

# FINANCIAL REVIEW

## — Opinion

### Victoria and ACT stand alone at the bottom as worst fiscal managers

In a federation, bad state governments do not go bankrupt. They look towards the federal government for handouts and bailouts.

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Should we really care if Australian governments spend up big and generate massive deficits and deb [\[https://www.afr.com/politics/victoria-s-population-and-construction-ponzi-scheme-20230522-p5da5kjt\]](https://www.afr.com/politics/victoria-s-population-and-construction-ponzi-scheme-20230522-p5da5kjt) for future generations? The question would seem rhetorical for those who spent their careers working in, or working towards, stable macro-fiscal environments.

A new view, however, pervades much of government and the financial community, which sees spending, deficits and inevitably debt securities as akin to money. The environment has changed as most major central banks periodically just conjure up more reserves (print money) in the face of economic shocks. Lucky for them market actors must hold some currency to transact and indeed pay taxes.



Australia's transport minister recently announced a full review of all Victorian infrastructure projects curiously excluding SRL **Jason South**

But at the state and territory government, access to “free money” requires a complicit federal Treasury taking direct action such as a fiscal bailout or indirect less transparent action such as permitting some form of Reserve Bank of Australia assistance in debt markets.

Which jurisdictions best personify the free money ethos of our times?

Certainly, Victoria [\[https://www.afr.com/policy/economy/the-horror-budget-that-reveals-victoria-s-state-of-decay-20210523-p57uff\]](https://www.afr.com/policy/economy/the-horror-budget-that-reveals-victoria-s-state-of-decay-20210523-p57uff) and ACT stand out as the worst economic and fiscal managers in recent years in departing from (a) their own medium-term trends before the pandemic and (b) the other states and the Northern Territory combined (rest of the states). These departures in fiscal policies and broader economic outcomes are visible from fiscal year 2015 onwards.

Ironically both had new leaders, Andrews in Victoria, and Barr in ACT, stepping in around the same time. We refer to the period 2000-01 to 2014-15 as medium-term, 2014-15 to 2018-19 as pre-pandemic, and 2014-15 to 2021-22 as recent.

**Both have been high taxing, high spending jurisdictions since before the pandemic.**

Historically, Victoria and the ACT stand out from the rest for the strength of their finances and overall financial management.

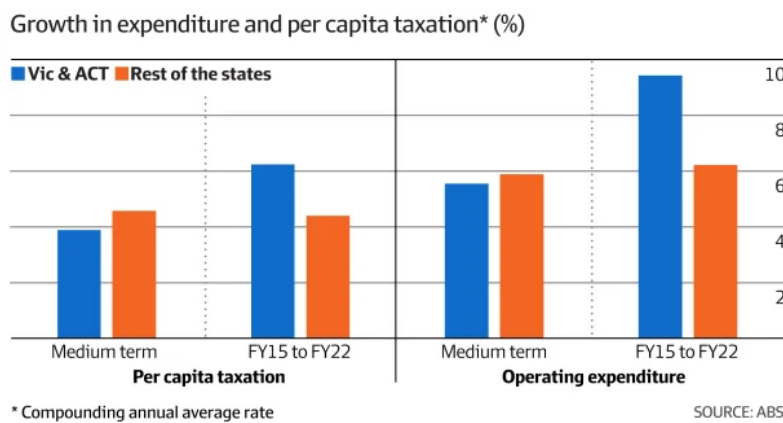
Victoria's net operating budget (NOB) surpluses averaged 4.8 per cent, more than double its traditional competitor NSW (2.1 per cent). ACT maintained a modest surplus even through the GFC and a negative net debt position.

Both are now marked by relatively poor financial positions, actually at the bottom, in various aspects. Both have been high taxing, high spending jurisdictions since before the pandemic.

Real per-capita taxation growth recently (from fiscal year 2015 to financial 2022) in these two jurisdictions combined has been 6.2 per cent per annum compared with 4.4 per cent for the rest. Historically, their annual per-capita taxation growth was lower (3.9 per cent) compared with the rest at 4.6 per cent.

This trend of excess taxation growth in [Victoria](https://www.afr.com/policy/economy/victoria-lags-after-decade-of-decline-20210528-p57w4zj) and ACT is also visible in the Australian Bureau of Statistics data before the pandemic with a 3 per cent differential. So, it is not about COVID-19.

Sadly, both have been unable to control recurrent spending which grew in the pre-pandemic years at 6.5 per cent per annum compared with 3.9 per cent for the rest of the states.



Since financial year 2015, recurrent spending rose on average by 9.4 per cent compared with 6.2 per cent for the rest of the states.

Notwithstanding the above-normal taxation growth, unrestrained spending growth led to Victoria's NOB dropping below NSW in the pre-pandemic years. Including the pandemic years, ACT's NOB is the largest deficit at -6.6 per cent of the budget, with Victoria the second worst at -4.1 per cent on average.

Similar trends are seen in capital spending, which for Victoria and ACT combined increased at 25 per cent annually in the pre-pandemic years, compared with 14 per cent for the rest of the states. Including the pandemic years, it rose at 19 per cent annually, compared with 11 per cent for the rest of the states.

Commensurate with the increased capital spending, net debt increased disproportionately, with net debt to revenue reaching 112 per cent for Victoria and

ACT combined, compared with 79 per cent for the rest of the states.

Projected net debt over the forwards for both jurisdictions look entirely unsustainable reaching 167 per cent of revenue which would lead to a junk credit rating.

Does all this unrestrained spending fuelled by excess taxation and debt, improve living standards for most working Victorians or Canberrans?

That answer depends on the necessity, quality, and efficiency of expenditure – a cost-benefit proposition.

All else being equal, taxation impacts on household consumption. Historically, per-capita household consumption growth in Victoria and ACT combined has been higher than the rest. The recent switch to higher taxation growth has corresponded with lagging per-capita consumption for householders.

Similarly, increased public investment crowds out private investment by business and even in dwellings due to constraints in the economy, as indeed has been seen. Increased demand and competition for labour and materials has resulted in cost blowouts and a substantial increase in unit costs generally.

Perhaps the most concerning tendency has been the breakdown of normal department policy development, planning and prioritisation processes. This is best illustrated regarding the mega construction projects such as the Suburban Rail Loop (SRL) in Melbourne and the Light Rail Transit (LRT) project in Canberra.

Both seem to have been captured by private vested interests including big four accounting firms, (an oligopoly of foreign-owned) major builders, construction unions, and foreign and domestic institutional investors.

Remarkably, the only cost-benefit analysis for SRL performed by the state's Parliamentary Budget Office rejected the project's 50 cent return on the dollar.

The ACT government has refused to release the cost-benefit for Stage 2 of LRT. The BCR for Stage 1 was only half that of the best alternative.

Both megaprojects are shockingly effective land acquisition, zoning and development projects, masquerading as traffic solutions. Those transport issues could be readily solved for a fraction of the cost.

So why are we doing them? Independent experts agree these projects are not productive welfare enhancing investment in our future economies. But they do appeal to powerful vested interests. Coincidentally, those same bodies, provide lifetime employment for ex politicians or staffers that have promoted their best interests. Is this Labor Inc. 2023 style?

In a federal system, robust macro management is only as good as its weakest link. Subnational governments do not go bankrupt. They look towards the federal government for handouts and bailouts.

The Commonwealth government must be cognisant of all the risks that go with unsound macro policy, where credit rating agencies understand fully that you are only as strong as your weakest links.

Australia's transport minister recently announced a full review of all Victorian infrastructure projects curiously excluding SRL. Projects with such poor economics facing obvious alternative lower cost solutions don't usually attract the unquestioning support of the Feds.

Indeed, in the assessment of the nation's best interests, ministers regularly reject a state's grand project vision. The impact of such an assessment is particularly acute

when balancing the competing interests of states' in their perennial fight for a bigger slice of national resources.

But not here.

Should the Albanese government fail to review SRL it will not only break an election promise regarding the Infrastructure Australia review, but it will also be endorsing massive irregularities in policy formation.

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