CHAPTER 8: STATE DEBT

Key findings of the Committee:

8.1 Net debt in the general government sector grew from $2.2 billion to $5.4 billion and from 0.8 per cent of GSP to 2.0 per cent of GSP. Net debt plus superannuation liabilities grew from 5.6 per cent of GSP to 9.7 per cent in 2008-09.

8.2 Net debt of the non-financial public sector in Victoria, which combines the general government and public non-financial corporations sectors, increased from $3.9 billion at 30 June 2008 (1.4 per cent of GSP) to $10.7 billion (4.0 per cent of GSP) at 30 June 2009, an increase of $6.8 billion or 174.4 per cent.

8.3 The increase in net debt reflects the State's substantial additional capital infrastructure program, aimed at stimulating economic growth and securing jobs, while enhancing the State's productive capacity over the longer term.

8.4 The Committee flagged the importance for the Government to closely monitor its budgetary position over the forward estimates period. The aim should be to prevent net debt levels from adversely impacting on the operating result and overall financial position of the State.

8.5 The Committee found that Victoria's net debt as a percentage of GSP at 30 June 2009 (4.0 per cent) was substantially lower than that of New South Wales (7.8 per cent).

8.6 The key measures of the general government sector's financial position are net debt and net financial liabilities. In this regard, Moody's Investors Service cited Victoria's strong balance sheet, diversified economy and prudent financial management as key reasons for reaffirming Victoria's triple-A rating in January 2009.

8.7 The level of State borrowings increased from $18.0 billion at 30 June 2008 to $25.8 billion at 30 June 2009, an increase of $7.8 billion or 43.3 per cent. Borrowings in the Australian market standing at $17.9 billion formed the largest component (69.3 per cent) of total moneys borrowed by the Victorian Government as at 30 June 2009.

8.8 With regard to the increase in borrowings of $7.8 billion from 30 June 2008 to 30 June 2009, the Committee noted that in terms of current borrowings, major movements occurred in foreign currency borrowings (an increase of $1.9 billion or 602 per cent) and derivative financial instruments (an increase of $2.1 billion or 539.5 per cent). Domestic borrowings of a non-current nature increased by $4.9 billion or 47.3 per cent.

8.9 The $7.8 billion increase in borrowings between 30 June 2008 and 30 June 2009 included $2.2 billion in derivative financial instruments (an increase of $2.1 billion in current borrowings and $0.1 billion in non-current borrowings) to hedge risks relating to foreign currency borrowings, and domestic and foreign currency borrowings amounting to $5.0 billion largely to fund capital projects relating to the education, water, transport and health sectors.

8.10 The Government discloses performance against a wide range of indicators in its Annual Financial Report that relate to net debt and borrowings.

8.11 In relation to measuring the level of sustainable debt (i.e. level of debt that can be repaid, principal and interest, given economic growth, interest rates and the future surplus generating capacity of the State), the ratio of borrowings and the superannuation liability to GSP for each sector has increased from 30 June 2008 to 30 June 2009 due to increased levels of gross State debt. From a whole of government perspective, the ratio increased from 11.5 per cent to 17.3 per cent over this period.

8.12 The increase in the Financial Sustainability and Flexibility ratios connected with net debt and borrowings as at 30 June 2009 compared to the prior year was largely due the raising of additional finance to fund, in part, the State's additional capital infrastructure program.

8.13 As the Government predicts that the net result from transactions will increase from $262 million in 2009-10 to $925 million in 2010-11, $739 million in 2011-12 and $1.8 billion in 2012-13, the Department of Treasury and Finance advised that such results will reduce the need to call on financial markets for borrowings. As revenues and GSP increase, debt ratios are expected to decline.

8.14 The Department of Treasury and Finance informed the Committee that there was nothing to indicate that the current level of borrowings posed any specific risk in terms of repayment.

8.1. Introduction

In relation to the handing down the 2008-09 Victorian Budget, the Treasurer stated in the Budget speech delivered on 6 May 2008 that: [181]

> *...we continue to keep debt at prudent levels. Worldwide, many governments carry a level of debt to drive their economies and invest in the future. They would be negligent if they did not.*

The Committee has flagged the importance for the Government to closely monitor its budgetary position over the forward estimates period. The aim should be to prevent net debt levels from adversely impacting on the operating result and overall financial position of the State.[182]

According to the Treasurer, the Government's perspective is to strike an appropriate balance between the short-term imperative of supporting the Victorian economy during a severe downturn and the longer term goal of keeping government borrowings at a sustainable level.[183]

With this background in mind, this chapter includes an analysis of net debt (at the Commonwealth level, the state level and internationally), State borrowings, indicators of financial condition and management of debt and associated risks.

181 Department of Treasury and Finance, Budget Paper No.1, *2008-09 Treasurer's Speech*, p.3

182 Public Accounts and Estimates Committee, *Report on the 2009-10 Budget Estimates – Part Two*, October 2009, p.29

183 Department of Treasury and Finance, Budget Paper No.1, *2009-10 Treasurer's Speech*, p.6

8.2. Net debt

The concept of net debt is the most commonly quoted and well known measure of a government's financial strength. One of the reasons is that it is part of everyday life for business and households. It is a measure that is internationally comparable as most OECD countries report on this item.[184]

Net debt is determined by deducting liquid financial assets from gross debt because in a period of financial difficulty, liquid assets would be readily available to redeem debt.[185] Net debt equals the sum of:[186]

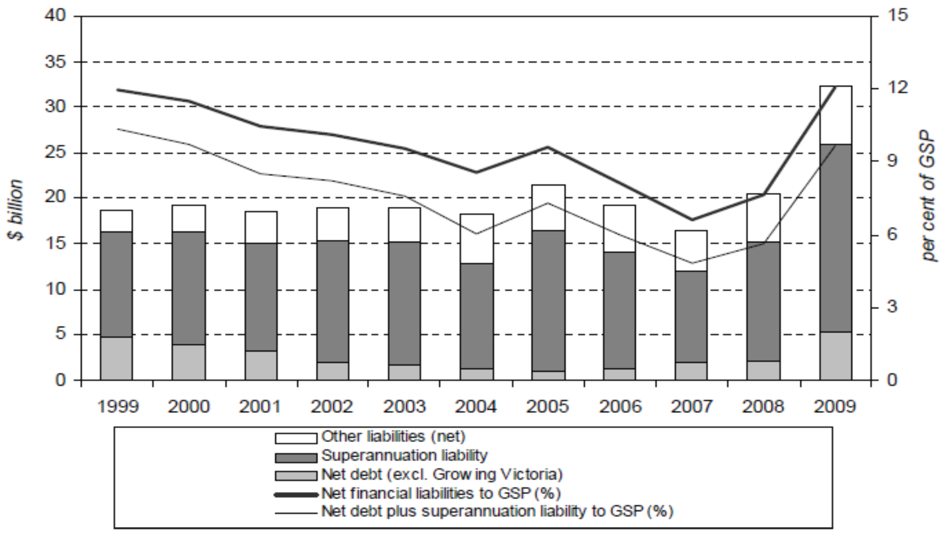
> *...deposits held, advances received, government securities, loans and other borrowing less the sum of cash and deposits, advances paid and investments, loans and placements, and investment in general government sector entities using the equity method.*

The general government sector net debt grew by $3.1 billion in 2008-09, from $2.2 billion (0.8 per cent of GSP) to $5.3 billion (2.0 per cent of GSP) at 30 June 2009. The general government sector net debt plus superannuation liabilities grew from $15.1 billion (5.6 per cent of GSP) to $26.0 billion (9.7 per cent of GSP). As reported by the Government, the increase in general government sector net debt:[187]

> *...enabled Victoria to undertake a substantial capital investment program in 2008-09, supporting the State's recovery through the global financial crisis by creating and securing jobs for Victorians.*

Figure 8.1 shows the net debt, superannuation liability and other liabilities (net) along with the net financial liabilities to GSP and net debt plus superannuation liability to GSP.

Figure 8.1: General government net financial liabilities as at 30 June



Source: Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, October 2009, p.3

184 Australian Government, Budget Paper No.1, *2009-10, Statement 7: Asset and Liability Management*

185 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.27

186 ibid., p.202

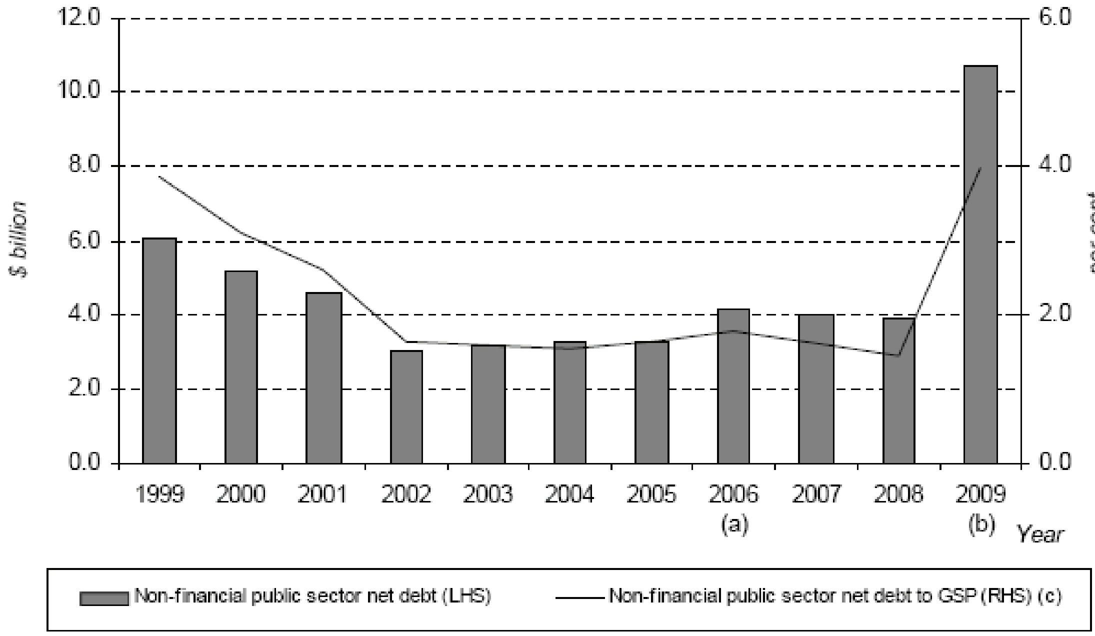
187 ibid., pp.26-27

Net debt of the non-financial public sector in Victoria, which combines the general government and public non-financial corporations sectors, increased from $3.9 billion at 30 June 2008 (1.4 per cent of GSP) to $10.7 billion (4.0 per cent of GSP) at 30 June 2009, an increase of $6.8 billion or 174.4 per cent.[188] This level of debt was evenly spread between the general government ($5.3 billion) and the public non-financial corporation sector ($5.4 billion) at 30 June 2009.[189]

Figure 8.2 shows a historical picture of the trend in net debt levels and net debt as a proportion of GSP for the non-financial public sector from 1999 to 2009. As reported by the Government, the increase during 2008-09 largely reflects:[190]

> *Additional debt required to fund the State's substantial capital infrastructure program, aimed at stimulating economic growth and securing jobs, whilst enhancing the State's productive capacity over the longer term.*

Figure 8.2: Non-financial public sector – net debt as at 30 June



Notes:

(a) 1999-2005 data are calculated under A-GAAP. 2006-2008 data are calculated under A-IFRS.

(b) 2009 data are calculated under AASB 1049.

(c) Historical figures are varied to reflect revisions to ABS estimates of the economy.

Source: Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, October 2009, p.37

The Committee found that Victoria's net debt as a percentage of GSP for the general government sector at 30 June 2009 (2.0 per cent) was slightly lower than that of New South Wales (2.2 per cent). Total general government sector net debt in New South Wales was $8.1 billion or 2.2 per cent of GSP at June 2009 compared to 1.6 per cent in June 2008.[191]

188 ibid., p.38

189 ibid., p.76

190 ibid., p.37

191 New South Wales Government, The Treasury, *New South Wales Report on State Finances,* 2008-09, p.i

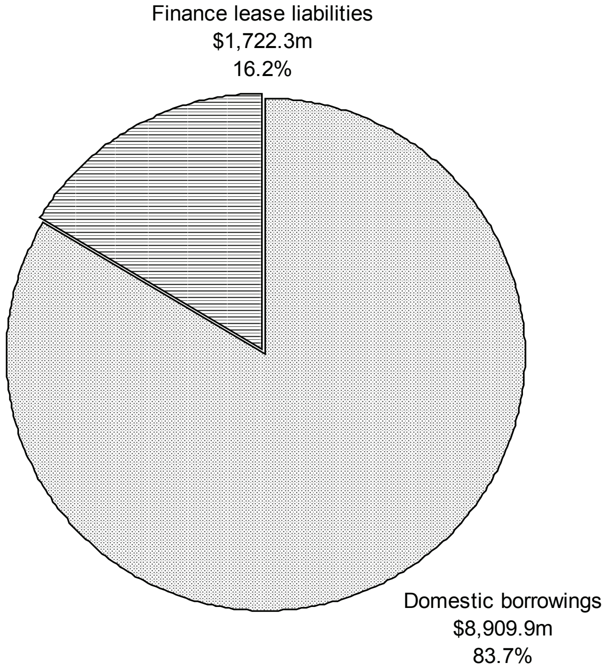
The Committee found that Victoria's net debt as a percentage of GSP for the non-financial public sector at 30 June 2009 (4.0 per cent) was substantially lower than that of New South Wales (7.8 per cent). Total State Sector net debt in New South Wales rose to $29.4 billion or 7.8 per cent of GSP in June 2009 compared to 6.1 per cent for June 2008 as a result of a record capital program in that state.[192]

The Committee noted the Government reports on the key measures of the general government sector's financial position of net debt and net financial liabilities and, in this regard, Moody's Investors Service cited Victoria's strong balance sheet, diversified economy and prudent financial management as key reasons for reaffirming Victoria's triple-A rating in January 2009.[193]

8.3. General government sector and State of Victoria borrowings

The level of general government sector borrowings increased from $7.8 billion at 30 June 2008 to $10.6 billion at 30 June 2009, an increase of $2.8 billion or 36.4 per cent.[194] As shown in Figure 8.3, which presents a breakdown of general government sector borrowings as at 30 June 2009, borrowings in the Australian market standing at $8.9 billion formed the largest component (83.7 per cent) of total moneys borrowed by the Victorian general government sector.

Figure 8.3: Composition of general government sector Borrowings 30 June 2009



Source *Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, p.113*

192 ibid.

193 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.26

194 ibid.

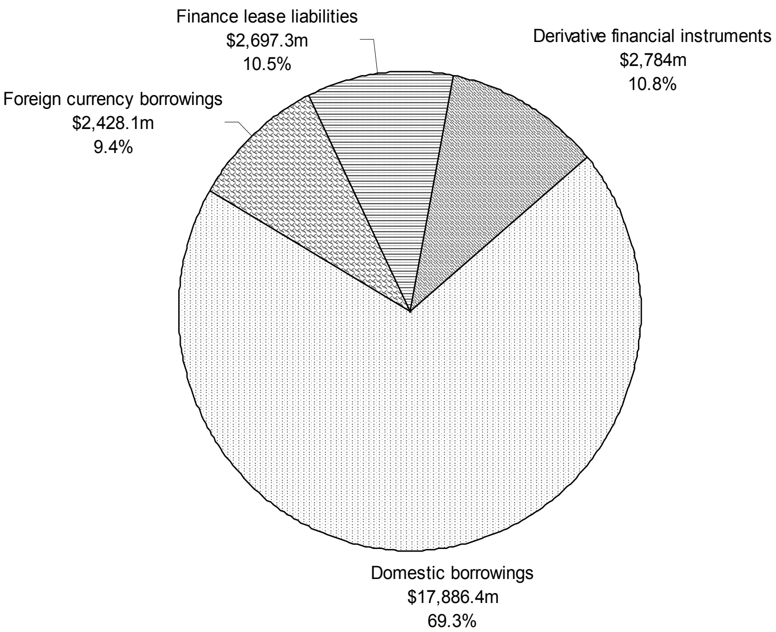
With regard to general government sector borrowings, the Committee noted that major movements occurred in the following components:[195]

- Non-current borrowings – Domestic borrowings – an increase of $3.3 billion from $5.0 billion to $8.3 billion or 66.0 per cent; and

- Non-current borrowings – Finance lease liabilities –an increase of $0.4 billion from $1.3 billion to $1.7 billion or 31.4 per cent.

The level of State borrowings increased from $18.0 billion at 30 June 2008 to $25.8 billion at 30 June 2009, an increase of $7.8 billion or 43.3 per cent.[196] As shown in Figure 8.4, which presents a breakdown of State borrowings as at 30 June 2009, borrowings in the Australian market standing at $17.9 billion formed the largest component (69.3 per cent) of total moneys borrowed by the Victorian Government.

Figure 8.4: Composition of State Borrowings 30 June 2009



Source: Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, p.113

With regard to State of Victoria borrowings, the Committee noted that major movements occurred in the following components:[15]

- Current borrowings – Foreign currency borrowings – an increase of $1.9 billion from $0.4 billion to $2.3 billion or 602 per cent;

- Current borrowings – Derivative financial instruments – an increase of $2.1 billion from $0.5 billion to $2.6 billion or 539.5 per cent; and

- Non-current borrowings – Domestic borrowings – an increase of $4.9 billion from $10.3 billion to $15.2 billion or 47.3 per cent.

195 ibid. p.113

196 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.47

The Auditor-General, in his *Report on the Annual Financial Report of the State of Victoria, 2008-09,* indicated that the State of Victoria borrowings included:[197]

- $2.2 billion in derivative financial instruments entered into to hedge risks relating to the foreign currency borrowings; and
- domestic and foreign currency borrowings amounting to $5.0 billion to fund primarily:
  - capital projects e.g. education renewal, water infrastructure, transport infrastructure, and health capital projects; and
  - the cost of dividends paid to the Department of Treasury and Finance of $154 million by the four metropolitan water bodies at lending rates of around 3 per cent.

The Committee noted that in comparing the current level of borrowings to historic levels, the Department of Treasury and Finance advised the Committee that:[198]

> *The current ratio of NFPS Net Debt to GSP of approximately 4 per cent is substantially lower than the 1962 level of 63 per cent, and is also lower than any subsequent year right through to 1998.*

At the national level, the Committee noted that net debt was low by international standards. According to the Australian Treasury, net debt is predicted to remain low by international standards and begin to improve once the budget approaches surplus. Net debt is projected to peak at 13.8 per cent of GDP in 2013-14, which is significantly smaller as a proportion of GDP than most other advanced countries. This is considerably lower than the 80 per cent net debt that the IMF predicts for countries such as the US, UK, Germany and France by 2014.[199]

At the State level, the Committee noted that in outlining the Victorian Government's agenda for 2010, the Premier stated, among other things, that:[200]

> *The good news is that Victoria has weathered the Global Financial Crisis better than most jurisdictions around the world…Our debt levels are among the lowest in the OECD.*

Victoria's ratio of net debt to GSP for the non-financial public sector of 4.0 per cent at 30 June 2009 is significantly lower than other advanced countries. Figure 8.5 shows how Australia's net debt compares by international standards as a proportion of GDP.

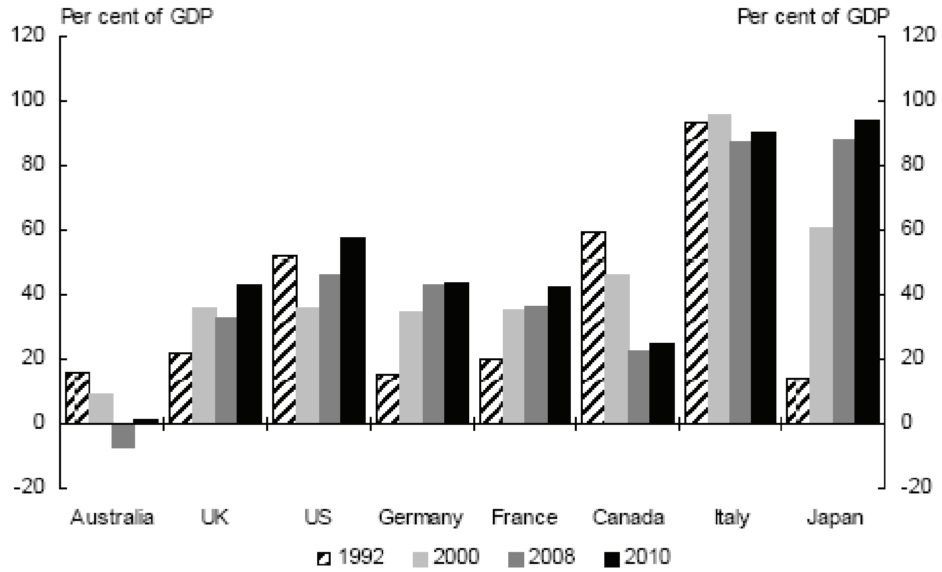
197 Victorian Auditor General, *Auditor General's Report on the Annual Financial Report of the State of Victoria, 2008-09*, p.32

198 Department of Treasury and Finance, response to the Committee's 2008-09 Financial and Performance Outcomes Questionnaire – Part Two, received 12 February 2010, p.13

199 Australian Government, Budget Paper No.1, *2009–10 Statement 3: Fiscal Strategy and Outlook*

200 Hon. John Brumby, Premier of Victoria, *2010 Statement of Government Intentions*, address to the Speaker and members of the Legislative Assembly, 2 February 2010, p.6

Figure 8.5: Australian and G-7 public sector net debt



Source: *Australian Treasury and OECD Economic Outlook No.84 (November 2008). Net debt figures are from the OECD Economic Outlook 84 except for Australia's 2010 figure which is the sum of the most recent forecasts for Australian, State and Territory general government sector net debt levels for 2009-10.*

8.4. Indicators of financial condition

The Committee noted that the Government discloses performance against various indicators in its Annual Financial Report that relate to net debt and borrowings. These are set out in Table 8.1.

Table 8.1: Indicators of financial condition that relate to net debt and borrowings

Ratio	30 June 2008 (per cent)	30 June 2009 (per cent)
General government sector		
Net debt to GSP	0.8	2.0
Net debt plus superannuation liabilities to GSP	5.6	9.7
Non-financial public sector		
Net debt to GSP	1.4	4.0
Net debt plus superannuation liabilities to GSP	6.3	11.7
State of Victoria		
Long-term borrowings to total assets	8.4	9.3
Total borrowings to total assets	12.0	13.3
Long-term borrowings to GSP	4.7	6.7
Total borrowings to GSP	6.7	9.6
Net debt plus superannuation liability to GSP	-0.4	6.1
Net debt plus superannuation liability to revenue	41.8	74.8
Borrowing costs to income from transactions	2.6	3.1
Superannuation expenses and borrowing costs to income from transactions	6.6	7.8

Source: *Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, October 2009, pp.27, 38–9*

An indicator sighted by the Committee that relates to debt sustainability (ratio of borrowings and the superannuation liability to GSP) is shown in Table 8.2. According to the Auditor-General, sustainable debt is the '*level of debt that can be paid back, principal and interest, given economic growth, interest rates and the future surplus generating capacity of the State'*.[201] Increased levels of gross State debt have resulted in an increase of this ratio at 30 June 2009 compared to the previous year.

Table 8.2: Debt sustainability: ratio of borrowings and the superannuation liability to GSP.

Ratio	30 June 2008 (per cent)	30 June 2009 (per cent)
State of Victoria	11.5	17.3
General government sector	7.7	11.6
Public non-financial corporations sector	2.1	2.9
Public financial corporations sector	6.2	8.7

Source: Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2008-09, p.33

The Committee observed that the increase in the Financial Sustainability and Flexibility ratios connected with net debt and borrowings as at 30 June 2009 compared to the prior year was largely due the raising of additional finance to fund, in part, the State's record capital infrastructure program.[202]

8.5. Management of debt and associated risk

8.5.1 Debt management strategy

With the level of borrowings for the State increasing from $18.0 billion in 2007-08 to $25.8 billion in 2008-09, the Committee was interested in ascertaining details concerning the Government's debt management strategy for reducing/retiring this level of debt over time.

The Department of Treasury and Finance informed the Committee that, notwithstanding this increase in borrowings, the Government continues to generate budget surpluses with substantial surpluses forecast out to 2012-13.[203] (The Committee noted that the Government predicts that the net result from transactions will increase from $262 million in 2009-10 to $925 million in 2010-11, $739 million in 2011-12 and $1.8 billion in 2012-13).[204] According to the Department, this level will reduce the need to call on financial markets for borrowings. As revenues and GSP increase, debt ratios are expected to decline.[205]

201 Victorian Auditor-General's Office, *Auditor-General's Report on the Annual Financial Report of the State of* Victoria, 2008-09, November 2009, p.33

202 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, pp.27, 38

203 Department of Treasury and Finance, response to the Committee's 2008-09 Financial and Performance Outcomes Questionnaire – Part Two, received 12 February 2010, p.13

204 Department of Treasury and Finance, *2009-10 Budget Update*, p.22

205 Department of Treasury and Finance, response to the Committee's 2008-09 Financial and Performance Outcomes Questionnaire – Part Two, received 12 February 2010, p.13

8.5.2 Risk management

From a risk perspective, the Committee inquired about whether the Government considered the current level of debt posed any risk to the State, the community and future generations in terms of repayment.[206]

The Committee was advised that there was nothing to indicate that the current level of borrowings posed any specific risk as:[207]

- budgets were still in surplus and were forecast to remain in surplus; and
- debt ratios remained comfortably below levels that may threaten the State's triple-A credit rating.

However, the Committee would welcome more reporting of risk management strategies in relation to allowances made for future contingencies and sensitivity analysis in relation to economic forecasts.

206 ibid.

207 ibid.