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Labor's Big Build Hits A Dead End – What's Next?

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Summary

The *Big Build* has reached a dead-end.

The Allan Labor Government acknowledged that it was time to rein in the *Big Build* during the release of the Victorian 2024-25 Budget.

But this was an illusion. The Government remains intent on keeping *Big Build* at the heart of the Victorian economy and continues to assume that Melbourne will grow from 5.2 million to 8 million by 2050.

If so, it will be a disaster for Victorians because, while the Federal Government refuses to provide the required funds, most of the state's capital will be directed to the *Big Build*, precluding other more important ends.

The most extravagant project, the Suburban Rail Loop, should be cancelled forthwith.

Instead of going cap in hand to the Federal Government for infrastructure funds, the state should insist that the Federal Government STOPS loading Victoria with so many migrants flowing from its Big Australia population policy.

And, to the extent that this flow continues, Victoria must demand that the Federal Government provides the funds to accommodate them.

The matter is urgent.

Victoria needs a new business model, focusing on completing its renewable energy transformation and on starting a new industry policy.

The Australian economy is trending towards a reliance on commodity industries. The Albanese Government's recent *Future Made in Australia* policy direction does not spend a penny in Victoria. It is mainly going to commodity extraction and processing in the north and west of the nation.

Meanwhile, largely unnoticed, Victoria has registered a huge and growing deficit on all international goods trade, equivalent to minus $11,997 per person in 2023, compared with minus $8,524 per person in NSW and a surplus of $75,350 for Western Australian residents.

The longstanding Victorian aspiration to become a globally competitive hub for knowledge intensive industries has failed. Moreover, despite Melbourne's massive size as a service centre, Victoria's international trade in services is also in deficit.

A new industry policy must be initiated. Otherwise, Victoria's outlook is that of a mendicant state propped up by federal handouts.

Background

It all happened so fast. When Treasurer Tim Pallas handed down the Victorian 2019-20 State Budget, the expectation was that the Victorian Government's net debt would reach $54.9 billion by June 2023. In fact, it reached $115 billion. According to the 2024-25 budget, net debt is expected to reach $187.8 billion by mid-2028. Annual interest payments by this time are projected to reach $9.4 billion.[1]

In 2019, the Victorian Treasury was assuring the public that this $55 billion debt would be easily paid for through the rapid expected growth of the State's economy, itself largely a consequence of the *Big Build*.

How things have changed. By 2024, the State Labor Government was publicly acknowledging second thoughts about the debt build up. Pallas's introductory speech to the 2024-25 State Budget contained multiple references to a new more 'disciplined', 'measured' and 'responsible' approach – such as in the following paragraph:

> *It's time for Government to recalibrate, ensuring our investments are right for today, and tomorrow. This year's Budget makes a range of sensible and disciplined decisions, while continuing to invest in the health, education, transport and housing Victorians need.*[2]

The Budget committed to a sharp reduction in new Government capital expenditure, from a peak of $24 billion in 2023-24, to $15.6 billion in 2027-28 and to a decline in State debt such that it would be lower in 2027-28 than in 2024-25. [3]

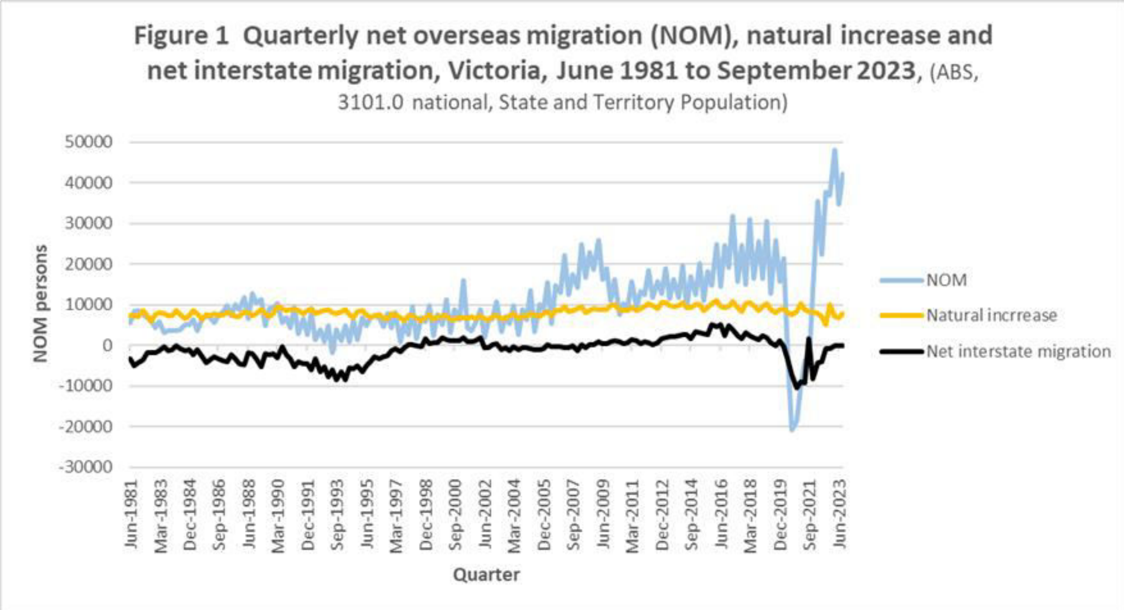
There was an audible sigh of relief amongst the many commentators worried about where the *Big Build* was taking the State.

But this relief was based on an illusion. The State Government had no intention of slowing the *Big Build* down. It remains committed to accommodating massive growth in Melbourne's population from 5.2 million now to 8 million by 2050.

It will go ahead with two gargantuan projects, the North East Link,[4] currently costed at $26 billion, and stage one of the Suburban Rail Loop,[5] costed at some $34 billion. In addition, there will have to be a multitude of further projects to provide for 8 million residents.

Victoria will continue to absorb a large share of the extra people delivered by the Federal Government's Big Australia commitment. The Federal Labor Government is heavily complicit. The post Covid Federal Government Jobs and Skills Summit unleashed a huge boost to immigration levels through 2022 and 2023. Even with current assurances that the numbers will decline, it projects that national net overseas migration (NOM) will continue at least 250,000 a year – more than enough to require a continuation of the *Big Build* in Victoria. Figure1 shows quarterly NOM for Victoria for the period June 1981 to September 2023.

Figure 1: Quarterly NOM, natural increase, net interstate migration, Vic, June 1981 - Sept 2023



Victoria is the bunny. It continues to accept this role even as the Federal Labor Government has made it clear that it will not provide the funds needed to accommodate the additional people.

The consequences for Victoria, as we detail later, are alarming.

First, we need to set the scene for readers to appreciate how Victoria fell into this population trap.

The origins of the Big Build

In the early 1990s, Victoria was hit by a deep recession. Its severity was partly attributable to the then state Labor Government's reckless debt-fueled investments. As a consequence, the State Bank had to be sold off. However, Victoria's manufacturing base had also been hit hard by the national recession. As Figure 1 shows, there was a net exodus of people from the state. Melbourne was being referred to as a 'rust belt' – in contrast to Queensland's flourishing 'sunbelt'.

The outlook was bleak. To make matters worse, in May 1991 the federal Hawke Labor Government announced that the manufacturing tariffs, which much of Victoria's industry depended on, were to be slashed during the 1990s.

The Victorian Kennett Government, elected in 1992, found a stop gap solution. It initiated the *Big Build* through its massive City Link project, which joined the eastern and northern freeways via a tunnel under the Yarra River. It managed to finance this and simultaneously cut state debt by selling off the state's gas and electricity utilities.

Kennett also pursued a new economic strategy, aimed at freeing Victoria from economic dependence on the state's declining and protected industrial base. This was to turn Melbourne into an event and entertainment orientated city. It was envisaged that creating new cosmopolitan districts (notably Docklands) that would appeal to the best and brightest globally mobile talent, and thus boost knowledge-based industries.

The Victorian Bracks/Brumby Labor Governments, first elected in 1999, put their stamp on this new strategy. (Bracks was premier from 1999 to 2007, and Brumby from 2007 to 2010.) Both Steve Bracks and John Brumby accepted that the protectionist era was over. They sought to lay the groundwork for new hi-tech industries. They included the pharmaceutical industry (where Melbourne had a strong academic research base). In 2000, the new Premier, Bracks, announced that Melbourne would aim to be recognised as 'one of the top five biotechnology locations in the world by 2010).[6]

They also put their faith in the motor vehicle industry. This may surprise, but in the early 2000s, Ford, General Motors and Toyota all had design as well as manufacturing operations in Melbourne. They were exporting motor vehicles, especially to the Gulf states. Bracks and Brumby thought this industry could provide a new hi-tech base for the state's economy in which the Melbourne design centres would be incorporated within the respective multinationals' international supply chains.

Bracks and Brumby accompanied this vision with a commitment to city building. By the end of the 1990s, Australia's migration program was expanding again and Melbourne was capturing a high share of international and interstate migrants.

In 2004, the Victorian Government projected that Victoria would grow by up to one million residents by 2025. Even though this was a product of Federal government immigration policies, the Victorian Government enthused over this prospect and advised Victorians why they should welcome its efforts to make it come to pass.[7]

The Government was aware that this target depended on Melbourne's continued strong population growth and that this in turn depended on the provision of cheaper housing on the fringe, more than was available in Sydney. To ensure this, in November 2005 there was a massive rezoning of additional fringe land for suburban development.[8]

This proved a successful strategy as high levels of housing construction helped drive Melbourne's economic growth.

When the Andrews Labor Government was elected in 2014, it endorsed the high population growth, hi-tech vision. This latter vision lives on in a residual institutional form in *Breakthrough Victoria*. This is a state-owned venture capital fund announced in 2021, and backed by $2 billion of state funds to be spent over the following decade. Brumby was appointed Chairman.

However, this hi-tech vision for the transformation of the Victorian economy has become a sideshow in comparison with the Andrews Government's commitment to population-driven city building. The *Big Build* was born again. The Government pursued multiple rail and road projects, largely financed by state debt.

This chain of events began with commitments to remove multiple level crossings and to embark on big new transport projects, including Melbourne Metro and the Westgate Tunnel.

Voters approved, and Labor easily won the 2018 state election. The Andrews Government apparently had found an appreciative electoral constituency. This was composed of the many beneficiaries of the *Big Build* (including the construction trade unions, the businesses profiting from rapid growth in Melbourne's population, together with the public servants and health, education and welfare workers providing the services for the expanding population).

The Government successfully ran again on the *Big Build* agenda at the 2022 State election. In advance of the election, it announced two new and gargantuan projects. The first was the North East Link, which was initially costed at $14 billion in 2021, but by 2024, even before tunneling had begun, was costed at $26 billion. The second was the Suburban Rail Loop, also announced in 2021 and initially costed at $34 billion. This was just for the first part of the loop: the underground rail connection from Cheltenham to Box Hill.

The aggressive Covid lockdown in 2020-21-22[9] put a spanner in the works. The Government committed huge funds to finance this, again, like the *Big Build*, largely financed by debt.

As noted, when Tim Pallas handed down the Victorian 2019-20 State Budget, it was expected net debt would reach $54.9 billion by 2023. In fact, it reached $118 billion and is now expected to reach $187.8 billion by mid-2028.[10]

The huge interest payments by this time belie the Treasury assurances that economic growth would provide a foundation to pay down the debt.

What went wrong?

For a start, the Covid Lockdown prompted huge additional expenditure financed by debt. Then, in May 2022, in response to inflationary pressures, the Reserve Bank increased its interest rate. There were further rate increases in June and July of 2022. Currently, the ten-year bond rate in Australia is 4.3 per cent. This a rough indicator of the price of the funds the Victorian Government is having to pay as it seeks new money and rolls over past debt. This is way above the interest rate that the Victorian Treasury had been assuming.

These inflationary pressures have been pronounced in building material and construction labour costs. These pressures have been major contributors to the huge blow-outs in the anticipated costs of *Big Build* projects.

Worse, the Federal Government has indicated that it will not contribute to more than a fraction of the required funds.

In the case of the North East Link, the Commonwealth Government has only agreed to contribute $5 billion out of the total estimated cost in 2023 of $26 billion. Some of this will be paid for by private tolling.

The situation with the Suburban Rail Loop (SRL) is even more serious. The Federal Labor Government has promised to contribute $2.2 billion. On May 15 after the release of the Commonwealth's 2024-25 Budget Papers, Tom Elliott of 3AW asked federal Treasurer Jim Chalmers if the Labor Government intended to add to the $2 billion it had already committed to the SRL. His answer:

> *We've made it clear in the past, and I'm happy to make it clear again that funding is, contingent on the project meeting the relevant conditions and working with Infrastructure Australia to make sure that we're getting value for money*. [11]

If the Commonwealth does not increase this commitment, it will be a financial disaster for the State Government. Premier Jacinta Allan[12] has recently revealed that her government has been assuming that it will provide a third of the funding, the Federal Government another third (some $11 billion) and that the remaining $11 billion will come from taxes on the businesses benefiting from increased economic activity in and around the SRL stations. It is hard to see the latter ever coming to pass, given that such taxes are likely to suppress business investment.

The prospect is that the State Government will be left holding a massive financial baby with multiple serious consequences for Victorians.

Why worry?

Victoria should be demanding that the Federal Government *stop* using Melbourne as a dumping ground for its Big Australia immigration policies. It should demand that the federal government significantly curtail immigration-led population growth.

At the very least, it should insist that this should only resume if the Federal Government promises to pay for the crushingly expensive city building required to accommodate rapid population growth.

The Victorian Government is doing neither of these things. Instead, it has settled on a comfortable, if supplicant, role as a recipient of Big Australia migrant flows. It has accepted this role even as it acknowledges that the earlier associated aspiration of turning Melbourne into a hi-tech production hub is dead.

In the 2024-25 Victorian Budget Papers, the Treasurer stated that:

> *Breakthrough Victoria was set up to help the economy recover and grow jobs after the pandemic – but with those tasks well underway, we will extend the fund's investment profile from 10-15 years, giving Breakthrough Victoria more time to review and be selective about quality investments*.[13]

In other words, the Treasurer is saying that the *Big Build* is working, so let's just continue to rely on it for the future.

What's wrong with that? Victorians are benefiting from Australia's commodity-based balance of payments strength, and the strong Australian dollar associated with this. After all, it allows unlimited relatively cheap imports and provides the State Treasury with access to global credit markets for loan funds.

Victorians can also rely on the Commonwealth Government to look after their wellbeing, via pension and benefit claims. They can also make a claim to a share of the Commonwealth tax revenue from resource companies via the special purpose funds the Commonwealth allocates to the States. However, Victorians are missing out on the royalties and other fee revenues that resource-rich States can charge to mineral companies. Nevertheless, they can make a claim for fiscal adjustment via a reallocation of GST (Goods and Services Tax) revenue to States without such revenue.

The problem is that there are limits to this redistribution. At present nearly half of Victoria's revenue comes from special purpose allocated by the Federal Government and from GST. The rest comes from State taxes, like property taxes or special levies, as with the Covid levy. To sustain the *Big Build* in a context where the Federal Government is a minor contributor to the capital required, the State will have to levy additional taxes, making it less attractive as a location for footloose capital and business investment.

The Victorian Labor Government appears to have decided that the *Big Build* at least gives Victoria a role and direction, even if it is as a mendicant state.

However, even as Victoria settles into this role, the Australian economy is changing in ways that make Victoria's economic situation more vulnerable. Australia is trending towards ever more reliance on commodity industries.

The Albanese Government announced during the 2024-25 Federal Budget that it will invest some $22 billion over a decade to promote the extraction and processing of critical minerals and the development of Australia's solar capacity, in particular its transformation into exportable green hydrogen. None of this modernising, export-orientated investment will occur in Victoria.

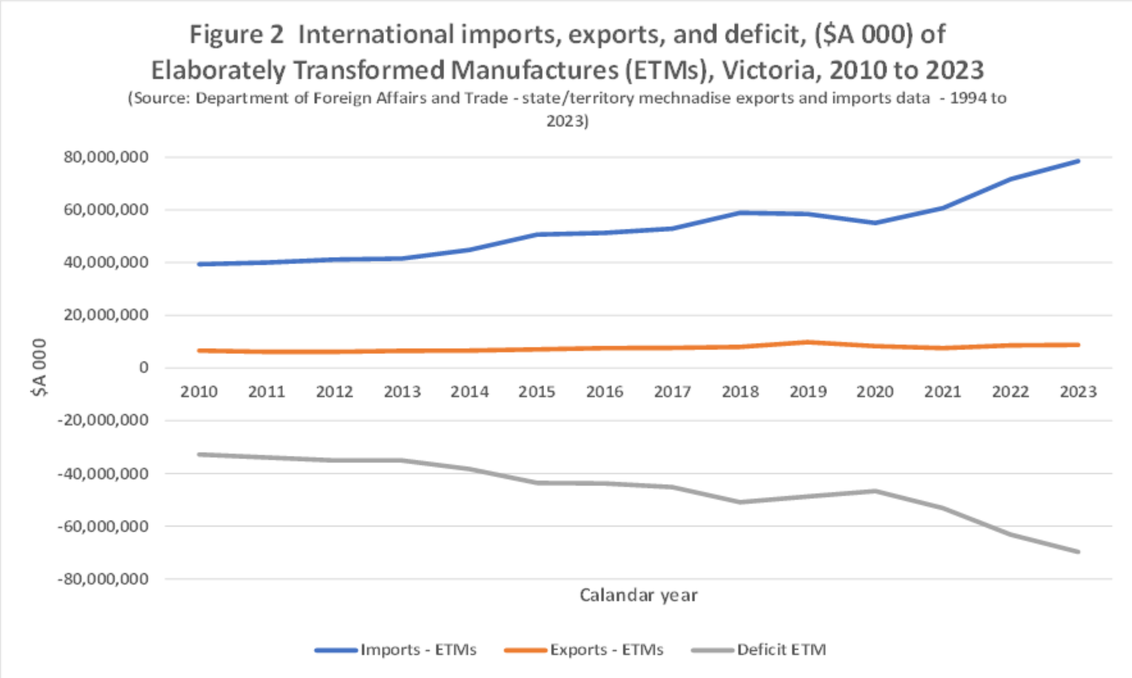
The Albanese Government clearly assumes that Australia's dependence on commodity industries will deepen and that the focus of the Australian economy will move towards the commodity rich northern and western States and regions.

Victoria's international trade record shows how far this process has gone.

We focus on the State's international trade record with Elaborately Transformed Manufactures (ETMs). In 2019, Victoria imported $58 billion of ETMs and exported $9.8 billion. Just four years later this gulf had massively enlarged. In 2023, Victoria imported $78 billion ETMs and exported $8.8 billion.

Under current industry policy settings, any prospect that Victoria could become an internationally competitive hub for hi-tech industries is a pipedream.

Figure 2: International imports, exports & deficit of ETMs, Victoria, 2010 - 2023



An example of population driven growth ETM imports is 'road motor vehicles and parts', which grew by 103 per cent between 2010 to 2023. By 2023, this import item alone accounted for 17 per cent of all Victorian merchandise imports, incurring a trade deficit for that item of nearly $18.5 billion.

Although a trade deficit for ETMs is not limited to Victoria, a clear contrast exists when Victoria is compared with minerals and fossil fuel exporting states with lower levels of population, such as Western Australia and Queensland. These states have an export base to compensate for the high consumption of ETM imports tied to high population growth. This outcome is illustrated in Table 1, which compares the trade balance of imports and exports across all merchandise categories for Western Australia, Queensland, New South Wales, and Victoria.

Table 1: Total merchandise trade balance, estimated residential population, and merchandise, trade surplus/deficit per capita, 2023

Table 1 Total merchandise trade balance ($000), estimated residential population and merchandise trade surplus/deficit per capita ($), 2023

	Total merchandise trade balance ($000)	Estimated Residential population	Merchanise trade surplus/deficit per capita ($)
Queensland	46,458,225	5,450,404	$8,524
Western Australia	214,271,799	2,843,690	$75,350
New South Wales	-74,706,267	8,341,073	-$8,956
Victoria	-81,499,346	6,793,450	-$11,997

Source: DFAT, State/territory merchandise exports and imports, 1994 to 2023
ABS, Population Projections by Region, 2022-2071

The merchandise trade surplus or deficit per capita for each of these states in 2023 is shown in Table 1. Western Australia and Queensland have a trade surplus per capita of $75,350 and $8,524, respectively. By contrast, Victoria and NSW have a merchandise trade deficit per capita of -$11,997 and -$8,956, respectively. The situation in NSW is alleviated somewhat relative to Victoria because of that state's strong export performance in 'unprocessed fuels'.

One response may be that Victoria has generated an alternative international trade surplus in services – after all, Melbourne is a huge metropolis in which service industries feature. However, the sad truth is that this is not the case. In 2022-23 (the latest available year), Victoria had a small net deficit on international trade in services of $1.6 billion. It would have been vastly more if not for a net surplus on education export services (overseas students) of $10.7 billion.[14] The latter is not much given that international students are a huge component of Victoria's net overseas migration intake, which in turn is the major factor driving the justification for the *Big Build*.

A new industry policy

It is disheartening how little awareness there is of this situation amongst commentators and Victorian government leaders. All that we have is ideas about how the *Big Build* can be done better, as with the State opposition's stance that the SRL should be cancelled and the funds allocated to more urgent *Big Build* projects like new hospitals.

The State needs another direction that at least holds out the prospect of a more productive and economically sophisticated future.

A new industry policy is a plausible, though expensive, alternative, but only if the state's investment capacity is freed from the financially crippling burden of the *Big Build*.

The Allan Government is mute on the issue of alternative uses of the funds it has leg-roped to provide for the *Big Build*.

In the case of the SRL, there is something to be said for enhancing middle suburbia business hubs, as around stations like Glen Waverley and Box Hill. But, the business case for the SRL did not consider whether a vastly cheaper and more flexible extension of bus services could have satisfied the need for extra transport capacity to these hubs.[15]

Even more important, the business case did not explore alternative uses of the investment funds, as with contributing to the state's renewable energy transition or with a revived state hi-tech industry policy.

This would aim at resuscitating the state's long held vision of Melbourne building on its hi-tech research capabilities.

This vision lives on, in vestigial form, in *Breakthrough Victoria*. But, the underlying assumption behind this vestige is demonstrably wrong. This is that all that is needed if the hi-tech vision is to come to pass is two criteria. The first is to provide education and research assistance and the second for some seed money to enterprises in fields where Victoria's research base is relatively advanced.

Breakthrough Victoria allocates start-up funds to promising tech ventures then leaves them to fight it out in the marketplace. However, in an environment dominated by multinationals who control decisions on the upstream development and marketing of products like pharmaceuticals, Melbourne start-ups have little chance. They must vie with competitors from other countries that are offering lower cost settings, as well as tax and operational subsidies.

It is notable that the Federal Labor Government, despite its free trade inheritance from the Hawke/Keating era, has also reached this conclusion. Its new *Future Made in Australia* focus is on selecting enterprises which have the best competitive prospects in the commodity extraction and processing industries. It is providing these enterprises with the sustained, very substantial funds needed to nurture them to fruition.

Any successful industry policy in Victoria will have to proceed on the same basis. This will require the State to declare where the best potential lies, as with bio-tech, then lay out a strategy to make it happen. The relevant academic and research centres would have to be tied into the production phase of the policy.

It has been done before. The blood products and vaccine multinational, CSL, still has research labs in Melbourne and has recently completed a plasma fractionating factory Iin Broadmeadows. CSL was originally a Commonwealth owned and financed entity. It combined applied research with production of vaccines, anti-venoms and blood products. It was privatised in 1994 and subsequently built on this base to succeed in global markets.

Something similar needs to be imagined, such as the creation of a generic drug producer capable of competing in huge market openings as many of Big Pharma's drug successes come off-patent. Victoria has the skills; it just needs the funds and vision to make it happen.

We are not claiming that there can be a quick fix. Nevertheless, it is urgent that some alternative direction to the State's *Big Build* policy agenda be nurtured, whether it be with focused industry policy or some other option. Victoria is still a big economic unit. It can go it alone. This cannot happen, however, if the state continues down the *Big Build* pathway and, in the process, squanders billions of dollars on low productivity, capital broadening economic activity.

Notes

[1] Craig Butt, 'How much money Covid-19 era taxes are raking in for Victoria', *The Age*, May 7, 2024

[2] Victoria Budget 2024-25, Budget Paper No. 1, p. 2

[3] Ibid., p.4

[4] The North-East Link involves 6.5 kilometres of tunnels and road links from Watsonia to Bulleen.

[5] The SRL is a plan for 90 Kilometres of rail from the Frankston to Werribee, much of it underground.

[6] John Brumby, *The Long Haul*, MUP, 2015, p. 157

[7] *Beyond Five Million, The Victorian Government's Population policy*, Released December 2004

[8] Bob Birrell, Ernest Healy and T. Fred Smith, *Melbourne's Second Speed Economy*, Centre for Population and Urban research, Monash University, 2006, pp, 37-38

[9] Platinum, accounting and taxation, Melbourne Lockdown Dates, 2020, 2021 and 2022

[10] Craig Butt, 'How much money Covid-19 era taxes are raking in for Victoria', *The Age*, May 7, 2024, op. cit.

[11] Australian Treasury transcripts of post-budget speeches and interviews of the Treasurer, Interview with Tom Elliott, 3AW, May 19, 2024

[12] Daniel Andrews was premier of Victoria from 2014 to September 2023, when Jacinta Allan, also from the Labor Party, became premier.

[13] Victoria Budget 2024-25 Treasurer's Speech, p. 3

[14] ABS, International trade in services, credits and debits, state by financial year, 14 December 2023

[15] Bob Birrell and Ernest Healy, *The Suburban Rail Loop: Not needed not fit for purpose and a debt bomb*, The Australian Population Research Institute, July 2022