



# Government resorts to smoke and mirrors

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Recent controversy over the Queensland government's plans to raise funds from investors through government-owned corporations highlights the dangers of governments engaging in smoke and mirrors financial engineering rather than achieving real change.

Personally, I'd much rather privatise government-owned corporations, as there are real benefits in doing so. Private operators are more efficient. However, given that the government has ruled out privatisation, is there anything wrong with its plans?

Usually, government-owned corporations are financed with government equity and government-guaranteed debt. While the government's comments have been vague and seemingly contradictory, its plans seem to have two main elements: inject funds from Queensland public servants' defined benefit fund (DBF) into government-owned corporations and encourage government-owned corporations to seek project finance from the private sector and/or the DBF.

Before considering each element, it is important to explain the arcane world of government finances. When politicians talk about the "budget", they're referring to the "general government" budget, which excludes government-owned corporations. While financial statements are also prepared for the "non-financial public" sector — which

combines general government and non-financial government-owned corporations — few read them. Statistics are also published on "gross" debt and "net" debt. Economists agree that net debt (which nets off cash and other financial assets available to pay gross debts) is a much better indicator of a government's true financial position.

There's nothing wrong with the government's plans per se.

The defined benefit fund is more than fully funded and the government has committed to maintaining full funding. If bad government-owned corporation investments cause a DBF shortfall, the government must ultimately meet it. However, while there's nothing wrong with the DBF investing in government-owned corporations, it produces zero benefit. It doesn't change total financial obligations and future cash flows of the non-financial public sector (inclusive of DBF payment obligations) one iota. It simply uses the DBF to make the general government books look superficially better, by reducing general government debt.

Project finance may be appropriate for some government-owned corporation infrastructure projects. Such finance usually has both debt and equity-like features, with security against project assets and investor returns paid out of the project's cash flows. This is consistent with Queensland Treasurer Curtis Pitt's example that "new commercial

expansions of port infrastructure could be privately funded with investors receiving agreed returns and the port remaining as a government-owned corporation".

Queensland's Premier

Palaszczuk has said that government-owned corporations would "remain 100 per cent owned", while Pitt has stated that investors would have "no decision-making role".

These carefully worded statements are technically correct, but they're designed to say what the investments aren't, rather than not what they'll be. True, investments will be in government-owned corporation projects (not government-owned corporations) and investors won't have control over government-owned corporations. However, the real benefits of project finance flow only under certain conditions, such as investors having at least partial control over projects and rights to take control of assets if projects fail. Unless such conditions apply, investors will price in extra risk and project finance will just become a very high-cost friend, but with no benefits.

If project finance is adopted to capture real economic benefits, that's great. But that doesn't seem to be what's really driving the government's plans.

A big reason why government-owned corporations may need further funding is that the government has already stripped their balance sheets. Take transmission government-owned corporation Powerlink, which was reportedly raised as a project finance candidate in government discussions with overseas pension funds. Powerlink stated in its financial 2015 annual report that at the current government's direction, it adopted a payout ratio of 100 per cent (\$156m) and declared a further distribution of \$1.121 billion. While the government extracted \$1.277bn, Powerlink's



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equity fell from \$2.6bn to \$1.5bn and its liabilities rose from \$5.1bn to \$6.6bn.

The government's smoke and mirrors goes way beyond Powerlink. In its latest MYEFO, the government trumpeted that its "Debt Action Plan" would cut general government debt by \$10.6bn by 2017/18 by: changing government-owned corporation capital structures and raising all government-owned corporation payout ratios to 100 per cent (\$5.1bn); funding long service leave as it happens, rather than setting aside financial assets (\$3.4bn); and temporarily suspending defined benefit contributions (\$2bn). None of these are real changes.

It's hard not to conclude that what's driving the government's smoke and mirrors is its need to meet its election promise to cut general government gross debt by \$12.1bn by financial 2025. The wording of this promise gave the government plenty of wiggle room to meet it without cutting either NFP sector debt or even general government net debt one iota.

If general government debt reduction is achieving real net benefits, this can improve government debt ratings and the cut government borrowing costs. But smoke and mirror tricks make no difference.

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