



Victorian Budget 18/19

GETTING THINGS DONE

Strategy and Outlook

Budget Paper No. 2
Presented by Tim Pallas MP,
Treasurer of the State of Victoria



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2018-19



Presented by

Tim Pallas MP

Treasurer of the State of Victoria

for the information of Honourable Members

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CHAPTER 1 – ECONOMIC AND FISCAL OVERVIEW

For the past three years the Government has been getting things done: investing in education and skills; improving healthcare; building new roads and rail lines; making our community safer; and creating more jobs for Victorians. The *2018-19 Budget* continues this momentum, maintaining a robust economy while delivering the services and infrastructure our growing state needs.

The *2018-19 Budget* is underpinned by strong economic and fiscal management. Real gross state product (GSP) increased by 3.3 per cent in 2016-17, the strongest of all the states and well above national real gross domestic product (GDP) growth of 2.0 per cent. Importantly, the benefits of our economic success are being shared. Our living standards are increasing, with GSP per capita growing by 0.9 per cent in 2016-17, above the 0.2 per cent growth experienced across Australia. This was the third successive rise in Victoria's GSP per capita, the longest period of growth since the global financial crisis.

Victoria's economic strength means more Victorians have the security and dignity of a job. More than 117 000 new jobs were added in 2016-17, the highest number of all the states, and more than 70 per cent of all new jobs created across Australia. From November 2014 to March 2018, employment in Victoria grew by 11.4 per cent or 333 900 persons, with the majority of jobs being in full-time employment and spread broadly across industries and regions. In 2017, employment in regional Victoria increased by 3.1 per cent, while the regional unemployment rate declined to 5.4 per cent.

The *2018-19 Budget* continues the Government's clear fiscal strategy with Victoria's finances remaining in excellent health, reflected in the State's triple-A credit rating. Looking forward, the operating surplus is expected to be \$1.4 billion in 2018-19, and average \$2.5 billion a year over the forward estimates. Government infrastructure investment will reach \$13.7 billion in 2018-19, and average \$10.1 billion a year over the budget and forward estimates. This is more than double the average of \$4.9 billion a year from 2005-06 to 2014-15. Total infrastructure investment announced by this Government since 2014 is expected to support the creation of over 75 000 new jobs.

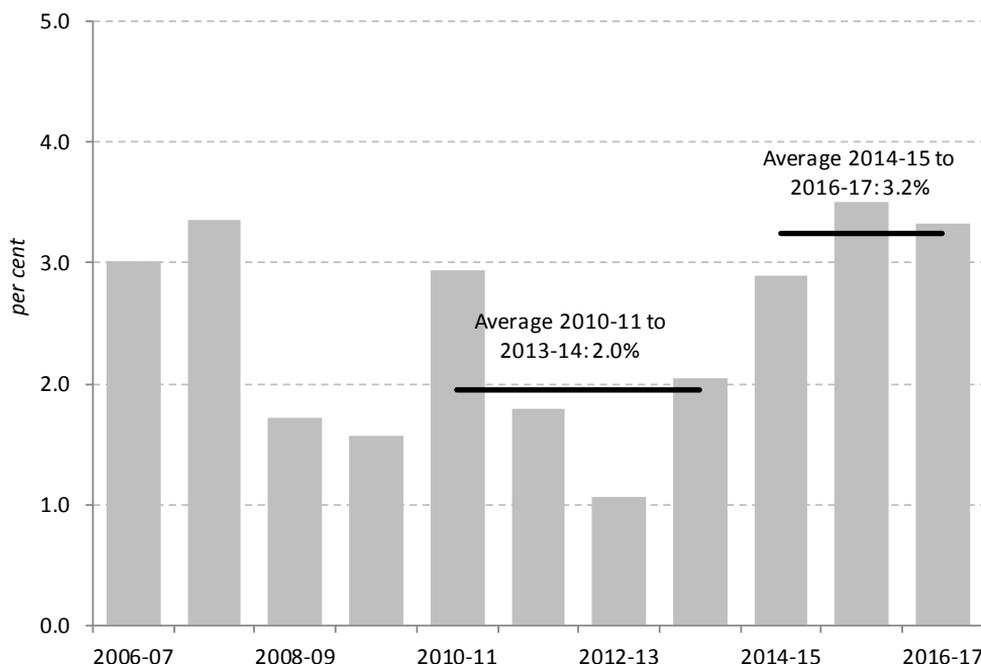
The *2018-19 Budget* continues the momentum of investing in a growing Victoria. The budget ensures the next generation of Victorians will have the skills to keep building the state by offering priority TAFE courses free and creating an opportunity for students to start an apprenticeship at school. It delivers new and upgraded roads to get people out of traffic and home sooner, and continues the overhaul of Victoria's public transport network. It builds good schools close to home, and upgrades existing schools. It grows jobs by further reducing the payroll tax rate in regional Victoria. Finally, the *2018-19 Budget* includes the biggest investment in mental health services in Victoria's history, with more beds and specialist emergency departments to give patients the treatment they need. Amidst this, Victoria remains one of only 10 sub-sovereign governments in the world with a triple-A credit rating from both major rating agencies.

THE ENGINE OF THE NATION

Improving living standards and growing jobs

Victoria's real GDP rose by 3.3 per cent in 2016-17, the highest rate of expansion of any state and well above national real GDP growth of 2.0 per cent. Over the past three years, real GDP growth has averaged 3.2 per cent a year. This represents a return to the rates of growth last experienced before the global financial crisis, and is a marked improvement on the average growth of just 2.0 per cent in the period between 2010-11 and 2013-14 (Chart 1.1).

Chart 1.1: Victorian real GDP growth, 2006-07 to 2016-17



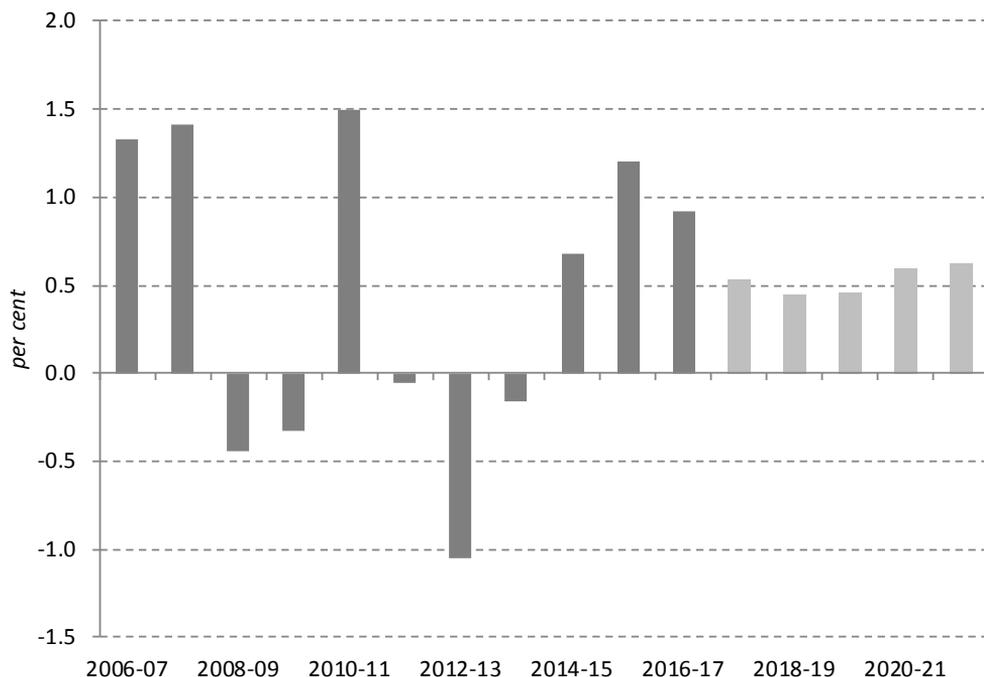
Source: Australian Bureau of Statistics

The Victorian economy is expected to record another year of above-trend growth in 2017-18, with growth projected to stabilise at the trend rate of 2.75 per cent a year in 2018-19 and over the forward estimates. Household consumption and public demand are expected to make the largest contributions to growth, the latter reflecting the Government's large infrastructure program.

Victoria's population is expected to grow by 2.2 per cent in 2018-19, easing to 2.0 per cent a year from 2020-21, while inflation and wages growth are forecast to rise toward their trend rate.

Real GDP has grown faster than the population in each of the past three years. This is the longest period of sustained growth in real GDP per capita since the global financial crisis, and proof that Victoria's economic strength is improving the average living standard of Victorians. GDP per capita is expected to continue to rise in future years as growth in real economic activity outpaces population growth in each year to the end of the forward estimates (Chart 1.2).

Chart 1.2: Victoria’s real GSP growth per capita, 2006-07 to 2021-22



Source: Australian Bureau of Statistics

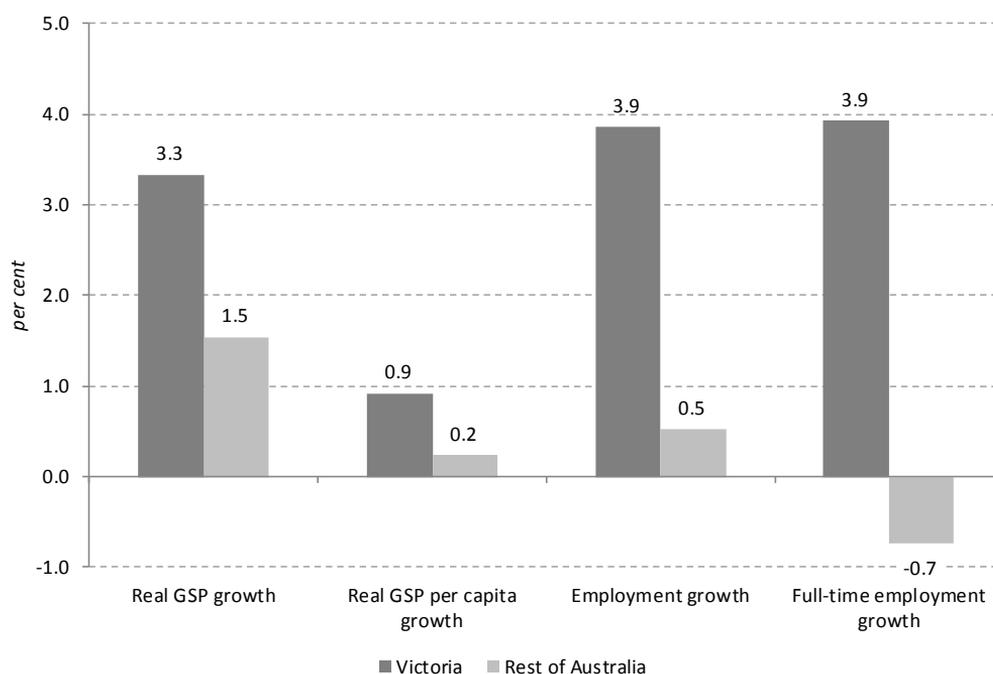
The clearest measure of the strength of the Victorian economy is the number of jobs that have been created – 333 900 since the Government came to office in November 2014. Employment has grown at an above-trend rate for three years; further growth of 2.75 per cent is expected in 2017-18 and 2.0 per cent in 2018-19.

The strength of Victoria’s labour market is broad-based. Full-time employment has grown strongly and the youth unemployment rate has fallen to be the second lowest in the nation. The majority of Victoria’s 19 industry groups expanded their employment in 2016-17, while employment in regional Victoria rose by 3.1 per cent in 2017.

Victoria is the engine driving the national economy, outperforming the rest of Australia across a broad range of economic indicators in 2016-17 (Chart 1.3). Real GSP growth in Victoria of 3.3 per cent in 2016-17 was more than double the rate of growth across the rest of Australia, while real GSP per capita rose at quadruple the rate. Employment growth and full-time employment growth both rose at an above trend rate of 3.9 per cent a year in Victoria, while the rest of Australia experienced much lower employment growth and a loss in full-time employment.

Since 2013-14, real GSP in Victoria has expanded by 10.1 per cent, well above the rate of growth across the rest of Australia. All three drivers of growth – population, participation and productivity – contributed positively to the Victorian economy over this period. The contribution from participation was strong, reflecting high labour force participation amidst one of the strongest employment cycles in Victoria’s history. Productivity also made a positive contribution, indicating that output per worker has increased even during a period of above-trend population and employment growth.

Chart 1.3: Selected economic indicators for Victoria and the rest of Australia, 2016-17



Source: Australian Bureau of Statistics

STRONG FINANCIAL FOUNDATIONS

The *2018-19 Budget* consolidates the Government’s demonstrated track record of responsible financial management.

The general government operating surplus (net result from transactions) is estimated to be \$1.4 billion in 2018-19, and average \$2.5 billion a year across the forward estimates. Over the next four years, revenue is expected to grow by an average of 4.0 per cent a year, which is greater than average annual expenses growth of 3.9 per cent. Net debt as a percentage of GSP is expected to be 4.6 per cent at June 2018 and increase to 6.0 per cent by June 2021, and remain at that level in 2021-22.

Table 1.1: General government fiscal aggregates^(a)

	Unit of measure	2016-17 actual	2017-18 revised	2018-19 budget	2019-20 estimate	2020-21 estimate	2021-22 estimate
Net result from transactions	\$ billion	2.7	2.0	1.4	2.0	2.7	2.9
Government infrastructure investment	\$ billion	9.1	11.6	13.7	10.0	8.9	7.6
Net debt	\$ billion	15.8	19.6	24.3	28.0	29.8	31.4
Net debt to GSP	per cent	3.9	4.6	5.4	5.9	6.0	6.0

Source: Department of Treasury and Finance

Note:

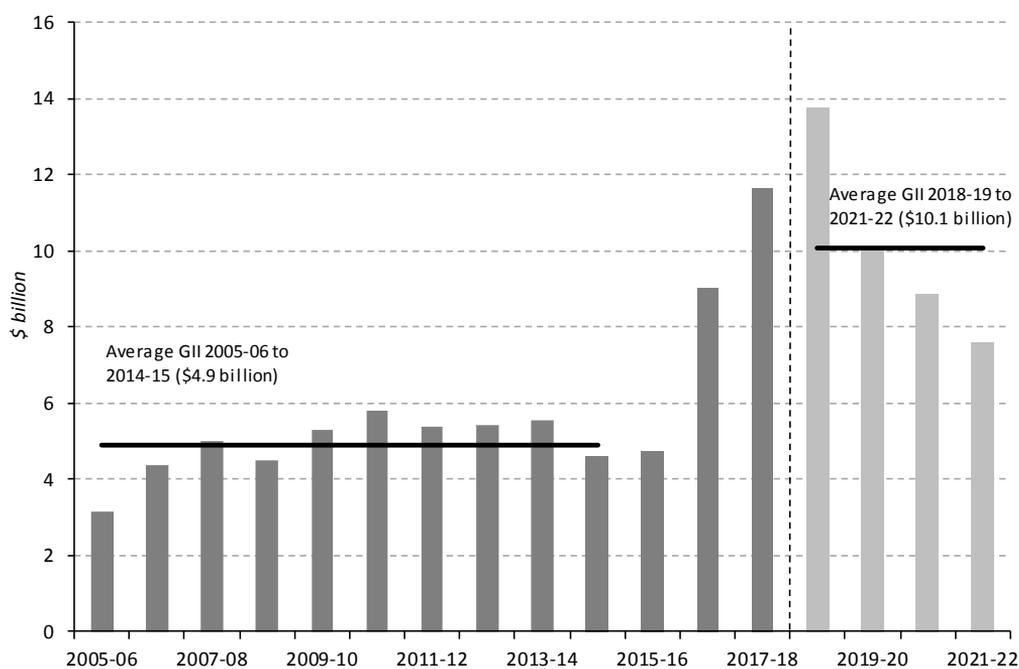
(a) Refer to Budget Paper No. 2, Chapter 4, Table 4.1 for notes on interpretation of key aggregates.

In each of its four budgets the Government has adhered to a clear and robust fiscal framework, enabling investments in services and infrastructure to meet the needs of a growing population while maintaining net debt as a percentage of GSP at no greater than its peak over the previous five years.

The 2018-19 Budget funds \$9.4 billion of new output initiatives with major funding increases for skills, schools, health, mental health and community safety.

The 2018-19 Budget also funds a further \$9.3 billion in new asset initiatives, underscoring the Government’s commitment to building productivity-enhancing infrastructure that will create jobs, drive economic growth and improve living standards for all Victorians. Overall, government infrastructure investment is forecast to average \$10.1 billion a year over the budget and forward estimates, more than double the average of \$4.9 billion a year from 2005-06 to 2014-15 (Chart 1.4).

Chart 1.4: Government infrastructure investment ^{(a)(b)}



Source: Department of Treasury and Finance

Notes:

- (a) Refer to Budget Paper No. 2, Chapter 4, Chart 4.1 for notes on interpretation of general government infrastructure investment.
- (b) The figure for 2017-18 is an estimate.

The Government’s record infrastructure program has been supported by its innovative approach of recycling assets to fund new capital projects. Following the success of the \$9.7 billion lease of the operations of the Port of Melbourne, the Government recently agreed to terms for the sale of Victoria’s share of Snowy Hydro Limited to the Commonwealth for \$2.1 billion, more than half of which will be invested in regional Victoria.¹ The Government is also in the process of commercialising land titles and registry functions of Land Use Victoria.

Asset recycling releases billions of dollars tied up in mature assets to reinvest in infrastructure, generating thousands of jobs across Victoria and improving economic productivity.

The *2018-19 Budget* reflects the Government’s long-term financial management objectives as set out in Table 1.2.

Table 1.2: Long-term financial management objectives

<i>Priority</i>	<i>Objective</i>
Sound financial management	Victoria’s finances will be managed in a responsible manner to provide capacity to fund services and infrastructure at levels consistent with maintaining a triple-A credit rating.
Improved services	Public services will improve over time.
Building infrastructure	Public infrastructure will grow steadily over time to meet the needs of a growing population.
Efficient use of public resources	Public sector resources will be invested in services and infrastructure to maximise the economic, social and environmental benefits.

Progress towards these long-term financial management objectives is supported by the measures and targets in Table 1.3.

Table 1.3: Financial measures and targets for the 2018-19 Budget

<i>Financial measures</i>	<i>Target</i>
Net debt	General government net debt as a percentage of GSP to be maintained at a sustainable level over the medium term.
Superannuation liabilities	Fully fund the unfunded superannuation liability by 2035.
Operating surplus	A net operating surplus consistent with maintaining general government net debt at a sustainable level over the medium term.

¹ See Budget Paper No. 4, Chapter 1 *State Capital Program 2018-19* Box 3 for further details.

CREATING OPPORTUNITIES THROUGH SKILLS

Victoria's growing economy is creating a high demand for skilled jobs, and the Government's sustained investment in services and infrastructure has accelerated this demand. The *2018-19 Budget* invests to deliver access to high-quality training through the TAFE and training sector, giving Victorian workers the skills they need and Victorian businesses the workers that they require.

The *2018-19 Budget* provides \$304 million to create thousands of new TAFE and training places, allowing more Victorians to access training.

The budget further provides \$172 million to make training for students at TAFEs free for 30 priority courses, from 1 January 2019. In addition, 18 Apprenticeship Pathway courses in government priority sectors will also be free. These quality courses will focus on the skills the economy needs – building infrastructure projects, responding to family violence, and caring for older Victorians or people living with disability.

To help young people get the skills they need, the budget includes \$49.8 million for *Head Start Apprenticeships and Traineeships* that will give secondary school students the option of an additional year of school to learn their trade at school and get a job sooner. The *2018-19 Budget* also funds \$25.9 million to improve the quality and availability of secondary vocational pathways. Careers education for secondary school students will commence from Year 7, to ensure that students can tailor their coursework to suit their longer-term career objectives.

Working with business to create jobs

The *2016-17 Budget* announced the payroll tax threshold would progressively increase to \$650 000, which cut taxes for more than 36 000 Victorian businesses. The *2017-18 Budget* brought forward these threshold increases and also reduced the tax rate for regional employers to 3.65 per cent – Australia's first regional payroll tax rate. This budget further reduces the payroll tax rate for regional employers to 2.425 per cent, making it the lowest payroll tax rate in Australia. In its last two budgets, the Government has halved the rate of payroll tax for businesses that are based in regional Victoria and pay at least 85 per cent of their wages to regional employees.

To help support and create jobs, this budget provides a \$10 million extension to the Premier's Jobs and Investment Fund; \$13.5 million for the small and medium enterprise sector; and \$16.1 million to grow agricultural exports – all creating new local jobs. The Government will continue to encourage interstate and international companies to invest in Victoria through a \$55 million boost to the Investment Attraction and Assistance Program.

Building on previous significant investment, the Government is providing an additional \$51.1 million in the *2018-19 Budget* for tourism marketing, attracting business events and expanding the Major Events Fund. A further \$4.6 million in funding will help commercialise Victoria's biomedical research into local jobs and industry, while \$103 million of funding, including a \$50 million Commonwealth contribution, will be invested in a hydrogen energy supply chain pilot project.

VICTORIA'S BIG BUILD

Over the past three budgets, the Government has committed more than \$40 billion to the Victorian road and rail network that gets people out of traffic and home sooner. The *2018-19 Budget* invests almost \$4.3 billion for better roads around Victoria and \$1.9 billion to continue the overhaul of Victoria's public transport network.

Upgrading Victoria's roads

Our suburbs are growing rapidly. This budget invests \$2.2 billion in the Suburban Roads Upgrade in Melbourne's northern and south-eastern suburbs, building on the Western Roads Upgrade funded in last year's budget. This will update and improve the local roads that drivers in Melbourne's outer suburbs use every day.

In the past three budgets, the Government has invested in upgrades to the M80 Ring Road, Monash, Tullamarine and West Gate freeways. The *2018-19 Budget* continues this investment with \$110 million to fast track the completion of detailed design and planning for the North East Link – the missing link in Melbourne's freeway network. The Government is also investing a further \$75 million in the Mordialloc Bypass to build a four-lane freeway connection between the Mornington Peninsula Freeway at Springvale Road and the Dingley Bypass, bringing total investment to \$375 million.

The *2018-19 Budget* also allocates \$941 million for Victoria's regional road network. Regional Roads Victoria (RRV) will be a new division of VicRoads, based in Ballarat and with staff in regional centres across the state to give regional Victorians the roads they can rely on.

Building a world-class public transport network

More people than ever rely on our public transport network.

Over the past three years, the Government has undertaken an overhaul of Victoria's public transport infrastructure, including building the Metro Tunnel to untangle the entire train network, extending the South Morang link to Mernda, removing 50 dangerous and congested level crossings and purchasing hundreds of new metro and regional train carriages.

The *2018-19 Budget* consolidates these major projects with an additional \$1.9 billion of public transport infrastructure investment that will reduce travel times and address overcrowding.

Victoria's rail network will be improved by the \$572 million investment to enable and plan for the duplication of the Cranbourne line, deliver power and signalling upgrades from the city to Cranbourne and Pakenham and undertake detailed design work to enable new high capacity metro trains to run to Sunbury.

A further five X'Trapolis trains are being ordered to meet increasing demand on the metropolitan network, and \$89.4 million is being committed to extend and add more services on the South Morang line to Mernda, along with additional services on the Hurstbridge and Dandenong lines.

THE EDUCATION STATE

The *2018-19 Budget* continues to build on the \$6 billion the Government has invested in Victoria's schools since 2014. With an estimated 90 000 new students entering Victorian schools over the next five years, effort is required to ensure every Victorian has access to a good quality school, and the opportunity for a better life. The *2018-19 Budget* provides nearly \$1.3 billion in school infrastructure funding that will build or plan 28 new schools and upgrade more than 130 others, through:

- \$272 million to purchase land for new school sites;
- \$353 million in investment for new and planned school projects; and
- \$483 million to upgrade existing schools.

The investment in the Education State is covering every corner of Victoria, with \$775 million already invested in regional Victorian schools. This budget commits a further \$181 million to build, plan and upgrade 60 regional schools, including plans to build five new schools and upgrade 55 existing primary and secondary schools.

A further \$126 million is provided statewide for the relocatable classrooms program, school pride and sport funds, and an asbestos removal program.

The *2018-19 Budget* provides \$43.8 million to reduce secondary school dropout rates through the Navigator program, as well as \$22.1 million to support quality teaching in core literacy and numeracy skills and \$32.9 million for 200 additional primary maths and science specialist teachers.

This budget positions Victoria as a national leader in inclusive education with \$288 million to support students living with disability or additional learning needs. This includes \$65.5 million for student health and wellbeing reforms, and \$55.6 million to upgrade 15 specialist schools across Victoria.

DELIVERING BETTER, FASTER CARE

All Victorians should be able to access quality healthcare close to home.

Over the past three years, the Government has undertaken record investment in healthcare, including in hospitals, mental health support, ambulance services and paramedics. This funding has improved the health and wellbeing of Victorians, but there is still more to do.

Better hospitals for better health

The *2018-19 Budget* invests \$1.2 billion to build and expand hospitals across the state. Works include upgrading the Alfred Hospital, delivering electronic medical records to the Parkville Precinct and funding an expansion of the Sunshine Hospital emergency department to meet demand in Melbourne's west.

Recognising that heart disease is one of the biggest killers of Victorians, this budget commits to building Australia's first specialist standalone heart hospital, to bring together the very best cardiac care, technology, treatment, education and research in one world-class facility at Monash University Clayton.

Victorian health services will receive a record investment of \$2.1 billion to address increasing demand on our hospitals, including \$218 million for an elective surgery blitz to cut waiting times and lists. Last year's flu season was one of the worst on record, resulting in a record number of Victorians presenting to emergency departments. This year's budget funds an additional \$50 million winter blitz so that hospitals can prepare for the flu season.

Box 1.1: Historic action on mental health

Mental health is as important as physical health. In 2015, the Government launched Victoria's 10-year Mental Health Plan, to help the estimated 45 per cent of Victorians who will experience mental health challenges in their lifetime.

To make sure Victorians facing mental illness and addiction get the treatment they need, the *2018-19 Budget* includes a record \$705 million investment in mental health. This includes:

- \$232 million to support growing demand, giving 12 800 more Victorians the support they need and funding 89 acute inpatient beds;
- \$101 million to establish six new emergency department crisis hubs, taking those who are dealing with mental health or addiction issues out of regular emergency departments and ensuring they get specialist care;
- \$40.6 million for three new regional residential drug rehabilitation treatment facilities in the Barwon, Gippsland and Hume regions; and
- \$18.7 million to expand the Hospital Outreach Post-suicidal Engagement initiative to a further six hospitals, supporting an additional 3 000 people a year.

Additional funding is provided for intensive service for high-need community mental health clients and high care packages for complex needs patients. Investments will be made to offer more treatment options and expand residential care facilities, including a day treatment centre and acute mental health facility at Ballarat Base Hospital. Further support is also extended for Aboriginal mental health and well-being initiatives.

Improving ambulance services

Ambulances are arriving faster to Victorians who are in life threatening situations. In the second quarter of 2017-18, 81.4 per cent of Code 1 ambulances arrived within 15 minutes of call-out, the best result in nine years.

The *2018-19 Budget* allocates \$58.5 million to meet future ambulance service demand as our population grows, with an extra 90 new paramedics and 12 ambulance vehicles. A further 39 paramedics and nurses will continue to support Ambulance Victoria's secondary triage service.

Regional health and hospitals

The Government is investing in regional health infrastructure to ensure every Victorian has the quality healthcare they deserve, close to home.

Victorians living in the Central Highlands will benefit from a \$462 million investment to redevelop the Ballarat Base Hospital. This includes expanding the operating theatre complex, inpatient units, intensive care unit and clinical support as well as a new emergency department, day treatment centre and acute mental health facility.

Victorians living in Southern Gippsland will benefit from a \$115 million investment to redevelop Wonthaggi Hospital that will see new inpatient, theatre and emergency department services.

A \$50 million boost to the Regional Health Infrastructure Fund (RHIF) will continue to improve health, safety and the quality of services for people in rural and regional Victoria. The RHIF will continue to support health services to respond to local priorities and maintain and enhance their service capacity.

KEEPING VICTORIANS SAFE

The Government has made record investments to ensure Victorians are kept safe, announcing the first ever Community Safety Statement in the *2017-18 Budget* – a \$2.0 billion investment in tackling crime. This plus other initiatives will recruit and deploy 3 135 new police and 100 protective service officers by 2022. Recent independent crime data shows Victoria’s criminal offence rate declined in 2017 for the first time since 2010, with the biggest decrease in the criminal offence rate for at least nine years.

Police, protection and prevention

The *2018-19 Budget* expands the investment and support being delivered to Victoria Police, including \$25 million for local crime prevention initiatives, \$25 million to provide Victoria Police with additional long-arm firearms and \$24.2 million to strengthen the response to technology-enabled crime.

More court and corrections capacity

The Government has committed \$129 million to introduce a new Bail and Remand Court in the Magistrates’ Court, in line with the recommendations of the Coghlan Bail Review and as part of the Government’s significant overhaul of the bail system in Victoria. This funding will also be used to provide additional magistrates as well as additional judicial appointments to the Supreme Court and County Court. Further capacity will be added to the Office of Public Prosecutions and Victoria Legal Aid.

The Government is further expanding prison capacity to complement tougher sentencing and bail laws, funding a \$689 million, 700-bed expansion at the Lara Prison precinct to construct a new maximum security facility for men.

A further \$160 million has been allocated to increase the number of secure custodial beds at the Malmsbury and Parkville Youth Justice Centres, and to tackle the causes of youth offending. Additional funding will be used to strengthen infrastructure and enhance security across the prison system.

Funding will also be provided to implement the recommendations of the Expert Panel on Terrorism and Violent Extremism Prevention and Response Powers, to combat violent extremism and keep the community safe. Additional funding is committed to support victims of crime, particularly children and vulnerable people who are providing evidence.

Strong families, safe children

The Government remains committed to implementing every recommendation of the Royal Commission into Family Violence, with the *Ending Family Violence: Victoria's Plan for Change* released in 2016 setting out the Government's approach to change the underlying causes of violence and better respond to the needs of victims.

Last year's budget included \$1.9 billion to address this need, and the *2018-19 Budget* provides a further investment to support strategic reform directions through increased access to support for victim survivors, including flexible support packages; improved refuge responses for victims of family violence; and new campaigns to encourage behavioural change that prevents family violence from occurring.

The *2018-19 Budget* invests an unprecedented \$858 million to continue the transformation of Victoria's children and family services system through the *Roadmap for Reform*, moving from crisis response to prevention and early detection. The budget includes \$226 million to employ more than 450 child protection workers – at around 35 per cent growth the largest ever expansion of this workforce – and expand its service capability to include after-hours response.

A STRONG, FAIR VICTORIA

Victoria is renowned as Australia's artistic, sporting and multicultural capital.

This budget builds on this reputation, while also ensuring Victoria continues to be proudly inclusive and fair.

This year's budget invests in the industries and individuals who underpin our artistic reputation, with \$82.7 million to support our galleries, museums and creative sectors.

There is \$231 million to redevelop some of Victoria's most-loved sporting venues, including a major redevelopment of Etihad Stadium, updating the National Sports Museum at the MCG and planning for further upgrades to Whitten Oval and Eureka Stadium.

This is complemented by the biggest boost to community sport in the state's history. This budget will provide \$242 million in funding to upgrade facilities at suburban grounds, local clubs and high-performance centres across the state.

The Government continues to invest in making things fair.

For children living with a disability, this year's budget provides \$288 million to help make sure students with disability and learning difficulties get the support they deserve.

To further celebrate Victoria’s diversity, the *2018-19 Budget* provides \$17.1 million for infrastructure around cultural precincts, community centres and aged care facilities; \$1.4 million to grow Victoria’s calendar of multicultural events and festivals; and \$300 000 for Multicultural Safety Ambassadors to promote safety across all Victorian communities.

Easing cost-of-living pressures

The *2018-19 Budget* will invest \$48 million in the Power Saving Bonus – aimed directly at getting Victorian families a better deal from power companies. All Victorian households will receive a \$50 payment if they seek out a better electricity deal on Victoria’s Energy Compare website, potentially saving hundreds of dollars on their power bills.

The Government has also worked with the state’s three largest energy retailers to provide rebates of up to \$720 to more than 285 000 Victorian customers on costly default and expired offers. In March 2018, the Government committed to further steps to create a more fair and more affordable energy market in its interim response to the *Independent Review of the Electricity and Gas Retail Markets in Victoria*.

The budget will provide \$22 million for further assistance to concession cardholders struggling to pay their utility bills by lifting the cap on the Utility Relief Grant Scheme from \$500 to \$650. This scheme helps households and families suffering unexpected hardship to pay their water, gas or electricity bills.

These initiatives build on other Government policies to make the cost of life’s essentials more affordable, including short-term motor vehicle registration options, the Fair Go rates cap and reduced regional public transport fares.

DELIVERING ON OUR COMMITMENTS

The *2018-19 Budget* also concludes the Government’s delivery of Labor’s Financial Statement 2014, with a further \$331 million of initiatives to complete the promised \$10.1 billion of funding commitments.

CHAPTER 2 – ECONOMIC OUTLOOK

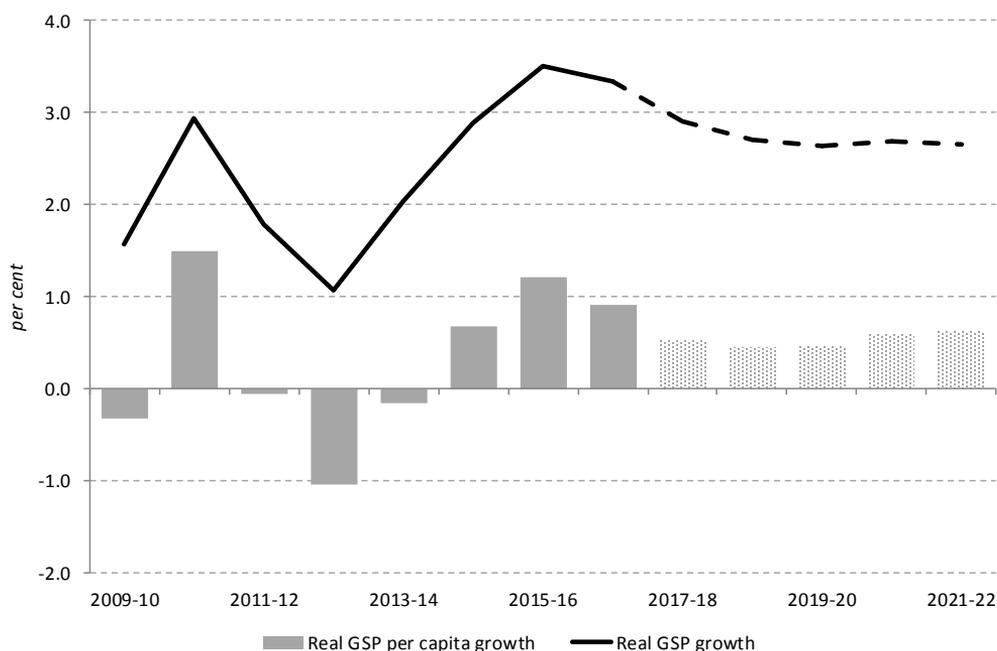
- Victoria’s economy is strong, with above-trend economic growth in recent years driving growth in employment and improving living standards. Real gross state product (GSP) grew by 3.3 per cent in 2016-17 and is expected to grow at a steady rate of 2.75 per cent each year over the budget and forward estimates.
- Economic activity has been supported by population growth and low interest rates, which have underpinned household consumption and dwelling investment. Public investment in infrastructure and services is expected to be an important source of economic growth and employment over the next four years, with government infrastructure investment expected to average \$10.1 billion a year to 2021-22.
- Employment is expected to grow by 2.0 per cent in 2018-19, representing the fifth consecutive year of above-trend growth, and to moderate toward trend thereafter.
- Population growth is anticipated to remain strong but to moderate to 2.0 per cent by 2020-21. Inflation expectations and wages growth are forecast to rise toward their trend rate.
- Risks to the economic outlook are balanced. The global growth backdrop is supportive, albeit with rising risks in trade policy and regional stability. Domestically, rising interest rates and a moderation in dwelling investment after years of above-trend growth could introduce downside risk to the outlook. However, this is balanced with upside risk to growth in labour supply if population growth and the labour force participation rate are higher than expected.

VICTORIAN ECONOMIC CONDITIONS AND OUTLOOK

In 2016-17, Victorian real GSP rose by 3.3 per cent, the strongest of all the states and well above national gross domestic product (GDP) growth of 2.0 per cent. This represents the third consecutive year of expansion at an above-trend rate.

The acceleration of Victoria’s economy is translating to higher standards of living for the average Victorian. Real GSP per capita rose by 0.9 per cent in 2016-17. This was the third successive rise in GSP per capita in Victoria, the longest period of sustained growth in living standards since the global financial crisis (Chart 2.1). GSP per capita is expected to continue to rise in future years as growth in real economic activity continues to outpace population growth each year to the end of the forward estimates.

Chart 2.1: Forecasts of Victoria’s real GSP and real GSP per capita



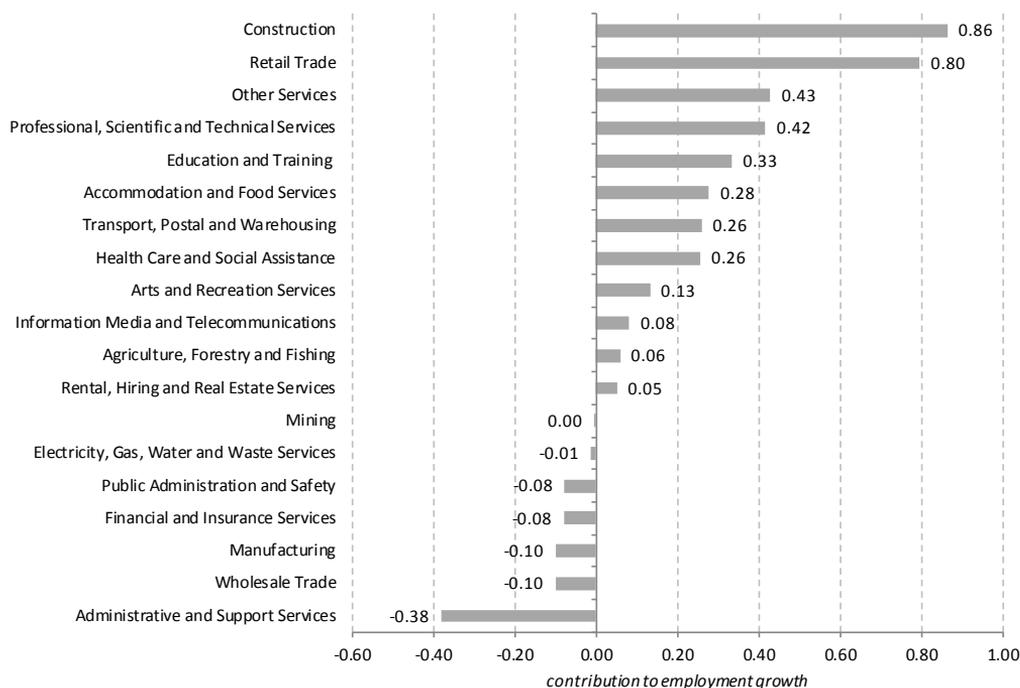
Source: Australian Bureau of Statistics.

The Victorian economy has benefited in recent years from strong population growth and low interest rates, both of which have supported strengthening consumption and dwelling investment. Public demand has also grown strongly, contributing more than half of the overall growth in GSP in 2016-17. Public investment is expected to continue to contribute to growth in the economy, with government infrastructure investment forecast to average \$10.1 billion a year to 2021-22, more than double the average of \$4.9 billion a year from 2005-06 to 2014-15.

Strong economic conditions have generated record levels of employment, with Victoria’s labour market the focal point of employment growth in the nation. The Victorian economy generated 117 300 new jobs in 2016-17, the highest of all the states and more than 70 per cent of new jobs created across Australia. Since November 2014, employment in Victoria has grown by 11.4 per cent or 333 900 persons, with the majority of growth in full-time employment. Employment growth has been broad-based across industries over the past year, led by service industries and construction (Chart 2.2).

Employment is forecast to grow by 2.0 per cent in 2018-19, representing five consecutive years of above-trend growth. The unemployment rate is anticipated to stabilise at 5.75 per cent in 2018-19 before declining to its trend rate of 5.50 per cent in 2019-20.

Chart 2.2: Contribution to annual average employment growth by industry (February 2018)



Source: Australian Bureau of Statistics.

Victoria’s population growth is expected to be 2.2 per cent in 2018-19 but to ease gradually to 2.0 per cent a year by 2020-21.

Table 2.1 sets out the economic forecasts for the 2018-19 Budget.

Table 2.1: Victorian economic forecasts^(a) (per cent)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	actual	forecast	forecast	forecast	projection	projection
Real gross state product	3.3	3.00	2.75	2.75	2.75	2.75
Employment	3.9	2.75	2.00	1.75	1.75	1.75
Unemployment rate ^(b)	5.9	5.75	5.75	5.50	5.50	5.50
Consumer price index ^(c)	1.9	2.00	2.25	2.50	2.50	2.50
Wage price index ^(d)	2.0	2.25	2.50	2.75	3.00	3.25
Population ^(e)	2.3	2.30	2.20	2.10	2.00	2.00

Sources: Department of Treasury and Finance; Australian Bureau of Statistics.

Notes:

- (a) Year average growth, except for the unemployment rate (see note (b)) and population (see note (e)). Forecasts are rounded to the nearest 0.25 percentage points, except for population (see note (e)). Projections for 2020-21 and 2021-22 represent long run average growth rates, except for the wage price index, which remains below trend by 2021-22, and population growth, which remains above trend by 2021-22. The key assumptions underlying the economic forecasts include: interest rates are reflective of movements in market expectations; an Australian dollar trade-weighted index of 64.3; and oil prices that follow the path suggested by the futures market.
- (b) Year average.
- (c) Melbourne consumer price index.
- (d) Wage price index, Victoria (based on total hourly rates of pay, excluding bonuses).
- (e) Percentage change over the year to 30 June. Forecasts are rounded to the nearest 0.1 percentage point.

Gross state product

Victoria's real GDP is forecast to grow by 2.75 per cent in 2018-19 and across the forward estimates. Household consumption and public demand are expected to make the largest contributions to growth, while international trade is expected to subtract modestly from growth in 2018-19.

Household consumption is forecast to grow at an above-trend rate in 2018-19. Consumption per capita is expected to rise, consistent with an increase in wages growth. Interest rates are assumed to rise in line with the current market outlook, but to remain low by historical standards.

Dwelling investment is expected to remain near historically high levels but with the rate of growth to moderate in 2017-18 and 2018-19. In the longer term, dwelling investment will be supported by Victoria's strong population growth and demand for new dwellings (See Box 2.1: Victoria's dwelling investment cycle).

Box 2.1: Victoria's dwelling investment cycle

Victoria's dwelling investment has been a key contributor to strong GDP growth over the three years to 2016-17. Dwelling investment expanded at an annualised rate of 8.3 per cent growth over this period, more than double the historical average growth rate of 4.1 per cent.

Compared to previous cycles, the recent pickup in dwelling investment has been most evident in attached dwellings, which includes townhouses and apartments (Chart 2.3). Within attached dwellings, high-density apartment construction, such as buildings with four or more stories, has been the largest contributor to growth.

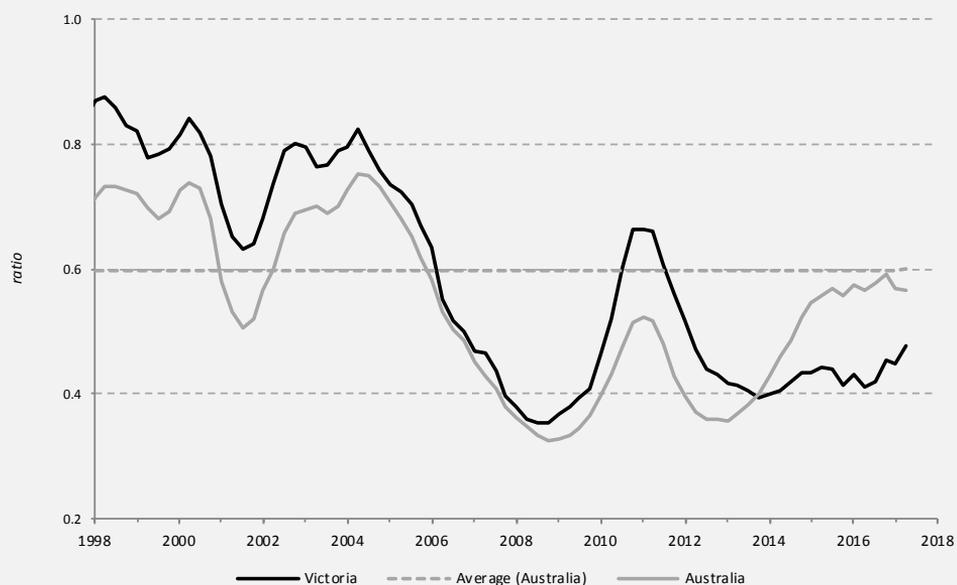
Chart 2.3: Victoria's building approvals



Source: Australian Bureau of Statistics, rolling 12-month sum.

Despite the increase in dwelling investment, the ratio of dwelling completions to population growth has remained around 0.4 over the past three years (Chart 2.4). The ratio is relatively low compared to the historical average and below the national ratio of around 0.6. This means the risk of an ‘overbuild’ in Victoria’s housing market is lower than the national average and suggests that the pace of construction is broadly in line with Victoria’s strong population growth.

Chart 2.4: Ratio of dwelling completions to population growth



Source: Australian Bureau of Statistics.

Business investment is forecast to grow modestly over the forward estimates. Non-residential construction is expected to contribute to growth, underpinned by solid demand and low capital costs. Machinery and equipment investment is expected to remain subdued, partly reflecting the relatively low capital intensity of Victoria’s major growth industries, including the services sector.

Public demand is anticipated to rise strongly in 2017-18 and 2018-19, driven by growth in both public consumption and investment. Growth in expenditure on public services is forecast to remain strong over the forward estimates, reflecting demand arising from Victoria’s expanding population. Public investment is forecast to remain high, in line with the Government’s budgeted infrastructure commitments. The large public infrastructure program occurring on the eastern seaboard is giving rise to capacity constraints as the construction industry faces rapidly increasing demand. See Chapter 3, Box 3.2 for a discussion of the Government’s approach to supporting the development of a skilled workforce needed to deliver Victoria’s infrastructure agenda.

In 2016-17, Victoria’s competitive education, tourism and professional services sectors generated \$17.9 billion in export income, \$2.0 billion more than in 2015-16. Services exports are forecast to grow at an above-trend pace in 2018-19, driven mostly by education exports.

Merchandise exports are expected to grow at around trend. Overall, net trade is expected to detract from economic growth in 2018-19 and over the forward estimates, as import growth outpaces export growth, consistent with the outlook for state final demand. While global economic conditions are expected to remain supportive, the recent shifts in global trade policy announced by Australia's largest trading partners represent a risk to the outlook.

OTHER ECONOMIC INDICATORS

Prices

Melbourne's inflation has been subdued in recent years, which has been reflected in both tradables and non-tradables inflation and is consistent with the experience of most economies within the Organisation for Economic Co-operation and Development. There has been downward pressure on the price of tradables, whose prices are determined largely by global forces, including heightened competition in the retail sector and a modestly higher exchange rate. Non-tradables inflation has been weighed down by below-trend wages growth.

The inflation rate is forecast to gradually increase towards the middle of the Reserve Bank of Australia's (RBA) target band of 2-3 per cent per annum by 2019-20. Higher global commodity prices and a strengthening global economy are expected to support the outlook for tradables inflation. Non-tradables inflation is anticipated to strengthen as spare labour market capacity reduces, wages growth picks up, and non-market inflation including in the utilities, health and housing cost sectors remains elevated.

Wages

Victoria's wage growth has been subdued in recent years despite strong labour market conditions. This is consistent with trends in other national and international jurisdictions.

Wages are forecast to grow by 2.50 per cent in 2018-19 and 2.75 per cent in 2019-20. After a period of above-trend employment growth, underutilisation of labour has reduced. This is expected to continue and will support an ongoing increase in wages growth. Victoria's wage price index is forecast to gradually increase toward its trend rate of 3.5 per cent a year over the budget and forward estimates. There are early signs that this anticipated recovery is underway (see Box 2.2: Early signs of an increase in wages growth for more detail).

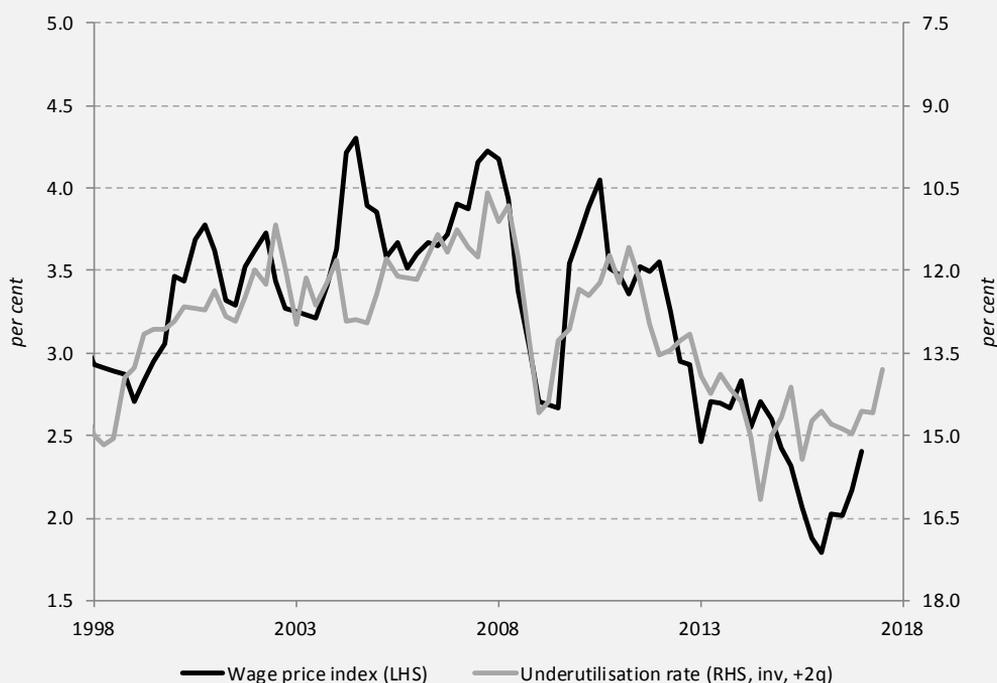
Box 2.2: Early signs of an increase in wages growth

Along with many other advanced economies, Victoria has experienced a period of subdued wage growth over the past few years. Wages in Victoria rose by 2.0 per cent in 2016-17, in line with the national average but below the trend growth rate of 3.5 per cent a year. The weakness in wage growth has been broad-based across industries, with no industry recording growth above 3.0 per cent in 2016-17.

There are signs the slowdown in Victoria's wage growth has bottomed out and is beginning to reverse. Annual wage growth has accelerated from a low of 1.8 per cent in the year to December 2016 to 2.4 per cent in the year to December 2017.

After a period of above-trend employment growth, Victoria's labour force underutilisation rate has improved and is supporting the pickup in wages growth (Chart 2.5).

Chart 2.5: Victorian wages growth and labour force underutilisation

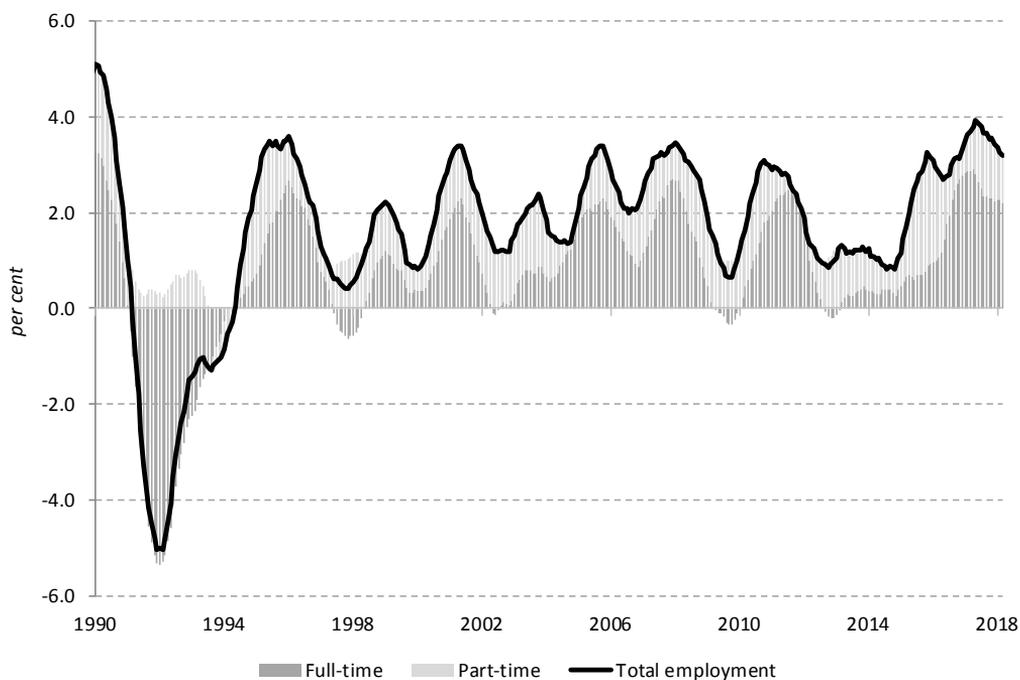


Source: Australian Bureau of Statistics.

The labour market

The Victorian economy is experiencing record-breaking employment outcomes, having produced above-trend employment growth since 2014-15 – the longest expansion since the global financial crisis. Employment grew by 3.2 per cent over the year to March 2018, well above trend and just below growth of almost 4.0 per cent over the year to May 2017, which was the highest annual growth rate since July 1990 (Chart 2.6). Employment growth has been supported by strong economic activity, modest growth in real unit labour costs and strong population growth.

Chart 2.6: Victoria’s employment growth, 12 month moving average



Source: Australian Bureau of Statistics.

Victoria’s employment growth is reflected in both full-time and part-time employment, and has been broad-based across industries and regions. Of Victoria’s 19 industry groups, 12 expanded their employment in 2016-17. In 2017, employment in regional Victoria rose by an average of 3.1 per cent, bringing about a 0.3 percentage point decline in the regional unemployment rate to 5.4 per cent in 2017.

The strength of the labour market is also creating opportunities for Victoria’s youth (aged 15-24 years). The youth unemployment rate was the second lowest in Australia at 13.0 per cent in the year to March 2018.

Employment growth is forecast to be 2.0 per cent in 2018-19, representing five consecutive years of above-trend growth. In the longer term, employment growth is expected to return to trend as wages growth picks up, population growth moderates and economic activity converges between the states.

Victoria's unemployment rate is forecast to be 5.75 per cent in 2018-19 and to fall to 5.50 per cent in 2019-20. Broader measures of spare capacity in the labour market, such as the labour force underutilisation rate, have begun to improve, which should support an increase in wages growth.

Victoria's labour force participation rate is forecast to remain elevated but to moderate from its current cyclical high as employment growth eases. Victoria's labour force participation rate was 65.6 per cent in March 2018, just below the historic peak in 2016-17. Recent increases have been driven primarily by a rise in participation by women, as discussed in Chapter 3, Box 3.1. Despite a high share of migration to Victoria comprising individuals in the prime working age cohort of 15-44 years, Victoria's population continues to age. This is expected to weigh slightly on Victoria's labour force participation rate over the medium term.

Population

Victoria's population grew by 2.4 per cent over the year to September 2017, the highest growth of the states and well above the national average.

In 2016-17, Victoria's net interstate migration was more than 17 000 persons, the most since the early 1980s, and second highest of all jurisdictions. This reflected Victoria's strong economic and employment growth, as well as the attractiveness of Victoria as a place to live and work.

Victoria's population growth is forecast to remain high but to moderate to 2.0 per cent by 2020-21 as economic conditions normalise between the states. The moderation in population growth is due to a forecast slowing in both net interstate and net overseas migration.

AUSTRALIAN ECONOMIC CONDITIONS AND OUTLOOK

Economic conditions in Australia are solid and growth is expected to accelerate in 2018-19 as the drag from weak mining investment diminishes.

Growth in Australia's real GDP was 2.0 per cent in 2016-17, below trend economic growth of 2.75 per cent. Activity has been supported by low interest rates and a gradual pickup in growth in the global economy, with accommodative policy settings in advanced economies.

The rebalancing of domestic economic activity following the end of the mining investment boom has progressed and is almost complete. Conditions in the mining states have begun to recover and converge with those in the non-mining states.

In the *2017-18 Mid-Year Economic and Fiscal Outlook* (MYEFO), the Commonwealth Treasury forecast Australia's real GDP to grow by 3.0 per cent in 2018-19, with growth supported by rising non-mining business investment, household consumption, public final demand and exports.

Growth in household consumption is expected to pick up over the forecast period in response to strengthening labour market conditions. Dwelling investment is expected to decline moderately over the forecast period, consistent with a reduction in building approvals. Growth in net exports is forecast to be positive by 2018-19, underpinned by rising resource exports.

Inflation is expected to remain subdued but gradually return to the midpoint of the RBA’s target band by 2019-20, supported by a fall in spare capacity. Wage growth is similarly expected to recover in line with above-trend economic growth.

Conditions in the national labour market strengthened in 2017 and there was a broad-based strengthening in employment growth across the states. The Commonwealth Treasury forecasts national employment to grow by 1.75 per cent in 2017-18 and 1.50 per cent in 2018-19.

The national unemployment rate has fallen to 5.4 per cent, the lowest rate in over four years. The participation rate has increased, including a notable increase in the female participation rate. The unemployment rate is forecast to decline from 5.50 per cent in the June quarter 2018 to 5.25 per cent in the June quarter 2019.

INTERNATIONAL ECONOMIC CONDITIONS AND OUTLOOK

The global recovery has gathered pace since the *2017-18 Budget Update* with the upswing in global investment and trade continuing into the second half of 2017. The International Monetary Fund (IMF) estimates global output to have risen by 3.8 per cent in 2017. Despite escalated trade tensions, the IMF has maintained its forecast for global growth of 3.9 per cent for 2018 and 2019 (Table 2.2).

Drivers of global activity have become increasingly broad-based and more closely synchronised across advanced and emerging economies. The cyclical upswing in growth is expected to continue into 2018, supported by a pickup in investment and world trade.

Table 2.2: Summary of IMF’s global economic forecasts^(a) (per cent)

	2016 <i>actual</i>	2017 <i>estimate</i>	2018 <i>projection</i>	2019 <i>projection</i>
World output	3.2	3.8	3.9	3.9
Advanced economies	1.7	2.3	2.5	2.2
United States	1.5	2.3	2.9	2.7
Euro area	1.8	2.3	2.4	2.0
Japan	0.9	1.7	1.2	0.9
Emerging market and developing economies	4.4	4.8	4.9	5.1
China	6.7	6.9	6.6	6.4
India	7.1	6.7	7.4	7.8
ASEAN – 5^(b)	5.0	5.3	5.3	5.4

Source: International Monetary Fund’s *World Economic Outlook*, April 2018.

Notes:

(a) Not all countries or regions are listed in the table.

(b) ASEAN-5 economies are Indonesia, Malaysia, The Philippines, Thailand and Vietnam.

Expansion in the advanced economies is projected to accelerate modestly due to higher growth in the United States. Activity in emerging market and developing economies is forecast to improve over the next three years. This is in spite of moderating growth in China.

Beyond the next couple of years, global growth is projected to soften once output gaps close and most advanced economies return to post-crisis potential growth rates, affected by ageing populations and subdued productivity growth.

RISKS TO THE OUTLOOK

The risks to Victoria's economic outlook are balanced. On the upside, faster than expected wages growth combined with favourable employment conditions would support consumption growth in the near term. Persistent strength in population growth or a higher participation rate could lead to higher employment and GSP growth.

While the *2018-19 Budget* forecasts a moderating labour force participation rate, it is possible that the structural drivers of higher female participation and delayed retirement could offset an expected weakening in the number of workers seeking employment. A larger labour force would contain pressures on wages and production costs, easing pressure on consumer prices. The boost to final demand and more contained wages growth could also stimulate employment, improve the productivity of capital and result in higher investment and GSP growth. See Appendix A *Sensitivity Analysis* for further information on the estimated fiscal impact of a higher labour force participation rate.

On the downside, continued weakness in income growth may constrain households' ability to maintain spending patterns. A further moderation of activity in dwelling investment, prompted by a rise in interest rates or a general economic downturn, could lead to weaker household sentiment, lower consumption and slower growth in employment, wages and real GSP. See Appendix A *Sensitivity Analysis* for further information on the estimated fiscal impact of a greater than expected moderation in consumption and dwelling investment.

Global economic and policy risks are broadly balanced with key downside risks relating to rising protectionist sentiment and financial market volatility.

In the domestic economy, the outlook for overall business investment is improving while the timing and pace of the recovery in non-mining business investment remains uncertain. Other downside risks stem from the impact of higher interest rates on the exchange rate and household consumption.

CHAPTER 3 – INVESTING IN VICTORIAN SKILLS FOR JOBS

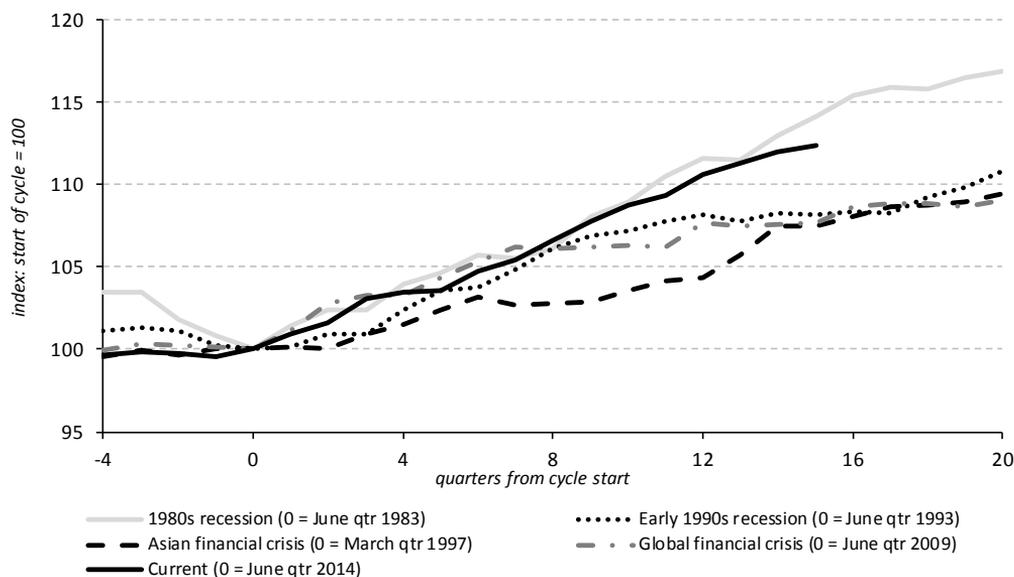
- The Victorian economy is growing strongly and demand for skilled workers is high. Victoria is experiencing one of the longest periods of above-trend employment growth in the past 25 years.
- Nearly 65 per cent of working-age Victorians now hold a post-school qualification – the highest among the states, and up from 55 per cent a decade ago. This translates into better outcomes for Victorians, with skilled workers more likely to participate in the labour force.
- The benefits of acquiring skills to provide access to the security and dignity of a job are clear. The unemployment rate of workers whose highest education level is secondary school or Certificate I is almost double the unemployment rate of the rest of the workforce.
- To operate productively, the Victorian economy needs diversity in the skills of the workforce. Evidence of rising job vacancy rates and skills shortages in occupations that rely upon vocational education and training qualifications suggests a pressing need to focus on technical and trade skill attainment for the benefit of the economy, as well as for individual workers.
- The Government is investing in the skills sector to ensure Victorian workers can attain the skills that are needed to strengthen and diversify Victoria’s labour market, and drive sustainable rises in living standards. The *2018-19 Budget* provides \$828 million for training and skills initiatives, including initiatives in schools, to expand the supply of skills that are most in demand. This investment, and others, will increase access to employment for more Victorians while supporting improved productivity and economic growth.

INTRODUCTION

Victoria is experiencing record jobs growth, with employment growing at an above-trend rate for three consecutive years. Since November 2014, Victorian employment has grown by 333 900 persons. Over the same period, employment across Australia increased by 919 200, meaning Victoria contributed 36 per cent of Australia’s total employment growth over the period.

Victoria’s current employment cycle has been one of the longest and strongest in history. Previous major employment cycles have typically plateaued at around 8 per cent growth, 12 to 16 quarters after the start of the cycle. A notable exception to this was the early 1980s cycle, where employment surged as the economy recovered from a recession (Chart 3.1). Since the current cycle began, Victorian employment has increased by 12.8 per cent, while employment across the rest of Australia increased by 6.5 per cent.

Chart 3.1: Employment level through major Victorian employment cycles since the 1980s^(a)



Source: Australian Bureau of Statistics

Note:

(a) The start of each cycle was determined based on identifying the low point in the level of employment that occurred around major economic events.

The strength of economic activity in recent years has been an important source of demand for labour. At the same time, the supply of labour has responded, particularly among female workers (Box 3.1).

Box 3.1: Education and labour force participation among females

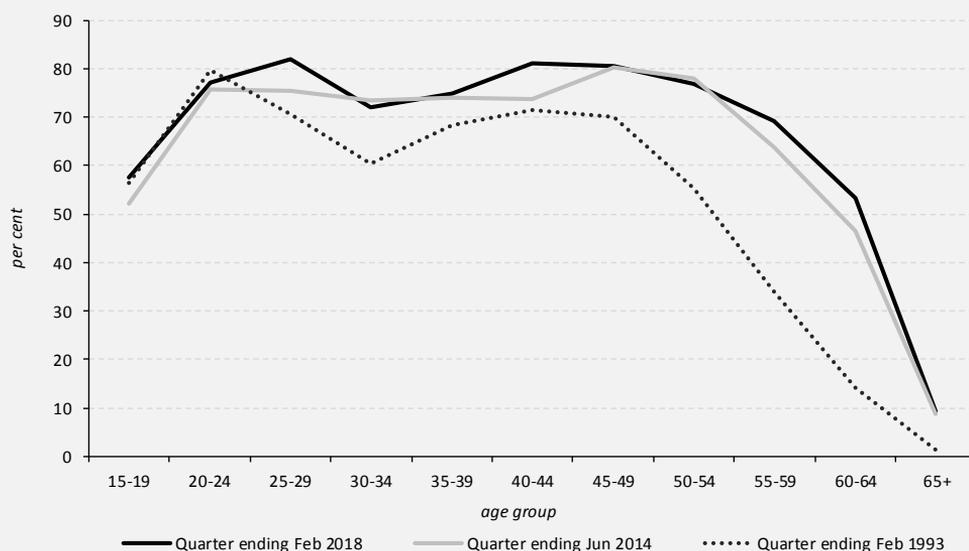
Increasing labour force participation has been a key feature of the current employment cycle. Victoria's labour force participation rate was 65.6 per cent in March 2018, up from 64.4 per cent in June 2014. It reached a record high of 66.4 per cent in December 2017.

Rising female participation has driven growth in the overall participation rate, contributing 74 per cent of the rise in Victoria's participation rate since June 2014. The participation rate for females was 60.1 per cent in March 2018, below the record high of 60.9 per cent in September 2017, but up markedly from 58.3 per cent in June 2014.

Growing demand from Victoria's services economy appears to be an important factor. For example, health care and social assistance – which has seen the strongest rate of employment growth since 2014 with 60 000 jobs created – employs a workforce that is 79 per cent female.

Rising female labour force participation is a long term trend. Chart 3.2 illustrates the change in female labour force participation by comparing a current snapshot of female participation against that in 2014 – the start of the current employment cycle – and 25 years ago. Female participation has increased across all cohorts, with the greatest rise being in females over the age of 50. Recently, females in their 20s and 40s have increased their participation. This trend has been supported by factors such as increasing educational attainment, growth in flexible working arrangements, improved access to child care and changing social norms relating to women in the workplace.²

Chart 3.2: Female labour force participation by age cohort, Victoria



Source: Australian Bureau of Statistics

² Connolly, E, Davis, K, Spence, G, 2011 'Trends in Labour Supply', June Quarter Bulletin, Reserve Bank of Australia

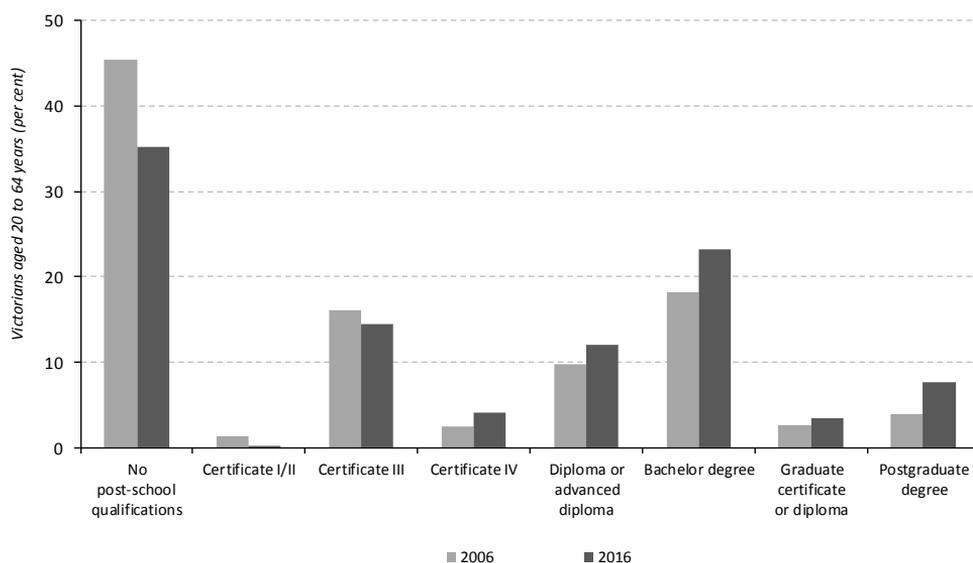
Increased educational attainment among females has been a particularly important contributor to growing workforce participation. The proportion of Victorian females with a post-school qualification has increased from 51 per cent in 2006 to 64 per cent in 2016, and is now broadly comparable with the corresponding rate for males. As of 2016, the share of females who have attained a bachelor's degree or higher qualification exceeded that of males, at 38 per cent versus 30 per cent, respectively.

This chapter investigates the link between the increasing skill attainment of Victorian workers and the ability of the workforce to meet the demands of an expanding economy and jobs market. The ability of the workforce to keep up with demand for skills is important in two respects. First, skilled workers participate in the labour force to a greater extent than those without post-school qualifications, and are more likely to be employed, leading to improved life outcomes. Second, strong alignment between the demand for skills by Victoria's major industries and the supply of skills from the workforce makes it easier for workers to find appropriate employment. Over time, both the rising skill level of the workforce and improved efficiency of the labour market enhance working outcomes and the standard of living of Victorians.

MORE SKILLS, BETTER JOBS

Victoria now has the highest share of workers with a post-school qualification of any state in Australia. The average qualification level of Victorian workers has increased over the past decade, with 65 per cent of Victorians aged 20 to 64 now holding a post-school qualification compared to 55 per cent in 2006 (Chart 3.3).

Chart 3.3: Highest post-school qualification, Victorians aged 20-64, 2006 and 2016

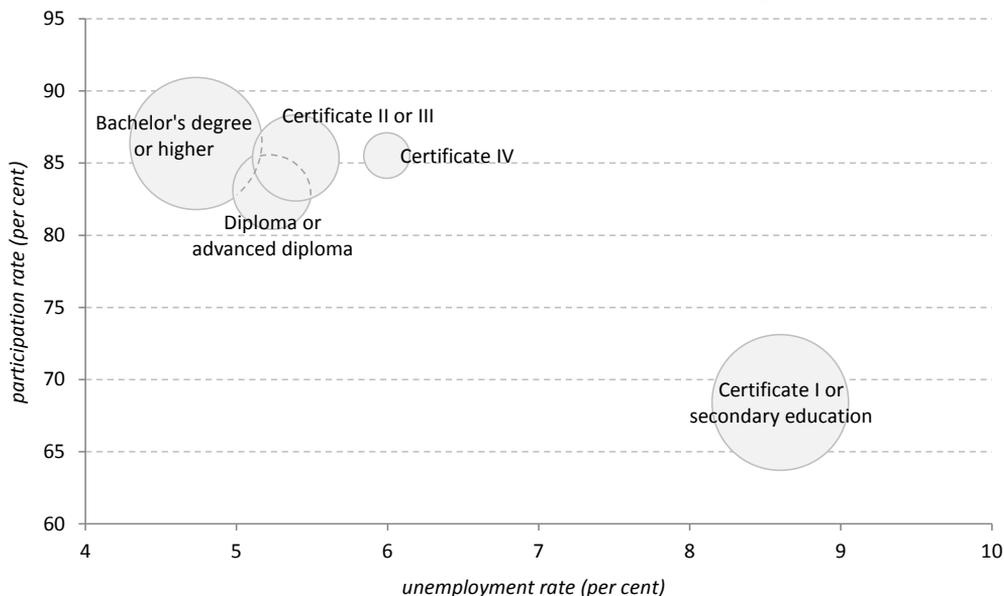


Source: Australian Bureau of Statistics

Higher participation, lower unemployment

Education is important for inclusion in the workforce. As illustrated in Chart 3.4, increasing educational attainment influences both Victorians' participation in the workforce and the likelihood of finding and keeping a job. In 2016, the unemployment rate for Victorians with a Certificate II or III was 5.4 per cent, and labour force participation was 85 per cent. These outcomes are significantly better than those experienced by Victorians with lower levels of educational attainment.

Chart 3.4: Labour force outcomes by education level, Victorians aged 20-64, 2016^(a)



Source: Australian Bureau of Statistics

Note:

(a) Bubble size represents cohort population size.

Meeting demand for higher skills

The growing skill level of Victorian workers is meeting demand for higher skilled employees from businesses, as the industrial base of Victoria's economy has diversified toward services, advanced manufacturing and knowledge-intensive industries.

Evidence of the demand for rising skill levels can be seen in the Australian Bureau of Statistics (ABS) data, which categorises all occupations across industries into five skill categories that reflect the level of skill required to competently perform the typical tasks undertaken by people in the role. Each of the skill categories is commensurate with a level of education that the ABS estimates would be required by someone working in the occupation given the range and complexity of the tasks. The greater the range and complexity of the tasks, the greater the skill level of an occupation.³

Table 3.1 provides an overview of the five skill levels defined by the ABS, and examples of occupations that are classified at each skill level, with level one having the highest educational equivalent and five the lowest.

Table 3.1: Skill level classifications and illustrative occupations

<i>Skill level</i>	<i>Educational equivalent</i>	<i>Example occupations</i>
1	Bachelor's degree or higher	School teachers, registered nurses, accountants
2	Advanced diploma or diploma	Police officers, chefs, retail managers
3	Certificate IV or III ^(a)	Carpenters, real estate agents, sports instructors
4	Certificate III or II	Aged carers, waiters, truck drivers
5	Certificate I or secondary education	Sales assistants, kitchenhands, domestic cleaners

Source: Australian Bureau of Statistics

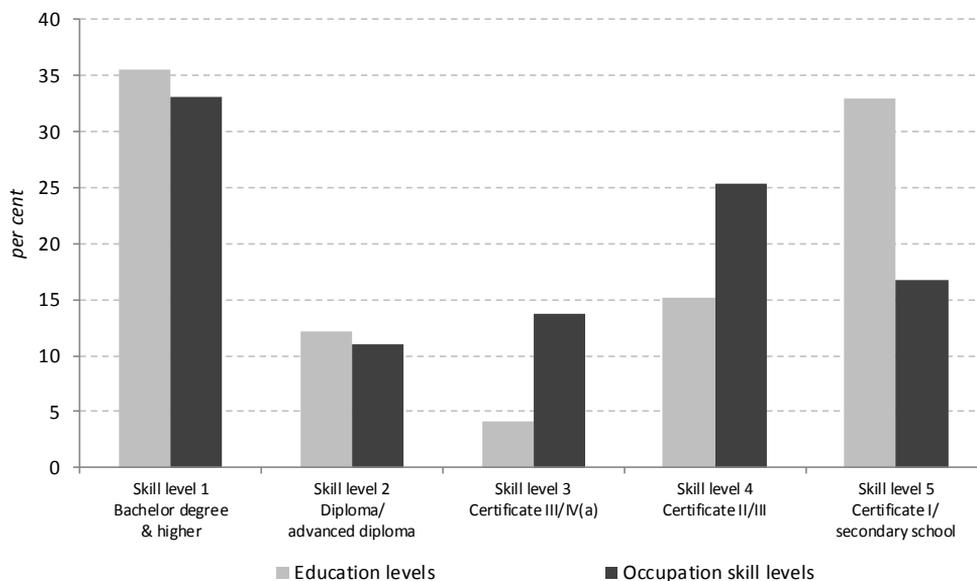
Note:

(a) Skill level three includes Certificate III with two years' on-the-job training.

The Victorian economy requires a high level of skill from its workforce. In 2016, 44 per cent of all roles in Victoria were categorised at diploma qualification or higher, while 17 per cent were at the lowest skill level (Chart 3.5). At the same time, Victoria's workforce has increased its level of education and skills, in line with the demands of the labour market and industry. The share of Victorians who have attained a diploma or higher was 48 per cent in 2016, which is slightly higher than the share of occupations at this skill level.

³ The ABS approach to occupation skill classification, undertaken as part of the Australian and New Zealand Standard Classification of Occupations (ANZSCO), was a joint program with the Commonwealth Department of Employment and Workplace Relations and Statistics New Zealand. The program involved consultation with individuals, government and private institutions, professional associations, industry training bodies and unions over a three-year period. This approach is similar to that of the International Labour Organisation's International Standard Classification of Occupations (ISCO), and the ABS provides a concordance for comparison between ANSCO and ISCO.

Chart 3.5: Skill level of occupations vs. educational attainment of the workforce, Victoria, 2016



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

Note:

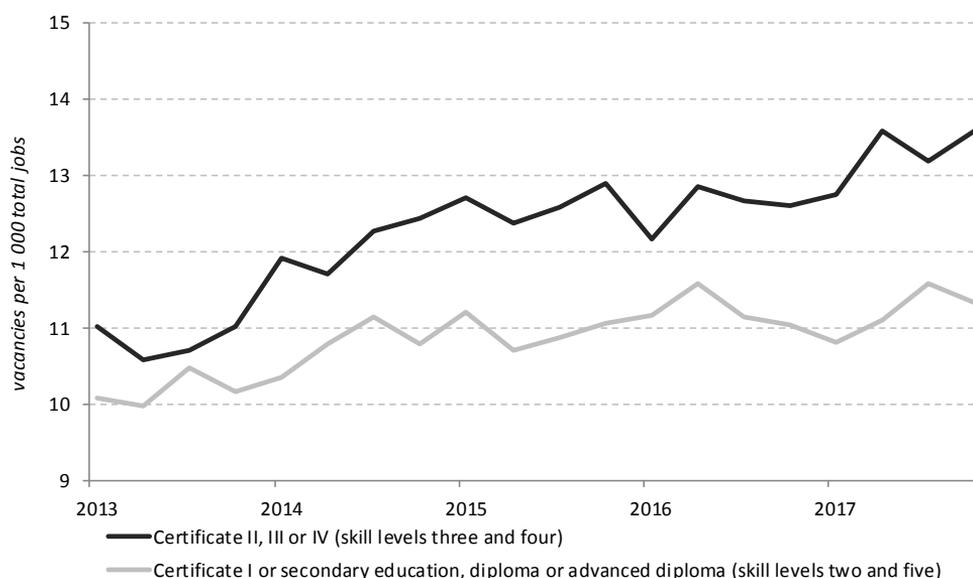
(a) Skill level three includes Certificate III with two years' on-the-job training.

In contrast, the Victorian economy has a potential shortfall of workers at skill levels three and four, where roles requiring trades and technical skills are concentrated. Among the existing workforce as of 2016, 19 per cent of workers had an education equivalent to skill level three or four. By comparison 39 per cent of roles were classified at these skill levels in 2016, indicating a material shortfall in workers with qualifications equivalent to skill levels three and four. The chart further shows that the highest educational attainment of 33 per cent of workers was secondary school or Certificate I (skill level five). However, only 17 per cent of occupations are classified at that skill level.

Shortages in technician and trades skills

Job vacancy data further suggests that Victorian businesses are finding it harder to fill positions in occupations at skill levels three and four, where many technical or trade specialist roles are classified. The vacancy rate (the ratio of vacancies per 1 000 total positions) for occupations in skill levels three and four, which includes occupations such as carpenters, aged carers and truck drivers, increased to 13.3 per 1 000 jobs in 2017, up from 10.8 per 1 000 jobs in 2013 (Chart 3.6).

Chart 3.6: Vacant jobs per 1 000 total jobs, 2013 to 2017



Source: Commonwealth Department of Jobs and Small Business

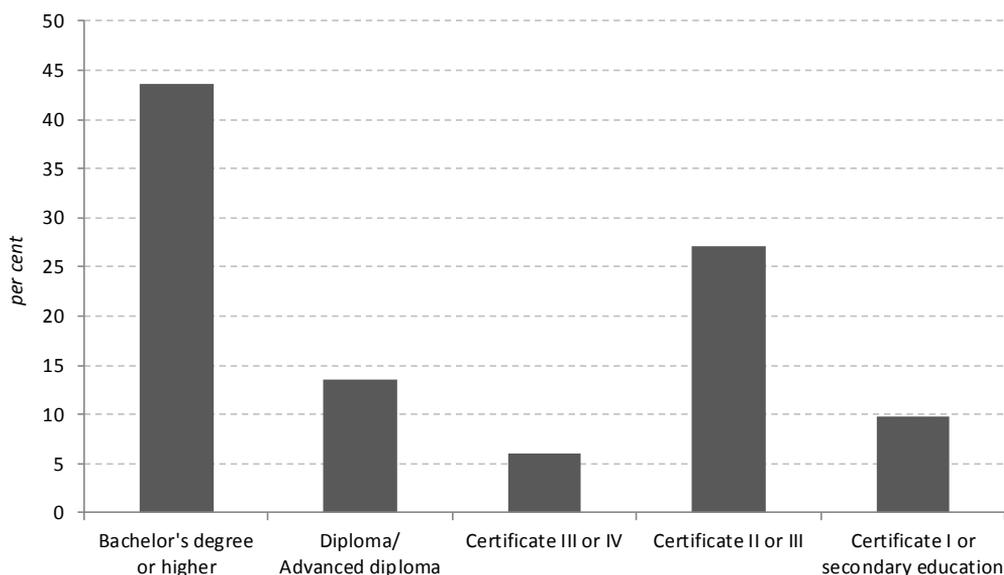
Survey results provide further evidence of an undersupply of middle skill workers. The Commonwealth Department of Jobs and Small Business’ Survey of Employers’ Recruitment Experiences found that technician and trades roles were more difficult to fill than professional roles. In 2016-17, 68 per cent of professional vacancies were filled, versus 56 per cent of technicians and trades vacancies. There were an average of 13.8 applicants for each professional position, but only 9.3 for each technical and trade position. This data indicates that the pool of available qualified labour is smaller for technician and trade roles, with these trends remaining broadly consistent over the past five to 10 years, suggesting an underlying shortage of labour supply in these specific segments.

Need for skills continues to grow

Demand for skilled workers is expected to remain strong into the future. Jobs requiring a bachelor’s degree or higher are likely to make up the largest share of national employment growth over the next five years (Chart 3.7). Victoria is well placed to meet growing demand at the highest skill levels, where a strong supply of skilled workers already exists.

However, there is a greater challenge to address the shortfall of workers in the technical and trade occupations at skill levels three and four (Certificate II, III or IV). Investing in Victoria’s TAFE and vocational sector will be important to address this shortfall. Failure to do so could impact on the productivity and growth of industries such as construction, which relies heavily on workers at skill levels three and four and is one of Victoria’s largest employers.

Chart 3.7: Share of forecast employment growth by qualification level, Australia, 2017 to 2022 ^(a)



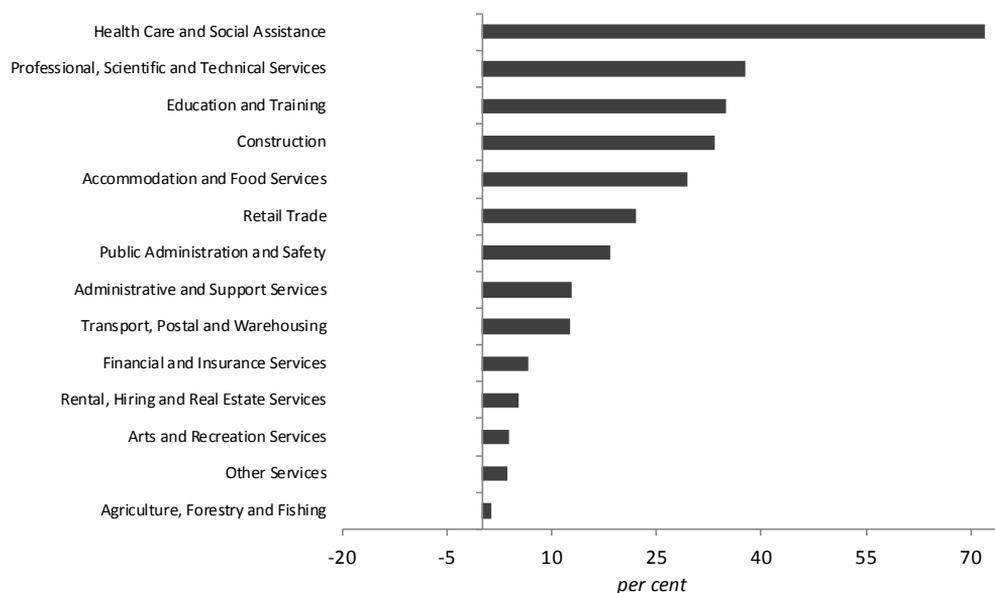
Source: Commonwealth Department of Jobs and Small Business

Note:

(a) Skill level three includes Certificate III with two years’ on-the-job training.

Labour demand is forecast to be strongest in Victoria’s services industries (Chart 3.8). While many of the strongest growing industries require a similar level of skill, the types of skills required across industries are diverse. This highlights the importance of both increasing the average skill level of the workforce and ensuring the mix of skills meets the range of requirements across industry sectors.

Chart 3.8: Projected Victorian employment growth, selected industry divisions, 2017 to 2022



Source: Australian Bureau of Statistics

As well as the right mix of skills, Victorian workers need high quality training. This ensures applicants are job-ready, with the skills Victorian employers need. High quality training means graduates spend less time looking for work.

The role of the education system is critical in developing a skilled and diverse workforce. The role of government is to ensure the quality, integrity and sustainability of this system, while supporting access to relevant skills and training so that all Victorians have the opportunity to maximise their employment prospects and life outcomes.

INVESTING FOR THE FUTURE

The Government has made significant progress in building the skills of Victorians for the future. In 2015 the Government appointed the first Victorian Skills Commissioner, who led reform to better align the TAFE and vocational training sector with the needs of industry and the economy. Ten Industry Advisory Groups were established as part of the Industry Engagement Framework covering industries ranging from construction and health, to resources and manufacturing. The groups provide advice to the Victorian Skills Commissioner on skill demand pressures and future industry skills needs.

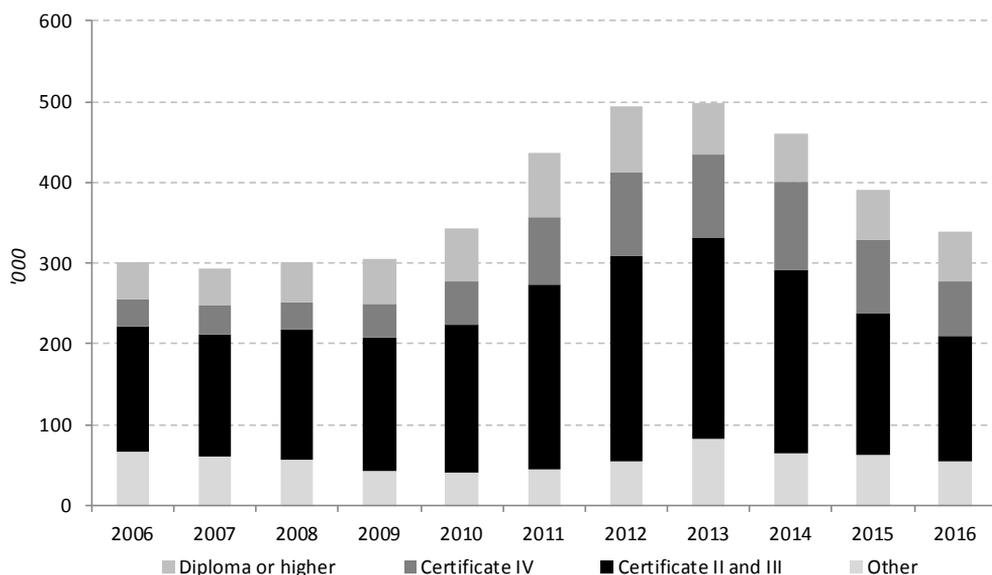
TAFEs are the cornerstone of the vocational training system. They play an important role as the public providers supporting students of all ages and abilities, and in all locations. That is why the Government has invested in TAFE through initiatives like the TAFE Rescue Fund, TAFE Back to Work Fund, and TAFE Boost Fund.

The Government also implemented the Skills First reforms in 2017 to strengthen the TAFE and vocational training sector. In the short period since implementation, there is already evidence that the share of enrolments in TAFE has increased and that vocational education and training (VET) enrolments are more closely aligned to Government priorities including apprenticeships, high-value traineeships and skills that workers need to address family violence and support the National Disability Insurance Scheme (NDIS).

In addition the Government has put in place a framework that will help deliver its pipeline of major infrastructure projects (Box 3.2).

These successes are encouraging, but more needs to be done. Without Government action, the shortfall in trade and technically skilled workers is likely to continue, with enrolments in Certificates II, III and IV courses in Victorian vocational education institutions declining in recent years (Chart 3.9). These trends suggest that further investment in the TAFE and vocational education sector is needed to strengthen Victoria’s workforce across the middle skill levels.

Chart 3.9: Vocational education enrolments by qualification level, Victoria, 2006 to 2016



Source: National Centre for Vocational Education Research

Box 3.2: Workforce skills to deliver infrastructure

The *2018-19 Budget* outlines the Government's plans to invest \$10.1 billion a year on average over the next four years in infrastructure across Victoria. This includes major new initiatives that will accommodate greater economic activity, such as the Suburban Roads Upgrade and the Monash Freeway upgrade – Stage 2, and ongoing projects such as the Metro Tunnel, West Gate Tunnel Project and Level Crossing Removal Program.

These projects will employ thousands of Victorians and boost Victoria's productivity. The projects will rely on a large, highly skilled workforce with expertise in all aspects of infrastructure to ensure these projects are delivered on cost, on time and to a high quality.

This comes at a time when other states – such as New South Wales and Queensland – are also making significant investment in infrastructure, and will be competing with Victoria for skilled workers. It is important to ensure Victoria will have the supply of skilled labour needed for the Government's infrastructure pipeline.

Research commissioned by Victoria's transport agencies identified priority skill areas for constructing transport infrastructure, including:

- railway signalling expertise;
- tunnelling expertise;
- cost engineers and quantity surveyors;
- project leadership;
- service relocation and utility network operation; and
- structural and pre-cast concrete.

Without action, labour supply constraints may also spill over into sectors such as health, education and building construction, all of which are linked to infrastructure in some way.

The Major Projects Skills Guarantee supports developing the skilled workforce that is needed for Victoria's major infrastructure projects. The Major Projects Skills Guarantee requires that at least 10 per cent of the work on major public projects is undertaken by local apprentices, trainees or engineering cadets. This provides opportunities for Victorians in the early stages of their careers to gain on the job experience working on some of Victoria's biggest building and infrastructure projects, including the Metro Tunnel and Level Crossing Removal Program, and encourages major employers to offer training positions.

Investing in a strong TAFE and vocational training sector

The Government is committed to ensuring Victorian workers are equipped for the jobs of the future, the jobs that will drive economic growth and enable workers to improve their lives.

The *2018-19 Budget* complements and builds on Victoria's strong skill development. It includes initiatives that will:

- continue to build the strength of the TAFE sector;
- increase access to training, and the number of Victorians with higher level skills; and
- improve the quality of training, especially of apprenticeships and traineeships.

These and other initiatives will support Victoria to be ready for the jobs of the future. A university education is not the right choice for everyone, and diversifying and improving the quality of non-university pathways suits the needs of individual Victorians and the broader economy.

Free TAFE for Priority Courses

To encourage Victorians to train in skills for the future, the *2018-19 Budget* provides \$172 million over four years to provide free TAFE for students in key areas of skills needs. From 1 January 2019, students will pay no course tuition fees for 30 priority non-apprenticeship courses and 18 Apprenticeship Pathway courses (also known as pre-apprenticeships). The initial 20 non-apprenticeship courses and 18 Apprenticeship Pathway courses are listed in Table 3.2. The Government will make further announcements to confirm the composition of the remaining 10 priority courses following consultation with industry. This initiative will reduce barriers to training and encourage a more efficient response to industry demand for trained graduates in priority areas. The initiative will enable more Victorians to develop their skills, which is particularly important given that most vocational education students do not have any post-school qualification (Box 3.3).

The non-apprenticeship courses have been selected based on a range of factors including employment projections, job advertisement data, data on improved employment status after training, student demand in 2017, gender balance, and alignment with Government priorities including infrastructure, prevention of family violence, and the roll-out of the National Disability Insurance Scheme.

Eighteen government-funded Apprenticeship Pathway courses will also be free of tuition fees. The importance of Apprenticeship Pathways was recently emphasised in the Victorian Skills Commissioner's Apprenticeship and Traineeship Taskforce Report, *Rebalance and Relaunch*.

Table 3.2: Initial 20 non-apprenticeship courses and 18 Apprenticeship Pathway courses in 2019

Certificate IV/Diploma/Advanced Diploma in Accounting	Certificate IV in Plumbing and Services
Certificate IV in Ageing Support	Certificate II in Automotive Air Conditioning Technology
Certificate II/III/IV in Agriculture	Certificate II in Automotive Body Repair Technology
Certificate III In Agriculture (Dairy Production)	Certificate II in Automotive Servicing Technology
Certificate III/IV in Allied Health Assistance	Certificate II in Automotive Vocational Preparation
Certificate IV/Diploma in Building and Construction (Building)	Certificate II in Construction Pathways
Certificate III in Civil Construction	Certificate II in Electrotechnology (Pre-vocational)
Certificate III/IV/Diploma in Community Services	Certificate II in Electrotechnology (Career Start)
Certificate III in Concreting	Certificate II in Engineering Pathways
Certificate III in Construction Waterproofing	Certificate II in Engineering Studies
Certificate III/IV in Dental Assisting	Certificate II in Furniture Making
Certificate IV in Disability	Certificate II in Glass and Glazing
Certificate III/IV in Education Support	Certificate II in Horticulture
Certificate IV in Engineering	Certificate II in Meat Processing (Food Services)
Certificate III in Horticulture	Certificate II in Plumbing (Pre-apprenticeship)
Certificate III in Hospitality	Certificate II in Printing and Graphic Arts (General)
Certificate III in Individual Support	Certificate II in Retail Baking Assistance
Certificate IV in Mental Health	Certificate II in Salon Assistant
Diploma of Nursing	Certificate II in Signage and Graphics

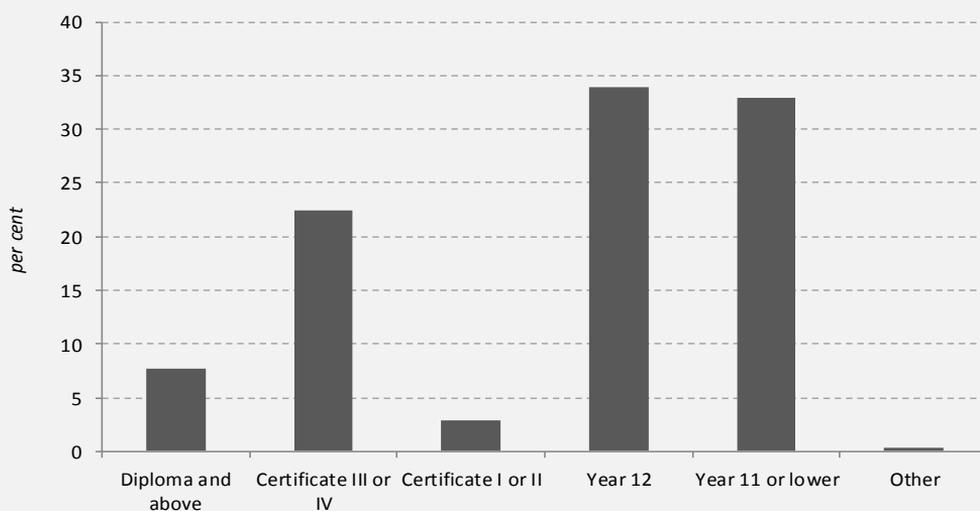
Box 3.3: A typical Victorian TAFE student

Young people, particularly those who have left school early or who are unemployed, often cite course tuition fees as a barrier to accessing training. Even relatively small amounts of money can be seen as a deterrent to study, and students from lower socio-economic backgrounds also tend to underestimate the benefits of post-school education. Making TAFE free for priority courses will remove this barrier, ensuring those who wish to undertake a priority TAFE course or Apprenticeship Pathway course can do so.

A typical student utilising a government-subsidised placement is young and has no post-school qualification (Chart 3.10). More than half of the government subsidised students enrolled in TAFE are under 25 years old. Two-thirds of VET students have no post-school qualifications and of those almost half have not completed school.

In addition, 74.4 per cent of government subsidised VET students are enrolled in courses at Certificate III or higher. This means completing a VET qualification is likely to significantly increase future employment and earning prospects for those students, increase their labour force participation rate and reduce the risk of long-term unemployment.

Chart 3.10: Previous highest level of education, Victorian VET students, 2016



Source: National Centre for Vocational Education Research

Investing in TAFE facilities

The performance of TAFEs, including the quality of the training they provide, depends on having fit-for-purpose facilities. The *2018-19 Budget* invests \$120 million in three TAFE refurbishment and development projects at Bendigo Kangan Institute McRae St Campus, Federation Training Morwell Campus, and Federation Training Port of Sale Campus. These works will ensure TAFEs remain modern and contemporary institutions at the heart of the training system, ready to build the skills needed now and improve lifelong education pathways.

More subsidised training places

Victorians are keen to train, and to build their skills. In addition to free TAFE in priority courses, the *2018-19 Budget* allocates \$304 million to respond to Victorian jobs growth with more training places for courses on the funded course list.⁴ This will ensure there is an affordable place available in a VET course for all Victorian students. This investment, and the other initiatives to make more training places available, will help to close the gap in skills Victoria currently faces.

Additional places will be made available in line with the existing emphasis on Skills First priority sectors, which have strong jobs outcomes and are linked to government priorities. These include: apprenticeships, high value traineeships, courses supporting infrastructure and the NDIS, and courses for those in family violence related occupations. The funded course list is updated annually based on employment forecasts and input from industry through a comprehensive stakeholder consultation process, led by the Victorian Skills Commissioner.

High quality apprenticeships and traineeships

The *2018-19 Budget* also invests in strengthening the quality and consistency of full-time apprenticeships and traineeships. Apprenticeships and traineeships are essential components of the broader vocational training system in Victoria, providing an opportunity for people to earn a wage while developing skills and knowledge on the job. TAFEs deliver around 70 per cent of all apprenticeships, making TAFEs critical to the success of efforts to improve and grow the apprenticeship model in Victoria.

The Government is investing \$44 million over four years to:

- work in partnership with industry to expand independent assessment of apprentices and trainees at the end of their training;
- reintroduce trade papers to recognise completion of a quality apprenticeship; and
- invest in high quality, up-to-date learning materials.

These reforms will both help to improve learning and increase the consistency of assessment, so students and employers will have more confidence in the value of a qualification.

⁴ The funded course list can be found at: www.education.vic.gov.au/skillsfirst/Pages/fundedcourses.aspx

Investing earlier to build skills for the future

The skill development journey begins at school. The *2018-19 Budget* includes funding to ensure school students have the knowledge and educational options available to make good choices about their future careers and begin developing the skills they will need now.

Expanding career choices

This budget provides funding to ensure all school students have access to relevant and timely advice about further learning options. Effective career education helps students understand the connection between school and future careers, improving their motivation and willingness to learn and, in turn, increasing their engagement at school. High quality career education also supports students to make informed course and career decisions and navigate multiple careers throughout their lives.

The *2018-19 Budget* allocates \$109 million over four years to reform career education in Victorian government schools, to empower students to take the career and pathway decisions that will best suit them. Expanded services will intervene earlier and provide career education for years seven, eight and nine students, so that students are better able to guide their secondary schooling choices with their career goals in mind. Career advice to year 10 to 12 students will also be maintained and improved. Key elements include:

- holding Career Exploration Workshops each year for all students in years seven and eight to explore strengths, interests and aspirations;
- creating a comprehensive Careers e-Portfolio for all year nine students at this pivotal time in their career planning journey, supported by a professional career diagnostic assessment and guidance service;
- providing tailored career counselling and high quality Career Action Plans for year 10 to 12 students;
- improving engagement with industry, including school-industry roundtables and industry engagement activities for disadvantaged students; and
- supporting career practitioners to attain qualifications in career education.

Enhancing vocational pathways in secondary school

This budget improves the critical pathways to vocational education in schools by investing \$49.8 million to pilot Head Start Apprenticeships and Traineeships and \$26 million in Vocational Education and Training in Schools (VETiS).

The new Head Start Apprenticeships and Traineeships pilot will give students the option of an additional year of school so they have the opportunity to learn their trade at school and get a job sooner.

The new Head Start Apprenticeships and Traineeships will be implemented with the aim of:

- ensuring students are well-prepared to undertake Head Start Apprenticeships and Traineeships through career counselling and strengthening the school's role in preparing students;
- securing high quality work opportunities by coordinating relationships with employers, trainings organisations and Local Learning and Employment Networks;
- increasing the quality and quantity of on-the-job learning, including through holiday work intensives and potentially starting in year 10 or incorporating a year 13; and
- incorporating high-quality assessment for all Head Start Apprenticeships and Traineeships so students are assessed to the same standard as full-time apprenticeships and traineeships.

This funding will enable the program to be implemented in 100 secondary schools, creating up to 1 700 new Head Start Apprenticeships and Traineeships in priority industries including construction technologies, health care and social assistance.

New investment will increase the quality and availability of VETiS to ensure all Victorian school students can access these options. The VETiS package includes:

- top-up funding for targeted VETiS programs to ensure funding is not a barrier to students accessing VETiS;
- initiatives designed to boost VETiS quality, including the implementation of a quality framework for VETiS; and
- a funding supplement to support increased provision of VETiS by TAFEs.

These reforms form an integrated package to raise the quality of school-based vocational pathways. The development of a quality framework for VETiS will make it clear what high quality looks like, and support consistent assessment in these units. Improving links with employers and TAFEs through Head Start Apprenticeships and Traineeships will help to raise the quality of both formal learning and employment placements. Bringing Head Start Apprenticeships and Traineeships assessment into line with that of full-time apprenticeships and traineeships will increase the consistency and confidence in these qualifications.

Cutting the cost for students, families and employers

The Government is cutting the cost of living for students and their families, and cutting costs for employers, by making training more accessible and affordable for more students. Initiatives such as offering free TAFE for priority courses, and others, will reduce the barriers to training, especially for those for whom the cost might be a deterrent. This will enable more Victorians to develop their skills, giving them access to the security and dignity of a job.

By reducing the cost and increasing the availability of training, more people will have skills that employers and businesses need, making it easier to grow and strengthen Victoria's economy.

SKILLING VICTORIA'S WORKFORCE

The Government is investing in Victoria's future by investing in its people. It is building Victoria as the Education State, where every student will have the knowledge, capabilities and attributes that will see them thrive throughout their lives.

Past investment has laid the foundations for the Education State to improve outcomes for all students by providing funding to build new schools in fast growing areas, supporting the development of teachers and positioning TAFE's at the heart of the training system.

The Government has also improved the fairness of the education system, so all students can succeed regardless of their background or circumstance, including by providing the largest ever boost to equity funding in schools, introducing extra funding for disadvantaged children in kindergarten, providing more support to re-engage students in education and helping disadvantaged job seekers into new jobs.

The *2018-19 Budget* builds on these earlier investments, and continues the progress towards the Education State, with additional investment in early childhood and schools, and a strong focus on skilling Victoria's workforce.

This budget provides funding to align the education system more closely with industry needs, link the schooling sector with post-school career pathways, improve the quality of TAFE and vocational training and provide all Victorians with the opportunity to increase their skills and improve their prospects in the labour market. This will put more Victorians in work, boost productivity and help grow the economy.

Investing in skills is just one of the ways the Government is making it easier for Victorians to learn, earn and improve their standard of living.

The changes being funded in this budget will continue laying the foundation for continued strong economic growth in Victoria and higher standards of living for all Victorians.

CHAPTER 4 – BUDGET POSITION AND OUTLOOK

- The *2018-19 Budget* builds on the past three years of investment by the Government in the services and infrastructure our growing state needs, while maintaining a strong and sustainable fiscal position.
- In this budget, the Government has announced \$9.4 billion in new output initiatives and up to \$9.3 billion total estimated investment (TEI) in new asset initiatives.
- The general government sector operating surplus in 2018-19 is estimated to be \$1.4 billion, with strong surpluses averaging \$2.5 billion across the forward estimates.
- In 2018-19, the general government sector is expected to collect \$69.5 billion in revenue, and spend \$68.1 billion on services. Revenue growth is expected to average 4.0 per cent a year over the budget and forward estimates, exceeding average expense growth of 3.9 per cent a year.
- Government infrastructure investment (GII) will average \$10.1 billion a year over the budget and forward estimates, more than double the average of \$4.9 billion a year from 2005-06 to 2014-15.
- Net debt is expected to be \$31.4 billion by June 2022. As a proportion of gross state product (GSP), net debt is projected to increase from its June 2018 level of 4.6 per cent to 6.0 per cent by June 2021, and remain at that level in 2021-22.
- The Government's prudent approach to financial management means Victoria's finances are in excellent health, which is reflected in the State's triple-A credit rating.
- The Government is on track to fully fund the State's unfunded superannuation liability by 2035.

This chapter outlines the budget position of the general government sector. The broader public sector is covered in Chapter 5 *Position and Outlook of the Broader Public Sector*. This budget paper takes into account the financial impacts as at 23 April 2018 of all policy decisions made by the Government, as well as other information that affects the financial statements, unless otherwise stated.

GENERAL GOVERNMENT SECTOR

Overview

The *2018-19 Budget* continues the Government's commitment to delivering the services and infrastructure our growing state needs. In each of its four budgets, the Government has adhered to a clear and responsible fiscal framework, enabling investments in services and infrastructure to meet the needs of a growing population while maintaining a strong fiscal position. This budget invests \$9.4 billion in additional services and up to \$9.3 billion TEI in new asset initiatives.

Revenue growth is expected to average 4.0 per cent a year over the budget and forward estimates, exceeding average expense growth of 3.9 per cent a year.

The operating result (net result from transactions) for the general government sector in 2018-19 is forecast to be a surplus of \$1.4 billion, with annual operating surpluses averaging \$2.5 billion over the forward estimates (Table 4.1).

Table 4.1: General government fiscal aggregates

	Unit of measure	2016-17 actual	2017-18 revised	2018-19 budget	2019-20 estimate	2020-21 estimate	2021-22 estimate
Net result from transactions	\$ billion	2.7	2.0	1.4	2.0	2.7	2.9
Government infrastructure investment ^{(a)(b)}	\$ billion	9.1	11.6	13.7	10.0	8.9	7.6
Net debt	\$ billion	15.8	19.6	24.3	28.0	29.8	31.4
Net debt to GSP ^(c)	per cent	3.9	4.6	5.4	5.9	6.0	6.0

Source: Department of Treasury and Finance

Notes:

(a) Includes general government net infrastructure investment and estimated cash flows for Partnerships Victoria projects.

(b) Excludes the impact of the medium-term lease over the operations of the Port of Melbourne and the divestment of Victoria's share of Snowy Hydro Limited.

(c) The ratios to GSP may vary from publications year to year due to revisions to the Australian Bureau of Statistics (ABS) GSP data.

Infrastructure investment, as measured by GII, will average \$10.1 billion a year over the next four years, more than double the average of \$4.9 billion a year from 2005-06 to 2014-15. Net debt as a proportion of GSP is expected to be 4.6 per cent at June 2018 and increase to 6.0 per cent by June 2021, and remain at that level in 2021-22.

The additional investments announced in the *2018-19 Budget*, combined with Victoria's strong economy and the Government's strong fiscal management, is consistent with maintaining a triple-A credit rating. The *2018-19 Budget* delivers against the Government's financial measures and targets outlined in Table 4.2.

Table 4.2: Financial measures and targets for the 2018-19 Budget

Financial measures	Target
Net debt	General government net debt as a percentage of GSP to be maintained at a sustainable level over the medium term.
Superannuation liabilities	Fully fund the unfunded superannuation liability by 2035.
Operating surplus	A net operating surplus consistent with maintaining general government net debt at a sustainable level over the medium term.

BUDGET AND FORWARD ESTIMATES OUTLOOK

Table 4.3 summarises the operating statement for the general government sector. A comprehensive operating statement is presented in Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the General Government Sector*.

Table 4.3: Summary operating statement for the general government sector^(a) (\$ million)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	actual	revised	budget	estimate	estimate	estimate
Revenue						
Taxation	22 272	22 446	24 081	25 245	26 074	27 483
Dividends, TER and interest ^(b)	1 521	1 638	1 786	1 369	1 397	1 376
Sales of goods and services	6 939	7 087	7 541	8 275	8 450	8 621
Grant revenue	27 542	30 342	33 458	33 107	34 002	34 778
Other current revenue	2 645	2 492	2 622	2 622	2 687	2 747
Total revenue	60 918	64 005	69 487	70 617	72 609	75 004
% change ^(c)	7.1	6.4	8.6	1.6	2.8	3.3
Expenses						
Employee expenses	21 497	22 989	25 562	26 354	27 302	28 288
Superannuation ^(d)	3 023	3 250	3 338	3 367	3 399	3 481
Depreciation	2 616	2 764	2 876	3 036	3 337	3 507
Interest expense	2 028	2 102	2 167	2 211	2 275	2 319
Other operating expenses	18 575	20 352	21 264	19 713	19 906	20 528
Grants and other transfers	10 471	10 506	12 901	13 966	13 674	13 991
Total expenses	58 210	61 963	68 108	68 646	69 894	72 114
% change	7.7	6.4	9.9	0.8	1.8	3.2
Net result from transactions	2 709	2 042	1 380	1 971	2 715	2 891
Total other economic flows included in net result^(e)	(150)	(694)	(242)	(83)	(202)	(226)
Net result	2 559	1 349	1 137	1 888	2 514	2 665

Source: Department of Treasury and Finance

Notes:

- (a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
- (b) Comprises dividends, income tax and rate equivalent revenue and interest.
- (c) The percentage changes in 2016-17 and 2017-18 refer to the previous years' actual figures. These are adjusted to remove the one-off receipt of revenue associated with the High Court of Australia's decision in favour of the State relating to the Tatts Group Limited's 'Gambling Licences' proceedings in 2015-16 and the upfront payment of the Port Licence Fee in 2016-17.
- (d) Comprises superannuation interest expense and other superannuation expenses.
- (e) This typically includes gains and losses from the disposal of non-financial assets, adjustments for bad and doubtful debts and revaluations of financial assets and liabilities.

Revenue outlook

As outlined in Chapter 2 *Economic Outlook*, Victoria's economy is strong, expanding at an above-trend pace in recent years and supporting growth in employment. The outlook is positive with economic growth forecast to remain robust.

The general government sector is expected to collect \$69.5 billion in revenue in 2018-19, with revenue growth projected to average 4.0 per cent a year over the budget and forward estimates. The State's strong economy and positive labour market conditions are expected to continue to underpin solid growth in tax revenue.

Taxation

State taxation revenue is expected to grow to \$24.1 billion in 2018-19, with growth expected to average 4.5 per cent a year over the forward estimates. Revenue will be supported by steady growth in the economy. Specifically:

- land transfer duty revenue is expected to grow by 3.8 per cent to \$7.1 billion in 2018-19, and is expected to increase by 3.2 per cent a year on average over the forward estimates. This forecast represents a moderation in growth of land transfer duty, and is in line with the outlook for the property market, following estimated growth of 11.0 per cent in 2017-18;
- land tax revenue is forecast to grow to \$3.1 billion in 2018-19, largely as a result of the biennial land revaluation that is currently underway. Land tax revenue is expected to grow by an average of 7.8 per cent over the forward estimates. This latest revaluation cycle covers the period from 1 January 2016 to 31 December 2017. As announced in the *2017-18 Budget*, from 1 July 2018, the Government will centralise land valuations with the Valuer-General of Victoria (VGV) and introduce annual valuations. This will smooth the volatility in land tax revenues associated with biennial valuations;
- payroll tax revenue is expected to grow by 4.1 per cent to \$6.2 billion in 2018-19 and by an average of 5.3 per cent a year over the forward estimates, supported by sustained growth in employment and wages;
- gambling tax revenue is forecast to grow by 1.9 per cent to \$1.9 billion in 2018-19 and by an average of 1.6 per cent a year over the forward estimates. This rate of growth in gambling revenue is broadly similar to that of recent years;
- insurance tax revenue is expected to grow by 8.1 per cent to \$1.4 billion in 2018-19 and by 6.4 per cent a year on average over the forward estimates; and
- motor vehicle taxes are expected to grow by 13.9 per cent to \$2.7 billion in 2018-19 and by an average of 4.7 per cent a year over the forward estimates. Continued population growth in Victoria is anticipated to sustain steady growth in motor vehicle revenue over the forward estimates.

Dividends, income tax equivalent and interest

Dividend and income tax equivalent (ITE) revenue is projected to be \$922 million in 2018-19 and decrease by an average of 15.7 per cent a year over the following three years. The increase in 2018-19, compared to 2017-18 is due to dividends received in 2018-19 from the Victorian Managed Insurance Authority.

Interest income is earned on holdings of cash and deposits. Total interest income is expected to be \$864 million in 2018-19, and to decline by an average of 1.6 per cent a year over the following three years as money is drawn down from the Victorian Transport Fund to fund infrastructure.

Sales of goods and services

Revenue from the sales of goods and services is expected to grow by 6.4 per cent in 2018-19 to \$7.5 billion. Over the forward estimates, growth is expected to average 4.6 per cent a year. This growth largely reflects an increase in the capital asset charge revenue from VicTrack associated with an increase in its asset base, an increase in TAFE fees for service and an increase in land registration fees.

Grants

Total grants revenue is expected to grow by 10.3 per cent to \$33.5 billion in 2018-19 with growth easing to 1.3 per cent a year on average over the forward estimates. The growth in 2018-19 is mostly driven by GST revenue, which is anticipated to grow by 9.6 per cent to \$16.9 billion in 2018-19. The lower growth in grants over the forward estimates is principally due to a levelling out of expected GST revenue following recent changes to GST relativities and the transfer of responsibility for disability services to the Commonwealth.

Victoria's share of the GST pool has increased from 24.0 per cent in 2017-18 to 25.6 per cent in 2018-19. This largely reflects continued strong population growth relative to other states, a related need for greater investment in infrastructure and a continued smaller share of Commonwealth infrastructure grants.

Over the forward estimates, Victorian GST revenue is expected to increase on average by 3.0 per cent a year, buoyed by the continued growth in the GST pool. Victoria's GST relativity is forecast to ease beyond 2018-19 partly due to the State's relatively stronger revenue outlook.

Commonwealth grants for specific purposes are projected to average \$15.3 billion a year across the forward estimates. The Commonwealth provides these grants as contributions towards healthcare, education, disability and other services, and major infrastructure investment.

Commonwealth grant revenue decreases in 2019-20 largely due to the transfer of responsibility for disability services, and the Commonwealth funding attached to these services from Victoria, to the National Disability Insurance Agency as part of the full roll out of the National Disability Insurance Scheme (NDIS).

Other current revenue

Other current revenue includes fines, royalties, donations and gifts, assets received free of charge and other miscellaneous revenues. Other current revenue is projected to increase by 5.2 per cent to \$2.6 billion in 2018-19 and by an average of 1.6 per cent a year across the forward estimates.

Budget Paper No. 5, Chapter 4 *State Revenue* contains further details of expected movements in the major categories of general government revenue.

Expenses outlook

The Government is expected to spend \$68.1 billion in 2018-19. Total expenses are expected to grow by 3.9 per cent a year on average over the four years to \$72.1 billion in 2021-22.

The growth in expenses reflect the Government's ongoing commitment to investing in services and infrastructure to meet the needs of a growing population, with major funding increases for skills, schools, health, mental health, community safety and the continuation of the Government's record infrastructure program. Specifically:

- grants and other transfer expenses are forecast to increase by 22.8 per cent to \$12.9 billion in 2018-19, largely driven by payments made to the National Disability Insurance Agency for disability services as part of the full roll out of the NDIS. Thereafter, growth is expected to moderate to an average of 2.7 per cent a year over the forward estimates;
- depreciation expense is forecast to grow by 4.0 per cent to \$2.9 billion in 2018-19 and increase by 6.8 per cent a year on average over the forward estimates to \$3.5 billion in 2021-22. This growth is broadly in line with the Government's increased investment in infrastructure;
- employee expenses (including superannuation) are forecast to grow by 10.1 per cent in 2018-19, moderating to an average annual increase of 3.2 per cent over the forward estimates. The growth in 2018-19 reflects increases in public sector workers to support Victoria's growing population, including teachers and education workers to deliver the Government's Education State commitment, public health and community services workers for increased acute and mental health services, and police and corrections officers to deliver the Government's community safety agenda. The increase in employee expenses also reflects changes in average remuneration levels consistent with enterprise bargaining agreements, including teachers, police and public health sector agreements;
- other operating expenses are forecast to increase by 4.5 per cent in 2018-19 and decrease by an average of 1.2 per cent a year over the forward estimates to \$20.5 billion in 2021-22; and
- interest expense is forecast to grow by 3.1 per cent to \$2.2 billion in 2018-19. Interest expense is expected to grow moderately over the forward estimates, growing by an average of 2.3 per cent a year.

Reconciliation of estimates to the 2017-18 Budget Update

Relative to the 2017-18 Budget Update, the net result from transactions has been revised down by \$737 million in 2018-19, down by \$16 million in 2019-20 and up by \$74 million in 2020-21 (Table 4.4).

Table 4.4: Reconciliation of estimates to the 2017-18 Budget Update^(a) (\$ million)

	2018-19 budget	2019-20 estimate	2020-21 estimate
Net result from transactions: 2017-18 Budget Update	2 117	1 987	2 641
Policy variations			
Revenue policy initiatives	(41)	(42)	(45)
Output policy initiatives ^(b)	(2 872)	(1 282)	(852)
	(2 913)	(1 324)	(897)
Economic/demographic variations			
Taxation	318	279	256
Investment income ^(c)	330	50	(56)
	647	329	200
Commonwealth grant variations			
General purpose grants	713	507	96
Specific purpose grants ^(d)	31
	744	507	96
Administrative variations			
Contingency offset for new policy initiatives ^(e)	300	500	800
Other administrative variations	484	(28)	(125)
	784	472	675
Total variation since 2017-18 Budget Update	(737)	(16)	74
Net result from transactions: 2018-19 Budget	1 380	1 971	2 715

Source: Department of Treasury and Finance

Notes:

- (a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
- (b) This is represented in Table 4.5 as the 2018-19 Budget output policy decisions.
- (c) Investment income includes dividends and income tax and rate equivalent revenue.
- (d) Reflects the change in grant revenue as per Note 1.2.4 of Budget Paper No. 5, Chapter 1 Grant Revenue less associated expense movements.
- (e) Represents releases from the funding not allocated to specific purposes contingency associated with 2018-19 Budget new output initiatives. Further information on total output contingencies can be found at Note 1.3.5 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the General Government Sector.

Policy variations

Policy variations reflect specific initiatives by the Government that have an impact on the next four years, and are related to a new policy or represent a change in the Government's existing policy position since the previous publication.

The *2018-19 Budget* funds \$9.4 billion in new output initiatives over the five years to 2021-22. Table 4.5 shows the impact of the new output initiatives in this budget. New revenue policy initiatives have resulted in a moderate downward variation to the operating result.

Details of specific new output and revenue policy initiatives are contained in Budget Paper No. 3, Chapter 1 *Output, Asset Investment, Savings and Revenue Initiatives*.

Table 4.5: Net impact of the 2018-19 Budget new output initiatives ^(a) (\$ million)

	2018-19 budget	2019-20 estimate	2020-21 estimate	2021-22 estimate
New output initiatives	3 676	2 261	1 705	1 511
Less:				
Reprioritisations and revenue offsets ^(b)	575	543	388	414
Adjustments ^(c)	229	436	466	372
Savings
2018-19 Budget output policy initiatives	2 872	1 282	852	726
Less: contingency offset for new policy ^(d)	300	500	800	800
Net impact	2 572	782	52	(74)

Source: Department of Treasury and Finance

Notes:

- (a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
- (b) This includes the reprioritisation of resources previously allocated to departments and revenue offsets.
- (c) Primarily incorporates the net impact of the creation and release of contingencies held for decisions made but not yet allocated.
- (d) Represents releases from the funding not allocated to specific purposes contingency associated with 2018-19 Budget new output initiatives. Further information on total output contingencies can be found at Note 1.3.5 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the General Government Sector.

Economic and demographic variations

Since the *2017-18 Budget Update*, economic and demographic factors have affected taxation and investment income:

- land tax revenue is forecast to be \$141 million a year higher on average from 2018-19 to 2020-21 compared with the *2017-18 Budget Update*. This largely reflects updated valuation data from the VGV suggesting that the recent strength in the property market will translate into significant increases in the value of residential, commercial and industrial land;
- land transfer duty is expected to be \$101 million a year higher on average from 2018-19 to 2020-21 compared with the *2017-18 Budget Update*, reflecting strong commercial activity in 2017-18 and 2018-19 partially offset by more moderate growth in the residential housing market over this period; and
- total investment income is expected to be \$108 million higher on average from 2018-19 to 2020-21, largely reflecting a rephase of dividends from the PFC sector.

Commonwealth grants variations

Commonwealth general purpose grants (or GST grants) estimates have been revised up by \$713 million in 2018-19, \$507 million in 2019-20 and \$96 million in 2020-21 compared with the *2017-18 Budget Update*.

Net changes to specific purpose grants have increased the operating result by \$31 million in 2018-19. This is largely due to revenue for the National Water Infrastructure Development Fund, the National Disability SPP and an update to revenue associated with the Goulburn-Murray Water Connections Project. Over the forward estimates the level of grants are largely unchanged.

Administrative variations

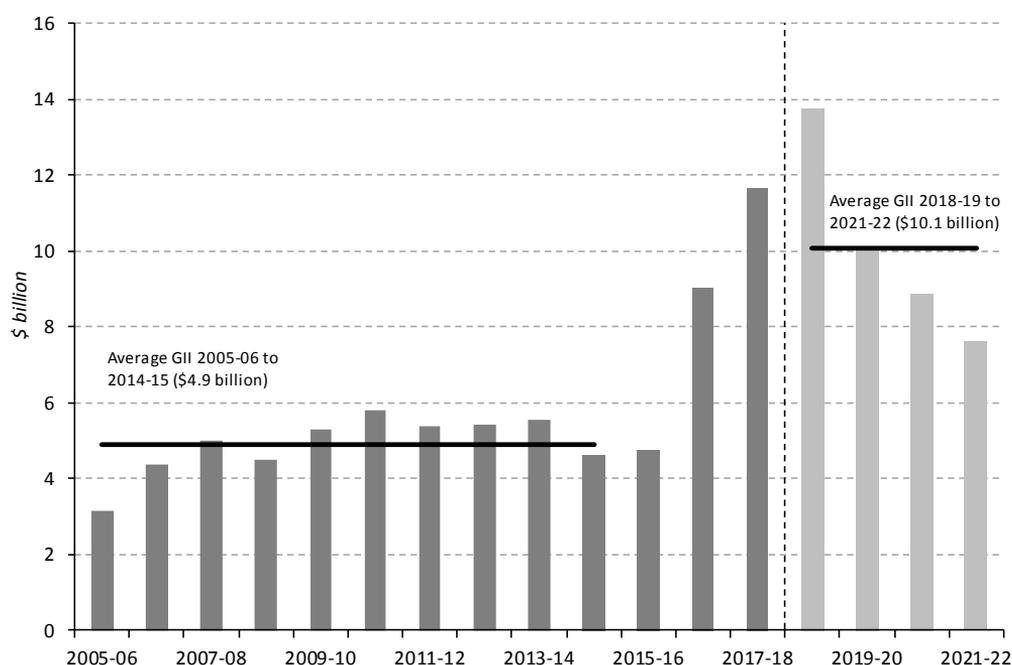
Other administrative variations are expected to increase the operating result by \$484 million in 2018-19, decrease it by \$28 million in 2019-20 and decrease it by \$125 million in 2020-21. These movements reflect depreciation adjustments to the VicRoads asset base, a decrease in superannuation expenses due to movements in the discount rate that underlie the key valuation assumptions and updates to outer entity financials in line with corporate plans.

Capital expenditure

GII, which measures investment funded or facilitated by the Government, is at historically high levels.

GII is forecast to average \$10.1 billion a year over the budget and forward estimates, more than double the average GII from 2005-06 to 2014-15 of \$4.9 billion a year (Chart 4.1).

Chart 4.1: Government infrastructure investment ^{(a)(b)(c)}



Source: Department of Treasury and Finance

Notes:

- (a) Includes general government net infrastructure investment and estimated cash flows for Partnerships Victoria projects.
- (b) Excludes the impact of the medium-term lease over the operations of the Port of Melbourne and the divestment of Victoria's share of Snowy Hydro Limited.
- (c) The figure for 2017-18 is an estimate.

New asset initiatives

The 2018-19 Budget includes up to \$9.3 billion TEI of new infrastructure investment, underscoring the Government's commitment to funding projects that will drive the economy in the future and meet the needs of a growing population.

Investment in new assets include:

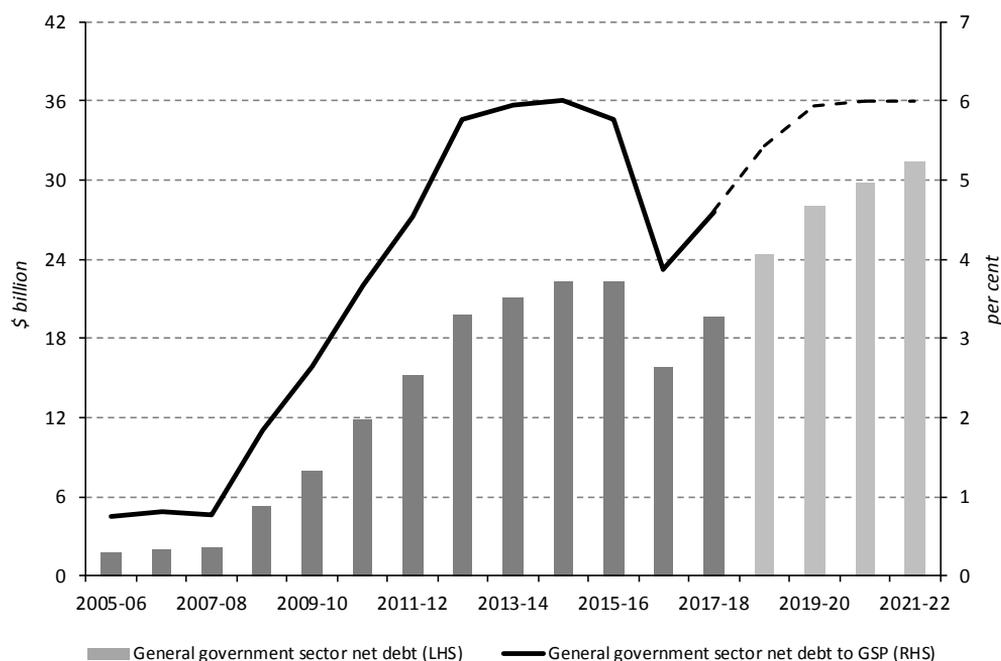
- \$2.2 billion for the Suburban Roads Upgrade, a targeted package upgrading some of the most congested arterial roads in the south-eastern and northern outer suburban areas of Melbourne;
- \$1.5 billion to continue upgrades to metropolitan and regional public transport;
- \$1.4 billion in new capital investment for acute health services and mental health;
- \$1.3 billion in continuing to make Victoria the Education State through new and upgraded school infrastructure and education modernisation programs; and
- \$689 million to expand the Lara Prison precinct, complementing tougher sentencing and bail laws and to meet the growing demands of the corrections system.

Budget Paper No. 3, Chapter 1 *Output, Asset Investment, Savings and Revenue Initiatives* contains details of individual asset initiatives.

Net debt

Net debt as a proportion of GSP is expected to be 4.6 per cent at June 2018, and increase to 6.0 per cent by June 2021, and remain at that level in 2021-22 (Chart 4.2). This meets the Government’s commitment to keep net debt as a percentage of GSP below the peak of the previous five year period.

Chart 4.2: General government net debt to GSP ^(a)



Source: Department of Treasury and Finance

Note:

(a) The decrease in 2016-17 reflects the receipt of proceeds from entering into a medium-term lease over the operations of the Port of Melbourne.

The application of cash resources for the general government sector (Table 4.6) outlines the annual movements in net debt. General government sector cash from operating activities is expected to average \$4.4 billion a year over the next four years.

Table 4.6: Application of cash resources for the general government sector ^(a) (\$ million)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	<i>actual</i>	<i>revised</i>	<i>budget</i>	<i>estimate</i>	<i>estimate</i>	<i>estimate</i>
Net result from transactions	2 709	2 042	1 380	1 971	2 715	2 891
Add back: non-cash revenue and expenses (net) ^(b)	2 816	2 045	4 171	1 588	1 062	1 928
Net cash flows from operating activities	5 524	4 087	5 551	3 558	3 777	4 818
Less: Total net investment in fixed assets ^(c)	6 857	4 277	8 099	4 463	3 826	5 362
Surplus/(deficit) of cash from operations after funding net investment in fixed assets	(1 333)	(190)	(2 548)	(904)	(49)	(543)
Finance leases ^(d)	544	648	451	1 034	526	448
Other movements	(8 423)	3 025	1 714	1 746	1 228	548
Decrease/(increase) in net debt	6 546	(3 863)	(4 714)	(3 684)	(1 804)	(1 539)

Source: Department of Treasury and Finance

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.

(b) Includes depreciation, prepayments and movements in the unfunded superannuation liability and liability for employee benefits, as well as operating cash flows not required to be recognised in the operating statement for the respective year.

(c) Includes total purchases of plant, property and equipment, and net capital contributions to other sectors of government net of proceeds from asset recycling.

(d) The finance lease acquisitions relate to the Bendigo Hospital - Stage 1 and 2, the New Schools PPP - Tranche 1 and 2, the metropolitan Melbourne buses contract, the Ravenhall Prison Project, the High Capacity Metro Trains (HCMT) Project, the Western Roads Upgrade, the Melbourne Convention and Exhibition Centre – Stage 2 development, the Casey Hospital Expansion, the Northern Roads Upgrade and the South Eastern Roads Upgrade.

Unfunded superannuation liability

The Government is on track to fully fund the State's unfunded superannuation liability by 2035. Note 1.6.3 of Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the General Government Sector* shows information on the reported superannuation liability.

FISCAL RISKS

This section discusses a number of risks which, if realised, are likely to impact on the State's financial position and budget outcomes.

Details of specific contingent assets and liabilities, defined as possible assets or liabilities that arise from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, are contained within Budget Paper No. 5, Chapter 6 *Contingent Assets and Contingent Liabilities*.

General fiscal risks

State taxes

State tax forecasts are primarily modelled on the relationships between taxation revenue and projected economic variables. As a result, the main source of uncertainty to the taxation estimates are unforeseen changes in the economic outlook.

Revenue from property based taxes, such as land tax and land transfer duty, are subject to unique risks and historically have been volatile. Property markets can exhibit large cycles typically related to changes in official interest rates and/or changes in sentiment. Forecasts for the *2018-19 Budget* anticipate a stable economic backdrop with an orderly moderation in the housing market in Victoria after a period of strong growth in prices. If property market sentiment were to deteriorate or interest rates rose more quickly than currently expected, or population growth remains at historically elevated levels, revenue from property based taxes would vary from forecast.

Further detail about the fiscal implications of variations in economic parameters from forecasts are outlined in Appendix A *Sensitivity Analysis*.

Employee expenses

Employee expenses are the State's largest expense. Two important determinants of employee expenses are wages growth and the number of employees.

One of the ways the Government manages employee expenses is through implementing a wages policy to deliver financially sustainable wage outcomes that recognise and reward the services public sector employees provide, while improving services to Victorians.

Other factors contributing to projected employee expenses include the composition and profile of the workforce as well as rostering arrangements.

Demand growth

Another key uncertainty is growth in demand for government services exceeding or being below current projections. This can occur, for example, as a result of higher than forecast population growth or expenditure in response to unforeseen events such as natural disasters, including bushfires and floods.

The estimates incorporate contingency provisions to mitigate the impact of expenditure risks, which may be realised during the next four years. The contingency provisions are sized to allow for the likely growth in Victoria's population and consequent derived increased demand for government services.

Note 1.3.5 and Note 1.3.6 of Budget Paper No. 5 Chapter 1 *Estimated Financial Statements for the General Government Sector* discloses general government output and asset contingencies not allocated to departments.

Specific fiscal risks

Commonwealth funding for housing and homelessness

In the Commonwealth's *2017-18 Budget*, the Commonwealth announced changes to funding arrangements for housing and homelessness. Funding provided under the National Affordable Housing Agreement and National Partnership Agreement on Homelessness would be combined and provided under a new National Housing and Homelessness Agreement (NHHA) from 1 July 2018.

In March 2018, the Commonwealth Parliament amended the *Federal Financial Relations Act 2009* to require that states and territories meet a number of conditions to be eligible to receive Commonwealth funding for the NHHA. These conditions include being party to a primary multilateral agreement and supplementary bilateral agreement, having housing and homelessness strategies that include specific content, matching Commonwealth homelessness funding and providing data and information to the Commonwealth.

Victoria continues to negotiate with the Commonwealth and other states and territories on the primary and supplementary agreements. The provision of Commonwealth funding for 2018-19 is subject to the outcome of these negotiations. The *2018-19 Budget* provides funding in 2018-19 for Victoria to match the Commonwealth's contribution to homelessness services.

National Disability Insurance Scheme

Victoria commenced transition to the NDIS on 1 July 2016 and is working towards reaching full roll-out across the state by July 2019. Once fully implemented, Victoria's investment in the NDIS will be an estimated \$2.5 billion a year, with the Commonwealth estimated to provide \$2.6 billion a year for Victorians in the scheme. The Victorian Government will continue to work with the Commonwealth to monitor and manage financial and operational risks within the scheme.

Commonwealth schools funding

In June 2017, the Commonwealth Government passed amendments to the *Australian Education Act 2013* to implement new national school funding arrangements for 2018 onwards. The Victorian Government has signed a one-year interim agreement with the Commonwealth to ensure funding is not at risk for schools for 2018.

Commonwealth contributions to school education are yet to be determined for the 2019 school year onwards. The quantum and conditions of funding are dependent on formal negotiations between the Commonwealth, the states and territories, and the non-government schools sector.

Universal Access to Early Childhood Education

The Commonwealth's financial contribution to assist the states and territories in providing 15 hours per week of preschool support per student is supplied under the National Partnership Agreement on Universal Access to Early Childhood Education. Funding under this agreement will cease in 2019 and ongoing Commonwealth funding arrangements are uncertain.

National Health Reform

Under the National Health Reform Agreement (NHRA), Commonwealth growth funding is derived from a complex model based on the number of procedures performed (activity) and an efficient price determined by an independent administrator.

These arrangements were scheduled to cease from 1 July 2017, however, in April 2016 the Commonwealth agreed to continue the NHRA from 1 July 2017 until 30 June 2020. Conditions attached to the Agreement may increase fiscal exposure for the State and include:

- a national cap on Commonwealth annual expenditure growth of 6.5 per cent (above which the State will be required to fund all hospital activity);
- reduced funding to the State for avoidable hospital admissions or unsafe care; and
- the Commonwealth withholding funds until hospital activity data is provided.

A Heads of Agreement for a new agreement was proposed by the Commonwealth at the Council of Australian Governments (COAG) on 9 February 2018, and negotiations are ongoing.

Victoria's GST revenue

The distribution of GST grants between states and territories is determined by the size of the national GST pool and each jurisdiction's population share weighted by its GST relativity. Revenue sharing relativities are determined by the Commonwealth Treasurer, as informed by the recommendations of the Commonwealth Grants Commission.

The Productivity Commission is currently inquiring into Australia's system of horizontal fiscal equalisation with the final report now expected to be handed to the Commonwealth Government by 15 May 2018. The Commonwealth's response to the inquiry may have implications for how GST revenue is distributed to the states and territories. For example, under one approach proposed by the Productivity Commission, it is estimated that Victoria's GST payments would have reduced by \$972 million in 2017-18, with an ongoing impact in future years.

If consumer prices and wages growth do not pick up as forecast, or if growth in dwelling investment is slower than expected, growth in the GST pool would be lower. Movements in the household savings ratio are also a key source of uncertainty for consumer spending and the GST pool outlook.

If Victoria's net overseas or interstate migration is higher than forecast, Victoria's share of GST revenue could increase. Conversely, should other states have higher than expected net overseas or interstate migration this would negatively affect Victoria's GST revenue. Victoria's share of Commonwealth grants payments can affect its GST revenue. Unforeseen movements in the property market also impact Victoria's share of the national GST pool. Variation in commodity prices relative to current forecasts, particularly in iron ore and coal, also poses uncertainties for Victoria's GST revenue.

CHAPTER 5 – POSITION AND OUTLOOK OF THE BROADER PUBLIC SECTOR

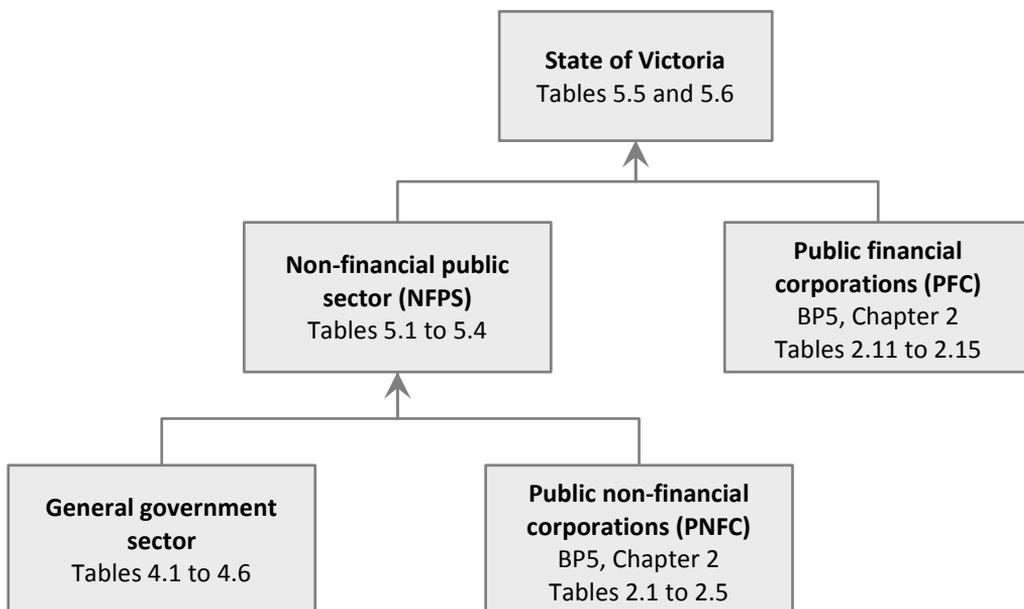
- The non-financial public sector (NFPS) is expected to achieve operating surpluses over the budget and forward estimates. This reflects the strong fiscal outlook in the general government sector.
- NFPS net debt as a proportion of gross state product (GSP) is estimated to average 9.4 per cent over the budget and forward estimates. The outlook for the State's financial position is consistent with Victoria's triple-A credit rating.
- The net result from transactions of the public non-financial corporations (PNFC) sector is anticipated to be an average deficit of \$533 million a year over the budget and forward estimates, while the average operating cash flow surplus is expected to be \$1.6 billion over this period.
- The net result of the public financial corporations (PFC) sector is forecast to improve over the budget and forward estimates from a deficit of \$328 million in 2018-19 to a deficit of \$148 million by 2021-22. The average operating cash flow surplus of the PFC sector over this period is \$864 million.

This chapter overviews the activities of the broader public sector, comprising:

- the NFPS, which consolidates the general government sector and the PNFC sector. The general government sector is discussed in Chapter 4 *Budget Position and Outlook*. The PNFC sector comprises a wide range of entities that provide services primarily funded from user charges and fees. The main services provided by PNFCs include water, housing, and transport services; and
- the State of Victoria, which consolidates the NFPS and the PFC sectors. PFCs can be categorised into two broad types: those that provide services to the general public and businesses (such as WorkSafe Victoria, the Transport Accident Commission and State Trustees Limited), and those that provide financial services, predominantly to other government entities (such as the Victorian Funds Management Corporation, Treasury Corporation of Victoria and the Victorian Managed Insurance Authority).

This chapter comments on each of the sectors but includes tables with data for the State of Victoria and the NFPS only. The equivalent information for the PFC and PNFC sectors can be found in Budget Paper No. 5, Chapter 2 *Supplementary Uniform Presentation Framework Tables*.

The following chart shows the relationship between the various sectors of the State and indicates the relevant tables that disclose the data on these sectors within this budget paper and Budget Paper No. 5.



NON-FINANCIAL PUBLIC SECTOR

The net result from transactions of the NFPS in 2018-19 is forecast to be a surplus of \$706 million before increasing to \$2.1 billion in 2021-22 (Table 5.1). This increase is largely due to the financial position of the general government sector, with a projected operating surplus that increases from \$1.4 billion in 2018-19 to \$2.9 billion in 2021-22.

Table 5.1: Summary operating statement for the non-financial public sector ^(a) (\$ million)

	2016-17 actual	2017-18 revised	2018-19 budget	2019-20 estimate	2020-21 estimate	2021-22 estimate
Revenue						
Taxation revenue	21 908	22 087	23 653	24 798	25 765	27 156
Dividends, income tax equivalent and interest ^(b)	652	494	947	607	621	599
Sales of goods and services	10 880	11 096	11 428	12 245	12 951	12 938
Grants	27 525	30 338	33 454	33 103	33 998	34 774
Other current revenue	3 388	3 247	3 220	3 231	3 299	3 375
Total revenue	64 352	67 262	72 702	73 984	76 633	78 841
% change	6.9	4.5	8.1	1.8	3.6	2.9
Expenses						
Employee expenses	22 643	24 183	26 779	27 603	28 580	29 599
Superannuation ^(c)	3 142	3 373	3 466	3 497	3 532	3 618
Depreciation	4 824	5 012	5 208	5 464	5 911	6 155
Interest expense	2 479	2 481	2 604	2 701	2 816	2 877
Grant expense	7 611	7 113	9 406	10 413	10 197	10 518
Other operating expenses	21 507	23 693	24 532	22 852	23 616	24 010
Total expenses	62 207	65 854	71 995	72 531	74 652	76 777
% change	8.1	5.9	9.3	0.7	2.9	2.8
Net result from transactions	2 146	1 407	706	1 453	1 982	2 064
Total other economic flows included in net result	(399)	(232)	(280)	(96)	(571)	(268)
Net result	1 747	1 175	426	1 357	1 411	1 796

Source: Department of Treasury and Finance

Notes:

(a) This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5 Statement of Finances. Figures in this table are subject to rounding and may not add up to the totals.

(b) Comprises dividends, income tax and rate equivalent revenue and interest.

(c) Comprises superannuation interest expense and other superannuation expenses.

The PNFC sector net result from transactions is projected to record an average annual deficit of \$533 million over the budget and forward estimates. A number of PNFCs, including the metropolitan water corporations, are projected to record surpluses in the net result from transactions. The average net result from transactions of the metropolitan water sector over this period is a surplus of \$261 million. The overall deficit in the PNFC sector is mainly due to the depreciation expense on the large asset bases of VicTrack and the Director of Housing.

However, VicTrack and the Director of Housing generate net operating cash flow surpluses averaging \$146 million a year over the budget and forward estimates. Strong cash flow surpluses indicate VicTrack and the Director of Housing remain in a financially sustainable position. The PNFC sector overall is projected to record an average operating cash flow surplus of \$1.6 billion over this period.

Application of cash resources

Table 5.2 shows the NFPS is projected to generate net cash flows from operating activities averaging \$5.9 billion a year over the budget and forward estimates, on average funding 66 per cent of the projected net investment in fixed assets. Net cash flows from operating activities were higher in 2016-17 due to the receipt of cash proceeds from the medium-term lease of the operations of the Port of Melbourne.

Table 5.2: Application of cash resources for the non-financial public sector^(a) (\$ million)

	2016-17 <i>actual</i>	2017-18 <i>revised</i>	2018-19 <i>budget</i>	2019-20 <i>estimate</i>	2020-21 <i>estimate</i>	2021-22 <i>estimate</i>
Net result from transactions	2 146	1 407	706	1 453	1 982	2 064
Add back: non-cash income and expenses (net) ^(b)	13 588	4 032	6 178	3 626	3 333	4 234
Net cash flows from operating activities	15 734	5 440	6 885	5 080	5 314	6 298
Less:						
Total net investment in fixed assets^(c)	8 628	9 645	12 673	8 449	6 930	7 879
Surplus/(deficit) of cash from operations after funding net investments in fixed assets	7 106	(4 206)	(5 789)	(3 369)	(1 616)	(1 581)
Finance leases ^(d)	544	648	451	1 034	526	448
Other movements	(167)	(112)	(157)	159	(12)	(71)
Decrease/(increase) in net debt	6 729	(4 742)	(6 083)	(4 562)	(2 130)	(1 959)

Source: Department of Treasury and Finance

Notes:

(a) Figures in this table are subject to rounding and may not add up to the totals.

(b) Includes depreciation, prepayments and movements in the unfunded superannuation liability and liability for employee benefits, as well as operating cash flows not required to be recognised in the operating statement for the respective year.

(c) Includes total purchases of plant, property and equipment, and capital contributions to other sectors of government net of proceeds from asset sales.

(d) The finance lease acquisitions relate to the Bendigo Hospital - Stage 1 and 2, the New Schools PPP - Tranche 1 and 2, the Metropolitan Melbourne Buses contract, the Ravenhall Prison Project, the High Capacity Metro Trains (HCMT) Project, the Western Roads Upgrade, the Melbourne Convention and Exhibition Centre - Stage 2 development, the Casey Hospital Expansion, the Northern Roads Upgrade and the South Eastern Roads Upgrade.

Infrastructure

Table 5.2 also provides estimates of net investment in non-financial assets, which is infrastructure expenditure net of proceeds from asset sales. The total net investments in non-financial assets by the NFPS will average \$9.5 billion over the budget and forward estimates.

The main PNFC sector infrastructure projects under development are:

- investment in transport infrastructure to meet patronage growth and improve network performance. This includes investment in the regional and metropolitan rail networks. Key regional rail investments include the Regional Rail Revival program and additional VLocity carriages. Metropolitan rail investments include the Cranbourne-Pakenham and Sunbury line upgrades, the Mernda Rail Extension Project and a range of other metropolitan rail infrastructure improvement projects; and
- various water-related infrastructure projects, such as the Western Treatment Plant Capacity Augmentation, Boneo Water Recycling Plant Upgrade, flood mitigation works, the Goulburn-Murray Water Connections Project, and the modernisation of various irrigation systems by Southern Rural Water.

Non-financial public sector net debt and net financial liabilities

Table 5.3 details the NFPS net debt and superannuation liabilities. It shows net debt is expected to increase from \$34.6 billion at 30 June 2018 to \$49.3 billion by 30 June 2022. NFPS net debt as a proportion of GSP averages 9.4 per cent over the budget and forward estimates.

The Government monitors the level of net debt for the general government and PNFC sectors and the projected level of net debt is consistent with the State's triple-A credit rating.

Superannuation liabilities are projected to fall, resulting in a decline in the net financial liabilities to GSP ratio from 18.4 per cent in 2018-19 to 16.5 per cent in 2021-22. This fall is mainly driven by the budget contributions that are made annually as part of the Government's commitment to fully fund the superannuation liability by 2035.

Table 5.3: Non-financial public sector net debt and financial liabilities ^(a) (\$ billion)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	<i>actual</i>	<i>revised</i>	<i>budget</i>	<i>estimate</i>	<i>estimate</i>	<i>estimate</i>
Assets						
Cash and deposits	6.7	5.6	5.4	5.4	5.4	5.4
Advances paid	0.3	0.3	0.4	0.3	0.3	0.3
Investments, loans and placements	4.8	5.0	5.1	5.6	5.8	6.0
Total	11.8	10.9	10.9	11.3	11.5	11.7
Liabilities						
Deposits held and advances received	1.0	1.2	0.9	1.0	1.0	0.9
Borrowings	40.6	44.3	50.7	55.5	57.9	60.1
Total	41.6	45.5	51.6	56.5	58.8	61.0
Net debt ^(b)	29.8	34.6	40.7	45.2	47.4	49.3
Superannuation liability	24.9	24.3	23.2	22.1	21.0	20.0
Net debt plus superannuation liabilities	54.8	58.9	63.9	67.4	68.4	69.3
Other liabilities (net) ^(c)	15.0	16.8	18.6	18.4	18.0	17.0
Net financial liabilities ^(d)	69.8	75.7	82.5	85.8	86.4	86.3
(per cent)						
Net debt to GSP ^(e)	7.3	8.1	9.1	9.6	9.5	9.4
Net debt plus superannuation liability to GSP ^(e)	13.5	13.8	14.3	14.3	13.8	13.3
Net financial liabilities to GSP ^(e)	17.2	17.7	18.4	18.2	17.4	16.5
Net debt plus superannuation liability to revenue ^(f)	85.1	87.5	87.9	91.1	89.2	87.9

Source: Department of Treasury and Finance

Notes:

(a) Figures in this table are subject to rounding and may not add up to the totals.

(b) Net debt is the sum of borrowings, deposits held and advances received less the sum of cash and deposits, advances paid, and investments, loans and placements.

(c) Other liabilities include other employee entitlements and provisions and other non-equity liabilities, less other non-equity financial assets.

(d) Net financial liabilities is total liabilities less financial assets (excluding investments in other sector entities).

(e) The ratios to GSP may vary from publications year to year due to revisions to the Australian Bureau of Statistics (ABS) GSP data.

(f) The sum of NFPS net debt (excluding advances paid) plus the superannuation liability as a proportion of NFPS total operating revenue.

Table 5.4 projects several indicators of financial sustainability for the NFPS over the budget and forward estimates.

The operating cash flow surplus to revenue ratio is an indication of the level of cash generated from operations that can be used to fund infrastructure. The ratio was significantly higher than the long-term average in 2016-17 due to the receipt of cash proceeds from the medium-term lease of the operations of the Port of Melbourne.

The overall debt burden is evidenced by the ratio of gross debt to revenue, which is estimated to be 71 per cent in 2018-19. The ratio of NFPS interest expense to revenue ratio is a measure of the State's debt service burden. This ratio is expected to average 3.6 per cent a year over the budget and forward estimates. This ratio is at a historical low level, having fallen from above 5 per cent in 2013-14. Future borrowings are assumed to be raised at interest rates implied by the Treasury Corporation of Victoria's yield curve.

Table 5.4: Indicators of financial sustainability for the non-financial public sector (per cent)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	<i>actual</i>	<i>revised</i>	<i>budget</i>	<i>estimate</i>	<i>estimate</i>	<i>estimate</i>
Operating cash flow surplus to revenue	24.4	8.1	9.5	6.9	6.9	8.0
Gross debt to revenue ^(a)	64.7	67.7	71.0	76.4	76.8	77.4
Interest expense to revenue	3.9	3.7	3.6	3.7	3.7	3.6

Source: Department of Treasury and Finance

Note:

(a) Gross debt includes borrowings and deposits held and advances received.

STATE OF VICTORIA

Table 5.5 shows the operating results for the State. The net result from transactions is projected to improve from a deficit of \$1.6 billion in 2018-19 to a surplus of \$343 million in 2021-22. This is before other economic flows, which are projected to average \$1.1 billion a year over the budget and forward estimates. The other economic flows include projected capital gains on the investments of the State's insurance agencies that are used to service the agencies' liabilities. When these other economic flows are included, the State net result improves to an average surplus of \$802 million over the budget and forward estimates, increasing from a deficit of \$491 million in 2018-19 to a surplus of \$1.6 billion in 2021-22.

Table 5.5: Operating results – State of Victoria ^(a) (\$ million)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	<i>actual</i>	<i>revised</i>	<i>budget</i>	<i>estimate</i>	<i>estimate</i>	<i>estimate</i>
Revenue						
Taxation revenue	21 892	22 071	23 636	24 781	25 747	27 138
Dividends, income tax equivalent and interest ^(b)	1 625	2 007	1 986	2 072	2 496	2 537
Sales of goods and services	14 539	14 815	15 296	16 285	17 177	17 358
Grants	27 350	29 763	32 735	32 294	33 391	34 103
Other current revenue	3 406	3 271	3 246	3 259	3 328	3 404
Total revenue	68 812	71 928	76 899	78 690	82 138	84 539
<i>% change</i>	6.3	4.5	6.9	2.3	4.4	2.9
Expenses						
Employee expenses	22 617	24 176	26 752	27 555	28 529	29 548
Superannuation ^(c)	3 168	3 400	3 492	3 524	3 559	3 645
Depreciation	4 869	5 059	5 253	5 520	5 975	6 229
Interest expense	2 729	2 518	2 622	2 705	2 821	2 880
Grant expense	7 624	7 129	9 423	10 431	10 216	10 537
Other operating expenses	27 053	29 980	30 921	29 543	30 560	31 357
Total expenses	68 058	72 262	78 464	79 278	81 659	84 197
<i>% change</i>	7.9	6.2	8.6	1.0	3.0	3.1
Net result from transactions	754	(334)	(1 565)	(587)	480	343
Total other economic flows included in net result	5 816	2 187	1 074	1 297	923	1 245
Net result	6 570	1 853	(491)	710	1 403	1 588

Source: Department of Treasury and Finance

Notes:

(a) This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5 Statement of Finances. Figures in this table are subject to rounding and may not add up to the totals.

(b) Comprises dividends, income tax and rate equivalent revenue and interest.

(c) Comprises superannuation interest expense and other superannuation expenses.

The whole of State result is mainly driven by the NFPS sector, but includes the PFC sector, which is forecast to record an average deficit in the net result from transactions of \$1.7 billion over the budget and forward estimates.

As previously discussed, other economic flows arising largely from projected capital gains on insurance investments are generated within this sector and average \$1.5 billion over the budget and forward estimates. When these are factored in, the average net result in the PFC sector improves to a \$248 million deficit over the budget and forward estimates.

State of Victoria – financial position

Table 5.6 shows the State's financial position is projected to improve over the budget and forward estimates. Financial assets are estimated to increase from \$55.0 billion in 2018-19 to \$58.8 billion by 2021-22. Non-financial assets, including infrastructure, are estimated to increase from \$261.4 billion in 2018-19 to \$290.4 billion by 2021-22. Borrowings are estimated to increase from \$55.0 billion in 2018-19 to \$64.6 billion by 2021-22. The State's net assets are forecast to increase from \$177.9 billion in 2018-19 to \$199.7 billion by 2021-22.

Table 5.6: Financial position of the State of Victoria ^(a) (\$ billion)

	2016-17 <i>actual</i>	2017-18 <i>revised</i>	2018-19 <i>budget</i>	2019-20 <i>estimate</i>	2020-21 <i>estimate</i>	2021-22 <i>estimate</i>
Assets						
Total financial assets ^(b)	59.2	55.0	55.0	55.4	56.6	58.8
Total non-financial assets ^(c)	242.6	251.6	261.4	276.8	283.7	290.4
Total assets	301.8	306.5	316.4	332.2	340.4	349.1
Liabilities						
Superannuation	24.9	24.3	23.2	22.1	21.0	20.0
Borrowings	48.8	49.7	55.0	59.8	62.4	64.6
Deposits held and advances received	1.9	1.8	1.6	1.6	1.6	1.6
Other liabilities ^(d)	53.9	54.9	58.7	60.5	62.1	63.3
Total liabilities	129.6	130.7	138.5	144.1	147.1	149.5
Net assets	172.2	175.9	177.9	188.1	193.2	199.7

Source: Department of Treasury and Finance

Notes:

- (a) Figures in this table are subject to rounding and may not add up to the totals.
- (b) Financial assets include cash and deposits, advances paid, investments, loans and placements, receivables, and investments accounted for using the equity method.
- (c) Non-financial assets include inventories, non-financial assets held for sale, land, buildings, infrastructure, plant and equipment, and other non-financial assets.
- (d) Other liabilities consist of payables, employee benefits and other provisions.

APPENDIX A – SENSITIVITY ANALYSIS

The *2018-19 Budget* relies on forecasts and judgements about the economic, operating and financial conditions for the Victorian general government sector. Uncertainty in these conditions, for example as a result of international developments and other risks to the national economy, may cause the actual results to differ from projections.

This sensitivity analysis explores the impact of variations in the macroeconomic outlook on key fiscal aggregates of the general government sector using two alternative approaches.

The first quantifies the fiscal impacts of scenarios involving simultaneous variations in economic parameters that represent key risks to the economic outlook described in Chapter 2 *Economic Outlook*. These scenarios were selected to cover plausible shocks that could affect Victoria over the medium term, and the modelling takes account of linkages between key international, Australian and Victorian economic aggregates.

The modelled outcomes are intended to be used as a guide and care should be exercised in interpreting the results. In particular, economic shocks tend to be idiosyncratic in nature, with the modelled scenarios unlikely to completely reflect any future shock that could occur. Departures from these scenarios would be expected to result in different impacts on the budget. Furthermore, these shocks do not incorporate any policy responses to the shock or the change in outlook.

The second approach considers the fiscal impacts of independent variations in major macroeconomic parameters, holding all parameters other than the indicator of interest constant. This analysis may be useful for assessing the impact on fiscal aggregates of a forecast error in a single economic parameter. In practice, economic variations rarely occur in isolation, and scenario analysis is likely to be more appropriate to illustrate the fiscal impacts of an economic environment materially different from that presented in the budget papers.

FISCAL IMPACTS OF VARIATIONS TO THE ECONOMIC OUTLOOK

This part of the sensitivity analysis quantifies some of the key risks identified in Chapter 2 *Economic Outlook* and presents how these risks might affect the State's economic and fiscal aggregates. Two scenarios are considered: a negative shock to the household sector that affects consumption and dwelling investment; and a positive shock to Victoria's labour force participation rate, partially accommodated through an increase in final demand.⁵

The economic impacts of both scenarios have been modelled as deviations from a business as usual base case generated from the Victoria University Regional Model (VURM).⁶ The changes in economic indicators resulting from the modelled shocks are then mapped into estimated revenue and expenditure impacts using elasticities that describe the historic relationship between fiscal outcomes and major macroeconomic parameters in Table A.5.⁷

Downturn in household consumption and dwelling investment

The household sector has been an important engine of growth for the Victorian economy, with both household consumption and dwelling investment growing strongly in recent years. However, there are signs of vulnerability. The housing construction cycle is maturing with building approvals looking to have moderated, and the increase in household leverage has left some households vulnerable to housing and mortgage stress should their circumstances change or borrowing costs rise. This could have broader implications for consumer spending, housing construction activity, the labour market and overall economic growth prospects.

Shocks to the household sector could arise through a more rapid rise in borrowing costs for mortgage holders, tighter lending standards or other prudential measures. Alternatively, a broader softening of economic conditions could cause households to reduce their appetite to take on debt, increase their rate of saving and shrink spending on discretionary items. Households may also reappraise their expectations about future asset price growth, meaning they require a higher rate of return to invest in property and other assets.

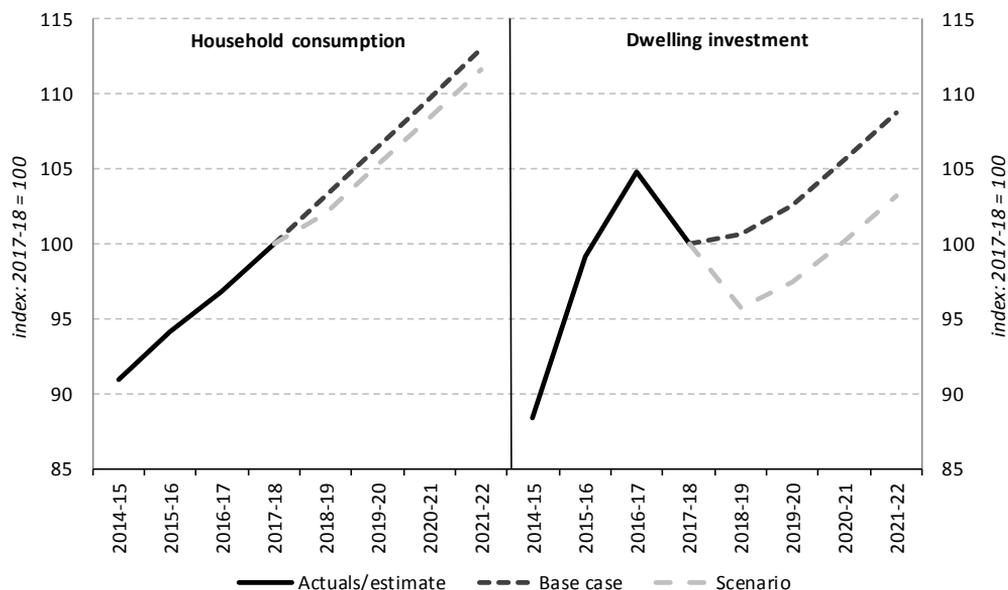
⁵ The results generated in each scenario are mutually exclusive and non-additive.

⁶ VURM is a dynamic computable general equilibrium model of Australia's six states and two territories, with each region modelled as an economy in its own right. See Adams, Philip, Dixon, Janine and Horridge, Mark (2015), 'The Victoria University Regional Model (VURM): Technical Documentation, Version 1.0', CoPS/IMPACT Working Paper Number G-254 for a more detailed description of the model's structure and data sources (available from www.copsmodels.com/ftp/workpapr/g-254.pdf).

⁷ The Department of Treasury and Finance maintains a comprehensive set of elasticities covering the relationship between major economic parameters and all revenue and expenditure lines, including superannuation, and dividends and income tax equivalents from the public financial and non-financial corporations.

To model this scenario in VURM, the shock has been applied to raise the national household saving rate and the threshold rate of return required by households to purchase newly constructed property. A national shock has been applied since the triggers for this type of downturn would likely apply to all states and territories, rather than Victoria in isolation. The weakening in national household consumption and dwelling investment has been calibrated as a five percentage point fall in national dwelling investment growth⁸ and a one percentage point decrease in national household consumption growth in the budget year.⁹ Chart A.1 illustrates how Victorian household consumption and dwelling investment evolve under the base case and the scenario.

Chart A.1: Household consumption and dwelling investment under the base case and scenario



Sources: Australian Bureau of Statistics, Centre of Policy Studies, Victoria University, and Department of Treasury and Finance

⁸ The magnitude of the shock to dwelling investment aligns with the difference between the annual growth rate in national dwelling investment in 2007-08 (1.5 per cent) and 2008-09 (-3.1 per cent). It is worth noting that the decline in dwelling investment in 2008-09 was ameliorated by successive reductions to the official cash rate and policy measures introduced by Commonwealth, state and territory governments aimed at stimulating first home buyer activity.

⁹ In the aftermath of the global financial crisis, Australia’s actual consumption was a little more than one per cent below its equilibrium consumption; see KPMG Economics (2017), ‘The Global Financial Crisis: 10 Years On’, August (available from <https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/global-financial-crisis-10-years-on.pdf>).

Table A.1 summarises the economic effects of this downside scenario on the Victorian economy. Real gross state product (GSP) is around one-quarter of a percentage point lower under the scenario in the budget year, with the falls in household consumption and dwelling investment partly offset by a boost to Victoria’s trade balance as a result of a depreciation in the Australian dollar. The weaker currency also raises tradable goods and services prices, adding to higher consumer price index (CPI) in 2018-19 and 2019-20. Employment falls in line with weaker conditions in the construction, accommodation and food services and retail trade industries (Chart A.2). Subdued demand conditions reduce growth in wages, which lowers production costs and the CPI in 2020-21 and 2021-22 through second-round effects. Consequent reductions in household incomes and asset returns also weigh on growth in real GSP, acting to depress household spending further.

Table A.1: The effect of a downturn in household consumption and dwelling investment on major economic parameters^(a) (per cent)

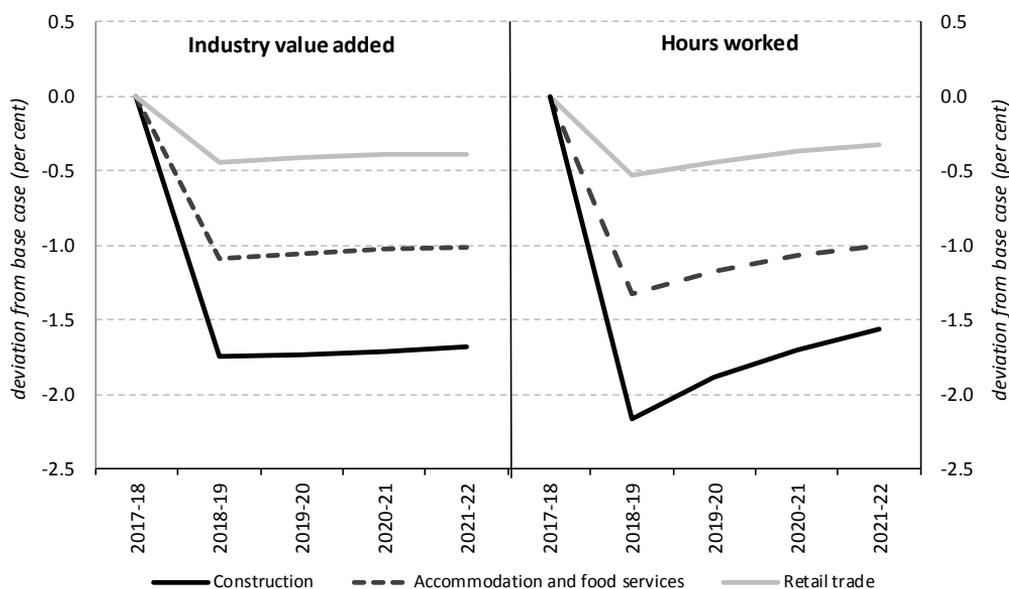
	2018-19 <i>estimate</i>	2019-20 <i>estimate</i>	2020-21 <i>estimate</i>	2021-22 <i>estimate</i>
Real GSP	(0.28)	(0.28)	(0.29)	(0.30)
Employment	(0.32)	(0.22)	(0.16)	(0.12)
Consumer price index	0.26	0.11	(0.01)	(0.12)
Wage price index	(0.02)	(0.37)	(0.64)	(0.85)

Source: Centre of Policy Studies, Victoria University

Note:

(a) Figures reported are the change in the level of each parameter relative to the baseline of no change in the economic outlook, for each year of the budget.

Chart A.2: Weaker conditions in the Victorian construction and discretionary spending sectors



Source: Centre of Policy Studies, Victoria University

Table A.2 summarises the fiscal impacts of this scenario. With slower growth in real GDP, employment and wages, income from transactions is lower over the budget and forward estimates. This is reflected in lower payroll tax and reduced GST grants revenue as a result of a smaller national GST pool relative to the base case.¹⁰ Land transfer duty collections are also lower, reflecting softer property prices. Growth in expenses from transactions is marginally slower in the scenario relative to the base case, reflecting lower public sector employment and a gradual pass-through of weaker economy-wide wage increases to public sector wage agreements. The impact on public sector employee expenses reflects the model's assumed relationship between private and public sector employment and wages. Public sector employment is assumed to be a fixed share of overall employment, while public sector wage growth is assumed to respond to private sector wage growth. Overall, the impact on employee expenses is insufficient to offset the fall in general government sector revenue and is reflected in a decline in the net result and an increase in net debt over the budget and forward estimates.

Table A.2: Projected fiscal impact of a downturn in household consumption and dwelling investment (\$ million)

	2018-19 estimate	2019-20 estimate	2020-21 estimate	2021-22 estimate
Income from transactions	(291.2)	(326.6)	(355.5)	(361.1)
Expenses from transactions	(18.9)	(55.7)	(159.6)	(248.7)
Net result from transactions	(272.3)	(270.8)	(195.9)	(112.5)
Other economic flows	(4.4)	(5.4)	(3.8)	(3.7)
Net result	(276.7)	(276.3)	(199.7)	(116.2)
Net debt (cumulative)	276.7	545.8	738.1	846.7
Net debt to GSP ratio (percentage point difference)	0.08	0.13	0.17	0.18

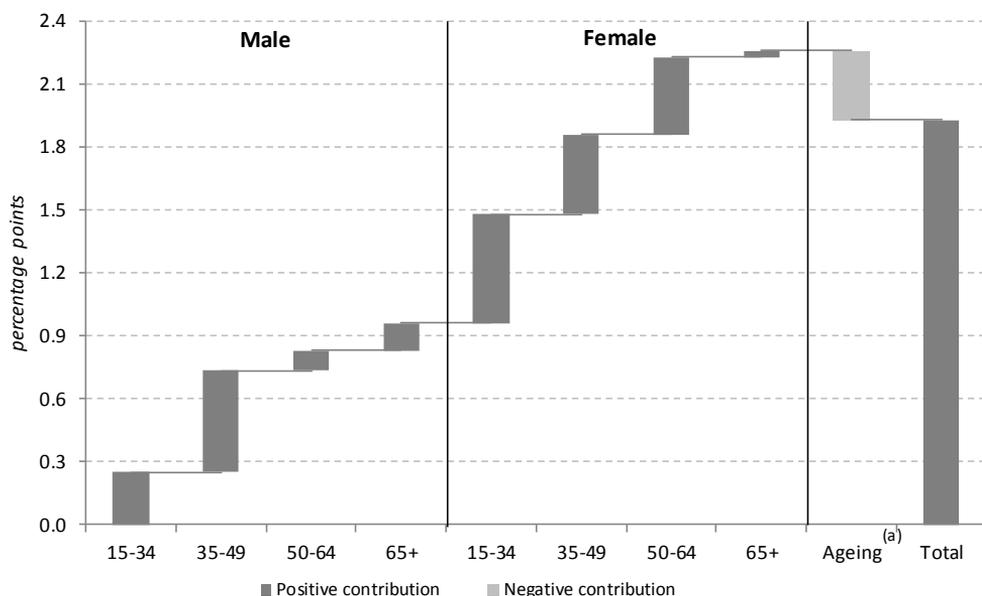
Source: Department of Treasury and Finance

Sustained high labour force participation in Victoria

Victoria's labour force participation rate has outperformed expectations in recent years. As noted in Chapter 3 *Investing in Victorian Jobs and Skills*, high labour force participation has supported the strongest period of job creation since the early 1990s. Longer-term structural trends, such as rising workforce participation by both females and those aged 50 years and over that reflect cultural, economic, and social changes in Australia have contributed significantly to the pick up in the participation rate over the past four years (Chart A.3). This has more than counteracted the role that demographic change through an ageing population has played in attenuating Victoria's participation rate.

¹⁰ This model does not consider the second-round effect associated with the change in GST relativity that could occur in response to changes in states' fiscal capacities.

Chart A.3: Contributions to changes in Victoria’s labour force participation rate, three months to June 2014 to three months to February 2018



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

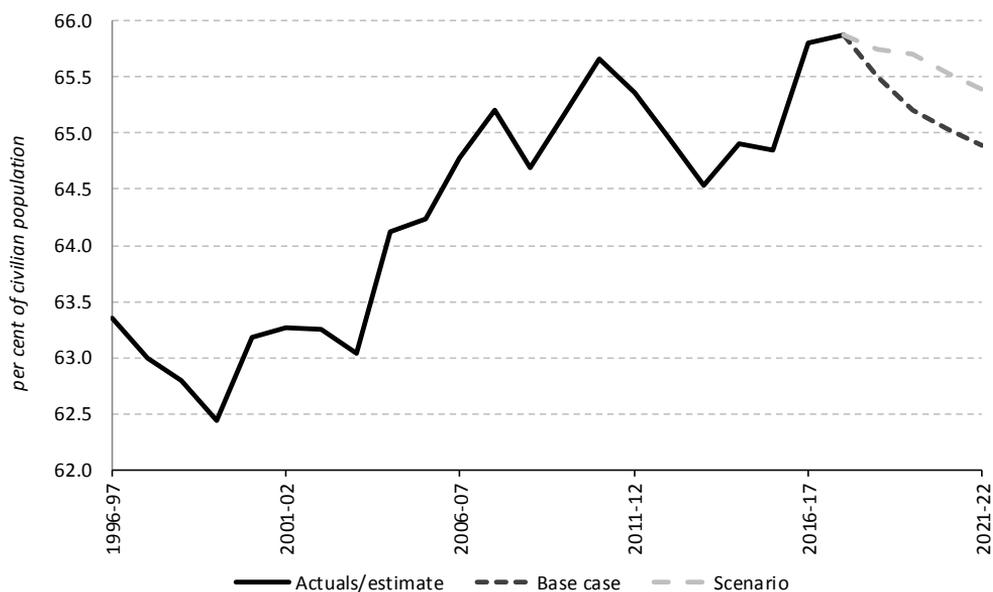
Note:

(a) Demographic change affects the size and composition of the potential workforce. Population ageing results in a higher proportion of the civilian population (aged 15 years and over) being in older age cohorts, which have relatively lower participation rates.

The forecasts in Chapter 2 *Economic Outlook* assume the labour force participation rate peaks at 65.9 per cent in year-average terms in 2017-18 and then moderates over the budget and forward estimates (Chart A.4). However, it is possible that the various factors that have underpinned the rise in participation across all age cohorts in recent years persist.

This upside scenario assumes that the labour force participation rate remains at around 65.9 per cent in the budget year before tapering over the forward estimates. This amounts to the aggregate participation being around 0.25 percentage points higher in the budget year and 0.5 percentage points higher than the base case for each of the following three years.

Chart A.4: Victoria’s labour force participation rate under the base case and scenario



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

The most recent upswing in the participation rate suggests such an increase would not happen exogenously; that is, more Victorians would not supply their labour without reasonable prospects of gaining work. For this reason, the shock has been implemented in VURM so that the rise in the participation rate has been accompanied by an increase in final demand from household consumption.¹¹ This results in the Victorian economy being able to accommodate much of the additional labour supply, leaving the unemployment rate little changed relative to the base case.

The effects of this scenario on major economic parameters are reported in Table A.3. Strong employment growth and household demand provides a short-term impetus to consumer price inflation in 2018-19 and 2019-20. Over time, the larger labour force exerts downward pressure on wages and production costs, spilling over into lower inflation by the end of the forward estimates relative to current forecasts. The boost to final demand and more contained wages growth stimulates employment and improves the productivity of capital, resulting in higher investment and output (Chart A.5).

¹¹ This scenario is similar in effect to the third scenario presented in the *2017-18 Budget*, where both population and participation are stronger than expected, but offers a different transmission channel. In the scenario described in last year’s budget, the higher population growth assumption provided the additional stimulus to absorb the increase in labour supply. In contrast, the scenario described here provides the stimulus directly through stronger growth in household consumption across 2018-19 and 2019-20.

Table A.3: The effect of higher participation on major economic parameters^(a) (per cent)

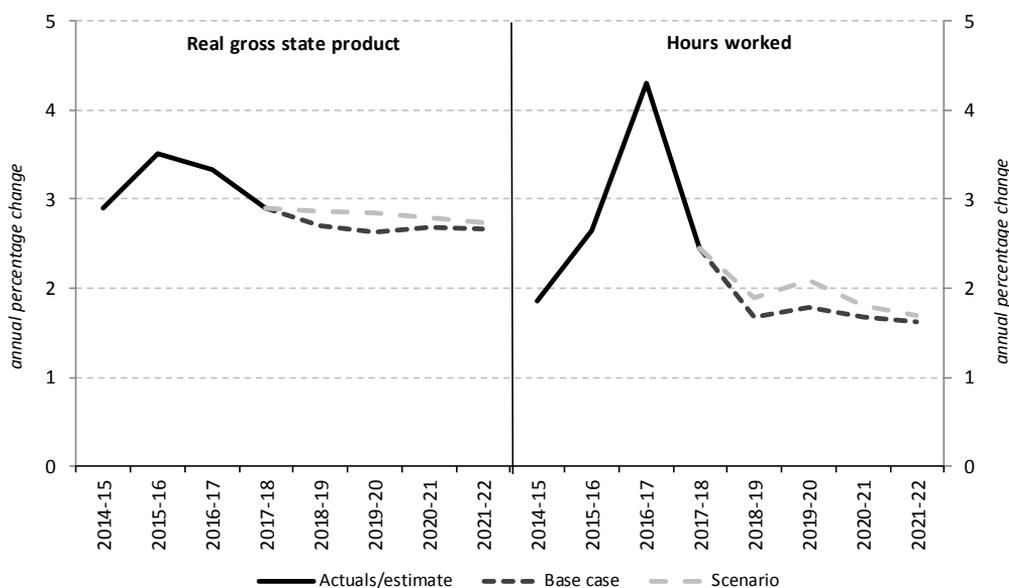
	2018-19 <i>estimate</i>	2019-20 <i>estimate</i>	2020-21 <i>estimate</i>	2021-22 <i>estimate</i>
Real GSP	0.16	0.37	0.47	0.54
Employment	0.22	0.51	0.63	0.70
Consumer price index	0.11	0.13	(0.01)	(0.09)
Wage price index	(0.04)	(0.25)	(0.50)	(0.65)

Source: Centre of Policy Studies, Victoria University

Note:

(a) Figures reported are the change in the level of each parameter relative to the baseline of no change in the economic outlook, for each year of the budget.

Chart A.5: The effects on growth and employment of high labour force participation



Sources: Australian Bureau of Statistics; Centre of Policy Studies; Department of Treasury and Finance

Under this scenario, general government sector revenue is higher, as shown in Table A.4. The boost to Victorian household consumption raises the GST pool,¹² while higher household disposable income leads to more property-based taxes being collected by the State Government. In contrast, payroll tax collections are only marginally higher in the scenario, as the effect of the higher level of employment and more modest wage growth almost negate each other.

¹² The increase in GST revenue reflects the impact of the Victoria-specific consumption shock on the national GST pool. The model used does not consider second-round effects that could alter Victoria's GST relativity over the forward estimates.

Table A.4: Projected fiscal impact of higher labour force participation (\$ million)

	2018-19	2019-20	2020-21	2021-22
	estimate	estimate	estimate	estimate
Income from transactions	210.1	338.8	297.1	286.9
Expenses from transactions	76.2	121.3	35.7	(24.6)
Net result from transactions	133.9	217.6	261.4	311.5
Other economic flows	2.2	5.6	3.7	3.7
Net result	136.1	223.2	265.1	315.2
Net debt (cumulative)	(136.1)	(361.6)	(628.9)	(946.4)
Net debt to GSP ratio (percentage point difference)	(0.04)	(0.10)	(0.15)	(0.21)

Source: Department of Treasury and Finance

Government expenses are marginally higher under the scenario, reflecting higher public sector employment. However, these effects largely unwind by the last year of the forward estimates, reflecting the pass-through of more modest economy-wide wages growth. These impacts reflect the assumed relationship between private and public sector employment and wages in the model, as discussed in the lower household consumption and dwelling investment scenario. Overall, the increase in revenue more than offsets the immediate rise in expenses, boosting the net result across all four years of the budget and forward estimates and leading to a fall in the stock of net debt.

SENSITIVITY TO INDEPENDENT VARIATIONS IN MAJOR ECONOMIC PARAMETERS

Table A.5 presents the sensitivity of financial aggregates where the levels of key economic parameters are one per cent (or, for interest rates, one percentage point) above the forecast for each year of the budget and forward estimates, holding all else constant. The impacts shown are broadly symmetric; that is, the estimated fiscal impacts would apply approximately equally in the opposite direction where there is a decrease in the parameter. Differences may arise to the extent that the impact on income tax equivalent income may not be symmetric because that line item is subject to a floor of zero, and the impact on dividends may be affected by some entities facing caps on the share of profits that can be returned to the general government sector.

Table A.5: Sensitivity of key fiscal aggregates to selected indicators being 1 per cent higher than expected from 2018-19^{(a)(b)(c)(d)} (\$ million)

	2018-19 estimate	2019-20 estimate	2020-21 estimate	2021-22 estimate
GSP				
Income from transactions	115	118	123	125
Expenses from transactions	1	(4)	(9)	(14)
Net result from transactions	114	122	132	139
Net debt	(114)	(236)	(368)	(507)
Employment^(e)				
Income from transactions	78	83	87	93
Expenses from transactions	260	275	293	311
Net result from transactions	(181)	(192)	(205)	(218)
Net debt	181	373	579	796
Consumer prices^(f)				
Income from transactions	240	180	262	319
Expenses from transactions	217	209	210	213
Net result from transactions	23	(29)	52	106
Net debt	(23)	(4)	(64)	(178)
Average weekly earnings^(g)				
Income from transactions	49	(22)	(27)	35
Expenses from transactions	4	3	4	4
Net result from transactions	45	(25)	(31)	31
Net debt	(45)	(20)	11	(19)
Total employee expenses^(h)				
Income from transactions	..	24	83	92
Expenses from transactions	261	313	333	354
Net result from transactions	(261)	(289)	(250)	(261)
Net debt	261	535	770	1 015
Domestic share prices				
Income from transactions	1	3	2	9
Expenses from transactions	..	(2)	(2)	(3)
Net result from transactions	1	5	4	12
Net debt	(1)	(4)	(6)	(16)
Overseas share prices				
Income from transactions	3	7	4	24
Expenses from transactions	..	(2)	(3)	(3)
Net result from transactions	3	9	7	27
Net debt	(3)	(10)	(15)	(39)
Property prices				
Income from transactions	97	99	104	107
Expenses from transactions	(2)	(7)	(11)	(16)
Net result from transactions	99	105	115	123
Net debt	(102)	(211)	(328)	(455)

	2018-19 estimate	2019-20 estimate	2020-21 estimate	2021-22 estimate
Property volumes				
Income from transactions	66	68	70	73
Expenses from transactions	(1)	(4)	(7)	(11)
Net result from transactions	68	72	78	84
Net debt	(68)	(140)	(218)	(301)
Interest rates ⁽ⁱ⁾				
Income from transactions	612	116	168	315
Expenses from transactions	(2)	149	143	120
Net result from transactions	614	(33)	25	195
Net debt	(614)	(747)	(936)	(1 282)

Source: Department of Treasury and Finance

Notes:

- (a) Variations are applied to the economic variables effective from the first day in the budget year (1 July 2018). It is assumed that each variable's growth rate matches that under a no-variation scenario for the forward estimates period. This implies economic variables, other than interest rates, are 1 per cent higher across the four years compared with a no-variation scenario; interest rates are assumed to be 1 percentage point higher in each year of the budget and forward estimates.
- (b) A positive number for income from transactions denotes an increase in revenue. A positive number for expenses from transactions denotes an increase in expenses (and hence a reduction in the net result from transactions). A positive number for the net result from transactions denotes a higher surplus or smaller deficit. A positive number for net debt denotes a higher level of net debt in the relevant year compared with a no-variation scenario. Numbers may not balance due to rounding.
- (c) Only reasonably quantifiable impacts have been included in the analysis.
- (d) Estimates of net debt are approximately equal to the cumulative impact of the net result from transactions. The difference between the cumulative net result from transactions and net debt is due to non-cash expenses and gross sale proceeds (where applicable).
- (e) A shock to employment is assumed to impact payroll tax revenue to an extent consistent with no change to historical relationships between total employment, part-time/full-time employment shares, and payroll tax revenue. Both public and private sector employment are assumed to be 1 per cent higher across the four years; the rise in public sector employment boosts general government sector employee expenses.
- (f) Incorporates the impact of departmental funding model arrangements. It is assumed that an increase in consumer prices within the budget year does not affect employee entitlements.
- (g) A positive shock to average weekly earnings increases the expenses of public financial and non-financial corporations and reduces the general government sector's income from dividends and ITEs.
- (h) Represents a one-off 1 per cent increase in total employee expenses relative to a no-variation scenario. This could be generated through a change in the size of the workforce, the price of the workforce (salaries, overtime, allowances and bonuses, long service leave expenses, fringe benefits tax and WorkCover premiums), through other management decisions regarding the composition and profile of the workforce or any combination of these.
- (i) Interest rates are assumed to be 1 percentage point higher in each year of the budget and forward estimates.

STYLE CONVENTIONS

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

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

n.a. or na	not available or not applicable
1 billion	1 000 million
1 basis point	0.01 per cent
..	zero, or rounded to zero
tbc	to be confirmed
ongoing	continuing output, program, project etc.
(x xxx.x)	negative amount
x xxx.0	rounded amount

Please refer to the **Treasury and Finance glossary for budget and financial reports** at dtf.vic.gov.au for additional terms and references.

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