

VICTORIA'S ECONOMY AND STATE FINANCES

PRESENTATION TO THE ECONOMIC SOCIETY OF AUSTRALIA –
VICTORIAN BRANCH

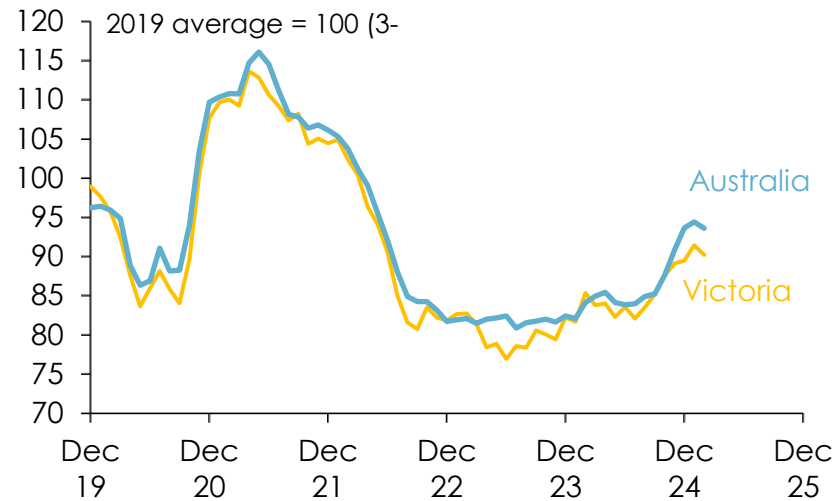
MELBOURNE, 5TH MARCH 2025

SAUL ESLAKE

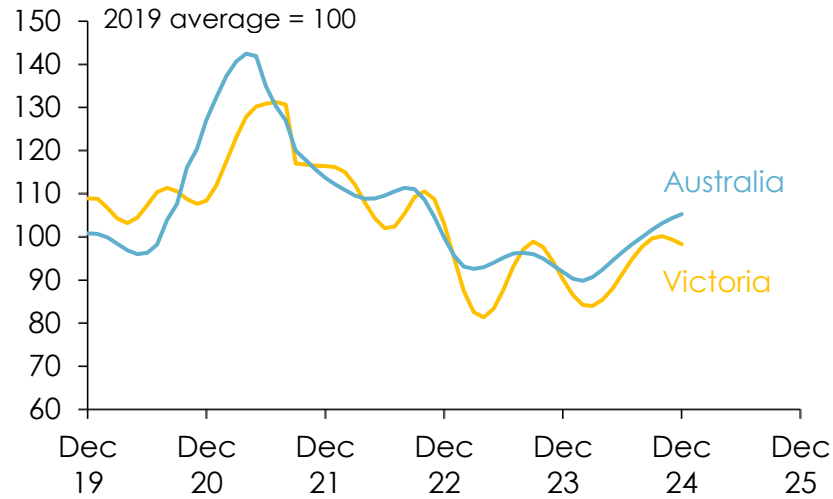
CORINNA ECONOMIC ADVISORY
INDEPENDENT ECONOMICS

On a wide range of metrics, Victoria's economy is starting to slip behind national averages

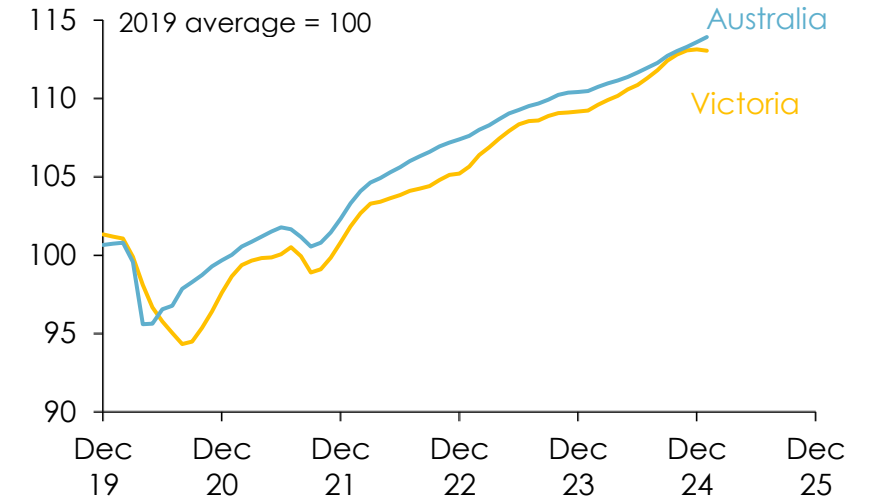
Consumer confidence



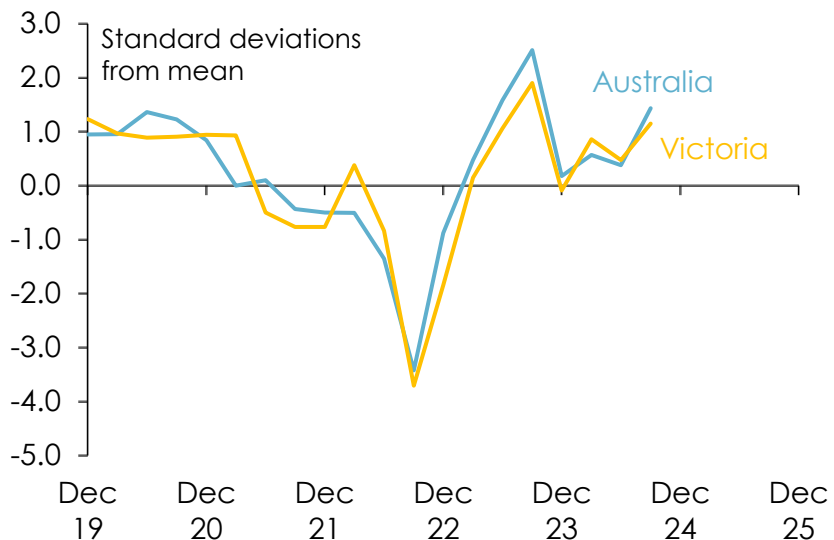
Residential building approvals



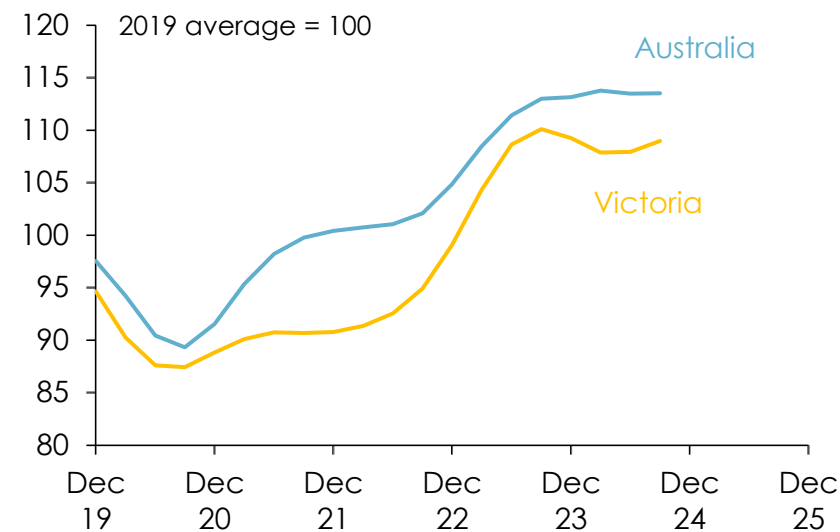
Employment



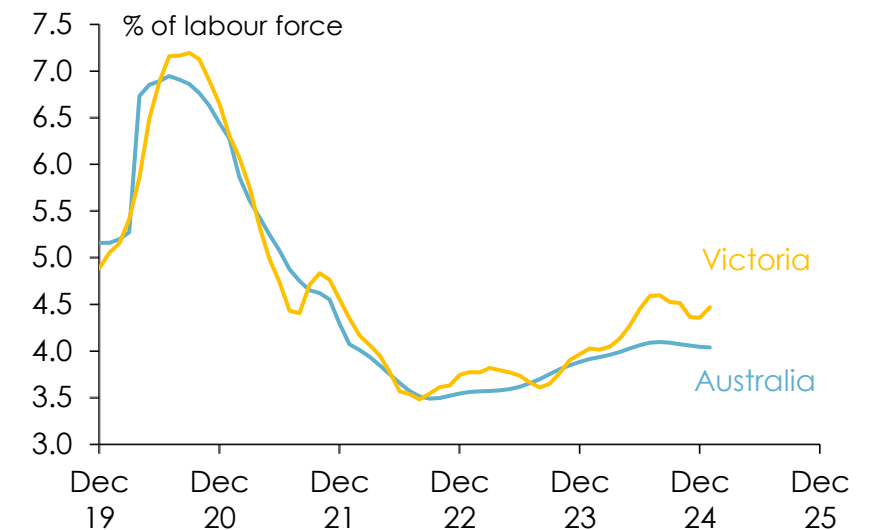
Business confidence



Business investment



Unemployment



Note: all data except for consumer and business confidence are derived from trend estimates. Sources: Westpac-Melbourne Institute, [Westpac-MI Consumer Sentiment](#), February 2025; National Australia Bank, [Quarterly Business Survey](#), December quarter 2024; ABS, [Building Approvals](#), December 2024, [Private New Capital Expenditure and Expected Expenditure](#), December quarter 2024, and [Labour Force](#), January 2025.

A lot of 'anecdotal evidence' is pointing to tough times in the Victorian economy

It was Ryan Stokes, the chief executive of industrial conglomerate SGH, who [blew the whistle on this issue](#) in the first key week of reporting season, when he declared the Victorian economy was in recession and warned that the state was suffering capital flight.

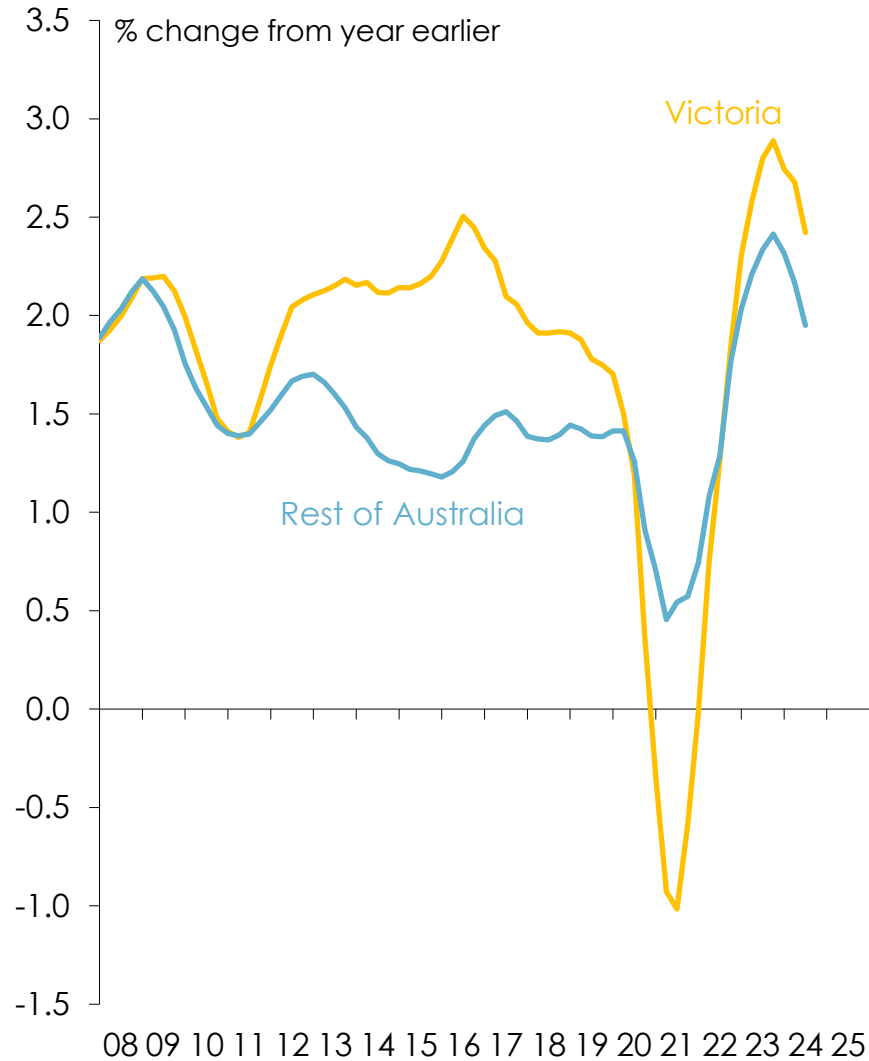
"I'd say development capital is probably fleeing Victoria for other jurisdictions where there aren't the same land tax penalties, where there isn't the same windfall gain tax, etcetera," Stokes said.

Wesfarmers chief executive Rob Scott is seeing the same broad trends as Stokes. His conglomerate, which spans the consumer and industrial sectors, sees Victoria as the laggard, particularly when compared with Western Australia, Queensland and, to a lesser extent, NSW.

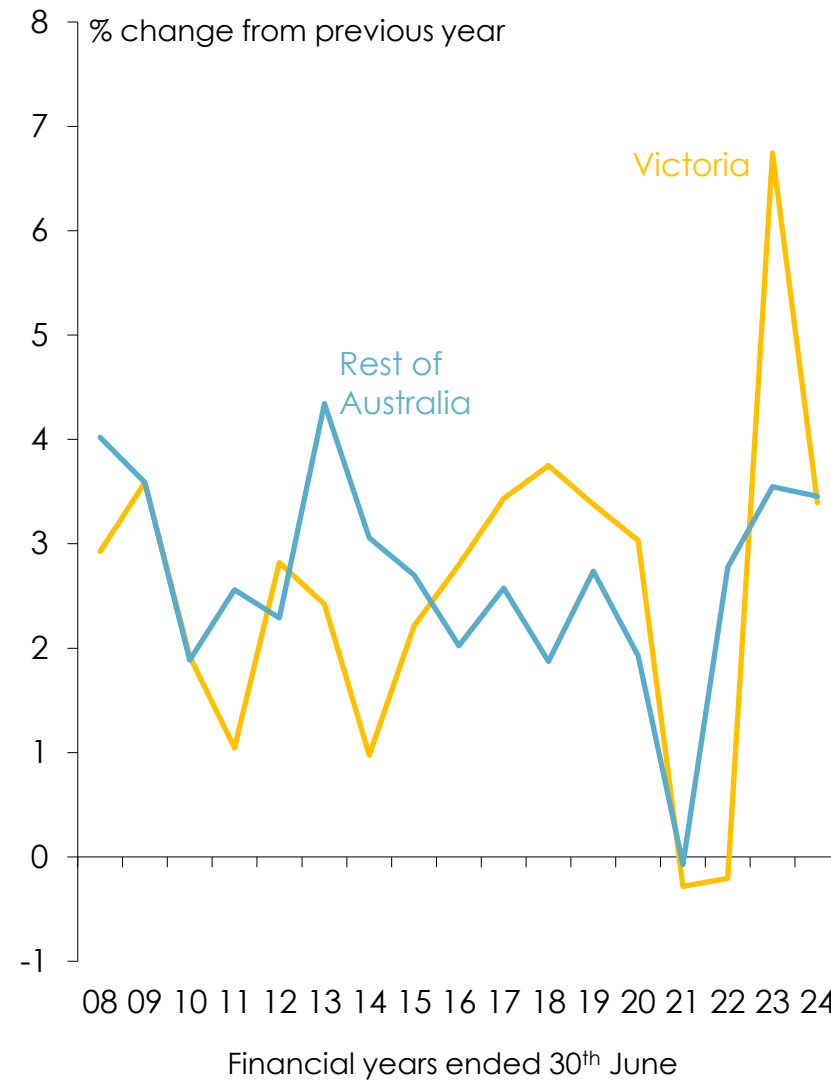
- ◆ JB Hi-Fi called out the weakness in the Victorian construction sector as a handbrake on growth in its commercial business.
- ◆ ARB, which makes and sells equipment for four-wheel drives, reported that aftermarket sales grew in all Australian states during the December half – except Victoria.
- ◆ At Super Retail Group, which owns Rebel, Macpac and BCF, chief executive Anthony Heraghty said there were two particular areas of weakness for the company's Super Cheap Auto business: the struggling New Zealand economy and Victoria.
- ◆ At property developer Stockland, the weakness in the Victorian housing market was a huge topic of conversation. Victoria is the only state where the company is having to offer rebates to sell house and land packages, with annual lot sales currently running at between 6000 and 7000, down from the 15,000 Stockland would expect to sell in what you might call a "normal" year.
- ◆ Bendigo Bank chief Richard Fennell said Victoria was "facing some economic challenges and housing arrears are slightly higher there" although this is not yet played through to higher credit costs.

And this is despite the fact that Victoria's population is continuing to grow faster than the national average, as it has for most of the past 17 years

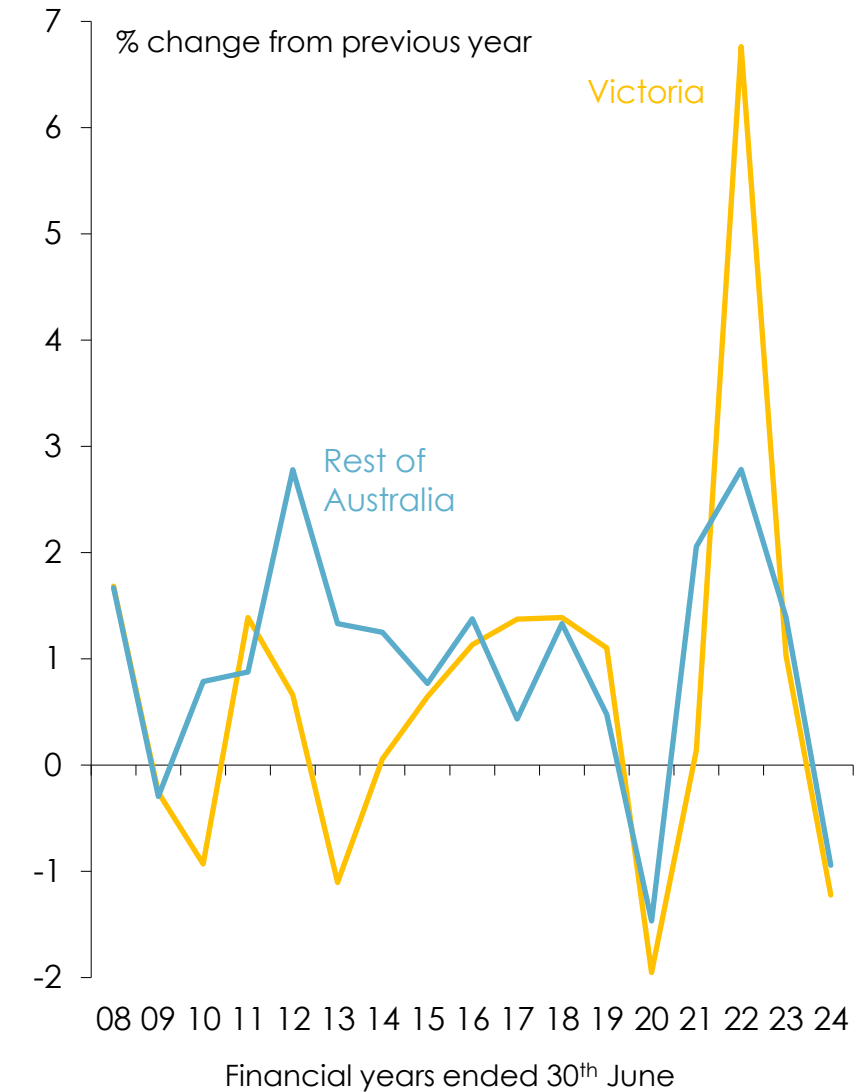
Population



Real gross state product



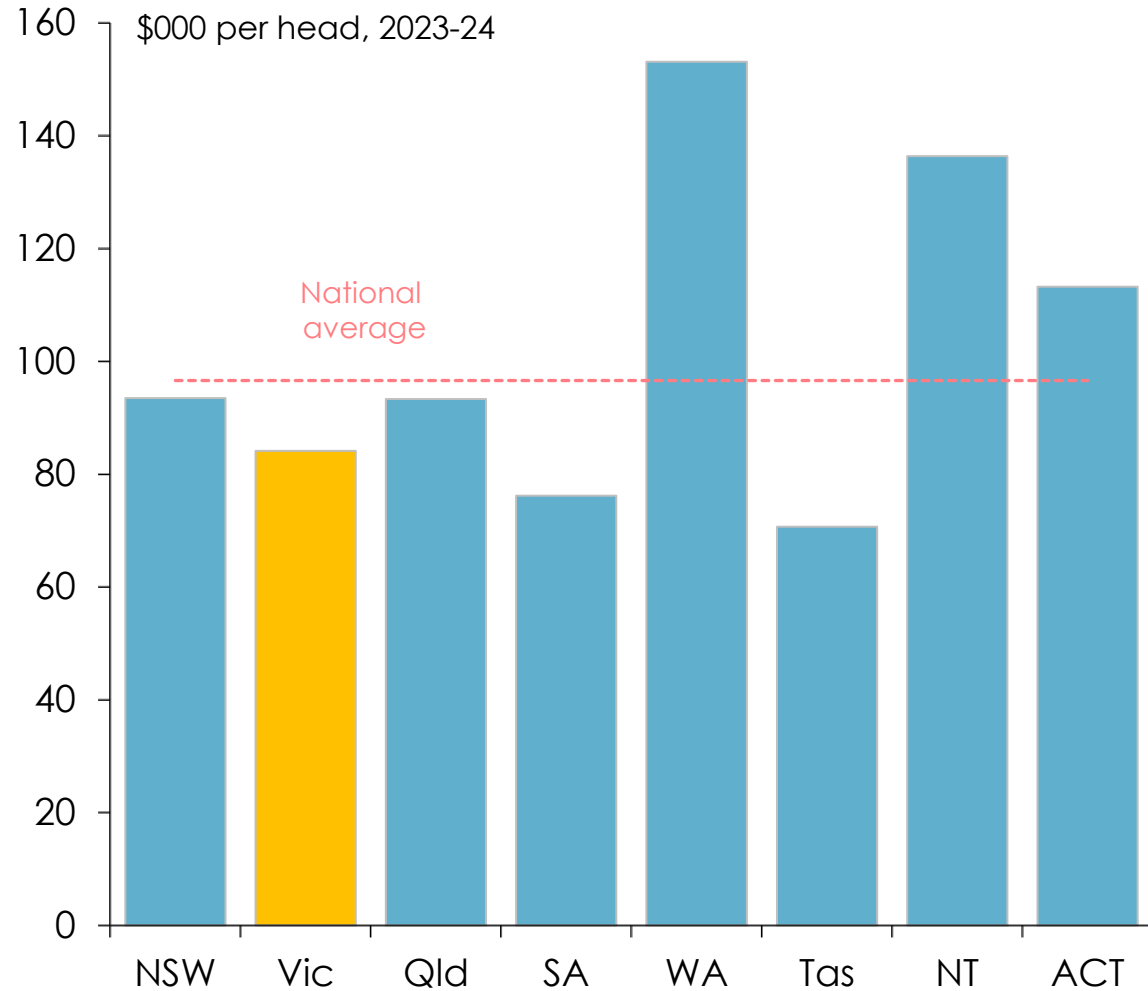
Real gross state product per capita



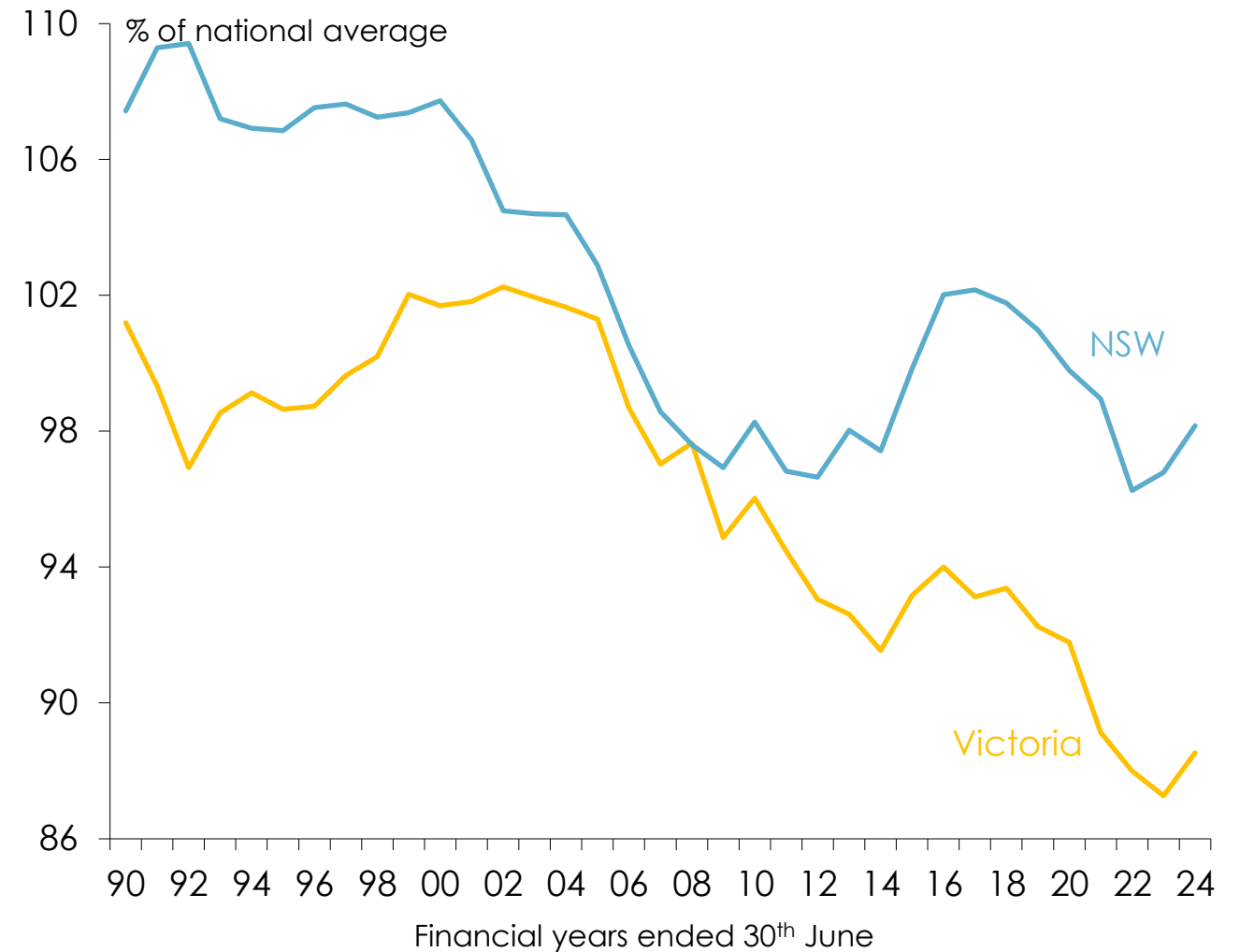
Sources: ABS, [National, state and territory population](#), June quarter 2024; and [Australian National Accounts: State Accounts](#), 2023-34.

Victoria is now the third-poorest state in the nation, as measured by gross state product per head

Gross state product per head, states and territories, 2023-24



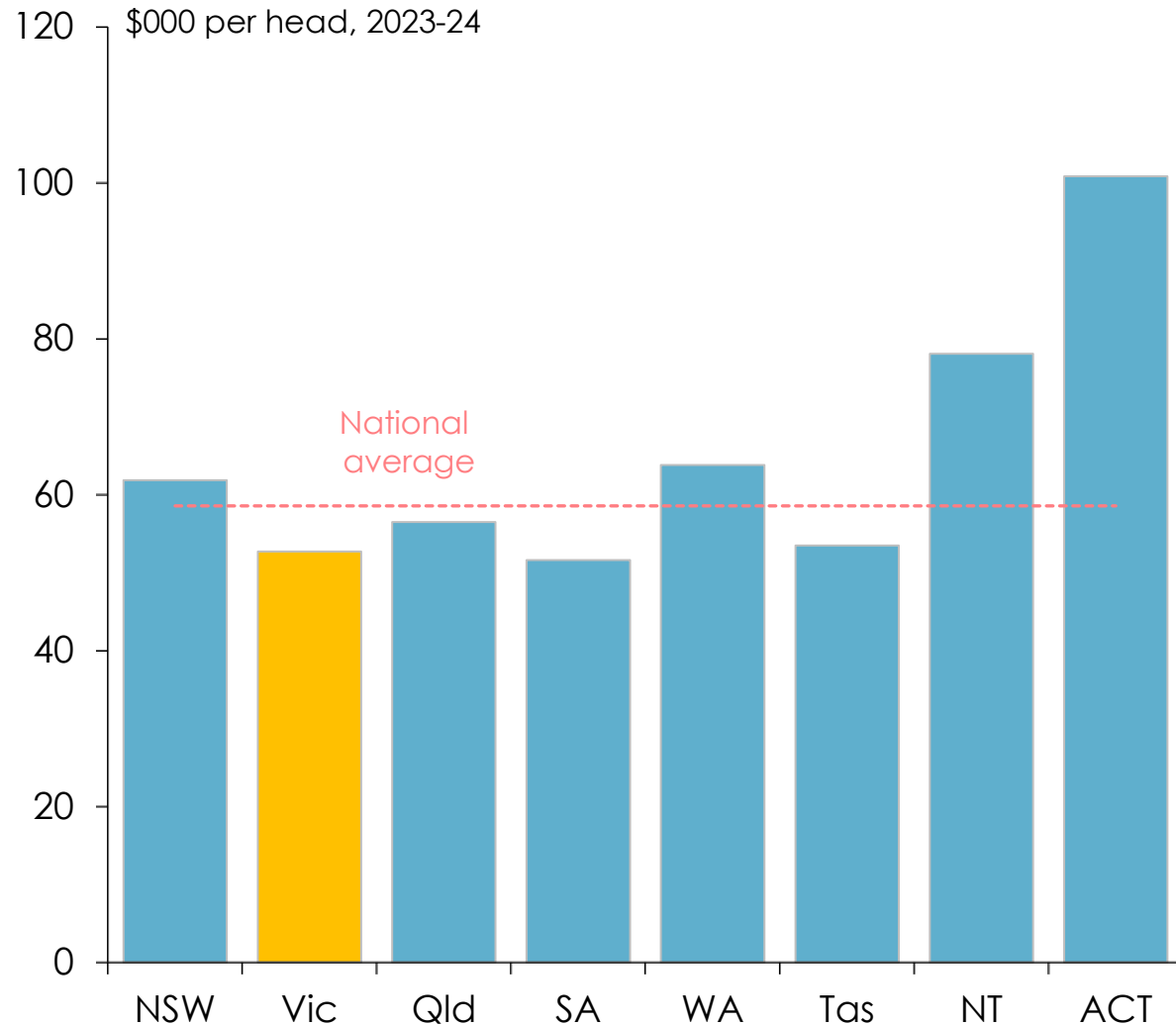
Gross state product per head as a pc of the national average, 1989-90 to 2023-24



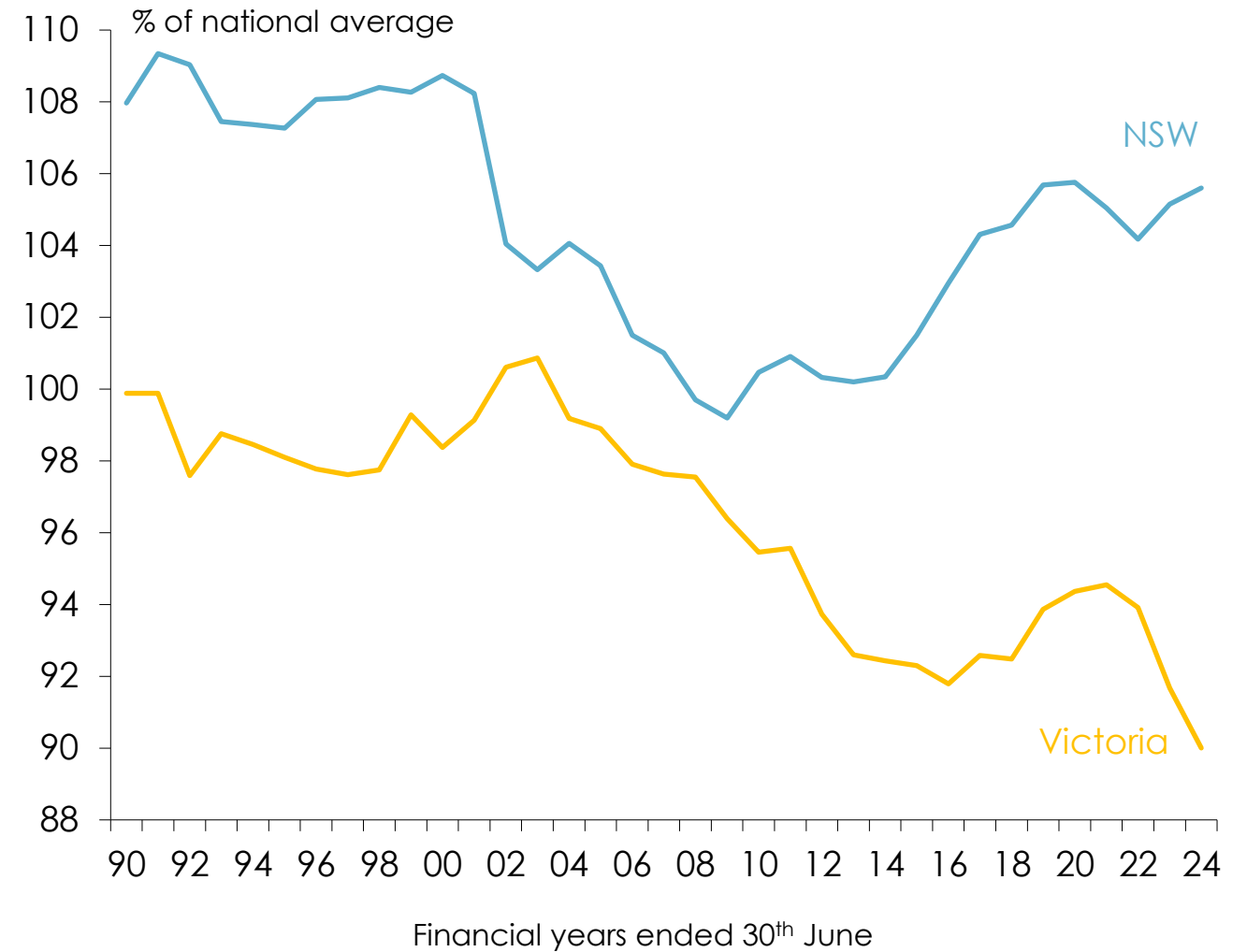
Sources: ABS, [Australian National Accounts: State Accounts](#), 2023-24.

Victoria's per capita household disposable income in 2023-24 was the second-lowest in the nation, lower even than Tasmania's

Household disposable income per head, states and territories, 2023-24



Household disposable income per head as a pc of the national average, 1989-90 to 2023-24



Sources: ABS, [Australian National Accounts: State Accounts](#), 2023-24.

A useful framework for understanding the reasons for differences in per capita gross state product

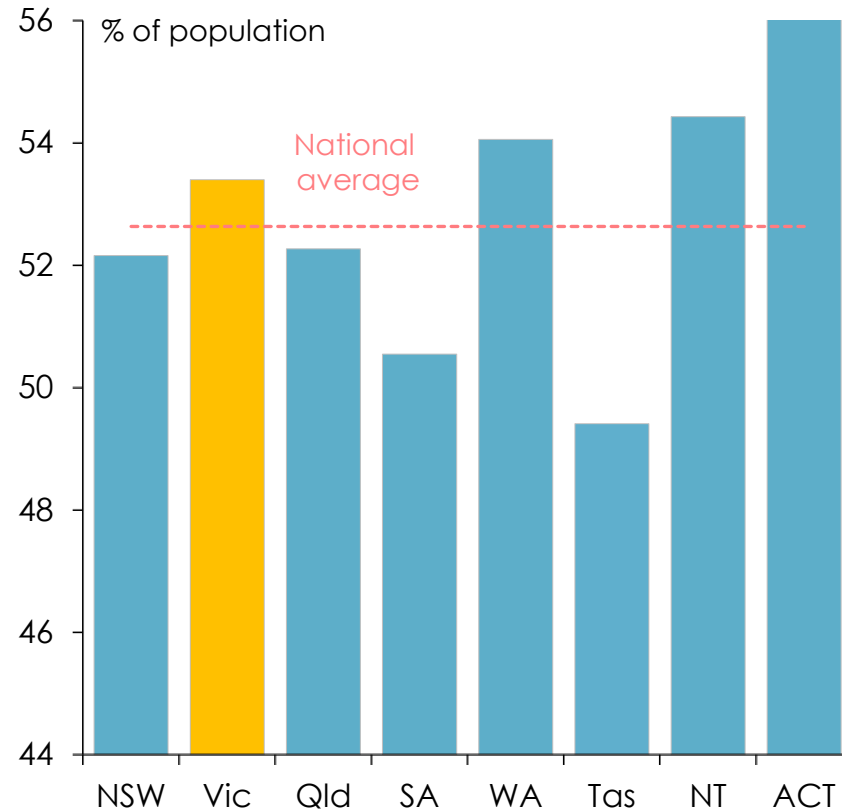
$$\frac{\text{gross state product}}{\text{population}} = \frac{\text{employment}}{\text{population}} \times \frac{\text{total hours worked}}{\text{employment}} = \text{participation rate} \times \text{average hours worked} \times \text{labour productivity}$$

The diagram illustrates the decomposition of per capita gross state product into three components: participation rate, average hours worked, and labour productivity. It shows the following relationships:

- $\frac{\text{gross state product}}{\text{population}} = \frac{\text{employment}}{\text{population}} \times \frac{\text{total hours worked}}{\text{employment}}$
- $\frac{\text{total hours worked}}{\text{employment}} = \text{average hours worked}$
- $\frac{\text{gross state product}}{\text{total hours worked}} = \text{labour productivity}$

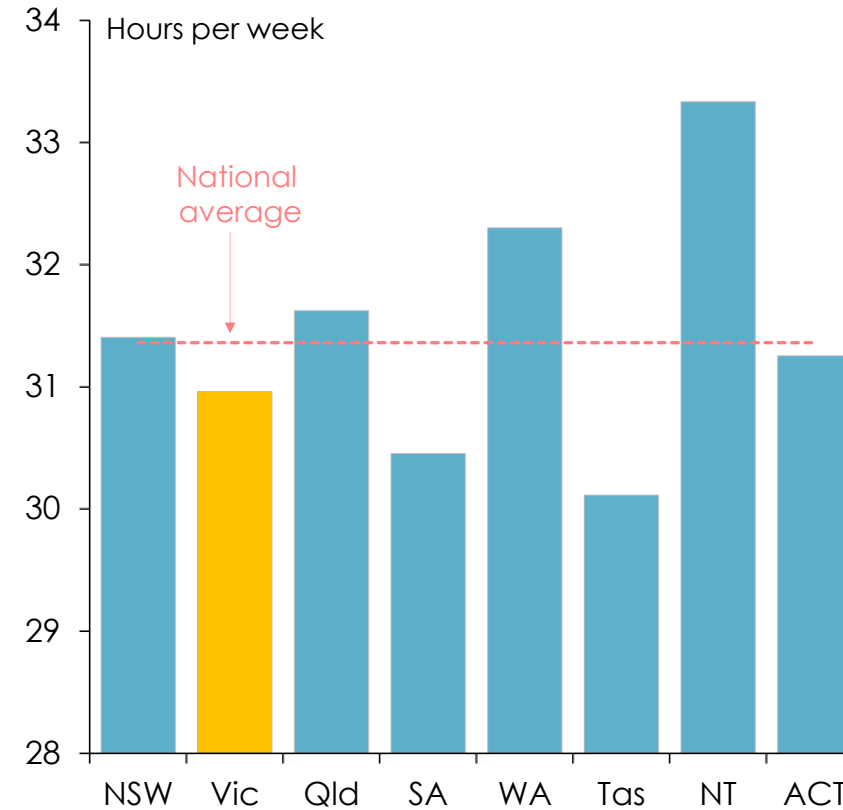
Victoria has become a 'poor state' not because fewer people are working, but because Victorians work fewer hours and because of poor productivity

People with jobs as a proportion of the population, 2023-24



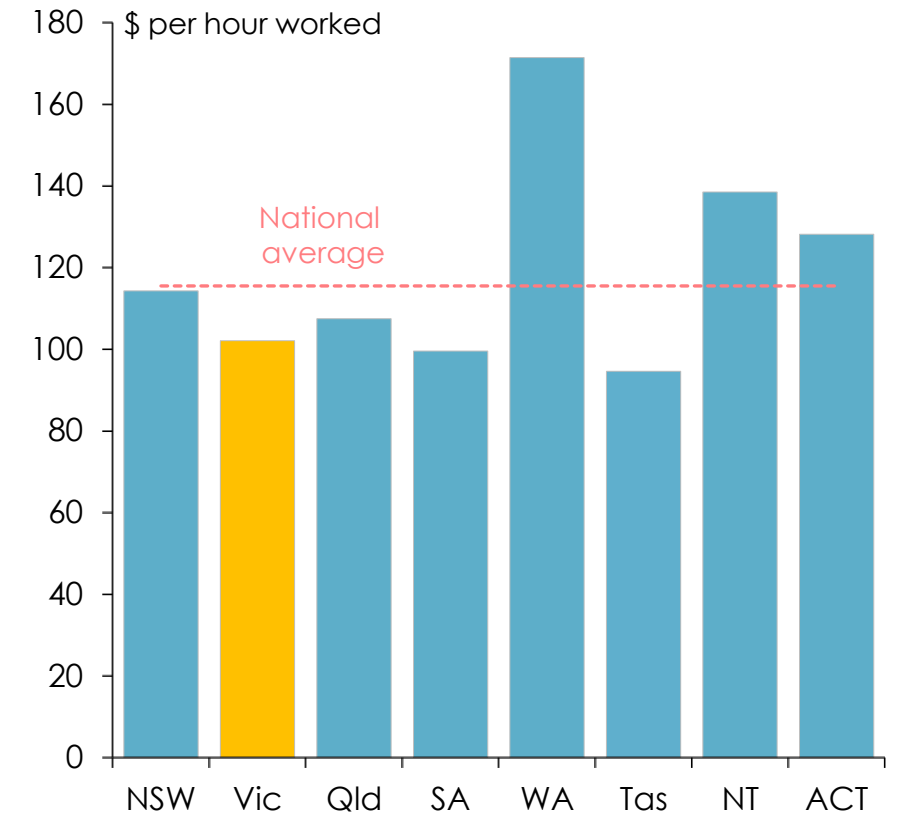
53.4% of Victorians have a job – that's 1.2 pc pt above the national average

Average hours worked by people with jobs, 2023-24



Victorians work an average of 0.4 hours per week less than the national average – equivalent to 3 days less per year

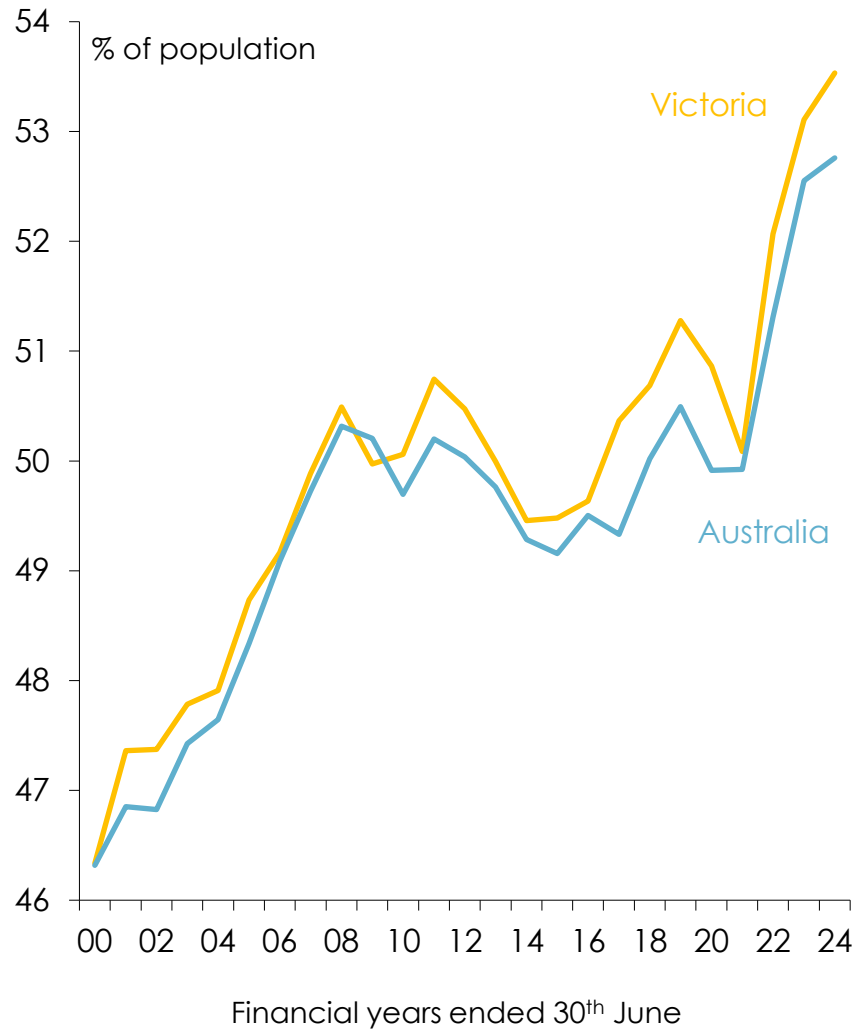
Output per hour worked by people with jobs, 2023-24



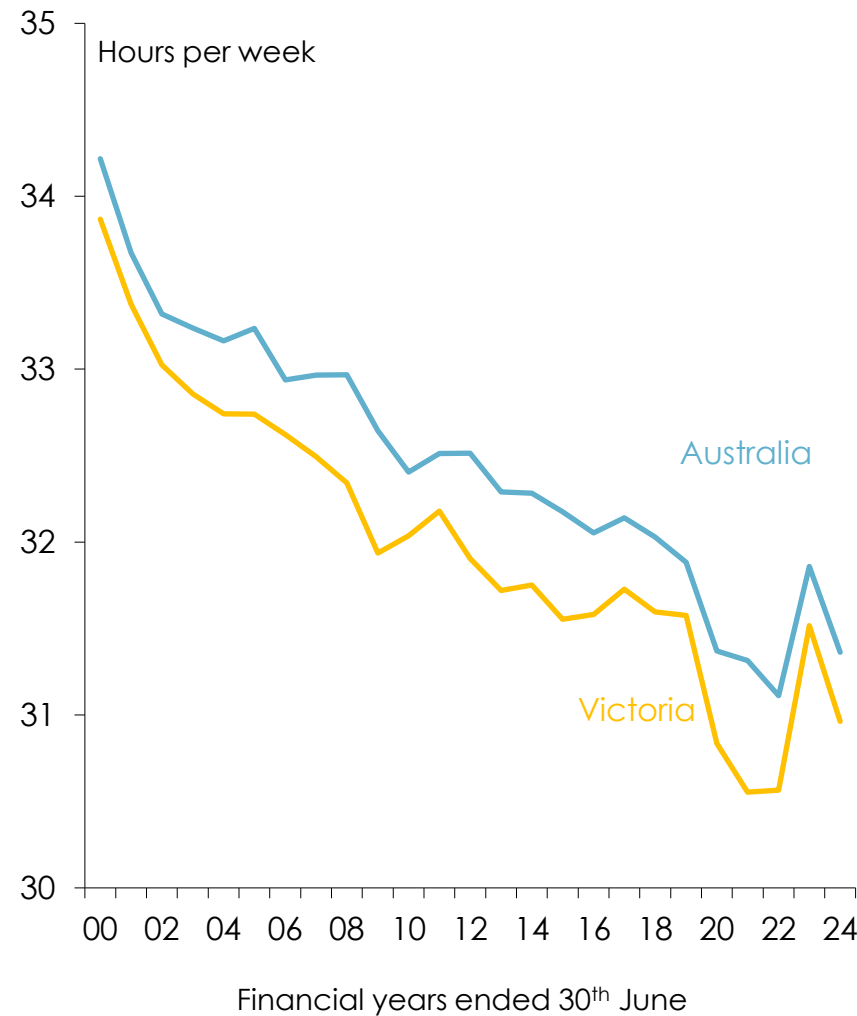
Victorians who do work produce about \$13.40 less per hour than the national average (ie labour productivity is about 11½% lower)

The deterioration in Victoria's economic performance relative to the rest of Australia is largely due to a widening 'productivity gap'

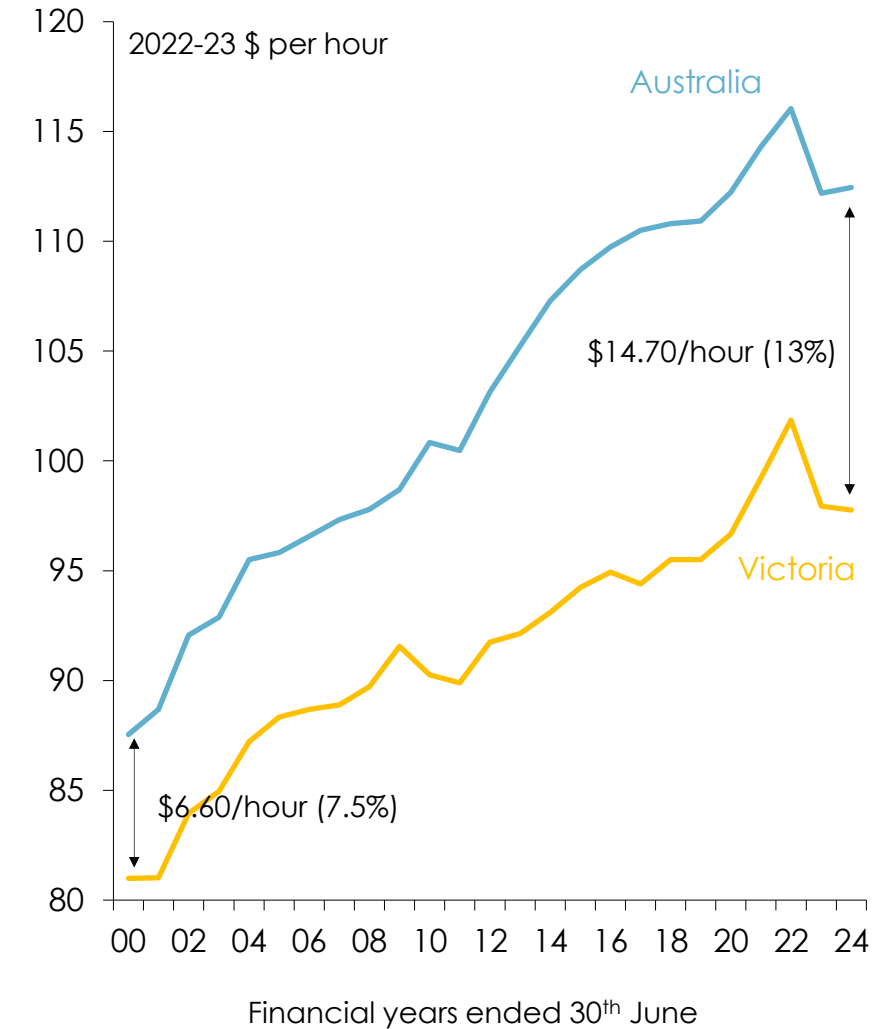
People with jobs as a proportion of the population



Average hours worked by people with jobs



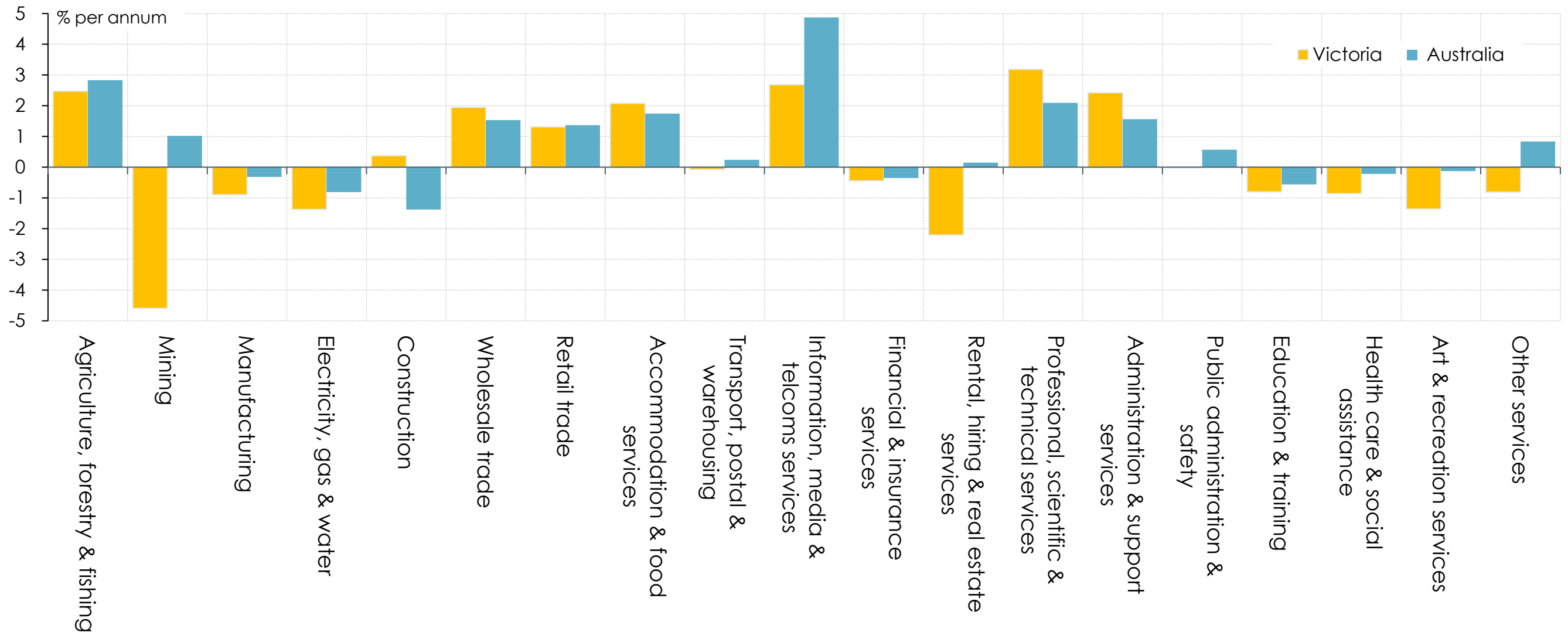
Output per hour worked (labour productivity) by people with jobs



Sources: ABS, [Australian National Accounts: State Accounts](#), 2023-24; [Labour Force, Australia](#), January 2025.

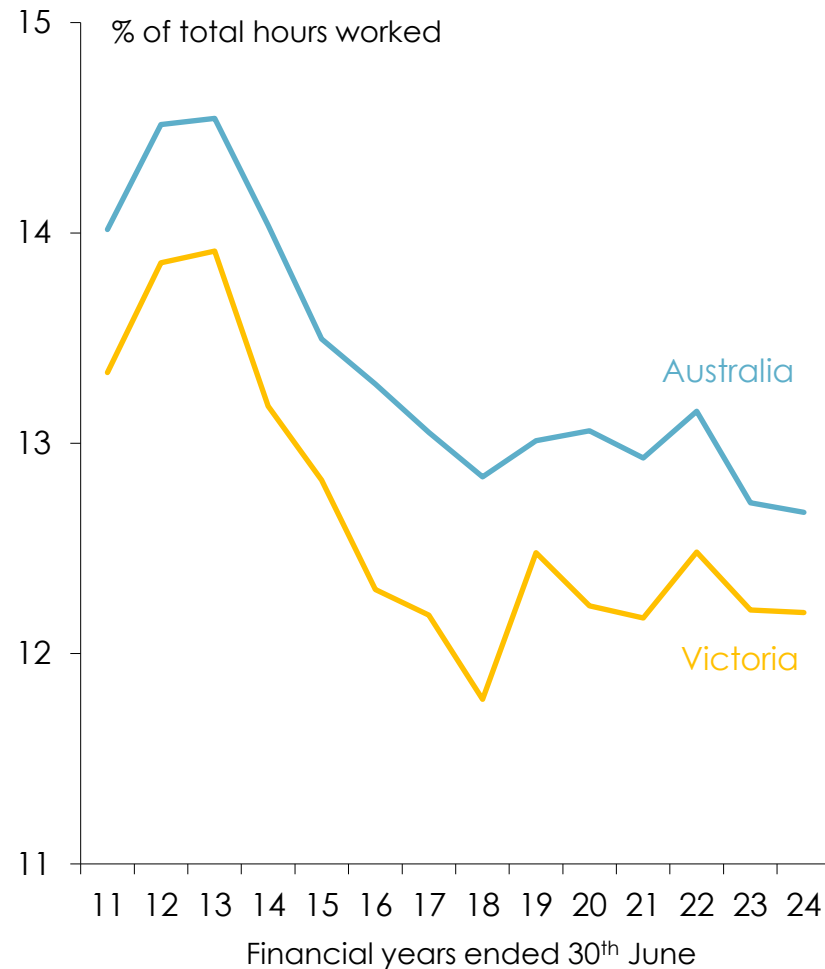
Victoria's poor productivity performance is partly the result of slower productivity growth in 14 out of 19 industry sectors ...

Labour productivity growth by industry, 2013-14 to 2022-24, Victoria and Australia compared

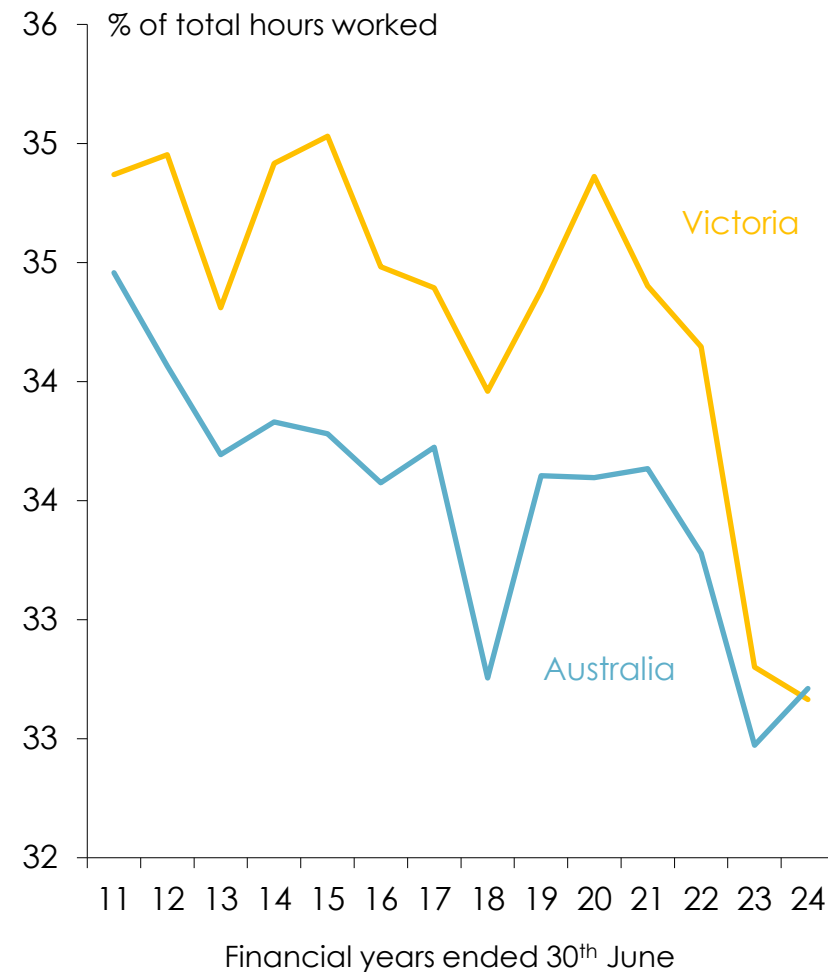


... but also because Victorian economic growth has been more skewed towards 'low-productivity industries'

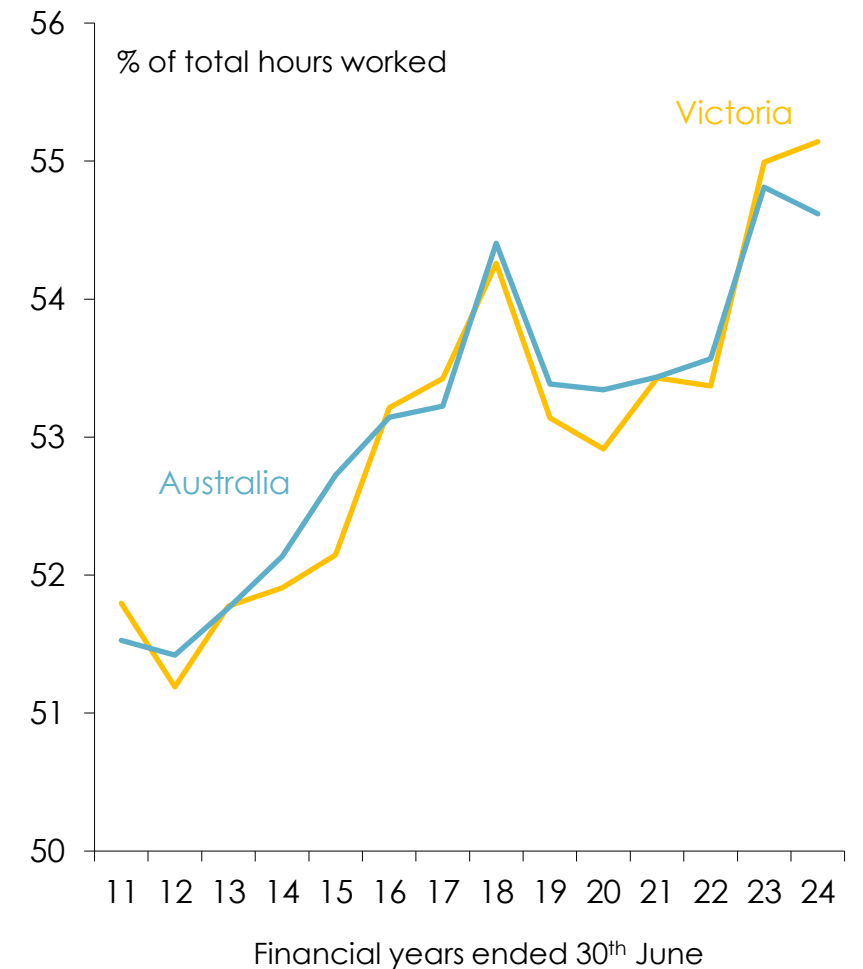
Pc of total hours worked in 'high productivity industries'



Pc of total hours worked in 'inter-mediate productivity industries'



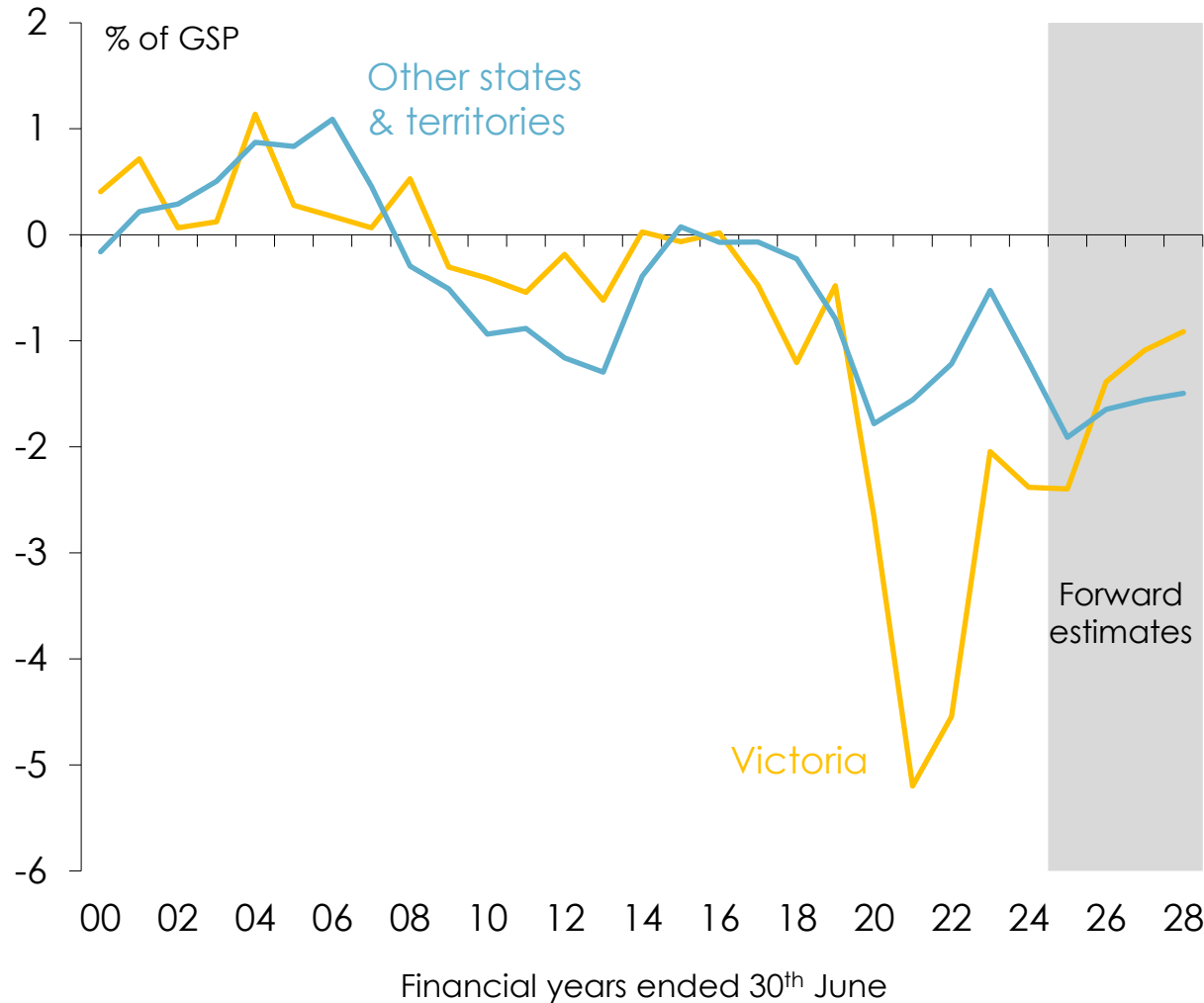
Pc of total hours worked in 'low productivity industries'



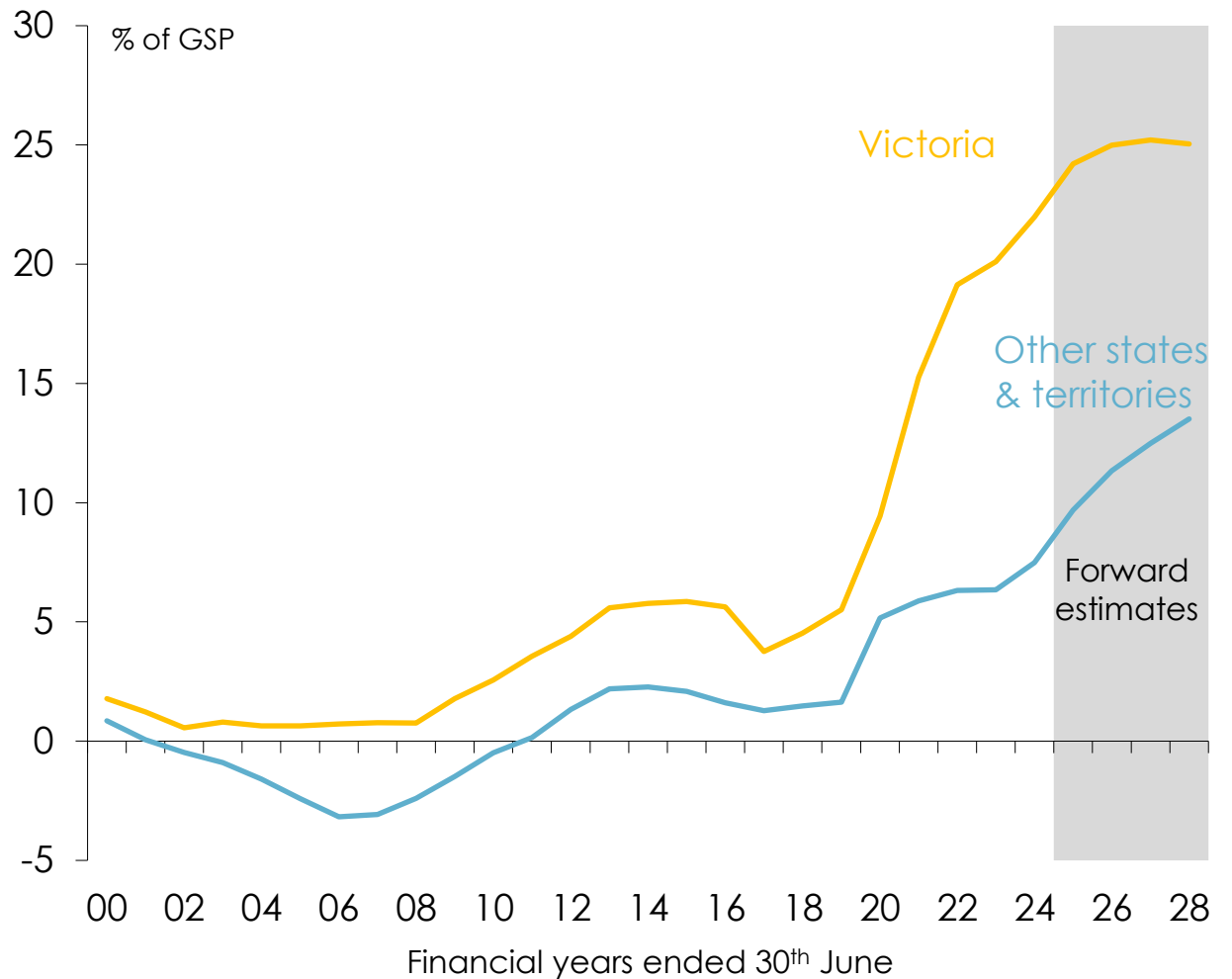
Note: 'High-productivity industries' are mining; finance & insurance; electricity, gas & water; rental, hiring & real estate services; information, media & telecoms services; and wholesale trade. 'Intermediate-productivity industries' are administration & support services; public administration & safety; agriculture, forestry & fishing; manufacturing; transport, postal & warehousing; and professional, scientific & technical services. 'Low-productivity industries' are construction; health care & social assistance; education & training; retail trade; arts & recreation services; and other services. Sources: ABS, [Australian National Accounts: State Accounts, 2023-24](#); [Labour Force, Australia](#), November 2024.

Victoria has run bigger cash deficits, and as result accumulated significantly more net debt, than other jurisdictions (on average)

General government cash balances, Victoria vs other states and territories



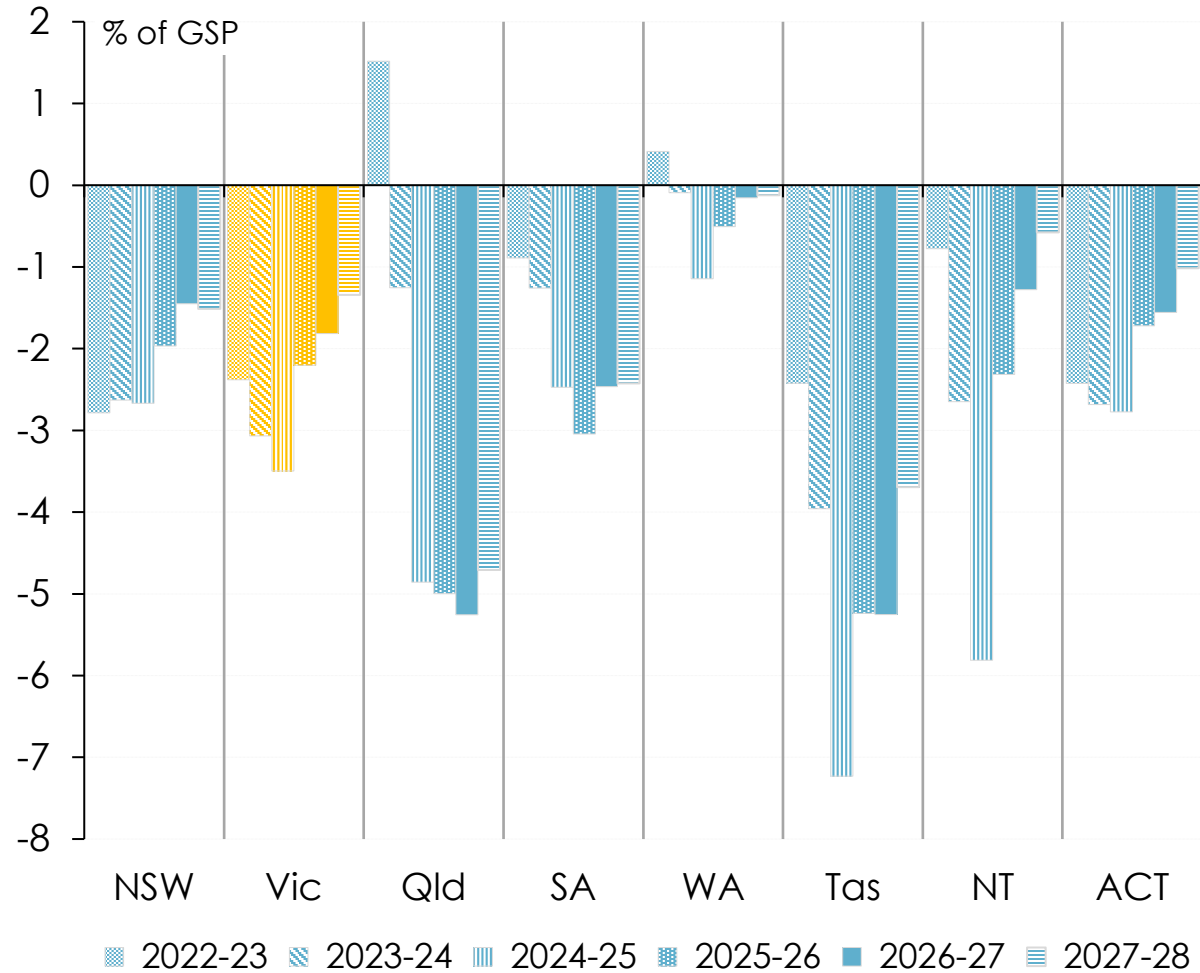
General government net debt, Victoria vs other states and territories



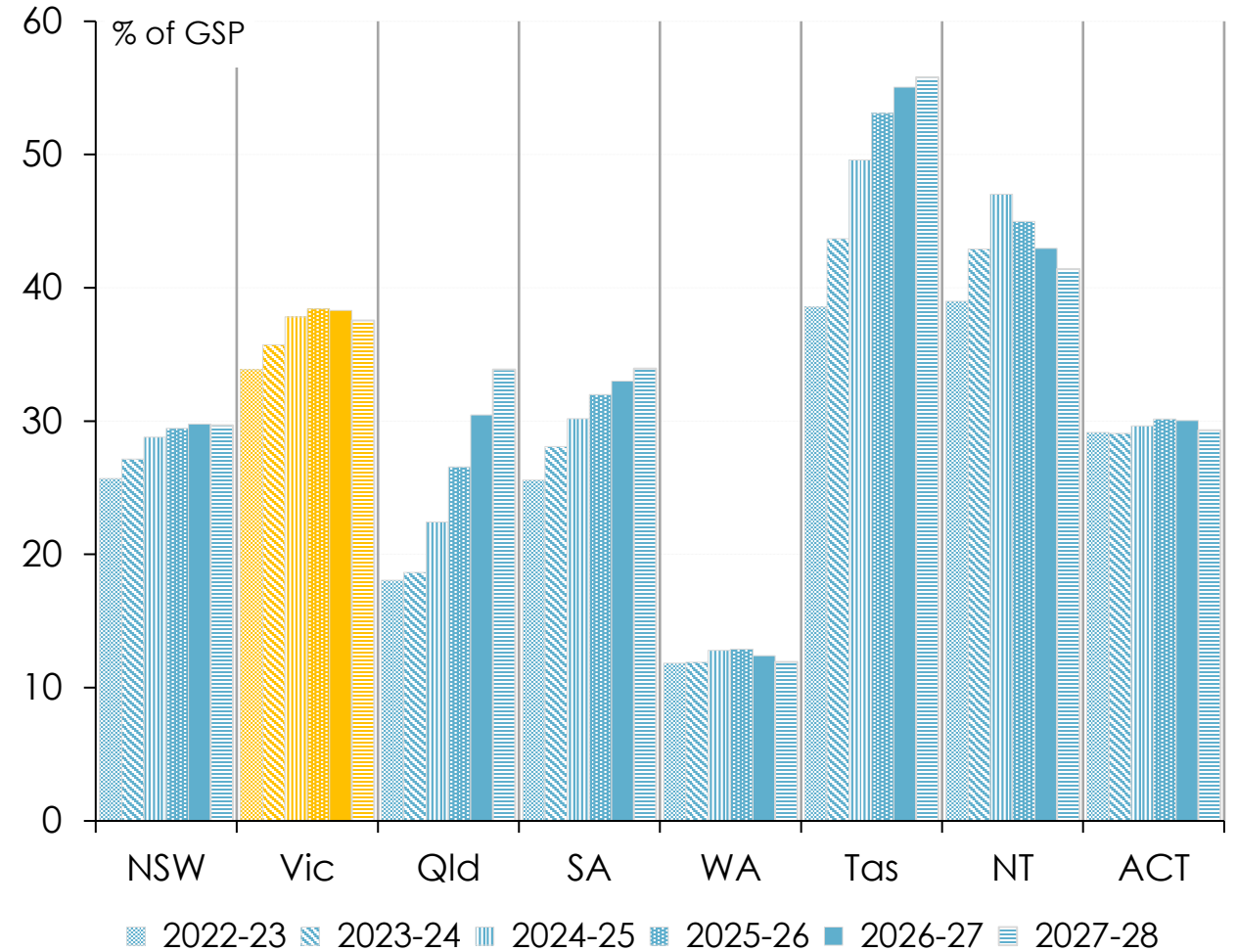
Sources: Victorian Department of Treasury and Finance, [State financial data sets](#), and [2024-25 Budget Update](#), December 2024, and equivalent publications from other states and territories.

Bad as Victoria's finances are, they're actually no longer the worst in the nation

Total non-financial public sector cash deficits, states and territories



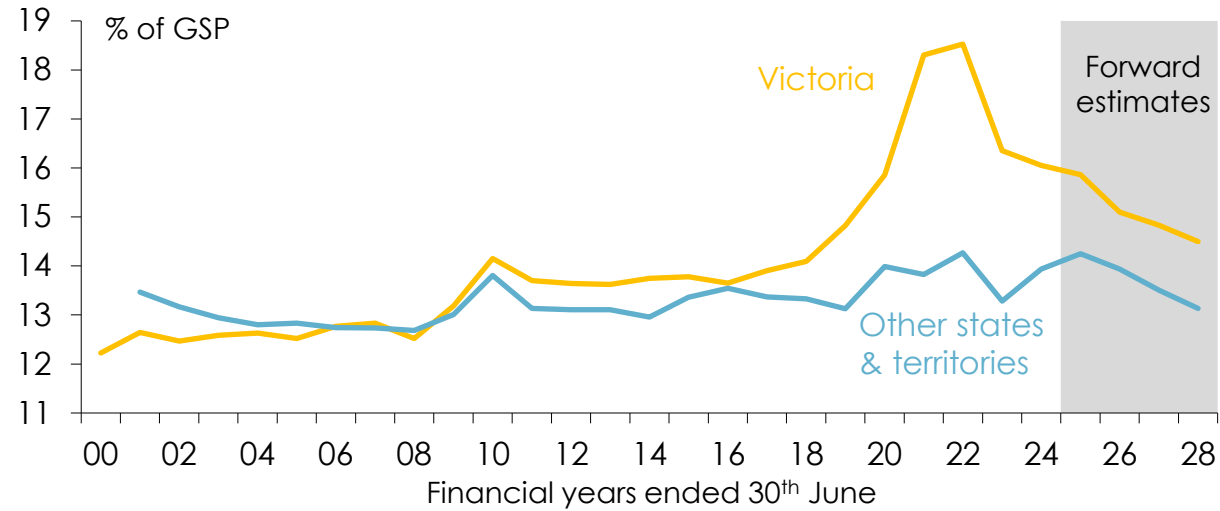
Total non-financial public sector net financial liabilities, states and territories



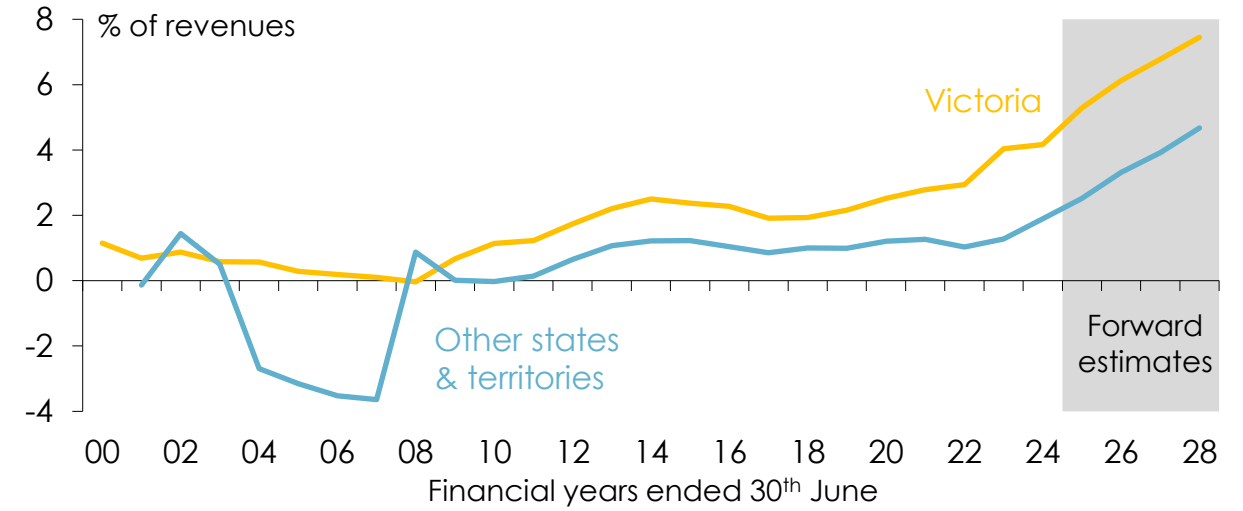
Note: Net financial liabilities includes unfunded superannuation and other liabilities as well as net debt. GSP is gross state product. Sources: State and Territory annual financial reports (final budget outcome documents) and 2024-25 mid-year budget updates; Corinna.

Victoria's financial woes are the result of higher levels of both opex and capex relative to other states, only partly and recently offset by higher taxes

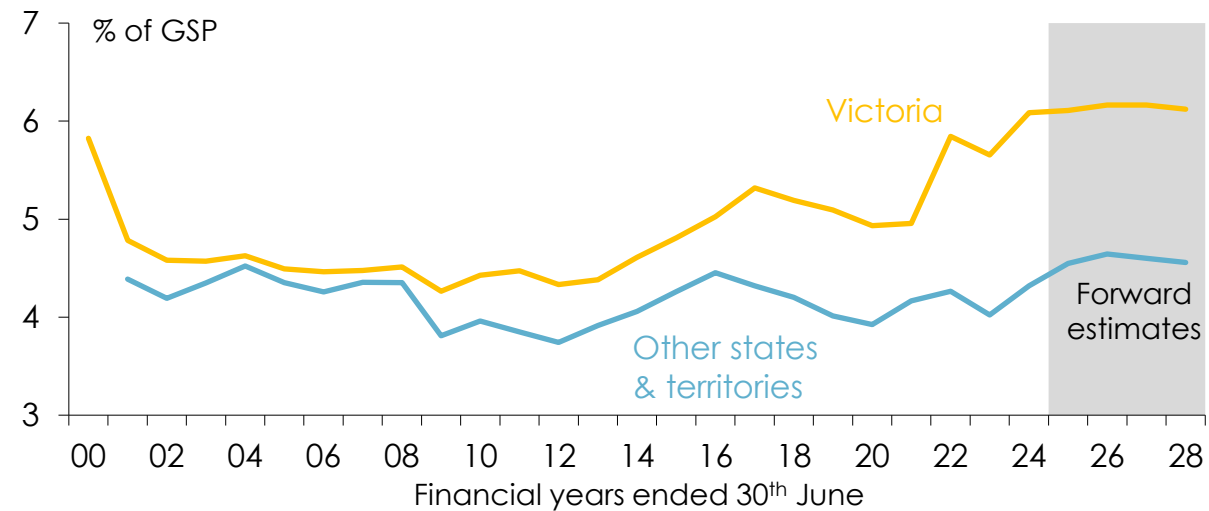
'Operating expenses'



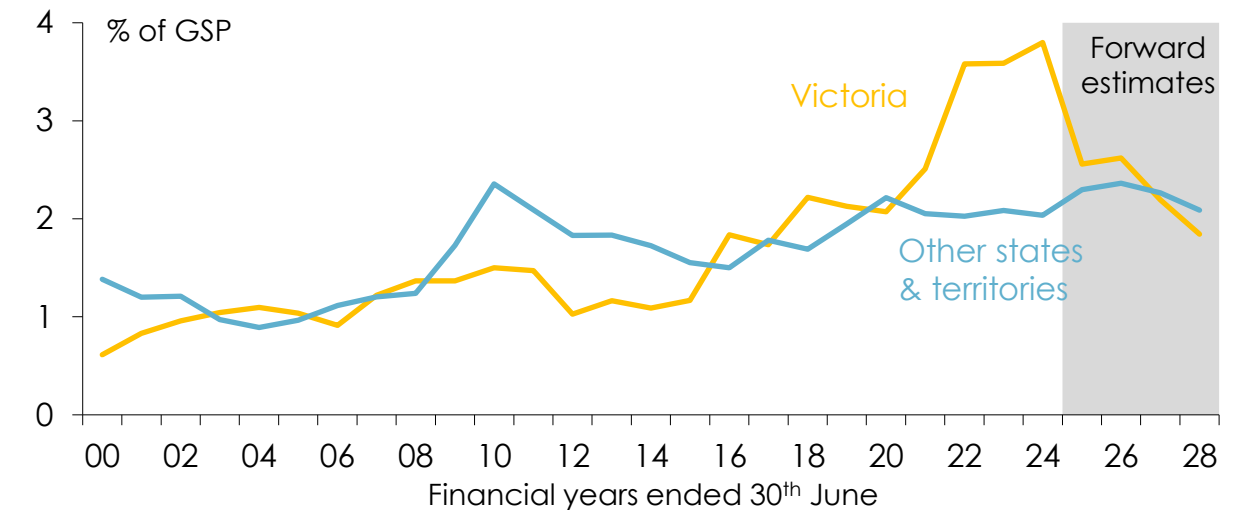
Net interest expense



Taxation revenue



'Purchases of non-financial assets' (capex)



Sources: Victorian Department of Treasury and Finance, [State financial data sets](#), and [2024-25 Budget Update](#), December 2024, and equivalent publications from other states and territories; Corinna.

Governments in financial positions like Victoria's (or Tasmania's, the Northern Territory's and now Queensland's) have only four broad options

❑ Raising additional revenues

- but Victoria's state taxes are already forecast to be the highest (as a pc of gross state product) of any jurisdiction over the next four years, and 1.1 pc pt above the average for all states and territories
- there is scope for Victoria to broaden the base of some of its taxes but it shouldn't be looking at higher tax rates

❑ Cut operating expenses ('opex')

- although there are significant 'economies of scale' in the delivery of most types of state public services, Victoria's opex as a pc of GSP over the next four years is projected to be 1.1 pc pt above the average for all states and territories (and 1.2 pc pt above the corresponding figure for NSW)
- Grants Commission estimates suggest Victorian opex over the four years to 2022-23 has been 8½% above what would be required to provide the average level of state public services at the average level of efficiency

❑ Cut infrastructure spending ('capex')

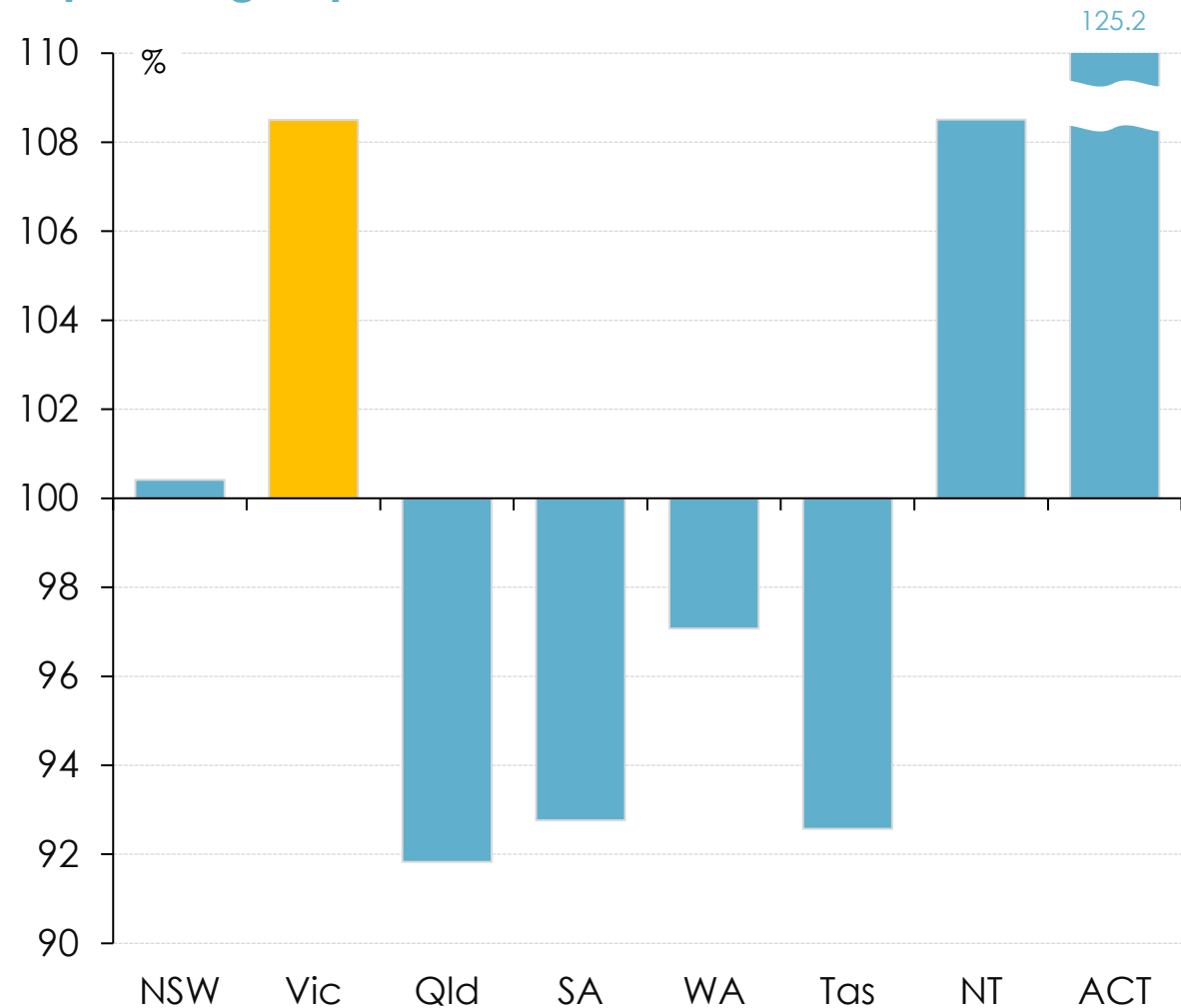
- Grants Commission estimates suggest that Victoria's infrastructure investment spending over the four years to 2022-23 has been 21% above what would have been required to provide the average level of infrastructure services

❑ Sell assets

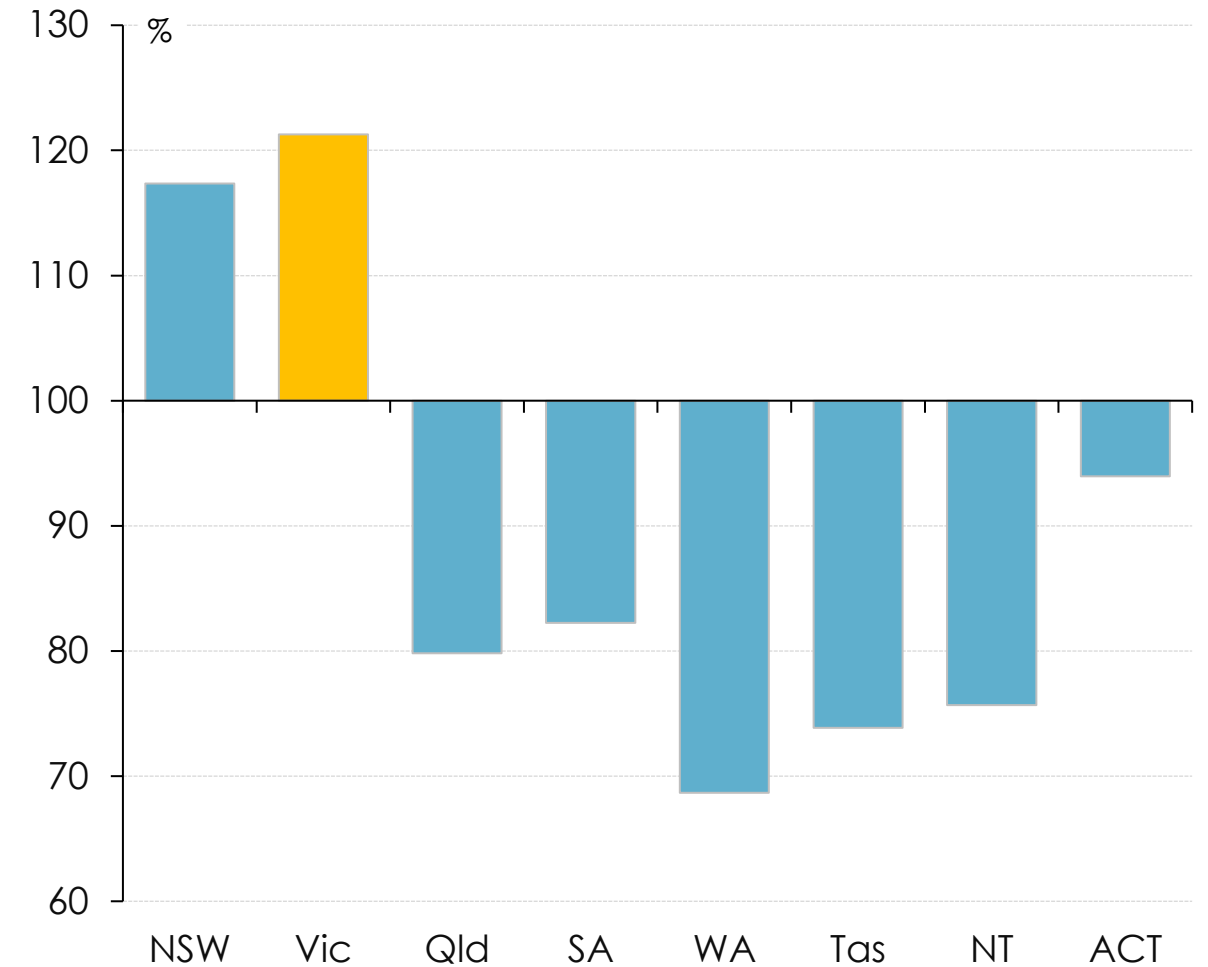
- which was a significant part of what Victoria did in the 1990s to extricate itself from a dire financial position
- but as a result of that, Victoria now doesn't have many assets to sell

Assessments by the Commonwealth Grants Commission show that Victoria's financial woes are largely the result of 'over-spending'

Average 'level of service provision' ratios for 'operating expenses', 2019-20 to 2022-23



Average 'level of service provision' ratios for infrastructure investment, 2019-20 to 2022-23

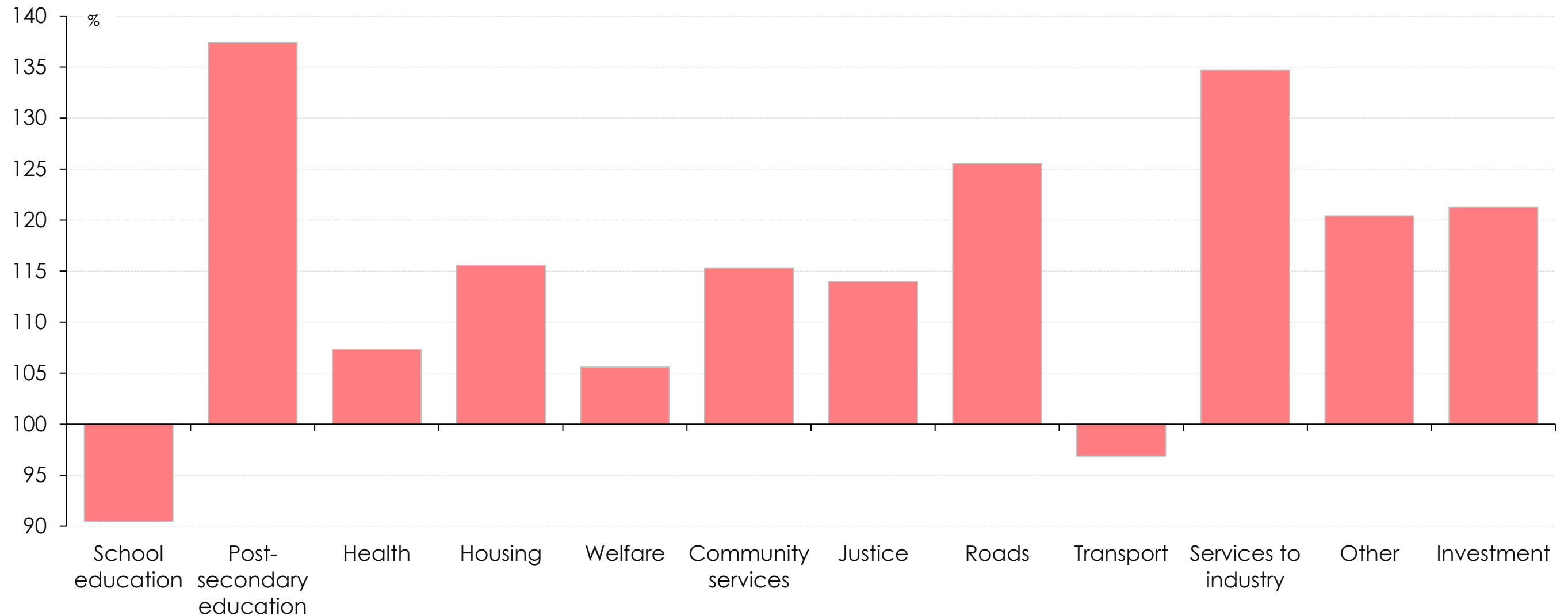


Note: The 'level of service provision' ratio is the ratio of total actual operating expenses by each state and territory to the Grants Commission's assessment of what it would need to spend in order to deliver the same level of services with the same 'efficiency' as the average of all states and territories. Estimates for the ACT are not directly comparable with other jurisdictions because the ACT Government is also in effect the Canberra City Council.

Sources: Commonwealth Grants Commission, [2024 Update of GST relativities](#), April 2024; Corinna.

Victoria has been 'over-spending', relative to what's required to provide the average level of services, in every area except schools and transport

Grants Commission assessed 'level of service provision ratios' for Victoria, averages 2019-20 to 2022-23

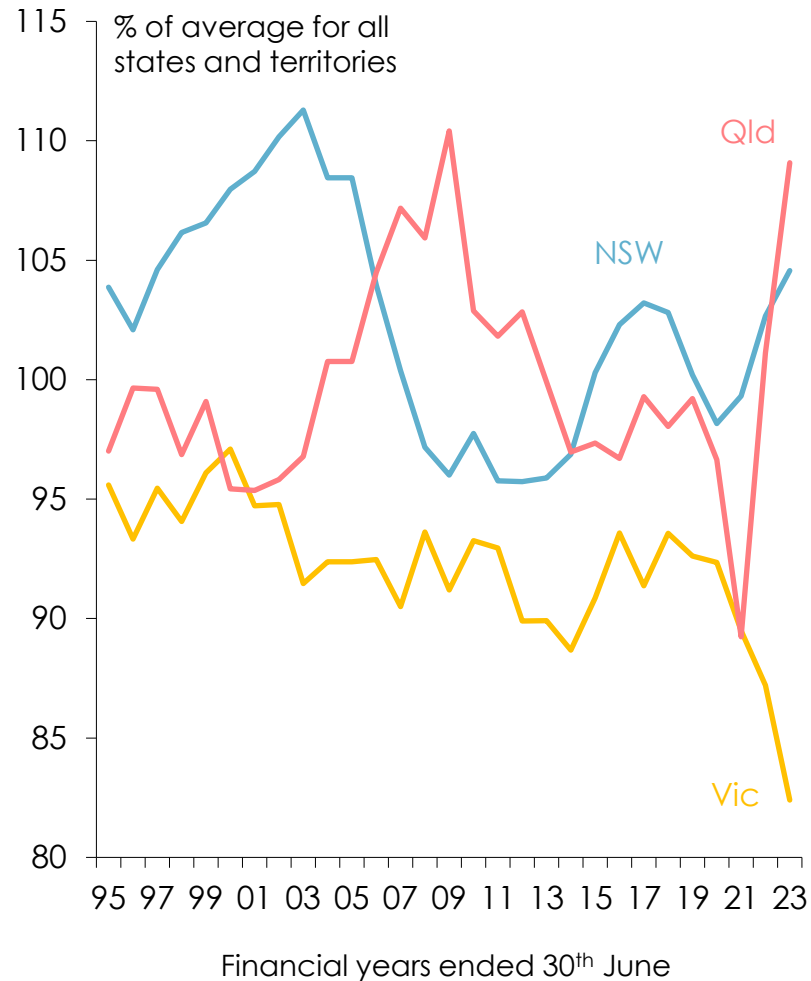


Note: The 'level of service provision' ratio is the ratio of total actual operating expenses by each state and territory to the Grants Commission's assessment of what it would need to spend in order to deliver the same level of services with the same 'efficiency' as the average of all states and territories.

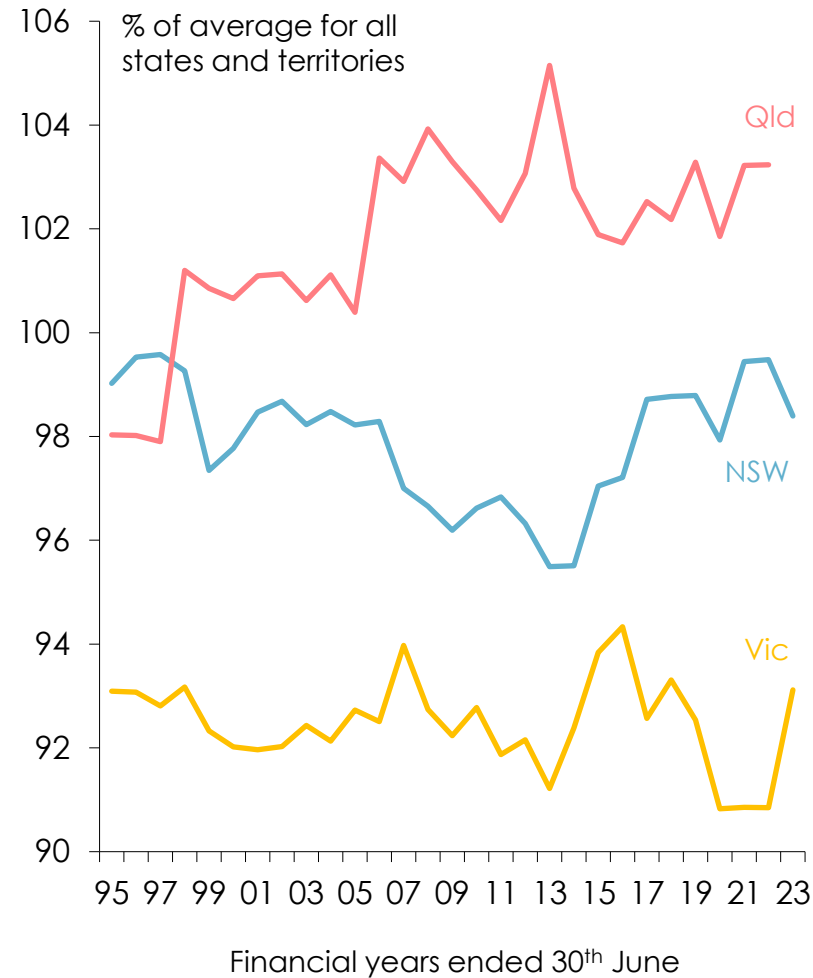
Sources: Commonwealth Grants Commission, [2024 Update of GST relativities](#), April 2024; [Independent Review of Tasmania's State Finances](#), August 2024.

Victoria might become what it (and NSW and more recently WA) have traditionally called a 'mendicant state'

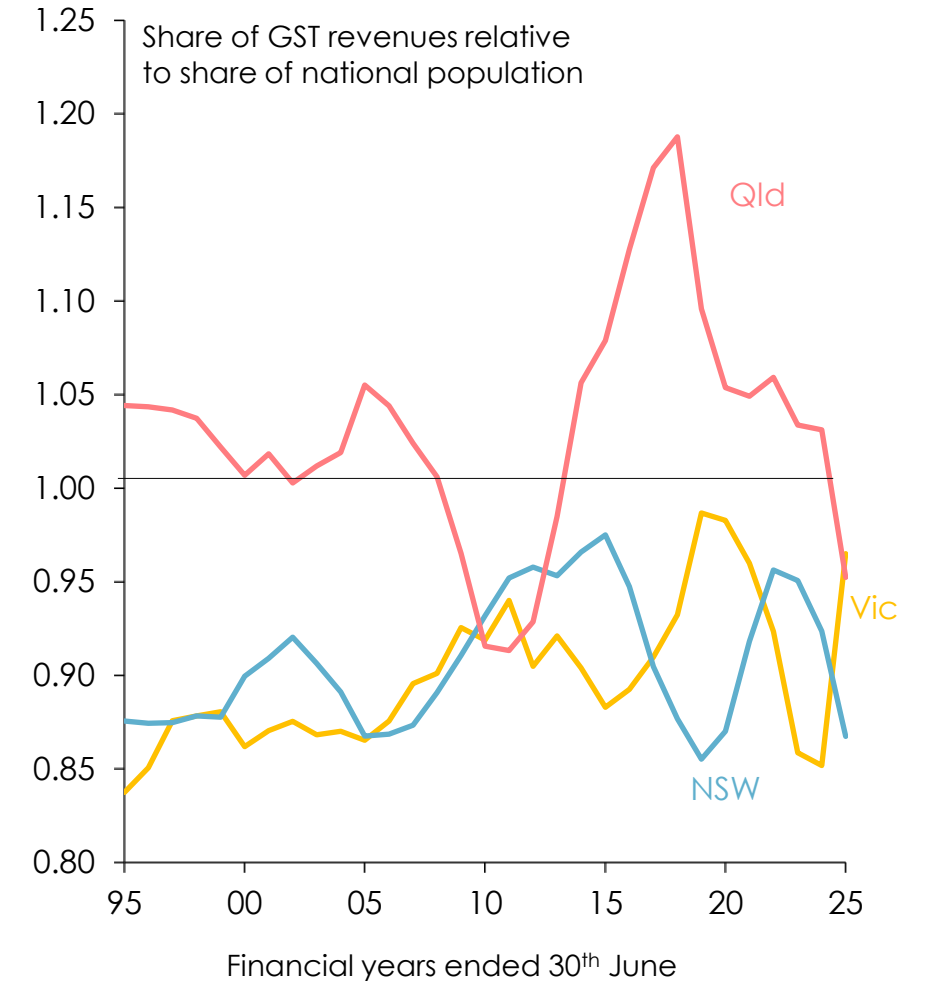
CGC assessments of 'revenue-raising capacity'



CGC assessments of 'expenditure needs'



GST relativities



Source: Commonwealth Grants Commission, [2024 Update - Tables, charts and supporting data](#), 12th March 2024,

Strong 'rules' around the preparation of budgets, the content of financial reports and the details of fiscal strategies are also important

- ❑ **The requirement for Treasury to publish a Pre-Election Fiscal Outlook statement (without Ministerial interference) does (largely) prevent incumbent Governments from concealing the 'true' condition of the state's finances**
 - provided that the Secretary to the Treasury is genuinely apolitical and sufficiently strong
 - it does of course mean that a newly-elected government can't claim its predecessors 'lied about the state of the books' (as almost every in-coming government did, everywhere in Australia, from the late 1980s to the early 2000s)
- ❑ **Victoria's Budget Papers should include a much more detailed 'policy and parameters' statement**
 - setting out the extent to which changes in forward estimates since the previous statement (Budget or Mid-Year Review) are the result of 'policy decisions' or 'parameter variations' (changes in economic assumptions, Commonwealth grants and GST revenue, etc)
- ❑ **Victoria's Budget Papers should include 10-year projections of the major budget aggregates**
 - as the Commonwealth's and the NT's do
- ❑ **The 'rules' around what political parties say about election commitments that affect the budget can and should be strengthened**
 - Tasmania's *Charter of Fiscal Responsibility Act 2007* requires political parties to issue 'fiscal strategy statements' during each election campaign
 - the 2024 Independent Review of Tasmania's State Finances recommended that this requirement be strengthened to require parties to spell out how their election commitments (to increase spending or cut taxes) will be paid for – or, alternatively, to state explicitly that they *won't* be paid for (but will instead be funded by smaller surpluses or bigger deficits)
 - it also recommended that parties should be required to publish these statements eight days before polling day (rather than at 5pm the day before polling day as has become the 'norm' at recent elections)
 - Victoria should do the same