

Queensland Asset Sell Offs, Budget Black Holes, Borrowings and Credit Ratings

BRIEFING PAPER

Prepared for:

QUEENSLAND COUNCIL OF UNIONS

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EXECUTIVE SUMMARY

The privatisation of public assets is contrary to Queensland ALP policy and there was no mention of the Bligh Government's privatisation agenda during the March 2009 election campaign (which was undertaken *after* the global financial crisis).

Yet two and a half months later the economic situation allegedly had such an adverse effect on the Government's finances that it needed to undertake a comprehensive program of asset sales as the main measure aimed at improving Queensland's fiscal position.

This paper analyses the Bligh Government's rationale for its privatisation proposals.

Queensland's finances better than presented

Section 1 examines *whether the State's finances are really in trouble* based on facts contained in audited financial statements for the Queensland public sector.

The agencies covered by the State Budget have consistently produced cash flow surpluses from continuing operations, including 2008-09 - notwithstanding the global financial crisis. Rather than a 2008-09 Budget deficit forecast of \$1.573 billion, the result was a surplus of \$34 million, which after a series of adjustments (including downward adjustments to the value of assets) produced a relatively modest deficit (on an accrual basis) of only \$88 million. The Statement of Cash Flows for the general government sector tells an even better story - showing a significant cash flow surplus from operating activities of \$3.7 billion. That cash surplus (together with borrowings) was mainly re-invested in social infrastructure - in 2008-09 purchases of non financial assets totalled \$6.96 billion.

In the case of the 'whole of government' sector on an 'accrual' basis, Queensland recorded major surpluses in 2005-06 (\$4.84 billion) and 2006-7 (\$5.40 billion) followed by deficits in 2007-08 (\$767 million) and 2008-09 (\$6.98 billion). While at first glance these results seem alarming, particularly the deficit in 2008-09, the major components were write-downs that may simply reflect a short-term deterioration in asset values.

Furthermore, it appears that government agencies have 'expensed' amounts of interest on borrowings during the construction period of new infrastructure. This is contrary to the requirements of international accounting standards, and Australian Accounting Standard AASB 123 'Borrowing Costs' (June 2007) and affected reported financial results. For example, if interest had been capitalised, the general government sector deficit of \$88 million in 2008-09 would have been converted into a surplus. On the face of it, accounting policies were adopted which made the Budget situation worse than it might reasonably have been reported.

In any event, accrual accounting data need to be read in conjunction with data from audited Statements of Cash Flows. Overall, Queensland Government agencies have produced positive cash flows . in 2008-09 there was a **cash surplus from continuing operations of \$3.58 billion**.

Whereas in the 2009-10 Budget, Treasurer Fraser claimed that the global financial crisis will result in a 'colossal drop in forecast revenue of more than \$15 billion across the forward estimates', this so-called loss is not from actual revenues but from 'forecasts' over five years. Already the validity of these forecasts is questionable. The audited *Report on State Finances of the Queensland Government 2008-09* shows that revenues for the year ended 30 June were \$1,134 million higher than shown only a couple of weeks earlier in the June Budget Papers.

Claims about a so-called \$15 billion black hole have continued despite the fact that economic conditions have improved since June 2009 . and ignore the Government's claims in its Budget Papers that it has taken measures that will improve the fiscal position by \$5.4 billion over four years.

In assessing the state of Queensland's finances, it must be recognised that Queensland's taxes are 'competitive' relative to other states, with per capita state tax estimated at \$2,087 in 2009-10, compared to an average of \$2,517 for other states and territories. Queensland has a great deal more capacity to raise taxes compared to other states. This paper does not canvass such an option.

In summary, at the time that dire predictions made by the Premier and the Treasurer were made about the alleged crisis in state finances, followed by the announcement of the asset sell off, Queensland's finances were substantially better than presented.

Queensland's debt not excessive and nothing wrong in borrowing to fund infrastructure

Section 2 reviews some of the claims that have been made about **Queensland's level of borrowings** and the supposed 'need' to respond to economic events by selling off assets. It examines the argument that the Government needs to accommodate the wishes of credit rating agencies.

The position taken in this paper is that there is nothing wrong with governments borrowing to finance infrastructure that will be of benefit to current and future generations. That is especially the case if the projects under contemplation . be they toll roads, or rail links, or new investment in public utilities . are also revenue producing.

To place debate about public sector debt in context: it is noted that Australian public sector debt is modest. Australia's net debt to Gross Domestic Product ratio as at June 2009 is **minus 5.3%** (reflecting the fact that debt was exceeded by holdings of financial assets). Even after government stimulus

packages funded by borrowings, net debt as a percent of GDP is projected to be still negative in 2010 . minus 0.1%. This compares very well with the ratios of other countries which are projected to be: UK 61%; Germany 56.9%; USA 69.3%; and Japan 106.6%.

Queensland debt ratios compare well not only in the international context but also in relation to the triple A credit rated NSW.

Standard & Poor's chosen 'measure of debt burden' focuses on its calculation of the ratio of net financial liabilities (net debt plus unfunded pension liabilities) of the *non-financial* public sector (general government plus government-owned enterprises). This fails to recognise the unusual arrangements in Queensland whereby accumulated employer contributions are held by the Queensland Treasury Corporation. Standard & Poor's calculation fails to offset the value of these financial assets (worth \$17 billion at 30 June) against the superannuation liability. A simple adjustment to their ratios would have provided a much more realistic picture.

Impact of changes in credit ratings overstated

In any case, the cost of a one-notch downgrade in credit rating is only around 20 to 30 basis points (i.e. only 20 . 30 per cent of one per cent).

For Queensland the only borrowing to mature in the near future is a loan of \$7,222 million due in May 2010. If interest rates were to increase by 10 basis points due to the downgrade, that would add only \$833,308 to the interest bill for the year ended June 2010. If rates increased by 30 points then the additional cost in the interest bill would be only \$2.5 million . not \$200 million as claimed by the Treasurer. This additional cost is .002 per cent to .006 per cent of general government operating expenses.

However, with the Queensland Government taking up the Commonwealth Government Guarantee, the downgrade is hypothetical except insofar as any fee paid to the Commonwealth for the CGG.

Moreover, it should be noted that the Standard & Poor's downgrade had more to do with the Government's own depressing **forecasts** than any assessment of the **actual** status of the State's finances.

10 misleading claims

Section 3 of the paper reviews some claims made about the impact of the GFC on Queensland's finances, the 'savings' that could eventuate from a sell-off of government businesses that are earning a positive rate of return . and the way the forecast sale proceeds have been presented as a 'magic pudding'. It examines and debunks the following misleading claims:

- Claim #1: How a \$4 billion reduction in forecast revenues became a Budget black hole of \$12 billion, then \$14 billion, then \$15 billion
- Claim #2: There is still a \$15 billion hole in the Budget
- Claim #3: The GFC has 'imposed' on Queensland an additional \$15 billion of debt
- Claim #4: An additional \$15 billion of debt adds \$2 billion a year to future budgets
- Claim #5: Retention of public assets will require \$12 billion in capital investment
- Claim #6: The proceeds of sale will both fund new infrastructure, and repay debt
- Claim #7: Downgrading the credit rating will immediately cost \$200 million annually
- Claim #8: Sell off will save \$750 million every year in interest payments (or is it \$1.8 billion?)
- Claim #9: Just as the Queensland Government got out of owning hotels and butcher shops, it should be prepared to sell state-owned infrastructure
- Claim #10: The sell off would 'save' \$30 billion.

None of these claims can be taken seriously. Some have featured inconsistency and exaggeration. Others have ignored the financial returns that would be enjoyed if government-owned businesses were retained in public ownership . particularly those assets that have the features of natural monopolies and stand to reap the benefits of a revitalised resources boom. Or they have involved adding 'apples' with 'oranges'.

Conclusions: sell-off a bad, unnecessary decision

The public assets listed for sale have been funded and accumulated by past generations. Proposals that they be sold in order to solve a short term revenue shortfall is a serious step that potentially could cost current and future taxpayers billions of dollars in lost value and earnings potential.

It is commonly accepted that government need not maintain budget surpluses at all times, and that it is good practice to run deficits during economic downturns . provided that the budget is restored to a 'balanced' position over the course of an economic cycle.

Moreover, it has become evident from recent experience that governments can incur major losses if they sell public assets for less than what they were worth if retained in public ownership.

Queensland has been blessed with significant natural resources. It stands to reap enormous benefits from the demand for those resources in future years. All the more reason to retain major items of infrastructure - rail, ports, coal loaders and tollways . in public ownership. A sell off of natural monopolies would in financial terms be a fundamentally foolish decision.

There is a fundamental inconsistency in the financial arguments for the sale of these assets. On the one hand, it is claimed that the government has to sell the assets because of the alleged financial crisis facing Queensland. On the other hand, it is asserted that the sales will not occur for several years . when the crisis is expected to be over.

When it comes to the sale of public assets, governments have only one chance to get it wrong.

INTRODUCTION

Sell off a breach of ALP Policy

The privatisation of public assets is contrary to Queensland ALP policy which states clearly:

Labor rejects a program of privatisation of public services, such as public hospitals and schools, public enterprises including subsidiary companies or utilities (in particular Rail, Ports, Public Hospitals, electricity and water) as an economic strategy. (Queensland Branch of the ALP, *2009 Platform*, p. 7).

And specifically:

Privatisation of public enterprises should not be used to solve revenue problems of governments. Labor believes that it is more through improved management of the existing public sector than through privatisation that Government can provide a wide range of benefits to the community (*idem*).

Pre- 2009 election position: sell off not mentioned

Moreover, there was no mention of the privatisation agenda during the March 2009 election campaign - even though when Premier Anna Bligh announced the election on 22 February 2009 on the website, YouTube, she cited:

The unprecedented impact of the global financial crisis on the Queensland economy and the 'continued heightened election speculation threatening the stability that we so desperately need' (Dr Mark Rodrigues, *Queensland election 2009*, Parliamentary Library Research Paper, 2 June 2009, p. 1).

Post-election position: sell off full steam ahead

By 2 June 2009 (two and a half months after the 21 March 2009 election) the economic situation allegedly had such an adverse effect on the Government's finances that it needed to undertake a comprehensive program of asset sales as the main measure aimed at improving Queensland's fiscal position (*2009-10 Queensland Budget Paper No. 2*, p. 1).

This sale program includes:

- the sale of Forestry Plantations Queensland's softwood business and possibly its hardwood plantations;
- the sale of Queensland Motorways Limited's business, incorporating a major upgrade of the Port of Brisbane Motorway;
- the sale of the Port of Brisbane Corporation Limited's business and assets; and
- the sale of QR Limited's above and below rail coal businesses and assets;

- the sale of the Ports Corporation of Queensland Limited, Abbot Point Coal Terminal (*ibid.*, pp. 12, 69).

In addition, the Government has foreshadowed investigating options for the most appropriate way to offer the sale of Queensland Rail, bulk freight, intermodal, retail and regional freight services to the market (*ibid.*, p. 12).

Premier Bligh told the 2009 ALP State Conference on 7 June 2009 that especially when the going gets tough the role of government is to intervene in the economy, not step away (p. 6). Referring to the 2009 election she explained:

Queenslanders made their decision in one of the most unique and ideological elections in recent memory.

• an election fought over the very question of the role of Government.

Labor put the case . . . as it always does . . . that the role of Government is to lend a hand, especially when the going gets tough:

• to stand by working people

• to stimulate the economy

• to invest in building and jobs

• to provide the services people rely on

• to intervene in the economy, not step away (pp. 5-6).

This briefing paper analyses the Bligh Government's privatisation proposals.

The first part of the paper examines ***whether the State's finances are really in trouble***. Claims about Queensland's financial circumstances have bandied about a mixture of what might be described as fact and fantasy . . . some factual information combined with pessimistic projections that have already been shown to be inappropriate. This section of the paper includes an explanation of some key concepts, and then presents data from reports released only last month which show that Queensland's finances remain strong.

Section 2 reviews some of the claims that have been made about ***Queensland's level of borrowings*** and the supposed 'need' to respond to economic events by selling off assets. It examines the argument that the Government needs to accommodate the wishes of credit rating agencies.

Section 3 of the paper reviews some claims made about the 'savings' that could eventuate from a sell-off of government businesses that are earning a positive rate of return . . . and the way the forecast sale proceeds have been presented as a 'magic pudding'.

The final section of the paper presents some observations about the inconsistent and flawed arguments that have been made about privatisation.

1. ARE QUEENSLAND'S FINANCES IN TROUBLE?

The short answer is no.

The longer answer starts with a brief technical explanation of four issues:

- the difference between accrual budgets and cash budgets;
- the scope of the budget . how government budgets focus on a sub-set of government agencies called the 'general government sector', how accrual budgeting is affected by inter-sector transfers, and how a better picture is provided by reports on the whole Queensland 'public sector';
- how accrual budgeting is affected by the choice of accounting methods;
- the difference between budgets and actual results . and how budget deficits depend on the adoption of assumptions about government policies.

Then this paper examines the facts, as contained in audited financial statements for the Queensland public sector.

Budget presentation techniques

Accrual budgeting: Queensland, along with the Commonwealth and other Australian states and territories, now uses accrual budgeting . a system that takes into account moneys owed and owing, rather than simply recording cash receipts and payments. Accrual budgeting - and reports on budget results using accrual accounting - also distinguish 'expenses' and the acquisition of assets. Conversely cash received from the sale of assets would not be regarded as 'revenue' but as the substitution of one asset for another (save for the extent that sale proceeds exceed recorded book values of those assets).

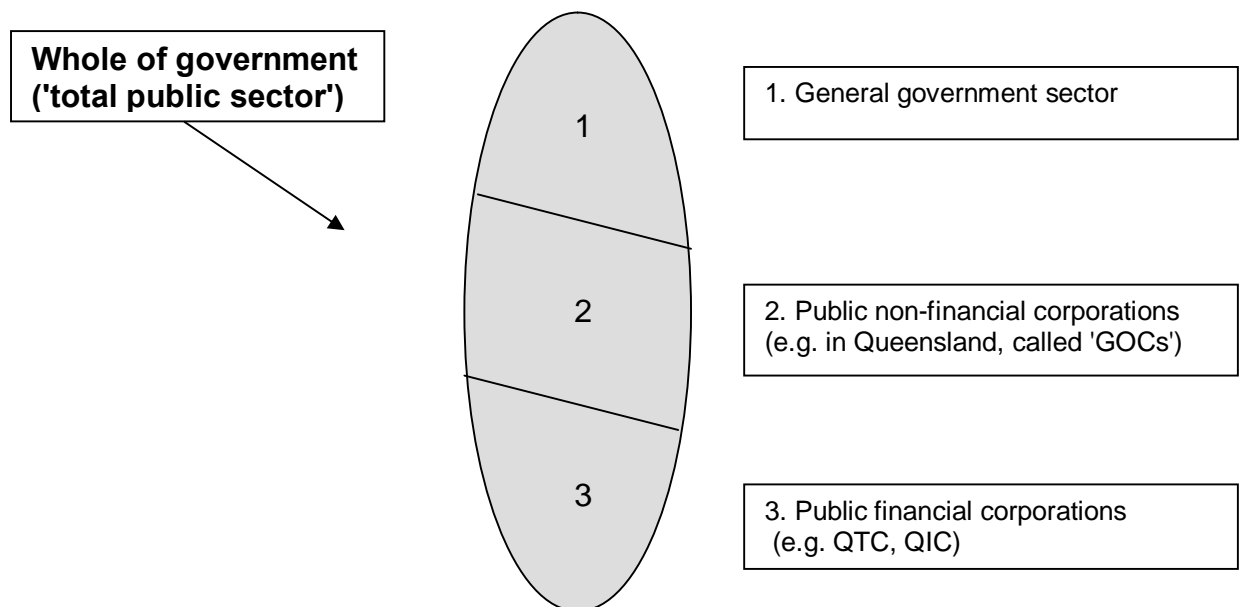
At the same time, Queensland also produces a statement of cash flows . presenting budget results on the same 'cash accounting' basis that was commonly used in the Australia public sector until the last decade or so . but with one important distinction. The 'statement of cash flows' distinguishes cash flows from operating, financing and investing activities. That is important when examining the facts about Queensland's finances . and claims that the recent financial turmoil compels the need for a fire sale of public-owned assets.

Scope of the budget: Arguably the most reported and debated financial reports produced by Australian governments are the 'budgets' that are provided to Parliament as the basis for Bills that appropriate funds to government departments and other agencies.

But, as is evident from the following diagram, the general government sector is only part of the overall public sector. Other agencies are described as 'Public non-financial corporations' and 'Public financial corporations').

'Public non-financial corporations' (formerly termed 'Non-financial public trading enterprises') include agencies that are primarily reliant on user charges rather than budgetary allocations to finance their operations. In Queensland, they are often termed Government-owned corporations ('GOCs') . though in terms of international reporting standards the sector can encompass entities such as statutory authorities and other agencies (not just those constituted in state legislation as 'corporations').

As the name suggests, 'Public financial corporations' are entities that are primarily engaged in handling borrowings or investments on the part of other agencies. Some Australian governments established 'Public financial corporations' to centralise borrowing arrangements. Queensland Treasury Corporation has such a role. Queensland Investment Corporation Limited (formerly known as QIC Limited) has an unusual role, insofar as it has managed investments that are earmarked to meet certain public sector defined benefit superannuation commitments . though this responsibility was transferred to the Queensland Treasury Corporation in the past financial year. More on that later.



These days, when the government presents a 'budget' and refers to a surplus or deficit, it is only talking about the forecast or actual financial results of the 'general government sector'. Obviously that is only part of the government's financial activities . the part that is substantially funded by taxpayers' funds as allocated by Parliament via budget appropriation bills.

But the budgets and financial results of the general government sector can be affected (some would say, 'manipulated') by inter-sector transfers. For example state-owned corporations (or GOCs) can be required to pay dividends or return capital to the consolidated fund - and hence 'improve' the results for the general government sector. At the same time, state-owned corporations can be required to carry high levels of borrowings in their balance sheets, and hence bear interest expenses that might otherwise be borne by the Treasury Department or elsewhere within the general government sector.

(State governments may also require local councils to assume responsibility for certain functions that previously they undertook themselves. Even though state governments effectively control local councils, they do not prepare financial statements encompassing the financial results and position of those entities.)

A better indication of how the government of a particular state or territory is travelling financially is to look at the financial results of the 'whole of government' . the total public sector, encompassing the results of all state-sector government agencies, including government businesses (such as Queensland Rail). That said, the reported results under a regime of accrual accounting can depend on the choice of accounting methods.

Choice of accounting policies: As in the private sector, public sector agencies have some discretion as to what methods are applied in the preparation of 'accrual' based reports. For example, some minor expenditures might be incurred in the acquisition of assets but for convenience are not regarded as 'material' and are recorded as 'expenses' within a reporting period. Or the value of certain asset items might be reduced by depreciation charges over their useful lives . so that choices have to be made about the rate of depreciation to be recorded, the estimated useful life of these assets, and their salvage value.

Budget projections versus 'actual' results: When reading reports about government finances, a distinction needs to be drawn between **forecast financial results** (or estimates) and **actual financial results**. And critical attention should also be given to any report that refers to a 'hole in the budget' (while reports about 'black holes' should be read with the utmost scepticism).

A budget deficit simply means that revenues are forecast to be less than expenses. Forecasts are not 'facts'. Nevertheless, forecasting is a useful tool for the management of government finances. While much government expenditure is pre-committed, budget deficits can be reduced or even reversed by increasing controllable revenues, or cutting expenses.

Another cautionary note: economic managers (and politicians) may wish to shape perceptions by carefully exaggerating the impact of external events or the generosity of their decisions. Rather than refer to extra expenditure on a particular program in Budget Papers of (say)

\$25 million per annum, increasing to \$100 million per annum next year and thereafter.

it sounds more generous if it is expressed as

\$400 million over four years.

The same goes for 'bad news' scenarios. If revenues have crashed as the product of external events (such as the GFC) the current year's shortfall can easily be extrapolated over four or more years. Hence a forecast \$3.75 billion shortfall in year one can magically become

A forecast revenue shortfall of \$15 billion over four years.

Then a few words can be deleted, so that it becomes:

A budget deficit of \$15 billion

or even

A hole in the budget of \$15 billion

or worse

A budget black hole of \$15 billion.

Queensland's financial results: General government sector

But let us examine Queensland's actual financial results, as presented in the *Report on State Finances* for the last four years.

The operating results for the general government sector showed a pattern of surpluses from continuing operations until 2007-08.

Table 1
General Government Sector

	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m
Continuing operations				
Revenues	30,084	33,313	32,824	37,008
Expenses	(26,370)	(30,026)	(32,928)	(36,974)
Operating result from continuing operations	3,714	3,287	(104)	34
Gains/losses from asset sales / revaluations / impairment adjustments; surplus (deficit) from discontinued operations		32	(250)	(122)
Surplus/(deficit)	3,714	3,319	(354)	(88)

Source: *Report on State Finances of the Queensland Government* 2005-06, 2006-07, 2007-08 and 2008-09. It was noted that comparative figures in the financial statements reflected some adjustments to the results reported in prior years, but as these did not alter trends, the data in the table is as originally reported in audited financial statements for those years.

Rather than a 2008-09 Budget deficit forecast of \$1.573 billion or a revised deficit of \$574 million, the result for the year ended 2008-09 was a surplus from continuing operations of \$34 million, which after a series of adjustments (including downward adjustments to the value of assets) produced a relatively modest deficit on an accrual accounting basis of only \$88 million. The Statement of Cash Flows for the general government sector tells an even better story . showing a significant cash flow surplus from operating activities of \$3.7 billion.

Table 2
General Government Sector:
Cash Flows from Operations

	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m
Cash flows from operating activities	7,447	6,297	396	3,716

Source: *Report on State Finances of the Queensland Government*, 2005-06 p. 4-10; 2006-07 p. 4-10; 2007-08 p. 4-10; 2008-09 p. 4-08.

In other words, the agencies covered by the State Budget have consistently produced a cash flow surplus over the past four years, including 2008-09 - notwithstanding the global financial crisis. That cash surplus together with borrowings was mainly re-invested in social infrastructure . the cash flow statements shows that in 2008-09 purchases of non financial assets totalled \$6.96 billion.

Queensland's financial results: Whole of government sector

Table 3 presents the results for the whole of government.

Table 3
Whole of Government Sector

	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m
Continuing operations	35,560	41,116	40,494	43,961
Revenues	35,560	41,116	40,494	43,961
Expenses	-30,658	-37,975	-41,613	-46,533
Operating result from continuing operations	4,902	3,141	-1,119	-2,572
Gains/losses from asset sales / revaluations / impairment adjustments; surplus (deficit) from discontinued operations	(61)	2,244	352	(4,413)
Surplus/(deficit)	4,841	5,385	(767)	(6,984)

Source: *Report on State Finances of the Queensland Government 2005-06, 2006-07, 2007-08 and 2008-09.*

At first glance these results seem alarming, particularly the deficit in 2008-09. However the major components of this deficit were write-downs in the value of assets held by the public financial corporations, that may simply reflect a short-term deterioration in asset values, and a somewhat pessimistic assessment of the extent to which the value of assets had been 'impaired' having regard to what was a fairly bleak outlook last June.

Furthermore, it appears that government agencies have 'expensed' amounts of interest on borrowings during the construction period of new infrastructure. This is contrary to the requirements of international accounting standards. Australian Accounting Standard AASB 123 'Borrowing Costs' (June 2007) provides for interest on qualifying assets to be capitalised during the construction period (i.e. added to the cost of the asset being constructed). A 'qualifying asset' is defined as an asset that 'necessarily takes an extended period of time to get ready before its intended use or sale'. The sum of construction costs (including interest) would then be depreciated over the useful life of the asset.

If this had been done, the accrual based Budget could have been in surplus . as explained below.

Accounting standard AASB 123 is the Australian equivalent of an international accounting standard (IAS 3) that has been in place since 1993. When issued in Australia it was stated that it could be applied to annual reports for periods beginning on or after 1 January 2005, but was to be mandatory from 1 January 2009.

The Queensland Government has chosen not to apply AASB 123 in its financial statements (and budgets). The effect of non-implementation of AASB 123 has been to substantially increase the reported deficit as calculated on an accrual basis. The *Report on State Finances of the Queensland Government – 30 June 2008* stated (within 19 pages of notes about 'significant accounting policies') that the State has not adopted this standard but acknowledged that the effect would have a material impact on the amounts recognised in the financial statements. The report avoided quantifying that impact on the ground that it had elected only to apply the accounting standard to projects with a commencement date on or after 1 July 2009. (Subsequently its mandatory application date has been further delayed.)

A rough estimate of the effect of the chosen accounting policy is as follows: according to successive *Reports on State Finances*, the State has spent close to \$40 billion on new non-financial assets in the three years from July 2006.

Table 4
Payments for Investments in Non-financial Assets

Year	General Government Sector \$m	Public Non-financial Corporations \$m
2006-07	4,418	6,363
2007-08	5,716	8,132
2008-09	6,960	8,353
	17,094	22,848

Source: *Report on State Finances of the Queensland Government*, 2006-07 p. 4-10; 2007-08 p.4-10; 2008-09 p. 4-08.

Much of this investment was financed by new borrowings:

Table 5
Net Borrowings by Sector

Year	General Government Sector \$m	Public Non-financial Corporations \$m
2006-07	-262	3,792
2007-08	4,175	5,067
2008-09	3,728	7,141
	7,641	16,000

Source: *Report on State Finances of the Queensland Government*, 2006-07 p. 4-10; 2007-08 p.4-10; 2008-09 p. 4-08.

It seems reasonable to suppose that the bulk of the new investment would have been in 'qualifying assets', and that at least the finance costs associated with 'new borrowings' could therefore have been capitalised. If it assumed that borrowings were at (say) an average rate of 6.5% then interest on these borrowings would have amounted to **around \$242 million for the general government sector in 2008-09, and \$464 million for the public non-financial sector in 2008-09**. Had these borrowing costs been 'capitalised' as required by international accounting standards, **the reported general government deficit of \$88 million on an accrual basis for 2008-09 would actually have been a surplus**, while the (often overlooked) deficit for the 'whole of government' would also have been substantially reduced.

On the face of it, Treasury officials adopted accounting policies which made the Budget situation worse than it might reasonably have been reported. Possibly the Treasurer and other Ministers were unaware of this. After all, many users of financial data take audited figures at face value.

In any event, these accrual accounting data need to be read in conjunction with data from the audited Statements of Cash Flows, summarised below:

Table 6
Whole of Government
Extracts - Statements of Cash Flows

	2005-06 \$m	2006-07 \$m	2007-08 \$m	2008-09 \$m
Cash flows from continuing operations	9,133	8,833	2,509	3,577

Source: *Report on State Finances of the Queensland Government*, 2006-07 p. 5-11; 2007-08 p. 5-11; 2008-09 p. 7-04. Again, data in the table is as originally reported in audited financial statements for those years.

The cash flow data confirms that overall, Queensland Government agencies have produced positive cash flows. The difference between the cash flow data and the accrual accounting data reflects a range of factors . charges for depreciation, and impairment write-downs or losses on investments etc . some of which have since been reversed.

Queensland's 2009-10 Budget

The \$15 billion revenue magic wipeout - fact or forecast? In the 2009-10 Budget, Treasurer Andrew Fraser claimed that the global financial crisis will result in a

colossal drop in forecast revenue of more than \$15 billion across the forward estimates (2009-10 Queensland Budget Paper No.1, p. 3).

Thus was repeated in Budget Paper No. 2:

Since the 2008-09 Budget, this downturn has stripped \$15 billion off the forward estimates of the State's key revenue streams of royalties, taxes and GST (2009-10 Queensland Budget Paper No.2, p. 1).

Note the so-called \$15 billion loss is not from actual revenue but **'forecast'** revenue. Even by its own admission this so-called loss includes the revision of forecasts because of the fact that ~~royalty revenue~~ was ~~never~~ forecast to stay at record highs (2009-10 Queensland Budget Paper No.1, p. 3).

And it is not for one year but across the **'forward estimates'**. According to Budget Paper No. 2 this downward revision is ~~across~~ the period 2008-09 to 2011-12' [sic]. Presumably it meant ~~to~~ 2012-13 since that is the forward estimates period (p. 87). That is, over **five years**.

Total General Government Sector Revenue was expected to move as follows.

Table 7
General Government Revenue

2008-09 Budget \$m	2008-09 Est. Act. \$m	2009-10 Budget \$m	2010-11 Projection \$m	2011-12 Projection \$m	2012-13 Projection \$m
36,582	35,874	37,192	37,029	38,100	40,431

Note: Figures for 2010-11 to 2012-13 are Forward Estimates.

Source: 2009-10 Budget Paper No. 2, p. 88.

The Government stated that the increase in 2009-10 primarily reflected increased Australian Government funding for specific purposes (p. 87).

However, as noted above, the projected revenue figures presented in the 16 June 2009 Budget should be taken with a grain of salt since the actual revenues for 2008-09 as presented in the audited *Report on State Finances of the Queensland Government 2008-09* were \$37,008 million or \$1,134 million higher than shown in the Budget Papers.

Moreover, the estimates were formulated on a no policy change basis (p. 88).

At the same time, the Budget Papers proudly stated that Queensland will retain its competitive tax status, with per capita state tax estimated at \$2,087 in 2009-10, compared to an average of \$2,517 for the other states and territories (p. 87).

A comparison with the other states together with the average tax per capita is shown below. The table shows that Queensland has a great deal more capacity to raise taxes compared to other states.

Table 8
Queensland's Tax Competitiveness

	QLD	NSW	VIC	WA	SA	TAS	ACT	NT	Avg
Taxation per capita (\$)	2,087	2,645	2,434	2,557	2,164	1,605	2,883	1,788	2,487
Taxation effort (%)	85.6	104.8	101.9	102.8	111.8	92.7	107.5	102.5	100.00
Taxation % of GSP (%)	4.46	5.16	4.80	4.04	4.87	3.90	4.41	2.53	4.75

Note: 'Taxation effort' reflects the revenue raising effort ratios assessed by the Commonwealth Grants Commission. The ratios isolate policy impacts from revenue capacity impacts and are an indicator of the extent to which the governments burden their revenue bases. Queensland's tax revenue raising effort is well below the Australian policy standard (equal to 100%) (2007-08 data: *Commonwealth Grants Commission: 2009 Update*).

Source: 2009-10 Budget Paper No. 2, p. 105.

Claims about the so-called \$15 billion black hole in the budget have continued to this day despite the fact that economic conditions have improved since June 2009, and that revenues are expected to improve further during the forward estimates period. The claims also ignore the measures announced

by the Government in the last Budget that will improve the fiscal position by \$5.4 billion over four years.

What all this means is that at the time of the dire predictions made by the Premier and the Treasurer followed by the announcement of the asset sell off, Queensland's finances were better than presented. This has significant implications for the credibility placed on the projections contained in the 2009-10 Budget.

2. QUEENSLAND'S BORROWINGS – AND THE RATING AGENCIES

The idea of reducing government debt has shaped a lot of political debate for some time. Until recently many viewed with alarm any suggestions that governments should borrow to fund long term investment in infrastructure. Some still do.

But there is nothing wrong with governments borrowing to finance infrastructure that will be of benefit to current and future generations. That is especially the case if the projects under contemplation . be they toll roads, or rail links, or new investment in public utilities . are also revenue producing. For that reason, many applauded the Bligh Government for its determination to borrow to invest in much-needed infrastructure. This is especially so since population increases in the state have established a need for greater investment on hospitals, schools and transport.

Arguably, Australian politicians have tended to borrow political themes that have worked elsewhere, particularly in the UK. The UK economy had high levels of borrowings and needed to do something about it. Similarly European economies had run up levels of debt . so that the Maastricht Treaty required members of the European Union to reduce debt levels to more affordable and sustainable levels. The internationally accepted indicator relates general government net financial liabilities as a percentage of gross domestic product (GDP). The target set for the European Union was 60% of Gross National Product.

In comparison, Australian public sector debt has been modest. Australia's net debt to GDP ratio in 2000 was 7.3% - one of the lowest in the world, and far lower than that for the United States (40.6%), Japan (46.4%), or the average of all European or OECD countries (55.6% and 44.9% respectively).

Thanks to the recent resources boom, Australia's levels of debt fell even further (until the global financial crisis prompted massive spending to avert a recession). Even so, Australia still has a surplus of financial assets over liabilities compared with significant net debt to GDP ratios for other developed countries (as shown below).

Table 9
Net Debt as a Proportion of Gross Domestic Product

	Net Debt as % of GDP 2008	Net Debt as % of GDP 2009	Net Debt as % of GDP 2010
UK	33.6%	47.5%	61.0%
Germany	45.1%	51.1%	56.9%
USA	48.2%	59.0%	69.3%
Japan	84.3%	97.1%	106.6%
Average of OECD	42.2%	51.1%	59.5%
Average of European Union	44.7%	51.5%	57.9%
Australia	-7.4%	-5.3%	-0.1%

Source: *OECD Economic Outlook 85 database*, June 2009.

The Budget Papers refer to a ratio of *net financial liabilities to revenue* as this concept is used by the credit ratings agency Standard & Poor's to assess financial sustainability (2009-10 Queensland Budget Paper No. 2, p. 5). It is stated that this ratio is expected to be 117% at the end of 2009-10 and to stabilise at below 130% after completion of the asset sale program (p. 5). The Papers concede that this measure differs from that used in the Uniform Presentation Framework tables. Using the data in the latter tables shows this ratio as follows.

Table 10
Queensland General Government Net Financial Liabilities to Revenue

	2008-09 Est. Act. \$m	2009-10 Budget \$m	2010-11 Projection \$m	2011-12 Projection \$m	2012-13 Projection \$m
Net financial liabilities	12,391	20,999	29,691	36,555	40,525
Revenue	35,874	37,192	37,029	38,100	40,431
Net financial liabilities/Revenue	34.5%	56.5%	72.01%	95.9%	100.2%

Source: 2009-10 Budget Paper No. 2, pp. 174, 177.

A comparison with triple A credit rated NSW on the same basis (see Table 11 below) shows a significantly higher ratio than Queensland for all the years except the last two forward estimates years. However, this appears to be attributable to Queensland's understatement of forecast revenues. The 2009-10 Budget forecasts revenues to grow at an average of 3.2% over the four years ended 2012-13. In the five years to 2006-07, growth in revenues averaged 11.45% - granted with an unusually high increase in 2003-04. However, even excluding that year shows an average increase of 8.1% (p. 184). While growth rates are expected to be lower during a downturn, recent events indicate that the downturn is not expected to be as deep or as protracted as previously assumed.

Table 11
NSW General Government Net Financial Liabilities to Revenue

	2008-09 Revised \$m	2009-10 Budget \$m	2010-11 Projection \$m	2011-12 Projection \$m	2012-13 Projection \$m
Net financial liabilities	50,261	53,837	53,719	55,050	55,705
Revenue	48,818	52,958	55,322	57,170	59,365
Net financial liabilities/Revenue	103.0%	101.7%	97.1%	96.3%	93.8%

Source: 2009-10 Budget Paper No. 2, pp. 9-10, 9-15.

Let's take another look at Standard & Poor's 'trigger' for a downgrade: the ratio of net financial liabilities to revenue. Standard & Poor's refers to what it calls a 'measure of debt burden':

net financial liabilities (net debt plus unfunded pension liabilities) of the non-financial public sector (general government plus government-owned enterprises) (Standard & Poor's, *Credit FAQ: How Stable is the Credit Quality of the Australian States?* 17 March 2009, p. 4)

The *Report on State Finances 2008-09* shows the financial position of the non-financial public sector . and liabilities include 'Superannuation - \$23.554 billion' (p. 4-07). This is a net figure . after deducting from the gross liability which is estimated at \$28.90 billion the value of superannuation plan assets held within the 'non-financial public sector' of some \$5.47 billion.

However as noted earlier, Queensland Investment Corporation Limited had a role in managing funds accumulated from *employer* contributions to meet certain public sector defined benefit superannuation commitments. According to the Queensland Treasury Corporation's *Blue Book*,

on 1 July 2008 the Queensland Government transferred to QTC approximately \$21 billion of the State's long term assets, *which are held to meet the future superannuation and other long-term obligations of the State*. These assets are managed by Queensland Investment Corporation (QIC) (p. 41, emphasis added).

(In the 2009 QTC annual report, 'long term assets' were valued at 'fair value' and had been reduced to \$17.47 billion principally because of asset write-downs - see p. 27 and pp. 40-41.)

Both QIC and the QTC are within the *financial* public sector. Hence their holdings of superannuation assets would not have been offset against the \$23.554 billion superannuation liability recorded in the *non-financial* public sector for the purpose of the Standard & Poor's calculations.

Standard & Poor's chosen 'measure of debt burden' fails to offset these asset holdings of around \$17 billion against the superannuation liability.

In short, Standard & Poor's calculation of the ratio of 'net debt/operating revenue' is distorted by the overstatement of 'net debt' by \$17 billion (or more, given that the values of the investments held by QTC are likely to have increased materially since 30 June 2009). A simple adjustment to their ratios . offsetting QTC's asset holdings against the recorded liability for superannuation - would have provided a much more realistic picture of the 'debt burden'.

Indeed, such a presentation may have even avoided the downgrade in Queensland's credit rating.

* * *

In any case, as noted above, the measure more commonly used internationally to calculate financial sustainability is *net debt as a proportion of Gross Domestic Product or Gross State Product*.

Net debt is the sum of advances received and borrowings less cash and deposits, advances paid and investments, loans and placements (*2009-10 Budget Paper No. 2*, p. 45, p. 136). The data shows that Queensland General Government net debt is negative. That is, it has a surplus of financial assets over financial liabilities. This surplus was \$17,808 million in 2008-09 and estimated at \$10,672 million in 2009-10 and \$2,796 million in 2010-11. It is only in 2011-12 that debt is estimated to exceed financial assets by \$2,749 million, increasing to \$5,901 million in 2012-13.

Table 12
Queensland General Government Net Debt

	2008-09 Est. Act. \$m	2009-10 Budget \$m	2010-11 Projection \$m	2011-12 Projection \$m	2012-13 Projection \$m
Queensland net debt	(17,808)	(10,672)	(2,796)	2,749	5,901
% of GSP	-8.4%	-5.0%	-1.3%	1.3%	2.8%

Note: Gross State Product (GSP) used in the calculations is as at March 2009. The ratios would be even lower if estimates of GSP were to be adjusted for growth in subsequent years.

Source: *2009-10 Budget Paper No. 2*, p. 42; Queensland Treasury Corporation 'Blue Book', 2009.

This means that General Government net debt as a proportion of Gross Domestic Product was -8.4% in 2008-09 and estimated to increase to just 2.8% by 2012-13.

This compares favourably with NSW at 2.2% in 2008-09 increasing to 3.6% by 2012-13.

Table 13
NSW General Government Net Debt

	2008-09 Est. Act. \$m	2009-10 Budget \$m	2010-11 Projection \$m	2011-12 Projection \$m	2012-13 Projection \$m
NSW net debt	8,087	12,821	15,100	15,826	15,756
% of GSP	2.2%	3.4%	3.9%	3.8%	3.6%

Source: *2009-10 Budget Paper No. 2*, p. 7-9.

Queensland's own Budget Papers state that:

The extent of accumulated net debt is used to judge the overall strength of a jurisdiction's fiscal position (*2009-10 Budget Paper No. 2*, p. 136).

And that:

Queensland's negative net debt of \$2,398 per capita compares to the weighted average net debt of \$1,189 per capita in the other states. This indicates the strength of Queensland's financial position relative to the other states (*2009-10 Budget Paper No. 2*, p. 136).

A comparison of projected net debt per capital at 30 June 2010 for all states is shown below.

Table 14
Projected Net Debt Per Capita at 30 June 2010

	QLD	NSW	VIC	WA	SA	TAS
Net debt per capita (\$)	2,087	2,645	2,434	2,557	2,164	1,605

Note: 'Taxation effort' reflects the revenue raising effort ratios assessed by the Commonwealth Grants Commission. The ratios isolate policy impacts from revenue capacity impacts and are an indicator of the extent to which the governments burden their revenue bases. Queensland's tax revenue raising effort is well below the Australian policy standard (equal to 100%) (2007-08 data: *Commonwealth Grants Commission: 2009 Update*).

Source: 2009-10 Budget Paper No. 2, p. 105.

Moreover, it should be remembered that the ratios for Queensland are after a significant forecast increase in State borrowings as follows.

Table 15
Queensland General Government Borrowings

2007-08 Actual \$m	2008-09 Est. Act. \$m	2009-10 Budget \$m	2010-11 Projection \$m	2011-12 Projection \$m	2012-13 Projection \$m
6,328	10,765	18,775	27,898	34,707	39,234

Source: 2009-10 Budget Paper No. 2, p. 42.

Credit Ratings

The State of Queensland is rated by two ratings agencies, namely, Moody's Investors Service Limited and Standard & Poor's.

Those ratings are highly dependent on the rating of the Commonwealth of Australia (for example, a State's credit rating cannot be higher than the Commonwealth's).

In February 2009, Standard & Poor's downgraded the State's AAA credit rating to AA+, while Moody's placed its rating under review for possible downgrade. In explaining the downgrade, Standard & Poor's said that it reflected:

the **projected** [emphasis added] deterioration of the state's budgetary performance and increasing net financial liabilities (Standard & Poor's Press Release, 20 February 2009).

And while stating that

Queensland's balance sheet remains strong (*idem*).

it then said that:

Queensland's balance sheet is **unlikely** [emphasis added] to remain consistent with a 'AAA' rating as Standard & Poor's has previously indicated that the rating would be reassessed if net financial liabilities as a proportion of operating revenue reach 100%-

110%. Given the forecasts released in today's economic and fiscal strategy, it is **likely** [emphasis added] that this number will be breached (*idem*).

On the basis of these statements, it appears that the Standard & Poor's downgrade had more to do with the Government's own depressing **forecasts** than any assessment of the **actual** status of the State's finances.

Treasurer Andrew Fraser immediately responded saying:

the Government's interest rate payments on its total borrowings will increase by about \$200 million next financial year because the state's credit rating had been downgraded (ABC News, 21 February 2009).

At the same time, then Opposition Leader Lawrence Springborg said:

What this basically means is that the Queensland State Government will be lining at the bottom of the queue at the pawn shop to get its money while other Australian states and territories that are AAA rated will be lining up at the front of the queue with our banks, to get their money cheaper (ABC News, 21 February 2009).

Both were wrong.

Moody's followed with a downgrade to AA1 in May 2009. In doing so, Moody's emphasised that the State had been forecasting a deficit position before the economic downturn but had no medium-term strategy to restore financial performance. In a media release issued on 20 May 2009 it described the rating outlook as stable and stated in part:

The state had been forecasting a deficit position (on a cash basis) before the current economic downturn largely due to rapid growth in current spending and an ambitious A\$54 billion four-year capital expenditure program. The emergence of the economic downturn created further budgetary pressures depressing state revenues.

As a result, the state is expected to produce a series of very large, recurring deficits. The widening budget gaps and the resulting additional borrowing that is being projected place the state on a debt trajectory that is no longer consistent with Aaa debt metrics.

The lack of a medium-term strategy to restore budgetary performance and financial flexibility also contributes to the rating downgrade.

Queensland retains strong credit quality features which support the stable outlook on the Aa1 rating including, ample discretionary budgetary powers, commonwealth government support, significant levels of internal liquidity and a diverse economic base (*Moody's Lowers Queensland's Rating to Aa1*, 20 May 2009).

Moody's also noted that:

the Commonwealth Government is now considering the introduction of a guarantee facility for state and territory government domestic currency debt obligations. Should this initiative be implemented, and should the state of Queensland utilize this guarantee facility, Moody's will assess the rating impact on the debt instruments affected at that time (*idem*).

On 25 March 2009, the Commonwealth Government announced that it would provide a time limited, voluntary guarantee over Australian State and Territory government borrowing. The guarantee is available for both existing and new issuances of securities over a range of maturities, but does not extend to issuances denominated in foreign currencies.

On 16 June 2009, the Queensland Government announced that it will take up the Commonwealth's offer of the guarantee on all existing AUD denominated benchmark bond lines (global and domestic) issued by QTC [Queensland Treasury Corporation] with a maturity date of between 12 months and 180 months. The Government also advised that it will consider selectively taking up the guarantee for new AUD debt which meets the guarantee criteria, but reserved the right to issue non-guaranteed bond lines (Queensland Treasury Corporation 'Blue Book').

The following shows the current ratings of debt securities issued by Australian governments.

Table 16
State Credit Ratings

State	Credit Rating
NSW	AAA
Victoria	AAA
Queensland	AA+
South Australia	AAA
Western Australia	AAA
Tasmania	AA+
ACT	AAA

Note: The Northern Territory is not rated.

Source: Standard & Poor's, *Submission to Senate Select Committee on State Government Financial Management*, 19 March 2008; Standard & Poor's Media Release, February 2009.

Standard & Poor's claims that it 'rates about 190 sub-sovereign governments in the developed world outside the United States and only 16% are rated AAA'. Moreover, according to Standard & Poor's an analysis of its database of 13,162 companies that it first rated as at 31 December 1980 or that were first rated between that date and 31 December 2007, found the following default rates:

- 0.5% of entities rated AAA had defaulted within seven years;
- 0.6% of entities rated AA;
- 1.3% of entities rated A;
- 4.2% of entities rated BBB;
- 15.4% of entities rated BB;
- 29.9% of entities rated B; and
- 50.2% of entities rated CCC/C.

It is important to note that the difference between credit ratings at the top end of the scale is minimal. Even Standard & Poor's, in referring to Tasmania's one notch lower AA+ rating, has stated:

Tasmania is rated 'AA+', a rating which differs from 'AAA' only to a small degree and represents a very strong ability to meet a financial commitment (Standard & Poor's, Submission to Senate Select Committee on State Government Financial Management, 19 March 2008).

The impact of a downgrading of a credit rating was discussed at length in our book, *Privatisation: Sell Off or Sell Out?* We cited a NSW Treasury publication (D. Nicholls, *Managing State Finance*, 1991) which suggested that a downgrading of NSW's credit rating by one notch (to AA+) would only increase borrowing costs by 15 to 20 basis points, equivalent to an extra interest bill of \$30 to \$40 million per annum. The 1999-2000 NSW Budget Papers claimed that retaining the Triple A credit rating saves NSW up to \$30 million per annum (at a time when Gross State Debt was reported to be almost \$31 billion). However these estimates appear to assume that all debt would be rolled over at once and interest charged on new borrowings at the higher rate. As we wrote previously:

In the event of a downgrading, existing borrowings would be unaffected and the financial impact of any re-rating would only be incurred as existing debt was rolled over. A government's debt can never be rolled over in a single year.

Of course, increases would also apply to other debt as it was rolled over and to any new borrowings undertaken to fund much-needed new infrastructure. But conversely, if that infrastructure generated revenues in excess of the interest payments the State's finances would actually be strengthened.

For Queensland, any additional interest payments attributable to the downgrade would be affected by the profile of outstanding debt. The profile for domestic and global bonds issued in Australian dollars and 'comprising in excess of 90% of total borrowings as at 30 June 2009' (*Queensland Treasury Corporation Annual Report 2008-09*, p. 14) is as follows.

Table 17
Queensland AUD Bonds, outstanding by maturity: as at 31 August 2009

Maturity Date	Interest Rate %	Domestic \$m	Global \$m	Total \$m
14 May 10	5.5	6,986	236	7,222
14 Jun 11	6.0	7,779	1,513	9,292
16 Apr 12	6.5	4,570	0	4,570
14 Aug 13	6.0	8,302	799	9,101
14 Oct 15	6.0	7,977	1,244	9,221
14 Sep 17	6.0	5,385	711	6,096
14 Jun 19	6.25	3,336	0	3,336
14 Jun 21	6.0	2,262	0	2,262
20 Aug 30	2.75	663	0	663
14 Mar 33	6.5	607	0	607
		47,866	4,502	52,368

Note: The Commonwealth Government Guarantee (CGG) applies to all existing (as at 30 July 2009) AUD benchmark bonds, maturing within 12 and 180 months (15 years). Thus the CGG applies to all the above issues other than the one maturing on 14 May 2010. The CGG may be applied to future bond lines.

Source: *Queensland Treasury Corporation Blue Book*, p. 51.

The above table shows that the only borrowing to mature in the near future is a loan of \$7,222 million due in May 2010. If interest rates were to increase by 10 basis points due to the downgrade, that would add only \$833,308 to the interest bill for the year ended June 2010. If rates increased by 30 points then the additional cost in the interest bill would be only \$2.5 million . not \$200 million as claimed by the Treasurer.

However, with the Queensland Government taking up the Commonwealth Government Guarantee, the downgrade is hypothetical except insofar as any fee paid to the Commonwealth for the CGG.

3. 10 MISLEADING CLAIMS ABOUT QUEENSLAND'S FINANCES

A review of media reports and published documents has identified a series of extravagant and exaggerated statements about the State's finances. The following lists the 'top 10' misleading claims.

Claim #1: How a \$4 billion reduction in forecast revenues became a budget black hole of \$12 billion, then \$14 billion, then \$15 billion ...

As noted in the annual report of QTC, the Treasury Mid-Year Fiscal and Economic Review in December 2008 referred to a forecast reduction in state revenue over four years of \$4 billion. In February 2009 Treasury's forecast escalated to \$12 billion (as cited in *QTC Annual Report 2008-09*, p. 12).

On 2 June 2009, in trying to justify the decision for the sell off, a Joint Statement of the Premier and Treasurer referred to

the economic meltdown which has punched a \$14 billion hole in government revenue (*Renewing Queensland: Future Investment Plan*, 2 June 2009).

Again, it claimed there was

a \$14 billion hole in our revenue over the next four years (*idem*).

By 16 June 2009, the 2009-10 Budget Papers were referring to a \$15 billion shortfall. Treasurer Andrew Fraser claimed that the global financial crisis will result in a

colossal drop in forecast revenue of more than \$15 billion across the forward estimates (*2009-10 Budget Paper No. 1*, p. 3).

This was repeated in *Budget Paper No. 2*:

Since the 2008-09 Budget, this downturn has stripped \$15 billion off the forward estimates of the State's key revenue streams of royalties, taxes and GST (*2009-10 Budget Paper No. 2*, p. 1).

Subsequent communications repeated the \$15 billion figure:

What has the global recession meant for Queensland? It's wiped \$15 billion off our revenues (*Caucus Brief*, October 2009).

In the same Caucus Brief

But the global financial crisis wiped \$15 billion from our revenues in about 6 months (*Caucus Brief*, October 2009).

Comment: Things have improved since the depths of the economic crisis. In the last annual report of the Queensland Treasury Corporation (apparently signed around 19 August 2009) QTC's chairman acknowledged that

the worst of the financial crisis appears to be behind us (p. 12).

However the so-called \$15 billion loss is not from a decline in **actual** receipts but an adjustment to **forecast** revenue. Even by its own admission this so-called loss includes the revision of forecasts because of the fact that ~~royalty~~ revenue was never forecast to stay at record highs (2009-10 Budget Paper No. 1, p. 3).

And it is not for one year but across the '**forward estimates**'. According to Budget Paper No. 2 this downward revision is ~~across~~ the period 2008-09 to 2011-12' [sic]. Presumably it meant ~~to~~ 2012-13 since that is the forward estimates period (p. 87). That is, over **five years**.

Claim #2: There is still a \$15 billion hole in the Budget

Writing in *The Courier Mail* Premier Bligh stated:

the global financial crisis ~~o~~ blew a \$15 billion hole in our Budget, and cost us our AAA credit rating (*Queensland asset sell off the only choice: Anna Bligh*, 26 October 2009).

In a statement issued jointly with the Treasurer on the same day (unveiling a campaign called the 'The Myths v The Facts') Ms Bligh claimed that:

the global financial crisis cut \$15 billion worth of income from our bottom line (*Bligh unveils The Myths v The Facts*, 26 October 2009).

Comment: Premier Bligh has not been consistent in her calculations. The Government claims that it has taken a number of measures which are aimed at improving Queensland's fiscal position by some \$5.4 billion over four years (2009-10 Budget Paper No. 2, pp. 1-2). So that even if we were to accept the Government's early claim of a reduction of \$15 billion in forecast revenues over five years, then the 'bottom line' has also been improved by budgeted cuts in expenses. In other words, the 'bottom line' has only been cut by

\$15 billion less \$5.4 billion

or \$9.6 billion (over five years).

Claim #3: The GFC has 'imposed' on Queensland an additional \$15 billion of debt

Chairman of QTC Sir Leo Hielscher was asked by Treasurer Andrew Fraser to 'analyse' a union paper suggesting that capital raising alternatives be considered rather than asset sales. In a letter distributed to union representatives, Hielscher dismissed such a suggestion in the following terms:

In simple terms, the repayment of \$15 billion of debt that the GFC has imposed on us is the 'straw that broke the camel's back'.

Comment: That is incorrect, on three counts. First a so-called \$15 billion budget black hole was claimed to arise from a decline in the projected growth of revenues over five years. Second, as noted above, the 2009-10 Budget proposed '\$5.4 billion of measures' to 'commence the turnaround of the State's finances' (2009-10 Budget Paper No. 1, p. 4) . reducing the budget adjustments to only \$9.6 billion. Third, and most important, it is illogical to equate a predicted decline in revenues against forecasts with an increase in debt. Debt would only arise if the government kept borrowing to fund all of its wish-list of future capital investments.

In any event, as the data cited above shows, on a whole of government basis, Queensland has enjoyed positive cash flows from its operating activities on both a 'general government' basis and on a 'whole of government' basis.

Those figures bear repeating. In the year ended June 2009, despite the GFC, the state on a 'whole of government' basis enjoyed a cash flow **surplus from continuing operations of \$3.577 billion**.

Claim #4: An additional \$15 billion of debt adds \$2 billion a year to future budgets

In a letter to Treasurer Fraser, Sir Leo Hielscher also stated:

Simple arithmetic shows that an additional \$15 billion of debt raised at Government-terms still adds another \$2 billion a year to future budgets if it is repaid at today's interest over the next 10 years.

Comment: Even if the Government continued to borrow to fund new investment on new projects, it would not be borrowing an extra \$15 billion in one hit . but over the next five years or so. And as mentioned above, that claimed reduction in the 'bottom line' has already been reduced by expenditure cuts to only \$9.6 billion. Revenues have also improved . and Sir Leo himself wrote only last August that 'the worst of the financial crisis seems to be behind us'.

No one has ever suggested that Queensland's capital program was concentrated within the general government sector . as Hielscher assumes when he refers to 'adding \$2 billion a year to future budgets'. In fact, it appears that most of any borrowings would be for investment in economic infrastructure by GOCs that would produce a financial return to the government. Hielscher chose to count the capital outlays while ignoring the revenue stream to be generated by those investments.

It seems that Hielscher needs a new calculator: even assuming that the government is prepared to borrow an additional \$15 billion, the annual interest cost on those borrowings would be far less than \$2 billion per annum; his 'simple arithmetic' assumes an interest rate of 13.33%!

The most generous interpretation of Hielscher's comments is that he assumed that \$15 billion would be borrowed in one lump sum immediately and then repaid in ten equal instalments (covering interest and principal) of \$2 billion over ten years. That's not the way most government borrowings are undertaken - most are on a long-term basis with the principal being repaid in a lump sum at the end of their term. But the basic flaw in his 'analysis' is his assumption that the *repayment of amounts borrowed are counted as expenses in the budget. In today's accrual-based budgets, that's simply wrong.* Loan repayments are not treated as 'expenses' but as reductions in the value of liabilities reported in the balance sheet.

Claim #5: Retention of public assets will require \$12 billion in capital investment

In her address to the 2009 ALP State Conference on 7 June 2009, Premier Bligh said that the assets slated for sale 'would *require* Government investment of some \$12 billion in capital expenditure' (p. 10). This has been subsequently repeated.

Comment: Ms Bligh failed to explain how this figure was arrived at, or over what period this expenditure would be ~~required~~

\$12 billion in capital investment might seem a big number . until examined more closely. The Budget Papers explain that the planned asset sales will:

result in approximately \$12 billion in required capital investment over the next five years being avoided (2009-10 Queensland Budget Paper No.2, p. 12).

So the \$12 billion is to be avoided over five years, at an average of \$2.4 billion per annum. To place that in perspective, the cash flow statements for the Queensland 'whole of government' sector show that purchases of non-financial assets amounted to \$15.37 billion in 2008-09 and \$14.05 billion in 2007-08. Most of that would have been on infrastructure or plant and equipment.

Plainly Queensland has been investing heavily on *social infrastructure* . schools and hospitals - and it needed to do, with a rapidly increasing population.

But the claimed \$12 billion of 'needed' investment in economic infrastructure is largely discretionary . it is only 'required' in the sense that it will enhance the growth of businesses operating in Queensland (and incidentally, directly and indirectly generate revenues for the State). Statements made about these 'needs' include:

QR needs around \$7 billion more over the next five years to fund new assets to keep it commercially strong (Caucus Briefing, October 2009); see also Queensland Treasury website www.qld.gov.au/assetssales/why-these-assets.shtml accessed 29 October 2009).

Abbot Point coal terminal 'requires \$3.5 billion over the next five years to increase export capacity (*idem*).

Port of Brisbane 'is expanding to meet the needs of (i) customers' - these expansions will cost almost \$1 billion over the next five years' (*idem*).

Forestry Plantations Queensland . 'the business requires \$100 million of Government investment over the next five years' (*idem*).

That list only totals \$11.6 billion . which is probably near-enough to the \$12 billion cited by Premier Bligh and Treasurer Fraser. Except that the numbers are questionable and their interpretation highly suspect.

Let's start with Queensland Rail. The June 2009 Budget Papers stated:

In 2009-10 Queensland transport GOCs will undertake significant investments worth \$2.8 billion in port and rail infrastructure to ensure that the State can take advantage of the economic recovery and respond to the expected return of demand for Queensland resources (2009-10 Budget Paper No. 2, p. 74).

QR is rolling out a \$2.1 billion capital program in 2009-10 to increase the capacity of its coal and passenger networks by acquiring new rolling stock and upgrading infrastructure (2009-10 Budget Paper No. 2, p. 75).

In other words, of the 'around \$7 billion' that was supposedly *required* over the next five years if QR was retained in public ownership, \$2.1 billion will be spent well before a sale transaction could be organised.

The same can be said about Abbot Point coal terminal. The Budget Papers report that one phase of the expansion was due to be completed last July, while work on other phases is in progress:

APCT is currently being expanded to 25 mtpa (X25) at a cost of \$95 million, of which \$17 million is allocated in 2009-10 with the majority of the expansion becoming operational by July 2009. Outloading works are to be completed in mid 2010. The expansion of up to 50 mtpa (X50) was approved by Government in June 2008. Total estimated cost for the X50 expansion is estimated to be \$818 million (inclusive of finance charges). Budget expenditure in 2009-10 is \$287.9 million (i) PCQ remains on schedule to deliver X50 by 2011 (i)

In 2009-10, \$23.5 million has also been allocated for renewal of stacker reclaimers at APTC, with a total cost of \$68.3 million and an expected completion date of 2011 (*ibid.*, 78).

It would appear that the \$3.5 billion supposedly 'required over the next five years to increase export capacity' is an even more ambitious project that promises to reap substantial financial returns to the coal industry . and revenues to the Government. Presumably Queensland government agencies have undertaken cost-benefit analyses of these projects before advocating the commitment of the substantial sums that have already been invested . and will be invested by the time the assets could be sold.

As for the Port of Brisbane, only last June the Budget Papers reported:

The sale of the Port of Brisbane will facilitate future investment and development of export facilities. It will also avoid the need for Government investment in the future capital expansion required at the Port totalling nearly \$500 million over the next five years (*2009-10 Budget Paper No. 2*, p. 70).

So the capital 'required' for the Port's expansion went from 'nearly \$500 million' (in June 2009) to \$1,000 million within a few months (in October 2009 . see above).

Finally, the claim that the business of Forest Plantations Queensland

requires \$100 million of Government investment over the next five years (Queensland Treasury www.qld.gov.au/assetssales/why-these-assets.shtml).

can be considered in relation to a test of 'reasonableness'. FPQ's last available balance sheet shows that the aggregate value of all of its property, plant and equipment is only \$98 million, of which \$44 million is attributed to land, \$18 million to buildings and \$17 million to access roads. FPQ's annual report makes no mention of any planned expansion or of the need to make major investments in new equipment, but it explains that the business utilises contractors. It is difficult to comprehend the reasons for a capital injection of \$100 million. The June Budget Papers made no mention of any 'required' expenditure. It seems this need for \$100 million equity injection may only have been identified when the Government set about constructing a case for asset sales.

* * *

It appears that rather than talking of investments that are **required**, the \$11.6 billion or \$12 billion might have been better described as a **wish list** that has been developed in response to submissions from the prospective beneficiaries of those investments.

Some with specialist industry knowledge suggest that a number of the items on the list will not be absolutely necessary within the next five years (e.g.

maximum enhancements of rail infrastructure to the Abbot Point coal terminal). It is suggested that if major businesses believe that such a project would enhance their profitability then they should be prepared to contribute financially to such an expansion . not necessarily via up-front capital contributions, but by higher user charges, or 'take or pay' financing arrangements that will guarantee the state an acceptable rate of return on any new investment.

After all, that is what private firms do when proposing contracts for toll roads via public private partnerships.

Claim #6: The proceeds of sale will both fund new infrastructure, and repay debt

According to the Budget Papers delivered on 16 June 2009:

The sale program will deliver an estimated \$15 billion in sale proceeds (*2009-10 Budget Paper No.2*, p. 12).

Comment: These proceeds will hardly assist the State to meet its contractual or political commitments to invest further in social infrastructure or repay debt since sales could not be completed for some years. As *Budget Paper No. 2* states:

In recognition of the complexity of the process and the need to undertake detailed planning in relation to appropriate sale structures, the Government envisages that the sales will be progressed in the market over the next three to five years. The staging of the asset sales will be influenced by the timing of the recovery in financial markets. (*2009-10 Budget Paper No.2*, p. 12).

And yet the Government claims that:

The program of asset sales will play an important role in funding the Government's infrastructure, reducing State debt and encouraging private sector provision of infrastructure. The sales are designed to realise value, reduce risk and obviate the need to further fund the significant ongoing capital requirements of these businesses, where the private sector can fund those requirements.

This will go a long way toward reducing the current level of indebtedness of the State and demonstrate to ratings agencies and financial markets the Government's willingness to reduce debt and return the State to a solid fiscal position (*2009-10 Budget Paper No.2*, p. 14).

The asset sales plan is being treated as a magic pudding that can be used to both fund infrastructure *and* reduce debt.

Claim #7: Downgrading the credit rating will immediately cost \$200 million annually

After Standard & Poor's downgraded Queensland's credit rating by one notch, Treasurer Andrew Fraser immediately responded saying:

the Government's interest rate payments on its total borrowings will increase by about \$200 million next financial year because the state's credit rating had been downgraded (ABC News, 21 February 2009).

Comment: Obviously interest payments would not increase immediately on *total borrowings* . only on those borrowings that roll-over in the near future. The Treasurer's own Department reports that the only borrowings to mature in the near future is a loan of \$7,222 million due on 14 May 2010. Suppose interest rates increased by 10 basis points . that would only add \$833,308 to the interest bill. OK, make it 30 basis points . that's only \$2.5 million . not \$200 million.

Claim #8: Sell off will save \$750 million every year in interest payments (or is it \$1.8 billion?)

Premier Bligh has claimed that

\$12 billion [in planned additional investment] will cost us \$750 million year-in year-out in interest payments (*Address to 2009 State Annual Conference*, p. 11).

This claim had also been made in a Joint Statement by the Premier and Treasurer issued on 2 June 2009:

the \$12 billion in avoided capital expenditure will save Queensland around \$750 million every year in interest (*Renewing Queensland: Future Investment Plan*).

Even the Government's presentation to the Queensland Council of Unions stated:

The sales are estimated to deliver proceeds of approximately \$15 billion and avoid a further \$12 billion in capital investment in these assets over the next five years, saving \$750 million per annum in interest (13 October 2009).

Comment: This simplistic and misleading statement implies that the state would borrow one lump sum of \$12 billion and pay an annual interest rate of 6.25% on that amount resulting in \$750 million annual interest payments.

Even if we were to accept that \$12 billion of capital expenditure is needed on the assets slated for sale, the Budget Papers admit that amount would be over five years . not one year. So initially, on a draw-down of (say) \$2.4 billion, the annual interest bill at 6.25% would be only \$150 million.

This amount would be more than offset by revenues from those investments. Ms Bligh admits that the assets slated for sale currently return around \$280 million (and possibly \$340 million) per annum to the budget . and that is while a number of major projects are close to completion but have yet to enhance those revenues. Plainly revenues would increase when projects are completed.

Yet Ms Bligh cemented her entry into this list by exaggerating her claim even further. In October 2009, she claimed \$750 million annual 'interest savings' had grown to \$1.8 billion. The Government told members of Caucus that:

When the sale process is completed, it is anticipated the Government will save \$1.8 billion every year in interest payments (Caucus Brief, *Asset Sales – Key Facts*, October 2009).

Writing in *The Courier Mail*, Ms Bligh stated:

Keeping these commercial businesses going over the next five years would cost Queenslanders \$12 billion – the Government will save \$1.8 billion every year in interest payments on the borrowings needed to sustain them as viable businesses (*Queensland asset sell off the only choice: Anna Bligh*, 26 October 2009).

The \$1.8 billion was also repeated in the Government's 'The Myths vs The Facts' campaign. What wasn't stated was that the calculation assumes borrowing \$12 billion in one go at an annual interest rate of 15%!

Claim #9: Just as the Queensland Government got out of owning hotels and butcher shops, it should be prepared to sell state-owned infrastructure

Premier Bligh has claimed that asset sales were appropriate because 'the world has changed':

At the start of the 20th century it was appropriate for Government to own butchers and hotels at a time when markets could not provide these services to a growing regional population. In 1915 under Premier Ryan, the State owned and ran butchers, sawmills, cattle stations, hotels, fisheries and coal mines. In 1926 Labor Premier William McCormack began a program of selling these entities – Governments throughout history have bought and sold assets as the State's needs dictated (Address to the 2009 ALP State Conference, 7 June 2009).

Comment: It is agreed that governments can not own everything. But there is a big difference between a butcher's shop and a railway network.

Governments around the world have found themselves running a range of enterprises, for a variety of reasons. Russia in recent times privatised its chicken abattoirs. But a chicken abattoir is not a natural monopoly.

The fact is that it would be impossible to have competing railway networks operating across Queensland. There is only room for so many ports. Rail and road corridors can only be established through the coercive activities of government . and it is appropriate that government also enjoy the financial returns that may flow from use of economic infrastructure.

For example, Treasury data recently provided to union representatives suggest that after system expansions and increases in capacity the profits of Queensland Rail are expected to escalate from \$86.8 million in 2009-10 to no less than \$564.2 million in 2012-13. Those figures are 'after tax' . after the notional tax that is paid to Queensland Treasury at prevailing corporate tax rates. Those figures represent an acknowledgement that Queensland is poised to benefit from the revival of the resources boom.

Claim #10: The sell off would 'save' \$30 billion

In the Government's 'The Myths v The Facts' campaign, one item reads:

We're looking at a \$15 billion return on the five businesses we're selling and we will not have to invest more than \$12 billion (plus interest) to upkeep them over the next five years.

That's about \$30 billion of Queenslanders money (*Bligh unveils The Myths v The Facts*, 26 October 2009).

Comment: As the saying goes, 'you can't add apples and oranges'. Numbers are only 'additive' if they represent measures of a common property in a common measurement scale. No one would suggest that a measure of length in metres could sensibly be added to a measure of mass in grams. Yet that is what this statement represents: it purports to add a measure of estimated sale proceeds with an estimate of a reduction of capital expenditure.

Moreover \$15 billion + \$12 billion only equals \$27 billion. Apparently the final figure of \$30 billion is after adding interest payments.

Putting that another way, the alleged 'savings in interest payments' have rocketed upwards from \$750 million to \$1.8 billion to \$3 billion.

* * *

None of these 10 claims can be taken seriously. Some might excuse them as examples of 'spin' – and suggest that one should not expect better from politicians.

However the public assets listed for sale have been funded and accumulated by past generations. Proposals that they be sold in order to solve a short term

revenue shortfall is a serious step that could cost current and future taxpayers billions of dollars in lost value and earnings potential.

A case could be mounted that certain activities – such as state-owned forestry operations – are hardly part of the core business of governments, and justifiably could be sold so that the proceeds could be re-invested elsewhere. It is certainly desirable to have a debate about the role of government in contemporary society.

But it is unfortunate that these exaggerated claims insult the intelligence of MPs from both sides of politics - and their constituents.

4. CONCLUSION: SELL OFF - A BAD, UNNECESSARY DECISION FINANCIALLY AND POLITICALLY

Politicians are rarely trained in economics, accounting or finance. They necessarily rely on advice.

But they need to question that advice.

All organisations can generate 'wish lists' of capital expenditure they would like to undertake. The task of governing bodies . be they boards of directors in the private sector, or politicians serving as ministers . is to ensure that such wish lists are appropriately ranked in terms of priorities. One way of doing that is to classify proposals in terms of those that are necessary or critical to the achievement of an organisation's goals, those that are likely to generate positive returns in terms of future benefits . and those that someone simply thinks it would be nice to have. That task is required in both the private sector and the public sector.

Plainly the Government has been advised by Treasury officials or by political advisers to pursue an agenda of smaller government and asset sales. One can sympathise with the position of a political leader who faced new challenges in the wake of the global financial crisis. After a long period of economic growth, many economic managers had not experienced a recession. For some public officials, drawing from their experience as householders, the natural response to an economic downturn would have been to advocate cuts in spending . and the sale of assets to raise the funds required to meet existing political and financial commitments.

Possibly some political operatives in ministerial offices or the public service would have taken to heart the admonition attributed to the US President's chief of staff Rahm Emanuel:

never waste a crisis.

It is understood that politicians aim to win elections. One way of winning may be to make promises to the electorate about providing enhanced services in the future. That requires a war chest of funds. To get those funds, Governments are able to sell off assets that predecessor generations have accumulated. It's that simple.

It may be simple. It is also bad management.

It is commonly accepted that government need not maintain budget surpluses at all times, and that it is good practice to run deficits during economic downturns . provided that the budget is restored to a 'balanced' position over the course of an economic cycle.

Moreover, it has become evident from recent experience that governments can incur major losses if they sell public assets for less than what they were worth if retained in public ownership.

Queensland has been blessed with significant natural resources. It stands to reap enormous benefits from the demand for those resources in future years. All the more reason to retain major items of infrastructure - rail, ports, coal loaders and tollways - in public ownership. A sell off of natural monopolies would in financial terms be a fundamentally foolish decision.

It is ironic that Premier Bligh described the proposed sell off as a *reform* (Premier's Address to 2009 State ALP State Conference, p. 9) and *new thinking* (p. 14) and *a new agenda* (p. 15) when many governments around the world have come to realise that sell offs are often not in the best interest of the community.

Even England, the home of the 1980s Thatcherite ideas on public policy has come to realise the folly of many of those policies.

There is of course a fundamental inconsistency in the financial arguments for the sale of these assets. On the one hand, it is claimed that the government has to sell the assets because of the alleged financial crisis facing Queensland. On the other hand, it is asserted that the sales will not occur for several years – when the crisis is expected to be over.

When it comes to the sale of public assets, governments have only one chance to get it wrong.

16 November 2009