

The Victorian economy and government financial position

**Presentation to
Victorian Council of Social Service
2006 Congress**

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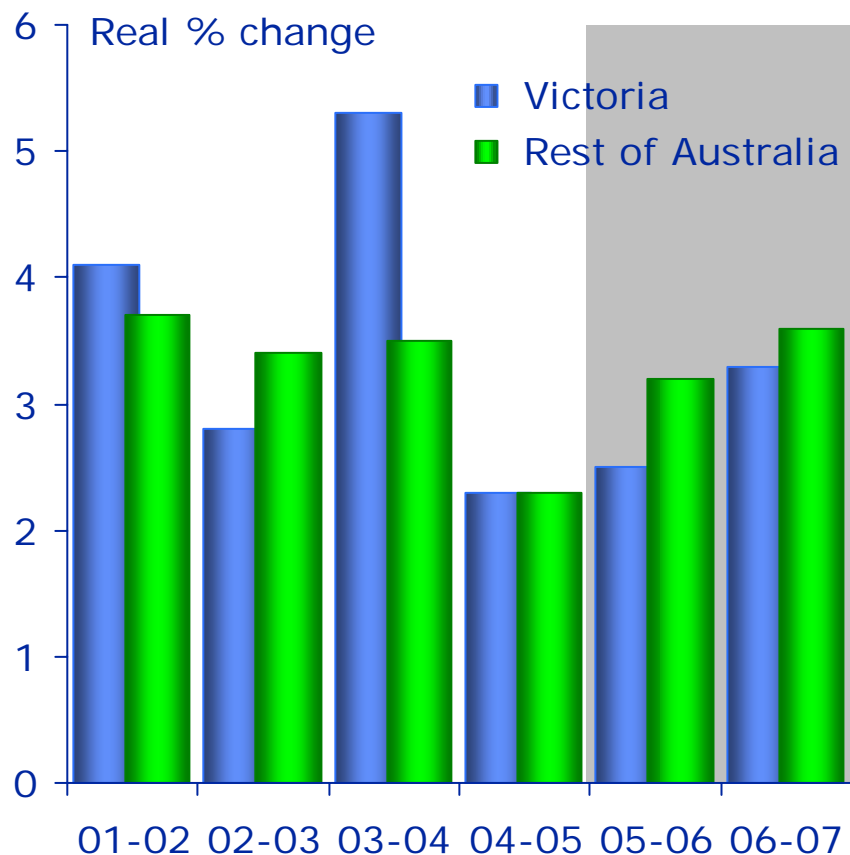
**RACV Centre
Melbourne
4th August 2006**

www.anz.com/go/economics

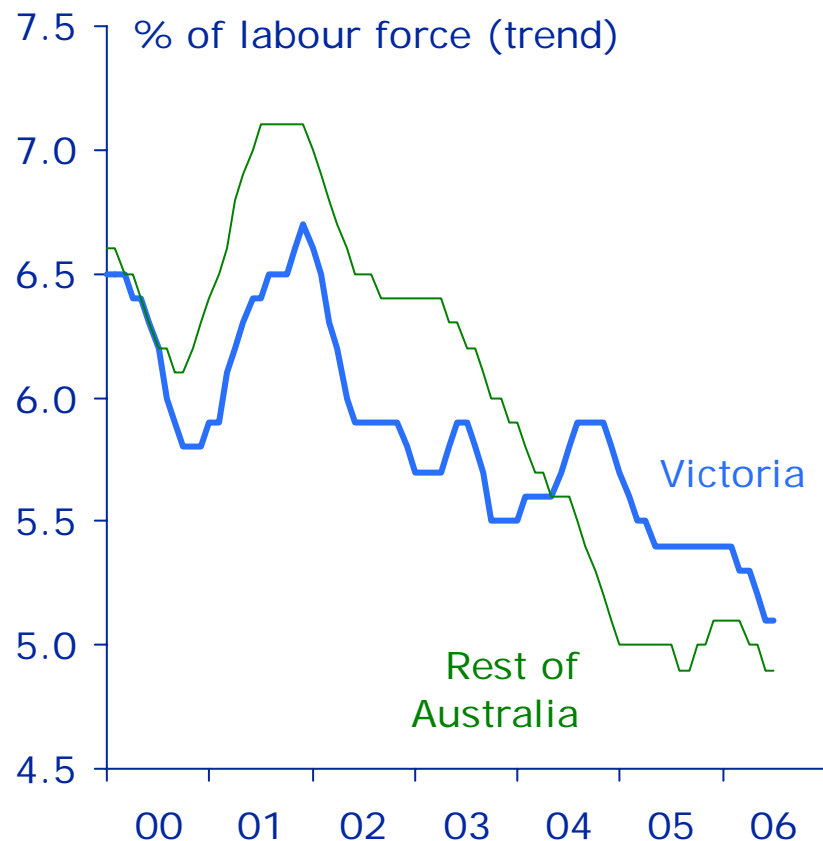
*economics@***ANZ**

Victoria's economy is performing well given the challenges posed by the resources boom

Real gross State product



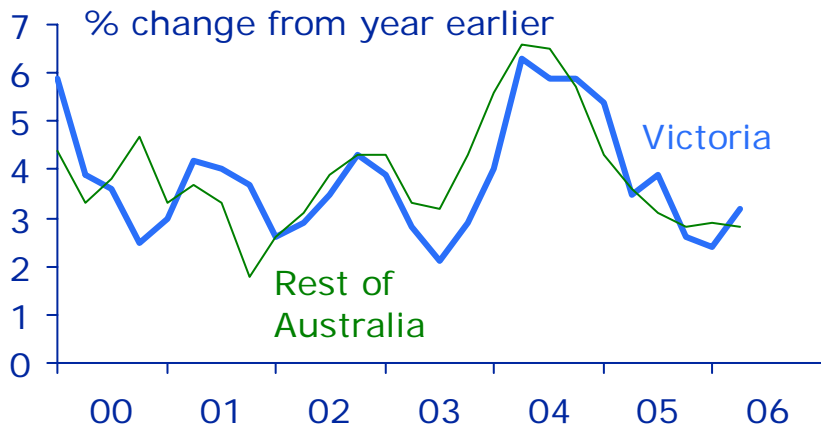
Unemployment



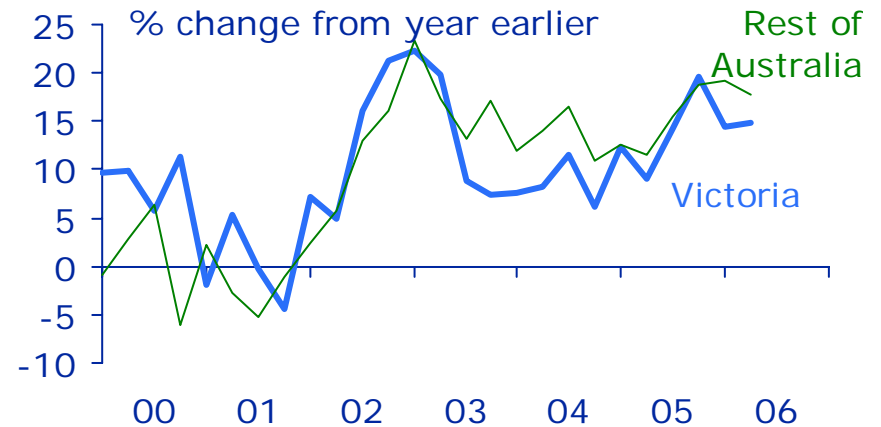
Sources: ABS; Economics@ ANZ; Victorian and Commonwealth Treasury forecasts for 2005-06 and 2006-07.

In some areas of economic activity Victoria is doing slightly better than the rest of Australia

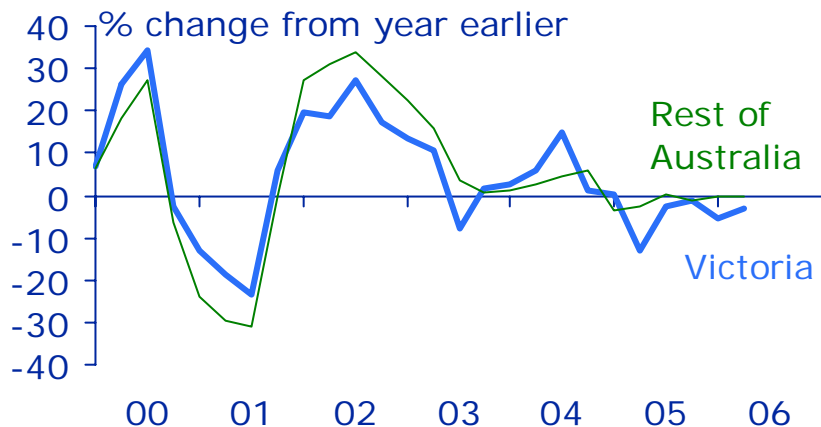
Consumer spending



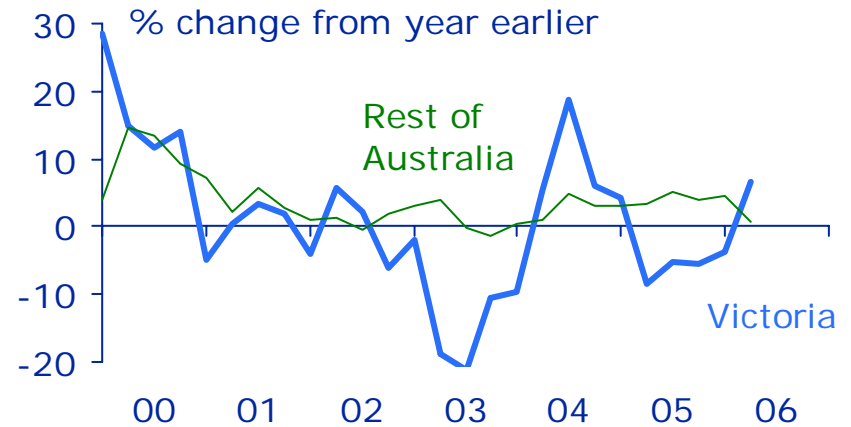
Business investment



Residential building

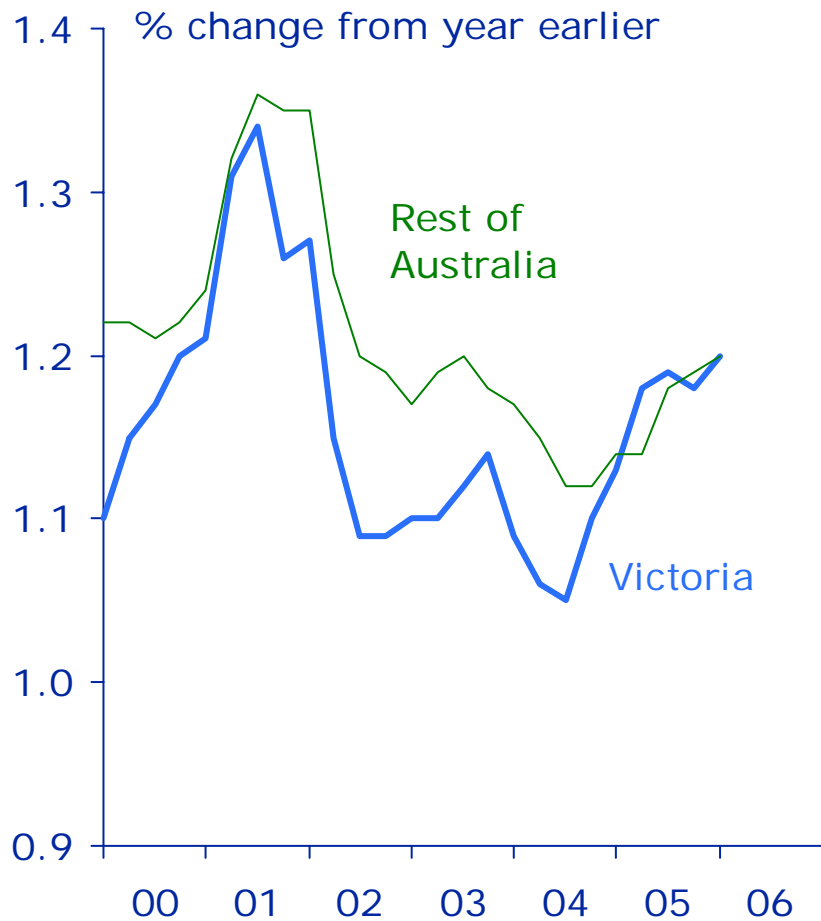


Exports of goods

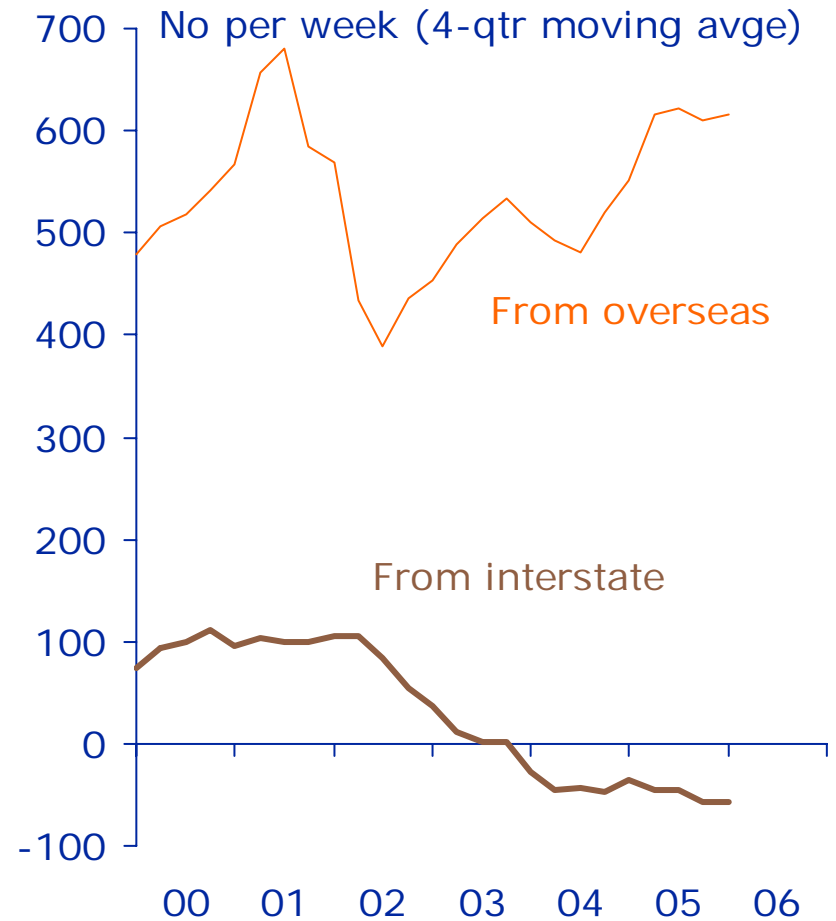


Victoria's population growth matches the national average, thanks to rising overseas immigration

Population growth

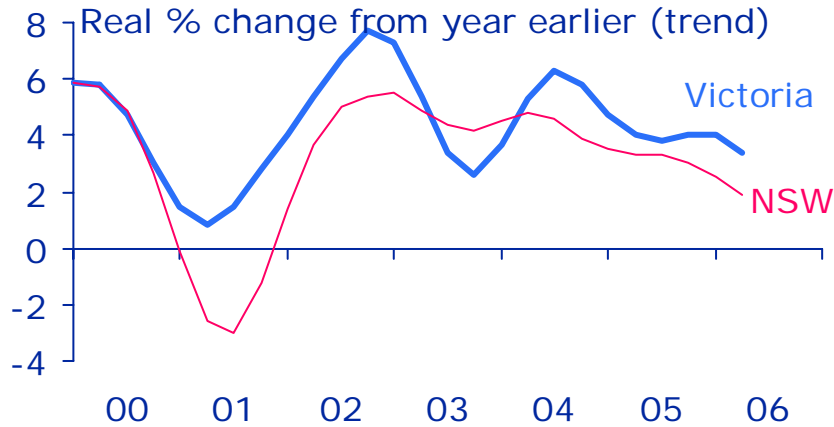


Migration to Victoria

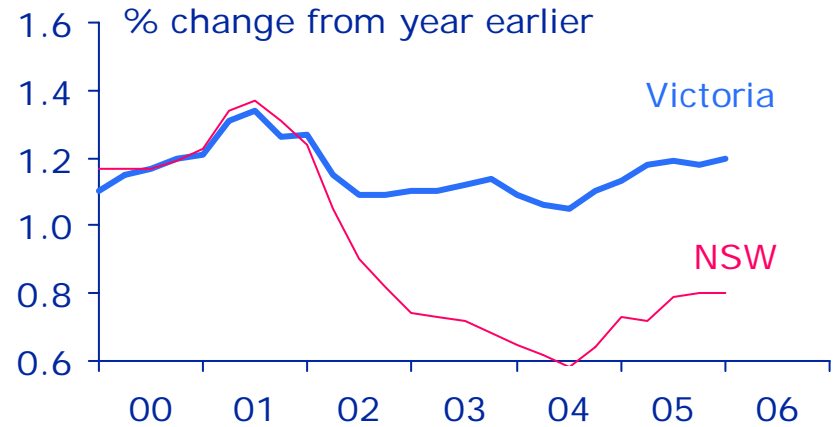


Victoria is, in particular, doing better than New South Wales

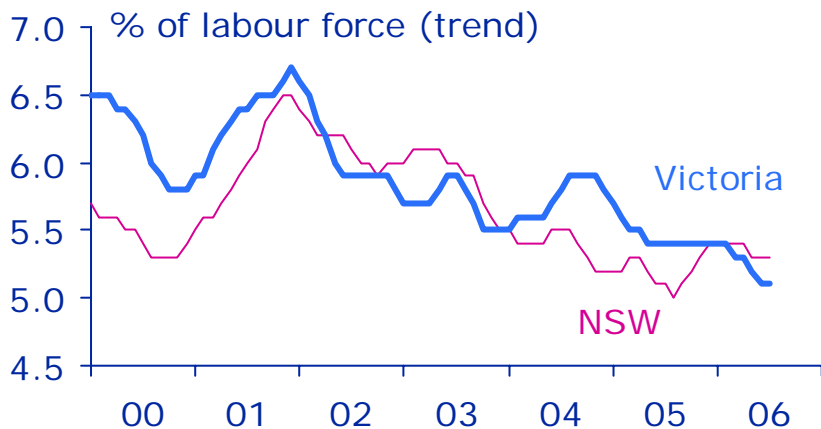
State final demand



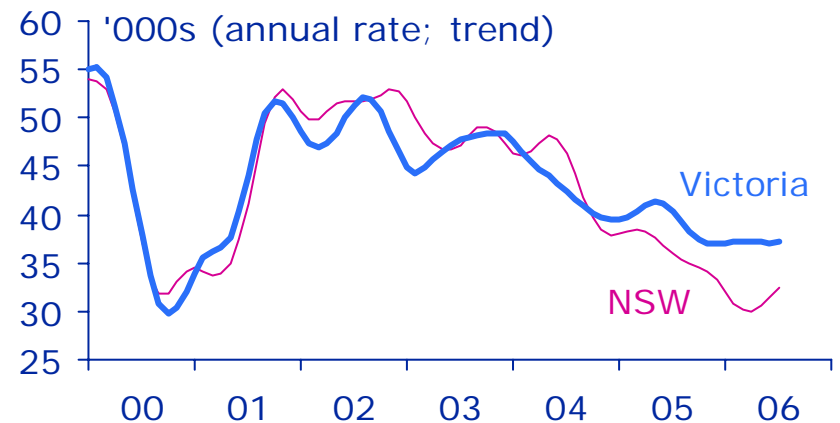
Population growth



Unemployment

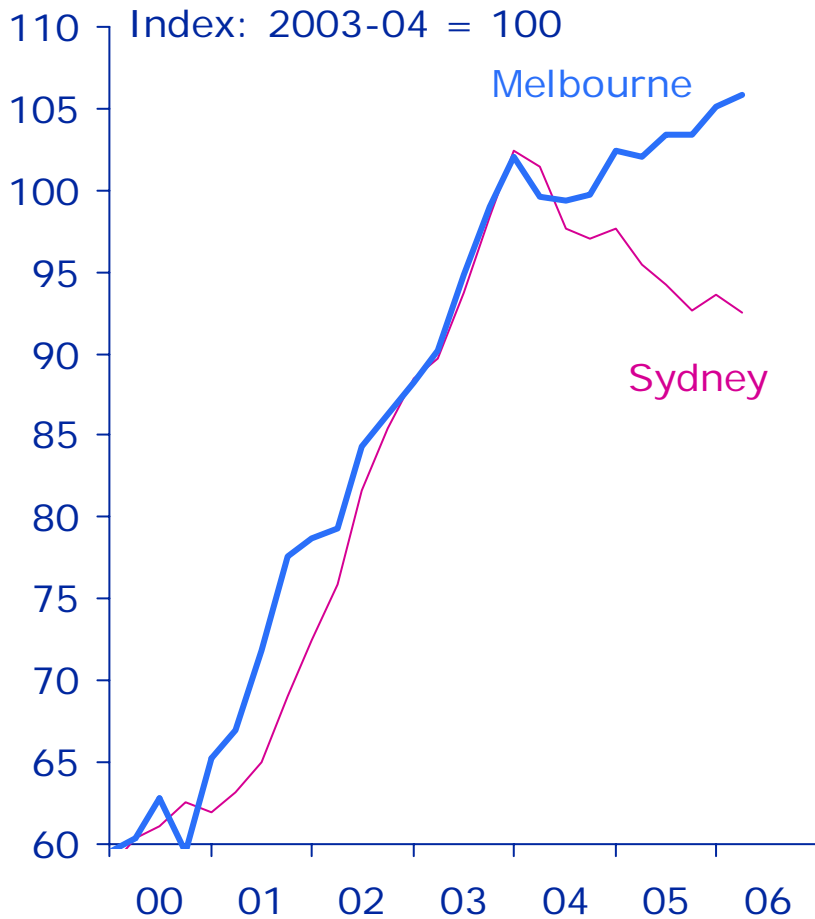


Residential building approvals

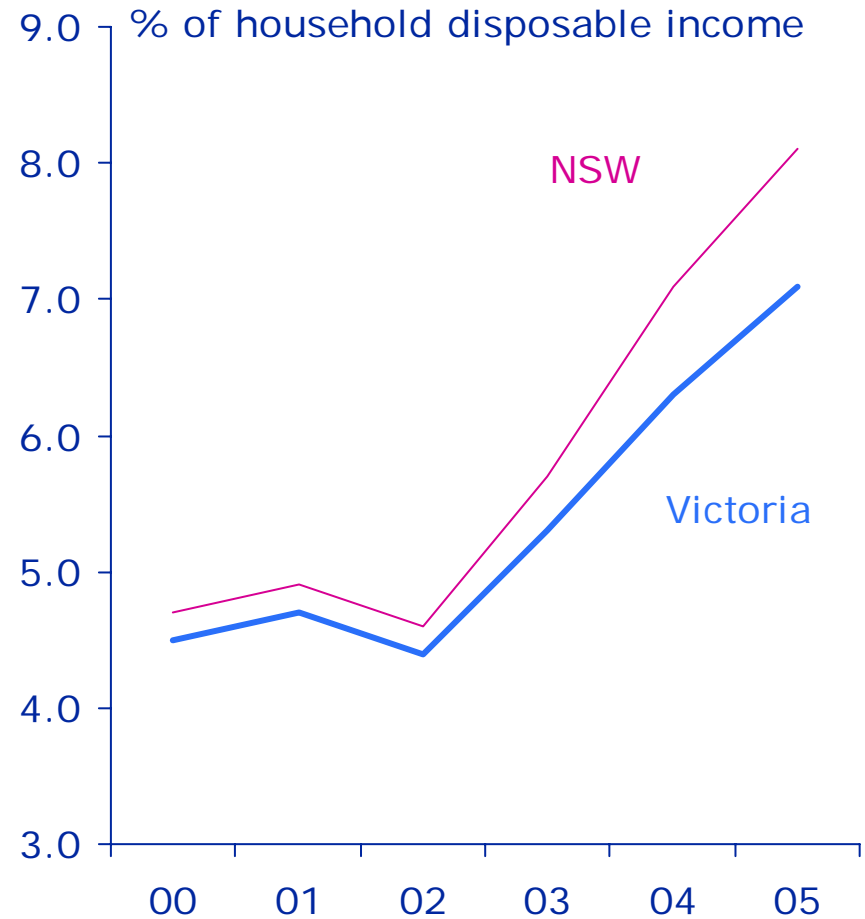


Melbourne house prices are holding up better, and Victorian home-buyers are under less stress

Established house prices

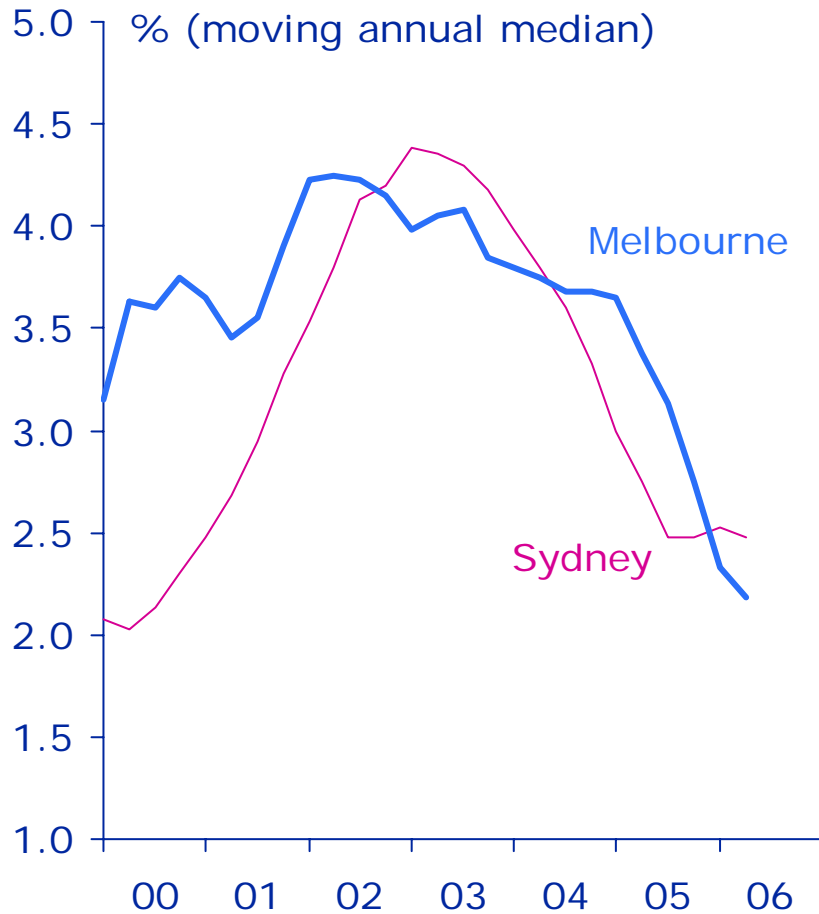


Mortgage interest payments

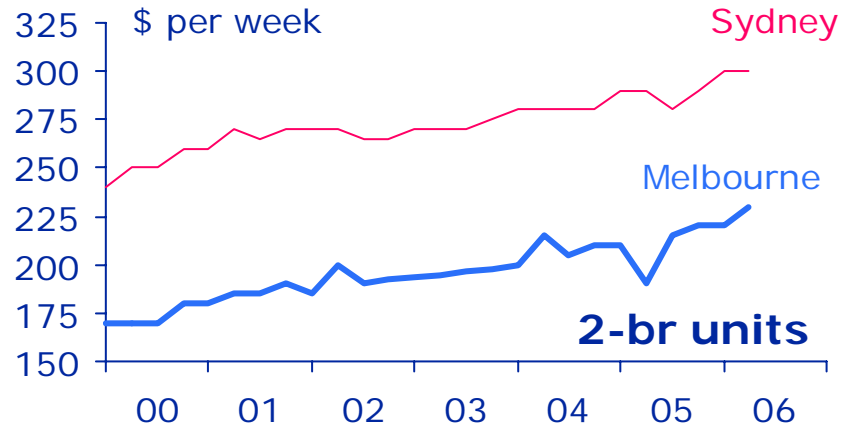
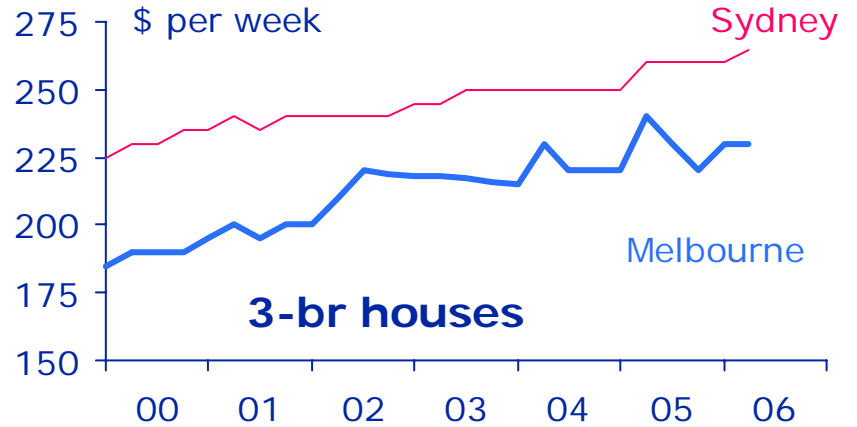


Melbourne's rental market is now tighter than Sydney's – which could mean pressure on rents

Rental vacancy rates

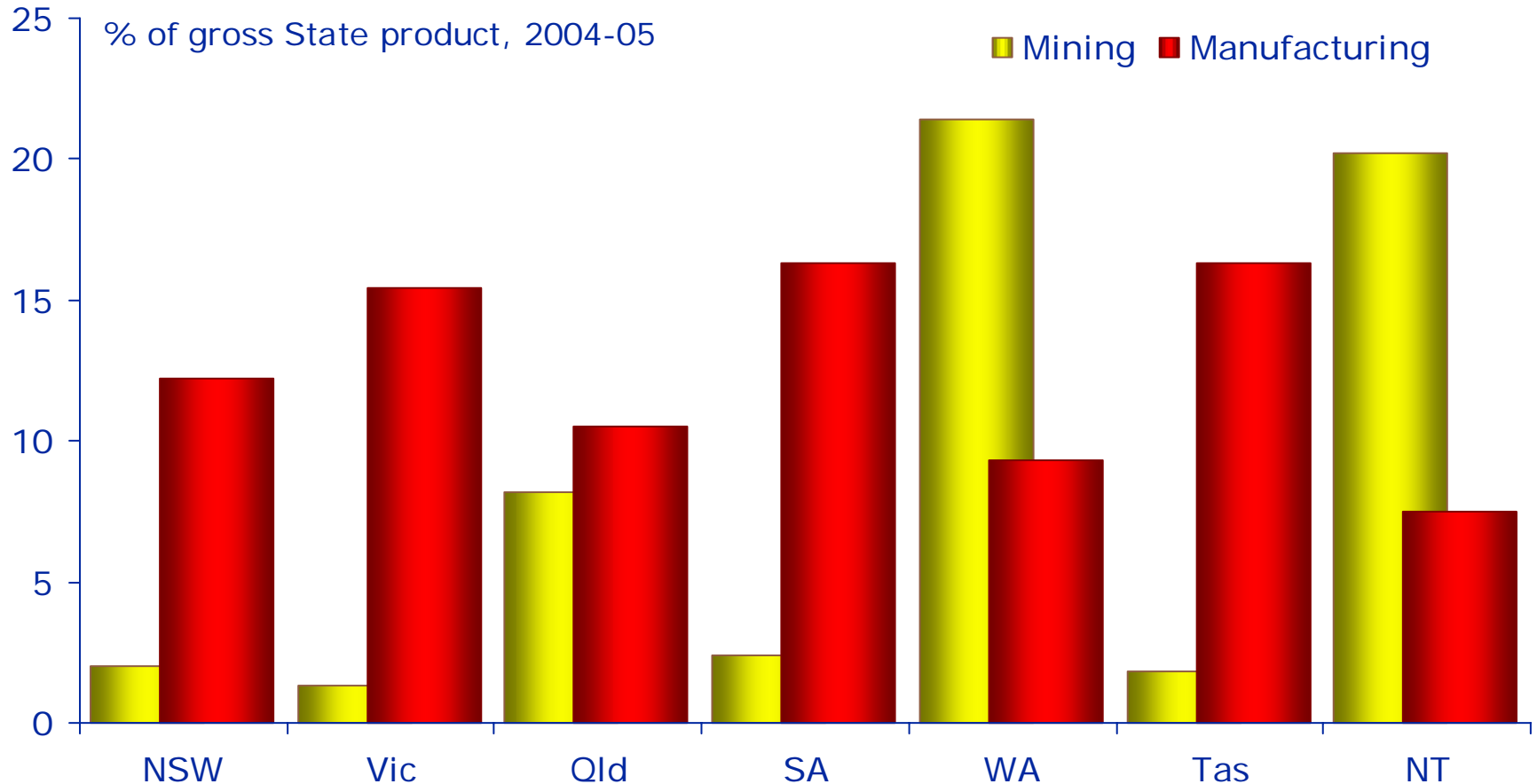


Median weekly rents



The resources boom benefits WA, Queensland and the NT more than other States

Mining and manufacturing as a share of State economies



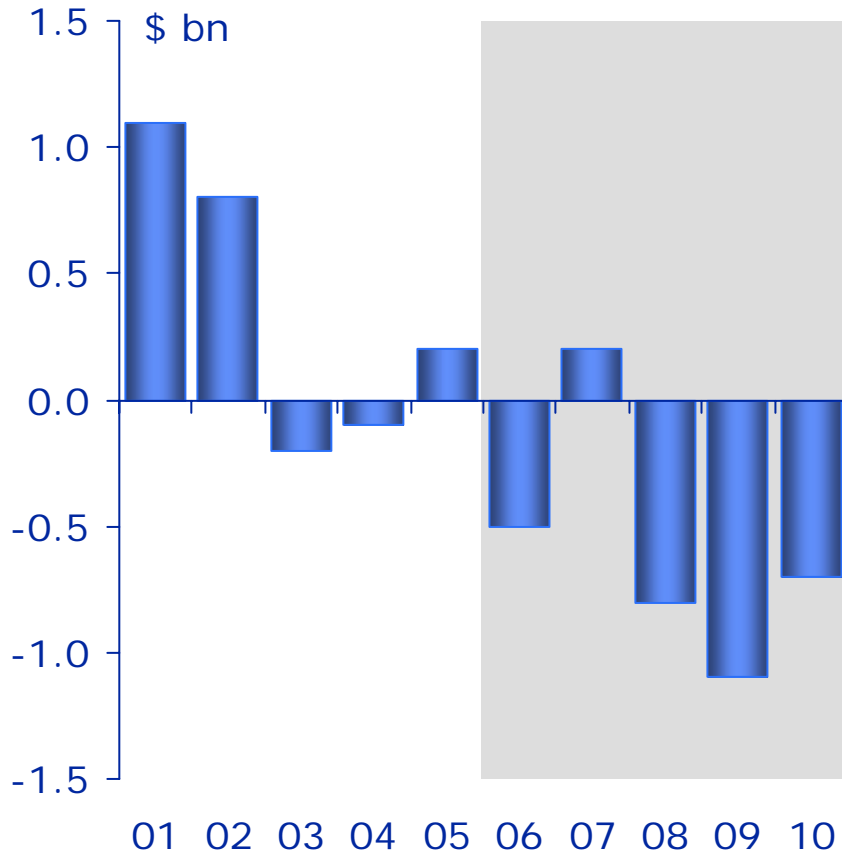
Sources: ABS; Economics@ANZ.

The resources boom will pose major challenges for Victoria in the years ahead

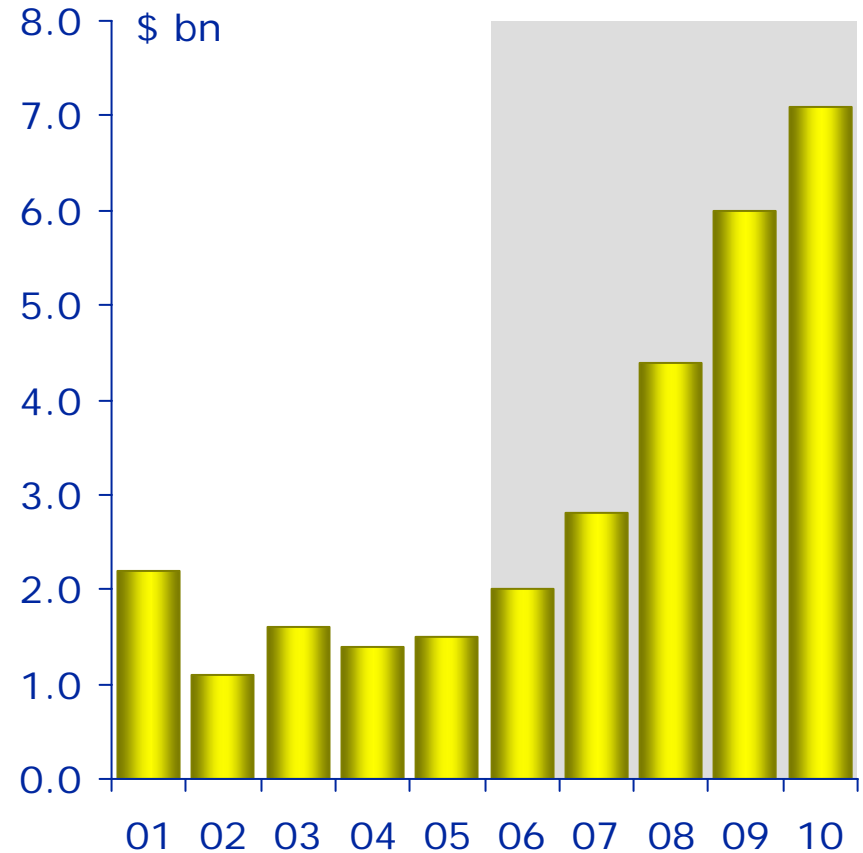
- Victorians are paying the cost of higher commodity prices (petrol, manufacturing inputs) but gaining few if any direct benefits from them
- Skilled labour and investment dollars may be pulled to the 'resource boom' States of WA, Qld and NT
 - likely to see an accelerated drift of mining company head offices to Perth
- Adverse effect of strong A\$ (induced by high mineral and energy commodity prices) on Victoria's trade-exposed manufacturing and rural sectors
 - if it wasn't for the commodities boom, the A\$ would probably be below US60¢ now
- Higher interest rates induced by the strains associated with the resources boom (including as a result of Commonwealth fiscal policy) will strain Victorian household finances

Victoria's budget will go into deficit over the next few years and net debt will increase ...

General government cash balance



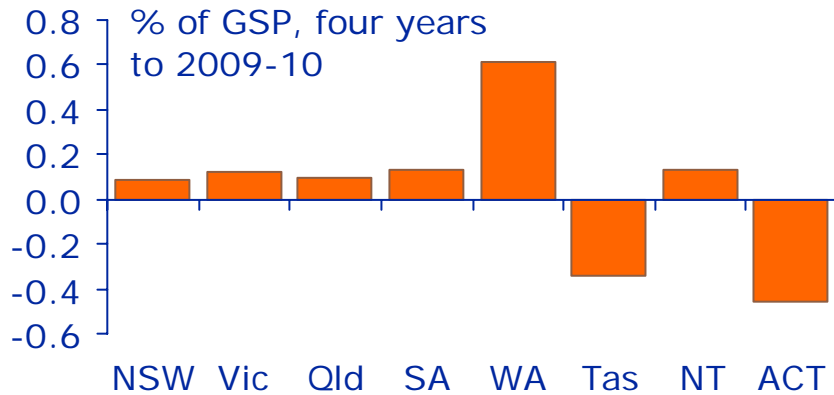
General government net debt



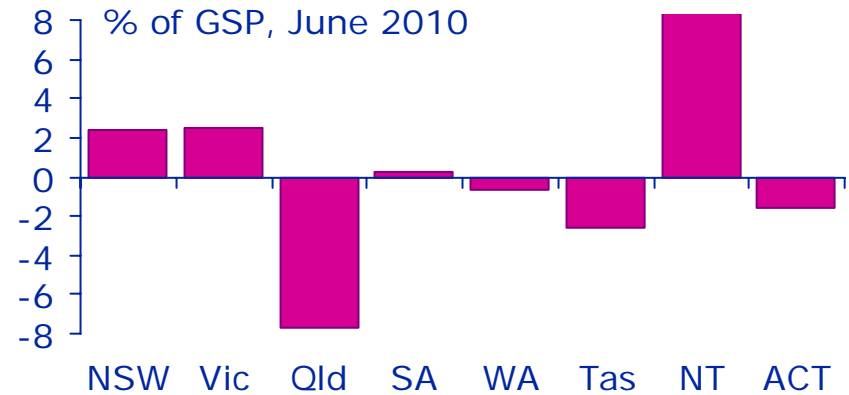
Sources: Victorian Budget Papers;
Economics@ ANZ.

However Victoria's budgetary position will remain strong relative to most other States

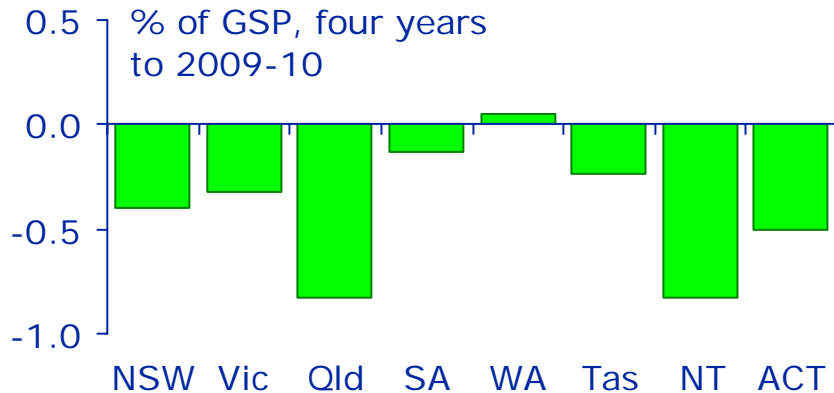
Net operating balance



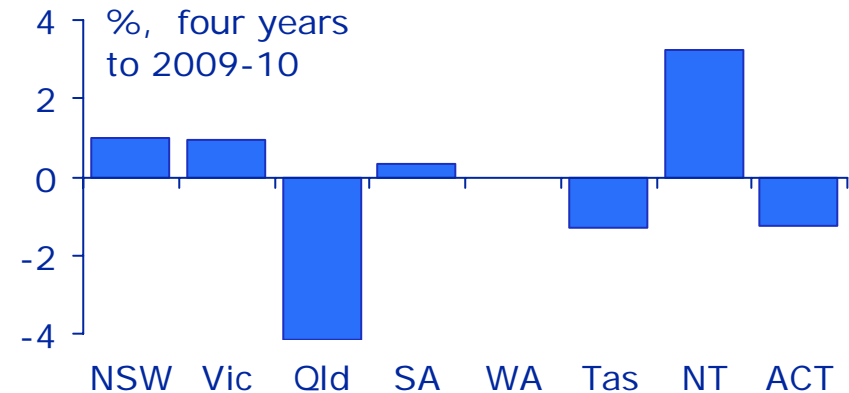
Net debt



Fiscal balance



Net interest as % of revenue



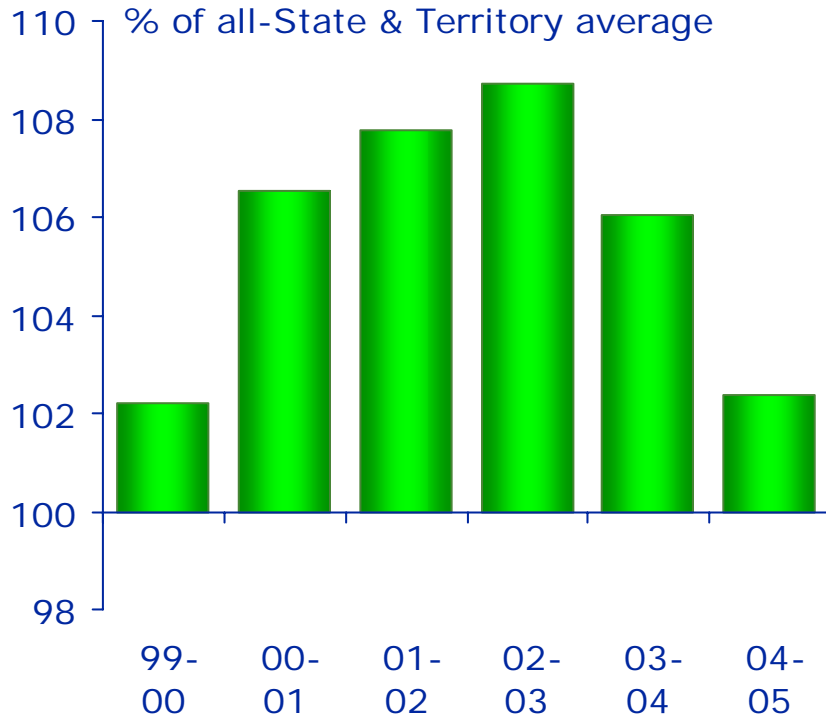
Note: SA figures are for three years ended 2008-09 or (for net debt) June 2009;
 GSP for Tasmania & NT after 2006-07 are ANZ estimates.
 Sources: ABS; State & Territory Budget Papers.

Some observations on State finances ...

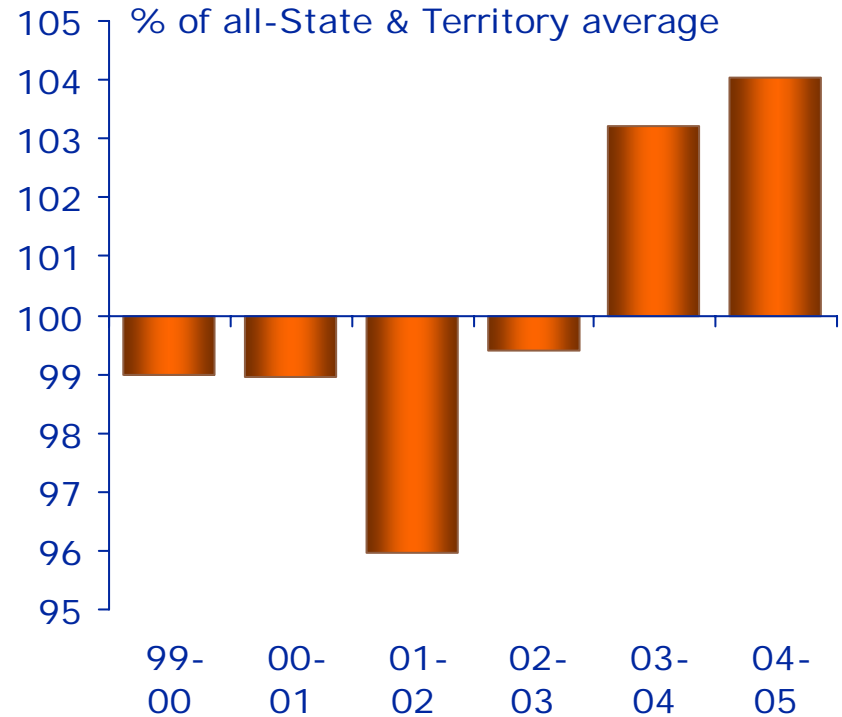
- In general, States should not run operating deficits
 - that is, recurrent expenses (wages & salaries, interest, grants etc) should not exceed revenue from taxes, Commonwealth grants, etc
 - States are not responsible for macro-economic policy
- There's nothing wrong, in principle, with States borrowing for capital expenditures (infrastructure)
 - there's no principle of economics or public finance which says the optimal level of debt for any government is zero
 - within reason, borrowing is an equitable way of ensuring that future generations of taxpayers contribute to the costs of creating assets from which they will benefit
- The borrowings now contemplated by the Victorian Government in no way imperil its finances)
 - Victoria regained its AAA-rating with a debt-GSP ratio around 6%
 - NSW never lost its AAA-rating even with a debt-GSP ratio of over 8%

Victoria already has above-average State taxes funding above-average public services

Victoria's "revenue-raising effort" ratio



Victoria's "level of service provision" ratio

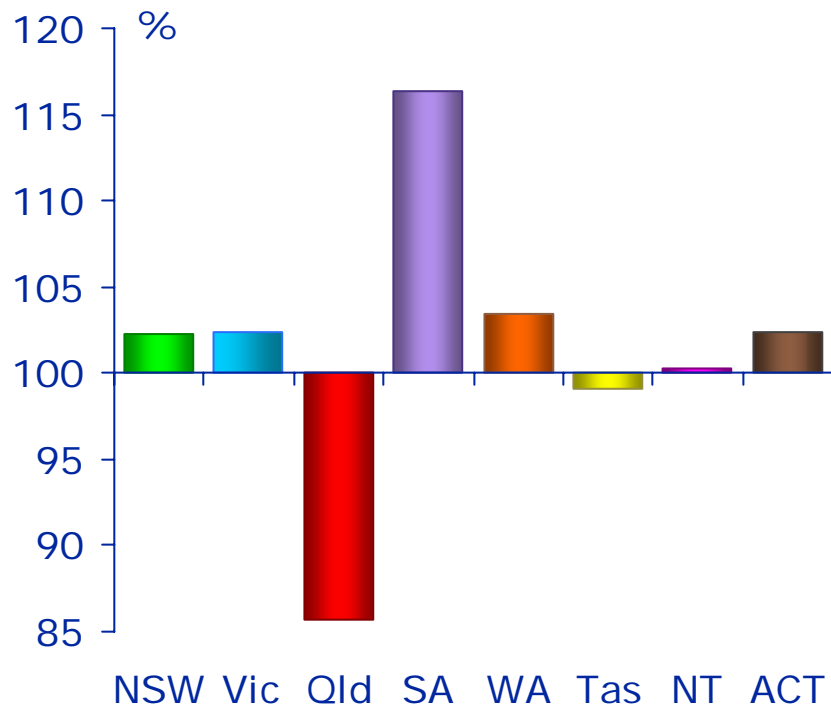


Note: "Revenue raising effort" is the ratio of actual per capita State taxation revenue to that which would be raised if the State tax regime were identical to the average of all States and Territories; while "level of service provision" is the ratio of actual per capita spending to that which would be required to provide services at the same level as the average of all States and Territories, in each case as assessed by the Commonwealth Grants Commission.

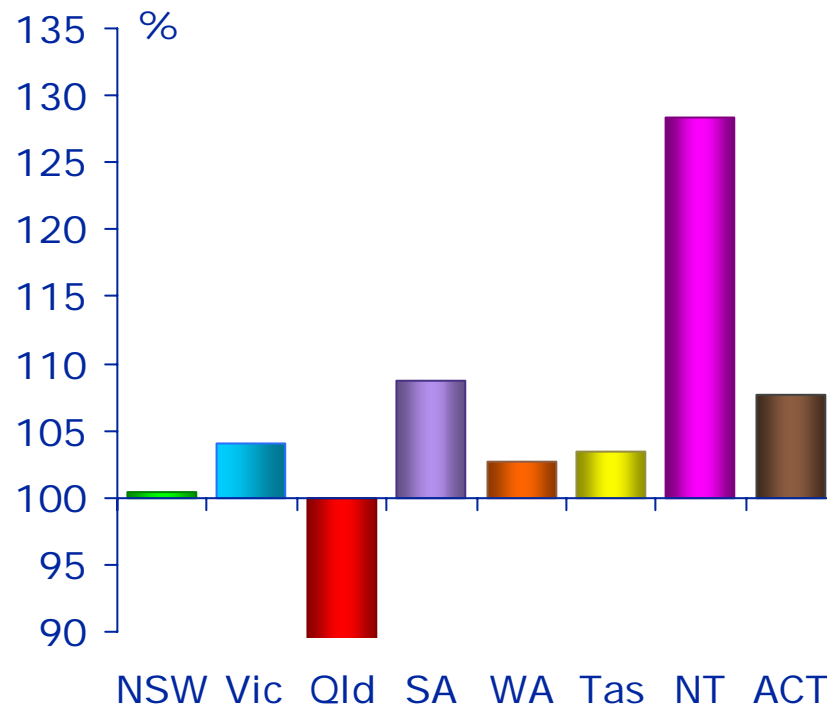
¹³Source: CGC 2006 Update; Economics@ANZ.

Victoria is by no means the 'highest taxing' - and certainly not the 'highest spending' State

State "revenue-raising effort" ratios, 2004-05



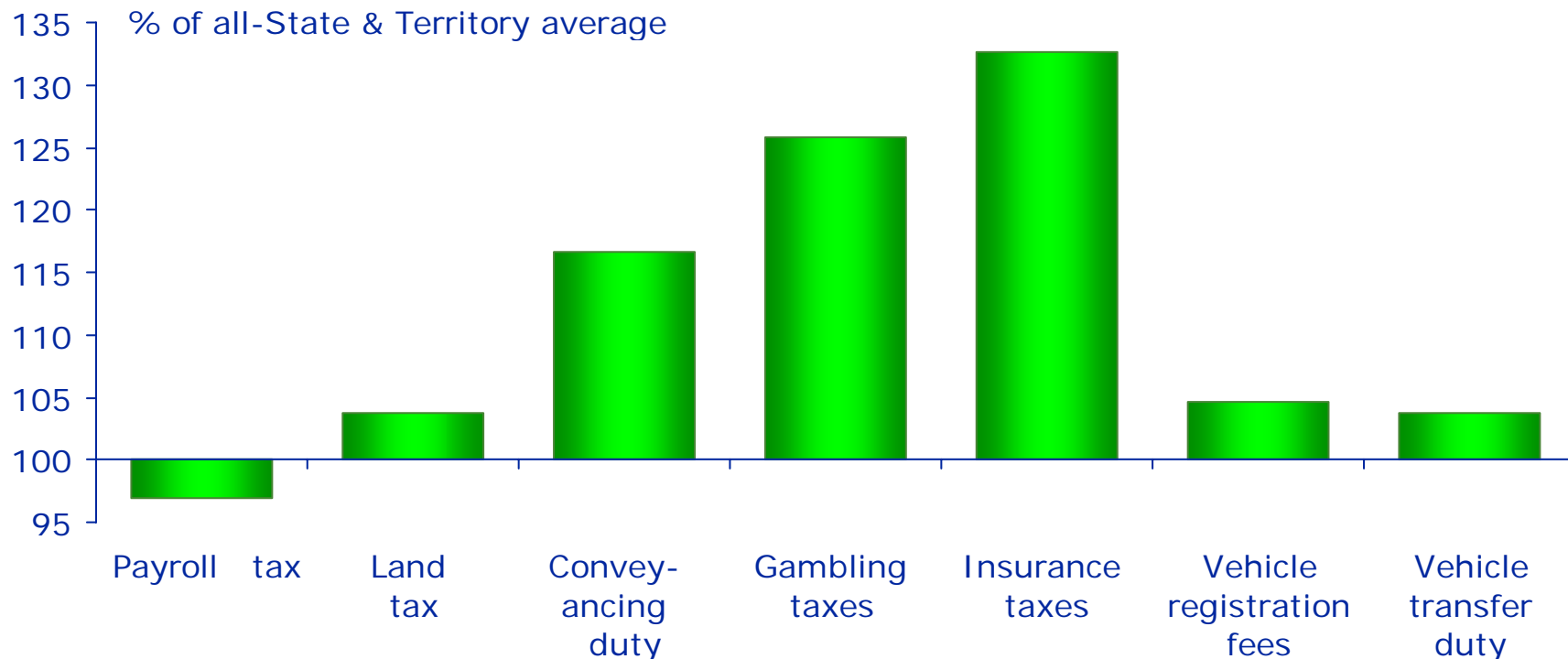
State "level of service provision" ratios, 2004-05



Note: "Revenue raising effort" is the ratio of actual per capita State taxation revenue to that which would be raised if the State tax regime were identical to the average of all States and Territories; while "level of service provision" is the ratio of actual per capita spending to that which would be required to provide services at the same level as the average of all States and Territories, in each case as assessed by the Commonwealth Grants Commission. *Source:* CGC Update 2006; Economics@ANZ.

Victoria relies relatively more heavily on stamp duties, gambling and insurance taxes

Victoria's "revenue-raising effort" ratio for selected taxes, 2004-05

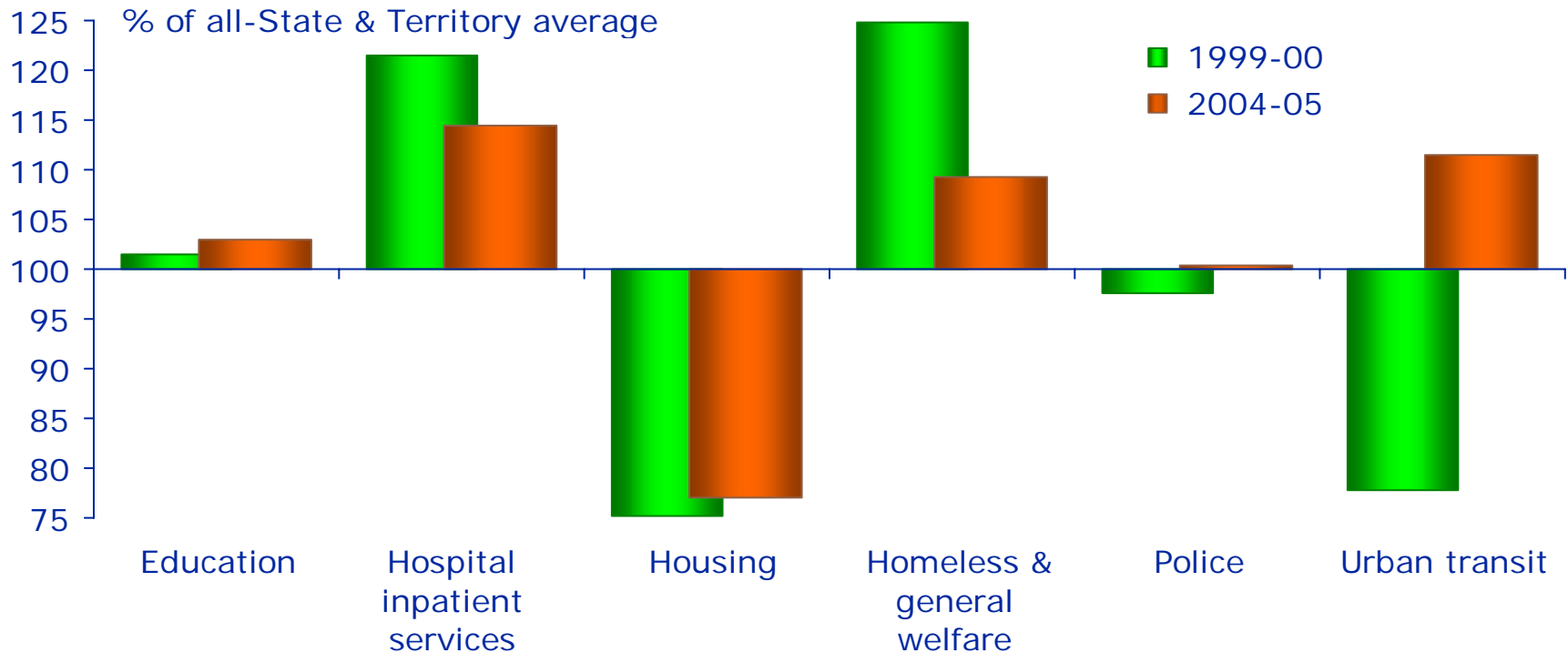


Note: "Revenue raising effort" is the ratio of actual per capita revenue to that which would be raised if the State tax regime were identical to the average of all States and Territories after taking account of differences in each government's capacity to raise revenue from each tax, as assessed by the Commonwealth Grants Commission.

Source: CGC State Update 2006 Attachment E.

Victoria is spending relatively more than average on most major service areas except housing

Victoria's "level of service provision" ratio for selected areas of State spending, 2004-05

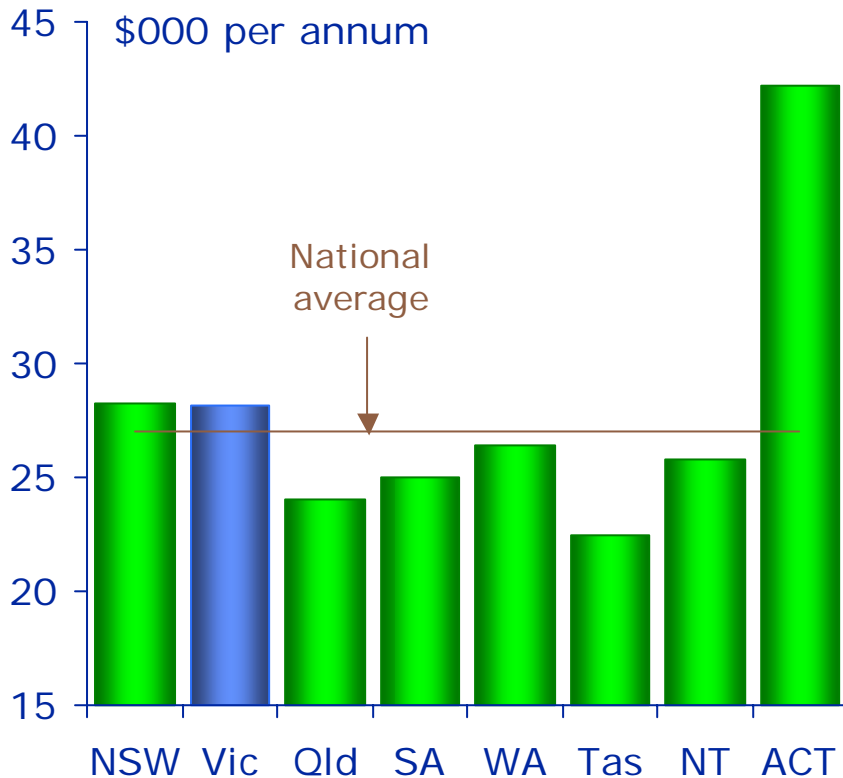


Note: "Level of service provision" is the ratio of actual per capita spending to that which would be required to provide services at the same level as the average of all States and Territories, after allowing for differences in the need for and per capita cost of providing each service, as assessed by the Commonwealth Grants Commission.

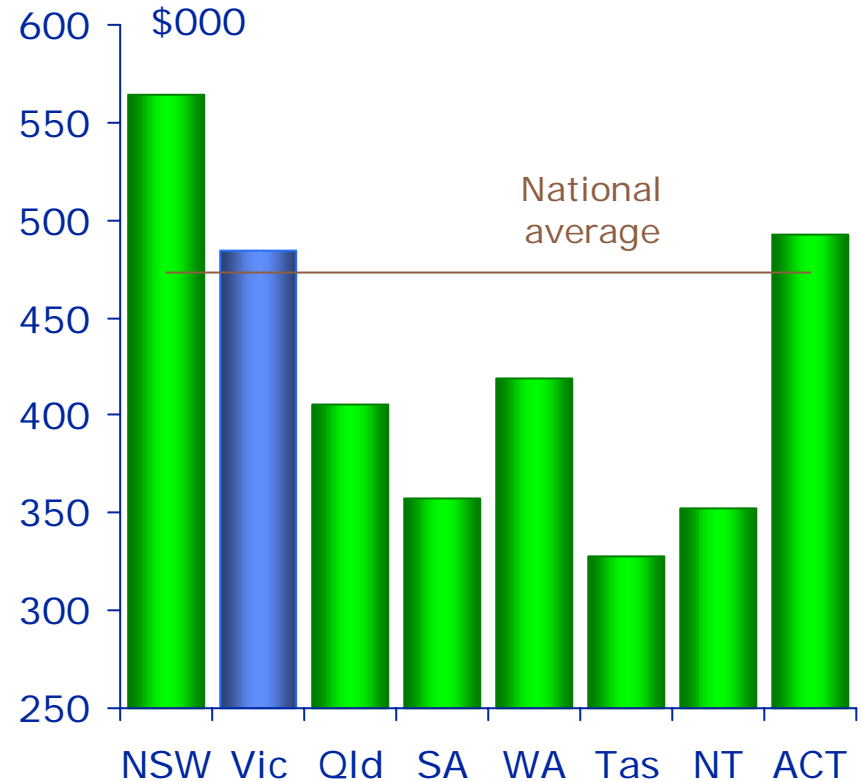
Source: CGC State Update 2006, Attachment E

Victoria remains a relatively wealthy State

Average household disposable income per capita, 2004-05



Average household net worth, 2003-04



Sources: ABS; Economics@ANZ.

Victoria should stop complaining about the Grants Commission's distribution of GST revenues

- Victoria is a rich State – per capita incomes 4% above the national average
 - it's odd to hear Labor Treasurers complaining about the redistribution of income from rich States to poor States (and Queensland is a relatively poor State)
- State Governments don't spend the tax revenues they raise in the areas where they raise it
 - so why should GST revenues be distributed in accordance with population or consumer spending?
- 'Horizontal fiscal equalization' is one of the main reasons why there's much less difference in income and wealth between Australian states than between US states or Canadian provinces
- The latest Grants Commission update suggests that WA and Queensland will cease being 'subsidized' within 3 years anyway

Conclusions

- **Victoria's economy has performed well in recent years**
 - economic growth has marginally exceeded the national average despite Victoria deriving little benefit from, and facing some challenges as a result of, the resources boom
 - in particular Victoria is faring much better than NSW
- **However Victoria's economy will probably grow a little less than the national average over the next few years**
 - as the resources sectors ('under-represented' in Victoria) draw jobs and investment dollars to the west and north
 - while manufacturing ('over-represented' in Victoria) struggles with rising costs and a strong exchange rate
- **Victoria's public finances are in good shape**
 - the fiscal deficits foreshadowed in the most recent State Budget are modest and manageable
 - but Victoria needs to ensure that its business environment (including State taxes, infrastructure and skills base) remains competitive
- **There is room for increased social spending but Victoria is already 'above-average' in many areas**