

## Chapter 4: Loan Council Arrangements and Fiscal Developments in the States

This chapter sets out the Loan Council Allocations (LCAs) nominated by the Commonwealth and each State for 2000-01 and endorsed by Loan Council at its meeting on 17 March 2000. It also reports the Commonwealth's 2000-01 Budget LCA estimate and provides an overview of public sector finances and fiscal developments in the States.

### **LOAN COUNCIL ALLOCATIONS FOR 2000-01**

The Australian Loan Council is a Commonwealth-State Ministerial Council that oversees public sector borrowings under voluntarily agreed arrangements. The present Loan Council arrangements, introduced in 1993-94, are designed to enhance the role of financial market scrutiny as a discipline on borrowings by the public sector, and therefore emphasise transparency of public sector finances rather than adherence to strict borrowing limits.

Under Loan Council arrangements, each jurisdiction nominates an LCA comprising:

- the estimated general government cash deficit/surplus (based on its mid-year report projections);
- its public non-financial corporation (PNFC) sector cash deficit/surplus (also based on mid-year report projections)<sup>1</sup>;
- net cash flows from investments in financial assets for policy purposes. Such transactions involve the transfer or exchange of a financial asset and are not included within the cash deficit. However, the cash flow from investments in financial assets for policy purposes has implications for a government's call on financial markets; and
- memorandum items (such as transactions that, while not formally borrowings, have many of the characteristics of borrowings).

These nominations are considered by Loan Council having regard to each jurisdiction's fiscal position and the macroeconomic implications of the aggregate figure. LCAs are on a headline rather than an underlying basis as they seek to measure a government's call on financial markets.

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<sup>1</sup> Under ABS reporting standards, this sector was previously referred to as the public trading enterprise (PTE) sector. Together, the general government and PTE sectors form the non-financial public sector (NFPS).

The LCAs nominated for 2000-01 are set out in Table 17. In aggregate, they represent a surplus of \$6.7 billion compared with an estimated surplus for 1999-2000 of \$15.4 billion.

Loan Council observed that economic growth in Australia is expected to remain strong in 2000-01 and noted the importance of consolidating the improvements in budgetary outcomes of recent years at this stage in the economic cycle. Against this background, Loan Council considered that the aggregate of LCA nominations is consistent with current macroeconomic policy objectives.

LCA nominations for all jurisdictions were prepared on a basis consistent with 1999-2000 mid-year reports. They thus provide an indication of the public sector's likely call on financial markets. The actual call may vary from the nomination primarily because of changes in economic parameters and policy measures. Updated information will be provided to financial markets through publication by each jurisdiction of its budget time LCA and a mid-year update of its expected LCA outcome.

A tolerance limit of 2 per cent of total non-financial public sector revenue applies between the LCA approved by Loan Council and the budget time LCA, and again between the budget time LCA and the LCA outcome. Tolerance limits recognise that LCAs are nominated at an early stage of budget processes and that estimates are likely to change as a result of policy and parameter changes before and after budgets are brought down. If a jurisdiction expects to exceed the upper or lower bound of the tolerance limit around its LCA estimate, it is obliged to provide an explanation to Loan Council and to make this explanation public. While Loan Council would not be required formally to approve the change, it would have the opportunity to pursue with the particular jurisdiction any concerns raised by the new LCA estimate.

In making their LCA nominations to the Loan Council, the Commonwealth, States and Territories also provide information on government contingent exposures under infrastructure projects with private sector involvement. These exposures, which are measured as the government's contractual liabilities in the event of termination of the project, are not included as a component of the LCA as they are unlikely to be realised and are thus materially different from actual borrowings undertaken to finance the public sector deficit. Government outlays under these projects, such as equity contributions and ongoing commercial payments to the private sector, continue to be included in the annual total public sector deficit, and hence the LCA.

## **BUDGET TIME COMMONWEALTH LCA FOR 2000-01**

Each jurisdiction is required to take into account its Loan Council approved LCA in formulating its budget, and to report a budget time LCA estimate in its budget papers.

The Commonwealth's budget time LCA estimate for 2000-01 is a \$8.5 billion surplus, compared with the nominated surplus of \$6.9 billion approved by Loan Council. The change in the LCA estimate since the Mid-Year Review primarily reflects an

improvement in the general government cash balance. The budget time LCA estimate is within the bound of the tolerance limit of 2 per cent of total non-financial public sector revenue. The components of the Commonwealth's nominated and budget time LCAs for 2000-01 are shown in Table 18.

Jurisdictions are required to disclose, as a footnote to their LCA, government termination liabilities under infrastructure projects with private sector involvement that operate for 10 years or longer and involve gross project liabilities of at least \$5 million. The Commonwealth plans no such projects in 2000-01.

## **OTHER LOAN COUNCIL DEVELOPMENTS**

Loan Council agreed (by correspondence) in March 2000 to the implementation of the *Accrual Uniform Presentation Framework* (UPF) for the reporting of financial information in budget documentation on an accrual basis.

The original UPF was agreed in 1991 and updated in 1997. It was agreed to revise the 1997 version, which was based on the ABS cash Government Finance Statistics (GFS) reporting standards, in light of the adoption by governments of accrual reporting and the shift by the ABS to an accrual framework for the GFS.

The UPF is a key feature of the Loan Council arrangements for oversight of public sector borrowing in Australia. The Accrual UPF will ensure that these arrangements remain relevant and effective in the environment of accrual budgeting and financial reporting.

It is expected that most jurisdictions will be able to conform to the Accrual UPF beginning with the 2000-01 budget cycle. Jurisdictions have until the 2002-03 budget year to fully implement reporting on an Accrual UPF basis.

**Table 17: Loan Council Allocations — 2000-01 Nominations (a)**

	NSW \$m	VIC \$m	QLD \$m	WA \$m	SA \$m	TAS \$m	ACT \$m	NT \$m	C/with \$m	Aggregate \$m
<b>Nominated 2000-01 LCAs</b>										
General government deficit/(surplus)	-1015	-200	-107	390	137	-59	-72	58	-454	
PTE deficit/(surplus)	243	200 (c)	467	66	116	10	7	-31	-843	
Non-financial public sector deficit/(surplus)	-770	-153 (d)	360	457	253	-49	-66	27	-1297	
NFPS net advances paid	38		63	-156	-59	-10	-19	-18	-6012	
Memorandum items	403	319	-169	45	-247	16	-11	0	398	
<b>Loan Council Allocation</b>	<b>-329</b>	<b>166</b>	<b>254</b>	<b>345</b>	<b>-53</b>	<b>-43</b>	<b>-96</b>	<b>9</b>	<b>-6910</b>	<b>-6657</b>
2000-01 Tolerance limit	584	372	446	190	138	49	41	39	3348	
<b>Latest estimates 1999-2000 LCAs</b>										
General government deficit/(surplus)	-1202	-1488	462	621	263	-53	-32	94	-3430	
PTE deficit/(surplus)	687	306	1132	189	-118	-24	25	-2	1250	
Non-financial public sector deficit/(surplus)	-504	-1350	1594	811	145	-77	-7	91	-2180	
NFPS net advances paid	17	-17	-620	181	-3554 (e)	-1	-25	-10	-9420	
Memorandum items (b)	121	802	-150	81	66	18	-10	0	-1409	
<b>Loan Council Allocation</b>	<b>-366</b>	<b>-565</b>	<b>824</b>	<b>1073</b>	<b>-3343 (e)</b>	<b>-60</b>	<b>-42</b>	<b>81</b>	<b>-13009</b>	<b>-15407</b>
1999-2000 Budget time estimate	-279	43	730	852	-294	-62	-58	3	-22254	-21319
1999-2000 Nomination	-512	-890	-187	704	-369	26	-61	45	-14370	-15614
1998-99 LCA outcome	-1079	-8123	403	323	-497	-72	-86	-3	-9142	-18275

- (a) LCA nominations for 2000-01 reflect current best estimates of non-financial public sector deficits/surpluses. Nominations have been provided on the basis of policies announced up to and included in jurisdictions' mid year reports. Nominations are based on preliminary estimates of general government finances provided by jurisdictions for purposes of their mid year reports, and projected bottom lines for each jurisdiction's PTE sector.
- (b) Memorandum items are used to adjust the non-financial public sector deficit/surplus for certain transactions — such as operating leases — that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used to deduct certain transactions that Loan Council has agreed should not be included in LCAs — for example, the funding of more than employers' emerging costs under public sector superannuation schemes, or borrowings by entities such as statutory marketing authorities. Where relevant, memorandum items include an amount for gross new borrowings of government home finance schemes.
- (c) The Victorian PTE sector deficit figure includes net advances paid, and excludes net advances received.
- (d) The Victorian non-financial public sector deficit figure includes non-financial public sector net advances paid.
- (e) South Australian non-financial public sector net advances paid for 1999-2000 include the proceeds received to date from the sale of South Australia's electricity retail operations and lease of electricity distribution assets.

**Table 18: Commonwealth's Loan Council Allocation for 2000-01**

	Loan Council Approved Nomination \$m	Budget time Estimate \$m
General government sector cash deficit	-454	-2844
PNFC sector cash deficit	-843	-988
Non-financial public sector cash deficit	-1297	-3832
<i>minus</i> Net cash flows from investments in financial assets for policy purposes(a)	6012	5163
<i>plus</i> Memorandum items(b)(c)	398	482
<b>Loan Council Allocation</b>	<b>-6910</b>	<b>-8513</b>

- (a) Such transactions involve the transfer or exchange of a financial asset and are not included within the cash deficit. However, the cash flow from investments in financial assets for policy purposes has implications for a government's call on financial markets.
- (b) For the Commonwealth, memorandum items comprise the change in net present value (NPV) of operating leases (with NPV greater than \$5 million), university borrowings, overfunding of superannuation and an adjustment to exclude the net financing requirements of statutory marketing authorities and Telstra from the LCA.
- (c) The Commonwealth does not expect to enter into any infrastructure projects with private sector involvement in 2000-01.

## FISCAL DEVELOPMENTS IN THE STATES

The State non-financial public sector — comprising the general government and PNFC sectors of all States — is expected, on a GFS cash basis, to record a deficit of \$0.8 billion or 0.1 per cent of GDP in 1999-2000. This compares with a deficit of \$5.5 billion, or 0.9 per cent of GDP in 1998-99.

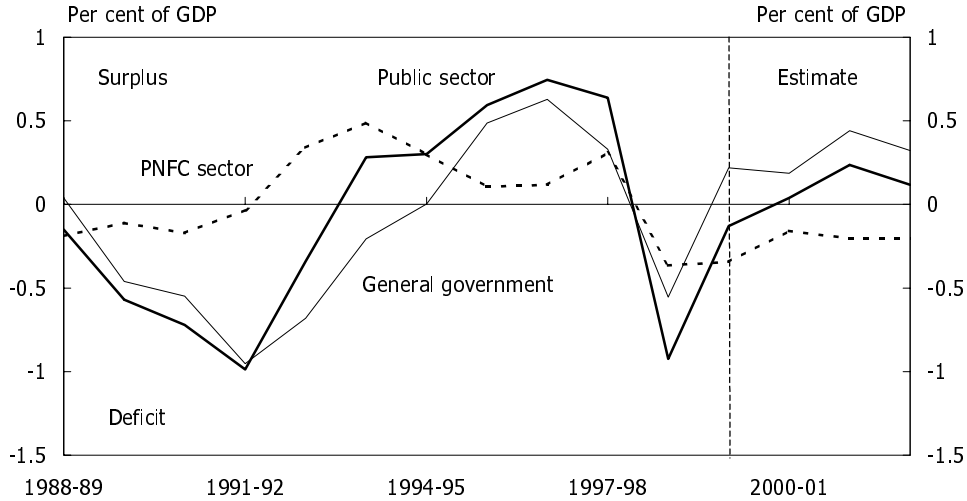
The large deficit in 1998-99, and subsequent improvement in 1999-2000, primarily reflects large 'one-off' expenditures by New South Wales and Victoria in 1998-99 to fund superannuation liabilities. These transactions added around \$5.8 billion or 1 per cent of GDP to total outlays of the State non-financial public sector.

The improvement in the position of the non-financial public sector is attributable to the absence of the abovementioned superannuation transactions. This more than outweighs the impact of an expected increase in remaining general government outlays and a decline in general government revenues.

The non-financial public sector, after recording in 1998-99, its first deficit since 1992-93, is expected to record a marginally smaller deficit in 1999-2000.

The latest available information on State budgets suggests that the general government sector is expected to record surpluses over the next few years, while the PNFC sector is likely to remain in a small deficit position. Consequently, the State non-financial public sector is expected to move into a balanced budget position for 2000-01 and then into surplus over the remainder of the forward periods. Trends in the cash surplus of the State general government, PNFC and non-financial public sectors are shown in Chart 5.

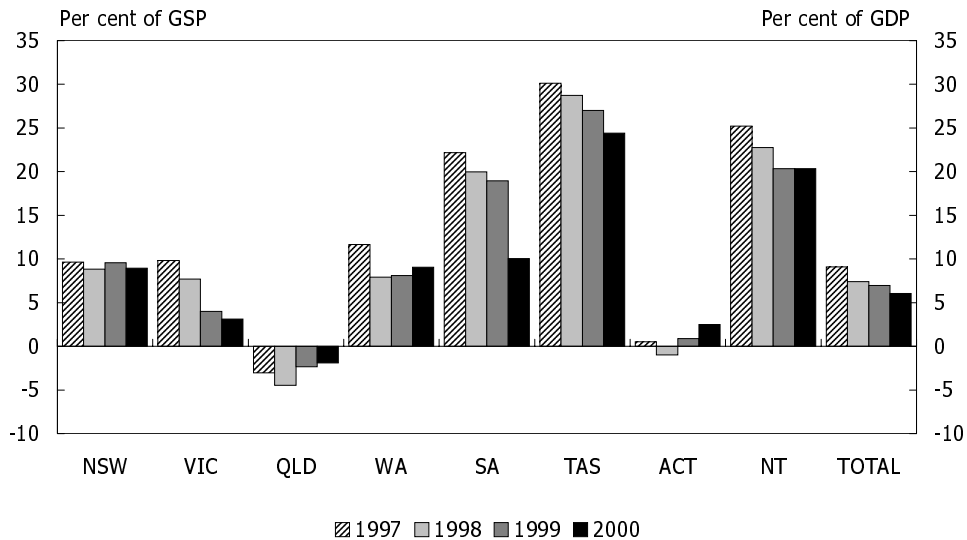
**Chart 5: State Cash Surplus by Sector**



Source: ABS reports, 1999-2000 State mid year reports, 2000-01 State budgets where available, and Commonwealth Treasury estimates.

The ratio of aggregate State net debt to GDP has been declining steadily since the early 1990s. This has largely resulted from improvements in State budget positions and the application of these funds, combined with revenue generated from equity asset sales, to retire debt. Chart 6 shows recent trends in the net debt to Gross State Product (GSP) ratio of each State along with the aggregate State net debt to GDP ratio.

**Chart 6: State Public Sector Net Debt as at 30 June<sup>(a)</sup>**



(a) Net debt is defined as gross debt less financial assets. The total is the total of State debt as a percentage of GDP.

Source: ABS reports, 1999-2000 State mid-year reports and 2000-01 State budgets where available.

Fiscal developments in individual States and Territories are outlined below.

**New South Wales** has improved its non-financial public sector position in 1999-2000 after a deterioration in the previous year. The general government sector has moved from a large deficit, which incorporated the impact of the Superannuation Conversion Offer, to a surplus of 0.5 per cent of GSP in 1999-2000. The projected operating statements of the general government sector for the four years from 1999-2000 show a steady trend of cash surpluses, reflecting constrained growth in current outlays and increased taxation revenue from stronger economic activity.

New South Wales expects to record a small non-financial public sector surplus in 1999-2000, following a deficit in 1998-99. The move into surplus largely mirrors the general government sector; the PNFC sector has only moderately impacted on the State non-financial public sector as it shifted out of balance to a small deficit. State non-financial public sector net debt climbed in 1998-99 but is expected to fall slightly in 1999-2000 reflecting a return to a budget surplus, while remaining above the State average.

The Government's fiscal objectives, founded on the *General Government Debt Elimination Act 1995*, include operating a sustainable surplus budget, eliminating general government net debt by 2020, fully funding employer superannuation contributions, maintaining or increasing general government net worth and constraining growth in the net cost of services.

The **Victorian** general government sector in 1998-99 recorded its first deficit in four years, but in 1999-2000 is expected to rebound to a strong surplus (0.9 per cent of GSP). A small surplus is forecast for 2000-01 as the Government increases outlays to meet its election commitments.

The PNFC sector in 1998-99 recorded a deficit of 1.3 per cent of GSP, primarily as a result of tax equivalent payments to the general government sector for previously accumulated liabilities. This 'one-off' increase in the sector's expenses contributed largely to the State non-financial public sector recording a deficit of 1.6 per cent of GSP in 1998-99.

In 1999-2000, the non-financial public sector is set to achieve a cash surplus of 0.8 per cent of GSP, with the general government sector surplus expected to outweigh a small deficit in the PNFC sector. A move into a deficit position is expected in later years.

Proceeds from Victoria's privatisation programme have contributed substantially to reducing State net debt. Victoria's non-financial public sector net debt has declined from 4.0 per cent of GSP in 1998-99 to 3.1 per cent in 1999-2000, well below the State average.

The Victorian Government is committed to a range of financial objectives including maintaining a substantial cash based operating surplus, providing competitive and fair

taxes for businesses and households, delivering capital works to enhance economic and social infrastructure throughout the State and maintaining public sector debt at prudent levels.

**Queensland** is widely regarded as having the strongest financial position of any State. Although Queensland's cash position has recently moved into deficit, the State remains comfortably in a negative net debt position of 1.9 per cent of GSP in 1999-2000.

Queensland's *1999-2000 Mid-Year Fiscal and Economic Review* shows that the general government sector is expected to record a budget deficit of 0.5 per cent of GSP. This deficit is expected to be only temporary, with a move back into surplus over the forecast period to 2002-03.

A deficit in the PNFC sector will contribute to the State non-financial public sector recording a deficit in 1999-2000 of 1.6 per cent of GSP up from 0.4 per cent in 1998-99. This position is expected to continue into 2000-01, albeit at a lower level, driven mainly by the forecast deficit in the PNFC sector.

The Queensland Government, under its *Charter of Social and Fiscal Responsibility*, has adopted a fiscal strategy of maintaining an overall general government operating surplus, ensuring a competitive tax environment and low tax status, undertaking capital investment that can be serviced within an operating surplus and managing all accruing and expected future liabilities, consistent with maintaining a AAA credit rating.

**Western Australia's** *1999-2000 Mid-Year Review* indicates a general government budget deficit (cash basis) of 0.9 per cent of GSP in 1999-2000, compared with a balanced budget in 1998-99. A small deficit is expected in 2000-01 before moving into a surplus position in later years.

Relatively small deficits in Western Australia's PNFC sector imply that the State non-financial public sector position will broadly mirror that in the general government sector. The State non-financial public sector is set to move into a surplus position in the medium term.

Western Australia's combined general government and PNFC net debt as a proportion of GSP increased in 1999-2000 from 8.1 per cent to 9.0 per cent, but is expected to remain stable for the medium term, albeit at a higher than average State level.

Western Australia's fiscal strategy continues to focus on the long-term stability of the public sector and remains consistent with the financial principles laid out in the Government Financial Responsibility Bill 1998. The Government is aiming to maintain or increase public sector net assets, effectively manage State debt, manage and fund superannuation liabilities and achieve an operating surplus for the total public sector over the forward years.

**South Australia's** general government sector is expected to record a deficit of 0.6 per cent of GSP, slightly larger than in 1998-99. It is projected that the general government sector will remain in deficit over the forward years. The PNFC sector will



record a small surplus in 1999-2000 before also moving into a continuing deficit position.

Accordingly, the medium-term outlook for the State non-financial public sector is to remain in a moderate deficit position.

Notwithstanding the above, South Australia's net debt position substantially improved in 1999-2000, moving from 19.0 per cent of GSP to 10.1 per cent, but remains above average for the States. This result was achieved primarily by the application to debt retirement of funds sourced from the lease of State assets.

The Government's fiscal strategy aims to achieve a balanced budget for the government sector, further reduce government debt in real terms with the aim of achieving a AAA credit rating, expand investment in public infrastructure, eliminate unfunded superannuation liabilities over the long-term and ensure that the State has competitive tax regime for business and investment.

In 1998-99, **Tasmania** again achieved a small surplus, despite budgetary pressures associated with lower than average economic growth. Revenue in the general government sector has grown faster than outlays resulting in a surplus of 0.5 per cent of GSP in 1999-2000, up from 0.2 per cent in 1998-1999. The PNFC sector has moved in a similar direction contributing to the State's budget position.

A small surplus budget is anticipated for the State non-financial public sector in 1999-2000, with further surpluses maintained in the forward years. The general government sector is expected to record larger surpluses in the medium term while the PNFC sector will fluctuate around a balanced budget position.

Tasmania's State non-financial public sector net debt as a proportion of GSP has fallen from 27.0 per cent in 1998-99 to 24.4 per cent in 1999-2000. This ratio should fall further over the medium term, but will remain significantly higher than the State average.

1999-2000 represents the first full year of the Government's medium term fiscal strategy. The key principles of this strategy include maintaining a cash based budget surplus, reducing State government net debt and the cost of servicing that debt, and achieving this without introducing new taxes or increasing existing tax levels.

The **Australian Capital Territory** in its 1999-2000 mid-year report show the general government sector surplus increasing slightly to 0.3 per cent of GSP in 1999-2000. Based upon expenditure restraint and further growth in revenue, the general government sector is expected to persistently strengthen its surplus budget position over the forward estimate years.

As a result of developments in the general government sector, combined with the sustained budget neutral position of the PNFC sector, the Australian Capital Territory's total non-financial public sector is also expect to record a surplus in 1999-2000 and beyond. Net debt is expected to rise as a proportion of GSP from 0.9 per cent in 1998-99 to 2.5 per cent in 1999-2000, but will remain substantially lower than the State average.

The Australian Capital Territory's fiscal strategy includes achieving a sustainable surplus by 2004-05, fully funding outstanding superannuation liabilities over time, constraining growth in output costs while increasing delivery efficiency and maintaining the Territory's AAA credit rating by managing risk and assets prudently.

The **Northern Territory's** general government cash balance has further weakened in 1999-2000, as moderate growth in revenue was unable to offset the sizeable increase in outlays. Largely influenced by the budget position of the general government sector, the Territory is expected to record a deficit in 1999-2000 of 1.3 per cent of GSP for the non-financial public sector.

The Northern Territory predicts that its fiscal position will steadily improve from 2000-01 onwards, achieving a surplus by 2002-03. The *1999-2000 Mid-Year Report* forecasts that the move to a surplus will be at a more moderate level than originally estimated at budget time. State non-financial public sector net debt decreased to 20.4 per cent of GSP in 1998-99, it is expected to fall slightly in 1999-2000.

The Northern Territory's fiscal strategy was reviewed and updated in 1998-99 and remained unchanged for the 1999-2000 Budget. The core strategies and fiscal targets for the Territory include constraining per capita current expenditure in real terms, maintaining infrastructure levels to meet economic and social needs, ensuring that own-source revenue will be broadly comparable to the States and reducing Territory debt as a proportion of economic output.