

VERIFIED VERSION

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Inquiry into Budget Estimates 2016–17

Melbourne — 6 May 2016

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Mr Tim Pallas, Treasurer,

Mr David Martine, Secretary,

Ms Melissa Skilbeck, Deputy Secretary, Budget and Finance,

Mr David Webster, Deputy Secretary, Commercial, and

Mr Mark Johnstone, Acting Deputy Secretary, Economic, Department of Treasury and Finance.

The CHAIR — I declare open the public hearings for the Public Accounts and Estimates Committee inquiry into the 2016–17 budget estimates. All mobile telephones should now be turned to silent.

I would like to welcome Tim Pallas, Treasurer of Victoria; David Martine, Melissa Skilbeck, David Webster and Mark Johnstone from the Department of Treasury and Finance. I would also like to welcome additional witnesses sitting in the gallery. Any witness who is called from the gallery during this hearing must clearly state their name, position and relevant department for the record.

All evidence is taken by this committee under the provisions of the Parliamentary Committees Act, attracts parliamentary privilege and is protected from judicial review. Comments made outside the hearing, including on social media, are not afforded such privilege. Witnesses will not be sworn but are requested to answer all questions succinctly, accurately and truthfully. Witnesses found to be giving false or misleading evidence may be in contempt of Parliament and subject to penalty.

Questions from the committee will be asked on a group basis, meaning that specific time has been allocated to members of the government, opposition and crossbench to ask a series of questions in a set amount of time before moving onto the next group. I will advise witnesses who will be asking questions at each segment.

All evidence given today is being recorded by Hansard, and you will be provided with proof versions of the transcript for verification as soon as available. Verified transcripts, presentations and handouts will be placed on the committee's website as soon as possible.

All written communication to witnesses can only be provided via officers of the PAEC secretariat. Members of the public gallery cannot participate in the committee's proceedings in any way. Members of the media must remain focused only on the persons speaking. Any filming and recording must cease immediately at the completion of the hearing.

I now invite the witness to make a very brief opening statement of no more than 10 minutes and this will be followed by questions from the committee.

Mr PALLAS — Thanks, Chair, Deputy Chair and members. It gives me great pleasure to present on the 2016–17 budget of the Andrews Labor government.

Visual presentation.

Mr PALLAS — The state budget is a clear demonstration that Victoria has regained its economic momentum and it is a plan that builds on the economic momentum for the benefit of every person in the state. The 2016–17 budget reflects the government's clear economic plan to bolster the state's financial position, to deliver a significant and sustained increase in infrastructure investment and to invest in our people to maintain our enviable living standards and also to ensure our communities are safe. The resurgence and, might I say, confidence in the Victorian economy means that Victoria is once again leading the nation.

Victoria's economy grew strongly in 2015. The latest state final demand data shows Victoria is leading the nation, rising by 4 per cent. Gross state product, which includes state final demand plus trade, rose by 2.5 per cent in 2014–15, the strongest of the non-mining states. Victoria's result was driven by solid business investment, dwelling investment and household spending supported by low interest rates and strong population growth. We are expecting growth in gross state product to accelerate to 3 per cent in the coming year.

The structure of our industries means that our economic growth brings jobs growth with it. Less than two years ago Victoria's unemployment rate was 6.9 per cent. Today it stands at 5.7 per cent. More than 112 000 Victorians have found work in this time. To put this into perspective, more Victorian jobs have been created in the first 18 months of the Andrews government than the entirety of the preceding four years. Average jobs growth on a monthly basis is three times what it was between 2010 and 2014. We recorded 2.7 per cent employment growth in 2015, the highest in the nation. This reflected improvements in confidence and trading conditions for our businesses. The lower Australian dollar has seen our exports become more competitive, and business investment and confidence measures are strong, leading all other states.

Rapid population growth is also driving demand and bolstering our economy. At 1.7 per cent in 2014–15, Victoria's population growth is the strongest in the nation, with more than 1900 new residents in the state each week. The state recorded the highest net migration of all jurisdictions and accounted for one-third of national

inward migration in 2015. Victoria's population is currently predicted to grow at 1.8 per cent a year. Forecasts suggest that Melbourne could overtake Sydney as Australia's most populous city as early as 2030. This growth is both an opportunity and a challenge, and we have the right ingredients for a sustained period of prosperity. But we need to ensure that we manage it strategically.

The first priority needs to be disciplined and responsible financial management. We are experiencing rapid increases in demand for services and infrastructure and will meet that demand. But we need to do it in a fiscally responsible way. The global economy remains in a period of considerable uncertainty and it is critical that we have the flexibility to respond to the unexpected. The 2016–17 budget projects average growth in revenue over the estimates of 3.4 per cent, which exceeds expense growth of 3.3 per cent. That forecast of 3.4 per cent over the estimates is well below the average revenue growth of 5.9 per cent over the past decade, as this chart clearly shows.

Focusing on tax growth, the average tax growth rate from 2011–12 to 2014–15 was 5.4 per cent compared to the average tax growth rate from 15–16 onwards of just 5 per cent. When it comes to tax, as this slide shows, Victoria's taxpayers pay comparable rates of tax to other states. Some states receive significant revenue from royalties. Royalty revenue makes these states less reliant on taxes to fund service delivery and investment in infrastructure. Incorporating royalty revenue, Victoria's ratio is lower than ratios in Western Australia and New South Wales. Taking royalties into account, Victoria's tax ratio is projected to decline to 5.1 per cent by the end of the forward estimates period.

This budget further strengthens Victoria's fiscal position and ensures that we are equipped to meet our economic challenges. Operating surpluses have been increased to 2.9 billion in the 2016–17 budget year and over 9.2 billion cumulatively across the budget and forward estimates. Net debt as a proportion of the economy has been maintained well below the levels inherited and is projected to fall to 5 per cent over the forward estimates. This will be kept at constant levels with our reconfirmed AAA credit rating. Even with a declining debt profile, we are stepping up infrastructure investment this year. This budget has a sustained increase in government infrastructure investment over the forward estimates, with an average of 4.9 billion per year over the past 11 years to 7.4 billion over the estimates.

So this investment will keep up with population growth and also drive productivity. This includes fully funding transformational infrastructure projects announced last year. The 16–17 budget provides all necessary funding for the Melbourne Metro tunnel and the western distributor. We were able to do this because we have been willing to explore and embrace alternatives to traditional financing for major projects. The 16–17 financial year will also see the lease of the port of Melbourne and investment of the proceeds into the Victorian Transport Fund and the removal of 50 level crossings.

Victoria's regional areas are a key part of the government's infrastructure spend in this budget, which delivers the biggest ever investment in regional infrastructure. This chart indicates the capital investments that have been made in regional areas only, not statewide, over the last several years. Our regional centres are growing, and we want to ensure that both growth and opportunity are shared equitably across the state.

In the last budget the government made a stand on education, delivering the single biggest injection of recurrent funding into our school system as part of our Education State initiatives. This budget delivers \$924 million in infrastructure funding for new schools and upgrades — the single biggest school capital investment in Victoria's history.

Like in education, the government has also committed to providing Victorians with the very best quality health care. We are investing in new and upgraded health facilities, infrastructure and vital health equipment.

This budget transforms Victoria's public transport and road system. The major transport announcement in the 16–17 budget is of course that the Andrews government will fully fund the construction of the Melbourne Metro tunnel. This budget includes \$2.9 billion in capital funding for the project, and provision has been made for the full cost of the project over the next decade.

In road investment \$1.46 billion will be contributed to the Western Distributor Public-Private Partnership. This budget ensures that projects vital to Victoria's will certainly be built.

Infrastructure investment is critical to ensuring a prosperous future for Victoria. We want to get even better in how such projects are delivered. So debt is trending down in this budget, but we need a fiscal strategy that will allow for further investment while maintaining prudent debt levels and our AAA credit rating. Historically this has been lacking in Victoria.

Budgeting for infrastructure investment has coincided with the four-year budget cycle. This is not long enough to fully consider the impact of transformative investments further into the future. It has led to decisions that have been made in an ad hoc way.

In this budget we are extending the capital planning horizon to 10 years. A 10-year planning horizon will allow the government to properly balance the need for ongoing renewal and incremental expansion with the need for major investment.

Maintaining general government sector net debt at around 6 per cent of GSP will still keep key financial indicators at prudent levels. This creates about \$16 billion in additional capacity to fund state-shaping infrastructure over the next decade.

This budget also introduces a range of new measures that will allow us to build on the economic momentum that we have and generate growth that benefits all Victorians. Last week the government also released the *Jobs for Victoria* plan, outlining six key actions to create jobs: building the projects we need; putting people first; making Victoria the best place to do business; keeping Victoria on the world stage; securing jobs in future industries; and supporting our regions.

We know that the key to lifting the economic tide is to attract new investment to Victorian shores, and we will fight for every opportunity to attract companies to Victoria. This effort will be backed up by a \$116 million boost to the investment attraction program set up to provide financial support to companies looking to expand into our markets. In addition, \$66 million will also be provided to increase funding and to expand the Victorian government business office network. We will reduce the tax burden on our businesses. The payroll tax threshold will be progressively lifted from \$550 000 to \$650 000 over the forward estimates. Thirty-six thousand businesses will benefit from these arrangements.

So this budget is a clear statement to the Victorian community about the Andrews government's values and priorities. The government can be relied upon to make the investment required to help the Victorian community succeed, but we will manage our finances responsibly.

Governments are always faced with difficult choices, but in the end only governments that strike a balance between addressing today's challenges and providing for the future can lay claim to holding up their end of the electoral bargain, and this budget and this government are doing exactly that.

The CHAIR — Thank you, Treasurer. Questions will now be asked by members of the government, which will last until 9.53 a.m. precisely, at which time their questioning will cease and we will go over to the opposition.

Ms WARD — Good morning everyone. Thank you for coming along. It is nice to see you, Treasurer, and can I say thank you for a fantastic budget, which has been very well received by my community, especially the money for the Hurstbridge line upgrade; thank you.

If I can get you to look at budget paper 2, chapter 1, page 2, and also page 2 of the presentation that we just saw, there is a reference to Victoria's economy growing faster and stronger than any other in the country. Can you unpack this further and explain to us in further detail what this growth actually means for our state?

Mr PALLAS — Sure. I think one of the interesting things about what is happening in the Victorian economy at the moment is what is happening to our state final demand figures. If you look at those figures, which were released in March of 2016, what they show is that the Victorian economy is leading the nation. Victoria's state final demand grew by 1.2 per cent in the December quarter and 4.6 per cent over the past year. So both results were amongst the strongest of all the states, with Victoria's annual state final demand continuing to grow at its fastest pace in the last five years.

If you look at growth in the Victorian economy, it has been broad based. We have got household consumption that is up by 1 per cent over the December quarter and up by 3.4 per cent over the year. We have got dwelling

investment in Victoria which rose by 2.8 per cent in the December quarter and 10.8 per cent over the year. Victorian private business investment was up 6.9 per cent over the year. Growth over the year was driven by non-dwelling construction which rose also by 11.4 per cent. Public investment was also up by 7 per cent in the quarter and 12 per cent over the year.

State final demand has grown by at least 1.2 per cent in four of the past five quarters, so we are seeing this consistent shift to the fundamentals of the economy and the underlying consumption and demand in the economy continuing to assist the economy to grow and gather momentum. The last time this occurred — that is, getting growth in four of the past five quarters — was about a decade ago. This follows on Victorian GSP growth from 14–15 being significant, at 2.5 per cent — significantly higher than the 14–15 budget estimate of 2.25 per cent.

It is particularly important that our GSP numbers or growth of 2.5 per cent have meant that we have experienced GSP per capita growth of 0.7 per cent, which is the largest increase since 2010–11 and the first positive growth since 2012. So in addition to our growth of 2.5 per cent, which was more than double that of the growth that Victoria experienced between 12–13 and 13–14 financial years, both years recorded GSP growth of about 1 per cent.

Ms WARD — So, Treasurer, with the population growth that you have spoken about and with population growth that is also referred to in the budget papers, and you have referred to it in your presentation, how is the population growth being addressed? How is this growth that we are seeing actually being managed and tackled?

Mr PALLAS — Sure. I suppose, put simply, it comes down to how we are addressing the needs for a continuing investment and substantial growth in infrastructure, recognising that Victoria's population is growing by 1.7 per cent in 2015; it is the highest in the nation. Our estimates suggest that population growth will continue to be strong, and indeed push up a little bit to about 1.8 per cent per annum across the forward estimates. So that means there will be increased pressure on Victoria's services and our infrastructure going forward, and the government will need to respond, and will need to respond decisively to it.

So the 15–16 budget was really the government taking the first steps in addressing those challenges, restoring the appropriate level of expense growth to ensure that services demand could be met as population grew. The 16–17 budget really goes a step further and ensures that Victorians will continue to enjoy a high quality of life, and how we are doing that is effectively a \$7.4 billion a year on average capital investment over the forward estimates period. There is \$7 billion for the Victorian road network in this budget; \$2 billion is being invested into infrastructure in regional Victoria — that is the highest on record. We are delivering a record \$2.9 billion boost to our health system; and following on from the first budget we have invested \$924 million into upgrading our school systems — that is the largest ever single investment in Victorian schools infrastructure.

Obviously building both our recurrent side — that is, our capacity to deal with services demand — and also growing the services and amenity to the community through our capital spend are two key components to dealing with population pressures. The other important thing is to recognise that everybody wants to be a meaningful participant in our economy, and that comes down to jobs for Victoria. The plan that we have released in cooperation with this budget which supports job creation, it invests in people and communities and it encourages the growth of future industries.

Ms WARD — So with the population growth being the highest in the nation, how is our economy performing compared with the rest of the nation as well? How is that tying in?

Mr PALLAS — It is performing very well I suppose is the short answer. And might I say — —

Ms WARD — I would prefer a longer answer.

Mr PALLAS — Well, performing above my expectations and I think most people's expectations. What the story of the last couple of years really is the surprising resilience of the Victorian economy. Victoria recorded GSP growth of 2.5 per cent, of course, in 14–15, as I have previously indicated. Victorian state final demand grew by 1.2 per cent in the December quarter and 4.6 per cent over the year. Now these results are interesting in the sense that they are amongst the strongest of all the states, with Victorian annual state final demand continuing to grow at its fastest pace in more than five years.

Just to put it into some context, Victoria's real GSP growth in 14–15 was the second highest of the states, behind Western Australia, which was at 3.5 per cent, and above Australian real GDP growth, which averaged at about 2.3 per cent. We performed most strongly of the non-mining states, followed by New South Wales at 2.4. It is the first year since 2008–09 that Victoria has recorded stronger GSP growth than New South Wales. I suppose one of the most interesting aspects of this growth and this change in circumstances is looking at where that growth is coming through.

If you look at the detail of our GSP, net exports of goods and services continued to contribute about 0.2 per cent to Victorian GSP growth, driven by strong growth in our service exports. Exports of services rose strongly by 13.2 per cent, so net international services trade contributed about 0.5 percentage points to GSP growth in 14–15. Just to give you an idea of where the growth is coming through in the industry —

Ms WARD — And with this growth in mind, how is mining fitting into this picture — the downturn in mining?

Mr PALLAS — Well, the downturn in mining — it has effectively given Victoria a much stronger position in the sense that what we have seen at the end of the construction mining boom has basically led to a reduction in the Australian dollar. The comparative performance and the lower embedded interest rates have also provided for our export expos industries to have a much stronger and better showing in terms of their international competitiveness.

Quite frankly, the fact that we have seen this flip in the economy from a two-speed economy — we still have a two-speed economy; it has just moved from those mining states to the non-mining states — the very interesting thing is if you look at the recent CommSec analysis of *State of the States*, what it tells us is that Victoria is the fastest improver on the field when it comes to the nation's economic growth. We are still — and I think justifiably — behind New South Wales in terms of where we have come from, but we are rapidly improving, and I think CommSec makes that point.

Mr DIMOPOULOS — Treasurer, welcome. Can I ask you, in relation to your comments, the government has been criticised about the full-time job creation and so it was pleasing and interesting to hear you say that this government has presided over greater employment growth in 17 or 18 months — I think that is what you said — than the previous four years. Can you give us a bit more detail about the full-time job aspect, and how that relates back to your Back to Work strategy.

Mr PALLAS — Sure. Our job numbers are quite impressive. It is basically acknowledged that in the time we have been in government we have put on 112 000 jobs, and of course when I say 'we' I mean that is the Victorian economy, and that is a clear sign that there is enormous resilience going on in the economy. Over about 71 000 of those 112 000 jobs are full time. If you pro rata the two-year target of 100 000 jobs, we are on track. It is a stretch target, but there is nothing wrong with trying to extend yourself; that is what good governments try to do.

Might I also make the point that we are creating about three times the number of jobs on a month-by-month basis compared to the previous term of government. What it does show is that all these growth industries are making a very substantial contribution to the capacity of the state.

Mr MORRIS — Good morning, Treasurer. Welcome to PAEC for 2016.

Mr PALLAS — Good to be here.

Mr MORRIS — I am sure it is. The budget reference is budget paper 5, page 26, and in particular the entities that deliver dividends to the state budget. I am particularly interested in some comments you made to VCCI, where you indicated that there will be more asset sales, reported in the *Age* on 1 May:

There will be more, let me be very clear about that.

...

We intend over the course of this year and next year of proving up the viability of certain assets.

Given that the effect of some asset sales would impact dividend revenue on the budget across the forward estimates, can you rule out the privatisation of Victoria's water businesses, including their assets?

Mr PALLAS — If by privatisation you are suggesting that there would be an asset sale, a divestment of ownership of these assets, absolutely. Look, I want to be really clear about this. I think it is important for the state to acknowledge that we do need to look at whether or not we are getting value for money from the assets that the state holds and whether or not we can work our balance sheet better in order to get a better return for the Victorian community.

I think one of the reasons the state has formed a view — and I understand that it is probably a view that is shared collectively, at least amongst the major parties in this state — is that it is important to make sure that we are getting value for the assets that the state holds. I do not see ‘asset recycling’ as a cute one-liner. I see it as being something very tangible and real in the sense that, if we asset recycle, that is we are changing a current status, which could in fact be a leasehold, into another state asset that we have formed a view has better and more immediate economic value for the state. So in net, over the long term, this is about growing the asset base of the state; it is not about reducing it, in my mind. That is why I think that the words ‘asset recycling’ are such a critical nuance and ones that need to be recognised.

Mr MORRIS — Treasurer, if I could just pick up on that point of leasehold, is the potential in the budget to lease water authorities or some of their assets?

Mr PALLAS — No, I do not see that. If the question really goes to, ‘Do we have any plans at the moment with respect to leaseholding of water authorities?’, the answer is no.

Mr MORRIS — So there will not be any change in the effective ownership of — —

Mr PALLAS — No, but I want to be clear about this, because I do not want there to be any misconception. We see no reason why the state cannot continue to run efficient water authorities. We think that the way that the water authorities are run may need to be looked at to improve. In fact I think the government has been doing — with the minister for water, about how we might improve the performance of our water authorities.

Mr MORRIS — But you do not see any change in the ownership status?

Mr PALLAS — No. I do not see any change. What I do see is that there would be probably a move to greater corporatisation and a need for greater commercial rigour around the way that our water authorities operate, the better utilisation of the assets that they have available to them, absolutely.

Mr MORRIS — Sticking with the same theme, I note the South Australian government has moved to privatise its equivalent of the TAC. Is the TAC on your shopping list?

Mr PALLAS — No, it is not. I know where most of these questions are going to go. I am not sure for how long and how much of the asset base of the state you want to get a categorical answer about, but I want to be clear about this. The government will continue a process of reviewing the performance of all of our assets to make sure that those assets are delivering value for the Victorian taxpayer. In so doing it is not our intention to start a wholesale divestment either of ownership, or might I even say of concessional management, of our asset base, but there will be some that, from time to time, will emerge that we will see as being appropriate. At the moment the government has not made any final decision about what those assets may be.

You will recall, Deputy Chair, that when I was before VCCI I made it very clear that from our perspective we still need to satisfy ourselves that any of the assets that were potential for asset recycling were appropriate, and I thought that it was also appropriate that I made the point then, and I will make it again here today: we are not going to jump into this without having a serious process of consultation with the affected stakeholders as well, because it goes to their livelihoods and their wellbeing.

Mr MORRIS — Thank you for that comprehensive answer, Treasurer. I am tempted to ask what assets you are considering privatising, but I want to move on. On the same subject, in the *Australian Financial Review* in November 2013 there was a comment from the now Premier in the context of the port of Melbourne leasehold. Quoting from the article:

... Mr Andrews said the party had no plans for broader privatisation or asset sales beyond those outlined in the document.

So I am just wondering why you are now seeking to push ahead with potential asset sales in contrast to that commitment from the now Premier in 2013?

Mr PALLAS — I think the very clear position of both the Premier and myself, and it is certainly reflected in the decisions that incorporate what is this budget, is that we do not have specific proposals that we are in a position to say we are planning to proceed with an asset recycling process.

Mr MORRIS — So you are saying you have no plans. So what you are saying is that because Mr Andrews said there were no plans, that does not mean that there will not be plans; it is just at that particular point there were no plans.

Mr PALLAS — Absolutely. And I use the term ‘advisedly’ because I know it is a term of phrase that the coalition understands and have used regularly when they have been in government. It means that at this point in time, at a particular point in time, there are no plans. It does not mean that there will never be plans. It means that the government is being entirely frank and is going through a process of assessing what if any assets should be recycled. You have asked me: do I have a view about it? I have answered quite directly to VCCI and I will answer directly to you. I think there are some that should be the subject of this rigour, and it is certainly the government’s intention that it will continue to subject them to rigour to see whether or not the taxpayer is getting adequate value.

Mr MORRIS — Well, Treasurer, I probably have a slightly different view. I would have said that when a prospective Premier goes out and says there are no plans for broader privatisation of assets, that that is an election commitment. Given that then a further sale would amount to a broken promise, will you give a commitment to put such an asset sale to the Parliament before any sale takes place?

Mr PALLAS — Am I being asked to respond to that? Because my answer would be really simple. I think what it was was a genuine statement.

Mr MORRIS — I am asking you whether you will put any proposed asset sales to the Parliament before they take place.

Mr PALLAS — We will use whatever powers are appropriate to us.

Mr MORRIS — So that is a no?

Mr PALLAS — Well, no. I do not know, because if we are talking about —

Ms WARD — Are you answering for the Treasurer, or are you going to let the Treasurer answer?

Mr PALLAS — a substantial asset, Deputy Chair, such as the port of Melbourne — something of multibillion-dollar significance — I think the simple answer would be yes. If, however, we are talking about an asset of the nature of the Rural Finance Corporation, where your government effected a trade sale — —

Mr MORRIS — We did not make a commitment not to sell assets. You did make that commitment.

Mr PALLAS — Nor did you give any indication, might I say — and I do not accept that we gave a commitment — nor did you give any indication that you intended to do it.

Mr MORRIS — We did not say it, but we are interested in the here and now.

Mr PALLAS — Might I say also that you took nobody in the community into your confidence before you did it. We all woke up one morning to see an asset effectively had been sold. So our approach is to be genuine and open with the Victorian community.

Mr MORRIS — We did not make a commitment not to sell assets. Clearly the Premier did in the context of 2013.

Mr PALLAS — When the Premier said we had no plans, I take the Premier — —

Mr MORRIS — I take that answer as a no.

Mr PALLAS — I would ask that you take the Premier at his word, that we had no plans. And when we have plans —

Mr MORRIS — I think that is a bit of a stretch.

Mr PALLAS — we will take the Victorian people into our confidence, unlike your government when you were last in power.

Mr MORRIS — That is clearly a no. Thank you.

Ms WARD — You are putting words into the mouth of the Treasurer.

Mr D. O'BRIEN — Treasurer, you say you have no plans. You told the VCCI lunch, though, that you are going to look at it. What are you going to look at? Can you tell us? Is there WorkCover on the table? And what is the process when you are looking at it?

Ms WARD — Sorry, which part of the budget papers are you referring to?

Mr MORRIS — The reference was given at the start of the segment.

Ms WARD — Sorry, you have gone down such a long and winding road.

Mr MORRIS — As agreed, we are still on the same subject.

The CHAIR — Order! We have got 35 seconds to go.

Mr PALLAS — If I just take you to page 38 of chapter 3 of the *Strategy and Outlook* paper, what we say is:

Asset recycling is boosted by the commonwealth government's asset recycling initiative that gives financial incentives to — states. And then we conclude:

The government will continue to explore opportunities for asset recycling and investing the proceeds — —

Mr MORRIS — Even though you told the electorate that you would when you were standing for election.

Mr PALLAS — No, we did not say that. And do not verbal the government or the Premier. What we said was that we had no plans. That was an honest and accurate assessment at the time.

Mr MORRIS — No plans?

The CHAIR — Order! Time has expired. Ms Pennicuik, you have 8 minutes, until 10.12.

Ms PENNICUIK — Thank you, Treasurer. Welcome, Treasurer, and everyone from the department. Could I start by referring to your presentation, page 14, which mentions new road and public transport infrastructure. I am interested, in this particular session, in the road section of that and in particular the western distributor. It is mentioned there, and also in budget paper 4, on page 10, there is a reference to the western distributor, stating that it is a \$5.5 billion project of which the government is contributing 1.46 billion over four years. Your presentation says that the project is fully funded, so we are expecting the other \$4.04 billion will be coming from the private sector, most likely Transurban. The budget paper says that the government is negotiating with Transurban under the market-led proposals. I understand that it is up to stage 4 of 5, so I am not sure how competitive this tender process is. You may wish to comment on that. My first question about this is: the government also claims it is consulting on various aspects of the project, including the long and short tunnel design, and I would like to know whether Treasury has developed costings for the short and long tunnel options. If you could answer that and provide some detail in regard to those options and the costings of them.

Mr PALLAS — I will try to unpack those, and if I let you down as I go through it, just pull me up and tell me where I have not answered all of those questions.

Ms PENNICUIK — I will.

Mr PALLAS — Can I just go to budget paper 2, the *Strategy and Outlook* paper. On page 33 what it shows is the capital allocations through the forward estimates period: 2016–17 — 262 million; 17–18 — 139; 18–19 — 486; and 19–20 — 555. The total TEI, as you rightly observed, is 5.5 billion, so what that means is the additional costs, to the extent that there are some beyond the forward estimates, are picked up, and to the extent that they go

beyond the 1.46 billion, then they are essentially picked up through the virtual arrangements we put in place publicly, and we have disclosed publicly, and that is that the state intends essentially to enter into an arrangement that would seek the extension of the concession deed — probably in the order of about 10 years. So the budget is providing \$1.46 billion for the project over the forward estimates period. The project encompasses up to \$400 million for the Monash Freeway upgrade and that will provide a new dedicated connection to the Bolte Bridge and also provide access to Webb Dock. We have announced that we will be establishing a western distributor authority to get the project done and we have released the first full designs for the project. There is a genuine process of community engagement going on.

The issue you have raised around the competitiveness, it is an interesting issue that confronts governments when they deal with market-led proposals. How do we actually get the competitive tension in a process where you have effectively got a single operator that you are dealing with? We have sought to do that by putting in place public sector comparators to assess whether or not we think we are getting value for money as we go through the process. We have announced that we will proceed with the western distributor. The good news of course is that it will take about 20 minutes off travel time. It will take about 6 hours for trucks — —

Ms PENNICUIK — Excuse me, Treasurer, if you could just direct your answer to the costings of the short and long tunnel options, because they are of great interest to the community, given the impact that one will have compared to the other in terms of the parkland and the portals being close to residential areas in Yarraville.

Mr PALLAS — Because I understand this is a new process of PAEC, I might throw to one of my departmental people. I think the simple answer is yes, we are currently working through the costings as part of the process of engagement, but you are probably getting tired of hearing me talk anyway, so either David or David.

Mr MARTINE — Thanks, Treasurer, but you have kind of just answered the question. We are currently in the process, as the Treasurer indicated, of working through the costings of the different options. As the Treasurer indicated, quoting the reference in budget paper 3, there is a profile of 1.46 billion with a total TEI of 5.5, so obviously there is an extra funding commitment beyond the forward estimates. But in terms of the costing of different elements of design et cetera they are matters that we are currently working through in conjunction with Transurban.

Ms PENNICUIK — Thank you, Mr Martine. So you are working through them. When do you expect to have worked through them and to have some idea of the difference between the cost of those? Can you give some ballpark figure or rough estimate as to what the difference in the two options may be?

Mr MARTINE — I certainly cannot give a rough estimate of the different costings, but in terms of timing I will just get Mr Webster to briefly talk about the process for the rest of this calendar year in particular.

Mr WEBSTER — In terms of timing, the current process is working through a series of public consultation. That then will lead to the planning process — the environmental impact statement. So until we get the final elements coming from the planning process it is not possible to finalise the actual design. In terms of the costings we will not actually be able to finalise the costings until we are out the other side of the planning process, which is the backend of the calendar next year.

Ms PENNICUIK — Thank you. If I could redirect to the Treasurer then. In terms of the budget, given that the costings of the short and long tunnel options may be quite different — there could be quite a large difference in terms of the costings — how is the government able to settle on the \$5.05 billion total cost without the costings that we are trying to get to the bottom of here?

Mr PALLAS — Well, because this is part of a broader commercial negotiation. But to put it simply, our expectation is that we will have provided for and we are confident that we have provided for sufficient funds for the more expensive option, and we believe that together with the arrangements that the government has put in place with concession — —

The CHAIR — Time for government questions until 10.22 a.m.

Mr DIMOPOULOS — Treasurer, I would like to take you back to slide 5, ‘Operating within our means’. You talked about growth and how other revenue has come into the budget. But I would like to talk more about

the land revaluation process and the impact of that on the budget. In asking you what that impact is, just highlighting that you said, I think, that the average revenue growth for the last 10 years has been 5.9 per cent, so the estimates in the forward budget seem quite modest compared to the last 10 years. What is the impact in your view of the land revaluation cycle in the Victorian budget estimates?

Mr PALLAS — Sure. If we are talking about land tax in particular — or is it tax revenue?

Mr DIMOPOULOS — Tax revenue. Whatever revenue flows from land revaluations.

Mr PALLAS — Okay. So land tax revenue is forecast to increase by 28.3 per cent to \$2.2 billion in the 16–17 financial year. The strong growth is basically due to significant increases in the revaluation of residential, commercial and industrial land. So from a land tax perspective, what we have is a process every two years where the valuer-general does an assessment of the impact upon the changing value of the asset base of land in the state. What practically that means is that we do tend to see a two-year cycle of land tax income coming in, higher in valuation years, and then dropping off in the non-valuation years. Unimproved land values are expected to have increased by 19.5 per cent from 1 January 2014 and 1 January 2016, based on the latest data, so that is the sort of figure we are seeing coming through. New valuations will be applied to land assessments for 2017 and 18. But —

Mr DIMOPOULOS — Treasurer, it has an impact on stamp duty revenue, I imagine — land revaluation?

Mr PALLAS — Absolutely. Of course the stamp duty issues I think really go to the question of what constitutes an appropriate impact associated with the value of the sale of a property. What we know is that we have got low interest rates and strong population growth that have contributed to strengthen our property market; in fact, one of the most attractive property markets in the nation, in Melbourne, if not the most attractive property market. Strengthened prices and transaction volumes have generated very strong growth in land transfer duty over the past few years.

More recently forward indicators have begun to ease, and we are starting to see that coming through. Certainly that has been incorporated into our projections going forward. Taking that into account, all the current information, the budget projections anticipate that the property market will experience a moderate correction in 2016–17, so we are not actually building our forward estimates on heroic assumptions going forward, can I put it that way. We expect that most of that easing will be as a result of transaction volumes easing rather than this being reflected in terms of price. So the expected continuation of low interest rates as well as solid economic and population growth support the central case for a gradual return to trend over the forward estimates period.

Mr DIMOPOULOS — Treasurer, can I ask you in relation to the assumptions the budget and the government make in relation to foreign investment in real estate and the impact of those trends on the budget, on the revenue side of it, and the surcharges that are in the budget in relation to foreign investment?

Mr PALLAS — Sure. Victoria has seen considerable inflows of money into our Victorian real estate from foreign investment in recent years. If you look at the 15–16 budget, the Andrews government introduced surcharges on foreign purchasing of Victorian property, and that included a duty surcharge of 3 per cent on the acquisition of residential property by foreign purchasers from 1 July 2015. At the same time we introduced a 0.5 per cent, or a half per cent, land tax surcharge on land that was owned by absentees from 1 January 2016.

The Foreign Investment Review Board annual report for 14–15 gives us an appreciation of what is going on here. It shows that foreign investment in residential property continues to be strong, with a total of \$26 billion of investment in Victorian real estate approved in 14–15, compared to \$14 billion in the preceding financial year. So foreign property owners continue to benefit from a very strong property price growth, driven in part by the government's investment in services and infrastructure. According to the REIV, what they believe is median house prices in Melbourne have grown by 8 per cent over the past year, and that growth has been concentrated in the inner suburbs, where median prices have grown by over 16 per cent.

According to the National Australia Bank survey data, foreign demand for new dwellings in Victoria continued after the surcharge was introduced, and certainly we are on trend to get the revenue projections that we put in the 15–16 budget, so there has been no demonstrable impact upon demand. So the surcharges increased to balance the need to raise revenue to fund government services and infrastructure for all property owners who benefit from them against an impost considered appropriate for this type of purchaser.

So it is essentially a balancing act. We think we have got the balance right. I think the idea of going in with a more modest offering in last year's budget has demonstrated that there is a continuing demand for Victorian property, and it is responsible, it is appropriate, in order to ensure that a fair share is paid for built infrastructure.

Mr DIMOPOULOS — Treasurer, thank you. Just quickly, obviously for foreign investors in real estate in Victoria there are a lot of considerations, and I think Mr Martine was saying the other day at the briefing that the devaluation of the dollar is probably a significant one, so looking at just the surcharges is really looking at one small part of the pie, I imagine, of what they consider to be a prudent investment.

Mr PALLAS — Absolutely. In fact, if you take into account the depreciation of the dollar, it was not so many years back that we had parity with the US dollar; we are now seeing quite considerable reduction in the Australian dollar, and of course on the back of the recent drop in interest rates again by the Reserve Bank, we have seen a further drop down. I have got to say that the depreciation in the Australian dollar is a good thing for the Victorian economy, but you do not want to have too much of a good thing; I think there is a point at which we would like to see that level out. But there is no doubt that foreign purchasers have been advantaged in the marketplace as a consequence of that. So low interest rates, low dollar, and the continuing strength of particularly the inner metropolitan Melbourne property prices I think have meant that there is a substantial uplift for foreign purchasers, and I think it is only fair that they make a contribution.

Ms SHING — Good morning, Treasurer, good morning, witnesses. I might ask a couple of questions on a topic that is dear to my heart: the brown coal royalty rate. I would like to get some responses from your witnesses, Treasurer, in relation to how that compares, that change, to other jurisdictions and then to move on to your views in relation to the budget funding for the Latrobe Valley in particular, and Gippsland more broadly, as part of that regional spend that you talked about in your opening presentation.

Mr PALLAS — Right. Well, I will do the royalties bit first, and I will get through it as quickly as I can.

Ms SHING — Thank you.

Mr PALLAS — What we are trying to do here is to ensure that the state receives fair value for the people of Victoria's resource. It is a non-renewable resource of course, and by increasing the brown coal royalty threefold we think what we are doing is putting it broadly into comparison rates with the other eastern states. So the holder of lignite mining licences must now pay royalties to the state for the brown coal that they produce. Most brown coal produced in Victoria is used for electricity generation. Our existing brown coal rate has been significantly lower than the other states, so what we are doing in terms of the royalty rate is it is about 7.6 cents per gigajoule unit of lignite. The last royalty increase occurred over a decade ago, so this now brings it broadly, in calorific terms, into order with New South Wales — slightly below New South Wales and slightly above Queensland — and of course \$90 million into the Latrobe Valley to build the region's future prosperity.

Mr D. O'BRIEN — Good morning, Treasurer. I want to go back to the western distributor. Budget paper reference: budget paper 4, page 3, but also Mr Martine highlighted budget paper 3, page 49. Treasurer, can you assure us that should the western distributor proceed, the government will make no agreement with Transurban that would either restrict or impose additional cost on any future government that may wish to build east-west link or a similar project?

Mr PALLAS — I do not know what the nature of the question is. What sort of impost would you imagine?

Mr D. O'BRIEN — An adverse effects clause, for example.

Mr PALLAS — Do you mean like currently exists in the concessional deed for Transurban?

Mr D. O'BRIEN — I am asking you if you are going to do that with the western distributor.

Mr PALLAS — Are you asking me are we going to seek to negotiate away the material adverse effects and compensatable enhancement provisions in the concession deed that the Kennett government entered into?

Mr D. O'BRIEN — No, I am asking you about the western distributor, Treasurer. It is your new project. Is there going to be an adverse concession deed in that?

Mr PALLAS — Sorry, member. The point here is that there already is a concession deed dealing with Transurban. We could deal with the western distributor as if it is an isolated part of the network, and quite frankly my view about what happened in 99 is that it happened for the circumstances that occurred at the time. I am not being critical of the previous government for entering into those arrangements — it was the first toll road of its nature in the state — but quite frankly I think they are relatively archaic provisions. I certainly do not see that there is much value in replicating them in new agreements going forward.

The question is, and this is subject to a negotiation: would we be in a position to negotiate with Transurban a network-wide or concession-wide variation to existing contractual provisions? I do not know. Certainly from my perspective I would like to try. But does that mean that we will be in a position where we can guarantee that the existing network implications that are incorporated into a current contract between the state of Victoria and Transurban should be now the subject of a wholesale review? That will be largely dependent upon whether or not there is a willingness on Transurban's part to do it, but certainly from my perspective I think they are relatively archaic provisions, and if we could, I would not like to see them preserved.

Mr D. O'BRIEN — So you are saying the provisions there at the moment will apply to the western distributor as well — there is no change to the contract with Transurban?

Mr PALLAS — Well, as you would appreciate, the nature of the contractual negotiations that would have to be entered into with Transurban — and I might throw to David Webster on this — will be about the extension of the concession deed. As we have indicated, the extension of that deed will be with all its contractual accoutrements as they currently exist. Now, does that open up a capacity for us to negotiate terms already struck? Well, I will defer to — —

Mr D. O'BRIEN — Before we go to Mr Webster, can I just get a very clear answer? If you go ahead with the western distributor, there is an agreement with Transurban, and presumably there is an additional contract as this is the new project. Will there be anything in that that forces a future government to pay compensation or any other costs if a future government goes ahead with an east–west link or something similar?

Mr PALLAS — No, there will be no further impost on the state other than that which exists at the moment. Now the point I am trying to make is that there currently are material adverse effects clauses in the concession deed. Simply by extending that concession deed there could well be a continuing obligation on the state. I am sure those on the other side of Parliament would no doubt have turned their minds to this issue at the time that you were looking at the east–west link, because no doubt there would be an issue of relevance around the provision of the concession deed. It no doubt would be a matter available to Transurban to seek to exercise rights in that contract entered into by the Kennett government, but is it our intention to seek to augment those rights as a consequence of the western distributor? The answer would be no.

Mr MORRIS — Treasurer, I think the question is: what would the government's reaction be should Transurban seek to exercise those rights in the context of the new project?

Ms SHING — Very speculative here.

Mr PALLAS — Well, can I put it in the context that I feel most comfortable with and you tell me if you feel uncomfortable with it. If in fact — —

Mr MORRIS — My comfort is of no concern.

Mr PALLAS — Our view would not be to augment the state's exposure but there is an exposure there, Deputy Chair, and that exposure is from an existing contract.

Mr MORRIS — The exposure is also to the existing infrastructure. You are proposing to extend the infrastructure. We are saying: will you permit the existing obligation to extend to the new infrastructure? That is the question, not what you might do about renegotiating an old deal. We are interested in whether that obligation will extend to the new infrastructure that is being constructed.

Mr PALLAS — I do not want to conduct a commercial negotiation through a parliamentary hearing. I have made my views clear, that I think they are relatively archaic provisions. I certainly would not want to see them extended. From our perspective — and I am not critical of the Kennett government, might I say, for doing this

and I am not trying to make a political point here — it was done in the context of there being no track record to assess what the risk to the taxpayer was. We now have a clearer appreciation.

Mr MORRIS — I think we are all in furious agreement on that, but what we are trying to find out is what the implications are going to be going forward for the taxpayers of Victoria and for future governments.

Mr PALLAS — I think I have answered the question.

Mr MORRIS — What sort of deal are we going to be signed up to?

Mr PALLAS — I have answered the question, have I not?

Ms SHING — You may not like the answer.

Mr MORRIS — No. We are certainly no wiser and the public are no wiser.

Ms WARD — That might say more about you.

Mr MORRIS — We can only assume from your answer that there in fact will be an obligation on future governments and an obligation on the taxpayers should alternative projects be — —

Mr PALLAS — Let me try and be as clear as I can.

Mr MORRIS — Okay.

Mr PALLAS — The contractual arrangements that relate to material adverse effects and compensatable enhancements that are currently within the contractual arrangements will remain and the state will honour contractual arrangements entered into by the Kennett government. It is our hope and our desire in a commercial negotiation not to see that those obligations are extended as a consequence of the western distributor.

Mr MORRIS — The hope of all of us.

Mr D. O'BRIEN — Treasurer, continuing on the theme, how much does Treasury estimate that Transurban will take in from the additional tolling revenue with the extension of the CityLink contract?

Mr PALLAS — That is part of a commercial negotiation. We are not at that point in terms of being able to give clarity around that, and quite frankly, Mr O'Brien, I think if we were to seek to go down that path, it would only undermine the state's negotiation hand in the context of these arrangements.

Mr D. O'BRIEN — Is that a figure that you expect would become available at a point in time?

Mr PALLAS — I think it not only will be available, it will be mathematically easy for somebody to evaluate in reasonably short order. But the point is I think, from our perspective, we are trying to run a commercial negotiation with Transurban at the same time as we are going through a market-led proposal, and we are very conscious of our obligations to try to ensure that the people of Victoria — that the taxpayers interests are best protected.

Mr D. O'BRIEN — Just following on from that, the extension of the tolls, it does not say at budget paper 3 how long it will be for. That is publicly — —

Mr PALLAS — No, we would expect something in the order of 10 years. We have not put a firm date on it, but I understand people want to have an appreciation of what it looks like, so we have tried to give an order of magnitude, and that is the order of magnitude. There is a commercial negotiation going on, and we will see how we go.

Mr D. O'BRIEN — Will there be any negotiation to reduce the tolls in that area, given that the benefits from the western distributor will not immediately flow to the people in the eastern suburbs?

Mr PALLAS — I have a reasonably firm view about this. When we talk about enhancing our freeway network, everybody benefits from an improved freeway network. Mr O'Brien, if I could make this point: when the state of Victoria decided that we were going to put an availability charge — that is, no tolls — on Peninsula

Link, all Victorians paid for that through our ongoing output allocations to the provision of that piece of road infrastructure. So the thing that we are doing — —

The CHAIR — Order! Dr Carling-Jenkins until 10.40.

Dr CARLING-JENKINS — Thank you, Treasurer. It is great to see you here. And good morning to everyone. From your presentation, Victoria appears to be the best state to be in at the moment, which is very encouraging, certainly in terms of growth in all areas, as you pointed out in your presentation. I also just want to take this opportunity to commend you on the whole-of-government initiatives in the budget, particularly around family violence and jobs.

I understand that there are a number of risks associated with what you described as economic momentum, and you have acknowledged that and certainly have pointed those out in budget paper 2 on pages 58 and 59. So in the 8 minutes I have been allocated I just want to ask a couple of questions on two of the fiscal risks here. The first one is around the state taxes. You touched on this a little bit in your answers to Mr Dimopoulos's questions as well, but I just wanted to narrow in on the land transfer duty. You have acknowledged this as being the source of a relatively volatile tax base and that revenue from these sources may be subject to substantial annual variations. I understand that this is also a tax that economists often describe as distortionary and that it pushes up the cost of housing, which disincentives people from making economically sensible decisions around moving.

I wonder if we could just unpack a little bit around housing affordability, and also I just want to ask a question around: has the government considered taking steps such as have been undertaken by the ACT government to move the tax base away from such a revenue stream that can be considered to be unreliable, distortionary and damaging to housing affordability?

Mr PALLAS — Well, look, an economist, a purist economist, will tell you tomorrow that it is, and I am surrounded by some very good economists and public policy planners. They will tell you tomorrow — —

Dr CARLING-JENKINS — That is encouraging. I am glad.

Mr PALLAS — They will tell you tomorrow that it is a valuable thing to move to putting a standardised tax on land rather than on transactions. But I have got to tell you: a wholesale transfer from transaction to land is not something that we are contemplating. Can I say the reason why that is such a problem for us? Yes, if you could take the transactional costs off contracting and the transfer of land, that would be a good thing, but it would not be a particularly good thing if the state of Victoria lost access to the revenue base that is implicit in it. However, the big problem is that it means that you are putting a tax on every residence, every private home, people's principal place of residence. For that reason, this government is not attracted to wholesale application of those sorts of arrangements.

Dr CARLING-JENKINS — Okay, so that is a definite no.

Mr PALLAS — Yes.

Dr CARLING-JENKINS — Excellent. Okay. I just wanted to clarify. I just wonder if you can unpack a little bit more around housing affordability, because I know that is something that you have identified as an ongoing problem in Victoria. We have such a healthy economy at the moment, which seems to be an opportunity to address this, and I just wonder if you can just speak to that point for a little while about what plans you have in place, because while you mentioned we have a very attractive housing market in your answer earlier, it is also a very difficult market for families and younger people to break into.

Mr PALLAS — It definitely is and there is a clear imperative, I think. The government needs to continue to work in this area. One thing I have been clear on is that we have decoupled from the budget process the fact that we are doing some work in and around housing affordability as a government. We anticipate until the end of the year that we will come up with and publish a broader housing affordability strategy for the government.

I want to say part of the issue here is that far too often, I think, we compartmental — —

Ms PENNICUIK — Compartmentalise.

Dr CARLING-JENKINS — That is the one. Thanks, Sue!

Mr PALLAS — Thank you very much. I am beholden to the Greens.

Dr CARLING-JENKINS — There is a break coming up, Treasurer, it is okay.

Mr T. SMITH — You said it, Treasurer! You said it.

Mr PALLAS — Certainly for pronunciation. We far too often disaggregate this problem into small parts, and we need to recognise that if you are going to do anything in this area, it is not that you have 1000 different solutions to the problem; it is about recognising that it has many different facets. It translates into a regime that the state puts in place around the rights that renters have. It goes to issues around public and community housing and how we provide more of those offerings into the community. The truth is we have seen a very poor investment over recent years into these areas. So we have made a start in this budget, recognising that there is still a lot more to do in this space.

Then of course obviously the other issues are around first home owners and also the availability of land supply into the market and how we minimise the transactional costs for developers in being able to make that land available for housing and approval, and that goes into the planning space. So there is a lot to unpack in this area. We are looking at it in a root-and-branch sense, and we hope by the end of the year to have some clear direction.

Dr CARLING-JENKINS — Sure. Thank you, Treasurer. I appreciate that answer. I would like to move on to another of the fiscal risks that you have identified in budget paper 2, page 59, and that is around the NDIS, which you probably expected to get a question from me on. As you would understand, people with disabilities in the community are getting nervous about how this is going to be funded and when they will be seeing that full fiscal commitment to the program. I just wonder, in the 30 seconds remaining, if you could address that. There is obviously a very significant amount more required.

Mr PALLAS — We reached the landmark agreement with the commonwealth in September 2015, where we would roll out the NDIS. By 1 June 2019 over 105 000 Victorians with disabilities will have transitioned into it. The NDIS will provide people with disability choice and control over the services that they receive to best meet their needs. In the first year of transition three Victorian regions will transition: the north-east from 1 July; Central Highlands from 1 January 2017; and the Loddon area from 1 May. Certainly —

The CHAIR — Order! That is time. We will break now for 10 minutes.

Mr DIMOPOULOS — Treasurer, following up from the previous questions on the western distributor — BP2, page 33 — in terms of the indicative cash flows, I just want to get a sense from you. Obviously this is a significant market-led proposal, and I would not imagine that the government would go down this path if it was not of real economic value as well as budget value. Can you just give us a bit more of a sense of that value?

Mr PALLAS — Yes, I certainly can. One of the things that the government was very intent upon was making sure that we could demonstrate to the community through the release of a business case, up against effectively a public sector comparator, what value there was in the provision of this vital piece of infrastructure. What I think might be useful is to throw to Mr Webster, who might want to just briefly take you through the content of that business case. And I understand you want it to be brief, because I do not want to take much of your time.

Mr WEBSTER — Thank you, Treasurer. As the Treasurer outlined, the business case, which effectively assumes a state build, forms a public sector comparator against which we can judge the value of the Transurban proposal. So in a very similar manner to a normal government procurement of a PPP, we will ultimately test the proposal that comes back from Transurban and the ultimate results of planning and downstream competition of the D&C contracts against that public sector comparator before government makes a final decision whether to enter into the contracts or not.

I think it is very important — that element of competition further down the track — if we do end up transacting with Transurban, because that does drive out a competitive element, and the vast majority of the costs of the western distributor will be competed through a competitive process which is overseen by the government for everyone but Transurban.

Ms SHING — Thanks, Treasurer. Thank you, witnesses. As I indicated at the outset, I would like to take you to the regional investment, which you referred to in your presentation, and most specifically to look at how

we are addressing infrastructure needs for regional Victoria. So if I can take you to budget paper 3, page 48, and ask you to comment on the level of investment in regional Victoria in this budget. If you would like to extrapolate by referring to any Gippsland-specific initiatives and the record spends that relate to this part of the world, no doubt I and Mr O'Brien would be very, very grateful for that.

Mr PALLAS — The government's goal of course is for regional cities to not have to rely on Melbourne for jobs and for services. Our investment is basically aimed at helping those cities to be home for industries of the future. There is a record budget in terms of investment in regional Victoria, with the highest regional infrastructure investment on record — over 2 billion TEI has been allocated.

Mr DIMOPOULOS — Sorry, can you repeat that? The highest ever?

Ms SHING — It is the highest on record, yes.

Mr PALLAS — A number of transformative investments are being made in regional Victoria. So we have got \$325 million for *Jobs for Victoria*. We have got a payroll tax cut of course which applies to every business across the state — about 36 000 businesses across Victoria that are already up against and beyond the payroll tax threshold. Regional rail is being boosted by \$1.3 billion, so \$518 million for the Ballarat line; \$280 million for 27 new VLocity carriages supporting more services right across the network; \$198 million to ensure V/Line can maintain its regional rail services and 141 million to address the backlog of major periodic maintenance works; \$131 million for passenger rail services to Ballarat, Geelong, Warrnambool, Bendigo, Traralgon and Shepparton; and \$23.6 million to improve access, security and comfort at our railway stations right across Victoria.

The issue of course with regard to Gippsland and the Latrobe Valley, I think one of the interesting elements around this package is of course recognising for the valley \$325 million in jobs initiatives has a very clear focus around making sure that we can deal with things like upgrades to irrigation and water security, mobile black spots, streetscaping and important planning work for local projects. There is \$30 million, for example, for the Korumburra district to connect into the water supply, \$25 million to upgrade five schools across Gippsland and the establishment of a local tech school in Gippsland.

Ms SHING — That is over and above the education funding that has been doubled for children in regional schools under the last budget?

Mr PALLAS — That is correct, as you would appreciate.

Mr D. O'BRIEN — I am glad the Dixers have been abolished!

Ms PENNICUIK — No Dorothy Dixers!

Ms WARD — I think it is important to reinforce points. It is very important to reinforce important points.

Mr DIMOPOULOS — It is a truth, Mr O'Brien. You cannot handle the truth.

The CHAIR — Order!

Mr PALLAS — I just saw that as an acknowledge of amazement at how substantial this investment is. One hundred and fifty-one million is going to be invested in modernising and upgrading or regenerating regional schools and local schools, like Baringa Special School, Drouin secondary, Morwell Park primary, Warragul Regional College and Yarram primary. Ellinbank primary will receive funds for special projects that build school and community capacity, and let us not forget Wonthaggi secondary will also get planning —

Mr D. O'BRIEN — Well, you forgot Korumburra.

Ms WARD — That is a lie. It is a long list, Mr O'Brien; it is a long list of schools.

Ms SHING — Mr O'Brien, you will get your turn, as you are no doubt sharing the excitement about this record budget as it is delivered for your particular part of the world. Treasurer, I would like to in particular focus on the Latrobe Valley, and BP3, page 19, refers to the 'Whole of government — Hazelwood' response as a consequence of the Teague reopened inquiry report and the implementation of those recommendations. Could

you actually comment on how those initiatives will actually deliver for the Latrobe Valley as far as medium to long-term growth and investment are concerned?

Mr PALLAS — Absolutely. If you appreciate, the government took a very substantial position to reopen the Hazelwood mine inquiry. That led ultimately to some very substantial commitments from the government with regard to ensuring that substantial action could occur. I suppose the most important thing that flowed from the reopening of the inquiry was the government providing additional asset and output funding of \$51.2 million over five years for initiatives to respond to the reopened inquiry; \$27.3 million has been provided for the health needs of residents of the Latrobe Valley; \$13.8 million to rehabilitate the Latrobe Valley mine sites and also for land use transition; and \$10.2 million for air quality monitoring and assistance to emergency services agencies to implement the inquiry's recommendations. There is also a recognition by the government that there needs to be a long-term plan for transition in the Latrobe Valley, so the government is working to diversify the local economy in the Latrobe Valley.

Ms SHING — In that regard, Treasurer, in the area of diversification and jobs creation, which you referred to in your presentation and which was also referred to in the course of earlier answers that you have given on jobs growth, youth employment is a serious issue within regional areas, as you would no doubt be aware. Can you elaborate on measures being taken to ensure that infrastructure investment drives that local employment that we need so badly?

Mr PALLAS — Clearly investment in regional infrastructure is critical and a key component of this budget. If I take you to, for example, our investment in regional roads as an illustration of this, we need safe, efficient roads, so the budget provides \$260 million to repair and upgrade unsafe and deteriorating roads. In regard to regional and rural Victoria, the budget provides \$427 million in investment to improve safety and to reduce death and serious injury, \$107 million for the Drysdale bypass and \$51.6 million of course most relevantly for the Princes Highway east between Orbost and the New South Wales border. The Midland Highway will get an upgrade. The Great Alpine Road, the Murray Valley Highway — —

Ms SHING — Support for new and emerging industries, Treasurer?

Mr PALLAS — Support for new and emerging industries? Of course the government has put in place processes through our Future Industries Fund and the augmentation of those funds, which demonstrates that the government has a continuing recognition of and commitment to new and emerging industries, particularly renewable energy. These are important, I think, for us to — —

The CHAIR — Order! Mr Smith for the next 10 minutes please.

Mr T. SMITH — Good morning, Treasurer. Referring to table 5.2 on page 169 of budget paper 5, you set out the value of various different tax concessions. One of those lines on the table refers to land transfer duty concessions for first home buyers of properties valued up to 600 000. Treasurer, you have said that housing affordability will be subject to a package of reform by your government in the second half of this year. My question is: do you commit that the current 50 per cent stamp duty concession for first home buyers introduced by the coalition will not be reduced or restricted in any way by your government?

Mr PALLAS — Sorry, Mr Smith, could you just restate the final question?

Mr T. SMITH — Will you reduce or restrict in any way the stamp duty concessions that were brought in by the previous coalition government as part of your package?

Mr PALLAS — I do not see myself constrained by policy of the previous government. What we said as a government — —

Members interjecting.

Mr PALLAS — I might make the point that the previous government restricted the government on first home owner grants in terms of the scope under which they applied. Of course they restricted it to new build in terms of property. So does this government consider itself constrained by whatever policy approaches the previous government put in place? No, we do not.

Mr T. SMITH — With respect, Treasurer, I am not asking whether or not you are being constrained by anything. I am asking whether or not you are going to change the stamp duty concession.

Mr PALLAS — Well, I simply said in response to a question from Dr Carling-Jenkins, and I will restate that position to you, the government has not yet concluded its consideration about how it intends dealing with the issues of housing affordability. I would make the point that it is pretty apparent to anybody who has got a kid trying to get into the housing market that the policy settings that are in place at the moment have not assisted in terms of dealing with reducing the pressures on housing affordability for first home owners, and the government is looking at all options available to it and we just do not have a finalised position on them. But we will by the end of this year.

Mr T. SMITH — Because I would contend that a \$15 000 reduction on a \$600 000 property is a significant concession that enables young people to buy their first home.

Mr PALLAS — And I would accept that.

Mr T. SMITH — And I am wondering why you will not give a commitment today that that will not be changed. I think you need to give confidence to young people who are trying to enter the property market.

Mr PALLAS — Look, I would accept your proposition that simply taking an allocation off the opportunity for people to access the homeowners market would have an adverse effect in the circumstance where that was the only thing you were doing. We have come to no final view with respect to all of the policy settings that are available to government, but I have to make the point that this is not working. Whatever it is that constitutes the raft of initiatives that the previous government oversights, we have seen first home owners become a lesser and lesser section of the cohort of people purchasing housing. So the government has to do something about it, and simply to start today ruling in and ruling out in terms of policy options things we might do —

I am more than happy to have myself held to account at a subsequent point by this committee on the actions that the government takes, but I think it would be both unfair and unreasonable in the absence of government having come to a concluded view about what an appropriate policy response would be — as I said, an appropriate root-and-branch policy response — for us to start ruling out all options.

Mr T. SMITH — But as a basic premise you would agree that increasing stamp duty for first home buyers will have a detrimental impact on housing affordability for them, would you not?

Mr PALLAS — I would accept that if there is an amount that first home owners would be disadvantaged from in terms of their capacity to access the market it would have an adverse effect upon them in the absence of alternative policy settings, and that is as far as my concession would go. I think government needs to look at are we getting value for all of the taxpayers funds that are being provided in these concession arrangements. I would certainly say that for any government that oversights what falls into the capacity of hundreds of millions of dollars of concessions you need to satisfy yourself that you are getting value for money, and clearly we are not because first home owners are falling further and further out of the homeowners market.

Mr T. SMITH — I would agree with that, as one of them. Thank you, Treasurer. My further question is: do you rule out any reduction to eligibility restriction of the \$10 000 first home owners grant that available to first home buyers purchasing a newly constructed home with a value of up to \$750 000?

Mr PALLAS — Well, I know where this is going and I think it may be a wonderful game that we are playing here where you attempt to get me to rule in and rule out —

Mr T. SMITH — I am not playing games, Treasurer. I am asking a very reasonable question.

Mr PALLAS — No, you are not, because you are asking me a hypothetical question in the context —

Mr T. SMITH — It is not a hypothetical question, Treasurer, with respect, because you have a task force in the Treasury that is looking at these matters. I think it is rather curious that you have increased your stamp duty take by 30-odd per cent, yet in the budget you have not said frankly anything about housing affordability and you have punted it off until the end of this calendar year, so I think it is a perfectly reasonable question and we want an answer.

Mr PALLAS — Well, here is the answer. This government is doing something about it. The previous government did nothing, and we saw the situation diminish progressively. This government is intent on looking at all of the policy options available to us, and I am not today going to start ruling in and ruling out anything.

Mr T. SMITH — Thank you for not answering my question.

Mr MORRIS — I will perhaps give the Treasurer a break and direct a question to Mr Martine, if I may. The reference is budget paper 4, page 114–15, but the broader subject is Melbourne Metro, so the questions are in that context. Starting with the funding — there is a slightly different budget paper reference for that — BP2, page 7 — but there is a TEI of \$10.9 billion. There seems to be 8 billion of that that is beyond the forward estimates, and I am wondering whether any decision has been taken yet how that 8 billion will be financed.

Mr MARTINE — Thank you, Deputy Chair, for the question. Perhaps the best way to answer that question is actually to refer you to page 33, chapter 3 of budget paper 2, where the budget papers outline forward projections as part of the 10-year capital plan out to the year 2025–26. It is page 33. There is a table at the top of that page which has the Melbourne Metro tunnel forward estimates profile; it makes reference to the \$10.9 billion TEI. But more importantly, chart 3.3 shows the current profile of net debt across the forward estimates, which incorporates the forward estimates profile for the Melbourne Metro. Then we extrapolate that net debt out to the year 25–26, which is the dotted line, and effectively the continuing funding for the Melbourne Metro, beyond what is in the forward estimates, to accommodate the 10.9, is then built into that dotted line across the 10 years to the year 25–26.

Mr MORRIS — So I take it that it is to be financed by debt?

Mr MARTINE — Effectively at this point in time we essentially assume a state build effectively fully funded by the state. Then we go to the process, obviously through design, tendering processes, contractual arrangements et cetera, which may then in the end change the delivery of how it is going to be achieved. But I guess the important point there is we have factored in for the next 10 years an amount to fully fund the Melbourne Metro, including beyond the forward estimates.

Mr MORRIS — What I am interested in is the source of the funding.

Mr MARTINE — I guess the best way to answer that question is the Melbourne Metro can be fully funded over the next 10 years, in the absence of any other policy change by the governments of the day, with net debt, based on current projections falling to 3.2 per cent in the year 25–26.

Mr MORRIS — So I am still none the wiser. We can only assume it is debt if there is a reference to debt.

Mr PALLAS — So can I just have a shot at it, Deputy Chair, in the context that what we are saying is there is \$7.4 billion over the forward estimates of capital allocations that are not impacting upon the debt profile of the state going forward. Then if you go from the year 5 to 10, there is the same sort of capacity — probably growing — going forward. Once again, that does not impact upon debt, and it is simply a question of choice about how you allocate those funds.

Mr MORRIS — Okay, yes.

Ms PENNICUIK — If I could refer the Treasurer to budget paper 3, page 116, and this is in relation to the brown coal royalty revenue initiative which Ms Shing was so excited about. So the forward estimates indicate there on table 1.30 that the brown coal royalty is projected to be \$36 million in this financial year, increasing to \$72 million for the next three years of the forward estimates, at a total of \$252 million in royalties. So the obvious inference from this table is that the government has no plans or anticipates no reduction in the amount of brown coal that will be used in Victoria's power stations over the forward estimates period, and therefore no reduction in greenhouse gas emissions from those power stations.

Mr PALLAS — Firstly, to just clarify why there is a difference — half — in the 16–17 year as opposed to the 17–18 year is largely because of the tax effect on 1 January, and therefore it is only half of a calendar year; then on an annualised basis on existing demand, and our expectation is that certainly over the four-year forward estimates the state needs electricity, and they are the principal providers of that electricity. So the government intends to ensure that we get fair value for that electricity, for the use of our non-renewable resources, by increasing our brown coal royalty rate threefold.

Brown coal is an emission-intensive fuel source — we acknowledge that — and the new royalty rate will support our transition to a cleaner energy generation mix and low emissions future. It is consistent with our commitment under the December 2015 Paris agreement to aim to limit global warming to 1.5 degrees. We acknowledge that this puts some commercial rigour into the use of the resource. Victoria's existing royalty rate has been significantly lower than the rates applied in other Australian jurisdictions, when it is standardised for energy content, for example, and the revised brown coal royalty rate will bring Victoria broadly into line with the royalty rates applicable to black coal used for energy generation in New South Wales when standardised for that energy content.

Ms PENNICUIK — Thank you, Treasurer. Just to clarify, that table 1.30 confirms that the government has no plan to reduce the use of brown coal in Victoria's power stations and thereby reduce emissions. So you are saying, 'a low emissions future', but this particular table indicates no level of reduction in the use of brown coal to the year 2019–20.

Mr PALLAS — Well, the table is as is; it basically shows a standard rate. What we are going forward, after the half-year allocations — —

Ms PENNICUIK — It says a standard rate, but that is a standard income expected by the government. So if the government is putting that into the forward estimates expecting to get that income from the royalties, it of course implies no reduction in the use or emissions.

Mr PALLAS — Of course our approach to that is in the context of making a commitment to renewable energies, and recognising that we have an obligation to manage the transition in the long term to a greater focus upon renewables, and we are doing that. We have indicated that we will be making comment in the future about what a Victorian renewable energies target will look like. We will put, effectively, market forces and state investment into this area. But if your suggestion is that the state should anticipate that there should be a massive falling away of brown coal usage in the next four years, I think that could have catastrophic implications to Victorian industry.

Ms PENNICUIK — Treasurer, I am not suggesting anything. I am suggesting there will be no reduction, whether it is massive or small. Your budget paper indicates no reduction. I want to know how you can say that the royalty rate will support the transition to cleaner energy sources?

Mr PALLAS — Well, the state has made an indication in its jobs strategy that it will be placing a greater contribution into looking at how we deal with renewable energies going forward. Those investments are clearly spelt out. The climate change and energy innovation jobs at 7.6 million is being put in place; driving renewable energy is at 12.4 million; saving energy, growing jobs, 24.2 — —

Ms PENNICUIK — How is a steady rate — —

The CHAIR — Order! Ms Ward for 10 minutes.

Ms WARD — Treasurer, I want to refer to budget paper 2, page 33, table 3.1 as well as page 14 of your presentation. You have spoken a little bit about Melbourne Metro, but I am interested to know how the funding is going to work beyond forward estimates and how the federal government changing the funding profile is going to fit in with the funding for the Melbourne Metro project. Can I say again I am extremely happy about the funding for the Hurstbridge line. Thank you.

Mr PALLAS — I think, really, just to augment what Mr Martine has said, what we have tried to do in the idea of a 10-year capital spend is to give some certainty — because the nature of this project extends well and truly beyond the four years of the forward estimates — and to give an appreciation that the state has the capacity, and the will, might I say, as evidenced by this budget, in making the necessary investment going forward. So we have fully funded Melbourne Metro. The 16–17 budget commits the state to \$2.9 billion over the forward estimates — that is, the four years of the forward estimates — to progress the construction of the project. We have also set aside, in terms of our planning, the choices that we make in terms of the available funds to the state going forward.

The announcement by the commonwealth of so-called asset recycling money for Melbourne Metro being their choice and their direction is, I think, most unfortunate, because it is a distortion of what that scheme was

supposed to be. How Joe Hockey described it, and how it was to apply was effectively at the choice of the state, and for good reason. Ultimately when the state converts through asset recycling a dividend provider to the state, we forgo revenue and we convert it into a corporation tax paid to the commonwealth. So they have now dipped in a second time and basically they want to get up and take a bow for money that is quite rightly the state's. This behaviour is entirely inconsistent with the previous positions and the basis under which we entered into these national partnerships around asset recycling. I would just make that point.

Ms WARD — Is there any additional capacity created through this announcement by the feds?

Mr PALLAS — No, not really. I suppose to the extent that it means that there will be funds incorporated into the Melbourne Metro project that we have already made provision for, it will probably provide some relief elsewhere in terms of our capital agenda.

Ms WARD — Is it substantial relief?

Mr PALLAS — The big problem with it from our perspective is that what the commonwealth has done, and rather ham-fistedly, is jump in on a capital spend profile that does not assist in the efficient delivery of this particular project. The state would have preferred to have managed the delivery of this project. There are other projects. We have been in correspondence and discussion with the commonwealth about how the moneys and projects that require immediate capital injections could have fitted more appropriately into the commonwealth's asset recycling agenda and were the priorities of the government for the purposes of being recipients of that. I mean most notably level crossing removals. But of course the commonwealth, for whatever reason, and I assume it was purely political, wanted to get up and take a bow and pretend that they were putting into Melbourne Metro when in fact this money was and always has been Victorian.

Ms SHING — Announcement recycling, perhaps.

Mr DIMOPOULOS — Thank you, Treasurer. I draw your attention to your presentation as well as Ms Ward's reference to the budget papers for Melbourne Metro, fully funding Melbourne Metro, as you described on page 14 of your presentation but also just a moment ago. How do the part-PPP arrangements figure in that funding model? Can you explain a bit more about how we are utilising the PPP instrument for delivering Melbourne Metro?

Mr PALLAS — Sure. The PPP arrangements around Melbourne Metro — the tunnel itself is being separated into four main packages of works. The early works package is being procured through a managing contract or arrangement, and that is led jointly by Yarra Trams and the state, and this includes utility service relocation, tram infrastructure works, construction, power and works to prepare the construction site. Proposals by shortlisted bidders for the package of works are currently being assessed by the government.

The tunnel and stations package represents the bulk of the project. It has been procured through an availability payment PPP. That package includes main tunnelling works, five underground stations, station fit-out, mechanical and electrical systems, specific operation and maintenance services for infrastructure delivered by the package and commercial opportunities at the new stations. The call for expressions of interest on this part of the project went out last week.

The rail infrastructure package will be procured through competitive alliancing, and this package includes works at the tunnel portals, realignment of the existing lines and other infrastructure works. The rail system package will also be procured through a competitive alliance, and that package will involve system design, installation works, rail system integration and commissioning. Finally, wider network enhancements will be procured on a case-by-case basis.

Mr DIMOPOULOS — Thank you. In relation to the risks, there is a high-risk, high-value project section, and Melbourne Metro is one of those. I think it is more high value than high risk, but nonetheless that is where it fits in. In terms of the PPP arrangements and what you just described, can you outline how the costs and risks will be managed, particularly in relation to the expertise type of market in relation to the construction and the procurement?

Mr PALLAS — Excellent. High value, high risk is I think in budget paper 4. Can I just defer to Mr Webster to take you through those safeguards that the state has put in place.

Mr WEBSTER — Thank you, Treasurer. The Treasurer outlined the PPP package for the tunnels and the stations. One of the important elements of a PPP is that the state actually does not start paying for any infrastructure or infrastructure services until effectively the scope has been delivered and has met its acceptance criteria. What that does do is actually isolate the state from construction risks, so once we have entered into the PPP, the construction risk around delivering that scope within the PPP package is fully taken by the PPP special purpose vehicle and passed down to the design and construct contractors, usually under a pretty stringent fixed-price, turn-key, lump-sum contract.

The state, effectively, in a PPP pays for results, so unless the private sector special purpose vehicle is meeting its key performance indicators, it gets abated against its availability-type payment. So it is a very good way of transferring risk to the private sector, particularly around the longer term performance of the assets and construction risk as well.

Mr DIMOPOULOS — Just to add, just for the record, BP4, page 10, is one of the budget paper references for this question, but Mr Webster, in relation to what you said, just as quite a tangible example, further to what the Treasurer said, what would that mean in the case of those four packages — I think it was four that the Treasurer was talking about. Would the private sector invest first? Is that what you suggested before?

Mr WEBSTER — Effectively for this size of PPP we would envisage the private sector funding the majority of the construction costs of the PPP, but also some government money going in towards the back end of the construction period to co-fund construction. We would further envisage the potential to look at grants at the end of construction, in addition to availability payments. That is all options we anticipate putting in front of government at the appropriate time.

Ms SHING — Thanks for that. Treasurer, I might just pick you up in relation to education capital investment, and ask about the level of investment in education capital — —

The CHAIR — Order! The Deputy Chair for 10 mins.

Ms SHING — Then I won't do that at all!

Mr MORRIS — Thank you, Chair. Can I go back to Mr Martine and continue that conversation we were having about Melbourne Metro. The specific budget reference this time is BP4, pages 114 and 115 under the VicTrack existing projects. In that context, I note that it is in the PNFC sector rather than an agency within the general government sector. If debt is raised to finance any of the future capital components of Melbourne Metro, will that debt be recorded in the GGS or in the PNFC sector?

Mr MARTINE — Thank you, Deputy Chair. Effectively, the assumption, as we have discussed, is a state build of the Melbourne Metro, which is a general government sector build. So those numbers that are disclosed in the budget papers across the budget and forward estimates are within the general government sector, and the page I referred you to in chapter 3, which has the debt profile down to 3.2, is general government sector debt.

Mr MORRIS — Given that it is recorded in the PNFC for projects, I just wanted to make sure that that was the case. Sticking to page 115, there is a footnote there that says:

The TEI includes funding announced as part of the 2015-16 budget information paper *Getting On With It*. This amount excludes financing costs.

So what I am interested to know is: how much of the \$3 billion-plus debt financing facility that was assumed by the state as a result of the east-west link compensation deal is financing the 2.9 billion forecast to be spent across the forward estimates?

Mr MARTINE — Thanks for the question. So as a general rule — I will try to answer it generally first — when we include initiatives in the budget papers, particularly around state builds, we do not include the financing costs. I get criticised when I use this comment in my department at times, but in a sense it is all 'fungible', so it all gets consolidated together. The Treasury Corporation of Victoria then manages the issuing of bonds, depending on whether debt needs to be raised or lowered, and there are obviously interest costs associated with that.

So as a general rule we do not include financing costs against specific initiatives. As the government announced during the course of last year — I think it was mid-2015 — the financing facilities that were associated with the former east–west link have been repurposed to sort of a bonds — —

I will look to Mr Webster. Is it sort of a bond issuance facility?

Mr WEBSTER — Yes.

Mr MARTINE — Of equivalent amount, which will then be drawn on to help fund the project.

Mr MORRIS — So it may or may not be used for this purpose. Is that the essential answer?

Mr MARTINE — Correct.

Mr MORRIS — Thank you. Coming back to the financing costs and accepting what you say about it not being exceptional practice, can you indicate to the committee what the financing cost will be for the project?

Mr MARTINE — Well, it is a very difficult question to answer, because in a sense we assume the state build across the period of the project, which is including beyond the forward estimates, and as I have indicated, outlined in chapter 3, even with Melbourne Metro included in the forward projections beyond the forward estimates, we have net debt continuing to fall.

Obviously in the absence of a government proceeding with the Melbourne Metro, and in the absence of any other decision, net debt would then fall a bit further. But until we sort of go through and finalise contractual arrangements — and the state build might end up being something a bit different, and Mr Webster outlined PPP arrangements that the government may end up proceeding with. It is a very hard question to kind of say, ‘Well, out of the TEI of 10.9, the financing cost is X’.

Mr MORRIS — You have got a TEI of 10.9. You say it excludes financing costs. But then — —

Mr MARTINE — That is right. That is the cost of building — that is the raw construction cost — —

Mr MORRIS — Just bear with me. But then with the chart on page — not 33, the other one with the net debt profile —

Mr MARTINE — Yes.

Mr MORRIS — presumably that includes a figure that relates to financing cost.

Mr MARTINE — Yes, so the chart on — —

Mr MORRIS — Given that that is the total cost.

Mr MARTINE — That is right. That is the total. Yes. So the chart on page 33, chart 3.3, projects the net debt profile out to 25–26, and that takes into account all current government commitments and decisions. And then we project beyond the forward estimates — —

Mr MORRIS — So there is provision for financing costs in that figure.

Mr MARTINE — I guess built in the aggregate profile of net operating result plus infrastructure spend — built into that is an aggregate financing cost, definitely, and that flows through the operating statement.

Mr MORRIS — Okay. All right. Given that it excludes financing costs — the 10.9 billion — does it exclude operational costs, maintenance costs, additional rolling stock? Have those costs been factored in or not?

Mr MARTINE — I might ask Mr Webster to briefly answer that.

Mr WEBSTER — Sure. Certainly the rolling stock is subject to different procurement processes, so to the extent that the rolling stock necessary is being procured under other contractual arrangements, that is reflected in the forward estimates. The operating costs on Metro obviously do not start until after the tunnel commences operations et cetera, which is well beyond the forward estimates.

Mr MORRIS — So it is included or not in the — —

Mr WEBSTER — There is no need to include any operating costs for Melbourne Metro in the forward estimates because the tunnel is not open and they are not being incurred.

Mr MORRIS — Okay. Thank you. Just going back to the rolling stock, you said they will be in other contracts and that is reflected in the budget papers. Are they included in the 10.9, albeit under another contract, or are they under a separate provision?

Mr WEBSTER — If you look at the high-capacity Metro Trains commitment, that does include additional rolling stock for the network.

Mr MORRIS — Going back to Mr Martine, if I could, and going back to budget paper 2, page 38. That refers to value capture as a method of financing infrastructure projects. Is it the intention to use value capture to in part finance Melbourne Metro?

Mr MARTINE — A bit hard for me to answer a question of, ‘Is it the government’s intention to fund Melbourne Metro through value capture?’. Clearly, as outlined in chapter 3, value capture is an option that governments can use to fund infrastructure, so certainly we look through the various options and provide the appropriate advice, but whether ultimately the government makes a decision on how it wishes to fund Melbourne Metro will ultimately then be a decision of the government.

Mr MORRIS — So I guess whether it is value capture or a special property levy, a surcharge, a tax, fare increases — they are all methods that could be used to assist in financing the project.

Mr MARTINE — If you look on page 38, there is certainly clear references to development of retail/entertainment spaces. That is certainly the focus we are having a close look at. And with Melbourne Metro there are certainly opportunities with the new stations being built, including at Arden. There are some opportunities around retail development that certainly one needs to have a close look at.

Mr MORRIS — So that is something that is being considered for all stations along the project?

Mr MARTINE — Well, we are considering, as you would expect, a range of options, and we will provide our advice to government, and ultimately government will make a decision on which, if any, value capture options it wishes to pursue.

Mr MORRIS — So the other options I mentioned — property levy, surcharges, taxes — they are all options that could be considered as well?

Mr MARTINE — As I said, it is ultimately government’s decisions on these sorts of options. I cannot really comment on whether — —

The CHAIR — Order! Dr Carling-Jenkins for 5 minutes, please.

Dr CARLING-JENKINS — Thank you, Chair. Treasurer, I wonder if we can look at the whole-of-government initiative around jobs, which, as I said earlier, I do commend the government for tackling. I would like to look particularly at the investment attraction and assistance program in budget paper 3, page 29. So this program has an investment of \$116 million over four years, and I just wonder a couple of things. Firstly, how the government will be determining the allocation of these funds. The second part is around the transparency around these funds, so how much will be given to particular businesses and the transparency around communicating how much investment is in turn delivered for Victorians as a result.

Mr PALLAS — Yes, thanks. The *Jobs for Victoria* plan, which is an integral part of the budget and is embedded in many different elements of the budget, does of course incorporate \$237 million for trade and investment activities. Certainly what we have said is that as a government we have put on notice other jurisdictions that we are serious about making sure that if there are operations looking to establish into Australia, we will be keen to attract them. In terms of the processes that government applies, they are pretty consistent and they have been consistently applied across government for some time. Obviously we do not want, nor do I see it as being beneficial, that the state would put its attraction strategies into the public domain. The reason I say that

is we are immediately telling our competitors exactly how much it is we are prepared to pay to attract jobs of a particular nature.

But the government does have a strategy underpinning it and requires justification around what the economic value of these investments are and how many jobs will be created specifically as a consequence. And when government makes a determination around it, it does it on the back of advice that it has received from the relevant departments, and the relevant department in this case is DEDJTR, but it has central agency oversight by both Treasury and Premier's. I think it is important, and perhaps I am not answering the question the way you would like in the sense that we will not and cannot put into the public domain exactly what the attraction numbers are because to do so would simply disadvantage the state and the potential beneficiaries of these arrangements — so there are future employees and in the long term the economic interests of the state.

Dr CARLING-JENKINS — Thank you, Treasurer. That might be something we take up at a later date, but within the 2 minutes remaining I wonder if we can revisit my question on the fiscal risk posed by the NDIS, which you were just getting into the swing of just before our break.

Mr PALLAS — I was, and I will try to get into the swing very quickly. There are continuing and considerable risks associated with the NDIS. The commonwealth has recently indicated there are potentially more funds likely to flow. The question is under what basis these funds will flow, and certainly we have heard some concerning overtures by the commonwealth about governance changes.

Those governance changes seem to imply that the commonwealth wants to have greater control over the NDIS system, and whether that goes specifically to the question of what constitutes qualification of access to the system is of great concern to the state of Victoria. We know already that the commonwealth is making it clear that their intention is not to cover certain categories of disability, mental health being one of the more concerning ones. That effectively means that the state once again, on top of our already considerable commitment and investment into the NDIS, will ultimately find itself in the position of being the funder of last resort.

Dr CARLING-JENKINS — Thank you, Treasurer. Actually, we only have 20 seconds left.

Mr PALLAS — Do you want to ask about education as well, and I might answer that.

Mr DIMOPOULOS — The meaning of life in 20 seconds.

Dr CARLING-JENKINS — That is a very good question, actually. I do appreciate the struggle, particularly around mental health, and that is something that we will obviously all be monitoring over the next few years. Thank you.

Ms SHING — Thanks, Treasurer. I would like to take you to budget paper 4, page 28. I would like to pick up where I was so rudely cut off in relation to education capital investment in this year's budget — the clock being against me — and to seek your comment in relation to the level of investment in education capital across the board, in particular by reference to previous envelopes as they have included funding for education capital.

Mr PALLAS — Yes. Thank you, Ms Shing, and I thought it was heroic that you attempted to get an answer in 30 seconds. Can I say the government is investing over \$924 million to build new schools and to upgrade classrooms right across Victoria. It is the largest ever single investment by a Victorian government in school infrastructure, helping students and also creating jobs for local tradies. This is part and parcel of the story: the government wants to make sure that the benefit of a big infrastructure spend is felt right across the state, and it is also reflected in improving the quality of education.

It is hard of course for kids to get a quality education and for teachers to provide that quality education in circumstances where the school is in disrepair and needs to be improved, and consequently all those secondary schools that have been assessed as being in the worst condition will be upgraded to meet modern standards. This funding goes to fixing the schools most in need, particularly those in regional Victoria. More than 175 schools and communities will benefit from access to the best schools and facilities available, and this is really part of the story about the state wanting to make sure that that capital spend is occurring as broadly as possible. So this is, as I say, a record investment in our schools.

We have delivered more for schools in our first two budgets than the previous government did in four, I might say. So the capital investment for this government's first two budgets is nearly \$1.6 billion. The former government's four-year total was \$1.1 billion, so between 2007 and 2008 and 2010–11 approximately \$520 million a year was invested in school infrastructure. In the 11–12 and 13–14 state budgets funding dropped to around \$200 million a year, and as a direct result of this underinvestment no new schools will be opening in 2016. So \$287 million will be allocated to acquire land, to build and to complete 23 new schools, many in Melbourne's growth areas, where they are most needed. There is \$92 million of course to invest in cutting-edge tech schools at TAFE, 68.5 million to upgrade 20 specialist schools in the poorest condition and \$63.6 million for modern relocatable classrooms. That is to ease the pressure where growing Victorian schools are starting to feel the pinch. There is \$50 million for a new shared facilities fund to help more schools become thriving community hubs, and that is an area that I am particularly interested in. It should have particular relevance in our growth areas.

Ms SHING — In relation to the implementation of those education capital spends across the board, BP3, page 62, refers to the establishment of the school building authority, and I would like you to explain the purpose of establishing that entity as part of these education deliverables and how that will actually perform the work that is currently undertaken by the department.

Mr PALLAS — It is really to help the Department of Education and Training to be in a better position to deliver the rapidly growing schools building program. We acknowledge that this is a quantum step up in terms of the capital spend, and it is going to put pressure essentially on the existing structures within that department to deal with it, so this is aimed at helping them deliver it in a timely and professional manner.

When we came to government the program was in a mess. The contract for new schools had not been completed, and some of the schools were in the wrong places. So in last year's budget we fixed those problems, and we signed up to build 15 new schools. In 2016, as I say, we have seen that there are no new schools opening, largely as a direct result of underinvestment under the previous government. So this year we have funded nine more new schools spread across the growth corridors and the inner city. We are restoring schools to areas where schools were shut down during the 1990s, and the total commitment for upgrading and also for maintaining school buildings over the last two budgets is now \$1.8 billion.

So it is a record commitment for schools. Over the next three years, as a result of the 15 and 16 budgets, we expect 24 new schools will be opened and 4 half-built schools will be completed, so you can see a very substantial effort going in — and recognising that we need a program of assistance and support within the department for a more commercial and efficient delivery of this program, establishing a standalone authority as an administrative unit under the Public Administration Act, we believe, is the most efficient way of assisting the department in doing this work.

Ms SHING — How is that going to streamline the impact felt by population growth, which you indicated in your opening comments is obviously bolstering the economy but also having us grow at the strongest pace in the nation, in relation to how the new schools will be developed in outer suburbs of Melbourne?

Mr PALLAS — There is no doubt that there are certain sections of our community that are particularly feeling the pressures of population growth, so, as I have said earlier, our population growth is substantial; it is 1.7 per cent over this year. It is the highest population growth of any state. Look at places like Casey, which is growing by an average of 7300 people per year; and in Wyndham, which includes my own electorate and I understand Dr Carling-Jenkins's as well, there are 12 babies born each day — that is about four school classrooms per week. This budget invests \$287 million to acquire land to build or complete 23 new schools, many in our growth areas where they are most needed, and 63.6 million for more relocatable classrooms to help with that step-up demand, as it were, to ease the pressure on those growing Victorian schools.

To give you an example: Manor Lakes college, construction of stage 5, \$10.9 million; Tarneit secondary college, 11.6; we are looking at land acquisition in Warringa Park; and we are looking at the Wyndham area. If you look at Casey, the Casey Fields land acquisition; and Cranbourne secondary upgrade, a modernisation of \$9 million. So there is a very substantial program not just of build but of upgrade and of land acquisition and planning, so it is all the way through the process so that we have this pipeline of delivery.

Ms SHING — What is the split like between metropolitan and regional areas and what is the rationale for that as far as investment is concerned?

Mr PALLAS — Well, the split is based on need, quite frankly. Basically what we have said as a government is that we see that the first and foremost requirement is where is the population coming through and what do we do in terms of identifying what the key requirement for the upgrade of schools is? Need is the obvious one. Where schools were seen as being in the most urgent need of repair, the government has made the necessary commitment for the capital upgrade. With respect to those schools that have inadequate supply for those communities, that have inadequate services because of population shift and population growth, we are making that investment. But the key here is that we have made a very substantial commitment right across the state.

Mr DIMOPOULOS — Treasurer, can I ask you a quick one? You touched on it a moment ago: BP3, page 65, the shared facilities — I think it is fantastic initiative. People do not expect governments to stick to their own area; they expect governments to work together. Will there be a dollar-for-dollar match commitment for councils, for example? How is it going to work in a funding sense?

Mr PALLAS — This will be on state facilities, so it will be a state asset that is being upgraded. The initiative is fundamentally about changing how we think of a school —

Ms WARD — It is working very well in St Helena.

Mr PALLAS — relative to its community. I think too often the school has been viewed as basically a weekday, 8–4 facility. If we continue in that view, then ultimately we are underselling a valuable asset.

Mr DIMOPOULOS — For nights and weekends?

Mr PALLAS — Yes, it is about the co-locating of services and giving the community access to what is an asset base that they should see as something that they have ownership of and are entitled to use — —

The CHAIR — Order! Mr Smith for 10 minutes.

Mr T. SMITH — I just want to refer to the conversation previously begun by Mr Morris, and particularly comments by Mr Webster and Mr Martine. Treasurer, why can you not tell us if the debt facility that was meant to be for the east–west link is or is not being used to finance Melbourne Metro? I would have thought — —

Ms WARD — What is your reference, Mr Smith?

Mr T. SMITH — I am referring to an earlier conversation; it is a perfectly reasonable question.

Mr PALLAS — Sorry, could you just restate the question?

Mr T. SMITH — Treasurer, I am trying to understand the debt facility from the east–west link. Is it or is it not financing Melbourne Metro?

Mr PALLAS — Well, the simple answer is yes, that is what the government has indicated is our intention to do. So as part of the arrangements that were put in place at the time of the agreed termination of the east–west contract for \$1 the government agreed also to take on the existing debt of the project company. We also indicated to the community that we would acquire the credit facility of \$3.145 billion. The government has indicated that it intends to negotiate with the banks to take over that and repurpose that facility. It will be available to the state to apply to the Melbourne Metro rail project. I do not believe there is anything inconsistent with what has been put to you other than that the state now has a capacity to utilise that facility as and when it sees fit for the purposes of this project.

Mr T. SMITH — So you have moved the 2.9 billion credit card from the east–west link to Melbourne Metro? That is not what your bureaucrats were telling us just before, Treasurer.

Mr PALLAS — Perhaps I will just ask the bureaucrats. If you are in the position of trying to put words in their mouths — —

Mr T. SMITH — I am not putting words in their mouth, Treasurer.

Mr PALLAS — It is not for me to try to contradict them. I understood the position that was being put was whether or not the state had a continuing intention and use for the credit facility. That is its — —

Mr T. SMITH — So it is currently being used?

Mr PALLAS — It is not currently being used. It is available to the state to utilise should we wish, and it is our intention to appropriately utilise it at an appropriate point in time.

Mr T. SMITH — Moving on to east–west, the \$1.5 billion that has been pledged to Victoria by the Turnbull government for a multitude of different projects, that is predicated on the state matching it dollar for dollar. I am just interested as to where in the budget that money has been appropriated and what projects you are going to be mutually funding with the commonwealth.

Mr DIMOPOULOS — Budget reference?

Mr MORRIS — BP5, page 5.

Mr PALLAS — Of course we have not as yet reached an agreement with the commonwealth. What we have indicated to them, and I think the Auditor-General in his observations indicated that an agreement is likely to be reached with the commonwealth and therefore — —

Mr T. SMITH — Sorry, can you repeat that, Treasurer? I missed it.

Mr PALLAS — The Auditor-General, in removing his qualification against the previous budget and not persisting with it in this budget, has indicated that it is likely that an agreement would be reached with the commonwealth around the \$1.5 billion that is repurposed for east–west. We have written to the commonwealth, both the Premier and myself, and we have indicated to the commonwealth that we are keen to enter into the negotiation for the purposes of applying and usefully directing the funds. And yes, incorporated within those arrangements is an obligation on the state to match the commonwealth dollar for dollar. When such an obligation is created, the state will have to account for that obligation, and we will do so when the obligation is created.

Mr T. SMITH — There is an obligation. What are the projects?

Mr PALLAS — No, there is no obligation at the moment.

Mr T. SMITH — You have agreed with the commonwealth that you will fund their projects dollar for dollar.

Mr PALLAS — Yes.

Mr T. SMITH — Okay.

Mr PALLAS — Of course we do not know how much that will be because some of the projects that we are currently undertaking overlap with what the commonwealth are currently contemplating. Most notably we are putting up to \$400 million into the Monash Freeway upgrade. We will need therefore to discount that against the state contribution. So we do not know what the level of the liability that the state will require as a consequence of that engagement; that is what a negotiation is about.

But if the simple proposition is: does the state intend to reach an agreement with the commonwealth? We do. We think it is ultimately in the state's best interest that we can apply and put to good use the \$1.5 billion that is effectively simply accruing interest on the Victorian books at the moment, and we will do that, and of course in applying it we will also meet whatever funding obligations we agreed with the commonwealth for the purposes of the state obligations. But let us recognise that this will obviously have to be in the context of a capital investment profile over a number of years.

Mr D. O'BRIEN — Treasurer, turning back to coal royalties again — budget paper 5, page 164 — the Premier made a very clear promise before the election of no new or increased taxes. How is the tripling of coal royalties not an increase or a new tax?

Mr PALLAS — I would put it simply this way. You could have also asked me the question: how does an increase of a foreign purchaser charge apply, and I will — —

Mr D. O'BRIEN — I know what your answer will be on that. I am asking this more specifically, Treasurer.

Mr PALLAS — I will give you both answers. Firstly, a royalty is a payment for the state resources — that is, for an asset that the state owns and provides to a company that seeks to — —

Mr D. O'BRIEN — A payment to the state is a tax, Treasurer, not a new thing.

Ms WARD — Do you want to let the Treasurer finish?

The CHAIR — Order!

Mr PALLAS — This is essentially an asset, a resource of the state, and we are getting fair value for it, so if you choose to recognise that as a tax, I would say that a tax has broader application and the people of Victoria would be very poorly served in circumstances where we know as a matter of fact that they are getting appreciably less.

Mr MORRIS — Every electricity consumer in Victoria is not broad application, is that what you're saying?

Mr PALLAS — So now you are talking about the downstream cost of it, are we, Deputy Chair?

Mr MORRIS — Yes. If you oppose a tax, you have got to know where it is going to hit.

Mr DIMOPOULOS — It is not a tax.

The CHAIR — Order! The Treasurer is answering the question.

Mr PALLAS — The advice that we have of course from Treasury is that the cost of this is so negligible in terms of consumption that we have made it pretty clear that the Essential Services Commission should take steps to ensure that these costs are not flowed on to consumers. Can I give you an appreciation of how minuscule this is?

Mr D. O'BRIEN — Okay, Treasurer. We have not got that much time. You have given the Treasury advice — minuscule. So the Minerals Council of Australia, Victoria Division, says:

There is no doubt that energy suppliers will be forced to increase costs to consumers in Victoria as a result of this decision ...

...

The expected increase in electricity costs will hit Victorian businesses hard ...

How can \$250 million additional tax on 90 per cent of our brown coal — 90 per cent of our electricity — not have an impact?

Ms SHING — It is a royalty. It has actually just been explained.

Mr D. O'BRIEN — How could it not have an impact?

Mr DIMOPOULOS — It is our resource, mate — —

The CHAIR — Order! The Treasurer is answering the question.

Mr PALLAS — As soon as you are ready for an answer, I will give you one. So, first point, a coal royalty — a payment for the fair value of the resources of the state — is the obligation of the state to make sure that Victorians get value for money.

Mr D. O'BRIEN — I am talking about those downstream impacts, Treasurer.

Mr PALLAS — Okay. Downstream impacts, the advice from Treasury that I have received tells me that the net cost upon average bills, consumer bills, is 0.18 of 1 per cent. That is so small that, given that these providers have been for 10 years getting under the odds at the subsidy — —

Members interjecting.

The CHAIR — Order! The Treasurer is answering the question.

Members interjecting.

The CHAIR — Order! Do you want the Treasurer to answer the question?

Mr D. O'BRIEN — Well, he has answered the question.

Mr PALLAS — They have been subsidised by the Victorian people for 10 years under the odds — below New South Wales, below Queensland. These rates put appropriate pricing rigour into the conduct of those generators and will also make sure that Victorians get fair value for their resources.

Mr MORRIS — Yes, by paying more for their electricity. That is what that is.

Mr PALLAS — It is 0.18 of 1 per cent.

Members interjecting.

Ms SHING — Well, this is fun, isn't it?

Mr D. O'BRIEN — Thanks for your assistance in answering questions, members of the government. That is actually for the Treasurer to do, thank you very much.

The CHAIR — Order! Time for questions has expired. I would like to thank the witnesses for their attendance: the Treasurer, Mr Martine, Ms Skilbeck, Mr Webster and Mr Johnstone. There were no questions on notice required.

Witnesses withdrew.