

CHAPTER 3 – BUDGET POSITION AND OUTLOOK

- The *2009-10 Budget* confirms Victoria's strong fiscal position, despite the substantial adverse impact of the economic downturn.
- The Government is meeting its revised budget objective of an operating surplus (net result from transactions-operating balance) of at least \$100 million over the forward estimates. The operating surplus is expected to be \$165 million in 2009-10 and an average of \$349 million a year over the forward estimates period.
- The Victorian budget has been able to meet the challenges of the Global Financial Crisis, significant reductions in taxation and GST revenue, and the financial impact of helping communities affected by the 2009 Victorian bushfires. Since the *2008-09 Budget*, GST and taxation revenue has been revised downwards by almost \$8 billion over the four years to 2011-12.
- The Government is responding to the current economic downturn by investing for the future and securing jobs. Net infrastructure investment to provide quality transport, education, health and housing services, and to improve long-term economic potential, is projected to be a record \$7 billion in 2009-10 and projected to average \$4.4 billion a year over the forward estimates.
- The Commonwealth Government has also responded with their \$42 billion *Nation Building – Economic Stimulus Plan*, of which Victoria will share in around \$5 billion, which aims to stimulate the economy and contribute towards Victoria making a good recovery from the economic downturn.
- Reflecting this substantial infrastructure program, general government net debt is projected to be 1.9 per cent of gross state product (GSP) by 30 June 2009 and to increase to 5.1 per cent of GSP by 30 June 2013. The Government is committed to maintaining the State's triple-A credit rating by constraining expenditure growth, maintaining an operating surplus and maintaining debt at prudent levels.

BUDGET ESTIMATES AND OUTLOOK

This chapter provides an overview of the budget position for the period 2009-10 to 2012-13 for the general government (GG) sector.

The budget and forward estimates are based on the economic projections outlined in Chapter 2, *Economic Conditions and Outlook*, and reflect the accounting policies and assumptions documented in Budget Paper No. 4, Chapter 1, *Estimated Financial Statements and Notes*.

Unless otherwise stated, the estimates take into account the financial impacts of all policy decisions taken by the Victorian Government, as well as Commonwealth funding revisions and other information that affects the projected general government sector financial statements as at 29 April 2009. Specific policy decisions that have been made since the *2008-09 Budget* and which affect the budget position have been summarised in Budget Paper No. 3, Appendix A, *Output, Asset Investment and Revenue Initiatives*.

The *2009-10 Budget* and forward estimates years, 2010-11 to 2012-13, represent planning projections based on unchanged policy and other assumptions throughout the forecast period. Outcomes will differ from these projections for many reasons, including any materialisation of risks, such as the impact of changed economic conditions as described in Chapter 2, *Economic Conditions and Outlook* and the sensitivity of the budget to these risks as noted in Appendix B, *Sensitivity Analysis Table*.

FISCAL OVERVIEW

The Government has maintained a strong fiscal position despite significant economic and fiscal challenges that have arisen during 2008-09. The strong operating statement and balance sheet, coupled with the State's existing triple-A credit rating, have positioned the Government to expand investment in key infrastructure, to provide quality transport, education, health and housing services, and to improve productivity in the economy.

As shown in Table 3.1, the Government is budgeting to achieve an operating surplus of \$165 million in 2009-10. Over the three years to 2012-13, operating surpluses are projected to average \$349 million a year. This outcome is consistent with the Government's broader strategy to position the Victorian economy to withstand current and future risks associated with the Global Financial Crisis. This outcome also delivers on the Government's short-term objective of a budget operating surplus of \$100 million or more per year. In the long term, the Government is committed to maintaining a budgeted operating surplus to provide the framework to deliver its infrastructure program and maintain high quality services, while retaining the triple-A credit rating.

Compared with the estimates published in the *2008-09 Budget Update*, the operating surplus is expected to be \$247 million lower in 2009-10 and \$246 million a year lower on average from 2010-11 to 2011-12. Although economic growth is expected to be significantly lower and economic conditions have worsened, revenue has been revised upwards since the *2008-09 Budget Update*. This primarily reflects payments from the Commonwealth for specific purposes associated with the *Nation Building – Economic Stimulus Plan*, partly offset by substantial reductions in GST revenue and State taxation revenue.

As shown in Table 3.1 and Chart 3.1, growth in revenue and expenses is similar in 2009-10 and 2010-11, but expenditure grows more slowly than revenue during the last two forward estimates years. This reflects the Government's prudent management of operating expenditure in a slower revenue growth environment. Revenue and expenses are both projected to grow by 8.3 per cent in 2009-10, largely due to the effect of fiscal stimulus payments from the Commonwealth, new policy announcements in this Budget, and general wages growth in line with the Government's wages policy. Total revenue is estimated to increase by 1.6 per cent a year on average over the forward estimates period, compared with growth of 1.3 per cent a year on average in total expenses.

Table 3.1: Net result from transactions 2009-10 to 2012-13^(a)

	(\$ million)			
	2009-10 Budget	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate
Revenue				
Taxation	13 273.7	13 987.7	14 439.4	14 951.0
Dividends, TER and interest ^(b)	813.5	962.7	1 249.3	1 076.2
Sales of goods and services	5 044.1	5 294.3	5 487.4	5 599.6
Grants	21 554.1	20 733.9	20 559.2	21 238.7
Other current revenue	1 702.9	1 623.4	1 534.1	1 524.5
Total revenue	42 388.3	42 602.1	43 269.3	44 390.0
% change	8.3%	0.5%	1.6%	2.6%
Expenses				
Employee expenses	15 276.5	15 925.5	16 629.4	17 247.1
Superannuation ^(c)	2 258.4	2 339.1	2 389.4	2 491.9
Depreciation	1 646.4	1 785.8	1 931.1	2 014.3
Interest expense	713.8	959.9	1 106.9	1 136.2
Other operating expenses	13 885.7	13 779.4	13 775.6	13 855.4
Grants and other transfers	8 442.3	7 617.0	7 146.6	7 083.0
Total expenses	42 223.2	42 406.8	42 979.1	43 827.9
% change	8.3%	0.4%	1.3%	2.0%
Net result from transactions	165.1	195.3	290.3	562.1
Total other economic flows included in net result	77.6	102.3	109.6	103.0
Net result	242.8	297.5	399.9	665.1

Source: Department of Treasury and Finance

Notes:

- (a) This is an abbreviated operating statement. The full statement is shown in Budget Paper No. 4, Chapter 1, Estimated Financial Statements and Notes, and provides additional information on economic flow measurements which, when added to the net result from transactions, yields the net result.
- (b) Comprises dividends, income tax and rate equivalent revenue and interest.
- (c) Comprises superannuation interest expense and other superannuation expenses.

Alternative measures of operating performance

In addition to the operating surplus, the Government uses other financial results to measure its performance. Table 3.2 below presents these alternative measures.

Table 3.2: Summary of alternative measures of financial performance

	(\$ million)			
	2009-10	2010-11	2011-12	2012-13
	Budget	Estimate	Estimate	Estimate
Net result from transactions (net operating balance) ^(a)	165.1	195.3	290.3	562.1
Net lending/(borrowing) ^(b)	(3 325.3)	(2 604.8)	(2 198.9)	(298.0)
Net result	242.8	297.5	399.9	665.1
Cash surplus/(deficit) ^(c)	(2 694.4)	(2 051.4)	(893.9)	4.1

Source: Department of Treasury and Finance

Notes:

- (a) *Net result from transactions or net operating balance is a key fiscal aggregate and is revenue from transactions minus expenses from transactions. It excludes gains and losses resulting from changes in price levels and other changes in the volume of assets.*
- (b) *The financing requirement of government, calculated as the net operating balance less the net acquisition of non-financial assets. A positive result reflects a net lending position and a negative result reflects a net borrowing position.*
- (c) *Cash surplus/(deficit) equals the net cash flows from operating activities less investments in non-financial assets.*

In summary, these measures of operating performance show that Victoria's financial performance remains strong over the forward estimates period, despite the impact of the economic downturn.

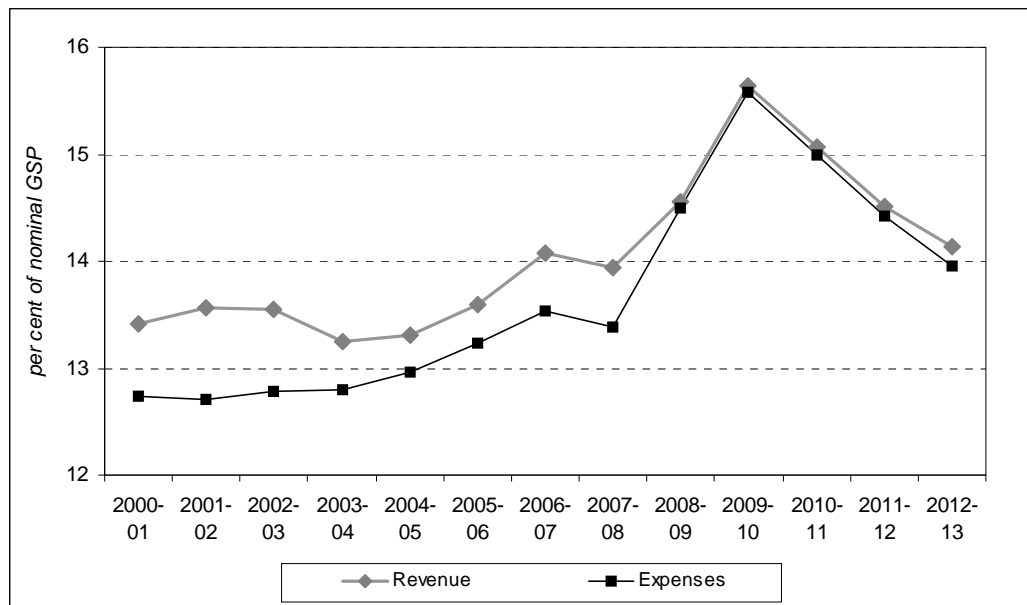
In particular, the net operating balance (equivalent to the net result from transactions) which is now the basis for measuring the budget estimates on an accrual basis in all Australian states and the Commonwealth, providing comparability with these jurisdictions, remains in surplus throughout the period.

The Government is borrowing \$3.3 billion in 2009-10 and an average \$1.7 billion a year over the forward estimates period, in order to support the implementation of the Government's infrastructure program.

The net result for the 2009-10 Budget is \$243 million and an average of \$454 million per year over the forward estimate period. The net result is obtained by adding various revaluation gains and losses on assets and liabilities, such as those arising from movements in market prices, or the disposal of physical assets, to the net result from transactions.

The Government will be in a net cash deficit position between 2009-10 and 2011-12, reflecting the phasing of the Government's significant infrastructure program. A return to cash surplus is expected in 2012-13 as the infrastructure program returns to lower levels and as the net result from transactions improves.

Chart 3.1: Revenue and expenses relative to nominal GSP



Source: Department of Treasury and Finance

OPERATING STATEMENT ANALYSIS

Revenue

Total revenue is forecast to increase by \$1.3 billion, or 3.2 per cent, a year on average over the budget and forward estimates period. Compared with the estimates published in the *2008-09 Budget Update*, total revenue is forecast to be \$2.9 billion higher in 2009-10, and \$1.1 billion a year higher on average over the period 2010-11 to 2011-12.

The revenue forecasts are affected by higher Commonwealth grants for specific purposes, including the Commonwealth's *Nation Building – Economic Stimulus Plan*, which has significantly boosted revenues over the forward estimates period, partly offset by significant reductions to the GST grants received from the Commonwealth and State taxation revenue. Since the *2008-09 Budget*, GST and taxation revenue has been revised downwards by almost \$8 billion over the four years to 2011-12.

Grants

Grants revenue received by the State has been affected by significant changes in the framework for Commonwealth State financial relations, which came into effect on 1 January 2009. The new framework, agreed by the Council of Australian Governments (COAG), is designed to improve the quality and effectiveness of government services by reducing Commonwealth prescriptions on service delivery by the States, and providing increased flexibility in the way services are delivered.

In particular, there has been a major rationalisation in the number of specific purpose payments (SPPs) to the States from the Commonwealth, with the creation of five new broad SPPs: health, education, skills, affordable housing and disabilities. Another new form of funding, National Partnerships (NP) payments, has also been created. These will fund specific projects and have been established to facilitate and/or reward states that deliver nationally significant reforms. Victoria will continue to work cooperatively with the Commonwealth Government on projects funded through its fiscal stimulus package and through the COAG process.

Grants, mainly from the Commonwealth, represent the largest source of revenue, accounting for \$21.6 billion (or 51 per cent) of total revenue in 2009-10. Grants are expected to increase by 14.7 per cent between 2008-09 and 2009-10, and then stabilise over the next three years. This primarily reflects:

- an average annual increase over the forward estimates period in GST grant revenue of 6.5 per cent. Since the *2008-09 Budget* there has been a downward revision to GST grants averaging \$1.6 billion a year between 2009-10 and 2011-12. Victoria's share of the GST pool is expected to increase based on a projection of Victoria's assessed relativities and population share;
- additional funding of approximately \$1.7 billion over five years to 2012-13 for the five new broadbanded Specific Purpose Payments in the areas of healthcare, schools, skills, affordable housing and disabilities;
- new funding associated with the creation of a new payment stream for National Partnerships (NP) to drive national economic and social reforms; and
- approximately \$5 billion from 2009-10 to 2011-12 for the *Nation Building – Economic Stimulus Plan* for timely economic stimulus aimed at improved nation building and supporting economic growth and jobs.

Taxation Revenue

Taxation is forecast to be \$13.3 billion (or around 31 per cent) of general government revenue in 2009-10.

Growth in taxation revenue is expected to be adversely affected by the slowdown in economic growth and inflation in 2009-10. In particular, payroll tax revenue is expected to grow by 1.5 per cent, as wages growth is partially offset by lower employment. Gambling revenue is expected to grow by only 1.0 per cent reflecting subdued household consumption. However, revenue will be supported by an expected rebound in stamp duty on land transfer revenue through the course of 2009-10 in response to historically low mortgage interest rates. The introduction of the Growth Areas Infrastructure Contribution, increased motor vehicle registration fees in line with population growth and CPI, as well as other factors such as the impact of rising insurance premiums on insurance taxation revenue will also contribute to taxation revenue growth in 2009-10.

Taxation revenue is expected to grow, on average, by 4.0 per cent a year over the forward estimates period, reflecting the following factors:

- payroll tax revenue is projected to grow by 5.0 per cent a year on average, reflecting a recovery in employment beginning in 2010-11 and continuing wages growth;
- stamp duty on land transfer revenue is projected to increase by 5.5 per cent a year. The strongest growth in land transfer duty will occur in 2010-11 as the full impact of current low interest rates work their way through the property market and as the economy recovers. The prospective recovery in economic growth will support land transfer duty from 2011-12, although this is expected to be moderated by a return to more normal levels of interest rates;
- growth (on average) in land tax revenue of 0.9 per cent a year, reflecting expectations of only modest growth in land valuations over the forward estimates period, offset by the ongoing disaggregation of land holdings which reduces the land tax base;
- revenue from gambling taxes is projected to increase by an average of 2.3 per cent a year, principally reflecting expected growth in consumer spending, partially offset by the impact of changes to racing tax arrangements which are to apply post 2012; and
- motor vehicle and insurance tax revenue are expected to increase by an average of 4.9 per cent and 4.6 per cent respectively, consistent with expected inflation and economic activity.

Dividends, income tax and rate equivalent, and interest revenue

This category of revenue comprises dividends, income tax and rate equivalent revenue received by the state from government business enterprises, and interest revenue. Dividend, income tax and rate equivalent and interest revenue is projected to be \$814 million in 2009-10 and is expected to increase to \$1.2 billion in 2011-12 and declining slightly in 2012-13.

Income tax and rate equivalent (ITE) revenue is expected to show a rising trend over the forward estimates period, underpinned by an expected improvement in the profitability of the water sector. ITEs from the Public Financial Corporation (PFC) sector have been significantly reduced due to the impact of the Global Financial Crises on expected profitability.

Dividend income is projected to increase to \$645 million by 2011-12, before falling to \$430 million by 2012-13. The increase to 2011-12 reflects growth in both the Public Non-Financial Corporation (PNFC) and PFC sector. Dividends from the PNFC and PFC sectors over the forward estimates period are expected to increase in line with the expected recovery from the current economic downturn.

In calculating income tax equivalents and dividends for PFCs that hold financial assets, an assumption is made that investment earnings from 2009-10 will revert to the long-term average. This assumption affects the profile of expected revenue over the forward estimates period. However, declines in financial markets have resulted in carry forward losses for the Transport Accident Commission (TAC) and Victorian WorkCover Authority (VWA) and no income tax equivalent revenue is expected to be payable during the forward estimates period from these agencies.

Other revenue

Together, grants, taxation revenue, dividends, income tax equivalent and interest are estimated to account for approximately 84 per cent of Victoria's revenue in 2009-10. The remainder is made up of sales of goods and services and other income including fines and regulatory fees. Combined, revenue from sales of goods and services and other current revenue are estimated to increase by 1.3 per cent a year on average between 2009-10 and 2012-13.

Further information on Victoria's revenue sources can be found in Budget Paper No. 4, Chapter 4, *State Revenue*, with detailed analysis and explanations of the differences between the forecast for 2009-10 to 2011-12 at the time of the *2008-09 Budget Update* and the revised forecast provided in Appendix A, *Operating Statement Analysis*.

Expenses

The *2009-10 Budget* builds on previous budgets by improving core service delivery in transport, education and health, by acting to secure jobs, by fostering innovation in science and technology, and assisting Victorians affected by the 2009 Victorian bushfires. However, the Government will also continue to focus on managing underlying expenditure growth during this period of slower revenue growth, through implementation of the new wages policy and constraining non-wage operating costs.

Total expenses from transactions are forecast to be \$42.2 billion in 2009-10. Compared with the estimates published in the *2008-09 Budget Update*, total expenses are forecast to be \$3.2 billion higher in 2009-10, and \$1.4 billion a year higher on average over the period 2010-11 to 2011-12.

Employee expenses

Employee expenses (including superannuation) are forecast to be \$17.5 billion in 2009-10. Growth in employee expenses over the forward estimates period is expected to average \$735 million, or 4 per cent, a year which is consistent with historical growth, and lower than the growth in employee expenses expected at *2008-09 Budget Update* (6.1 per cent a year on average).

In April 2009, the Government announced it would be securing and preserving jobs in the public sector through a new wages policy. In response to lower inflation forecasts, the Government announced that the 3.25 per cent a year guideline rate a year for Enterprise Bargaining Agreements would drop to 2.5 per cent, with the opportunity for further increases in line with productivity increases. This revised guideline rate for wage increases is reflected in the forward estimates as lower costs of employee expenses compared to those in the *2008-09 Budget Update*.

The year on year growth primarily reflects the outcome of appropriately remunerating front line staff, as well as output policy initiatives, including *2009-10 Budget* initiatives. The increased Commonwealth specific purpose payments discussed previously also have corresponding expenditure that contributes to the growth in services. These additional services will be delivered by additional staff and will contribute to growth in employee expenses over the forward estimates period.

Expenditure associated with own source revenue by general government (GG) entities such as schools, TAFEs and hospitals is expected to increase in line with the associated increase in revenue.

Other operating expenses

Other operating expenses, which include purchases of supplies and services, maintenance expenses, and operating lease payments, are forecast to be \$13.9 billion in 2009-10, representing 33 per cent of total expenditure.

These expenses are projected to decrease by an average of \$10 million (or less than 1 per cent) a year across the forward estimates. This change mainly reflects the Government's policy initiatives including those announced in the *2008-09 Budget Update* and *2009-10 Budget*, and increases relating to flow-on expense impacts of increased Commonwealth specific purpose payments and expenditure associated with own source revenue by entities such as schools, TAFEs and hospitals.

In line with lower inflation expectations, the Government will also revise the existing departmental funding and price review models used to inform the appropriate level of funding for non-wage costs from 2010-11 onwards. Together the changes to how wage and non wage costs are funded will allow the Government to manage underlying expenditure growth while supporting the government's commitment to maintaining real wages and its pledge to protect public sector jobs.

Grants and other transfers

Grants and other transfers, which represent 20 per cent of total expenses, are forecast to increase by 17 per cent between 2008-09 and 2009-10 to \$8.4 billion. The level of grants and other transfers is expected to decrease back to 2008-09 levels by 2012-13.

This trend primarily reflects the pattern of fiscal stimulus payments received from the Commonwealth for on passing as grants to schools and for housing to be delivered by the PNFC sector.

Depreciation expense

Depreciation expense is projected to be \$1.6 billion in 2009-10 and to grow by 7 per cent a year on average over the forward estimates period. This reflects the Government's investment in infrastructure and forecast revaluations of existing assets.

Interest expense

Interest expense is estimated to grow in line with the anticipated increase in borrowings that is being used to fund the Government's infrastructure program. The growth of the interest expense is expected to moderate in line with the completion of the infrastructure program.

New output initiatives by department

Table 3.3 shows the budget impact of the new output initiatives which will be implemented in order to deliver the Government's policy objectives for the *2009-10 Budget*. These new initiatives have a net impact of \$689 million in 2009-10 and an average of \$220 million a year from 2010-11 to 2012-13. This is in addition to the net impact of \$46 million a year on average from 2009-10 to 2011-12 from *2008-09 Budget Update* output initiatives.

Table 3.3: Net impact of 2009-10 Budget new output initiatives^(a)

(\$ million)

	2009-10 Budget	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate
Education and Early Childhood Development ^(b)	382.4	377.6	408.5	429.2
Human Services ^(c)	575.8	508.7	528.4	545.8
Innovation, Industry and Regional Development	88.5	54.9	37.9	15.5
Justice	118.9	96.4	84.4	78.7
Planning and Community Development	60.0	44.6	31.9	24.7
Premier and Cabinet	13.1	21.2	18.6	19.1
Primary Industries	5.4	4.3	4.1	4.4
Sustainability and Environment	4.1	12.2	15.5	16.3
Transport	98.4	87.4	130.1	152.1
Treasury and Finance	141.8	47.1	14.1	10.6
Parliament	1.3	..	..	..
Government-wide	203.5	91.9	86.1	57.2
Total 2009-10 Budget output funding	1693.2	1346.2	1359.6	1353.5
Less funding from demand contingency and other efficiencies	1004.2	1121.3	1219.7	1059.4
Net impact of 2009-10 Budget output funding	689.1	224.9	139.9	294.2
Add: 2008-09 Budget Update net output funding ^(d)	64.4	56.2	17.8	na
Net budget impact of output funding since 2008-09 Budget	753.4	281.0	157.7	294.2

Source: Department of Treasury and Finance

Notes:

- (a) These numbers show the net impact on the general government sector net result from transactions and differ from Budget Paper No.3, Appendix A, as amounts funded from internal reprioritisation or other existing sources have been deducted from the figures above.
- (b) Variance is attributable to three main factors:
- (i) the impact of an output price review;
 - (ii) initiatives funded from within the 2009-10 Budget;
 - (iii) additional supplementation funded by the Commonwealth and price escalation for anticipated cost increase in 2009-10.
- (c) Output price increases arise from initiatives funded within the 2009-10 Budget, additional supplementation provided by the Commonwealth, an output price review and price escalation for anticipated cost increases in 2009-10.
- (d) Net impact of 2008-09 Budget Update output initiatives is net of funding from demand contingency and other efficiencies.

Budget Paper No. 3, Chapter 1, *Service and Budget Initiatives*, provides more detail on the Government's service delivery and strategy, while Budget Paper No.3, Appendix A, *Output, Asset Investment and Revenue Initiatives*, provides a detailed list and description of all service delivery initiatives announced in this budget.

Other economic flows

Differences between the net result from transactions and the net result are due to other economic flows. This includes actuarial adjustments arising from movements in market prices, gains and losses on the disposal of physical assets and provisions for doubtful debts.

Total other economic flows included in the net result from 2009-10 to 2012-13 primarily relate to the sale of non-financial assets such as land and property, plant and equipment, in particular the estimated revenue in the forward estimates from the sale of surplus government land including crown land.

FISCAL RISKS

Economic risks are outlined in Chapter 2, *Economic Conditions and Outlook*. In addition to these risks, the Government's projected financial performance may also be affected by specific major revenue and/or expenditure risks outlined below.

Revenue risks

Commonwealth grants

Commonwealth grants are a major source of revenue for the Victorian Government with estimated grants income of approximately \$21.4 billion in 2009-10. Commonwealth grants include general purpose grants (GST grants), specific purpose payments (SPPs) and National Partnership agreement payments (NPs).

A new framework for Commonwealth grants, agreed by COAG, came into effect on 1 January 2009, and is designed to improve the quality and effectiveness of government services by reducing Commonwealth prescriptions on service delivery by the states, and providing increased flexibility in the way services are delivered. The number of SPPs to the states from the Commonwealth was rationalised from over 90 to five. These five new, broad-based SPPs are in the areas of health, education, skills, affordable housing and disability services. Another new form of funding, called National Partnerships (NP) payments, have also been phased in to fund specific projects and to facilitate and/or reward states that deliver nationally significant reforms.

The level of GST grants is affected by the general level of activity in the Australian economy and the GST revenue sharing relativities calculated by the Commonwealth Grants Commission (CGC). The CGC provides updates of its GST revenue sharing relativities in February each year. These are then subject to the approval of the Commonwealth Treasurer. Any changes to economic conditions will have a direct impact on the amount of GST revenue to be distributed among the states.

Commonwealth grants revenue estimates represent the latest information available to the Victorian Government at the time of finalisation of the *2009-10 Budget*.

Taxation revenue

The State's tax revenues are, for the most part, forecast on an assumed or estimated relationship between taxation revenue and projected economic variables. As a result, there are two main sources of risk to the taxation estimates. Firstly, changes in economic conditions from those projected will affect taxation revenue. For example, higher than expected economic activity or inflation will tend to lead to higher taxation revenue. This risk is quantified in Appendix B, *Sensitivity Analysis Table*. Secondly there is a risk of changes in the relationship between the economic variables and taxation revenue.

Moreover, some state taxes, such as stamp duty on land transfer, are sourced from tax bases which are particularly volatile and revenue from these sources may be subject to substantial annual variation.

Expenditure risks

General expenditure risks, such as unforeseen changes in the size and structure of the Victorian population, can be broadly classified into those affecting all government departments and those that are department specific.

The main risks to specific departmental expenditures relate to growth in the demand for government services, government commitments contingent on external factors, and government responses to unforeseen events such as natural disasters and bushfires.

The *2009-10 Budget* estimates include a contingency provision to allow for the likelihood that some expenditure risks will eventuate during the budget year or during the forward estimates period. The contingency includes a provision for:

- changes to the growth and composition of Victoria's population, and consequent derived demand for government services;
- an allowance for depreciation expenditure associated with future infrastructure investment, which is funded from the capital provision approved but not yet allocated (subject to government approval); and
- other expenditure risks which were unforeseen or not quantifiable, or that were not formalised at the time of construction of the budget estimates.

In addition, the *2009-10 Budget* estimates include a contingency from 2010-11 that acknowledges funding for a number of existing programs that will conclude in 2009-10 or the following years. A provision is made on the basis that Government may endorse a number of these programs to continue or be replaced to meet service delivery priorities.

The inclusion of an operating contingency provision in the budget estimates mitigates the potential impact of expenditure risks on the overall budget position. Realised expenditure risks will only affect total expenditure, and consequently the annual budget position, to the extent that these cannot be accommodated within the contingency provision. The aggregate level of the contingency provision is shown in Table 3.1, Budget Paper No. 4, Chapter 3, *Departmental Financial Statements*.

Sensitivity analysis

In addition to the financial risks outlined above, Appendix B, *Sensitivity Analysis Table*, quantifies the impact on revenue, expenses and the net result from transactions associated with variations to forecasts of selected economic and financial variables.

USE OF CASH RESOURCES

The Government continues to invest in strategic infrastructure projects in order to secure jobs in the short-term and deliver world class infrastructure assets that increase the economic, social and environmental benefits for current and future generations.

These infrastructure projects offer longer-term returns to the Victorian economy, by maximising the State's economic potential and supporting sustainable long-term growth. The Government has used the *2009-10 Budget* to reiterate its commitment to infrastructure investment and ensure that Victoria is well positioned for the projected economic recovery.

Table 3.4 provides a summary of cash generated through the operations of Victorian Government departments and other general government sector agencies, and how that cash is applied to infrastructure investment, and the associated impact on net debt. Projected infrastructure spending also includes an approved capital provision that will be allocated to specific projects in future budgets.

Table 3.4: Application of cash resources

	(\$ million)				
	2008-09 Revised	2009-10 Budget	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate
Net result from transactions	163.0	165.1	195.3	290.3	562.1
Add back: Non-cash income and expenses (net) ^(a)	1 769.8	2 146.2	2 168.3	2 396.0	2 316.2
Net cash flow from operating activities	1 932.8	2 311.3	2 363.6	2 686.2	2 878.2
Less:					
Net investment in fixed assets					
Expenditure on approved projects	4 543.1	7 183.4	5 668.2	3 965.7	2 582.1
Capital provision approved but not yet allocated	..	..	262.8	555.0	845.0
Proceeds from asset sales	(190.5)	(222.8)	(228.3)	(261.5)	(252.4)
Total net investment in fixed assets	4 352.6	6 960.6	5 702.7	4 259.2	3 174.7
Finance leases ^(b)	..	74.7	121.0	840.1	..
Other investment activities (net)	664.6	(39.7)	(27.1)	(27.7)	(28.0)
Decrease/(increase) in net debt	(3 084.4)	(4 684.2)	(3 433.1)	(2 385.5)	(268.5)

Source: Department of Treasury and Finance

Notes:

- (a) Includes depreciation and movements in the unfunded superannuation liability and liability for employee benefits.
- (b) The finance leases in 2009-10 and 2010-11 is in relation to the Partnerships Victoria in Schools project and the finance lease recognised in 2011-12 is in relation to the redevelopment of the Royal Children's Hospital.

Table 3.5 provides reconciliation between the measure of infrastructure used by the Victorian Government and that used by the Australian Bureau of Statistics (ABS).

The Victorian Government measure of net investment in fixed assets is equal to the investment by the general government sector for fixed assets, including investment by PNFC's which is funded by the general government sector, less asset sales.

In contrast, the ABS measure of gross fixed capital formation excludes transfers to and from the PNFC sector, purchases and sales of non-produced assets, acquisitions under finance lease and assets given and received free of charge.

Table 3.5: Reconciliation between net infrastructure investment and gross fixed capital formation

	(\$ million)				
	2008-09 Revised	2009-10 Budget	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate
Net Investment in fixed assets	4 352.6	6 960.6	5 702.7	4 259.2	3 174.7
Add:					
Assets received free of charge	214.8	56.7	51.0	0.7	0.8
	4 567.4	7 017.4	5 753.7	4 260.0	3 175.5
Less:					
Net (purchase)/disposal of investments for policy purposes	1 295.0	1 954.8	1 287.8	679.1	300.5
Acquisitions under finance leases and similar arrangements	231.4	74.7	121.0	840.1	..
Non-produced assets	171.7	145.4	23.3	58.4	19.6
Assets given free of charge	60.7	..	..	..	..
	1 758.8	2 174.9	1 432.1	1 577.6	320.2
Gross fixed capital formation	2 808.7	4 842.4	4 321.6	2 682.4	2 855.3

Source: Department of Treasury and Finance

Since coming to office in 1999, the Government has completed or committed to unprecedented infrastructure renewal and expansion in the areas of health, education, public safety, social housing, and transport. The Government's net infrastructure investment program (which includes total purchases of property, plant and equipment, capital contributions to other sectors of government and net proceeds from sale of assets) is projected to be \$7 billion in 2009-10 and to average \$4.4 billion over the forward estimates period.

Around 50 per cent of the \$20 billion infrastructure program over the four years to 2012-13 will be funded from the cash surpluses from operating activities. The remainder of the infrastructure program will be funded by borrowings.

Total net investment in infrastructure includes expenditure on new projects approved in the 2009-10 Budget. Table 3.6 shows the new asset funding by department in 2009-10. The 2009-10 Budget commits substantial funding for the first tranche of initiatives under the *Victorian Transport Plan*, with \$4.9 billion being provided to deliver new services and infrastructure to begin the transformation of Victoria's transport system. Additional projects funded in the 2009-10 Budget include upgrades to hospitals in Bendigo, Dandenong and Geelong, targeted urban renewal projects in Broadmeadows, and upgrades to emergency services infrastructure. In addition, the 2009-10 Budget delivers a boost to social housing which is expected to deliver over 5 000 new houses.

Victoria is also working actively with the Commonwealth Government to cushion the economy while the global financial system remains under stress and to build Victoria's future economic potential. The Commonwealth's *Building the Education Revolution* funding and the State's *Victorian Schools Plan* investment in the 2009-10 Budget provides funding of \$2.9 billion for Victorian schools.

Table 3.6: 2009-10 Budget new asset funding

(\$ million)

	2009-10 Budget	TEI ^(a)
Education and Early Childhood Development	1446.5	2677.1
Human Services	556.9	1074.9
Innovation, Industry and Regional Development	31.6	92.7
Justice	38.7	80.2
Planning and Community Development	13.1	118.5
Premier and Cabinet	9.5	31.8
Primary Industries	..	..
Sustainability and Environment	14.0	24.5
Transport	911.2	4450.3
Treasury and Finance	22.7	39.2
Parliament	..	..
Government wide	41.4	78.3
Total 2009-10 Budget asset funding	3085.6	8667.6
Add: 2008-09 Budget <i>Update</i> asset funding	223.1	780.8
Asset funding since the 2008-09 Budget	3308.7	9448.4

Source: Department of Treasury and Finance

Note:

(a) Total estimated investment. Includes projects which are to be delivered through the public non-financial corporations sector on behalf of the government.

Budget Paper No.3, Appendix A, *Output, Asset Investment and Revenue Initiatives* includes a detailed list and description of all asset initiatives announced in the 2009-10 Budget.

FINANCIAL POSITION

Table 3.7 presents the general government sector balance sheet which comprises assets and liabilities of all government departments and other bodies that provide services free of charge or at prices significantly below their cost of production.

The general government net asset position, measured by subtracting liabilities from assets, is an important indicator of the sector's financial strength. A strong net asset position allows the government to expand the infrastructure investment program while maintaining prudent borrowing levels.

Table 3.7: General government sector statement of financial position as at 30 June

	(\$ billion)						
	1999	2008	2009	2010	2011	2012	2013
	Actual	Actual	Revised	Budget	Estimate	Estimate	Estimate
	AAS	GFS- GAAP	GFS- GAAP	GFS- GAAP	GFS- GAAP	GFS- GAAP	GFS- GAAP
FINANCIAL POSITION							
Assets							
Non-financial assets	32.4	66.0	68.6	75.3	81.5	88.7	92.4
Financial assets	3.3	8.7	8.8	8.7	8.9	9.4	9.9
Investments in other sector entities							
PNFC ^(a)	21.9	41.1	41.9	43.5	44.8	44.8	44.8
PFC ^(a)	1.2	3.8	0.3	0.8	1.6	2.3	2.8
Total assets	58.8	119.5	119.6	128.4	136.9	145.2	149.9
Liabilities							
Superannuation	11.4	12.9	24.4	24.7	25.0	25.4	25.6
Borrowings ^(b)	7.1	8.2	11.4	15.9	19.5	22.3	23.1
Other liabilities	3.6	8.0	9.1	9.4	9.6	9.8	10.0
Total liabilities	22.2	29.1	44.9	50.0	54.1	57.5	58.6
Net assets	36.7	90.4	74.8	78.4	82.7	87.7	91.3

Source: Department of Treasury and Finance

Notes:

(a) PNFC: Public non-financial corporations, PFC: Public financial corporations.

(b) Borrowings include deposits held and advances received.

Assets

General government sector assets are forecast to be \$120 billion by 30 June 2009 and to rise by a further \$30 billion by 30 June 2013, at an average rate of 5.8 per cent a year.

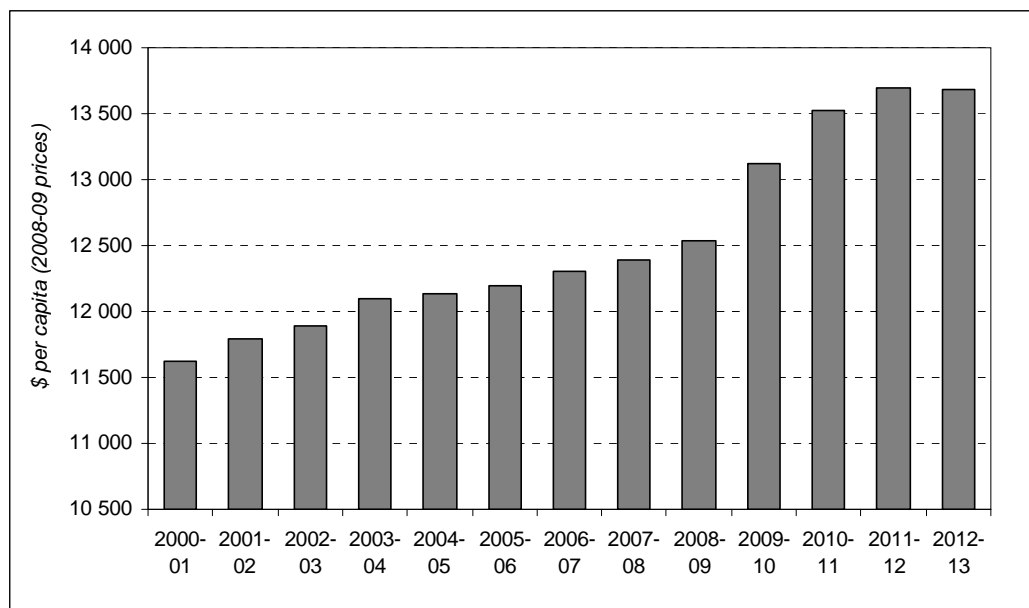
Non-financial assets

Non-financial assets are projected to be \$69 billion at 30 June 2009 and projected to grow to \$92 billion by 20 June 2013.

This growth is driven by the government's infrastructure program, which is forecast to average \$5 billion a year over the four years to 2012-13, exceeding depreciation by an average of \$3.2 billion.

Chart 3.2 shows that there has been strong growth in the real capital stock per capita in recent years, and that this growth is projected to continue over the forward estimates period.

Chart 3.2: General government sector real capital stock per capita as at 30 June^(a)



Source: Department of Treasury and Finance

Note:

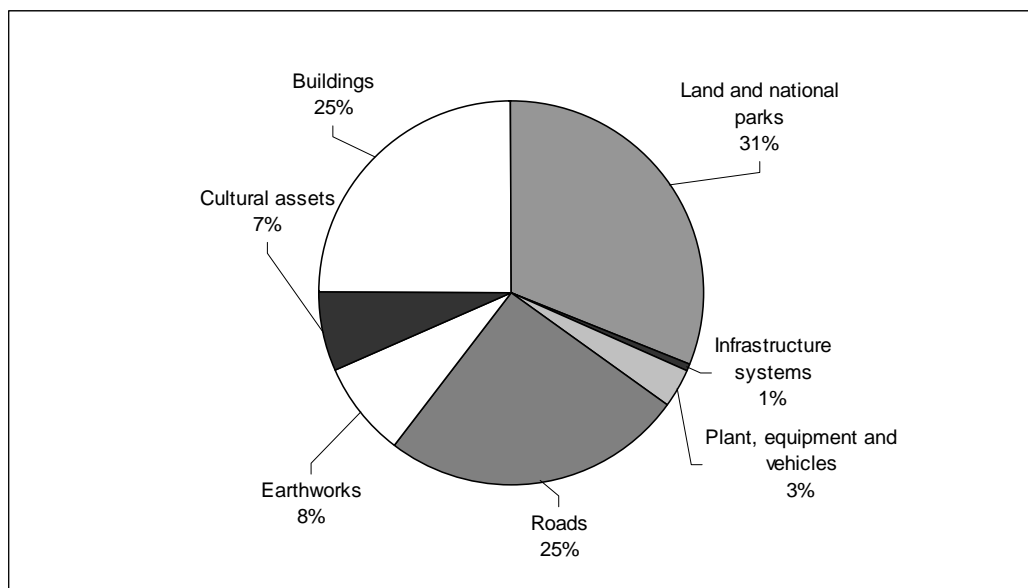
(a) Real capital stock is equal to total non-financial assets less inventories, non-financial assets held for sale and other non-financial assets in 2008-09 prices.

The growth in the real capital stock per capita is expected to stabilise by 2012-13, reflecting the Government's strategy of scaling back the historically high infrastructure program in order to reduce the future call on borrowings as the economy recovers from the current economic downturn.

This projected growth will nevertheless be sufficient to maintain the Government's asset base to support service delivery and economic growth. The real capital stock is expected to continue to grow at least in line with population growth.

Chart 3.3 shows the general government sector's capital stock as at 30 June 2009 by asset class. The four largest classifications are land and national parks (31 per cent of the total capital stock), buildings (25 per cent), roads (25 per cent) and earthworks (8 per cent). This composition of the capital stock is consistent with previous years.

Chart 3.3: General government sector capital stock as at 30 June 2009^{(a)(b)}



Source: Department of Treasury and Finance

Notes:

- (a) Due to a change in methodology by including the revaluation of capital stock, effective from the 2007-08 Budget, this chart is not directly comparable to similar charts shown in previous years.
- (b) Capital stock is equal to total non-financial assets less inventories, non-financial assets held for sale and other non-financial assets.

Investments in other sector entities

Investments in other sector entities consist of the net assets of the State's PFCs and PNFCs. Investments in PNFCs and PFCs are expected to increase from \$42.8 billion in June 2009 to \$50.2 billion by June 2013. This increase is driven by equity injections from the general government sector, combined with revaluation gains on the value of investments. The revaluation increments largely reflect the impact of an expected return to trend growth in financial markets on the PFC sector.

Financial and other assets

The general government sector also holds other financial assets including cash and deposits, receivables and investments, loans and placements. Cash and deposits are expected to increase by around \$700 million by June 2013, as cash balances are restored for liquidity management purposes following the impact of the Global Financial Crisis.

Liabilities

General government liabilities are projected to be \$45 billion as at 30 June 2009 and are projected to grow to \$59 billion by 30 June 2013.

Superannuation liability

The State recognises a liability in respect of its defined benefit superannuation schemes, based on the difference between the assets of these schemes and the present value of the underlying obligation to members.

While the State's reported superannuation liability is projected to increase by \$11.5 billion in 2008-09, \$7.4 billion of this increase is attributable to a reduction in the discount rate that is required to be used to value the superannuation liability. The discount rate, which is based upon long term Commonwealth Government bond rates, has fallen from 6.54 per cent a year as at 30 June 2008 to 4.66 per cent a year as at 31 March 2009. It is important to note that the increase in the reported superannuation liability arising from the reduction in discount rate has no impact on the amount of cash required to fund the State's superannuation liability over time. Funding requirements continue to be calculated using a long term investment return, currently 8 per cent a year before tax.

The ongoing Global Financial Crisis has also continued to impact significantly on investment markets and the return on superannuation scheme assets has been far lower than expected. However, given the long-term nature of superannuation it is appropriate to maintain a strategy with a long-term focus rather than attempting to predict, and react to, short-term volatility.

Beyond 2008-09, the State's reported superannuation liability is projected to increase from \$24.4 billion in 2008-09 to \$25.6 billion in 2012-13. This projected increase is primarily attributable to the use of a lower discount rate, as discussed above, along with the fact that some of the schemes are only partially funded and so the return on assets is not sufficient to offset the growth in accrued liabilities. However, given the sensitivity of the State's reported superannuation liability to movements in the discount rate the reported liability may continue to exhibit considerable volatility.

Based on current projections, the state remains on track to achieve full funding of the unfunded superannuation liability in respect of the State Superannuation Fund by the target date of 2035.

Borrowings

Total borrowings (including deposits held) for the general government sector are expected to increase from \$11.4 billion in June 2009 to \$23.1 billion by June 2013. Moderate growth in borrowings is expected from 2011, reflecting the completion of substantial components of the Government's existing infrastructure program by the end of the forward estimates period.

KEY FINANCIAL INDICATORS

Table 3.8: General Government sector net debt, net financial liabilities and key ratios as at 30 June

	1999 Actual AAS	2008 Actual GFS- GAAP	2009 Revised GFS- GAAP	2010 Budget GFS- GAAP	2011 Estimate GFS- GAAP	2012 Estimate GFS- GAAP	2013 Estimate GFS- GAAP
		(\$ million)					
Net Debt ^(a)	4.8	2.2	5.2	9.9	13.4	15.7	16.0
Net Financial Liabilities	18.8	20.4	36.0	41.3	45.2	48.1	48.7
		(per cent)					
Net Debt to GSP ^(b)	3.1	0.8	1.9	3.7	4.7	5.3	5.1
Net interest to total revenue ^(c)	2.1	..	0.4	0.7	1.2	1.5	1.6
Net Financial Liabilities to GSP ^(b)	11.9	7.6	13.4	15.2	16.0	16.1	15.5
Net interest + superannuation interest expense to total revenue	4.6	0.8	2.0	2.2	2.8	3.2	3.2

Source: Department of Treasury and Finance

Notes:

- (a) Net debt is the sum of deposits held, advances received and borrowings less the sum of cash deposits, advances paid, and investments, loans and placements.
- (b) Ratios to GSP may vary from publications year to year due to revisions to the ABS GSP data.
- (c) Net interest equals interest expense less interest revenue.

Net debt

The Government balance sheet remains solid. Victoria's triple-A credit rating was re-affirmed by Standard & Poor's in November 2008 and Moody's Investor Services in January 2009. The Government's continued sound management of its balance sheet underpins this rating.

A key measure of balance sheet strength is net debt, which is calculated by subtracting liquid financial assets from gross debt. General government net debt is expected to increase from \$5 billion in June 2009 to \$16 billion by June 2013. This is above recent levels, and reflects the increase in borrowings required to fund the Government's infrastructure program over the forward estimates period.

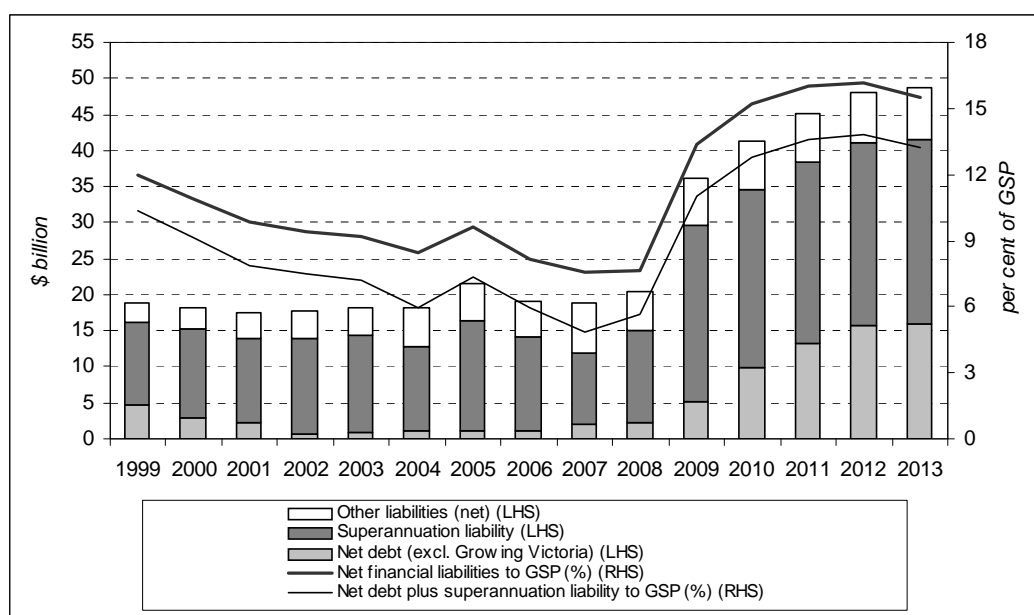
Over the budget and forward estimates period, as a percentage of GSP, net debt will rise from 1.9 per cent as at June 2009, to 5.3 per cent as at June 2012, before declining to 5.1 per cent as at June 2013. The reduction of the net debt to GSP ratio in 2012-13 reflects the government's commitment to repay borrowings, and limit new borrowings by reducing the infrastructure program to lower, historical levels, without comprising the quality of service delivery.

A significant proportion of infrastructure spending will be financed by cash operating surpluses, thereby limiting the reliance upon additional borrowings.

Net financial liabilities

In examining the liabilities of governments, the financial community focuses on net financial liabilities as a measure of indebtedness. Table 3.8 shows that net financial liabilities of the general government sector are expected to increase from \$36 billion in June 2009 to \$49 billion by June 2013.

Chart 3.4: General government sector net financial liabilities as at 30 June



Source: Department of Treasury and Finance

As depicted in Chart 3.4, the ratio of net financial liabilities to GSP will increase in comparison to recent historical levels. This movement largely reflects the growth in the superannuation liability and in general government borrowings during the period, consistent with the State's strategy of using its strong financial position to respond to the economic downturn by investing in infrastructure with a focus on projects that can start quickly and generate new jobs.

There will be a significant increase in net debt and net financial liabilities in the medium term. By 2011-12, the increase in debt is expected to moderate, with cash operating surpluses expected to meet in excess of 60 per cent of net infrastructure investment. The Government is committed to maintaining fiscal discipline, and has undertaken a number of initiatives (including a more conservative wages policy for public service employees) to maintain debt at prudent and sustainable levels over the longer term.

