

CHAPTER 5 – ECONOMIC REFORM AGENDA

- The current economic downturn has reinforced the need for Victoria to vigorously pursue its economic reform agenda to ensure that the State is well placed for the upturn, and to address medium- and long-term challenges.
- To prepare for the upturn, and to address the longer term challenges presented by the ageing population, the Government continues to encourage productivity growth through skills reform, infrastructure initiatives, and reducing the burden of state regulation on businesses.
- The current fiscally-constrained environment also makes it imperative for the public sector to improve even further the efficiency of its own operations in order to protect jobs and maintain key government services for a growing and ageing population.

Victoria has been a national leader in economic reform. In addition to its own program of state-based reforms, the Victorian Government is working collaboratively with the Commonwealth and other Australian governments to pursue national reforms in a number of key areas, including health and ageing, education, skills, training, climate change and water, infrastructure, business regulation and competition, housing and indigenous reform, and Commonwealth-State financial relations. A strong record of reform, coupled with sound economic and financial management, has positioned Victoria well to weather the challenges presented by the current Global Financial Crisis and economic downturn.

Even so, the Global Financial Crisis is expected to have a significant impact both on the Victorian economy and on the State's finances. This is reflected in the sharp downward revisions in the economic forecasts that underpin this year's budget and makes the task of maintaining a sound financial position and of maintaining a focus on Victoria's underlying economic competitiveness all the more challenging. Yet these challenges must be met if Victoria is to position itself to respond quickly to recovery when it comes.

Thus, in responding to the economic downturn, the emphasis of the Government's strategy is stimulating jobs and enhancing Victoria's competitiveness. These objectives are being pursued through reforms designed to:

- skill the workforce for transition and recovery;
- improve business competitiveness;

- deliver more efficient infrastructure and facilitate investment;
- improve the efficiency of the Government's own operations;
- ease the adjustment to a carbon-constrained economy; and
- implement more outcomes-focused Commonwealth-State financial arrangements.

The additional challenge of responding to the Global Financial Crisis makes it even more imperative to pursue lasting reforms that will position Victoria to take full advantage of economic recovery, and help to address the longer term challenges posed by slowing productivity, the ageing population and climate change.

SKILLING THE WORKFORCE FOR TRANSITION AND RECOVERY

Boosting investment in training in times of economic downturn enables people to develop skills that can be utilised when the economy recovers.

Maintaining training effort in areas that will flourish again when demand picks up will be essential to ensure that skill bottlenecks do not represent a constraint to growth in the recovery. Similarly, dynamic shifts in skill requirements through the downturn and into the recovery phase and the emergence of new industries post recovery, underscore the need for a highly flexible, responsive and demand-driven training system.

The greatest demand and need for training will come from those who are about to enter the labour force – particularly young school leavers and those just completing their post-school education and training – and those most likely to be displaced during a downturn: young people, those with little work experience, and those with low levels of education. In past economic downturns, youth unemployment has increased more quickly and to a greater degree than adult unemployment rates.

In Victoria, the vocational education and training sector is being transformed into a flexible and responsive system through the reforms and increased funding the Government announced in August 2008: *Securing Jobs for your Future – Skills for Victoria*. There is a two-stage implementation, with eligible Victorians able to access the Victorian Training Guarantee to undertake training at the Diploma and Advanced Diploma level at a wider range of training providers from 1 July 2009. The second stage of this initiative will apply to all qualification levels from 1 January 2011.

These reforms mean the training system will be even better equipped to cater for the needs of youth and displaced workers. For example:

- all people aged up to 20 years, and those 20 and over who do not have a qualification at Diploma or Advanced Diploma level or higher, can access a government-subsidised place in these higher level courses from 1 July 2009;
- from 1 January 2011, Victorians will be guaranteed a government subsidy to undertake training towards qualifications higher than the qualifications they hold, and those aged up to 20 will be able to access subsidised training at any qualification level; and
- a limited number of exemptions to eligibility criteria are available on a case-by-case basis, such as retrenched workers whose qualifications are redundant and who need to retrain to improve their future employment prospects.

These reforms will boost the system's capacity to deliver what individuals and businesses need. The Victorian Training Guarantee is a ground-breaking initiative that brings government subsidised training within the reach of thousands more people.

In addition to state-based reforms, Victoria continues to work closely with the Commonwealth and other states and territories to improve the delivery of education and training services. This includes the Council of Australian Governments (COAG) National Partnership agreement for the delivery of training under the Productivity Places Program, which commenced in January 2009. The Commonwealth Government has also announced funding to encourage employers to keep apprentices on.

IMPROVING BUSINESS COMPETITIVENESS

A key priority for Victoria in improving the business environment has been to keep the taxes and charges on business low and competitive. Victoria has also long been a national leader in regulatory reforms to reduce the burden of 'red tape' on businesses.

Reforms in these areas improve the national and international competitiveness of all Victorian businesses and foster economic growth.

Reducing the burden of regulation

Key elements of Victoria's best practice regulation making and review frameworks include:

- an independent gatekeeper, the Victorian Competition and Efficiency Commission (VCEC) to assess the adequacy of the assessments of regulatory proposals;
- targeted reductions in the administrative burden of regulation ('red tape') through the *Reducing the Regulatory Burden* initiative;
- the *Victorian Guide to Regulation*, which sets out the principles and characteristics of good regulation for all Victorian regulators;

- leadership in harmonisation of regulation through collaboration with other jurisdictions; and
- comprehensive public inquiries into regulatory matters conducted by the VCEC, the Essential Services Commission, and the State Services Authority.

Through the *Reducing the Regulatory Burden* initiative, the Government has committed to cutting red tape by 15 per cent over three years and 25 per cent over five years. The targets amount to \$154 million and \$256 million per annum, respectively, in red tape savings. The Department of Treasury and Finance has estimated that the productivity boost from reducing red tape has the potential to expand Victoria's economy by up to \$747 million a year (in 2005-06 prices) by 2016.

Victoria is progressing well against the three-year 30 June 2009 target. The Treasurer reported in November 2008 that departments have accelerated their regulatory review activities and, as a result, net reductions based on current initiatives are now estimated to be in the order of \$162 million a year. The Treasurer will provide a further update later in 2009.

The VCEC is expected to deliver its final report on environmental regulation in mid-2009. As part of this inquiry, VCEC will identify opportunities for Victoria to maintain its leadership in this area and will consider ways in which the regulations can be improved to meet the future challenges of environmental sustainability and a carbon-constrained economy. It is a very timely inquiry as acting on its recommendations will help streamline Victoria's environmental regulatory and approval processes. Together with ongoing reforms to planning regulations, this will be vital to the efficient delivery of the large infrastructure program needed to meet the challenge of climate change.

The Government has also made significant progress on its commitment to reduce the number of principal Acts of Parliament by 20 per cent by 2010. A total of 153 Acts have been repealed to date, and the Victorian Parliament will consider repealing up to another 100 Acts during 2009.

Victoria continues to be at the forefront of national action to reduce the burden of regulation for Victorian businesses operating across state borders. Victoria and New South Wales were the first states to adopt harmonised payroll tax arrangements and Victoria has continued to push strongly for national regulatory reform. In late 2008, COAG signed a National Partnership Agreement to deliver a seamless national economy in 36 areas, which will reduce costs incurred by business and individuals in complying with unnecessary and inconsistent regulation across jurisdictions.

The seamless national economy agenda includes a historic agreement to harmonise occupational health and safety laws by 2011. Businesses have consistently identified overlapping health and safety laws as a major source of unnecessary red tape. Other reforms that will enhance business competitiveness include:

- a national trade licensing system to facilitate a more mobile workforce;
- streamlined environmental assessment and approval processes, with development proposals assessed only once, through a combined assessment process covering both Commonwealth and State responsibilities;
- increasing uptake of electronic development assessments to speed up approvals; and
- reforms to infrastructure regulation, which will improve access and reduce bottlenecks for essential economic infrastructure.

With the introduction of the Commonwealth's Carbon Pollution Reduction Scheme (CPRS) as the key driver of reductions in greenhouse gas emissions across the Australian economy, streamlining existing greenhouse gas-reducing policies across all jurisdictions will be critical to ensure cost-effective change. A rigorous reform process will aim to reduce duplication and ensure a competitive business environment conducive to adjusting to a low-carbon economy.

There will also be a need to address regulatory overlap and 'green tape' once the CPRS is in place.

Business tax competitiveness

The Government remains committed to providing a fair and efficient tax system that is competitive with other states. Victorian businesses have benefited from substantial tax reform over the past decade. These reforms have been designed to improve economic outcomes by increasing the efficiency and equity of the Victorian tax system. The reforms implemented include:

- over \$5.3 billion worth of announced tax cuts;
- abolishing eight state taxes as agreed with the Commonwealth Government under the *Intergovernmental Agreement on Federal Financial Relations*, faster than any other state;
- a flattening out of the land tax scale and significant reductions in payroll and land tax rates;
- significant reform of land tax to moderate the impact of the property market boom; and
- measures to reduce the capacity for tax evasion so that taxpayers who are doing the right thing are not unduly burdened. Examples include strengthening anti-avoidance provisions in the conveyancing duty base and reducing the incentive for landowners to minimise their land tax liabilities through the use of trusts.

Victorian businesses now face the second lowest rate of payroll tax in Australia at 4.95 per cent, with Queensland's at 4.75 per cent. However, due to the way that payroll tax is calculated in Queensland, Victorian businesses effectively pay the lowest payroll tax for payrolls valued between \$4.9 million and \$13.6 million.

A further examination of Victoria's tax competitiveness with other Australian jurisdictions is provided in Chapter 1.

WorkCover premiums

While tax competitiveness is an important part of business decision-making, low WorkCover insurance premiums are another factor that improves the competitiveness of Victoria as a business location. Successive reductions in the WorkCover insurance average premium rates in recent years ensure that Victoria's WorkCover scheme continues to have one of the lowest average premium rates in Australia.

DELIVERING MORE EFFICIENT INFRASTRUCTURE AND FACILITATING INVESTMENT

Victoria has been investing heavily in economic and social infrastructure and is continuing to do so in the *2009-10 Budget*. The delivery of efficient infrastructure is a fundamental foundation for enhancing business competitiveness and fostering economic growth. A strong focus on investment in infrastructure is also playing a pivotal role in the Government's response to the current economic downturn.

The Government is accelerating its own infrastructure program, as well as working alongside the Commonwealth Government to deliver investments as part of the *Nation Building – Economic Stimulus Plan*, and projects funded by the Building Australia Fund. The implementation of new infrastructure projects generates activity and jobs in the short term, while also boosting the medium- and long-term productive capacity of the State and improving the underlying competitiveness of the Victorian economy.

Meanwhile, the Victorian Government is improving the efficiency of its infrastructure networks through pricing and regulatory reforms.

The private sector is a major provider of infrastructure, both in its own right, and in partnership with the Government in the delivery of major projects. The Government can facilitate such investment through streamlining planning rules and approval processes.

Economic regulation of infrastructure

More efficient investment in, and usage of, key infrastructure facilities can sometimes be achieved through greater reliance on market mechanisms, including price signals, to create appropriate incentives for both owners and users. Because much infrastructure exhibits natural monopoly characteristics, there is a lack of competition to impose market discipline. Nevertheless, efficient outcomes can be achieved through the use of well-designed economic regulation.

Victoria has strong credentials in the effective economic regulation of infrastructure services. Recently, the focus of economic regulation in Victoria has shifted to areas such as water and freight networks, and a number of reforms are occurring in these sectors.

Prolonged periods of drought and the consequent restrictions on water usage have emphasised the importance of the efficient provision of water and sewerage services, and the development of innovative solutions for balancing supply and demand. The major water supply augmentation announced in the *Our Water Our Future – The Next Stage of the Government’s Plan* will result in new and diversified sources of bulk water, and optimal management of future water supplies will require supporting institutional reforms.

Accordingly, the Government announced in July 2008 that it would develop an access regime for water and sewerage infrastructure services to enable effective competition in markets upstream and downstream from the natural monopoly segments of the market. In November 2008, it directed the Essential Services Commission to undertake an inquiry into developing a state-based access regime to achieve the Government’s objectives.

The Essential Services Commission is expected to report its findings to the Minister for Finance by the end of September 2009.

Freight networks are another important area of ongoing reform. The *Victorian Transport Plan*, announced in December 2008, includes measures to improve the efficient operation and productivity of the transport network. It included a strategy to develop an efficient and sustainable freight network. *Freight Futures: Victorian Freight Network Strategy* establishes the Government’s vision to modify the physical structure of the Victorian freight network and to provide access to more productive vehicles that should enable industry to operate more efficiently and addressing growing public concerns about local congestion and environmental impacts.

At a national level, progress continues to be made on the COAG-endorsed reform of the national pricing system for heavy vehicles. A key feature of the 2008 Heavy Vehicle Charges Determination was the removal of cross-subsidies between vehicle classes so that individual trucks now face a greater cost of their wear and tear on the national road network.

Facilitating private sector investment

With investment by the private sector a key component of aggregate demand, reforms to stimulate activity in this area will help to sustain employment and boost economic growth.

The Government is already taking action to help facilitate approval to unblock major private sector projects. Since April 2009, the Government has announced decisions to fast-track ten significant projects – including housing, retail and office space developments – which will help to boost economic activity and maintain jobs.

At the same time, the Government is progressing permanent improvements in planning and investment approval processes to reduce avoidable time delays and facilitate household and private business investment. These reforms will ensure that there are no unnecessary barriers to the State positioning itself for recovery. As part of the Government's *Reducing the Regulatory Burden* initiative, reforms to the planning system will provide substantial cost savings to Victorian businesses while improving housing affordability, including:

- the review of the *Planning and Environment Act 1987*, which will streamline current laws, remove redundant provisions, and strengthen timeliness in the planning process, including an examination of the planning permit and amendment processes;
- cutting red tape in Melbourne's growth areas by replacing complex planning processes with new Precinct Structure Plans, with a stronger role for the Growth Areas Authority, in consultation with local government; and
- the Planning Applications Online initiative which will put paper-based planning applications online, substantially reducing the time and complexity of the planning permit process.

The impact of current environmental approval processes on the delivery of projects is also being examined by the VCEC in the context of its inquiry into environmental regulation. The VCEC's draft report, released in March 2009, outlined ways to streamline the environmental assessment process (for example, by applying time limits to all stages of the process), which could reduce delays, without compromising Victoria's environmental objectives.

IMPROVING THE EFFICIENCY OF GOVERNMENT'S OWN OPERATIONS

Just as the economic downturn is forcing the private sector to examine ways to improve its productivity, so too has the current fiscally-constrained environment reinforced the need for the Government to look at its own operations with a view to improving efficiency and maximising the value of Victorian taxpayers' money.

Better asset utilisation is being achieved through the Government's Shared Facility Partnerships guide to good governance for schools and the community, which focuses on facilities that can be shared by schools and the broader community, including libraries and resource centres, halls and meeting spaces, recreational/sporting facilities, information technology centres, and performing arts spaces. To examine the potential for increased sharing of government and community facilities in Victoria, both in relation to existing and new facilities, the Government has asked the VCEC to undertake an inquiry in this area. A draft report for consultation purposes is expected to be released by the VCEC in June 2009.

The Government is also keeping its corporate services cost efficient through a series of *Efficient Government* initiatives, including establishing a new shared library service for government departments and agencies, consolidating Victorian Government car pools, establishing a shared facilities management service for Victorian Government accommodation, and development work towards one information technology service for government by standardising core information and communication technology services across government.

Harnessing the power of the marketplace to provide efficient solutions to achieving policy outcomes and the delivery of government services is another area of increasing focus and reform. Victoria is already well-advanced in the use of innovative market-based instruments in natural resource management and in the more efficient and effective delivery of environmental outcomes. For instance, the BushTender program, which uses auctioned conservation contracts to conserve native vegetation is one example of how market-based instruments are being applied in Victoria.

ADJUSTING TO A CARBON CONSTRAINED ECONOMY

While there is a strong focus on responding to the effects of the Global Financial Crisis, work is nevertheless continuing on addressing the longer term challenges posed by climate change.

Fundamental to the Commonwealth Government's proposed climate change strategy is the introduction of a Carbon Pollution Reduction Scheme (CPRS). This would place a cap on the amount of carbon pollution industry can emit and, by requiring affected businesses to buy a permit for each tonne of carbon they contribute to the atmosphere, would effectively introduce an explicit price for carbon. Determined by the market, this carbon price will be the driving factor behind structural adjustments to the carbon-constrained economy.

The development of an effective national response to climate change is an established priority for COAG. Over the past year, COAG's Working Group on Climate Change and Water has been working toward the achievement of three key objectives:

- a single national emissions trading scheme (ETS) incorporating state schemes;
- a nationally consistent set of climate change measures to support the ETS; and
- a national cooperative approach to long-term adaptation to climate change.

Some notable progress has been made towards these goals but, while these achievements are significant, they do not address the breadth of issues that Australia must tackle in the decades ahead. Further national reform aimed at assisting the Australian community to adjust effectively to the CPRS and climate change is required.

Aspects of the design and operation of the proposed CPRS have the potential to impact directly on state finances. These include scheme coverage (particularly how the scheme will treat areas of state policy responsibility such as agriculture and forestry), the scale and nature of assistance for adversely affected groups and additional state spending requirements imposed by the CPRS. To avoid adverse consequences for the States and Territories, the Commonwealth Government will need to consult and work with state and territory governments on all aspects of CPRS design that affect them. This includes consultation in the lead-up to legislation being passed, and over time as the impacts of the scheme emerge.

REFORMING COMMONWEALTH-STATE FINANCIAL RELATIONS

The nature of financial relations between the Commonwealth and state governments will be a key determinant of the success of future nation-building reforms.

On 1 January 2009, a new framework for federal financial relations, agreed by COAG came into effect. The framework is designed to improve the quality and effectiveness of government services and provide the States with increased flexibility in the way they deliver jointly-funded services.

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 covering health, schools, skills and workforce development, affordable housing and disabilities. Each SPP is associated with a National Agreement that contains objectives, outcomes, outputs and performance indicators, and clarifies the roles and responsibilities that will guide the Commonwealth and the States in the delivery of services across the relevant sectors.

Another new form of funding, National Partnership (NP) payments, has been created. These will fund specific projects and facilitate and/or reward states that deliver nationally significant reforms.

The new federal financial framework provides a clearer specification of roles and responsibilities of each level of government and an improved focus on public accountability for better outcomes and better service delivery. The accountability of governments to the public will be enhanced through simpler, standardised and more transparent public performance reporting for all jurisdictions. The independent COAG Reform Council (CRC) will provide annual reports to COAG containing the performance data to assist the public in assessing governments' progress against agreed objectives outcomes and outputs. The CRC will also report its own comparative analysis of the performance of governments in meeting the objectives of the National Agreements. The new performance reporting framework is to be further developed and overseen by the Ministerial Council for Federal Financial Relations, in consultation with relevant COAG Working Groups and other Ministerial Councils, with the aim of consolidating the current range of reporting requirements to make them more efficient.

The COAG reforms to federal financial relations are a positive step in establishing genuinely collaborative approaches to delivering core services. The challenge now facing governments is to use these reforms to ensure that more simple and flexible agreements are developed so that resources are more focused on the achievement of improved outcomes for the community.

Commonwealth review of Australia's tax and transfer system

In May 2008, the Commonwealth Government announced a comprehensive review ('the Henry Review') into all aspects of Australia's tax and transfer system (including state taxes and transfers). The Victorian Government welcomes the Henry Review as it represents an opportunity to identify major taxation and transfer payment reforms that will drive economic growth and make the Australian tax system simpler, fairer and more transparent.

Significant improvements to our tax and transfer system can help prepare Australia for a strong recovery and a prosperous future, by ensuring the most productive use of our resources.

To make these changes, the Commonwealth and state governments will need to work together. Improvements to Commonwealth taxation are needed, as well as improvements to state taxation. Most importantly, this review is the first time in 50 years that Commonwealth and state taxation have been seriously examined together.

Over decades, our tax and transfer system has changed incrementally, often without a clear plan or direction, and sometimes with unintended consequences.

In its submission to the review, the Victorian Government has highlighted the need for reform in the following areas:

- **Improving workforce participation and productivity.** The existing interaction between personal income tax and the welfare system can create high effective marginal tax rates, which discourages people from entering the workforce or working more. Workforce participation and productivity are key elements in promoting Australia's long-term economic growth, particularly as the population ages, and the relative size of the workforce declines.
- **Reducing the complexity of the tax and transfer system.** The Australian tax system is complex, which costs businesses, individuals and governments time and resources to understand and comply with its requirements. There is a wide range of options that could be considered to reduce the burden of complying with taxation laws and make the system simpler and more transparent. For example, the Commonwealth could consider reducing the number of tax expenditures, simplifying the welfare system and its administration, and standardising taxation of capital. For its part, the Victorian Government has already acted to make tax administration simpler, including by taking a national leadership role with New South Wales in harmonising the administration of payroll tax.

- **State governments need better access to secure taxation revenue to fund services.** Much of the tax paid in Australia is not spent by the level of government that collects it. The Commonwealth collects over 85 per cent of taxes and has access to some of the largest, broadest and fastest-growing taxes. However, the Commonwealth is only responsible for around half of expenditure on government services, with state governments having primary responsibility for school education, hospitals, infrastructure, police and emergency services, and a range of other areas.

This imbalance, often referred to as vertical fiscal imbalance, has grown in recent years, with net Commonwealth payments to the States (as a proportion of gross domestic product) at historically low levels.

This imbalance results in confused accountability, blame shifting, and inefficient churn of tax revenues between levels of government. It also reduces the flexibility for states to respond to community needs, plan future investment and respond to shocks and crises. Future cost pressures, including an ageing population and climate change, will put states in an increasingly difficult position.

The Commonwealth and the States have recently agreed to a new federal financial relations framework, which aims to address some of these issues. However, this imbalance still stands in the way of significant reform to state taxation, which will require deeper, structural reforms and greater cooperation between the different levels of government. For example, a move by the States away from a reliance on stamp duties could only be realistically achieved if this revenue stream was replaced with revenue collected by the Commonwealth Government. This could be achieved in the following two broad ways (or a combination of both): increasing existing Commonwealth Government grants to the States and/or the States sharing revenue from Commonwealth tax bases. Such a reform would need to be implemented carefully to ensure the States have increased fiscal autonomy to deliver services.

The review of Australia's tax system provides an opportunity to agree to major reforms that could accelerate Australia's future economic recovery. The right reforms can help ensure our economy is dynamic and position governments to be able to provide the best schools, hospitals, police infrastructure and environmental management to prepare us for the future.

THE STRENGTHENED CASE FOR REFORM

Victoria's strong track record of ambitious economic reform has helped sustain strong rates of economic growth in the past and is now helping the State weather the effects of the global economic downturn.

A key lesson from past economic downturns is that the economy does not simply revert to its former state when recovery occurs. While some sectors can be expected to rebound once credit restrictions ease and confidence and consumer demand picks up, in other sectors of the economy the downturn will accelerate a process of longer term structural decline. Firms that survive will emerge leaner and more efficient. Some jobs will disappear for good; but new jobs in other emerging industries will take their place.

Keeping business costs low and competitive, investing in productivity enhancing infrastructure, minimising red tape, ensuring that planning and project approval processes do not unduly delay recovery in private investment, and ensuring that Victoria's education and training institutions and models of service delivery are flexible and responsive to changing needs, will all be crucial to ensuring that Victoria is positioned to respond quickly when recovery comes.

These imperatives strengthen the case for further reform. Accordingly, the Government's strategy includes reforms in skills, education and retraining that will strengthen the human capital of the workforce for the future. It will continue to pursue reductions in the regulatory burden to help boost business competitiveness, while working with the Commonwealth and other Australian governments to improve the Australian taxation system. There are reforms to encourage the efficient provision and usage of key infrastructure networks, while measures are underway to facilitate increased private sector investment. The Government is also examining its own operations, and introducing efficiency-enhancing reforms in order to protect jobs and maintain key government services.

Meanwhile, the Government continues to work with the Commonwealth and other Australian governments in shaping an effective response to the challenges of climate change, and in the development of a new framework for Commonwealth-State financial relations that provide incentives for reform, while maintaining a focus on the achievement of improved outcomes for the community.

