Tuesday, 23 May 2023

Fiscal Insights

Coughing Up the Cost of COVID

- **Victoria's net operating balance (or bottom line) is expected to be a deficit of $10.3bn in 2022-23, before improving to a deficit of $4.0bn in 2023-24. On the back of new levies, the Victorian Government is projecting an improvement, leading to an estimated surplus of $1.0bn in 2025-26.**
- **The 2023-24 Victorian Budget includes two COVID Repayment levies, additional revenue initiatives and savings measures to help place the State's finances back on a more sustainable footing.**
- **The COVID Repayment levies will raise almost $11bn over the next four years, by increasing the amount of payroll tax paid by some businesses and land tax paid by property investors. These measures are in addition to the Mental Health and Wellbeing Levy for employers introduced in 2021.**
- **The State Government is forecasting a slowdown in the Victorian economy on the back of weaker household spending. Residential construction is expected to fall this year and in 2023-24, which will put further strain on the housing market. Unemployment is forecast to rise and inflation is expected to decline to the RBA's target band in 2024-25.**
- **Against this backdrop, the Victorian Government announced bonus electricity subsidies for certain households, further spending on health, and tax reform. The latter included a transition away from stamp duty on commercial and industrial property, which will help support activity in the sector.**
- **Stamp duty on commercial and industrial property will be replaced by a flat 1% land tax on the unimproved value of land. There will be a ten-year transition period where a purchaser can pay stamp duty through annual instalments.**
- **The focus on budget repair is prudent. However, given the slowdown in the economy and the tightness in residential rental markets, there is some risk the higher threshold and rates for land tax are passed on to renters. Victoria's Government has not announced additional support for renters in this Budget. The Federal Budget did include an increase in rental assistance.**

Victorian Treasurer, Tim Pallas, has described his ninth budget as the most difficult he has had to deliver. There was a pressing need to put the state finances on a sustainable footing. This had to be balanced against the risk of adding to the slowdown underway in the Victorian economy.

The Victorian Government has landed on increases in taxes on some businesses, land tax on investors and cuts to the public service. This was balanced by some cost-of-living support, investment in health and land-tax reform geared toward growing the economy. There's a risk that higher land taxes could be passed on to renters in a residential rental market that is already tight.

Paying back COVID emergency support – higher taxes and lower payments

The COVID Repayment levies will raise near $11 bn over the next four years and includes:

- Higher payroll tax - businesses with payrolls above $10mn will face a 0.5% payroll tax rate, while businesses with payrolls above $100mn will face a 0.5 percentage point increase in their current rate.
- Higher land tax for property investors – the tax-free threshold for land tax rates will fall from $300k to $50k. The land tax will be levied on a scaling basis, starting from $500 a year for landholdings between $50k and $100k to $975 plus 0.1 per cent of the value of the landholdings above $300k.

The Victorian Government will raise money by increasing the absentee owner surcharge applying mainly for foreigners, the betting tax rate and removing the payroll tax exemption for certain non-government schools.

In addition, Victoria's State Government plans to generate savings by reducing spending on consultancy, labour hire and increasing efficiency. The public service is set to be downsized over the next four years. Departmental funding is forecast to fall from $26.1bn in 2023-24 to $25.7bn in 2026-27.

The economic outlook and dwelling investment

Victoria's economy is forecast to grow by 1.5% in 2023-24 – this is a subdued pace and well below trend. Softer economic growth is expected to result in an increase in the unemployment rate. Real wages growth (i.e. wages growth adjusted for inflation) is not forecast to materialise until the end of 2024-25. Against this backdrop the Government is trying to make the economy larger and provide cost of living support to households.

Table 2.1: Victorian economic forecasts [(a)]

	2021-22 actual	*2022-23 forecast*	*2023-24 forecast*	*2024-25 forecast*	*2025-26 projection*	*2026-27 projection*
Real gross state product	5.6	2.75	1.50	2.50	2.75	2.75
Employment	3.9	3.50	0.75	1.00	1.75	1.75
Unemployment rate [(b)]	4.3	3.75	4.25	4.50	4.75	4.75
Consumer price index [(c)]	4.0	7.00	4.25	2.75	2.50	2.50
Wage price index [(d)]	2.4	3.50	3.50	3.50	3.25	3.25
Population [(e)]	1.1	1.90	1.90	1.80	1.70	1.70

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)).
The key assumptions underlying the economic forecasts include interest rates that broadly follow market economists' expectations; an Australian dollar trade-weighted index of 61.6; and oil prices that follow the path suggested by oil futures.

(b) Year average.

(c) Melbourne consumer price index. The Commonwealth's CPI forecasts included in its 2023-24 Budget are 6 per cent over the year to June 2023 and 3.25 per cent over the year to June 2024. Differences in magnitude between the Victorian and Commonwealth forecasts are largely presentational, mainly reflecting that growth rates in year-average terms and in over-the-year terms are not comparable.

(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.

Cost of living support

The Budget includes a bonus electricity subsidy for certain households - the Government announced $400mn for another round of the Power Saving Bonus.

In addition:

- $4.9bn for health including to improve nurse-to-patient ratios in emergency departments and introducing incentives for medical graduates to work as general practitioners
- $186mn to expand the eligibility criteria for Free TAFE.

Making the tax system more efficient

- Under the stamp duty tax reform, stamp duty on commercial and industrial property will be replaced by a flat 1% land tax on the unimproved value of land. There will be a ten-year transition period where a purchaser can pay stamp duty through annual instalments.
- The tax-free threshold on payroll tax for small business will be raised to $1 million from $700k by 1 July 2025.
- Business insurance duty will be abolished over a 10-year period. The State Government estimates that over the first three years alone this will save businesses more than $275mn.

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