

Yesterday's Victorian Budget has been brought down in an economic context which has been consistently better than might have been expected for a State which has the smallest mining sector of any State or Territory and a manufacturing sector which accounts for almost 2 percentage points more of its economy than the national average.

Yet despite these apparent disadvantages, in circumstances where across the nation the resources sector is deriving enormous advantage from the global boom in demand for minerals and energy while the manufacturing sector's international competitiveness is eroded by the strength in the A\$ (which is in turn a by-product, in part, of the commodities boom), Victoria's economy has done remarkably well in recent years.

Over the past five years, Victoria's economy has grown at an average annual rate of 3% per annum, in line with the national average, while real per capita gross product growth of just over 2% per annum has actually exceeded the national average by around one-quarter of a percentage point per annum. In particular, Victoria has done much better than New South Wales, even though NSW is the second-largest exporter of Australia's largest commodity export, coal. Victoria's real per capita growth rate has been nearly three times faster than its larger northern neighbour over the past five years.

As a result, it would not be surprising if, when figures for 2006-07 are published in November this year, Victoria's per capita gross product exceeded New South Wales' for the first time since 1985-86 – a dramatic turnaround from the beginning of this decade when Victoria's per capita gross product was almost 8% below the equivalent figure for New South Wales.

Victoria has also done surprisingly well in employment creation. Over the five years to March, more jobs have been created in Victoria than in any other State except Queensland, and almost 10% more than in New South Wales. The proportion of working-age Victorians in employment has in recent years consistently been around 1.5 percentage points higher than in New South Wales.

Differences in economic performance among the States and Territories reflect a myriad of factors, including resource endowment, demographic factors and historical experience, State economic policies can have an impact at the margin, for better or worse.

In Victoria's case the impact of State economic policies has been positive. In the first place, the Kennett and Bracks Governments have consciously and actively sought economic growth, something which has not always been the case in New South Wales over the same period. Successive Victorian Governments have welcomed population growth, and the development which has accompanied it. Partly as a result, more dwellings were commenced in Victoria last year than in any other State, nearly 30% more than in New South Wales where until about two years ago it was official State Government policy to discourage immigration.

Second, successive Victorian Governments have consciously sought to foster a competitive business environment. According to Commonwealth Grants Commission estimates, Victoria has the third lowest State tax burden (after Queensland and Tasmania) of any State or Territory. In addition, Victorian businesses have benefited from successive reductions in workers' compensation premiums, and from the Kennett Government's referral of industrial relations powers to the Commonwealth (which, conspicuously, has not been reversed by the Bracks Government).

This is reflected in the surprisingly strong growth in Victorian business investment, which in 2005-06 represented an above-average 16% of Victoria's gross product, well above the business investment share of gross product in NSW.

Third, Victoria has been more assiduous in pursuing economic reform than most other States, and in particular New South Wales. As an example, Victoria privatized its electricity utilities in the mid-1990s and created contestable electricity markets, whereas New South Wales and (for the most part) Queensland have not done so. Over the last five years, electricity prices in Melbourne have risen by less than one-third as much as in Sydney or Brisbane. More recently Victoria has taken a leadership role in advocating a new wave of economic reforms in infrastructure, education and health.

To be sure, Victoria will continue to face significant economic challenges as a result of the 'pull' of labour and capital to the resource-boom states, an elevated exchange rate, and the impact of climate change. It would be quite unrealistic to expect Victoria's economy to grow as strongly as Western Australia's or Queensland's over the remainder of the decade. But Victoria is facing these challenges from a stronger position than its bigger neighbour.