Putting Patients First

STRATEGY AND OUTLOOK
Budget Paper No. 2
Presented by Tim Pallas MP
Treasurer of the State of Victoria
Strategy and Outlook

2022-23

Presented by

Tim Pallas MP
Treasurer of the State of Victoria
for the information of Honourable Members

Budget Paper No. 2
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CHAPTER 1 – ECONOMIC AND FISCAL OVERVIEW

VICTORIA’S ECONOMY ROARING AHEAD

The outlook for the Victorian economy is positive, with the economy forecast to grow by 3.25 per cent in 2022-23. This is set to follow expected growth of 5.50 per cent in 2021-22 amid the economy’s recovery from the effects of the COVID-19 pandemic.

The outlook for the labour market is also strong. Employment is forecast to grow by 1.75 per cent in 2022-23, following expected growth of 3.00 per cent in 2021-22. Unemployment is forecast to remain around its lowest level since current records began, averaging 4 per cent through 2022-23.

Employment has risen strongly in recent months, as public health restrictions necessary to contain the Delta variant of COVID-19 in the second half of 2021 were eased, and the demand for workers was at very high levels. The Omicron variant was another challenge for the Victorian labour market in January 2022, although employment declined only modestly and had fully recovered by February.

The Government’s Jobs Plan, announced as part of the 2020-21 Budget, included a target to create 400 000 jobs by 2025, with half of these by 2022. The strength of the Victorian economic recovery means the interim target of 200 000 jobs has already been met, and the Victorian economy is well on track to reach the overall target.

Overall, employment has risen by 280 000 people since the trough in September 2020 and full-time employment is well above its pre-pandemic levels, and the workforce participation rate is near a record high. The unemployment rate is at 4 per cent, the lowest since current records began, and the underemployment rate, which reflects employed workers who want to work more hours, is at its lowest level since 2002. In regional Victoria, the unemployment rate is around a record low at 3.2 per cent.

The recovery in the labour market has been inclusive. Women, young people and single parents were most affected during the COVID-19 outbreaks in both 2020 and 2021, given their higher levels of employment in the industries most affected, including hospitality, arts and recreation, and administrative and support services. Many single parents – predominantly women – were also affected by the need to leave work to undertake caring responsibilities. Yet by early 2022, the proportion of workers among these groups had recovered to be above pre-pandemic levels.
Robust household and business balance sheets, and a planned increase in business investment, will underpin strong economic growth in 2022-23. Growth will also be supported by high levels of government infrastructure investment. With the economy having recovered well to date, and further strong growth expected, real GSP per capita (a key measure of living standards) is also expected to be higher across the forward estimates than was forecast in the 2019-20 Budget Update prior to the pandemic.

While the impacts of COVID-19 have been severe across the global economy since early 2020, the Victorian economy has proven highly resilient and has recovered with increasing speed following each COVID-19 outbreak. Following the Delta variant of COVID-19 and associated public health restrictions from July 2021, Victoria’s state final demand again recovered to be above pre-pandemic levels by December 2021.

Support from both the Victorian and Commonwealth governments, along with the Reserve Bank of Australia, helped cushion the impact of COVID-19 and necessary public health restrictions on the economy. Along with support to households and businesses, public demand has played a key role in supporting the economy during the pandemic. From the latter part of 2021, private spending has increasingly driven the economy, with household spending and business investment recovering strongly. Further growth in consumer spending and business investment is expected to drive economic growth in 2022-23.

Following the strength of the economic recovery to date, and further growth forecast in 2022-23, the Victorian economy is expected to be 8.7 per cent larger in 2022-23 than it was in 2018-19, despite the impact of the pandemic over this period.

**Chart 1.1: Real economic growth, actual and forecast, Victoria and Australia (a)**

![Chart 1.1: Real economic growth, actual and forecast, Victoria and Australia (a)](chart1.png)

*Source: Australian Bureau of Statistics; Department of Treasury and Finance; Commonwealth Treasury*

*Note:*

(a) Forecasts are rounded to the nearest 0.25 percentage points.
STRONG FINANCIAL MANAGEMENT

Prior to the COVID-19 pandemic, the Government demonstrated its strong financial management by adhering to a robust fiscal framework, including consistent operating surpluses and maintaining debt at a sustainable level, while delivering improved services and infrastructure.

Over the past two years, the COVID-19 pandemic severely impacted the state’s financial position and outlook. The Government prioritised the use of its balance sheet to support the Victorian community, Victorian households and the economy. This approach was consistent with stimulus approaches elsewhere in Australia and around the world.

In the 2020-21 Budget at the height of the pandemic, the Government developed a fiscal strategy to manage the extreme circumstances the state was facing and provide the foundations for recovery. It involved a four-step plan to support Victorians through the COVID-19 pandemic and to restore the budget in the medium term. The four-step plan provided a clear framework:

- **Step 1**: creating jobs, reducing unemployment and restoring economic growth
- **Step 2**: returning to an operating cash surplus
- **Step 3**: returning to operating surpluses
- **Step 4**: stabilising debt levels.

Central to the Government’s COVID-19 strategy was supporting and delivering funding to the health system along with the necessary support for those most affected by the impact of public health restrictions.

This strategy of supporting the vulnerable and protecting the economy delivered strong foundations to manage the impact of COVID-19 and ensured the economy was in a robust position to rebound quickly as restrictions eased.

**Progress towards achieving the Government’s fiscal strategy**

The Government remains committed to the four-step fiscal strategy. Recent economic indicators have showed this strategy is working, with the economy rebounding strongly in part due to the measures included in the Jobs Plan announced in the 2020-21 Budget. As a result, the 2022-23 Budget is forecasting significant improvement in the state’s key fiscal aggregates when compared to the 2021-22 Budget Update, released in December 2021.

The first step – creating jobs, reducing unemployment and restoring economic growth – has progressed well. Employment has risen strongly in recent months, as public health restrictions necessary to contain the Delta variant of COVID-19 in the second half of 2021 were eased, and the demand for workers increased. The Omicron variant was another challenge for the Victorian labour market in January 2022, although employment declined only modestly and had fully recovered by February.

The second step in the Government’s fiscal strategy, returning to an operating cash surplus, means the state is generating sufficient cash inflows to offset its cash outflows on operating activities, a key pillar of fiscal sustainability. The Government is forecasting a return to an operating cash surplus from 2022-23 onwards, in line with the 2021-22 Budget Update.
The third step, returning to an operating surplus, is important as this is where the Government generates sufficient revenues to not just cover its cash expenditure, but also support the ongoing replacement of existing assets. The 2022-23 Budget shows the net result from transactions for the general government sector is forecast to be in surplus by $0.7 billion in 2025-26.

The fourth and final step in the Government’s fiscal strategy, stabilising net debt as a percentage of GSP, remains an important medium-term objective.

Net debt is expected to be lower in each year of the forward estimates compared with the 2021-22 Budget Update – and $7.8 billion lower by June 2025. The Government remains committed to stabilising net debt as a percentage of GSP over the medium term.

Financial position

The net result from transactions for the general government sector is forecast to be in surplus by $0.7 billion in 2025-26, demonstrating the Government’s commitment to strong financial management despite the challenges over the last two years.

The net cash flows from operating activities for the general government sector is forecast to be in surplus by $1.3 billion in 2022-23, increasing to $5.5 billion in 2025-26, an improvement compared with the position in the 2021-22 Budget Update.

Total revenue for the general government sector is expected to be $81.9 billion in 2021-22, an upgrade of $3.9 billion from the 2021-22 Budget Update largely due to the continued strength in Victoria’s property market. Revenue growth is then expected to average 2.8 per cent a year over the budget and forward estimates, reaching $91.4 billion in 2025-26.

Total general government sector expenditure is expected to reach $99.5 billion in 2021-22, before reducing by 9.7 per cent to $89.8 billion in 2022-23. This reduction reflects the targeted and short-term nature of initiatives to fund the public health response and support the economic recovery. Expenditure growth is expected to remain moderate over the forward estimates, reaching $90.8 billion in 2025-26.

Government infrastructure investment (GII) is expected to average $21.3 billion a year over the budget and forward estimates, reflecting the continuation of Victoria’s Big Build.

Net debt is expected to be $101.9 billion at June 2022 and $167.5 billion by June 2026. As a proportion of GSP, net debt is projected to be 19.8 per cent at June 2022 and 26.5 per cent by June 2026.

Interest expense as a share of total revenue is expected to remain modest, averaging 6.0 per cent a year over the budget and forward estimates, well below the levels seen during the 1990s.
### Table 1.1: General government fiscal aggregates

<table>
<thead>
<tr>
<th>Measure</th>
<th>Unit of measure</th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net result from transactions</td>
<td>$ billion</td>
<td>(14.6)</td>
<td>(17.6)</td>
<td>(7.9)</td>
<td>(3.3)</td>
<td>(1.1)</td>
<td>0.7</td>
</tr>
<tr>
<td>Net cash flows from operating activities</td>
<td>$ billion</td>
<td>(13.0)</td>
<td>(11.8)</td>
<td>1.3</td>
<td>0.8</td>
<td>3.6</td>
<td>5.5</td>
</tr>
<tr>
<td>Government infrastructure investment</td>
<td>$ billion</td>
<td>15.0</td>
<td>18.9</td>
<td>21.4</td>
<td>23.0</td>
<td>21.7</td>
<td>19.2</td>
</tr>
<tr>
<td>Net debt</td>
<td>$ billion</td>
<td>72.7</td>
<td>101.9</td>
<td>118.5</td>
<td>137.4</td>
<td>154.8</td>
<td>167.5</td>
</tr>
<tr>
<td>Net debt to GSP (c)</td>
<td>per cent</td>
<td>15.3</td>
<td>19.8</td>
<td>21.7</td>
<td>24.1</td>
<td>25.8</td>
<td>26.5</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) Includes general government net infrastructure investment and the estimated construction costs of public private partnership projects.
(b) Includes the estimated private sector construction related expenditure associated with the North East Link held in the public non-financial corporations (PNFC) sector.
(c) The ratios to gross state product (GSP) may vary from publications year to year due to revisions to the Australian Bureau of Statistics GSP data.

### Debt stabilisation strategy

Step 4 of the fiscal strategy is to stabilise the growth in net debt. This step involves progressively improving the operating cash flow surplus to pre-pandemic levels. These surpluses will fund a higher proportion of capital expenditure, reducing the reliance on borrowings.

The net debt to GSP ratio provides an indication of the size of the state’s debt compared to the size of the economy. By comparing what the state owes with what it produces, the net debt to GSP ratio provides an indication of the state’s ability to service its debt.

Chart 1.4 shows that the annual growth rate of net debt to GSP increased across the three years from 2019-20 due to the impact of the COVID-19 pandemic. While both net debt and net debt to GSP are still projected to rise over the forward estimates, the rate of growth slows from 2022-23 and will continue to reduce further over the medium term.
Chart 1.4: Annual net debt to GSP ratio \(^{[a][b]}\)

Source: Department of Treasury and Finance

Notes:
(a) The decrease in 2016-17 largely reflects the receipt of proceeds from entering into a medium-term lease over the operations of the Port of Melbourne.
(b) The increase in 2019-20 also reflects the impact of accounting standards changes. The step change increase in net debt includes the requirement to classify operating leases as debt and the treatment for service concession arrangements, including certain public-private partnerships.

Box 1.2: The Victorian Future Fund

The Government increased public spending to cushion the impact of COVID-19 on the Victorian economy, households and community, and the use of the Government’s balance sheet to support the Victorian community has led to a necessary increase in debt.

The Victorian Future Fund (the Fund) will be established by the Government to manage the fiscal impact of COVID-19 and deliver positive outcomes for Victorians by reducing the debt burden on future generations. The Fund will support the state’s debt stabilisation strategy.

The Fund will initially be established using proceeds from the VicRoads Modernisation Joint Venture that is currently progressing. The investment returns from the Fund will be quarantined and returned to the Fund so that its balance will grow over time to offset borrowings. Both the initial investment and future returns will be used to repay COVID-19 borrowings. The Fund is projected to have a balance of around $10 billion in the medium term.

Further investments will be made in the future into the Fund through proceeds from designated government land sales and a proportion of future budget surpluses once net debt stabilises.
The Fund will be managed by the Victorian Funds Management Corporation (VFMC), the state’s specialist investment agency, by implementing a diversified investment strategy designed to deliver returns that exceed the savings that would otherwise have been achieved. These excess returns will, over time, improve the state’s operating result and net debt position, further supporting the state’s debt stabilisation strategy.

The Fund will be managed in line with strict environmental, social and governance (ESG) principles consistent with other investments managed by the VFMC.

**Longer-term objectives and targets**

The long-term financial management objectives remain unchanged from the 2021-22 Budget Update.

**Table 1.2: Long-term financial management objectives**

<table>
<thead>
<tr>
<th>Priority</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sound financial management</td>
<td>Victoria’s finances will be managed in a responsible manner to provide capacity to fund services and infrastructure and support households and businesses in the economic recovery at levels consistent with sound financial management.</td>
</tr>
<tr>
<td>Improved services</td>
<td>Public services will improve over time.</td>
</tr>
<tr>
<td>Building infrastructure</td>
<td>Public infrastructure will grow steadily over time to meet the needs of a growing population.</td>
</tr>
<tr>
<td>Efficient use of public resources</td>
<td>Public sector resources will be invested in services and infrastructure to maximise the economic, social and environmental benefits.</td>
</tr>
<tr>
<td>A resilient economy</td>
<td>Increase economic resilience by supporting an innovative and diversified economy that will unlock employment growth, long-term economic growth and productivity in Victoria.</td>
</tr>
</tbody>
</table>

Progress towards these financial management objectives is supported by the measures and targets in Table 1.3. These measures and targets are also unchanged from the 2021-22 Budget Update.

**Table 1.3: Financial measures and targets for the 2022-23 Budget**

<table>
<thead>
<tr>
<th>Financial measures</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net debt to GSP</td>
<td>General government net debt as a percentage of GSP to stabilise in the medium term.</td>
</tr>
<tr>
<td>Interest expense to revenue</td>
<td>General government interest expense as a percentage of revenue to stabilise in the medium term.</td>
</tr>
<tr>
<td>Superannuation liabilities</td>
<td>Fully fund the unfunded superannuation liability by 2035.</td>
</tr>
<tr>
<td>Operating cash surplus</td>
<td>A net operating cash surplus consistent with maintaining general government net debt at a sustainable level after the economy has recovered from the COVID-19 pandemic.</td>
</tr>
</tbody>
</table>
SUMMARY OF INITIATIVES

The 2022-23 Budget provides $22.2 billion in output spending and invests $6.7 billion in new and improved assets. This will build world-class hospitals and schools, help Victorians into housing, and develop Victoria’s iconic sporting and cultural facilities.

Since 2014, our infrastructure agenda has supported, or will support, more than 191 000 jobs. Importantly, this budget also supports Victorian workers by investing in training, sick leave for casual and insecure workers, and mental health services.

Pandemic Repair Plan

The COVID-19 pandemic has put unprecedented pressure on health systems right across Australia and around the world. The Government’s Pandemic Repair Plan includes more than $12 billion for the health system, improving emergency response and supporting healthcare workers following the impacts and disruptions of the COVID-19 pandemic.

The Government is investing $1.5 billion to provide 40 000 extra surgeries in the next year, building up to a total of 240 000 surgeries annually by 2024 and to increase elective surgery capacity to beyond pre-pandemic levels. Funding is provided to establish Rapid Access Hubs, access private surgical capacity to deliver public surgeries, recruit up to 2 000 healthcare workers through an international recruitment search, and Frankston Private Hospital will be transformed into a public surgery centre with the capacity to support up to 9 000 public patients per year once fully operational in 2023.

The 2022-23 Budget provides $4.2 billion to continue to support the health system to manage the COVID-19 pandemic. This includes $1.1 billion to purchase and distribute rapid antigen tests, $284 million for personal protective equipment (PPE) for healthcare workers to work safely and effectively and $110 million to continue to care for patients recovering from COVID-19. This builds on the investments made in last year’s budget that supported the health system to care for Victorians and control the spread of COVID-19.

This budget also provides $698 million to continue to deliver healthcare in the home through home-delivered and virtual care where clinically appropriate and selected by patients, further easing pressure on hospitals and health services.

The COVID-19 pandemic placed a significant burden on frontline ambulance services. This budget provides $124 million for Ambulance Victoria to recruit more paramedics and improve fleet management, rostering and support functions to meet the growth in demand for ambulance services. Funding is also provided for Ambulance Victoria to implement the recommendations of the Equal Opportunity and Human Rights Commission’s review into workplace equality.

To further support Victoria’s emergency response, funding of $333 million is provided to increase call-taking and dispatch capacity for Triple Zero services including ambulances. This budget also invests $236 million to at least double emergency department capacity at Casey Hospital and Werribee Mercy Hospital.
The 2022-23 Budget builds on the Government’s previous investments in health infrastructure with more than $900 million for a new hospital for the west of Melbourne in Cobblebank. The new Melton Hospital will include a 24-hour emergency department, over 100 medical and surgical beds, an intensive care unit, maternity and neonatal services, mental health services, ambulatory care and clinical supports. Funding of more than $500 million is also provided for the Barwon Women’s and Children’s Hospital to increase capacity in maternity, women’s and paediatric services as well as to build a new inpatient tower. This budget also invests an additional $300 million in the Regional Health Infrastructure Fund to improve the quality and amenity of infrastructure across rural and regional health services.

The 2022-23 Budget continues the work to reform Victoria’s mental health services and infrastructure as recommended by the Royal Commission into Victoria’s Mental Health System. This budget builds on the Government’s record mental health investment in the 2021-22 Budget by providing $1.3 billion to take the next steps in mental health reform. This includes $372 million to continue building the pipeline of workers required to deliver Victoria’s mental health reform agenda and deliver Victoria’s first mental health and wellbeing workforce strategy.

This budget invests a further $218 million to operationalise 82 new beds in Victoria’s mental health system to improve mental health acute care services and to expand inpatient services for Victorians with eating disorders. Funding of $124 million is also provided for the next stage of the Thomas Embling Hospital, progressing the Royal Commission’s recommendation to refurbish the existing beds and provide an additional 107 beds.

Box 1.3: Early Intervention Investment Framework

The Government pioneered Victoria’s Early Intervention Investment Framework (EIIF) to improve life outcomes for individuals, while also reducing pressure on acute services – supporting opportunities to reinvest all avoided costs back into the broader social system.

The 2022-23 Budget invests $504 million and builds on the investment of $324 million in the 2021-22 Budget to deliver a range of initiatives designed to address people’s needs early across the health, education, community services and criminal justice systems. Investments from these two packages are estimated to generate system-wide impacts from reduced acute service usage of around $500 million over the next decade, which will be reinvested in future EIIF initiatives and improve outcomes for Victorians.

There are 16 EIIF initiatives in this budget, including:

- providing a pathway to help chronically homeless people exit homelessness sustainably. This includes active street outreach and tailored case management to address factors driving homelessness like substance abuse illness, poor physical and mental health and limited social supports
- delivering integrated treatment, care and support to people living with acute mental illness and substance use or addiction
• expanding the Navigator program to provide intensive support for severely disengaged young people to reconnect with education
• reducing re-offending by providing a range of supports for repeat offenders and over-represented cohorts in the justice system, including employment and family support, targeted support for those with a disability and access to safe and secure accommodation for offenders who would otherwise be at risk of homelessness.

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Department</th>
<th>5-year output funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enhanced Navigator Program</td>
<td>DET</td>
<td>37.0</td>
</tr>
<tr>
<td>Continuing early intervention for vulnerable children</td>
<td>DET</td>
<td>18.7</td>
</tr>
<tr>
<td>Targeted investment to improve educational outcomes in youth justice</td>
<td>DET</td>
<td>30.3</td>
</tr>
<tr>
<td>Sustaining student mental health services for schools</td>
<td>DET</td>
<td>41.3</td>
</tr>
<tr>
<td>Reducing future justice demand and keeping the community safe</td>
<td>DJCS</td>
<td>73.6</td>
</tr>
<tr>
<td>Implementing a COVID fines concessional scheme</td>
<td>DJCS</td>
<td>1.0</td>
</tr>
<tr>
<td>Preventing youth crime through early intervention</td>
<td>DJCS</td>
<td>4.5</td>
</tr>
<tr>
<td>Supporting community legal centres</td>
<td>DJCS</td>
<td>7.0</td>
</tr>
<tr>
<td>Early Intervention to counter violent extremism</td>
<td>DJCS</td>
<td>4.7</td>
</tr>
<tr>
<td>Legal assistance</td>
<td>DJCS</td>
<td>50.0</td>
</tr>
<tr>
<td>Investing to make homelessness rare, brief and non-recurring</td>
<td>DFFH</td>
<td>51.3</td>
</tr>
<tr>
<td>Responding to demand for child protection and family services</td>
<td>DFFH</td>
<td>57.6</td>
</tr>
<tr>
<td>Strengthening community-based services</td>
<td>DH</td>
<td>115.5</td>
</tr>
<tr>
<td>Mobile Stroke Unit <em>(a)</em></td>
<td>DH</td>
<td>10.3</td>
</tr>
<tr>
<td>Pre-paid public transport tickets for school students in crisis</td>
<td>DOT</td>
<td>0.8</td>
</tr>
<tr>
<td>Data integration to support the Government’s Early Intervention Investment Framework</td>
<td>DPC</td>
<td>0.6</td>
</tr>
<tr>
<td><strong>Total</strong> <em>(b)</em></td>
<td></td>
<td><strong>504.1</strong></td>
</tr>
</tbody>
</table>

Notes:
(a) Component of the Supporting our frontline ambulance services initiative.
(b) Figures may not add up to the total due to rounding.
Education

The 2022-23 Budget continues to invest to ensure that all Victorians can reach their potential, through an education and training system that strives for excellence.

With funding in this budget, the total investment in new and upgraded Victorian schools is more than $12.8 billion over the past eight years. This budget provides $1.8 billion for building, upgrading and maintaining schools. The Government is fulfilling its commitment to open 100 new schools by 2026, and this budget supports building 13 new schools and upgrades to 65 schools.

Funding in this budget also means that since taking office, this Government has provided funding for a major upgrade for every special school in Victoria.

The 2022-23 Budget builds on the Government’s $5 billion investment in three-year-old kinder over the next decade with continued investment in early childhood education. Funding is provided for initiatives that improve children’s universal access to high-quality kindergarten, with additional supports for children in out-of-home care, from culturally and linguistically diverse, or refugee or asylum seeker backgrounds, or with disability or complex needs.

This budget also invests $131 million to continue four-year-old kindergarten services, including important support for rural and small services, and continued help for disadvantaged children to access kindergarten.

This budget supports Victorian students to reach their full potential, providing schools the resources they need to lift student outcomes. This includes $131 million for literacy and numeracy support, $37 million to continue the Student Excellence Program and $17 million to extend the Primary Mathematics and Science Specialists initiative to train an additional 100 government primary school teachers as mathematics specialists.

This budget will invest $779 million to recruit around 1 900 more teachers. That means more time for each teacher to prepare and focus on each student.

To give every secondary school student more choice and ensure they have the skills they need for post-school education or work, from 2023, a new VCE Vocational Major and Victorian Pathways Certificate will replace the Victorian Certificate of Applied Learning (VCAL). This budget invests $277 million to deliver this transformation of Victoria’s senior secondary system. This includes $86 million to improve access to a core offering of vocational and applied learning pathways in secondary schools, $88 million to support and expand the teaching workforce and support schools to deliver excellent programs, and $69 million to expand the Head Start school-based apprenticeship and traineeship model to support students to complete their senior secondary certificate while progressing towards a qualification.

The 2022-23 Budget continues to place TAFE at the centre of a strengthened skills and training system, providing $83 million to enhance strategic collaboration across the TAFE network, support TAFE students to sustainably transition to a new funding model and expand coordination of practical placements for TAFE students.
Jobs

The 2022-23 Budget continues to invest in job creation and support Victoria’s strong recovery from the COVID-19 pandemic, in line with the 2021-22 Budget’s Jobs Plan to create 400,000 new jobs by 2025. Already 280,000 jobs have been created since September 2020, well ahead of the interim target of 200,000 jobs by the end of 2022.

The COVID-19 pandemic has had a disproportionate impact on Victorians in insecure work. This budget provides $246 million for the Sick Pay Guarantee pilot to support casual and insecure workers in selected industries who do not otherwise receive sick or carer’s pay. More than 150,000 Victorians with insecure work in eligible occupations will be able to participate in the pilot, with the Government providing up to five days’ sick or carer’s pay per annum at the national minimum wage. This builds on the $163 million invested in this budget to support workers through the pandemic through the Test Isolation Payment and Pandemic Leave Disaster Payment.

The tourism, creative and major events industries were particularly impacted by COVID-19. The 2021-22 Budget included a new Creative State Strategy to support recovery and growth. The 2022-23 Budget continues this investment, providing $246 million to help these industries bounce back from the impacts of the pandemic. This budget includes $32 million for the National Gallery of Victoria to bring new major exhibition experiences to the public and $17 million for the creative infrastructure grants program to fund theatre repairs and arts precinct planning, also supporting jobs in the construction and trades sector. The Government has invested $1.7 billion in Australia’s largest cultural infrastructure project to transform the Melbourne Arts Precinct and position Victoria as a global arts destination.

The 2022-23 Budget provides $5 million for international marketing campaigns to boost tourism, $2.6 million to attract national business events to Melbourne and regional Victoria, and a $4.4 million events recovery and support program to re-establish Victoria’s calendar of world-class events.
Box 1.4: Supporting Victorian Industry

The 2022-23 Budget funds a $120 million Victorian Industry Fund package to support sovereign capability, advanced manufacturing, attract business investment, build supply chains and support small business and employment. The fund prioritises strategically important areas including health, defence, agriculture and renewable energy while helping to reach the Government’s Jobs Plan target of creating 400,000 jobs by 2025.

The package includes $40 million in grants to support growing businesses as part of the Victorian Industry Investment Fund. This builds on more than $13 billion in business support allocated by the Victorian Government since the COVID-19 pandemic began, of which the State has funded more than $10 billion.

A further $40 million is provided to attract international business investment into Victoria, and $20 million for an equity investment pilot fund to attract companies that align with Victoria’s strengths such as medical technology.

The Low-Carbon Manufacturing Grant Program will support Victorian manufacturers to compete globally for renewable energy components, supporting Victoria to decarbonise and creating green jobs.

To support defence manufacturing, the 2022-23 Budget provides $1.5 million for the Defence Science Institute’s research and development, and $2.6 million to deliver defence manufacturing internship programs.

The 2022-23 Budget also provides $1.5 million to explore the co-location of the CSIRO agrifood research and development capability with AgriBio at La Trobe University.

$4.5 million will fund 300 Digital Jobs for Manufacturing internships to train the Victorian workers supporting these industries.

Box 1.5: Commonwealth Games

Victoria is Australia’s sporting capital and has a proven record of hosting world class major events. This helps create tourism, jobs, and most importantly, well-deserved pride in our state.

The Victorian Government is working with the Commonwealth Games Federation and Commonwealth Games Australia to host the Commonwealth Games in 2026.

The Games will showcase Victoria’s regions, bringing visitors and creating local jobs.

The 2022-23 Budget invests $2.6 billion to run the games and build and upgrade sporting venues, accommodation and supporting infrastructure which will serve regional communities for years to come.
Supporting stronger communities

The Government is continuing to invest to deliver on commitments to Victoria’s ongoing treaty process with First Nations’ Peoples, as required under the Advancing the Treaty Process with Aboriginal Victorians Act 2018. Over $400 million is provided for programs and services directly related to the Aboriginal community, including $151 million to support self-determination and the treaty process between First Nations’ Peoples and the State.

The Government continues to support Victorians with disability. An investment of $15 million in the State Disability Plan will help make our community and facilities more inclusive and accessible for everyone. A further $135 million is provided to continue necessary support to Victorians with disability who are not eligible for the NDIS, and to provide tailored support to Victorians with disability through the health, justice and child protection service systems.

The 2022-23 Budget provides $15 million to strengthen the health, wellbeing, social and economic outcomes of LGBTIQ+ Victorians. Initiatives include continuation of the LGBTIQ+ Grants Program, the Pride Events and Festivals Fund, Melbourne Pride, specialist LGBTIQ+ legal services at the Victorian Pride Centre and the Trans and Gender Diverse in Community Health Program.

The 2022-23 Budget continues to support vulnerable children to stay safe and help families stay together when possible. The Government has invested $2.9 billion since the 2019-20 Budget in the child protection system to expand the child protection workforce, increase out-of-home placements and provide a wide range of support for vulnerable families. This budget continues this investment to support families and children including $85 million to increase the number of residential care placements and continue the Care Hub program. $58 million is provided to meet increasing demand for targeted and specialised family services and strengthen support for the child protection workforce.

The 2022-23 Budget continues investment towards ending family violence by continuing to implement recommendations from the Royal Commission. This budget includes $69 million to continue funding for family violence refuges, build and operate two new women’s refuges, upgrade three existing facilities and purchase six new crisis accommodation properties to support victim survivors. It also includes $43 million for family violence services, including additional crisis case management for victim survivors of family violence, specialised therapeutic counselling services for children and young people and financial supports for victim survivors fleeing family violence. $30 million will expand the capabilities of the Central Information Point, a critical service that collates and shares relevant information about risks posed by known perpetrators and helps keep victim survivors safe.

The Government is ensuring Victoria Police has the resources they need to keep communities safe. The 2022-23 Budget invests $342 million to recruit 502 new police and 50 protective service officers, $215 million to fund conducted energy devices, body-worn cameras and training to provide frontline officers additional non-lethal options to resolve dangerous situations, and $47 million to build a replacement South Melbourne police Station and a new police station at Point Cook.
Victoria’s 2022-23 Budget is also leading the nation when it comes to gender equality, and draws on international best practice to make sure this Budget supports the needs of all Victorians with Gender Responsive Budgeting (GRB). GRB is a way to create budgets that consider the impacts of investment decisions on all Victorians. It provides a process to better tailor these investments to deliver programs, services and infrastructure that meet the needs of women, men and gender diverse people. This year, the Government has measured the gender impacts of investments across health, education, transport and jobs. The 2022-23 Budget invests around $940 million in initiatives primarily focused on improving outcomes for women.

**Box 1.6: Helping Victorians into home ownership and securing affordable housing**

The Government is playing its part to make homes more affordable and accessible. Initiatives include upgrading social housing, improving services to find a home, creating a more stable rental market and helping more people to buy their first home.

The Government intends to work with the community housing sector to make available a further $1 billion in low interest loans and government guarantees to community housing agencies to deliver social and affordable housing. This is expected to create up to 6 000 new social and affordable houses, providing accommodation for some of our most vulnerable Victorians.

This builds on the Government’s record investment over the past two years in more affordable and accessible housing for Victorians. Funded in the 2020-21 Budget, Victoria’s $5.3 billion Big Housing Build is delivering the largest single increase and largest ever investment in social and affordable housing in Victoria’s history and will deliver more than 12 000 new homes.

In October 2021, the Government launched its $500 million Victorian Homebuyer Fund, a shared equity scheme that has already helped over 900 Victorians to buy a home and approved more than a further 1 400 to start house hunting.

First home buyers may be exempt from paying stamp duty if they buy a property for $600 000 or less, with concessions available for properties valued up to $750 000. In 2021, over 51 000 stamp duty concessions and exemptions totalling nearly $900 million were provided to Victorians. The First Home Owner Grant provides eligible first home buyers $10 000 to help them purchase a newly constructed home. Over 21 000 grants valuing $275 million were provided in 2021, a 23 per cent increase in number compared to 2020.

To make housing more affordable by increasing the supply of rental properties, the Government is supporting the establishment of the build-to-rent (BTR) sector. BTR projects are large-scale residential developments where the properties are held and managed by a single entity to be rented out over the medium to long-term, providing greater security of tenure. From 1 January 2022 until 31 December 2031, eligible BTR developments receive a 50 per cent land tax concession for up to 30 years and a full exemption from Absentee Owner Surcharge over the same period.
Better connected communities

The Government recognises the need for high-quality, safe and accessible transport to support Victorians to access employment and services and to strengthen Victoria’s productivity.

The 2022-23 Budget invests $3.5 billion in transport across Victoria including planning, infrastructure, maintenance and services. $383 million is provided for additional train services across the state and to operate new transport infrastructure that is being delivered as part of the Big Build, including level crossing removals, rail extensions, train station upgrades and road upgrades. Preparation activities for day one operations of the Metro Tunnel will also be progressed, including the recruitment and training of train drivers and other critical staff, maintenance of new assets and the development of wayfinding and customer information.

The Government is ensuring that new transport investments support local jobs. Funding of $250 million is provided to purchase an additional 12 VLocity trains for services on the Shepparton and Warrnambool lines to enable more accessible, comfortable and safer journeys on these lines. These trains will be built in Victoria, supporting local manufacturing and supply chain jobs.

The Government is investing $993 million in Victoria’s road network and to improve road safety. $213 million is being invested to upgrade Mickleham Road between Somerton Road and Dellamore Boulevard and the planning and development of a future stage.

Victoria’s regional businesses and producers are critical to the state’s economic growth and prosperity. The 2022-23 Budget invests $248 million to deliver a package of V/Line projects to support the reliability and efficiency of V/Line operations, and major periodic maintenance and routine maintenance works across Victoria’s rail freight corridors to support the safety and sustainability of rail freight in regional Victoria.

Box 1.7: Road maintenance

The 2022-23 Budget continues this Government’s record road maintenance investment with a focus on long-term investments that make the State’s roads safer for longer.

Combining output and asset funding, this budget invests $780 million in road asset management in 2022-23 – more than 37 per cent higher than the average of the previous decade ($567 million).

In addition to maintaining output expenditure on works such as routine maintenance and pavement resurfacing, this budget will include a record asset expenditure of $187 million on pavement rehabilitation, drainage renewal and structures renewal.

The scale and quality of this government’s investment yielded returns in the regions again in 2021-22, with expected performance exceeding performance measure targets for road quality measures on roughness, cracking and rutting.

This long-term investment is extending the life of our roads – for safer and more efficient journeys for longer.
CHAPTER 2 – ECONOMIC CONTEXT

- Victoria’s economy is forecast to grow by 3.25 per cent in 2022-23, following estimated growth of 5.50 per cent in 2021-22.
- The economy is moving beyond recovery to a consolidation phase. High vaccination rates, a gradual increase in migration and substantial household savings should all support further strong economic growth over the coming year.
- This follows significant government support across the health and economic responses to COVID-19, which cushioned the economy and helped enable its strong recovery.
- Victoria’s economy has been resilient in the face of COVID-19 outbreaks in 2021 and early 2022, and is in a strong position heading into 2022-23. Consumers and businesses increasingly adapted to COVID-19 and necessary public health restrictions, and the flexibility of the economy also aided its recovery.
- Victoria’s labour market has been particularly strong. Employment has risen by 280 000 since its trough in September 2020, the unemployment rate, at 4 per cent, is the lowest since current records began, and labour force participation is near a record high. Leading indicators of employment, such as job advertisements, remain very strong.
- The risks to Victoria’s economic outlook remain greater than were typical prior to the pandemic. These include ongoing risks relating to the COVID-19 pandemic, and elevated uncertainties relating to the Russian invasion of Ukraine.
VICTORIAN ECONOMIC CONDITIONS AND OUTLOOK

Victoria’s economy is expected to grow by 3.25 per cent in 2022-23, employment by 1.75 per cent from already high levels, and the unemployment rate is expected to remain at its lowest level since current records began, averaging 4 per cent. This follows a strong and rapid recovery in late 2021 and early 2022 from the impacts of the Delta variant of COVID-19 and necessary public health restrictions.

With the economy expected to be growing strongly in the final months of 2021-22, overall GSP growth in this year is expected to be 5.50 per cent, with the economy entering 2022-23 in a healthy position. High vaccination rates, an elevated level of household savings and a gradual increase in migration will all support further strong growth over the coming year. Leading indicators of employment, such as job advertisements, are at very high levels. Risks to the outlook, however, remain elevated.

By mid-2021, prior to the outbreak of the Delta variant of COVID-19, the Victorian economy was performing well. The Delta variant of COVID-19 required the resumption of public health restrictions in the first few months of 2021-22, which led to a decline in both activity and employment – although these declines were far less severe than the declines in the June and September quarters in 2020 amid the first two COVID-19 outbreaks (see Box 2.1).

Box 2.1: Victoria’s resilience through the Delta outbreak in 2021

The Victorian economy has proven resilient and flexible, enabling it to mitigate the impacts of COVID-19 outbreaks and associated necessary public health restrictions in 2021 and to recover strongly as these eased.

The outbreak of the Delta variant of COVID-19 led to the resumption of public health restrictions in July 2021, and again from early August to late October, which were necessary to contain the spread of the virus and save lives. While this led to a decline in both activity and employment, these declines were far less severe than the declines in the June and September quarters in 2020. The declines in both state final demand and employment were also smaller than the falls recorded in New South Wales during the Delta outbreak over a similar period, despite broadly similar public health restrictions in both states.

Consumers and businesses remained much more confident during the Delta outbreak than during earlier COVID-19 outbreaks (see Chart 2.1), and they increasingly adapted to mitigate the effects of necessary public health restrictions on their business operations and consumption of goods and services. State final demand fell by just 1.5 per cent in the September quarter 2021 during the Delta outbreak, much smaller than the 8.9 per cent fall between the March and September quarters in 2020 (see Chart 2.2). Consumer spending, the largest component of state final demand, fell by 5.1 per cent in the September quarter 2021 as opportunities to spend on some customer-facing services were constrained. However, the fall in consumer spending was much smaller than in 2020 as consumers and businesses made more use of online retailing and increased spending on goods. In other parts of the economy, business investment and dwelling construction actually rose despite the COVID-19 pandemic.
Chart 2.1: Business confidence \(^{(a)}\)

Source: National Australia Bank, Department of Treasury and Finance

Note:
\(^{(a)}\) Number of standard deviations from the long-run average.

Chart 2.2: State final demand and employment \(^{(a)}\)

Source: Australian Bureau of Statistics, Department of Treasury and Finance
Employment fell by 5.2 per cent between August and October 2021 compared to the larger 6.9 per cent peak-to-trough decline in 2020. Yet the number of workers who remained attached to their job – whether still employed, or stood down but with a job to return to – indicates that underlying employment conditions remained considerably stronger during the Delta outbreak than the official employment data suggests. The number of workers who were attached to a job fell by 4.7 per cent in 2020 during Victoria’s second outbreak. During the Delta outbreak, by contrast, the number of workers attached to a job fell by only 1.2 per cent (see Chart 2.3).

Chart 2.3: Employment and job attachments (a)

Progress on the rollout of COVID-19 vaccinations, and the easing of restrictions from late October 2021, led to a strong rebound in activity in the December quarter. State final demand recovered to be well above pre-pandemic levels, and employment had also fully recovered pandemic-related losses by December. The outbreak of the Omicron variant of COVID-19 in early 2022 – when high vaccination rates meant that only modest public health restrictions were put in place – led to a small and temporary decline in employment in January, which fully recovered by February. Consumer spending also appears to have held up well, despite reports of some weakness in early January. By March 2022, the unemployment rate had fallen to 4 per cent, the lowest since current records began.
Support from both the Victorian and Commonwealth governments, along with the Reserve Bank of Australia, helped cushion the impact of COVID-19 and necessary public health restrictions on the economy. Over 2019-20 and 2020-21, private demand fell, but this was partially offset by growth in public demand (see Chart 2.4). Public demand is expected to have made a further major contribution to growth in 2021-22. With the State’s economic recovery now well advanced, the private sector is expected to increasingly drive economic growth, led by a recovery in household spending and strong growth in business investment.

Chart 2.4: Contributions to annual GSP growth, public vs private sector demand (a)(b)

A major contributor to Victoria’s resilience and recovery has been the economy’s adaptability and flexibility. Consumers, workers and businesses have all adapted to lessen the impacts of COVID-19 and to take advantage of new opportunities.

Consumers switched towards spending more on goods during the pandemic, as public health restrictions, including international border restrictions, reduced opportunities to spend on services such as hospitality, recreation and international tourism. By the December quarter 2021, retail sales were 8 per cent above pre-COVID levels, while non-retail spending, such as on travel and personal training, remained 6 per cent lower. Spending on recreation goods, clothing, purchase of vehicles, and food and alcohol has been particularly strong (see Chart 2.5).
The shift of consumers’ discretionary spending towards goods helped maintain overall consumer spending throughout the pandemic. This supported overall economic activity and employment. Spending on services is expected to return to more normal levels in 2022-23 as consumers and businesses continue to adapt to living with the virus, and high vaccination rates mean lesser reliance on public health restrictions.

Chart 2.5: Consumer spending by type, December quarter 2021, per cent change from pre-COVID level (a)

Many Victorian businesses were quick to adapt to new ways of operating, such as by adopting remote working on a large scale, or changing work practices. For example, an increased number of retailers and hospitality businesses offered delivery and ‘click and collect’ services. Hospitality venues also increased outdoor dining spaces, including expanding to on-street dining areas with government support, to accept higher customer numbers amid indoor density restrictions. Real estate agents switched to online home inspections and auctions when in-person gatherings were restricted.

Victorian workers also adapted quickly to health restrictions. Workers moved from industries with fewer employment opportunities to stronger performing industries. This flexibility limited the impact of necessary health restrictions on Victoria’s labour market, and provided a strong foundation for Victoria’s unemployment rate recently reaching record lows, notwithstanding that employment in some industries has not returned to pre-pandemic levels (see Box 2.2).
Box 2.2: Victoria’s resilient labour market

The Victorian labour market has shown itself to be dynamic through the COVID-19 pandemic. Workers shifted between industries as Victoria’s economy recovered from the impacts of the pandemic, supporting a strong overall recovery in jobs.

Employment declined significantly between February and August 2020 in several industries most directly affected by COVID-19 and necessary public health restrictions – such as hospitality, arts and recreation, and administrative and support services (which includes travel agencies and tour operators). While there has been some recovery since August 2020, employment remains below pre-pandemic levels in these industries.

Employment also remains subdued in manufacturing and in agriculture, the latter being affected by a lack of temporary foreign workers due to previous national and state border restrictions (see Chart 2.6).

This has been more than offset by strong employment growth in some other industries. Employment has increased the most in the professional, scientific and technical services, (up by 68 000 persons, relative to its February 2020 level) and financial and insurance services (up by 36 000), with most of these employment gains taking place since August 2020 as the economy recovered from the first outbreaks of COVID-19. These industries were more easily able to adapt to remote working so were less affected by restrictions limiting in-person activity.

Elsewhere, employment in health care and social assistance has increased by 30 000 persons since February 2020. Employment is also above pre-pandemic levels in many other industries, including transport and logistics, information, media and telecommunications, education, utilities and public administration.

Chart 2.6: Changes in industry employment during the pandemic

Source: Australian Bureau of Statistics, Department of Treasury and Finance
Table 2.1 sets out the economic forecasts for the 2022-23 Budget, while Box 2.3 provides details of the major assumptions underpinning the forecasts. The nature of the COVID-19 pandemic means that the economic forecasts are subject to a higher degree of uncertainty than usual. However, as discussed later in the chapter, new risks to the outlook have emerged aside from COVID-19, including geopolitical uncertainties.

### Table 2.1: Victorian economic forecasts (a)

<table>
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<tr>
<th></th>
<th>2020-21 actual</th>
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<th>2022-23 forecast</th>
<th>2023-24 forecast</th>
<th>2024-25 projection</th>
<th>2025-26 projection</th>
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<tr>
<td>Real gross state product</td>
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<td>1.00</td>
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<tr>
<td>Unemployment rate (b)</td>
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<td>4.25</td>
<td>4.00</td>
<td>4.25</td>
<td>4.50</td>
<td>4.75</td>
</tr>
<tr>
<td>Consumer price index (c)</td>
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<td>3.00</td>
<td>2.50</td>
<td>2.25</td>
<td>2.50</td>
<td>2.50</td>
</tr>
<tr>
<td>Wage price index (d)</td>
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<td>2.50</td>
<td>2.75</td>
<td>3.00</td>
<td>3.00</td>
<td>3.00</td>
</tr>
<tr>
<td>Population (e)</td>
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<td>0.10</td>
<td>1.20</td>
<td>1.70</td>
<td>1.70</td>
<td>1.70</td>
</tr>
</tbody>
</table>

Sources: Australian Bureau of Statistics; Department of Treasury and Finance

Notes:
(a) Percentage change in year average terms compared with the previous year, except for the unemployment rate (see note (b)) and population (see note (e)). Forecasts are rounded to the nearest 0.25 percentage points, except for population (see note (e)).
(b) Year average.
(c) Melbourne consumer price index.
(d) Wage price index, Victoria (based on total hourly rates of pay, excluding bonuses).
(e) Percentage change over the year to 30 June. Forecasts are rounded to the nearest 0.1 percentage point.

### Box 2.3: Key COVID-19-related forecast assumptions

The economic forecasts presented in this chapter are predicated on underlying assumptions in relation to COVID-19. These key assumptions are outlined below. Other factors that may affect the forecasts are discussed in the risks section in this chapter.

- Further intermittent outbreaks of COVID-19 are assumed to occur. But high vaccination rates, and increased adaptation by consumers and businesses to outbreaks, mean that these have limited economic impacts.
- Migration remains low until mid-2022, before gradually picking up, with international students returning slowly, and tourist numbers picking up throughout 2022.
Gross state product

Victoria’s GSP is forecast to grow by 3.25 per cent in 2022-23, following an estimated increase of 5.50 per cent in 2021-22 (see Chart 2.7). The forecast for 2022-23 reflects an expectation for ongoing growth through the year, following a strong recovery in 2021-22 from the decline in activity in the September quarter 2021 amid the Delta outbreak.

The strength of recent and forecast economic growth means that GSP per capita – a key measure of living standards – is expected to be higher over the entire forward estimates than was forecast in the 2019-20 Budget Update prior to the pandemic.

Chart 2.7: Real Victorian GSP levels and annual growth rates, estimated actuals and forecast

Source: Department of Treasury and Finance

Notes:
(a) The quarterly GSP estimates are derived by the Department of Treasury and Finance. The Australian Bureau of Statistics only publishes annual GSP estimates.
(b) The figures above annual average lines refer to the annual average growth rate, in per cent.
Consumer spending is expected to be the largest contributor to growth in 2022-23, with strong growth in private business investment also making a significant contribution. Dwelling investment is expected to add to growth, while expenditure on costs associated with the transfer of assets is expected to decline amid lower housing turnover, deterring a little from growth. After a large contribution to growth in 2021-22, public demand is expected to detract slightly from growth in 2022-23, while net trade is expected to make a significant negative contribution as demand for goods imports and overseas travel picks up (see Chart 2.8).

**Chart 2.8: Forecast contributions to real GSP growth, 2022-23 (a)**

Household consumption is forecast to make a strong contribution to GSP growth in 2022-23, as spending continues to recover from an extended period of COVID-19-related disruptions. A strong labour market will support household income, and in turn growth in household consumption.

Elevated levels of household savings, which have been accumulated through the pandemic, will also support consumer spending (see Chart 2.9). Household savings increased during the pandemic since spending opportunities were constrained – especially on services, including hospitality, recreation and international travel – while incomes were sustained by government support programs. This high level of savings is expected to support consumer spending even while consumers face some headwinds from expected rising interest rates and higher petrol prices. The household savings rate is also expected to continue to decline to more normal levels, with a greater share of income being spent than over the past two years.
Consumer spending fell sharply in the September quarter 2021, following the resumption of public health restrictions to contain the Delta variant, but the fall was much less than during the 2020 lockdowns. Spending rebounded very strongly in the December quarter to close to pre-pandemic levels. Consumer spending is expected to increase further in the second half of 2021-22 and in 2022-23.

The outlook for spending remains more uncertain than usual. Asset price growth has eased, although this follows a period of strong price growth for both dwellings and equities. Consumer confidence has also fallen recently amid rising inflation, the prospect of higher interest rates and elevated global uncertainty. Real income growth will also be constrained by higher consumer inflation. Against this backdrop, consumers may become more risk-averse and keep a higher rate of precautionary savings than anticipated.

Alternatively, a high level of pent-up demand, supported by elevated savings, may lead households to spend more than expected, notwithstanding the headwinds described above. This could be supported by consumers’ confidence in the labour market outlook – surveys indicate consumers are very optimistic about their employment prospects, with households’ unemployment expectations near record lows.

 Dwelling investment is forecast to increase modestly in 2022-23, following an expected solid rebound in 2021-22. Activity will be underpinned by a large pipeline of work that has been supported by record-low interest rates and government incentives that generated a surge in approvals to build detached houses during 2020-21. In addition, approvals for apartments and other attached dwellings have increased somewhat amid a reduction in rental vacancy rates and an increase in dwelling prices.
Dwelling investment was constrained in the December quarter 2021 due to a nation-wide shortage of construction materials and skilled labour, though these supply-side issues are expected to gradually abate, allowing the elevated pipeline to be worked through.

An expected rise in interest rates is anticipated to dampen house prices and demand for new housing in 2022-23. Growth in construction activity is therefore expected to ease in the second half of 2022-23 but remain at elevated levels. See Budget Paper No. 5, Chapter 4 *State revenue* for a discussion on Victorian dwelling prices.

Business investment is forecast to continue growing in 2022-23, building upon strong growth in 2021-22. Forward indicators, such as surveyed business investment intentions and the pipeline of engineering construction activity, support this positive outlook.

Business investment picked up in the first half of 2021-22, following pandemic-driven falls in 2020-21. This growth was driven by solid increases in spending on machinery and equipment, intellectual property assets and engineering construction. Machinery and equipment investment should continue to benefit from Commonwealth tax incentives in 2022-23. Engineering construction activity is expected to remain at high levels due to the elevated pipeline of work yet to be done, especially for transport and energy construction. Non-residential building construction will also be supported by a strong pipeline of activity, driven by offices, industrial, and health. In the short term, however, shortages of materials, skilled labour and rising input costs could constrain non-residential construction output. Further ahead, demand for new office and retail construction may ease until uncertainty around the extent of structural changes stemming from the pandemic, such as individuals’ changed work and shopping patterns, dissipates.

Public demand has been a key driver of Victoria’s GSP growth since the onset of the pandemic, and is forecast to make another strong contribution to GSP growth in 2021-22. It is forecast to decline modestly in 2022-23, as some of the temporary increases in government consumption to support the COVID-19 response are wound back. Nonetheless, the Government’s pipeline of transport and social infrastructure projects will continue to underpin high levels of public investment.

Net services trade is likely to detract from growth in 2022-23, with growth in imports, notably overseas travel, expected to exceed growth in exports. Two-way international services trade remained severely disrupted throughout 2021 due to national border restrictions. Services exports fell to a pandemic-era low in the December quarter 2021, and services imports remain at very low levels. Services exports and imports are expected to gradually improve in 2022-23. International borders reopened to fully vaccinated travellers in February 2022 and international students began slowly returning to Australia in late 2021. As international students gradually return, spending by these students will increasingly contribute to services exports – education accounted for nearly half of services exports before the pandemic. Meanwhile, services imports will gain momentum as Australians begin to travel abroad again for work and leisure. It is expected to take some time for both services import and export levels to return to pre-pandemic levels, although there is considerable uncertainty about the outlook. The extent of ongoing caution among would-be travellers amid the persistence of COVID-19, and a potential re-evaluation by businesses of how much business-related travel is worthwhile – among other factors – affect the outlook.
Net international trade in goods is also forecast to detract from growth in 2022-23, as a robust Victorian economy leads to further growth in imports. Growth in machinery and equipment investment is expected to underpin further growth in imports of capital goods. Household spending growth should further support imports. However, ongoing supply chain disruptions may hinder trade volumes somewhat, despite elevated demand.

**OTHER ECONOMIC INDICATORS**

**The labour market**

Employment is forecast to continue to grow in 2022-23, by 1.75 per cent. This follows expected growth of 3.00 per cent in 2021-22 as the labour market recovers from the effects of COVID-19 and associated necessary public health restrictions. The unemployment rate is forecast to remain around its record low through 2022-23.

Later in the forecast period, employment growth is expected to remain solid but slow from the elevated levels of 2021-22 and 2022-23, with further growth constrained by the size of the working age population. Employment growth is then forecast to pick up a little by the end of the forward estimates as population growth rises to more normal rates (see Chart 2.10). The unemployment rate is projected to gradually rise from very low levels in 2022-23 to an estimated trend rate of 4.75 per cent by the end of the forward estimates, consistent with stable inflation within the Reserve Bank of Australia’s target band.

**Chart 2.10: Victorian employment, quarterly, actual and forecast**

![Chart 2.10: Victorian employment, quarterly, actual and forecast](source: Australian Bureau of Statistics; Department of Treasury and Finance)
The Victorian labour market has proven resilient and is in a strong position as it enters 2022-23, notwithstanding the impact of public health restrictions in the first few months of 2021-22 to contain the Delta outbreak of COVID-19, and the outbreak of the Omicron variant from late 2021. Victoria’s unemployment rate is the lowest since current records began, employment has risen by 280 000 people since its trough in September 2020, and full-time employment is well above its pre-pandemic level. Leading indicators of employment, such as job advertisements and job vacancies, remain very strong (see Chart 2.11).

**Chart 2.11: Job vacancies (per cent of labour force) (a)**

![Job vacancies chart](image)

*Source: Australian Bureau of Statistics*

*Note: (a) Not seasonally adjusted. The ABS did not collect job vacancy data between May 2008 and November 2009.*

For most of 2021, the Victorian labour market had been recovering strongly from the first year of the COVID-19 pandemic. Initially, the labour market was resilient through the brief periods of health restrictions from May to July in response to outbreaks, with the proportion of the population in employment reaching a record high by August 2021 and the unemployment rate falling to its lowest since current records began.

Public health restrictions from early August 2021, which were necessary to contain the Delta outbreak, reversed some of these previous gains, but as restrictions lifted in late October the Victorian labour market recovered quickly. By December 2021, total employment was above pre-pandemic levels, the unemployment rate was back near record low levels, and the participation rate hit a then record high of 67.0 per cent.
The arrival of the Omicron variant prompted employment to decline modestly in January, but it had fully recovered by February. By March 2022, employment was 41,000 people above its pre-pandemic level. The unemployment rate fell to the lowest since current records began, at 4 per cent, and Victoria’s workforce participation rate remained near a record high. The underemployment rate, which captures employed workers who would like to work more hours, had also fallen sharply to be at its lowest level since 2002 (see Chart 2.12).

Labour market outcomes have been particularly strong in regional Victoria. The unemployment rate in regional Victoria fell from a recent peak of 5.3 per cent in September 2020 to around a record low of 3.2 per cent in March 2022, well below its pre-pandemic rate of 4.6 per cent. Employment in March 2022 was above pre-pandemic levels. Strong labour market conditions in regional Victoria are likely to continue. Job ads are nearly double pre-pandemic levels, pointing to ongoing high levels of labour demand.

**Chart 2.12: Unemployment and underemployment rates (per cent)**

[Chart showing unemployment and underemployment rates from 1978 to 2022]

*Source: Australian Bureau of Statistics*
Wages

Victorian wage growth is expected to increase to 2.75 per cent in 2022-23. As the economy continues to expand and the labour market remains tight, wages growth is expected to increase further to 3.00 per cent per annum over the remainder of the forecast period.

Prior to the COVID-19 pandemic, Victorian wage growth had been subdued – consistent with the experience of other Australian states and other countries – but was generally slightly ahead of the national average.

Wage growth slowed in 2020 as many businesses introduced wage freezes or temporary wage cuts due to COVID-19. Some weakness in wages growth persisted over 2021, as the effects of the Delta outbreak, and subsequent public health restrictions, affected labour market conditions.

More recently, wage growth has begun to strengthen, rising from a trough of 1.2 per cent over the year to September 2020 to reach 2.3 per cent over the year to December 2021. This reflects a strong labour market as well as the partial unwinding of earlier wage freezes.

Business surveys indicate that, nationally, wage pressures have picked up more strongly in some industries than others, which is consistent with findings from the Reserve Bank of Australia (RBA). In its February 2022 Statement on Monetary Policy, the RBA reported that wages growth was stronger in those industries where there have recently been reports of labour shortages, such as professional services and construction, especially for selected skills in high demand. However, for most other industries there was little evidence that wages were rising beyond the relatively subdued rates of growth seen in the years leading up to the pandemic. The RBA further noted that there was evidence of businesses continuing to use various non-wage strategies to attract and retain staff, such as targeted bonuses, flexible work policies (including working from home), more training and hiring of staff with less experience. This is expected to keep wage growth contained in the near term. However, with unemployment expected to remain very low, over time businesses are expected increasingly to offer higher wages to attract staff.

Prices

Inflation has risen from very low rates in 2020-21 and is expected to reach 3.00 per cent on average in 2021-22, before easing to 2.50 per cent on average in 2022-23.

Global oil prices have been a major influence on Victorian inflation since the onset of the COVID-19 pandemic, and are expected to continue to be influential in 2022-23. Oil prices fell sharply in early 2020 as the pandemic unfolded and global demand for oil fell. Oil prices returned to around pre-pandemic levels by early 2021 amid the subsequent global economic recovery and, though volatile, continued to trend higher through the rest of the year. These price rises flowed through to Victorian retail petrol prices, with the price of automotive fuel in Melbourne growing by around 30 per cent over 2021. This contributed significantly to Victorian inflation over the year to December 2021.
The Russian invasion of Ukraine in late February 2022, and associated Western sanctions on Russia, have severely disrupted global oil and other commodity markets (see Box 2.4). Oil futures suggest that global oil prices may have peaked but will remain elevated over the rest of 2022 and into 2023, although there is considerable uncertainty about the outlook. The Commonwealth’s temporary reduction of fuel excise will put downward pressure on retail fuel prices between April and September 2022.

Global supply chain disruptions have also contributed to consumer price growth. This has been particularly evident in prices for new dwellings. Shortages of some construction materials have pushed up construction costs which, amid a period of strong demand, have been passed on as higher prices to purchasers of new housing. The cessation of HomeBuilder grants in April 2021 has also temporarily added to new dwelling inflation; consumers, who were previously paying construction prices that were lowered by these grants, are once again paying the full price of dwelling construction.

Price growth in these two spending items – automotive fuel and new dwelling purchases – contributed 1.3 percentage points to the 2.5 per cent rise in Melbourne consumer prices over the year to December 2021, more than half the overall increase.

On a year-average basis, inflation is expected to peak at 3.00 per cent in 2021-22. Supply chain constraints are expected to ease, with consumer price growth moderating to 2.50 per cent in 2022-23 and to 2.25 per cent in 2023-24. Later in the forecast period, higher wage growth is expected to lead inflation to rise to 2.50 per cent, the middle of the RBA’s inflation target band.

Inflation forecasts reflect data available at the 2022-23 Budget’s compliance date of 21 April. On 27 April, the Australian Bureau of Statistics published CPI data for the March quarter, showing Melbourne CPI increasing strongly, by 4.5 per cent from March 2021 to March 2022. The year-average CPI change in 2021-22 is likely to be lower than this outcome.

**Population**

Victoria’s population growth is forecast to pick up to a moderate rate of 1.2 per cent in 2022-23 as net overseas and interstate migration begins to recover, following weak or negative growth since the onset of the COVID-19 pandemic in early 2020. Later in the forecast period, population growth is expected to return to around the average growth rate of the past two decades as migration patterns normalise.

Victoria’s population growth had been strong over the decade leading up to the COVID-19 pandemic. Annual population growth had been higher than in any other state or territory since 2013, reflecting Victoria’s attractiveness as a place to live, work and study. The COVID-19 pandemic, though, has had a significant negative impact on population growth, with Victoria’s population falling over the course of 2020-21.
Net overseas migration had been the largest driver of Victoria’s population growth for more than a decade. Australia’s border restrictions, which came into effect in March 2020, have led to negative net overseas migration since June 2020 as more students and other foreigners living in Victoria returned home than expatriate Australians and migrants moved from overseas to Victoria. With border restrictions now eased, the flows of migrants and foreign students to Victoria are expected to gradually increase over the course of 2022, reaching around pre-pandemic levels by 2023-24. Victoria’s strong labour market, highly ranked education sector, welcoming and diverse multicultural community, and liveability should once again attract an outsized share of Australia’s overall migrant intake.

Alongside overseas migration, net interstate migration has also recently detracted from population growth since June 2020. Interstate migration is expected to improve over the course of 2022 and 2023, with the state’s liveability and strong labour market again expected to attract people from other states.

While population growth is expected to normalise within the forecast period, the recent and ongoing period of weak population growth, principally driven by national border closures, means Victoria’s population will be lower than what it would otherwise have been in the absence of COVID-19 (see Chart 2.13).

Chart 2.13: Components of population growth and population forecasts

Sources: Australian Bureau of Statistics, Department of Treasury and Finance
AUSTRALIAN ECONOMIC CONDITIONS AND OUTLOOK

The Australian economy has performed strongly over the past year and has recovered well from major disruptions caused by COVID-19 and public health restrictions in 2020 and 2021. Gross domestic product (GDP) is above its pre-COVID-19 level, employment has fully recovered pandemic-related losses and the unemployment rate has fallen to very low levels.

Following the outbreaks in 2020, COVID-19 outbreaks continued to weigh on the Australian economy in 2021 and early 2022. GDP fell in the September quarter 2021, following the resumption of public health restrictions in several jurisdictions to contain the spread of the Delta variant of COVID-19. Activity then rebounded strongly in the December quarter as restrictions were eased, led by a surge in consumer spending. Rising vaccination rates also supported the rebound in activity. This positive momentum appears to have continued into 2022, with further gains in spending and employment. This is notwithstanding the negative, but short-lived, effects on the economy from the outbreak of the Omicron variant.

In its 2022-23 Budget, the Commonwealth forecast the Australian economy to grow by 3.50 per cent in 2022-23. This follows estimated growth of 4.25 per cent in 2021-22. Household consumption and business investment are expected to be the main contributors to GDP growth in 2022-23, with dwelling investment also expected to increase. Public demand is forecast to contribute only modestly to GDP growth, as some pandemic-related spending is wound back. Meanwhile, net exports are forecast to detract from growth in 2022-23, due to continued strong demand for goods imports and a rebound in outbound tourism. This strength in imports will more than offset forecast increases in mining exports and tourism and education exports.

The labour market outlook is positive. Employment has increased strongly over the past year, led by growth in full-time positions, and job vacancies are at very high levels. The Commonwealth forecasts a further solid increase in employment and a decline in the unemployment rate in 2022-23. These strong labour market conditions are expected to lead to a pickup in wages growth.

Inflation is expected to remain elevated, at 3.00 per cent over 2022-23, although this is down from an estimated 4.25 per cent over 2021-22. Meanwhile, population growth is forecast to increase over the next few years, with a return to stronger inflows from net overseas migration.
INTERNATIONAL ECONOMIC CONDITIONS AND OUTLOOK

The International Monetary Fund (IMF) estimates that the global economy expanded by 6.1 per cent in 2021, as the economies of many countries improved following the initial impacts of COVID-19 in 2020. This was despite further significant COVID-19 outbreaks in the year. By the end of 2021, output in most advanced economies, and in Victoria’s major trading partners, had either broadly returned to or had exceeded pre-pandemic levels (see Chart 2.14). Strong household and business balance sheets, supportive fiscal and monetary policies, and a high rate of vaccination coverage have been among the factors supporting this recovery in the United States and other advanced economies. Output in China, which recovered from COVID-19 in 2020 faster than other major economies, continued to grow at a solid pace in 2021, although challenges facing its residential property sector weighed on activity in the second half of the year.

Chart 2.14: Real GDP, December quarter 2019 = 100 [a]

The outbreak of the Omicron variant of COVID-19 led to some easing in economic activity in many advanced economies in early 2022, although the impact appears to have been relatively short lived, with high vaccination rates and the absence of widespread restrictions in these countries. In China, by contrast, authorities have responded to a recent increase in COVID-19 case numbers with rolling lockdowns in several cities, including its financial capital, Shanghai, as China continues to pursue a policy of suppressing the virus.
The improvement in global economic activity in 2021, high energy prices and ongoing pandemic-induced supply disruptions have led to an accumulation of price pressures globally. Inflation has been higher than expected in many advanced economies – including the United States, the United Kingdom and Germany where inflation is at multi-decade highs. Initially, the increase in price pressures was concentrated in prices of consumer goods, as COVID-19-related restrictions resulted in households spending more on goods than services against a backdrop of supply chain disruptions. However, price pressures have become more broad-based in some countries with prices for consumer services also having begun to increase. In the United States and United Kingdom, where workforce participation remains below pre-pandemic levels amid strong labour demand, wage growth has risen strongly and added further to inflationary pressure in those economies.

More recently, the Russian invasion of Ukraine has added to global inflationary pressure. The conflict has led to sharp rises in prices of some key commodities, affected some global supply chains, and is likely to weigh on global growth (see Box 2.4).

**Box 2.4: Impact of the Russian invasion of Ukraine on the Victorian economy**

Russia’s invasion of Ukraine, which commenced in late February, is first and foremost a humanitarian disaster, resulting in significant loss of life and displacement of millions of Ukrainians. The invasion, and associated Western sanctions on Russia, also present a major source of uncertainty for the global economy. With limited direct exposure to the Russian and Ukrainian economies, the major impact on the Victorian economy will be through higher inflation, due predominantly to elevated energy prices.

The effects of the conflict on Victoria’s economic growth are expected to be very limited. The Russian and Ukrainian economies collectively represent only 2 per cent of global economic activity. Victoria has little direct trade with Russia and Ukraine: two-way trade with Russia accounted for just 0.2 per cent of total Victorian imports and exports in 2020–21, while Victoria’s two-way trade with Ukraine is negligible.

However, the disruption to Russia and Ukraine’s economies arising from the invasion and from Western sanctions has led to sharp rises in key commodity prices. These price increases are expected to add to global inflationary pressures. Russia is the world’s second largest crude oil producer, accounting for 12 per cent of global crude production, and is also a key supplier of natural gas to European markets. Russia and Ukraine are also major exporters of wheat and barley, collectively accounting for nearly 30 per cent of exports (see Chart 2.15).
The prices of many key commodities have increased sharply following the invasion, including oil, which peaked close to US$130 per barrel in early March (see Chart 2.16). Agricultural commodities as well as some base metals such as nickel and aluminium have also experienced price increases.

Reduced supply of other major exports from the region – such as grain and some precious metals – may also affect inflation, potentially pushing up the prices of bread, electronic goods and cars. Global wheat prices surged in early March 2022, increasing by over 50 per cent since mid-February. While prices have since eased somewhat, they remain well above their average over recent years. These elevated commodity prices are expected to add further to global inflation, which was already elevated prior to the invasion.
For Victoria’s economy, the main effect of the conflict is expected to be the rise in automotive fuel prices, due to higher global oil prices, that has already been experienced in recent months – adding to consumers’ cost of living. Melbourne petrol prices reached $2.20 per litre in the middle of March, an increase of 60 cents per litre compared with the start of the year. Prices have since eased alongside a moderation in global oil prices and the Commonwealth’s temporary halving of the fuel excise.

Beyond this impact on the Victorian economy, sustained higher fuel costs will add to businesses’ costs and may increasingly flow through to price rises for other goods and services, such as manufacturing and transport services, if businesses seek to pass on their higher costs to consumers. However, the Victorian and Australian economies are now much less exposed to the price of oil than they were during the global oil shocks of the 1970s (see Chart 2.17). This should help contain any pass-through of higher petrol prices to broader price rises relative to that time.

**Chart 2.17: Energy intensity of overall economic activity, Australia and Victoria**

![Energy intensity chart](image)

*Source: Department of Industry, Science, Energy and Resources; Department of Treasury and Finance*

The trajectory and duration of the conflict remain unpredictable, and this poses a high degree of uncertainty for global inflation and economic activity.

In response to rising prices, central banks in a number of major advanced economies – including the United States and United Kingdom – have commenced raising policy interest rates and are expected to continue raising rates throughout 2022 and beyond. In China, where inflation remains contained and growth has slowed, the People’s Bank of China has eased its monetary policy stance to support economic activity.
Global economic growth is expected to moderate in 2022, with higher inflation and the Russia–Ukraine conflict weighing on the outlook relative to earlier forecasts. The IMF’s outlook for global growth, as well as for major advanced and developing economies, is presented in Table 2.2. The IMF has downgraded its global growth forecast for 2022 substantially (relative to its October 2021 forecast). Both Russia and Ukraine are expected to record deep contractions, while many other regions are negatively impacted through commodity, trade and financial linkages.

The outlook for the United States has been lowered since October due to a combination of a downwardly revised outlook for fiscal policy, ongoing supply-chain disruptions, faster tightening of monetary policy to rein in inflation, and slower trading partner growth. China’s growth downgrade reflects COVID-19 mobility restrictions weighing on consumption, and weak real estate investment. Growth in the euro area, which relies heavily on gas exports from Russia, is expected to be 1.5 percentage points lower in 2022 than was forecast in October, due to higher energy costs as well as supply-chain disruptions that will weigh in particular on countries with relatively large manufacturing sectors, such as Germany and Italy.

Table 2.2: Summary of IMF’s global economic forecasts (a)(b) (per cent)

<table>
<thead>
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<th>2020 actual</th>
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<th>2022 projection</th>
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<td>2.3</td>
</tr>
<tr>
<td>Japan</td>
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<td>1.6</td>
<td>2.4</td>
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<td>8.2</td>
<td>6.9</td>
</tr>
<tr>
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<td>3.4</td>
<td>5.3</td>
<td>5.9</td>
</tr>
</tbody>
</table>

Source: IMF, World Economic Outlook, April 2022

Notes:
(a) Not all countries or regions are listed in the table.
(b) The ASEAN-5 economies are Indonesia, Malaysia, Philippines, Thailand and Vietnam.

RISKS TO THE VICTORIAN OUTLOOK

Risks to Victoria’s economic outlook remain greater than normal and the forecasts are subject to a higher degree of uncertainty. Risks relating to COVID-19 continue to create a higher than usual level of uncertainty for the outlook. Other key risks include the outlook for inflation, and hence for interest rates, as well as prospects for global economic growth against a backdrop of elevated geopolitical volatility.

In terms of upside risks, the tight labour market could lead to a larger than anticipated rise in household consumption. Robust employment growth and a stronger than expected increase in wages would further boost household income. Coupled with very high levels of household savings and past strength in asset prices, this could lead to consumer spending rising more strongly than anticipated over the coming year.
On the downside, COVID-19 remains a significant source of uncertainty. There remains a risk that new variants will emerge that are resistant to current vaccines. The emergence of such a variant could lead to a renewed global economic downturn and set back Victoria’s economic recovery. Appendix A Sensitivity Analysis considers this scenario. In this scenario, further COVID-19 outbreaks lead to renewed public health measures in major economies outside Australia, thereby slowing the global economic recovery. Heightened uncertainty weighs significantly on Victorian consumer and business confidence, leading to lower consumer spending and businesses investment.

Russia’s invasion of Ukraine presents a new and major source of uncertainty for the global economy. An escalation of the conflict or further Western sanctions could lead to larger impacts on commodity prices, greater strain on global supply chains, and weigh more heavily on global growth. Major central banks may respond to higher global inflation through more rapid interest rate increases, further weighing on global economic activity. In such a scenario, Victorian inflation would rise further, and Victoria’s economy would not be immune from a global slowdown.

There is significant uncertainty about the inflation outlook more generally, with implications for the Reserve Bank of Australia’s (RBA) monetary policy. Global supply chain pressures could persist for longer than expected. Currently elevated inflation could raise expectations of future inflation, which may become self-sustaining as workers and businesses build these higher expectations into wage bargaining and price-setting behaviour. Such a scenario could lead the RBA to raise interest rates faster than is currently assumed, which would weigh on economic activity and employment growth.

Another source of uncertainty is how quickly wage growth will increase amid a tight labour market. One consideration is the level of labour underutilisation associated with stable wage growth and inflation, and whether this is significantly different from what it was in the years prior to the pandemic. Another relates to how quickly and to what extent wage-setting behaviour responds to a tight labour market environment, following employers and workers being conditioned by a decade of low wage growth and businesses’ sharp focus on controlling costs.

Finally, a further key uncertainty relates to future levels of net overseas migration. This poses a long-term risk to the economic outlook. It is assumed that migration levels, including temporary international student migration, will approach pre-COVID-19 levels by 2023-24. The recovery in net overseas migration could occur more quickly than expected, adding to both supply and demand. A slower than expected recovery would weigh on the longer-term economic outlook for the state.
CHAPTER 3 – VICTORIA’S ECONOMIC RECOVERY
DESPITE INSUFFICIENT COMMONWEALTH SUPPORT

- The COVID-19 pandemic caused a major disruption to Victoria’s economy – as it did to Australia and the world. Yet Victoria’s economic recovery has been impressive, and the Victorian Government’s health and economic responses have been crucial to this recovery.

- The Victorian economy was leading the nation prior to the onset of the COVID-19 pandemic in early 2020. Over the five years to 2018-19, Victoria’s economic and employment growth rates were higher than in any other state.

- The Victorian Government responded quickly to address the impacts of the COVID-19 pandemic on the state’s economy, supporting the public health response as well as workers, businesses and the community.

- Investment in major infrastructure projects has been critical in supporting the state’s economic recovery. However, the state continues to receive inadequate infrastructure funding from the Commonwealth. Victoria’s share of Commonwealth infrastructure funding has consistently been well below the state’s population share.

- The GST is a vital source of funding for Victoria. However, the Commonwealth Government has not allowed the independent GST umpire, the Commonwealth Grants Commission, to account for the impacts of the COVID-19 pandemic on GST distribution. In addition, changes made to the GST system in 2018 to benefit Western Australia continue to pose a significant fiscal risk to Victoria, and all other states, if the no-worse-off guarantee is not extended beyond 2026-27.

- Changes to the GST distribution put at risk Victoria’s capacity to support recovery from the pandemic and fully fund essential services such as schools and hospitals, given GST funding accounts for almost a quarter of Victoria’s total revenue.
The Victorian economy was severely affected by the COVID-19 pandemic but it was able to recover strongly, with economic activity now above pre-pandemic levels and the unemployment rate reaching its lowest level since current records began. Government economic support, along with interventions from the Reserve Bank of Australia, helped the economy withstand and recover from the pandemic. The resilience and flexibility of Victorian households and businesses, including the movement of workers between industry sectors, and the growth in remote work and online shopping, further supported the recovery of the Victorian economy.

Victoria’s households and businesses have in general recovered well from the impacts of the COVID-19 pandemic – though this is not to play down the substantial challenges many cohorts, households and businesses faced ahead of mass vaccination and economic recovery.

Beyond the recovery, prospects for a fair and inclusive economy, and essential public services that benefit all Victorians, rely on continued funding support from the Commonwealth across several key areas, including health, education and infrastructure.

Around half of the state’s revenue is distributed by the Commonwealth, in the form of tied grants and GST grants, meaning the Commonwealth has considerable influence over how much funding the state has available to deliver its services, as well as how it uses this funding.

Since 2001-02, Victoria has received less than its population share of infrastructure funding every year, apart from 2012-13 and 2013-14. Victoria has never received its population share of GST, and has been subsidising other states since the inception of the GST in 2000-01. Further, despite the need for fair, sustainable funding to manage the pandemic’s ongoing impacts to the health system, the Commonwealth has not appropriately adjusted the terms of the National Health Reform Agreement (NHRA), a critical source of health funding for the state.

**VICTORIA’S ECONOMY WAS POWERING THE NATION BEFORE THE COVID-19 PANDEMIC**

Victoria’s economy was performing strongly prior to the COVID-19 pandemic on a range of measures. Economic growth averaged 3.3 per cent, employment growth averaged 3.1 per cent, and growth in business investment averaged 5.5 per cent a year over the five years to 2018-19 – the strongest growth of all the states (see Chart 3.1).

The strong fundamentals of the Victorian economy, which drove this outperformance prior to the onset of the COVID-19 pandemic, remain in place. Victoria’s diversified and flexible economy, well-educated and healthy workforce, and attractiveness as a place to live, work and raise a family will continue to underpin Victoria’s economic performance. As the economy moves to the next phase of growth, these fundamentals are expected to continue to support Victoria’s robust economic outlook.
Victoria has recovered strongly from COVID-19 outbreaks

The Victorian economy is poised to enter 2022-23 in a strong position. The COVID-19 pandemic severely affected Victoria’s economy – as it did the rest of Australia and the global economy. Yet, as discussed in Chapter 2, Economic context, the economy’s recovery has been remarkably strong. Economic activity has fully recovered and is above pre-pandemic levels, and the labour market is even stronger than prior to the COVID-19 pandemic. The share of the population in employment is at a record high, and the unemployment rate is at a record low of 4 per cent. GSP per capita – a key measure of living standards – is expected to be higher over the entire forward estimates than was forecast in the 2019-20 Budget Update prior to the pandemic.

The outlook for the Victorian economy is also strong. With job vacancies near a record high, the outlook for the labour market is particularly robust. Other indicators also point to an ongoing strong recovery driven by the private sector. Strong employment growth will support growth in household incomes, and elevated levels of household savings will also support consumer spending. Ongoing tax incentives and an elevated pipeline of engineering work are forecast to underpin further growth in business investment in 2022-23.
The Victorian Government’s assertive economic response to COVID-19, including business and household support payments, tax relief and infrastructure spending, helped drive this strong economic recovery. The Government has provided more than $13 billion in business support since the COVID-19 pandemic began, with more than $10 billion funded by the Victorian Government. The Government also implemented programs to support Victorian households, such as a payment for concession card holders and welfare recipients to help pay their power bills, rent relief grants for Victorians who lost income as a result of the pandemic and payments to support workers to stay home from work and isolate while waiting for the results of a COVID-19 test. This significant support during necessary public health restrictions meant that, in aggregate, businesses and households were in a robust position as the economy reopened.

Thanks to these actions and the economy’s resilience, the jobs recovery has been broad-based and inclusive. The industries most affected by COVID-19 and necessary public health restrictions – including hospitality, arts and recreation, and administrative and support services – collectively employ high proportions of women and young people. These workers were disproportionally affected by the Delta variant of COVID-19 and necessary public health restrictions in mid-2021, as they were by the first two waves of COVID-19 in 2020 (see Chart 3.2). Employment among 15-to-24-year-olds fell by more than that for other age groups between August and October 2021 amid the Delta outbreak, as it did in 2020. Employment among single mothers fell by 24 per cent between March and September 2020, and fell by 10 per cent during the Delta outbreak in 2021. However, by early 2022, labour market conditions had recovered for all of these groups, with the proportion of women, young workers and single mothers in employment returning to be above pre-pandemic levels.

**Chart 3.2: Employment to population ratio, by gender and age group**

![Chart 3.2](image-url)

Source: Australian Bureau of Statistics; Department of Treasury and Finance

Note:

(a) Data for age groups are in original terms; total is in seasonally adjusted terms.
Despite a longer period of necessary public health restrictions in Victoria in 2020 than in other states, by early 2021 Victoria had broadly caught up to the national economy on many key economic indicators. Employment, state final demand, business conditions and business and consumer confidence had all recovered to be broadly in line with the recovery nationally. The 2020-21 Budget’s interim Jobs Plan target of 200,000 more people employed from September 2020 was reached by February 2021, well ahead of the 2022 target. By August 2021, the share of the population in employment and the workforce participation rate were both at a record high, and the unemployment rate was at a record low.

While the outbreak of the Delta variant of COVID-19 in mid-2021 posed a renewed challenge to the Victorian economy, consumers and businesses appeared to have increasingly adapted to outbreaks and restrictions. On a range of measures, the economy withstood this outbreak much better than in 2020. The recovery was also faster as restrictions eased in October than it was after earlier outbreaks. Businesses remained more confident during the Delta outbreak than during outbreaks in 2020, and many businesses maintained connections with workers who were stood down in anticipation of a strong rebound in trading conditions once public health restrictions eased.

Along with consumers’ and businesses’ ongoing confidence amid later COVID-19 outbreaks, Victoria’s high vaccination rate has further strengthened the economy’s resilience. The outbreak of the Omicron variant, which peaked in January 2022, was a modest temporary setback to Victoria’s strong recovery, but was much briefer and had a much smaller economic impact than earlier outbreaks. High vaccination rates meant that the outbreak could be contained with low-level public health restrictions, while economic activity remained elevated.

Overall, the Victorian economy’s recovery from COVID-19 outbreaks in 2020, 2021 and early 2022 has been impressive. It was aided by the considerable economic support for businesses and households, a strong health response and widespread rollout of vaccines. It also reflects the resilience and adaptability demonstrated by Victorian consumers, workers and businesses.

**VICTORIA’S RECOVERY UNDERPINNED BY COMPREHENSIVE GOVERNMENT RESPONSE**

The Victorian Government continues to play a central role supporting the economic recovery, allowing Victoria to resume its significant contributions to the nation’s GDP and productivity.

Victorian small to medium-sized businesses impacted by COVID-19 public health measures were provided with direct grant and non-grant support to help them retain their employees. More than $13 billion in business support has been provided during the pandemic, with the majority funded by the Victorian Government. The grants supported hospitality, entertainment and tourism businesses, Victoria’s Alpine region and other small businesses experiencing reductions in revenue as a result of public health measures.
The key business support measures delivered by the state included the $5 billion Business Cost Assistance Program, the $2.6 billion Business Support Fund and the $1.3 billion Small Business COVID Hardship Fund, which provided financial assistance to eligible small to medium-sized businesses. Grants paid under the $1.2 billion Licensed Hospitality Venue Fund supported liquor licensees to continue operations, meet business expenses during public health restrictions and perform business continuity planning.

Other recent initiatives include a $200 million stimulus package announced in February 2022 to support businesses to recover from the effects of the Omicron variant, including a $5 million contribution from the City of Melbourne. This included funding for an extended voucher scheme for dining, travel and entertainment, funding to support businesses to purchase ventilation equipment to reduce the spread of COVID-19, and funding to place more workers in jobs.

A $196.6 million package of grants for construction businesses impacted by public health restrictions was introduced in 2021, solely funded by the Victorian Government. The Commonwealth Government did not contribute to this initiative, despite having provided funding for NSW construction businesses as part of the NSW assistance package.

The Government also made significant investments to support our health system and facilitate high vaccine uptake, protecting vulnerable cohorts in our communities from COVID-19, and strengthening our defence against future pandemics. These investments included:

- committing funding for the mass vaccination program of $901.2 million. Victoria’s involvement represents a significant departure from the state’s traditionally limited role in the delivery of vaccines. The Commonwealth Government is paying up to $16.23 per dose delivered by the states
- $639.4 million to secure and maintain a PPE stockpile, with a further $284 million invested as part of this budget
- $759 million in the 2021-22 Budget for more paramedics, triage care, and support staff for Ambulance Victoria, as well as targeted funding to improve flow in our busy emergency departments and open new beds across the state
- funding for medical research, including $400 million for the new Australian Institute for Infectious Disease in Victoria and $50 million for mRNA Victoria to fast-track local vaccine manufacturing
- $3.8 billion to deliver the recommendations of the Royal Commission into Victoria’s Mental Health System. Around $250 million in mental health support was announced throughout the pandemic.

The Government was able to leverage its investment in the existing pipeline of major Victorian infrastructure projects to create new jobs and sustain the state’s economic recovery. The level crossing removal program was expanded with a further 10 level crossings to be removed, bringing the total to 85 to be removed by 2025. The construction contract was signed for Victoria’s biggest road project, the $11.1 billion North East Link Primary Package (Tunnels), that is expected to create more than 10 000 jobs.

Measures introduced by the Victorian Government were critical in supporting consumer spending, the resilience of the labour market and the adaptability of businesses. Victoria’s economic recovery from the impacts of the pandemic reflects the effectiveness of these investments, with unemployment at record lows.
FAIR COMMONWEALTH FUNDING IS CRITICAL TO VICTORIA’S SUSTAINED RECOVERY

The Commonwealth has consistently taken a punitive approach to the distribution of funding to Victoria, despite the state’s vital role in driving the national economy.

The Commonwealth now needs to play a larger ongoing role in supporting the Victorian – and as a result national – recovery. Policy decisions made by the Commonwealth Government, including those relating to public health, economic supports and international borders, will influence Victoria’s ability to not only achieve a sustained recovery, but resume its role as the engine room of the national economy. The Commonwealth Government is better placed to fund large-scale measures given its greater revenue raising capacity. Where the Commonwealth has failed to act, the states have had to step in.

Health

Short- and medium-term health outcomes rely heavily on Commonwealth engagement and investment as the state manages the ongoing impacts on hospitals and the health system.

COVID-19 outbreaks continue to put pressure on Victoria’s health and hospital systems. The Commonwealth has made welcome co-contributions to the delivery of COVID-19 related health services but has not provided certainty around ongoing funding.

Under the NHRA costs are subject to a reduced Commonwealth contribution (of 45 per cent, compared to 50 per cent) as well as a more restrictive annual funding growth cap compared to the National Partnership Agreement on COVID-19 Response (COVID-19 NPA). In particular, Commonwealth funding to the states is uncapped under the COVID-19 NPA but capped under the NHRA.

Transitioning COVID-19-related health costs to the NHRA would increase the cost to the states to deliver unavoidable health services, particularly given the uncertainty around how long intensive COVID-19 health responses will be required into the future and the effects of long COVID. To help meet broader health related costs, the states deserve fairer funding arrangements under the NHRA. However, the Commonwealth Government does not acknowledge the extent of the pressure the states and territories face in the ongoing health response.

In addition, the Commonwealth Government has not specified ongoing roles and responsibilities for some major categories of COVID-19-related health costs, including the vaccine rollout and the procurement of rapid antigen tests.

The Commonwealth has constitutional responsibility for quarantine and overseas international border controls. In March 2020, states and territories stepped up when it was clear Australia urgently needed to establish a large-scale quarantine program to mitigate the risk of COVID-19, operating designated quarantine facilities and meeting significant costs associated with safely managing quarantine operations.
Economic support

As outlined above, Victoria provided more than $13 billion to support businesses impacted by the public health restrictions, with the majority of programs funded solely by the Victorian Government. This includes grants delivered through the Business Support Fund, the Business Costs Assistance Program, the Licensed Hospitality Venue Fund and the Small Business COVID-19 Hardship Fund. Tax relief measures, such as the full payroll tax refunds and waivers, offered small and medium-sized businesses financial assistance between 2019-20 and 2022-23.

While Victorian workers and businesses benefited from the Commonwealth’s JobKeeper payments in the first year of the pandemic, Commonwealth funding for joint business support measures commenced much later, with most starting only at the end of July 2021 – over a year after the start of the pandemic. The Commonwealth also subjected initial rounds of state business support grants to company income tax, reducing the benefit eligible businesses would receive from these grants, and instead redirecting it in part to the Commonwealth. Despite requests from the states, the Commonwealth has been unwilling to broaden its narrow eligibility requirements, meaning many state business support grants remain ineligible for tax-free treatment.

The Commonwealth did not co-fund support for critical economic contributors, including the construction industry, which accounts for 9.2 per cent of Victorian employment. The Victorian Government assisted construction businesses impacted by public health restrictions through a $196.6 million package of grants, which the Commonwealth refused to contribute to. In addition, universities faced barriers to accessing support through the JobKeeper program, which also excluded international student migrants without permanent residency. The Victorian Government supported the state’s universities amidst global border closures, including through a $50 million International Education Resilience Fund in the 2021-22 Budget Update for international student support services, improved delivery of remote learning and increased student engagement programs. This complements previous investments for international education recovery announced in the 2020-21 and 2021-22 Budgets, including the $350 million Victorian Higher Education State Investment Fund, and payroll tax deferrals for Victoria’s universities.

While the Commonwealth Government’s Pandemic Leave Disaster Payment (PLDP) program eventually provided financial relief to workers whose ability to earn an income was impacted by COVID-19 response measures, some vulnerable cohorts were excluded from receiving the PLDP. In particular, the states and territories funded PLDP payments for temporary visa holders, who otherwise would have been excluded from the program. The Victorian Government also had to step up to provide support, particularly to those from vulnerable cohorts, at its own cost. These supports included the COVID-19 Test Isolation Payment program, to allow workers to stay home while waiting for their PCR test results – the costs for which increased with high rates of PCR testing – as well as rent relief grants, to assist those experiencing rental hardship due to the COVID-19 pandemic to stay in safe, secure and stable accommodation.

The 2022 Victorian Parliamentary Inquiry into Commonwealth Support for Victoria noted that both the Victorian and Commonwealth Governments provided significant assistance to households and businesses to maintain economic activity, but that the lack of Commonwealth funding for COVID-19 has placed additional pressures on Victoria’s fiscal position.
Infrastructure

Infrastructure investment has been pivotal to supporting public demand and contributing to the state’s economic recovery, but Commonwealth support has been lacking.

Historically, Victoria does not receive an adequate share of Commonwealth infrastructure funding. Of the over $3.5 billion in new infrastructure investment to the states announced in the Commonwealth Budget 2022-23, Victoria will receive just 5.9 per cent over the forward estimates. Moreover, Victoria’s average share of overall infrastructure funding from the Commonwealth over the five years to 2025-26 is just 20.4 per cent, falling far below our average population share over this same period of approximately 26 per cent.

In the Commonwealth Budget 2022-23, the Commonwealth did not allocate any funding to Victoria as part of its Energy Security and Regional Development Plan – a $7.1 billion investment to develop key Australian regions into export hubs. However, funding was provided to regions in New South Wales, Queensland, Western Australia and the Northern Territory.

The recent Victorian Parliamentary Inquiry into Commonwealth Support for Victoria also noted the longstanding and significant gap between Victoria’s share of Commonwealth infrastructure funding and its population share, as well as a lack of transparency around Commonwealth infrastructure funding decisions.

Chart 3.3: Victoria’s share of Commonwealth infrastructure funding and population share

Source: Commonwealth Budget, Department of Treasury and Finance

Note:
(a) Victoria was allocated increased infrastructure funding through the Building Australia Fund, as well as additional funding for other projects driving the peak in 2013-14.
THE GST SYSTEM UNFAIRLY DISADVANTAGES VICTORIA FOR RESPONDING TO THE PANDEMIC

GST is a vital source of funding for Victoria and comprises almost a quarter of Victoria’s total revenue, providing budget flexibility compared to specific purpose payments due to its untied nature.

However, recent actions by the Commonwealth Government have significantly cut Victoria’s GST distribution. This puts Victoria’s ability to continue to bear the majority of responsibility for supporting its COVID-19 recovery at risk. The Department of Treasury and Finance estimates that a continued lack of action by the Commonwealth on how COVID-19 expenditures are treated by the GST system will lead to a loss of more than $3 billion for Victoria over four years.

The GST system

The GST system is intended to follow the principle of horizontal fiscal equalisation, which aims to balance the revenue raising capacities and expenditure requirements of each state, so that states are able to provide the same level of infrastructure and services to their residents. Fiscally stronger jurisdictions, like Victoria, receive less than their population shares of GST, whereas those with greater expenditure burdens and lower ability to raise revenue, like the Northern Territory, receive more.

Implementing the principle of horizontal fiscal equalisation, GST revenue is intended to act as a balancing item for states’ budgets providing revenue sources to meet their expenditures, ensuring equity amongst the states.

The GST distribution is calculated and recommended to the Commonwealth Treasurer by the Commonwealth Grants Commission (CGC), an independent Commonwealth agency. The CGC considers each state’s circumstances and identifies how much of the GST pool it requires, in line with the principle of horizontal fiscal equalisation.

2018 changes to the GST system

In 2018, the Commonwealth Government made significant changes to the GST system through the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018. The legislation undermined the GST system by departing from the former tenet of horizontal fiscal equalisation and introducing a new standard of equalisation and a relativity floor.

The new equalisation standard lifts states’ fiscal capacities to deliver the same level of government services as the stronger of Victoria or New South Wales, rather than the fiscally strongest state overall, which is currently Western Australia.

Additionally, the Commonwealth introduced a relativity floor of 0.70 within the GST system from 2022-23 onwards, rising to 0.75 in 2024-25. Only Western Australia’s relativity is expected to fall below the floor over the Budget and forward estimates, which will artificially raise its relativity to the floor and increase its share of GST revenue. This floor provides a fiscal boost to the state that is already fiscally strongest – at the expense of all other jurisdictions.
Recognising the potential impacts of the new system, in 2018 Victoria led negotiations between the states and the Commonwealth for a guarantee to ensure states would not be disadvantaged. As a result, the Commonwealth agreed to implement a no-worse-off guarantee to offset the impacts of the new system until 2026-27.

The *Commonwealth Budget 2022-23* indicates Victoria would lose $4.4 billion over the next four years to 2025-26 if not for the guarantee. This is equivalent to funding for over 8 100 teachers, 8 400 police officers or 9 000 nurses a year for four years. Without the guarantee all other states are also estimated to lose, except WA which stands to gain $17.5 billion.

For further detail on the impacts of the new system and the no-worse-off guarantee to Victoria, refer to Budget Paper No. 5, Chapter 4, *State revenue* Box 4.2: The fiscal risk to Victoria from the new GST distribution system.

### Further disadvantage due to COVID-19 expenses

Victoria experienced the greatest ramifications of the pandemic in Australia, both in terms of impacts to health and the economy. The Government responded with unprecedented measures designed to provide vital support for the health system, businesses, and workers.

As such, Victoria had a greater need for expenditures than other states in response. According to the principle of horizontal fiscal equalisation, this should mean Victoria receives more GST to compensate for this relatively large expenditure burden. A 2021 report by academics at the Melbourne Institute supported Victoria’s position that the GST system should change to accommodate these unique expenses.

Ahead of the 2022 update of GST distributions by the CGC, Victoria, along with NSW, advocated for changes to the GST methods to account for the unavoidable expenses incurred in supporting our communities.

The CGC agreed with the need to change its methods, but the Commonwealth Treasurer did not allow the CGC to account for these impacts in its most recent 2022 update of the GST distribution.

### The Commonwealth Treasurer has discretion to change the GST system to respond to COVID-19

Explicit direction from the Commonwealth Treasurer is required for the GST system to respond to the unprecedented changes in expenditure driven by COVID-19. The system typically undergoes a formal update every five years. Outside of the five-yearly reviews, the CGC conducts annual updates that largely address ad hoc data issues. The annual update may also consider methodology changes, such as those required by the COVID-19 pandemic, but only with the express direction of the Commonwealth Treasurer.

The Commonwealth Treasurer did not exercise his significant discretion on GST to respond to COVID-19. Instead, the Commonwealth Treasurer specifically directed the CGC not to update the methodology, moving the GST distribution away from the core principle of horizontal fiscal equalisation.
The last methodology review commenced in November 2016. In 2020 the review was finalised, and the report made publicly available mere weeks before the pandemic caused a worldwide shutdown. This same pre-pandemic method is the one that is being relied upon to distribute GST in a global pandemic and will continue to apply until 2025, unless the Commonwealth Treasurer acts.

**Health**

Health is a significant component of all states’ expenses, making up on average 30 per cent of total expenses over the past three years. Under its current methods, set in 2020, the CGC determines that states have a greater need for spending on health services if they have higher remote or Indigenous population shares. However, these factors are not the same as the needs driving expenses due to COVID-19. In 2020-21, COVID-19 disproportionately impacted higher density areas such as cities and culturally and linguistically diverse communities, which are not reflected in the existing approach to the GST assessment.

The CGC agreed with Victoria’s position that its 2020 method did not accurately account for COVID-19. In its 25 March 2022 report, the CGC noted that its ‘existing method of assessing state health expense needs does not align with the drivers of COVID-19 related health spending’.

Victoria invested significantly in health during the pandemic and spent disproportionately more than most other states, both in absolute terms and on a per capita basis, as demonstrated in Chart 3.4 below.

**Chart 3.4: COVID-19 public health responses by states under the National Partnership on COVID-19 Response 2020-21 (a)**

Source: Commonwealth Final Budget Outcomes 2020-21

Note:

(a) State health spending responding to COVID-19 is larger than reported under the National Partnership on COVID-19 Response, but it provides a consistent basis to compare the spending of states.
**Business support**

The CGC’s 2020 method assumes that a state’s need to spend on business support is only related to the size of its population. However, the economic impacts of COVID-19, and state’s need to support businesses in response were disproportionate. Victoria faced greater impacts from the pandemic and therefore a significantly higher need to support businesses than other states.

The CGC agreed with the need to change its methods to account for COVID-19 business support spending, noting in its report that ‘state spending to support businesses during the COVID-19 pandemic is distinctly different from states’ usual business development programs’.

Victoria proposed adjustments to the GST system to ensure that the drivers of expenses due to COVID-19 were accurately captured. These were rejected by the Commonwealth Treasurer, despite agreement from the CGC as the independent arbiter that changes were required.

**Accurately representing the impacts of COVID-19 through the GST**

The Commonwealth Treasurer had the power to change the GST methods to ensure that GST is distributed fairly.

Victoria and New South Wales advocated that the CGC be allowed to consider fair and reasonable adjustments to the GST system to ensure that states are not fiscally disadvantaged by providing vital support to their residents during the pandemic.

Victoria provided the CGC and the Commonwealth with extensive analysis of the impacts of COVID-19, including a report from academics at the Melbourne Institute.

There were multiple engagements on this issue between treasurers, including correspondence and discussions highlighting concerns with the GST system and its ability to deal with significant economic events.

However, despite compelling evidence and arguments, the Commonwealth Treasurer rejected requests for methodological adjustments and specifically directed the CGC not to update the GST system for COVID-19 related expenses.
CHAPTER 4 – BUDGET POSITION AND OUTLOOK

• The 2022-23 Budget outlines the improvement in the Government’s fiscal position as the Victorian economy consolidates its recovery from the peak of the COVID-19 pandemic, with a return to an operating surplus now forecast for 2025-26.

• This is a significant achievement considering the challenges all Victorians have faced over the past two years, and delivers on the next stage of the Government’s clear fiscal strategy first set out in the 2020-21 Budget.

• Total revenue for the general government sector is expected to be $81.9 billion in 2021-22, an upgrade of $3.9 billion from the 2021-22 Budget Update. Revenue growth is then expected to average 2.8 per cent a year over the budget and forward estimates, reaching $91.4 billion in 2025-26.

• Total expenditure is expected to be $99.5 billion in 2021-22, before reducing by 9.7 per cent to $89.8 billion in 2022-23. This reflects the targeted and short-term nature of initiatives to fund the public health response and support the economic recovery. Expenditure growth is then expected to remain moderate over the forward estimates, reaching $90.8 billion in 2025-26.

• In this budget, the Government is announcing $22.2 billion in new output initiatives and $6.7 billion total estimated investment (TEI) in new asset initiatives.

• Government infrastructure investment (GII) is expected to average $21.3 billion a year over the budget and forward estimates, reflecting the continuation of Victoria’s Big Build.

• Net debt is projected to be $167.5 billion by June 2026, lower in each year of the forward estimates than was forecast in the 2021-22 Budget Update.

• The Victorian Future Fund will be established by the Government to manage the fiscal impact of COVID-19 and support the state’s debt stabilisation strategy.

• Interest expense as a share of total revenue is expected to remain modest, averaging 6.0 per cent a year over the budget and forward estimates, well below the levels seen during the 1990s.

• The Government is on track to fully fund the state’s unfunded superannuation liability by 2035.

This chapter outlines the budget position of the general government sector. The Budget takes into account the financial impacts as at 21 April 2022 of all policy decisions made by the Government, as well as other information that may have a material impact on the financial statements, unless otherwise stated. This chapter also reconciles and explains any movements since the 2021-22 Budget Update that affect the estimated net result from transactions.
GENERAL GOVERNMENT SECTOR

Overview

Over the past two years, the COVID-19 pandemic severely impacted the state’s financial position and outlook. The Government prioritised the use of its balance sheet to support the Victorian community, Victorian households and the economy. This approach was consistent with stimulus approaches elsewhere in Australia and around the world.

In the 2020-21 Budget at the height of the pandemic, the Government developed a fiscal strategy to manage the extreme circumstances the state was facing and provide the foundations for recovery. It involved a four-step plan to support Victorians through the COVID-19 pandemic and to restore the budget in the medium term. The four-step plan provided a clear framework:

• **Step 1**: creating jobs, reducing unemployment and restoring economic growth
• **Step 2**: returning to an operating cash surplus
• **Step 3**: returning to operating surpluses
• **Step 4**: stabilising debt levels.

Central to the Government’s COVID-19 strategy was supporting and delivering funding to the health system along with the necessary support for those most affected by the impact of public health restrictions.

This strategy of supporting the vulnerable and protecting the economy has delivered strong foundations as we continue to manage the impact of COVID-19 and ensured the economy was in a robust position to rebound quickly as restrictions eased.

Recent economic indicators have showed this strategy is working, with the economy rebounding strongly. As a result, the 2022-23 Budget is forecasting significant improvement in the state’s key fiscal aggregates when compared to the 2021-22 Budget Update, released in December 2021.

The net result from transactions for the general government sector is forecast to be in surplus by $0.7 billion in 2025-26, demonstrating the Government’s commitment to strong financial management despite the challenges over the past two years.

The net cash flows from operating activities for the general government sector is forecast to be in surplus by $1.3 billion in 2022-23, increasing to $5.5 billion in 2025-26, an improvement compared with the position in the 2021-22 Budget Update.

Total revenue for the general government sector is expected to be $81.9 billion in 2021-22, an upgrade of $3.9 billion from the 2021-22 Budget Update largely due to the continued strength in Victoria’s property market. Revenue growth is then expected to average 2.8 per cent a year over the budget and forward estimates, reaching $91.4 billion in 2025-26.
Table 4.1: General government fiscal aggregates

<table>
<thead>
<tr>
<th>Measure</th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
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<tbody>
<tr>
<td>Net result from transactions</td>
<td>$ (14.6) billion</td>
<td>(17.6) billion</td>
<td>(7.9) billion</td>
<td>(3.3) billion</td>
<td>(1.1) billion</td>
<td>0.7 billion</td>
</tr>
<tr>
<td>Net cash flows from operating activities</td>
<td>$ (13.0) billion</td>
<td>(11.8) billion</td>
<td>1.3 billion</td>
<td>0.8 billion</td>
<td>3.6 billion</td>
<td>5.5 billion</td>
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<tr>
<td>Government infrastructure investment (a)(b)</td>
<td>$ 15.0 billion</td>
<td>18.9 billion</td>
<td>21.4 billion</td>
<td>23.0 billion</td>
<td>21.7 billion</td>
<td>19.2 billion</td>
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<tr>
<td>Net debt</td>
<td>$ 72.7 billion</td>
<td>101.9 billion</td>
<td>118.5 billion</td>
<td>137.4 billion</td>
<td>154.8 billion</td>
<td>167.5 billion</td>
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<tr>
<td>Net debt to GSP (c)</td>
<td>15.3 per cent</td>
<td>19.8 per cent</td>
<td>21.7 per cent</td>
<td>24.1 per cent</td>
<td>25.8 per cent</td>
<td>26.5 per cent</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) Includes general government net infrastructure investment and the estimated construction costs of public private partnership projects.
(b) Includes the estimated private sector construction related expenditure associated with the North East Link held in the public non-financial corporations (PNFC) sector.
(c) The ratios to gross state product (GSP) may vary from publications year to year due to revisions to the Australian Bureau of Statistics GSP data.

Consistent with the Government’s fiscal strategy, new initiatives announced in this budget focus on putting patients first, consolidating Victoria’s rapid economic recovery and growing employment to build a strong economic foundation.

This budget provides $22.2 billion over five years in output spending and $6.7 billion TEI in new and improved assets – creating jobs, continuing to drive Victoria’s economic recovery, and supporting the health and wellbeing of all Victorians.

Total general government sector expenditure is expected to reach $99.5 billion in 2021-22, before reducing by 9.7 per cent to $89.8 billion in 2022-23. This reduction reflects the targeted and short-term nature of initiatives to fund the public health response and support the economy from the impacts of the pandemic. Expenditure growth is then expected to remain moderate over the forward estimates, reaching $90.8 billion in 2025-26.

Total expected expenditure includes the impact of all relevant Government decisions, including those relating to service delivery and savings. While there are no new savings decisions in this budget, previously agreed base and efficiency review and savings initiatives have been allocated across their relevant portfolios. These will be redirected to ensure the continued efficient and effective delivery of government priorities.

Government infrastructure investment (GII) is expected to average $21.3 billion a year over the budget and forward estimates, reflecting the continuation of Victoria’s Big Build.

Net debt is expected to be $101.9 billion at June 2022 and $167.5 billion by June 2026. As a proportion of GSP, net debt is projected to be 19.8 per cent at June 2022 and 26.5 per cent by June 2026.

Interest expense as a share of total revenue is expected to remain modest, averaging 6.0 per cent a year over the budget and forward estimates, well below the levels seen during the 1990s.
Table 4.2 summarises the operating statement for the general government sector.

A comprehensive operating statement is presented in Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the general government sector.

### Table 4.2: Summary operating statement for the general government sector (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
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<tr>
<td><strong>Revenue and income from transactions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Taxation</td>
<td>23 613</td>
<td>30 063</td>
<td>30 488</td>
<td>32 216</td>
<td>33 312</td>
<td>35 003</td>
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<tr>
<td>Dividends, TER and interest (b)</td>
<td>1 214</td>
<td>1 189</td>
<td>1 317</td>
<td>1 464</td>
<td>1 629</td>
<td>1 651</td>
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<tr>
<td>Sales of goods and services (c)</td>
<td>7 949</td>
<td>5 491</td>
<td>6 366</td>
<td>6 410</td>
<td>6 495</td>
<td>6 527</td>
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<tr>
<td>Grants</td>
<td>36 958</td>
<td>41 869</td>
<td>40 351</td>
<td>40 884</td>
<td>43 019</td>
<td>44 825</td>
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<tr>
<td>Other revenue and income</td>
<td>2 915</td>
<td>3 257</td>
<td>3 459</td>
<td>3 619</td>
<td>3 209</td>
<td>3 434</td>
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<tr>
<td><strong>Total revenue and income from transactions</strong></td>
<td>72 649</td>
<td>81 870</td>
<td>81 980</td>
<td>84 593</td>
<td>87 665</td>
<td>91 440</td>
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<td><strong>% change</strong></td>
<td></td>
<td>12.7</td>
<td>0.1</td>
<td>3.2</td>
<td>3.6</td>
<td>4.3</td>
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<td><strong>Expenses from transactions</strong></td>
<td></td>
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<td></td>
<td></td>
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<td>Employee expenses</td>
<td>30 044</td>
<td>33 178</td>
<td>33 087</td>
<td>34 240</td>
<td>34 774</td>
<td>35 362</td>
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<td>Superannuation (d)</td>
<td>3 731</td>
<td>4 184</td>
<td>4 449</td>
<td>4 624</td>
<td>4 714</td>
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<td>Depreciation</td>
<td>4 165</td>
<td>4 411</td>
<td>4 650</td>
<td>4 656</td>
<td>4 748</td>
<td>4 972</td>
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<td>Interest expense</td>
<td>2 614</td>
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<td>Grant expense (c)</td>
<td>22 086</td>
<td>24 865</td>
<td>17 391</td>
<td>15 517</td>
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<tr>
<td>Other operating expenses</td>
<td>24 568</td>
<td>29 820</td>
<td>26 367</td>
<td>23 955</td>
<td>23 757</td>
<td>24 167</td>
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<tr>
<td><strong>Total expenses from transactions</strong></td>
<td>87 207</td>
<td>99 501</td>
<td>89 844</td>
<td>87 856</td>
<td>88 791</td>
<td>90 788</td>
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<tr>
<td><strong>% change</strong></td>
<td></td>
<td>14.1</td>
<td>(9.7)</td>
<td>(2.2)</td>
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<td>2.2</td>
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<td><strong>Net result from transactions – net operating balance</strong></td>
<td>(14 558)</td>
<td>(17 631)</td>
<td>(7 864)</td>
<td>(3 263)</td>
<td>(1 126)</td>
<td>652</td>
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<tr>
<td><strong>Total other economic flows included in net result (e)</strong></td>
<td>761</td>
<td>(247)</td>
<td>(347)</td>
<td>(342)</td>
<td>(262)</td>
<td>(248)</td>
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<tr>
<td><strong>Net result</strong></td>
<td>(13 797)</td>
<td>(17 878)</td>
<td>(8 212)</td>
<td>(3 605)</td>
<td>(1 388)</td>
<td>403</td>
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Source: Department of Treasury and Finance

Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Comprises dividends, income tax and rate equivalent revenue and interest.
(c) As outlined in the 2021-22 Budget, the capital asset charge (CAC) policy is discontinued from 2021-22. The removal of CAC reduces the Sales of goods and services and Grant expense by the same amount.
(d) Comprises superannuation interest expense and other superannuation expenses.
(e) This typically includes gains and losses from the disposal of non-financial assets, adjustments for bad and doubtful debts and revaluations of financial assets and liabilities.
Revenue outlook

Total revenue for the general government sector is forecast to increase by 12.7 per cent to $81.9 billion in 2021-22, following a period of reduced revenues in 2019-20 and 2020-21 because of the pandemic. Total revenue is then expected to increase by 0.1 per cent to $82.0 billion in 2022-23 and then grow by an average of 3.7 per cent a year over the forward estimates.

Compared with forecasts from the 2021-22 Budget Update, taxation revenue, goods and services tax (GST) grants and most other revenue streams have been upgraded across the budget and forward estimates. Total revenue has increased by $2.2 billion in 2022-23, $2.5 billion in 2023-24 and by $2.6 billion in 2024-25.

Taxation

State taxation revenue is forecast to increase by $6.4 billion in 2021-22, as the continued strength in the Victorian property market drives the recovery from the pandemic-affected taxation revenue in 2020-21. Taxation revenue is forecast to increase by 1.4 per cent in 2022-23 and then grow by an average of 4.7 per cent a year over the forward estimates.

- Revenue from land transfer duty is expected to increase to $10.2 billion in 2021-22, consistent with strong residential dwelling price growth across 2021 and elevated transaction volumes. This represents a significant improvement since the 2021-22 Budget Update. Land transfer duty revenue is forecast to decline to $8.2 billion in 2022-23, in line with a forecast moderation in residential property market activity. Land transfer duty revenue is then expected to grow by an average of 2.0 per cent a year over the forward estimates.

- Revenue from land tax is expected to increase to $4.8 billion in 2022-23 and is expected to grow by an average of 7.2 per cent a year over the forward estimates. The strong price growth in Victoria’s residential property market in 2021 is expected to support 2022-23 land tax revenue, which is based on land valuations as at 1 January 2022.

- Revenue from payroll tax is expected to increase to $6.8 billion in 2022-23. Payroll tax revenue is then expected to grow by an average of 6.5 per cent a year over the forward estimates. Forecasts for payroll tax revenue have been revised up compared with the 2021-22 Budget Update, largely driven by a stronger outlook for the Victorian labour market. Credits earned by businesses through the New Jobs Tax Credit initiative announced in the 2020-21 Budget are reducing payroll tax revenue forecasts in 2021-22 and 2022-23, contributing to the strong growth of payroll tax revenue forecast in 2023-24.

- Revenue from the Mental Health and Wellbeing Levy is estimated to be $819 million in 2022-23 and is expected to grow at an average annual rate of 4.7 per cent over the forward estimates, in line with expected growth in the payroll tax base. The Government has legislated that revenue raised from the Levy must be spent on mental health services, supporting investment in Victoria’s mental health system.
• Revenue from gambling taxes is forecast to increase to $2.4 billion in 2022-23. Gambling tax revenue is expected to grow by an average of 4.2 per cent a year over the forward estimates. The increase in 2022-23 is largely driven by the expected return of ordinary operations for Victorian gaming venues after temporary closures across 2020-21 and 2021-22 due to public health restrictions.

• Revenue from motor vehicle taxes is expected to increase to $2.9 billion in 2021-22 as strong consumer demand and supply constraints have led to increases in the prices of both new and used cars, supporting strong growth in stamp duty revenue from vehicle sales. Revenue from motor vehicle taxes is forecast to increase to $3.1 billion in 2022-23 and grow by an average of 4.6 per cent a year over the forward estimates.

• Revenue from insurance taxes is expected to increase to $1.8 billion in 2022-23. Insurance tax is expected to grow at an average of 6.8 per cent a year over the forward estimates.

**Dividends, income tax equivalent and interest**

Dividend and income tax equivalent revenue is projected to be $0.6 billion in 2022-23 and increase by an average of 10.3 per cent a year over the forward estimates.

Interest revenue is received on the cash and deposits held by the Government. Total interest is expected to increase to $0.7 billion in 2022-23 and is forecast to increase by an average of 5.7 per cent a year over the forward estimates.

**Sales of goods and services**

Revenue generated by the sales of goods and services is expected to increase to $6.4 billion in 2022-23, largely reflecting the expected recovery in various service fees after the easing of public health restrictions. Impacted by the pandemic, sales of goods and services was lower in 2021-22. Growth is forecast to increase by an average of 0.8 per cent a year over the forward estimates.

**Grants**

Grants recognised by the state largely comprise GST and grants for specific purposes from the Commonwealth. Total grant revenue is expected to increase to $41.9 billion in 2021-22 but decrease to $40.4 billion in 2022-23. This is largely due to the increase in Commonwealth grants as part of the jointly funded business support packages provided in 2021-22. Total grant revenue is expected to grow by an average of 3.6 per cent a year over the forward estimates.

Victoria’s GST revenue is expected to grow to $18.7 billion in 2022-23 after decreasing by $0.5 billion in 2021-22. The fall in Victoria’s GST revenue in 2021-22 is driven by declines in Victoria’s assessed relativity and population share and weaker GST receipts. Over the forward estimates, GST revenue is expected to grow by an average of 4.5 per cent a year.

Victoria’s GST revenue forecast is driven by an improved outlook for the national GST pool corresponding with a strong outlook for economic growth in 2022-23. Growth in the GST pool is also supported by an expected increase in consumption activity flowing on from increases in wage growth and improved household wealth.
Offsetting this is Victoria’s national population share, which is forecast to be steady in 2022-23 after decreasing in 2021-22. Since the start of the COVID-19 pandemic, there has been a net outflow of Victorian residents to other states, and international border restrictions have limited overseas migration, which has historically been strong for Victoria. Victoria’s population share is expected to gradually increase from 2023-24 onwards.

The outlook for Victoria’s assessed relativities has slightly improved since the 2021-22 Budget Update, reflecting the surge in commodity prices in 2022. The sustained strength in commodity prices will increase mining states’ revenue raising capacity which lowers their states’ GST requirements, resulting in more GST revenue being redistributed to other states and territories. This is partially offset by Victoria’s lower population growth contributing to a lower assessed need for infrastructure in 2021-22 and 2022-23.

In 2018, the Commonwealth Government legislated a new system for distributing GST to the states. Despite the Commonwealth Government’s initial claim that all states would be better off from the legislation, after two years into the six-year transition it is now clear from several sources that the new system poses a significant fiscal risk for Victoria and most other states if the no-worse-off guarantee is not extended beyond 2026-27. These risks are discussed further in Budget Paper No. 2, Chapter 3 Victoria’s economic recovery despite insufficient Commonwealth support and in Budget Paper No. 5, Chapter 4 State revenue.

Commonwealth grants for specific purposes are projected to average $21.3 billion a year over the budget and forward estimates. The Commonwealth provides these grants as contributions toward healthcare, education, disability, major infrastructure investment and other services.

**Other current revenue**

Other revenue and income includes fines, royalties, donations and gifts, assets received free-of-charge and other miscellaneous revenues. Other revenue is expected to grow to $3.5 billion in 2022-23, followed by an average decline of 0.2 per cent a year over the forward estimates. This revenue profile is primarily driven by the progressive recognition of the Cross Yarra Partnership Consortium’s contribution to additional costs borne by the operator as part of the Metro Tunnel settlement.

Budget Paper No. 5, Chapter 4 State revenue contains further details of expected movements in the major categories of general government revenue.

**Expenses outlook**

The Government is expected to spend $99.5 billion in 2021-22. This is a 14.1 per cent increase relative to total expenditure of $87.2 billion in 2020-21, reflecting the additional support provided to Victorians and to the economic recovery during the COVID-19 pandemic. Expenses are then expected to decline by 9.7 per cent in 2022-23, reflecting the tapering of targeted, short-term economic support, before increasing by an average of 0.3 per cent a year over the forward estimates.
Year-on-year movements should be interpreted with care due to the impacts of the COVID-19 pandemic and the Government’s response.

Moderation of expenditure growth over the forward estimates supports the Government’s fiscal strategy to achieve an operating surplus by the end of the forward estimates.

- Employee expenses (including superannuation) are forecast to grow to $37.5 billion in 2022-23, primarily reflecting the Government’s significant response to the COVID-19 pandemic in 2021-22. Average growth over the forward estimates of 2.2 per cent a year is forecast, consistent with the requirements of service delivery and enterprise bargaining agreements.

- Depreciation expense is forecast to grow to $4.7 billion in 2022-23 and by an average of 2.3 per cent a year over the forward estimates to $5.0 billion by 2025-26. Growth in depreciation is broadly in line with continuing high levels of investment in infrastructure.

- Interest expense is forecast to grow to $3.9 billion in 2022-23, and to $6.4 billion by 2025-26, as the Government increases borrowings to fund its response to the COVID-19 pandemic and continue significant levels of infrastructure investment under Victoria’s Big Build. Interest expense as a share of total revenue is expected to remain modest, averaging 6.0 per cent a year over the budget and forward estimates, well below the levels seen during the 1990s.

- Grant expenses are forecast to fall to $17.4 billion in 2022-23 largely due to the additional business support grants provided to Victorian businesses in 2021-22. These business support payments were in relation to COVID-19 lockdowns in 2021 and have now concluded. Grant expenses are then expected to decline by an average of 4.5 per cent a year over the forward estimates, largely reflecting the tapering of COVID-19 pandemic support initiatives.

- Other operating expenses are forecast to fall to $26.4 billion in 2022-23, reflecting the additional support provided for the Government’s health response to the COVID-19 pandemic in 2021-22. Other operating expenses are then expected to decline by 9.1 per cent in 2023-24 as expenditure commitments attributable to the COVID-19 response continue to reduce.
Reconciliation of estimates to the 2021-22 Budget Update

Relative to the 2021-22 Budget Update, the net result from transactions has been revised down by $2.6 billion in 2022-23, up by $0.2 billion in 2023-24 and up by $1.0 billion in 2024-25 (Table 4.3).

Table 4.3: Reconciliation of estimates to the 2021-22 Budget Update (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net result from transactions: 2021-22 Budget Update</td>
<td>(5 276)</td>
<td>(3 447)</td>
<td>(2 105)</td>
</tr>
<tr>
<td>Policy variations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue policy initiatives</td>
<td>(1)</td>
<td>27</td>
<td>28</td>
</tr>
<tr>
<td>Output policy initiatives (b)</td>
<td>(5 000)</td>
<td>(2 390)</td>
<td>(1 529)</td>
</tr>
<tr>
<td>Economic/demographic variations</td>
<td>(5 001)</td>
<td>(2 364)</td>
<td>(1 501)</td>
</tr>
<tr>
<td>Taxation</td>
<td>1 014</td>
<td>1 158</td>
<td>992</td>
</tr>
<tr>
<td>Investment income (c)</td>
<td>126</td>
<td>134</td>
<td>148</td>
</tr>
<tr>
<td>Commonwealth grant variations</td>
<td>1 140</td>
<td>1 292</td>
<td>1 140</td>
</tr>
<tr>
<td>General purpose grants</td>
<td>7</td>
<td>424</td>
<td>514</td>
</tr>
<tr>
<td>Specific purpose grants (d)</td>
<td>278</td>
<td>277</td>
<td>417</td>
</tr>
<tr>
<td>Administrative variations</td>
<td>285</td>
<td>701</td>
<td>930</td>
</tr>
<tr>
<td>Contingency offset for new policy initiatives (e)</td>
<td>250</td>
<td>300</td>
<td>400</td>
</tr>
<tr>
<td>Other administrative variations</td>
<td>737</td>
<td>254</td>
<td>11</td>
</tr>
<tr>
<td>Total variation since 2021-22 Budget Update</td>
<td>(2 588)</td>
<td>184</td>
<td>979</td>
</tr>
<tr>
<td>Net result from transactions: 2022-23 Budget</td>
<td>(7 864)</td>
<td>(3 263)</td>
<td>(1 126)</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) This is represented in Table 4.4 as the 2022-23 Budget output policy initiatives.
(c) Comprises dividends and income tax and rate equivalent revenue.
(d) Reflects the change in grant revenue as per Note 1.2.4 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the general government sector less associated expense movements.
(e) Represents releases from the funding not allocated to specific purposes contingency associated with 2022-23 Budget new output initiatives. Further information on total output contingencies can be found at Note 1.3.5 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the general government sector.
Policy variations

Policy variations reflect specific initiatives by the Government that have a fiscal impact and are related to a new policy or represent a change in the Government’s existing policy position since the 2021-22 Budget Update.

The 2022-23 Budget funds $22.2 billion in new output initiatives over the five years to 2025-26. Table 4.4 shows the impact of the new output initiatives in this budget from 2022-23.

Details of specific new output and revenue policy initiatives are contained in Budget Paper No. 3, Chapter 1 Output, asset investment, savings and revenue initiatives.

Table 4.4: Net impact of the 2022-23 Budget new output initiatives (a)  ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>New output initiatives</td>
<td>6 378</td>
<td>3 999</td>
<td>2 808</td>
<td>3 121</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reprioritisations and revenue offsets (b)</td>
<td>845</td>
<td>550</td>
<td>388</td>
<td>833</td>
</tr>
<tr>
<td>Adjustments (c)</td>
<td>533</td>
<td>1 059</td>
<td>891</td>
<td>905</td>
</tr>
<tr>
<td>Savings</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>2022-23 Budget output policy initiatives</td>
<td>5 000</td>
<td>2 390</td>
<td>1 529</td>
<td>1 383</td>
</tr>
<tr>
<td>Less: contingency offset for new policy (d)</td>
<td>250</td>
<td>300</td>
<td>400</td>
<td>500</td>
</tr>
<tr>
<td>Net impact</td>
<td>4 750</td>
<td>2 090</td>
<td>1 129</td>
<td>883</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance
Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) This includes the reprioritisation of resources previously allocated to departments and revenue offsets.
(c) Primarily incorporates the net impact of the specific creation and release of contingencies held for decisions made but not yet allocated.
(d) Represents releases from the funding not allocated to specific purposes contingency associated with 2022-23 Budget new output initiatives. Further information on total output contingencies can be found at Note 1.3.5 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the general government sector.

Economic and demographic variations

Since the 2021-22 Budget Update, taxation revenue has been revised upwards by $1.0 billion in 2022-23, $1.2 billion in 2023-24 and $1.0 billion in 2024-25. This includes upgrades to land transfer duty, land tax and payroll tax.

Commonwealth grants variations

Commonwealth general purpose grants (or GST grants) have been revised down by $86 million in 2021-22 compared to the 2021-22 Budget Update.

GST grants have been revised upwards by $7 million in 2022-23, $424 million in 2023-24, and $514 million in 2024-25. These changes reflect upgrades to forecasts for the national GST pool following the strong outcome in the 2021 December quarter national accounts and robust GST receipts in early 2022, partially offset by Victoria’s population share decrease and the upgrades to Victoria’s state taxation revenue. The revisions also reflect elevated commodity prices in the near term.

Net changes to specific purpose grants have increased the operating result by an average of $324 million a year from 2022-23 to 2024-25 compared with the 2021-22 Budget Update. The movements primarily reflect additional infrastructure grants.
Administrative variations

Other administrative variations are expected to increase the operating result by $0.7 billion in 2022-23 and $0.3 billion in 2023-24. The variations since the 2021-22 Budget Update include:

- adjustments to the provisions for decisions made but not yet allocated that are outlined in Note 1.3.5 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the general government sector; partially offset by

- an increase in the superannuation interest expense on the state’s defined benefit superannuation liability from 2022-23, due to increases in the bond yields that underlie the key superannuation valuation assumptions

- an increase in interest expense in line with increased global bond rates since the 2021-22 Budget Update.

Capital expenditure

Government infrastructure investment (GII), which measures investment funded by the Government and estimated private sector construction related expenditure on public private partnership projects, is expected to average $21.3 billion a year over the budget and forward estimates – more than four times the 10-year average to 2014-15.

This includes investments in health, housing, education, transport and cultural precincts, as well as major productivity-enhancing projects such as the North East Link, the Metro Tunnel, the West Gate Tunnel, the Melbourne Airport Rail, the Geelong Fast Rail, the Suburban Rail Loop and the removal of 85 level crossings by 2025.

Current market capacity constraints due to the high levels of infrastructure activity across Australia have resulted in a slightly moderated GII forecast over the forward estimates, to $21.3 billion on average over the next four years. The revised forecast supports the alignment of the state’s capital expenditure profile with project milestones. It also takes into consideration that industry has high confidence in delivering 10–15 per cent annual growth over the short term as identified in Infrastructure Australia’s 2021 Infrastructure Market Capacity Report.

Further information on the Government’s infrastructure investment, and how it will support jobs and the economic recovery, is available in Budget Paper No. 4, Chapter 1 State Capital Program 2022-23.

Budget Paper No. 3, Chapter 1 Output, asset investment, savings and revenue initiatives contains details of new individual asset initiatives.
Net debt

Net debt is projected to be $101.9 billion at June 2022 and is forecast to increase to $167.5 billion by June 2026. This is a decrease of $2.5 billion by June 2022 and of $7.8 billion by June 2025 compared with the 2021-22 Budget Update.

As a proportion of gross state product (GSP), net debt is projected to increase from 19.8 per cent in June 2022 to 26.5 per cent by June 2026, although remains lower in each year of the forward estimates than was forecast in the 2021-22 Budget Update.

Expenditure in response to the COVID-19 pandemic over the last two years and, in particular, in response to the recent Delta and Omicron outbreaks of COVID-19, has been focused on the short term to allow required services and economic support to be provided while maintaining the fiscal strategy.

Throughout the pandemic, the Government has prioritised the use of its balance sheet to support the Victorian community and economy. This approach was consistent with stimulus approaches elsewhere in Australia and around the world.

Stabilising net debt as a percentage of GSP – the last step in the Government’s fiscal strategy – is an important medium-term objective for the Government.

Chart 4.2 outlines the movements in general government net debt levels and the net debt to GSP ratio since 2010-11. It highlights the impact of the COVID-19 pandemic with debt rising across the three years from 2019-20.
While both net debt and net debt to GSP are still projected to rise over the forward estimates, the rate of growth has slowed and will continue to slow over the medium term.

The Victorian Future Fund (the Fund) will be established by the Government to manage the fiscal impact of COVID-19 and support the State’s debt stabilisation strategy.

The Fund will be established using proceeds from the VicRoads Modernisation Joint Venture that is currently progressing. The investment returns from the Fund will be quarantined and returned to the Fund so that its balance will grow over time to offset borrowings. Both the initial investment and future returns will be used to repay COVID-19 borrowings. The Fund is projected to have a balance of around $10 billion in the medium term.

Further investments will be made in the future into the Fund through proceeds from designated government land sales and a proportion of future budget surpluses once net debt stabilises.

**Chart 4.2: General government net debt to GSP**

The application of cash resources for the general government sector (as shown in Table 4.5) outlines the annual movements in net debt.
### Table 4.5: Application of cash resources for the general government sector (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net result from transactions</td>
<td>(14 558)</td>
<td>(17 631)</td>
<td>(7 864)</td>
<td>(3 263)</td>
<td>(1 126)</td>
<td>652</td>
</tr>
<tr>
<td>Add back: Operating cash flows not recognised in the net operating balance (b)</td>
<td>1 601</td>
<td>5 868</td>
<td>9 145</td>
<td>4 040</td>
<td>4 746</td>
<td>4 885</td>
</tr>
<tr>
<td>Net cash flows from operating activities</td>
<td>(12 958)</td>
<td>(11 763)</td>
<td>1 281</td>
<td>776</td>
<td>3 620</td>
<td>5 536</td>
</tr>
<tr>
<td>Less: Total net investment in fixed assets (c)</td>
<td>11 551</td>
<td>13 881</td>
<td>15 874</td>
<td>18 829</td>
<td>20 252</td>
<td>18 106</td>
</tr>
<tr>
<td>Surplus/(deficit) of cash from operations after funding net investment in fixed assets</td>
<td>(24 509)</td>
<td>(25 644)</td>
<td>(14 593)</td>
<td>(18 052)</td>
<td>(16 632)</td>
<td>(12 570)</td>
</tr>
<tr>
<td>Less: Leases and service concession arrangements (d)</td>
<td>2 987</td>
<td>2 588</td>
<td>2 312</td>
<td>2 444</td>
<td>915</td>
<td>298</td>
</tr>
<tr>
<td>Other movements</td>
<td>927</td>
<td>977</td>
<td>(341)</td>
<td>(1 574)</td>
<td>(132)</td>
<td>(199)</td>
</tr>
<tr>
<td>Decrease/(increase) in net debt</td>
<td>(28 423)</td>
<td>(29 208)</td>
<td>(16 564)</td>
<td>(18 922)</td>
<td>(17 415)</td>
<td>(12 669)</td>
</tr>
</tbody>
</table>

**Source:** Department of Treasury and Finance

**Notes:**

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Includes depreciation, prepayments and movements in the superannuation liability and liability of employee benefits for the year, and the progressive unwinding of the grant of a right to the operator liability.
(c) Includes total purchases of plant, property and equipment, and net capital contributions to other sectors of government net of proceeds from asset sales.
(d) Includes most operating leases which are now required to be recognised as lease liabilities. It also includes the financial liabilities relating to public private partnership projects including the High Capacity Metro Trains Project, the Metro Tunnel, the new Footscray Hospital, the Frankston Hospital Redevelopment and the Western Roads Upgrade.

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**Unfunded superannuation liability**

The Government is on track to fully fund the state’s unfunded superannuation liability by 2035. Note 1.6.3 of Budget Paper No. 5, Chapter 1 *Estimated Financial Statements for the general government sector* shows information on the reported superannuation liability.
FISCAL RISKS

This section discusses a number of risks which, if realised, are likely to impact on the state’s financial position and budget outcomes.

Details of specific contingent assets and liabilities, defined as possible assets or liabilities that arise from past events whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, are contained within Budget Paper No. 5, Chapter 6 *Contingent assets and contingent liabilities*.

**General fiscal risks**

**COVID-19**

The risks to Victoria’s economic outlook remain greater than were typical prior to the pandemic. These include ongoing risks relating to the COVID-19 pandemic, and elevated uncertainties relating to the Russian invasion of Ukraine.

The Government’s forecast revenues, expenses and borrowings are predicated on a series of assumptions, including those related to the global recovery. If these assumptions do not eventuate, the actual financial outcomes may differ from the Government’s current budget.

Appendix A *Sensitivity analysis* contains information on the impact of variations in the macroeconomic outlook on the Government’s key fiscal aggregates. This includes a scenario of a renewed global downturn resulting from the emergence of a vaccine-resistant COVID-19 strain, leading to renewed outbreaks and restrictions in major economies outside Australia.

**National Partnership on COVID-19 Response**

To support the national and coordinated health response to the COVID-19 pandemic, in April 2020 the Commonwealth and states agreed shared funding arrangements via a new National Partnership Agreement. The Agreement does not have a clear sunset date for budget purposes. The Commonwealth has only committed funding until 2022-23 despite ongoing impacts on the health system from the COVID-19 pandemic. As such, if the Agreement is terminated before the COVID-19 pandemic response ends, the state may bear increased costs without Commonwealth contributions, particularly if there are future outbreaks of COVID-19.
State taxes

State tax forecasts are primarily modelled on the relationships between taxation revenue and projected economic variables. As a result, the main source of uncertainty to state taxation estimates is unforeseen changes in the economic outlook.

Revenue from property-based taxes, such as land tax and land transfer duty, is subject to unique risks and historically has been volatile as property markets can exhibit large cycles typically related to changes in interest rates and/or changes in sentiment.

The 2022-23 Budget anticipates a decline in Victorian dwelling prices of 4.0 per cent over the 2023 calendar year after significant growth in 2021-22, reflecting in-part anticipated rises in the RBA cash rate commencing around mid-2022, in line with market expectations. This price decline is expected to be concentrated in the high-value segment of the market, which is accounting for an elevated share of land transfer duty revenue in 2021-22. Transaction volumes are also forecast to decline in year-on-year terms from the March quarter of 2022 until 2024. Both price and transaction volume movements pose as risks for property-based tax collections.

Employee expenses

Employee expenses are the state’s largest expense. Two important determinants of employee expenses are wages growth and the number of employees.

Wages growth is primarily driven by enterprise bargaining agreements, the outcomes of which are moderated by application of the Government’s wages policy. The Government announced changes to the Victorian Public Sector Wages Policy that took effect from 1 January 2022. The new wages policy parameters continue to encourage public sector agencies to take a strategic approach to enterprise bargaining. Other factors contributing to projected employee expenses include the anticipated composition and profile of the workforce.

Demand for government services

Another key uncertainty is whether growth in demand for government services will exceed or be lower than current projections. This can occur, for example, as a result of higher than forecast population growth or expenditure in response to unforeseen events such as natural disasters, including bushfires and floods.

The estimates incorporate contingency provisions to mitigate the impact of expenditure risks that may be realised during the next four years. The contingency provisions are sized to allow for the likely growth in Victoria’s population and the derived increased demand for government services.

Note 1.3.5 and Note 1.3.6 of Budget Paper No. 5, Chapter 1 Estimated Financial Statements for the general government sector discloses general government output and asset contingencies not allocated to departments.
**Capital program risks**

The Government is delivering a historically large program of capital investments aimed at supporting jobs and improving productivity and the quality of public service delivery. The Government’s project pipeline will continue to support elevated levels of activity in the construction sector over the medium term with several committed major projects in the planning and procurement phase complementing the large volume of existing projects in delivery.

The key risks impacting the capital program include managing the effects of the COVID-19 pandemic, market capacity constraints, and high demand for skills and resources. These factors are exacerbated by competition for skills and resources from other jurisdictions with significant infrastructure programs.

The Government is implementing several strategies to help mitigate these delivery challenges which are discussed in in Budget Paper No. 4, Chapter 1 *State Capital Program 2022-23*.

While the COVID-19 pandemic has created some uncertainty on the state’s capital program during 2020 and 2021, to date the impacts have been well managed with project delivery agencies working with contractors to minimise project disruption and deliver best for project outcomes.

**Specific fiscal risks**

**Commonwealth schools funding**

In June 2017, the Commonwealth Government passed amendments to the *Australian Education Act 2013* to implement a new national school funding model. In mid-2019, Victoria signed the National School Reform Agreement and an accompanying bilateral agreement, which expire on 31 December 2023. Estimates of funding required to acquit the Schooling Resource Standard target in a given year are based on student number and profile projections for that year. Expenditure targets are finalised towards the end of or after each school year based on actual student data, creating a risk that the Victorian and Commonwealth targets differ from the funding allocated that year.

**National Health Reform Agreement Funding Cap**

Under the 2020-25 Addendum to the National Health Reform Agreement (NHRA), the Commonwealth co-funds public hospitals by contributing 45 per cent of the cost of eligible activity, with the Commonwealth’s contribution capped at a growth rate of 6.5 per cent compared to the previous year’s contribution.

This is a ‘soft cap’ that applies at a national level, with states entitled to receive Commonwealth contributions beyond the cap until the growth rate of national expenditure reaches 6.5 per cent. Uncertainty around expenditure growth in other states and territories may create a fiscal risk to the State if the Commonwealth does not fund 45 per cent of additional eligible hospital spending.
In addition, should the Commonwealth’s participation in the National Partnership on COVID-19 Response not be extended beyond the current commitment, additional hospital activity and costs relating to the COVID-19 response could fall instead under the NHRA, which would increase the risk of breaching the 6.5 per cent cap for annual efficient growth in Commonwealth funding.

**National Skills Agreement**

In July 2020, the Commonwealth and the states agreed to negotiate a new National Skills Agreement (NSA) to replace the National Agreement for Skills and Workforce Development. The quantum and conditions of funding are dependent on ongoing negotiations between the Commonwealth and states, with further negotiations expected to take place later in 2022. Conditions of the new Agreement, as currently proposed, may increase fiscal and policy risks to the State.

**Victoria’s GST revenue**

Victoria’s GST revenue is broadly determined by three key factors:

- the amount of GST collected by the Commonwealth (the national GST pool)
- Victoria’s GST relativity
- Victoria’s share of the national population.

**National GST pool**

The outlook for the national GST pool has improved following the economic resilience seen in 2021-22 amid public health restrictions and extreme flooding events. A slower-than-expected recovery in consumption growth or dwelling investment could slow growth in the GST pool. Key risks to the recovery profile include decreasing vaccine efficacy and the emergence of new variants of the COVID-19 virus.

Further sources of uncertainty for the outlook of the national GST pool include how households draw down their accumulated savings, the outlook for inflation and interest rates, and the prospects for global economic growth against a backdrop of elevated global uncertainty.

**GST relativities**

The national GST pool is shared between states and territories based on relativities determined annually by the Commonwealth Treasurer, which are informed by the recommendations of the Commonwealth Grants Commission.

These relativities are based on the relative fiscal capacity of each jurisdiction and are influenced by differences in revenue bases and costs of delivering services. Relativities are sensitive to a broad range of factors, including demographics, infrastructure needs, developments in property markets and global commodity prices (particularly for iron ore and coal). Uncertainty in these factors represents risks for Victoria’s GST revenue.
In addition, the Commonwealth Government has not allowed the independent GST umpire, the Commonwealth Grants Commission, to account for the impacts of the COVID-19 pandemic on GST distribution. This puts at risk Victoria’s capacity to support recovery from the pandemic and fully fund essential services. Further information on this risk is provided in Budget Paper No. 2, Chapter 3 *Victoria’s economic recovery despite insufficient Commonwealth support.*

**Population**

Since the start of the COVID-19 pandemic, Victoria’s national population share has decreased due to a net outflow of Victorian residents to other states and restrictions on overseas migration. As international borders re-open, if Victoria’s population growth is higher than forecast compared to other states, then Victoria’s share of GST could increase. Conversely, should other states have higher population growth than expected compared with Victoria this could negatively affect Victoria’s GST revenue.

**Commonwealth no-worse-off guarantee for GST entitlement**

In 2018, the Commonwealth legislated a change in the system of horizontal fiscal equalisation (HFE), which introduced:

- a minimum GST revenue sharing relativity (relativity floor) of 0.70 commencing in 2019-20, supported by transition payments from the Commonwealth and facilitated within the GST distribution from 2022-23, rising to 0.75 from 2024-25
- a small boost to the GST revenue pool from 2021-22 with additional Commonwealth financial assistance
- the transition of the HFE system from full equalisation (so called equalising to the strongest state) to ‘reasonable’ equalisation, based upon the fiscal capacity of the stronger of New South Wales or Victoria.

During the six-year transition period commencing in 2021-22, each state and territory is entitled to receive additional Commonwealth financial assistance to ensure it is no worse off compared to its GST entitlement had full equalisation been maintained. The no-worse-off guarantee is currently only legislated until the end of the transition period in 2026-27, which poses a fiscal risk to states and territories. The Commonwealth’s 2022-23 Budget indicates that without the guarantee, Victoria would lose $4.4 billion over the next four years to 2025-26. Actual impacts may be greater than reported in the Commonwealth’s budget as it is based on the assumption that its estimates of no-worse-off payments are reduced by 50 per cent in 2025-26.

Further information on the potential impact of the failure to extend the no-worse-off guarantee is presented in Budget Paper No. 5, Chapter 4 *State Revenue Box 4.2 The fiscal risk to Victoria from the new GST distribution system.*

Victoria continues to work with other state governments and the Commonwealth to ensure Victoria receives its fair share of GST.
CHAPTER 5 – POSITION AND OUTLOOK OF THE BROADER PUBLIC SECTOR

- The State of Victoria’s net result from transactions is projected to improve from a deficit of $13.1 billion in 2022-23 to a deficit of $6.1 billion in 2025-26, with an average deficit of $8.9 billion over the budget and forward estimates.

- The net result from transactions of the non-financial public sector (NFPS), which includes both the general government and the public non-financial corporation (PNFC) sectors, is expected to improve from a deficit of $8.9 billion in 2022-23 to a deficit of $605 million by 2025-26. This improvement is primarily driven by the general government sector, for which revenues are growing faster than expenses over the budget and forward estimates.

- The net result from transactions of the PNFC sector is anticipated to average a surplus of $150 million a year over the budget and forward estimates. Once non-cash items such as depreciation are removed, the operating cash flow surplus of the PNFC sector is expected to average $1.7 billion a year over this period.

- The net result from transactions of the public financial corporations (PFC) sector is forecast to average a deficit of $4.8 billion a year over the budget and forward estimates, while the net result for this sector is expected to average a deficit of $2.2 billion a year. The significant improvement relative to the net deficit from transactions is due to other economic flows which include unrealised capital gains on the investments held by the State’s insurance agencies along with movements in deferred tax assets.

- As a proportion of gross state product (GSP), NFPS net debt is estimated to average 28.9 per cent over the budget and forward estimates.
This chapter provides an overview of the activities of the broader public sector, comprising:

- the NFPS, which consolidates the general government and the PNFC sectors. The general government sector is discussed in Chapter 4 *Budget position and outlook*. The PNFC sector comprises a wide range of entities that provide services that are primarily funded by user charges and fees. The main services provided by PNFCs include water, housing, and transport services.

- the State of Victoria, which consolidates the NFPS and the PFC sectors. PFCs can be categorised into two broad types: those that provide services to the general public and businesses (such as WorkSafe Victoria, the Transport Accident Commission and State Trustees Limited), and those that provide financial services, predominantly to other government entities (such as the Victorian Funds Management Corporation, Treasury Corporation of Victoria and the Victorian Managed Insurance Authority).

This chapter comments on each of the sectors but includes tables with data for the State of Victoria and the NFPS only. The equivalent information for the PFC and PNFC sectors can be found in Budget Paper No. 5, Chapter 2 *Supplementary Uniform Presentation Framework Tables*.

The following chart shows the relationship between the various sectors of the State and indicates the relevant tables that disclose the data on these sectors within this budget paper and Budget Paper No. 5 *Statement of Finances*.
NON-FINANCIAL PUBLIC SECTOR

The net result from transactions of the NFPS is forecast to be a deficit of $8.9 billion in 2022-23, improving to a deficit of $605 million in 2025-26. This improvement is largely driven by the general government sector for which the net result from transactions is forecast to improve from a deficit of $7.9 billion in 2022-23 to a surplus of $652 million in 2025-26 as a result of revenues growing, on average, at a rate that exceeds expenditure growth over the budget and forward estimates.

The general government sector and PNFC sector results may not equal the results shown for the NFPS due to inter-sector transfers.

Table 5.1: Summary operating statement for the non-financial public sector (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue and income from transactions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td>23 184</td>
<td>29 609</td>
<td>30 011</td>
<td>31 723</td>
<td>32 980</td>
<td>34 659</td>
</tr>
<tr>
<td>Dividends, income tax equivalent and interest (b)</td>
<td>405</td>
<td>455</td>
<td>618</td>
<td>656</td>
<td>765</td>
<td>780</td>
</tr>
<tr>
<td>Sales of goods and services</td>
<td>11 477</td>
<td>11 839</td>
<td>13 221</td>
<td>13 475</td>
<td>13 681</td>
<td>13 833</td>
</tr>
<tr>
<td>Grants</td>
<td>36 977</td>
<td>41 854</td>
<td>40 345</td>
<td>40 881</td>
<td>43 017</td>
<td>44 822</td>
</tr>
<tr>
<td>Other revenue and income</td>
<td>3 690</td>
<td>3 875</td>
<td>4 046</td>
<td>4 211</td>
<td>3 820</td>
<td>4 079</td>
</tr>
<tr>
<td>Total revenue and income from transactions</td>
<td>75 733</td>
<td>87 632</td>
<td>88 241</td>
<td>90 946</td>
<td>94 262</td>
<td>98 174</td>
</tr>
<tr>
<td>% change</td>
<td>6.5</td>
<td>15.7</td>
<td>0.7</td>
<td>3.1</td>
<td>3.6</td>
<td>4.1</td>
</tr>
<tr>
<td>Expenses from transactions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee expenses</td>
<td>31 449</td>
<td>34 694</td>
<td>34 637</td>
<td>35 820</td>
<td>36 378</td>
<td>36 997</td>
</tr>
<tr>
<td>Superannuation (c)</td>
<td>3 871</td>
<td>4 330</td>
<td>4 600</td>
<td>4 780</td>
<td>4 876</td>
<td>4 932</td>
</tr>
<tr>
<td>Depreciation</td>
<td>6 872</td>
<td>7 109</td>
<td>7 433</td>
<td>7 627</td>
<td>7 911</td>
<td>8 248</td>
</tr>
<tr>
<td>Interest expense</td>
<td>3 034</td>
<td>3 424</td>
<td>4 321</td>
<td>5 324</td>
<td>6 198</td>
<td>6 934</td>
</tr>
<tr>
<td>Grant expense</td>
<td>16 968</td>
<td>22 859</td>
<td>15 637</td>
<td>13 971</td>
<td>13 680</td>
<td>13 721</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>29 500</td>
<td>34 209</td>
<td>30 476</td>
<td>27 793</td>
<td>27 546</td>
<td>27 948</td>
</tr>
<tr>
<td>Total expenses from transactions</td>
<td>91 695</td>
<td>106 625</td>
<td>97 104</td>
<td>95 315</td>
<td>96 589</td>
<td>98 779</td>
</tr>
<tr>
<td>% change</td>
<td>17.3</td>
<td>16.3</td>
<td>-8.9</td>
<td>-1.8</td>
<td>1.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Net result from transactions</td>
<td>(15 961)</td>
<td>(18 993)</td>
<td>(8 862)</td>
<td>(4 369)</td>
<td>(2 327)</td>
<td>(605)</td>
</tr>
<tr>
<td>Total other economic flows included in net result</td>
<td>(623)</td>
<td>(807)</td>
<td>(368)</td>
<td>37</td>
<td>(285)</td>
<td>(280)</td>
</tr>
<tr>
<td>Net result</td>
<td>(16 585)</td>
<td>(19 801)</td>
<td>(9 230)</td>
<td>(4 332)</td>
<td>(2 612)</td>
<td>(886)</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5 Statement of Finances. Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Comprises dividends, income tax and rate equivalent revenue and interest.
(c) Comprises superannuation interest expense and other superannuation expenses.
The net result from transactions of the PNFC sector is projected to improve from a surplus of $20 million in 2022-23 to a surplus of $262 million in 2025-26. This reflects a progressive increase in revenues as the sector and broader economy recovers from the peak of the COVID-19 pandemic.

On average, the surplus of the PNFC sector is projected to be $150 million a year over the budget and forward estimates.

Over this period, metropolitan water authorities are projected to report an average surplus of $320 million a year. While Homes Victoria maintains a net operating cash flow surplus (see below), it is projected to report an average deficit of $132 million a year.

Application of cash resources

Table 5.2 shows the net cash flows from operating activities of the NFPS is projected to increase from a surplus of $2.7 billion in 2022-23 to a surplus of $7.1 billion by 2025-26. This reflects the clear fiscal strategy set out by the Government in the 2020-21 Budget. The surplus net cash flows from operating activities fund 13.8 per cent of the projected net investment in fixed assets in 2022-23 and is expected to increase to 34.4 per cent by 2025-26. The remaining investment in fixed assets is funded largely by borrowings.

Homes Victoria is projected to generate an average net operating cash flow surplus of $116 million a year over the budget and forward estimates. This cash flow surplus indicates that Homes Victoria remains in a financially sustainable position despite the net result from transactions deficit noted above which primarily relates to non-cash expenses such as depreciation. Overall, once non-cash items such as depreciation are removed, the PNFC sector is projected to record an average operating cash flow surplus of $1.7 billion a year over the budget and forward estimates.

Table 5.2: Application of cash resources for the non-financial public sector (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget estimate</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net result from transactions</td>
<td>(15 961)</td>
<td>(18 993)</td>
<td>(8 862)</td>
<td>(4 369)</td>
<td>(2 327)</td>
<td>(605)</td>
</tr>
<tr>
<td>Add back: operating cash flows not recognised in the net operating balance (b)</td>
<td>5 434</td>
<td>7 710</td>
<td>11 550</td>
<td>6 628</td>
<td>7 478</td>
<td>7 675</td>
</tr>
<tr>
<td>Net cash flows from operating activities</td>
<td>(10 527)</td>
<td>(11 284)</td>
<td>2 687</td>
<td>2 259</td>
<td>5 151</td>
<td>7 069</td>
</tr>
<tr>
<td>Less: Total net investment in fixed assets (c)</td>
<td>15 175</td>
<td>16 856</td>
<td>19 519</td>
<td>22 393</td>
<td>23 170</td>
<td>20 570</td>
</tr>
<tr>
<td>Surplus/(deficit) of cash from operations after funding net investments in fixed assets</td>
<td>(25 702)</td>
<td>(28 140)</td>
<td>(16 832)</td>
<td>(20 133)</td>
<td>(18 019)</td>
<td>(13 501)</td>
</tr>
<tr>
<td>Less: Leases and service concession arrangements (d)</td>
<td>3 022</td>
<td>3 059</td>
<td>3 928</td>
<td>2 778</td>
<td>1 390</td>
<td>1 069</td>
</tr>
<tr>
<td>Other movements</td>
<td>(250)</td>
<td>(277)</td>
<td>(334)</td>
<td>224</td>
<td>9</td>
<td>(111)</td>
</tr>
<tr>
<td>Decrease/(increase) in net debt</td>
<td>(28 474)</td>
<td>(30 922)</td>
<td>(20 425)</td>
<td>(23 136)</td>
<td>(19 418)</td>
<td>(14 458)</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:

(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Includes depreciation, prepayments and movements in the superannuation liability and liability of employee benefits, and the progressive unwinding of the grant of a right to the operator liability.
(c) Includes total purchases of plant, property and equipment, and capital contributions to other sectors of government net of proceeds from asset sales.
(d) Includes most operating leases which are now required to be recognised as lease liabilities. It also includes the financial liabilities relating to public private partnerships including the High Capacity Metro Trains Project, the Metro Tunnel, the new Footscray Hospital, the Frankston Hospital Redevelopment, the North East Link, and the Western Roads Upgrade.
Infrastructure

Table 5.2 also provides estimates of the net investment in non-financial assets which represents the difference between infrastructure expenditure and the proceeds from asset sales. The total net investment in non-financial assets by the NFPS is projected to average $22.1 billion a year over the budget and forward estimates.

The main PNFC sector infrastructure projects under development are:

- investment in transport infrastructure and rolling stock to meet patronage growth and improve network performance. This includes the new metropolitan trains, Next Generation Trams, tram infrastructure upgrades and maintenance facilities for rolling stock
- investment to deliver the North East Link – Primary Package (Tunnels) by the State Tolling Corporation
- various water and sewer related infrastructure projects, such as the Western Treatment Plant 5W NRP Project, Aurora Recycled Water Treatment Plant, upgrade to the Gisborne Recycled Water Plant and the East Grampians Rural Water Supply project.

Further detail on these projects is contained in Budget Paper No. 4, Chapter 3 Public non-financial corporations capital program.

Non-financial public sector net debt and net financial liabilities

Table 5.3 details the NFPS net debt and superannuation liabilities. It shows that net debt is expected to increase from $119.4 billion at 30 June 2022 to $196.8 billion by 30 June 2026. As a proportion of GSP, NFPS net debt averages 28.9 per cent over the budget and forward estimates with general government sector net debt as a proportion of GSP averaging 24.5 per cent. The increase in net debt is predominately due to additional borrowings required by the general government sector to fund the Government’s response to the COVID-19 pandemic and Victoria’s Big Build.

The unfunded superannuation liabilities of the former State Superannuation Fund are projected to fall over the budget and forward estimates due mainly to the annual budget contributions that are being made as part of the Government’s commitment to fully fund this liability by 2035.

Overall, the net financial liabilities to GSP ratio is projected to increase from 33.8 per cent in 2021-22 to 40.2 per cent in 2025-26.
Table 5.3: Non-financial public sector net debt and net financial liabilities \(^{(a)}\) ($ billion)

<table>
<thead>
<tr>
<th>Assets</th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and deposits</td>
<td>16.5</td>
<td>15.8</td>
<td>15.6</td>
<td>15.7</td>
<td>16.0</td>
<td>16.5</td>
</tr>
<tr>
<td>Advances paid</td>
<td>0.5</td>
<td>0.7</td>
<td>0.9</td>
<td>0.6</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Investments, loans and placements</td>
<td>3.7</td>
<td>4.4</td>
<td>10.6</td>
<td>11.7</td>
<td>13.0</td>
<td>14.2</td>
</tr>
<tr>
<td>Total</td>
<td>20.7</td>
<td>20.8</td>
<td>27.1</td>
<td>28.0</td>
<td>29.4</td>
<td>31.2</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits held and advances received</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Borrowings</td>
<td>107.4</td>
<td>138.5</td>
<td>165.3</td>
<td>189.2</td>
<td>210.1</td>
<td>226.3</td>
</tr>
<tr>
<td>Total</td>
<td>109.2</td>
<td>140.2</td>
<td>166.9</td>
<td>190.9</td>
<td>211.8</td>
<td>228.0</td>
</tr>
<tr>
<td>Net debt (^{(b)})</td>
<td>88.4</td>
<td>119.4</td>
<td>139.8</td>
<td>162.9</td>
<td>182.3</td>
<td>196.8</td>
</tr>
<tr>
<td>Superannuation liability</td>
<td>27.2</td>
<td>24.1</td>
<td>23.6</td>
<td>23.1</td>
<td>22.6</td>
<td>22.4</td>
</tr>
<tr>
<td>Net debt plus superannuation liability</td>
<td>115.7</td>
<td>143.5</td>
<td>163.4</td>
<td>186.0</td>
<td>205.0</td>
<td>219.2</td>
</tr>
<tr>
<td>Other liabilities (net) (^{(c)})</td>
<td>28.8</td>
<td>30.8</td>
<td>36.0</td>
<td>36.2</td>
<td>35.8</td>
<td>35.3</td>
</tr>
<tr>
<td>Net financial liabilities (^{(d)})</td>
<td>144.5</td>
<td>174.2</td>
<td>199.3</td>
<td>222.2</td>
<td>240.8</td>
<td>254.5</td>
</tr>
</tbody>
</table>

\((\text{per cent})\)

| Net debt to GSP \(^{(e)}\)                   | 18.7           | 23.1            | 25.7           | 28.6             | 30.3             | 31.1             |
| Net debt plus superannuation liability to GSP \(^{(e)}\) | 24.4           | 27.8            | 30.0           | 32.6             | 34.1             | 34.6             |
| Net financial liabilities to GSP \(^{(e)}\) | 30.5           | 33.8            | 36.6           | 39.0             | 40.0             | 40.2             |
| Net debt plus superannuation liability to revenue \(^{(f)}\) | 152.8          | 163.7           | 185.1          | 204.5            | 217.5            | 223.3            |

Source: Department of Treasury and Finance

Notes:
\(^{(a)}\) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
\(^{(b)}\) Net debt is the sum of borrowings, deposits held and advances received less the sum of cash and deposits, advances paid, and investments, loans and placements.
\(^{(c)}\) Other liabilities include other employee entitlements and provisions and other non-equity liabilities, less other non-equity financial assets.
\(^{(d)}\) Net financial liabilities is total liabilities less financial assets (excluding investments in other sector entities).
\(^{(e)}\) The ratios to GSP may vary from publications year to year due to revisions to the Australian Bureau of Statistics GSP data.
\(^{(f)}\) The sum of NFPS net debt plus the superannuation liability as a proportion of NFPS total operating revenue.
Table 5.4 shows several indicators of financial sustainability for the NFPS over the budget and forward estimates.

The operating cash flow surplus to revenue ratio is an indication of the extent to which the cash generated from operations can be used to fund infrastructure. This ratio increases from 3.0 per cent in 2022-23 to 7.2 per cent by 2025-26 due to successive increases in the operating cash flow surplus over the budget and forward estimates. These increases reflect the re-alignment of revenue and expenditure, driven by the combined impact of increased revenue associated with the economic recovery, the tapering of targeted, short-term expenditure that supported Victorians during the public health restrictions and the implementation of savings and efficiencies to improve the effectiveness of departmental spending.

The ratio of gross debt to revenue, which indicates the overall debt burden, is estimated to be 189.2 per cent in 2022-23. The NFPS interest expense to revenue ratio is a measure of the state’s debt service burden. This ratio increases in 2022-23, in line with the increase in debt, but is expected to remain manageable at an average of 6.1 per cent a year over the budget and forward estimates.

Table 5.4: Indicators of financial sustainability for the non-financial public sector

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating cash flow surplus/(deficit) to revenue</td>
<td>(13.9)</td>
<td>(12.9)</td>
<td>3.0</td>
<td>2.5</td>
<td>5.5</td>
<td>7.2</td>
</tr>
<tr>
<td>Gross debt to revenue (a)</td>
<td>144.1</td>
<td>160.0</td>
<td>189.2</td>
<td>209.9</td>
<td>224.7</td>
<td>232.2</td>
</tr>
<tr>
<td>Interest expense to revenue</td>
<td>4.0</td>
<td>3.9</td>
<td>4.9</td>
<td>5.9</td>
<td>6.6</td>
<td>7.1</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Note:
(a) Gross debt includes borrowings, deposits held and advances received.

STATE OF VICTORIA

Table 5.5 shows the operating results for the State. The net result from transactions is projected to improve from a deficit of $13.1 billion in 2022-23 to a deficit of $6.1 billion in 2025-26, with an average deficit of $8.9 billion over the budget and forward estimates. This improvement is primarily due to revenues growing faster than expenses over the forward estimates which is driven by movements in the general government sector that are explained in Chapter 4 Budget position and outlook. When other economic flows are included, the state’s net result improves from a deficit of $12.0 billion in 2022-23 to a deficit of $4.1 billion in 2025-26, with an average deficit of $7.2 billion a year over the budget and forward estimates.

The whole of state result is mainly driven by the NFPS but includes the PFC sector. While the PFC sector is forecast to report an average net result from transactions deficit of $4.8 billion a year over the budget and forward estimates, this excludes some significant drivers of the sector’s performance.
Therefore, the net result is considered to provide a more meaningful indication of the projected financial strength of the PFC sector as it includes other economic flows such as unrealised capital gains on the investments held by the state’s insurance agencies and movements in deferred tax assets. Other economic flows for the PFC sector are expected to average $2.6 billion a year over the budget and forward estimates, which improves the PFC sector net result, relative to the net result from transactions, to an average deficit of $2.2 billion a year.

Across the budget and forward estimates, other economic flows for the PFC sector solely relate to estimated unrealised capital gains on the investments held by the state’s insurance agencies and the estimated impact of movements in deferred tax assets. In 2020-21 and 2021-22, other economic flows for the PFC sector also include revaluations that reflect actual market movements for the financial year to date. Given recent market movements have had a favourable impact on the PFC sector, significant gains are currently reported in both of these periods. The gain or loss that is ultimately reported for 2021-22 will vary in accordance with market experience for the remainder of the financial year.

Table 5.5: Operating results – State of Victoria (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue and income from transactions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td>23 167</td>
<td>29 589</td>
<td>29 991</td>
<td>31 702</td>
<td>32 958</td>
<td>34 637</td>
</tr>
<tr>
<td>Dividends and interest (b)</td>
<td>2 363</td>
<td>2 063</td>
<td>2 402</td>
<td>2 508</td>
<td>3 217</td>
<td>3 329</td>
</tr>
<tr>
<td>Sales of goods and services</td>
<td>15 787</td>
<td>16 262</td>
<td>17 797</td>
<td>18 273</td>
<td>18 705</td>
<td>19 097</td>
</tr>
<tr>
<td>Grants</td>
<td>36 739</td>
<td>41 244</td>
<td>39 638</td>
<td>40 319</td>
<td>41 913</td>
<td>43 348</td>
</tr>
<tr>
<td>Other revenue and income</td>
<td>3 723</td>
<td>3 902</td>
<td>4 075</td>
<td>4 240</td>
<td>3 849</td>
<td>4 109</td>
</tr>
<tr>
<td><strong>Total revenue and income from transactions</strong></td>
<td>81 778</td>
<td>93 061</td>
<td>93 902</td>
<td>97 042</td>
<td>100 642</td>
<td>104 520</td>
</tr>
<tr>
<td><strong>% change</strong></td>
<td>5.8</td>
<td>13.8</td>
<td>0.9</td>
<td>3.3</td>
<td>3.7</td>
<td>3.9</td>
</tr>
</tbody>
</table>

**Expenses from transactions**

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee expenses</td>
<td>31 338</td>
<td>34 655</td>
<td>34 597</td>
<td>35 783</td>
<td>36 347</td>
<td>36 969</td>
</tr>
<tr>
<td>Superannuation (c)</td>
<td>3 907</td>
<td>4 372</td>
<td>4 643</td>
<td>4 826</td>
<td>4 923</td>
<td>4 981</td>
</tr>
<tr>
<td>Depreciation</td>
<td>6 941</td>
<td>7 190</td>
<td>7 525</td>
<td>7 718</td>
<td>8 003</td>
<td>8 336</td>
</tr>
<tr>
<td>Interest expense</td>
<td>3 437</td>
<td>3 390</td>
<td>4 294</td>
<td>5 287</td>
<td>6 166</td>
<td>6 901</td>
</tr>
<tr>
<td>Grant expense</td>
<td>16 442</td>
<td>22 815</td>
<td>15 321</td>
<td>13 954</td>
<td>13 646</td>
<td>13 705</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>37 985</td>
<td>43 479</td>
<td>40 632</td>
<td>38 579</td>
<td>38 806</td>
<td>39 748</td>
</tr>
<tr>
<td><strong>Total expenses from transactions</strong></td>
<td>100 049</td>
<td>115 901</td>
<td>107 012</td>
<td>106 146</td>
<td>107 891</td>
<td>110 640</td>
</tr>
<tr>
<td><strong>% change</strong></td>
<td>15.9</td>
<td>15.8</td>
<td>-7.7</td>
<td>-0.8</td>
<td>1.6</td>
<td>2.5</td>
</tr>
</tbody>
</table>

**Net result from transactions**

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>(18 271)</td>
<td>(22 840)</td>
<td>(13 110)</td>
<td>(9 104)</td>
<td>(7 249)</td>
<td>(6 120)</td>
<td></td>
</tr>
<tr>
<td><strong>Total other economic flows included in net result</strong></td>
<td>6 950</td>
<td>9 244</td>
<td>1 085</td>
<td>1 771</td>
<td>1 886</td>
<td>1 983</td>
</tr>
</tbody>
</table>

**Net result**

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>(11 321)</td>
<td>(13 596)</td>
<td>(12 025)</td>
<td>(7 333)</td>
<td>(5 362)</td>
<td>(4 138)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) This is a summary operating statement. The comprehensive operating statement is presented in Budget Paper No. 5 Statement of Finances. Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Comprises dividends and interest.
(c) Comprises superannuation interest expense and other superannuation expenses.
Table 5.6 shows the state’s net assets are projected to decrease slightly over the budget and forward estimates from $178.6 billion in 2021-22 to $178.5 billion by 2025-26. While total assets are expected to increase over the budget and forward estimates, this increase is offset by higher liabilities, largely due to increased borrowings.

In particular, financial assets are estimated to increase from $80.6 billion in 2021-22 to $97.6 billion by 2025-26 and non-financial assets, including infrastructure, are estimated to increase from $356.2 billion in 2021-22 to $447.4 billion by 2025-26.

The superannuation liability is projected to fall from $24.1 billion in 2021-22 to $22.4 billion in 2025-26 reflecting the contributions the Government is making to fully fund the liabilities of the former State Superannuation Fund by 2035.

As noted above, these favourable movements are largely offset by a projected increase in borrowings from $140.0 billion in 2021-22 to $228.9 billion by 2025-26. Other liabilities are also projected to increase from $92.3 billion in 2021-22 to $113.4 billion by 2025-26 largely due to growth in the value of the outstanding claims liabilities reported by the state’s insurance agencies.

Table 5.6:  Financial position of the State of Victoria (a) ($ billion)

<table>
<thead>
<tr>
<th></th>
<th>2020-21 actual</th>
<th>2021-22 revised</th>
<th>2022-23 budget</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total financial assets (b)</td>
<td>79.8</td>
<td>80.6</td>
<td>88.5</td>
<td>91.2</td>
<td>94.6</td>
<td>97.6</td>
</tr>
<tr>
<td>Total non-financial assets (c)</td>
<td>341.9</td>
<td>356.2</td>
<td>378.8</td>
<td>403.9</td>
<td>430.8</td>
<td>447.4</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>421.7</td>
<td>436.7</td>
<td>467.2</td>
<td>495.1</td>
<td>525.4</td>
<td>545.0</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Superannuation</td>
<td>27.2</td>
<td>24.1</td>
<td>23.6</td>
<td>23.1</td>
<td>22.6</td>
<td>22.4</td>
</tr>
<tr>
<td>Borrowings</td>
<td>116.3</td>
<td>140.0</td>
<td>166.9</td>
<td>191.6</td>
<td>212.7</td>
<td>228.9</td>
</tr>
<tr>
<td>Deposits held and advances received</td>
<td>1.8</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Other liabilities (d)</td>
<td>88.3</td>
<td>92.3</td>
<td>101.4</td>
<td>105.7</td>
<td>109.5</td>
<td>113.4</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>233.6</td>
<td>258.1</td>
<td>293.7</td>
<td>322.1</td>
<td>346.6</td>
<td>366.5</td>
</tr>
<tr>
<td><strong>Net assets</strong></td>
<td>188.1</td>
<td>178.6</td>
<td>173.5</td>
<td>173.0</td>
<td>178.8</td>
<td>178.5</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) Figures in this table are subject to rounding to the nearest million and may not add up to totals.
(b) Financial assets include cash and deposits, advances paid, investments, loans and placements, receivables, and investments accounted for using the equity method.
(c) Non-financial assets include inventories, non-financial assets held for sale, land, buildings, infrastructure, plant and equipment, and other non-financial assets.
(d) Other liabilities consist of payables, employee benefits, contract liabilities and other provisions.
APPENDIX A – SENSITIVITY ANALYSIS

The 2022-23 Budget relies on forecasts and judgements about the economic, operating and financial conditions for the Victorian general government sector. Uncertainty in these conditions, for example as a result of international developments and other risks to the national economy, may cause the actual results to differ from budget projections.

This sensitivity analysis explores the impacts of variations in the macroeconomic outlook on key fiscal aggregates of the general government sector using two alternative approaches.

The first approach quantifies the fiscal impacts of a scenario involving simultaneous variations in economic parameters that represent key risks to the economic outlook described in Chapter 2 Economic context. This scenario was selected to cover a plausible shock that could affect Victoria over the budget period, and the modelling takes account of linkages between key international, Australian and Victorian economic aggregates.

The modelled outcomes are intended to be used as a guide and care should be exercised in interpreting the results. In particular, economic shocks tend to be idiosyncratic in nature, with the modelled scenario unlikely to completely reflect any future shock that could occur. Departures from this scenario would be likely to result in different impacts on the budget. Furthermore, the modelled results of the shocks do not incorporate any policy responses to the shocks and their subsequent effects on the economic or fiscal outlook.

The second approach considers the fiscal impacts of independent variations in major macroeconomic parameters, holding constant all parameters other than the indicator of interest. This analysis may be useful for assessing the impact on fiscal aggregates of a forecast error in a single economic parameter. In practice, economic variations rarely occur in isolation, and scenario analysis is likely to be more appropriate to illustrate the fiscal impacts of an economic environment materially different from that presented in the budget papers.
FISCAL IMPACTS OF VARIATIONS TO THE ECONOMIC OUTLOOK

This part of the sensitivity analysis quantifies a key risk identified in Chapter 2 Economic context and presents how this risk might affect the state’s economic and fiscal aggregates.

The scenario considered is the emergence of a new COVID-19 variant that leads to a setback in global growth, which weighs on the Victorian economy. Under the scenario, domestic policy responses for the duration of the outbreak such as tighter border controls – though not a return to the tight restrictions required in 2020 and 2021 ahead of mass vaccination – also slow economic activity. The behavioural responses of businesses and households, reflected in labour supply and supply chain challenges, and downward pressure on business and consumer confidence, also slow economic activity.

The economic impacts of the scenario have been modelled using VURMTAX, a computable general equilibrium model developed by the Centre of Policy Studies at Victoria University. The results of the scenario are analysed as a deviation from the ‘business as usual’ base case, which represents the economic forecasts outlined in Chapter 2 Economic context.

The changes in economic variables resulting from the modelled shocks are then mapped into estimated revenue and expenditure impacts using elasticities that describe the historical relationship between fiscal outcomes and major macroeconomic parameters in Table A.1.1.

Scenario: Global COVID-19 outbreak

More than two years after the World Health Organization declared a global pandemic, the world economy has recovered. After falling by 3.1 per cent in 2020, world economic output rebounded strongly in 2021 and is above pre-pandemic levels in major economies (see Chapter 2, Economic context). Success in rolling out vaccines, particularly in advanced economies, has allowed public health restrictions to be eased despite elevated COVID-19 case numbers (Chart A.1). Advanced economies are increasingly resilient to COVID-19 disruptions, supported by access to vaccines that continue to display high effectiveness at preventing severe disease and death.

While most economies are recovering well, there remains a high degree of uncertainty around the global economic outlook. The World Health Organization has warned that more transmissible and deadly variants of COVID-19 may evolve as long as a substantial share of the world population remains unprotected. Such a development would be a major setback for the global economy.

This scenario explores the implications of the emergence of such a variant, which leads to a renewed global economic downturn that disrupts Victoria’s economy.

In this scenario, global economic activity falls with the reimposition of health restrictions in major economies outside Australia. Global growth is assumed to be 1.6 percentage points lower than the baseline in 2022.

---

1 The Department of Treasury and Finance maintains a set of elasticities covering the relationships between major economic parameters and revenue and expenditure lines, including superannuation, and dividends and income tax equivalents from the public financial and non-financial corporations.
Significant outbreaks overseas are assumed to lead to the reimposition of Australia’s national border restrictions for a period of 12 months. In Victoria, subdued global demand and reimposition of border restrictions have an adverse impact on immigration and services trade, including international education and tourism exports.

International migration has historically been a key driver of population and therefore economic growth in Victoria. Due to the renewed national border closure, net overseas migration falls sharply relative to the baseline, and the Victorian population is 0.8 per cent smaller than in the base case by 2025-26. This weighs on Victorian consumer spending, dwelling investment and business investment relative to the base case.

A setback in international student arrivals has a significant negative impact on Victoria’s education exports. Accounting for nearly a third of onshore students in Australia, international education is Victoria’s largest service export. Tourism, which accounted for 3.3 per cent of the Victorian economy in 2018-19, is also adversely affected by the national border restrictions. While there is some substitution from international tourism to domestic tourism by Victorian consumers in the scenario, the net impact on the Victorian economy is negative. In the scenario, national border restrictions result in a 5.8 per cent fall in Victoria’s service exports relative to the base case over 2022-23. Service imports also decline by 2.7 per cent.

Reports of global outbreaks of a vaccine-resistant COVID-19 variant, lower levels of global growth, and national border closures are assumed to weigh on Victorian consumer and business confidence during the first 12 months of the global outbreak. Lower consumer confidence leads consumers to increase precautionary savings, which weighs on their spending. A fall in business confidence leads businesses to delay some investment. These impacts are in addition to those caused by lower trade and population flows.

Source: Johns Hopkins University
The shocks to exports, net overseas migration and consumer and business confidence reduce Victoria’s gross state product (GSP) by 0.66 per cent in 2022-23, 0.50 per cent in 2023-24, 0.51 per cent in 2024-25 and 0.53 per cent in 2025-26 compared with the base case.

The peak economic impact occurs in 2022-23, when consumer and business confidence effects are assumed to have a significant role in lowering household consumption and business investment (see Chart A.2). Later in the forecast period, as these confidence effects dissipate, consumption and investment recover somewhat, but lower global growth and a lower population mean they remain weaker than in the baseline.

Government consumption is also lower over the forecast period as a smaller population requires a lower level of expenditure. In the scenario, there is no further discretionary fiscal expenditure assumed to occur in response to the shock. In practice, governments and the Reserve Bank of Australia may intervene to mitigate the shock’s impacts.

Weaker domestic activity puts downward pressure on the real exchange rate, leading to a depreciation of the domestic currency that increases the international competitiveness of domestic exporters. This raises goods export volumes relative to the baseline, more than offsetting the low service exports in the scenario. Overall, net trade adds to growth and somewhat offsets the impacts of the shocks.

Subdued domestic activity lowers the demand for labour, with employment growth 0.48 per cent lower than the base case in 2022-23. Labour supply is also reduced due to the decline in international migration, and employment is 0.60 per cent lower in 2025-26 compared with the base case. Weaker economic growth increases the level of spare capacity in the labour market, which puts downward pressure on wages.

The depreciation of the domestic currency raises the cost of imports to households, placing upward pressure on consumer prices. This effect on consumer prices is more than offset, though, by weaker domestic activity, with the net effect that consumer prices are lower in the scenario.

Table A.1 summarises the economic effects of this shock.
**Chart A.2: Scenario impact on select variables**

Source: Department of Treasury and Finance

**Table A.1: Projected economic impact of a global COVID-19 outbreak (a) (per cent)**

<table>
<thead>
<tr>
<th></th>
<th>2022-23 estimate</th>
<th>2023-24 estimate</th>
<th>2024-25 estimate</th>
<th>2025-26 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GSP</td>
<td>(0.66)</td>
<td>(0.50)</td>
<td>(0.51)</td>
<td>(0.53)</td>
</tr>
<tr>
<td>Employment</td>
<td>(0.48)</td>
<td>(0.51)</td>
<td>(0.56)</td>
<td>(0.60)</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>(0.53)</td>
<td>(0.26)</td>
<td>(0.22)</td>
<td>(0.20)</td>
</tr>
<tr>
<td>Wage price index</td>
<td>(0.62)</td>
<td>(0.30)</td>
<td>(0.13)</td>
<td>(0.02)</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

**Note:**
(a) Figures reported are the change in the level of each parameter relative to the baseline forecasts as presented in Chapter 2 Economic context.
The shock has a negative fiscal impact on the State’s finances (see Table A.2). Lower population growth, because of lower overseas migration, slows the recovery in property-related taxation revenue, including land transfer duty and land taxes. Reduced consumption leads to a smaller national GST pool – and hence smaller GST grants revenue for Victoria. As a result, income from transactions is lower over the forward estimates.

Expenses from transactions are also lower in the scenario relative to the base case, mainly due to lower employment growth which lowers employee expenses. These estimated impacts on expenses reflect the assumed relationships between private and public sector employment and wages in the model – namely that public sector employment is a fixed share of overall employment, and public sector wage growth corresponds to private sector wage growth in the medium to long-term.

Table A.2: Projected fiscal impact of a global COVID-19 outbreak (a) ($ million)

<table>
<thead>
<tr>
<th></th>
<th>2022-23</th>
<th>2023-24</th>
<th>2024-25</th>
<th>2025-26</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from transactions</strong></td>
<td>(1 053.1)</td>
<td>(831.4)</td>
<td>(775.5)</td>
<td>(774.3)</td>
</tr>
<tr>
<td><strong>Expenses from transactions</strong></td>
<td>(309.7)</td>
<td>(182.5)</td>
<td>(177.7)</td>
<td>(152.0)</td>
</tr>
<tr>
<td><strong>Net result from transactions</strong></td>
<td>(743.4)</td>
<td>(648.9)</td>
<td>(597.7)</td>
<td>(622.4)</td>
</tr>
<tr>
<td><strong>Other economic flows</strong></td>
<td>(16.3)</td>
<td>(6.4)</td>
<td>(4.3)</td>
<td>(3.1)</td>
</tr>
<tr>
<td><strong>Net result</strong></td>
<td>(759.8)</td>
<td>(655.3)</td>
<td>(602.0)</td>
<td>(625.4)</td>
</tr>
<tr>
<td><strong>Net debt (cumulative)</strong></td>
<td></td>
<td>1 283.5</td>
<td>1 762.1</td>
<td>2 273.3</td>
</tr>
</tbody>
</table>

**Net debt to GSP ratio (percentage point difference)**

<table>
<thead>
<tr>
<th></th>
<th>2022-23</th>
<th>2023-24</th>
<th>2024-25</th>
<th>2025-26</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Source:</strong> Department of Treasury and Finance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| **Note:**
| (a) Figures may not add due to rounding. |
SENSITIVITY TO INDEPENDENT VARIATIONS IN MAJOR ECONOMIC PARAMETERS

Table A.3 presents the sensitivity of financial aggregates where the levels of key economic parameters are 1 per cent (or, for interest rates, 1 percentage point) above the forecast for each year of the budget and forward estimates, holding all else constant.

The impacts shown are broadly symmetric, that is, the estimated fiscal impacts would apply approximately equally in the opposite direction where there is a decrease in the parameter. Differences may arise to the extent that the impact on income tax equivalent income may not be symmetric because that line item is subject to a floor of zero, and the impact on dividends may be affected by some entities facing caps on the share of profits that can be returned to the general government sector.

<table>
<thead>
<tr>
<th>Table A.3: Sensitivity of key fiscal aggregates to selected indicators being 1 per cent higher than expected from 2022-23 (a)(b)(c)(d)(e) ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GSP</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
</tr>
<tr>
<td>Net result from transactions</td>
</tr>
<tr>
<td>Net debt</td>
</tr>
<tr>
<td><strong>Employment (f)</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
</tr>
<tr>
<td>Net result from transactions</td>
</tr>
<tr>
<td>Net debt</td>
</tr>
<tr>
<td><strong>Consumer prices (g)</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
</tr>
<tr>
<td>Net result from transactions</td>
</tr>
<tr>
<td>Net debt</td>
</tr>
<tr>
<td><strong>Average weekly earnings (h)</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
</tr>
<tr>
<td>Net result from transactions</td>
</tr>
<tr>
<td>Net debt</td>
</tr>
<tr>
<td><strong>Total employee expenses</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
</tr>
<tr>
<td>Net result from transactions</td>
</tr>
<tr>
<td>Net debt</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>--------------------------</td>
</tr>
<tr>
<td><strong>Domestic share prices</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
</tr>
<tr>
<td>Net result from transactions</td>
</tr>
<tr>
<td>Net debt</td>
</tr>
<tr>
<td><strong>Overseas share prices</strong></td>
</tr>
<tr>
<td>Income from transactions</td>
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<tr>
<td>Expenses from transactions</td>
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<tr>
<td>Net result from transactions</td>
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<td>Net debt</td>
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<tr>
<td><strong>Property prices</strong></td>
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<tr>
<td>Income from transactions</td>
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<td>Expenses from transactions</td>
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<tr>
<td>Net result from transactions</td>
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<tr>
<td>Net debt</td>
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<tr>
<td><strong>Property transaction volumes</strong></td>
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<tr>
<td>Income from transactions</td>
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<tr>
<td>Expenses from transactions</td>
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<tr>
<td>Net result from transactions</td>
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<tr>
<td>Net debt</td>
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<tr>
<td><strong>Interest rates</strong> (i)</td>
</tr>
<tr>
<td>Income from transactions</td>
</tr>
<tr>
<td>Expenses from transactions</td>
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<tr>
<td>Net result from transactions</td>
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<tr>
<td>Net debt</td>
</tr>
</tbody>
</table>

Source: Department of Treasury and Finance

Notes:
(a) Variations are applied to the economic variables effective from the first day in the budget year (1 July 2022). It is assumed that each variable’s growth rate matches that under a no-variation scenario for the forward estimates period. This implies that the level of all economic variables (other than interest rates) is 1 per cent higher in level terms in each year of the budget and forward estimates. Interest rates are assumed to be 1 percentage point higher in each year of the budget and forward estimates.

(b) A positive number for income from transactions denotes an increase in revenue. A positive number for expenses from transactions denotes an increase in expenses (and hence a reduction in the net result from transactions). A positive number for the net result from transactions denotes a higher surplus or smaller deficit. A positive number for net debt denotes a higher level of net debt in the relevant year compared with a no-variation scenario.

(c) Only reasonably quantifiable impacts have been included in the analysis.

(d) Estimates of net debt are approximately equal to the cumulative impact of the net result from transactions. The difference between the cumulative net result from transactions and net debt is due to non-cash expenses and gross sale proceeds (where applicable).

(e) Figures may not add due to rounding.

(f) A shock to employment is assumed to impact payroll tax revenue. Both public and private sector employment levels are assumed to be 1 per cent higher across the four years, with the shares of full-time and part-time employment held constant; the rise in public sector employment boosts general government sector employee expenses.

(g) Incorporates the impact of operating expenses such as the purchase of supplies and consumables and the purchase of services. It is assumed an increase in consumer prices within the budget year does not affect employee entitlements.

(h) A positive shock to average weekly earnings increases the expenses of public financial and non-financial corporations and reduces the general government sector’s income from dividends and ITEs.

(i) Interest rates are assumed to be 1 percentage point higher in each year of the budget and forward estimates. The fiscal impact is based on the portion of government debt that would change value due to being refinanced, as well as new debt issuance.
STYLE CONVENTIONS

Figures in the tables and in the text have been rounded. Discrepancies in tables between totals and sums of components reflect rounding. Percentage changes in all tables are based on the underlying unrounded amounts.

The notation used in the tables and charts is as follows:

- n.a. or na: not available or not applicable
- 1 billion: 1,000 million
- 1 basis point: 0.01 per cent
- ..: zero, or rounded to zero
- tbc: to be confirmed
- ongoing: continuing output, program, project etc.
- (x xxx.x): negative amount
- x xxx.0: rounded amount

Please refer to the Treasury and Finance glossary for budget and financial reports at dtf.vic.gov.au for additional terms and references.