VERIFIED VERSION

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Inquiry into budget estimates 2012–13

Melbourne — 4 May 2012

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Witnesses

Mr K. Wells, Treasurer.

Mr G. Hehir, Secretary,

Mr D. Yates, Deputy Secretary, Budget and Financial Management Division,

Mr B. Flynn, Deputy Secretary, Economic and Financial Policy Division, and

Mr D. Webster, Deputy Secretary, Commercial Division, Department of Treasury and Finance.

Necessary corrections to be notified to executive officer of committee

The CHAIR — I declare open the Public Accounts and Estimates Committee hearing on the 2012–13 budget estimates for the portfolio of the Treasurer. On behalf of the committee I welcome the Honourable Kim Wells, MP, Treasurer, and from the Department of Treasury and Finance: Mr Grant Hehir, secretary; Mr Dean Yates, deputy secretary, budget and financial management division; Mr Brendan Flynn, deputy secretary, economic and financial policy division; and Mr David Webster, deputy secretary, commercial division. Members of Parliament, departmental officers, members of the public and the media are also welcome.

In accordance with the guidelines for public hearings, I remind members of the public gallery that they cannot participate in any way in the committee's proceedings. Only officers of the PAEC secretariat are to approach PAEC members. Departmental officers, as requested by the Treasurer or his chief of staff, can approach the table during the hearing to provide information to the Treasurer, by leave of myself as chairman. Written communication to witnesses can only be provided via officers of the PAEC secretariat. Members of the media are also requested to observe the guidelines for filming or recording proceedings in the Legislative Council Committee Room, and no more than two TV cameras are allowed at any one time in the allocated spaces. May I remind TV camera operators to remain focused only on the persons speaking and that panning of the public gallery, committee members and witnesses is strictly prohibited. As previously advised to witnesses here today, I am pleased to announce that these hearings are being webcast live on the Parliament's website.

All evidence taken by this committee is taken under the provisions of the Parliamentary Committees Act, attracts parliamentary privilege and is protected from judicial review. However, any comments made outside the precincts of the hearing are not protected by parliamentary privilege. This committee has determined that there is no need for evidence to be sworn; however, witnesses are reminded that all questions must be answered in full and with accuracy and truthfulness. Any persons found to be giving false or misleading evidence may be in contempt of Parliament and subject to penalty.

All evidence given today is being recorded. Witnesses will be provided with proof versions of the transcript to be verified and returned within two working days of this hearing. Unverified transcripts and PowerPoint presentations will be placed on the committee's website immediately following receipt, to be replaced by verified transcripts within five days of receipt.

Following a presentation by the Treasurer, committee members will ask questions relating to the inquiry. Generally the procedure followed will be that relating to questions in the Legislative Assembly.

I remind all members of the gallery, witnesses and members of the committee to turn off their mobile phones.

I now call on the Treasurer to give a brief presentation of no more than 10 minutes on the more complex financial and performance information that relates to the budget estimates for the Treasury portfolio.

Mr WELLS — Thanks, Chair. Thanks to the committee. PAEC plays an important role in the parliamentary process, so I welcome the opportunity. The budget we brought down on Tuesday was a tough budget but we believe a responsible budget. The state is facing difficult financial circumstances, so a number of difficult decisions had to be made. But we believe that the budget sets up the state over the forward estimates period. We need to live within our means. We need to generate jobs, build vital infrastructure and provide quality services on the front line. We believe this budget addresses that.

Overheads shown.

Mr WELLS — I will get into the slides for a summary of the budget. As I said, it is the most difficult budget that the state has had to put together for at least a decade. Conditions are tough. The budget delivers an operating surplus of $155 million in 12–13. Net debt will decline by the end of the forward estimates. The government is driving jobs and growth through a record infrastructure spend and cutting businesses costs. There is an extra $1 billion investment in skills, and we have targeted investment in key industries. These investments ensure that public services will keep pace with a growing community and reaffirm our focus on caring for the most vulnerable in our community.

The international economic outlook has weakened over the past six months. Economic growth and forecasts in 2012 for the major economies have been downgraded since the 11–12 budget update, which I brought down on 15 December last year.

The mining boom is attracting investment to resource-rich WA, Queensland and the Northern Territory. Investment in mineral extraction continues to rise in line with the construction-intensive phase of development among emerging Asian economies.

This chart shows the current outputs and employment growth, which are subdued. You can see that employment for 12–13 is 0.25. That has been marked down from 1.5, building up to 2 per cent, because you would normally get a bounce. So that has been marked up from 1.5 per cent and then flattening out at 1.75 across the forward estimates.

The weaker economic outlook has impacted heavily on Victoria's taxes and GST revenue. Since the 11–12 budget update we have lost a total of $827 million in tax and GST revenues in 12–13. Over $3 billion over the four years to 14–15. The majority of this write-down in tax revenue relates to land transfer duty and payroll tax. Compared with the estimates made in late 2010, Victoria has lost $6.1 billion in GST revenue over the forward estimates from 12–13. Much of this write-down is due to a reduction in consumption, but some of it is the unfair share that we are receiving in GST. With respect to the surplus, as you can see from this slide, we have, in 12–13, $155 million; in 13–14, $861 million; and in 14–15, a bit over $1 billion rising to $2.5 billion in 15–16. You will note with the net debt to GSP that it peaks at 6.5 per cent in 13–14 and then drops in 14–15 and 15–16.

We have had to make further savings, and the 12–13 budget measures will return $1.8 billion over four years, as you can see by this chart. We have had to introduce another round of departmental efficiencies and program savings, which will lead to a further headcount reduction of around about 600 people in the VPS. Fines have been increased. Growth in MPs' salaries will be limited to 2.5 per cent. Growth in salaries of senior public servants will also be limited to 2.5 per cent. We have made adjustments to the School Start bonus, and the education maintenance allowance is being refocused. This brings the total level of savings and targeted revenue to an average of $2.2 billion a year since we came to government.

This slide here shows how Victoria compares to all of the other states. It goes to show that the need to stay in surplus, we believe, is a high priority, and only WA and Victoria remain in surplus. If you look at all the other states, they are in deficit, with the odd exception in some years. We are very proud of the fact that we remain in surplus.

The strong finances in this budget are the result of expenditure restraint. Over the decade to 10–11, state government spending grew at an average of 7.3 per cent per annum. That is just simply unsustainable. With the decisions we have taken in last year's budget, the budget update and this budget, actual expenditure growth was 3.6 per cent in 10–11; expenditure growth in 11–12 is expected to be 2.7 per cent — and that is down from 3.9 per cent, so we have been able to drive expenditure lower again; and the forecast growth for 12–13 is 3.1 per cent but will average out at 2.9 per cent over the forward estimates. I believe we are now in a better position to deal with future revenue shocks. As I said, over the decade to 10–11 there was average annual expenditure growth of 7.3 per cent and at the same time revenue of 6.9 per cent, so that was just unsustainable. Over the next four years, as I said, we will contain expenditure growth to about 2.9 per cent. Revenue growth we are estimating to be 4.1 per cent.

If spending were to keep growing as it did over the past decade, we would be faced with a budget deficit of about $4 billion in 12-13. That would be growing to a deficit of nearly $10 billion by 2015–16, as this chart shows.

The next chart is in relation to net debt. The government's fiscal strategy will see net debt peak at 6.5 per cent, and it will fall to 6 per cent by the end of the forward estimates. Strong ongoing operating surpluses will allow further debt reduction over the longer term. Had we not taken the action, this net debt would have increased to $60 billion, which would have represented 15 per cent of GSP by 2016. The actions we have taken mean we have been able to get a tick, with the AAA being reaffirmed by Moody's and by Standard and Poor's.

Operating surpluses provide a source of funding where the government can build necessary infrastructure without having to go deeper into debt or to go further into unsustainable borrowings. In 2010–11 the government's infrastructure spend was only 44 per cent funded from net cash flows from operating activities. We could not continue on that trend. The actions we have taken in this budget mean we are able to decrease that debt over time. If you look at this graph, in 2015–16 infrastructure will be entirely funded from cash generated from the operating surpluses, which will mean debt can be reduced.

Victorian general government sector infrastructure expenditure is expected to reach record levels in 12–13. So after excluding extraordinary capital expenditure associated with the Commonwealth fiscal stimulus, we have been able to allocate $5.8 billion in 12–13 and will be commencing new projects worth $2.7 billion in 12–13. Where is some of that money being spent? On new road infrastructure. Let me give you an example about eliminating some of the level crossings. During peak hour the Springvale Road level crossing is closed for approximately 50 minutes of a 2-hour peak time; around 40 per cent of the time the boom gates are down. At Mitcham Road the boom gates are closed for approximately 54 minutes during peak time, or 45 per cent of the time. This means that if we are able to get rid of these level crossings, trip times around those areas will improve by about 25 per cent. The Dingley bypass is an important project — being able to complete the arterial link between the manufacturing hubs of Moorabbin and Dandenong.

To cut business costs — one of our priorities — we have been able to cut WorkCover premiums by about 3 per cent on average, which is good news. That will save Victorian businesses between 55 and $60 million per annum. We still remain the lowest across the country.

The budget invests a further $1 billion in skills. The additional funding helps to meet the massive growth in enrolment which has occurred since the move to a demand-driven model. The government also is introducing reforms to ensure that the funding is sustainable. We had to take this action, because it was clearly not sustainable. In particular, high-priority courses will see an increase in the hourly rate, while other courses will have funding levels reduced. So funding for certificate III and IV courses in skills such as carpentry, bricklaying, plumbing, engineering, automotive, children's services, aged care and disability will increase. All apprenticeship courses will see an increase in funding. Other courses will have their funding levels reduced.

The budget includes significant funding for manufacturing and agriculture and to promote exports and investment.

The government is continuing to deliver on its commitments in regard to health, so the 12–13 budget provides $13.7 billion to the hospitals and health system. The government's investment in the health system will deliver efficiency and we believe meets the needs of the community.

In justice, we went to the election in 2010 with a tough-on-crime approach. We have brought in a lot of legislation. At that time the prison system was significantly overcrowded. We needed to fix that, so we have been able to fund 395 beds across the existing prison system and also put money aside for a new 500-bed male prison. We believe that that is important. It also provides $113 million over four years for stronger management of serious sex offenders and increased funding for legal aid. We believe that they are important issues.

A strong centrepiece of this budget is protecting Victoria's vulnerable children. I think this should be welcomed by everyone. We are providing $336 million over five years to deliver front-line services across the health, education, justice and human services portfolios to help meet the needs of Victoria's children and families in crisis. We have all heard some of these heart-wrenching stories, and we believe that this money will go some way to addressing that.

In schools and TAFE, if we are going to talk about productivity, we need to ensure that there is the support and development of a better-educated and skilled workforce. So the 12–13 budget includes asset funding of $225 million in the TAFE and schools system.

In conclusion, this has been a difficult budget — difficult decisions have had to be made. Running a deficit, from the Baillieu government's point of view, would not have been the right response. We believe that we have the fundamentals right and strong finances and a strong economy are vital to underpinning everything the Baillieu government does.

The CHAIR — Thank you very much, Treasurer. The remaining time available will be dedicated to questions, and I would like to ask you initially: given the key growth and efficiency initiatives announced in the budget, can you please outline for the committee the likely impact of the budget on enhancing service delivery, promoting productivity and achieving efficiency gains within your portfolio and across government? In your response, could you please indicate how you intend to monitor the effectiveness of maximising the improvements in these areas?

Mr WELLS — We believe the service and knowledge-based economy and Victoria's growth prospects and long-term living standards are founded on productivity growth. If you look at what happened during the 1990s, you see that Victoria had a proud record of being above the national average when it came to productivity. Between 2000 and 2010 that productivity fell below the national average. So that is something that we have had to address.

If I can move to the four pillars that we have set out that we need to deal with — —

Mr PAKULA — The five pillars or the four pillars?

Mr WELLS — We are dealing with the four pillars. The first is that we obviously need to have a stronger budget capacity. That is crucial. It will enable us to be able to invest in those front-line services and to build the infrastructure we need to be able to reduce the debt over time. The second is improving productivity, as I mentioned. It is about cutting the red tape. It is making sure that we have a strong, efficient public service, and it is about being able to create competitive markets as well as building infrastructure that is productivity enhancing. Growing export markets is the third pillar. We believe that that is significant. Those super missions — the Premier has been over to India — are significant. Being able to connect the Victorian suppliers with the demand in India and China we believe is significant, as is supporting industries and workers in transition. The manufacturing industry is doing it tough with the high Australian dollar and other factors that will impact it as of 1 July, and we stand ready to be able to work with it.

We have said that committing to public sector productivity means streamlining and improving the governance of non-departmental government entities. We believe that is important. We have to ensure that there is greater transparency in all government operations. We need to provide service delivery by providing choice for service users and giving those who deliver the services the power to be able to manage their operations efficiently.

There is a focus on the newly created Better Services Implementation Taskforce. That is to ensure that we get rid of the duplication in the public service. As an example of how we are going to go about monitoring, in the Department of Treasury and Finance, which will come under Rob Clark's domain, we have set up the construction code compliance unit to assist us to implement the guidelines to the Victorian code of practice for the building and construction industry. That means that we have a set of guidelines on large government sites, such as the regional rail, and this unit will be out there making sure that the guidelines that we have set with the constructors to be able to build those large projects are being monitored. There is no point in having a set of guidelines and then no-one enforcing those guidelines. We have large infrastructure projects coming along and we want to make sure that we get good value for money for the taxpayer. That is what this is about.

The CHAIR — Thanks, Treasurer. Just to quickly follow up, can I ask: would you inform the committee of what you consider to be the likely impact on industry and the community of the initiatives across government but particularly within the Treasury portfolio?

Mr WELLS — I guess the first issue we had was that when we came to government we had a large number of major projects we had to deal with which had run over time and over budget, so what we did was set up what is called the high-value, high-risk unit in the Department of Treasury and Finance. That means any project that is more than $100 million — or IT projects, because from our experience when you look at an IT project in government, trying to implement an IT project has high risk. Having high value, high risk those projects need to come in. It has an enormous amount of rigour around those projects, and if it does not get through high value, high risk, I do not sign it off. Once high value, high risk have signed something off, then I can be assured that the project should proceed.

I also mentioned earlier the implementation of a construction code compliance unit getting out onto the work sites to make sure that the rules and guidelines are being implemented. I think most people would say that if you enter into a contract with the unions, the employers and the construction companies, then we expect that the project would proceed under those guidelines. We think that is fair and reasonable, and that will happen. We are looking for assurances that we improve productivity, and we want flexibility to be able to ensure that over the forward estimates we are able to improve our productivity, reduce red tape and the cost of business so we can generate more jobs.

Mr PAKULA — Treasurer, can I just ask you if the State Revenue Office is a front-line service for the purposes of the government's sustainable government initiative?

Mr WELLS — We have said from day one that with the State Revenue Office or with all departments within government that front-line services will not be affected, but for the actual question in regard to the SRO, I will refer to the secretary.

Mr HEHIR — With respect to the implementation of the government's sustainable government initiative, how that will be implemented within the SRO will be to ensure that the capacity of the SRO to deliver the revenue services it provides for government will continue to be maintained.

The focus on driving efficiency in the SRO will, like in other areas of government, be focused on back office efficiency, using IT more effectively to deliver services. For example, the SRO at the moment has been rolling out a much more e-tax model over the last 12 months, and it is continuing to develop that. That produces efficiencies both for the SRO, because it can reduce the number of staff it has who deal directly with the public, and it also increases the efficiency for the business community. We have estimated that there are quite significant red tape savings as a result of that because businesses, rather than having to turn up to a shopfront to deal with tax matters, can more effectively deal with it online. My understanding is that there has been a significant take-up of the use of e-taxation as a result of measures such as that which have been implemented.

The drive for efficiency is around the back office — making sure that is more effective — and better use of IT so that you can achieve both efficiencies in operation and efficiencies through the interaction with business and cut the cost of business. The implementation of the government's initiative will be around about that type of framework within the SRO.

Mr PAKULA — If I could follow up, Treasurer, I am interested to hear Mr Hehir talk about all the efficiencies in the SRO because, according to the DTF questionnaire, at the same time that there are 4200 public servants getting the chop, the number of full-time equivalent employees in the State Revenue Office, which collects tax for the government, has gone up from 458 in June 2011 to 488 in June 2012. While all other agencies, including front-line service delivery agencies are getting the chop, the SRO full-time equivalent numbers are going up.

Mr WELLS — We made two decisions regarding last year's budget and this year's budget. We are going to improve the compliance regime at the SRO, and we have increased dollars going into the SRO to improve the compliance to make sure that we have people out there checking to make sure that people are paying their land tax, their payroll tax — —

Mr PAKULA — More tax collectors.

Mr WELLS — No. What we expect is that people abide by the law. That is what we expect. If someone is liable for a tax payment, then we expect the SRO to be able to collect it. Protecting our revenue base is very important. We have made a conscious decision in last year's budget and again in this year's budget to improve that by putting more dollars into the SRO. That will mean more people will be in the units of compliance. I think that should be supported by anyone. We do not want people avoiding taxation. We want those people who are liable for the taxation to pay.

Mr MORRIS — Treasurer, I refer to page 5 of BP 5, the operating statement. You have obviously projected a surplus of $155 million in the current year building to some $2.5 billion over the forward estimates. Can you give the committee an indication of the sort of financial and economic challenges that you faced in preparing the budget, framing the budget and meeting the commitment that the government made to a minimum $100 million surplus?

Mr WELLS — Framing the budget last year was very difficult. We were set to moving along a particular path, and then we were given the news that the share of GST we were going to receive was going to be cut from 94 cents to 90 cents. Just that one decision cost us $2.5 billion over the forward estimates period. Then we received further news that the pool had shrunk another $1.6 billion. So moving into the 2011–12 budget we were already facing a downturn in GST of $4.1 billion. So that was significant. As a result of that, we wrote to the Prime Minister and said that the GST share that Victoria is receiving is unfair. The Prime Minister agreed with our approach and set up a committee with former premiers Nick Greiner, John Brumby and also Bruce Carter from South Australia. Although we do not necessarily agree with the interim report that they brought down just recently, at least we believe that there are some positives and that we will get some fairer outcome from that.

Ms HENNESSY — GST revenues are forecast in budget papers — —

The CHAIR — Order!

Ms HENNESSY — I mean, let's tell the truth!

The CHAIR — Ms Hennessy, allow the Treasurer to complete his response to Mr Morris's question, and you will get a question later. If you keep interjecting in that manner, you may be bypassed, all right? Now, Treasurer, would you like to complete your answer?

Mr WELLS — Well, I actually thought it was fact that the numbers that were given to us were a cut from 94 cents to 90 cents and that the impact was $2.5 billion, and that was confirmed by the Commonwealth Grants Commission. In addition to the cut in GST, we have had the high Australian dollar and we have had the weakening world economy and the uncertainty coming out of the eurozone. In addition to that, we have had a weakening national economy, and we have had to deal with the uncertainty that is facing Victoria with the carbon tax and other issues that we will need to deal with. As we have said, we have had to downgrade over the forward estimates and write down $6.1 billion on the GST plus the land transfer duties of another $1.5 billion. So we have had to write-down $7.6 billion over the forward estimates, and that is significant.

There was a large revenue write-down; this has been a larger write-down than during the global financial crisis. When the global financial crisis was on, the commonwealth government added $13.2 billion into the Victorian economy, and of course that has not happened this time around. We have also had the situation where the revenue and the expenditure over the last 10 years has not matched, and, as shown in those slides, we had expenditure growth of 7.3 per cent on average and at the same time we had revenue of only 6.9 per cent, so that made it more difficult, which meant that we had to address that particular issue.

We have had to make difficult decisions about restraining growth in expenditure, and that is important. And, as I said in my presentation, we have had a situation where we now have the savings and target revenue of an average of about $2.2 billion per annum since we have come into government. It has not been easy, but it is something that we have just had to do.

Mr SCOTT — Treasurer, I refer you to page 90 of budget paper 3 of the 2011–12 budget, which contains information about the — —

Mr WELLS — Sorry, 2011 — —

Mr SCOTT — The 2011–12 budget.

Mr WELLS — Is that part of the estimates?

The CHAIR — Perhaps Mr Scott, you should elaborate on your question so we can all understand what the point is.

Mr SCOTT — It refers to the first home bonus. I could not find the bonus referred to anywhere. Could you confirm to the committee that it has been abolished in this year's budget?

Mr WELLS — When we went to the election in 2010 and we did our election commitments and costings, we put aside one year. We allowed the first home bonus to be funded for one year. This was a lapsing program and obviously was not meant to go on.

Mr PAKULA — As are all of your programs.

Ms HENNESSY — That's right.

Mr SCOTT — What, yours are funded in perpetuity — all of them?

The CHAIR — You will allow the Treasurer to complete his answer, please.

Mr WELLS — We funded it and we released all of our costings to the government, to the opposition and to the media at that time, but we had in our forecasts in our election commitments — year by year by year — that the first home bonus would only be in play for one year. When we looked at the budget situation we said all the way along that we have to live within our means. Not all programs could continue, but we have stuck to our election commitment of assisting first home buyers with our cut to the stamp duty. We said at the election time that that would be 50 per cent for those first home buyers up to a $600 000 threshold level. At the moment that is 20 per cent, but by 1 January next year that will move to 30 per cent and progressively move to 50 per cent by September 2014. In addition, the $7000 first home owners grant still remains.

Mr SCOTT — That is federal money.

Mr WELLS — That will still continue to be funded. As I said, the bonus will cease as of 30 June this year. It is a situation where we have to live within our means, and not all programs could be funded.

The CHAIR — Do you have a follow-up question?

Mr SCOTT — I do. If you use the source of the valuer-general, the median house price in Melbourne is $475 500 and in regional Victoria it is $276 500, and if you do a calculation of stamp duty payable by a first home buyer purchasing for owner-occupier purposes on 1 July 2012, the stamp duty payable is 16 400 on that median price in Melbourne and 8156 in regional Victoria. If you calculate the savings based on 20 per cent, my calculation is 4100 in metro Melbourne and 2039 in regional Victoria. The value of the first home bonus in metropolitan Melbourne was $13 000 and in regional Victoria $19 500. Surely, Treasurer, you have not made first home buyers of newly constructed homes worse off, have you?

Mr WELLS — As I said, we have had to live within our means, and we could not afford to fund or continue to fund all programs. The first home buyers bonus will cease as of the 30 June this year.

Mr ANGUS — Treasurer, I refer you to the GST information contained in the budget papers as well as detailed in your presentation in one of the charts that we saw earlier. Indeed following up on Mr Morris's previous question, can you please advise the committee how much is the forecast revenue from GST and state taxes expected to decline over the forward estimates, and how does this compare to previous forecasts or actuals?

Mr WELLS — If I could, Chair, I ask to bring up the slide in regards to the GST.

As I said, state revenue had fallen, and we believe that we have received an unfair share in regards to GST, with this chart showing a $6.1 billion fall, with the adding of the land transfer duty of another $1.5 billion giving us a cut of $7.6 billion. This has been very difficult. If I could explain, if we compare this to the 2010–11 budget update forecast, it was originally $12.6 billion that we were to receive in 12–13. The changes to the pool will be $1.1 billion, and the changes to relativity will be $0.4 billion, giving a cut of $1.6 billion, which means that the 12–13 forecast will now be $11 billion.

If I go to 13–14, the 10–11 budget update forecast was $13.1 billion. Changes to the pool are $1.2 billion, the relativities are 0.3 billion and that gives a cut of $1.5 billion, which means that the 12–13 forecast is $11.6 billion.

If you look at 14–15, the budget update forecast was $13.7 billion. If you look at the change in the pool of $1.4 billion and the change in relativity of $0.2 billion, it means that there is a cut of $1.5 billion, which means that the 12–13 budget forecast is $12.1 billion.

In 15–16 the 2010–11 budget update was $14.5 billion, which would have been significant to the forward estimates. The change to the pool is $1.4 billion, the change to relativity is $0.1 billion and that means a total cut in GST of $1.5 billion, so the 12–13 budget forecast is now $13 billion. If you put that across the line, the total pool change is $5.1 billion, and you look at the relativities of $1 billion to give you the $6.1 billion reduction.

In summary, that is the change from the 10–11 budget update, which we were working on over the forward estimates. The change to the pool is $5.1 billion, plus the relativities of 1, gives you a $6.1 billion cut to the 12–13 budget forecast.

Mr PAKULA — It is up by 6.3 per cent. Table 5 shows a 6.3 per cent jump in GST revenue.

The CHAIR — Are you wanting to ask a question in lieu of Ms Hennessy?

Mr PAKULA — No, Chair, I am not.

The CHAIR — Right; you be quiet. Ms Hennessy can ask the question.

Mr PAKULA — Are you a schoolteacher?

The CHAIR — Yes. If I have to treat you like schoolchildren, I will.

Ms HENNESSY — Treasurer, if I can just refer you to budget paper 2, page 25, how much has Victoria's productivity improved in the current financial year as a result of measures taken in last year's budget, and how much do you expect productivity to improve from additional measures that you claim the government is taking? Given that you have referenced past productivity fluctuations in percentage variations, could you please provide the committee with the percentage in your answer — that is, percentage of productivity growth directly linked to your budget initiatives in the last financial year and in this financial year?

The CHAIR — Treasurer, you may choose which question you answer, I think.

Ms HENNESSY — It is one question. It is two percentages. It is not too hard.

Mr WELLS — The issue for us is that during the 1990s the productivity growth in Victoria was above the national average, and that is important. In the past 10 years the productivity growth has fallen below the national average. Productivity is a very important issue for us as a government. What does it mean? It means that we have had to hold the wages policy at 2.5 per cent plus productivity offset. So when we negotiate with the nurses, the health workers, the teachers, the firefighters and the ambulance paramedics, who are coming up, the wages policy is 2.5 per cent plus productivity offset. We believe that those sorts of measures are important to be able to improve the overall productivity of the state.

It is also about cutting red tape. We have a target of a 25 per cent reduction in red tape by 2014, and that is a very important target. Every time you talk to small business one of the real problems that they talk about in relation to doing business with the government is the issue of red tape and regulations. What they want is to be able to get on with their business. That will save the economy $715 million a year in productivity, which is significant.

We have also chosen in regard to infrastructure that when we are building infrastructure it has to be productivity-enhancing infrastructure. It is things such as getting rid of the railway crossings. It is about proceeding with the — —

Ms HENNESSY — I just want a productivity percentage.

Mr WELLS — If I can talk, maybe there is a difference of opinion between the government and the opposition, but we would have thought that choosing infrastructure that enhanced productivity was crucial, absolutely crucial — —

Mr PAKULA — So what is the number?

Ms HENNESSY — You would know the number, as the Treasurer.

The CHAIR — Allow the Treasurer to complete his answer.

Mr PAKULA — But he is answering what he wants rather than the question he was asked.

The CHAIR — Deputy Chair, with great respect, as you know, as a former minister, ministers can answer questions in the way that they choose, not in the way that the questioner would like them to answer. The Treasurer will answer the question in his own manner and his own style, and you will be satisfied with the answer when it is completed. Treasurer, do you wish to make any further comment, and if you do, would you conclude your answer?

Mr WELLS — There may be a difference of opinion about which infrastructure we choose to build, but we are focused on productivity-enhancing infrastructure. It is absolutely crucial for us to ensure the supply chain and untangle the road and rail networks. It is about being able to get goods and services moving across the state of Victoria, and that is important because you do not want your port caught up in a tangle — or your rail network or road network. It is costing business millions and millions of dollars. We choose that sort of infrastructure to be able to provide productivity growth right across the system. I know that the person who asked the question would know that when you are calculating productivity it is actually over a five-year period. So we have a four-year plan to be able to improve productivity. I maintain that in the area of red tape we are well on target. We believe that in regard to the wages policy we are holding firm on the 2.5 per cent plus productivity offset. So we believe we have the fundamentals right to achieve our targets on productivity growth.

The CHAIR — Ms Hennessy, I am sure, would like to follow that up.

Ms HENNESSY — I would. Treasurer, can you at least guarantee that in percentage terms productivity will grow over the next year? I must say that my initial question was to ask: in percentage terms, how much do you anticipate productivity will grow? This was a matter you spoke about in great detail on 31 August last year.

The CHAIR — Thank you — —

Ms HENNESSY — You were happy to talk about percentages then.

The CHAIR — You have put your question, Ms Hennessy.

Mr WELLS — I guess the main point for me as Treasurer is to look at the two graphs — and I will get to answering your question. During the 1990s, as I said, we were below the national average when it came to productivity. For 10 years, for some reason — between 2000 and 2010 — the productivity fell below the national average. And that is a fact. Something happened in 10 years of government that — —

Mr PAKULA — Which means you must be able to measure it.

Mr WELLS — That is right — —

Ms HENNESSY — You are the Treasurer, and you are telling us you cannot tell us — —

Mr WELLS — No, no, I am getting to — —

Members interjecting.

The CHAIR — May I call the meeting to order, please. Thank you. Just relax a bit and allow the Treasurer to proceed.

Mr WELLS — I can understand why the opposition gets very excited about the issue of productivity when they oversaw a falling away of productivity. Our first aim is to start aiming to at least be on average across the nation in regard to productivity, and I think that is the first step. If we are below the national average, then we need to be able to drag that up to at least be the benchmark across the nation. These are five-year rolling averages, and this is a term-of-government policy. But we will improve productivity across this state.

Mr O'BRIEN — Treasurer, I refer you to chart 1.4 on page 7 of budget paper 2 and ask: what interstate comparisons can be made in relation to fiscal indicators like the operating balance and net infrastructure investment?

Mr WELLS — Could I just get that chart brought up, please. I guess, as I said, when you are framing a budget it is very difficult when your revenue is on the decline. With GST of $6.1 billion, land transfer duty of another $1.5 billion, so when you are looking at a $7.6 billion cut to revenue, you have to make difficult decisions, and one of the decisions that the government was faced with is: do we run a deficit, or do we drive further efficiencies and further savings and run a surplus? We maintain that running a surplus puts us in a very strong position to be able to live within your means, to be able to build up those surpluses and then to be able to use those surpluses to pay for front-line services and to fund infrastructure without going further and further into debt.

When you look at the other states, based on the 11–12 updates, of all the states WA, with all their wealth from the mining boom, and Victoria are the only two that remain in surplus. That is very important. When you look at New South Wales, Tasmania, Queensland and South Australia they are expected to post further deficits, at least in the short term. They will have significant work that will need to take place in a budgetary sense to be able to get their budgets into surplus.

But there is another important point to all this. If there is another GFC, if there is another shock on revenues, Victoria is well positioned to be able to manage future revenue shocks. If we had not taken this action, the budget today would have been in a deficit of $4 billion. If further decisions had not been taken, that deficit would have blown out to $10 billion by 15–16. So if we were hit by another revenue shock, this state would have had severe financial difficulties. The Baillieu government did not accept the premise of running a deficit. We have put in place a $155 million surplus building up to a $2.5 billion surplus, and we believe that will put our state in a strong position to deal with front-line services, to deal with the infrastructure we need and to protect us against future revenue shocks.

Mr PAKULA — Treasurer, I ask you to turn to page 169 of budget paper 5. In that document you refer to the bushfires royal commission recommendation to 'replace the fire services levy with a property-based levy and introduce concessions for low-income earners'. I note that you say you are soon going to announce details of the new property-based levy, but can you at least provide the committee and the Victorian community with an assurance that no-one who presently makes a contribution to the fire services levy will have to pay more under the new scheme?

Mr WELLS — Thanks, Martin. We went to the election in 2010 with a commitment to move from an insurance-based fire service levy to a property-based fire service levy. We are working through that process now, and we will be able to release details shortly.

The CHAIR — Did you want to follow that up?

Mr PAKULA — Well, I do. The notion behind this change was that there would be a new cohort of people captured who do not currently pay the fire services levy. I understand that you are telling us that the details will come shortly. But all we want, I think, is an assurance that the hundreds of thousands, or millions, of people who currently pay the levy — not the people who do not pay but the ones who already pay it — will not be paying more when the new scheme is introduced.

Mr WELLS — The issue is that under the old system only those people who paid for insurance on their house or their contents paid a contribution towards the fire services, whether it be —

Mr PAKULA — They are the people I am talking about. They are the ones I am talking about.

Mr WELLS — in the metro for the MFB or for the CFA. We are in the process of designing a system to make it fairer right across the board so all property owners will contribute to the fire services. Once we have finalised those details, then we will release them. I am happy to provide them to public accounts.

Mr PAKULA — Sorry, but does that mean the ones who already pay will not pay any more?

The CHAIR — I think you have had the answer.

Mr WELLS — Once it is finalised I am happy to provide those details to public accounts.

The CHAIR — In effect at this time I will just take that on notice.

Mr WELLS — Yes, sure. Absolutely.

The CHAIR — I am particularly interested in expenditure and expenditure growth, which has been a challenge for the government. I refer you to page 5 of BP 2, and I ask: what is the estimated expenditure growth for 2012–13 and over the forward estimates, and how does that compare with previous forecasts and/or actuals?

Mr WELLS — The government in the 12–13 year will spend $48.2 billion delivering services in key areas such as health, education, transport and public safety. From the period 2000–2010, the blue on this graph shows that expenses grew on average at 7.3 per cent. This is unsustainable, because as soon as a shock comes along, how do you continue to spend at 7.3 per cent? At that point if your revenue is still only growing at 6.9 per cent on average over those 10 years, then a hit with a revenue shock is significant. We have had to make some difficult decisions. I make the point that during the global financial crisis the commonwealth stimulus was worth about $13.2 billion. So when it came to framing a budget the previous government had the benefit of this stimulus package coming in to keep their bottom line afloat. We are doing it without any stimulus package. That is why we have had to drive these further savings.

I might just make this point — and it is very difficult to let this go — the shadow Treasurer made some claims in his budget reply yesterday. It is unfortunate that the shadow Treasurer cannot get his numbers right. We have seen that with his authorisation of the desalination plant and other decisions he has made. But he made this claim, and I think it is important when we look at this graph. When you are the shadow Treasurer you have the responsibility of making sure your numbers are factually correct, especially if you are going to give a budget reply — —

Members interjecting.

Mr WELLS — It is very important that when the shadow Treasurer is making a public comment or reply he needs to be able to get his figures right. This is what he said yesterday in his reply:

> … Victoria's revenue and expenditure growth pretty much —

I am not sure about what economic term 'pretty much' is —

> paralleled each other over Labor's period in office. This can hardly be a revelation to the Treasurer …

Well actually it is a revelation to the Treasurer, because I have actually asked for the figures to be pulled out. If you look at the expenditure in 01–02 — this is nowhere near the global financial crisis, so this is outside the global financial crisis — he is saying that if you take out the commonwealth stimulus, then that would be pretty much on track. If you look at the expenditure for 02–03, the growth in expenditure was 6.8 per cent. The revenue at the same time was 6.1 per cent.

Mr SCOTT — That is one year.

Mr WELLS — All right, let's go to the next year — thanks, Robin. In 03–04 expenditure growth was 7.7 per cent; revenue was only 5.2 per cent. In 04–05 expenditure was 5.9 per cent; revenue growth was 5.1 per cent. Even in 05–06, when the state was gangbusters, expenditure was 7.3 per cent; revenue was 7.2 per cent. Then you start getting into the global financial crisis. The shadow Treasurer made this outrageous claim that 'pretty much' if you took out the commonwealth stimulus, the numbers were pretty close. He is factually incorrect, and he has a responsibility, as shadow Treasurer, to make sure that when he is making public comment he get his facts right.

The CHAIR — Mr Scott, you may now have the opportunity to ask a question.

Mr SCOTT — Treasurer, I refer you to budget paper 3, page 235, note 6 of appendix B. Under 'Other revenue' there is a line item 'Fair value of assets received free of charge or for nominal consideration'. There is a change in the valuation of that particular line item from $1.1 million to — —

It is in budget paper 5.

Mr WELLS — We need to start again, then.

Mr SCOTT — Okay, sorry. Yes, it is budget paper 5.

The CHAIR — You did say budget paper 3.

Mr SCOTT — Sorry.

Mr WELLS — So we will go to budget paper 5.

Mr SCOTT — It is budget paper 5, appendix B, note 6, on page 235. There is a line item there: 'Fair value of assets received free of charge or for nominal consideration'. There is a revaluation from 1.1 million in the actual to March to 129 million to the revised budget. I am just asking, firstly, for an explanation of that revision of that figure of, well, many tens of thousands of per cent — I mean hundreds of thousands of per cent.

Mr WELLS — If you do not mind, I will refer to the secretary to explain the nine month period.

Mr HEHIR — I am confused about which numbers you are comparing it to.

Mr SCOTT — I am comparing the figure 1.1 and how it increases to 129.

The CHAIR — March with the revised budget.

Mr HEHIR — One point one is the actual to March for that line. What we were expecting to happen was 129.

Mr SCOTT — What is that, in a sense?

Mr HEHIR — I will have to find out what it actually is. I am not even certain whether it has been revised very much.

Mr WELLS — Can we take that on notice?

Mr HEHIR — Can we take that on notice and get back to you?

Mr SCOTT — When you are taking it on notice, just to clarify: my understanding is that that increase is over the actual amount for the surplus, so I would be very keen to understand exactly what it is.

Mr WELLS — I am happy to take it on notice.

Mr MORRIS — Can I refer you to budget paper 2 and the tables relating to the application of cash resources, particularly for the general government sector and the non-financial public sector, pages 48 and 58. I ask: how much of the capital spend for this year is funded from debt and how do you see that changing over the forward estimates?

Mr WELLS — Can I bring up that slide in regard to the funding of infrastructure? This graph shows one of the reasons why we are needing to try for larger surpluses. In the past there has been a tendency to be able to fund infrastructure through debt, and we believe that is not the right way or the responsible way to deal with infrastructure spend over a longer period of time. As I mentioned with the surplus of $155 million, being able to build up to $2.5 billion means that we are able to use our own money, our own cash resources, to be able to pay for infrastructure. In answer to the question: in the 11–12 year, 77 per cent of net infrastructure will be funded from net debt, and that will continue a large capital program, as you can see. But we have implemented, as I said, with the savings, and we believe that by being able to better manage the debt, and consistent with AAA credit rating, there will be less reliance on debt.

Net operating surpluses from transaction will increase the $2.5 billion. All that cash generated by the surpluses will go towards infrastructure, so by 15–16 the capital infrastructure program will be fully funded from the surplus. There will not be a need for the reliance on debt.

Mr PAKULA — What capital infrastructure program?

Mr WELLS — The infrastructure program is significant for us, and what it means is that over the longer period we have said in the budget papers that we have a target of 1.3 per cent of GSP to be spent on infrastructure, which is important, so as the economy grows infrastructure grows in line with that. At this stage we are looking at a 1.4 per cent spend, which is slightly above the target that we have set for ourselves. We think it is the right thing to do: to be able to build this infrastructure, live within our means and to be able to protect the AAA credit rating.

Ms HENNESSY — Treasurer, if I could just take you to budget paper 5, pages 164 to 172. Effectively that takes in the various references to fees and fines paid by Victorian people. As the Treasurer would be aware, there is a process of annual automatic indexation, which you personally approve. One commentator has described automatic indexation as an unjust burden that will hit all Victorians and said that there is no justification for these outrageous increases when Victorian families are battling to make ends meet.

Given that automatic indexation will flow from 1 July 2012, as indeed it did last year with the Treasurer's personal approval, can you explain to the committee why you think that commentator is wrong?

Mr WELLS — Thanks, Jill. The situation is that we live in tough and difficult financial times. There is no question about that.

Mr PAKULA — And the GFC was not?

Mr WELLS — And we believe that we have a situation where we needed to live within our means. As we have said all the way along, there have been significant savings decisions but there have also been targeted revenue decisions that we have also had to take. In addition to that, we have a wages policy of 2.5 per cent plus productivity offset. So the indexation is important to maintain pace with expenditure and revenue. If we had a wages policy of zero, then you could look at indexation in another context. The reality is that we have a wages policy of 2.5 per cent, so you need to be able to grow and continue to grow your revenue in line pretty much in part with that wages policy. That money is needed to protect the revenue base and, as I said, it is about living within our means, it is about building up surpluses and protecting the revenue base, so the indexation as of 1 July will be 2.5 per cent.

Ms HENNESSY — I do have a follow-up. Treasurer, the person who said that there is no justification for these outrageous increases when Victorian families are battling to make ends meet was in fact you. Why the backflip? In fact when you made the comments in 2008 it was in the context of the GFC. Times have changed, it seems, Treasurer.

Mr WELLS — As I said, we are in a very difficult financial situation.

Mr PAKULA — The GFC was not?

Mr WELLS — Let me make that point: when the GFC hit, the commonwealth government pumped $13.2 billion into Victoria for stimulus payments. The federal government pumped $13.2 billion into the Victorian economy. We are going through what are now more difficult financial times from the Victorian state point of view. We have to live within our means, and that involves having savings programs and targeted revenue decisions that we have had to make. We have said this is not easy. At the end of the day we are in a situation where we will live within our means and build up those surpluses to be able to pay for front-line services and infrastructure spend.

Mr O'BRIEN — Sounds like responsible financial management.

Ms HENNESSY — Treasurer, you have changed.

Mr ANGUS — Treasurer, I just want to follow up on Mr Morris's question regarding state capital matters. I refer you to budget paper 4, page 5. Can you please advise the committee how much is the state capital spending in 2012–13 and over the forward estimates period?

Mr WELLS — Thank you. The capital expenditure for the non-financial public sector in 2012–13 is expected to be $7.9 billion, with an average spend over the forward estimates period of $6.5 billion. We believe that is significant. For the general government sector, the net investment in fixed assets in 12–13, as I mentioned earlier, will be $5.8 billion, and that is taking out the commonwealth stimulus package amount. From a state-funded point of view, that is a record infrastructure spend. The average over the forward estimates at this point will be $4.3 billion.

The total value of Victorian public sector capital projects under way in 12–13 is about $41 billion. That is including projects from the general government sector and the public non-financial corporations. It includes such projects as the Webb Dock development. We think that is a significant investment; it will maintain our position as the no. 1 port in the country. Five hundred million dollars will be funded from the port of Melbourne and then the private sector will come in, and when we have the port and the boxes coming in growing at such a significant rate, it is absolutely crucial that the port is expanded.

Along with that we need to be able to get the traffic moving out of the port. That is why we are moving somewhat in regard to projects such as the east-west link — —

Ms HENNESSY — Somewhat!

Mr WELLS — Somewhat — —

Mr PAKULA — Fifteen metres of it.

Ms HENNESSY — Fifteen metres is what your budget allocation will buy.

Mr PAKULA — Fifteen metres of it — here to the window!

The CHAIR — Treasurer, would you like to complete your answer?

Mr WELLS — I actually think it is significant that we start the first step of the east-west connection. I think the east-west link is absolutely crucial — —

Mr O'BRIEN — We do the feasibility before we announce projects, unlike what you did. The north–south pipeline, no feasibility. Look what happened there.

Ms HENNESSY — David, go back to the Premier's media unit.

The CHAIR — Thank you very much for your assistance, colleagues. May I ask the Treasurer to complete his answer.

Mr WELLS — I think that this government has already built up a reputation of making sure that any project that we put money towards is spent wisely, within community expectations and to ensure that we get value for taxpayers money — —

Mr PAKULA — You have not done anything. That is your reputation.

Mr WELLS — I know that the opposition snigger about the $15 million business case that we are putting forward for the east-west link, but that is how we will go about doing business to ensure that we get the numbers right. We do not go out and build infrastructure projects and wait for large cost blow-outs or time overruns. Look at myki, where they spent significant amounts of money and they still did not get it right. It took this government to come in and to re-scope it to get it up and going. It has taken this government to untangle the embarrassing mess when it came to the Melbourne Markets. They were going to move the markets from Footscray out to Epping and they did not have one person signed up, so there was no guaranteed revenue stream for the Epping market and it was already $200 million over budget.

It was this government that got the regional rail project under way. The previous government, when it was doing its work in regard to regional rail, forgot to put in the cost of the signals and it forgot to put in rolling stock. So they were going to build a brand-new railway line coming in from Ballarat, Bendigo and Geelong, but have no new trains running on it. That is the way they did business.

This government, for the east–west link, will start with a business case. That business case will be finished, hopefully and we believe, by early 2013. That will be significant, because part of that business case will look at the funding options. We are calling on Julia Gillard not to be held captive by the Greens. This is an important project and we want the commonwealth to pay their fair share. We do not want Adam Bandt from the Greens out there telling Julia Gillard, 'Do not put any money into this project'. This is a time when she needs to stand up and bat for Victoria and fund this very important project.

Mr PAKULA — So it is all down to the commonwealth?

The CHAIR — Deputy, you may now ask a question if you choose.

Mr PAKULA — Thank you, I will, Chair. Treasurer, I ask you to turn to budget paper 2, and on page 14 of that there is a table. The table has got the projection for jobs growth for the current financial year of 0.00 per cent. I am just wondering if you can tell the committee with any certainty, given that we have only got about seven weeks left of the financial year, whether that projection will be met?

Mr WELLS — Thanks, Martin. The issue is the last 12 months has seen the eurozone go into a very difficult situation and a sluggish American economy, and that has filtered through to the Australian and the

Victorian economies. That has meant that there have been job losses across the entire world in regard to the uncertainty and the shrinkage of demand. We have also faced in this country, apart from the weakening economy, a high Australian dollar, which is putting significant pressure on our industries in manufacturing, in education and in tourism, and that has impacted and impacted very hard on us.

What is the government doing in regard to ensuring that we are able to assist with job creation? It is about making sure that we live within our means — being able to provide those surpluses to be able to fund front-line services and productivity-enhancing infrastructure to be able to create those jobs. So you could have a situation of when we are building — —

Mr PAKULA — I am just asking if the projection is going to be met.

Mr WELLS — We are talking about jobs.

Mr PAKULA — No, that is not the case. My question was: are you going to meet the zero projection — —

The CHAIR — Deputy, the Treasurer is answering the question in his own manner; he knows what he is doing — —

Mr PAKULA — On a point of order, Chair, surely a question that might touch on jobs is not an invitation to the Treasurer to simply talk about anything he wants, so long as it touches on jobs. It was a very specific question about whether a particular projection was going to be met; it was not an invitation to just wax lyrical about the government's projects.

The CHAIR — The point of order that has been proposed by the member, in my view, is inappropriate on the basis that the member has asked a question specifically about the realisation of forecast estimates in the budget papers. The Treasurer is invited to comment on that; that is what he is doing. It may be that you are not satisfied with his answer to this point, but if you allow him to finish, you may be satisfied by the conclusion of his answer.

Mr PAKULA — Not 'will be', 'may be'.

Ms HENNESSY — We live in hope.

Mr WELLS — As I said, what are we doing? It is about generating those surpluses, and it is about being able to pay the money for those front-line services and build the infrastructure. That is absolutely crucial from a productivity point of view and to be able to have that longer term plan. It is not just about building a hospital or building schools or building roads because that is creating construction jobs; it is also that when you are building a hospital, you are employing more nurses, more teachers in schools, more police stations, more police. It is those sorts of very important policy decisions that we are taking.

We do not say that the current financial situation is easy; it is not. If you look at this chart, with the employment, the 11–12, from the budget update, it was at 0.75. It has been written down; the forecast is zero.

Mr PAKULA — That is my question: are you going to hit that?

Mr WELLS — The forecast for 12–13 — 1.5. It has been written down to 0.25 — —

Ms HENNESSY — Are you going to reach zero?

Mr WELLS — In 13–14 it was 1.5, but there is a bounce, Chair, to 2 per cent, and then it flattens out at 1.75 per cent. We believe we are doing everything within the state's power to be able to create jobs, and we are getting on with it.

Mr PAKULA — Treasurer, I note you have not indicated whether this 0.00 will or will not be hit, but let us go to 0.25 for 12–13. Can you just tell me how many actual jobs 0.25 per cent growth represents?

Mr WELLS — Seven thousand.

The CHAIR — On that note, it is a good time to have a short break. We will resume in 5 minutes. We will resume now, and I invite Mr O'Brien to direct a question to the Treasurer.

Mr O'BRIEN — Thank you, Chair, and thank you, Treasurer. I refer you again to budget paper 2, chapters 1 and 4, and ask: Treasurer, why is the government's commitment to an annual operating surplus so important, and what does this mean for Victorian taxpayers?

Mr PAKULA — It is a hard-hitting question.

Ms HENNESSY — It is a slide.

Mr ANGUS — A very good question.

Mr WELLS — We have said that building up a surplus is very important. It is about living within our means and it is being able to deliver those surpluses across the forward estimates to be able to protect us from future revenue shocks. It is about delivering front-line services. It is about building infrastructure. We notice with great interest that the independent review of state finances headed up by Mike Vertigan — —

Mr PAKULA — The one you will not release; that is the one you will not release.

The CHAIR — Let the Treasurer answer.

Mr WELLS — And Don Challen and Ian Harper. They have released their interim report, and they pointed out very clearly that the budget was not in a sustainable state, and that is just crucial. As I have mentioned with the slides, if you have a situation where the expenditure is growing on average at 7.3 per cent and your revenue is growing at 6.9 per cent, it is not sustainable. As I mentioned with the chart, from 2000 across that 10-year period you are looking at an unsustainable situation, so you do not just blame the global financial crisis part of it; you look at all of the figures right across the 10 years, and that is significant.

The budget position has gradually declined, and since 2008–09 the operating surplus has averaged less than $500 million. The 12–13 budget, as I mentioned, builds up that surplus starting at $155 million. We had the option of running a deficit, but we do not believe that is a responsible measure of a Baillieu government, and that is why we had to take the course of action to deliver more efficiencies.

What does it mean, the action that we have taken in regards to building up those surpluses? It means that we can preserve the AAA credit rating, and that is essential, especially when you have, as an example, large mining companies and a couple of the banks, and when you have BHP, Rio, Newcrest and the ANZ and NAB which have their head offices here in Melbourne. They are wanting to deal with AAA-status governments. Being in England just recently, when you talk to the investment houses they are looking at projects around the world to invest, but they are saying very clearly that they will invest where it is AAA, so it is significant.

We are able to approve new infrastructure projects — as we said, $5.8 billion, but $2.7 billion of new projects will start in 12–13. It is being able to increase funding for our hospital system. It is being able to support that package of $366 million for vulnerable children and families in crisis. It is being able to put that $1 billion into the VET system. It is being able to get rid of those railway crossings. It is being able to build that new prison.

You could not have a situation where you have the justice system and have the prison system so overcrowded. It had to be dealt with. It is also about delivering on the 1700 new police; it is about the 940 PSOs — which is important, and I understand that both sides of the chamber support that. And it is about the $58 million for the manufacturing strategy, and that is good. As we said, the manufacturing strategy is important. About 10 per cent of economic activity in the state is reliant on manufacturing. They are doing it hard with the high Australian dollar, with the carbon tax coming on and with the increase in power prices. We need to be able to connect the manufacturers here with the Asian market. It is about ensuring that they are connected into government programs. It is being able to assist them with that leap-ahead technology, so they are absolutely important.

As I said, there is that medium-term strategy across the forward estimates. It is about that infrastructure spend, that target of 1.3 per cent of GSP; it is about eliminating the unfunded superannuation liability by 2035; and it is being able to have that operating surplus of at least $100 million, which was an election commitment when we came to government. So it is those reasons why it is very important to maintain an operating surplus.

The CHAIR — Thank you, Treasurer.

Mr SCOTT — Treasurer, I would like to take you to budget paper 4, pages 3 and 4, which list the total list of approved high-value and high-risk projects, and in planning and development. Given that the state government started committing funding to the port of Hastings project in the last budget, why is this $10 billion-plus project not on the list?

Mr WELLS — The port of Hastings will come on to the high-value, high-risk unit list. At the moment they have received $4 million in this budget. They received funding last year, and that is for planning and development. And the next phase, when we start to — —

Mr SCOTT — But when?

Mr WELLS — Well, the next phase when we — —

Mr PAKULA — But a lot of these are on planning and development as well.

Ms HENNESSY — That is right.

Mr PAKULA — And they are on the list.

Ms HENNESSY — Evidence has been given to this committee that the prison went there before it was funded.

The CHAIR — Allow the Treasurer to complete the answer.

Mr WELLS — I am just giving the assurance that the $4 million that we have put in this budget for the port of Hastings is for planning and for development, but I can assure the committee that the port of Hastings will come into the high-value, high-risk unit.

Mr SCOTT — When?

Mr WELLS — Well, very shortly. We need to get the planning and the development of the money into that system. It is about employing the right personnel down there, and then the next stage will be that it will come into high-value, high-risk, but I can assure the committee that the project — as we said, any project more than $100 million or the IT projects that are normally of high risk — will be dealt with by the high-value, high-risk unit.

Members interjecting.

The CHAIR — The Treasurer has concluded his answer. Mr Pakula will have to wait. Treasurer, I refer you to BP 2, page 4, chart 1.1, the net debt chart, and I ask: what would the net debt and operating balance positions have been across the forward estimates if the government had not taken significant corrective action by way of measures detailed in the 2011–12 budget, the 2011–12 budget update and now of course the budget that we have before us in 2012–13?

Mr WELLS — If I could I bring up that slide. Chair, the problem we had coming into government and dealing with the finances, as we said, was that 7.3 per cent average of expenditure and the 6.9 per cent revenue growth was unsustainable. That was obviously confirmed by Treasury and then confirmed independently by the Vertigan report. So had the government not taken corrective action and spending continued — —

Members interjected.

The CHAIR — Colleagues, I have asked a question. I am interested in the Treasurer's answer. If you are not interested in the answer, you can at least allow the Treasurer to complete his answer.

Mr WELLS — Let me repeat: the issue that we were faced with is that expenditure was growing at 7.3 per cent on average over the past 10 years. Revenue at that same time was only growing at 6.9 per cent. It was an unsustainable situation. That was confirmed by Treasury and it was confirmed independently by the Vertigan report.

Mr PAKULA — That you won't release.

Mr WELLS — Had we not taken corrective action; had we not put in those revenue measures; had we not put in the savings and efficiency targets then what would have happened is that the deficit for the 12–13 year would have been $4 billion. Can you imagine — —

Mr PAKULA — In your made-up numbers.

Mr WELLS — Can you imagine that the state was faced, in difficult financial times, with a $4 billion deficit?

Mr PAKULA — But it wasn't.

Mr WELLS — We had a situation of $5.8 billion in 13–14 — it would have increased to 5.8 — almost $8 billion in 14–15, and the deficit would have grown to $10 billion in 15–16. So why that changed was the election of the Baillieu government in December 2010 to take the necessary course to change direction.

If I could turn to net debt, Chair. Net debt would have risen to almost — —

Mr SCOTT — Point of order, Chair.

The CHAIR — Sorry, Treasurer.

Mr SCOTT — I enjoy political rhetoric as much as the next person, but the answers to this question have to be factual, and to claim the revenue and savings initiatives for 2015–16, for example, are just over $2.6 billion, to claim that if they were not taken, there would have been a deficit — what was the figure, $10 billion, that you just spouted? It is clearly — —

The CHAIR — Can I interrupt you, Mr Scott? Sorry to do this to you, but with the greatest respect, a point of order is not a place to have a debate about the detail of numbers. The procedure in this place is that questions are put, witnesses answer the questions to the best of their knowledge and ability and you are either satisfied with the answer or not. But in this case the minister, the Treasurer, is entitled to put his answer to the question. A point of order is inappropriate if it is that you want to make a political point.

Mr SCOTT — I am not making a political point.

The CHAIR — Thank you. There is no point of order. Treasurer, resume your answer.

Mr WELLS — Thank you, Chair. It is important to reinforce that point that with the change of government we saw the corrective action in regards to ensuring and balancing the books and being able to generate a surplus. Had we not taken this corrective action then the figure for the deficit, if the figures had continued to grow — that is, expenditure of 7.3 per cent — —

Mr SCOTT — Just not budgeted.

Mr WELLS — And revenue declining.

Mr SCOTT — Which was not the estimates budget.

Ms HENNESSY — It is rubbish.

Mr WELLS — I am referring to graphs in budget paper 2 — —

Mr SCOTT — You are misleading the committee.

Mr WELLS — And charts 1.1, table 1.1 and chart 1.2 — —

Mr SCOTT — Rubbish in, rubbish out; that is your analysis.

Mr ANGUS — Just listen and you might learn something.

The CHAIR — Mr Scott, thank you.

Ms HENNESSY — It is a nice fairytale.

The CHAIR — I am starting to become incredibly aggravated by the interruptions that are completely unnecessary. We treat all our witnesses with courtesy here, and if you do not like it, there is a way that can be dealt with and you can take it outside to another chamber. This committee is not the place to be discourteous to witnesses. Treasurer, would you please proceed.

Mr WELLS — Thank you, Chair. I am just referring to budget paper 2, pages 4 and 5 where you have chart 1.1, table 1.1 and chart 1.2. These are the tables of Treasury and Finance that make up part of the budget papers. What we are saying, and these charts show very clearly, is that had expenditure continued at 7.3 per cent and revenue declining, the situation would have been that the deficit would have been $4 billion in 2012–13, $5.8 billion in 13–14, $8 billion in 2014–15 and growing to a deficit of $10 billion in 2015–16. The point is: had the corrective action not been taken in last year's budget, in the budget update and this budget those deficits would have been reached — —

Mr PAKULA — We never had a deficit in 11 years, and you are trying to convince people that it would have grown to 10 — —

The CHAIR — Thank you for your interruption, Deputy. I think the Treasurer is concluding his answer.

Mr WELLS — I was only just warming up.

The CHAIR — Indeed. Please conclude your answer then.

Mr WELLS — Okay. Just to reinforce that point. You have those deficits building up based on the expenditure that was being forecast at 7.3 per cent and have been on average over that decade, and then you put that against the declining revenues that we have had over time. In regard to net debt, the net debt would have risen to about $60 billion or 15 per cent of GSP. Maybe I could ask — —

Mr PAKULA — Doubled it in two years.

Mr ANGUS — Just listen to something.

The CHAIR — Thank you for your assistance, Deputy.

Mr WELLS — If I could ask the secretary to comment further on the debt.

The CHAIR — Thank you. Mr Hehir?

Mr HEHIR — I just wanted to make a few comments about the debt strategy of the government with respect to debt-related issues. There are a number of fiscal targets which the government has announced in this budget which are around how you develop a sustainable fiscal position. When you are starting to look at your cash flow and balance sheet and how you get that into a sustainable position, the first thing you need to develop as a parameter is what level of infrastructure you need to fund to keep your service delivery capacity of the state going along. This has been a relatively longstanding component of budget process development, and it was articulated in the *Independent Review of State Finances Interim Report*. That determines the level of infrastructure you need as a starting position for developing your financial strategy. The independent review came up with a number for net infrastructure spend of about 0.5 per cent of GSP which is essential for the maintenance of your infrastructure and to grow it with population, et cetera.

What the government has done in its target is to transfer that to more the common definition of infrastructure, which is gross that has been utilised by the state for about the last 10 years, and when you do that calculation you get to about 1.3 per cent of GSP as being the financial target if you want to keep investing in your infrastructure to meet its capacity.

If you start from there and then think about what you need to do in your financial statements to meet a particular debt target, it becomes a relatively simple mathematical equation, because to fund that, you can only fund it through cash generated through your operating statement or from increasing debt. It is quite simple from that perspective. If you want to have debt stay flat in nominal terms — that is, add no additional borrowings to government expenditure — all you can do is fund your capital expenditure from the cash from your operating statement, which is your operating surplus plus the non-cash components of that operating surplus, which is largely depreciation. So that is what you see.

The government's strategy is to stabilise debt and reduce it through time. You see a situation where the funding of the capital program starts to be funded more and more from the cash generated from the operating surplus. In terms of the dollars we have in the budget at the moment, to stop net debt from growing — in nominal terms, not against GSP — and you set an infrastructure GSP target, you end up with, say, $4.5 billion a year and you have $2 billion of depreciation. It means you need to get an operating surplus of $2.5 billion just to stabilise that. Anything below that, and you see nominal debt rising. You see that through the numbers that we have put forward in the financial statements.

The elements of a strategy around managing debt need to have a clear understanding of what your infrastructure need is going forward and what your debt targets are, and then your operating surplus sort of flows straight from that. That is sort of the framework on which the government has approached the debt issue and is building up a strategy to deal with it.

Mr WELLS — Just to conclude, with this and with the deficits being at $4 billion had we not taken corrective action, building up to $10 billion by 15–16, it is based on the 7.3 per cent expenditure and the current revenue growth forecast we are facing at the moment.

Ms HENNESSY — Treasurer, obviously the coalition had an election commitment to provide $165 million for the Royal Victorian Eye and Ear Hospital. There was nothing in last year's budget. Last year at PAEC the evidence you gave was, and I am quoting you here:

> … in 12–13 that funding will come out of the unallocated capital which we have put aside.

Could you direct us to where in the budget papers the $165 million is for the eye and ear hospital this year?

Mr WELLS — As I said, we are facing difficult times, but we are absolutely committed to all of those election promises — —

Mr PAKULA — You made a promise here, 12 months ago.

Ms HENNESSY — You gave evidence that it would be in this — —

The CHAIR — Ms Hennessy, you have put your question. Just allow the Treasurer to complete the answer.

Mr WELLS — We have made a number of commitments in regard to health. We have looked at funding the Bendigo hospital, we have already announced the cancer centre, which is starting to continue, we have made commitments to Sunshine Hospital and we have made commitments to building the Monash Children's hospital and upgrades to the eye and ear hospital. They are election commitments, and they will be delivered on. The funding in part for the eye and ear hospital remains in unallocated capital.

Ms HENNESSY — Treasurer, given that you told us last year that you would give $165 million for the eye and ear hospital this year, why should we believe the evidence that you are giving this year when the evidence that you gave last year was wrong?

Mr WELLS — As I said, we have election commitments in regard to health. The eye and ear hospital is an important election commitment, and we will deliver on that very important commitment.

Ms HENNESSY — But you told us that last year, and you did not deliver — 165 million.

Mr MORRIS — Treasurer, you touched on the issue of the AAA rating earlier in evidence, but can you indicate to the committee why it is important for the future financial sustainability of the state that we maintain the AAA rating?

Mr WELLS — We are very strong on the issue of protecting and maintaining our AAA credit rating. We do not have the natural wealth that WA and Queensland have in minerals, so we have to rely on what we do best. It is the issue of being able to provide high productivity. It is about generating jobs and making sure that the infrastructure spend on those front-line services is well targeted.

I mentioned earlier that AAA is also very important when you are attracting and maintaining large head offices in Victoria. When you look at the mining states, we have BHP, we have Rio Tinto and we have Newcrest with their head offices here in Melbourne. They want to be dealing with a government that has a AAA credit rating. When the mining states do well, Victoria does well as a result of the mining states.

Mr PAKULA — Tell that to manufacturing!

Mr WELLS — As I said earlier, manufacturing accounts for about 10 per cent of economic activity. Professional services have actually overtaken manufacturing. It is the superannuation, it is the insurance, it is the legal, it is the accounting and the actuary — it is those sorts of services. And in part it is driven by the huge demand by those large mining companies and the large banks having their head offices here in Melbourne. I am sure that many people in Victoria would think that manufacturing is still the no. 1 driver, and we are, as I said, committed to the $58 million to be able to assist and improve manufacturing in this state. They have difficulties. But in the meantime there is a structural shift to the high-end professional services, which is significant. When you have the mining states doing well, Victoria does well.

When you look at investment in Victoria and you are looking at those investment companies, whether they be in the US or in Europe, they would be hesitant to deal with a government, where they are building a project, that does not have AAA. The other important point is that when we have AAA it means not only that there is strength and confidence within business, but it also allows a lower borrowing cost. That is why we have worked very hard to keep this budget in surplus while being able to have a situation where the debt is peaking at 6.5 per cent, moving down to 6.3 per cent and 6 per cent of GSP. I think the credit ratings look at those numbers and know that we are financially responsible and building up that surplus so we are able to fund infrastructure over the forward estimates period. We believe that, had we lost the AAA credit rating, additional interest costs would have been approximately $225 million by the end of the forward estimates period; $225 million which we can now spend on health, education or community safety. It is significant.

Mr PAKULA — Treasurer, I want to refer to your budget speech. On page 3 of the speech— and I know you will know what you said — you talked about further targeted departmental efficiencies. That is on top of the 3600 job losses that were announced last year. You say these savings will lead to a further reduction in staff numbers by around 600. You go on to say the government will continue to protect front-line service delivery. Yesterday in his budget reply speech the shadow treasurer made reference to the solemn pledges that you made about there being no public sector job losses, but let us take the fact that there are public sector job losses as a given. The 600 extra jobs that you announced on Tuesday will go. Can you at least give the public sector an assurance that there will be no forced redundancies in that number?

Mr WELLS — We need to live within our means.

Mr PAKULA — Yes, you have said that.

Mr WELLS — We need to live within our means.

Ms HENNESSY — You made a series of promises.

Mr WELLS — We have said all the way along that one of the priorities of the government is the need to run surpluses. We need to be able to build up those surpluses to be able to fund infrastructure and front-line services without going further into debt. At budget update time we announced there would be 3600 voluntary redundancies offered across the public service, and one of the reasons we had to get to that situation is that there was a period in the previous government — —

Ms HENNESSY — Come on, you made choices. At least take responsibility for them.

The CHAIR — Ms Hennessy, I have told you before that you do try my patience.

Mr WELLS — Your mentor!

Ms HENNESSY — I will leave that alone!

Mr WELLS — Regarding the 3600 we have said that one of the reasons we had to take that decision is because during the term of the previous government we had a population growth of 2 per cent per annum, and there was a period in which the public service grew at 5.3 per cent. Something does not gel. If you are looking at the VPS, and the population is growing at 2 per cent and the VPS is growing at 5.3 per cent, you can see that is unsustainable. It had to be addressed, so we made the decision at budget update time that that number in the VPS needed to be reduced to about 2008 levels. It needed to be brought from 2012 back to 2008. When we started working on this current budget, the 12–13 year, having made the decision: do you go into deficit or do you stay in surplus, and living within our means we realised we had to go further for greater efficiencies and savings. So there will be around about another 600 reductions, and I am very confident that they will be achieved through voluntary redundancies. I will now hand over to the secretary. He is actually on the committee of the Better Services Implementation Taskforce, and he can explain how this will be implemented.

Mr HEHIR — One of the things that the government has identified in asking the public service to drive more efficiencies is that there is a lot we can learn from how other jurisdictions have gone about this. Over the last four or five years many countries in the world have confronted the types of challenges that this country is facing at the moment in respect of fiscal challenges, and probably to a much greater degree. They have gone through restructuring processes which have been quite significant. When implementing the staffing reductions, in order to make sure the opportunity is taken not just to salami-slice across the public service but to implement a program which drives efficiency, the government set up the Better Services Implementation Taskforce, which is chaired by the Secretary of the Department of Premier and Cabinet, Helen Silver. I am also on the task force. Other members include the New Zealand state services commissioner, who brings public sector experience; a former senior commonwealth public servant, Jeff Whalan; the former vice-chancellor of Deakin University, Sally Walker; and the CEO and managing director of GrainCorp, Alison Watkins, who is also a director of the ANZ bank.

The concept is to get this task force to sit across the reform processes that are happening across government so that as staffing reductions are implemented, not only can we protect front-line services but we can implement reform across a range of areas to enhance their delivery. Some of the lessons we are learning from around the world in terms of public sector delivery are around the success of devolved versus centralised approaches to policy rollout. A lot of work has gone on in the UK in particular, but also in New Zealand, which has led to the conclusion that you can actually get better service delivery outcomes if you put accountability and frameworks in place which give a lot more authority on the ground to schools and hospitals et cetera. You get your central public service to ration down to focus on the accountability side of service delivery and not so much on oversight and telling people what to do, which will leave a lot more control in that process.

What we are trying to do by sitting over that is help departments or oversee them in the implementation of those types of programs and also provide advice to departments about how they can rationalise a number of entities et cetera and fix up all of that. By putting that type of framework in place, then you can roll on to implement the savings in such a manner where you can protect the front-line service and do it in a planned and systematic way driving forward so that as we do the implementation of it we can effectively target the reforms so it protects service delivery but enhances it going forward.

The CHAIR — Mr Pakula, do you have a supplementary or follow-up question?

Mr PAKULA — I do have a follow-up. That is great, Mr Hehir. But the question, Treasurer, was to you about getting an undertaking that there would not be forced redundancies. I find it very difficult to accept that you cannot give the committee a categorical undertaking about no forced redundancies, given that we found out today that you are going to put 50 more staff on in the State Revenue Office to gouge more tax out of Victorian businesses and taxpayers. If you can grow the State Revenue Office, you can give a guarantee about no forced redundancies.

Ms HENNESSY — That is right — while you sack 4200 people.

The CHAIR — Ms Hennessy, Mr Pakula, the deputy, has just directed a fairly vigorous question to the Treasurer, and the — —

Mr PAKULA — I just want an answer to the first question I asked.

The CHAIR — If you stop interrupting, I will invite the Treasurer to respond.

Mr WELLS — Let me take the first part of the follow-up question. I maintain, and we may have a difference of opinion, that if there is a tax liability for people in this state, people should pay that tax. I think that is the responsible thing to do.

Mr PAKULA — The extra hundred million bucks in fines you have just put on?

Mr ANGUS — It is voluntary.

Ms HENNESSY — It is voluntary? A fine is voluntary now? Wow!

Mr WELLS — We may have a difference of opinion between the government and the opposition, but we believe that if there is a tax liability, whether it be payroll tax or stamp duty or land tax, then a Victorian has the responsibility to pay that. We made a decision in last year's budget to ensure that the compliance unit in SRO was sufficient to ensure that the tax that was liable comes in. We do not expect people to pay tax that they should not be paying, and significant numbers of people have written to the SRO and said, 'Look, I don't think I should be paying', and the commissioner has agreed or adjudicated one way or the other. But at the end of the day it is about protecting the revenue base and being responsible and fair.

In regard to the 600, my view, and the advice that I have received, is that we are confident that the 600 will be achieved on a voluntary basis.

Mr PAKULA — If they are not?

Mr WELLS — If the 600 are not achieved on a voluntary basis, then there is limited — I want to stress to the committee that in limited cases, in those few cases, the department can make application to me for a targeted separation package. But I say that as a last resort — and this will be a last resort — and based on information that we have received, we are very confident that the voluntary redundancy packages will be taken up by that 600.

Members interjecting.

Mr ANGUS — I refer you to budget information paper 3, page 1. Can you advise the committee what is the impact on the state budget in 2012–13 and over the forward estimates of federal-state financial policies in relation to GST distribution and national partnerships?

Mr WELLS — We have said that it is very important that Victoria receives its fair share of GST. We believe that if you are 25 per cent of the population, you should receive 25 per cent of the GST, so it is a dollar-for-dollar basis, and that is important. For every dollar that a Victorian pays in GST, last year we were receiving 94 cents, and that was cut back to 90 cents. That one decision cost the state over the forward estimates last year $2.5 billion. When you are trying to frame a budget, that is significant, and then we had the shrinkage of the pool of another $1.6 billion. That is difficult, and it is very hard to manage.

As I mentioned earlier, we wrote to the Gillard government asking them to review the current arrangements on GST. For example, in the case of Victoria, we have high congestion because we have higher urban living. If you take WA where there is a large amount of remoteness, they receive a reward payment as part of the factor for remoteness, but there is not one for Victoria when it comes to high congestion. The second point is that you have high wage growth in some states. They are actually rewarded in the GST payments for a higher wage growth. In Victoria, if we are able to control and be responsible in regard to wage growth, we are actually penalised because we do not receive that increase in regard to reward payments. That is disappointing. But, as I said, we have written, they have accepted and set up the committee.

What is disappointing is that whilst we agreed with the committee being set up and getting on with their work — and the Premier and I met with the committee and had a very good, well-informed discussion with the committee — there were supplementary terms of reference that were put to the committee which we were not informed or consulted about, which is grossly unfair, because we were working with the commonwealth in good faith to be able to get a good outcome. The supplementary terms of reference meant, in part, effects on the mining boom, but secondly tying some of the GST money coming to Victoria. In the past that GST money has come to Victoria, and we have been able to deal with it in the priorities that we have set, not being forced by the federal government and what they want us to do.

So you have the ridiculous situation that if our priority is health, for example, and they have a different priority and they say, 'Well, we want you to focus and we are going to hold back your GST money whilst you focus on our priority', we just think that that is wrong. We have complained directly to the Treasurer that that is unfair, and that there should be no justification for tying the GST grants. There are other programs that they can tie grants to, and they might choose particular roads or hospitals, and that is their right, and we work with them whether it be on a 50-50 basis or some other formula. The amount of money, had we received it, if it were on a dollar-for-dollar basis, would have been an additional $900 million per year, and you can imagine what we would have been able to do with $900 million with our fairer share of the GST.

In regard to the national partnership agreements, I support the federal Treasurer in pushing for a surplus. I think it is very important that Wayne Swan, the federal Treasurer, brings down a surplus next week. What we are concerned about is whether they will start cutting some of the national partnership programs for Victoria. I draw your attention to page 12 of the document, budget information paper 3, which you referred to in your question, and we have in table 1 'Expiring national partnerships that should be rolled into a national specific purpose payment'. You have a number of national partnerships that we rely on. If you look at 'Homelessness', if you look at 'Hospital and health workforce reform', 'Activity-based funding', 'Subacute care', 'Taking the pressure off public hospitals', 'Improving teacher quality', 'Literacy and numeracy' and 'Low SES school communities', those national partnerships are important. It is important that we receive that federal money coming into the state.

If the commonwealth government, with its push for a surplus, which we support, starts cutting and hacking into national partnerships, it makes it very difficult for Victoria to pick up that share of the cut from the federal government into those very, very important programs. It would be very difficult for us to be able to pay for the commonwealth shortfall in those programs. If you look at those programs on page 12, every single one of them is very important to the fabric of our society.

Mr SCOTT — Treasurer, I take you to budget paper 2 and the appendix A that starts on page 65. I ask you to explain to the committee the impact on the 2011–12 budget bottom line and the 2012–13 budget bottom line of the decision by the Reserve Bank of Australia on Tuesday to lower the official cash rate by 50 basis points. I note that on page 67 there is some commentary in the notes, but could you translate this into actual dollars, because it has happened?

Mr WELLS — I will give an opening comment and then switch to the secretary to explain. With the sensitivity tables that we have used, obviously, in opposition, and that governments use, if there is a change in a particular part, whether it be employment, CPI or average weekly earnings, the sensitivity table enables you then to work out what changes, whether it be up or down, over the forward estimates period. That is an important table that we use. I notice 'Overseas share prices' and '*Property volumes'. Obviously property volumes and property prices impact on our stamp duty. So by looking at the sensitivity tables, we are able to find out, if it is a 1 per cent movement one way or the other, that it will have an impact on the state budget. In regard to the interest rates and income from transactions, my understanding is that if it is a 1 per cent increase, income from transactions would increase by $60 million in 12–13, 60 million in 13–14, 61 million in 14–15 and 63 million in 15–16.

Mr SCOTT — We can read.

Mr PAKULA — We asked you about a 0.5 per cent decrease, which is what we just had.

Mr WELLS — So for a 0.5 per cent, my understanding is then that would be a $30 million reduction in income from transactions.

Mr PAKULA — Each year.

Mr WELLS — This is on page 67 in table A.1. So if there is a 0.5 per cent reduction in income from transactions in 12–13, then there would be an impact of $30 million less from income from transactions. I will ask the department secretary to comment further.

Mr HEHIR — The underlying assumption of the scenario analysis is to provide some indications of the impact of changes in the economic variables, as the note that you referred to under it says. The underlying assumption there is that if you had a 1 per cent change in interest rates across the whole term of borrowing, for both borrowing and the deposit things that we hold, then it would have this type of impact.

Your question related to a change by the Reserve Bank of the cash rate, and I think one of the things that you have to bear in mind is that a change by the Reserve Bank of 0.5 per cent in the cash rate does not necessarily flow into our cost of borrowings or our revenue. To use those tables to draw on that for an answer to your question is actually if not very difficult then maybe impossible, because that is not what that scenario is trying to say. It is looking at something else.

If you look at the two sides of the equation — our cash invested, which is where you get the revenue from, and the borrowings, which is the cost — our cash invested tends to be in relatively liquid term deposits on the banking side, but it is still term deposits which have varying interest rates, so the immediate impact would be negligible. I cannot tell you the exact cost of it, but I think it would be a relatively small impact through the budget year, because again there is not a straight linkage between the cash rate and our deposit rates.

On the borrowing side of things, as this says, the impact is very small in the first year because you tend to have a lot of locked-in interest rates going forward. In fact most of our debt tends to be locked in, so on the borrowing side you would have a very small impact. The nature of a change to the cash rate and its implications on the budget just is not one to one, and you would need to see what has happened to the broader scope of interest rates to determine that. My guess is that it would be significantly less than what is indicated in here for the interest-earning asset side of it. On the debt side, it is difficult to say at this stage because we have not seen the flow-through on the TCB debt markets. If it shows a long-term trend of interest rates coming down, it may have a positive impact, but most of the medium-term forecasting of interest rates had already built in significant reductions in interest rates when we set the budget numbers. In terms of your long-term rates, a half a per cent reduction was probably already built in to the market’s expectations of long-term debt. My answer to it would be that on the debt side it would be very minimal, and on the asset side it would be small, and not 60 million.

The CHAIR — Thank you very much. Mr Scott, would you like an expansion on that answer?

Mr SCOTT — In fact I am wanting clarification just to be clear. I was wanting a slightly more accurate, to be frank, explanation than the one that was given. It boiled down to something less than 60 million and something less than minus 2 million. that seemed to be the gist of your answer. Just to clarify, you have not actually calculated the impact on this decision as part of your management of the state’s finances?

Mr HEHIR — I suppose what I was saying is that you are talking about the difference between a very short-term rate, which the RBA sets, which is effectively the amount at which they will lend money to banks and its impact on our deposits, not our borrowings — —

Mr SCOTT — Yes, I understand the difference. Don’t take that tone of voice.

Mr HEHIR — And there is no direct relationship between those two things with institutions and our debt, and my answer on the debt side is that I do not think the decision would have much impact at all.

Mr SCOTT — Could I have the answer on notice, please?

Mr HEHIR — The answer will be much the same, but I am happy to take it on notice.

Mr SCOTT — In actual fact are you saying — —

Mr HEHIR — I am sorry. It is not a matter of not knowing; they are not the same thing.

The CHAIR — Mr Scott, I think — can I just interrupt here? Sorry, Mr Hehir. I think the secretary of the department is actually going to some great endeavour to explain a matter to you. The fact is that it is not possible for him to give the precision which you are seeking. I think we will just leave that there.

Mr O’BRIEN — Treasurer, I would like to ask you a question in relation to budget paper 2, chapter 1, and I would ask: as a result of the measures adopted in this budget, will the state be in a position to withstand future revenue or other economic shocks?

Mr WELLS — Thanks, David. I will just bring up the chart in relation to net results and transactions.

Mr PAKULA — How come we do not get a graph when we ask a question? It is like these ones are preplanned.

Ms HENNESSY — It is like they are preplanned, isn't it? It is amazing.

The CHAIR — I do not think that is true. He has actually brought a couple up for you.

Mr WELLS — With the budget papers we have outlined the medium new fiscal parameters, and we believe that this is a strong step in making sure that we are able to protect Victoria against future revenue shocks. We have said that infrastructure investment of 1.3 per cent of GSP is our target, and that is calculated on a five-year rolling average. At the moment we are sitting at 1.4 per cent, so we are slightly above the target, which is good news, but we believe that you need to build infrastructure as the economy and your community grows. With general government net debt, we want to reduce it as a percentage of GSP over the decade to 2022. We want to fully fund the unfunded superannuation liability by 2035, and that was a decision by both governments — by both sides of the chamber. Also, having a net operating surplus of $100 million. We believe that is consistent with the infrastructure and debt parameters. We maintain that with that strategy — and if you look at the forward estimates, looking at revenue flatlining at 4.1 per cent and you have your expenditure growing at 2.9 per cent — that will allow you the ability to be able to achieve those financial parameters that we have set, and that is very important.

You are able to fund the infrastructure spend at 1.3 per cent, as well as paying down debt over that decade to 2022. That is crucial and that is important, and we believe that by that strategy, by continuing to restrict expenditure by that 2.9 per cent, is absolutely crucial. Being able to contain the costs of running government at 2.9 per cent is the key to this. As we have said, from the December update last year it has been a matter of Treasury being able to contain those costs and living within our means, and it is absolutely certain that we will continue to do that. The other part of the graph is 'net debt to GSP'. You will see that 4.9 per cent does increase to 6.5 per cent, and that is reflective of the smaller surplus that we have had this year but the need to be able to have a responsible infrastructure spend. By 15–16 you will note that with the debt being at 6 per cent of GSP but still having a fully funded infrastructure program being paid for out of the surplus is significant. That means overall that we believe that the budget is in a very strong position to withstand any future shocks across the forward estimates.

Ms HENNESSY — Treasurer, in last year's budget — I am happy to provide it to you if you do not have it — you calculated that the land transfer duty concession for farmers under 35 years of age would cost the budget $3 million each year over the forward estimates period from 2011 to 2012. In this year's budget, at page 190 of BP 5, the cost to the budget of the concession has been revised down to just $800 000, from 3 million in the 2011–12 financial year and then 2 million in each of the remaining years over the forward estimates period. Treasurer, you were warned when you originally introduced that measure that few farmers would actually be eligible for the concession. Can you guarantee this committee that the far more modest tax expenditure will actually flow on to Victorian farmers?

Mr WELLS — This was an important election commitment for us. I suppose you have a choice when you are running into an election: do you assist Victorians with land tax or payroll tax? We decided that we would look at stamp duties, and in regards to the first home buyers we were able to cut stamp duty by 50 per cent, and that will come into play by 2014. We obviously have a threshold for that. The second part of the land transfer duty was for pensioners and the downsizing from large houses to smaller ones; there were stamp duty benefits for them. The third part of it was for farmers under the age of 35. You are right. I am looking at page 190, chapter 5 of budget paper 5 — —

Ms HENNESSY — We went from 3 million to 800 000 because it would not flow.

Mr WELLS — So in the 11–12 year we are expecting it to be 800 000, which is less than what we anticipated, and it is about 2 million in the forward estimates. Part of the reason is the slower turnover of farmland, but can I give this assurance to the committee? We have met with the VFF on a couple of occasions to discuss this, and it may be that we need to review the guidelines that we have — —

Mr PAKULA — Which is what we said last year.

Ms HENNESSY — That is what we said last year to you, Treasurer.

Mr PAKULA — We said the eligibility criteria — —

Mr ANGUS — We are not interested in what you said; we are interested in what the Treasurer — —

Mr MORRIS — Your eligibility criteria were zero.

Mr O'BRIEN — That is what the minister has been saying. Agriculture is thriving under Minister Walsh.

The CHAIR — The Treasurer is responding to a question from Ms Hennessy about a government initiative, and the Treasurer is quite capable of answering the question himself.

Mr WELLS — I did not realise that the then Labor government was offering any stamp duty concessions for young farmers — —

Ms HENNESSY — This is a question about your policy and your policy failures — —

Mr WELLS — I thought it was our policy.

Ms HENNESSY — That is what the question is about.

Mr ANGUS — Misleading again.

Mr WELLS — I thought it was our policy and our desire to assist young farmers under 35 to be able to buy — —

Mr PAKULA — Twenty-five per cent of it went out the door; 25 per cent of what you said would go out went out.

Mr O'BRIEN — Listen to the answer!

The CHAIR — Treasurer, please continue.

Mr WELLS — This is a very important policy for the government, and we want to work with the VFF to ensure that those young farmers who are wanting to buy in and move onto the land can do so. I think it is a great policy, and it is something we are very keen about. We will continue to work with the VFF and young farmers to make sure that they are receiving the incentive to be able to do that. You look at what the agriculture industry does for this state: it is a multibillion-dollar industry. We need to be able to work with those young farmers and make sure that we do whatever we possibly can in regards to reductions in stamp duties. I think it is a very good policy, but we will continue to work with the VFF and young farmers to ensure that there is a genuine benefit.

Ms HENNESSY — Given that only 25 per cent of the money went out the door to young farmers, what went wrong?

Mr WELLS — I think it was a very good policy.

Mr ANGUS — It is a good initiative.

Mr WELLS — I think it is a fantastic initiative.

Ms HENNESSY — But you just said that you need to revise it — —

Mr ANGUS — People do not take it up.

Ms HENNESSY — That clearly on the statistics it has not worked.

Mr O'BRIEN — What went wrong with the desalination plant, the north–south pipeline and myki?

The CHAIR — Thank you, colleagues!

Mr O'BRIEN — How about those answers?

The CHAIR — I think we can all take it that Ms Hennessy is making a rhetorical point.

Ms HENNESSY — No, I am actually not. I am actually asking a genuine question about the effective expenditure of taxpayers money. If it has not achieved its desired policy objectives, then I would like to hear the Treasurer on how he intends to address that.

Mr MORRIS — Your approach would be to loosen the guidelines to make sure the money gets spent whether it achieves the policy objectives or not?

Ms HENNESSY — His policy settings have failed. Why?

Mr MORRIS — Spend the money regardless of whether you get an outcome or not?

Ms HENNESSY — It is your election commitment, and you have not delivered on it. The policy settings failed. It is legitimate for me to ask why.

The CHAIR — Would you like to just take it outside?

Ms HENNESSY — I would just like to ask why. It is a legitimate question, Chair.

The CHAIR — Order! This is unprofessional, frankly. The situation is that a question has been directed to the Treasurer, the question was responded to, and there has been a supplementary comment, which in my view is a rhetorical observation. The Treasurer had given a complete answer and I am not going to invite the Treasurer to pursue it any further.

Ms HENNESSY — Unbelievable!

Mr WELLS — Can I just make the point that I am not used to this poor behaviour from the Public Accounts and Estimates Committee.

Ms HENNESSY — What? Having policy failures exposed transparently?

The CHAIR — I know, Treasurer, your tongue is firmly planted in your cheek. I wish to ask a question on Victorian economic projections, and I refer you to BP 2, page 14. What I am referring to in effect is a better understanding of the forthcoming commonwealth carbon tax implementation impacts from 1 July this year and how they will affect the 2012–13 state budget parameters and the forward estimates beyond 2012–13.

Mr WELLS — We are finding it very difficult to understand why the Gillard government would want to bring in a carbon tax at this point in time. This is going to hit Victoria very, very hard. When we look at 500 years of brown coal supply, that part of the supply will be hit and hit very hard. The power price increases for schools, hospitals, households — —

Mr O'BRIEN — Manufacturers.

Mr WELLS — And manufacturers are significant. When you are talking about growing an economy and about manufacturers who are looking to set up somewhere around the Asia-Pacific area, I am not sure whether a manufacturer would want to choose our country because of the slug of the carbon tax on power prices. Power prices are a significant part of production for manufacturers. This is going to hit and hit hard, and I just do not understand why the Labor Party remains captive to the Greens. It simply does not make sense. The Prime Minister promised all people who were going to vote that there would be no carbon tax.

Members interjecting.

The CHAIR — I take it, Treasurer, that you are coming to your commentary on the forward estimates.

Mr WELLS — We believe that with the introduction of the carbon taxc that prices will increase by about 2.5 per cent, so according to the GSP, it is expected to be about .25 per cent lower on GSP by 2015–16. We further believe that the cost increases in regard to the carbon tax will put pressure on the budget, and it is not a situation where the government is compensated by the federal government in regard to power prices for hospitals or for schools. That is additional money that we will have to find. It in part relies on the departments having to find efficiencies themselves to be able to pay for the increased power prices for hospitals, and this is just, I think, grossly unfair.

We remain in a very difficult position; this carbon tax will take place as of 1 July. As we say, this is going to hit power prices and, as we say, if 10 per cent of economic activity is reliant on the manufacturing sector, for example, how they are going to cope with the high Australian dollar, higher power prices — —

Members interjecting.

The CHAIR — Order. Thank you, Mr O'Brien; thank you, Deputy. Treasurer, would you like to conclude your answer.

Mr WELLS — As I said, with the carbon tax and with manufacturing being around about 10 per cent of economic activity, it is going to hit power prices, it is going to hit employment, it is going to hit those people who are trying to produce for export overseas, especially into that Asian market, and it will mean that in some cases we will become less competitive, and that is very disappointing.

The CHAIR — Thank you, Treasurer. Regrettably we have run out of time and I have to conclude the hearing. I would like the thank the Treasurer and departmental officers for their attendance. I note that there were some questions taken on notice and I look forward to receiving responses to those, which we will follow up in writing with you, within 21 days. Thank you very much. That concludes the hearing.

Witnesses withdrew.