department of Treasury and Finance.

While the exemption for the principal place of residence will provide relief for home owners, the new land tax rate scale provides major tax relief on business and investment land valued in the range $540 000 to $2.7 million. For example, a medium-sized manufacturing business with a land value of $800 000 will pay $2 805 under the new system compared with $8 540 under the old rate scale. For properties valued at up to $2 million, the new rate structure will greatly improve the competitiveness of the land tax system in Victoria, as landowners and tenants in this State will now pay significantly less tax than owners of land of equivalent value in most other mainland States, as illustrated in Table 5.5.

The lowering of the tax-free threshold will mean that business and investment properties with site values between $85 000 and $200 000 will attract land tax for the first time. However, the tax rate applicable to such properties will be only 0.1 per cent, so that tax payable on such properties for the 1998 year will be restricted to between $85 and $199. Because the principal place of residence will be exempt, these costs will apply mainly to business and investment properties and are deductible for Commonwealth tax purposes against income from all sources.

Table 5.5: 1998 Land Tax Liability: Mainland Australian States

	1998 Tax Liability ($)				
Site value of land ($)	*Victoria*	*New South Wales*	*Queensland*	*Western Australia*	*South Australia*
100 000	100	nil	nil	150	175
200 000	200	840	nil	500	525
500 000	800	6 390	3 095	3 490	4 175
1 000 000	6 230	15 640	10 625	10 650	12 425
2 000 000	33 880	34 040	36 000	31 165	49 425

Sources: Department of Treasury and Finance; Interstate Comparison of Taxes 1997-98, *New South Wales Treasury, Research & Information Paper.*

With the restructuring of the land tax rate scale overcoming the problems associated with the previous steeply progressive rate structure, the capping arrangements in place since 1994 are no longer necessary to protect landowners from the effects of very large year to year increases in their tax liability. The removal of capping will mean that some taxpayers will face a one-off adjustment in 1998 to bring them into line with other taxpayers with land of equivalent value.

Estimated revenues from land tax in 1997-98 have been revised down to $355 million compared to the April 1997 Budget estimate of $427 million. This fall is due to a combination of factors, including:

- the restructuring of the rate scale;
- the introduction of the principal place of residence exemption; and
- a downward movement in the valuation of some higher valued properties.

Victoria’s relative revenue-raising effort

The 1998-99 tax cuts bring Victoria’s overall taxation effort a further step towards alignment with the average of the Australian States. Based on the 1998 Commonwealth Grants Commission (CGC) assessment of Victoria’s relative revenue-raising effort, alignment with the average tax effort of all the States would require further tax cuts estimated at around $220 million (compared with $900 million just three years ago). This remaining gap is after adjustment of the CGC ratios (which are based on 1996-97 financial outcomes) for tax increases subsequently implemented or announced in other States and for the successive Victorian tax cuts announced in 1997-98 and in this year’s Budget.

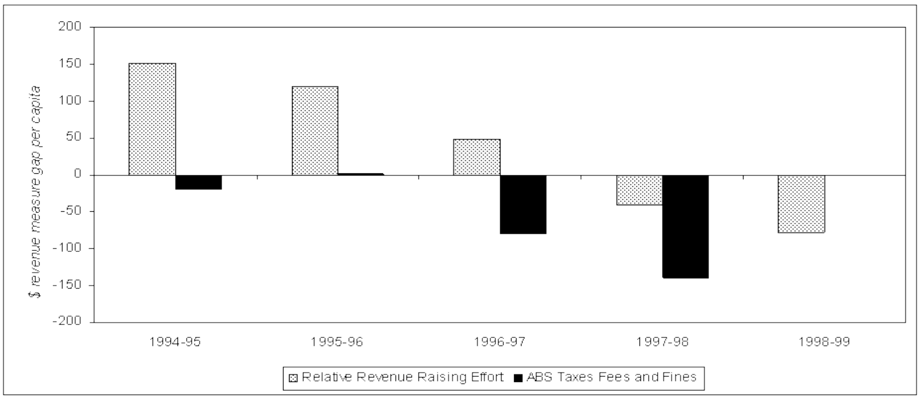
Even before the 1998-99 tax cuts, Victoria’s relative revenue-raising effort (on a CGC basis) had fallen some $190 million (or $41 per capita) below that of New

South Wales, and this year's Budget measures will further widen this gap to over $350 million.

Other well-accepted measures of relative tax severity show Victoria to have had a lower tax burden than New South Wales for some years. Estimates published by the Australian Bureau of Statistics (ABS) show that, in per capita terms, Victorian taxes were some $140 lower than New South Wales in 1997-98.

Chart 5.1 compares Victoria's relative tax burden with New South Wales on both the CGC and the ABS bases. It shows how much higher (or lower) in per capita terms Victoria's tax burden has been, in each of the past four years. It reveals that, on a CGC basis, Victoria had a higher per capita revenue-raising effort than New South Wales up to 1997-98, when the situation was reversed. On an ABS basis, on the other hand, the Chart shows that, with the exception of 1995-96, Victoria's taxes fees and fines per capita have been lower than in New South Wales throughout the period. Similarly, when taxes, fees and fines are expressed as a proportion of gross state product, Victoria's tax burden has been below that in New South Wales throughout the period 1990-91 to 1997-98 (Chart 5.2).

Chart 5.1: Measures of Relative Tax Severity: Victoria and New South Wales

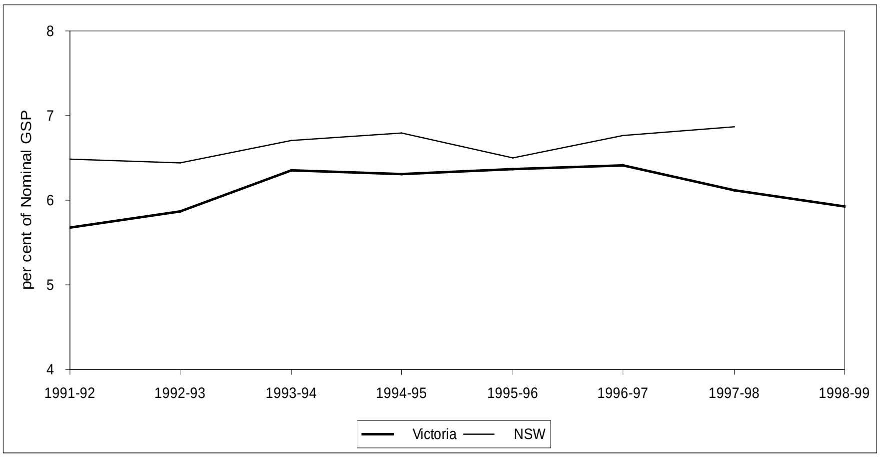


Sources: Taxation Revenue Australia, Australian Bureau of Statistics, Cat No. 5506.0; Commonwealth Grants Commission Report on General Revenue Grant Relativities 1998 Update; New South Wales Budget Papers 1997-98; Victorian Budget Papers 1997-98.

Note:
The NSW 1998-99 estimate of Taxes, Fees and Fines is not available and consequently the ABS based comparison of the differential is not possible.

An alternative measure of Victoria's relative cost competitiveness is the effect of State taxes and charges on the long-run profitability of firms which can relocate in response to the promise of a lower business cost environment. When the combined impact of State taxes and charges on the long-run profitability of such 'footloose' firms is taken into account, Victoria's overall cost environment is much more favourable than its relative tax rates would suggest. This reflects the fact that utility charges and workers' compensation costs, which are lower in Victoria than most other States, are a relatively more significant component of business costs for many firms (particularly in manufacturing and resource processing industries) than State taxes.[1]

Chart 5.2 : Taxes Fees and Fines as % of Nominal Gross State Product



Sources: *Taxation Revenue Australia. Australian Bureau of Statistics, Cat. No. 5506.0; National Accounts, State Production Accounts; Australian Bureau of Statistics, Cat. No. 5242; Victorian Budget Papers 1997-98; New South Wales Budget Papers 1997-98.*

Loss of business franchise fees

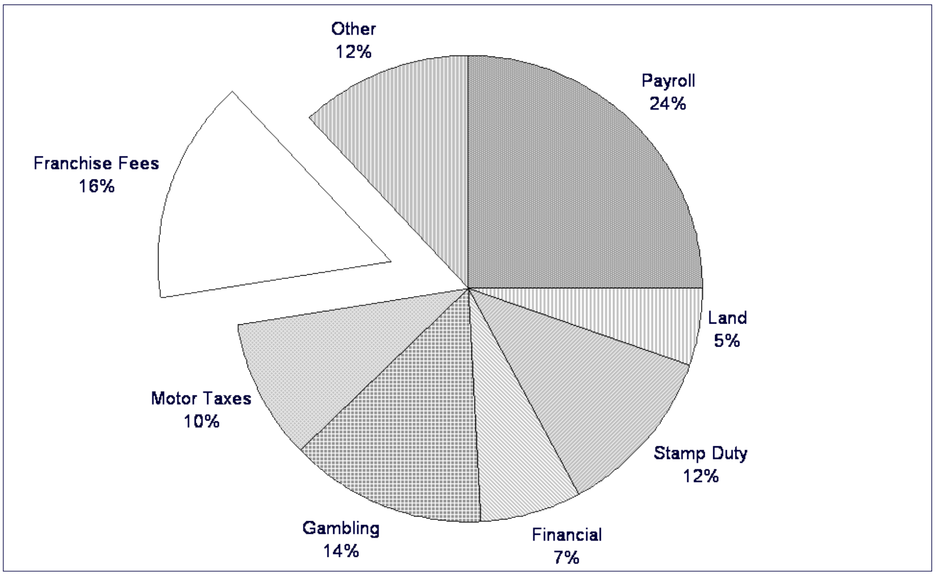
For some years, States and Territories have imposed business franchise fees on tobacco and liquor merchants and on fuel distributors in return for the grant of a licence to trade in these goods. These franchise fees typically comprised a fixed fee and an *ad valorem* fee, with the *ad valorem* component determined by reference to the value of wholesale sales or purchases in a previous period. Franchise fees became an increasingly important source of revenue for the States and Territories over the last two decades, rising from around 5 per cent of all State and Territory taxes fees and fines in the mid-1970s to over 15 per cent

[1] Based on a study by Arthur Andersen commissioned by the Department of Treasury and Finance in 1995-96.

by the mid-1990s. In 1997-98, business franchise fees on these three products were estimated to yield $1.2 billion in Victoria, and over $5 billion nationally.

Franchise fees have been periodically subject to legal challenge under Section 90 of the Commonwealth Constitution, which confers on the Commonwealth exclusive power to levy duties of customs and duties of excise. While the States have asserted that duties of excise are taxes imposed only on the *production* of goods, over the years the High Court, by a narrow majority, has come to interpret excise duties as a tax on goods at any stage of the production/distribution chain up to the point of final sale.

Chart 5.3: Composition of Victorian Taxes, Fees and Fines, 1996-97*(a)(b)*



Source: Department of Treasury and Finance.

Notes:
(a) Based on actual collections in 1996-97.
(b) Excludes privatisation effects.

On 5 August 1997 the High Court of Australia ruled that tobacco franchise fees levied by New South Wales were duties of excise and were therefore invalid under Section 90 of the Constitution.[2] States and Territories received legal advice that the decision cast sufficient doubt on the constitutional validity of

[2] *Ngo Ngo Ha and Anor* v *State of New South Wales & Ors* and *Walter Hammond & Associates Pty Ltd* v *New South Wales and Ors*, (1997) 146 ALR 355.

their franchise fees on tobacco, liquor and petroleum that they should immediately cease collection of *ad valorem* fees on all three products.

The decision has major ramifications for the Australian federal system. In the absence of constitutional change, not only has it ruled out any prospect of the States levying sales or consumption taxes in the future, it has deprived them of more than 15 per cent of their current own-source revenues, dramatically worsening Australia's already unacceptably high degree of vertical fiscal imbalance (see Chapter 9 *Commonwealth-State Financial Relations*).

Safety net arrangements

The day after the decision, and at the unanimous request of the States and Territories, the Commonwealth announced safety net arrangements whereby the Commonwealth would collect equivalent revenues, on behalf of the States and Territories, by imposing replacement taxes on the same products. The Commonwealth also announced that it would legislate to protect States and Territories from refunds sought on past payments of franchise fees.

As a result, federal wholesale sales tax on liquor and federal excise duty on tobacco and petroleum products was increased on 6 August 1997 to replace former business franchise fees. The revenues thereby generated were to be returned to the States and Territories in accordance with a formula agreed by them. In addition, Commonwealth legislation was enacted to apply a 100 per cent windfall gains tax, with retrospective effect, to any refunds of franchise fees paid in respect of a period prior to 5 August on the grounds that the fees were invalid.

Although business franchise fee rates varied across jurisdictions, the replacement taxes had to be imposed by the Commonwealth at uniform rates throughout Australia to comply with the Constitution. So that higher franchise fee States would suffer no loss of revenue, the increases in excise and sales tax were greater in some jurisdictions than the franchise fees which they replaced. This meant that some States, including Victoria, stood to receive revenues in excess of their estimated franchise fee revenues. These 'surplus' revenues are being returned to taxpayers with the aim of avoiding, as far as possible, price increases for consumers. In this Budget Paper, payments to return surplus revenues to taxpayers are netted off gross safety net receipts to show net revenues retained by Government.

Legislation to repeal Victoria's *ad valorem* fees on tobacco, liquor and petroleum passed through both Houses of Parliament in Spring 1997. The *Business Franchise Fee (Safety Net) Act* 1997 also repealed provisions requiring wholesalers of tobacco and petroleum products to be licensed. However, premises which sell liquor continue to be subject to licensing provisions, with the former *ad valorem* licence fee now replaced by a fixed fee of $150 per annum in most cases. The safety net legislation also provides appropriation authority for the Treasurer to make payments to return surplus revenues to taxpayers, as necessary, in accordance with the safety net arrangements for each product.

Fuel safety net

Under the safety net arrangements, State petroleum franchise fees have been replaced by a surcharge on Commonwealth customs and excise duties on petroleum products. At a uniform national rate of 8.1 cents per litre (cpl) the fuel excise surcharge is slightly higher than Victoria's former franchise fees of 7.67 cpl for motor spirit and 7.35 cpl for diesel fuel.

To prevent this higher tax rate flowing through to petroleum prices, Victoria is making payments to petroleum wholesalers equal to the difference between the new and the old tax rates. This is 0.43 cpl for motor spirit and 0.75 cpl for diesel fuel. These payments are conditional upon the wholesalers guaranteeing not to pass the tax increase on in wholesale prices. The Australian Competition and Consumer Commission is monitoring these arrangements to ensure that petrol prices do not change as a result of the change in taxation arrangements.

Payments are also being made to fuel wholesalers to fully offset the 8.1 cpl excise surcharge on diesel fuel sold for off-road use in order to maintain the effect of the former franchise fee exemption. The *Business Franchise Fee (Safety Net) Act* 1997 provides for the first time a legislative foundation for this exemption scheme, which had previously operated on an administrative basis. This provides greater certainty for beneficiaries of the scheme under the changed fuel taxation arrangements. The legislation also provides for the periodic renewal of exemption certificates. Under the former administrative scheme, there was no limit on the life of certificates issued and this left the scheme exposed to possible abuse through the transfer of certificates to ineligible persons. The Act provides for certificates to be valid for three years, unless revoked sooner, and to be renewable upon application.

Liquor safety net

Liquor franchise fees have been replaced by a 15 per cent surcharge on Commonwealth wholesale sales tax on liquor products. To ensure that prices of formerly exempt products do not change as a result of the change in taxation arrangements, Victoria is making payments to:

- liquor wholesalers to fully offset the 15 per cent surcharge on low alcohol products; and

- Victorian licensed vignerons to fully offset the surcharge on cellar door wine sales and tastings and related mail order wine sales.

For full strength liquor, the change in the taxation arrangements means a slight increase in the tax rate. However, once put on a comparable basis, the difference between the 15 per cent surcharge and the former Victorian licence fee is only 1.14 per cent for wine and 1.58 per cent for full strength beer and spirits. Accordingly, any price effects due to the on-passing of the excess surcharge is expected to be minimal.

Following a recent review of the operation of the liquor subsidy arrangements, the coverage of liquor payments will be extended to include wine stocks used for free tastings and other promotional purposes. Because these stocks are not 'sold', they were not caught by the former liquor franchise fee, which applied mainly at the retail level. Promotional liquor stock is, however, subject to Commonwealth wholesale sales tax and was therefore affected by the 15 per cent safety net surcharge.

The wine industry has argued that the provision of free stock for consumer wine tastings and for retailer education is essential to marketing and selling wine, since a large number of relatively small producers are producing a highly diversified product. In light of evidence put forward by the industry that the tax is a significant impost on business costs, the Government has decided to offset the 15 per cent wholesale sales tax surcharge on promotional wine stocks produced by holders of a Victorian vignerons licence. Provided adequate records are available, this measure will be backdated to 6 August 1997, the date from which the safety net surcharge was imposed.

In August 1997, Victoria undertook to make ex gratia payments to liquor licensees to cover the unexpired portion of their 1997 liquor licence fees as at 6 August 1997, when the replacement tax regime came into effect. This is at an estimated additional cost to the Budget of $52 million in 1997-98. By the end March 1998, some $50 million of these ex gratia payments had been disbursed.

Tobacco safety net

Initially, the safety net provided for tobacco franchise fees to be replaced by a $167 per kilogram surcharge on Commonwealth customs and excise duties on tobacco products. Following representations to the Commonwealth by major tobacco companies concerned that the replacement of *ad valorem* franchise fee with a weight based duty would give rise to windfall gains and losses within the industry, the weight based duty was replaced, for most tobacco products, by an *ad valorem* tax set at 50.32 per cent of final wholesale list prices. This was set in combination with a small weight based surcharge of $2.65 per kilogram.

Replacement tax rates for tobacco were set at a slightly higher rate than applied under the former State and Territory franchise fees. The additional revenues thereby generated are necessary to ensure that States and Territories whose former fuel franchise fee rates were higher than the 8.1 cpl safety net surcharge are not out of pocket. Nevertheless, the increase in the effective tax rate on tobacco products is relatively small (approximately 2.5 per cent) and has had only a minor impact on prices.

1997-98 safety net revenues

While safety net surcharge rates are expected to generate adequate ongoing revenues to compensate States and Territories for the loss of business franchise fees, revenues in 1997-98 will fall short of the original Budget estimate.

One reason is that timing differences between franchise fee collections and replacement tax collections have resulted in one-off revenue losses in 1997-98. These transitional timing losses will not recur in future years, but nor will they be recovered from future safety net collections.

Another reason is that tobacco collections in 1997-98 are likely to fall well short of budgeted estimates due to actions taken by tobacco manufacturers/importers at the time of the High Court decision to bring forward bond clearances of stocks that would otherwise have been subject to the excise surcharge imposed from 6 August 1997. These actions led to losses estimated at $200 million for the States and Territories combined, of which Victoria's share would have been $43 million.

Deferral of approximately one month's fuel surcharge collections as a result of arrangements entered into with oil companies at the start of the safety net arrangements will also mean the loss of one month of net cash collections (worth approximately $32 million for Victoria) in 1997-98 only. However, this loss has been recognised in the revised 1997-98 Budget estimates on an accrual basis, as it is expected to be recovered when the safety net arrangements are eventually terminated.

Future of safety net arrangements

The business franchise fee safety net arrangements are temporary, pending the development of longer term revenue replacement options arising from national tax reform. It is expected that the safety net will remain in place at least until the end of the 1998-99 financial year. States and Territories are currently discussing with the Commonwealth the basis of the distribution of safety net revenues for 1998-99 and future years. Pending finalisation of these discussions, the estimates in this Budget assume the same distribution formula as applied in 1997-98.

'Mirror' State taxes at Commonwealth places

A further significant development in 1997-98 was the resolution of the future collection of State taxes imposed on activities conducted at Commonwealth places. There had been uncertainty surrounding the status of State taxes at Commonwealth places since 6 November 1996 when the High Court ruled in the *Allders* case[3] that Victorian lease duty applied to a lease agreement at Melbourne airport was invalid under Section 52(i) of the Commonwealth Constitution. This decision cast some doubt on the constitutional validity of other State taxes applied to activities conducted at Commonwealth places.

Advised that there were insurmountable constitutional impediments to the removal of restrictions on them imposing taxes on business located at these places, the States asked the Commonwealth to legislate to ensure that the same State taxation obligations apply to these as other businesses. Three primary concerns underpinned this request:

- the need to ensure neutrality in the tax treatment of businesses, regardless of where within the State those businesses were conducted;
- the need to prevent Commonwealth places becoming 'tax-free havens' with respect to State taxes; and
- the need to protect State revenues, past and future.

States were particularly concerned that, unless action was taken by the Commonwealth, businesses located at Commonwealth places would be provided with significant tax advantages. Not only would the situation be inequitable, it would also distort business location decisions. Clearly neither of these effects would be in the national interest. With the privatisation of Commonwealth airports and the increasing trend towards privatisation or contracting out of a range of functions carried out at other Commonwealth places, States were also concerned that the situation could eventually lead to significant revenue loss.

Accepting the States' arguments, the Commonwealth, on 6 October 1997, announced its intention to legislate to apply State stamp duty, payroll tax, financial institutions duty and debits tax on businesses operating in or on Commonwealth places and to return the revenues thereby generated to the State in which the taxes were collected. The Commonwealth also announced that it would also legislate as necessary to apply any other State tax found to be invalid as a result of S52(i), and to impose a 100 per cent windfall gains tax on any refunds of State taxes where the refund was sought on the basis of the

[3] *Allders International Pty Ltd* v *Commissioner of State Revenue* (1996), 140 ALR 189.

constitutional invalidity of tax on a Commonwealth place. All of these measures were to apply as of 6 October 1997.

On 5 March 1998, the Commonwealth introduced legislation to ‘mirror’ in Commonwealth places the taxes and thresholds of the States in which the Commonwealth place is located. In this way, each State Government will continue to determine the taxes applying in these places in their States. Amendments to Victorian statutes to facilitate collection of ‘mirror’ taxes at Commonwealth places are expected to be introduced in the Spring 1998 Session of Parliament.

Arrangements for the collection of Commonwealth ‘mirror’ taxes are to be the subject of bi-lateral agreements between the Commonwealth and each State. Victoria will continue to work closely with the Commonwealth and with revenue collection agencies in other States to ensure a seamless application of ‘mirror’ taxes on behalf of the taxpayer.

National tax reform: implications for State taxes

The loss of State and Territory business franchise fees has further narrowed the tax bases of the States and significantly worsened Australia’s already unacceptable degree of vertical fiscal imbalance. This has served to highlight the need for a new allocation of tax powers in the Australian federal system. It is essential that States and Territories have real control over their own income in order to overcome the adverse effects of fiscal imbalance.

On 13 August 1997, the Prime Minister announced the establishment of a task force to advise on national tax reform in accordance with the following principles:

- there should be no increase in the overall tax burden;
- any new taxation system should involve major reductions in personal income tax with special regard to the taxation treatment of families;
- consideration should be given to a broad-based indirect tax to replace some or all of the existing indirect taxes;
- there should be appropriate compensation for those deserving of special consideration; and
- reform of Commonwealth/State financial relations must be addressed.

Victoria welcomes the Commonwealth's commitment to national tax reform and, in particular, to reform of indirect taxes and of Commonwealth-State financial relations. Genuine national tax reform must incorporate reform of State as well as Commonwealth indirect taxes. It is now widely recognised that a number of State taxes - particularly those imposed on financial and capital transactions - are narrowly based, inequitable and significantly impede Australia's international competitiveness.

Victoria would be prepared to consider abolishing some of its more inefficient taxes in return for gaining access to a share of the personal income tax base. This would be achieved by the Commonwealth lowering its share of personal income tax to allow States to levy a surcharge, with no overall increase in income tax rates. Access to such a tax base would allow State revenues to grow in line with growth in the economy and the population – the same factors which drive demand for the services which form the State's major expenditure responsibilities. It would also provide a replacement for the States' loss of business franchise fees and could be used to reduce their dependence on Commonwealth grants, thus improving the balance between the States' taxing and spending responsibilities.

Revised 1997-98 Budget outlook

Own-source revenues

Revenue from State sources is expected to total $11 475.3 million in 1997-98 compared to the April 1997 Budget estimate of $11 292.3 million - a variance of $183 million.

Taxes, fees and fines

Excluding privatisation receipts, total revenue from taxes, fees and fines is expected to be \$8 549.5 million in 1997-98, \$47 million (or 0.5 per cent) below the 1997-98 Budget projection (see Table 5.6). This results from significant but broadly offsetting variances in key revenue lines.

These have involved some large downward adjustments, in particular:

- one-off losses of \$155 million in safety net revenues due to transitional effects in the switch from business franchise fees to replacement tax collections;
- the abolition of the public authority contribution from December 1997, representing a reduction in taxation receipts of \$201.4 million in 1997-98 (but largely offset by an increase in public authority income); and
- a \$72 million reduction in forecast revenues from land tax reflecting the major package of land tax reforms announced in November 1997, combined with the effects of some re-valuations.

They have also involved offsetting gains, in particular from:–

- a strengthening property market, with receipts from conveyancing duty expected to exceed the April Budget estimate by \$262.5 million; and
- stronger than forecast growth in gambling taxes, now running some \$51.2 million above Budget, mainly due to higher use of electronic gaming machines (EGMs).

Table 5.6: Taxes, Fees and Fines 1997-98

	$ million 1997-98 Budget Estimate	1997-98 Revised Estimate	Variation from Budget $	Variation from Budget %
Employers' payroll taxes	2 189.6	2 180.0	- 9.6	-0.4
Taxes on property	2 055.6	2 273.9	218.3	10.6
Public authority contribution	333.0	131.6	- 201.4	-60.5
Gambling taxes	1 238.8	1 290.0	51.2	4.1
Taxes on insurance	342.0	347.1	5.1	1.5
Motor vehicle taxes	824.2	851.1	26.9	3.3
Safety net revenues	1 242.9	1 087.8	- 155.0	-12.5
Other taxes, fees and fines	370.7	403.2	32.5	8.8
Total Taxes, Fees and Fines	**8 596.7**	**8 564.6**	**- 32.0**	**-0.4**
Less Privatisation proceeds		*15.1*	15.1	
Total Taxes, Fees and Fines excluding privatisation	**8 596.7**	**8 549.5**	**- 47.1**	**-0.5**

Source: Department of Treasury and Finance.

Note:
1997-98 Budget estimates for business franchise fees on tobacco, liquor and petroleum; 1997-98 Revised estimates incorporate franchise fee collections to 5 August 1997 and thereafter replacement revenues under safety net arrangements.

The property market upturn which commenced in calendar year 1997 has continued to strengthen into calendar year 1998, with strong rises in both price and volume flowing through to buoyant conveyancing duty revenues. The growth in activity is predominantly in the residential and smaller commercial and industrial property market segments. The larger commercial and industrial segments are broadly on track with budget expectations. The current upturn has been aided by continued improvements in housing affordability following two further interest rate reductions since the April 1997 Budget.

Marketable securities stamp duties are also expected to exceed the 1997-98 Budget estimate due to:

- significant off-market sales by an overseas holding company;
- very high turnover associated with the sharp share market correction in late October; and
- secondary trading in Telstra shares following the November float.

Gambling taxes are running some $51.2 million (or 4.1 per cent) ahead of Budget mainly due to higher than expected use of EGMs and a recovery in racing taxes following vigorous marketing by the racing industry.

Increased current market demand, particularly for lower priced imported vehicles, combined with increased availability of finance, have contributed to higher motor vehicle taxes which are up some $26.9 million (or 3.3 per cent) against the Budget estimate.

On the other hand, projected safety net revenues are expected to fall some $155 million short of the Budget forecast. As noted earlier, this reflects the one-off losses associated with changes to the timing of tax collections on liquor, tobacco and petroleum, plus actions by tobacco companies to minimise their tax liabilities at the time of the change in taxation arrangements. The $155 million shortfall includes $52 million in ex gratia payments to liquor licensees to cover the unexpired portion of their 1997 liquor licence fees.

Revenues from land tax are expected to fall some $72 million short of the Budget forecast as a consequence of the package of reforms announced in November 1997 which included both rate relief and the introduction of a principal place of residence exemption. The downward adjustment to land tax receipts also includes falls in valuations of some higher valued properties.

The abolition of the public authority contribution with effect from 11 December 1997, as part of the restructuring of the gas industry, has necessitated a large ($201.4 million) downward adjustment to taxes, fees and fines. However, this will be largely offset by higher public authority dividend payments from GASCOR and its successor entities.

Inclusion of an additional $15 million in privatisation-related taxation receipts (which includes $10 million in stamp duty from the sale of PowerNet Victoria) brings the revised 1997-98 estimate of revenue from taxes, fees and fines including privatisation proceeds to $8 564.6 million.

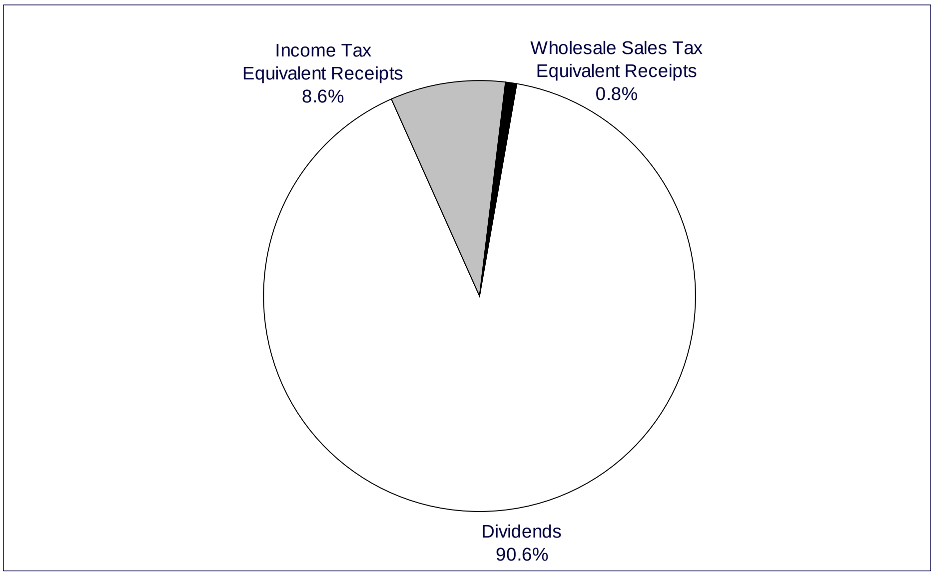
Public authority income

Public authority income includes dividends and tax equivalent payments by public authorities, but excludes electricity franchise fees and licence fees from GPU PowerNet (the new owner of PowerNet Victoria) and the Financial Accommodation Levy, which are classified as taxes, fees and fines.

Dividends paid by public authorities are anticipated to account for 90.6 per cent of public authority income in 1997-98 (see Chart 5.4). The payment of dividends by government business enterprises (GBEs) recognises that equity capital has alternative uses and therefore an appropriate return should be paid to the State for its investment in the GBE.

The remaining public authority income is in the form of income tax equivalent payments (8.6 per cent) and wholesale sales tax equivalent payments (0.8 per cent). The Victorian tax equivalent system ensures the competitive neutrality of GBEs with competing private sector firms and strengthens the financial discipline on GBEs by factoring income and wholesale sales tax equivalent payments into their business decisions.

Chart 5.4: Composition of Public Authority Income, 1997-98 *(a)*



Source: Department of Treasury and Finance.

Note:
(a) 1997-98 Revised estimates excluding privatisation effects.

Public authority income is estimated to be $1 123.4 million in 1997-98 ($944.8 million after excluding privatisation receipts). This is $439.9 million more than the 1997-98 Budget estimate.

Table 5.7: Public Authority Income 1997-98

$ million	*1997-98 Budget Estimate*	*1997-98 Revised Estimate*	*Variation from Budget*	*Variation from Budget (%)*
Dividends	556.7	856.0	299.3	53.8
Income Tax Equivalent Payments	116.7	259.9	143.2	122.6
Wholesale Sales Tax Payments	10.1	7.5	- 2.6	(25.4)
Total Public Authority Income	**683.5**	**1 123.4**	**439.9**	**64.4**
Less Privatisation Proceeds		178.7	178.7	
Total Public Authority Income excluding privatisation	683.5	944.8	261.2	38.2

Source: Department of Treasury and Finance.

The higher than expected increase in public authority income (excluding privatisation receipts) is due to structural changes in the Victorian gas industry and revised estimates of profitability from a number of GBEs. Increases in some items are expected to be partly offset by decreases in other items.

Reforms to the Victorian gas industry have resulted in the repeal of the former public authority contribution (PAC) from 11 December 1997. This has resulted in a downward adjustment to taxes, fees and fines. However, this will be largely offset by increased dividends from the gas industry. Chapter 8 contains further details on reforms in the gas industry.

Proceeds from privatisations accounted for $178.7 million – comprising increased tax equivalent receipts of $170.4 million resulting from the sale of PowerNet Victoria and $8.3 million from the sale of Southern Hydro Limited.

Other revisions to public authority income relative to the original Budget estimate are due to:

- strong profitability by the water sector in the first half of 1997-98 which led to increased distributions of $43 million;
- the incorporation of Aluvic into Victoria's tax equivalent regime and therefore its liability for tax equivalent payments for the first time; and
- increased distributions of $55 million from the Transport Accident Commission as a result of increased profitability.

Sales of goods and services

Receipts from sales of goods and services include user charges levied by TAFE colleges, public hospitals, and schools. Estimated receipts for 1997-98 have been revised down by $27.0 million to $1 703.3 million. This largely reflects the change in revenue arrangements associated with the restructure of the Building Services Agency. There has been a commensurate decrease in associated operating expenses.

Outlook for own-source revenues

After allowing for the tax cuts announced in this Budget, revenue from all State sources (including sales of goods and services) is projected to increase to $11 641.4 million in 1998-99, an increase of $166.1 million or 1.4 per cent on the revised 1997-98 estimate of $11 475.3 million. Over the forward estimates period to 2001-02, own source revenues average growth of just less than 1 per cent per annum. This apparently subdued outlook largely reflects the expected return of property market activity to longer term trend levels, together with the phasing out of electricity franchise fees and a decline in gas utility distributions as energy markets are exposed to full competition.

1998-99 Budget estimates of taxes, fees and fines

Excluding the effects of abolition of the public authority contribution, which is largely offset by an increase in gas utility dividends, the unchanged policy outlook for taxes, fees and fines is for growth of 5.2 per cent in 1998-99. The effects of this year's tax cuts reduces this growth to 3.8 per cent.

The forecasts assume that payroll tax and insurance duty receipts will grow broadly in line with the economy. But for the effect of the $42 million in conveyance duty relief, receipts from land transfers would have been set to rise again in the coming year, with the current buoyancy in the property market expected to peak during 1998-99 following the very strong growth recorded in the first nine months of 1997-98.

After several years of very rapid growth in gambling taxes – particularly from EGMs and the casino – the Budget projection is for growth to moderate and become more evenly dispersed across the gambling industry as the market matures.

Motor vehicle taxes are expected to continue to grow, reflecting increased market demand, particularly for smaller and relatively cheaper vehicles, combined with the increased availability of financing.

Table 5.8: Taxes, Fees and Fines, Estimates, 1998-99 to 2001-02

$ million

	1998-99 Budget Estimate	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*

Employers' payroll taxes	2 236.0	2 341.8	2 482.4	2 628.4
Taxes on property	2 297.3	2 273.9	2 262.5	2 253.6
Gambling taxes	1 341.3	1 368.7	1 418.6	1 470.8
Taxes on insurance	364.3	382.2	403.3	424.7
Motor vehicle taxes	871.3	899.1	949.4	996.7
Safety net revenues	1 270.7	1 297.5	1 328.0	1 360.0
Other taxes, fees and fines	353.2	368.3	274.2	206.2
Total Taxes, Fees and Fines	**8 734.1**	**8 931.4**	**9 118.4**	**9 340.5**

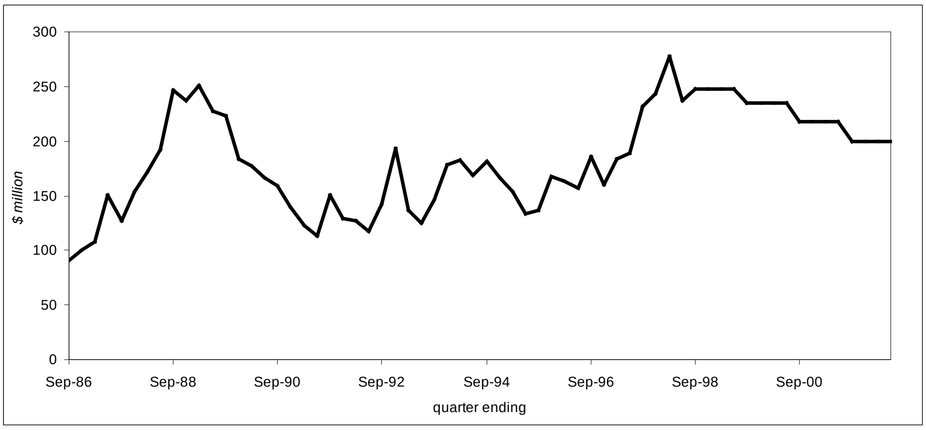
Source: Department of Treasury and Finance.

Forward estimates of taxes, fees and fines: 1999-00 to 2001-02

Revenue from taxes, fees and fines is expected to increase at an average annual rate of just 2.3 per cent over the three years 1999-00 to 2001-02, well below annual growth of 5.4 per cent projected for nominal GSP over the same period.

The major influence on the projected trend is the expected return of property market activity to more normal levels over the course of the next four years. As shown in Chart 5.5, conveyance duty receipts are set to peak during 1998-99 and thereafter to fall in each of the out-years. However, unlike the 1980s property boom, which was followed by a collapse in both prices and sales lasting a number of years, the downturn from the current property boom is expected to be more gradual and to stabilise at higher activity levels than seen in the first half of the 1990s.

Chart 5.5: Conveyance Duty Quarterly Receipts (excluding privatisation)



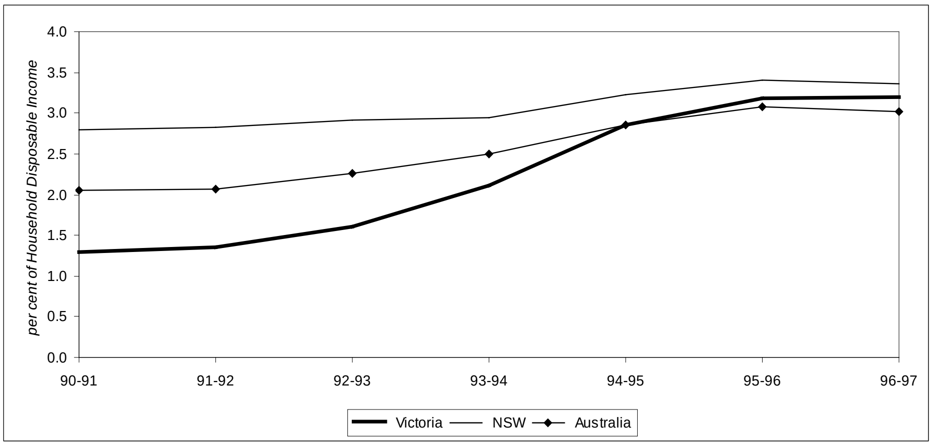
Source: Department of Treasury and Finance.

Other factors making for relatively slow growth in taxes fees and fines over the next four years include the phasing out of electricity franchise fees as full competition is introduced into electricity markets and very slow projected growth in financial taxes.

There will also be a moderation in growth in gambling taxes. Over recent years, there have been significant changes to the gambling industry with the introduction of EGMs in mid-1992, the subsequent expansion of the network, and the opening of the temporary casino in June 1994 and the permanent casino in May 1997. Reflecting these changes, as evidenced by Chart 5.6, gambling expenditure as a proportion of household disposable income in Victoria grew from well below the national average in 1992 to just over the average by 1995-96. By 1996-97, this growth had begun to moderate and stabilise at expenditure levels below those in New South Wales. The essential structure of the gambling industry is now in place and, with the current ceiling of 27 500 on the number of EGMs recently confirmed, no further major changes are expected in either 1998-99 or the forward estimate period. While recent developments in East Asia are expected to have some impact on casino premium player activity, it is unlikely to have a significant impact on the overall gambling taxes estimate.

While some taxes are growing more slowly, or declining, others grow broadly in line with the economy. Payroll tax receipts are projected to grow at an annual average rate of around 5½ per cent, broadly in line with growth in nominal GSP. Growth in motor vehicle taxes is expected to average 4.6 per cent per year, although growth rates will fluctuate during the forecast period. Based on projections supplied by the Commonwealth, safety net revenues net of subsidies are expected to average growth of around 2.3 per cent per annum.

Chart 5.6: Gambling Expenditure as a percentage of Household Disposal Income



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

1998-99 Budget estimates of public authority income

Public authority income for 1998-99 is estimated to be $940.5 million. This is a fall of only $4.2 million against the revised, privatisation adjusted 1997-98 estimate.

The small movement in aggregate public authority income is the result of a number of offsetting variations within government business enterprises in different industry sectors.

Significantly, total distributions from the metropolitan water sector are estimated to decrease by some $196 million in 1998-99 compared to 1997-98. In October 1997 the Government introduced a package of pricing reforms to the metropolitan water sector. These reforms, which will deliver an average 18 per cent reduction in bills to over 85 per cent of domestic properties, will impact on future distributions to the Government.

The change from basing metropolitan water bills more on usage than on property values, benefits customers by giving them greater control over their total water bills. However, future revenues to the metropolitan water retailers will be more sensitive to climatic conditions. The forward estimates of distributions to Government have been calculated on the basis of anticipated consumption patterns in an average year.

On the other hand, as discussed earlier, reforms in the Victorian gas sector have resulted in the abolition of the public authority contribution and this will be largely offset by higher dividends classified as public authority income.

Forward estimates of public authority income: 1999-00 to 2001-02

The forward estimates for the period 1999-00 to 2001-02 continue to reflect the fact that most of the electricity businesses have now been privatised (Generation Victoria being the only electricity utility remaining in Government ownership). It is therefore anticipated that there will be no further substantial distributions from this sector.

Table 5.9: Public Authority Income Estimates, 1998-99 to 2001-02

$ million

	1998-99 Budget	*1999-00 Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Dividends	810.0	749.7	745.9	541.8
Income Tax Equivalent Receipts	122.7	105.7	110.3	115.9
Wholesale Sales Tax Equivalent Receipts	7.8	7.5	7.5	7.5
Total Public Authority Income (excl. privatisation receipts)	**940.5**	**862.9**	**863.6**	**665.2**

Source: Department of Treasury and Finance.

Public authority income is expected to remain at around $860 million for 1999-00 and 2000-01 and then decrease to $665 million in 2001-02. This decrease is due to an expected reduction in gas authority dividends following changes under existing gas supply arrangements and the introduction of full competition into the gas market from 2000-01.

1998-99 Budget estimates and forward estimates of other revenues

Sales of goods and services are projected to increase to $1 744.8 million in 1998-99 and thereafter to grow at an average annual rate of 0.3 per cent.

Other revenues, comprising mainly rent on Crown leases, coal and forest royalties and interest received, are projected to remain relatively static at just over $200 million per annum throughout the forward estimates period. The projected fall in other revenues from 1997-98 to 1998-99 results from a one-off transaction in 1997-98 when, as the result of the sale of Southern Hydro, former SECV towns were transferred to the budget sector for public recreation use. This transfer has been reflected in a one-off increase in operating revenue of $67.7 million in 1997-98. The non-recurrence of this item in 1998-99 will see other revenues fall back to normal levels.

Chapter 6: Asset and Liability Management

Introduction

On 27 March 1998, Standard & Poor's (S&P) announced that it was placing Victoria's local currency rating of AA+ on CreditWatch Positive. S&P stated that this decision reflected the moderate and still falling levels of the Victorian Government's debt burden, the 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 recent developments in East Asia. It was noted that should these positive financial and economic trends be affirmed in the Budget, a rating upgrade is likely.

Asset and liability management advanced significantly when fully audited financial statements for the State of Victoria were tabled in Parliament for the first time in October 1997. These statements were prepared on a full accrual accounting basis which enables better asset management and more transparent Government decision making.

Asset management

The State's audited balance sheet shows that the public sector had total assets of $71.5 billion as at 30 June 1997. All State assets are now recognised, reliably measured and recorded.

As at 30 June 1997 the public sector had $53 billion in non-current physical assets, of which:

- $20.5 billion was in land and buildings (38 per cent);
- $18.9 billion in plant and equipment (36 per cent);
- $12.1 billion in roads (23 per cent); and
- $1.6 billion in other assets including works of art, museum collections and rare book collections.

The Management Reform Program and recent changes to legislation will, for the first time, implement accrual output-based budgeting for the Budget Sector. This will result in improved asset management for the State. The ongoing financial management reforms are designed to sensitise managers to the costs of capital, provide a setting for alternative means of delivering services and provide the basis for sustained fiscal responsibility for the State.

Liability management

The continued use of privatisation proceeds and budget surpluses for reduction of net debt and other liabilities has enabled further significant reductions in Victoria's public sector liabilities, and in its public sector net debt and debt servicing ratios during 1997-98. As a result, Victoria's long-term goal of reducing debt and debt servicing ratios to levels consistent with those of other triple-A rated Australian States has now been achieved.

The ratio of Victoria's State Government sector net debt to gross state product (GSP), estimated to reach 7.3 per cent by 30 June 1998, is now substantially below those of Western Australia and New South Wales, last reported at 30 June 1997 at 12.9 per cent and 10.4 per cent respectively.

Over the past three years, more than 65 per cent of Victoria's public sector net debt has been repaid. Since 30 June 1995, public sector net debt has fallen by $21.4 billion and will fall to an estimated $11.1 billion by 30 June 1998. Public sector net debt has fallen from $7 208 per person in 1995 to only $2 389 per person in 1998: a significant achievement for the community.

Most of the reduction in public sector debt during 1997-98 occurred in the budget sector where net debt is expected to fall by a net of $1.9 billion after allowing for the assumption of $850 million of debt by the Budget sector from the Metropolitan Water Authorities. Budget sector net debt is expected to fall from $10.6 billion at 30 June 1997 to $8.7 billion by 30 June 1998.

Victoria's interest burden has also continued to fall. Budget sector interest paid, forecast to be $806.3 million in 1998-99, is projected to absorb just 5.1 per cent of revenue and current grants in 1998-99, less than half of the 12.4 per cent required in 1995-96.

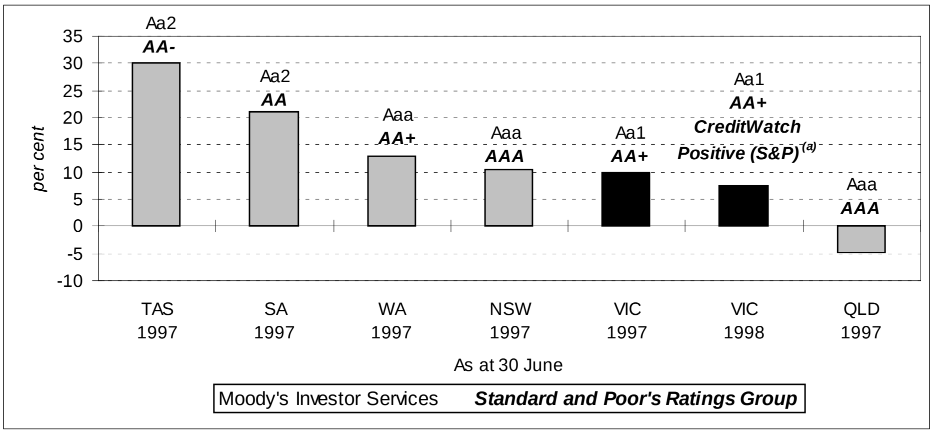
Credit rating status: Aa1/AA+

Victoria's current long-term rating of AA+ CreditWatch Positive from S&P and Aa1 from Moody's Investors Service, recognises the substantial fiscal and financial improvements made in Victoria and the Government's continuing commitment to reform.

Victoria's ratings are now just one rung below the Government's objective of triple-A. Achievement of this rating will depend on the rating agencies' assessment of the State's commitment to reform and the ability of the Budget to accommodate cyclical economic downturns.

Chart 6.1 shows the improvement in the ratio of Victoria's State Government net debt to GSP between 30 June 1997 and 30 June 1998, and compares the current rating status and net debt position as at 30 June 1997 for other Australian States.

Chart 6.1: Comparison of State Government Net Debt to Gross State Product and Current Australian State Ratings



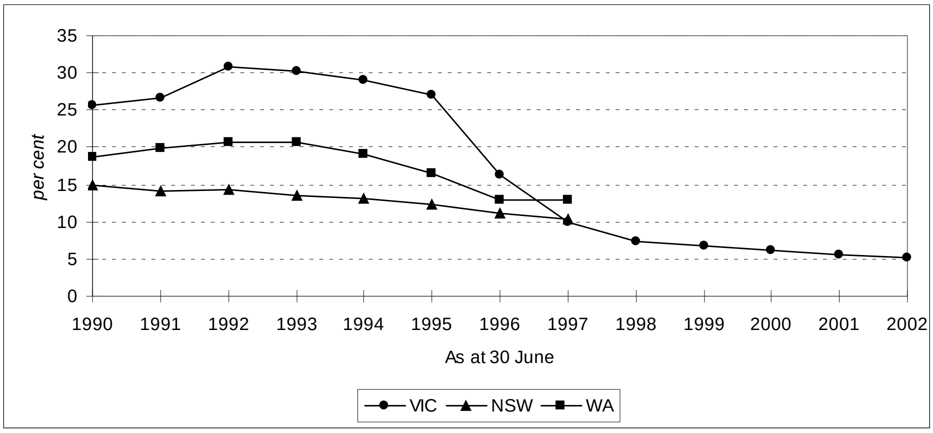
Sources: Australian Bureau of Statistics, Cat. No. 5513.0 & Cat. No. 5242.0; Department of Treasury and Finance.

Note:

(a) Victoria was placed on CreditWatch Positive on 27 March 1998 by Standard & Poor's.

Chart 6.2 shows that the ratio of Victoria's State Government net debt to GSP, is now well within the range of the triple-A rated States.

Chart 6.2: State Government Net Debt to Gross State Product Comparison with triple-A rated States



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

Use of privatisation proceeds

As a result of the sale of PowerNet Victoria and Southern Hydro, cash proceeds totalling $2 946 million were received from privatisations in 1997-98. Of this amount, $796 million has been used to repay the debt of the privatised companies held by the Treasury Corporation of Victoria (TCV).

$1 742 million has been used to repay budget sector debt and $63 million has been used to meet privatisation and reform expenses and associated payments to Goulburn Murray Water. The remaining $345 million has been invested in liquid financial assets.

The net financial benefit to the budget sector and SECV Shell, after adjustments for revenue forgone from privatised entities, is calculated to be around $762 million for 1998-99.

The forward estimates do not include the use of future expected privatisation proceeds for the reduction of either debt or other liabilities.

Asset management

Since 1993 a series of management improvement initiatives have been introduced to improve the management of the State's assets. These were made as part of a long-term strategy based on five principles.

The fundamental principle is that service delivery needs to guide asset practices and decisions so that the best, most efficient services are provided to taxpayers in ways that most meet their needs. This means public sector managers should have the information and incentives available to them to maintain assets adequately or dispose of them depending on the service objectives of the organisation and the needs of its clients.

The supporting principles are:

- that asset planning and management is integrated with corporate and business plans, and budgetary and reporting processes;
- that asset management decisions are based on the evaluation of alternatives, taking into account the full life-cycle costs, benefits and risks of assets;
- that ownership, control, accountability and reporting requirements for assets be established, clearly communicated and implemented; and
- that asset management activities are undertaken within an integrated Government asset management policy framework.

Impact of management reform on asset management

A thorough approach to asset management ensures that both the costs and risks associated with holding assets are assessed.

The cost of holding and maintaining assets is reflected in the Capital Assets Charge (CAC) charged to budget sector agencies, generally imposed on the written-down values of non-current physical assets. The rate of the CAC has generally been set at 8 per cent for 1998-99.

The CAC replaced the Interim Capital Charge that was introduced in the 1994-95 budget and applied only to new capital expenditure. The cost of capital imposed through the CAC is distributed across outputs funded by Government. In this manner departments will be able to benchmark the costs of service against other jurisdictions and sectors. Such comparisons enable reconfiguration of the capital used in the production of these outputs and allow consideration of services being provided by non-public sector agencies.

Because all of the State’s assets have been recognised, reliably measured and recorded, thorough asset management can now take place. With robust valuation and depreciation regimes, expenses attributable to depreciation are incorporated in the cost of production and hence the prices paid by Government for services purchased. By establishing the full cost of services, alternative methods of providing services can be benchmarked and considered. Full costing is also a prerequisite for implementing a competitive neutrality policy. Capital investment decisions can be better evaluated in relation to their contribution to service delivery along with full costing of services and the costs of assets.

Monitoring of the asset registers of departments and participating bodies is being undertaken by the Victorian Managed Insurance Authority (VMIA) which was established in 1996 to assist departments identify, quantify and manage risks. By underwriting assets against risk, the VMIA helps the management reform process to attach a cost to carrying assets of a particular type and use.

Public and budget sector assets

During 1996-97 the State objective was to value all material non-current physical assets. Written down replacement costs were determined independently by accredited valuers using approved valuation processes in accordance with government policy.

Charts 6.3 and 6.4 show the asset profiles of the public and budget sectors. As at 30 June 1997, non-current physical assets for the public sector totalled $53 billion. Of this, the State held $20.5 billion in land and buildings, $18.9 billion in plant and equipment, $12.1 billion in roads and $1.6 billion in other assets including works of art, museum collections and rare book collections. Non-current physical assets for the budget sector totalled $26.3 billion as at 30 June 1997, and comprised primarily roads (47 per cent) and land and buildings (42 per cent).

Chart 6.3 Public Sector Assets

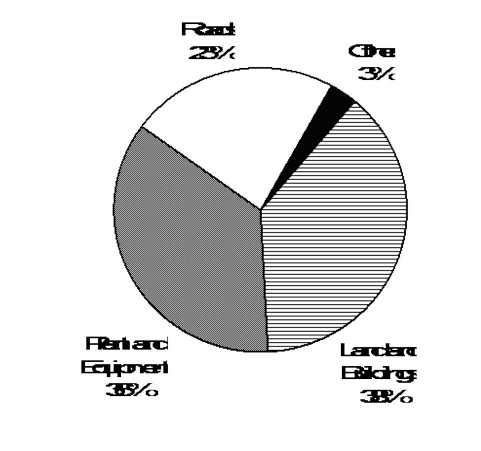
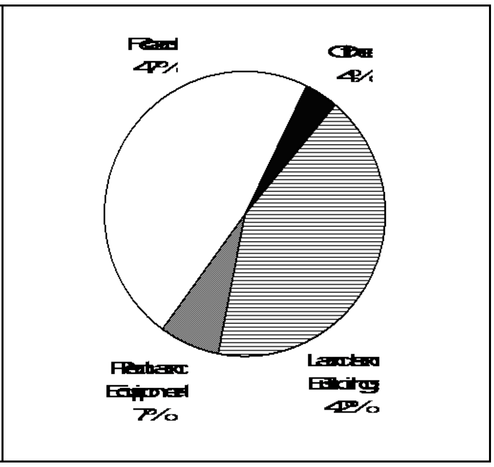


Chart 6.4 Budget Sector Assets



Source: Financial Statements for the State of Victoria, 1996-97.

Total financial liability status and outlook

The main components of the State's total net financial liabilities are debt and unfunded superannuation liabilities. Other liabilities include payables, accrued expenses and other employee entitlements, less receivables and prepaid expenses (see Table 6.1 and Chart 6.5).

Victoria's total net financial liabilities have fallen by 37 per cent, from $53.7 billion at 30 June 1995 to an expected $33.6 billion by 30 June 1998.

During 1997-98, public sector net debt is estimated to have fallen by $3.2 billion, while superannuation liabilities are estimated to have increased by $0.3 billion. Superannuation liabilities, projected to be $15.9 billion as at 30 June 1998, will exceed public sector net debt obligations of $11.1 billion by $4.8 billion.

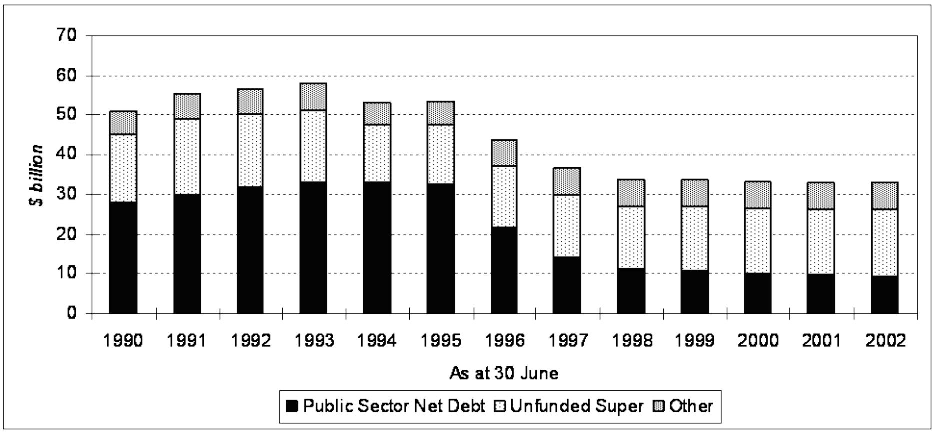
Table 6.1: Public Sector Net Financial Liabilities[(a)]

	1997 Actual	1998 Estimate	1999 Estimate	2000 Estimate	2001 Estimate	2002 Estimate
	As at 30 June					
	$ billion					
Public Sector Net Debt	14.3	11.1	10.9	10.3	9.8	9.5
Unfunded superannuation	15.6	15.9	16.1	16.4	16.6	16.7
Other	6.7	6.7	6.7	6.7	6.7	6.7
Total liabilities	**36.6**	**33.6**	**33.8**	**33.4**	**33.1**	**33.0**
	per cent					
Liabilities to GSP	27.7	24.1	22.9	21.5	20.2	19.0

Source: Department of Treasury and Finance.

Note:
(a) Net liabilities equals total liabilities, less financial assets.

Chart 6.5: Public Sector Net Financial Liabilities



Source: Department of Treasury and Finance.

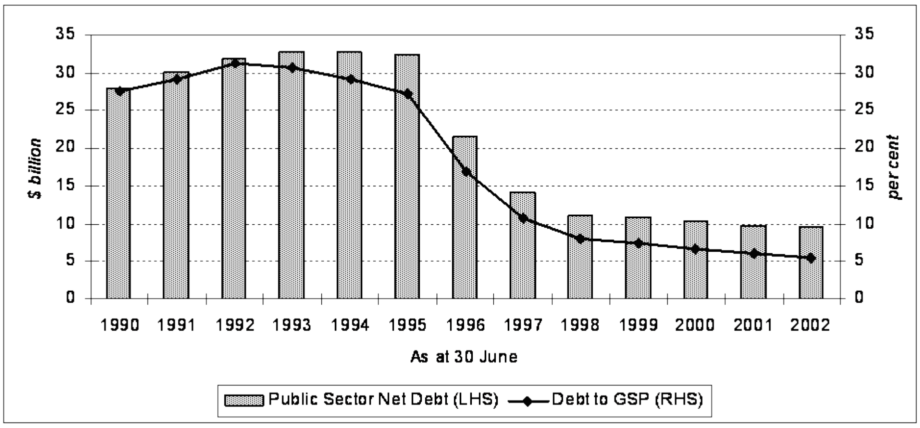
The forward estimates do not include the use of future expected privatisation proceeds for the reduction of either debt or other liabilities. However, they do include the impact of projected budget surpluses. Over the next four years, with no further privatisations included, the pace of debt reduction will moderate and will be offset by modest growth in unfunded superannuation liabilities. On this basis, the State's total net financial liabilities are expected to plateau at around $33.0 billion in the period to June 2002 and will continue to decline as a per cent of GSP.

Debt and interest paid status and outlook

Public sector

Public sector net debt has declined by more than 65 per cent since 1995 (see Chart 6.6). It will have fallen by $21.4 billion from $32.5 billion at 30 June 1995 to an estimated $11.1 billion by 30 June 1998. Assuming no further privatisations, it is expected to reach $9.5 billion by 30 June 2002.

Chart 6.6: Public Sector Net Debt*[(a)]*



Source: Department of Treasury and Finance.

Note:
(a) Public sector net debt equals budget sector net debt, plus non-budget sector net debt, less inter-sectoral advances.

The ratio of public sector net debt to GSP will fall from 10.8 per cent at 30 June 1997, to an estimated 7.9 per cent at 30 June 1998, and is expected to decline to 5.5 per cent by 30 June 2002. Public sector net debt includes the debt of budget and non-budget sector entities, but excludes the debt of public financial enterprises such as TCV and the Rural Finance Corporation.

Budget sector

The majority of the reduction in public sector debt during 1997-98 occurred in the budget sector. Budget sector net debt is expected to fall from $10.6 billion at 30 June 1997 to an estimated $8.7 billion by 30 June 1998 (see Chart 6.7). Assuming no further privatisations, budget sector net debt is expected to fall to $7.2 billion by 30 June 2002, as a result of estimated cash budget surpluses applied to debt reduction over the forecast period.

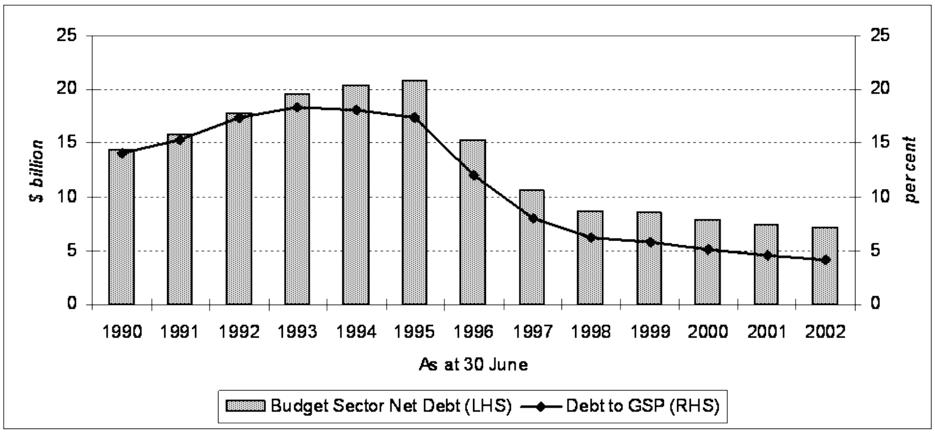
Table 6.2: Net Debt and Net Debt to Gross State Product Ratios

	As at 30 June					
	1997 Actual	*1998 Estimate*	*1999 Estimate*	*2000 Estimate*	*2001 Estimate*	*2002 Estimate*
			$ billion			
Public Sector Net Debt	14.3	11.1	10.9	10.3	9.8	9.5
Budget Sector Net Debt	10.6	8.7	8.5	7.9	7.4	7.2
			per cent			
Public Sector Net Debt to GSP	10.8	7.9	7.4	6.6	6.0	5.5
Budget Sector Net Debt to GSP	8.0	6.2	5.8	5.1	4.5	4.1

Source: Department of Treasury and Finance.

The ratio of budget sector net debt to GSP should fall from 6.2 per cent at 30 June 1998, to 4.1 per cent by 30 June 2002 (see Table 6.2).

Chart 6.7: Budget Sector Net Debt



Source: Department of Treasury and Finance.

Budget sector interest payments should fall from an estimated $821.3 million in 1997-98 to $806.3 million in 1998-99 as a result of the significant debt reductions achieved (see Table 6.3 and Chart 6.8). Interest, as a percentage of cash revenue and current grants, is expected to remain constant at 5.1 per cent in 1997-98 and 1998-99 and is expected to fall to 4.0 per cent by 2001-02.

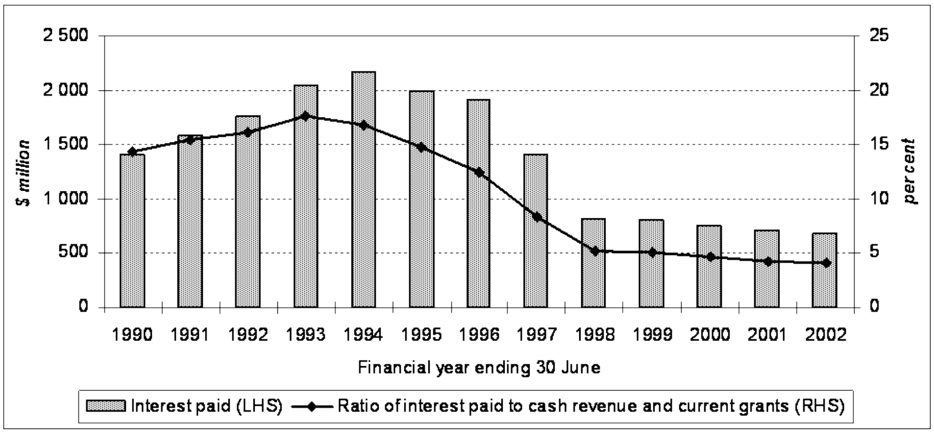
On an accrual basis, budget sector interest expense for 1997-98 is estimated to be $821.3 million and is forecast to fall to $806.3 million for 1998-99. Interest expense as a percentage of total accrual revenue is estimated to fall from 4.4 per cent in 1997-98 to 4.3 per cent in 1998-99.

Table 6.3: Budget Sector Interest Payments [(a)]

	Financial year ending 30 June					
	1997	*1998*	*1999*	*2000*	*2001*	*2002*
	Actual	*Estimate*	*Estimate*	*Estimate*	*Estimate*	*Estimate*
			$ million			
Interest Paid (cash)	1 400.5	821.3	806.3	754.6	706.4	684.2
			per cent			
Ratio of interest paid to cash revenue and current grants[(b)]	8.3	5.1	5.1	4.6	4.2	4.0

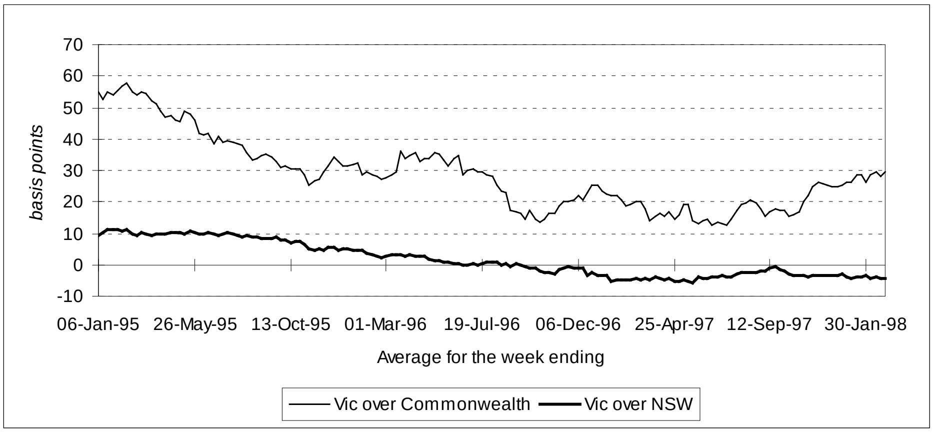
Source: Department of Treasury and Finance.
Note:
(a) In future years, the ratios will be calculated on an accrual basis.
(b) Revenue and current grants exclude grants for on-passing.

Chart 6.8: Budget Sector Interest Payments



Source: Department of Treasury and Finance.

Chart 6.9: Victorian Borrowing Margins Over Commonwealth and New South Wales Ten-Year Bonds



Source: Bloomberg.

A significant benefit of the reduction in Victoria's debt has been the lower borrowing margins achieved by TCV over the past two years. This reduction is best demonstrated by comparing the margin between the yields of Victorian ten-year bonds and those of Commonwealth and New South Wales ten-year bonds (see Chart 6.9). Since August 1996, Victoria's borrowing margins have been maintained in a stable range of 15 to 30 basis points over Commonwealth ten-year bonds, and zero to five basis points under New South Wales ten-year bonds. This represents strong evidence of the financial market's support for the State's program to improve its financial management.

Liability management

Budget Sector Debt Portfolio

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;
- minimising refinancing risk; and
- managing, in a conservative manner, the financial and operational risks of the budget sector treasury operations.

Future budget sector debt management activities will continue to focus on increasing the flexibility and lengthening the maturity of the funding facilities provided by TCV.

Risk reduction through management of structured financing facilities

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

During 1997-98 an important focus of this activity was the assessment of indemnity claims and associated issues arising from the termination of the World Congress Centre financial arrangements. In addition, the termination by TCV in 1996 of a Gold Loan borrowing transaction provided by the FAI Group of companies in 1987, has been the subject of litigation. The case, *TCV vs Victorian Bullion Securities and others* was heard in the Supreme Court of Victoria before Mr Justice Mandie from 9 February to 2 March 1998. The case was adjourned, *sine die*, while the Judge is preparing his judgement, which could be completed by early May 1998.

Currently under review is the annuity loan transaction entered into between TCV and the FAI group in 1986 which is subject to State indemnities and has received an adverse Part IVA taxation assessment.

The financing and leasing arrangements for the Monash Medical Centre, entered into between 1983 and 1987, are also being reviewed and legal advice is being sought. A decision on the future management of this transaction will be made when the review is completed.

Superannuation status and outlook

The 'unfunded liability' of a superannuation scheme represents the *present* value of future benefits that its members have accrued during *past* service. Unfunded liabilities have arisen in public sector superannuation schemes because the State's share of superannuation costs have not been contributed as benefits accrue, but only when a benefit is actually paid. This is known as the 'emerging cost' payment basis.

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. The prior service costs are currently funded via an annual 'top-up' payment that is based on the level of benefit payments which are expected to be made each year.

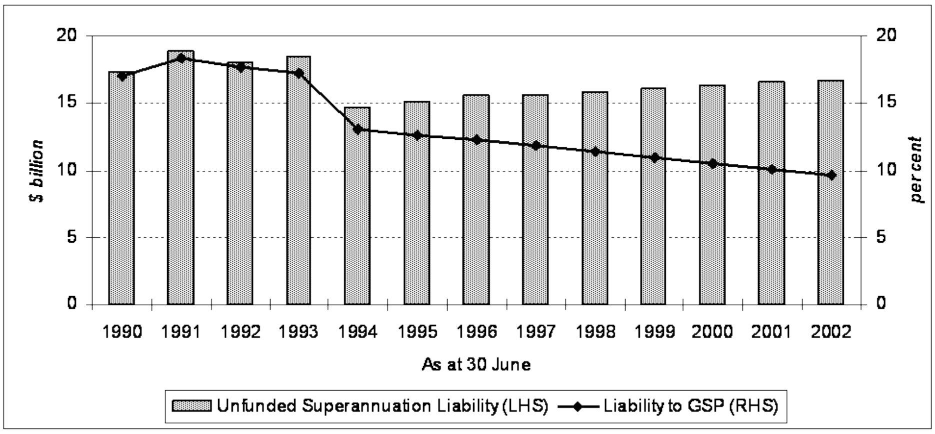
Unfunded superannuation liabilities

The unfunded liabilities shown in the following charts represent the total unfunded liabilities of Victoria's public sector superannuation schemes. This liability is expected to increase marginally from $15.6 billion as at 30 June 1997 to $15.9 billion by 30 June 1998 (see Chart 6.10).

As at 30 June 1998, the State's share of the total unfunded superannuation liabilities is expected to be $15.3 billion compared with $15.2 billion as at 30 June 1997. This is because some of these liabilities are expected to be funded from sources external to the State public sector (e.g. by universities).

Following a recent review of cost-sharing arrangements between the Commonwealth and the State on superannuation funding of universities, unfunded liabilities totalling approximately $200 million have been passed from the State to the Commonwealth during 1997-98.

Chart 6.10: Unfunded Superannuation Liabilities



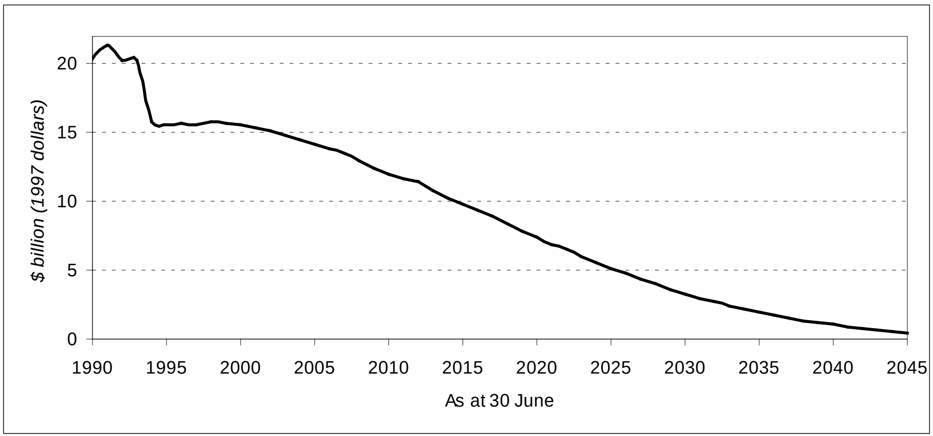
Source: Department of Treasury and Finance.

On the assumption that emerging costs will continue to be funded, the unfunded liability associated with State defined benefit schemes is expected to grow on a nominal basis over the forward estimates period to around $16.7 billion by 30 June 2002 (see Table 6.1).

However, the expected fall in the ratio of unfunded superannuation liabilities to GSP from 11.3 per cent as at 30 June 1998 to 9.6 per cent as at 30 June 2002, shows that the growth in nominal unfunded superannuation liabilities will be less rapid than the growth in nominal GSP.

Chart 6.11 shows that, on an unchanged policy basis, the level of unfunded superannuation liabilities, measured in real terms (1997 dollars), is expected to fall from 1999-00 as the impact of previous reforms take effect.

Chart 6.11: Unfunded Superannuation Liabilities - Long-Term Projection (1997 Dollars)

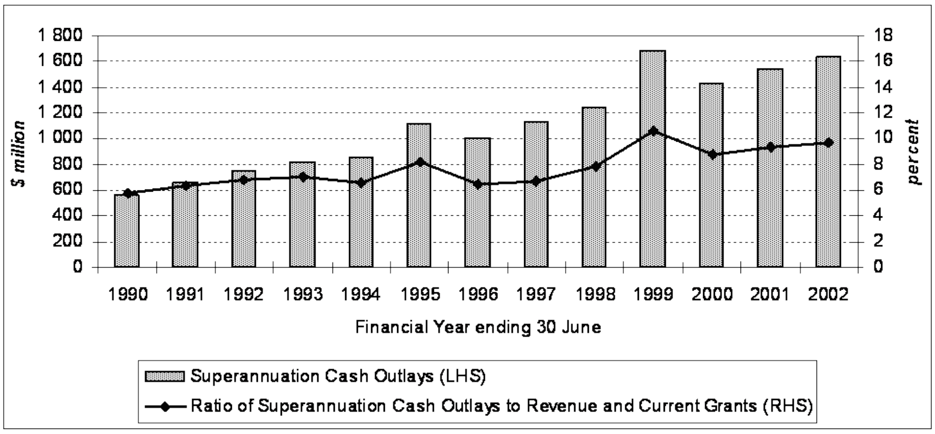


Source: Department of Treasury and Finance.

Budget superannuation cash outlays

Projected budget superannuation cash outlays are based on the actual liabilities expected to be paid out each year. The actual cash payments, are determined by the number of public sector employees who have left budget sector departments and agencies, their age, years of superannuation membership and salary levels at the time of exit. Total budget superannuation cash outlays are expected to increase from $1 250.2 million in 1997–98 to $1 686.4 million in 1998-99 as a result of superannuation payments associated with the privatisation of the PTC and the growth in minimum contributions from 6 per cent to 7 per cent, pursuant to Commonwealth legislation (see Table 6.4 and Chart 6.12).

Chart 6.12: Budget superannuation cash outlays[(a)]



Source: Department of Treasury and Finance.

Note:

(a) Excludes payment of $1.4 billion in deferred superannuation employer contributions in 1993-94.

Table 6.4: Budget superannuation cash outlays[(a)]

	1997 Actual	*1998 Estimate*	*1999 Estimate*	*2000 Estimate*	*2001 Estimate*	*2002 Estimate*
			$ million			
Superannuation cash outlays	1 128.0	1 250.2	1 686.4	1 427.9	1 549.4	1 638.8
			per cent			
Ratio of superannuation cash outlays to cash revenue and current grants[(b)]	6.7	7.8	10.6	8.8	9.3	9.7

Financial year ending 30 June

Source: Department of Treasury and Finance.
Note:
(a) In future years, the ratios will be calculated on an accrual basis.
(b) Revenue and current grants exclude grants for on-passing.

The ratio of superannuation cash outlays to cash revenue and current grants is expected to increase from 7.8 per cent in 1997-98 to 9.7 per cent in 2001-02 (excluding the one-off payment to PTC in 1998-99) over the forward estimates period. The increase in the ratio of superannuation cash outlays to cash revenue and current grants over this period reflects both the increasing average age of the public sector workforce covered by defined benefit schemes and a higher proportion of members entering retirement.

On an accruals basis, superannuation expenditure for 1997-98 is estimated to be $1 500.2 million and 8.0 per cent of total accrual revenue. For 1998-99 this is forecast to be $1 622.4 million and 8.6 per cent of accrual revenue.

SECV liabilities

The Government is continuing to restructure or extinguish a number of long-term liabilities residing with the SECV Shell which arose from arrangements entered into prior to the electricity industry reform program.

Contracts between the previous government and Alcoa to supply electricity to the Portland and Point Henry aluminium smelters, and the cost of supplying under these contracts, constitute the remaining material liability.

The difference between the cost of power to SECV and payments by smelters had previously been funded from the budget. A number of measures have now been taken to reduce or offset the losses under the contracts with SECV. As a result, from July 1998 the Budget subsidy to the SECV will be terminated, improving the Budget by $209 million.

Chapter 7: Economic Outlook

From the low point of recession in the early 1990s the Victorian economy has now experienced six years of continuous growth. Over this period, gross state product has grown by almost 25 per cent, private business investment has more than doubled, employment has increased by more than 200 000 persons, and the trend unemployment rate has fallen from a peak of 12.5 per cent in mid-1993 to just over 8 per cent.

Introduction of structural reforms by the Government has improved the competitiveness of Victorian businesses and resulted in Victoria's strong productivity growth relative to Australia as a whole. Victoria has, for example, replaced Queensland as Australia's third largest exporter of merchandise. The opportunities created by these reforms have attracted financial and human resources, with business investment rising strongly and population losses to other States dropping from a peak of almost 30 000 in 1993-94, to under 3 000 in 1997.

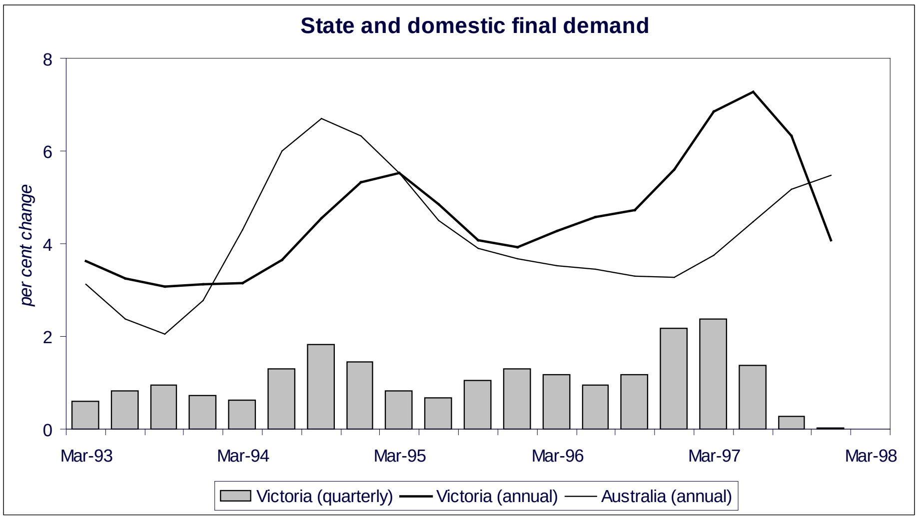
Recent economic trends

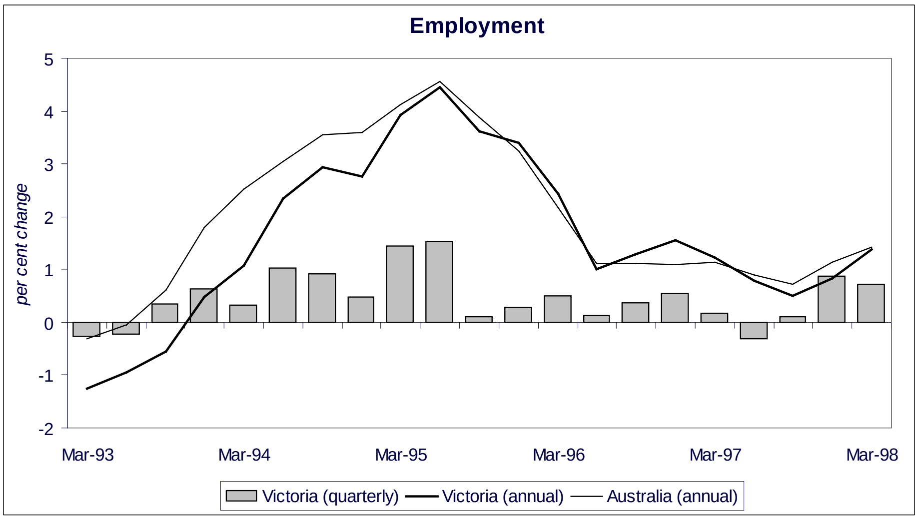
Victoria experienced a surge in demand in 1997, well in advance of the pick-up at the national level (see Chart 7.1). Annual growth in trend state final demand rose from around 4.5 per cent in 1996 to peak at 7.3 per cent during 1996-97. Consumer spending grew strongly and was supported by a cyclical upswing in the housing sector and a strong rise in private business investment.

Both demand growth and private business investment eased in Victoria in the second half of 1997. However, demand growth was still running at around 4 per cent per annum, being supported by strong growth in consumer spending and housing investment.

At the same time, Victorian and national labour market conditions improved significantly (see Chart 7.1). Between July 1997 and March 1998, Victorian employment rose steadily, by an average of around 5000 persons per month. Trend Victorian employment reached its highest level on record in March 1998 (2 131 200 persons).

Chart 7.1: Activity Indicators(a)(b)





Sources: Australian Bureau of Statistics, Cat. No. 5206.0, Prod. No. 5206.0.40.001 and Cat. No. 6202.0.

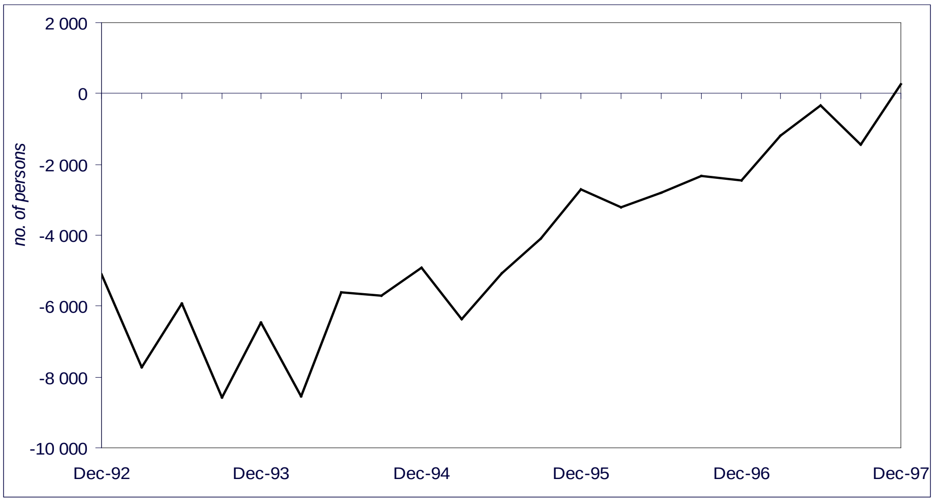
Note:

(a) Trend data.

(b) Latest state and domestic final demand data are as at December quarter 1997.

Progressive improvement in Victoria's economic conditions has helped reverse population losses to other States. In the December quarter 1997, Victoria was estimated to have gained net population from other States for the first time since this measure was recorded in 1980 (see Chart 7.2).

Chart 7.2: Net Interstate Migration to Victoria



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

The impact of recent developments in East Asia

The outlook for the Victorian and national economies remains uncertain in light of the financial and economic disturbances affecting East Asia. While there is likely to be a contractionary impact on East Asian demand for Australian exports, Victoria is unlikely to be more severely affected by the East Asian slowdown than the rest of Australia.

Following relatively subdued growth of around just over 4 per cent in 1997, private forecasters now expect South-East Asia to be in recession in 1998. Growth in North-East Asia (outside Japan) is expected to decline from over 7 per cent in 1997 to around 4½ per cent in 1998, mainly due to economic difficulties being experienced by South Korea. In Japan, another year of little or no growth is expected, and government attempts to stimulate its economy are yet to have a significant impact.

Lower East Asian economic activity may also place downward pressure on global commodity prices. Mineral prices (in US dollars) have been declining since the middle of 1997 and the advances in rural commodity prices in the first half of 1997 have largely dissipated.

In 1996-97, East Asia and Japan accounted for almost 60 per cent of Australia's merchandise exports, and for a little over half of those from Victoria. In 1995-96, East Asia and Japan also accounted for around 45 per cent of Australia's exports of services.

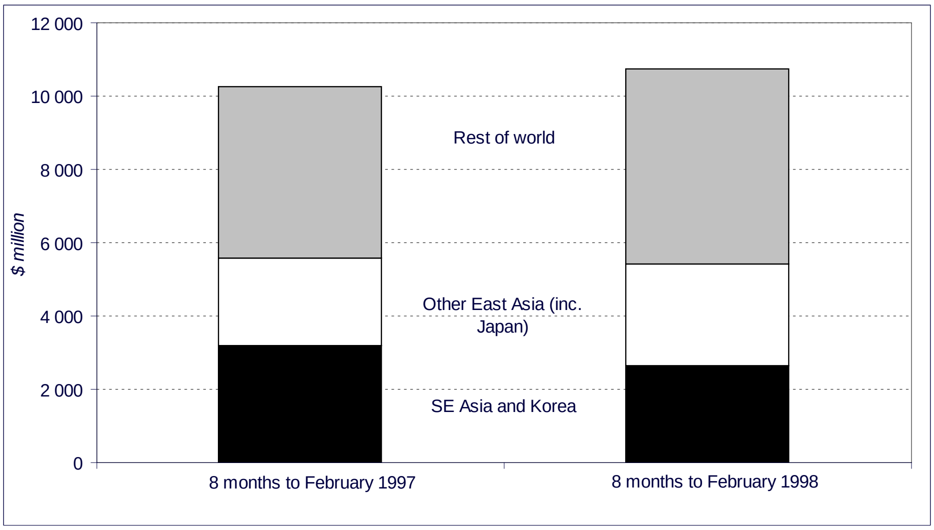
Victoria's exposure to the most vulnerable economies in East Asia, those of South-East Asia and South Korea, is about the same as for Australia as a whole. In 1996-97, demand for Victorian merchandise exports from these regions comprised 3.7 per cent of Victorian GSP, a similar proportion to that for Australia as a whole.

Processed food, machinery, and some raw materials are among Victorian merchandise exports most likely to be affected by a slowdown in East Asia. However, the Asian economic slowdown has yet to be reflected in overall Victorian export earnings. The eight months ending February 1998 compared with the same period last year, saw Victorian merchandise exports to South-East Asia and South Korea fall by one-sixth, but Victorian exports to all other East Asian countries (including Japan) and the rest of the world actually increased in the same period (see Chart 7.3). A significant decline in gold exports to South Korea was largely offset by increased gold exports to other Asian countries, notably Hong Kong. In assessing the economic impact on the State, it should be noted that much of Victoria's gold exports are mined outside the State.

Turning to earnings from the exports of services, Victoria should be less affected on average than other States by any downturn in international tourism from East Asia. Total short-term international visitor arrivals to Victoria in 1997 were around 14 per cent of the national total, and Victoria's share of international visitor nights in 1996-97 was around 19 per cent.

Victorian educational institutions appear to have a similar degree of reliance on overseas students, particularly from the vulnerable East Asian countries, as the national average. In 1997, 26 per cent of overseas students in Australia, and only about 15 per cent of South Korean students, studied in Victoria. Students from Malaysia and Singapore, however, tended to be more heavily represented in Victoria than elsewhere.

Chart 7.3: International Merchandise Exports from Victoria



Source: Unpublished Australian Bureau of Statistics foreign trade data.

The adverse impact on growth elsewhere in Australia is likely to result in reduced interstate exports and income for Victoria. The East Asian currency realignments also mean that there is greater scope for cheaper imports into Australia from the region.

Economic outlook

This section discusses the economic projections for Victoria and Australia over the forward estimates period (see Table 7.1).

The short-term outlook

The recent momentum in Victorian consumer spending is expected to continue into the first half of 1998 based on the improvement in the labour market. The pick-up in construction on new dwellings and additions may add to the demand for household equipment and furnishings.

Table 7.1: Victorian Economic Projections *(a)*

		Forecasts		
	1997-98	*1998-99*	*1999-00*	*2000-01 to 2001-02 (average)*
Gross state product	3 ½	2 ¾	2 ¾	3
Employment	1 ¼	1 ½	1 ½	1 ½
Unemployment rate (per cent) *(b)*	8 ¼	8 ¼	8	8
Participation rate	63 ¼	63 ½	63 ¾	64 ¼
Consumer price index	¼	2 ½	2 ½	2 ½
Average weekly earnings *(c)*	4	3 ½	3 ½	3 ½
Population	1	¾	¾	¾

Source: Department of Treasury and Finance.

Notes:
(a) Per cent change on preceding year unless otherwise indicated.
(b) Estimate for June quarter.
(c) Average weekly ordinary time earnings (AWOTE).

Output of the Victorian economy is expected to grow by 3½ per cent in 1997-98, compared with 2.1 per cent in the previous year. State final demand is also projected to grow by 3½ per cent in 1997-98, compared with 5.9 per cent in 1996-97.

Forward indicators suggest that the improvement in Victorian labour market conditions evident in the second half of 1997 is likely to continue over the next few months. The ABS job vacancy series has increased strongly over the past year. The ANZ employment advertisement series has stabilised at a relatively high level in recent months.

Employment growth in 1997-98 is projected to be 1¼ per cent, broadly in line with growth in 1996-97. This relatively weak year-average growth in employment reflects the low base from which it has been growing since mid-1997. Labour force participation is expected to be slightly lower than in the previous year. The unemployment rate is projected to remain around 8¼ per cent by June 1998.

The slowdown in East Asia is likely to be more evident in the outcomes for 1998-99. More moderate growth in consumer spending should contribute to GSP growth of 2¾ per cent and growth in state final demand of around 3 per cent. Employment is projected to grow by around 1½ per cent. With labour market conditions relatively subdued, labour force participation is assumed to remain broadly unchanged, yielding little change in the unemployment rate.

There are indications that consumer spending growth is starting to ease. Retail turnover has been declining since December and new motor vehicle registrations appear to be approaching a peak. According to the April Westpac-Melbourne Institute index of consumer sentiment, there has been an increase in the number of consumers expecting economic conditions to deteriorate over the next 12 months.

Consumer spending growth should ease during the second half of 1998 as the East Asian slowdown begins to affect growth in incomes in Victoria and elsewhere in Australia. A number of other factors are likely to have a moderating effect on domestic spending, such as the housing and business investment cycles, and moderate growth in public sector demand.

Although housing commencements grew strongly during 1997, the latest data for housing approvals suggest housing activity in Victoria could reach a plateau in the middle of 1998 (see Chart 7.4).

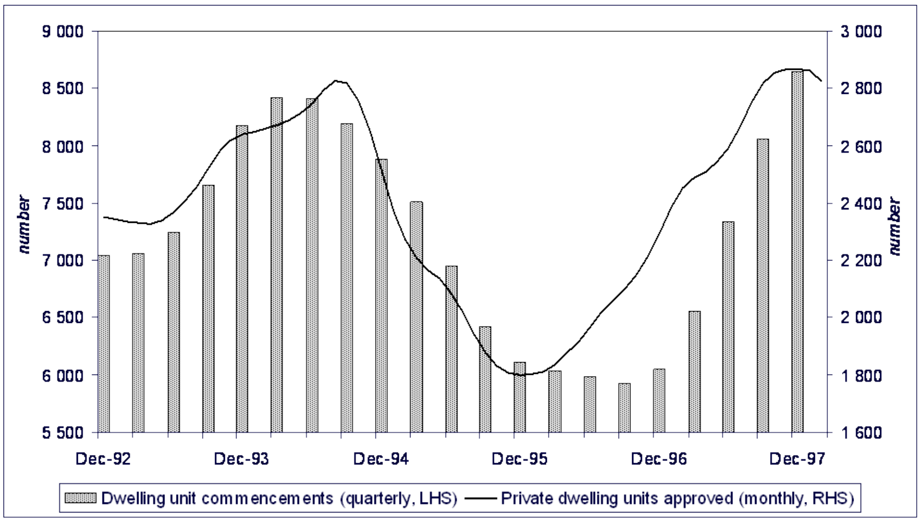
The estimated value of non-residential building and engineering construction work yet to be done is high by historical standards, and is likely to be supported by the continuation of City Link and the commencement of the Docklands project. Recent levels of underlying business fixed investment relative to GSP reflect the timing of activity on large projects. Investment is projected to ease by the end of 1998-99.

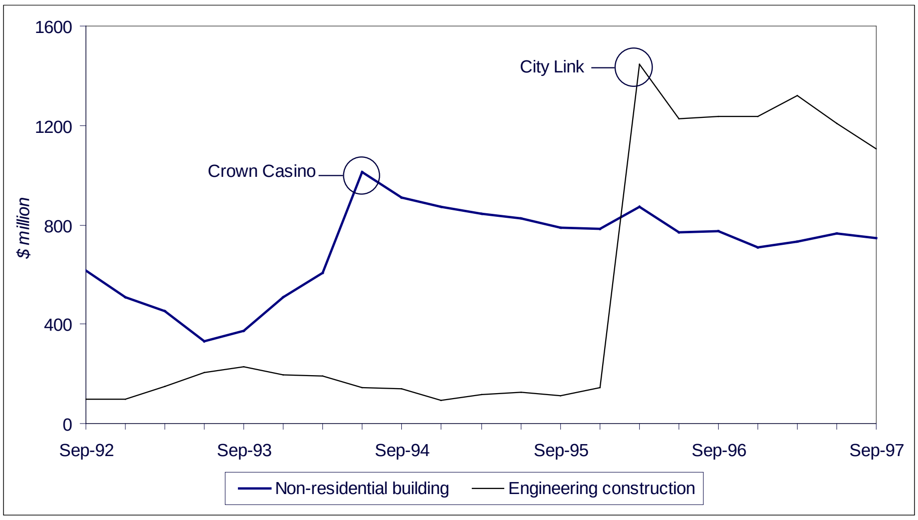
A number of major investment projects are under way. Work on the first stage of the $2 billion-plus Docklands project — the Docklands Stadium — has commenced. Toyota recently announced plans to upgrade its Altona plant to produce a new vehicle, involving up to $1 billion in expenditure. Other recently announced major projects reported by Business Victoria include:

- the doubling of the capacity of the Mars Confectionery plant in Ballarat;
- the expansion of braking systems production by Robert Bosch at Clayton;
- the expansion of the Bremer Wollkammerei Geelong Wool Combing plant;
- the establishment of a colour printing plant in Sunshine by Diamond Press Holdings; and
- the proposed replacement of a chlorine-alkali plant by Orica.

Telstra has announced the establishment, by the year 2000, of a Global Network Operations Centre to manage its domestic, international and offshore networks. This will involve the relocation of 540 interstate staff to Melbourne.

Chart 7.4: Forward Indicators — Dwelling and Non-dwelling Construction





Sources: Australian Bureau of Statistics, Cat. No. 8731.0, Cat. No. 8750.0, Cat. No. 8752.0 and Cat. No. 8762.0.

Public final demand is expected to grow modestly in Victoria during 1998-99.

As discussed earlier, the contribution to growth from net exports is likely to be dampened in the wake of the East Asian economic slowdown.

Victorian respondents to the ABS *Australian Business Expectations Survey* have forecast a rise in manufacturing sales over the 12 months to March 1999, with demand partly being met through further destocking. Increased capital expenditure is also expected.

Prospects for the farm sector are likely to be influenced by seasonal conditions and the impact of East Asian economic conditions. Over the past year, the Victorian farm sector has suffered from the strong El Niño effect and, more recently, a slowdown in Asian demand. Dry conditions in the State contributed to lower grain production in 1997-98. Victorian wheat production is likely to decline by about one-third on the previous season (but still be around the average level of the past five years). The Victorian barley crop is expected to fall by one-quarter in 1997-98 and Victorian wool production has declined as flock sizes have been reduced. Exports of nearly all fruit and vegetables have declined as East Asian consumers switch to local produce. However, most climate models predict that the strong El Niño pattern will dissipate by mid-1998.

About two-thirds of Victorian milk production is exported and international spot prices for skim and whole milk powder should remain relatively low in 1998-99. Victorian wool production in 1998-99 is expected to reach its lowest point in the past decade following poor seasonal conditions. Lamb prices should become lower over the next few years in the face of rising supply in Australia and stronger competition from New Zealand in export markets.

The Victorian wine industry is expected to grow strongly and increases in wine exports are likely to continue. Victoria should remain a major supplier of high quality young beef for Australian domestic markets and will be less affected than the northern States by the disruption to live cattle exports to Indonesia and the Philippines.

The effects of the decline in export demand in South-East Asia have been somewhat offset by currency movements which have favoured Australia’s competitive position in these markets.

Price inflation as reflected by the consumer price index (CPI) is slowing from 1.3 per cent in 1996-97 to an expected ¼ per cent in 1997-98, mainly due to reductions in mortgage interest rates. Mortgage interest and consumer credit charges will be removed from the CPI in the September quarter 1998. CPI inflation is projected to drift up to around 2½ per cent per annum in 1998-99 and beyond. This is in line with the Reserve Bank’s 2 to 3 per cent target range for underlying inflation.

Victorian average weekly ordinary time earnings are expected to grow by around 4 per cent in 1997-98, and by around 3½ per cent in 1998-99 and subsequent years.

The medium-term outlook

Looking beyond the 1998-99 Budget year, forward estimates are predicated upon a return of Victorian economic growth to 3 per cent per annum by early next century. Assumptions underpinning this medium-term growth outlook include:

- annual population growth of ¾ to 1 per cent;
- annual productivity growth of about 1½ per cent; and
- a small additional contribution from an increasing labour force participation rate.

This medium-term outlook for Victoria implies an unemployment rate of around 8 per cent at the turn of the century.

Structural change

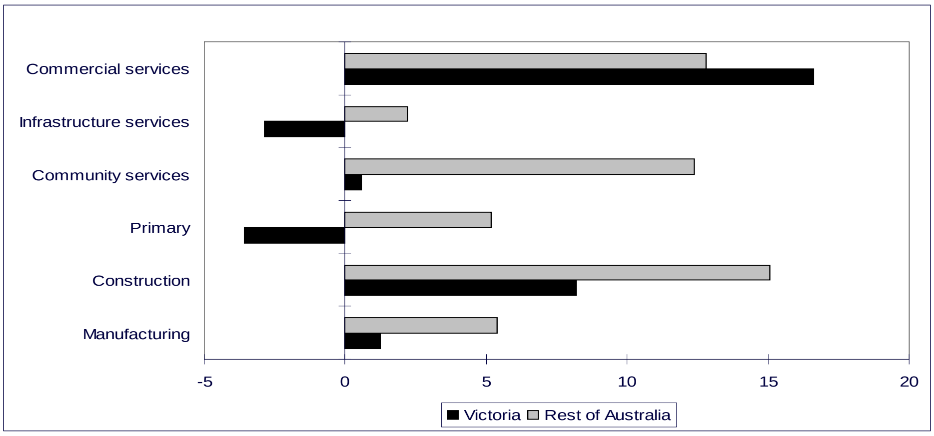
Throughout the 1990s, the Victorian economy has responded to opportunities created by rapid change in information technology and telecommunications, strong growth in global demand for many types of services, and rising living standards in Asia. These responses have been aided by Victorian Government competition reforms aimed at creating a flexible, competitive economy, and ensuring an efficient government sector which provides quality services at least cost to consumers and to business.

This section discusses the extent of recent structural change that has occurred in Victoria and highlights the significant improvement in labour productivity in this State compared with the national average. See Chapter 8, *Competitive Victoria*, for detailed discussion of competition reforms and the benefits of reform.

The extent of structural change

During the early 1990s, Victoria’s growth occurred mainly in the commercial services sector, which includes finance, insurance, property, business, cultural, recreational and personal services and wholesale and retail trade. Meanwhile, the manufacturing sector has declined in relative importance. The strength of employment growth in Victorian's commercial services sector during the 1990s, as compared with the rest of Australia, is shown in Chart 7.5. During the same period, Victorian employment growth has been much more restrained in the infrastructure services sectors, where reforms have led to efficiency improvements, and in the community services sector, where service delivery has been rationalised.

Chart 7.5: Employment Growth by Major Industry Group — Victoria and Rest of Australia, 1991-92 to 1996-97



Source: Australian Bureau of Statistics, Cat. No. 6203.0.

To some extent, services employment has grown more strongly because functions previously performed within manufacturing firms and by community service establishments have been outsourced to businesses in the services sector. In many cases, the incentive to do so has been the search for increased productivity and efficiency in such areas as accounting and financial services and property management, or in the provision of community services.

But there has also been an ongoing trend for the demand for services to run ahead of the demand for manufactured goods. This has been a global trend which has been evident in the strong growth in overseas and interstate tourism, in enrolments by overseas students at Victorian tertiary institutions, and in anecdotal evidence of increased exports of professional services.

The growth of commercial services employment has occurred despite the rationalisation of employment in the finance sector.

Victorian Government policy has focused on removing impediments that prevent businesses responding to new opportunities. Wide-ranging economic reforms that have contributed to this flexibility include the introduction of competition in the provision of infrastructure services (such as the electricity, gas, ports and road transport industries), and in providing electricity customers with a choice of supplier.

The reforms are also delivering lower utility prices and improved service quality in these areas. Water supply pricing reforms, involving the adoption of a user-pays approach, are expected to lead to a majority of businesses receiving lower prices. The privatisation of public transport is also expected to improve services and reduce costs.

Workers' compensation arrangements have been reformed and have led to improvements in workplace safety, higher rates of return to work and savings in excess of $500 million to Victorian businesses.

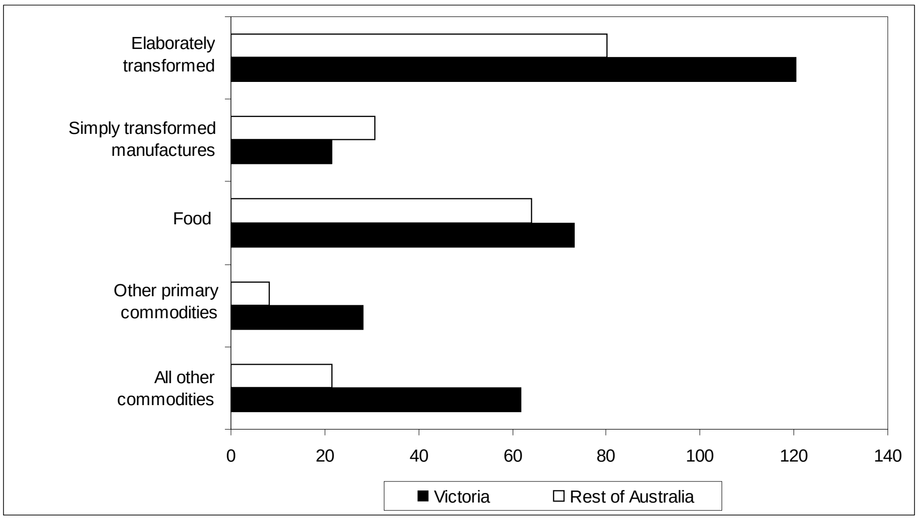
In the industrial relations area, Victoria referred its powers to the Commonwealth to create a single industrial relations system for Victoria under the Commonwealth *Workplace Relations Act 1996*.

Industry policy has also played a role by promoting and facilitating investment, reducing the regulatory burden on business (including the deregulation of retail shopping hours), shifting from input-based to output-based environmental controls, and providing fundamental research and development and enabling technologies. The development of an education and training system capable of enhancing workforce skills has also been important.

The impact of reform on competitiveness

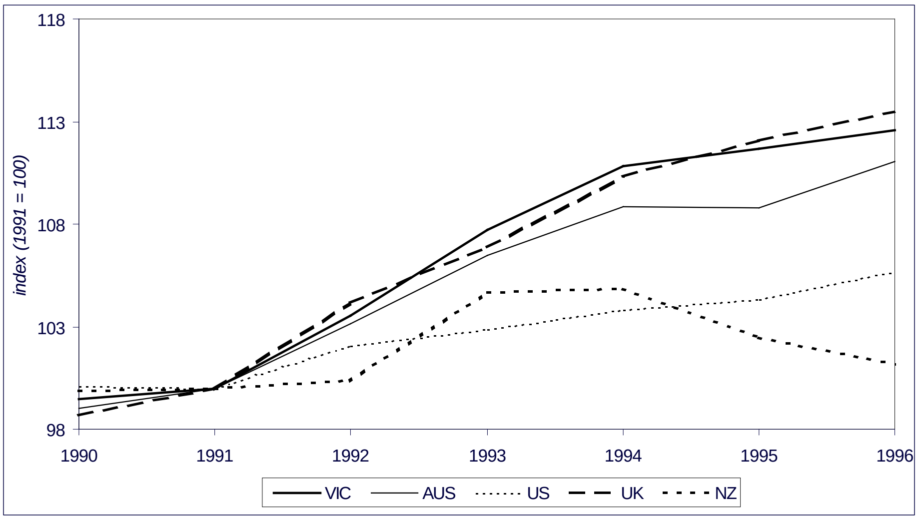
Structural reform has been instrumental in improving the competitiveness of Victorian businesses, and this has been demonstrated by the strength of Victoria's recent export performance. During the 1990s, Victoria moved from fourth to third highest overseas exporter of merchandise (behind New South Wales and Western Australia). International export growth has been based heavily on elaborately transformed manufactures (which have grown much more rapidly here than elsewhere in Australia) and food products (see Chart 7.6).

Chart 7.6: International Merchandise Exports, 1991-92 to 1996-97, percentage change



Source: Department of Foreign Affairs and Trade unpublished data.

Chart 7.7: Labour Productivity — Victoria, Australia, United States, United Kingdom and New Zealand (a)



Sources: Australian Bureau of Statistics, Cat. No. 5206.0 and Prod. No. 5206.0.40.001; International Monetary Fund, International Financial Statistics.

Note:

(a) Gross domestic product at 1990 prices per employed person. US employment adjusted for 1994 methodological changes using estimates from US Bureau of Labor Statistics.

Since 1991-92, Victoria has experienced relatively strong productivity growth compared with the rest of Australia. This is evident in its relative labour productivity performance, which has outstripped the United States and New Zealand, and has kept pace with that of the United Kingdom (see Chart 7.7).

There are strong indications that this improvement in Victorian productivity has been largely associated with the structural reform process, rather than other factors.

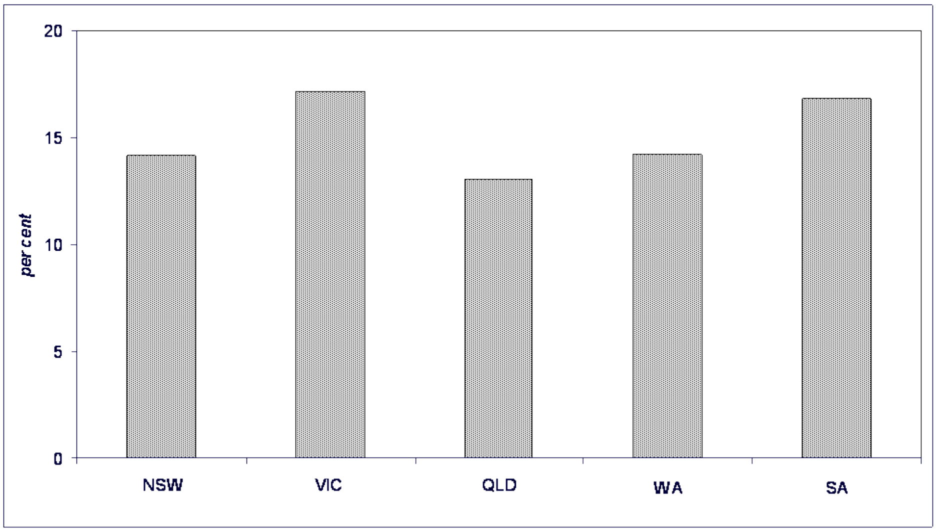
First, Victoria's strong labour productivity performance does not appear to have resulted from a relatively higher growth rate in its stock of buildings and equipment compared with other States. The Melbourne Institute of Applied Economic and Social Research estimates that, among the Australian States, the contribution to growth in Victoria from improvements in total factor productivity (that is, after allowing for changes in physical capital as well as labour) was second only to that of Western Australia in the first half of the 1990s.

Second, Victoria's productivity gains have not relied on the discovery and exploitation of new mineral resources, which are likely to have been an important explanation for the productivity gains in resource-rich States such as Western Australia. Excluding the mining sector, Victoria's labour productivity performance may have outstripped Western Australia's and most of the other major States (see Chart 7.8).

Third, there is evidence that structural reforms have been important in improving the overall productivity performances of individual sectors in the national economy. Industry Commission research indicates that transport and utilities have made the most rapid improvements in multifactor productivity in the market sector of the national economy since the late 1980s. The Commission noted the role of increased competitive pressures in the improved productivity performances in these sectors during the 1990s. Victoria's competitive reforms in such areas as utilities are therefore likely to have contributed to marked improvements in their efficiency. These, in turn, can be expected to generate benefits for utility customers in the form of lower prices (see Chapter 8 for more detail).

The structural reform process continues through such measures as the restructuring of the water industry, the privatisation of the gas industry and of all public transport services, and the restructuring of health services. Chapter 8 contains a detailed discussion of these reforms and their benefits.

Chart 7.8: Gross Product at Factor Cost per Employed Person, excluding Mining, 1991-92 to 1995-96, percentage change[(a)]



Sources: Australian Bureau of Statistics, Cat. No. 5220.0 and Cat. No. 6203.0.

Note:

(a) Percentage change in gross product at factor cost excluding ownership of dwellings and mining industries divided by employed persons excluding mining industry.
Note that changes in gross product at factor cost arise from changes in both the quantity of production and its price (unlike Chart 7.7 which is affected only by changes in the quantity of production). This affects the reliability of Chart 7.7 as an indicator of productivity movements.

Chapter 8: Competitive Victoria

In 1998-99, the Government will further advance its program to achieve a Competitive Victoria. This Chapter outlines: the rationale for the Government's reforms and their benefits; how competition is being achieved; reforms to government business enterprises (GBEs) made to date; the likely future direction of reforms; and the Government's key National Competition Policy commitments.

Overview - why reform?

The Government's objective is to lift the economic performance of the State, making it a better place to live, to invest and to do business, and thereby improve living standards for all Victorians.

It aims to do this by creating a world-class competitive business environment which provides growing opportunities for investment and the creation of jobs, and by implementing reforms which will deliver low-cost, quality services that are responsive to the needs of the community.

The Victorian Government influences economic activity in three main areas:

- as an owner and operator of GBEs responsible for providing services such as water, sewerage, gas and public transport;
- as the funder and/or provider of budget sector services such as health, education and justice; and
- as a regulator of private markets.

The role of competition

The key principle underlying many of the Government's economic reforms is that competition delivers better outcomes for the community in terms of price and quality by:

- providing consumers with greater choice when making purchase decisions;
- motivating businesses to reduce costs and improve quality; and

- providing the feedback needed for an economy to change over time, as consumer needs change.

Competition, or the threat of it, is a powerful force in driving efficient outcomes, and forces suppliers to work harder to satisfy their customers.

Harnessing competition wherever possible

The Government has sought to encourage competition in a number of ways.

Competition for outputs means a key component of GBE reform is to break up existing GBE monopolies into potentially competitive elements. This enables other businesses to compete directly in areas such as electricity or gas supply and provide customers with a choice of supplier.

Competition by comparison means that where direct competition for services is not technically possible, peer benchmarking (such as occurs with the three geographically based metropolitan retail water businesses) can stimulate efficiencies.

Competition for the right to provide a market occurs where bidders are asked to compete for exclusive rights to provide a service. Exclusive rights are usually granted for a specific period and subject to competitive re-tender at the conclusion of the period. An example of this is the contracting out by the Government of the management of the Port of Hastings. TNT Port Logistics (subsequently Toll Holdings) was awarded the contract for a period of 10 years (plus two five-year options), after which the contract will be re-tendered. Public transport will also be provided through franchises that will be subject to re-tender.

Competition for inputs means searching for the most suitable provider of input goods or services, such as information technology, construction or legal advice. Competition for inputs takes the form of competitive tendering and is widespread across the public sector. The recently published *Victorian Outsourcing Activity Survey 1995-96* indicates Victoria has achieved significant savings to government from outsourcing.

These different means of introducing competition are often used in combination. For example, direct competition for the supply of outputs between privatised electricity companies is complemented by benchmarking their performance by the Office of the Regulator-General. This assists informed consumer choices. Similarly, electricity companies competing for outputs/services will also be competing for inputs (such as maintenance, wholesale electricity and billing services) in order to find cheaper and better ways of delivering their services.

The Government's commitment to reform is driven by its quest for a more efficient economy. This commitment is underpinned by its agreement to the National Competition Policy, to which all governments are parties, and which sets out key milestones for reform (details are discussed later in this Chapter).

The benefits of reform

Competition reform has already been achieved in a number of areas and is delivering substantial benefits to Victorians.

Electricity

It is estimated that average Victorian households will pay $74 less than the cost of inflation on their electricity bills in 1998 due to legislated price pegging introduced as part of Victoria's electricity reforms. Commencing in 1998, household and small business consumers will also receive a Winter Power Bonus, which will reduce their electricity bills by a further $60 per annum for the next three years.

The Office of the Regulator-General has reported that overall service standards in the electricity industry have been maintained or improved and that customers are now better off than they were under the SECV.

Intense retail competition and a steadily decreasing trend in average electricity wholesale market prices since 1995 have produced price reductions of up to 40 per cent for large users of electricity. This trend is expected to continue with the next group of customers (those who consume more than 160MWh/Yr) who will be able to choose their supplier from 1 July 1998.

Privatisation

The Government's privatisation program has now raised over $20 billion in sale proceeds. The proceeds have mainly been applied to reducing public sector net debt from $32 billion to around $11 billion and, as a result, the State will achieve ongoing net savings of approximately $762 million per annum.

Gas

Gas consumers have benefited from $32 million annual savings on gas prices due to real price reductions. As with electricity, prices will be pegged below inflation until customers can choose their own supplier.

Water and sewerage

The Office of the Regulator-General has reported more affordable water and sewerage services during 1996-97, and improvements in water quality. Pricing reforms currently being implemented are projected to deliver an average 18 per cent reduction in bills to domestic properties across Victoria.

Ports

Port reform has resulted in service and efficiency improvements. The TNT Port of Geelong has reduced ship turnaround times by 8 per cent. Infratil, the owner of the Port of Portland, has reported a 33 per cent increase in operational profitability and a 7.8 per cent increase in revenues in its first two years of ownership. The introduction of competing providers for port services, for example mooring, at the Port of Melbourne has led to reductions in service charges for the users of those services.

Departmental expenditure

The *Victorian Outsourcing Survey 1995-96* confirms that there are average cost savings to government from outsourcing of 28.2 per cent. Departments report an average cost of 1.9 per cent of contract expenditure for managing contracts. Comparison of data with New South Wales and Western Australia shows that Victoria has achieved the highest levels of savings and a lower cost of managing contracts.

Local Government

Aggregate revenue from local government rates and charges was reduced by approximately 18 per cent between 1993-94 and 1995-96. This reflects the impact of the amalgamation of councils. Additional savings and improvements in service delivery have resulted from the compulsory competitive tendering process for council services.

Transport

The contracting out of metropolitan bus services has reduced costs by around $10 million per annum. Service quality has improved and routes have been beneficially redesigned.

Reform of GBEs

The GBE reform strategy involves:

- removing regulatory functions from business functions of GBEs;
- dividing monopoly businesses into entities which can potentially compete against each other;
- corporatising government businesses to encourage more commercial behaviour, and formalising community service obligations;
- introducing, where necessary, independent oversight of prices and standards;
- establishing a performance monitoring regime; and
- privatising, where a net public benefit is available.

These reforms reduce barriers to entry and establish incentives for businesses to provide high quality, low-cost services which are responsive to customer needs.

Privatisation

While competition-oriented reforms can achieve considerable efficiency benefits, such benefits are difficult to sustain while the GBEs remain within public ownership. Consequently the Government is continually reviewing the case for continued government ownership of GBEs.

Private ownership provides compelling incentives for owners and managers to improve efficiency, make appropriate investment decisions and maximise the return to equity. Privatisation is designed to realise maximum value to the Victorian community, within the policy framework set by the Government. To maximise competition and efficiency, market structures must be reformed and regulatory regimes established prior to privatisation.

Monitoring of performance

While GBEs are retained in Government ownership, a performance monitoring framework is established to represent the Government's shareholder interest. This framework subjects GBEs to the disciplines of corporate planning and regular performance reporting, and is analogous to the financial markets' monitoring of publicly listed corporations.

Highlights of GBE reform

Significant reform has already taken place in the following industries: electricity, gas, ports and water.

Electricity

The Government has provided strong leadership in energy sector reform and privatisation of the electricity industry and Victoria is well positioned to take advantage of the momentum of national reform.

As a result, the State's electricity industry has been transformed from a monopoly based structure to a dynamic and competitive structure designed to deliver a reliable supply of electricity at low cost to the Victorian community.

The program, which has involved the disaggregation and privatisation of the original SECV into competing generation and distribution businesses and the creation of wholesale electricity markets, is now almost complete.

These reforms have resulted in substantial benefits for consumers and businesses in terms of lower prices and improved service and reliability. These benefits have been outlined above.

Some of the highlights of electricity reform during 1997-98 include:

- the privatisation of PowerNet Victoria, Southern Hydro and Victorian Electricity Metering bringing cash proceeds to the State of approximately $3 billion;
- the effective establishment and operation of the NEM1 wholesale electricity market; and
- an increasing number of participants entering the NEM1 market.

The NEM1 market links the electricity markets in Victoria and New South Wales and provides for unrestricted trading of electricity between generators, wholesalers and retailers across the jurisdictions of Victoria, New South Wales and the Australian Capital Territory.

This market has been characterised by intense competition between the six disaggregated Victorian generation businesses, three New South Wales generators, the Snowy Mountains Hydro Electric Authority and one South Australian generator.

Electricity consumers in Victoria consuming greater than 750 Mwh of electricity per annum are benefiting from competition at the generation, wholesale and retail levels. There are currently 19 licensed retailers in Victoria competing to supply contestable customers. Other electricity consumers who consume greater than 160 Mwh per annum will be able to choose their retailer in July 1998 and take advantage of the benefits of increased competition.

Gas

The Government has delivered structural reform of an industry previously dominated by a State-owned monopoly to increase competition and promote efficiencies. As occurred with electricity reforms, the gas industry restructure is based on separating the monopoly elements of the industry such as transmission and distribution from the competitive functions of production and retailing. New market and regulatory arrangements have been established to support the industry restructuring. The new industry structure is designed to deliver the lowest possible prices and highest standards of service to all customers.

A detailed statement of the Government's gas industry reform is contained in *Victoria's Gas Industry, Implementing a Competitive Structure,* Information Paper No.3, Second Edition, April 1998.

Some of the highlights of gas reform during 1997-98 include:

- the disaggregation of GASCOR into 3 paired gas businesses each comprising unbundled and separate distribution and retail functions namely Westar/Kinetik, Multinet/Ikon and Stratus/Energy 21;
- the corporatising of the Gas Transmission Company (GTC), the owner and operator of the high-pressure transmission pipes, as Transmission Pipelines Australia, which now owns and maintains the high-pressure transmission pipes;
- the creation of VENCorp, a business responsible for operating high-pressure transmission pipes and system security;
- the establishment of the Gas Services Business to provide centralised services to the gas distributors and retailers;
- the establishment of a project to develop the gas wholesale market to be operated by VENCorp;
- a commitment to build an inter-connect pipeline between New South Wales and Victoria to be completed in 1998;
- planning for the development of an underground gas storage facility at Port Campbell to improve system security and facilitate competition;
- the establishment of the Office of Gas Safety to regulate industry safety requirements; and

- development of a regulatory framework to support gas reforms, with access arrangements already before the Australian Competition and Consumer Commission and the Office of the Regulator-General for approval.

Reform of the ports

The objective of the port reform strategy is to provide a more efficient port system in Victoria, reduce costs for users, and contribute to the attractiveness of Victoria as an investment location.

The strategy has involved:

- corporatisating the former Port of Melbourne Authority as the Melbourne Port Corporation;
- separating regulatory functions from former port authorities and allocating these to the Environment Protection Authority, the Marine Board of Victoria, the Health and Safety Organisation and the Office of the Regulator-General;
- regulating prices, using maximum weighted average revenue caps, over each port and channel business;
- establishing a regime for third-party access to the shipping channels, accredited by the National Competition Council, and administered by the Office of the Regulator-General;
- privatisating the ports of Portland and Geelong; and
- contracting out of management rights for the Port of Hastings.

In 1995-96 the Victorian Channels Authority (VCA) was established as a separate entity accountable for the management and maintenance of channels in the ports of Melbourne, Geelong, Portland and Hastings. VCA has retained its responsibilities in Melbourne and Geelong and has delegated this responsibility to the private port operators at Portland and Hastings.

The port reform program concluded during 1997-98 with the sale of Melbourne Port Services in May 1997 and the successful contracting out of the management of the Port of Hastings in July 1997. Melbourne Port Services, a subsidiary of Melbourne Port Corporation providing contestable services to port users, was sold for $8 million to Skilled Engineering and the management of Port of Hastings was contracted out in July 1997 for a period of 10 years (plus two five-year options), in return for a throughput-related management fee from TNT Port Logistics (now Toll Holdings).

Reform of the water industry

Since January 1995, the Government has been introducing a series of reforms into the water industry, which are progressively improving its capacity to operate efficiently and to deliver real and lasting benefits to consumers. Structural reform and reforms to pricing have laid the groundwork for further progress.

Melbourne Water was disaggregated into Melbourne Parks and Waterways and one wholesale and three retail corporatised businesses. The wholesale business, Melbourne Water Corporation, is primarily responsible for the management of the major dams and sewage treatment plants, and for bulk supply to the three retail businesses - City West Water, South East Water and Yarra Valley Water.

All four businesses have performed well, achieving improved efficiencies and profitability, while maintaining or improving service quality.

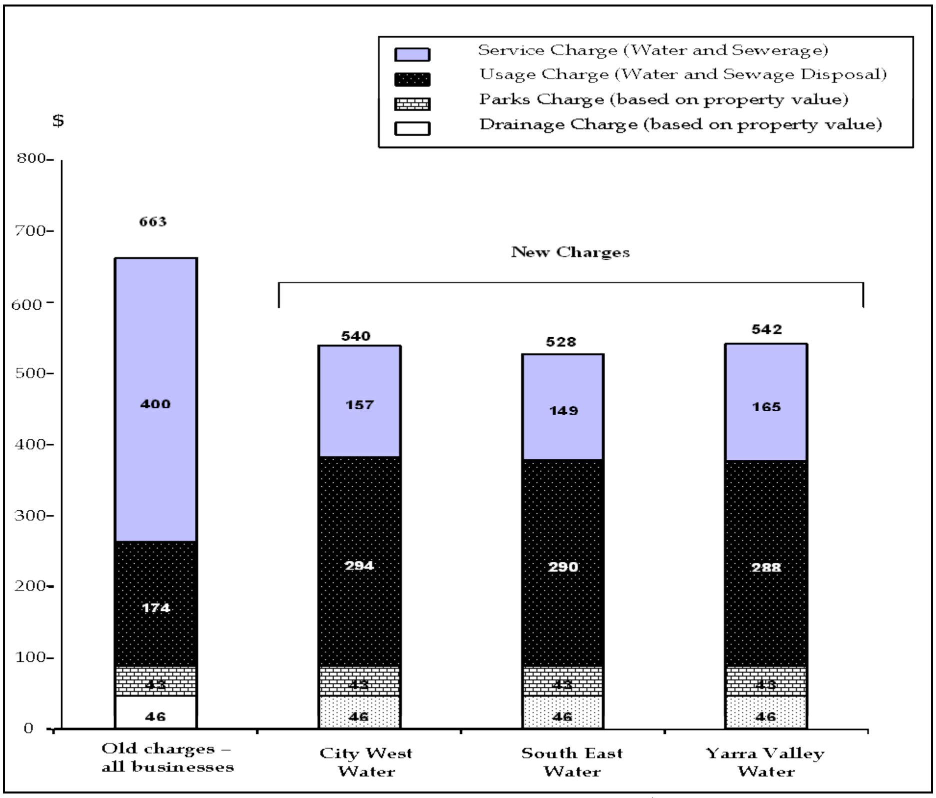
There has also been steady reform of the Non-Metropolitan Urban Water Authorities, which supply Victoria’s provincial towns. More than 80 small authorities have been amalgamated into 15 Government-owned businesses which are able to take advantage of economies of scale and attract skilled boards and management.

Fundamental, wide-ranging reforms to pricing in the metropolitan water industry were announced in October 1997. The pricing reform package, under which the Government provided financial assistance of $850 million in the form of a debt/equity restructure, brings the approach to pricing water and sewerage into line with that of other utility industries, and provides significant benefits by:

- delivering to over 85 per cent of domestic properties an average 18 per cent reduction in bills;
- significantly reducing non-domestic sector water bills, thereby delivering a boost to Victorian businesses;
- increasing water usage charges to about 70 per cent of the average bill, providing an incentive for water conservation and paving the way for associated environmental benefits; and
- abolishing property value based rates and replacing them with fixed service charges for each connected property, thereby curtailing cross-subsidies and improving pricing equity.

Consumer benefits from the metropolitan reform package are summarised in Chart 8.1. This shows that, while the proportion of the bill based on ‘user pays’ increases, the average metropolitan household bill falls by more than $120 per annum.

Chart 8.1: Comparative Breakdown of the Average Household Bill



Note: For an average household bill: Net Annual Property Value = $7 500;
Water consumption = 230 kilolitres per annum
Sewage disposal return rate = 70 per cent of water consumption

GBE reform: the way ahead

Key items on the GBE reform program for 1998-99 are:

- privatisation of the three gas distribution/retail businesses and the gas transmission business, subject to market conditions;
- commencement of a gas market on 1 September 1998;
- privatisation of Aluvic, which holds the State's 25 per cent interest in the Portland Smelter;
- privatisation of V/Line Freight;
- restructuring of the Public Transport Corporation's operations and sale via franchise contracts by March 1999;
- privatisation of the Victorian Plantations Corporation in 1998 through offers of long-term management and harvesting rights to bidders; and
- continued regulatory and structural reform of water.

Details of some of these reform programs are set out below.

Water

In addition to the metropolitan reform package, the Government has announced other initiatives to improve water services across regional Victoria.

Some $410 million has been injected into the 15 non-metropolitan urban water business authorities during 1997-98. These funds will assist the businesses to accelerate investments to improve water quality and ensure compliance with EPA licences.

The announced pricing reforms have achieved an average 18 per cent reduction in prices, ensuring that non-metropolitan residents receive benefits of the same order as metropolitan water consumers. As part of the process of creating more commercial businesses, the practice of basing dividends paid by the non-metropolitan urban water businesses on residential assessments will be replaced progressively by dividends based on profitability.

The 1998-99 Budget provides for rural areas to fund 12 dam improvement projects and other catchment management projects.

Under the funding package, the non-metropolitan urban and rural water authorities have committed to ensuring efficient service delivery through competitive arrangements. The Government has encouraged the use of Design and Construct and, where appropriate, Build, Own, Operate and/or Transfer

(BOO/BOOT) methods of procurement to ensure the private sector has the opportunity to maximise cost-effective delivery of the required outcomes.

As part of this process, a number of competitive BOOT tendering processes are currently underway for water and waste water treatment projects. These projects are:

- Castlemaine waste water treatment plant and reticulation for Maldon;
- water treatment for Bendigo, Castlemaine and Kyneton; and
- water treatment for Ballarat and neighbouring towns.

A number of other water and waste water treatment projects are currently being evaluated as to the potential benefit of BOOT delivery.

1998-99 will see further work to promote the use of commercial disciplines in the water industry and consider other major issues including water trading and access regulation.

Public Transport

The efficiency of Victoria's public transport system is a key factor affecting the quality of life of its citizens and the Government's aim is to turn Victoria's public transport system into a best practice service, which genuinely meets the needs of the travelling public at a cost which is affordable for taxpayers. In August 1997, the Government announced details of its plans to build on the recent reforms and privatise the PTC's train and tram services. Privatisation is scheduled to be complete by March 1999.

This Government inherited a run-down and disjointed public transport system characterised by overstaffing and poor patronage.

Since 1992, the Public Transport Corporation (PTC) has undertaken some major reforms resulting in:

- the annual cash operating deficit reducing by some $245 million;
- improved service quality;
- more patronage; and
- reduced overstaffing.

Comparison with other public transport systems demonstrates that substantial further improvements can be made.

The effect of the introduction of accrual budgeting and capital charging is that the 1998-99 operating subsidy to the PTC is forecast to be $783 million. This does not include any provision for a backlog in maintenance which, while uncertain at this point, could initially be around $40 million per annum. In addition, this amount does not reflect costs related to publicly owned transport reflected elsewhere in the Budget including costs relating to V/Line Freight and VicTrack, and superannuation liabilities for current and former PTC staff assumed by Government.

This operating subsidy clearly represents a significant increase from the 1997-98 cash-based subsidy of $203 million and reflects the costs that the Government has always carried to support the PTC. It does not add to public expenditure and is an accounting change only. While the Government has achieved large reductions in the PTC subsidy since 1992, the underlying subsidy costs (which have always existed) such as the cost of the PTC's large capital base, are only now beginning to be identified.

The total subsidy is still subject to change upon privatisation not just because of the efficiencies and other changes franchisees will introduce, but for factors not yet quantified such as: differences between existing asset valuations and the value at which assets will be transferred to franchisees; financial obligations that may be imposed on franchisees for bonding or other purposes; tax payments; and improvements to service levels. The impact of these changes will become clearer as we move through the reform process.

The first stage has been to restructure the PTC. Two metropolitan train services (Hillside and Bayside) have been established; and two companies (Yarra and Swanston) now operate Melbourne's tram system.

These companies, as well as the V/Line Passenger network, will be privatised by way of franchise contracts. Franchising involves entering into fixed term contracts for rail and tram operations with the private sector and the Government buying back services on behalf of the public.

Within the franchise agreements, the Government:

- contractually specifies the services which the franchisee must provide - including frequencies, stopping points and journey times;
- regulates annual fare increases;
- sets out a regime of incentives and penalties to encourage efficient, high quality services; and
- requires the franchisee to provide concession fares, multi-modal tickets, and train and tram information.

In return, the franchisee receives a pre-determined level of financial support from the Government.

Over the next 12 months, franchises for each of the five passenger businesses will be awarded on a competitive basis and, while subsidy levels will be a key criterion in assessing bids, investment proposals and other service enhancements will also be taken into account. The more intense the competition between bidders, the better the deal for the travelling public and the Victorian taxpayer.

The Government also intends to privatise the V/Line Freight business in the second half of 1998. Privatisation will give Victoria's rail freight industry a major opportunity to expand its business, and to compete effectively with road transport.

Victorian Plantations Corporation

The Victorian Plantations Corporation (VPC) has operated as a commercially focused business since 1993.

It supplies plantation softwood and a small amount of hardwood timber to the Victorian timber processing industry. VPC manages 107 000 hectares of softwood plantations and 8 000 hectares of hardwood plantations on a total estate of approximately 170 000 hectares of Crown land vested from Government.

Since it was established in July 1993, the Corporation has:

- increased its net profit before tax from $12 million in 1993-94 to $29.7 million in 1996-97; and
- increased its operating revenue from $29.8 million to $55.3 million over the same period.

The Government has now decided to privatise the VPC and is confident that the sale will:

- stimulate an internationally competitive industry which is not only sustainable but highly profitable;
- provide the impetus for industry-wide reform within the Victorian and Australian timber industry;
- remove the Government as a direct participant from an already competitive timber industry;
- encourage new investment in softwood plantations and timber processing; and
- provide an environment conducive to increased employment throughout regional Victoria.

The privatisation will be effected via a trade sale, which encourages both domestic and international bidders, in a process beginning mid-1998. While the Government will consider bids for the whole or parts of the business, the privatisation will not sell freehold title. Rather, a plantation licence in perpetuity will provide the new owner with long-term rights to manage the land and harvest and replant the timber.

Competition in budget sector service delivery

In 1991-92, Commonwealth Grants Commission estimates indicated that Victoria was spending almost 10 per cent more than other Australian States (on a per capita basis, after adjusting for cost differences across States) on social and community services such as public education, transport and health. But despite higher spending on these services, Victorians were not receiving correspondingly higher levels of delivered service. Instead, widespread inefficiency in service delivery was becoming increasingly evident in long hospital waiting lists, unreliable public transport and growing community concerns about education standards.

The Government recognised that, in addition to the immediate need to restore fiscal discipline, reforms in service delivery and in financial management were critical in order to address the strain on public resources created by the conflicting pressures of limited revenue growth and the growing demand for services. This required both a reassessment of the core activities of government and re-engineering of the way government services are delivered - including through the introduction of greater competition.

Competitive tendering

Competitive tendering and contracting out has been widely adopted internationally as a tool to improve budget sector performance and lower costs. Financial management reforms to fully cost all services, and competitive neutrality pricing to offset the artificial advantages of government ownership of in-house suppliers, are fundamental to the successful introduction of competitive tendering.

The appropriate response is for Government to separate its role as purchaser (or funder) of activities from that of provider. The recognition that there may be a number of potential providers of a service gives Government greater choice, enabling it to secure more cost effective outcomes.

In Victoria there is a growing list of functions formerly provided by in-house resources which have been outsourced following competitive tender. Functions such as construction, legal advice, cleaning of schools, court reporting, prisoner transport, fleet management, road construction and maintenance and information technology related services have all been successfully sourced externally.

Services now being outsourced include those that were considered core government activities such as hospital services, technical and further education, public transport, and prison management. A number of significant new infrastructure projects have been initiated by the Government with most of the development, construction and management risks being transferred to the private sector while also ensuring the delivery of high quality services.

City Link

Construction of the City Link project to connect Melbourne's fragmented freeway system is being undertaken by the Transurban consortium at an estimated cost of $1.8 billion. It is to be completed by 2000, and will provide improved access and traffic flow between Melbourne's port, rail and airport facilities, and reduced travel times for motorists. In addition to the 6000 to 8000 jobs created during the construction phase, it is estimated that an additional 2000 jobs will be created when the City Link is operational.

Prisons

Three new prisons in Victoria have been financed, designed, constructed and operated by the private sector, to the value of $140 million. The new prison project has resulted in substantial benefits to the State through the achievement of service provision costs lower than the benchmark costs of the existing public prisons while establishing defined levels of correctional services.

Hospitals

In January 1997 a 20-year contract with the private sector to provide a $50 million 257-bed hospital in the Latrobe Valley was finalised. This hospital is due to open in August 1998 and the Government has since announced four further hospital developments that will be seeking private sector involvement.

In keeping with the Latrobe Hospital project, the Government intends to seek delivery of these four new developments via build-own-operate arrangements, with risk for design, construction, ownership and operation being largely in the hands of the private sector providers. In addition to risk transfer benefits, the Government also expects health care services to be delivered at a saving to the publicly funded system and at performance levels which meet standards for accreditation Australia-wide. Payments to the private sector providers will be at risk on their service delivery contracted performance.

Emergency Services

The Bureau of Emergency Services Telecommunications (BEST) was set up in 1994 to contract with a single private provider for computer aided call taking and dispatch services to all Victorian emergency services. This project is also delivering higher levels of service than were previously being achieved by the individual emergency services operating their own in-house communication systems.

Regulatory reform

As a regulator of private markets, government is increasingly aware of the impact that its regulations have on private sector competition. Regulations may:

- create statutory monopolies;
- impede the entry of potential competitors into markets; or
- establish different business conditions for different types of activities.

The Government has recognised that it is important to examine the impact of its regulatory activity on competition and to justify any restrictions on competition in light of the public interest. In previous years the Government examined and reformed legislative restrictions governing statutory marketing schemes such as those which operate in the dairy and tobacco industries, has removed legislative monopolies on supply of services such as electricity, and has reformed restrictions on trading hours.

The Government is now engaged in a comprehensive review of remaining legislative restrictions on competition in line with the National Competition Policy requirements (see below). All legislation which restricts competition will be reviewed and, where appropriate, reformed by the year 2000.

National Competition Policy

The National Competition Policy is an agreement by all States and the Commonwealth to systematically apply the principles of competition across all areas of the economy. The Victorian Government's competitive reforms are underpinned by its commitment to the National Competition Policy. In large part, the Victorian Government's implementation of competitive reforms predated but is entirely consistent with, the National Competition Policy.

Key elements of the National Competition Policy that are directly relevant to the Government's reform program are as follows.

Structural reform

The National Competition Policy sets out principles for structural reform, prices oversight and access to essential facilities. These principles are embodied in the GBE reforms implemented in Victoria ensuring the structural separation of monopolies into competitive elements, the application of economic regulation and prices oversight (in Victoria via the Office of the Regulator-General) and the establishment of regimes for third-party access to essential facilities.

Competitive Neutrality

Another important principle of competition policy is that, where businesses remain in government ownership, they should not derive any advantages from public ownership. This is known as competitive neutrality.

In June 1996, the Government published its *Competitive Neutrality Policy Statement* which included a timetable for application of competitive neutrality to all GBEs and other significant business activities undertaken by the budget sector and its agencies.

Victorian GBEs are corporatised and subject to the application of equivalents for taxes that would accrue if they were privately owned. These corporatised businesses also operate at arms length from government, within a corporate planning and monitoring framework, with a clear commercial focus and are subject to commercial dividend payments.

In 1997, the Department of Treasury and Finance published a *Guide to Implementing the Competitively Neutral Pricing Principles (*which apply to all other government business activities (not GBEs) from July 8 1997). These pricing principles are another important feature of budget sector reform and ensure that comparisons between in-house providers and external providers occur on a like-for-like basis.

In addition, a unit has been established in the Department of Treasury and Finance to handle complaints from parties who claim to have suffered a direct and material disadvantage as a result of a government business appearing to enjoy net competitive advantages due to public sector ownership.

Legislation review

Under the *Competition Principles Agreement*, legislative restrictions on competition are to be reviewed by December 2000 according to the principle that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

Outcomes of reviews so far include:

- repeal of the *Shop Trading Act 1987*;
- reform of the *Audit Act 1994*; and
- reform of the *Veterinary Practice Act 1997*.

The *Shop Trading Act 1987* was repealed to deregulate shop trading hours. The most significant impact of this reform is improved consumer welfare in the form of increased convenience and satisfaction. The 'value' of this benefit has been estimated in one study as the equivalent of $330 million per annum.

Reform of the *Audit Act 1994* will introduce greater competition into the performance of public sector audits. This will allow for price and quality improvements in audits while retaining essential safeguards on the independence of the Auditor-General.

Reform of the *Veterinary Practice Act 1997* removes restrictions on the ownership of veterinarian businesses and on the reservation of particular functions to registered vets. This will remove barriers to entry for commercial operators of vet practices, providing scope for efficiency improvements, while maintaining registration and restrictions on the use of drugs by non vets.

Reviews of the *Liquor Control Act 1987* and the *Dentists Act 1972* are currently underway. Jointly with South Australia, the Government has also announced the deregulation of the domestic market for feed and malting barley in Victoria and the privatisation of the Australian Barley Board.

Chapter 9: Commonwealth-State Financial Relations

Introduction

The major weakness in the existing system of Commonwealth-State financial relations in Australia is that the States' lack of access to a broad tax base causes them to rely too heavily on payments from the Commonwealth. This weakness surfaced with dramatic effect during the course of 1997-98.

As detailed in Chapter 5, *Revenue*, the States' revenue autonomy was further compromised by the High Court decision on business franchise fees. The introduction by the Commonwealth of special safety-net arrangements has allowed the States to protect revenue flows on a temporary basis.

These new restrictions on the States' revenue-raising ability and the Commonwealth's refusal to return an appropriate share of revenues to the States is severely constraining the capacity of the State governments to deliver the services required by the community.

The latest example of this was the Commonwealth Government's refusal to negotiate over its inadequate funding offer for health. Over the period of the current Medicare Agreement, total Commonwealth funding to the States has declined from 27 per cent to 21 per cent of Commonwealth tax collections. This represents a funding shortfall for the States of $7 800 million in 1997-98, and $1 700 million for Victoria, i.e. more than three-quarters of the amount raised by Victorian payroll taxes or one-quarter more than the amount spent on Victorian secondary education.

States need direct access and control over a tax base that reflects the rate of growth in economic activity and growth in service delivery demands. Clearly this can only be addressed as part of national tax reform which should include abolition of some of the States' most distortionary indirect taxes.

This Chapter provides a detailed discussion of the trends in, and outlook for, Commonwealth grants to the States. It also examines several major Commonwealth-State issues including: the declining relative trend in Commonwealth payments to the States; the extent of vertical fiscal imbalance (VFI) due to differences in the taxing powers and expenditure responsibilities between the Commonwealth and the States; the process of horizontal fiscal equalisation (HFE) whereby the residents of Victoria and New South Wales currently provide a significant subsidy to residents in less populous States; and developments in specific purpose payments (SPPs).

Commonwealth grants: 1998-99 and forward estimates

Following the breakdown of negotiations at the Premiers' Conference on 20 March 1998, the Commonwealth indicated that funding for the States would be in accordance with its initial offer, involving:

- a continuation of the real per capita guarantee;
- health funding based on the new Australian Health Care Agreement (AHCA) which will replace the Medicare Agreement that commenced in 1993-94;
- second payment of the national competition policy (NCP) payments;
- no overall cut to SPPs against the Commonwealth's forward estimates in 1998-99; and
- the above arrangements being conditional on the payment by the States of the final instalment of the State fiscal contribution.

Commonwealth grants are made up of general purpose payments (GPPs) and specific purpose payments (SPPs). Total SPPs include grants which are expended in the general government sector, and those which are on-passed to universities, local government authorities and non-government schools.

Table 9.1 summarises the main components of grants received for the years 1997-98 to 1998-99. Total grants, excluding grants for on-passing, are estimated to decrease by 1.3 per cent in 1997-98 and increase by 4.2 per cent in 1998-99.

Key factors affecting the 1998-99 estimates of Commonwealth grants to Victoria include:

- indexation of financial assistance grants for inflation and population growth;
- the third State fiscal contribution payment to the Commonwealth;
- the Commonwealth's offer of a new AHCA; and
- the overall increase in SPPs to Victoria is distorted by a switch from general purpose payments. The switch is driven by the elimination of the Medicare guarantee payment to Victoria which acts to reduce general purpose payments. The increase in SPPs is due to Victoria receiving a larger share of health care grants (which in overall terms is offset by the loss of the

Medicare guarantee payment). Other budget-on-budget increases relate mainly to grants provided under the Australian National Training Agreement and the Natural Heritage Trust Agreement.

Table 9.1: Grants Received 1997-98 to 1998-99

$ million

	1997-98 Budget	*1998-99 Budget*
General Purpose Grants	3 676.4	3 602.0
less Fiscal Contribution	*158.2*	*74.4*
Net General Purpose Grants	3 518.2	3 527.6
Specific Purpose Grants	2 639.0	2 838.1
Sub Total	6 157.2	6 365.7
(Year on year % change)	*-0.5*	*3.4*
Grants for On-Passing	888.0	948.0
TOTAL COMMONWEALTH GRANTS (a)	**7 045.2**	**7 313.7**
(Year on year % change)	*0.0*	*3.8*

Source: Department of Treasury and Finance.

General purpose payments

General purpose payments comprise financial assistance grants (which from 1997-98 include identified road grants), special revenue assistance and, from 1997-98, the National Competition Policy (NCP) payment.

Financial assistance grants

Financial assistance grants are increased each year to reflect population growth and inflation (the so-called ‘real per capita guarantee’). The ‘real per capita guarantee’ is part of the NCP and related reforms agreed to by the Commonwealth, State and Territory Governments at the April 1995 meeting of the Council of Australian Governments (COAG). NCP payments are conditional on the States meeting their NCP obligations.

Relativities

Each year, the Commonwealth Grants Commission (CGC) updates the relativities recommended to the Premiers’ Conference as the basis for distributing financial assistance grants and hospital funding grants. The Commonwealth will apply the relativities recommended by the CGC in its *1998 Update* as the basis for distributing these grants in 1998-99.

The *1998 Update* relativities were calculated using five years of budget data from 1992-93 to 1996-97. Victoria's relativity in 1998-99 will be marginally lower than in 1997-98. This is mainly due to revisions to Australian Bureau of Statistics payroll data on wages, salaries and supplements which reflect growth in the Victorian economy.

The CGC relativities adopted are based on the new AHCA arrangements. The new AHCA involves less funding being quarantined from the CGC fiscal equalisation process, and the subsequent loss of the Medicare guarantee payments to Victoria (and New South Wales) to compensate for their low share of the previously quarantined payments. Therefore it is appropriate to use the CGC's Equalisation relativities rather than the Medicare-adjusted relativities previously adopted from 1993-94.

Fiscal contribution payment

State Governments agreed at the 1996 Premiers' Conference to make a State fiscal contribution payment to the Commonwealth Government to assist the Commonwealth 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 and Territories are made on an equal per capita basis.

Although the Commonwealth's fiscal position has improved dramatically over the past two years, with a substantial underlying surplus of $2 458 million forecast for 1998-99, the Commonwealth has made its funding offer conditional on the States making their final fiscal contribution payment.

Since the original agreement was that payments would be reviewed in the light of the Commonwealth's fiscal position, the States argue that their fiscal contribution in 1998-99 should not be made. This would represent a saving to Victoria of $74 million.

The States had agreed to help the Commonwealth address its fiscal consolidation task on the basis that it reduce the projected Budget deficit by $8 000 million over two years. By 1997-98, however, the Commonwealth has not delivered on its promise. It is $800 million below target in 1997-98 and will be $1 400 million below in 1998-99. In these circumstances, the Commonwealth is not justified in forcing the States to make the final fiscal contribution payment.

Victoria and the other States cannot continue to operate in an environment where they receive a declining share of Commonwealth revenues and are also expected to meet the shortfall in the Commonwealth's own deficit reduction measures.

Special revenue assistance

The initial distribution of funding under the last Medicare Agreement, which was implemented in 1993-94, would have disadvantaged Victoria and New South Wales. As an inducement to both States to sign the Agreement, the Commonwealth guaranteed to increase financial assistance grants to them by amending the terms of reference to the CGC. However, the effect of the amended terms of reference was to make both States worse off. In order to meet the Medicare guarantee, it was agreed at the 1993 Premiers' Conference that both States should receive special revenue assistance funded mainly from the pool of general purpose funding and partly by the Commonwealth. This arrangement has continued for the life of the present Medicare Agreement.

In 1997-98, Medicare guarantee payments of $190 million and $242 million are to be paid to New South Wales and Victoria respectively. In accordance with established arrangements, the Commonwealth directly contributes $62 million to these payments, including $26 million to Victoria.

As noted above, with the expiry of the existing Medicare Agreement, the Medicare guarantee will cease in 1998-99.

National Competition Policy payment

As part of the NCP Agreement signed by the Commonwealth and all States and Territories at the April 1995 COAG meeting, the States agreed to implement a minimum set of microeconomic reforms within a set timetable. Since the benefits to the wider economy are expected to be reflected in a strengthening of the Commonwealth's rather than the States' revenue base, the Commonwealth was to make a payment to the States and Territories, provided that they fulfil the agreed conditions.

This payment commenced in 1997-98 at $200 million in 1994-95 prices and is indexed and distributed among the States and Territories on an equal per capita basis. It will double to an indexed $400 million in 1999-00 and increase to $600 million at 1994-95 prices in 2001-02. Victoria's program of microeconomic reform in the public sector is well advanced and it expects to receive its share of the 1998-99 dividend, which is worth an estimated $54 million (see Chapter 8, *Competitive Victoria).*

Forward estimates: 1999-00 to 2001-02

It is assumed that financial assistance grants will remain indexed in real per capita terms, provided that Victoria continues to meet its obligations under the NCP Agreement. Accordingly, the forward estimates have also been made on the assumption that Victoria continues to receive the NCP payment.

Specific purpose payments

The SPPs provided to Victoria are to ensure that policy objectives set by the Commonwealth, or national policy objectives agreed between the Commonwealth and the State, are met. The extent of the Commonwealth's involvement varies significantly from one agreement to another.

Table 9.2 shows the total amount of SPPs scheduled to be received from the Commonwealth, excluding grants for on-passing. The estimates recorded in the Table are derived from the Commonwealth Offer Document provided to the States and Territories prior to the March 1998 Premiers' Conference. It reveals that Victorian SPPs are expected to be 9.5 per cent or $245 million higher in 1998-99 than in 1997-98. Excluding the firearm buy-back scheme, underlying SPPs in 1998-99 are estimated to increase by $270 million compared to 1997-98. This increase, however, will be largely offset by the elimination of the Medicare guarantee payment, which is classified as a general purpose payment.

Key factors affecting estimated SPPs in 1998-99 include:

- the proposed introduction of a new AHCA to replace the existing Medicare Agreement;
- a decline in Commonwealth funding for public housing in nominal terms; and
- continuation of a Commonwealth 'efficiency dividend' (cut) on certain SPP running costs.

Details on the full range of SPPs 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 1998-99*.

Table 9.2: Specific Purpose Grants by Agency [(a)]

$ million

	1997-98 Budget	*1998-99 Budget*	*% Change*
Grants for Government Programs: Current			
Education	493.0	511.9	14.5
Human Services	1 598.2	1 816.0	13.6
Infrastructure	6.2	2.8	-54.5
Justice	64.8	41.2	-36.5
Natural Resources and Environment	21.3	55.8	162.0
State Development	3.3	3.1	-5.5
Treasury and Finance	5.9	5.7	-2.3
Total Current Grants	2 192.8	2 436.6	13.5
Grants for Government Programs: Capital			
Education	95.6	94.5	-33.2
Human Services	263.1	219.1	-16.7
Infrastructure	86.6	87.9	1.5
Natural Resources and Environment	0.9	0.1	..
Treasury and Finance	0.1	..	..
Total Capital Grants	446.2	401.6	-18.4
Total Specific Purpose Grants	**2 639.0**	**2 838.1**	**7.5**

Source: Department of Treasury and Finance.

Note:
(a) Excludes grants for on-passing.

Commonwealth-State issues

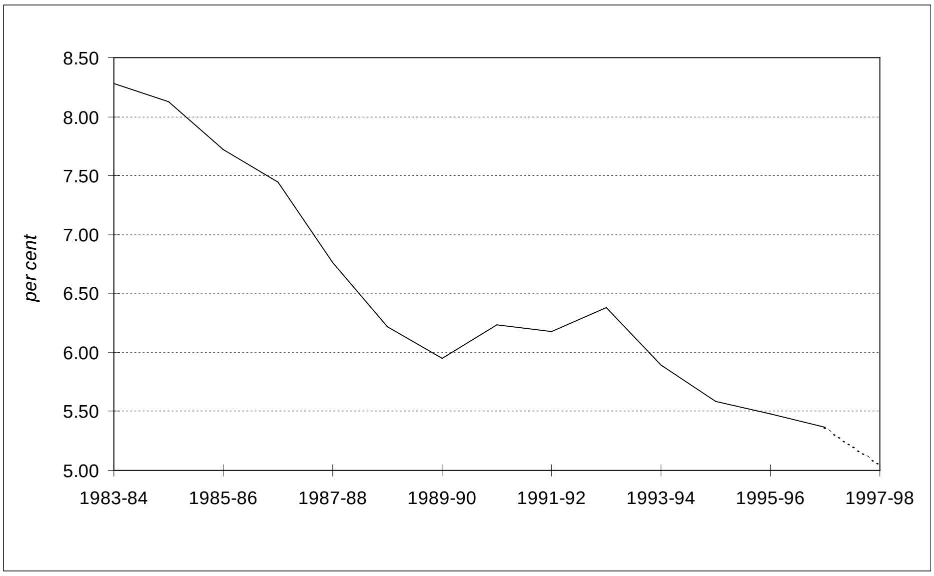
Key issues covered in this section are trends in Commonwealth payments, vertical fiscal imbalance, horizontal fiscal equalisation and policy issues in SPPs.

Trends in Commonwealth payments

Financial relations continue to be dominated by a declining trend in Commonwealth payments to the States, whether measured as the ratio of Commonwealth grants to the States relative to gross domestic product or to Commonwealth taxation revenue (see Charts 9.1 and 9.2). Reflecting cuts to specific purpose payments over the past couple of years, the share of total grants, which are tied to expenditure for specific purposes, has fallen marginally but nonetheless remains at high levels (see Chart 9.3). This further constrains the fiscal flexibility of the States.

As can be seen in Charts 9.1 and 9.2, 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. Even after allowing for this one-off effect, in the years following 1993-94, the sum of all grants to the States including financial assistance grants, health funding grants and SPPs declined from around 6 per cent of GDP to 5 per cent by 1997-98. Grants as a share of Commonwealth taxes also declined from 27 per cent to 21 per cent in the five years from 1993-94. This is against the background of a longer term decline since 1983-84.

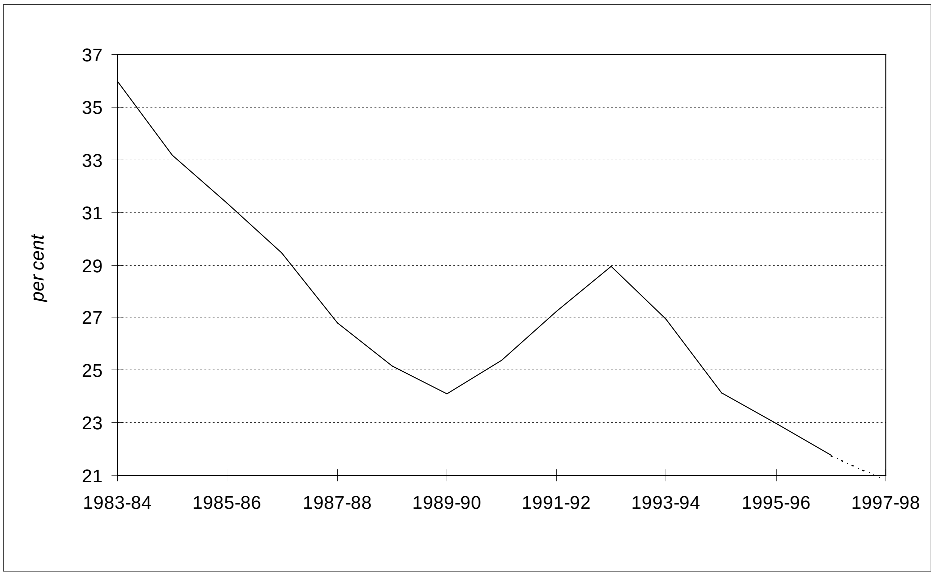
Chart 9.1: Commonwealth Grants as a Share of Gross Domestic Product



Source: Commonwealth Budget Papers, 1997-98 and earlier issues.

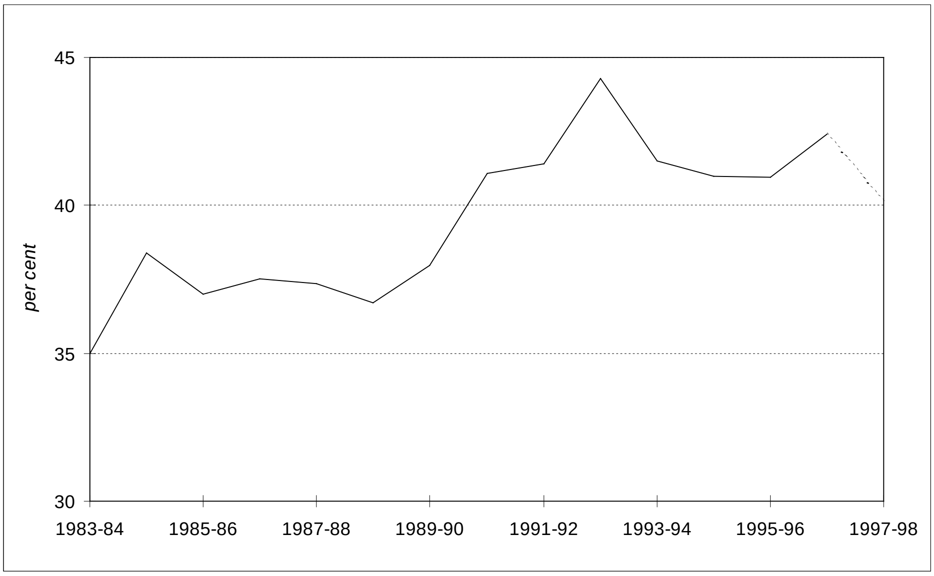
Commonwealth payments to the States as a proportion of GDP has declined from more than 8 per cent in 1983-84 to about 5 per cent in 1997-98.

Chart 9.2: Commonwealth Grants as a Share of Commonwealth Taxes



Source: Commonwealth Budget Papers, 1997-98 and earlier issues.

Chart 9.3: Proportion of Commonwealth Grants which are Tied



Source: Commonwealth Budget Papers, 1997-98 and earlier issues.

Vertical fiscal imbalance and the tax debate

While the debate on taxation reform must address the problems of restrictive and regressive tax bases currently available to the States, it must also focus on the Commonwealth-State relationship. The States see the issue of reducing VFI as being part of the necessary reform of the national tax arrangements to make the Australian federal system more accountable (see Chapter 5, *Revenue*, for detailed discussion on national tax reform).

One of the fundamentals of an accountable, democratic system of government is its capacity to be responsive to the people who elect the Government. It is impossible 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.

Constraints on States' revenue have seriously undermined their capacity to deliver to their citizens the services expected and demanded. The fiscal autonomy of the States is compromised by an increasingly inadequate and insecure State tax base, exacerbated in the light of the 5 August 1997 High Court decision relating to Section 90 of the Constitution which denies the States the power to tax goods. With the loss of autonomy over $5 000 million in franchise fee revenues, the States are now even more tied to Commonwealth determined outcomes.

In the interests of greater accountability and efficiency, the States have consistently argued for a realignment of taxing powers and/or expenditure responsibilities to lessen 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, not by withholding from the States funding needed for essential services.

States must also be accountable. To get true accountability to the taxpayer, people must be able to see a clear link between the money raised by governments through taxation, and the range of services provided to the community. Moreover, they must be able to voice their preferences to governments about the combined package of taxation and service provision.

At present, with various streams of revenue and expenditure and substantial transfer payments, it is not clear who pays for what. States and Territories should be held responsible for delivering the services according to regional needs. States need direct access and control over a growth tax. Clearly this can only be addressed as part of national tax reform which should include abolition of some of the States' most distortionary indirect taxes.

It is essential that the States obtain access to a secure revenue tax base that grows in line with the economy and matches growth in service delivery demands.

While some imbalance in revenue and spending responsibilities exists in all federal systems, other comparable federations have nothing like the extreme imbalance that occurs in Australia (see Table 9.3). The United States of America, Canada and Germany have a measure of imbalance of less than one-quarter of the Australian level. This is mainly because taxing powers are more centralised in Australia than elsewhere.

Table 9.3: International Comparisons of Vertical Fiscal Imbalance (VFI)[(a)]

	Year	Level of Government		Absolute difference in VFI ratios between central & middle levels of government
		Central	Middle	
Australia	1995-96	1.20	0.63	0.57
Canada	1990-91	1.05	0.92	0.13
Germany	1995-96	1.02	0.97	0.03
USA	1994-95	0.99	1.13	0.14

Source: IMF, Government Finance Statistic Yearbook, 1997.

Note:
(a) The VFI ratio in this Table is defined as the ratio of own-purpose revenue to own-purpose outlays.

Horizontal fiscal equalisation

Substantial grants are distributed from the Commonwealth to the States in the form of financial assistance grants, not only to offset the consequences of VFI but also to effect HFE among the States. HFE is currently based on the premise that each State is entitled to receive a share of general revenue funding from the Commonwealth which would enable it to provide government services at standards that are not appreciably different from those of the other States without having to impose taxes and charges at levels appreciably higher than those of the other States.

Regional differences in Australia in terms of income per capita, and in patterns of economic activity and economic growth rates, are small by international standards. However, 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 HFE as the basis for distributing grants.

Two broad measures of the extent of HFE using 1997-98 data are shown in Table 9.4. The first is an equal per capita share of grants and the second is based on personal income tax paid. The absolute size of the differences varies between the two measures, but both measures indicate the enormous subsidy currently provided each year by residents of Victoria and New South Wales to residents of Queensland, South Australia, Tasmania and the Northern Territory.

While grants are distributed according to State needs, they can use the funds in any way they wish. This can lead to the perverse position where Victorian taxpayers subsidise the Queensland Government on the grounds that it is more costly to provide services to Queensland citizens. Yet rather than use the funds to meet these so-called cost disadvantages, the Queensland Government chooses to have lower taxes and encourages business away from other States so as to benefit from these low taxes. The Queensland Government would not be able to sustain such low taxes in the absence of the subsidy that is provided through the HFE process.

The difference in the distribution of Commonwealth funding to Queensland compared to a distribution based on personal income tax paid, accounts for over three-quarters of the difference in per capita tax levels between Victoria and Queensland. This highlights the wide gap between the theory of HFE and its practical effects. It also highlights the tensions between equalisation principles and national economic efficiency. The fact that the Queensland Government can attract business from Victoria by lower HFE funded tax levels, represents a clear loss to overall national economic welfare. However, the CGC's current methodology gives full weight to equity considerations and ignores the efficiency consequences.

Table 9.4: Impact of Horizontal Fiscal Equalisation on the Distribution of the Pool of Financial Assistance Grants and Hospital Funding Grants 1997-98

$ million[(a)]

	Distribution using amended relativities[(b)]	Distribution on an equal per capita basis[(c)]	Difference in distribution [1] - [2]	Distribution on the basis of personal income tax paid[(d)]	Difference in distribution [1] - [4]
	[1]	[2]	[3]	[4]	[5]
NSW	6 003	6 844	- 840	7 383	-1 380
VIC	4 390	5 003	- 614	5 049	- 659
QLD	3 896	3 760	136	3 237	659
WA	1 958	1 969	- 10	2 000	- 42
SA	1 925	1 618	307	1 445	480
TAS	797	515	282	438	359
ACT	299	339	- 39	512	- 213
NT	979	200	779	183	796
Total	20 247	20 247	0	20 247	0

Source: Reproduced from Commonwealth Budget Paper No. 3, 1997-98, p.18.

Notes:

(a) The pool consists of $16 144.0 million in financial assistance grants and $4 102.9 million in hospital funding grants.

(b) 1997 relativities as recommended by the CGC.

(c) Based on ABS population projections.

(d) Based on each State's contribution to total net tax paid by individuals for 1994-95, as shown in Table, p. 15 of Australian Taxation Office, Taxation Statistics 1994-95.

Policy issues in Specific Purpose Payments

The Victorian Government has identified a number of problems with the proportion of Commonwealth funding tied to SPPs and the conditions attached to them. These problems have arisen partly because many small SPPs are in areas for which State Governments have traditionally been responsible.

The growth of agreements has confused the roles and responsibilities of Commonwealth and State Governments. As a result, the Victorian Government's ability to achieve efficiencies through restructuring of operations has been severely constrained. Often the creation of a separate stream for program development and accountability has also resulted, leading to poor service for clients and duplication of administrative effort.

These are major issues requiring resolution. The Victorian Government has been seeking a reduction of SPPs, both in number, and as a proportion of Commonwealth funding. Ideally, the State would prefer to be financially independent of the Commonwealth through reform of VFI, or next best, to receive funding that is untied with no restrictive terms or conditions attached.

As an intermediate step, SPPs should, wherever possible, be replaced by identified funding grants (IFGs) in the general purpose grant stream. An IFG is a grant for an identified area of broad activity, which is not accompanied by specific performance conditions applied by the Commonwealth. IFGs have none of the restrictions placed on SPPs and therefore yield budgetary and program flexibility and administrative savings. This means better value for money for taxpayers. Improved services and more responsive programs will result. Funds will be better targeted to changing needs and there will be greater flexibility in service delivery.

It is likely, however, that some agreements will continue to provide for Commonwealth funding in the form of SPPs. In any such agreements, the general policy objectives of the Victorian Government are:

- to identify the most efficient and effective means of meeting program objectives in areas that require cooperation with the Commonwealth;
- to avoid distortion of State priorities in the provision of services;
- to provide the State Government with a reliable source of revenue so that predicability, stability and forward planning may be improved, while maintaining flexibility in budget management;
- to eliminate the unnecessary and costly duplication of functions; and
- to minimise the administrative costs associated with monitoring and reporting mechanisms.

Removal of input controls

Increasingly, the Commonwealth Government has been insisting that the States ‘maintain effort’ across a program area as a condition for receipt of new or increased Commonwealth funding. This has usually meant maintenance of inputs (i.e. expenditure) rather than outputs or outcomes. A recent example is the revised Home and Community Care (HACC) Agreement. While this Agreement contains certain administrative improvements, it retains an input-based requirement for the State to maintain expenditure in real terms. Victoria’s suggestion for an alternative arrangement based on achievement of agreed outputs was not accepted by the Commonwealth.

Victoria has increased output and improved efficiency in many areas over the past few years, yet the inclusion of maintenance of expenditure measures has prevented the State from making savings associated with increased productivity gains. Such requirements discourage improved efficiency in programs funded through SPPs. The requirement is also in conflict with the view that the evaluation of programs should be based on outputs or outcomes rather than inputs.

Similarly, many Commonwealth–State agreements require States to match Commonwealth funding, usually dollar-for-dollar. Such matching requirements cause the State to redirect funds away from its priorities, place an added burden on State finances, and in some cases, leave the State responsible for a program when Commonwealth attention has shifted to a new area.

The current interim Commonwealth-State Housing Agreement (CSHA) is an example of the State having to direct its own expenditure under terms and conditions determined in Canberra, rather than in a manner it considers appropriate to the needs of the local community. The interim CSHA is due to expire in June 1999. In the forthcoming negotiations for a new agreement, Victoria will continue to pursue an IFG to provide greater flexibility to respond to the changing needs of the community and be able to manage services more efficiently. As an absolute minimum, Victoria will argue for a more acceptable SPP arrangement, focused on outputs rather than input controls such as matching.

Australian Health Care Agreement

The most significant SPP currently under negotiation is a new AHCA to replace the present 'Medicare' Agreement, which is due to expire on 30 June 1998.

The Commonwealth made an offer to States and Territories late last year. Following consideration, the States and the Northern Territory rejected this offer as inadequate to meet the health care needs of Australians over the next five years. The Commonwealth refused to reconsider its offer at the 1998 Premiers' Conference.

State and Northern Territory concerns about the offer are twofold. The Commonwealth's offer does not provide adequate funding for the expected growth in public hospital demand over the next five years. Funding needs to be significantly increased to enable States and Territories to meet escalating cost and demand pressures in public hospitals.

Medicare is a Commonwealth commitment that guarantees Australians free and uncapped access to the public hospital system. Accordingly, the Commonwealth must provide adequate funding to honour this. However, the Commonwealth proposal makes no allowance for the major decline in private health insurance over recent years. On the Commonwealth's own figures, this has placed an additional cost burden on the States and Territories of more than $600 million per annum. Due to projected growth in demand, all States and Territories are experiencing significant workload increases. While the Commonwealth's proposal includes a 1.6 per cent utilisation growth factor, it is expected that the additional demand on State public hospital systems will significantly exceed this provision.

Appendix A: Reconciliation of Accrual Operating Result to Cash Result

Table A1 provides a summary reconciliation of the factors contributing to the difference between the projected cash budget surplus for 1997-98, as published in the *1997-98 Budget Statement*, and the corresponding accruals operating surplus published in the 1998-99 budget papers. A reconciliation of the 1998-99 cash to accrual operating result is also provided for comparison. A detailed explanation of changes to the presentation of budget estimates in the 1998-99 Budget papers is provided in the *Guide to the 1998-99 Budget Papers*.

Table A1: Reconciliation of Accrual Operating Surplus to Cash Surplus
1997-98 Published Budget and 1998-99 Budget, $ Million

	Note	*1997-98 Budget*	*1998-99 Budget*
Published Cash Budget Surplus		443.7	164.6
Less : Carryover adjustments	*1*	57.6	..
Equals : *adjusted* cash Budget Surplus		386.2	164.6
Accrual Adjustments			
Add back :			
Gross Investment in fixed assets	*2*	1 415.6	1 340.7
Net advances/other capital outlays	*3*	- 159.7	175.5
Less : *Accrued (non-cash) expenses*			
Depreciation	*4*	757.3	784.9
Superannuation	*5*	250.0	- 64.0
Long service leave and other employee entitlements	*6*	140.3	156.6
Other accrued expenses	*7*	- 42.2	- 34.3
Plus : Accrued (non-cash) revenue	*8*	- 12.3	70.2
Equals : Budget Accrual Operating Surplus		548.9	767.3

Source: Department of Treasury and Finance.

Notes to Accompany Reconciliation Adjustments

1. Carryover adjustments

This adjustment reflects the impact of higher than originally budgeted actual carryovers of unspent appropriations from 1996-97 to 1997-98. It is the net result of a $60.7 million increase, relative to the published 1997-98 Budget, in current expenditure carryovers and a $3.2 million decrease in capital expenditure carryovers.

2. Gross investment in fixed assets

The cash budget statement includes all Budget sector expenditure on fixed assets and land, net of proceeds from sale of non-current physical assets. In contrast, the accrual operating result does not include any of this capital expenditure and includes as a revenue item only the net profit or loss on the book value of assets.

Gross investment in fixed assets (in cash terms equivalent to Gross Fixed Capital Expenditure, less any profit/loss on sale of fixed assets) therefore makes a significant contribution to the difference between the reported cash and accruals budget results.

3. Net advances/other capital outlays

This cash budget balance takes into account net advances, loans and equity investment transactions in non-budget and private sector entities. These capital transactions are not included in the accrual operating result.

4. Depreciation

Depreciation is based on the book value of non-current physical assets used in the production of outputs by budget sector agencies during the course of the year. Since this is a non-cash cost, it is not reflected in the cash-based result.

5. Superannuation

The accrual operating surplus includes a provision for the employer superannuation expense accruing during the year to all budget sector employees. Ordinarily, the accrual expense would be expected to be greater than the cash paid during the year, reflecting long term growth in the budget sector unfunded superannuation liability. However it is anticipated that in 1998-99 there will be a decline in the unfunded liability, reflecting a significant pay out of the existing superannuation liability for some Public Transport Corporation (PTC) employees. This is associated with the reorganisation of the

PTC. As a result, cash superannuation costs during 1998-99 are anticipated to exceed the expense accruing during the year.

6. Long service leave and other employee entitlements

The accrual operating surplus includes a provision for employee entitlements such as long service leave that build up steadily during the course of employment but do not require cash payment until the employee exercises these entitlements. The accrual expense is expected to exceed the cash paid to employees actually exercising these entitlements during the course of the year.

7. Other accrued expenses

The cash and accrual budget results both include a number of other operating costs such as purchases of goods and services, personal benefits payments and grants to other sectors. The accrual operating statement includes expenses incurred, but not necessarily paid, during the course of the year (including purchases of goods and services on trade credit terms and commitments to pay grants). In 1997-98 and 1998-99, budgeted cash payments for these items (including payments in respect to expenses incurred in previous years) exceed the accrual expense.

8. Accrued (non cash) revenue

The accrual operating result includes revenue earned (including taxes receivable and revenue owing from Public Trading Enterprises) during the course of a year, even if the cash is not received during the year. The difference between accrual and cash revenue primarily reflects timing factors.

Appendix B: Consolidated State Non Financial Public Sector Estimates

Consolidated State public sector estimates

Classification of Victorian state public sector bodies

In the classification scheme for Government Finance Statistics (GFS), all state public sector bodies are categorised into one of three institutional sectors: general government (GG), public trading enterprises (PTE) and public financial enterprises (PFE). The first two of these, when brought together and consolidated, constitute the *non financial public sector*. The PFEs, operating as financial intermediaries, are brought to account in the non financial public sector only to the extent of transfer payments between them and the GG/PTE sectors.

Table B1 sets out the administrative and institutional classifications adopted by the Department of Treasury and Finance and the Australian Bureau of Statistics (ABS) for Victorian state non financial public sector bodies.

Uniform presentation of government finance statistics

Under the *Uniform Reporting Framework Agreement* (URF) between the Commonwealth, State and Territory Governments, all Australian jurisdictions are required to provide timely publication of government financial data consistent with Australian Bureau of Statistics (ABS) *Government Finance Statistics* (GFS) standards.

The URF was agreed by the Commonwealth, State and Territory Treasurers at the March 1997 Loan Council meeting.

Reporting under the URF integrates and improves aggregate budget reporting previously required under the Uniform Budget Presentation Agreement of 1990 and Loan Council and National Fiscal Outlook reporting arrangements. Features of the URF are the inclusion of forward estimates for the GG sector and financial outcome information for the PFE sector. URF tables are to be published by jurisdictions at budget time, in February (a mid-year budget review report) and at year-end (a budget outcomes statement). The PFE Sector has been incorporated into the reporting arrangements for the first time. This inclusion will bring Government Finance Statistics' coverage into line with the coverage of *Annual Financial Statement* (AFS) which was recently accepted as an accounting standard for whole of government reporting. The State PFE Sector includes state-owned financial intermediaries and insurance and superannuation bodies such as Treasury Corporation of Victoria, Rural Finance Corporation, WorkCover Authority, Transport Accident Commission. Reporting of this sector will be on an outcomes basis only and is therefore not included in the following estimates tables.

Jurisdictions are formally required to implement the improved reporting arrangements in their 1998-99 Budget Papers - Victoria implemented the arrangements one year ahead of this, consistent with its commitment to enhanced financial reporting.

In Tables B2 to B6, financial information for the Victorian non financial public sector for 1997-98 revised and 1998-99 (and forward estimates for the GG sector) is presented on a basis consistent with the URF agreement.

Table B1: 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, Nursing Homes and Ambulance Service	*	*		
Office of Housing			*	*
Infrastructure				
Public Transport Corporation			*	*
Roads Corporation	*	*		
Other	*	*		
Justice	*	*		
Natural Resources and Environment	*	*		
Premier and Cabinet	*	*		
State Development	*	*		
Treasury and Finance	*	*		
Aluminium Smelters of Victoria			*	*
Barwon Water			*	*
Central Gippsland Region Water			*	*
Central Highlands Region			*	*
City West Water Ltd.			*	*
Coliban Region Water Authority			*	*
Country Fire Authority and Appeals Tribunal	*			*
East Gippsland Region Water			*	*
Energy 21			*	*
First Mildura Irrigation Trust			*	*
Glenelg Region Water Authority			*	*
Gas Service Business			*	*
Gas Transmission Corporation			*	*
GasCor			*	*
Gasmart			*	*

Table B1: Classification Of Public Sector Agencies - *continued*

	General Government Sector [(a)]	Budget Sector [(b)]	Public Trading Enterprises [(a)]	Non Budget Sector [(b)]
Goulburn Valley Region Water			*	*
Grampians Region Water			*	*
Ikon Energy			*	*
Kinetik Energy			*	*
Lower Murray Region Water			*	*
Melbourne and Olympic Parks Trust			*	*
Melbourne Port Corporation			*	*
Melbourne Water Corporation			*	*
Metropolitan Parks & Waterways	*			*
Metropolitan Fire and Emergency Services Board	*			*
Multinet Gas			*	*
North East Region Water			*	*
Portland Coast Region Water			*	*
South East Water Ltd			*	*
South Gippsland Region Water			*	*
South West Water			*	*
Southern Rural Water Authority			*	*
Former State Electricity Commission of Victoria				
SECV Shell			*	*
PowerNet Victoria [(c)]			*	*
Victoria Power Exchange			*	*
Generation Victoria (ECOGEN Energy Ltd)			*	*
Southern Hydro Ltd [(c)]			*	*
Stratus Networks			*	*
Sunraysia Rural Water Authority			*	*

Table B1: Classification Of Public Sector Agencies - *continued*

	General Government Sector [(a)]	Budget Sector [(b)]	Public Trading Enterprises [(a)]	Non Budget Sector [(b)]
Urban Land Authority			*	*
Vic Energy Network			*	*
Victorian Channels Authority			*	*
Victorian Dairy Industry Authority			*	*
Victorian Plantations Corporation			*	*
Westar			*	*
Western Region Water			*	*
Westernport Region Water			*	*
Wimmera Mallee Rural Water Authority			*	*
Yarra Valley Water Ltd.			*	*
Commonwealth Contribution to Debt Retirement Reserve Trust A/c	*	*		

Source: Department of Treasury and Finance

Notes:

(a) As presented in ABS, Government Financial Estimates, Australia.

(b) As presented in Victorian Budget Papers.

(c) Agencies sold during 1997-98.

Uniform Reporting Format Presentation

B2 General Government Sector Transactions 1997-98 to 2001-02

B3 Public Trading Enterprise Sector Transactions 1997-98 and 1998-99

B4 State Public Sector Transactions 1997-98 and 1998-99

B5 State Public Sector Taxes, Fees and Fines 1997-98 and 1998-99

B6 State Public Sector Outlays by Purpose 1997-98 and 1998-99

Table B2: Uniform Reporting Format - General Government Sector Transactions

($ million)

	1997-98 Revised	*1998-99 Budget*	*1999- Estimate*	*2000-01 Estimate*	*2001-02 Estimate*
Current Outlays					
Final consumption expenditure	10 398.6	11 417.4	11 629.0	12 120.8	12 424.4
Interest payments	1 158.0	808.7	757.0	708.8	686.6
Subsidies to PTEs	279.6	391.6	251.7	298.3	356.4
Current grants	2 076.2	2 159.2	2 140.7	2 179.4	2 229.8
Other current payments	852.3	542.3	527.0	531.4	427.4
Total Current outlays	**14 764.7**	**15 319.2**	**15 305.4**	**15 838.8**	**16 124.7**
Capital Outlays					
Expenditure on new fixed assets	1 467.9	1 457.9	1 658.6	1 804.1	1 960.2
Expenditure on secondhand assets (net)	- 156.9	- 7.4	- 6.5	- 18.8	- 17.1
Gross fixed capital expenditure	1 311.1	1 450.5	1 652.1	1 785.3	1 943.1
Capital grants	329.9	389.9	357.4	336.0	326.4
Net advances paid	-1 359.5	324.2	56.7	23.3	10.0
Other capital outlays	- 91.2	- 66.1	- 53.9	- 62.6	- 45.5
Total Capital outlays	**190.2**	**2 098.5**	**2 012.3**	**2 082.0**	**2 233.9**
Total Outlays	**14 954.8**	**17 417.7**	**17 317.8**	**17 920.7**	**18 358.6**
Total Outlays excluding net advances	**16 314.4**	**17 093.5**	**17 261.0**	**17 897.5**	**18 348.6**
Revenue and Grants Received					
Taxes, fees and fines	8 787.9	9 028.9	9 162.7	9 380.4	9 577.1
Interest received	114.5	105.9	92.2	91.0	89.6
Grants received	7 213.3	7 353.2	7 671.1	7 895.3	8 161.2
Dividends received from PTEs and PFEs	1 180.2	953.5	866.2	862.7	663.2
Other revenue	383.9	142.7	145.0	148.2	147.4
Total Revenue and Grants Received	**17 679.8**	**17 584.2**	**17 937.1**	**18 377.6**	**18 638.4**
Financing Transactions					
Net advances received	- 0.4	- 0.3	- 0.4	- 0.2	- 0.2
Net domestic and overseas borrowing	-2 786.0	226.3	- 404.8	- 2.5	270.8
Increase in provisions (net)	..	..	..	..	..
Other financing transactions	61.5	- 392.5	- 214.1	- 454.1	- 550.4
Total Financing Transactions	**-2 724.9**	**- 166.5**	**- 619.4**	**- 456.9**	**- 279.8**
less increase in provisions (net)	**..**	**..**	**..**	**..**	**..**
Deficit	**-2 724.9**	**- 166.5**	**- 619.4**	**- 456.9**	**- 279.8**
Net Advances Paid	**-1 359.5**	**324.2**	**56.7**	**23.3**	**10.0**
Deficit adjusted for Net Advances Paid	**-1 365.4**	**- 490.7**	**- 676.1**	**- 480.1**	**- 289.8**
Net Debt	**6 959.6**	**6 468.9**	**5 792.8**	**5 312.7**	**5 022.9**

Source: Department of Treasury and Finance.

Table B3: Uniform Reporting Format - Public Trading Enterprise Sector Transactions

($ million)

	1997-98 Revised	*1998-99 Budget*
Current Outlays		
Interest payments	509.9	435.8
Other Current Payments	1 040.9	849.5
Total Current Outlays	**1 550.8**	**1 285.3**
Capital Outlays		
Expenditure on new fixed assets	1 157.8	1 279.1
Expenditure on secondhand assets (net)	- 189.9	- 55.9
Gross fixed capital expenditure	967.9	1 223.2
Capital Grants	..	..
Net Advances Paid	-3 040.9	- 90.8
Other capital outlays	- 28.2	- 17.5
Total Capital Outlays	**-2 101.2**	**1 114.9**
Total Outlays	**- 550.4**	**2 400.2**
Total Outlays excluding net advances paid	**2 490.5**	**2 491.0**
Revenue and Grants Received		
Net operating surplus of PTEs	1 096.4	1 266.7
Interest received	146.7	113.9
Grants received	264.2	253.2
Other revenue	98.9	90.8
Total Revenue and Grants Received	**1 606.1**	**1 724.6**
Financing Transactions		
Advances received (net)	-1 137.0	131.0
Borrowing (net)	-1 282.1	- 156.6
Increase in Provisions (net)	378.1	356.5
Other financing transactions	- 115.6	344.7
Total Financing Transactions	**-2 156.6**	**675.7**
less Increase in Provisions (net)	378.1	356.5
Deficit	**-2 534.7**	**319.2**
Net Advances Paid	-3 040.9	- 90.8
Deficit adjusted for Net Advances Paid	**506.3**	**410.0**
Net Debt	**5 778.3**	**6 097.5**

Source: Department of Treasury and Finance.

Table B4: Uniform Reporting Format - State Public Sector Transactions

($ million)

	1997-98 Revised	*1998-99 Budget*
Current Outlays		
General Government Final consumption expenditure	10 398.6	11 417.4
Interest payments	1 600.3	1 176.9
Current grants	2 077.6	2 158.1
Other current payments	1 129.7	929.9
Total current outlays	**15 206.1**	**15 682.2**
Capital Outlays		
Expenditure on new fixed assets	2 625.8	2 737.0
Expenditure on secondhand assets (net)	- 346.8	- 63.3
Gross fixed capital expenditure	2 278.9	2 673.7
Capital grants	91.6	150.9
Net Advances Paid	-3 128.6	206.2
Other capital outlays	- 119.4	- 86.3
Total capital outlays	**- 877.4**	**2 944.6**
Total Outlays	**14 328.7**	**18 626.8**
Revenue and Grants Received		
Taxes, fees and fines	8 787.9	9 028.9
Net operating surplus of PTEs	1 283.9	1 413.5
Interest received	192.8	152.9
Grants received	7 202.2	7 326.6
Other revenue	472.4	222.9
Total Revenue and Grants Received	**17 939.2**	**18 144.8**
Financing Transactions		
Net Advances received	34.0	- 0.0
Net Domestic and Overseas Borrowing	-4 068.1	69.7
Increase in provisions (net)	378.1	356.5
Other financing transactions	45.5	55.7
Total Financing Transactions	**-3 610.5**	**481.9**
less increase in provisions -net	378.1	356.5
Deficit	**-3 988.6**	**125.4**
Net Advances Paid	-3 128.6	206.2
Deficit Adjusted for Net Advances Paid	**- 860.1**	**- 80.8**
Net Debt	**12 294.9**	**12 214.2**

Source: Department of Treasury and Finance.

Table B5: Uniform Reporting Format - State Public Sector Taxes, Fees & Fines

($ million

	1997-98 Revise	*1998-99 Budget*
Employers' payroll taxes	2 169.6	2 225.4
Taxes on property		
Taxes on immovable property	371.2	497.1
Stamp duties	1 326.4	1 327.0
Financial institutions transactions taxes	584.0	597.4
Financial Accommodation Levy	8.1	7.8
Taxes on provision of goods and services		
Excises and Levies	188.3	..
Taxes on gambling	1 292.7	1 340.5
Taxes on insurance	519.8	539.5
Taxes on use of goods and performance of activities		
Motor vehicle taxes	851.1	871.3
Franchise taxes	1 227.3	1 360.4
Other	16.1	12.1
Fees	97.6	116.1
Fines	135.8	134.3
TOTAL TAXES, FEES AND FINES	**8 787.9**	**9 028.9**

Source: Department of Treasury and Finance.

Table B6: Uniform Reporting Format: State Public Sector Outlays By Purpose

($ million)

	1997-98 Revised	*1998-99 Budget*
General Public Services		
Current outlays	1 585.7	2 134.9
Capital outlays	-202.8	34.4
Total	**1 382.9**	**2 169.2**
Public Order & Safety		
Current outlays	1 310.9	1 259.8
Capital outlays	39.3	101.9
Total	**1 350.2**	**1 361.7**
Education		
Current outlays	3 943.2	4 087.8
Capital outlays	272.7	349.3
Total	**4 215.9**	**4 437.1**
Health		
Current outlays	3 270.3	3 539.7
Capital outlays	255.1	463.7
Total	**3 525.5**	**4 003.4**
Social Security and Welfare		
Current outlays	1 185.3	1 258.6
Capital outlays	34.4	46.3
Total	**1 219.7**	**1 304.9**
Housing & Community Amenities		
Current outlays	195.7	174.7
Capital outlays	603.3	780.6
Total	**799.0**	**955.3**
Recreation & Culture		
Current outlays	297.6	281.4
Capital outlays	173.6	277.2
Total	**471.2**	**558.5**

Table B6: Uniform Reporting Format: State Public Sector Outlays By Purpose - *continued*

($ million)

	1997-98 Revised	*1998-99 Budget*
Fuel & Energy		
Current outlays	7.3	136.5
Capital outlays	-2,848.9	228.0
Total	**-2 841.7**	**364.5**
Agriculture, Forestry, Fishing & Hunting		
Current outlays	326.0	303.3
Capital outlays	26.3	43.8
Total	**352.2**	**347.1**
Mining & Minerals Resources, Manufacturing & Construction		
Current outlays	55.9	44.9
Capital outlays	2.8	2.1
Total	**58.7**	**47.0**
Transport & Communication		
Current outlays	733.0	883.3
Capital outlays	750.2	700.2
Total	**1 483.2**	**1 583.5**
Other Economic Affairs		
Current outlays	178.0	124.3
Capital outlays	18.0	19.5
Total	**196.0**	**143.9**
Other Purposes		
Current outlays		
Public debt - including interest	1 600.9	1 177.5
Other	516.5	275.6
Capital outlays	-1.5	-102.5
Total	**2 115.9**	**1 350.5**
TOTAL OUTLAYS STATE PUBLIC SECTOR	**14 328.7**	**18 626.8**

Source: Department of Treasury and Finance.

Appendix C: Victoria's Nominated 1998-99 Loan Council Allocation

Table C1, Loan Council Allocation (LCA), compares Victoria's 1998-99 LCA nomination with the revised LCA based on the 1998-99 Budget estimates.

The 1998-99 General Government sector surplus and PTE sector net financing requirement do not provide for any future privatisations. If further privatisations were to occur in 1998-99 Victoria may breach the tolerance limit of $353 million applying to its nominated 1998-99 LCA. Loan Council will be notified, in line with Loan Council Reporting Arrangements, if a breach of tolerance limits is expected.

It should be noted that Victoria expects to favourably exceed the tolerance limit applying to its 1997-98 LCA mainly due to the sale of PowerNet Victoria for $2.555 billion (excluding licence fees) in October 1997 and the sale of Southern Hydro Limited in November 1997 for $391 million. Victoria's 1997-98 LCA outcome will be published in a separate outcomes report after the end of the 1997-98 financial year in line with the Uniform Presentation Framework.

Listed below are details of Victoria's Infrastructure Projects with Private Sector Involvement where contracts are expected to be signed in the 1998-99 financial year.

In line with the current Loan Council guidelines for the treatment of such projects, the termination liabilities as measured by the Government's contingent exposure, are to 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 1998-99 LCA outcome.

Table C1 : Loan Council Allocation

($ million)

	1998-99 nomination	1998-99 Revised
(+) DEFICIT/(-) SURPLUS		
General Government sector [(a)]	-376	-167
PTE sector net financing requirement	222	188
Non-Financial Public sector	-154	22
Memorandum Items [(a)]	145	148
Loan Council Allocation	**-9**	**170**
Tolerance limit (2.0% of non-financial public sector revenue)	*353*	*353*

Source: Department of Treasury and Finance.

Notes:

(a) 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.

(b) Totals may not add due to rounding.

Water and Sewerage

In October 1997, Government announced a series of water reforms that will benefit all Victorians. The reform package includes a $450 million allocation for capital projects outside the metropolitan area, that is designed to improve the quality of drinking water as well as upgrading waste water management systems.

It is Government's intention to ensure efficient delivery of these capital expenditure projects and will therefore invite the private sector to participate in their delivery by way of Build-Own-Operate (BOO) or Build-Own-Operate-Transfer (BOOT) financing schemes.

Already, the Coliban Region Water Authority has committed to a BOO project for a waste water treatment plant, with expressions of interest called for the delivery of a water treatment plant that will service their Bendigo, Castlemaine and Kyneton locations. These projects alone will total around $60 million. It is expected that full contractual obligations for these projects will arise during the 1998-99 financial year.

Additionally, projects for the Grampians and Central Highlands Region Water Authorities totalling around $115 million are currently under consideration, with an expectation that contracts would be exchanged by 30 June 1999.

Government has advised the Water Authorities that all demand/usage risk attaching to the various plants must be assumed by the contractor. Additionally, no residual risk will attach to the respective Authorities, or Government, as a result of a default caused by the contractor which leads to termination of the contract(s).

Roads

As part of the City Link project, Government approved the creation of an extension of Exhibition Street across the existing Jolimont railyards, so as to join the City Link project at the Swan Street / Batman Avenue intersection. For traffic management reasons, additional slip roads and alterations to other structures are also required.

The capital cost of these works has been estimated at around $95 million. At this time, it is anticipated that the majority, if not all of the financing risk will be assumed by the private sector, preferably by way of a BOOT scheme.

Whilst no firm agreement of the proposed structure has been reached or contracts negotiated, there is an expectation that contracts will be exchanged during the 1998-99 financial year, to ensure a seamless integration with the rollout of the City Link project.

As was the case in the City Link project, all demand risk will be borne by the selected contractor, assuming a BOOT scheme is selected. There will be no residual payment liability attaching to the State, in the event of contractor default leading to contract termination.

Health

The Department of Human Services has announced the development of two public hospitals, to be situated at Berwick and Mildura, that are intended to be under contractual obligations by April 1999. It is the Department's intention to attract private sector involvement in these hospital projects, by way of BOO schemes, in similar fashion to the provision of the Latrobe Regional Hospital transaction in 1996-97.

Whilst final determination of the optimal number of beds is yet to occur, there is an expectation that the combined capital cost of these projects will be around $100 million. Recurrent funding for public hospital services provided will also be an operational impost upon the State during the anticipated 10 to 15 year operating terms of the respective service contracts. However, demand risk, in addition to the usual constructions risks under a BOO scheme, will be borne by the private sector contractor.

Government will possess the ability to exercise a right of 'step-in', should the selected service provider/contractor not provide the service standards as agreed. Such a circumstance would be an event of default, giving rise to contract termination. Government is under no liability to effect a termination payment to the service provider/contractor under a default scenario.

Glossary

Accrual accounting	Recognition of revenue, expenses, assets and liabilities when the economic transaction occurs, irrespective of the timing of the related cash flow. For example, revenue for sale of goods is recorded as of the invoice date; rather than the date on which payment is received.
Accrual output-based management	The Government, as funder, decides which outputs it will fund 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.
Amount appropriated	The limit of appropriation authority to make arrangements, and to incur expenses and obligations. This is the amount in the Appropriation Bill against 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 government 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 make a report to Parliament explaining the Finance Statement in full.
Appropriation	An authority from the Parliament which is not to exceed the amount specified, to make arrangements, and to incur expenses and obligations.
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. buildings) or *non-physical* (e.g. investment). 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.
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. The budget sector accounts for nearly all of the general government sector entities.
Capital (account) balance	The difference (deficit or surplus) between capital outlays and capital revenue.
Capital Assets Charge	A charge generally on the written down value of assets within the Budget Sector which are non-current, physical, non-administered 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 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. That is using measures which identify groups of diagnoses requiring a similar level of resources to treat a patient. Diagnosis related groups (DRGs) are the most commonly known casemix measure.
Cash accounting	The recording of receipts and payments as they occur. Cash accounting does not recognise products and services bought or sold on credit, nor 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 report that provides information on the cash inflows and outflows as they relate to operating, investing and financing activities. The net cash flow is added to the opening balance to report the cash on hand.
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 Commonwealth Government funding as financial assistance grants amongst the States.
Community Service Obligation	An activity or service performed or provided by a government business enterprise at the direction of Parliament or the Government which it would either provide commercially at a higher price, or not elect to provide on a commercial basis.

Consolidated Fund	The government's primary account, established by the *Financial Management Act 1994*, that receives all Consolidated Revenue under the *Constitution Act* and from which payments appropriated by Parliament for government purposes are made. The Consolidated Fund, together with the Trust Fund, form the Public Account.
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 provide a government business enterprise with a more commercial focus, by establishing a structure of incentives similar to those that exist for private sector firms. Key elements of corporatisation include an independent board of directors, explicit performance targets, explicit funding by the government of community service obligations, tax-equivalent payments, and a requirement to comply 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	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 net interest payments to total revenue, and net interest payments to own-source 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 between expenses and revenue. More formally, 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/funding.
Depreciation	A non-cash cost that represents the ‘using-up’ of an asset over the years of its productive life.
Expenditure	Cash costs associated with the provision of services.
Expenses	Consumption or losses of future economic benefits. These may also be in the form of reductions in assets or increases in liabilities resulting in a decrease in equity during the reporting period.
Financial assets	Service potential or future economic benefits controlled by an entity (e.g. a department) as a result of past transactions. For example, cash, investments, receivables.
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 report against three financial statements:

- Cash flow statement
- Operating statement
- Statement of financial position

Fixed 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).

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. Franchising is often seen as a way of introducing competition into an industry that might otherwise be a natural monopoly.

General government
General government includes: all budget sector agencies except the PTC and Housing and Construction Victoria; and a number of non-budget sector agencies such as the CFA, MFESB and universities and colleges.

General government sector
That part of the government that provides goods and services for consumption by governments and the general public. Costs of production are mainly financed from public revenues. Products and services are often provided free of charge or at nominal charges below the full costs of production.

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. GBEs are often referred to as public trading enterprises (PTEs) or, more recently, as state-owned enterprises.
Government Finance Statistics	The economic framework developed 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. That is, 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 education institutions, and local governments.
Domestic final demand	The total expenditure within a given period on final goods and services (that is, 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.
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 (CGC). The States and territories that, according to the CGC, must 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 *Specific purpose payments*.

Level of service provision ratio

The ratio of actual expenditure to standardised expenditure as assessed by the Commonwealth Grants Commission (CGC). 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 CGC'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 *Contingent liabilities*.

Loan Council

A body comprising the Commonwealth Treasurer (as Chairman) 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.

Medicare Agreement

An agreement between the Commonwealth and the States to provide all Medicare beneficiaries with inpatient and outpatient care at public hospitals without charge.

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 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.
Net operating surplus	The amount by which the revenue of an entity exceeds the costs incurred in producing its output.
Net surplus	Operating surplus plus or minus abnormal items.
Non-budget sector	General government sector entities that are not classified as “budget sector”. For example, the Country Fire Authority.
Operating balance	The difference (deficit or surplus) between an entity’s operating revenue and the operating expenses (wages and salaries, intermediate inputs, etc).
Operating deficit	The change in the financial position for the reporting period where operating expenses exceed operating revenue incurred in the production of outputs.
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 using up of assets (depreciation), the servicing of debt, and grants.
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 report providing information for the reporting period on the revenue and expenses and the surplus or deficit of an entity.
Operating surplus	The amount by which operating revenue exceeds operating expenses incurred in the production of outputs and other trading activities for the reporting period.
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 are expected to contribute to government outcomes.
Outlays	The current and capital expenditure; a measure of the cost of providing non-marketable goods and services; the net extent to which resources are directed through the budget, after offsetting recoveries and repayments against relevant payments and the proceeds from the sale of capital assets.
Output	A product or service supplied to external consumers. For example, 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 all direct and indirect costs (on a full accrual basis) 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 revenues	See *State-source revenues*.
Performance measures	Dimensions 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.
Public Authority Contribution	A payment made by GASCOR to the Victorian Government in relation to its natural gas revenue.
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 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.
Purchaser/provider split	A structural separation of the funding and service delivery roles within the health system. 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 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. It allows departments to make arrangements and incur expenses and obligations in the delivery of outputs and additions to the net asset base. Amounts are deemed to be appropriated upon receipt to the Consolidated Fund. Receipts credited appropriations are also referred to as *Annotated appropriations*.

Revenue	The non-repayable receipts available to finance the outlays of public authorities. Revenue includes taxes, grants, interest, royalties, dividends and the operating surpluses of public trading enterprises. For State governments, revenue is often categorised into grants from the Commonwealth and State-source or own-source revenues.
Revenue on behalf of the State	Revenue collected from sources such as taxes and Commonwealth Financial Assistance Grants, that is collected for the purpose of funding State government generally. These revenues are not retained specifically by the department which collects them, and are not related to the provision of departmental outputs.
Revenue-raising effort ratio	The ratio of actual revenue to *standardised revenue* as measured by the Commonwealth Grants Commission (CGC). Revenue-raising effort ratios may be calculated for individual revenue sources or for total State-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 of 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 - that is, 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 owned enterprises — Widely used as an alternative term for Government Business Enterprises. Strictly speaking, however, a GBE 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-source revenues	Revenues which a State government collects from the taxes, charges and other levies which it imposes under its own legislation, as distinct from those revenues it obtains by way of grants from the Commonwealth. Sometimes referred to as 'own-source revenues'.
Statement of financial position	A report that provides information on the assets and liabilities of an entity. The statement also reflects the financial position or the net worth of an entity for the reporting period. Also known as 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.
Tax-equivalent payments	Payments which a Government Business Enterprise may be required to make in order to ensure that, as far as possible, it has the same taxation obligations as private sector firms. For example, although GBEs are ordinarily exempt from Commonwealth income taxes, they may be 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).

Index

E

F

S

T

V

W