CORRECTED VERSION

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Inquiry into 2003–04 budget estimates

Melbourne – 14 May 2003

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Mr J. Brumby, Treasurer;

Mr I. Little, Secretary;

Mr S. Helgeby, Deputy Secretary, Budget and Financial Management; and

Mr J. Monforte, Director, Budget Development and Production, Department of Treasury and Finance.

The CHAIR — I welcome theTreasurer; Mr Ian Little, the Secretary of the Department of Treasury and Finance; Mr Stein Helgeby, deputy secretary, budget and financial management; and Mr Joe Monforte, director, budget development and production, Department of Treasury and Finance. I will hand over to you, Treasurer.

Overheads shown.

Mr BRUMBY — I know some of you have seen these slides because the secretary presented them to the Public Accounts and Estimates Committee breakfast, so I will not run through all of them again, but just quickly on the budget, the main themes, as you can see, are there on the slide.

On the substantial operating surplus, you see there a very good set of budget surplus numbers going forward. Obviously the numbers kick up in 2006–07, when we get the Commonwealth Games behind us. Another way of showing that is through the Australian Accounting Standards 31 (AAS 31) operating result verses the government finance statistics (GFS). What is interesting is that if you look at the AAS31 operating result, we, of course, run at a surplus right through the forward estimates period.

It was interesting last night, when watching the federal Treasurer bring down the federal budget, to note that in the financial year 2002-03, the current financial year, on AAS 31 the federal budget is in deficit to the tune of $1.46 billion. In 2003-04 they are in surplus to the tune of $1.1 billion; and in 2004-05 the federal government is in deficit to the tune of $1.8 billion on the AAS 31 result. I highlight that so that the committee notes the strength of the Victorian government's budget position. Each year running forward we are running surpluses on AAS 31 and on GFS net operating balance. You cannot say that for the federal government — it is in deficit this year; in very small surplus next year; and in substantial deficit in 2004-05.

Another way of looking at that is the indicators of financial condition. These are in the budget papers. There is a whole series of them there. It does not matter which one you pick out — they are all strong numbers. The one comment made by the federal Treasurer last night with which I would agree is that it is a challenging international environment. In those circumstances we do have to be prudent in the way we manage the state's accounts. We are certainly being prudent. Whether it is long-term borrowings, total liabilities, total assets or borrowing costs to total revenue coming down, this is a very strong set of numbers.

I mentioned infrastructure and I just want to show this here today. Over the next four years there will be close to $10 billion worth of capital investment. We believe the state was substantially underinvesting in economic and social infrastructure in the 1990s. There is quite a backlog; we have caught up with some of it, but there is more to do. We are investing well in excess of replacement and well in excess of depreciation, but we are doing that because we believe if you want to drive productivity growth and link better with our human and creative capital you have to make that investment in infrastructure.

'Business investment' — this is a nice graph for Victoria. It is growing strongly and this slide shows a per capita measure. Obviously we want to see this graph continue going forward. This slide is another way of showing it — the fundamentals. We have really been the standout performer. Business investment is well above the national growth rate. Housing construction and employment — housing construction will moderate. Late last year we were running at close to 30 per cent of national approvals, so well above our population level. On the other hand, as I said before in the Department of Innovation, Industry and Regional Development (DIIRD) presentation, we have been getting strong net interstate migration to Victoria. So there is a lot of housing demand, but there will be some moderation. Having said that, the finance approval figures out yesterday were pretty solid for the state. We seem to have moderated but are still at a reasonably good level.

This is the graph I referred to before in the DIIRD presentation. It shows the net interstate and overseas migration. So two factors have been working in the last few years. We are getting people moving to Victoria from other states, and in the current year only Queensland and Victoria have recorded net interstate migration. But we are also more attractive to overseas migrants than we have been in the past. There are a lot of reasons for that including job opportunities, quality of life and expensive real estate in New South Wales. So we are doing well and as a government we have been unabashed in our support for stronger population growth. The Premier and the government have been rock solid on that, and the last two years show that the net flow is 40 000 a year. That is why I said in the budget speech that people are moving to Victoria in record numbers.

The CHAIR — Treasurer, just a warning on time!

Mr BRUMBY — Right. This shows Victorian economic growth with great numbers running forward. All the fundamentals are very sound and you will see that that will give us 10 years of very strong growth.

On budget initiatives, I think you know about modern and efficient government. I would pick out a couple of things. The Chief Information Officer is a first for an Australian state. The federal government has one, but we spend a large amount every year on information technology and it is very important to focus on that.

I have mentioned investment in infrastructure right across the state. There is a big agenda on innovation. We touched on part of that in the DIIRD presentation earlier — 'Smarter, healthier, safer', additional teachers, additional student welfare officers, 900 more nurses and support staff, treating 35 000 additional patients and 600 additional police over the next four years. There is a good agenda for environmental sustainability including in the Otways, support for private plantations, the establishment of the Victorian Water Trust — so that is a big agenda for the environment. Also stronger communities with the establishment of the Department for Victorian Communities and a raft of new initiatives there.

We have listed a few of the department's strategic priorities going forward. I will focus on the second one — medium-term fiscal pressures. A month ago I released what I can only describe as a really first-rate detailed paper prepared by Treasury called *Shaping a Prosperous Future* which looks at the medium-term fiscal pressures. It shows that the state and the commonwealth face equivalent pressures from an ageing population, and how we tackle that. Our answer is not just to tax and spend, as Peter Costello has done. We believe there is a more optimistic and positive outlook which is about driving productivity growth.

On improved infrastructure project management, I announced in the budget a new process called Gateway. This is really to ensure that we have the best project management on capital projects across government and again it is first-rate work by the Department of Treasury and Finance and, of course, making sure that the government is focused on the key outcomes it wants to see from Growing Victoria Together.

Those are the strategic priorities, the achievements over the last year. We supported the Garnaut-Fitzgerald report which was leading research on the ramshackle system of commonwealth-state financial relations, really putting the focus out there on the form. I mentioned *Shaping a Prosperous Future* and I mentioned the Gateway project. The national competition policy report was filed with the federal government and Victoria is the state that most complies with national competition policy. We believe in competition and you have seen the decisions we have made in the last couple of years which have built a more competitive economy. On investment attraction, we have led the way in getting all of the other states except Queensland to sign up to an agreement on non-poaching investment attraction. That is good for taxpayers and good for business investment.

Finally, last year there was the pre-election budget update (PEBU) where Treasury, independently of government, produced a PEBU so that all political parties and the public would have an understanding of the state's finances. It has been a very positive year. We will move now to the secretary of the department, Ian Little.

The CHAIR — Ian, would you mind talking in shorthand, please, because we have very limited time.

Mr LITTLE — I think I have four slides. I would like to briefly run through those three topics. The first are the departmental objectives. These are the objectives that have been agreed with government for the Department of Treasury and Finance over the next three to five-year period, and I will read them out. Sound financial management of the state's fiscal resources with an emphasis on maintenance of the substantial budget surplus, so a financial management emphasis. The next one is about policy. Guide government actions to best increase living standards for all Victorians through the provision of innovative policy advice. The last is about service delivery to champion an integrated whole-of-government approach for optimal service delivery and provision of world-class infrastructure. They are the things we are aiming for over a three to five-year period.

The next slide briefly shows the budget that we have to do that, and it shows Treasury's output delivery budget for the last six or seven years. The 2003–04 budget is for $178 million. That is about $43 million down on the year we are just in, and it extends a trend of reducing the DTF budget, which has more than halved over the last five years. As to the most recent fall from $221 million to $178 million for the next year, half of that is due to a machinery of government change — the transfer of the gaming portfolio out of Treasury and Finance to Justice. That is worth about $19 million. There is also a change in accounting policy regarding motor vehicles. The output price for motor vehicles includes a return on the capital element, so it has been exempted from the round robin capital assets charge, and that is worth about $16 million. You can see those two changes add up to about $35 million of the $43 million reduction, so that $35 million is not really budget cuts; it is more classification changes.

The CHAIR — In the final two slides, can you just direct us to exactly what you particularly want us to note, because we have run out of time.

Mr LITTLE — Okay. The next slide shows how that $178 million budget for next year is made up. The ones with 'F' beside them in output groups are Minister of Finance. The ones with 'T' are for the Treasurer, so you might want to focus on the Treasurer's components there. The first two show substantial declines, and that reflects those classification changes I mentioned a moment ago. The next four are typical core Treasury functions. They are pretty much unchanged, really. The last one, revenue management services, is the State Revenue Office's outputs. That is benefiting from cost-effective management. So that is our output groups.

The next slide runs through the initiatives for the portfolio in the year ahead. There is one for the State Revenue Office where the government has provided additional funding of $1.8 million for two years, so that the SRO can increase its investigative capability of potential revenue leakages through the possible avoidance of duty on high value conveyancing transactions. I am talking about transactions here where the potential duty is over $1 million. The value of land has more than doubled in the last four or five years, and the incentive for clever structuring of sales of land has accordingly increased a lot, and we think it is worth while for the revenue office to have a close look at this. The second one is the Gateway project, which the Treasurer mentioned. That has been internally funded within Treasury through re-prioritisation, and that is about applying more rigorous risk management procedures to publicly built infrastructure projects as opposed to privately built.

DTF has no capital projects and only one administrative initiative which received funding from the government of $6 million. That is the next stage, defending the Longford gas incident, where we have been joined in that class action. The potential risk there is in the hundreds of millions of dollars to the state, although it is very unlikely that that risk will eventuate, but we need to ensure that we defend that case properly.

The CHAIR — Thank you very much. The first question, Treasurer, that I would like to pose is that the state budget had a number of initiatives that had factored in federal government support, such as the Geelong bypass, the Commonwealth Games and the Wimmera–Mallee pipeline. Can you outline how last night's federal budget has impacted on our state budget?

Mr BRUMBY — I can. Thank you for the question. If I could start with road funding, the preliminary analysis that we have done suggests that after last night's federal budget the total Victorian share of national road funding in fact is falling from 23.6 per cent to just 17.6 per cent in 2003-04. That includes, of course, the money that the federal government says it is leaving there for Scoresby. So this is a disaster, and it is nothing short of highway robbery by the federal government. We are 25 per cent of the national population; we are more than 25 per cent of the national freight effort; and for Victoria to receive just 17.6 per cent of national road funds is nothing short of a disgrace.

If you look at specific projects that were not supported by the federal government last night, again there is no funding for the capital stages of the Wimmera–Mallee pipeline. I talked about this early in the Department of Innovation, Industry and Regional Development presentation. Why a national government would not fund a project which saves 83 000 megalitres of water is quite beyond me. There is no funding for rail standardisation, no funding for the federal government's half share of the Geelong western ring-road. The Geelong–Melbourne road is now the second busiest road in Australia. If you use it, you can see the huge traffic on it, and it is absurd to expect that motorists using that are going to have to drive through Geelong for the next 5, 10, 25 years. Geelong needs that ring–road. We committed in the election, we committed in this budget to the planning stage of that $4.9 million. It is clearly a road of national importance (RONI). We have seen that on the Geelong road where the federal government funded half of the cost of the Geelong road. This is an extension of it. It is a ring-road, a bypass, but there was nothing in the budget.

There is no funding for the half share of the Calder Highway. We put $70 million in the budget — nothing from the federal government. There is no transfer of defence land at Port Nepean as the federal government did with land in Sydney adjoining the harbour. The Pakenham bypass is a $242 million project. We have budgeted $121 million. The federal government has offered only $100 million despite the fact that it is clearly a RONI, so it is short-changing the state there. I also note that there is no funding for the promised $42 million expansion of the East Sale RAAF base, promised by the then defence minister in writing in 2001, and by the federal science minister and local member, Peter McGauran, due to start in 2002, and no mention of it in the budget last night. So you could only describe this budget as a shocker for Victoria. There is nothing for those specific projects. Apparently New South Wales and Queensland are more important politically to the federal government. Of course if you look at the key issues — education and health — under what has been offered under the budget last night, the AHCA agreement, that short-changes Victoria by $300 million in health funding, and in higher education on the estimates we have done something like 23 000 Victorian students who want to go to university will miss out on a place because of the cuts to higher education funding. So if you put all that together it is certainly not a good budget for Victoria, and the federal government really needs to lift its game and get behind Australia's best performing state.

Mr CLARK — I want to raise the issue of the dividend income that the state budget has been receiving. In last year's budget papers there was a budgeted figure of $406.5 million for dividend income. In the pre-election budget update that went to $547.3 million, and in the revised figures, $577.7 million. This year's budget papers do not have a separate breakdown of those dividend components as last year's budget paper 3 did. I would like a general account of the composition of those dividends, in particular, how much dividend was taken from the Transport Accident Commission in the current financial year 2002–03, and can it be fairly said that the increase in TAC charges that was made public this morning is yet another example of a slug on motorists in order to pay the money to the black holes in your budget?

Mr BRUMBY — I think you were going well until the last bit. I will start with the Transport Accident Commission increase. That increase is announced every year in exactly the same way as it has been announced this year, which is that it is gazetted and then announced. The increase this year is above the level of inflation because the federal government has chosen to terminate the GST transitional arrangements. Those arrangements — I do not have the exact numbers — were worth in excess of $10 million to the TAC and they terminate.

Mr CLARK — Was that not something Bob Cameron told us about two or three years ago?

Mr BRUMBY — No, listen to the answer. They terminate from 1 July. I am advised they represent more than 2 per cent of the premium increase. If you add that to inflation that is how you get the 5 per cent increase. It is as simple as that. We are putting it up by around about the rate of inflation as I believe we do most years, which is a reasonable thing to do. The federal government, because of the GST transitional arrangements, has added more than 2 per cent of the cost to the TAC insurance premiums, and they are therefore reflected in what was gazetted earlier this week.

You talk about motorists, and I will find the actual numbers to set the record straight. If you look at the motor registration and drivers licence fees for Victoria for a person who drives a standard car, because they differ in some states from V8s to 4s, in Victoria even after the increase in motor registration and licence fees they are the cheapest in Australia. If you add today the third-party insurance premium to that, the number you get for Victorian motorists for a standard car is $534.70. The only states at this stage which, in aggregate, are less than that are Tasmania at $513 and Western Australia at $500. But I make it clear about them. As I understand it they have not yet announced their insurance premium increases. When they do, and when you add all the costs on motorists and put them together, in all likelihood we will still be either the lowest or one of the lowest anywhere in Australia.

This whole argument you have been running about motorists and being slugged is a nonsense. It is factually incorrect. If you dispute my figures, I welcome your doing that, but I do not see you are doing that. My figures are factually correct. On motor registrations and on licence fees we are the best in Australia, and if you add the third-party insurance, we are either the lowest or among the lowest. That is the fact of the matter. The third-party premium increase is inflation plus the withdrawal of the GST transitional arrangements done in the normal way and in the normal process.

Can I say on the issue of the TAC, the dividend for the black spot program this year was $110 million. As previously announced that money had been put aside, as I think you are aware, in a reserve contingency, so it had no effect on the bottom line operating results of the TAC. We did what we said we would do. We put $240 million into the black spot program, and we drew $110 million out of the reserve fund in 2002–03, which is totally consistent. The Treasury notes confirm that. A dividend of $110 million was paid by the TAC in 2002–03, representing the final of the series of special dividends with a total of the $240 million to fund the accident black spot program. The TAC had previously provided for these funds in a reserve establishment in the TAC's accounts for this purpose, and therefore the dividend payments for this program were unaffected by changes in the TAC financial performance.

Generally on the question of dividends, if you look particularly at some of the water businesses over last year, they have been very profitable, if I can use that expression, because we have had very high levels of housing development in Victoria. They have had strong revenues. They have had the capacity to pay strong dividends, and they have paid those. Other agencies — for example, the TAC — as you know, are affected by the international equity markets, the same as superannuation funds, so you will see in the forward estimates the amount that we are expecting from dividends, I think, in 2004–05 and 2005–06 is less than we have been receiving at the moment. That simply reflects the difficult economic circumstances and the impact of equity markets — I think that is correct, Mr Little?

Mr LITTLE — The other factor would be Gascor.

Mr BRUMBY — And the other is Gascor, which again, as you know, while there was a regulated market we extracted in a sense a fee through that from the gas companies, but as we moved to a fully competitive market in the arrangements we inherited as the government we moved to create more competition, and, as you know, we put up the option last year and Gascor has been dissolved in a sense, and we do not get the dividend that we once used to get because we now have a competitive market.

Mr CLARK — The TAC dividend is $110 million in the current year, is that correct?

Mr LITTLE — I believe that is correct.

Ms GREEN — A key theme in your presentation was fiscal responsibility. Can you tell the committee what the financial settings are that have been put in place to ensure prudent financial management and how the ratings agencies have responded?

Mr BRUMBY — The ratings agencies have responded very favourably to the fiscal settings that we have put in place. On either the day of the budget or the day after the budget Standard and Poor's reaffirmed its AAA credit rating for Victoria, and AAA is the best you can get. It has reconfirmed that. I understand that Moody's issued a statement to the markets a little earlier this morning, again confirming Victoria's AAA credit rating. I am just waiting to get a copy of its press release which I have asked to be walked into me today. I am told that it strongly reaffirms the AAA credit rating and it has been issued to the market.

The reason for that, of course, is we have been prudent managers. We have substantially paid down net debt as a proportion of GDP. In the first few budgets we brought down our economic growth, our revenue growth was somewhat stronger than we anticipated and the larger than anticipated cash surpluses we have been able to use them to pay down net debt and also to establish the Growing Victoria fund which we use to essentially pay for some of our capital funding. You may recall the slide I showed earlier in the budget presentation on the financial indicators. They are about as good as you can get. I repeat that going forward on all the usually accepted measures — GSF and AAS31 — we have strong surpluses going forward.

It is important to stress the forward estimates. If you look at the forward estimates of revenue growth over the forward estimates period, they are a little in excess of 3 per cent per annum. Given the economy will be growing by probably 5 per cent in nominal terms or better, that is prudent. Expenses are growing at a little less than that, at about 3 per cent. The reason I mention that is I opened the papers this morning and saw the headlines that say 'tax cuts'. But if you look at the federal budget and its revenue projections, the federal budget revenues even after tax cuts are growing at well in excess of 4 per cent — in fact, close to 4.7 per cent per annum. It goes to the point, as one of the commentators said last night on the tax cuts, if you assume a 4 per cent wage growth over the year, as the federal budget does, a worker earning $40 000 today will, after 12 months, actually pay $480 more in income tax on their income but will receive just a $208 tax cut. All this business about low taxing federally is a nonsense. The tax cuts give back far less than what has been gained in bracket creep.

Mr FORWOOD interjected.

Mr BRUMBY — You raise an interesting question by interjection, Mr Forwood. If you look at federal taxes as a proportion of GDP they are at record high levels. If you look at ours, ours are in fact trending down, not trending up. If you want to have an argument about that, have it. We have cut $1 billion of taxes and the example I just gave you about a worker on $40 000 a year — they will be worse off after these tax cuts than they are at the moment.

Mr BAXTER — I want to go to the issue of priority setting and water. The Treasurer in both presentations has spoken about water, particularly the Wimmera–Mallee pipeline. Is it not a fact that the rural water authority in question had $15 million in the bank to get on with the planning stage but was unable to do so until the government had ticked off on it, which it recently has done, and therefore any federal money that might have been in this year's budget would not have been spent this year and not a dollar of your $77 million in the forward estimates has been spent either or is anticipated to be spent this year.

In terms of Eildon, bearing in mind that it is low because of the drought and is nearly empty, an ideal time to upgrade it to meet world dam safety standards, which we now have to meet for reservoirs, gets nothing in the budget yet a footbridge in Melbourne gets $28 million, which would have fixed Lake Eildon. I would like some explanation of how priorities are decided because they seem distinctly out of line to me.

Mr BRUMBY — I will have a quick go at that and probably the rest of that debate is better had with the environment and water minister. We had a cabinet meeting in Horsham last Monday. As an aside, the mayor, Cr Bernie Dunn, said that in his living memory he could not remember when the full cabinet had ever previously been in Horsham. We were there because we believe in growing the whole state. They had hoped to have federal funding in last year's budget. They did not get it last year and they did not get it this year. If you want to go ahead with a 10-year project — that is essentially what this is if you take into account the pre-feasibility and planning stages, all of reconstruction and the operational stages, it is 8, 9 or 10 years in that order — you need certainty. That is what they need.

Mr BAXTER — There is money to go ahead with the next step in the process — it is already there.

Mr BRUMBY — With respect, last night we were looking — —

Mr BAXTER — That is all I am trying to achieve at this moment — they have money to get on with the planning stages and which the government has just signed off on.

Mr BRUMBY — We would like to start building it. Since you have raised the question, we were first elected in late 1999 and I went to Nhill early in 2000 and had a meeting with, I think, Stewart Petering and Darryl Argall, amongst others, and they raised with me that they had been trying to get funding for a study to look at the Wimmera–Mallee pipeline for the best part of a decade. They could not get a cent out of any government minister under the Kennett government. I found $150 000 out of the regional development section of my department and Sherryl Garbutt found $150 000 out of DNRE. The origins of that project go to that $300 000 feasibility study which we funded. Let us be clear about it — this project would not have got off the ground were it not for the Bracks government. We funded the feasibility study. We now have a partnership which is agreed with all the farmers, all the councils, the water authorities and the state government, and the only people who have not yet committed are those in the federal government. That is the fact of the matter.

Mr BAXTER — Despite the fact that the northern ones have all been completed with federal money. Anyway, we have that on the record.

Mr BRUMBY — That is not true either. My understanding is that if you go to the northern pipeline some of the first work on that was undertaken when Steve Crabb was the water minister. That is certainly what I was told in Horsham last Monday. I am happy to be corrected, but that is what I was told in Horsham.

Mr BAXTER — The point I am making is that there is federal money.

Mr BRUMBY — If there is federal money in that — if it is good enough to fund that one it is good enough to fund this one.

Mr BAXTER — My Eildon question has not been answered.

Mr BRUMBY — The question about specific priorities, whether it is money going into Eildon or into irrigation projects, is a matter that should probably be raised with the Minister for Water. Certainly in the budget last Tuesday we honoured our election commitments by setting up the Victorian Water Trust and committed funding for all of the things that we promised at the last election. We did not make a promise about Eildon at the last election. I guess that will be considered amongst all of the other priorities for funding.

Mr MERLINO — Chapter 3 of budget paper 2 at page 46 outlines the Victorian economic projections. The Treasury economic forecast of 3.75 per cent seems bullish considering the growth of 2.75 per cent this year and the forecast downturn in the property market. Can you provide the committee with further information about the assumptions behind the economic projections?

Mr BRUMBY — I will, then it might be that the secretary may wish to add to it briefly. I went in part to this earlier today. The 2.75 per cent this year is after the impact of the drought which has knocked about 1 per cent or 1.2 per cent off GDP growth, so it has had a very significant impact indeed. We are assuming that the drought breaks, and we have to make some assumptions about that. We get all the best advice on that. Certainly the west and south-west of the state have had their best season for many years, particularly if you go down to the Glenelg catchment. In the north of the state it is still very serious indeed.

On the assumption that there are some decent winter rains then that will obviously add to some confidence, investment and growth back into regional areas. The other key driver looking to 2002–03 to 2003–04 is the international environment. We are guided by the best estimates that we get from the private forecasters, what we call the consensus forecast. Every quarter Treasury gives me a summary of all of the major private forecasters, and groups like the IMF and the World Bank and others. They average those out and you get a nice graph usually with a curve in it ranging from quarter to quarter to quarter.

We believe there will be some recovery internationally. It will be tough, but there will be some recovery. China is obviously growing, Japan just had its first quarter of growth after many quarters, and the IMF is predicting somewhere between 0.5 per cent and 1 per cent growth this year. The United States of America has been sluggish for two years. We think with significant tax cuts and the significant budget stimulus that has been given there will be some recovery, modest but some — I stress 'modest' coming out of the United States. Europe is growing. When you put all that together the forecast of 3.75 per cent is achievable. To give one example of why it is achievable — and we may well be better than that — our exports today from Victoria, and this is a similar picture across Australia, are around 15 per cent lower than they were two years ago; therefore two years ago we got the huge devaluation of the dollar and a stronger world economy, which was fantastic internationally for us. Since then it has been tougher; the dollar stronger, world economy slowed, 11 September and a whole host of other factors, so exports are down, which if you look nationally is what is opening up the current account deficit.

Exports are around 20 per cent of our economy — $1 in $5 is generated essentially driven by exports. It is down 15 per cent, a fifth of our economy. If we recover, say, 10 percentage points of that 15 per cent over the next year then that in itself — this is just rough back-of-the-envelope stuff — is worth around 2 percentage points of GDP growth for just that recovery alone. Exports will be a significant factor in that.

The secretary and I were talking about this yesterday when looking over some of the data. Over the last six to nine months with the effects of Bali, the Iraq war, the bushfires and the drought consumers have, not surprisingly, been subdued. They have taken a breather for six or nine months and, if you look at the numbers, they are lower. We think 2003–04 with stronger export performance, consumers coming back, end of the drought, the fundamentals in a first rate condition, then you will see that 3.75-based percentage, which is the target estimate.

Mr CLARK — My question relates to wages growth and growth in levels of public sector employment in the general government sector. My concern is that the forward estimates you have on that are very tough indeed to meet on my calculation of 3.6 per cent compound growth rate in the total general government wages bill, including staff increases as well as per capita increases in wages. My concern is reinforced by your earlier reference to the 4 per cent federal figure which is in wages per head growth, let alone staff numbers growth. My question is: do you stand by that forecast rate of growth in your forward estimates? Do you believe you can achieve it as a government? What total increase in public sector employment numbers are you expecting in the general government sector, therefore how much room are you leaving for per head wages growth? What are the forthcoming major wages rounds that you are going to have to tackle in bringing the forward estimates in on those numbers?

Mr BRUMBY — There was a fair bit in that question. Can I just say that employee benefits expenditure is expected to increase by 3.6 per cent from 2003–04 and 3.7 per cent over the forward estimates period from 2003–04. That is broadly in line with what we expect wage and price inflation and population growth to be. It also reflects and builds into that increases in the numbers of teachers, nurses and police, funded by government to improve service delivery to the community. As you know from the budget last week, there will be around 700 additional staff in schools, 900 nursing and other staff in hospitals and health care, 600 police — the 600 police is over the four-year period. I believe that is consistent.

Going forward on the wages question, the wages environment will be a more difficult one for the economy generally. I had a meeting of the innovation economy board yesterday. One of the members of that board, who represents a very large international information technology company, said that she had just sent out a memo yesterday to her employees saying there would be no wage increases in 2003–04 given the state of the industry globally. She said it is the first time she has had to do that in 20 years. It is a more difficult environment.

In that more difficult environment we have made it clear — I have made it clear and the Premier has made it clear — that wages growth will need to be more subdued. The starting position that we take in this matter is that inflation will be around 2.25 per cent and 2.25 per cent needs to be, if you like, the baseline and anything above that will need to be reflected in productivity growth or improved service outcomes. That is the view the government will be putting, whether it is teachers, nurses or public sector employees generally. In a sense if you want real wage growth it needs to come from productivity improvements or improved whole-of-government service outcomes. If they cannot be provided, essentially there will be no wages growth in real terms.

Mr CLARK — Are you expecting any increase in public sector staff numbers over the next four years other than those you announced in the budget last week?

Mr BRUMBY — Sorry?

Mr CLARK — Apart from the extra staff that you referred to in the budget, in your forward estimates have you factored in any further increase in general government employment levels over the forward estimates period?

Mr BRUMBY — Not at this stage. What we have factored in is the three-year effect of what we announced last week. As I said, increases in teachers, firefighters and police will take place over a period of four years. In the health system the employment impact is much more immediate but they are all factored into forward estimates.

In addition, as I made clear last week in releasing the budget, if there are recurrent election commitments which started in the second, third or fourth years they are all fully provided for in the budget forward estimates in the contingencies. They are all, in a sense, paid for and factored into numbers going forward. I cannot predict future budgets and whether we employ more teachers, nurses, police, firefighters or whoever it might be will be a matter for determination in future budgets. The numbers you see going forward are the numbers which reflect the current position.

Mr FORWOOD — You have an extra 40 going into the State Revenue Office.

Mr BRUMBY — Some of that is compliance, but we are putting an increased effort into compliance.

Ms ROMANES — Can you outline how the issues identified on page 22 of chapter 1 of budget paper 2, and sourced from the Department of Treasury and Finance discussion paper *Shaping a Prosperous Future*, will impact on the Victorian budget in the coming years?

Mr BRUMBY — Thank you for that. That is the paper that I described earlier as an excellent paper which Treasury prepared and released about a month ago. This is really an attempt to look at what is going to happen to Australia and Victoria over the next 20 and 40 years and what are the medium-term pressures. There are pressures there. There are two key points I would like to get out today and reinforce. The first is that there will be equal pressures on both the state and the commonwealth governments. If you looked at the federal government's intergenerational report last year, you would have been wrong to assume that only the federal government was going to face this increased budget pressure. State governments will too, as this analysis clearly shows. In fact for a variety of reasons we are affected a little bit earlier than the federal government. That is the first point — all governments are affected.

The second is if you look at the federal government's intergenerational report it was pretty pessimistic. You can divide these groups into the optimists and the pessimists and they were way down the pessimist route saying we are all getting older — it is a bit like '"We'll all be ruined," said Hanrahan' — spending is going to go up and shock, horror, we will have to increase taxes and increase spending and it will have a big impact on the budget. That was essentially the story. We take a different view. We are not the whole way up the optimist scale, but we are further up the scale. We say that is true but let us not forget that we have a growing and dynamic economy and dynamic people who make up our population. If our productivity growth increases by just 1.5 per cent per annum over the next 40 years we will still be 78 per cent wealthier in real terms so we will have a lot more disposable income and be better able to look after ourselves and our families and we will be better able to pay taxes. If we got just a bit more productivity growth out by doing things a bit smarter and a bit better, our wealth would be doubled in 40 years and our capacity to do things and pay for things and look after an increased level of dependent population would be so much greater.

The framework we came up with said it is a problem for all of us, but the answer is not just the sky is falling in, the answer is to say let us address this in a positive way and let us look too at what we can do to drive some productivity growth by being smarter, being brighter, doing more with less — all of those things — and tackle it that way rather than the old-fashioned 'we'll all be ruined' spend-and-tax equation.

Mr CLARK — Can I ask about the up-front payment of $66 million the state government got in relation to the Spencer Street station redevelopment that is mentioned at page 217 of budget paper 2? What is the commercial justification for the state government taking a $66 million up-front payment when, as I recall, it is paying out about $33 million for 30 years down the track? It smells of a cash-back figure, a trade-in sort of transaction. Given that the state has taken that $66 million payment, how is it justified to treat that payment as a revenue item?

Mr BRUMBY — I will make a preliminary comment and ask Ian Little to go into the detail of that. We entered into this arrangement. It was a contractual arrangement and like all of our major contractual arrangements it has all been listed out there on the Web. Construction starts in light of the commercial development which essentially occurred because of this arrangement. The state as part of those contracts had an entitlement to an up-front payment reflecting that commercial development. There has been no secrecy about that, I think that has all been out in the open, but I will let Ian go through that.

Mr LITTLE — There are two parts of that station development. One part is provision of the station and the railway services to the public, which will commence in 2005–06, and the government will make an annual payment for that as those services are delivered. If the services are not properly delivered we will not pay the operator as much as the contract indicates. The second part is the development of commercial property rights. Some of them are air rights on top of the railway station, and I think some are ground level rights separate from the station but adjacent. I am not totally sure about that, but I think that is the case.

In return for those property rights the consortium paid the government an amount of money — I think the $66 million you mentioned was correct. If that second venture fails the operator has no right to recover that $66 million from us because the operator has paid for that as a separate transaction to undertake property development on that site. Therefore under normal accounting rules we are entitled, given that they are separable transactions; there is no right of recourse back on the state if the property market is such in three or four years time that the operator cannot build something. This has been run through the accounting standards. I believe the auditors looked at it when they were looking at the budget statements. The purple part of the budget statements is reviewed by the auditors and that element was in the purple part of the budget statement. I cannot prejudge the auditor's opinion; at the year end the auditor will form her own opinion. However, I am pretty sure the auditor looked at this issue, so this is in accordance with accounting standards.

Mr CLARK — As a matter of commerciality, why is it that you structured the deal so you would get $66 million in one year and then you would start paying out $33 million or whatever it is per annum down the track? Why do you not take it as a net item? It seems artificial to be taking a $66 million up-front payment for a purported sale of commercial exploitation rights for a long time; why are you not simply using that to reduce your ongoing payments down the track?

Mr LITTLE — I think we wanted to keep the two transactions separate. If there is a problem with the provision of the railway services in the future we want to be able to look at the books for the cost of that service, relate it to the service being provided and decide whether we should make a full payment for it. It is in relation to the cost of providing that service, not with respect to another transaction which is not relevant because it is a development of property around the station but not related to the provision of transport services to the public. This was a clean, separable way of keeping those two transactions distinct, and it will make contract management for the state easier from 2005. I know what you are getting at — that it will make payments higher in the future by taking a payment now, but that is not the case.

Mr DONNELLAN — What new initiatives is the government considering in the private-public partnerships area and its Partnerships Victoria policy as outlined in chapter 6 of budget paper 2, page 114?

Mr BRUMBY — On PPPs, we think this has been a great success for the state. As you are aware the guiding principle in relation to Partnerships Victoria, the framework that we have set up under the Bracks government, is value for money. You can go back to previous governments and find all sorts of motivation. You can go back to when the Thatcher government in Britain introduced PPPs, and they were essentially to shift debt off the balance sheet. That is not what our PPPs are about; they are about value for money. Indeed any arrangements entered into are fully reflected on the balance sheet.

In terms of projects, obviously we have just been talking about Spencer Street which was a Partnerships Victoria project; a film studio is also under way, the County Court — an important project that we picked up from the early days of government — is now complete and has fantastic facilities.

A number of other public-private projects are being readied for the market or are under consideration, and I should mention those. They include the Melbourne Convention Centre plenary hall, which I mentioned in the budget papers and speech. The government has not made a final decision about that project. We will be giving it careful consideration over the next few months, and part of which would be if it did go forward would it do so as a public build or as a Partnerships Victoria project? Also included is the showgrounds redevelopment, funded in last year's budget; and potentially the Royal Women's Hospital redevelopment and the eastern treatment plant upgrade. We are putting out an expression of interest in the near future on the Werribee Plains vision and we will look at a range of propositions there for partnership arrangements. Potentially too there is the Melbourne wholesale fruit and vegetable, flower and fish markets redevelopment. We are about to commence, as we promised at the last election, a full review of how Partnerships Victoria is proceeding. We think it has been a great success but we can always do better with it going forward.

I come back to where I began. The answer is that what drives Partnerships Victoria is value for money. If it is better to do it as a partnership, that is what we are interested in; if it is better to do it as a traditional public sector build, we will do it as a traditional public sector build. The key is value for money. I should have mentioned we also have prisons projects out in the market for some replacement provision, so a number or projects are in the market.

Mr RICH-PHILLIPS — Where does the Commonwealth Games village at Parkville fit in relation to Partnerships Victoria? It is unusual; it is not a straight traditional procurement.

Mr BRUMBY — I do not think it has been run as a Partnerships Victoria project.

Mr RICH-PHILLIPS — Was it considered?

Mr BRUMBY — I do not believe — —

Mr LITTLE — No, I do not think it was.

Mr RICH-PHILLIPS — Can you think of any particular reason for that? I would have thought that would be an obvious consideration.

Mr BRUMBY — It is essentially a contract arrangement.

Mr FORWOOD — It is a property deal.

Mr BRUMBY — It is a contractual arrangement and the best value for the state we thought was a traditional property development. The arrangement was a straight contractual relationship, and that is what we have with Australand.

Mr CLARK — I refer to page 34 of the Department of Treasury and Finance response to the committee's questionnaire attachment 1 which refers to one of the activities undertaken by DTF as being delivery of a budget tax strategy. Does it follow from that that a lot of effort is now being devoted by Treasury and Finance to finding ways in which to raise additional revenue for the government? What plans does the government have to address the increasing burden of Victorian property taxes — both stamp duty and lands tax — which as you know are causing a considerable degree of angst among the Victorian community generally, and particularly among potential investors in the state. Further, can you rule out increased taxes in future budgets, for example, of the sort that Western Australia has recently introduced?

Mr BRUMBY — I understand the paper you are referring to is DTF 2002–03, 'Major initiatives', budget paper 3?

Mr CLARK — That is correct.

Mr BRUMBY — Yes, that is the 2002–03 budget, the current year.

Mr CLARK — So the delivery of that has been the budget that you handed down?

Mr BRUMBY — Yes, so the delivery of the budget tax strategy is the delivery of the remaining elements of Better Business Taxes, which, of course, for this budget was the reduction in the payroll tax rate from 5.35 per cent to 5.25 per cent.

Mr CLARK — That was last year.

Mr BRUMBY — But this is about the delivery of it in this budget.

Mr CLARK — That does not involve new work by the department, surely. Does that not refer to work done on the tax initiatives in this budget just passed?

Mr BRUMBY — That is referring to the implementation of those initiatives and some of the work that occurred on broader revenue issues including things like motor registration, which we discussed earlier, on the fees and charges issue. Generally — and I made this point before — the burden of Victorian taxation is considerably lower today than it was 4, 5, 6 or 7 years ago. You can shake your head, but that is the fact.

Mr CLARK — Nineteen hundred dollars per household since the change of government! And it has been increasing.

Mr BRUMBY — If you want to look at Victorian taxation, taking into account all of the taxes and all of the fees and all of the charges and add them up and say what are they as a proportion of gross state product, they are considerably less today than they were 4, 5, 6 and 7 years ago. The federal government cannot say that, but we can. One of the reasons for that is we have been busy cutting and abolishing taxes. We have cut the payroll tax from 5.75 per cent to 5.25 per cent. It is a 0.5 percentage point cut. We have abolished, totally, duty on non-residential leases. The cost to budget is about $50 million a year. Ask some of the small retailers downtown what they think of that initiative. It is the most important initiative for their business in the last 20 years. We have abolished duty on unquoted marketable securities. We have done those things. From next year's budget, 1 July 2004, we will abolish duty on mortgages at a cost to budget of $122 million. We have been busy reducing taxes. We chose payroll tax — you may disagree with that — but we believed it was a tax on employment, and we wanted to see Victoria's position consolidated as the second lowest payroll taxed state in Australia.

When you put that with the taxes abolished as part of the intergovernmental agreement (IGA), duty on quoted marketable securities and, of course, FID, you have seen something like five taxes abolished in Victoria in the first term of the Bracks government. We have come from the state with the highest number of taxes to the state with the equal lowest number. I would have thought that that was a good achievement.

In terms of stamp duty, the reality is that while our property market has been the strongest performer in Australia other states have also benefited. Stamp duty has gone up all around Australia, it has not gone up just in Victoria. Because there has been a strong economy stamp duty has gone up in New South Wales, Queensland and South Australia. It has gone up even in Tasmania. Our share of GDP compared with other states remains at the Australian average.

In relation to land tax we have not changed the land tax system at the top end. It is exactly as you left it when we won government. At the bottom end we have reduced the threshold from $85 000 up to $150 000, which has taken tens of thousands of people out of the land tax system. I make another point about land tax. Ninety-seven per cent of Victorians — that is, 97 out of every 100 — who pay land tax pay less land tax in Victoria than do their counterparts for a similar transaction in Queensland and New South Wales. Our top rate is higher, as it was under your government. Unchanged, isn't it, Robert?

Mr CLARK — You make no adjustment for property values?

The CHAIR — I think the Treasurer has already made that point.

Mr BRUMBY — I recall reading one of your speeches where you said you supported a flat rate land tax, but you did not implement that in government and nor have we. So we have a system that is unchanged except that we have provided relief at the bottom end. However, in terms of its impact, understand that while our top rate is higher than other states with the way it is structured in Victoria 97 per cent of people who pay land tax in Victoria pay a lower level of land tax than do counterparts in New South Wales or Queensland.

From a business point of view — and you made the point about this affecting employment growth — for small and medium-sized businesses our environment is a better one than New South Wales and Queensland. It may be arguable at the top end, but medium and small-sized businesses actually pay less land tax than do their competitors in other states. Take the case of Mr Kennard, which was referred to publicly. If he goes to New South Wales — he is not going to New South Wales but if he did — he would pay significantly more payroll tax than he pays in Victoria. It is 5.25 per cent in Victoria. It would be considerably more in New South Wales.

The CHAIR — In relation to chapter 7 of budget paper 2 reference is made to 'Election commitments — implementation report card'. Can you outline the extent to which the government is able to deliver on its election commitments, both in terms of infrastructure and recurrent expenditure?

Mr BRUMBY — We inserted this chapter because we thought it was important to report to the Victorian people on the implementation of our election commitments. On the recurrent basis this year in this budget we implemented 133 of our recurrent election commitments. They are all fully funded and fully implemented. There were some recurrent election commitments which we said would start from 2004–05 and 2005–06. They are fully funded in the forward estimates in the demand contingencies, so we have already paid for those promises.

In relation to capital works — our capital program — we made it clear at election time that these projects would be completed or substantially undertaken at the time of the next election, and those projects will be completed or undertaken by the time of the next election. Again, if you look at the unallocated capital provision going forward, there is more than adequate capital provision to fund all of those capital commitments over the four-year time frame.

Mr CLARK — My question, which might be a bit technical in some aspects and you might want to take it on notice, is about how you are dealing with contingencies in the Treasurer's advance in the budget papers. Perhaps there is a component that you might like to take on notice. Can you provide the committee with an explanation as to how the contingency provision for 2003–04 has changed since last year's budget for 2003–04? Last year there was a contingency figure of $1000.8 million, now it is $488.1 million. There have been ins and outs, but it is very difficult for people reading the budget papers to understand how these things change over time. It would be particularly useful to the committee if you could provide the committee with that information.

Perhaps you could address this now: in relation to contingencies can you give the committee some idea of the make-up of the current contingency provisions that are in the budget for this year in the forward estimates — that is, $488.1 million for 2003–04, $1117 million for 2004–05 et cetera. Some of the elements are known, such as the latest financial statement initiative and the demand set aside for demand strategy, but what are the other components? Also, why has the Treasurer's advance been set at around $620-odd million this year in the appropriation legislation compared with the Treasurer's advance of, say, $341 million in 1998–99? It seems a very big increase and, of course, it was one of the aspects the Auditor-General remarked upon in his recent report.

Mr BRUMBY — It is a very detailed question.

The CHAIR — They are a significant number of questions on the Treasurer's advance, but you are able to provide details later if you wish.

Mr BRUMBY — I am advised by the secretary that we will provide some detail, but bear in mind some aspects of the contingency are obviously confidential. We provide for wages, as have previous governments. We are not going out today to broadcast what amount is there for employees to bid against. That would not be good policy. We also provide, as we have said publicly, an amount for what we believe may be the increased cost of operating public transport franchises. We have put a broad global number out there in the market, but we are not going to the precise detail of that again because these things will be matters of commercial negotiation with private operators. In addition there is the Treasurer's advance, which is included in contingencies. There is demand growth in things like the health system which is included in contingencies. Of course, as I mentioned before, the election commitments, which commence in 2004–05 and 2005–06, are also included in there. There is quite a substantial amount. Ian may want to add to that.

Mr LITTLE — No, I think it is a fairly detailed question. I would be happy to provide you with something but I agree with the Treasurer that while some of those we will be able to describe but we will not quantify for commercial-in-confidence reasons. The only additional broad element of the contingency that I would add to the Treasurer's list is there is also an amount in there for depreciation. We have an unallocated capital pool which has not been allocated to particular projects. There is an ongoing cost to the budget once that capital is allocated to a particular project, so we also keep the ongoing cost of future capital projects not yet specified in the contingency as well. We will give you as precise as we can, but in some instances we will not quantify.

Mr CLARK — Is that last factor the reason the Treasurer's advance in the appropriation bill, which I think is around $620 million, is higher than the $488 million total contingency figure?

Mr LITTLE — That would be one of the reasons.

Mr MONFORTE — Every year we know departments underspend on their appropriations and they have an entitlement to carry over under section 32 of the Financial Management Act. Departmental estimates themselves assume departments spend their full budgets. Because we know the departments will underspend it is just part of the normal provisions that we make an allowance for that underspending in the Department of Treasury and Finance contingency. That is the primary factor why the $488 million is lower in the Treasurer's advance — it is just an estimate of normal departmental underspending.

Ms GREEN — Chapter 4 of budget paper 2, pages 96 and 97 refers to modernising government. Could you outline further for the committee the budget initiatives that will ensure modern and efficient government in Victoria?

Mr BRUMBY — There is a range of initiatives there. One of the key ones I would like to highlight is the budget provision which has been made for a Chief Information Officer. As I said before, states in general spend hundreds of millions, if not billions, in aggregate each year on information technology. What we are doing in this budget is putting in place a Chief Information Officer whose job it will be to manage and develop the medium and long-term strategies for the use of information technology and the way in which we use that to deliver more efficient government and deliver better services to our citizens through e-government.

Victoria has been a leader in this area. I think it is fair to say we were a leader under the former Kennett government. We have been a leader under the Bracks government, and we want to maintain that leadership going forward. This is a major new initiative. It will give us a much stronger focus on e-government, linking up government with citizens, breaking down some of the silos, delivering better services at lower costs. In addition I include some of the initiatives in the hospital system. Patient management and hospital management systems are pretty ramshackle and are using old technology, and they do not talk to each other, so we are replacing those. We have allocated $24 million for electronic prescribing. There are obviously cases in hospitals where the wrong medications at the wrong doses are provided and electronic prescribing will help to minimise the risk in that. There is a range of initiatives and they all go to building a more modern and efficient government.

Mr CLARK — On the issue of debt and liabilities, you have a chart at page 122 of budget paper 2 which shows Victoria's general government net financial liability to GSP ratio. On that chart it appears that of those states which enjoy a AAA credit rating, Victoria has the highest net financial liabilities to GSP ratio. What is the maximum ratio of net financial liabilities to GSP that you believe is consistent with a AAA credit rating? Apart from your goal of maintaining a AAA credit rating as a target which you set out at page 10 of budget paper 2 in relation to net financial liabilities, do you have any other targets, goals or measures by which you assess the adequacy or appropriateness of Victoria's net financial liabilities level?

Mr BRUMBY — Can I come to a couple of those questions. In the table you have there Western Australia, as I understand it, still runs its electricity and gas systems. If you include that, which is what the ratings agencies take into account, it is a much higher number, running up to somewhere between 10 and 15 per cent if one wants to make the comparisons. On the debt issue generally, I mentioned before Moody's and I have just been handed the release — I have not got its full report — it put out just 1 hour ago on our budget, which is headed 'Moody's reports Victoria's AAA rating and stable outlook due to low debt and sound fiscal performance'. The first paragraph states:

> In its annual report on Victoria, Moody's Investor Services says the Australian state's AAA rating and stable outlook are due to a modest debt burden, prudent budgetary practices that result in annual surpluses, and a diverse economic base.

It goes on to talk about the international economy:

> The government's strong financial position and prudent fiscal policies assure that sufficient steps would be taken to address any potential adverse developments ...

It is a very strong endorsement of our position.

In terms of the targets we set, in the budget papers in chapter 1 at page 10 we list the financial objectives, long term and short term. The short-term objectives are:

> Operating surplus of at least $100 million in each year.

Implement strategic infrastructure projects ...

Implement 2002 election commitments.

Implement reforms to Victoria's business tax system.

Maintain a triple-A credit rating.

So all of those are achieved.

In relation to the operating surplus of at least $100 million, you saw the chart before but of course we measure, as you know, on AAS 31. I mentioned earlier on that measure that if you look at the federal government under the stringent AAS 31 measure we use, it is running deficits this year and in 2004–05. If you use the measure more generally used by the commonwealth and other states, which is the government finance statistics, I am advised that Victoria is forecasting averages of $608 million over, it says four years to 2005–06, compared with $308 million for all other states on a GFS basis. So our surplus position is very strong, our net debt position is very strong, and Moody's refers to that.

Mr CLARK — The guts of my question was that apart from maintaining a AAA credit rating, what other constraints, targets or objectives do you have in relation to net financial liabilities and debt?

Mr BRUMBY — The other one which we determined in our first term, and we have had no reason to change it in the second despite the more adverse conditions in equity markets, is the payout of unfunded superannuation liabilities in our state schemes. When we were elected it was 2042, I believe. We bought that forward when I was finance minister in the first few months to 2035. So we are on track and on schedule to meet that pay down time by 2035. It is important to remember that we inherited — and it is no different for the government opposition members were a part of — a scheme which was not fully funded with defined benefits — and they have an impact. Paying that out of the system does take some time, but we have brought forward the pay down date for those unfunded liabilities, and that pay down date is 2035.

I have just been reminded of the graph on page 120 of budget paper 2, and in real terms there is a continuing decline in our net financial liabilities. On page 121, the figure for net financial liabilities to GSP at 30 June 1999 is 10.9 per cent. The actual for 30 June 2000 is 10.1 per cent. We have continued to pay that down, and it is now at 8.3 per cent of GSP; and it will be at 8 per cent by 2007.

Mr MERLINO — Treasurer, in your presentation you highlighted that the 2003–04 budget continues to grow the whole state. Can you expand on what the government is doing to promote economic development in regional Victoria?

Mr BRUMBY — Thank you for that. I partly touched on that earlier, but there is a whole raft of initiatives out there ranging from the Regional Infrastructure Development Fund to the fast rail projects to the regions. Can I say about those that they have been extraordinarily successful in rebuilding confidence in country Victoria in the major provincial centres; so whether it is Geelong, Ballarat, Bendigo, or the Latrobe Valley the work has started on those projects, and they know that the transport links will be stronger going forward.

There is then a whole raft of water projects. In terms of schools, hospitals and nursing homes, we have significantly increased funding to improve the state-owned nursing homes, many of which are in country Victoria. In terms of country hospitals, in this year's budget Nhill hospital received $8.5 million for 35 new acute beds there. In terms of police stations, there have been dozens of new police facilities constructed across the state, and in this budget Bendigo received $20 million, along with many smaller amounts to smaller stations.

You put all of that together and it is the most substantial investment in country Victoria for a long, long time. We are getting the results from that in terms of business investment, and committee members will remember the statistics I showed them morning in terms of the new investment facilitator of $1.6 billion. Of that figure, $700 million was in country Victoria. So we are seeing results in terms of investment, people, and major events in country Victoria. So you have to put the infrastructure in place. We underinvested in the 1990s and we have some catching up to do, and we are doing the vast majority of this without any borrowings. We are doing it and paying for it.

Mr CLARK — I take you to page 189 of budget paper 2, and in particular note 9 on total expenses from ordinary activities by department. In those forward estimates a number of the smaller departments are all projected to have declines in their nominal budgets between 2004–05 and 2006–07. These departments include Innovation, Industry and Regional Development, Parliament, Premier and Cabinet, Primary Industries, Sustainability and

Environment and Victorian Communities. They are all set to have budget falls. There is certainly a contingency factor not allocated to departments, but that only goes, as I understand it, to wage increases. In terms of locked-in current policy and current parameters all of these departments are set to face significant cuts in their budgets over that period. Can you explain whether that is, in fact, a correct representation of the position; and if so, how it is that those departments will all cope with fairly significant net reductions in their budgets?

Mr BRUMBY — Looking at, for example, the Department for Victorian Communities, in that case if you look at 2005–06 to 2006–07, the major impact there is the Commonwealth Games, so that is a single event where we are spending each year but the majority of that will be in the 2005–06 financial year, so that drops down. In relation to the others, the major factors really would be wages growth which is, as you have said, included in the contingencies, so in a number of areas you have agreements that run out. In the Department of Education and Training, for example, agreements with teachers I think expire late this year, so post that period obviously there is nothing in there for a wage increase but there will be some increase and there has been a provision, which as I said before is not disclosed publicly, that we have put in those contingencies to ensure we can meet relevant budget costs.

The same applies to the Department of Human Services. The big one there is its agreement, which runs out in 2004. Again, there is nothing in the forward estimates for that. In terms of other changes I think just generally there is probably a public sector wage award coming up at some stage as well, within a year, so that would be the principal explanation. There are, of course, as we announced in the budget, some whole-of-government savings, but they are described as modest. They are targeted — whole-of-government savings of $141 million in 2003–04 building to $167 million in 2006–07. So they will have some downward pressure, but the major factor there is that wage agreements expire, and the new funding is in the contingency, not allocated against departments.

Mr CLARK — So leaving aside the question of wages growth, all of these lesser departments are scheduled to have real reductions in their budgets over the 2004–05 to 2006–07 period?

Mr BRUMBY — I do not think you can say that because these are total expenses for departments. For some of these departments their wage bill is well in excess of a third of the total expenses, and in some cases it is more than half. So there will be a wage increase of some description, size and quantum, and if you have a department which has half of its total expenses in wages — let us say it is Human Services — and you round it out to $10 billion, then $5 billion of that is wages. You then add 2.5 per cent to that and that will give you $125 million a year or thereabouts times three years, so it is $375 million over the forward estimates period.

Mr CLARK — Sure, but you are not pulling that out when the wages deal expires. You do your forward estimates assuming the wage rates continue as to what they are under the current deal. So if you look at the Department of Premier and Cabinet, the figure of $389.8 million decreases to 376.2 million. You are assuming constant wages when the public service wages deal runs out, but you are still factoring in that reduction. The same applies for the Department of Sustainability and Environment — about a $25 million-odd cut.

Mr BRUMBY — There is also, of course, the productivity dividend which is embedded into those numbers, and which is 1.5 per cent per annum.

Mr DONNELLAN — I refer to budget measures in chapter 1 on page 13 and also on page 20. Can the Treasurer outline what Victoria receives back from the federal government relative to GST collected by the state and provide any comparisons, if possible, to what other states receive, or can I get them at a later date?

Mr BRUMBY — What I can say generally about the GST is that for every dollar that Victorians pay in the GST we get back just 83 cents. This money gets taken away from us and it gets given to other states. But I will make a more general point about the GST, because Victoria does not get ahead under the GST until 2007–08, and there is a lot of misunderstanding out there about the GST, most of it created by our federal parliamentary colleagues. I particularly refer to the federal government, which asserts that the GST provides this windfall for the states when nothing could be further from the truth. So for every dollar you pay, whether you are buying a car or having a meal in a restaurant, only 83 cents comes back to Victoria, and that will not change until 2007–08. People forget that as part of the GST agreement we had to abolish a whole range of state taxes and charges and take up other responsibilities. I mentioned before quoted marketable securities and FID. They used to be state taxes. They are gone, and instead we rely on GST revenues.

Let me put this equation to you: if it were not for what is called the guaranteed minimum payment, or budget balancing assistance which tops it up, between now and 2007–08 Victoria would be down the gurgler to the tune of more than $1 billion because of the GST. In other words what we have given up is more than what we are getting back under the formula and the only thing that keeps us in the game is the budget balancing assistance, and that is an important point to make. We have got rid of the taxes, we have done our bit, we administer the first home owners scheme; and we would be worse off were it not for the top-up.

It will not be until 2007–08 that we will get ahead. In the meantime you are seeing all of this money redistributed away from Victoria and there is the parallel debate with the federal government about where that money goes. A lot of it goes to places that should not be receiving it, including Queensland and the Australian Capital Territory. I often say that in the ACT income per head is 40 per cent higher than the Australian average. It is like putting a new tax on Victorians to pay a bonus to the good residents of Brighton — and that is what is happening nationally. So the per head cost to Victoria is $220 per year. My family — Rosemary and I and the three kids, five of us — are paying $1100 each year to Peter Costello so that he can give it to other states. Is that fair? No it is not, and what really rankles is when he pays it to places like the ACT. He might as well pay it to Brighton. It does not need the funding, and all we want out of this is a fair deal going forward, and that is what we have been working towards achieving.

Mr CLARK — Can I take you to budget paper 2, page 136, which is the final page of chapter 7 on the delivery of election promises. On that page there is a figure of $3063 million as the unallocated capital provision across the forward estimates period. I then go to page 10 of budget paper 3, table 1.2 on purchase of fixed assets by department, and the line 'Not allocated to departments'. On my arithmetic, if you add up that, the 'not allocated to departments' figure across the forward estimates period comes to a little under $2.5 billion, and my question is: what is the explanation for the difference; or to put it another way, how is that $3063 million calculated? If it is too complicated to answer now, perhaps you could take it on notice.

Mr BRUMBY — No, the short answer to the question is that table 7.4 'Unallocated capital' includes the unallocated elements out of the Better Roads Victoria program as well, whereas table 1.2 does not include it, and I am advised that that accounts for the difference.

Ms ROMANES — Treasurer, could you outline the proposed new department funding system which features on page 97 of budget paper 2?

Mr BRUMBY — We are moving towards a new departmental funding system. The one we have has been in place for a long time , and we are in the continual improvement business and want to see whether we can do this better going forward. So we announced in the budget that we are looking to move to a new system in the 2004–05 financial year, and over the next year the Department of Treasury and Finance will be doing all of the detailed work to ensure that this change can take place. We are doing it because we want to look at a system that will better drive productivity growth across government and achieve improved policy outcomes. The new system that will take place from financial year 2004–05 will mean that departments will no longer receive supplementary funding for changes in costs which they might incur in things like wages, for example. Instead the broad principle is that departments will be given a whole budget and they will be required to fully manage all of the costs within an agreed price for delivering their services.

At the moment the system has a mishmash of funding mechanisms. Baseline funding and funding for new initiatives is built in, and there are things like the productivity dividend which apply to some sections of government but not all. Then there is wage supplementation which comes out of the contingency. That all goes into a pot which finally departments have access to. We want to look at putting all of that together and ensuring that departments then get a single allocation or price for delivering all of their outputs. Particularly in relation to wage negotiations and agreements. Those departments will then be able to argue from a position which puts a greater emphasis on productivity outcomes and improved policy outcomes.

As we go forward this really is a key issue for us and other state governments. Since the budget we have had quite a bit of interest in this new model from other states. All of us want to ensure that on the one hand we pay the best wages but on the other that we are getting the best productivity outcomes. I mentioned before the long-term challenge for Victoria in *Shaping a Prosperous Future*. The best way of resolving that challenge is getting better productivity outcomes and better policy outcomes. This new system is designed to better link, if you like, funding of departments to improved public policy outcomes and to productivity in wages agreements, and that is what it is going to require departments to focus on. It is a big change. In many ways it is as big a change as when we moved to accrual accounting, so there is a lot of work involved in it. But the principle is that it gives a better focus on the outcomes we want to see achieved, and a better focus on driving productivity change.

Mr FORWOOD — Will it include section 29 receipts as well?

Mr BRUMBY — The way we work productivity dividend and all of those things, including the section 29s, will be considered over the next 9 to 12 months as we get the detail of the system up and operating.

Mr LITTLE — Just to add to that, in a way it relates to an earlier point that Robert Clark raised. There are departments that look at the forward estimates and say, 'Why is my forward estimate declining and it does not look reasonable?', as you said. The answer from their point of view is that they know that they will be receiving some more money from Treasury at a point in the future. They do not know exactly how much it will be: it depends on all these other factors. So it is a little hard in that environment to really say to the departments, 'You undertake three to four-year planning now' — which is what work force negotiation implies — if they do not know the bottom line they are working to. We are aiming to give them that bottom line so that contingency will get much smaller and much more of it will appear in the forward estimate for the third and fourth year, so they know that is the position. They need to have productivity and other plans in order to get to that medium-term position.

Mr CLARK — Another one you might want to take on notice is whether it is possible to provide the committee with a reconciliation between how the individual department output summaries are calculated at budget paper 3 — for example at page 26, the one for the Department of Education and Training — how those reconcile with the operating expenses by department that are set out at page 9 of budget paper 3? Also, whether you are able to provide the committee with the projected departmental outcomes for 2002–03 in the format that is used in budget paper 2 — in other words, the operating expenses by department, because that seems to be a big gap in the budget papers? There is no revised figure for 2002–03 to be found anywhere in that format.

Mr LITTLE — I think we will take that on notice. Joe, did you want to add anything off the top of your head?

Mr MONFORTE — In terms of the reconciliation it is a variety of things. It includes interest sector transactions which net out. It also includes a range of administrative type expenditures which also net out, the detail of which I think it is better to take on notice.

Mr LITTLE — One example that came to my mind was payroll tax, so when you consolidate it in the budget paper 2 levels we take out payroll tax which is paid by departments to the government. When we are looking at a government on its own we include the payroll tax. That is a pretty big amount; and there are other things like that which we can explain.

The CHAIR — Thank you. That concludes the budget estimates for the portfolios of treasury, state and regional development and innovation. I thank the Treasurer, his departmental officers and staff. It has been a very useful session, and there are a number of matters that will be followed up as promised.

Witnesses withdrew.