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Budget Estimates – Part Two**

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Report on the 2014-15 Budget Estimates – Part Two

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DUTIES OF THE COMMITTEE

The Public Accounts and Estimates Committee is a joint parliamentary committee constituted under the *Parliamentary Committees Act 2003*.

The Committee comprises seven members of Parliament drawn from both Houses of Parliament.

The Committee carries out investigations and reports to Parliament on matters associated with the financial management of the State. Its functions under the Act are to inquire into, consider and report to the Parliament on:

- any proposal, matter or thing concerned with public administration or public sector finances;
- the annual estimates or receipts and payments and other budget papers and any supplementary estimates of receipts or payments presented to the Assembly and the Council; and
- any proposal, matter or thing that is relevant to its functions and has been referred to the Committee by resolution of the Council or the Assembly or by order of the Governor in Council published in the Government Gazette.

The Committee also has a number of statutory responsibilities in relation to the Office of the Auditor-General. The Committee is required to:

- recommend the appointment of the Auditor-General and the independent performance and financial auditors to review the Victorian Auditor-General's Office;
- consider the budget estimates for the Victorian Auditor-General's Office;
- review the Auditor-General's draft annual plan and, if necessary, provide comments on the plan to the Auditor-General prior to its finalisation and tabling in Parliament;
- have a consultative role in determining the objectives and scope of performance audits by the Auditor-General and identifying any other particular issues that need to be addressed;
- have a consultative role in determining performance audit priorities; and
- exempt, if ever deemed necessary, the Auditor-General from legislative requirements applicable to government agencies on staff employment conditions and financial reporting practices.

ACRONYMS AND TERMS

Agency	Government entities which generally receive their funding through ‘departments’ and for which ‘departments’ are responsible for reporting. Examples include Victoria Police, Court Services Victoria, hospitals and TAFEs. Agencies, like ‘departments’, are directly accountable through one or more ministers to Parliament.
Asset initiative	A new program or project (‘initiative’) that delivers assets. See ‘asset investment’.
Asset investment	Expenditure on assets (generally infrastructure such as roads or hospitals) as opposed to expenditure on the delivery of products and services (‘outputs’).
BERC	Budget and Expenditure Review Committee
Budget estimates	Forecasts for future years made in the budget papers about matters such as income, expenditure, assets, liabilities and goods and services to be delivered.
Budget papers	The set of documents released with the annual budget. These normally include the Treasurer’s speech and volumes on: strategy and outlook; service delivery; capital investment; and the estimated financial statements. The set also includes the annual financial report, published after the end of the budget period.
Contingency provisions	Amounts included in a budget for expenses that have not been determined at the time of the budget. These provisions are for both predictable expenditure (such as dealing with population growth and initiatives to be released in future budgets) and unpredictable expenditure (such as unforeseen natural disasters).
Department	Large government entities. At 30 June 2014 there are selected to be nine departments in Victoria, plus the Parliamentary Departments. Funding for most ‘agencies’ is generally provided through departments and departments are required to report on the financial and performance results of the agencies for which they are responsible. Departments, like ‘agencies’, are directly accountable through one or more ministers to Parliament.
Depreciation	The amount of the reduction in value of the assets from being used during the year, and the amount of the asset’s useful life that has been consumed during the year. This amount is listed as an expense on the operating statement, and the cash equivalent to that amount is usually used to partially fund ‘asset investment’.
Direct investment	See ‘purchases of non-financial assets’.

Entity	Either a ‘department’ or an ‘agency’.
Forward estimates period	The period for which estimates are made in the budget papers. This includes the budget year and the following three financial years. The forward estimates period for the 2014-15 Budget was 2014-15 to 2017-18 inclusive.
General government sector	Government ‘entities’ which provide services either with no charge to the user or with charges significantly below the cost of providing the services. This includes all ‘departments’ and many ‘agencies’.
Gross state product (GSP)	The total value of goods and services produced by the state in a year. This includes the goods and services delivered by the Government and the private sector.
GST	Goods and services tax
Information and Communications Technology (ICT)	A program or project that delivers hardware and/or software assets to assist output delivery
Initiative	A specific program or project detailed in the budget papers. Budget papers can include ‘asset initiatives’, ‘output initiatives’, ‘revenue initiatives’, ‘revenue foregone initiatives’ and ‘savings initiatives’.
Investments in financial assets for policy purposes	‘Asset investment’ funded through another sector (most commonly funded by the ‘general government sector’ and through the ‘public non-financial corporations sector’) for an asset that becomes part of that other sector. May be reported as gross inflows, gross outflows or net cash flows.
Liabilities	Amounts that an organisation is obliged to pay in future years. Examples include borrowings and defined benefits superannuation plans.
Net borrowings	New interest bearing liabilities raised from public borrowings during the year (less interest bearing liabilities repaid). Not to be confused with ‘Net lending/borrowing’.
Net debt	A calculation based on the difference between the value of selected categories of financial assets and financial liabilities. Essentially, the difference in value between what the Government owes and assets that it could easily convert to cash. Not all financial assets and liabilities are included.
Net lending/borrowing	A measure of financial performance in a year, calculated by adding economic flows (such as changes in the values of financial assets and liabilities) and ‘asset investment’ (net of asset funding) to the ‘net operating balance’.
Net operating balance	A measure of an entity’s financial performance in a year which is calculated by subtracting an entity’s ‘output expenditure’ in the year from its ‘revenue’. Also known as the ‘net result from transactions’ or ‘operating result’. ‘Asset investment’ is not included in the operating balance.

Net result from transactions	See 'net operating balance'.
Non-financial public sector (NFPS)	The 'general government sector' and 'public non-financial corporations sector' consolidated together.
Operating revenue	See 'revenue'.
Operating surplus	A positive 'net operating balance'.
Output	An aggregate of goods and services (such as health care or policing services) delivered by a 'department' or its agencies. Outputs are identified in the budget papers.
Output expenditure	Expenditure on 'outputs' (that is, goods and services). This is distinct from 'asset investment' although it includes expenditure on 'public private partnerships'.
Output initiative	A new program or project ('initiative') that delivers goods and services (part of a department's 'outputs'). Output initiatives are usually for a limited period of time, although they are sometimes perpetual.
Public financial corporations (PFC) sector	Government 'agencies' that provide financial services, such as the Treasury Corporation of Victoria or the Transport Accident Commission.
Public non-financial corporations (PNFC) sector	Government 'agencies' that provide goods or services with charges that recover most of the cost of producing them, such as water authorities and trusts administering certain facilities. Does not include 'agencies' providing financial services (see 'public financial corporations sector').
Public private partnership (PPP)	An arrangement in which the private sector delivers an asset on behalf of the Government. Ownership of the asset usually passes to the Government after a defined period of time.
Public sector as a whole	The 'general government sector', 'public non-financial corporations sector' and 'public financial corporations sector' consolidated together. Referred to in the budget papers and Annual Financial Report as the 'State of Victoria'.
Purchases of non-financial assets	'Asset investment' by the 'general government sector' managed by an 'entity' within that sector for an asset that becomes part of that sector.
Revenue	Income received by the Government, mostly from State taxes and grants from the Commonwealth Government.

Savings initiative	Changes in the provision of ‘outputs’ that result in reductions to the cost of the ‘output’. This may be done by reducing the services provided or providing the same services more efficiently. Savings initiatives are only one factor affecting ‘output expenditure’. Thus, they may not reduce a department’s total ‘output expenditure’ compared to the previous year if other factors (such as ‘output initiatives’) are greater in value. Savings initiatives are usually perpetual.
Specific-purpose grants	Grants from the Commonwealth Government to the State Government with restrictions on how the funding can be spent.
State of Victoria	See ‘public sector as a whole’.
TAFE	Technical and Further Education
Total estimated investment (TEI)	An estimate of the total amount of expenditure required to deliver an ‘asset investment’ project.

CHAIR'S FOREWORD

The annual inquiry into the budget estimates by the Public Accounts and Estimates Committee examines the Government's fiscal and economic plans for the next four years. The focus of the inquiry each year is on the transparency and accountability of the budget process. The reports help readers to understand the budgets and the recommendations identify areas where the budget papers and associated processes can be enhanced.

Over the course of the 57th Parliament, the Committee's budget estimates inquiries have produced a total of 231 recommendations, primarily related to disclosure in the budget papers. Many of these have been implemented and I am proud, as a member of the Committee, to have contributed to improving the budget papers in this way.

On behalf the Committee, I now present Part Two of the *Report on the 2014-15 Budget Estimates*, the final budget estimates report for the 57th Parliament.

This report aims to bring together and analyse the evidence presented to the Committee about the 2014-15 Budget. This includes departmental questionnaires, the budget estimates hearings and the budget papers themselves.

There are chapters covering the major aspects of the Budget, including the Government's plans regarding revenue, debt, liabilities, asset investment and output expenditure. The report also examines the Government's fiscal and economic assumptions and projections. In presenting this analysis, the Committee seeks to provide the Parliament and community with a valuable source of information on the 2014-15 Budget.

This Part Two of the report also presents the Committee's considered view on the presentation and process of the estimates and includes recommendations where the Committee considers that improvements could be made. Some broad themes to these recommendations include providing further details about underlying assumptions, preventing ambiguity and promoting comparability to previous years.

The Committee is grateful for the time put into responding to questionnaires, attending the public hearings, and answering questions on notice. In particular, recognition should go to the Presiding Officers, Premier, Deputy Premier, Treasurer, Assistant Treasurer, Attorney-General, ministers, departmental secretaries and heads of agencies. Thanks should also go to the many staff that supported them.

Thanks are also due to the Committee's secretariat. They have put in a considerable amount of work during this inquiry, and I, along with the rest of the Committee, have appreciated their hard work, advice and professionalism.

Finally, I would like to thank my fellow Committee members for their contribution. The budget estimates inquiry is a lengthy and complex process. A collegiate approach was evident throughout the hearings and was sustained for the balance of the inquiry. For that I am grateful.

DAVID MORRIS MP
Chair

FINDINGS AND RECOMMENDATIONS

CHAPTER 2

Key Aspects of the 2014-15 Budget

2.3

Structure of the 2014-15 budget papers

FINDING: The 2014-15 budget papers mostly follow the same structure and presentation as the 2013-14 budget papers. New information has been included throughout. There is no longer an information paper on Federal financial relations.

page 11

2.4

Budget setting and strategic direction

FINDING: The 2014-15 budget papers present a positive assessment of Victoria's economic outlook and identify the factors that underpin the Government's key strategy of 'Building a Better Victoria'.

page 13

FINDING: The Government's strategic framework to support its economic reform decisions and financial management incorporates an economic and fiscal strategy and a medium-term fiscal strategy. Both strategies, and the Government's long-term financial management objectives, are outlined in the 2014-15 budget papers.

page 15

FINDING: The 2014-15 Budget proposes funding allocations totalling \$5.7 billion for new output initiatives (additional goods and services to be delivered) up to and including 2017-18. The Budget also proposes between \$21.7 billion and \$26.8 billion of new asset investments (infrastructure and other physical assets) up to and beyond 2017-18.

page 16

FINDING: Around 44.8 per cent of the cost of new output initiatives announced in the 2014-15 Budget will be met through reprioritisation of resources previously allocated to departments, savings initiatives and release of contingency provisions, after adding cost adjustments for policy decisions yet to be allocated.

page 19

2.5

Operating surplus

FINDING: The Budget forecasts an operating surplus of \$1,326.7 million in 2014-15, which is substantially higher than the Government's medium-term fiscal target of at least \$100 million. This forecast is also well above the revised estimate for the year of \$911.0 million, published in December 2013 in the 2013-14 Budget Update.

page 20

FINDING: The Government forecasts that its operating surplus will rise significantly in 2015-16 to a level above \$3.0 billion and remain above that level in the remaining two years of the forward estimates period. *page 21*

2.6

Asset investment

FINDING: The Government expects that its asset investment program will be substantially funded (by 70.5 per cent) from internal cash resources in 2014-15 and able to be fully funded internally, without borrowings, in the remaining years of the forward estimates period. *page 24*

FINDING: Major asset recycling decisions relating to the Port of Melbourne and the Rural Finance Corporation, announced by the Government in the 2014-15 Budget, are expected to generate positive cash flows totalling around \$5 billion in 2015-16. The Government has identified that the proceeds from these decisions will be invested in new infrastructure projects. *page 24*

FINDING: Information on the Government’s asset investment program is presented in a variety of ways across the budget papers. Specific information on the program and proposed asset investment in regional and rural Victoria is included in two budget information papers released with the budget documents. *page 25*

FINDING: The Government has four public private partnership (PPP) projects currently in procurement, with the tender process for two projects likely to be complete by the end of 2014. The Government forecasts that its infrastructure investment on PPPs in 2014-15 will total \$1,854.0 million. *page 26*

FINDING: The Government expects net debt to decrease sharply from \$23.4 billion in June 2015 to \$18.5 billion in June 2016, with marginal further reductions in net debt as a proportion of GSP by June 2018. This significant downward trend in net debt estimates reflects the Government’s asset recycling decisions announced in the 2014-15 Budget. *page 27*

2.7

Victoria’s credit rating

FINDING: Commentary on the Budget by the two international rating agencies engaged by the Government indicates a positive response to the 2014-15 Budget. *page 27*

2.9 Contingency provisions

FINDING: The 2014-15 Budget includes contingency provisions totalling \$5.8 billion for outputs and \$9.4 billion for asset investment over the four years to 2017-18. The contingency provision for asset investment purposes is significantly larger than the equivalent allowance for asset contingencies identified in the previous budget. *page 32*

CHAPTER 3

Revenue

3.2 The Government's strategy

FINDING: Since the 2013-14 Budget, revenue initiatives which are expected to increase revenue by \$1.2 billion (over up to five years) have been announced by the Government. Revenue foregone initiatives, decreasing revenue by an estimated \$250.4 million (over five years) have also been released in the 2014-15 Budget. *page 36*

3.3 Revenue over the forward estimates period

FINDING: The Government expects \$52.9 billion of revenue for 2014-15. The Government projects an average growth rate for revenue of 3.7 per cent per annum over the forward estimates period. *page 36*

FINDING: The Government's revenue, in real terms, is expected to decrease from \$8,894 per Victorian in 2014-15 to \$8,725 in 2017-18, while the Government's revenue as a share of GSP is expected to decrease from 14.3 per cent in 2014-15 to 13.6 per cent in 2017-18. *page 38*

3.4 Comparison to previous budget estimates

FINDING: The 2014-15 Budget forecasts that \$1.7 billion more revenue will be received between 2014-15 and 2016-17 than predicted in the 2013-14 Budget, mainly driven by additional Commonwealth grants, changes in economic and demographic variations and revenue initiatives. *page 40*

3.5 State-sourced revenue

FINDING: Revenue from State taxation is expected by the Government to increase from \$18.1 billion in 2014-15 to \$20.6 billion in 2017-18. This is largely a result of macroeconomic factors, although revenue and revenue foregone initiatives have also had an impact. *page 42*

FINDING: The Government expects revenue from sales of goods and services to increase from \$6.5 billion in 2014-15 to \$6.8 billion in 2017-18. *page 43*

FINDING: The Government expects revenue from dividends, income tax equivalent and rate equivalent revenue to fall to \$584.7 million in 2014-15. However, this is expected to rise to \$1.1 billion in 2017-18, driven by strong growth in both dividends and tax and rate equivalent revenue. This is primarily driven by the Government's expectations of increased profitability for the State's insurance agencies. *page 45*

FINDING: The average loss due to revenue being unable to be fully collected is expected to be \$144.7 million per year over the forward estimates period, an increase from the preceding four-year average of \$101.0 million. *page 46*

3.6

Commonwealth-sourced revenue

FINDING: The Victorian budget is tabled before the Commonwealth budget and therefore does not include some announcements and decisions made by the Commonwealth. *page 49*

RECOMMENDATION 1: The Government should investigate the potential benefits of tabling the Victorian budget after the Commonwealth budget. *page 49*

FINDING: The Government expects general-purpose (GST) grants to the State to be \$11.8 billion in 2014-15, increasing to \$14.9 billion in 2017-18. This is primarily driven by a more favourable anticipated relativity for the State and expected growth in the GST pool. *page 51*

FINDING: The budget papers assume that 'grants for specific purposes' will be \$9.8 billion in 2014-15 before steadily decreasing to \$8.8 billion in 2017-18. Announcements in future Commonwealth budgets may increase this figure. *page 52*

FINDING: Revenue from specific-purpose grants for on-passing is expected to increase from \$3.1 billion in 2014-15 to \$3.7 billion in 2017-18. This is mostly due to increases in grants for non-government schools. *page 53*

CHAPTER 4

Borrowings, Debt and Liabilities

4.2

Borrowings and net debt over the forward estimates period

FINDING: Net debt for the general government sector is anticipated by the Government to be \$23.4 billion in June 2015. The Government expects net debt to fall during 2015-16 before rising over the rest of the forward estimates period. *page 56*

FINDING: The Government plans to use funds received following the lease of operations at the Port of Melbourne to reduce cash borrowings during 2015-16. The net impact of this and other factors will be a reduction in borrowings by \$4.6 billion in 2015-16 and net debt by \$4.9 billion. *page 58*

FINDING: Purchases of non-financial assets and sales of non-financial assets are presented as 'net cash flows from investments in non-financial assets' in the 2014-15 budget papers. *page 59*

RECOMMENDATION 2: The Department of Treasury and Finance continue the practice of separately reporting purchases of non-financial assets and sales of non-financial assets for all sectors in the Annual Financial Report. *page 59*

FINDING: Net debt for the public non-financial corporations sector is anticipated by the Government to be \$16.6 billion in June 2015. The Government expects this to increase to \$17.3 billion by June 2018. *page 60*

FINDING: Net debt for the Port of Melbourne Corporation is anticipated to fall to zero by June 2017. Net debt for other entities in the public non-financial corporations sector is expected to continue to rise consistently over the forward estimates period. *page 60*

4.3

The Government's strategy

FINDING: The Government expects general government sector net debt as a proportion of GSP to peak in June 2015 before falling over the forward estimates period. The fall in net debt over 2015-16 is mainly a result of the leasing out the operations of the Port of Melbourne. Net debt is forecast to fall from 6.1 per cent of GSP in June 2014 to 4.5 per cent of GSP by June 2018. *page 62*

FINDING: The Government anticipates that the unfunded superannuation liability will decrease gradually over the forward estimates period. *page 64*

4.4 Comparison to previous estimates

FINDING: The 2014-15 budget papers anticipate lower levels of net debt than previously estimated. A decline in debt over 2015-16 is expected at a faster-than-previously-predicted rate. However, after June 2016, the budget papers now anticipate borrowings and net debt to rise, in contrast to earlier budgets, reflecting expected increases in asset investment. *page 65*

4.5 Risks

FINDING: A summary of the Government’s assessment of the sensitivity of net debt to various scenarios is set out in the budget papers. The analysis identifies the effects of a change in a number of variables. *page 65*

CHAPTER 5 Output Expenditure

5.2 Components of output expenditure

FINDING: Employee expenses for the general government sector are expected to be \$18.4 billion in 2014-15, accounting for 35.8 per cent of the total output expenditure. These expenses are estimated to increase each year over the forward estimates period, at a growth rate varying from 1.9 to 5.3 per cent. *page 70*

FINDING: ‘Other operating expenses’ are the second largest component of the Government’s output expenditure in 2014-15, accounting for 33.5 per cent of the total (\$17.3 billion). These expenses are expected to decrease by \$845.2 million (4.9 per cent) between 2014-15 and 2015-16 and then increase by an average of 3.7 per cent per annum for the remaining years of the forward estimates period. *page 71*

5.3 The Government’s strategy

FINDING: The Government’s expenditure strategy is to constrain the expenditure growth rate over the forward estimates period to a lower rate than revenue growth. The Government intends to do this in order to achieve larger operating surpluses over the forward estimates period to fund infrastructure without borrowings. *page 73*

5.4 Output expenditure over the forward estimates period

FINDING: The Government's expenditure estimate for 2014-15 is \$51.6 billion. The Government expects an average annual growth rate of 2.6 per cent over the next four years. *page 74*

FINDING: The Government has revised its expenditure estimates downwards in the 2014-15 Budget. Compared to the 2013-14 Budget, the Government expects to spend \$0.9 million less in 2014-15, \$596.6 million less in 2015-16 and \$415.2 million less in 2016-17. *page 75*

FINDING: The Government's 2014-15 Budget forecasts less expenditure between 2014-15 and 2016-17 compared to the 2013-14 Budget. This has been primarily driven by the release of contingencies and other administrative variations. *page 76*

5.5 Goods and services provided

FINDING: The total number of performance measures has decreased by 14, from 1,187 in 2013-14 to 1,173 in 2014-15. The factors contributing to this variance include a reduction of 21 performance measures by the Department of State Development, Business and Innovation. *page 78*

FINDING: When broken down by government purpose classification, health and education are the largest areas of expenditure, accounting for 53.1 per cent of total output expenditure. *page 79*

5.6 Base funding

FINDING: Three departments provided the Committee with base funding estimates for 2013-14 and 2014-15, seven departments did not. *page 81*

5.7 New output initiatives

FINDING: The 2014-15 Budget provides \$5.7 billion of funding for new output initiatives over the forward estimates period (\$2.2 billion higher than the 2013-14 Budget). *page 82*

FINDING: The 2014-15 Budget introduced three output initiatives with expenditure in 2014-15 over \$100 million. These focus on catering for increased demand in the areas of education and health. *page 84*

5.8

Funding the new output initiatives

FINDING: The 2014-15 Budget announced one expenditure reduction measure, worth \$80.0 million between 2014-15 and 2017-18. The budget also reprioritised \$587.5 million of previously committed funding over the next four years. These will partially fund new output initiatives. *page 86*

FINDING: The 2014-15 Budget contains contingencies for outputs totalling \$5.8 billion across the four years of the forward estimates period. This is money that the Government can utilise to fund new output initiatives or meet increased demand in future budgets. *page 87*

CHAPTER 6

Asset Investment

6.2

The Government's strategy

FINDING: The Government's medium-term fiscal strategy includes an infrastructure investment target of 1.3 per cent of gross state product, calculated as a rolling five-year average. *page 90*

FINDING: The Commonwealth Government has introduced an 'asset recycling' initiative, which provides the State Government with incentives for both asset divestment and reinvestment. Divestment projects that take advantage of this initiative have had a significant impact on the forward estimates for the 2014-15 Budget. *page 91*

FINDING: The Government's newly-released 'Unsolicited Proposal Guideline' is an additional mechanism for Government infrastructure investment. The Committee looks forward to future analysis as to the success of the initiative. *page 92*

6.3

Expenditure on asset projects

FINDING: Net purchases of non-financial assets (direct asset investment) for the general government sector are anticipated by the Government to be \$4.9 billion in 2014-15, a 34.6 per cent increase over 2013-14. Direct asset investment for the general government sector is anticipated to increase over the forward estimates period, although it may be reduced when some projects are converted to PPPs. *page 94*

FINDING: 'Net cash flows from investments in financial assets for policy purposes' (investment through other sectors) are expected to be \$676.8 million, a 43.1 per cent decrease from 2013-14. The lease of operations of the Port of Melbourne will contribute to a net cash inflow for 2015-16. Investment through other sectors is expected to decrease over the forward estimates period following the completion of the *Regional Rail Link* project. *page 95*

FINDING: Public private partnership (PPP) infrastructure investment quantifies the value of work done by the private sector on behalf of the Government while constructing PPPs. The private sector is expected to carry out \$1.9 billion of construction work on PPP projects during 2014-15. This is more than five times the amount estimated for 2013-14. *page 97*

FINDING: Estimates of public private partnership (PPP) infrastructure investment are useful, as they are the only figures showing anticipated annual investment on PPP projects. The figures are an important element in Government accountability. *page 97*

RECOMMENDATION 3: The Department of Treasury and Finance publish historical figures for public private partnership infrastructure investment. *page 97*

FINDING: Government infrastructure investment is expected to rise by \$2.3 billion to \$7.5 billion for 2014-15, and then reduce over the forward estimates period to \$6.4 billion. *page 98*

FINDING: The Government infrastructure investment figure is a useful investment indicator. It is the only published investment figure that includes a component for public private partnership projects under construction. *page 99*

RECOMMENDATION 4: In estimating, publishing and discussing government infrastructure investment figures, the Department of Treasury and Finance build on existing disclosure by quantifying, to the extent compatible with protecting the State's financial interests, all components of government infrastructure investment for each year of the forward estimates period after the budget year. *page 99*

6.4

Anticipated effects of asset expenditure

FINDING: Government infrastructure investment is expected by the Government to be approximately 1.7 per cent of GSP (as a rolling five-year average) over the forward estimates period. This is an increase on previous estimates, and is above the Government’s infrastructure investment target. *page 100*

FINDING: Real infrastructure investment per Victorian adjusts government infrastructure investment for both inflation and population change. In 2014-15 terms, it is expected to rise from \$905 in 2013-14 to \$1,254 in 2014-15 and then settle to \$953 by 2017-18. *page 101*

FINDING: Over the forward estimates period, the general government sector plans to build up assets faster than they will depreciate. *page 102*

FINDING: The majority of investment for 2014-15 is anticipated to be for transport, public order and health purposes. *page 103*

FINDING: The 2014-15 budget papers include increased estimates for net purchases of non-financial assets compared with the 2013-14 budget papers. These increases are funded by higher expected operating surpluses and lower investment through other sectors. The anticipated amount of investment through other sectors has been lowered, mostly due to a reduction in the expected cost of the *Regional Rail Link* project and inflows from the lease of operations of the Port of Melbourne. *page 104*

6.5

New initiatives since the 2013-14 Budget (including the 2013-14 Budget Update)

FINDING: The 2014-15 Budget released new asset projects to be funded by the general government sector. These projects have an aggregate total estimated expenditure of between \$21.7 and \$26.8 billion. Three transport-related projects make up the bulk of this investment: the *Cranbourne-Pakenham Rail Corridor*; the *Melbourne Rail Link* project; and the *East West Link – Western Section*. *page 105*

6.6

Additional disclosure

FINDING: The Department of Treasury and Finance provides definitions for some terms on its website that are not included in the glossary in the budget papers. *page 110*

RECOMMENDATION 5: The Department of Treasury and Finance include the definitions of the following terms from its website in Budget Paper No.4 (State Capital Program):

- (a) 'government infrastructure investment'; and
- (b) 'PPP infrastructure investment'.

page 110

RECOMMENDATION 6: The Department of Treasury and Finance continue to refine the definitions in Budget Paper No.4 (State Capital Program) to ensure that terms which are used interchangeably are not defined differently.

page 110

1.1**Background**

The Government introduces appropriation bills into Parliament each May. These bills authorise the release of money for use during the next financial year. The bills are accompanied by budget papers, which detail the estimates, assumptions, strategies and aims underpinning the appropriations.

This year the Treasurer tabled five budget papers, two budget information papers and an overview document. The Department of Treasury and Finance also published various online data sets related to the papers, which are available on its website.

The budget papers were tabled on 6 May 2014, and the Appropriation (2014-2015) Bill and the Appropriation (Parliament 2014-2015) Bill were passed by both Houses on 10 June 2014.

The *Parliamentary Committees Act 2003* requires the Public Accounts and Estimates Committee to inquire into the budget estimates and budget papers each year.¹ This report, in two parts, presents the Committee's findings and recommendations resulting from the Inquiry into the 2014-15 Budget Estimates.

The primary aims of the inquiry are to:

- » assist members of Parliament in their deliberation on the appropriation bills;
- » provide feedback on the performance measures that the Government has proposed discontinuing with the 2014-15 Budget;
- » give members of Parliament and the community a better understanding of the budget estimates;
- » promote clear, full and precise disclosure in the budget papers of the Government's objectives and intended results; and
- » encourage efficient and effective government administration.

1.2**Key findings and recommendations****1.2.1****Budget analysis**

Two significant decisions have affected the 2014-15 budget estimates. The Government has sold the Rural Finance Corporation, and has announced plans to lease the operations of the Port of Melbourne from 2015-16. These activities are partly in response to the Commonwealth Government's asset recycling initiative, which provides state governments with an incentive to divest existing infrastructure assets and reinvest in new infrastructure. Chapters 2, 4 and 6 discuss the impact of these divestment activities on the State's borrowings, net debt and asset investment levels.

¹ *Parliamentary Committee Act 2003*, s.14

The Government plans to grow the operating surplus considerably over the forward estimates period, from \$1.3 billion in 2014-15 to \$3.3 billion in 2017-18. This is partly a result of anticipated increases in revenue, along with an intention to constrain expenditure growth, ensuring that revenue growth is higher than expenditure growth. In nominal terms, output expenditure will grow by an average of 2.6 per cent per annum over the next four years. The Government anticipates being able to fully fund infrastructure investment with cash from operations from 2015-16.

1.2.2 Improving disclosure and transparency

As part of this inquiry, the Committee made a number of recommendations about enhancing the level of disclosure and transparency in the budget papers.

The Committee noted several areas where additional transparency would be advantageous, including:

- » the inclusion of retrospective and prospective figures;
- » further discussion of assumptions underlying predictions and calculations; and
- » providing further detail on potentially ambiguous line items and terms.

Chapter 3 examines the date that the Victorian Budget is tabled, and the Committee recommends considering moving the date to follow the Commonwealth Budget. This could provide more certainty about grants from the Commonwealth, which account for almost half of State Government revenue.

1.3 The inquiry process

1.3.1 Questionnaire

A questionnaire was sent to all departments in April 2014 seeking details of the budget estimates and underlying assumptions relating to each department. The questions focused on:

- » departmental strategic priorities;
- » the bases on which the budget was prepared;
- » spending, including new initiatives;
- » efficiencies and savings;
- » revenue, including Commonwealth grants;
- » net debt;
- » performance measures;
- » staffing matters; and
- » the implementation of previous recommendations.

The responses to the questionnaire can be found on the Committee's website (www.parliament.vic.gov.au/paec).

1.3.2

Public hearings

From 9-23 May 2014, the Committee held public hearings with each minister and the Parliament's Presiding Officers. These hearings provided ministers with an opportunity to give presentations on their portfolios to the Committee. The hearings also enabled the Committee to ask questions on any aspects of the budget estimates related to each portfolio.

In total, there were 50 hearings, lasting over 54 hours.

Slide shows of ministers' presentations and documents tabled in the hearings can be downloaded from the Committee's website (www.parliament.vic.gov.au/paec). Transcripts of the hearings are also available on the website. Part One of this report provides summaries of the issues raised at each hearing.

1.3.3

Questions on notice

Ministers took questions on notice at the hearings for 28 portfolios (see Appendix A1.2). Ministers' responses have been published on the Committee's website.

1.3.4

Timeliness of responses

Departments' responses to the Budget Estimates Questionnaire are important sources of information for the Committee in developing questions at the public hearings. Responses must be received early enough for the Committee to consider the content before the hearings with the relevant ministers. Questions on notice and clarification questions also form a part of the Committee's body of evidence for the inquiry.

Appendix A1.1 lists the dates on which responses to the questionnaire were received.

Appendix A1.2 lists the dates on which responses to questions on notice were received.

Appendix A1.3 lists the dates on which responses to clarification questions were received.

1.3.5

Report

Based on the questionnaires, public hearings and other research undertaken by the Committee, the Committee has produced this report, including findings and recommendations.

1.4

Structure

Part One of the report was tabled on 12 June 2014, and contains an overview of the budget papers and budget estimates, along with summaries of the issues raised in the public hearings.

Part Two repeats the overview (Chapter 2) and adds more detailed analyses of the budget estimates and budget papers, broken down by the following themes:

- » revenue (Chapter 3);
- » borrowings, net debt and liabilities (Chapter 4);
- » output expenditure (Chapter 5); and
- » asset investment (Chapter 6).

1.5 Portfolio changes in 2014

In March 2014, a small number of changes were made to the ministerial portfolios of the Victorian Government.² These included changes to one existing portfolio, and discontinuation of one portfolio (see Table 1.1 below).

Table 1.1 Changes to portfolios

Portfolios at the time of the 2013-14 Budget	Portfolios at the time of the 2014-15 Budget
Minister for Innovation, Services and Small Business	Minister for Small Business Minister for Innovation
Minister responsible for the Teaching Profession	-

Source: Public Accounts and Estimates Committee

1.6 Acknowledgement

The Committee acknowledges the substantial contribution to this inquiry made by the Presiding Officers, Premier, Deputy Premier, Treasurer, Assistant Treasurer, Attorney-General, Ministers, Clerks, departmental secretaries, deputy secretaries, heads of agencies and staff. The Committee thanks everyone involved for their effort in preparing responses to the questionnaires, attending the public hearings and responding to questions on notice and requests for further information.

1.7 Cost

The cost of this inquiry was approximately \$68,900.

² *Victoria Government Gazette*, No.S79, 17 March 2014, pp.1-2

2.1

Introduction

This chapter presents the Committee's overview of the 2014-15 Budget. It is the Government's fourth budget and the second for the Hon. Michael O'Brien MP as the Treasurer.

The chapter begins with a discussion of the key components of the Budget. These components and their relationship to each other are described and identified diagrammatically in Section 2.2.

The chapter then seeks to answer the following questions about the Budget:

- » How are the budget papers structured? (Section 2.3)
- » What is the setting in which the Budget was released? This includes the challenges facing the Government, its strategic directions and the new initiatives it has announced. (Section 2.4)
- » What will the operating surplus be and how will it be achieved? (Section 2.5)
- » What are the Government's plans for asset investment? (Section 2.6)
- » How did the 2014-15 Budget impact on the State's credit rating? (Section 2.7)
- » How is the sustainability of the Government's finances expected to change over the forward estimates period? (Section 2.8)
- » What contingencies has the Government built into the Budget? (Section 2.9)

Many of the topics discussed in this chapter will be analysed in more detail in other sections of this report.

2.2

Key components of the State Budget

Figure 2.1 below illustrates the key components of the Budget. Its purpose is to provide an overall understanding of how the components of a budget are connected to each other and how money flows from one area to another.

The amounts used in the diagram relate specifically to the Government's estimates for 2014-15 in the general government sector. The amounts are detailed and compared to the previous year's revised estimates in Table 2.1.

The first component of the diagram is **REVENUE**. Over half of this (53.3 per cent) is **STATE-SOURCED REVENUE**. The remainder is **COMMONWEALTH-SOURCED**.

The bulk of the revenue funds the Government's **OUTPUT EXPENDITURE**. This expenditure primarily covers the goods and services delivered by the Government.

The amount of revenue that remains after output expenditure has been funded is the **NET OPERATING BALANCE**. Achieving a surplus of at least \$100 million is one of the Government's targets in its medium-term fiscal strategy (see Section 2.4.2). The Government expects to achieve a surplus of \$1.3 billion in 2014-15, and plans to increase the surplus substantially to \$3.0 billion in 2015-16, and \$3.3 billion in 2017-18 (see Section 2.5.2).

Costs such as **DEPRECIATION** are included in output expenditure. These costs are recorded as output expenditure in line with accounting standards, but do not involve any transfer of cash. As a result, the cash equivalent of these costs is still available from revenue to be used by the Government as it sees fit.

Usually the cash equivalent to items such as depreciation is used to fund asset investment (that is, infrastructure and other physical assets). Some, or all, of the operating surplus is also normally used for this purpose. Where the amounts from these two sources are not enough to fund the planned annual asset investment, the Government will usually use proceeds from **SALES OF NON-FINANCIAL ASSETS** and **NET BORROWINGS**.

The amount of net borrowings expected to be made in 2014-15 is \$1.9 billion.³ However, the Government expects not to require cash borrowings in 2015-16, with net debt actually falling by \$4.9 billion.⁴ This position arises from:

- » a significantly higher forecast operating surplus in that year; and
- » positive net cash flows from the Government's asset recycling strategies relating to the Port of Melbourne's operations and the Rural Finance Corporation (see Section 2.6.2 of this report).

The **ANNUAL ASSET INVESTMENT** funded by the above sources is delivered through two avenues. **PURCHASES OF NON-FINANCIAL ASSETS** covers projects directly delivered by the general government sector (that is, the departments and agencies that do not generally charge for their services). **NET CASH FLOWS FROM INVESTMENTS IN FINANCIAL ASSETS FOR POLICY PURPOSES** covers those projects which are funded by the general government sector but where the assets are delivered by the public non-financial corporations sector. The major portion of this funding in 2014-15 relates to the Regional Rail Link.⁵

Payments are also made each year by the private sector on behalf of the public sector through **PUBLIC PRIVATE PARTNERSHIPS (PPPs)**. The Government's **PPP INFRASTRUCTURE INVESTMENT** is forecast to amount to \$1.9 billion in 2014-15.⁶

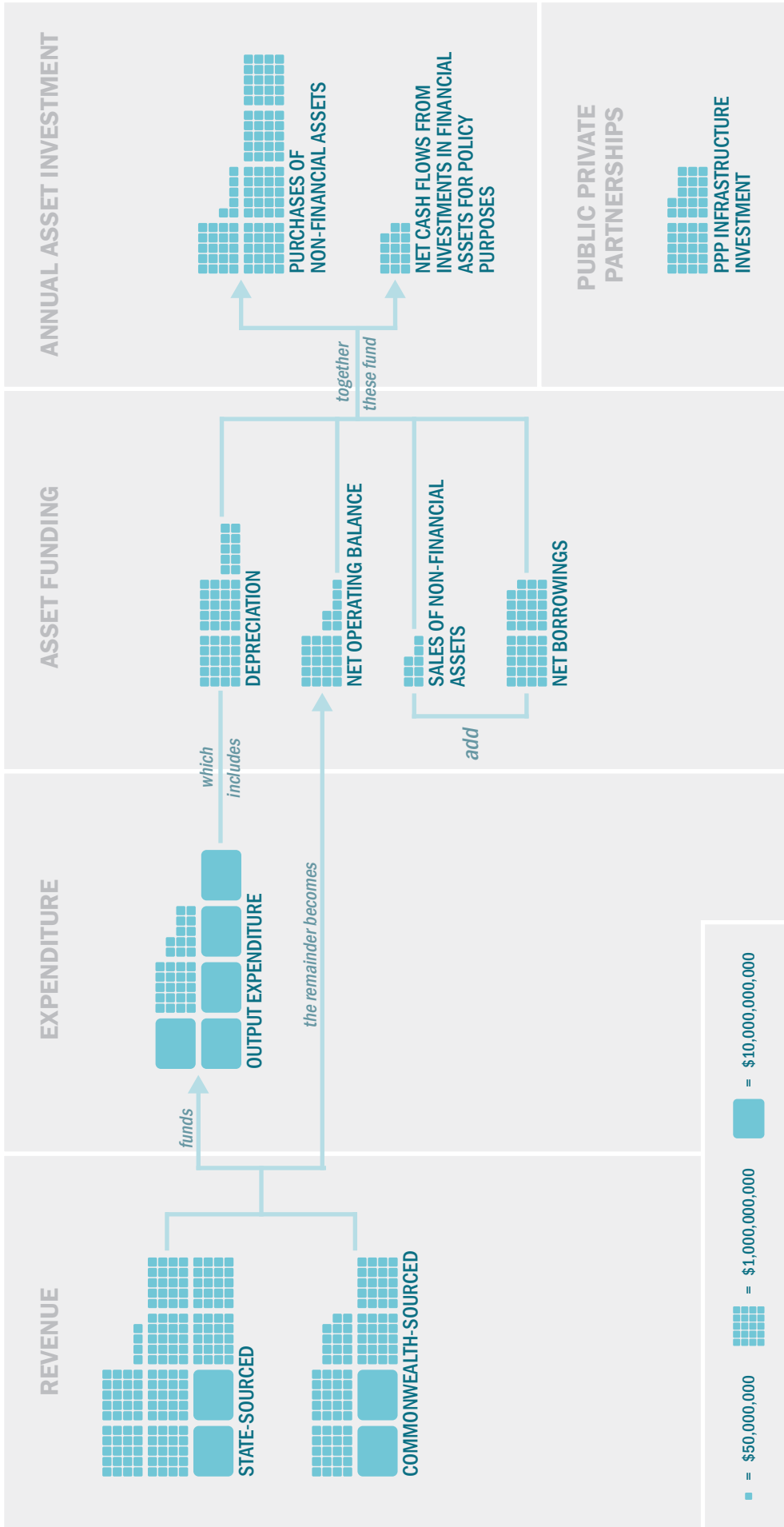
3 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.8

4 *ibid.*, p.62

5 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.16

6 *ibid.*, p.15

Figure 2.1 Key components of the 2014-15 Budget



Source: Public Accounts and Estimates Committee

Table 2.1

Key components of the Budget, 2013-14 and 2014-15

Key component	2013-14 revised estimate	2014-15 Budget	Variance	
	(\$ million)	(\$ million)	(\$ million)	(per cent)
Revenue	51,093.5	52,901.9	1,808.4	3.5
• State-sourced	27,105.1	28,187.0	1,081.9	4.0
• Commonwealth-sourced	23,988.4	24,714.9	726.5	3.0
Expenditure	50,158.8	51,575.1	1,416.3	2.8
• Depreciation	2,418.1	2,496.0	77.9	3.2
Net operating balance	934.7	1,326.7	392.0	41.9
Sales of non-financial assets	304.2	384.9	80.7	26.5
Net borrowings	1,668.2	1,935.8	267.6	16.0
Annual asset investment	5,152.8	5,989.2	836.4	16.2
• Purchases of non-financial assets	3,964.0	5,312.4	1,348.4	34.0
• Net cash flows from investments in financial assets for policy purposes	1,188.8	676.8	- 512.0	-43.1
PPP infrastructure investment	n/a	1,854.0	n/a	n/a

Sources: Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.15; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, pp.5, 8, 24, 165, 215, 218, 227

2.3

Structure of the 2014-15 budget papers

The 2014-15 budget papers consist primarily of five documents:

- » the Treasurer's speech (Budget Paper No.1);
- » a paper on the budget strategy and outlook (Budget Paper No.2);
- » details of the Government's new output and asset initiatives, departmental output performance statements (including performance measures) and local government financial relations (Budget Paper No.3);
- » the Government's capital program, incorporating an outline of expenditure on new and existing asset investments (Budget Paper No.4); and
- » the estimated financial statements of the general government sector (as reviewed by the Auditor-General), each department's estimated financial statement and other financial information (Budget Paper No.5).

This repeats the structure of the 2013-14 budget papers. The core papers are accompanied by:

- » a budget overview document;
- » various online data sets; and
- » two budget information papers.

The budget information papers, which were also published in 2013-14, address the Government's budget strategies in:

- » regional and rural Victoria; and
- » infrastructure investment.

These documents supplement the budget papers and bring together specific information on their topics. This information helps readers particularly interested in those topics to better understand the context of the Budget.

2.3.1 Changes in the 2014-15 budget papers

While the overall structure of the budget papers is similar to the previous year, there are a number of changes to the information presented in the individual documents (see Table 2.2). Most of the changes relate to new items added or other items restructured in 2014-15. There was one machinery-of-government change that had an impact on the structure of the budget papers. A new statutory body, Court Services Victoria, was created under the *Court Services Victoria Act 2014*. It will provide facilities and administrative services for the courts and the Victorian Civil and Administrative Tribunal (VCAT) that were previously delivered by the Department of Justice.⁷

Table 2.2 Key changes between the 2013-14 and the 2014-15 budget papers

Chapter	Type of change	Details
<i>BUDGET PAPER NO.2 (2014-15 STRATEGY AND OUTLOOK)</i>		
Chapter 1	Removal	Discussion and details of variations to revenue compared with estimated aggregate savings and targeted revenue measures.
	Addition	Discussion and details of annual expenses growth have been added along with discussion about the State's AAA rating.
Chapters 1 & 4	Removal	The table of general government fiscal aggregates and measures no longer includes: <ul style="list-style-type: none"> • 'Government fiscal result' (this showed the impact of an accounting standard change applicable from 2013-14).
	Addition	New sections showing the amount of debt and cash used to fund infrastructure have been included with discussion about the sources of funding.
Chapter 2	Restructure	The methodology used to forecast the unemployment rate changed to now reflect historical behaviour after periods of industry adjustment.
	Restructure	A key assumption underlying the economic projections changed for the interest rate component. The interest rate is now held constant after the short term rather than remaining at zero.
	Addition	Discussion has been included for regional economies as well as a chart comparing Australian states' regional unemployment rates.
Chapter 3	Addition	A large discussion on structural changes to industries and the economy has been added. This includes comparison to other states and the national average.

⁷ Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.82

Chapter	Type of change	Details
Chapter 4	Addition	The table of the net impact of new output initiatives now includes a separate disclosure for whole-of-government items.
	Restructure	The table of the net impact of new output initiatives now separately discloses 'funding from reprioritisation of existing resources' and 'adjustments'.
	Restructure	The table of application of cash resources for the non-financial public sector previously included three sub-accounts to make the total 'net investment in fixed assets'. These have been aggregated into one account total.
Appendix A	Addition	The sensitivity analysis for key fiscal aggregates now includes the impact on net debt from each indicator.
BUDGET PAPER NO.3 (2014-15 SERVICE DELIVERY)		
Chapter 1	Addition	A section on the 'Whole of Government – Bushfire Package' output and asset initiatives has been included.
	Addition	Courts Services Victoria outputs and asset initiatives are now reported separately.
Chapter 2	Addition	Court Services Victoria is now reported as a new statutory public sector body with its own mission statement, objectives, indicators, outputs and performance measures.
Other	Removal	'Abbreviations and acronyms' section.
BUDGET PAPER NO.4 (2014-15 STATE CAPITAL PROGRAM)		
Chapter 1	Restructure	In 2013-14, high-value and high-risk projects were grouped in two tables according to being 'approved' or 'in planning/development'. There is now one table for all projects subjected to the framework.
	Restructure	The overview no longer states that commercially sensitive projects have been excluded from the total estimated investment of all projects. This is stated later in the budget paper.
	Addition	Discussion has been included about: <ul style="list-style-type: none"> • Commonwealth funding; • capital recycling opportunities; • investigating value capture opportunities; and • the new unsolicited proposal framework.
	Restructure	The reconciliation of general government sector capital expenditure aggregates includes 'PPP infrastructure investment', and has a reference to the Department of Treasury and Finance. This was previously called 'cash flows from PPP payments' and had a reference to Budget Paper No.2.
Chapter 2	Restructure	Aggregated 'other capital expenditure' for the Department of Education and Early Childhood Development has been split into two. This separates minor capital works from the new item 'TAFEs and Schools' which contains projects primarily externally funded and also includes construction value of new school PPPs.
	Restructure	Projects by the Department of Transport, Planning and Local Infrastructure that have significant Commonwealth funding are no longer separately itemised under the heading of 'Commonwealth funding'. References to funding are now located in the footnotes to the table.

Chapter	Type of change	Details
Chapters 2 & 3	Restructure	The estimated completion dates of projects have changed from 'early/mid/late' in the year, to 'qtr 1/2/3/4'.
	Restructure	Projects that are estimated to be completed after the Budget publication date but before the Budget period have been separately listed from projects actually completed at the time of publication.
Chapter 3	Restructure	Projects by Victorian Rail Track are no longer separately itemised as being delivered by the Department of Transport, Planning and Local Infrastructure.
Definitions and Style Conventions	Restructure	Definitions have been updated and style conventions expanded.
BUDGET PAPER NO.5 (2014-15 STATEMENT OF FINANCES)		
Chapter 1	Restructure	The expected return on assets of the superannuation assumptions was restructured. The 'Emergency Services and State Super' now includes the former 'Parliamentary Contributory Superannuation Fund'.
	Addition	Note 3(b) to the estimated financial statements reports dividends by entity.
Chapter 2	Restructure	Certain items for the public non-financial corporations (PNFC) sector financial statements have been aggregated due to commercial sensitivities of balances.
Appendix B	Addition	A list of the Government's major infrastructure projects, 'The Government's infrastructure scorecard to 31 March 2014', has been added.
	Removal	Note 16 of the '2013-14 Budget outcome incorporating the financial report for the March quarter 2014' has been removed.
BUDGET INFORMATION PAPERS		
All	Restructure	Budget information papers are no longer numbered.
BUDGET INFORMATION PAPERS 'INFRASTRUCTURE INVESTMENT' AND 'RURAL AND REGIONAL VICTORIA', 'BUDGET OVERVIEW'		
All	Restructure	The structure and content of these documents have been modified to reflect changes in Government programs, projects and priorities.
BUDGET INFORMATION PAPER 'FEDERAL FINANCIAL RELATIONS'		
-	Removal	There is no budget information paper on Federal financial relations.

Source: Public Accounts and Estimates Committee

FINDING: The 2014-15 budget papers mostly follow the same structure and presentation as the 2013-14 budget papers. New information has been included throughout. There is no longer an information paper on Federal financial relations.

2.4

Budget setting and strategic directions

2.4.1

Budget setting

The key theme underpinning the Government's assessment of the 2014-15 budget setting is 'Building a Better Victoria'.⁸ This follows on from the Government's 'Building for Growth' theme adopted for its 2013-14 Budget.

In his concluding comments to his budget speech, the Treasurer described the Budget as one that:⁹

- » ... builds stronger services to ensure more Victorians are safer, healthier and better educated.
- » ... builds a once-in-a-generation infrastructure program of up to \$27 billion that will create thousands of new jobs, grow our economy, drive productivity and secure our quality of life.
- » ... will build a better Victoria.

As part of an overview of Victoria's economic standing, the Treasurer, in his budget speech, commented that:¹⁰

Low interest rates, improved consumer and business sentiment and an improved global outlook will, along with our policy settings and infrastructure investment, drive economic growth over the near term.

As the investment phase of the mining boom recedes in favour of the less labour intensive production phase, Victoria is well placed to benefit from emerging drivers of economic growth.

The Treasurer's overview comments help to inform the setting around which the Government has framed its 2014-15 Budget.

The strategy and outlook budget paper includes specific commentary on Victoria's current and forecast economic conditions.¹¹ A positive economic outlook for Victoria is presented with factors supporting this outlook, including:¹²

- » the State's positioning to take advantage of the national shift from mining investment toward more broad-based drivers of economic growth;
- » stronger household consumption and private investment;
- » a more positive international economic outlook;
- » improved labour market conditions; and
- » continued strong population growth.

The budget papers also outline the risks to Victoria's projected economic outlook.¹³ These risks, which are stated as more balanced than they were a year ago, include potentially stronger-than-predicted economic growth arising from recent free trade

⁸ The sub-heading incorporated on the front cover of each budget document.

⁹ Budget Paper No.1, *2014-15 Treasurer's Speech*, May 2014, p.13

¹⁰ *ibid.*, p.2

¹¹ Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, pp.4-5, 11-20

¹² *ibid.*, p.11

¹³ *ibid.*, pp.19-20

agreements, the impact of continuing low interest rates and the consequences to Victoria's interstate exports and imports following a peak in the mining investment boom.

FINDING: The 2014-15 budget papers present a positive assessment of Victoria's economic outlook and identify the factors that underpin the Government's key strategy of 'Building a Better Victoria'.

2.4.2

Strategic directions

The 2014-15 budget papers refer to the Government's two key fiscal strategies, namely:

- » the economic and fiscal strategy;¹⁴ and
- » the medium-term fiscal strategy.

The economic and fiscal strategy

This strategy has the following three components:¹⁵

- » *rebuilding budget capacity;*
- » *improving productivity, including through the provision of major infrastructure, continuing to build the skills and capabilities of the Victorian workforce and more responsive and productive service delivery; and*
- » *ensuring Victoria is a competitive and low-cost place to do business.*

The budget papers identify the role of the strategy in the following terms:¹⁶

The Government's plan to grow the economy and create jobs capitalises on Victoria's competitive strengths, highly skilled workforce and liveability. The Government's economic and fiscal strategy directly addresses the challenges facing Victoria's economy, and is used to guide financial management and economic reform decisions.

The budget papers include commentary on particular elements of the strategy incorporating reference to related budget initiatives.¹⁷

¹⁴ A fiscal strategy generally deals with the financial aspects of government activities, such as raising taxes and levels of government expenditure. In contrast, an economic strategy generally seeks to bring about changes in the broader economy as well.

¹⁵ Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.32

¹⁶ *ibid.*

¹⁷ *ibid.*, pp.32-46

The medium-term fiscal strategy

The Government’s medium-term fiscal strategy (see Table 2.3) is unchanged from the previous year. The budget papers state that the 2014-15 Budget delivers on the medium-term fiscal parameters formulated under the medium-term strategy.¹⁸ The budget papers state that:¹⁹

Victoria is the only Australian state forecasting consistent budget surpluses over the next four years, and holds a triple-A credit rating from both major credit rating agencies. Victoria’s infrastructure investment exceeds the medium term fiscal parameter of 1.3 per cent of GSP [Gross State Product].

On the latter point mentioned in the above comments, the budget papers explain that ‘net investment in fixed assets’ estimates identified in the Budget do not include infrastructure investment through public private partnerships (PPPs).²⁰ Cash flows associated with PPPs in 2014-15 are estimated to total \$1.9 billion²¹ giving an aggregate infrastructure investment in 2014-15 of \$7.5 billion.²² The equivalent aggregate estimate over the forward estimates period is stated to be \$6.6 billion a year on average.²³ Drawing on these projections, the budget papers identify that the Government’s infrastructure fiscal parameter of 1.3 per cent of GSP as a rolling five-year average will be exceeded in every year of the forward estimates period.²⁴

Table 2.3

Medium-term fiscal strategy

Financial measures	Target
Infrastructure investment	Infrastructure investment of 1.3 per cent of GSP (calculated as a rolling five-year average).
Net debt	General government net debt reduced as a percentage of GSP over the decade to 2022.
Superannuation liabilities	Fully fund the unfunded superannuation liability by 2035.
Operating surplus	A net operating surplus of at least \$100 million and consistent with the infrastructure and debt parameters.

Source: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.9

The budget papers also reiterate the Government’s long-term financial management objectives. These long-term objectives are listed as:²⁵

- » managing responsibly;
- » looking after the future;
- » managing the unexpected;
- » improving services; and
- » maximising community benefit.

18 *ibid.*, p.8

19 *ibid.*

20 *ibid.*, p.63

21 Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.15

22 *ibid.*

23 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.63

24 *ibid.*

25 *ibid.*, p.8

Each long-term objective is briefly explained in the budget papers.

FINDING: The Government's strategic framework to support its economic reform decisions and financial management incorporates an economic and fiscal strategy and a medium-term fiscal strategy. Both strategies, and the Government's long-term financial management objectives, are outlined in the 2014-15 budget papers.

2.4.3

New output and asset initiatives

Information published by the government of the day on new output and asset funding initiatives is a core and usually much-awaited feature of each year's State budget. The information details a government's intended allocation of new funds over the next four years for specific service delivery purposes and infrastructure investments. Decisions reached by a government on these new funding allocations normally reflect the strategies underpinning the direction of the Budget.

The 2014-15 Budget proposes new output initiatives with an estimated cost of \$5.7 billion between 2014-15 and 2017-18.²⁶ This compares with \$3.5 billion in the 2013-14 Budget.²⁷ The new initiatives involve outputs managed by departments and related agencies within the general government sector.

The major increase in new output funding in the current Budget primarily reflects significantly higher levels of new allocations for:

- » education and early childhood development – particularly for additional vocational education and training, resourcing of schools to raise performance and student enrolment growth;²⁸ and
- » transport, planning and local infrastructure – mainly for affordable public transport and maintenance and operations for the *Regional Rail Link* project.²⁹

The 2014-15 Budget also proposes new asset initiatives with a total estimated investment (TEI) over the life of the projects of around \$21.7 billion to \$26.8 billion, with \$954.4 million planned for allocation in 2014-15.³⁰ The equivalent new asset funding TEI figure for 2013-14 was \$8.5 billion to \$10.5 billion, with \$825.0 million earmarked for 2013-14.³¹

The significant increase in the TEI for new asset initiatives reflects the inclusion of two major projects within the Public Transport and Roads portfolios, namely:³²

- » the **Western Section of the *East West Link*** project, which has a TEI of between \$8.0 billion and \$10.0 billion with anticipated Commonwealth funding of \$1.5 billion. Initial expenditure in 2014-15 is estimated to be \$100.0 million. The TEI figure includes funding beyond the forward estimates period; and

26 *ibid.*, pp.60-1

27 Budget Paper No.2, *2013-14 Strategy and Outlook*, May 2013, pp.53-4

28 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, pp.8-12

29 *ibid.*, pp.55-63

30 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, pp.63-4

31 Budget Paper No.2, *2013-14 Strategy and Outlook*, May 2013, p.56

32 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, pp.64-5

- » the *Melbourne Rail Link* project, with a TEI of between \$8.5 billion to \$11.0 billion and also including funding beyond 2017-18. Initial expenditure in 2014-15 is budgeted to be \$40.0 million.

The higher TEI figure also takes into account a \$500.0 million package of capital works for new schools, the upgrading of existing schools and delivery of modern teaching environments, with most expenditure expected to occur in 2014-15 and 2015-16.³³

Information on the new output and asset funding initiatives can be found in several sections of the 2014-15 budget papers and the supporting budget overview document:

- » the *2014-15 Budget Overview* describes the Government's main new funding decisions under several headings, with particular emphasis on what is described as 'State-shaping infrastructure' initiatives;³⁴
- » Budget Paper No.2 (*2014-15 Strategy and Outlook*) provides tables disclosing the expected aggregate value of new output and asset initiatives for each department (incorporating a separate allocation for Courts and whole-of-government). It also details the net financial impact of the new output initiatives on the Budget;³⁵
- » Budget Paper No.3, *2014-15 Service Delivery*, lists all new output and asset initiatives announced in the Budget under departmental headings. The information includes descriptions of each initiative, funding estimates for 2014-15 and across the forward estimates period, and links to the relevant departmental outputs;³⁶ and
- » Budget Paper No.4, *2014-15 State Capital Program*, tabulates all new and existing asset projects for both the general government sector and the public non-financial corporations (PNFC) sector. The tables include for each project the total estimated investment, the estimated expenditure for 2014-15, the estimated remaining expenditure and the estimated completion date.³⁷

The above disclosures are supplemented by detailed descriptions of projects and their proposed funding allocations in the two budget information papers on *Infrastructure Investment* and *Regional and Rural Victoria*.

FINDING: The 2014-15 Budget proposes funding allocations totalling \$5.7 billion for new output initiatives (additional goods and services to be delivered) up to and including 2017-18. The Budget also proposes between \$21.7 billion and \$26.8 billion of new asset investments (infrastructure and other physical assets) up to and beyond 2017-18.

33 *ibid.*, pp.12-13

34 *2014-15 Budget Overview*, May 2014, pp.4-16

35 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, pp.61, 64

36 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, pp.4-77

37 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, Chapters 2 and 3

2.4.4

Meeting the cost of the new output initiatives

The estimated cost of new output initiatives announced in the 2014-15 Budget, \$5.7 billion,³⁸ represents their expected aggregate gross cost over the four years to 2017-18. The equivalent gross figure in the 2013-14 Budget was \$3.5 billion.³⁹

Each year, the budget papers identify the estimated extent to which the gross costing allocations for new output initiatives will be varied to reflect their anticipated net financial impact for the budget year and the three years of the forward estimates period. The 2014-15 budget papers disclose the projected net financial impact calculated after taking into account the following internal management mechanisms:⁴⁰

- » reprioritisation of existing resources;
- » adjustments;
- » savings; and
- » release of contingency provisions.

Table 2.4 illustrates this position. It shows that the estimated net impact of the new output initiatives in 2014-15 is an increase in expenditure of \$762.9 million, or 55.2 per cent of the projected gross cost. In other words, an estimated 44.8 per cent of the total cost projections for new output initiatives is not expected to require an actual outlay of funds by the Government in 2014-15. The average net percentage increase over the three years of the forward estimates period is 48.7 per cent of the gross costs.

Table 2.4**Net financial impact of the new output initiatives announced in the 2014-15 Budget**

	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Output initiative costs (gross)	1,381.5	1,451.7	1,434.0	1,434.1
LESS:				
• Funding from reprioritisation of existing resources	140.9	155.0	147.5	144.1
• Savings	20.0	20.0	20.0	20.0
• Release of contingency provisions	518.0	782.2	880.3	820.5
Total	678.9	957.2	1,047.8	984.6
ADD:				
• Adjustments	60.4	214.5	253.2	306.2
Total net deductions	618.6	742.8	794.7	678.4
NET FINANCIAL IMPACT	762.9	708.9	639.3	755.7

Source: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.61

38 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.61

39 Budget Paper No.2, 2013-14 Strategy and Outlook, May 2013, p.54

40 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.61

Funding from reprioritisation of existing resources

Funding from reprioritisation of existing resources is identified by way of an explanatory note which states ‘*This includes the reprioritisation of resources previously allocated to departments.*’⁴¹

A line item titled ‘existing resources’ showing reductions of gross cost estimates in the departmental tables presented in the service delivery budget paper has a new explanatory footnote ‘*Existing departmental resources have been reallocated to contribute to the delivery of new initiatives.*’⁴² This information identifies for users of the budget papers the extent to which funding from this internal management mechanism has been quantified on a departmental basis, although the source of the existing resources within each department is still not disclosed.

Savings

The efficiency and expenditure reduction measures announced in the 2014-15 Budget are substantially smaller than previous budgets and total \$80.0 million over the four years to 2017-18.⁴³ The allocation across individual departments is not disclosed.

The projected savings arise from the application of an efficiency dividend to non-frontline departmental expenditure. The budget papers state that the purpose of this efficiency dividend is ‘*to continue an incentive to drive efficiency improvements.*’⁴⁴

Release of contingency provisions

This cost-reducing item is significantly larger than the preceding two items. It indicates how much the Government expects to draw on unused contingency provisions built into the estimates in previous budgets to fund new output initiatives. In total, the Government plans to draw down \$3.0 billion from its aggregate contingency provisions over the four years to 2017-18 to offset the expected costs of new output initiatives.⁴⁵

Further comment on the quantum and level of presentation of contingencies in the 2014-15 Budget is given in Section 2.9 of this report.

Adjustments

In previous budgets, this item has been combined with the above-mentioned item relating to the reprioritisation of existing resources.

The separate disclosure of the item in the 2014-15 Budget enables users of the budget papers to identify that it:⁴⁶

» is described as incorporating ‘*policy decisions taken but not yet allocated*’; and

41 *ibid.*

42 For example, Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.56

43 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.61

44 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.79

45 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.61

46 *ibid.*

- » involves, unlike the preceding three items, an increase in the published gross cost of new output initiatives totalling \$834.3 million over the four years to 2017-18.

The budget papers do not describe the nature of the policy decisions taken but not yet allocated or their likely placement across departments and individual departmental outputs.

FINDING: Around 44.8 per cent of the cost of new output initiatives announced in the 2014-15 Budget will be met through reprioritisation of resources previously allocated to departments, savings initiatives and release of contingency provisions, after adding cost adjustments for policy decisions yet to be allocated.

2.5 Operating surplus

2.5.1 Budgeted surplus for 2014-15

The difference between the total revenue received and the total output expenditure is referred to in various sections of the budget papers as the 'operating surplus', 'net operating balance' or 'net result from transactions'. This operating surplus, when added to non-cash items such as depreciation, is typically used to fund infrastructure spending (which is not included in output expenditure) or pay off debt.

In the 2014-15 Budget, the Government has reiterated its medium-term fiscal strategy of a '*net operating surplus of at least \$100 million and consistent with the infrastructure and debt parameters*'.⁴⁷

Consistent with and substantially exceeding this target, the Government is forecasting a surplus of \$1.3 billion in 2014-15.⁴⁸

Table 2.5 shows the revenue and expense projections for 2014-15 together with the original budget and the latest estimate (referred to as the 'revised estimate') for 2013-14.

Table 2.5 Revenue and expense estimates for 2013-14 and 2014-15

Operating item	2013-14 Budget	2013-14 revised estimate	2014-15 Budget
	(\$ million)	(\$ million)	(\$ million)
Revenue	50,327.5	51,093.5	52,901.9
Output expenditure	50,103.0	50,158.8	51,575.1
OPERATING SURPLUS	224.5	934.7	1,326.7

Sources: Budget Paper No.2, *2013-14 Strategy and Outlook*, May 2013, p.45; Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.52

⁴⁷ *ibid.*, p.9

⁴⁸ *ibid.*, p.52

Table 2.5 identifies that the operating surplus for 2014-15 is expected to be \$392.0 million (41.9 per cent) higher than the latest estimate for 2013-14. This is expected to be achieved by increasing revenue by \$1,808.4 million (a growth rate of 3.5 per cent) and increasing expenditure by \$1,416.3 million (growth of 2.8 per cent).

The marked rise of \$1,102.2 million in the projected operating surplus for 2014-15, when compared with the equivalent initial forecast for 2013-14, represents an increase of about 491 per cent. Relevant to this increase was a sharp rise of \$712.9 million in the revised estimate for the operating surplus in 2013-14 disclosed in the 2014-15 Budget when compared with the equivalent revised figure published in the 2013-14 Budget Update released in December 2013 (\$221.8 million⁴⁹ rising to \$934.7 million⁵⁰).

The 2013-14 Budget Update document identified a revised estimated operating surplus for 2014-15 of \$911.0 million,⁵¹ an increase of \$512.3 million from the forward estimate disclosed in the 2013-14 Budget.⁵² The estimate shown for new policy measures totalled \$203.3 million,⁵³ representing the then-estimated impact of the Government's announced new revenue initiatives.

The 2014-15 budget papers identify that the further projected increase of \$415.7 million (\$911.0 million rising to \$1,326.7 million) in the budgeted operating surplus largely reflects:⁵⁴

Commonwealth grants for East West Link and higher taxation and investment income forecasts, partially offset by lower GST [goods and services tax] revenue and the impact of new policy initiatives announced in the 2014-15 Budget.

FINDING: The Budget forecasts an operating surplus of \$1,326.7 million in 2014-15, which is substantially higher than the Government's medium-term fiscal target of at least \$100 million. This forecast is also well above the revised estimate for the year of \$911.0 million, published in December 2013 in the 2013-14 Budget Update.

2.5.2

Projected future operating surpluses

The Government is budgeting for revenue to grow at a faster rate than expenses over the three-year forward estimates period to 2017-18. It expects average revenue growth over that period to be 3.7 per cent and average expenditure growth to be 2.6 per cent.⁵⁵

49 Department of Treasury and Finance, *2013-14 Victorian Budget Update*, December 2013, p.53

50 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.52

51 Department of Treasury and Finance, *2013-14 Victorian Budget Update*, December 2013, p.53

52 Budget Paper No.2, *2013-14 Strategy and Outlook*, May 2013, p.45

53 Department of Treasury and Finance, *2013-14 Victorian Budget Update*, December 2013, p.21

54 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, pp.56-7

55 *ibid.*, pp.52, 55

The 2014-15 Budget shows that the operating surplus is projected to grow markedly in 2015-16 to \$3.0 billion, with more modest increases in the following two years (see Table 2.6). The Treasurer explained:⁵⁶

These strong operating surpluses are critical to Victoria's future. They fund our major infrastructure investments without having to resort to unsustainable debt.

Table 2.6

Revenue and expense estimates, 2014-15 to 2017-18

Operating item	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Revenue	52,901.9	54,980.0	56,764.0	58,994.6
Output expenditure	51,575.1	51,950.0	53,580.8	55,664.9
OPERATING SURPLUS	1,326.7	3,030.0	3,183.2	3,329.7

Source: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.52

The table above shows that the Government is anticipating there will be a major increase in the operating surplus in 2015-16. In that year, the surplus is expected to rise by \$1.7 billion or 128.4 per cent. The Government expects revenue growth of 3.9 per cent in that year and expenditure growth of just 0.7 per cent, by far the smallest for the period.⁵⁷

FINDING: The Government forecasts that its operating surplus will rise significantly in 2015-16 to a level above \$3.0 billion and remain above that level in the remaining two years of the forward estimates period.

2.6

Asset investment

2.6.1

Level of government infrastructure investment

Introduced in 2013-14, the Government uses the term 'government infrastructure investment' to represent the aggregate of asset investment by the general government sector, investment by other sectors which is paid for by the general government sector and PPP payments (less proceeds from asset sales).⁵⁸

In 2014-15, the Government is expecting 'government infrastructure investment' to total \$7.5 billion, comprising \$5.6 billion as the net investment in non-financial assets (before PPPs) and \$1.9 billion for infrastructure investment in PPPs.⁵⁹ The Government projects that its total asset investment will average \$6.6 billion over the forward estimates period.⁶⁰

56 Budget Paper No.1, 2014-15 Treasurer's Speech, May 2014, p.2

57 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.52

58 Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.15

59 ibid.

60 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.49

The Treasurer has used the heading ‘*State-Shaping Infrastructure to Build a Better Victoria*’, when referring in his budget speech to the ‘*record infrastructure program of up to \$27 billion*’ to be delivered in the 2014-15 Budget.⁶¹ The use of this heading by the Treasurer reflects the Government’s key theme underpinning its 2014-15 Budget of ‘Building a Better Victoria’.

The 2014-15 budget estimates include the commencement of funding for the *Metropolitan Rail Link* which has an expected total estimated investment over its life cycle of \$8.5 to \$11.0 billion.⁶² The budget estimates also include funding for the planning and construction of the *East West Link – Western Section* with a total estimated investment of \$8.0 to \$10.0 billion,⁶³ including anticipated Commonwealth funding of \$1.5 billion.⁶⁴ This Western Section will join the Eastern Section of the project announced in the 2013-14 Budget and completes the full East West Link.⁶⁵

2.6.2 Funding asset investment

As mentioned in Section 2.2 above, funding for the Government’s infrastructure program comes primarily from four sources:

- » the operating surplus – that is, the money left over after output expenditure has been deducted from the revenue;
- » depreciation and similar – these are included in the output expenditure for accounting reasons but do not actually involve any cash outflows, so the cash equivalent to these amounts is still available;
- » proceeds from asset sales; and
- » cash borrowings, in the event that more funding is needed to meet the budgeted infrastructure investment.

Table 2.7 below shows the estimated proportion of the Government’s asset investment that could be funded from the first three of these sources between 2014-15 and 2017-18. This investment figure includes asset investment by the general government sector and investment by other sectors which is paid for by the general government sector, but does not include PPP infrastructure investment.

As identified in Table 2.7, the increasing level of expected operating surpluses from and inclusive of 2014-15 means that the proportion of asset investment that can be funded from sources other than borrowings will increase from an estimated 70.5 per cent in 2014-15 to the full amount in the remaining three years of the forward estimates period.

Table 2.7 also shows that, in 2015-16, cash flows from investment paid for by the general government sector and delivered through other sectors (which usually represent outflows for the funding of particular asset projects) are forecast to be positive to the extent of \$5.0 billion.

61 Budget Paper No.1, *2014-15 Treasurer’s Speech*, May 2014, p.4

62 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.64

63 *ibid.*

64 *ibid.*, p.65

65 Budget Paper No.1, *2014-15 Treasurer’s Speech*, May 2014, p.5

Table 2.7

Projected asset investment, 2014-15 to 2017-18

Item	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Funding from the surplus, 'non-cash income and expenses' and the sale of assets [A]	4,224.3	6,037.3	6,178.3	6,456.9
ASSET INVESTMENT ^(a)				
• Purchases of non-financial assets	5,312.4	4,727.5	5,705.6	4,849.8
• Net cash flows from investments in financial assets for policy purposes	676.8	-5,003.8	-190.3	183.2
• Unallocated capital	-	300.0	400.0	1,000.0
Total asset investment [B]	5,989.2	23.7	5,915.3	6,033.0
Proportion of asset investment [B] that could be funded by [A] (per cent)	70.5	100.0	100.0	100.0

(a) Does not include PPP infrastructure investment and is therefore different to the Government's 'Government infrastructure investment' figure.

Source: Committee calculations based on Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.62

This key feature of the infrastructure investment element of the 2014-15 Budget relates to the Government's major policy decisions on asset recycling announced in the Budget. These decisions involve the Government:

- » entering into a medium-term lease over the Port of Melbourne's operations; and
- » divesting the Rural Finance Corporation.

The budget papers state that:⁶⁶

The proceeds from the lease of the Port of Melbourne will be invested in new productive economic infrastructure including the Melbourne Rail Link and East West Link – Western Section. The proceeds from divestment of the Rural Finance Corporation will facilitate investment in new productive economic infrastructure in rural and regional Victoria.

The budget papers also indicate that:⁶⁷

This approach is supported by the Commonwealth Government's announcement of a new asset recycling initiative that will provide financial incentives to state and territory governments to divest assets and reinvest the proceeds in additional productive infrastructure.

The Government has identified in the budget papers that its increased estimate of Commonwealth specific-purpose grants and national partnership grants revenue over the period 2014-15 to 2016-17 reflects in part:⁶⁸

Commonwealth asset recycling payments relating to the divestment of the Rural Finance Corporation and the entering into a medium-term lease over the operations of the Port of Melbourne.

66 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.37

67 *ibid.*, p.8

68 *ibid.*, p.59

As a consequence of the two policy decisions relating to the Port of Melbourne and the Rural Finance Corporation, the Government's net debt is expected to decrease by \$4.9 billion in 2015-16.⁶⁹ In effect, the Government's planned infrastructure investment program for 2015-16 is expected to be almost fully funded through the proceeds of these policy decisions, with the operating surplus for the year available to sharply reduce the level of net debt. Further comment on net debt is given in Section 2.6.5 of this report.

FINDING: The Government expects that its asset investment program will be substantially funded (by 70.5 per cent) from internal cash resources in 2014-15 and able to be fully funded internally, without borrowings, in the remaining years of the forward estimates period.

FINDING: Major asset recycling decisions relating to the Port of Melbourne and the Rural Finance Corporation, announced by the Government in the 2014-15 Budget, are expected to generate positive cash flows totalling around \$5 billion in 2015-16. The Government has identified that the proceeds from these decisions will be invested in new infrastructure projects.

2.6.3

Disclosure in the budget papers

Details of the Government's asset investment program are spread across the various 2014-15 budget papers. For example:

- » Budget Paper No.2 (*2014-15 Strategy and Outlook*) outlines some of the major infrastructure projects in the context of the Government's economic and fiscal strategy, provides details of the aggregate expenditure on asset investment over the forward estimates period and shows the allocation of new asset spending across departments;⁷⁰
- » Budget Paper No.3 (*2014-15 Service Delivery*) details each new asset initiative announced in the 2014-15 Budget. Initiatives are listed by department. Details include a description of each project, the total estimated investment, estimated expenditure for each year to 2017-18 and the relevant output to which the initiative contributes;⁷¹
- » Budget Paper No.4 (*2014-15 State Capital Program*) lists new and existing asset initiatives under departmental and agency headings. It shows each project's total estimated investment, estimated expenditure to 30 June 2014, estimated expenditure in 2014-15, projected remaining expenditure and estimated completion date by financial year and quarter;⁷² and
- » Budget Paper No.5 (*2014-15 Statement of Finances*) identifies (within each department's projected financial statements) the expected cash outlays on asset investment.⁷³ It also identifies in a consolidated table the total estimated asset purchases from 2014-15 to 2017-18 by department and government purpose.⁷⁴

69 *ibid.*, p.62

70 *ibid.*, pp.32-8, 62-4

71 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, Chapter 1

72 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, Chapter 2

73 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, Chapter 3

74 *ibid.*, pp. 35-6

In addition to the above, information on the asset investment program is given in a:

- » budget information paper on *Infrastructure Investment* which provides an overview of the infrastructure program with details of key infrastructure projects and recent Government policy reforms to support infrastructure planning and delivery; and
- » budget information paper on *Regional and Rural Victoria* which focuses on asset investment across regional and rural areas of Victoria.

FINDING: Information on the Government's asset investment program is presented in a variety of ways across the budget papers. Specific information on the program and proposed asset investment in regional and rural Victoria is included in two budget information papers released with the budget documents.

2.6.4 Public private partnerships

The budget papers indicate that there are currently 27 PPP projects, with 20 commissioned and now operational.⁷⁵ The papers identify that four PPP projects, *Citylink – Tulla Widening*, *Cranbourne-Pakenham Rail Corridor Project*, *East West Link – Eastern Section* and *Ravenhall Prison*, are currently in procurement, with the tender process for the latter two projects due to be complete by the end of 2014.⁷⁶

Upcoming infrastructure projects to be procured under the PPP model involve packages within the *East West Link – Western Section*, packages within the *Melbourne Rail Link* and the *Schools PPP package*.⁷⁷ The latter project relates to the construction of 11 new schools to address growing demand as a component of the Government's school capital program.⁷⁸

The Government has commented in the budget papers on the application to particular projects of its previously announced reforms to the PPP model. It has indicated that these reforms:⁷⁹

... make it easier for companies to compete to provide a greater range of services along with delivery of new or upgraded infrastructure. Early assessments indicate that this is working well on tender processes for East West Link – Eastern Section and Ravenhall Prison.

The Government estimates that PPP infrastructure investment in 2014-15 will total \$1,854.0 million.⁸⁰ This figure is presented in the State Capital Program budget paper in order to reconcile the estimated aggregate Government infrastructure investment with the figure for that investment shown in other budget papers. Beyond inclusion within this reconciliation (which cites the Department

75 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.11

76 *ibid.*

77 *ibid.*

78 *ibid.*

79 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.38

80 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.15

of Treasury and Finance as the appropriate reference point⁸¹), there are no further references in the budget papers to estimated PPP expenditure in 2014-15 and over the forward estimates period.

FINDING: The Government has four public private partnership (PPP) projects currently in procurement, with the tender process for two projects likely to be complete by the end of 2014. The Government forecasts that its infrastructure investment on PPPs in 2014-15 will total \$1,854.0 million.

2.6.5

Net debt

As noted in Section 2.6.2, where the level of asset investment exceeds the funding available, additional borrowings are required. These additional borrowings contribute to the Government’s level of net debt, which is essentially a measure of the difference between what the Government owes and its cash (including assets that it could easily convert into cash).⁸²

The Government’s expected changes in net debt for the general government sector from 30 June 2014 to 30 June 2018 can be seen in Table 2.8.

Table 2.8

Net debt as at 30 June, 2014 to 2018

	2014 revised estimate	2015 Budget	2016 estimate	2017 estimate	2018 estimate
Net debt (\$ billion)	21.5	23.4	18.5	19.0	19.5
Net debt (per cent of GSP)	6.1	6.3	4.7	4.6	4.5

Source: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.67

In dollar terms, net debt is expected to increase to June 2015, before reducing sharply to June 2016 and then increasing marginally by June 2018. The Government expects net debt as a proportion of GSP to also fall markedly by June 2016 and to further fall marginally by June 2018.

The Government’s net debt is expected to decrease by \$4.9 billion in 2015-16.⁸³ As mentioned in Section 2.6.2 of this report, this decrease (through a reduction in borrowings) primarily reflects the expected consequence of the Government’s policy decisions relating to the medium-term lease of the Port of Melbourne operations and the divestment of the Rural Finance Corporation.

The following comment is included in the budget papers on the links between these policy decisions and new infrastructure investment:⁸⁴

Where it is in the community’s interest to recycle assets, capital currently tied up in mature businesses can effectively be recycled, with the proceeds used to build new assets for the benefit of the Victorian community. The

81 ibid.

82 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.67

83 ibid., p.62

84 ibid., p.66

asset recycling approach indirectly accesses private savings to fund new infrastructure.

FINDING: The Government expects net debt to decrease sharply from \$23.4 billion in June 2015 to \$18.5 billion in June 2016, with marginal further reductions in net debt as a proportion of GSP by June 2018. This significant downward trend in net debt estimates reflects the Government's asset recycling decisions announced in the 2014-15 Budget.

2.7

Victoria's credit rating

Victoria currently holds a AAA credit rating from the rating agencies of Standard and Poor's, and Moody's Investors Service.⁸⁵ In his opening address to the Committee at the budget estimates hearing, the Treasurer identified the importance of Victoria having a AAA credit rating. The Treasurer stated that:⁸⁶

... having that AAA credit rating is very important. It is an important marker of confidence and it is important from the point of view of lower interest costs.

Both rating agencies published a bulletin following the release of the Victorian Budget providing commentary on the Budget's impact on the State's credit rating. These bulletins do not constitute credit ratings.⁸⁷

Standard & Poor's noted that:⁸⁸

In our view, the Victorian government's budgetary performance is benefiting from several years of strong fiscal discipline, as evidenced by expenditure increasing less than revenue growth. As a consequence of this fiscal discipline, the Victorian government has introduced some modest revenue and expenditure measures without significantly affecting either its budgetary performance or debt burden.

Moody's Investors Service noted that the State Budget:⁸⁹

... shows improvement when compared to the 2013/14 budget and to mid-2014 estimates which is a credit positive for the State.

The Committee notes that both agencies responded positively to the 2014-15 Budget.

FINDING: Commentary on the Budget by the two international rating agencies engaged by the Government indicates a positive response to the 2014-15 Budget.

85 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.1

86 Hon. M. O'Brien MP, Treasurer, 2014-15 budget estimates hearing, transcript of evidence, 9 May 2014, p.3

87 Standard & Poor's affirmed Victoria's rating at 'AAA/A-1+' on 5 September 2014.

88 Standard & Poor's, 'Bulletin: Ratings on Australia's State of Victoria Unchanged After State Budget Announcement', 6 May 2014, p.1

89 Moody's Investors Service, 'Announcement: Moody's Reports on Victoria's 2014/15 Budget', 6 May 2014, p.1

2.8

Sustainability of finances

The State Budget outlines a number of fiscal challenges for Victoria going forward, including a growing population and an increased demand for services.⁹⁰ In light of these challenges, the Victorian Government’s economic strategy has a strong focus on responsible financial management.⁹¹ The Government explains its budget position as follows:⁹²

A strong budget position is at the heart of the Government’s economic strategy. It provides the basis for new investment in infrastructure and services, while keeping taxes competitive and sustainably managing net debt.

The Committee uses three key financial indicators to provide a picture of the sustainability of Government finances for the forward estimates period.

The first indicator of sustainability is the net operating balance (operating surplus), which the Government has identified as one of the four measures in its medium-term fiscal strategy (see Section 2.4.2 of this report). The second indicator of sustainability is net debt as a percentage of GSP, and this is also a measure used in the medium-term fiscal strategy. A more detailed discussion of the net operating balance is set out in Section 2.5 of this report, while net debt is considered in Section 2.6.5.

In addition, the Australian Bureau of Statistics (ABS) has developed an indicator called net lending/borrowing which can also be used to help provide an understanding of the sustainability of the State’s finances. The Australian Accounting Standards Board requires this indicator to be disclosed as part of public sector reporting,⁹³ and it is also used by Moody’s Investors Service in analysing the Budget.⁹⁴

These three indicators are described in more detail in Table 2.9.

Table 2.9

Financial sustainability indicators

Indicator	Description
Net operating balance	This indicates the difference between revenue and output expenditure, but does not include all of the Government’s spending on asset investment.
Net lending/borrowing	This indicator is similar to the operating result, but also includes some money spent and received in relation to asset investment (including public private partnership liabilities). A net lending position means that the Government has more revenue than it spends, and net borrowing means that it does not have enough.
Net debt as a percentage of GSP	Net debt is a measure of the total amount owed as a result of borrowing and other debt, less cash and assets that can easily be converted into cash. This indicator compares net debt to GSP, which reflects Victoria’s total productive capacity (that is, its ability to repay debt).

Source: Public Accounts and Estimates Committee

90 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.10

91 *ibid.*, p.8

92 *ibid.*, p.47

93 Australian Accounting Standards Board, AASB 1049: Whole of Government and General Government Sector Financial Reporting, 2012, p.21

94 Moody’s Investors Service, ‘Announcement: Moody’s Reports on Victoria’s 2014/15 Budget’, 6 May 2014, p.1

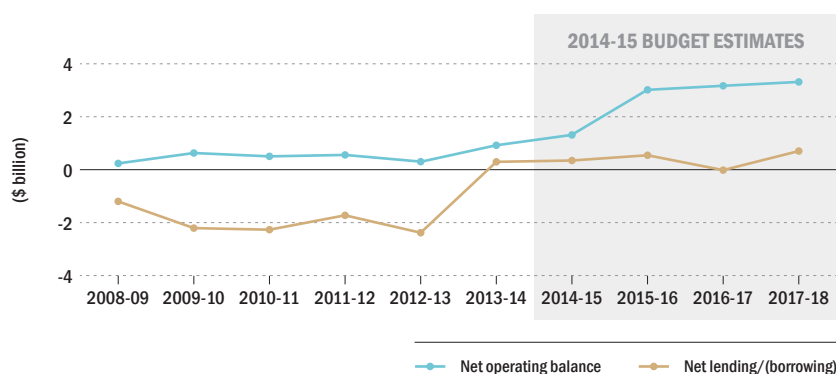
The following sections consider these three indicators for both the general government sector and the public sector as a whole.

2.8.1 General government sector

The general government sector is comprised of all government departments and agencies which provide services free or below cost.

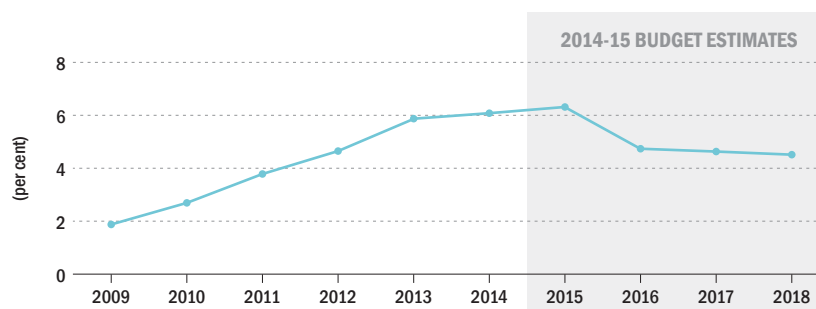
The Government's projections for the three indicators for the general government sector are set out in Figures 2.2 and 2.3. These projections convey a forecast positive trend from a sustainability perspective.

Figure 2.2 Net operating balance and net lending/borrowing (general government sector), 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Historical and Forward Estimates Financial Statements: General Government Sector: Consolidated Comprehensive Operating Statement' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Financial-statements>, accessed 14 May 2014

Figure 2.3 Net debt as a percentage of GSP (general government sector), 2009 to 2018



Sources: Department of Treasury and Finance, 'Historical and Forward Estimates Financial Statements: General Government Sector: Consolidated Balance Sheet' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Financial-statements>, accessed 14 May 2014; Department of Treasury and Finance, 'Macroeconomic indicators' data set, <<http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>> accessed 14 May 2014

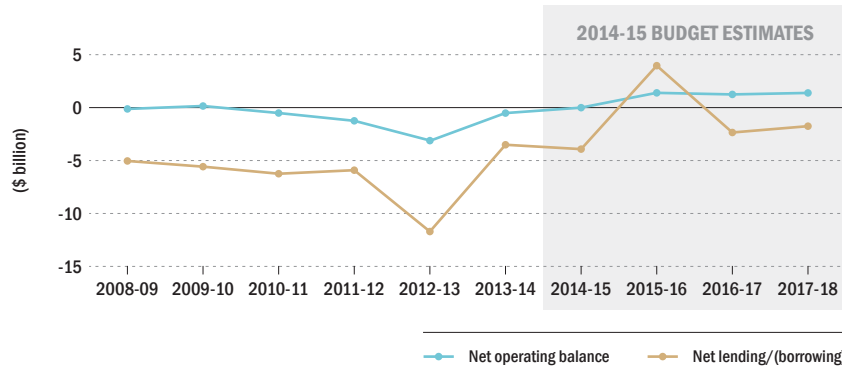
2.8.2 Public sector as a whole

The public sector as a whole comprises the general government sector, the government entities that charge for services (such as water corporations) and government entities offering financial services.

The Government's projections for the three indicators for the public sector as a whole (referred to in the budget papers as the 'State of Victoria') are set out in Figures 2.4 and 2.5.

Figure 2.4

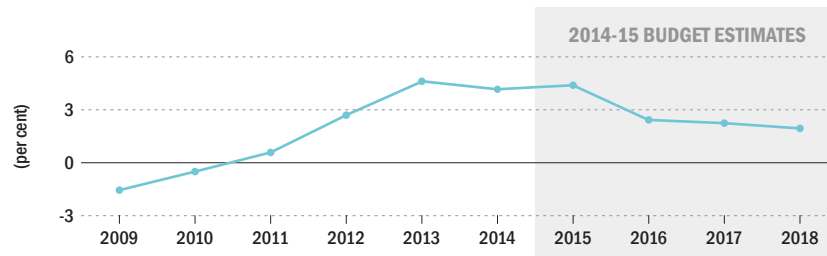
Net operating balance and net lending/borrowing (public sector as a whole), 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Historical Financial Statements: Whole of State: Consolidated Comprehensive Operating Statement' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Financial-statements>, accessed 14 May 2014

Figure 2.5

Net debt as a percentage of GSP (public sector as a whole), 2009 to 2018



Sources: Department of Treasury and Finance, 'Historical Financial Statements: Whole of State: Consolidated Balance Sheet' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Financial-statements>, accessed 14 May 2014; Department of Treasury and Finance, 'Macroeconomic indicators' data set' <http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators> accessed 14 May 2014

2.9

Contingency provisions

In each budget, contingency provisions are made for both output and asset purposes. These provisions are for expenditure that has not been determined when the budget is prepared, including for:⁹⁵

- » unforeseen events, such as natural disasters (including bushfires and floods);
- » likely growth in Victoria’s population and consequent increased demand for government services; and
- » projects that have not been determined at the time of the budget.

Three types of contingency provision are made, as indicated in Table 2.10.

The Government has put sizeable contingency provisions aside over the four years to 30 June 2018, with \$5.8 billion (up from \$4.2 billion in the previous budget⁹⁶) set aside for outputs and \$9.4 billion (up substantially from \$2.6 billion in the previous budget⁹⁷) for asset investment. In addition, the amount available under the Advance to the Treasurer in 2014-15 has increased from \$378.3 million to \$681.1 million.

95 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, pp.68-9
 96 Budget Paper No.5, *2013-14 Statement of Finances*, May 2013, p.32
 97 *ibid.*, p.37

Table 2.10

Contingency items within the 2014-15 Budget and Appropriation Bill, 2014-15 to 2017-18

Contingency item	2014-15 (\$ million)	2015-16 (\$ million)	2016-17 (\$ million)	2017-18 (\$ million)	Total (\$ million)
Output contingencies ^(a)	-232.0	960.2	1,854.3	3,202.8	5,785.3
Asset contingencies ^(b)	131.3	1,711.9	3,183.0	4,370.0	9,396.2
Advance to the Treasurer to meet urgent claims ^(c)	681.1	-	-	-	681.1

(a) Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.31

(b) *ibid.*, p.35

(c) Appropriation (2014-2015) Bill 2014, page 15 of Schedule 1. The Advance to the Treasurer is released on a yearly basis. It is expected that broadly similar figures would also be made available in future years.

The magnitude of the above contingency provisions means that the Government has significant flexibility available to it over the forward estimates period on both operating and capital fronts. The Government can progressively utilise these contingencies, as circumstances warrant, without the risk of impacting on its set budget estimates.

The budget papers indicate that the output contingency provision includes ‘provisions available to be allocated to specific departments and projects, future demand growth, departmental underspending and items not yet formalised at the time of publication.’⁹⁸

The budget papers also identify that the asset contingency provision represents the ‘Estimated amount available to be allocated to departments and projects in future budgets, including for East West Link and the Melbourne Rail Link. It also includes departmental underspending, which may be subject to carryover’.⁹⁹

The Committee has previously advised the Parliament that it does not have a view on the appropriate level of contingency provisions incorporated by the Government in the budget. It can be argued that a large contingency is important for risk management. It can also be argued that excess provisions should be avoided so that funds can be used to deliver services.¹⁰⁰

The Committee has also previously recommended that the Government present expanded information about contingencies in future years, including their role in the budgetary process and the methodology employed for determining their quantification.¹⁰¹

The Government supported that recommendation, indicating that the Department of Treasury and Finance ‘will explore opportunities to enhance discussion around the basis and role of contingencies.’¹⁰²

98 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.31

99 *ibid.*, p.35

100 Public Accounts and Estimates Committee, *Report on the 2011-12 Budget Estimates — Part One*, June 2011, p.30

101 *ibid.*, Recommendation 8, p.31

102 Victorian Government, Government Responses to the Recommendations of Public Accounts and Estimates Committee’s 102nd Report on the 2011-12 Budget Estimates — Part One, tabled 24 November 2011, p.5

The presentation of material on contingencies in the 2014-15 Budget continues to be essentially unchanged from the time of the above response. There remains therefore scope for enhanced disclosure, ideally through a consolidated presentation, of contingency provisions in future budget papers.

The Committee also notes that a line item, ‘Capital provision approved but not yet allocated’, is identified in the budget papers as forming part of projected infrastructure spending.¹⁰³ The item is described in the budget papers as the ‘*amount available to be allocated to specific departments and projects in future budgets, including contributions to other sectors.*’¹⁰⁴ The estimates shown for the item are lower than the asset contingencies shown in Table 2.10.

FINDING: The 2014-15 Budget includes contingency provisions totalling \$5.8 billion for outputs and \$9.4 billion for asset investment over the four years to 2017-18. The contingency provision for asset investment purposes is significantly larger than the equivalent allowance for asset contingencies identified in the previous budget.

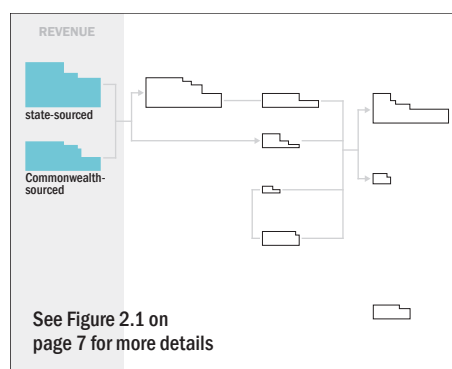
103 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.62

104 *ibid.*

3.1

Introduction

The Government’s operating revenue is mostly obtained from State taxes and grants from the Commonwealth. Operating revenue funds the State’s output expenditure and also contributes to asset investment (see Section 2.2 of this report).



In analysing revenue estimates for the next four years, this chapter addresses the following questions:

- » What is the Government’s revenue strategy? (Section 3.2)
- » What are the overall trends for revenue? (Section 3.3)
- » How do current expectations compare to previous budget estimates? (Section 3.4)
- » What are the major components of State-sourced revenue? (Section 3.5)
- » What are the major components of Commonwealth-sourced revenue? (Section 3.6)

Total revenue for the general government sector is expected to rise by 3.5 per cent in 2014-15 compared to 2013-14. It is then expected to increase by an average of 3.7 per cent per annum between 2014-15 and 2017-18 (see Table 3.1).

Table 3.1

Revenue and revenue growth rate, 2013-14 to 2017-18

	2013-14 revised estimate	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
Total revenue (\$ million)	51,093.5	52,901.7	54,980.0	56,764.0	58,994.8
Total revenue annual growth rate (per cent)		3.5	3.9	3.2	3.9

Source: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.155

State-sourced revenue is estimated to account for \$28.2 billion (53.3 per cent) of the revenue in 2014-15 (see Section 3.5 of this report).¹⁰⁵

The balance of revenue is made up of grants from the Commonwealth Government.¹⁰⁶ These account for \$24.7 billion (46.7 per cent) of expected revenue in 2014-15 (see Section 3.6 of this report).¹⁰⁷

¹⁰⁵ Budget Paper No.5, 2014-15 Statement of Finances, May 2014, pp.5, 24

¹⁰⁶ *ibid.*, p.165

¹⁰⁷ *ibid.*, p.24

3.2

The Government's strategy

The Government expects revenue to increase over the forward estimates period, mostly due to growth in the economy.¹⁰⁸ This overall growth, coupled with a planned lower rate of output expenditure (see Section 5.3 of this report), is expected to contribute to the Government's medium-term fiscal strategy of:¹⁰⁹

A net operating surplus of at least \$100 million and consistent with the infrastructure and debt parameters.

The budget papers identify a number of factors external to the State Government which have contributed to the growth in revenue, including:¹¹⁰

- » growth of the Victorian population;
- » growth of the Victorian and Australian economies;
- » land revaluation;
- » growth in wages and the labour market; and
- » changes to the relativity affecting GST revenue.

The Government also released a number of initiatives in the 2013-14 Budget Update and 2014-15 Budget which have impacted on the amount of revenue expected.

Overall, revenue initiatives announced since the 2013-14 Budget are expected to increase revenue by \$1,224.1 million (over up to five years¹¹¹). Revenue foregone initiatives are anticipated to reduce revenue by \$250.4 million (over five years).¹¹²

Table 3.2 summarises the Government's revenue initiatives and revenue foregone initiatives since the 2013-14 Budget.

Table 3.2

Revenue initiatives and revenue foregone initiatives, 2013-14 Budget Update and 2014-15 Budget

Revenue/revenue foregone initiative	Net impact over forward estimates period ^(a)
	(\$ million)
2013-14 BUDGET UPDATE	
Expanding the Congestion Levy Area	84.0
Hotel and Club Electronic Gaming Machine Levy	287.0
Public Transport Fare Changes	134.4
Regulatory Cost Recovery	32.0
Restore the Real Value of a Fee Unit	51.0

108 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.58

109 *ibid.*, p.9

110 *ibid.*, pp.53-5

111 Initiatives released in the 2013-14 Budget Update provide only four-year totals.

112 The *Casino Electronic Gaming Machine Levy* has not been included in either revenue initiatives or revenue foregone initiatives.

Revenue/revenue foregone initiative	Net impact over forward estimates period ^(a)
	(\$ million)
2014-15 BUDGET	
Abolish Inefficient Taxes – Stamp Duty on Life Insurance	-16.1
Increase in Rate of Stamp Duty on Motor Vehicles and Increase in Motor Vehicle Registration Fee	584.4
Metropolitan Planning Levy	51.3
Reduce Payroll Tax Rate by 0.05 per cent from 1 July 2014	-234.3
TOTAL	973.7

Note: A Casino Electronic Gaming Machine Levy was introduced in the 2013-14 Budget Update, but estimates were removed from the 2014-15 Budget, as mutual agreement between the Government and the casino operator had not been achieved by the time of the Budget (Budget Paper No.3, 2014-15 Service Delivery, May 2014, p.78). These changes have been excluded from the table above.

(a) For budget update initiatives, this reflects 2013-14 to 2016-17, for budget initiatives, this reflects 2013-14 to 2017-18.

Sources: Budget Paper No. 3, 2014-15 Service Delivery, May 2014, p.78; Department of Treasury and Finance, Victorian Budget Update 2013-14, December 2013, p.130

Table 3.3 identifies the total impact in 2014-15 of these initiatives and all other revenue and revenue foregone initiatives from budgets since 2011-12. The cumulative impact of these initiatives is additional revenue of \$818.1 million in 2014-15.

Table 3.3

Estimated impact in 2014-15 of revenue initiatives and revenue foregone initiatives from the 2011-12 to 2014-15 budgets^(a)

	Revenue initiatives (\$ million)	Revenue foregone initiatives (\$ million)
2011-12 Budget	154.4	-253.6
2011-12 Budget Update	320.5	-
2012-13 Budget	211.9	-1.5
2012-13 Budget Update ^(b)	627.5	-604.5
2013-14 Budget	137.8	-
2013-14 Budget Update	203.3	-
2014-15 Budget	136.8	-114.5
NET IMPACT IN 2014-15		818.1

(a) These figures are based on original published budget estimates.

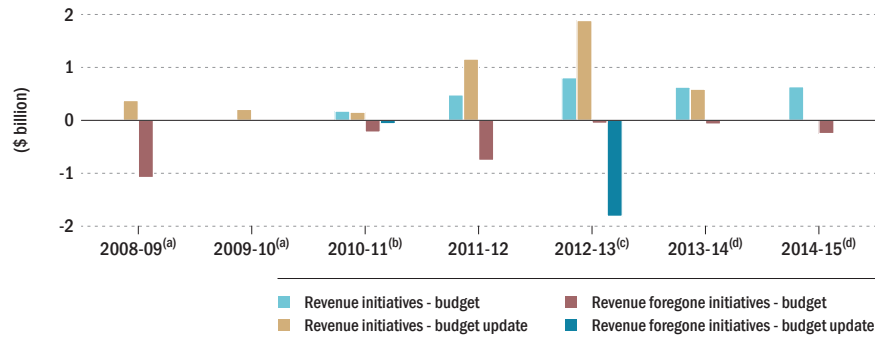
(b) These large amounts reflect primarily the discontinuation of previous mechanisms for gathering fire-related contributions and their replacement by the Fire Services Property Levy.

Sources: Budget Paper No.3, Service Delivery, 2011-12 to 2014-15; Victorian Budget Update, 2011-12 to 2013-14

Figure 3.1 shows the total value (over up to five years) of revenue initiatives and revenue foregone initiatives announced in each budget since 2008-09.

Figure 3.1

Revenue initiatives and revenue foregone initiatives (up to five years), 2008-09 to 2014-15 budgets



- (a) Initiatives included in previous budget updates have been removed from the totals given in Budget Paper No.3 prior to 2010-11 to avoid double counting.
- (b) The Budget Update initiatives for 2010-11 are from the Pre-Election Budget Update rather than in the 2010-11 Budget Update.
- (c) These large amounts reflect primarily the discontinuation of previous mechanisms for gathering fire-related contributions and their replacement by the Fire Services Property Levy.
- (d) A *Casino Electronic Gaming Machine Levy* was introduced in the 2013-14 Budget Update, but estimates were removed from the 2014-15 Budget, as mutual agreement between the Government and the Casino operator had not been achieved by the time of the Budget (Budget Paper No.3, 2014-15 Service Delivery, May 2014, p.78). These changes have been excluded from the figure above.

Sources: Committee calculations based on Budget Paper No.3, *Service Delivery*, 2008-09 to 2014-15; Department of Treasury and Finance, *Victorian Budget Update*, 2008-09 to 2013-14

The revenue initiatives released in the 2013-14 Budget Update and the 2014-15 Budget support the Government’s intention to grow revenue.

The 2013-14 Budget Update contained only initiatives that increased revenue, and the initiatives announced in the 2014-15 Budget are expected to have a cumulatively positive result on revenue.

FINDING: Since the 2013-14 Budget, revenue initiatives which are expected to increase revenue by \$1.2 billion (over up to five years) have been announced by the Government. Revenue foregone initiatives, decreasing revenue by an estimated \$250.4 million (over five years) have also been released in the 2014-15 Budget.

3.3

Revenue over the forward estimates period

As seen in Section 3.1, the Government expects total revenue to be \$52.9 billion in 2014-15, an increase of 3.5 per cent compared to the revised estimate for 2013-14 (\$51.1 billion).¹¹³

Figure 3.2 below shows total revenue from 2008-09 to 2013-14, and the revenue expected over the forward estimates period. As noted in Section 3.1, the Government projects annual revenue to grow by an average of 3.7 per cent per annum to \$59.0 billion in 2017-18.¹¹⁴

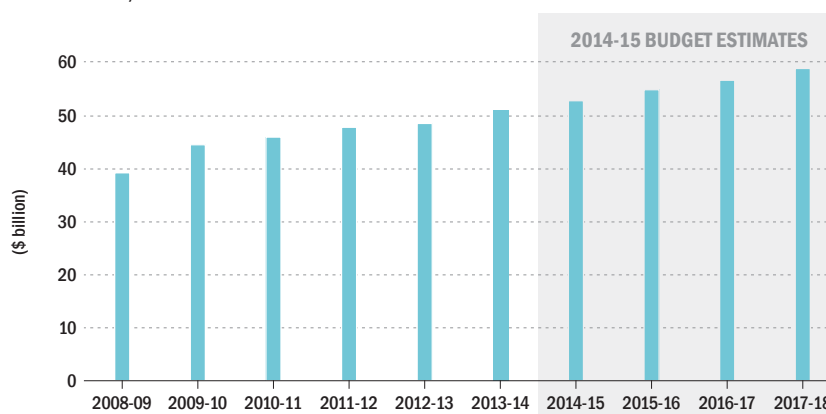
FINDING: The Government expects \$52.9 billion of revenue for 2014-15. The Government projects an average growth rate for revenue of 3.7 per cent per annum over the forward estimates period.

¹¹³ Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.155

¹¹⁴ *ibid.*

Figure 3.2

Total revenue, 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

3.3.1

Revenue per Victorian and revenue as a share of GSP

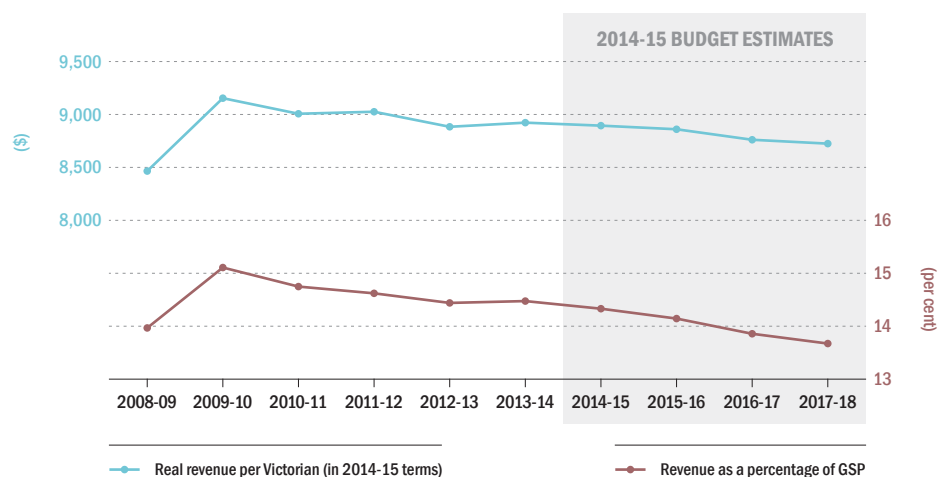
The Committee uses two indicators for analysing the amount of revenue from a demographic and economic perspective:

- » real revenue per Victorian, which shows the average amount of revenue collected per Victorian adjusted for inflation (that is, in real terms); and
- » revenue as a proportion of gross state product (GSP), which shows the Government's income as a proportion of the whole State's output for the year.

Figure 3.3 compares the trend for both indicators since 2008-09 and the expected trend over the forward estimates period.

Figure 3.3

Revenue per Victorian in real terms (2014-15 prices) and revenue as a proportion of GSP, 2008-09 to 2017-18



Note: Real revenue is calculated using the price deflator implicit in the Department of Treasury and Finance's calculation of real and nominal GSP. Figures are provided in 2014-15 prices.

Sources: Committee calculations based on Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.5; Department of Treasury and Finance, *Annual Financial Reports, 2008-09 to 2012-13*; Department of Treasury and Finance, 'Macroeconomic Indicators' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>, accessed 26 June 2014

Real revenue per Victorian is expected to decrease from \$8,894 in 2014-15 to \$8,725 in 2017-18. While revenue in nominal terms is increasing, the population and/or inflation are growing at a greater rate.

The Government’s revenue as a percentage of GSP is expected to be 14.3 per cent in 2014-15, then decline to 13.6 per cent in 2017-18. The changes between 2008-09 and 2011-12 are largely due to Commonwealth economic stimulus during the global financial crisis. The declining trend over the forward estimates period reflects the expected growth in gross state product being greater than the expected growth in revenue.¹¹⁵

FINDING: The Government’s revenue, in real terms, is expected to decrease from \$8,894 per Victorian in 2014-15 to \$8,725 in 2017-18, while the Government’s revenue as a share of GSP is expected to decrease from 14.3 per cent in 2014-15 to 13.6 per cent in 2017-18.

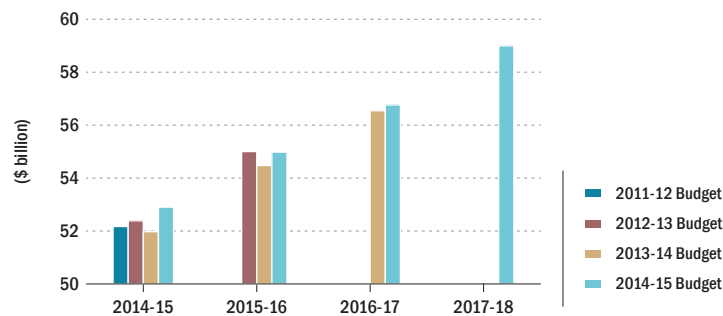
3.4 Comparison to previous budget estimates

At the time of each budget, the Government forecasts revenue over the forward estimates period. Subsequent budgets provide an opportunity for the Government to adjust its expectation of revenue given changing circumstances.

Figure 3.4 shows the Government’s revenue estimates in the 2014-15 Budget, and compares them with estimates from previous budgets.

Figure 3.4

Total revenue, comparison with previous forward estimates, 2014-15 to 2017-18



Source: Budget Paper No.5, *Statement of Finances*, 2011-12 to 2014-15

Between the 2013-14 Budget and the 2014-15 Budget, revenue has been revised upward for every year for which budgets provided estimates. The causes are shown in Table 3.4 below.

The Committee notes that revenue estimates for 2014-15 to 2016-17 contained in the 2014-15 budget papers increase the estimated amount of revenue in every year compared to the estimates in the 2013-14 budget papers. This is primarily driven by Commonwealth specific-purpose grants, economic and demographic variations and the State Government’s revenue initiatives. These increases are partly offset by administrative variations in each year.¹¹⁶

115 Committee calculations based on Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.5; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13; Department of Treasury and Finance, ‘Macroeconomic Indicators’ data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>, accessed 26 June 2014

116 Department of Treasury and Finance, *Victorian Budget Update 2013-14*, December 2013, p.21; Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.57

Table 3.4

Drivers of variations in revenue estimates between the 2013-14 and 2014-15 budgets

	2014-15 (\$ million)	2015-16 (\$ million)	2016-17 (\$ million)
Estimated revenue in the 2013-14 Budget	51,974.7	54,474.3	56,543.4
ADD:			
• Revenue initiatives	225.6	293.9	325.6
• Economic and demographic variations ^(a)	344.1	523.4	738.6
• Commonwealth specific-purpose grants variations	934.5	362.0	167.8
• Own-source revenue variations ^(b)	59.3	-1.8	-9.8
LESS:			
• Commonwealth general-purpose grants variations	2.0	41.3	173.8
• Administrative variations ^(c)	634.3	630.5	827.8
Total variations	927.2	505.7	220.6
Estimated revenue in the 2014-15 Budget	52,901.8	54,980.1	56,764.1

(a) Includes State-sourced taxation, dividends, income tax and rate equivalent receipts, and interest.

(b) Variations in revenue received by departments.

(c) Includes public transport fare estimates, changes to the public transport ticketing sharing arrangements and administrative revisions to TAFE estimates.

Sources: Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.5; Department of Treasury and Finance, 2013-14 Victorian Budget Update, December 2013, p.21; Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.57

The budget papers explain that the increases expected from 'economic and demographic variations' are related to:¹¹⁷

- » *land transfer duty increases ... reflecting the stronger than expected recovery in the property market in 2013-14 and the associated flow-on to the following years; and*
- » *land tax increases ... reflecting an upward revision to the expected 2014 land revaluation and higher than anticipated compliance activity, with flow-on effects through the forward estimates.*

Economic and demographic influences have increased investment income by \$56 million in 2014-15 and an average of \$318 million a year in 2015-16 and 2016-17. This reflects:

- » *growth in income tax equivalent revenue from the public financial corporations (PFC) sector ... due to increased forecast profitability of the State's insurers;*
- » *growth in dividend revenue from the PFC sector ... due to increased investment returns for the State's insurers; and*
- » *growth in dividend revenue from the public non-financial corporations (PNFC) sector ... due to increased forecast profitability for Melbourne Water Corporation.*

117 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.58

Decreases from ‘administrative variations’ at the time of the 2013-14 Budget Update are attributed to:¹¹⁸

... a downwards revision to public transport fare revenue estimates and the contracted change in public transport fare revenue sharing arrangements with Metro Trains and Yarra Trams following the full rollout of the myki ticketing system.

Further revenue decreases from ‘administrative variations’ in the 2014-15 Budget are described as:¹¹⁹

... primarily reflecting administrative revisions to TAFE estimates. Revenue estimates have also decreased in 2016-17 due to the flow-on impact of significant asset sales on future dividend, income tax equivalent and licence fee revenues.

The revenue initiatives that contribute to the increased revenue expectations are described in Section 3.2.

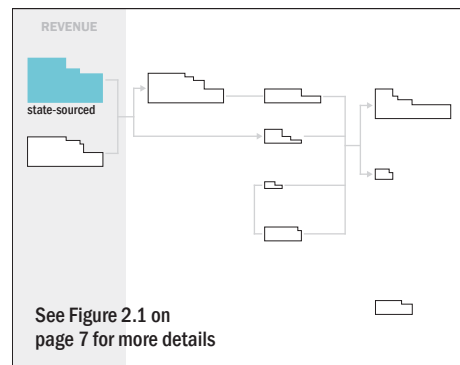
FINDING: The 2014-15 Budget forecasts that \$1.7 billion more revenue will be received between 2014-15 and 2016-17 than predicted in the 2013-14 Budget, mainly driven by additional Commonwealth grants, changes in economic and demographic variations and revenue initiatives.

3.5

State-sourced revenue

State-sourced revenue can be divided into four categories:

- » taxation and levies;
- » sales of goods and services;
- » dividends, income tax equivalent and rate equivalent revenue; and
- » other revenue line items (such as interest revenue, fines and royalties).



State-sourced revenue is expected to be \$28.2 billion (53.3 per cent of total revenue) in 2014-15.¹²⁰ Figure 3.5 below shows the various components as a proportion of State-sourced revenue.

The first three components are discussed below. ‘Other revenue line items’ are expected to be \$3,056.4 million (10.8 per cent) and are expected to remain steady over the forward estimates period, reaching \$3,079.0 million in 2017-18.¹²¹

118 Department of Treasury and Finance, *2013-14 Victorian Budget Update*, December 2013, p.24

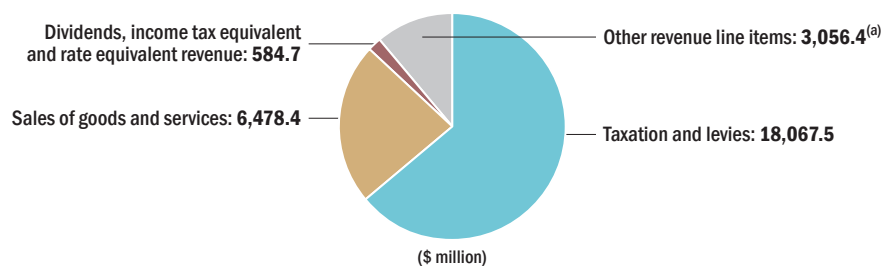
119 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.59

120 Committee calculations based on Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.5, 24

121 *ibid.*

Figure 3.5

Components of State-sourced revenue, 2014-15



(a) Includes 'interest', 'other contributions and grants', and 'other revenue'
 Source: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, pp.5, 165

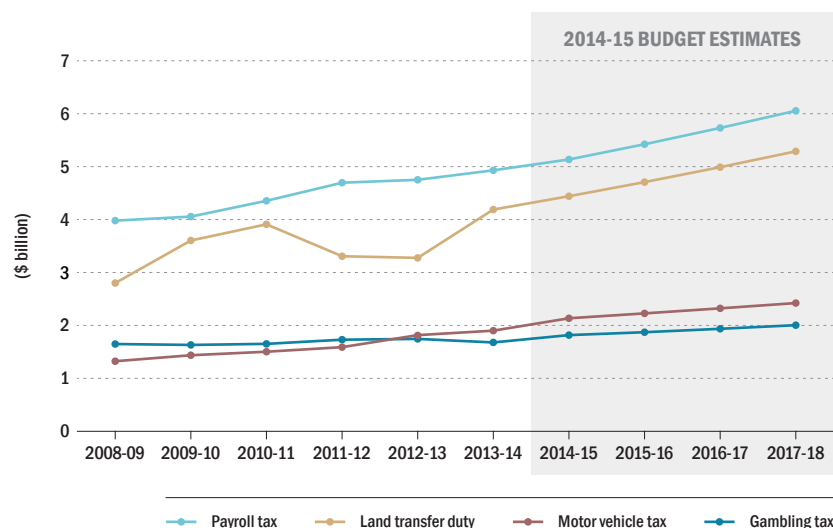
3.5.1

Taxation and levies

Revenue from State taxation in 2014-15 is expected to reach \$18.1 billion and then increase to \$20.6 billion by 2017-18.¹²² The major components of State taxation are shown in Figure 3.6.

Figure 3.6

Major components of State taxation, 2008-09 to 2017-18



Sources: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.157; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13

The movement in payroll tax over the forward estimates period is described in the budget papers as being 'consistent with trend growth in wages and the labour market'.¹²³ This is partially offset by the decision to reduce the payroll tax rate by 0.05 percentage points from July 2014 (see Section 3.2 of this report).¹²⁴

The 6.0 per cent annual growth predicted by the Government for land transfer duty over the forward estimates period is described in the budget papers as reflecting 'a return to trend growth following strong growth of 27.9 per cent in 2013-14'.¹²⁵

122 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.157

123 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.53

124 Budget Paper No.3, 2014-15 Service Delivery, May 2014, pp.78-9

125 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.53

The increase in the ‘motor vehicle taxes’ component is primarily driven by an initiative (see Section 3.2). This initiative increases the rate of stamp duty on motor vehicles and transfers of registration by 0.2 percentage points across all vehicle types. This is accompanied by an increase in light vehicle registration fees.¹²⁶ The budget papers indicate that:¹²⁷

... revenue from these initiatives will support Government investment in major new road infrastructure and initiatives which support works from industries in transition including the automotive industry.

Gambling taxes are projected to increase by an average of 3.3 per cent over the forward estimates period. According to the Government, this growth is lower than total taxation revenue growth and reflects a longer-term reduction in gambling’s share of household consumption.¹²⁸ As discussed in Section 3.2, the *Hotel and Club Electronic Gaming Machine Levy* initiative is estimated to provide additional revenue of \$287.0 million over the forward estimates period.

Overall, State taxation revenue is expected to increase at an average of 4.4 per cent per annum over the forward estimates period.¹²⁹

FINDING: Revenue from State taxation is expected by the Government to increase from \$18.1 billion in 2014-15 to \$20.6 billion in 2017-18. This is largely a result of macroeconomic factors, although revenue and revenue foregone initiatives have also had an impact.

3.5.2

Sales of goods and services

Revenue from the sales of goods and services is expected to fall by 1.4 per cent to \$6.5 billion in 2014-15 and then increase to \$6.8 billion in 2017-18.¹³⁰ The major components of sales of goods and services are the provision of services and the ‘inter-sector capital assets charge’. Together, these two components make up 86.6 per cent of sales of goods and services.¹³¹ These are shown in Figure 3.7 below.

Revenue from the provision of services is expected to fall by \$161.0 million to \$4.0 billion in 2014-15. The budget papers explain that this:¹³²

... primarily reflects a change in public transport fare revenue sharing arrangements with Metro Trains and Yarra Trams following the full rollout of the myki ticketing system.

The ‘inter-sector capital asset charge’ represents the charge imposed by the general government sector on different public sector entities related to the value of their assets.

126 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.78

127 *ibid.*, p.79

128 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.161

129 *ibid.*, p.156

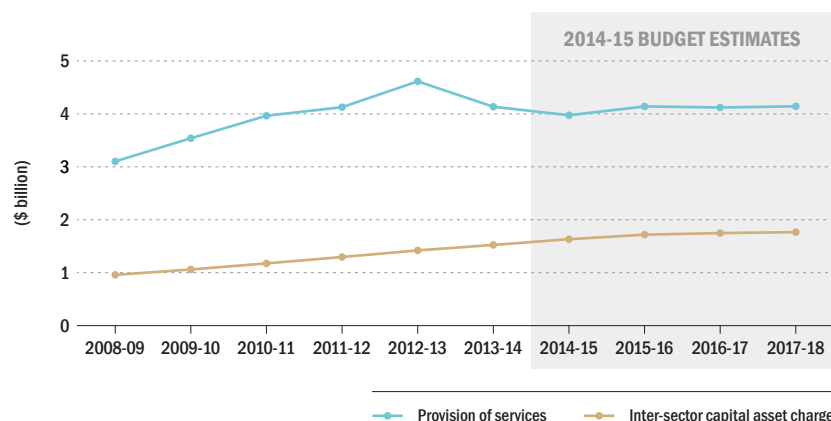
130 *ibid.*, p.164

131 *ibid.*

132 *ibid.*

Figure 3.7

Selected components of sales of goods and services, 2008-09 to 2017-18



Sources: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.24; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13

FINDING: The Government expects revenue from sales of goods and services to increase from \$6.5 billion in 2014-15 to \$6.8 billion in 2017-18.

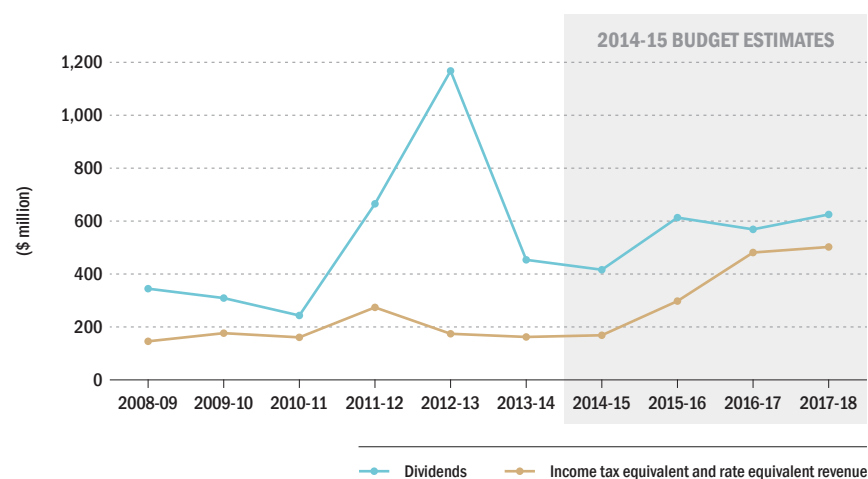
3.5.3

Dividends and income tax equivalent and rate equivalent revenue

Revenue from 'dividends and income tax equivalent and rate equivalent revenue' is expected to fall by 9.5 per cent to \$584.7 million in 2014-15 and then to increase to \$1.1 billion in 2017-18.¹³³ The major components of this are shown in Figure 3.8.

Figure 3.8

Dividends, income tax equivalent and rate equivalent revenue, 2008-09 to 2017-18



Sources: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.23; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13

Dividends are received from time to time from a number of agencies within the public non-financial corporations (PNFC) sector and the public financial corporations (PFC) sector. The amount of a dividend is based on the agency's

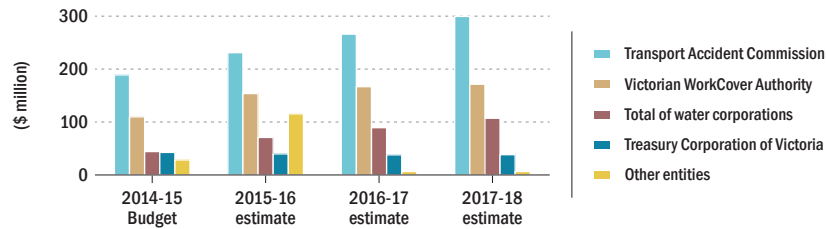
financial performance, with some negotiation between the agency and the Department of Treasury and Finance.

The Committee notes that, for the first time, the 2014-15 budget papers disclose the entities which are expected to contribute dividend payments over the forward estimates period.¹³⁴ This reflects part of a recommendation from the Committee.¹³⁵

Figure 3.9 shows the main entities contributing to dividend revenue over the forward estimates period.

Figure 3.9

Entities contributing to dividend revenue, 2014-15 to 2017-18



Source: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.23

Dividends for 2014-15 are anticipated to fall by 8.3 per cent to \$416.1 million, before rising to \$624.9 million in 2017-18.¹³⁶ The expected growth in dividends is mainly due to ‘strong growth in profits within the State’s insurance agencies, which are forecasting improving investment returns attributable to favourable financial market conditions’.¹³⁷ This can be seen in Figure 3.9, which shows that the Transport Accident Commission and the WorkCover Authority are expected to contribute the largest amounts of growth. The State Electricity Commission of Victoria is also expected to provide \$88.0 million in 2015-16, but not in other years.¹³⁸ This is reflected in Figure 3.9 in ‘other entities’.

Income tax and rate equivalent receipts are anticipated to fall by 12.4 per cent to \$168.6 million in 2014-15. However, by 2017-18, they are expected to rise to \$502.2 million.¹³⁹ This is predominantly income tax equivalent revenue, with local government rate equivalent revenue contributing only around 3.4 per cent of this component.¹⁴⁰

Government-owned corporations are required to pay income tax and equivalent charges ‘to ensure they operate on a competitively neutral basis with the private sector, consistent with National Competition Policy’.¹⁴¹ The Government anticipates a high growth rate of income tax equivalent revenue over the forward estimates period due to ‘increased forecast profitability of the State’s insurers’.¹⁴²

134 *ibid.*, p.23
 135 Public Accounts and Estimates Committee, *Report on the 2012-13 Budget Estimates – Part Two*, September 2012, Recommendation 12, p.58
 136 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.23, 226
 137 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.54
 138 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.23, 226
 139 *ibid.*, p.23
 140 *ibid.*
 141 Department of Treasury and Finance, *Corporate Planning and Performance Reporting Requirements-Government Business Enterprises*, October 2009, p.114
 142 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.58

FINDING: The Government expects revenue from dividends, income tax equivalent and rate equivalent revenue to fall to \$584.7 million in 2014-15. However, this is expected to rise to \$1.1 billion in 2017-18, driven by strong growth in both dividends and tax and rate equivalent revenue. This is primarily driven by the Government's expectations of increased profitability for the State's insurance agencies.

3.5.4 Collection of revenue

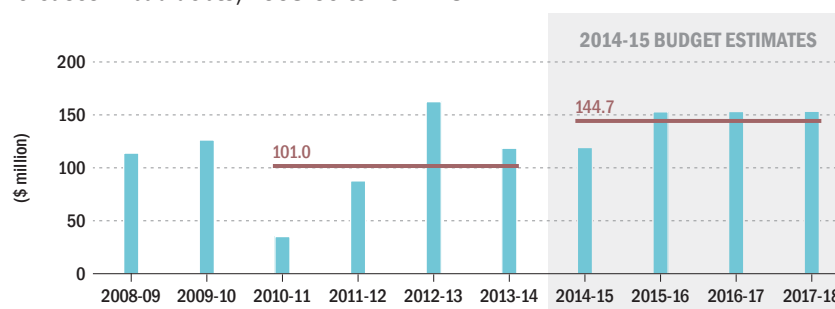
Under current reporting requirements, revenue estimates include the full value of money expected to be owed to the Government. However, the actual cash may not always be collected in full. Cash that may not be able to be collected is estimated in 'provision for doubtful debts'. When there is enough evidence to suggest that the revenue will never be collected, it becomes a 'bad debt', which is recognised as a loss for the Government.

For example, fines and other regulatory fees are counted as 'receivables' in the budget papers and a provision is made in the budget papers for bad and doubtful debts resulting from cases where fines are not paid.

The budget papers include estimates for the increase in bad debts in each year, as shown in Figure 3.10.

Figure 3.10

Increases in bad debts, 2008-09 to 2017-18



Sources: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, pp.32, 230; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13

The Committee notes that the average expected increase in bad debts over the forward estimates period is \$144.7 million per year. This is more than the average over the preceding four years of \$101.0 million per year. A contributing factor to this is that the total value of fines issued is expected to increase over the forward estimates period.¹⁴³

In relation to bad and doubtful debts administered by the Department of Justice, the Government states that:¹⁴⁴

Outstanding debts will continue to be vigorously pursued through all legal means, however prudent accounting requires that provision be made for such debts.

¹⁴³ Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.24

¹⁴⁴ *ibid.*, p.110

The budget papers include details of the change in the value of doubtful debts, and the balance of receivables is net of doubtful debts. However, the Annual Financial Report for the State provides additional details in a note to the balance sheet.¹⁴⁵ These details include the gross value of receivables and the balance of doubtful debts being carried by the Government.

FINDING: The average loss due to revenue being unable to be fully collected is expected to be \$144.7 million per year over the forward estimates period, an increase from the preceding four-year average of \$101.0 million.

3.6

Commonwealth-sourced revenue

Commonwealth grants accounts for 46.7 per cent (\$24.7 billion) of expected revenue in 2014-15.¹⁴⁶ There are two principal types of Commonwealth Government grants to the State. General-purpose grants may be used by the State without restriction. Specific-purpose grants must be spent in specified ways (see Table 3.5).

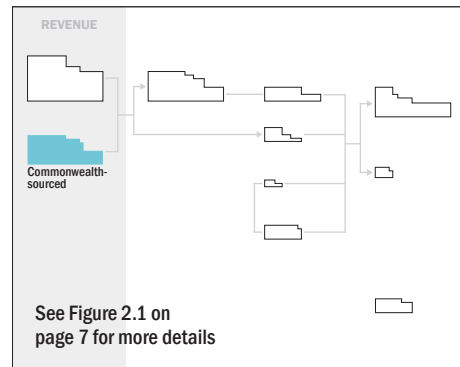


Table 3.5

Major types of Commonwealth grants received by Victoria

Grant	Restrictions
GENERAL-PURPOSE GRANTS (GST)	No restrictions on how this funding can be spent
SPECIFIC-PURPOSE GRANTS	
National Agreements	Funding must be spent in a specified sector, but the State can determine how the money is spent within the sector. The agreements are generally ongoing.
National Partnerships	Funding must be spent on specified projects or is dependent on specified reforms. The partnerships are generally over a fixed period.
Other agreements	Health payments delivered through the <i>National Health Reform</i> agreement based on increases in State service provision activity. Education payments for schools will be delivered through the <i>Student First</i> agreement.

Source: Public Accounts and Estimates Committee

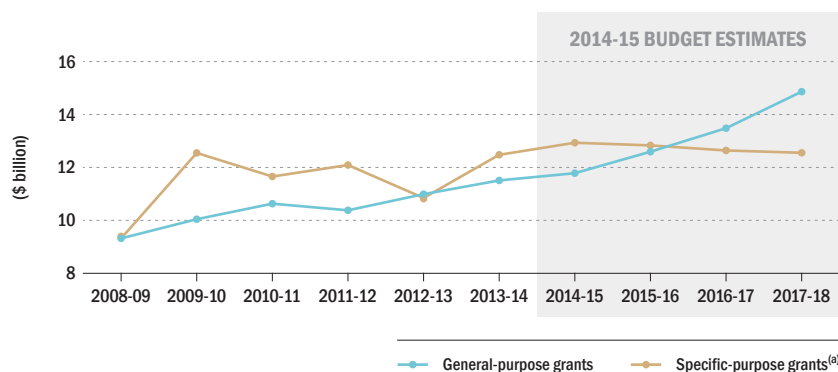
Figure 3.11 shows the trends for general-purpose and specific-purpose grants from 2008-09 to 2017-18. Figure 3.12 shows these two items adjusted for inflation and population over the same period.

¹⁴⁵ Department of Treasury and Finance, *2012-13 Financial Report*, October 2013, p.79

¹⁴⁶ Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.5, 165

Figure 3.11

General-purpose and specific-purpose grants, 2008-09 to 2017-18



(a) Includes 'specific purpose grants for on-passing' to bodies outside the State Government.

Source: Sources: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.165; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13

Figure 3.12

General-purpose and specific-purpose grants per Victorian in real terms (2014-15 prices), 2008-09 to 2017-18



Note: Both indicators are calculated using the price deflator implicit in the Department of Treasury and Finance's calculation of real and nominal GSP. Figures are provided in 2014-15 prices.

Sources: Committee calculations based on Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.24; Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13; Department of Treasury and Finance, 'Macroeconomic Indicators' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>, accessed 26 June 2014

General-purpose grants (in nominal terms) are expected to rise by 2.4 per cent to \$11.8 billion in 2014-15, and are expected to continue to increase over the forward estimates period to \$14.9 billion in 2017-18.¹⁴⁷

The estimates for specific-purpose grants rise by 3.6 per cent to \$12.9 billion in 2014-15, before declining over the forward estimates period to \$12.6 billion in 2017-18.¹⁴⁸

The causes of the expected changes are discussed in Sections 3.6.2 and 3.6.3 of this report.

The Committee notes that these estimates do not incorporate a number of grants which were not confirmed at the time of the Budget, such as funding for *Early Childhood Education* and for *Improving Public Hospital Services*.¹⁴⁹

147 *ibid.*, p.165

148 *ibid.*

149 *ibid.*

3.6.1

Timing of the Budget and Commonwealth announcements

A number of changes to Commonwealth grants are typically announced in the Commonwealth budget. Because the State budget is tabled before the Commonwealth budget, this information is not available at the time the State budget is prepared.

Prior to the Commonwealth budget, at his budget estimates hearing, the Minister for Health noted the impact of the uncertainty surrounding specific-purpose grants on the framing of the State budget:¹⁵⁰

What the state has sought to do in this budget is to represent as fairly as we can the position we think things are at. I have pointed to the uncertainty that we do not know what the commonwealth budget will contain; we do not know what will be there ...

Similarly, the Premier noted that:¹⁵¹

... we anticipated that a number of the national partnerships may be at risk and we weren't prepared to put them into the Budget until they were locked in ...

Overall, the State estimate for specific-purpose grants for 2014-15 was \$12.93 billion.¹⁵² However, the Commonwealth budget papers announced that total payments to Victoria for specific purposes were expected to be \$11.16 billion (\$1.77 billion less revenue than expected by the State).¹⁵³

An example of the Commonwealth changes was provided by the Minister for Community Services:¹⁵⁴

We were surprised on budget night to hear that the concessions NPA [National Partnership Agreement] would be concluded. That is about \$300 million a year right across the country and, in this coming financial year for the concessions NPA, \$73 million.

Noting the difficulties from the current timing the Premier commented that:¹⁵⁵

... in future we should consider in this state as to whether our budget should be produced ahead of a federal budget. I think there is a sound argument for Victoria to have our budget one or two weeks after the federal budget so that all these matters can be considered.

The Committee notes that most Australian states table their budgets after the Commonwealth. Figure 3.13 compares the tabling dates for the Commonwealth, state and territory budgets in 2014. Five are tabled after the Commonwealth's and use the latest Commonwealth announcements and decisions to make their estimates.

150 Hon. D. Davis MLC, Minister for Health, 2014-15 budget estimates hearings, transcript of evidence, 9 May 2014, p.26

151 Hon. Dr D. Napthine MP, Premier, transcript of media conference, 14 May 2014 <www.premier.vic.gov.au/media-centre/transcripts/9967-full-transcript-of-media-conference-by-premier-denis-napthine-14-may-2014.html>, accessed 29 July 2014

152 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.24

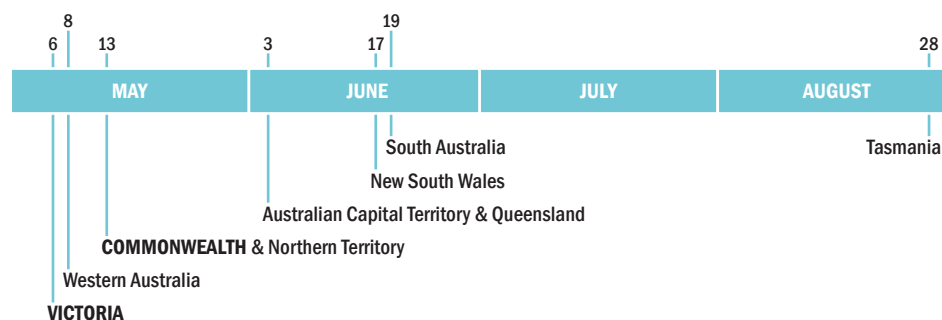
153 Commonwealth Budget Paper No.3, *2014-15 Australia's Federal Relations*, May 2014, p.5

154 Hon. M. Wooldridge MP, Minister for Community Services, 2014-15 budget estimates hearings, transcript of evidence, 22 May 2014, p.9

155 Hon. Dr D. Napthine MP, Premier, transcript of media conference, 14 May 2014 <www.premier.vic.gov.au/media-centre/transcripts/9967-full-transcript-of-media-conference-by-premier-denis-napthine-14-may-2014.html>, accessed 29 July 2014

Figure 3.13

Tabling dates of the Commonwealth and Australian jurisdictions, 2014-15 budget papers



Source: Public Accounts and Estimates Committee

The Committee considers that tabling the Victorian budget after the Commonwealth budget would provide an opportunity to improve grant revenue estimates and provide a more accurate forecast of consequent expenditure.

FINDING: The Victorian budget is tabled before the Commonwealth budget and therefore does not include some announcements and decisions made by the Commonwealth.

RECOMMENDATION 1: The Government should investigate the potential benefits of tabling the Victorian budget after the Commonwealth budget.

3.6.2

General-purpose (GST) grants

The Commonwealth Government collects the goods and services tax (GST) and distributes the funds through general-purpose grants to states and territories. Total general-purpose grants to Victoria are expected to be \$11.8 billion in 2014-15 and then increase to \$14.9 billion in 2017-18.¹⁵⁶

There are three key factors that determine the amount of general-purpose grants Victoria receives:

- » the total pool of GST funds available for distribution;
- » Victoria's population as a proportion of the Australian population; and
- » Victoria's GST relativity, which adjusts the amount to assist states and territories that need more support to deliver the same level of service.

The method to calculate Victoria's share of the total GST pool is:

$$\text{Victoria's share of GST} = \text{Total GST pool} \times \frac{\text{Victoria's population}}{\text{Australia's population}} \times \text{Victoria's GST relativity}$$

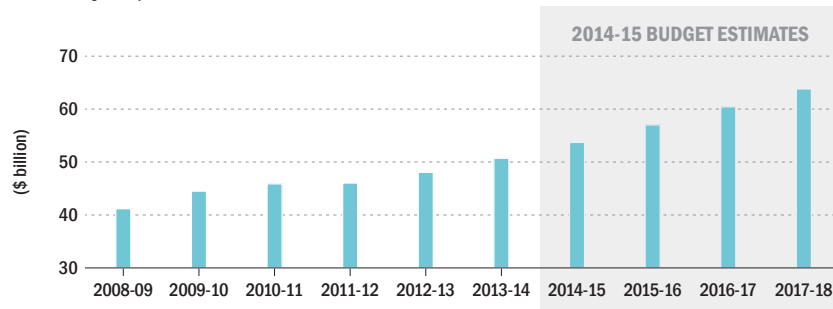
Figure 3.14 shows the Commonwealth Government's estimates for the total GST pool over the forward estimates period. The pool is expected to grow consistently. The same assumption was made in the State Budget, which indicates that the

¹⁵⁶ Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.165

forecast growth in GST revenue ‘reflects forecast growth in the national pool and some improvement in Victoria’s relativity’.¹⁵⁷

Figure 3.14

Total GST pool, 2008-09 to 2017-18



Sources: Commonwealth Government, Final Budget Outcomes 2008-09 to 2012-13; Commonwealth Budget Paper No.3, 2014-15 Australia’s Federal Relations, May 2014, p.93

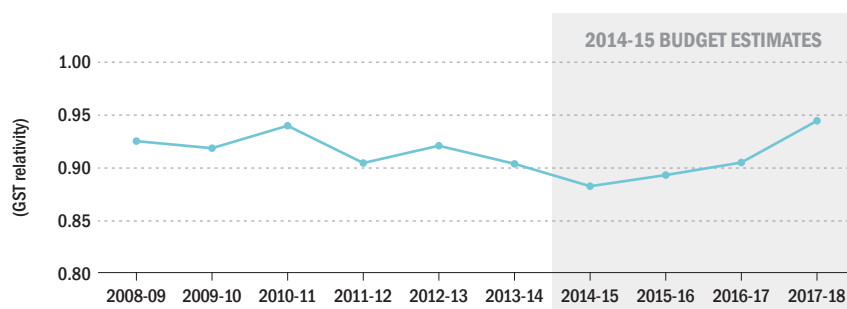
Based on data from the Australian Bureau of Statistics, Victoria’s population is expected to grow by 1.8 per cent annually over the forward estimates period.¹⁵⁸ Likewise, the Australian population is expected to grow by 1.8 per cent annually.¹⁵⁹ This suggests that Victoria’s share of the national population will remain relatively stable over the forward estimates period.

Figure 3.15 shows that the GST relativity in 2014-15 for Victoria is expected to be 0.88282 in 2014-15 and it is expected by the State Government to rise substantially over the forward estimates period to 0.94460 in 2017-18.¹⁶⁰ The Treasurer commented on Victoria’s share of GST collections at the budget estimates hearings:¹⁶¹

One of the issues we continue to face is the inequitable distribution of GST. Victoria is now one of the greater donor states. In fact I think we are the only state that since federation has consistently been a donor state.

Figure 3.15

GST relativity for Victoria, 2008-09 to 2017-18



Sources: Commonwealth Government, Final Budget Outcomes, 2008-09 to 2012-13; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.166

157 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.54
 158 ibid., p.13
 159 Commonwealth Budget Paper No.3, 2014-15 Australia’s Federal Relations, May 2014, p.107
 160 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.166
 161 Hon. M. O’Brien MP, Treasurer, 2014-15 budget estimates hearings, transcript of evidence, 9 May 2014, p.3

FINDING: The Government expects general-purpose (GST) grants to the State to be \$11.8 billion in 2014-15, increasing to \$14.9 billion in 2017-18. This is primarily driven by a more favourable anticipated relativity for the State and expected growth in the GST pool.

3.6.3 Specific-purpose grants

The budget papers divide specific-purpose grants into ‘grants for specific purposes’ (which are predominantly grants to the State Government) and ‘specific-purpose grants for on-passing’ (which are provided to the State Government but passed on to non-government schools and local government). The Committee notes that the budget estimates for these components move in opposite directions. Grants for on-passing are anticipated to increase. The estimates for grants for State government programs are expected to decrease.

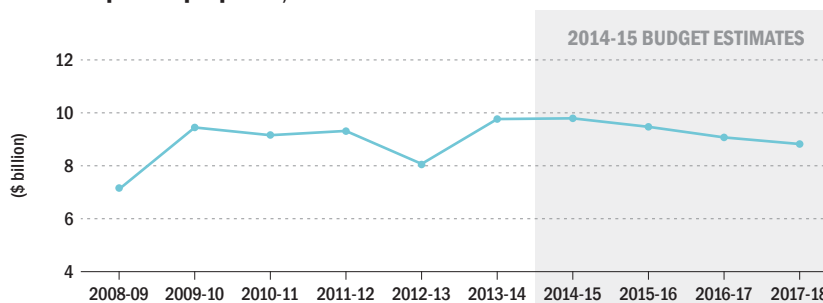
Grants for specific purposes

Grants for specific purposes are received as part of agreements with the Commonwealth such as national partnerships.

The estimates for grants for specific purposes used in the budget papers increase (by 0.3 per cent) to \$9.8 billion in 2014-15 before decreasing over the forward estimates period, reaching \$8.8 billion in 2017-18 (see Figure 3.16).¹⁶²

Figure 3.16

Grants for specific purposes, 2008-09 to 2017-18



Sources: Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13; Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.165

The Committee notes that the estimates do not include any allowance for additional grants announced by the Commonwealth Government in future budget papers. The decline may be partly a result of this practice and the actual figures may therefore be quite different to the estimates used in preparing the State Budget.

Changes since the 2013-14 Budget include new ‘efficient growth funding’ added to the *National Health Reform*, contributing to a 7.8 per cent increase in funding under that agreement from 2013-14.¹⁶³

¹⁶² Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.165

¹⁶³ *ibid.*, pp.95, 170

Funding for school services has fully transitioned from the former *National Education Agreement* to the new *Students First – A Fairer Funding Agreement for Schools*.¹⁶⁴ This has resulted in an increase in funding for government schools, from an estimated \$1,053.2 million in 2013-14 to \$1,200.8 million in 2014-15.¹⁶⁵

The 2014-15 Commonwealth budget announced \$3.9 billion for all states for the *Asset Recycling Initiative*,¹⁶⁶ which provides a potential incentive payment of 15 per cent of the sale price when existing state assets are sold and the funds used to invest in new infrastructure. The amount received:¹⁶⁷

... will be agreed between the Commonwealth and individual States on a first-come, first-served basis, until the total amount of funding available under this measure is exhausted.

The Victorian Treasurer explained that Victoria anticipates additional funding from two major divestments as part of the asset recycling initiative, the Rural Finance Corporation and the Port of Melbourne lease of operations.¹⁶⁸ The Treasurer explained that Victoria will get 15 per cent of the total Rural Finance Corporation divestment under the asset recycling initiative:¹⁶⁹

... if, for example, the final price is around \$400 million, we will get 15 per cent on top of that. That is \$460 million that the state has been able to deliver in additional infrastructure for rural and regional Victoria, and that is a very important outcome.

The lease of the operations of the Port of Melbourne will also result in additional funding under the initiative.

This is also discussed in Section 6.2 of this report.

FINDING: The budget papers assume that ‘grants for specific purposes’ will be \$9.8 billion in 2014-15 before steadily decreasing to \$8.8 billion in 2017-18. Announcements in future Commonwealth budgets may increase this figure.

Specific-purpose grants for on-passing

The State acts as a conduit for Commonwealth grants which are passed on to non-government schools and local government. For these grants, the revenue received is equal to the expenditure recognised when it is passed on. Therefore, there is no impact on the net operating balance for the State.

Specific-purpose grants for on-passing are expected to total \$3.14 billion in 2014-15, with grants passed to non-government schools expected to be \$2.57 billion and grants passed to local government \$0.57 billion.¹⁷⁰

164 *ibid.*, p.172

165 *ibid.*

166 Commonwealth Budget Paper No.3, *2014-15 Australia's Federal Relations*, May 2014, p.66

167 *ibid.*

168 Hon. M. O'Brien MP, Treasurer, 2014-15 budget estimates hearings, transcript of evidence, 9 May 2014, p.27

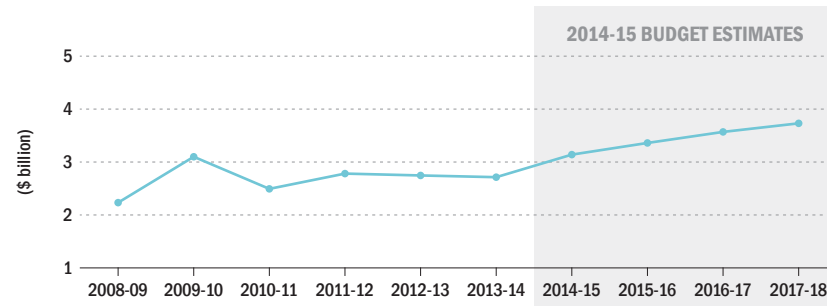
169 *ibid.*, p.8

170 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.168

Figure 3.17 shows total grants for on-passing over the forward estimates period. The growth over the forward estimates period is mostly due to increases in grants passed to non-government schools under the *Students First – A Fairer Funding Agreement for Schools*, which came into force on 1 January 2014.¹⁷¹

Figure 3.17

Specific-purpose grants for on-passing, 2008-09 to 2017-18



Sources: Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13; Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.165

The *Students First – A Fairer Funding Agreement for Schools* expires at the end of 2017. Therefore, the remaining portion of revenue in 2017-18 is subject to future agreement between governments.¹⁷²

FINDING: Revenue from specific-purpose grants for on-passing is expected to increase from \$3.1 billion in 2014-15 to \$3.7 billion in 2017-18. This is mostly due to increases in grants for non-government schools.

¹⁷¹ Committee calculations based on Commonwealth Budget Paper No.3, *2014-15 Australia's Federal Relations*, May 2014, pp.36, 84; Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.168

¹⁷² Commonwealth Budget Paper No.3, *2014-15 Australia's Federal Relations*, May 2014, p.36

4.1

Introduction

As noted in Chapter 2, funding for asset investment is provided by the depreciation allowance, sales of assets and the operating surplus.¹⁷³ If these sources are not sufficient to fund the desired level of asset investment, borrowings are required, raising net debt. If, on the other hand, the sources of funding exceed requirements, borrowings may be repaid, which decreases net debt.

In addition to asset investment, net debt is increased on the commissioning of public private partnership (PPP) projects. While no cash transaction occurs at the time of commissioning, the value of the Government's future commitments (discounted to the 'present value') is added to net debt.

The 2014-15 budget papers anticipate that borrowings and net debt will increase in the general government sector and the public non-financial corporations (PNFC) sector in 2014-15. However, expectations for the remainder of the forward estimates period are less uniform.

A number of the aspects of the 2014-15 Budget that are discussed in Chapter 2 have influenced borrowings and net debt. These include once-off policy decisions (especially the sale of the Rural Finance Corporation and the lease of operations at the Port of Melbourne), up-front receipt of grants from the Commonwealth for the *East West Link*, and increased expectations for operating surpluses.

This chapter addresses the following questions:

- » What are the trends for borrowings and net debt over the forward estimates period? (Section 4.2)
- » What parts of the Government's strategy relate to borrowings and net debt? Is the Government on track to meet its targets? (Section 4.3)
- » How do the latest estimates for borrowings and net debt compare with those from previous budgets? (Section 4.4)
- » What options does the Government have to manage risks that affect borrowings and debt? (Section 4.5)

This chapter contains an examination of borrowings and net debt for the general government sector and the PNFC sector, as both sectors are considered in assessing the State's credit rating.¹⁷⁴

¹⁷³ And other minor factors such as the cash equivalent of movements in the unfunded superannuation liability and liability for employee benefits.

¹⁷⁴ Moody's Investors Service 'Announcement: Moody's Reports on Victoria's 2014/15 Budget', 6 May 2014, p.1; Standard & Poor's, 'Bulletin: Ratings on Australia's State of Victoria Unchanged After State Budget Announcement', 6 May 2014, p.1

4.2

Borrowings and net debt over the forward estimates period

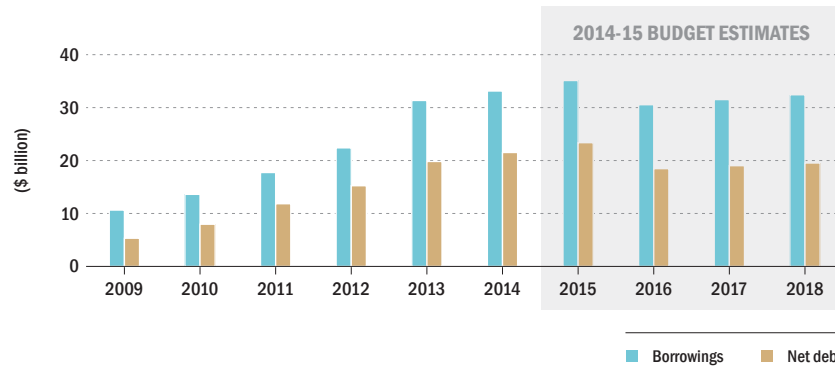
4.2.1

General government sector

The general government sector is made up of departments and other entities that do not charge users for the services they provide (or charge significantly below the cost of their services). Figure 4.1 shows borrowings and net debt for the general government sector.

Figure 4.1

Borrowings and net debt, general government sector, as at 30 June, 2009 to 2018



Sources: Department of Treasury and Finance, Annual Financial Reports, 2009-10 to 2012-13; Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.7

Borrowings for the sector are anticipated to rise from \$33.1 billion in June 2014 to \$35.1 billion in June 2015.¹⁷⁵

Net debt for the sector is expected to rise with borrowings, from a revised \$21.5 billion in June 2014 to \$23.4 billion in June 2015.¹⁷⁶

Figure 4.1 also shows that the Government expects borrowings and net debt to fall sharply in 2015-16 before rising more gradually over the rest of the forward estimates period. The profile over the forward estimates period reflects income from the lease of operations of the Port of Melbourne and the sale of the Rural Finance Corporation, as well as up-front receipt of Commonwealth grants for *East West Link*.¹⁷⁷

FINDING: Net debt for the general government sector is anticipated by the Government to be \$23.4 billion in June 2015. The Government expects net debt to fall during 2015-16 before rising over the rest of the forward estimates period.

175 Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.7

176 *ibid.*

177 Cf. Budget Paper No.2, 2014-15 *Strategy and Outlook*, May 2014, p.65

Project delivery types and the effects on borrowings

Borrowings for the general government sector are principally made up of two components:¹⁷⁸ cash borrowings¹⁷⁹ and finance lease liabilities.¹⁸⁰ In June 2015, borrowings are expected to be made up of \$27.2 billion in cash borrowings and \$7.9 billion in finance lease liabilities.¹⁸¹

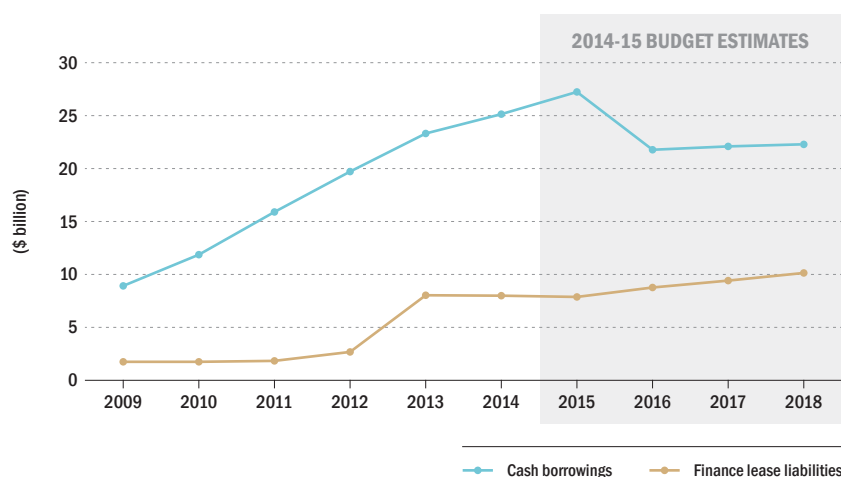
The contribution that finance leases make to borrowings is primarily determined by PPP projects.¹⁸² In years when no PPP project is commissioned,¹⁸³ finance lease liabilities fall slightly, as the existing liability is paid down. In years when PPP projects are commissioned, finance lease liabilities increase. An example of this occurred during 2012-13 with the commissioning of the *Victorian Desalination Plant* project.

Cash borrowings are largely a result of 'traditional' or 'design and construct' infrastructure projects, with the funds used directly by the Government.

The expected trend in these two components is shown in Figure 4.2.

Figure 4.2

Cash borrowings and finance lease liabilities, general government sector, as at 30 June, 2009 to 2018



Sources: Department of Treasury and Finance, Annual Financial Reports, 2009-10 to 2012-13; Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.37

The Government plans to spend between \$5.0 billion and \$6.1 billion on direct general government sector asset investment in each year of the forward estimates period.¹⁸⁴ This will contribute to increased borrowings in 2014-15. However, in the following year, this will be more than offset by a cash inflow from the lease of the Port of Melbourne operations.¹⁸⁵ This means that cash borrowings peak in June 2015 before falling sharply by June 2016 (see Figure 4.2).

¹⁷⁸ A third component, derivative financial instruments, is small, making up less than 0.1 per cent of borrowings.

¹⁷⁹ Also known as 'domestic borrowings' in the budget papers (Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.37).

¹⁸⁰ Changes in finance lease liabilities are not a cash transaction, but rather the recognition of a change of a liability. This means the item 'total borrowings' is a mixed concept, with cash and non-cash components.

¹⁸¹ Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.37

¹⁸² Budget Paper No.2, 2014-15 *Strategy and Outlook*, May 2014, p.62, specifically footnote (d) to Table 4.5

¹⁸³ Commissioning refers to the point at which the construction of the PPP project is complete and the project begins operating.

¹⁸⁴ Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, p.8

¹⁸⁵ Budget Paper No.2, 2014-15 *Strategy and Outlook*, May 2014, p.65

Following this, the Government intends that ‘*net infrastructure investment is fully funded by cash from operations each year from 2015-16*’.¹⁸⁶ That is, after cash costs have been deducted from cash received for the year, what remains can more than pay for cash payments for infrastructure. This is shown in Section 2.6.2 and Appendix A4.2 where, for years after 2015-16, sources of cash are greater than infrastructure investment. This leads to cash borrowings after 2016 being relatively stable (see Figure 4.2).¹⁸⁷ According to the Treasurer:¹⁸⁸

As we get up towards those \$3 billion surpluses in some of the out years, that will be the highest level of surplus Victoria has ever seen in nominal terms ... By 2015-16 we expect to be able to fund our infrastructure projects effectively from operating cash.

The Committee notes that the Government plans to increase its cash reserves by over 20 per cent over the forward estimates period.¹⁸⁹ The use of some of the available cash to grow reserves rather than fund infrastructure may partly explain the need for cash borrowings.

The contribution of PPP projects to total borrowings through finance lease liabilities is expected to decrease slightly in 2014-15,¹⁹⁰ as no projects are scheduled to be commissioned during that year.¹⁹¹ However, after 2015, the contribution is expected to rise, as shown in Figure 4.2. This is because the Government anticipates the commissioning of four new PPP projects over this period:¹⁹²

- » the *Victorian Comprehensive Cancer Centre* project;
- » the *Bendigo Hospital* project;
- » the *Ravenhall Prison* project; and
- » the *Cranbourne-Pakenham Rail Corridor* upgrade.

FINDING: The Government plans to use funds received following the lease of operations at the Port of Melbourne to reduce cash borrowings during 2015-16. The net impact of this and other factors will be a reduction in borrowings by \$4.6 billion in 2015-16 and net debt by \$4.9 billion.

Separate disclosure of transactions

The Committee understands that the decrease in net debt for the general government sector in 2015-16 is primarily associated with the leasing of operations of the Port of Melbourne.

In the financial statements, the anticipated cash inflow from the lease is included for the PNFC sector in ‘net cash flows from investments in non-financial assets’. In most years, this figure is negative, but in 2015-16 it is positive.¹⁹³

186 *ibid.*, p.6. Net infrastructure investment is also known in the budget papers as total net investment in fixed assets (Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.62).

187 Cash borrowings rise slightly over this period, partially funding a build-up of cash and deposits held by the Government (Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.7).

188 Hon. M. O’Brien MP, Treasurer, 2014-15 budget estimates hearing, transcript of evidence, 9 May 2014, pp.4-5

189 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.7

190 *ibid.*, p.37

191 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.62

192 *ibid.*, specifically footnote (d) to Table 4.5

193 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.46

This is a net figure which is made up of a mixture of transactions, some of which increase and some of which decrease the net figure. The Committee notes that reporting the figure as net is a new development, and that previous budget papers (and annual financial reports) have reported 'purchases of non-financial assets' and 'sales of non-financial assets' separately.¹⁹⁴ Similar aggregations are made in other parts of the budget papers that are affected by the lease.¹⁹⁵

Because of this aggregation, there is no specific disclosure in the budget papers of the amounts the Government anticipates will be received from the Port of Melbourne. The Committee understands that the Government does not wish to disclose this figure, as this may compromise negotiations with potential partners. This is noted in the budget papers, and the Committee accepts the necessity for this.¹⁹⁶

The Committee considers that it is important for transparency and accountability for 'purchases of non-financial assets' and 'sales of non-financial assets' to be reported when they are finalised. The Annual Financial Report, which reports these important figures separately, is the appropriate place for this.

FINDING: Purchases of non-financial assets and sales of non-financial assets are presented as 'net cash flows from investments in non-financial assets' in the 2014-15 budget papers.

RECOMMENDATION 2: The Department of Treasury and Finance continue the practice of separately reporting purchases of non-financial assets and sales of non-financial assets for all sectors in the Annual Financial Report.

4.2.2 Public non-financial corporations (PNFC) sector

The PNFC sector is made up of entities that charge full (or close to full) price for the goods and services they provide (such as water or rail infrastructure). In the PNFC sector, the Committee notes that borrowings and net debt follow very similar paths over the forward estimates period. Figure 4.3 below shows that, following a period of strong growth, both measures will continue to increase to June 2015, with borrowings rising to \$17.8 billion and net debt rising to \$16.6 billion.¹⁹⁷

For the year ended June 2016, both measures are expected to fall slightly, with borrowings easing to \$17.6 billion and net debt to \$16.4 billion.¹⁹⁸ The Committee notes that the year is characterised by a peak in net cash flows from operating activities in the sector.¹⁹⁹ The same year includes a large cash inflow from investments in non-financial assets associated with the lease of operations of the

¹⁹⁴ Budget Paper No.5, *2013-14 Statement of Finances*, May 2013, p.48; Department of Treasury and Finance, *2012-13 Financial Report*, October 2013, p.62

¹⁹⁵ Amalgamations have been made for the non-financial public sector and the public sector as a whole (Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.54, 70).

¹⁹⁶ For example, Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.47, note (a)

¹⁹⁷ Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.45

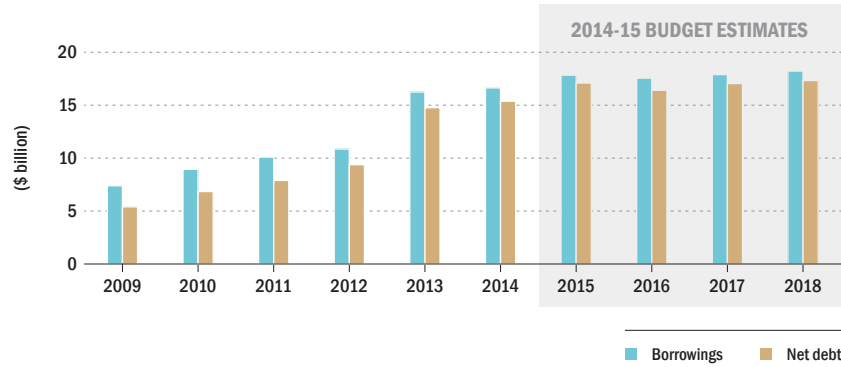
¹⁹⁸ *ibid.*

¹⁹⁹ *ibid.*, p.47

Port of Melbourne.²⁰⁰ Following this, the Government expects both borrowings and net debt for the sector to grow by a small amount each year, with borrowings rising to \$18.2 billion and net debt rising to \$17.3 billion in June 2018.²⁰¹

Figure 4.3

Borrowings and net debt, public non-financial corporations sector, as at 30 June, 2009 to 2018



Sources: Department of Treasury and Finance, Annual Financial Reports, 2009-10 to 2012-13; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.45

FINDING: Net debt for the public non-financial corporations sector is anticipated by the Government to be \$16.6 billion in June 2015. The Government expects this to increase to \$17.3 billion by June 2018.

Individual entities in the sector

In order to examine net debt in the PNFC sector, the Committee obtained preliminary net debt projections for the nine main public non-financial corporations. These entities make up 98.6 per cent of estimated net debt for the PNFC sector at June 2014.

The largest share of net debt in the PNFC sector is held by the water corporations, making up 88.2 per cent of the total. Melbourne Water alone is expected to hold 54.2 per cent of the net debt at 30 June 2014 (see Appendix A4.1).

Appendix A4.1 shows that the Port of Melbourne Corporation is expected to increase its net debt until June 2016. After this, the Corporation is anticipated to hold no debt.

Net debt for the main PNFC entities (other than the Port of Melbourne Corporation) is anticipated to continue to rise consistently over the forward estimates period.

FINDING: Net debt for the Port of Melbourne Corporation is anticipated to fall to zero by June 2017. Net debt for other entities in the public non-financial corporations sector is expected to continue to rise consistently over the forward estimates period.

200 *ibid.*

201 *ibid.*, p.45

4.2.3

Projects with construction beyond the forward estimates period

The 2014-15 budget papers list a number of construction projects that are expected to be completed after the end of the forward estimates period. These include:²⁰²

- » *East West Link – Western Section;*
- » *Melbourne Rail Link;* and
- » *Cranbourne-Pakenham Rail Corridor.*

The Government plans to procure portions of these projects through PPPs.²⁰³

The combined value of these three projects is estimated by the Government to be between \$18.5 and \$23.5 billion.²⁰⁴

4.3

The Government's strategy

The five elements of the Government's long-term financial strategy are outlined in the budget papers.²⁰⁵ The first two of these, 'managing responsibly' and 'looking after the future', provide the impetus for the Government's medium-term fiscal strategy (see Section 2.4.2).

Elements of the medium-term fiscal strategy that are relevant to debt, borrowings and liabilities are that:²⁰⁶

- » general government sector net debt will fall as a share of gross state product (GSP) over the decade to 2022; and
- » the unfunded superannuation liability will be fully funded by 2035.

These two targets are discussed below.

The Committee also notes that a third element of the medium-term fiscal strategy, that the level of infrastructure investment will be at least 1.3 per cent of GSP, interacts with the first element, as infrastructure investment is a key determinant of borrowings and net debt. This element is discussed in Chapter 6.

In his hearing, the Premier linked the strategic element of 'managing responsibly' with the retention of the State's AAA credit rating when describing the Budget as:²⁰⁷

... a responsible budget. It is a budget that maintains us in a position to keep our AAA credit rating.

Further, the Treasurer pointed out that the continued AAA credit rating was a partial consequence of the Government's strategy, in particular the element of decreasing net debt as a proportion of GSP:²⁰⁸

202 Department of Treasury and Finance, *2014-15 Budget Overview*, May 2014, pp.10-11

203 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.11

204 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, pp.64-5

205 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.8

206 *ibid.*, p.9

207 Hon. Dr D. Naphine MP, Premier, 2014-15 budget estimates hearing, transcript of evidence, 13 May 2014, p.4

208 Hon. M. O'Brien MP, Treasurer, 2014-15 budget estimates hearing, transcript of evidence, 9 May 2014, p.3

Because of this management, our ... net debt to GSP also falls from 6.3 per cent to 4.5 per cent. That supports our AAA credit rating.

In pointing out the benefits of the AAA rating, the Treasurer remarked that:²⁰⁹

Having that AAA credit rating is very important. It is an important marker of confidence and it is important from the point of view of lower interest costs. If we needed to refinance Victoria's debt portfolio and we had Queensland's credit rating, we would be paying an extra \$170 million a year, every year, in higher interest payments.

The credit rating for Victoria is discussed in greater detail in Section 2.7 of this report.

4.3.1 Net debt as a proportion of gross state product

General government sector net debt as a proportion of GSP is shown in Table 4.1 (see also Figure 2.3).

Table 4.1 Growth rates of general government sector net debt and GSP, 2014 to 2018

	2014 revised estimate	2015 Budget	2016 estimate	2017 estimate	2018 estimate
	(per cent)	(per cent)	(per cent)	(per cent)	(per cent)
Net debt as a proportion of GSP	6.1	6.3	4.7	4.6	4.5
Growth rate of GSP	4.8	4.6	5.3	5.4	5.3
Growth rate of net debt	8.5	8.6	-21.0	3.0	2.6

Note: Net debt is as at 30 June in each year. GSP is for the year ended 30 June.

Sources: Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.6; Committee calculations based on Department of Treasury and Finance, 'Macroeconomic Indicators' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>, accessed 26 June 2014; Committee calculations based on Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.7

The budget papers anticipate that net debt as a proportion of GSP will increase from a revised estimate of 6.1 per cent in June 2014 to 6.3 per cent by June 2015.²¹⁰ As a result of Government action, including the leasing out the operations of the Port of Melbourne, this is expected to decline to 4.7 per cent in June 2016,²¹¹ before declining further to 4.5 per cent of GSP in June 2018.

FINDING: The Government expects general government sector net debt as a proportion of GSP to peak in June 2015 before falling over the forward estimates period. The fall in net debt over 2015-16 is mainly a result of the leasing out the operations of the Port of Melbourne. Net debt is forecast to fall from 6.1 per cent of GSP in June 2014 to 4.5 per cent of GSP by June 2018.

209 *ibid.*

210 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.6

211 *ibid.*

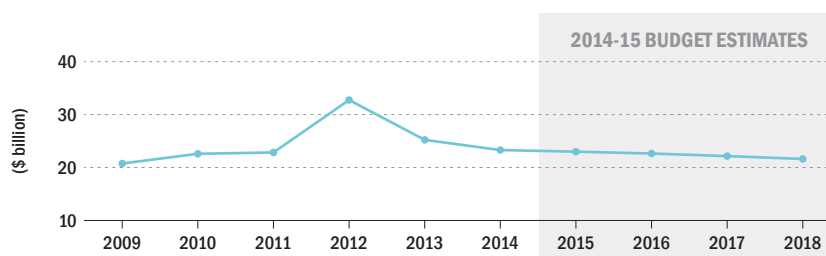
4.3.2

The unfunded superannuation liability

Defined benefit superannuation schemes are those that guarantee fixed payments to the beneficiaries. This is different to the (now) more common defined contribution schemes, where beneficiaries receive amounts defined by the past performance of the superannuation funds.

Although these schemes are mostly closed (with a small exception for emergency services workers), there remain a large number of beneficiaries who will be paid benefits into the future. Currently, the assets held by the schemes are less than the amounts expected to be paid into the future. The unfunded superannuation liability is the excess of the obligations to beneficiaries over the assets held.

Figure 4.4 shows the unfunded liability anticipated for the general government sector over the next four years.

Figure 4.4**Unfunded superannuation liability, public sector as a whole^(a), as at 30 June, 2009 to 2018**

(a) Most of the unfunded superannuation liability comes from the general government sector.

Source: Department of Treasury and Finance, Annual Financial Reports, 2009-10 to 2012-13; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.69

The Committee notes that the unfunded superannuation liability is anticipated to decrease over the forward estimates period. The primary drivers of this decrease include:

- » the number and age of surviving beneficiaries;
- » the growth of assets held by the defined benefit funds; and
- » bond rates and other determinants of the estimated returns for the fund.

Because the defined benefits schemes are mostly closed, the number of surviving beneficiaries is expected to decrease into the future. In addition, the remaining years of life for beneficiaries will decrease each year.

The unfunded liability is also reduced by an increase in the value of the fund established to offset the liability. During 2014-15, the Government expects the size of the fund to increase by \$472.7 million to \$18.9 billion. Over the forward estimates period, these assets are anticipated to grow to \$20.1 billion.²¹²

The Assistant Treasurer advised the Committee that *'we are on track to meet our 2035 target of full funding'*.²¹³

²¹² Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.26

²¹³ Hon. G. Rich-Phillips MLC, Assistant Treasurer, 2014-15 budget estimates hearings, record of transcript, 23 May 2014, p.9

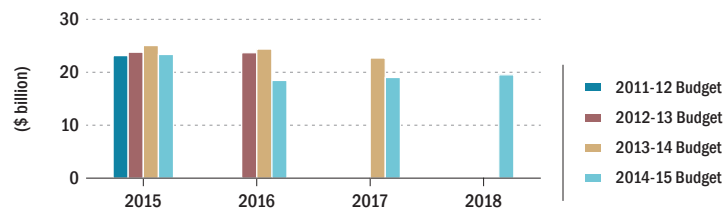
The superannuation fund is assessed and re-valued every three years. The next assessment will be as at 30 June 2015,²¹⁴ and is likely to be tabled in the Parliament in March 2016.

FINDING: The Government anticipates that the unfunded superannuation liability will decrease gradually over the forward estimates period.

4.4 Comparison to previous estimates

Figure 4.5 shows estimates for general government sector net debt over the past four budgets. Details for both net debt and borrowings are given in Appendix A4.3.²¹⁵

Figure 4.5 General government net debt, comparison with previous forward estimates, as at 30 June, 2015 to 2018



Sources: Budget Paper No.5, 2011-12 Statement of Finances, May 2011, p.10; Budget Paper No.5, 2012-13 Statement of Finances, May 2012, p.7; Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.7; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.7

Figure 4.5 shows that levels of borrowings and net debt anticipated in the 2014-15 budget papers are lower for all years that appeared in earlier budgets.

When commenting on lower estimates of borrowings and net debt in comparison to the 2013-14 Budget, the Department of Treasury and Finance advised the Committee that:²¹⁶

The decline over the forward estimates is driven by the impact of growing operating surpluses and the timing of proceeds from entering into a medium term lease over the operation of the Port of Melbourne, partly offset by spending on a record program of infrastructure projects over the forward estimates period.

For a number of years, budgets have predicted that net debt would peak in June 2015 before declining (see Appendix A4.3.1). The Committee notes that, while the Government still anticipates the peak in June 2015, it also expects that both net debt and borrowings will begin to increase again after June 2016.²¹⁷ This is different to the earlier patterns that saw a decline each year after the peak. This is primarily a result of infrastructure projects announced in the 2014-15 Budget (see Section 6.5).

214 PricewaterhouseCoopers, Emergency Services Superannuation Scheme – Triennial Valuation of Liabilities of the ESSS Defined Benefit Fund and the State Superannuation Fund as at 30 June 2012, December 2012, p.6

215 The profile for borrowings is very similar to that for net debt, so no graph is included here.

216 Department of Treasury and Finance, response to the Committee’s 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.34

217 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.7

FINDING: The 2014-15 budget papers anticipate lower levels of net debt than previously estimated. A decline in debt over 2015-16 is expected at a faster-than-previously-predicted rate. However, after June 2016, the budget papers now anticipate borrowings and net debt to rise, in contrast to earlier budgets, reflecting expected increases in asset investment.

4.5

Risks

An important part of evaluating the forward estimates is an assessment of the risks involved. A summary of the Government's assessment of the sensitivity of net debt to various scenarios is set out in the budget papers.²¹⁸

The Committee emphasises that it does not have a view on whether these risks have been accurately assessed and estimated by the Department of Treasury and Finance.

Expectations of changes in borrowings are generally determined by the funding equation referred to in Section 2.6.2 and Appendix A4.2. This equation states that the difference between cash from operations and amounts spent on asset investment is to be balanced by asset divestment (including leases) and new borrowings.²¹⁹

Risks from a number of sources can impact on the amount of cash available from operations. For example, revenues may be lower than expected due to variances in grants received, other revenues (such as stamp duty) may be lower than expected due to economic conditions, and expenses may be higher than expected due to unanticipated demand for services. Alternatively, asset sales may not bring in the amounts anticipated, or in the time expected.

The equation referred to above suggests a number of options the Government can use to manage variances in cash from operations. It can:

- » increase cash from operations through revenue or efficiency measures;
- » increase the amount of assets sold or leased out;
- » alter the scope or construction schedule of asset investment projects; or
- » increase the amount of borrowings raised.

As mentioned earlier, the budget papers contain a sensitivity analysis that identifies the effects of a number of variables (such as employment, consumer prices and interest rates) on the operating result and net debt.²²⁰ This identifies probable variances in cash from operations, as the operating result forms a significant and variable part of cash from operations. It does not identify or discuss actions that the Government can take in response to these variances.

FINDING: A summary of the Government's assessment of the sensitivity of net debt to various scenarios is set out in the budget papers. The analysis identifies the effects of a change in a number of variables.

218 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, Appendix A

219 Where the asset is procured through a PPP arrangement, the effect on borrowings is similar. The only difference is that increased borrowings are recognised on commissioning of the asset rather than at the time the cash is spent on construction.

220 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, Appendix A

5.1

Introduction

Output expenditure primarily relates to the funding of services delivered by the Government. Depreciation, which is used to partially fund asset investment, is also included within output expenditure (see Figure 2.1).

Table 5.1 shows that the total output expenditure in 2014-15 for the general government sector is estimated to rise by 2.8 per cent (compared to the revised estimate for 2013-14) and by an average of 2.6 per cent per annum between 2014-15 and 2017-18.

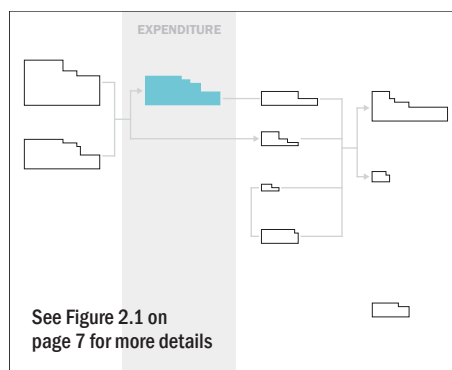


Table 5.1

Output expenditure and output expenditure growth rate, 2013-14 to 2017-18

	2013-14 revised estimate	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
Total expenses (\$ million)	50,158.8	51,575.1	51,950.0	53,580.8	55,664.9
Total expenses annual growth rate (per cent)		2.8	0.7	3.1	3.9
Average annual growth rate (2014-15 to 2017-18) ^(a)					2.6

(a) Compound annual growth rate.

Source: Committee calculations based on Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.52

While the Government’s revenue is strongly affected by activity in the broader economy, output expenditure is influenced by the Government’s discretionary decisions.

In analysing the Government’s expected output expenditure in 2014-15 and over the forward estimates period, this chapter discusses the following:

- » What are the main components of output expenditure? (Section 5.2)
- » What is the Government’s strategy for output expenditure? (Section 5.3)
- » What is the trend for output expenditure over the next four years? How does this compare with previous budgets? (Section 5.4)
- » What are the Government’s main areas of expenditure? How do these differ from previous years? (Section 5.5)
- » How much base funding is provided to departments in the 2014-15 Budget and how much funding for new output initiatives was announced? (Sections 5.6-5.7)
- » How is the Government funding these initiatives? (Section 5.8)

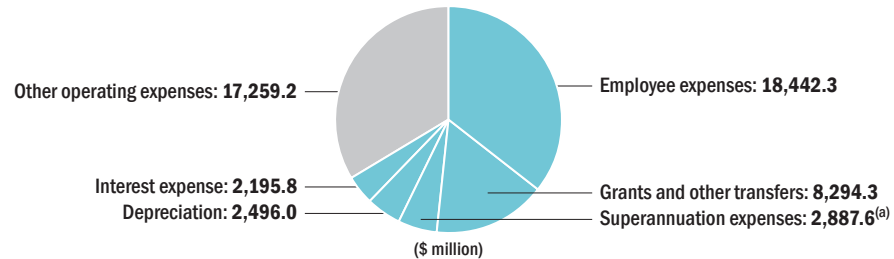
5.2

Components of output expenditure

Figure 5.1 shows the major components of output expenditure for the general government sector in 2014-15. Appendix A5.1 provides these figures across the forward estimates period.

Figure 5.1

Major components of output expenditure, 2014-15



(a) Made up of 'net superannuation interest expense' and 'other superannuation'.
 Source: Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.5

The largest components of output expenditure are:

- » employee expenses;
- » 'other operating expenses'; and
- » grants and other transfers.

5.2.1

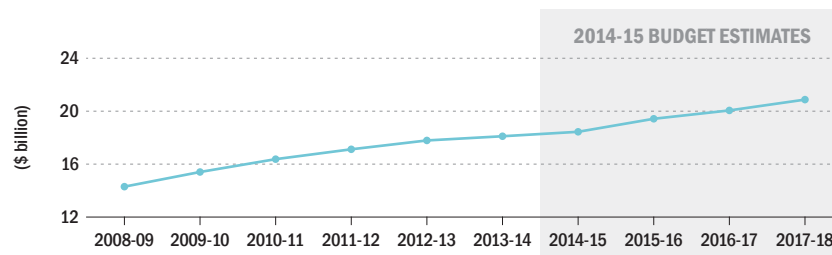
Employee expenses

The largest component of output expenditure for the general government sector is employee expenses, accounting for 35.8 per cent (\$18.4 billion) of the total output expenditure in 2014-15.²²¹ Employee expenses include wages and salaries, redundancies, fringe benefits, leave entitlements and some costs associated with superannuation.²²²

Figure 5.2 shows employee expenses for the general government sector.

Figure 5.2

Employee expenses, 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

The Government projects employee expenses to grow by an average of 4.2 per cent over the forward estimates period. This growth is consistent with the average growth estimated between 2008-09 and 2013-14 of 4.8 per cent. Year on year

221 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.5

222 Department of Treasury and Finance, 2012-13 Financial Report, October 2013, p.189

growth rates over the forward estimates period vary for each year, as seen in Table 5.2.

Table 5.2

Employee expenses, 2013-14 to 2017-18

	2013-14 revised estimate	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
Employee expenses (\$ million)	18,106.5	18,442.3	19,425.5	20,057.5	20,874.5
Total employee expenses annual growth rate (per cent)		1.9	5.3	3.3	4.1
Average annual growth rate (2014-15 to 2017-18) ^(a)					4.2

(a) Compound annual growth rate.

Source: Committee calculations based on Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.52

As part of the risk assessment included in the budget papers, the Government considers that the major enterprise bargaining agreements are one of the main risks likely to impact the Government's expenditure over the forward estimates period.²²³ According to the budget papers, major enterprise bargaining agreements will become a risk '*if the related costs above the guideline rate [2.5 per cent per annum²²⁴] are not offset by genuine productivity gains*'.²²⁵

There are a number of major enterprise bargaining agreements that are due to be negotiated within the forward estimates period, such as:

- » the *Victorian Public Service Workplace Determination 2013*, which expires on 31 December 2015;²²⁶
- » the *Victorian Government Schools Agreement 2013*, which expires on 31 October 2016;²²⁷ and
- » the *Nurses and Midwives (Victorian Public Health Sector) (Single Interest Employers) Enterprise Agreement 2012-2016*, which expires on 31 March 2016.²²⁸

Budget Paper No.2 Appendix A includes an estimate of potential increases in expenditure over the forward estimates period with a 1 per cent increase in all government enterprise agreements.²²⁹

According to the Government, employee expenses growth is primarily a result of '*increased service demand, restrained wage increases due to the Government's wages policy and efficiency gains in non-service delivery functions*'.²³⁰

The Committee notes that the growth rates for employee expenses vary over the forward estimates period, from 1.9 per cent between 2013-14 and 2014-15 to 5.3 per cent the next year. The Committee considers that it would be valuable to

223 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.68

224 Department of Treasury and Finance, *Public Sector Workplace Relations Policies*, December 2012, p.7

225 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.68

226 *Victorian Public Service Workplace Determination 2012*, Clause 4.1

227 *Victorian Government Schools Agreement 2013*, Clause 5

228 *Nurses and Midwives (Victorian Public Health Sector) (Single Interest Employers) Enterprise Agreement 2012-2016*, Clause 7.2

229 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, pp.84-5

230 *ibid.*, p.55

understand the causes of the varying growth rates. The Government’s explanation does not enable a reader to do that.

FINDING: Employee expenses for the general government sector are expected to be \$18.4 billion in 2014-15, accounting for 35.8 per cent of the total output expenditure. These expenses are estimated to increase each year over the forward estimates period, at a growth rate varying from 1.9 to 5.3 per cent.

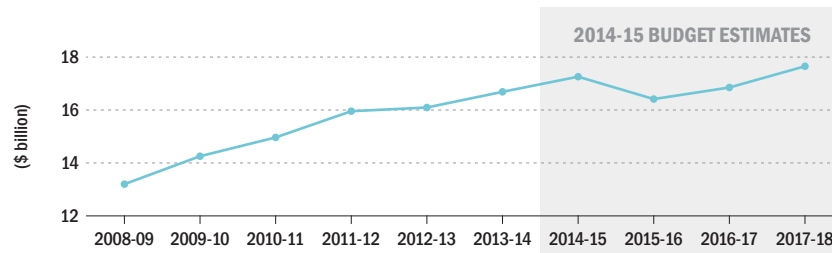
Other operating expenses

‘Other operating expenses’ are the second largest component of the general government sector’s expenses, accounting for 33.5 per cent (\$17.3 billion) of the total output expenditure in 2014-15.²³¹ These expenses are mainly comprised of the cost of supplies and services.²³²

Figure 5.3 shows ‘other operating expenses’ from 2008-09 to 2017-18.

Figure 5.3

‘Other operating expenses’, 2008-09 to 2017-18



Source: Department of Treasury and Finance, ‘Consolidated Comprehensive Operating Statement’ data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

‘Other operating expenses’ are expected to drop by \$845.2 million (4.9 per cent) between 2014-15 and 2015-16 (mainly driven by a decrease in the purchase of services²³³) and grow at an average of 3.7 per cent per annum from 2015-16 to 2017-18, reaching \$17.7 billion.²³⁴ This is substantially less than the 4.8 per cent average growth rate between 2008-09 and 2013-14.

Based on information received from the departments, variances between 2013-14 and 2014-15 in other operating expenses are exclusively attributed to Government initiatives. Examples of this include:

- » an increase of \$108.7 million in ‘operating supplies and consumables’ by the Department of Health due to ‘*the impact of State Government initiatives announced in the 2014-15 Budget, continuing implementation of initiatives announced in previous budgets and anticipated cost increases in 2014-15*’;²³⁵ and

231 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.5
 232 Department of Treasury and Finance, *2012-13 Financial Report*, October 2013, p.40
 233 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.28
 234 *ibid.*, p.5
 235 Department of Health, response to the Committee’s 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.8

- » a decrease of \$78.1 million in the cost of goods sold by the Department of State Development, Business and Innovation, which '*reflects a lower number of lots being sold for Kew Residential Services Redevelopment...*'²³⁶

FINDING: 'Other operating expenses' are the second largest component of the Government's output expenditure in 2014-15, accounting for 33.5 per cent of the total (\$17.3 billion). These expenses are expected to decrease by \$845.2 million (4.9 per cent) between 2014-15 and 2015-16 and then increase by an average of 3.7 per cent per annum for the remaining years of the forward estimates period.

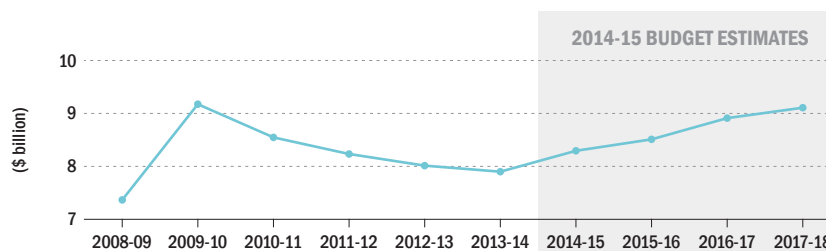
Grants and other transfers

This item consists of grants provided to entities outside the general government sector, including the public non-financial corporations (PNFC) sector and the private sector. It includes grants from the Commonwealth which are passed on to non-government schools and local government.²³⁷

The Government estimates that these expenses will rise consistently over the next four years, by an average of 3.2 per cent per annum, reaching \$9.1 billion in 2017-18 (see Figure 5.4). The Committee notes that the budget papers describe this item's expected trend over the forward estimates period, but do not provide any explanations for this trend.²³⁸

Figure 5.4

'Grants and other transfers', 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

Only one department was required to provide details of large variances of grants and other transfers between 2013-14 and 2014-15 in response to the Committee's questionnaire:

- » the Department of Justice estimates an increase of \$106.4 million due to the following:²³⁹
 - » *rephasing from 2013-14 to 2014-15 to align with the timing of racing grants and an additional gambling prevention program;*

²³⁶ Department of State Development, Business and Innovation, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 7 May 2014, p.9

²³⁷ Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.56

²³⁸ *ibid.*

²³⁹ Department of Justice, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.10

- › increase in the estimated payments to the Victorian Civil and Administrative Tribunal for Residential Tenancies List, Domestic Building List and Owners Corporations List from Consumer Affairs Victoria managed trust funds. These payments were previously part of a transfer to the Courts Division within the department;
- › additional grant payments are to be paid from the Victorian Property Fund to support affordable housing; and
- › increased grants to Country Fire Authority for fleet purposes.

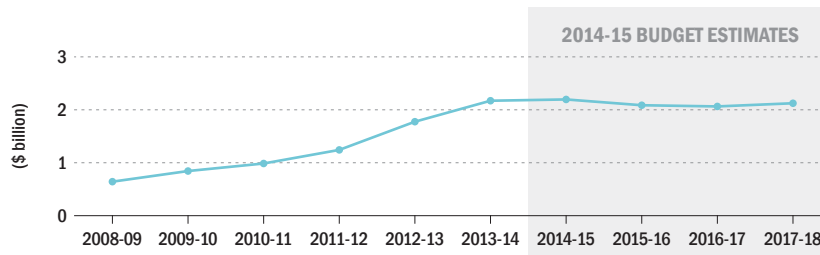
Variations reported by other departments were smaller and departments were not required to provide explanations in response to the questionnaire.

Interest expense

Figure 5.5 shows the Government’s estimate for interest expense for the general government sector from 2008-09 to 2017-18.

Figure 5.5

Interest expense, 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

Interest expense is related to the gross amount of borrowings (including cash borrowings and PPPs). After an estimated annual average growth of 22.7 per cent between 2008-09 and 2014-15, the Government expects interest expense to remain relatively steady at around \$2.1 billion for the next three years.²⁴⁰ Section 4.2.1 of this report further discusses the drivers of interest expenses, specifically cash borrowings and finance leases.

The Government’s strategy

As discussed in Section 2.4.2, the Government has defined four financial measures as part of its medium-term fiscal strategy. Three of them are related to Government expenditure:²⁴¹

- › infrastructure investment of 1.3 per cent of GSP (calculated as a rolling five-year average);
- › general government net debt reduced as a percentage of GSP [Gross State Product] over the decade to 2022; and

²⁴⁰ Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.5

²⁴¹ Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.9

- » a net operating surplus of at least \$100 million and consistent with the infrastructure and debt parameters.

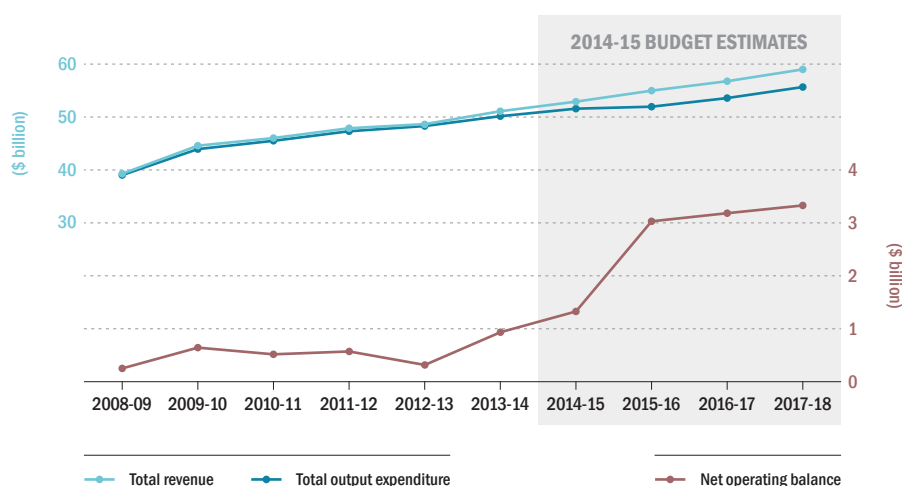
In each case, the target requires output expenditure to be significantly below revenue, creating an operating surplus. The budget papers state that:²⁴²

The medium-term fiscal strategy explicitly recognises that operating and cash surpluses are essential to funding new infrastructure without resorting to unsustainable net debt. Running down these surpluses can only come at the expense of new infrastructure or relying on debt which will put Victoria's triple-A credit rating at risk.

In relation to the Government's current approach to expenditure, the budget papers state that 'in order to ensure the triple-A credit rating is supported, and in the face of previous revenue shocks, the Government has acted decisively to constrain expenses growth'.²⁴³

The general government sector's total revenue, output expenditure and net operating balance (surplus) can be seen in Figure 5.6.

Figure 5.6 Total revenue, total output expenditure and net operating balance, 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

The Government expects to be able to constrain the general government sector's expenditure growth to a lower rate than revenue growth, particularly from 2014-15, increasing the operating surplus in the next four years.

The Government's revenue strategy is discussed in Section 3.2 of this report.

FINDING: The Government's expenditure strategy is to constrain the expenditure growth rate over the forward estimates period to a lower rate than revenue growth. The Government intends to do this in order to achieve larger operating surpluses over the forward estimates period to fund infrastructure without borrowings.

242 *ibid.*, p.51

243 *ibid.*, p.9

5.4

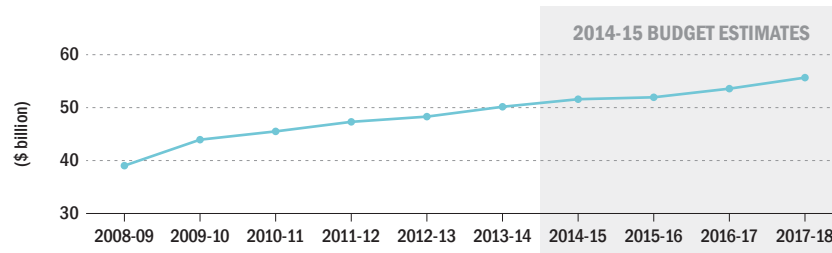
Output expenditure over the forward estimates period

The total output expenditure for the general government sector is forecast to be \$51.6 billion in 2014-15. This is an increase of 2.8 per cent compared to the revised figure for 2013-14 of \$50.2 billion.²⁴⁴

Figure 5.7 compares the total output expenditure estimated for the next four years with expenditure since 2008-09.

Figure 5.7

Total expenditure, 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

As discussed in Section 5.1, annual output expenditure is expected to increase by an average of 2.6 per cent over the forward estimates period, from \$51.6 billion in 2014-15 to \$55.7 billion in 2017-18. This estimate is lower than the average annual growth rate of 4.8 per cent between 2008-09 and 2014-15. This is consistent with the Government's strategy to constrain expenditure (see Section 5.3 of this report).

FINDING: The Government's expenditure estimate for 2014-15 is \$51.6 billion. The Government expects an average annual growth rate of 2.6 per cent over the next four years.

5.4.1

Expenditure in comparison to previous estimates

The Government updates its planned expenditure with the annual release of the budget papers. Figure 5.8 below compares the Government's expenditure estimates since the 2011-12 Budget.

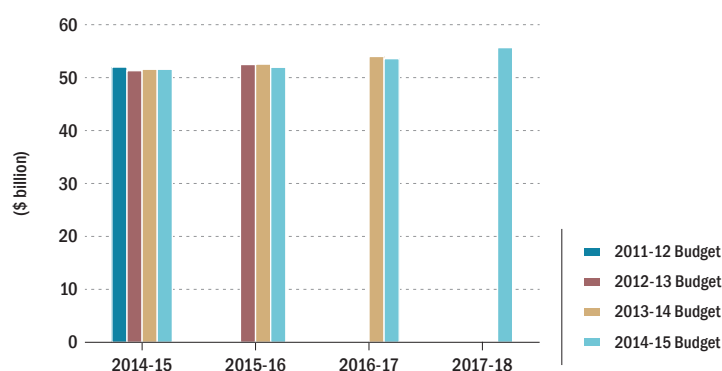
The Committee notes that the estimates for expenditure over the forward estimates period have generally been revised downwards in the 2014-15 Budget compared to the previous three budgets. The latest revisions, compared to the 2013-14 Budget, reduced expenditure by \$0.9 million in 2014-15, \$596.6 million in 2015-16 and \$415.2 million in 2016-17.²⁴⁵

²⁴⁴ *ibid.*, p.52

²⁴⁵ Budget Paper No.5, *2013-14 Statement of Finances*, May 2013, p.5; Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.5

Figure 5.8

Total expenditure, comparison with previous forward estimates, 2014-15 to 2017-18



Source: Budget Paper No.5, 2011-12 Statement of Finances, May 2011, p.9; Budget Paper No.5, 2012-13 Statement of Finances, May 2012, p.5; Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.5; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.5

FINDING: The Government has revised its expenditure estimates downwards in the 2014-15 Budget. Compared to the 2013-14 Budget, the Government expects to spend \$0.9 million less in 2014-15, \$596.6 million less in 2015-16 and \$415.2 million less in 2016-17.

Table 5.3 shows the main factors influencing the Government's expenditure revisions since the 2013-14 Budget.

Table 5.3

Drivers of variations in expenditure estimates made in the 2013-14 and 2014-15 budgets for 2014-15 to 2016-17

	2014-15 (\$ million)	2015-16 (\$ million)	2016-17 (\$ million)
Estimated expenditure in the 2013-14 Budget	51,576.0	52,546.6	53,996.0
ADD:			
• New initiatives	1,458.3	1,546.3	1,524.0
• Commonwealth variations and changes in own-source revenue	123.2	-494.8	-267.8
• Other policy decision variations	2.3	0.2	0.4
LESS:			
• Savings	30.0	44.0	44.0
• Reprioritisation and adjustments	80.5	-59.5	-105.7
• Release of contingencies	421.4	500.7	282.4
• Other administrative variations	1,052.7	1,163.1	1,451.0
Net impact	-0.8	-596.6	-415.1
Estimated expenditure in the 2014-15 Budget	51,575.1	51,950.0	53,580.8

Sources: Committee calculations based on Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.5; Department of Treasury and Finance, 2013-14 Budget Update, December 2013, p.21; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.5; and Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, pp.57, 61

The Committee notes that expenditure estimates between 2014-15 and 2016-17 have been reduced primarily by the expected release of contingencies and other administrative variations.

The Government's measures to fund new initiatives over the forward estimates period are discussed in Section 5.8 of this report.

FINDING: The Government's 2014-15 Budget forecasts less expenditure between 2014-15 and 2016-17 compared to the 2013-14 Budget. This has been primarily driven by the release of contingencies and other administrative variations.

5.5 Goods and services provided

The budget papers classify the general government sector's expenses in two ways: through the output framework and the 'government purpose classification'.

5.5.1 Output expenditure and service delivery performance

The Government's output framework is a tool to demonstrate what is expected to be delivered each year and the efficiency and effectiveness with which it is delivered.

Budget Paper No.3 (*2014-15 Service Delivery*) includes the details of each department's outputs (that is, the goods and services to be delivered), including performance measures for:²⁴⁶

- » the *quantity* of goods and services expected to be delivered during the year;
- » the *quality* of goods and services expected to be delivered during the year;
- » the *timeliness* of output delivery; and
- » the *cost* for each output.

Budget Paper No.3 Appendix A includes the output performance measures that departments have proposed discontinuing for 2014-15 or which have substantially changed from last year's budget papers.²⁴⁷

The Committee has undertaken a comprehensive assessment of this system in its *Review of the Performance Measurement and Reporting System*.²⁴⁸ In that report, the Committee made a number of recommendations to strengthen the system. These issues are being considered by the Government and its response is expected by September 2014. Additionally, the Committee has undertaken a review of both the discontinued and newly introduced performance measures in Chapter 3 of its *Report on the 2014-15 Budget Estimates – Part One*.²⁴⁹

Budget Paper No.3 breaks down output expenditure for the general government sector into 117 outputs expected to be delivered in 2014-15 (up from 116 in 2013-14²⁵⁰).

Although the net impact of changes to the output structure with the 2014-15 Budget is one additional output in 2014-15, there were a number of modifications to the output structure, including four outputs which no longer appear in the 2014-15 budget papers and five new outputs for 2014-15. Two outputs administered by the Department of Environment and Primary Industries

246 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, Chapter 2

247 *ibid.*, p.313

248 Public Accounts and Estimates Committee, *Review of the Performance Measurement and Reporting System*, March 2014

249 Public Accounts and Estimates Committee, *Report on the 2014-15 Budget Estimates – Part One*, June 2014, Chapter 3

250 Budget Paper No.3, *2013-14 Service Delivery*, May 2013, p.70

(‘Forest and Parks’ and ‘Public Land’) were consolidated into one new output (‘Management of Forests, Parks and Public Land’). In addition, one output (‘Development of Primary Industries’) was split in three different outputs (‘Agriculture’, ‘Biosecurity’ and ‘Sustainably Manage Fish and Forest Resources’).²⁵¹ Further, the Department of Premier and Cabinet discontinued one output (‘State Services Authority’) and replaced it with one output (‘Public Administration Advice and Support’).²⁵²

In addition, the creation of the Courts as an independent statutory body has seen one output moved to the new entity which was formerly part of the Department of Justice.²⁵³

The 2014-15 budget papers include a total of 1,173 performance measures. This is a reduction of 14 performance measures compared to 2013-14 (1,187). Table 5.4 shows performance measure trends by department from 2011-12 to 2014-15.

Table 5.4 Performance measures, 2011-12 to 2014-15

Department	2011-12 ^(a)	2012-13 ^(a)	2013-14 ^(a)	2014-15	Change, 2013-14 to 2014-15
	(number)	(number)	(number)	(number)	(per cent)
Business and Innovation	73	48	-	-	n/a
Education and Early Childhood Development	100	85	85	86	1.2
Environment and Primary Industries	-	-	113	111	-1.8
Health	185	182	181	188	3.9
Human Services	102	97	93	94	1.1
Justice	112	152	155	132	-14.8
Planning and Community Development	88	83	-	-	n/a
Premier and Cabinet	108	110	121	115	-5.0
Primary Industries	64	65	-	-	n/a
State Development, Business and Innovation	-	-	89	68	-23.4
Sustainability and Environment	85	86	-	-	n/a
Transport	187	172	-	-	n/a
Transport, Planning and Local Infrastructure	-	-	209	212	1.4
Treasury and Finance	94	93	99	101	2.0
Parliament	44	42	42	42	0.0
Courts	-	-	-	24	n/a
TOTAL	1,242	1,215	1,187	1,173	-1.2

(a) Includes measures reinstated in budget updates for the year.

Sources: Budget Paper No.3, 2011-12 Service and Delivery, May 2011, Chapter 3; Budget Paper No.3, 2012-13 Service and Delivery, May 2012, Chapter 2; Budget Paper No.3, 2013-14 Service and Delivery, May 2013, Chapter 2; Budget Paper No.3, 2014-15 Service and Delivery, May 2014, Chapter 2

251 Budget Paper No.4, 2014-15 Service Delivery, May 2014, p.108

252 *ibid.*, p.207

253 *ibid.*, p.182

The Committee notes that there has been a general trend of consolidating the total number of performance measures. The largest variance between 2013-14 and 2014-15 is found in the Department of State Development and Business Innovation, with a total reduction of 21 performance measures (23.4 per cent).

The Committee notes that a reduction in the total number of performance measures does not necessarily imply a decrease in the quantity of goods and services delivered. For example, changes may reflect alterations to programs, the way in which outputs are delivered each year, or improvements to performance measures.

Table 5.5 shows the reconciliation of performance measures between 2013-14 and 2014-15.

Table 5.5

Reconciliation of performance measures, 2013-14 and 2014-15

	Performance measures (number)
Performance measures in 2013-14	1,187
LESS:	
• Cost measures discontinued	4
• Non-cost measures proposed for discontinuation ^(a)	86
• Non-cost measures further disaggregated	2
Sub-total	92
ADD:	
• New cost measures	5
• Non-cost measures	69
• Measures created by disaggregation	4
Sub-total	78
Performance measures in 2014-15	1,173

(a) Included in Budget Paper No.3, Appendix A

Source: Committee calculations based on Budget Paper No.3, 2014-15 Service Delivery, May 2014, Chapter 2; Department of Treasury and Finance, 2013-14 Victorian Budget Update, Appendix B; Budget Paper No.3, 2013-14 Service Delivery, May 2013, Chapter 2

Overall, 78 new measures were created in the 2014-15 budget papers, while 92 performance measures from 2013-14 no longer appear in the 2014-15 Budget, including 86 measures proposed to be discontinued in the budget papers.

FINDING: The total number of performance measures has decreased by 14, from 1,187 in 2013-14 to 1,173 in 2014-15. The factors contributing to this variance include a reduction of 21 performance measures by the Department of State Development, Business and Innovation.

5.5.2

Government purpose classification

In addition to breaking down the Government’s expenditure by components (see Section 5.2) and by output (see Section 5.5.1), the budget papers break down the general government sector’s expenditure according to the ‘government purpose classification’. This category classifies expenditure in terms of government functions and was developed by the Australian Bureau of Statistics to *‘facilitate the study of the*

*broad function of public sector spending and the effectiveness of this spending in meeting government policy objectives’.*²⁵⁴

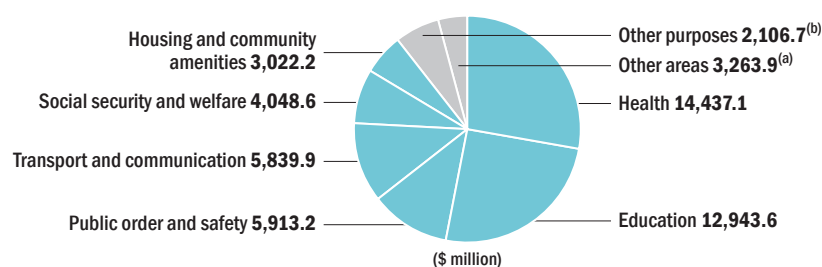
In relation to the expense estimates by government purpose classification, the budget papers indicate that there was a change in the methodology used between the 2013-14 budget papers and the 2014-15 budget papers:²⁵⁵

In 2013-14, the methodology used to allocate expenses across classification categories has been refined to better reflect departmental data allocations. The figures in [the budget estimates] reflect this.

Figure 5.9 shows the Government’s estimates for total expenditure in 2014-15 according to the government purpose classification.

Figure 5.9

Total expenditure by major purpose classification, general government sector, 2014-15



(a) ‘Other areas’ combines: ‘recreation and culture’; ‘fuel and energy’; ‘agriculture, forestry, fishing and hunting’; ‘general public services’; ‘mining, manufacturing and construction’; and ‘other economic affairs’.

(b) ‘Other purposes’ includes provisions to be allocated in the future.

Source: Department of Treasury and Finance, ‘Consolidated Government Purpose Classification Data 2014-15’ data set, <www.dtf.vic.gov.au/files/965eeea4-f1bf-4d1a-91f1-a32300b1b92e/Consolidated-GG-Expenses-by-GPC-Budget-2014-15.xls>, accessed 18 June 2014

The budget papers include estimates for government purpose classification across the forward estimates period. However, a certain portion of future expenditure has not yet been allocated by purpose. This portion (along with other expenses) is included in the line item ‘other purposes’, which increases from \$2.1 billion in 2014-15 to \$5.6 billion in 2017-18.²⁵⁶

As a result of this, the Committee considers that the trends over the forward estimates period for government purpose classification will not fully reflect the likely outcome until a purpose is assigned to unallocated funds.

FINDING: When broken down by government purpose classification, health and education are the largest areas of expenditure, accounting for 53.1 per cent of total output expenditure.

254 Australian Bureau of Statistics, *Explanatory Notes, Government Finance Statistics, 2010-11*, Catalogue Number 5512.0 <www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5512.0Explanatory%20Notes12010-11?OpenDocument>, accessed 29 January 2014.

255 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.30

256 *ibid.*

5.6

Base funding

The Committee has previously analysed departmental expenditure in two main categories:²⁵⁷

- » ‘base funding’, which funds the ongoing activities undertaken by departments to deliver goods and services; and
- » ‘initiative funding’, which funds specific programs or projects over a limited period.

‘Initiative funding’ is further discussed in Section 5.7 of this report.

Budget Paper No.5 (2014-15 Statement of Finances) provides financial statements for the budget and earlier years for each department.²⁵⁸ Information included for each department, however, does not explicitly distinguish the classifications mentioned above.

As it has done for previous inquiries, the Committee sought specific base funding figures from departments through its Budget Estimates Questionnaire. The purpose of this exercise was to understand the operations described in the Department of Treasury and Finance guidance, ‘BFMG – 06 Departmental Funding Model – Output Pricing’, which describes how output prices are set.²⁵⁹

The guidance states that prices are set from one year to another in the following way:²⁶⁰

The base output prices, across the forward estimates, are indexed to reflect general price movements in the economy, except for a limited number of exclusions...

Uniform indexation is not applied to all departmental estimates since some components of output delivery are subject to different price indexation as a result of:

- » *explicit Government decisions (e.g. non-wage health specifics such as drugs and prosthetics);*
- » *special arrangement such as Commonwealth/State matching arrangements (e.g. Young People in Nursing Homes); or*
- » *existing contracts to deliver outputs negotiated through a tender process (e.g. public transport contracts).*

The Committee notes that the majority of departments did not provide base funding details for 2013-14 and 2014-15. Seven departments informed the Committee that:²⁶¹

257 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, p.107

258 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, Chapter 3

259 Department of Treasury and Finance, *Budget and Financial Management Guidelines*, ‘BFMG 06 – Departmental Funding Model – Output Pricing’, October 2007

260 *ibid.*, p.134

261 Departmental responses to the Committee’s 2014-15 Budget Estimates Questionnaire from the Departments of: Environment and Primary Industries; Human Services; Premier and Cabinet; Transport; Planning and Local Infrastructure; Health; Treasury and Finance; and Justice.

The original base year for 2013-14 was created four years ago as part of the creation of the (then) new financial year, and since that time it has been varied in accordance with output decisions made by Government as part of ongoing budgetary processes.

The underlying indexation rate applied was 2.5%, in line with consumer price index published in Budget Paper No. 2 Strategy and Outlook. However uniform indexation is not applied equally to all department estimates since some components of output delivery are subject to different price indexation.

The Department of State Development, Business and Innovation indicated that base funding for 2013-14 was \$266.0 million and is \$268.4 million for 2014-15 (an increase of 0.9 per cent). However, it informed the Committee that:²⁶²

An overall escalation factor cannot be determined accurately due to the allocation and application of various savings and efficiency measures, as well as differences in escalation levels received and provided for to various areas that have moved in and out of the Department over recent years as part of machinery-of-government changes.

The Parliamentary Departments indicated that departmental base funding is \$80.8 million for 2013-14 and \$84.0 million for 2014-15, with an escalation factor of 2.5 per cent.²⁶³ The Department specified that:²⁶⁴

[Figures] are base funding figures that get escalated each year. They do not include Special Appropriations, Grant, s29 revenue and fixed price funding for CAC [capital asset charge] & depreciation.

The 2014-15 base funding figure includes \$986K additional funding approved as per 2014-15 BEREC [Budget and Expenditure Review Committee] submission.

The Department of Education and Early Childhood Development reported a departmental base funding figure of \$9.4 billion for 2013-14 and \$9.8 billion for 2014-15, a 3.8 per cent variance between 2013-14 and 2014-15.²⁶⁵

As noted above, Budget Paper No.5 (2014-15 Statement of Finances) contains each department's financial statements. However, the Committee notes that that the budget papers do not provide base funding estimates.

FINDING: Three departments provided the Committee with base funding estimates for 2013-14 and 2014-15, seven departments did not.

²⁶² Department of State Development, Business and Innovation, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 7 May 2014, p.18

²⁶³ Department of Parliamentary Services, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 1 May 2014, p.12

²⁶⁴ *ibid.*

²⁶⁵ Department of Education and Early Childhood Development, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 7 May 2014, p.15

5.7

New output initiatives

5.7.1

The trend in new initiatives

The 2014-15 Budget introduces new output initiatives with an estimated total cost of \$5.7 billion from 2014-15 to 2017-18. Of this, the Government plans to spend \$1.4 billion in 2014-15 (See Table 5.6).²⁶⁶ Appendix A5.2 breaks down the output initiatives by department.

Table 5.6

New output initiatives, 2014-15 to 2017-18 (\$ million)

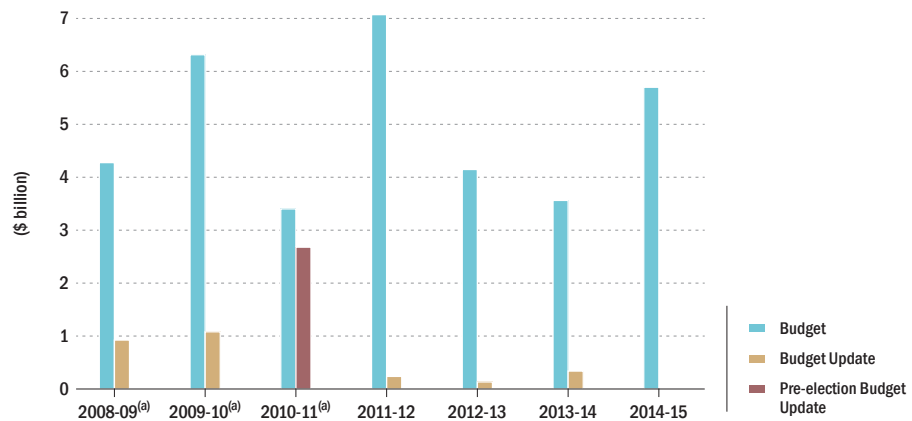
	2014-15	2015-16	2016-17	2017-18
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
New output initiatives	1,381.5	1,451.7	1,434.0	1,434.1

Source: Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.61

Figure 5.10 compares the total funding for new initiatives in the 2014-15 Budget to previous budgets.

Figure 5.10

Funding for new initiatives (up to five years), 2008-09 to 2014-15 budgets



(a) Funding released in prior years' budget updates has been removed from the totals given in Budget Paper No.3 for 2008-09 to 2010-11 to avoid double counting.

Sources: Budget Paper No.3, *Service Delivery*, 2008-09 to 2014-15; Department of Treasury and Finance, *Victorian Budget Update*, 2008-09 to 2013-14; Department of Treasury and Finance, *2010-11 Pre-Election Budget Update*, November 2010

The Committee notes that the amount of funding for new initiatives in the 2014-15 Budget was \$2.2 billion higher than the output initiatives announced in the 2013-14 Budget.²⁶⁷

FINDING: The 2014-15 Budget provides \$5.7 billion of funding for new output initiatives over the forward estimates period (\$2.2 billion higher than the 2013-14 Budget).

266 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, pp.60-1

267 Budget Paper No.3, *2013-14 Service Delivery*, May 2013, Chapter 1

Main initiatives (over \$100 million)

The 2014-15 Budget introduces three new output initiatives with expenditure in 2014-15 over \$100 million (see Table 5.7). No outputs over \$100 million were announced in the 2013-14 Budget Update.

Table 5.7

Initiatives with expenditure in 2014-15 over \$100 million in the 2014-15 Budget

Department	Initiative	2013-14	2014-15	2015-16	2016-17	2017-18	5- year Total
		(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Education and Early Childhood Development	Additional Vocational Education and Training Funding	139.6	171.2	164.0	163.8	160.4	799.0
	Student Enrolment Growth	113.0	142.1	143.6	145.2	146.9	690.8
Health	Responding to Patient Demand Growth	-	179.4	183.8	188.4	193.1	744.7

Source: Budget Paper No.3, 2014-15 Service Delivery, May 2014, pp.8, 19

The largest new output initiatives in the 2014-15 Budget are in the areas of education and health.

The initiative *Additional Vocational Education and Training Funding* is expected to have a total cost of \$799.0 million from 2013-14 to 2017-18. The budget papers indicate that:²⁶⁸

Given the growing demand for training in Victoria, the government will allocate additional funding in order to refocus and improve Victoria's training system. The Government's reforms will allow Victorians to access training and develop the skills they need to participate in the workforce. Over time, a more highly skilled workforce will increase business productivity, supporting higher levels of economic growth across the state.

Regarding the *Student Enrolment Growth* initiative, with a total cost of \$690.8 million over five years (2013-14 to 2017-18), the budget papers state that:²⁶⁹

Additional and ongoing funding is provided for government and non-government schools to meet forecast student enrolments up to the end of the 2014 school year.

This initiative is expected to provide \$142.1 million of additional funding to the Department's *School Education – Primary* and *School Education – Secondary* outputs in 2014-15.²⁷⁰ More funding is provided to both outputs than the estimated cost for 2013-14, reflecting this new initiative and other funding sources.²⁷¹

268 Budget Paper No.3, 2014-15 Service Delivery, May 2014, p.10

269 *ibid.*, p.12

270 *ibid.*

271 *ibid.*, pp.95, 99

The initiative *Responding to Patient Demand Growth* has a total cost of \$744.7 million over the forward estimates period. This initiative includes Commonwealth funding, as it contributes to activity under the National Health Reform Agreement.²⁷²

The Department of Health stated that:²⁷³

Funding is provided to enable Victorian health services to respond to growing patient demand for services, ensuring more patients will receive the services they need. The range of services funded under this initiative includes emergency department presentations and admissions, intensive care and maternity services. More chemotherapy, dialysis and radiation services will also be funded under this initiative. A pilot funding model for heart, lung and heart/lung transplants will be implemented with Alfred Health. This will provide greater flexibility in funding arrangements to accommodate variability in transplant activity levels.

The initiative relates to three different outputs. All three are expected to increase their cost in 2014-15 compared to the expected outcome in 2013-14.²⁷⁴

FINDING: The 2014-15 Budget introduced three output initiatives with expenditure in 2014-15 over \$100 million. These focus on catering for increased demand in the areas of education and health.

5.8 Funding the new output initiatives

As discussed in Section 5.3 of this report, the Government plans to constrain output expenditure growth over the forward estimates period. To achieve this, the costs of new output initiatives have been partially offset by:

- » efficiency and expenditure reduction measures;
- » reprioritisation and adjustments; and
- » the release of contingencies.

5.8.1 Efficiency and expenditure reduction measures

Efficiency and expenditure reduction measures refer to the ‘savings’ that the Government expects departments to achieve internally in order to reduce their expenditure. These can be achieved by ending or reducing the size of the programs delivered or by introducing efficiency measures.

The 2014-15 Budget contains only one efficiency and expenditure reduction measure, *Application of an Efficiency Dividend to Non-Frontline Departmental Expenditure*, with total savings of \$20.0 million each year over the forward

272 *ibid.*, p.20

273 *ibid.*, p.21

274 *ibid.*, pp.137-9

estimates period.²⁷⁵ In addition, the 2013-14 Budget Update introduced two efficiency measures (see Table 5.8).²⁷⁶

Table 5.8

Efficiency and expenditure reduction measures, 2013-14 Budget Update and 2014-15 Budget

		2013-14	2014-15	2015-16	2016-17	2017-18
		(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
2013-14 Budget Update	<i>Energy Technology Innovation Strategy – Return of Surplus Funds</i>	10.0	10.0	10.0	10.0	-
	<i>Regulatory Efficiency</i>	-	-	14.0	14.0	-
2014-15 Budget	<i>Application of an Efficiency Dividend to Non-Front line Departmental Expenditure</i>	-	20.0	20.0	20.0	20.0

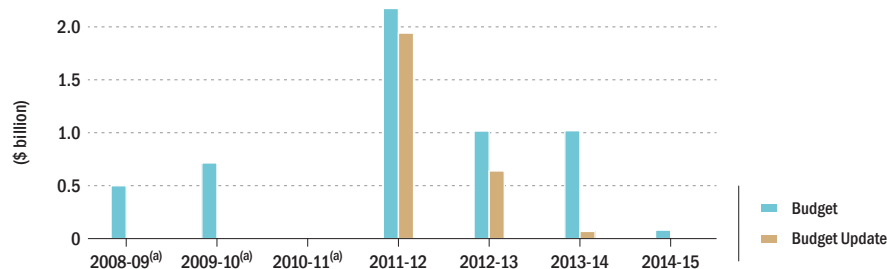
Sources: Budget Paper No.3, 2014-15 Service Delivery, May 2014, p.79; Department of Treasury and Finance, 2013-14 Budget Update, December 2013, p.129

In relation to the efficiency dividend, the budget papers explain that *‘the Government will apply an efficiency dividend to public sector departments for their policy and administrative functions to continue an incentive to drive efficiency improvements’*.²⁷⁷ This follows similar initiatives announced in the 2012-13 Budget Update²⁷⁸ and the 2013-14 Budget.²⁷⁹

Figure 5.11 shows the value of efficiency and expenditure reduction measures introduced since the 2008-09 Budget.

Figure 5.10

Efficiency and expenditure reduction measures (up to five years), 2008-09 to 2014-15 budgets



(a) Funding released in prior years' budget updates has been removed from the totals given in Budget Paper No.3 for 2008-09 to 2010-11 to avoid double counting.

Sources: Budget Paper No.3, Service Delivery, 2008-09 to 2014-15; Department of Treasury and Finance, Victorian Budget Update, 2008-09 to 2013-14; Department of Treasury and Finance, 2010-11 Pre-Election Budget Update, November 2010

275 *ibid.*, p.79

276 Department of Treasury and Finance, 2013-14 Victorian Budget Update, December 2013, p.129

277 Budget Paper No.3, 2014-15 Service Delivery, May 2014, p.79

278 Department of Treasury and Finance, 2012-13 Victorian Budget Update, December 2012, p.124

279 Budget Paper No.3, 2013-14 Service Delivery, May 2013, pp.62-3

The Committee notes that the efficiency and expenditure reduction initiatives announced in the 2013-14 Budget Update (\$68.0 million) and in the 2014-15 Budget (\$80.0 million) are considerably smaller than those introduced in previous budgets.

5.8.2 Funding from reprioritisation of existing resources

A new feature of the 2014-15 budget papers is the distinction between the reprioritisation of funds previously allocated to departments, 'funding from reprioritisation of existing resources', and the amount of money which reflects funding for 'policy decisions taken but not yet allocated', referred to as 'adjustments'.²⁸⁰ Previously these two items were added together and a net figure published in the budget papers. The Committee welcomes this change and considers it adds to the transparency of the budget papers.

The 2014-15 Budget announced a total of \$587.5 million that has been reprioritised over the four years from 2014-15 to 2017-18 (see Table 5.9).

Table 5.9 Funding from reprioritisation of existing resources, 2014-15 to 2017-18

	2014-15 (\$ million)	2015-16 (\$ million)	2016-17 (\$ million)	2017-18 (\$ million)	Total (\$ million)
Funding from reprioritisation of existing resources	140.9	155.0	147.5	144.1	587.5

Source: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.61

FINDING: The 2014-15 Budget announced one expenditure reduction measure, worth \$80.0 million between 2014-15 and 2017-18. The budget also reprioritised \$587.5 million of previously committed funding over the next four years. These will partially fund new output initiatives.

5.8.3 Adjustments

The 2014-15 budget papers contain total adjustments of \$834.3 million over the forward estimates period (see Table 5.10).

Table 5.10 Adjustments, 2014-15 to 2017-18

	2014-15 (\$ million)	2015-16 (\$ million)	2016-17 (\$ million)	2017-18 (\$ million)	Total (\$ million)
Adjustments	60.4	214.5	253.2	306.2	834.3

Source: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.61

This is expenditure that has been committed to in addition to the amounts detailed for new initiatives in Budget Paper No.3 (see Table 5.6). As this is a new item, the Committee is not able to compare these figures to previous years.

280 Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.61

5.8.4

Output contingencies

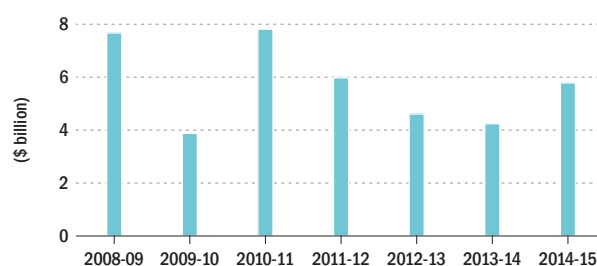
Output contingencies are referred to as ‘contingencies not allocated to departments’ in the budget papers. They include:²⁸¹

Provisions available to be allocated to specific departments and projects, future demand growth, departmental underspending and items not yet formalised at the time of the publication [of the budget papers].

In other words, output contingencies are amounts that the Government has included in the budget estimates for expenses to be determined in the future. Figure 5.12 compares the output contingencies announced in each budget since the 2008-09 Budget.

Figure 5.11

Contingencies not allocated to departments (four-year totals), 2008-09 to 2014-15 budgets



Sources: Budget Paper No.4, *State Capital Program*, 2008-09 to 2010-11; Budget Paper No.5, *Statement of Finances*, 2011-12 to 2014-15

Output contingencies contained in the 2014-15 Budget total \$5.8 billion over the four years of the forward estimates period. This is the largest output contingency figure since the first budget of this Government in 2011-12. The Committee notes that the output contingencies were larger in 2010-11. This means that the Government has more capacity to fund future decisions without modifying its budget estimates.

FINDING: The 2014-15 Budget contains contingencies for outputs totalling \$5.8 billion across the four years of the forward estimates period. This is money that the Government can utilise to fund new output initiatives or meet increased demand in future budgets.

281 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.31

6.1

Introduction

Over 2014-15, the Government intends to invest \$7.5 billion on infrastructure or other physical assets.²⁸² This is a 44.2 per cent increase over the revised figure for 2013-14.

Asset investment by the general government sector is procured in three ways:

- » direct investment (listed in the financial statements as ‘cash flows from investments in non-financial assets’), totalling an expected \$4.9 billion in 2014-15;²⁸³
- » investment through other sectors (in the financial statements as ‘net cash flows from investments in financial assets for policy purposes’), estimated at \$0.7 billion in 2014-15;²⁸⁴ and
- » asset provision through public private partnership (PPP) arrangements (described in the budget papers as ‘PPP infrastructure investment’), worth an anticipated \$1.9 billion in 2014-15.²⁸⁵

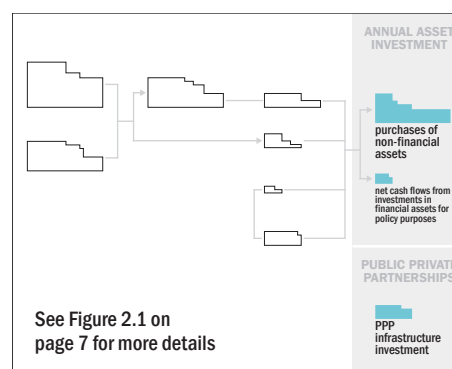
In addition to investment from the general government sector, the public non-financial corporations (PNFC) sector is able to invest on its own account. For 2014-15, the PNFC sector is expected to invest approximately \$2.6 billion of its own funds in addition to the \$0.7 billion from the general government sector.²⁸⁶

New asset initiatives released in the 2014-15 Budget have committed the Government to between \$21.7 and \$26.8 billion in asset expenditure over the forward estimates period and beyond.²⁸⁷

Investment during 2014-15 will be made up of expenditure on these projects as well as multi-year projects from previous budgets.

This chapter seeks to answer the following questions:

- » What is the Government’s strategy for asset investment? (Section 6.2)
- » How much does the Government plan to invest in assets over the forward estimates period? (Section 6.3)
- » What does this investment mean for Victoria? (Section 6.4)
- » What new investments are included in the 2014-15 Budget? (Section 6.5)



282 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.6

283 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.8. ‘Cash flows from investments in non-financial assets’ is made up of ‘purchases of non-financial assets’ less the proceeds of ‘sales of non-financial assets’.

284 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, p.8

285 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.15

286 Committee calculations based on Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.8, 46

287 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.64

6.2

The Government's strategy

As discussed in Chapter 2, the budget papers include the Government's 'long-term financial management objectives'. Two of these objectives are relevant to asset investment:²⁸⁸

- » 'improving services' (which is relevant to both infrastructure provision and service provision); and
- » 'looking after the future'.

A third objective, 'maximising community benefit'²⁸⁹ is more general, but includes the benefit of infrastructure provision.

In his budget estimates hearing, the Premier established the benefits of infrastructure provision by pointing out that:²⁹⁰

... investment in key infrastructure [is] to provide immediate jobs benefits and long-term productivity and efficiency to grow our economy.

The Treasurer also noted that the long-term benefits of infrastructure provision were gained through improved productivity, remarking that:²⁹¹

... our economic strategy is very much focused on improving productivity, and one of the ways that you improve productivity is to provide major infrastructure that links the state.

These long-term objectives lead to the Government's 'medium-term fiscal strategy', which is discussed in Chapter 2. This strategy includes a specific target²⁹² that infrastructure investment will be at least 1.3 per cent of gross state product (GSP), calculated as a rolling five-year average.²⁹³

The Government's performance against this target is discussed in Section 6.4.1.

FINDING: The Government's medium-term fiscal strategy includes an infrastructure investment target of 1.3 per cent of gross state product, calculated as a rolling five-year average.

Asset recycling strategy

The Government intends to take advantage of:²⁹⁴

... the Commonwealth Government's announcement of a new asset recycling initiative that will provide financial incentives to state and territory governments to divest assets and reinvest the proceeds in additional productive infrastructure.

288 *ibid.*, p.8

289 *ibid.*

290 Hon. Dr D. Napthine MP, Premier, 2014-15 budget estimates hearings, record of transcript, 13 May 2014, p.4

291 Hon. M. O'Brien MP, Treasurer, 2014-15 budget estimates hearings, record of transcript, 9 May 2014, p.7

292 The budget papers refer to the target as a 'parameter'.

293 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.9

294 *ibid.*, p.8

This incentive is achieved by the Commonwealth providing the State with a grant to supplement funds raised through asset sales ('divestments'). The grants are equal to 15 per cent of the funds received in this way (if they are reinvested in infrastructure).²⁹⁵

The State Government anticipates that it will take advantage of the Commonwealth's initiative with two projects. The Treasurer noted that:²⁹⁶

RFC [Rural Finance Corporation] is obviously one. The medium-term lease to be issued over the port of Melbourne is the other.

These two divestments have had a significant effect²⁹⁷ on the 2014-15 Budget,²⁹⁸ and are discussed in a number of places in this report.

A condition of the Commonwealth initiative is that funds from asset sales are to be subsequently reinvested into new infrastructure. In both cases, the Government has nominated what the resulting funds will be used for.

When discussing the lease of operations at the Port of Melbourne, the Minister for Ports referred to reinvesting in the proposed Port of Hastings, commenting that:²⁹⁹

The Port of Hastings expansion is a considerable investment not just in the port infrastructure itself but in the transport links that service it, and the proceeds of the lease will ensure that we can meet our construction timetable. The timing of the sale means that we also benefit from the commonwealth's new asset recycling initiative, which means we get a commonwealth contribution on top of the proceeds of the sale, so taking advantage of that has very much influenced the decision as well.

While discussing the sale of the Rural Finance Corporation, the Treasurer also suggested that resulting funds would be reinvested in infrastructure in rural and regional Victoria, noting that, if the Commonwealth agrees to the project, it:³⁰⁰

... will give us a 15 per cent top-up. So if, for example, the final price is around \$400 million, we will get 15 per cent on top of that. That is \$460 million that the state has been able to deliver in additional infrastructure for rural and regional Victoria ...

The Committee notes that, as at September 2014, the Commonwealth's asset recycling initiative has not yet been passed into law, with negotiations continuing between the Government and other parties.

FINDING: The Commonwealth Government has introduced an 'asset recycling' initiative, which provides the State Government with incentives for both asset divestment and reinvestment. Divestment projects that take advantage of this initiative have had a significant impact on the forward estimates for the 2014-15 Budget.

295 Commonwealth Government, *Building Australia's Infrastructure*, May 2014, p.5

296 Hon. M. O'Brien MP, Treasurer, 2014-15 budget estimates hearings, record of transcript, 9 May 2014, p.27

297 The impact of these divestments on the 2014-15 Budget has not been disclosed, but is likely to be between \$5 and \$6 billion.

298 Most notably, for 2015-16.

299 Hon. D. Hodggett MP, Minister for Ports, 2014-15 budget estimates hearings, record of transcript, 12 May 2014, pp.2-3

300 Hon. M. O'Brien MP, Treasurer, 2014-15 budget estimates hearings, record of transcript, 9 May 2014, p.8

Unsolicited Proposal Guideline

An additional mechanism for Government infrastructure investment is its new ‘Unsolicited Proposal Guideline’.³⁰¹ This was released in February 2014. The rules include how private parties ‘*being in a unique position or having ownership of strategic assets integral to delivering the proposal*’³⁰² may approach the Government with project proposals. The guideline allows the Government, under some circumstances, to accept such proposals without a competitive process.

The first two projects that utilise the system are the *Cranbourne-Pakenham Rail Corridor* and the *CityLink-Tulla Widening* projects. Together, these projects have a total value of between \$2.9 and \$3.4 billion.³⁰³ The *Cranbourne-Pakenham Rail Corridor* is discussed in greater detail in Section 6.5.2.

The ‘Unsolicited Proposal Guideline’ acknowledges the ‘*absence of competition*’³⁰⁴ in negotiations with private parties in such a ‘*unique position*’.³⁰⁵ In his hearing, the Treasurer noted the unique position of Transurban with respect to the *CityLink-Tulla Widening* project:³⁰⁶

Transurban approached us about that, and Transurban is the owner and operator of CityLink. It would be very hard to have a discussion with anybody other than Transurban about the widening of CityLink, because they own the asset.

FINDING: The Government’s newly-released ‘Unsolicited Proposal Guideline’ is an additional mechanism for Government infrastructure investment. The Committee looks forward to future analysis as to the success of the initiative.

6.3

Expenditure on asset projects

The main indicator for asset investment in the 2014-15 budget papers is ‘government infrastructure investment’. This shows the total amount spent on asset investment by, or on behalf of, the general government sector.

Figure 6.1 below sets out the three main sources for government infrastructure investment:

- » direct investment by the general government sector;
- » investment by the general government sector through other sectors; and
- » investment by the private sector on behalf of the State.

Trends over time for these three components are shown in Figure 6.2 below. These components are discussed in the following sections.

301 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.8

302 Department of Treasury and Finance, *Unsolicited Proposal Guideline*, February 2014, p.6

303 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.10

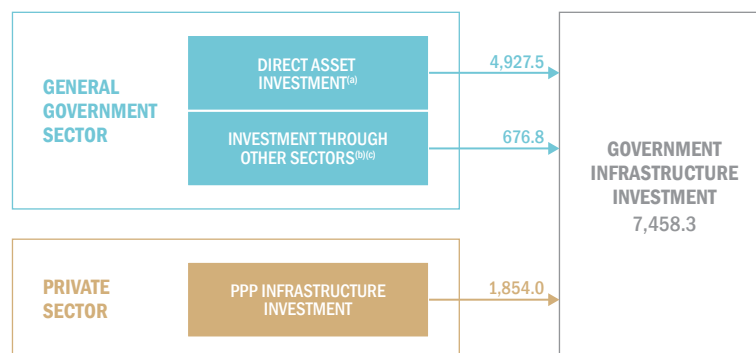
304 Department of Treasury and Finance, *Unsolicited Proposal Guideline*, February 2014, p.7

305 *ibid.*, p.2

306 Hon. M. O’Brien MP, Treasurer, 2014-15 budget estimates hearings, record of transcript, 9 May 2014, p.15

Figure 6.1

Sources for government infrastructure investment, 2014-15 (\$ million)

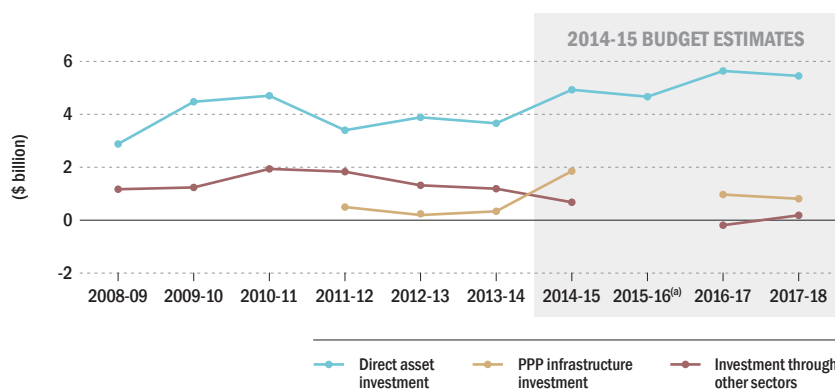


- (a) Net figure includes direct investment of \$5,312.4 million offset by proceeds from asset sales of \$384.9 million.
 (b) Net figure includes both cash outflows and inflows.
 (c) For 2015-16, cash inflows from the lease of operations of the Port of Melbourne are not included.

Sources: Committee calculations based on Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.15; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.8

Figure 6.2

Components of government infrastructure investment, 2008-09 to 2017-18



- (a) PPP infrastructure investment figure not available for 2015-16. Investment through other sectors for 2015-16 has not been included because cash outflows by the Government are more than offset by inflows resulting from the lease of operations of the Port of Melbourne.

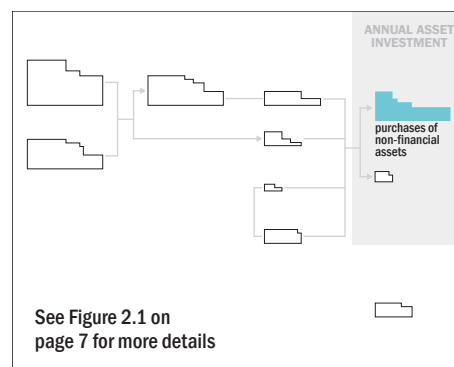
Sources: Committee calculations based on Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014; Department of Treasury and Finance, 'Consolidated Cash Flow Statement' data set, <www.dtf.vic.gov.au/files/9f70878d-6893-4047-8281-a32300b1b8d5/Consolidated-GG-Cash-Flow-Statement-Budget-2014-15.xls>, accessed 26 June 2014; Hon. M. O'Brien MP, Treasurer, 2013-14 budget estimates hearings, response to questions on notice, received 9 July 2013; Department of Treasury and Finance, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.21

6.3.1

Direct asset investment

Entities in the general government sector commonly invest directly in assets,³⁰⁷ subsequently owning and managing them. This is known in the budget papers as the 'purchases of non-financial assets'.

The Government anticipates net purchases of non-financial assets (direct asset investment less proceeds from asset



307 These assets include roads, land, buildings, equipment and other types of infrastructure.

sales) for the general government sector to be \$4.9 billion in 2014-15.³⁰⁸ This is an increase of \$1.3 billion (34.6 per cent) over the revised figure of \$3.7 billion for 2013-14.³⁰⁹ This increase is partly a result of new initiatives released in the 2014-15 budget papers, which are described in Section 6.5.

Figure 6.2 shows that the level of direct investment by the general government sector is expected to increase over the forward estimates period. By 2017-18, net direct investment is anticipated to be \$5.4 billion.³¹⁰

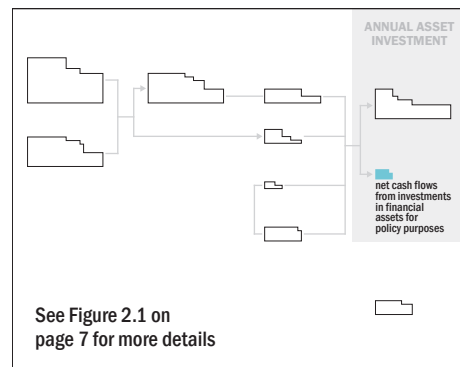
The Committee notes that the direct asset investment estimates include an allocation for the two stages of the *East West Link* project.³¹¹ These projects may be fully or partially converted to PPP projects.³¹² Such a conversion would result in the anticipated direct investment estimates over the forward estimates period being lowered, as the projects would no longer be funded by the general government sector. However, PPP infrastructure investment would increase to reflect the projects' delivery as PPPs.

FINDING: Net purchases of non-financial assets (direct asset investment) for the general government sector are anticipated by the Government to be \$4.9 billion in 2014-15, a 34.6 per cent increase over 2013-14. Direct asset investment for the general government sector is anticipated to increase over the forward estimates period, although it may be reduced when some projects are converted to PPPs.

6.3.2

Investment through other sectors

The Government commonly invests in infrastructure projects that are subsequently owned and operated by entities in other sectors, such as the PNFC sector. In recent years, these investments have mainly been in rail infrastructure, but investments in water infrastructure, ports and other projects managed by PNFC entities also occur.



This is included in the budget papers as the 'net cash flows from investments in financial assets for policy purposes'. These also include cash flows back to the general government sector as a result of these projects. For 2014-15, net investment through other sectors is anticipated to be \$676.8 million,³¹³ a decrease of \$512.0 million (43.1 per cent) on the revised estimate for 2013-14 of \$1,188.8 million.³¹⁴

308 This is made up of purchases of \$5,312.4 million, partly funded by asset sales of \$384.9 million (Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.8).

309 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.218

310 *ibid.*, p.8

311 *ibid.*, p.36; Budget Paper No.4, 2014-15 State Capital Program, May 2014, pp.48, 50

312 Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.11

313 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.8

314 *ibid.*, p.218

As noted above, not only does the Government make investments in other sectors, but it also receives cash in relation to investments made previously. Cash inflows may be significant for this item, the amount in 2012-13 being \$463.0 million compared to the cash outflow of \$1,779.9 million.³¹⁵ While cash inflows and outflows for this figure are presented separately in the Annual Financial Report, they are not reported in the budget papers.

Figure 6.2 shows that investment through other sectors has followed a downward trend over the last five years. This is largely due to the anticipated completion (in mid-2015) of the *Regional Rail Link* project.³¹⁶ This trend is associated with a similar pattern in purchases of non-financial assets by the PNFC sector. For this sector, in the last two years of the forward estimates period, net purchases of non-financial assets are expected to be less than depreciation, meaning that assets will be used up at a faster rate than they are replaced.³¹⁷

In 2015-16, the cash inflow resulting from the lease of operations of the Port of Melbourne (see Section 2.6.2 of this report) is expected to be greater than the expected cash outflow for investment through other sectors. This is anticipated to result in 'net cash flows from investments in financial assets for policy purposes' being an overall cash inflow in 2015-16.³¹⁸

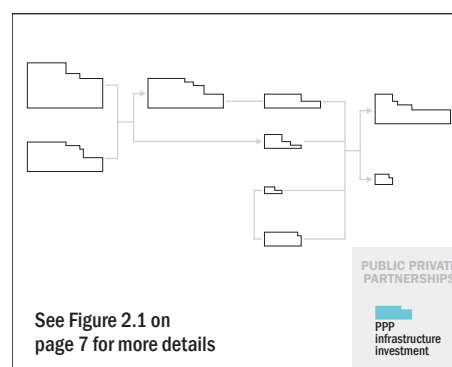
The new *Melbourne Rail Link* project is currently represented as a traditional asset project in the budget papers, contributing \$600.0 million to investment through other sectors in 2017-18.³¹⁹

FINDING: 'Net cash flows from investments in financial assets for policy purposes' (investment through other sectors) are expected to be \$676.8 million, a 43.1 per cent decrease from 2013-14. The lease of operations of the Port of Melbourne will contribute to a net cash inflow for 2015-16. Investment through other sectors is expected to decrease over the forward estimates period following the completion of the *Regional Rail Link* project.

6.3.3

Public private partnership infrastructure investment

A portion of asset investment each year is delivered through PPPs. In 2014-15, for the second year, the budget papers have included a figure measuring 'PPP infrastructure investment'.³²⁰



315 Department of Treasury and Finance, *2012-13 Financial Report*, October 2013, p.28

316 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.117

317 Budget Paper No.5, *2014-15 Statement of Finances*, May 2014, pp.43, 46

318 *ibid.*, p.8

319 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.64; Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.115

320 The figure was known in the 2013-14 budget papers as 'cash flows from PPP payments' (Budget Paper No.4, *2013-14 State Capital Program*, May 2013, p.11).

As part of the 2014-15 Budget, the Department of Treasury and Finance included a section on ‘additional definitions of key terms’ on its website, including PPP infrastructure investment. Here, the Department of Treasury and Finance defines PPP infrastructure investment as:³²¹

... the annual capital expenditure cash flows modeled in the Financial Model forming part of a public private partnership (PPP) contract, exclusive of capitalised interest and any Victorian Government capital contribution. This amount is separately calculated and is not sourced from a particular line of a financial statement.

The Committee contacted the Department of Treasury and Finance for further details on how the PPP infrastructure investment component was calculated. The Department responded that:³²²

The PPP investment (‘cash flows from PPP payments’) figure aggregates, for all PPP projects in the design and construction phase, the value of construction activity to be undertaken by the private sector during the budget year, excluding components (such as State contributions) which are represented elsewhere in the budget papers.

That is, PPP infrastructure investment quantifies the value of work done by the private sector on behalf of the Government. It is separate to any work carried out by the Government on PPP projects and therefore does not appear in the Government’s financial statements.

The Committee obtained estimates for PPP infrastructure investment over the forward estimates period, including a revised estimate for 2013-14. These are given in Table 6.1, together with previous estimates. The latest estimates are higher than those from the 2013-14 budget papers partly as a result of newly announced PPP projects such as the *Cranbourne-Pakenham Rail Corridor* project.

Table 6.1

PPP infrastructure investment,^(a) estimates from 2013-14 and 2014-15 budgets

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
2013-14 Budget	496.1	238.7	310.1	1,465.0	1,078.6	0.0	-
2014-15 Budget	-	-	334.0	1,854.0	nfp ^(b)	968.0	808.0

(a) Referred to in the 2013-14 budget papers as ‘cash flows from PPP payments’.

(b) Not for publication.

Sources: Department of Treasury and Finance, response to the Committee’s 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.21; Hon. M. O’Brien MP, Treasurer, 2013-14 budget estimates hearings, response to questions on notice, received 9 July 2013, p.4

The Government anticipates that the private sector will carry out \$1.9 billion of construction work on PPP projects during 2014-15.³²³ This is more than five times the revised 2013-14 estimate of \$334.0 million,³²⁴ and reflects the shift into the

321 Department of Treasury and Finance, ‘State Capital Program’ <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/State-capital-program>, accessed 9 July 2014

322 Department of Treasury and Finance, response to the Committee’s 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.22

323 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.15

324 Department of Treasury and Finance, response to the Committee’s 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.21

construction phases for projects such as the *East West Link – Eastern Section*, the *Cranbourne-Pakenham Rail Corridor* and the *CityLink Tulla Widening* projects.³²⁵

FINDING: Public private partnership (PPP) infrastructure investment quantifies the value of work done by the private sector on behalf of the Government while constructing PPPs. The private sector is expected to carry out \$1.9 billion of construction work on PPP projects during 2014-15. This is more than five times the amount estimated for 2013-14.

The Committee considers that PPP infrastructure investment is a useful indicator of asset investment. PPP infrastructure investment is the only indicator showing anticipated annual expenditure on PPP construction.

The Committee examined this figure in its *Report on the 2013-14 Budget Estimates – Part Two*. As would be expected with new indicators, the Committee made a number of recommendations.³²⁶

The Government responded that it:³²⁷

... supports the principle that the budget papers include an explanation of how cash flows from PPP payments are calculated. This will be done in a way which ensures that commercially sensitive information relating to PPPs under construction remains confidential.

The Government also supported explaining variations in the value of PPP infrastructure investment from one year to the next, responding that ‘*the budget papers will include an explanation of variations*’.³²⁸

The Committee anticipates that the usefulness and robustness of the PPP infrastructure investment figures will continue to be enhanced in the future.

Historical figures for PPP infrastructure investment would also give stakeholders a more comprehensive understanding of the Government infrastructure investment figure, including the calculation of its five-year average. These averages are important as they underpin the Government’s infrastructure investment target.

FINDING: Estimates of public private partnership (PPP) infrastructure investment are useful, as they are the only figures showing anticipated annual investment on PPP projects. The figures are an important element in Government accountability.

RECOMMENDATION 3: The Department of Treasury and Finance publish historical figures for public private partnership infrastructure investment.

325 Budget Information Paper, *Infrastructure Investment*, May 2014, pp.6-7

326 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, Recommendations 31 and 32, p.156; and Recommendation 34, p.159

327 Victorian Government, Government Responses to the Recommendations of Public Accounts and Estimates Committee’s 116th Report to the Parliament – Report on the 2013-14 Budget Estimates – Part Two, tabled 16 April 2014, p.10

328 *ibid.*, p.11

6.3.4

Government infrastructure investment

Figure 6.3 below shows government infrastructure investment over time. Figure 6.2 above shows the disclosed components of government infrastructure investment.

The Government expects government infrastructure investment for 2014-15 to be \$7.5 billion, which is an increase of \$2.3 billion (44.2 per cent) over the expected figure for 2013-14.³²⁹ Over the forward estimates period, the Government anticipates it to fall to \$6.4 billion. This is a result of a decrease in investment through other sectors, principally because of the anticipated completion of the *Regional Rail Link* project at the end of 2014-15,³³⁰ as well as the lower level of PPP construction anticipated after 2016-17 (see Figure 6.2 above).

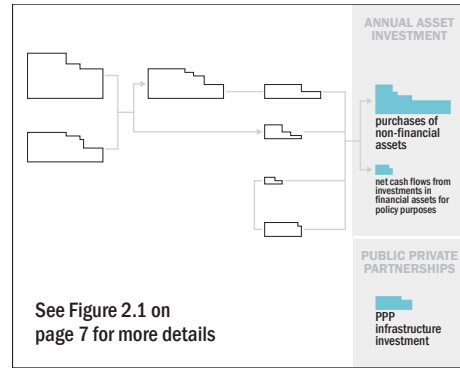
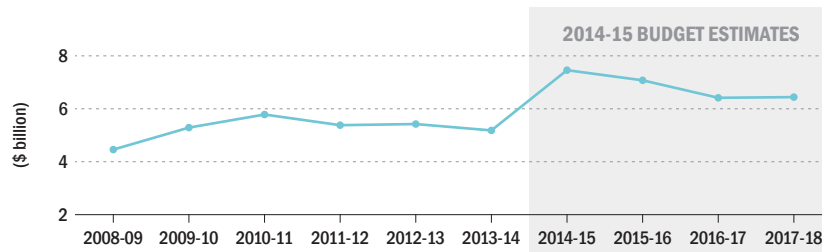


Figure 6.3

Government infrastructure investment, 2008-09 to 2017-18



Source: Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014

FINDING: Government infrastructure investment is expected to rise by \$2.3 billion to \$7.5 billion for 2014-15, and then reduce over the forward estimates period to \$6.4 billion.

Calculating the government infrastructure investment figure

The government infrastructure investment indicator was first included in the 2013-14 budget papers.³³¹ With the 2014-15 Budget, the Department of Treasury and Finance published historical figures for the indicator back to 2000-01.³³² The Committee welcomes this additional disclosure.

The three main components of this indicator have been discussed in Sections 6.3.1 to 6.3.3 above.

329 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.6
 330 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.117
 331 Budget Paper No.4, *2013-14 State Capital Program*, May 2013, p.11
 332 Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014

The Committee has previously recommended that individual components of government infrastructure investment be disclosed in budget papers.³³³ The Government supported this in principle, but responded that:³³⁴

The budget papers already provide detailed information on components of the Government's infrastructure program in Budget Paper No.4, State Capital Program.

FINDING: The Government infrastructure investment figure is a useful investment indicator. It is the only published investment figure that includes a component for public private partnership projects under construction.

RECOMMENDATION 4: In estimating, publishing and discussing government infrastructure investment figures, the Department of Treasury and Finance build on existing disclosure by quantifying, to the extent compatible with protecting the State's financial interests, all components of government infrastructure investment for each year of the forward estimates period after the budget year.

The government infrastructure investment figures support the Government's infrastructure investment target (see Section 6.4.1). Because of this, the Committee considers that the inclusion of estimates in the budget papers and actual results at the end of the financial year are critical elements of the accountability cycle. In a previous report, the Committee recommended that the components making up the actual result for government infrastructure investment be included in the Annual Financial Report.³³⁵ The Government is reviewing this matter, and is considering how best to report the components while taking into account commercially sensitive information.³³⁶ The Committee looks forward to the Government's response.

6.4 Anticipated effects of asset expenditure

6.4.1 Comparison to the Government's target

As noted in Section 6.2, the Government has set a target that infrastructure investment will be at least 1.3 per cent of GSP.³³⁷

Table 6.2 shows the rolling five-year average of government infrastructure investment as a proportion of GSP. Over the forward estimates period, average infrastructure investment remains close to 1.7 per cent of GSP.

333 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, Recommendation 33, p.159

334 Victorian Government, *Government Responses to the Recommendations of Public Accounts and Estimates Committee's 116th Report to the Parliament – Report on the 2013-14 Budget Estimates – Part Two*, tabled 16 April 2014, p.11

335 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, Recommendation 34, p.159

336 Department of Treasury and Finance, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.51

337 Budget Paper No.2, *2014-15 Strategy and Outlook*, May 2014, p.9

Table 6.2

Government infrastructure investment, 2012-13 to 2017-18

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Government infrastructure investment (\$ billion)	5.4	5.2	7.5	7.1	6.4	6.4
Nominal GSP (\$ billion)	337.5	353.9	370.1	389.7	410.7	432.6
Average government infrastructure investment as a proportion of GSP ^(a) (per cent)	1.7	1.7	1.7	1.7	1.7	1.7

(a) Rolling five-year average.

Sources: Committee calculations based on Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014; Department of Treasury and Finance, 'Macroeconomic Indicators' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>, accessed 26 June 2014

These figures are higher than comparative figures calculated from the 2013-14 budget papers.³³⁸ For 2016-17, this is mainly a result of direct investment projects released in the 2014-15 Budget. For 2015-16, the source of the increase is undisclosed.³³⁹

FINDING: Government infrastructure investment is expected by the Government to be approximately 1.7 per cent of GSP (as a rolling five-year average) over the forward estimates period. This is an increase on previous estimates, and is above the Government's infrastructure investment target.

6.4.2

Real infrastructure investment per Victorian

Real infrastructure investment per capita adjusts the government infrastructure investment figure for both inflation and population growth. This provides an understanding of the level of investment, given the changing value of money and number of Victorians sharing the infrastructure.

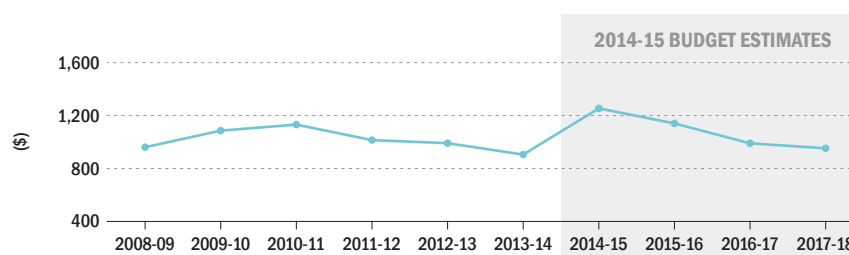
Figure 6.4 shows that real infrastructure investment per Victorian has been declining since 2010-11, reaching the revised estimate of \$905 for 2013-14. However, the expenditure on assets included in the 2014-15 Budget is expected to cause a 38.6 per cent increase in real infrastructure investment (to \$1,254 per Victorian). Over the forward estimates period, a downward trend will return, with investment reaching \$953 per Victorian by 2017-18.

338 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, p.158

339 The source of the increase is either PPP infrastructure investment or cash outflows in investment through other sectors, neither of which are disclosed in the budget papers.

Figure 6.4

Government infrastructure investment per Victorian in real terms (2014-15 prices), 2008-09 to 2017-18



Note: Real investment is calculated using the price deflator implicit in the Department of Treasury and Finance's calculation of real and nominal GSP. Figures are provided in 2014-15 prices.

Sources: Committee calculations based on Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014; Department of Treasury and Finance, 'Macroeconomic Indicators' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>, accessed 26 June 2014

FINDING: Real infrastructure investment per Victorian adjusts government infrastructure investment for both inflation and population change. In 2014-15 terms, it is expected to rise from \$905 in 2013-14 to \$1,254 in 2014-15 and then settle to \$953 by 2017-18.

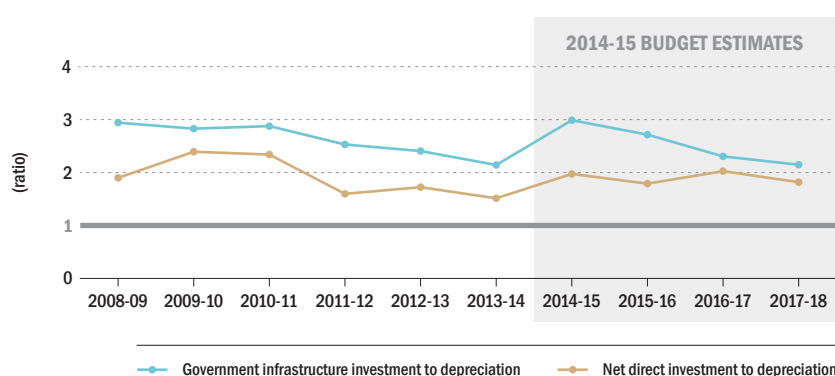
6.4.3

Investment sustainability

Figure 6.5 shows the ratio of asset creation (measured by net purchases of non-financial assets) to asset use (measured by depreciation) for the general government sector. It also shows the ratio of the new government infrastructure investment figure to depreciation for the general government sector. A ratio greater than 1.0 means that investment is larger than asset use, meaning the overall amount of assets is being built up. However, a ratio below 1.0 shows that the asset base is being used faster than it is being replaced.

Figure 6.5

Ratios of asset creation to asset use, 2008-09 to 2017-18



Sources: Committee calculations based on Annual Financial Reports 2008-09 to 2012-13; Budget Paper No.5, 2014-15 *Statement of Finances*, May 2014, pp.5, 8, 43, 46; Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014

Figure 6.5 shows that net purchases of non-financial assets have been more than the level of depreciation in recent years, showing that the general government sector asset base is being consistently built up. This is anticipated to remain the case over the whole of the forward estimates period.

For the first time, the Committee has also considered the ratio of Government infrastructure investment to general government sector depreciation. This includes the provision of PPP projects.

Over the whole of the period, the Government infrastructure investment is more than double the level of depreciation in the general government sector. Therefore, the anticipated general government sector asset base, including assets provided through PPPs, is consistently built up.

FINDING: Over the forward estimates period, the general government sector plans to build up assets faster than they will depreciate.

6.4.4 Purposes of investment

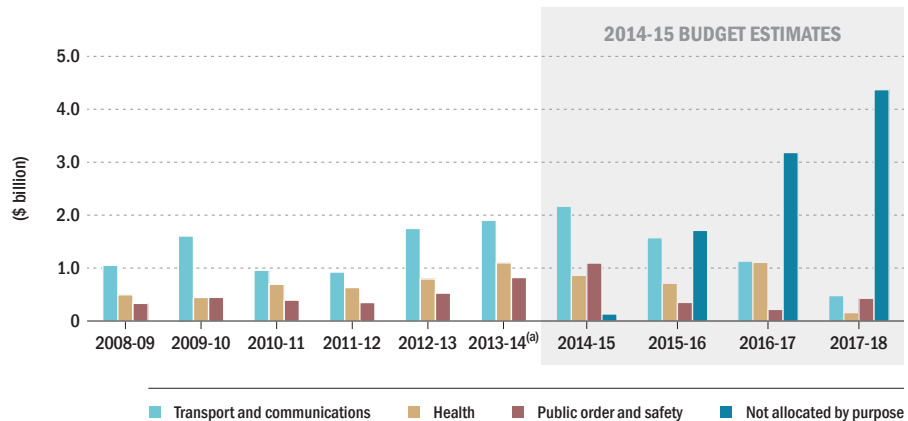
The budget papers include a break-down of purchases of non-financial assets by the general government sector according to the Australian Bureau of Statistics’ government purpose classification.³⁴⁰ Figure 6.6 shows the amount of expenditure in the three largest categories between 2008-09 and 2017-18.

For 2014-15, the budget papers anticipate that the major area of investment will be in the ‘transport and communications’ category. Investment in ‘public order and safety’ is expected to become the Government’s second-highest priority, surpassing health investment in 2014-15.

Figure 6.6 also shows that more than half of expenditure planned after 2014-15 is not currently allocated by purpose, in line with usual practice. Future budgets will allocate these funds.

Figure 6.6

Purchases of non-financial assets by government purpose classification, general government sector, 2008-09 to 2017-18



(a) Revised estimate from the 2013-14 Budget Update.
 Sources: Department of Treasury and Finance, Annual Financial Reports, 2008-09 to 2012-13; Department of Treasury and Finance, 2013-14 Victorian Budget Update, December 2013, p.81; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.35

340 Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.35

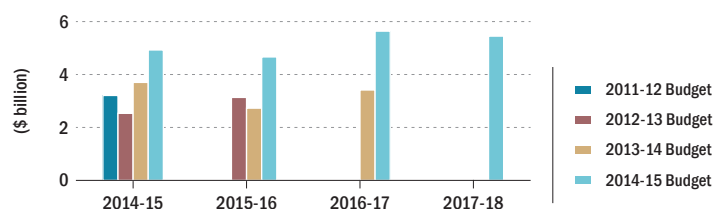
Investment through other sectors (investments in financial assets for policy purposes) is not broken down in the budget papers by government purpose. However, the budget papers show that this expenditure, like direct investment, is primarily for transport projects, such as the *Regional Rail Link* project and the *Port of Hastings Development*.³⁴¹

FINDING: The majority of investment for 2014-15 is anticipated to be for transport, public order and health purposes.

6.4.5 Comparison to previous estimates

Figure 6.7 shows estimates from the last four budgets of the amount of direct asset investment anticipated by the Government between 2014-15 and 2017-18.

Figure 6.7 Net purchases of non-financial assets, comparison with previous forward estimates, 2014-15 to 2017-18



Sources: Budget Paper No.5, 2011-12 Statement of Finances, May 2011, p.11; Budget Paper No.5, 2012-13 Statement of Finances, May 2012, p.8; Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.8; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, pp.8, 218

Figure 6.7 shows that the Government's anticipated levels of asset expenditure have increased over predictions made in previous budgets. This increase is apparent for all years covered in previous budgets.

These increases are partly funded by the Government's increased expectations of operating surpluses compared to earlier budgets.³⁴² In addition, for 2014-15 to 2016-17, anticipated investment through other sectors (investments in financial assets for policy purposes) has decreased in the 2014-15 Budget compared to the 2013-14 budget estimates.³⁴³

Figure 6.8 below shows estimates from the last four budgets of 'net cash flows from investments in financial assets for policy purposes' (investment through other sectors) anticipated by the Government between 2014-15 and 2017-18.

For both the 2013-14 and 2014-15 budgets, investment through other sectors has been dominated by the *Regional Rail Link* project.³⁴⁴ The total estimated cost of this project has been lowered by \$0.7 billion in the 2014-15 budget papers,³⁴⁵

341 Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.16

342 Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.5; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.5

343 Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.8; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.8

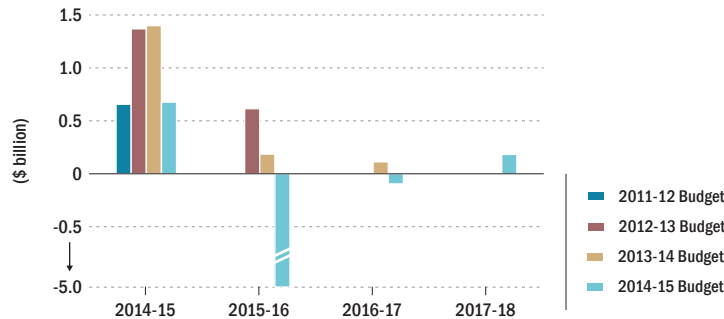
344 Budget Paper No.4, 2013-14 State Capital Program, May 2013, p.12; Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.16

345 Budget Paper No.4, 2014-15 State Capital Program, May 2014, p.117. The TEI had previously been raised by \$0.5 billion in the 2013-14 budget papers (Budget Paper No.4, 2013-14 State Capital Program, May 2013, p.125).

specifically reducing expenditure anticipated in 2014-15 and 2015-16. This is a major contributing factor to the decrease in investment through other sectors in the forward estimates period.

Figure 6.8

Net cash flows from investments in financial assets for policy purposes (investments through other sectors), comparison with previous forward estimates, 2014-15 to 2017-18



Sources: Budget Paper No.5, 2011-12 Statement of Finances, May 2011, p.11; Budget Paper No.5, 2012-13 Statement of Finances, May 2012, p.8; Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.8; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, pp.8, 218

The lower-than-previously-anticipated investment for 2015-16 is related to the newly announced cash inflow from the lease of operations of the Port of Melbourne (see Section 6.3.2).

The Committee notes that the latest budget papers have also decreased anticipated expenditure for 2016-17 so that the net result is a cash inflow of \$190.3 million.³⁴⁶

FINDING: The 2014-15 budget papers include increased estimates for net purchases of non-financial assets compared with the 2013-14 budget papers. These increases are funded by higher expected operating surpluses and lower investment through other sectors. The anticipated amount of investment through other sectors has been lowered, mostly due to a reduction in the expected cost of the *Regional Rail Link* project and inflows from the lease of operations of the Port of Melbourne.

6.5 New initiatives since the 2013-14 Budget (including the 2013-14 Budget Update)

6.5.1 Value of projects released in the 2014-15 Budget

The total estimated investment (TEI) of a project is the sum of all expenditure on construction or purchase of the asset. In the case of large projects, the period of construction may be a number of years.

The TEI of asset projects released in the 2014-15 Budget is a significant increase over previous budgets. The anticipated expenditure is expected to be between \$21.7 and \$26.8 billion.³⁴⁷

³⁴⁶ Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.8

³⁴⁷ Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.64. This figure does not include asset projects funded internally by the public non-financial corporations sector.

Three large projects, which are discussed in more detail in Section 6.5.2, provide the large majority of this expenditure. The combined TEI of these projects is between \$18.5 and \$23.5 billion,³⁴⁸ around 87 per cent of the newly announced expenditure. These projects are:

- » the *Cranbourne-Pakenham Rail Corridor*;
- » the *Melbourne Rail Link*; and
- » the *East West Link – Western Section*.

The budget papers indicate that the *Cranbourne-Pakenham Rail Corridor* project is expected to be provided as a PPP. In addition, the other two projects are expected to include packages that are provided through PPPs.³⁴⁹

FINDING: The 2014-15 Budget released new asset projects to be funded by the general government sector. These projects have an aggregate total estimated expenditure of between \$21.7 and \$26.8 billion. Three transport-related projects make up the bulk of this investment: the *Cranbourne-Pakenham Rail Corridor*; the *Melbourne Rail Link* project; and the *East West Link – Western Section*.

6.5.2 Key projects in 2014-15

In the evidence presented to the Committee at the public hearings, ministers outlined some of the major asset investments included in the 2014-15 Budget.

The three particularly significant asset initiatives mentioned in Section 6.5.1 will be outlined in this section. The Premier noted that these infrastructure investments would:³⁵⁰

... grow the economy, create jobs, improve the efficiency and scale of freight and logistics, increase productivity and better link people, products and markets.

Cranbourne-Pakenham Rail Corridor

The *Cranbourne-Pakenham Rail Corridor* project is a new initiative in the 2014-15 Budget. It is intended to provide improved rail connections through Melbourne's south-east corridor, as well as reduce road congestion via level crossing improvements.³⁵¹

³⁴⁸ Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.64

³⁴⁹ Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.11

³⁵⁰ Hon. Dr D. Napthine MP, Premier, 2014-15 budget estimates hearing, transcript of evidence, 13 May 2014, p.3

³⁵¹ Budget Paper No.3, *2014-15 Service Delivery*, May 2013, p.67; Budget Information Paper, *Infrastructure Investment*, May 2014, p.12

The Minister for Public Transport stated that:³⁵²

It will deliver a capacity increase on the line of 30 per cent. It will fund the removal of crossings . . . , rebuild the stations at Clayton, Murrumbeena and Carnegie and deliver a new train maintenance depot at Pakenham East.

The Government has anticipated a \$20.0 million outlay in 2014-15, with a TEI of between \$2.0 and \$2.5 billion.³⁵³ The large majority of the project will be delivered as a PPP by MTR Corporation, the current owner of Metro trains. Works are expected to begin in 2015.³⁵⁴ The Treasurer outlined to the Committee that the Government accepted an unsolicited proposal from a consortium for the contract, but that:³⁵⁵

. . . where we have entered into exclusive negotiations . . . this is all subject to a final value-for-money assessment. We will make sure that it represents value for money for taxpayers.

The expected completion date for the project is 2019.³⁵⁶

Melbourne Rail Link

The *Melbourne Rail Link* project replaces the previous *Melbourne Metro Rail Tunnel*.³⁵⁷ It entails the construction of an underground tunnel between Southern Cross and South Yarra stations, two new stations, and a rail link to Tullamarine airport.³⁵⁸ The project is intended to reduce congestion and therefore increase capacity by separating existing lines.³⁵⁹

The Minister for Public Transport explained that the project will also involve consequential developments to tram and bus services, and that the Government:³⁶⁰

. . . will invest \$100 million in tram and bus improvements in the Parkville precinct.

According to the Minister for Planning, the project will also contribute to the ‘urban renewal’ of Fisherman’s Bend through:³⁶¹

. . . the provision of a railway station which the government will build in the Melbourne Rail Link in that urban renewal area . . .

352 Hon. T. Mulder MP, Minister for Public Transport, 2014-15 budget estimates hearing, transcript of evidence, 16 May 2014, p.4

353 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.48

354 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.67

355 Hon. M. O’Brien MP, Treasurer, 2014-15 budget estimates hearing, transcript of evidence, 9 May 2014, p.15

356 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.67

357 See Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, pp.165-6; Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.115

358 Budget Information Paper, *Infrastructure Investment*, May 2014, p.10

359 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.68

360 Hon. T. Mulder MP, Minister for Public Transport, 2014-15 budget estimates hearing, transcript of evidence, 16 May 2014, p.4

361 Hon. M Guy MP, Minister for Planning, 2014-15 budget estimates hearing, transcript of evidence, 20 May 2014, p.13

The Government anticipates that expenditure in 2014-15 will be \$40.0 million, with a TEI of between \$8.5 and \$11.0 billion.³⁶² The budget papers indicate that packages within this project will be delivered as PPPs, but do not disclose the proportion of the project that these PPPs will cover.³⁶³

The Government expects the *Melbourne Rail Link* project to be under construction for an extended period, with early works anticipated to begin in mid-2016³⁶⁴ and completion expected in 2024.³⁶⁵

East West Link – Western Section

The Committee outlined *East West Link – Stage 1* (now known as the *East West Link – Eastern Section*) in its *Report on 2013-14 Budget Estimates – Part Two*.³⁶⁶ The *East West Link – Western Section* is an extension of Stage 1, and extends the road to connect with the Western Ring Road.³⁶⁷

The Premier told the Committee that the project will provide:³⁶⁸

... that vital second river crossing to ease congestion on the West Gate Bridge and give people choices and options, ... creating 3000 jobs at its peak.

The project is expected to commence in late 2015, with a TEI of between \$8.0 and \$10.0 billion.³⁶⁹ The TEI includes \$1.5 billion funded by the Commonwealth.³⁷⁰

Like the *Melbourne Rail Link* project, the budget papers indicate that packages within this project will be delivered by the private sector.³⁷¹ The 2014-15 budget papers note that the Eastern Section of the East West Link will be delivered as an ‘availability PPP’, with, ‘at least initially’,³⁷² the State retaining toll revenue and making regular payments over the period of the concession.³⁷³ The budget papers do not indicate whether or not the Western Section will have the same arrangement.

6.5.3 Other new asset initiatives

In addition to the projects outlined in Section 6.5.2, the 2014-15 Budget released a range of other initiatives. The largest of these are set out below.

362 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.115

363 *ibid.*, p.11

364 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.68

365 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.115

366 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, p.164

367 Budget Information Paper, *Infrastructure Investment*, May 2014, p.14

368 Hon. Dr D. Napthine MP, Premier, 2014-15 budget estimates hearing, transcript of evidence, 13 May 2014, p.4

369 Budget Information Paper, *Infrastructure Investment*, May 2014, p.14; Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.64

370 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, pp.48-9

371 *ibid.*, p.11

372 *ibid.*

373 *ibid.*

Transport projects

There are a number of new transport-related asset initiatives, including:³⁷⁴

- » *Metro Level Crossing Blitz Program* (\$679.3 million);
- » *Princes Highway Duplication Project – Winchelsea to Colac* (\$349.5 million); and
- » *Murray Basin Rail Project* (between \$180.0 and \$220.0 million).

Smaller initiatives include the upgrading of various intersections and roads, planning for future rail expansion and safety improvements in the City Loop.³⁷⁵

The Committee notes that the Government is also considering a *CityLink – Tulla Widening* project. This project was initiated by an unsolicited proposal from Transurban.³⁷⁶ Transurban will fully fund the project, with an expected cost of \$850.0 million.³⁷⁷

Health projects

New health-related asset initiatives include upgrades to the Boort Hospital (\$14.0 million) and Latrobe Regional Hospital (\$73.0 million).³⁷⁸ A new Barwon Health facility will be initiated in 2014-15 (\$28.1 million), along with general equipment and infrastructure upgrades across the system.³⁷⁹

The Minister for Health informed the Committee that initiatives like those mentioned above:³⁸⁰

... are playing a critical role in refreshing and replacing infrastructure, building new capacity and at the same time creating construction jobs in local communities around the state.

The Minister for Ageing explained that asset initiatives also impacted on the Ageing portfolio, saying that the Boort Hospital upgrade ‘includes 25 aged-care beds’.³⁸¹

Education projects

The 2014-15 Budget contains a \$500.0 million (TEI) allocation for the *School Capital Program*.³⁸² As well as upgrades and modernisations, this year’s allocation will provide 12 new schools.³⁸³ Expenditure in 2014-15 on new projects will be \$215.0 million.³⁸⁴

374 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.64

375 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, pp.64-5

376 Hon. M. O’Brien MP, Treasurer, 2014-15 budget estimates hearing, transcript of evidence, 9 May 2014, p.15

377 Budget Information Paper, *Infrastructure Investment*, May 2014, p.16

378 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.34

379 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.24

380 Hon. D. Davis MLC, Minister for Health, 2014-15 budget estimates hearing, transcript of evidence, 9 May 2014, p.6

381 *ibid.*, p.2

382 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.12

383 Budget Information Paper, *Infrastructure Investment*, May 2014, p.22

384 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.12

As part of the program, 11 of the 12 new schools will be procured under PPP arrangements.³⁸⁵ The Minister explained that:³⁸⁶

The PPP is what we call a school with the lot. It is built for 25 years, so a successful consortium will build all the 11 schools. They will build and maintain that school for 25 years ... It will be furnished, it will be landscaped, it will have all the equipment inside it and the principal and the new staff and children will just walk into that school ready-made.

The TEI for the PPP part of the program is \$190.7 million, and the proposed schools are listed in the budget papers.³⁸⁷

Justice projects

The 2014-15 Budget allocates \$140.8 million to continue the expansion of the corrections system.³⁸⁸ The initiative is intended to increase prison capacity across both men's and women's prisons. Part of the initiative provides funding 'for strategies to manage demand on police cells'.³⁸⁹

Funding is also provided for the redevelopment of the Shepparton Law Courts, a project with a TEI of \$67.8 million.³⁹⁰

Business and employment

The Government has provided \$30.2 million for stage one of the *Ballarat West Employment Zone* project.³⁹¹ The project will provide infrastructure to enable land to be subdivided and released for businesses to relocate to Ballarat.³⁹²

The Minister for Regional Cities stated that the Government:³⁹³

... have funded the Ballarat West link road, which is now out to tender and construction will start shortly, which is vital for that development ... over \$30 million [is] provided by this budget for the next stage of development to get that land ready for investment and job creation ...

Sport and recreation

The 2014-15 Budget includes the second stage of the redevelopment of Melbourne Park. The Government has allocated \$30.8 million of funding in 2014-15.³⁹⁴ The TEI of this project is \$366.1 million, and includes contributions of \$28.0 million from the Commonwealth Government, and \$40.0 million from the Melbourne and Olympic Parks Trust.³⁹⁵

385 *ibid.*, p.13

386 Hon. M. Dixon MP, Minister for Education, 2014-15 budget estimates hearing, transcript of evidence, 13 May 2014, p.9

387 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.21

388 *ibid.*, p.41

389 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.36

390 *ibid.*, p.77

391 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.46

392 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.54

393 Hon. Dr D. Naphthine MP, Minister for Regional Cities, 2014-15 budget estimates hearing, transcript of evidence, 13 May 2014, p.5

394 Budget Paper No.3, *2014-15 Service Delivery*, May 2014, p.65

395 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.129

The project will involve a refurbishment of Rod Laver Arena, infrastructure for media and administration, and a pedestrian footbridge to improve access to the facility.³⁹⁶ Construction is expected to be complete by June 2020.³⁹⁷

6.6 Additional disclosure

6.6.1 Glossary of terms

As part of its *Report on the 2013-14 Budget Estimates*, the Committee recommended that two terms, ‘government infrastructure investment’ and ‘cash flows from PPP payments’ (now retitled ‘PPP infrastructure investment’), be added to the definitions given in Budget Paper No.4 (State Capital Program).³⁹⁸ The Committee notes that the Department of Treasury and Finance has added the terms to its website,³⁹⁹ but that they do not appear in the budget papers themselves.⁴⁰⁰ In addition, there is no mention in the budget papers of further terms being defined on the website.

FINDING: The Department of Treasury and Finance provides definitions for some terms on its website that are not included in the glossary in the budget papers.

RECOMMENDATION 5: The Department of Treasury and Finance include the definitions of the following terms from its website in Budget Paper No.4 (State Capital Program):

- (a) ‘government infrastructure investment’; and
- (b) ‘PPP infrastructure investment’.

RECOMMENDATION 6: The Department of Treasury and Finance continue to refine the definitions in Budget Paper No.4 (State Capital Program) to ensure that terms which are used interchangeably are not defined differently.

396 Hon. D. Drum MLC, Minister for Sport and Recreation, 2014-15 budget estimates hearing, transcript of evidence, 20 May 2014, p.4

397 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.129

398 Public Accounts and Estimates Committee, *Report on the 2013-14 Budget Estimates – Part Two*, October 2013, Recommendation 38, p.173

399 Department of Treasury and Finance, ‘State Capital Program’, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/State-capital-program>, accessed 21 July 2014

400 Budget Paper No.4, *2014-15 State Capital Program*, May 2014, p.137

APPENDICES TO CHAPTER 1

INTRODUCTION

Appendix A1.1 Return dates of the 2014-15 Budget Estimates Questionnaire (distributed 4 April 2014)

Department	Due date	Extension granted until	Received
Education and Early Childhood Development	7 May 2014	-	7 May 2014
Environment and Primary Industries	7 May 2014	-	8 May 2014
Health	7 May 2014	-	8 May 2014
Human Services	7 May 2014	-	9 May 2014
Justice	7 May 2014	-	8 May 2014
Premier and Cabinet	7 May 2014	-	7 May 2014
State Development, Business and Innovation	7 May 2014	-	7 May 2014
Transport, Planning and Local Infrastructure	7 May 2014	-	7 May 2014
Treasury and Finance	7 May 2014	-	8 May 2014
Parliamentary Departments	7 May 2014	-	1 May 2014

Source: Public Accounts and Estimates Committee

Appendix A1.2 Return dates of questions on notice from the 2014-15 budget estimates hearings (distributed 23 June 2014)

Portfolio	Due date	Extension granted until	Received
Aboriginal Affairs	14 July 2014	-	16 July 2014
Agriculture and Food Security	14 July 2014	-	15 July 2014
Assistant Treasurer	14 July 2014	-	14 July 2014
Attorney-General	14 July 2014	-	14 July 2014
Aviation	14 July 2014	-	11 July 2014
Bushfire Response	14 July 2014	-	8 July 2014
Children and Early Childhood Development	14 July 2014	-	14 July 2014
Community Services	14 July 2014	18 July 2014	16 July 2014
Employment and Trade	14 July 2014	-	14 July 2014
Energy and Resources	14 July 2014	-	14 July 2014
Environment and Climate Change	14 July 2014	-	14 July 2014
Health	14 July 2014	-	11 July 2014
Higher Education	14 July 2014	-	18 July 2014
Housing	14 July 2014	-	17 July 2014
Industrial Relations	14 July 2014	-	14 July 2014
Innovation	14 July 2014	-	14 July 2014
Local Government	14 July 2014	-	14 July 2014
Manufacturing	14 July 2014	-	14 July 2014

Portfolio	Due date	Extension granted until	Received
Multicultural Affairs and Citizenship	14 July 2014	-	14 July 2014
Parliamentary Departments	14 July 2014	-	14 July 2014
Planning	14 July 2014	17 July 2014	15 July 2014
Police and Emergency Services	14 July 2014	-	8 July 2014
Ports	14 July 2014	-	8 July 2014
Roads	14 July 2014	23 July 2014	22 July 2014
Small Business	14 July 2014	-	14 July 2014
Veterans' Affairs	14 July 2014	-	3 July 2014
Water	14 July 2014	-	15 July 2014
Youth Affairs	14 July 2014	-	18 July 2014

Source: Public Accounts and Estimates Committee

Appendix A1.3 Return dates of clarification questions from the 2014-15 budget estimates questionnaire (distributed 20 June 2014)

Department	Due date	Extension granted until	Received
Environment and Primary Industries	11 July 2014	-	17 July 2014
Health	11 July 2014	-	11 July 2014
Human Services	11 July 2014	18 July 2014	16 July 2014
Premier and Cabinet	11 July 2014	18 July 2014	16 July 2014
Treasury and Finance	11 July 2014	-	14 July 2014

Source: Public Accounts and Estimates Committee

APPENDICES TO CHAPTER 4: BORROWINGS, DEBT AND LIABILITIES

Appendix A4.1 Estimated net debt by main PNFC entity, as at 30 June, 2014 to 2018^(a)

	2014 revised estimate	2015 Budget	2016 estimate	2017 estimate	2018 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Melbourne Water Corporation	8,329	8,510	8,533	8,533	8,573
Yarra Valley Water Corporation	1,972	2,169	2,335	2,498	2,661
South East Water Corporation	1,181	1,353	1,487	1,605	1,715
City West Water Corporation	1,033	1,176	1,259	1,372	1,479
Barwon Region Water Corporation	590	606	629	631	622
Coliban Region Water Corporation	458	473	493	506	504
Victorian Rail Track	827	738	646	554	475
Urban Renewal Authority Victoria (Places Victoria)	345	349	333	284	232
TOTAL FOR ENTITIES OTHER THAN PORT OF MELBOURNE CORPORATION	14,735	15,374	15,715	15,983	16,261
Port of Melbourne Corporation	417	799	915	-	-
TOTAL NET DEBT, MAIN PNFC ENTITIES	15,152	16,173	16,630	15,983	16,261
PNFC TOTAL NET DEBT	15,375	16,626	16,408	17,047	17,329

(a) Data presented to the Committee without decimal places.

Sources: Department of Treasury and Finance, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.33; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.45

Appendix A4.2 Changes in net debt: sources and uses for cash, 2011-12 to 2017-18

	2011-12 actual	2012-13 actual	2013-14 revised estimate	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Net result from transactions	571.2	316.4	934.7	1,326.7	3,030.0	3,183.2	3,329.7
Depreciation and similar	2,186.3	1,375.9	2,348.0	2,512.7	2,643.5	2,527.3	2,727.3
Proceeds from asset sales	167.1	248.0	304.2	384.9	363.8	467.8	399.9
TOTAL SOURCES OF CASH	2,924.6	1,940.3	3,586.9	4,224.3	6,037.3	6,178.3	6,456.9
Direct asset investment	3,564.9	4,133.2	3,964.0	5,312.4	4,727.5	5,705.6	4,849.8
Asset investment through other sectors	1,831.1	1,316.8	1,188.8	676.8	-5,003.8	-190.3	183.2
Asset expenditure contingencies	-	-	-	-	300.0	400.0	1,000.0
TOTAL INFRASTRUCTURE INVESTMENT	5,396.0	5,450.0	5,152.8	5,989.2	23.7	5,915.3	6,033.0
TOTAL NET INVESTMENT IN FIXED ASSETS^(a)	5,228.9	5,202.0	4,848.6	5,604.3	-340.0	4,447.6	5,633.1
Finance leases	916.0	1,064.8	111.0	36.4	1,050.4	793.3	892.6
Other investment activities (net)	12.7	10.7	16.0	51.7	57.6	29.4	34.0
TOTAL FINANCE LEASES AND OTHER	928.7	1,075.5	127.0	88.1	1,108.0	822.7	926.6
DECREASE/(INCREASE) IN NET DEBT	-3,400.1	-4,585.2	-1,692.9	-1,853.0	4,905.4	-559.8	-502.7

(a) Infrastructure investment less proceeds from asset sales

Sources: Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.62; Department of Treasury and Finance, 2011-12 Financial Report, October 2012, pp.12, 30

Appendix A4.3 Comparison to previous estimates

Appendix A4.3.1 General government sector net debt, comparison with previous forward estimates, as at 30 June, 2014 to 2018

	2014 revised estimate	2015 Budget	2016 estimate	2017 estimate	2018 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
2011-12 Budget	21,989.1	23,153.2	-	-	-
2012-13 Budget	23,122.1	23,790.5	23,695.8	-	-
2013-14 Budget	22,983.1	25,052.6	24,385.3	22,695.6	-
2013-14 Budget Update	22,702.9	24,782.3	23,893.2	22,793.8	-
2014-15 Budget	21,515.0	23,368.0	18,462.5	19,022.4	19,525.1

Sources: Budget Paper No.5, 2011-12 Statement of Finances, May 2011, p.10; Budget Paper No.5, 2012-13 Statement of Finances, May 2012, p.7; Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.7; Department of Treasury and Finance, 2013-14 Victorian Budget Update, December 2013, p.55; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.7

Appendix A4.3.2 General government sector borrowings, comparison with previous forward estimates, as at 30 June, 2014 to 2018

	2014 revised estimate	2015 Budget	2016 estimate	2017 estimate	2018 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
2011-12 Budget	32,195.8	33,676.9	-	-	-
2012-13 Budget	34,588.5	35,707.2	36,115.5	-	-
2013-14 Budget	34,824.6	37,132.1	36,773.3	35,474.8	-
2013-14 Budget Update	34,250.7	36,573.9	36,050.0	35,371.2	-
2014-15 Budget	33,132.1	35,111.8	30,540.9	31,509.7	32,420.9

Sources: Budget Paper No.5, 2011-12 Statement of Finances, May 2011, p.10; Budget Paper No.5, 2012-13 Statement of Finances, May 2012, p.7; Budget Paper No.5, 2013-14 Statement of Finances, May 2013, p.7; Department of Treasury and Finance, 2013-14 Victorian Budget Update, December 2013, p.55; Budget Paper No.5, 2014-15 Statement of Finances, May 2014, p.7

Appendix A4.3.3 General government sector net debt as a proportion of gross state product, comparison with previous forward estimates, as at 30 June, 2014 to 2018

	2014 revised estimate	2015 Budget	2016 estimate	2017 estimate	2018 estimate
	(per cent)	(per cent)	(per cent)	(per cent)	(per cent)
2011-12 Budget	5.9	5.9	-	-	-
2012-13 Budget	6.5	6.3	6.0	-	-
2013-14 Budget	6.4	6.6	6.1	5.4	-
2013-14 Budget Update	6.4	6.7	6.1	5.6	-
2014-15 Budget	6.1	6.3	4.7	4.6	4.5

Sources: Budget Paper No.2, 2011-12 Strategy and Outlook, May 2011, p.22; Budget Paper No.2, 2012-13 Strategy and Outlook, May 2012, p.37; Budget Paper No.2, 2013-14 Strategy and Outlook, May 2013, p.44; Department of Treasury and Finance, 2013-14 Victorian Budget Update, December 2013, p.16; Budget Paper No.2, 2014-15 Strategy and Outlook, May 2014, p.48

APPENDICES TO CHAPTER 5 OUTPUT EXPENDITURE

Appendix A5.1 Components of expenditure, 2008-09 to 2017-18

	2008-09 actual	2009-10 actual	2010-11 actual	2011-12 actual	2012-13 actual	2013-14 revised estimate	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Employee expenses	14,296.9	15,404.8	16,374.8	17,120.1	17,788.5	18,106.5	18,442.3	19,425.5	20,057.5	20,874.5
Superannuation expenses ^(a)	2,013.9	2,394.5	2,627.2	2,632.5	2,370.2	2,875.5	2,887.5	2,908.0	2,914.3	2,907.1
Depreciation	1,515.8	1,869.7	2,010.0	2,126.5	2,254.3	2,418.1	2,496.0	2,605.5	2,782.9	2,999.2
Interest expense	642.4	843.3	985.6	1,242.6	1,775.3	2,171.5	2,195.8	2,086.2	2,063.7	2,123.9
Grants and other transfers	7,366.3	9,174.5	8,547.4	8,233.8	8,013.9	7,899.5	8,294.3	8,510.7	8,911.4	9,108.1
Other operating expenses	13,198.4	14,254.9	14,964.6	15,955.6	16,094.1	16,687.8	17,259.2	16,414.0	16,851.0	17,652.0
TOTAL EXPENSES	39,033.7	43,941.7	45,509.6	47,311.0	48,296.4	50,158.8	51,575.1	51,950.0	53,580.8	55,664.9

(a) Made up of 'net superannuation interest expense' and 'other superannuation'.

Source: Department of Treasury and Finance, 'Consolidated Comprehensive Operating Statement' data set, <www.dtf.vic.gov.au/files/54ee3d1c-75a4-4a9a-9a62-a32300b1b8f6/Consolidated-GG-Comprehensive-Operating-Statement-Budget-2014-15.xls>, accessed 18 June 2014

Appendix A5.2 New output initiatives, 2014-15 and 2017-18

Department	2014-15	2015-16	2016-17	2017-18
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
Education and Early Childhood Development	430.0	524.3	500.2	514.6
Environment and Primary Industries	33.0	13.2	10.4	9.7
Health	330.2	275.9	286.4	293.9
Human Services	91.7	95.8	91.5	88.5
Justice	99.7	97.1	96.6	99.5
Premier and Cabinet	19.0	9.3	12.1	3.6
State Development, Business and Innovation	60.6	45.9	69.5	66.9
Transport, Planning and Local Infrastructure	169.1	232.3	216.9	210.6
Treasury and Finance	1.8	-	-	-
Courts	0.5	1.5	2.5	2.6
Parliament	1.0	1.3	0.4	0.2

Source: Budget Paper No.3, 2014-15 Service Delivery, May 2014, Chapter 1

APPENDIX TO CHAPTER 6 ASSET INVESTMENT

Appendix A6.1 Asset investment, 2008-09 to 2017-18

	2008-09 actual	2009-10 actual	2010-11 actual	2011-12 actual	2012-13 actual	2013-14 revised estimate	2014-15 Budget	2015-16 estimate	2016-17 estimate	2017-18 estimate
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)
GENERAL GOVERNMENT SECTOR:										
• Purchases of non-financial assets	3,146.8	4,661.2	4,886.3	3,564.9	4,133.2	3,964.0	5,312.4	5,027.5	6,105.6	5,849.8
• Sales of non-financial assets	-268.2	-187.4	-184.3	-167.1	-248.0	-304.2	-384.9	-363.8	-467.8	-399.9
Net purchases of non-financial assets	2,878.6	4,473.9	4,702.1	3,397.9	3,885.2	3,659.9	4,927.5	4,663.7	5,637.9	5,449.9
Net cash flows from investments in financial assets for policy purposes										
	1,168.5	1,236.6	1,937.5	1,831.1	1,316.8	1,188.8	676.8	-5,003.8	-190.3	183.2
PPP infrastructure investment	undisclosed	undisclosed	undisclosed	496.1	238.7	334.0	1,854.0	undisclosed	968.0	808.0
Government Infrastructure Investment (net of selected Commonwealth stimulus payments)	4,458.3	5,289.4	5,783.2	5,380.7	5,423.7	5,182.8	7,458.8	7,076.0	6,415.3	6,441.3
OTHER SECTORS: NET PURCHASES OF NON-FINANCIAL ASSETS:										
• Public non-financial corporations sector	4,150.1	4,133.5	4,245.0	3,768.2	3,546.1	3,325.4	3,249.8	-3,623.0	1,823.0	1,861.2
• Public financial corporations sector	60.9	17.1	47.5	56.0	74.4	74.5	64.4	57.1	63.5	65.5
• Public sector as a whole	7,089.6	8,624.5	8,994.5	7,222.0	7,191.5	7,038.4	8,273.1	948.9	7,674.8	7,370.2

Sources: Annual Financial Reports, 2008-09 to 2012-13; Budget Paper No. 5, 2014-15 Statement of Finances, May 2014, pp.46, 62, 70; Department of Treasury and Finance, 'Consolidated Cash Flow Statement' data set, <www.dtf.vic.gov.au/files/970878d-6893-4047-8281-a3230061b8d5/Consolidated4GG-Cash-Flow-Statement-Budget-2014-15.xls>, accessed 26 June 2014; Department of Treasury and Finance, 'Other Financial Aggregates: Net Infrastructure Investment' data set, <www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Other-financial-aggregates>, accessed 8 July 2014; Hon. M. O'Brien MP, Treasurer, 2013-14 budget estimates hearings, response to questions on notice, received 9 July 2013; Department of Treasury and Finance, response to the Committee's 2014-15 Budget Estimates Questionnaire, received 8 May 2014, p.21; 2014-15 Budget Information Paper, *Infrastructure Investment*, May 2014, p.3

